

Update on ADF-13 Financing Framework

Discussion Paper

ADF-13 Mid-term Review
11-13, November 2015
Abidjan, Cote d'Ivoire



AFRICAN DEVELOPMENT FUND

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Abbreviations

ACA	Advance Commitment Authority
ACC	Advance Commitment Capacity
ADF	African Development Fund
AfDB	African Development Bank
DSF	Debt Sustainability Framework
MDRI	Multilateral Debt Relief Initiative
UA	Unit of Account

Key messages

- 1) *Whereas significant payments pertaining to previous replenishments have been received by the Fund, delays in the subscriptions and payments to ADF-13 constrain its commitment capacity. Every UA pledged by Donors that does not materialize into a fully paid subscription is a UA that will not be committed to finance development projects in Africa. Delays in payment and encashment of subscriptions beyond what was assumed in the calculation of ADF-13's ACC reduce the Fund's liquidity and thus internally generated resources.*
- 2) *Should the core assumptions of the ACC model remain in line with what was considered for ADF-13, the level of internally generated resources should remain stable over the next two replenishments and increase markedly from ADF-16, reflecting the measures introduced in ADF-13 to strengthen the Fund's financial capacity.*
- 3) *The ACC model will be recalculated for the new replenishment cycle, ADF-14, and will reflect any deviation between expected versus actual cash flows received by the Fund during ADF-13.*

1. Introduction

- 1.1. This document provides an update on the ADF-13 Financing Framework for the purpose of its Mid-Term Review. Section II reviews the resources provided by Donors to the replenishment. Section III discusses internally generated resources, in particular, the Advance Commitment Capacity (ACC), its historical evolution and potential level in future replenishments under certain conditions. Finally, section IV presents Management's conclusions and recommendations.

2. Analysis of the Financing Framework of ADF-13

Subscriptions and Payments from Donors

Subscriptions

- 2.1 The thirteenth replenishment of the Fund, covering the period 2014-2016, was adopted by the Board of Governors on 31 January 2014. State participants agreed on an ADF-13 resource level of UA 5,345 million including (i) donor subscriptions of UA 3,789 million, (ii) supplementary contributions of UA 56 million and (iii) an Advance Commitment Capacity of UA 976 million. In view of the specific circumstances of the replenishment, and in order to maximize the contributions from certain donors, it was agreed to cap the technical gap¹ at UA 524 million or 12.00% of the replenishment level.
- 2.2 Annex I presents the subscriptions received from State participants and Donors to ADF-13, as of 15 September 2015. It is relevant to note that there have been some delays in subscriptions (UA 43.37 million), as a few countries have not yet been able to fulfil their pledges and subscribe to the replenishment.
- 2.3 Brazil's pledge of UA 10.27 million has not yet been formalized due to changes at the Ministry of planning, budget and management. Libya's subscription of UA 24.53 million has been delayed due to the political and civil unrest affecting the country. Portugal indicated that its subscription of UA 8.58 million will be delayed until the end of the economic adjustment program and Spain did not submit a pledge during the replenishment meetings, but is still considering subscribing to ADF-13.
- 2.4 Sweden informed the Fund on 22 May 2015 that, due to unexpected constraints impacting the Government's international aid budget, it would not be in a position to pursue its potential supplementary contribution (UA 40.68 million) in 2015. Switzerland is expected to confirm its supplementary subscription (UA 15 million) at the forthcoming Mid-Term Review. However,

¹ The technical gap represents the difference between the target replenishment amount and the amount pledged by Donors.

should the delayed donor subscriptions not be received, and the supplementary contributions not confirmed to the Fund during the 3-year replenishment cycle, the replenishment's technical gap will increase to 14.01%, well above the agreed 12% target level.

Payments

- 2.5 As of 15 September 2015, the Fund had received payments amounting to UA 2,235 million, representing 88% of the expected payments² for the years 2014-2015. The difference between paid and expected amounts is explained by (i) optional payment arrangements between some State participants and the Fund³, and by (ii) payment delays⁴. The Fund is still expecting the remaining amount of the U.S.'s first instalment (UA 12.2 million) and the full second instalment (UA 128.66 million), and has sought guidance from the Authorities with regards to the potential timing of their payment.

