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REVIEW OF CDB's LENDING PRODUCTS – FINAL REPORT

May 2012

Final Report

REVIEW OF CDB LENDING PRODUCTS

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ABBREVIATIONS

ADB	Asian Development Bank
ADF	Asian Development Fund
BMC	Borrowing Member Country
BNTF	Basic Needs Trust Fund
CARTAC	Caribbean Regional Technical Assistance Centre
CDB	Caribbean Development Bank
CCLIP	Conditional Line of Credit for Investment Projects
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CSF	Countercyclical Support Facility
CTCS	Caribbean Technological Consultancy Services
DFID	Department for International Development
ECCU	Eastern Caribbean Central Bank
EIB	European Investment Bank
ERL	Emergency Response Loans
EU	European Union
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IL	Investment Loan
IMF	International Monetary Fund
LIBOR	London-Based Interbank Rate
MfDR	Managing for Development Results
MDB	Multilateral Development Bank
MPL	Multi-phase Programmed Loan
OCR	Ordinary Capital Resources
OECS	Organisation of Eastern Caribbean States
OSF	Other Special Funds
PBL	Policy-Based Lending
PBLs	Policy-Based Loans
PPP	Public Private Partnership
SDF	Special Development Fund
SFR	Special Funds Resources
TA	Technical Assistance
UK	United Kingdom
US	United States

REVIEW OF CDB LENDING PRODUCTS

CONTENTS

EXECUTIVE SUMMARY

Introduction

The goal of the review of lending products is to determine whether the CDB possesses the appropriate product and services menu to remain relevant to the demands of its borrowing member countries (BMCs). The CDB operates in an environment in which bilateral providers of development assistance are increasingly active, and in which the lending instruments of its Multi-lateral Development Bank (MDB) partners undergo a process of continuous evolution and diversification in an attempt to maintain relevance in an increasingly competitive lending environment. It makes recommendations for reform of CDB lending procedures and products that would make the bank more responsive to the needs of its BMCs.

Comparison of CDB Charter and Lending Framework with Other MDBs

The provisions of the **CDB Charter** defining permissible lending operations make it, in theory at least, a full-service bank. In other words, the choice of lending instruments is not limited by Charter. For example, unlike the IDB, the CDB can lend for equity investment, and unlike the World Bank, it can lend without government guarantee. Indeed, lending instruments employed by the CDB can run the gamut of known lending instruments in use by other MDBs, to new and innovative instruments recommended by Management and approved by the appropriate governing authority of the Bank.

One obvious difference between the CDB and other MDBs is that the CDB employs a narrower range of investment and policy-based lending instruments than the major MDBs. This is particularly true in the investment loan (IL) category. An area of concern taken up by the report is the extent to which the loan identification, processing and approval procedures employed by CDB are more or less flexible than those of partner MDBs.

CDB Performance

After increasing by almost eighty percent (78.9%) in 2010, loan approvals declined sharply in 2011 by eighty seven percent (87%) to $144.6 million. Three fourths (seventy six percent) of the decline in total lending between 2010 and 2011 can be accounted for by a decline in policy lending of $95 million. The decline in 2011 total lending is even more dramatic when it is noted that no less than fifty percent ($72.5 million) in total lending in 2011 represented emergency lending to repair damage from natural hazard events.

Disbursements and Net Transfers also declined sharply in 2011 from 2010 levels. Disbursements declined by over $150 million, while Net Transfers declined to less than ten percent of 2010 levels.

If CDB is to arrest a decline in lending and the even less desirable situation in which net transfers become negative, some recovery in the capacity to approve and disburse policy loans would seem highly desirable. This form of lending has accounted for at least thirty five percent of total lending in each of the years 2008, 2009, and 2010, and there is no evidence to suggest that BMCs have lost their appetite for policy-based loans.

The conceptual case for policy lending therefore needs to be emphasized. The justification for policy reform is that the policy framework of a country has a powerful influence on the benefits to be derived from investment activity. If the policy framework is inappropriate, the structure of relative prices at the macro and sectoral level will likely yield less than optimal investment results.

Recommendations for renovation of the CDB policy lending instrument are useful but somewhat beside the point as long as the Bank has exhausted its authority (head-room) to approve new loans of this type. Loans outstanding at December 31, 2011 were $1,613 mil. The limit on policy based lending of 20% of this amount was $322.6 mil. Policy-based disbursements in 2011 exceeded the cap by 24 mil. The delinking of the policy loan lending limit from loans outstanding is also recommended here.

CDB was for all practical purposes net resource neutral for its BMCs as a whole in 2011. There are currently, as noted above, limitations in the capacity of the Bank to finance significant net resource flows. This makes it imperative that the Bank view its BMCs as partners whose combined efforts are greater than the sum of their individual parts, because it no longer has the control and leverage that comes with being a source of significant net resource transfers.

Recent Lending Reforms in Select MDBs

Lending Reforms in the World Bank 2009 – 2011. Parallel with reform of its IL instrument, the Bank continued a critical review of its development policy lending (DPL) framework. In 2004 Directors approved a new operational policy, Development Policy Lending; that replaced a host of separate adjustment lending instruments and brought together all policy-based lending in **a single operational framework**. The new DPL covered all Bank operations that provided "rapidly disbursing policy-based financing to address actual or anticipated development financing needs of external or domestic origins."

A new instrument – Programme-for-Results (P4R) – adopted in January 2012, would help countries to improve the design and implementation of their own development programmes and would finance a portion of the country's programme expenditures. It would focus on development results by linking disbursements to results or performance indicators, which can be outputs, outcomes, or other actions/results that are tangible, transparent, or verifiable. It would also permit the Bank to strengthen partnerships with governments and development partners by means of pooled funding arrangements.

Lending Reforms in the IDB. By 2010 the IDB disposed of panoply of lending instruments, including 3 policy-based instruments, 10 investment loan instruments, and 2 lending "approaches" that were capable of encompassing a variety of instruments.

According to the IDB's independent evaluation office (OVE), the proliferation of lending instruments was a way for the IDB to address the declining demand for traditional investment lending, borrower concerns regarding high transaction costs, and the fiscal constraints of borrowing member countries. In 2011, IDB Management and the Board consequently reviewed those instruments, but only 2 (Innovation Loans and Sector Facilities) were eliminated.

A major reason for the declining demand for specialized investment loan instruments is that relatively inflexible Bank policies and procedures, which had been the rationale for developing New Lending instruments, have themselves been reformed in recent years. The <u>elimination of the foreign exchange matrix</u> (allowing the borrower to choose the share of Bank and counterpart financing) and the <u>adjustment to the policy on financing of cost overruns</u> broadened the use of <u>all</u> investment lending instruments. The new policy on the eligibility of expenditures (allowing any necessary expenditures to be financed) all contributed to making traditional IDB lending products more useful to its borrowers.

Similarly, the implementation of a <u>new approval and project cycle process</u> in 2007 shifted the emphasis from approval to execution in all IDB projects. It gave project teams flexibility to define the degree of ex-ante project preparation, based on the risks inherent in each operation, and streamlined the approval process by focusing discussion on policy issues, risks, and results. The four components of the framework include: lending programme priorities, regional development goals, output contributions to regional goals, and operational effectiveness and efficiency.

Irrespective of the lending instrument chosen to finance individual operations, the focus on development effectiveness requires that the intended <u>outputs</u> and <u>outcomes</u> of each operation be clearly defined, monitored, and evaluated to document performance. Each operation consequently has a Development Effectiveness Matrix which emphasizes the evaluability aspects of the operation, enables project teams to monitor the outputs and outcomes of the project, and at project completion, compare actual project results with expected results at time of approval.

Lending Reforms in the ADB. In 2008 a different type of financial crisis hit Asian Development Bank's (ADB's) borrowers, originating not in structural weaknesses of developing countries as in the 1980s and 1990s, but in industrialized countries, and requiring international financial institutions to respond differently. ADB's response entailed flexible use of conventional programme lending instruments, and the creation of the Countercyclical Support Facility (CSF), a temporary instrument to be employed in 2009 and 2010, with a cap of US $3 billion, to support fiscal stimulus at the macroeconomic level in ADB's DMCs. No structural reforms were required. Although ADB judged this effort to be a success, the CSF expired as scheduled at the end of 2010.

ADB's latest policy review of Policy Based Lending[1] recommends that its Board approve the following reforms to ADB's programme lending policy:

(a) Mainstreaming programmatic budget support by: formally referring to programme lending as policy based lending (and to PCA as a programmatic approach);

[1] ADB, "Review of ADB's Policy Based Lending", June 2011.

removing the restriction on retroactive financing; and dimensioning loan size on the basis of financing needs rather than the costs of adjustment directly related to the implementation of reforms.

(b) Enhancing ADB's crisis response capacity by: improving the pricing and terms of SPLs (to be renamed SPBLs); and mainstream the CSF, with pricing and terms equivalent to the SPBLs.

D. The Current Development Environment and Lending Instrument Issues

Investment Lending. The IL or project model is recognized within and outside MDBs as failing to meet or effectively solve, in the WB's words, "the varied needs of the Bank's clients and the inefficiency, rigidity, and insularity of the processes and requirements that apply to it." It requires substantial amounts of time and effort to comply with internal processing, review, and documentation requirements. Yet, it remains the primary lending instrument of almost all MDBs. However, IL projects can be developed around programmatic or framework-based project models in which the lender agrees to finance a portion of the borrower's programme in a given sector.

Lending for Results. Developing countries and donors are agreed that to the extent possible, an emphasis on results will be the goal of ***all*** lending. And yet, the rollout of a WB instrument to address this goal directly has not been without controversy and concern. Indeed, the WB itself is placing strict limits on the use of the new instrument before adopting it as a main stay of its lending.

Study Recommendations for New Lending Products

It is recommended that CDB move toward a more programmatic approach in its lending operations, in keeping with similar steps taken by other MDBs. Although there is no commonly agreed definition of the term "programmatic", the IDB's Evaluation Office (OVE) has stressed that a programmatic approach should focus on countries and problem solving, and should incorporate the following basic elements:

(a) A long term commitment to address a particular problem in a country; it is not a one-shot, one project approach,

(b) A clear joint statement by the Bank and the Country regarding the results to be achieved over time, as a result of this engagement; it should be results-focused,

(c) The effective integration of Bank resources with country systems and resources in the pursuit of the common results agenda; a programmatic approach is a partnership, with the country in the lead.[2]

2 OVE, "Evaluation of the New Lending Framework, 2005-2008"

In keeping with that recommendation, two specific new lending products are proposed for consideration by CDB, corresponding to the two most successful programmatic instruments adopted by the IDB:

(a) the Programmatic Policy-based Loan, and

(b) the Multi-phase Programme Loan.

A third instrument, the Conditional Line of Credit (CCLIP) for Investment Projects is favorably reviewed but not recommended for adoption at this time. The first of the recommended instruments, the Programmatic PBL, is a policy-based lending product whose implementation would be subject to increasing CDB's lending cap for such operations. The Multi-phase Programme Loan is an investment vehicle that could be implemented without changing CDB's lending structure.

