Revised Integrated Borrowing Framework

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Useful references:
IFAD’s Integrated Borrowing Framework (EB 2020/131(R)/R.21/Rev.1)
Capital Adequacy Policy (EB 2019/128/R.43)
Liquidity Policy (EB 2020/130/R.32)
Resources available for commitment (EB 2022/137/R.12)

Action: The Executive Board is invited to approve the Revised Integrated Borrowing Framework as presented in this document.
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Revised Integrated Borrowing Framework

I. Proposed revisions and rationale

1. **Borrowing will continue to play an important role for IFAD in realizing its ambitions.** As highlighted in the Report of the Twelfth Replenishment of IFAD’s Resources (IFAD12), IFAD’s ambition is to increase financing to all eligible borrowers while preserving its own financial sustainability. While replenishment will remain the bedrock of IFAD’s financing, IFAD is conscious that the macro outlook for both contributors and recipients of financing is such that financing needs may rise in direct correlation with a scarcity of easily accessible funding. To reach the levels of delivery required to make a significant impact for IFAD’s beneficiaries, borrowing is a necessary component of funding. Accordingly, IFAD will continue to pursue a gradual increase in leverage, adjusted proactively to the evolving needs of the institution. IFAD’s universal client base represents a key operational and financial strength, since borrowed resources could be used not only to finance projects in upper-middle-income countries, but also to finance selected lower-middle-income countries and low-income countries borrowing on semi-concessional and concessional terms.

2. **The Integrated Borrowing Framework (IBF) has proven to be a successful tool to increase IFAD’s access to funding.** The IBF was approved in December 2020. In December 2021 IFAD established its Euro Medium-Term Note Programme, issuing its two first private placements in June 2022. In November 2022 IFAD signed a framework loan agreement with the European Investment Bank, a supranational institution. It is therefore clear that innovations introduced by the IBF in 2020, in particular introducing private placements to private institutional investors and multilateral and supranational institutions as eligible lenders, were the right strategy, resulting in IFAD securing 65 per cent of the IFAD12 borrowing target by the end of 2022.

3. **The IBF is also an important tool to strengthen IFAD’s liquidity management.** The primary goal of IFAD’s borrowing activity is to disburse loans to its borrowers. Under the IBF, borrowing is also used for liquidity management. This includes maintaining liquidity requirements in line with IFAD’s AA+ rating and also for collateral management with the aim of, inter alia, increasing the pool of swap counterparts. An enhanced use of derivatives for hedging purposes is key to increasing the flexibility of funding and available options.

4. **Revisions to the IBF are needed based on lessons learned and best practices.** As described in the update on the implementation of the IBF, clear lessons can be drawn at this stage of IBF implementation. Ahead of IFAD13, the IBF should be revised to boost its effectiveness, reduce funding risk and, ultimately, increase the predictability of IFAD’s ability to mobilize resources for development. Additionally, the IBF should remain a framework while the financial limits and ratios should be specified in the appropriate policy documents. The IBF establishes and regulates the following five pillars governing all of IFAD’s borrowing activities:

   (A) Eligible lenders;

   (B) Borrowing instruments;

   (C) Use of borrowed funds;

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1 GC 44/L.6/Rev.1.
2 The latter through concessional loans such as concessional partner loans.
3 EB 2022/137/R.24.
(D) Borrowing governance; and
(E) Risk management.

5. The changes proposed in this revised IBF are to pillar C, on the use of borrowed funds; pillar D, on borrowing governance; and pillar E, on risk management. It is further proposed to delete annex I, which includes the terms and conditions governing concessional partner loans (CPLs). No changes are proposed to pillars A, on eligible lenders; or B, on borrowing instruments.

6. The following paragraphs present the proposed changes and underlying rationale. Section II presents the final revised IBF, including the proposed changes. It should be noted that additional revisions were made to the original 2020 document by deleting outdated references and structuring the IBF, to the extent possible, as a timeless self-contained framework document. Therefore, the rationale for the changes is presented separately in this section I.

