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Investing in rural people

## Corporate-level evaluation on IFAD's financial architecture

### Approach paper

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For: Review

## Contents

Abbreviations and acronyms	ii
I. Background	1
II. IFAD's financial architecture	1
A. IFAD's Sources of Financing	1
B. Selected corporate policies related to the financial architecture and on-going work	2
C. Products and financing terms	5
III. Objectives of the evaluation, evaluation framework and process	5
A. Scope of the evaluation	5
B. Approach and methodology	6
C. Data collection and information sources	8
IV. Evaluation process	10
Appendices	
Appendix I: Evaluation Time Line	1
Appendix II: Evaluation Framework	2
Appendix III: Financial Indicators	7
Appendix IV: Key Policies Supporting the Financial Architecture	10
Appendix V: Loans and DSF Grants by Type	14
Appendix VI: MDB's Progress in Reforming Their Financial Architecture	16
Appendix VII: Key Dates in the Evolution of IFAD's Financial Architecture	20
Appendix VIII: Glossary of Terms	21
Appendix IX: Bibliography	23

## Abbreviations and acronyms

ACA	Advanced Commitment Authority
ADB	Asian Development Bank
AFD	Agence Française de Développement
AfDB	African Development Bank
ALM	Asset Liability Management
APR	Asia and the Pacific
ASAP	Adaptation for Smallholder Agriculture Programme
CLE	Corporate-level evaluation
COSOP	Country Strategic Opportunities Programme
DSF	Debt Sustainability Framework
ESA	East and Southern Africa
FOD	Finance Operations Department
GAVI	Global Alliance for Vaccines and Immunisation
HIPC	Heavily Indebted Poor Countries
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IOE	Independent Office of Evaluation of IFAD
LAC	Latin America and the Caribbean
MDB	Multilateral Development Bank
MIC	Middle-income country
NEN	Near East and North Africa
ODA	Official Development Assistance
OECD-DAC	Organisation for Economic Co-operation and Development – Development Assistance Committee
PoLG	Programme of Loans and Grants
SBF	Sovereign Borrowing Framework
SDG	Sustainable Development Goal
SDR	special drawing right
WCA	West and Central Africa

# Corporate-level evaluation on IFAD's financial architecture

## I. Background

1. IFAD's financial architecture can be defined as the policies and systems adopted to mobilize, manage, allocate and disburse financial resources to support the Fund's objective "to mobilize additional resources to be made available on concessional terms for agricultural development in developing Member States".<sup>1</sup> When evaluating the financial architecture, the fundamental question is how IFAD creates value for Member States through sound investment decisions and financial strategies. Work is under way in IFAD to explore options for changing the financial architecture, to broaden the funding base and strengthen the treasury and financial management functions, so as to increase the size of the programme of loans and grants (PoLG) and provide better services to borrowing Member States.
2. Reforms are also ongoing in other International Financial Institutions (IFIs). For example, in 2017 the Asian Development Bank (ADB) will combine its concessional and ordinary lending operations, with an annual increase in lending of 50 per cent. The International Development Association, following its 18<sup>th</sup> Replenishment, plans to leverage its capital for non-concessional loans through a private-sector set-aside window. The African Development Bank (AfDB) is opening its non-concessional window to the poorest countries.
3. The Executive Board has approved the undertaking of a corporate-level evaluation (CLE) on IFAD's financial architecture as part of the work programme and budget of the Independent Office of Evaluation of IFAD (IOE) for 2017.<sup>2</sup> IOE is conducting the first independent evaluation of financial architecture conducted among multilateral development banks (MDBs). This evaluation will build upon the findings of previous CLEs, such as the ones on efficiency (2013), replenishments (2014), Policy for Grant Financing (2014) and Performance-based Allocation System (2016). The evaluation is timely, since Management plans to discuss adjustments to IFAD's financial architecture with the Executive Board in 2017 and 2018. It will also inform future decisions to be taken by Management which will have implications on the Fund's long-term financial sustainability of, and contribution to, the 2030 Agenda for Sustainable Development (Agenda 2030).

## II. IFAD's financial architecture

### A. IFAD's sources of financing

4. IFAD was established in 1976 as a Specialized United Nations Agency and an IFI: periodic replenishments, provided as equity, are at the heart of the Fund's financial architecture. The replenishment consultations provide a forum for strategic dialogue on the past results and future directions of its business model, governance, operational capacity and the financial architecture.<sup>3</sup>
5. In addition to Members' replenishment contributions, IFAD's funding sources (financial inflows) include loan reflows and investment income, interest on loans, and management and service charges. Compensation for income forgone, as a result of debt forgiveness under the Heavily Indebted Poor Countries (HIPC) Debt Initiative, can also be considered as a source of funding. Since the Ninth Replenishment of IFAD's Resources (IFAD9) period (2013-2015), the Fund has also

<sup>1</sup> Article 2, Agreement Establishing IFAD.

<sup>2</sup> Document EB 2016/119/R.2/Rev.1.

<sup>3</sup> Corporate-level evaluation on IFAD replenishments, EB 2014/111/R.3/Rev.1.

accessed sovereign loans (see appendix VII for the evolution of IFAD's financial architecture). Beyond these core resources, IFAD also receives complementary and supplementary funds which will also be considered by this evaluation. IFAD's uses of funds (outflows) include disbursements for loans and grants, uncompensated HIPC debt forgiveness, the administrative budget and other expenses.<sup>4</sup>

6. IFAD's total equity is the sum total of replenishment contributions plus general reserves. Over 90 per cent of its assets are funded by equity. In the current financial architecture, IFAD has a tight ceiling on leverage. Managing liquidity plays an important role: a PoLG is judged to be cash-flow sustainable if, by projecting all the cash inflows and outflows resulting from past, current and future PoLGs, IFAD's liquidity never falls below the minimum liquidity requirement (60 per cent of annual projected gross disbursements). The Fund's Investment Policy Statement governs the investment of its liquid assets (see table 4 in appendix III for key ratios used to monitor IFAD's financial performance). The structure of IFADs' balance sheet differs from those of MDBs, since the latter have credit ratings and issue debt (bonds) on the financial markets to leverage their lending activities.
7. Reliance on replenishments served IFAD well during IFAD6 (2004-2006), IFAD7 (2007-2009) and IFAD8 (2010-2012). Total financing grew by a factor of 2.5 from US\$1,425,000,000 to US\$3,626,000,000.<sup>5</sup> Members' contributions more than doubled from US\$506 million to US\$1.2 billion, and the share of total expenditure financed by replenishments fell from 39 to 33 per cent. The PoLG stabilized at US\$3.0 billion for IFAD8, IFAD9 and IFAD10 (2016-2018). Members' contributions increased to US\$1.5 billion for IFAD9<sup>6</sup> and declined slightly to US\$1.35 billion for IFAD10. During IFAD9 and IFAD10, the Fund became more reliant on Members' contributions than on reflows to finance its costs.
8. Trends in Official Development Assistance (ODA) may have implications for IFAD's replenishments. ODA from member countries of the Organisation for Economic Co-operation and Development (OECD) increased by nearly 50 per cent between 2004-05 and 2015, measured at 2014 prices and exchange rates, to reach a level of US\$146.68 billion. Although there were increases from 2012 to 2014, ODA fell by 4 per cent in 2015. ODA contributions to multilateral institutions also declined in 2015.<sup>7</sup>
9. According to the IFAD10 Financial Framework and Programme of Work, the demand for IFAD resources, estimated at US\$5.5 billion, exceeded the projected funding availability from core contributions and internal resources. The main constraint to increasing the Fund's development assistance was considered to be on the supply side rather than on the demand side. IFAD9 and IFAD10 consultations paid considerable attention to the financial architecture and to broadening the Fund's sources of financing beyond Members' contributions.

## B. Selected corporate policies related to the financial architecture and ongoing work

10. While many policies approved by IFAD have contributed to shaping its financial architecture (appendix IV), five deserve special attention in this introduction:

<sup>4</sup> Depending on future changes, there may be additional sources of funds (e.g. compensation for forgone Debt Sustainability Framework [DSF] reflows, sovereign loans and other funding mobilized) and uses of funds (e.g. uncompensated foregone DSF reflows and repayment of sovereign loans and other resources mobilized).

<sup>5</sup> IFAD8 consultations, held in the context of the food crisis, received an extraordinary contribution from internal resources.

<sup>6</sup> IFAD9 benefitted from a special earmarked thematic contribution for the Adaptation for Smallholder Agriculture Programme (ASAP).

<sup>7</sup> [www.oecd.org/dac/financing-sustainable-development/development-finance-data](http://www.oecd.org/dac/financing-sustainable-development/development-finance-data).

- (i) Highly Indebted Poor Countries (HIPC) Debt Initiative since 1996. This implied an agreed reduction of loan repayments to IFAD, with compensation payments being made to IFAD's loan fund accounts for the associated losses.
  - (ii) Performance-based allocation system (PBAS). Compared to other MDBs, IFAD has a unique financial architecture in that all loans and country grants, including the proceeds of sovereign borrowing, are allocated through the PBAS. Other MDBs only use their PBASs to allocate concessional funds, while their ordinary lending is allocated on the basis of asset liability management (ALM) considerations.
  - (iii) Debt Sustainability Framework (DSF). IFAD provides financial support for countries with: (i) low debt sustainability: 100 per cent grant; (ii) medium debt sustainability: 50 per cent grant and 50 per cent loan; and (iii) high debt sustainability: 100 per cent loan. This implies a forgone reflow of funds which, as of 31 December 2016, was projected at 1.09 billion special drawing rights (SDR) to 2056. This will increase as more DSF grants are approved.<sup>8</sup> During IFAD10, Members agreed to compensate IFAD for forgone principal payments but not for forgone service charges, and the compensation is expected to take place through the replenishment processes.
  - (iv) Single-currency lending. While IFAD's loans were traditionally denominated in SDRs, the Fund has introduced the option of borrowing in a single currency (United States dollars or euros). The first pilot phase attained its ceiling of US\$200 million in early 2016. In November 2016, the ceiling was raised to US\$ 1.6 billion, equivalent to about half of IFAD10, and Management expects that it will continue to grow. While this makes borrowing simpler, it increases exposure to currency volatility and may require cross-currency swaps.
  - (v) Sovereign Borrowing Framework (SBF).<sup>9</sup> This allows IFAD to mobilize additional resources to increase the PoLG by approximately 1:1 (see IFAD's balance sheet evolution in appendix III, table 5). The Fund has established prudential norms and risk mitigation measures to manage the effects of sovereign borrowing on liabilities.
11. Since 2014 (see appendix VII) IFAD has taken the following steps to enhance its financial capacity and management:
- (i) IFAD's financial model. The Advance Commitment Authority (ACA) was replaced with a sustainable cash-flow approach<sup>10</sup> from IFAD9 onwards, to align with other IFIs. At the end of 2016 a new financial projection model was developed that was more closely aligned with the approach used for ALM in other MDBs. A proposal for compensating IFAD for forgone principal arising from the DSF was approved.<sup>11</sup>
  - (ii) Internal resource mobilization. The Policies and Criteria for IFAD Financing were updated in view of those of the International Development Association (IDA) and the International Bank for Reconstruction and Development.<sup>12</sup> The Fund's internal resources were enhanced by soliciting payment of loan and contribution arrears and exploring the possibility of loan prepayments.
  - (iii) Explore new sovereign donors and alternative financing modalities. The Additional Resource Mobilization Initiative was launched to explore the

<sup>8</sup> Forgone principal repayments: SDR 1.0 billion; forgone interest/service charges: SDR 0.2 billion.