Encashments

- 2.6 The encashment of subscriptions to ADF-13 is occurring in line with expectations. As of 15 September 2015, the Fund had received or encashed a total of UA 979.11 million, representing 26% of the subscriptions received up to that date⁵. Seven countries, with subscriptions totalling UA 959 million (26% of the subscribed amount), have taken advantage of the accelerated encashment framework using the credits earned by this process to (i) increase their contributions and burden share in the replenishment (Canada, Denmark, France and Finland), (ii) pay a discounted amount on their subscription while maintaining their burden share (Belgium), (iii) reduce ADF-13's technical gap (China), and (iv) pay for other commitments to the Fund (Saudi Arabia for MDRI compensation).
- 2.7 It is important to highlight that no country opted for the "four-year" standard encashment calendar, which had been introduced to increase the Commitment Capacity of the Fund for ADF-13 and subsequent replenishments⁶.

Resources carried over from previous replenishments

- 2.8 An amount of UA 377.71 million related to qualified or late subscriptions from previous replenishments was carried over into ADF-13, as well as UA 173.22 million pertaining to commitment capacity available at the end of the ADF-12 replenishment cycle as shown in Table 1.

Table 1: Carry-over resources into ADF-13

Resources Carried Over	ADF-3	ADF-8	ADF-9	ADF-10	ADF-11	ADF-12	Total
Qualified Subscriptions	7.02	0.16	23.28	2.55	-	315.14	348.15
Late subscriptions						29.56	29.56
Unutilized commitment capacity						173.22	173.22
Total	7.02	0.16	23.28	2.55	-	517.92	550.93

Qualified subscriptions

- 2.9 The amount shown under qualified subscriptions in table 1 was comprised of (i) UA 16.79 million from Argentina's subscriptions to ADF-3 and ADF-12, (ii) UA 108.43 million from

² Expected payments amount to UA 2,530 million. This value is determined assuming that all State participants that have subscribed to the replenishment will pay their subscriptions in strict accordance with the standard payment dates outlined on paragraph 6a) of the Resolution, i.e. in 15 January 2014, 2015 and 2016.

³ In some instances, State participant's budgetary cycles do not coincide with the calendar year. This has meant that they cannot comply with the standard payment dates of the Resolution. Instead, they agree with the Fund on paying their instalments later in the year. Other State participants have taken advantage of the accelerated encashment framework and are following asymmetrical, staggered payment calendars.

⁴ The United States was only able to subscribe to ADF-13 during the first quarter of 2015, making a payment of UA 116.46 million towards its subscription of UA 385.97 million.

⁵ ADF-13's standard encashment calendar covers the period 2014 to 2023.

⁶ "ADF-13 Financing Framework and Capacity", Second Replenishment Meeting, June 2013, Tunis.

Spain's subscription to ADF-12 and (iii) UA 222.92 million from the United States' subscriptions to ADF-8, ADF-9, ADF-10 and ADF-12.

- 2.10 During the fourth quarter of 2014, Spain made a payment of UA 71.24 million, leaving an outstanding amount of UA 37.19 million under its subscription to ADF-12. The United States also made a payment of UA 114.87 million towards its subscription to ADF-12 leaving an outstanding amount of UA 82.06 million. Thus, as of 15 September 2015, a total of UA 186.10 million pertaining to previously qualified subscriptions and the full amount of ADF-12 unused commitment capacity (UA 173.22 million) has been made available to the ADF-13 replenishment.

Late subscriptions

- 2.11 On 27 November 2013 the Fund received a late subscription from Portugal for ADF-12 amounting to UA 29.56 million, which could not be used under the ADF-12 period. This subscription has been carried over into ADF-13, and payments will start in February 2016.

Contingency for qualified and late subscriptions

- 2.12 In order to protect the ADF from over-committing its resources, and to ensure that only the portion of resources expected to be available during the replenishment period are effectively allocated to countries, the Fund set aside a contingency for qualified and late subscriptions. To determine this contingency, an analysis was performed on State participants' historical payment patterns over the previous three replenishments, and the feedback, if any, on potential timing of the payment of qualified subscriptions was taken into account.
- 2.13 The contingency for qualified and late subscriptions was set to UA 362 million in 2014, incorporating information from both the amount of carry-over resources that was not expected to become available during ADF-13, and on subscriptions that would not be received and/or fully paid during the new replenishment cycle.
- 2.14 The receipt of qualified and late subscriptions has been in-line with expectations, which has resulted in a reduction of the amount of carry-over resources from the UA 377.71 million estimated at the end of ADF-12 to the current UA 162.03 million. However, and as noted in paragraphs 2.8 to 2.11, there have been some delays in subscriptions and payments to ADF-13. These delays justified setting the contingency in 2015 at UA 266 million.

