IDA’s Financial Model

February 7, 2024
Evolution of IDA’s financial model
- from revolving fund to hybrid

Deployable Strategic Capital (DSC)
- IDA’s main anchor in financial planning

IDA’s medium to long-term financial planning
- Triangulation plus BSO

Looking forward
Evolution of IDA’s financial model

• Hybrid allows IDA to increase financing to clients through leveraging in the capital markets. As such, IDA’s financing capacity is no longer bound by cash inflows from donor contributions and loan repayments.

• As additional IDA stakeholders, investors and rating agencies bring new requirements that IDA did not have to satisfy under the previous model.
Additional requirement of IDA’s financial management

Before IDA18

IDA’s main concern was to ensure that its cash inflows (donor encashment and loan repayments) were larger than its cash outflows (loan disbursements).

Under Hybrid Model

With market investors and rating agencies becoming new stakeholders, IDA needs to assure that it can pay back investors, even in stressed environments, by maintaining strong liquidity and capital adequacy as demanded by investors and rating agencies, amongst others.

- **Strong liquidity position** ensures that IDA can pay back its obligations to investors in disrupted markets when there is no access to additional market funding – IDA ensures this by setting aside around 2 years of liquidity buffer.

- **Strong capital adequacy position** (DSC for IDA) assures that when there is a stressed environment and IDA does not receive those future cash flows against which investors lent to IDA, IDA is still solvent (net asset value being above 0) and can still honor its obligations.
Financial power of the hybrid model: $3-4 of financing to clients for each $1 donor contribution

* IDA19 and IDA20 were combined together as some of the IDA19 resources were carried over into IDA20
Growth in Equity mostly via new donor contributions, with modest income adding to reserves.

Strong equity allows IDA to leverage capital markets by market borrowing to fund its activities and execute swaps to hedge balance sheet exposures. It also protects bondholders from risk of potential borrower defaults and other losses from adverse market movements.

Inaugural bond issue in April 2018, triple-A rated.
Presentation Outline

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• Designed to ensure IDA holds sufficient capital at the triple-A level to absorb unexpectedly large losses connected to credit risk, market risk, and operational risk on IDA’s books.

• DSC represents the capital available for additional development financing above the minimum capital needed to support the risks of IDA’s current portfolio plus a buffer.
Components of DSC (as of September 2023)

\[ \text{TRA} - \text{TRR} - \text{CB} = \text{DSC} \]

- **Loan Loss Reserve**
- **Total Equity (Financial Statement)**

**Total Resources Available = TRA**

**$190bn**

**Total Resources Required = TRR**

**$127bn**

**Key measure of headroom**

$45bn (23%)

**Conservation Buffer = $19 bn**

**10% Buffer**

**Interest Rate Risk**

**Credit Risk**

**Operational risk**

**PSW and Grants**

\[ \text{TRA} - \text{TRR} - \text{Conservation Buffer} = \text{DSC} \]
Major factors impacting IDA’s DSC

Increased lending to riskier countries (e.g., with more focus on FCV) or shocks to countries’ credit profile would increase capital requirements for credit risk and reduces leveraging capacity.

Increased share of concessional loans (vs. loans with less concessionality) requires more capital for interest rate PV adjustment of loan portfolio.

Increased grant financing due to higher volumes of FCV financing or due to worsening of debt sustainability assessment reduce IDA’s capital.

Higher market interest rates would increase IDA’s funding cost and lower IDA’s income and equity. The stress rate in IDA’s DSC framework could also be affected by the level of market rate.
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Looking forward
The “Three Cs” - Medium- to long-term financial planning

<table>
<thead>
<tr>
<th>Balance sheet optimization (BSO)</th>
<th>Impact</th>
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<tbody>
<tr>
<td><strong>Release capital</strong>&lt;br&gt;Such as: CVP swaps, fixed rate bonds, reassess risk capital allocation needs</td>
<td>Released capital can be used to increase volume, increase concessionality, and/or reduce donor contributions</td>
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<tr>
<td><strong>Concessionality/volume tradeoff</strong>&lt;br&gt;Such as: SML, 50-yr credit, and floating rate loan</td>
<td>For the same donor contribution, increase (decrease) replenishment volume by decreasing (increasing) concessionality</td>
</tr>
<tr>
<td><strong>Supplement donor grant contributions</strong>&lt;br&gt;Such as: CPL, guarantee, callable capital, hybrid capital</td>
<td>Increased donor contribution can be used for additional volume and/or concessionality</td>
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Balance Sheet Optimization Examples to improve DSC – *Implemented*

**Credit Value Protection (CVP) Swaps:**
- $15bn interest rate swaps implemented in IDA19 to switch part of fixed loan income into floating rate (i.e., transfer the interest rate risk to the market), increased IDA19 volume by around $5bn.

**Borrowing fixed rate bonds from the market (in IDA20) and from donors (through CPLs since IDA17):**
- The fixed rate liability can partially offset the interest rate risk arising from fixed rate assets (concessional loans). $15bn fixed rate bonds was originally planned in IDA20 to increase the replenishment volume by $5bn. If market allows, additional $5bn fixed rate bond would be issued to enhance IDA’s financing capacity in IDA20.

**Reducing the share of grant in total IDA envelope:**
- The switch of lending terms of yellow light countries from 50/50 grant/38-yr credit into 100% 50-yr credits in IDA20, increased IDA20 volume by $1.8bn, while keeping the total grant element unchanged.

**Reducing the maturity of IDA loans:**
- The introduction of Shorter Maturity Loans (SMLs) in IDA20, which only has 12-year maturity, increased IDA20 volume by $7.2bn with significantly less donor contribution.
Balance Sheet Optimization Examples to improve DSC – *in consideration for IDA21*

**Measures to enhance capital efficiency:**
- CAF review,
- Long-term bond issuance,
- Others.

**Measures that require donor support:**
- Hybrid capital,
- Portfolio guarantees,
- Faster encashment schedules.

**Measures that require borrower efforts:**
- Floating rate loans,
- Replacing grants with 70 yr credits,
- Others.
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Looking forward
Historical IDA Replenishments and looking forward

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Donor Contribution

Agreed Replenishment

Stronger contribution for IDA21 is needed to achieve a record-high volume to meet the challenges that IDA countries are facing.