

WORLD BANK GROUP

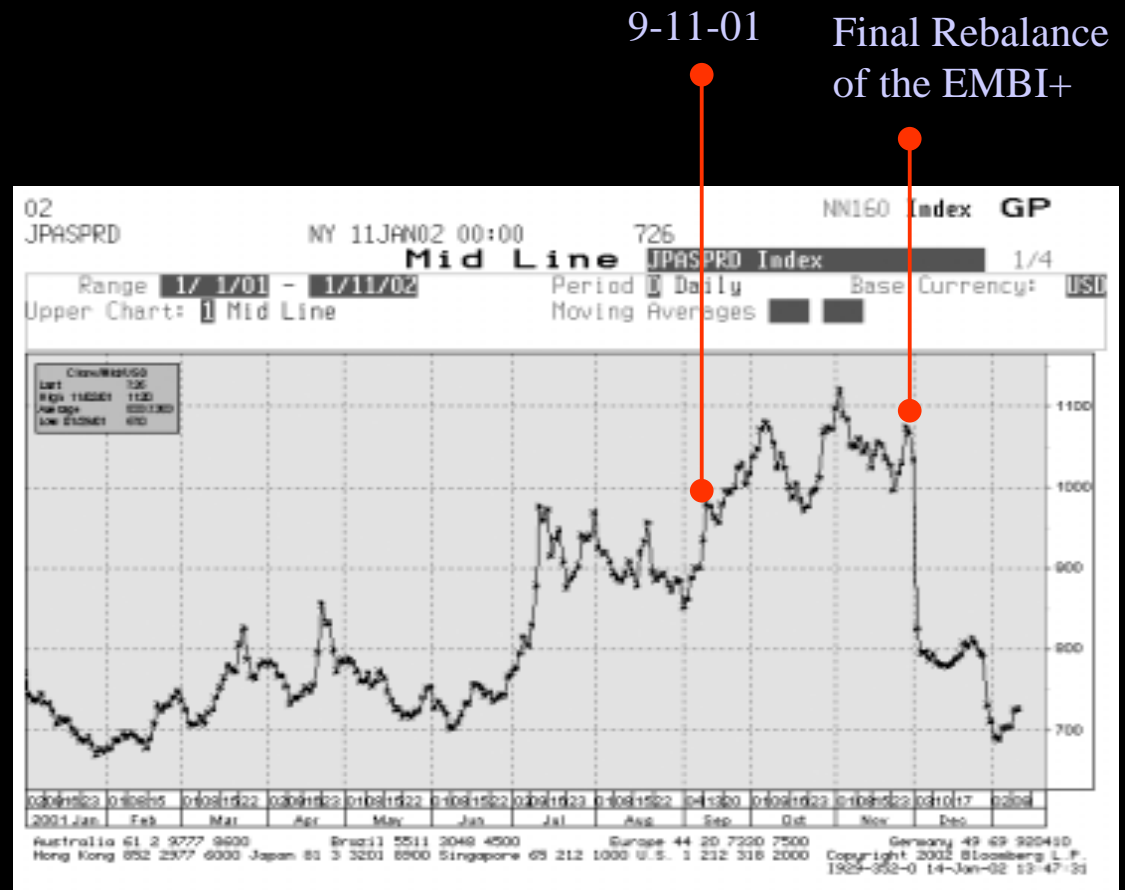
# Risk Mitigation Instruments

2nd European Congress  
on Participation in Global  
Infrastructure  
Frankfurt  
January 22, 2002



# We may be moving beyond the Argentina and Sept 11 crisis

|               | EMBI |
|---------------|------|
| – Jan 29, 01  | 670  |
| – Sept 10, 01 | 900  |
| – Sept 14, 01 | 981  |
| – Dec 3, 01   | 1034 |
| – Dec 4, 01   | 826  |
| – Jan 11, 02  | 726  |



*Post Final Rebalancing of the EMBI+  
 Argentina weight lowered from 23% to 5% since June 2001*

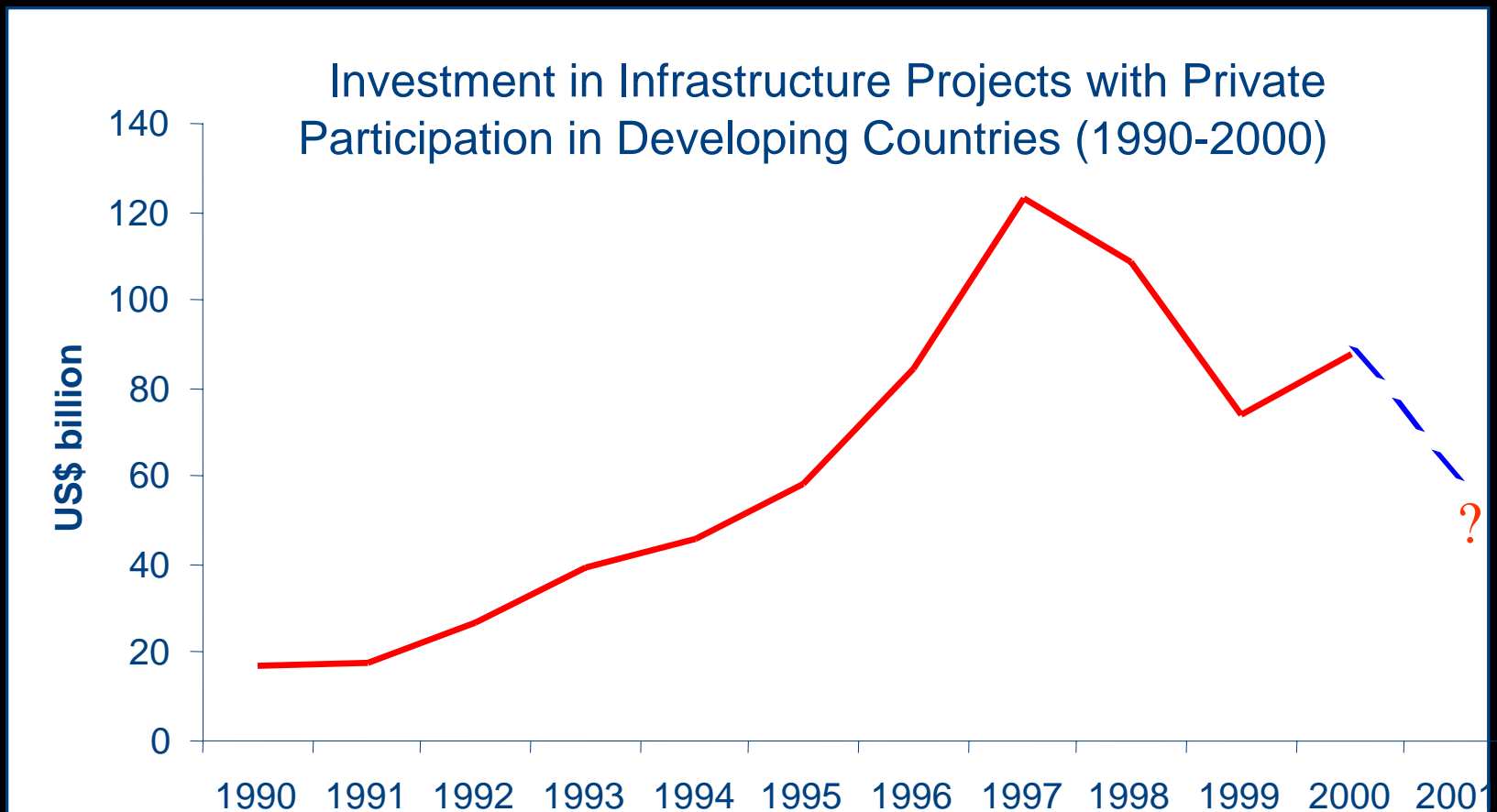
# But risk aversion in the market has increased...