<sup>9</sup> According to the OECD definition of ODA, Member States can count sovereign loans as ODA.

<sup>10</sup> A Glossary of terms is provided in appendix VIII.

<sup>11</sup> There is no commitment to compensate IFAD for forgone interest and service charges.

<sup>12</sup> IFAD approved new blend terms, effectively replacing two products between highly concessional and ordinary terms (i.e. intermediate and hardened loans).

scope for increasing financing from additional new sources. The IFAD9 replenishment was not sufficient to finance the planned US\$3.1 billion PoLG. To bridge the gap, IFAD negotiated a EUR 400 million loan with the German KfW Development Bank. Under IFAD10, in 2016 a EUR 200 million loan from Agence Française de Développement (AFD) was approved by the Executive Board. Complementary contributions were also sought for selected thematic areas, including climate-change mainstreaming, nutrition-sensitive agriculture, South-South and Triangular Cooperation and public-private-producer partnerships.<sup>13</sup>

12. While core replenishment resources are likely to remain the foundation of IFAD's financing, during IFAD10 options will be examined for: (i) sustained mobilization of core and unrestricted complementary contributions through replenishment cycles; (ii) increased leverage of IFAD's resources by: (a) sovereign loans; (b) exploring the scope for borrowing from the financial markets;<sup>14</sup> and (c) expanding the programme of work through other sources of financing. The Fund's target was to supplement the IFAD10 replenishment by mobilizing up to US\$1.5 billion of additional resources. The Additional Resource Mobilization Initiative is also exploring other sources of financing, including from philanthropic foundations, and ways to increase the amount of cofinancing.
13. Risk Management: When IFAD's financing sources were limited to replenishments and it only made sovereign loans financed by its equity, it faced financial risks related to: (i) its treasury investments; and (ii) foreign exchange risks (lending is denominated in SDRs, whereas IFAD's unit of account is in United States dollars);<sup>15</sup> and (iii) erosion of its capital base in a high-inflation environment (IFAD's lending was at concessional fixed interest rates). As the financial architecture was broadened, with the introduction of the SBF and single-currency lending, IFAD faced additional potential risks (e.g. interest and maturity risks).
14. IFAD has established a Management's Corporate Working Group on the Review of the Policies and Criteria for IFAD Financing. A report was presented to Management's Investment and Finance Advisory Committee and the Audit Committee in December 2016.
15. In 2012, the Fund created the Financial Operations Department (FOD), headed by an Associate Vice-President/Chief Financial Officer/Chief Controller, with three divisions: (i) Financial Management Services; (ii) Treasury Services; and (iii) Accounting and Controller's Division.
16. IFAD has reshaped its organizational support for the financial architecture: (i) FOD was reconfigured into the Financial Management Services Division and the Accounting and Controller's Division; (ii) financial planning was split from the controller's function; (iii) IFAD introduced an online portal so clients can manage their loans more effectively; and (iv) risk management/compliance was separated from the Treasury Services Division and now reports directly to the Chief Financial Officer.
17. IFAD has also reformed the finance and treasury infrastructure. This has involved: (i) making changes to the investment guidelines (December 2015); (ii) concluding negotiations on IFAD's first International Swaps and Derivatives Association Master Agreement and building in-house capacity to engage in cross-currency swaps;

<sup>13</sup> See EB 2016/119/R.31, Proposed framework for new financing facilities: Enhancing IFAD's catalytic role in mobilizing resources for rural transformation. In addition, IFAD plans to mobilize supplementary funds to explore new funding mechanisms: (i) Professional Pathways Programme; (ii) Accelerator Fund; and (iii) Smallholder and Small and Medium- Sized Enterprise Investment Finance Fund.

<sup>14</sup> Borrowing from the markets is not expected to take place during IFAD10.

<sup>15</sup> An additional foreign-exchange risk was inherent in the fact that capital pledges were multi-year and, unless the amounts were fixed in United States dollars or hedged back into dollars, were subject to foreign exchange movements.

(iii) improving the treasury model to bring it closer to what is used in MDBs for ALM by end-2016; (iv) more sophisticated reporting on financial ratios (i.e. debt/equity; liquidity; debt coverage); (v) creating a high-level task force on borrowing; and (vi) improving risk management.

### C. Products and financing terms

18. IFAD's products include: (i) loans and DSF grants to support development initiatives in individual countries; (ii) grants to support innovation, research, policy engagement and capacity building; and (iii) reimbursable technical assistance, introduced in 2012. The Lending Policies and Criteria for IFAD financing were first introduced in 1978 and have been revised several times, most recently in 2013. IFAD approved policies for grant financing in 2003, 2009 and 2015; and, in 2007, a separate policy was approved for grant financing in the DSF context.
19. The terms of IFAD's funding reflect the country's per capita gross national product (GNP), debt sustainability and debt-servicing capacity, which are harmonized with IDA. Each year IFAD provides about two thirds of loans on highly concessional terms.<sup>16</sup> By end-2015, IFAD had provided US\$16.4 billion in financing to support 1,150 projects (appendix V). Of that financing: (i) 9.4 per cent was in the form of DSF grants; (ii) 63.4 per cent was highly concessional loans; (iii) 13.9 per cent was lending between highly concessional and ordinary rates; and (iv) 13.3 per cent was ordinary lending.<sup>17</sup> Thus, consistent with article 2 of the Agreement Establishing IFAD, the financial support was provided on concessional terms.<sup>18</sup> However, providing funds on ordinary terms is an important feature of the financial architecture, because faster reflows and higher interest from such loans support IFAD's financial sustainability.

## III. Objectives of the CLE, evaluation framework and process

20. The overarching purpose of this CLE is to make an independent assessment of IFAD's financial architecture and the adequacy of the policies and instruments that IFAD uses to help reduce rural poverty by funding the PoLG. The objectives of this evaluation are to assess: (i) the relevance of the financial architecture in mobilizing resources; (ii) the value-added of IFAD's financial instruments to Member States; (iii) the efficiency of IFAD's financial architecture; (iv) the contribution of the investment and financial strategies to IFAD's financial sustainability; and (v) to make recommendations as to alternatives and options related to the financial architecture that would strengthen IFAD's capacity to fund rural poverty reduction programmes.

### A. Scope of the evaluation

21. As noted, the evaluation's definition of IFAD's financial architecture includes: (i) the sources of funds mobilized through replenishments, cofinancing and other sources including sovereign borrowing; (ii) the use and allocation of the resources to countries; (iii) the financial support instruments and their performance; (iv) IFAD's corporate financial management and oversight systems (senior management oversight, treasury and financial services); (v) the external financial oversight system (including the relevant role of the Governing Council, the Executive Board and the replenishment process). This CLE will draw on analytical material from previous evaluations, where available.

<sup>16</sup> Policies and Criteria for IFAD Financing, para 15(a)(ii)(1).

<sup>17</sup> Under IFAD8, ordinary lending accounted for 17 per cent of total allocations. This increased to 23 per cent during IFAD9.

<sup>18</sup> Even ordinary terms are concessional when the grace and repayment periods are considered, as per standard practice and understanding in all IFIs.

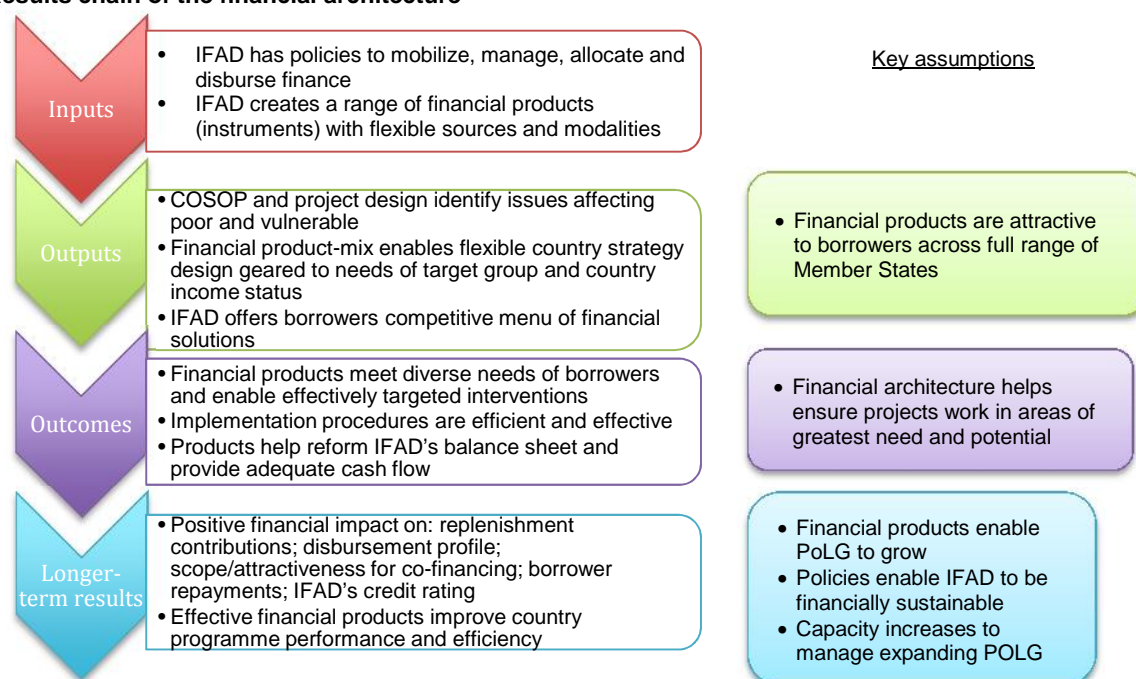


22. The evaluation timeframe will cover the period from 2004 up to 2017. During that time, several important changes were introduced that have an impact on IFAD's financial architecture (e.g. introduction of PBAS, launching of the Additional Resource Mobilization Initiative, adoption of the SBF [see appendix VII]). The evaluation will review developments prior to 2004 to the extent that they are relevant to understanding the evolution of IFAD's financial architecture.
23. In addition to looking at internal factors, the evaluation will examine the external environment to identify factors that affect IFAD's financial architecture and financial performance (e.g. trends in ODA and capital markets; experience of comparator organizations).
24. The evaluation will also have a formative component, since Management is looking at diversifying IFAD's sources of financing and possibly changing the financial architecture, sources of financing and products. The evaluation will also draw from the experience of the ongoing replenishment process which will be completed in 2017.

## B. Approach and methodology

25. Methodology. The evaluation will be undertaken within the framework of the Revised IFAD Evaluation Policy (2011), and will follow the broad methodological fundamentals set out in the second edition of the Evaluation Manual (2015). It will be anchored in four common evaluation criteria: relevance, effectiveness, efficiency and financial sustainability.
26. Key guiding principles can be harnessed to assess the merits of IFAD's current financial architecture and possible future enhancements. A desirable financial architecture would:
  - (i) Mobilize sufficient resources to maximize IFAD's contributions to help borrowing countries overcome poverty.
  - (ii) Provide instruments that respond to the recipient countries' priorities for rural poverty reduction.
  - (iii) Provide opportunities to enhance IFAD's financial efficiency through leveraging, while giving due consideration to institutional capacities, costs and risk management.
  - (iv) Ensure that IFAD is financially sustainable in the long term and not subject to undue risks.
  - (v) Allow IFAD to finance a growing PoLG.
27. Figure 1 presents a simplified scheme of the results chain of the financial architecture, which helps build an analytical framework. The evaluation will assess initial conditions underlying the financial architecture and issues at the input, output and outcome levels, and how these can support longer-term results. An important caveat is that outcomes and longer-term results, including development results, are affected by many other factors (e.g. the strategic approach identified in Country Strategic Opportunities Programmes [COSOPs]; the quality of project identification, implementation support; price movements; macroeconomic conditions; security conditions; governance; institutional capacity). This means that the financial architecture can be seen as one of several factors contributing to development results, and its contributions are likely to be indirect in many cases.

