

The ADF-12 Financing Framework

Discussion Paper

ADF-12 Replenishment
February 2010
Cape Town, South Africa



AFRICAN DEVELOPMENT FUND

Executive Summary

The ADF-12 replenishment comes at a time when the Fund's resources are under more pressure than ever before. The effects of the financial and economic crises are deeply felt in Africa, and the ADF has experienced a substantial increase in requests for assistance. Complementing the paper "The Long-Term Financial Integrity of the ADF," this paper discusses sources of financing, specifically (i) donor contributions, (ii) internally generated resources based on the Advance Commitment Capacity (ACC), and (iii) funds carried over from previous replenishments. It also proposes financing terms for donor contributions and presents an indicative financing framework for 2011-2013 with three financing scenarios.

Donors and Management alike face considerable financial challenges in providing the Fund with a replenishment for ADF-12 that will allow the Fund to maximize its capacity as a powerful force for Africa's development, which it now has the demonstrated capacity to be. In particular, Management's scope for generating internal resources is severely constrained compared to the exceptional level of UA 2,063 million achieved in ADF-11. This is primarily due to two factors: lower investment income due to lower interest rates, and the unanticipated food and financial crises, which led to greater loan restructuring and, consequently, lower loan cancellations. Management is committed to doing all it can to maximize internally generated resources, in partnership with the strong efforts of ADF donors, so as to ensure an overall resource level that allows the Fund to respond to ADF countries' needs and fulfill its mandate.

Deputies are invited to provide their views on these financing scenarios and to endorse Management's proposals for (i) a 6-month reference period for determining the exchange rates for the replenishment; (ii) a standard payment and encashment schedule; and, (iii) an index for the discount rate for accelerated encashments.

Based on current demand, this paper presents three financing scenarios: (i) a baseline scenario that maintains the level of ADF-11 resources constant in real terms; (ii) a 50 percent increase in the Fund's resources as compared to ADF-11; and, (iii) a 70 percent increase over ADF-11. Because of the lower ACC during ADF-12, contributions from donor countries will need to increase significantly in each of the three scenarios.

Table of Contents

Abbreviations	iii
1. Introduction	1
2. Fund Resources	1
<i>Donor Resources: Components and Financing Terms.....</i>	<i>1</i>
<i>Internally Generated Resources: The Advance Commitment Capacity</i>	<i>4</i>
<i>Resources carried over from previous replenishments</i>	<i>7</i>
3. Indicative Financing Framework	8
4. Conclusion and Recommendations	9
Annex I: Compensation for ADF-9 Grants During the ADF-12, ADF-13 and ADF-14 Periods.....	10
Annex II: Core Assumptions for ADF-10, ADF-11 and ADF-12.....	11
Tables	
Table 1: The Standard Encashment Schedule for ADF-12	3
Table 2: Advance Commitment Capacity Amounts According to Various Multilateral Debt Relief Initiative Compensation Scenarios	6
Table 3: Estimated Carry-Over Resources in ADF-12	7
Table 4: Three Indicative Financing Scenarios for ADF-12.....	8
Figures	
Figure 1: Advance Commitment Capacity	5

Abbreviations

ACA	Advance Commitment Authority
ACC	Advance Commitment Capacity
ADB	African Development Bank
ADF	African Development Fund
ADF-8	Eighth General Replenishment of the African Development Fund
ADF-9	Ninth General Replenishment of the African Development Fund
ADF-10	Tenth General Replenishment of the African Development Fund
ADF-11	Eleventh General Replenishment of the African Development Fund
ADF-12	Twelfth General Replenishment of the African Development Fund
CIRR	Commercial Interest Reference Rate
MDRI	Multilateral Debt Relief Initiative
OECD	Organisation for Economic Co-operation and Development
SDRs	Special Drawing Rights
UA	Units of Account

THE ADF-12 FINANCING FRAMEWORK

1. Introduction

- 1.1 This financing framework paper describes expected sources of financing for the Twelfth General Replenishment of the African Development Fund (ADF-12), namely donor contributions, internal resources, and funds carried over from previous replenishments. It analyzes the financial variables that influence the level of the Fund's resources, including its Advance Commitment Capacity (ACC). The paper also proposes (i) a 6-month reference period for the determination of the exchange rates to be used for the replenishment; (ii) a standard payment and encashment schedule; and (iii) an index for the discount rate for accelerated encashments. Finally, the paper presents scenarios of expected sources and uses of ADF-12 funds.
- 1.2 The guiding principle of the African Development Fund (ADF or Fund)'s financial management practices and policies is to exercise financial prudence while maximizing resources for financing development on the continent.

