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Utilizing World Bank partial guarantees in support of sovereign or sub – sovereign commercial debt financings



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Glossary

ADB	Asian Development Bank
AUM	Assets under management
CDS	Credit Default Swap
DPF/DPO	Development Policy Financing/ Development Policy Operation
EIB	European Investment Bank
EM	Emerging Market
ETF	Exchange Traded Funds
EU	European Union
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IPF	Investment Project Financing
IMF	International Monetary Fund
IFI	International Financial Institutions
JLM	Joint Lead Manager
MDB	Multilateral Development Banks
ODA	Official development assistance
PBG	Policy-Based Guarantee
SDG	Sustainable development goals
SOE	State Owned Entity
S&P	Standard & Poor's
WB	World Bank
WBG	World Bank Group

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1. Executive Summary

1.1 Introduction

Rothschild has conducted this study for the World Bank (“WB”) to assess the feasibility and attractiveness for sovereigns and sub-sovereigns to access public bond markets for their fiscal and infrastructure needs with the support of a WB partial guarantee. This report summarizes the findings and presents our recommendations following a three-month assignment.

Our report is based on the combination of:

- In-house theoretical analysis regarding potential alternative structuring and pricing of partially-guaranteed instruments
- Market-based analysis relying on Ghana 2030 feedback, meetings with key fixed income investors, banks, interactions with rating agencies and index teams
- We met with over 25 leading EM investors in Europe and in the US along with the 3 leading credit rating agencies and a leading index provider

1.2 Ghana partially-guaranteed bond issue

In October 2016, Ghana issued a USD 1 billion 144A/Reg S registered international bond due 2030 (“Ghana 2030 bond”), which was partially-guaranteed by the International Development Association (‘IDA’) arm of the WB. This credit support also represented the reintroduction by the WB of the application of partial guarantees to public bonds.

Issuer:	The Republic of Ghana
Size:	USD 1 billion, of which USD 400 million guaranteed by IDA
Date of issuance:	October 14th 2015
Issuers’ rating:	Moody’s: B3 (Negative Outlook), Fitch: B (Negative Outlook)
Notes’ rating:	Moody’s: B1, Fitch: BB- (two notch uplift)
Format:	144A / Reg S
Structure:	Senior unsecured, benefiting from the Partial Guarantee
Tenor:	15 years, amortizing 3 equal instalments in years 13, 14 and 15
Use of proceeds:	Refinancing of existing debt

1.3 Cyclicity of market access for EM issuers

Financing for Emerging Markets has been increasingly disintermediated. Since the 2008 financial crisis, global banks have been forced to reduce their cross-border positions, reversing their large expansion in the period 2000-2008. Improved economic indicators in EM economies and low yields in advanced economies have attracted a wider range of investors to emerging financial markets during the last decade. This phenomenon has contributed to the increasing importance of EM debt for investors and the creation of specialized investment vehicles to facilitate investment in EM debt markets. The total funding pool for EM bonds stands at ca. USD1 trillion

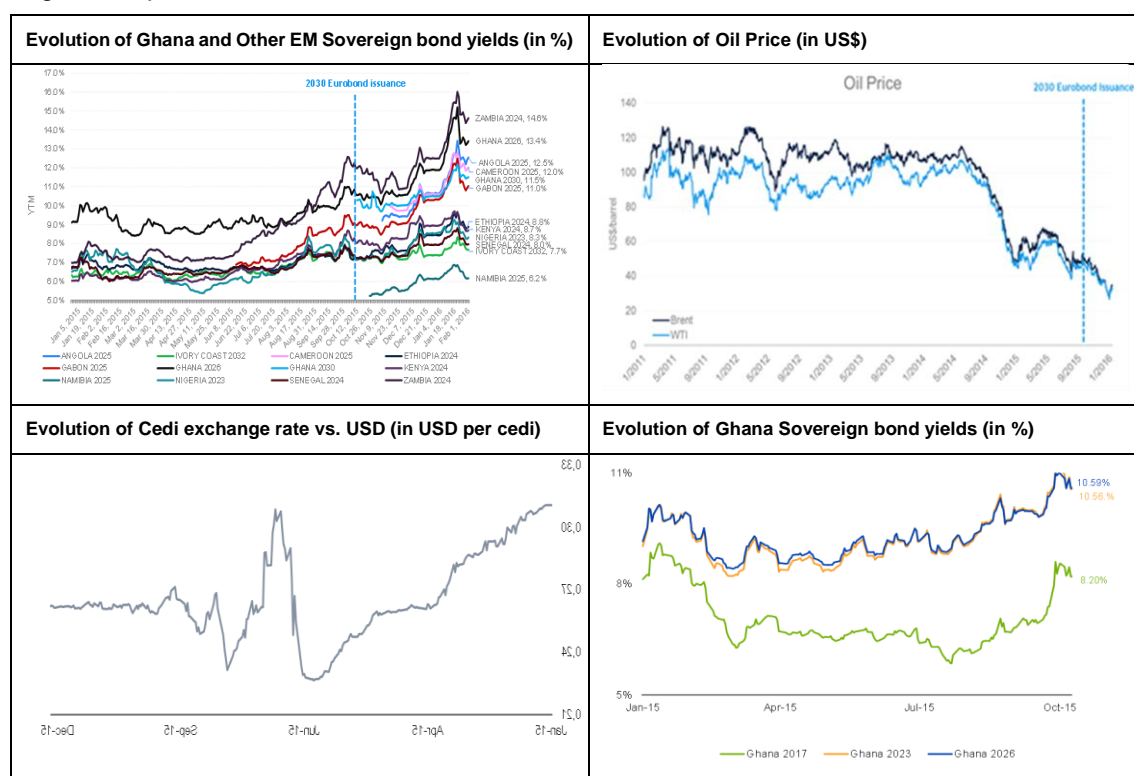
under management, which represents the largest pool of capital available for emerging markets risk.¹

However, market volatility is pronounced in EM markets, partly due to the macro-financial volatility of issuers. This is also due to the structure of the EM investor base which is impacted by the activities of a small group of market leaders and forced divestments by index-tracking funds. Volatility in portfolio flows mean countries risk being unable to access debt capital markets at certain times. Secondary market yields skyrocket when capital outflows are significant, in part due to limited liquidity. Especially lower rated EM Sovereigns are only able to issue during specific periods, referred to as market windows. They are therefore much more impacted by external shocks and may not have control over the timing of their issuances. Not all debt issuances occurring in capital markets are successful and not all are oversubscribed.

Due to market windows, even for Sovereigns with similar macro characteristics and credit ratings, the amount raised, its cost and the success of the issuance can be significantly different depending on when the issue is made. Some issuers may even have to pull back issuances after a roadshow due to lack of demand. For example, over the second half of 2015 and early 2016, significant capital outflows prevented most EM issuers from accessing markets. A number of issuers had to pull back from the market or rescale their target issue size.

1.4 Context on the Ghana credit at the time of issuance

Given this negative market backdrop and a challenging credit story, Ghana did not have access to the international bond market on a standalone basis in October 2015. Despite the on-track IMF program, the drop in oil and commodity prices, as well as the Cedi instability, were having a negative impact.



Source: Bloomberg

¹ IMF, April 2015, <https://www.imf.org/External/Pubs/FT/GFSR/2015/01/pdf/c3.pdf>

On the other hand, in the context of the IMF program, the refinancing of expensive short-term borrowings was critical to reduce further fiscal impact. Ghana had USD100m of its IDA allocation left at the WB which it could borrow as USD100m or use as a USD400m guarantee given the way guarantees are booked. This leverage benefit, amongst others, led the Government of Ghana to request IDA to provide a Policy-Based Guarantee ('PBG') as credit enhancement to enable market access in these difficult conditions.

1.5 Strategic transaction for Ghana which yielded significant benefits

The WB and the Government initiated a macroeconomic reform operation titled First Macroeconomic Stability for Competitiveness and Growth which was structured to include a USD400m guarantee to enable the raising of up to USD1bn in the international bond markets. The WB's macroeconomic reform program and presence of the WB team during roadshow meetings alongside the government of Ghana underlined the support Ghana had received from the international community and communicated the merits of its homegrown reform program.

The transaction milestones included the following:

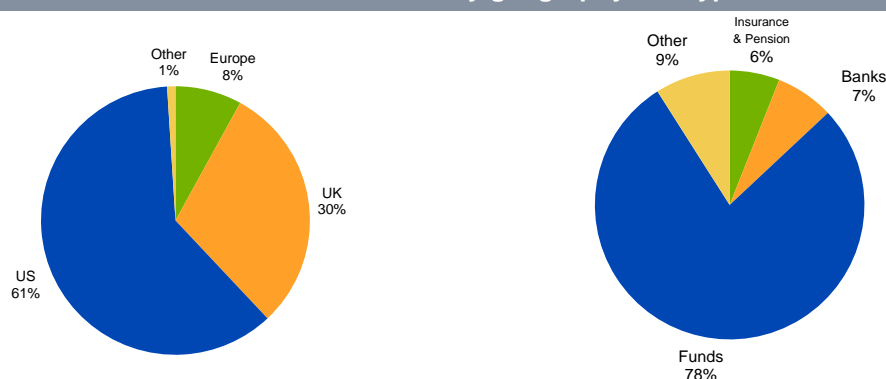
- i. First PBG supported bond issuance in the market in 14 years
- ii. Longest Eurobond tenor of 15 years first achieved by a Sub-Saharan African Sovereign (except South Africa)
- iii. Reducing yields by 150-200bps compared to a theoretical uncovered 15Y Eurobond (theoretical because Ghana did not have standalone access)
- iv. 100% oversubscribed order book with a diversified investor base compared to standalone bonds

Furthermore, c. 15% of the final order book went to new investors that helped expand the investor base.

The proceeds of the issue were used by Ghana to refinance short-term domestic debt (90 days to 2 years) coming up for refinancing bearing a nominal interest rate of 25%, at a time when there was no market access. Cedi has also experienced considerable stability since the Ghana 2030 issuance.

1.6 Feedback from investors and other counterparties

Chart 1. Ghana 2030 investors breakdown by geography and type



Source Joint Lead Managers

Feedback from the investor meetings can be summarized as follows:

- Investment rationale for investors: Investors choosing to invest in the Eurobond underlined the importance of WB support as a necessary credit enhancement to make them comfortable with the offering. Investors firstly assessed Ghana's standalone creditworthiness, which they

considered as the key investment driver. Being convinced by the credit was a necessary condition for investment without being a sufficient one, and the partial guarantee was instrumental in the final decision to invest. Discussions focused on the country's growth story, its ongoing fiscal consolidation, WB macroeconomic stability program, the involvement of bilateral organizations and the on-track IMF program. Investors benefited from the Bank's independent opinion on the country and were able to rely on a set of prior actions as part of the WB and IMF reform program helping to lay a foundation for positive medium and long-term prospects. Investors perceived the guarantee as a signal of the WB's faith in the credit and economic fundamentals of the country.

- Impact of JPM EM bond index exclusion: Exclusion from the index was seen as limiting liquidity and trading on the secondary market. Despite such limitations, the issue still managed to benefit from 100% oversubscription from a large investor base, indicating the advantage of WB partial guarantees. Contrary to expectations, over the first six months following the transaction, analysis shows that trading was higher than on other Ghana bonds – probably due to the size and timing of the partially-guaranteed issuance. However, some investors expressed concern that the trading could further decrease over time without index inclusion.
- Credit ratings: Fitch and Moody's are the only two rating agencies that give a rating uplift to partially-guaranteed sovereign transactions. Standard & Poor's has taken the view that the lack of a standard sovereign bankruptcy code would prevent them from assigning value to partial guarantees. Fitch and Moody's both provided two notch uplifts to the transaction, rating it B1 / BB- vs. standalone sovereign rating of Ghana which was B3 / B. While investors also performed their own internal analysis, they paid close attention to the rationale of rating agencies underpinning the rating uplift.
- Sales process and pricing of the instrument: Investors' view of the condition of Ghana's public finances and its need for a large issuance within a short timeframe introduced additional challenges in the issuance process. Investors also needed further explanation to understand features regarding the triggers of the guarantee, the implications of various restructuring scenarios and key differences with previous guaranteed structures on the market.

Nonetheless, Ghana was able to achieve spread savings of c. 150-200 bps vs where a theoretical standalone bond may have priced. While many of the challenges were as a result of relatively new structure and challenging market environment, more such issuances could provide opportunities to improve the understanding of investors and potentially gain additional pricing benefits.

1.7 Benefits and considerations for issuers in general

The benefits and considerations surrounding partially-guaranteed bonds can be summarized as follows:

Benefits	Considerations
<ul style="list-style-type: none"> • Demonstrate international support, bridge the knowledge gap • Enhancing access to international capital markets • Extend maturities • Reduced funding costs • Increasing the investor base 	<ul style="list-style-type: none"> • <u>Signaling effect of requiring support by IFIs:</u> Some market participants may perceive the use of a guarantee as a sign of weakness. However, investors also take comfort that the role of IFIs improve the credibility of the issuance underpinned by a reform program. • <u>Opportunity cost of the guarantee when replacing concessional loans with low price and long tenor:</u> There is a trade-off to be made between the quantum of financing and external benefits obtained through the use of guarantees vs. low cost of concessional WB loans

<ul style="list-style-type: none"> • Tightening of yields for existing instruments • Increasing available funding for private projects 	<ul style="list-style-type: none"> • <u>Risking cannibalization of investor bases between Sovereigns and its SOEs</u> may come up as a concern in instances where the sovereign's investor base lacks depth and the partially-guaranteed SOE instrument is priced widely vs the sovereign • <u>Risk of yield curve distortion for Eurobonds</u>: It is essential for an issuer to develop a non-guaranteed yield curve to support and optimize the pricing of its future instruments. This needs to be weighed against the benefits of a partial guarantee
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1.8 Further considerations on format and approach to marketing

In light of the Ghana experience as well as the above mentioned benefits and considerations, a number of practical recommendations can be drawn.

- Investors are keen to find out more about WB involvement on the ground while building their credit view of the Issuer. Roadshows present an opportunity to publicize the DPF or IPF accompanying the guarantee. In the marketing of future transactions, there would be merit in highlighting more strongly the prior actions or undertakings by the issuer that form the basis of the underlying WB operation. An even greater focus on objectives, ambition, detailed planning of reforms and follow-up implications of the WB's involvement should be explored.
- Application of the partial guarantee in different markets: The partial guarantee can be optimized on a case-by-case basis depending on several factors such as issuer characteristics, type of investor targeted (for example public bond, syndicated loan, private placement or other) and the general debt market conditions. Analysis should thus be undertaken so as to optimize pricing, maturity and guarantee terms, and to adapt the product to the relevant market environment. The impact of the guarantee differs depending on the issuer as well. B-rated countries benefit from a significant pricing impact, improved maturity and facilitated market access. With lower uncovered yields, BB-rated countries have an impact framed around the messaging of the WB support and potentially reaching investment-grade.
- Other placement formats: Private placements (as opposed to public placements) allow a more flexible and confidential process, as well as raising smaller quanta of debt compared to international public bond issuances. In the Emerging Markets space, private placements are currently not favored by real money investors, essentially due to their lack of liquidity. Loan formats (whether syndicated or private) interestingly provide flexibility in the structure conception and privacy as to final terms for the borrower. However, there are few institutional investors (apart from infrastructure funds, some commercial banks and some insurance companies) who have the possibility of investing in partially-guaranteed loans, which limits the investor base.

