



IDA18

**Further Details on the Proposed
IFC-MIGA
Private Sector Window in IDA18**

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

Fiscal year (FY) = July 1 to June 30

ADF	African Development Fund	LICs	Low Income Countries
AfDB	African Development Bank	MTR	Mid-Term Review
BFF	Blended Finance Facility	MDB	Multilateral Development Bank
CRO	Chief Risk Officer	MIGA	Multilateral Investment Guarantee Agency
CIDA	Canadian International Development Agency	MGF	MIGA Guarantee Facility
CAFEP	Conflict Affected and Fragile Economies	MSME	Micro, Small and Medium Enterprise
CPF	Country Partnership Framework	OECD	Organisation for Economic Co- operation and Development
DFID	UK's Department for International Development	OPCS	Operations Policy and Country Services
DFIRM	Development Finance IDA Resource Mobilization	PRI	Political Risk Insurance
FfD	Financing for Development	PSF	Private Sector Facility of the African Development Fund
FCS	Fragile and Conflict-Affected State	PSW	Private Sector Window
FDI	Foreign Direct Investment	RMF	Risk Mitigation Facility
GAFSP	Global Agriculture and Food Security Program	RSF	Risk Sharing Facility
GIF	Global Infrastructure Facility	SDGs	Sustainable Development Goals
GDP	Gross Domestic Product	SME	Small and Medium Enterprise
GNI	Gross National Income	SOEs	State-Owned Enterprises
GNP	Gross National Product	SIDA	Swedish International Development Cooperation Agency
IBRD	International Bank for Reconstruction and Development	TCX	The Currency Exchange
IDA	International Development Association	T&C	Trade & Competitiveness Global Practice
IFC	International Finance Corporation	UN	United Nations
ISC	IFC Startup Catalyst	WEF	World Economic Forum
IMF	International Monetary Fund	WBG	World Bank Group
JIPs	Joint Implementation Plans		
LCF	Local Currency Facility		

EXECUTIVE SUMMARY

i. **Participants at the second IDA18 Replenishment meeting in June 2016 endorsed the creation on a pilot basis of a US\$2.5 billion IFC-MIGA Private Sector Window (PSW) within IDA.**¹ Participants supported the PSW’s objective to expand private investment in IDA-only countries, with a particular focus on Fragile and Conflict Affected States (FCS). Participants recognized that the private sector lies at the center of a sustainable development model and that expanding support to the private sector will be critical for achieving the Sustainable Development Goals (SDGs) and the IDA18 objectives – while at the same time recognizing that the uncertainties and unpredictability involved in engaging in some markets prevent private sector investment from happening at the necessary scale.

ii. **This paper presents further details on the key parameters and design features of the PSW, taking into account the guidance provided by Participants.** Specifically, Participants have underscored that the PSW should be clearly aligned with IDA objectives, minimize subsidies and potential market distortions, and demonstrate additionality to World Bank Group’s (WBG) activities in IDA-only countries and IDA-eligible FCS². The paper responds to the requests for (i) clear benchmarks to measure additionality; (ii) prioritization and consolidation of the proposed facilities under the PSW to ensure complementarity with existing WBG instruments and external market solutions; (iii) updated analysis of each of the proposed facilities; and (iv) accountable, transparent and effective governance and risk management frameworks.

iii. **The objective of the PSW is to expand private investment in IDA-only countries, with a particular focus on IDA-eligible FCS.** This objective, which is in line with one of the key strategic directions of the Forward Look exercise with WBG shareholders, requires additionality to existing WBG programs and a strong focus on mobilization of private investment through leveraging IDA resources. In addition to being central to the Jobs and Economic Transformation IDA18 special theme, the PSW will help advance other IDA18 special themes. Progress towards the PSW objective will be monitored through a PSW results management framework, and built into the PSW governance structure. PSW progress and initial results will be reviewed at the IDA18 Mid-Term Review (MTR).

¹ See “WBG Collaboration: Proposal for an IFC-MIGA Private Sector Window in IDA18”, June 8, 2016.

² IDA-only refers to IDA regular, non-gap, non-blend countries. FCS refers to IDA-eligible FCS countries. See Annex 5 for the current list of IDA-only and IDA-eligible FCS countries for illustration. The final list of PSW-eligible countries will be confirmed at the beginning of IDA18 and used for the duration of the IDA18 period, adjusted for countries that become IDA-only and/or IDA-eligible FCS during the IDA18 period. For the rest of the paper in places where PSW eligible countries are referred to, the use of “IDA” and “FCS” refers to IDA-only and IDA-eligible FCS respectively. Exceptions may be considered for sub-national regions of IDA blend and non-gap countries that experience extreme fragility and conflict.

iv. **The PSW responds to considerable demand for pioneering and responsible investments in markets that need to develop their private sectors by building upon the WBG’s long-standing support for private sector development.** Together, IDA, IFC and MIGA have a strong understanding of the public goods and market failures that constrain the private sector from entering poor countries and fragile markets. They have a range of tools to support the private sector and the proposed IDA18 financing scenarios will enable a considerable scale-up of IDA’s engagement in this area. As a complement, when existing instruments are not deemed sufficient to meet investor requirements, the PSW will enable IDA to operate in the space where public policy and private investment meet by leveraging the capacity and experience of IFC and MIGA to directly support investments that grow the domestic private sector and create conditions for long-term responsible investment. It is anchored in the public policy rationale that well-targeted public resources, when applied appropriately, can help promote public goods through supporting direct private interventions. The demand for such support is strong as private investors are increasingly looking to invest in frontier markets but need risk mitigation.

v. **Additionality of the PSW comes from increasing both the scale and the scope of the WBG support to private sector investment in IDA and FCS markets and will be ensured through monitoring and governance frameworks.** “Scale additionality” will be mainly assessed through monitoring against an agreed baseline where IFC’s and MIGA’s annual activities in IDA-only and FCS countries would amount to US\$1.2 billion and US\$330 million respectively over IDA18: the PSW is expected to enable significantly higher volumes. “Scope additionality” refers to the PSW enabling IFC and MIGA to increase the scope of their activities into new sectors and markets, and create opportunities for new ways of doing business. Importantly, the PSW will be deployed only when existing products and market solutions are not deemed sufficient to address investor requirements, and a minimum concessionality approach will be adopted to minimize market distortion. Additionality requirements will be built into the results framework, the eligibility criteria, and the governance structure.

vi. **Robust and transparent governance arrangements are proposed to ensure the effective implementation of the PSW.** Five organizing principles have been developed to guide the governance arrangements: *accountability* through independent decision-making by each institution; *strong oversight* through clear reporting and review arrangements; *conflict of interest management* through each institution vetting cross-institutional transactions independently and arms-length arrangements; *transparent risk-return sharing* to ensure that IDA is compensated for some of the risks it assumes under the PSW; and *operational efficiency* through leveraging existing processes to the extent possible without compromising other governance principles. Guided by these principles, the proposed PSW governance structure has three levels (supported by a PSW Secretariat): a facility-specific process to enable decision-making at the transaction level; an Oversight Committee to provide strategic direction and monitoring, as well as to review transaction-specific disagreements; and ultimately the respective Boards of the three institutions. These arrangements reflect the fact that the PSW will be maintained on IDA’s balance sheet and ensure that the PSW activities are carried out within the agreed parameters to protect IDA’s financial sustainability and be consistent with future leveraging strategy.

vii. **The number of facilities supported by the PSW has been reduced from six to four:** (i) *a Risk Mitigation Facility* to provide project-based guarantees without sovereign indemnity to crowd-in private investment in large infrastructure projects; (ii) *a MIGA Guarantee Facility* to expand the coverage of MIGA guarantees through shared first-loss and risk participation via reinsurance; (iii) *a Local Currency Facility* to provide long-term local currency investments in countries where capital markets are not developed and market solutions are not sufficiently available; and (iv) *a Blended Finance Facility* to blend PSW support with IFC investments to support small and medium enterprises (SMEs), agribusiness and other pioneering investments. While each of the Facilities has its own design and focus, they will be managed collectively using a portfolio approach to reflect the overall objectives of the PSW.

viii. **Given the increased risks that the PSW would introduce to IDA, this paper proposes means to mitigate them, while still enabling high impact projects in difficult markets.** Bearing in mind IDA's fiduciary responsibility to the funds entrusted to it by contributing partners, Management has analyzed the financial, reputational, development and implementation risks to inform the risk management measures needed for the facility. The PSW first faces *financial risks*. The Chief Risk Officer (CRO) has conducted a preliminary independent risk assessment to review the related financial risks to IDA's balance sheet from the proposed financial structures, to understand the expected and unexpected losses and propose ways to contain the risks to acceptable levels. It should be noted that the main reason the private sector and IFC/MIGA are unable to assume these risks on their balance sheets is because these risks either command too high of a price, or cannot be quantified and bound within acceptable levels of confidence. Accordingly, while appropriate guidelines will be developed to manage financial risks, for purposes of IDA capital adequacy, the entire amount of the PSW will be deducted from IDA's capital when estimating available capital for core lending business. The guidelines will require that the transactions be limited such that the maximum loss to IDA is the notional amount of the window (US\$2.5 billion) with similar caps on losses to IDA for each of the facilities. Second, *reputational risks* arise from related-party transactions as well as from IDA's main role as a trusted government advisor. The governance structure will ensure that the PSW achieves its objectives and maintains IDA's ultimate approval authority in deciding the use of the PSW resources. In addition, reputational risks might arise from any bias or perception of bias that IDA's policy advice to public sector clients would be partial towards protecting its investments through the PSW or towards firms that benefit from support of the PSW. Third, *development risks* arise from the uncertain ability to achieve the expected demonstration effect through PSW investments, as well as the risk of market distortions. Finally, *implementation risks* arise given the challenging nature of the markets and transactions targeted by the PSW. This will require, beyond the PSW implementation efforts, additional project preparation resources and the alignment of staff incentives to further increase IFC's and MIGA's focus on engagement in more challenging markets. Moreover, it will take time to develop sound, bankable projects that the PSW can target, especially in the infrastructure space. The success of PSW-supported projects will also depend on ongoing sectoral and investment climate reforms, led by our member countries and supported across the WBG. Governance arrangements and transparent reporting mechanisms have been designed to help mitigate these risks, and a risk management framework will be built to guide implementation.

ix. **Recognizing both the challenges and potential development impact from the PSW, IDA, IFC and MIGA Management are committed to focus their efforts on the successful**

implementation of the window for IDA18. All institutions will be mobilized to establish and implement the PSW as an important priority. Based on financial and development results as well as learning through feedback loops, Management will adjust the pilot and adapt as necessary towards successful implementation. The IDA18 Mid-Term Review (MTR) and appropriate evaluations in due course will also provide additional guidance to the PSW.

x. **Management requests IDA Deputies' support for the updated proposal to create an IFC-MIGA Private Sector Window under IDA18.** With Deputies' endorsement, Management will present the PSW proposal to the Executive Directors of IDA for approval, together with IFC and MIGA Boards' approval of each institution's participation. Further implementation details will be developed for the PSW to be operational at the start of the IDA18 period on July 1, 2017.

I. INTRODUCTION

1. **This paper advances the proposal for an IFC-MIGA Private Sector Window (PSW) in IDA18 based on Participants' broad support for its creation at the second IDA18 replenishment meeting.** As recognized by Participants in Myanmar, the private sector lies at the center of a sustainable development model. The PSW will contribute to IDA's broader objectives of expanding private investment in the poorest IDA countries alongside support to the public sector, and IDA18's special focus on scaling up efforts in FCS. In the broader context of an ambitious IDA18 replenishment to support achieving the Sustainable Development Goals (SDGs), it is an important innovation that creates space for IDA to support the expansion of the private sector and mobilize private capital.

2. **The paper presents further details of the proposal that reflects the guidance received from Participants regarding key design features of the PSW.** Specifically, Participants strongly underscored that the PSW should be clearly aligned with IDA objectives; should minimize subsidies and potential market distortions; and demonstrate additionality to the WBG's activities in IDA countries and FCS. They requested (i) the development of clear benchmarks and a results framework by which to measure additionality; (ii) the prioritization and consolidation of the proposed facilities under the PSW, including how the window would leverage existing structures to ensure complementarity to existing WBG instruments and external market solutions; (iii) updated analysis of each of the proposed facilities; and (iv) accountable, transparent and effective governance and risk management frameworks to address potential conflict of interest/moral hazard issues.

3. **The paper is organized as follows.** Section II further elaborates on the objectives of PSW in the IDA18 context, highlighting the additionality the PSW aims to achieve. Section III presents the overall governance framework of the PSW underpinned by a set of principles of good governance that incorporate lessons learned from past inter-WBG transactions. Section IV discusses the prioritized facilities proposed for deployment under the PSW. Section V reviews the framework for managing the risks of the PSW. Section VI sets out the issues for discussion. Additional details are provided in annexes attached to the paper.

II. STRATEGIC POSITIONING AND ADDITIONALITY OF THE PSW

A. ADDRESSING GLOBAL AMBITIONS

4. **The private sector plays a pivotal role in economic development, supporting the creation of pathways out of poverty that are essential to achieve the SDGs.** It provides 90 percent of jobs and the biggest source of income for people living in IDA countries. A healthy and inclusive private sector raises workers' productivity levels and links them to local, regional and global value chains. It also offers opportunities for entrepreneurship, develops critical skills, expands learning opportunities for the labor force, facilitates technology transfer, increases the tax base, and in many cases, supports the public sector in designing and providing public services. To achieve the SDGs in the poorest developing countries, it will be necessary both to continue to strengthen the public sector and to expand the private sector to meet development challenges directly.

5. **The challenges in developing the private sector in many IDA countries, and especially those that are fragile and/or affected by conflict, are substantial.** As presented to Participants in June³, in many of these countries, the domestic private sector is small and informal, and constrained by a weak macroeconomic and regulatory environment, infrastructure bottlenecks and a limited skilled labor force. These constraints, combined with high country risks, make foreign investors reluctant to engage, particularly in FCS where security risks add to the list of concerns. As a result, IDA countries' ability to attract private investment and grow the private sector remains limited. Consequently, although aggregate private capital flows to emerging markets outweigh public development finance, the poorest and most fragile countries continue to rely heavily on donor funds. The PSW provides an opportunity to make strategic use of public resources to catalyze private investments in these challenging markets by de-risking and mobilizing private capital. This is especially important given the limitations on IFC and MIGA capital, which are constrained in their ability to significantly ramp up their own activities in the poorest countries.

6. **Attracting foreign investment and growing the domestic private sector in the frontier IDA and FCS markets require continued strengthening of the business environment.** Through its long-established engagement in low-income countries, IDA supports sector reforms that enable the private sector to grow in improved business environments. Such work fosters regulatory reforms, strengthens macroeconomic and structural policies, allows for infrastructure projects, and improves labor market and skills policies. In addition, IDA's sector knowledge and resources are used to finance the private sector directly through lines of credit and policy and project-based guarantees. Similarly, IFC's Advisory Services, including Trade & Competitiveness (T&C) Advisory, project preparation and other capacity building support are essential to the overall efforts; the IFC is committed to scale up these efforts to support the long-term development impact of the PSW.

7. **The demonstration effect that comes from first movers willing to make pioneer investments in challenging environments is also critical to show the viability of business in these frontier markets.** Successful pioneering investments can help reduce investor risk perceptions and open up the countries to more domestic and foreign capital. They can help propel governments to develop regulations and supporting services, establish business and consumer markets, and generate externalities that overcome market failures. The demonstration effect can then lead other companies to enter and expand the market for the private sector to grow.

8. **Complementing IDA's public policy role in supporting private sector development, the proposed PSW is a key part of IDA's response in supporting pioneering and responsible investments in the poorest countries, and especially in FCS.** The proposed window builds upon the WBG's long-standing support for private sector development, and its understanding of the public goods and market failures that constrain the private investments from entering poor countries and fragile markets. The PSW will enable IDA to operate in the space where public policy and private investment meet by leveraging the capacity and experience of IFC and MIGA to support direct investments that grow the domestic private sector and create

³ See June PSW Paper; Footnote 1, page 5.

conditions for long-term responsible investors. This would further enable IDA's catalytic role to shape the nature and form of critical private investments in IDA countries- especially in FCS- which face the greatest challenges in mobilizing private capital. The PSW is not designed to address the public and market failures in the IDA/FCS markets by itself, but it can play a complementary role to IDA's continued focus on the enabling environment and sectoral reforms and IFC's Advisory Services. The PSW is anchored in a clear public policy rationale that well-targeted public resources when applied appropriately can help promote public goods through supporting direct private sector interventions.

9. **Demand for such support is strong as investors and commercial institutions are looking to invest in frontier markets but need support to help mitigate risks.** At the macro level, the global capital markets appear to have entered a protracted period of high liquidity and low cost. The downward pressures on returns in developed markets make emerging and frontier markets more appealing. But capital flows to these markets are hindered by real or perceived risks and market inefficiencies. Development finance can therefore play an important role in mitigating risks and bringing risk-adjusted returns in line with investor requirements.⁴ Recent experiences at the WBG with IFC's blended finance platform including the climate facilities, the private sector window under the Global Agriculture and Food Security Program (GAFSP) and SME facility, and MIGA's Conflict-Affected and Fragile Economies Facility (CAFEF) have seen considerable demand, some of which were unmet due to inadequate financing or risk mitigation.

10. **In line with IDA's track record of innovation, the PSW would allow IDA to leverage the IFC and MIGA platforms in a financially efficient manner, and provide an entry point into the area of "blended finance".** The blended finance concept has received increased global attention and recognition in recent years.⁵ Many bilateral and multilateral development institutions have piloted blended financing initiatives as a new model of support and leverage to crowd-in the private sector as an intermediary between pure grants and investments with full commercial returns. The design of the PSW benefits from selected experiences and lessons learned from similar activities including IFC's own experience with blended finance and donor-funded investments for more than 15 years (see Annex 1), MIGA's experience with CAFEF (see Annex 2), and those implemented by others. Annex 3 discusses the lessons learned from the African Development Fund's (ADF) Private Sector Facility (PSF).

⁴ See "Blended Finance Vol 1: A Primer for Development Finance and Philanthropic Funders", OECD, World Economic Forum, September 2015.

⁵ General blended finance should not be confused with the Blended Finance Facility described in section IV proposed under the PSW. The World Economic Forum and the OECD define blended finance as "the strategic use of development finance [...] to mobilize private capital flows to emerging and frontier markets, [...] mitigating risks and managing returns in line with similar investments in developed markets". See "Blended Finance in the Private Sector Context", World Economic Forum and OECD, 2014.

Box 1: Blended Finance Experiences

The scale of capital to achieve the SDGs agreed by the international community has fueled the emphasis on innovative approaches to finance such as blended financing. The World Economic Forum (WEF) and the Organisation for Economic Co-operation and Development (OECD) launched a “Redesigning Development Finance Initiative” initiative in 2015 to collate insights and published a toolkit on adopting blended finance approaches. Some examples of blended finance arrangements, outside of the WBG, used by bilateral and multilateral donors over the last decade are provided below.

