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The ADF-13 Financing Framework

Discussion Paper

ADF-13 First Replenishment Meeting
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AFRICAN DEVELOPMENT FUND

Executive Summary

1. The Thirteenth Replenishment of the African Development Fund (ADF-13) takes place in challenging times, with countries both inside and outside Africa trying to adjust to the impact of various crises. The African Development Fund does not yet have the capacity to reasonably self-finance the current level of development assistance required for eligible regional member countries, and therefore relies heavily on contributions from donors who share the same development vision for a better Africa.

2. The expected resources for ADF-13 are the replenishment amount (subscriptions from donors including the technical gap), the internal resources of the Fund (based on the Advance Commitment Capacity), and funds carried over from previous replenishments. This financing framework paper analyzes the main financial variables that will determine the ultimate size of the resources of the Fund for 2014-2016.

3. The replenishment level should provide an accurate reflection of the amount that the Fund will be able to commit to new operations over the ADF-13 period. Consequently, Management recommends revising the technical gap back to 5.0% of the replenishment level, from 7.5% for ADF-12. Proposals related to the determination of the ADF-13 exchange rates are made in this paper, and the standard encashment schedule for ADF-13 is presented. Furthermore, to preserve the financial integrity of the Fund, Management proposes an accelerated encashment framework that is fully hedged in order to protect development resources from unnecessary and avoidable losses.

4. While the paper presents preliminary estimates for the Advance Commitment Capacity and its key driving parameters, an in-depth analysis of the parameters that underpin the internally generated resources of the ADF are included in the companion paper, “Long-Term Financial Capacity of the African Development Fund”.

5. The indicative ADF-13 pipeline of operations amounts to UA 7,589 million. Three replenishment scenarios, considering both the development financing needs of eligible countries and the financial challenges facing many of the Fund’s State participants are submitted for Deputies’ consideration.

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Abbreviations

ACA	Advance Commitment Authority
ACC	Advance Commitment Capacity
ACE	Accelerated Encashment
AfDB	African Development Bank
ADF	African Development Fund
CIRR	Commercial Interest Reference Rate
CCTA	Cumulative Currency Translation Adjustment
CEAS	Cumulative Exchange Adjustment on Subscriptions
IGR	Internally Generated Resources
EONIA	Euro Overnight Index Average
LIBOR	London Interbank Offered Rate
MDRI	Multilateral Debt Relief Initiative
NDR	Net Development Resources
OECD	Organisation for Economic Co-operation and Development
OIS	Overnight Index Swap
PBA	Performance Based Allocation
SDR	Special Drawing Right
UA	Unit of Account

THE ADF-13 FINANCING FRAMEWORK

1. Introduction

1.1. This financing framework paper presents the expected sources of financing for the Thirteenth Replenishment of the African Development Fund (ADF-13), namely subscriptions from donors, internally generated resources, and funds carried over from previous replenishments. It reviews the financial terms of the upcoming replenishment and analyzes the main financial variables that will determine the resources available for commitment under ADF-13.

1.2. In-depth analyses of the parameters that underpin the internally generated resources of the ADF are included in the accompanying paper, "Long-Term Financial Capacity of the African Development Fund". Financial issues and challenges identified during the ADF-12 period and solutions proposed to deal with such issues are also presented in this paper. Scenarios of replenishment levels, considering both the development financing needs of eligible countries and the financial challenges facing many of the Fund's State participants are submitted for Deputies' consideration.

1.3. Following this introduction, Section 2 examines the burden sharing framework, technical gap, and financing terms of the replenishment and proposes some enhancements. Section 3 presents the framework for grant and Multilateral Debt Relief Initiative compensation in ADF-13. Section 4 provides the preliminary estimates for the Advance Commitment Capacity. Section 5 examines resources that will be carried over from previous replenishments and Section 6 submits indicative financing scenarios for Deputies' consideration. The conclusions and recommendations are provided in Section 7.

2. Subscriptions from Donors

2.1. The African Development Fund does not yet have the capacity to substantially self-finance the current level of development assistance to eligible regional members, given the historical size of its replenishments and its highly concessional nature. Therefore, it relies heavily on the support from donors who share the same development vision for a better Africa and belief in the ADF as an effective channel for development assistance to Africa. A significant part of the ADF-13 replenishment resources will need to come from regular subscriptions from donors, with additional donor contributions provided to reduce potential shortfalls in the targeted replenishment size (the technical gap).

Burden sharing and technical gap

2.2. In general, donors calculate their subscription to the Fund by multiplying their burden share from the preceding replenishment by the targeted new replenishment size. The ADF's burden-sharing framework was reviewed in 2007 to ensure that future targeted replenishment levels could be met. In effect, Deputies agreed during the ADF-11 negotiations on a maximum (technical) gap of 5%. That level would give State participants the flexibility to increase their burden share during a particular replenishment without exceeding the target replenishment level. It would also allow increased or additional subscriptions during the life of a replenishment, while accommodating the subscriptions of new donors. By recalibrating burden shares during ADF-11, the Fund substantially reduced the gap between pledges and the replenishment from 27% in ADF-10, to 5% for ADF-11.

2.3. The technical gap for ADF-12 was set at 7.5%. This level was based on the expectations that the formalities undertaken by Turkey and Luxembourg to become members would have been completed and their contribution to the Fund received, and that certain countries who were constrained by burden share would contribute a higher nominal amount. While the membership formalities of Turkey and Luxembourg are not yet finalized, part of the ADF-12 technical gap was reduced through supplementary contributions from Austria, Canada, China, Spain and Sweden, amounting to UA 28.7 million or 0.7% of the replenishment level.

2.4. For ADF-13, Management recommends setting the technical gap back to 5% of the replenishment level. The replenishment size should indeed accurately reflect the amount that the ADF will be able to commit to new operations over the replenishment period. This level of gap still allows for potential increases in contributions from both regular donors and new Fund members.

2.5. To arrive at the smaller gap, the burden share of all donors will be recalibrated by 3% to represent 95% of the replenishment, not the current 92.176%. Annex 1 presents the evolution of burden shares from ADF-9 to ADF-12, and Annex 2 the proposed recalibrated burden shares. Management emphasizes that recalibration does not change countries' relative burden shares, as all shares are rescaled proportionally.

