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Investing in rural people

## **Review of the status of the Debt Sustainability Framework**

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Consultation on the Tenth Replenishment of IFAD's Resources —  
Third Session

Rome, 7-8 October 2014

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**For: Review**

# Review of the status of the Debt Sustainability Framework

## I. Background

1. Following the adoption of the Report of the Consultation on the Seventh Replenishment of IFAD's Resources (IFAD7) by the Governing Council in 2006, IFAD decided to implement the provisions of the Debt Sustainability Framework (DSF). In line with this decision of the Governing Council, the Executive Board approved a recommendation at its ninetieth session in April 2007 to enable IFAD to begin implementing a DSF modelled on the framework adopted by the International Development Association. At the same session of the Executive Board, Member States agreed that they would compensate the Fund for grants provided under the DSF. As with other international financial institutions (IFIs), the Board approved the principle of compensation on a pay-as-you-go basis. This meant that Member States would compensate the Fund for the principal repayments that would have been due had the Fund provided the financial resources to the countries involved on highly concessional loan terms rather than on a grant basis. Pay-as-you-go means payments are to be made by Member States as and when the principal repayments forgone would have fallen due.

## II. Implementation of the pay-as-you-go principle (calculation of the share of compensation)

2. In implementing the above agreement by IFAD's membership, the Governing Council decided, at its thirty-fifth session in 2012, that a key deliverable under IFAD9 would be a proposal from Management to the Executive Board on how Member States would share the burden of compensating the Fund for forgone reflows arising from the adoption of the DSF, which would begin to fall due during the IFAD10 period. Following an analysis of the comparative methodologies adopted by other IFIs, it was determined that the approach of the African Development Bank was most applicable to IFAD's circumstances. Management therefore recommended that this approach be adopted to calculate compensation shares for contributing Member States. Under this methodology, the total pledges for the replenishment period in which the grants were committed are used as the basis for calculating each contributing Member State's share of the total compensation to be paid to IFAD for forgone principal payments under the DSF. IFAD committed the first DSF grants in 2007, during the IFAD7 period. Therefore, a Member State's percentage share of the total pledges made during IFAD7 would be used as the basis for calculating that Member's share of the compensation for the forgone principal, which would have fallen due in IFAD10 from the DSF grants approved in 2007.

## III. Implementation of the pay-as-you-go principle (mechanism for membership contributions)

3. The following are the key recommendations endorsed by the Executive Board at its 110th session in December 2013 with regard to the DSF compensation mechanism:
  - (a) Donors should be expected to contribute towards compensation for the forgone principal reflows as was originally agreed in April 2007.
  - (b) A threshold of US\$10,000 should be established as the minimum expected compensation.
  - (c) DSF beneficiary countries should be excluded from the responsibility of contributing towards compensation.

4. Donors may opt to make a single pledge of a fixed amount from which both their assessed DSF compensation and their core replenishment contribution are taken, or they may pledge two separate amounts in respect of their DSF compensation and core replenishment contribution. If donors choose to make a single pledge, or if the separate DSF pledge is less than the assessed DSF compensation amount, then their obligation towards DSF compensation should take precedence, and only the amount remaining after covering the DSF compensation contribution will be regarded as their core replenishment contribution.
5. Member States will receive commensurate votes for their DSF compensation contributions.
6. The Executive Board endorsed the submission of the paper on the Review of the status of the Debt Sustainability Framework (EB 2013/110/R.31/Rev.2) to the Consultation on the Tenth Replenishment of IFAD's Resources (attached in the annex). The Consultation is invited to endorse the recommendations in paragraph 41 of the document for submission to the Governing Council for approval through the Report of the Consultation on the Tenth Replenishment and the IFAD10 resolution (to be attached as an annex thereto).

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Enabling poor rural people  
to overcome poverty

## **Review of the status of the Debt Sustainability Framework**

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Executive Board — 110<sup>th</sup> Session  
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**For: Review**

## Preamble

As one of its key commitments during the Consultation on the Ninth Replenishment of IFAD's Resources, Management committed to 'Present[ing] a proposal to the Executive Board on how responsibility for compensation for forgone principal arising from adoption of the Debt Sustainability Framework will be managed, starting in IFAD10.'<sup>1</sup>This document is an enhancement of the Debt Sustainability Framework (DSF) paper presented to the Audit Committee at its 128<sup>th</sup> meeting in September 2013. At that meeting, Management presented a revised version of the original June 2013 paper to respond to requests made by the Committee. That paper included options open to the Fund in establishing a mechanism for Member State contributions to compensate the Fund for principal repayments forgone as a result of providing grants under the DSF, and recommended an option for adoption. Following the Board's review at the September session, Management was again requested to revisit the paper and make it more streamlined and focused.

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<sup>1</sup> REPL.IX/4/R.2/Rev.2

## Recommendation

The Executive Board is invited to review the document and proposed contribution modalities and to endorse the recommendations contained in paragraph 41 and its submission to the Consultation on the Tenth Replenishment of IFAD's Resources.

