This document presents the results of a survey questionnaire of approaches to determining concessionality of loans. It is for INFORMATION and DISCUSSION at the meeting of the Task Team.

For each question on the questionnaire, responses have been copied bodily from survey returns. Given the difficulty of contacting members over the holiday period, and the need to issue the document quickly in time for the meeting, the Secretariat has not attempted to correct any typographical or grammatical errors.

Only those who have replied to the questionnaire are mentioned. "No answer" means a country or organisation responded to the questionnaire, but not to the specific question indicated. "Not applicable" means that the country or organisation said that the specific question was "not applicable".

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Contact: Ms Julia Benn (julia.benn@oecd.org)
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SURVEY OF APPROACHES TO DETERMINING CONCESSIONALITY OF LOANS

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A. Does your country/organisation have an operational definition of “concessional in character”? If so, please write it out here:

AUSTRALIA

AusAID does not have a separate operational definition of "concessional in character" in relation to ODA loans. As noted below (under C.), the only loans which Australia provides are under the Australia-Indonesia Partnership for Reconstruction and Development. These are highly concessionary (see below), and it is evident that they are ODA.

AUSTRIA

Austria provides concessional loans only via the soft loan programme of the Austrian MoF. This programme follows the rules of the OECD “Arrangement on officially supported Export Credits” and the concessionality definition as defined in the arrangement. These loans are not reported as ODA. Austria only reports the subsidies from its MoF to the soft loan programme on an annual basis.

Loans provided by the Development Bank of Austria are based on market terms and are not concessional in character as they do not contain any subsidy. Hence we do not report them as ODA but as private flows.

BELGIUM

No.

CANADA

An investment, a loan, or financing is considered to be “concessional in character” if it provides benefit relative to the recipient’s best market-based source of financing. Benefit may be determined on the basis of an investment’s price (interest rate), tenor, and/or repayment structure.

DENMARK

No, Denmark has no operational definition – Denmark has not provided ODA-loans since 1988.
EU

In our understanding the DDR are the generally accepted measure for "prevailing market rates" as confirmed by the DCD Secretariat in bilateral correspondence and in official publications (see Annex 3 below [Annex 4]). The DDR was also the departure point in a failed attempt to tighten the conditions for concessionality in 2003-2004 [DCD/DAC/RD(2004)17/RD3]. The proposal to measure the interest rates against a percentage of DDR not succeeding, the reference for measure logically stays the DDR.

FRANCE

Our operational definition of concessionality in character is based on what is mentioned in the Directives: a loan is said to be concessional if it is extended to the borrower “below the prevailing market rate”. We consider the market rate to be defined from the borrower’s point of view. The references mostly taken are the loans or sources of borrowing of comparable duration of the receiving country/counterpart.

In several cases, where there is no alternative source, the reference loan rate is the rate derived from the DFI own calculation including cost of the resource, operating cost, and risk quotation (country, counterpart and exchange rate as relevant) but excluding remuneration of equity capital.

GERMANY

Our operational definition is as spelled out in the Directives: a loan is considered concessional, if it is extended to the borrower “below the prevailing market rate”. References (depending on availability) can be either:

- the DDR Rate

- comparision with other loans or sources of borrowing (of comparable duration) of the receiving recipient/country

- comparision with other loans or sources of borrowing (of comparable duration) of the receiving recipient/country

- Comparision with bonds (of comparable duration) of the receiving recipient/country

- Comparision with CDS Spreads if available

In many cases the DDR-Rate is the only available reference. If there is a subsidy in the loan which lowers the interest rate, we consider it as concessional in character.

HUNGARY

The 232/2003 (XII.16) Government Decree set the legislative, administrative and financial conditions for tied aid financing, which enables Eximbank to provide tied aid credits and MEHIB to cover the related...
export credit risk. Under this Government Decree definitions for tied aid and concessionality are
determined according to the OECD Arrangement rules and definitions.

By definition the Hungarian tied aid credit is mixed credit which has a concessional credit part and a
grant element part. The concessional credit part contains interest rate subsidy and the grant element part
is equal to the risk premium.

ITALY

Our country considers concessional loans in character the loans that have a grant element at least
equal to 25 % with a DDR equal to 10 %.

Regarding the tied aid, our country consider concessional loans in character the loans that have a
concessionality level at least equal to 35 % with a DDR less than 10 %

JAPAN

Japan understands “concessional in character” as interest rates below the prevailing market rate.
Prevailing market rate is DDR.

KOREA

Operational definition of ‘concessional in character’ is as defined above by DAC; the loan must be
below the prevailing market rate and/or more favourable than the market rate, as well as have more than
25% of grant element. Not only the rate but also other financial terms and conditions(maturity, grace
period, etc) are more favourable than those the market offers. In terms of GE, DDR based method with the
discount rate 10% is used and likewise concessionality levels are calculated with the discount rate of
“CIRR + margin”.

LUXEMBOURG

Luxembourg is currently not reporting any loans.

PORTUGAL

No.

SPAIN

Spain uses the DDR as a reference for determining if a loan is concessional in character or not
(below market interest rates). However, we do not believe this is the ideal way of interpreting the concept.
More attention should be paid to the financial situation of recipient countries, including market rates, risk
rating, price of government bonds etc. Taking into account the recipient country market is in line with the
Busan.