Figure 1

**Results chain of the financial architecture**

Source: IOE

28. Evaluation framework. Appendix II contains the CLE evaluation framework. It includes the four criteria used in the evaluation (relevance; effectiveness; efficiency; financial sustainability), together with key questions and sub-questions by criterion, sources of data, and instruments for data and information collection. It will be fine-tuned during the evaluation process.
29. Relevance. The evaluation will assess the relevance of the current financial architecture and supporting policies and instruments to fulfil IFAD's mandate as expressed in the Agreement Establishing IFAD and subsequent corporate documents. It will assess the extent to which the financial architecture has facilitated the financing of interventions designed to help the rural poor overcome poverty. Key questions are:
- How relevant was/is the financial architecture in mobilizing financial resources and offering them to Member States for the expected value and types of interventions in rural poverty reduction and development?
  - How relevant were the assumptions underpinning the financial architecture to IFAD's operational performance, risk-adjusted results and cost efficiency? Are they still valid?
  - How can IFAD's financial architecture be made more relevant in a changing international development context and appetite for replenishments?
30. Effectiveness. The evaluation will assess the effectiveness of IFAD's financial architecture in fulfilling its rural poverty reduction mandate, by examining the extent to which the commitments made in several replenishment processes were fulfilled over time and the trends in IFAD's priorities. The related sub-questions are:
- Were the instruments used effectively (loans, grants, reimbursable technical assistance) in serving rural development demands from different countries (e.g. in countries eligible for DSF grants/highly concessional/blend/ordinary terms) and setting priorities against needs and performance?

- (ii) Was IFAD's financial architecture effective in mobilizing sufficient resources to meet the demand for its financing and allow the PoLG to grow without incurring disproportionate risks? This will include a review of the volume, pricing, tenor and flexibility of financing, as well as of potential new products.
  - (iii) How did IFAD's financial strategies contribute to mobilizing additional financial resources beyond core replenishments (e.g. complementary funds, cofinancing) and achieve the corporate scaling up objectives? What changes may be required?
31. Efficiency. Under this criterion, the evaluation will examine two main aspects: financial efficiency and financial organizational matters. Under the former, the evaluation will review: (i) treasury functions (maximizing investment returns within cash and risk constraints); (ii) corporate administrative cost ratios and their trends; (iii) liquidity and other standard financial ratios. Under financial organizational matters, the evaluation will review: financial control and accounting, treasury and resource mobilization strategies, policies and procedures, as well as financial management support systems.
  32. Financial sustainability means that profits obtained from loan margins and treasury investments cover the operating costs and also help build a buffer of provisions to deal with the institution's financial, credit and operational risks in the long term. The evaluation will assess IFAD's financial sustainability in terms of its ability to provide the funds needed to fulfil IFAD's mandate over the long term. By running simulations on the enhanced treasury model, the CLE will use standard financial ratios to assess financial sustainability by examining projected sources and uses of financing.
  33. The related sub-questions are:
    - (i) What are the effects of the mix of financial products, terms and conditions on IFAD's short- and long-term financing?
    - (ii) What are the key drivers of IFAD's financial sustainability? What are the implications of external factors?
    - (iii) What are the lessons from other comparable organizations that could help enhance IFAD's financial sustainability and risk management?

### C. Data collection and information sources

34. Management self-assessment. In line with the Evaluation Policy, Management normally conducts a self-assessment as an input to CLEs. Management is currently engaged in major work to review the financial architecture. Building on that exercise, Management will be requested to prepare a self-assessment to be discussed with IOE in a half-day internal workshop.
35. Document review. The evaluation team will review key documents available in IFAD that are related to the financial architecture and the associated policies and instruments (e.g. reports from replenishment consultations, financial statements, annual programmes of work and budget, medium- and long-term strategic frameworks, the President's bulletins, related policies and procedures, minutes of Audit Committee meetings and selected audit reports). The evaluation will also review selected documents prepared by the G20 and MDBs, related to their financial architectures and replenishments of their concessional windows. The evaluation team will mine IOE evaluation reports, particularly the latest CLEs.
36. Key informant interviews in IFAD. Semi-structured interviews (both individual and in groups) will be an important source of information for the evaluation team (information coding may involve the use of specialized software). A wide range of people will be interviewed at headquarters, including selected members of the Replenishment Consultation, Executive Board, Evaluation and Audit Committees, IFAD Senior Management and key staff in FOD, selected staff in the Programme

Management Department, the Partnership and Resource Mobilization Office and other departments or divisions as required. Feedback collected through interviews will be treated as confidential and will not be disclosed in a manner that can be traced back to the source.

37. Analysis of IFAD's quantitative data. The evaluation will extract and analyse quantitative data from IFAD's financial systems, financial statements and reports and operational databases (i.e. the Grant and Investment Projects System and Oracle FLEXCUBE). Based on historical performance and various assumptions, the new treasury model will be used to simulate long-term forecasts to assess the implications of various possible courses of action. The analysis will also draw on the analysis and sensitivity tests currently conducted on the revised PBAS model.
38. Statistical analysis will be performed on evaluation ratings, and ratings from self-evaluation systems where appropriate (including the performance of the project portfolio, non-lending activities and COSOP performance) across types of financing (e.g. DSF grants; highly concessional assistance; blend loans; ordinary loans). This analysis will be caveated by the fact that the ratings are likely to be correlated with country characteristics (e.g. governance indicators; the strength of institutions and policies; human-resource skills). Options for dealing with sample selection bias will be explored.
39. As required, the evaluation will seek data from external sources. Examples include OECD Development Assistance Committee (OECD-DAC) data on trends in ODA flows, trends in fiscal deficits in List A countries, trends in oil prices, World Bank data showing the countries where the rural poor live, and trends in interest rates and returns on international capital markets.
40. Online survey of IFAD staff and stakeholders. An online survey will extend the reach of the evaluation team to seek feedback from stakeholders (e.g. Executive Board representatives, Senior Management, IFAD staff, key government officials in List A, B and C countries). Survey questions will be formulated to cover key issues identified in the evaluation framework. The online survey will be designed to assess stakeholders' views on the current financial architecture, possible changes in the future and the likely demand for new products based on pricing and terms.
41. Selected country visits. The time and resources available will limit the number of country visits for the CLE. However, IOE will obtain input from selected government officials and development organizations to ascertain the degree to which changes in the terms of IFAD loans are feasible from a project perspective, lending/relending terms, the extent to which end-users benefit from IFAD's grants/concessional rates and long maturities, and to assess how private-sector lending could be built up, should this be an option. Visits will be made to selected IFAD's borrowing countries and selected capitals of List A and B countries. The selection will focus on: (i) including a mix of countries from different borrowing terms; (ii) countries where COSOPs are due to be prepared later in 2017 or 2018 to learn if financing considerations affect the potential projects included in the pipeline or the decision to start design; and (iii) feasible logistics that result in cost efficient travel.
42. Review of comparator organizations. The evaluation team will collect information on the governance, products and terms, balance sheet restructuring to increase leverage and the views of donors as enunciated by the G20 and during recent replenishments of concessional windows, for the major MDBs (e.g. the World Bank, ADB, AfDB, European Bank for Reconstruction and Development [EBRD] and Inter-American Development Bank).
43. More detailed information will be sought from: (i) organizations that have implemented major reforms of their concessional loan windows (e.g. World Bank, AfDB); (ii) a bilateral agency that has introduced reforms to grow its balance sheet

and borrow on the capital markets (e.g. AFD, the Netherlands Development Finance Company); and (iii) the Global Alliance for Vaccines and Immunisation (GAVI). GAVI brings together key United Nations agencies, governments, the vaccine industry from developed and developing countries, the private sector and civil society. GAVI has developed an innovative financing structure to turn long-term pledges into large-scale, long-term funding through the International Finance Facility for Immunisation; and it raises financing on international capital markets.

44. Boundaries and constraints. While acknowledging the implications of the financial architecture for the ultimate rural development effectiveness of IFAD-funded interventions, it may prove challenging to establish a causal relationship between features of the financial architecture and rural development results (e.g. project impacts). Another challenge derives from the fact that there is no established methodology for assessing financial architecture in a comprehensive manner, and this evaluation will break new ground.

#### IV. Evaluation process

45. Phases. The CLE on IFAD's financial architecture will be undertaken in seven phases: (i) collecting information at headquarters through: (a) a review of relevant documents (e.g. legal and governance issues; policies, approvals, products, liabilities and assets); (b) interviews of Executive Board representatives, Management and staff, including half-day workshops at the beginning of the evaluation; (ii) designing, implementing and analysing an e-survey; (iii) undertaking selected country case studies; (iv) examining comparator organizations; (v) running simulations of alternative scenarios; (vi) sharing emerging findings with Management, preparing the draft report and considering comments by Management; and (vii) finalizing the report, preparing Management's response and disseminating the evaluation, conclusions and recommendations. The phases will be iterative, conducted in parallel and partially overlapping.
46. Deliverables, review process and feedback. The main deliverables include the approach paper, the final evaluation report and an IOE Profile.<sup>19</sup> Management will be invited to provide written comments on the draft approach paper and draft final report. The Evaluation Committee will also review the draft approach paper, and their comments will be duly considered in the design and implementation of the evaluation. IOE will prepare an audit trail, which will transparently illustrate how Management comments were treated in the final report.
47. Evaluation team. Under the overall strategic direction of IOE Director, Mr Oscar A. Garcia, the CLE will be led by IOE Deputy Director, Mr Fabrizio Felloni. At this stage, the team composition envisaged is as follows: Mr Marcus Fedder, former Treasurer at EBRD, with senior advisory experience in investment and financial matters in MDBs; Mr Bruce Murray, former Director General of the Independent Evaluation Department at ADB, with senior experience in international development programme management, country allocation and lending operations; Mr John Markie, former Director of the Office of Evaluation at the Food and Agriculture Organization of the United Nations, with experience in assessing resource mobilization in multilateral development agencies and in rural development; Mr Ruslan Guseynov, a financial and investment analysis specialist with experience in MDBs. The team combines experience in finance and operational issues in IFIs with an understanding of rural development and rural poverty reduction issues, which is crucial given IFAD's specific mandate. In addition, Mr Derek Poate, a senior international development and evaluation specialist, will provide methodological

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<sup>19</sup> Profiles are among the key IOE communication products, produced at the end of the evaluation once the report has been finalized. The Profile will contain a summary of the main evaluation findings and recommendations.

support throughout the process. Three local consultants, based in Rome, will work on data collection and provide analytical and quantitative support.

48. The core team will be supported by a panel of three technical advisers comprising: Mr Fredrik Korfker, financial and banking operations specialist and former Chief Evaluator at EBRD ; Ms Zenda Ofir, international development specialist and former President of the African Evaluation Association; and Mr Jack Glen, Adjunct Professor in Credit Market and Credit Risk at Johns Hopkins University and former Chief Evaluation Officer, World Bank Group. The advisers will review and comment on the methodology and draft final report and provide additional technical support as required.
49. Timeline. The evaluation will start in 2017 and be completed in 2018 (appendix I).

