

Document:	<u>EB 2010/99/R.8</u>
Agenda:	<u>7</u>
Date:	<u>15 April 2010</u>
Distribution:	<u>Public</u>
Original:	<u>English</u>

E



Enabling poor rural people
to overcome poverty

Haiti: An IFAD structure for permanent debt relief

Executive Board — Ninety-ninth Session
Rome, 21-22 April 2010

For: **Approval**

Note to Executive Board members

This document is submitted for the approval of the Executive Board.

To make the best use of time available at Executive Board sessions, representatives are invited to contact the following focal point with any technical questions about this document before the session:

Bambis Constantinides

Director, Financial Services Division
telephone: +39 06 5459 2054
e-mail: c.constantinides@ifad.org

Josefina Stubbs

Director, Latin America and the Caribbean Division
telephone: +39 06 5459 2318
e-mail: j.stubbs@ifad.org

Brian Baldwin

Senior Operations Management Adviser, Programme Management Department
telephone: +39 06 5459 2377
e-mail: b.baldwin@ifad.org

Queries regarding the dispatch of documentation for this session should be addressed to:

Deirdre McGrenra

Governing Bodies Officer
telephone: +39 06 5459 2374
e-mail: d.mcgrenra@ifad.org

Recommendation for approval

The Executive Board is invited to approve the following recommendations:

- (i) Authorizes the Fund to accept contributions from Member States to be used to cancel Haiti's debts in respect of IFAD loans on a pay-as-you-go basis. Such funds shall be deposited in an administrative account managed and accounted for separately from other IFAD resources and reported on periodically to the Executive Board.
- (ii) Decides that the balance of any amount due by Haiti to the Fund under outstanding loans, which cannot be liquidated with resources from the account referred to in paragraph (i) or otherwise, shall be converted into grants as the repayments fall due, up to 30 per cent (US\$15.2 million) of the total outstanding loans at net present value terms (US\$50.7 million) as estimated on 31 January 2010. Such conversions shall be periodically reported to the Executive Board.

Haiti: An IFAD structure for permanent debt relief

I. Background

1. This document presents information on IFAD's efforts to provide permanent debt relief to Haiti and seeks Board approval for the related administrative arrangements, in accordance with the Group of Seven (G7) call for forgiveness of Haiti's external public debt burden.
2. The Governing Council, at its thirty-third session held on 17-18 February 2010, which included the Haiti side event, took note of the Member States' commitment to support IFAD in providing permanent debt forgiveness to Haiti and the wish expressed by participants that all Members support such an initiative. In response, Management has formulated a plan to set up an administrative account to receive and manage external donor resources to repay Haiti's debt to IFAD. This also responds to formal requests from Member States for an IFAD mechanism to channel contributions for debt relief.
3. The Heavily Indebted Poor Countries (HIPC) Debt Initiative is providing ongoing support to the Haiti debt relief efforts. In April 2007, IFAD joined other international financial institutions (IFIs) – the World Bank and the Inter-American Development Bank (IDB) – in approving the decision point under HIPC to provide Haiti with irrevocable debt relief. IFAD's assessed requirement was SDR 2.2 million. Once Haiti reached its completion point, IFAD began to deliver this debt relief. As part of the agreed HIPC approach, IFAD front-loaded 100 per cent of the relief to ensure that it would have an immediate effect. At completion point, other IFI creditors were able to provide additional relief through the Multilateral Debt Relief Initiative (MDRI).
4. When Haiti reached the decision point, all creditors agreed that the required level of multilateral debt relief to bring its debt service down to sustainable levels (the "common reduction factor") should be established at 15.1 per cent of public external debt. Subsequently, further debt relief was provided for the balance through the MDRI by the International Development Association (IDA) and the International Monetary Fund (IMF). However, IFAD does not participate in the MDRI initiative and the HIPC Debt Initiative is not expected to be replenished for further debt relief for Haiti. Consequently, under normal conditions, full debt service payments to IFAD would be expected to resume in the second half of 2011.
5. IFAD's short- and long-term response to the 12 January earthquake focuses on sustainably improving food security and income generation in affected rural areas. This has included a US\$2.5 million grant for irrigation and watershed rehabilitation,¹ benefiting 12,000 households, that will rehabilitate productive infrastructure (3,000 km of irrigation systems, 12 km of rural roads, community centres and marketing stores), provide agricultural inputs, support watershed management and reforestation over 900 hectares and provide 200,000 person/days of employment to displaced persons, in addition to accelerating ongoing project activities (loans 496-HT, 587-HT and 715-HT), for an estimated annual budget of about US\$12.5 million. Additional resources are being mobilized from IFAD and cofinanciers for the design of a new project to be presented to the Executive Board in 2011. This project would call for IFAD funding of up to US\$18 million in Debt Sustainability Framework (DSF) grants, and cofinancing for a further US\$12 million is being sought.