Compensation for foregone principal reflows due to grants

- 2.15 In order to mitigate the reduction of future reflows resulting from increased grant financing, State participants have agreed, since ADF-9, to compensate the Fund for foregone reflows above 7.5% of the replenishment amount, as the reflows arise, using the "pay-as-you-go" approach. Each State participant's contribution to grant compensation is based on its normalized burden share for the corresponding replenishment.
- 2.16 In order to determine the indicative proportion of grants for the year, the Fund uses the outcome of the relevant Debt Sustainability Analysis (DSA)⁷. For ADF-13, the indicative proportion of grants was assumed to be 33.45%⁸. The actual amount of grants allocated under ADF-13 will depend on annual DSAs. As of 15 September 2015, the grant level in ADF-13 is 37.8% (see Annex II).
- 2.17 An amount of UA 4.9 million, representing the 2014 and 2015 compensation for grants extended during ADF-9 and ADF-10, has become due during ADF-13. As of 15 September 2015, fourteen State participants (out of twenty four) have paid their contributions for a total of UA 2.6 million (see Annex III). Six other State participants are following accelerated calendars, and the grant compensation amounts due during ADF-13 will be considered paid once the full subscription is encashed.

⁷ The joint World Bank–International Monetary Fund Debt Sustainability Framework (DSF), introduced in April 2005, is designed to guide the borrowing decisions of Low Income Countries in a way that matches their financing needs with their current and prospective repayment ability, taking into account each country's circumstances,

⁸ This is based on the level of grant financing estimated for the full ADF-12 cycle.

Compensation for foregone principal reflows due to the Multilateral Debt Relief Initiative (MDRI)

- 2.18 In addition to regular contributions to ADF replenishments, State participants are expected to make additional contributions to the MDRI. The MDRI compensation scheme started in 2006 to ensure that debt relief provided under the MDRI initiative would not affect the financial capacity of the Fund. Foregone reflows from loans cancelled through the MDRI are compensated by State participants, using the “pay-as-you-go” approach on a dollar-for-dollar basis.
- 2.19 The cost of the MDRI is revised at the beginning of each new replenishment cycle. The 2013 update revised the amount to UA 5.68 billion⁹, down from the previous estimate of UA 5.94 billion. As of 15 September 2015, 93% of the contributions due for the 2006-2015 period, amounting to UA 766.42 million, have been received by the Fund, with South Africa having fully paid its contribution upfront in 2006. The 7% outstanding represents Italy’s 2013-2015 contributions, a portion of the contribution due from the United States for the year 2012, as well as their entire contribution for the 2013-2015 period.
- 2.20 The MDRI faces a structural gap¹⁰ of UA 30.35 million for the 2017-2054 period, meaning that additional pledges and commitments from Donors will be required for the Fund to be fully compensated for debt cancelled under this initiative. Management will reach out to new ADF State participants to assess whether they will be willing and able to close the gap. Annex IV presents an overview of the MDRI payment situation.
- 2.21 The cash flow assumptions supporting the Advance Commitment Capacity of the Fund incorporate the timeliness of payment/encashment of MDRI contributions. Under the Advance Commitment Capacity for ADF-13, it was assumed that 91.1% of cash flows expected each year will be received on time while 7.2% will be received with a delay of 1-year (i.e. 98.3% recovery rate). As shown on Table 2, a recent analysis on the timeliness of MDRI payments showed that only 78% of payments to date had been received on time, with an additional 10% being received with a delay of one year. This change in timeliness has been driven by payment delays from two State participants, Italy and the United States.

Table 2: Timeliness of MDRI compensation

ADF-11	ADF-12	ADF-13	Update
84%	90%	98.3% (Including lag of 7.2%)	88% (Including lag of 10%)

3. Internally Generated Resources

Advance Commitment Capacity

- 3.1 The second source of financing for the Fund is its internally generated resources. These resources are made available to the replenishment based on the Advance Commitment Authority (ACA). The ACA estimates the level of the Advance Commitment Capacity (ACC) that could be generated sustainably from all funding sources other than State participant and donor subscriptions. It allows the Fund to make loan and grant commitments while relying on predictable future inflows such as those of loan repayments.
- 3.2 The ACA relies on prudent assumptions of future flows. Changes to the parameters of the model that occur during a replenishment period do not translate into immediate changes in the commitment capacity available during that replenishment. For example, changes in the

