

Document: PBAS 2021/15/W.P.2
Date: 25 January 2021
Distribution: Public
Original: English

E



Minutes of the Fourteenth Meeting of the Working Group on the Performance-Based Allocation System

Note to PBAS Working Group members

Focal points:

Technical questions:

Thomas Eriksson
Director
Operational Policy and Results Division
Tel.: + 39 06 5459 2425
e-mail: t.eriksson@ifad.org

Luis Jiménez-McInnis
Secretary of IFAD
Tel.: +39 06 5459 2254
e-mail: l.jimenez-mcinnis@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and
Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Working Group on the Performance-Based Allocation System –
Fourteenth Meeting

Rome, 15 December 2020

For: Approval

Minutes of the Fourteenth Meeting of the Working Group on the Performance-Based Allocation System

1. The discussions at the fourteenth meeting of the Working Group on the Performance-Based Allocation System (PBAS) held on 15 December 2020 are summarized in this document.

Agenda item 1: Opening of the meeting

2. The meeting was attended by Working Group members from Angola, Canada, Dominican Republic, Japan, Nigeria (Chair), the Republic of Korea, Switzerland and the Bolivarian Republic of Venezuela. Executive Board observers from Bangladesh, China, Germany, Mexico and the United States were also in attendance. Management was represented by the Associate Vice-President, Programme Management Department; the Associate Vice-President, Financial Operations Department; the Director, Operational Policy and Results Division; the Director, Financial Management Services Division; the Treasurer; the Director, Office of Enterprise Risk Management; the Secretary of IFAD; and other IFAD staff.

Agenda item 2: Adoption of the agenda

3. The provisional agenda contained the following items: (i) opening of the meeting; (ii) adoption of the agenda; (iii) Borrowed Resources Access Mechanism (BRAM); (iv) dates for PBAS Working group meetings in 2021; and (v) other business.
4. Members adopted the provisional agenda as proposed.

Agenda item 3: Borrowed Resources Access Mechanism

5. Management began its presentation by pointing out the nexus between the Integrated Borrowing Framework (IBF), approved by the Executive Board at its 131st session in December, and the BRAM. The IBF would pave the way for IFAD to leverage core resources to pursue its mandate by ensuring the supply of borrowed funds – the main source of the BRAM – to the programme of loans and grants (PoLG). Management also reminded the Working Group of the important role it played in formalizing the BRAM.
6. Management delivered a presentation and described how the BRAM proposal would work, including elements agreed upon to date; country selectivity criteria for the Twelfth Replenishment of IFAD's Resource (IFAD12); the process for countries to access BRAM resources; and financing conditions for BRAM resources.
7. Elements on which agreement had already been reached included: maintaining the IFAD11 PBAS formula for IFAD12; allocating 100 per cent of core resources to low-income countries(LICs)/lower-middle-income countries (LMICs) and 11 to 20 per cent of PoLG to upper-middle-income countries (UMICs), in line with the graduation discussion paper; that the BRAM would be accessible to creditworthy countries; the determination of risk-based ceilings for countries accessing BRAM, while also keeping the maximum 5 per cent of PoLG accessible to any given country; the confirmation that BRAM would be demand-based and predictable (not first come, first served); and the inclusion of some additional borrowers in BRAM, especially those who borrowed in IFAD10. Members were also reassured that all IFAD-financed projects would be in line with IFAD's mandate and development effectiveness principles, regardless of the source of financing.
8. Management then provided an overview of the BRAM review process and expected next steps, which would culminate in the Audit Committee and Executive Board discussions and potential approval by the Executive Board in April 2021. This brought the discussion towards the issues Management sought Working Group agreement on, some of which had been raised at the group's previous meeting in October. These were the selectivity criteria for IFAD12

