DAC Working Party on Development Finance Statistics

IMPLEMENTATION OF THE HLM AGREEMENT ON CONCESSIONALITY: TREATMENT OF LOANS TO MULTILATERAL INSTITUTIONS

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Members are invited to comment at the WP-STAT meeting on 2-3 November 2015 and in writing by 15 November 2015.

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IMPLEMENTATION OF THE HLM AGREEMENT ON CONCESSIONALITY: TREATMENT OF LOANS TO MULTILATERAL INSTITUTIONS

1. The December 2014 DAC High Level Meeting (HLM) agreed to modernise the reporting of concessional loans by introducing a grant equivalent system for the purpose of calculating ODA figures; it also acknowledged risk in the assessment of concessionality and agreed upon a quantitative definition of concessionality differentiated by income group. The Working Party on Development Finance Statistics (WP-STAT) was tasked to implement the agreement by the end of 2015. The review of the implication of these changes on the reporting of loans to multilateral institutions and multi-country agreements was separately identified in the workplan to implement the HLM decisions [DCD/DAC/RD(2015)7/RD5]. In light of members’ earlier comments on this topic, initial consultations with multilateral institutions, and analysis of risk ratings of multilateral development banks, this note presents a first proposal on the treatment of loans to multilateral institutions and multi-country agreements in modernised ODA. The proposal is presented for members’ comments at the WP-STAT meeting on 2-3 November 2015 and in writing by 15 November 2015. The Secretariat will subsequently consult with multilateral organisations more broadly to confirm they find the proposal appropriate, and finalise it for inclusion in the draft revised Reporting Directives to be presented for approval by the DAC by the end of 2015.

I. Loans to multilateral institutions

2. To analyse the implications of the HLM agreement on the treatment of loans to multilateral organisations and to derive the appropriate modalities of its application, all parameters of the agreement need to be reviewed and a decision taken on whether any adjustments are needed for implementing the agreement in the reporting on loans to multilateral institutions. Parameters comprise i) the methodology for accounting ODA (grant equivalent); ii) the assessment of concessionality based on differentiated discount rates; and iii) the eligibility thresholds.

i) Method for accounting ODA – grant equivalent system

HLM decision: “modernise the reporting of concessional loans to make it easier to compare the effort involved with that in providing grants, by introducing a grant equivalent system for the purpose of calculating ODA figures”

3. The reasoning of grant equivalents facilitating comparisons of donor effort involved in providing loans and grants is valid to contributions to multilateral institutions in the same manner as bilateral contributions. Also, it would not seem consistent to mix in the same ODA measure grant equivalents for bilateral loans and flows for loans to multilaterals. It therefore seems logical to modernise the reporting on loans to multilateral institutions by introducing a grant equivalent system for accounting them in ODA. In their earlier comments, members have indicated that they agreed with that approach and there does not seem to be any impediment to do so.¹

→ Proposal: apply the grant equivalent system to loans to multilateral institutions

¹ This was discussed at the WP-STAT meeting in March 2015 (see action points in Annex) and several members subsequently commented either in meetings or in writing in that sense.
ii) Assessment of concessionality – differentiated discount rates

**HLM decision:** “The donor effort in providing a loan consists both of the funding cost of the loan and the risk associated with it. Recognising that lending to poorer countries involves greater donor effort than lending to richer countries, we have decided to assess concessionality based on differentiated discount rates. The rates will consist of a base factor, which will be the IMF discount rate (currently 5%), and an adjustment factor of 1% for UMICs, 2% for LMICs and 4% for LDCs and other LICs.”

4. To construct the discount rate for assessing the concessionality of loans to multilateral institutions, two elements need to be determined *i.e.;* the base factor (reflecting the funding cost) of the loan and the adjustment factor (cost of risk). Lending to a multilateral versus a bilateral body has no bearing on the funding cost of the loan and the base factor should be aligned to the IMF discount rate, *i.e.* 5% currently. As regards the risk associated with lending to multilateral institutions, members have earlier indicated that they generally agreed that it was lower than in lending to countries, but that there may be differences between major multilateral organisations with preferred creditor status (such as World Bank, Regional Development Banks) and sub-regional organisations.