## Review of the status of the Debt Sustainability Framework

### I. Introduction and background

1. Since 1996, IFAD and its Member States have demonstrated their commitment to global initiatives aimed at ensuring that the debt of poor countries does not become an obstacle to their development. As part of this commitment, IFAD has joined other international financial institutions (IFIs) – the World Bank, Asian Development Bank (ADB) and African Development Bank (AfDB) – in implementing specific debt relief initiatives. This effort started with the implementation of the Heavily Indebted Poor Countries (HIPC) Debt Initiative in 1996, which had the goal of reducing the historical debt stock of poor countries to sustainable levels. IFAD is the seventh largest provider of such relief worldwide and the fifth largest in Africa.
2. Following the HIPC Initiative, donor countries agreed to implement a Debt Sustainability Framework (DSF) in 2005 to ensure that the poorest countries' development efforts are not compromised by the re-emergence of unsustainable levels of debt. To this end, and based on a country by country debt sustainability analysis carried out by the International Monetary Fund (IMF), donors agreed to provide grants or a combination of grants and concessional loans under the DSF for countries deemed unable to sustain even concessional loans. The DSF has been implemented by the World Bank, AfDB and ADB, as well as by most donor countries providing assistance to these countries.
3. In 2006, following the Governing Council's adoption of the Report of the Consultation on the Seventh Replenishment of IFAD's Resources (IFAD7), the Fund decided to implement the provisions of the DSF. In line with the decision of the Governing Council, the Executive Board approved the recommendation contained in document EB 2007/90/R.2 (see annex III for the executive summary), at its ninetieth session in April 2007, that IFAD begin implementing a DSF modelled on the framework adopted by International Development Association (IDA).
4. In addition, at its ninetieth session, the Executive Board agreed that Member States would compensate the Fund for grants provided under the DSF. As with other IFIs, the Board approved the principle of compensation on a pay-as-you-go basis. This meant that Member States would compensate the Fund for the principal repayments that would have been due had the Fund provided the financial resources to these countries on highly concessional terms rather than on a grant basis under the DSF. As IFAD's highly concessional loans are repaid over a 40-year period, compensation by Member States would likewise be effected over such periods. "Pay-as-you-go" therefore means payments being made by Member States as and when the principal repayments forgone fall due.
5. Table 1 sets out the amounts of principal and service charges forgone as a result of the commencement of the DSF initiative in 2007. The estimates for IFAD9 are also included. These forgone flows will start materializing in 2018 and continue until 2055. The Board has been provided with an annual report setting out the amount of principal and net service charge payments forgone in relation to DSF grants. The cumulative amount of principal is estimated at US\$1.446 billion, and service charges at US\$219 million.

6. According to projections, DSF grants will account for approximately 21 per cent of the overall annual programme of loans and grants over the medium term. However, DSF compensation will average 6 per cent of the total projected inflows over the same period. This is attributable to the timing difference between DSF disbursements and the underlying repayment schedule. The ratio of DSF compensation to overall forecast inflows will increase over time. Towards the end of the IFAD18 period, DSF compensation as a percentage of total projected reflows is expected to stabilize at between 9 per cent and 10 per cent.

Table 1

**Forgone reflows by corresponding replenishment**  
(Millions of United States dollars)

<i>Replenishment period</i>	<i>Years</i>	<i>Principal repayments forgone</i>	<i>Forgone service charge</i>	<i>Total forgone reflows from DSF</i>
IFAD7	2007	101.7	15.4	117.1
IFAD7	2008	112.9	17.1	130.0
IFAD7	2009	196.6	29.8	226.4
<b>Subtotal IFAD7</b>		<b>411.2</b>	<b>62.4</b>	<b>473.5</b>
IFAD8	2010	154.8	23.5	178.2
IFAD8	2011	211.3	32.0	243.3
IFAD8	2012	231.3	35.1	266.4
<b>Subtotal IFAD8</b>		<b>597.4</b>	<b>90.6</b>	<b>688.0</b>
IFAD9	2013	142.2	21.6	163.8
IFAD9	2014	145.8	22.1	167.9
IFAD9	2015	149.4	22.7	172.1
<b>Subtotal IFAD9</b>		<b>437.4</b>	<b>66.3</b>	<b>503.7</b>
<b>Total</b>		<b>1 445.9</b>	<b>219.3</b>	<b>1 665.2</b>

## **II. Methodologies applied by IDA, the African Development Fund (AfDF) and the Asian Development Fund (ADF) in determining DSF compensation shares and compensation approaches used**

7. This section describes the methodologies used by IDA, the African Development Fund (AfDF) and the Asian Development Fund (ADF) to determine shares to fund principal repayments and compensation contributions. Management conducted this comparison in order to harmonize and adopt best practice to the extent applicable to IFAD's circumstances.

### **International Development Association**

8. At IDA, donor contributions for debt relief and grant compensation are considered additional to regular contributions. Donors are expected to cover 100 per cent of principal repayments forgone as a result of grants by making additional contributions to future replenishments on a pay-as-you-go basis.
9. For IDA16, donors will provide regular contributions as well as additional contributions to cover costs related to the Heavily Indebted Poor Countries (HIPC) Debt Initiative and compensation for principal forgone on grants. Donors' burden share percentages were originally based on IDA13 basic burden shares. At the time of the Multilateral Debt Relief Initiative (MDRI), donors were asked to scale up their burden share to fully eliminate the financing gap in respect of debt relief. Many donors have individually scaled up their burden share over the IDA14 to IDA16 period.

10. Encashments for HIPC contributions. Under the current compensation arrangements, partner financing of HIPC costs occurs on a pay-as-you-go basis, over the three-year commitment period of IDA replenishments. For IDA16, financing contributions to cover IDA's HIPC-related costs are encashed in three equal annual amounts.
11. Compensation for principal forgone on grants. Under IDA14, donors committed to replace forgone principal reflows of grants provided by IDA, on a pay-as-you-go basis. As with the pay-as-you-go approach to HIPC contributions, donors were asked to provide compensation for forgone reflows during the three year replenishment period (i.e. IDA16 – fiscal years 2012 through 2014). As described above, HIPC contributions will be encashed in three equal instalments over the three-year commitment period of IDA16. IDA will apply this same process to compensation for forgone principal from grants.

