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Private sector instruments: treatment of reimbursable grants and other clarifications

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As part of the review of the provisional reporting methods for private sector instruments (PSI), this note presents a proposal for the treatment of reimbursable grants in DAC statistics and other clarifications. Developed in line with the agreed 2016 HLM general principles for PSI, the proposal takes into account the outcomes of the Part 1 of the review in the first semester of 2022 and builds upon members' discussions in the context of the WP-STAT since September 2022. Seeking consistency with methods for loans to the private sector and equities, the proposal on reimbursable grants puts forward ODA-eligibility rules, methods for calculating grant equivalents and related parameters, reporting requirements, rules for data disclosure as well as ODA-integrity safeguards and other considerations. Further, this paper provides clarifications on some issues related to PSI that have been raised with regard to the review.

This paper is shared for DISCUSSION under item 6.a of the draft annotated agenda [DCD/DAC/STAT/A(2023)2].

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Private sector instruments: treatment of reimbursable grants and other clarifications

1. Background

1. The provisional reporting methods for private sector instruments (PSI) do not provide any guidance on the treatment reimbursable grants in DAC statistics. Their treatment therefore remains vague, which in turn disincentivises their deployment and limits donors' capacity to mobilise private finance for sustainable development. Furthermore, members' deliberations on PSI and other topics have invited clarifications on the treatment of guarantees other than credit guarantees [DCD/DAC(2023)22], portfolio guarantees, bonds and hybrid instruments. Members have also requested guidance on the treatment of non-grant instruments to Public-Private Partnerships (PPPs) [DCD/DAC/STAT/RD(2021)3], including loans to collective investment vehicles [DCD/DAC/STAT(2022)49/REV1].[1]

2. This paper therefore first proposes rules for the treatment of reimbursable grants. It subsequently provides clarifications on the treatment of guarantees other than credit guarantees, portfolio guarantees, bonds, convertible debt and other hybrid instruments as well as non-grant instrument to PPPs and loans to collective investment vehicles.[2]

3. The proposal has been developed in line with the 2016 HLM general principles for PSI[3], taking into account the outcomes of Part 1 of the review of the provisional reporting methods in Q1-2 of 2022 [DCD/DAC/STAT(2022)15 and DCD/DAC(2022)39/REV1] as well as methods approved under the first batch of issues [DCD/DAC(2023)22]. It has also benefitted from members' discussions in the past[4] and during the PSI review to date as well as bilateral consultations with Austria (on the treatment of loans to collective investment vehicles and non-grant instruments to PPPs), Canada (on the treatment reimbursable grants) and France (on portfolio guarantees).

4. **Members are invited to indicate whether they can approve**

   a. **The method for treating reimbursable grants in DAC statistics;**

   b. **Other clarifications on the treatment of guarantees other than credit guarantees, portfolio guarantees, bonds, convertible debt and other hybrid instruments, loans to collective investment vehicles and non-grant instruments to PPPs.**

[1] Details on the approach for members' discussions in the context of the review Part 2 can be found in DCD/DAC/STAT(2022)29.

[2] These clarifications and guidance complement methods for the treatment of credit guarantees and loans to the private sector [DCD/DAC(2023)22], equities [DCD/DAC/STAT(2023)3/REV1] and mezzanine finance instruments [DCD/DAC/STAT(2023)4/REV1].

[3] See DAC-HLM-Communique-2016.pdf

[4] See DCD/DAC/STAT(2016)2 and DCD/DAC(2017)18/REV1.

2. Reimbursable grants

2.1. Scope

5. The existing directives define reimbursable grants as contributions "to a recipient institution for investment purposes, with the expectation of long-term reflows at conditions specified in the financing agreement. The provider assumes the risk of total or partial failure of the investment; it can also decide if and when to reclaim its investment."[5]

6. Further consultations with members have suggested two distinct types of reimbursable grants used in the context of development finance: loan-type reimbursable grants and reflow-based reimbursable grants.

a. For loan-type reimbursable grants, details on repayments are agreed ex ante upon the conclusion of the financing agreement. Such reimbursable grants involve exposure to risk that is comparable to loans.

b. For reflow-based reimbursable grants, details on reflows are unknown ex ante as they depend on the performance of the underlying investments. This type of reimbursable grants typically involves exposure to risk that is comparable or greater to that of equities, irrespective of the channelling institution type.[6]

2.2. 2016 HLM Principles

7. The general principle xii. of the 2016 HLM Communiqué states that

> *Reimbursable grants are hybrid debt instruments with different types of agreement and initial investment profiles. In cases where enough information is available to estimate the reflows and risk undertaken, measurement will be on a grant equivalent basis; in other cases, an ex-post calculation will be applied. HLM follow-up: elaborate a method for reporting on reimbursable grants, taking into account their hybrid nature*.