SWEDEN

The level of subsidy for development loans shall be maximum eighty percent, defined as Sida’s
donation in relation to the financed amount consisting of Sida’s donation and the loan on market
conditions.
AFDB

The Bank follows the IMF definition of concessionality, this is “a net present value calculation, measured at the time the loan is extended, that compares the outstanding nominal value of a debt and the future debt-service payments discounted at an interest rate applicable to the currency of the transaction, expressed as a percentage of the nominal value of the debt” (IMF, 2003, External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary, IMF, Washington DC.)

The difference between the AfDB’s methodology and that of the IMF for the calculation of the grant element is on the use of an equivalent fixed rate of Non-concessional financing as Discount rate rather than the CIRR. For ADF-12 loan terms (2011-2013), this flat discount rate was estimated at 6%. The rate is currently determined at each ADF replenishment rather than annually.

IADB

At the IDB the appropriate degree of concessionality for each country is derived from the risk of debt distress indicators stemming from the Debt Sustainability Framework (DSF). A country with a high risk of debt distress would be granted a higher level of concessionality to contain the risk of debt accumulation and countries with a lower risk may receive lower concessionality. The IDB uses the IMF methodology to calculate concessionality.

The Debt Sustainability Framework and Enhanced Performance-Based Allocation (DSF/EPBA) framework was implemented as part of the concessional reform at the Bank after debt relief for D2 countries was approved under the IDB 07-relief initiative. Under the DSF/EPBA, the overall allocation of concessional resources is determined by a combination of country needs and performance, which determines the Fund for Special Operations (FSO) allocation; and the level of risk of debt distress, which defines the appropriate blend of Ordinary Capital (“OC”) resources with the individual countries’ FSO allocation. The DSF/EPBA therefore aims to ensure a strong link between concessional resource allocation and absorption capacity while preserving alignment with debt sustainability. (Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-Based Allocation 2009-2010)

The implied definition of concessionality is that anything offered on terms softer than those of the Ordinary Capital of the Bank is considered concessional.

***

B. Loans made from market-raised funds: How do you determine whether loans made from funds borrowed on the capital market are concessional? Please explain here:

AUSTRALIA

The Australian aid program does not provide loans from market raised funds.

AUSTRIA

The funds raised on the capital market are on the lending side offered on terms and conditions fulfilling the minimum concessionality requirement of the OECD Arrangement.
BELGIUM

Belgium has an interest bonification system. Interest bonifications are loans issued by a private banks for which the Federal Public Service Foreign affairs reduces the interest up to 0% and extends the repayment to 10 to 15 years depending on the DDR-level used by the OECD-Arrangement on officially supported export credits. The bonification results in a concessionality level of 35% by using the DDR as actualisation rate. The DDR is based on the CIRR ( DDR2012: 4,1% for loans with a repayment term less than 15 years.)

CANADA

Please see answer in A. The determination of concessionality should be made from the perspective of the recipient, not the provider.

EU

The EU applies for all its loans the three conditions as described above regardless of the source of funds. In fact, the current Directives does not make any difference between loans financed trough government budget or trough funds borrowed on the capital market.

Additionnally, from economics point of view lending at 2% interest from tax ressources is even more profitable (less effort from the donor side) for the donor as compared to lending at 3% from funds borrowed at 2% on the market.

In our opinion this question is misleading and completely detached from the question currently being discussed under the DAC mandate.

FRANCE

Conditions that determine whether a loan is concessional, or not, do not rely on the sources of the fundings (loan from the capital market or government revenue, or from a blending of both...) and at what cost the lender himself has raised these funds from the market.

The concessionality in character is determined in relation to the borrower’s access to the capital market: we consider a loan to be concessional if the rate applied to the borrower is lower than the one that he would have paid by raising funds on the capital markets. Another indication for concessionality is the non-existence of other capital market based instruments with the same maturity as the issued loan for the borrower.

GERMANY

We consider loans to be concessional if they are offered to the borrower at a lower rate than the borrower would normally pay on the capital markets. It does not matter how the lower rate is attained (e.g. through direct or indirect subsidies) and at what cost the lender himself has raised these funds from the market.

Another indication for concessionality is the non-existence of other capital market based instruments with the same maturity as the issued loan for the borrower.
HUNGARY

Eximbank borrows its funds from the market. The difference between the interest rate of the borrowed fund and the interest rate of the tied aid loan is compensated from the central budget.

ITALY

Loans made from funds borrowed on the capital market are considered as concessional when the loan grant element is at least equal to 25% with a DDR equal to 10%.

JAPAN

Japan understands “concessional in character” as interest rates below the prevailing market rate. Prevailing market rate is DDR.

KOREA

We consider that the concessionality of the loan does not depend upon how the fund is raised; the point to determine the concessionality of the loan is that under what condition the lender offers loan to the borrower (more favourable than the market rate or not). If the loan is provided with the condition suggested in ‘concessionality in character’ (as above explained), the loan can be considered to be concessional. Additionally, our institution does not raise the fund from the market.

PORTUGAL

We do not extend loans from funds directly borrowed on the capital market.

SPAIN

Not applicable.

SWEDEN

Our country combine a grant with marketbased financing.

AFDB

Given the calculation of the grant element explained in (A), loans made from funds borrowed on the capital market are deemed concessional if their implied grant element is at least 35%.

IADB

The IDB uses the IMF Concessionality Calculator and the CIRR discount rates.