#### **African Development Fund**

12. At the AfDF, the contribution of each donor country is computed by normalizing its burden share for the replenishment for which grants are being compensated. To ensure that AfDF is fully compensated for grants extended under a specific replenishment, the sum of all donors' subscriptions must be 100 per cent. Donor subscriptions refer to replenishment pledges corresponding to the period in which the grants were made, as a basis for determining burden shares. For example, grant compensation for AfDF-9 is based on the normalized burden share of all donors that participated in the AfDF-9 replenishment.
13. Donors compensate the forgone principal reflows on a pay-as-you-go basis. Each year, based on their normalized burden share, they pay into AfDF what would have been the amount of the reflow had the grant been provided as a loan. When donors do not wish to make a separate pledge for DSF grants compensation, their part of the compensation is subtracted from their total pledge – lowering their basic replenishment contribution and burden share. Donors receive voting rights for all payments made to AfDF for grants compensation.
14. At AfDF, donor compensation for forgone principal repayments on grants was applied for AfDF-12, as this was the first replenishment cycle under which forgone principal repayments on DSF grants would have fallen due. During the AfDF-9 negotiations, the AfDF deputies had agreed to finance the forgone principal on a pay-as-you-go basis. In addition, the deputies had agreed that the burden share used during the replenishment cycle in which the DSF grants were made would be used to calculate the burden share of member states for DSF compensation. For AfDB, this meant that as the first DSF grants were provided in the AfDF-9 cycle and the forgone reflows for these began to arise in AfDF-12, the first compensation payments under AfDF-12 would be based on AfDF-9 burden shares.

#### **Asian Development Fund**

15. The ADF offers donors a choice of two burden-sharing frameworks for the ADF XI replenishment:
  - (i) Adjusted ADF X burden share; or
  - (ii) ADF X burden share.
16. The adjusted burden share of ADF X was determined based on total ADF X contributions net of the ADF X financing gap, which resulted in a scaled-up burden share to enable ADF to receive full compensation from these two items.
17. However, while most donors opted for the adjusted ADF X burden share, a few opted for their respective ADF X burden shares for both basic contributions and the two compensation items. The burden share is linked to the ADF X, the replenishment immediately prior to ADF XI, rather than the replenishment when grants were approved (ADF IX), since the compensation in future replenishments



will involve multiple replenishments. The burden-sharing framework to be adopted for compensation items in the next replenishment (ADF XII) will be subject to donors' agreement during replenishment negotiations. At ADF, donors have also agreed to compensate the institution for forgone principal on a pay-as-you-go basis. Compensation for forgone principal was agreed among donors when the DSF grant provision was introduced under the ninth replenishment of the Asian Development Fund (ADF IX), which started in 2005. This agreement was included in the ADF IX donors' report and the grant framework paper approved by ADB's board of directors. The compensation is part of donors' total contributions for ADF XI, 2013-2016.

#### **Determination of DSF compensation shares at IFAD**

18. IDA's membership composition is different from IFAD's and the basis used for determining the percentages is IDA-specific; this is also the case with ADB. Given that IFAD's financing system does not use burden shares,<sup>2</sup> these approaches are considered not entirely applicable to IFAD's system and membership circumstances. Management therefore does not recommend that IFAD adopt the burden-sharing methodology used by IDA and ADB for DSF principal forgone.
19. Management has found the AfDB approach to be simple and readily adoptable under IFAD's circumstances and therefore recommends the adoption of this approach for calculating the compensation shares for contributing Member States. This methodology uses the total pledges for the replenishment period in which the grants were committed to calculate the percentage shares. This is the normalized burden share approach used by the AfDB.
20. Annexes I and II show the share of each Member State's contribution to compensate for the principal repayments forgone falling due in the IFAD10 and IFAD11 cycles.

#### **Compensation schemes towards DSF contributions**

21. IDA (in 2005) and AfDF (in 2004), under their respective replenishments (IDA14 and AfDF-9), agreed on full compensation by member states for forgone principal repayments on a pay-as-you-go basis. Their member states pledged to make additional contributions over and above core replenishment support, equivalent to the forgone reflows caused by application of the DSF.
22. The decision taken during IDA14 guided IDA member states during the IDA16 replenishment discussions (concluded in December 2010) when donors started to compensate for grants extended in IDA13. IDA member states agreed that an additional SDR 56.44 million to finance the forgone principal reflows should be included as part of IDA's overall financing commitments during IDA16 based on fair burden share.
23. At AfDF, donor compensation for the forgone principal repayments on grants was applied in AfDF-12, as this was the first replenishment cycle under which the compensation for forgone principal repayments on DSF grants fell due. During AfDF-9 negotiations, the AfDF deputies had agreed to finance the forgone principal on a pay-as-you-go basis. In addition, the deputies had agreed that the burden share used during the replenishment cycle in which the DSF grants were made would be used to calculate the burden share of member states for the DSF compensation. For AfDB, this meant that as the first DSF grants were provided in the AfDF-9 cycle and the forgone reflows for these began to arise in AfDF-12, the first compensation payments under AfDF-12 would use the AfDF-9 burden shares.
24. At ADF, donors have also agreed to compensate the institution for forgone principal on a pay-as-you-go basis. Compensation for forgone principal was agreed among

<sup>2</sup> Indeed, replenishment contributions are voluntary and the resolution does not create obligations for Member States to contribute to the replenishment. An obligation to contribute will only arise upon the deposit of an instrument of contribution for the amount stated therein.

donors when the DSF grant provision was introduced under the ninth replenishment of the Asian Development Fund (ADF IX), which started in 2005. This agreement was incorporated into the ADF IX donors' report and into the grant framework paper approved by ADB's board of directors. The compensation is expected to be additional to donors' contributions for ADF XI, 2013-2016. ADF XI is the first replenishment in which DSF forgone principal repayments will be compensated.

