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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the President

January 29, 2008

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Proposal To Enhance The IBRD Deferred Drawdown Option (DDO) And To Introduce A DDO Option For Catastrophic Risk

I. INTRODUCTION

1. MICs have expressed interest in "financial products like the IBRD's existing Deferred Drawdown Option (DDO) that could be used in the case of adverse events (such as a natural catastrophe, a downturn in economic growth, or adverse changes in commodity prices or terms of trade)".[1] As part of its broader response, the Bank has undertaken a comprehensive review of its operational practice and internal procedures involving DDOs.[2]

2. Drawing on the results of this review, this paper proposes revisions to the existing DDO instrument to increase its attractiveness and to introduce a specialized DDO product that focuses on providing immediate liquidity in emergency situations caused by natural disasters and catastrophes. The paper also proposes to align the pricing structure for existing and new DDO instruments with recent pricing changes for IBRD countries, which would remove any implicit penalties on DDOs.[3] These proposed changes would offer additional operational flexibility for the use of DDOs within the existing legal and policy framework governing such operations.

II. THE EXISTING DPL WITH A DDO FEATURE (DPL DDO)

3. **Features of the existing DPL DDO product.** As originally introduced in 2001, the DDO was intended as a risk management tool supporting core structural programs in countries

[1] "Strengthening the World Bank's Engagement with IBRD Partner Countries", SecM2006-0354 dated August 4, 2006 (hereinafter, "Strengthening the World Bank's Engagement with IBRD Countries"), paragraph 49 page 20.

[2] This review also fulfilled a long-standing need for the Bank to evaluate the use of DDOs in operations. Such a review was envisaged when DDOs were introduced as part of the Bank's menu of policy based lending instruments in September 2001. See "Proposal to Introduce a Deferred Drawdown Option (DDO) for Use with IBRD Adjustment Loans", R2001-0174 dated September 26, 2001 (hereinafter, the "2001 DDO Board Paper"), paragraph 29 page 10.

[3] As part of the recent exercise on IBRD loan pricing, Management undertook to revise the pricing structure for loans with a DDO structure. See "Recommendations for Simplifying and Improving the Competitiveness of IBRD New Loan Pricing", R2007-0196 dated September 19, 2007, paragraph 12, pages 4-5.

that are eligible for IBRD loans and are not making full use of the Bank's resources, e.g., because they are nearing graduation and/or enjoying good, yet unsteady, financial market access.[4] The DDO feature gives an IBRD borrower the option of deferring disbursements under a development policy loan (DPL) for up to three years (renewable for an additional three years with Board approval), provided that the borrower's overall program implementation and macroeconomic policy framework remain adequate. Under current Bank policy, compliance with program implementation and the adequacy of the macroeconomic framework are monitored at inception, during the drawdown period, and when the Bank receives a borrower's request for a drawdown. Current DDO pricing includes a commitment fee premium of 0.25%, and DDOs opting for extended maturity are subject to a 0.25% per annum interest rate premium.[5]

4. **Review of the experience to-date.** Despite the DDO's salient features, borrowers have been generally hesitant to avail themselves of Bank financing on DDO terms. To date, the Bank has approved two DPLs DDOs: the Latvia Private Sector Adjustment Loan-2 (IBRD Loan No. 71450), and the Chile Social Protection Sector Adjustment Loan (IBRD Loan No. 72020). One reason for the limited use of the DPL DDO has been that pricing is higher than that of a DPL without the deferred drawdown feature. Another reason has been the perception by borrowers that loan funds may not be readily available when they require them. Under current procedures[6] the borrower's request for withdrawal under the DDO triggers a review by the Bank to reconfirm whether the borrower's macroeconomic policy framework is adequate and the overall program implementation is satisfactory before the Bank authorizes the disbursement. Such review may delay the drawdown and borrowers may suspect that they might have to fulfill additional conditions to receive the drawdown.

5. Member countries' feedback has included the suggestion to provide greater assurance of the ability to drawdown funds to enhance the DDO product's attractiveness. Other suggestions have aimed at a simplification of the DDO pricing structure and the underlying financial terms and conditions.

III. THE ENHANCED DPL DDO

6. **Purpose**. The purpose of the enhanced DPL DDO would stay the same under this proposal. It would continue to provide a source of liquidity for IBRD member countries. It would provide borrowers with access to long-term IBRD resources to maintain ongoing structural programs if a financing need materializes. It would also provide a formal basis for continued policy-based engagement with the Bank when the borrower has no need for immediate funding but values Bank advice and access to immediate liquidity whenever deemed necessary.

7. **Eligibility criteria**. The DDO feature would continue to be available for IBRD-eligible borrowers, including countries that borrow from both IBRD and IDA ("blend countries"). The operational policy requirements for proceeding with an operation with a DDO feature are the same as those set out for regular development policy operations – maintenance of an adequate

[4] "2001 DDO Board Paper", paragraph 4 page 1.
[5] *Ibid.*, paragraphs 21-22, page 7.
[6] Bank Procedure (BP) 8.60 – Development Policy Lending, paragraphs 13-14.

macroeconomic policy framework and satisfactory implementation of the overall program. The process of DDO effectiveness would be the same as under existing DPL policies.

8. **Changes in Bank Drawdown Procedures**. A streamlined verification protocol entailing more proactive monitoring by the Bank of drawdown[7] conditions is proposed. This streamlined protocol would require certain changes to current procedures outlined in BP 8.60. The revised procedures are intended to provide borrowers with greater certainty regarding the availability of DPL DDO funds. Under the proposed procedures, throughout the drawdown period, the borrower and the Bank would maintain a close policy dialogue. During this period, Bank staff would monitor the borrower's macroeconomic policy framework and its continuing adherence to the overall program. Such periodic monitoring may take place at a frequency consistent with the information needs of the Bank, but no less than every 12 months, and can be initiated by either the Bank or the borrower. If at any time during the drawdown period the Bank concludes that macroeconomic policies are no longer adequate and/or the overall program is not being implemented in a manner satisfactory to the Bank, the Bank would promptly advise the borrower of the need for a subsequent review to confirm that both conditions are satisfied before it would be able to grant any request for drawdown. In this case, follow-up monitoring would be more frequent until a review confirms that both drawdown conditions are met. Once the Bank is satisfied that both drawdown conditions are again in place, the Bank would inform the borrower that its eligibility to submit disbursement requests has been restored.

9. **Drawdown request.** Following the request for withdrawal, the borrower may draw down the funds unless the borrower has received prior notification from the Bank that one or more drawdown conditions are not met and that a subsequent review is necessary. This proposed drawdown procedure is a change from the existing legal and policy framework for DPLs and DDOs (see paragraph 10).

10. **Risk of disbursing in exceptional circumstances.** Management believes that providing clients with more certainty of disbursement is essential for the success of this product. Although the proposed monitoring and drawdown procedures would provide for enhanced ex-ante supervision and monitoring mechanisms to ensure that the Bank has the latest information about a borrower's compliance with drawdown conditions, this approach does not fully eliminate the risk that the Bank could find itself obligated, in exceptional circumstances, to disburse funds in situations where the borrower may no longer satisfy those conditions. There could be a significant and sudden change in circumstances in a country, either immediately before or shortly after the Bank receives a drawdown request, resulting in a material impact on the borrower's ability to satisfy the two drawdown conditions (viz., adequate macroeconomic policy framework and/or satisfactory program implementation). While this risk cannot be eliminated completely, management believes the measures described in paragraph 8 to strengthen its country monitoring and response processes, would adequately mitigate this risk in most circumstances.

[7] The drawdown period is the period between a loan's effectiveness date and closing date during which funds are available for withdrawal by a borrower.

11. **Enhanced financial features.** Table 1 below presents the existing and proposed enhanced financial features.