## Evaluation Time Line

<b>Timeline</b>	
<b>(January 2017-September 2018) Activities</b>	
<b>23 March 2017</b>	Revised draft approach paper discussed by the Evaluation Committee
<b>End April 2017</b>	Complete team recruitment
<b>May-July 2017</b>	Interviews and group discussions, and information extraction from IOE reports
<b>August-September 2017</b>	Statistical and data analysis for relevance, effectiveness and efficiency assessments
<b>July – September 2017</b>	Selected country visits in APR, ESA, LAC, NEN and WCA and List A and B capitals
<b>July-October 2017</b>	Visits to comparator organizations
<b>July-November 2017</b>	Analysis of financial management, organizational arrangements, administration, human resource, treasury modelling and systems, risk management/compliance and corporate governance/voting power issues.
<b>September 2017</b>	Half-day workshop on Management's self-assessment of the financial architecture
<b>October- December 2017</b>	Financial modelling for relevance, effectiveness, efficiency and sustainability
<b>Mid-February 2018</b>	Draft Financial Architecture CLE report - Internal peer review in IOE and review by Independent Advisors
<b>Late February 2018</b>	Presentation of emerging findings to Management
<b>Mid-March 2018</b>	Draft evaluation report sent to Management for comments and in-house workshop organized on main findings and recommendations
<b>Mid-April 2018</b>	Management provides written comments on draft final report
<b>End-May 2018</b>	IOE finalizes the evaluation report
<b>June 2018</b>	Final report transmitted to the Office of the Secretary for editing and translation. Management prepares its written response
<b>September 2018</b>	Presentation of the final report to the Evaluation Committee
<b>September 2018</b>	Presentation of the final report to the Executive Board

# Evaluation Framework

<i>Evaluation criteria</i>	<i>Evaluation questions</i>	<i>Indicators</i>	<i>Data sources</i>
<b>Relevance</b>	KEY QUESTION: How relevant has IFAD's financial architecture been in mobilizing the necessary funding to maximize IFAD's contribution to reducing rural poverty?	Timeline of key events in the evolution of IFAD's financial architecture from 1978 to the present.	Analysis of corporate policies, strategies and IFAD replenishment documents.
	How relevant was/is the financial architecture in mobilizing financial resources and offering them to member states to increase investment in rural poverty reduction and development?	Responses to the Financial Architecture CLE E-survey	Analysis of selected evaluation reports, especially the Replenishment CLE.
	How relevant were the design and assumptions underpinning the financial architecture? Are these still valid?	The degree that the financial architecture mobilized financial resources to deliver the corporate objectives set out in key documents (e.g. Articles Establishing IFAD; IFAD replenishment papers; medium/long term strategies).	Interviews with Executive Board members, IFAD management and staff. The Financial Architecture CLE E-survey
	What needs to be done to enhance the future relevance of IFAD's financial architecture in the context of the changing international development context and appetite for replenishments?	Mapping trends in IFAD's financial assistance by type and the location of the countries in which the world's rural poor live.	Interviews with clients during selected country visits.
	What are the implications of increased financial leverage on IFAD's mission, operations and risk management? Would IFAD be more relevant in terms of reducing rural poverty if it: (i) retains the current financial architecture; or (ii) changes the financial architecture to expand or widen its financing activities?	Ability to respond to requests for increased financial assistance from client countries	Data extracted from IFAD's systems Financial support provided to groups of countries.
	What changes would be required in the Agreement Establishing IFAD and other legal documents?	Trends in the PoLG and gaps between the size of PoLGs and IFAD replenishments.	Location of the world's rural poor. Analysis of comparator institutions.
		IFAD's ability to meet the needs of all borrowing countries ranging from the poorest to the MICs.	Shareholders' view about: (i) IFAD's structure and focus on providing loans exclusively to sovereign entities; (ii) enhancing the sovereign borrowing framework to provide more incentives for the providers of sovereign loans; (iii) enhancing IFAD's cofinancing instrument including commercial cofinancing; (iv) mobilizing thematic or geographic trust funds; providing equity to enable IFAD to grow its balance sheet by borrowing funds; (v) providing other forms of support (e.g. in the form of long term guarantees) to allow IFAD to borrow long term funds to increase lending to MICs.
		Analysis of the end-clients who are the recipients of IFAD's funds.	
		Analysis of risk management practices	
		Risk adjusted returns	
	Lessons from MDB for risk management		
	Under what conditions would countries be willing to borrow from IFAD on harder terms for projects that are focused on the rural poor?		



<i>Evaluation criteria</i>	<i>Evaluation questions</i>	<i>Indicators</i>	<i>Data sources</i>
<b>Effectiveness</b>	KEY QUESTION: How effective were IFAD's financial architecture and instruments used in supporting IFAD's contributions to reducing rural poverty?	Influence of key events in the evolution of IFAD's financial architecture on its effectiveness.	Interviews with Executive Board members, IFAD management and staff.
	Were the instruments used effective in delivering development results?	Trends in the size and composition of PoLGs (increase in IFAD lending relative to increase in MDB lending for agriculture)	Interviews with clients during selected country visits.
	Do the rural poor benefit from the subsidized interest rates/grants associated with IFAD's instruments?	Analysis of evaluation report ratings by type of IFAD financial support: (i) DSF grants; (ii) highly concessional assistance; (iii) blended terms; (iv) ordinary loans	The Financial Architecture CLE E-survey
	Was IFAD's financial architecture effective in mobilizing sufficient resources to meet the demand for IFAD's financing and allow the PoLG to grow without incurring disproportionate risks? How did IFAD manage its risks? (treasury investment risks, foreign exchange risks relate to replenishment pledges/payments, risks related to lending in SDRs, inflation risks)	Analysis RIMS estimate of the number of people moving escaping rural poverty in countries eligible for various types of IFAD financial support.	Analysis of corporate policies, strategies, IFAD replenishment documents, the MICs strategy and the RIMS.
	Would new products enhance IFAD's effectiveness in reducing rural poverty by offering more flexibility to borrowers and generating additional income to IFAD?	Comparison of the demand for IFAD financing, PoLGs and actual vs. pledged contributions (by borrowing terms)	Data extracted from IFAD's systems
	Do the products and instruments influence the type of projects included in COSOPs? How has IFAD's financial architecture contributed to mobilizing additional financial resources beyond core replenishments?	The degree that various policies, instruments and processes enhanced or detracted from the effectiveness of IFAD's financial architecture and decisions to include projects in COSOPs.	Analysis of evaluation ratings of country strategies and projects.
	What are the key drivers of IFAD's ability to mobilize non-core resources related to financial architecture and concerned policies?	Trends in the amount of international and domestic cofinancing leveraged during the replenishment periods by classification of borrowing country.	Analysis of the impact of key IFAD policies and range of products on IFAD's financial architecture.
	How have the financial policies and procedures supported the financial architecture and risk management and what needs to be strengthened?	Trends in the amount of other funding mobilized during the replenishment periods by classification of borrowing country.	Data extracted from IFAD's systems related to the PoLG, approvals, cofinancing and other funding mobilized. Examination of the experience gained by comparator organizations that is relevant to IFAD and its financial architecture.
	Does the experience gained by comparator organizations suggest alternatives that IFAD should consider to strengthen its financial architecture?	Analysis of general financial policies; credit risk management for lending; credit risk management for treasury; market risk management; treasury policies; borrowing; lending products; pricing; liquidity; etc.	Model simulations of various scenarios Analysis of projects IFAD has lent to Analysis of other IFI's financial policies and governance structure Analysis of: - DSF, including reimbursing IFAD for forgone principal and interest reflows - One PBAS covering all financial support or two PBASs, one for

<i>Evaluation criteria</i>	<i>Evaluation questions</i>	<i>Indicators</i>	<i>Data sources</i>
		<p>Responses to the Financial Architecture CLE E-survey</p> <p>Need for a graduation policy that better defines which countries are eligible for which types of assistance.</p>	<p>concessional financing and one for ordinary lending allocated depending on the ALM</p> <p>- Sovereign borrowing framework and procedures for managing the associated risks.</p> <p>- Single currency, phasing out the use of SDRs and procedures for managing the associated risks and converting existing SDR loans into single currency loans appropriate for the borrower.</p> <p>Analysis of lessons from: (i) The World Bank/IFC/IDA; (ii) the African Development Bank; (iii) MDB's private sector agriculture lending activities; (iii) bilateral organizations that have changed their financial architecture (e.g. AFD or FM); (iv) from GAVI, an organization that uses innovative financing and includes non-government representatives on the Board.</p>
<b>Efficiency</b>	<p>KEY QUESTION: How efficient is the financial architecture?</p> <p>Policy for investing treasury assets, borrowing funds, asset and liability management. Are risk management and the middle and back office adequately staffed to support treasury and lending?</p> <p>Is IFAD's treasury IT system adequate and does it allow the correct reporting of risks and P/L</p> <p>Is the governance and organizational framework adequate to support IFAD's financial architecture?</p> <p>The oversight framework, including the guidance and control provided by the governing bodies, including the Executive Board and the Governing Council and the establishment of the Audit Committee.</p> <p>Organization of the governing bodies and related decision making and voting procedures, Board representation and membership in Lists A, B and C.</p> <p>Incentives to encourage members to contribute to replenishments</p>	<p>Financial efficiency indicators (e.g. P/L; risk-return analysis liquidity ratio; cost of funds).</p> <p>Optimal debt-equity ratio for IFAD to obtain a high credit rating by the key rating agencies?</p> <p>Appropriate separation of front office and middle and back office and risk management</p> <p>Risk management framework</p> <p>Changes in ways IFAD covers administrative costs and overheads</p> <p>Adequacy of IFAD's corporate governance and organizational framework related to financial</p>	<p>Data extracted from IFAD's systems</p> <p>Interviews with Executive Board members, IFAD management and staff.</p> <p>Interviews with clients during selected country visits.</p> <p>The Financial Architecture CLE E-survey</p> <p>Findings from IOE studies including</p>

