



IDA19

Proposal for IDA19 IFC-MIGA Private Sector Window

May 24, 2019

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ACRONYMS AND ABBREVIATIONS
Fiscal year (FY) = July 1 to June 30

| | | | |
|--------|---|-------|--|
| AfDB | African Development Bank | JET | Jobs and Economic Transformatio |
| ADB | Asian Development Bank | LCF | Local Currency Facility |
| AIMM | Anticipated Impact Measurement and Monitoring | LIBOR | London Interbank Offered Rate |
| ANZ | Australia and New Zealand Banking Group Limited | LICs | Low-Income Countries |
| BFC | Blended Finance Committee | LLP | Loan Loss Provision |
| BFF | Blended Finance Facility | LPOI | Loan Purchase Obligation Instrument |
| CDC | Commonwealth Development Corporation | MDB | Multilateral Development Bank |
| CMAW | Creating Markets Advisory Window | MFI | Microfinance Institution |
| CMU | Country Management Unit | MFD | Maximizing Financing for Development |
| CPSD | Country Private Sector Diagnostics | MGF | MIGA Guarantee Facility |
| CPIA | Country Policy and Institutional Assessment | MIGA | Multilateral Investment Guarantee Agency |
| CRO | Chief Risk Officer | MOU | Memorandum of Understanding |
| CRRH | Caisse Régionale de Refinancement Hypothécaire | MRC | Mortgage Refinancing Company |
| DFI | Development Finance Institutions | MSME | Micro, Small and Medium Enterprise |
| E&S | Environmental & Social | MTR | Mid-Term Review |
| EBRD | European Bank for Reconstruction and Development | OECD | Organization for Economic Co-operation and Development |
| EIB | European Investment Bank | PPI | Private Participation in Infrastructure |
| EIP | External Investment Plan | PPP | Public-Private Partnership |
| EC | European Commission | PRG | Project Risk Guarantee |
| EU | European Union | PSW | Private Sector Window |
| FCV | Fragility, Conflict and Violence | RMF | Risk Mitigation Facility |
| FCS | Fragile and Conflict-Affected Situations | RSF | Risk Sharing Facilities |
| FDI | Foreign Direct Investment | SDG | Sustainable Development Goal |
| FMO | Entrepreneurial Development Bank | SDR | Special Drawing Right |
| FX | Foreign Exchange | SLGP | Small Loan Guarantee Program |
| GDP | Gross Domestic Product | SME | Small and Medium Enterprise |
| GHG | Greenhouse Gas | TCX | The Currency Exchange Fund |
| HKL | Hattha Kaksekar Limited | TICAD | Tokyo International Conference on Africa's Development |
| IAD | Internal Audit Vice-Presidency | TMRC | Tanzania Mortgage Refinancing Corporation |
| IBRD | International Bank for Reconstruction and Development | TRR | Total Resources Required |
| IDA | International Development Association | UNCDF | United Nations Capital Development Fund |
| IDD | Integrity Due Diligence | US | Generally Accepted Accounting Principles |
| IDLC | IDLC Finance Limited | GAAP | Principles |
| IE | Implementing Entity | UT1 | Upper Trishuli 1 |
| IFC | International Finance Corporation | VC | Venture Capital |
| IMF | International Monetary Fund | WAEMU | West African Economic and Monetary Union |
| IMPACT | Impact Measurement and Project Assessment Comparison Tool | WDI | World Development Indicators |
| IPAII | I&P Afrique Entrepreneurs II L.P. | WEO | World Economic Outlook |
| J-CAP | Joint Capital Markets Program | WBG | World Bank Group |
| JICA | Japan International Cooperation Agency | | |

EXECUTIVE SUMMARY

- i. **The IDA18 International Finance Corporation (IFC)-Multilateral Investment Guarantee Agency (MIGA) Private Sector Window (PSW) pilot has continued to make progress since the IDA18 Mid-Term Review (MTR).** With three new projects approved since the MTR, by end-April 2019 over US\$300 million from PSW has been allocated to support more than US\$800 million of IFC investments and MIGA guarantees, and is expected to mobilize an additional US\$1.5 billion of private investments. In addition, pipeline development has accelerated in recent months. Over US\$2 billion worth of transactions are now in the mid-stream and downstream pipelines. This acceleration has been built on continued upstream work by all World Bank Group (WBG) entities, a growing level of common understanding and collaboration among WBG staff, and the adoption of programmatic approaches that standardize and pool small transactions. As the pipeline grows, there is a continued focus on exercising rigor in deciding on the use of PSW and subsidy level for each project through a disciplined governance process.
- ii. **IDA18 experience has demonstrated that PSW is a useful blended finance instrument, complementing the International Development Association (IDA)'s support through the public sector and IFC and MIGA's commercial engagement with the private sector, to scale up private investment in IDA countries.** Guided by the WBG Forward Look at the corporate level and country strategies on the ground, all WBG institutions are committed to scaling up their support to private sector development in IDA countries to further progress toward the Sustainable Development Goals (SDGs). During IDA18 to date, IDA's support to private sector development has already passed US\$13 billion. IFC's mobilization of external investment has increased significantly in IDA countries, although its own-account investment at US\$1.87 billion in FY18 decreased following a high volume in FY17. IFC is committed to expand engagement in IDA and in Fragile and Conflict-Affected Situations (FCS) and reach 40 percent of total commitments to these countries by 2030. MIGA has issued a total of US\$1.6 billion gross guarantees in IDA countries as it continues to expand its reach in IDA markets. As part of these WBG efforts, IDA18 experience demonstrates that targeted use of PSW can mobilize additional private investment to IDA countries by making otherwise "unbankable" projects bankable.
- iii. **Experience and learning from implementation of PSW continues to accumulate.** During IDA18, Small and Medium Enterprise (SME) finance and housing finance have received significant PSW support, and engagement with local sponsors has been a key feature of many PSW-supported transactions. A broad set of financial structures have been deployed, often with PSW taking higher risks reflecting the window's design feature to transfer risks from IFC, MIGA and their private sector clients to IDA. By employing a rigorous review process assessing PSW-supported transactions against PSW criteria, IDA, IFC and MIGA continue to accumulate experience in applying blended finance principles, particularly related to additionality, the economic rationale for blended finance, and minimum concessionality. Each facility has also yielded critical lessons specific to each instrument as it addresses different risks.
- iv. **Management proposes to continue the PSW under IDA19 to support the ambitious agenda of IDA19.** Under the IDA19 overarching theme – "Ten years to 2030: Growth, People and Resilience" – private sector-led investment, growth and economic transformation will be essential. The Jobs and Economic Transformation (JET) Special Theme in particular will require a step up in efforts to mobilize the private sector, supported by a "Whole-of-WBG" approach that includes

PSW to develop greater synergies and impact across IDA, IFC and MIGA. Key objectives of IDA19 will guide PSW implementation, with a clear commitment to mobilize and scale up the volume of private investment and focus on high-impact priority areas, such as the digital economy, infrastructure, and agribusiness and manufacturing linking to value chains, as well as closing gender gaps in private sector operations in line with the Gender and Development Special Theme. In addition, local currency solutions will be enhanced to support the growth of local businesses.

v. **IDA19 will retain the overall PSW framework with a few modifications designed to further amplify PSW's impact.**

- **Building on the IDA18 experience, Management proposes to retain the overall PSW framework and its main features:** (1) The overall size of the PSW will be maintained at US\$2.5 billion; (2) The four facilities under the PSW will remain; (3) Private sector client interface will be through IFC and MIGA only; and (4) PSW governance principles remain the same, including PSW Representatives' participation in IFC and MIGA review processes and the rigorous application of the PSW criteria.
- **Modifications to the IDA19 PSW Framework are proposed to reflect demand and experience gained during IDA18 and enable PSW to deliver on its IDA19 objectives.** These include: (1) Adjusting indicative allocations across the four facilities to reflect expected demand. The Blended Finance Facility (BFF) and the Local Currency Facility (LCF) will receive larger allocations relative to IDA18, while the Risk Mitigation Facility (RMF) will receive commensurately lower allocation. The MIGA Guarantee Facility (MGF) will remain the same as in IDA18; (2) Continuing to define eligibility for PSW as IDA-only and IDA-eligible FCS countries, while introducing a transition cycle of one replenishment period for countries becoming ineligible for PSW in IDA19. PSW eligibility will take into account the outcome of the ongoing work to refine the definition of FCS under the new WBG Strategy for Fragility, Conflict and Violence (FCV); and (3) Allowing PSW-ineligible IDA Gap and Blend countries to benefit from regional and programmatic projects when needed for structuring purposes. Benefits to these otherwise ineligible countries will be subject to a cap of 20 percent of the total IDA19 PSW amounts deployed for regional or programmatic approaches.
- **Management also proposes to explore adjustments to individual PSW facilities to enable each facility to further advance its objectives.** Aimed at increasing local currency financing, they include: (1) A Loan Purchase Obligation Instrument under BFF; and (2) Enabling LCF support for third party local currency lending alongside IFC loans.

vi. **The financial risks PSW faces are high, and risk management of PSW will continue to be prudent.** While it is too early to assess the financial performance of the current PSW portfolio, estimations of expected losses suggest that financial losses to IDA could be substantial. The potential adjustments to the BFF and LCF may also add some new risks to IDA, and the trade-off between financial losses, operational complexity and fulfilling PSW's development objectives will become more apparent. Until more actual financial performance data can be collected and assessed, IDA Management proposes to continue its prudent approach in managing PSW financial risks. IDA also continues to be exposed to reputational and operational risks that need to be carefully managed.

vii. **Issues for discussion:**

- (a) Do Participants agree to extend the PSW under IDA19 with an allocation of US\$2.5 billion for the four existing PSW facilities?
- (b) Do Participants agree to the proposed modification to the PSW framework on country eligibility for accessing the PSW, and for Management to explore further potential adjustments to two PSW facilities?
- (c) Do Participants agree with the Management approach to risk management, in light of the potential financial risks IDA faces?

I. INTRODUCTION

1. **Over the past two years, the IDA18 International Finance Corporation (IFC) - Multilateral Investment Guarantee Agency (MIGA) Private Sector Window (PSW) has delivered an initial set of projects with important impact and learning.** The PSW was established as a pilot with the objective of mobilizing private investment in the most difficult markets. Over the course of IDA18 implementation to date, PSW financing has provided considerable leverage to crowd in private investment. Over US\$300 million from the PSW has been allocated to support more than US\$800 million in IFC investments and MIGA guarantees and is expected to mobilize an additional US\$1.5 billion of investments from private sector. The initial years of PSW experience have also provided important lessons on using blended finance to mobilize private investments in the poorest countries. Progress was reviewed at the IDA18 Mid-Term Review (MTR) with guidance provided by the IDA Participants “to make all necessary efforts to deploy the available financing, while not compromising on projects’ quality”.¹

2. **Building on the IDA18 experience and guided by the overall direction of IDA19, this paper proposes continuation of the PSW under IDA19.** The paper outlines the rationale for continuing PSW to enable the World Bank Group (WBG) to support increased private investment in the most challenging markets. The paper proposes emerging areas of focus for the PSW under IDA19, consistent with IDA19’s emphasis on Jobs and Economic Transformation (JET), as well as adjustments to the PSW operational framework aimed at better achieving its intended objectives.

3. **The paper is comprised of six sections.** Following the introduction, Section II presents the continued need for the PSW as a key instrument of the WBG to mobilize increased private investment in IDA countries and contribute to the strategic goals of IDA19 towards achieving the SDGs. Section III provides an update on PSW implementation following the MTR, including lessons from experience, which inform the proposal for the PSW framework in IDA19. Section IV presents the proposed IDA19 PSW framework incorporating modifications to the IDA18 framework, and potential adjustments to the facilities that may be explored. (Indicative features on these adjustments are presented in Annex 5.) Section V provides an assessment of financial and other risks faced by the PSW during IDA18, and the approach for IDA19 risk management, taking into account the additional risks that may be expected in IDA19. Section VI concludes the paper and outlines guidance sought from IDA Participants at the June 2019 Replenishment meeting.

¹ IDA18 Mid-Term Review Co-Chairs’ Summary. Livingstone, Zambia, November 13-15, 2018.

II. THE CONTINUED NEED FOR PSW UNDER IDA19

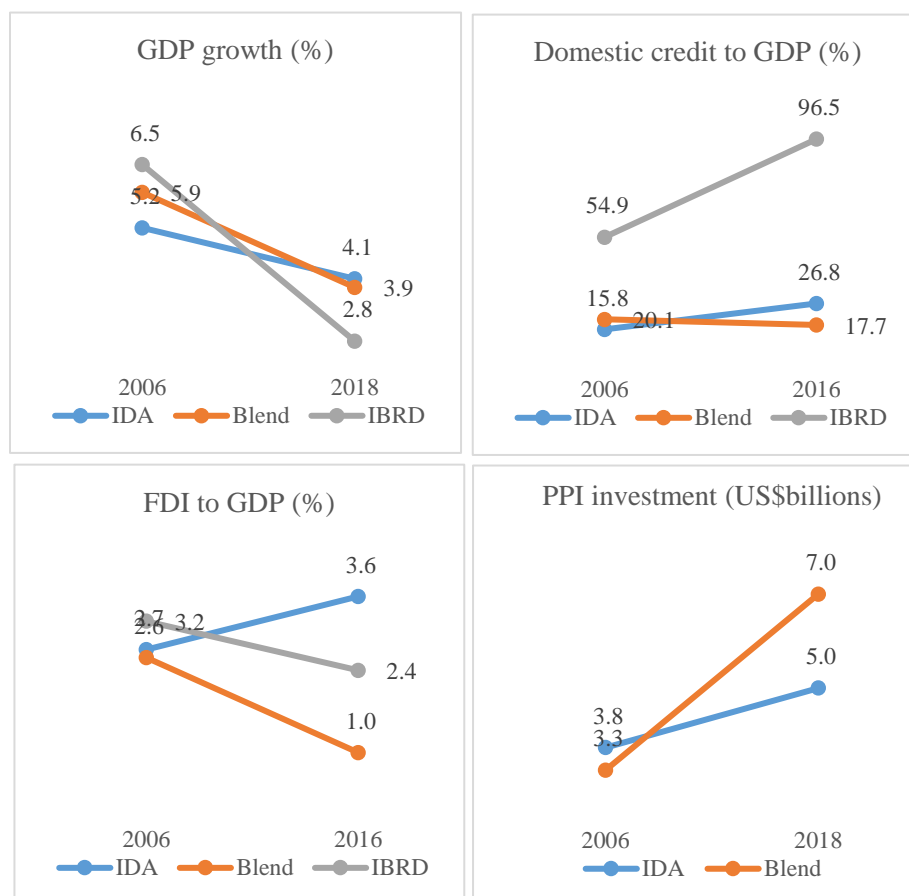
A. PSW AS PART OF WBG EFFORTS TO DEEPEN PRIVATE INVESTMENT IN IDA COUNTRIES

4. **With only 10 years left to 2030, a strong private sector and increased private investment remain critical to achieve the Sustainable Development Goals (SDGs) in IDA countries, and will have increasing importance under IDA19.** Private investment has been embraced as a critical component to meet the scale of financing needed to achieve the SDGs. Private finance's contribution to development includes the creation of jobs (nine out of 10 new jobs are created in the private sector), direct investments (both foreign and domestic), as well as indirect contributions through taxes on revenues generated. This in turn supports domestic resource mobilization to finance social services, infrastructure, and other spending. Private sector growth also builds skills (e.g., training locally hired employees in new technologies and processes), supports reducing inequalities (e.g., between men and women), and creates upstream and downstream linkages (e.g., setting up local supplier and distributor networks) in the economy. The “Billions to Trillions” agenda underscores the importance of the private sector to enable developing countries to achieve sustainable growth.

5. **However, current trends indicate that private sector investments are not rising to the level needed to meet the SDGs.** Overall economic growth in IDA countries has stalled in recent years (see Figure 1). Sluggish Foreign Direct Investment (FDI) flows and limited access to credit are contributing factors to this slow growth. FDI flows have slowed over the last decade in IDA Blend countries (with a steeper decline relative to the International Bank for Reconstruction and Development (IBRD) countries) and have shown only very marginal increases in IDA-only countries and IDA countries as a whole. Credit to the private sector is not growing at the speed needed in most IDA countries. Even where there have been gains, they have often been affected by currency depreciation. Critical gaps in sectors such as infrastructure remain significant in IDA countries. Total investments are far below the 4.5 percent of Gross Domestic Product (GDP) needed to enable IDA countries to achieve the infrastructure-related SDGs.²

² Rozenberg, Julie; Fay, Marianne. 2019. *Beyond the Gap: How Countries Can Afford the Infrastructure They Need while Protecting the Planet*. Sustainable Infrastructure; Washington DC: World Bank.

Figure 1. Private Sector Investment Indicators in IDA vs IBRD Countries



Source: IMF WEO, WDI indicators, PPI data base. Note that all data is based on 3-year rolling averages.

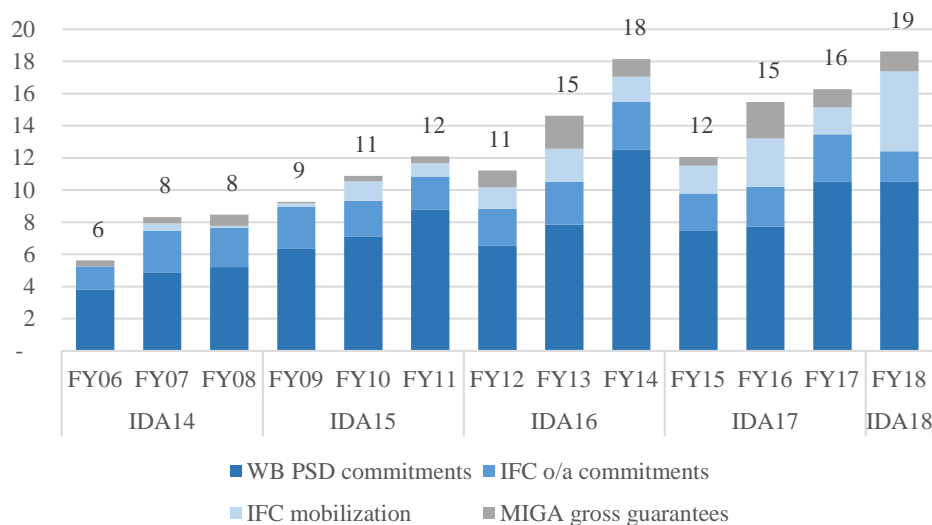
6. **The WBG Forward Look and strategies and platforms at the country level have underpinned a strong push by all WBG entities to step up support to increase private investment in IDA countries.** In the decade prior to IDA18, IDA financing had averaged US\$8 billion a year in enabling infrastructure, skills development, agribusiness, Small and Medium Enterprises (SMEs), financial systems, and other private sector linked activities. Under IDA18, the introduction of the JET new Special Theme provided added focus and new momentum for IDA to scale up its efforts to create the conditions for private sector business and investment to establish and thrive, with a focus on job creation.³ IDA has provided analytic and advisory services, support for policy reform and other upstream support to pave the way for increased private activity across sectors. Under IDA18 so far, IDA lending to support private sector investment has reached US\$13

³ World Bank, IDA18 Mid-Term Review Progress Report on Jobs and Economic Transformation, November 2018.

billion⁴ (see Figure 2), and US\$8.8 billion of IDA support had an explicit focus on jobs.⁵ This support will continue in IDA19.

Figure 2. WBG Investments in IDA Countries

IDA, IFC own-account investments and MIGA guarantees in IDA countries in FY 06-18 (US\$ billions)



Source: WBG staff estimates. IFC data excludes Nigeria, Pakistan and Kenya

7. IFC continues to work towards its commitment to scale up engagement in IDA countries. Over the past ten years, IFC has invested approximately 26 percent (US\$24.3 billion) of its own account in IDA countries and mobilized an additional US\$18.5 billion. In FY18, IFC’s own-account investment at US\$1.87 billion has decreased following a high volume in FY17, but its mobilization impact has increased significantly. Through FY19, IFC’s performance has been subdued, affected by a challenging macro-economic environment including constrained global economic growth, economic downturns in key markets, geopolitical vulnerabilities, and IFC’s adjustment to a range of organizational changes. In IDA and FCS markets in particular, ongoing political instability, economic weakness in resource-rich economies and increasing risk of debt crises has contributed to lower own account investment (see Figure 2). Through IFC 3.0 Creating Market strategy and the recent capital increase package (see Box 1), IFC has committed to reach a 40 percent share of its commitments in IDA and FCS countries by FY30, of which 15 to 20 percent of commitments will be in Low-income IDA and IDA FCS countries.⁶ Given the year-on

⁴ IDA lending commitments for private sector development comprise commitments in the following sectors that directly or indirectly support private sector growth: Transportation; Energy and Mining; Information and Communication; Water, Sanitation and Flood Protection; Industry and Trade; and Finance.

⁵ This is based on projects tagged as having a “jobs” theme. These are defined as a World Bank lending activity that has an explicitly stated and substantive link to creating jobs, improving the quality of existing jobs, and/or helping individuals connect to jobs or move to better jobs. This means that activities are selected or designed with a focus on jobs or on addressing a jobs challenge.

⁶ Based on IDA17 country list.

year volatility in the economic environment, IFC's 3.0 Creating Markets strategy remains focused on building a sustainable, long-term pipeline of bankable transactions in these markets. To achieve ambitious targets, IFC will continue to scale up its investments in IDA countries, applying diagnostic tools such as the Country Private Sector Diagnostics (CPSD)⁷ and Sector Deep Dives, advisory approaches through the Creating Markets Advisory Window (CMAW), and blended finance tools such as the PSW. Recent IFC efforts also include establishing Global Upstream Project Development Units in industry departments to deepen project origination efforts. These tools and approaches are moving IFC toward more strategic country and sector engagements, and position IFC to develop more, and more creative, private sector solutions to scale up investments in IDA countries.