Proposed financing terms

Currency of subscription and exchange rates

Currency of subscription

2.6. Donors can denominate their subscriptions to the replenishment, in special drawing rights (SDR), an SDR component currency (U.S. dollar, euro, Japanese yen or pound sterling), or their own national currency, if it is freely convertible and its average domestic inflation rate has not surpassed 10% in the preceding three years.

Exchange rate risk

2.7. Major deviations can occur between the exchange rate set for a given replenishment and the exchange rate prevailing at the moment a State participant effectively pays its subscription, thus exposing the Fund to increases or decreases in its replenishment resources. Annex 3 shows the fluctuation between the exchange rates set for previous replenishments and the actual rates on the dates of payments.

2.8. To mitigate this foreign exchange risk, the Fund sets aside at the beginning of the replenishment a contingency reserve, which is subtracted from its available resources in order to avoid over-commitment of resources. Intended to cover possible adverse exchange rate differences between the replenishment rates and the actual exchange rates on the dates the subscriptions are paid, this contingency reserve has varied between 1% and 2% of the replenishment level. The cumulative exchange adjustment on subscriptions and contributions (CEAS), a line item in the Fund's financial statements, captures that difference, which amounted to UA 291 million as of October 31, 2012.

Determination of the replenishment exchange rates

2.9. In previous replenishments, three considerations governed the determination of the reference period for computing the average exchange rates for the replenishment. First, the reference period was to allow donors enough lead time to determine the national currency amounts required to meet their share of the replenishment objective. Second, the exchange rate reference period needed to be forward-looking to avoid the use of known rates. Third, the reference period needed to be long enough to minimize the effects of short-term currency fluctuations. Based on these considerations, the average of the daily exchange rates during a six month period, ending a few weeks before the last replenishment meeting and pledging session, has been used to determine the currency rates for the replenishment.

2.10. For ADF-13, Management proposes using the six months period starting on February 1, 2013 and ending on July 31, 2013, as the reference period for exchange rates. However, to further protect the Fund's net development resources and minimize the impact of CEAS, Management invites all donors in a position to do so to subscribe to the replenishment in SDR.

Payment of subscriptions

Timing

2.11. Donors are required to pay their respective subscriptions in three equal annual installments, so that subscriptions can be committed to financing projects or programs in a timely manner. Management proposes to maintain the subscriptions payment date adopted for ADF-12, which is 15 January of each year. This helps mitigate disruptions in operations by ensuring adequate commitment capacity earlier in the year.

2.12. Nonetheless, some donors have indicated their inability to comply with the 15 January deadline due to their legislative procedures and processes. In effect, for the 2012 payment deadline, only 10 ADF donors of 26 contributing to 30% of the replenishment were able to pay their contribution on time.

Form of Payments

2.13. Payments for each subscription can be in cash or, at the option of the donor, by depositing in the designated ADF custody account, non-negotiable non-interest-bearing notes (promissory note) or similar obligations, encashable on demand by the Fund.

Encashment of subscriptions

2.14. Donor countries usually make their payments in promissory notes, which are subsequently converted into cash over time (encashed), in accord with a pre-agreed schedule. This schedule computes the proportion of a State participant's payment that must be encashed each year to ensure that the Fund holds enough resources to meet disbursement requests from beneficiaries at all times. ADF participants may choose between the standard encashment calendar and a customized calendar, which should be equal on a net present value basis to the standard encashment calendar.

Standard encashment schedule

2.15. The proposed ADF-13 standard encashment schedule reflects the projected disbursement profile of loan and grant commitments to be funded by the replenishment. It ensures that the Fund's liquid resources are in line with its liquidity policy[1]. The computation of the encashment schedule is based on the following four assumptions:

- Donor subscriptions will be committed evenly over the three years of the replenishment.
- Disbursements on development projects and on policy operations would follow the historical disbursement pattern observed since 2007, with 15% of loans and grants starting to disburse during the year they are approved, and the remaining 85% starting disbursement the following year.
- A maximum of 18.75% of operations projected for ADF-13 financing are assumed to be policy-based operations[2]. Their disbursements and those of project loans and grants, institutional support, and study grants, will be based on historical profiles.
- The target liquidity level in any given year, in line with the Fund's policy guidelines, will be set at 62.5% of the three year moving average of net disbursements. This level of liquidity is an adequate buffer and allows the Fund to meet both unexpected faster-than-projected disbursements and shortfalls in encashment from donors.

2.16. The standard encashment schedule proposed for ADF-13 has the same encashment period and level of encashment as that of ADF-12 (table 1).

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1 The Fund must hold between 50 % and 75% of the three-year moving average of expected disbursements in liquid assets.

2 As in both ADF-11 and ADF-12, this figure assumes that policy-based operations will constitute no more than 25% of aggregate country allocations and country allocations will account for 75% of all available ADF-13 resources.

Table 1: Standard encashment schedule for ADF-13

Year	Annual encashment of subscription
2014	5.03%
2015	10.34%
2016	14.76%
2017	15.07%
2018	12.98%
2019	11.17%
2020	10.14%
2021	9.13%
2022	8.33%
2023	3.04%

Accelerated encashment framework

2.17. Since ADF-9, donors have been given the option of accelerating the rate of encashment of their subscriptions by selecting a customized encashment schedule. The returns generated by investing these funds received in advance are credited to donors based on a pre-agreed discount rate. These acceleration credits can be used to meet[3] or increase[4] donors' burden share, lower the technical gap of the replenishment[5], or fulfil the donor's MDRI commitments[6].

Issues and Challenges

2.18. Interest rates have been declining and are at all-time low following intense and coordinated action by the world's major central banks in the aftermath of the global financial crisis. Most discount rates extended under previous ADF replenishments were granted at a time when the prevailing interest rates were much higher than current levels and the Fund is currently unable to earn the rates of return used in the discounting of accelerated encashments.

