IFAD
Investing in rural people

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Review of the implementation of Management's response to the 2018 corporate-level evaluation of IFAD's financial architecture

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Action: The Evaluation Committee is invited to consider the review of the implementation of Management's response to the 2018 corporate-level evaluation of IFAD's financial architecture.

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Executive summary

1. Of the seven recommendations of the 2018 corporate-level evaluation of IFAD's financial architecture, four were deemed implemented and three partially implemented.

2. Recovering administrative costs and thereby allowing more efficient use of replenishment resources, while maintaining the Fund's AA+ credit rating, is a challenge that IFAD faces with its business model (based on concessional loans focusing on poorer countries).

3. The review notes the significant steps taken by IFAD Management to address this challenge, such as:

   - Updating key financial policies, such as the Debt Sustainability Framework reform;
   - Introducing the Borrowed Resource Access Mechanism (BRAM) to expand ordinary loans;
   - Establishing the Office of Enterprise Risk Management;
   - Obtaining two AA+ ratings;
   - Executing first capital market borrowings.

4. The review highlights the following recommended measures to strengthen the coverage of IFAD's operating expenses:

   (i) IFAD would benefit from exploring an optimal debt-to-equity ratio that is higher than 1:0.5, provided there is adequate demand for ordinary term loans, while maintaining its credit rating and mandate to serve primarily lower-income countries.

   (ii) To this end, IFAD should consider revisiting the 20 per cent maximum of the programme of loans and grants that upper-middle-income countries can receive and the target average BB credit rating of the BRAM portfolio.

   (iii) BRAM loans could be priced to cover risks and help to cover the operating costs of IFAD.

Review of the implementation of Management's response to the 2018 corporate-level evaluation of IFAD's financial architecture

I. Introduction

A. Context and rationale

1. As part of its 2023 workplan approved by the Executive Board,[1] the Independent Office of Evaluation of IFAD (IOE) undertook a review of the implementation of Management's response to the 2018 corporate-level evaluation (CLE) of IFAD's financial architecture. This review is an example of a pilot evaluation product intended to provide concise, action-oriented assessments, in line with the IOE multi-year evaluation strategy. The review involved an assessment of the extent to which IOE evaluations are used by IFAD to correct course and further the achievement of its mandate.

2. This 2018 CLE was selected for review because a solid financial architecture is central to enabling IFAD to fulfil its mandate; because it is directly linked to advancing the Sustainable Development Goals, particularly Goals 1, 2, 5, 8, 13, 15 and 17, as part of Agenda 2030; and because the effects of IFAD's response to the 2018 CLE have become measurable.

3. The 2018 CLE remains relevant. Achieving Agenda 2030 and the Sustainable Development Goals will require a significant increase in funding (approximately US$3.3 trillion to US$4.5 trillion per year) at a time when major donor countries are cutting back on their development budgets. The G20 are now encouraging development finance institutions (DFIs) to reform their financial architecture to more efficiently leverage the equity in their balance sheets, while maintaining a high credit rating.

B. Scope and methodology

4. The review covers Management's response to the recommendations and the status of implementation (see appendix I for the recommendations and appendix II for the status of Management's response as determined by Management). Specifically:

   (i) The extent to which the recommendations were relevant and implementable;

   (ii) The status of implementation of Management's response to the seven CLE recommendations;

   (iii) The extent to which the response addressed the strategic issues underpinning each recommendation;

   (iv) The underlying reasons for what worked (or not) and why in implementing the Management response.

5. The assessment drew evidence from document reviews and interviews with key personnel and triangulated methods and sources. In assessing the status of implementation of Management's response to the recommendations of the 2018 CLE, IOE used the categories "implemented", "partially implemented" and "not implemented". In assessing the status, the evaluation recognized the possibility of Management pursuing pathways not specified by the 2018 CLE to achieve the recommended outcomes.

   (i) **Implemented:** The recommendation was considered implemented if Management actions addressed key aspects of the recommendation, including all sub-recommendations. When Management actions were ongoing,

[1] EB 2022/136/R.3. High-level preview of IFAD's 2023 results-based programme of work, regular and capital budgets, and budget outlook for 2024-2025, and the preview of the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2023 and indicative plan for 2024-2025.

judgment was exercised to determine if these were likely to achieve the outcomes being sought.

(ii) **Partially implemented:** If one or more key aspects of the recommendation or sub-recommendations were not adequately addressed, the status was deemed to be partially implemented.

(iii) **Not implemented:** If insignificant progress was achieved towards addressing the recommendations, the status was determined to be not implemented.

6. The assessment of status was based on evidence collected from a review of all relevant documents and from key stakeholder interviews. Collected data was triangulated to arrive at the evidence necessary to assess the implementation status.

7. In assessing the implementation of the recommendations, this review takes note of the fact that, as a United Nations agency, IFAD's mandate and business model is distinct from that of many other multilateral development banks (MDBs).

II. Key findings

A. General

8. Stakeholders reiterated that the CLE findings and recommendations were of high relevance and that the recommendations had helped IFAD Management to better engage with Member States and had enabled IFAD to better fulfil its mandate and have greater outreach and higher impact.

9. The review found that Management was committed to addressing the key 2018 CLE recommendations, which it did by dealing with the Debt Sustainability Framework (DSF), installing an independent Chief Risk Officer, introducing and modernizing key financial policies, preparing for leveraging the balance sheet through capital market borrowings (including two AA+ ratings) and introducing Borrowed Resource Access Mechanism (BRAM) loans.

10. Management set the framework for change and provided ongoing DSF financing to the poorest IFAD-borrowing countries, in line with the recommendations. In addition to grants, this financing also included highly concessional loans and the newly introduced super highly concessional loans with maturities of 50 years, no loan interest rate and a low annual fee of 0.10 per cent (if denominated in special drawing rights [SDR]).