Fund/ Facility	Objectives/ Sector focus	Partners	Size /Instruments	Deployment (as reported)
European Fund for Strategic Investments (EFSI) (2015)	Increase investment and competitiveness gap in EU to achieve targeted GDP shares, high market liquidity, overcome public budget constraints and financial/non-financial barriers to investment. Focus sectors- infrastructure & SMEs	<ul style="list-style-type: none"> • EU • European Investment Bank (EIB) 	<ul style="list-style-type: none"> • Size: €21 billion • Blending finance to reduce finance cost • Guarantees • Advisory 	<ul style="list-style-type: none"> • As of 2016, €20.4 billion EU approved (€10.9b signed) • €115.7 billion investment mobilized • 289 transactions in 26/28 EU countries
EU-Africa Infrastructure Trust Fund (EU-AITF) (2007)	Increase infrastructure investment in sub-Saharan Africa by blending long term loans from financiers with resource grants	<ul style="list-style-type: none"> • European Commission and selected EU member states (financier) • EIB • Participating financiers/stakeholders, including AU, AfDB, NEPAD, ICA, PPIAF and Regional Economic Communities 	<ul style="list-style-type: none"> • Size: €812 million • Equity/quasi-equity investments/ grants • Interest rate subsidies • Guarantees • Technical advisory 	<ul style="list-style-type: none"> • As of 2015, €655 million EU approved • €8.9 billion Euro projects investment • 104 grants, 77 projects approved
Danish Climate Investment Fund (KIF) (2012)	Support climate projects which contribute to direct or indirect reduction in GHG emissions	<ul style="list-style-type: none"> • Investment Fund for Developing Countries (IFU) • Private sector (primarily Danish) 	<ul style="list-style-type: none"> • Size: DKK1.3 billion in committed capital (US\$200 million) • Risk capital (including co investment) • Advisory 	<ul style="list-style-type: none"> • As of 2015, 11 projects committed • Direct investments of DKK404 million • Investments mobilized of DKK6.6 billion
New Partnership for Africa’s Development – Infrastructure Project Preparation Facility (NEPAD-IPPF) (2003)	Provide grant resources to assist African countries to prepare high quality/ viable infrastructure related projects to be financed by public and private sources	<ul style="list-style-type: none"> • AfDB • Canada (CIDA) • Denmark (DANIDA) • Germany (KfW) • Norway (NORFUND) • Spain • UK (DFID) 	<ul style="list-style-type: none"> • Size: US\$46 million • Grants for project development 	<ul style="list-style-type: none"> • As of 2012, US\$44 million in grants • 55 regional projects- 29 completed, 22 ongoing • Mobilized investments of US\$5 billion
Kenya Commercial Bank/USAID/ General Electric partnership (2014)	Make available local financing to SMEs for developing private health facilities in Kenya	<ul style="list-style-type: none"> • USAID • General Electric (GE) • Kenya Commercial Bank (KCB) 	<ul style="list-style-type: none"> • Size: US\$10 million • Risk sharing • Longer tenured lending • Training 	<ul style="list-style-type: none"> • Not reported

Source: Web-based research and World Economic Forum and OECD (2015), “Blended Finance, A development philanthropic funders report”.

B. LINKS TO IDA18 POLICY COMMITMENTS AND THE FORWARD LOOK

11. **The PSW is a key IDA18 policy commitment and a platform for supporting the Jobs and Economic Transformation special theme’s objective of creating better and more inclusive jobs.** Support from the PSW aims to improve risk sharing in investments and to crowd-in private capital, with the ultimate goals of enhancing competitiveness, strengthening integration into global markets, and encouraging private sector-led transformation in IDA countries and FCS. The PSW will be complemented and informed by the other policy commitments under the Jobs and Economic Transformation special theme⁶.

12. **The PSW is also an integral part of IDA18’s goal of substantively scaling up support to FCS.**⁷ The PSW complements IDA18’s commitment to scale up support to FCS on the public sector side by aiming to catalyze private investment to help address critical development challenges, including delivering essential goods and services, building critical infrastructure, improving resilience, and creating economic opportunities and jobs in FCS countries. It also allows IDA to play a catalytic role to expand IFC’s and MIGA’s capacity to be part of the early response in post-conflict and fragile situations and supports IDA’s, IFC’s and MIGA’s ability to bundle efforts to lend meaningful support to the private sector in the most challenging markets. The PSW’s focus on FCS will be reported and monitored at the portfolio level.

13. **Private sector development is also linked to making progress on other IDA18 special themes including gender and climate change.** In the broader context of crowding-in private investments into difficult markets, wherever possible, the PSW will seek to contribute to women’s economic empowerment through women-led businesses and entrepreneurship especially in SMEs and agribusiness; to low-carbon growth paths including through investments in climate-smart infrastructure (including renewable energy generation), energy access and climate-smart agribusiness; and to widen the tax base to finance public service delivery. The reporting of the PSW will show clear linkages to the IDA18 special themes.

⁶ For further detail on IDA18 policy commitments under the Jobs and Economic Transformation theme, please refer to draft “Report from the Executive Directors of the International Development Association to the Board of Governors. Additions to IDA Resources: Eighteenth Replenishment. Towards 2030: Investing in Growth, Resilience and Opportunity”, presented in draft form in parallel to the present paper, and to be approved by the Board of Executive Directors of IDA in early 2017.

⁷ Details on IDA18 commitments on Fragility, Conflict and Violence, see draft “Report from the Executive Directors of the International Development Association to the Board of Governors. Additions to IDA Resources: Eighteenth Replenishment. Towards 2030: Investing in Growth, Resilience and Opportunity”, Section III.

Box 2: WBG Mobilization Efforts

Under the Financing for Development (FfD) Agenda, the MDBs reaffirmed their role as the main engines of development finance - “we not only provide direct financial assistance, but also mobilize, catalyze, and crowd-in public and private sources of development finance”. The WBG is helping lead the FfD Agenda, and pledged to mobilize and channel greater volumes and new types of private and public finance in support of the 2030 Agenda.

The WBG is taking concrete actions to further enhance its mobilization effort.

- IDA’s ambitious steps under IDA18 through market access and leveraging including the proposed PSW
- New implementation of platforms including the MENA Financing Facility, the Global Infrastructure Facility (GIF) and the Pandemic Emergency Facility (PEF)
- IFC’s large Syndicated Lending Program with more than US\$50 billion mobilized in more than 110 emerging markets, Asset Management Company (AMC) and Managed Co-Lending Portfolio Program (MCP)
- IFC’s blended finance platform catalyzes private sector participation by leveraging every dollar of donor support in blended finance, to US\$7 to US\$8 or more of IFC and third party financing (including 2-3x the IFC part)
- MIGA’s CAFEF
- WBG Guarantees as an effective way to leverage WBG capital, with strong WBG collaboration

The WBG is increasingly leveraging and building partnerships to enhance mobilizing private finance.

- Joint IMF-WBG Tax Initiative to build in-country domestic resource mobilization capacity launched during the 2015 Annual Meetings
- Global Infrastructure Forum to improve MDB alignment and coordination to mobilize public and private resources for infrastructure financing - launched at 2016 Spring Meetings
- Development Finance Forum (DFF) to improve public-private alignment and unlock ideas and partnerships for investment opportunities (led by Bank/IFC/MIGA)
- WBG core member of UN ECOSOC Interagency Task Force to monitor progress on Addis Ababa Financing for Development commitments

The WBG is taking measures to shift towards a mobilization culture by aligning internal processes, incentives, metrics & targets.

- The WBG Mobilization Working Group (MWG) is developing WBG-wide measures of mobilization and catalyzation (and will be reported in the Corporate Scorecard) and is in the process of defining and aligning measures of co-financing to be systematically used for WBG operations in FY17.
- IFC on behalf of the WBG is leading a Joint MDB Task Force on Catalyzation which aims to harmonize metrics and reporting across the MDBs.
- WBG-wide Guarantees Steering Committee addressing the scale-up of guarantees

14. **The IDA18 replenishment is creating space for innovations in support of transformational private sector development in IDA countries.** The PSW needs to be seen in the broader context of a significant scale-up in financial support under IDA18 to meet unprecedented demand towards the SDGs including a doubling of resources for FCS. Based on historical trends, if IDA continues to devote almost half of its commitments to supporting private sector development, then IDA18 could potentially provide an additional US\$10-15 billion in commitments to supporting private sector development. Building on this additional support, IDA18 provides a unique opportunity to achieve the potential for attracting private sector capital

and investors to the least developed markets. In addition to the proposed introduction of market debt onto IDA's balance sheet, which increases the available resources for IDA to invest, the PSW seeks to mobilize significant additional private sector investments directly in IDA countries, in support of the international community's *Billions to Trillions* agenda.

15. **The PSW is also a critical effort linked to strengthening the WBG's engagement with the private sector, which features prominently in the discussion with shareholders on the Forward Look⁸.** This discussion has recognized that achieving the SDGs and Financing for Development (FfD) agenda requires partnerships with the private sector to create jobs, provide capital and provide solutions for inclusive economic growth. The proposed PSW would form a part of the WBG's broader mobilization effort to enhance its ability to bring private sector expertise and finance to bear on development challenges (see Box 2). It will also strengthen progress achieved to date towards closer WBG collaboration.⁹

C. ADDITIONALITY

16. **As Participants emphasized at the June meeting, the PSW needs to demonstrate clear additionality to IFC's and MIGA's activities in IDA-only and FCS countries.** Clearly defined additionality drives the overall design of the window, governance considerations, facilities selected, implementation arrangements, and reporting and evaluation of the PSW.

17. **The main additionality of the PSW is to enhance the *scale* and *scope* of the WBG support to crowd in private sector investment in IDA and FCS markets through the design and deployment of new and expanded development solutions in high-impact sectors.** The impact of the PSW will be demonstrated through enhanced IFC and MIGA engagements in IDA and FCS markets, thus leveraging the institutions' successful business models, platforms and networks, as well as IDA's long-standing partnerships with clients. In addition, the PSW will increase the scope of IFC and MIGA activities into new sectors and markets, and create opportunities for new ways of doing business, encouraging and supporting economic transformation of these frontier markets. Additionality will be demonstrated and measured quantitatively with meaningful indicators where possible, and qualitatively when data does not necessarily capture the results and impacts.

18. **The expected additionality of the PSW and results measurements need to balance ambition and realism, and recognize the trade-off between risks and leveraging impacts.** The additionality of the PSW is built into its design by targeting the most difficult and risky markets. Given the difficult business environment and the operational risks involved, the balance between risk and results will be managed carefully in implementation to provide the right incentives for project teams. A portfolio approach will be adopted to manage the window. Progress of the PSW will be reviewed at the IDA18 MTR.

⁸ The Forward Look exercise, initiated in early 2016, has provided a platform for the Board and Management to stipulate a vision by the Annual Meetings 2016 to enhance the WBG's ability to support the 2030 Agenda for Sustainable Development.

⁹ More details on the rationale of the PSW, see June PSW paper.

SCALE

19. **At the aggregate level, the PSW will enhance the growth trend of IFC's and MIGA's commitments in IDA-only and FCS countries.** Over the past 10 years (FY07-16), IFC invested US\$7.8 billion in these markets, of which US\$4.8 billion (over 50 percent) were in the past four years, reflecting IFC's important shift and increased focus on these markets. MIGA's gross issuances in the same countries over the same period amounted to US\$3.6 billion of which US\$2 billion was in FCS. While IFC and MIGA have made significant progress in growing their FCS and IDA commitments in recent years guided by both institutions' commitments to support investment in IDA and FCS countries, further support from the PSW would enable an even higher level of growth, especially into some of the most difficult markets.

20. **PSW support will enable IFC and MIGA to more than triple their growth in IDA-only and IDA-eligible FCS as compared to the levels of growth that they could achieve on their own in these markets.** Applying the current IDA-only and IDA-eligible FCS country list (see Annex 5), Table 1 shows the annual average of IFC's own account commitments (US\$1.2 billion), and the number of investments from FY13 to FY16, as well as MIGA's average gross issuance (US\$332 million), and number of guarantees from FY06-16.¹⁰ Using these averages as baseline with a five percent MIGA and IFC corporate annual growth projection for FY18-20,

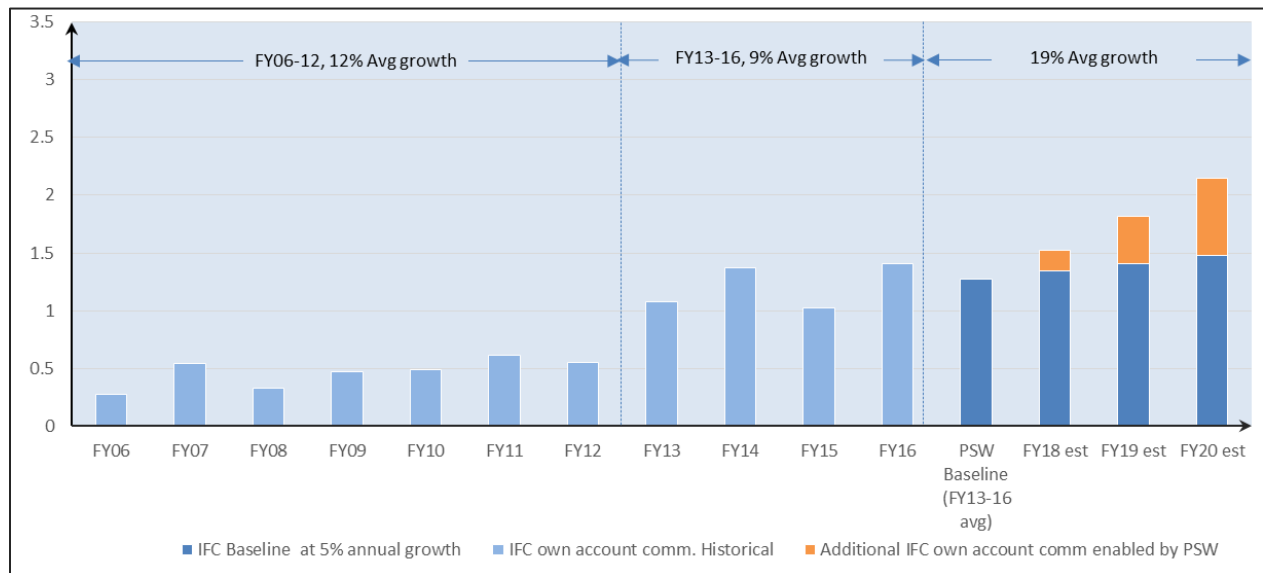
- The PSW is expected to support an increase in IFC's own account investments in the IDA-only and FCS markets by over 15 percent over the FY18-20 period, which represents a significant increase over IFC's baseline forecast of five percent growth between FY17 and FY19, as projected in IFC's Strategic Business Outlook. In volume terms, IFC's annual engagements in these countries are expected to grow from a baseline of US\$1.2 billion to over US\$2 billion during the IDA18 period, including IFC own account commitments enabled by PSW. (See Figure 1)
- The PSW could significantly enhance MIGA's commitments to IDA and FCS countries by adding on average close to US\$400 million annually to MIGA's gross issuance in these countries over three years. One of the main benefits of the PSW would be to enable MIGA to increase its guarantee issuance in difficult markets, particularly FCS, and stabilize the share of IDA and FCS countries in MIGA's portfolio at a consistently higher level, beyond MIGA's overall expected new issuance growth of five percent annually from FY17 to FY20. (See Figure 2)
- These quantitative indicators on volume of commitments and number of engagements will be monitored on a continuous basis as part of the PSW results framework. It is to be noted that the projected growth is to convey a sense of an overall upward trajectory of IFC's and MIGA's engagements in IDA/FCS markets, while the actual growth will be more volatile in these fragile and least developed markets.

¹⁰ As data in the past ten years shows, IFC had a significant increase in the past 4 years on its engagements in IDA/FCS markets and has since maintained its engagement at a similar level, therefore using the past 4 years average as baseline reflects the reality more closely. For MIGA, the data shows the volatility of MIGA's engagements in IDA/FCS markets, the past 10 years average is in fact similar to past 4 year average.

Table 1: IFC and MIGA Own Account Commitments/Gross Issuance, in US\$, Millions

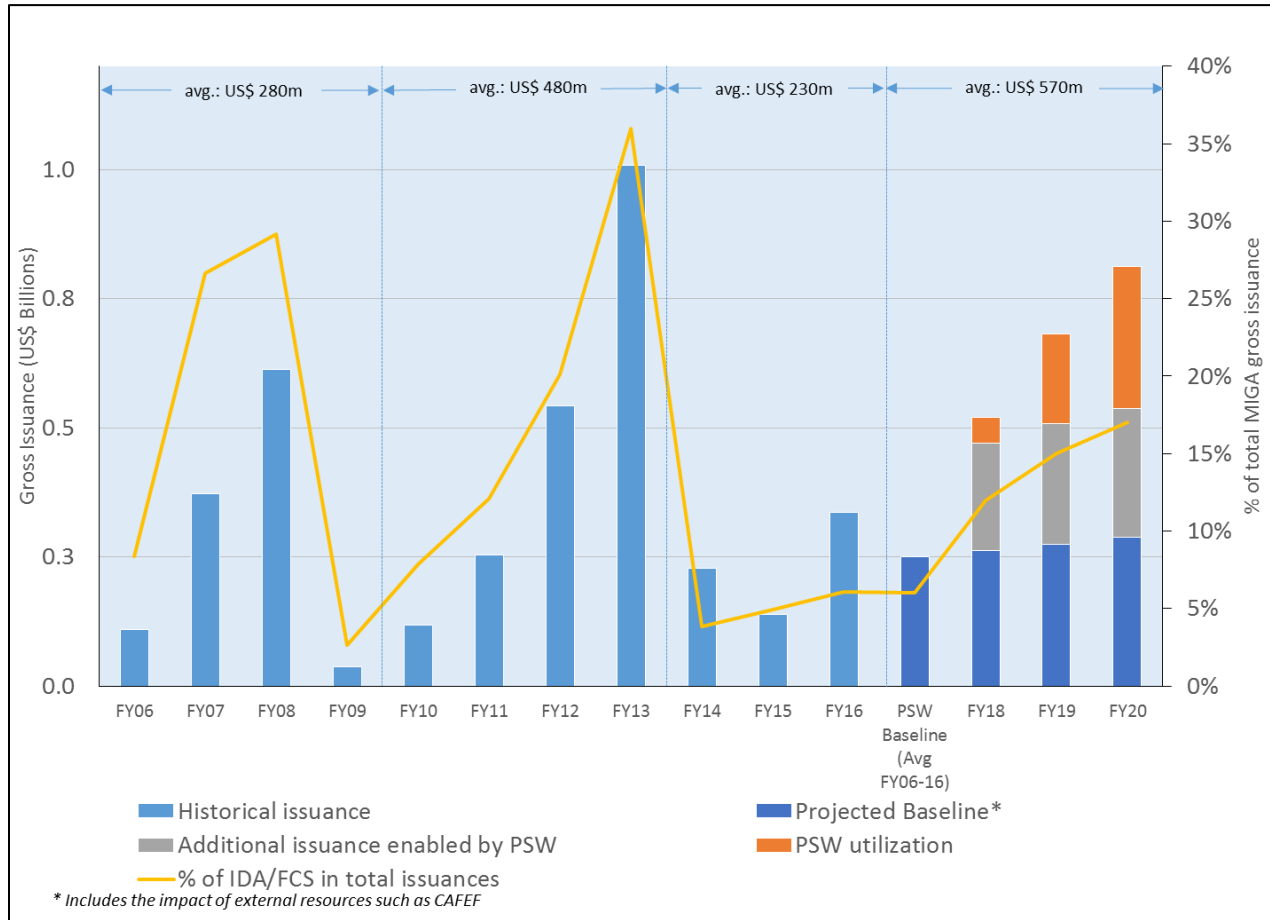
	IFC (Baseline FY13-16 Avg.)		MIGA (Baseline FY06-16 Avg.)	
	Own account commitments \$ millions	Investments (#)	Gross Issuance \$ millions	Guarantees (#)
IDA-only Non-FCS	848	55	156	4
FCS (all IDA-eligible)	368	24	176	4
Total	1,216	79	332	8

Figure 1: IFC’s Projected Growth in IDA-only and IDA-eligible FCS Markets with PSW Support in US\$, Billions¹¹



¹¹ IFC projected growth includes IFC’s own account commitments, which refers to investments from IFC’s balance sheet. PSW usage is not reflected in the chart as it will be used as a guarantee or backstop across facilities in most cases.