Table 1 – Existing and proposed financial features		
	Existing	**Proposed Enhancement**
Applicable Contractual Lending Spread	Contractual spread at time of signing	Contractual spread at time of each drawdown.[8]
Pricing	Standard FSL pricing, except for the following: • 0.25% per annum surcharge for DDOs with extended maturity • Front-end fee is payable upon drawdown • 0.25% commitment fee surcharge	Follows regular loan pricing. See Paragraphs 14-15
Repayment terms	FSL disbursement-linked repayment schedules only	FSL commitment-linked or disbursement-linked repayment schedules available
	Repayment schedule commences at time of commitment	Repayment schedule commences at drawdown
	Repayment schedule is determined at time of commitment	Repayment schedule may be determined at time of drawdown within country category limits[9]
	Extended maturity (counted from time of commitment) available for 0.25% per annum surcharge	Extended maturity available without surcharge. See paragraph 15.
	Repayment schedule is not extended when drawdown period is renewed	Repayment schedule commences upon drawdown
	All drawdowns have identical, FSL disbursement-linked repayment schedules	Each drawdown may have a different repayment schedule, within country category limits[10] prevailing at time of drawdown

[8] As drawdown may occur up to six years after commitment for a DPL DDO and IBRD loan pricing will be reviewed annually, determining the contractual lending spread at time of drawdown will reduce the financial risk to the Bank by having the contractual lending spread reflect current Bank pricing.

[9] A proposal has been distributed to the Executive Directors ("Proposal to Extend Maturity Limit for New IBRD Loans and Guarantees and to Simplify and Consolidate IBRD Loans into a Unified Single Product Line", R2008-0007 dated January 18, 2008) to eliminate country categories and replace them with a single average maturity and final maturity limit for all borrowers. If the proposal is approved by the Executive Directors, the average maturity and final maturity limit so approved by the Executive Directors will apply to DDOs.

[10] See footnote 11.

12. **Renewal of DDOs.** The DDO may be renewed for an additional period of up to three years.[11] The renewal would be aligned with Bank procedures for extension of closing dates beyond 2 years; i.e. the task team leader would prepare a memorandum to the Regional Vice President (RVP) seeking approval of the renewal. Renewals would require that the original program remains largely in place and that the macroeconomic policy framework is adequate.

13. **Restructuring of the DPL-DDO.** Major changes in the program would either require Board approval of an entirely new operation or would be treated as restructuring. In line with BP 8.60, in cases where there would be a major restructuring or departure from the parameters as previously approved by the Board such restructurings would be approved by the Executive Directors.

14. **Pricing.** The pricing of DPL DDOs would reflect the simplified pricing structure of IBRD loans which was approved by the Executive Directors on September 27, 2007[12]. Any subsequent revisions in the pricing of IBRD loans would be reflected in the pricing of DPL DDOs. The front-end fee would be applied to the approved loan amount upon effectiveness rather than at draw-down as is the case for the current DDO[13]. At the same time, the proposed pricing would eliminate the existing 25 basis point premium on the commitment fee for the use of DDOs since the premium would no longer be needed to compensate for the delayed collection of the front-end-fee under the current DDO. The interest rate to be charged on disbursed and outstanding amounts would be the rate for variable spread or fixed spread based loans, respectively, in effect at the time of withdrawal. This proposed pricing which fully aligns DDO and DPL pricing gives borrowers the choice of a regular DPL or a DPL DDO without regard to pricing considerations.

15. It is also proposed to have the repayment term commence at the time of disbursement. The latter would have a similar effect as the option to extend the maturity under the current DDO.[14] However, the interest rate premium of 25 basis points applicable to the existing DPL DDOs with an extended maturity would be eliminated since its main rationale, to cover the opportunity cost of foregone new loan commitments, would no longer be valid under the new pricing structure. Under the old pricing structure a portion of the Bank's income would have been generated from commitment fees, which no longer exist under the new pricing structure.

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[11] Under current policy, requests for extension of the DDO drawdown period are approved by the Board. See "2001 DDO Paper", Box 1 footnote 6 and Attachment I.

[12] The pricing currently comprises a front-end fee of 25 bps payable at effectiveness and a contractual lending spread of 30 bps over the IBRD's cost of funding, net of any applicable risk premia.

[13] As is the case with standard IBRD loans, borrowers would have the choice of capitalizing the front-end fee or paying it up front.

[14] Currently, borrowers may opt for an extended maturity DDO, which would extend the average repayment maturity by 3 years beyond standard country limits at an additional cost of 0.25% per annum. However, under the existing DDO policy the repayment schedule is calculated from the time of commitment, as opposed to the time of drawdown.

16. **Operational and implementation aspects.** The operational prerequisites and implementation arrangements for DPL DDOs[15] would be reflected in the proposed revisions of Operational Policy (OP) 8.60 and Bank Procedure (BP) 8.60 (Attachment III).

IV. THE PROPOSAL FOR CATASTROPHIC RISK DDO (CAT DDO)

17. **Purpose.** A new category of the DDO product, the Cat DDO, would be offered in response to the request from the MICs for loans that better address countries' immediate liquidity needs in the aftermath of natural disasters [16]. The main purposes of this product would be to develop/enhance the capacity of borrowers to manage natural hazard risk, and to provide a source of immediately available liquidity that could serve as a source of bridge financing while other sources (e.g. concessional funding, bilateral aid, or reconstruction loans) are being mobilized following a natural disaster. This product would be consistent with the Bank's emphasis on disaster prevention, as opposed to disaster response, as the presence of a hazard risk management program would be a prerequisite.

18. **Positioning within the Bank's Comprehensive Framework for Hazard Risk Management**. The Bank has promoted ex ante catastrophic risk financing as part of the five-pillar hazard risk management framework. The Cat DDO would also complement existing market-based catastrophic risk financing instruments such as (parametric) insurance and reinsurance, catastrophe bonds or national/regional reserve funds, and would contribute to the development and implementation of cost-effective country-specific risk financing strategies.

19. The Cat DDO would complement the Bank's other instruments for emergency response, including Supplemental DPLs, stand-alone DPLs, and emergency recovery loans (ERLs)[17]. The Cat DDO would be covered by the development policy operations framework set forth in OP 8.60 and would be based on a hazard risk management program. As a pre-approved operation, the Cat DDO can deliver liquidity at shorter notice than an ERL or a standard DPL prepared after the disaster.

20. **Eligibility.** The Cat DDO would be available to IBRD-eligible borrowers, including borrowers in "blend countries". Prerequisites would include an appropriate macroeconomic policy framework and a hazard risk management program.

21. **Monitoring and Drawdown.** Throughout the drawdown period, the satisfactory implementation of the hazard risk management program would be monitored periodically. Unlike other operations processed under OP 8.60, the Cat DDO would only require the adequacy of the macroeconomic framework to be established at effectiveness and reconfirmed at renewal. The primary development objectives attached to the Cat DDO require quick (but limited) liquidity injection after catastrophic events, which may be hampered if the disbursement is

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[15] The original operational prerequisites and implementation requirements for DDO operations approved by the Board are set forth in "2001 DDO Paper", Box 1, p. 3.

[16] "Strengthening the World Bank's Engagement with IBRD Countries", paragraph 15 page 7.

[17] The Board approved the Bank's emergency policy and procedures in "Toward a New Framework for Rapid Bank Response to Crises and Emergencies", R2007-0010/4 dated April 10, 2007, hereinafter referred to as "Rapid Bank Response".

conditioned on reconfirming the adequacy of the macroeconomic policy framework. Throughout the drawdown period, the borrower and the Bank would maintain a close policy dialogue on hazard risk management issues. During this period, Bank staff would monitor the borrower's implementation of the hazard risk management program. Such periodic monitoring may take place at a frequency consistent with the information needs of the Bank, but no less than every 12 months, and could be initiated by either the Bank or the borrower.

22. If at any time during the drawdown period the Bank concludes that the hazard risk management program is not being implemented in a manner satisfactory to the Bank, the Bank would promptly advise the borrower of the need for a subsequent review to confirm that the program is implemented satisfactorily before it would be able to grant any request for drawdown. In this case, follow-up monitoring would be more frequent until a review confirms that the program is back on track. Once the Bank is satisfied that drawdown conditions are again in place, the Bank would inform the borrower that its eligibility to submit disbursement requests has been restored. Following the request for withdrawal, the borrower may draw down the funds if a trigger event occurs unless the borrower has received prior notification from the Bank that a subsequent review is required.