11. It was found that, at the same time, grants and DSF financing required shareholders to provide regular replenishments, since all highly concessional loans make it difficult for IFAD to ensure adequate coverage of the operating expenses from the fees received from such loans. Grants, DSF financing and highly concessional loans are an integral part of IFAD's unique mandate, and covering operating expenses without using replenishment resources is a somewhat lesser priority for both shareholders and Management.

12. **IFAD should continue to strengthen its efforts to increase the share of replenishment resources going to smallholder farmers.**

Table 1
IFAD's consolidated income and expenditures (2022)[2]

Items	*In US$ (millions)*
EXPENSES	
Operating expenses	218
Interest expense	17
Allowances for loan impairment losses	36
Depreciation	12
Total expenses	**283**
REVENUES	
Loan income	82
Treasury income	4
Other sources of income	11
Total income	**97**
Net annual operating loss	**186**

Source: EB 2023/138/R.17 (presented to the Executive Board at its 138th session, 10-11 May 2023).

13. IFAD's consolidated running costs, expressed as operating expenses, amounted to US$283 million in 2022. However, revenues amounted to only US$97 million. As a result, IFAD shows an annual operating loss of US$186 million.[3] To highlight this shortfall, expenses associated with the DSF and grants, as well as losses due to foreign exchange, were not included in this table. Currently, replenishments cover shortfalls of operating and other expenses as well as loan impairment and foreign exchange losses in addition to DSF and grants payments. Accordingly, a greater share of replenishment resources will become available for smallholder farmers if a higher proportion of these operating expenses are covered by IFAD's revenues.

14. The shortfall of US$186 million could be bridged by increasing either loan margins or loan volumes, or both, as expenses cannot be reduced substantially without negatively impacting the performance of operations. If the loan volumes were to be kept static, loan margins would have to be raised by 2.20 per cent to cover expenses, which is not feasible given IFAD's mandate. There is therefore a need to assess and discuss feasible increases to fees and loan margins.

15. The other pathway towards reducing the operating loss is to optimize the leverage ratio by increasing it from the current level of 1:0.25 to, for example, 1:1, which is the leverage ratio of the International Development Association (IDA) and quite conservative by DFI standards (see paragraph 37 for more details). Such an increase would allow IFAD to make additional loans under the BRAM. However, IFAD faces the following limiting considerations in increasing the leverage ratio (share of the BRAM):

    (i) The concessional business model requires IFAD to serve primarily those countries in need of concessional loans (including grants). In fact, in the discussions related to the creation of the BRAM during the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12), members called for setting a specific range of resources to be accessed by upper-middle-income

[2] For the purpose of this review, expenses related to grants and Heavily Indebted Poor Countries (HIPC) initiatives are excluded, as are the revenues from contributions. IFAD-only data are presented in appendix III, which includes the full set of income and expenditures.
[3] As per IFAD's 2022 financial statements https://www.ifad.org/en/-/consolidated-financial-statements-2022?p_l_back_url=%2Fen%2Fcorporate-documents.

countries (UMICs) and agreed on a cap of 20 per cent of the programme of loans and grants (PoLG).[4]

(ii) The adverse effect that leveraging might have on IFAD's credit rating. To avoid this, IFAD has a higher target average credit rating of BB for the portfolio of BRAM loans, compared with the overall target average credit rating of B for its total loan portfolio.

(iii) The existence of sustained and sufficient demand for BRAM loans.

16. The review recognizes that, within the above parameters – specifically, the cap on the share of PoLG that could be allocated to higher-rated UMICs and the higher target average rating of the portfolio of ordinary loans (BB rating) – it would be difficult for IFAD to increase its BRAM loans to match demand. The feasibility of modifying these parameters should be explored to increase the optimal volume of BRAM loans and to maximize IFAD's impact on the ground.

17. Hence, ongoing attention should be given to exploring the feasibility of increasing the optimal leverage level that would help to offset the annual operating losses and thereby improve the efficiency of IFAD's replenishment resources.

18. Like many DFIs, **IFAD's Management has taken significant steps to improve the efficient use of its replenishment resources**. It has updated key financial policies since the 2018 CLE, including the DSF reform, Asset and Liability Management (ALM) Framework, Liquidity Policy, Capital Adequacy Policy and Integrated Borrowing Framework. All of these were approved by the Executive Board, and they laid the foundation for IFAD to obtain AA+ credit ratings. All these steps were a sine qua non for leveraging IFAD's equity through borrowings in capital markets to increase IFAD's lending activities, outreach and development impact. Additionally, funding ordinary loans (and BRAM loans) from borrowed resources freed up equity for lending to the poorest on concessional terms.

19. Only loans on ordinary terms are provided through the BRAM.[5] Adding BRAM loans allowed lending to better-rated borrowers (i.e. UMICs) and made it possible to provide additional loans to borrowers who generally receive funding under the performance-based allocation system (PBAS) (i.e. lower-middle-income countries [LMICs] and low-income countries [LICs]) but have additional financing needs. The demand for BRAM loans did not emanate primarily from UMICs, and concessional loans were not curtailed by this expansion. This early evidence points to the possibility of avoiding mission drift and maintaining an optimal level of BRAM loans. As shown in more detail in paragraphs 35 and 36, during the IFAD12 period (2022–2024), UMICs have accounted for 12 of the 52 countries for which BRAM loans have already been approved or are in the pipeline.[6] During this period, the approved or planned BRAM financing has totalled US$937.7 million.[7]

B. Status of implementation of Management's response

20. The review recognized that the 2018 CLE recommendations (see appendix I for the full list of recommendations) were in certain cases very specific (e.g. the recommendation to address the DSF issue by taking DSF off IFAD's balance sheet), while others were not. Management should have the flexibility to address the underlying issues leading to the recommendations in different ways, as long as the desired outcomes are achieved.