Figure 2: MIGA’s Projected Growth in IDA-only and IDA-eligible FCS Markets with PSW Support in US\$, Billions¹²



21. **The PSW will demonstrate a clear impact on mobilizing and crowding in additional private investment, both foreign and domestic, through IFC’s and MIGA’s enhanced engagements in IDA/FCS markets.** Building on IFC’s and MIGA’s existing projected growth, the US\$2.5 billion PSW is expected to catalyze an additional US\$6-8 billion in private sector investment to IDA and FCS countries (see Figure 3 for IFC’s and MIGA’s leveraging impacts). The PSW offers a significant leverage¹³ of IDA funds. On average¹⁴, the PSW enables a leveraging ratio of every dollar of IDA capital invested to four dollars the overall investment into the IDA countries including IFC own account commitments and MIGA’s additional issuance. At the facility level, the leverage is as follows:

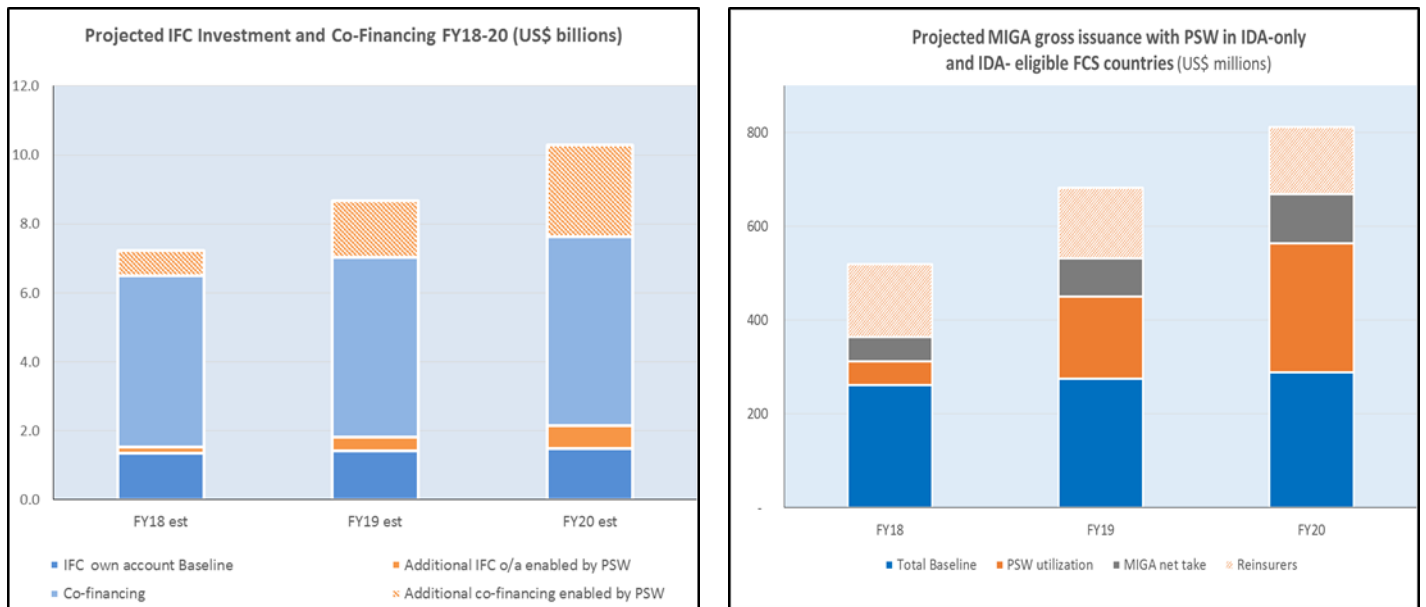
¹² PSW usage included in MIGA gross issuance since it will be used to issue guarantees, provide reinsurance and first loss instruments under the MIGA guarantee facility (MGF).

¹³ There is an ongoing WBG Joint MDB Task Force on Catalyzation which aims to harmonize metrics and reporting across the MDBs and will be adopted by the PSW for tracking leveraging. Once definitions are finalized, these will be incorporated in the PSW results indicators for tracking.

¹⁴ Based on an approximation of expected projects to be financed under the PSW, and assuming the allocation range as specified in Section IV. Leverage ratios are based on IFC’s and MIGA’s past experience.

- In infrastructure, every dollar channeled into risk mitigation instruments, leverages as much as US\$4 of total investment.¹⁵
- Through first loss and reinsurance structures, every dollar of PSW resources deployed results in around US\$5 of private sector investment mobilized and co-financed in MIGA projects on top of what it would have delivered without PSW.
- Every dollar invested into blended finance, with a focus on SMEs and agribusiness, leverages up to US\$5 in additional investment from the private sector, including IFC’s own investment over the IDA18 period.
- Through local currency hedging, every dollar is expected to leverage an additional dollar of IFC investments.

Figure 3: IFC’s Investment & Co-Financing and MIGA Gross Issuances in IDA-only and IDA-eligible FCS markets with PSW support¹⁶



22. **Impact on FCS markets will be a particular focus of the PSW.** The PSW is a key instrument of IDA18’s scaled-up support to FCS, mobilizing both public and private sector support. By pioneering new instruments, and expanding successful recent innovations, the PSW is expected to support IFC’s ability to accelerate its impact in some of the most challenging FCS markets—by enabling growth in IFC investments to increase from an expected 5 percent annually to over 15 percent.¹⁷ The PSW would also support MIGA’s commitment¹⁸ to FCS

¹⁵ This includes up to 25 percent of IFC own account investment.

¹⁶ IFC own account (o/a) investments refers to investment from IFC’s balance sheet. In IFC estimates, co-financing is defined as total private sector investment catalyzed for each \$1 of IFC own account investment.

¹⁷ IFC Strategy & Business Outlook for FY17-19.

countries by providing a reliable source of first loss and reinsurance capacity that would help leverage further the private sector – whether through investment or risk participation – and increase the amount of long-term finance available for these countries.

SCOPE

23. **In addition to increased volumes and scale, additionality also lies in the expanded scope of IFC’s and MIGA’s support, including entering frontier markets and sectors, encouraging and supporting economic transformation.** Currently, IFC and MIGA together have investments and guarantees in 45 out of the 53 IDA-only/FCS countries. The PSW can enable IFC and MIGA to enter some new markets where there are basic conditions for investments, but where high risks have prevented previous engagement. In markets where IFC and MIGA have already engaged but not at a significant scale, the PSW can enable IFC and MIGA to expand engagements for projects with high development impact, which is especially relevant for the FCS countries. These enhanced activities could encourage and support economic transformation of these frontier markets, through improving productivity, generating jobs, and increasing incomes. A portfolio approach will be adopted to manage the PSW. As part of the overall portfolio, the PSW will look to support a few large-scale projects that can potentially have transformational impact (see illustrative examples in Annex 7).

24. **The PSW facilities will be deployed when existing products and market solutions are not deemed sufficient to address investment requirements.** The PSW will enable IFC and MIGA to enter and help accelerate investment in new sectors and address specific gaps in sectors that drive job creation and higher incomes. In infrastructure, limits on the capacity to structure bankable projects, and the high risk profile associated with specific investments in IDA countries have hampered progress. Similarly, the PSW aims to tackle key barriers in other sectors with high development impacts such as SME finance, agribusiness, services, and pioneering investments in manufacturing, social sectors (health & education), technology and local entrepreneurship. The recent decline in global commodity prices has resulted in the depreciation and increased volatility of currencies of many IDA countries, increasing the risk associated with foreign currency lending for private investors. Making local currency financing available would help mitigate risks for clients most vulnerable to currency risk.

25. **As such, PSW support will involve an element of subsidy.** Recognizing this element will provide indication of the PSW’s ability to take risks that the private sector alone is not prepared to take which is directly linked to the additionality of IFC’s and MIGA’s strong engagement in IDA-only and IDA-eligible FCS countries. At the same time, building on IFC’s and MIGA’s experience with blended finance, the PSW governance framework will include discussion when subsidies are required at the transaction level, and how to ensure minimal concessionality to avoid market distortion and support to sectors that could achieve financial sustainability. (See Annexes 1 and 2 on IFC’s and MIGA’s experiences)

26. **Finally, the PSW offers an opportunity to innovate and test new ways of doing business by broadening the client base and the ultimate beneficiaries of the PSW.** The

¹⁸ MIGA Strategic Directions FY15-FY17 and Mid-Term Strategy Update 2016.

proposed PSW facilities could enable IFC and MIGA to explore new possibilities to broaden its reach to potential beneficiaries, including through SMEs, increase focus on developing domestic private sector, and other ways to generate bigger development impacts through private sector solutions. As an example, the PSW could expand SME finance beyond what it can do today by helping banks expand lending to riskier segments; working with financial institutions in markets that would otherwise be too risky and costly for IFC to serve; and helping banks test innovations that can lower costs and increase the scale of SME lending, e.g., women-owned SMEs, healthcare SMEs, or digital finance and other FinTECH solutions that could play an important role in FCS countries. (See the Blended Finance Facility Section for more details). This would build on past successes of similar initiatives such as the Private Sector Window of the GAFSP that has enabled IFC to make a shift in the type of projects that it supports—the beneficiaries are not only big private sector companies, but also smallholder farmers, and of the climate blended finance facilities that has enabled IFC to enter and/or accelerate private sector involvement in new markets and support new climate-smart technologies.

D. PORTFOLIO GOALS, PROPOSED RESULTS INDICATORS & ELIGIBILITY CRITERIA

27. The portfolio-level goals of the PSW will be built into the PSW’s governance process, and guide the direction of PSW operations. These goals are to:

- Scale IFC/MIGA engagements in IDA-only/FCS markets;
- Focus on FCS markets;
- Crowd in private investments; and
- Support IDA18 Objectives and Special Themes, including Jobs and Economic Transformation.

28. Clear indicators will be built into the PSW’s results management framework to measure and report progress, and enable portfolio management to drive the strategic direction of the PSW. The PSW’s results monitoring framework will be built on IFC’s and MIGA’s current results management frameworks (see Annex 4) and aligned with IDA18’s overall Results Management System, as well as the MDBs’ ongoing efforts to harmonize measurements on private capital mobilization. Results will be captured quantitatively where possible, and qualitatively on further impacts that are not necessarily well captured only by data, such as the PSW’s role in creating opportunities in new sectors, countries, through deployment of new instruments and innovations. Key quantitative results indicators are summarized in Table 2, reflecting the portfolio goals of the PSW. Additionally, possible limits in data availability in some markets or for new transactions may require Management to develop other relevant quantitative and qualitative indicators. The complete set of results framework and indicators will be developed as part of the operationalization of the PSW.

Table 2 Selected Key Indicators for the PSW

Objectives	Key indicators
Scaling up IFC/MIGA engagements in IDA-only/FCS markets	<ul style="list-style-type: none"> • Cumulative volume of IFC commitments & Gross issuances of MIGA Guarantees in IDA-only/FCS markets (with a further breakdown of FCS markets; with and without PSW) • Cumulative number of IFC investments & MIGA guarantees in IDA-only/FCS markets (with and without PSW)
PSW's Special Focus on FCS	<ul style="list-style-type: none"> • Share of FCS projects in cumulative PSW commitments, in volume and in number
Crowding-in private sector finance with minimum subsidy	<ul style="list-style-type: none"> • Cumulative volume of private capital mobilized, cumulative volume of private financing of WBG-supported transactions, and cumulative number of private investments catalyzed • Amount re-/co-insured with private sector participants • Assessment of subsidy element of PSW-related transactions with explanation of development need and potential impact
Support IDA Special Themes, especially on Economic Transformation	<p>Selected Development Outcome Indicators, including gender-specific indicators where available, aligned with IDA's RMS</p> <ul style="list-style-type: none"> • Access to infrastructure services, including generation capacity of energy constructed or rehabilitated, etc. • People reached with financial services • Farmers adopting improved agricultural technology • Number of SMEs supported (following IFC's own reporting)

29. Four main eligibility criteria are proposed to ensure the intended use of the PSW resources:

- The use of PSW resources will be limited to IDA-only and IDA-eligible FCS countries¹⁹. This will ensure that PSW support reaches the poorest and most vulnerable countries with unmet needs for support.
- All PSW-supported activities will need to be aligned with IDA's objectives and its poverty focus, and demonstrate linkages to the IDA18 special themes. PSW-supported activities should support one or more IDA18 special themes.
- All PSW-supported activities need to be aligned with WBG country diagnostics and strategies, in the form of Systematic Country Diagnostics (SCDs), Country Partnership Frameworks (CPF), or other country strategies. In FCS, the PSW-support activities will

¹⁹ IDA-only refers to IDA regular, non-gap, non-blend countries. FCS refers to IDA-eligible FCS countries. See Annex 5. List of eligible countries will be confirmed at the beginning of IDA18 and used for the duration of the IDA18 period, adjusted for countries that become IDA-only and/or IDA-eligible FCS during the IDA18 period. On an exceptional basis, support to activities in fragile or conflict-affected sub-regions of IDA gap and blend countries may also be considered and approved by the Oversight Committee.

be informed by the Risks and Resilience Assessments and other relevant fragility analysis as part of the CPFs. This would include consultation with relevant World Bank country and sector teams in the early stage of deal origination by IFC and MIGA teams.

- The PSW facilities will be deployed only when existing products and market solutions are not deemed sufficient to address investment requirements. This is an important step to minimize the prospects for PSW resources to contribute to market distortions, or crowd out market solutions that could have been financed from other sources. Management will develop a “minimum concessionality” approach to ensure that projects supported by the PSW only receive the minimum level of subsidies required for the projects to be viable and this will be embedded in the governance process.

In addition to these overarching criteria, each of the four proposed facilities will have specific parameters based on their individual purposes.

III. GOVERNANCE ARRANGEMENTS FOR PSW

30. **Effective implementation of the proposed PSW requires robust and transparent governance arrangements.** This paper proposes a framework designed to ensure that PSW-supported activities achieve the intended objective of increasing sustainable and responsible private investment in the poorest IDA countries. A central feature of this framework is that IDA’s fiduciary responsibility vis-à-vis its contributors is preserved through oversight and decision-making authority over how the resources will be deployed, both during the management review and approval processes before projects are brought to the Boards, as well as through the requirement that each project financed or supported by the PSW be approved by IDA’s Executive Directors or pursuant to a delegation of authority by the Executive Directors to Management. As a corollary, each of IFC and MIGA will each retain responsibility for their respective projects that are financed or supported by the PSW. The PSW-supported projects will be conceived, approved and implemented in accordance with IFC’s and MIGA respective policies and procedures as the case may be. The governance framework is also designed to provide oversight, advice and recommendations on implementation issues and conflict of interest/moral hazard concerns. Five organizing principles have been developed to guide the governance arrangements. (See Box 3) The PSW governance arrangements reflect the fact that PSW will be maintained on IDA’s balance sheet and ensure that PSW activities are carried out within the agreed parameters to protect IDA’s financial sustainability. The proposed framework balances the need to ensure robust and transparent governance while striving for operational efficiency.

31. **In addition, to prevent fraud and corruption in the implementation of PSW-funded projects, as is the case with existing WBG collaboration, the fiduciary safeguard arrangements approved by the Boards of IFC and MIGA would apply to transactions under the PSW involving IFC and/or MIGA.** These include compliance with IFC and MIGA’s integrity and procurement policies, safeguard policies and procedures, policies on use of offshore financial centers, etc. Existing redress and investigation mechanisms such as IFC’s and MIGA’s Compliance Advisor, Ombudsman office and INT can be utilized as needed. The principles listed above will help mitigate risks to IDA’s reputation; additional considerations regarding reputational risks are included in Section V below.

Box 3: Organizing Principles for PSW Governance

The framework is based on five organizing principles that cover accountability, oversight, conflict of interest, transparent risk-return sharing and operational and financial efficiency, agreed by all three WBG institutions. These principles drive the overall PSW-level governance as well as the facility-level governance processes.

Accountability through Independent Decision-making by each Institution. Each of IDA, IFC and MIGA has a distinct legal personality, mandate and associated operational and fiduciary policies and procedures. Each Institution would therefore make an independent decision, in conformity with its own governance structure, as to whether to participate in any project supported by or financed through the PSW in light of its distinct mandate, the requirements that flow from it and the PSW eligibility criteria. Accordingly, each participating Institution shall be afforded access to such information as is necessary for its decision-making. Ultimately, the use of the PSW resources for any particular purpose would require the approval of IDA's Executive Directors.

Oversight. To ensure accountability and effectiveness of the PSW to achieve maximum impact, clear reporting and review arrangements will be put in place. In this respect, an Oversight Committee will be formed, made up of one Vice-Presidential level representative from each of the three institutions, which will meet on a regular basis to review progress in light of agreed results frameworks and financial reporting, and to discuss risks and implementation issues (including conditions for financing). While implementing projects in accordance with the policies and procedures of their respective institutions, MIGA and IFC will periodically provide PSW portfolio and PSW project-level information and will promptly disclose any project-level information which could reasonably pose integrity or reputational risks for IDA. MIGA and IFC shall provide to IDA such further information as it may request in order to permit IDA to adequately address any such integrity or reputational risks and IDA will have the right to join implementation/supervision missions where appropriate in consultation with IFC and/or MIGA, in order to permit IDA to adequately review and address any such integrity or reputational risks in a manner consistent with and subject to the applicable contractual arrangements between IDA and IFC/MIGA. Where further actions are agreed by the Oversight Committee, subject to each institution's governance structure, they will be implemented by the responsible entity. In all cases the Oversight Committee shall ensure appropriate arrangements are in place to protect the confidentiality of client information while ensuring adequate information flow for informed decision-making and streamlining of monitoring and evaluation. The proposed Oversight Committee can also be convened if there is any issue to be considered or escalated for resolution.

Conflict of Interest Management. Each Institution would vet cross-institutional transactions independently. To the extent conflict of interest issues arise, these would be addressed in accordance with the Guidelines on Inter-Institutional Operational Conflicts of Interest. Participating institutions will ensure compliance with the PSW Eligibility Criteria and governance framework with recourse to Oversight Committee for review of any conflict of interest issues that may be raised by the parties. Arrangements between/among the Institutions with respect to financing under the PSW will be negotiated on an arm's length basis, ensuring that transactions are in each institutions' best interests and that there is no question of divided loyalty, compromised fiduciary duties or the subordination of one Institution's interest to another. Decisions regarding conflicts of interest shall not be delegated to another Institution or require "group" decision- amongst IDA, IFC and MIGA, but shall instead follow arms-length arrangements, so that each Institution can ensure that its financial interests and development objectives, as well as those of its respective clients, are protected. Within IDA's internal processes, the Finance and Risk Committee would assess as needed the risk of managing actual or perceived conflict of interest arising from cross-institutional financial engagements solely from IDA's perspective.

