



IDA18

**WBG Collaboration: Proposal for an IFC-MIGA
Private Sector Window in IDA18**

**IDA Resource Mobilization Department (DFiRM)
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ACRONYMS AND ABBREVIATIONS

Fiscal year (FY) = July 1 to June 30

AAAA	Addis Ababa Action Agenda	MFI	Multilateral Financial Institution
CAFEF	Conflict Affected and Fragile Economies	MIGA	Multilateral Investment Guarantee Agency
CASA	Conflict Affected States in Africa	MSME	Micro, Small and Medium Enterprise
CPF	Country Partnership Framework	MTR	Mid-Term Review
DFE	Development Finance Forum	ODA	Official Development Assistance
DFIRM	Development Finance IDA Resource Mobilization	OPCS	Operations Policy and Country Services
EDSA	Electricity Distribution and Supply Authority	PBA	Performance Based Allocation
FCS	Fragile and Conflict-Affected State	PRI	Political Risk Insurance
FCV	Fragility, Conflict and Violence	PSW	Private Sector Window
FDI	Foreign Direct Investment	RSF	Risk Sharing Facility
GAFSP	Global Agriculture and Food Security Program	SCD	Systematic Country Diagnostic
GDP	Gross Domestic Product	SDGs	Sustainable Development Goals
GNI	Gross National Income	SOEs	State-Owned Enterprises
GNP	Gross National Product	SME	Small and Medium Enterprise
GoSL	Government of Sierra Leone	UN	United Nations
IBRD	International Bank for Reconstruction and Development	WBG	World Bank Group
IDA	International Development Association		
IFC	International Finance Corporation		
IMF	International Monetary Fund		
JIPs	Joint Implementation Plans		
LICs	Low Income Countries		
MDB	Multilateral Development Bank		
MDGs	Millennium Development Goals		

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EXECUTIVE SUMMARY

1. **The private sector lies at the center of a sustainable development model.** Recognizing the pivotal role of the private sector in supporting economic development, the 2015 “UN Third International Conference of Financing for Development” conference in Addis Ababa stressed the importance of private capital in achieving the ambitious Sustainable Development Goals (SDGs).¹ Making progress on IDA18 Special Themes also requires strong contribution from the private sector to ensure women’s economic empowerment; to invest in low-carbon growth paths; to achieve stability in fragile situations; and to widen the tax base to finance public service delivery. In the context of the Addis Ababa Action Agenda and World Bank Group (WBG) “Forward Look”, Executive Directors are exploring how best to mobilize the private sector to reach the WBG goals of reducing poverty and enhancing shared prosperity in a sustainable way. This paper responds to the Participants’ request at the first IDA18 Replenishment meeting in Paris for a joint WBG proposal to enhance private sector investment in IDA countries, especially Fragile and Conflict Affected States (FCSs). It recommends establishing a new IFC-MIGA Private Sector Window (PSW) under IDA18.

2. **Over the years, the WBG has built up a strong understanding of public and market failures that constrain the private sector in IDA countries, especially in FCSs where security risks add to the list of concerns.** In many IDA countries, the private sector is small and predominantly informal, with large skills and knowledge gaps. Apart from the weak macroeconomic and regulatory environment, *domestic* private investment is constrained by a weak financial sector and large public deficits that soak up available financing. Meanwhile, *foreign* investors are reluctant to engage in these countries because of perceived political risks, the small size of markets limiting economies of scale and discouraging competition; macroeconomic and regulatory uncertainty making business risky; high transport costs and infrastructure bottlenecks elevating production costs; country risks affecting banks’ risk weighted assets that constrain available finance; and information asymmetries and coordination problems making pioneering investments difficult. As a result, private investment and foreign direct investment in many IDA countries are low, at 16 and 3 percent of Gross Domestic Product (GDP), respectively.

3. **Over the past decade, on their own accounts, IDA, IFC and MIGA have supported over US\$100 billion in private sector investment in IDA countries to create an enabling environment, make complementary investments, provide guarantees, and directly invest in the private sector.** IDA, IFC and MIGA work together at a *strategic* level on Systematic Country Diagnostics (SCDs) and Country Partnership Frameworks (CPFs); at a *sector* level through Joint Implementation Plans (JIPs); and at the *project* level through joint, parallel or sequenced financing and complementary risk-sharing. In the past decade, IDA financed projects worth US\$71 billion to support private sector activities, of which US\$9 billion in FCS. In particular, IDA supported over US\$3 billion in Project-Based Guarantees benefiting private sector participants, in partnership with country governments and supported by sovereign counter-guarantees. Over the

¹ UN Sustainable Development Summit 2015, “Transforming our World: the 2030 Agenda for Sustainable Development”.

same period, IFC financed US\$25 billion on its own account in IDA countries, of which US\$3 billion in FCS, and mobilized an additional US\$11 billion, supporting projects worth approximately US\$80 billion. And MIGA's issuance of guarantees in IDA countries totaled US\$9 billion in the past decade, of which US\$3 billion in FCS.

4. **While IDA, IFC and MIGA work together to support the private sector in IDA countries, there are gaps.** Beyond the broad constraints to the investment climate in IDA countries, and the three institutions' certain constraints, this paper focuses on five critical challenges. First, despite a significant infrastructure gap, IDA countries face challenges in attracting the private sector to fill this need. Second, poor access to finance stymies growth of the Small and Medium Enterprise (SME) sector. Third, the absence of developed and viable bond and swap markets to deal with local currency risks prevents some private sector investments from happening. Fourth, pioneering investments in challenging environments and important sectors such as agribusiness do not happen because of the risks involved in being a first mover. And fifth, the limitations of the private market reinsurance capacity in IDA and FCS markets restrict the size of guarantees available for transactions where they are most needed and at pricing that keeps project costs viable.

5. **To accelerate support for the private sector in IDA countries – with a special focus on FCS – and deepen collaboration across the WBG, Management proposes to establish a Private Sector Window (PSW) that would help IDA work more closely with IFC and MIGA.** The proposed PSW would be just one of the innovations in IDA18 that seeks to scale up financial support to meet unprecedented demand in IDA countries, including in FCS. The financial structure would seek to leverage IDA's sectoral knowledge and equity and enable IFC and MIGA to efficiently deploy their capital to support low-income IDA countries and FCS while meeting their financial sustainability objectives. The PSW will draw on IFC's and MIGA's long-standing experience in emerging markets where overall investment and guarantee underwriting experience has been largely positive and resulted in development impact through their opportunity-driven business model. The implementation experience, demand and use of the PSW would be reviewed for possible expansion at the IDA18 Mid-Term Review (MTR).

6. **For the PSW, IDA's total exposure would be capped at the window's proposed size of US\$2.5 billion.** Aligned with efforts to leverage IDA's equity and as a complement to existing instruments supporting the private sector, US\$2.5 billion of IDA's equity would backstop the PSW. IDA's support could be used for un-funded guarantees and reinsurance, though other forms of support would emerge as this proposal is developed. Most of this amount would remain on IDA's balance sheet and generate fees for coverage provided unless the underlying investments or guarantees in the window realize losses for which IDA would pay its share.

7. **For IDA, the PSW contributes to its larger objectives of expanding private investment in IDA countries, in particular FCS, in line with IDA18 priorities and Special Themes.** It needs to be seen in the broader context of an ambitious IDA18 replenishment, which creates space for IDA to increase its support to private sector. IFC and MIGA will focus on the domestic private sector and on attracting responsible foreign investors, and will demonstrate clear *additionality* of the proposed PSW to their current activities. The PSW will emphasize and measure mobilization

of the private sector. It is aligned with the IDA18 themes, and will seek to focus on FCS countries. The results measurement system will prioritize jobs, especially for women and youth.

8. **Within the PSW, facilities are being considered that target specific barriers to private sector development.** For an initial pilot, six possible facilities are being considered. For illustrative purposes, they could include: (i) a risk mitigation facility, which would unlock transformative infrastructure and Public-Private Partnership (PPP) investments; (ii) a local currency hedging facility, which would tackle the lack of options for coping with local currency risks; (iii) an SME guarantee facility, which would further expand access to finance for SMEs; (iv) a co-investment facility, which would enable investments in SME equity, agribusiness, technology and social services; (v) a first loss facility, which would expand access to political risk insurance guarantees in the most challenging environments; and (vi) a reinsurance arrangement, which would enable increased deployment of guarantees where private options are currently limited. The final selection of facilities will incorporate further analysis to ensure additionality, adequate risk management, and complementarity with existing WBG instruments, especially IDA guarantees.

9. **The PSW governance will ensure accountability and effectiveness.** From the outset, the PSW will use a rule-based approach with jointly developed investment parameters to guide the allocation of resources with the aim of diversification, alignment with IDA18 themes, and emphasis on IDA's financial sustainability. The management of the PSW will build on IFC's and MIGA's experience and core skills, while drawing from IDA's sectoral expertise and experience with guarantees and other relevant private sector operations. It will aim to address both IDA's public sector client concerns, as well as IFC's and MIGA's private sector client focus. To ensure accountability, clear reporting arrangements with regular senior management oversight processes will be established. Arms-length agreements will be established to address conflict of interest concerns. The governance structure will build on existing structures, including the role of the IDA, IFC and MIGA Boards, as well as IFC's and MIGA's experience and track record with blended finance.

10. **Governance arrangements will be tailored to facilities.** Facilities under consideration carry different levels of risk, and require different levels of oversight. For facilities with clearly aligned incentives between IDA and IFC/MIGA – e.g., through pari passu investments/guarantees – IDA could largely delegate implementation, building on IFC's/MIGA's own pricing and risk assessment frameworks. For facilities where IDA takes a first loss to IFC or MIGA or absorbs non-commercial risks, more upfront work on guidelines and agreements, as well as a more detailed governance framework will be required to ensure that the right amount of IDA's equity, at the right price, is used. This will build on experience from IFC's and MIGA's blended facilities; whenever possible, arms-length processes will be used; and oversight will ensure strategic alignment with WBG programs, including existing instruments, and proper risk management.

11. **A principle-based approach to risk and return will be developed.** Similar to IFC's and MIGA's current pricing structures, PSW facilities will be priced based on relevant WBG benchmarks – in this case IDA's non-concessional rates, which represent an alternative return on IDA's equity. Relative to this benchmark, a spread or risk premium would be required to adjust for private sector risk. Given the nature of the targeted transactions and the objective to make them viable, pricing might not fully capture risks – e.g., for transactions where no market exists to price risks – or might not reflect the externalities of “first mover” or “pioneering” investors

(through demonstration effects, catalyzing the enabling environment, etc.). Such “concessionality” would need to be driven by a business need where the development impact outweighs the potential financial costs.

12. **There are substantial risks associated with the proposed PSW.** IDA’s exposure to private credit and non-commercial risk without sovereign indemnity is allowed by its Articles of Agreement; nevertheless there are reputational and financial risks associated with these facilities, some of which IDA and its shareholders have not faced before. Reputational risks arise because of IDA’s role as an impartial advisor to Governments, including in its roles in policy advice and policy-based lending operations. IDA bears fiduciary responsibility to the funds entrusted to it by contributing partners which are intended to benefit recipient countries. The financial transactions among the WBG institutions may result in negative reputational impact if they are not managed appropriately and with clear accountability. Implementation risk is also significant considering the challenging market environment in many FCS countries. Finally, the risky nature of transactions could result in IDA incurring losses. The PSW will be managed to minimize potential losses and preserve to the extent possible the amount of IDA equity allocated to the window; the window would generate fees that could offset potential losses. Furthermore, Management will put mitigating measures in place, monitor closely and adjust implementation as necessary, in particular to ensure the window is consistent with IDA’s overall financial sustainability and future leveraging strategy.

13. **Feedback is sought from Participants at the second IDA18 Replenishment meeting on the rationale and organizing principles for the PSW.** A comprehensive proposal with operational details would be developed for review and endorsement at the third meeting in October 2016.

Questions to Participants for guidance	Section
<i>Does the paper present a compelling rationale to establish a new IFC/MIGA Private Sector Window for IDA18?</i>	Section A on challenges in IDA countries; Section B on WBG track-record; Section C on rationale
<i>What are Participants’ views on the indicative facilities explored so far and the principles underpinning governance arrangements?</i>	Section D on indicative facilities; Section E on governance arrangements
<i>What are Participants’ views on the window’s size and on risks for IDA, including the possibility that IDA’s equity could be negatively impacted?</i>	Section D on size; Section E on risks

INTRODUCTION

1. **The private sector plays a critical role in development, creating sustainable pathways out of poverty for millions in IDA countries.**² Scaling up efforts for private sector development and mobilization of private sector finance has emerged as a key part of the global development agenda. The WBG has worked with Governments and the private sector over the past 60 years, and will continue to focus on the private sector as an engine of job creation, growth and development to achieve its strategic goals. The ongoing “Forward Look” exercise emphasizes the need to work with the private sector as “one WBG.” This paper responds to the Participants’ request at the first IDA18 Replenishment meeting in Paris for a joint WBG proposal to enhance private sector investment in IDA countries, especially FCS. It recommends the establishment of a new IFC-MIGA PSW under IDA18 to contribute to the broader policy commitments of Jobs and Economic Transformation (Box 1).

2. **This paper is organized as follows.** Section A highlights key features of the private sector and its challenges in IDA countries. Section B outlines the WBG’s track record in supporting private sector development in IDA countries. Section C presents the rationale of the PSW. Section D presents the key parameters and possible facilities under the PSW. Section E concludes with a discussion on finance, governance and risks.

Box 1: Jobs and Economic Transformation Policy Commitments in IDA18

Building on lessons from WBG’s long experience to support jobs and private sector-led economic transformation, as well as building on momentum from successful actions in IDA17, specific policy commitments in IDA18 include:

Analytics to inform current operations

1. IDA will undertake eight inclusive global value chain analyses to understand how they can contribute to inclusive job creation and economic transformation.
2. IDA will expand the use of spatial mapping and spatial data analysis tools to assess jobs dynamics, urbanization trends, and infrastructure impacts.

Learning and measurement to inform future operations

3. IDA will carry out Impact Analyses of SME and entrepreneurship programs in eight countries, including in four FCS, to understand overall impacts and differentiated outcomes for women and youth.
4. IDA will develop and implement measurement tools and systems to gain a deeper understanding on the impacts of investment operations on the number, nature, and inclusiveness of jobs, with a specific emphasis on gender outcomes.

Leveraging the WBG for private sector investment

5. WBG will enhance existing and introduce new operational instruments to improve risk sharing in projects and crowd-in private capital in high risk.

² Cf. “Jobs and Economic Transformation”, IDA18 Special Theme paper.

