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**IDA18 IFC-MIGA PRIVATE SECTOR WINDOW (PSW)**

**IDA18 Mid-Term Review**

**October 24, 2018**

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ACRONYMS AND ABBREVIATIONS

Fiscal year (FY) = July 1 to June 30

ABI	Atlantic Business International	IDLC	Industrial Development Leasing Company
AIMM	Anticipated Impact Measurement and Monitoring system	IFC	International Finance Corporation
ANZ	Australia and New Zealand Banking Group	IFI	International Financial Institutions
BFC	Blended Finance Committee	IMPACT	Impact Measurement and Project Assessment Comparison Tool
BFF	Blended Finance Facility	IPAE	Investisseurs et Partenaires Afrique Entrepreneurs
BOAD	Banque Ouest Africaine de Développement	LCF	Local Currency Facility
CAFEF	Conflict-Affected and Fragile Economies Facility	LICs	Low-income Countries
CD	Country Director	LLP	Loan Loss Provisions
CFAA	Country Financial Accountability Assessment	MDBs	Multilateral Development Banks
CMAW	Creating Market Advisory Window	MFD	Maximizing Finance for Development
CMU	Country Management Unit	MGF	MIGA Guarantee Facility
CPF	Country Partnership Framework	MICs	Middle-income Countries
CPSD	Country Private Sector Diagnostics	MIGA	Multilateral Investment Guarantee Agency
CRO	Chief Risk Officer	MSME	Micro, Small and Medium Enterprises
CRRH	Caisse Regional de Réfinancement Hypothécaire	ODA	Official Development Assistance
DEIS	Development Effectiveness Indicator System	ODI	Overseas Development Institute
DFE	Development Finance Forum	OPCS	Operations Policy and Country Services
DFIs	Development Finance Institutions	PE	Private Equity
DFi	Development Finance Vice Presidency	PPP	Public Private Partnership
DOTS	Development Outcomes Tracking System	PRI	Political Risk Insurance
FCS	Fragile and Conflict-Affected State	PSD	Private Sector Development
FCV	Fragility, Conflict and Violence	PSW	Private Sector Window
GAAP	Generally Accepted Accounting Principles	RMF	Risk Mitigation Facility
GAFSP	Global Agriculture and Food Security Program	RMS	Results Measurement System
GCI	General Capital Increase	RSA	Risk Sharing Agreement
HKL	Hattha Kaksekar Limited	RSF	Risk Sharing Facility
IAD	Internal Audit Vice Presidency	SCD	Systematic Country Diagnostic
JCAP	Joint Capital Markets Initiative	SDGs	Sustainable Development Goals
IBRD	International Bank for Reconstruction and Development	SIB	Société Ivoirienne de Banques
IDA	International Development Association	SLGP	Small Loan Guarantee Program
		SME	Small to Medium Sized Enterprise
		SUF	Scale Up Facility
		TCX	The Currency Exchange Fund
		UNCDF	United Nations Capital Development Fund
		WAEMU	West African Economic and Monetary Union
		WBG	World Bank Group
		XOF	West African CFA Franc

## EXECUTIVE SUMMARY

**i. The IDA18 IFC-MIGA Private Sector Window (PSW) is a key innovation introduced by IDA18.** By leveraging IFC and MIGA business platforms, for the first time IDA can provide direct support to the private sector in the poorest and most fragile IDA markets. With an initial allocation of US\$2.5 billion and four different facilities, PSW is designed to help mobilize private investments in difficult markets by transferring risks in IFC and MIGA supported investment operations to IDA. Built upon a One-WBG model, PSW is IDA's deliberate effort to maximize finance for development and an important tool to support IFC's General Capital Increase (GCI) policy package and its 3.0 Creating Market strategy, as well as MIGA's FY18-FY20 Strategy which focuses on IDA and FCS countries. Globally, PSW is a concrete example of how the WBG puts the blended finance concept into practice and constitutes a major scale-up effort to target the poorest and most fragile markets.

**ii. During its first 15 months IDA18 PSW has had a solid start.** Following IDA Partners endorsement and approval by the Boards, an innovative joint platform for all three WBG entities was set up with an operational framework that includes interface with frontline teams, governance framework, and necessary back-office functions. Outreach within the WBG and externally to private sector clients has been extensive, given the origination challenges in IDA markets and, while the dissemination of knowledge of PSW is still work-in-progress, the combination of a wide outreach effort, connection to the broader Maximizing Finance for Development agenda, and sustained engagement with shareholders and Partners is paying off.

**iii. Twelve transactions and one program have been approved for PSW support in the first 15 months, demonstrating that IDA can help IFC and MIGA close projects in challenging markets.** A total amount of US\$185 million of IDA resources has been committed, enabling a total of US\$608 million of IFC/MIGA investments/guarantees, and about US\$800 million additional private financing. Aggregated subsidies, as part of the total amount of PSW resources approved, stand at about US\$42 million – averaging around US\$4 million per project and 5 percent of total project costs. Support has been provided through three out of the four PSW Facilities. No project under the Risk Mitigation Facility has been approved yet, reflecting the complexity and longer time required to structure infrastructure projects. SMEs (including in the agriculture sector), housing finance, renewable energy, manufacturing, and telecom sectors have received the most support. Africa and Asia are the main regions in which most transactions were approved. From the 12 projects, 5 country-specific projects are located in 4 fragile states, and 6 fragile states are set to benefit from other regional transactions and platforms. The median size of PSW-supported projects is US\$50 million and the average PSW allocation use is US\$9 million per transaction.

**iv. While small in comparison to IDA, IFC, and MIGA's own traditional portfolio supporting the private sector, these initial PSW transactions are expected to have high development impact.** IDA support to private sector development more broadly has remained strong thus far in the first half of IDA18 with commitments of around US\$11.5 billion overall. PSW projects are complementary to IDA operations on the public sector side. Despite the relatively small amounts deployed, strong development impact is expected, particularly in the realm of SME financing, a critical sector in IDA countries. On expected outcomes, these include over 25,000 SMEs to be reached (through risk sharing facilities); 15,000 small loans the majority

of which will be to women; and support to 3,000 farmers. PSW has also introduced several innovations, such as the first bond issuance in Cambodia, first targeted private equity fund in the Kyrgyz Republic, and a global risk-sharing platform, all supporting SME financing.

**v. Pipeline and mid-stream opportunities indicate that over US\$2 billion out of US\$2.5 billion of PSW could be committed in IDA18 and that potential for utilization of the four facilities will likely be different from the initial notional allocation.** The Blended Finance Facility (BFF) and Local Currency Facility (LCF) are expected to be fully utilized and could meet additional demand. A growing Risk Mitigation Facility (RMF) pipeline indicates that a number of RMF-supported projects are expected to be committed during the second half of IDA18 but may not fully utilize the US\$1 billion initial allocation. The MIGA Guarantee Facility's (MGF) pipeline is developing robustly, but should some of the larger projects not materialize in time, this facility may also use less resources than originally envisaged. Given the nature of IFC and MIGA's business, the PSW pipeline is expected to continue evolving dynamically and less predictably than the traditional IDA pipeline.

**vi. True to the "learning by doing" approach, initial experience has led to some early lessons centered on additionality, concessionality/subsidy, governance, and risk.** Each facility also has its own lessons based on operational experience. Many of the lessons and forward looking considerations identified in this report are aligned with the findings of the recent Assurance Review conducted by the World Bank's internal auditors.

- **Understanding of the concept of additionality is evolving based on project experience.** Assessing whether projects are appropriate for PSW support requires judgment and an appreciation of IFC and MIGA's business models. While articulating the scale and scope additionality can be very project and context specific, a common understanding of PSW additionality is evolving as more experience is accumulated by WBG teams. This understanding is anchored in having an economic rationale for using concessionality, including whether PSW is addressing risk tolerance, positive externalities, market failures, or affordability considerations.
- **Similarly, minimum concessionality is a complex consideration, combining analytic tools and judgement.** Approximately, ninety percent of PSW resources allocated so far involved some form of embedded subsidies – half of them targeted at minimizing incremental financing costs to project beneficiaries. Experience to date suggests a correlation between the level of subsidy required and the PSW instrument used (e.g., local currency swaps and risk-sharing facilities tend to require a higher level of subsidy). There is also a trade-off between subsidy intensity and PSW exposure (for a similar level of risk transfer, PSW can have a small, highly subsidy-intense exposure or a larger, much less subsidy-intense exposure). The growing experience and data on subsidy use can inform IDA's future decisions.
- **PSW Governance needs to take into account both the need for accountability and greater efficiency.** The PSW governance process built in a clear design intent to advance WBG synergies. While critical for accountability and for broadening the understanding of the PSW, its efficiency is hampered by a steep learning curve and by the large number of

small and diverse transactions to be reviewed. Larger infrastructure projects as well as Programmatic platforms, such as the Small Loan Guarantee Program (SLGP), can improve efficiency and reduce costs, while allowing PSW to achieve scale. Further familiarity with the PSW across the World Bank Group will also enable some simplification in due course.

- **Balancing the trade-off between financial risks considerations for PSW and the development impact PSW aims to achieve.** The limited track record on PSW exposures, combined with the lack of financial performance data to date, warrants leaving PSW's current risk management approach unchanged. Management has observed that most approved transactions so far have been structured with IDA taking a significant portion of the risk: subsidy levels in PSW transactions might reduce PSW capital over time, particularly in cases where pricing does not cover expected losses. PSW investment decisions are informed by a clear line of sight to additionality and impact on the one hand, and financial risks faced by IDA on the other.

**vii. Building on the experience so far, Management will continue PSW implementation with rigor while learning to adapt for the remainder of the IDA18 Replenishment period.** IDA, IFC, and MIGA teams will continue fine-tuning the four facilities and governance processes to ensure accountability, while enhancing efficiency. Where appropriate, programmatic approaches will be used for better impact and more efficiency.

**viii. Management would welcome IDA Partners' views on the following:**

- Do Partners concur with the initial lessons learned from implementing PSW?
- Do Partners support the proposal to request IDA Board's approval of delegated authority to IDA Management to process sub-projects under programmatic approaches?
- Do Partners support that Management retains flexibility for potential reallocations away from PSW depending on pipeline development?

## I. INTRODUCTION

1. **The IDA18 IFC-MIGA Private Sector Window (PSW) is an important innovation as part of the IDA18 transformational package.**<sup>1</sup> Responding to the call for mobilizing the private sector to support IDA countries' economic transformation efforts, PSW is a partnership among IDA, IFC and MIGA to maximize private finance for development. By leveraging IFC and MIGA business platforms, for the first time, IDA is able to provide direct support to the private sector in the poorest IDA markets. During the IDA18 replenishment discussion, IDA Partners expressed strong support for the creation of the PSW. They encouraged IDA Management to “pursue a flexible ‘learning by doing’ approach, recognizing that the PSW will require engaging in difficult markets with a high degree of uncertainty.”

2. **This paper responds to Partners' request to take stock of progress, discuss lessons learned from the initial phase of implementation, and introduce next steps.** This builds on the PSW progress updates that were provided at the IDA technical sessions at the sidelines of Spring and Annual Meetings. The paper is structured as follows: Section II briefly revisits the main features of PSW design; Section III provides the context of PSW implementation in the first 15 months of IDA18 replenishment period; Section IV presents the implementation progress of PSW including setting up the operational platform, commitments, expected results and pipeline; Section V shares the initial lessons learned from PSW implementation; last, Section VI concludes with recommendations for the remainder of the IDA18 period and beyond.

## II. STRATEGIC OBJECTIVES AND MAIN DESIGN FEATURES

3. **PSW is designed to mobilize private sector investments in underserved sectors and markets in the poorest and most fragile IDA countries.** With an initial allocation of US\$2.5 billion under IDA18 three-year cycle, PSW is designed to mobilize private investment into difficult markets and a broader variety of sectors for greater impact beyond the scope that existing instruments allow. These PSW-supported investments are intended to show other investors that such undertakings can be profitable and thus open up opportunities for future private investment. These investments provide positive externalities including proof of concept, skills development and training, and market development.

4. **PSW is built upon a One-WBG model that leverages business platforms and skills across the three Institutions, with the explicit objective of catalyzing WBG synergies and pushing the boundaries of collaboration.** This unique program expands the role of IDA from financier of policy and public-sector projects, to one of catalyst of private financing. It enables IFC and MIGA to develop and support private investments that they would not otherwise be able to finance or guarantee. Its innovative upstream engagement and governance process are designed to enable WBG collaboration in an unprecedented way.

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<sup>1</sup> “Operationalizing the IDA18 IFC-MIGA Private Sector Window” (IDA/R2017-0078/1) and updated version (IDA/R2017-0347).



5. **The four facilities under PSW were created to address specific risks in challenging markets with an emphasis on learning what works.** Each facility aims at specific forms of investment requiring specific types of risk mitigation<sup>2</sup>.

- i. The *Risk Mitigation Facility* (RMF) provides project-based guarantees without sovereign indemnity to crowd in private investment in large infrastructure projects and public-private partnerships supported by IFC with MIGA as an administrator. The initial allocation of this facility was US\$1 billion.
- ii. The *MIGA Guarantee Facility* (MGF) expands the coverage of MIGA guarantees through shared first-loss and risk participation akin to reinsurance, for investments in areas such as infrastructure, agribusiness, manufacturing and services, financial markets and PPPs. The initial allocation of this facility was US\$500 million.
- iii. The *Local Currency Facility* (LCF) provides local currency solutions to reduce currency risk for impactful projects while supporting capital market development in countries where such solutions are absent or underdeveloped. The initial allocation of this facility was US\$400 million.
- iv. The *Blended Finance Facility* (BFF) blends PSW support (in the form of debt, equity and guarantees) with IFC investments across different sectors with high development impact. The initial allocation of this facility was US\$600 million.

6. **Management committed to implement PSW with rigor while learning to adapt.** The PSW includes a diverse set of facilities to address risks, test demand, finetune the modalities for supply, and assess impact – with a view to replicating successful modalities and provide lessons learned. Initial allocations were set with the knowledge that these may need to be adjusted depending on demand. Through a set of eligibility criteria<sup>3</sup> around additionality, impact, and potential for financial sustainability, and a deliberate governance process, clear discipline, accountability and efficiency have been built into the management of PSW resources. The substantial financial risks carried by PSW were clearly acknowledged upfront and recognized by IDA Partners. IDA Management committed to closely monitor the financial risks and performance experience of PSW and refine the risk management approach over time. Executing, monitoring, reporting, learning and adapting are critical parts of PSW implementation.

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<sup>2</sup> “Operationalizing the IDA18 IFC-MIGA Private Sector Window” (IDA/R2017-0078/1) and updated version (IDA/R2017-0347).

<sup>3</sup> These criteria are in line with Blended Finance Principles broadly agreed amongst DFIs. In October 2017, the DFI Working Group on Blended Concessional Finance chaired by IFC, developed the blended concessional finance enhanced principles for private sector projects (“DFI Working Group on Blended Concessional Finance for Private Sector Operations Summary Report”, October 2017). These enhanced principles were adopted by 23 DFIs, and the DFI working group continues its activities to exchange experiences in the implementation of these principles and refine data collection efforts.

### III. CONTEXT OF PSW IMPLEMENTATION IN THE FIRST HALF OF IDA18

7. **Increasingly, “blended finance”<sup>4</sup> has emerged as an important tool in mobilizing private capital to markets most in need.** The articulation of blended finance as a concept is becoming clearer among development finance practitioners. Private investors can bring capital, innovation and efficiency to development solutions, but must achieve the objective of financial sustainability in the face of high risks and costs in the most challenging environments. In contrast, development finance institutions and development partners have a primary objective of maximizing development impact with their public funds and bring their extensive knowledge of development processes and country contexts. Blended finance marries these two objectives. To support critically impactful but highly risky operations, blending private and public funds provides an opportunity to spread risk and create a more attractive risk-reward profile for investors seeking commercial returns, in anticipation of them eventually operating at a financially sustainable basis.