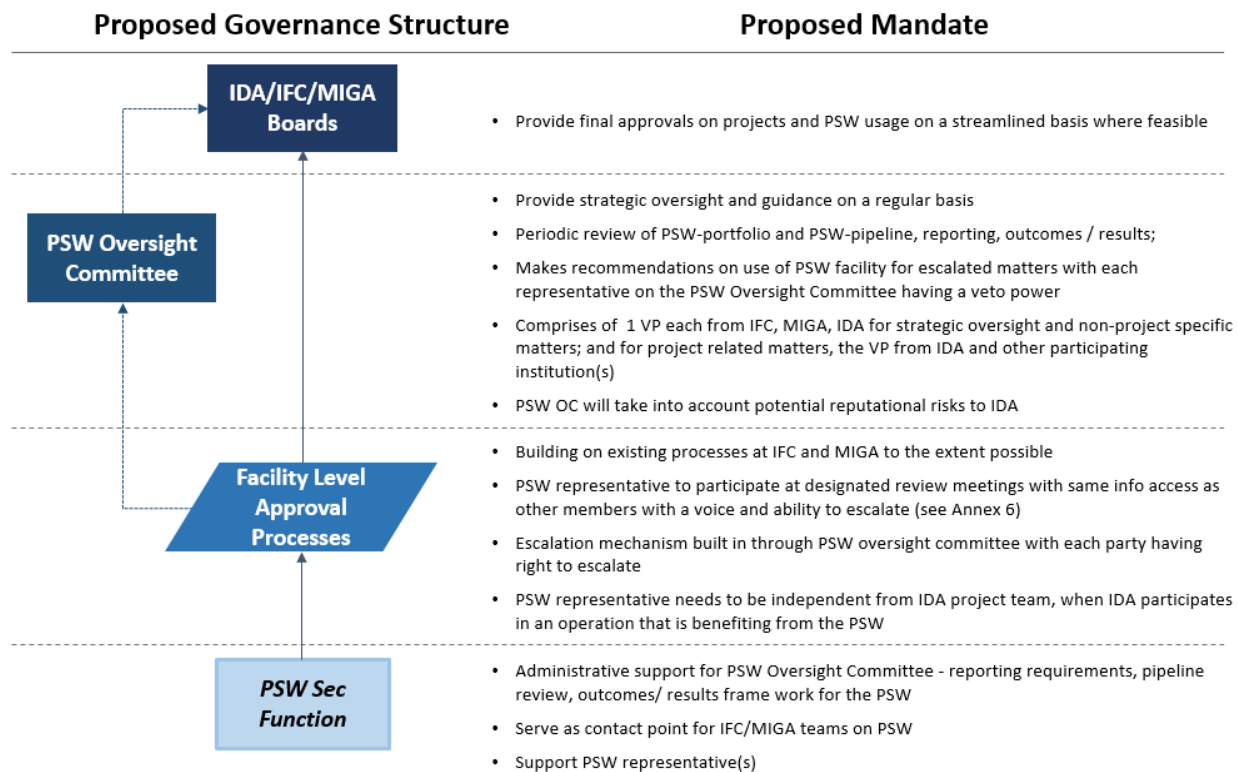
Fees and Cost Sharing. To ensure that IDA is compensated for the risk it assumes under the PSW and each institution for their administrative costs (e.g., origination, portfolio management) related to the PSW, there would be an agreement that each Institution, including IDA, would receive fees and, where agreed, a share of any recoveries and/or any resulting proceeds. The types of risk participation and volume of contribution by each Institution would be taken into account when determining the amount of such fees and appropriate sharing arrangements. Where the fees for any of the facilities will be determined by Management, there will need to be a delegation by the Board of Executive Directors of IDA to Management.

Operational Efficiency. In the interest of efficiency, and without compromising any of the principles outlined above, the Oversight Committee shall review soonest the processing of projects to be financed out of or supported by the PSW and look to streamline such processing to the greatest extent possible, including through the reliance on the existing processes of each Institution. In addition, it may be possible to set in place an expedited approval process based on pre-agreed criteria for eligible investments – aligning the interest of each Institution – which would then be approved by the Board of each Institution, where feasible, on an absence of objection basis.

32. **The overall PSW governance framework has three structural components, supported by a secretariat function, as depicted in Figure 4.** IDA’s Executive Directors have the ultimate authority on the use of PSW resources. A PSW Oversight Committee that comprises of senior management with equal representation of IDA, IFC and MIGA provides oversight, advice and recommendations with respect to any differences of approach that may arise. The four PSW facilities each have their own facility-level governance process, leveraging existing IFC/MIGA processes to the extent possible. A PSW Secretariat provides day-to-day support to the PSW governance process.

33. **The ultimate authority for approving the use of the PSW resources rests with IDA’s Board of Executive Directors.** The use of PSW resources in any IFC investment or MIGA guarantee will have to be approved by IDA’s Executive Directors or pursuant to a delegation of authority to Management, following IDA’s existing governance structure and processes, while the IFC and MIGA operations will be approved by their respective Boards. To ensure efficiency, joint Boards approval will be sought where needed with appropriate documentation and procedures.

Figure 4: Overview of PSW Governance Structure



34. **The PSW Oversight Committee (“Committee”) will be responsible for providing strategic oversight and guidance on a regular basis, conduct periodic review of the PSW’s performance at the portfolio level, and provide management advice and recommendations on transactions escalated to its attention.** The Committee will be comprised of one senior management representative at the Vice-President level each from IDA, IFC and MIGA and will

convene regularly to review progress at the portfolio level PSW funded projects, including how the PSW is achieving development impact, strategic targets in IDA and FCS, allocation across the facilities, and any escalated matters as needed. Periodic review will also focus on the pipeline of potential projects and any emerging risk issues including overall exposure across countries and sectors. The Committee could also propose adjustments based on learning from feedback loops. This review can be convened every quarter, or more frequently especially in the initial stage of the PSW. For any issues escalated to the Committee, agreements on advice and recommendations will be made on a consensus basis.²⁰ In addition, the Committee will provide regular (twice annually) results updates to the leadership of each institutions—the World Bank’s Managing Director, IFC’s Executive Vice President and MIGA’s Executive Vice President—for information and guidance.

35. At the facility level, governance arrangements will be tailored to facilities, but build on three common principles. First, facility-level governance will build on existing processes at IDA, IFC and MIGA to the extent possible. This will ensure that the additional transaction processing time and cost are minimized without undermining the governance principles of the PSW. The Local Currency Facility is the only facility where there is no existing process. Second, IDA, as the manager of PSW resources, will participate through representation at the designated facility-level review processes with the same information access as other reviewing members, and with a voice and ability to escalate. These IDA PSW representatives will be tasked to consider proposed utilizations from a PSW perspective, taking into account inputs by relevant World Bank country and sector teams. Third, an escalation mechanism is built into all facility-level processes that each party in the review processes has the right to escalate to PSW Oversight Committee in the event of disagreement on PSW use. These PSW governance processes should be time-bound and efficient to meet timelines of private sector clients and projects. Figure 5 provides a prototype of facility-level governance process. Specific facility-level governance frameworks are presented in the facilities section below and Annex 6.

36. The proposed PSW governance reflects the organizing principles. IDA retains full authority to approve the use of the PSW funds for any project proposal that meets the PSW eligibility criteria. Through representation, IDA Management will participate at the relevant reviews (as shown in Annex 6) for each project or investment proposed for the PSW, with the same information access as other reviewing members and with a voice and ability to escalate. The role, as representative at relevant reviews, will give IDA an opportunity to review that projects meet the agreed upon eligibility criteria of the PSW. In its role, IDA PSW’s representatives will be able to escalate a project, when in their judgment, the proposal does not meet those criteria or based on concerns over reputational or policy issues. When a project is escalated to the PSW Oversight Committee, consensus²¹ will be required to allow it to use PSW funds. Ultimately, IDA Board and/or Management approvals (where decisions may be delegated) on usage of the PSW funds will be required for each utilization. Approval of IDA’s Executive Directors or Management, as the case may be, will be sought at the same time as any IFC and MIGA Board approval where needed. Management of inter-institutional operational conflicts of

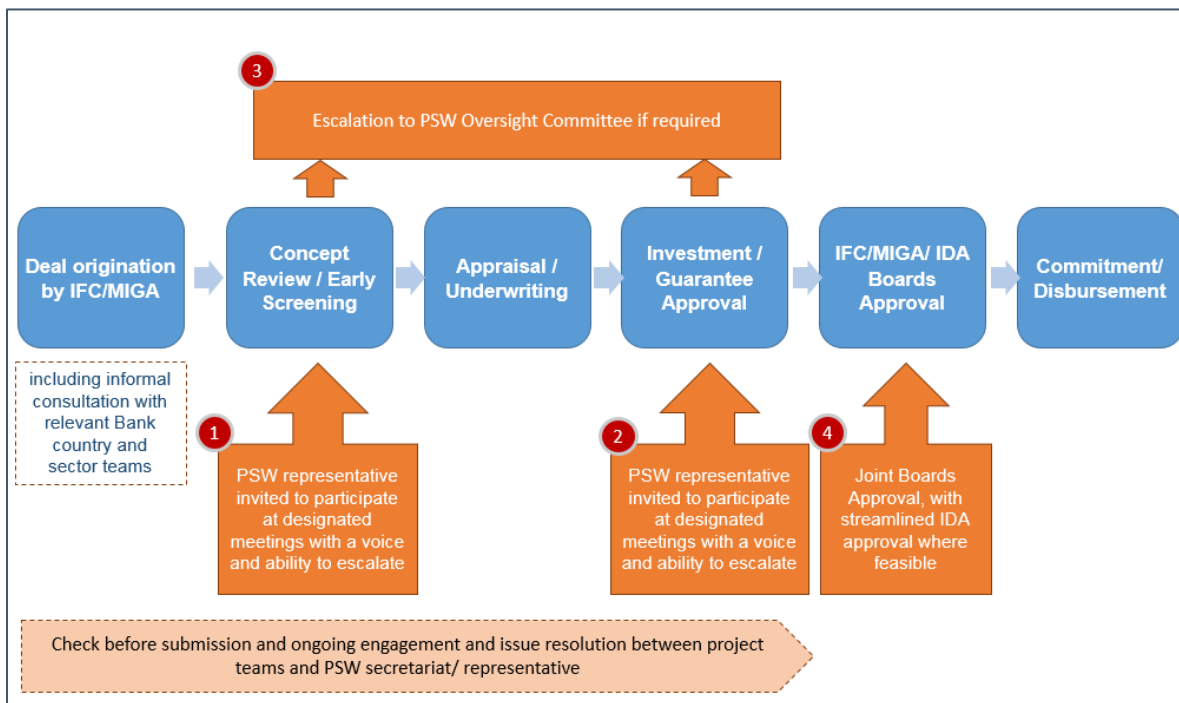
²⁰ Consensus for this purpose means the agreement of all of the relevant members of the Oversight Committee to a particular course of action.

²¹ Where consensus is defined as in Footnote 20.

interest is enhanced through the transparent disclosure of the program, advance publication of the rules and eligibility for each facility and ensuring independent decision-making by IDA, IFC and MIGA, with arms' length arrangement, rather than a WBG-level decision-making. Oversight is carried out by the PSW Oversight Committee, with transparent reporting. The Oversight Committee will provide advice and recommendations on the strategic directions of the PSW and any other escalated matters, including review of any conflict of interest issues that may be raised by the parties. The Oversight Committee would also present the PSW progress to the top management of the WBG institutions. Fees and cost sharing is embedded in the design of the financial mechanics of the facilities. And finally, operational efficiency is achieved by leveraging IFC's and MIGA's existing project review and approval processes.

37. **The PSW Secretariat will provide required administrative support to the PSW Oversight Committee, relevant facility-level governance processes, and coordination among the IDA, IFC and MIGA teams.** The Secretariat will be the first point of contact for IFC and MIGA teams as regards the use of the PSW, and will be responsible for facilitating review and clearance processes including supporting the IDA's representative(s) in participating in the review sessions. Projects teams will be encouraged to check with the PSW Secretariat before submission and engage the Secretariat on an ongoing basis for any issue resolution. The Secretariat will manage the results framework of the PSW, provide the periodic reporting of the PSW and organize evaluation as necessary, and support knowledge and learning, as well as communication and outreach functions. The Secretariat is intended to be a nimble function that provides efficient support, rather than a bureaucratic structure.

Figure 5: Stylized Facility-Level Governance Process Map



IV. PROPOSED FACILITIES

38. To achieve the overarching objectives of the PSW, Management proposes four facilities: a Risk Mitigation Facility, a MIGA Guarantee Facility, a Local Currency Facility, and a Blended Finance Facility. These facilities are organized according to their underlying purpose and proposed governance arrangements leveraging existing platforms. Within each facility, various instruments can be used to meet the specific needs of the underlying projects. Most instruments are current IFC and MIGA instruments; however, their application under the PSW has been modified to bridge specific gaps that prevent high-impact projects from moving forward. While the PSW proposes four specific facilities, the implementation of the PSW would incorporate flexibility to allow innovation and adaptation to changing demands. Similarly, based on the experiences of the PSW over time – both early successes and challenges – flexibility is proposed in the resource allocation across facilities. The range of indicative uses and allocations of the facilities is presented in Table 3. While each of the Facilities has its own design and focus, they will be managed collectively using a portfolio approach to reflect the overall objectives of the PSW.

Table 3: Indicative uses for PSW funds²²

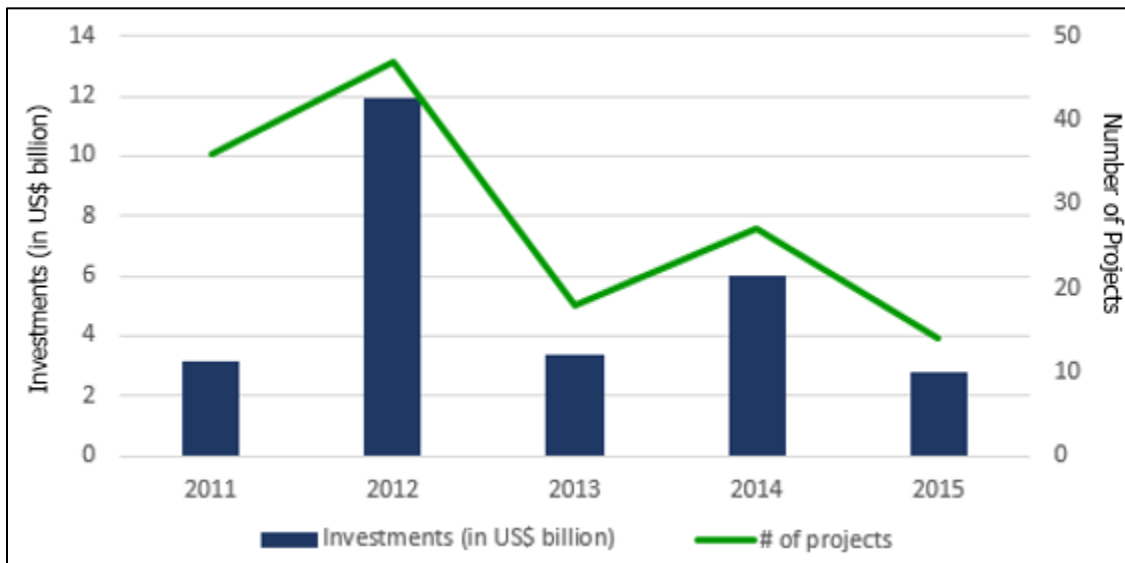
Facility	PSW instrument on IDA balance sheet	Instruments offered to end-use clients	Sector(s)	Additionality	Indicative Allocation (US\$ millions)
Risk Mitigation Facility for Infrastructure (RMF)	Project-based guarantees without sovereign indemnity	Project-based guarantees without sovereign indemnity to private sector IFC arranged transactions, where MIGA acts as guarantee administrator	Infrastructure (includes power, water & sanitation, transport & logistics, municipal infrastructure, telecom, and natural resource-related infrastructure)	Increased investment in IDA-only and IDA-eligible FCS countries above IFC's baseline Expanded uses for existing MIGA products (liquidity support, IFC loan enhancement for A&B loans)	Possible range between US\$800-1200m
MIGA Guarantee Facility (MGF)	Guarantees to MIGA projects (in the form of reinsurance or shared first loss)	MIGA Political Risk Insurance (PRI) products to private sector	Infrastructure, Agribusiness, Manufacturing and Services, Financial Markets	Increased risk participation in IDA-only and IDA-eligible FCS above MIGA's baseline	US\$500m
Local Currency Facility (LCF)	Guarantee or Swap with IFC	Local currency denominated loans or hedges to private sector clients (e.g. SMEs) who operate in markets where there are limited currency hedging capabilities	Sectors will be linked to the underlying loan	Enables local currency financing for clients in IDA-only and IDA-eligible FCS clients (e.g. SMEs) who operate in markets where there are limited currency hedging capabilities Development of local currency financing instruments, and capacity building	Possible range between US\$300-500m
Blended Finance Facility (BFF)	Loan, equity, subordinated debt (to private sector); guarantee (to private sector or IFC)	Loans, subordinated debt, equity, guarantees and risk sharing (to private sector)	SMEs, Access to Finance, Agribusiness & Manufacturing, Health & Education, Telecom and Technology, Climate finance	Increased investment in IDA and IDA FCS above IFC's baseline Blended Finance Investments in new sectors and to underserved client base (early-stage and women-owned SMEs) Expanded uses for existing products (e.g. longer tenors)	Possible range between US\$400-800m

²² Financing to a non-sovereign without a sovereign indemnity or guarantee would require a change in current operational policy; provision by IDA of equity investments will require specific authorization in the Board of Governors Resolution.

A. RISK MITIGATION FACILITY FOR INFRASTRUCTURE (RMF)

39. **Development challenge.** Infrastructure²³ is a critical priority for most IDA countries. Fiscal constraints and capacity limitations lead many countries to look for private sector capital and capacity to address these gaps. However, private investment into most IDA economies falls significantly short of actual needs. In fact, over the past five years private participation in infrastructure (PPI) investments in IDA countries has declined markedly.²⁴ In 2012, PPI investments in IDA countries peaked at US\$11.9 billion (1.5 percent of GDP), largely as a result of a surge in investments in a single country. Since then, PPI has dropped to US\$2.8 billion (0.3 percent of GDP in 2015), with a majority of investments concentrated in just a few countries. (See Figure 6.) Moreover, only 39 percent of PPI investment was financed by private sector sources (i.e. commercial banks and private sponsors), while the majority of financing came from MDBs, bilateral institutions and public sector sources.

Figure 6: PPI Investments as Percentage of GDP and Number of Projects in IDA countries 2011-2015



Source: World Bank PPI Database as of August 2016

40. **The challenge in increasing PPI in IDA countries reflects not only structural/regulatory reform challenges, but also the limited capacity to bring forward bankable projects, and the high level of real and perceived risks associated with long-term infrastructure investments in these markets.** Most high-impact projects in infrastructure depend upon government commitments for extended periods of time, sometimes for decades in the form of off-taker agreements, regulatory enforceability or government contributions under PPP type structures. In challenging environments, the level of credibility of governments as key

²³ Infrastructure broadly includes power, transport, water & sanitation, municipal infrastructure and telecommunications as well as natural gas/LNG/ or other natural resource-linked infrastructure, logistics, cold storage and other relevant infrastructure linked to supply chains.

²⁴ “PPI Investments in IDA Countries, 2011 to 2015”, 2016 IDA PPI Update.

counterparties for risks such as offtake, or termination is often not sufficient to achieve project bankability.

41. **Objective.** The RMF will aim to crowd in PPI by providing guarantees to cover key non-commercial risks and where existing instruments may not be commercially suitable.²⁵ Eligible projects include power, transport including logistics and infrastructure linked to supply chains, natural gas/LNG/other natural resource-related infrastructure, water & sanitation, municipal infrastructure and telecommunications projects in IDA-only and IDA FCS countries. The facility would be deployed alongside IFC investments, and will have the ability to provide direct risk mitigation coverage to IFC, thereby supporting the scale-up of IFC's significant origination, structuring and mobilization capabilities.²⁶ The RMF will be aligned with the WBG's coordinated effort to further ramp up investment climate, tariff reform, creditworthiness of State-Owned Enterprises (SOEs), and infrastructure program prioritization.

42. **Additionality.** There is currently a major gap in infrastructure financing for IDA-only and FCS countries. It is clear that both public and private financing are required to address this gap. The RMF will allow the WBG to support additional private capital investments in infrastructure projects that are economically viable but currently unable to proceed due to lack of protection against certain risks e.g. political and offtake risks. The RMF will catalyze high-impact projects in fragile and low-income economies where governments have constrained fiscal space and institutional capacity, and where investor risk perceptions prevent them from attracting commercial capital. The RMF has the potential to enable large-scale investments that could reach transformational impacts. Moreover, the additional de-risking capacity afforded by the RMF could allow for more innovative projects that could offer governments the opportunity to put in place new energy strategies focused on lower carbon-intensity power generation, which thus far have been limited by the availability of private capital. The RMF will enable the WBG to scale up the use of guarantees in new ways. In addition, MIGA acting as guarantee administrator may be able to expand the applications of its current products, for example, applying breach of contract cover or liquidity support for SOEs in IDA-only and IDA-eligible FCS. Finally, the risk mitigation coverage of the RMF will also enable an increase in IFC's own account investments.