A. PRIVATE SECTOR IN IDA COUNTRIES

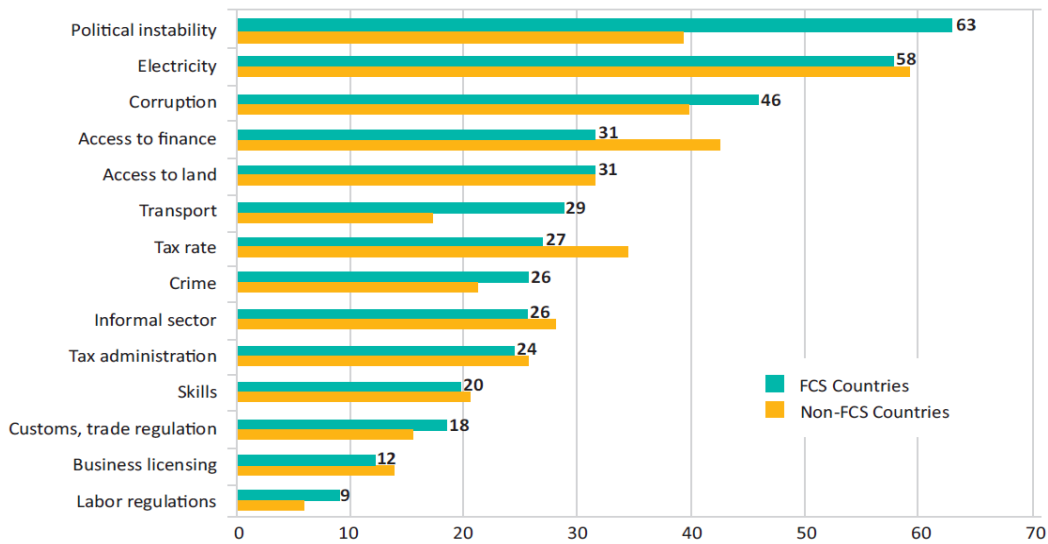
3. **Enhanced private sector competitiveness and integration with global markets can lead to reductions in poverty by creating more and better-paying jobs.** The private sector invests in and implements ideas and solutions that drive sustainable growth, and provides 90 percent of jobs in developing countries (to which SMEs contribute 65 to 80 percent). In addition to directly generating jobs and increasing income levels, healthy private sector growth also (i) drives learning and skills building of the broad labor force and population, (ii) facilitates technology transfer to recipient countries, and (iii) increases the tax base. The private sector can also be a vital partner in the design and delivery of public services. It contributes expertise, efficiency, innovation, and increasingly plays an important role in augmenting public sector capacity. When appropriately designed, private-sector-led solutions based on market mechanisms can help enhance the coverage and quality of basic services, like water, sanitation, electricity, and transportation.

4. **There is increasing global recognition that, to advance the development agenda in the poorest countries, it is not enough to just work with the public sector: engagement with the private sector needs to scale up, too.** This goes back to the blueprint of the creation of the WBG institutions designed to work with both governments and private sector, and it has become even more relevant in the context of the ambitious global development goals. The 2015 Financing for Development conference in Addis Ababa emphasized the importance of mobilizing domestic resources and private capital and expertise to accelerate structural transformation. It also highlighted the important role development assistance can play to mobilize private capital for development. The private sector's role was also featured prominently in the SDGs. Hence, for the WBG, mobilizing private sector investments and solutions is crucial to increasing impact.

5. **Yet, in many IDA countries, especially FCS, the domestic private sector is small and informal and faces challenges.** Private companies operate in small and underdeveloped markets with modest purchasing power. In most cases, critical infrastructure is missing or of low quality, corruption makes rules of the game opaque, access to finance is constrained, skilled labor force is in short supply, and private property is not adequately protected and enforced by law. Barriers to entry for firms are high, and many countries continue to have a “missing middle” of strong sustainable SMEs, which can create jobs and alleviate poverty. FCS often face additional challenges of lack of security, political risks, and destruction of productive assets during conflict.³ (Figure 1).

³ See IDA18 Special Theme Paper on Fragility, Conflict and Violence (FCV).

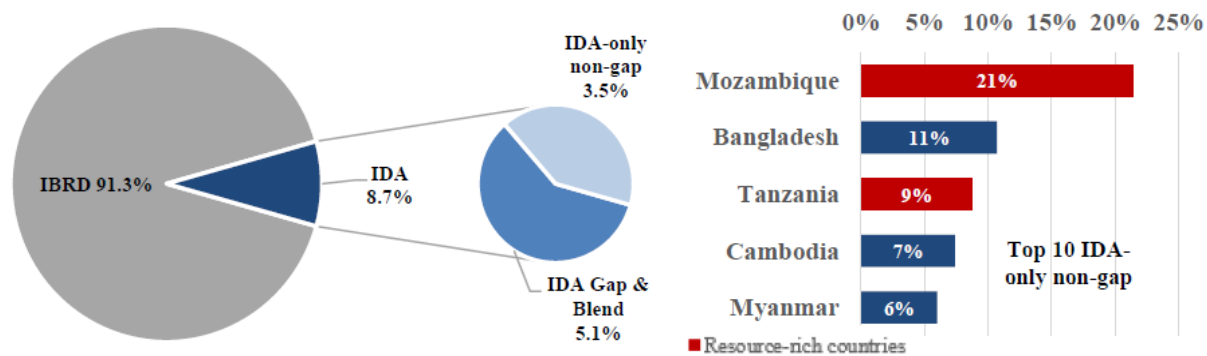
Figure 1. Perceived Constraints to Private Sector Development in Low-Income Countries



Sources: World Bank enterprise surveys, 2014

6. **Foreign investors are often unwilling to engage in IDA countries, especially FCS, due to perceived excessive risks and lack of long-term responsible investors.** While IDA countries attract 67 percent of Official Development Assistance (ODA), they attract less than 9 percent of the total foreign direct investment to the emerging markets (Figure 2) with the bulk going to resource-rich countries. Portfolio capital flows are also relatively low in IDA and FCS countries as a percent of GDP, and IDA countries score low on measures of access to credit for businesses.

Figure 2: Foreign Direct Investment to IBRD and IDA countries



Source: WDI, IDA18 Strategic Directions paper, March 2016.

7. **A broad range of challenges contributes to low private investment levels in IDA countries, especially in FCS.** The bottom line for investors is that potential investments may have high costs for development, high operating costs, and high risks in terms of project completion and revenue generation, as well as significant reputational risks – all of which can make investments unviable or unprofitable. Information asymmetries and coordination problems render risk sharing

and risk mitigation efforts essential to encourage pioneering investors, and support local micro and small enterprises.

8. **Barriers to private sector growth could stem from inefficiencies on the public sector side.** The reluctance of investors may be driven by macroeconomic and regulatory uncertainty, which increases risks, hinders industry dynamism, limits entry of new firms, and discourages competition. Weak financial sectors, combined with large fiscal deficits in many IDA countries, often constrain funding available for private financing. Weak institutional capacity and poor governance can also be challenging. Meanwhile, State-Owned Enterprises (SOEs) can often tilt the playing field in key sectors and affect investor interest. Land ownership and lack of property rights also often pose problems. Combined with high transport and production costs due to infrastructure and energy bottlenecks, inputs are typically very expensive.

9. **Challenges also exist on the private sector side.** Private entrepreneurs may lack capacity, skills, and financial resources to develop complex projects, including having the ability to address important environmental and social issues. Market data may be scarce. Financial institutions and suppliers may not be well developed, limiting availability of finance and the ability of companies to source locally. Country risks affect international banks' required risk-weighted assets for funding in-country, hindering their investment and constraining availability of finance for borrowers on the ground. There are weak or non-existent capital markets, and limited options for syndicating risk such as insurance and reinsurance. In particular, markets to hedge local currency risks are often non-existent. Integrity risk issues, including possible ties to the financial, political or military elite, can be a problem especially in FCS and low-income IDA countries.

10. **A clear challenge is the ability of IDA countries to attract successful pioneering and responsible investments.** Such investments, in turn, would help reduce investor risk perceptions, and thus open up the countries to domestic and foreign capital beyond these investments. Pioneering investments can also help propel governments to develop regulations and supporting services, establish business and consumer markets, and demonstrate the viability of businesses. Pioneer investors generate externalities that overcome market failures, although the rewards for doing so are not always captured. Taking advantage of these changes and the information gained, other companies can follow with more investments – the demonstration effect. Opening up new markets and expanding growth and job creation are public benefits that justify support of the first movers.

11. **Amid the extensive barriers to private investment in IDA countries, five critical constraints underpin the proposal to pilot the Private Sector Window.**

- **Infrastructure** is an urgent priority for most IDA countries. While there has been some growth in investment, it has fallen far short of what is needed. Of the approximately US\$100 billion per year that Africa currently needs to invest to close its infrastructure gap, just under half is financed, and there are limited prospects of major growth in public sector investment. Fiscal constraints and capacity limitations lead many countries to look for private sector capital and capacity to address these gaps. Declining energy factor costs – notably in wind, solar and natural gas – also offer governments unprecedented opportunities to put in place new energy strategies and lock-in lower cost, lower carbon-intensity power generation. Yet, most countries are making minimal

headway on realizing these ambitions. This reflects both general limitations in the capacity to bring forward bankable projects, and high risk profiles associated with specific infrastructure investment risks. Most high-impact projects in infrastructure depend upon government commitments (e.g., public off-takers for power) for extended periods of time, sometimes for decades. In high risk environments, the credibility of governments as key counterparties for risks such as offtake, or termination is often not sufficient to achieve project bankability.

- Helping grow **SMEs** is key for job creation in IDA countries. With 600 million new jobs needed in emerging markets over the next 15 years, supporting job creators is critical. In IDA countries, SMEs play a bigger role in their local economies and face greater constraints than in other emerging markets. Access to finance remains a major constraint in most markets. Due to investment climate and information asymmetry issues discussed earlier, banks and other financial intermediaries, while beginning to show interest in this sector, are risk averse, generally only serve the select SMEs that can borrow on a fully secured basis.
- The lack of **long-term local currency financing** in many high-risk countries constrains investments. With underdeveloped, volatile local financial markets and in the absence of currency hedging instruments and counterparties, projects in an IDA or FCS country can only obtain foreign currency financing. For example, only a handful of FCS countries currently have an existing mechanism available (e.g., some combination of derivatives, structured finance, or bond issuance) to facilitate IFC provision of local currency financing. Although USD-denominated loans may offer lower interest rates and longer tenors than those available in local financial markets, these advantages could be offset if the consumer base in the country has mostly local currency revenues and the exchange rate depreciates. Available local currency finance is predominantly short-term. The consequences of currency mismatches can be particularly harmful when they are used for projects, such as electric power or toll roads, in which a local currency decline is often passed on directly to a vulnerable consumer base which may be poorly equipped to pay higher tariff rates. Paradoxically, the most vulnerable in the poorest countries are left to bear the negative effects of currency risk, while middle-income and high-income countries have access to better developed capital markets to provide currency protection as needed.
- Despite their potential powerful demonstration effect to other investors, in IDA and FCS countries, many **investments in SME equity/entrepreneurship, agribusiness, and social inclusion** fail to meet bankability standards and cannot find adequate long-term funding to meet their needs. However, many could potentially be viable over time and have a demonstration effect in the market if appropriate risk mitigation instruments and funding sources are available to support them. These potential investments could help address some of the challenges faced in IDA and FCS countries and would contribute to job creation, productivity growth (e.g., agricultural productivity, industrialization), as well as supporting local entrepreneurship (e.g., SME equity platforms), technology & innovation, and social inclusion (e.g., PPPs in health & education).

- **Attracting the participation of the private reinsurance market is challenging in FCS markets and for small transactions.** Arranging private market reinsurance capacity in IDA-eligible countries and FCS is often a challenge, particularly for large infrastructure projects in difficult environments. IDA Project-Based guarantees for the private sector (which include Partial Risk Guarantees (PRGs)) have been used on many projects, together with IFC investment loans and equity investments and on MIGA Political Risk Insurance (PRI) to backstop governmental obligations that have been identified as key constraints to private sector investments. However these IDA PBGs may not be fully available due to individual country capacity limits and the inherent trade-off made by client countries in how to allocate valuable resources vis-a-vis other lending / grant instruments.

12. **Nonetheless, for countries that have achieved a basic governance and investment climate capacity, investment potential is significant.** Several IDA countries have internationally-renowned resources and often an entrepreneurial business class. Some countries offer advantageous geographical locations near major markets (e.g., Haiti, Mozambique, Myanmar and Benin) which may provide export potential. Post conflict situations also often have significant presence of international organizations (at least temporarily) and government activity focused on rebuilding, and public procurement can form the basis of incipient market activity, such as in construction.

13. **Client demand to address these challenges and explore the untapped potential is strong.** A recent discussion with ministers from g7+ and FCS countries at the WBG/IMF Spring Meetings highlighted important priorities for these countries in promoting private sector development. FCS countries need more foreign direct investment, but also to grow their domestic private sector in both capacity and size. FCSs also need significant investment to close the infrastructure gap. Creating employment for young women and men is a demographic as well as political imperative for FCS countries. The recent Development Finance Forum also confirmed the need to support the private sector in FCS markets and the value that multilateral institutions like the WBG can bring to design and channel the appropriate support (Box 2).

Box 2: 2016 Development Finance Forum, “Unlocking Opportunities in Fragile Markets”

The second Development Finance Forum (DFF) took place in Dublin, Ireland on May 18-19th 2016. Building on last year’s success in supporting the “Billions to Trillions” agenda of the MDBs and helping prepare for the agreement on the Addis Ababa Action Agenda, this year’s Forum focused on how to improve public and private alignment in FCS and increase investments from private sources. Over 200 experts and decision-makers from the public and private sectors, as well as civil society, joined the Forum.