2. Fund Resources

- 2.1 The ADF's resources are composed of (i) subscriptions received from State Participants based on their burden share; (ii) additional subscriptions made to reduce the Fund's structural gap¹; (iii) internally generated resources based on the ACC (including ADF loan reflows, compensation for loans cancelled under the Multilateral Debt Relief Initiative (MDRI), compensation for grants, and African Development Bank (ADB or Bank) net income allocations); and (iv) resources carried over from previous ADF replenishments.

Donor Resources: Components and Financing Terms

- 2.2 The Fund's replenishment amount (i.e., donor resources) includes regular subscriptions based on donors' burden shares and additional contributions provided by State Participants to reduce shortfalls in the targeted replenishment size.

Subscriptions: Burden-sharing and gap

- 2.3 In general, State Participants calculate their subscription to the Fund by multiplying their burden share² 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. By recalibrating burden shares, the ADF substantially reduced the gap between pledges and the replenishment size from 27 percent in the Tenth General Replenishment of the African Development Fund (ADF-10) to 5 percent for the Eleventh General Replenishment of the African Development Fund (ADF-11). In effect, Deputies agreed during the ADF-11 negotiations on a maximum (technical) gap of 5 percent for the purposes of (i) giving State Participants the flexibility to increase their burden share during a particular replenishment without exceeding the target replenishment level; (ii) allowing increased or additional subscriptions during the life of a replenishment; and (iii) accommodating the subscriptions of new donors.
- 2.4 As a result of additional contributions from some State Participants after the close of negotiations and of a new pledge by Brazil, which had not participated in the ADF-11 consultations, the technical gap has been reduced to 3.7 percent as of December 31, 2009.

¹ The structural gap is the difference between the target replenishment amount and pledges or donor subscriptions actually received.

² Burden share is the ratio of a donor's subscription to the target replenishment amount.

- 2.5 In line with ADF-11, Management proposes a maximum technical gap of 5 percent for ADF-12, in anticipation of possible additional contributions by existing State Participants and probable subscriptions by new State Participants such as Turkey and Luxembourg. Both Turkey and Luxembourg are undertaking formalities to become members of the Bank Group.

Exchange rates for subscriptions

- 2.6 Donors may denominate their subscriptions to the Fund in (i) Special Drawing Rights (SDRs), (ii) an SDR component currency (the US dollar, the euro, the Japanese yen or the pound sterling), or (iii) their own national currency, provided that this currency is freely convertible and that the average domestic inflation rate has not surpassed 10 percent in the preceding 3 years.
- 2.7 As was the case in previous replenishments, three considerations will govern the determination of the reference period to be used for computing the average exchange rates for the replenishment. First, the reference period should allow donors sufficient lead time to determine the national currency amounts required to meet their share of the replenishment objective. Second, the exchange rate reference period should be forward-looking so as to avoid the use of known rates. Finally, the reference period should be long enough to mute the effects of short-term currency fluctuations.
- 2.8 Based on these considerations and given that the ADF-12 negotiations are expected to conclude in July 2010, Management proposes the 6 months from 1 December 2009 to 31 May 2010 as the reference period for the ADF-12 replenishment exchange rates. Should the negotiations conclude in September 2010, Management recommends using the period from 1 February 2010 to 31 July 2010 as the reference period.

Payment of subscriptions

- 2.9 State participants are required to pay their subscription in three equal annual instalments, either in cash or by depositing a promissory note in an ADF custody account, so that subscriptions can be committed to financing projects or programs.
- 2.10 Management proposes to change the subscriptions payment date from 30 April to 15 January of each year. This will mitigate disruptions in operations by ensuring adequate commitment capacity in the first months of the year, particularly in years when frontloading might occur (frontloading took place in 2009). The MDRI uses 15 January as its annual subscriptions payment date.