25. The treatment of forgone income from interest and service charges varies across IFIs. Both IDA and AfDF were authorized to use a "complex" scheme for compensation for lost service charges, based on using a retained element of the modified volume approach discount in blended loan operations. IDA finances this with the volume discount and with International Bank for Reconstruction and Development transfers. The practice at AfDF is to offset an upfront charge on grants in order to ensure a neutral effect on the AfDF's financing capacity. At ADF, forgone interest from grants has been financed through additional donor contributions computed since ADF IX on the basis of the total grant envelope. IFAD's position is to continue to implement the April 2007 decision of the Executive Board on forgone interest and service charges – that as they are relatively modest they are not compensated.

### **III. Effect of DSF compensation contributions on voting rights**

26. In accordance with article 6.3(a)(ii)(B) of the Agreement Establishing IFAD, contribution votes shall be distributed among all Members in the proportion that each Member's paid contribution to the resources contributed to the Fund by Members for each replenishment bears to the aggregate of the total contributions paid by all Members to the said replenishment.
27. Donors receive voting rights according to their contributions towards regular replenishments. In the case of contributions towards DSF compensation, the policy at the World Bank is that this increase in resources available for debt relief costs is recognized for voting rights purposes. Such voting rights are normally recorded during the general adjustment of votes for the next regular replenishment cycle. In light of the relatively small adjustment necessary for the IDA14 period, voting rights for contributions during IDA14 were to be recorded at the time of the IDA15 replenishment.
28. At AfDF, donors contribute additional resources equivalent to the forgone principal repayments for each replenishment period by submitting pledges over the life of the DSF initiative. The compensatory financing arrangements take the form of a general increase in the contribution of member states over and above regular contributions. The contributions received from member states under the compensatory financing arrangements are not counted as part of the burden share for the replenishment period in which such resources are received, but do carry voting rights in the same manner as normal subscriptions.
29. Since DSF compensation will be part of the replenishment and will constitute core contribution, contribution votes corresponding to DSF compensation will be distributed among all Members in conformity with the methodology described in article 6.3(a)(ii)(B) of the Agreement.

Table 2  
**IFI compensation mechanisms**

<i>IFI</i>	<i>First DSF commitment</i>	<i>First principal repayments due</i>	<i>Basis for contribution shares for DSF compensation</i>	<i>Mechanism for contributing towards DSF compensation</i>
IDA (World Bank)	2005	IDA16 (2012)	Predetermined and preassigned burden shares assigned to donors at time of replenishment	Additional replenishment contribution, separate from regular contributions
African Development Bank	2004	AfDF-12 (2011)	DSF compensation shares based on proportions determined from pledged contributions in year grants were committed	Additional replenishment contribution
Asian Development Bank	2005	ADF XI (2013)	Predetermined and preassigned burden shares applied to donors at time of replenishment	Additional replenishment contribution, separate from regular contributions
IFAD	2007	IFAD10 (2018)	To be determined	In addition to regular replenishment contributions, either separate or as part of regular contributions

#### **IV. Proposed IFAD approach to compensation for DSF grants provided**

30. As noted in paragraph 4 above, IFAD's membership has agreed to compensate the Fund for forgone principal for grants provided under the DSF, and the Board, at its ninetieth session, endorsed the pay-as-you-go principle. At its thirty-fifth session in 2012, the Governing Council decided that a key deliverable under IFAD9 would be a proposal from Management to the Executive Board on how Member States would share the burden of compensating the Fund for forgone reflows arising from the adoption of the DSF, which would start falling due during IFAD10 period.
31. In response to the above decision, and following an analysis of the comparative review of methodologies in part II above, it has been determined that the AfDB approach is most applicable to IFAD's circumstances. Management therefore recommends that this approach be adopted to calculate compensation shares for contributing Member States. This methodology – the normalized burden share approach – uses total pledges for the replenishment period in which the grants were committed to calculate the percentage shares.
32. Annexes I and II show each Member State's contribution to compensation for principal repayments forgone during the IFAD10 and IFAD11 cycles.
33. Management proposes that IFAD continue to follow the April 2007 decision of the Executive Board not to compensate forgone interest and service charges in view of their relatively modest size.
34. As described in paragraph 28 above, member states will receive commensurate votes for contributions corresponding to DSF compensation.
35. Moreover, it is recommended that the overall IFAD compensation criteria be based on the following considerations:
  - (a) Donors be expected to contribute towards compensation for the forgone principal reflows as was originally agreed in April 2007 when the DSF was introduced ("IFAD Member States, and particularly those that are major contributors of official development assistance, should agree to compensate IFAD fully for principal repayments forgone as a result of application of the debt sustainability framework within a pay-as-you-go mechanism as adopted in IDA14").
  - (b) That a threshold be established as a minimum expected compensation for efficiency purposes, below which member countries will not be expected to

contribute, and that this be an absolute amount of US\$10,000 (an illustration of the impact on IFAD10 and IFAD11 is set out in annex I and annex II). In order to avoid the administrative burden of liaising with contributing member countries whose compensation shares are considered too low, Management set a threshold of US\$10,000 as the minimum compensation share amount. All amounts below this threshold are to be aggregated and distributed among countries with higher compensation shares on a proportional basis to ensure 100 per cent contribution towards principal repayments forgone. This is in line with practice at other IFIs, where contributions are adjusted upwards to address structural financing gaps.

- (c) In the spirit of maintaining development assistance and not overburdening countries that are DSF beneficiaries, which are often the poorest and most vulnerable, it is recommended that DSF beneficiary countries be excluded from the responsibility of contributing towards compensation for the principal repayments forgone on a pay-as-you-go basis.