<i>Evaluation criteria</i>	<i>Evaluation questions</i>	<i>Indicators</i>	<i>Data sources</i>
	and provide sovereign loans	architecture.	the Efficiency Evaluation
	Organizational structure for the internal financial management and procedures, IFAD's financial indicators and reporting procedures and systems.	Adequacy of incentives for members to contribute to IFAD's financing.	Examination of the experience gained by comparator organizations that is relevant to IFAD and its financial architecture.
	Are IFAD's supporting systems for the financial architecture appropriate?	Appropriate roles of structures for risk management, asset and liability management, loan approval and pricing.	Analysis of the trends in IFAD's administrative costs and overheads.
	What proportion for IFAD's administration costs could be recovered under new financial architecture options?	Adequacy of IFAD's human resources/skills, treasury tools and systems related to financial architecture.	Financial modelling
	Estimated incremental costs to support a new financial architecture	Responses to the Financial Architecture CLE E-survey	Review of IFAD's corporate governance and procedures for determining voting power.
	Timing and phasing to implement the required changes.		Analysis of IFAD's organizational structure, human resources/skills and systems supporting IFAD's financial architecture.
<b>Financial Sustainability</b>	KEY QUESTION: How financially sustainable is IFAD?	Responses to the Financial Architecture CLE E-survey	Interviews with Executive Board members, IFAD management and staff.
	How does the mix of financial products, terms and conditions affect IFAD's short and long term financing? (e.g. optimality of the balance sheet, use of financial leverage, amount of liquidity held and revenue generated from management of liquid assets. Interest/service charges)	Possible trends in ODA and the implications for future IFAD replenishments.	Interviews with clients during selected country visits.
	Do the profits from loan margins and treasury investments cover both the operational costs and help build a buffer of provisions to deal with IFAD's financial, credit and operational risks?	Key indicators of IFAD's past and expected future financial performance. A PoLG was judged to be Cash Flow Sustainable if, by projecting all the cash inflows and outflows resulting from the past, current and future PoLGs if IFAD's liquidity never fell below its minimum liquidity requirement (60 per cent of the annual projected gross disbursements).	Data extracted from IFAD's systems The Financial Architecture CLE E-survey
	Would shorter tenors lead to higher turnover of the loan portfolio, higher impact and better financial sustainability?		OECD DAC trends in ODA in absolute terms, as a per cent of GDP and the trends in fiscal deficits in donor countries. Past and expected future trends in oil prices.
	What are the implications of external factors (e.g. interest rates and ODA trends on IFAD's sustainability?)		Analysis of the impact of key IFAD policies (e.g. Policies and Criteria for IFAD Financing; products, pricing and terms; DSF; PBAS) and possible new policies (e.g. graduation policy; commitment charge).
	Can IFAD operate in the long term without further financial support from its shareholders? How does IFAD need to be structured to be financially sustainable in the long term with and without further sizable member contributions?	Comparison of inflows (e.g. loan reflows, treasury investment income, compensation for forgone DSF principal and interest reflows; contributions through IFAD replenishments; other contributions; sovereign loans; market borrowings) and outflows (disbursements for loans and grants for the past, current	Past IFAD replenishments and assumptions about future
	What are the needs arising from a possible new financial architecture to enhance IFAD's financial sustainability and risk management?		
	Given the increased cost of funds that IFAD may face, what would be		

<i>Evaluation criteria</i>	<i>Evaluation questions</i>	<i>Indicators</i>	<i>Data sources</i>
	<p>the resultant lending rates/credit margins IFAD would have to charge to operate sustainably?</p> <p>Does IFAD have the right financial structure to successfully broaden its financial infrastructure?</p> <p>What would be the optimal capital structure and balance sheet in terms of equity and debt?</p> <p>Would a private sector window (e.g. lending to or making equity investments in private sector micro credit institutions or agro-processing/supply chain businesses closely linked to the rural poor) generate a profit to enhance financial sustainability?</p> <p>What organizational changes would be required to deal with added risk factors associated with changes in the financial architecture, sources of financing, products and terms?</p>	<p>and future PoLGs; uncompensated forgone DSF principal and interest reflows; repayment of sovereign loans; repayment of capital market borrowings; disbursements for administration, budget and other expenses).</p> <p>Key indicators of IFAD's past and future financial performance under different scenarios and assumptions (e.g. IFAD: (i) covers its costs; (ii) covers its risks, including potential loan losses; (iii) quantifies the elements of loan subsidies; (iv) either receives further contributions to cover subsidies, covers them by profits from its operations and/or its treasury portfolio or reduces the amount of subsidies provided and focuses the remaining subsidies on the most needy.</p> <p>Ratio of reflows to contributions and administrative charges</p> <p>Proportion of contributions likely to be counted as IFAD equity by rating agencies.</p>	<p>replenishments and the demand for various types of products.</p> <p>Possible changes in IFAD's financial architecture.</p> <p>Model simulations of various scenarios going forward.</p>

## Financial Indicators

Table 1  
Evolution from IFAD6 to IFAD10 of the annual programme of loans and grants and sources of financing

Element of financial architecture	IFAD6	IFAD7	IFAD8	IFAD9	IFAD10
Annual PoLG (UUS\$ billion)	NA	2.0	3.0	2.95	3.0
Total financing required (UUS\$ billion)	1.425	2.427	3.626	3.530	3.6
Members' contribution (UUS\$ billion)	0.560	0.800	1.200	1.5	1.44
Ratio of PoLG to Contributions	NA	2.5	2.5	2.0	2.1
% of total financing covered by contributions	39%	33%	33%	42%	40%

Table 2  
Evolution from IFAD6 to IFAD10 of key policies related to IFAD's financial architecture

Element of financial architecture	IFAD6	IFAD7	IFAD8	IFAD9	IFAD10
<b>Related policies</b>					
Members' core and supplementary contributions	✓	✓	✓	✓	✓
HIPC debt forgiveness	✓	✓	✓	✓	✓
Performance Based Allocation System	✓	✓	✓	✓	✓
Debt Sustainability Framework		✓	✓	✓	✓
Other resource mobilization				✓	✓
Sovereign loans/KfW loan				✓	✓

Table 3  
Evolution from IFAD6 to IFAD10 of key financial indicators used by IFAD

Element of financial architecture	IFAD6	IFAD7	IFAD8	IFAD9	IFAD10
<b>Key financial indicators</b>					
Asset liability management system		✓	✓	✓	✓
Advance commitment authority <sup>a</sup>	✓	✓	✓	✓	
Sustainable cash flow model <sup>b</sup>				✓	✓
Equity ratio	✓	✓	✓	✓	✓
Liquidity ratio	✓	✓	✓	✓	✓
Debt to equity ratio					✓
Debt coverage ratio					✓

Table 4  
IFAD's Key Financial Ratios

Financial Ratio	Measure	IFAD6		IFAD7		IFAD8		IFAD9		IFAD10 (First Year)				
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Liquidity ratio	Not lower 5%	37.8%	37.7%	34.2%	33.0%	31.1%	30.4%	29.7%	28.5%	25.1%	21.6%	20.3%	17.8%	—
Equity ratio	Not lower 60%	66.1%	71.3%	72.1%	66.9%	64.6%	68.1%	71.7%	72.8%	77.5%	80.7%	88.4%	93.5%	—
Debt to equity		—	—	—	—	—	—	—	—	—	—	—	2.0%	—
Debt coverage ratio	Not higher 50%	—	—	—	—	—	—	—	—	—	—	—	0.1%	—

Notes: (i) The financial ratios are calculated on IFAD stand-alone financial statements in nominal terms. (ii) The debt-related ratios were zero up to 2014 as there were no borrowing activities until 2015 when the KfW loan was approved.

Source: Accounting and Controllers Division of IFAD.

Table 5  
IFAD's Balance Sheet Composition (2005-2015)

	VERTICAL ANALYSIS* (change between items)						HORIZONTAL ANALYSIS** (change between years)			
	2005		2010		2015		2005-2010		2010-2015	
	US\$ (000)	%	US\$ (000)	%	US\$ (000)	%	US\$ (000)	%	US\$ (000)	%
Cash and Investments	2 505 186	45	2 591 048	34	1 525 161	21	85 862	3	(1 065 887)	(41)
Net receivables (incl. contribution and promissory notes)	511 421	9	814 047	10	806 508	11	302 626	59	(7 539)	(1)
Net loans outstanding	2 608 769	46	4 152 322	55	5 058 692	68	1 543 553	59	906 370	22
Fixed and intangible assets			3 458	0	11 027	0	3 458		7 569	219
<b>Total assets</b>	<b>5 625 376</b>	<b>100</b>	<b>8 232 327</b>	<b>100</b>	<b>7 401 338</b>	<b>100</b>	<b>1 935 499</b>	<b>34</b>	<b>(159 487)</b>	<b>(2)</b>
Payables and liabilities	325 957	6	279 374	4	171 319	2	(46 583)	(14)	(108 055)	(39)
Undisbursed grants	42 210	1	78 462	1	66 428	1	36 252	86	(12 034)	(15)
Deferred revenues	3 140	0	78 303	1	73 225	1	75 163	2 394	(5 078)	(6)
Borrowing liabilities					162 948	2			162 948	-
<b>Total liabilities</b>	<b>371 307</b>	<b>7</b>	<b>436 139</b>	<b>6</b>	<b>473 920</b>	<b>6</b>	<b>64 832</b>	<b>17</b>	<b>37 781</b>	<b>9</b>
Total contributions	4 618 124	82	6 157 886	81	7 897 222	107	1 539 762	33	1 739 336	28
General reserve	95 000	2	95 000	1	95 000	1	-	-	-	-
Retained earnings	540 945	10	871 850	12	(1 064 754)	(14)	330 905	61	(1 936 604)	(222)
<b>Total equity</b>	<b>5 254 069</b>	<b>93</b>	<b>7 124 736</b>	<b>94</b>	<b>6 927 468</b>	<b>94</b>	<b>1 870 667</b>	<b>36</b>	<b>(197 268)</b>	<b>(3)</b>
<b>Total liabilities and equity</b>	<b>5 625 376</b>	<b>100</b>	<b>7 560 875</b>	<b>100</b>	<b>7 401 388</b>	<b>100</b>	<b>1 935 499</b>	<b>34</b>	<b>(159 487)</b>	<b>(2)</b>

Source: IFAD documents (EB 2006/87/R.32/Rev.1; EB 2011/102/R.42/Rev.1; GC 40/L.7)

## Key Policies Supporting the Financial Architecture

### A. Heavily Indebted Poor Countries Debt Initiative

1. Since 1996, IFAD has been involved debt relief and debt management in Member States by participating in the Heavily Indebted Poor Countries (HIPC) debt initiative. The objective of the HIPC debt initiative is to reduce the net present value of the debt of poor countries that carry unsustainable levels of debt to a level that will no longer compromise their ongoing economic reform and rural poverty eradication efforts.
2. Five principles guided the design of the HIPC debt initiative to ensure that it: (i) addressed a country's total debt sustainability with a reliable exit strategy and involve all creditors to be effective and equitable; (ii) assisted only countries with a track record of economic policy and structural reform, and that are making efforts towards poverty eradication; (iii) built on the existing mechanisms of debt relief; (iv) preserved the financial integrity of the IFIs involved; and (v) secured a continued flow of new external financing on appropriately concessional terms from IFIs and from the private sector.
3. For IFAD the HIPC debt initiative involves two financial movements: (i) agreed reduction of debt repayments from debtor countries to IFAD; and (b) payments to IFAD's loan fund accounts to compensate for the associated loss of the financial reflows. IFAD participated in the HIPC debt initiative on a country-by-country basis.
4. IFAD established an operational policy framework for its participation in the HIPC Debt Initiative and a Trust Fund. The main issues that IFAD addresses during the preparation of each country specific HIPC debt initiative are: (i) the country's policy focus on rural poverty eradication; (ii) the strength of the country's poverty eradication and rural development programme; and (iii) the sensitivity to rural poverty eradication of the ongoing structural adjustment efforts.
5. During replenishments IFAD's compensation for the debt write-off for HIPC countries is shown separately.

### B. Performance based allocation system

6. Introducing the PBAS had important implications for the financial architecture. The PBAS formula incorporates measures of both country needs and country performance.<sup>20</sup> With the PBAS IFAD abandoned the provision in Para 21 of the Lending Policies and Criteria that IFAD "will not seek to develop a pattern of country allocations; it will, instead, designate a number of priority countries for programming purposes."
7. Prior to the PBAS, IFAD's funding was allocated by region, based on country needs, with Africa receiving about half of the funding. Under the PBAS APR had the highest allocation (33 per cent), followed by ESA (22 per cent), WCA (19 per cent), NEN (14 per cent) and LAC (12 per cent). Although regional lending shares were not included in the PBAS design, 41 per cent of total funds were allocated to sub-Saharan Africa. If countries in North Africa were included, then Africa received nearly half of the financing.
8. The PBAS CLE concluded that although some issues that needed to be addressed, the PBAS resulted in a more transparent, flexible and predictable resource allocation system and contributed to greater fairness in the allocation of IFAD's resources across developing Member States than was the case with the allocation system in place before 2003. IOE found that the PBAS was generally well tailored to IFAD and enhanced IFAD's credibility.