1.9 Conclusions

The Ghana 2030 bond benefiting from an IDA partial guarantee set a strong precedent and opened the way for other select Sovereigns, quasi-sovereigns and SOEs to access capital markets in a challenging environment.

In the third quarter of 2015, while a number of issuers had to pull or scale back issuances, Ghana was able to raise USD1 billion under turbulent market conditions. Despite being impacted by negative market sentiment and a challenging credit story, Ghana nonetheless achieved 150-200 bps in spread savings. Demonstrating its homegrown reform program and the support of international organizations enabled market access when there was none.

1.9.1 Types of issuers which could benefit from a partial guarantee

Based on the Ghana experience and taking into account the recommendations discussed in this report, we believe partially-guaranteed bond issuances can be impactful for selected types of issuers, which exhibit one or more of the following characteristics:

- Countries with limited concessional funding allocation but on the path towards sector reforms and development of investment programs by crowding-in private sector;
- Issuers which may benefit from accessing a completely new investor base (for example investment-grade, inaugural issuances in a different currency);
- Complicated credit story involving some form of turnaround or reform with the assistance of WB or other international organizations;
- New issuers without previous market experience either in the sovereign or sub-sovereign space;
- Access problems (volume and/or tenor) which would benefit from demonstrating support from the international community.

1.9.2 Recommendations to optimize and scale-up the product

Looking forward, based on discussions with the various stakeholders including member countries, investors, rating agencies, banks and JPM EMB index provider, our key recommendations for further developing the product and maximizing its impact can be summarized as follows:

- Keeping a broadly stable structure would ensure continuity and facilitate the emergence of an asset class: Maintaining the existing rolling guarantee structure seems to be the optimal way to accustom the public bond market investors to the instrument. The level of guarantee should be adapted to the rating level targeted for the issue for successful execution.
- Expand volume of deals and continue education of the investor base: Building a pipeline of circa USD5 billion per annum in volume would help in establishing this product as a new asset class with investors. Educating investment banks and investors about the partially-guaranteed bond structure is critical to extracting the best value from the WB guarantee. Attracting a solid base of new investors can be facilitated by the identification of a pool of cornerstone anchor investors to support future deals. Another idea may be the creation of a fund of institutional investors for partially-guaranteed transactions.
- Addressing investors' concerns on the impact of a restructuring on the partial-guarantee: Given the consent requirements of the WB in the event of a restructuring, it would as a minimum measure, be useful to clarify how the institution would react in standard restructuring scenarios. Further work should be pursued with legal counsels in order to assess what can be added to the guarantee agreement or the prospectus, so as to limit uncertainty on this point.
- Moving towards index eligibility: Focusing the attention of investors on a stable structure can guide the market towards inclusion of the product in standard indices. In particular, an inclusion in the JPM's Emerging Markets index would make the product more attractive. A short-term objective should therefore be to build a significant volume of issuances in time for the next JPMorgan EMBI index annual meeting.
- Continue work with rating agencies: Past experience and discussions with Moody's and Fitch Ratings have led to the conclusion that reaching a two-notch uplift is possible with a 40%

guarantee for a B-rated issuer. The next step is therefore to determine how alternative structures would be rated depending on credit standings and Sovereign / SOE, especially with regards to private transactions for which there is less need for standardization. The support of agencies will be key to facilitate the instrument's further deployment.

2. Introduction

2.1 Purpose of the Study

Rothschild has conducted a study for the World Bank (“WB”) to assess the feasibility and attractiveness for sovereigns and sub-sovereigns to access public bond markets for their fiscal and infrastructure needs with the support of a WB partial guarantee. This report summarizes the findings and presents our recommendations following a three-month assignment.

In the context of the current disintermediation of Emerging Market financing, growing development finance needs and to achieve further leveraging of WB resources, the WB has reintroduced as a new product the application of partial guarantees² to public bonds³. The first instance of this was through the guarantee support it provided the USD1 billion Ghana 2030 public bond. Following up on the Ghana issuance in October 2015, this report looks at the application of partial guarantees for sovereigns and sub-sovereigns / SOEs to access commercial finance on a senior unsecured basis and assesses the potential to build this as a new asset class, based on analysis and market feedback. It does not look at other forms of WB guarantees such as Loan Guarantees and Payment Guarantees, which have been widely used and are well-established in project finance transactions.

Our report is based on the combination of:

- In-house theoretical analysis regarding potential alternative structuring and pricing of partially-guaranteed instruments;
- Market-based analysis relying on Ghana 2030 feedback, meetings with key fixed income investors, banks, interactions with rating agencies and index teams.

Together with the WB Financial Solutions Team, we met with over 25 leading fixed income investors with varied investment philosophies. Our research also brought us to analyze rating methodologies and organize specific meetings with the three major rating agencies’ sovereign teams. Finally, we also met the JPMorgan index team.

This report relies on candid feedback from opinion-leader market participants and provides perspectives on future transactions.

² Please refer to Annex D for an overview of WB guarantees and types of guarantees available

³ Please refer to Annex E for earlier examples of WB partial guarantees applied to public bonds issued by sovereigns or quasi-sovereigns

3. General market context for partial guarantees

3.1 Accessing financial markets for Emerging Market⁴ borrowers

About debt capital markets

Capital markets are financial markets where participants can buy and sell medium and long-term debt or equity-backed securities. These securities are listed and tradable, unlike most regular bank loans. Such borrowings are generally subject to fewer constraints and covenants on issuers than lending from banks. Sovereigns and corporates have found financing costs to be lower and maturities longer in debt capital markets rather than with bank borrowing. Together with the increasing impact of Basel II / III regulations on bank balance sheet availability for long tenors, capital markets have experienced significant growth over recent years.

Financing for Emerging Markets has also been increasingly disintermediated. Since the 2008 financial crisis, global banks have been forced to reduce their cross-border positions, reversing their large expansion in the 2000-2008 period. This trend has been reinforced in recent years both for Sovereign and corporate issuers. Capital markets today are the primary source of external funding for emerging market ('EM') sovereigns, although there are significant degrees of access/investor following for different sovereigns driven by regional, economic and other factors. The bank loan market for sovereign financings is limited and capital markets are usually favored when the sovereign has access to it.

Corporate EM borrowers continue to rely heavily on bank lending, however, both in foreign and local currencies. While there could be other factors for this, such as reliance on relationship banking, smaller deal sizes and lack of publicly rated issuers, their access to capital markets is nonetheless more limited, with constraining high yield covenants for a majority of EM issuers rated below the Investment-grade category. Corporates' yield curves are closely linked to that of the corresponding Sovereign.

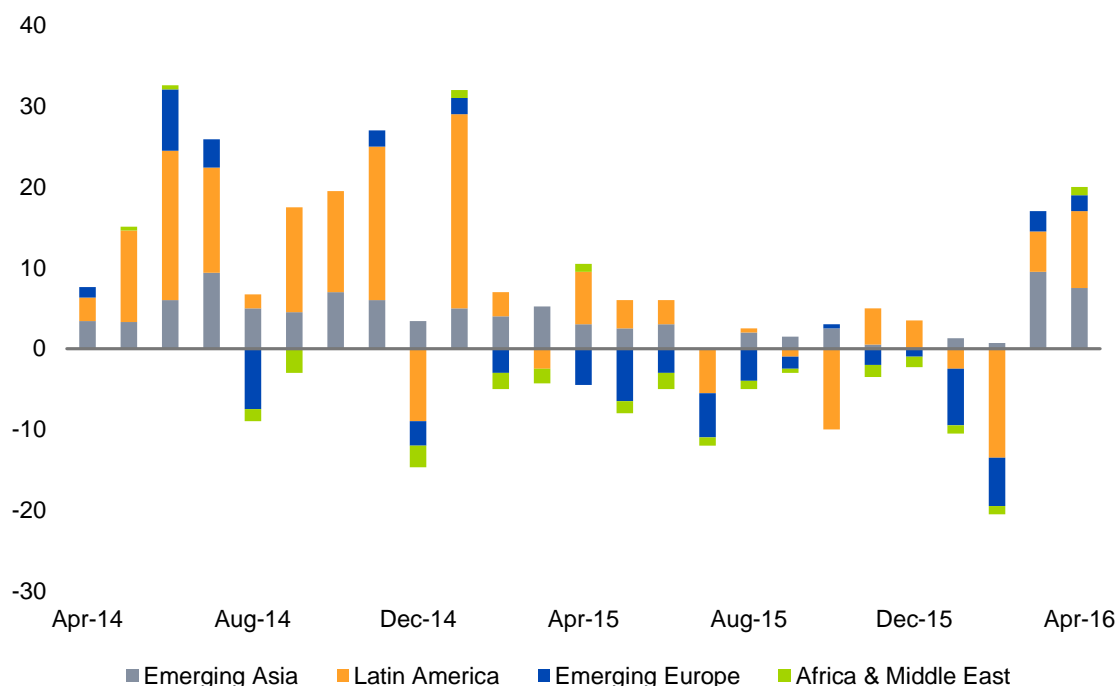
Cyclicality of EM access to capital markets and concept of market windows

In capital markets, there is a clear distinction between investment-grade and sub-investment-grade issuers. Market makers for sub-investment-grade sovereigns consist of highly selective and specialized investors focusing exclusively on Emerging Market credits. Unlike Investment-grade Sovereigns, EM entities (most of which are rated sub-investment-grade) are only able to issue during specific periods which are limited in time because of volatility, and with a limited amount of available funding. These periods are referred to as market windows.

Due to significant volatility in portfolio inflows or outflows, such countries risk being unable to access debt capital markets at certain times. Secondary market yields skyrocket when capital outflows are significant, in part due to the limited liquidity of EM sovereign bonds. For example, over the second half of 2015, significant capital outflows prevented most EM issuers from accessing markets. EM Sovereigns are therefore much more impacted by external shocks and may not have control over the timing of their issuances.

⁴ Emerging markets should meet one of the following two criteria: (i) Low-lower-middle, or upper-middle income economy as defined by WB (WB's main classification criterion \Rightarrow GNI per capita) or (ii) Low investable market capitalization relative to most recent GDP figures. In contrast, developed markets should meet both of the following conditions: (i) GNI per capita exceeds the WB's upper middle income threshold for at least three consecutive years and (ii) Investable market capitalization to GDP in the top 25 percent of the emerging market universe for three consecutive years

Chart 2. Portfolio debt flows (USD bn)



Historically, investors were primarily interested in external debt of sovereign and quasi-sovereign issuers to reduce exchange rate risks for themselves. With the maturing of economies, appetite for local currency domestic debt increased..

Issuances of bonds by quasi-Sovereigns/SOEs to support the funding of specific projects are included in the EM space; these instruments are used for refinancings or to finance existing and new infrastructure – to that extent being significantly different from project bonds. The pool of investors interested in SOE debt is partly the same as for Sovereign, although some infrastructure investors may also be interested.

The number of corporate issuances increases after the creation of a yield curve by the Sovereign. Corporates are able to benefit from the yield curve created by the Sovereign as a basis for their own and reduce financing costs by accessing a larger pool of investors.

Chart 3. Table of selected issuances as of June 13th 2016

Issuer (S&P/Moody's/Fitch)	Date of issuance	Maturity	Amount issued (m)	Issue Price	Yield at issuance in %	Yield as of June 2016 (mid-YTM) in %
Africa						
Ghana (B-/B3/B)	Oct-15	Oct-30	\$1 000	100,0	10,8	10,4
	Sep-14	Jan-26	\$1 000	99,2	8,1	10,7
	Aug-13	Aug-23	\$1 000	99,2	7,9	10,8
Côte d'Ivoire (NR/Ba3/B+)	Mar-15	Mar-28	\$1 000	98,0	6,4	6,9
	Jul-14	Jul-24	\$750	98,1	5,4	6,4
Zambia (B/B3/B)	Jul-15	Jul-27	\$1 250	97,3	9,0	11,4
	Apr-14	Apr-24	\$1 000	99,2	8,5	11,4
	Sep-12	Sep-22	\$750	98,1	5,4	10,4
Latin America						
Venezuela (CCC/Caa3/CCC)	Oct-11	Oct-26	\$3 000	95,0	11,8	29,4
	Aug-11	Aug-31	\$4 200	100,0	12,0	28,4
	Aug-10	Aug-22	\$3 000	100,0	12,8	32,9
	Oct-09	Oct-19	\$2 496	140,0	7,8	42,9
Europe						
Serbia (BB-/B1/BB-)	Dec-13	Dec-18	\$1 000	98,9	5,9	3,0
	Feb-13	Feb-20	\$1 500	98,4	4,9	3,9
	Nov-12	Nov-17	\$750	99,1	5,3	2,4
Croatia (BB/Ba2/BB)	Nov-13	Jan-24	\$1 750	98,5	6,0	4,6
	Apr-13	Apr-23	\$1 500	99,1	5,5	4,4
	Apr-12	Apr-17	\$1 500	99,5	6,3	2,0

Source Bloomberg, S&P, Moody's, Fitch

3.2 Types of emerging markets investors

Improved economic indicators in EM economies and low yields in advanced economies have attracted a wider range of investors to emerging financial markets during the last decade. This phenomenon has contributed to the increasing importance of EM debt for investors and the creation of specialized investment vehicles to facilitate investment in EM debt markets.

Overview of EM investors

As previously mentioned, Emerging Market investors are influenced by the opinion of ca. 40 market leaders which have the largest impact on secondary market trading levels. Typical buyers of EM public and private bonds can be divided into two main categories of investors:

- i) real money accounts⁵, including asset managers, fund managers, institutional investors and infrastructure investors, and
- ii) hedge funds⁶.

The total funding pool for EM bonds stands at ca. USD1 trillion under management, which represents the largest pool of capital available for emerging markets risk.⁷ Despite recent stagnation, the share of global funds and hedge funds investing in EM products has increased over the last decade.

Specific investment requirements

There is a broad range of investors in EM debt as described above, and based on their specific investment objectives, they would be able to/interested in buying a particular security depending on its yield, rating, geography and type of issuer. Overall, EM investors usually require instruments to be listed and rated, in particular to increase liquidity and disclosure requirements.

Specific investors such as hedge funds are usually looking for high yielding issuances and are therefore willing to trade part of their requirements to gain higher return. For example, some may be interested in private placements, despite lower liquidity, to gain higher yield.

Managing EM investment funds and reaching a stable investor base

Within real money, there are several types of mutual funds⁸, each of them inducing specific investment behavior and strategies. Broadening the investor base for a Sovereign issuer is crucial to benefit from a wide demand on issuances. However, not all investors are similar in their investment profile. Buy and hold investors can be supportive in difficult times for the issuer. Short-term investors can buy significant portions of debt, but will not remain in the credit in difficult times.

In recent years, Exchange Traded Funds (ETF) launched by fund managers to satisfy retail investor demand for EM risk have increased significantly. These securities track the evolution of a specific metric and replicate its behavior. For specific EM trackers, tracking indexes is a standard practice. As a result, fund managers have little ability to decide on their allocation of funds outside the index in question. Specifically, when instruments are removed from indexes, or should the rating go to the sub-Investment-grade area, depending on the ETF's mandate, automatic divestment can be triggered. This can spread uncertainty and volatility among the investor base in EM credits.