2.3. Eligibility

8. In line with the spirit of the HLM Communiqué and members' discussions to date as well as the general principles underpinning the DAC statistics, for reimbursable grants to be ODA-eligible, they need to be

a. Allocated to countries or territories included on the DAC List of ODA Recipients;[7]

b. Administered with the promotion of economic development and welfare of developing countries as their main objective;

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[5] See Annex 10b of the Reporting Directives in DCD/DAC/STAT(2023)9/ADD1.

[6] Reimbursable grants are typically provided when more concessional financing is required than what DFIs could offer. When reimbursable grants are administered by multilateral partners, donors do not benefit from the preferred creditor status and do not own shares in the fund; the level of risk is the same as in funds managed by private entities.

[7] This may also include reimbursable grants invested in financial intermediaries in donor and third countries, provided the main objective of the financing is the promotion of economic development and welfare of ODA Recipients, and relevant due diligence has been carried out by the extending PSI vehicle.

c. Additional financially, in value or both, combined with their development additionality;

d. Of a maturity of more than one year.

2.4. Parameters, methods, reporting requirements, data disclosure and safeguards

9. Donor effort in extending reimbursable grants is measured on a grant equivalent basis. Given the different levels of available information and different risk levels regarding reflows depending on the type of reimbursable grant, grant equivalents are calculated:

a. Using the same method and parameters as for loans [DCD/DAC(2023)22 and DCD/DAC/STAT(2023)9] in cases where terms and conditions are set at the commitments stage (e.g. loan-type reimbursable grants);

b. Using the same method and parameters as for equities [see DCD/DAC/STAT(2023)3/REV1] in cases where reflows are subject to the performance of the underlying investment (e.g. reflow-based reimbursable grants).

10. Reporting requirements, data disclosure and safeguards on reimbursable grants are the same as those for loans to the private sector or equities, as relevant.

11. To facilitate members' reporting and in the interest of transparency and monitoring, the Secretariat will review and, if need be, refine the sub-categories of financial instruments concerning reimbursable grants in Annex 10b of the Reporting Directives [DCD/DAC/STAT(2023)9/ADD1].

12. In addition, the treatment of non-grant instruments extended to multilateral organisations, including the trust funds they administer, will be discussed after the review of the provisional reporting methods for PSI.

2.5. Implementation

13. The implementation of reporting donor effort in extending reimbursable grants on a grant equivalent basis follows that for loans to the private sector or equities, as relevant. Members that are unable to implement these reporting methods in 2024 may use a transition period of one year during which the provisional reporting methods would continue to apply as regards ODA accounting and data disclosure.[8]

3. Other clarifications

3.1. Treatment of guarantees other than credit guarantees

14. Members' technical discussions on the treatment of guarantees as part of the first batch of issues were limited to credit guarantees [see DCD/DAC(2023)22]. Members advised to address the treatment of guarantees on financial instruments other than loans, such as equity or mezzanine finance instruments, in conjunction with their deliberations on those underlying instruments.

[8] The provisional reporting methods [DCD/DAC/STAT(2023)9/ADD3] do not provide specific guidance on reimbursable grants. Cash-flow accounting in ODA would therefore continue to apply.

15. Taking into account members' discussion on the second batch of issues and building upon the approved method on treatment of credit guarantees, the following guidance is provided:

a. Donor effort in issuing guarantees on financial instruments other than loans is measured on a grant equivalent basis at the issuance stage. The related calculation method is identical to that for credit guarantees.

b. As regards discount rates, the base and risk-adjustment factors are the same as for credit guarantees. The surcharge component of the discount rate is proposed to be aligned with the values agreed for the guaranteed instruments (see Table 1).