No answer: DENMARK, LUXEMBOURG

***
C. Loans made from government revenue: How do you determine the concessionality in character of loans made from general revenue rather than from borrowing? Please explain here:

AUSTRALIA

The AIPRD (the Australia-Indonesia Partnership for Reconstruction and Development) is the only AusAID program under which loans are made within the Australian Government's aid program. The Australia-Indonesia Partnership for Reconstruction and Development Loans are highly concessional and meet the concessionality definition for including in ODA reporting. The financial characteristics of the AIPRD Loans, are:

A forty year loan;

Zero repayments for the first ten years, 1% semi-annually for the next ten years, and 2% semi-annually for the final twenty years; and

No interest accrues on the loans, other than on overdue repayments.

AUSTRIA

We do not provide loans from government revenue.

BELGIUM

The state to state loans provided by the Federal Public Service Finance have:

- a 0 or 2% interest rate depending on the World Bank status (linked to the GDP per capita) of the host country and the level of the OECD-arrangement DDR
- and a repayment terms of 20 years preceded by a 10 year grace period.

The calculation of the concessionality level is based on the Arrangement DDR for loans with a repayment schedule of 30 years or more (4.6 for 2012). The current concessionality level is 58.86% for 0% loans and 49.025% for 2% loans. These concessional loans are generally combined with commercial credit loans to reach a global concessionality level of 35% and, for LLDC’s even 50%.

CANADA

Please see answer in A. The determination of concessionality should be made from the perspective of the recipient, not the provider.

EU

See reply to question B above.

FRANCE

As explained in the previous answer, there is no distinction in terms of concessionality between loans made from government revenue or loans made from capital market fundings. Some loans even use a blendind of both sources.
GERMANY

As all MS agree that the definition of ODA should not be changed before 2015, we should not discuss the definition of concessional in character for all development loans.

What is in question now and what the DAC-chair has mandated the Working Party to clarify is the definition of concessional in character for market-based loans. We should not go beyond this remit.

ITALY

Loans made from governamental revenue are considered concessional when the loan grant element is at least equal to 25% with a DDR equal to 10%.

JAPAN

Japan understands “concessional in character” as interest rates below the prevailing market rate. Prevailing market rate is DDR.

KOREA

The loan our institution deals with is made from the government funding and this loan obviously aims the development and welfare of the developing countries, which satisfies with the criteria of ODA.

PORTUGAL

They must have an interest rate below the correspondent DDR.

SPAIN

See A.

Not applicable: SWEDEN, AFDB, IADB, HUNGARY.

No answer: DENMARK, LUXEMBOURG.

***

D. Possible qualitative test for concessionality of loans involving market-raised funds: Please indicate whether either or both options below would be acceptable to you. If both are acceptable, mark them 1 and 2 according to your preference. Leave boxes blank if options are unacceptable or you have no opinion.

Loans made from funds borrowed on the capital market should only be reported as concessional if:

a. the loan terms are more favourable than the terms on which the funds were borrowed.

b. a subsidy has been added which results in terms softer than those on which the funds were borrowed.

Only a. marked: ITALY.
Only **b.** marked: AUSTRIA, HUNGARY.

First preference **b.** and second preference **a.**: DENMARK and AFDB.

**a.** and **b.** both not acceptable: CANADA, EU, GERMANY, IADB, KOREA, SPAIN.

EU

**Comment:** The current DAC directives measure the concessionality through 2 different elements.

1. The first element is **quantitative** – the Grant Element formula calculated against 10% reference rate. This indicator shows the value of the donor effort measured against the lost economic opportunity for the donor. All the possible elements affecting the concessionality are integrated in this formula – grace period, maturity, interest rate including direct or indirect subsidy and type of repayment. The proposal from the Secretariat in this question limits the choice to the single interest rate subsidy between all possible financial elements available for achieving concessionality.

   From the other side, if the interest rate of the lending is to be below the cost of borrowing, this will completely invalidate the concept of lost opportunity for the donor. In fact not a single donor will borrow on the capital market if his most profitable use of funds gives an opportunity cost below the cost of the funds.

   At the last, this concept applied to funds from taxation implies a negative interest rate on the loan.

2. The second element is **qualitative** – the loan should be "concessional in character". The loan has to bear an interest rate below the rate that the borrower (partner country) would normally pay on the capital market. The concept of concessionality level set out in the Arrangement on Guidelines for Officially Supported Export Credits calculates the benefit for the borrower using the DDR as reference for market rates. If a loan bears an interest rate below the DDR, its concessionality is positive, thus giving the loan the qualitative measure for concessional in character.

   **Comment:** The Balance of payment manual defines in its paragraphs 104 and 105 concessional operations as follows: "other transactions may take place at implied prices that include some element of grant or concession so that those prices are not market prices. Examples of such transactions could include ... government loans bearing lower interest rates than those consistent with grace and repayment periods or other terms for purely commercial loans" (paragraph 104) and "In conformity with the procedure used for the national accounts, such resources should be valued at the market prices that would have been received if the resources had been sold." (para. 105).

   This shows clearly that market rates considered for concessionality are not the costs of funds for the lender, but well the price of the resseling of this funds.

FRANCE

Given AFD uses the reference market rate of the borrower, the options are irrelevant.

GERMANY

**Comment:** We think it should be distinguished whether members have no opinion or whether they find the options below unacceptable. For Germany neither of the two options is acceptable.
We do understand the Directives in a way that concessionality is determined by the borrowing costs for the recipient; not by the cost of funds for the lender.

If we took the costs of borrowing (fund raising) of the lender as reference, a lender would be “punished” for having a good credit rating. A bad credit-rating of the lender is of no value to the developing country whereas a good rating can be passed through.

KOREA

Concessionality does not seem to be related with the condition the donor borrows the fund. Same comments on the second option.