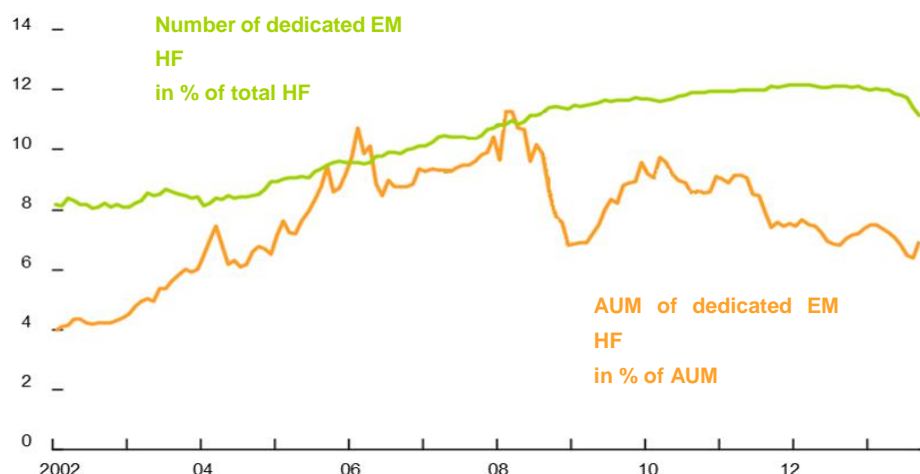
⁵ A "Real Money Account" is an account managed by a money manager that has funds to buy securities at their full value. Real money does not borrow or leverage to buy the securities but has the actual cash required to buy the securities.

⁶ Hedge funds are alternative investments using pooled funds that may use a number of different strategies in order to earn active return for their investors. Hedge funds may be aggressively managed or make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark).

⁷ IMF, April 2015, <https://www.imf.org/External/Pubs/FT/GFSR/2015/01/pdf/c3.pdf>

⁸ A mutual fund is an investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets

Chart 4. Dedicated EM Hedge Funds (in %)



Source IMF April 2014, *How do changes in the investor base and financial deepening affect EM economies?*

Given the automaticity of investments of ETFs and the amount they represent in the total Emerging Market debt pool, managing the non-ETF investor base is crucial to avoid fleeing of investors during difficult times. Ensuring communications with them, especially real money investors, should create a trusting relationship.

It is recommended that EM issuers adopt a differentiated approach to have a diversified investor base. Institutional investors and asset managers with a long-term perspective on the country should become trusted partners. Infrastructure investors should be approached with long-term plans. Hedge funds, on the other hand, should be considered for initial issuances, during the building of a yield curve for the country.

Widening the investor base to stabilize secondary market performance and improve access to markets

Through the broadening of the investor base, issuers are able to build a strong relationship with key investors who know the credit and will support its growth over the long run. Such knowledge reduces volatility of the secondary market curve, since these investors will then have the confidence to take long-only positions.

Furthermore, this could facilitate return to capital markets with a wider pool of potential buyers, irrespective of negative short-term news. With a sustained access to markets, a sovereign can build a more precise and comprehensive yield curve over time, reducing its financing costs in the process.

Identified means of expanding an investor base include specific non-deal roadshows, informal discussions with key accounts, ongoing discussion with existing investors and at the time of transactions, a roadshow targeted to a wide range of investors (different locations, investment styles, and so forth).

3.3 Emerging Markets facing ever-increasing financing needs

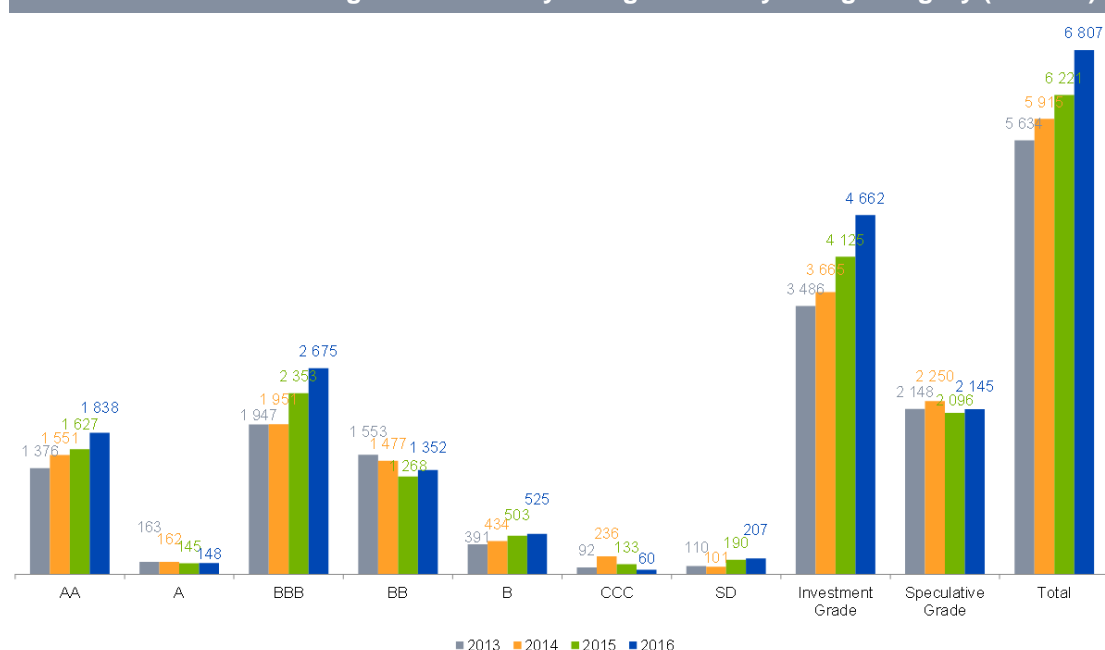
Emerging markets are currently facing unprecedented financing needs to sustain global development. There is a clear call for further financing for Sovereigns, State Owned Entities as well as for infrastructure projects. Sustained growth in emerging markets and developing economies requires long-term, reliable capital to finance productive investment. Such growth of

financing requirements make alternative funding sources necessary, ranging from capital markets to project financing, microcredit and specific financing instruments – project bonds, green bonds, etc.

Key figures regarding EM financing needs and upcoming financing challenges

In 2016, Emerging Market Sovereigns are expected to borrow an equivalent of USD1.2 trillion from long-term commercial sources – of which 51.4% is to refinance maturing long-term debt⁹. The total debt stock is therefore expected to reach USD6.8 trillion by 2016 a 9.4% year-on-year increase. This represents over USD500bn of additional funding needs for Sovereigns for 2016 alone. Furthermore, global needs for infrastructure funding in the next 15 years are estimated at USD57 trillion¹⁰.

Chart 5. Total EM Sovereign debt stock by foreign currency rating category (USD bn)



Source S&P - *Emerging Markets Sovereign Debt Report 2016*

After a period of growth in EM issuances, volumes started plateauing in 2014 / 2015. As a consequence of subdued growth expectations due to falling prices of commodities and in combination with increasing interest rates in the US, the Eurobond market for EM countries was hit by net outflows of EM capital and an increase in yields. Due to these fragile market conditions, the availability of long-term financing became more constrained, which has had a particularly negative impact on developing economies lacking reliable access to international bond markets. Low-rated Sovereigns are now facing challenging market access conditions. Therefore, there is a growing need to enhance market access as well as diversify sources of funding, in particular by requesting Multilateral Development Banks support ('MDBs').

At the same time, fiscal space has been eroded by the global financial crisis and the direct lending capacity of MDBs remains constrained while regulation and capital requirements on commercial and investment banks' balance sheets have been increasingly limiting available resources. This heightens the importance of the official sector's catalytic role in mobilizing long-term financing from the private sector by drawing on its ability to reduce and share risk.

⁹ Standard & Poor's, *Emerging Markets Sovereign Debt Report 2016: Borrowing Is Pointing Up This Year*, Feb 2016

¹⁰ McKinsey Global Institute

3.4 Multilateral Development Banks providing innovative financings to expand their balance-sheets

International Financial Institutions¹¹ ('IFIs'), and MDBs within IFIs, have been adopting innovative ways to expand the use of their balance sheets to match the increasing financing needs and to facilitate market access of borrowers within their available lending capacity. They are also committed to financing the United Nations' Sustainable Development Goals ('SDG's'), which demand ambition in using the "billions" of dollars in current flows of Official Development Assistance ('ODA') and all available resources to attract, leverage and mobilize "trillions" in investments of all kinds – public and private, national and global. In this context, leveraging and crowding-in private sector financing has been a key theme for the IFIs and MDBs. Specifically, we understand that the WB is keen on remaining at the forefront of innovative financing products. Structuring partial guarantees to support Sovereign, sub-Sovereign and SOE transactions with innovative features may allow the WB to pursue new routes to support development.

MDBs expand their balance-sheets

MDBs have been looking for innovative means to leverage their balance sheet in order to finance development programs together with policy advice and technical support in the field. Among these instruments are special grants and loans, guarantees, risk-sharing vehicles, equity investments or policy-based aid programs.

The WB Group's "margins for maneuver" initiative is leveraging IBRD's balance sheet and IDA is discussing ways to leverage its capital for non-concessional loans. IFC is also expanding its Asset Management Company and syndications platforms to mobilize more third party capital. In addition, the WBG is hosting the Global Infrastructure Facility, which will support greater collaboration in preparing and structuring complex infrastructure projects to attract long-term financing from private investors.

In Asia, the Asian Development Bank ('ADB') combined its balance sheet with the Asian Development Fund, which boosted ADB's total annual lending and grant approvals to as high as USD20 billion, 50% higher than the previous level.

In Europe, the European Investment Bank ('EIB') blended concessional and non-concessional resources into risk-sharing projects, and thus reached an acceptable level of creditworthiness for private investors. EIB project bonds have been designed to address large EU infrastructure financing needs in the aftermath of the financial crisis. Project bond issues had become more difficult to achieve since 2007 / 2008 as monoline insurers which used to guarantee project bonds ("monoline wraps") have been far less active. The EIB and the European Commission have sought to fill this credit enhancement funding gap through the "Project Bond Initiative". The EIB provides credit enhancement to increase the credit rating of eligible projects and thus attract institutional investors back into project bonds. This credit enhancement is structured around a subordinated instrument (both funded and unfunded) subscribed by the EIB to support senior project bonds and enhance their recovery prospects.

MDBs mobilize commercial financing

MDBs need to optimize the use of their balance sheets to address development financing challenges. This can be obtained by (i) further leveraging their balance sheet, (ii) attracting private funding at the country / project level (iii) judicious use of concessional financing – such as new areas or high-risk environments to create a demonstration effect and build track-record to allow crowding-in private investments or (iv) mitigating risk of existing exposure (via syndication, reinsurance etc.) to increase room for new instruments. The former would include capitalization and rating implications which are not discussed in this report. The latter can be obtained by reducing the risk of the underlying credit, both quantitatively and qualitatively. Providing partial

¹¹ International financial institutions (IFIs) are institutions that provide financial support (via grants and loans) for economic and social development activities in developing countries

guarantees to mobilize private capital constitutes an efficient means of increasing the quantum of available financing for MDBs' clients while reducing their cost of financing.

Overall, for every dollar invested by MDBs' shareholders, new initiatives are able to commit 2 to 5 dollars in further financing every year through the leveraging of MDB balance sheets while retaining AAA ratings. If USD1 in MDB financing leverages 4 to USD10 in additional financing, additional private investments can continue to increase, as indicated, by a fourfold increase in private sector investments in the last 15 years.¹²

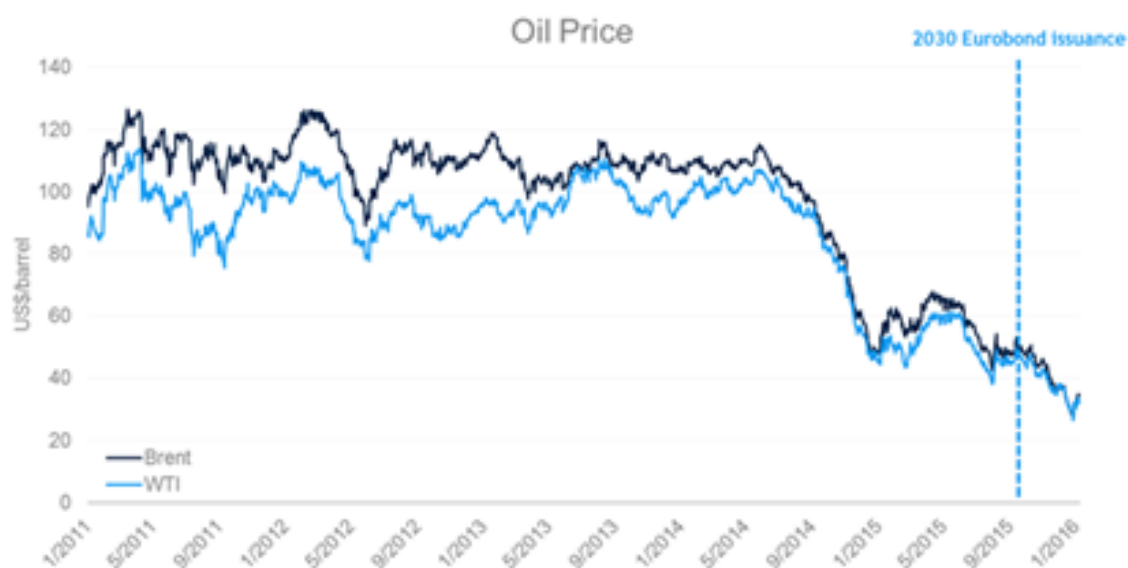
¹² "From Billions to Trillions : MDB Contributions to Financing for Development", Jul 2015, WB

4. Evaluation of the Ghana 2030 transaction issued in October 2015

4.1 Context on the Ghana credit at the time of issuance

In October 2015, Ghana issued a USD 1 billion 144A/Reg S registered international bond due 2030 ("Ghana 2030 bond"), which was partially-guaranteed by the International Development Association ('IDA') arm of the WB. Leading up to the issuance, the country was going through significant economic turmoil. Year 2015 was its fourth consecutive year of economic slowdown. The main cause was the end of the super commodity cycle which resulted in falling commodity prices such as oil or gold, and a deep domestic energy crisis.

Chart 6 A. Evolution of Oil Price (in US\$)



Ghana had entered an IMF Extended Credit Facility Program in April 2015. The program had been requested on August 8th 2014 from the IMF in the wake of domestic economic difficulties and entailed a USD918m credit facility. The disbursement of funds was structured around eight reviews over the course of three years.

Nonetheless, market perception of Ghana's creditworthiness and ability to access markets had significantly deteriorated by this time. Investors expressed concerns regarding indebtedness levels and debt sustainability, and questioned the ongoing fiscal adjustments. In particular, it was pointed out that Ghana's credit story was historically reliant on commodities and the increase of energy production.