23. **Drawdown Trigger.** Funds may be drawn down upon occurrence of a natural disaster resulting in a declaration by the borrower of a state of emergency. As the scope and procedures for declarations of emergency may vary from country to country, the triggers would be defined on a case-by-case basis, taking into consideration the borrower's national hazard risk management legal and policy framework. Disbursement would occur only after the natural disaster has taken place.

24. **Risk of disbursing in exceptional circumstances.** The primary development objectives attached to this product require quick (but limited) liquidity injection after catastrophic events. This may result in disbursing in an adverse macroeconomic environment if the macroeconomic policy framework has deteriorated significantly since the time of effectiveness/renewal. To mitigate this risk, it is proposed to limit the volume of the Cat DDO to 0.25% of the country's GDP or USD 500 million, whichever is smaller.

25. **Financial Features.** Financial features of the Cat DDO would be similar to those available for DPL DDO (see Table 1 and Attachment II), with one exception: the Cat DDO would have a revolving feature; i.e. amounts repaid prior to the closing date would be available for drawdown.

26. **Renewals.** The Cat DDO may be renewed up to four times. The adequacy of the macroeconomic framework and the hazard risk management program would be reconfirmed and updated upon renewal. Renewal would take place no earlier than one year before, and no later than 6 months before the expiry date. The renewal would be aligned with Bank procedures for extension of closing dates beyond 2 years; i.e. the task team leader would prepare a memorandum to the Regional Vice President (RVP) seeking approval of the renewal. Renewals would require that the original program (hazard risk management and macroeconomic framework) remains largely in place.

27. **Restructuring of the Cat-DDO.** Major changes in the program would either require Board approval of a new operation or would be treated as restructuring. In line with BP 8.60, in

cases where there would be a major restructuring or departure from the parameters as previously approved by the Board, such restructuring would be approved by the Executive Directors.

28. **Pricing.** Similar to the pricing of DPL DDO option, the pricing of the Cat DDO would reflect IBRD's loan pricing structure in that a front-end fee would be applied to the approved loan amount upon effectiveness[18] and the interest rate to be charged on disbursed and outstanding amounts would be the rate for variable spread or fixed spread based loans, respectively, in effect at the time of withdrawal. Any subsequent revision in the pricing of IBRD loans would be reflected in the pricing of Cat DDOs.

29. **Operational and Implementation Aspects.** The operational prerequisites and implementation arrangements for a Cat DDO would be reflected in the proposed revisions of OP 8.60 and BP 8.60 (Attachment III).

V. POLICY AND LEGAL IMPLICATIONS

30. With the exception mentioned in paragraphs 8-9 and 24, the proposed enhancements would not modify the existing legal framework for policy based lending, which also includes DDOs, anchored in the "special circumstances" provision of the Bank's Articles. The proposed enhancements would require additions to the operational policy 8.60 and modifications to existing Bank procedures and practices (BP 8.60).

31. Management also proposes small changes to other policy provisions of OP 8.60. In paragraph 22, reference to the Bank-Fund relations annex is being removed as the latter is no longer used following the Joint Management Action Plan for Bank-Fund collaboration adopted in 2007. In paragraphs 4 and 12, the reference to country performance triggers is being removed as this is already subsumed in the start of paragraph 4 which states that the expected total volume of development policy lending for a borrower is determined in the CAS. (Apart from eliminating repetition, this is also appropriate given that IDA CASs and some IBRD CASs do not contain lending scenarios nor triggers). Similarly the reference to the inclusion of the DDO within the CAS lending envelope is being eliminated in paragraph 21 as again this point is covered in the start of paragraph 4. Attachment III summarizes the proposed additions and modifications to OP 8.60 and the resulting changes to BP 8.60. Attachment IV contains the proposed revised OP 8.60 and BP 8.60.

[18] Borrowers would have the choice of either capitalizing the front-end fee or paying it up front.

VI. RECOMMENDATIONS

32. It is recommended that the Executive Directors approve:

a) the enhancement of the DPL DDO as described in paragraphs 6-15 above;
b) the introduction of the Cat DDO as described in paragraphs 17-28 above;
c) the changes to OP 8.60 and BP 8.60 as described in paragraph 30-31 above and detailed in Attachment IV; and,
d) the enhancement to the DPL DDO under (i) above and the introduction of the Cat DDO under (ii) above apply to loans approved by the Executive Directors on or after the date of approval of these recommendations.

Robert B. Zoellick
President

by Vincenzo La Via
Chief Financial Officer

Attachment I

PROPOSED TERMS OF IBRD DPL DDO	
Purpose	To provide immediate liquidity when the borrower needs it
Eligibility	All IBRD-eligible borrowers (upon meeting pre-approval criteria)
Pre-approval criteria	Appropriate macroeconomic policy framework Satisfactory implementation of the overall program
Currency	Same as regular IBRD loans
Drawdown	Up to the full loan amount is available for disbursement at any time within three years from loan signing. Drawdown period may be renewed.
Repayment Terms	May be determined either upon commitment, or upon drawdown within prevailing maturity policy limits. Repayment schedule would commence from date of drawdown. [1/]
Lending Rate Base Rate	Same as regular IBRD loans
Lending Rate Spread	The prevailing spread for regular IBRD loans at time of each drawdown.
Front-End Fee	Same as regular IBRD loans. No front-end fee would be charged for renewal of the drawdown period.
Currency Conversions, Interest Rate Conversions, Caps, Collars, Payment Dates, Conversion Fees, Prepayment	Same as regular IBRD loans

1/ For purposes of administering the repayment term flexibility for DDO loans, a 1.5 year expected average disbursement period would be assumed for disbursement-linked repayment schedules.

Attachment II

PROPOSED TERMS OF IBRD CAT DDO	
Purpose	• To enhance/develop the capacity of borrowers to manage hazard risk • To provide immediate liquidity to fill the budget gap after a natural disaster • To safeguard on-going development programs
Eligibility	All IBRD-eligible borrowers (upon meeting pre-approval criteria)
Pre-approval criteria	Appropriate macroeconomic policy framework Satisfactory implementation of a hazard risk management program
Country limit	Maximum size of 0.25% of GDP or the equivalent of USD 500 million, whichever is smaller.
Currency	Same as regular IBRD loans
Drawdown	Up to the full loan amount is available for disbursement at any time within three years from loan signing. Drawdown period may be renewed up to a maximum of four extensions.
Repayment Terms	May be determined either upon commitment, or upon drawdown within prevailing maturity policy limits. Repayment schedule would commence from date of drawdown. 1/
Revolving Features	Amounts repaid by the borrower would be available for drawdown, provided that the closing date has not expired.
Lending Rate Base Rate	Same as regular IBRD loans
Lending Rate Spread	The prevailing spread for regular IBRD loans at time of each drawdown.
Front-End Fee	Same as regular IBRD loans. No fee would be charged for renewal of the drawdown period.
Currency Conversions, Interest Rate Conversions, Caps, Collars, Payment Dates, Conversion Fees, Prepayment	Same as regular IBRD loans

1/ For purposes of administering the repayment term flexibility for DDO loans, a 1.5 year expected average disbursement period would be assumed for disbursement-linked repayment schedules.