SPAIN

The reporting Directives don’t make a distinction between different sources for obtaining funds. According to Spain no criteria should be applied related to where the funds come from.

IADB

IDB prefers a quantitative methodology to avoid ambiguity. The qualitative tests presented leave a lot of room for interpretation of what is meant by “more favourable”. These tests could also result in concessionality measures that are not consistent with the DSF.

No answer: AUSTRALIA, BELGIUM, JAPAN, LUXEMBOURG, PORTUGAL, SWEDEN.

***

E. Possible quantitative tests of concessionality of all loans: Previous DAC discussions have proposed numerical tests of “concessionality in character”. Please indicate whether one or more of the three options below would be acceptable to you by marking them 1, 2, 3, according to your preference. Leave boxes blank if options are unacceptable or you have no opinion.

GERMANY

Comment: Section E proposes more definitions of concessional in character than are in question.

Again, as the ODA definition itself should not be amended before 2015, we should not discuss completely new options of definitions here. We should stick to the options for interpretation that the current Directives propose. Thus, the question is:

Does concessional in character require (1) a direct subsidy or is an indirect subsidy sufficient and (2) a rate below the prevailing market rate for the borrower or the lender?

E.1 Tests based on interest rate:

a. Interest rate lower than the DDR [cf. DCD/DAC(2003)25].

First preference: EU, GERMANY, JAPAN, KOREA, PORTUGAL, SPAIN. Third preference: AFDB, HUNGARY. See comments of others below.
b. Interest rate at least 25% below the DDR [cf. DCD/DAC/RD(2004)17/RD3].

First preference: AUSTRIA, DENMARK. Second preference: KOREA, AFDB, HUNGARY. See comments of others below.

c. Further option: Interest rate at least 25% below the CIRR (see last column here: http://www.oecd.org/dataoecd/44/36/49361333.pdf).

First preference: AFDB, BELGIUM, HUNGARY. Second preference: AUSTRIA. See comments of others below.

AUSTRIA

Comment: The preference below does not apply to the Austran Soft Loan Programme mentioned above, which follows the rules of the arrangement.

CANADA

a. Not acceptable
b. Not acceptable
c. Not acceptable

EU

b. Not acceptable
c. Not acceptable

Comment: The options 2 and 3 were rejected from the DAC in 2003-2004 so they can't be considered as current working reference for the "prevailing market rates" defining the concessional character of ODA loans.

FRANCE

Given AFD uses the reference market rate of the borrower, the options are irrelevant.

GERMANY

a. “of the borrower” added at the end of option a.

b. Not acceptable
c. Not acceptable

SPAIN

a. 1 Interest rate lower than the DDR, although recipient country financing conditions should be taken into account

b. Not acceptable
c. Not acceptable

IADB

*Using an interest rate based approach might not ensure the necessary level of concessionality according to the DSF.*

No answer: AUSTRALIA, ITALY, LUXEMBOURG, SWEDEN.

***

E.2 Tests based on a minimum concessionality benchmark: Other tests of concessionality are also in use. Please indicate whether one or several options below would be acceptable to you. If all three are acceptable, mark them 1, 2 and 3 according to your preference. Leave boxes blank if options are unacceptable or you have no opinion.

a. Tied Aid benchmark: minimum 35% concessionality level, measured against the DDR applying in the year of the loan (cf. paragraph 38 in


First preference: HUNGARY, ITALY, KOREA, PORTUGAL. Second preference: BELGIUM. Third preference: AFDB. See comments of others below.

b. IMF benchmark: minimum 35% “grant element” [concessionality level], measured against CIRRs differentiated according to loan length (http://www.imf.org/external/np/pdr/conc/index.htm)

First preference: BELGIUM, DENMARK, AFDB, IADB. Second preference: KOREA. See comments of others below.

c. Further option: Possible simplified IMF approach: minimum 35% grant element, measured against average of the CIRRs (i.e. the rates shown each year in the last column here: http://www.oecd.org/dataoecd/44/36/49361333.pdf)

Second preference: AFDB. See comments of others below.

CANADA

a. Not acceptable

b. Not acceptable

c. Not acceptable

EU

Comment: Any one of this options implies a change in the current ODA definition.

Additionally all the three options represent a quantitative mesure for concessionality, so they can't be considered as current working mesure for DAC reporting of ODA loans, as the quantitative mesure is the Grant Element.
**FRANCE**

*Given AFD uses the reference market rate of the borrower, the options are irrelevant.*

**SPAIN**

*We understand that this question does not apply to the definition of “concessional in character” and therefore does not have any relevance in the context of this Facilitator Group.*

**IADB**

*b. 1 Please note that although the 35% is a benchmark, the IMF accepts lower GE levels if consistent with DSF and capacity management.*

No answer: AUSTRALIA, AUSTRIA, GERMANY, JAPAN, LUXEMBOURG, SWEDEN.

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**F.** If you have any other suggestion(s) on how to determine “concessionality in character”, please write it/them here:

[As this question was optional, only substantive replies are shown.]