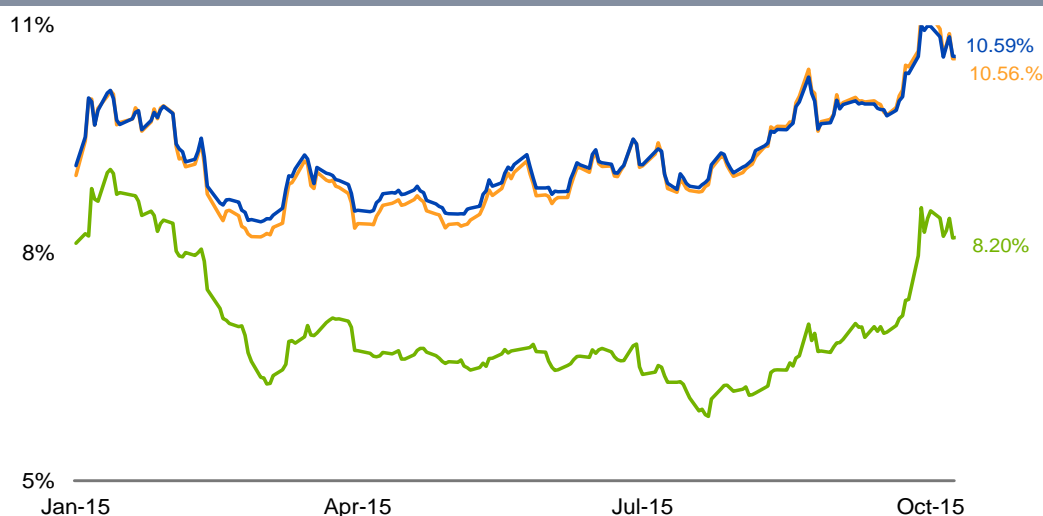
Prior to the issuance, in September 2015, the first review of the IMF program was published. Key conclusions were:

- Performance criteria had been met, except for one requirement;
- Most structural benchmarks were put in place after some delays;
- Further efforts on fiscal adjustments were required in order to meet fiscal consolidation objectives for 2015.

Despite the satisfactory completion of the review, market perception of the credit remained negative, which led to further widening of secondary trading yields for Ghana's Eurobonds. At the

time of issuance, outstanding bonds were trading at 8.2% for Ghana 2017, 10.6% for Ghana 2023 and at 10.8% for Ghana 2026.

Chart 6B. Evolution of Ghana Sovereign bond yields (in %)



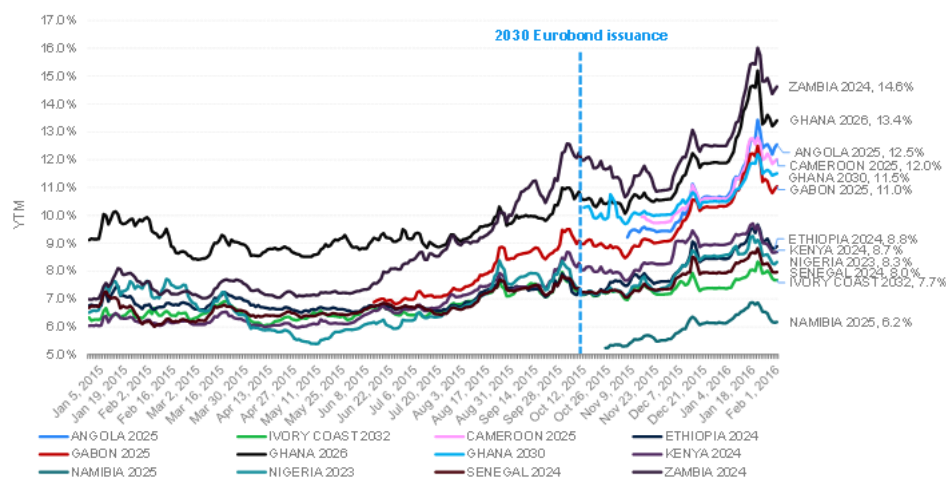
Source Bloomberg

— Ghana 2017 — Ghana 2023 — Ghana 2026

Furthermore, EM Sovereign bond market conditions were particularly unstable at the time. The general macroeconomic context in most emerging economies was bleak. Several key countries were facing substantial domestic imbalances, lower growth and pressure on exchange rates. China's plummeting equity markets and reduced growth contributed to further destabilization in the global markets. At the same time, a long-awaited hike in Fed rates increased uncertainty and volatility. As a result, fewer credits considered issuing, and issuers choosing not to delay their transaction were considered as requiring an immediate inflow of foreign hard currency.

"The pricing benefit was material for Ghana since, at the time, Ghana would have issued at a yield of 13.5 to 14%." An Investor

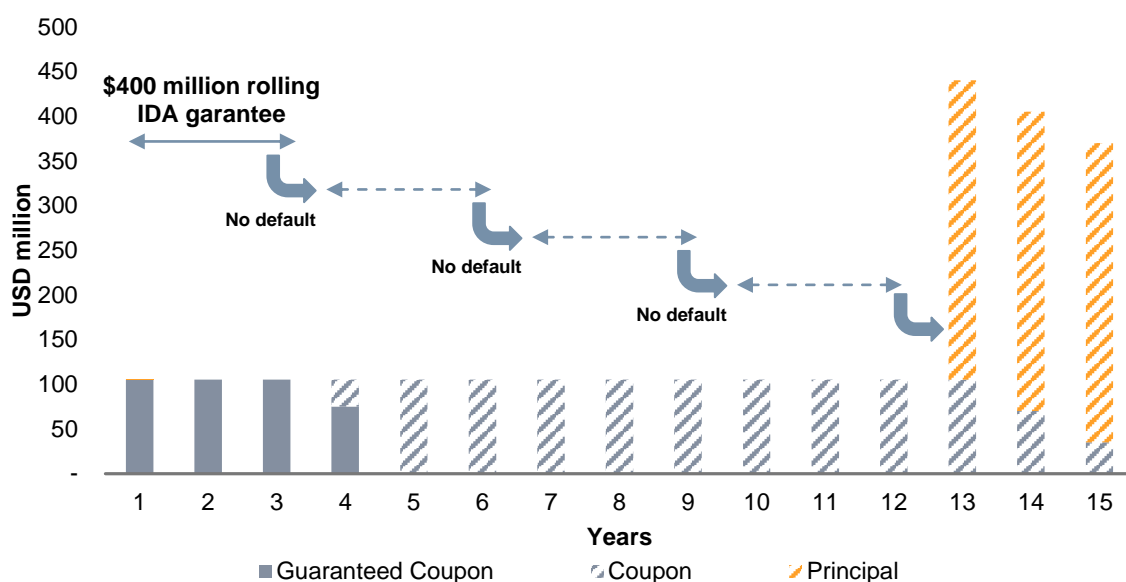
Chart 6 C. Evolution of Ghana and Other EM Sovereign bond yields (in %)



Given this negative market context, Ghana would not have had access to the international bond market on a standalone basis. On the other hand, the refinancing of expensive short-term borrowings was critical to reduce further fiscal impact. Therefore, the Government of Ghana requested IDA to provide a Policy-Based Guarantee ('PBG') as credit enhancement to enable market access in these difficult conditions. Ghana had USD100m of its IDA allocation left at the WB which it had the option of using as a USD400m guarantee. The WB and the Government initiated a macroeconomic reform for the country through a development policy operation "First Macroeconomic Stability for Competitiveness and Growth", which included a USD400m guarantee to enable the raising of up to USD1bn in the international bond markets. The WB's macroeconomic reform program and presence of the WB team during roadshow meetings alongside the government of Ghana underlined the support it had received from the international community and communicated the merits of its homegrown reform program.

4.2 Key features of the Ghana 2030 bond partial guarantee

The guarantee for Ghana was structured as a rolling guarantee for up to USD400m. This entailed that the guarantee could be used to pay for any missed scheduled debt service (coupon or principal) payments should the need for it occur. In the absence of non-payments, the guarantee would roll over to the following scheduled payment dates.



Like all other WB Guarantees, the Government entered into an Indemnity Agreement, whereby the Government would indemnify the WB / IDA in the event the WB makes payments under the Guarantee. Unlike previous transactions partially-guaranteed by the WB at the end of the 1990s / early 2000s, the guarantee is not re-instateable. In other words, after a payment by IDA, should the government pay IDA back through the Indemnity Agreement, the available amount for future guaranteed payments would still be reduced by the used amount.

Should the government default on the Eurobond, even if investors decided to accelerate the security to demand payment of the full principal, the guarantee itself cannot be accelerated and would pay out, up to the guaranteed amount, as per the original payment schedule as long as the Ghana 2030 bond is outstanding. Any changes to the terms, such as for restructuring of the bond, would be subject to WB consent.

4.3 Strategic transaction for Ghana which yielded significant benefits

The USD 1billion proceeds from the Ghana 2030 bond enabled to refinance short-term domestic debt (90 days to 2 years) coming up for refinancing bearing a nominal interest rate of 25%, at a time when there was no international market access.

The long-term nature of the bond smoothed out the debt maturity profile without increasing the total debt stock. It also contributed to reducing interest payments, in an environment of high domestic rates prevailing at the time, resulting in interest savings.

The country was able to extend its funding curve on international markets and further diversify its pool of investors.

“The partial guarantee allowed to have market access at a time when there was none and facilitated a reduction in cost. Furthermore, it allowed reaching a \$1bn deal while most people assumed only \$500m could be raised on the markets.” An Investor

The transaction milestones included the following:

- i. First PBG bond issuance in the market in 14 years;
- ii. Longest Eurobond tenor of 15 years first achieved by a Sub-Saharan African Sovereign (except South Africa);
- iii. Reducing yields by 150-200bps compared to a theoretical uncovered 15-year Eurobond (based on theoretical comparison);
- iv. 100% oversubscribed order book with a diversified investor base compared to standalone bonds.

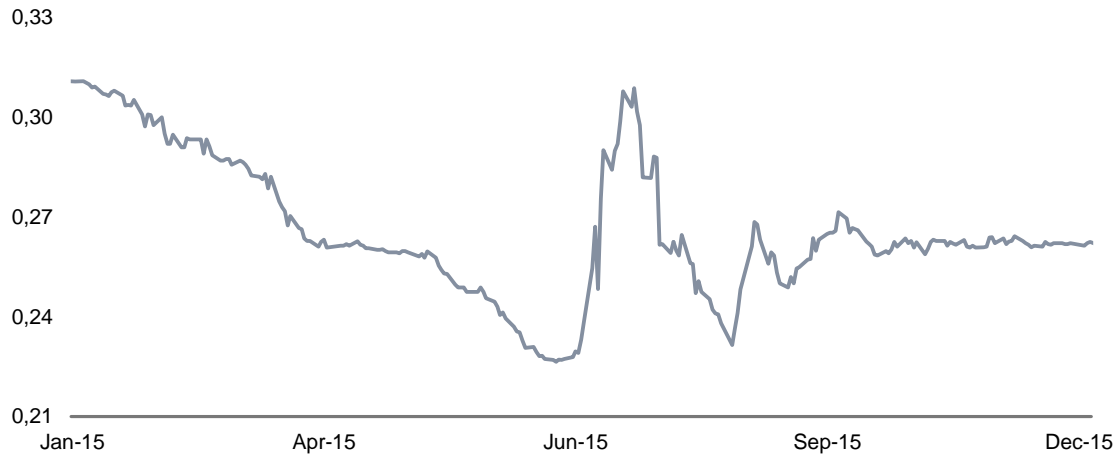
Furthermore, c. 15% of final order book went to new investors that helped expand the investor base.

Cedi has also experienced considerable stability since the Ghana 2030 issuance (see Chart 7).

“The choice for Ghana in terms of available financing unfortunately has been limited, and was limited at that time. The access to the sovereign bond market was always part of the financing plan. The timing may not have been the best to optimize interest expense given the global market developments, but it was certainly consistent with the debt management strategy that had been designed under the program. At the time, of course, domestic debt was considerably more expensive for Ghana. So we are confident with the pursuit of the fiscal adjustment effort in the course of this year and beyond that Ghana will indeed be successful in containing its debt.”

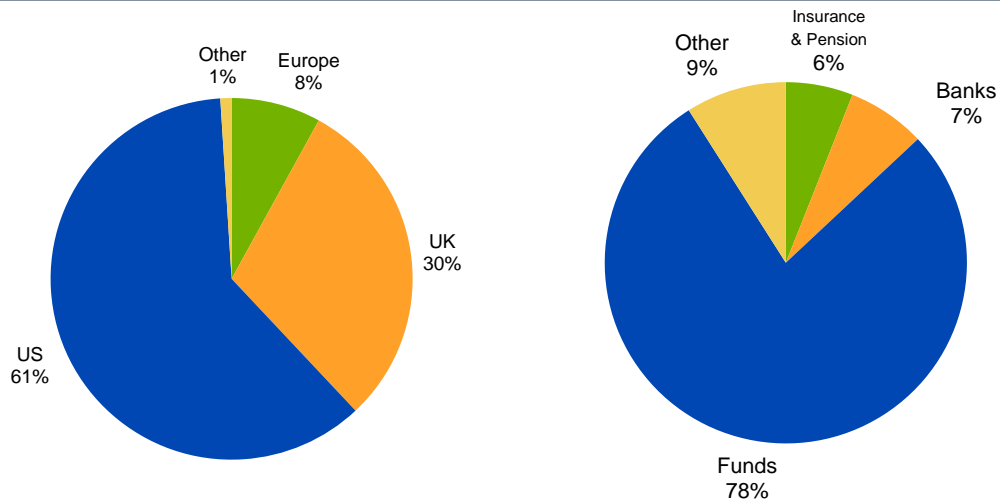
IMF Director of African Department, Madam Antoinette Sayeh

Chart 7. Evolution of Cedi exchange rate vs. USD (in USD per cedi)



Source Bloomberg as of 31/12/2015

Chart 8. Ghana 2030 investors breakdown by geography and type



Source Joint Lead Managers

5. Investment rationale for investors

5.1 Underlying quality of the credit is the key determining investment factor

The deal's success partly comes from the marketing effort. In total, Ghana and the WB team met circa. 55 different investors on the roadshow, including key London and US fund managers. Discussions focused on the country's growth story, its ongoing fiscal consolidation, WB macroeconomic stability program, the involvement of bilateral organizations and the on-track IMF program.

To decide whether to invest in the partially-guaranteed issuance, the majority of investors first assessed Ghana's standalone creditworthiness. They considered it as the key investment driver despite the existence of a partial guarantee. Being convinced by the credit was a necessary condition for investment without being a sufficient one.

The transaction was conditional upon Ghana using proceeds to refinance debt and therefore not increasing the total stock of debt. However, the market remained concerned about total indebtedness which had been rapidly increasing in preceding years. Questions about debt sustainability played a crucial role in potential investors' appetite for the credit.

After reviewing the underlying creditworthiness, investors proceeded to assess the impact of the guarantee. Investors choosing to invest in the issuance underlined the importance of WB support as a necessary credit enhancement to make them comfortable with the offering.

"Governance is a big issue in EM countries which the guarantee addresses." An Investor

5.1.1 Institutional support from the WB critical

The involvement of the WB in preparing the transaction was decisive. In particular, the roadshow was smoother and marked by greater transparency compared to previous issuances. Investors benefited from the WB's independent opinion on the country and were able to rely on a set of prior actions as part of the WB and IMF reform program helping to lay a foundation for positive medium and long-term prospects. Investors perceived the guarantee as a signal of the WB's faith in the credit and economic fundamentals of the country.

"Ghana has significantly improved on the communications front between the roadshows. It is very positive to see support from the WB for these countries and having the WB at roadshows has a significant impact." An Investor

The signaling effect of having senior WB staff alongside the issuer during the roadshow was also critical. The staff helped the government explain the rationale for the WB's involvement and why the WB's approval of a PBG could be seen as a sign of strength. Overall, increased WB staff involvement facilitated the understanding by investors of the partially-guaranteed structure.