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- Flight to quality
- Banks capital eroded
- Reduced equity investments
- Increased dispersion of spreads
- Reduced availability of private PRI

# More selectivity, reduction in private investments to emerging countries is expected

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... 14% of the the World's FDIs were affected by the Argentina crisis

# Pushing the frontier of private investments

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## IFC

IFC A Loan  
IFC B Loan  
IFC Guarantees  
(partial credit structures  
usually for local financing)

## MIGA

Political Risk Insurance  
(expropriation, transfer restriction,  
breach of contract, war & civil  
disturbances)

## IBRD/IDA

Guarantees  
-Partial Risk  
-Partial Credit  
-Policy Based  
IBRD Loan  
IDA Credit

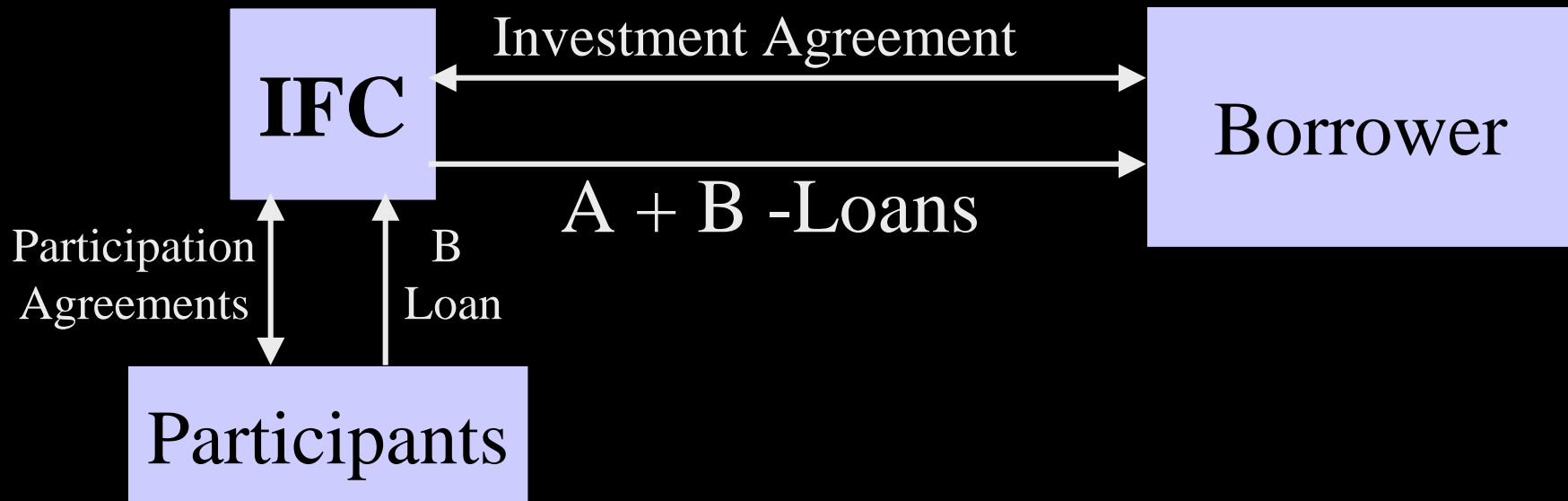
- Deployment of the instruments is client/project specific
- Similar requirements on safeguards, development impact
- Joint transactions (e.g., MIGA/IFC)

# IFC B-Loan program

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- Cornerstone of IFC's mobilization effort
- Over \$20 billion in B-Loans raised since the product was launched in 1957
- Today \$7.5 billion in B Loans outstanding with 215 financial institutions in 266 B-Loans
- Average of \$1.5 billion in new B-Loans signed every year in about 40 projects per year
- Tenures between 5-15 years, average of 8 years

# IFC B-Loan mechanics



- A Loans are for IFC's own account
- B-Loans are for account of participant banks
- Only one Loan Agreement, signed by the borrower & IFC
- IFC is the Lender of Record for the entire Loan (A+B)

# B-Loan mechanics

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- IFC administers the entire loan and collects all payments from the Borrower
- IFC commits to distribute payments pro rata among itself and the Participants
- IFC cannot be repaid in full unless and until all Participants are paid in full
- Any default to a Participant is a default to IFC

# IFC's Preferred Creditor Status

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## What it means:

- Preferred access to foreign exchange in the event of country foreign exchange shortage
- Excluded from general country debt reschedulings as part of the London Club; Not subject to mandatory new money obligations under a general country debt rescheduling
- Exemption from taxation including withholding tax
- Bank regulators provide exemption from automatic country risk provisioning, when applicable

# IFC's Preferred Creditor Status

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## How it is granted:

- de facto status (same for IFC and World Bank)
- Granted by member governments of IFC and recognized by other creditors
- Embodied in practice and consistently recognized worldwide
- Status of all World Bank Group institutions is the same; universal recognition has consistently not discriminated among the affiliates

## Why it is granted:

- To enable IFC to fulfill its mandate to:
  - Lend long-term in the most difficult countries and during times of financial crisis
  - Mobilize long-term funds from commercial institutions
  - Restore confidence in an economy

# IFC B-Loan signings FY01 top twenty Participants

| Held Portfolio Rank | FY01 Signings Rank | Financial Institution         | Held Portfolio Amount ('000) |
|---------------------|--------------------|-------------------------------|------------------------------|
| 4                   | 1                  | ABN AMRO Bank                 | \$260,385                    |
| 5                   | 2                  | Société Générale              | \$259,996                    |
| 1                   | 3                  | Dresdner Bank Group           | \$519,345                    |
| 2                   | 4                  | HVB Group                     | \$353,350                    |
| 15                  | 5                  | Barclays Bank                 | \$109,603                    |
| 10                  | 6                  | Deutsche Bank AG              | \$175,831                    |
| 7                   | 7                  | Crédit Lyonnais               | \$202,468                    |
| 12                  | 8                  | Citigroup                     | \$132,799                    |
| 14                  | 9                  | Westdeutsche Landesbank       | \$117,896                    |
| 49                  | 10                 | Deutsche VerkehrsBank         | \$40,000                     |
| 24                  | 11                 | Standard Chartered Bank       | \$74,932                     |
| 30                  | 12                 | Banque of Nova Scotia         | \$67,234                     |
| 34                  | 13                 | Dexia Group                   | \$58,118                     |
| 11                  | 14                 | Sumitomo Mitsui Banking Corp. | \$139,868                    |
| 60                  | 15                 | San Paolo-IMI Spa             | \$34,185                     |
| 3                   | 16                 | ING Group                     | \$304,961                    |
| 39                  | 17                 | Royal Bank of Scotland        | \$51,365                     |
| 83                  | 18                 | MashreqBank                   | \$22,875                     |
| 33                  | 19                 | Erste Bank                    | \$60,291                     |
| 31                  | 20                 | Fortis Bank                   | \$65,001                     |

# Recent syndication awards

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- **IFR Awards 2001:** Europe Middle-East Africa Project Finance Loan of the Year
  - Chad-Cameroon Pipeline
- **Project Finance International 2002/Europe Middle East Africa Award:** Oil & Gas Deal of the Year
  - Chad-Cameroon Pipeline
- **Finance Asia Awards:** Best Project Finance Deal
  - Ninoy Aquino International Airport
- **PFI Asia:** Asia Infrastructure Deal of the Year
  - Ninoy Aquino International Airport
- **IFR Asia Award:** Philippine Loan of the Year
  - Ninoy Aquino International Airport

# Why do Banks rely on IFC?

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- **Benefits from IFC's multilateral status:**
  - Preferred creditor status/reduced country risk
  - Exemption from country risk provisioning
  - Pierces sovereign ceiling
  - Relationship with member governments
- **Benefits from IFC's experience and practices:**
  - Extensive emerging market experience
  - Detailed pre-investment appraisal (legal, technical, environmental, social); ongoing supervision
  - Convergence of interests: IFC and Participants

# Recent experience with sovereign risk

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- Preferred Creditor Status upheld:
  - Russia and Pakistan
- Advanced Workouts in Asia Crisis:
  - Thailand, Indonesia, and Pakistan

# IFC Partial Credit Guarantees

For loans and bonds

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- Some advantages of IFC's partial guarantees for loans and bonds:
  - Local currency focus
  - No counter-guarantee from host Government
  - Private sector projects

# IFC Partial Credit Guarantees

For loans and bonds

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- How do they work?
  - All types of risk covered
  - Pay-out capped at predetermined partial amount
  - Guarantees structured case by case

# IFC Partial Credit Guarantees

For loans and bonds

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- What do they achieve?
  - Access to new funding sources
  - Access to long-term funding
  - Access to local currency
  - IFC's due diligence and supervision
  - Liquidity backstop feature
  - Capital market development

# IFC Local Currency Loans and Hedges

LC LOANS: IFC swaps local debt service payments received into dollars

LC HEDGES: IFC swaps existing client dollar loans into local currency loans

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Available in 11 emerging markets:

## Asia:

- Korean won
- Indian rupee
- Indonesian rupiah
- Philippine peso
- Thai baht

## Europe:

- Czech koruna
- Hungarian forint
- Polish zloty
- Slovak Koruna

## Other:

- Mexican peso
- S. African rand

# IFC other Local Currency products

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- **IFC Securitizations for clients**
  - Building local capital markets
  - Enhancing lending capacity of local banks
    - Asset classes:
      - Mortgage loans
      - SME loans
      - Leases
      - Trade receivables
- **IFC Insurance products**
  - Weather risk management: agriculture, energy

# Miga's Guarantee Program

## Case for PRI

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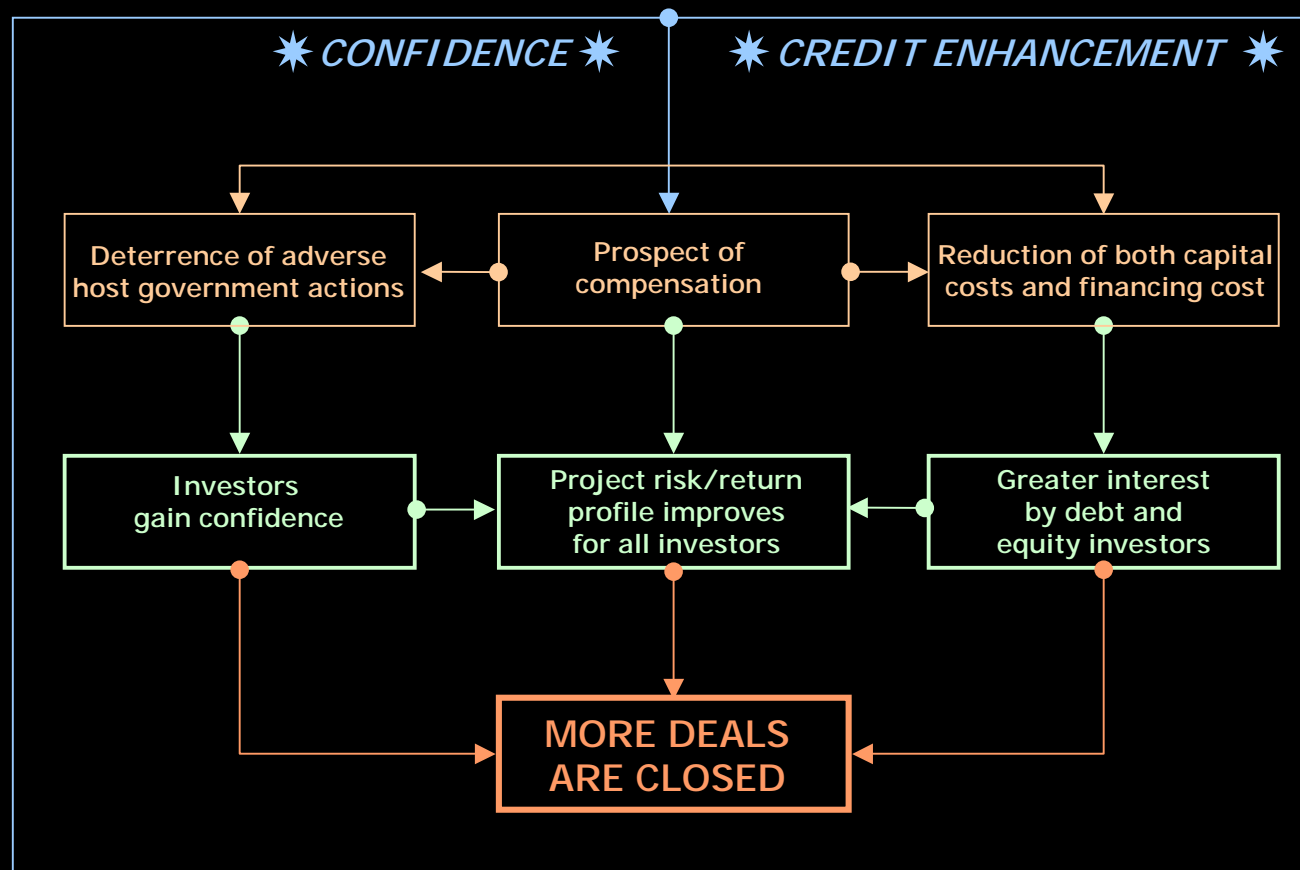
Perception that classical political risks were irrelevant changed with global financial crisis:

- Repossessions of privatized assets
- Defaults on government obligations
- Revocation of concessions given by previous governments
- Legal and regulatory framework in many countries inadequate
- Lenders unprepared to cover non-commercial risks

# MIGA

## A tool in your risk management kit

### POLITICAL RISK INSURANCE FOR PROJECTS



# MIGA value-added

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- No counter guarantee required from host government
- Capacity-acting as lead arranger for PRI with private and public partners
- Maturity of contracts can go to extended to 20 years

# Market changes

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- Increased demand for infrastructure projects, capital market transactions
- Considerable interest for projects at the subnational level, both because of localization and privatization of several sectors (e.G . transportation and water) in many countries
- Increased interest in breach of contract coverage for sub-sovereign risks
- Distinction between political and commercial risks in complex deals increasingly blurred

# Main project finance risks

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# Eligible investments

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- New cross-border investments between member countries
- Capital expansions / modernizations
- Privatizations
- Financial restructurings
- Plus other structures that might require case by case analysis

# Eligible investors

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- Nationals of MIGA member countries other than host country where investment is being made
- Nationals of host country provided funds originate from overseas and host government approves investment
- Corporations/financial institutions incorporated in, and operating in, a MIGA member country
- Corporations/financial institutions majority-owned by nationals of MIGA member countries
- State-owned corporations when run on a commercial basis

# Investments & Liabilities covered

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- Equity and quasi-equity
- Shareholder loans and loan guaranties
- Commercial loans
- Other forms of investments
  - Technical assistance
  - Management contracts
  - Leases
  - Franchising and licensing agreements
  - Performance bonds
  - Others