5. The Secretariat has reviewed the credit ratings of multilateral institutions. It notes that concessional windows of multilateral development banks are not credit rated (they obtain funds through replenishments and retained earnings and do not need to raise funds on the markets). The rating is at AA or above for practically all global and regional institutions covered in the analysis of “Supranationals special edition 2012 from the Sovereign Ratings Group, Standard & Poor’s ratings Services” (see Annex 2). This confirms that lending to multilateral institutions is generally less risky than lending to countries, and there seems to be little ground for including a risk factor in the assessment of concessionality of loans to global and regional institutions, i.e. the discount rate should only reflect the funding cost. A risk factor could be considered for subregional institutions given that they generally have lower credit ratings. **Members’ comments are invited.**

→ Proposal: calculate the grant element of loans to global and regional institutions using the IMF uniform discount rate (currently 5%); consider a risk factor for sub-regional institutions.

iii) Eligibility thresholds

**HLM decision:** “To ensure that loans to LDCs and other LICs are provided at highly concessional terms, only loans with a grant element of at least 45% will be reportable as ODA. The need for concessionality reduces as countries become richer. So we have agreed that loans to LMICs need to have a grant element of at least 15%, and those to UMICs of at least 10%, in order to be reportable as ODA.”

6. A few members have commented on the appropriateness of the thresholds to lending to multilateral institutions. Some noted that safeguards in the form of concessionality thresholds were not necessarily required as debt sustainability concerns were not relevant in this. However, others emphasised that any decision on the ODA eligibility of loans to multilateral organisations should be taken in consultation with them. Indeed, the conditions of loans may affect the way institutions work and a low concessionality may skew their allocations. At the same time, multilateral development banks use the IMF definition of concessionality. Therefore, for the sake of consistency, the Secretariat proposes to apply the IMF concessionality threshold of 35%.

→ Proposal: apply the IMF threshold of 35%

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2. The methodology for establishing the credit rating for a multilateral institution is based on both its stand-alone financial strength (including capital adequacy and liquidity) and the strength of its shareholder support (through callable capital).

3. EIB and CEB are classified as “other multilateral lending institutions” in this analysis.
7. In recent years members have reported only a few loans to a few multilateral organisations, including to the IMF. Although this type of financing could be increasing in future, the Secretariat would recommend a pragmatic approach as outlined above, noting that these loans would in any case be part of the Secretariat monitoring exercise planned as part of the implementation of the HLM agreement.

II. Multi-country agreements

8. For loans in the form of multi-country agreements or cases where the exact allocation and beneficiaries are not specified at the time of commitment (credit lines), the Secretariat proposes the pragmatic approach of applying the discount rate and threshold of the income group to which all, or a majority of countries in the agreement, belong. Members would be requested to indicate the list of countries in their CRS reporting (text field), for the sake of transparency and to allow quality controls.
ANNEX 1. ACTION POINTS FROM THE WP-STAT INFORMAL MEETING IN MARCH 2015

2.c Treatment of loans to multilateral organisations, multi-country agreements (oral presentation)

9. The Secretariat explained that under the current Reporting Directives the ODA eligibility of a loan was assessed on the basis of its developmental motivation and its terms, but no distinction was made between official and private borrowers, or bilateral and multilateral borrowers. With the understanding that the HLM agreement only applied to sovereign loans, further work was required to specify the treatment of loans to private borrowers (see agenda item 3.b) and multilateral borrowers.

10. Members generally agreed that the reporting on loans to multilateral organisations should be on grant equivalent basis. They also generally agreed that the risks in lending to multilateral organisations were lower than in lending to countries, but that there was a difference between major multilateral organisations with preferred creditor status (such as World Bank, Regional Development Banks) and sub-regional organisations.

11. The Secretariat will present an analysis of the risk profiles of multilateral organisations for discussion at WP-STAT meeting in the Fall. Members are invited to send to the Secretariat any relevant material in this regard. (The base factor of the discount rate would be the same as for sovereign loans.)
ANNEX 2. CREDIT RATINGS OF ODA-ELIGIBLE MULTILATERAL INSTITUTIONS

_Supranationals special edition 2012 from the Sovereign Ratings Group, Standard & Poor's ratings Services_


**Global institutions**
- International Bank for Reconstruction and Development: AAA
- International Finance Corporation: AAA

**Regional institutions**
- African Development Bank: AAA
- African Export-Import Bank: BBB-
- Asian Development Bank: AAA
- Andean Development Corporation: AA-
- European Bank for Reconstruction and Development: AAA
- Inter-American Development Bank: AAA
- Inter-American Investment Corporation: AA
- Islamic Development Bank: AAA

**Subregional institutions**
- Black Sea Trade and Development Bank: A-
- Caribbean Development Bank: AA
- Central African States Development Bank: _not rated_
- Central American Bank for Economic Integration: A
- Eastern and Southern African Trade and Development Bank (Moody’s): BB+
- West African Development Bank (Moody’s): BBB+

**Other multilateral lending institutions**
- Council of Europe Development Bank: AA+
- European Investment Bank: AAA