5.2 Impact of index exclusion

“Inclusion in indexes is governed by country rules based in part (i) on the country’s WB status and (ii) investment rules allowing replication of the structure to ensure issuances are comparable. Deciding this will require feedback from investors.” JPMorgan Index Team

Investors follow two main indexes in the EM asset class: JPMorgan’s EMBI index and Barclays’ EM Aggregate. These benchmarks are made through independent analysis and are based on strict eligibility rules such as a minimum face value of USD500mn for JPM’s EMBI, as well as secondary market trading liquidity criteria. The Ghana 2030 bond was included in Barclays’ index but not in JPM’s EMBI, which is the most widely followed by fund managers. The rationale was that its partial guarantee structure did not meet the existing index eligibility rules, which explicitly prohibit partially-guaranteed transactions.

“The lack of index inclusion in JPMorgan index could be a major issue, since investors are inclined not to invest outside of index because of transparency of information and the difficulty to track pricing.” An Investor

Index exclusion was highlighted by many investors as a negative factor prior to and after the transaction. Indeed, a significant portion of funds under management can only be invested in bonds included in the EMBI JPMorgan index. The JPMorgan EMBI family covers over USD600bn assets-under-management, of which USD250bn are in the global diversified index¹³. Many portfolio managers are under scrutiny by their clients regarding decisions to invest in bonds outside the relevant indices. The result was a reduced pool of available funds for partially-guaranteed transactions, notwithstanding the quality of the credit.

Exclusion from the index was seen as limiting liquidity and trading on the secondary market. Despite such limitations, the issue still managed to benefit from 100 % oversubscription from a large investor base, indicating the advantage of WB partial guarantees. Contrary to expectations, over the first six months following the transaction, analysis shows that trading was higher than on other Ghana bonds – probably due to the size and timing of the partially-guaranteed issuance. However, some investors expressed concern that the trading could further decrease over time without index inclusion.

Nevertheless, some investors are able to invest in non-index bonds, provided they receive a premium for the perceived lack of liquidity. This premium is a function of issuer credit as well as market conditions. In the case of the Ghana 2030 bond, a 45 bps premium was estimated to have been added to compensate the index non-inclusion. It is expected to be lower in better markets.

“Seeing a significant number of PBG bonds outstanding would create a new asset class and would bring index investors to rethink their position and to participate in further deals” An Investor

Creating a new asset class through a large number of issuances could facilitate index inclusion, as we shall discuss in later chapters of this report.

¹³ JPMorgan EMBI Global Diversified Index significantly represents EM smaller issuers, including Ghana, within government issuers

5.3 Sales process and pricing of the instrument

5.3.1 Challenges in the bond sales process

Considering the innovative structure of the guarantee, Ghana's macroeconomic situation, challenging market environment and a tight timeframe, the sales process required significant effort by the Government and the WB to explain the credit and structure to the JLMs and subsequently to final investors. Investors' knowledge of the poor condition of Ghana's public finances and its need for a large issuance within a short timeframe introduced additional challenges in the issuance process. Investors needed further explanation to understand features regarding the triggers of the guarantee, the implications of various restructuring scenarios and key differences with previous guaranteed structures on the market.

A specific feature of the bond is that any restructuring is subject to the consent of the WB¹⁴. Many investors sought clear guidance from the JLMs and the WB on what exact steps would be taken by the WB in a restructuring scenario. Such guidance was sought to adopt a firm view on the various outcomes, their probability and the resulting expected recovery.

Finally, questions were asked regarding the impact of the WB's potential preferred creditor status on the guaranteed Eurobond, compared to Ghana's standalone bonds. Implications of a cross-default or non-payment on other WB loans had to be clearly explained to the investors.

While many of these challenges were as a result of relatively new structure and challenging market environment, more such issuances could provide opportunities to improve the understanding of investors and potentially gain additional pricing benefits.

"We are receiving a number of calls by investors regretting not having participated in the transaction" JLM

5.3.2 Some potential for improvement in pricing

Prior to the Ghana 2030 bond launch, there was no analysis provided by JLMs to investors regarding the theoretical pricing of the guarantee. Investors had little guidance as to the methodologies to use and had no recent precedents to which they could refer. This may have partly been due to the various marketing directives in place which prohibited the banks from discussing valuation methodologies with the investors.

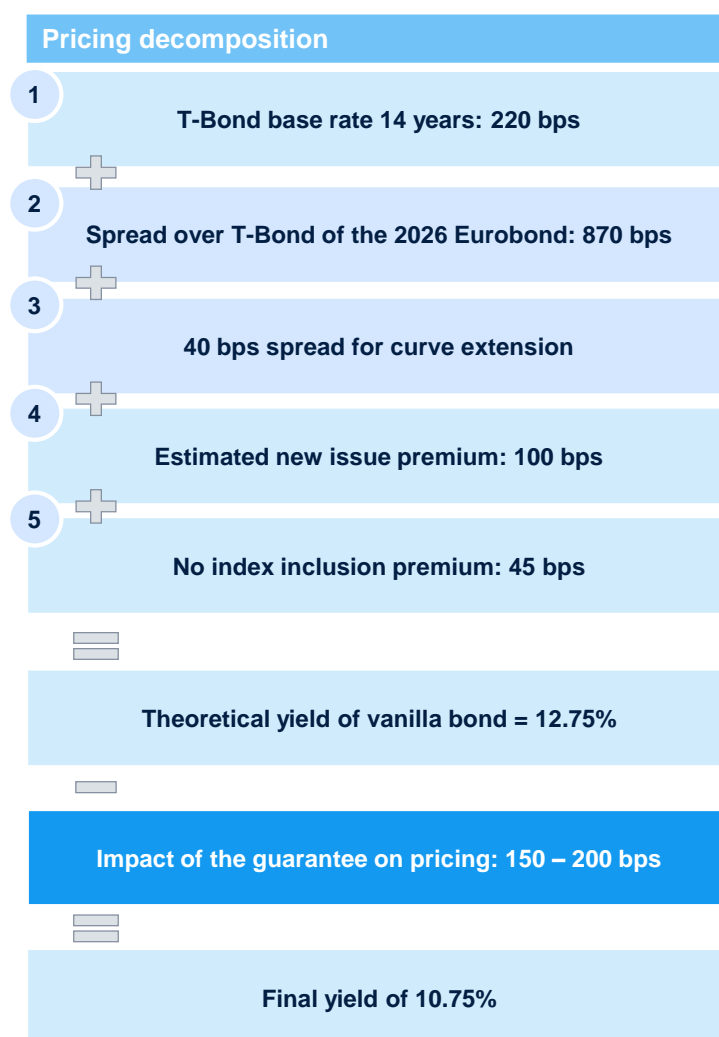
When assessing the price range for the transaction, JLMs benefited from limited pricing feedback from investors. This reduced the ability for JLMs to strategically announce the IPTs¹⁵ range. Due to the difficult market conditions prevailing at the time and the large size of the transaction (USD500 million - USD 1billion) the issuer was looking to print by a certain date, only limited tightening of the IPT was possible.

When analyzing the final pricing based on trading of outstanding Eurobonds at the time, a non-guaranteed similar Ghana transaction was estimated to have required a yield of c. 12.30-12.75%. Such calculations lead to a **150 to 200 basis points** saving thanks to the partial guarantee. This amount is net of the significant new issue and illiquidity premiums, which were due to poor market conditions and lack of index-inclusion respectively.

¹⁴ Ghana 2030 issuance prospectus , page 120: « Any modification of any provision of, or any action in respect of, these Conditions or the Agency Agreement in respect of the Notes may be made or taken if approved by a Single Series Ordinary Resolution, a Single Series Extraordinary Resolution or a Single Series Written Resolution [...] so long as the IDA Guarantee remains in effect and has not otherwise been terminated in accordance with the terms of the Deed of Guarantee, require the prior written consent of the Guarantor. »

¹⁵ Initial Price Talks, giving indications of the price range considered when launching the transaction

Chart 9. Ghana 2030 theoretical pricing decomposition analysis



Source Joint lead managers

The final pricing can be explained by two main factors:

First, in such volatile market conditions, issuers who chose to issue and hence accept significant New Issue Premiums ('NIP') were considered as having few alternative sources of financing. Despite the use of proceeds being earmarked to refinance expensive domestic debt, investors had the perception Ghana needed new money at all costs. Ghana's need and determination to access the markets at the chosen time, when global markets were down, allowed the investors to adopt an aggressive pricing approach, limiting the issuer's negotiating power.

Second, investors' limited understanding of the pricing mechanism did not help. Without formal, agreed methodology to frame discussions, the full theoretical price-benefit range of the guarantee was partly eroded by the high new issue premium and an element of value discounting.

However, the level of oversubscription and post-deal feedback from several investors indicates strong preference for WB guaranteed issuances for the right kind of issuers. Disseminating features of the Ghana 2030 guarantee structure and having more such issuances can improve the understanding of investors and better reflect the value proposition of WB guarantees.

6. Credit rating approach¹⁶

Moody's and Fitch both decided to grant a two-notch uplift to the Ghana 2030 bond versus the issuer's standalone credit rating, rating it B1/BB- vs. B3/B for Ghana sovereign. However, investors active in the EM bond markets also rely on their own rating scale, thus limiting the impact of the rating agencies' final uplift decisions. Overall, close attention was paid to the rating rationale.

Moody's methodology for credit substitution through third-party guarantees relies on several core principles. Firstly, credit documentation should indicate that the guarantee is irrevocable and unconditional. Secondly, the guarantee must ensure full and timely payment of the underlying obligation. Finally, the guarantee must be enforceable against the guarantor under a suitable jurisdiction (typically New York or London), and the term of the guarantee should extend to the length of the underlying risk being mitigated.

Moody's assessment of the credit rating is influenced by debt structure and credit quality of the issuer, credit quality of the guarantor and whether both principal and coupons are guaranteed. However, it is neither influenced by maturity (as long as it is market standard), nor by amortization structure, or acceleration provisions of the Guarantee.

The agency's approach relies upon a blended expected loss ratio. In the case of Ghana, there was a perceived 40% AAA risk and a 60% B3 expected loss. This is adjusted for the 4-year Expected Loss Table for Sovereigns, showing the amount of investment not recovered, estimated in the range of 40 to 45%. The lower the naked rating of the country, the wider is the impact of the guarantee on rating. In this case, the reduction of expected losses by 40% was consistent with two notches of uplift from B3 to B1.

Fitch methodology¹⁶ also granted a two-notch upgrade to the guaranteed bond. Its approach was similar to that of Moody's. Their rating methodology also relied on a blended expected loss ratio, as well as on the historical recovery of Sovereigns. Analysis estimated that on a standalone basis, Ghana's expected recovery would amount to 31-50%. The rating committee thus concluded that the 40% guarantee, leading to a 71-90% recovery bracket, was consistent with two-notch uplift.

When assessing the impact of the WB partial guarantee on the bond's rating, two key metrics were assessed: recovery rate and ability of the guarantee to provide liquidity in a non-payment event. In the case of the Ghana 2030 bond, one notch improvement was obtained for each criterion. The liquidity criterion was improved through the rolling guarantee and with a specific emphasis for B-rated countries. Regarding the liquidity criteria, BB-rated issuers may not be regarded as favorably with regards to liquidity support.

The recovery rate of partially-guaranteed bonds is assessed based on the following table (Chart 11). Based on standard Sovereign recovery rates, the impact of a 40% guarantee is at the high end of one notch on the RR4 factor. The lack of accelerability of the guarantee has a limited impact on the rating enhancement. Overall, keeping broadly unchanged characteristics will allow maximum enhancement under Fitch's methodology. The percentage of guarantee as well as consideration of the rolling feature is assessed on a case by case basis, in particular with regards to the rating of the issuer. Moreover, an amortizing guarantee limited to a fixed percentage of outstanding bond notional, which would not impact Fitch's rating uplift, can be explored as an alternative guarantee structure.

¹⁶ These rating rationales reflect our understanding of rating agencies' approach

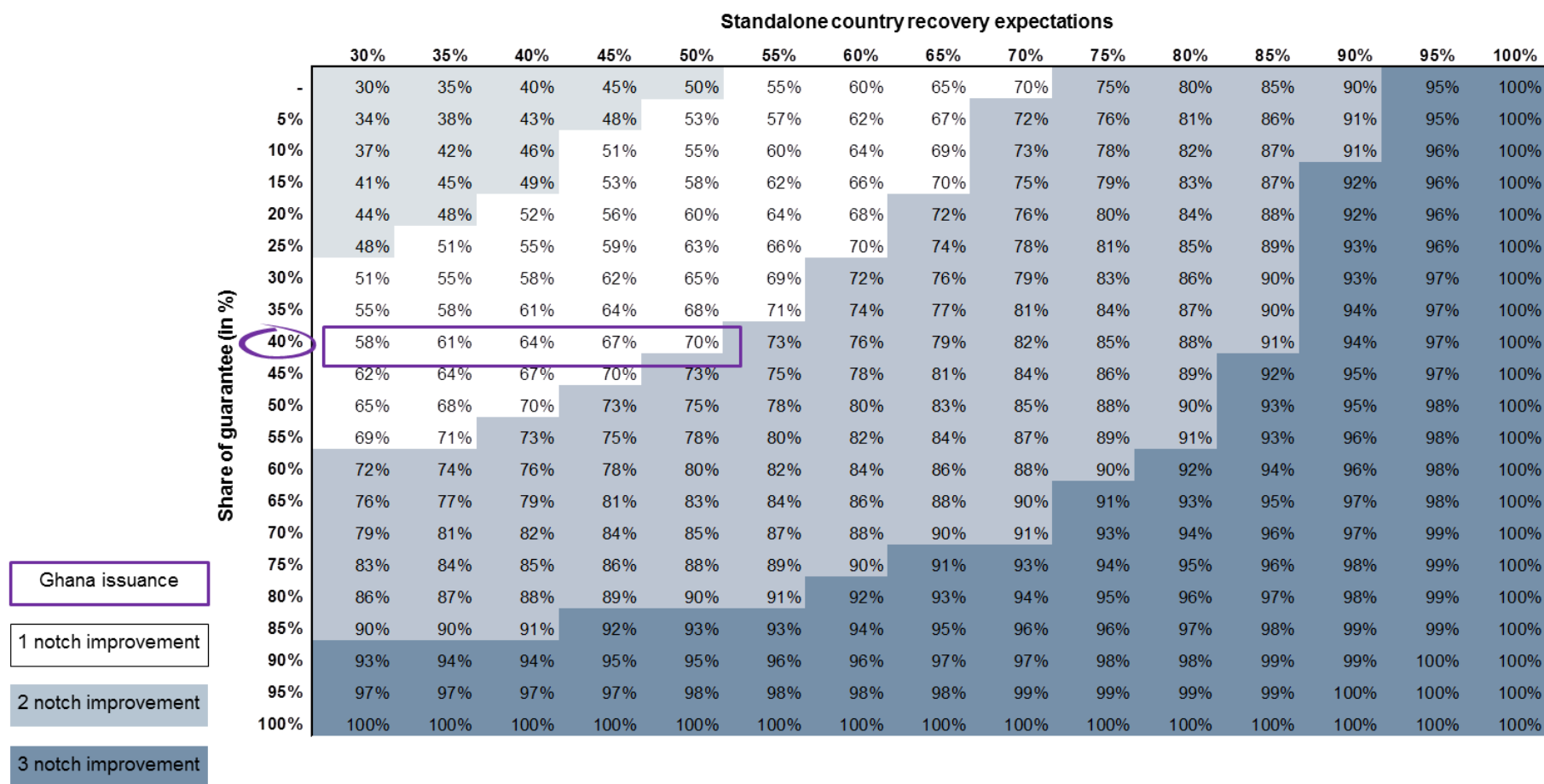
In summary, rating agency methodologies are adaptable to different guarantee structures and amongst other analysis, rely principally on Expected Loss Tables for the final rating. The main rationale for the uplift relies on the irrevocable and unconditional nature of the guarantee. The rolling guarantee feature helped increase expected recovery ratios.