In making the recommendation for the adoption of programmatic lending instruments – policy and investment – it cannot be too strongly stressed that success depends, above all, on willingness to adopt, strengthen and work through country systems. This may be a leap of faith for some. The reality is that the comparator MDBs (IDB, WB, and ADB) have already moved in this direction and that the development community has endorsed this approach.

Programmatic lending instruments not recommended for adoption by CDB at this time are:

(a) Conditional Credit Line for Investment Projects (CCLIPs), and

(b) the Programme-for-Results (P4R).

The principal reason for not recommending consideration of these lending products at this time are that they require demonstrated prior performance by executing agencies and a strong borrower monitoring and evaluation capacity which does not exist in most CDB BMCs.

Approved by the Board of Executive Directors of the WB in January 2012, P4R is a new instrument with no track record by which to evaluate its performance. It is described by the WB as different from, but complementary to, IL and DPL. The former provides project support while the latter provides policy support. By supporting a government programme, P4R will place more direct emphasis on results by making them the basis for disbursements. Most importantly, it will enable the WB to leverage its own financing and collaborate with other development partners by pooling partner resources and focusing efforts on supporting government programmes.

Monitoring and Evaluation Implications of Proposed New Lending Products

If CDB intends to offer the proposed new lending products to its borrowers in the near term, substantial efforts will have to be made to strengthen its own results-based M&E capacity at the project level. Moreover, since much of the performance data on outputs and outcomes will have to be collected by borrower institutions, significant efforts will also have to be made to assist borrowers in developing their own M&E capacity. Specifically, CDB should assist BMCs in the development of simple statistical systems, covering perhaps 3 or 4 sectors, for gathering basic data on relevant development indicators, as opposed to simply arranging for project-specific data to be collected during implementation. This is an integral part of the ADB and WB MfDR action plans.

Conclusions and Recommendations

The Consultant believes that the level of PBL lending should be demand driven, within an envelope of resources determined by liquidity constraints, and not by a predetermined limit (cap) that bears no relationship to the supply and demand for PBLs at a given period. This position is not inconsistent with the consultant's agreement with the DaCosta recommendation that the 20% cap should be increased to 33% of loans outstanding. It merely takes that recommendation a step further in the direction of placing the legitimacy of policy lending on equal footing with investment lending. Given the realities of donor reaction to no limit on policy-based lending, an increase of the cap to 33% of loans outstanding is therefore recommended.

The justification given by the author of the 2011 Consultant Report on PBL reform is worth quoting here:

> "*This option—similar to that adopted in the World Bank—would allow the Bank to remain engaged in a transparent way in lending for policy support in the difficult and uncertain environment currently facing the region, while preserving investment lending as the Bank's core function."*

Also supported, is the recommendation of the 2011 Report that CDB should explore options for redefining the basis of the cap based on the use of OCR resources only, as opposed to combined OCR and SDF financing, as follows:

> "*[Given] the risks associated with the front loaded nature of PBL disbursements and the recent shift to single tranche PBLs support the recent decisions by the Bank to fund the latest PBLs with OCR. As part of this shift, the Bank should consider PBLs funded by a blend of OCR and SFR only in cases where the loans contain a significant social sector or poverty reduction component, or finance essential TA in lower income borrowers*."

CDB BMCs agreed that the central problem facing the Bank was ***declining lending levels***. An important conclusion of this report is that reform of CDB lending products can mitigate this problem, but that there are other constraints to lending other than the efficacy of its product menu. Recommendations on specific lending instrument reform are made in Section F of the main report. ***This section addresses more general themes having to do with more efficient resource flows to BMCs***.

The following recommendations are made to address both the need for greater resource flows required by BMCs and the efficient delivery and use of increased flows:

1. Supplement the CDB product menu with programmatic lending options for both investment and policy lending.

2. As the programmatic approach to lending is phased in, less reliance can be placed on multiple specific instruments for each situation.

3. If the programmatic approach to lending is to be successful, greater reliance will have to be placed on country ownership and country systems and the types of activities that are to be financed.

4. Improved monitoring and evaluation is crucial to the requirement to demonstrate positive developmental impact at the project level, regardless of the chosen instrument.

5. Adopt a greater focus on results in response to partner mandates. (See Section C dealing with Current Development Issues).

6. Limitations on loan size such as the requirement for counterpart financing, and constraints on inputs eligible for financing, should be removed.

7. Increase the current cap on policy lending of 20% of loans outstanding to 33%.

8. The scope and number of conditionalities attached to a PBL should be limited.[3]

9. It should be possible to include policy reform in elements in investment loans and investment loan elements in policy loans when they help to strengthen each other.[4]

10. The roll out of the new private sector lending policy should be completed as soon as possible.

[3] The WB has worked diligently to reduce DPL conditionalities over the years. In their 2007 Review of Conditionalities, "Conditionality in Development Policy Lending", they noted that the average number of conditions attached to a policy loan went from 38 in 1996 to 10 in 2007.

[4] The IDB version of this arrangement is the Hybrid Loan.

A.Critical Review of CDB Lending Products

Final Report

Introduction

1. CDB borrowing member countries (BMCs) are confronting new development challenges ranging from the loss of preferential access for key exports to financial and economic instability that has depressed economic growth and eroded social gains. The CDB itself operates in an environment in which bilateral providers of development assistance are increasingly active, and in which the lending instruments of its MDB partners undergo a process of continuous evolution and diversification in an attempt to maintain relevance in an increasingly competitive lending environment.

2. The goal of the review of lending instruments is to determine whether the CDB possesses the appropriate product and services menu to remain relevant to the demands of its borrowing member countries (BMCs). The current report describes findings regarding some of the main aspects of the inquiry, as follows:

(a) CDB's Charter, Lending Policy, Resolutions and Reports of contributors to its lending resources. It compares these to the corresponding product offerings of other development agencies;

(b) A comparison of CDB lending products with other MDBs (IDB, WB, EIB, and ADB);

(c) A review of recent lending reforms in the IDB, WB, ADB, and EIB.

(d) Discusses the current development assistance environment and issues raised by current thinking on lending instrument fitness;

(e) Provides a summary of the comments and conclusions of the workshop with CDB Management and stakeholders.

(f) It makes recommendations for reform of CDB lending procedures and products that would make the bank more responsive to the needs of its BMCs.

A. Comparison of CDB Charter and Lending Framework with Other MDBs

Table 1: Charter Authorization on Operations

	IL	PBL	EI	GNTs	LWG	CF
CDB	Yes	Yes	Yes	Yes	Yes	Yes[5]
IDB	Yes	Yes	No	Yes	Yes	Yes
WB	Yes	Yes	No	Yes	No	Yes
IFC	Yes	No	Yes	Yes	Yes	Yes
ADB	Yes	Yes	Yes	Yes	Yes	Yes
EIB	Yes	No	Yes	Yes	Yes	Yes

IL = investment loan. PBL = policy-based of fast-disbursing loan. EI = equity investment. GNT = guarantees. LWG = lending without government guarantee. CF = Cofinancing with institutions and private investors.

Investment Loans (ILs). Typically used to finance specific investment activities whose transactions are used for the purchase of goods, and services.

Policy-Based Lending (PBL). PBL is the preferred instrument to support policy and institutional reforms. It links disbursements to evidence that agreed actions have been adopted.

Equity Investment (EI). Invests directly in a company's equity, or through private equity funds in developing countries.

Guarantees (GNTs). Guarantees promote private financing in BMCs by covering risks the private sector is not normally in a position to absorb or manage.

Lending Without Government Guarantee (LWG). As noted above, some MDB Charters permit them to lend to non-governmental borrowers without government guarantee.

3. The provisions of the **CDB Charter** defining permissible lending operations make it, in theory at least, a full-service bank. In other words, the choice of lending instruments is not limited by Charter. (See Table 1 above). For example, unlike the IDB, the CDB can

4. Lend for equity investment, and unlike the World Bank, it can lend without government guarantee. Indeed, lending instruments employed by the CDB can run the gamut of known lending instruments in use by other MDBs, to new and innovative

[5] Only in collaboration with IFIs or, in the private sector, in collaboration with "suitable" financial institutions.

instruments recommended by Management and approved by the appropriate governing authority of the Bank.

5. MDBs engage in two broad categories of lending: investment/project and policy/fast-disbursing. For the most part, differences in MDB focus can be accounted for by the range of lending options within these two broad categories. Charter limitations aside, a breakdown of instruments by category is largely a matter of convention and convenience. The range of instruments within a given category varies from MDB to MDB, and from time to time for the same MDB. The situation is complicated too by the fact that different MDBs sometimes use slightly different names for the same instrument, in addition to employing different types of instrument within the two broad categories.

6. For the reasons stated in the foregoing paragraph, we will categorize MDB lending instruments (LIs) by **the *purposes*** to which lending resources are directed, as follows:

(a) Investment or project

(b) Policy or fast-disbursing.

(c) Emergency (natural disaster or financial crisis).

(d) Results (effectiveness).

(e) Private sector.

7. **Table 2** below attempts to simplify the breakdown of lending categories to facilitate a comparison of CDB lending response capabilities with the comparator group (IDB, WB, EIB, and ADB). It is useful to bear in mind that Emergency, and Results lending can be of the Investment or Policy type. More importantly, so-called results lending has now been adopted as a cross-cutting mandate for ***all*** forms of lending. Finally, an institution might respond to, for example, an emergency/crisis with existing lending instruments (investment and/or policy) by relaxing normal lending procedures without resorting to the use or adoption of lending instruments developed for that purpose. A comparative table of MDB Lending Products is given at Appendix I.

8. The range of **Lending Instruments** (LIs) employed by the CDB is more limited than those in use by MDBs who lend to their common BMCs. The differences lie, not so much in the broad categories of instruments employed, as it does in the range of instruments within each category. Before we can address the question of whether CDB ought to broaden the range of instruments it employs, or to discard any of its current instruments in favor of newer instruments, we first need to identify where the differences are to be found, and ask why these differences exist.

9. One obvious difference is that CDB employs a narrower range of investment and policy-based lending instruments than the major MDBs. This is particularly true in the IL category. What Table 2 does not tell us is whether the loan identification, processing and approval procedures employed by CDB are more or less flexible than those of partner MDBs. Recommendations are made in this report to improve the flexibility in the Bank's lending responses.