Box 1. International Finance Corporation (IFC) Capital Increase Package

World Bank Group (WBG) shareholders endorsed a transformative Capital Package for the International Bank for Reconstruction and Development (IBRD) and IFC during the April 2018 Spring Meetings, including a historic US\$13 billion paid-in capital increase and an ambitious set of internal reforms and policy measures.

Included in the commitments are IFC's aim to expand commitments in IDA and in Fragile and Conflict-affected Situations (FCS) countries, and reach up to 40 percent of all IFC commitments by 2030 and an average of 32.5 percent over FY19-FY30. This compares to a baseline of 24 percent at that time. IFC would also deliver 75 percent more in own account and mobilization in IDA/FCS between FY19 and FY30 than if there were no package. IFC also aims to utilize the IDA PSW to substantially increase own account annual commitments in Low-Income Countries (LIC)-IDA17 and IDA FCS countries, to 15-18 percent and 15-20 percent of total annual commitments by 2026 and 2030 respectively, compared to a baseline of about seven percent in FY17 (subject to the continuation and sizing of the PSW).

While the package includes the discontinuation of IFC transfers to IDA in IDA19, it included substantial commitments to do more in IDA countries. The discontinuation was agreed on the rationale that if IDA transfers were suspended, IFC retained earnings could be increased thereby strengthening the Corporation's capital position and reducing other capital requirements.

As part of its April 2019 update to the Development Committee on the Forward Look and the IBRD-IFC Capital Package Implementation, IFC noted progress as follows – (i) investing in and mobilizing private sector investments in IDA and FCS countries; (ii) implementing a revised additionality framework to enhance ability to selectively support clients in upper middle income countries; (iii) strengthening its partnership with the World Bank in the development of the coordinated WBG Fragility, Conflict and Violence (FCV) strategy; (iv) increasing its climate investments to 35 percent of commitments by 2030 and reach an average of 32 percent between FY20 and FY30; (v) implementing its four capital commitments related to gender; (vi) increasing its mobilization ratio, as well as developing the Operating Principles for Impact Management; (vii) introducing a new approach to equity investments in November 2018; and (viii) pursuing a number of internal initiatives to drive further efficiencies.

Sources: Sustainable Financing for Sustainable Development: World Bank Group Capital Package Proposal, prepared by the World Bank Group for the April 21, 2018 Development Committee Meeting. And "Update: The Forward Look and IBRD-IFC Capital Package Implementation" prepared by the World Bank Group for the April 13, 2019 Development Committee Meeting.

8. MIGA's strategy beyond 2020 also supports an increased activity in IDA countries. MIGA has continued to grow its portfolio in IDA countries, in part thanks to the help of the PSW. Since the start of the IDA18 period to April 30, 2019, MIGA has issued US\$1.72 billion in gross guarantees in IDA countries, in support of 15 projects, six of which were in FCS countries and

⁷ As of end-February 2019, seven of 12 CPSDs completed are in IDA countries with nine more under development. Country strategies have been developed for four IDA countries with 12 planned for FY19/FY20.

three of which were supported by PSW (See Figure 2). MIGA has further committed to step up its engagement in IDA countries going forward. It will continue to collaborate with the World Bank and IFC to scale up its guarantees in IDA countries, by applying the four pillars of MIGA's strategy: growing core business, innovating applications, creating projects, and creating markets.

9. **There is a growing consensus that well-targeted use of blended finance can play an important role, as part of overall public-private efforts, in mobilizing private investment in IDA countries.** Blended finance complements IDA's support through the public sector and IFC and MIGA's engagement with the private sector through commercial solutions. Blended finance instruments strategically deploy development finance to help unlock local and foreign private capital for investment. These instruments help mobilize private finance in difficult investment environments by making otherwise "unbankable" projects bankable. Scarce concessional resources, such as from IDA, can be used when appropriate and well-targeted to balance the risk/return profiles of individual transactions by bearing relevant risks and/or providing other forms of concessionality. Several new initiatives have been launched in recent years to deploy blended finance, while accompanying principles for deployment continue to be developed (see Box 2). The development community recognizes that blended finance is not a panacea. It must be well-designed, used only when there is sufficient rationale, and be accompanied by progress on policy and sector reforms, which are critical ingredients to sustained private investment. Government thus has a clear role to play to pave the way for and accompany many of these investments by maintaining macroeconomic stability and undertaking needed reform to create conducive business environments to encourage investment. Capacity building and technical assistance for individual companies and/or at the sector-level are also important. The need for these combined efforts by public, private and multilateral stakeholders has been underscored in global initiatives such as the G20 Compact with Africa.

Box 2. Evolution of the Blended Finance Landscape

Instruments to support blended finance have existed for some time, but the field has evolved more rapidly in recent years as the advantages of private capital to accompany public investment has been increasingly recognized as a key to further economic development and meet the Sustainable Development Goals (SDGs). This has been particularly true for countries with investment climates, such as those in many IDA countries, that have not been attractive to private investors. While some of the original instruments have proven successful in more sophisticated developing markets, there have been fewer resources available and less uptake in more challenging markets. This has prompted the development community to consider additional approaches to de-risk transactions to make them more “investable” and attractive to private investors.

New instruments and approaches: Several Multilateral Development Banks (MDBs) and multilateral organizations have launched blended finance initiatives, working with Development Finance Institutions (DFIs) or directly with private sector actors. These include the United Nations Capital Development Fund (UNCDF), the European Union (EU)’s External Investment Plan (EIP) Guarantee, the IDA18 Private Sector Window and several bi-lateral funds. The total amount of blended finance activities is unknown but estimated to be up to US\$ 0.7 billion per year between 2014 and 2016 based on estimates from the 23 institutions represented in the Development Finance Institutions (DFI) Working Group on Blended Concessional Finance for Private Sector Projects. With the expected increase in the EIP and other instruments (e.g., in the climate area) these numbers will see huge growth.

Principles for blended finance: As the use of blended finance has increased and evolved, lessons learned have been captured to help guide the diverse stakeholders supporting blended finance. From an implementation perspective, enhanced principles have been developed by the DFIs to guide the use of blended finance to support private sector operations at the transaction level, including clarifying the rationale for when to use blended concessional finance, promoting the minimum use of concessionality, and promoting sustainability and the adoption of high standards including environmental and social standards, and transparency and strong governance. (See Annex 8 on Blended Concessional Finance Definition and Enhanced Principles for DFI Private Sector Operations.) In addition, at the policy level, the Organization for Economic Co-operation and Development (OECD) has also developed principles for blended finance focusing on SDG financing, while the Tri Hita Karana Blended Finance Roadmap underscores the need to promote shared values and coordination among stakeholders in the deployment of blended finance.

10. The WBG has played an active role in the blended finance community and the experience of the IDA18 PSW has informed broader discussions on blended finance. Prior to PSW, IFC worked for over a decade to develop and deploy blended finance instruments (see Box 3) and MIGA has also developed facilities targeting FDI and private sector projects in FCS countries.⁸ In addition, the WBG has been active in sharing experiences on blended finance with other MDBs and blended finance practitioners, and has worked with them to develop and promote the adoption of the Development Finance Institutions (DFI) Enhanced Principles⁹ to ensure a disciplined approach to blended concessional finance in private sector projects. The WBG, spearheaded by IFC as chair of the DFI working group, has developed a common definition for blended finance. In conjunction with the PSW effort, it has created a platform for engagement with partners to exchange ideas on improving the practice and effectiveness of blended finance. As an

⁸ It includes MIGA’s work in Bosnia Herzegovina, the West Bank and Gaza Guarantee Trust Fund, and the Afghanistan Investment Guarantee Facility, as well as the donor-supported Conflict-Affected and Fragile Economies Facility (CAFEF) which targets FCS countries globally.

⁹ Enhanced principles jointly developed and endorsed by representatives from Development Finance Institutions (DFIs) in 2017 and updated in 2018. See “DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update”.

example, in February 2019, IFC and the Commonwealth Development Corporation (CDC), in collaboration with Oxford University, convened a group of 27 DFIs to consider ways to increase their impact in facilitating more private investment into FCS economies including through using de-risking instruments.¹⁰

Box 3. International Finance Corporation (IFC)’s Blended Finance Activities

IFC has launched several blended finance instruments in the past decade employing donor funding to leverage private investment. During FY10-FY18, IFC deployed US\$929 million of concessional funds to support 169 high-impact projects in over 50 countries, leveraging US\$3.5 billion in IFC financing and more than US\$4 billion from other private sources.

FY18 was a record year, with IFC leveraging US\$219 million in donor funds to secure US\$1 billion in IFC financing (US\$1.3 billion total) for 50 projects. The pace continues to accelerate – as of end of April 2019, over 91 IFC-managed projects (approx. US\$1.5 billion in concessional donor funds) across the various Blended Finance resources (including PSW) were reviewed and endorsed by IFC’s Blended Finance Committee for further processing and consideration.

11. The PSW has emerged as an important blended finance instrument for the WBG to advance the Maximizing Financing for Development (MFD) strategy and the Cascade approach. The PSW has facilitated stronger synergies across the WBG to implement the Cascade approach. It provides a linkage between upstream sector reform interventions, often supported by IDA, and downstream private sector advisory and transactions supported by IFC and MIGA. It exemplifies the approach of deploying risk-reduction tools in markets where sector reform alone is not sufficient to induce private investment. As an example, PSW supported the longest tenor bond issuance by a secondary mortgage provider, Caisse Régionale de Refinancement Hypothécaire (CRRH), in West Africa, following IDA support for building its capacity and an earlier equity investment by IFC. In Haiti, PSW complemented earlier upstream efforts by IDA to create an SME collateral database through its support for IFC’s investment in the first leasing company in the country.

B. PSW’S LINKAGE TO IDA19 POLICY AGENDA

12. Embodying the “Whole-of-WBG” approach, the PSW will be a key instrument to support IDA19 strategic goals, particularly around the JET Special Theme. With ten years remaining to deliver on the 2030 SDGs, the need for more and better jobs remains a top development priority and the challenge is becoming more acute in IDA countries with large youth populations. IDA19’s overall ambition to invest in Growth, People and Resilience¹¹ cannot be reached without the private sector stepping up to invest in IDA markets. The JET framework of IDA19 will focus on “creating and connecting to markets” and “building capabilities to link workers to markets”.¹² It is an agenda that will require mobilizing the entire WBG at both the strategic and transaction levels. The PSW will play an important role to support this agenda and enable IFC and MIGA to mobilize further private investments in IDA markets, complementing

¹⁰ The Forum builds on the [Escaping the Fragility Trap](#) report released by the LSE-Oxford Commission on State Fragility, Growth and Development.

¹¹ IDA19 Paper: Setting the Agenda for IDA19: Ten Years to 2030—Growth, People, Resilience. June 2019.

¹² IDA19 Special Theme Paper: Jobs and Economic Transformation. June 2019.

IDA's support on policy reforms and institution building. PSW is also important for the IDA19 Special Themes of Gender and Development by supporting women entrepreneurship and Climate Change through support to renewable energy projects.

13. **Building on IDA18 progress, IDA19 is poised to set more ambitious and clearer directions to guide PSW implementation, including through a set of policy commitments under JET.** The outlook set forth in the JET Special Theme builds on what PSW has been able to achieve and pushes the agenda further. IDA19 will further leverage IFC and MIGA's connections with the private sector to bring together stakeholders to catalyze investments in high potential areas. Several policy commitments made under IDA19's JET Special Theme provide direct guidance on PSW implementation (see Box 4).¹³

Box 4. Jobs and Economic Transformation (JET) Policy Commitments Related to the implementation of the Private Sector Window (PSW)

Under the JET Special Theme, a set of policy commitments were made. Three of them provide direct guidance to PSW implementation.

The World Bank Group (WBG) commits to the operationalization of joint International Finance Corporation (IFC)-World Bank (WB) diagnostics in 10 IDA countries through IDA and IFC interventions leveraging from among the WBG's full suite of instruments, including technical assistance, policy advice, lending and investment. PSW will be a key instrument available as part of the WBG toolbox.

IFC will aim to increase the share of its commitments in Fragile and Conflict-affected Situations (FCS)-IDA17 & Low-Income Countries (LIC)-IDA17 countries, reaching 10-15 percent of its own-account commitments during the IDA19 cycle. The baseline percentage for FY18 is 6 percent. PSW will be an important instrument for IFC's expanding engagements in IDA countries

85 percent of new jobs themed projects will track at least one jobs indicator and the IFC will track direct jobs and estimates of indirect jobs associated with all PSW investments. The impact of PSW will continue to be closely monitored and reported.

14. **In addition to scaling up the volume of private investment, IDA19 will focus PSW support on high-impact priority areas to support the JET agenda.** Building on PSW's support to SMEs, affordable housing and infrastructure under IDA18 (see next section), IDA19 priorities will guide more PSW support towards catalyzing private sector investment in key sectors that are central to the IDA19 JET agenda, including the digital economy, infrastructure, agribusiness and manufacturing value chains and SMEs. In addition, local currency solutions will be critical to support the growth of local business in domestic markets.

- Under IDA19, the **WBG is committed to building the foundation of the digital economy in IDA countries**, including through the Digital Economy for Africa initiative. Two of the key pillars of the initiative – “Connectivity” and “Digital Start-ups” – require active private sector participation. Private and public sectors will need to work together to build digital infrastructure, improve services, create new markets and increased demand for jobs. IDA and IFC teams will work together to leverage WBG's full suite of instruments, including technical assistance and advisory, policy reforms, lending and investment, guarantees and

¹³ Ibid.

PSW support. IFC is in the initial stages of developing an investment program to support early stage venture capital and accelerators in these areas. MIGA has supported expansion of digital telecom services in Myanmar and Sierra Leone by leveraging PSW and will continue to support digital infrastructure under IDA19.

- **Narrowing the infrastructure gap will require persistent efforts.** Addressing the infrastructure bottleneck will continue to be central to drive economic transformation and create opportunities for new industries and jobs. Supporting infrastructure investment will continue to be a priority for PSW. Lessons from PSW implementation in IDA18 point to the need to work upstream jointly across WBG teams drawing on diverse WBG instruments and partnerships. Other actions that will be critical under IDA19 include leveraging investment platforms, like the Compact with Africa, Tokyo International Conference of Africa's Development (TICAD), and the WBG's own Development Finance Forum. At transaction level, different PSW facilities can be used to address specific risks.
- **Agribusiness and manufacturing businesses and SMEs linking to value chains have significant potential in creating jobs and generating incomes.** These businesses, especially new firms, have a proven track record with their job creation impact. IDA18 PSW support to agribusiness, such as the Rikweda Fruit Processing Company in Afghanistan, demonstrates that such private investments are possible even in very fragile settings. The IDA19 agenda will scale up these types of activities in these sectors.
- **IDA19 PSW will promote local currency lending to support local sponsors and contribute to local capital market development.** PSW is already supporting local currency lending with Local Currency Facility (LCF) support and through the Blended Finance Facility (BFF) risk sharing facilities with local financial institutions. These efforts will continue and may be enhanced under IDA19 should Management be able to explore potential adjustments to the PSW facilities (see Section IV). (Annex 4 provides examples of on-going local currency interventions by IFC that PSW could enhance and build on.) PSW also allows MIGA Guarantee Facility (MGF) support in select non-Special Drawing Right (SDR) currencies, such as Rand and CFA, which can enable MIGA to better support 'south-south' investments.

III. IDA18 PSW IMPLEMENTATION PROGRESS AND LESSONS LEARNED

15. **IDA18 implementation of the PSW continues to make good progress.** This section provides an update on the overall delivery and pipeline, observed trends from deploying PSW resources and continued learning from doing.

A. OVERALL DELIVERY AND PIPELINE

Box 5. Recent Board Approvals of of Private Sector Window (PSW) Projects

Upper Trishuli (UT1) II Project, Nepal: The UT1 Project involves the development, construction, operation of a 216 megawatt (MW) run-of-river hydropower plant on the Trishuli River, 70 km north of Kathmandu. The transaction represents one of Nepal's largest Foreign Direct Investments (FDIs) to date, requiring development of new, bankable project agreements with an average feed-in-tariff of US¢5.1 per kilowatt hour (kWh), backed by a government guarantee. PSW provided support of up to US\$103 million including a US\$65 million subordinated loan from the Blended Finance Facility (BFF) and US\$37.8 million political risk first loss cover from the MIGA Guarantee Facility (MGF). The project is expected to (i) increase domestic power supply by one-third from 2018 levels; (ii) provide a large proportion of output during the dry season; (iii) create a model for future investment in the sector, including on environmental and social impact and climate resilience; and (iv) reduce Greenhouse Gas (GHG) emissions and improve energy security by replacing thermal-based electricity imports. The demonstration effects and positive externalities resulting from this project are expected to open the way for future private sector projects. BFF support was specifically required to mitigate risks for international senior lenders. Similarly, MGF's first loss risk mitigation was deemed necessary for the Multilateral Investment Guarantee Agency (MIGA) to provide the requested cover and the need to reduce MIGA's premium to a bankable level given the Project's modest equity returns. UT1 was made possible by close collaboration across the WBG, bilateral and multilateral blended finance facilities including the BFF, as well as from the project sponsors over the last seven years.

Ayiti Leasing, Haiti: Micro, Small and Medium Enterprises (MSMEs) employ about 80 percent of the total workforce in Haiti but face numerous hurdles to grow, create jobs, generate value, with a lack of access to finance being amongst the most critical challenges. To address the financing gap, the International Finance Corporation (IFC) offered a US\$11 million medium-term financing package to Ayiti Leasing to support the growth of its SME leasing portfolio. PSW provided a BFF senior loan of US\$5.5 million along with IFC and other investors. This package included a senior secured loan from IFC and a B Loan, alongside a concessional loan from PSW. Leasing is a financial product that is particularly well-suited to meet the needs of SMEs, which often lack the collateral to obtain affordable loans. The leasing initiative in Haiti began through IDA efforts in 2012, which helped to lay the foundation to facilitate the launch of a leasing market in the country. Since 2014, IFC Advisory Services has been involved with Ayiti Leasing to establish the Company's business plan, policies and procedures, information technology (IT) infrastructure and organizational framework. A second IFC advisory services project now aims to build the Company's capacity in scaling up its leasing operations in a commercially sustainable way.

Dole, Sierra Leone: Located in the Lugbu Chiefdom, Bo District of Southern Sierra Leone, the Project involves the design, construction and operation of a greenfield agro-industrial operation that will cultivate, harvest, and process tropical fruits (mainly pineapple) for exports to principally Europe, the United States, and the Middle-East. It is developed by Dole Asia Holdings Pte (Dole), a subsidiary of Itochu Corporation (one of Japan's largest multi-industry conglomerates), and one of the world's largest producers and marketers of high-quality fresh fruit. The Project is expected to: (i) gradually create up to 3,500 direct formal jobs; (ii) introduce new technology in Sierra Leone; (iii) provide extensive technical training to local staff; (iv) implement a Community Development Action Plan centered around agricultural improvements for local farmers and social projects in the Lugbu Chiefdom (e.g., clinic and school); (v) in subsequent phases, develop an out-grower scheme focused on tropical fruits (e.g., mango, papaya, and passion fruit) that will enhance farmers income and access to markets; (v) generate up to US\$35 million of foreign currency receipts per year; (vi) contribute to the development of the local agricultural logistics chain; (vii) contribute to Sierra Leone's economic diversification away from the mining sector; and (viii) have a strong demonstration effect through increased investor confidence in the agribusiness sector. IDA's support was necessary because the Project is considered *high risk* due to various factors, including its poor rural location with limited infrastructure, its significant size of land and cultivation areas, its greenfield nature, and the agribusiness sector's risks exposure to unpredictable factors such as weather and pests. A 35 percent first-loss layer resulting in a US\$10.1 million allocation from PSW-MGF provided the additional comfort that MIGA needed to proceed with this US\$40+ million investment. Alongside IDA, MIGA is also mobilizing up to US\$11 million of reinsurance capacity from the Japanese export credit agency NEXI, who in addition to reinsuring MIGA will also provide the cover against the risks of War and Civil Disturbance.

16. **Between IDA18 MTR and end of April 2019, three new PSW projects have been approved by the IDA Board, bringing the total PSW-supported projects and platforms to**

date to 14. These Board approvals include: BFF support for the first leasing company in Haiti; BFF and MGF support in the Upper Trishuli 1 (UT1) hydropower project in Nepal, the largest PSW allocation (US\$103 million) so far supporting one of the largest recent FDIs (US\$647 million) in Nepal; and MGF support for Dole’s greenfield agro-industrial operation in Sierra Leone that will process and market tropical fruit for exports (see Box 5). As of end-April 2019, a total of US\$304 million of PSW resources has been approved, supporting more than US\$800 million IFC investments and MIGA guarantees and expected to mobilize an additional US\$1.5 billion of private investments. (See Annex 1 for the list of approved PSW support so far). While most of these PSW-supported transactions are still in early stage of operationalization, the expected results are promising (see Annex 2 for detailed results framework). Box 6 shows the early results of a PSW-supported equity fund.

Box 6. Early Results of the Private Sector Window (PSW) Investment in I&P Afrique Entrepreneurs (IPAE) II Equity Investment Fund

The IPAE II Fund is a 10-year generalist impact fund that aims to invest in small and medium enterprises in Sub-Saharan Africa. The International Finance Corporation (IFC), with PSW support, provided US\$15 million in equity investment, as one of the early PSW supported transactions approved in March 2018.