Standard & Poor's ('S&P')¹⁶ did not rate the instrument as its methodology does not grant any rating uplift to partially-guaranteed sovereign instruments following the Ecuador default¹⁷, during which investors holding partially-guaranteed bonds did not receive much more than investors holding non-guaranteed bonds. Indeed, the Sovereign took into account what was received under the guarantee when making its allocation between bondholders.¹⁸ Despite the unconditional and permanent feature of the Ghana partially-guaranteed structure, S&P was not prepared to change its approach to partial guarantees, mainly due to lack of a bankruptcy code for sovereigns, which in their opinion left uncertainty regarding the amount of final recoveries and value of the guarantee. This view is specific to S&P and the other two rating agencies continue to see value in partial credit support for sovereigns and assign such transactions rating uplifts as per their published methodology.

¹⁷ Although the structure of Ecuador's issuance has limited comparability with Ghana's structure, especially due to the existence of a collateral

¹⁸ S&P Methodology (Rating Partially-guaranteed Sovereign Debt, May 2013)

Chart 11. Fitch Expected recovery based on standalone recovery rate and share of guaranteed issuance (in %)



Source Fitch

7. Benefits and additional considerations of the partial guarantee for sovereigns and sub-sovereigns

"We issued our fourth sovereign bond, which was over-subscribed by \$1 billion. The 15-year tenor of the bond is the first by any Sub-Saharan African country besides South Africa. With that, our target is to shift away from short-term debt instruments when financing the capital budget. Instead we will target long-term development projects. This has brought with it the capacity to refinance short-term debts and upcoming sovereign bond debts, as well as the remaining principal of the Eurobond that will mature in 2017." Seth Terkper, Minister of Finance, Ghana

7.1 Benefits of using a partial guarantee

Using a partial guarantee provides several benefits to the borrower. Among them are: enhanced access to debt markets, an improved debt profile, a reduced cost of financing and an increased investor base. Below are the key benefits that were identified throughout the process.

- Demonstrate international support, bridge the knowledge gap: The WB development policy or investment project financing operation in the country, as well as independent views from a reputable institution like the WB infuse confidence around the borrower's ability to perform and reform in difficult times.
- Enhance access to international capital markets: Benefiting from a partial guarantee can facilitate access to complex and volatile markets by reassuring investors. By underlining the WB's involvement with the issuer at different levels of government, endorsing the reform program as well as providing actual credit support, the partial guarantee strengthens the perceived credit quality of the borrower.
- Extend maturities: Benefiting from the support of the implicit AAA WB rating and from its attractive funding curve on long maturities allows the issuer to increase the tenor of its borrowings at an attractive cost.
- Reduce funding costs: The borrower reduces its funding costs due to the blended pricing advantage of the WB guarantee. The cost for the guarantee priced by the WB is sufficiently low to enable an attractive pricing benefit for the borrower.
- Increase the investor base: Through the two-notch improvement of the rating and in certain cases through reduced financing risks, the borrower is able to attract new investors which are not already invested in standalone debt of the credit, especially in the context of an uncertain external environment.

- Tightening of yields for existing instruments: The accompanying reform program can provide a recovery path for the issuer, further improving general prospects on the credit. Such a positive signaling effect, combined with yield savings obtained on the guaranteed instrument, entails a global tightening of the yield curve.
- Increase available funding for private projects: A WB-guaranteed issuance increases credit available for the private sector through reduced domestic government issuance¹⁹. This reduces pressure on funding costs in a challenging external environment.

7.2 Additional considerations in using a partial guarantee

When deciding whether to opt for a partially-guaranteed instrument, a series of considerations can be identified.

- Signaling effect of requiring support by IFIs: Requesting institutions to support the issuer by guaranteeing a debt instrument can be perceived by some market participants as a sign of financial weakness. However, investors also take the comfort that the role of IFIs improve the credibility of the issuance when underpinned by a reform program.
- Opportunity cost of the guarantee when replacing concessional loans: Borrowers face a higher cost of funding when replacing allocated concessional loans by guarantees to be used on privately funded instruments. On the other hand, MDBs such as WB also incentivizes countries to use guarantee instruments, where appropriate, to crowd-in private investments and growth. There is a trade-off to be made between the external benefits and larger quantum of financing obtained through the use of guarantees, and concessional cost of WB loans.
- Risking cannibalization of investor bases between Sovereigns and its SOEs: When using the guarantee for an SOE rated lower than the Sovereign by rating agencies (which is usually the case), benefiting from a rating uplift through a partial guarantee can lead Sovereign investors to shift to SOE issuers to obtain higher yields. If the Sovereign's investor base lacks sufficient depth and the SOE bond is priced wider than the sovereign despite the partial guarantee, there may be a risk of cannibalization.
- Risk of yield curve distortion for Eurobonds: Adding guaranteed issuances to an existing non-guaranteed yield curve can complicate the pricing of future non-guaranteed instruments. Indeed, it is essential for an issuer to develop a non-guaranteed yield curve to support and optimize the pricing of its future instruments. Nevertheless, this risk needs to be weighed against the benefits of the partial guarantee, such as gaining market access, extending tenors and positive messaging. In addition, the partiality of the guarantee coverage does not significantly change the essence of the instrument.

¹⁹ When domestic government debt is replaced by external debt

8. Further considerations on format and approach to marketing

8.1 Opportunity to publicize the Development Policy Operation (DPO)

“Such a structure going forward could be interesting for inaugural issuances, to get the ball rolling for countries to get known by markets; it could also push a credible story of reform for an EM country. The key question on a case-by-case basis is: Will the policy prescriptions change the fundamentals of the country and be mandatory in their implementation?”
An Investor

The WB's presence alongside the issuer during the roadshow was strongly appreciated. Such institutional support strengthens the credit story and gives an independent take on the issuer.

In the marketing of future transactions, there would be a merit in further highlighting the PBG prior actions completed by the issuer and included in the underlying WB Development Policy Operation. All prior action and future indicators are expected to be in the Program Document. Depending on when the marketing starts, the Program Document is expected to already be in the public domain, which will make it easier during the roadshow to be explicit about its content. An even greater focus on objectives, ambition, detailed planning of reforms and follow-up implications of the WB's involvement should be explored.

Indeed, the PBG follows agreement with client Governments on required reforms and supports the Government's own efforts to improve the fundamentals and long-term prospects of its economy. As a whole, the credit's long-term quality is improved. Roadshows are the opportunity to remind investors about the potential transformational impact of the WB's support.

8.2 Application of the partial guarantee in different market environments

The partial guarantee can be optimized on a case-by-case basis depending on several factors such as issuer characteristics, investor type (for example public bond, syndicated loan, private placement or other) and the general debt market conditions. Analysis should thus be undertaken so as to optimize pricing, maturity and guarantee terms, and adapt the product to the relevant market environment.

The impact of the guarantee differs depending on the issuer as well. The cost benefit analysis of a partially-guaranteed bond would be different for different market environments, depending on secondary market trading levels of the issuer's standalone bonds, which would form the basis for pricing the partially-guaranteed issuance.

The analysis below assumes a 15-year partially-guaranteed bond (40%) and an IBRD 15-year yield of 3.0%. It is gross of any new issue, non-index eligibility premium as well as of the guarantee fee (30 - 40bps) which may reduce the net spread saving benefits.

The range of potential savings is driven by the guaranteed cash flows. The closer in time the guaranteed cash flows, the lower the spread savings –leading us to conclude with a range rather than a precise number.

Therefore, the impact of the guarantee differs depending on the market environment and how it prices the sovereign's standalone credit. B-rated countries with higher yields benefit from a significant pricing impact, improved maturity and facilitated market access. With lower uncovered yields, BB-rated countries have an impact framed around the messaging of the WB support.

This can also be interpreted as the partial guarantee performing the role of an insurance policy, yielding greater cost benefits at times when the markets are pricing EM credit more widely than usual.

Chart 12. Theoretical yield range of partially-guaranteed bond (in % depending on the guarantee percentage)

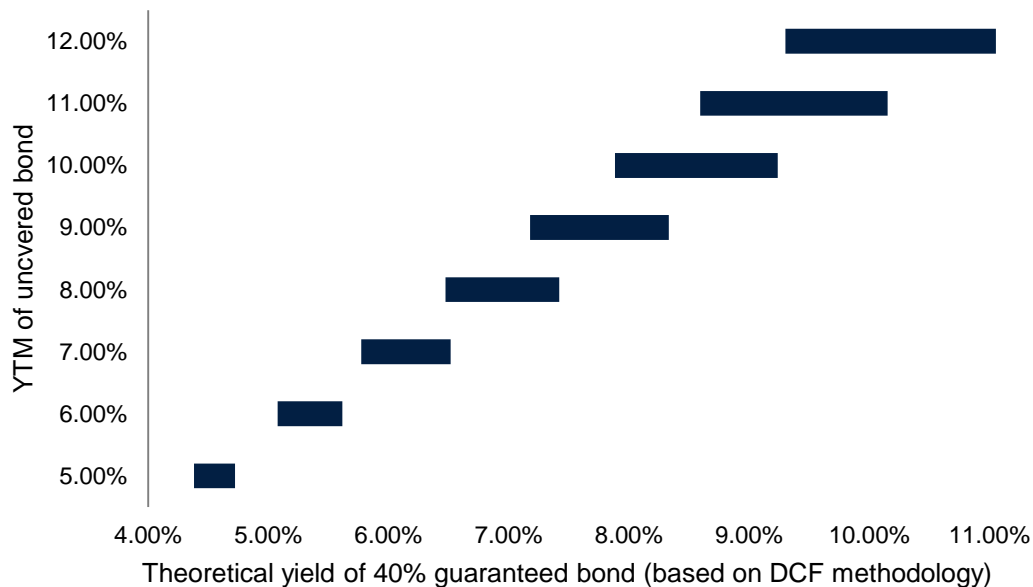
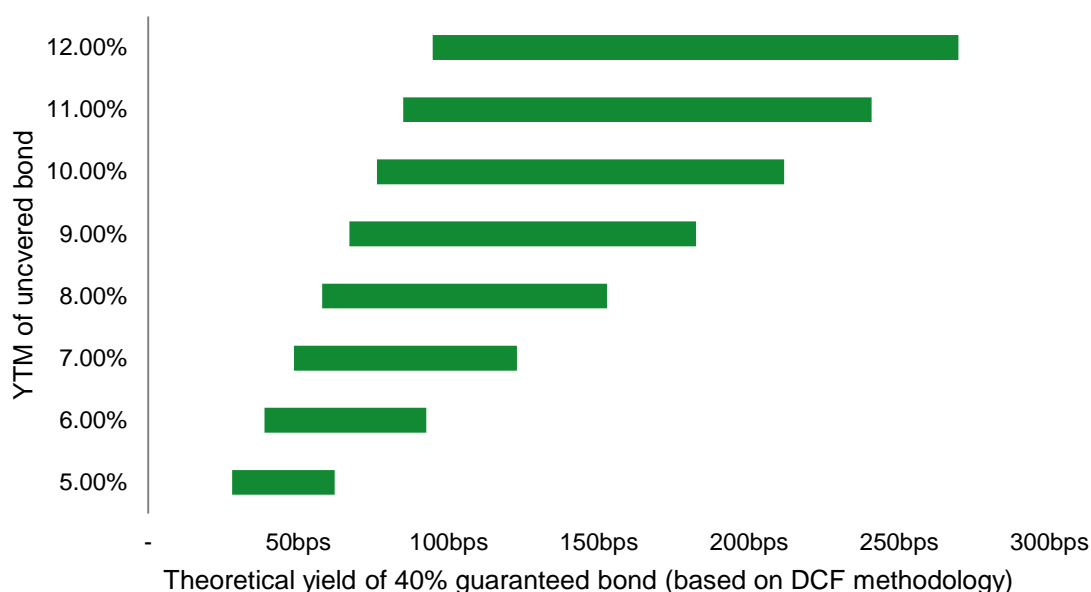


Chart 13. Theoretical gross spread savings vs. uncovered bond (in % depending on the guarantee percentage)



8.3 Limited benefits of alternative formats perceived at this stage of the product's development

8.3.1 Private placements and loan formats

Private placements allow a more flexible and confidential process, as well as raising smaller quanta of debt compared to international public bond issuances. In the Emerging Markets space, private placements are currently not favored by real money investors, essentially due to their lack of liquidity. Private placements into banks have a series of precedents, usually sized up to USD300m. However, increasing regulation has reduced the pool of potential funding and increased costs for issuers.

"When pricing a private placement, borrowers with access to the market will need a 150 bps premium over secondary. The guarantee would be valued separately through a 100bps reduction in spread for loans. The sizing sweet spot is a USD 50 to 100m ticket covering less than 50% of the total issuance." An Investor

Adding a partial guarantee to private placements does not seem to significantly increase traditional asset managers' interest in the structure. Indeed, most have portfolio constraints on private placements, which the partial guarantee does not solve. It shall be noted however that a number of hedge funds showed significant interest in the product, assuming they are able to hold a large enough portion of the issuance. Insurance companies and pension funds could also be good candidates for private placements in high-rated emerging markets, as these investors do not require liquidity, as they are usually buy-and-hold investors.

"We could be interested in engaging up to five other investors to structure a private placement for a 7-year amortizing structure". An Investor

A syndicated loan market exists for projects and corporates meeting certain general criteria but not for sovereign financing. Creating additional capital market PBG instruments could help the development of syndicated loans for EM sovereigns in the future.

Loan formats, whether syndicated or private, provide flexibility in the structure conception and privacy as to final terms for the borrower. Compared to bond formats, loans can accommodate smaller amounts of funding, shorter maturities and certainty on pricing. However, there are few institutional investors, apart from infrastructure funds, some commercial banks and some insurance companies, that have the appetite of investing in partially-guaranteed loans, which limits the depth of the investor base.

The buyers of PBG-backed sovereign loans at banks would be niche EM or structured finance proprietary trading desks of investment banks which would enter into bilateral negotiations with an issuer and underwrite tailor-made loans. PBG issuance in the loan format to date has been placed into investment banks, primarily into their structured credit trading desks with high levels of guarantee support in the 60-80% range with 5 to 7 years average tenors, reflecting cash flow cover in excess of 45%. As bank balance sheets are becoming more expensive due to regulation, these desks are also seeing their limits reduced or for some exiting the market.

It is also important to note that the privacy component of loans can result in opacity in the subsequent tranching or repackaging of the partially-guaranteed loan. Such repackaging can be the split into a “Guarantor” highly-rated tranche and an uncovered tranche by the intermediary bank. The former can be sold to an international institutional investor, while the latter can be sold to, for example, local banks. Such repackaged loan structures carry two main disadvantages: (i) they only value the quantitative aspects of the partial guarantee, i.e. the pricing benefit of a AAA guarantor, and not the qualitative aspects of the underlying program and support provided by the WB, and (ii) they create significant leeway for intermediaries to structure undisclosed remuneration in connection with the repackaging, to the detriment of the borrower.