Table 1. Discount rate architecture for guarantees other than credit guarantees

	LDCs and other LICs	LMICs	UMICs
Base factor	1%	1%	1%
Risk-adjustment factor	4%	2%	1%
Surcharge	As for the guaranteed instrument • 4% for guaranteed equities • 2.5% for guaranteed mezzanine finance instruments	As for the guaranteed instrument • 3.5% for guaranteed equities • 2% for guaranteed mezzanine finance instruments	As for the guaranteed instrument • 3.1% for guaranteed equities • 1.6% for guaranteed mezzanine finance instruments
Discount rates per guaranteed instrument:			
Equity	**9%**	**6.5%**	**5.1%**
Mezzanine finance	**7.5%**	**5%**	**3.6%**

16. This guidance complements the approved method for the treatment of credit guarantees [see DCD/DAC(2023)22]. Eligibility rules, reporting requirements and rules for data disclosure are the same as for credit guarantees. Moreover, reported data on guarantees other than credit guarantees will be subject to the same ODA-integrity and analytical safeguards as other PSI guarantees.[9]

17. To facilitate members' reporting and in the interest of transparency and monitoring, the Secretariat will review and, if need be, refine the sub-categories of financial instruments concerning guarantees in Annex 10b of the Reporting Directives [DCD/DAC/STAT(2023)9/ADD1].

3.2. Treatment of portfolio guarantees

18. Aside from guarantees on individual transactions, donors also issue guarantees on portfolios of financial intermediaries, such as local finance institutions and investment funds. Typically, such portfolio guarantees aim to promote financial inclusion in developing countries through enhancing access to financial services by small and medium-sized enterprises (SMEs).

[9] See also section 5 (pp. 20-21) of the part on the treatment of guarantees in DCD/DAC(2023)22 for further clarification on the scope of the proposal.

19. Contrary to guarantees on individual transactions, portfolio guarantees are characterised by their filling period at the beginning and diverse amortisation profiles of the guaranteed assets. Neither of these details is known to the guarantor ex ante.

20. To overcome these challenges, donor effort in issuing portfolio guarantees is proposed to be measured using the same method as for credit guarantees [see DCD/DAC(2023)22], noting that

a. A coefficient is applied to the guaranteed amount to take into account the limited use of the portfolio guarantee during the filling period and possibly thereafter.[10]

b. The exposure reduction starting date is estimated as the point in time after the filling period when the guaranteed amount begins to decrease due to the amortisation of the guaranteed assets.

c. For the sake of simplicity, the exposure reduction is assumed to be linear, similar to the logic of equal principal repayments (EPP) of loans.

d. Other variables (e.g. guarantee fee rate and guarantee maturity) reflect the terms and conditions agreed between the guarantor and the obligor (i.e. manager of the guaranteed portfolio).

e. Discount rates are based on the geographic allocation of the guaranteed portfolio and the type of assets in the guaranteed portfolio (see paragraph 15). For mixed portfolios, it is recommended to apply a surcharge that is the most conservative.

21. This guidance complements the approved method for the treatment of credit guarantees [see DCD/DAC(2023)22]. Eligibility rules, reporting requirements and rules for data disclosure are the same as for credit guarantees. Moreover, reported data on portfolio guarantees will be subject to the same ODA-integrity and analytical safeguards as other PSI guarantees.[11]

22. The treatment of non-grant instruments extended to multilateral organisations, including the trust funds they administer, will be discussed after the review of the provisional reporting methods for PSI.

3.3. Treatment of bonds

23. Bonds are a specific type of debt instruments with a fixed interest rate, repayment schedule and maturity. In contrast to loans, however, bonds are often traded. In most cases, the exact timing of the bond sale is unknown at the bond subscription stage.

24. Donor effort in subscribing bonds is measured using the method and parameters for the treatment of loans to the private sector [see DCD/DAC(2023)22]. In their ex-ante reporting, members calculate their donor effort in subscribing bonds with the full bond maturity.

25. Upon sale if traded indeed, an ex-post adjustment is introduced to the grant equivalents reported ex ante as a correction for the shortened bond maturity. The evolution

[10] Should information to estimate the expected use of portfolio guarantees be unavailable, it is recommended to use a coefficient of 75%.