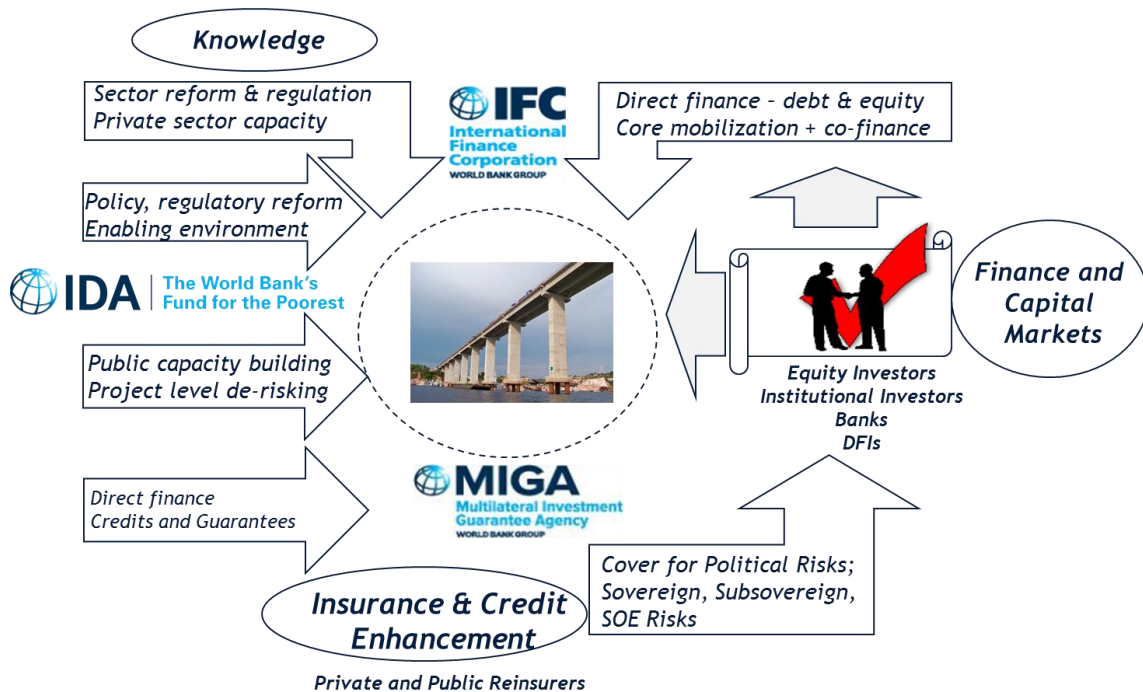
The precarious position of pioneer investors in FCS surfaced as one of the main topics of conversation in Dublin. Successful pioneers in FCS often see their first-mover advantage disappear as soon as new entrants appear in their market with significantly lower costs and risks. This prospect of loss as a ‘reward’ for success has a deterring effect on investment in FCS. Helping these investors hedge their first loss risk will be an important building block in scaling up private investment in the coming years.

Participants underscored the need to use public development finance to address these specific FCS concerns, for instance by providing capital at below market rates, by providing insurance or by actively partnering in the management of enterprises. To ensure such ‘subsidy’ is used where it is most needed and to avoid market distortion, participants called for transparency, for instance by using the value-added of multilateral platforms, such as the WBG and IDA.

B. WBG TRACK RECORD IN SUPPORTING PRIVATE SECTOR IN IDA COUNTRIES

14. **IDA/IBRD, IFC, and MIGA have the ability to tackle constraints to private sector development on the public sector and private sector sides** (Figure 3). In low-income countries, IDA provides a central platform for the WBG support to the private sector through its work on improving regulatory quality, strengthening macroeconomic and structural policies, providing quality infrastructure, and improving labor market and skills policies. IDA can also directly support the private sector through lines of credit and guarantees backstopping Government/SOE payment and performance obligations.⁴ IFC provides direct investment, in the form of equity, debt and credit guarantees on commercial credit risks, as well as advisory services. MIGA provides guarantees to cover non-commercial risks in the form of political risk insurance and credit enhancement. All three institutions aim at direct financing (on the public or private side) as well as mobilization.

Figure 3: WBG value chain in supporting the private sector



15. **The WBG has delivered over US\$100 billion over the last decade to support private sector investment (Table 1).** Increasing investments and improving results in FCS has been a special theme for IDA since IDA15:

- Since IDA14, IDA has invested US\$71 billion in lending in infrastructure, skills development, agribusiness, SME, financial inclusion, competitive industries, and financial systems. Of this, 13 percent was in FCS countries (14 percent in IDA17). Through a broad spectrum of interventions, IDA provides a mix of finance and policy-

⁴ See Moldova Private Sector Project.

based operations to support reforms and technical assistance for a range of reforms, e.g., customs. Much of IDA's support to enhance quality infrastructure provides short-term jobs and critical long-term conditions for private sector growth. At the transaction level, IDA also provides project- and policy-based guarantees (by policy requiring a counter-guarantee from the sovereign) that benefit the private sector, broadens access to finance for micro, and small and medium enterprises.

- Since IDA14, IFC financed US\$25 billion from its own account in IDA countries – of which US\$3 billion was in FCS – and mobilized an additional US\$11 billion, supporting projects worth approximately US\$80 billion. Of this total, 12 percent was in FCS countries (growing to 16 percent in IDA17). IFC also spent US\$830 million in advisory service projects in IDA countries, of which 24 percent in FCS countries.⁵ In Africa, IFC has a dedicated advisory facility, Conflict Affected States in Africa (CASA), to leverage partner support to ensure presence on the ground and client engagement. Special project development programs, such as InfraVentures and SME Ventures, are designed to expand investments in infrastructure and SMEs. The blending programs in agribusiness, SMEs and climate have created opportunities that otherwise would not be viable. IFC has utilized risk sharing facilities and jointly delivered infrastructure in IDA countries where IDA has provided Project-Based Guarantees. Underpinning all of these efforts, a set of internal incentives and processes are in place to facilitate IFC investments in IDA and FCS countries.
- Since IDA14, MIGA has issued guarantees for US\$9 billion of investments in IDA countries with the total investment mobilized around twice the amount guaranteed. Of this, 31 percent was in FCS countries and where the overall level of foreign direct investment supported was two to three times the amount guaranteed. MIGA also brings in private sector participation by way of reinsurance with the private reinsurance market. MIGA introduced private reinsurance that can take up to 80 percent of MIGA's guarantee exposure which over time has led to greater private guarantee capacity in these markets. MIGA's work in these markets focuses on key development challenges related to jobs, access to power and access to finance. MIGA's political risk insurance and credit enhancement products address non-commercial risks, and help mobilize debt and equity investment. It has also built specialized guarantee facilities for FCS situations that have allowed MIGA to conduct business in FCS markets, such as the West Bank and Gaza Investment Guarantee Trust Fund, the Afghanistan Investment Guarantee Facility, and the Conflict Affected and Fragile Economies (CAFEF) Facility (Annex 4). MIGA's existing portfolio is 11 percent in FCS. Similar to IFC, MIGA's support to infrastructure projects in IDA countries include many examples where the projects have been jointly de-risked with IDA, for example covering operational risks in a project such as off-take risks in power generation projects, and termination.

⁵ See "What it Would Take to Scale-Up IFC Activities in Fragile and Conflict Situations and Low Income IDA Countries", IFC, April 25, 2016.

Table 1: IDA-IFC-MIGA Support for Private Sector Development (PSD) in IDA-eligible Countries
(US\$ million)

	IDA14			IDA15			IDA16			IDA17		TOTAL
	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16 YTD	FY06-FY16 YTD
IDA ^{1/}												
New Lending Commitments for PSD ^{2/, 3/}	3,804	4,868	5,222	5,850	6,487	7,971	6,071	7,244	11,861	7,120	4,661	71,161
of which in FCS	709	675	701	685	816	843	655	1,008	1,300	550	1,104	9,046
IFC ^{4/}												
(i) Advisory Services (AS) Project Expenditure in IDA-eligible Countries ^{5/, 6/}	NA	51	65	75	87	94	103	110	109	80	54	831
of which in FCS	NA	NA	NA	26	27	25	23	25	27	20	12	185
(ii) IFC Own Account Commitments in IDA-eligible Countries ^{7/}	1,459	2,610	2,465	2,590	2,193	2,069	2,279	2,665	2,973	2,289	1,592	25,183
of which in FCS	172	353	82	202	423	236	257	286	479	230	364	3,085
IFC Total: (i) + (ii)	1,459	2,661	2,529	2,666	2,280	2,164	2,382	2,775	3,082	2,369	1,646	26,013
of which in FCS	172	353	82	229	450	262	280	311	506	249	376	3,270
MIGA												
New Guarantees Issued in IDA-eligible Countries	374	387	690	105	343	421	1,056	2,047	1,107	544	2,268	9,343
of which in FCS	150	148	517	10	3	232	341	1,140	200	99	50	2,890
TOTAL	5,638	7,916	8,441	8,621	9,110	10,557	9,509	12,067	16,050	10,033	8,575	106,517
of which in FCS	1,031	1,176	1,300	924	1,269	1,337	1,275	2,459	2,006	899	1,530	15,206

Memo Item: IFC Mobilization in IDA-eligible Countries (including FCS) (US\$ million)

	IDA14			IDA15			IDA16			IDA17		TOTAL
	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16 YTD	FY06-FY16 YTD
IFC Mobilization in IDA-eligible Countries ^{8/}	NA	464	110	223	1,215	832	1,332	2,044	1,533	1,720	1,896	11,369
of which in FCS	NA	0	0	60	78	29	184	608	310	91	24	1,384

Source: WBG databases and staff calculations

Notes:

1/ IDA advisory services and IDA co-financing in support of PSD are not included in this table.

2/ IDA lending commitments for PSD comprise commitments in the following sectors that directly or indirectly support private sector growth: Water, Sanitation and Flood Protection; Transportation; Energy and Mining; Information and Communication; Industry and Trade; and Finance.

3/ IDA lending commitments exclude country amounts for regional projects.

4/ IFC investment data exclude IFC mobilization amounts in IDA-eligible countries. See memo item on IFC mobilization.

5/ Advisory services project expenditure exclude country amounts for regional projects.

6/ Advisory services project expenses for FY07 and FY08 are provided in, "Business Advisory Services Operational Report FY08," page 8.

7/ IFC own account commitments exclude short-term financing and country amounts for regional projects.

8/ IFC mobilization amounts exclude country amounts for regional projects.

16. Efforts to enhance WBG collaboration have received renewed impetus in recent years. Working as “One WBG” was a focus of the WBG strategy endorsed by its Governors in 2013. When global practices were created in 2014, two of them – Trade and Competitiveness and Finance and Markets – merged staffs from IDA and IFC. In practice, working as “One WBG” takes place on three levels:

- *Strategic and country level:* through joint SCD and CPF – to date, 18 SCDs and 6 CPFs have been jointly prepared in IDA countries. One core piece of diagnostics feeding into SCDs is the analysis of binding constraints to private sector development.
- *Sector Level:* through Joint Implementation Plans (JIPs) – 27 JIPs are being implemented in 21 IDA countries. Specific sectoral or thematic initiatives, such as the

Scaling Solar initiative, also bring together the key capacities in the WBG toolbox⁶; and

- *Project level*: through collaboration to complete own and private sector financing for a single project, as well as parallel or sequenced projects with a shared objective. Innovative collaboration and joint financing models have been used for a range of infrastructure projects and for financial sector projects designed to increase access to finance for micro, small and medium enterprises (Annex 5: IEG evaluations summaries on relevant WBG support).

17. **“One WBG” collaboration has led to results in delivering critical infrastructure, agricultural transformation and SME development, through value chain development, productivity enhancement and access to finance.** Many examples of World Bank investment climate and regulatory work have paved the way for important IFC investments or MIGA guarantees, e.g., in Myanmar, the Democratic Republic of Congo (DRC) and Côte d’Ivoire. Energy and agri-business are two focus areas of JIPs that are in progress in IDA countries, including nine in FCSs.⁷ World Bank private sector Project-Based Guarantees (which include risk guarantees in addition to credit and payment guarantees) and MIGA Political Risk Insurance worked alongside IFC investments, especially in the power sector, such as in Ghana, Nigeria, Senegal, Cameroon, Kenya, Uganda and Sierra Leone. Risk sharing facilities with IFC and IDA have been used with some benefits in Africa to support MSMEs, as demonstrated by recent evaluations (Annex 5). In countries such as Cameroon and Rwanda, IDA and IFC have worked closely together to develop private sector-led value chains to enhance agricultural productivity and agribusiness competitiveness to enhance nutrition and food security and increase incomes for farmer, the majority of whom are women.⁸

18. **A recent IEG evaluation of WBG support to electricity access identified the unique WBG synergies in the energy sector** through (i) breaking ground for the private sector (e.g., first independent power provider; first private or privatization of a power company/utility; mobilization of other sources of financing); and (ii) ability to tackle large and complex projects, requiring long maturities. IEG’s earlier review of WBG Guarantee Instruments concluded that WBG guarantees have facilitated the flow of investment in large infrastructure projects in high-risk countries, particularly by enhancing the credibility of untested regulatory regimes.⁹ The IDA Project-Based Guarantee has proven critical to independent power producer bankability for IFC and MIGA projects because of the significant development work that is an integral part of IDA’s engagement. Over the past decade (FY06-15), IDA (through IDA Project-Based Guarantees), IFC and MIGA

⁶ A good example is the Scaling Solar initiative which aims to bring together a suite of WBG services under a single engagement, with the objective of creating viable markets for solar power in each client country. The “one stop shop” program aims to make privately funded grid-connected solar projects operational within two years and at competitive tariffs. When implemented across multiple countries, the program will create a new regional market for solar investment. The suite of services includes: (i) advice; (ii) simple and rapid tendering; (iii) templates of bankable project documents; (iv) competitive financing and insurance; and (v) risk management and credit enhancement products. It currently has engagements in Madagascar, Senegal and Zambia. (Source: <http://www.scalingsolar.org/>).

⁷ Burundi, Cote d’Ivoire, DRC, Great Lakes, Horn of Africa, Madagascar, Mali, Sahel, and Sierra Leone.

⁸ More information and examples, see IDA Special Theme paper on Jobs and Economic Transformation.

⁹ Independent Evaluation Group. 2009. The World Bank Group Guarantee Instruments, p. xii.

have worked jointly in a number of projects, including seven where IDA Project-Based Guarantees were deployed in IFC -financed power generation projects in Sub-Saharan Africa (ex. South Africa) with four MIGA PRI supported projects also largely in energy in Africa.

Table 2: WBG Guarantee Products

IDA / IBRD	IFC	MIGA
<ul style="list-style-type: none"> • Project-Based Guarantee (includes PRGs) <ul style="list-style-type: none"> <u>Loan Guarantee</u> ✓ Credit Guarantee: Covers lenders against debt service default, typically in a public sector project ✓ Covers lenders against debt service default caused by a government’s failure to meet specific obligations, normally for a private sector project <u>Payment Guarantee</u> ✓ Covers payment default of non-debt service related government payment obligations (such as offtake risk) for a private sector project and public-to-public cross-board transaction • Policy-Based Guarantee: Covers lenders against debt service default under a sovereign borrowing supporting a program of policy and institutional reforms 	<ul style="list-style-type: none"> • Credit guarantees (partial, full and credit-linked) of private sector client loan and bond obligations • Risk participation and risk sharing facilities covering credit and performance risks of private borrower loan portfolios of client banks • Global Trade Finance Program: covering non-payment by banks in the markets for trade-related transactions • Client Risk Management Guarantees: Covering counterparty credit risk on private borrowers in derivatives transactions 	<ul style="list-style-type: none"> • Political Risk Insurance covering - <ul style="list-style-type: none"> ✓ Currency inconvertibility and transfer restrictions ✓ Expropriation, including expropriation of funds / commercial bank capital optimization ✓ War, terrorism, and civil disturbance ✓ Breach of contract • Credit Enhancement against Non-Honoring of Sovereign, Sub-sovereign, and SOE • Financial Obligations, including in interest rate and currency swaps, and capital market issuances • Reinsurance: MIGA mobilizes private sector through syndicating up to 80% of its exposure to the private reinsurance market

19. **Given that guarantees are an important part of the WBG effort to mobilize private sector investment, an ongoing effort across the WBG is looking to optimize the use of guarantee products and enhance WBG collaboration.** The initiative is focused on: (i) assessing the optimal level of capital when using guarantees; (ii) mobilizing private sector with least subsidy needed; and (iii) clearly delineating the WBG’s roles along a “value-chain” of a transaction and the necessary institutional environment to facilitate optimizing the use of guarantees (Table 2). For instance, MIGA has a nearly 30 year track record of underwriting political risk guarantees, and using its capital efficiently by mobilizing private reinsurance. MIGA’s current portfolio of guarantee issuances is 47 percent in IDA and 11 percent in FCS, and in FY16, support to IDA countries is expected to comprise more than half of MIGA’s new guarantees for the year. IBRD/IDA also has 30 years of backstopping government obligations in emerging markets; since

1999, when the IDA guarantee program was initiated. Building on a 2009 IEG evaluation, the operational policy framework for guarantees has been revised in 2014, which allowed for all guarantee products to be available in all IDA countries. In this revamp of the policy framework, whilst additional flexibility has been provided to deploy the instrument, Management retained the requirement of a counter-guarantee (even though it is not required by IDA's Articles of Agreement) as well as following the PBA process for country allocations for the use of the guarantee instrument.