Taking each of the preceding considerations into account, we recommend the bilateral loan format benefiting from high guarantee percentages should be addressed with caution at this stage.

9. Recommendations for future issuances

9.1 Considerations on potential structure adaptations to build a robust investor base

9.1.1 *Keeping a broadly stable legal structure to ensure continuity and facilitate the emergence of an asset class*

The structure adopted for the Ghana 2030 issuance could potentially be modified for further issuances in the future, both for Sovereigns and SOEs. However, we believe that adopting a broadly similar structure and adjusting the percentage of rolling guarantee features constitutes the best option, based on extensive market feedback. We also appreciate there may be an occasional need for customization to optimize execution (for example to achieve requisite rating uplift).

- **Investors:** It is important for investors to be able to compare new issuances with past issuances, with regards to terms and conditions as well as pricing. A stable and well-known structure can help build a robust investor-base and a new asset class.
- **Rating agencies:** A 40% partial-guarantee is usually close to the lower boundary required to obtain two-notch uplift. Rating agencies further underlined that shifting the percentage for a B-rated issuer upwards by a few percentage points would not significantly impact the rating uplift.
- **Index providers:** Potential index inclusion can be envisaged in the future on the basis of (i) similar structures creating an identifiable asset class and (ii) a guarantee level which does not change the essence of the instrument. Indeed, there is little difference between the secondary market direction of standard non-guaranteed bonds and the Ghana 2030 bond since the guarantee only covers 17% of cash flows (40% of notional).

Therefore, adopting a similar structure seems an optimal take, as a general principle for upcoming issuances.

“The simpler the structure, the better. It's already not easy to make an investment decision; we do not need additional complexity. We see no issue with the current structure. Moreover, the more you issue, the better the pricing, since people need to get used to the structure.”
An Investor

9.1.2 *Optimizing guarantee percentage*

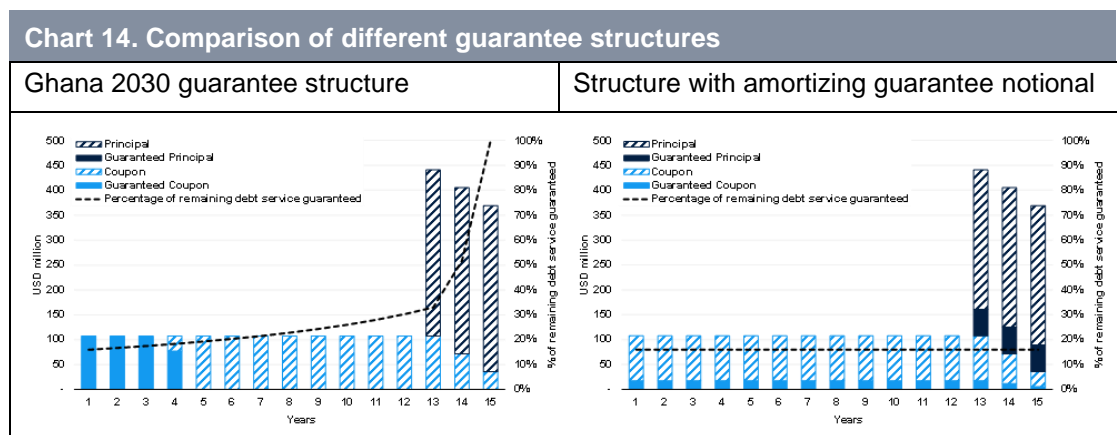
While maintaining the existing structure seems to be the optimal way to accustom investors to the instrument, changing the percentage of guarantee depending on the issuer and the tenor can be considered.

A 40% standard level of partial guarantee could be favored especially for public bond instruments, in order to benefit from the optimal rating uplift (for B-rated issuer) and the replicability of the structure. However, a case-by-case analysis could determine alternate structures for higher-rated issuers and SOEs, which would best suit the borrower and the investors. A set number of parameters should be kept flexible in order to adapt to issuers' characteristics and to address

investors' risk appetite on the specific credit. For example, specific infrastructure funds or insurance companies could require a minimum rating for an instrument, which can be obtained by selectively increasing the level of the guarantee support.

The level of guarantee should be adapted to the rating level of the country. The lower rated the country, the most impactful the guarantee.

Exploring an amortizing guarantee by fixing the guarantee amount as a percentage of outstanding notional (as opposed to original notional as in the case of Ghana 2030 bond) can be considered to reduce the costs of the guarantee for issuers.



9.1.3 Guarantee type

Various features of the structuring of the guarantee have significant impact on its pricing. In particular, the rolling coupon feature slightly increased the total guarantee fee payable by the issuer by c. 14% (3.5 bps per annum) in the case of the Ghana PBG. This entails, however, a much larger pricing benefit. Indeed, the increase in pricing benefit thanks to the rolling feature for a country with a 10% 10-year yield stands at over 150 to 200 basis points. For a USD1bn issuance, savings are therefore larger than USD12m per year, which underlines the cost-benefit advantage of this feature. Moreover, for Fitch, the rating upgrade due to this feature is one notch, further underlining the need for such a feature.

9.1.4 Other structuring thoughts

The combination of (i) a standard instrument recognized by markets and benefiting from the institutional support of the WB to address financing needs, and (ii) a series of alternative tailor-made formats to respond to client / investor needs, will enable the WB to address a range of financing needs. This will also maintain flexibility for financial innovation to address specific needs as they may arise.

Specifically, green bonds or alternative structures for SOEs linked to specific projects can be recognized by markets as fulfilling the WB's mission to enhance development and address climate change. These alternative financings would be in line with the WB's objective of introducing innovative financing mechanisms to its development operations.

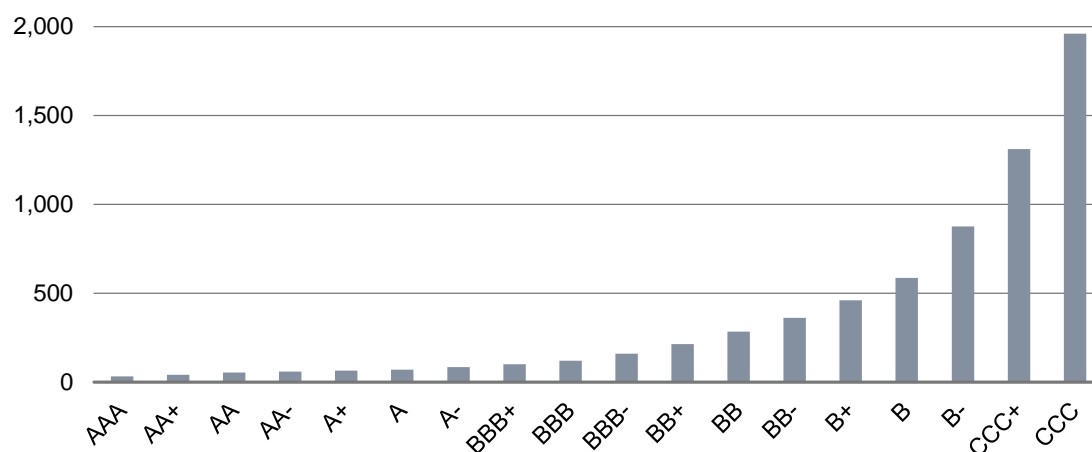
A difference in structuring between IBRD and IDA-supported instruments can also be accommodated to respond to significant differences between countries in the portfolio.

9.2 Choice of issuer

The investors' feedback regarding potential issuers leads to the identification of three main types of relevant issuers (whether sovereigns or SOEs).

- (i) Cross-over credits: Countries within the BB / BB+ area would reach the Investment-grade category with a two-notch upgrade, thus enabling Investment-grade investors to take part in the transaction. Among these investors are insurance companies and other buy-and-hold institutional investors which have the capacity to invest in very long-term tenors at highly attractive rates. This could be particularly relevant for SOEs with long life infrastructure assets. The partial guarantee would therefore act as a strong catalyst for these 'premium' private investors with lending capacity closer to that which IFIs can provide their clients compared to pure EM investors. The pricing benefit of the guarantee would however be more limited in absolute basis points in the case of higher-rated issuers, as illustrated below.
- (ii) Issuers within the B category: Thanks to the 40% guarantee, a two-notch uplift would bring B or B+ credits within the BB-category, which may help these issuers lengthen maturity and support some pricing benefit. As these issuers tend to be highly exposed to the volatility in international capital markets, the partial guarantee could be used to diversify their investor base by either bringing additional bond investors or by selectively accessing loan markets with increasing tenors.
- (iii) Issuers deprived of market access: Sovereigns without significant bond market presence or with negative market perception would be good candidates. Countries with high yield indicating market challenges could benefit as well, to the extent they fulfill WB eligibility requirements and are participating in a WB Development Policy Operation. Adding a guarantee support to their financing would facilitate market access and improve market perception of existing issuances, if any. At the time of the investor meetings, such country names highlighted by investors were: Iraq, Zambia, Nigeria, Ghana, Ecuador, Mongolia, etc.

Chart 15. Credit Default Swaps benchmarks by rating level (in basis points)



Source Standard & Poors as of 29/04/2016

Infrastructure owning SOEs:

SOEs that own critical infrastructure assets seem particularly well-suited to WB partial guarantees. It is important to specify that WB policy-based guarantees (as in Ghana 2030) cannot be applicable to SOEs. However, WB project-based guarantees in the context of Investment Project Financing ('IPF') can be used and are ideally placed for this purpose. WB involvement would provide a layer of oversight as well as credibility for SOEs accessing capital markets for the first time or on the basis of a reform program.

Infrastructure assets being long-term, they require a solid long-term investor base, whereas key investors, such as pension funds or insurance companies, are usually constrained by investment-grade and low-risk portfolios. Reaching investment-grade status thus plays a crucial role in facilitating long-tenor funding at an attractive cost. Partially-guaranteed issuances could therefore be an opportunity for SOEs to finance wide infrastructure programs and bring new investors into the country with significantly beneficial impact on the economy. The key to successful execution would be to identify such institutional investors with appetite for investment-grade risk out of emerging market countries.

Furthermore, by using a partial guarantee structure, the debt undertaken for the SOE project may not be reflected in the government debt ratios apart from any explicit support provided by the government to the SOE. Such a structure could allow refinancing of existing infrastructure assets through debt at the SOE level rather than at the government level.

"Most SOEs are too small to consider since for liquidity purposes, the minimum size needs to be \$500mn. However, if there was a partial-guarantee, we could consider looking at the underlying credit." An Investor

9.3 Address investors' concerns on the impact of a restructuring on the partial-guarantee

"How does guarantee survive a restructuring? The multitude of possible scenarios does not facilitate the precise pricing of the guarantee." An Investor

The Ghana 2030 bond guarantee's main limitation in its current form, as pointed out by a large number of investors, is the range of possible scenarios depending on the trajectory of a theoretical Sovereign default or restructuring.

The IDA guarantee cannot be accelerated. Investors have the right to call on the guarantee and receive payments, as per the original debt service schedule, on each payment date up to the guarantee amount, as long as the partially-guaranteed bond is outstanding. In the Ghana 2030 bond framework, any restructuring would have to be approved by IDA since it would represent an amendment to the bond's terms and conditions. Investors have expressed concern that harsh amendments to the guarantee could be proposed, hence their desire for more clarity. In particular, in the case of pre-emptive restructurings, they fear current instruments may end up being replaced by new bonds, including a diluted guarantee feature. Therefore, it will be crucial to clarify a set of standard scenario with a planned response to various restructuring and default scenarios.

Acceleration of the guarantee could potentially address to a certain extent the concerns voiced by some investors regarding (i) the capacity of the sovereign to penalize guaranteed bondholders in a restructuring scenario, in so far as the guarantee would have paid off prior to the conclusion

of the restructuring and investors left with an uncovered instrument similar to other outstanding bonds, and (ii) the difficulty of pricing the instrument .

WB guarantees provided by IDA cannot be accelerated. There is clear rationale and policy restrictions for IDA-guaranteed instruments not to have an accelerable guarantee – as the WB would not want to add additional financial burden to the borrower to an already distressed situation. Acceleration for IBRD-guaranteed instruments which are by nature more remote from a potential default can only be considered on an exceptional basis..

Given the consent requirements of the WB in the event of a restructuring, as a minimum measure, it would be useful to clarify how the institution would react in standard restructuring scenarios. Indeed, this would reassure a number of investors and contribute to further expansion of the investor base.

In conclusion, further work could be pursued with legal counsels in order to assess what can be added to the guarantee agreement or the prospectus, so as to limit uncertainty.

“Ghana will presumably repay the USD400m guarantee first in case of default as the sovereign has an indemnity agreement with the IDA – even though the IDA is legally ranked pari passu with other senior creditors. “The IDA is the de facto preferred creditor,” said Elisa Parisi-Capone, lead sovereign analyst for Ghana at Moody’s, which is rating the notes B1. “Under the indemnity agreement, Ghana has an obligation to reimburse for any called guarantee.” IFR, October 2nd 2015

9.4 Further explore new routes to expand the volume of deals and educate the investor base

To succeed in building a new asset class, a critical volume of transactions should be reached so as to attract a larger set of investors, obtain index inclusion and optimize the rating treatments of guaranteed instruments. Stable and well-known structures are indeed reassuring in the eyes of investors. Succeeding in standardizing some product structures will be another step towards the expansion of the volume of issuances. The ideal volume target to meet these objectives is estimated at c. USD5bn per annum.

The investor base is expected to increase over time by diversifying and adapting the types of products proposed, not only to Sovereigns but also to SOEs. Partially-guaranteed transactions have the potential of becoming a new asset class. However, such a process does not constitute an immediate evolution and will take time. Ongoing contacts with market-makers should accelerate the process. On top of transactional roadshows and communications organized by issuers, which constitute interesting vectors to address fixed-income investors, direct contact should be kept with investors, banks and rating agencies.

A wide range of issuers can be interested by such issuances, which have the advantage of being highly flexible and tailor made for the issuer on top of bringing a price advantage at issuance. The PBG guarantee can be used both for FX and domestic currency issuances, as well as potentially supporting swap transactions, helping at all stages of the construction of a financing plan. With regards to structure, public or private placements can be considered depending on the issuers’ needs. A variety of eligible issuers can be considered with regards to their geography, their type – both SOEs and governments – and their rating. The development of this product will go through

the construction of a mix of deals to expand the number of transactions and the range of interested investors.

9.4.1 Opportunity to attract institutional investors (insurance companies or select EM funds) to participate as cornerstone anchor investors in future deals

Attracting a solid base of new investors can be facilitated by the identification of a pool of cornerstone anchor investors to support future deals. The idea would be to identify a number of tier-one institutional investors, willing to invest time in a partially-guaranteed transaction, on the back of their understanding and appreciation of the benefits of the structure.

JLMs, together with the WB and the Issuer, could define optimal parameters of a public transaction ahead of launch, limit the execution risk and ensure more certainty of outcome.

For a limited number of investors, a specific process called wall-crossing could be initiated prior to the launch of public transactions. This would enable JLMs to work more closely with select tier-one investors in designing the transaction to fit these investors' needs and form a view on potential pricing range ahead of formal launch. Should the mandate letter signed with bookrunners allow it, securing a minimum size in the final granted allocation could incentivize such investors to participate.

Furthermore, the WB could engage directly with institutional investors to discuss the possibility of creating dedicated funds investing exclusively in partially-guaranteed issuances. There has already been one reverse enquiry related to a dedicated fund. The WB would therefore be in a position to offer to its clients a dedicated tier-one investor base, alongside the above mentioned benefits of the structure.