[4] During the IFAD12 Consultation related to BRAM creation, members requested that UMICs access resources channelled through the BRAM only and called for setting a specific range of resources to be accessed by UMICs: 11–20 per cent of the PoLG.
[5] www.ifad.org/documents/38711624/47268192/guidelines-financing-terms-2023.pdf/c336d4b6-97ad-f854-d6a6-7856dc97618d?t=1676473102360.
[6] The total number of countries that can access new IFAD financing in a given cycle has been set at 80 since IFAD11.
[7] https://bi.ifad.org/analytics/saw.dll?Dashboard&PortalPath=%2Fshared%2FIFAD%20Projects%20Financing%2F_portal%2FPoLG&page=PoLG.

21. **Recommendation 1(a)**. IFAD has taken steps to address the DSF issue raised by the 2018 CLE. Departing from its previous policy, IFAD allowed new DSF grants to be pre-financed through new replenishment contributions. The pre-funded DSF mechanism and the establishment of the sustainable replenishment baseline are likely to ensure that IFAD's commitments to new DSF grants will not erode the Fund's liquidity and capital. Limited DSF grants are to be redirected exclusively to countries with the highest debt distress. During IFAD12, countries in moderate debt distress will no longer receive grants, but will be eligible for loans on super or highly concessional terms.

22. DSF grants were not taken off IFAD's balance sheet as suggested in the 2018 CLE. However, the changed policy makes spending on DSF and grants predictable – and linked to replenishments. As part of IFAD's DSF reform approved by the Board, the Office of Enterprise Risk Management determined IFAD's overall grant capacity (including regular grants and DSF grants) following the definition of the sustainable replenishment baseline to ensure that IFAD does not overcommit on its unrecoverable expenses. Accordingly, for the period of IFAD12, the regular grants amount was set at US$75 million, much lower than the earlier value of 6.5 per cent of the PoLG.[8] The rating agencies viewed this positively. This part of the recommendation was deemed implemented.

23. **Recommendation 1(b)**. Increasing the fees and loan margins is potentially a contentious issue. IFAD has taken small steps to adjust spreads and to reduce risks. In this context, IFAD introduced (i) a maturity premium differentiation, and (ii) a change in the funding spread added to ordinary and BRAM loans in order to reflect IFAD's actual cost of funding as an institution with a AA+ rating, where previously IFAD had simply charged the AAA-rated funding spread of the International Bank for Reconstruction and Development, which is by definition lower. The new funding spread is calculated per currency and includes hedging costs.

24. Some decision makers expressed the view that a potential increase in the fees and loan margins was not off the table. Furthermore, the margins on private sector loans would be higher than those on public sector loans, taking into account, inter alia, project/borrower risks. Such an increase would contribute to cover the gap between IFAD's consolidated income from loans of US$82 million and its operating expenses (not including other expenses) of US$218 million. While the current market conditions may make such increases difficult, there is no evidence of discussions to increase the loan margins for ordinary loans or the fees for concessional loans prior to the crisis induced by the pandemic and war. Overall, this part of the recommendation was not deemed to have been fully addressed.

25. **Recommendation 1(c)**. Some cost-efficiency measures, such as increasing the average loan volume, have been implemented. The average project size increased from US$43 million in 2018 to US$50 million in 2022, but other ratios have not changed. It is thus too early to evaluate whether any economies of scale can be achieved. The volume of concessional loans funded from equity and concessional partner loans is dependent on the total volume of equity and on the concessional partner loans that IFAD receives, which can only grow with increasing replenishments (or a decreasing use of replenishments for DSF and to cover operating expenses). Consequently, increasing the average amount of concessional loans would imply decreasing the total number of loans that IFAD can make. Only BRAM loans and other ordinary loans can increase in volume without negatively impacting other lending, as they are funded from borrowings, which could be increased, subject to a cap on the leverage ratio.

[8] The 2021 Regular Grants Policy of IFAD (EB 2021/132/R.3) capped the total regular grant allocation at US$100 million (footnote 13) for the IFAD12 replenishment cycle.

Table 2
Efficiency ratios at the corporate level

	2016	*2017*	*2018*	*2019*	*2020*	*2021*
Ratio 1: Total administrative budget/PoLG	17%	11%	11%	8%	16%	12%
Ratio 2: Total administrative budget/programme of work	11%	7%	6%	3%	7%	5%
Ratio 3: Value of portfolio/total administrative budget (US$ millions)	47	45	45	45	58	49
Ratio 4: Total administrative budget/total disbursements	27%	24%	24%	25%	26%	25%
Ratio 5: Average size of projects approved (PoLG/number of approved projects) (US$ millions)	36	41	43	49	50	50
Ratio 6: Total full-time equivalent/unit of output	7.9	7.1	7.9	7.4	9.5	9.0

Source: IOE corporate-level evaluation of IFAD's decentralization experience 2023.

26. In summary, of the three parts of this recommendation, recommendation 1(a), related to the DSF, and recommendation 1(c), related to improving cost-efficiency measures were considered implemented, while recommendation 1(b), on increasing fees and margins, was determined to be partially implemented. **Hence, IOE deems recommendation 1 to be partially implemented.**

27. **Recommendation 2(a)**. IFAD approved the introduction of new features related to financing conditions, such as: (i) a differentiated maturity and grace period; (ii) the introduction of an adjusted maturity premium based on a country's gross national income (GNI); and (iii) the option of loans in United States dollars and euros, but not yet loans in local currency or on a fixed-rate basis. IFAD reports that thus far there has been little or no demand for loans in local currency from the public sector. IFAD has therefore not offered such loans. However, as demand from private sector borrowers expands, demand for local currency loans will follow. To avoid incurring foreign exchange risk, IFAD's Treasury Services Division is in the process of preparing itself for providing local currency funding through hedging in the future.