8. **Policy discussion on blended finance has accelerated in the past year and experience from PSW has contributed practical lessons to the discussion.** In addition to the DFI Working Group on Blended Concessional Finance's work on "enhanced principles of blending concessional finance for private sector projects", the OECD has produced principles of blended finance, endorsed by the OECD Development Assistance Committee High Level Meeting in 2017. These OECD principles are broad-based and address more policy aspects than the DFI enhanced principles, which are focused at a practitioner level. The Overseas Development Institute (ODI) and the United Nations Capital Development Fund (UNCDF) have launched studies on development finance which show a total of US\$81 billion of concessional resources invested by MDBs and DFIs' in emerging markets overall from 2012-2016. The body of this research points out that development finance funds appear to be invested in low hanging fruits in MICs rather than being targeted at the earliest stages in the investment cycle to overcome the most pervasive market failures in LICs.<sup>5</sup> As a group, for the DFIs focusing on private sector operations in 2017, the largest share of blended concessional funds was invested in lower middle-income countries, with significant emphasis in Sub-Saharan Africa.<sup>6</sup> It would be important to monitor whether this is the start of a trend that continues, including with the support of PSW resources, in the future. The Center for Global Development has also carried out important analytical work on different aspects of blended finance and advocated various ideas to advance blended finance.

9. **The rationale for creating PSW to mobilize private investment in IDA-only and IDA-eligible FCS countries remains compelling in the first phase of PSW implementation.** The global development community continues to emphasize the importance of mobilizing private investments towards the Sustainable Development Goals (SDGs). Private sector investment in low income countries and fragile states requires special attention. In endorsing the capital increase

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<sup>4</sup> “Blended finance” in this case is defined broadly as blending concessional and commercially priced finance in private sector projects.

<sup>5</sup> The research suggests that this is partly reflective of conservative MDBs and DFIs risk appetites and argues that these institutions need to be provided with more headroom to engage in riskier markets using both their own resources and bilateral and multilateral grants which they can use to blend in LICs. Attridge, S. and Engen, L. (2018, forthcoming), *“Shifting the financing needle in LICs: understanding blended finance in a LIC context”*. And UNCDF, *“The Role of Blended Finance in the LICs”*.

<sup>6</sup> DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update.

package for IBRD and IFC on April 2018, the Development Committee Communique noted that “as the main driver of investment, innovation and jobs, the private sector needs to play a much greater role in development... the WBG must continue to crowd in private sector resources... IDA’s increased focus on jobs and economic transformation, including through the innovative Private Sector Window, is encouraging investment in IDA countries.”

**10. Within the WBG, PSW implementation is part of a stronger WBG push to mobilize private investment and maximize development finance in the poorest IDA and fragile markets.** IDA is continuing its work to create the conditions and enabling environment for the private sector to operate. Together with IDA, IFC and MIGA continue focusing on expanding their activities and support in IDA countries and the most challenging environments.

- *IDA support to private sector development has remained strong in the first 15 months of IDA18. Of the nearly US\$27 billion IDA commitments as of September 2018, about US\$11.5 billion supports private sector development.<sup>7</sup>*
- *In FY18, IFC’s own account commitments in IDA countries reached US\$1,874 million, with a total mobilization of US\$4,963 million and total financing volume of US\$6,837 million. IFC Advisory work sustained a ramp up of upstream efforts delivering US\$147 million of services in IDA/FCS countries.*
- *In FY18, MIGA issued gross guarantees of US\$1.24 billion in IDA eligible countries in support of 13 projects.*

**11. Key to IFC’s General Capital Increase (GCI) policy package and IFC’s 3.0 strategy of creating markets, PSW is an essential tool to support IFC’s commitment to significantly step up its engagement in the most difficult IDA markets and aligns incentives for ever closer collaboration among WBG institutions.** With the GCI agreement with its shareholders, IFC has the long-term ambition to step up financing in IDA and FCS countries to 40 percent of its total commitments by 2030, as well as to increase the share of its annual commitments in Low Income IDA countries and IDA FCS economies to reach 15-20 percent of its total annual commitments. This strategic shift will need an array of risk mitigation tools to be in place in order to maintain IFC’s financial sustainability in the long term. De-risking mechanisms such as the PSW are ideally suited to play this role and will be needed for IFC to meet its ambitions. As part of its 3.0 strategy, IFC has developed an array of tools that are complementary to PSW, such as: (1) **Country Private Sector Diagnostics** (CPSDs) & Sector Deep Dives which help IFC analyze and understand opportunities in a country or sector in coordination with the World Bank; (2) the **Creating Markets Advisory Window** (CMAW), a funding source that helps IFC jumpstart work in IDA and FCS countries through undertaking diagnostics and preparing advisory projects to support clients and potential clients; and, (3) the **Anticipated Impact Measurement and Monitoring** (AIMM), a key new tool that IFC uses to assess, select, and articulate the expected development impact of its projects.

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<sup>7</sup> IDA support to private sector development comprise commitments which directly or indirectly support private sector growth: Water, Sanitation and Waste Management; Transportation; Energy and Extractives; Information and Communication; Industry, Trade and Services; and Financial Sector.

12. **MIGA’s FY18-20 Strategy lays out three focus areas: IDA, FCS and Climate change.** MGF is proving to be instrumental for MIGA to expand its activities in the toughest markets. All three projects approved under MGF in FY18 were in FCS countries – Afghanistan, Myanmar, and Sierra Leone.

13. **Bringing IDA, IFC and MIGA together, PSW puts WBG collaboration into practice as a concrete Maximizing Finance for Development (MFD) initiative to better align the WBG institutions around private investment for development.** Building on continuous efforts to shift the three institutions—WB, IFC, MIGA—to work in an ever more coordinated fashion, MFD represents the WBG’s effort to address development challenges by considering a spectrum of public-private WBG solutions that leverages the private sector in sustainable ways and which bolster scarce public resources. As a de-risking tool in the MFD framework, PSW is designed deliberately to leverage WBG platforms and collaboration to advance the MFD agenda. PSW-supported projects open an opportunity for a collaborative process to align WBG interventions at the transaction level, while facilitating discussions by WBG teams on the needed sector strategy based on a common understanding of public and private solutions in the medium term. PSW delivers these projects in some of the most challenging environments, and it does so with a rigorous justification of why blending concessional funds with private investment is required.

14. **PSW is a concrete example of how the WBG puts the blended finance concept into practice and constitutes a major scale-up effort to target the poorest and most fragile markets.** Overall, blended finance remains a small share of development finance and even less blended finance flows into the poorest countries. Programs targeted to low income and fragile countries where the risk-reward ratio is unattractive, and investors are not willing to invest on their own, are only recently emerging. PSW is helping to test blended finance in these most challenging environments and draw lessons for future replication. In terms of volume, assuming a major portion of the allocated US\$2.5 billion is committed during IDA18 and a healthy mobilization ratio, PSW is expected to significantly increase the volume of private financing flow to the poorest IDA markets.

#### **IV. PSW IMPLEMENTATION PROGRESS: SETTING UP THE OPERATIONAL PLATFORM, COMMITMENTS, PIPELINE, EXPECTED RESULTS, AND REPORTING**

##### **A. SETTING UP THE OPERATIONAL PLATFORM**

15. **Translating IDA Partners’ endorsement of a policy idea into an operational framework took time and dedication from the three institutions, with extensive engagements with the Boards of each of IDA, IFC and MIGA.** The initial design of PSW was discussed by the IDA Partners on two separate occasions<sup>8</sup>, prior to the endorsement as part of the IDA18 package and at the December 2016 Replenishment meeting.<sup>9</sup> Following that, the operational framework was reviewed by the Board Audit Committee and approved by the Boards of the WBG institutions in

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<sup>8</sup> “WBG Collaboration: Proposal for an IFC-MIGA Private Sector Window in IDA18” (June 8, 2016) and “Further Details on the proposed IFC-MIGA PSW in IDA18” (Sept. 16, 2016).

<sup>9</sup> “IDA18: Towards 2030—Investing in Growth, Resilience and Opportunity, Jan 12, 2017 (modified Jan 31, 2017)

April 2017. Technical briefings and bilateral consultations were conducted prior to the Board discussions. Additional adjustments were approved in December 2017.<sup>10</sup>

**16. Establishing a joint platform for three legal entities, with separate management teams, operational procedures, balance sheets and accounting processes, was a complex task.** In parallel to the discussion during the IDA18 replenishment and with the Boards, Management initiated detailed implementation arrangements for PSW governance and decision-making, cost recovery, loan loss provisioning requirements, accounting and disclosure.<sup>11</sup> On the financial side, IDA, MIGA and IFC negotiated and signed a cost recovery and fees arrangement to share risks and costs. The three institutions also worked together to develop a new loan loss provisioning (LLP) framework<sup>12</sup> for PSW transactions by leveraging the expertise, experience and approaches of all the institutions. In addition, respective accounting systems have been upgraded to allow the three institutions to transact with each other. This has implied on the IDA side, for instance, changes in the loan disbursement systems to account for loans/guarantees disbursed to IFC and MIGA and not only to IDA member countries. Likewise, from a legal and administrative perspective, framework agreements and underlying contracts were drafted and agreed for each of the four facilities. These legal, financial and accounting arrangements are critical aspects of the PSW setup that required efforts by multiple teams from Legal, Risk, Treasury, and Accounting made up of members of each of the three WBG institutions.

**17. Deal origination in PSW-eligible markets does not come easy, and considerable efforts are underway to build a good pipeline of projects for PSW support.** Given the challenges in deal origination in IDA-only markets, efforts were initiated even in the run-up to IDA18 to mobilize a cadre of staff in the three institutions that serve as program sponsors to support pipeline development and advise on procedures for project processing compatible across the WBG. For IFC, senior staff have taken on the additional roles of Facility Coordinators for each of the three facilities and have stepped up to serve as PSW anchors in industry teams and country offices supporting regions or sub-regions. MIGA has assigned senior staff as PSW point contacts and has established a hub in Senegal to expand origination in Africa. Central units within IFC's Blended Finance Department, MIGA and DFi have been set up to support operational teams in obtaining approval of PSW transactions, including a PSW Secretariat in DFi and a PSW Coordination Unit in IFC. Monitoring and reporting processes have been established within the three institutions for management oversight and to enhance staff incentives.

**18. Outreach has been a critical element for the PSW roll-out.** Outreach and co-education efforts were undertaken and continue within and across the three institutions, both in the headquarters and in the field. Materials have been developed to support teams on facility-specific requirements and key elements of PSW transactions. As projects enter the pipeline, they are processed in accordance with the newly developed PSW specific procedures and are brought to the Board for approval. An increasing number of staff are becoming familiar with the potential for

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<sup>10</sup> "Operationalizing the IDA18 IFC-MIGA Private Sector Window" (Nov 20, 2017).

<sup>11</sup> "IDA/IFC/MIGA Procedure: PSW Oversight Committee" (Dec 23, 2017)"; IDA Procedure: PSW Secretariat and Representatives (Dec 19, 2017); IDA/IFC/MIGA Policy: PSW Bank Access to Information Policy Designation" (Dec 14, 2017); "PSW Cost Recovery and Fee Arrangements" March 5, 2018.

<sup>12</sup> While from a risk management perspective, PSW resources are fully set aside, the development of an LLP Framework for PSW transactions is a requirement under US Generally Accepted Accounting Principles (GAAP).

PSW, as well as the critical elements of successful project design. However, knowledge of PSW remains inconsistent and outreach across the three institutions will continue for the remainder of the IDA18 cycle to: 1. help broaden and solidify a common understanding of the PSW and its four facilities; 2. continue developing a pipeline; 3. recognize the potential to leverage the resources of IDA/IBRD to create an appropriate enabling environment for the private sector in eligible countries; 4. consider the use of PSW resources to enable projects which without an element of concessional finance would not pass concept stage at IFC or MIGA; and 5. facilitate the process

**Box 1: The WBG Development Finance Forum 2017 & 2018: Unlocking Investment Opportunities in Africa**

The DFF is the World Bank Group's flagship event that brings together investors, policy-makers, and thought leaders from different geographies to address critical development issues and design concrete actions. Following the conclusion of the IDA18 replenishment and the introduction of PSW, the 2017 and 2018 DFF have been devoted to increasing private sector investment and job creation in Africa.

The 2017 DFF was held in Ghana, May 31-June 1, with country-based sessions in Sierra Leone and Cote d'Ivoire. The Forum focused on Agribusiness, Energy, and ICT opportunities in West Africa. The 2018 DFF was held in Rwanda, September 11-12, focusing on Housing finance, Agribusiness and Tourism in the East African Community.

Both events served as prominent platforms to present the IDA18 package to the public and private sector participants, and PSW was introduced as a key tool. With early experience available, PSW-supported transactions were presented at the 2018 DFF as examples that can be replicated and scaled up for private investment opportunities.

of behavioral change for enhanced WBG collaboration. In addition, there has been external outreach to potential private sector clients by IDA, IFC and MIGA together and separately, including at joint WBG events such as the Development Finance Forum (DFF) in Ghana (2017) and Rwanda (2018). (see Box 1)

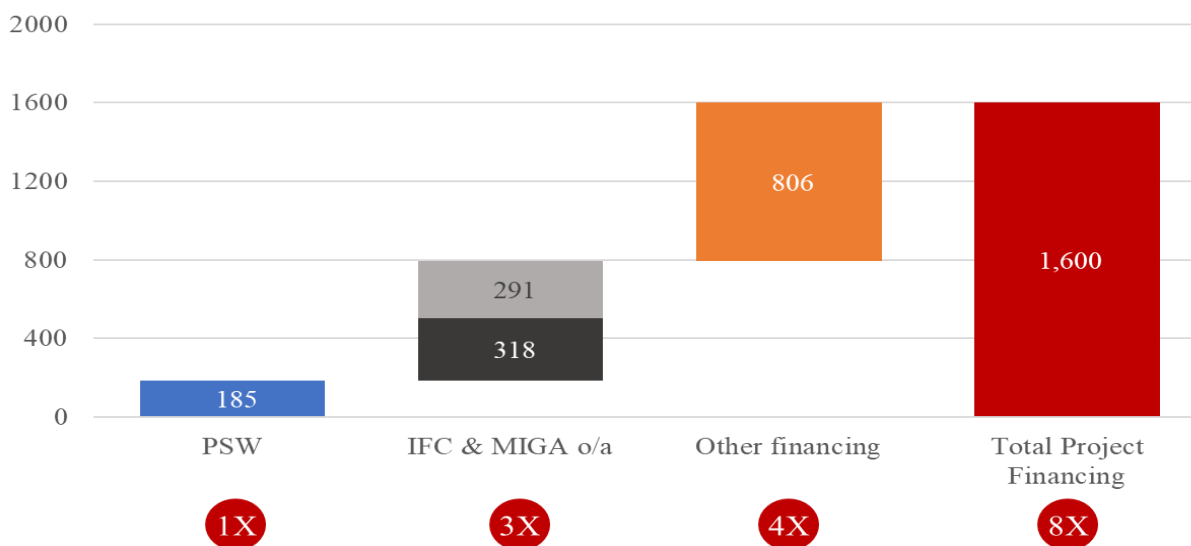
**19. PSW is the first IDA Window executed through IFC and MIGA, rather than just through the World Bank itself.** The completion of the PSW operational framework took time, and longer than expected, because of the significant resources required to build processes and systems to ensure proper coordination. The outcome of these efforts is an innovative framework to engage the three institutions in an unprecedented joint work which is of value in and of itself. The upfront investment was worthwhile to build the foundation for PSW implementation and a WBG platform for future endeavors. Nevertheless, given the three-year window of IDA18, the time taken to develop the operational framework has compressed the remaining time to deliver PSW transactions for Board approval.