**BELGIUM**

*Belgium is much in favour of a uniformity between de DAC-Stat and the OECD-arrangement for the calculation of the concessionality level of loans.*

**CANADA**

*As reflected in the definition provided in question A, we are of the opinion that the concessionality of financing should be determined based on the benefit to the borrower, either in form of reduced cost, or in terms of other risks being taken over by the lender. Concessionality determined from the perspective of the provider introduces complicating factors, including the provider’s creditworthiness and cost of funds, that have no bearing on the financial or development benefit that the funds provide for the recipient. We would be opened to discuss definitions that take these perspectives into account.*

**FRANCE**

*The concessionality is defined from the borrower’s side. For further explanations, please find attached to this survey a more detailed note. [This is provided in the Annex.]*

**JAPAN**

*Regarding the question D., Japan can only accept the case that the loan terms are more favourable than the terms on prevailing market loan rate. Prevailing market loan rate is DDR.*
All options in the question E.2 is the point at issue about ODA definition. We should not discuss this theme in the task team, because the argument about the way of calculating a grant element deviates from the mandate specified by the DAC.

**LUXEMBOURG**

Similar to comments made by Germany we would like to underline that the definition of ODA should not be changed before 2015 and a change in reporting practice/ definitions should avoid impacts on ODA volumes which could put the credibility of DAC reporting at risk.

**SPAIN**

Until now, only the capital of donor countries has been taken into account for considering if a loan is “concessional in character”. For a partner country it is more relevant if the interest is concessional in the sense that it is below the interest against which it would have to finance itself on the market. It would be good to take this into account in the discussion on this subject.

**SWEDEN**

When using a discount rate for calculation of the concessionality, it is important that it is realistic and not a fixed rate at 10%.

**IADB**

Some of the concepts used to define concessionality for CRS reporting may require special consideration in the case of MDBs.

It would be useful to clarify if the concessionality of a given loan is to be determined at the time of approval or at the time of reporting.
Annex 1. Response by POLAND [text below]

Referring to the clarification of the existing definition of “concessionality in character” in DAC statistics, let me inform you as follows:

The concessionality level of tied aid credits provided by Polish Ministry of Finance is defined in the “Arrangement on officially supported export credits” published by Trade and Agricultural Directorate OECD. According to this document, the concessionality level of export credits should be equal to minimum 35 % (or 50 % in the case of the poorest countries) and is calculated on the basis of the annually published DDR (Differentiated Discount Rate) dependent on the currency of a credit and its repayment terms.

The subject of the questions contained in the Concessionality Survey concerns loans of minimum 25 % concessionality level calculated on the basis of 10 % discount rate. Loans under such conditions are not currently provided by the Polish Ministry of Finance.

However, the Polish position on loans provided under conditions presented by the DAC is subject to an analysis in the Ministry of Finance and will be sent to DAC OECD in the near future.

Annex 2. Letter by GERMANY: note from the Federal Ministry for Economic Cooperation and Development of Germany to the members of the DAC WP-STAT, 18 July 2012. [attached as a PDF]

Annex 3. Note by FRANCE : « Of the Measure of the Concessionality »/ « De la mesure de la concessionnalité », 16 July 2012. [attached as a PDF]

Annex 4. Appendix 3 of the EU survey reply: DDR as reference rate for prevailing market rates e-mails from DCD Secretariat and official publication
Federal Ministry for Economic Cooperation and Development, Germany

ANNEX 2: Letter by GERMANY

18 July 2012

To the members of the OECD/DAC Working Party on Development Finance Statistics

Dear fellow members of the Working Party,

On 16 June 2012, the Survey of Approaches to Determining Concessionality of Loans was circulated and we were asked to explain, by 23 July 2012, the way we apply the definition of "concessional in character."

We would like to thank Hedi Riegler and the team of Simon Scott that they launched this extremely important and urgent process so quickly. As you know, DAC Chair Brian Atwood has mandated WP STAT to submit proposals for the clarification of the definition in time for the High Level Meeting in December. So it is important that we ensure constructive and swift progress of the work of the Facilitator Group/Task Team and that we engage in an open discussion. We greatly welcome the fact that the process was started by asking members to describe their practice in interpreting the definition.

At the same time, however, we would like to remind us that at the Senior Level Meeting in April we agreed that the Directives should be clarified in greater detail but that the definition of ODA should remain unchanged until 2015. In view of this, we deem it very important that the effort to clarify the definition of "concessional in character" be limited, from the beginning, to those points that are actually contentious.

In our understanding, there is a single definition of "concessional in character" for loans made from government revenue that is applied by all member states alike and enjoys universal acceptance. It is only when it comes to loans made from market-raised funds that there are differing views on whether (1) "concessional in character" requires a direct subsidy or whether indirect subsidies such as guarantees are also acceptable, and whether (2) the resulting interest rate must be below the donor's acquisition cost or whether it must be below the market interest rate that the borrower would usually have to pay. This does not affect the other criterion, a grant element of 25 per cent.

Given this background, we feel that the survey should focus on the said points over which there is disagreement. Part C of the survey is not relevant to these points. Part D (qualitative tests) should inquire about the alternative interpretations mentioned before.

Moreover, when it comes to quantitative tests (Part E), discussion should be limited to those that have already been proposed. No new concepts should be proposed. There are undoubtedly more concepts than the one that has so far been the basis of the OECD's definition of ODA, but we should discuss them in the debate about a post-2015 FfD Reporting Framework and not before.

We would be glad if the survey could produce a clear standpoint that upholds the integrity of the definition of ODA and that can serve as a basis for the Facilitator Group/Task Team to continue its work on clarifying the definition of "concessional in character."
Given this background, we would like to encourage members to answer the survey in such a way that existing practice can be upheld to the greatest possible degree and that only those points that are really contentious are clarified. Moreover, for the sake of methodological accuracy it should be made absolutely clear whether an empty box means "no opinion" or "unacceptable."