28. **Recommendation 2(b)**. The Fund determines the lending terms for its borrowing Member States before the start of a replenishment period, and they remain in effect for the entire replenishment period. Prior to the replenishment period, if IFAD determines that a borrower has become eligible for less concessional lending terms, it applies the new terms gradually through the phasing-out/phasing-in mechanism. The mechanism is only applicable to countries transitioning from highly concessional to blended terms, and from blended to ordinary terms. In addition, the lending terms are reviewed annually during the replenishment period. In the annual review, if it is found that a borrower has become eligible for more concessional lending terms, the new lending terms will be effective from 1 January of the following calendar year. If it is found that a borrower is eligible for less concessional lending terms, then the new lending terms will be effective from the next replenishment period.

29. **Recommendation 2(c).** Although not all the products mentioned in the recommendation were implemented, BRAM loans, as further discussed under recommendation 3 below, could be seen as the introduction of a key financial instrument to address some of the issues mentioned above. Furthermore, IFAD introduced super highly concessional loans as part of the DSF reform, with a service charge of 0.10 per cent per annum for loans denominated in SDR[9] and a maturity of 50 years.

30. **Recommendation 2(d)**. The Agribusiness Capital Fund (ABC Fund) has deployed US$30 million through 27 investments. Of these, 70 per cent were in financial intermediaries such as microfinance institutions. In direct investments, the ABC

[9] See footnote 4.

Fund concentrated on trade finance (facilitating exports). There were no micro-level loans. The ABC Fund focused on counterparties not yet serviced by the impact investment community so as to remain as an additional option and act as a catalyst for further lending.

31. Although there were competing impact investors with multi-year experience in lending to smallholder farmers in client countries, the management of the ABC Fund was awarded to Bamboo Capital Partners despite the company having less experience in making loans and limited experience in lending to smallholder farmers. At this stage, no independent evaluative evidence on investment performance data (including non-performing loans) is available to assess whether the ABC Fund's investments have been successful.

32. The establishment of IFAD's Private Sector Financing Programme (PSFP) is a positive step. Rather than limiting itself to the investment in the ABC Fund, IFAD has now made direct loans to financial intermediaries and agricultural businesses.[10] At this point, the total volume of private sector financing is limited. With growing experience, private sector financing could become a potential contributor of positive revenues to IFAD.

33. In summary, recommendations 2(b) and 2(d) were considered implemented, while the implementation of recommendation 2(a) (introduction of local currency loans) was considered ongoing. Although recommendation 2(c) has not been fully addressed, important changes in the form of BRAM and super highly concessional loans were introduced. **IOE therefore deems recommendation 2 to be implemented**.

34. **Recommendation 3**. The BRAM was introduced in 2021. It created the basic conditions for potentially greatly expanding IFAD's lending activities, outreach and impact. Under IFAD12, IFAD's equity was US$7.97 billion as at 31 December 2022 (on a consolidated basis it amounted to US$8.06 billion). Total borrowings amounted to US$1.9 billion as at 31 December 2022,[11] which is only 24 per cent of equity. The amount of BRAM loans available was restricted to US$1.09 billion under IFAD12. Interviews with key stakeholders indicated that there is considerable scope for expanding the volume of BRAM loans, based on the demand expressed.

35. Also, LICs and LMICs eligible for super highly concessional, highly concessional, and blended terms, may access additional financing on ordinary terms (category 1) under BRAM conditions.[12] As a result, with 52 of the 78 IFAD12 countries identified as BRAM eligible, it is expected that BRAM loans will be approved for 11 LICs, 29 LMICs and all 12 UMICs during the IFAD12 period (2022–2024). As table 3 shows, in 2022 a total of US$66.7 million in BRAM resources was approved for six countries (three LICs, two LMICs, and one UMIC). The approved/planned BRAM financing is US$376 million for 2023 and US$495 million for 2024.

[10] IFAD intends to provide other financial products as well through the PSFP.
[11] EB 2023/138/R.17. Consolidated financial statements of IFAD as at 31 December 2022: https://www.ifad.org/documents/38711624/45440636/consolidated-financial-statements_2022.pdf/b8e194cf-38eb-a621-f793-f0597bd03d07?t=1682082459200.
[12] See footnote 4.

Table 3
BRAM loans approved in 2022

Country	*Category*[13]	*BRAM size (US$)*
Cambodia	LMIC	14 000 000
Madagascar	LIC	8 000 000
Brazil	UMIC	18 000 000
Benin	LMIC	15 000 000
Democratic Republic of the Congo	LIC	4 500 000
Liberia	LIC	7 170 000
Total amount		**66 670 000**

Source: IOE analysis of Board documents.

36. These numbers clearly show that BRAM loans were taken up not just by UMICs, but also by LIC and LMIC borrowers. Interviews with some key stakeholders showed that there was more demand for BRAM loans than was being processed. It would nonetheless be necessary to see the final distribution of such loans among LICs, LMICs and UMICs and verify that there is sufficient demand for BRAM loans from LICs to avoid mission drift and enable the credit rating to be maintained.

37. It would be useful to determine if there is room for increasing IFAD's leverage while ensuring these conditions are met. IFAD's leverage ratio, expected to be around 0.5 times equity till 2030, is conservative.[14] For instance, IDA's leverage ratio is 1:1 – in other words, for each dollar of equity, IDA has 1 dollar of debt.[15] The median leverage ratio of the AAA-rated DFIs is 1:2.8. The World Bank's leverage ratio stood at 1:4.75 in 2021, down from 1:5.19 in FY2020, and this high leverage had no negative impact on its AAA rating.[16] Therefore, it can be assumed that there is also potential room for an IFAD leverage ratio that is higher than 1:0.5.

38. The window for ordinary loans was considerably expanded with the establishment of the BRAM, which enables borrowers to obtain loans outside the PBAS framework. **IOE therefore deems recommendation 3 to be implemented**.