Table 2: Main Lending Instruments by Institution

	CDB	IDB	WB	EIB	ADB
Investment					
SP	√	√	√	√	√
FI/FIL[6]	√	√	√	√	√
TA	√	√		√	√
MW/GMW		√	√		√
CCLIP		√			
Policy-based					
EW	√		√		√
S/SS	√	√	√		√
DBT/DS		√	√		√
APL/PPBL		√	√		√
Emergency					
ND	√	√	√		√
FIN		√	√[7]		√
Results					
Framework	√	√	√	√	√
Instrument		√	√		√
Private Sector					
Loans	√	√	√	√	√
A/B		√	√		√
Guarantees	√	√	√	√	√

SP = specific projects. FI = financial intermediary. TA = technical assistance. MW/GMW = (global) multiple works. CCLIP = conditional credit lines. APL/PPBL = adaptable programme loans/programmatic PBL. EW = economy wide. S/SS = sector/sub-sector. ND = natural disaster. FIN = financial crisis. A/B = co financing where the B loan is financed by private investors. DBT/DS = debt and debt service reduction.

[6] Sometimes referred to as Global Credit Loans
[7] No special instrument. Increased support mainly by means of PBLs.

B. CDB Performance

10. After increasing by almost eighty percent (78.9%) in 2010, loan approvals declined sharply in 2011 by eighty seven percent (87%) to $144.6 million. Three fourths (seventy six percent) of the decline in total lending between 2010 and 2011 can be accounted for by a decline in policy lending of $95 million. The decline in 2011 total lending is even more dramatic when it is noted that no less than fifty percent ($72.5 million) in total lending in 2011 represented emergency lending to repair damage from natural disasters. (Table 3).

11. An important question that can only be partially answered with the available information is, to what extent is this decline a one year aberration, or a trend that can be explained by circumstances that are self-correcting.

Table 3: Lending by Instrument (US4M)

	2007	2008	2009	2010	2011
Investment	179.1	167.5	83.4	175.5	144.6
-- of which Private	30.0	18.2	38.0	20.0	1.0
-- of which Emergency	20.5	54.2	0.4	0	72.5
Policy	0	130.0	67.8	95.0	0
Total	179.1	297.5	151.2	270.5	144.6

12. Disbursements and Net Transfers also declined sharply in 2011 from 2010 levels. Disbursements declined by over $150 million, while Net Transfers declined to less than ten percent of 2010 levels. (See Table 4).

Table 4: Disbursements (US$M)

	2007	2008	2009	2010	2011
Amount in OCR	93.4	101.6	115.7	246.4	94.9
Amount in SFR	44.8	33.2	64.1	49.3	47.2
Total	138.2	134.8	179.8	295.7	142.1
Net Transfers	22.2	1.6	70.0	180.1	15.4

13. If CDB is to arrest a decline in lending and the even less desirable situation in which net transfers become negative, some recovery in the capacity to approve and disburse policy loans would seem highly desirable. This form of lending has accounted for at least thirty five percent of total lending in each of the years 2008, 2009, and 2010, and there is no evidence to suggest that BMCs have lost their appetite for policy-based loans.

14. The BOD/BOGs of all MDBs place limits on this form of lending. In almost all cases, too, the limits are either routinely exceeded (WB), or exceptions are made to the policy to permit fast-disbursing lending (so-called Financial Emergency Loans) that do not count against the established limit (ADB and IDB).

15. Given the importance of CDB as a source of policy advice and financing for its BMCs, a case can be made for immediately revisiting and revising the current limit of 20% of total loans outstanding and rescuing the Bank from its 2011 position of not having the authority to approve any policy loans, regardless of their merits. Loans outstanding at December 31, 2011 were $1,613 million. The limit on policy based lending of 20% of this amount was $322.6 million. Even with zero new PBL approvals in 2011, PBL disbursements at December 31, 2011 was $347million thereby exceeding the cap by $24million.

16. Limits on policy lending are often referred to as "prudential" limits, implying that there is perhaps something profligate in this form of lending. **The conceptual case for policy lending therefore needs to be emphasized. The justification for policy reform is that the policy framework of a country has a powerful influence on the benefits to be derived from investment activity. If the policy framework is inappropriate, the structure of relative prices at the macro and sectoral level will likely yield less than optimal investment results.**

17. On the other hand, a badly designed and poorly implemented policy loan is worse than a giveaway; it is a dis-service to the Bank and the borrower, regardless of the limits on such lending. The answer is to adopt procedures that ensure well designed and implemented loans. Recommendations to achieve this goal were made in a recent report to the CDB prepared for that purpose. The delinking of the policy loan lending limit from loans outstanding is also recommended here. The 20% cap should be replaced by an amount based on overall resource availability.

18. The nature of the disbursements required by policy loans raises special problems for maintaining capital adequacy and liquidity ratios that it would be unwise for the Bank to ignore. Until the problem of capital adequacy is satisfactorily overcome, the capacity of the Bank to finance significant net resource flows is severely constrained. However, solutions to this problem are beyond the scope of this paper.

19. A review of CDB recent lending performance would be incomplete without a review of its net resource transfer role. Net resource transfers to eight of its thirteen LDCs were negative for January 1, 2011 to December 31, 2011. Net transfers were also negative for the LDC group as a whole. Net resource transfers were negative for three of its five MDCs, but positive for the group as a whole by almost the same amount as they were negative for LDCs. Net resource transfers become positive only when account is taken of disbursement and repayments of Regional Programmes.

20. CDB was for all practical purposes net resource neutral for its BMCs as a whole in 2011. There are currently, as noted above, limitations in the capacity of the Bank to finance significant net resource flows. This makes it imperative that the Bank view its

BMCs as partners whose combined efforts are greater than the sum of their individual parts, because it no longer has the control and leverage that comes with being a source of significant net resource transfers.

C. Recent Lending Reforms in Select MDBs

21. ***Lending Reforms in the World Bank 2009 – 2011***. In the years 2009 to 2011, the WB gave high priority to reform of both its IL and DPL instruments. These reforms were driven, for the most part, by three factors: (i) the elaborate and overly restrictive rules that governed IL, (ii) competition from new development assistance providers, and (iii) the requirement, especially by development assistance partners (donors), that the design and implementation of both the Bank's IL and DPL products should demonstrate success in achieving development assistance goals (results).

22. On the one hand, IL continues to account for the largest share of WB lending and commitments. On the other hand, a Concept Paper (2009) that outlined the need for reform of the Bank's IL instrument stated the following:

> *"Some borrowers -- especially middle-income countries (MICs) that have access to alternative sources of financing -- have begun to feel that the nonfinancial costs and rigidities associated with IL may outweigh the benefits associated with Bank involvement."*

23. Another factor that has led the Bank to give high priority to reform of its IL instrument, with its rules-based approach to project design, is the emergence of bilateral sources of development assistance such as China, India and Brazil, with whom the Bank would need to work to remain relevant in its BMCs.

24. Parallel with reform of its IL instrument, the Bank continued a critical review of its development policy lending (DPL) framework. In 2004 Directors approved a new operational policy, Development Policy Lending; that replaced a host of separate adjustment lending instruments and brought together all policy-based lending in **a single operational framework**. The new DPL covered all Bank operations that provided "rapidly disbursing policy-based financing to address actual or anticipated development financing needs of external or domestic origins." The new instrument (DPL) typically supports a programme of policy and institutional actions and finances the borrower's overall budget expenditures, with the exception of items on a standard list.

25. In the course of continuing work on reform of its IL instrument, WB Management proposed a new instrument that would be separate from, but complementary to, both IL and DPL. The new instrument – Programme-for-Results (P4R) -- would help countries to improve the design and implementation of their own development programmes and would finance a portion of the country's programme expenditures. It would focus on development results by linking disbursements to results or performance indicators, which can be outputs, outcomes, or other actions/results that are tangible, transparent, or verifiable. It would also permit the Bank to strengthen partnerships with governments and development partners by means of pooled funding arrangements.

26. In a paper dated December 29, 2011, Management proposed that P4R would have the following key features:

a) Finance and support borrowers' programmes.

b) Disburse upon achievement of programme results.

c) Focus on strengthening the institutional capacity needed for programmes to achieve their desired results.

d) Provide assurance that Bank financing is used appropriately and that the environmental and social impacts of the programme are adequately addressed.

27. The new instrument was presented for WB Board approval after extensive consultation with think tanks, stakeholders, and within the Bank itself over a period of several months. The Board of Executive Directors approved the new Programme-for-Results instrument that ties lending directly to verified development results on January 24, 2012.

28. ***Lending Reforms in the IDB.*** When the IDB was founded, its principal objective was to finance the foreign exchange component of specific investment projects and to provide technical assistance loans and grants aimed at strengthening institutions in its borrowing member countries. New lending instruments were introduced in the 1970s and 1980s to speed up the approval process for repeat operations (global multiple works and global credit operations), and in the 1990s Policy-Based and Emergency lending was introduced to meet the needs of the financial crisis. After 1998, however, the IDB experienced a sharp decline in demand for investment lending, due in part to borrowers' perceptions that IDB lending instruments were rigid and cumbersome, generated high transaction costs, and were not agile enough in meeting their changing needs. The IDB responded by developing a host of New Lending Instruments, designed to fast track the approval process, facilitate execution and avoid cumbersome internal procedures under specific circumstances. By 2010 the IDB disposed of panoply of lending instruments, including 3 policy-based instruments, 10 investment loan instruments, and 2 lending "approaches" that were capable of encompassing a variety of instruments.

29. According to the IDB's independent evaluation office (OVE), the proliferation of lending instruments was a way for the IDB to address the declining demand for traditional investment lending, borrower concerns regarding high transaction costs, and the fiscal constraints of borrowing member countries. In 2011, IDB Management and the Board consequently reviewed those instruments, but only 2 (Innovation Loans and Sector Facilities) were eliminated.

30. The IDB currently has three lending categories (policy-based lending, emergency lending, and investment lending). Within **the investment category**, the IDB has developed eight lending instruments:

- Specific investment loans
- Global Multiple works loans
- Global Credit loans
- Technical cooperation loans
- Project Preparation and Execution Facility (PROPEF) loans
- Immediate Response Facility for Emergencies caused by Natural and Unexpected Disasters
- Multiphase Programme loans
- Performance-Driven loans

31. Demand for global credit loans, global multiple works loans and multi-phase programme loans has increased during the past decade, including the use of Conditional Credit Line for Investment Projects (CCLIPs)[8] operations. This is true particularly after 2007 when the Board authorized de-linking of the grace period from the disbursement period of individual operations. Demand for specific investment loans on the other hand has remained stable (accounting for about half of total investment lending), while demand for other products including PROPEF, TC/TA, Innovation and Immediate Response loans declined to only one or two operations per year.

32. A major reason for the declining demand for specialized investment loan instruments is that relatively inflexible Bank policies and procedures, which had been the rationale for developing New Lending instruments, have themselves been reformed in recent years. Major changes came in 2004, for example, when the Board approved a new policy on eligibility of expenditures under which ***any*** expenditures required to achieve a project's development objectives could be financed. The elimination of the foreign exchange matrix, allowing the borrower to choose the share of Bank and counterpart financing, and the adjustment to the policy on financing of cost overruns broadened the use of these policies to all investment lending instruments.