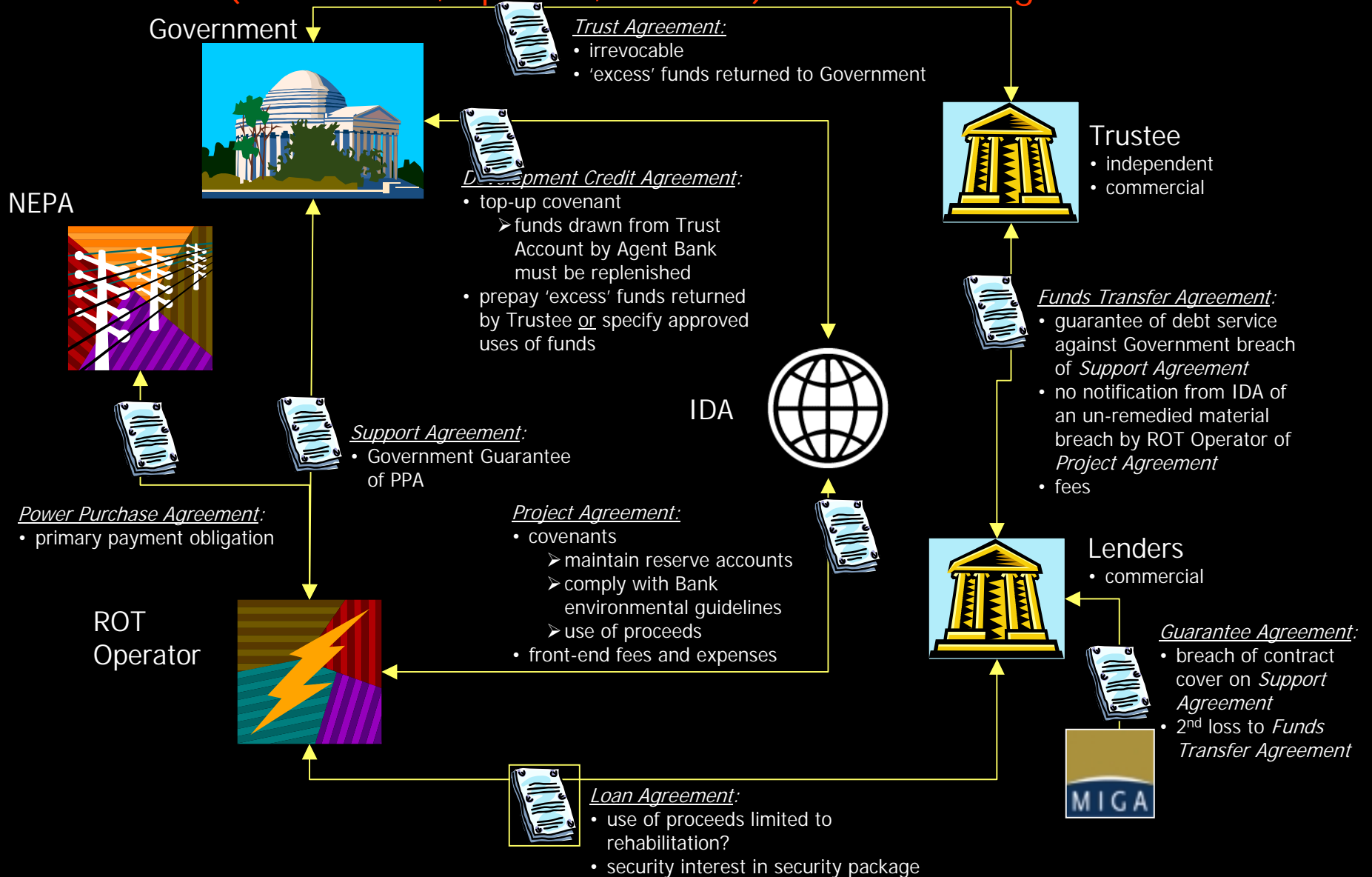
# Terms

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- Choice of coverage
- Equity covered up to 90%
- Debt covered up to 95%
- Coverage up to 15 years
- Investor has option to cancel policy after three years; MIGA may not cancel the coverage
- Coverage up to \$200 million directly
- Syndication of insurance

# Increasing cooperation among sister organizations to ensure optimum risk allocation:

## ROT (rehabilitate, operate, transfer) Guarantee Legal Structure



# Risk allocation

## development

- technical feasibility ●
- commercial / financial feasibility ●
- project economics ●
- permits / authorizations ●●
- third-party intervention ●●
- political change ●● MIGA

## construction

- schedule ●●
- cost ●●
- performance ●●
- design changes ●●
- interest rate escalation ●●
- consequential damages ●●
- Force Majeure / country risk ●●● MIGA
- currency changes ●●
- availability of foreign exchange ●●● MIGA

## operations

- market changes ●●● MIGA
- capacity / production shortfalls ●●
- fuel / materials supply interruption and cost escalation ●●●
- operations and maintenance cost escalation ●●
- interest rate escalation ●●
- currency depreciation ●●
- statutory change / civil unrest / strikes ●●● MIGA
- act of God ●●
- third party liability ●●● MIGA
- plant residual value ●●

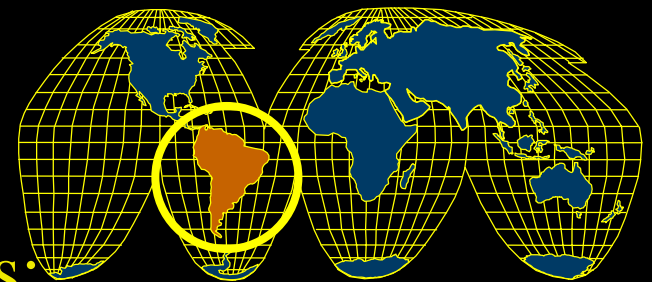
- sponsor risk
- contractor risk
- lender risk
- host government / offtaker risk

# Guayaquil water project

## ECUADOR

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- New Concession for the privatization of municipal water services in Guayaquil
- Concession includes progressive qualitative standard measurements:  
Non compliance would trigger Performance Bond at any time during the duration of the concession
- MIGA insures the risk of Wrongful Call of the Performance Bond as well as the equity investment



# Guayaquil water project

## ECUADOR

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- The inability to recover from the host country the compensation set forth in a final arbitration award or court decision rendered against the host country, as a consequence of the wrongful (or unfair) calling of the performance bond.
- The amount of compensation will not exceed the amount of the performance bond.

wrongful call

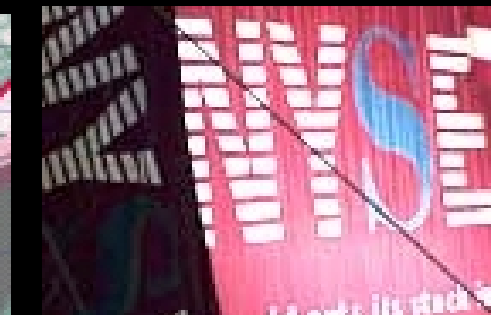
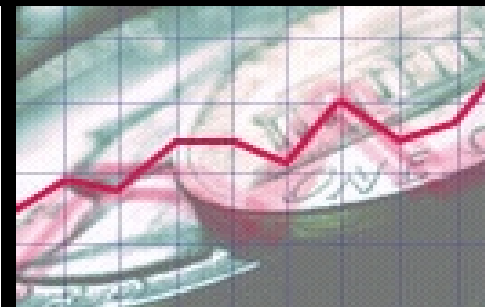
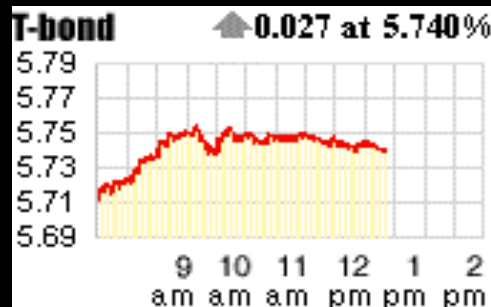
breach of contract

denial of justice

# World Bank Guarantees objective

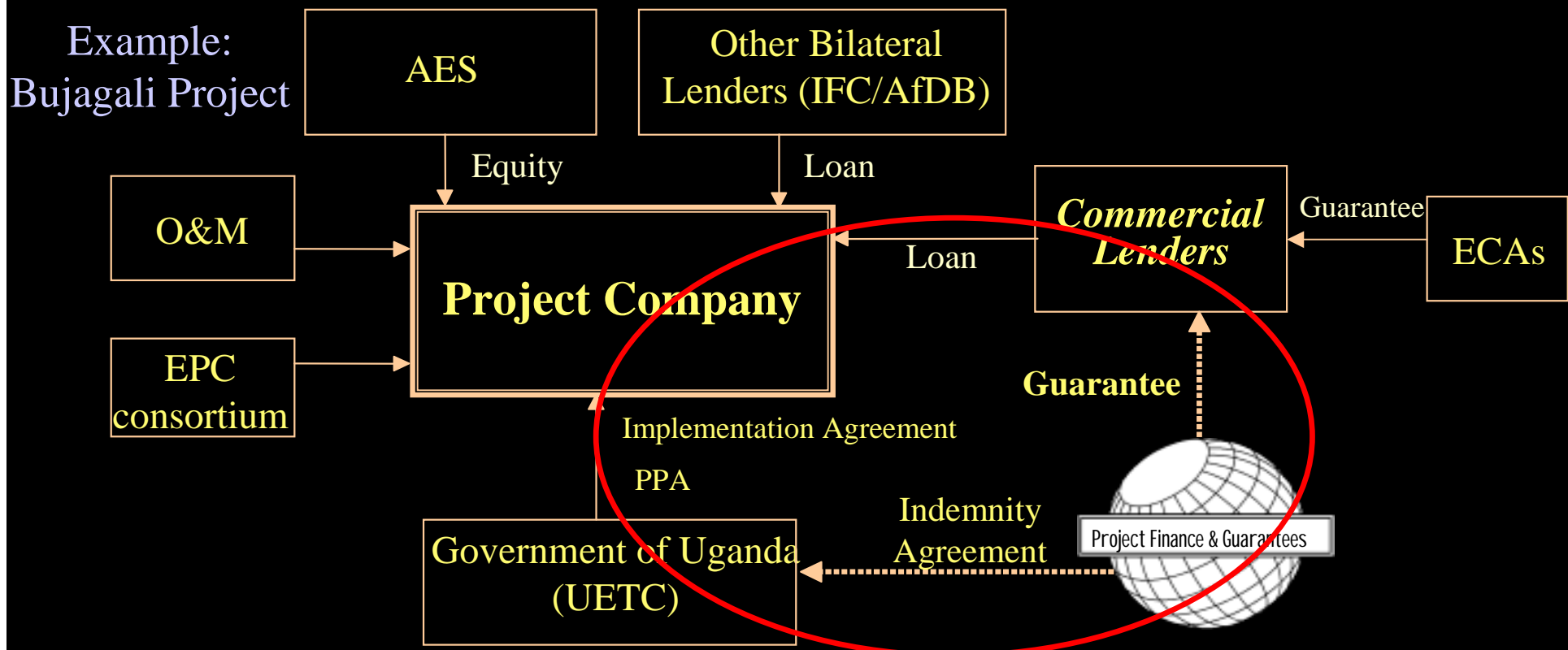
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- Catalyzing private finance in frontier markets, when IFC and MIGA instruments do not suffice