II. Current debt status

6. The annex presents the current debt status of Haiti as at 31 January 2010. The outstanding loans relate to seven loans granted since 1978, for a total of

¹ Haiti Post-Earthquake Support Programme for Food Security and Employment Generation in Affected Rural Areas, approved through vote by correspondence on 24 March 2010.

SDR 63 million (US\$98 million equivalent) on highly concessional terms. The total amount disbursed as at 1 March 2010 is SDR 48 million. As of 2007, all approved financing to Haiti has been on grant terms in line with the DSF.

7. Haiti's outstanding debt as at 31 January 2010 was SDR 37.3 million (US\$57.8 million), with repayments falling due until 2046. Of this amount, SDR 1.4 million (US\$2.2 million) will be covered by HIPC debt relief (since loan 715 is not covered by HIPC debt relief, service charges on amounts disbursed to date and falling due in 2010 are excluded). The United States dollar equivalents are based on the SDR/US\$ rate on 31 January 2010 (1.549).²
8. A further amount of about SDR 15 million (US\$23.2 million) has yet to be disbursed from approved loans. Thus, Haiti's total debt to IFAD (excluding service charges) in relation to approved loans is expected to reach SDR 50.9 million (US\$78.8 million) if no amounts are repaid to IFAD in the meantime.
9. The estimated amount required for providing debt relief on a pay-as-you-go basis in respect of outstanding debt (net of HIPC) and the portion of approved loans still to be disbursed, plus the related service charges, is estimated at US\$50.7 million. This estimate is based on net present value (NPV) as at January 2010 and on the assumption that the full amount will be made available from the outset, i.e. early 2010, to generate returns which will be set off against debt repayments as they fall due. A discount rate of 3.9 per cent was applied.³

III. Debt relief approach and options considered

10. IFAD has internally reviewed several options for providing debt relief to Haiti, including temporary debt relief (e.g. a temporary suspension of Haiti's loan repayment obligation), the formal and immediate conversion of loans to grants, the possible assumption of Haiti's loan repayments by other Member States (e.g. Member States providing funding to IFAD to be used either directly for an immediate repayment of part of the debt or for debt relief on a pay-as-you-go basis). These options were presented to Member States at a side event in conjunction with the thirty-third session of the Governing Council.
11. An outright formal debt cancellation would necessitate a significantly higher initial financial outlay than the provision of debt relief on a pay-as-you-go basis. Under a pay-as-you-go methodology, loan repayments are made as they fall due using funding from an IFAD administrative account to be set up for this purpose. The debt will remain on IFAD's accounts until the last repayment due date (2046). Under this approach, the objective of relieving Haiti of the debt burden can be achieved while minimizing the funding requirement, which is based on the NPV of future principal repayments and service charges. This is the methodology IFAD applies for HIPC debt relief and is in line with the approach of other IFIs.
12. The debt relief options are as follows:

Option 1: IFAD as sole contributor

13. This option gives rise to the following considerations:
 - (i) **Use of IFAD resources for debt relief.** The Agreement Establishing IFAD limits the purposes for which the Fund may use its resources. The Fund was authorized to use its own resources for debt relief only for the HIPC scheme, as approved by the Governing Council, representing an internationally coordinated initiative whereby all participating agencies follow the same principles and approach. IFAD receives partial compensation of up to 2/3 of agreed debt relief through the HIPC Trust Fund managed by the World Bank,⁴

² The United States dollar equivalent will fluctuate in accordance with the SDR/US\$ exchange rate fluctuations.

³ The special drawing rights-based discount rate calculated using six-month averages of the commercial interest reference rate (CIRR). The CIRR is a discount rate used for debt relief and DSF purposes.

⁴ Now renamed the Debt Relief Trust Fund.

and provides the balance from its own resources. The Executive Board is informed when a transfer is made from regular resources to the IFAD HIPC account.