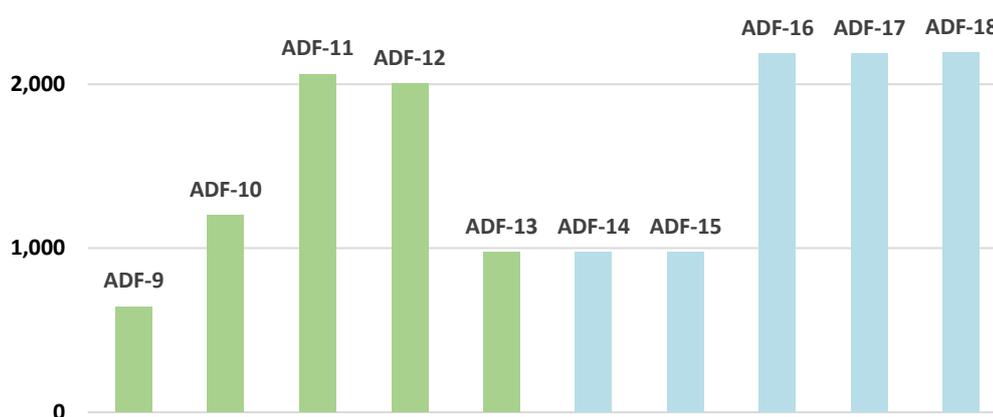
⁹ The MDRI covers the period 2006 - 2054.

¹⁰ When MDRI first became effective in 2006, ADF-10 normalized burden shares were used to determine the share of each donor’s cost. Austria substantially increased its contribution to ADF-10 (burden share of 1.65%), compared to ADF-9 (burden share of 0.98%) and therefore indicated that it could not use normalized burden share as its fair contribution to financing the cost of the initiative, hence the existence of a structural gap in MDRI. Austria has agreed, on a voluntary basis, to use the credit generated by the accelerated encashment of its ADF-11 subscription to cover a portion of the MDRI structural gap. This voluntary contribution covers the period 2006-2016 and a portion of 2017.

prevailing level of interest rates that differ from what was assumed during the determination of the ACC will not lead to its immediate revision. Rather, the ACA model is recalibrated at the beginning of each replenishment cycle to account for differences between estimated and actual cash flows and to determine the ACC level of the next replenishment.

- 3.3 During the negotiations of ADF-13, management proposed, and Deputies approved the introduction of certain measures to strengthen the Fund's financial capacity. These measures included (i) differentiation and hardening of lending terms, (ii) encouragement of graduation, (iii) accelerated repayment and voluntary pre-payment of ADF loans, and (iv) the introduction of innovative financial instruments.
- 3.4 The historical evolution and potential future levels of the ACC¹¹ is presented in Figure 1. Should all parameters remain in line with what was assumed for the calculation of ADF-13's ACC, its level should remain stable for the next two replenishments, as it is constrained in the near future by the Fund's liquidity position and past high levels of approvals. However, starting from ADF-16, the ACC level could increase significantly, reflecting the effect of the measures introduced in ADF-13 to boost the Fund's financial capacity.

**Figure 1: Historical evolution and projection of the ACC
(UA million)**



- 3.5 As mentioned on paragraph 3.2, the ACC model is recalibrated at the beginning of each ADF cycle. For ADF-14, the core assumption will be reviewed to reflect the then prevailing market conditions and observed parameters. Particular emphasis will be put on (i) the evolution of interest rates, (ii) the Fund's disbursement profile¹² and (iii) timeliness of payment of Grant and MDRI compensation.
- 3.6 With regards to the evolution of interest rates, and as shown on Annex V, since ADF-13's ACC was set, rates have dropped markedly in the main investment currencies of the Fund. In fact, during the first year of the replenishment, the ADF portfolio had a return of 1.61%¹³, below what was assumed for the ACC of 2.65%.
- 3.7 The ADF disbursement profile is currently under review to reflect changes in both the speed with which committed operations have been disbursing in recent years, the impact on disbursement of the new lending terms, and the split between regular operations and quick disbursing operations such as the Transition Support Facility.
- 3.8 As noted in paragraphs 2.17, 2.19 and 2.21, the Fund has experienced a certain level of payment delays in both the Grant compensation scheme and the MDRI, beyond what was assumed in the determination of the ADF-13 ACC. These will have to be analysed further in preparation for the next replenishment cycle, given their structural importance in the context of the Fund's cash flows.

¹¹ Projections made based on the assumptions used to calculate the ADF-13 ACC.