33. Similarly, the implementation of a new approval and project cycle process in 2007 shifted the emphasis from approval to execution in all IDB projects. It gave project teams flexibility to define the degree of ex-ante project preparation, based on the risks inherent in each operation, and streamlined the approval process by focusing discussion on policy issues, risks, and results. The implementation of the new project cycle decreased the median number of days needed to take a project from the project profile stage to loan approval from 406 days in 2005, to 206 days in 2009 and 184 days in 2010. Many of the procedural obstacles to approval that had in the past given rise to the development of specialized instruments, were consequently eliminated.

34. The focus of the mandate given to the Bank by its Board of Governors under ***the Ninth General Increase in Resources in 2010***, has been on improving and documenting

[8] The CCLIP is a framework under which individual operations involving different lending vehicles can be combined for approval of a single line of credit.

the effectiveness and performance of the Bank as a development institution, where performance is measured in terms of:

(a) what the Bank does, and

(b) how the Bank works.

A Results Framework has consequently been established for the organization, modeled on lessons learned and best practices from others in the development community, including the Asian Development Bank and the World Bank. The four components of the framework include: lending programme priorities, regional development goals, output contributions to regional goals, and operational effectiveness and efficiency.

35. Irrespective of the lending instrument chosen to finance individual operations, the focus on development effectiveness requires that the intended outputs and outcomes of each operation be clearly defined, monitored, and evaluated to document performance. Each operation consequently has a Development Effectiveness Matrix which emphasizes the evaluability aspects of the operation, enables project teams to monitor the outputs and outcomes of the project, and at project completion, compare actual project results with expected results at time of approval.

36. Reform of **Policy-Based lending** centered on the introduction of Programmatic PBLs (PPBLs) in 2005. Demand for PPBLs has grown and now significantly outpaces the demand for multi-phase PBLs. A Programmatic PBL consists of a series of single-tranche operations (each with its respective loan contract) set within a medium term framework of reforms. It is approved on a phased basis to support the borrower in achieving the country's reform programme, with specified triggers for transitioning from one operation to the next. It is considered to be particularly appropriate where there is uncertainty on the precise measures needed to achieve programme objectives due to changing country and external circumstances, and also reduces commitment fees for borrowers.

37. Significantly, only 7 of 36 Programmatic PBLs approved by the IDB by the end of 2011 had not been followed by a subsequent loan, indicating that Programmatic PBLs have been used as the policy intended.

38. ***Lending Reforms in the EIB.*** Since 2003, the EIB's operations in the ACP and OCT regions have been carried out under the ACP-EU Cotonou Partnership Agreement and the Overseas Association Decision. The Bank manages the EUR 3.5bn Investment Facility (funded from EDF resources), which meets the financing needs of investment projects in the region with a broad range of flexible risk-bearing instruments such as junior loans, equity, quasi-capital, guarantees and, in particular cases, interest rate subsidies. For the period 2007-2013, the Bank can also lend up to EUR 2bn, using its own resources with a guarantee from the Member States. The Bank's product range in the region is usefully complemented by technical assistance grants, which can be used to support or improve projects.

39. The EIB's overriding aim in the African, Caribbean, and Pacific (ACP) region is to support projects that deliver sustainable economic, social and environmental benefits. Infrastructure, including energy efficiency and climate change mitigation and adaptation, as well as the financial sector are the Bank's core strategic priorities in the region. The Bank supports public sector projects that are critical for private sector development and the creation of a competitive business environment and concentrates on fostering private sector-led initiatives that promote economic growth and thus help to reduce poverty. The industrial and services sectors are therefore eligible. The EIB also seeks to reinforce partnerships and cooperation with the European Commission and peer institutions, EU bilateral agencies, the European Development Finance Institutions (EDFIs), the African Development Bank, other regional donor agencies and multilaterals. With an average of about EUR 700m of new lending per annum, the EIB is a modest but nevertheless significant player in the ACPs and OCTs.

40. ***Lending reforms in the Asian Development Bank (ADB).*** In late 1999 and early 2000, ADB surveyed its major OCR borrowers on practices, objectives, and concerns in debt management, as well as their preferences for loan products. The principal conclusion of the survey was that ADB's OCR borrowers emphasized the need to go beyond individual project risk considerations and focus in addition on the over-all debt portfolio requirements in an assets-liability framework. At least 5 "triggers" were credited with influencing borrowers:

(a) Lessons learned from the Asian Financial Crisis: i.e., that the core problem was the mismatch of maturities and of currency denominations which translated into national balance sheet vulnerability;

(b) The results of numerous workshops organized by the IMF and World Bank which had stimulated awareness of the importance of managing risks in the national debt portfolio;

(c) Extensive outreach by the World Bank to its clients about its new loan products, introduced in 1999;

(d) Borrower's own initiatives in seeking advice from commercial financial houses on external debt management issues;

(e) The astounding growth of the derivatives market, which had become a standard building block of risk management by corporations and governments.

41. Based on the results of these consultations, the ADB revised its traditional loan product menu in 2001 to include:

(a) LIBOR-based floating rate and fixed rate loans;

(b) Risk management products such as currency and interest swaps;

(c) Flexibility in the choice of grace period, final maturity, and amortization structure; and

(d) Conversion of existing currency pool-based loans into LIBOR-based loans.

42. Further steps were taken in 2005, when the ADB's Board approved creation of a new lending instrument: the Local Currency Lending Facility, designed to assist borrowers (such as sub-national authorities) that were not in a position to hedge their foreign currency risks.

43. ADB's support of policy-based lending began in 1978, in response to foreign exchange shortages of its borrowers stemming from the international oil crisis of the 1970s. The initial purpose of "programme lending" was therefore to finance the importation of goods that were essential for the fuller utilization of the productive capacity of its developing member countries (DMCs). ADB removed the need to demonstrate balance of payments needs from its policy based loans in 1987, but its legacy is still reflected in the practice of linking disbursements to imports.[9] In the 1980s, the scope of programme lending was broadened to address a wide range of policy reforms, following the World Bank's introduction of structural adjustment loans (SALs), and in 1983 ADB reformulated its programme lending to support policy reforms, including introduction of the development policy letter and policy matrix.

44. Lessons learned by ADB and other MDBs from the adjustment experiences of the 1990s led to the conclusion that reforms only worked when they were fully owned by the client country. Moreover, the imposition of an extensive list of tranche release conditions that surpassed the implementation capacity of client countries was increasingly seen as counterproductive. In 1999, the ADB introduced its first Programmatic instrument, the programme cluster approach (PCA), modeled on the World Bank's Programmatic SAL, as a means of reconciling the objectives of assuring borrower ownership of reforms, while providing resource predictability. ADB also introduced its Special Programme Loans (SPLs), designed to provide liquidity to DMCs in times of special financial crisis. Like World Bank Special DPLs or IDB's Emergency Loans, ADB's SPLs are relatively expensive and relatively short maturity.

45. IN 2008 a different type of financial crisis hit ADB's borrowers, originating not in structural weaknesses of developing countries as in the 1980s and 1990s, but in industrialized countries, and requiring international financial institutions to respond differently. ADB's response entailed flexible use of conventional programme lending instruments, and the creation of the Countercyclical Support Facility (CSF), a temporary instrument to be employed in 2009 and 2010, with a cap of US $3 billion, to support fiscal stimulus at the macroeconomic level in ADB's DMCs; no structural reforms were required. Although ADB judged this effort to be a success, the CSF expired as scheduled at the end of 2010.

[9] ADB, "Review of ADB's Policy-Based Lending", June 2011

46. ADB's latest policy review of Policy Based Lending[10] recommends that its Board approve the following reforms to ADB's programme lending policy:

(a) Mainstreaming Programmatic budget support by: formally referring to programme lending as policy based lending (and to PCA as a Programmatic approach); removing the restriction on retroactive financing; and dimensioning loan size on the basis of financing needs rather than the costs of adjustment directly related to the implementation of reforms.

(b) Enhancing ADB's crisis response capacity by: improving the pricing and terms of SPLs (to be renamed SPBLs); and mainstream the CSF, with pricing and terms equivalent to the SPBLs.

D. The Current Development Environment and Lending Instrument Issues

47. ***Investment Lending.*** The IL or project model is recognized within and outside MDBs as failing to meet or effectively solve, in the WB's words, "the varied needs of the Bank's clients and the inefficiency, rigidity, and insularity of the processes and requirements that apply to it." It requires substantial amounts of time and effort to comply with internal processing, review, and documentation requirements. Yet, it remains the primary lending instrument of almost all MDBs.

48. The enduring importance of IL no doubt derives from the fact that it was designed to enable MDBs to provide assistance to a broad number of sectors and purposes such as infrastructure, agriculture, and human development (e.g., schools and health facilities) that are critical foundations for development efforts. In addition, success can be measured by identifiable and easily defined outputs such as schools, bridges and roads. Quality at entry can be verified by highly refined techniques such as cost-benefit analysis and least-cost options. As a result, it has not been so much abandoned as it has evolved. IL projects can be developed around Programmatic or framework-based project models in which the lender agrees to finance a portion of the borrower's programme in a given sector. To some extent, ILs can even be adapted to permit disbursements against impact and results (outcomes).

49. There are limits, however, to the adaptation process without losing control of assuring quality of projects at entry. Indeed, the WB recognized that –

> *"The IL instrument is facing both intrinsic issues that undermine the efficiency with which investment operations are prepared and implemented/supervised, and more fundamental constraints that keep the*

[10] ADB, "Review of ADB's Policy Based Lending", June 2011, op cit.

IL instrument from appropriately responding and adapting to the evolution in the global development paradigm and environment."[11]

50. Factors that impede further IL reform include, but are not limited to:

- *Delays and nonfinancial costs of prolonged project preparation.*
- *Delays and additional costs, and unpredictable flow of funds during project implementation often associated with MDB fiduciary, safeguards, and reporting requirements and procedures.*
- The IL ring-fenced project model undermines the ability to truly support country-led programmes using borrower systems in close coordination with other donors.
- A disconnect between MDB focus on results (outcomes and outputs) and continued concentration of appraisal and supervision efforts on inputs and expenditures.
- Suboptimal effectiveness in meeting different borrower needs and achieving agreed developmental results.
- Lack of appropriate tools, incentives, and resources for candid risk identification, reporting, and management, especially during project supervision.
- Lack of clarity on expectations, responsibilities, and tools for handling fraud and corruption.

51. ***Development Policy Lending (DPL).*** DPLs provide general budget support and do not earmark loan proceeds for specific expenditures or programmes. They disburse against specific policy and institutional actions and not against the results or output/outcomes associated with sector/programme expenditures.

- Issues raised by DPL are common to almost all MDBs and include:
- The prudent share of policy-based lending in total lending.
- The design of DPLs: multi-tranche or single tranche?
- When is a Programmatic lending approach justified?
- The degree of complexity in loan design and tranche conditionality.

[11] The development paradigm to which they refer is of course the partner emphasis on results. World Bank, "Investment Lending Reform: Concept Note" 2009.

- The desirability of an appropriate institutional and policy framework versus country ownership.

