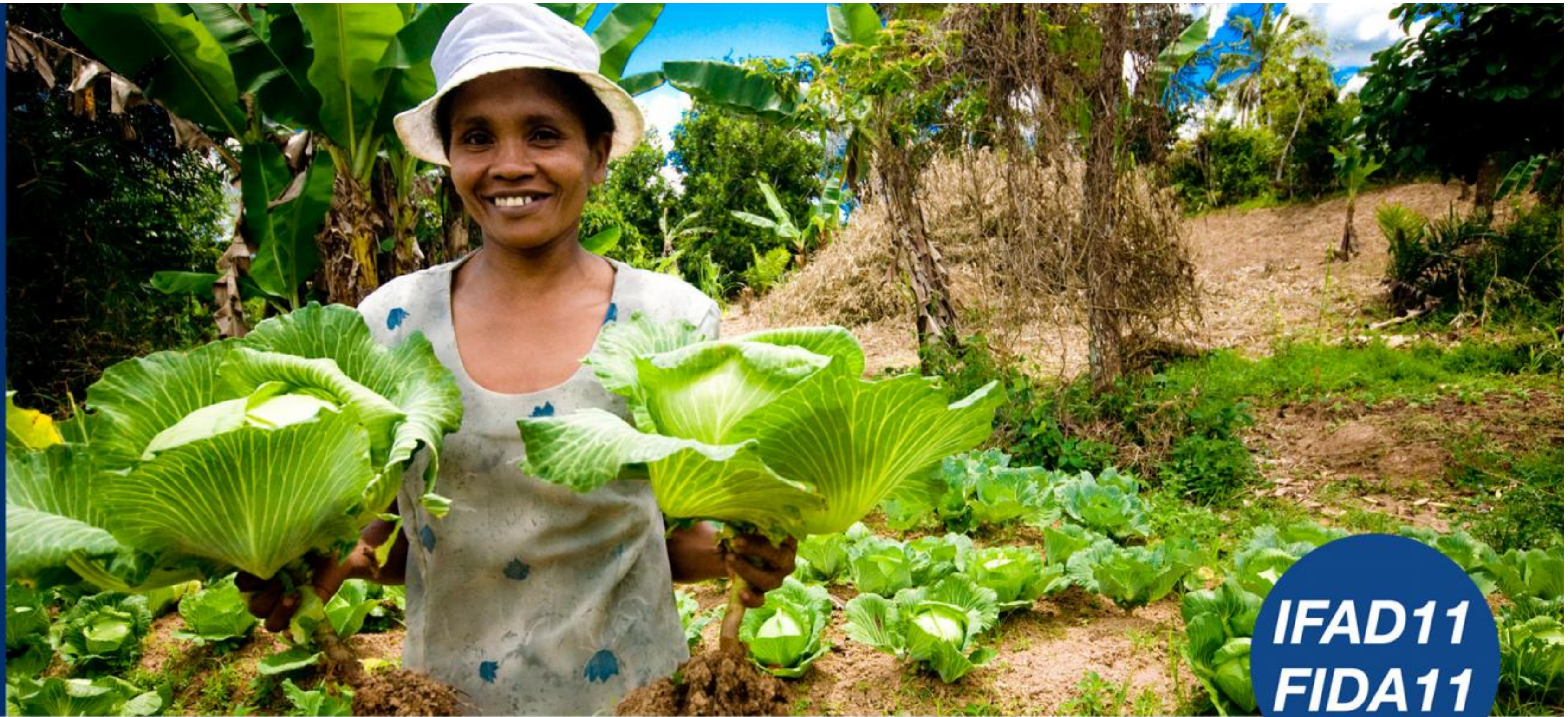

Review of Debt Sustainability Framework (DSF) at IFAD and other IFIs and proposal on future approach

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The DSF Mechanism at IFAD

IFAD11
FIDA11

- DSF means IFAD agreed to give selected countries **grants** rather than concessional loans.

- As DSF is a grant to recipient countries, DSF **reduces reflows due IFAD** and generates immediate **negative impact** on the financial sustainability of the Fund as result of asymmetries in accounting treatment and timing of receipt of cash flows.

- Member states **agreed to offset the loss of reflows** through additional compensatory contributions over and above regular replenishment contributions.

- IFAD's financial **planning assumptions have counted on full compensation** for DSF, otherwise, IFAD would have to lower its PoLG.

- IFAD10 was the first replenishment when DSF compensation was due, where only **partial compensation has been received** and Management therefore considers it necessary to review and **amend the DSF policy.**

DSF Cycle: Year-to-date and Projected Compensation*

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US$ millions

	Year-to-date 2007 - 2016	2017 - 2025	2026 - 2056	Financial Impact	Reflected in IFAD's Accounting Records as:
Approved	1 460.4				
Disbursements	(805.9)	(654.5)		(1 460.4)	EXPENDITURE
Repayments - Principal			1 460.4	1 460.4	EQUITY
- Interest	19.1**		215.9**	235**	FOREGONE

Compensation via future replenishments

*Projections based on existing DSF policy at IFAD

**These Interest calculations are notional as interest is substantially foregone based on existing DSF policy at IFAD

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DSF Principal Compensation in IFAD10, IFAD11, IFAD12

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DSF Principal Compensation in IFAD10, IFAD11, IFAD12

US$ Millions

Replenishment	Compensation Target	Pledges Received	Financing Gap
IFAD10	3.4	2.9	0.5
IFAD11	37.0*	?	?
IFAD12	89.5*	?	?

Expected compensation in IFAD11 and IFAD12 is significantly higher than IFAD10

* Estimates based on 2016 year end exchange rates

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Risks with current DSF Policy at IFAD

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There is a risk that the current DSF compensation policy **does not adequately compensate the Fund** for costs incurred by IFAD relating to DSF i.e. interest and principal

Potential negative impact on IFAD's resources

Potential negative repercussions for IFAD's ability to continue grant operations

DSF Compensation - IFAD compared to Other IFIs

IFAD11
FIDA11

	IFAD	Other IFI's (IDA, AfDB, ADB)
PRINCIPAL	• "Agreement in principle" to compensate IFAD • Not additional to IFAD replenishment	• Commitment to "burden sharing" from Member States • Additional to standard replenishment
INTEREST	• Foregone*	• Compensation through Modified Volume Approach** (MVA***)
MVA %**	5%	20%

*Substantively foregone as IFAD reallocates the entire hold back to all recipient countries benefiting from the PBAS

** Modified Volume Approach (MVA) is the mechanism for compensating for foregone interest through a hold back of a portion of the proposed DSF financing which is redistributed as loans to recipient countries benefitting from the PBAS. Some IFIs allocate a part of the MVA hold back to their liquidity to compensate for interest foregone

*** For IDA, the MVA was used up to and including IDA17, however, for IDA18 the MVA was eliminated for simplification and as other mechanisms for interest compensation exist

Options on DSF Compensation and Recommendation

IFAD11
FIDA11

Option 1

Continue offering DSF financing but harmonize compensation model with other IFIs

- 20% MVA – interest compensation
- Members States reaffirmed commitment to DSF compensation
- Timely payment of DSF compensation contributions
- Continuation of a valuable financial instrument to qualifying countries

Option 2

Discontinue DSF financing from IFAD11 onwards, ensuring compensation for DSF already approved

- Higher liquidity from IFAD11 since loan reflows assured for loans issued
- Avoidance of PoLG reduction through assurance of future cash flows
- Loss of a valuable financial instrument available to qualifying countries

Benefits under both options: Greater long-term financial sustainability and supports IFAD's evolving business model

Management recommends adoption of Option 1

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