## **V. Proposed modalities for compensation of principal repayments forgone under IFAD10**

36. As IFAD10 will be the first replenishment cycle during which the forgone reflows arise, it is proposed that IFAD membership make pledges during the IFAD10 Consultation to pay for forgone DSF principal repayments, in addition to its regular replenishment pledges for IFAD10.
37. The procedure for the compensation process would be to include the amounts to be compensated on a pay-as-you-go basis in a financial framework paper for presentation to the IFAD10 Consultation, in accordance with the practice at other IFIs. Donors may opt to make a single pledge of a fixed amount from which their assessed DSF compensation contribution is taken, or they may pledge two separate amounts in respect of DSF compensation and the regular replenishment contribution. If donors choose to make a single pledge, or if the separate DSF pledge is less than the assessed DSF compensation, then their obligation towards DSF should take precedence and only the amount remaining after covering the DSF contribution will be regarded as the regular replenishment contribution.<sup>3</sup>
38. To avoid any loss of principal to the Fund, Member States must compensate IFAD fully each year for DSF principal falling due during the year. For IFAD10, Member States would need to pay their share of the forgone principal prior to the last year of the IFAD10 period, that is, 2018, the first year in which forgone principal becomes due. For IFAD11, Member States will be requested to compensate the Fund for each of the three years of the IFAD11 period (2019, 2020 and 2021) and subsequent replenishments during which DSF repayments will fall due. The total amount of principal forgone in each replenishment cycle is shown in table 3.

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<sup>3</sup> This will be reflected in the replenishment resolution, which will set forth the drawdown schedule and payment instalments.

Table 3  
**Impact of DSF grant approvals in IFAD7, IFAD8 and IFAD9 on future replenishments**  
(Millions of United States dollars)

<i>Replenishment period</i>	<i>Years</i>	<i>Annual impact of DSF approved up to 2015</i>	<i>Cumulative impact</i>
		<i>Principal repayments forgone</i>	<i>Cumulative principal forgone</i>
7	2007-2009	-	-
8	2010-2012	-	-
9	2013-2015	-	-
10	2016-2018	3.4	3.4
11	2019-2021	39.5	42.9
12	2022-2024	97.9	141.0
13	2025-2027	139.6	280.6
14	2028-2030	144.6	425.2
15	2031-2033	144.6	569.8
16	2034-2036	144.6	714.4
17	2037-2039	144.6	859.0
18	2040-2042	144.6	1 003.6
19	2043-2045	144.6	1 148.2
20	2046-2048	141.2	1 289.4
21	2049-2051	104.9	1 394.3
22	2052-2054	46.7	1 441.0
23	2055	5.0	<b>1 446.0</b>

39. Table 3 illustrates the level of compensation required as a result of IFAD's implementation of the DSF, estimated at US\$1.446 billion for principal repayments forgone until 2055. Without compensation of the forgone principal amounts on a pay-as-you-go basis, the resources available for the programme of loans and grants will be reduced by an amount much higher than the compensation shortfall in principal repayments, in terms of both future lending forgone and the opportunity cost of investment income.

## VI. Proposed contribution modalities

40. To compensate IFAD for the reflows forgone as a result of DSF grants, the Governing Council may consider and adopt in its replenishment resolution the following approach to structure Member States' compensation commitments to IFAD:

Member States make a contribution commitment for grant compensation falling due during that specific replenishment period in order to compensate the Fund for forgone principal repayments of DSF grants. They may choose to make payments of such contributions outright or in line with IFAD10 standard or alternative payment schedules. This is the procedure followed by IDA (IDA16), AfDB (AfDB/AfDF-12) and ADB (ADB/ADF XI).

## VII. Recommendations

41. In an effort to ensure as equitable a mechanism as possible, while bearing in mind the need to meet the obligation to maintain IFAD's long-term financial viability, IFAD Management recommends that:
- (a) Member States reaffirm their commitment to compensate the Fund for principal forgone as a result of DSF implementation. In line with the practice at other IFIs, this would mean applying the pay-as-you-go principle approved by the Executive Board in April 2007. Adopting this approach would also ensure alignment of IFAD's practice with those of other IFIs;

- (b) IFAD adopt the methodology used by AfDF to calculate the share of each Member State to compensate IFAD for DSF implementation, as this is considered the most viable and relevant option for IFAD;
- (c) DSF beneficiary countries be excluded from the requirement to contribute to compensation for forgone principal repayments in addition to regular contributions on a pay-as-you-go basis;
- (d) A threshold be set below which compensation shares are not required if the amounts payable are deemed too low; Management proposes a minimum threshold of US\$10,000 to be applied to List C Member States;
- (e) Adjustments made as a result of items (c) and (d) be redistributed to other contributors to finance the gap;
- (f) New members or countries that did not pledge in the relevant replenishment period be encouraged to volunteer to contribute even when not legally bound by the above; such contributions should nonetheless not be taken into account in determining compensation shares;
- (g) Voting rights be considered for DSF compensation share contributions;
- (h) Donor contributions made in future replenishments be used to cover DSF obligations first, with any residual balance being considered as regular replenishment contributions; and
- (i) The decision of the Executive Board in April 2007 – that forgone interest and service charges not be compensated – be maintained.