- countries; the process for accessing BRAM resources; and differentiation of financing conditions for BRAM resources.
9. Management proposed to maintain the IFAD11 selectivity criteria and apply them also in IFAD12. The criteria were based on strategic focus (countries having a valid country strategic opportunities programme/country strategy note); ownership (no projects already approved by the Board have been pending counterpart signature for more than 12 months); and absorption capacity (effective operations are disbursing).
 10. Management then elaborated on the operational process to access BRAM funding, explaining that the process would be articulated around three phases: availability and eligibility; demand management; and design and delivery. In response to members' request at the last meeting, Management also outlined divisional responsibilities for the various parts of the process. Management described the determination of risk-based limits and prioritization among BRAM eligible countries.
 11. Regarding availability and eligibility, Management explained that IFAD12 countries would undergo an eligibility assessment based on creditworthiness and country capacity to absorb additional debt, to be carried out by the Financial Management Services Division. Countries with risk of debt distress at moderate level or better could access borrowed resources following due process; countries at high risk or in debt distress would not be eligible. Regarding the following step in the process – the determination of risk-based country limits to ensure portfolio quality – the Office of Enterprise Risk Management would lead the assessment. Treasury would in turn determine the size of the BRAM envelope. As discussed in the last meeting, this would be based on the resources available for commitment.
 12. In terms of the second step, demand management, the Programme Management Department would liaise with BRAM eligible partner countries to communicate eligibility and ensure interest in accessing BRAM resources. The following step focused on the prioritization of countries that access BRAM resources. The last steps would be the design of BRAM-financed projects and programmes in line with IFAD's current procedures and approval by IFAD's Executive Board.
 13. Management focused on two aspects in which members had expressed special interest: the setting of risk-based limits and the country prioritization process. Regarding risk-based country limits, Management emphasized the importance of the application of rigorous risk management practices under the new financial architecture, especially when dealing with borrowed resources. The risk management approach regarding BRAM would be based on two core principles: (i) the aggregation of exposure by countries (regardless of funding sources and allocation mechanisms); and (ii) the utilization of specific exposure management criteria to reassure lenders and rating agencies that IFAD operated within best practices and used sound risk management approaches, the most notable being the introduction of country limits to help determine the maximum possible exposure by country.
 14. In addition, Management explained, that in line with best practices in safe and sound management of risk exposures, access to borrowed resources by each country would thus need to take into consideration the country's individual creditworthiness and other risk parameters such as its capital consumption. Loan portfolio concentration and the loan portfolio credit quality would also be considered. The appropriate analysis and monitoring of these factors would be assured by the Office of Enterprise Risk Management.
 15. With regard to country prioritization, Management explained that this would take place at country level instead of project level if demand for borrowed resources outstripped supply. The criteria used would include elements of the needs component of the PBAS formula, which included variables such as gross national income per capita, rural population and the IFAD Vulnerability Index. Additional

elements would be a country's fragility classification, and portfolio performance. In undertaking the prioritization, Management reassured members that all relevant IFAD12 commitments would be taken into account.

16. Management then moved to the third part of the discussion, which centred on the differentiation of financing conditions. Management stated that the guiding principles of the financing conditions for BRAM resources would be in line with pillar 2 of the graduation discussion paper. It was highlighted that pricing would ensure financial sustainability for IFAD and borrowers and that there would be no subsidization from core resources. Management explained that the pricing differentiation in the financing conditions would continue to be based on countries' economic trajectories, as already introduced in 2019.
17. Furthermore, Management noted that there were currently four different categories to distinguish countries in terms of their economic trajectories. These were being explored with members to further refine those categories to better reflect the graduation principles, and also to introduce a new category for the LICs/LMICs that were currently not accessing ordinary term borrowing, to allow them to access BRAM resources at a lower pricing level than higher-income countries, but ensuring cost recovery for IFAD. Management then explained how the other three country categories (LMICs already accessing ordinary term financing, UMICs below the graduation discussion income (GDI) threshold, and UMICs above the GDI threshold) would have progressively increasing premiums. Therefore the differentiation would accommodate lower pricing for the LICs and effectively mean that the higher-income countries would pay a small premium on top of the overall cost of IFAD's borrowing.
18. Management indicated that the approach, including guidance received from the Working Group, would be outlined in greater detail in the BRAM paper, which would be shared with Member States in January 2021. Management invited Member States interested in contributing further to the paper to do so by continuing discussions bilaterally.
19. After Management's presentation, the Working Group discussed specific aspects of the functioning of the BRAM and the pricing associated with BRAM resources.

Demand management and country prioritization

20. Several members enquired how projects would be prioritized and asked for more details regarding the variables that would be utilized in this process. The importance of avoiding subjectivity and keeping criteria constant over time was emphasized. Clarification was also sought on what weight each prioritization criterion would have, how these would be applied and whether there was an associated formula.
21. Management emphasized that IFAD was not proposing a formula for governing access to BRAM. Eligibility would depend on creditworthiness and country limits on risk considerations. Then, a set of criteria would help prioritize among countries when needed, reflecting both countries' needs and their performance; a specific weight would not be attributed to each criterion. Criteria would include factors such as fragility and portfolio performance. Evidence-based support would guide prioritization and ensure that IFAD12 commitments were respected and that IFAD maintained its focus on countries most in need. Moreover, the criteria would not change over time. It was clarified also that there was no formula associated with the prioritization criteria, nor with determining country ceilings. Management noted that analyses from previous replenishment cycles showed that not all countries utilized resources at the same time but that the uptake was usually smooth across the three years of the replenishment, which would help in managing demand and supply.
22. Management reminded the Working Group that IFAD12 commitments applied to all resources, including BRAM. Lastly, Management stressed that BRAM would be a demand-based mechanism and that IFAD would monitor whether there was

more demand than supply. The prioritization would allow IFAD to honour IFAD12 commitments in a transparent and predictable manner.