43. **Because the RMF is intended to be used when existing guarantee products are not sufficient to mitigate a project's risks, the origination process specific to the RMF will be instrumental in identifying projects that require support beyond what is available through existing guarantee coverage.** After the need to use PSW funds to provide risk mitigation for an infrastructure project has been identified, the relevant team will propose a structure that best leverages existing experience within institutions. Origination for the facility will involve expanded efforts primarily from IDA and IFC country teams as well as IFC's infrastructure teams and MIGA's teams. They will be increasingly engaged in pro-active transaction

²⁵ Such risks may include: (i) non-payment risk from critical counterparties (e.g., power off-takers, water utilities, government/SOE) across infrastructure sectors such as power, water & sanitation, transport, and telecommunications; (ii) fuel supply risk; (iii) political/regulatory risks such as termination/breach of contract risk for independent power producers or other PPPs; (iv) credit/counterparty risk of municipal/sub-sovereign entities (e.g., support municipal urban transport investments); and (v) cross-border transactions.

²⁶ When deemed necessary to support bankability and resource mobilization for a project, the risk mitigation instruments deployed under the RMF could also cover development finance institutions mobilized by IFC.

structuring to unlock new opportunities, often as part of WBG sectoral approaches or Joint Implementation Plans. In some cases, the needs may be identified from WBG-wide engagement in sector reforms, by MIGA, Bank/IDA teams or directly from a private sector client. Additionally, RMF projects may benefit from the upstream project preparation expertise of the Global Infrastructure Fund (GIF) or other WBG initiatives which seek to help prepare infrastructure institutions/projects.²⁷

44. The facility's additionality will be demonstrated by the leverage of total investment in infrastructure, above existing pipelines; over the FY18-20 period, the RMF could leverage up to 4 times in total investment in the priority sectors, including as much as US\$1 billion of IFC own account investments, and investments from MIGA-covered equity or loans. MIGA-supported investments could also benefit from MIGA's ability to bring in reinsurers.

45. **Financial mechanics.** RMF guarantees will be instruments that do not have recourse back to host governments. These transactions will provide coverage without sovereign indemnities for risks associated with payments by off-takers/government-owned counterparts, termination of contractual arrangements, and, more generally, breach of contract, among others, over a specified period, during which private investors will pay guarantee fees/premiums. If any of these risks are triggered and cause a loss to the covered investor, the PSW will make payments to satisfy the called RMF obligations. MIGA will typically serve as administrator and issuer of the guarantee contracts, but the guaranteed obligations will remain on IDA's balance sheet. Calls on the guarantee would be paid out from the RMF, pursuant to the mechanics set forth in the guarantee documentation with the relevant investor.

46. **Pricing and risk/return allocation.**²⁸ By providing guarantee coverage, IDA will earn fees. The RMF guarantee pricing will be set at a premium to IDA's existing project-based instrument, given the absence of recourse to a sovereign. A transparent pricing framework based on clear guidelines and risk parameters will be established to determine a projected portfolio and the appropriate level of fees for the RMF. A fixed pricing structure will be developed for each instrument under the RMF with the aim to cover expected losses on a portfolio basis, while unexpected losses will be covered to the extent possible. The targeted coverage of such losses, i.e., the element of concessionality compared to a commercial price, will reflect IDA's risk tolerance as well as the RMF's objective of enabling new transactions. While a fixed pricing structure would limit the ability to adjust pricing to risks on a transactional basis, the approach will result in lower structuring costs as project teams will have clear guidelines upfront as to the target risk and pricing for a project; this approach is also likely to help increase deployment of the facility, while providing greater clarity to external private and public stakeholders. The proposed approach also reflects the challenges in estimating risk distributions for the transactions targeted by the RMF. In addition to transaction level processes, regular management reviews will ensure that the actual risks of the portfolio closely track the risks and concessionality

²⁷ Including Public Private Infrastructure Advisory Facility (PPIAF), the IFC PPP Transaction Advisory team, Infracore.

²⁸ Where the fees for any of the facilities will be determined by Management, there will need to be a delegation by the Board to Management.

assumed in the projected portfolio; if the actual risks significantly deviate beyond agreed parameters, the pricing structure will be adjusted accordingly.²⁹

47. **Expected returns/losses.** The RMF is expected to take a wide range of risks, given the different mitigation instruments that it would provide; for instance, the liquidity support guarantees mitigating payment risk are expected to carry greater risk than breach of contract guarantees or IFC loan enhancement guarantees, but are likely to require lower amounts per project. As the RMF is designed to offer new instruments that build on and go beyond current WBG offerings to make a broader range of projects bankable, RMF transactions may be riskier and untested. This makes an up-front estimation of returns/losses challenging. Preliminary and rough estimates indicate that liquidity support guarantees could result in annual expected losses of 2 percent on a portfolio basis, while breach of contract and IFC loan enhancement guarantees are each estimated to have expected losses of 1 percent per annum on a portfolio basis. Expected losses could be different for other products which could so be deployed with RMF support. The extent to which the RMF capital will be preserved or lost due to unexpected losses will depend on the aggregate level of risk. There is therefore a trade-off between the level of risk that the RMF ultimately underwrites and the need to preserve its capital over the long-term. A portfolio approach to managing the RMF will incorporate limits that reflect IDA's risk tolerance while preserving the ultimate objective for the facility of breaking new ground in supporting infrastructure projects in IDA-only and FCS countries.

48. **Governance.** To ensure operational efficiency and use of existing procedures to the extent possible, when a WBG entity is originating a prospective transaction, in which participation of other WBG entities is contemplated (including IDA backing through the PSW), regular internal approval meetings of the originating institution, with representation from IDA, would review and approve relevant project design and structuring. Each institution participating in a project supported by or financed through the PSW would need to seek Board approval for the project in conformity with its own governance structure. The operationalization of the RMF will also be informed by the ongoing efforts at the WBG level to scale up the WBG guarantees, including working towards a set of principles of deployment, improving coordination and collaboration across the WBG, incentivizing operational teams, and enhanced learning and awareness building. See Annex 6 for an illustration of the approval process.

B. MIGA GUARANTEE FACILITY (MGF)

49. **Development challenge.** Investors considering entry into challenging markets seek risk mitigation, including – or even especially – against non-commercial risks. Private market insurance and/or reinsurance capacity to provide coverage for such non-commercial risks as war and civil disturbance, expropriation, currency inconvertibility and transfer restriction and breach of contract is not always available for IDA countries and FCS in substantial amounts and over long horizons. If available, these are oftentimes at prices that would make covered projects financially infeasible in these IDA and FCS markets.

²⁹ For MIGA-administered transactions, the RMF will build on MIGA's existing pricing methodology and experience in underwriting non-commercial risks without a sovereign indemnity for which service it will receive a fee.

50. To facilitate investments in the most challenging markets, MIGA uses its own guarantee capacity and capacity arranged with reinsurers to provide coverage for such investments. However, there are instances where MIGA-arranged capacity is not sufficient to cover the scope of the investment. Where MIGA-arranged capacity falls short, there is typically no alternative: (i) Public providers of investment insurance coverage need to meet national content requirements in the underlying investment as a qualification for their participation. (ii) Meanwhile, the private insurance/reinsurance market is not available, i.e. ‘off cover’ in high risk markets due to capacity constraints and perceived or actual risks that are significant or their pricing needs to meet the risks covered make the client project uneconomical. Inability to syndicate exposures in these riskier markets also results in increased concentration of MIGA risk capital that ultimately affects how much exposure MIGA would be able to hold overall. This is a critical constraint particularly when MIGA is called upon to support programmatic approaches or a series of projects in-country, or significantly-sized transactions, such as those typical in critical basic services sectors like power, transport or telecommunications - essential building blocks to support broader and dependent investments that subsequently follow.

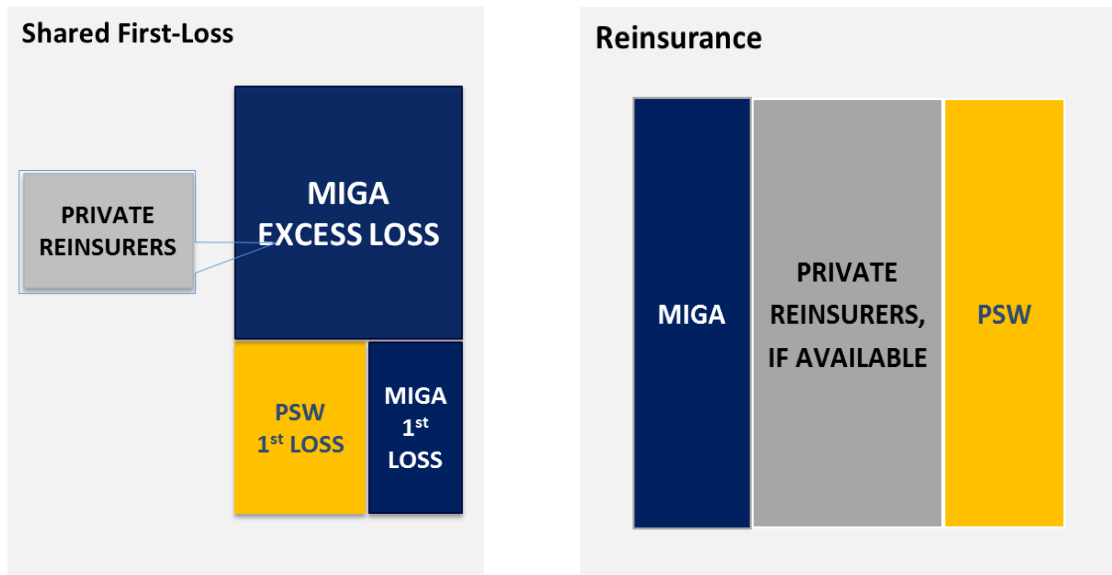
51. **Objective.** The MGF aims to bridge the gaps in the availability of coverage for MIGA-eligible non-commercial risks and crowd in private investment in IDA-only and FCS countries.

52. **Additionality.** The proposed MGF will provide additionality by increasing both the scale and scope of MIGA’s activities in IDA-only and FCS countries. Moreover, the additional capacity afforded by the PSW could allow for more innovative projects that could offer governments the opportunity, for instance, to put in place new energy strategies focused on lower carbon-intensity power generation, or attract investments in job-generating agribusiness, manufacturing or services investments which thus far have been limited by the availability of private capital. This additionality will be demonstrated by an increased number of projects and associated volumes of transactions that MIGA will undertake in IDA countries and FCS beyond what is currently projected. Over the FY18-20 period, through first loss and reinsurance structures, every dollar of PSW resources deployed is expected to result in around US\$5 of private sector investment mobilized and co-financed in MIGA projects, similar to MIGA’s experience with CAFEF but tempered in light of expected higher risk markets or higher risk transactions. Origination for the MGF will involve continued efforts by MIGA, as well as through pro-active transaction structuring to unlock new opportunities, often as part of WBG sectoral approaches or Joint Implementation Plans. In some cases, the need may be identified from WBG-wide engagement in sector reforms, by MIGA, IFC, WB/IDA teams or directly from a private sector client.

53. **Financial mechanics.** The MGF will be deployed in two structures. **IDA-MIGA Shared First Loss transactions** would increase the reach of MIGA’s traditional PRI products in markets where currently these are underutilized. This facility would include risk sharing or allocation of losses to a first loss position, and provides an added layer of reinsurance to reinsurers covering investments against non-commercial risks. MIGA would have a share in the first loss with the PSW. This feature has been key in attracting participations from the private reinsurance market to support larger transactions at prices which make the projects viable for ultimate beneficiaries. The MGF’s participation in a first loss position would encourage investment into risky environments and bring in the private reinsurance market to support such investments. For MIGA, this ability to attract participation from reinsurance markets to take up the “excess loss”

helps offset concentration risks and resulting increased capital charges, allowing MIGA to support multiple investments and programmatic approaches where it otherwise could not.

Figure 7: Risk Sharing in IDA-MIGA Shared First Loss Facility and as Risk Participant to MIGA Reinsurance



54. To mitigate the absence of reinsurance markets, **IDA as Risk Participant to MIGA Reinsurance** would enter in an agreement with MIGA to share MIGA’s risk exposure on a per transaction basis, and receive a share of the premium income paid by the private sector participant for the guarantee. MIGA has successfully entered in similar agreements with commercial reinsurers through reinsurance arrangements. IDA countries that face limited or non-existent commercial reinsurance appetite or capacity, or projects that are not covered with MIGA’s current reinsurance agreements, would strongly benefit from such a risk sharing arrangement. Coverage initially offered by the Facility would provide protection against key political risks of: expropriation, breach of contract, transfer restrictions and inconvertibility, and war and civil disturbance. MIGA and the MGF would share the risk exposure of and returns to a project the same way as with MIGA’s reinsurers, which means that each entity, where agreed, would bear its share of losses pro-rata to its share of project exposure, but also income and any claim recoveries, net of fees. For losses under both structures, the facility would reimburse losses only up to the designated allocation of PSW’s resources of US\$500 million.

55. **Pricing and risk/return allocation.** Given the risk-sharing proposed under the MGF, the pricing framework will mainly rely on MIGA’s models, and, if necessary, reinsurance market pricing. IDA and MIGA will absorb their proportional share of risk of capital loss in case guarantees are called. Pricing will be in line with project-based risk assessment, which incorporates costs and expected and unexpected loss estimates. IDA will receive a share of the premium income paid by private sector participants based on IDA’s pro-rata share of risk, net of

MIGA's customary ceding commissions³⁰. The proposed guarantees would be designed to avoid market distortions and would be structured to apply the minimum level of concessionality required to make a high-impact transaction possible.

56. **Expected returns/losses.** The MGF builds on MIGA's experience with CAFEF, and with its reinsurance program. The CAFEF portfolio is still relatively young; however, the experience has been positive thus far as guarantees issued with CAFEF support benefited from the same underwriting and guarantees management that MIGA provides to its own investments. In the meantime, MIGA has used reinsurance arrangements over the last 20 years to increase its overall capacity and country capacities, where reinsurers provide cover alongside MIGA's own coverage and are exposed to the same risks. Over its 28 year operating history, MIGA has been instrumental in resolving more than 100 pre-claim situations and successfully helped clients continue with their projects. MIGA has paid eight claims totaling US\$27.5 million on guarantees issued of over US\$40 billion, covering 800 projects thus far. Most of these are War or Civil Disturbance cases where a MIGA covered project was affected. To limit losses, the MGF will have risk limits on project size and total capacity for any country.

57. **Governance.** The governance of the MIGA Guarantee Facility builds on MIGA's current process of review and approval of MIGA guarantees, with the participation of a PSW representative at MIGA-PSW Early Screening and Project Review meetings. The meeting Chair and/or the PSW representative as the case may be can escalate to the PSW Oversight Committee. Experience and good practices from similar platforms like the CAFEF will be incorporated in implementation. See Annex 6 for an illustration of facility-level governance.

C. LOCAL CURRENCY FACILITY (LCF)

58. **Development challenge.** Medium and long-term local currency financing for high-impact projects in many of the poorest countries is lacking due to underdeveloped and volatile local financial markets and the absence of currency hedging instruments and creditworthy counterparties. Only about 19 IDA-only countries (out of 59) have some limited market based solutions for accessing local currency financing and, most of the time, the maturities available are very short and the pricing too high to allow for financially feasible projects.³¹ When available, local currency finance is predominantly short-term which limits IFC's ability to finance medium and longer term projects. In the poorest countries, the most vulnerable are left to bear the ill-effects of currency risk, while middle-income and high-income countries have access to better developed capital markets to provide currency protection as needed. For many IDA countries and FCS, there is often no way for a project to finance itself other than through foreign currency loans. Although USD loans may offer lower interest rates and longer tenors than available in local financial markets, these advantages can be more than offset if businesses in the country have mostly local currency revenues and the currency depreciates severely. In addition, many developmental financial institutions, including IFC, are unable to source local currency

³⁰ Ceding Commission: An allowance made by the reinsurer for the ceding company's cost of acquiring the business, where the ceding company is the company that is obtaining reinsurance, in this case MIGA.

³¹ Specialized currency funds, such as TCX, may also have some limited ability to provide local currency in additional IDA-only countries, but these solutions would be offshore and, based on experience, also subject to significant limitations in terms of maturity and pricing.

through domestic providers due to these providers' low credit standing. In response, some entities, such as The Currency Exchange (TCX), have emerged to promote long-term local currency financing. However, the demand far exceeds existing solutions. Therefore, a key part of expanding the local currency financing capacity in IDA countries is to broaden the number of counterparties able to provide local currency services; this effort will also help build the human resource and technical capacity necessary to provide these solutions prudently.

59. **Objective.** The LCF would allow IFC to provide financing in local currency in IDA countries and FCS countries where local currency solutions are underdeveloped or completely missing. This facility is targeted to clients who operate in markets in which currency hedging options are absent or very limited. (See Annex 7 for an illustrative example.)

60. **Additionality.** The facility is designed to enable ways for IFC to manage currency risks so that it can provide local currency loans, while fostering complementarity with existing solutions, such as domestic banks, TCX, central banks, etc. The facility will use as a first option market solutions by broadening the number of market counterparties with whom IFC could transact. For example, under the facility, IFC would look to transact with local subsidiaries of international banks, domestic banks, and official counterparts, e.g., central banks, that offer local currency solutions, but who are currently not allowable IFC counterparts because they do not meet IFC's current credit standards. IFC will also try to source local currency through domestic and/or international capital markets. With the resources provided by the PSW to absorb the credit risk of these riskier counterparties and capital market based solutions, IFC would be able to enter into local currency financing arrangements with these counterparts. At the same time, the ability to work with more local counterparties through the LCF will help to develop local capital markets and build the technical capacity of these local market counterparties.

61. **When no adequate market solution is available, the facility could also partner with specialized funds such as TCX, in order to provide onshore deliverable solutions for clients who are unable to manage the complexity involved in offshore lending facilities.**³² Offshore counterparts (such as TCX, and some international banks) primarily provide non-deliverable currency hedging. IFC could hedge with such offshore counterparts as it currently does, but the LCF would allow IFC to provide a deliverable transaction to its clients by covering those risks that are related to cross-border transfers and conversions, facilitating clients' access to simpler local currency solutions.

62. **Developing local currency markets in IDA and FCS with local market-based solutions can often provide more cost efficient financing that will deepen the local markets.** Markets will develop only with multiple players providing alternative price discovery opportunities for local currency. Offshore funds and banks already play an important role in this. The LCF will serve as an additional (and complementary) source for fostering pricing of risk in jurisdictions in which markets for hedging do not yet exist and help to increase supply of local currency solutions in the markets where only few hedge providers currently operate to facilitate competitive pricing of local currency risks. Additionally, the maximum value of local currency

³² Onshore deliverable swaps provide cash flows in the actual local currency, while offshore non-deliverable swaps are settled in USD, but linked to the local currency rates to mitigate currency risk.

transactions that the market and other mechanisms can offer may be limited. The PSW could offer “top-up” hedges, if a hedging counterpart has a value limit that does not cover the full loan amount.

63. **Finally, when no other solution is effectively available, the PSW may need to provide open market risk hedging to IFC for impactful investments in the PSW’s target countries.** This solution would be employed when other solutions cannot fill any remaining gaps, specifically:

- **Coverage of IDA countries.** Some countries’ currencies cannot be hedged by any existing solution. If local currency financing is necessary for an IFC loan in one of these places, the facility would provide a hedge against IFC’s currency exposure.
- **Tenor.** For a number of IDA/FCS currencies, hedging options do exist, but are quite short-term with respect to the tenor available (often less than 3 years). The LCF could offer longer hedges, if the required tenor exceeds, for example, an available solution provider’s available maturity limits.
- **Pricing is prohibitively high.** At times, market sources can provide local currency solutions, but only at a price that would make projects financially infeasible, given oftentimes prohibitive capital costs associated with most illiquid currency hedging markets. Thus to the extent market counterparts are constrained with respect to their pricing being too high when benchmarked against WBG’s own analysis, the LCF will be used to provide local currency solutions to IDA and FCS clients.³³

64. **The success, additionality and impact of the facility would be demonstrated through clear metrics of key indicators.** They include, but are not limited to the amount of local currency committed for approved projects, the provision of local currency where no other provider was available at the time, the extension of tenor beyond what was otherwise available from other providers, the provision of deliverable local currency, a greater number of local counterparties, and improved pricing for clients through a comparison of the all-in cost of the local currency financing versus alternative local currency solutions, and related activities that assist in the development of the local currency capital markets in IDA countries and promote human resource and technical capacity building in the area of local currency finance. Ultimately, the local currency solutions will be an integral part of the IFC’s investments to enhance private sector growth in difficult markets.