Encashment of subscriptions

- 2.11 Payments made in the form of promissory notes are converted into cash (i.e., encashed) in accordance with an encashment schedule. This schedule determines the proportion of a State Participant's payment that must be encashed each year and ensures sufficient resources to meet disbursement requests from borrowers and beneficiaries at all times. This schedule is defined and agreed upon during the replenishment discussions.
- 2.12 The encashment of a State Participant's subscription can either follow the standard calendar designed specifically for the replenishment (the standard encashment schedule), or use a customized calendar according to which encashments are accelerated (i.e., take place over a shorter time).
- 2.13 The standard encashment schedule mirrors the projected disbursement profile of loan and grant commitments funded by the replenishment, while ensuring that the level of the Fund's liquid resources that results from the encashment of promissory notes respects the Fund's liquidity policy. The schedule also guarantees that donor funds are received when needed for operational purposes (disbursement) or for prudent financial management (liquidity risk mitigation). The following assumptions underlie computation of the standard ADF-12 encashment schedule:
- As with preceding replenishments, donor subscriptions will be committed over the 3 years of the replenishment.

- Analysis of the history of disbursements since 2007 reveals increased institutional efficiency in operations. This efficiency markedly increased the number and volume of loans that started disbursing during the year they were approved, an important change in the disbursement profile. Accordingly, the assumption for ADF-12 is that 15 percent of loans and grants will start disbursing during the year they are approved (compared to 10 percent for ADF-11), and that the remaining 85 percent will start disbursing the following year.
- A maximum of 18.75 percent of operations projected for ADF-12 financing are assumed to be policy-based.³ Their disbursements and those of project loans and grants, institutional support, and study grants, will be based on a historical profile.
- As per the Fund's liquidity policy guidelines, the target liquidity level for ADF-12 encashment in any given year will be set at 62.5 percent of the 3-year moving average of net disbursements. This liquidity level mitigates liquidity risks arising from faster-than-projected disbursements and encashment shortfalls.

2.14 The standard encashment schedule for ADF-12 is shown in Table 1. While the encashment period is expected to remain to the same as that of ADF-11 (10 years), the level of encashment is expected to increase notably during the first 5 years. This increase will be mainly due to recent enhancements to the Bank's portfolio management and performance, enhancements which have shortened the time lapse between approval and first disbursement. Increased efficiency has also boosted the amounts of loans approved, signed and disbursed in the same year. In addition, policy-based operations are now fully disbursed within 3 years, versus 5 to 6 years in the past.

Table 1: The Standard Encashment Schedule for ADF-12

Encashment Year	Encashment Percentage
2011	5.03%
2012	10.34%
2013	14.76%
2014	15.07%
2015	12.98%
2016	11.17%
2017	10.14%
2018	9.13%
2019	8.33%
2020	3.04%

Source: African Development Bank

2.15 During ADF-10 and ADF-11, State Participants had the option of accelerating the rate of encashment of their subscriptions by selecting a customized encashment schedule. The returns generated by investing these funds (which are not immediately needed for disbursements) are credited to donors based on a pre-agreed rate, and can be used to meet or increase donors' ADF burden share, fulfill donors' MDRI commitments, or lower the technical gap. Because the discount rate is fixed for the length of the replenishment, any shortfall or gain as compared to the actual rate at the time of encashment is borne by the Fund. The option of a customized encashment schedule will be maintained in ADF-12.

³ This figure assumes that, as in ADF-11, policy-based operations will constitute no more than 25 percent of aggregate country allocations and country allocations will account for 75 percent of all available ADF-12 resources.

- 2.16 For the past two replenishments, the Fund has used a currency-specific discount rate based on the Commercial Interest Reference Rate (CIRR) for credits up to 5 years, adjusted downwards by 100 basis points. 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. The 5-year horizon is closely aligned to the maximum period over which the Fund is able to generate returns from accelerated encashments.
- 2.17 Management recommends using the CIRR of April 2010⁴ adjusted downwards by 100 basis points to determine the accelerated encashment amounts for each currency of payment.