**Annex I****PROPORTIONATE CONTRIBUTION SHARES BASED ON REPLENISHMENT PLEDGES FOR IFAD7 and IFAD8**

(United States dollars)

	<i>Principal repayments due during IFAD10 (US\$10,000 minimum)</i>		<i>Principal repayments due during IFAD11 (US\$10,000 minimum)</i>	
	<i>(Based on percentage of IFAD7 pledges)</i>		<i>(Based on percentage of IFAD8 pledges)</i>	
<b>List A</b>				
Austria	1.7%	60 706.21	1.7%	658 360.98
Belgium	2.6%	90 266.38	3.2%	1 252 970.79
Canada	4.9%	172 000.94	7.2%	2 857 945.84
Denmark	1.6%	55 555.75	1.5%	599 818.66
Finland	1.3%	44 967.57	1.8%	715 983.32
France	4.8%	165 626.39	5.3%	2 088 284.66
Germany	6.5%	224 837.83	6.9%	2 743 170.75
Ireland	1.4%	47 556.90	0.9%	357 991.66
Italy	8.2%	286 699.28	7.9%	3 135 052.28
Japan	5.3%	185 491.21	5.9%	2 351 289.21
Luxembourg	0.1%	-	0.2%	94 051.57
Netherlands	6.3%	220 835.19	7.4%	2 939 111.52
Norway	5.2%	182 174.85	4.5%	1 783 060.99
Portugal	0.2%	-	0.2%	70 538.68
Spain	4.8%	165 626.39	5.7%	2 267 280.51
Sweden	5.4%	186 445.24	5.7%	2 272 069.73
Switzerland	2.7%	94 996.97	2.0%	788 427.01
United Kingdom	8.1%	281 047.28	6.4%	2 547 229.98
United States	8.7%	303 531.07	8.9%	3 526 933.82
<b>Total</b>	<b>80.0%</b>	<b>2 768 365.45</b>	<b>83.5%</b>	<b>33 049 571.94</b>
<b>List B</b>				
Algeria	0.2%		1.0%	391 881.54
Gabon	0.0%		0.0%	13 643.87
Indonesia	0.8%	28 104.73	0.5%	195 940.77
Iraq	0.3%	11 241.89	0.1%	58 782.23
Kuwait	1.3%	44 967.57	1.2%	470 257.84
Nigeria	0.8%	28 104.73	1.5%	587 822.30
Qatar	1.6%	56 209.46	0.0%	-
Saudi Arabia	1.6%	56 209.46	2.0%	783 763.07
United Arab Emirates	0.2%	-	0.1%	39 188.15
Venezuela (Bolivarian Republic of)	2.4%	84 314.18	0.7%	257 422.71
<b>Total</b>	<b>9.2%</b>	<b>309 152.01</b>	<b>7.1%</b>	<b>2 798 702.48</b>
<b>List C</b>				
Albania	0.0%		0.0%	74 457.49
Angola	0.0%		0.2%	97 970.38
Argentina	0.3%	11 241.89	0.2%	-
Bangladesh	0.1%		0.1%	23 512.89

Brazil	1.3%	44 496.88	1.3%	523 553.73
Cameroon	0.1%		0.1%	36 389.73
China	2.6%	89 935.13	2.2%	862 139.38
Congo	0.0%		0.0%	11 756.45
Egypt	0.5%	16 862.84	0.3%	117 564.46
Ghana	0.1%		0.0%	15 675.26
Guyana	0.0%		0.0%	18 913.26
India	2.7%	95 556.08	2.5%	979 703.84
Korea, Republic of	0.5%	16 862.84	0.6%	235 128.92
Lebanon	0.0%		0.0%	11 756.45
Mexico	0.5%	16 862.84	0.0%	-
Morocco	0.0%		0.1%	27 431.71
Pakistan	0.6%	22 483.78	0.8%	313 505.23
Paraguay	0.0%		0.0%	19 628.95
Peru	0.0%		0.0%	11 756.45
South Africa	0.0%		0.1%	35 763.23
Sri Lanka	0.2%		0.1%	39 227.34
Syrian Arab Republic	0.1%		0.0%	19 594.08
Thailand	0.0%		0.0%	11 756.45
Tunisia	0.1%		0.1%	23 512.89
Turkey	0.1%		0.1%	47 025.78
Viet Nam	0.1%		0.0%	19 594.08
Yemen	0.1%		0.1%	39 188.15
<b>Total</b>	<b>10.8%</b>	<b>314 302.28</b>	<b>9.5%</b>	<b>3 616 506.57</b>
<b>Grand total</b>	<b>100%</b>	<b>3 391 819.00</b>	<b>100%</b>	<b>39 464 781.00</b>