65. **Financial mechanics.** This facility would be backed by IDA resources set aside to backstop the LCF so that IFC can provide various operations in local currency. The facility would act as a loss-bearing vehicle for IFC operations in IDA-only and FCS only up to the designated allocation of PSW’s resources, indicated as between US\$300 and US\$500 million. While IFC would continue to hold the credit risk of the underlying investments, the main operations of the LCF would cover the following risks:

- (i) Counterparty credit risk. When IFC enters into a local currency transaction, it hedges the currency risk of the transaction with an offshore or onshore market counterpart; under

³³ Protocols will be developed to document when IFC is unable to use market solutions or TCX.

this approach, the LCF resources would absorb the counterparty credit risk of IFC's hedging counterparty if its credit quality does not meet IFC's standard counterparty criteria or if they are non-traditional counterparties;

- (ii) Market and credit risk associated with managing short-term liquidity in local currency instruments. IFC may also issue IFC bonds in a local market to obtain the needed currency for its loans and then invest in the local fixed income market until the local currency funds are disbursed to the client; in this structure, the PSW would cover changes in the value of the local investments into which the proceeds of its bond issuance were temporarily invested until disbursement;
- (iii) Transfer/convertibility risk. When using local counterparties IFC could offer a deliverable swap but hedge the market risk with an undeliverable swap obtained offshore; the LCF resources would cover the inability to convert/transfer the currency without a loss when the underlying hedged loan matures.
- (iv) Open currency/interest rate risk. If market-based solutions are not available, IFC would hedge its currency and interest rate risk with the LCF; the LCF would cover any losses (or receive the gains) related to changes in market rates over the term of the hedged investment. The LCF will be actively managed on a portfolio basis to facilitate diversification of risks borne by the LCF resources, which may include employing strategies to hedge open risks. Should IFC suffer actual, realized losses on local currency investments undertaken with the LCF, IFC would submit a payout request to IDA for reimbursement of the amount of the loss when LCF is providing risk protection to IFC under. Or the LCF would exchange cash flows under a swap arrangement with IFC to realize gains and losses when LCF is taking open market risks to facilitate local currency lending.

66. ***Pricing and risk/return allocation.*** Local currency hedges provided by the facility would be priced such that, in expectation and over a long time horizon, the IDA resources set aside to backstop the LCF would be managed with the goal of sustainability for catalyzing local currency financing for IDA countries. The LCF pricing framework will incorporate transparent practices that i) establish a reference price and then ii) quantify the concessionality needed to enable a transaction. First, an agreed pricing method will determine a reference price, based on expected and unexpected loss estimates as well as IFC's required return. At these levels, proposed LCF transactions may be unfeasible because the risks are too high or difficult to quantify. In these cases, the reference price would incorporate a return on IDA's capital instead of IFC's required return (which is higher); there is an expectation of concessionality with these transactions, for which a methodology for determining this element of subsidy will be developed. With this result, pricing will compensate for expected losses and seek to provide a return on the capital IDA is required to hold for unexpected losses. Recognizing that these inputs – especially for unexpected losses – are based on limited data, the proposed pricing framework will have flexibility to adjust the level of concessionality by modifying the fee compensation and risk tolerance related to unexpected losses and the evolving portfolio risks. Any adjustment to concessionality would be clearly documented and align with minimum concessionality principles. It should be noted that over shorter periods of time, based on market movements, the LCF may not earn a positive return and may, in fact, show a negative impact on the LCF's initial capital on a mark-to-market

or mark-to-model basis. However, short-term movements in currencies that can result in mark-to-market gains/losses do not necessarily result in realized gains/losses at the time that investments financed with the LCF mature, are refinanced, or cancelled.

67. **Expected returns/losses.** The proposal could expose IDA to commercial counterparty credit and market risks³⁴, based on which solution is applied. This exposure could be substantial as it is subject to currency movements from less liquid and more volatile currency markets. Preliminary analysis indicates that a LCF's portfolio of risk exposures could lose approximately 15-30 percent of its value under certain stress scenarios over medium term. Losses with respect to individual currency exposures or interim periods could be significantly higher. However, gains on this facility are also possible.

68. Quantifying and estimating risk exposure and losses precisely will be difficult, given the lack of data in many IDA-only and FCS. Complementary stress testing and scenario analysis will enhance the risk assessment process. The facility will need to be governed by robust guidelines that incorporate capital limits, diversification objectives, collateralization requirements and credit risk assessments. Furthermore, IDA resources should be viewed as 'patient capital' that facilitates local currency financing of high-impact projects and development of local currency markets in IDA/FCS countries with a long-term objective of self-sustainability.

69. **Governance.** Under the local currency facility, to ensure that objectives of arm's length arrangements are balanced with the needs to keep operational efficiency, it is proposed the governance of the LCF is organized through (1) upfront IDA's Executive Directors approval of the use of PSW resources for the facility with a delegation of authority to Management to approve transactions that meet pre-determined criteria; (2) Pre-agreed Facility Guidelines between IDA and IFC to facilitate automatic cover of transactions that meet pre-agreed criteria up to pre-specified ceilings; (3) In the case of exceptions, the transactions be brought to IDA's attention for review and decisions, including escalation to the PSW Oversight Committee when needed; (4) in all cases, IDA has the ability to consult World Bank Treasury, the department of the Chief Risk Officer, the Conflicts of Interest Office, within the Bank and also other third-parties to provide necessary advisory services. See Annex 6 for an illustration.

D. BLENDED FINANCE FACILITY (BFF)

70. **Development challenge.** Pervasive market failures and weak investment climates found in IDA and FCS markets create significant risks and obstacles that prevent scaling up of high-impact private investments in SME finance/entrepreneurship and agribusiness, as well as pioneering investments in a variety of areas such as manufacturing, energy access, social sectors (health & education), telecommunications & technology, local entrepreneurship, climate finance (including renewable energy generation and other climate-smart infrastructure investments), and water & sanitation.

³⁴ The market risk of the PSW could include currency, interest rate, transfer and convertibility risks.

- Access to finance remains one of the primary constraints to **SMEs** in these markets.³⁵ Banks and other financial intermediaries are typically extremely risk averse and generally only serve the top tier of SMEs that can borrow on a fully secured basis. In addition, the financing needs of many SMEs are unmet by traditional bank loans. These SMEs require risk capital – forms of funding that involve a higher risk tolerance and more flexible, extended timeframes than typical bank loans. Such risk capital is even scarcer than credit in IDA and FCS. Most FCS lack private equity funds or similar models that deliver risk capital to high-growth SMEs and the lack of funding for tech-enabled and other innovative start-ups—seen as having the highest levels of risk – is particularly pronounced.

Box 4: Critical Role of SMEs in Creating Jobs and Economic Growth

A vibrant SME sector is essential to economic growth and job creation in IDA and FCS economies. With 600 million new jobs needed in emerging markets over the next 15 years, supporting job creators is critical. Recent research from the World Bank and IMF confirms (1) over 90 percent of net job growth in emerging markets comes from SMEs, (2) early-stage firms play an outsized role in net job creation, (3) increasing finance to SMEs leads to job growth and (4) SME finance contributes to a reduction in inequality in most markets. Yet SMEs identify access to finance as their primary constraint in most emerging markets. Moreover, in IDA countries, SMEs play a bigger role in their local economies and face greater constraints than in other emerging markets. Banks and other financial intermediaries, while beginning to show interest in this sector, are extremely risk averse and often only serve a small segment of top tier SMEs that are able to borrow on a fully secured basis. The Bank and IFC are focused on this segment, but faces risk constraints, both at the financial institution level and with regard to the underlying SME portfolio risk.

Current WBG efforts on strengthening support to SMEs focus on four areas: Fostering high growth entrepreneurs, integrating SMEs into value chains, strengthening women-led SMEs and harnessing technology for SMEs. The BFF will be aligned with this effort.

Sources: WBG SME Working Group; “Small vs Young firms across the World”, April 2011.

- In **agribusiness**, countries with a high share of agriculture employment and persistently low rates of agricultural productivity experience a substantial drag on economic growth, as observed in Sub-Saharan Africa. Significant increases in agricultural productivity are needed to feed growing populations which, in turn, generate increased incomes in agriculture. Increases in productivity can be achieved through private investments that increase access to inputs, machinery, improved farming techniques, and a range of logistics, processing, distribution and related downstream industries.
- **Energy access** continues to be a main challenge to development, where there are currently 1.4 billion people in IDA countries who do not have access to energy. Traditional on-grid generation as well as innovative off-grid solutions (e.g., solar) are beginning to address this challenge, but penetration is constrained by lack of available financing and structural challenges.

³⁵ World Bank Group Enterprise Surveys analysis.

- In **other key sectors**, such as telecommunications, pioneering investments often fail to meet bankability standards and cannot find adequate long-term funding to meet their needs; however, many could potentially be viable over time and have a demonstration effect in the market if appropriate risk mitigation instruments and funding sources are available to support them.

71. **Objective.** The proposed BFF will support IFC-led, high-impact investments in SME finance/entrepreneurship and agribusiness. The facility will also consider supporting pioneering investments in other key sectors such as manufacturing, social sectors (e.g., health & education), energy access/distributed power generation, and telecommunications and technology. The facility will build on IFC's existing blended finance platforms, including the private sector window of GAFSP, the Global SME Facility and the Blended Climate Finance program. The facility would also seek to leverage existing platforms designed to support local entrepreneurship such as IFC's SME Ventures³⁶ and could consider supporting emerging platforms such as the IFC Startup Catalyst (ISC)³⁷.

72. **Additionality.** The facility will enable IFC to expand work in existing sectors and enter new ones critical to IDA and FCS, in complement to IDA's existing engagements.

- The PSW could expand **SME finance** beyond what the Global SME Facility can currently do by helping banks expand lending to riskier client segments (i.e. women-owned or healthcare SMEs) and markets and by enabling commercial banks to test innovations to lower costs and increase SME lending. With PSW backing, first loss guarantees for risk sharing facilities or subordinated funding can allow for more flexible lending terms to SMEs to fund innovative projects that may have higher risk or longer payout periods and more flexible terms. The PSW will also allow space for SME finance to focus on new areas such as FinTech, high growth/early stage SMEs, digital SME finance & value chains; digital payments/alternative delivery channels. Moreover, building experience and knowledge in these new areas can be shared with the World Bank and help advance IDA's own work and initiatives in developing SME finance.
- In **SME equity**, PSW funding would: i) provide catalytic co-investment for SME Ventures funds, enabling the funds to shorten the time for financial closing and accelerate the time at which SMEs can receive their funding; ii) increase market confidence in new fund managers; iii) increase overall investments into women-owned enterprises; iv) attract new types of investors by reducing risks and signaling the viability of the funds; v)

³⁶ SME Ventures develops and invests in risk capital funds for high-growth SMEs, working with third-party fund managers; 50 percent of the program's capital is to be invested in FCS, with the remainder in non-FCS IDA countries. The program provides technical assistance to develop both fund managers and SMEs, and collaborates with the World Bank Group's Finance and Markets Global Practice to develop regulatory environments necessary for such funds to operate.

³⁷ The IFC Startup Catalyst supports investments in early stage, tech-enabled, startup businesses in the markets where technology/innovation ecosystems are beginning to take hold. While such ecosystems do not currently exist in all IDA-only countries, and very few in IDA-FCS, the IDA funding could, in select geographies, enable/strengthen innovation ecosystems and associated advancements (through technology transfer) across an array of sectors including health, education, financial services, and others. Currently, the funding for tech-enabled and other innovation startups is particularly limited, preventing them from scaling beyond concept/prototype stage.

develop the ecosystem for high-growth SMEs in markets, where private equity is scarce on unavailable thereby pave the way for other entrants in the private equity market. Some of these investments could be made alongside IFC on pari passu terms, and as such may not require the approval of IFC's Blended Finance Committee if no subsidy is required. IDA funding could also support the ISC in a select group of markets.

- In **agribusiness**, the facility will build on the GAFSP's experiences implementing its Private Sector Window in catalyzing private investment in agriculture in the lowest income countries, with the focus on increasing the commercial potential of small and medium-sized agribusinesses and small holder farmers, thereby improving livelihoods.
- In **energy access**, the facility will focus on providing traditional on-grid as well as innovative off-grid and distributed energy solutions (e.g., scaling up pay-as-you-go solar business models) to people who are without current or reliable access to power. Currently, scalability in off-grid solutions is limited by the financing requirements of the sector, which need to cover inventory, for example, solar home systems financing and/or end user financing, even though the majority of the operators are early stage companies.
- The facility would enable **pioneering investments in new sectors**, which are currently not covered by IFC's Blended Finance Facilities, including manufacturing, telecommunications, health & education, water & sanitation and vocational training through risk mitigation instruments and available funding sources.

73. **Financial mechanics.** All existing IFC financial products will be eligible for clients under the facility, including senior loans, subordinated loans, equity (direct and through funds), preferred equity and guarantees (e.g., first-loss in risk sharing facilities). The IDA PSW funds will enable IFC to undertake these additional projects by providing: i) blended financing to enable IFC to support projects which are not yet able to meet fully commercial financing terms, but which promise to be sustainable and have strong development impact; and ii) risk mitigation, through subordination, deferrals, provision of first loss, and structuring flexibility (e.g. longer tenors) to enable IFC to support higher risk projects. Long tenors are particularly important for green-field projects, which typically have higher risk than expansion projects, but which are more common in IDA and FCS countries. The facility would reimburse losses only up to the designated allocation of PSW's resources, indicated between US\$300 million and US\$500 million for the BFF.

74. **Pricing and risk/return allocation.** All investments under the BFF would adhere to IFC's Blended Finance Approach and Principles and would be priced on the principle of minimum concessionality. The BFF pricing framework will incorporate transparent practices that i) establish a "market" based price as a reference point and then ii) quantify the concessionality needed to enable a transaction. First, an agreed pricing model will determine the "market" price, based on expected and unexpected loss estimates as well as IFC's required return. Pricing is determined (for the IFC's own account investment) first by using IFC's internal risk and pricing model to establish a "commercial" price. At these levels, proposed BFF transactions are unfeasible because the risks are too high or difficult to quantify. Therefore, against this reference, pricing would incorporate IDA's cost of capital instead of the IFC's required return (which is higher); applying IDA's cost of capital embeds concessionality into the transaction.

With this result, pricing seek to compensate for expected losses. For unexpected losses, pricing will seek to compensate for the capital IDA is required to hold for unexpected losses on a portfolio basis to the extent possible. Recognizing that these inputs – especially for unexpected losses – are based on limited data, the proposed pricing framework will have flexibility to adjust the level of concessionality by modifying the compensation related to unexpected losses, of overall risk of the portfolio and what is needed to achieve effective utilization—and thus deliver the expected impact—of the BFF. Any adjustment to concessionality would be clearly documented. Pricing will vary depending on the instrument, market conditions, and the specific need for blended finance, including development impact. The financial structure of each investment – including size, tenor, credit enhancements – will factor into the pricing.

75. ***Expected returns/losses.*** The purpose of the blended finance approach is to support project that otherwise may not happen either because the actual or perceive risk of the transaction is too high or because the potential returns are not commensurate for the level of risk. The portfolio of projects in GAFSP and SME Finance is still relatively young and it is difficult to assess their performance at this stage; however, based on IFC’s experience with donor-funded investments in climate for over 15 years, it is expected that the credit risk rating of the blended finance portfolio in these sectors be one to two notches down compared with the corresponding IFC’s portfolio. Though ex-ante transactions blended finance transactions are expected to be financially viable in the long term, some transactions may produce negative returns, given the challenging countries and sectors in which the projects will be undertaken. IFC’s own account investment provides alignment of interest to a certain extent, but both the PSW- and IFC- funded investments will retain the project risk. Furthermore, loss severity could be higher due to lack of sovereign indemnity and putting IDA in first loss position. Using IFC’s existing SME Facility as a proxy, the expected loss is estimated between 2 and 3 percent, while the expected loss of IFC’s existing GAFSP Private Sector Window is estimated between 8 and 10 percent, or 2 percent per annum. For first loss risk sharing facilities, the expected loss for both facilities is estimated between 10 and 15 percent, or 2 to 3 percent per annum. Since the risk of losing IDA’s investment principal is elevated, guidelines will establish IDA’s risk tolerance and set notional limits, by investment mechanism, sector and country, subject to review and modification by the Oversight Committee.

76. ***Governance.*** The facility level governance of the BFF would build on IFC’s Blended Finance Approach and Principles as endorsed by the IFC Board in 2012. In addition to the overall PSW governance principles and criteria, the BFF would also follow existing principles such as minimum concessionality, avoiding market distortion, and investments leading to sustainability. Prior to presentation to the IFC and IDA Boards, proposals will be approved by the designated Blended Finance Committee, with participation by a PSW representative. IFC’s existing Blended Finance team would also be leveraged to support the Blended Finance Facility. See Annex 6 for an illustration.

V. RISK MANAGEMENT

77. **Given the increased risks that the PSW would introduce to IDA, this paper proposes establishing approaches to manage the various risks, while still enabling high-impact**

projects in difficult markets.³⁸ Bearing in mind IDA's fiduciary responsibility to the funds entrusted to it by contributing partners, Management has analyzed the reputational, financial, development impact and implementation risks to inform the risk management measures needed for the Window. As part of developing the PSW, the CRO has conducted a preliminary independent risk assessment to review the related financial risks to IDA's balance sheet from the proposed financial structures, to understand the expected and unexpected losses and propose ways to contain the risks to acceptable levels. It should be noted that the main reason the private sector and IFC/MIGA are unable to assume these risks on their balance sheets is because these risks either command too high of a price, or cannot be quantified and bound within acceptable levels of confidence. Accordingly, while appropriate guidelines will be developed to manage financial risks, for purposes of capital adequacy for IDA, the entire amount of the PSW will be deducted from IDA's capital and will not be included in the estimation of available capital for its core lending business. The guidelines will require that the transactions be limited such that the maximum loss to IDA is the notional amount of the window (US\$2.5 billion) with similar caps on losses to IDA for each of the facilities. Furthermore, risk-return principles will balance financial risks with the potential development impact of PSW. Such principles will incorporate transparent practices in which both i) the risk of loss and ii) the minimum concessionality needed to enable a transaction would be assessed. The strong governance structure will ensure that the PSW achieves its objectives and maintains IDA's ultimate approval authority in deciding the use of the PSW resources. (See Box 5)

78. **Reputational risks.** Reputational risks from the PSW arise when the intended objectives of the window or IDA's overall mandate are compromised. In particular, conflicts of interest or moral hazard must be managed in inter-WBG transactions; and to ensure that IDA can continue to provide its core advice and support to public sector clients, while also backing the PSW. The primary means to managing reputational risk will be accomplished through a strong governance structure as described in Section III. To ensure that the PSW is designed to achieve its objectives, clear eligibility and investment criteria are essential and need to be agreed by IDA, IFC and MIGA. Incorporating transparency in the PSW's implementation processes including pricing, decision-making and results reporting will mitigate potential risks. Any deviations from criteria or cases with elevated risks (including reputational risks) would be escalated to Senior Management, i.e. PSW Oversight Committee, for guidance. When possible, existing governance processes have been incorporated into the proposed facility-level approval and governance to enable streamlined business operations. However, those processes will be adjusted to take into account IDA's ultimate approval authority in deciding the use of the PSW resources for any particular purpose and that IDA will have appropriate project level audit rights to review projects when reputational issues arise. Finally, the PSW transaction may raise bias or perception of bias that IDA's policy advice to public sector clients would be partial towards protecting its investments through the PSW or towards firms that benefit from support from the PSW. Each Institution has independently negotiated eligibility criteria and the PSW governance framework to, among other things, mitigate the risk of actual or perceived conflicts of interest in respect of matters under the PSW. The Guidelines on Inter-Institutional Operational Conflicts of Interest will apply to IDA policy advice and IFC/MIGA investment teams. In relation to all other matters, IFC/MIGA engagements will continue to be based on market principles; and PSW will

³⁸ IFC and MIGA policies will apply to their respective projects.

only be used to the minimal extent. Continued attention and risk management will be required in implementation to ensure IDA's policy neutrality is maintained.