# Partial Risk Guarantee

- A Partial Risk Guarantee (PRG) will cover lenders in case of a default on a covered contractual obligation to a project company leading to a Debt Service Default



# Criteria for deployment of the PRG

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- PRGs can be considered in the following situations:
  - Sectors in early stages of reform
  - Larger size/riskier operations
  - Operations highly dependent on support/undertakings of governments

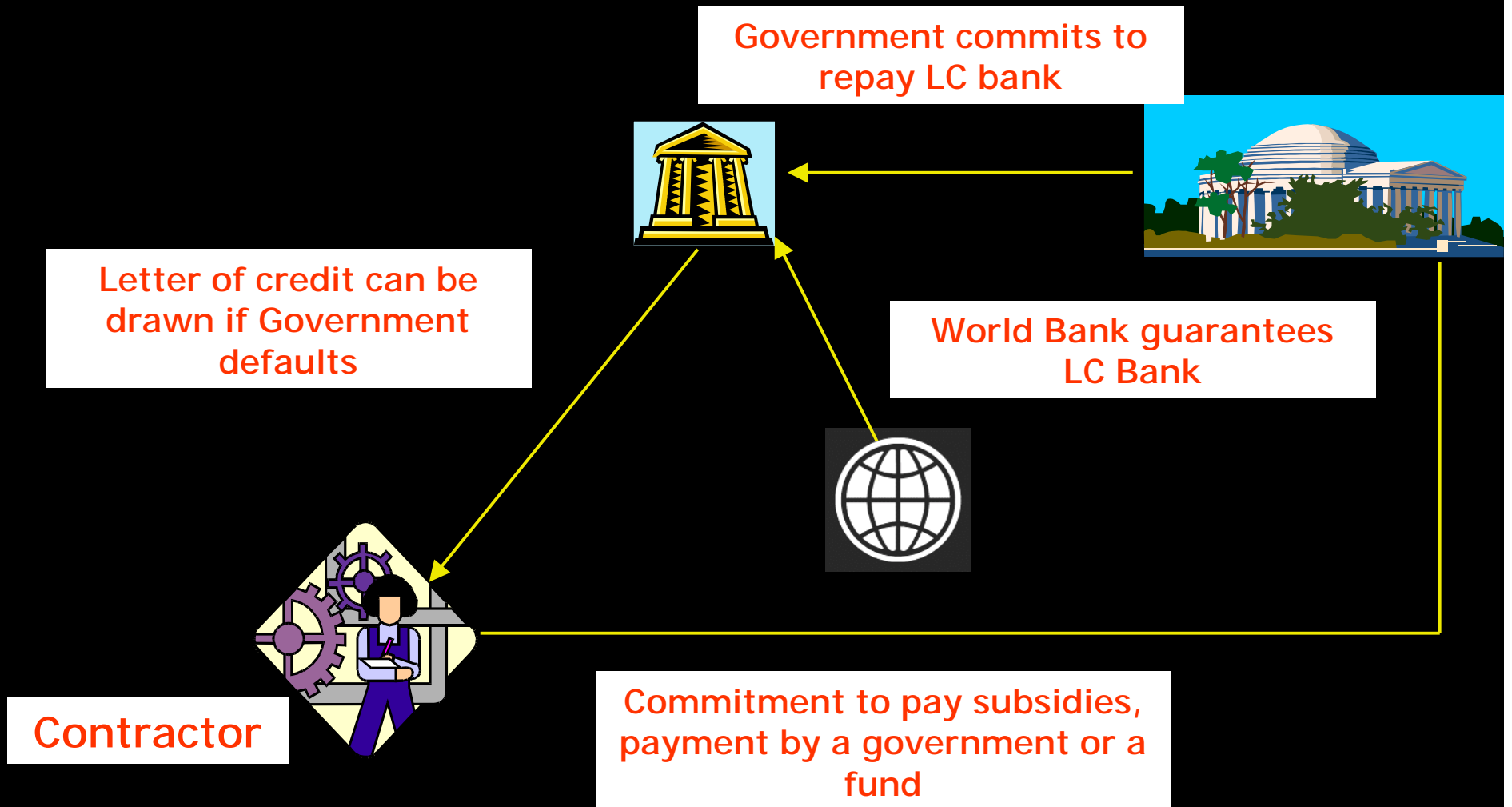
# The WB Partial Risk Guarantee does not increase contingent liabilities

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- “The host government’s indemnity of the World Bank does not increase the government’s liabilities when the government is already directly obligated to the private sector on the same liabilities.”, IMF.

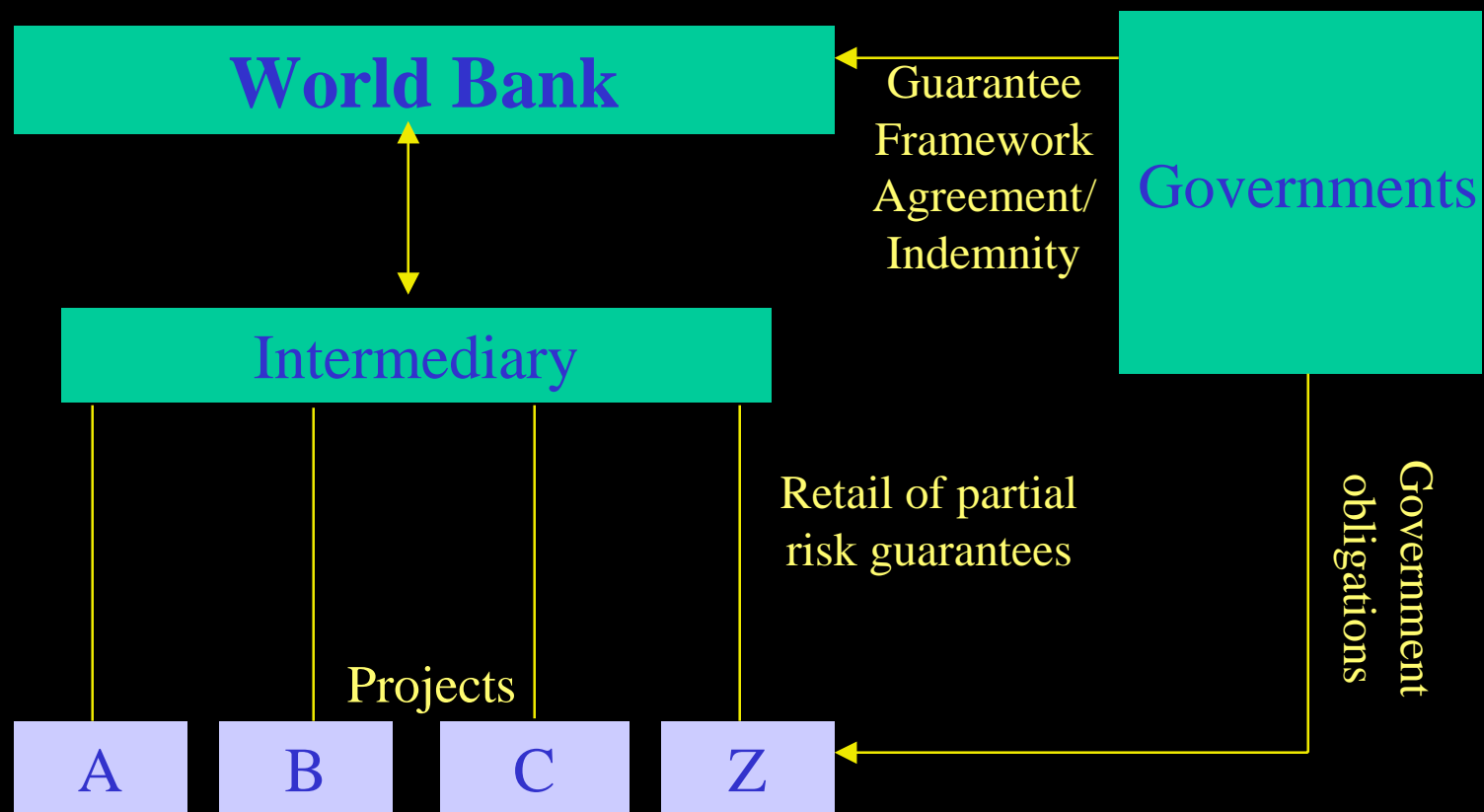
“Involving the Private Sector in Forestalling and Resolving Financial Crises – Private Project Finance Flows to Developing Countries,” IMF Board Paper SM/99/211, August 20, 1999, page 21.