Proposed changes

7. **Use of borrowed funds.** The proposal is to refer explicitly to liquidity management as one of the uses of borrowed funds. This encompasses sourcing funds to maintain IFAD’s liquidity requirements in line with its Liquidity Policy and credit rating, as well as for collateral management.

8. **Rationale for proposed change.** As in the case of any development finance institution (DFI), IFAD uses borrowing to support lending as well as for day-to-day liquidity management in treasury operations. The IBF should make explicit reference to this use of borrowed funds for the purposes of good governance and to ensure that all legal grounds are covered. An enhanced use of derivatives, for which collateral management might be needed, will also increase the flexibility of funding and funding opportunities.

9. **Borrowing governance.** The proposal is that the Executive Board delegate to the President the authority to approve potential loan agreements, private placement transactions and potential investors. Borrowing size will continue to be regulated by the yearly funding plan approved by the Board as part of the resources available for commitment (RAC) document.

10. **Rationale for proposed change.** IFAD will continue to borrow exclusively from eligible types of lenders through eligible instruments. The current governance arrangements, whereby investors and funding transactions must be pre-approved by the Executive Board – arrangements that no other DFI has in place – pose significant challenges. Funding windows and investor preferences open and close very quickly, and investors are ready to transact only when and if the market conditions are right, when they have available liquidity and the investment opportunity is aligned with their preferences (preferred currency, coupon level, liquidity position, hedging costs, etc.). Having to obtain pre-approval of potential investors and transactions requires at least two months, thereby potentially foregoing funding opportunities. A change in the current governance process that allows Management to execute loan agreements and transactions with investors within the IBF’s established categories and report ex post to the Board will increase IFAD’s funding opportunities and thus decrease the funding risk. IFAD will continue to apply rigorous due diligence for private investors and inform the Board after executing a transaction or entering into a loan.

11. **Risk management.** The IBF is a framework document that regulates the pillars of IFAD’s borrowing strategy. The proposed change is therefore to exclude the financial ratios from the IBF and instead to refer to the respective financial policies. Table 1 shows the appropriate policy where such ratios will be reflected going forward.
Table 1
Financial ratios governing IFAD’s borrowing and appropriate policy document

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt coverage ratio</td>
<td>Liquidity Policy</td>
</tr>
<tr>
<td>Liquidity ratio</td>
<td>Liquidity Policy</td>
</tr>
<tr>
<td>Debt/equity ratio</td>
<td>Capital Adequacy Policy</td>
</tr>
</tbody>
</table>

12. **Rationale for proposed change.** A framework is a conceptual document that serves as a guide and provides a structure for building the underlying policies and guidelines. Therefore, a framework should be, to the extent possible, a stable and timeless document. Financial ratios, thresholds and prudential limits should be governed by the respective policies, amended more frequently to adapt to changing market conditions. Specifically, the debt/equity ratio is naturally a ratio that is driven by capital availability and capital consumption. IFAD’s Capital Adequacy Policy (CAP) is therefore the most appropriate policy to contain the ratio. IFAD’s CAP was approved in 2019 and includes the target ratio of 35 per cent to 50 per cent. This somewhat higher threshold, which was already envisaged for long-term planning at the time of the CAP, should now be the driving target of prudently growing leverage for IFAD while remaining significantly lower than that of other DFIs. The liquidity ratios are naturally to be included in the Liquidity Policy at its next revision.⁴ This increases the clarity of governance in IFAD’s document and aligns to best practices.

13. **Annex I.** The proposed change is the deletion of annex I, which includes the terms and conditions governing CPLs.

14. **Rationale for proposed change.** CPLs are instruments that are closely linked to the replenishment cycle in which they are granted. The terms and conditions of CPLs, including the applicable coupons and discount rates, are recalculated for every replenishment cycle and, for purposes of transparency and fairness towards members, remain stable for the entire cycle. Therefore, while the reference to CPLs as allowed borrowing instruments should remain in the IBF, from a governance perspective the right place for the actual terms and conditions is the report of the consultation of the relevant replenishment of IFAD’s resources, or replenishment report. No changes

(A) **Eligible lenders.** No change is proposed to the eligible lenders specified in the 2020 IBF.