Compensation for foregone principal reflows due to grants

- 2.18 ADF-12 will be the first replenishment cycle under which the compensation for foregone principal repayments on grants comes due. During the ADF-9 negotiations, Deputies agreed to finance the reflows of foregone principal due to the extension of grants during the ADF-9 period on a pay-as-you-go basis, with donors committing to compensate these reflows as they arose. Similar agreements were reached for ADF-10 and ADF-11. In other words, in addition to regular subscriptions, donors will make additional contributions to compensate the Fund for foregone principal reflows due to the extension of grants. It should be highlighted that the Fund expects a total compensation amount of UA 468 million for ADF-9 grants between 2013 and 2055. Annex I presents the compensation expected from donors during the ADF-12 period, which amounts to UA 83,060.

Internally Generated Resources: The Advance Commitment Capacity

Overview of the Advance Commitment Authority⁵

- 2.19 The Advance Commitment Authority (ACA) estimates the level of 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, ADB net income transfers, projected net profits and loan cancellations.⁶
- 2.20 While the ACC is fixed for each replenishment period and is based on a set of assumptions, 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.
- 2.21 The ACA is long-term in nature. In the past two replenishments, the ACA used deliberately conservative assumptions as a means of supporting the future flows on which ACC amounts were determined and extended. This strategy prevented the risk of over-commitment and protected the integrity of previously extended ACC amounts. Changes to the parameters of the model that occur during a replenishment 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 3-year replenishment period. Rather, the ACA model is recalibrated at the beginning of each replenishment (i.e., every 3 years) to account for differences between estimated and actual cash flows and to determine the ACC of the next replenishment. This prevents both the risk of over-commitment and preserves the integrity of previously extended ACC amounts.

⁴ If final consultation meetings are scheduled in September 2010, the proposed rate is May 2010

⁵ A comprehensive analysis of internally generated resources is presented in the ADF-12 Discussion Paper *The Long-Term Financial Integrity of the African Development Fund*, February 2010, Cape Town, South Africa.

⁶ The model uses core financial assumptions to derive the ACC level for a particular replenishment. These assumptions include future donor replenishments, loan repayments, loan and grant charges, MDRI compensation, repayment and disbursement sensitivity factors, net income transfers, estimated returns on investments, and loan cancellations.

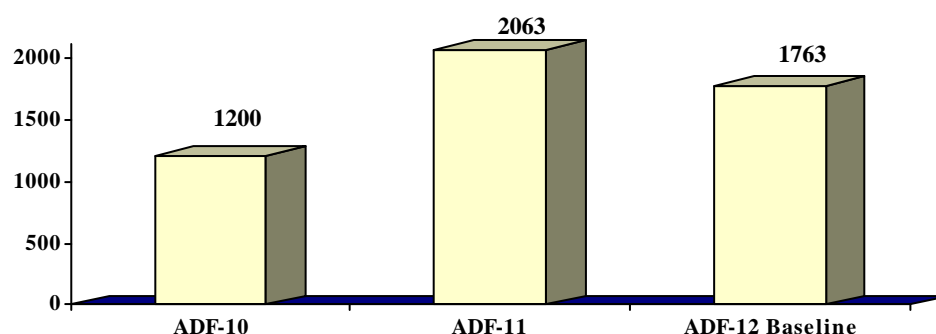
2.22 In sum, this adjustment mechanism allows the Fund to absorb the effects of changing exchange rates, loan cancellations, and other factors, while preserving the integrity of the ACC amounts extended under previous replenishment periods.

Preliminary ACC estimates for ADF-12

2.23 Annex II details the key assumptions of the ACA model for ADF-10, ADF-11 and the ADF-12 baseline scenario. In the baseline scenario, the ACC is estimated at UA 1,763 million, and represents 30 percent of replenishment resources compared to 37 percent for ADF-11.

Figure 1: Advance Commitment Capacity

(UA millions)



Note: UA=Units of Account

Source: African Development Bank

2.24 While the ACC increased by 72 percent between ADF-10 and ADF-11, it is estimated to decrease by 16 percent between ADF-11 and ADF-12, mainly as a result of the following two factors detailed in the paper on the Fund’s long-term financial integrity:

- *Lower investment income due to low interest rates.* The ACC derived for ADF-11 assumed an interest rate of 4.45 percent for 2008 onwards. The impact of current low interest rates on the ADF-12 ACC is estimated at UA 361 million. To mitigate this impact, Management proposes to use forward rates as a means of better estimating the Fund’s investment returns. The ACA model postulates the forward interest rate in 2010 as 2.6 percent, with rates slowly rising to 4.5 percent from 2016 onwards.
- *Lower loan cancellations due to loan restructuring in response to the food and financial crises.* The Fund responded rapidly to the food and financial crises by restructuring cancellable loans in order to speed up disbursement. Restructuring rather than cancelling loans led to lower-than-expected loan cancellations during ADF-11. For example, UA 104 million from cancellable loans was used to fund the African Food Crisis Facility. This exceptional, crisis-induced loan restructuring mechanism enabled the Fund to react quickly to ADF countries’ new needs. Given this important restructuring, Management recently reviewed the stock of cancellable loans and lowered its estimate for the base case assumption of UA 300 million of cancellations in 2008-2010 to the actual level of loans expected to be cancelled (UA 100 million). For the ADF-12 period and beyond, however, the base case assumes annual cancellations of UA 100 million, in line with portfolio growth.

2.25 Thanks to safety mechanisms built into the ACA model, the Fund is able to deliver the committed ADF-11 ACC in full, the corollary being a lower ACC for ADF-12 onwards. The ACC amount committed for ADF-11 was determined in part by anticipating annual loan cancellations of UA 100 million and investment returns of 4.45 percent for 2008-2020 (the ADF-12 disbursement period). These results have not yet materialized. Management has explored alternatives to increase the Fund’s internally generated resources for ADF-12. Key financial parameters that could maximize the ACC of ADF-12 have been assessed in the ADF-12 paper “The Long-Term Financial Integrity of the African Development Fund”.

Scenarios of various levels of MDRI compensation

- 2.26 State Participants decided to compensate the Fund for foregone principal reflows from loans cancelled under the MDRI on a dollar-for-dollar basis, using the pay-as-you-go approach. Deputies agreed that compensation for loans cancelled under the MDRI should be included in the cash flow stream supporting the ACC so that the impact of the MDRI on the Fund's commitment capacity would be neutral. Donors further agreed to preserve the level of the ACC in future replenishments by making commitments over a rolling 10-year window to match the disbursements of future ADF replenishments.
- 2.27 The MDRI compensation scheme has been implemented since 2006. As of 31 December 2009, the Fund had received the equivalent of 69 percent of unqualified MDRI commitments and 21 percent of qualified commitments for the ADF-10 disbursement period (2006-2017), resulting in an MDRI coverage factor of 87 percent⁷ for that replenishment. Ten percent of MDRI costs for the ADF-10 disbursement period are still not covered by commitments and a small structural gap of 0.08 percent remains. Similarly, the MDRI coverage factor for the ADF-11 disbursement period (2008-2020) is 84 percent, with 12 percent of the costs not yet covered by any commitments and a structural gap of 0.3 percent. Based on current MDRI costs, which are scheduled to be updated this year, the MDRI coverage factor for ADF-12 (2011-2023) is currently 76 percent. However, Management is expecting additional commitments in the coming months.
- 2.28 Donors had agreed that MDRI costs should be updated at the commencement of each ADF replenishment, in order to account for (i) exchange rate-induced excesses or shortfalls that materialized over the previous replenishment period, (ii) changes in the timing of beneficiary countries reaching the completion point, (iii) the future amount of Heavily Indebted Poor Countries Initiative debt relief, and (iv) the ADF replenishment rate used to determine donor contributions in national currencies.
- 2.29 The MDRI cost applicable during the ADF-12 replenishment period will be determined during the second quarter of 2010, and a revised schedule of MDRI contributions sent to donors in May 2010. To cover the 2011-2023 period and maximize the ACC, donors would therefore need to adjust their MDRI instruments of commitment by July 2010. Table 2 indicates ADF-12 ACC levels for three scenarios of MDRI compensation.

Table 2: Advance Commitment Capacity Amounts According to Various Multilateral Debt Relief Initiative Compensation Scenarios

	Scenario 1	Scenario 2	Scenario 3
Level of MDRI and grant compensation	85%	90%	100%
ADF-12 ACC (in UA millions)	1,763	1,800	1,879

Note: ACC=Advance Commitment Capacity; MDRI=Multilateral Debt Relief Initiative; UA=Units of Account

Source: African Development Bank

- 2.30 Experience with the MDRI to date highlights the risk that some donors may be late in meeting their obligations. Similar to ADF-11, when selecting inputs for the ADF-12 ACA model, Management will use the MDRI compensation level prevailing at the conclusion of the replenishment meetings. Donors are therefore strongly urged to meet their MDRI commitments fully and on time.