Attachment III

Summary of Proposed Changes to OP 8.60 and BP 8.60	
Current policy formulation in OP 8.60	**Required adaptation for DPL-DDO/CAT-DDO and other minor revisions**
4. *Volume/Share*. The expected total volume or share of development policy lending for a borrower is determined in the CAS, taking the following factors into consideration: (a) the country's financing requirements, given the actions necessary to achieve the expected results of the program, the costs of the program, the size and disbursement profile of the Bank's lending program, and other financing available; (b) for IDA borrowers, the country's relative allocation of available concessional resources; and for IBRD borrowers, the country's exposure to IBRD in the context of creditworthiness and risks; (c) the borrower's overall debt sustainability, based on an assessment of the expected impact of development policy program on the debt condition of the country; (d) the country's absorptive capacity; and (e) country performance triggers for CAS lending scenarios.	4. *Volume/Share*. Volume/Share. The expected total volume or share of development policy lending for a borrower is determined in the CAS, taking the following factors into consideration: (a) the country's financing requirements, given the actions necessary to achieve the expected results of the program, the costs of the program, the size and disbursement profile of the Bank's lending program, and other financing available; (b) for IDA borrowers, the country's relative allocation of available concessional resources; and for IBRD borrowers, the country's exposure to IBRD in the context of creditworthiness and risks; (c) the borrower's overall debt sustainability, based on an assessment of the expected impact of development policy program on the debt condition of the country; and d) the country's absorptive capacity
12. *Program Funding and Size of Operation.* The Bank extends a development policy loan only when the overall program is adequately funded, considering both domestic and external sources of finance. The size of each development policy operation is determined individually on the basis of country circumstances, including the following factors: a) overall projected financing requirements at the time of the operation (including the costs of reform, if applicable), the availability of alternative financing, debt sustainability, and	12. *Program Funding and Size of Operation*. The Bank extends a development policy loan only when the overall program is adequately funded, considering both domestic and external sources of finance. The size of each development policy operation is determined individually on the basis of country circumstances, including the following factors: a) overall projected financing requirements at the time of the operation (including the costs of reform, if applicable), the availability of alternative financing, debt sustainability, and creditworthiness (IBRD) or relative

Summary of Proposed Changes to OP 8.60 and BP 8.60	
creditworthiness (IBRD) or relative claim on available concessional resources (IDA); b) the lending envelope envisaged and the share of development policy lending in total lending in the CAS; and c) compliance with country performance triggers set out in the CAS.	claim on available concessional resources (IDA); and b) the lending envelope envisaged and the share of development policy lending in total lending in the CAS
21. A deferred drawdown option (DDO) allows a borrower to postpone drawing down a loan for a defined drawdown period after the loan agreement has been declared effective. A DDO is included within the CAS envelope and does not constitute a window for additional resources.	21. A deferred drawdown option (DDO) or deferred drawdown option for catastrophic risks (Cat DDO) allows a borrower to postpone drawing down a loan for a defined drawdown period after the Loan Agreement has been declared effective.
22. *Eligibility, Drawdown Period, and Conditions*. IBRD-eligible borrowers may defer disbursement of a single- or multiple-tranche development policy loan for up to three years, provided that (a) overall program implementation is consistent with the Letter of Development Policy, and (b) the macroeconomic policy framework remains adequate. All specific conditions of tranche release for a development policy loan with a DDO must be met before Board presentation; none are included as effectiveness conditions in the Loan Agreement.	22. *Eligibility, Drawdown Period, and Conditions*. IBRD-eligible borrowers may defer disbursement of a single- or multiple-tranche development policy loan for up to three years. During this time, the borrower must continue to implement its development program in accordance with the Letter of Development Policy, and, for a DDO, must maintain an adequate macroeconomic policy framework. For a DDO, the drawdown is available upon the borrower's request; for a Cat DDO, the drawdown is available only if a pre-specified trigger linked to a natural catastrophe—typically the borrower's declaration of a state of emergency—has been met. All specific conditions of tranche release for a development policy loan with a DDO or Cat DDO must be met before Board presentation; none are included as effectiveness conditions in the Loan Agreement.
23. *Financial Terms*. A development policy loan with a DDO includes a three-year drawdown period. The repayment term, including a grace period, commences from the beginning of the interest period following drawdown.[18] The Bank may extend the drawdown period for an additional period of up to three years if the	23. *Financial Terms*. A development policy loan with a DDO or Cat DDO includes a deferment period of up to three years. The repayment term, including the grace period, may be determined at, and commences from the time of, disbursement.[18] A DDO or Cat DDO may be renewed if the country's implementation of its reform program and its macroeconomic policy framework

Summary of Proposed Changes to OP 8.60 and BP 8.60	
country's implementation of its reform program, and its macroeconomic policy framework, remain satisfactory.	remain satisfactory. A DDO may be renewed once for up to three additional years. A Cat DDO may be renewed four times for up to three additional years, for a total deferment of 15 years. Cat DDO amounts repaid during the deferment period are again available for drawdown.
29. For each development policy operation proposed for Bank financing, the Bank prepares a Program Document that describes and appraises the operation.[21] An annex on Bank/Fund relations is attached.[22] The Program Document is available to the public after the operation has been approved by Executive Directors.	29. For each development policy operation proposed for Bank financing, the Bank prepares a Program Document that describes and appraises the operation.[21] The Program Document is available to the public after the operation has been approved by Executive Directors.
Current Policy Formulation in BP 8.60	**Required adaptation for DDO/CAT-DDO**
13. Throughout the drawdown period, the borrower and the Bank maintain a close policy dialogue. As part of regular loan supervision, Bank staff periodically consult with the IMF on the adequacy of the borrower's macroeconomic framework and monitor the borrower's continuing adherence to the overall program. If at any time during the drawdown period Bank staff conclude that the borrower does not meet one or both of these two drawdown conditions, they promptly advise the borrower and conduct more frequent follow-up monitoring until the borrower again meets both drawdown conditions.	13. Throughout the deferment period of a DDO or a Cat DDO, the Bank maintains a close policy dialogue with the borrower. As part of regular loan supervision and at least every 12 months, the Bank reviews the borrower's continuing adherence to the overall program laid out in the LDP; and, for a DDO, the adequacy of the borrower's macroeconomic policy framework. If at any time during the deferment period the Bank concludes that the borrower no longer complies with the LDP program (or, for the DDO, no longer has an adequate macroeconomic policy framework), the Bank promptly notifies the borrower, including the reasons for its determination; advises that if the borrower requests a drawdown it will be subject to a full review of program implementation (and, for the DDO, of the macroeconomic policy framework); works with the borrower to help it meet the relevant conditions; and notifies the borrower when those conditions are again met.
14. *Drawdown*. The Bank responds rapidly to the borrower's request to draw on the loan. If the	14. *Drawdown and Renewal.* The Bank responds rapidly with the disbursement to the borrower's request

Summary of Proposed Changes to OP 8.60 and BP 8.60	
Bank has not previously had to advise the borrower of the need for a subsequent review to confirm that both conditions are met as a prerequisite for a drawdown, the Bank would quickly reconfirm whether the two conditions remain satisfied. If the Bank had previously advised the borrower of the need for such a subsequent review, the Bank conducts a full review of the macroeconomic policy framework and overall program implementation as early as possible on receipt of the borrower's drawdown request. When the borrower asks to draw on the loan, Bank staff reconfirm whether the two conditions remain satisfied;[6] and if they are, the Bank grants the borrower's request to draw on the loan. If Bank staff determine that the borrower does not meet one or both drawdown conditions, they advise the borrower promptly of the reasons for this determination. The general policies and procedures on waivers of conditions apply.	to draw on the loan (for the Cat DDO, after confirming that the natural disaster trigger has been met). However, if the Bank has previously advised the borrower that it does not meet relevant conditions for the drawdown (set out in OP 8.60, para. 22) and the borrower has not yet returned to compliance with those conditions, the Bank conducts a full review of the overall program implementation (and, for the DDO, of the macroeconomic policy framework) as early as possible on receipt of the borrower's drawdown request. Once the Bank confirms that the borrower has met the relevant drawdown conditions the Bank proceeds with disbursement. DDOs and Cat DDOs can be renewed with approval of the RVP provided that the overall program continues to be implemented in a manner satisfactory to the Bank and macroeconomic policies are adequate.

Attachment IV

Proposed OP 8.60 - Development Policy Lending

1. Development policy lending is rapidly disbursing policy-based financing, which the Bank[1] provides in the form of loans or grants to help a borrower address actual or anticipated development financing requirements that have domestic or external origins. The Bank may provide development policy lending to a member country or to a subnational division of a member country.[2]

Considerations in Providing Development Policy Lending

2. Development policy lending aims to help a borrower achieve sustainable reductions in poverty through a program of policy and institutional actions that promote growth and enhance the well-being and increase the incomes of poor people. Development policy operations are supportive of, and consistent with, the country's economic and sectoral policies and institutions aimed at accelerated sustainable growth and efficient resource allocation. They typically support a program of policy and institutional actions, for example, to improve the investment climate, diversify the economy, create employment, and meet applicable international commitments. Any investment lending subcomponent included in a development policy operation is subject to the relevant operational policies for investment lending.[3]

3. Lending Criteria and Selectivity. The appropriateness of providing development policy lending to a country is determined in the context of the Country Assistance Strategy (CAS). The Bank's decision to extend development policy lending is based on an assessment of the country's policy and institutional framework—including the country's economic situation, governance, environmental/natural resource management, and poverty and social aspects. The Bank considers the strength of the program and the country's commitment to and ownership of the program against its track record. It also assesses the country's institutional capacity and ability to implement effectively the program to be supported and describes the country's capacity-building efforts.