(B) **Types of borrowing instruments.** No change is proposed to the types of borrowing instruments specified in the 2020 IBF.

15. **The pillars of the IBF apply irrespective of a decision on an allocation mechanism for borrowed funds.** Strategic decisions about a separate allocation mechanism to channel borrowing are not considered to be earmarking. Financial sustainability and avoidance of cross-subsidization of borrowed funds with members’ contributions will remain key conditions for IFAD to borrow.

16. **The IBF does not introduce the possibility of market borrowing.**⁵ IFAD does not have the power to issue bonds in public financial markets. The authority will rest with IFAD’s competent governing bodies to approve any future

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⁴ IFAD will continue to measure, monitor and comply with the two liquidity ratios in any interim period before the next revision of the Liquidity Policy.

⁵ See resolution 204/XLI on IFAD11. Public offers of bonds can give access to a wide range of retail or institutional investors. These bonds are sold through a negotiated or competitive sale and are actively traded in the secondary market.
recommendation by Management introducing the possibility of market borrowing. Table 2 shows the proposed changes to the 2020 IBF as described above.

Table 2

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Eligible lenders</td>
<td>No change</td>
</tr>
<tr>
<td>B. Borrowing instruments</td>
<td>No change</td>
</tr>
<tr>
<td>C. Use of borrowed funds</td>
<td>Inclusion of possibility to borrow for collateral management</td>
</tr>
<tr>
<td>D. Borrowing governance</td>
<td>Delegation to the President of the authority to approve investors and transactions within limits of funding plan, CAP and Liquidity Policy</td>
</tr>
<tr>
<td>E. Risk management</td>
<td>Exclusion of borrowing limits from IBF and reference to appropriate policy</td>
</tr>
</tbody>
</table>

Annex I

Deletion of CPL terms and conditions (to be included in replenishment report)

II. IFAD’s Integrated Borrowing Framework

A. Objectives and scope

17. The IBF aims to fulfil two objectives:

(i) **Objective 1. Timely and cost-effective funding for disbursements of loans:** ensuring timely access to the best-priced borrowed resources to disburse loans to recipients.

(ii) **Objective 2. Efficient liquidity management:** sourcing funds to maintain IFAD’s liquidity requirements and to efficiently manage liquidity in treasury operations.

18. **The scope of the IBF is to establish and regulate the following five pillars of IFAD’s borrowing activities:**

(A) Eligible lenders;
(B) Borrowing instruments;
(C) Use of borrowed funds;
(D) Borrowing governance; and
(E) Risk management.

III. Five pillars of IFAD’s borrowing activities

A. Eligible lenders

19. The following lenders are eligible under the IBF:

(i) **Sovereign states and state-supported institutions.** Sovereign states refer to both IFAD Member States and other sovereign states that are not members of IFAD. State-supported institutions include all state-owned or state-controlled enterprises and DFIs of IFAD Member States.

(ii) **Supranational and multilateral institutions.** These institutions are natural counterparts for IFAD. IFAD will continue to notify Executive Board members through the Interactive Member State Platform of any potential borrowing or private placement debt issuance transactions with supranational and multilateral institutions before the relevant Audit Committee review process to allow such members to express any concerns in relation to the proposed transaction. Such concerns will be addressed, as appropriate, before any proposals are submitted to the relevant session of the Audit Committee for review, and to the Executive Board for subsequent approval.
(iii) **Private institutional impact investors, including environmental, social and governance (ESG) investors.** Entities that are not state-owned or state-supported and are focused on investing in assets that address ESG issues, including agricultural development and food systems, fall into this category, with large untapped potential for IFAD. The ESG market has experienced strong growth, as demonstrated by the growth in the number of signatories to the United Nations-supported Principles for Responsible Investment and the volume of their assets under management. Together with the growth in investor interest, the volume of green, social and sustainability bonds has experienced unprecedented growth.

20. **The additionality rule** applies to CPLs but not to non-CPLs.7

21. **State-supported institutions, supranational and multilateral institutions and private institutional impact investors are not entitled to voting rights.** As they do not contribute to IFAD’s replenishment, such lenders are not entitled to any voting rights, and the rule relating to additionality to counter substitution risk does not apply (except in relation to CPLs from IFAD Member States and state-supported institutions).