¹² The ADF disbursement profile is currently under review to take into account changes in both the speed with which committed operations have been disbursing in recent years, and the split between regular operations and quick disbursing operations.

¹³ These figures do not include the hedged returns of the ACE portfolios, used by the Fund to recoup discounts / credits offered to Donors that choose to accelerate the encashment of their subscriptions.

4. Conclusion and Recommendations

- 4.1 There have been some delays by State participants and Donors in subscriptions and payments to ADF-13. It is recommended that concerned State participants and Donors promptly fulfil outstanding obligations given that these delays constrain the Fund's commitment capacity, and thus the amount of loans and grants that it will be able to approve during the replenishment cycle.
- 4.2 Significant payments pertaining to previous replenishments have been received by the Fund. However, some qualified subscriptions are still outstanding. It is recommended that these outstanding payments are paid to the Fund so that additional resources could still be committed during ADF-13.
- 4.3 ADF-13 saw the introduction of several measures aimed at boosting the Fund's commitment capacity. Should the core assumptions of the ACC model remain in line with what was considered for ADF-13, the level of internally generated resources should remain stable over the next two replenishments and then increase significantly from ADF-16.
- 4.4 The ACC model will be recalculated for the new replenishment cycle, ADF-14, and will reflect any deviation between expected versus actual cash flows received by the Fund during ADF-13. The recalculation will also reflect the then prevailing level of interest rates, the update to the Fund's disbursement profile and re-assessment of the timeliness of payment of Grant and MDRI compensation.

Drafting and reviewing team composition

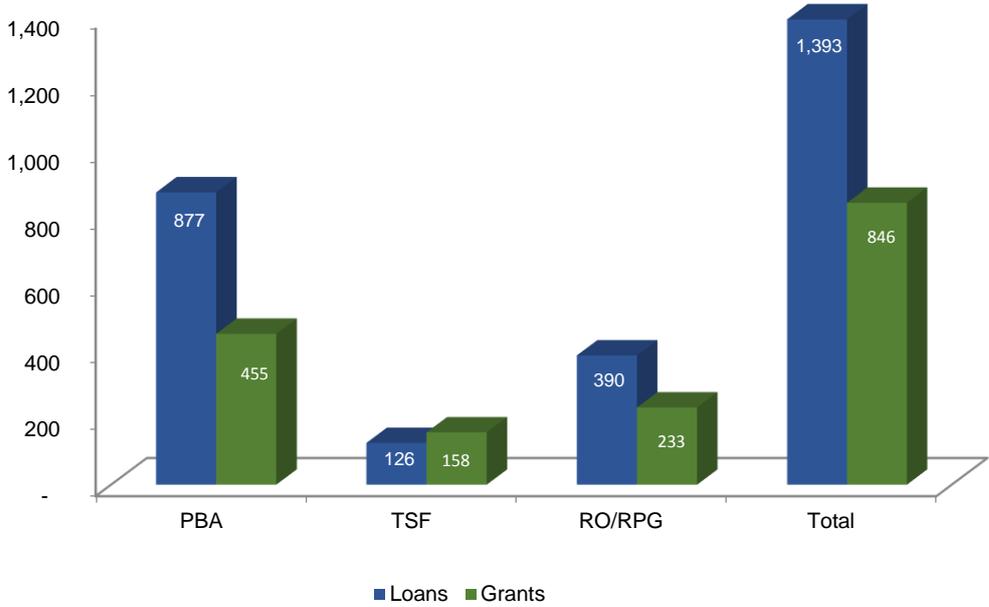
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Annex I: ADF-13 subscriptions received