<sup>20</sup> IOE found that 65 per cent of a country's allocation is driven by country needs and 35 per cent by country performance. See IOE. Corporate-level evaluation of IFAD's performance-based allocation system. 2016



9. Relative to the other MDBs, IFAD has a unique financial architecture in that all loans and country grants, including the proceeds of sovereign borrowing, are allocated through the PBAS.<sup>21</sup> The other MDBs only use their PBASs to allocate concessional funds and their ordinary lending is allocated on the basis of asset liability (ALM) management considerations. Consequently, MDBs have been able to grow their market related portfolios by increasing their lending to MICs and other countries that were able to absorb the increased lending. By growing that part of their portfolios, future MDB profitability will increase. This will generate funds that can be contributed to their soft windows, technical assistance funds, reserves and finance increased administrative costs.

### C. Debt sustainability framework

10. Since 1996, IFAD has been involved debt relief and debt management in Member States by participating in the Debt Initiative for Heavily Indebted Poor Countries (HIPC). The Debt Sustainability Framework (DSF) was developed to complement the HIPC initiative. Since 2007 the DSF has been an important part of IFAD's financial architecture because it governs the form of its financial assistance provided to eligible countries. IFAD uses the IMF/World Bank debt sustainability country classification,<sup>22</sup> to determine which countries are eligible for DSF grants.
11. Based on the country classification, IFAD provides financial support as governed by the PBAS on the following basis: (i) for countries with low debt sustainability: 100 per cent grant; (ii) for countries with medium debt sustainability: 50 per cent grant and 50 per cent loan; and (iii) for countries with high debt sustainability: 100 per cent loan.<sup>23</sup>
12. Under the 2007 DSF policy, IFAD's Member States expressed a commitment "to compensate IFAD within a pay as-you-go mechanism as adopted under the fourteenth replenishment of the International Development Association" (underscoring added). IFAD is to be compensated for the financial impact from the DSF in a way that reflects the repayment schedule of the loans that were converted into DSF grants. Since IFAD's first DSF grant financed projects were approved in 2007 and included 10-year grace periods, the impact of the forgone flows will materialize from 2017 onwards. Since the PoLG has increased, and the 10-year grace periods will end for a larger number of projects in future years, the impact of the DSF on IFAD's financial position will grow progressively from 2017 onwards. As of 31 December 2015 the estimated forgone reflows until 2055 totalled SDR 1.2 billion, which will increase as more DSF grants are approved.
13. There are several issues related to the IFAD's compensation for the DSF: (i) during the IFAD10 replenishment consultations, Members agreed to compensate IFAD for forgone principal payments but not for forgone service charges; (ii) for IFAD10 only five countries made an incremental pledge to cover the DSF; and (iii) some countries that were part of IFAD7 and IFAD8 were not part of IFAD10, raising the issue of how their share of DSF compensation would be covered if they are not part of IFAD11 and subsequent replenishments. As part of the IFAD11 replenishment IFAD will prepare a paper on its experience and the experience of other MDBs on the DSF reflecting actual and estimated net losses in service charge payments proposals on future approaches to compensation. If IFAD were not fully reimbursed for the forgone DSF reflows it would have an adverse impact on IFAD's financial sustainability because the volume of reflows would be less than expected, thus putting downward pressure on the feasible size of future PoLGs.

<sup>21</sup> In principle, about 95 per cent of the PoLG is allocated through the PBAS with the remaining 5 per cent is set aside for the Regional and Global Grants programme.

<sup>22</sup> The World Bank and the IMF assessed the debt sustainability of 38 countries, of which 35 are receiving debt relief. Sudan, Somalia and Eritrea are not yet eligible.

<sup>23</sup> Since most of DSF-eligible countries are in Africa, the greatest impact of the DSF among MDBs is on the World Bank (IDA), AfDB and IFAD.

## D. Single currency window

14. Most countries in APR and LAC would prefer to borrow in dollars, while the economies and currencies of some countries in NEN and WCA are more closely linked to the Euro. IOE received feedback that some countries were unhappy at being required to borrow in Euros when their projects were financed from the proceeds of the KfW loan.
15. IFAD has made progress in introducing the single currency lending option. The first ceiling of UUS\$200 million was reached in the first year of IFAD10. The ceiling was increased to UUS\$1.6 billion, about half of IFAD10, and will eventually reach 100 per cent.
16. As long as single currency loans are made in US dollars, and out of equity, IFAD would not face foreign currency risk as the institution's equity is denominated in US dollars. Loans made in another currency would either have to be funded in that currency or hedged back into US dollars via a cross currency swap. Equally, borrowings denominated in non US dollars would have to be either swapped back into US dollars or on-lent in that currency. Consistent with the practice of MDBs, IFAD should have the ability to lend in a currency that is demanded by, and appropriate for, the client's project. If IFAD received attractive funding in Japanese Yen, market conditions suggest that it might be challenging to find natural takers of Yen denominated loans. If that proves to be the case IFAD would have to swap such funding into US dollars. Funding denominated in Renminbi, however, could be interesting for a number of IFAD's Asian borrowers.

## E. Sovereign borrowing framework

17. The IFAD9 replenishment was not sufficient to finance the planned US\$3.1 billion PoLG. To fill that gap, in 2014 IFAD negotiated a loan of up to EUR 400 million with KfW to be used to finance loans on ordinary terms and allocated through the PBAS.<sup>24</sup> Although the KfW loan facility was approved prior to the Sovereign Borrowing Framework (SBF),<sup>25</sup> all the financial covenants of the SBF are being monitored for the KfW facility. Based on lessons learned from implementation of the KfW facility, IFAD is strengthening its in-house capacity to manage forthcoming SBF loans.
18. The SBF was approved in 2015 for borrowing from sovereign states and state-supported institutions to provide a mechanism to mobilize additional resources to be made available on concessional terms during IFAD10 and beyond. Sovereign borrowing is to be: (i) demand-driven with consideration given to the terms (i.e., interest rate, currency denomination, and grace and maturity periods); (ii) incremental to, and not a substitute for, the contribution of Members to replenishments; (iii) condition free (i.e., no beneficiary, purpose, theme or geographic area restrictions); (iv) allocated through the PBAS if the sovereign borrowing is expected to fund the PoLG<sup>26</sup> and in accordance with the Policies and Criteria for IFAD Financing; and (iv) satisfy the principles of financial sustainability in isolation (or "self-funding"). The anticipated impact of the sovereign borrowing framework would be to increase IFAD's PoLG by approximately 1:1. Each sovereign borrowing could be about US\$500 million. The Executive Board approved a sovereign loan from AFD in 2016.

<sup>24</sup> The establishment of the Spanish Food Security Cofinancing Facility Trust Fund (Spanish Trust Fund) in 2010 gave IFAD some experience managing borrowed funds. As the Spanish Trust Fund resources are considered cofinancing, they are not allocated through the PBAS and can be used to increase IFAD's support in particular countries/areas. The grant element of the Spanish Trust Fund facilitates IFAD's on-lending to Member States at concessional rates. However, at least 50 per cent of the Spanish Trust Fund will be allocated under IFAD's ordinary terms.

<sup>25</sup> The SBF was patterned on Concessional Partner Loans developed for IDA17.

<sup>26</sup> The framework also envisions the possibility that sovereign loans could be used to increase the PoLG above the level decided on during replenishments.

19. IFAD has established prudential norms to manage the impact of sovereign borrowing on the financial architecture: (i) debt/equity: not higher than 35 per cent; (ii) liquidity ratio: not lower than 5 per cent; and (iii) debt service coverage ratio: not higher than 50 per cent.
20. IFAD has also adopted risk mitigation measures for sovereign borrowing related to term risk, interest rate risk, currency risk, default risk, liquidity risk, operational risk, conflict of interest risk, and other risks that IFAD faces in its normal operations (e.g. reputational, environmental and social) that are mitigated through IFAD's existing measures.

## F. The Replenishment Process

21. Although not a "policy", the replenishment is at the cornerstone of the financial architecture of IFAD. Over 90 per cent of IFAD's assets are funded by equity which includes replenishment contributions and general reserves.
22. According to the Agreement establishing IFAD, the Governing Council "shall periodically, at such intervals as it deems appropriate, review the adequacy IFAD of the resources available to the Fund". Similar to other IFIs, IFAD's replenishments have taken place on a three-year cycle. The responsible governing body is the Replenishment Consultation, a committee of the Governing Council, where all the members of list A and B participate and 18 are selected from list C members.
23. As the 2014 CLE on IFAD Replenishment states, replenishment have taken up three interlinked objectives: (i) mobilize resources; (ii) provide an opportunity for IFAD to explain its evolving strategy to reduce rural poverty and present its achievements and results; and (iii) provide Member States an opportunity to offer strategic guidance to the organization.
24. As previously noted, replenishment pledges more than doubled between IFAD6 (US\$506 million) and IFAD 8 (US\$1.2 billion). Member's pledges further increased to US\$1.5 for IFAD9 but declined slightly to US\$1.35 billion for IFAD10. During IFAD9 and IFAD10, IFAD became more dependent on members' contributions relative to reflows to finance its costs. At the same time, the IFAD9 replenishment was not sufficient to finance the envisaged PoLG and a loan from KfW was taken to fill in the gap (see previous section).

## Loans and DSF Grants by Type

1. IFAD policies state concessional loans must be provided on more favourable terms (i.e., in terms of interest rate, maturity period, fees, etc.) than borrowers can obtain from the market.<sup>27</sup> The policy on concessionality states that developing Member States that have graduated from IBRD may receive concessional loans from IFAD subject to the availability of funds, including funds that IFAD obtains from sources other than replenishment. That approach allows IFAD to coordinate its lending to concessional borrowers with the different sources of funding (e.g. the Spanish Food Security Cofinancing Facility Trust Fund).
2. IFAD provides financing on the following terms:<sup>28</sup>

	Interest rate	Maturity	Grace period	Service charge	Observation
<b>DSF grants</b>					Financing is provided as a grant
<b>Highly Concessional</b>	Interest free	40 years	10 years	0.75 per cent per annum	
<b>Blend</b>	1.25 per cent per annum	25 years	5 years	0.75 per cent per annum	
<b>Ordinary</b>	A variable interest rate plus a spread. The interest rate is based on the six-month Libor rate for the four SDR currencies (Euribor rate for EUR) weighted by the SDR weights. SDR weights are based on SDR units and exchange rates published by IMF.	15 to 18 years	3 years. The Executive Board may vary the grace period.		The IBRD variable spread for loans with maturity greater than 15-18 years is applied.
<b>Hardened</b>	Interest free	20 years	10 years	0.75 per cent per annum	Discontinued in 2012
<b>Intermediate Terms</b>	An interest rate of one half of the IFAD Reference Interest and have a 20 years maturity, including a 5 years grace period. This product was discontinued in 2011	20 years	5 years. The Executive Board may vary the grace period.		Discontinued in 2012

Source: IFAD. Review of the Lending Policies and Criteria. 2012.

<sup>27</sup> IFAD. Review of the Lending Policies and Criteria. 2012.

<sup>28</sup> The Policies and Criteria for IFAD Financing states "No commitment charge shall be levied on any loan."