Yours sincerely,

[Signature]

Dr. Jürgen Zattler
Deputy Director-General for European and Multilateral Development Policy; Globalization and Trade
Of the measure of the concessionality

The DAC Working Party on statistics launched a work on the clarification of concept of « concessionality in character » which is one of the conditions of eligibility to ODA.

The present note displays, from the experience of Agence Française de Développement (AFD), on the various elements which compose the cost a donor when it operates with loans, the advantage brought to the borrower, and the origin of variation of these two measurements.

The definition of ODA answers to three criteria which release from a double logical frame:

1. it measures flows which have to contribute to the economic and social development of the beneficiary countries;

2. to be able to qualify in ODA, it must bear a cost of opportunity for the donor (in comparison with a reference discount rate of 10 %, supposed to reflect the marginal economic rate of return on public investment in the donor country);

3. finally, it must be concessional in character, i.e. present « favourable conditions » in comparison with a reference market. This third condition has remained ambiguous since the origin, because it has never been clarified whether it refers to the beneficiary’s (in coherence with the logic expressed by the first criteria) or the donor’s reference market (in link with the logic expressed by the second criteria).

One proposes below a diagram breaking up the various components of the cost of a loan and its relationship to the advantage for the recipient.

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**ANNEX 3: Note by FRANCE**
The cost of reference of a loan for the donor is the addition of several components:

- (a) the cost of the resource of reference: the majority of the financing of the loans of AFD comes from emissions on the financial markets. Only the very concessional loans (30 years including 10 years of grace period, interest rate 0.5%) are entirely refinanced by loans of the French State to AFD. For the other loans, AFD is refinanced on the financial markets, and it shares with the recipient his privileged access with resource in EURO or in USD. In the case of the AFD, the estimated average costs of the resource is based on a refinancing at 10 years, which is shorter than the duration of the majority of the loans offered to the partner countries. This is an advantage since the spread between the borrowers with best ratings and those with worst ratings tend to increase when the duration of the credit increases. Moreover, the AFD offers a foreseeability of the level of rates offered higher than the markets (the average costs of the resource are updated semi-annually): it thus protects the recipients from part of the fluctuations of the markets;

- (b) the operating margin: it is equal to the costs of structure necessary to the preparation and the implementation of the credit. It does not integrate the return on the equity capital: the operation of the Agency is thus non profitable;

- (c) the country risk: the sovereign risk is the risk associated in a given State. The measurement of this risk is an essential variable of the credit cost and highly varies from one country to another. The OECD Arrangement, for example, identifies 7 levels of country risk amongst developing countries. An agency as AFD draws up its own estimation of the cost of the country risk premium, mainly based on the fundamental parameters of the country and thus relatively stable. Its financial offer has a stability for this reason definitely higher than those based on the market ratings, which are more volatile and generally more penalizing for the developing countries;

- (d) the risk of counterpart: it is the risk specifically related to the borrower, when this one is not the State or does not receive a State guarantee (local government agency, public enterprise, development bank, institution of meso or microfinance, private company for specific operations…). As for the case of the countries, the estimated risk premium can highly vary from one counterpart to another;

- (e) the exchange rate risk is calculated when AFD proposes a credit in local currency. The loans in local currency are still rare because of their cost for the borrower, who often prefers to support the exchange rate risk by itself, in particular if part of its revenues, general or those expected from the financed project, is denominated in foreign currencies;

- (g) the donor can, if necessary, bring a subsidy to reduce the lending rate of his credit (f) if it is required by the direct return on investment of the financed project, or if the capacities of repayment of the borrower are fragile.

On these bases, the estimate of the advantage offered to the recipient (j) can be evaluated according to situations:

- when there exists a market of reference (k) for the recipient, the advantage is the difference between the borrowing rate (h) offered to the recipient by the co-operation agency and this rate of alternative financing (k). This one can break up into two elements: on the one hand, a possible contribution of subsidy (g), i.e. a public finance explicitly intended to lowering the interest rate of the credit; on another hand, the notional advantage gotten by the intermediation of the donor’s public agency (i) due to the fact that the sum of the costs (a) to (e) will be generally lower than the local financial market offered rate;
if there is no alternate financial market, it is obvious that the credit is done “with favorable conditions” since it does provide a service which, otherwise, would not exist. In practice, it is the case on many countries for maturities to which AFD operates (on average 17 years and up to 30 years for AFD, with a clause of non-repayment before mid-term, which guarantees that the financing is actually used for long-term investments).

In short, the contribution of a subsidy is the most visible of the brought advantages but it is not the only one: in practice, the notional advantage gotten by the intermediation of the co-operation agencies, their capacity to lend at long to very long term, and their tolerance to risks, also play a central role in terms of development assistance. In addition, due to the fact that the access cost to the financial markets of certain member countries of the DAC is, at the present time, higher than that of certain developing countries, the contribution of a subsidy is not a sufficient condition to constitute an advantage.

The approach suggested by the questionnaire primarily amounts wondering about the value which must be used as reference for the calculation of the cost of the resource (a), while letting aside all the other variables contributing to determine the advantage provided to the recipient.

However, the capacity to accept and manage the risks specifically associated with development (longer term financing, new or unknown actors or sectors, managed volatility or even contracyclical role) contributes largely to the added-value of the development finance institutions. The measurement of the gotten advantage, if it evolves, must imperatively integrate the cost of the risks, because failing this would explicitly encourage the least risky loans. Not taking into account the risks would go against two recommendations of the Busan Conference: need for integrating and for managing the risks associated with development (§18.a.) and the challenge to support the diversification of the societies, in particular reinforcement of the local governments (§21.b) and of the private sector (32.c).