20. **IDA will continue to support an expanded use of the IDA guarantee instrument within the existing IDA country allocation system, which could increase in IDA18** (See “Jobs and Economic Transformation” paper). Under an updated operational framework,¹⁰ IDA countries have access to Project-Based Guarantees for the private and public sectors as well as Policy-Based Guarantees, all of which can be flexibly applied. Recent trends in IDA's guarantees program have signaled an expansion in the overall volume and types of guarantees. As a result, since FY14, IDA's guarantee portfolio has grown substantially, with a record ten transactions worth US\$2 billion commitments, supporting primarily infrastructure and energy projects (almost 90 percent of the current pipeline of Bank's guarantee projects are in IDA countries). Further, a strong indicative pipeline for guarantees in IDA countries suggests that robust growth is expected to continue. The emerging demand for new guarantee structures and larger operations has created opportunities for IDA to leverage its resources for high-impact development projects. A scaled-up level of commitments proposed for IDA18 coupled with additional financial flexibility enabled by IDA accessing debt could ease allocation constraints for using existing guarantee instruments in IDA countries.

21. **Overall, the WBG experience shows that well-targeted public resources when applied appropriately can help address market failures and promote public goods through supporting private investment.** The WBG has tested innovative approaches to use targeted public resources to support public policy objectives (Annex 4). IFC's blended finance program has shown how public resources can help overcome market barriers related to higher risks and high cost such as investing in green technologies. MIGA's CAFEF has also demonstrated that blending partner funding can expand the use of guarantees to mobilize the private sector to invest in infrastructure, banks, agriculture, manufacturing and services in FCS. MIGA has likewise been able to blend the use of public resources in providing PRI cover to SMEs in non-MIGA member countries and FCS, for instance through Afghanistan Investment Guarantee Facility, and in non-MIGA member countries, for instance through its West Bank & Gaza Investment Guarantee Trust Fund.

C. RATIONALE FOR AN IFC-MIGA PRIVATE SECTOR WINDOW IN IDA18

22. **Aligned with the directions set in the Forward Look, IDA18 aims to step up efforts in developing the private sector, especially in FCS countries.** Making progress on the IDA18 Special Themes requires strong contributions from the private sector: to create jobs and drive economic transformation, to foster women's economic empowerment, to invest in low-carbon growth paths, to achieve stability and move out of fragility, and to widen the tax base to build

¹⁰ “Enhancing the World Bank's Operational Policy Framework on Guarantees”, R2013-0206; IDA/R2013-0298, dated November 20, 2013 and approved December 3, 2013.

strong institutions. More broadly, echoing the “Financing for Development” agenda, the Forward Look emphasizes that, given the private sector’s risk-return considerations, at the country level, the institutions of the WBG should work to improve policies and institutions to enable and de-risk opportunities for foreign and domestic private investment; develop bankable projects; invest in and catalyze investment for specific private sector solutions; and mobilize additional private funding for those solutions through various mechanisms and platforms. It also envisions that the WBG would work to support the development of robust local capital and financial markets; build private delivery capacity where needed; support vibrant local entrepreneurship development; have a systematic approach to the most strategic use of public, private and public-private solutions; advise on public-private partnerships; and advise on and bring in the most appropriate partners. The Forward Look sees the WBG as an intermediary of private capital flows (traditional and unconventional) into developing countries, developing and de-risking mobilization mechanisms; and as an enabler of solutions.¹¹ The WBG is in a unique position to combine strengths in public sector work with private sector engagement and to develop comprehensive solutions.

23. In that context, the WBG has set high goals on its engagement with private sector in IDA countries, and especially in FCSs. IDA18 seeks a significant scale up in financial support to meet unprecedented demand – including a doubling of resources for FCS.¹² Based on historical trends, if IDA continues to devote almost 50 percent of commitments to private sector, then the IDA18 package could provide an additional US\$10 to 15 billion in commitments to support the private sector. The PSW needs to be seen in the context of this broader package. In addition, IDA’s detailed commitments for IDA18 are spelled out in the “Jobs and Economic Transformation” paper (Box 1). IFC also aims to scale up further its activities in IDA and FCS. IFC’s recent Strategy and Business Outlook envisions, with the appropriate instruments and resources, an increase in the FCS portfolio from the current 3 percent to an indicative 6-8 percent by FY19. MIGA targets IDA and FCS countries as priority areas of interventions as clearly stated in its three year Strategic Directions paper.¹³ More than sixty percent of MIGA’s guarantee issuance in FY16 is expected to be in IDA countries.

24. To achieve these objectives, IDA and its partners IFC and MIGA must overcome obstacles. While much can be achieved by scaling up existing instruments that have performed well in the past, there are gaps that motivate the proposal for a new approach.

25. Beyond its ability to scale up financing through the IDA18 package, IDA could experiment with approaches that would foster further collaboration with IFC and MIGA. In some IDA and FCS markets, job creation requires pioneering investors creating a demonstration effect for foreign and domestic investors. While IDA helps create an enabling environment for the private sector, it could partner with IFC, MIGA and the private sector to help deal with higher risks and invest in these difficult environments. Direct private sector interventions, with the right standards, would be key to bringing pioneering and responsible investors to IDA markets. IDA can solidify and leverage opportunities arising from IFC and MIGA to support investment to grow domestic private sector and create conditions to attract long-term, responsible foreign investors. IDA’s guarantee products, the Project-Based guarantee (which includes risk, credit and payment

¹¹ Forward Look: Interim Report to Governors, Development Committee Discussion Note, February 2016.

¹² “The Demand for IDA18 Resources and the Strategy for their Effective Use”.

¹³ MIGA Strategic Directions FY15-17.

guarantees), which requires sovereign guarantee, works well, but might not always be the appropriate instrument, e.g., when (i) there are difficult trade-offs between direct public investment and government-backed guarantee to catalyze private investment within country envelopes; (ii) there is a critical timing mismatch between planned public investment and more opportunity-driven private investments; and (iii) the size of country envelopes is insufficient.¹⁴ Another option that will be considered as these proposals are further explored is IDA revisiting its requirement for a sovereign guarantee for its guarantee products.

26. IFC's growth in IDA and FCS is primarily constrained by investment climate and government and private sector capacity issues that lead to high risks and costs for private investment.¹⁵ As discussed in Section A, IFC and private investors face challenges related to a small private sector and markets, weak investment climate and government capacity, difficulty finding acceptable sponsors, potential for difficult environmental and social issues, coupled with a sometimes volatile environment. These climates lead to both financial and non-financial risks and potential high costs for investors. IFC's own results are indicative of the issues. For debt, IFC's average risk-adjusted return over the last five years is negative 1.3 percent for all IDA, negative 7.1 percent for LIC-IDA (not including FCS), and negative 7.6 percent in FCS, against a +4.2 percent return across all IFC clients. This is primarily due to the high costs of IFC operations in IDA countries, especially FCS and LIC-IDA. Equity returns in IDA and FCS have generally been similar to IFC's overall portfolio.

27. MIGA is constrained by (i) limited, unavailable or highly priced private market reinsurance capacity in high risk countries; (ii) higher capital requirements for projects in challenging environments; and (iii) risk-based guarantee pricing adding additional costs to small scale projects in IDA and FCS markets that can lead to higher overall costs to projects and consumers. A significant change in the risk diversification of MIGA's balance sheet to a much more risky position may have an adverse effect on MIGA's ability to continue providing guarantees in markets where MIGA's concentration is approaching exposure limits, or else affect MIGA's financial sustainability. MIGA also faces increased project complexity leading to longer time to complete, and higher costs of, underwriting of guarantees in IDA and FCS projects.

28. These broad challenges call on IDA to take on an additional role. IDA could potentially play a critical role in adopting new tools to address the specific constraints outlined in para 11 and enable IFC and MIGA to help expand private sector development in high risk countries. It builds on IDA's comparative advantage in supporting the enabling environment but also extends IDA's reach and influence by enabling more engagement with responsible private investors intermediated by IFC and MIGA. This opportunity could potentially further enable IDA's catalytic role to shape the nature and form of critical private investments in IDA countries, especially in FCS.

29. Management is therefore proposing the creation of an IFC-MIGA Private Sector Window (PSW) to enable IDA to deepen its direct engagement with the private sector,

¹⁴ It should be noted that the requirement for a sovereign counter-guarantee in IDA guarantee, could be waived as a policy. Additionally, IDA guarantees are priced more cheaply than MIGA insurance (for example) and set at the same rate for all IDA countries, unlike IFC/MIGA project-specific pricing.

¹⁵ See "What It Would Take to Scale-Up IFC Activities in Fragile and Conflict Situations and Low Income IDA Countries", IFC, April 25, 2016.

address specific challenges in infrastructure, SME financing, local currency hedging, pioneer investments, and reinsurance, and deepen WBG collaboration. A new PSW would be funded by a portion of IDA's equity for direct interventions with the private sector. This would be aligned with efforts to leverage IDA's equity. This window would enable IDA to deliver flexible, real-time responses to private sector opportunities, leveraging IFC's and MIGA's operational platforms and strong expertise, standards, track records, and partnerships with the private sector. It would promote and facilitate a close collaboration and coordinated approach across IDA, IFC, and MIGA, leveraging the strengths of each – including the sector knowledge, policy dialogue and financial strength of IDA, the project development, structuring, mobilization platforms, and global client relationships of IFC, and MIGA's political risk knowledge underpinned by established underwriting, pricing, claims management and reinsurance capabilities. The PSW would help countries crowd-in the private sector and expand the range of solutions available to address IDA country challenges, with a significant leveraging impact. The window needs to be seen in the broader context of the overall WBG engagement on private sector development, including IDA's and IFC's technical assistance to the public and private sectors respectively. In parallel with PSW activities, IDA engagements may be developed to focus on sector level reforms and other activities that support pioneering investment.

D. KEY PARAMETERS AND POTENTIAL FACILITIES

30. **Size.** IDA obligations under the PSW would be covered through an allocation of IDA's equity in the amount of US\$2.5 billion. Possible expansion could be discussed at the time of IDA18 Mid-Term Review based on progress and client demand.

31. **Additionality.** IDA, IFC and MIGA will demonstrate clear additionality of the proposed PSW to their current activities. The PSW would cover all IDA-only countries, with a special focus on FCS, and be aligned with IDA18 special themes, especially jobs and economic transformation.¹⁶ Likely focus areas include: infrastructure, SMEs, agribusiness, social inclusion, and innovation & technology (Annex 1). A clear baseline will be established to show what specifically it means for IFC and MIGA to expand into more frontier environments in terms of risks, financing, and operating models and how the PSW can support what is truly "additional". Strong private sector mobilization will be a key objective of the window and tracked accordingly.

32. **Allocation.** The PSW would not be subject to country allocations or require sovereign counter-guarantee, in order to allow flexible deployment of resources in partnership with private sector clients, building on IFC's and MIGA's opportunity-driven business models. It would allow IFC and MIGA to respond more quickly to private sector partners, especially those who are successful and experienced in riskier markets, and changing market conditions. Clear, transparent parameters would be developed jointly by senior level management to guide the allocation of resources, ensure alignment with IDA priorities and avoid a concentration of risks, recognizing that resources will be more concentrated than in the regular IDA allocation system.

33. **Possible facilities.** To enable a discussion around the broad rationale and organizing principles of the PSW, six potential facilities have been considered so far, in part to illustrate the

¹⁶ See IDA18 Special Themes Papers on Fragility, Conflict and Violence (FCV) for definition of IDA FCS as well as Jobs and Economic Transformation.

opportunities and challenges of the PSW. Importantly, further design will explore ways to keep the PSW more focused and avoid fragmentation. Facilities would be designed to bring the risk and return considerations of investing in FCS markets to a range where private sector investors and participants would be willing to engage in projects that otherwise would be unviable. Regular commercial risks that investors would bear under normal circumstances (e.g., credit, construction, reputational) would still be borne by investors, while non-commercial risks, mostly related to sovereign/sub-sovereign/SOE or social/civil issues, need to be mitigated so that private investors will be able to participate. The level and extent of such mitigation measures need to be temporary and phased out over time. Specifically:

- To address the challenges of private sector participation in infrastructure, a **Risk Mitigation Facility to support Infrastructure and PPPs** would provide guarantees backed by IDA's equity, to supplement existing WBG instruments covering key non-commercial counterparty risk, e.g., breach of contract, particularly as it pertains to SOE payments under power purchase agreements, water purchase agreements or road use minimum revenue guarantees, without sovereign guarantees. Such coverage enhances project viability to facilitate private sector participation. The facility would not be subject to current IDA country allocations and would be deployed without sovereign indemnity, thus de-linking a government's capital expenditures for a project from any additional guarantee obligation required to de-risk the project. While existing guarantee products have been essential to facilitating infrastructure investments in challenging markets, their use can be constrained by factors such as: (i) the size of available country envelopes vis-a-vis the country's overall investment needs; (ii) critical timing mismatches between planned public investment and private investments; (iii) the need for sovereign counter-guarantee can constrain their use in many of the poorest countries with limited fiscal space; and (iv) existing IDA guarantee instruments that cannot by Bank Guarantee policy directly cover IFC loans. IDA's first loss in collaboration with MIGA through this facility would also allow MIGA to extend its product range to offer Breach of Contract cover for liquidity payments by off-takers to complement its existing Breach of Contract cover for termination payments. This extension would complement IDA's existing role (including the coverage, since the 2014 reform, of these risks under a separate Bank instrument) and increase the bankability of deals in IDA markets. Such facility could lead to a substantial increase in private investment in IDA countries. IDA's equity, combined with IDA reform support to governments, could be leveraged up to 6 times in total investment in the priority sectors, including IFC own account investments, and investments from MIGA-covered equity or loans. MIGA-supported investments would also benefit from MIGA's ability to bring in reinsurers. Recognizing that such facility may pose overlap with existing WBG guarantees – including IDA possibly undertaking guarantees without sovereign guarantee – next steps will ensure each institution's comparative advantages are incorporated. A key consideration to pursue this facility will be to assess when, given the nature of the risks covered, a sovereign counter-guarantee is an effective mitigation strategy.
- To address the challenge of non-existent currency hedging markets and instruments, a **Local Currency Hedging Facility** would hedge the market risk (interest rate, exchange rate) of local currency financing provided IFC in countries where it is

currently not feasible to hedge these exposures. In other words, the Facility would bear the currency and interest rate risks of local currency investments originated by IFC for projects in IDA countries and hedged with the Facility. The relevant IFC or private investors would bear the credit risk of the projects. The Facility would provide cross currency/interest rate swaps and/or forwards to facilitate local currency financing solutions for these projects for both IFC's own loans and/or syndicated loans. Given that the Facility would not be leveraged initially, the Facility would allow for the provision of local currency investment in countries in which hedging markets are underdeveloped or completely missing. Once experience is gained and a diverse pool of currency exposures is built-up, the Facility could potentially be leveraged into as much as twice its initial equity base. Such facility would provide clear additionality vis-a-vis existing solutions which cannot be used in many of these markets due to a lack of sufficient deep/liquid bond markets (essential for pricing hedges), creditworthy counterparties, and a local skill base trained in the prudent employment of hedging products. In certain cases, hedging options do exist in the countries but are not available for long-term projects or at pricing that would allow their use in a financially feasible way. Two key challenges for pursuing this facility further will be to develop a pricing model, since market prices usually used for this are largely absent; and to see how such arrangement can have a sustainable impact, beyond the ability to facilitate one transaction.