9.4.2 Education of investor base

Without any issuance of partially-guaranteed bonds of a similar nature to that of Ghana over the past 15 years, investors had limited recent precedent to value the guarantee and were left assessing the best methodology to use.

Upcoming issuances should see their pricing significantly facilitated for investors as a result of the research paper published by the WB in February 2016. The paper *Pricing partially-guaranteed bonds*²⁰, combined with the publication of the underlying financial model, should enable investors to benefit from a consolidated and harmonized view on potential pricing.

In this paper, four different alternative pricing are considered and detailed:

- Nominal weighted average yield: Based on the weights of guaranteed and non-guaranteed cash-flows, calculating an average bended yield
- Rolling nominal weighted average yield: calculating the percentage of the remaining cash flows guaranteed by the WB year by year, averaging the yields obtained and iterating to reach the yield
- Discounted cash flows: Calculating the WB guaranteed NPV as well as the non-guaranteed NPV at their respective discount rates and equalizing their sum to the face value

²⁰ <http://documents.worldbank.org/curated/en/723281467998238063/Main-report>

- Recovery analysis: extracting the implied annual probability of default from the current trading levels, and finding the yield which, adjusted for the probability of default and the payments received from the WB guarantee, is equal to a US Treasury bond with a similar maturity

9.5 Moving towards index eligibility

9.5.1 *Expanding the volume issued with a stable structure*

Focusing the attention of investors on a stable structure can also guide the market towards inclusion of the product in standard indexes. In particular, an inclusion in the JPM's Emerging Markets index would likely make the product more attractive. It would bring many current index-constrained investors to the table.

A short-term objective should therefore be to build a significant volume of issuances in time for the next JPMorgan EMBI index annual meeting. This would incentivize key stakeholders to take this new asset class into greater account and to consider means of including it in indexes.

9.5.2 *Enhancing the number of investors championing index inclusion of the product*

It is critical to continue building momentum with the JPM index team based out of New York. Given the independent nature of the JPM EMBI index, this would be best achieved over time with increasing reverse enquiries from investors in the Ghana 2030 bond and future transactions requesting index inclusion and contacting the JPM index team directly.

9.6 Continue work with rating agencies

Past experience and discussions with Moody's and Fitch Ratings have led to the conclusion that reaching a two-notch uplift is possible with a 40%-guarantee (for a B-rated issuer). The next step is therefore to determine how alternative structures would be rated, especially for SOEs. Indeed, rating methodologies in the corporate space may be different and use more thorough recovery approaches. The support of agencies will be key to facilitate the instrument's deployment in the SOE space.

At the same time, discussions could be pursued with Standard & Poor's to reassure the agency that measures could be put in place to ensure the Sovereign would not use unfairly its discretion to penalize partially-guaranteed instruments in a restructuring scenario which would neutralize the value of the partial guarantee. Additional measures by the WB could be considered, such as including clauses in the Indemnity Agreement to incentivize the Sovereign to treat guaranteed creditors equitably. Over time and through regular issuances, the agency may update its methodology.

10. Conclusions

The Ghana 2030 bond benefiting from an IDA partial guarantee set a strong precedent and opened the way for other select Sovereigns, quasi-sovereigns and SOEs to access capital markets in a challenging environment.

In the third quarter of 2015 when a number of issuers had to pull or scale back issues, Ghana was able to raise USD1 billion under turbulent market conditions. Despite being impacted by negative market sentiment and a challenging credit story, Ghana nonetheless achieved 150-200 bps in spread savings. Demonstrating its homegrown reform program and the support of international organizations enabled market access when there was none.

Based on the Ghana experience and taking into account the recommendations discussed in this report, we believe partially-guaranteed bond issuances can be impactful for selected types of issuers which exhibit one or more of the following characteristics:

- Countries with limited concessional funding allocation but on the path towards sector reforms and development of investment programs by crowding-in private sector;
- Issuers which may benefit from accessing a completely new investor base (for example investment-grade, different currency);
- Complicated credit story involving some form of turnaround or reform with the assistance of WB or other international organizations;
- New issuers without previous market experience either in the sovereign or sub-sovereign space;
- Access problems (volume and / or tenor) which would benefit from demonstrating support from the international community.

10.1.1 *Recommendations to optimize and scale-up the product*

In summary, our key recommendations for developing the product and maximizing its impact can be summarized as follows:

- Keeping a broadly stable structure would ensure continuity and facilitate the emergence of an asset class: Maintaining the existing rolling guarantee structure seems to be the optimal way to accustom investors to the instrument. The level of guarantee should be adapted to the rating level of the country. The lower rated the country, the greater the benefits from the guarantee. Changing the percentage of guarantee depending on the issuer and the tenor can be considered. Exploring an amortizing guarantee by fixing the guarantee amount as a percentage of outstanding notional can also be considered to reduce the costs of the guarantee for issuers.
- Expand volume of deals and continue education of the investor base: Building a pipeline of circa USD5 billion per annum in volume would help in establishing this product as a new asset class with investors. Educating investment banks and investors about the partially-guaranteed bond structure is critical to extracting the best value from the WB guarantee. Attracting a solid base of new investors can be facilitated by the identification of a pool of cornerstone anchor investors to support future deals. JLMs, together with the WB and the Issuer, could define optimal parameters of a public transaction ahead of launch, limit the execution risk and ensure more certainty of outcome. For a limited number of investors, a specific process of wall-

crossing could be initiated prior to the launch of public transactions. Another idea may be to explore the creation of a fund of institutional investors for partially-guaranteed transactions.

- Resolve investors' concerns on the impact of a restructuring on the partial guarantee: While there is clear rationale and policy restrictions for IDA-guaranteed instruments not to have an accelerable guarantee – as the WB would not want to add additional financial burden to the borrower in an already distressed situation, the WB could explore making acceleration non-exceptional for IBRD-guaranteed instruments which are by nature more remote from a potential default. Indeed, this could widen the category of investors from standard Emerging Market investors, and entice those who would appreciate a less structured and simpler guarantee mechanism. Given the consent requirements of the WB in the event of a restructuring, it would as a minimum measure, be useful to clarify how the institution would react in standard restructuring scenarios. Indeed, this would reassure a number of investors and contribute to further expansion of the investor base. Further work should be pursued with legal counsels in order to assess what can be added to the guarantee agreement or the prospectus, so as to limit uncertainty on this point.
- Move towards index eligibility: Focusing the attention of investors on a stable structure can guide the market towards inclusion of the product in standard indices. In particular, an inclusion in the JPM's Emerging Markets bond index would make the product more attractive. It would bring many current index-constrained investors to the table. A short-term objective should therefore be to build a significant volume of issuances in time for the next JPMorgan EMBI index annual meeting.
- Continue work with rating agencies: Past experience and discussions with Moody's and Fitch Ratings have led to the conclusion that reaching a two-notch uplift is possible with a 40%-guarantee for a B-rated issuer. The next step is therefore to determine how alternative structures would be rated, especially for issues of different credit standing and for SOEs. Indeed, rating methodologies in the corporate space may be different and use more thorough recovery approaches. The support of agencies will be key to facilitate the instrument's further deployment.

Appendices

A. Ghana 2030 issuance - Termsheet

- **Issuer:** The Republic of Ghana
- **Size:** USD 1 billion, of which USD 400 million guaranteed
- **Date of issuance:** October 14th 2015
- **Issuers' rating:** Moody's: B3 (Negative Outlook), Fitch: B (Negative Outlook)
- **Notes' rating:** Moody's: B1, Fitch: BB- [two notch uplift]
- **Format:** 144A / Reg S
- **Structure:** Senior unsecured, benefiting from the Partial Guarantee
- **Tenor:** 15 years, amortizing 3 equal instalments in years 13, 14 and 15
- **Use of proceeds:** Refinancing of existing debt
- **Events of default:**
 - Non-payment under the Notes (If IDA pays under Demand Notice, there is no Event of Default)
 - Cross default if non-payment on a Ghana Note or guarantee exceeding USD25mln
 - Ceasing of IMF membership

B. Overview of WB Guarantee Program²¹

WB guarantees help countries mobilize private financing by sharing with private lenders the risk of payment or debt service default or the occurrence of other specified risks that may arise due to a government or government-owned entity's failure to fulfill its obligations. WB guarantees cover risks only to the extent necessary to obtain the required private financing. The existing policy is that WB guarantees remain partial in nature given that they are aimed at leveraging private financing. All WB guarantees require a sovereign indemnity under which the sovereign agrees to indemnify the WB if it pays out on guarantee claims.

The WB's mandate for providing guarantees is rooted in its Articles of Agreement. The WB started issuing guarantees in 1983 for the purpose of attracting private co-financing for WB-financed projects. In 1994, the Executive Directors approved specific policy provisions for the use of partial risk guarantees (PRGs) and partial credit guarantees (PCGs) for private and public sector projects in IBRD-eligible countries. PRGs became available for projects in IDA-only countries in 1997 in the form of IBRD guarantees for enclave projects, and IDA PRGs for private sector projects. Policy-based guarantees (PBGs) were introduced in 1999 for well-performing IBRD borrowers. In 2002, Management summarized the WB guarantee policy provisions approved by the Executive Directors since 1994 in an Operational Policy statement (OP 14.25, *Guarantees*) and issued an accompanying WB Procedures statement (BP 14.25, *Guarantees*).

The new WB's Operational Policy Framework on Guarantees went into effect on July 1, 2014. Guarantees have since then been available as a form of financing – alongside grants, credits, and loans – in Development Policy (DPO) and Investment Project Financing (IPF) operations²². The ultimate objective of the enhanced operational policy framework was to support the more widespread, more effective use of WB guarantees in country engagements to leverage more effectively WB resources in delivering critical infrastructure, other investments and reform programs, and allowing for more streamlined collaboration across the WB Group (WBG) in deployment of guarantees for private and public sector projects. The policy changes built upon extensive internal discussions and also incorporated feedback received from relevant parties on three continents, including with lenders and investors, governments and donor agencies, bilateral and multilateral development partners, and non-governmental organizations.

WB guarantees are distinct from, but complementary to, MIGA and IFC guarantees in mobilizing private sector financing. Each WBG institution has a mandate that is defined under its Articles and each serves the needs of its clients according to these mandates. Given that IBRD and IDA clients are first and foremost member countries, WB guarantees play a different yet complementary role to that of MIGA's and IFC's guarantees. MIGA provides guarantees in the form of political risk insurance for cross-border direct investments for a wide range of private sector clients. IFC provides credit guarantees for private sector participants as their primary clients. Neither MIGA nor IFC guarantees require an explicit sovereign counter-guarantee. WB guarantees can also support private sector projects but only by backstopping public sector obligations for which the member country is willing to provide a Member Country Indemnity²³. One example of natural convergence for WBG support through guarantees comes in the support to PPPs, where IFC loans, MIGA political risk insurance and WB guarantees have been deployed together. In practice, IFC guarantees are designed in a manner that there is very little overlap with MIGA and WB guarantees

Types of Guarantee:

WB Guarantees consist of Project Based Guarantees which follow Investment Project Financing guidelines and Policy-Based Guarantees which are provided through Development Policy Operations. Although the financing mobilized with Guarantees is obtained from commercial sources, a Development Policy

²¹ For more information, see worldbank.org/guarantees

²² The policy led to the use of the terms 'PRG' and 'PCG' becoming redundant

²³ Member Country Indemnity means the counter-guarantee and indemnity provided by a member country to the Bank in connection with a Bank Guarantee

Objective which is consistent with policy guidance is prepared for each Guarantee operation in the same as way for traditional WB loan operations. Eligible Guarantee projects need to follow the WB's standard environmental and social safeguards, and integrity and anti-corruption requirements, along with other considerations.

Project Based Guarantees

A WB Guarantee covers, in relation to a project: (i) loan-related debt service defaults caused by government²⁴ failure to meet specific payment and/or performance obligations arising from contract, law or regulation; and/or (ii) payment default on non-loan related government payment obligations. The WB provides guarantees to the extent necessary to mobilize private financing for the project and/or to mitigate payment risks of the project, taking into account country, project and market circumstances. The member country requesting the WB Guarantee provides a Member Country Indemnity to the WB. The financial costs and benefits, access to private and public financing, and leverage of WB resources, among other considerations, are considered in deciding on the form of IPF financing, as appropriate.













Policy-Based Guarantees

Policy-Based Guarantees (PBGs) help to improve governments' access to capital markets in support of social, institutional, and structural policies and reforms as agreed with the WB. While they are structurally the same with Project Based loan guarantees provided, PBGs are offered for general balance of payments support. Like loan guarantees, PBGs cover a portion of debt service on a borrowing (loans or bonds) by an eligible member country from private foreign creditors in support of agreed structural, institutional, and social policies and reform. While the actual structure would be determined on case by case basis, the guarantee could be self-standing or part of a larger package of WB financial support.

- **Eligible country/borrowers:** Sovereign governments eligible for the WB's fiscal support programs termed as Development Policy Operations (DPO). PBGs are selectively offered to countries with a strong track record of performance with a satisfactory social, structural, and macroeconomic policy framework and a coherent strategy for gaining (or regaining) access to international financial markets.
- **Eligible debt:** PBGs can be used for any commercial debt instruments (loans, bonds) provided by any private institution. PBGs can cover foreign currency debt. Proceeds of the guaranteed debt can be used for any budgetary purposes.
- **Guarantee coverage:** PBGs, like partial credit guarantees, cover part of the scheduled repayments of commercial loans or capital market borrowings against all sovereign default risks.

²⁴ For the purposes of Bank Guarantees, "government" includes a member country's political and administrative subdivisions and all other public sector entities.

C. Past WB partially-guaranteed public bonds

Country	Project	Borrower	Lead Bank(s)	Amount
Argentina 	Budget Support	Republic of Argentina	 JPMORGAN CHASE & CO.	USD 1,165 million (US 144A bond market)
Colombia 	Financial Sector Budget Support	Republic of Colombia	 JPMORGAN CHASE & CO.	USD 1.000 million (US 144A bond market)
Jordan 	Telecommunications Project	Jordan Telecommunications Corporation		USD 50 million (Eurobond market)
Lebanon 	Power Sector Restructuring and Transmission Expansion	Republic of Lebanon		USD 100 million (Eurobond market)
Philippines 	Leyte Luzon Power Project	National Power Corporation		USD 100 million (US 144A bond market)
Thailand 	EGAT Investment Program	Kingdom of Thailand		USD 300 million (US 144A bond market)

Contact details

Rothschild & Co

23bis, avenue de Messine

75008 Paris

France

Tel.: +33 1 40 74 40 74

The World Bank

1818 H Street

NW Washington, D.C. 20433

United States

Tel.: +1 202 473 1000

guarantees@worldbank.org

worldbank.org/guarantees

Anne-Laure Kiechel

Partner – Global Advisory

anne-laure.kiechel@rothschild.com

Pankaj Gupta

Practice Manager - Financial Solutions

pgupta2@worldbank.org

Alexandre Gélas

Assistant Director – Global Advisory

alexandre.gelas@rothschild.com

Sebnem Erol Madan

Senior Infrastructure Finance Specialist

serol@worldbank.org

Gatien Bon

Analyst – Global Advisory

gatien.bon@rothschild.com

Jukka Strand, CFA

Senior Infrastructure Finance Specialist

jstrand@worldbank.org

Vincent Launay, CFA

Infrastructure Finance Specialist

vlaunay@worldbank.org