2.19. Specifically, the time between the determination of the applicable discount rate and the actual investment of funds received in advance (which can fluctuate from a few months to several years)[7] has exposed the Fund to interest rate mismatches. As of December 2011, the accelerated encashment program from ADF-9 to ADF-11 has a gain of UA 48 million which is projected to turn into a cumulative loss of UA 59 million by the end of 2017 if the low interest rate trend persists[8].

2.20. Given the small volume of funds received annually when the accelerated encashment program was established back in 2004, the bulk of those funds were invested in the ADF "trading portfolio", which manages the Fund's liquidity. However, the substantial increase in the size of the program combined with the low interest rate environment has triggered a change in the investment strategy. As a result, an accelerated encashment (ACE) special portfolio was

[3] When a donor does not have the budget to pledge an amount that will keep its burden share at the same level as that of the previous replenishment, it can use the accelerated encashment framework. This would allow the donor to earn an accelerated encashment credit which would be used to cover the shortfall and maintain its burden share at a level similar to the previous replenishment.

[4] When a donor has the budget to pledge an amount that will keep its burden share at the same level as that of the previous replenishment, it can use the accelerated encashment framework to increase its contribution to the Fund. This would allow the donor to earn an accelerated encashment credit that would be used to increase its subscription and its burden share.

[5] When a donor has the budget to pledge an amount that will keep its burden share at the same level as that of the previous replenishment, it can use the accelerated encashment framework to reduce the gap of the replenishment without increasing its burden share. The additional funds generated through accelerated encashment (accelerated encashment credit) will be used to decrease the technical gap of the replenishment, but will neither increase the donor's burden share nor its voting powers.

[6] A donor may use the accelerated encashment framework to generate accelerated encashment credit which can be used to pay its contribution to MDRI.

[7] Discount rates are fixed at least six months ahead of the replenishment period. Advance payments in cash are received one to five years after the adoption of the replenishment.

[8] Shortfall or gains due to accelerated encashment are borne by the Fund.

created to invest funds received under the accelerated encashment framework, as presented in the following section.

The Accelerated Encashment (ACE) portfolio

2.21. The accelerated encashment portfolio was established in early 2012 with the sole purpose of investing the flows received from donors that elected to accelerate their encashments. Its key objective is to recoup the discount granted to donors by investing such accelerated encashments to replicate the standard replenishment schedule and thus to minimize the interest rate risk.

2.22. All the sub-portfolios within the accelerated encashment portfolio are benchmarked against the discount rates provided to donors. This special portfolio has allowed the Fund to manage and significantly reduce its exposure to interest rate risk stemming from the accelerated encashment program.

2.23. To further preserve the financial sustainability of the Fund, Management proposes to revise the accelerated encashment framework as described below.

Reference discount rate

2.24. The establishment of the accelerated encashment portfolio allows the Fund to hedge its future accelerated encashment flows using derivatives. This will ensure that the credit extended to donors matches, to the extent possible, the returns generated by the Fund. In previous replenishments, the Fund has used a currency-specific discount rate based on the Commercial Interest Reference Rate (CIRR)[9] for credits up to five years, adjusted downward by 100 basis points. For ADF-13, Management recommends discontinuing the use of the adjusted CIRR rate and to replace it with Overnight Index Swap (OIS)[10] rates, which can be operationalized within the ACE investment framework and will allow for better hedging of the interest rate risk generated by the accelerated encashment program.

2.25. *Discount rate:* The Overnight Index Swap rate will be used as the discount rate for accelerated encashment based on the donor's desired accelerated payment schedule. To hedge the interest rate risk of accelerated encashments, the Fund will enter into an OIS swap in which it receives an annual fixed rate set at the outset of the transaction (effectively the discount rate granted) and pays a floating rate based on daily compounded overnight rates (the federal funds rate in the case of U.S. dollar, the EONIA rate for the Euro and equivalent overnight rates for the Japanese yen, pound sterling and Canadian dollar).

2.26. *Eligible currencies*: Accelerated encashment will only be offered in subscriptions denominated in U.S. dollars, euros, Japanese yen, pound sterling and in Canadian dollars[11].

Accelerated encashment modalities

2.27. This revised accelerated encashment framework proposed by Management for ADF-13 is a fully hedged accelerated encashment mechanism to ensure that the Fund protects its development resources from losses.

2.28. <u>Timing of discount rate setting:</u> To fully immunize the Fund against interest rate risk arising from the accelerated encashment framework, Management recommends that accelerated encashment be handled case by case, with the discount rate set when a donor irrevocably commits to a specific, pre-agreed accelerated encashment schedule. The Fund will then be positioned to execute the necessary hedges from the market and communicate the discount rate to donors, thus ensuring that the discount is commensurate with the returns achievable in the market. This process is similar to what has been offered to member countries for advanced payment under the Sixth General Capital Increase of the African Development Bank.

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9 The CIRR is computed by the Organisation for Economic Co-operation and Development (OECD) and is used by OECD members as a reference for the minimum interest rates applicable to official financing support for export credits.

10 An OIS is a fixed to float interest rate swap where the floating leg is computed using a published overnight index rate such as the Federal Funds rate.

11 Derivatives markets in these currencies are sufficiently liquid to allow the Fund to effectively and efficiently hedge the risks of the accelerated encashment program.

2.29. Irrevocability: The election of accelerated payment will be irrevocable as of the date that the Fund and relevant donor agree on the future payment dates of the accelerated encashment schedule. A donor not in a position to subsequently provide the funds in accordance with the agreed schedule, will have to bear the cost (including the cost of ADF unwinding its hedge) associated with the delay. Indeed, in the event of a non-payment, drawings will have to be made on ADF's liquidity to meet the missed payments, therefore applicable interest will need to be charged to the donor.

2.30. Process: Management and the donor country will agree on a date for determining the applicable ADF-13 discount rate (the fixing date). The fixing date cannot be more than 30 calendar days before the receipt of the donor's first accelerated encashment amount. The Fund will execute the hedge in the market[12] on the fixing date and communicate to the donor the final irrevocable discount rate obtained on the hedge.