- To finance the growth of SMEs, an **SME Guarantee Facility** would be designed to support a portfolio of SME finance projects in higher risk countries requiring credit risk mitigation for IFC to invest. Instruments eligible for inclusion in the SME finance portfolio would primarily include risk sharing facilities, partial credit guarantees, loans and small equity investments. The proposed risk pool could also be used to support housing finance and green/climate finance. Guarantees supported by IDA equity could be leveraged at least seven-fold to increase access to finance for tens of thousands of SMEs, and directly create hundreds of thousands of jobs, with additional job multipliers. In addition, outside of the PSW, complementary advisory services would be needed for banks to support prudent growth of the SME portfolio with appropriate risk management, and for advice to support financial infrastructure. Two key challenges for such facility are its pricing and its ability to generate a sustainable impact (beyond the time horizon of the guarantee itself). IDA has substantial experience in providing SME support and the design of such facility will draw upon this experience to ensure it fills gaps and does not duplicate existing approaches. As these options are developed and existing IDA and IFC products are further strengthened, particular attention will be paid to ensuring consistency across approaches..
- To facilitate pioneering private investments in sectors such as agribusiness, entrepreneurship, technology, and social inclusion, an **IDA-IFC Co-Investment Facility** would enable IDA to co-invest alongside IFC to help de-risk high impact investments. The proposed IDA co-investments would allow IFC and commercial investors to take on higher risk investments and help crowd-in private capital, know-how and access to markets in IDA and FCS countries. Co-investment would be deployed through existing (e.g., the Global Agriculture and Food Security Program Private Sector Window – GAFSP PSW) and new blended finance investment platforms

managed by IFC. IDA capital from the proposed co-investment facility would be leveraged approximately seven times to increase investment (either via debt or equity) in the priority sectors, including IFC own account investments. Along with this facility, outside of the PSW, complementary IDA engagements as well as Advisory Services to support project development and build client capacity would be necessary. Further analysis of the legal and reputational risks to IDA on this option will be carried out.

- To enable further investments in challenging contexts, and in addition to the use of first loss to provide Breach of Contract Liquidity support under the Risk Mitigation Facility for Infrastructure and PPPs above, an **IDA-MIGA Shared First Loss Facility**, would increase the reach of MIGA's traditional PRI products in markets where currently these are underutilized. This facility would include risk sharing or allocation of losses to a first loss position, and act as a risk mitigant and provides an added layer of reassurance to insurance and guarantee providers covering investments against non-commercial risks. MIGA would have a position in the first loss with IDA. This feature has been key in attracting participations from the private reinsurance market to support larger transactions at prices which make the projects viable for ultimate beneficiaries. And for MIGA, it helps offset the capital charges associated with supporting investments into riskier countries where conditions would be expected to lead to a higher incidence of loss. There is also potential for this window to be selectively used to cover MIGA PRI premium payment for small investments in FCS countries, similar to donor-funded collaboration with MIGA in the past. Thus, this IDA-MIGA first loss facility would support a multiple of investments as it would have a revolving feature – e.g., as guarantees mature or are canceled, the Facility capacity released would be used to support additional investments. IDA's participation in a first loss position would encourage investment into risky environments and bring in the private reinsurance market to support such investments. IDA can leverage MIGA's established processes to ramp up quickly.
- To mitigate the absence of reinsurance markets, **IDA as Risk Participant (Reinsurer)** would enter in an agreement with MIGA to share MIGA's risk exposure on an equal footing, and receive a share of the premium income paid by the private sector participant for a guarantee. MIGA successfully entered in a similar agreement with commercial reinsurers through reinsurance arrangements. IDA countries that face limited or non-existent commercial reinsurance appetite or capacity, or projects that are not covered with MIGA's current reinsurance agreements, would strongly benefit from such a risk sharing arrangement. Coverage initially offered by the Facility would provide protection against key political risks of: expropriation, breach of contract, transfer restrictions and inconvertibility, and war and civil disturbance. MIGA and IDA would share the risk exposure and returns to a project on an equal footing, which means that each entity would bear its share of losses pro-rata to its share of project exposure, but also income and any claim recoveries.

E. FINANCIAL IMPLICATIONS, GOVERNANCE AND RISKS

34. **This section highlights key considerations in operationalizing the PSW, including financial implications, governance and risks.** Based on Participants' guidance, further details will be developed for the third IDA18 meeting. This work would also be reviewed in detail within WBG governance systems.

35. **Under the structure, IDA's exposure would be capped at the window's proposed size of US\$2.5 billion.** Although other forms of support could emerge as the proposal is developed, IDA's support could be used for un-funded guarantees and reinsurance, which are contingent in nature and would not require any disbursement of funds unless there was a loss event. Therefore, although initially the facility would likely require significant provisioning for risk management purposes, most of this equity would remain on IDA's balance sheet until the underlying investments or guarantees in the window realize losses for which IDA would pay its share. A few of the potential facilities – including the IDA/IFC co-investment – would require IDA funding. IDA would ensure that it has adequate liquidity to satisfy any expected payouts. The accounting implications will need to be further assessed.

36. **Pricing and risk/return allocation.** A principle-based approach to risk and return will be developed. Similar to IFC's and MIGA's current pricing structures, facilities used in the PSW will be priced based on relevant WBG benchmarks – in this case IDA's non-concessional rates, which represent an alternative return on IDA's equity. Relative to this benchmark, a spread or risk premium would be required to adjust for private sector risk. In practice, the objectives of the PSW – making transactions commercially viable while minimizing market distortions – are such that a premium to IDA's non-concessional rates might not always fully reflect all the risks involved. This is because (i) the risks in question are primarily non-commercial in nature, for which markets do not exist and so are difficult to quantify; and (ii) any ex-ante estimate of such risks would lead to pricing that would simply not be viable for the countries, sectors and projects being targeted.

37. **In order for high-impact or pioneering investments in challenging markets to be feasible, the PSW might provide pricing that does not fully reflect the risks that IDA is bearing** – i.e., involving some “concessionalality”. Unlike IDA's concessional lending to countries, this concept of concessionalality is the subsidy necessary to induce the intended investment.¹⁷ This would be driven by a business need where the development impact outweighs the potential financial costs. A clear justification of such an approach is that the PSW is specifically designed to support pioneering investments in challenging environments, where initial investors create positive externalities for future investors (through demonstration, catalyzing enabling environment etc.), but cannot capture the benefit of such externalities themselves; and so need to be supported. Based on the principle of minimum concessionalality, Management would develop pricing structures with appropriate review (e.g., similar to existing blended finance process, Annex 4).

¹⁷ Minimum “concessionalality” is the subsidy embedded in a blended financing package should not be greater than necessary to induce the intended investment. This approach reduces the potential for market distortions and helps to accelerate transformation of nascent markets. It also maximizes the leverage of the resources available to fund subsidies. See Annex 4.

38. **Rule-based platform and arms-length agreement.** The PSW would use a rule-based platform which establishes joint development objectives, results measurement standards, investment parameters and a clearly defined set of roles for each WBG institution. As a principle, arms-length agreements amongst IDA, IFC and MIGA will be reached to minimize potential conflicts of interest and ensure that IDA's financial interests and development objectives are protected. For instance, arrangements could be developed to distinguish between financing decisions and daily management of funds. Because market opportunities and client needs evolve, the PSW will be designed to allow for flexible use across the proposed facilities based on changing conditions.

39. **Governance.** Given the proposed collaboration, the linkages across WBG instruments, and financial arrangements between IDA, IFC and MIGA, strong governance is of utmost importance and still needs to be carefully considered and approved. (See Annex 6.) The governance structure will aim to be accountable and effective to ensure that all resources are utilized for maximum impact and IDA's fiduciary responsibilities to the IDA donors are appropriately met. It will aim to address both IDA's public sector client concerns, as well as IFC's and MIGA's private sector client focus. While these interests may not be fully aligned, the PSW will seek to support private investments that yield strong development impact and positive externalities. To ensure accountability, clear reporting arrangements with regular senior management oversight processes will be established. Mechanisms will include a senior level committee to provide oversight and governance for the WBG partnership. The committee would meet to review progress, discuss implementation issues, and consider risks. Results and impacts would be measured and reported accordingly, with clear indicators in areas such as jobs and FCS. Building on IFC and MIGA experience with blended facilities, particular attention will be paid to ensure that capital is optimally allocated and priced so that transactions are viable while minimizing elements that are priced at non-risk adjusted levels. A working level secretariat would also be considered to manage the day-to-day operations and ensuring optimal approach to IDA's participation. For the avoidance of doubt, IDA, IFC, and MIGA will each evaluate the risks and rewards of deployment of PSW Facilities for their respective institutions; the extent of transaction-level review will be determined for each proposed facility during the negotiation of the framework agreements that will govern each. In these discussions, the interests of all WBG institutions will be considered.

40. **Existing governance structures, including the role of the IDA, IFC and MIGA Boards, will be leveraged.** The ongoing management of the PSW will build on IFC's and MIGA's experience and core skills, while drawing from the Bank's sectoral expertise and experience with guarantee and other related products. For example, in developing joint CPFs, potential objectives supported by the PSW could be identified. IFC's track record and experience with strong and transparent governance that provides comfort to all parties, including its experience with blended finance, and MIGA's track record and experience structures such as CAFEF (Annex 4) offer useful lessons on a robust governance process necessary to ensure clear additionality, pricing policies to avoid distortion, and sustainability, with clear guidance on reporting, and managing potential conflicts of interest, and financial and reputational risks. As part of the value addition of the window, the governance structure will give IDA the opportunity to provide appropriate strategic inputs and sector knowledge to help ensure consistency of the proposed facilities with a country's larger development strategy and poverty reduction goals.

41. **The specific governance arrangements will depend on the nature of the facilities** (Table 3). The facilities considered so far fall along the continuum between two implementation approaches – de-risking and co-investment/participation. These approaches carry different levels of risk and return, and will require different levels of oversight.

- **Co-investment/participation.** The incentives of IDA and IFC or MIGA are aligned through a “pari passu” approach to investment/guarantees. These facilities – MIGA risk participation and MIGA shared first loss in FCS – augment the capacity of IFC and MIGA for individual projects or portfolios of existing risks, hence will help them expand their portfolios in IDA and FCS markets where both capital and capacity are constrained. IDA would be a co-investor in IFC’s projects or a risk participant in MIGA’s guarantees, sharing risks and returns. This arrangement would ensure alignment of incentives, reducing the need for an overly complex oversight and negotiation structure. IDA would be able to leverage IFC’s or MIGA’s risk assessments and will require a strong baseline to assess “additionality”. While this would enable a simpler and transparent design and implementation, the structure offers less risk reduction of transactions than a ‘de-risking approach’.
- **De-risking.** In this approach, IDA takes more risks than IFC or MIGA, to unlock investments that would otherwise not happen. In these cases – e.g., the risk mitigation facility, co-financing facility, local currency hedging, SME risk sharing facility – IDA mitigates portions of key non-commercial risks that IFC, MIGA and their private sector co-investors cannot accept, which currently prevents the development of high-impact projects. By helping address the risk constraints, this approach result in more mobilization and investing in transactions than would otherwise be unviable. At the same time, given the different risk positions taken by IDA vis-à-vis IFC and MIGA, the risk implications will need to be scrutinized and a more involved governance mechanism will need to be established to oversee design and implementation and manage risks. It can build on existing governance systems, such as those for IFC’s Blended Finance Facility and MIGA’s CAFEF. For these facilities, arms-length arrangements will be considered to the extent possible to ensure appropriate governance.

42. **Based on Participants feedback, a comprehensive proposal will establish governance and oversight.** In addition to this proposal, operational specifics on project selection and allocation criteria, pricing and approval, will be prepared. This will be reviewed and agreed through relevant decision-making processes, including with the Board.

Table 3: Summary of Structuring Approaches

	Co-investment/Risk-participation	De-risking
Approach	IDA and IFC/MIGA take a pari passu participation in a transaction or portfolio	IDA provides credit enhancement (e.g., in the form of guarantee or co-investment) to support IFC investments and MIGA guarantees.
Examples	<p>IDA reinsurance of MIGA, for new and existing exposures, sharing risk on a pari-passu basis</p> <p>IDA first loss with MIGA to expand the reach of political risk insurance products, and to provide liquidity support to offer its breach of contract cover to a broader range of public finance and project finance loans, particularly for infrastructure</p>	<p>IDA counterparty risk guarantee infrastructure for projects</p> <p>Local currency hedging</p> <p>First loss for portfolio of SME financing</p> <p>IDA co-investments with IFC</p>
Potential impact	Provides additional capacity for IFC to invest in and for MIGA to issue guarantees for private sector where currently such capacity is limited (too expensive or unavailable)	Enables transactions that would otherwise not pass risk/return thresholds
Governance	Streamlined, relying on alignment of incentives for IDA to delegate management	Robust, to protect IDA's interest – including proper targeting of public resources. Would build on existing practices (e.g., blended finance and CAFEF)
Pricing	Builds directly on IFC/MIGA methodology	Requires developing and negotiating a pricing methodology; can build on existing approaches (e.g., blended finance, CAFEF) more start-up investment and time
Financial Risk	Financial risks, similar to that of IFC/MIGA	IDA exposed to higher risk and severity of loss than IFC/MIGA
Reputational Risk from Conflict of Interests	Minimized because of pari passu arrangement	Higher reputational risks

43. **There are substantial risks with the proposal.** IDA's exposure to private credit risk without sovereign indemnity is allowed by its Articles of Agreement, but has not been applied in practice. There are reputational and financial risks with these investments, which IDA and its shareholders have not yet faced. IDA also bears fiduciary responsibility to the funds entrusted to it by contributing partners intended for poverty reduction in recipient countries. To mitigate these risks to IDA, pre-agreed frameworks can be negotiated at arms-length based on several well-established mechanisms that delegate of authority to IFC and MIGA for origination and monitoring of business completed under the Facilities with IDA resources. Such models include IFC's Blended Finance Facility and MIGA's CAFEF program. These frameworks provide important protection and monitoring/reporting protocols for the benefit of third-party entities providing partner funds for IFC and MIGA projects, with the aim of extending the reach and capacity of each in challenging markets. The application of these frameworks will depend on the facilities

ultimately selected and some of the implementation challenges might be significant enough not to proceed with one or more of the facilities.