52. ***Lending for Results.*** At the 3rd High Level Forum on Aid Effectiveness, held in Accra in 2008, Ministers of developing and developed countries agreed, *inter alia*, as follows:

"We will improve our management for results by taking the following actions:

a) Developing countries will strengthen the quality of policy design, implementation and assessment by improving information systems, including, as appropriate, disaggregating data by sex, region and socioeconomic status.

b) Developing countries and donors will work to develop cost-effective results management instruments to assess the impact of development policies and adjust them as necessary. We will better co-ordinate and link the various sources of information, including national statistical systems, budgeting, planning, monitoring and country-led evaluations of policy performance.

c) Donors will align their monitoring with country information systems. They will support, and invest in strengthening, developing countries' national statistical capacity and information systems, including those for managing aid.

d) We will strengthen incentives to improve aid effectiveness. We will systematically review and address legal or administrative impediments to implementing international commitments on aid effectiveness. Donors will pay more attention to delegating sufficient authority to country offices and to changing organizational and staff incentives to promote behavior in line with aid effectiveness principles."

53. In the review of lending reforms in the WB and the IDB above, we noted that ***irrespective of the lending instrument chosen***, a focus on development effectiveness requires that the intended <u>outputs</u> and <u>outcomes</u> of each operation be clearly defined, monitored, and evaluated to document performance. To the extent possible, an emphasis on results will be the goal of ***all*** lending. And yet, the rollout of a WB instrument to address this goal directly has not been without controversy and concern. Indeed, the WB itself is placing strict limits on the use of the new instrument before adopting it as a main stay of its lending. The concern about the downside of the emphasis on outcomes, the pooling of resources, and on reliance on country systems, is perhaps best summed up by the World Resource Institute who commented as follows:

> *"Of course, these trends will bring both benefits and challenges for development. Yet early indications suggest that the Bank could respond to these trends by stepping away (sometimes unintentionally) from environmental and social responsibility in its investments. It is becoming*

more difficult for the public to monitor and hold the Bank accountable for its use of public funds."

54. Another issue raised by emphasis on the results paradigm is whether reliance on country systems, the pooling of resources, and conflating of several projects in the same lending programme make it possible to accurately and reliable identify costs and benefits *ex ante*, and for borrowers to know to what extent the benefits to be derived from undertaking a programme exceed its costs.

55. ***Safeguards.*** **S**afeguard policies are operational policies that provide guidance to the bank and to its BMCs to ensure that bank operations do no harm to people and/or the environment. There are ten safeguard policies, comprising the Bank's policy on: Environmental Assessment (EA), Cultural Property, Disputed areas, Forestry, Indigenous Peoples, International Waterways, Involuntary Resettlement, Natural Habitats, Pest Management, and Safety of Dams.

56. The WB introduced safeguard policies in the 1980s to prevent or significantly reduce the harm to people and the environment of large infrastructure projects. As lending has become more Programmatic (less project centric), more reliant on country systems and less reliant on WB mandatory guidelines, and more results rather than output focused, civil society organizations, whose purpose it is to monitor WB compliance with its safeguard policies, have increasingly voiced fears that WB's compliance with safeguard policies is incompatible with its "modernizing" process. Concurrently with the later process, the WB is undertaking a review of its safeguard policies.

57. Safeguards can be applied to any aspect of a loan, but for the Bank's instruments (IDB), they have tended to fall into four categories:

- Safeguards related to the purpose of the loan
- Safeguards related to the procedures that must be followed to assess impact of the proposed activity
- Fiduciary safeguards aimed at ensuring the funds are spent properly
- Safeguards related to the overall use of the instrument by the Bank, and the terms and conditions on which the funds are lent

58. Safeguards constrain and limit how instruments can be used. To be effective in promoting development, safeguards must be clear and transparent so that Bank staff and country authorities have the same information about the parameters established for each instrument, and for the collective portfolio of instruments.

E. Stakeholder Consultations

59. The study included consultations on CDB's existing lending instruments with important stakeholders, including CDB staff and BMCs, as well as partner MDBs

(notably the World Bank and IDB). In the case of CDB's staff and borrowers, this consultation was done in the context of a special one-day workshop held at CDB Headquarters on March 21, 2012, supplemented by interviews with selected stakeholders by telephone and electronic media.

Summary of Workshop Conclusions

60. In her welcome to participants, the Vice President of Operations, Dr. Carla Barnett, stressed that MDBs were increasingly being asked to focus on development results, and noted that the WB and IDB had developed new and innovative products and retooled existing instruments to meet the demands of their borrowing and non-borrowing member countries. She said CDB needed to do the same in order to remain relevant and effective. She encouraged BMCs to provide clear views on how well, or badly, CDB was meeting their needs, particularly in comparison with other MDBs, and urged them to give suggestions for changes in existing products or implementation of new products that were: (a) flexible, (b) responsive to BMC needs, and (c) competitive with other MDBs.

61. After some discussion, the group agreed that the central problem statement should be: **"CDB** is **experiencing declining lending levels."** Participants gave their opinions and comments on some of the contributing causes and features of this decline, as follows:

- Some BMCs have reached borrowing limits, while others would like to borrow but CDB cannot respond due to its own lending constraints.
- CDB's market share has declined, even though other MDBs have increased lending to the region.
- The private sector is also a competitor. Some BMCs are looking beyond CDB because they can get loans on similar terms, but with much faster access to the borrowed funds.
- BMCs currently need funds to support basic services, not projects. That's why PBLs were important. Project financing procedures, which mean disbursements over long periods of time, are not helpful in terms of financing operational expenses, such as staff costs. However, BMCs can get such assistance from the private market.
- Access to funds from CDB (and WB) is slow, compared with the private market, which can provide resources in 1-2 months. Slowness applies in terms of conditions for disbursement, as well as the approval process itself.
- CDB procedures require it to look at quality standards, environmental aspects, etc. to assure <u>sustainability</u> of the project. Private sector contractors coming to BMCs with projects for financing, on the other hand, require no such safeguards and have higher costs, but the BMCs "can get the road within a year."

- There is demand for projects, but for BMCs facing difficulties in covering recurrent expenses, such as salaries, new projects seem like "luxuries" they cannot afford.

- CDB has not done much in the private sector, and has tended to finance lines of credit to local financial institutions. CDB's financial policies should be reviewed in this context.

- In addition to lending products, CDB needs to provide technical assistance to build capacity within BMCs to work alongside donor agencies.

- Borrower capacity is important to bear in mind when discussing which lending products are appropriate (e.g. PBLs).

- CDB's principal lending constraint is supply, not demand. If the CDB is too risk averse, it will not be able to compete with the IDB or WB, and should think about confining itself to "niches".

- We need a "nimbler" CDB, to respond to the changing needs of CDB borrowers.

- Regarding "risk aversion", CDB is judged (by its stakeholders, rating agencies, etc.) in the context of the "family" of similar lending organizations, regardless of size.

62. Workshop participants agreed on 4 critical areas that contributed to the central problem of declining CDB lending and that should be examined in further detail by individual working groups: (1) Lack of flexibility, (2) Slowness in responses, (3) Absorptive capacity **limitations**, and (4) CDB financial constraints. (A fifth area -- competition from other sources -- was left out of the discussion as it was felt the group could have no influence on that issue.) The following reflects the outcome of each working group:

Group 1: Lack of Flexibility in CDB Operations

IL inflexibility. The appraisal process is cumbersome; terms and conditions are not transparent. Furthermore, repayment and grace periods are standardized and non-negotiable, as are commitment fees and counterpart requirements. Disbursement procedures are generally not subject to negotiation.

PBL inflexibility. Demand exceeds the cap on this form of lending. PBLs require a defined reform programme and strong country participation.

Emergency loan inflexibility. Intermediate Response Loans (IRLs) and Rehabilitation Loans are not fast disbursing; Rehabilitation Loan are project-based (as opposed to IMF loans which are budget support); Rehabilitation Loans require rebuilding in a more resilient manner (raising the question of country capacity).

Private sector loan inflexibility. Constrained by policy and risk aversion; they require government guarantees (for public sector owned entities) or security for direct lending to private sector entities. There are as well internal CDB capacity constraints.

Group 2: Slow Response of CDB

Lack of clarity on strategy (e.g., private sector)

Direct payments to contractors are not permitted by all countries.

Private sector has same operational structure as public sector.

Group 3. Limited Country Absorptive Capacity

A number of governments are unable to:

(a) take on ***additional debt;***

(b) ***meet increased recurrent expenditures;*** or

(c) ***counterpart financing.***

Group 4: CDB Financial Constraints.

Disbursement levels are constrained by liquidity requirements.

F. Recommendations for New Lending Products

63. It is recommended that CDB add to its current complement of lending instruments a more Programmatic approach in its lending operations, in keeping with similar steps taken by other MDBs. Programmatic lending/instruments are not new. Programmatic approaches have been applied to policy and investment lending instruments for some time now, first in the WB (2003) and then in the IDB (2005) and in the ADB. A world Bank review of experience with this approach to lending stated as follows:

> *"The Programmatic approach has been used to provide sustained, flexible and predictable support to credible medium-term reform programmes or strong performers with good track records—such as Brazil, Latvia, Mexico and Uganda. It has also been useful in countries with sound reform programmes but weaker capacity or track records, or those emerging from crisis or instability—such as Jamaica, Peru, Turkey and Ukraine"*

64. Although there is no commonly agreed **definition** of the term "Programmatic" the IDB's Evaluation Office (OVE) has stressed that a Programmatic approach should focus on countries and problem solving, and should incorporate the following basic elements:

(d) A long term commitment to address a particular problem in a country; it is not a one-shot, one project approach,

(e) A clear joint statement by the Bank and the Country regarding the results to be achieved over time, as a result of this engagement; it should be results-focused,

(f) The effective integration of Bank resources with country systems and resources in the pursuit of the common results agenda; a Programmatic approach is a partnership, with the country in the lead.[12]

65. In keeping with that recommendation, two specific new lending products are proposed for consideration by CDB, corresponding to the two most successful Programmatic instruments adopted by the IDB:

(a) the Programmatic Policy-based Loan; and

(b) the Multi-phase Programme **Loan**.

A third instrument, the Conditional Line of Credit for Investment Projects is favorably reviewed but not recommended for adoption at this time. The first of the recommended instruments, the Programmatic PBL, is a policy-based lending product whose implementation would be subject to increasing CDB's lending cap for such operations; the Multi-phase Programme Loan is an investment vehicle that could be implemented without changing CDB's lending structure.

Programmatic Instruments recommended for consideration by CDB:

1. Programmatic Policy-Based Loan (PPBL)

66. Programmatic Policy-Based Loans consist of a series of single-tranche PBLs to assist BMCs in addressing medium-term programmes of policy reforms and institutional changes, while supporting balance of payments needs or budget deficits. Each operation in the progression has its own **loan** contract, so commitment fees are charged only for those loans which have been activated (reducing transaction costs for borrowers). Disbursements are made when the policy conditions of each operation have been complied with. Completion of previously agreed achievement "triggers" sets the stage for design and approval of the next operation. Each of the loans is designed to build upon progress made in earlier operations, to achieve the ultimate objectives of the programme.