**B. PSW COMMITMENTS TO DATE**

**20. The early transactions supported by PSW demonstrate that IDA PSW can help IFC and MIGA close transactions in challenging markets.** In the first 15 months of PSW operations, 12 transactions and one program have been approved by the Board(s) (see Annex 1 for full list of PSW commitments). A total amount of US\$185.5 million of IDA resources were committed, and this amount unlocked over US\$608 million of IFC investments and MIGA guarantees, and further

mobilized over US\$800 million of private financing. Overall, the total amount of activities financed per US\$1 of PSW resources is US\$8, a healthy ratio of 1:8 ratio.<sup>13</sup> The first three transactions of each Facility - MGF, LCF and BFF - were discussed and approved by the full Boards.

**Figure 1: PSW-approved projects - sources of financing**



21. **Some trends are emerging for PSW utilization so far.** The 12 approved projects have focused on SMEs, housing finance, renewable energy/energy efficiency, manufacturing, and telecom sectors. Six of these projects support SMEs in three novel ways: local currency financing in Cambodia, private equity funds in Kyrgyz Republic, Myanmar, and Africa, and risk-sharing mechanisms globally. Africa and Asia are the main regions for which transactions were approved. From the 12 projects, 5 country-specific projects are located in 4 fragile states<sup>14</sup> and up to 6 additional fragile states are set to benefit from other PSW-supported regional transactions and platforms. Very often, the investment in an FCS market is a result of extended advisory support and handholding, higher preparation costs, and overall sector improvements over multiple years. One of the first projects - the Afghanistan Rikweda Fruit Process Company - combined expertise and financing from all three institutions, with PSW support through the MIGA Guarantee Facility (see Box 2).<sup>15</sup>

22. **Like the transaction in Afghanistan, PSW transactions are often complementary to IDA interventions on the public sector side, reflecting the unique value-added of WBG solutions.** The West Africa housing finance transaction with Caisse Regional de Réfinancement Hypothécaire (CRRH) was complemented by an IDA Scale Up Facility (SUF) credit to the Banque

<sup>13</sup> The amount referred to in here includes all project financing, which is different from mobilization through PSW as provided in the PSW results framework in Annex 2. The latter follows the formal MDB definition for mobilization.

<sup>14</sup> Afghanistan, Sierra Leone, Myanmar, and Cote d'Ivoire.

<sup>15</sup> The PSW-supported Rikweda and Small Loan Guarantee Program (see Box 5) projects were both awarded the FY18 IFC Corporate Award for work that led to concrete results in support of IFC 3.0 strategy.

Ouest Africaine de Développement (BOAD) and an IDA grant to the West African Economic and Monetary Union (WAEMU).<sup>16</sup> The SME transactions often take place in a business environment where IDA provides broader support on improving regulatory reforms or capacity building for entrepreneurs. In the Pacific, the renewable energy transaction supported by PSW and IDA's public sector lending are targeting complementary market segments. This model of complementarity will continue and strengthen as WBG teams are engaged in more and more upstream discussion on sector challenges on the ground.

### **Box 2: Combining Efforts Across the WBG in Afghanistan**

Agriculture is a mainstay of the Afghan economy, contributing 25 percent of GDP and supporting over 80 percent of the population. Development of its raisin sector has however been curtailed by challenges such as lack of infrastructure and technology, dearth of market outlets for raisin farmers, and inefficient farming practices.

The Afghanistan Rikwenda Fruit Process Company project supports a greenfield processing plant to process raisins from local farmers, thereby increasing exports of locally-produced raisins. It will introduce modern technology and integrate local raisin farmers into more structured supply chains. This will in turn support sustainable livelihoods for thousands of rural smallholder farmers, improve their incomes and expand the role of women in agriculture in Afghanistan.

This project is supported by an integrated range of WBG interventions: (i) IDA's long-time engagement in Afghanistan's agriculture sector including the more recent project to improve raisin-drying and storage capacity and its Agribusiness Job Charter, as well as PSW financing; (ii) IFC (with GAFSP support) through a short-term working capital facility of US\$2.5million (A Loan) and a US\$0.5 million C Loan, as well as IFC's Advisory Services; and (iii) a MIGA guarantee of up to US\$7.8 million to cover the risk of War and Disturbance of which PSW-MGF takes a 40% percent exposure (US\$3.1 million) in a first loss position. The investors sought coverage from MIGA due to unavailability of sufficiently long tenor and affordable price in the private insurance market. In turn, the PSW's participation provides the risk mitigation that enables MIGA to offer the requested coverage.

Reflecting the high cost and long lead times of doing business in FCS market, IFC team first met the sponsor in 2013. Structuring the transaction took more than a year of intensive efforts at an estimated cost of over \$700,000.

23. **Three out of the four PSW Facilities have been utilized, through instruments including loans, equity investments, risk sharing facilities, and direct currency swaps.** BFF has supported six transactions, two of which under a global program; LCF and MGF each have had three transactions approved. This distribution reflects IFC's past experience of using blended finance programs, and, to some extent, MIGA's experience with the Conflict-Affected and Fragile Economies Facility (CAFEF), upon whose models PSW operations have been built. LCF, as a completely new facility, has received considerable attention and demand, demonstrating the needs for local currency financing in IDA markets across sectors. No commitments have been made from the RMF reflecting the complexity and longer time required to structure infrastructure projects,

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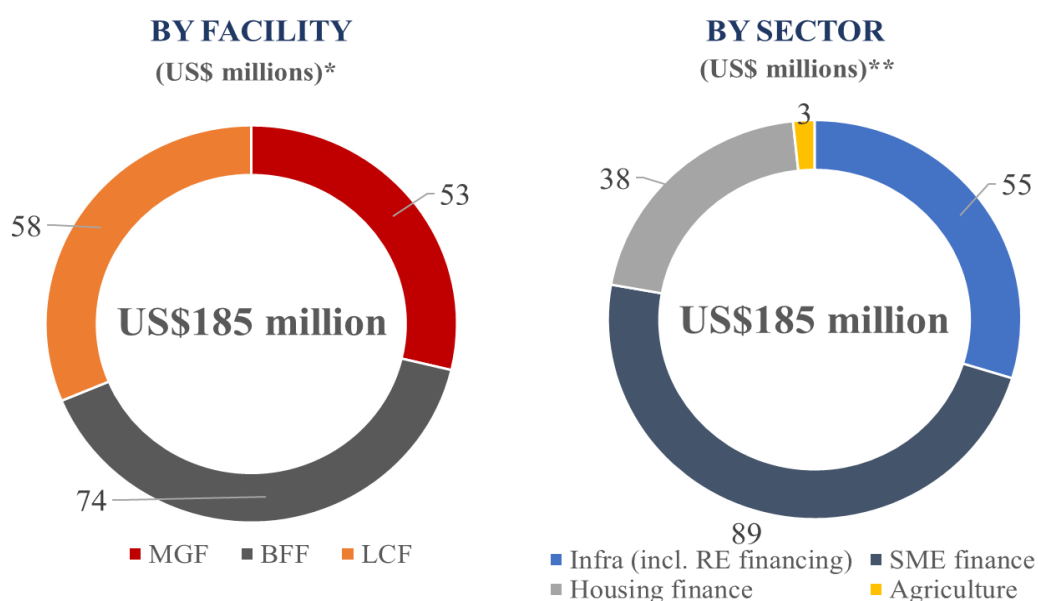
<sup>16</sup> See SUF Review Paper.



although several RMF transactions have been reviewed at Concept stage. More detailed reflections on each facility are provided in section V below.

24. **The median size of PSW-supported project is US\$50 million, and average PSW use is US\$9 million per transaction.** This reflects the often small size of the IDA/FCS markets and transactions, and the types of projects and sectors that IFC and MIGA support. With the exception of projects in the infrastructure sector which take much longer to develop, the PSW-supported projects are expected to remain relatively small, in line with IFC and MIGA’s own experience with non-infrastructure investments in IDA countries. The approved Small Loan Guarantee Program (SLGP) offers a promising example of building a programmatic platform to pool together smaller transactions (see section V below) and reduce individual transaction costs.

**Figure 2: PSW-approved projects - by facility and sector**



25. **Subsidy use in the approved transactions: as of end of Q1FY19, total estimated “embedded” subsidies are about US\$42 million from the US\$185 million committed.** The average amount of subsidy is US\$3.6 million per project, equivalent to about 5 percent of total project cost and to 23 percent of PSW resources deployed in such projects. These subsidy levels are driven by the high level of project, credit, country and other risks, and resulting reference pricing estimated by IFC and MIGA for these PSW supported transactions. More details including at the facility level are presented in the Minimizing Concessionality section.

26. **Project selectivity has been a key feature of PSW approval.** In addition to existing IFC and MIGA project and credit assessments, project selection has been guided by PSW-specific eligibility criteria.<sup>17</sup> A list of critical review questions developed by the IDA team are embedded in IFC and MIGA project documents to facilitate management review and approval processes. In the past 15 months, through IFC and MIGA’s own screening, engagement with the Bank teams,

<sup>17</sup> The Board paper, “Operationalizing the IDA18 IFC-MIGA Private Sector Window” (IDA/R2017-0078/1) and updated version (IDA/R2017-0347) presents the criteria for reviewing PSW proposals.

and the formal PSW governance process, several project proposals for PSW have been declined as these projects were assessed to lack clear and strong additionality or alignment with WBG engagements in the country. In addition, three projects were dropped after initial concept review either because the project sponsor chose a different financing structure, or put their projects on hold, reflecting the uncertain nature of structuring private investments on the ground.

### **Box 3: The Missing Transactions**

Many PSW project proposals do not proceed toward Board approval. This is mostly due to three reasons, depending on how far each transaction progresses into the review process.

First, some projects never get to the PSW review process. It might be that IFC or MIGA management decides early on that the transaction, even though it would meet the development objectives and eligibility criteria of PSW, does not require PSW support. It might also be that the investment officers or underwriters do not explore support of PSW to improve the impact of a more traditional project given lack of understanding of the options provided by the PSW. The incentives set up by IFC and MIGA (e.g., targeted volumes in FCS and LIC IDA countries; incentives based on AIMM or IMPACT scores) and the outreach on the PSW instruments should gradually address this constraint. Clarity on the risk appetite and the expectations for additionality of the PSW is important.

Second, some projects come to the PSW review process, but do not pass it. In one example in the energy sector, important questions were raised on the risks in the sector and whether it was appropriate for PSW to de-risk such transactions, vs. allocate some of these risks to the party best placed to manage them - the Government in that case (issues were related to clearance of arrears and need for tariff increase). In another example, in the agri-business sector, the IFC Blended Finance Committee considered that a similar transaction had been done previously with no subsidy and therefore recommended against PSW support. This demonstrates the value of the governance process and the need for a good understanding of where PSW is the right instrument for de-risking and commercial sustainability.

Third, some projects clear the PSW review process, but do not reach financial close. This happens for non-PSW transactions too, as IFC might not get the mandate after concept endorsement or after appraisal the project doesn't satisfy viability tests. In the case of PSW, we also have one example of a transaction in the energy sector where IFC did not get the mandate from the sponsor, as another DFI offered support with a higher level of subsidy. Such example demonstrates the importance of the Blended Finance Principles.

## **C. EXPECTED RESULTS & REPORTING**

**27. The PSW performance and expected results are reported using the PSW Results Framework focusing on Financial Performance, Scale and Scope Additionality, and Expected Project Outcomes.**<sup>18</sup> Details are presented in Annex 2. The PSW results will feed into the IDA RMS once results are achieved and can be measured.

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<sup>18</sup> The Performance and Results Framework for the IDA18 Private Sector Window was outlined in Annex 3 of the Operationalizing the Private Sector Window paper. The framework was developed to focus on monitoring the delivery of the PSW objectives to crowd in private sector investments and support a scaling up of IFC and MIGA investments in PSW eligible countries. It is also developed to track development indicators leveraging IFC and MIGA's development impact framework.

- **Financial performance:** a total of 12 projects and one program has been approved by the Board. In practice, project financials are confirmed at financial commitment and actual development impact tracked once projects are fully operational. As of the end of September 2018, of the 12 approved projects, six have been committed/executed to the benefit of end clients. Disbursement, revenues and net losses data are too early to be meaningful.
- **Scale additionality:** based on board approvals to date, PSW is expected to leverage every dollar of IDA capital deployed to six-eight dollars the overall investment into IDA countries, including IFC own account commitments and MIGA's additional issuance. For every dollar of IDA capital, IFC own account commitments and MIGA own exposure has been around three dollars. IFC own account and mobilization and MIGA gross issuances into IDA/PSW countries have overall increased from FY17 to FY18. IFC own account commitments in IDA/PSW countries was US\$1.1 billion in FY18, with a total mobilization of US\$3.3 billion, compared to US\$1.2 billion commitments and US\$1 billion mobilization in FY17. During the same period, MIGA issued gross guarantees of US\$1.24 billion in IDA/PSW countries, compared to US\$0.8 billion in FY17.
- **Scope additionality:** PSW support has created a number of notable "firsts": LCF utilization is enabling the first ever local bond issuance in Cambodia setting the stage for the development of a local bond market. BFF has supported the first PE fund in the Kyrgyz Republic, thus opening the possibility to build a new asset class supporting SME financing. In addition, the MGF-supported Rikweda project will implement a state-of-the-art facility that includes laser sorting technology for raisins that is currently unavailable in Afghanistan. The technology allows Rikweda to calibrate raisins to fit the size and color specifications of international buyers, thereby capturing market traction in global supply chains and conferring a price premium that benefits farmers.
- **Development outcomes:** some of the expected outcomes of the PSW-supported projects include reaching 3,000 farmers (through SMEs and agri-business project), over 25,000 SMEs (through risk sharing facilities), 15,000 small loans the majority of which will be to women (through local currency loan support), 10,000 construction jobs, and 4,000 km of fiber optic network, and up to an aggregate 25MW in renewable energy generation in the Pacific. Actual PSW results will depend on the timing for financial close and implementation timeline of the approved projects. The development outcome indicators for these projects will be available in the next three to five years as the projects are implemented and become operational.

28. **IFC's AIMM framework, implemented in FY17, has provided a useful framework to understand ex-ante the expected development impacts of PSW-supported transactions.** Through assessing the project and market impacts of the transactions, the AIMM framework produces a score on the scale of 0-100 as an indication of the anticipated development impact. The 12 projects and 1 program approved have consistently scored between Good and Excellent indicating the high anticipated development impact in difficult markets. Average AIMM scores for PSW supported projects have been 82, higher than the IFC non-blended transactions average of 57. A similar ex-ante framework—IMPACT (Impact Measurement and Project Assessment Comparison Tool)—was adopted on trial basis by MIGA starting July 1, 2018. This will provide

a useful framework to better understand ex-ante the expected impact of MGF supported transactions.

29. **Management reporting and monitoring has been formalized.** Progress on PSW implementation is regularly provided to IDA Partners and Board members at the time of the Spring and Annual Meetings. PSW commitments are part of the IDA's Quarterly Operational Update to the Board, as well as IFC and MIGA's portfolio updates to their Boards, and relevant PSW reporting is included in IDA's Quarterly Business and Risk Review to the Board. Within Management, PSW use is regularly reviewed at different regional and institutional levels, and the monthly PSW Oversight Committee meeting provides regular guidance to implementation.

30. **Public disclosure by IDA of PSW use has also been implemented, enhancing the transparency standards for blended finance.** As one of the first MDBs to publicly disclose its use of blended finance, information about the approved PSW allocations are available on IDA's website, with links to IFC and MIGA disclosure websites describing the underlying investment projects. All IDA Replenishment and Board Papers on PSW policy and operational framework are also publicly disclosed.