On the funding side, as one of the early investors of the Fund, IFC’s investment with PSW support sent positive signal to other public investors, including European Investment Bank (EIB) and Japan International Cooperation Agency (JICA), the African Development Bank, the Dutch Good Growth Fund, and private investors such as AXA IM, Société Générale, Mirova-Natixis AM, as well as individual investors. Thanks to IDA-PSW support, IPAE II had its second closure at 75 million euro and is ready for its third closure at 90 million euro this summer.

On the investment side, 12.5 million euro have been invested in startups and businesses, with each ticket size ranging from 0.5 to one million euro. The supported enterprises include a digital platform providing classified advertisements based in Senegal called “Le Coin Afrique”, a face-to-face and online training platform for young professionals in East Africa called “African Management Initiative”, healthcare facilities in Cote d’Ivoire (“Procréa”), Ghana, Cameroon, and Senegal, as well as an agribusiness venture supplying cattle feeds in Burkina Faso. The Fund will continue to build its investment portfolio for socially-oriented and startup businesses, aligned with the Fund’s objectives. It bridges a financing gap and supports performing and impactful businesses in the least developed and fragile countries, with a strong focus on West Africa.

17. The PSW project pipeline has accelerated with a moderate attrition rate. After the initial ramp-up phase, the post-Concept Review downstream pipeline¹⁴ has accelerated over the last quarters, with over US\$1 billion in place (see Table 1). In addition, midstream opportunities have also grown with over US\$1 billion in identified investments. The PSW pipeline is expected to continue to experience some dropped projects both in the midstream and downstream stages. However, continued upstream development work and increased familiarity of IFC and MIGA teams with the PSW instrument has improved the quality of midstream opportunities, and both the midstream and downstream pipelines are expected to continue to grow. Management will continue to monitor the evolution of the pipeline.

¹⁴ PSW governance process outlined in the Operationalizing PSW Board Paper defines the following decision points with PSW Representatives’ participation before a project proposal is brought to IDA’s, IFC’s and/or MIGA’s Boards: (i) Concept Review, and (ii) Approval meeting. Projects past Concept Review are termed “downstream” pipeline. There are also projects that are under development (“midstream opportunities”) but not yet brought for formal Concept Review, as well as projects that are in very early stages of development (“upstream”).

Table 1. PSW Utilization and Pipeline (US\$ millions) as of April 30, 2019

| Facility | Post Concept Pipeline | Board Approved (including Client Committed) | Client Committed |
|---------------------------|-----------------------|--|------------------|
| BFF | 425 | 145 | 75 |
| LCF | 222 | 58 | 38 |
| MGF | 250 | 101 | 37 |
| RMF | 248 | 0 | 0 |
| Total IDA PSW | 1,144 | 304 | 150 |
| <i>from which FCS/FCV</i> | 478 | 169 | 50 |
| Total IFC | 1,591 | 380 | 225 |
| Total MIGA | 682 | 489 | 57 |
| Total IFC+MIGA | 2,273 | 869 | 282 |
| Project size | 5,505 | 2,302 | 1,525 |
| <i>from which FCS/FCV</i> | 1,467 | 1,558 | 911 |
| Other private funding | 3,232 | 1,433 | 1,243 |
| Subsidy estimate* | 184 | 65 | 37 |

Note: *Subsidy estimates are based on the midpoint value in the subsidy range for pipeline and Board Approved projects. Client Commitments subsidies are based on information from Board Approved projects

18. **The use of Programmatic Approaches is beginning to enhance the scale and efficiency of PSW deployment, following the endorsement by IDA Participants and approval by IDA’s Board after the MTR.** The use of programmatic approaches was proposed to reduce processing costs for small projects of similar type, leverage economies of scale, and enable pooled or platform solutions that are appropriate to address requisite transaction and financing constraints.¹⁵ Several programmatic projects have been approved or are in the pipeline (see Box 7). There are also programmatic LCF approaches under consideration, including several thematic programs in SME equity investments, local currency micro finance, and affordable housing finance.

¹⁵ The MTR paper outlined some key principles to inform the use of this approach. The criteria for developing programmatic approaches have been further developed and include four key features. **Standardized interventions:** these include a defined pricing range, size of support and rationale for a repeated transaction type. **Small, but repeatable transaction sizes:** programmatic approaches are particularly suitable for SME-level transactions where the individual transaction is very small and will have high overhead cost if processed individually. **Prior experience by IFC/MIGA:** programmatic approaches will be more effective where IFC or MIGA have gained experience in individual transactions and understand the general risks so as to have the capability to structure a programmatic approach that is replicable in other PSW countries. **Pooled risk solutions:** like the Small Loan Guarantee Program, the use of pooled mechanisms can support individual transactions where the pooling effect can provide improved risk mitigation approaches and program flexibility relative to transaction by transaction allocation.

Box 7. Platforms and Programmatic Finance Support the Efficient Provision of Small and Medium Enterprise (SME) Financing

The Private Sector Window (PSW) has supported a variety of programmatic approaches targeted to increase the provision of SME Finance in challenging markets and regions. Projects such as the pan-African investment in I&P Afrique Entrepreneurs II L.P. (IPAE II), the Small Loan Guarantee Program (SLGP), and the Australia and New Zealand Banking Group Limited (ANZ) Pacific Risk Sharing Facilities (RSF) have used or are in the process to use IDA18 PSW funds to execute program-based approaches that provide a more strategic, coordinated and larger-scale response to sector and regional needs.

The PSW-supported SLGP is a scalable platform for the expansion of the International Finance Corporation (IFC) RSFs in IDA/Fragile and Conflicted-affected Situations (FCS) countries. The SLGP was established to help address the large SME finance gap in IDA countries, by sharing the risk of bank lending to SMEs, particularly in Low-Income Countries (LICs) and segments that are currently considered too risky. The novel structure of the SLGP includes a pooled first loss funded by the IDA PSW Blended Finance Facility (BFF), which will support the IFC portion of the risk-share of each portfolio of SME loans originated by a client bank. In the pilot initial phase, the IDA allocation of US\$50 million has been approved to support IFC RSFs totaling up to US\$166 million, which in turn will cover 50 percent of a US\$333 million pool of SME loans. The goal is to create a global, diversified portfolio of SME loans in low income and fragile states, using a structure and pricing (2 percent-2.5 percent) that maximizes utilization and impact. The pipeline of individual RSFs has developed quickly and request to increase the PSW first loss for SLGP is expected to proceed to IDA's Board by the end of FY19.

Long term equity financing through SME funds are also being supported. Three Board approved proposals for PSW-BFF support SME Ventures-type projects which have all been committed to end clients. These include the pan-African IPAE II; the Highland Private Equity and Mezzanine Fund L.P. (Highland), the first PE fund focused on Kyrgyz Republic; and Anthem Asia Myanmar SME Venture Fund L.P. (Anthem Asia) that supports SMEs in Myanmar. IFC plans to build on these efforts by preparing a PSW-BFF envelope of up to US\$50 million which aims to provide SMEs in PSW-eligible countries access to growth capital, while developing the private equity asset class where it would not otherwise develop naturally due to the limited interest by potential investors and higher perceived or actual financial and operational risks involved in these markets. Through this envelope, IDA PSW can help SME Venture funds raise capital to reach their first close, or scale through a subsequent close, attract other investors to invest in these funds, improve access to finance, and help develop an ecosystem for SMEs in challenging markets.

19. **Pipeline evolution reflects the level of discipline in PSW project selection, based on the PSW criteria for deploying blended finance** (see Box 8). Over twice the number of projects have been dropped from consideration for PSW support compared to those that have been endorsed for presentation to the Board. Of the 66 projects which have passed Concept Review since FY18, 13 have since been dropped accounting for US\$397 million. Of these, the most cited reason for projects dropping from the pipeline is the challenge in aligning with investor needs, particularly related to pricing. In these cases, the endorsed level of concessionality in line with PSW Criteria – in particular the Blended Finance Principles – or the level of de-risking PSW provided was not sufficient for the project to progress to completion. This suggests that PSW is not using excessive subsidies to pursue deals. (See detail on subsidy experience in Section III C.) The next most cited reason was rejection by the management review committees, particularly for projects not suitable for concessional finance, underscoring the level of rigor employed when reviewing the economic rationale for use of concessional resources. Very few projects are dropped due to internal disagreements on the need for PSW in a given project, suggesting increased familiarity with the PSW instrument as the rationale for its use is now better understood across the WBG (see Figure 3 and Annex 6).

Box 8. Criteria for Assessing Projects for Private Sector Window (PSW) Support

These criteria are based on the eligibility and risk considerations governing the IDA18 International Finance Corporation (IFC)-Multilateral Investment Guarantee Agency (MIGA) PSW. IFC and MIGA teams provide responses to these questions as they prepare transactions proposed for PSW support.

1. Country / Facility Criteria

- a. Is the proposed PSW-supported project located in a PSW-eligible country / sub-region?
- b. Does the transaction comply with the applicable IFC / MIGA risk parameters and PSW overall facility limits?

2. Strategic Alignment with the World Bank Group (WBG) and IDA Strategies

- a. Is the project aligned with the relevant WBG country strategy and on-going WBG operations?
- b. Does the project support IDA18 Special Themes and IDA’s poverty focus?
- c. Is the project aligned with the WBG’s approach to private sector development?

3. Principles for Using Concessional Finance. Does the proposal align with the following principles:

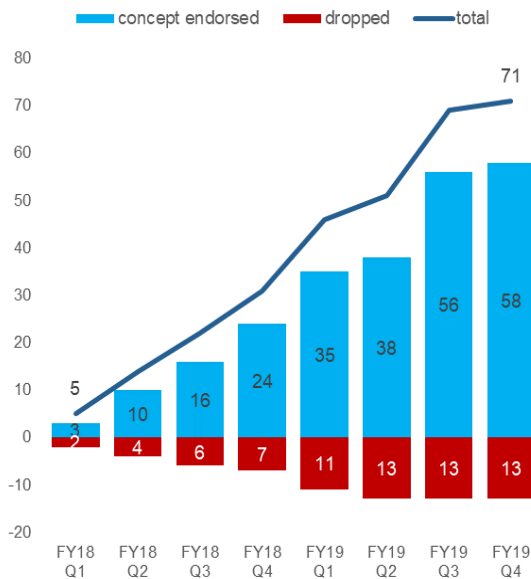
- a. Economic Rationale for Using Blended Concessional Finance
- b. Crowding-in and Minimum Concessionalality
- c. Commercial Sustainability
- d. Reinforcing Markets
- e. Promoting High Standards

4. Risk Considerations to IDA

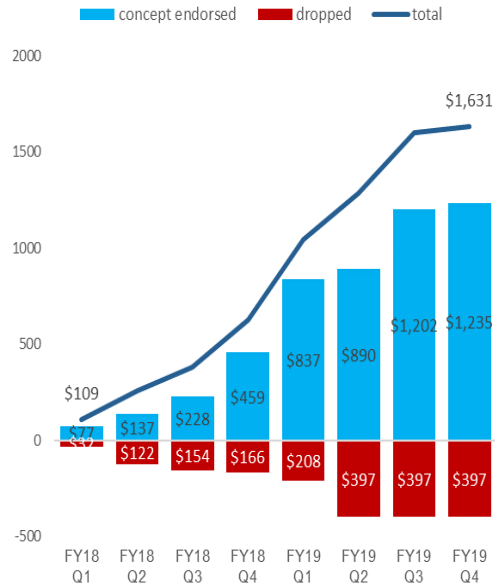
- a. How significant are the risks associated with the PSW transaction?
- b. What are the risk mitigation strategies to manage these risks to the PSW transaction?
- c. What does the risk transfer cost?

Figure 3. PSW Post-concept Pipeline (cumulative FY18-19)

a. Endorsed vs. dropped by quarter (cumulative number of projects)



b. Endorsed vs. dropped by quarter (cumulative USD million)



B. OBSERVED TRENDS FROM DEPLOYING PSW

20. **PSW has used a broad set of financial structures to reduce the risks for private sector sponsors, IFC and MIGA.** An assessment of the post-Concept Review pipeline and Board approved projects indicates that the BFF has used the most diverse types of structures while both the LCF and MGF have utilized a single mechanism in all transactions reviewed to date. (See Figure 4 for Use of Financial Instruments by Type in Post-Concept Review Pipeline and Board Approved PSW projects.)

- All LCF transactions have been structured as direct foreign exchange (FX) swap agreements (open FX) thus far. The ability to use other structures in the LCF cascade¹⁶ has been limited by the lack of local swap market counterparties or the prohibitive pricing when counterparties are available, as well as challenges in obtaining regulatory approvals for IFC-led local currency liquidity operations. A noteworthy update relates to the Hattha Kaksekar Limited (HKL) Cambodia transaction,¹⁷ where LCF resources were released after IFC's recent issuance of an IFC Khmer Riel bond. Where feasible, the World Bank and IFC are working together to address regulatory issues that hinder development of local capital markets often as part of their Joint Capital Markets Program (J-CAP)¹⁸ Initiative. However, in the host countries of projects reviewed for PSW support thus far, there are currently no commercial alternatives to LCF that can provide the necessary loan tenors nor pricing to enable the underlying project. Several transactions blended open FX with other local currency solutions such as The Currency Exchange Fund (TCX) or IFC bond issuances at the time of disbursement.
- All MGF deployments thus far has been in the form of shared first loss; there are as of yet no transactions where MGF was used as a form of reinsurance. This reflects the high level of political risks in the host countries and sectors of projects seeking MGF cover thus far. MIGA has required MGF support as first loss in these types of projects in order to proceed.
- The Risk Mitigation Facility (RMF) pipeline is led by liquidity support guarantees, with four out of six total RMF proposals. This reflects the dominant needs for covering liquidity risks, and points to more incidences of public entity bankability concerns rather than

¹⁶ IFC follows a “solutions hierarchy” when attempting to source local currency for PSW-supported projects. It will first seek to provide the needed currency through existing market solutions, other non-market providers such as TCX, and through existing or new IFC liquidity operations in PSW-eligible countries before resorting to options provided by the LCF.

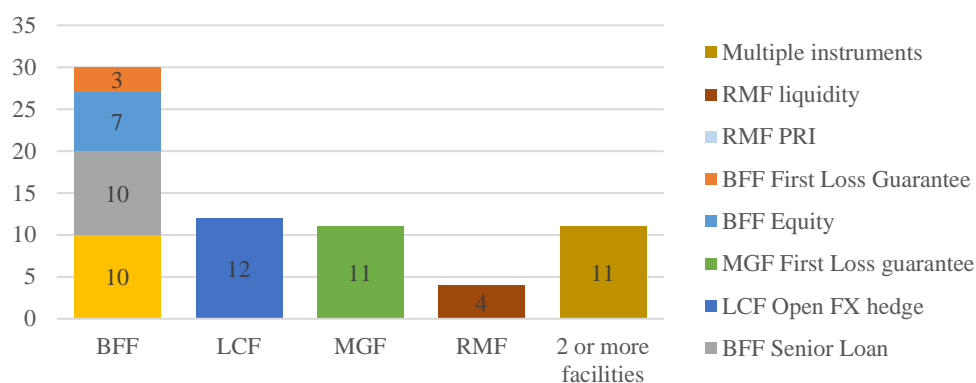
¹⁷ In the HKL transaction approved by the IFC and IDA Boards in June 2018, the IFC investment was initially hedged with an open FX swap from the LCF. Later, IFC was able to issue a domestic Khmer Riel (KHR) bond which helped reduce the need for the LCF to cover the currency risk on the entire investment. The open FX swap from LCF was restructured to cover only 40% of the investment, therefore releasing US\$12 million capacity that could be used by the LCF to provide local currency solutions to other projects. This example of “blending” illustrates the flexibility the LCF offers when more market-based solutions become available during the life of the investment. Management envisions this approach will be used more going forward.

¹⁸ J-CAP, a joint World Bank-IFC initiative, aims to coordinate interventions by various market participants and stakeholders (IFC's Financial Institutions Group (FIG) and Treasury, the joint Finance, Competitiveness, and Innovation Global Practice, and World Bank Treasury) as well as deepen relationships with the capital markets unit at the International Monetary Fund (“IMF”) and other partner Multilateral Development Banks (“MDBs”).

concerns with transfer and convertibility, breach of contract, expropriation, or war and civil disturbance risks in the projects being originated for the RMF.

- BFF by design has used a diverse set of structures, which are also represented in the pipeline going forward. Post-concept projects proposed for BFF support include senior loans with concessional interest rates (10 of total 30) and subordinated investments/quasi equity (also 10 projects). There are also several projects utilizing equity structures (seven projects in total). Recent proposals show more limited use of stand-alone risk sharing facilities, both at around three projects, reflecting the use of a broader program as a vehicle for this instrument and the higher risks the PSW often takes in BFF transactions.

Figure 4. Number of Use of Financial Instruments by Type in Post-Concept Review Pipeline and Board Approved PSW projects



Note: Count considers utilization of each instrument by facility. Projects may comprise multiple instruments. Each program with multiple sub-projects using the same instrument is counted once.

21. **Engaging local sponsors has been a feature in many PSW-supported projects.** Of the ten approved IFC transactions, five are linked to direct support for local sponsors in IDA countries.¹⁹ MGF by design supports FDIs, but these projects often include linkages to local contractors, suppliers and many businesses in the project’s value chains. IFC-led projects supporting local sponsors also feature prominently in the pipeline. Local sponsor support is particularly frequent with the BFF and LCF, where local financial institutions (or local subsidiaries) and mid-scale manufacturing or agri-businesses are present in the markets and supported through the PSW instrument. Of the post-concept BFF, LCF and RMF pipeline projects, 26 of 34 (over 75 percent) are providing direct support for local sponsors across several sectors.

22. **SMEs remain a priority for PSW support.** Through its provision of lending and advisory services, including to microfinance institutions (MFIs), IFC supports lending to the smallest and most nascent businesses in PSW-eligible countries, and helping to close the financing gap including for women and women-owned businesses. The SME Ventures platform and high

¹⁹ These five projects are Ayiti Leasing, Anthem, Highland, Hattha Kaksekar Limited (HKL) Cambodia, and IDLC Finance Limited (IDLC).

demand for the Small Loan Guarantee Program (SLGP) are examples. Also, one of LCF's first transactions was undertaken to support a bond issuance by a leading Cambodian microfinance lender, HKL, the third largest MFI in Cambodia with substantial reach to base-of-the-pyramid borrowers in the rural areas of the country.²⁰ Additionally, IFC is preparing a broader program of support to the MFI sector in Cambodia in order to build on the success of HKL and to capitalize on the recent strong support from Cambodian regulators for its efforts.

23. The affordable housing market in IDA PSW countries significantly benefits from BFF and LCF support on both the supply and demand sides.

The private sector currently serves only the housing needs of the top income levels. The PSW can help kickstart the participation of the private sector in the affordable housing space by helping it to go down market to lower income segments and proving the business case. On the demand side, the PSW helps mortgage providers and mortgage refinancing corporations (MRC) to match the financing needs of middle and lower-income market segments who can only afford mortgages in local currency and/or with long tenors normally unavailable in IDA PSW countries. In particular, MRCs are critical to build deep and liquid markets for retail mortgage financing (see Box 9). On the supply side, the PSW helps developers, and financial intermediaries that lend to them, offset risks stemming from asset-liability mismatches (in local currency and tenors), slow sales ramp-up and high costs for first entrants that have to build supportive infrastructure. Technical assistance is a critical tool that accompanies the use PSW, and it helps build sustainable capacity of banks and developers as they move down to new market segments. The PSW pipeline and approved projects currently include eight affordable housing projects under the BFF and LCF for a total of US\$256 million (see Table 2), and a programmatic approach is also being developed.

Box 9. Mortgage Refinancing Corporations (MRCs) Help Support Affordable Housing

MRCs provide liquidity to the market by purchasing portfolios of mortgage loans from participating banks, allowing these banks to recycle the proceeds of these asset sales into new lending. Eventually, as markets develop, the MRCs can be expected to enter into securitization transactions with local institutional investors, providing these local institutions (pension funds and insurance companies) with the long-term local currency assets they need to support their contractual savings obligations. The sale of MRC assets will, in turn, allow the MRCs to purchase additional assets from the banks, creating a virtuous circle of funding from the capital markets to support bank lending to home purchasers.

Supporting MRCs is an especially value-adding activity that is enabled by the Loan Currency Facility (LCF), as the type of funding these entities require – long-term and local currency – cannot be easily sourced in many IDA markets. The International Finance Corporation (IFC) has already approved and purchased two long-term bonds issued by Caisse Régionale de Refinancement Hypothécaire (CRRH), a West African regional mortgage refinancing company in which IFC also holds an equity investment. In addition, IFC expects to bring for board approval a proposal to purchase two bonds issued by the Tanzania Mortgage Refinancing Corporation (TMRC). These two efforts will be further extended through a regional MRC financing effort.

24. Infrastructure opportunities are emerging for RMF, BFF as well as MGF. Despite long project development cycles, the initial infrastructure projects being supported by PSW are

²⁰ Following this trade, IFC is planning an offshore bond issuance and there are some indications that another private bond issuance could follow in the medium term. The World Bank is also engaged with the Ministry of Economy and Finance to establish a framework for the development of a domestic government debt market.

coming to fruition, such as BFF and MGF support to the UT1 hydropower in Nepal and MGF support to the Fiber Optic Communication Network in Myanmar, as well as the Telecom Infrastructure project in Sierra Leone. There are also emerging pipeline opportunities to support energy projects, including through the scaling solar program where the BFF and RMF can support program expansion in other PSW-eligible countries.