67. Unlike traditional multi-tranche PBLs, however, where the conditionality of each of the subsequent tranches is defined ex-ante (and which experience has shown frequently results in delays and/or waivers of compliance due to the inflexibility of this

12 OVE, "Evaluation of the New Lending Framework, 2005-2008"

model), Programmatic PBLs are designed to accommodate changing country and external developments in defining the specific conditions to be applied in the next operation. PPBLs are therefore **particularly** well-suited to deal with medium-term policy reforms that must be implemented during periods of political or economic uncertainty, since the policy conditions of each phase can be tailored to current conditions.

68. As with any Policy-Based loan, Programmatic PBLs need to be aligned with Country Strategy objectives; require strong ownership and commitment from the Borrower; must be undertaken within a sound macroeconomic framework; should be undertaken in concert with technical advice and support to borrower agencies; and require a strong results framework that includes:

(a) clearly stated objectives and results,

(b) verifiable triggers to signal readiness for design and implementation of the next phase; and

(c) A satisfactory monitoring and evaluation plan.

69. The advantages of Programmatic PBLs over traditional multi-tranche PBLs include the fact that they:

(a) provide **flexibility** in adjusting programme implementation to meet programme objectives;

(b) assure continuous dialog and technical support needed for the sector reform agenda, and

(c) facilitate continuity of reforms from administration to administration despite changes in government and/or turnover in ministries.

70. The principle risks of PPBLs are that subsequent projects in the series may not materialize, or that in countries with a slow ratification process, the reform agenda may take a longer time to implement. The IDB's experience with its Progammatic PBLs, however, is **instructive**: demand for PPBLs has grown dramatically since they were first introduced in 2005, and now significantly outpaces the demand for traditional multi-tranche PBLs. Moreover the majority of Programmatic PBLs approved to date form part of a series of PBLs aimed at achieving medium-term reform objectives: of the 67 PPBLs approved in 2005-2010, 41 are the first loans in a series, while the other 26 represent subsequent loans in a Programmatic series, suggesting that the Programmatic approach is working.

2. Multi-phase Programme Loans (MPLs)

71. Multi-phase Programme Loans may be thought of as the investment loan equivalent of Programmatic PBLs. MPLs consist of a series of separate, but interdependent, investment loan operations designed to provide long-term support for far-reaching programme objectives **that** require more than a single project cycle to complete.

Like PPBLs, each MPL has a separate loan contract, and commitment fees are charged only as each loan is activated, reducing transaction costs for borrowers for the long-term programme. And, as in the case of PBLs, compliance with predetermined performance targets that measure progress towards medium to long-term objectives, triggers eligibility for the subsequent phase. At the IDB, approval procedures are also streamlined in the sense that only the first operation is subject to formal Board discussion and approval; the second and subsequent phases are approved by simplified procedure (i.e., on a non-objection basis).

72. Demand for MPLs has grown steadily at the IDB, which introduced this lending product in the year 2000. Between 2000 and November of 2011, 93 MPL operations had been approved by the IDB, compared with 499 standard investment operations. In reviewing the performance of its existing lending instruments in 2011[13] IDB Management recommended only one change in the MPL instrument: that "...subsequent phases in a multi-phase programme loan operation … should be subject to the request of the borrower and be linked to one of the strategic areas of the respective Country Strategy."[14]

73. In making the recommendation for the adoption of Programmatic lending instruments – policy and investment – it cannot be too strongly stressed that success depends, above all, on willingness to adopt, strengthen and work through country systems. This may be a leap of faith for some. The reality is that the comparator MDBs (IDB, WB, and ADB) have already moved in this direction and that the development community has endorsed this approach.

Programmatic lending instruments not recommended for adoption by CDB at this time are:

1. Conditional Credit Line for Investment Projects (CCLIPs)

74. Like the Programmatic Policy-based Loan (PPBL) and the Multi-phase Programme Loan (MPL) discussed above, the CCLIP is an IDB lending instrument that has met with significant success in **generating** loan demand from IDB BMCs. It was designed to increase the Bank's efficiency and speed in preparing and approving project loans, and to reduce loan processing costs for both the Bank and its BMCs.

75. The CCLIP may be used in a multi-sector approach, where the CCLIP's development objectives are maximized by financing projects in a number of diverse sectors. The **CCLIP** is established with the government's liaison institution and the projects are executed by the respective agencies or line Ministries in each sector.

76. It should be noted that this instrument is different from the existing multi-phase loan instrument. A multi-phase loan provides long-term support of a far-reaching investment programme, which by its nature and complexity requires more than one

13 "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments, Second Revised Version", 29 November, 2011.,
14 This recommendation was also made for individual loan operations in the CCLIP.

project cycle to complete. This multi-year framework serves as an umbrella for a series of individual operations each of which builds on the previous ones in supporting the goals set in the overall framework. In the case of the CCLIP, on the other hand, the projects financed under the credit line are independent of one another. Projects do not build on previous ones, and do not depend on previous projects to achieve their objectives.

77. There are a number of benefits for borrowers associated with the use of this instrument, among them being:

(a) timely resources allowing investment programmes to have continuity;

(b) a vehicle for efficient Bank support and continuous presence in sectors in which investments have achieved their development objectives;

(c) the authorization of the credit line will result in a "conditional commitment" by which the borrower and the Bank will not actually incur the cost of committing resources until the individual loans are approved; and

(d) it places a premium on continuous institutional analysis.

78. Nevertheless, a recommendation for adoption of this instrument at this time is <u>NOT</u> being made for the following reasons:

(a) It can only be used in those cases where ***prior*** successful project performance can be demonstrated, both with respect to execution and results.

(b) To obtain a credit line the borrower needs to meet a number of criteria, including but not limited to: the executing agency must have completed one similar project within the last five years in each of the sectors for which the credit line is being requested.

(c) Many of the advantages of the CCLIP can be achieved by reform in loan processing and approval procedures.

2. Programme-for-Results (P4R)

79. The key features of P4R are described in Section C above. In its policy paper recommending adoption of the instrument, WB Management stated as follows:[15]

> *"Programme-for-Results will be the instrument of choice when the objective is to support the performance of a government programme* ***using the government's own systems*** *(emphasis added); when the results require expenditures; and when the risks to achieving the programme's objectives relate to the governance and capacity of the systems to achieve*

[15] A New Instrument to Advance Development Effectiveness: Programme-For-Results Financing, July 18, 2012.

better results, including with respect to fiduciary and environmental and social issues."

80. Approved by the Board of Executive Directors of the WB in January 2012, P4R is a new instrument with no track record by which to evaluate its performance. It is described by the WB as different from, but complementary to, IL and DPL. The former provides project support while the latter provides policy support. By supporting a government programme, P4R will place more direct emphasis on results by making them the basis for disbursements. Most importantly, it will enable the WB to leverage its own financing and collaborate with other development partners by pooling partner resources and focusing efforts on supporting government programmes.

81. On the one hand, the WB promotes this new policy as a key feature of the Bank's modernizing process that takes them away from the procedurally laden project-by-project approach of the traditional IL instrument. They also stress the ownership benefits of reliance on country systems (e.g., procurement and accountability). On the other hand, they are cautious in the role out of the instrument to blunt criticisms that the instrument lacks the teeth to prevent fraud and corruption, and that the pooling of partner resources and the conflating of individual projects and activities of a Programmatic approach dilutes the effectiveness of safeguard policies that have been adopted as a the result of pressure from civil society organizations.

82. A recommendation for adoption of this instrument at this time is <u>NOT</u> being made for the following reasons:

(a) P4R is the newest of all lending instruments and there is no track record on which to base its efficacy. In short, will it work as advertised?

(b) The WB with all its expertise and financial resources is limiting P4R lending to five percent of commitments in the first two years of operation after approval. A full review and assessment is promised to the BOD at the end of this period.

(c) The instrument places considerable reliance on the competence and reliability of country systems. For much of CDB borrowing membership, this may well be too much of a stretch.

3. Financial Emergency Loans

83. Workshop participants made a recommendation for the adoption by the CDB of this instrument. It should be borne in mind that the IMF is historically the proper source for this type of assistance. We should also note that the IDB, on the insistence of its Finance Department, attached pricing to this instrument that was appropriate to the degree of risk involved. One benefit of this instrument was that lending was exempted from the policy lending cap. Neither the tenor (five years) nor the price 400 basis points above LIBOR) made it a popular choice, even for countries in straightened circumstances.

84. IDB Emergency loans are in US dollars with an interest rate tied to the six-month U.S. dollar LIBOR rate, plus 400 basis points. They have a five-year term and a three-year grace period. Local counterpart funding is not necessary.

85. The fall-out from the recent and ongoing internal financial collapse has made demand for financial emergency lending a much sought after instrument of BMCs. It is understandable; therefore, that the CDB, with its intimate knowledge of the region and the circumstances of its individual BMCS, would wish to be of assistance at a time of critical need. In the circumstances, the CDB has three options:

(a) A standard or traditional PBL that is made available when the borrower faces and exogenous shock that creates a liquidity crisis.

(b) The same as (a) above, but made available only in the context of an IMF programme.

(c) A Financial Emergency Loan whose tenor and coupon are designed to reflect the risk of lending to a highly illiquid borrower.

Re (a) – This type of loan in emergency circumstances carries risks to the lender that are not reflected in the terms of the loan and without adequate safeguards for repayment (an independently monitored programme for fiscal adjustment). The Consultant knows of no MDB that has **officially** adopted stepped up PBL lending as the sole solution to fiscal crisis, although the WB's external evaluation office has pointed to a correlation between increased WB traditional policy lending and financial emergencies. **An added difficulty of the approach of using standard PBL is that there is no justification for excluding this lending from the policy lending cap.**

Re (b) – This approach is recommended with the observation that for many borrowers an IMF Programme is anathema. **Association with an IMF Programme is the minimal condition for seeking to exempt this lending from the policy lending cap**.

Re (c) – Recommended with the observation that even on these terms, as is the case in the IDB, an IMF Programme ought to be a condition of financial emergency lending**. In the IDB and ADB Emergency Loans of this type are exempt from the policy lending cap.**

4. An Insurance Product along the Lines of CCRIF

86. No development bank can legally offer its BMCs anything remotely resembling an insurance product.

G. Monitoring and Evaluation Implications of Proposed New Lending Products

87. Monitoring and Evaluation of MDB lending products in terms of results began in the early 1970s, when the World Bank established an experimental unit (now the

Independent Evaluation Group, IEG) to 'find out whatever happened to World Bank projects'. Previously, the World Bank had tracked project performance only in terms of disbursement patterns and milestones in terms of elapsed calendar time. Although it was known that implementation problems often resulted in disbursement delays, this initiative was the first to compare actual with expected performance in terms of development results. Early results showed that about one-third of the operations financed by the WB were judged not likely to fully achieve their expected development objectives. Similar efforts launched by the IDB in the 1980s confirmed similar results: Project Completion Reports reviewed by the IDB's Operations Evaluation Office concluded that about one third of projects were not expected to achieve their intended development objectives, another third seemed clearly on-track to complete their objectives, and the remaining third did not contain sufficient information to form a judgment one way or another.