# PRGs can Guarantee payments by Governments or Funds



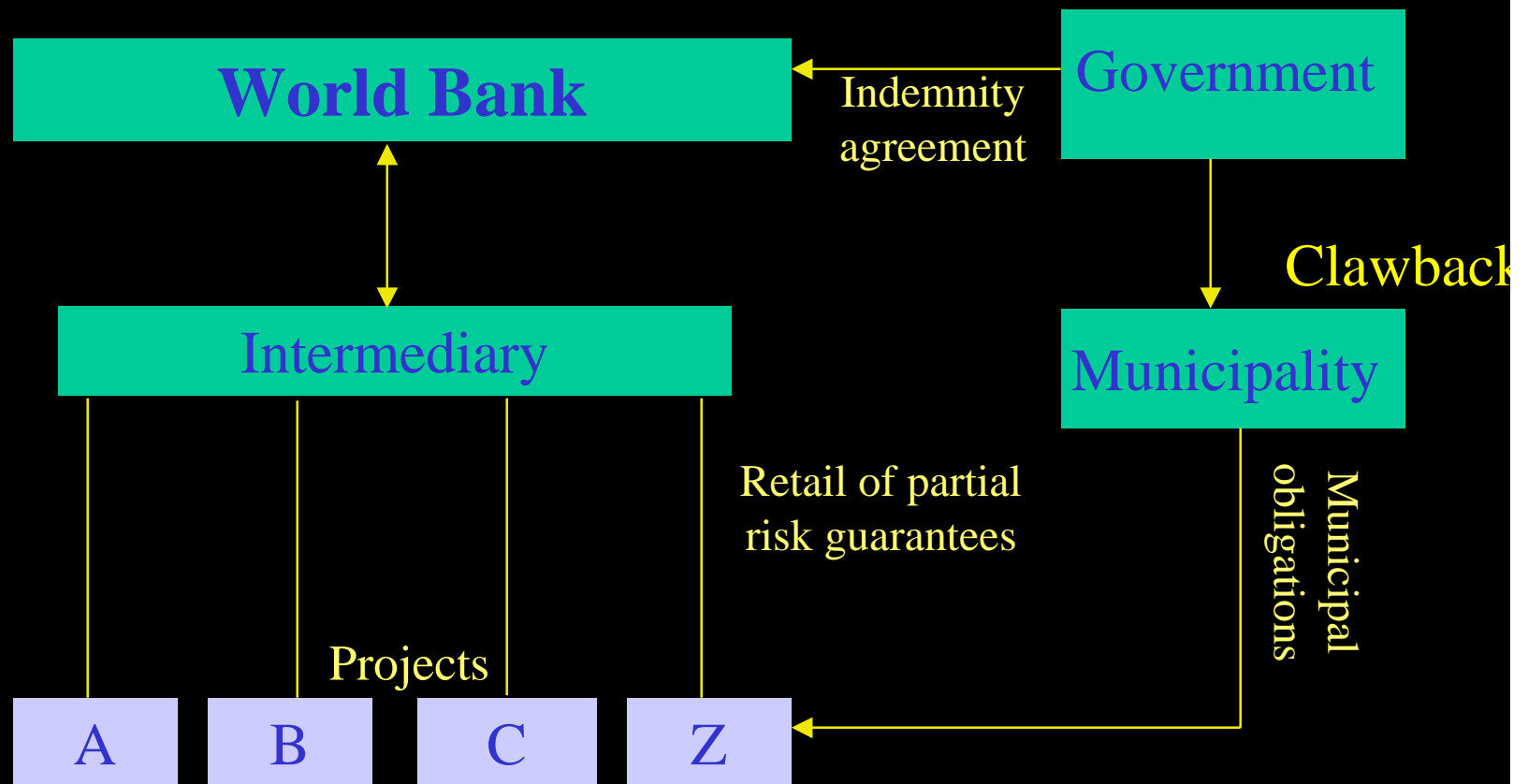
# PRGs can be used for a series of smaller projects

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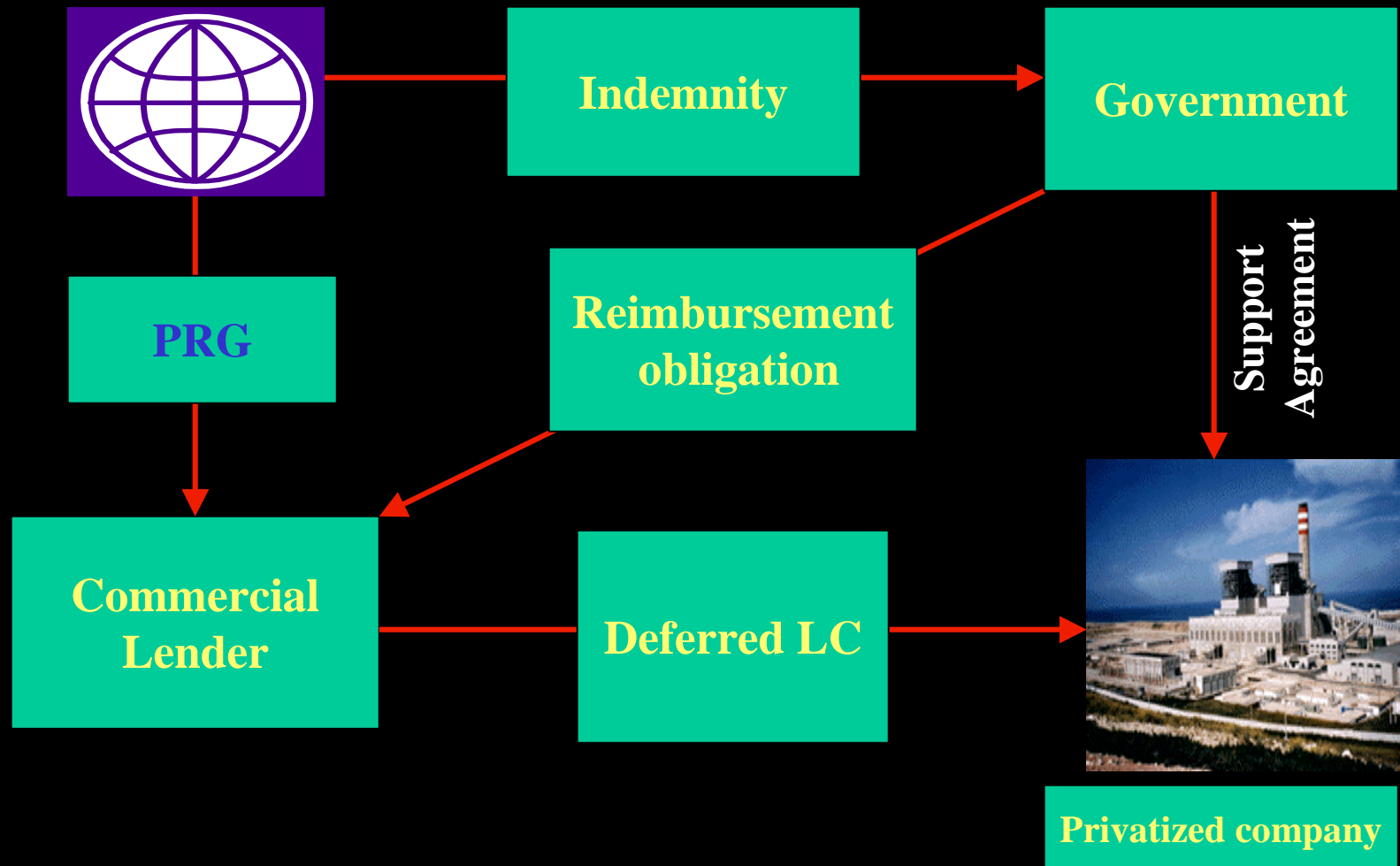
# PRGs can backstop municipal undertakings