⁷ The MDRI coverage factor is a weighted average of both qualified and unqualified commitments received from donors. Unqualified commitments are factored in at 100 percent in ACC, while qualified commitments are factored in at 85 percent. The 15 percent discount in qualified commitments reflects uncertainty in the timeliness of payments. This safety margin ensures that the flow of the ADF-11 ACC is not disrupted by delayed payments.

2.31 The final ACC amount for ADF-12 will depend on various factors: the amount of donor subscriptions pledged for ADF-12; the amount of grants to be provided during the ADF-12 period as per debt sustainability analyses; the Bank's net income allocation (including the transfer of arrears clearance proceeds); and the level of MDRI compensation covered by qualified or unqualified instruments of commitment for the ADF-12 disbursement period (2011-2023) at the conclusion of the replenishment discussions.

Resources carried over from previous replenishments

2.32 The new carry-over formula established during the ADF-11 negotiations has worked well and Management proposes to continue to use it for ADF-12. Established during the ADF-11 replenishment, the carry-over formula authorizes the Fund to administer and use resources from previous replenishments under the terms of the current replenishment. Consequently, all resources stemming from previous replenishments will be pooled with available resources and administered in accordance with the terms and conditions of ADF-12.

2.33 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 replenishment cycle. UA 359 million was carried over to ADF-10 and UA 294 million was carried over to ADF-11. In ADF-12, State Participants' qualified and late ADF-11 subscriptions and uncommitted available resources are expected to total UA 343 million in carry-over resources. Table 3 presents the composition of carry-over amounts in ADF-12.

Table 3: Estimated Carry-Over Resources in ADF-12

(UA millions)

	Carry-Over Resources From ADF-9	Carry-Over Resources From ADF-10	Carry-Over Resources From ADF-11 (expected)	Total
Subscriptions				
Qualified subscriptions	23.28	2.55	108.87	134.64
Late subscriptions	0	13.64	194.64	208.28
Amounts carried over from previous replenishments	0	0	0	0
Total	23.28	16.19	303.51	342.98

Note: UA=Units of Account

Source: African Development Bank

Qualified subscriptions

2.34 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 Fund⁸.

2.35 Although all ADF resolutions require that qualified subscriptions be unqualified by the payment dates specified in the replenishment, donors have not always complied⁹. Some countries have not been able to unqualify and pay their subscriptions on time and the Fund still counts as part of its resources qualified commitments from previous replenishments (Table 3).

⁸ A qualified subscription is a subscription instrument that expressly qualifies that the payment of the subscription is subject to budgetary appropriation by the donor country.

⁹ See the ADF-12 Discussion Paper *Issues concerning ADF Resource Allocation Framework*, February 2010, Cape Town, South Africa.

- 2.36 The amount that remains qualified for ADF-8, ADF-9 and ADF-10 consists of subscriptions from the United States. Based on current information and past trends, Management expects the carry-over from ADF-11 to come from Brazil (UA 6.56 million) and the United States (UA 102.31 million).

Late subscriptions

- 2.37 Italy has not yet subscribed to ADF-11. However, considering past trends and the absence of a deadline by which countries must subscribe to a replenishment, Management anticipates that Italy's pledge of UA 195 million will be carried over to ADF-12.

3. Indicative Financing Framework

- 3.1 Based on the demand for ADF resources projected for 2011-2013, Table 4 sets out three financing scenarios. This demand is discussed in the overview paper "ADF-12 Strategic Directions and Indicative Lending Scenarios".
- 3.2 The baseline scenario sets the level of ADF-12 resources at the ADF-11 level in real SDR terms (4.49 percent inflation). The baseline scenario would only allow the Fund to finance 47 percent of the pipeline of proposed projects for the ADF-12 cycle. Based on demand to date, two other scenarios are also put forward. The central case scenario assumes a 50 percent increase in the Fund's resources over ADF-11: this would allow the Fund to finance 68 percent of the present pipeline. The third scenario—the upper case scenario—would raise the Fund's resources by 70 percent and ensure financing for 77 percent of the pipeline.