#### **D. PIPELINE FOR THE REMAINDER OF IDA18**

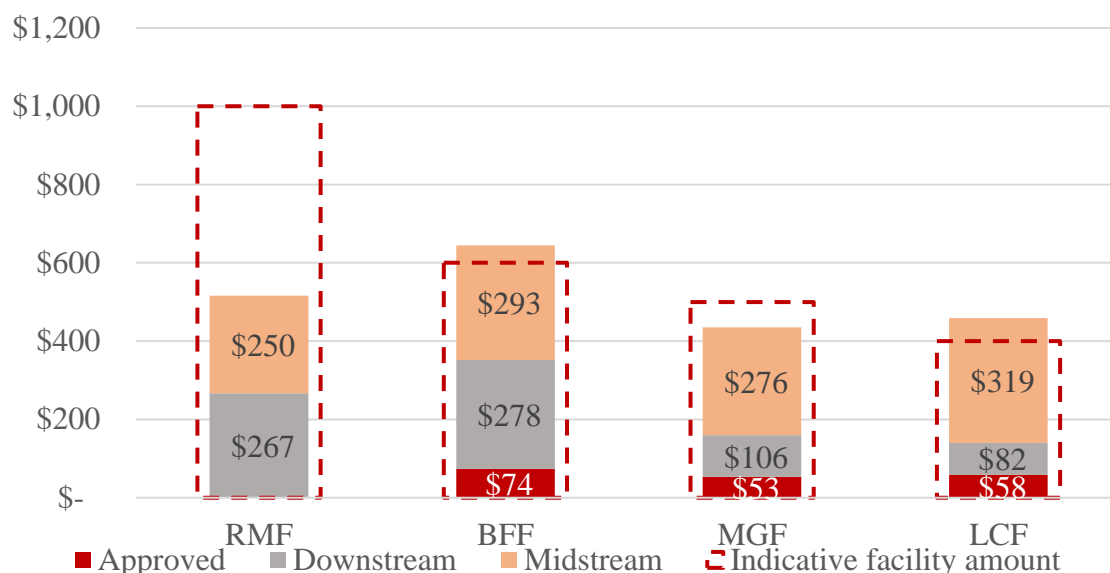
31. **After the initial buildup and with the learning achieved by the three institutions thus far, pipeline development has accelerated.** In the second half of IDA18, it is expected that volume will increase with greater diversity in project size and sectors. As it stands, the current pipeline including downstream and midstream opportunities comprises approximately US\$1.6 billion in PSW investments for the next twelve months period. Africa makes up about 60 percent of the pipeline, followed by South Asia, and East Asia. Infrastructure which generally takes longer than other sectors to develop now comprises about 50 percent of the pipeline. Other sectors with pipeline projects include manufacturing, agribusiness, energy, financial services and tourism. Education and health sectors will also likely see PSW support.

32. **The PSW pipeline will continue to evolve though dynamically and less predictably than the traditional IDA pipeline due to its different counterparties (private vs. public) and other factors.** Both IFC and MIGA's experiences suggest that one third of pipeline projects may at any point fall out, with new ones being added at the same time. Various factors are at play including: IFC and MIGA determining it is able to proceed without the need for concessional finance or using other WBG or other blended finance sources; projects dropped because of sector challenges, sponsor's risk appetite, due diligence issues (e.g., market, sponsor and financial), or because not meeting the blended finance principles; projects may also face delays due to complex project structuring, particularly in infrastructure.

33. **The PSW pipeline is growing with over US\$730 million past early concept discussions (downstream) and over US\$1.1 billion in midstream opportunities. However, the current pipeline indicates that utilization of the four facilities will likely not reflect the initial notional allocation.** Two of the facilities - BFF and LCF - are expected to be fully utilized and could meet additional demand, particularly LCF. A number of energy projects to be supported under RMF are expected to be committed during the second half of IDA18, but it is possible that the initial indicative allocation of US\$1 billion will not be fully utilized due to the long gestation period

required in the infrastructure sector. MIGA’s projects tend to be lumpy and their size can vary significantly. The pipeline of potential projects for MGF is ramping-up. However, if some of the larger projects do not materialize in the IDA18 timeframe, MGF utilization may not fully reach the US\$500 million initial allocation. Notwithstanding IFC and MIGA teams continuing efforts to originate PSW transactions, there is a possibility that not all the PSW allocation would be exhausted by end-June 2020.

**Figure 3: PSW approved transactions, downstream pipeline & midstream opportunities (US\$ millions)**



34. **PSW support for transactions in FCS locations and PSW-eligible Small States is expected to increase, underpinned by a growing pipeline.** The IDA Board has approved five projects in FCS locations so far under PSW. Four transactions valued at US\$61 million have been deployed to support infrastructure projects and SME investments in FCS. PSW support to IDA-eligible Small States comprises a US\$5 million first loss support for a risk sharing facility in the Pacific Islands. There are downstream opportunities of over US\$310 million and midstream opportunities of over US\$440 million in FCS locations, and over US\$50 million potential pipeline opportunities for MGF utilization in PSW-eligible Small States such as Solomon Islands and Djibouti.

35. **IDA18 upstream work and pipeline development is setting the stage for increased opportunities in the years beyond the current IDA cycle.** As staff and clients become more familiar with PSW, origination and pipeline development are gathering steam. However, given the long lead time required to develop new business such as infrastructure, some of the upstream business development efforts undertaken during IDA18 will only bear fruit during IDA19 and beyond. Over the medium term, the WBG’s ongoing upstream work including through Country Private Sector Diagnostics point to potential areas for WBG engagements beyond IDA18 implementation period, such as the efforts on PPP development in transport and scaling solar in Africa, and agribusiness development across countries.

## V. PSW IN PRACTICE: LEARNING FROM IMPLEMENTATION

36. **True to the “learning by doing” approach, initial experience of PSW implementation has led to some early lessons.** They are centered around the key aspects of PSW design: additionality, concessionality/subsidy, governance, risks, eligibility, and some facility specific issues.

### A. UNDERSTANDING ADDITIONALITY

37. **The understanding of additionality is evolving based on project experience.** PSW rests on a concept of additionality which was agreed by Management and IDA Partners.<sup>19</sup> Additionality is first assessed “when existing WBG products and market solutions are not deemed sufficient to address investment requirements” to present a case for utilizing PSW funds. This has required that each project team determines that the proposed project would not take place and/or achieve the intended impact in the absence of PSW support. As part of the process of determining PSW use, the extent of additionality is assessed and articulated against both scale and scope parameters. PSW additionality builds on the own additionality that IFC and MIGA bring to the supported projects.

38. **In practice, judgement is required in assessing if there is sufficient additionality to merit PSW financing and support.** The question of whether a project can take place without PSW support does not always have a simple answer. While it can be more obvious in some cases (e.g., very high political risks in a country in a state of civil unrest or conflict), the counterfactual is often difficult to prove (see box 4 for different cases of private equity funds requiring PSW support).

#### **Box 4: SME Private Equity (PE) Funds: Additionality of PSW support in different scenarios**

The Blended Finance Facility has supported three IFC equity investments in FY18. These are SME funds engaged in some challenging markets in Africa, Myanmar and Kyrgyz republic. In the case of the Kyrgyz PE fund, which was the first in the country, the fund struggled to get enough investors to reach the first closing. Without reaching the first close, a PE fund will not be able to proceed, not having adequate capital to cover the fund’s operating cost. Through PSW support, the fund was able to reach first close and become operational.

In the case of the Africa SME fund, the fund manager had reached first close, but was struggling to meet the second closing which was critical to enable the intended expansion to more difficult markets such as Mali. In PE funds, the second close is a larger fund size, which enables greater leverage factor over the operating costs and improves the expected return of the fund and enhances the expected impact. In turn, this accelerates more investments into the fund. With PSW support, the fund was able to achieve its second close and improve expected fund return.

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<sup>19</sup> See “Operationalizing the IDA18 IFC-MIGA Private Sector Window”, Nov 20, 2017, para 23 (page 8) and Annex 2 (page 51). The additionality is articulated as a “scale” additionality, in the form of the project further leveraging additional private investment. Additionality also refers to one of “scope” which has been defined as activities with potential market creation impact (such as entry into new, and expansion of existing, sectors and markets; and opportunities for new or improved ways of doing business and economic transformation in frontier markets).

39. **Articulating scale and scope additionality can also be very project and context specific.** On scale, it might be difficult to demonstrate significant mobilization of private finance in the context of an individual project, but the success of one project may lead to similar projects in the future with scale additionality being demonstrated over time. For scope additionality, expectations of market creation may not always be realistic and evidence is difficult to show in the short term. Does the “halo effect” that is created by a first-mover investor entering into a new market/country by itself justify PSW support? By definition, these questions require judgment and are often influenced by the experience and institutional perspective of the project reviewers. The review process of PSW brings these different perspectives from the WBG teams together, and, through robust discussions, to arrive at an agreeable solution.

40. **Going forward, the WBG teams will continue to forge a common understanding of PSW additionality.** As management and staff become more familiar with the PSW additionality concept and its application, agreement can be reached faster on the selection of projects. IFC and MIGA staff are using new tools, such as IFC’s AIMM and MIGA’s IMPACT frameworks, earlier in the project design to articulate development impact and additionality with support from the Economics and Private Sector Development Vice Presidency of IFC and the Economics and Sustainability Department of MIGA. The IDA teams are also becoming more familiar with issues critical to private sector transactions and when PSW use would be necessary and appropriate.

## **B. MINIMIZING CONCESSIONALITY**

41. **Minimum concessionality is a complex consideration, combining analytic tools and judgement.** Consistent with the DFI Enhanced Principles, the underlying principle is that PSW should provide a level of concessionality *just enough* to address the risk/return gaps in risky markets and enable the underlying private sector investment. It is important to provide a sufficient level of concessionality to support project viability and, to the extent possible, replicability to open up markets. At the same time, concessionality should be kept small enough to minimize potential market distortion. A method for estimating concessionality *ex-ante* was laid out in the PSW operational framework.<sup>20</sup> The estimated subsidy provided is presented in each project submitted for Board approval and quantified as a percentage of total project financing.

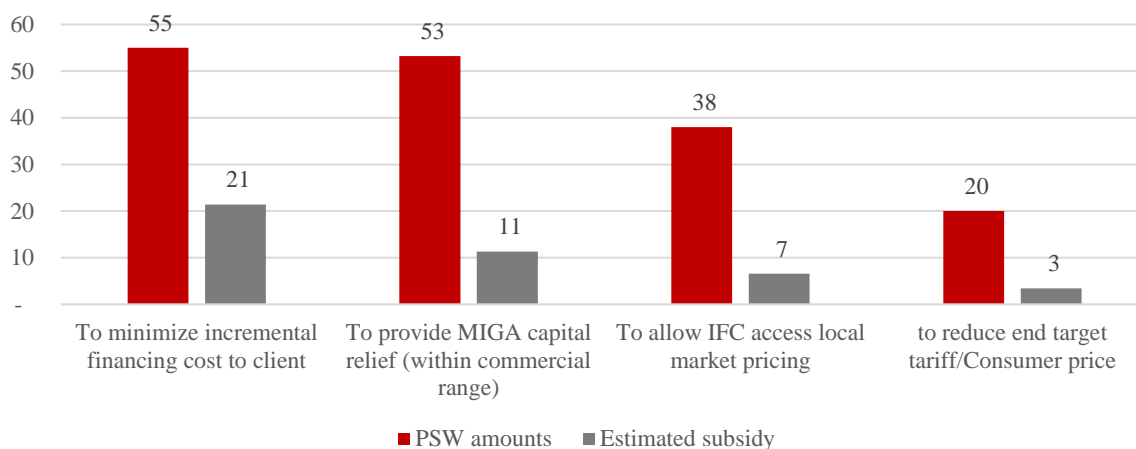
42. **For each PSW-supported project, the level of subsidy proposed is reviewed to consider who the ultimate beneficiary of the subsidy is and to address the risk of providing excessive gains to project sponsors or lenders vis-à-vis their exposure in a now de-risked project.** The IFC Blended Finance Committee has played a key role in guiding this review, considering on a case by case basis the subsidy as a percent of project costs, the resulting sponsor expected internal rate of returns, and lenders return - including IFC’s resulting return on risk adjusted capital - to affirm that the subsidy level requested is justifiable and not excessive. To the extent possible, comparator data from past and similar projects are used. Thus far, the main rationale for PSW subsidy use and driver for level of subsidy have centered around supporting affordable debt service level requirements for project sponsors to enable projects to proceed or ensuring that the end consumer pricing levels from PSW-supported projects remained at accessible levels.

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<sup>20</sup> Often in PSW-operated markets, market reference pricing is not readily available. Specific solutions to reference pricing, or proxy commercial price were agreed on a project-by-project basis during management review of each project, to calculate subsidy.

43. **Approximately ninety percent of PSW resources deployed so far have involved some form of embedded subsidy.** Of these estimated subsidies, half was targeted at minimizing incremental financing costs to end-clients, about 10 percent was deployed to reduce end consumer rates, a third allowed MIGA to release some risk capital and provide excess loss coverage, and 15 percent of these resources were deployed towards enabling IFC meet a local currency market established bond price through concessional swap rates.

**Figure 4: PSW subsidy use and rationale (US\$ millions)**



44. **Experience to date suggests that the level of subsidy required has a link to the PSW instrument being used.**

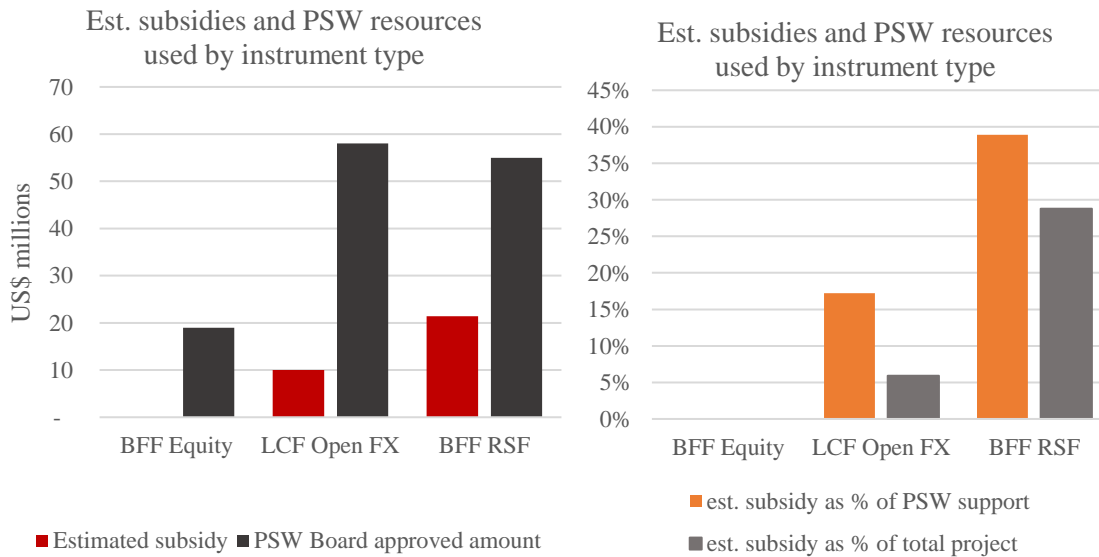
- i. The role of PSW in supporting guarantees for Political Risk Insurance (PRI) is first to make them available in markets where they are normally not available and at prices that would enable financial close. Thus far, pricing subsidies required by MGF to enable provision of PRI at bankable levels have been negligible compared to reference pricing derived from MIGA’s pricing model<sup>21</sup>. Such levels may not be replicable for the liquidity guarantees to be provided under RMF, as RMF is expected to cover the risk of non-payment by unrated state-owned enterprises, taking an asymmetrical risk compared to IFC’s.
- ii. Equity linked transactions can also pose challenges in estimating subsidy levels. Determining subsidy for equity is even less precise than for debt due to the higher variability of equity returns compared to debt returns. PSW resources in such transactions have thus far been invested alongside IFC funds to fill a financing gap that IFC, in view of its risk-return expectations, cannot fill, and have been brought in on the same terms as other mobilized equity investors. Going forward, subordination of PSW resources to other investors may be required and will be considered, as and when necessary to crowd-in other investors and achieve the desired market impact.