4. Volume/Share. The expected total volume or share of development policy lending for a borrower is determined in the CAS, taking the following factors into consideration:

a) the country's financing requirements, given the actions necessary to achieve the expected results of the program, the costs of the program, the size and disbursement profile of the Bank's lending program, and other financing available;
b) for IDA borrowers, the country's relative allocation of available concessional resources; and for IBRD borrowers, the country's exposure to IBRD in the context of creditworthiness and risks;
c) the borrower's overall debt sustainability, based on an assessment of the expected impact of development policy program on the debt condition of the country; and
d) the country's absorptive capacity

5. Macroeconomic Framework. The Bank undertakes development policy lending in a country only when it has determined that the country's macroeconomic policy framework is appropriate.[4] The release of each tranche requires the maintenance of an appropriate macroeconomic policy framework. For development policy lending to a subnational entity, the state or region must have an appropriate expenditure program, as well as appropriate fiscal arrangements with the central government.

6. Consultations and Participation. As part of its country dialogue, the Bank advises borrowing countries to consult with and engage the participation of key stakeholders in the country in the process of formulating the country's development strategies.[5] For a development policy operation, the country draws on this process of strategy formulation to determine, in the context of its constitutional and legislative framework, the form and extent of consultations and participation in preparing, implementing, and monitoring and evaluating the operation. Bank staff describe in the Program Document the country's arrangements for consultations and participation relevant to the operation, and the outcomes of the participatory process adopted in formulating the country's development strategy. Relevant analytic work conducted by the Bank, particularly on poverty and social impacts and on environmental aspects, is made available to the public as part of the consultation process, in line with the Bank's disclosure policy.

7. Coordination with Development Partners. In preparing development policy operations, the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining responsibility for its financing decisions.

Design of Development Policy Operations

8. Development Objectives. The Executive Directors consider and approve each development policy operation as meeting the special circumstances provision of the Bank's Articles of Agreement.[6] The Program Document sets out the country's program being supported and the specific results expected from the resource transfer. The program design includes measurable indicators for monitoring progress during implementation and evaluating outcomes on completion.

9. Analytic Underpinnings. A development policy operation draws on relevant analytic work on the country undertaken by the Bank, the country, and third parties. Drawing on a consultative process, the CAS assesses the adequacy of analytic work on the country and indicates how gaps will be addressed. The Program Document describes the main pieces of analytic work used in the preparation of the operation and shows how they are linked to the proposed development policy program. As appropriate, prior analytic work includes analyses of the country's economywide or sectoral policies and institutions aimed at stimulating investment, creating employment, accelerating and sustaining growth, as well as analyses of the poverty and social impacts of proposed policies,[7] environment and natural resource management,[8] governance and public expenditure management, procurement, and financial accountability systems.

10. Poverty and Social Impacts. The Bank determines whether specific country policies supported by the operation are likely to have significant poverty and social consequences, especially on poor people and vulnerable groups.[9] For country policies with likely significant effects, the Bank summarizes in the Program Document relevant analytic knowledge of these

effects and of the borrower's systems for reducing adverse effects and enhancing positive effects associated with the specific policies being supported. If there are significant gaps in the analysis or shortcomings in the borrower's systems, the Bank describes in the Program Document how such gaps or shortcomings would be addressed before or during program implementation, as appropriate.

11. Environmental, Forests, and other Natural Resource Aspects. The Bank determines whether specific country policies supported by the operation are likely to cause significant effects on the country's environment, forests, and other natural resources.[10] For country policies with likely significant effects, the Bank assesses in the Program Document the borrower's systems for reducing such adverse effects and enhancing positive effects, drawing on relevant country-level or sectoral environmental analysis. If there are significant gaps in the analysis or shortcomings in the borrower's systems, the Bank describes in the Program Document how such gaps or shortcomings would be addressed before or during program implementation, as appropriate.

12. Program Funding and Size of Operation. The Bank extends a development policy loan only when the overall program is adequately funded, considering both domestic and external sources of finance. The size of each development policy operation is determined individually on the basis of country circumstances, including the following factors:

a) overall projected financing requirements at the time of the operation (including the costs of reform, if applicable), the availability of alternative financing, debt sustainability, and creditworthiness (IBRD) or relative claim on available concessional resources (IDA); and

b) the lending envelope envisaged and the share of development policy lending in total lending in the CAS.

13. Conditions. The Bank determines which of the agreed policy and institutional actions by the country are critical for the implementation and expected results of the program supported by the development policy loan. The Bank makes the loan funds available to the borrower upon maintenance of an adequate macroeconomic policy framework, implementation of the overall program in a manner satisfactory to the Bank, and compliance with these critical program conditions.[11] The Bank seeks to harmonize these conditions with other development partners in consultation with the country.[12]

14. Tranching. Development policy lending can be provided in one or more tranches, depending on the country's policy environment and capacity, the country's financing requirements and other available financing, and the content and phasing of the program being supported by the development policy operation.[13] Development policy operations following a programmatic approach consist of a series of operations within a medium-term framework of policy and institutional actions.[14] Self-standing single-tranche development policy operations are embedded in an explicit medium-term framework and are based on adequate prior policy and institutional actions. For all operations, tranche release depends on the maintenance of an appropriate macroeconomic policy framework and the satisfactory completion of tranche conditions.

15. Risk Management. The borrower is responsible for managing operational risks affecting the development effectiveness of the development policy operation. The Bank independently

identifies the financial and nonfinancial risks[15] associated with the program and ensures that the operation contains appropriate mitigation measures and monitorable indicators to track high-probability risks.

16. Implementation, Monitoring, and Evaluation. The borrower implements the development policy operation, monitors progress during implementation, and evaluates results on completion. Bank staff assess and monitor the adequacy of the arrangements by which the borrower will carry out these responsibilities, with due regard to the country's capacity. In addition, Bank staff review implementation progress during supervision to verify fulfillment of program conditions and compliance with legal covenants, and to validate monitoring and evaluation findings.[16] Supervision includes a focus on development impact, assessing the changes in outputs and outcomes resulting from the operation.

Fiduciary Arrangements for a Development Policy Operation

17. Drawing on relevant analysis of the country's public financial management, the Bank determines whether the operation should include measures to address identified fiduciary weaknesses.

18. Disbursements. Development policy lending funds are disbursed against satisfactory implementation of the development policy lending program, including compliance with tranche release conditions and maintenance of a satisfactory macroeconomic policy framework. The borrower commits not to use development policy lending funds for ineligible expenditures. The Bank normally disburses the loan proceeds into an account that forms part of the country's official foreign exchange reserves (normally held by the central bank), and an amount equivalent to the loan proceeds is credited to an account of the government to finance budgeted expenditures.

19. Fiduciary Arrangements. The Bank focuses on the borrower's overall use of foreign exchange and budget resources as follows:

a) Foreign exchange. Bank staff review, and discuss with IMF staff as appropriate, the IMF's most recent assessment of the borrower's central bank. When the assessment shows that the control environment of the central bank is satisfactory, or reveals issues for which the borrower has agreed remedial actions that are monitored by the IMF, the Bank takes no further action.

b) Budget resources. The Bank reviews the country's public financial management and procurement arrangements through diagnostic work and through reports prepared by the borrower and others, including published annual audit reports of the central bank and of the government.