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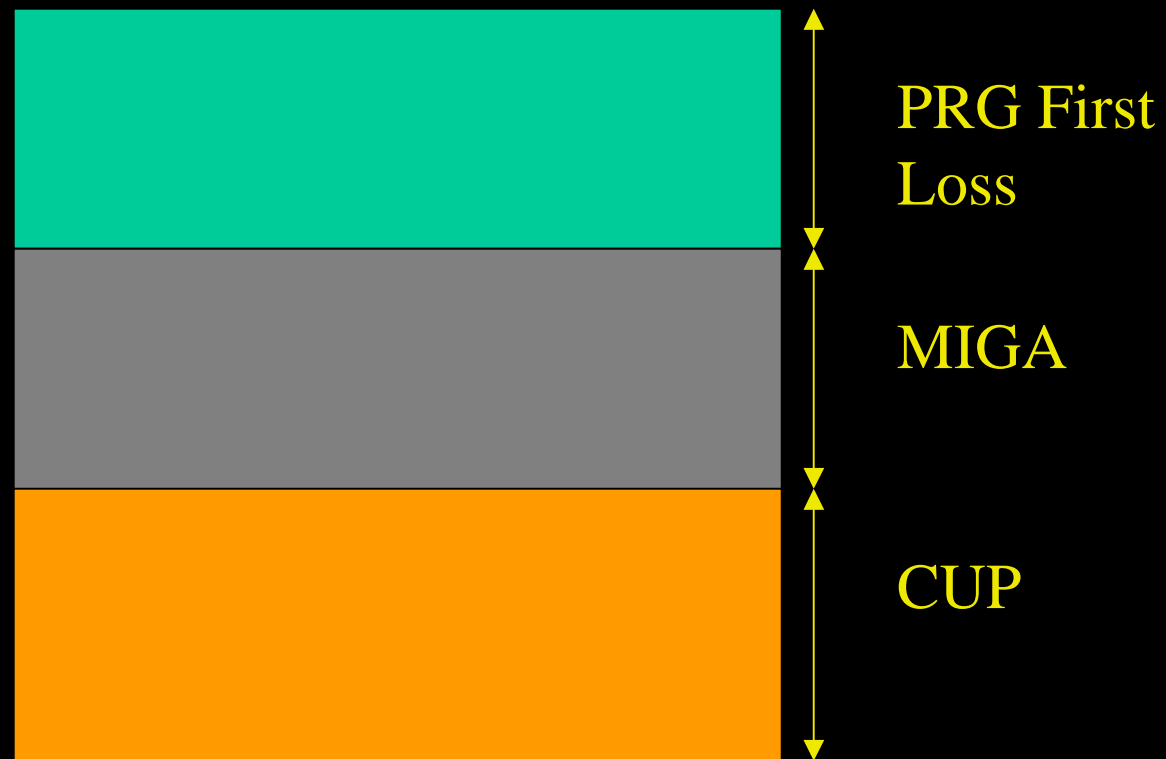
# PRG to enhance privatization response

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# Collaboration with MIGA

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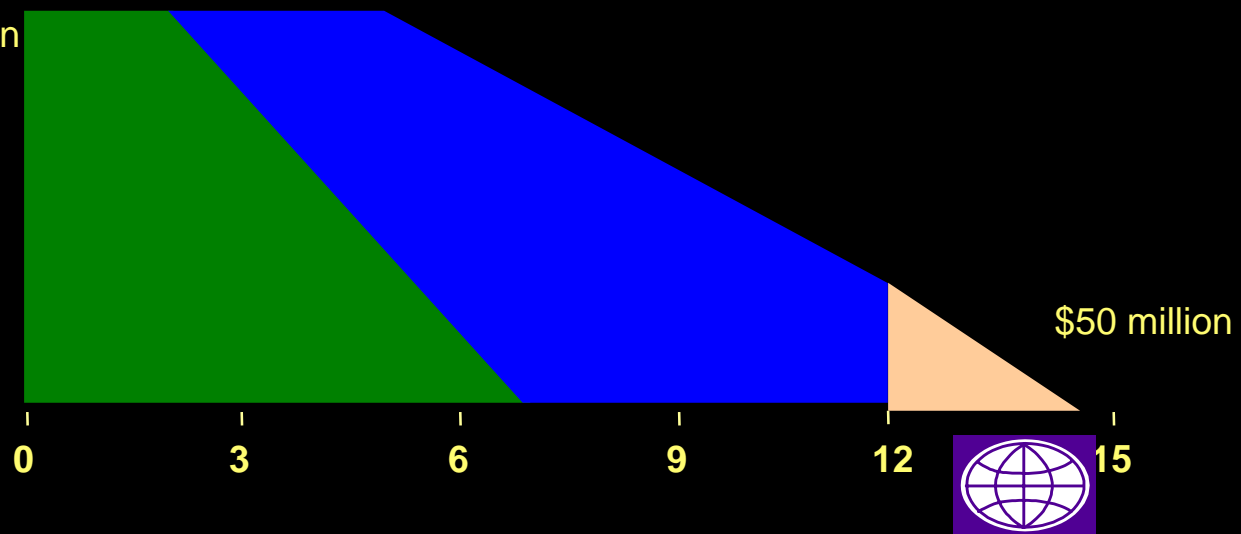


# Partial Credit Guarantee

- WB will guarantee debt service for specific periods

Example: China  
Ertan Power  
Project

\$150 million



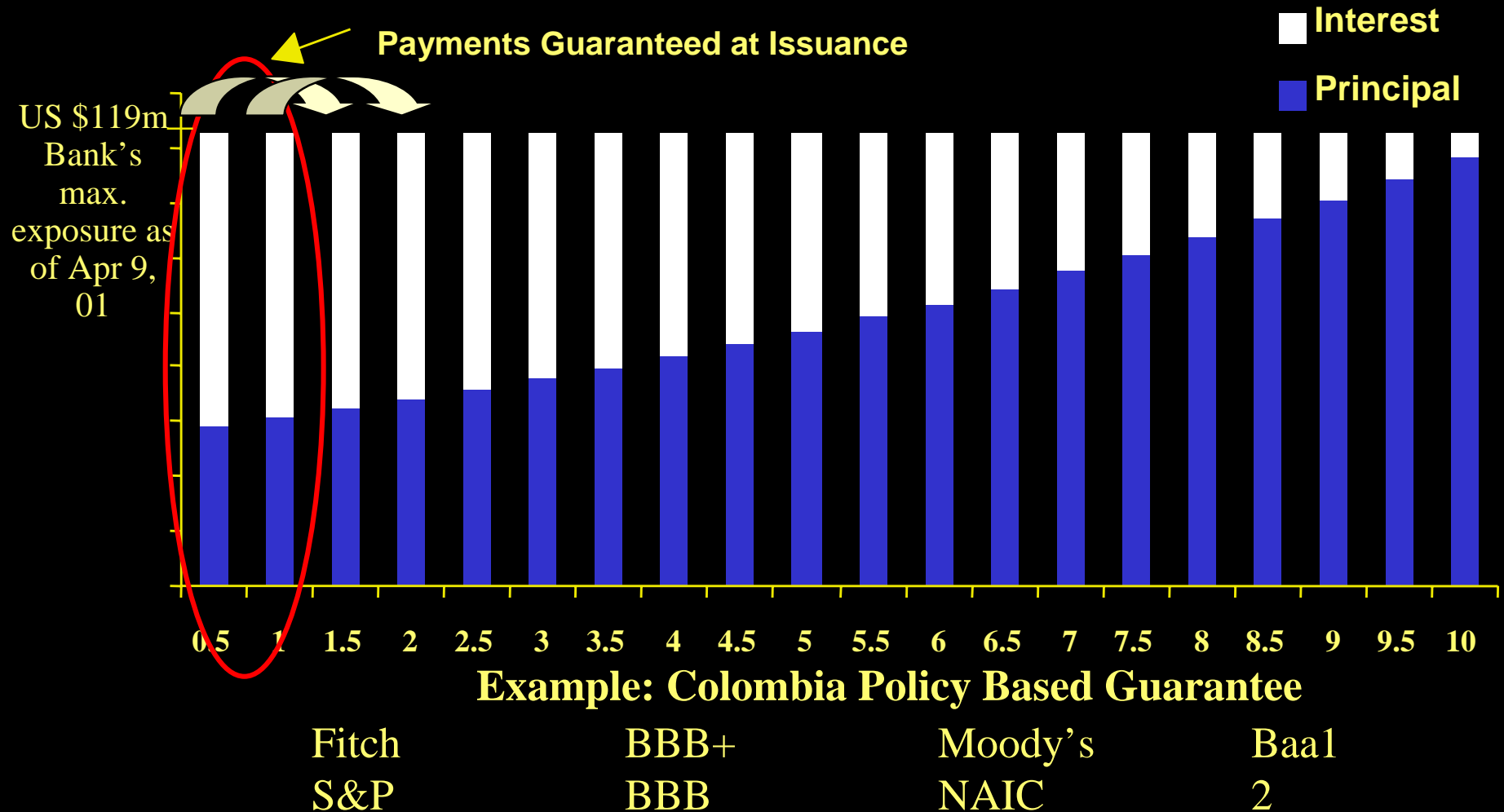
Average financing term for  
China without  
World Bank Guarantee