**Annex II**

## PROPORTIONATE CONTRIBUTIONS SHARES BASED ON IFAD7 and IFAD8 PLEDGES (WITHOUT US\$10,000 THRESHOLD)

	<i>Principal repayments due during IFAD10 (US\$)</i> <i>(Based on percentage of IFAD7 pledges)</i>		<i>Principal repayments due during IFAD11 (US\$)</i> <i>(Based on percentage of IFAD8 pledges)</i>	
<b>LIST A</b>				
Austria	1.7%	59 108.80	1.7%	656 182.31
Belgium	2.6%	87 891.12	3.2%	1 248 824.42
Canada	4.9%	167 474.92	7.2%	2 848 488.24
Denmark	1.6%	54 093.86	1.5%	597 833.72
Finland	1.3%	43 784.29	1.8%	713 613.97
France	4.8%	161 268.12	5.3%	2 081 374.05
Germany	6.5%	218 921.47	6.9%	2 734 092.97
Greece	0.2%	6 820.30	0.0%	-
Iceland	0.1%	1 696.64	0.0%	1 367.05
Ireland	1.4%	46 305.49	0.9%	356 806.98
Italy	8.2%	279 155.11	7.9%	3 124 677.68
Japan	5.3%	180 610.21	5.9%	2 343 508.26
Luxembourg	0.1%	4 367.68	0.2%	93 740.33
Netherlands	6.3%	215 024.16	7.4%	2 929 385.33
Norway	5.2%	177 381.12	4.5%	1 777 160.43
Portugal	0.2%	5 863.97	0.2%	70 305.25
Spain	4.8%	161 268.12	5.7%	2 259 777.56
Sweden	5.4%	181 539.14	5.7%	2 264 550.94
Switzerland	2.7%	92 497.23	2.0%	785 817.93
United Kingdom	8.1%	273 651.83	6.4%	2 538 800.62
United States	8.7%	295 543.98	8.9%	3 515 262.39
<b>TOTAL</b>	<b>80.0%</b>	<b>2 714 267.55</b>	<b>83.5%</b>	<b>32 941 570.45</b>
<b>LIST B</b>				
Algeria	0.2%	6 020.34	1.0%	390 584.71
Gabon	0.0%	401.68	0.0%	13 598.71
Indonesia	0.8%	27 365.18	0.5%	195 292.36
Iraq	0.3%	10 946.07	0.1%	58 587.71
Kuwait	1.3%	43 784.29	1.2%	468 701.65
Nigeria	0.8%	27 365.18	1.5%	585 877.07
Qatar	1.6%	54 730.37	0.0%	-
Saudi Arabia	1.6%	54 730.37	2.0%	781 169.42
United Arab Emirates	0.2%	5 473.04	0.1%	39 058.47
Venezuela (Bolivarian Republic of)	2.4%	82 095.55	0.7%	256 570.84
<b>TOTAL</b>	<b>9.2%</b>	<b>312 912.07</b>	<b>7.1%</b>	<b>2 789 440.94</b>
<b>LIST C</b>				
Albania	0.0%	54.73	0.0%	390.58
Angola	0.0%	1 094.61	0.2%	74 211.09

Argentina	0.3%	10 946.07	0.2%	97 646.18
Armenia	0.0%	61.30	0.0%	497.29
Azerbaijan	0.0%	-	0.0%	3 905.85
Bangladesh	0.1%	3 283.82	0.1%	23 435.08
Benin	0.0%	-	0.0%	4 882.31
Bhutan	0.0%	164.19	0.0%	1 171.75
Bolivia (Plurinational State of)	0.0%	1 641.91	0.0%	-
Boznia and Herzegovina	0.0%	410.48	0.0%	3 515.26
Botswana	0.0%	410.48	0.0%	5 858.77
Brazil	1.3%	43 326.00	1.3%	521 821.17
Burkina Faso	0.0%	547.30	0.0%	3 905.85
Burundi	0.0%	54.73	0.0%	390.58
Cambodia	0.0%	1 149.34	0.0%	8 202.28
Cameroon	0.1%	4 344.02	0.1%	36 269.31
Central African Republic	0.0%	-	0.0%	-
Chad	0.0%	164.19	0.0%	-
Chile	0.0%	547.30	0.0%	2 343.51
China	2.6%	87 568.59	2.2%	859 286.36
Columbia	0.0%	932.50	0.0%	7 811.69
Congo	0.0%	1 641.91	0.0%	11 717.54
Congo, Democratic Republic of	0.0%	1 094.61	0.0%	7 811.69
Cote d'Ivoire	0.0%	-	0.0%	-
Cyprus	0.0%	164.19	0.0%	2 343.51
Ecuador	0.0%	-	0.0%	1 952.92
Egypt	0.5%	16 419.11	0.3%	117 175.41
Eritrea	0.0%	54.73	0.0%	390.58
Ethiopia	0.0%	164.19	0.0%	1 171.75
Fiji	0.0%	54.73	0.0%	-
Gambia (The)	0.0%	82.10	0.0%	585.88
Ghana	0.1%	2 189.21	0.0%	15 623.39
Guatemala	0.0%	1 368.26	0.0%	-
Guinea	0.0%	383.11	0.0%	3 124.68
Guyana	0.0%	-	0.0%	18 850.67
India	2.7%	93 041.62	2.5%	976 461.78
Israel	0.0%	-	0.0%	-
Jordan	0.0%	547.30	0.0%	3 905.85
Kenya	0.0%	547.30	0.0%	3 905.85
Korea, Democratic People's Republic of	0.0%	109.46	0.0%	-
Korea, Republic of	0.5%	16 419.11	0.6%	234 350.83
Lao, People's Democratic Republic	0.0%	279.12	0.0%	1 991.98
Lebanon	0.0%	437.84	0.0%	11 717.54
Lesotho	0.0%	547.30	0.0%	3 905.85
Madagascar	0.0%	531.08	0.0%	7 811.69
Malawi	0.0%	-	0.0%	1 952.92
Malaysia	0.0%	684.13	0.0%	1 952.92