Box 5: Summary of WBG CRO's Risk Assessment

CRO has undertaken a preliminary assessment of the PSW at level of each of the facilities to determine the scope of the transactions, to identify the nature of the risks to be borne by IDA and, to the extent possible, get orders of magnitude of expected and unexpected risks. Key findings are as follows.

First, while the scope and description of each of the facilities varies, in all cases it must be recognized that there are limitations to being able to quantify and/or price the risks. Indeed this is the main rationale for the facility as the private sector is unable to take such risks. Accordingly, for capital adequacy purposes, IDA will deduct the entire amount of the PSW of US\$2.5 billion from available capital and risk guidelines will ensure that the total volume of transactions is limited such that IDA's losses are capped.

Second, while in each facility, it is expected that IDA will be paid a fee to at least cover expected losses (to the extent that these can be estimated), such fees are unlikely to cover unexpected losses and hence the PSW is to be accepted as deeply concessional/subsidized financing or even in some cases, analogous to a grant facility. This should be viewed in the context of supporting private sector development in very challenging environments. Guidelines will be established to set eligibility criteria for the use of the PSW so that such subsidies are used only when necessary.

Third, given the significant potential for conflicts of interest or perception of conflict of interests, governance procedures will be put in place for the overall window and for each facility to ensure independence of decision-making. In the case of the MIGA Guarantee Facility, MIGA will share with IDA its framework for pricing and economic capital requirements. In addition, MIGA will share with IDA the pricing and economic capital requirements for each individual PSW transaction as presented to MIGA's designated decision-making bodies. Conflicts of interest and adverse selection/moral hazard are mitigated since risks and returns are shared on a pari-passu basis with MIGA (net of MIGA's customary ceding commissions in the case of IDA participation as reinsurer). In the case of the Blended Finance Facility and the Risk Mitigation Facility with IFC (which is the largest sub-facility), some degree of risk-sharing may be worth exploring to align incentives.

Fourth, in the case of the Local Currency Facility, while risks to IDA are very significant, there is transparency in the nature of the transactions and types of risks and IFC is establishing a hierarchy of when various approaches (for example market, TCX, internal hedging, LCF) will be used. This will enable the LCF to be used only when other mechanisms are not available and will also provide complementarity with TCX thus mitigating perceived conflicts of interest between IFC and TCX. IDA's exposures to the LCF will be capped at US\$400 million.

For all sub-facilities, Guidelines will be established on the various types of transactions, eligible counterparties and concentration limits (based on scenarios and stress tests) to contain IDA's exposures.

79. **Financial risks.** The proposed PSW financial activities will expose IDA to private sector (or to SOEs but without a sovereign counter guarantee) and currency risk. In some cases, as detailed in the Section IV, the financial risk of loss could be substantial. Most notably, for one option within the LCF, IDA may have open currency exposure to highly volatile and illiquid currencies which carry a significant risk of loss over the life of the facility. Further, because some of the proposed facilities would be new financial mechanisms (e.g. local currency) or in

uncharted markets or sectors, the process for estimating and modelling the financial performance of the facilities will be difficult, which will impact not only pricing but overall risk assessment.

80. **Measures will be adopted to mitigate financial risks.** First, the PSW will be implemented as a pilot during IDA18 to ensure that the attendant risks of the PSW are manageable on IDA's balance sheet. Potential losses associated with the PSW will be limited to the proposed US\$2.5 billion and this amount will be deducted from available capital for capital adequacy purposes. Second, clear investment criteria and eligibility for each facility will embed limits to manage concentration risk and encourage diversification. Third, as proposed, IDA will receive fee income and investment returns for providing its financial support in PSW activities that will be based on the additional risk of the transaction (and, in the MGF, subject to MIGA's customary ceding commission). This income may help offset some expected losses, however, the returns are unlikely to compensate IDA for the actual losses. Also, given the difficulty in predicting the financial performance of some transactions, management will consider using alternative risk measures, including stress testing and sensitivity analysis, to assess the risks on a transaction and portfolio basis. Finally, while most financial structures proposed under the PSW will require IDA to assume a more risky financial position to enable high risk projects, IFC and/or MIGA will maintain financial interest in the underlying financings or guarantees under the PSW. For example, PSW participation in the MGF will be on a quota share or first loss provider basis alongside MIGA. And even with the LCF, IFC will maintain on its balance sheet the credit risk of the loans it issues in local currency.

81. **Development impact risks.** Development impact risks arise from the uncertainty in achieving the expected demonstration effect through PSW investments and participations in frontier markets and sectors. Furthermore, while PSW interventions will be necessary to enable projects in challenging markets, there is a risk that these interventions will distort markets and not foster sustainable private sector development. Therefore, measures that focus on prioritizing development impact over transaction volumes will be critical. Especially given how the success of PSW projects could result in demonstration impact, the early successes PSW-backed operations will need to focus on how well the project aligns with the country's strategy. Planned projects in the pipeline can also provide good insight on the potential development impact of future PSW operations. It will be critical to reinforce that PSW engagements incorporate minimum concessionality and are time-bound to ensure that such concessionality is used only to establish a track record. So while the leveraging impact of a specific PSW project will be an important measure of the extent the PSW helps to mobilize the private sector, perhaps more important will be private sector mobilization for subsequent projects in the same market. Implementation of the PSW will build on existing experiences such as the principles guiding the IFC's Blended Finance facilities. (See Annex 1 for details). Relatedly, environmental and social risks will be managed through identification of environmental and social impacts, risks and opportunities of projects and effective community engagement through disclosure of project-related information and consultation with local communities. These risks are a key consideration for both IFC and MIGA in supporting projects especially in higher risk environments. All IFC and MIGA-supported projects are expected to meet the Performance Standards.³⁹

³⁹ Please refer to "Performance Standards on Environmental and Social Sustainability", January 1, 2012.

82. **Implementation risks.** Given the challenges and additional risks resulting from increased private sector investment in difficult environments, expectations for scaling up the PSW engagements need incorporate ambitious, yet realistic goals. While needs are overwhelming, it will take time to develop sound, bankable projects, especially in the infrastructure space. Furthermore, the success of PSW-supported projects will also be dependent on ongoing sectoral reforms initiated across the WBG that improve overall investment climate, government capacity, governance, lack of private sector sponsors, high cost and risk of operations. For example, in the infrastructure space, this work would include tariff reform/state-owned enterprise (SOE) creditworthiness and infrastructure program prioritization. The PSW is intended to allow new activities that are currently not viable, which will require expanded origination efforts and project preparation resources including advisory services to develop a pipeline of projects meeting the PSW eligibility and targets. The capacity of IFC and MIGA would need to be adjusted to accommodate the increase in operations; project preparation would be more labor intensive given the increase in volume and risk; the resources required to implement PSW governance and IDA's role in administering each window will need to be reviewed. Additionally, Management will consider the incentives needed to increase staff's engagement in more difficult investment climates. Furthermore, conducting ex-post evaluations of PSW projects will be critical in developing lessons learned and allowing for adjustments.

83. **Finally, ongoing risk management will be a critical part of the PSW's implementation.** At the management level, the PSW Oversight Committee will review the financial and development progress of PSW activities, upcoming pipeline development, and arising risks in the overall PSW portfolio. In addition, the Committee will be involved in addressing matters that are escalated for its guidance. On a transaction level, each entity's approval process will uphold investment standards while ongoing monitoring and reporting will update management on progress of each PSW-funded activity. Management would look to adjust the pilot based on financial and development results as well as lessons learned during implementation.

84. **Recognizing both the challenges and potential development impact from the PSW, IDA, IFC and MIGA Management are committed to focus their efforts on the successful implementation of the window for IDA18.** All institutions will be mobilized to establish and implement the PSW as an important priority. Based on financial and development results as well as learning through feedback loops, Management will adjust the pilot and adapt as necessary towards successful implementation. The IDA18 Mid-Term Review (MTR) and appropriate evaluations in due course will also provide additional guidance to the PSW.

VI. ISSUES FOR DISCUSSION

85. **This paper further develops the proposal for the creation of a US\$2.5 billion PSW, which Deputies endorsed at the second IDA18 Replenishment meeting.** In addition to this endorsement, Deputies requested that the PSW be reviewed at the IDA18 Mid-Term Review. The views of Deputies are sought on the following key issues:

- Do Deputies find the expected additionality of the PSW appropriate to ensure a scaling-up of private sector engagement in IDA-only countries, with a focus on FCS?

- Do Deputies agree with the proposed facilities, their design features and approaches for managing their related risks to achieve the objectives of the PSW, including alignment with IDA's objectives?
- Do Deputies agree with the proposed governance framework driven by organizing principles that incorporate lessons learned from inter-WBG transactions?

86. **Management requests IDA Deputies' support for the PSW proposal as presented in this paper.** With Deputies' endorsement, Management will present the PSW to the Executive Board of IDA for approval, together with IFC and MIGA Boards' approval of each institution's participation, following which, further implementation details will be developed for the PSW to be operational at the start of the IDA18 period on July 1, 2017.

Annex 1: IFC's Blended Finance Experience

1. With the increasing use of public funds to support private sector projects, the term 'blended finance' has become more popular and with a variety of meanings. In the context of IFC, blended finance refers to a financing package comprised of concessional funding provided by development partners and commercial funding provided by IFC. Blended Finance solutions can provide financial support to high-impact projects, that would not attract financing on strictly commercial terms because its risk are high and its returns are either unproven or not commensurate with the level of risk. Blended finance co-investments can be structured as debt, equity, risk sharing and guarantee products, and performance-based incentive structures with differences in rate, tenor, security or rank to mitigate risks and support projects that address some kind of market failure or unfavorable market conditions.

2. Over the past decade, IFC has developed a targeted and disciplined approach to its blended finance operations that relies on non-grant instruments (loans both senior and mezzanine, equity, and guarantees) funded by donor partners to help the private sector overcome the financing challenges endemic in many of emerging markets in which IFC operates. IFC and its clients see first-hand how often commercial banks have avoided investing in risky sectors and in frontier markets. Regulatory, political, currency, and other risks, in addition to reputational risks stemming from complex environment and social challenges, keep banks and investors from volunteering to be the first to jump into a market.

3. Investors generally look for successful first-of-their-kind demonstration projects in a particular sector to ensure that a market segment has been sufficiently de-risked before allocating large amounts of capital for follow-on projects. And for years, blended finance has provided exactly that initial demonstration effect in a market.

4. Since 2012, IFC has blended more than US\$500 million in concessional investment capital to support more than 90 investment projects that have leveraged over US\$5 billion in third party financing (including over US\$270 million in concessional investments to IDA countries). Box i provides a list of IFC's blended finance facilities in different sectors. These investments have supported pioneering projects including innovative energy efficiency financing in Turkey and catalytic solar photovoltaic facilities in Thailand – these two being examples of markets where commercial financiers are now comfortable participating.

5. Blended finance was the ideal tool to help support these high-impact, transformational projects in sectors that were unable to attract commercial financing, but had the potential to become commercially viable over time. By blending public sector funds in the form of co-investments in private sector projects, IFC not only directly enabled these important projects, but also helped demonstrate to private developers and financiers that these sectors were in fact profitable, stimulating a series of follow-on investments.

LESSONS FROM IFC'S EXPERIENCE

6. In IFC's own blended finance operations, we have identified two elements that are critically important to effectively apply blended finance in frontier markets. First, strong governance: IFC has a mature and well established set of Board-endorsed principles for

governing its blending operations. At the individual project level, IFC applies the same standards when investing on behalf of donor partners as it does with respect to the administration and management of IFC's own affairs, including the application of integrity due diligence and environmental and social safeguards. IFC has also established a senior committee to approve the use, structure, and terms of donor-funded concessional finance used as part of the overall blended financial package provided to the client. IFC uses a targeted and disciplined approach for its blended finance investments through the following: *(i) Focusing on projects where IFC financing alone is unable to make the project happen; (ii) Minimizing concessionality to avoid market distortion; (iii) Supporting sectors that could achieve financial sustainability in the medium term; and (iv) Ensuring transparency and effective governance.*

7. Second, effective execution: Over the past decade, following the successful deployment of pilot projects, IFC has created a dedicated blended finance product offering. This has enabled IFC to build a track record as a disciplined investor of concessional donor funds, employing well defined procedures that encompass all stages of the project cycle, from project due diligence/approval to monitoring and evaluation. IFC's blended finance operations allow IFC, as well as its donor partners, to engage in new sectors, technologies, and countries sooner and/or at a larger scale than without blending. This approach has made donors comfortable with delegating authority to IFC for project approvals, maximizing efficiency in the support of impactful projects.

IFC's Blended Finance Platform

CLIMATE				
Fund/ Facility	Objectives/ Sector focus	Partners	Size /Instruments	Deployment at end of FY16
IFC-Canada Climate Change Program	Address market barriers that prevent the faster, more wide-spread or more long-term sustainable adoption of low-carbon technologies and/or business models that address climate change	<ul style="list-style-type: none"> • Canada 	<ul style="list-style-type: none"> • Size: \$335 million • Senior Debt • Subordinated Debt • Local Currency 	<ul style="list-style-type: none"> • US\$154 million committed to investments • US\$76.5 million committed to IFC Catalyst Fund
Climate Investment Funds	The Climate Investment Funds (CIF) support 72 low and middle income countries in addressing their challenges arising from climate change and to reduce their greenhouse gas emissions. The CIFs are a family of four programs that focus on renewable energy, energy efficiency, and forestry, transport and climate resilience.	<ul style="list-style-type: none"> • Climate Investment Funds 	<ul style="list-style-type: none"> • Size: up to \$730 million • Senior Debt • Subordinated Debt • Equity • Local Currency 	<ul style="list-style-type: none"> • US\$130 million committed to investments
Green Climate Fund	<i>[Accredited in March 2016]</i> Promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change.	<ul style="list-style-type: none"> • GCF 	<ul style="list-style-type: none"> • Size: Initial proposals under discussion • Senior Debt • Other instruments likely to be available in the future 	<ul style="list-style-type: none"> • N/A
Global Environment Facility	<i>[New Proposal Under Discussion]</i> To assist in the protection of the global environment and to promote environmental sustainable development through its 18 implementing partner agencies. Their focal areas include climate change, Persistent Organic Pollution (POPs), ozone depletion, combating desertification, and protecting biological diversity.	<ul style="list-style-type: none"> • GEF 	<ul style="list-style-type: none"> • Size: \$10 million (new proposal under discussion) • Guarantee (Second Loss) 	<ul style="list-style-type: none"> • N/A from the New Proposal • Note: From 1998, IFC deployed and has managed over time a portfolio of GEF investments of more than US\$95 million.
AGRIBUSINESS & FOOD SECURITY				
Fund/ Facility	Objectives/ Sector focus	Partners	Size /Instruments	Deployment at end of FY16
Global Agriculture and Food Security Program (GAFSP)- Private Sector Window	Support and demonstrate new and innovative financing aimed at increasing the commercial potential of small and medium sized agribusinesses and farmers by bringing them into the local, national, and global value chain.	<ul style="list-style-type: none"> • Canada • Netherlands • UK • Japan • United States 	<ul style="list-style-type: none"> • Size: \$308 million • Senior Debt • Subordinated Debt • Risk Sharing Facilities (First-Loss guarantees) • Partial Credit Guarantees • Equity • Local Currency 	<ul style="list-style-type: none"> • US\$163 million committed to investments

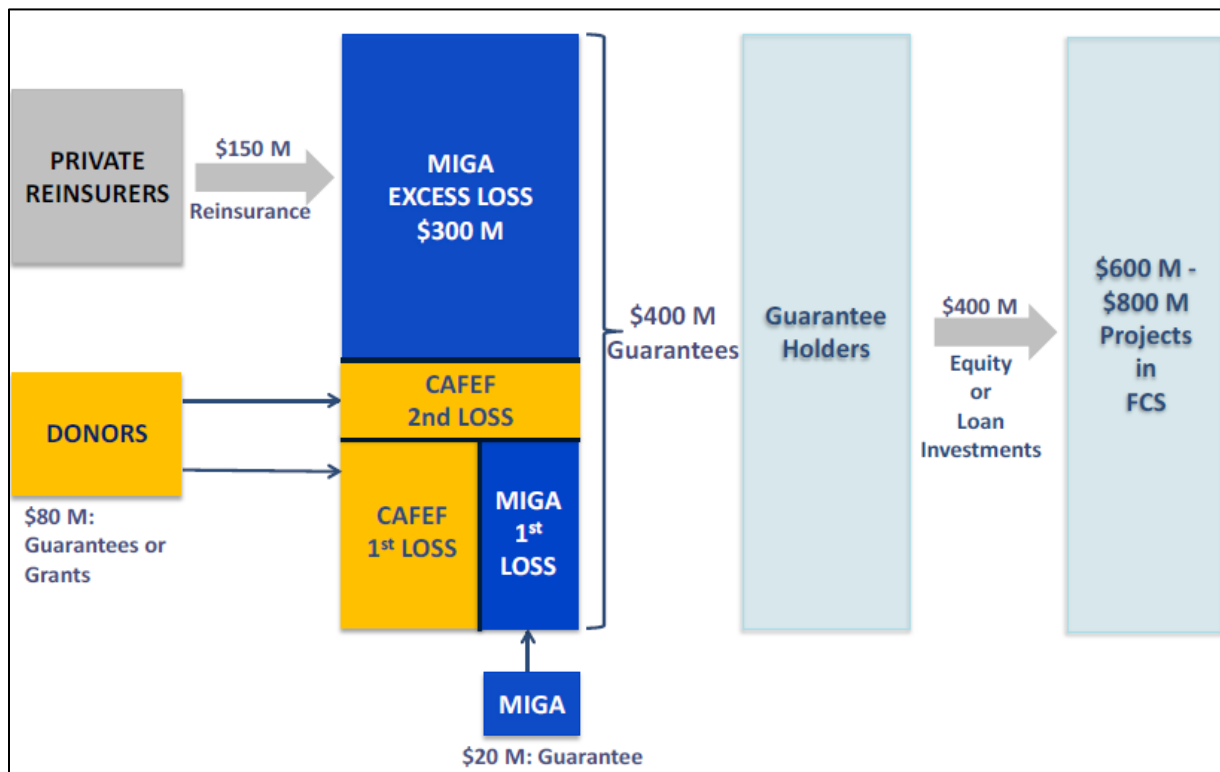
SME FINANCE				
Fund/ Facility	Objectives/ Sector focus	Partners	Size /Instruments	Deployment at end of FY16
Global SME Finance Facility Program	Reduce the financing gap of SMEs in DFID's priority countries by providing funding and capacity building to financial institutions (FIs) to on-lend to under-served SME segments, including women-owned-businesses, SMEs in fragile and conflict affected states and frontier regions.	<ul style="list-style-type: none"> • DFID (UK) 	<ul style="list-style-type: none"> • Size: \$60 million • Senior Debt • Subordinated Debt • Risk Sharing Facilities (First-Loss guarantees) • Partial Credit Guarantees • Interest Rate Buy-downs (i.e. Performance incentives) 	<ul style="list-style-type: none"> • US\$36 million committed to investments
Women Entrepreneurs Opportunity Facility	Expanding access to capital for women-owned SMEs globally and demonstrating the commercial viability of investing in such women-owned SMEs. The Facility aims to address both supply-side and demand-side challenges of access to capital by women entrepreneurs	<ul style="list-style-type: none"> • Goldman Sachs Foundation 	<ul style="list-style-type: none"> • Size: \$32 million • Senior Debt • Subordinated Debt • Risk Sharing Facilities (First-Loss guarantees) • Partial Credit Guarantees • Interest Rate Buy-downs (i.e. Performance incentives) 	<ul style="list-style-type: none"> • US\$13 million committed to investments
MENA Facility/Trust Fund for Lebanon (TFL)	Enhance and strengthen the capacity of banks for risk taking and financing to SMEs in the Middle East & North Africa region, with the aim to help bridge the financial services gap for SMEs and to make a meaningful contribution towards greater financial inclusion.	<ul style="list-style-type: none"> • IDA 	<ul style="list-style-type: none"> • Size: \$11 Million (Lebanon Only) • Risk Sharing Facilities (First-Loss guarantees) • Partial Credit Guarantees • Interest Rate Buy-downs (i.e. Performance incentives) 	<ul style="list-style-type: none"> • US\$3 million committed to investments

Annex 2: MIGA’s Experience with Conflict Affected and Fragile Economies Facility

1. MIGA launched its first multi-country FCS trust fund, the Conflict Affected and Fragile Economies Facility (CAFEF) in April 2013. It is designed to support MIGA’s activities in FCS through addressing the need for greater support of cross-border investment and lending into FCS through the provision of political risk insurance.