3. Compensation for Foregone Reflows Due to Grants and MDRI

Grants

3.1. Starting with ADF-9, donors agreed to make supplementary contributions in addition to regular subscriptions to compensate the Fund for foregone principal reflows due to the extension of grants. The portion of grants had been steadily rising over time, and to preserve the Fund's financial capacity, donors committed to compensate the Fund for this loss of reflows (principal).

3.2. ADF-12 was the first replenishment cycle under which the compensation for forgone principal repayments on grants became due (compensation for ADF-9 grants started in 2011). Given the Fund's structure, the amounts expected during the early years of the compensation period are relatively small, with grant compensation during the ADF-12 period amounting to UA 83,060.

3.3. ADF-13 will mark the beginning of compensation for grants extended under ADF-10. Annex 4 presents the grant compensation amounts expected from donors during the ADF-13 period, totalling UA 8.85 million.

Multilateral Debt Relief Initiative (MDRI)

3.4. The MDRI compensation scheme started in 2006 to ensure that debt relief provided under the initiative does not affect the financial capacity of the Fund. Forgone reflows from loans cancelled through the MDRI are compensated by donors, using the "pay-as-you-go" approach on a dollar-for-dollar basis. It should be highlighted that 10% of MDRI payments expected for 2011 have not been paid on time[13], while 10% of the amount due for 2011-2012 has not yet been received.

3.5. MDRI costs are updated at the end of each ADF replenishment, and take into account the following factors:

- Exchange rate induced excesses or shortfalls that materialized over the replenishment period;
- Changes in the timing of beneficiary countries reaching completion point;
- Future amount of debt relief from the Heavily Indebted Poor Countries Initiative;
- The ADF replenishment rate used to determine donor contributions in national currencies for the upcoming replenishment period.

3.6. The MDRI cost applicable for the ADF-13 period will be determined during the third quarter of 2013, and updated schedules of MDRI contributions will be sent to donors by September 2013.

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[12] If a donor country is paying its contribution in a single upfront installment, the Fund would purchase the safest government bond STRIPS - Separated Trading of Registered Interest and Principal Securities - in the relevant currency, with a face value and maturity to match the standard schedule, thus drawing on the Fund's liquidity. For multiple installments, the Fund will enter into OIS derivative transactions to hedge the interest rate risk associated with the payment schedule agreed with the donor country.

[13] Payment received 1 year later.

4. Internally Generated Resources

4.1. Another source of financing for the Fund is its internally generated resources, based on its 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 donor subscriptions. It allows the Fund to make loan and grant commitments while relying on predictable future inflows such as loan repayments, AfDB net income transfers, projected net profits and loan cancellations.

Overview of the Advance Commitment Authority

4.2. The ACC is fixed for each replenishment period, and its level is based on assumptions detailed in Annex 5. Safety margins have been built into the model to mitigate the risk of over-committing the Fund or breaching its prudential minimum liquidity limits. These safeguards make the ACA an efficient means of using available resources with a negligible risk of over-commitment.

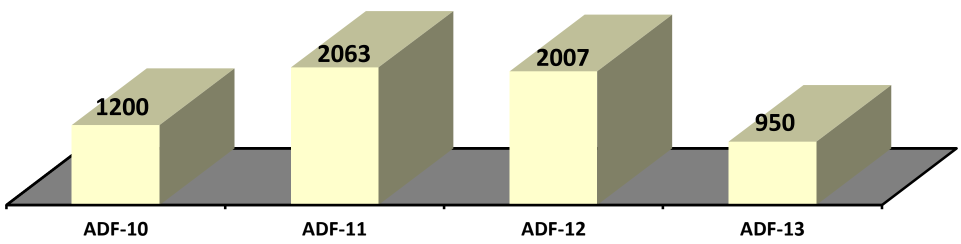
4.3. The ACA, long term in nature, relies on prudent assumptions of future flows. Changes to the parameters of the model that occur during a replenishment period do not translate into immediate changes in commitment capacity during that replenishment. For example, interest rates or loan cancellation levels that deviate from those initially assumed for the determination of an ACC do not change the level of the ACC established for that three year replenishment period. Rather, the ACA model is recalibrated at the beginning of each replenishment (i.e., every three years) to account for differences between estimated and actual cash flows and to determine the ACC of the next replenishment. Such an adjustment mechanism effectively prevents the risk of over-commitment, and preserves the integrity of previously extended ACC amounts.

4.4. A comprehensive analysis of internally generated resources and ACC estimates for ADF-13 are presented in the companion paper "Long-Term Financial Capacity of the African Development Fund".

Preliminary ACC estimates for ADF-13

4.5. Management has carefully reviewed and explored all alternatives to boost the Fund's internally generated resources.[14] The baseline replenishment scenario for ADF-13 assumes that donors' subscriptions remain constant in real terms compared with ADF-12 (adjusted by the 6.84% inflation rate for the SDR). The ACC for ADF-13 is estimated at UA 950 million for the baseline scenario (figure 1). It could rise to UA 1,052 million if donor subscriptions increase by 53% in nominal terms.

Figure 1: Advance Commitment Capacity (UA millions)



4.6. The ACC for the baseline scenario represents a 52.7% reduction as compared to the size of the ACC for ADF-12. This substantial reduction in internally generated resources is the result of various factors, some of which are highlighted below[15].

[14] See the paper *"Long-Term Financial Capacity of the African Development Fund"*
[15] All the variables affecting the ACC are extensively discussed in the Fund's "Long term financial capacity of the African Development Fund"

Interest rates

4.7. Low interest rates result in lower investment income for the Fund. Interest rates have continued to decline since the onset of the financial crisis. Although the ACC for ADF-12 used forward interest rates to better predict investment returns, and assumed a slow rise from 2.6% to 4.5% for 2016 onward, the depth of the global financial crisis and the coordinated action of the world's major central banks targeting zero interest rate policies proved those estimates to be too optimistic. Considering the current yield of the portfolio and latest estimates, the rate of return of the investment portfolio is expected to be 2.65%. The immediate impact of this lower rate from 2014 and beyond is an estimated reduction of UA 443 million in the ACC.