Donor	ADF-13 Burden Share	Amount pledged (in UA million)	Amount subscribed (in UA million)	Amount paid (in UA million)	Balance (in UA million)
Austria	2.131%	93.10	93.10	62.07	31.03
Belgium	2.060%	90.00	90.00	55.66	34.35
Brazil	0.235%	10.27	-	-	-
Canada	4.909%	214.48	214.48	133.47	81.00
China	1.929%	84.28	84.28	84.28	-
Denmark	1.721%	75.17	75.17	26.41	48.76
Egypt	0.030%	1.33	1.33	0.88	0.44
Finland	2.504%	109.38	109.38	35.30	-
France	8.335%	364.17	364.17	227.30	136.87
Germany	9.217%	402.68	402.68	268.45	134.23
India	0.283%	12.36	12.36	8.24	4.12
Italy	4.631%	202.34	202.34	0.50	201.84
Japan	6.715%	293.38	293.38	195.58	97.79
Korea	1.317%	57.54	57.54	38.39	19.18
Kuwait	0.180%	7.86	7.86	7.86	-
Libya	0.516%	24.53			
Netherlands	3.813%	166.61	166.61	166.61	-
Norway	4.612%	201.52	201.52	134.35	67.17
Portugal	0.196%	8.58	-	-	-
Saudi Arabia	0.531%	23.20	23.20	23.20	-
South Africa	0.371%	16.20	16.20	16.20	-
Sweden	4.745%	207.30	207.30	138.41	69.10
Switzerland	3.000%	131.07	131.07	87.52	43.69
UK	13.997%	611.55	611.55	407.70	203.85
USA	8.834%	385.98	385.98	116.46	269.51
Total	86.857%	3,794.87	3,751.50	2,234.83	1,516.66

Annex II: Share of grants in relation to total ADF approvals (as of 15 September 2015)

UA million



Annex III: Payments received under the ADF-9 & ADF-10 grant compensation due during the ADF-13 replenishment period

State participant	Amount paid (In UA)
Austria	61,114
Belgium	Acceleration
Canada	Acceleration
China	Acceleration
Denmark	Acceleration
Finland	Acceleration
France	Acceleration
Germany	520,777
India	10,848
Italy	68,935
Japan	549,617
Korea	39,645
Kuwait	28,510
The Netherlands	230,641
Norway	220,667
Saudi Arabia	80,059
South Africa	20,141
Sweden	249,342
Switzerland	187,006
United Kingdom	342,845
Total	2,610,147

Annex IV: Overview of the MDRI payment situation

MDRI Participants		Burden share	2013 revised cost	Total Payment due (2006-2015)	Total payments received (2006-2015)	Total Advanced/ Excess payments received	Total payment expected (2016-2054)
1	AUSTRIA	1.650%	93,809,271	12,392,941	12,392,941		81,416,330
2	BELGIUM	2.154%	122,463,739	16,178,421	16,178,508		106,285,231
3	CANADA	6.253%	355,521,119	46,967,131	46,967,131	48,696,879	259,857,109
4	CHINA	2.282%	129,725,706	17,137,784	17,137,784		112,587,922
5	DENMARK	1.512%	85,944,081	11,353,888	11,353,888		74,590,194
6	FINLAND	2.084%	118,507,040	15,655,710	15,655,710		102,851,330
7	FRANCE	12.784%	726,843,177	96,021,689	96,021,689		630,821,488
8	GERMANY	9.185%	522,209,276	68,987,945	68,987,945		453,221,331
9	INDIA	0.242%	13,748,617	1,816,300	1,816,300		11,932,317
10	ITALY	5.558%	316,018,773	53,702,922	36,724,109		279,294,663
11	JAPAN	9.285%	527,899,456	69,739,662	69,739,662	11,687,623	446,472,171
12	KOREA	0.884%	50,246,985	7,572,406	7,572,406		42,674,579
13	KUWAIT	0.232%	13,193,784	1,743,002	1,743,002	11,381,693	69,088
14	THE NETHERLANDS	4.585%	260,715,487	34,442,563	34,442,563		226,272,925
15	NORWAY	4.919%	279,676,614	36,947,476	36,947,476		242,729,138
16	PORTUGAL	0.785%	44,654,029	5,899,148	5,899,148		38,754,881
17	SAUDI ARABIA	0.418%	23,788,179	3,142,605	3,142,605	2,365,847	18,279,726
18	SOUTH AFRICA	0.168%	9,562,362	1,541,600	1,541,600	8,020,762	-
19	SPAIN	3.057%	173,810,325	22,961,708	22,961,708	25,205,465	125,643,152
20	SWEDEN	5.558%	316,018,773	41,748,561	41,748,561		274,270,212
21	SWITZERLAND	3.567%	202,822,988	26,838,537	26,838,537	23,667,042	152,317,409
22	UNITED KINGDOM	10.422%	592,535,199	80,367,325	80,367,325		512,167,874
23	USA	11.773%	669,399,344	88,432,908	47,943,652		621,455,692
24	Structural Gap	0.643%	36,542,585	4,827,562	4,827,562	1,366,946	30,348,077
TOTAL		100.000%	5,685,656,908	766,419,795	708,951,814	132,392,257	4,844,312,836

Annex V: Evolution of interest rates since ADF-13's ACC was set