Table 4: Three Indicative Financing Scenarios for ADF-12

(UA millions)

Sources of Financing	ADF-11	ADF-12 Baseline Scenario	Change From ADF-11	ADF-12 Central Case Scenario (50% increase over ADF-11)	Change From ADF-11	ADF-12 Upper Case Scenario (70% increase over ADF-11)	Change From ADF-11
Advance Commitment Capacity	2,063	1,763	-15%	1,959	-5%	2,044	-1%
Donor subscriptions	3,518	4,115	17%	6,479	84%	7,519	114%
Additional contributions	44	-	-	0	-	0	--
Total Resources	5,625	5,878	4.5%	8,438	50.0%	9,563	70.0%
Carry-over amount	294	343		343		343	
Resources Including Carry- Over Amount	5,919	6,221		8,781		9,906	
Uses of Financing							
Country allocations	4,142						
Regional envelope	965						
Fragile states	408						
Contingencies and other adjustments	404						
Total Uses	5,919						
ADF-12 pipeline fulfillment		47%		68%		77%	
National pipeline		63%		90%		102%	
Multinational pipeline*		28%		40%		45%	

Note: ADF=African Development Bank; UA=Units of Account

(*): assuming same resource allocation and cost sharing rules as ADF-11

Source: African Development Bank

- 3.3 The **ADF-12 baseline scenario** assumes that resources under ADF-12 will equal those under ADF-11, adjusted for inflation. The SDR inflation rate for 2008-2010 is currently estimated at 4.49 percent and brings ADF-12 resources to UA 5,878 million. Under this scenario, donor subscriptions increase by 17 percent to reach UA 4,115 million. The preliminary estimate for the ACC at that level of subscription is UA 1,763 million, a 15 percent decrease compared to ADF-11.
- 3.4 The **ADF-12 central case scenario** assumes a 50 percent increase over ADF-11 resources. Under this scenario, donor subscriptions increase by 84 percent to reach UA 6,479 million, raising the ACC to UA 1,959 million (5 percent lower than for ADF-11) and bringing Fund resources to UA 8,438 million.
- 3.5 The **ADF-12 upper case scenario** brings the resources of the Fund to UA 9,563 million, a 70 percent increase over ADF-11. It postulates that donor subscriptions will rise by 114 percent and reach UA 7,519 million. Under this scenario, the ACC totals UA 2,044 million, 1 percent less than ADF-11.

4. Conclusion and Recommendations

- 4.1 This paper has examined sources of financing for ADF-12, specifically donor contributions, internal resources, and funds carried over from previous replenishments. It has also analyzed a range of financial variables that underpin Fund resources and has presented a range of scenarios that explore different sources and uses of ADF-12 funds. Deputies are urged to deposit unqualified instruments of commitment for the MDRI, to cover the ADF-12 disbursement period (2011-2023) as soon as possible.
- 4.2 Deputies are invited to provide their views on the financing scenarios presented here and to endorse the following proposals:
- to use the 6 months from 1 December 2009 to 31 May 2010 as the reference period for determining the exchange rates applicable to the replenishment;
 - to set a new subscriptions payment date of 15 January of each year;
 - to set the standard 10-year encashment schedule as shown in Table 1; and
 - to use the CIRRR of April 2010 adjusted downwards by 100 basis points as the discount rate for accelerated encashment for each currency of payment.

Annex I: Compensation for ADF-9 Grants During the ADF-12, ADF-13 and ADF-14 Periods

