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

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

Rome, 12 January 2022

For: Information

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

1. The discussions at the seventeenth meeting of the Working Group on the Performance-Based Allocation System (PBAS) held virtually on 12 January 2022 are summarized in this document.

Agenda item 1: Opening of the meeting

2. The Chairperson welcomed participants and members of IFAD Management to the meeting.

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) scenarios for PBAS and the Borrowed Resource Access Mechanism (BRAM) for IFAD12; and (iv) other business.
4. No items were proposed for consideration under other business and members adopted the provisional agenda as proposed.

Agenda item 3: Scenarios for PBAS and BRAM for IFAD12

5. Two scenarios were presented for the Working Group's consideration: a base case scenario and a Management-proposed scenario, which sought to address the constraints encountered in the base case. The Management option was considered effective in reducing the severity of the country-level changes in resource allocations between the Eleventh Replenishment of IFAD's Resources (IFAD11) and IFAD12. Members thanked Management for the information provided, and expressed appreciation for Management's efforts to find a balance between financial sustainability and the interests of the poorest countries, and provide a broader view of IFAD financing, encompassing both PBAS and BRAM resources. Recognizing that the document presented the two resource allocation mechanisms in a comprehensive and integrated manner, members took note that the distribution of the aggregated resources presented therein remained indicative and would depend on the availability of core resources for PBAS and the actual demand for borrowed resources for BRAM.
6. Members expressed some concerns about the distribution of resources resulting from the Management option, but acknowledged that this was what could be achieved given the structural constraints resulting from reduced core resource availability. In particular, the significant reduction in resources to DSF countries was noted, although it was acknowledged that the IFAD11 cycle had been financially unsustainable and that IFAD12 had been planned in line with newly adopted policies to ensure IFAD's long-term financial sustainability.
7. Specifically, some members expressed uneasiness about moving away from the strictly rule-based approach that formed the basis of agreed PBAS and BRAM methodologies to an ad hoc approach. Management clarified that in developing the Management option, methodological soundness had been ensured and that its associated risks were linked to factors beyond IFAD's control, namely the availability of core resources and the demand for borrowed resources.
8. Members and Management concurred on the importance of ensuring that IFAD maintained its relevance for the poorest countries while at the same time achieving financial sustainability. Members recognized that this was the first time a dual mechanism was being used to finance the programme of loans and grants, and a shift in thinking from PBAS resources towards overall resourcing was required. Management reiterated that the introduction of the BRAM would not entail mission drift by IFAD, and that in terms of the IFAD12 commitments, IFAD would have, for the first time, 100 per cent of its core resources allocated to low-income countries (LICs) and lower-middle-income countries (LMICs). It was also noted that although the borrowed resources would not be allocated through the PBAS, they would be

subject to the same principles and requirements as core resources in terms of development effectiveness, as BRAM-financed projects would undergo established IFAD design and quality assurance processes.

9. Management re-emphasized that IFAD's objective was to continue providing DSF grant resources to countries that were experiencing high levels of debt or were "in debt distress". The offer would be conditional on the level of replenishment achieved and the related sustainable grant capacity of IFAD.
10. Members enquired about IFAD's engagement with BRAM-eligible LICs and LMICs in order to assess demand for borrowed resources. Management explained that in 2020 IFAD had reached out to 70 partner countries to explore their initial interest in the possibility of accessing resources under the financing conditions of the BRAM. About 60 per cent of the responses received were positive. In 2021, IFAD reached out to all eligible countries through an official letter requesting a formal expression of demand. Since then, integrated teams from the Financial Operations Department, the Operational Policy and Results Division and the Office of Enterprise Risk Management were in discussion with BRAM-eligible countries, and countries were being briefed on the BRAM's principles and criteria. So far, IFAD had received encouraging responses, but it was noted that demand for borrowed resources would only be truly understood over the duration of the IFAD12 cycle. This would allow Management to further fine-tune its approach moving forward.
11. Members asked how other international financial institutions (IFIs) addressed structural problems, and whether they faced similar challenges to those encountered by IFAD. Management explained that other IFIs had different financing structures as they had multiple funding windows in addition to the core concessional financing distributed through their performance-based systems. While acknowledging that IFAD had limited experience with multiple financing windows as the BRAM was only just being introduced, Management expressed its willingness to engage with its partner institutions and learn from their experiences.
12. At the request of one member, Management also provided further information on the average BB credit rating of the BRAM portfolio. It was noted that the Fund's credit rating depended on the amount of capital, support from Member States and the credit quality of the overall portfolio (both PBAS and BRAM). Management confirmed that there had been a declining trend in the credit quality of the overall IFAD portfolio in recent years due to several downgrades in the credit rating of recipient countries. Therefore, maintaining a BRAM portfolio credit rating equivalent to BB was fundamental to compensate for a riskier PBAS portfolio, as was ensuring that the average credit rating remained at the level of past years and was aligned with rating agencies' and investors' expectations.
13. Members and Management agreed that further analysis was required in the preparation for IFAD13, based on the learning derived from applying these two resource windows in IFAD12, in order to ensure a structured rule-based approach to financing, which balanced significant financing for the poorest countries with the need to maintain financial sustainability.
14. In answer to members' questions, Management explained how the PBAS reserve worked under the Management option. The reserve would be created as a result of capping the PBAS country allocations on the basis of an assessment of absorption capacity. This reserve would then be set aside and used to lessen the reduction in resources between IFAD11 and IFAD12 for LICs and LMICs.
15. A member enquired about a number of DSF countries that would experience an increase in the financial offer under IFAD12 according to Management's proposed scenario. Management explained that this was a result of capping the allocation for Afghanistan, a DSF country, and redistributing the amount derived to the remaining DSF countries through the PBAS formula.

16. In reply to a question by an observer, Management reiterated its commitment to meeting the ambitious cofinancing target for IFAD12, through collaboration with domestic and international partners such as the World Bank, the Asian Development Bank, the Global Environment Facility, the Global Agriculture and Food Security Program and other bilateral development partners.
17. An observer also asked whether, in the development of the proposed scenarios, Management had taken into consideration the effect of rising inflation. Management confirmed that this had been considered, and that a mechanism was envisioned to continue supporting countries that were encountering potential debt aggravation.
18. Consensus was reached that the proposed Management option should be presented for approval to a special session of the Executive Board on Friday, 4 February 2022. Members appreciated the transparency and clarity of the analysis provided by Management, the methodological soundness, and the candid discussion of the structural constraints and their impact on resource availability.

Agenda item 4: Other business

19. The Secretary informed the Working Group that invitations to the special session of the Executive Board scheduled for 4 February would be issued shortly.
20. No other items were raised under other business and the meeting was adjourned.