20. These reviews inform Bank decisions on the amounts of development policy loans, tranching, program content, conditionality, and risk mitigation measures. When the available analysis identifies weaknesses in the borrower's central bank control environment or budget management system, or when an acceptable action plan to deal with identified weaknesses is not in place, the Bank will identify the additional steps needed to secure acceptable fiduciary arrangements for development policy lending: for example, requiring dedicated accounts for loan

proceeds or counterpart funds, and having a right to request an audit on the dedicated accounts. The Bank may also agree with the borrower on the use of loan proceeds or counterpart funds.[17]

Options

A development policy operation may include one or more options that have specific requirements.

Deferred Drawdown

21. A deferred drawdown option (DDO) or deferred drawdown option for catastrophic risks (Cat DDO) allows a borrower to postpone drawing down a loan for a defined drawdown period after the Loan Agreement has been declared effective.

22. Eligibility, Drawdown Period, and Conditions. IBRD-eligible borrowers may defer disbursement of a single- or multiple-tranche development policy loan for up to three years. During this time, the borrower must continue to implement its development program in accordance with the Letter of Development Policy, and, for a DDO, must maintain an adequate macroeconomic policy framework. For a DDO, the drawdown is available upon the borrower's request; for a Cat DDO, the drawdown is available only if a pre-specified trigger linked to a natural catastrophe—typically the borrower's declaration of a state of emergency—has been met. All specific conditions of tranche release for a development policy loan with a DDO or Cat DDO must be met before Board presentation; none are included as effectiveness conditions in the Loan Agreement.

23. Financial Terms. A development policy loan with a DDO or Cat DDO includes a deferment period of up to three years. The repayment term, including the grace period, may be determined at, and commences from the time of, disbursement.[18] A DDO or Cat DDO may be renewed if the country's implementation of its reform program and its macroeconomic policy framework remain satisfactory. A DDO may be renewed once for up to three additional years. A Cat DDO may be renewed four times for up to three additional years, for a total deferment of 15 years. Cat DDO amounts repaid during the deferment period are again available for drawdown.

Special Development Policy Lending

24. For IBRD-eligible countries that are approaching or are in a crisis with substantial structural and social dimensions, and that have urgent and extraordinary financing needs, the Bank may, on an exceptional basis, provide special development policy lending beyond the level set out in the CAS. The magnitude of such financial support is subject to the availability of adequate IBRD financial and risk-bearing capacity.

25. Design and Eligibility Criteria. To be eligible for special development policy lending, the country must have a disbursing IMF-supported program in place. Special development policy lending must be part of an international support package—which may include multilaterals, bilateral donors, and private lenders and investors—of structural, social, and macroeconomic policy, with conditionality embedded in a strong policy program. The Bank determines that the country's external financing plan is sustainable, and ascertains that the special development policy lending and its associated debt service are within medium-term debt sustainability limits. A special development policy loan may have one or more tranches.

26. Financial Terms. The financial terms of special development policy lending reflect the special nature and high risks of lending for crisis support beyond anticipated levels.[19]

Supplemental Financing

27. In exceptional cases, the Bank may provide supplemental financing—a separate loan additional to the loan provided for in the original Loan Agreement—in support of the objectives of the program under implementation. Supplemental financing may be provided for a development policy operation for which an unanticipated gap in financing jeopardizes a reform program that is otherwise proceeding on schedule and in compliance with the agreed policy agenda. Supplemental financing is approved only when:

a) the program is being implemented in compliance with provisions of Loan Agreement;
b) the borrower is unable to obtain sufficient funds from other lenders on reasonable terms or in a reasonable time;
c) the time available is too short to process a further freestanding Bank operation; and
d) the borrower is committed to the program and the implementing agencies have demonstrated competence in carrying it out.

Debt and Debt Service Reduction

28. There may be circumstances under which the Bank may be called upon to use its financial resources in support of loan restructuring, equity conversion, or interest rate swaps. Lending for debt and debt service reduction helps highly indebted countries reduce commercial debt and debt service to a manageable level, as part of a medium-term financing plan in support of sustainable growth. The focus is on rationalizing the country's external commercial debt, by either converting it to lower-interest instruments or buying it back at a discount. Funds are disbursed against tendered commercial debt for buy-backs or for purchasing acceptable collateral, to reduce principal and interest payments on new instruments issued in exchange for existing debt. The following cases may be distinguished:

a) In countries where a program of structural reform supported by development policy lending is already in place or is agreed to at the same time as the Bank-supported debt restructuring, the Bank must satisfy itself that the savings resulting from debt reduction will increase resources available for investment, because of the comprehensiveness of the program or specific assurances by the borrower.

b) In countries where the Bank is not currently engaged in development policy lending, to lend to the country for debt restructuring the Bank would need to show (i) that the reduction in debt service permitted by the operation is expected to be translated into increased productive domestic investment[20] and thus enhance economic growth and development even in the absence of an accompanying Bank-supported development policy program, and (ii) that the borrower's supportive policy framework is expected to remain in place.

c) Debt/equity Conversion and Interest Swaps. For debt/equity conversion (direct and indirect) and interest rate swaps, Bank involvement is justified when the Bank lending or guarantees assist the borrower to (i) undertake a specific new investment, (ii) to enhance an existing project, or (iii) in special circumstances, to pave the way, significantly and materially, for conditions more conductive to investment so as to justify the intervention.

Documentation and Disclosure

Program Document

29. For each development policy operation proposed for Bank financing, the Bank prepares a Program Document that describes and appraises the operation.[21] The Program Document is available to the public after the operation has been approved by Executive Directors.

Letter of Development Policy

30. The borrower sets out the program of objectives, policies, and measures to be supported by the development policy operation—typically a subset of the government's overall strategy—in a Letter of Development Policy (LDP), which is included in the loan documentation presented to the Board.[22] The LDP is available to the public after Executive Directors approve the operation, unless they decide otherwise.

Tranche Release Documents

31. In a multiple-tranche development policy operation, for each tranche after the first one, the Bank prepares a Tranche Release Document that reports on the status of the program being supported under the operation. The Tranche Release Document is available to the public (a) after Bank Management has approved the release of the tranche and the Board has been informed, or (b) if a waiver of tranche release conditions is recommended, after Executive Directors have approved the waiver.

Crisis and Post-Conflict Situations

32. Countries affected by crisis[23] or conflict[24] may require an unusually quick response from the Bank. There may not be sufficient time or country capacity to adequately address design considerations (such as possible distributional effects, effects on natural resources and the environment, fiduciary arrangements), or a strong policy program developed with stakeholder consultation

33. In such situations, development policy lending is justified on an exceptional basis. In seeking Board approval of such operations, Bank staff describes in the program document when and how remaining design considerations would be addressed.

[1.] "Bank" includes IBRD and IDA, "loans" includes IDA credits and IDA grants, "borrower" includes borrower and IDA grant recipient, and "subnational divisions" refers to states or provinces.

[2.] See OP 7.00, Lending Operations: Choice of Borrower and Contractual Agreements.

[3.] See OP/BP 10.00, Investment Lending.

[4.] The presence of an appropriate IMF program is usually an important input in this determination. If there is no Fund arrangement, Bank staff ascertain, before making their own assessment, whether the Fund has any major outstanding concerns about the adequacy of the country's macroeconomic policies. Any outstanding issues relevant to the adequacy of the macroeconomic policy framework raised by the IMF are communicated to Executive Directors. For internal guidelines to assist in the application of OP and BP 8.60 on assessing the macroeconomic policy framework, staff may refer to Good Practices in Designing Development Policy Operations.

[5.] Key stakeholders include social groups directly affected by the operations, as well as public sector, private sector, and donor organizations relevant to the operation. Country strategies include the poverty reduction strategy paper (PRSP) process in IDA counties or the country' overall or sectoral development strategy in IBRD countries. For internal guidelines to assist in the application of OP and BP 8.60 on consultations and participation, staff may refer to the Good Practice Note in Supporting Participation in Development Policy Operations.

[6.] The Bank's Articles of Agreement provide that Bank loans should finance specific projects. "except in special circumstances." IBRD Articles, Article III, Section 4 (vii); and IDA Articles, Article V, Section 1 (b).