Loan cancellations

4.8. Lower loan cancellations result in lower loan reflows. To improve portfolio management and enhance the development impact of Bank Group operations, the loan cancellation guidelines were amended in May 2011. To provide meaningful incentives to ADF countries to undertake portfolio restructuring and cancel nonperforming operations, 70% of cancelled resources are now retained by the country for commitment to on-going operations or new activities consistent with the country strategy paper, while the remaining 30% are to be returned to the Fund's general resource pool. The ADF-12 ACC computations assumed annual cancellations of loans for the ADF-12 period and beyond to be UA 100 million. These cancellations were projected to be fully retained in the Fund's liquidity, while that level is reduced to only 30 per cent following the revised guidelines. The impact on the ACC for ADF-13 is immediate and steep, and estimated at UA 452 million.

MDRI

4.9. Experience with the MDRI highlights the risk that some donors may be unable to meet their obligations on time. Both MDRI and grant compensation are included in the cash flow stream that supports the ACC. As a result, delays or non-payments of compensation lower the amount of ACC. In line with ADF-12 and past experience, the model assumes that 90% of the MDRI contributions will be received on time, and a further 3% with a delay. If all donors were to meet their MDRI commitment fully and on time, the ACC would increase to UA 1,021 million from the baseline scenario. Donors are strongly urged to meet their MDRI commitments fully and on time.

Encashment period

4.10. To further maximize the ACC, donors can agree to encash their ADF-13 subscriptions over a period shorter than the standard 10 years. For example, an encashment period of four years as set out in table 2 would increase the ACC by 22%, bringing it from its baseline of UA 950 million to UA 1,157 million.

Table 2: Example four year encashment schedule for ADF-13

Year	Annual encashment of subscriptions
2014	25%
2015	25%
2016	25%
2017	25%

4.11. The safety mechanisms built into the ACA model protects the integrity of the Fund, ensuring that the committed ACC resources from ADF-12 will be delivered despite the fact that anticipated inflows during 2011-2013 have not materialized. The corollary is a lower ACC for ADF-13. The key assumptions underlying the ACA model from ADF-10 to ADF-13 are presented in Annex 5.

5. Resources Carried Over from Previous Replenishments

5.1. The two main sources of carry-over resources are subscriptions and payments received after the end of a given replenishment period, and available resources not committed during the previous replenishment cycle.

5.2. An amount of UA 512 million is expected to be carried over into ADF-13, including UA 482 million of qualified subscriptions and UA 30 million of late subscriptions (table 3). Assuming that the resources in Pillar II of the Fragile States Facility will be used for arrears clearance during the ADF-12 period, Management expects all ADF-12 resources to be committed by the end of the cycle[16].

Table 3: Estimated carry-over resources in ADF-12 (UA millions)

Resources carried over:	ADF-3	ADF-8	ADF-9	ADF-10	ADF-11	ADF-12 (estimate)	TOTAL
Qualified subscriptions	7	0.16	23	2.5	64	385	**482**
Late subscriptions						30	**30**
Uncommitted resources			0	0	0	0	**0**
Total	**7**	**0.16**	**23**	**2.5**	**64**	**415**	**512**

Qualified subscriptions

5.3. Under the terms of the replenishment, the subscriptions of State participants become available for payment and commitment in three equal annual tranches. Donors whose payments are subject to annual legislative or parliamentary approvals deposit a qualified Instrument of Subscription with the Fund.

5.4. Although all ADF resolutions require that qualified subscriptions be unqualified by the payment dates specified in the replenishment that has not always been the case, due to each donor's particular circumstances. Some subscriptions across replenishments from ADF-3 to ADF-10, are still qualified and represent expected contributions from Argentina (ADF-3) and the United States. The qualified subscriptions from ADF-11 and ADF-12 expected to be carried over into ADF-13 amount to UA 449 million and represent subscriptions from Argentina (UA 9.8 million), Spain (UA 88 million), Italy (UA 200 million) and the United States (UA 152 million).

Late subscriptions

5.5. Neither Egypt nor Portugal has yet subscribed to ADF-12. However, the Fund and Portugal have agreed on a payment calendar which starts in 2016 and that has an equivalent value, in net present value terms, to that of the standard ADF-12 encashment calendar.

5.6. In line with practices under previous replenishments, carry-over resources will be pooled with available ADF-13 resources, and administered and used under the terms and conditions of ADF-13.

[16] This assumption and expectation will be reviewed before every replenishment meeting.

6. Indicative Financing Framework

6.1. Based on the demand for ADF resources expected for 2014-2016, and the financial constraints experienced by donors, the following three financing scenarios are submitted to Deputies for discussion.

- A **low scenario**, where the ADF-12 subscriptions from donors are adjusted by the cumulative SDR inflation rate (6.84 %);
- A **consolidation scenario** where subscriptions increase by 38% in nominal terms (29% in real terms) in order to attain a flat real growth in total ADF resources vis-à-vis ADF-12;
- A **transformation scenario** where subscriptions increase by 53% in nominal terms (43% in real terms) in order to achieve 10% real growth in total ADF resources vis-à-vis ADF-12.

6.2. Table 4 shows the implication of each of these scenarios on both the replenishment and total resource levels of ADF-13.

Table 4: Impact of scenarios on replenishment and total resources of ADF-13

Replenishment scenario	Growth over ADF-12 subscriptions in real terms	Growth over ADF-12 subscriptions in nominal terms	Growth over ADF-12 resources in real terms	Growth over ADF-12 resources in nominal terms
Low	0%	7%	**-20%**	**-14%**
Consolidation	29%	38%	0%	7%
Transformation	43%	53%	10%	18%

6.3. The financing demand from ADF recipients is discussed in the ADF-13 Overview Paper. Based on the Board-approved country strategy papers covering 2014, 2015 and 2016, a pipeline of regional operations developed by the Regional Integration and Trade Department, and the indicative operational program developed in the context of the 2013-2015 Program and Budget Document, the indicative ADF-13 pipeline of operations amounts to UA 7,589 million. Of this amount, UA 3,660 million is foreseen for regional operations and UA 3,929 million for national operations. Table 5 presents the three financing scenarios based on various levels of replenishment.