<sup>21</sup> An estimate of subsidies under MGF is currently not available as the methodology to calculate them is being finalized.



- iii. Lending and guarantee operations reviewed thus far have typically required larger spread differentials or subordinated positions for PSW resulting in relatively higher subsidy levels<sup>22</sup>. Examples of such use in the last 15 months include BFF concessional subordinated loans to effect blended rates and/or repayment structures that allow for critical projects to get to financial close and be operationally viable; or BFF resources being deployed as first loss protection to enable lending to unbanked or underserved markets where banks are currently either uncomfortable to lend or lend on prohibitive terms. Subsidy use for risk sharing facilities has been highest at about 39 percent of PSW resources and 29 percent of project costs so far. While relatively costly in terms of subsidy, these PSW-backed risk-sharing facilities are seen to allow broader reach than a funded PSW project could provide when liquidity or access to finance is not the main constraint.
- iv. Local currency swaps provided through LCF so far have also used significant subsidies for some currencies. LCF swaps represent a spread on top of already high credit risk spreads - which are higher than in many emerging markets - but have been set to enable final all-in pricing that the underlying projects can sustain. Furthermore, in PSW eligible markets, the 'market reference' swap rates have also been higher than in most emerging markets. The combination of these factors has resulted in subsidy levels of 15-22 percent of PSW resources, equivalent to 4-10 percent of project costs. As also noted in the Financial Risk session below, pricing at levels consistently below expected loss, whether on LCF supported transactions or other transactions, would over time lead to capital depletion.

**Figure 5: Estimated subsidies and PSW resources by instrument (US\$ millions)**

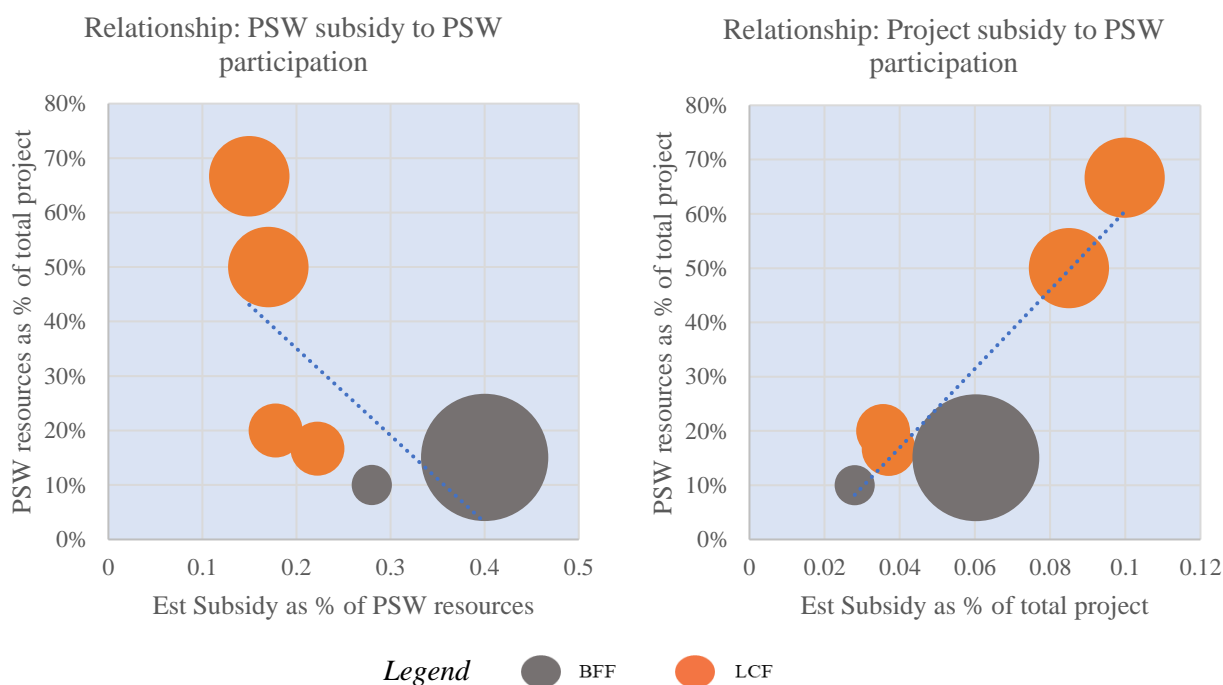


45. **Initial experience also suggests that there is a relationship between the amount of PSW resources required and the subsidy intensity of these PSW resources (measured by subsidy as a percent of PSW resources), hinting at the relationship between mobilization and subsidy**

<sup>22</sup> An example of such projects is the Small Loan Guarantee Program where the estimated subsidy level is between 26% and 54% of PSW resources approved.

**intensity.** To achieve the same level of concessionality required for a transaction, one could allocate more PSW resources with a lower level of subsidy intensity or allocate less PSW resources with higher subsidy intensity. The higher the intensity, the closer the intervention would resemble a grant buydown. In extreme cases, grants would present the least resources required to achieve a target blended rate and would mobilize more private sector investments. However, PSW – with objectives of promoting eventual commercial sustainability and minimizing distortion – is not currently set up to award grants, but rather to blend concessional with non-concessional resources. Overall, this presents a trade-off between subsidy provision and allocation of PSW resources, in the context of mobilizing private investment.

**Figure 6: PSW subsidy intensity, PSW participation and overall project subsidy relationships**



46. **The growing experience and data on subsidy use will inform IFC, MIGA, and IDA’s decision on future transactions.** The teams continue to track experience of subsidies with PSW allocations to understand how these impact private investments mobilization and PSW sustainability. As the key driver of overall concessionality of projects, PSW resources must be deployed with prudence so as to avoid market distortion. With more data and over time, project reviewers and decision makers will be able to compare the subsidy level of similar projects in similar contexts and make more informed judgment calls.

### C. PSW GOVERNANCE: BALANCING EFFICIENCY AND ACCOUNTABILITY

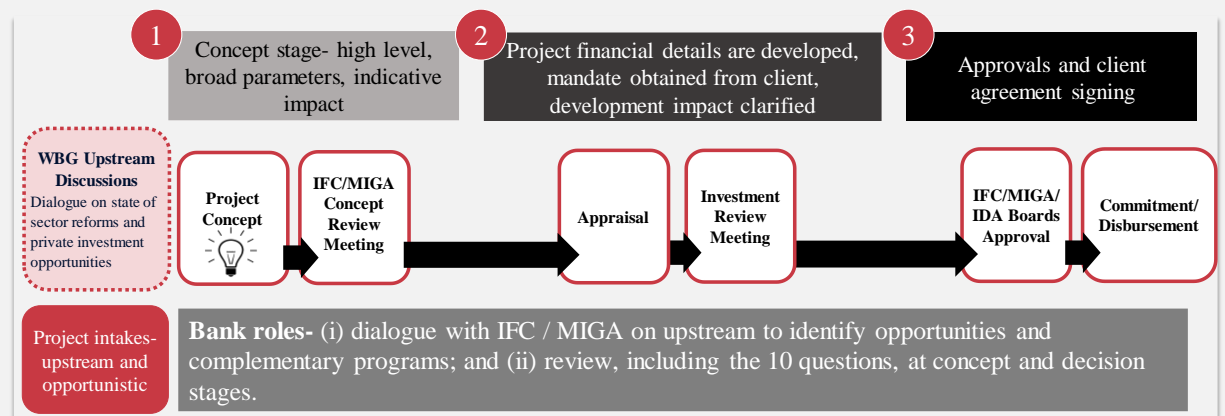
47. **The PSW governance was designed as a unique WBG framework with a deliberate intent to enhance WBG synergy.** As built into the PSW design, each PSW project involves extensive collaboration between IFC/MIGA transaction teams and Bank country and Global Practice teams. This has significantly increased the degree and substance of WBG cooperation - because it is actual investments being discussed where both IDA and IFC/MIGA will have

financial participation in. Considerable effort has been made to clarify and communicate the respective roles of Bank, IFC and MIGA staff in the PSW review process (see Box 5). While WBG staff are becoming more accustomed to these new arrangements, PSW transactions will continue to require more coordination efforts given the multiple institutions – with sometimes differing views about the role of private sector in development – involved.

**Box 5: WBG Collaboration on PSW Projects**

IFC, MIGA and Bank teams have worked collaboratively to delineate respective roles and responsibilities for PSW projects. Ideally, WBG upstream dialogue from sector diagnostics would suggest areas for PSW projects. When this upstream dialogue happens, the downstream transaction review becomes natural and straightforward. However, moving from upstream dialogues to downstream transactions often takes time and it is not necessarily a linear process. Also, dialogues and pipeline development are often not synchronized.

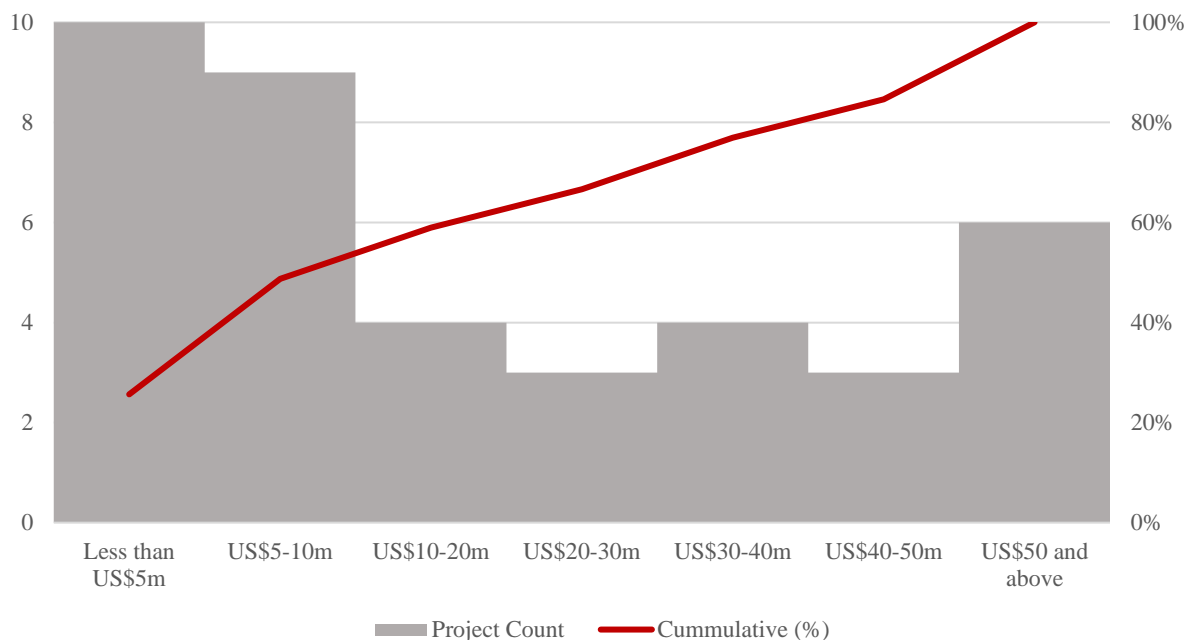
In reality, especially at this early stage of PSW implementation, IFC and MIGA often source deals in a relatively rapid and opportunity-driven fashion, often in response to their private sector clients. This creates a short timeframe for WBG staff to jointly discuss and gain agreement on: *strategic alignment* of the project (with country strategy, IDA special themes, and WBG PSD approach); the overall *development impact*; and the specific *rationale* for using the concessional financing. The Bank Country Director (CD) plays a key role in formulating a consensus on these key issues among Bank colleagues, including from Global Practices, at the country level. Based on initial experience, recommended steps for upstream engagement across the various institutional actors have been developed and rolled-out, to mark needed consultations and gain agreement at different stages of project decision-making.



48. **A structural factor affecting the efficiency of the governance process is the potentially large number of PSW transactions that may need to be reviewed given the average small size of PSW transactions.** Assuming a small size of PSW transactions, in order to utilize US\$1.5 billion (i.e., excluding RMF), up to 100-150 individual projects will need to be reviewed by WBG teams and approved by the Board during IDA18. Relative to project sizes under a regular IDA program, this suggests higher transaction costs including the time spent reviewing by Bank teams, and the Board submission preparation by the PSW Secretariat. Programmatic platforms such as the Small Loan Guarantee Program, as highlighted below, as well as the deployment of PSW in

support of large infrastructure projects from the second half of the IDA18 cycle and going forward, should help address the issue of high transaction costs.

**Figure 7: Number of Board approved and pipeline projects by size of PSW support**



49. **SLGP introduces a potential approach to consolidate smaller projects through a programmatic platform and, at the same time, enhance the efficiency of governance process.** SLGP pools together a portfolio of IFC Risk-Sharing Facilities (RSF) to enable reduced risk for participating banks’ SME lending (see Box 6). From a governance perspective, the platform, with its total envelope of US\$50 million of PSW-pooled first loss support, was formally approved by the IDA Board, while each individual transaction has been approved on an absence-of-objection basis.<sup>23</sup>

50. **Programmatic platforms like SLGP can scale up the PSW impact, and in the meantime, improve the efficiency of the PSW governance process.** These approaches allow a consistent broader program focusing on specific interventions to achieve scale and make more impact. Some key features include:

- **Standardized interventions** – including a defined pricing range, size of support and rationale for a repeated transaction type.
- **Pooled risk solutions** – Like the SLGP, the use of pooled mechanisms can support individual transactions where the pooling effect can provide improved risk mitigation approaches and program flexibility relative to transaction by transaction allocation. This is the case with the SLGP and the pool funding under the local currency solution.

<sup>23</sup> After the Program is approved by the IDA & IFC Boards, IFC Management has the delegated authority from IFC Board to approve individual transactions.

- **Small, but repeatable transactions** – programmatic approaches are particularly suitable for SME-related projects where the individual transaction’s amount is very small and would have high transaction costs if processed individually.

51. **To ensure accountability, these programmatic platforms will continue to go through the PSW governance process and be approved by the IDA Board, but the approval of follow-on individual transactions could be streamlined.** Under SLGP, the program was approved by the IDA Board, and follow-on individual transactions are submitted for IDA Board approval on absence-of-objection (AOB) basis. With more experience from SLGP implementation, IDA Management intends to consult the IDA Board on the possibility of delegating approval of individual transactions to management after the Board approval of the overall program. IFC

**Box 6: Small Loan Guarantee Program: Mechanism to Scale Up PSW for Impact**

By pooling portfolios of RSFs, IFC can provide risk sharing with financial institutions that is more efficient, price competitive, and scalable than supporting multiple stand-alone RSFs.

The SLGP is a global program aimed at addressing market failures that constrain SME access to finance in IDA-FCS markets. It is expected to encourage lending into these new markets and establish a performance track record and pricing experience that will inform future lending, demonstrate the commercial viability of lending in this sector, and avert the need for a guarantee in the future. Under the SLGP, IFC will share 50 percent of the SME portfolio risk with local financial institutions and provide finance and comprehensive advisory services to support high-impact SMEs that lack access to finance. The SLGP uses a pooled first loss of US\$50 million provided by the BFF to de-risk IFC and enable it to offer the risk-sharing product at a price that can be absorbed by the financial institutions and encourage them to increase their SME loan portfolio.

Platforms such as this provide potential for a more rapid scaling up of PSW deployment and providing access to finance for a wide swath of the underserved SME market.

Management already has such delegated authority for IFC investments under SLGP and alignment on the IDA side could make the governance process more cost effective<sup>24</sup>. Beyond SLGP, considering the inclusion of delegated authority in appropriate programmatic approaches to be brought to the IDA Board in the future would contribute to efficiencies in managing the PSW.