Pricing of BRAM resources

23. Most members expressed support for the differentiated pricing. Some asked for further details on how IFAD would ensure that it was able to offer competitive pricing, compared with bond issuances (including what premiums would be applied) and how it would assess what was a reasonable cost to the organization that would enable it to onlend at semi-concessional pricing while ensuring recovery of its own average portfolio costs.
24. Management noted that borrowed resources required different pricing from the pricing currently in place. This would allow LICs and LMICs on more concessional lending terms to access semi-concessional pricing, which had not been the case up to now. This was why different pricing categories were needed. Setting IFAD's own pricing methodology was a complex exercise that IFAD would undertake towards the end of IFAD12 or in IFAD13, once it had more certainty over volumes and about the prices at which it could borrow from private investors. Therefore in this first phase, IFAD's proposal was to maintain a pricing system as similar as possible to that now in place, i.e. which pegs to the International Bank for Reconstruction and Development principles, while proposing that LICs pay slightly less and UMICs above the GDI threshold pay slightly more for borrowed resources.
25. Another main change would be that UMICs would no longer have access to very concessional pricing for longer average loan durations; and that the concept of commitment fees and upfront fees would be introduced, in order to ensure that IFAD matched the costs that it incurred.

Risk-based country limits

26. A question was asked about the interaction between country eligibility and country limits and whether all countries would have a limit for accessing BRAM. In addition, members wished to know what would be the "ideal" or expected credit rating for countries to access borrowed resources and which formula would be used to determine the amounts accessed by countries.
27. Management highlighted that countries' credit ratings did not drive access to BRAM. They were, in fact, a way to calculate the average capital consumption of each country, which would ultimately have an effect on individual country limits. It was clarified that there was no "ideal" credit rating to access BRAM, rather the link between eligibility and country limits was that as long as a country was eligible, it would have a ceiling. If the country was not eligible due to its debt situation, then the limit was zero and it would not be able to access BRAM.
28. Moreover, Management explained that monitoring the quality of the portfolio as a whole was important for the capital planning moving forward, and that credit ratings were key to assessing capital utilization. Management reminded the Working Group that in 2019 IFAD had started operating under a Capital Adequacy Framework that determined country limits so as to remain within a prudent capital exposure. While all countries would have a limit, there would be no specific formula but rather a constant monitoring of the capital consumption. In managing BRAM, IFAD would aim at maintaining the quality of its current portfolio of ordinary term loans. Management also explained that the Fund's portfolio level would be monitored and maintained at a comfortable level. Given that borrowed resources had to be supported by capital, consumption of capital was calculated every six months with findings reported to both the Executive Board and the Audit Committee.

Why BRAM is needed

29. While noting their support for setting up BRAM, additional information was requested on why PBAS could not be adjusted to embed risk criteria so that IFAD could keep a single mechanism for all resources.
30. Management explained that embedding risk considerations into a PBAS-type formula would imply detaching from best practices and from what peer international financial institutions did. It was further explained that (i) the PBAS did not allocate enough resources to countries borrowing on ordinary terms. This implied a mismatch between ordinary term allocations and borrowed funds, and pointed to the need to allocate resources to countries at less concessional terms than those terms applicable for core resources; (ii) using a PBAS-type formula would give the impression of certainty since allocations were perceived by countries as entitlements whereas borrowed resources would depend on the actual level of borrowing; (iii) having two mechanisms would help separate core resources from borrowed resources, and reassure members about the commitment of providing 100 per cent of core resources to LICs/LMICs; (iv) UMICs would get a fixed amount of resources rather than allowing flexibility based on demand, within a range 11 to 20 per cent PoLG as per commitments made.

Additional issues raised

31. Regarding the possibility of considering regional projects under the BRAM, Management replied that, in principle, these would be possible but that the process would be complicated. Management would benefit from lessons learned from the first two regional operations, recently approved by the Board, and in light of this experience would consider extending the possibility to BRAM.
32. In response to a request for clarification, Management confirmed that the Investment and Finance Advisory Committee was an internal body and would have an active oversight role in the BRAM process.

Agenda item 4: Dates for PBAS Working Group meetings in 2021

33. Members agreed to the dates as proposed by Management, including the additional meeting proposed for 28 January, with the understanding that meetings would be convened only if deemed necessary.

Agenda item 5: Other business

34. No items under other business were raised and the meeting was adjourned.