Table 5: Financing scenarios

(UA millions, unless otherwise indicated)

Amounts	ADF-12	Low scenario 0% real growth in subscriptions	Consolidation scenario 29% real growth in subscriptions	Transformation scenario 43% real growth in subscriptions
ACC	2007	950	1018	1052
Donor subscriptions	3769	4027	5185	5771
Additional contributions	29	-	-	-
Total resources	**5805**	**4978**	**6203**	**6823**
Carry-over amounts	458	512	512	512
Resources including carry-over	**6263**	**5490**	**6715**	**7335**
Country allocations	3893	-	-	-
Regional envelope	1164	-	-	-
Fragile States Facility	764	-	-	-
Contingencies and other adjustments	442	-	-	-
Total uses	**5821**	-	-	-
ADF-13 pipeline fulfilment*		66.1%	81.8%	89.8%
National pipeline		68.3%	89.1%	99.6%
Regional pipeline		43.0%	53.2%	58.3%

* *The pipeline fulfilment estimates are based on assumptions concerning allocable resources (total resources taking into account carry-overs and contingencies), maintenance of the current resource allocation between the Fragile States Facility, the Regional Operations envelope and the Performance-Based Allocations, and the existing framework for cost-sharing of ROs and exemptions for Regional Public Goods.*

7. Conclusion and Recommendations

7.1. This paper has examined the sources of financing for ADF-13, specifically donor contributions, compensation for forgone reflows, internal resources and funds carried over from previous replenishments. It has also analyzed a range of financial parameters that underpin the Fund's resources and presented a range of scenarios that explore different sources and uses of ADF-13 financing.

7.2. Deputies are invited to provide their views on the financing scenarios in the paper and to endorse the following proposals:

- To set the technical gap of the replenishment at 5% and recalibrate their burden shares accordingly;
- To use the six months period from February 1, 2013 to July 31, 2013, as the reference period for determining the exchange rates applicable to the replenishment;
- To use the standard 10-year encashment schedule or to adopt a shorter standard encashment schedule;
- To use the revised framework for accelerated encashment.

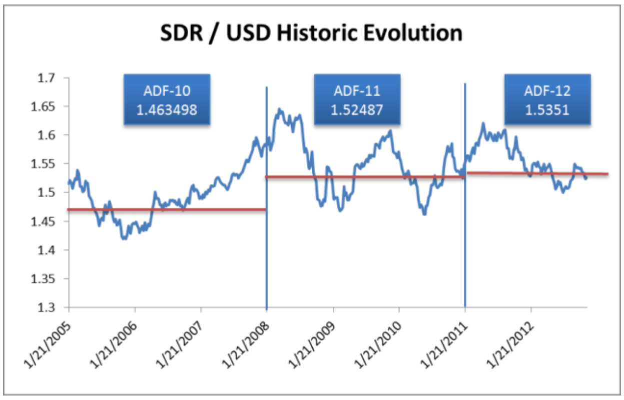
Annex 1: The Evolution of the Burden Shares of Donors over the Past Three Replenishments

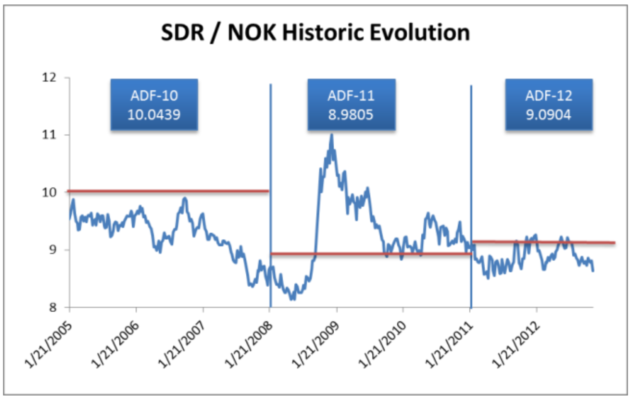
Country	ADF-10	ADF-11	Evolution ADF-10/ADF-11	ADF-12	Evolution ADF-11/ADF-12
Argentina	0.000%	0.000%	-	0.239%	-
Austria	1.650%	2.340%	+42%	2.340%	0%
Belgium	1.550%	2.075%	+34%	2.060%	-1%
Brazil	0.000%	0.177%	-	0.235%	+32%
Canada	4.500%	4.999%	+11%	4.999%	0%
China	1.642%	2.161%	+32%	2.052%	-5%
Denmark	1.088%	1.384%	+27%	1.891%	+37%
Egypt	0.000%	0.000%	-	0.032%	-
Finland	1.500%	2.413%	+61%	2.739%	+14%
France	9.200%	10.907%	+19%	8.710%	-20%
Germany	6.610%	10.817%	+64%	9.781%	-10%
India	0.174%	0.174%	0%	0.231%	+32%
Italy	4.000%	5.264%	+32%	4.751%	-10%
Japan	6.682%	7.070%	+6%	6.715%	-5%
Korea	0.636%	0.878%	+38%	1.317%	+50%
Kuwait	0.167%	0.180%	+8%	0.180%	0%
The Netherlands	3.835%	5.437%	+42%	4.917%	-10%
Norway	3.540%	4.517%	+28%	4.396%	-3%
Portugal	0.565%	0.801%	+42%	0.723%	-10%
Saudi Arabia	0.301%	0.443%	+47%	0.478%	+8%
South Africa	0.118%	0.193%	+64%	0.255%	+32%
Spain	2.200%	3.000%	+36%	3.000%	0%
Sweden	4.000%	4.354%	+9%	4.354%	0%
Switzerland	2.567%	2.466%	-4%	2.466%	0%
United Kingdom	7.500%	14.796%	+97%	13.997%	-5%
United States of America	8.170%	8.300%	+2%	9.319%	+12%
Total	**72.195%**	**95.146%**		**92.176%**	