However, it is difficult to objectify the measurement of the risks today. The OECD Arrangement provides indications for the measurement of the country risks through the definition of the minimum premium rate declined according to 7 categories of developing countries, but there does not exist standardized evaluation of the cost of the risks of counterparts and exchange rate which the DAC could readily use.

Any revision of the mode of estimate of the “favourable conditions” offered to the recipient towards a formal calculation should initially pass by this stage of calculation of the “cost of the risk”. Failing this, a qualitative evaluation of the gotten advantage, such as it is currently carried out, remains the best solution.

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1 “Developing countries efforts and plans to strengthen core institutions and policies will be supported through approaches that aim to manage - rather than avoid - risk, including through the development of joint risk management frameworks with providers of development co-operation”.

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ANNEX 3: Note by FRANCE

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De la mesure de la concessionnalité

Le groupe de travail du CAD sur les statistiques a lancé un travail sur l’explicitation du concept de « concessionnalité en caractère » qui est une des conditions de l’éligibilité à l’APD.

La présente note expose, à partir de l’expérience de l’AFD, les divers éléments qui composent le coût d’une offre pour un bailleur de fonds lorsqu’il opère avec des prêts, et l’avantage procuré au bénéficiaire, et les sources de variation de ces deux mesures.

La définition de l’APD répond à trois critères qui relèvent d’une double logique :

1. elle mesure des flux qui doivent contribuer au développement économique et social des pays bénéficiaires ;

2. elle doit, pour être qualifiable en APD, présenter un coût d’opportunité pour le donateur (par rapport à une référence de 10% censée refléter la rentabilité économique marginale de l’investissement public dans le pays donateur) ;

3. enfin, elle doit être concessionnelle en caractère, c’est-à-dire présenter des « conditions favorables » par rapport à un marché de référence. Cette troisième condition reste ambiguë depuis l’origine, car il n’a jamais été explicité s’il s’agit du marché de référence du pays bénéficiaire (en cohérence avec la logique exprimée par la condition 1) ou bien celui du pays donateur (en lien avec la logique exprimée par la condition 2).

On propose ci-dessous un schéma décomposant les diverses composantes du coût de revient d’un prêt et de sa relation avec l’avantage procuré au bénéficiaire.
Le coût de référence d’un prêt pour le donateur est l’addition de plusieurs composantes :

- (a) le coût de la ressource de référence : la majorité du financement des prêts de l’AFD provient d’émissions sur les marchés financiers. Seuls les prêts très concessionnels (30 ans dont 10 ans de différé, taux d’intérêt 0,5%) sont entièrement refinancés par des prêts de l’Etat français à l’AFD. Pour les autres prêts, l’AFD se refinancie sur les marchés financiers, et elle partage avec le bénéficiaire son accès privilégié à de la ressource en EURO ou en USD. Dans le cas de l’AFD, le coût moyen estimé de la ressource est basé sur un refinancement à 10 ans, ce qui est plus court que la durée pondérée de la majorité des crédits offerts aux pays bénéficiaires. Or, l’écart de taux entre les emprunteurs les mieux notés et ceux moins bien notés tend à s’accroître lorsque la durée du crédit s’accroît. En outre, l’AFD offre une prévisibilité du niveau de taux offerts supérieure aux marchés (le coût moyen de la ressource est actualisé semestriellement par l’AFD) ; elle protège ainsi les bénéficiaires d’une partie des fluctuations des marchés ;

- (b) la marge opérationnelle : elle est égale aux coûts de structure nécessaires à la préparation et la mise en œuvre du crédit. Elle n’intègre pas la rémunération des capitaux : le fonctionnement de l’Agence est donc non lucratif ;

- (c) le risque pays : le risque souverain est le risque associé à un Etat donné. La mesure de ce risque est une variable essentielle du coût des crédits et varie fortement d’un pays à l’autre. L’Arrangement de l’OCDE, par exemple, identifie 7 niveaux de risque pays au sein des pays en développement. Une agence comme l’AFD établit sa propre estimation du coût du risque pays, principalement basée sur les paramètres fondamentaux du pays et donc relativement stable. Son offre financière présente à ce titre une stabilité nettement plus élevée que celles basées sur les notations de marché plus volatiles et généralement plus pénalisantes pour les pays en développement ;

- (d) le risque de contrepartie : c’est le risque spéciﬁquement lié à l’emprunteur, lorsque celui-ci n’est pas l’Etat ou ne bénéﬁcie pas de la garantie de l’Etat (collectivité locale, régie ou entreprise publique, banque de développement, institution de méso ou micro-finance, entreprise privée dans certains cas particuliers, …). Comme pour le cas des pays, le coût d’appréciation du risque peut varier fortement d’une contrepartie à une autre ;

- (e) le risque de change se calcule lorsque l’AFD propose un crédit en devise locale. Les crédits en devise locale sont encore rares du fait de leur coût pour l’emprunteur, qui préfère souvent prendre lui-même le risque de change, notamment si une partie de ses recettes, générales ou celles attendues du projet ﬁnancé, se fait en devises ;

- (g) le donateur peut, le cas échéant, apporter une boniﬁcation pour réduire le coût de sortie de son crédit (f) si la rentabilité directe du projet ﬁnancé le requiert ou si les capacités de remboursement de l’emprunteur sont fragiles.