**B. Borrowing instruments**

22. The following borrowing instruments are eligible under the IBF:

(i) **Concessional partner loans.** A CPL is a key instrument in the financial framework of an international financial institution as a concessional loan (e.g. with interest rates significantly lower than market rates, long maturities, and/or long grace periods) that, in the case of IFAD, complies with the terms and conditions governing CPLs as set forth in the relevant replenishment report and comprises a grant element that entitles the lender to certain voting rights. A CPL from a state-supported institution will entitle the Member State that owns or controls such agency to receive voting rights for the grant element of the CPL.

(ii) **Loans in non-CPL form.** As loans that are not subject to the pre-defined terms and conditions governing CPLs, loans in non-CPL form do not entitle the lender to voting rights.

(iii) **Private bond placements.** A security sold directly to a private investor, rather than as part of a public offering.

**C. Use of borrowed funds**

23. **IFAD will borrow to disburse loans to beneficiaries and to efficiently manage its liquidity within its Asset and Liability Management (ALM) Framework.** IFAD will continue borrowing to increase its development impact. Through borrowing, IFAD will also source funds for effective liquidity management. This entails maintaining its liquidity requirements in line with the Liquidity Policy and credit rating, including temporary use for collateral management. Borrowing will continue to be managed on a balance sheet level and in line with IFAD’s ALM Framework.9

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6 As further detailed in box 1.
7 The additionality rule states that Member States providing CPLs (either directly or through a state-supported institution) will be expected to provide core contributions equal to at least 80 per cent of a minimum grant contribution benchmark and target a total grant equivalent contribution (which includes core contribution and the grant element of the CPL) to at least their minimum grant contribution benchmark. The minimum grant contribution benchmark will be equal to 100 per cent of the average core contribution in local currency of the preceding two replenishment periods (for IFAD13, the average of IFAD12 and IFAD11 contributions).
8 For the remainder of IFAD12, any CPL will be governed by the terms and conditions included in annex I of the existing IBF (EB 2020/131(R)/R.21/Rev.1).
24. Within active ALM, the following two conditions will continue to apply to all borrowed funds:

- **No earmarking.** In principle, a lender may not restrict the use of the funds being lent to IFAD (e.g. in terms of beneficiaries, purpose, theme or geographic area). In limited cases, a thematic instrument with no specific earmarking to a subset of loan assets will be considered, only if the proposed theme is in line with IFAD’s core mission and has strong linkages to IFAD’s loan portfolio in its entirety; and

- **Financial sustainability – borrowing will not be subsidized through core resources.** IFAD’s ALM Framework and balance sheet position will determine the acceptable borrowing terms, with the aim of mirroring the concessionality of the loan assets to be financed where applicable. This approach takes into account any potential hedging costs to ensure that IFAD is immunized against any currency and interest rate risks. The proceeds from borrowed funds will be onlent to borrowers on terms that ensure the funding costs are fully covered by the interest rate charged on loans, thereby safeguarding financial sustainability.

25. **These conditions apply irrespective of the allocation mechanism for borrowed funds.** Strategic decisions about a separate allocation mechanism to channel borrowing (e.g. to a specific income category) are not considered to be earmarking imposed by the lender. Financial sustainability will always be the first driver for any allocation mechanism or policy applied to borrowed funds.

**D. Borrowing governance**

26. **The Executive Board will approve the annual funding plan.** The total indicative borrowing envelope levels for a three-year replenishment cycle will be determined based on the target programme of loans and grants in the context of each replenishment consultation. Annual borrowing requirements will be reflected in a funding plan to be included in the RAC document. Both the funding plan and the RAC will be approved by the Executive Board every year. Annual borrowing amounts will be within the established maximum thresholds as included in the CAP and the Liquidity Policy. The funding plan will include details of the actual, committed, planned and new borrowing amounts.