[11] See also section 5 (pp. 20-21) of the part on the treatment of guarantees in DCD/DAC(2023)22 for further clarification on the scope of the proposal.

of bond value is not taken into account. See Table 2 for an example of the ex-post adjustment.

26. This guidance complements the approved method for the treatment of loans to the private sector [see DCD/DAC(2023)22]. Eligibility rules, reporting requirements and rules for data disclosure are the same as those for loans to the private sector. Moreover, reported data on bonds will be subject to the same ODA-integrity and analytical safeguards as other PSI.

Table 2. Example of an ex-post adjustment for a traded bond

Reporting year	Activity	Description	Grant element	Grant equivalent, USD thousand	Reported GEq adjustment, USD thousand
2020	Bond subscription	Bonds subscribed at USD 10 million, with a maturity of 10 years and interest fixed at 5%, paid quarterly.	16.21%	1620.95	
2025	Bond sale	Bonds sold. Real maturity borne by the bond subscriber is thus reduced to 5 years.	9.55%	955.43	**-665.52** (= 1620.95 - 955.43)

Note: Grant elements in this example have been calculated with the rate of discount of 7.5%.

3.4. Treatment of convertible debt and other hybrid instruments

27. Convertible debt refers to debt instruments (standard loans, bonds etc.) intended to be repaid through their conversion into equity. The exact timing of the debt-to-equity conversion is usually unknown when the debt financing is extended.

28. For the same of simplicity, convertible debt and other hybrid instruments are proposed to be treated as junior loans [see DCD/DAC/STAT(2023)4/REV1].

3.5. Treatment of loans to collective investment vehicles

29. Members' deliberations on loans to the private sector invited discussions on the treatment of loans to investment funds and similar collective investment vehicles (CIVs) in conjunction with those on equities [see DCD/DAC(2023)22 and DCD/DAC/STAT(2023)3/REV1]. The discussion should consider the lower risk profile of debt instruments compared to equity shares and the need to avoid potential incentivisation of debt over equity when capitalising funds.

30. The different risk profiles of debt and equity investments have played a central role in designing parameters and methods for measuring donor effort in private sector instruments thus far. In particular, the equity surcharge has been set higher than the private sector surcharge for loans. Donor effort calculated for equity is thus generally higher than for loans and other debt instruments invested in CIVs (see Table 3 for an illustrative example).

31. **It is therefore proposed to treat debt instruments invested in CIVs the same way as loans to the private sector**, including discount rates [see DCD/DAC(2023)22]. This guidance is consistent with the treatment of PSI to other types of financial intermediaries, such as local financial institutions.

Table 3. Donor effort per type of financial instrument invested in a CIV

Instrument used	Description	Grant element calculation	Grant element
Equity shares/units	8% expected return per annum over 10 years	Lump-sum	33.68%
"Bullet" bond	5.5% fixed interest per annum. Principal and interest are paid in lump sum upon the bond maturity	Lump-sum	24.79%
"Regular" bond	5% fixed interest per annum. Interest is paid quarterly	EPP, grace period = maturity	17.16%
Standard loan	4.5% fixed interest per annum. Principal and interest are paid annually following an equal principal payment (EPP) schedule with a one-year grace period	EPP	12.54%

Note: Discount rates used in this demonstration are 7.5% for debt instruments and 10.5% for shares/units.

32. In this context, it is recalled that

a. Specific transparency and additionality safeguards apply to loans channelled through private intermediaries in donor or third countries. See paragraph 15 of the method for the treatment of loans to the private sector [DCD/DAC(2023)22]. It is further clarified that the country of residence of the fund has no bearing on the discount rates used for calculating donor effort.

b. For loans to financial intermediaries active in multiple ODA recipients or in cases where the exact allocation and beneficiaries are not specified at the time of commitment (e.g. credit lines), donor effort is measured using the discount rate of the DAC income group to which all, or a majority of targeted countries belong. See paragraphs 238 and 384 of the DAC Reporting Directives DCD/DAC/STAT(2023)9.

3.6. Treatment of non-grant instruments to PPPs

33. Several members have been inquiring about the method and parameters to be used for measuring donor effort in extending non-grant instruments to channels that are neither sovereign nor for-profit private. In 2021, members approved rules for the treatment of loans to INGOs, with clarifications on Public-Private Partnerships (PPPs) to follow as part of the review of the provisional reporting methods for PSI [see DCD/DAC/STAT/RD(2021)3].