52. **Ultimately, for PSW to succeed in being a catalyst of enhanced WBG collaboration requires continual change in behavior.** PSW requires change management processes to enable more working together across three institutions. This in turn will require *incentives* for both IFC/MIGA and IDA management and staff; *education and training* for all institutions to better understand each other’s mandates, instruments, and processes; *joint products* such as the newly launched diagnostics under MFD; and *joint processes* for WBG collaborative decision making. Upstream WBG dialogue through SCD, CPF, country and sector dialogues - focusing on the

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<sup>24</sup> For instance, the SLGP proposal approved by the IDA Board of Executive Directors included this process for approving individual RSFs to be included in the SLGP (see para. 3 of the SLGP MOP, IDA/R2008-0073). IFC Board Approval of IFC’s operation under the SLGP (IFC/R2018-0088) included delegated authority for IFC Management to approve individual RSFs that meet defined criteria, i.e., the partner Financial Institution (FI) is an existing client in good standing, and the project presents no E&S issues.

sequencing of public and private intervention to address specific development challenges is expected to generate more project opportunities that might require support from PSW. They can include issues such as the state of sector reforms, risks and constraints, and private investment opportunities to identify areas where the public and private financing envisaged by the PSW is the most viable, and projects that may require PSW support.<sup>25</sup> This is particularly needed in low income and fragile countries, where there is less understanding of the interplay between the public and private sectors.

#### **D. COUNTRY ELIGIBILITY**

**53. Management will continue assessing the appropriateness of expanding PSW access to IDA Gap countries and to IDA-eligible small states.** Several IDA Gap countries face risk impediments and security challenges similar to those typical in IDA-PSW eligible countries, i.e., a fragmented and opaque regulatory environment, government instability, high currency risks, as well as underdeveloped capital markets which hamper private-sector led growth and inhibit FDI flows. In addition to the above impediments, many small states have high fixed cost levels and lack opportunities for scale due to small land mass and population size which adversely impact private sector led development. As requested by IDA Deputies during the 2017 Annual Meetings, Management will continue reviewing the merits for expanding PSW eligibility, including performing periodic comparative analysis of foreign direct investment and private sector activity across these country groups. On a case by case basis, IDA management could also identify specific PSW interventions, where exceptions could be requested, to allow PSW to benefit such countries.

#### **E. FACILITY-SPECIFIC LEARNING**

**54. Each facility has had its own experience and faced its specific challenges.** Management and teams continue to finetune operation and internal oversight of each of the facilities.

##### *a. BFF (BLENDED FINANCE FACILITY)*

**55. Drawing on IFC's long experience with other blended finance facilities, the launch of BFF has been relatively smooth.** There is broadly a greater awareness among IFC teams working in the financial, SME, and energy sectors on how to identify projects requiring concessionality, and these are sectors where projects can be processed more rapidly. Also, in these sectors, IFC and Bank's pipeline of projects are considerably more complementary with each other. PSW has not supported transactions in the agribusiness sector so far, mostly because IFC has an existing blended finance platform dedicated to the sector, the GAFSP.

**56. BFF will continue to innovate on its use of instruments to enhance impact.** The BFF will likely fully utilize the US\$600 million indicative allocation, with a large number of small to medium size transactions. A few large transactions in the infrastructure sector and programmatic approaches such as the SLGP are also expected under the BFF going forward. A critical objective for BFF projects, and its portfolio as a whole, is to ensure financial sustainability (e.g. capital

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<sup>25</sup> This sector-specific dialogue can be complemented or enhanced by undertaking diagnostics (jointly or individually) through tools such as INFRA-SAP, CMAW, CPSD, JIPs or IFC Deep Dives, or providing advisory services through a variety of programs. Typically, the frequency and depth of this dialogue would be greater in sectors such as energy and agri-business, and less intensive, for example, in tourism and SME/microfinance.

preservation plus possibility of return) at the facility level. Scaling up BFF impact by bundling and replicating BFF projects that serve a large number of similar clients (e.g., SMEs and financial institutions) will be key going forward; and the programmatic platform discussed above serves as a good approach. It is important to note that pooling risk mitigation through programmatic approach, and the use of first loss guarantee structures, will likely require higher levels of concessionality than individual projects, and over time will need to be balanced with transactions where capital preservation is more likely.

*b. LCF (LOCAL CURRENCY FACILITY)*

**57. As a new Facility, LCF has met considerable demand, reflecting the high foreign exchange risks in PSW-eligible markets.** The following operational issues will be refined further during the remainder of IDA18.

- i. **Cascade:** The LCF proposal anticipated a ‘cascade’ of preferred solutions<sup>26</sup> based on the level of impact on developing capital markets and efficiency of the use of LCF resources. However, LCF-supported projects approved by the Board so far have been structured as open FX transactions, the least preferred and potentially highest risk solution, highlighting the challenges in implementing the above “cascade”. Preferred solutions involving market counterparts are sometimes available, but often at pricing levels that render funding costs too high to make the project feasible. To mitigate this limitation, IFC has proposed to blend a portion of the total swap amount with a market counterpart and the rest with an open F/X swap provided by the LCF. This implies that the base rate earned by LCF in a blended swap will be lower than if it had been executed without the blending with higher cost market counterparts. However, this approach ultimately frees up LCF resources to support more transactions and contributes to the PSW’s goal of creating and deepening markets in PSW countries indirectly by involving different market Partners or facilitating an IFC bond issuance. The trade-off is that the subsidy required by each transaction could potentially be higher in either percentage rate terms (i.e., subsidy as a percent of LCF resources used) or US dollar terms, or both. Therefore, the risk of loss to IDA could be higher and will need to be managed.
- ii. **Pricing models:** Assessing the reference price for the frontier markets where PSW operates relies on several methodologies which sometimes involve various assumptions. IFC is working to refine its pricing approach, keeping IDA updated. The refined approach is being evaluated for potential implementation by the third quarter of FY19 and relies on data analysis in line with the pricing models used by the Currency Exchange Fund’s (TCX) macro-economic forecasting.
- iii. **Counterparty solutions:** One of the key “market building” aspects of LCF is the goal of developing local counterparties (whether domestic or foreign owned) with whom to engage in hedging operations for PSW and other IFC projects. Linked to the desire to see more transformative interventions, IFC is seeking to develop a pipeline of potential domestic counterparties to increase the feasibility of the solution hierarchy, particularly for local market players. IFC has commenced legal due diligence to identify and develop

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<sup>26</sup> In order, these solutions are (1) taking counterparty risk, (2) providing transfer and convertibility cover working in conjunction with a TCX hedging solution, (3) supporting IFC local currency bond issuances and managing local liquidity, and (4) entering into direct open FX transactions with IFC only where the other solutions are not feasible.

counterparties in the WAEMU zone. Initial findings indicate that there might be some regulatory hurdles to IFC being able to transact freely with commercial banks in the region. This is related to local regulatory restrictions which only permit these banks to enter into XOF to EUR/USD swaps to the extent such transactions are used by the banks for their own hedging purposes. IFC is working with the Bank in a coordinated effort to approach the local authorities and regulators on this issue. The WBG Joint Capital Markets initiative (JCAP) can help advance these endeavors.

*c. MGF (MIGA GUARANTEE FACILITY)*

**58. Additionality and subsidy considerations of MGF need to be understood within MIGA's business model as an insurer.** For investors, political risk coverage is a cost item rather than a source of financing. MIGA's role as insurance provider is different from that of a financier (i.e., an equity stakeholder or a debt provider). As such, it is challenging to ascertain that the PSW subsidy accrues to the end-users. When it comes to subsidy calculation, the subsidy represents the difference between the insurance premium IDA earns from its first-loss participation and the premium IDA should earn if it were pricing to risk and to cover its own administration costs. These issues will need to be fine-tuned further as the MGF moves forward. MIGA also shares a portion of the first loss; as such, the MGF presents a symmetric risk sharing between IDA and MIGA.

*d. RMF (RISK MITIGATION FACILITY)*

**59. Developing a pipeline for the RMF will take time.** After a slow start, the RMF pipeline has grown significantly in the last few months and it is expected that utilization could reach US\$800 million or more by the end of IDA18. There is significant demand for private sector interventions in infrastructure sectors and public-private partnerships (PPPs) in low-income/fragile countries. However, the significant sector, legal and regulatory challenges, as well as lack of track record in attracting large scale private investment in the PSW target markets, mean that a considerable amount of upstream work is required to develop and structure those bankable transactions that attract private investment. For example, energy is one of the most relevant sectors for the RMF, yet this is a sector which - in the PSW-eligible countries - is largely underdeveloped and requires significant sector reforms and complementary public investments. These are not issues that can be resolved quickly in order to generate short-term opportunities for private investment. Development of a robust RMF pipeline will require continued efforts to align expectations across the institutions regarding required sector reforms and appropriate investments from the public and private sectors, respectively.

**F. UNDERSTANDING PSW FINANCIAL RISKS**

**60. PSW carries substantive financial risks for IDA, as recognized by IDA Partners since inception.** The risks in PSW go beyond those currently taken by IFC and MIGA in the other "high risk" activities they already undertake. Such risks cannot be completely quantified using existing models and the possibility of significant losses exists. This assessment had led to IDA's risk management approach to bound risk via hard loss limits at the facility level, a capital allocation of 100 percent for PSW commitments, and an active "learning by doing" approach in risk management. In the past 15 months, this risk management approach has been put in practice. Critical to this approach and as required under US GAAP, IDA CRO worked with IFC and MIGA risk teams to develop a loan loss provisioning framework for IDA which leverages IFC and MIGA



risk estimation approaches with adjustments to reflect the additional risk faced by IDA. Transaction data have been carefully collected for each transaction. As of the end of FY18, four transactions have risk exposure on IDA's balance sheet.

**61. While limited transactions to date and the absence of financial performance data imply that there is no basis to change the current risk management approach, including capital allocation, there have been important learnings on the financial risks faced by IDA.**

- **The approved transactions so far have been structured such that IDA takes a significant part of the risk.** IDA takes the full first-loss layer in BFF transactions structured with first-loss guarantees provided by IDA, or the larger (80 percent) share of the first-loss layer in the case of MGF transactions. In LCF transactions, IDA takes all the FX risk. For equity linked transactions IDA shares the risks with IFC *pari passu*. These structures reflect the initial view of the level of risk accepted by IDA in providing PSW support for these transactions.
- **The subsidy levels in PSW transactions can reduce the PSW capital level, particularly in cases where the expected losses are not covered.** As presented earlier, PSW subsidies at the project level have averaged 23 percent (with a range of 4 to 40 percent) of PSW resources deployed thus far. Some transactions such as the BFF risk-sharing facilities and Open FX LCF structures approved thus far have required subsidies that are potentially capital depleting to the PSW. The PSW review process systematically consider the possibilities to compensate IDA for expected losses in deciding on the level of subsidies for PSW proposals, but it is not always possible in all transactions.
- **Ultimately, PSW needs to balance the tradeoff between financial risk considerations and the development impact it aims to achieve.** PSW by design is taking on certain financial and non-commercial risks that private investors are not willing to take in exchange for the development impacts generated by the transactions it enables resulting in IDA having a different risk profile than other investors including IFC and MIGA. As such, it will often be the case that IDA and IFC/MIGA cannot share risks on a *pari-passu* basis. Decisions on whether IDA should take the full first loss or consider more risk sharing between IDA and IFC/MIGA, or whether IDA should aim to recover its expected loss, are driven first and foremost by whether the transaction is worth supporting from the development impact and additionality point of view, and then what it takes for the transactions to be viable. In accepting any risk transfer to IDA, PSW investment decisions need to be informed by a clear line of sight to additionality and impact on the one hand and financial risks faced by IDA on the other.

**62. IDA Management will continue to closely monitor the PSW transactions, and over time better understand the financial risks IDA faces to refine its risk management approach as appropriate.** As more financial performance data emerges, the nature and magnitude of the risks IDA is facing and the related costs will become clearer and will inform the development of a financial risk appetite. IDA management will keep IDA Partners and the Board informed on PSW's financial performance, and on any proposed adjustments to risk management approach. IAD is also in the process of finalizing its Assurance Review of the Management of IDA18 IFC MIGA PSW and its findings are aligned with Management's own learning as highlighted in this section of the report. Also, see Annex 3 for CRO's Independent Statement on PSW progress to date.

## VI. CONCLUSIONS AND RECOMMENDATIONS FOR REMAINDER OF IDA18 AND BEYOND

63. **The first half of IDA18 has seen substantive progress in PSW implementation and has generated important lessons for the remainder of the IDA18 period.** The completion of the PSW operational framework and enabling infrastructure as well as the commitments of the first set of projects were predominant during the initial phase of PSW. The Board has reviewed the first three projects from three of the four facilities and significant lessons have been learned by all parties. The remainder of the IDA18 cycle will feature an intensive focus on bringing projects to fruition, while ensuring that PSW principles are consistently applied and learning is captured.

64. **IAD's recently completed review of the "Management of IDA18 IFC MIGA Private Sector Window" provided assurance that management has designed an effective governance and operational framework to support the implementation of PSW.** Specifically, IAD noted that the following key controls are in place and operating as intended: (i) A decision-making framework is in place, which by design, incorporates a high degree of contestability, enabled by multiple levels of review and decision-making involving various stakeholders who review and opine on the project from different perspectives; (ii) The process to review and apply eligibility criteria are in place and found to be working; (iii) Information sharing processes have been strengthened by Management recognizing the importance of pipeline development; and (iv) Management has commenced reporting on key aspects of PSW.

65. **Recognizing that learning occurs with exposure to projects and complexities across the different sectors, facilities, and products which characterize PSW, IAD's review has also identified the need for deepening the engagement with Country Management Units (CMUs) as a key area for the successful implementation of PSW.** The review noted that it will be critical to further develop a shared understanding of engagement timelines and of the CMUs' role in the decision-making process to ensure alignment of PSW projects with IDA's country strategy as well as timely processing of eligible transactions. This area of improvement will be addressed by Management through specific management action plans that IAD will report to the Audit Committee and track to completion. In addition, IAD's review identified forward looking considerations for management attention for PSW's increased efficiency and effectiveness which are in line overall with the lessons learned already captured in this paper.

66. **Management proposes to continue PSW implementation for the remainder of the IDA18 Replenishment period within the agreed parameters.** Within the total envelope, the allocation to different facilities will likely be adjusted towards the last year of IDA18 to reflect business demands. Allocations could be moved from RMF and, possibly, MGF, to BFF and LCF to better meet project needs. This reflects PSW pipeline buildup for the remainder of IDA18 period and ensures the full use of IDA18 resources. According to PSW governance, the PSW Oversight Committee will make the reallocation based on progress towards the last year of IDA18 and IDA Management will keep IDA Partners informed at the IDA technical updates at Spring and Annual Meetings. In addition, consistent with the broader proposal to retain flexibility on resource distributions across IDA, Management proposes to also retain flexibility to potentially reallocate resources from PSW in the second half of the IDA18 cycle according to pipeline developments in case some of the projects being developed would seem unlikely to close by the end of IDA18

cycle. Based on current pipeline and mid-stream opportunities, resources to be potentially allocated away from PSW amount to up to US\$500 million.

**67. IDA-eligible Small States and IDA Gap countries could be considered for eligibility in the next IDA cycle.** In aggregate, the differences in foreign direct investment levels between PSW-eligible and non-eligible small states is narrowing even though there are variances within these groups.<sup>27</sup> Consistent with the WBG's focus on Small States, Management could consider extending PSW eligibility to these countries in the next IDA cycle, in order to make available the whole spectrum of IDA tools in these challenging environments which are currently receiving insufficient FDI flows. Similarly, IDA management will also continue assessing FDI's trends in IDA Gap countries, in absolute terms and relative to IDA-only countries, to determine whether there is substantive evidence to support extending PSW eligibility to this group of countries, either as a whole or on an individual case-by-case basis.

**68. IDA, IFC, and MIGA teams will continue finetuning each of the facilities to enhance impact and refine the implementation of PSW to ensure accountability, while reducing transaction costs.** Where appropriate, programmatic approaches will be used to pool together risks for better impact and more efficiency. IDA Management intends to submit to the IDA Board a proposed change to the PSW Policy to introduce delegated authority to process sub-projects after the overall approval of a programmatic platform like SLGP. IDA, IFC, and MIGA teams will also continue to work together to smooth PSW processes, increase knowledge across the board, and contribute to the broader WBG collaboration agenda under MFD. Other improvements will also be carried out jointly as needed.