39. **Recommendation 4**. IFAD has obtained two AA+ credit ratings and has taken steps to strengthen its financial management in the governance and policy dimensions. IFAD's Office of Enterprise Risk Management, headed by an Associate Vice-President, was established in 2019. Instituting a Financial Risk Management Committee (FRMC) with asset and liability committee functions strengthened institutional governance. Revising or designing key policies, such as the DSF reform, the sustainable replenishment baseline, the ALM framework, the Capital Adequacy Policy, the Liquidity Policy, the Integrated Borrowing Framework and the new resources available for commitment (RAC) methodology set the parameters for leverage. The issue of foreign exchange swings is discussed in paragraphs 42 and 43.

40. IFAD has started tapping capital markets so far only in the form of private placements. However, it is very unusual (i) to limit borrowings to private placements, and (ii) to make it a condition that the Board (and now the President)[17] has to approve investors and each issue. Other MDBs, including the World Bank, issue bonds in the markets without knowing the ultimate investors. This is market

[13] The income category for each country has been extracted from the 2022 classification shown in the following document: IFAD, 2022. Approach for the Performance-based Allocation System and Borrowed Resource Access Mechanism for IFAD12.
[14] IFAD is reviewing its Capital Adequacy Policy at present, including the leverage ratio.
[15] Financial year 2019 to 2022: Moody's rating report of IDA. (https://thedocs.worldbank.org/en/doc/daed9065774b50e10261008f065969ca-0340022023/original/Moody-s-IDA-03Feb2023.pdf).
[16] Ibid.
[17] The approval of borrowing transactions has now been delegated to the President.

standard, and IFAD should feel comfortable following the same standard. In other DFIs, the decision to issue a bond is taken at the level of the treasurer or the head of funding.

41. **IOE deems recommendation 4 to be implemented**, given that IFAD successfully completed the preparation to borrow in capital markets by changing internal policies, establishing the Office of Enterprise Risk Management and the FRMC, and obtaining AA+ credit ratings.

42. **Recommendation 5.** IFAD Management introduced several new financial policies, including an ALM framework, to update its risk management concepts and practices. IFAD did not hedge future non-dollar replenishment payments, as it considers that most of the inherent foreign exchange risks are offset naturally by having unhedged SDR-denominated loans. The remaining open positions from such non-dollar replenishment pledges amount to US$300 million. Moreover, the foreign exchange risk inherent in SDR loans remains unhedged. This will continue to negatively impact IFAD's financials as long as the SDR basket depreciates vis-à-vis the United States dollar.

43. SDR loans continue to constitute a major currency risk for IFAD, as do certain future non-dollar replenishment pledges, which IFAD did not hedge as recommended in the 2018 CLE. Management, however, introduced many new financial policies to update its risk management concepts and practices in order to mitigate risks. Hence**, IOE deems recommendation 5 to be partially implemented.**

44. **Recommendation 6(a)**. The terms of reference of the Audit Committee have not been amended and minimum qualifications of individuals for Audit Committee membership have not been introduced, as recommended in the 2018 CLE.

45. **Recommendation 6(b)**. As stated above, IFAD further elaborated its financial policies and guidelines, set up an FRMC with asset and liability management committee functions and established an independent Office of Enterprise Risk Management, headed by an Associate Vice-President. Regarding liquidity management, the review notes that the practice of setting disbursement envelopes, or disbursement caps, with the aim of ensuring that IFAD stays within its liquidity policy is being corrected now. Disbursement caps or envelopes are not used by other DFIs. Managing liquidity based on more conservative assumptions regarding available equity and debt to service all disbursement requests should therefore be an operational standard.

46. In summary, given that recommendation 6(a) was not implemented, while recommendation 6(b) was implemented, **IOE deems recommendation 6 to be partially implemented**.

47. **Recommendation 7(a)**. A change in representation was introduced in IFAD12, whereby List A and List B Members gave up two seats each. Consequently, the new formal representation in the replenishment consultation became 25 Member States from List A, 10 Member States from List B and 22 Member States from List C. It should be noted that countries decide whether they wish to remain on List C. No changes have been made to the composition of Executive Board committees or other subsidiary bodies.

48. **Recommendation 7(b)**. Some changes were instituted regarding supplementary funds and complementary contributions. Supplementary funds, in contrast to complementary contributions, do not constitute part of IFAD's core resources. They are funds managed on behalf of the donors. Supplementary funds are subject to service and management charges, but do not carry any voting rights and are not part of the replenishment headlines. Complementary contributions, which do not entail any service charges, will cease to exist from IFAD12 onwards. Under IFAD13 there is a proposal for the creation of a new regular contribution, the "additional

climate contribution", which will confer voting rights (percentage to be determined) and will be part of the replenishment. Any contributions or donations to IFAD from private sector donors continue to require approval by the Board.

49. Given that non-fee-levying complementary contributions were abolished, and greater representation was accorded to List C countries in the replenishment processes, **IOE deems recommendation 7 to be implemented**.

Table 4
Summary of implementation status of 2018 CLE recommendations

Recommendation No	*Status*	*Rationale*
1	Partially implemented	Of the three sub-recommendations, one (DSF reform) was fully implemented and the other two (increasing fees and loan margins; introducing cost-efficiency measures) were partially implemented
2	Implemented	All four sub-recommendations were implemented or are ongoing (efforts to lend in local currency under way; flexibility in lending terms introduced; BRAM loans introduced; ABC Fund deployed)
3	Implemented	Windows for ordinary loans were expanded with the establishment of BRAM financing
4	Implemented	IFAD secured two AA+ ratings, established the Office of Enterprise Risk Management, and started tapping capital markets through bonds
5	Partially implemented	Managing currency risks was not fully implemented
6	Partially implemented	Of the two sub-recommendations, one (ensuring capacity for financial oversight of governing bodies) was not implemented, while the other (measures to manage financial risks) was implemented
7	Implemented	Complementary contributions discontinued after IFAD12; List C countries better represented in replenishment process

Source: IOE analysis.

III. Way forward

A. Increasing the share of regular resources going to the PoLG to benefit smallholders

50. Expanding the outreach and impact of financial resources available for lower-income countries while ensuring partial or full coverage of operating losses through revenues was the focus of the 2018 CLE. This section presents a way forward to strengthen the Management response to achieve this end.

