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IFAD

Enabling poor rural people
to overcome poverty

Technical note on advance commitment authority

Consultation on the Eighth Replenishment of IFAD's
Resources — Third Session
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For: **Information**

Note to Consultation members

This document is submitted for the information of the Consultation on the Eighth Replenishment of IFAD's Resources.

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Technical note on advance commitment authority

I. IFAD approach

1. The overall IFAD financing framework is based on the definition of resources available for commitment adopted by IFAD (article 4 of the Agreement Establishing the International Fund for Agricultural Development). Resources available for commitment are composed of all resources in freely convertible currency net of IFAD's commitments for loans and grants.

2. IFAD's resource definition is more prudent than that of other international financial institutions (IFIs) in that contributions are considered as part of committable resources only when paid in cash or received in the form of a promissory note. Loans and grants become obligations when approved by the Executive Board. This resource definition is based on a full upfront backing of commitments.

3. In 1997, IFAD's Executive Board approved the use of the advance commitment authority (ACA), which permits 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 amount was expanded to five years of future loan reflows for the Seventh Replenishment period.

4. Since 2003, following an overall review of the Fund's financial risk exposure and management, IFAD makes projections and manages its short- and long-term resources through the asset liability management (ALM) framework. Within this framework, IFAD developed a Liquidity Policy, which was approved by the Executive Board in December 2006. The policy requires IFAD to maintain, at all times during the Seventh Replenishment period, a minimum liquidity composed of highly liquid assets equal to 60 per cent of the sum of total annual gross disbursements (cash outflows) and a component for meeting unexpected cash needs caused by liquidity shocks. Together with prudence in the resource definition and use of ACA, the liquidity policy has further strengthened the integrity of IFAD's financing framework relative to other IFIs. This point will be discussed in more detail below.

II. Other IFIs' resource management approaches

5. The **International Development Association (IDA)** pioneered the advance commitment scheme in 1988 in order to make lending commitments against future reflows. IDA's current financing framework is based on an ALM framework that establishes that future cash needs (liabilities), mainly arising from loan disbursements, do not have to be fully cash-funded at the time of their commitment. The majority of IDA's investment portfolio is invested and managed so that all projected cash flows, whether generated internally (in the form of loan reflows and investment income) or externally (in the form of member state contributions), will be progressively matched against the future cash needs over loan disbursement periods in terms of both timing and volume.

6. In 1998, the **African Development Fund** (AfDF) introduced the asset and liability management authority to allow more flexible resource management while addressing financial risks in much the same way as IDA does. AfDF uses ACA to estimate the level of total commitment capacity that can be sustained with all funding sources during a given replenishment period. Compared with IFAD's ACA, AfDF's ACA is a cash flow projection model to help match the proceeds from all funding sources with payments of new loans and grants, which take an average of ten years. To prevent any cash flow mismatches, AfDF sets aside a prudential portion of its investment portfolio as minimum liquidity under its liquidity policy.

7. In 2007, the **Asian Development Fund** (AsDF) realigned its financial framework with IDA's by adopting the expanded advance commitment authority, which uses a projection of cash reflows from all loan repayments, service charges net of administrative charges and investment income as the basis for planning and making new commitments. Disbursement obligations of new commitments are funded by 85 per cent of the projected cash reflows, with the remaining 15 per cent covering various uncertainties. The AsDF investment portfolio is invested and managed broadly in line with that of IDA.

8. Other IFIs thus manage their resources more dynamically than IFAD does by matching cash inflows and outflows deriving from outstanding and future commitments through an ALM framework. They do not set any predetermined ceiling on the number of years of future loan reflows against which to make new commitments. In general, other IFIs structure their investment portfolio into different layers or tranches. One tranche is dedicated to ensuring that financial obligations are timed and matched by a sequence of projected cash inflows over the average loan disbursement period. Another tranche is set aside to provide minimum liquidity for unexpected situations and is also partially intended to maximize returns. If all cash flow elements are taken into account, the de facto ACA ceiling of the other IFIs is approximately 10-11 years.

9. A table comparing IFAD's and other IFIs' resource management structures is provided in the annex.

III. Extension of IFAD's ACA ceiling

10. The financial scenarios presented at this Consultation session in document REPL.VIII/3/R.5[1] are based on a measured approach in the use of IFAD's enhanced capacity to deliver a larger volume and higher quality programme of work. An extension of ACA from the current five years (see paragraph 3) to seven years will allow for a balance between internal funding and external funding, comparable to that of the Seventh Replenishment. The following are the three scenarios presented in the above document:

- **Higher scenario:** The total programme of work would be US$3.3 billion and Member State contributions would be US$1.5 billion.
- **Base scenario:** The total programme of work would be US$3.0 billion and Member State contributions would be US$1.2 billion.
- **Lower scenario:** The total programme of work would be US$2.8 billion and Member State contributions would be US$1.0 billion.

11. It should be noted that extending the ACA ceiling to seven years of future loan reflows is significantly more prudent than the practice adopted by other IFIs, whose de facto ACA ceiling is 10-11 years. Furthermore, an extension to seven years will not affect IFAD's ability to maintain sound financial management of its resources; nor will it have an impact on the Fund's capacity to fulfil future financial obligations, as measured by the various indicators of financial soundness shown in the following table.