88. Based on these findings, both organizations established monitoring systems to track project implementation progress in terms of the execution of project components (<u>outputs</u>), since the timely execution of project components is, by definition, a necessary condition for ultimately achieving expected development results (<u>outcomes</u>). On-line monitoring systems were established to identify projects that appeared to be at risk of not achieving their output and outcome results, so that timely corrective action could be taken. Increasingly, emphasis was placed on defining outcome and output indicators that were unambiguous, measurable, and time-specific, so that judgments on implementation performance would be as objective as possible. The development of results frameworks for individual operations prior to Board approval, which specified which indicators would be used to measure output and outcome performance at specific points in time (as well as who was responsible for collecting the necessary data and the sources to be used in that process) became the basic elements of their Managing for Development Results (MfDR) approach at the project and portfolio levels. Eventually, the same approach was adopted at higher levels of the MfDR pyramid: country and institutional strategies.

89. In recent years, increasing demand for financial resources by borrowers, coupled with increasing scrutiny on the funding provided by non-borrower shareholders, have led most MDBs to increase their emphasis on reporting on MfDR in order to justify requests for increased contributions of capital. The Asian Development Bank, for example, developed a formal Results Framework for the institution as part of its strategic plan, which became an input into the approval of a capital increase by its Board of Governors in 2009. The ADB's results framework included regional development outcomes, institutional outputs, and operational and efficiency indicators. Similar efforts were undertaken by the World Bank in the context of discussions on replenishing the resources of the International Development Association, as well as bilateral agencies including DFID, CIDA, and the US Millennium Challenge Corporation.

90. Based on lessons learned in this process, including reporting standards adopted by the MDB Evaluation Cooperation Group, the IDB developed its Results Framework in the context of discussions on its Ninth General Increase in Capital in 2010. The IDB results framework includes four components:

(a) strategic lending priorities;

(b) regional development goals;

(c) IDB's output contribution towards achieving regional goals; and

(d) IDB's operational effectiveness and efficiency.

In the parlance of the OECD's Development Effectiveness Committee (OECD-DAC), the first two components measure the extent to which the IDB is doing "the right things", while the second two components measure the extent to which the IDB is "doing things right". The first two components require prioritization, planning and a Programmatic approach to lending, by country and sector, based upon commonly perceived goals between the Bank and borrower. The second two components essentially involve managing, monitoring and evaluating projects in the execution stage, to assure that the intended impact is achieved in an efficient manner.

91. At higher levels of the MfDR pyramid, CDB has followed a similar path: a Results Monitoring Framework (RFM) was adopted in the context of the Seventh replenishment cycle of its Special Development Fund, which took effect in 2009, and the RFM was expanded and applied across the Bank within the context of the 2010-2014 Strategic Plan developed for the General Increase in Capital Resources approved by CDB's Board of Governors in May 2010. CDB's RFM establishes a framework for reporting on CDB's effectiveness at 4 levels:

(a) regional progress towards Caribbean Millennium Development Goals (CMDG) targets and development outcomes,

(b) the contribution of CDB outputs to achieving country and regional outcomes,

(c) CDB's operational and organizational effectiveness, and

(d) partnership, harmonization and alignment with borrowers and other MDBs.

The Strategic Plan includes an ambitious implementation programme for strengthening CDB's actions at each level, some of which have specific target dates and others which are meant to be on-going. CDB's latest work programme and budget document[16] lists the principal outputs expected to be produced in 2011-2012. From a monitoring and evaluation perspective, some of the most important work programme outputs include:

(a) Development of a manual on methodology and guidelines for evaluation of operational strategies and policies (2012);

(b) Implementation of a Managing for Development Results (MfDR) Action Plan for the Bank, with associated change management initiatives and a RMF (third and fourth quarters of 2011);

[16] CDB, "Work Programmeme, and Administrative and Capital Budgets 2012 – 2013", September 2011

(c) Preparation of Quality at Entry, Quality of Supervision and Project Supervision Verification Reports as well as Review Reports of the Operations Area (2012);

(d) Harmonization initiatives in evaluation approaches, MfDR and reporting requirements of the OECD/DAC (2011 and beyond).

92. However, these and other efforts, such as the proposed Evaluation Policy currently under development by the CDB, focus on the top tiers of the MfDR agenda: corporate reporting, harmonization with the principles of the Paris Declaration, country strategy planning, etc. Unlike the other MDBs, which started building their MfDR capacity at the project level, CDB has made relatively little progress in establishing a results-based monitoring and evaluation capacity for its operations:

(a) Although operational staff have received training in developing results frameworks to assess project performance in terms of outputs and outcomes, few results frameworks actually define good performance indicators, particularly at the outcome level.

(b) Development of an on-line system to monitor implementation progress in terms of outputs and outcomes has been under discussion for some time, but still has not been implemented. In the meantime, project performance monitoring continues to be assessed on the basis of generic criteria and disbursement rates.

(c) Relatively little progress has been made in preparing Project Completion Reports for completed operations: the 2010 – 2014 Strategic Plan calls for 100% of projects completed in the previous two years to have PCRs by 2012, but the actual level achieved in 2010 was only 2 out of 22 due.

93. In principle, the new lending products recommended for consideration by CDB in this report do not require any monitoring and evaluation (M&E) tools that should not be applicable to existing CDB lending products and programmes. Since each of the proposed products (Programmatic PBLS and Multi-phase Loans ~~and CCLIP operations~~) consists of a series of individual policy or investment operations, the monitoring and evaluation requirements essentially involve: (a) an M&E plan for each of the individual operations in the series, and (b) an overall assessment of the effectiveness and efficiency of the series as a whole. What <u>is</u> different about M&E for the recommended lending products is that -- since the justification for approving the next step in each series depends crucially on the success of the previous operation -- the adequacy of M&E arrangements for these operations is critically important from an operational perspective (since it helps define CDB's future lending programme), as well as from an ex-post performance reporting perspective.

94. <u>A good M&E plan for individual operations</u> in the Programmatic series should include the following elements:

(a) A good results framework that clearly identifies expected outputs of the operation, and the development outcomes that will be generated by those outputs;

(b) A risk matrix that defines the principal risks that need to be monitored, and the steps to be taken to manage those risks, if needed;

(c) Clearly defined performance indicators, including baseline data, interim targets and triggers for subsequent phases that are SMART (Specific, Measurable, Achievable, Relevant, Time-based);

(d) A data collection plan that clearly establishes what data will be collected, by whom, with what frequency, and from what sources;

(e) An on-line monitoring system that encourages candid reporting and enables decision-makers to identify implementation problems as they arise, and permit timely corrective actions to be taken;

(f) A project completion reporting system that compares original output and outcome expectations with final achievements, and contributes lessons learned for improving similar future operations.

95. A good M&E system for the Programmatic series should include the same elements, but based on the broader and longer term objectives of the programme as a whole (e.g., sectoral targets, contribution to regional development goals) and efficiency aspects (e.g., implementation speed and operational/transaction costs compared with what might have transpired without a Programmatic approach).

96. If CDB intends to offer the proposed new lending products to its borrowers in the near term, substantial efforts will have to be made to strengthen its own results-based M&E capacity at the project level. Moreover, since much of the performance data on outputs and outcomes will have to be collected by borrower institutions, significant efforts will also have to be made to assist borrowers in developing their own M&E capacity. Specifically, CDB should assist BMCs in the development of simple statistical systems, covering perhaps 3 or 4 sectors, for gathering basic data on relevant development indicators (as opposed to simply arranging for project-specific data to be collected during implementation. This is an integral part of the ADB, IDB and WB MfDR action plans.

H. Conclusions and Recommendations

Removal of Cap on Policy-Based Lending

97. The Consultant believes that the level of PBL should be demand driven, within an envelope of resources determined by liquidity constraints, and not by a predetermined limit (cap) that bears no relationship to the supply and demand for PBLs at a given period. This position is not inconsistent with the consultant’s agreement with the

DaCosta recommendation that the 20% cap should be increased to 33% of loans outstanding. It merely takes that recommendation a step further in the direction of placing the legitimacy of policy lending on equal footing with investment lending. Given the realities of donor reaction to no limit on policy-based lending, an increase of the cap to 33% of loans outstanding is therefore recommended.

98. The justification given by the author of the 2011 Consultant Report on PBL reform is worth quoting here:

> "*This option—similar to that adopted in the World Bank—would allow the Bank to remain engaged in a transparent way in lending for policy support in the difficult and uncertain environment currently facing the region, while preserving investment lending as the Bank's core function.*"

Also supported, is the recommendation of the 2011 Report that CDB should explore options for redefining the basis of the cap based on the use of OCR resources only, as opposed to combined OCR and SDF financing, as follows:

> "*[Given] the risks associated with the front loaded nature of PBL disbursements and the recent shift to single tranche PBLs support the recent decisions by the Bank to fund the latest PBLs with OCR. As part of this shift, the Bank should consider PBLs funded by a blend of OCR and SFR only in cases where the loans contain a significant social sector or poverty reduction component, or finance essential TA in lower income borrowers*."

99. CDB BMCs agreed that the central problem facing the Bank was ***declining lending levels***. An important conclusion of this report is that reform of CDB lending products can mitigate this problem, but that there are other constraints to lending other than the efficacy of its product menu. Recommendations on specific lending instrument reform are made in Section F above. ***This section addresses more general themes having to do with more efficient resource flows to BMCs***.

100. Needless to say, all transfers of financial resources from the Bank to a borrower create debt as well as an asset. If the present value of future benefit flows are less than the present value of future economic costs (debt servicing), then the country is worse off for having taken on the debt for financing of a specific activity or project. It follows then that not only must resources flow from the Bank to its BMCs; it must deliver resources as efficiently as possible. Development impact is the combined result of asset creation and efficiency improvements. In this connection, ***loan approval procedures*** and ***reform of borrower policy frameworks*** are as important to lending benefits as the size of resource flows.

101. The following recommendations are made to address both the need for greater resource flows required by BMCs and the efficient delivery and use of increased flows:

1. Supplement the CDB product menu with Programmatic lending options for both investment and policy lending.

2. As the Programmatic approach to lending is phased in, less reliance can be placed on multiple specific instruments for each situation.

3. If the Programmatic approach to lending is to be successful, greater reliance will have to be placed on country ownership and country systems and what types of activities are to be financed.

4. Improved monitoring and evaluation are crucial to the requirement to demonstrate positive developmental impact <u>at the project level</u>, regardless of the chosen instrument.

5. Adopt a greater focus on results in response to partner mandates. (See Section D dealing with Current Development Issues).