Table 2. Summary of Board Approved and Downstream Pipeline Affordable Housing Projects

Amounts in US\$ millions

| Name | Country | IDA category | Supply/ Demand | Project size | IFC | BFF | LCF | PSW leverage |
|---------------------------------|---------------|--------------|----------------|--------------|------------|-----------|------------|--------------|
| <i>Board approved/ Executed</i> | | | | | | | | |
| CRRH | West Africa | IDA | Demand | 100 | 18 | | 18 | 6x |
| IDLC | Bangladesh | IDA | Demand | 40 | 40 | | 20 | 2x |
| Total | | | | 140 | 58 | - | 38 | 3.7x |
| <i>Post-concept pipeline</i> | | | | | | | | |
| Project 1 | Tanzania | IDA | Demand | 10 | 3 | 1 | 2 | 3x |
| Project 2 | Côte d'Ivoire | IDA FCS | Supply/ Demand | 100 | 45 | | 45 | 2x |
| Project 3 | Rwanda | IDA | Supply/ Demand | 226 | 31 | 31 | | 7x |
| Project 4 | Guinea | IDA | Supply | 24 | 7 | 7 | | 3x |
| Project 5 | MENA-Africa | IDA | Supply/ Demand | 850 | 170 | 25 | 75 | 9x |
| Total | | | | 1,210 | 256 | 64 | 122 | 7x |

C. CONTINUED LEARNING FROM IMPLEMENTATION

25. **Lessons from experience continue to accumulate, specifically on deploying PSW through WBG collaboration and on the use of blended finance more broadly.** Given the short time since IDA18 MTR, lessons from the MTR PSW paper remain relevant, and additional lessons continue to be garnered. This experience is being used to further improve the PSW operating model, shape the design of the IDA19 Framework proposal (see Section V). It also contributes to the development of blended finance design and deployment in the broader development community, notably on key elements such as additionality, the economic rationale, and minimizing concessionality.

- **Understanding Additionality and the Economic Case for Blending.** The concepts of Scale and Scope Additionality have broadened to include the “Economic Case for the Use of Blended Finance”, a concept which is now applied to all IFC blended finance projects. Projects continue to be reviewed based on the additional volume of commitment and mobilization over what would have been achieved by IFC or MIGA without PSW support, or the notable “firsts” that PSW is supporting. In addition, projects are now reviewed even more closely based on their contribution to country or sector reform efforts or their market-level impacts to assess if they warrant concessional support, as detailed in IFC’s Anticipated Impact Measurement and Monitoring (AIMM) framework and MIGA’s Impact Measurement and Project Assessment Comparison Tool (IMPACT) assessment. AIMM and IMPACT ratings of projects reviewed maintain the high bar reported at MTR: the Board Approved and post-Concept projects proposed for PSW support have AIMM and IMPACT ratings higher than non-PSW supported IFC and MIGA projects (at 90 average AIMM and 86 average IMPACT ratings for PSW-supported IFC and MIGA

projects versus 57 average AIMM and 58 average IMPACT ratings for non-PSW supported IFC and MIGA projects). These projects also note clear development impact indicators with target levels and baselines information.

- **Minimizing Concessionality and Crowding-In Private Financing.** Minimizing concessionality continues to be a complex consideration, combining best estimates of subsidy and use of judgment on whether such estimated amounts are (i) *just enough* to address the risk/return gaps in target markets to enable the underlying private sector investment while avoiding or at least minimizing risk of market distortion, and (ii) not excessive vis-à-vis the economic case for their use. There is also robust scrutiny on who the ultimate beneficiary of the subsidy is and an analysis of how the benefits of the subsidy flow through to these beneficiaries. For instance, for clean energy infrastructure projects, the focus is on how the proposed subsidy impacts the tariff, while for manufacturing projects there are questions on whether the subsidy goes to enhancing returns to players in a protected sector. The suggested correlation between the level of subsidy required and the PSW instrument used (e.g., local currency swaps and risk-sharing facilities tend to require a higher level of subsidy) continued to hold in the proposals reviewed since MTR. There also continues to be an indication of a trade-off between subsidy intensity and PSW exposure (e.g., for a similar level of risk transfer, PSW can have a small, highly subsidy-intense exposure or a larger, much less subsidy-intense exposure). For instance, larger exposure with lower subsidies has been more typical when using PSW concessional loans in combination with IFC commercial A and B loans. Based on the Board approved projects and post-concept project pipeline to-date, the PSW is poised to provide estimated subsidies of US\$184 million, which represents 2.9 percent of total estimated project cost, and 17.7 percent of PSW resources deployed. This is a decrease from the levels reported at MTR of five percent of total project cost and 23 percent of PSW resources.
- **Understanding PSW Financial Risks.** In some of the PSW transactions executed thus far, PSW has provided financing on pari-passu terms as IFC to help projects get to financial close (as in the SME Ventures transactions supported with PSW) or has shared in the first loss (as in all MGF transactions). More typically – and as was envisaged in the IDA18 PSW design – PSW is utilized to de-risk projects by taking on the riskier tranche of transactions. As there is currently sparse information to estimate PSW potential expected losses and capital costs, IDA’s conservative approach of setting aside 100 percent of the PSW contribution from IDA’s leverageable capital remains prudent (see Section V for more details).
- **PSW Governance as a Catalyst for Behavioral Change to Increase WBG collaboration.** PSW design had a clear intent to enhance the interactions across IDA, IFC and MIGA teams and align incentives for collaboration. Over the past two years, a growing level of common understanding and collaboration across the WBG teams have led to improved engagements in project review and approval processes. This is leading to increased familiarity with products and processes across WBG entities. Several projects have involved all three WBG institutions (e.g., Rikweda in Afghanistan and UT1 in Nepal), which has further enhanced cross-institutional understanding and collaboration.

- **Importance of Back-office Functions.** As more types of instruments are supported by the PSW, there is continued need for adapting standard processes and procedures to ensure the robust administration of PSW, particularly from the IDA side. These efforts typically require significant engagement with Bank, IFC and MIGA legal, finance, accounting, and risk teams. For IDA, often manual interventions are needed to record and administer the first transaction of each type and provide accounting and risk provisioning. This is expected to ease going forward now that the loss provisioning, valuation and recording mechanisms for more types of transactions are executed and put in place. At the same time, however, the increasing volume and value of transactions also mean a more established approach would be necessary, which would incur additional cost and efforts. IDA management will take stock of these and propose adjustments for approval of IDA, IFC and MIGA's Boards as relevant in time for IDA19.

26. **Each PSW facility has generated facility-specific lessons.** The four facilities have all been launched at different paces, experienced different successes and challenges. Overall, many of the initial challenges have been overcome to enable an expansion of PSW deployment, and valuable lessons are being gleaned for the future for the WBG and for external partners.

27. **The BFF has been successful in achieving scale, building on IFC's prior experience with blended finance activities.** The flexibility of BFF instruments, including the ability to deploy it across multiple sectors, has helped ensure that the most appropriate solution is structured to tackle the relevant transaction-specific market barriers. The BFF has also been able to expand its reach and impact by supporting banks through loans and guarantees and investing in private equity funds to finance investments in priority sectors and underserved segments, such as SMEs, including very small SMEs, women-owned SMEs, agri-SMEs, and climate SMEs. Perhaps most significantly, programmatic approaches and platforms that apply consistent criteria and approach, and embed a streamlined approval process, have increased the rate of utilization of BFF resources (e.g., SLGP), and have also facilitated the development of similar platforms in the pipeline across sectors.

28. **Challenges remain for the BFF to further expand its impact.** Given the typically small size of BFF transactions for non-infrastructure projects, there is a strong rationale to encourage regional or thematic platforms and/or programmatic approaches. However, such platforms are challenging to structure solely in PSW countries. From the perspective of potential investees, PSW eligibility does not often allow enough diversification of both risks and benefits. For instance, there have been several private equity funds covering multiple countries, including some that are not PSW eligible. As PSW pushes to support more such regional or programmatic approaches, this demand for diversification will increasingly need to be taken into account.

29. **Uptake of the LCF has underscored the strong demand for local currency solutions, as well as the challenge of offering affordable local currency swaps to enable these transactions.** LCF implementation to date underscores the issue of the high price of long-term local currency loans in many markets. This pricing has necessitated a significant subsidy to make these long-term loans affordable, and has highlighted the need to ease regulatory constraints to allow markets to develop. Other non-LCF solutions for long-term local currency finance – such as a hedge from a third-party entity or funding from IFC local currency bond – often entail a price

which is too high to enable local currency transactions in PSW-eligible countries. As such, the LCF open FX exposure has frequently been blended with these non-LCF solutions to allow projects to be priced at feasible levels. This has led to a greater use of open FX operations for LCF than was initially expected and a higher subsidy per dollar allocated than other facilities, particularly in high inflation countries and for longer tenor loans. Longer-term efforts to develop additional local market options are ongoing and increasing but will take time to produce results (see Box 10).

30. **With the MGF, experience to date has demonstrated useful lessons in understanding and calculating concessionality for the MGF-supported guarantee product.** To determine the MGF use, MIGA has devised a framework based on country and project risks. The MGF capacity allocation in each transaction will consider the country risks rating as determined by MIGA's country analysis, the country's history in related risks claim/pre-claims, reinsurance capacity, the project risks for which insurance is being sought, and the number of covers to be provided for the investors. Depending on the classification of these factors considered and the number of risks covered, MIGA Management forms an assessment if the risks are deemed as very high or high, and proposes a percentage of MGF usage. Accordingly, based on MIGA's pricing model, a methodology is established to calculate the implicit subsidy as the price difference between (i) the first-loss pricing MGF could have received calculated by the model; and (ii) the actual pricing MGF receives.

Box 10. The Challenges of Local Currency Transactions

Regulatory Issues: Lack of regulatory approvals has hindered deployment of Local Currency Facility (LCF) resources. The International Finance Corporation (IFC) must receive approvals, or be already permitted under local laws and regulations, to enter into currency hedging transactions in order to provide local currency loans to clients. Regulatory constraints often inhibit IFC's ability to engage with local counterparties, and significant upstream work is required to obtain necessary approvals and to prepare local counterparties to transact. To effectively develop local counterparties, a phased plan is being developed in conjunction with the WBG's Joint Capital Markets Program (J-CAP) Initiative in the selected J-CAP countries. This will require upstream reforms, agreements with local authorities and potential waivers to implement.

Pricing: Pricing local currency transactions remains a challenge given the lack of observable market data. To determine reference price proxies, IFC has relied mostly on currency counterparty quotes which are executable as opposed to purely theoretical modelled pricing. Quotes are checked against observable data such as government bonds, T-bills, central bank deposit rates and commercial rates to avoid market distortion. These rates are then compared with the level of end-client pricing that would make the project feasible. This is reviewed by IFC's Blended Finance Committee with input from Private Sector Window (PSW) Representatives, in line with the minimum concessionality principle, to seek the level of LCF swap pricing which adequately balances risk and reward between IFC and IDA and does not translate into excess windfalls for the end-client. This has been a learning process as nearly every currency and project context present new considerations. In a similar fashion, the lack of observable market data creates a valuation and audit challenge for IDA's financial reporting on these arrangements.

31. **The RMF has been gradually building a pipeline, and initial projects are expected to be brought for Board consideration in the coming months.** From the early implementation challenges, important lessons have emerged to guide project development. These include the need for extensive upstream work to develop bankable private investments, the need for coordination with the pace of sector reforms, and the need to assess the complementarity of the array of WBG instruments to support individual transactions. The lack of adequate progress on critical sector

reforms in many IDA markets has led to a slower than expected pipeline development and, consequently, lower utilization than expected of the RMF. In a number of cases, existing Bank instruments, such as the IDA Project Risk Guarantees (PRGs), are determined to be more appropriate to ensure adequate progress on sector reform. Additionally, the very long gestation period of infrastructure projects in target markets continues to affect the ramp-up of RMF utilization in the medium term. Complex infrastructure projects in IDA and FCS markets can take as long as five or more years to develop and often face high rates of failure (e.g., due to sector challenges, market disruption, integrity due diligence (IDD) issues, and environmental and social challenges). More joint WBG upstream work will help pipeline development and provide more certainty to clients at early stages on the potential to access appropriate WBG risk mitigation instruments.

IV. PROPOSAL FOR THE PSW FRAMEWORK IN IDA19

32. **Building on the experience of the IDA18 pilot and the pipeline being developed, Management proposes to extend the PSW as part of the IDA19 Replenishment.** The implementation of the PSW during IDA18 has created a solid foundation for its continuation during IDA19. Many of the initial start-up challenges experienced during IDA18, such as setting up the supporting infrastructure and adapting existing processes and procedures, will no longer be faced in IDA19. Building on the experience and momentum gained, the overall PSW framework is proposed to be retained during IDA19 with only a few modifications to the framework and some adjustments to the facilities (see Box 11).

Box 11. Proposal for the Private Sector Window (PSW) Framework under IDA19

The PSW Framework will retain the main features of IDA18 during the IDA19 period:

- The overall size of the PSW will be maintained at US\$2.5billion.
- The four facilities under the PSW will remain.
- Private sector client interface will be with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) only.
- PSW Governance principles remain the same.

Modifications to the PSW Framework for IDA19 include:

- Indicative allocations across the four facilities will be recalibrated relative to IDA18, to reflect expected demand. The Blend Finance Facility (BFF) and the Local Currency Facility (LCF) will receive larger allocations, while the Risk Mitigation Facility (RMF) will receive commensurately lower allocation. The MIGA Guarantee Facility (MGF) will remain the same as in IDA18.
- Introduction of a transition cycle of one replenishment for countries becoming ineligible. This will imply that all current IDA18 eligible countries will remain eligible for PSW support through the end of IDA19.
- Allowing PSW-ineligible IDA Gap and Blend countries to benefit from regional and programmatic projects when needed for structuring purposes. Benefits to these otherwise ineligible countries will be subject to a cap of 20 percent of the total IDA19 PSW amounts deployed for regional or programmatic approaches.

Potential Adjustments to the PSW facilities include:

- Adding a Loan Purchase Obligation Instrument under BFF.
- Enabling LCF support for third parties in projects with financing from IFC.

A. RETAINING THE OVERALL PSW FRAMEWORK

33. **IDA19 will continue to allocate US\$2.5 billion to PSW, shared among the same four facilities: BFF, LCF and RMF with IFC, and MGF with MIGA.** The continuing momentum of origination efforts is expected to lead to a stronger pipeline for IDA19 than existed during most of IDA18. IFC and MIGA Managements have projected potential demand for the IDA19 period and are confident that an envelope of US\$2.5billion is appropriately sized to be fully utilized under IDA19. This is also in line with the policy commitment under the JET Special Theme to expand IFC's own account commitments in IDA countries to 10-15 percent by the end of IDA19 (as referred to in Boxes 1 and 4).

34. **The overall mechanisms for how the PSW Framework functions will remain unchanged during IDA19.** Launching PSW required the establishment of new policies and procedures, as well as a shared view on the purpose and division of labor across multiple actors within the WBG. While some finetuning has been undertaken during the course of IDA18, the mechanisms – including client interface and governance – for how PSW has been used will continue to underpin the PSW in IDA19.

- PSW will continue to leverage IFC and MIGA's business platforms, and IDA will not have direct interface with private sector clients. This feature has worked well to achieve the key objective of the PSW to mobilize private investment and expand the reach of IFC and MIGA in IDA markets. It reinforces the WBG value proposition and the respective comparative advantages of each entity. It also helps IDA manage the non-financial risks it is exposed to, as IFC and MIGA's operational policies and procedures, rather than IDA's, apply in PSW-supported IFC or MIGA transactions.
- PSW's governance will continue to employ a robust assessment process. The PSW was designed to bring IDA PSW Representatives to IFC's Blended Finance Committee (BFC) and MIGA's Management review processes. This feature has worked as intended to bring staff and management of the WBG entities together to assess and validate projects, and it will continue during IDA19. The PSW criteria which include DFI enhanced principles for using blended concessional finance will continue to guide the assessment of PSW proposals in a consistent fashion across the WBG. Good practices will continue to be adopted, and efficiency gains (including through more streamlined processes, and use of programmatic approaches) will be implemented when possible. The ultimate authority for approving the allocation of PSW resources continues to rest with the IDA Board.

B. MODIFICATIONS TO THE OVERALL PSW FRAMEWORK

35. **While maintaining the key features of the PSW Framework, Management proposes three modifications to further enable PSW to deliver on its objectives during IDA19.** First, IDA18 implementation experience points to the need to recalibrate the indicative facility allocations. Second, the current eligibility criteria are proposed to continue, with a proposed transition period for any countries no longer considered IDA-only or FCS in IDA19. Finally, IDA Gap and Blend countries will be allowed to benefit from PSW in platform solutions – such as

regional and programmatic projects – when such structuring is needed to facilitate required scale and diversification.

36. **Management proposes that indicative envelopes for each facility be set to meet expected demand and utilization with some adjustments relative to IDA18.** Experience to date has highlighted the need for a larger allocation to the BFF and the LCF, while maintaining flexibility for adjustments in allocations during the IDA19 period. The indicative envelopes for each facility are presented in Table 3, indicating changes relative to IDA18 allocations. The expected growth in demand for the BFF – based on expected increases in co-investing, platform solutions, and new approaches to support local bank financing in infrastructure – underpins the need for the BFF to receive a higher allocation relative to IDA18. The LCF is also expected to see increased demand, reflecting the ability to provide support through IFC third-party investors. To enable the increased indicative allocations of BFF and LCF, RMF allocation will be lower, and the MGF will remain the same size as in IDA18. As under IDA18, Management will retain authority to reallocate resources across the facilities and will keep the Board of IDA Executive Directors and IDA Participants apprised of any changes.

Table 3. Proposed PSW indicative envelope under IDA19

In US\$ millions

| | <i>IDA18</i> | <i>IDA19</i> | <i>Change (%)</i> |
|--------------------------------|--------------|--------------|-------------------|
| Risk Mitigation Regime (RMF) | 1000 | 500-600 | Decrease 40-50% |
| Blended Finance Facility (BFF) | 600 | 800-900 | Increase 33-50% |
| MIGA Guarantee Facility (MGF) | 500 | 500 | 0% |
| Local Currency Facility (LCF) | 400 | 500-600 | Increase 25-50% |
| Total PSW envelope | 2500 | 2500 | 0% |

37. **Country eligibility criteria will remain the same.** Under IDA18, PSW eligible countries were defined as IDA-only countries and IDA-eligible FCS countries.^{21,22} During IDA18, in response to some IDA Participants’ request, the issue of expanding the PSW country eligibility criteria to include IDA Gap/Blend countries and small islands were discussed in two occasions, but no consensus was reached. In preparation for IDA19, an assessment was carried out which indicated that Gap and Blend countries on average fare better on key private sector activity indicators compared to IDA-only countries. However, the FCS Blend and Gap countries (including Blend and Gap countries with sub-national FCS status) do score lower on private sector activity indicators relative to other Blend and Gap countries. This underscores the rationale for FCS Blend and Gap countries (including those with sub-national FCS status) to continue to be eligible for PSW finance, as they have been during IDA18. Based on this analysis, Management recommends

²¹ In addition, parts of Kenya, Nigeria and Pakistan with sub-regional fragility were made eligible for PSW support. A total of 54 countries were eligible under these parameters, and the list was frozen for exit for the three-year IDA18 period.

²² The definition of FCS is being refined under the new WBG Strategy for Fragility, Conflict and Violence (FCV). The new definition will be used to decide on PSW eligibility.

not to re-open the PSW eligibility issue for non-FCS Gap and Blend countries (see Annex 3 for details of the assessment).

38. Management is proposing to introduce a transition period for countries which become ineligible during IDA19. Under IDA18, countries may graduate from the harmonized FCS list or become gap countries, making them ineligible for PSW support during IDA19. However, an abrupt change in eligibility status could adversely impact project origination, particularly for infrastructure projects which take time to prepare. Recognizing these issues, Management proposes to transition countries over one replenishment cycle following a change in PSW eligibility. This would provide clarity to private sector clients and IFC and MIGA transaction teams, and allow time for pipelines to be fully developed and projects to be delivered. Thus, the list of IDA18 eligible countries plus any new IDA countries becoming PSW eligible will be used for IDA19; however, under IDA20, such transition countries will no longer be eligible for PSW finance. The specific IDA19 PSW eligibility list will be made available at the beginning of IDA19.

39. Management proposes to allow PSW-ineligible Gap and Blend countries to join selected regional or programmatic projects when there is a structuring need. Benefits to these otherwise ineligible Gap and Blend countries will be subject to a cap of 20 percent of the total IDA19 PSW amounts deployed to regional or programmatic approaches. IDA18 regional and programmatic projects have revealed challenges related to the inclusion of non-PSW eligible countries, or in some cases, sub-regions of countries.²³ Approval has been granted in selected projects to include exceptional flows to some non-PSW eligible countries/sub-regions of countries, when the majority of the project benefits will accrue to PSW-eligible countries.²⁴ Given the growing demand for regional and programmatic projects (see Box 12), Management proposes to grant capped access to PSW-ineligible IDA Gap and Blend countries when there is a structuring need for diversification. This will enable the PSW to: (i) partner effectively with other regional or programmatic development funds where coverage may extend to IDA non-PSW eligible countries; and (ii) work with regional investors using a portfolio approach that includes investment in both PSW-eligible and non-PSW eligible IDA countries. The amount of PSW resources benefiting PSW ineligible IDA countries will be capped at 20 percent of the total PSW envelope used to support regional or programmatic approaches across all facilities, ensuring that the vast majority of PSW resources will be used only for PSW-eligible countries.