Mali	0.0%	695.25	0.0%	3 774.26
Mauritius	0.0%	-	0.0%	195.29
Mexico	0.5%	16 419.11	0.0%	-
Moldova (Republic of)	0.0%	71.15	0.0%	1 015.52
Mongolia	0.0%	-	0.0%	390.58
Morocco	0.0%	1 641.91	0.1%	27 340.93
Mozambique	0.0%	437.84	0.0%	3 319.97
Namibia	0.0%	109.46	0.0%	-
Nepal	0.0%	-	0.0%	1 952.92
Nicaragua	0.0%	109.46	0.0%	-
Niger	0.0%	273.65	0.0%	1 952.92
Oman	0.0%	273.65	0.0%	1 952.92
Pakistan	0.6%	21 892.15	0.8%	312 467.77
Panama	0.0%	181.70	0.0%	972.56
Paraguay	0.0%	-	0.0%	19 564.00
Peru	0.0%	1 094.61	0.0%	11 717.54
Philippines	0.0%	1 094.61	0.0%	-
Romania	0.0%	547.30	0.0%	-
Rwanda	0.0%	39.95	0.0%	1 952.92
Senegal	0.0%	620.47	0.0%	7 811.69
Seychelles	0.0%	-	0.0%	-
Sierra Leone	0.0%	-	0.0%	2 343.51
South Africa	0.0%	-	0.1%	35 644.88
Sri Lanka	0.2%	5 478.51	0.1%	39 097.53
Sudan	0.0%	1 368.26	0.0%	-
Swaziland	0.0%	190.46	0.0%	-
Syrian Arab Republic	0.1%	1 915.56	0.0%	19 529.24
Tajikistan	0.0%	2.19	0.0%	23.44
Tanzania, United Republic of	0.0%	328.38	0.0%	4 687.02
Thailand	0.0%	820.96	0.0%	11 717.54
Togo	0.0%	-	0.0%	-
Tunisia	0.1%	3 283.82	0.1%	23 435.08
Turkey	0.1%	4 925.73	0.1%	46 870.17
Uganda	0.0%	246.29	0.0%	3 515.26
Uruguay	0.0%	547.30	0.0%	3 905.85
Uzbekistan	0.0%	-	0.0%	390.58
Viet Nam	0.1%	2 736.52	0.0%	19 529.24
Yemen	0.1%	3 283.82	0.1%	39 058.47
Zambia	0.0%	547.30	0.0%	3 389.85
<b>TOTAL</b>	<b>10.8%</b>	<b>364 639.38</b>	<b>9.5%</b>	<b>3 733 769.62</b>
<b>GRAND TOTAL</b>	<b>100%</b>	<b>3 391 819.00</b>	<b>100%</b>	<b>39 464 781.00</b>
<b>Total of amounts US\$10,000 or less (threshold)</b>		<b>89,252</b>		<b>130,598</b>
<b>Percentage of amounts below threshold to Grand Total</b>		<b>2.5%</b>		<b>0.3%</b>

**Notes:**

1. The table above shows countries highlighted in green (darker grey) as being DSF countries *based on the 2013 Debt Sustainability Framework Traffic Lights*.
2. All countries with calculated compensation shares below US\$10,000 are highlighted in grey.
3. All the DSF countries are below the threshold of US\$10,000 except for Ghana and Yemen which exceed the threshold in the IFAD11 compensation shares computation.
4. A few non DSF countries are below the threshold, especially in the IFAD10 shares computation but exceed the threshold in the computation for IFAD11.
5. DSF countries make up 12.5 per cent of the amounts below the threshold under the IFAD10 compensation shares and 28 per cent of the amounts below the threshold under the IFAD11 compensation shares.

### Annex III

## **Proposed arrangements for implementation of a debt sustainability framework at IFAD (EB 2007/90/R.2) (Document extract)**

### **Executive summary**

1. In the context of IFAD's full commitment to the international effort to reduce the impact of unsustainable debt on the pace of poverty reduction (through its participation in the Debt Initiative for Heavily Indebted Poor Countries), and of the global emphasis on the harmonization and alignment of development assistance, the Report of the Consultation on the Seventh Replenishment of IFAD's resources, adopted by the IFAD Governing Council at its twenty-ninth session, recommended that, commencing in 2007, IFAD should adopt the International Development Association (IDA) model of a debt sustainability framework (DSF) to govern the allocation of assistance to countries eligible for highly concessional assistance and with high to moderate debt-distress risk. It was further decided that IFAD management should submit to the Executive Board in September 2006 proposals for the operation of the debt sustainability framework, including provisions for: reporting on progress; the share and implications for IFAD's finances; the implications for IFAD's disbursements to developing countries; the implementation of the appropriate modified volume approach (MVA) for the generation of compensation for service charges forgone; and IFAD's participation in the collaboration among multilateral financial institutions (MFIs) for refining and reviewing methodologies used under the debt sustainability framework, as well as calibration of IFAD's approach with the approaches of other such institutions. Given that the finalization of IFAD's proposals for implementation of the DSF depended upon the outcome of the review of DSF methodology in the midterm review of the fourteenth replenishment of IDA, submission of IFAD's proposals to the Executive Board was deferred to its April 2007 session.
2. It is recommended, inter alia, that:
  - (a) IFAD immediately implement a DSF to govern the form of its financial assistance to countries eligible for highly concessional lending;
  - (b) IFAD use the classification of countries in terms of debt sustainability as produced by the World Bank and the International Monetary Fund in their country debt sustainability analyses;
  - (c) IFAD extend financial support projects and programmes governed by the performance-based allocation system (PBAS) in countries eligible for highly concessional loans on the following basis, in line with IDA and the African Development Fund (AfDF):
    - (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;
    - (iii) For countries with high debt sustainability: 100 per cent loan.
3. The implementation of the DSF at IDA and AfDF involves the application of an MVA whereby the part of a country's PBAS allocation delivered in the form of a DSF grant is discounted by 20 per cent. This serves to maintain the performance linkage with the resource allocation system and to generate resources for a mechanism of compensation for service charges forgone. It is proposed that at IFAD a 5 per cent discount level be applied, in order to maintain PBAS principles, but minimize the impact of the DSF on up-front flows of assistance to the poorest and often most-vulnerable countries.

4. Under IDA14 and AfDF-10, the DSF was adopted within the framework of zero impact on the resource position of the participating MFIs. Correspondingly, IFAD would be compensated for principal repayments forgone as a result of extending support on a grant basis under the DSF. As in IDA14 and AfDF-10, this would be on a pay-as-you-go basis, with Member States compensating IFAD in each replenishment for the value of principal repayments forgone in the previous replenishment period through contributions in addition to core replenishment contributions. IFAD would generate compensatory flows for the loss of service charge income through the operation of the MVA. The adequacy of the mechanism relative to the objective of zero overall financial impact of the DSF on IFAD would be assessed in the context of the Consultation on the Eleventh Replenishment of IFAD's Resources.