[7]. For guidance on poverty analysis, see OP 1.00, Poverty Reduction. For specific guidance on analyzing distributional effects, staff may refer to the User's Guide on Poverty and Social Impact Analysis.

[8]. See the sections on Country Environmental Analysis and Strategic Environmental Assessment in the Analytic and Advisory Assistance section of the World Bank Environment website.

[9.] For internal guidelines to assist in the application of OP and BP 8.60, including possible criteria for the selection of policies for analysis, staff may refer to the Good Practice Note on Poverty and Social Impact Analysis and Development Policy Lending.

[10]. For internal guidelines to assist in the application of OP and BP 8.60 on analyzing environmental and natural resource risks and opportunities in development policy lending, staff may refer to the Good Practice Note on Environmental and Natural Resource Aspects in Development Policy Lending.

[11.] For internal guidelines to assist in the application of OP and BP 8.60 on conditionality, staff may refer to Good Practices In Designing Development Policy Operations.

[12]. See Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality (SecM2001-0461), August 23, 2001.

[13.] For internal guidelines to assist in the application of OP and BP 8.60 on tranching, staff may refer to Good Practices In Designing Development Policy Operations.

[14.] This approach involves (a) clear monitorable indicators and progress benchmarks, (b) triggers for moving from one operation in the series to the next, and (c) notional timing and amounts of subsequent operations. A poverty reduction support credit (PRSC) is a development policy operation in the context of a programmatic approach in support of a country' PRSP.

[15.] These include operational, developmental, macroeconomic, political economy, social, environmental, governance, reputational, and capacity/implementation risks, as appropriate. For internal guidelines to assist in the application of OP and BP 8.60 on risk assessment, staff may refer to Good Practices In Designing Development Policy Operations.

[16.] For internal guidelines to assist in the application of OP and BP 8.60 on implementation and monitoring, staff may refer to Good Practices In Designing Development Policy Operations.

[17.] Where the Bank agrees with the borrower on specified purposes for which the loan proceeds may be used, the Bank' policies on procurement would apply (see OP 11.00, Procurement). In addition, in such cases, retroactive financing is permitted under the following conditions: (a) the payments are for items that are eligible for financing under the terms of the Loan Agreement; (b) the payments are for items that have been procured in accordance with applicable Bank procurement procedures; (c) such payments do not exceed 20 percent of the loan amount; and (d) the payments were made by the borrower not more than 12 months before the expected date of Loan Agreement signing. The date after which payments may be made is agreed at appraisal, confirmed during negotiations, and

recorded in the Loan Agreement. In extraordinary circumstances, such as in response to crisis and post-conflict situation (as described in paragraphs 32-33 of this OP), exceptions to these retroactive financing limits may be approved by the Regional Vice President in consultation with the Vice President, Operations Policy and Country Services. Proposals for retroactive financing, including any exceptions to normal limits for such financing, are spelled out in the Program Document.

[18.] See the World Bank Treasury website for the financial terms for DDOs.

[19.] Information about the pricing for special development policy lending can be found in The Fixed Spread Loan, April 2003.

[20.] Investment has been defined broadly in the Bank' practice to include spending not only for enlarging the productive basis of a country, but also for making it more productive. Investment includes both physical and human capital, as well as spending which directly substitutes for future investment requirements, such as spending on improved operations and maintenance.

[21.] For supplemental financing, a concise program document, known as a Supplemental Financing Document, is prepared. It is disclosed in the same fashion as the PD.

[22]. When the country has prepared its own strategy document describing its development and reform program (such as the PRSP), that strategy document-- depending on its coverage and specificity-- may serve as the primary vehicle for setting out the substance of the country's program. The LDP can then become a short letter reflecting specific parts of the country's own strategy supported by the operation.

[23]. Countries affected by crisis referred to in this OP are those facing either an urgent financial crisis (actual or potential) with substantial structural and social dimensions, or actual or potential serious economic dislocation caused by shocks. These might include countries eligible for special development policy lending under paragraphs 24-26 of this policy statement.

[24.] Countries affected by conflict referred to in this OP are those that need development policy lending for urgent rehabilitation, while their medium-term structural reform agenda is still emerging. (For countries affected by conflict, staff may refer to OP 2.30, Development Cooperation and Conflict.)

Proposed BP 8.60 - Development Policy Lending

Identification and Preparation

1. At an early stage of preparation of a development policy operation, the task team consults with the IMF and with relevant units in the Bank,1 IFC, and MIGA.2 As appropriate, to establish a coordinated approach to the development policy program, the task team in coordination with the borrower solicits the views of the concerned regional development bank and other external donors on policy objectives.

2. After the program concept is clearly defined, but before detailed preparation of the operation begins, the task team prepares a Concept Document3 explaining the rationale for the proposed operation, linking it with the most recent Country Assistance Strategy, and describing its objectives, expected outcomes, and provisions. The task team also prepares an initial Program Information Document (PID) summarizing the main elements of the evolving operation. The Concept Document and PID are reviewed and cleared according to Regional procedures, and the task team sends the PID to the InfoShop. As preparation of the development policy operation proceeds, the task team keeps the PID updated and sends each revision to the InfoShop.

3. For proposed special development lending,4 the Region consults informally with the Board at an early stage of preparation, and thereafter as necessary.

Appraisal and Review

4. As the operation is prepared, the task team drafts the Program Document (PD), which includes the policy matrix. The PD clearly sets out the objectives of the proposed operation in terms of the specific outcomes expected from the resource transfer and the government program being supported. It includes measurable indicators for monitoring progress during implementation and evaluating outcomes on completion. In addition, it covers the considerations, design provisions, and fiduciary arrangements discussed in OP 8.60.

5. Before appraisal, the Region submits the proposed operation for corporate review by the Regional Operations Committee (usually chaired by the Regional vice president) or the Operations Committee (usually chaired by the Managing Director, Operations).5 On conclusion of the review, the Regional Operations Committee or Operations Committee specifies further actions, and, as appropriate, authorizes appraisal and negotiations.

6. During appraisal, the task team assesses the adequacy of the proposed program to achieve its stated objectives. Before negotiations, the team includes in the documentation the borrower's draft Letter of Development Policy (LDP), unless the borrower has objected to its disclosure, and the lawyer prepares the draft Loan Agreement.

Negotiations and Board Presentation

7. Invitation to Negotiate. The country director issues the invitation to negotiate a development policy operation. The invitation includes a statement that it is the Bank's policy to make the PD and any Tranche Release Document (TRD) available to the public after the loan or credit has been approved by Executive Directors. It also indicates that the LDP will be made available to the public following Board approval, unless the Executive Directors decide otherwise. It requests that the borrower's negotiating team be prepared to identify, during negotiations, any sections of the PD that are confidential or sensitive, or that may adversely affect relations between the prospective borrower and the Bank, if disclosed.

8. Finalizing the PD. When finalizing the PD, the team leader makes appropriate adjustments to it to deal with any matters raised by the borrower. If any information raises issues of confidentiality or sensitivity, or may adversely affect relations between the Bank and the borrower, and is relevant to the Executive Directors in their decision making process, the team leader incorporates it in the Memorandum of the President (MOP). The LDP is normally attached as an annex to the PD; but if the borrower has objected to the disclosure of the LDP, it is included as an annex to the MOP. The cover of the PD indicates to which document the LDP is annexed.

9. Distribution of the PD to Executive Directors. After the PD has been cleared for distribution to Executive Directors following the corporate review process, the Regional vice president transmits the PD to the Corporate Secretariat's Board Operations Unit (SECBO), indicating in the Board Submission Form that the PD will be made publicly available after the loan or credit is approved.

10. Board Presentation. The Board approves the loan on the basis of the Program Document—setting out the program content, conditionality, and terms—and the government's Letter of Development Policy.

a) For programmatic development policy operations, including poverty reduction support credits, the Board approves each individual operation in the series. If there are no substantive changes in the policy program and performance is adequate, subsequent operations are presented to the Board on a streamlined procedure basis.

b) For special development policy operations, the Region may propose fast-track consideration by Executive Directors (that is, consideration within not less than one calendar week following distribution of the documents).