²³ Within countries having sub-regional eligibility, there have been challenges allocating portion of funds to eligible areas when the operating firm was serving the location but had other operations in non-eligible parts of the country. This has also been a challenge for private equity fund proposals.

²⁴ The approval was given on the basis that a significant share of the fund's investments would be in PSW eligible countries relative to the share of PSW contribution to the fund, and investment funds' business model necessitates room for possible temporary flows outside of target areas following the operations of their underlying investee SMEs.

Box 12. Pragmatic Considerations for Allowing IDA Gap and Blend Countries to Benefit from Programmatic Approaches

The International Finance Corporation (IFC) foresees the use of additional programmatic approaches during IDA19 including the extension of the Small Loan Guarantee Program (SLGP), an envelope for affordable housing, climate insurance for financial institutions' Small and Medium Enterprise (SME) lending, and early stage venture capital (VC) ecosystem support (e.g., digital economy).

As momentum builds towards the use of concessional funding to increase investments which address trans-border issues and achieve greater global benefits, it is expected that programmatic approaches will expand opportunities for Private Sector Window (PSW)-financed investment. These approaches are particularly beneficial to facilitate partnerships with other concessional resource providers, and other regional investors. These other donor or investor partners, however, do not always limit their engagement only to those countries defined as PSW-eligible by IDA, or have different eligibility criteria, requiring the inclusion of some non-PSW eligible countries in the PSW-supported programmatic projects.

For example, IFC is exploring a potential partnership with the European Commission (EC) to set up a structure similar to the SLGP which would allow leverage of concessional funds through a pooled approach to support more risk sharing facilities in PSW-eligible countries. Using EC funds follows a different list of eligible countries. Pooling the PSW and EC funds together will necessarily have to allow some PSW-ineligible countries to benefit from the same pool.

IFC is also seeking to support the digital entrepreneurship pillar of the Digital Economy for Africa initiative through a regional VC fund which would provide investments in high potential start-ups and accelerator hubs in the region. To be effective, these investments would be situated in key start-up hubs in the continent (Johannesburg, Nairobi, Lagos) which are not PSW-eligible. However, these hubs will serve start-ups in PSW eligible countries, hence achieving the desired impact. Also, VC hubs in Africa are under development in regional hubs in countries not eligible for PSW support, such as Kenya, Ghana, and Nigeria, before they can expand to PSW eligible markets. Therefore, in order for IFC to tap into the expansion of the VC platform in Africa using PSW funds, it will be necessary to allow some investment in vehicles targeting both PSW and non-PSW countries. This will enable growth of the VC platform to other viable markets, and also test and develop models through investment opportunities in PSW ineligible countries which can be replicated in more challenging markets.

C. POTENTIAL ADJUSTMENTS TO PSW FACILITIES

40. **At the facility level, Management would also like to explore possible adjustments to the BFF and LCF aimed at increasing local currency financing.** These adjustments could further enhance PSW local currency solutions and strengthen domestic markets and institutions in PSW-eligible countries. Under the BFF, Management proposes to explore the development of a *Loan Purchase Obligation Instrument* to support local bank participation, so that they can provide long-tenor financing in local currency to support investments in critical sectors with a focus on infrastructure. Under the LCF, Management would like to explore the possibility of *expanding coverage of local currency solutions to loans extended by third parties alongside IFC loans*, allowing local sponsors as the underlying borrower to benefit from receiving a larger financing package in local currency terms (see Annex 5 for indicative features of the potential adjustments). Should Management be able to explore these potential adjustments, operational details will be refined and implementation arrangements will be presented as appropriate for approval by the IFC and IDA Boards.

41. **A Loan Purchase Obligation Instrument for the BFF is envisioned to enable locally-domiciled banks to provide local currency loans at extended loan tenors to IFC-led projects,**

thus facilitating longer-term financing required in critical sectors such as infrastructure. Local banks are sometimes constrained from lending for longer durations by regulatory limitations on their capital use, or by their own lack of access to long-term funding in their domestic markets. These constraints preclude them from entering into loan agreements of the required tenor, thus (i) limiting the number of typically big-ticket, high-impact, and long-tenor projects, or (ii) pushing project sponsors to borrow in hard currency from foreign investors at a higher cost to the project, and indirectly, for the country as well. This possible use of the BFF would allow local banks to offer long-term local currency financing, with the understanding that, should certain pre-defined and pre-agreed regulatory or liquidity events arise during the life of their loan, they would be able to exit the financing on a pre-defined and pre-agreed exercise date based on pre-defined and pre-agreed terms and conditions, and transfer their loan to IFC as PSW BFF implementing entity (IE). This potential BFF instrument would function as a purchase obligation (e.g., a put option) sold by IFC as PSW BFF IE to the local bank for a fee (option premium). If the option is not exercised on the pre-set exercise date, the obligation to purchase the loan falls away. Should the option be exercised and IFC as PSW BFF IE purchases the loan and steps into the shoes of the local bank, IDA PSW would be exposed to the credit risk of the underlying project and the local currency risk on debt service receipts for the remaining maturity of the loan. This product would only be available for projects in which IFC also has a direct loan exposure, thereby assuring alignment of interests between IFC and IDA and allowing IDA to benefit from the project due diligence, risk rating, execution, and administration of IFC. By supporting locally-domiciled financial institutions in this fashion, this instrument serves to increase local bank capacity, including their ability to evaluate more complex projects, and decreases the potential financial obligation – particularly due to dollarization – from host governments.²⁵

42. The potential adjustment to support third parties under the LCF seeks to expand local currency financing to critical projects by helping lenders hedge currency exposure risks or by helping clients/projects hedge with IFC the currency risks on their USD/Euro loans from non-IFC lenders. With such an adjustment, projects would benefit from additional financing from other DFIs and/or commercial financial institutions who may not have the instruments or risk capacity to provide local currency loans in PSW's target markets. To facilitate greater access to third-party finance, IFC would enter into a hedge with IDA and pass on the benefits of the hedge to the third-party investors/lenders in approved LCF projects. Expanding the LCF to include offering local currency to other lenders in situations where IFC faces exposure constraints, or to provide hedging directly to clients who have USD/Euro borrowings from non-IFC lenders, would allow project sponsors to benefit from receiving the full financing package in local currency. It would only apply to projects with IFC own-account lending that is also supported by LCF for the local currency access. IFC would continue to directly face these third parties as IE of PSW-LCF, ensuring that all parties benefit from the PSW review processes and implementation oversight.

43. If endorsed by IDA Participants, Management will explore and develop further these facility-specific adjustments for presentation to the IDA Board for approval, as needed,

²⁵ This is, in contrast to other guarantee instruments such as the IDA Guarantee, whereby the host government would be required to either provide a free loan purchase obligation on behalf of the local bank or would to provide a counterindemnity as a backstop to the guarantee.

before the beginning of IDA19. Any new features endorsed by IDA Participants will be developed further by IFC and MIGA teams, and assessed by IDA Management, including for financial impact and risks to PSW, and implementation arrangements. Proposals would only proceed should such arrangements be satisfactory to all institutions involved. These adjustments - especially the LPOI – could pose new and complex challenges from a financial and operational risk perspective. Once fully developed, these features – if not already covered in the IDA18 PSW policy framework – will be submitted for IDA, IFC, and MIGA Boards’ approval. The PSW policy will be revised accordingly to enable IFC and MIGA to utilize these new features from the beginning of IDA19.

V. PSW RISK MANAGEMENT

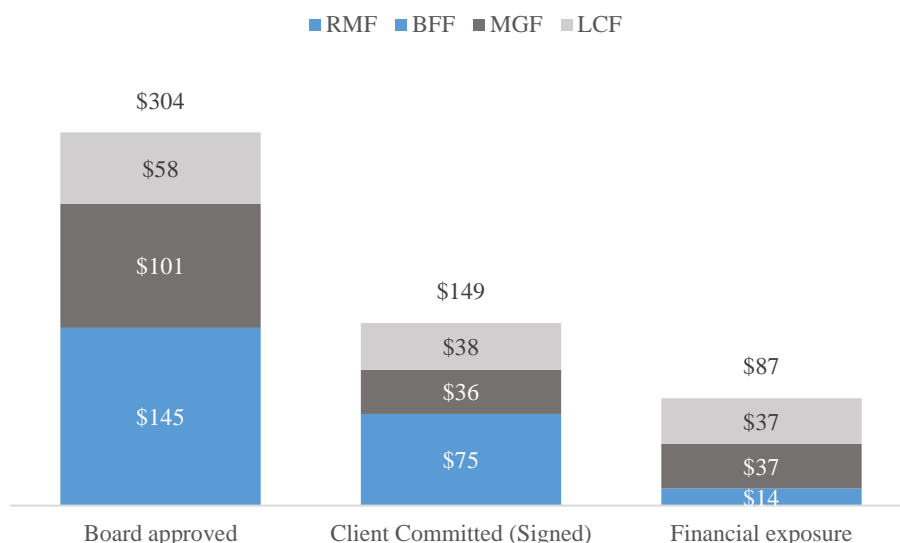
44. **IDA will continue to carefully manage the financial and non-financial risks of PSW.** The progress and practice of PSW has been examined by an internal audit completed in October 2018. The internal audit found that Management has designed an effective governance and operational framework to support the implementation of the PSW. Key controls are in place and the framework is operating as intended particularly regarding: (i) the decision-making framework; (ii) processes to review and apply eligibility criteria; (iii) information sharing processes; and (iv) the early reporting process. The Internal Audit Vice Presidency (IAD) encouraged further engagement with Country Management Units (CMUs) to further familiarize with the PSW processes, which Management has been implementing on a continuous basis. Management also takes into consideration IAD’s forward-looking suggestions on: (i) the use of programmatic platforms; (ii) flexibility to re-allocate PSW funds; (iii) assessment of risks for capital allocation; and (iv) measuring the cost of delivering the PSW.

A. FINANCIAL RISK MANAGEMENT

45. **Under IDA18, the PSW is governed by a prudent risk framework through facility-level caps and 100 percent capital backing.** The PSW is designed to de-risk IFC and MIGA investments by transferring these risks to IDA. Over the course of IDA18, IDA (through the PSW) has borne risks related to private sector transactions, while in most cases not receiving a market-based return commensurate to these risks. Given the high risks and uncertain markets involved, a prudent risk framework was put in place, with ongoing learning and adjustments. In addition, IFC and MIGA have also followed their own risk frameworks to guide operations.

46. **It is too early to evaluate the financial performance of approved PSW transactions.** With only US\$304 million of PSW resources approved by the IDA Board to date, and the early stage implementation of the underlying investments, there is not enough actual data to assess the financial risks faced by PSW (see Figure 5 on Summary of PSW Deployment). No losses have been realized and loan loss provisioning for eligible transactions (e.g., US\$87.3 million in exposure) stand at US\$5.8 million or 6.6 percent as of end-March 2019. Total received fees and income from PSW activities is limited at US\$0.3 million reflecting the relatively short timeframe post-commitments of PSW transactions in IDA’s financials.

Figure 5. Summary of PSW Deployment (US\$, millions)



47. **In lieu of actual financial performance, a useful proxy may be the ‘expected performance’, as measured by the risk and return structure of approved transactions.** An assessment of the Board approved transactions has been conducted to estimate the expected financial performance of PSW transactions.²⁶ This initial assessment suggests that the expected performance of PSW investments varies by instrument. Observations related to Risk Sharing Facility (RSF) type of projects point to IDA being unlikely to recover its full principal should expected losses materialize. For loan financing, the expected returns approximated are slightly above the expected loss. Expected returns are positive for equity and quasi-equity financing, although these are expected to have higher variability.

48. **Based on the Board approved projects for the BFF and MGF,²⁷ the BFF’s overall expected “life of instrument” financial performance results in a net loss of ~US\$ 9 million, while MGF political risk guarantees are nearly at breakeven** (see Table 4). As mentioned, BFF loan transactions have been priced to cover expected losses to break even, while Risk Sharing Facilities deployed thus far – and expected pricing of RSFs in the future – are more likely to result in higher subsidies compared to loan products. An example, SLGP – one of the largest BFF platforms – has a net expected loss position reflecting the perceived (and modelled) high risk of

²⁶ This approach uses the estimated revenues from PSW final pricing (net of subsidies) less the expected loss of the transaction as measured by IFC and /or MIGA risk assessment in US Dollars. The results of this assessment are limited to the BFF and MGF client committed projects, as the RMF and LCF present difficulties estimating the expected loss levels. It is important to note that expected losses or revenues can be materially different from actual results in practice and are only used to provide an indication of how the PSW could perform financially based on assessed risk.

²⁷ There are three Board approved projects for LCF as of this writing. For these, LCF PSW derivative transactions exposed on IDA’s balance sheet had a net income of US\$0.24 million during FY19YTD and US\$0.03 million during FY18. This is based on mark-to-market adjustments which could change significantly over time. The LCF Maximum Exposure Amount being monitored (a maximum of US\$400 million) currently puts net cash flow exchanges at a net positive flow of US\$25,576.

the SMEs supported. Because of the conservative approach to estimating risks, the actual results might vary significantly.

Table 4. Summary of ‘expected’ PSW Performance for Select Board Approved Projects by Facility and Instrument

All amounts in US\$ millions

| | # of projects assessed | Indicative PSW allocation | Expected Loss related to PSW | Estimated Revenue (Interest/Fees) | Net Expected P&L |
|------------------------------------|------------------------|---------------------------|------------------------------|-----------------------------------|------------------|
| <i>Risk sharing Facilities</i> | 2 | \$ 55.0 | \$ 31.7 | \$ 11.2 | \$ (20.5) |
| <i>Political risk insurance</i> | 3 | \$ 37.1 | \$ 4.3 | \$ 0.5 | \$ (3.8) |
| <i>Loan financing</i> | 2 | \$ 70.5 | \$ 16.2 | \$ 27.4 | \$ 11.2 |
| Total for analyzed projects | 7 | \$ 162.6 | \$ 52.1 | \$ 39.0 | \$ (13.1) |

*With regard to estimation of premium revenues (i) amounts are based on 100% current exposure and assume that the guarantee is maintained for the full tenor. (ii) lifetime premium is based on existing payment schedule (iii) Premium amounts exclude the 15% commission retained by MIGA.

**Sample includes one project with allocation from more than one facility. Calculations of expected revenue for all RSFs and loans are only for the BFF allocation.

49. **Arrangements for cost recovery are being implemented as planned.** The total costs incurred in managing the PSW between IDA, IFC and MIGA has amounted to US\$3.2 million in FY18, excluding costs of investment teams and country teams review of PSW supported activities. Both the realized revenues and costs of the PSW have been below expected levels, which is explained by the slower take-off of the PSW in IDA18 than staff budgeting exercises had expected.

50. **The proposed modifications to the PSW Framework for IDA19 are not expected to change the overall financial performance of the PSW.** Allowing transitioning countries to remain in the program through the end of IDA19 and allowing exceptions to include IDA Gap and Blend countries in regional and programmatic projects are not expected to significantly change the financial performance of the PSW. Depending on the regional project, it is possible that partial coverage for PSW ineligible countries could improve the PSW portfolio through increased diversification or cross-subsidized risk between these country investments and those of PSW eligible countries. However, this impact would overall be limited because of the cap on these transactions.

51. **The potential adjustments to two of the PSW facilities may present new or enlarged risks, particularly related to local currency exposure and to operational risks.** The increase in exposure to local currency risks would be similar across the two facilities; the possible adjustment to the BFF poses new and complex operational challenges. While potentially posing additional risk, these adjustments should only modestly increase the risk profile of the PSW, as use of these transaction types are expected to be limited. A preliminary assessment of the additional risks to IDA brought about by these adjustments are presented in Annex 5. Should Management be able to explore these further, further assessments of these risks will be performed and the proposals will be further refined.

52. **Management proposes to continue its prudent risk management approach taken in IDA18 for IDA19.** Similar to IDA18, the Chief Risk Officer (CRO) of the World Bank also conducted a review of PSW risks, with a view to assessing the proposed adjustments to the PSW framework under IDA19 (see Annex 7 for CRO independent statement). As the PSW portfolio becomes larger (potentially up to US\$5 billion by the end of IDA19), IDA will further review its financial risks and how they are managed.

B. OPERATIONAL AND REPUTATIONAL RISK MANAGEMENT

53. **As PSW grows as a share of IDA’s balance sheet, greater attention to potential operational risk issues would also be warranted.** Management is exploring the potential for increased effectiveness and efficiencies from changes to certain structural aspects of PSW implementation. Under consideration are options related to the current reliance on IFC and MIGA’s valuation and loss provisioning estimations, and/or the present use of exceptions in valuation governance to record PSW treasury-related transactions through the LCF or BFF equity investments support. Any changes to PSW policy will be brought to IDA, IFC and MIGA Boards for approval.

54. **IDA, IFC and MIGA will continue to enhance transparency to mitigate reputational risks.** Some observers have called for increased transparency of PSW processes and for increased disclosure of information on the investments it supports. Working with IFC and MIGA, IDA management has outlined a process to build on IFC and MIGA disclosure processes, which includes additional relevant information more in line with IDA’s public sector practices. PSW-supported projects that have been approved by the Board are disclosed on IDA’s website.²⁸ Portfolio-level information and learnings, including subsidies, reach, impact and results, are included in IDA’s periodic stakeholder reporting, including replenishment and review papers. This approach enables IDA to manage disclosure in a way that is more in line with public sector standards, while being consistent with IFC and MIGA’s current Access to Information policies. Under IDA19, IDA, IFC and MIGA will work to further enhance disclosure practices to lead the transparency standards in the blended finance community.

55. **Beyond increased transparency, there have also been calls for some form of competition to deploy subsidies to maximize development impact at lowest cost.** Where feasible, such as in concession arrangements in energy and infrastructure, PSW will provide support through public bidding or other competitive processes. For example, PSW support is currently being considered for projects in renewable energy in Africa in connection with the WBG’s “Scaling Solar Program”. In this case, the terms of the blended finance component, including amount and the concessional rate, is provided as part of indicative terms offered by IFC (together with its own account financing terms), which is then translated into lower tariffs offered by bidders. This has been done in the context of the Scaling Solar Zambia and Scaling Solar Senegal projects with the support of the Canada-IFC and Finland-IFC blended finance facilities.

²⁸ See the list of approved PSW supported projects: <http://ida.worldbank.org/replenishments/ida18-replenishment/ida18-private-sector-window/ida18-private-sector-window-projects>

VI. CONCLUSION

56. **IDA18 experience has demonstrated that the PSW is a critical tool for the WBG to mobilize private sector investments in IDA countries, and Management proposes to extend the PSW under IDA19.** The PSW will support IDA19's ambition and objectives, continue to support IFC to deliver on its capital increase commitments for increased investments in IDA countries, enable MIGA to increase its exposures in challenging IDA markets, and ultimately mobilize more local and foreign private sector investments in the poorest IDA markets.

57. **While retaining the overall PSW Framework, some adjustments are proposed under IDA19.** These adjustments are intended to provide greater support for private investment and private sector growth, with a focus on strengthening PSW's ability to support local financing. While most of these adjustments are moderate, they are important to continue the momentum of origination efforts to build pipeline projects that need support from PSW, and to enable local financing alongside attracting FDI.

58. **The financial risks PSW faces continue to be high.** Based on the expected loss estimates, financial losses to IDA could be substantial. The potential adjustments could also result in added risks to IDA, and the trade-off between financial losses and fulfilling the objectives of the PSW is becoming more apparent. Until more actual financial performance data can be collected and assessed, IDA Management proposes its continued prudent approach in managing PSW risks.

59. **Issues for discussion:**

- (a) Do Participants agree to extend the PSW under IDA19, with an allocation of US\$2.5 billion for the four existing PSW facilities?
- (b) Do Participants agree to the proposed modification to the PSW framework on country eligibility for accessing the PSW, and for Management to explore further potential adjustments to two PSW facilities?
- (c) Do Participants agree with the Management approach to risk management, in light of the potential financial risks IDA faces?