6. Limitations on loan size such as the requirement for counterpart financing, and a matrix of inputs eligible for financing should be removed.

7. Increase the current cap on policy lending of 20% of loans outstanding to 33%.

8. The scope and number of conditional ties attached to a PBL should be limited.[17]

9. It should be possible to include policy reform in elements in investment loans and investment loan elements in policy loans when they help to strengthen each other.[18]

10. The roll out of the new private sector lending policy should be completed as soon as possible.

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[17] The WB has worked diligently to reduce DPL conditionalities over the years. In their 2007 Review of Conditionalities, "Conditionality in Development Policy Lending", they noted that the average number of conditions attached to a policy loan went from 38 in 1996 to 10 in 2007.

[18] The IDB version of this arrangement is the Hybrid Loan.

COMPARATIVE TABLE OF MDB LENDING PRODUCTS

	Investment	Policy	Emergencies	Results	Private Sector
CDB	• Investment/Project Loans • Loans to self-financing public agencies (e.g., utilities) • Loans to financial intermediaries or public entities • Technical Assistance	• Policy-based loans (in support of economy-wide reforms • Sector Adjustment loans • Policy-based guarantees	• Emergency Relief Grant • Immediate Response Loan • Rehabilitation and Reconstruction Loan	• A corporate-wide Results Framework	• Long term loans • Equity and quasi-equity Investments • Guarantees • Technical Assistance
IDB	• Loans for specific projects • Loans for Multiple Works Programmes • Global Credit Lines • Conditional Credit Lines (CCLIPs) • Multiphase Loans (MLs) • Project Preparation and Execution Facility (PROPEF) • Technical Assistance • Sector Wide Approach (SWAp)	• Policy-based Loans (in support of institutional and policy reforms at the sector or sub-sector level) • Multi-tranche • Programmatic (single tranche) • Hybrid Loan (a sector adjustment loan that includes an investment component)	• Emergency Lending Programme for: financial or economic crises • Emergency Reconstruction Facility for: natural or other disasters • Natural disaster contingency line	• Performance Driven Loans (PDLs)	• Long term loans and grants with Sovereign Guarantee • Guarantees • Technical Assistance Equity (through IIC and MIF)

Appendix 1

	Investment	Policy	Emergencies	Results	Private Sector
World Bank	• Specific Investment Loans • Sector Investment and Maintenance Loans • Technical Assistance Loans • Adaptable Programme Loans • Financial Intermediary Loans	• Development policy lending • Deferred drawdown option (DDO) • Special development policy lending • Supplemental financing • Debt and debt service reduction	• Emergency Recovery Loans[19] • Increase/fast-tracking of IL and DPL	• Programme-for-Results (P4R)	• Partial Risk Guarantee • Partial Credit Guarantee • Policy Based Guarantee
ADB	• Specific Investment Loans • Technical Assistance Loans • Project Preparation and Execution Facility • Global Multiple Works Loans • Global Credit Loans	• Sector Loans • Multi-tranche Loans • Programmatic PBLs	• Disaster and Emergency Assistance is under comprehensive review	• A corporate-wide Results Framework	• Long term loans • Equity Investments • Guarantees • B-loan Lender of Record
EIB	• Individual loans • Intermediate lines of credit • Technical Assistance • Guarantees	• No policy-based lending	•	• No formal Results Framework	• Venture Capital • Public-Private Partnerships • Microfinance • Carbon credit funds • SMEs

[19] Replaced in 2007 with Rapid Response to Crises and Emergencies (OP/BP 8.00).

TERMS OF REFERENCE

A CRITICAL REVIEW OF CDB'S LENDING PRODUCTS

1. BACKGROUND

1.01 The global and regional environment within which the CDB operates has radically changed over the past decade. Within the Caribbean, new development challenges have emerged, including increased competition with the loss of preferential access for key outputs; severe weather-related threats precipitated by the global warming phenomena, which compound existing environmental vulnerabilities; and more recently, financial and economic instability that has depressed economic growth and eroded social gains. Economic and weather-related shocks have compounded the already precarious fiscal positions of most of CDB's BMCs adding to already high debt burdens and hampering government's ability to stimulate sustainable increases in income growth and drive down poverty levels. Beyond these challenges, development agencies and partners are increasingly concerned about the effective use of resources and are demanding greater accountability and attention to results. In this environment, many multilateral development institutions including the International Monetary Fund, the World Bank, the Inter-American Development Bank (IDB) as well as the Asian and African Development Banks have undertaken, or are in the process of undertaking, a strategic reassessment. This is being done particularly with respect to the nature and type of products and instruments available at their disposal to support a country's development agenda. Of critical importance in the reassessment are the criteria of relevance, efficiency and development effectiveness.

1.02 CDB, similarly, is at a critical juncture. In the wake of the recent economic and financial crisis, it is necessary for the Bank to review its suite of products and determine whether it possesses the requisite or appropriate product menu that will allow it to meet the changing demands of its BMCs and to respond efficiently and effectively to the changing and more complex environment within which the BMCs now operate. CDB's Products should be flexible enough to leverage and to enhance development effectiveness at the institutional and country level. Currently, CDB provides Loans either from its Ordinary Capital Resources or SFR (or a combination of the two) which provide different terms and conditions. The Bank's Lending Products are sourced from these resources and comprise: Investment Loans; Policy-Based Loans (PBL)[1]; Disaster Risk Management Loans, including Immediate Response Loans, Technical Assistance Loans (all sectors); Contingently Recoverable Loans; and Guarantees. Within investment lending, there is a range of products, as follows:

(a) Capital Investment Loans (Private and Public Sector);

(b) Financial Intermediary Loans often in the form of Lines of Credit targeted at specific sectors including Agriculture, Industry, Tourism, Small and Medium-Size Enterprises, Education[2], Housing; and

(c) Disaster Risk Management Loans including Immediate Response Loans.

1.03 Given the changing environment, CDB's BMCs are demanding new loan products, especially in light of the current low interest rate regime and other favourable terms in wider capital markets.

1.04 The foregoing considerations therefore indicate that it is now appropriate for CDB to comprehensively reassess its lending products.

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[1] PBLs were introduced in 2006 (as a formal policy instrument). Earlier policy-type structural adjustment reform interventions predated the PBL.

[2] CDB Student Loans include a poverty-focussed concessionary component.

2. OBJECTIVES

2.01 The objective of the consultancy is to design a menu of relevant, attractive and results-oriented lending products which will enable CDB to be a more effective and responsive development partner to its BMCs.

3. SCOPE OF SERVICES

3.01 The assignment will entail a review of the current lending products and instruments and an assessment of their relevance and effectiveness given their stated objectives and in the context of the current global situation and its effects on CDB's BMCs, taking account of the Bank's role as a development partner to other Development Finance Institutions. In carrying out the assignment the Consultant is expected to work closely with staff of the Finance, Projects, Economics and Legal Departments of CDB. The Consultant will be required to:

(a) review recent studies on CDB's PBL Product in terms of its relevance and 'fitness' for its stated purpose and assess its suitability for addressing the range of financing needs in the BMCs, including those related to financial structuring;

(b) undertake a critical assessment of each of CDB's Lending Products with a view to determining its effectiveness and 'fitness' for purpose;

(c) undertake a comprehensive review of recent lending reforms (i.e. with the past three to five years) in other development banking institutions and discuss their applicability to CDB and the relevant lessons learnt;

(d) discuss and recommend new or modified lending products that could support economic growth and poverty reduction in the BMCs and identify the key feature of each proposed product;

(e) engage in consultation on the existing lending products with important stakeholders including BMCs, CDB and other partner MDBs (particularly World Bank, IDB and European Investment Bank) and obtain their feedback on possible new lending products; and

(f) provide a system to monitor and evaluate the performance of the recommended products, their relevance, effectiveness, flexibility and lessons learnt.

4. METHODOLOGY

4.01 The Consultant(s) will be required to review all relevant documentation, including, but not limited to, CDB's Charter, CDB's Lending Policy, the Resolution and Report of Contributors on SDF 7, the 2011 Evaluation[3] of CDB's PBL Product, sector evaluations, a sample of approved CDB loans (including PBLs) over the five-year period 2007-2011, Country Strategy Papers[4] and the corresponding policies and product offerings of other development agencies.

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[3] "A Review of the Framework for Future Policy Based Lending"
[4] The Consultant should review the most recent Country Strategy Paper for each BMC.

4.02 The Consultant(s) will also be required to interview key stakeholders including, but not limited to, management and staff of CDB, stakeholders in the BMCs (including personnel attached to Bank-financed projects) and other donor agencies with operations in the Caribbean.

5. DELIVERABLES AND REPORTING REQUIREMENTS

5.01 The Consultant(s) shall report to CDB's Vice President (Operations) or his/her designate. The Consultant(s) will be required to provide to CDB three (3) hard copies and one electronic copy, of the following reports and deliverables:

(a) Within one week of commencing the consultancy, the Consultant(s) will be required to submit an Inception Report detailing a work plan, approach and methodology, schedule for undertaking the consultancy and data to be collected and reviewed. The Consultant(s) will adjust the work programme in accordance with the comments received;

(b) Within five weeks of commencing the consultancy, the Consultant(s) will be required to submit to CDB an Interim Report for review and comments. The Interim Report shall contain the Consultant's findings from the review of recent studies on CDB's PBL Product and the assessment of both CDB's Lending Products and the lending reforms undertaken by other development agencies, as cited at paragraph 3.01 (a) to (c) above. The Report will also include the recommendations for new or modified products cited at paragraph 3.01 (d), as informed by the stakeholder consultations cited at paragraph 3.01 (e). CDB will provide feedback to the Consultant within two (2) weeks of receipt of the Interim Report;

(c) Within nine weeks of commencing the consultancy, the Consultant(s) will be required to submit a Draft Final Report. The Draft Final Report will contain the revisions to the Interim Report, based on CDB's feedback. The Draft Final Report will also detail the system for monitoring and evaluating the performance of the recommended products at paragraph 3.01 (f) above. The Consultant(s) will be required to facilitate discussions with internal stakeholders, including making a presentation to CDB's Advisory Management Team, to garner feedback on his/her recommendations in the Draft Final Report. CDB will provide feedback to the Consultant within two (2) weeks of receipt of Draft Final Report; and

(d) Within thirteen weeks of commencing the consultancy, the Consultant(s) will be required to submit the Final Report. The Final Report will take account of the feedback received from CDB's management and staff on the Draft Final Report.

6. QUALIFICATIONS AND EXPERIENCE

6.01 The Consultant(s) should have at least post-graduate qualification or equivalent professional qualification in the relevant disciplines, for example: development banking; finance; and economics. Considerable knowledge of lending and non-lending products and terms, available within the Caribbean region and its development context as well as hands-on experience working for Financial Intermediaries, donor organisations and MDBs would be an asset.

7. DURATION

7.01 It is expected that the assignment will require an effort of 60 person-days over a period of 3.5 calendar months.