Sur ces bases, l’estimation de l’avantage procuré au bénéficiaire (j) peut être évalué selon deux cas de figure :

- lorsqu’il existe un marché de référence (k) pour le bénéficiaire, l’avantage procuré est l’écart entre le taux de sortie (h) proposé au bénéficiaire par l’agence de coopération et ce taux de ﬁnancement alternatif (k). Celui-ci peut se décomposer en deux éléments : d’une part, un apport éventuel de boniﬁcation (g), c’est-à-dire un ﬁnancement public explicitement destiné à diminuer le taux d’intérêt du crédit ; d’autre part, l’avantage notionnel procuré par l’intermédiaire de l’agence publique (i) qui résulte du fait que la somme des coûts (a) à (e) sera généralement inférieure à ce que peut oﬀrir le marché ﬁnancier local ;

ANNEX 3: Note by FRANCE
s’il n’y a pas de marché financier alternatif, il est évident que le crédit se fait « à conditions favorables » puisqu’il rend un service qui, autrement, n’existerait pas. En pratique, c’est le cas sur de nombreux pays pour les maturités auxquelles intervient l’AFD (en moyenne 17 ans et jusqu’à 30 ans pour l’AFD, avec une clause de non remboursement avant la moitié du prêt qui garantit que le financement est effectivement utilisé pour des investissements à long terme).

En résumé, l’apport de bonification est le plus visible des avantages apportés mais il n’est pas le seul : en pratique, l’avantage notionnel procuré par l’intermédiation des agences de coopération, leur capacité à prêter à long ou très long terme et leur tolérance au risque, joue également un rôle majeur d’aide au développement. Par ailleurs, l’apport de bonification n’est pas une condition suffisante pour fournir un avantage, dès lors le coût d’accès aux marchés financiers de certains pays membres du CAD est, à l’heure actuelle, supérieur à celui de certains pays en développement.

La démarche proposée par le questionnaire revient essentiellement à s’interroger sur la valeur qui doit servir de référence pour le calcul du coût de la ressource (a), en ignorant l’ensemble des autres variables contribuant à déterminer l’avantage fourni au bénéficiaire.

Or, la capacité à accepter et gérer les risques spécifiques au développement (durée longue, acteurs ou domaines nouveaux et peu connus, moindre volatilité voire rôle contracyclique) contribue largement à la valeur ajoutée des financements des institutions financières de développement. La mesure de l’avantage procuré, si elle doit évoluer, doit impérativement intégrer le coût des risques, car à défaut ceci encouragerait explicitement les prêts les moins risqués. L’absence de prise en compte des risques irait à l’encontre de deux recommandations de la Conférence de Busan : la nécessité d’intégrer et gérer les risques inhérents au développement (§18.a) et l’enjeu d’appuyer la diversification des sociétés notamment le renforcement des collectivités locales (§21.b) et du rôle du secteur privé (§32.c).

Toutefois, il est difficile aujourd’hui d’objectiver la mesure des risques. L’Arrangement fournit des indications pour la mesure des risques pays à travers la définition des taux de prime minimum décliné selon 7 catégories de pays en développement, mais il n’existe pas d’évaluation standardisée du coût du risque de contrepartie et de change que le CAD pourrait facilement s’approprier.

Toute révision du mode d’estimation des « conditions favorables » offertes au bénéficiaire vers un calcul formel devrait en premier lieu passer par cette étape de calcul du « coût du risque ». A défaut, une évaluation qualitative de l’avantage procuré, telle qu’elle est effectuée actuellement, reste la meilleure solution.

1 les efforts déployés et les plans définis par les pays en développement pour renforcer leurs institutions essentielles et leurs politiques seront soutenus au moyen d’approches visant à gérer - et non à éviter - les risques, notamment à travers la mise au point de cadres conjoints de gestion des risques avec les fournisseurs de coopération pour le développement.
Appendix 3: DDR as reference rate for prevailing market rates e-mails from DCD Secretariat and official publication

From: DCD Secretariat  
Sent: Friday, November 28, 2008 5:46 PM  
To: EU  
Subject: FW: STAT(2008)45 Prêts de la BEI

....

From: DCD Secretariat  
Sent: Friday, November 07, 2008 11:10 AM  
To: EU  

....

2. Les « ressources propres ». L’élément don ≥ 25% est un critère APD. Par contre, selon la définition du CAD, la bonification d’intérêt n’en est pas un... Si ces projets ont un objectif développemental explicite (visible dans la description du projet), alors ils seraient considérés comme prêts APD. Par contre, si l'objectif est commercial alors ils tomberaient sous la catégorie AASP (d’après le fichier excel, les conditions sont assez proches de celles du marché...).

CONCESSIONAL IN CHARACTER

From the earliest discussions of the concept of ODA, Members agreed that it should represent an effort in favour of developing countries by the official sector. Loans at market terms were excluded. When in the early 1970s interest rates began rising sharply, it was further specified that loans could only be reported as ODA if they had a grant element of at least 25 per cent, calculated against a notional reference rate of 10 per cent per annum.

These elements remain today. In recent years, long-term interest rates in most OECD Member countries have fallen well below 10 per cent, so the 25 per cent grant element level has become easier to attain. But to qualify as ODA, loans must still be concessional in character, i.e. below market interest rates.

Where concessional and non-concessional financing are combined in so-called “associated financing packages”, the official and concessional elements may be reported as ODA, provided they have a grant element of at least 25 per cent. Such contributions must also meet the special concessionality tests for associated financing, which are based on market interest rates and set out in the Arrangement on Guidelines for Officially Supported Export Credits (OECD, 2006 Revision).