51. The optimal use of resources continues to be a critical issue for all DFIs, as evidenced by the 2022 Independent Review of MDBs' Capital Adequacy Frameworks[18] conducted by the G20. Though IFAD does not consider itself an MDB, the findings of this G20 report can apply equally to IFAD. Taken together, its recommendations aim to increase development investments and impact and improve financial management while maintaining the credit rating and mitigating the associated risks, the key recommendation being the adoption of more efficient management of MDB capital and risk and the use of financial innovation.

B. Next steps

52. Based on the discussion above and the analysis of the implementation status of Management's response, the review highlights the following steps to strengthen the coverage of IFAD's operating expenses:

(i) IFAD would benefit from determining an optimal debt-to-equity ratio in discussion with the rating agencies. IFAD should explore the feasibility of a

[18] Boosting MDBs' investing capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks, 2022. https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/news/news/CAF-Review-Report.pdf.

ratio higher than 1:0.5 while maintaining its AA+ rating. This would allow for higher loan volumes and greater outreach and impact.

(ii) On that basis, IFAD should consider revisiting the 20 per cent maximum of the PoLG that UMICs can receive and the target average BB credit rating of the BRAM portfolio. Based on demand and these considerations, the volume of BRAM loans could be optimally increased without mission drift.

(iii) BRAM loans could be priced to cover risks and to help cover the operating costs of IFAD.

53. The review reiterates the CLE recommendation to provide borrowers with a wider choice of loan options, including fixed-rate loans and local currency loans, together with flexible, project-specific disbursement periods and grace periods.

54. Managing available funds to service concessional loan disbursement requests should be an operational standard. More conservative assumptions regarding IFAD's available equity are likely to prevent the need to impose disbursement caps in the future.

55. Private sector activities should be increased gradually, without competing with existing impact investors. Additionality is key. If investments in funds were desired, then it would be better to invest in existing funds managed by experienced agricultural and microfinance impact investors.

56. IFAD should align its practices for accessing international capital markets with those of other international financial institutions by:

(i) Borrowing in international capital markets via "normal" bond issues to establish IFAD as a "premium" issuer. Such borrowings can have shorter maturities.

(ii) Establishing benchmarks to help raise private placements on favourable terms.

(iii) Delegating bond-issuance authority to the Treasurer.

(iv) Setting up a commercial paper programme to provide more flexible cash management.

57. IFAD should assess the option of hedging SDR-denominated loans and the US$300 million in non-SDR-currency future replenishment payments, recognizing that a perfect hedge of the latter is not possible from a timing standpoint.

58. IFAD should expand the corporate finance dashboard to ensure comprehensive reporting to the Audit Committee.

Recommendations of the 2018 Corporate Level Evaluation of IFAD's Financial Architecture

1. Recommendation 1. Address the problem of systematic financial losses which leads to substantial capital erosion.

2. Recommendation 1(a). IFAD needs to address the long-terms effects and risks on its balance sheet connected to DSF and regular grants. Reducing the degree of future uncertainty would improve IFAD's situation in terms of both financial sustainability and when seeking a credit rating. All DSF and grants could be moved to a special purpose fund that is not consolidated on IFAD's balance sheet. At each replenishment, the accounts of this fund would be refilled and further DSF and grants would not be approved until the accounts have been replenished. As an alternative, IFAD may consider turning future compensation for DSF principal into a legally binding agreement.

3. Recommendation 1(b). In order to move closer to financial sustainability, it will be important to improve the return of the IFAD portfolio of loans. A measure to be considered is to increase interest rate margins for ordinary loans, and this can be done to a level that remains favourable compared to prevailing market rates for borrowing by sovereign entities, as shown by this evaluation.

4. Recommendation 1(c). In order to support the above fundamental changes to IFAD's financial architecture, this CLE reiterates the importance of cost-efficiency measures that have been recommended by past evaluations (notably the CLE on IFAD's Institutional Effectiveness). Measures to reduce the size of expenses, increase the PoLG, or increase the average size of loans (PoLG/number of operations), would improve economies of scale and reduce operating expense ratios.

5. Recommendation 2(a). Provide more flexible conditions for existing financial products and prepare for the introduction of new products. IFAD should conduct feasibility studies on both broadening choices on terms and conditions of current loans and on introducing new financial products. These studies will need to review current practices in other international DFIs and assess their adaptability to IFAD's context. Broaden the options on existing financial products. IFAD should offer more flexibility regarding the length of the grace period, maturity period and the amortization schedule, including the accelerated repayment option as is currently provided by some MDBs. IFAD could also offer the option of selecting of currency for new loans (e.g., euro, US dollars), including in some cases national currencies, appropriately priced, if IFAD can generate such funding either through borrowing in the market or via cross currency swaps.

6. Recommendation 2(b). Adjusting the terms of new loans to reflect changes in a country's classification. For new loans and DSF, IFAD could introduce a clause allowing loan terms to be adjusted to reflect changing country classifications (thus hardening or softening of terms, depending on the direction of change). In particular, the lending conditions for DSF or highly concessional loans would be applied as long as a country classification remains in that category.

7. Recommendation 2(c). Preparing the introduction of new financial instruments. This may include: (i) loan products designed to facilitate scaling up, drawing from experience of other DFIs and streamlining project approval procedures (e.g., results-based lending, multi-tranche financing facility or IDA scale-up facility); (ii) instruments to better respond to natural disasters or situations of fragility; and (iii) instruments to pre-finance project implementation preparedness and reducing project start-up time.

8. Recommendation 2(d). The Smallholder and small and medium-sized enterprise investment finance fund (SIF) would benefit from further refinements. For financially sustainable results and a viable exit strategy and to enhance efficiency,

the SIF could emphasize working through intermediaries (e.g., in the finance sector or marketing, whether these be micro-finance institutions, investment funds, banks, mobile phone companies or more apex-level marketing or processing companies) rather than processing and administering many small loans at the quasi-retail level.