**Summary of IFAD loans by lending terms, and of DSF grants, 1978-2015<sup>a</sup>**

Amounts in US\$ million

	1978-2006	2007-2009	2010-2012	2013-2015	2015	1978-2015
<b>DSF grants</b>						
Amount	-	401.5	680.7	457.0	224.9	1 539.2
Number of grants	-	43	50	33	12	126
<b>Highly concessional loans</b>						
Amount	6 825.8	948.6	1 315.4	1 283.9	533.8	10 373.7
Number of loans	545	55	61	62	28	723
<b>Hardened loans</b>						
Amount	-	8.5	50.6	-	-	59.1
Number of loans	-	1	4	-	-	5
<b>Intermediate loans</b>						
Amount	1 605.8	171.4	197.4	-	-	1 974.7
Number of loans	133	9	6	-	-	148
<b>Blend loans</b>						
Amount	-	-	-	249.5	145.9	249.5
Number of loans	-	-	-	13	8	13
<b>Ordinary loans</b>						
Amount	950.8	186.5	441.5	594.0	323.0	2 172.8
Number of loans	69	17	24	25	14	135
<b>Total amount</b>	<b>9 382.4</b>	<b>1 716.6</b>	<b>2 685.6</b>	<b>2 584.4</b>	<b>1 227.6</b>	<b>16 369.0</b>
<b>Total number of loans and DSF grants<sup>b, c</sup></b>	<b>747</b>	<b>125</b>	<b>145</b>	<b>133</b>	<b>62</b>	<b>1 150</b>

Source: Grants and Investment Projects System.

<sup>a</sup> Amounts as per the President's report for each programme or project approved by the Executive Board. Includes Regular Programme loans, Special Programme for Sub-Saharan African Countries Affected by Drought and Desertification loans and DSF grants. Includes a loan on highly concessional terms approved in 2005 for Indonesia made up of unused proceeds of a loan approved in 1997 on intermediary terms. Any discrepancy in totals is due to rounding.

<sup>b</sup> A programme or project may be financed through more than one loan or DSF grant and thus the number of loans and DSF grants may differ from the number of programmes or projects shown in other tables.

<sup>c</sup> Fully cancelled or rescinded loans are not included.

Extracted from IFAD Annual Report 2015,

## MDB's Progress in Reforming Their Financial Architecture

### A. The context

1. Some factors constrain direct comparisons of IFAD to the MDBs. IFAD was established as a fund within the UN system whereas MDBs were established as banks and were expected to generate operational surpluses. MDBs provide both financing raised in the capital markets by issuing bonds and on concessional terms. The MDBs have high (AAA – AA) credit ratings.<sup>29</sup> Funds for concessional lending are raised through periodic replenishments, reflows and transferring net operating surpluses. The administrative budgets are financed from net operating surpluses on the MDBs' operations. The MDBs have sophisticated treasury and financial management systems.
2. All MDBs are much larger than IFAD, operate in many sectors and have larger average loan sizes. Size and economies of scale matter. These factors undermine the relevance of MDB comparisons with IFAD using standard indicators of efficiency (e.g. administrative overheads as a ratio of the active portfolio; size of the portfolio per staff; disbursements per staff; cost per dollar disbursed).
3. IFAD's main product is sovereign project financing. While all MDBs provide considerable project financing, they have many more products (e.g. large structural/sector adjustment loans; counter-cyclical support facilities; programmatic approaches; multi-tranche financing facilities; quick disbursing policy loans; sector wide approaches; trade finance; programs for results). All MDBs also have a private sector window, either within the institution, or in a sister organization, that make non-sovereign loans that are risk priced and equity investments. In addition to providing their own financing the MDBs also mobilize cofinancing from official and commercial sources and offer various forms of guarantees and credit enhancement products.
4. Although most MDBs offered loans denominated in SDRs when they were created, they shifted to providing appropriately priced loans in currencies requested by their clients 20 to 30 years ago.

### B. Reforming MDBs' financial architecture to help achieve Agenda 2030

5. Achieving Agenda 2030 will require about US\$2 to US\$3 trillion per year in additional funding with the largest amounts needed for infrastructure, climate change and agriculture.<sup>30</sup> There is a significant financing gap. By 2013 the G20 began calling on MDBs to change their financial architecture by optimizing their balance sheets to increase leverage and lending while maintaining their AAA credit ratings. This reflected a number of factors including the need to mobilize more resources to fill the SDG funding gap, the fiscal constraints of many major shareholders that was limiting the size of the replenishments for the MDBs' concessional funding and the appetite for general capital increases, limited head

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<sup>29</sup> The major MDBs, including EIB and the Islamic Development Bank, have AAA credit ratings, although AfDB had an AA rating for a considerable period of time. The ratings of the smaller MDBs generally range between A- and AA+. The Asian Infrastructure Investment Bank's rating has not yet been assigned. The New Development Bank, owned by the BRICs, received an AAA rating from Chinese rating agencies but has not yet received a rating from international credit rating agencies.

<sup>30</sup> Brilherman. 2016. Exploring the role of Multilateral Development Banks and Development Finance Institutions in conjunction with capital markets, and how they can contribute to the funding need related to the new UN Sustainable Development Goals in emerging markets and developing economies. <https://brilherman.wordpress.com/.../exploring-the-role-of-multilateral-development-b...>

room to increase lending, the methodology that credit rating agencies adopted in 2012 to rate MDBs and the conservative financial policies that MDBs use.

6. The 2015 Addis Ababa Action Agenda built on this theme by stressing “that development banks should make optimal use of their resources and balance sheets, consistent with maintaining their financial integrity, and should update and develop their policies in support of the post-2015 development agenda, including the sustainable development goals.”<sup>31</sup>
7. The G20’s 2015 Antalya Action Plan re-iterated the call for MDBs to increase their lending by better leveraging their balance sheets and encouraged the MDB’s to modernise their financial architecture by endorsing the Multilateral Development Banks Action Plan to Optimize Balance Sheets.<sup>32</sup>
8. The 2016 G20 Leaders Summit in Hangzhou welcomed the MDBs’ response to the G20’s MDB Balance Sheet Optimization Action Plan. MDBs are exploring new and different ways to reform their financial architectures to deploy existing financial capacity more effectively and efficiently. This includes expanding access to traditional financing for the poorest countries, leveraging concessional windows without reducing funding for the poorest countries and combining financial windows.<sup>33</sup> Within the framework of the G20 request, MDBs have made progress in reforming their financial architectures and restructuring their balance sheets.

### C. Steps MDBs have taken to reform their financial architecture

9. In 2013 ADB began planning the combination of Asian Development Fund’s (ADF’s) equity and lending operations with the Ordinary Capital Resources (OCR) balance sheet. When completed in 2017 it will allow ADB’s annual lending to increase by 50 per cent to US\$20 billion, OCR equity will triple from US\$18 billion to US\$53 billion and donor contributions to ADF grant operations will fall by 50 per cent from US\$1.2 billion, beginning with the 2017 ADF replenishment. These measures will increase ADB’s lending capacity by more efficiently and effectively utilizing existing resources. This merger did not change ADB’s governance or voting power and ADB retained its AAA credit rating.
10. AfDB is opening its non-concessional window to the poorest countries. The African Development Fund (ADF) 13 Mid Term Review concluded that graduation out of ADF was likely to be modest to 2022 assuming retention of AfDB’s graduation criteria. However, based on an assessment of the changing nature of its clients and the possible changes in the income levels and creditworthiness of ADF eligible countries it was felt that a significant proportion of ADF funds could be subject to harder terms given possible changes in seven countries to ADF-gap, blend or transition status.<sup>34</sup> That assessment was, however, sensitive to the risk of economic shocks. The mid-term review also raised the possibility of granting voting rights for the grant element of sovereign loans to AfDB.
11. In 2015 IADB began maximizing its policy mandate and providing better services to member countries. The IADB and the Inter-American Investment Corporation (IIC) consolidated the IADB group’s private-sector activities to better use resources and improve coordination with private- and public sector projects. The structure involved a US\$2.03 billion capital increase for the IIC (US\$1.305 billion new contributions, payable over a seven-year period starting in 2016; US\$725 million in capital transfers from the IADB as of 2018).

<sup>31</sup> The Addis Ababa Agenda for Action also recognized IFAD’s efforts in mobilizing investment to enable rural people living in poverty to improve their food security and nutrition, raise their incomes, and strengthen their resilience.

<sup>32</sup> G20 Antalya Summit, 15-16 November 2015

<sup>33</sup> World Bank Group. 2016. Inter-Agency Task Force on Financing for Development. Issues Brief Series. Multilateral Development Banks.

<sup>34</sup> AfDB. ADF-13 Mid-Term Review. African Development Fund Working Group on Innovative Approaches for ADF-14. November 2015

12. In 2015 the World Bank, AfDB and IADB approved an innovative framework agreement to exchange sovereign exposures to optimize their balance sheets. The sovereign exposure exchange agreement is a risk management tool developed by the major MDBs that was launched in October 2013 by the World Bank and endorsed by the MDB heads following a meeting of the G8 Ministers of Finance. Regional MDBs lend to a relatively small number of sovereign states, resulting in asset concentration, thus requiring them to hold additional capital. Exchanging exposures between MDBs enhances flexibility and efficiency in capital management. In the past MDBs managed their capital concentration risks by reducing or limiting exposure in countries where lending volumes were especially high. The G20 endorsed this initiative and it was discussed at multiple international conferences, including the Financing for Development Forum in Addis Ababa in July 2015. On 15 December 2015, AfDB, IADB and IBRD approved the first three bilateral exposure exchanges totalling US\$6.5 billion.
13. The World Bank Group's "margins for manoeuvre" initiative is designed to leverage IBRD's balance sheet. The IFC is expanding its Asset Management Company and syndication platforms to mobilize more third party capital. The IDA18 replenishment discussed ways to leverage IDA's capital for non-concessional loans through a private sector set aside window. During the IDA18 consultations participants acknowledged the strong demand for resources to help countries' achieve their 2030 goals. The innovative and ambitious IDA financing package will fundamentally change IDA's financial architecture. The ground breaking IDA18 financing package will pioneer market leverage and new instruments and blending partners' grant contributions with capital market debt. This change in the financial architecture will bring IDA to a new level the efficient use of resources. The systems required to implement the new IDA financing model are being put in place. As a first step in September 2016 Standard and Poor and Moody's rated IDA AAA, a necessary pre-condition to issue bonds in the capital markets. Further steps will include: (i) updating IDA's financial framework, accounting policies and risk management parameters to ensure robust sustainability rules, commensurate with capital market and AAA rating requirements; and (ii) preparing for an IDA bond issuance and investor engagement by obtaining all required regulatory approvals, devising a funding strategy, program, and outreach, and establishing needed operational protocols and systems.<sup>35</sup> The IDA18 consultations recognised that Concessional Partner Loans (CPLs) (i.e., sovereign loans) complement market debt in increasing the size of IDA18. The existing IDA voting rights system will continue for the IDA18 period and the Concessional Partner Loan contributors will receive additional voting rights based on the grant element of CPLs. Concessional Partner Loan funding will not be earmarked for any purpose and will be allocated to IDA's pool of funding. This may have implications for IFAD's voting rights formula.
14. In 2016 ADB and the Swedish International Development Cooperation Agency (SIDA) signed an agreement on an innovative risk transfer mechanism. SIDA will guarantee up to US\$155 million of ADB's sovereign loans. The guarantee will allow ADB to increase its lending capacity by US\$500 million over the next 10 years from its Ordinary Capital Resources. Risk transfer agreements pass specified risks from one party to another party in return for a fee. This can release capacity for additional operations by improving the risk profile of bank balance sheets and reducing the capital held in reserve to cover guaranteed loans. This was the first time such a risk transfer arrangement was used for a sovereign loan portfolio of an MDB.
15. EIB is enhancing its use of risk-sharing instruments, blending concessional and non-concessional resources to bring projects to a credit level acceptable to private

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<sup>35</sup> World Bank Group. 2016. IDA18. Draft of IDA18 Deputies' Report. Additions to IDA Resources: Eighteenth Replenishment. Towards 2030: Investing in Growth, Resilience and Opportunity.



investors.