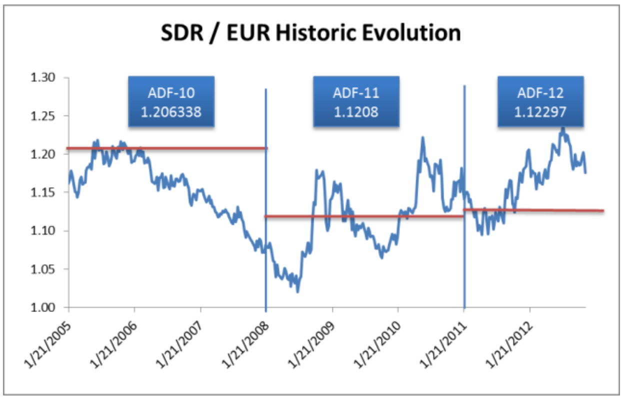
Annex 2: Proposed Recalibrated Burden Shares for ADF-13

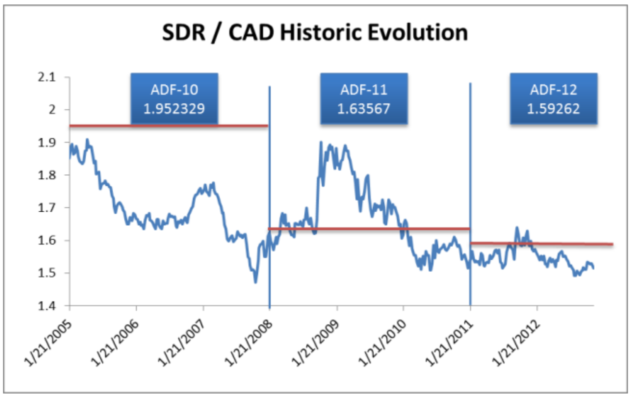
Donor	ADF-12 burden shares	Proposed ADF-13 burden shares
Argentina	0.239%	0.246%
Austria	2.340%	2.412%
Belgium	2.060%	2.123%
Brazil	0.235%	0.242%
Canada	4.999%	5.153%
China	2.052%	2.115%
Denmark	1.891%	1.949%
Egypt	0.032%	0.033%
Finland	2.739%	2.823%
France	8.710%	8.977%
Germany	9.781%	10.081%
India	0.231%	0.238%
Italy	4.751%	4.896%
Japan	6.715%	6.921%
Korea	1.317%	1.357%
Kuwait	0.180%	0.186%
The Netherlands	4.917%	5.067%
Norway	4.396%	4.531%
Portugal	0.723%	0.745%
Saudi Arabia	0.478%	0.493%
South Africa	0.255%	0.263%
Spain	3.000%	3.092%
Sweden	4.354%	4.487%
Switzerland	2.466%	2.541%
United Kingdom	13.997%	14.426%
United States Of America	9.319%	9.604%
	92.176%	95.000%

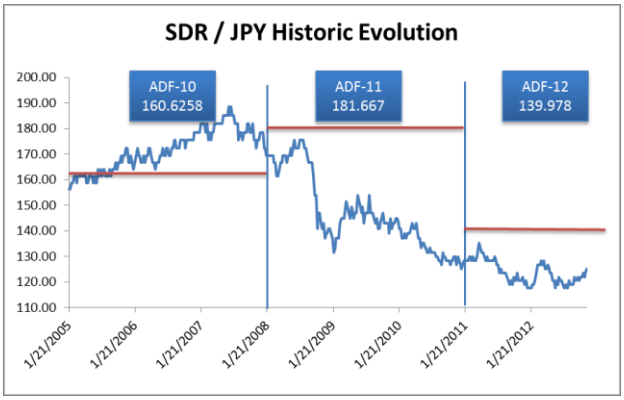
Annex 3: Fluctuation in Exchange Rates Versus Replenishment Rates of the Major Subscription Currencies