44. **Financial risk.** The proposed window would introduce higher financial risks – namely private sector and currency exposure – to IDA’s balance sheet. Losses from the underlying transactions will negatively impact IDA’s commitment authority. While pricing under the PSW will aim to preserve capital as much as feasible, the probability of losses will increase and may be significant in some cases. FCS and IDA environments are inherently risky and possible portfolio concentrations for IDA in a few countries could add significant risk that are difficult to model or predict. As a starting point, IFC’s and MIGA’s loss experience can be helpful in illustrating a range of potential losses. The PSW will be managed to minimize potential losses and preserve IDA’s equity to the extent possible. As next step, management would conduct a comprehensive analysis of financial risks, including losses, and design the PSW in a way that is consistent with IDA’s overall financial sustainability and future leveraging strategy.¹⁸

- The facilities would have varied levels and sources of risk for IDA. IFC’s existing SME Facility could serve as a reference point for the potential SME First Loss Facility; IFC’s facility has seen modest negative returns, which may be higher for IDA given the proposed first loss position. As another point of reference for the IDA/IFC Co-Investment Facility, IFC’s GAFSP private sector window has realized breakeven returns.¹⁹
- The market risk associated with currency hedging of non-freely-convertible denominations is substantial. IDA’s exposure would be subject to currency movements from less liquid and more volatile currency markets especially given that IDA would have no means to offload this risk on its own. Preliminary analysis indicates that a Currency Hedging Facility could lose approximately 15-30 percent of its capital under certain stress scenarios.²⁰ These losses, if realized over the 10-year time horizon of the Facility, would result in a depletion of the IDA equity allocated to this Facility. However, gains on this Facility (over the same 10-year time horizon) are also possible and would result in a commensurate augmentation of IDA’s equity. In the interim, losses/gains could be even greater and may draw reduce (or increase) the equity allocated to this facility. There would need to be clear agreement in advance on how excess losses with respect to the Currency Hedging Facility would be handled.
- MIGA’s underwriting experience has been positive so far, with only eight claims paid of US\$22 million on US\$30 billion of guarantees issued over its 28 year operation history. This also reflects MIGA’s capabilities and processes to manage risks at pre-claim level (only eight claims paid out of over 110 pre-claims among over 800 projects thus far). CAFEF, which would represent a similar instrument to MIGA’s Shared First

¹⁸ For modeling purposes, in the “IDA18 Financing and Leveraging Framework” paper, the PSW is modeled as a guarantee.

¹⁹ Both exclude technical assistance expenditures; after accounting for these expenses, returns would be lower and/or even more negative.

²⁰ This is a high-stress scenario, which is not the baseline expectation of the facility. The hedging facility would follow a pricing approach that would on average preserve the facility’s capital resources over a long time horizon.

Loss proposal, has not recorded any losses so far, though scaling up in FCS markets would certainly increase MIGA's and IDA's risk exposure due to a number of factors including the inability to assist in claims situation successfully; severe losses and slow recoveries; and inability to mobilize substantial reinsurance.

- Because IDA does not currently manage these financial risks²¹, the structure of the proposal will be designed to enable IDA to address these risks prudently. Most importantly, management will place a clear limit on IDA's capital usage and incorporate an appropriate pricing framework. The proposal recognizes that using IDA's capital for higher risk investments for the PSW could result in losses against IDA's equity, especially given the absence of a sovereign indemnity. Any losses for IDA would be capped to the equity it has invested. Risk-adjusted pricing where feasible – received as guarantee fees and insurance premia – will provide a layer of protection to IDA's commitment authority against potential losses. Additionally, while IFC and MIGA will use their experience to optimize the risk-return of each transaction, specific review of these transactions will be important to ensure transparency and equity. Furthermore, initial guidelines would be established to determine size, concentration limits and tenors.

45. **Reputational risk.** Reputational risks for IDA are significant especially for its policy-based lending instruments and its role in providing unbiased advice on Government policy. Systems will be established to reduce any perception that IDA policy advice is biased towards protecting its investments through the PSW or towards firms likely to get support from it. Closely related to financial risks, reputational impact to all parties also arises from the intra-WBG nature of the proposal. The risk will be mitigated by clearly aligning incentives and interests that will enable a reliance on IFC and MIGA policies and processes while accounting for the objectives of the jointly funded window. Under a de-risking approach, where the structure of the PSW does not align interests, reputational risk is particularly significant. The proposal would need to address conflicts of interest that arise with respect to financial transactions between different entities in the WBG, through well-established mechanisms. Arms-length agreements amongst IDA, IFC and MIGA will minimize potential conflicts of interest and ensure that neither party unfairly benefits from the financial arrangements. In addition, clear and efficient senior management oversight will be designed. Regular reporting of financial and performance indicators will be developed for stakeholders, building on proven processes established at IFC and MIGA.

46. **Implementation risk.** Finally, given the objective of expanding engagement in difficult markets, IFC and MIGA will need to consider actual demand and their capacity to implement targeted, eligible investments. Increasing investments, in particular in FCS, requires more care as deal origination can be more time-intensive, costly and is operationally risky. This risk to delivering on the intended objectives would be mitigated by adopting a pilot approach, and the initial funding usage and outcomes to be reviewed at the Mid-Term Review. Management would adjust the pilot by drawing on financial and development results as well as lessons learned.

²¹ IDA does not manage currency risk to non-freely convertible local currencies.

CONCLUSION AND NEXT STEPS

47. **The creation of a Private Sector Window as part of IDA18 provides a unique opportunity to leverage the strengths of each WBG institution to increase impact in IDA countries.** The private sector will be a critical partner in helping IDA countries create good jobs, drive economic transformation, and reduce poverty, and accelerate progress toward key IDA goals, especially in FCS. The proposed PSW requires and facilitates a close collaboration and coordinated approach across IDA, IFC, and MIGA, leveraging the strengths of each – including the sector knowledge and financial strength of IDA, the project structuring, mobilization platforms, and global client relationships of IFC, and MIGA’s political risk knowledge underpinned by established underwriting, pricing, claims management and reinsurance capabilities. With the strengthened partnership, the institutions would be better able to address critical constraints to the private sector, increase private sector engagements in IDA countries including in FCS, help mobilize private capital, and facilitate pioneering investments. The design of the facility will balance the potential for the WBG to expand its scope of activities to higher impact and more market creating activities with the significant reputational and financial risks it poses.

48. **The proposed PSW would be structured to ensure additionality beyond current WBG activities and use IDA funds for high efficiency through strong governance.** Facilities in the PSW could include enhanced risk mitigation for infrastructure and SMEs, co-financing to support SME equity and projects in agribusiness, technology and the social sectors, a currency hedging facility to provide critical long term local currency financing in IDA countries that currently lack market hedging mechanisms, and critical risk sharing to mobilize reinsurance. These facilities would address gaps or capacity limitations in the current WBG capabilities. The impact of these activities could be substantial in ramping up private infrastructure, expanding SME finance including to underserved sectors such as women entrepreneurs, demonstrating and scaling up models for equity finance for SMEs, expanding agribusiness supply chains including integration of farmers into regional and global markets, and helping pioneer new technologies that could have a significant impact on growth and poverty reduction.

49. **Feedback is sought from Participants at the second IDA18 Replenishment meeting on the rationale and organizing principles for the PSW.** Based on Participants’ guidance the proposed window and its organizational principles would be further developed for review and endorsement at the third meeting in October. In particular, details on key issues such as governance, pricing, risk management, and conflict of interests will be developed and vetted with due diligence. Guidance is sought from Participants on the following questions:

- Does the paper present a compelling rationale to establish a new IFC/MIGA Private Sector Window for IDA18?
- What are Participants’ views on the potential facilities and the principles underpinning governance arrangements?
- What are Participants’ views on the window’s size and on risks for IDA, including the possibility that IDA’s equity could be negatively impacted?

Annex 1: Key Investment Focus for the Private Sector Window

<u>Areas of Focus</u>	Closing the Infrastructure Gap	Financial Inclusion & SMEs	Agribusiness and productivity	Social inclusion, innovation and technology
Development Challenge	Over 1.3 billion people – almost 20% of the world’s population – have no access to electricity, and nearly 800 million people lack access to clean water.	A large share of the global populations lacks access to finance: 72% of Africa SMEs are credit constrained; 77% of adults living on US\$2/day are unbanked.	Despite recent drops in global food prices, food security remains an essential development priority: over 900 million people around the world are undernourished.	Exponential rates of mobile phone, internet and broadband adoption create a unique opportunity to harness innovation and technology to address critical development challenges and address social inclusion.
Objective	Catalyze private capital and know-how to help close the global infrastructure gap. US\$1.5Bn of IDA capital could help catalyze US\$6Bn of private investment.	Leverage IDA and IFC resources in partnership with IFC’s banking and equity platforms to help close the financial inclusion gap. US\$300m of IDA capital could support US\$2bn in SME lending and equity funding. Expand the use of MIGA’s capital optimization product to support investment into IDA and FCS countries to expand access to finance.	Leverage IDA resources and private capital alongside IFC investment and advisory to address the global food security challenge.	Harness rapidly evolving technologies to establish a new paradigm for reaching and uplifting the poor.
Expected Impact	Expand access to infrastructure in IDA/FCS countries; contribute to economic growth, economic transformation and job creation.	Expand access to finance for SMEs in IDA/FCS markets-including expanding SME access to equity capital. Expand entrepreneurship, economic growth, and job creation.	Support firms which work with smallholder supply chains, generating increased yields and productivity, while meeting higher quality and ESG standards.	Reduce transaction and service delivery costs, enhance competition and transparency in markets, support entrepreneurship and inclusion.
Cross-cutting themes addresses	Jobs & Economic Transformation -- FCS & Low Income IDA -- Climate Change -- Gender			

Annex 2: Summary of Key Information Potential PSW Facilities

<i>Instrument</i>	Risk Mitigation Facility for Infrastructure and PPPs Project-level non-commercial risk mitigation	SME Guarantee/First Loss Facility	IDA/IFC Co-Investment Facility	Local Currency Hedging Facility	Shared First Loss with MIGA	Risk Participation with MIGA / Reinsurance
Development Objective	<p>Crowd-in private investment in infrastructure in the most challenging markets by covering significant non-commercial (e.g., key public counter-party risks such as offtakers risk). Capitalize on the complementarities of IDA's, MIGA's and IFC's business models, in which each can bear risks that the other cannot and thereby achieve greater reach into IDA countries and undertake higher risk/higher impact private sector projects</p>	<p>IDA first loss risk mitigation pool to stimulate private sector investment in SMEs in IDA and FCS markets. The proposed first loss facility risk pool will allow IFC and other investors to take on additional risk, will help crowd-in private capital to challenging markets and sectors such as SMEs, (including women-owned SMEs), and provide a demonstration effect to other investors.</p>	<p>IDA co-investments to support priority sectors such as SME equity/entrepreneurship, agribusiness, technology, and social inclusion in IDA and FCS countries. The proposed IDA co-investments will be blended with IFC and private capital and will allow commercial investors to take on additional risk, will help crowd-in private capital to challenging markets and sectors, and provide a demonstration effect to other investors</p>	<p>Currency hedging facility to support provision of long-term local currency investments and local currency guarantees for high impact projects in IDA/FCS countries, where capital markets are not developed and commercial local currency/hedging is not available.</p>	<p>In challenging markets, risk sharing or allocation of losses to a first loss position acts as a risk mitigant and provides an added layer of reinsurance to insurance and guarantee providers covering investments against non-commercial risks. This feature has been key in attracting participations from the private reinsurance market to support larger transactions at prices which make the projects viable for ultimate beneficiaries.</p>	<p>IDA countries which face limited or non-existent, or prohibitively-priced commercial reinsurer availability would strongly benefit from such a risk sharing mechanism. MIGA successfully entered in a similar agreement with commercial reinsurers.</p> <p>This is particularly relevant for large projects or sectoral programs supported by IDA requiring significant private investor involvement.</p>

<i>Instrument</i>	Risk Mitigation Facility for Infrastructure and PPPs Project-level non-commercial risk mitigation	SME Guarantee/First Loss Facility	IDA/IFC Co-Investment Facility	Local Currency Hedging Facility	Shared First Loss with MIGA	Risk Participation with MIGA / Reinsurance
Financial Mechanics	<p>De-risking A guarantee facility backstopped by IDA that would cover key government counter-party risks, (including broad credit risk or specific risks that increase the risk to a project’s financial feasibility (e.g., government offtakers) for private sector infrastructure and PPPs. Transactions may be structured without a sovereign indemnity.</p>	<p>De-risking IDA would provide a first loss guarantee mechanism to back a portfolio of local bank support of SMEs through various instruments, including risk sharing facilities, partial credit guarantees, loans to SMEs and small equity investments. IFC would manage the risk pool on a portfolio basis.</p>	<p>Co-Investment IFC would originate loans and equity investments in target sectors and countries. Complementing IFC’s financing, IDA would finance a share of the investment.</p>	<p>De-risking IDA would establish a dedicated pool of capital to support the provision of local currency funding for IFC projects and also possibly for MIGA local currency guarantees for MIGA clients. IFC would execute industry regulated swap agreements with project sponsors to provide the needed local currency funding or with MIGA to effect local currency guarantee cover; IFC would then hedge the market risk (currency, interest rate, commodity price) with the Hedging Facility. IFC would then manage this portfolio, providing some reduction in risk over time.</p>	<p>Risk Participation IDA would share in a first-loss position with MIGA for MIGA’s Political Risk Insurance (PRI) products to (i) expand MIGA’s reach into IDA and FCS markets and for smaller projects, and (ii) to provide liquidity support to allow MIGA to offer its breach of contract cover to a broader range of public finance and project finance transactions. Along with reinsurers, MIGA would also guarantee a portion of the senior tranche of the guarantee. The first-loss tranche would be capped at a certain level, based on demand from the reinsurance market.</p>	<p>Risk Participation IDA would provide reinsurance on a pari passu basis for either specific MIGA projects in IDA LIC/FCS or a portfolio of MIGA guarantees where MIGA is reaching concentration limits to free up additional MIGA capacity to deploy its products in FCS.</p>
Subject to Country Allocation	No	No	No	No	No	No