Annex 1: Private Sector Window (PSW) Board Approved Projects

| # | Project name | PSW amount | Project size | Facility | Approval status | IFC/ MIGA Ir Instrument | Tenor | Country/ Region | Currency | FCS | Sector |
|----|---------------------------------------|------------|--------------|----------|---------------------------|---|-------|-----------------------|----------|---------|-------------------------------|
| 1 | RSF ANZ Pacific | \$ 5.0 | \$ 50.0 | BFF | Board approved | \$ 25.0 BFF First Loss Guarantee | 8 | Pacific Islands | USD | non-FCS | Renewable Energy |
| 2 | Sonatel Telecom | \$ 31.1 | \$ 721.7 | MGF | Client Committed (Signed) | \$ 194.5 MGF First Loss guarantee | 15 | Sierra Leone | EUR | FCS | Telecoms |
| 3 | CRRH- 12 year | \$ 9.0 | \$ 45.0 | LCF | Client Committed (Signed) | \$ 9.0 LCF Open FX hedge | 12 | Western Africa Region | USD | non-FCS | Financial Markets |
| | CRRH- 15 year | \$ 9.0 | \$ 54.0 | LCF | Client Committed (Signed) | \$ 9.0 LCF Open FX hedge | 15 | Western Africa Region | USD | non-FCS | Financial Markets |
| 4 | Highland PE Mezz | \$ 4.0 | \$ 30.0 | BFF | Client Committed (Signed) | \$ 4.0 BFF Equity | 12 | Kyrgyz Republic | USD | non-FCS | Financial Markets |
| 5 | Anthem Asia | \$ 7.5 | \$ 50.0 | BFF | Client Committed (Signed) | \$ 7.5 BFF Equity | 10 | Myanmar | USD | FCS | Financial Markets |
| 6 | Rikweda | \$ 3.1 | \$ 9.0 | MGF | Client Committed (Signed) | \$ 7.2 MGF First Loss guarantee | 10 | Afghanistan | USD | FCS | Manufacturing and Agriculture |
| 7 | IDLC Ltd | \$ 20.0 | \$ 40.0 | LCF | Board approved | \$ 40.0 LCF Open FX hedge | 7 | Bangladesh | TAK | non-FCS | Financial Markets |
| 8 | Small Loan Guarantee Program (SLGP I) | \$ 50.0 | \$ 332.0 | BFF | Client Committed (Signed) | \$ 166.0 BFF First Loss Guarantee | 10 | Total PSW eligible | USD | non-FCS | Financial Markets |
| 9 | Second Hyalroute FOC Network Project | \$ 19.0 | \$ 119.0 | MGF | Client Committed (Signed) | \$ 118.8 MGF First Loss guarantee | 8 | Myanmar | USD | FCS | Telecoms |
| 10 | HKL Cambodia | \$ 20.0 | \$ 30.0 | LCF | Client Committed (Signed) | \$ 20.0 LCF Open FX hedge | 3 | Cambodia | KHR | non-FCS | Financial Markets |
| 11 | Upper Trishuli-1 Nepal | \$ 102.8 | \$ 647.0 | multiple | Board approved | \$ 187.2 BFF Subordinated Loan; MGF First Loss guarantee | 16.5 | Nepal | USD | FCS | Renewable Energy |
| 12 | Ayiti leasing Haiti | \$ 5.5 | \$ 11.0 | BFF | Client Committed (Signed) | \$ 2.8 BFF Senior Loan | 3 | Haiti | USD | FCS | Financial Markets |
| 13 | IPAE II | \$ 7.5 | \$ 123.0 | BFF | Client Committed (Signed) | \$ 7.5 BFF Equity | 10 | Africa wide | EUR | non-FCS | Financial Markets |
| 14 | Dole | \$ 10.1 | \$ 40.0 | MGF | Board approved | \$ 36.0 MGF First Loss guarantee | 15 | Sierra Leone | USD | non-FCS | Manufacturing and Agriculture |

Annex 2: Private Sector Window (PSW) Performance and Results Framework as of April 30, 2019

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

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|--|--|---|---|
| PSW Financial Performance- This dimension of the results framework covers PSW commitments, disbursements, PSW revenue and losses. | | | |
| PSW deployment | PSW commitments: <i>Cumulative commitments from PSW</i> | Board approvals: US\$304 million (across 14 transactions, excluding three transactions under the SLGP) Client signed commitments: US\$149 million has been under client commitment across 10 transactions (including two transactions covered by the US\$50 million SLGP pool) | Reporting focused on Board approvals as there are limited client signings. Project count based on number of board approvals. After Board approval, IFC and MIGA teams work with the client to finalize the contract within the approved parameters. In some cases, the final amounts contracted are less than Board approvals. |
| | PSW disbursements: <i>Cumulative disbursements/allocation from PSW (not applicable to RMF, BFF and MGF guarantees which are not disbursed)</i> | LCF: Supported IFC loans and bonds of US\$37 million disbursed BFF: disbursement and guarantee exposure of US\$13.9 million | Amount in LCF were executed via swap arrangement with IFC. BFF: US\$13.5 million pertains to SLGP guarantee and US\$0.4 million is the receivable against equity disbursed. Data as of March 31, 2019 |
| PSW Revenue | Fees collected from PSW transactions | Guarantee income US\$305,000 | As of March 31, 2019, 9 projects and 2 SLGP sub-projects under the PSW have gone to financial commitment. Fees are only generated on transactions in client contract. |
| PSW Net Losses and Provisions | Net losses on PSW transactions | No crystalized losses to date Loan loss provision (LLP): US\$5.8 million | This includes loan loss provisions for guarantees and loans as well as mark to market losses for LCF transactions. |

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|---|---|--|---|
| PSW Scale Additionality: This dimension considers the PSW objective to scale up IFC/MIGA engagements in IDA-only/FCS markets | | | |
| Scale up IFC/MIGA engagements in PSW-eligible markets | IFC Commitments & MIGA Gross issuances in PSW-eligible markets with PSW participation: <i>Cumulative volume of PSW enabled IFC Commitments & Gross issuances of MIGA Guarantees in PSW-eligible markets within IDA18 period</i> | Expected IFC commitments and MIGA gross issuances (based on PSW board approvals): <i>US\$831 million.</i> <i>IFC: US\$380 million; MIGA: US\$451 million</i> Realized commitments (based on client signed): US\$282 million <i>IFC: US\$225 million; MIGA: US\$57 million</i> | As of April 30, 2019. Realized commitment data is based on client signed contracts. IFC amount includes separate US\$2.5 million investment alongside an MGF supported project. |
| | IFC and MIGA investments/project count with PSW participation: <i>Cumulative number of PSW-enabled IFC Commitments & MIGA guarantees in PSW-eligible markets within IDA18 period</i> | IFC: 10 and MIGA: 5 PSW-enabled IFC Commitments & MIGA guarantees (excluding transactions under programs and considering UT 1 as both IFC and MIGA) | This translates to an average transaction size of US\$18.9 million compared to IFC and MIGA overall average transactions of US\$20.6 million and US\$113.4 million respectively. IFC project count excludes subsidiary operations within single larger business entity. |
| | Total IFC Commitments & MIGA Gross issuances in PSW-eligible markets: <i>Cumulative volume of IFC Commitments & Gross issuances of MIGA Guarantees in PSW-eligible markets within IDA18 period</i> | IFC client commitments: FY19 as of end-April: US\$732 million, FY18-FY19YTD cumulative: US\$2.05 billion MIGA gross issuances: FY19 as of end-April: US\$473 million; FY18-FY19Q3: US\$1.7 billion | Data as of April 30, 2019 and includes Nigeria, Kenya and Pakistan. Excluding these countries amounts to US\$1.9 billion for IFC client commitments |
| | Total IFC and MIGA investments/project count in PSW-eligible markets: <i>Cumulative number of IFC Commitments & MIGA guarantees in PSW-eligible markets within IDA18 period</i> | IFC projects: FY19 as of end-April: 30, FY18-FY19YTD: 108 MIGA projects: FY18-FY19YTD, 15 | For IFC project count implying smaller average project sizes (relative to volumes invested) while MIGA project count implies increase in average project size. |
| | Share of PSW-supported engagements in total PSW eligible IFC commitments & MIGA gross issuances: <i>% of PSW-supported engagements in total IFC commitments & MIGA gross issuance (in volume) in PSW-eligible countries</i> | 14 percent of IFC's total commitments (FY18-FY19 as of end-April) 2.2 percent of MIGA gross issuances in FY18-FY19 as of end-April | Data for FY18-FY19YTD. FY18: 17% of IFC's total commitments FY19YTD: 9% of IFC's total commitments FY18: 5% of MIGA's gross issuance |

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|-------------------------------------|---|--|---|
| | Share of PSW-supported engagements in total PSW eligible IFC commitments & MIGA gross issuances- <i>% of PSW-supported engagements in total IFC commitments & MIGA gross issuance (in number of investments/projects) in PSW-eligible countries</i> | 14 percent of IFC projects; 15 projects including 9 projects under the SLGP ²⁹ . 21 percent of MIGA projects, three projects | Data as of end-April FY19. Uses IFC project count methodology. |
| Focus on FCS | Share of FCS projects in cumulative PSW-supported commitments: <i>% of FCS projects in cumulative PSW commitments (in volume and in number of investments/projects)</i> | Volumes: 58 percent (US\$169 million) of Board approved and 35 percent of committed projects (US\$49 million) | Based on IDA Board approved PSW projects |
| | | Projects: 43 percent (6 of 14) of Board approved and 70 percent of committed projects (6 of 10 projects) | Based on IDA Board approved PSW projects and committed projects up to April 2019 |
| | Share of FCS projects in cumulative total number of IFC and MIGA commitments in PSW-eligible countries | Projects: IFC- 6 percent (24 projects), MIGA -100 percent (3 of 3 projects) | Data as of end-April 2019. Based on IFC and MIGA client committed projects. Excludes regional projects with FCS sub-components. |
| | Share of FCS projects in cumulative volume of total IFC and MIGA commitments in PSW-eligible countries: <i>% of IFC / MIGA's total FCS volumes</i> | Volumes: IFC- 12 percent (US\$13 million), MIGA -100 percent | Based on IFC and MIGA client committed projects. Excludes regional projects with FCS sub-components. |
| Crowd in private investments | Private Capital Directly Mobilized- <i>Financing from entities other than IFC that becomes available to Client due to IFC's direct involvement in raising resources. For MIGA private direct mobilization is the total amount of the equity or loan that MIGA is guaranteeing</i> | MIGA Private Direct Mobilization under the MGF three transactions committed is US\$1.447 billion. | Data as of end-March 2019. |

²⁹ IFC's approach to counting projects under the SLGP recognizes each of the subsidiaries as constituting a project in its reporting.

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|-----------|---|--|---|
| | <p>Private (co-)financing of WBG-supported transaction- <i>is financing from private entities provided in connection with a specific activity for which an MDB is providing financing, where no MDB is playing an active or direct role that leads to the commitment of the private entity's finance. This includes sponsor financing, if the sponsor qualifies as a private entity (For MIGA this includes Private Direct Mobilization and Private Indirect Mobilization.)</i></p> | <p>MIGA Private Co-financing under the MGF three transactions approved is US\$0.82 billion. IFC expected Co-financing is US\$330 million</p> | |
| | <p>Amount re-/co-insured with private sector Partners- <i>Amount co-insured or reinsured with the private sector under the MIGA Guarantee Facility (MIGA specific)</i></p> | <p>N/A</p> | <p>No re-insurance transactions have been entered into to date</p> |
| | <p>Subsidy element of PSW use: <i>Amount of cumulative indicative subsidy- calculated as the difference between commercial terms (or model price) available for the same or similar product and the terms of PSW-supported solution in any given investment and narrative explaining rationale</i></p> | <p>US\$65 million</p> | <p>For Board approved transactions. The subsidy has been estimated as the difference between the reference pricing and the final transaction price approved for the transaction. Where subsidies have been estimated in ranges, the average of the range has been used.</p> |
| | <p><i>% implied subsidy to total PSW project transactions volume (transaction size including other investors)</i></p> | <p>3 percent of total financing for PSW projects 21 percent of PSW resources approved</p> | <p>For Board approved transactions. The subsidy has been estimated as the difference between the reference pricing and the final transaction price approved for the transaction.</p> |

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

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|--|---|--|--|
| New countries and sectors coverage | New countries and sectors PSW transactions are expected to enable | <i>The MGF has supported the first fiber optic cable construction in Myanmar and the first raisin processing plant in Afghanistan.</i> <i>The BFF supported Ayiti Leasing, the first leasing company in Haiti. PSW will support the expansion of its business of offering leases to small and medium enterprises to access machinery, equipment, or vehicles needed to grow their businesses.</i> | |
| New and expanded use of instruments | PSW enabled new or expanded instrument use | <i>The LCF has supported the first ever bond issuance in Cambodia setting the stage for the development of a bond market. The BFF has also supported the first fund in Kyrgyz republic opening the possibility to build a new asset class supporting SME financing.</i> | |
| Expanded client reach | New ways of client reach and new approaches | <i>Under the BFF, the SLGP has supported two RSFs which aim to reach smaller SMEs than earlier RSFs were able to support and expanded to include lending to start ups.</i> | |
| Market impact | Market creation impact & risks | <i>The introduction of AIMM by IFC allowed a system to measure the anticipated market impact at the time of Board approval. To date there have been several AIMM scores for PSW supported projects.</i> | MIGA has launched its anticipated results tool called ‘impact’ which is in early stages of implementation. |

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

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

| Objective | Indicator | Update based on Board approved PSW transactions | Comments |
|--|---|---|--|
| & reporting starts 3 years after commitment * IFC, MIGA feed directly into these indicators | WBG Corporate Scorecard Tier 2 Client Results supported by WBG Operations: Growth & Inclusiveness | Construction jobs: Through political risk insurance provided by MGF support, 4,000km of fiber optic network will be installed and about 10,000 construction jobs created in Myanmar during the project life. | As above |
| | | Mortgage access: The LCF support to a leading Bangladeshi mortgage lender is expected to lead to the origination of 5,500 mortgages | As above |
| Satisfactory outcome of PSW funded operations- (evaluation process starts 3 years after signing for MIGA), FY23 (IFC) | IEG Project Evaluation results: % of evaluated PSW projects with satisfactory evaluation ratings | N/A | from FY23 |
| | Average AIMM score for PSW supported projects (IFC projects only) | 90 | from FY21. IFC will be retiring DOTs and replace it with AIMM scores |
| | Average IMPACT score for MGF supported projects | 86 | |
| | IEG assessment of IFC and MIGA work quality on PSW-supported projects: % of evaluated PSW projects with satisfactory evaluation ratings | N/A | from FY23 |

Annex 3: Analysis of Private Sector Window (PSW) Eligibility for IDA Gap and Blend Countries

Overview

1. In response to IDA Participants' request to consider the potential for expanding PSW eligibility to include non-Fragile and Conflict-affected Situations (FCS) IDA Gap and Blend countries, IDA staff have analyzed the performance of private sector activities based on a set of selected indicators. These areas covered by these indicators include: (i) domestic financing to private sector, (ii) foreign investment, (iii) labor and productivity and (iv) perception of constraints to business development. Objective indicators in each area (except area iv, which is perception driven) were assessed based on available data. IDA Gap and Blend countries were assessed by comparing their performance individually against the median level performance of IDA-only countries. (see Figure A3.1 for a summary of the analysis). The analysis was done to compare the performance as a group and identify any outliers.

Summary of findings

2. On the whole, Blend countries perform better than IDA-only countries. Most of Blend countries with poor performance can already benefit from PSW because of fragility (Cameroon CPIA below 3.2) or sub-regional fragility (Pakistan). FCS Blend countries tend to perform worse than the IDA median in foreign investment indicators and banking & finance indicators (two out of three FCS Blend countries are below the 25th percentile in foreign investments). The correlation between FCS status and PSW eligibility seems to be strong, with the three FCS countries among the poorest performers out of the 15 blend countries.

3. Gap countries tend to perform better than Blend countries in foreign investment indicators, while performance in other indicators (labor, banking and business development perceptions) is similar. Bangladesh achieved Gap status in IDA18, performing worse than the IDA-only median in six out of 15 indicators. Among Gap countries, the relationship between FCS status and poor performance is not as clear as in Blend countries, ranging from poor performers, such as Côte d'Ivoire (worse than median in nine indicators) to relatively good performers, such as Myanmar (worse in three indicators, better in two). Lesotho seems to be the only non-FCS and non-PSW eligible outlier lagging behind (worse than IDA-only median in seven out of 15 indicators).

Assessment by issue area

4. **Foreign investment:** Lack of foreign investment is a challenge among Blend and Gap countries; 13 out of the 28 Blend/Gap countries had Foreign Direct Investment (FDI) as a share of Gross Domestic Product (GDP) lower than the median of PSW-eligible countries even though most of these countries are above the 75th percentile of PSW-eligible countries in exports. The size of the country seems to contribute to lower FDI as a share of GDP and FDI per capita, with countries such as Kenya, Pakistan, Nigeria and Bangladesh with levels of foreign investment net inflows lower than the 25th percentile of PSW-eligible countries. Two small states - Timor-Leste (Blend) and Bhutan (Gap) - are also among the countries with the lowest levels. However, this lower level translates to much higher FDI inflows compared to PSW eligible countries.

Figure A3.1: Summary of Analysis Outcomes Compared to IDA

| status | Country | PSW Eligible? | FCS? | Small Status | Foreign investment | | | | | Labor & productivity | | Banking & Financing | | | Perception on Constraints to business development | | | | |
|--------|-------------------|-------------------|------|--------------|----------------------------|------------------------------|--------------------------|-------------------------|----------------------------|--------------------------|---------------------------|---------------------------|-------------------------|------------------------------|---|-----------------------------------|---------------------------|------------------------------|-------------------------------|
| | | | | | FDI (% of GDP) 5-yr Avg | FDI Per Capita (\$) 5-Yr Avg | GFCF (% of GDP) 5-Yr Avg | GFCF Private Sector (%) | Percent of Firms Exporting | Annual Employment Growth | Annual Labor Productivity | Domestic Credit Available | Percent of Firms Buying | Percent of Firms with a Bank | Access to Finance as a Major | Electricity as a Major Constraint | Transportation as a Major | Crime, Theft and Disorder as | Proportion of Skilled Workers |
| Blend | Pakistan | Sub-national only | | | | | | | | | | | | | | | | | |
| Blend | Cameroon | Sub-national only | | | | | | | | | | | | | | | | | |
| Blend | PNG | ✓ | ✓ | | | | | | | | | | | | | | | | |
| Blend | Nigeria | Sub-national only | | | | | | | | | | | | | | | | | |
| Blend | Kenya | Sub-national only | | | | | | | | | | | | | | | | | |
| Blend | Timor-Leste | ✓ | ✓ | ✓ | | | | | | | | | | | | | | | |
| Blend | Congo, Rep. | ✓ | ✓ | | | | | | | | | | | | | | | | |
| Blend | Dominica | | | ✓ | | | | | | | | | | | | | | | |
| Blend | Cabo Verde | | | ✓ | | | | | | | | | | | | | | | |
| Blend | St. Lucia | | | ✓ | | | | | | | | | | | | | | | |
| Blend | Mongolia | | | | | | | | | | | | | | | | | | |
| Blend | Uzbekistan | | | | | | | | | | | | | | | | | | |
| Blend | Moldova | | | | | | | | | | | | | | | | | | |
| Blend | Grenada | | | ✓ | | | | | | | | | | | | | | | |
| Blend | St. Vincent & the | | | ✓ | | | | | | | | | | | | | | | |
| Gap | Cote d'Ivoire | ✓ | ✓ | | | | | | | | | | | | | | | | |
| Gap | Lesotho | | | | | | | | | | | | | | | | | | |
| Gap | Bangladesh | ✓ | | | | | | | | | | | | | | | | | |
| Gap | Djibouti | ✓ | ✓ | ✓ | | | | | | | | | | | | | | | |
| Gap | Honduras | | | | | | | | | | | | | | | | | | |
| Gap | Ghana | | | | | | | | | | | | | | | | | | |
| Gap | Kosovo | ✓ | ✓ | | | | | | | | | | | | | | | | |
| Gap | Lao PDR | | | | | | | | | | | | | | | | | | |
| Gap | Bhutan | | | ✓ | | | | | | | | | | | | | | | |
| Gap | Zambia | | | | | | | | | | | | | | | | | | |
| Gap | Myanmar | ✓ | ✓ | | | | | | | | | | | | | | | | |
| Gap | Guyana | | | ✓ | | | | | | | | | | | | | | | |
| Gap | Nicaragua | | | | | | | | | | | | | | | | | | |
| | | IDA-only 25% | | | 1.1 | 11.7 | 11.0 | 6.1 | 3.4 | 3.2 | -8.8 | 12.2 | 33.9 | 10.2 | 21.5 | 26.2 | 16.3 | 13.0 | 67.8 |
| | | IDA-only median % | | | 2.0 | 22.6 | 14.2 | 9.3 | 6.2 | 6.7 | -2.2 | 19.1 | 42.6 | 22.6 | 38.8 | 44.1 | 23.0 | 22.0 | 74.0 |

5. **Labor & productivity:** Productivity and employment growth appear to be more limited in Blend and Gap countries, with 21 out of 28 countries showing Annual Employment Growth lower than the median for PSW-eligible countries.

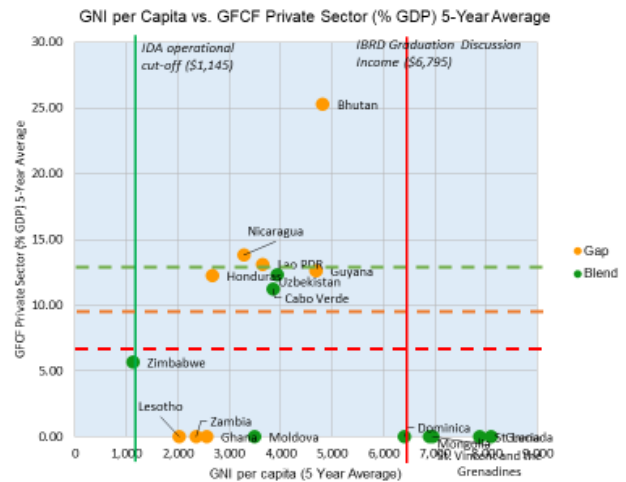
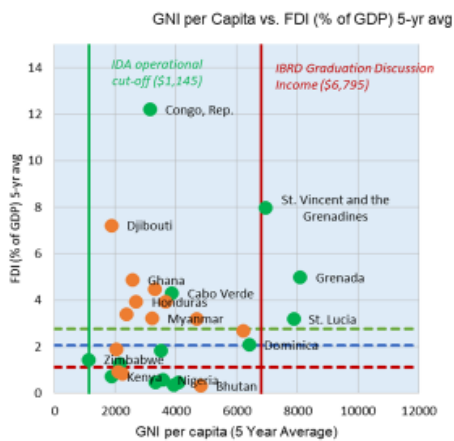
6. **Banking & Financing:** Overall, most Gap/Blend countries are above the PSW eligible median in indicators related to credit access and banking. Thirteen out of 28 Gap/Blend countries are above the 75 percent quartile as measured by Percent of Firms Using Banks to Finance Investments (an average of 28 percent in comparison to PSW eligible countries with an average of 17 percent).