**69. PSW beyond IDA18 will be discussed as part of the IDA19 Replenishment negotiations.** Future discussions could be based on the initial experience and learning and the momentum that has been built. Lessons from this experience such as understanding additionality and concessionality will be a public good, available for others to learn from and replicate the most successful aspects. PSW can serve as a model for the international community on complex issues such as: how to leverage private investment in difficult economies; how to target public funding to entice investments in high risk areas, providing needed concessionality in the most fiscally prudent way to minimize market distortion; and how to ensure that subsidized funding will not crowd out otherwise attractive private investment. These lessons will be captured and disseminated to further the concept of blended concessional finance beyond the WBG. As many of these lessons are expected to materialize only in the coming years, this will require a horizon beyond IDA18.

70. Management would welcome IDA Partners' views on the following:

- Do Partners concur with the initial lessons learned from implementing PSW?
- Do Partners support the proposal to request for IDA Board's approval of delegated authority to IDA Management to process sub-projects under programmatic approaches?
- Do Partners support that Management retains flexibility for potential reallocations from PSW depending on pipeline development?

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<sup>27</sup> 5 year average Net FDI (2012-2016) between PSW-eligible and non-PSW eligible small states amounted to US\$726 million and US\$587 million; while median Net FDI was US\$80 million and US\$17 million respectively.

## **Annex 1: List of Approved PSW-supported Projects as of September 30, 2018**

### ***From the Blended Finance Facility (BFF):***

- ANZ Bank New Zealand Risk Sharing Facility - to support growth of infrastructure subprojects in the Pacific with a specific focus on renewable energy and energy efficiency.
- Highland - a first of its kind private equity and mezzanine fund financing SMEs in the Kyrgyz Republic.
- IPAEII Fund - to provide equity funding for SMEs in underserved markets in West Africa.
- Anthem Asia - a private equity fund in Myanmar targeting smaller-sized and early stage SMEs.
- Small Loan Guarantee Program (SLGP) - a platform risk sharing facility with financial institutions to provide SME financing and advisory services. Under SLGP, two sub-projects were approved:
  - ABI - a pan-African facility for SME lending in 8 PSW-eligible countries in West and Central Africa; and
  - SIB - a risk-sharing facility to promote increased SME lending, in particular to smaller SMEs and in longer tenors, in Cote d'Ivoire.

### ***From the Local Currency Facility:***

- Caisse Regional de Réfinancement Hypothécaire (CRRH) - to enable a bond issuance which will support banks to extend the tenor of their mortgage loans for more affordable housing for lower and middle-income households in West African CFA countries.
- IDLC Finance - seeking to create a new asset class focused on the lower-middle income segment of the housing market in Bangladesh.
- Hattha Kaksekar Ltd (HKL) - the third largest microfinance institution in Cambodia for the issuance of local currency bonds to support its local currency financing to SMEs in underserved rural areas, including women owned SMEs.

### ***From the MIGA Guarantee Facility:***

- Afghanistan Rikweda Fruit Process Company - provides a guarantee to cover war and civil disturbance risk for an investment in a greenfield processing plant to increase exports of locally-produced raisins.
- Hyalroute, Myanmar - a political risk guarantee to support a project on the installation and maintenance of fiber optic communication network, which is envisaged to increase telecom access and connectivity.
- Sonatel, Sierra Leone - political risk guarantee for an equity stake in a mobile telecom operator which is expected to undertake significant investment to improve the quality of and access to telecommunication services.

List of Approved PSW-supported Projects

Project name	Project summary	PSW amount (\$ m)	Project size (\$ m)	Facility	Approval status	Projected Board Date	Project status	IFC/ MIGA Investment (\$ m)	Instrument	Tenor	Country/ Region	Currency	FCS	Sector
RSF ANZ Pacific	Enabling scale up EE & RE investments up to 25MW across the region	\$ 5.0	\$ 50.0	BFF	Committed	29-May-18	Ongoing	\$ 25.0	BFF First Loss Guarantee	10	Pacific Islands	USD	Non-FCS	Renewable Energy, FIF
Sonatel Telecom	Political Risk Insurance to Support network expansion, assets modernization and roll out of mobile banking and other services	\$ 31.1	\$ 721.7	MGF	Committed	21-Jun-18	Ongoing	\$ 194.5	MGF First Loss guarantee	15	Sierra Leone	EUR	Non-FCS	Telecoms
CRRH- 12 year	Direct swap to facilitate local currency housing finance bond across West Africa	\$ 9.0	\$ 45.0	LCF	Committed	19-Dec-17	Ongoing	\$ 9.0	LCF Open FX hedge	12	Western Africa Region	USD	Non-FCS	Financial Markets
CRRH- 15 year	Direct swap to facilitate local currency housing finance bond across West Africa	\$ 9.0	\$ 54.0	LCF	Committed	19-Dec-17	Ongoing	\$ 9.0	LCF Open FX hedge	15	Western Africa Region	USD	Non-FCS	Financial Markets
Highland PE Mezz	Equity investment in first PE fund in the Kyrgyz Republic seeking to raise US\$30 million.	\$ 4.0	\$ 30.0	BFF	Committed	8-Mar-18	Ongoing	\$ 4.0	BFF Equity	9	Kyrgyz Republic	USD	Non-FCS	Financial Markets
Anthem Asia	Equity investment in Myanmar focused SME fund seeking to raise US\$50 million.	\$ 7.5	\$ 50.0	BFF	Committed	9-May-18	Ongoing	\$ 7.5	BFF Equity	10	Myanmar	USD	FCS	Financial Markets
IPAE II	Equity investment in francophone Africa SME follow on fund seeking to raise 100 million Euros	\$ 7.5	\$ 123.0	BFF	Committed	8-Mar-18	Ongoing	\$ 7.5	BFF Equity	10	Africa wide	Euro	Non-FCS	Financial Markets
Rikw eda	War, Civil Disturbance cover for 15KT Raisin processing plant	\$ 3.1	\$ 5.0	MGF	Committed	8-Mar-18	Ongoing	\$ 7.2	MGF First Loss guarantee	10	Afghanistan	USD	FCS	Manufacturing and Agriculture
IDLC Ltd	Local currency loan to support entry of IDLC into the affordable housing finance market and directly support 1,500 new mortgages	\$ 20.0	\$ 40.0	LCF	Committed	24-May-18	Ongoing	\$ 40.0	LCF Open FX hedge	7	Bangladesh	TAK	Non-FCS	Financial Markets
Small Loan Guarantee Program (SLGP)	Pooled first loss to support Risk-sharing facilities under IFC small loan guarantee program in PSW eligible countries.	\$ 50.0	\$ 332.0	BFF	Committed	5-Apr-18	Ongoing	\$ 166.0	BFF First Loss Guarantee	10	Total PSW eligible	USD	Non-FCS	Financial Markets
2nd Hyalroute FOC Network Project	TR, Expropriation risk, and War civil disturbance cover for Fibre-Optic cable investment project	\$ 19.0	\$ 119.0	MGF	Committed	19-Jun-18	Ongoing	\$ 118.8	MGF First Loss guarantee	8	Myanmar	USD	FCS	Infrastructure
HKL Cambodia	3 year Cambodian Riel (KHR) bond support to facilitate IFC subscription to first ever bond issuance in Cambodia	\$ 20.0	\$ 30.0	LCF	Committed	7-Jun-18	Ongoing	\$ 20.0	LCF Open FX hedge	3	Cambodia	KHR	0	Financial Markets
		<b>\$ 185.2</b>	<b>\$ 1,599.7</b>					<b>\$ 608.5</b>						

**Annex 2: PSW Performance and Results Framework as of September 30, 2018**

**The projected results for the PSW Board approved projects will be presented in the main captions outlined in the PSW results framework-** Financial performance, scope and scale additionality, and development impact.

<i>Objective</i>	<i>Indicator</i>	<i>Update based on Board approved PSW transactions</i>	<i>Comments</i>
<b>PSW Financial Performance-</b> This dimension of the results framework covers PSW commitments, disbursements, PSW revenue and losses.			
<b>PSW deployment</b>	PSW commitments: <i>Cumulative commitments from PSW</i>	<p><b>Board approvals:</b> US\$185 million (across 12 transactions, including two transactions under the Small Loan Guarantee Program (SLGP))</p> <p><b>Client signed commitments:</b> US\$107 million has been under client commitment across 8 transactions (including 2 transactions covered by the US\$50 million SLGP pool)</p>	<p>Reporting focused on Board approvals as there are limited client signings. Project count based on number of board approvals.</p> <p>After Board approval, IFC and MIGA teams work with the client to finalize the contract within the approved parameters. In some cases, the final amounts contracted are less than Board approvals.</p>
	PSW disbursements: <i>Cumulative disbursements/allocation from PSW (not applicable to RMF, BFF and MGF guarantees which are not disbursed)</i>	<p>LCF: Supported IFC loan of US\$9.03 million disbursed</p> <p>BFF: disbursement of US\$49,271</p>	<p>Amount in LCF cash movements in a swap arrangement with IFC.</p> <p>A disbursement under a BFF equity transaction was effected in October 2018.</p>
<b>PSW Revenue</b>	Fees collected from PSW transactions	Revenue received at US\$171,480 from 4 transactions	To date, 8 projects under the PSW have gone to financial commitment. Fees are only generated on transactions in client contract

<b>Objective</b>	<b>Indicator</b>	<b>Update based on Board approved PSW transactions</b>	<b>Comments</b>
<b>PSW Net Losses and Provisions</b>	Net losses on PSW transactions	No crystalized losses to date Loan loss provision: US\$4.4million	This includes loan loss provisions for guarantees and loans as well as mark to market losses for LCF transactions.
<b>PSW Scale Additionality:</b> This dimension considers the PSW objective to scale up IFC/MIGA engagements in IDA-only/FCS markets			
<b>Scale up IFC/MIGA engagements in PSW-eligible markets</b>	IFC Commitments & MIGA Gross issuances in PSW-eligible markets with PSW participation: <i>Cumulative volume of PSW enabled IFC Commitments &amp; Gross issuances of MIGA Guarantees in PSW-eligible markets within IDA18 period</i>	<b>Expected IFC commitments and MIGA gross issuances</b> (based on PSW board approvals): <i>US\$608 million. IFC: US\$291 million; MIGA: US\$318 million</i> <b>Realized commitments</b> (based on client signed): IFC- US\$ 187 million, MIGA- US\$218 million	As of September 30, 2018. Realized commitment data is based on client signed contracts. IFC amount includes separate US\$2.5 million investment alongside an MGF supported project.
	IFC and MIGA investments/project count with PSW participation: <i>Cumulative number of PSW-enabled IFC Commitments &amp; MIGA guarantees in PSW-eligible markets within IDA18 period</i>	12 (including 8 subsidiaries) IFC and 3 MIGA PSW-enabled IFC Commitments & MIGA guarantees	This translates to an average transaction size of US\$15.6 million compared to IFC and MIGA overall average transactions of US\$18.4 million and US\$131 million respectively. IFC project count includes subsidiary operations within single larger business entity.
<b>Scale up IFC/MIGA engagements in PSW-eligible markets (cont'd)</b>	Total IFC Commitments & MIGA Gross issuances in PSW-eligible markets: <i>Cumulative volume of IFC Commitments &amp; Gross issuances of MIGA Guarantees in PSW-eligible markets within IDA18 period</i>	IFC client commitments: FY18: US\$1.33 billion (-7% from FY17 levels), FY18-FY19Q1 cumulative: US\$1.39 billion MIGA gross issuances: FY18: US\$1.24 billion (+45% from FY17 level); indicative FY19Q1: US\$155 million	Data as of FY18 and includes Nigeria, Kenya and Pakistan. Excluding these countries amounts to US\$1.05 billion MIGA data as of FY18 and includes Nigeria and Pakistan. Excluding these countries amounts to US\$1.10 billion

<b>Objective</b>	<b>Indicator</b>	<b>Update based on Board approved PSW transactions</b>	<b>Comments</b>
	Total IFC and MIGA investments/project count in PSW-eligible markets: <i>Cumulative number of IFC Commitments &amp; MIGA guarantees in PSW-eligible markets within IDA18 period</i>	IFC projects: FY18, 78 (up from 64 in FY17), FY18-FY19Q1 cumulative, 87 projects MIGA projects: FY18, 13 (down from 15 in FY17)	For IFC project count implying smaller average project sizes (relative to volumes invested) while MIGA project count implies increase in average project size.
	Share of PSW-eligible engagements in total IFC commitments & MIGA gross issuances: <i>% of PSW-supported engagements in total IFC commitments &amp; MIGA gross issuance (in volume) in PSW-eligible countries</i>	16% of combined IFC's total commitments and MIGA gross issuances in FY18	Data for FY18. Based on IFC and MIGA client commitments of US\$187 million, and US\$218 million respectively.
	Share of PSW-eligible engagements in total IFC commitments & MIGA gross issuances- <i>% of PSW-supported engagements in total IFC commitments &amp; MIGA gross issuance (in number of investments/projects) in PSW-eligible countries</i>	18% of total combined IFC and MIGA projects; 15 projects including 9 projects under the SLGP <sup>28</sup> .	Data for FY18 . Uses IFC project count methodology.
<b>Focus on FCS</b>	Share of FCS projects in cumulative PSW-supported commitments: <i>% of FCS projects in cumulative PSW commitments (in volume and in number of investments/projects)</i>	<b>Volumes:</b> 32% (US\$60 million) of Board approved and 41% of committed projects (US\$44 million)	Based on IDA Board approved PSW projects
		<b>Projects:</b> 42% (5 of 12) of Board approved and 63% of committed projects (5 of 8)	Based on IDA Board approved PSW projects and committed projects up to FY19 Q1

<sup>28</sup> IFC's approach to counting projects under the SLGP recognizes each of the subsidiaries as constituting a project in its reporting.



<b>Objective</b>	<b>Indicator</b>	<b>Update based on Board approved PSW transactions</b>	<b>Comments</b>
	Share of PSW-eligible FCS projects in cumulative total number of IFC and MIGA commitments: <i>% of IFC / MIGA's total FCS investments/projects</i>	<b>Projects:</b> IFC- 11% (30 projects), MIGA -100% (4 of 4 projects)	Data for FY18. Based on IFC and MIGA client committed projects. Excludes regional projects with FCS sub-components.
	Share of PSW-eligible FCS projects in cumulative volume of total IFC and MIGA commitments: <i>% of IFC / MIGA's total FCS volumes</i>	<b>Volumes:</b> IFC- 3% (US\$339 million), MIGA -100%	Data for FY18 based on IFC and MIGA client committed projects. Excludes regional projects with FCS sub-components.
<b>Crowd in private investments</b>	Private Capital Directly Mobilized- <i>Financing from entities other than IFC that becomes available to Client due to IFC's direct involvement in raising resources. For MIGA private direct mobilization is the total amount of the equity or loan that MIGA is guaranteeing</i>	MIGA Private Direct Mobilization under the MGF three transactions approved is US\$0.21 billion.	
	Private (co-)financing of WBG-supported transaction- <i>is financing from private entities provided in connection with a specific activity for which an MDB is providing financing, where no MDB is playing an active or direct role that leads to the commitment of the private entity's finance. This includes sponsor financing, if the sponsor qualifies as a private entity (For MIGA this includes Private Direct Mobilization and Private Indirect Mobilization.)</i>	MIGA Private Co-financing under the MGF three transactions approved is US\$0.82 billion. IFC expected Co-financing is US\$334 million	

<b>Objective</b>	<b>Indicator</b>	<b>Update based on Board approved PSW transactions</b>	<b>Comments</b>
	Amount re-/co-insured with private sector Partners- <i>Amount co-insured or reinsured with the private sector under the MIGA Guarantee Facility (MIGA specific)</i>	N/A	No re-insurance transactions have been entered into to date
	Subsidy element of PSW use: <i>Amount of cumulative indicative subsidy- calculated as the difference between commercial terms (or model price) available for the same or similar product and the terms of PSW-supported solution in any given investment and narrative explaining rationale</i>	US\$43 million	For Board approved transactions. The subsidy has been estimated as the difference between the reference pricing and the final transaction price approved for the transaction. Where subsidies have been estimated in ranges, the average of the range has been used.
	<i>% implied subsidy to total PSW project transactions volume (transaction size including other investors)</i>	3% of total financing for PSW projects 23% of PSW resources approved	For Board approved transactions. The subsidy has been estimated as the difference between the reference pricing and the final transaction price approved for the transaction.