<i>Instrument</i>	Risk Mitigation Facility for Infrastructure and PPPs Project-level non-commercial risk mitigation	SME Guarantee/First Loss Facility	IDA/IFC Co-Investment Facility	Local Currency Hedging Facility	Shared First Loss with MIGA	Risk Participation with MIGA / Reinsurance
Sovereign Indemnity	No	No	No	No	No	No
Financial Source	IDA equity that would remain on IDA's balance sheet; IDA funding would be called to cover IDA's share of any claims losses	IDA equity that would remain on IDA's balance sheet; IDA funding provided when required.	IDA's part of the co-investments will be funded by IDA	IDA equity that would remain on IDA's balance sheet; IDA funding provided to cover interim mark-to-market losses	IDA equity that would remain on IDA's balance sheet; IDA funding would be called to cover IDA's share of any claims losses	IDA equity that would remain on IDA's balance sheet; IDA funding would be called to cover IDA's share of any claims losses
Financial Terms	Payments for losses would be made as they come due (no acceleration). Returns/losses to IDA will depend on underlying performance of Facility.	Payments for losses would be made as they come due (no acceleration). Returns to IDA will depend on credit performance of Facility. Pricing based on IFC Blended Finance guidelines.	IDA 'non-concessional' terms expected, but subject to the actual performance of the facility. Pricing based on IFC Blended Finance guidelines.	Facility managed on a preservation of capital basis over a 10-year period (i.e., on a breakeven basis). Upside after costs, if any, would accrue to the IDA ring-fenced pool.	IDA will receive a share of the premium income paid by private sector participants generated by the guarantee based on its pro-rata share	IDA will receive a share of the premium income paid by private sector participants generated by the guarantee based on its pro-rata share
Benefits	Mitigates market failures; Powerful mobilization tool for private investment to help close the infrastructure gap in IDA/FCS countries	Mitigates market failures; Powerful mobilization tool for private investment for SMEs and job creation in IDA/FCS countries	Helps mitigate market failures; Mobilize private investment for agribusiness, social inclusion and entrepreneurship (e.g., SME equity) in IDA/FCS countries	Addresses a key market failure (lack of access to long-term local currency) that negatively impacts long-term project feasibility. Protects fragile populations/end-users.	Attracts participations from the private reinsurance market to support larger transactions at prices which make the projects viable for ultimate beneficiaries.	Allows MIGA to underwrite political risks for large projects or sectoral programs supported by IDA requiring significant private investor involvement, or for small projects where MIGA's reinsurance partners are not able to participate.

<i>Instrument</i>	Risk Mitigation Facility for Infrastructure and PPPs Project-level non-commercial risk mitigation	SME Guarantee/First Loss Facility	IDA/IFC Co-Investment Facility	Local Currency Hedging Facility	Shared First Loss with MIGA	Risk Participation with MIGA / Reinsurance
Private Sector Leverage/Mobilization Potential	Similar to IDA's current PRG offerings, these proposals could leverage IDA's capital 6x with private investments. This could benefit from MIGA's 14x leverage of capital (across its full portfolio). High usage in the most challenging markets could negatively impact leverage.	IDA is expected to be leveraged approximately 7x in SME lending.	IDA funds could mobilize approximately 7x in private investments.	The initial leverage of this facility would be on a 1 for 1 basis but could be up to 2-3x over time	Based on MIGA's blended finance experience, leverage of this facility could be up to 10x	Based on MIGA's reinsurance experience, leverage of this facility could be up to 6-7x
Risks/Issues	Possible overlap with existing Bank Guarantees. May lead to large/lumpy exposures in the infra space. Loss severity could be higher due to lack of sovereign indemnity. Risk of meaningful loss of capital.	Loss severity could be higher due to lack of sovereign indemnity and putting IDA in first loss position.	Legal risk and reputational impact need to be further analyzed. IDA exposed to private credit risk; loss severity could be higher due to lack of sovereign indemnity.	Risk of meaningful loss of capital, particularly over short time horizons	IDA continues to be exposed to political risks; although this time without a sovereign guarantee, and delegating the underwriting, pricing, and risk management to MIGA	IDA continues to be exposed to political risks; although this time without a sovereign counter-guarantee, and delegating the underwriting, pricing, and risk management to MIGA
Loss Experience	N/A	Existing IFC SME Facility: modest negative returns, excluding TA expenditures	Existing IFC GAFSP Private Sector Window: breakeven returns, excluding TA expenditures	Difficult to model; volatility and losses could be high over shorter periods. Preliminary analysis based on historical currency movements in IDA countries the facility was estimated to lose no more than approximately 15-30% of its capital at a stress level.	No losses so far in CAFEF experience	8 claims thus far

Annex 3. – IFC & MIGA Project Examples

1. The project examples below are indicative of the types of projects that could be supported by the proposed Private Sector Window. Such projects may never reach financial close or would take significantly longer to materialize without the support of the PSW.

Infrastructure Risk Mitigation Facility:

2. **Bangladesh Onshore LNG Terminal to Power Scheme.** Bangladesh requires large amounts of private investment in natural gas import infrastructure in order to deal with dwindling domestic gas supplies and meet a growing energy deficit. IFC is seeking to support Bangladesh in the development of an up to US\$4bn Onshore LNG Terminal to Power Scheme to enable the import of approximately 500 mmcf/d of natural gas to support as much as 3,000 MW of power generation. The project will underpin the country's economic growth by providing access to low-cost gas to support a critical need for efficient base load power generation. In addition to early stage engagement in the development of the project through IFC InfraVentures, IFC could potentially provide as much as 10-15 percent of the required investment amount for the project, in addition to mobilization. In order to ensure access to low-cost long term LNG supply contracts, however, the project requires IDA support to mitigate government payment risk. Bangladesh's limited fiscal space coupled with limited IDA envelope may constrain use of existing instruments such as PRGs to mitigate this risk. Absent direct IDA support, the project would require as much as US\$150m in risk mitigation instruments/guarantees to help reduce payment risk to LNG suppliers and provide access to competitive gas supply.

3. **Sahel Solar PV Projects.** The power sectors of Burkina Faso and Mali face similar challenges: small grids, low availability of existing generation units, heavy reliance on imports and fuel oil-based generation (and exposure to associated price volatility), and high production costs which are not recovered by end-user tariffs, resulting in offtakers relying heavily on government subsidies. Due to the high level of solar irradiation in both countries, the speed with which solar PV plants can be built, and the ongoing rapid decline in solar PV module costs, solar PV represents a prime opportunity to increase electricity supply at competitive prices and energy security. Accordingly IFC is seeking to arrange financing for the countries' first solar Independent Power Producer (IPP) projects, including the 26.8 MWp Zina Solaire IPP in Burkina Faso and the 33.0 MW Ségou solar IPP in Mali. However, given the financial fragility of the countries' offtakers and absence of payment track record under Power Purchase Agreements (PPAs) with IPPs, investors require adequate risk mitigation to cover these risks to make the projects bankable.

4. While the PRG has been used in many successful joint IDA-IFC IPP projects in other countries, it is unavailable in the case of the Zina Solaire IPP in Burkina Faso, and difficult to implement in the case of the Ségou solar IPP in Mali.

5. **WBG energy solutions in IDA and FCS.** In certain countries that are fragile or emerging from conflict, private investors are contemplating to re-enter markets and take advantage of potential opportunities afforded to 'first-movers'. For instance, in Sierra Leone, MIGA and IDA are proposing investment guarantees for a power project, a country with a substantial power generation deficit and still recovering from the recent Ebola crisis. The project will help balance

out the high seasonality in Sierra Leone's installed hydropower generation capacity and strengthen private sector participation in the power sector. MIGA proposes to provide guarantee coverage for equity investments and shareholder loans; IDA is proposing a guarantee of the Government of Sierra Leone (GoSL) and Electricity Distribution and Supply Authority's (EDSA) payment security obligations under the power purchase agreement, which guarantee is taken out of the IDA country allocation for Sierra Leone.

6. This transaction is important and MIGA is able to support it with IDA's Guarantee on this small scale. The WBG's Joint Country Assistance Strategy for Sierra Leone emphasizes energy investment as one of its three priority areas. However, for potentially larger scale IPP projects in the range of \$500 million and above in IDA and FCS countries similar to Sierra Leone, the ability to provide coverage at scale would be critical to improve the bankability of projects and mobilize private finance. A Risk Mitigation Facility that provides first loss support would enable MIGA to offer enhanced coverage - for instance, Breach of Contract cover on liquidity on top of termination payments of sovereign and sub-sovereign counterparties (including SOEs) - at scale, as this would benefit from MIGA's underwriting and reinsurance processes.

Local Currency Hedging Facility: CFA Zones

7. In addition to the protection provided to many countries with floating currency regimes, the proposed LC Hedging Facility could provide critical protection to the poor in countries with pegged currencies, such as the those in the West Africa CFA Zones. Although the pegged exchange rate regime provides stability between the member Zone countries and the Euro, significant movements can occur between the CFA Zone countries and other currencies, such as the US dollar or Chinese RMB. By allowing projects to benefit from a "locked" exchange rate set at the commencement of a project, future potential currency valuation changes would not imperil the financial viability of high impact projects (such as for power generation/distribution), nor place an undue cost onto vulnerable populations, on whom the burden of unfavorable exchange rate movements would otherwise fall.

SME Guarantee Facility: Risk Sharing Facility with Ecobank Transnational (ETI)

8. Recently, IFC has entered into a Risk Sharing Facility (RSF) with ETI. The purpose of the RSF is to expand SME lending across eight of its affiliates in fragile and conflict affected states. The project will provide needed risk mitigation to enhance the participating banks' SME lending capacity, and contribute to the prudent growth of the Bank's SME business. The project is part of the Global SME Finance Facility, a partnership between IFC and the European Investment Bank (EIB) as senior investors and DFID, the Netherlands and EIB as the junior investors. The RSF guarantees an SME portfolio of up to US\$ 110 million, covering independent portfolios generated over time by eight of ETI's subsidiary banks in fragile states. IFC, together with EIB jointly guarantee 50 percent of the principal losses on the local currency sub-portfolio of each participating affiliate, up to US\$55 million, while the participating affiliates retain 50 percent of the risk in the portfolio. 25 percent of losses covered under the IFC/EIB portion (approximately US\$13.75 million equivalent) benefit from a pooled first loss allocation provided by junior partners of the Global SME Finance Facility. Although the risk of each subsidiary is different, the coverage level and risk sharing fee is the same for each subsidiary for maximum simplicity. The

pooled first loss coverage reduces the risk and pricing of the Risk Sharing Facility, making the RSF economical for the clients and the senior investors and ensuring prices to the end borrower do not increase. Without the first loss coverage, the RSF would not be feasible. The pooled structure of the first loss also ensures the efficiency as the US\$13.75 million will be made available for losses under any affiliate in the structure, providing scale and risk diversification benefits. At the same time, the structure provides the junior investors with 7 times leverage on their funding.

9. RSFs have maximum impact when the facilities ramp up quickly and when they have high levels of utilization. To stimulate utilization, the project also includes a performance incentive. The incentive is applied if the participating affiliates achieve 50 percent utilization within 12 months, and is effected by reducing the counter-guarantee fee to the junior participants. To bolster utilization, IFC also provides early operational support to the clients to ensure rapid ramp-up and a clear understanding of the eligibility and reporting requirements for the RSF.

Co-Investment Facility: Mountain Hazelnuts, Bhutan

10. In Bhutan, agriculture is the main source of livelihood for more than half the population but accounts for less than one-fifth of GDP. This blended finance project to promote hazelnut production in Bhutan will not only directly benefit 15 percent of Bhutan's population but will also help to sequester carbon and improve the environment.

11. In 2015, IFC and the Private Sector Window of the Global Agriculture and Food Security Program (GAFSP) invested US\$6 million in a small farmer-based hazelnut production company called Mountain Hazelnuts to help the company expand their hazelnut production. With IFC and GAFSP's support, Mountain Hazelnuts will provide hazelnut tree plantlets, inputs and support to local farmers. The trees will be planted on fallow land that otherwise has no commercial use for the farmers. Once the trees produce hazelnuts, the company will purchase the crop from the farmers at a guaranteed minimum price and market the hazelnuts to international buyers. The first commercial volumes of hazelnuts are expected in the second half of 2016.

12. This IFC/GAFSP equity investment is expected to benefit 15,000 farmer households, mostly located in Bhutan's poorer eastern regions. These households are expected to double their household incomes on the basis of these entirely incremental earnings from the sale of the nuts. These attractive returns are expected to slow down urban migration towards the capital Thimphu where employment opportunities are limited.

13. Farmers involved in the project will gain market access and be fully integrated into an international supply chain. Over time, the project is expected to create over 400 additional jobs at Mountain Hazelnuts and to triple female employment. In addition the company's expansion program includes capital expenditure for a hazelnut processing facility and collection centers in addition to investments in nursery operations, planting and tree distribution and farmer training and monitoring.

14. In time, Mountain Hazelnuts aims to plant ten million new trees across Bhutan that will help to sequester up to 1.5 million metric tons of carbon dioxide over their lifetime.

Shared First Loss with MIGA: Supporting the financial services sector in South Sudan

15. In LIC FCS IDA-eligible countries, investment insurance capacity is scarce because of risk perceptions and actual loss experience. These factors deter private market reinsurers from offering sizeable amounts of coverage and limit options available to investors seeking to insure their investments. A shared first loss facility would support investments and provide much needed capacity. While MIGA can support small size projects, there are limitations with regard to size of coverage due to high levels of risk capital utilization associated with these projects.

16. MIGA is working with a regional bank based in Nairobi to bolster their regional operations in South Sudan, to guarantee equity investments of \$36 million for a period of 10 years. The economic situation in South Sudan is very strained due to the country's deteriorating fiscal and external position caused by the volatility of oil production and exports, as well as government war spending. As a result, levels of current foreign exchange reserves, which had been previously estimated by IMF at 3 weeks of import coverage, are now at 1-2 weeks.

17. MIGA's support will offer support to a sector under severe pressure and lend comfort to the investors through its coverage; this then allows continued support to the bank's clients, which includes in large part job-supporting SMEs. However MIGA's risk capital allocation to this transaction is very high and will limit its ability to other similarly important transactions. First loss risk sharing with IDA as envisioned under the PSW window would provide additional support to important projects like this and others in the most challenging LIC, FCS and IDA-eligible countries. It would reduce MIGA's capital requirements, and improve the pricing levels. In addition, private sector reinsurers would have an additional layer of risk mitigation and could be possibly drawn into transactions.

