

February 8, 2013

Response from CIF Administrative Unit on Proposal Related to the Use of Local Currency Loans Under the SCF Trust Fund

Dear CTF and SCF Trust Fund Committee Members:

We are writing regarding the proposal seeking approval of local currency lending in the SCF on an interim basis that was circulated for review and approval on January 16, 2013.

In response to the initial proposal, the Committee Member from Denmark raised an issue concerning the impact of a potential loss from local currency lending and how that impact would affect the SCF contributors if and when the SCF Trust Fund was liquidated.

The Trustee responded to the issue raised by the Member from Denmark (see below), after which the Member from Denmark informed us that he can approve the proposal for the use of local currency lending in the SCF on an interim basis.

The Member from Switzerland also raised a question regarding this proposal, and the response of the Trustee to that question has today been posted on our website.

With the circulation of this email, we would like to extend by an additional forty-eight hours from the circulation of this e-mail the period for providing comments and expressing any objection to the proposed decision. If we do not receive an objection to the proposed decision by close of business on **February 12, 2013**, the decision will be approved.

For your reference, the full text of the proposed decision is as follows:

The joint meeting of the CTF and SCF Trust Fund Committees, recalling its request to the Trustee made in November 2012 to prepare a proposal as to resources that should be set aside to allow the CTF and SCF Trust Funds, as an interim measure pending the development of the Enterprise Risk Management Framework, to bear the currency risks related to the use of local currencies in private sector projects up to May 2013, welcomes the proposal related to the use of local currency loans under the SCF Trust Fund that was prepared by the Trustee and circulated to the members of the joint meeting of the CTF and SCF Trust Fund Committees and:

- a) takes note of the request from the MDBs that they be authorized to issue local currency loans for the following two SREP**

projects for which funds are expected to be committed by the Trustee in the period up to May 2013:

- i. ***Nepal Small Hydropower Finance Program, USD 19 million, jointly implemented by ADB and IFC (approved by the SREP Sub-Committee on November 1, 2012); and***
 - ii. ***Maldives Waste to Energy Program, USD 5 million, jointly implemented by ADB and IFC.***
- b) **agrees that up to USD 24 million in SCF resources may be utilized to provide local currency lending to the two programs listed in (a); and**
- c) **endorses the Trustee's proposal that it is not necessary to set aside resources to address the financial risks associated with local currency lending to these two programs as there are no liabilities to loan contributors under the SCF Trust Fund.**

The joint meeting of the CTF and SCF Trust Fund Committees further agrees to review the local currency needs for all three SCF targeted programs in May 2013 as part of the risk assessment to be carried out under the Enterprise Risk Management Framework approved at the joint meeting of the CTF and SCF Trust Fund Committees in November 2012.

Sincerely,

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Communication from the Trustee to the Council Member from Denmark (February 5, 2013)

Thank you for your email regarding Denmark's approval of the use of local currency lending for both the Nepal and Maldives programs under SREP.

With regard to Denmark's understanding that only capital contributions will cover a potential loss when the SCF Trust Fund is liquidated, we consulted the Trustee to elaborate on whether the arrangement you describe reflects the current understanding among the contributors as set forth in the SCF legal agreements.

The Trustee informed us that pursuant to the Standard Provisions Applicable to the SCF, as attached to the SCF Contribution Agreement, Paragraph 3.1, grant and capital contributions to the SCF TF may be used for any purposes under the Contribution Agreement, except that not more than 10% of the capital contribution may be used for financing grants. Contributions made to the SCF TF are commingled and are administered by the trustee in accordance with the terms of the Contribution Agreement.

In addition, also in accordance with Paragraphs 13.1 and 13.4 of the Standard Provisions Applicable to the SCF, at liquidation of the SCF Trust Fund, all contributors would share in all losses (e.g., defaults on outgoing loans as well as losses due to foreign exchange movements on local currency loans) on a pro rata basis, after deducting any pro rata portion of a contributor's share that was used for outgoing grant funding. Correspondingly, any gains (e.g., gains due to foreign exchange movements on local currency lending, net income, fees and charges earned on outgoing loans or other financial products) would also be shared on a pro rata basis. As in the case of losses, the pro rata share is calculated after deducting any portion of a contributor's share that was used for outgoing grant funding.

Response from Member from Denmark (February 8, 2013):

Thank you for the explanation. I acknowledge that the standard provisions for the SCF do allow for grant contributions to be used as loans. I must admit that I was not aware of that because we initially allocated loans and grants according to the amounts available from capital respective grant contributions. While there is thus a legally basis for using grants to cover potential loss of loans in local currency, my concern is the amounts of the SCF to be set aside to cover the exchange rate risk – an amount that will remain passive and unused in the respective programmes. I am therefore looking forward to a further discussion of the issue at the next CIF meeting.

Meanwhile Denmark can approve the proposals regarding Nepal and the Maldives where no set aside of resources have been requested to cover the exchange rate risks.