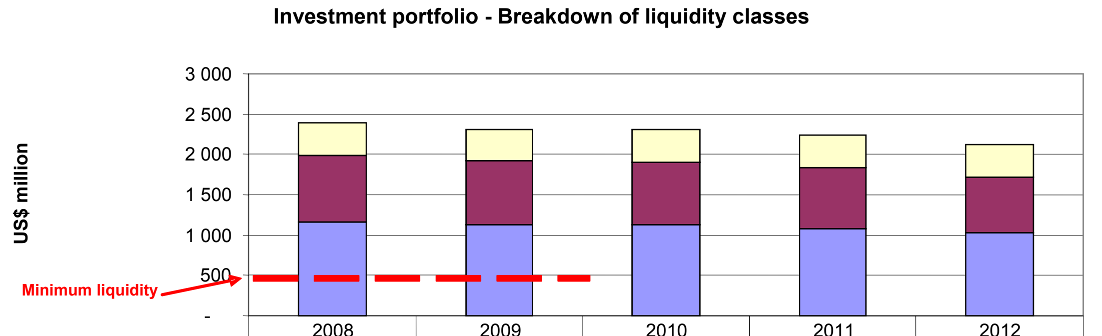
[1] "IFAD's Eighth Replenishment – financial scenarios"

Financial soundness indicators

	Eighth Replenishment level		
	Lower scenario	*Base scenario*	*Higher scenario*
Projected scenario indicators			
Average annual programme of work (US$ million)	933	1 000	1 100
Investment portfolio balance at the end of Eighth Replenishment period (US$ million)	1 994	2 118	2 309
ACA usage (number of years of future loan reflows)	6.8	6.8	6.8
Financial soundness indicators (as at end of Eighth Replenishment period)			
ACA usage versus total assets (percentage)	29	28	28
Investment portfolio versus total assets (percentage)	25	26	27
Investment portfolio versus disbursements (years)	2.6	2.7	2.8

12. Highly liquid assets in IFAD's investment portfolio as at 31 December 2007 amounted to US$1.3 billion, which comfortably meets the minimum liquidity requirement of US$0.4 billion under the current liquidity policy. As shown in the following chart, at the end of the Eighth Replenishment, the level of highly liquid assets, in the base scenario, are estimated to be US$1.0 billion, compared with a projected minimum requirement of approximately US$0.6 billion.[2] Similarly the lower and higher scenarios comfortably comply with the current liquidity policy principle at any given time during the Eighth Replenishment period.

Investment portfolio breakdown



	2008	2009	2010	2011	2012
Partially liquid assets	400	400	400	400	400
Fairly liquid assets	833	792	790	751	691
Highly liquid assets	1 161	1 123	1 121	1 084	1 027

13. IFAD's investment portfolio, which amounts to US$2.5 billion (as at 31 December 2007), is fully committed for the disbursement of loans and grants already approved by the Executive Board. The investment portfolio will decrease only slightly to US$2.3 billion by the end of the Eighth Replenishment as per the higher scenario

[2] This projected minimum liquidity level of US$0.6 billion is based on the assumption that the same minimum liquidity principles for the Seventh Replenishment will be applied to the Eighth Replenishment. IFAD's liquidity policy is to be reviewed at the end of the Seventh Replenishment for the Eighth Replenishment period to reflect the evolving financial risk profile.

and to slightly lower levels in the base and lower scenarios, depending on the timing of outflows and inflows, especially the receipt of Member State contributions.

14. The current level of the investment portfolio represents 4.5 times the level of current annual disbursements. The projected investment portfolio of US$2.1 billion at the end of the Eighth Replenishment period in the base scenario would cover nearly three years of disbursement needs (see table above).

15. The high liquidity and overall size of the investment portfolio will ensure that IFAD continues to be in a position to meet all its financial disbursement requirements throughout the Eighth Replenishment period with an ACA ceiling of seven years.

IV. Conclusions

16. Extending the ACA ceiling will not affect IFAD’s capacity to fulfil future financial obligations. The Fund’s financial structure is very sound and is projected to remain solid over the Eighth Replenishment period. This sound financial structure will enable IFAD to meet the larger disbursement needs deriving from a larger programme of work level during the Eighth Replenishment period.

17. As discussed, IFAD’s practice in the use of ACA is substantially more prudent than that of other IFIs. Moreover, IFAD’s liquidity policy serves as a funding backstop to meet all financial obligations, including unforeseen needs. Thus, with an extended ACA to seven years, IFAD financial health is projected to remain very sound throughout the Eighth Replenishment period as already indicated in the above table and chart.

Comparison of IFAD and other IFI resource management structures[1]

Committable resources include:	*IFAD*	*Other IFIs (IDA, AfDF, AsDF)*
A. Member State contributions	YES (instruments of contributions receivables are excluded)	YES (instruments of contributions receivables are included)
B. Cash and investments	YES	YES
C. Loan reflows of the current year	YES	YES
D. Loan reflows of future years		
- What basis used?	ACA concept	ALM framework
- How many years into the future?	Maximum five years (currently authorized ACA ceiling)	An average of ten years (in line with the related disbursement duration)
- Subject to any other constraints?	Liquidity policy	Liquidity policy
E. Income transfer from mother bank	NO	YES

[1] IFAD matches currently committable resources and new commitments for each replenishment while other IFIs match cash inflows and outflows over the related disbursement duration.