Risk Participation with MIGA: Large scale long-term solutions

18. There is a significant need for experienced partners in delivering innovative solutions for large scale long-term projects in more challenging environments. MIGA brings forward this experience and its ability to work to with project sponsors that are commercial lenders and equity investors, as well as reinsurers which provide risk mitigation.

19. MIGA, as part of an international consortium of technical and financial partners, is often called upon to support large scale transformational projects at significant exposure amounts and at long tenors against the risks of expropriation, transfer restriction and inconvertibility, war and civil disturbance, and breach of contract. However, given the scale of these projects, MIGA will need additional guarantee capacity beyond that provided by its private reinsurance partners. The IDA PSW allocation would be perfectly suited to offer such capacity to support required guarantees and significantly enhance both the WBG's and MIGA's ability to support big transformational projects in LIC FCS IDA-eligible countries.

IDA as Portfolio Reinsurer: Supporting a investments in IDA countries

20. MIGA has guarantee exposures to IDA-eligible and FCs countries on its books and some of these countries are among the top consumers of MIGA's risk capital. Afghanistan, Cote d'Ivoire, Ghana, Honduras and Senegal, for instance, take a disproportionate share on a risk basis. Reinsuring these exposures on a portfolio basis with IDA under the PSW would make MIGA's capital available for use in additional projects in these countries. In turn, IDA would be receive a geographically diversified portfolio of risk exposure and the associated premium. This would be similar to how MIGA's reinsurers hold shares of MIGA's risk exposures. While these countries and the portfolio carry higher risk ratings on average, MIGA's claims experience to date has resulted in few losses.

Annex 4: Governance Structure Examples: IFC's Blended Finance Program and MIGA's CAFEF

IFC's Blended Finance Program and Lessons Learned

1. IFC started piloting blended finance projects in the early-mid 2000s, recognizing that blending public resources with private investment as an instrument could help achieve development objectives that fully market-based approaches could not have achieved otherwise. In the last three years (FY13-15), US\$385 million of partner funds have leveraged over US\$4.7 billion from IFC and private sector investors. From the US\$385 million of partner commitments, US\$212 million (55%) have been IDA, catalyzing more than US\$1.2 billion from IFC and other private sector financing in these countries. Increasing demand for blended finance and the recognition of its strategic value has spurred IFC to create a dedicated blended finance product. Today, the blended finance program focuses on climate change, SMEs, and agribusiness, supported by a dedicated unit, and governed by a mature and well established set of policies and procedures.

2. The Board discussed IFC's approach to blended finance in 2012. It presented four key principles guiding IFC's blended finance program: (1) moving beyond IFC additionality, (2) avoiding market distortion/seeking minimum concessionality, (3) leading to sustainability, and (4) strong governance. These important principles and lessons learned could provide important inputs to how the PSW could be designed and implemented.

3. Based on IFC's experience, blending concessional funds from partners alongside IFC's own commercial financing requires a robust governance system to (i) address potential conflicts of interest that may arise when managing third party funds; and (ii) ensure that blended finance investments minimize market distortions and catalyze projects that would not otherwise happen. The benefit of IFC's governance is particularly evident in jeopardy situations (i.e., where features, such as separate teams/separate approval body for the partner co-investment, aid in ensuring the partner interest is well represented).

Elements of this mechanism included:

Standard of Care for Partner-Managed Resources. IFC policies require it to exercise the same standard of care investing on behalf of partner partners as it exercises with respect to the administration and management of its own affairs, including the use of qualified staff and the application of other relevant IFC policies and procedures, such as performance standards and integrity due diligence. This has aligned interests between partners and the IFC and made partners comfortable with delegating authority to IFC for project approvals, maximizing efficiency and processing times for private sector projects.

Managing Potential Conflicts of Interest. To address concerns around the blending of concessional funds with IFC's own, IFC policies require an effective segregation of funds; separate

investment staff overseeing the structuring of partner concessional funds within a blended package; separate approval bodies for partner concessional funds as needed; and transparency to both partners and investment clients.

Blended Finance Unit. In order to bring consistency to IFC's approach to blending concessional funds for specific development objectives, IFC established a dedicated unit to manage the concessional partner funding it uses for blended finance operations. Working in close partnership with regional and industry teams, the unit has the mandate to reinforce IFC's disciplined approach to blended finance, including the circumstances in which blended finance is appropriate, as well as the governance framework for managing concessional partner funds.

Reporting to the Board. All projects that have been blended with a portion of concessional funds follow the applicable board procedure for the IFC own account investment. Board documentation includes the justification for blended finance. In addition, IFC reports periodically to the Board on its Blended Finance activities.

Clearly established expectations and guidelines. The successful deployment of blended finance requires clarity in the risk/return expectations from contributors, as to ensure that both their financial and developmental objectives are ultimately met.

MIGA's Conflict Affected and Fragile Economies (CAFEF) Facility

4. In April 2013, MIGA launched its first multi-country FCS trust fund, the Conflict Affected and Fragile Economies Facility (CAFEF) supported by the Canadian International Development Agency, the Swedish International Development Cooperation Agency, and the UK's Department for International Development. The Facility's loss sharing structure provides an initial loss layer, which mitigates claims risk and allows MIGA to increase its exposure to FCS countries where risk is higher. The protection offered by the Facility results in lower capital utilization for projects in these riskier markets. The Facility is also critical to reinsurers who might otherwise be unwilling to take the risk. In November 2013, MIGA issued a guarantee where the Facility provided initial loss coverage for a project covering an investment of up to US\$100 million to support the construction, expansion and operation of a telecom tower network in the Democratic Republic of Congo. At March 31, 2016, US\$66.4 million of the total capacity of US\$90.0 million is allocated to projects signed and approved by the Board, supporting total guarantees issued of US\$221.9 million.

5. The Facility is administered by MIGA, with full delegation on decisions regarding issuance of guarantees to MIGA. Standard MIGA processes and underwriting procedures are followed and Board papers include rationale for using of CAFEF. Each year, a governing committee meeting is held with partner representatives from each of partner countries and MIGA (chair) to discuss the progress of the activities undertaken by the Facility. Reporting is prepared twice a year to update partner on projects underwritten or other pertinent items.

6. The Facility shares in premium income for the guarantees it provides. This along with the investment income slowly grows the corpus of the Facility. Any claims paid reduce the capital, while potential recoveries restore partial or fully losses incurred. As guarantees expire, or are

cancelled, the freed up capital can be redeployed to support additional new business. CAFEF is capacity is expected to be used 2-3 times over its 20 year life based on MIGA claims and recovery experience.

Annex 5: IEG Evaluation Summaries

Evaluation 1: Evaluation of WBG support to investment climate reforms²²

In 2014, the Independent Evaluation Group (IEG) published an evaluation of the WBG's work on investment climate reforms. It concluded:

“In this evaluation, the Independent Evaluation Group (IEG) finds that the World Bank Group has supported a comprehensive menu of investment climate reforms. These reforms were generally supported in the right countries and generally addressed the right areas of the regulatory environment. In providing its support, the Bank Group relies on a variety of investment climate diagnostic tools, but their coverage is incomplete.

Intervention and country case analysis shows that, within the limits of the available measures of investment climate indicators, the Bank Group has been successful in improving investment climate in client countries, as measured by number of laws enacted, streamlining of processes and time, or simple cost savings for private firms. However, the impact on investment, jobs, business formation, and growth is not straightforward, and the social value of regulatory reforms—that is, their implications for inclusion and shared prosperity as reflected in effects on a range of stakeholders – has not been properly included in the design of reforms and assessment of their impact. While regulatory reforms need to be designed and implemented with both economic and social costs and benefits in mind, in practice, World Bank Group support focuses predominantly on reducing costs to businesses.

Simplicity of design and good risk assessment play a special role in achieving satisfactory outcomes. Political instability and lack of political commitment remain major problems, limiting the effectiveness of investment climate reforms.

7. In supporting investment climate reforms, the World Bank and the International Finance Corporation (IFC) use two distinct but complementary business models. Coordination within the World Bank Group on investment climate reforms is higher than in the rest of the Bank Group; but despite the fact that investment climate is the most integrated business unit in the World Bank Group, coordination is mostly informal, relying mainly on personal contacts.”

8. It recommended the WBG to: (1) expand the coverage of current diagnostic tools and integrate them to produce comparable indicators so that these can capture the areas of the business environment not yet covered by existing tools; (2) develop a differentiated approach to identify the social effects of regulatory reforms on all groups expected to be affected by them beyond the business community; and (3) ensure that the World Bank Group takes advantage of the complementarity and strengths of the World Bank and IFC business models when designing the

22 Source: IEG, "Investment Climate Reforms: An Independent Evaluation of World Bank Group Support to Reforms of Business Regulations", 2014.

new T&C Global Practice. Exploit synergies by ensuring that World Bank and IFC staff improve their understanding of each other's work and business models. Maintain the richness of the two delivery models while addressing factors that discourage collaboration.

Evaluation 2: Joint IDA-IFC Micro, Small and Medium Enterprise (MSME) Pilot Program for Africa²³

9. A Joint IDA-IFC Micro, Small and Medium Enterprise (MSME) Pilot Program for Africa was launched in December 2003 to deliver an integrated package of products to support MSMEs in Africa. It was designed in response to the call by the IDA Deputies for innovative private sector development programs and IDA-IFC collaboration during the IDA13 Replenishment discussions. Key features of the Program include drawing on the skills and resources of both the World Bank and the IFC, taking an integrated approach to supporting the MSME sector, and having an umbrella framework for individual country programs for IDA's and IFC's respective Boards. The program initially envisaged a total commitment of about US\$225 million from IDA (US\$130 million), IFC (US\$60 million) and other partners (US\$35 million) over a three-to-four-year period to support seven new projects in Ghana, Kenya, Madagascar, Mali, Nigeria, Tanzania and Uganda, in addition to three existing projects in Burkina-Faso, Mozambique and Rwanda.

10. At the end of the program, ten projects covered by the pilot program leveraged a total commitment of US\$727 million, far exceeding the envisaged volume, within which IDA committed the biggest share of US\$546 million. Initial assessment conducted in 2006 found that IDA and IFC partnership has the potential to add value to the ground by bundling financial products, providing technical assistance services and reforming the business environment. The innovative joint IDA-IFC business model of bundling IDA performance-based grants along with IFC financial instruments, and using IDA funds on a first loss basis under risk-risking arrangements with IFC, helped mobilize local currency funding for MSMEs in countries where neither IFC nor IDA alone could have an impact. The leveraging impact of small amounts of IDA resources for increased lending to SMEs was similarly recognized by a task force reviewing the use of IDA funds for Risk Sharing Facilities and Partial Credit Guarantee Projects.

11. Further evaluation of the pilot projects including from IEG evaluations and the project teams' own implementation completion reports (ICRs) also revealed important lessons. While the majority of the projects achieved moderate satisfaction, the IEG rated a few project as unsatisfactory or moderately unsatisfactory. Overall the implementation progress was slower than originally anticipated, and delays took place on all sides: IDA, IFC, WBG level, as well as with government and external partners. The initial government reluctance to adopt a more facilitative, rather than directive role, was time-consuming to overcome. The diverse set of local partners involved required enhanced capacity and commitment of all parties involved especially the implementation agencies. The different IDA and IFC team structure and policies and procedures required deep learning curve, and enhanced efforts on communication and knowledge sharing. The WBG level processes put in place i.e., to address conflict of interest concerns led to multiple teams involved in the same projects and increased transaction time and cost. The bundling of IDA

23 Sources: IEG evaluation and ICRs of MSME pilot projects; A Review of the Joint IDA-IFC Micro, Small and Medium Enterprise Pilot Program for Africa, IDA14 MTR Paper, October 2006

and IFC products also led to delay in processing products. The unsatisfactory projects also cited causes related to complex project design, lack of capacity, weak M&E, weak project management units, and lack of proactive planning and supervision.

Evaluation 3: IEG Evaluation of WBG's Targeted Support to SMEs, 2006-2012²⁴

12. In 2014, the IEG evaluated the WBG's Targeted support for SMEs (TSME) between 2006 and 2012. The IEG recognized that the WBG support SMEs through both systemic and targeted interventions. Targeted – meaning focusing benefits on one size-class of firms to the exclusion of others – support to SME is a significant business line for the WBG, averaging around US\$3 billion a year in commitments, expenditures, and gross exposure over the 2006–12 period. In the context of broader reforms, TSME support can be a powerful tool for the WBG to use effectively.

13. The IEG recognized the each WBG institution's longstanding commitment and significant support to SMEs, especially IFC's long history starting with its first project development facility more than 30 years ago. It finds that each Bank Group institution operates differently, but there are benefits from collaboration, communication, and shared strategic objectives. Inconsistencies and lack of coordination across institutions result in missed opportunities. The lack of institutional consensus on what constitutes an SME, when it is appropriate to support them, and what constitutes success needed to be improved as the Bank Group moves towards a “one WBG” model.

14. IEG made the following recommendations:

Clarify its approach to targeted support to SMEs. IFC, MIGA, and the World Bank should harmonize their SME approaches to make clear the objectives and analytic justification for targeted SME support, how it relates to systemic reform, where it is appropriate, what main forms it will take and how it will be monitored and evaluated.

15. The WBG Management broadly concurred with IEG's conclusions and recommendations, agreed to further actions on harmonizing SME approaches including M&E leveraging the opportunity of introducing the Global Practices; increasing its focus on the frontier markets including women-led enterprises, smaller firms, and underserved markets; improving analytical underpinning including the enterprise survey led by the GPs, continuing to improving WBG documentation, data quality and relevance, system coding, and reforming MIGA's SIP program.

24 Source: IEG, "The Big Business of Small Enterprises: Evaluation of the World Bank Group Experience with Targeted Support to SMEs, 2006-12", March 2014.

Annex 6: Governance Issues to Address

Any delegation of IDA roles to IFC and/or MIGA will need to maintain IDA's ability to fulfill its own fiduciary responsibilities. As part of the complete governance review and proposal, the following issues – at a minimum - would need to be addressed and decided:

1. Acknowledgement from Deputies that IFC/MIGA fiduciary, safeguards and other policies would apply with a clear understanding of the consequences of doing so;
2. Clearly articulated criteria for eligibility of proposed PSW investments, extent of use of IDA resources vis-à-vis investment levels of IFC/MIGA (participation ratios), pricing structures, etc.;
3. Input from IDA regarding the potential use of existing instruments available to support identified private sector investments.
4. Confirmation from IFC and MIGA that in using IDA's equity resources for PSW investments, they would apply the same standards they use for purposes of making their own investments;
5. Review capacity over any proposed PSW investment, including invitation at concept review meetings;
6. IDA's rights related implementation support/supervision missions and visibility to portfolio/project performance;
7. IDA's rights governing audits of any projects and use of funds;
8. An agreement that IDA would receive its pro rata share of (i) any profit realized on the disposition of any IFC PSW-funded investment and (ii) any proceeds from the exercise of security taken by IFC over PSW-funded assets and/or subrogation rights exercised by either IFC or MIGA.