Additional uncovered  
risk taken by  
commercial banks

**World Bank  
Guaranteed**

Total risk assumed by commercial banks

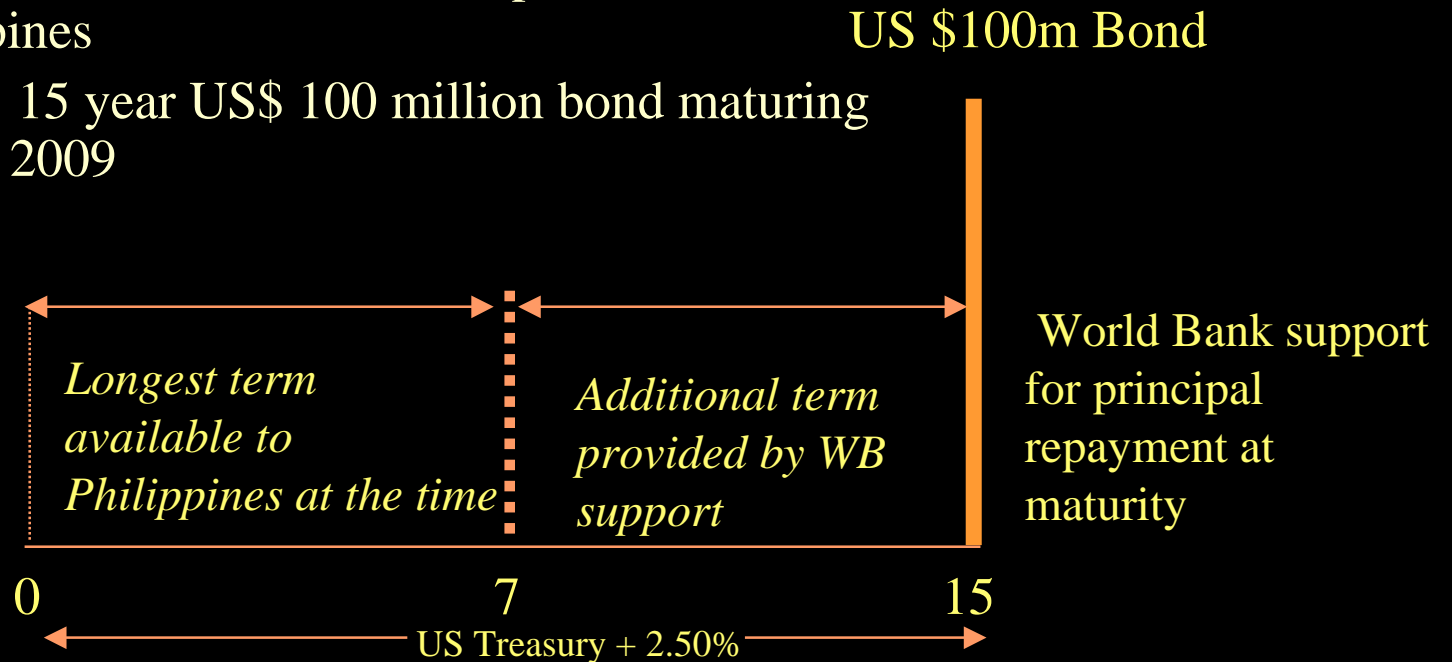
# Policy Based Guarantee: Leveraging adjustment loans



# Various PCG structures can be developed

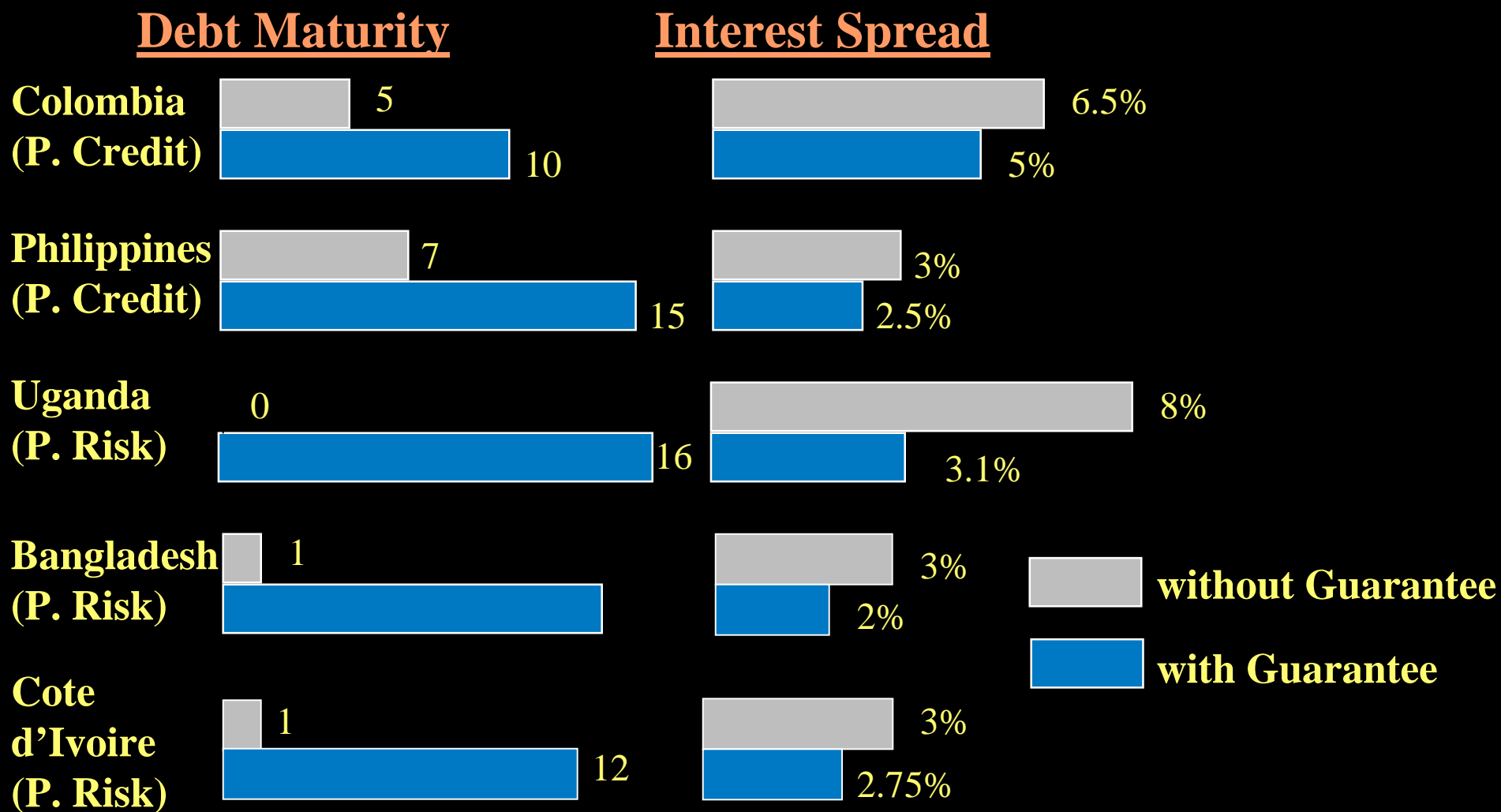
- **Example:**

- Borrower: National Power Corporation, Philippines
- Terms: 15 year US\$ 100 million bond maturing in July 2009



*Similar structures have been used in the past for project-based partial credit guarantee in Lebanon, Jordan etc.*

# Partial Guarantees help access private finance at sustainable terms



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