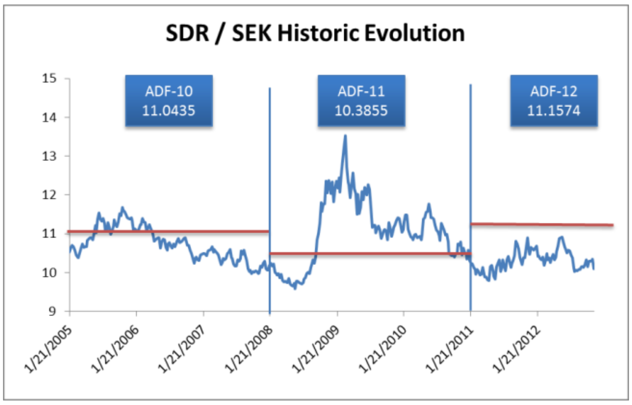


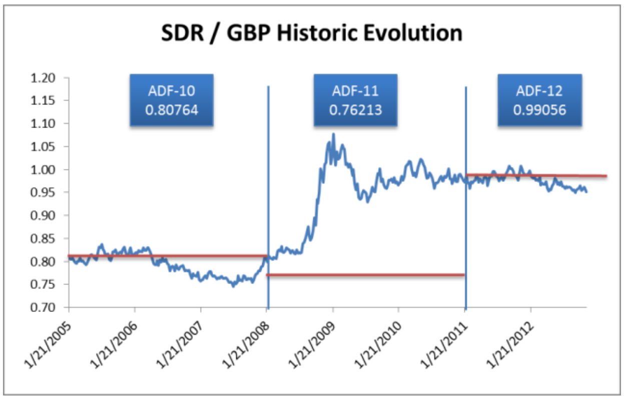












Annex 4: Grant Compensation Schedule for ADF-9 and ADF-10

State Participants	ADF-9 Normalized Burden Share	ADF-9 Grant Compensation ADF-13 2014	2015	2016
1 ARGENTINA	0.000%	-	-	-
2 AUSTRIA	1.248%	12,500	34,372	58,395
3 BELGIUM/	2.100%	21,037	57,847	98,278
4 BRAZIL	0.447%	4,477	12,310	20,913
5 CANADA	5.729%	57,375	157,764	268,030
6 CHINA	2.090%	20,935	57,566	97,801
7 DENMARK	3.819%	38,250	105,176	178,687
8 FINLAND	1.910%	19,125	52,588	89,343
9 FRANCE	9.328%	93,429	256,902	436,459
10 GERMANY	10.635%	106,519	292,895	497,609
11 INDIA	0.222%	2,219	6,101	10,365
12 ITALY	5.474%	54,825	150,752	256,118
13 JAPAN	11.224%	112,417	309,115	525,165
14 KOREA	0.810%	8,109	22,297	37,882
15 KUWAIT	0.213%	2,128	5,852	9,943
16 THE NETHERLANDS	4.710%	47,175	129,717	220,380
17 NORWAY	4.507%	45,135	124,108	210,850
18 PORTUGAL	0.817%	8,185	22,508	38,239
19 SAUDI ARABIA	0.688%	6,886	18,935	32,170
20 SOUTH AFRICA	0.150%	1,503	4,134	7,023
21 SPAIN	2.921%	29,258	80,450	136,679
22 SWEDEN	5.092%	51,000	140,235	238,249
23 SWITZERLAND	3.819%	38,250	105,176	178,687
24 UNITED ARAB EMIRATES	0.000%	-	-	-
25 UNITED KINGDOM	7.002%	70,125	192,823	327,592
26 USA	15.045%	150,687	414,346	703,944
TOTALS	100.00% 8,434,320	1,001,550	2,753,970	4,678,800

State Participants	ADF-10 Normalized Burden Share	ADF-10 Grant Compensation ADF-13 2016
1 ARGENTINA	0.000%	-
2 AUSTRIA	2.285%	9,474
3 BELGIUM/	2.147%	8,900
4 BRAZIL	0.000%	-
5 CANADA	6.233%	25,838
6 CHINA	2.274%	9,428
7 DENMARK	1.507%	6,246
8 FINLAND	2.078%	8,613
9 FRANCE	12.743%	52,825
10 GERMANY	9.156%	37,953
11 INDIA	0.241%	999
12 ITALY	5.541%	22,967
13 JAPAN	9.255%	38,366
14 KOREA	0.881%	3,652
15 KUWAIT	0.231%	959
16 THE NETHERLANDS	5.312%	22,020
17 NORWAY	4.903%	20,326
18 PORTUGAL	0.783%	3,245
19 SAUDI ARABIA	0.417%	1,729
20 SOUTH AFRICA	0.163%	677
21 SPAIN	3.047%	12,632
22 SWEDEN	5.541%	22,967
23 SWITZERLAND	3.556%	14,741
24 UNITED ARAB EMIRATES	0.000%	-
25 UNITED KINGDOM	10.389%	43,064
26 USA	11.316%	46,909
TOTALS	100.00% 414,530	414,530

Annex 5: Key Assumptions for ACC over ADF Replenishments

Assumptions	Description	ADF-10	ADF-11	ADF-12	ADF-13
Donor Contributions in Future Replenishments	To establish the ACC for the baseline scenario, donor subscriptions for future replenishments are conservatively assumed to remain unchanged in real terms. The nominal amount of donor contributions is estimated to increase by the cumulative rate of inflation (for the special drawing right-SDR) of the previous replenishment period. The same inflation rate is used to project future increases in donor contributions.	0.0%	7.0%	4.49%	6.84%
MDRI Compensation	In addition to regular contributions, donors are expected to make additional contributions during future replenishments to cover 100% of MDRI costs for eligible countries on a pay-as-you-go basis. Based on historically observed MDRI recovery rate, the model assumes a percentage of contributions for MDRI compensations that will be received in ADF-13 and in future replenishments	0.0%	84.0%	90.0%	93.0% (incl. lag of 3%)
Share of Grants in Replenishment	The grant level for the replenishment is determined as per the debt sustainability analysis. For the purpose of this paper, the share of grants in ADF-13 is assumed to remain the same as that of 2012, and will be updated in 2013.	44.0%	28.4%	30.65%	34.5%
Upfront Charge on Grants	In addition to regular contributions, donors have agreed to finance 100% of foregone principal reflows due to grants through additional contributions in future replenishments, on a pay-as-you-go basis. Foregone charges income is addressed through volume discounts on grants. This volume discount (set at 20% for ADF-12) includes: 1) An upfront grant charge deducted from the Grant amount as compensation for forgone service charges that returns to the liquidity pool used to estimate the ACC (14.57% for ADF-12). 2) The remaining discount amount is allocated under PBA to ADF-only countries (5.43% for ADF-12). The upfront compensation for ADF-13 will be adjusted when the replenishment discount rate will be fixed.	11.9%	10.12%	14.57%	14.57%
Administrative Expenses	These expenses are based on the relevant budget program and are set to increase annually thereafter at the percentage indicated.	3.0%	3.0%	3.0%	3.0%
ADB Transfers Per Year	Constant annual transfer from ADB net income, in UA millions	10	20	35	35
Repayment Sensitivity Factor	To account for delayed repayments by countries in arrears to the Fund, repayment flows are maintained constant at a percentage of expected loan repayments.	85.0%	85.0%	90.0%	90.0%
Disbursement Sensitivity Factor	To account for grant compensation and loan cancellations, reductions in disbursement flows are maintained constant at a percentage of signed loans.	93.18%	93.18%	95.18%	95.18%
Investment Return Rate	Annual rate of return of the investment portfolio	3.42%	4.45%	4.5%[1]	2.65%[2]
Minimum Prudential Level of Annual Liquidity	To comply with the Fund's liquidity policy, the level of liquidity is maintained at a percentage of projected disbursements for the following three years.	100%	75%	75%	75%
Effective loan cancellations returning to the liquidity pool	The model assumes a certain level of annual cancellations in nominal terms, in UA millions. During ADF-12, the loan cancellation policy was modified and only 30% of loan cancellations are re-injected in the liquidity pool while 70% remain allocated to the country. Accordingly, for ADF-13 we assume that only UA 30 million (30% of the gross cancellations of UA 100 million) will return to the liquidity pool used to estimate the ACC.	0	100	100	30
Estimated Advance Commitment Capacity	Level of the Advance Commitment Capacity resulting from the model, in UA million	1200	2063	2007	950

1 - Average of the then prevailing Forward Rates; 2 – Potential Portfolio Returns based on current Portfolio composition and the Forward Curve