9. Recommendation 3. Revise the financial allocation system. IFAD’s plans to substantially increase leverage through borrowing would mean that the totality of resources cannot be lent through the existing PBAS only. Responding to this challenge would consist of creating a second lending window for proceeds from borrowing (e.g., sovereign loans; bonds issued on international markets). This window would be for ordinary loans (i.e. Libor-based, single currency with a margin that compensates IFAD for the risk and administrative costs), separate from the PBAS, administered in a manner that is consistent with IFAD’s asset liability management strategy. The PBAS could then be used to allocate concessional funds only. In line with practices in other DFIs, IFAD could allow selected Member States to borrow amounts in excess of their PBAS allocation on terms that are similar to ordinary loans.

10. Recommendation 4. Conduct preparatory work for potential access to capital markets. Learning from the IDA example, it may not be strictly necessary for IFAD to be profitable to tap markets. However, a high credit rating is a condition sine qua non and would in all likelihood require a restructuring of IFAD’s financial architecture, by addressing those factors that create uncertainty. In particular, it would be fundamental to address the issues of DSF, grants and foreign exchange swings. IFAD would need to obtain a rating from at least two of the main rating agencies that have experience in rating DFIs (i.e., S&P, Moody’s and Fitch/IBCA) and early initial discussions may be helpful in order to be able to address any fundamental concerns of credit rating agencies.

11. Recommendation 5. Use hedging instruments to better manage foreign exchange risks. To reduce risks connected with foreign exchange fluctuations, IFAD could consider hedging future replenishment pledges into US dollars either fully or at certain stages during the encashment process. Pledges are not legally binding but have had a fair degree of certainty of being realized. In addition, IFAD could consider offering its clients the possibility of converting their existing portfolios of SDR-denominated loans to US dollars or euro-denominated loans. In this context, IFAD may consider the pros and cons of undertaking currency swaps into the US dollar for the remaining SDR loans to hedge the foreign exchange risk. Finally, IFAD could also hedge non-US dollar administrative expenditures (e.g., staff salaries) or operate a split budget, holding the latter in euro.

12. Recommendation 6. Strengthen IFAD’s financial governance. This includes aspects of both the external and internal governance, in particular:

13. Recommendation 6(a). Enhance the capacity of the IFAD Governing Bodies for financial oversight. As the complexity of IFAD financial architecture increases with the introduction of borrowing, further leverage and hedging, it may be beneficial to extend the terms of reference and role of the audit committee and to specify minimum qualifications of individuals for audit committee membership.

14. Recommendation 6(b). Elaborate more detailed guidelines for asset and liability management and for risk management. IFAD would benefit from more detailed policies and guidelines for asset and liability management and for liquidity management. These would cover the use of derivatives, swaps, futures, and options as hedging mechanism, as well as the hedging of future replenishment payments and budgetary items, and liquidity. An Asset and Liability Committee (ALCO) should be reconstituted to periodically review these policies and their application. Moreover, should IFAD significantly increase borrowing, it would need to strengthen the internal Risk Management function which could be tasked with

overseeing Treasury and other risk factors such as treasury market risks (interest rate, foreign exchange, derivatives, credit, spreads, and liquidity), treasury operational risk (including middle and back office and IT), operational risk of lending and of any fund managed.

15. Recommendation 7(a). In the replenishment consultation, there is a need to improve the balance of representation between A and B countries, the poorest borrowing countries and the growing number of List C donors.

16. Recommendation 7(b). Complementary contributions and supplementary funds should be treated in the same way. Both may be announced in headline replenishment figures, but both should be subject to service charges to cover the administrative costs related to them, which are currently subsidized by IFAD's regular administrative budget. IFAD management also needs more flexibility for acceptance of supplementary funds for minor amounts in line with the agreed strategy and criteria, including from private sources.

Management Assessment of the Status of its Response to Corporate-Level Evaluation: IFAD's financial architecture 2018

Table 1
Management Assessment of the Status of its Response to Corporate-Level Evaluation: IFAD's financial architecture 2018

Eval	*Rec #*	*Level*	*Nature*	*Theme*	*Recommendation*	*2017 Follow up*	*2019 Follow Up*	*2021 Follow Up*	*Status*
CLE	3	IFAD	PLCY	ALL	Revise the financial allocation system. If IFAD substantially increases its leverage through borrowing, it will need to lend the proceeds for ordinary loans to avoid incurring losses. The current PBAS constrains IFAD's ability to increase ordinary lending relative to other types of lending. Thus, IFAD would need to create a second lending window for ordinary loans, to be allocated through a risk-based system.		Discussions are continuing internally in the context of the IFAD2.0 with additional borrowed resources and we look forward to external feedback in the May 2019 EB retreat. FOD and OPR are also exploring revisions to the current PBAS to assess whether it is feasible and desirable to integrate a debt component into the methodology which recognizes the debt status of countries and/ or a financial ceiling to the total grants provided by IFAD in a given replenishment cycle	In 2021, the EB has approved [EB 2021/132/R.9/Rev.1] the creation of the Borrowed Resources Access Mechanism (BRAM), a risk-based mechanism which will govern access to borrowed resources. The five principles for the implementation of the BRAM are as follows: (a) country selectivity and eligibility; (b) supply of borrowed resources; (c) risk-based country limits; (d) differentiated financing conditions; and (e) demand-based access. In IFAD12, the PBAS will only allocate core resources to LICs and LMICs; it is through BRAM that countries will access most of ordinary lending during the IFAD12 period. Through the creation of BRAM, IFAD will ensure that financial considerations relevant for the prudent use of borrowed resources are accounted for (e.g. credit risk mitigated by the introduction of risk-based country limits etc.). The BRAM will become effective once the relative amendments to the Policies and Criteria for IFAD Financing have entered into force (following approval by the Governing Council in February 2022). 1 (a) Strategic Focus – a valid country strategy (COSOP or country strategy note) is available early in the cycle; (b) Ownership - no approved projects are pending signature for more than 12 months; (c) Absorptive Capacity - all projects in a country that have been effective for more than one year must have disbursed funds at least once in last 18 months; and (d) Level of indebtedness – as assessed by FMD.	F