7. **Perceptions on constraints to business development:** When considering indicators of perception on constraints to business development, 13 out of 28 of Gap/Blend countries were above the median for PSW-eligible countries in identifying electricity as a major constraint, while 11 out of the 28 Gap/Blend countries were above the median in identifying Crime, Theft and Disorder as Major Constraint.

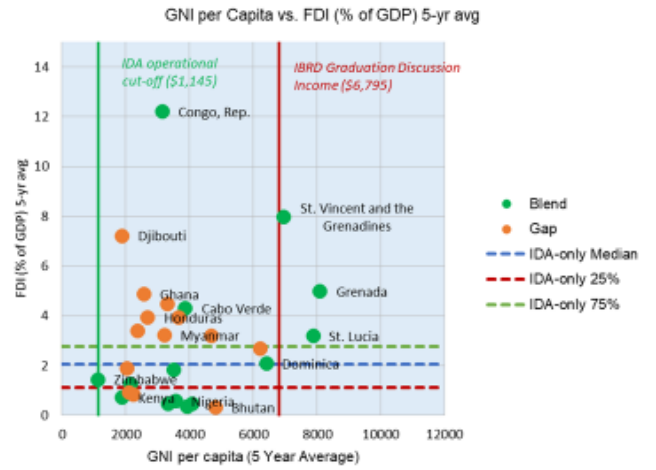
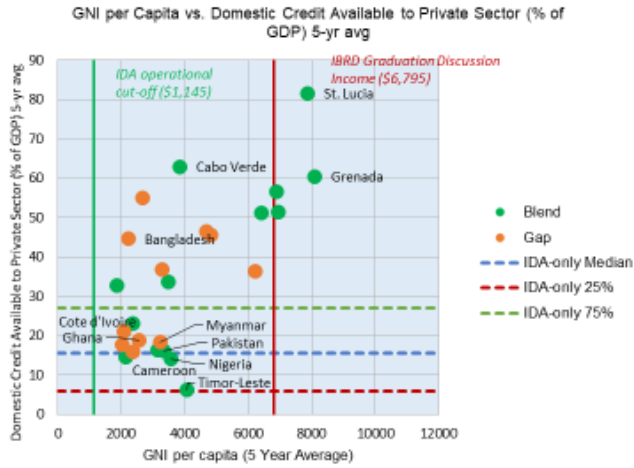
Figure A3.2: Summary of Performance of IDA Gap and Blend Countries Compared to PSW Eligible Median

Most gaps/blends are above PSW eligible median. Uzbekistan, Bhutan and Mongolia have levels lower than the 25% percentile

While some data is missing, only Zimbabwe seems to be below the PSW-eligible median



Most gaps/blends are above PSW eligible median. Nigeria, Cameroon and Timor Leste have levels lower than the IDA-only median.



Annex 4: International Finance Corporation (IFC) Activities on Local Currency

IFC has carried out local currency lending over the years, on its own and in partnership with entities such as the Currency Exchange Fund (TCX)³⁰. Increasingly, working with the Bank, more upstream work has been undertaken to create local capital markets under initiatives such as the Joint Capital Markets Program (J-CAP). Below are some examples:

Ethiopia – IFC recently signed a memorandum of understanding (MOU) with the National Bank of Ethiopia that allowed IFC to lend in local currency for the first time utilizing the Loan Currency Facility (LCF). Though the approval is currently restricted to a limited number of industry sectors, IFC will continue efforts to expand the scope of its permitted local currency operations with regulators. A first transaction was recently endorsed by Blended Finance Committee (BFC) for Loan Currency Facility (LCF) funding based on this MOU.

Liberia & Sierra Leone – IFC has worked on a market study (i.e., a diagnostic) of the legal/regulatory regime in the two countries. IFC is considering the development of a pipeline of potential business and possible local counterparties, and will request certain government approvals identified as needed in the study.

Nepal – IFC has been engaged for more than two years to obtain regulatory consent to broaden its local currency capabilities in Nepal. IFC treasury and country teams continue to work toward obtaining the necessary approvals to undertake LCF and standard IFC local currency business operations in the country.

Myanmar – IFC has engaged with two local banks to determine their suitability for engaging in currency hedging operations. However, the Integrity Due Diligence (IDD) and/or credit related issues have prevented IFC from moving forward with this effort to engage further in operational discussions.

Cambodia, Bangladesh, Indonesia – IFC’s regional team is to vet a potential local counterparty in Cambodia and determine the interest of local subsidiaries of two major international banks to engage with IFC in hedging operations in Bangladesh and Indonesia.

West African Economic and Monetary Union (WAEMU) Region – IFC treasury, in conjunction with the current J-CAP efforts in the region, is reviewing the potential to engage with local counterparties in this multi-country pegged currency region. IFC received CMAW funds to finance a review of the legal/regulatory framework, which has been completed and also identified a number of both regional and country-specific regulatory issues to be addressed in order for IFC to be able to transact with local counterparties.

³⁰ The TCX was founded in 2007 by a group of DFIs, specialized microfinance investment vehicles, and donors to offer solutions to manage currency risk in developing and frontier markets, such as swaps and forward contracts that enable TCX’s clients to provide their borrowers with financing in their own currency while shifting the currency risk to TCX.

Haiti – IFC has worked for several years to develop capacity to work in local currency with Haitian clients. TCX does provide non-deliverable hedging in the country, but it is expensive and currency control risks are significant. IFC has also explored setting up a hedging program with the Central Bank of Haiti, but IFC's corporate risk committee has declined to endorse the pursuit of these efforts.

Annex 5: Potential Adjustments to the Blend Finance Facility (BFF) and the Local Currency Facility (LCF)

Blended Finance Facility

1. Under IDA18, the BFF has supported multiple blended finance instruments: equity, subordinated loans, senior loans and first loss credit risk guarantees. To expand this toolkit, Management proposes to explore the introduction of a *Loan Purchase Obligation Instrument* (LPOI) under the BFF to support local bank participation in infrastructure, PPPs and other sectors requiring long-tenor financing. The LPOI is envisioned to allow eligible projects to access long tenor (e.g., 10-20 years) local currency loans from local banks where such is currently not yet available. The instrument would function as a put option to be offered to local banks to enable them to participate in a long-term project financing package (e.g., where 15-year financing is needed) to IFC-led projects where they otherwise would not be able to participate at the same tenor.
2. **Financial structure illustration:** A local bank would extend a loan to a project also financed by IFC in local currency for a longer tenor than typically feasible in that country context (for instance from 10 to 20 years) with the agreement that the International Finance Corporation (IFC) as the Implementing Entity (IE) for the Private Sector Window (PSW) BFF would buy the loan at a specified and pre-agreed point in time (for instance on year 10) in case the local bank faces (i) regulatory constraints or (ii) pre-defined and pre-agreed liquidity issues that preclude them from renewing or continuing their participation in the project financing. The mechanics of the loan purchase on exercise date would likewise be pre-agreed. In the event the local bank exercises their option, IFC as PSW BFF IE would assume the exposure from the local banks backstopped by IDA PSW resources. If the option is not exercised on the agreed exercise date, the Loan Purchase Obligation falls away and IDA's exposure through IFC as PSW BFF IE is released.
3. **Additionality:** In PSW-eligible countries, projects typically cannot access long tenor (e.g., 10-20 years) local currency loans from local banks due to banks' own inability to access long-term funding in their markets or regulatory limitations on long-term lending. Depending on the cost, local bank participation – as co-lender to IFC in the projects envisioned for this kind of PSW support – provides significant benefits: it de-risks a project where tariffs or off-take contracts have a higher local currency component, allows local costs to be funded in local currency, provides risk mitigation through the participation of local financial institutions, increases local bank capacity and strengthens their ability to evaluate long-tenor financing of projects, and decreases potential additional financial obligation for host governments. IFC, which will always be lender to the project, will likely provide its loan in hard currency.
4. Existing IDA instruments (e.g., Project Risk Guarantees - PRGs) have been used in a few cases (e.g., Kribi and Nachtigal power projects in Cameroon) to support local bank participation in projects with long-tenor loans. The structures utilized to date require governments to assume a no-cost 'put' or loan purchase obligation to the local banks backstopped by an IDA Guarantee. The IDA Guarantee in turn is supported by a counter-indemnity from the host country. While the objective of a PSW LPOI may have potential overlap with the government "put" backstopped by an IDA Guarantee, the envisioned PSW instrument would be additional to existing WBG

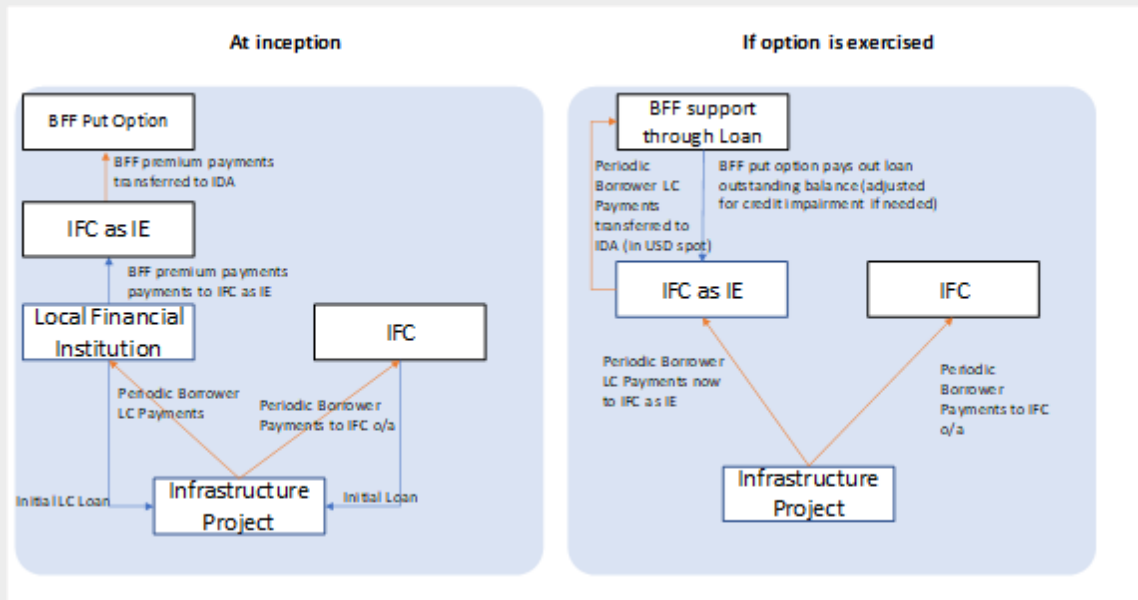
instruments since it (i) would not require governments to provide a free loan purchase obligation for the benefit of local banks, and (ii) would not require a government counter-indemnity to be in place as a backstop to the IDA guarantee. It would thus fill a space analogous to that being filled by other blended finance instruments, and considerations that guide the use of PSW blended finance vis-à-vis existing World Bank Group (WBG) instruments, and the same governance that includes IDA representation will apply.

Box A5.1. Illustration of Loan Purchase Obligation Instrument under the Blended Finance Facility (BFF)

Example

A hydropower plant which requires 14-year loans can use this Loan Purchase Obligation Instrument to mobilize local banks' participation in the financing alongside the International Finance Corporation (IFC) and the Development Finance Institutions (DFIs)/international commercial lenders. As an example, this instrument would allow local banks to commit to a 14-year loan with the ability to have IFC acting on behalf of the Private Sector Window (PSW) to step into its obligations in year 7 provided the project has met its repayment obligations up to that point.

Similarly, if a larger hydropower project requires an 18-year loan, including a local currency financing component, the above structure could be enhanced to include two Availability Dates: (i) in year 6; and (ii) in year 12, respectively. Provided amounts are the same as in the above example, IDA's risk exposure would be the same, though for a longer tenor (12 years vs. 7 years).



5. **Operational Mechanics and Governance implications:** The LPOI would combine two instruments: (i) a put option up to exercise date, and (ii) local currency loan should the option be exercised. There would be need to work with IFC to develop appropriate policies and procedures for appraising, structuring, valuing, pricing, provisioning and administering this instrument, building on World Bank and IFC's existing experience with derivatives and local currency loans. In the case of local currency loans in PSW-eligible countries where IFC's typical local currency liquidity sources may not be available, pricing would be determined similarly to current

arrangements for the LCF enabled loans. LPOI use will be originated by IFC teams and reviewed by (a) IFC management for transaction-related aspects and (b) by the BFC with PSW representation in a similar way as other existing IFC instruments in other BFF-supported transactions, and under the same criteria and governance.

6. **Fees to IDA:** Fees (option premium) would be determined in accordance with existing practices, including assessing the economic rationale for use of PSW and minimizing concessionality. As with other BFF-supported instruments, PSW will leverage IFC risk rating, pricing, valuation and provisioning capabilities to estimate and price PSW's risk exposure on a project-by-project basis. In the case of power projects for instance, the fee for making the LPOI available would be set recognizing the need for a subsidy that would make the underlying local currency tariff of the project viable. Analysis will be conducted on a project-by-project basis to determine this fee while retaining project viability. Should the option be exercised, IFC would collect the remaining debt service on the loan purchased and then remit these to PSW.

7. **Risks to IDA:** The LPOI brings new and complex challenges – financial, operational, and others – and further assessment would need to be made whether it is cost efficient to deploy vis-à-vis its expected additional value. As currently envisioned, under the **BFF LPOI**, should the option be exercised and IFC as PSW BFF IE steps in, IDA would obtain the economic rights to the loan purchased by IFC as IE, and de facto be exposed to the credit risk of the underlying project and the local currency risk for the remaining maturity of the loan. PSW already takes credit risks on projects / sponsors in its existing BFF operations, and local currency risks on loans through its existing LCF operations.

- **Should the LPOI be exercised and IDA acquires the economic rights to the loan purchased by IFC as PSW BFF IE, IDA would be exposed to the credit risk of underlying loan performance.** In that period prior to exercise date, PSW's exposure to credit risk would be lower than for instance IFC, who is a lender from the start as this structure results in IDA not being exposed to the construction and pre-operating risks (which are typically the highest risks in real sector projects), and is contingent until and should the option be exercised. If the option is exercised and IDA gains economic rights to the loan, its interests would align with IFC who remains a senior lender to the project. To mitigate against risk of adverse selection – for instance that local banks exercise their right to have the PSW assume the loan if the project goes into distress approaching the exercise date – the option legal documentation would include project performance covenants and termination provisions should the loan default or become non-performing. To adjust for any changes in the underlying credit, assuming at exercise date that the loan is still performing but has deteriorated in credit-worthiness, IFC, in purchasing the loan on IDA's behalf, would purchase the loan at pre-set terms and conditions, including purchasing the loan at an "impaired market value" determined for instance by a third-party independent assessment.
- **IDA would face the risk of nominal exchange rate fluctuations of the local currency, which IDA cannot hedge, and capital restrictions in the country, as well as transfer and convertibility risks in collecting proceeds in hard currency.** This is because some local currencies are not converted or traded offshore. This includes the risk of currency

appreciation when the option is exercised and the risk of currency depreciation when the loan is being repaid. The conversion of loan repayment to IDA in US Dollars can be affected by the capital restrictions of the country. If the option is exercised, IDA's exposure will be in local currency (vs. IDA's commitment, which will be in US Dollars). Furthermore, the repayment of the loan may come at risk in the event the central bank runs short of foreign reserves. It should be noted that IDA assumes contingent currency exposure through this structure, which falls away if the option is not exercised.

- **IDA would need to set aside the full transaction amount at the outset.** In case the option is exercised, IDA would have to fund the loan amount (net of loan repayments by the project up to that date) at each period where the transfer of the loan could be exercised. IDA would then receive reflows as per the remaining repayment schedule of the underlying loan. IDA will need to retain sufficient liquidity to cover the purchase amount.
- **There are various operational challenges** – in particular related to pricing, valuation, reporting, and risk management – that would also need to be agreed among the institutions involved.

Local Currency Facility

8. The LCF is facing high demand under IDA18, which is expected to exceed the initial indicative sub-facility allocation of US\$400 million. This demonstrates the strong demand for local currency financing in PSW-eligible countries at tenors that allow private investment to work. Under IDA19, management proposes to explore an adjustment to LCF to enable support for third parties in projects financed by IFC. Building on IFC's experience with providing hedging instruments to third parties in more developed markets, under this adjustment, LCF would be used to hedge the currency exposure deriving from the participation of third-party co-investors/co-lenders investing in local currency in approved PSW projects, or to hedge currency exposure of project sponsors that have borrowed in foreign currency (USD or EUR). Third-party co-lenders could be other DFIs and/or private/commercial entities. Commercial lenders will only be supported when there is adequate evidence that they lack the capability to manage Foreign Exchange (FX) risk. Expanding LCF access to other lenders could allow better support for projects/clients who would benefit from receiving a larger financing package in local currency terms relative to only the IFC loan amount; expanding the LCF access to borrowers would help protect projects or businesses that likely collect revenues in local currency from foreign currency risk. Use of this instrument would be limited to projects in which IFC is providing a loan for its own account.

9. **Additionality:** This possible adjustment expands the ability of the LCF to support local financing packages to high impact projects. Specifically, it:

- (a) Builds on the Maximizing for Development (MFD) principles of mobilizing private sector funds as the first option for financing WBG projects. The ability to mobilize other investors in local currency for selected projects is expected to have a positive impact for entities operating in the most challenging environments;

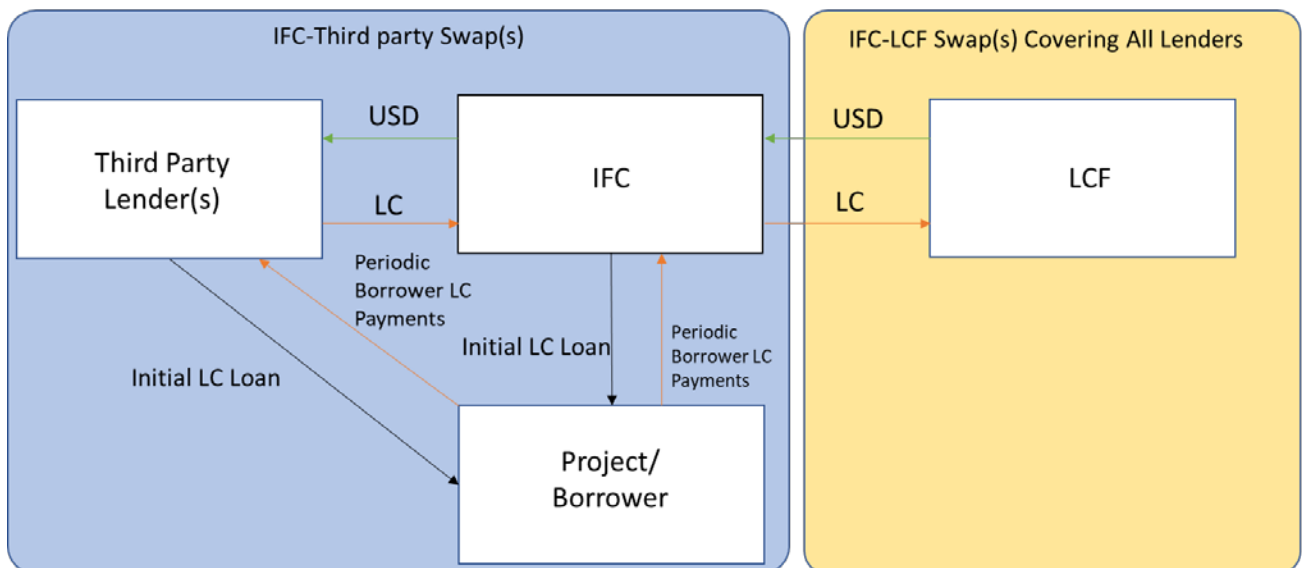
- (b) Allows borrowers to receive a larger portion of the financing package in local currency terms as opposed to only the IFC loan amount (e.g., when IFC exposure is at its risk limit), which helps to mitigate the currency risk from a client’s perspective;
- (c) May simplify inter-creditor negotiations/agreements in certain projects, as security pledged against liabilities in different currencies can complicate the enforcement of security arrangements;
- (d) Provides local currency coverage to co-financiers in the project, along with IFC, and helps extend the benefits of local currency financing to PSW projects while ensuring that existing oversight and governance of the PSW applies to co-financier agreements with IFC. This is a clear benefit for IDA compared to having to negotiate institution-specific oversight and governance agreements with new entities.

10. **Operational mechanics:** Under this adjustment, there are two financial structures being considered to address the two following scenarios:

- (a) IFC would be facing a Third Party for a loan extended by the Third Party in local currency or;
- (b) IFC would be facing the client for a loan extended by a Third Party in hard currency.

11. In both scenarios, PSW would cover the third-party credit spread in the LCF swap to ensure better participation from them and optimize usage. This adjustment would only apply when there is adequate evidence that the Third party and the client lack the capability to access currency risk solutions with the market.