27. **The President will approve single transactions, loan agreements and potential investors after the due diligence process is concluded.** IFAD’s due diligence process for private institutional investors, as described in box 1, is solid and tested. The process will continue to apply and the authority to approve potential investors and associated transactions will be delegated to the President.\(^{11}\)

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\(^{10}\) The use of proceeds will ultimately be reflected in the bilateral agreement.

\(^{11}\) For sovereign states and state-supported institutions and for supranational and multilateral institutions, the due diligence process will not be undertaken. IFAD will however endeavour to perform due diligence also on state-owned pension funds and/or insurance companies.
Box 1
Due diligence process for private institutional impact investors

Private institutional impact investors will undergo internal due diligence verification informed by the existing process for IFAD’s corporate private sector partnerships. Private institutional impact investors will be screened against the following criteria, recently reviewed and updated by Management:

(i) **Minimum engagement criteria.** To set a basis for engagement, IFAD shall utilize the minimum engagement criteria defined in the Guidelines on Cooperation between the United Nations and the Business Sector (November 2009), namely: IFAD “will not engage with Business Sector entities that are complicit in human rights abuses, tolerate forced or compulsory labour or the use of child labour, are involved in the sale or manufacture of anti-personnel landmines or cluster bombs, or that otherwise do not meet relevant obligations or responsibilities required by the United Nations”; and IFAD “will not engage with Business Sector entities violating sanctions established by the United Nations Security Council”.

(ii) **ESG profile and reputational risk assessment.** The ESG performance of a potential private institutional impact investor will be examined using indicators from several specialized sources, including ESG risk ratings provided by specialized platforms such as Sustainalytics [www.sustainalytics.com] and RepRisk [www.reptist.com]. In addition, through IFAD’s External Relations and Governance Department, each private institutional impact investor will be screened to identify any current or pre-existing (direct or indirect) relationship with IFAD to ensure that any potential conflict of interest is addressed.

(iii) **Alignment of mandate.** Assessments of a potential private institutional impact investor’s mission and priorities will be carried out, including as regards adherence to relevant industry standards or recommendations such as the United Nations Principles for Responsible Investment [www.unpri.org] and the United Nations Global Compact [www.unglobalcompact.org].

(iv) **Anti-money laundering (AML) and countering the financing of terrorism (CFT).** IFAD has developed a “know your customer” questionnaire aligned with global standards and practices in peer institutions. This questionnaire assesses a counterpart’s AML, CFT and sanctions policies and procedures as well as relevant training of staff and processes for monitoring and reporting suspicious activities. The questionnaire, in its most recently amended form, will form part of the integrity due diligence checks that IFAD undertakes on potential private institutional impact investors. IFAD further assesses potential new investors against industry standard AML-CFT databases to support compliance with its AML-CFT Policy.

(v) **Relationship with other DFI s.** Existing relationships with other DFIs, including exposure of investors to peer institutions will be assessed and reported.

28. **The Executive Board will be informed of all executed transactions.**
Management will submit to the next practicable session of the Executive Board an information note on every executed transaction and loan agreement. The note will include all the disclosable details respecting when needed the confidentiality requirements of the investors.

29. **Risk management**

29. **Borrowing will continue to be managed at balance sheet level in line with IFAD’s ALM Framework and supported by ALM reporting.** The purpose of ALM is to ensure that liabilities are adequately managed (i.e. that debt is repaid on time). The need for active ALM arises from mismatches between the financial profile of assets and liabilities in terms of denomination currencies, maturities and interest rates. If such mismatches are not managed, these exposures can create liquidity constraints and shortages for an institution and, eventually, affect its capitalization. IFAD’s ALM Framework was introduced to take a holistic approach to managing balance sheet risks. Box 2 recalls the key elements of the exposures that IFAD will be monitoring and reporting on.

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12 The Principles for Responsible Investment are a voluntary set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The principles were developed by investors under the leadership of the United Nations and have attracted a global signatory base representing a majority of the world’s professionally managed investments.

13 The United Nations Global Compact supports companies to do business responsibly by aligning their strategies and operations with 10 principles on human rights, labour, environment and anticorruption; and promotes strategic action to advance broader societal goals such as the Sustainable Development Goals, with an emphasis on collaboration and innovation.