CLE	4	IFAD	PLCY	FA	Conduct preparatory work for potential access to capital markets. IFAD needs to review the requirements to obtain a high credit rating, which are likely to include reducing the uncertainty linked to future DSF compensation.	Per the GC resolution on market borrowing, FOD is in progress to conduct preparatory work in relation to the potential access to capital markets. Key policies and processes have been introduced in 2018 and will continue in 2019 from all areas of FOD, with specific focus on risk management and treasury, also in preparation for the envisioned credit rating process. Key positions are being filled both in the revamped Risk Management Unit, Treasury and Controller's Divisions. Many of these new initiatives, policies and processes are also in line with recommendations made by the independent financial risk assessment performed by Alvarez & Marsal, approved by the Board. The DSF mechanism resolution is in progress and is being presented for review at the EB in May 2019. FOD has also initiated a project in coordination with ICT to enhance FOD's IT Landscape to meet current and future operational needs for Treasury, Accounting and Risk Management. Key systems will be implemented in the course of 2019 and 2020. FOD is in the process of preparing for an informal private credit rating assessment to take place in the second half of 2019, in advance of the formal credit rating exercise envisioned in 2020.	In preparation of the credit rating process started in 2019, IFAD introduced several financial reforms to strengthen its financial architecture. These included fully staffing a Risk Management Office with five key professional positions as well as introducing several financial policies to ensure the optimal level of operational planning vis a vis financial capacity. The main policies, all approved by the Executive Board, are: the DSF Reform, the Sustainable Replenishment Baseline, the ALM Framework, the Capital Adequacy Policy, the Liquidity Policy, the Integrated Borrowing Framework and the new RAC Methodology. The key metrics approved as part of the policies, like the Deployable Capital, the Minimum Liquidity Requirement and the financial ratios are reported periodically to the EB. This transformation underpinned the success of the credit rating process that culminated in two AA+ ratings from Fitch (November 2020) and S&P (December2020).	F
CLE	5	IFAD	PLCY	FA	Use hedging instruments to manage foreign exchange risks. IFAD is exposed to foreign exchange risks for the following reasons:(i) most of its loans are	TRE is currently employing hedging strategies to manage foreign exchange risk to the extent possible for its existing SDR loans. Additionally, IFAD is progressively increasing USD and EUR denominated loans to naturally hedge the balance sheet towards those SDR	The ALM framework presented to the EB in 2019 guides IFAD’s overall foreign exchange risk management. In recent years, loans financed by borrowed funds in EUR and USD, have predominantly been denominated in USD and EUR, with the aim of reducing IFAD’s currency exposure. In line with the ALM framework, IFAD	O

	denominated in SDR; (ii) some replenishment pledges are denominated in currencies other than United States dollars; and (iii) some operational expenses are not denominated in United States dollars. Other DFIs use hedging instruments and IFAD could learn from their practices.	currencies. An updated Asset Liability Management framework will be presented in collaboration between Treasury and the Risk Management Unit in the second half of 2019 to further address asset/liability, currency and interest rate mismatches.	is currently using hedging instruments to manage foreign exchange risks. Furthermore, regular updates about IFAD's ALM-related activities are presented to the EB.	

Key

F= Full follow-up: recommendations fully incorporated into the new phase/design of activities, operations or programmes, and the relevant policies or guidelines

O = Ongoing: actions initiated in the direction recommended

Source: PRISMA 2022 Vol I

IFAD-only income and expenditures (2022)

Table Annex III-1
IFAD-only income and expenditures (2022)

Items	*In US$ (millions)*
EXPENSES	
Operating expenses	191
Interest expense	17
Allowances for loan impairment losses	35
Depreciation	12
Grant expenses, including grants to countries in debt distress, and HIPC	280
Total expenses	**535**
REVENUES	
Loan income	80
Treasury income	11
Other sources of income	23
Total revenue	**114**
Net annual “operating loss”	**424**

Source: FOD communications on 15/09/2023

List of persons interviewed

Audit Committee	
Gian Paolo Ruggiero	Audit Committee Chair
Executive Board Representative	
Ronald Meyer	Counsellor, Alternate Permanent Representative of the Federal Republic of Germany to the International Organizations in Rome
Corporate Services Support Group	
Alberto Cogliati	Associate Vice-President and Chief Risk Officer, Office of Enterprise and Risk Management, RMO
Katherine Meighan	Associate Vice-President, Office of the General Counsel, LEG
External Relations and Governance	
Max Von Bonsdorff	Chief Partnership Officer, Global Engagement, Partnership and Resource Mobilization, GPR
Leon Williams	Senior Partnership Officer, Global Engagement, Partnership and Resource Mobilization, GPR
Financial Operations Department	
Alvaro Lario	President of IFAD (Former Chief Financial Officer, Chief Controller, and Associate Vice-President, Financial Operations Department, FOD)
Alvarado Hernan	Associate Vice President, Chief Financial Officer and Chief Controller, Financial Operations Department, FOD
Advit Nath	Director and Controller, Financial Controller’s Division, FCD
Ruth Farrant	Director, Finance Management Service Division, FMD
Gulnara Yunusova	Director and Treasurer, Treasury Services Division, TRE
Programme Management Department	
Nigel Brett	Director, Operational Policy and Results Division, OPR
Strategy and Knowledge Department	
Thouraya Triki	Director, Sustainable Production, Markets and Institutions Division, PMI
Private Sector	
Michael Hamp	Former IFAD staff member
Susan Tirop	ABC Fund member

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