34. PPPs are a relatively broad category of channels. The Reporting Directives define a PPP as "an operational partnership whose board or other governance structure includes both public officials and private individuals" [see paragraph 261 of DCD/DAC/STAT(2023)9].

35. Two distinct types of institutions can be identified under the heading "Public-Private Partnerships (PPPs)" of the Annex 2 List of ODA-eligible international organisations. For the purposes of this note, a distinction is made between "fund-like PPPs" and "INGO/multilateral-like PPPs" (see also Table 4). Acknowledging the distinct nature of either PPP type, members' non-grant contributions to these channels are proposed to be treated as follows:

a. **Donor effort in extending non-grants to fund-like PPPs is proposed to be measured in line with the reporting methods for PSI**, i.e. on a grant equivalent basis, using instrument-specific discount rates (incl. surcharges). This type of PPPs primarily consists of investment funds and comparable vehicles supported by donors (including their DFIs), multilateral organisations and the private sector to pursue development objectives in ODA recipients through market-based solutions, like for-profit investment funds.

b. **Donor effort in extending loans to INGO/multilateral-like PPPs is proposed to be measured like loans to INGO or multilateral organisations other than global institutions or multilateral development banks**, i.e. on a grant equivalent basis, using a 6% discount rate and applying a 10% eligibility threshold.[12] These PPPs are mostly supported to pursue specific not-for-profit objectives at the international level, similarly to INGOs and multilateral organisations other than global institutions or multilateral development banks.[13]

36. Accordingly, in the context of main DAC aggregates, non-grant contributions to fund-like PPPs would be categorised as private sector instruments, whereas loans to INGO/multilateral-like PPPs as bilateral (sovereign) loans.

37. Moreover, it is clarified that the Annex 2 List continues to provide reporting guidance on core support to PPPs that work across ODA-eligible and non-eligible themes or geographies and where an ODA coefficient may need to be applied. Accordingly, grant equivalents calculated for members' contributions to PPPs should continue being multiplied by the ODA coefficient in the Annex 2 List.

[12] See Tables 1 and 2 of DCD/DAC/STAT(2023)9 on pp. 21.

[13] It is noted that loans are channelled to/through this type of PPPs on a very exceptional basis only. These PPPs are not considered to be likely channels of other non-grant instruments, such as equities.

Table 4. Types of PPPs currently included on the Annex 2 List of ODA-eligible international organisations

Channel code	Abbreviation	Channel name	Proposed treatment of non-grant contributions
Fund-like PPPs			
30019	TCX	Currency Exchange Fund N.V.	Like private sector instrument (PSI), i.e. on a grant equivalent basis, using instrument-specific discount rates (incl. surcharge).
30016	EFSE	European Fund for Southeast Europe	
30012	GCPF	Global Climate Partnership Fund	
30015	GEEREF	Global Energy Efficiency and Renewable Energy Fund	
30020	GEEREF II	Global Energy Efficiency and Renewable Energy Fund II	
30013	MEF	Microfinance Enhancement Facility	
30014	REGMIFA	Regional Micro, Small and Medium Enterprise Investment Fund for Sub-Saharan Africa	
30017	SANAD	SANAD Fund for Micro, Small and Medium Enterprises	
INGO/multilateral-like PPPs			
30018	AFC	Africa Finance Corporation	Like loans to INGOs or multilateral organisations other than global institutions or multilateral development banks, i.e. on a grant equivalent basis, using a 6% discount rate and applying a 10% eligibility threshold.
30008		Cities Alliance	
31006	CEPI	Coalition for Epidemic Preparedness Innovations	
30007	GAID	Global Alliance for ICT and Development	
30001	GAIN	Global Alliance for Improved Nutrition	
47043		Global Crop Diversity Trust	
30003	GeSCI	Global e-Schools and Communities Initiative	
30004	GWP	Global Water Partnership	
30005	IAVI	International AIDS Vaccine Initiative	
30006	IPM	International Partnership on Microbicides	
30011	IUCN	International Union for the Conservation of Nature	
21056	REEEP	Renewable Energy and Energy Efficiency Partnership	
30009	SAS	Small Arms Survey	
30018	AFC	Africa Finance Corporation	