

IDA's Hybrid Financial Model

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The International Development Association (IDA) is the world's largest source of development finance for low-income countries. IDA provides concessional loans and grants to support economic growth so that countries can chart their own long-term future, free of donor support. Currently, IDA provides nearly one third of its financing in the form of development grants.

IDA's hybrid financial model

From 1960 to 2017, IDA depended largely on donor contributions. In 2017, IDA introduced a hybrid financial model that enabled it to use its equity to access funds from capital markets. By combining these funds with donor contributions and other income, IDA could substantially increase the financing it provides to client countries. In its most recent replenishment cycle (IDA20), IDA was able to multiply donor contributions by a factor of 3.5.

As part of its financial model, IDA manages various risks to maintain the confidence of donors, borrowers, investors, counterparties, and rating agencies. These include:

- **Country credit risk** – borrower countries being unable to repay their loans.
- **Counterparty credit risk** – parties (non-borrowers) in market-facing financial transactions defaulting on their obligations.
- **Market risk** – factors such as fluctuations in interest and exchange rates.
- **Liquidity risk** – a lack of cash or liquid assets, or the inability to access funding when needed.
- **Operational risk** – potential losses arising from internal processes, systems, or human error.

IDA's Capital Adequacy Framework is a critical part of its risk management strategy.

What is capital adequacy and why is it important?



Capital adequacy refers to the ability of a financial institution, such as a bank, to meet its financial obligations, including to investors, after absorbing potential losses in a stressed economic environment. It is a measure of financial strength and stability, typically measured by calculating the ratio of a bank's available capital to the capital required to cover its losses. For multilateral development banks such as the World Bank, of which IDA is a part, capital requirements are determined by the bank's desired credit rating and risk appetite, among other factors.

Triple-A credit rating

Triple-A is the highest credit rating and signifies that an entity has a very low risk of defaulting on its financial obligations. To determine an entity's creditworthiness, credit-rating agencies assess various factors, including capital adequacy. IDA, the International Bank for Reconstruction and Development (IBRD), and the International Finance Corporation (IFC) all have triple-A credit ratings, which confer benefits such as enhanced ability to access funds from the markets, increased investor confidence, and lower borrowing costs that can support lending.



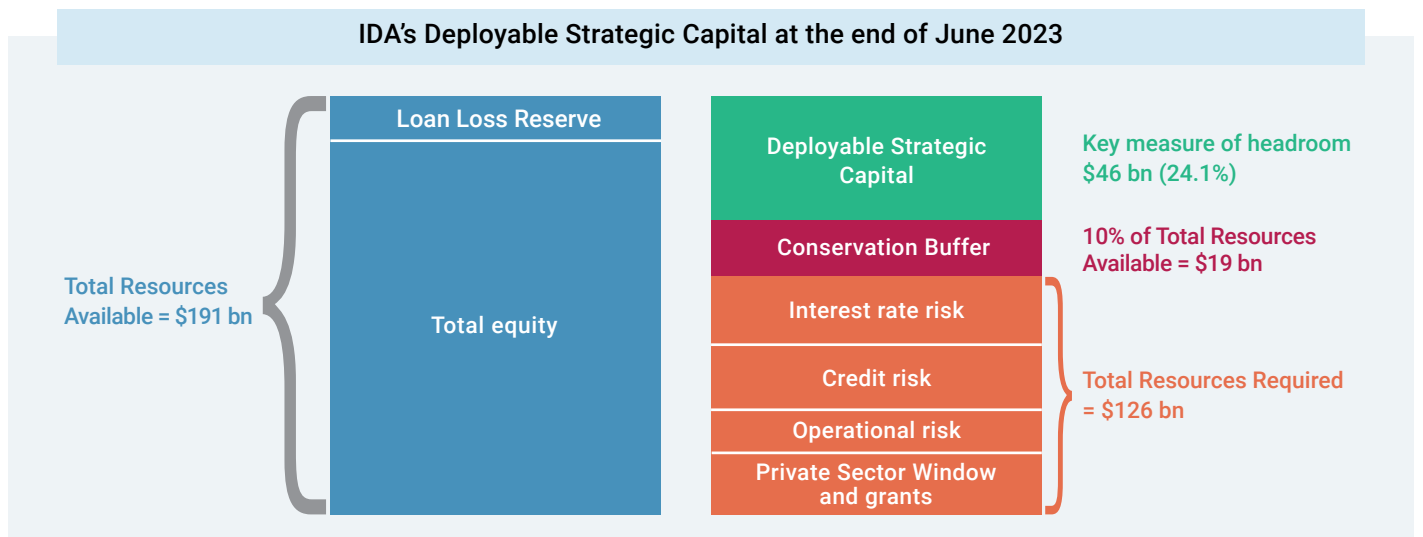
What is IDA's Deployable Strategic Capital?



IDA's Capital Adequacy Framework has four main components: Total Resources Available (TRA), which is essentially a measure of available equity to cover losses during a shock; Total Resources Required, which measures the minimum amount needed to cover potential losses from operations and assets; a Conservation Buffer that serves as an additional safety net; and Deployable Strategic Capital (DSC).

Deployable Strategic Capital is the main measure of IDA's capital adequacy. It is calculated by subtracting Total Resources Required and the Conservation Buffer from Total Resources Available. This metric provides key information to assess IDA's capital position, manage risks, ensure stability, and support decision making, showing IDA's "headroom" for capital that can be used in new lending operations. IDA's Board requires IDA to keep its Deployable Strategic Capital ratio (DSC/TRA) at levels higher than or equal to zero percent so that it can maintain its triple-A credit rating.

Major factors affecting Deployable Strategic Capital include increased lending to riskier countries or shocks to countries' credit profiles, an increased share of concessional loans, and increased grant financing.



How will IDA21 affect Deployable Strategic Capital?

IDA has calibrated its Deployable Strategic Capital model to maintain a triple-A credit rating, which enables it to provide large low-interest loans and grants to clients, even in stressed market environments. With each replenishment IDA faces a trade-off between the volume of financing, the level of donor contributions, and the financing terms provided to borrowers. These same considerations will come into play as IDA Deputies determine the total amount to be made available for IDA21.