- (ii) **Financial integrity of the Fund.** The allocation of resources to cover the full funding requirement for Haiti debt relief will impact IFAD's capital base (equity including retained earnings). According to the 2009 financial statements, the level of retained earnings, after allowing for exchange movements, has dropped to its minimum level. This is attributable primarily to the implementation of the DSF, whereby projects are funded with grants rather than loans. Given the trend towards increasing use of the DSF facility, an allocation of resources for Haiti relief in 2010 could have a significant impact on retained earnings in 2010. A separate paper on DSF implementation will be presented to the Executive Board at its September 2010 session.
 - (iii) **Future events.** The major devastation experienced by Haiti is a truly tragic and exceptional event. However, circumstances may occur in another country in the future where similar needs arise. Given the principle of equitable treatment of Member States, any decision taken in the present case must be replicable in similar cases. Moreover, the Agreement Establishing IFAD requires the Executive Board to decide on the use of the Fund's resources with due regard to the long-term viability of the Fund and the need for continuity in its operations.
 - (iv) **Limited IFAD funding sources.** Other IFIs with Haiti debt (IDB, IDA) have more diverse financing and funding structures and more versatile ways of addressing ad hoc funding needs to avoid impact on funds destined for their programmes of work. IDA can access its International Bank for Reconstruction and Development (IBRD) resources and additional IDA facilities,⁵ and IDB indicates that Haiti debt relief will be a specific part of discussions concerning future financial support from shareholders. IFAD, on the contrary, relies solely on replenishment funding, which is provided to IFAD to finance its programme of work and particularly its loans and grants.
 - (v) **Resources available for projects.** The allocation of IFAD resources in 2010 for Haiti debt relief would lead to an equivalent reduction in resources available for IFAD's programme of loans and grants to all countries. This reduction would place further strain on the very low level of projected committable resource balance at the end of the Eighth Replenishment period, which could affect the projected US\$3 billion programme of loans and grants for the period. The full allocation of US\$50.7 million for this purpose in 2010 would mean approximately two projects less for this replenishment period and the consequent loss of future reflows in the case of project financing on loan terms.
 - (vi) **Future reimbursement of debt relief.** Consideration has been given to the option of having IFAD advance the full amount from its resources in 2010 and invite the membership to replenish this amount as an incremental contribution to the Ninth Replenishment of IFAD's resources. Although Eighth Replenishment contributions are still being received, there is an immediate concern that this may discourage Members who wish to commit incremental resources now for Haiti debt relief. Even if such an advance is fully recovered through incremental funding, its impact on the Fund's resources and capital base would be as described above, at least for the next three to four years.
14. In conclusion, Management considers that an option whereby IFAD advances the full amount of Haiti debt relief from its own resources would have an adverse impact on the Fund's ability to deliver its programme of work for the Eighth Replenishment period and on the integrity of its capital base. Additionally, it would not be in

⁵ Thirteen IDA donors have agreed to use unallocated investment income in the World Bank-administered Debt Relief Trust Fund and other resources to compensate Haiti's outstanding US\$38.8 million IDA credit following the meeting held in New York on 31 March 2010 (World Bank press release no. 2010/326/LAC)

compliance with some of the parameters established by the Governing Council as to the purpose and financing modality of IFAD activities.

Option 2: Members contribute all incremental funds to IFAD for Haiti debt relief

15. IFAD would manage Member State contributions received for this specific purpose through an administrative account, segregated from IFAD resources, to be set up with the approval of the Executive Board. This arrangement is similar to that already in place for the HIPC Debt Initiative.⁶
16. IFAD would front-load 100 per cent of the contributions received for debt relief, i.e. it would start applying full relief for service charges due in 2010 and principal repayments due in 2011 (once the HIPC relief is fully depleted). Should the funding provided not be sufficient to cover the total debt burden, Haiti would need, at some point in the future, to resume debt service to IFAD.
17. As indicated above, the estimated funding requirement of US\$50.7 million is based on NPV as at January 2010, on the assumption that all contributions are received by IFAD in early 2010. It is implicit in the NPV methodology that the full amount would need to be available from the outset to generate returns, which would be set off against debt repayments as they fall due. Any delay in receipt of funds would lead to a recalculation of requirements and therefore an increased funding requirement for the same amount of debt relief. Furthermore, prompt contributions would be required to cover the immediate service charge due for loan 715-HT. Under the IFAD arrears policy, IFAD assistance to Haiti may be suspended if the service charge dues remain unpaid after 180 days from the billing date. Such support would help prevent Haiti from entering into arrears status.
18. As this option is based on the premise that funding to be applied for Haiti debt relief would be incremental to the regular resources of the Fund, its adoption by the Board would have no impact on resources available for commitment for loans and grants.