**PSW Scope Additionality:** This review covers the incremental impact of the PSW in pushing boundaries through increased scope of interventions or new ways of working and sub-sectors. Scope additionality in projects approved to date has covered several applications:

<b>New countries and sectors coverage</b>	New countries and sectors PSW transactions are expected to enable	<i>The MGF has supported the first fiber optic cable construction in Myanmar and the first raisin processing plant in Afghanistan.</i>	
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<b>New and expanded use of instruments</b>	PSW enabled new or expanded instrument use	<i>The LCF has supported the first ever bond issuance in Cambodia setting the stage for the development of a bond market. The BFF has also supported the first PE fund in Kyrgyz republic opening the possibility to build a new asset class supporting SME financing.</i>	
<b>Expanded client reach</b>	New ways of client reach and new approaches	<i>Under the BFF, the Small Loan Guarantee Program (SLGP) has supported two Risk Sharing Facilities (RSFs) which aim to reach smaller SMEs than earlier RSFs were able to support and expanded to include lending to start ups.</i>	
<b>Market impact</b>	Market creation impact & risks	<i>The introduction of AIMM by IFC allowed a system to measure the anticipated market impact at the time of Board approval. To date there have been several AIMM scores for PSW supported projects.</i>	MIGA has launched its anticipated results tool called ‘impact’ which is in early stages of implementation.

**PSW Development Outcomes and Impact-** PSW supported projects are expected to create trackable outcomes as measured by IFC DOTs system and MIGA’s DEIS system to track project outcomes. These development outcomes are determined by the nature of the projects supported. Some of the expected results are highlighted below:

<b>Support IDA18 objectives and Special themes</b>  <i>*selected indicators to report from IFC/MIGA results reporting;                  *actual results data collection &amp; reporting starts 3 years after commitment</i>	WBG Corporate Scorecard	<b>Farmers reached:</b> <i>Under programs related to BFF risk sharing facilities and MGF agri-processing, the PSW is expected to support 3,000 farmers over the next decade;</i>	Expected results, actual measurements will happen from FY21
	Tier 2 Client Results supported by WBG Operations: Growth & Inclusiveness	<b>Renewable Energy:</b> <i>Through a BFF Risk sharing facility supporting efficient energy infrastructure, over 25MW of renewable energy capacity is expected to be installed and serve about 100,000 people;</i>	As above
	* IFC, MIGA feed directly into these indicators	<b>SMEs:</b> <i>Through the SLGP pooled first loss mechanism, over 25,000 SMEs are expected to be reached with financing while the LCF support to Cambodia is expected to support 38,000 micro loans including about 26,000 to women</i>	As above

* IFC, MIGA feed directly into these indicators	WBG Corporate Scorecard	<i>Construction jobs: Through political risk insurance provided by MGF support, 4,000km of fiber optic network will be installed and about 10,000 construction jobs created in Myanmar during the project life.</i>	As above
	Tier 2 Client Results supported by WBG Operations: Growth & Inclusiveness	<i>Mortgage access: The LCF support to a leading Bangladeshi mortgage lender is expected to lead to the origination of 5,500 mortgages</i>	As above
<b>Satisfactory outcome of PSW funded operations-</b> (evaluation process starts 3 years after signing for MIGA), FY23 (IFC)	IEG Project Evaluation results: % of evaluated PSW projects with satisfactory evaluation ratings	N/A	from FY23
	Average AIMM score for PSW supported projects (IFC projects only)	82	from FY21. IFC will be retiring DOTs and replace it with AIMM scores
	IEG assessment of IFC and MIGA work quality on PSW-supported projects: % of evaluated PSW projects with satisfactory evaluation ratings	N/A	from FY23

### Annex 3: CRO Independent Statement

#### I. BACKGROUND

The IDA Private Sector Window was established to focus on private sector investment in frontier markets (especially in FCS countries). As discussed with the IDA Board, risk management of the PSW was expected to be challenging as transactions would be in countries and markets featuring limited or no market breadth or data to support risk assessment, pricing, mitigation, and reporting. As opposed to other “high risk” activities that IFC and MIGA already undertake, the risks in PSW, for the most part can be difficult to assess, and the possibility of significant losses exists.

The practical approach was to bound the risk to IDA (via hard loss limits with a 100% capital allocation) and actively engage in “learning by doing”. In that spirit, Board-level loss limits were established for each window (e.g. US\$1,000 million for RMF, US\$600 million for BFF, US\$500 million for MGF and US\$400 million for LCF). IFC and MIGA maintain a financial interest (via underlying financings or guarantees) in three of the windows: MGF, BFF, and RMF although the risks taken by IFC/MIGA are by design lower than those assumed by IDA (in accordance with PSW governing principles). This approach enables IDA to at least make use of IFC and MIGA’s assessment of their own risks in operations under these facilities, and build on these, given the lack of data for an independent arms-length assessment. The LCF, which offers four types of currency management coverage, does not feature sharing of currency risk although IFC does have an underlying investment in the project.

For all PSW Windows, since IDA currently lacks private sector expertise, it relies on IFC’s and MIGA’s internal processes and guidelines for sourcing and pricing transactions. The ability to rely on IFC and MIGA internal limits (e.g. country exposure limits) also provides flexibility in the pipeline development stage to pursue the most developmentally valuable transactions. At end FY18, there were four PSW transactions with outstanding exposure. The list of all PSW transactions approved by the Board is provided in Annex 1, while the table below lists the PSW transactions with outstanding exposure as of end FY18.

*Table 1: PSW Transactions with Outstanding Exposure as of end-FY18*

<b>Project Name</b>	<b>Host Country</b>	<b>Facility Transaction Type</b>	<b>FY18Q4 Exposure (USUS\$ M)</b>
Afghan Raisins	Afghanistan	MGF First Loss: Equity Guarantee	2.1
MFOCN Fiber Network, Phase 2	Myanmar	MGF First Loss: Debt Guarantee	18.4
Orange Sierra Leone	Sierra Leone	MGF First Loss: Equity Guarantee	15.6
CRRH Bond - 12 Year	W. Africa Region	LCF Open FX Hedge	9

As previously agreed, the capital requirement for PSW activities to be included in the Total Resources Required measure for assessing IDA Capital Adequacy is 100 percent of maximum exposure. This reflects: (a) the nature of these risk-taking activities, focused on FCS and the private sector, whereby losses can be substantial, and risk is extremely difficult to assess, and (b) the lack of a track record of IDA or IFC/MIGA with such risks.

## II. OBSERVATIONS AND LESSONS LEARNED

### 1) LCF Pricing and Subsidies

**Pricing and Risk Assessment in Frontier Markets:** The November 2017 Board paper<sup>29</sup> noted the anticipated challenges in terms of pricing and risk assessment in frontier markets, particularly for LCF. In practice, we have observed that indeed pricing and risk measurement with any substantive level of confidence is extremely difficult. To date, for LCF (3 projects approved of which 1 has been traded, plus various others in the pipeline), it has not been possible to separately estimate expected and unexpected loss. Furthermore, each trade requires a customized, approach based on many assumptions to address the lack of robust market data and models.

**Subsidies and Costs:** The Board paper laid out the components of pricing and the specific contributions from IDA. Regarding the LCF, it noted that for an LCF trade, a market price typically consists of compensation for expected and unexpected losses. The unique feature of PSW was that while IDA would generally be compensated for expected loss, PSW could require a lower return on capital and therefore less than market compensation for unexpected loss. As a result, the expectation was that it would be possible to tolerate additional unexpected losses, but also to potentially generate gains, depending on the movements in exchange rates.

However, in practice, we have observed that LCF trades typically require a pricing subsidy depleting IDA capital on average by about 15-20% of the LCF exposure. In terms of the costs to IDA, as in the case of other PSW facilities, this subsidy does not include other costs of deal preparation (including costs associated with deals that did not make it to the Board, nor the cost of start-up of the window). The consistent requirement of large subsidies indicates a model whereby the US\$400 million window would be depleted over time as opposed to a model that is expected to largely breakeven as envisioned in the Board paper.<sup>30</sup>

**Required Staff Resources:** The experience with LCF to date has helped assess the resources needed for its management. The low proportion of proposals transacted compared to those considered, the frequently changing nature of each transaction (regarding pricing, deal terms/structure), the small deal size, and the customized nature of each proposal have made the LCF far more resource intensive than originally envisaged. It is hoped that further familiarity and experience with transactions will over time bring these requirements down.

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<sup>29</sup> AC2017-0037 “Operationalizing the IDA18 IFC-MIGA Private Sector Window”

<sup>30</sup> The November 2017 paper stated that for the LCF, “Pricing will target to compensate for expected losses and seek to provide a return on the capital IDA is required to hold for unexpected losses.”

## 2) Loan Loss Provisioning for Exposure under the Private Sector Window

Over time, PSW is expected to create a portfolio of non-sovereign credit and market risk exposures in IDA countries, especially in FCS. BFF, MGF, and RMF transactions in turn will create loan and guarantee exposure on IDA's books which under US GAAP require estimation of Loan Loss Provisions (LLP). This exposure will be towards private-sector entities without sovereign guarantees or will consist of project-based political risk guarantees without sovereign indemnity.

Prior to PSW, IDA exposure for which the LLP assessment was required consisted exclusively of exposure to sovereign entities or with sovereign guarantees. Accordingly, IDA's LLP framework was exclusively geared towards sovereign guaranteed exposure. IDA did not have a framework in place for risk assessment or provisioning for BFF, MGF or RMF exposure and thus needed to develop a new provisioning framework.

The new LLP framework avoids unnecessary duplication of efforts across the World Bank Group by leveraging the expertise, experience and established provisioning frameworks of IFC and MIGA. As the originators of these transactions, IFC and MIGA provide IDA with the inputs and information required for LLP calculation, based on the specific risks assumed by IDA.

*However, while IFC and MIGA provide inputs and information, as a separate entity, IDA remains responsible for estimating LLP for IDA PSW exposure despite its lack of expertise in private sector risk assessment<sup>31</sup>. IDA also remains responsible for presenting the provisioning results to the relevant approval committees and for discussing developments as required with external auditors with input from IFC and MIGA as needed.*

IDA's new provisioning framework for PSW transactions combines the experience of all the three institutions to calculate, on a quarterly basis, the loan loss reserve for PSW exposures on IDA's balance sheet. The LLP framework for PSW exposure considers that IFC and MIGA already have established risk and LLP frameworks for private-sector exposure and political risk insurance products. The framework also considers that IFC and MIGA will originate PSW transactions, perform risk analysis based on their detailed knowledge of the transactions, and take risk alongside IDA in the transactions.

IDA has gained considerable understanding of the provisioning methodologies used by IFC and MIGA, the calculation of inputs such as default probabilities and severities by IFC and MIGA, as also the associated implications for IDA specific risks. Development of this framework provided IDA with considerable experience in coordinating across multiple WBG entities and departments and in negotiating a mutually agreeable approach to provisioning. IDA CRO has also participated in a successful review of the PSW provisioning procedures by IDA's external auditors.

**Required Resources:** The LLP process for PSW transactions is complex and people intensive due to:

**Risk nature and structure:** The risks inherent in PSW transactions differ significantly from the sovereign risks that the current IDA portfolio is exposed to. This distinct nature of PSW

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<sup>31</sup> This does create a risk that if, ex post IDA provisions are found to be misestimated, IDA may be held responsible even though it essentially has to rely on IFC/MIGA for information.

transactions indicates the possibility of losses that can be both substantial and difficult to assess, hence the need for close risk monitoring. Moreover, IDA also needs to expand its own knowledge horizon to encompass the specific nature and structure of PSW transactions.

*Risk management best practice:* Good risk management requires that every institution fully understand the risks that it takes on its balance sheet. A review of the new LLP framework for PSW transactions by IDA's external auditors stressed the need for CRO to develop sufficient understanding of PSW transactions and their risk assessment to be able to independently assess the reasonableness of the loan loss provisioning outcomes produced by IFC and MIGA.

*Large number of transactions:* The three MGF transactions that resulted in the first PSW exposures with provisioning implications in FY18Q4 averaged US\$24 million, with the smallest at US\$3.1 million. Consequently, the IDA18 PSW envelope of US\$2.5 billion could result in many transactions, each requiring quarterly LLP assessment and processing. This is in contrast for LLP assessment for IDA's sovereign exposure, calculated at the country level rather than the individual loan level.

*Lack of data on exposure taken by IDA:* IDA lacks any data on PSW financial performance, particularly in the context of risks that are specific to IDA. Due to the structure of PSW transactions IDA is taking more risk, than IFC and MIGA. Therefore, the track record of such exposures is expected to differ from that for IFC and MIGA.

*Coordination role & outreach responsibility:* CRO also acts as a coordinating unit working closely with IFC and MIGA, along with other Bank units, to ensure timely availability of inputs, smooth information flow on specific transactions, development of procedures to manage PSW transactions, and coordination with auditors. Outreach on risk and loan loss developments vis-à-vis the Board and senior management will also be the responsibility of CRO, which highlights the need for CRO to have a full understanding of PSW transactions and their risk and resource implications.

### **III. ISSUES FOR FUTURE CONSIDERATION**

#### **1) Risk Sharing Considerations**

While three of the PSW windows, MIGA Guarantee Facility MGF, The Blended Finance Facility BFF and the Risk Mitigation Facility RMF, feature some level of risk participation from IFC and/or MIGA, the degree of participation varies from full risk sharing to tranching (with IDA alone responsible for first loss). The LCF features no participation from IFC in the risks being borne by IDA.

In view of the fundamental lack of market information (regarding pricing and risk assessment) as well as the benefits of streamlining (to reduce costs), to better align incentives across the institutions, some *pari passu* (even if less than 50%) risk sharing alongside IDA by IFC/MIGA could be considered if the PSW is to be scaled up beyond the pilot. This is best practice in market transactions and could over time become more important for IDA in view of its own AAA standing and market perception. This will require further discussion and assessment by WBG management.



## **2) Capital Requirements**

The first exposures under the LCF became effective during the second quarter of FY18 and create a total exposure of US\$9 million by end-FY18. The first exposures under the MGF (three transactions) became effective in the last quarter of FY18 for a total of US\$36 million by end-FY18. At end-FY18, there were no BFF or RMF exposures outstanding. The consequent lack of PSW track record, which was one of the reasons for the 100% capital requirement assessment, therefore continues to hold true.

As originally envisioned, the nature of these transactions, with their focus on the private sector in FCS, indicates the possibility of substantial and hard-to-assess losses. Moreover, a review of these transactions suggests that IDA takes most of the risk. For example, two of the five BFF transactions approved by the Board are first-loss guarantees provided by IDA, while MGF transactions approved to date consist of IDA taking the largest share of the first loss layer. Until more transactions are undertaken and enough time elapses to yield meaningful data on actual outcomes, the 100% capital backing remains appropriate. Under these conditions, and in view of IDA's own AAA and market standing, PSW transactions with more aligned risk sharing between IDA and MIGA/IFC should be discussed, especially if PSW is to be scaled up from the next replenishment onwards.

## **3) Forward Look**

Management should continue to monitor PSW with an eye toward simplifications, scalability and tradeoffs between cost/risk impact, consider deploying risk sharing, better alignment of incentives, and simplification of processes.