14 This will be done to the extent possible, respecting when needed the confidentiality requirements of the investors.
Box 2
ALM exposure monitoring and management

ALM is a practice used by financial institutions to mitigate financial risks resulting from a mismatch of assets and liabilities. A mismatch in the financial profile of assets when compared to liabilities, in the form of a currency, interest rate or duration/maturity, could expose the institution to the risk of being unable to honour its debt obligations, thereby eroding its capital.

IFAD's overarching strategy is to strive to ensure a close match between its assets and liabilities, including through the use of derivatives to hedge financial risks. IFAD's ALM Framework provides the basis for the monitoring and reporting of ALM exposures, and is structured around the following principles:

(i) Maintaining sufficient liquidity to meet IFAD's obligations, namely disbursement requests from clients and the servicing of its debt;
(ii) Adequately managing the currency composition of its assets and liabilities to limit losses deriving from fluctuations or a reduction in IFAD's financing capacity;
(iii) Protecting IFAD from fluctuations in market interest rates in order to reduce volatility in earnings and avoid reduction in capital.

The above risks are measured against established thresholds as detailed in various policies. Some measures are reported internally to finance committees and form the basis of financial planning, while others are periodically reported to governing bodies.

Liquidity risk management. The Liquidity Policy establishes the target liquidity level and the minimum liquidity requirement that IFAD must hold to meet its obligations even in times of stress. It inherently embeds all the cash flows related to borrowing.

Refinancing risk can arise from maturity mismatches between assets and liabilities. The average residual maturity of assets is compared to the average residual maturity of borrowing liabilities to ensure a close match.

Currency risk management. IFAD may borrow in a different currency than the onlending currency. Currency risk is managed by matching the currency of borrowing liabilities with the currency of the assets financed, or by employing currency hedging instruments if needed. Capital is allocated for the residual unhedged currency risk.

Interest rate risk management. IFAD’s interest rate risk management objective is to reduce the risk of loss resulting from a mismatch of duration between its assets (investment portfolio and loan portfolio) and liabilities (borrowed funds). IFAD mitigates interest rate risk by ensuring that fixed-rate liabilities (e.g. CPLs) finance fixed-rate loan assets (e.g. IFAD’s blend loans) and floating rate assets (IFAD’s ordinary loans) are financed by liabilities indexed to the same floating base rate (typically LIBOR or EURIBOR).

30. Capital planning. Capital adequacy is an indicator of solvency that is used to measure IFAD’s capacity to absorb potential losses derived from its development operations. It compares the level of capital available with the capital required to offset those potential losses. The projected level of deployable capital is essential to determine IFAD’s risk-bearing capacity and leverage levels. Capital adequacy and liquidity are complementary and are interlinked through the ALM Framework, which aims to minimize the residual exposure to non-core risks. The result of this dynamic relationship will determine the relevant limits of the yearly funding plan.

31. Conflict of interest risk and reputational risk. All potential new lenders will undergo an internal due diligence screening aimed at assessing any potential conflict of interest or reputational risk. Private institutional impact investors will undergo a more detailed screening, as detailed in box 1 above.

32. Operational risk. Operational risk related to the processing of increased borrowing transactions will be managed by upgrading internal accounting and payment systems, a process that has already begun. IFAD’s financial model was upgraded in order to fully reflect borrowing transactions and related key metrics, and is undergoing further enhancement that will allow for more sophisticated reporting on current and forecasted ALM positions. IFAD’s borrowing strategy is to increase leverage in a gradual and prudent manner.

33. Legal risk. As is standard in international financial markets, bilateral loan and bilateral bond agreements (and any hedging, services or similar agreements) with counterparts may be subject to national laws. Disputes may be referred to an appropriate mechanism for resolution and enforcement of the parties’ rights, as agreed between IFAD and the prospective lender or relevant party. Management will conduct negotiations with the assistance of outside counsel, if appropriate, in
the relevant jurisdictions. Subject to the provisions relating to the resolution of disputes, nothing in the aforementioned agreements shall be deemed a waiver of IFAD’s privileges and immunities.