Option 3: IFAD contributes to debt relief provided by Members

19. In line with the arrangements already in place for the HIPC DI, consideration could be given to a contribution from IFAD resources together with Member contributions. As Haiti receives IFAD financing on a grant basis under the DSF (see para 6 above), with the approval of the Executive Board, IFAD will convert loans into grants as the loan repayments fall due. Together with the member funded administrative account, this will be used to provide the necessary relief to Haiti as debt payments fall due; i.e. the pay as you go approach. The allocation of IFAD resources for this purpose will be placed in advance in a separate account and would decrease resources available for commitment through the programme of loans and grants, but could be kept within manageable levels if a ceiling is clearly established.
20. Guided by the level of financing that IFAD provides to eligible Member States under the HIPC Debt Initiative, IFAD proposes to contribute up to 30 per cent of the estimated total debt relief requirement (US\$15.2 million). If Members are able to contribute sufficient funds through the administrative account, this would reduce the need to use funds currently earmarked for the loans and grants programme and member contributions will be front-loaded in this respect.
21. In addition, IFAD will also use its resources to cover shortfalls arising from currency exchange differences or lower returns than anticipated earned on the Haiti Administrative Account assets (conversely any surpluses will be transferred back to IFAD resources). The investment strategy to be adopted for the Haiti Administrative Account assets will be tailored to the currency mix and disbursement profile associated to the debt relief flows, however, differences are always likely to arise.

⁶ In this regard, members may also consider to use the World Bank administered Debt Relief Trust Fund to earmark and transfer funds contributions to IFAD.

IV. Recommendation

22. Upon consideration of the above options, Management recommends an approach that safeguards the Fund's financial integrity while minimizing the burden on donors and IFAD, through the application of the pay-as-you-go methodology. While members would make contributions to a specific administrative account, in addition, recognizing the severity of the conditions facing Haiti, Management is prepared on an exceptional basis to transfer resources to a separate IFAD account up to a specified limit to convert future loan repayments to grants. If funds made available by Members are not sufficient to meet the required amount for full debt relief, debt repayments would need to resume once the funds available in the administrative account and separate IFAD account are depleted.
23. Therefore, the Executive Board is invited to approve the following recommendations:
 - (i) Authorizes the Fund to accept contributions from Member States to be used to cancel Haiti's debts in respect of IFAD loans on a pay-as-you-go basis. Such funds shall be deposited in an administrative account managed and accounted for separately from other IFAD resources and reported on periodically to the Executive Board.
 - (ii) Decides that the balance of any amount due by Haiti to the Fund under outstanding loans, which cannot be liquidated with resources from the account referred to in paragraph (i) or otherwise, shall be converted into grants as they fall due up to 30 per cent (US\$15.2 million) of the total outstanding loans at net present value terms (US\$50.7 million) as estimated on 31 January 2010. Such conversions shall be periodically reported to the Executive Board.

Haiti debt status^a

(in thousands of special drawing rights)

<i>Loan number</i>	<i>Last billing</i>	<i>Approved</i>	<i>Disbursed</i>	<i>Repaid</i>	<i>Outstanding</i>	<i>Undisbursed</i>	<i>Remaining HIPC coverage</i>	<i>Nominal incl. undisbursed</i>
004 ^b – HAI	2028	2 259	2 259	1 203	1 056	-	80	976
088 – HT	2031	10 882	10 882	5 016	5 866	-	377	5 489
126 – HT	2033	4 620	4 620	1 963	2 657	-	169	2 488
241 – HT	2038	8 200	8 200	2 255	5 945	-	292	5 653
496 – HT	2038	10 950	9 763	365	9 398	1 187	511	10 074
587 – HT	2041	17 400	10 925	-	10 925	6 475	-	17 400
715 – HT	2046	8 800	1 483	-	1 483	7 317	-	8 800
Total SDR		63 111	48 132	10 802	37 330	14 979	1 429	50 880
US\$ equivalent (in thousands)		97 793	74 583	16 738	57 845	23 210	2 214	78 841
NPV (in US\$ thousands)					37 673	10 549	2 494	50 716

^a In addition to the loans in the table, a Debt Sustainability Framework grant of SDR 3.65 million was approved for Haiti, which is still to be disbursed.

^b Loan denominated in United States dollars (amounts in table converted to special drawing rights).

9

Assumptions:

SDR/US\$ at 31 January 2010 exchange rate of 1.549.

Undisbursed loans will be disbursed in five years.

Discount rate for NPV 3.9 per cent in SDR terms.

The NPV amounts also include the NPV of the service charges which are additional to the repayment of principal.