Illustrative Diagram of Local Currency Loan with IFC facing a Third Party for a loan extended by the Third Party in Local Currency (one possible option under Structure 1 above)



12. **Governance implications:** Should this adjustment be developed further, Management recommends that the LCF amounts to be available for use with third-party investors/lenders be capped at US\$100 million initially. LCF would face IFC under the swap structures outlined above, not private sector clients directly.
13. **Risks to IDA: The LCF extension of cover third parties** presents the following risks.
- **Credit spread hedging may result in higher subsidies and possible losses for LCF than current arrangements.** LCF currently does not hedge IFC's credit spread, as IFC as a practice does not hedge its credit spread in its non-PSW exposures. However, certain third-party co-investors/co-lenders might require this cover. Providing this additional cover may increase the notional amount of potential losses to LCF, as it would take FX risk not only on the principal and base rate but also on the credit spread. The pricing of the LCF rate on the loan extended by Third Parties would be calculated on an equivalency basis to the LCF rate provided on IFC's loan, to ensure fairness among lenders. The subsidy will be calculated in the same fashion as presently using the applicable reference rate (for example, the Currency Exchange Fund - TCX).
 - **There could be reputational risks faced by IDA in supporting third parties, in particular, commercial lenders.** In LCF transactions, the estimated subsidy (in US\$) on the swap is passed through in cheaper local currency financing to the project and the benefit of the subsidy is not captured by IFC or other lenders. To avoid perceptions of reputational risks with supporting foreign co-investors or co-lenders, Management recommends that access to LCF be restricted to Development Finance Institutions (DFIs) and only those commercial lenders or investors without ability to hedge FX risks fully in PSW countries. Possible DFI co-investing partners would include those that invest in private sector projects in PSW countries, e.g., African Development Bank, Asian Development Bank, Entrepreneurial Development Bank (FMO), European Bank for Reconstruction and Development, etc. Also, transactions will only be approved when there is adequate evidence that the Third party and the client lack the capability to access currency risk solutions with the market.
 - **Increased currency exposure, and potentially heightened concentration by currency with larger exposures on projects.** With these structures, IDA would face more currency exposure related to a specific transaction stemming from the extension of LCF hedging capacity to third-party investors, but this would not change the overall level of risk taken by IDA through LCF operations which is capped at the facility limit.

Annex 6: Private Sector Window (PSW) Pipeline and Discipline around Blended Finance Lessons from the International Finance Corporation (IFC)'s experience

Current Program & Pipeline

1. The PSW pipeline and program supporting IFC's investments are picking up, with a total pipeline of over US\$2.0 billion as of March 2019. Committed amounts are now at US\$112 million with another US\$90 million of board approvals expected to commit soon. In addition, nearly \$400 million in 19 projects are scheduled for consideration for board approval by end of FY19. Additionally, US\$714 million an increase from US\$613 million last quarter and the early stage "midstream" pipeline of projects being considered for PSW support is nearly US\$1.2 billion.

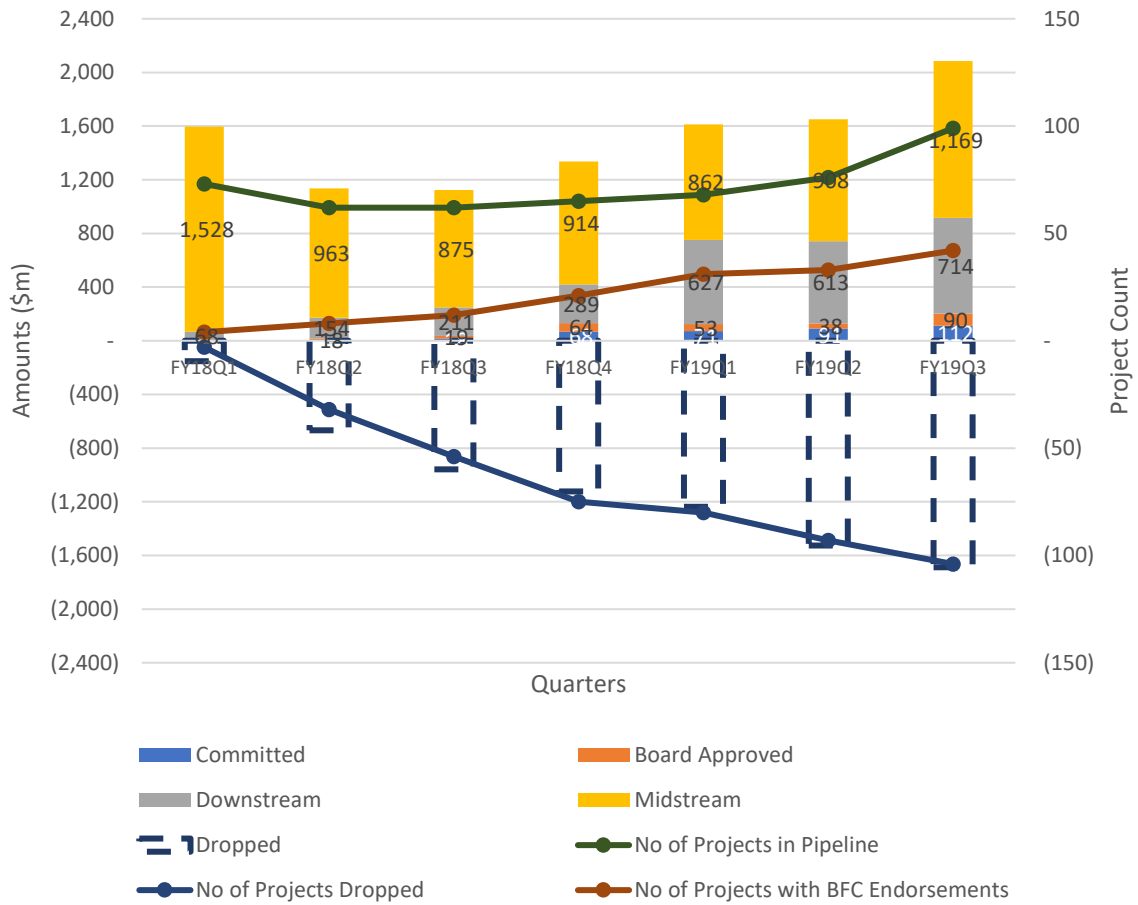
Evolution of Pipeline and Disciplined Approach

2. The chart below (Figure A6) shows the evolution of the pipeline, from the **initial enthusiasm for use of the PSW** in the first quarter of its availability when the **Midstream pipeline (projects expected to be presented to the Blended Finance Committee (BFC) for concept endorsement within 12 months) was US\$1.5 billion**, to the relatively slow build-up of the downstream pipeline through the first year.

3. IFC and World Bank staff had steep learning curves on the appropriate use of a new concessional finance program for the private sector. Over time, the **quality of the Midstream pipeline has improved as projects were reviewed against the Blended Finance Principles. Many projects were 'dropped' from the pipeline due to non-eligibility** (no economic case for concessionality, IFC could do the project on its own, projects not viable even with PSW support, IFC dropped project, or too early stage). The Downstream pipeline increased from US\$289 million as of June 2018 to US\$627 million as of September 2018 while the Midstream pipeline remained stable. **In the second year, pipeline projects have been dropped at a slower rate**, suggesting that IFC project teams, with the support of the Blended Finance department review, were starting to have a **better understanding of the types of projects that could qualify**. While the first year was one of experimentation, in the second year we have seen the emergence of **more programmatic approaches** building on the first year's lessons.

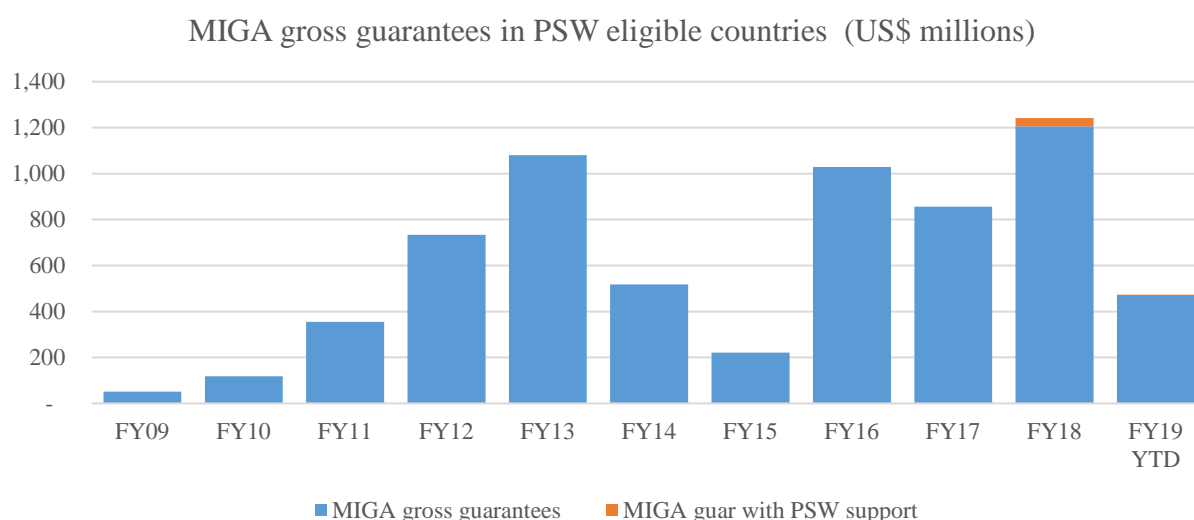
4. As of March 2019, over 100 projects (for over US\$1.6 billion PSW support) had been considered for PSW support but have been dropped from consideration through the process of independent review by the Blended Finance team and management, as well as the BFC and PSW Representatives or by IFC operations. **This represents two times as many projects as have been approved for consideration by the BFC.**

Figure A6. IDA18 PSW IFC Pipeline, Program Results & Dropped Projects



Lessons from the Multilateral Investment Guarantee Agency (MIGA)'s experience

1. With the MIGA Guarantee Facility (MGF), experience to date has demonstrated the difficulties in attracting quality investors and investments in IDA markets. MIGA experience over the years is that projects in IDA countries are harder to source and support. They take much longer to reach financial close, and are costlier to underwrite. Moreover, there are fewer international companies and banks of sufficient quality, who can implement MIGA's robust E&S Performance Standards and Integrity standards, and with whom MIGA is comfortable working with in these economies.



2. Despite some initial challenges, MIGA's pipeline has been growing steadily as a result of greater business development efforts and the focus of its operational staff, specifically its regional representatives. At the start of the operational period of the PSW, MIGA's pipeline stood at US\$411 million in potential guarantees for seven projects, of which US\$81 million was estimated for PSW use. The pipeline has grown to a total of 23 projects as of April 30, 2019, with close to US\$1.5 billion in potential guarantees of which US\$477 million has been estimated for PSW use. During the same period, 14 projects were evaluated and dropped from consideration mainly due to:

- Investors deeming MIGA's due diligence process onerous and pricing disadvantageous;
- Projects did not meet IDA PSW's eligibility/ additionality criteria for deployment;
- In a few cases, investors chose not to proceed due to reasons unrelated to MIGA.

3. There has been a learning curve for all parts of the WBG involved in implementing the PSW. Experience during IDA18 has shown that greater communication and earlier engagement are needed between MIGA and IDA teams. The current pipeline of projects is robust and the PSW usage will be critical for its realization and delivery on the development impacts.

Annex 7: Chief Risk Officer (CRO) Independent Statement

I. BACKGROUND

1. The IDA Private Sector Window (PSW) was established to focus on private sector investment in frontier markets, especially in Fragile and Conflict-affected Situations (FCS) countries. As discussed with the IDA Board³¹, risk management of the PSW was expected to be challenging as transactions would be in countries and markets featuring limited or no market breadth or data to support risk assessment, pricing, mitigation, and reporting. As opposed to other high-risk activities that the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) already undertake, the risks in PSW are for the most part difficult to assess, and the possibility of significant losses has been disclosed.

2. The practical approach was to manage this unquantifiable risk to IDA via hard loss limits with a 100 percent capital allocation and actively engage in “learning by doing”. In that spirit, Board-approved loss limits were established for each window (US\$1 billion for the Risk Mitigation Facility (RMF), US\$600 million for the Blended Finance Facility (BFF), US\$500 million for the MIGA Guarantee Facility (MGF) and US\$400 million for Local Currency Facility (LCF)).³² IFC and MIGA maintain a financial interest via underlying financing or guarantees in three windows (MGF, BFF and RMF) and assume other types of risk in the transactions. The LCF, on the other hand, which currently offers four types of currency management coverage, does not feature sharing of currency risk although IFC does have an underlying investment in the project.

3. Since IFC/MIGA are engaged in the projects, this enables IDA to at least make use of IFC and MIGA’s assessment of their own risks in operations under three facilities (RMF, BFF and MGF) and build on these, given the lack of data for an independent, arm’s-length assessment.

4. For all PSW facilities, since IDA currently lacks private sector expertise, it relies on IFC’s and MIGA’s internal processes and guidelines for sourcing and pricing transactions. The ability to rely on IFC and MIGA internal limits (e.g., country exposure and other concentration limits) also provides IFC and MIGA flexibility in the pipeline development stage to pursue the most developmentally valuable transactions.

5. As previously agreed, the capital requirement for PSW activities to be included in the Total Resources Required (TRR) measure for assessing IDA Capital Adequacy is 100 percent of maximum exposure. This reflects: (a) the nature of these risk-taking activities, focused on FCS and the private sector, where losses can be substantial, and risk is extremely difficult to assess; (b) the lack of a track record of IDA or IFC/MIGA with such risks; and (iii) IDA’s own AAA rating and associated need for a conservative approach until a track record has been established.

³¹ AC2017-0037 “Operationalizing the IDA18 IFC-MIGA Private Sector Window”

³² This is now proposed to be changed to: RMF US\$500-600 million, BFF US\$800-900 million, LCF US\$500-600 million, while the limit for MGF will remain the same of US\$500 million.

II. OBSERVATIONS AND LESSONS LEARNED

1) LCF Pricing and Subsidies

6. **Pricing and Risk Assessment in Frontier Markets:** The November 2017 Board paper³³ noted the anticipated challenges in terms of pricing and risk assessment in frontier markets, particularly for LCF. In practice, we have observed that indeed pricing and risk measurement with any substantive level of confidence is extremely difficult. To date for LCF, with three projects approved of which two have been executed plus various others in the pipeline, it has not been possible to separately estimate expected and unexpected loss. Furthermore, each trade requires a customized approach based on many assumptions to address the lack of robust market data and models.

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

8. In practice, however, the LCF trades undertaken so far typically require a pricing subsidy which is expected to reduce IDA capital by a range of 10-20 percent of the exposure. As in the case of other PSW facilities, this subsidy does not include other costs of deal preparation (including costs associated with deals that did not make it to the Board, the cost of start-up of the window, or IDA costs of processing, valuing, reporting, etc.). The consistent requirement of such levels of subsidy indicates a model whereby the US\$400 million window could be reduced over time, as opposed to a model that is expected largely to break even as initially envisioned in the Board paper.³⁴

9. **Required Staff Resources:** The experience with LCF to date has helped assess the resources needed for its management. The low number of proposals transacted compared to those considered, the frequently changing nature of each transaction (regarding pricing and deal terms/structure), the small deal size, and the customized nature of each proposal have made the LCF far more resource intensive than originally envisaged at both the investment level and in terms of valuation and reporting. While repeat transactions of the same type could, over time, enable standardization and bring these requirements down, this may be offset by the need to constantly innovate and customize transactions (as for example in the new types of transactions being considered under IDA19).

2) Loan Loss Provisioning for Exposure under the PSW

³³ AC2017-0037 “Operationalizing the IDA18 IFC-MIGA Private Sector Window”

³⁴ The November 2017 paper stated that for the LCF, “Pricing will target to compensate for expected losses and seek to provide a return on the capital IDA is required to hold for unexpected losses.”

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

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

12. The new LLP framework seeks to avoid duplication of efforts across the World Bank Group by leveraging the expertise, experience, and provisioning frameworks of IFC and MIGA. As the originators of these transactions, IFC and MIGA provide IDA with the inputs and information required for LLP calculation. IDA's new provisioning framework for PSW transactions combines the experience of all the three institutions to calculate the loan loss reserve for PSW exposures on IDA's balance sheet on a quarterly basis. The LLP framework for PSW exposure considers that IFC and MIGA already have established risk and LLP frameworks for private-sector exposure and political risk insurance products. The framework also considers that IFC and MIGA will originate PSW transactions, perform risk analysis based on their detailed knowledge of the transactions, and take risk alongside IDA in the projects, *although the risk assumed by them is different from that passed on to IDA.*

13. IDA has gained considerable understanding of the provisioning methodologies used by IFC and MIGA, the calculation of inputs such as default probabilities and severities by IFC and MIGA, as well as the associated implications for IDA-specific risks. Development of this framework has given IDA experience in coordinating across multiple WBG entities and departments and in negotiating a mutually agreeable approach to provisioning. IDA CRO has also participated in a successful review of the PSW provisioning procedures by IDA's external auditors. However, it should be recognized that *while IFC and MIGA provide inputs and information, as a separate entity, IDA remains responsible for estimating LLP for IDA PSW exposure despite its lack of expertise in private sector risk assessment.*³⁵ IDA also remains responsible for presenting the provisioning results to the relevant approval committees and for discussing developments as required with external auditors with input from IFC and MIGA as needed.

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

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

³⁵ This does create a risk that if, ex post IDA provisions are found to be misestimated, IDA may be held responsible even though it essentially has to rely on IFC/MIGA for information.

of PSW transactions indicates the possibility of losses that can be both substantial and difficult to assess, hence the need for close risk monitoring by IFC and MIGA, who have better expertise to assess these non-sovereign risks.

- **Risk management best practice:** Good risk management requires that every institution fully understand the risks that it takes onto its balance sheet. A review of the new LLP framework for PSW transactions by IDA's external auditors stressed the need for CRO to develop sufficient understanding of PSW transactions and their risk assessment to be able to independently assess the reasonableness of the LLP estimates produced by IFC and MIGA. While IDA has tried to leverage the knowledge and data provided by IFC, a model that places accountability on IDA management and staff while relying on data and judgement from IFC/MIGA staff exposes IDA to asymmetric risks and may not be sustainable, especially if this activity is scaled up. Accordingly, if PSW activity expands, IDA also needs to expand its own knowledge to encompass the specific nature and structure of PSW transactions and may need to hire appropriate expertise or reconsider the funding and/or governance model.
- **Large number of transactions:** The three MGF transactions that resulted in the first PSW exposures with provisioning implications in FY18Q4 averaged US\$24 million, with the smallest at US\$3.1 million. Consequently, the IDA18 PSW envelope of US\$2.5 billion could result in many transactions, each requiring quarterly LLP assessment and processing. This is in contrast for LLP assessment for IDA's sovereign exposure, calculated at the country level rather than the individual loan level. The resource intensity is further compounded by unstandardized transactions, changes to the transaction structure over time, and increased customization.
- **Lack of data on exposure taken by IDA:** IDA lacks any data on PSW financial performance, particularly on risks that are specific to IDA. Due to the structure of PSW transactions, IDA is taking more risk than IFC and MIGA. The track record of such exposures is therefore expected to differ from that for IFC and MIGA.
- **Coordination role & outreach responsibility:** CRO also acts as a coordinating unit working closely with IFC, MIGA, and other Bank units to ensure timely availability of inputs, smooth information flow on specific transactions, development of procedures to manage transactions, and coordination with auditors. Outreach on risk and loan loss developments vis-à-vis the Board and senior management will also be the responsibility of CRO, which highlights the need for CRO to have a full understanding of PSW transactions and their risk and resource implications.

III. ISSUES FOR FUTURE CONSIDERATION

1) Risk Sharing Considerations

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

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

2) Capital Requirements

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

3) Forward Look

18. The PSW will need to be monitored with a view toward simplifications, scalability, and tradeoffs between cost and risk on the one hand and development impact on the other. Potential refinements could include better alignment of incentives, risk sharing, and simplification of processes, as well as the balance between innovation and customization on the one hand and resource intensity and lack of meaningful data on the other. In addition, alternative structures could be considered (such as a Trust Fund to provide guarantees with appropriate eligibility criteria and governance, building in-house IDA expertise, or opening the PSW to other entities to increase competition and aid price discovery and creation of markets), to provide financial backing while also aligning incentives and accountabilities.

Annex 8: Blended Concessional Finance Definition and Enhanced Principles for DFI Private Sector Operations

Blended Finance Definition: Combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the Sustainable Development Goals (SDGs), and mobilize private resources.

Blended Finance Principles:

- ***Economic Case for Using Blended Concessional Finance:*** DFI support for the private sector should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector. BF should address market failures.
- ***Crowding-in and Minimum Concessionality:*** DFI support for the private sector should, to the extent possible, contribute to catalyzing market development and the mobilization of private sector resources and minimize the use of concessional resources.
- ***Commercial Sustainability:*** DFI support for the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must contribute towards the commercial viability of their clients. Level of concessionality in a sector should be revisited over time.
- ***Reinforcing Markets:*** DFI support for the private sector should be structured to effectively and efficiently address market failures and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.
- ***Promoting High Standards:*** DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity, and disclosure.

Blended Finance Definition and Principles were adopted and being implemented by 23 private sector DFIs,³⁶ including IFC (Chair of the DFI Blended Finance Working Group). Discipline in the market cannot be achieved if DFI/MDB Donors do not require application of principles in project implementation

³⁶ The DFI Blended Concessional Finance Working Group aims to set common standards for implementation of blended concessional finance in private sector operations and reviews the merits and adequacy of existing approaches. The ultimate objective of the working group is to increase development impact, crowd-in private investments while ensuring minimum concessionality, and enhance trust and transparency amongst practitioners. It also aims to share and promote the use of such best practices in blended concessional finance implementation by other market players. The working group is composed of the African Development Bank (AfDB), the Asian Development Bank (ADB), the Asia Infrastructure Investment Bank (AIIB), the European Bank for Reconstruction and Development (EBRD), European Development Finance Institutions (EDFI), the European Investment Bank (EIB), the Inter-American Development Bank Group (IDBG), the Islamic Corporation for the Development of the Private Sector (ICD), and the International Finance Corporation (IFC, Chair of the DFI Working Group).