16. In 2016 Standard and Poor's Ratings Services noted that the shareholders of the 19 Multilateral Lending Institutions (MLIs) were encouraging them to increase their activities to maximize their mandates. Standard and Poor's estimated that, in aggregate, with the current ratings MLIs could accommodate an additional US\$1 trillion of credit exposure, a 72 increase rise from the US\$1.5 trillion outstanding exposure. Most of this additional capacity would be with the 'AAA' rated entities because of their robust capital adequacy and reserves of 'AAA' rated callable capital.<sup>36</sup> Standard and Poor's concluded that distribution of available capacity was not uniform and ranged from 0 per cent to 240 per cent of existing exposures, with only five MLIs able to double the current level of exposure.<sup>37</sup>

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<sup>36</sup> The 'AAA' rated entities, which include all of the MDBs, control about 96 per cent of this additional capacity.

<sup>37</sup> Standard and Poor's. 2016. How Much Can Multilateral Lending Institutions Up The Ante?

## Key Dates in the Evolution of IFAD's Financial Architecture

Timeline	Main Events
2017	IOE undertakes a corporate-level evaluation on IFAD's financial architecture. Management makes a preliminary presentation on IFAD's financial architecture to the Board.
2016	The report of the Corporate Working Group on IFAD's Financial Policies presented to Management's Finance and Investment Committee and the Audit Committee. The Sovereign Borrowing Framework reviewed. Treasury model enhanced. Executive Board approves sovereign loans from AFD for Euro 200 million.
2015	Sovereign Borrowing Framework adopted. Grant policy revised.
2014	The Financial Framework for IFAD10 adopted and Financing options for IFAD beyond 2015. KfW and IFAD sign the framework agreement a EUR 400 million loan.
2013	The Governing Council adopted a revised version of the Lending Policies and Criteria and renamed it Policies and Criteria for IFAD Financing. The DSF reviewed.
2012	The Additional Resource Mobilization Initiative launched. Lending policies and criteria reviewed. IFAD aligned its products with those of IDA and IBRD with due regard to IFAD's specificity. New blend terms approved, effectively replacing two products between highly concessional and ordinary terms (i.e., the intermediate and hardened loans) to accelerate loan repayments through shorter grace periods and higher interest rates and offering loans on ordinary terms to all countries not eligible for highly concessional assistance). ACA was replaced with a sustainable cash flow approach. Reimbursable technical assistance programme established to serve MICs that seek only technical support from IFAD.
2011	IFAD adopted Financing requirements, modalities for IFAD9: Review of the adequacy of IFAD's resources to combat rural poverty. The policy for IFAD's Engagement with Middle-Income Countries approved.
2009	Grant policy revised. Enterprise Risk Management Committee established and the risk management policy formulated.
2008	
2007	Debt Sustainability Framework and the first DSF grant approved.
2006	Lending Policies and Criteria for IFAD Financing revised.
2004	PBAS introduced and the policy for grant financing was approved. IFAD's ALM system reviewed.
2000-2004	Governing Council decided that IFAD would participate in the Debt Initiative for HIPCs.
1999	Executive Board approves the following allocation of IFAD's lending programme resources by geographic region: 39.4% for Africa, 28.5% for Asia and the Pacific, 17.0% for Latin America and the Caribbean, 7.1% for the Near East and North Africa, and 8% for Eastern Europe and the Newly Independent States.
1994-1998	Lending Policies and Criteria for IFAD Financing revised. Lending Policies and Criteria for IFAD Financing revised. Advanced Commitment Authority approved. Lending Policies and Criteria for IFAD Financing revised Lending Policies and Criteria for IFAD Financing revised. Lending Policies and Criteria for IFAD Financing revised.
1993	Lending terms changed, including from fixed to variable interest rates on ordinary and intermediate loans (without changing the maturity period) and reduced the service charge for highly concessional loans from 1 to 0.75 per cent with a shortened repayment period from 50 to 40 years). IFAD applies IBRD's average spread for its variable loans.
1992	Consistent with the policies of most UN organizations and IFIs, IFAD's approach to internal control is founded on the Internal Control – Integrated Framework model issued by the Committee of Sponsoring Organizations of the Treadway Commission in New York in 1992 (i.e., the COSO model).
1986	The concept of complementary contributions was introduced.
1982	The Audit Committee, a sub-committee of the Executive Board, was established.
1981	New resources made available so that IFAD can undertake a US\$1.5 billion programme of work between 1981 and 1983.
1978	The Governing Council adopted the Lending Policies and Criteria and stated that they would be reviewed periodically in the light of actual experience.
1976	Agreement Establishing IFAD Adopted by the United Nations Conference on the Establishment of an International Fund for Agricultural Development

## Glossary of Terms

<b>Additional Resource Mobilization (ARM)</b>	<i>Launched by the President of IFAD in May 2012 to implement Governing Council resolution 166/XXXV (2012), the ARM initiative explores possibilities for mobilizing new resources beyond the Replenishment to finance agricultural and rural development that are in line with IFAD's operational, financial and legal structures.</i>
<b>Advanced Commitment Authority (ACA)</b>	The ACA allowed IFAD to use its stable and predictable loan reflows as a basis for commitment authority to make loans and grants. ACA was used for the first time in 2001, with the maximum amount available through ACA equal to the total loan reflows expected for the subsequent three years. This maximum had increased to seven years for IFAD8 and IFAD9.
<b>Asset Liability Management (ALM)</b>	ALM is the management of financial risks, arising mainly from an institution's mismatches between its assets and liabilities of interest rates, foreign exchange denominations and maturity profiles.
<b>Cash flow sustainable</b>	For IFAD9 steps were taken to ensure that financing projections were cash flow sustainable meaning: (i) for all PoLG scenarios, IFAD's liquidity (i.e. the balance of its cash and investments) should never breach the minimum liquidity requirement stipulated in its Liquidity Policy over the next 40 years; and (ii) the donor contribution requirement for a given PoLG scenario should be sustainable in future replenishments.
<b>Core replenishment contributions</b>	Contributions that are additional resources to the resources of the Fund. These contributions are made without restriction as to their use and carry voting rights
<b>Debt/equity ratio</b>	(a) The ratio of (i) principal portion of total outstanding debt to (ii) total contributions plus General Reserve (expressed in percentage terms); (b) Calculated as (total outstanding debt principal/contributions + General Reserve); (c) The threshold to be complied with by IFAD shall not be higher than 35 per cent.
<b>Debt service coverage ratio</b>	(a) The ratio of (i) principal and interest to all IFAD lenders in a given year to (ii) total yearly loan reflows from IFAD borrowers as per latest audited financial statements; (b) Calculated as total debt service (principal and interest)/(average of the previous year's actual total loan reflows and the current year's projected total loan reflows); (c) The threshold to be complied with by IFAD shall not be higher than 50 per cent.
<b>Demand for IFAD resources</b>	Demand for IFAD's resources for projects funded by IFAD's programme of loans and grants
<b>Equity ratio</b>	(a) The ratio of (i) total contributions plus General Reserve to (ii) total assets (expressed in percentage terms) (b) Calculated as (total contributions and General reserve)/total assets (c) The threshold to be complied with by IFAD shall not be lower than 60 per cent.
<b>Existing lending terms</b>	See document GC 36/L.9 – Review of the Lending Policies and Criteria
<b>Financial statements</b>	The consolidated and unconsolidated financial statements (including a balance sheet, income statement, statement of changes in equity, cash flow statement and notes to the accounts of IFAD, prepared in accordance with International Financial Reporting Standards on a yearly basis and in nominal terms semi-annually.
<b>Framework agreement</b>	An umbrella agreement covering the terms and conditions of the total amount borrowed.
<b>General Reserve</b>	IFAD's General Reserve as established by Governing Council resolution 16/IV.
<b>Governance structures</b>	As defined in the Agreement Establishing IFAD. EB 2015/114/R.17/Rev.
<b>IFAD Member</b>	State Membership of IFAD is open to any state that is a member of the United Nations, any of its specialized agencies or the International Atomic Energy Agency.
<b>IFAD's minimum liquidity requirement</b>	As defined in the Liquidity Policy ( <a href="http://www.ifad.org/gbdocs/eb/89/e/EB-2006-89-R-40.pdf">http://www.ifad.org/gbdocs/eb/89/e/EB-2006-89-R-40.pdf</a> )
<b>IFAD resources</b>	IFAD's resources consist of external resources (Replenishment contributions from Member States) and internal resources.
<b>IFAD total equity</b>	Total contributions plus General Reserve.
<b>Internal resources</b>	Internal resources consist mainly of loan reflows, investment income and future net flows in the amount determined under the Sustainable Cash Flow approach.
<b>Investments</b>	The investments at amortized costs as well as investments at fair value as stated in IFAD's balance sheet in accordance with IFRS.
<b>Liquidity ratio:</b>	(a) The ratio of (i) cash-in-hand and in banks plus investments to (ii) total assets, expressed in percentage terms;

	(b) Calculated as (cash-in-hand and in banks + investments)/total assets; (c) The threshold to be complied with by IFAD shall not be lower than 5 per cent.
Loan products	See document GC 36/L.9.
Periodic reports	The Financial Statements, IFAD Annual Report and financial ratios reports.
Programme of loans and grants (PoLG)	The annual total of IFAD loans, Debt Sustainability Framework (DSF) grants, and grants for approval in a specific year. This also includes grants financed under the Adaptation for Smallholder Agriculture Programme (ASAP) (as of 2012) and loans provided under the KfW Development Bank loan (as of 2014).
Programme of work (PoW)	This includes the PoLG plus other funds managed by IFAD from the Spanish Food Security Cofinancing Facility Trust Fund, Global Environment Facility/Least Developed Countries Fund, Global Agriculture and Food Security Program (GAFSP), European Commission and European Union, in addition to bilateral supplementary/complementary grants. In addition, the PoW includes cofinancing (net of cofinancing managed by IFAD and domestic cofinancing) (see GC.38/L.6, page 7, table 3).
Recipient countries	IFAD Member States that are entitled to borrow from IFAD.
Total assets	The aggregate of IFAD's balance sheet assets in accordance with IFRS or in nominal terms, and off-balance sheet engagements in accordance with IFRS or in nominal terms.
Total debt service (principal and interest)	The interest received from loans plus the loan principal repayments, as defined in the consolidated cash flow statement of IFAD.
Total loan reflows	The cash flows from financing activities as defined in the Financial Statements of IFAD.
Sovereign States	IFAD Member States and Sovereign States that are not members of IFAD.
State-Supported Institutions	All state-owned or state-controlled enterprises and development finance institutions of IFAD Member States.

Note: Financial ratios are calculated regularly on the basis of IFAD's unconsolidated and consolidated financial statements. All financial ratios are based on figures calculated in accordance with the International Financial Reporting Standards (IFRS) and all applicable laws.

Source: Adapted from IFAD. Sovereign Borrowing Framework: Borrowing from Sovereign States and State-Supported Institutions. 2015

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