State Participants	ADF-9 Normalized Burden Share	ADF-9 Grant Compensation						
		ADF-12	ADF-13			ADF-14		
		2013	2014	2015	2016	2017	2018	2019
1 ARGENTINA	0.000%	-	-	-	-	-	-	-
2 AUSTRIA	1.248%	1,037	12,500	34,372	58,395	58,395	58,395	58,395
3 BELGIUM	2.100%	1,745	21,037	57,847	98,278	98,278	98,278	98,278
4 BRAZIL	0.447%	371	4,477	12,310	20,913	20,913	20,913	20,913
5 CANADA	5.729%	4,758	57,375	157,764	268,030	268,030	268,030	268,030
6 CHINA	2.090%	1,736	20,935	57,566	97,801	97,801	97,801	97,801
7 DENMARK	3.819%	3,172	38,250	105,176	178,687	178,687	178,687	178,687
8 FINLAND	1.910%	1,586	19,125	52,588	89,343	89,343	89,343	89,343
9 FRANCE	9.328%	7,748	93,429	256,902	436,459	436,459	436,459	436,459
10 GERMANY	10.635%	8,834	106,519	292,895	497,609	497,609	497,609	497,609
11 INDIA	0.222%	184	2,219	6,101	10,365	10,365	10,365	10,365
12 ITALY	5.474%	4,547	54,825	150,752	256,118	256,118	256,118	256,118
13 JAPAN	11.224%	9,323	112,417	309,115	525,165	525,165	525,165	525,165
14 KOREA	0.810%	672	8,109	22,297	37,882	37,882	37,882	37,882
15 KUWAIT	0.213%	177	2,128	5,852	9,943	9,943	9,943	9,943
16 THE NETHERLANDS	4.710%	3,912	47,175	129,717	220,380	220,380	220,380	220,380
17 NORWAY	4.507%	3,743	45,135	124,108	210,850	210,850	210,850	210,850
18 PORTUGAL	0.817%	679	8,185	22,508	38,239	38,239	38,239	38,239
19 SAUDI ARABIA	0.688%	571	6,886	18,935	32,170	32,170	32,170	32,170
20 SOUTH AFRICA	0.150%	125	1,503	4,134	7,023	7,023	7,023	7,023
21 SPAIN	2.921%	2,426	29,258	80,450	136,679	136,679	136,679	136,679
22 SWEDEN	5.092%	4,229	51,000	140,235	238,249	238,249	238,249	238,249
23 SWITZERLAND	3.819%	3,172	38,250	105,176	178,687	178,687	178,687	178,687
24 UNITED ARAB EMIRATES	0.000%	-	-	-	-	-	-	-
25 UNITED KINGDOM	7.002%	5,816	70,125	192,823	327,592	327,592	327,592	327,592
26 USA	15.045%	12,497	150,687	414,346	703,944	703,944	703,944	703,944
TOTAL	100%	83,060	1,001,550	2,753,970	4,678,800	4,678,800	4,678,800	4,678,800

Note: UA=Units of Account

Source: African Development Bank

Annex II: Core Assumptions for ADF-10, ADF-11 and ADF-12

Assumptions	Comments	ADF-10	ADF-11	ADF-12
Donor Contributions in Future Replenishments	To establish the baseline scenario, donor subscriptions for future replenishments are conservatively assumed to remain unchanged in real terms. In other words, the nominal amounts are assumed to increase by the assumed cumulative rate of inflation over the previous replenishment period.	0%	7%	4.49%
MDRI Compensation	In addition to regular contributions, donors pledged to cover 100% of MDRI costs for all heavily indebted poor countries (on foregone principal and interests) by making additional contributions to future replenishments on a pay-as-you-go basis without leaving a financing gap.	0%	84%	85%
Grant Share 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-12 is assumed to remain the same as that in ADF-11.	44%	28%	28%
Compensation for Grants	In addition to regular contributions, donors would 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 included as a volume discount on subscriptions as upfront compensation.	11.9%	10.12%	10.12%
Administrative Expenses	These expenses are based on the relevant budget program and are set to increase annually thereafter at the percentage indicated.	3%	3%	3%
ADB Transfers Per Year	Constant annual transfer from ADB net income, in UA millions	10	20	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%	85%	90%
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%
Investment Return Rate	The rate of return of the investment portfolio	3.42%	4.45%	Forward curve
Minimum Prudential Level of Annual Liquidity	As a percentage of the following 3-years' projected disbursements	100%	75%	75%
Loan Cancellations	Constant annual cancellations in nominal terms, in UA millions	0	100	100
Advance Commitment Capacity	Level of the Advance Commitment Capacity resulting from the model, in UA millions	1,200	2,063	1,763

Note: ADB=African Development Bank; MDRI=Multilateral Debt Relief Initiative; UA=Units of Account

Source: African Development Bank