11. Disclosure. After the Executive Directors approve the operation, if their discussion does not necessitate revisions to the PD, SECBO notifies the Internal Document Unit (IDU) and the InfoShop that the document may be made available to the public. If further revisions to the PD are required, SECBO notifies IDU and the InfoShop about the need for revisions. Once the document has been revised and cleared according to Regional procedures, the country director transmits the revised final document to SECBO, indicating in the Board Submission Form that the PD may be made available to the public. SECBO notifies IDU and the InfoShop that the PD may be made available to the public.

12. Signing and Effectiveness. Once the Bank approves a development policy operation, authorized representatives of the borrower and the Bank sign the legal agreements for the loan. After signing, the legal agreements become effective only after the borrower furnishes to the

Bank satisfactory evidence that the borrower has met standard and special conditions of effectiveness. OP/BP 13.00, Signing of Legal Documents and Effectiveness of Loans and Credits, sets out the relevant requirements and procedures.

Development Policy Operations with Deferred Drawdown Option

13. Throughout the deferment period of a DDO or a Cat DDO, the Bank maintains a close policy dialogue with the borrower. As part of regular loan supervision and at least every 12 months, the Bank reviews the borrower's continuing adherence to the overall program laid out in the LDP; and, for a DDO, the adequacy of the borrower's macroeconomic policy framework. If at any time during the deferment period the Bank concludes that the borrower no longer complies with the LDP program (or, for the DDO, no longer has an adequate macroeconomic policy framework), the Bank promptly notifies the borrower, including the reasons for its determination; advises that if the borrower requests a drawdown it will be subject to a full review of program implementation (and, for the DDO, of the macroeconomic policy framework); works with the borrower to help it meet the relevant conditions; and notifies the borrower when those conditions are again met.

14. *Drawdown and Renewal*. The Bank responds rapidly with the disbursement to the borrower's request to draw on the loan (for the Cat DDO, after confirming that the natural disaster trigger has been met). However, if the Bank has previously advised the borrower that it does not meet relevant conditions for the drawdown (set out in OP 8.60, para. 22) and the borrower has not yet returned to compliance with those conditions, the Bank conducts a full review of the overall program implementation (and, for the DDO, of the macroeconomic policy framework) as early as possible on receipt of the borrower's drawdown request. Once the Bank confirms that the borrower has met the relevant drawdown conditions the Bank proceeds with disbursement. DDOs and Cat DDOs can be renewed with approval of the RVP provided that the overall program continues to be implemented in a manner satisfactory to the Bank and macroeconomic policies are adequate.

Supervision, Monitoring, and Evaluation

Supervision

15. Supervision of a development policy operation covers monitoring, evaluative review, reporting, and technical assistance activities to:

a) ascertain whether the borrower is carrying out the program with due diligence to achieve its development objectives in conformity with the legal agreements;
b) identify problems promptly as they arise during implementation and recommend to the borrower ways to resolve them;
c) recommend changes in program concept or design, as appropriate, as the program evolves or circumstances change;
d) identify the key risks to program sustainability and recommend appropriate risk management strategies and actions to the borrower; and
e) prepare the Bank's Implementation Completion Report (ICR), and draw lessons to improve the design of future operations, sector and country strategies, and policies.

16. In supervising a development policy operation, the task team monitors the country's overall economic performance and the timely adoption and effective implementation of the agreed program conditions. For multiple-tranche operations, the task team assesses the borrower's progress toward meeting the conditions for release of the next tranche. For programmatic operations, the task team assesses the borrower's progress in implementing the expected actions for the subsequent operation in the series. The task team also validates the borrower's monitoring and evaluation findings on the progress and results of program implementation. The task team consults and coordinates with the IMF and any cofinanciers in carrying out its supervision work.

17. During program implementation, if priorities or circumstances surrounding the program change, it may be desirable to introduce corresponding changes in the development operation, its design, or the implementation arrangements. On receipt of a written request from the borrower for the change, the country director, in consultation with the team leader and the lawyer, determines whether the change is significant or minor. Significant changes in the operation are submitted for approval to Executive Directors. Minor changes are submitted to the country director for approval.

Supplemental Financing

18. Before considering supplemental financing, Bank staff work with the borrower to explore other solutions, including identifying alternative sources of funds. Staff develops a concise program document, known as the Supplemental Financing Document (SFD), that explains why supplemental financing is needed and what measures have already been taken to deal with the situation. The SFD sketches the recent developments relevant to the program and shows that the criteria for supplemental Bank financing have been met. It also describes any changes required in the loan documents. Supplemental financing is provided as a separate loan and constitutes a new loan commitment. The financial terms and conditions for the supplemental loan are set in accordance with the provisions of OP 3.10, Financial Terms and Conditions of IBRD Loans, IBRD Hedging Products, and IDA Credits. The legal documentation for a supplemental loan usually consists of an amendment to the Loan Agreement. The supplemental loan is normally considered at a Board meeting under standard procedures. However, Board approval may be sought under streamlined procedures when (a) the supplemental financing raises no complex or controversial issues; (b) the proposed loan is small relative to the original operation; (c) the loan does not involve a major change in the Bank's share of financing; and (d) no substantial changes are proposed in the program objectives or design. The SFD is disclosed following the same procedures as for the PD (para. 11.).

Tranche Release

19. During the preparation of a TRD the team leader consults with the borrower to identify any sections of the TRD that are confidential or sensitive, or likely to adversely affect relations between the borrower and the Bank. As appropriate, the team leader makes adjustments to the TRD to deal with any matters raised by the borrower.

20. When the borrower has in all material respects satisfactorily met the conditions for tranche release specified in the Loan Agreement, the Regional vice president approves the tranche release and sends the announcement to SECBO, indicating in the Board Submission Form that the TRD will be made publicly available. The MOP that accompanies the TRD may incorporate any information raising issues of confidentiality, sensitivity, or adverse relations between the borrower and the Bank that the Regional vice president wishes to convey to Executive Directors. SECBO distributes the TRD to Executive Directors for information and notifies IDU and the InfoShop that the TRD may be made available to the public.

21. Board approval is required for a waiver or amendment of loan agreement requirements. If the borrower has not met the tranche release conditions and the Region proposes to waive or amend the loan agreement requirements, the Regional vice president consults with the Managing Director concerned before recommending approval of the tranche release and sending the announcement to SECBO for issuance to Executive Directors for approval on a non-objection basis.

Contractual Provisions

22. The following contractual provisions for Bank loans are relevant for development policy operations: Closing Dates (OP/BP13.30), Suspension of Disbursements (OP/BP13.40), Cancellations (OP/BP13.50).

Evaluation

23. The task team prepares an ICR on completion of an operation. For programmatic development policy lending, an ICR is prepared on completion of the program and includes a separate assessment of the contribution of each individual operation to the program. The ICR assesses (a) the degree to which the program achieved its development objectives and outputs as set out in the program documents; (b) other significant outcomes and impacts; (c) prospects for the program's sustainability; and (d) Bank and borrower performance, including compliance with relevant Bank policies. It draws on the data and analysis to substantiate these assessments, and it identifies the lessons learned from implementation.

[1.] "Bank" includes IBRD and IDA, and "loan" includes IDA credit and IDA grant. "Borrower" includes borrower and IDA grant recipient.

[2.] See Bank-Fund Collaboration in Assisting Member Countries (R89-45), March 31, 1989.

[3.] Examples of the Concept Document and other development policy lending documents are available at the World Bank OPCS website.

[4.] See OP 8.60, Development Policy Lending, paras. 24-26.

[5.] For internal guidelines to assist in the application of OP and BP 8.60 on the corporate review process and the Operations Committee, staff may refer to the OPCS website.

[6.] If the Bank needs to conduct a full review of the macroeconomic framework and overall program implementation, Bank staff examine and Bank management makes a judgment on the adequacy of the macroeconomic policy framework, taking into account the Fund's assessment, and on the continued consistency of government actions and policies with the objectives of the program agreed at negotiations and set out in the LDP. Depending on country and external developments, government actions may remain consistent with the objectives of the program even if one or more prior actions might have been partly or fully reversed. In such a case, Management would consider the drawdown condition on adherence to the program fulfilled.