2. The Facility’s loss sharing structure provides an initial loss layer, which mitigates claims risk and allows MIGA to increase its exposure to FCS countries where risk is higher. The protection offered by the Facility results in lower capital utilization for projects in these riskier markets. The Facility is also critical to reinsurers who might otherwise be unwilling to take the risk. For example, in November 2013, MIGA issued a guarantee where the Facility provided initial loss coverage for a project covering an investment of up to US\$100 million to support the construction, expansion and operation of a telecom tower network in the Democratic Republic of Congo.

Illustrative risk sharing arrangement under CAFEF



3. The Facility’s supporting partners include the Canadian International Development Agency (CIDA), the Swedish International Development Cooperation Agency (SIDA), and the UK’s Department for International Development (DFID). At June 30, 2016, US\$77.2 million of the total capacity of US\$90.0 million is allocated to projects signed and approved by the Board, representing 86% utilization, supporting total guarantees issued of US\$221.9 million. Sectors supported by MIGA guarantees using CAFEF include energy, services, financial sector and telecom in FCS markets like Democratic Republic of the Congo, West Bank and Gaza, Iraq, Myanmar, South Sudan and Sierra Leone.

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

5. The Facility shares in premium income for the guarantees it provides. This along with the investment income slowly grows the corpus of the Facility. Any claims paid reduce the capital, while potential recoveries restore partial or fully losses incurred. As guarantees expire, or are cancelled, the freed up capital can be redeployed to support additional new business. CAFEF capacity is expected to be used 2-3 times over its 20 year life based on MIGA claims and recovery experience.

Annex 3: African Development Fund's experiences with its Private Sector Facility

1. In order to address the substantial financing gap for infrastructure and industrial capacity in African LICs, the African Development Fund (ADF) established a private sector facility under ADF13 (2014-2016). ADF observed that in spite of the increasing interest of foreign and domestic investors to enter these markets, non-sovereign financing in low income countries attracts a punitive risk capital charge, due to high perceived and actual risks in these markets. Hence, ADF identified an opportunity for deployment of a private sector facility.
2. The Private Sector Credit Enhancement Facility (PSF) was launched in 2015, on a pilot basis, at an initial size of UA165 million that serves as liquidity reserve to cover potential losses on credit exposures amounting to up to three times its level of unimpaired risk capital, in other words up to UA 495 million of credit risk exposures. The PSF provides guarantees to the African Development Bank's (AfDB) private sector operations, exclusively in ADF eligible countries. The facility is operationally and financially autonomous from the Fund and the Bank, and has its own governance structure, procedures, eligibility criteria, portfolio construction and capital adequacy reviews. It is overseen by the ADF Board which also has approval authority for risk participations in the AfDB's NSO, informed by recommendations issued by the administrator of the facility, responsible for day to day management, reporting and resource mobilization. The administrator function is part of the arms-length arrangement to mitigate potential conflict of interest between the Fund, the Bank and the facility, in addition to other measures such as strict eligibility criteria and a strong legal foundation (including a risk participation agreement between the facility and the Bank).
3. The facility's risk sharing covers up to two thirds of the credit risk of a transaction, pro-rata between the AfDB and the facility, and is guided by a set of principles: (i) moral hazard risk mitigation, through the autonomous set-up and an arms-length agreement between the facility and AfDB; (ii) additionality and crowding-in; (iii) prudent leverage and financial management, through application of the Bank's capital adequacy and risk management frameworks and a maximum leverage of about three times; and (iv) transactional efficiency by using the Bank's operational capacity and alignment with corporate policies and processes.
4. ADF-only, blend and graduating countries are eligible to access the facility. Proposed projects must comply with the AfDB's policy and guidelines for private sector operations, consisting of alignment to national development priorities, commercial viability, development impact, additionality and compliance with integrity, social and environmental safeguards. Typical instruments used include project financing (in infrastructure, industrial development, services, agriculture and MSMEs), as well as corporate loans to enterprises and financial intermediaries. Only loans and guaranties are eligible instruments. PSF strives for a balanced portfolio composition taking into account sectors, geographies, and credit quality. The design of the facility enables a BBB equivalent level of credit enhancement to be assigned to covered exposures.
5. Since its establishment in 2015, the facility has seen a significant uptake, including more than half of its allocations in high risk countries (most of which are eligible to the ADF's fragile

states envelop), and is expected to utilize its full capacity by mid-2017. It is therefore currently being considered for extension and topping up under the ADF14 replenishment consultation. To inform the design of the PSW, IDA consulted ADF and PSF on the lessons learned with the PSF so far, some of which provide useful inputs for the establishment of the PSW. They include:

i. **Clear eligibility criteria and strong prudential risk parameters are essential to guide decisions about inclusion of projects into the portfolio and the desired risk level of the facility.**

- High portfolio granularity and a prudent maximum transaction size are important measures to mitigate the risk of losses on large projects. In this regard, PSF's experience suggests that building a diversified portfolio by sector, geography, maturity is good practice, and can best be done through a structured and programmatic review process of the pipelines proposed by sector/country teams.
- PSF experience further emphasizes the importance of portfolio balancing, with the inclusion of both moderate alongside high-risk rated projects.
- The PSF model assumes that the pricing of risk participations and underlying loans must be commensurate with expected and unexpected losses if the vehicle is to operate sustainably from its capital endowment and revenues from operations.

ii. **Moral hazard is a risk that needs to be managed carefully through governance arrangements and clear roles and responsibilities of all participants in each project.**

- The PSF relies entirely on the appraisal, due diligence, contract negotiation of the ADB. During implementation, the ADB remains the lender of record and is responsible for all supervision, restructuring, workouts, etc. activities, with PSF retaining specific consent rights.
- PSF's experience suggests establishing and maintaining appropriate arms-length relations, and a clear separation of functions between the team originating and supervising the loan and the team recommending and managing the risk participation.
- The ADF Board of Directors is responsible for approving all PSF transactions based on recommendations of the PSF administrator. This recommendation concerns not only whether the PSF should risk participate a give transaction or not, but also the quantum of credit risk exposure to participate.

Annex 4: IFC and MIGA Results Framework

The IFC Results Measurement System

1. The IFC results measurement system is built on three mutually reinforcing components: i) The IFC Development Goals; ii) An integrated monitoring system to track results; and iii) Project and program evaluations of our impact.

A. The IFC Development Goals: Supporting the IFC Strategy

2. The IFC Development Goals (IDGs) are corporate targets towards five goals that have a direct impact on people's lives:

- Improving livelihoods of farmers
- Boosting health and education
- Expanding access to financial services
- Strengthening infrastructure
- Reducing greenhouse emissions.

3. The IDGs provide IFC with an ex-ante estimation of its direct development results, which contributes to give strategic direction to IFC's business, and also help communication with shareholders and the general public about how IFCs' work contributes to the WBG's goals of ending poverty and boosting shared prosperity. Additionally, the IDGs integrate IFC's mission into its incentive system as they are embedded in the IFC Corporate Scorecard, and offer a common framework for Investment Services (IS), Advisory Services (AS) and IFC's Asset Management Company (AMC) operations.

B. Integrated Monitoring and Reporting System: Adding Value to Operations and Strategy

4. IFC uses the Development Outcome Tracking System, or DOTS, to track progress, monitor performance, and measure the development results of its investment and advisory services on an annual basis. DOTS is fully integrated into IFC's operational work.

5. Monitoring investment projects. Regardless of the size of the IFC investment, DOTS measures – through standard, mostly sector-specific indicators – the number of people reached by IFC clients, or the dollar benefit to particular stakeholders. DOTS also provides a framework to measure the performance of clients in terms of development outcome, with an overall rating that is a synthesis of four performance areas: financial, economic, environmental and social, and private sector development impact.

6. Monitoring advisory projects. DOTS for advisory services integrates monitoring into every stage—from conception to completion—of a project's lifecycle. The overall DOTS score, or development-effectiveness rating, builds on standard indicators and is a synthesis of the

overall strategic relevance, effectiveness, and efficiency, following similar rating scales that are applied to investment projects.

IFC standard DOTs indicators

Key Impact Area	Select Indicators (across sector groups)
Financial Performance	ROIC (%) annual, life of project FRR (%) life of project
Economic Performance	ERR (or EROIC or EROE) Direct employment (perm + temp, gender) Taxes and fees paid to host government
Environmental and Social Performance	E&S management systems
Private Sector Development	Investment supported Domestic purchases Demonstration effect

C. Evaluations: Identifying Evidence of Impact

7. IFC conducts project and program evaluations to assess the impact of its clients beyond the results monitored through DOTs. Evaluations enable IFC to fill in knowledge gaps on what works or what doesn't, and learn lessons that can be used to improve operations. At the same time, sector evaluations help improve the understanding of how IFC's activities in a sector contribute to job creation and economic growth. In addition, IFC continues considering and piloting alternative frameworks and models that seek to help IFC better articulate, understand and estimate the developmental impact of private investments on our client countries' economies, the WBG's twin goals and relevant SDGs, as well as the main drivers of these impacts over time.

D. The MIGA Results Measurement System

8. In line with the WBG goals, MIGA is required to pay equal attention to the developmental results from its activities as well as the amount (volume, number) and financial sustainability on a portfolio basis of guarantees it writes. MIGA has introduced a standardized approach to collecting development outcome information from its clients, called the Development Effectiveness Indicators System (DEIS). The DEIS provides a system of routine data collection on development outcome indicators that can be used for a variety of purposes (reporting, analysis, self-evaluation) and aggregated to understand overall development outcomes of MIGA's portfolio.

The DEIS includes the following:

- (a) A defined set of indicators for measuring development outcomes of projects and the overall portfolio.
- (b) A team responsible for making sure that the system is updated, addressing DEIS-related issues, facilitating the implementation of the system, and acting as champions who serve as points of knowledge and guidance for the broader Agency.
- (c) Specific language in the MIGA guarantee contract (which consistently define the indicators).
- (d) Procedures for defining and assessing project indicators during project underwriting, including responsibilities for project team members.
- (e) Specific data gathering and analysis requirements for the Agency, with specific roles for teams (such as MIGA's Operations Department (MIGOP) and Economics and Sustainability Department (MIGES)).
- (f) A database for managing and housing information.
- (g) A web-based tool for clients to report indicators and for analyzing and publishing aggregated indicators.

E. Development Outcome Indicators

9. The development outcome indicators measure development outcomes of project enterprises supported by MIGA in four key impact areas: i) financial performance, ii) economic performance, iii) environment and social (E&S) performance and iv) private sector development (PSD). Some of these indicators are estimated during project underwriting only, while others are estimated during underwriting and then collected from clients annually. Development outcomes will be assessed at the level of the project enterprise.⁴⁰ Every project will have a set of general indicators which are mandatory for all projects summarized in Table 2; and also sector specific indicators to supplement this.

⁴⁰ Underwriting teams will need to use their judgment in determining the boundaries of the project enterprise. For project finance type transactions, the boundaries of the project enterprise are usually quite clear. With corporate finance type transactions, the team will need to make a reasonable determination of the "project enterprise" which may only be a sub-set of the activities of the corporation supported.

MIGA Project general indicators

Key Impact Area	General Indicators
Financial Performance	FRR (or ROIC or ROE)
Economic Performance	ERR (or EROIC or EROE) Direct employment (perm + temp, gender) Taxes and fees paid to host government
Environmental and Social Performance	E&S management systems
Private Sector Development	Investment supported Domestic purchases

Two types of development outcome data are compiled through the DEIS:

- Forecast data are estimates of the project enterprise’s development outcome at the time of full commercial operations and gathered at the time of project underwriting. Forecasted development outcome indicators should be collected for all the project’s indicators, both mandatory and “as applicable.” A select number of these indicators are only collected during project underwriting;
- Actual data on development outcomes indicators for individual projects gathered annually after contract execution. These development outcome indicators are a sub-set of the complete list of indicators, and are identified in the guarantee contract under the ‘DEIS Annex’.

F. Results Tracking and Reporting

10. A DEIS team, comprising professionals from operations, legal, risk and key support MIGA functions is responsible for the implementation of the DEIS. The DEIS team provides support for relevant operations teams, risk management, environment and safeguards specialists in collating the data and are also be responsible for modifications to the DEIS such as adjustments to indicator lists and definitions.

11. Forecast data (estimates of development outcomes gathered during project underwriting) is collated with support of Underwriters, Risk management officers, E&S specialists and Lawyers which ensure that the DEIS database has consistent information from clients and that the development outcome indicators are included in the guarantee contract, as defined by the project team and as required by the details of the transaction.

12. All MIGA contracts include a DEIS annex which requests MIGA clients to provide the development outcome data annually, on a calendar year basis, within one quarter of the end of the calendar year.

13. Data is gathered from clients on a calendar year basis in order to be available for publication on an aggregate basis in MIGA's annual report. The DEIS team are responsible for managing the annual data gathering exercise supported by relevant MIGA operations professionals who reach out to clients to collect the necessary data. All new data will be entered into the DEIS database.

14. MIGA also has robust processes for evaluating/verifying indicator data. DEIS team is also leading the effort to build a web-based tool for submission of DEIS data by clients.

Annex 5: List of IDA countries, by grouping and category, eligible for PSW support (FY17)

Countries	IDA grouping	FCS Category
Afghanistan	Regular	FCS
Burundi	Regular	FCS
Central African Republic	Regular	FCS
Chad	Regular	FCS
Comoros	Regular	FCS
Congo, Democratic Republic of	Regular	FCS
Eritrea	Regular	FCS
Gambia, The	Regular	FCS
Guinea-Bissau	Regular	FCS
Haiti	Regular	FCS
Kiribati*	Regular	FCS
Liberia	Regular	FCS
Madagascar	Regular	FCS
Mali	Regular	FCS
Marshall Islands*	Regular	FCS
Micronesia, Federated States of	Regular	FCS
Myanmar	Regular	FCS
Sierra Leone	Regular	FCS
Solomon Islands	Regular	FCS
Somalia*	Regular	FCS
South Sudan	Regular	FCS
Sudan	Regular	FCS
Togo	Regular	FCS
Tuvalu*	Regular	FCS
Yemen, Republic of	Regular	FCS
Cote d'Ivoire	GAP	FCS
Kosovo	GAP	FCS
Djibouti	GAP	FCS
Papua New Guinea	Blend	FCS
Zimbabwe	Blend	FCS
Bangladesh	Regular	non-FCS
Benin	Regular	non-FCS
Burkina Faso	Regular	non-FCS
Cambodia	Regular	non-FCS
Ethiopia	Regular	non-FCS
Guinea	Regular	non-FCS

Countries	IDA grouping	FCS Category
Kenya	Regular	non-FCS
Kyrgyz Republic	Regular	non-FCS
Malawi	Regular	non-FCS
Maldives	Regular	non-FCS
Mauritania	Regular	non-FCS
Mozambique	Regular	non-FCS
Nepal	Regular	non-FCS
Niger	Regular	non-FCS
Rwanda	Regular	non-FCS
Samoa	Regular	non-FCS
Sao Tome and Principe	Regular	non-FCS
Senegal	Regular	non-FCS
Tajikistan	Regular	non-FCS
Tanzania	Regular	non-FCS
Tonga*	Regular	non-FCS
Uganda	Regular	non-FCS
Vanuatu	Regular	non-FCS

*Not MIGA member countries

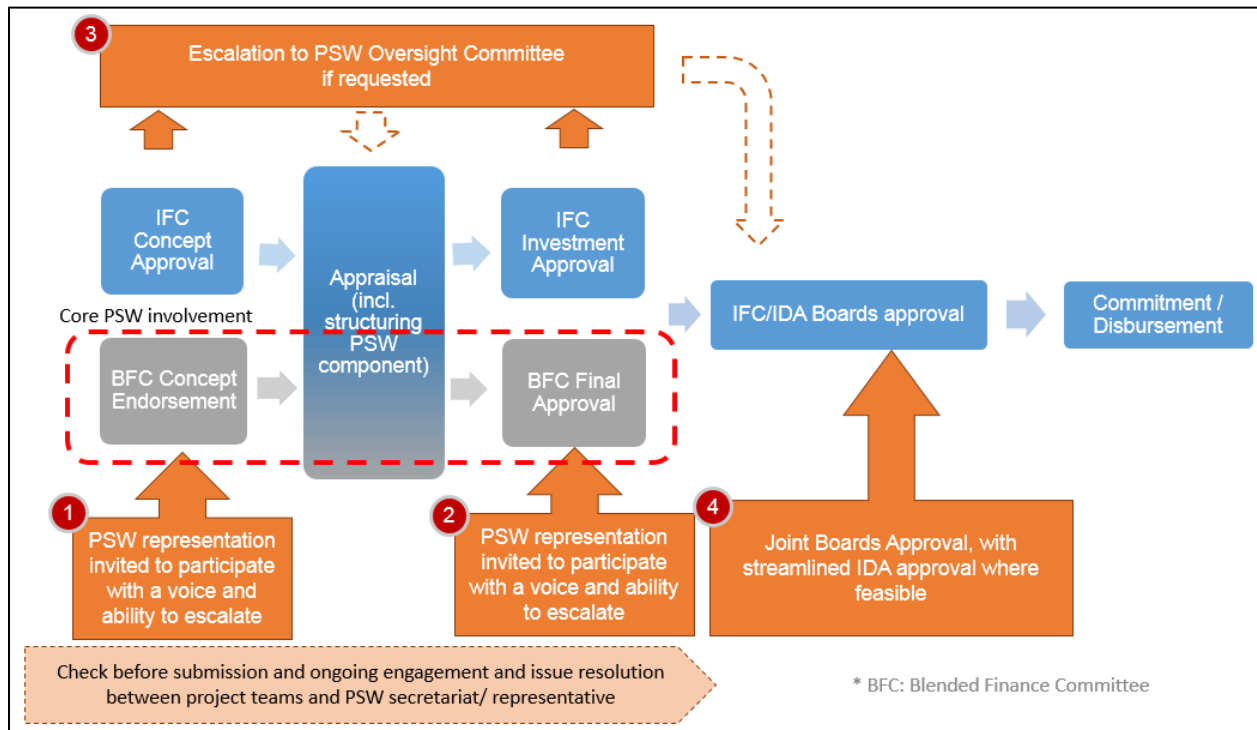
Annex 6: Facility-Level Governance

Principles of Facility level Governance

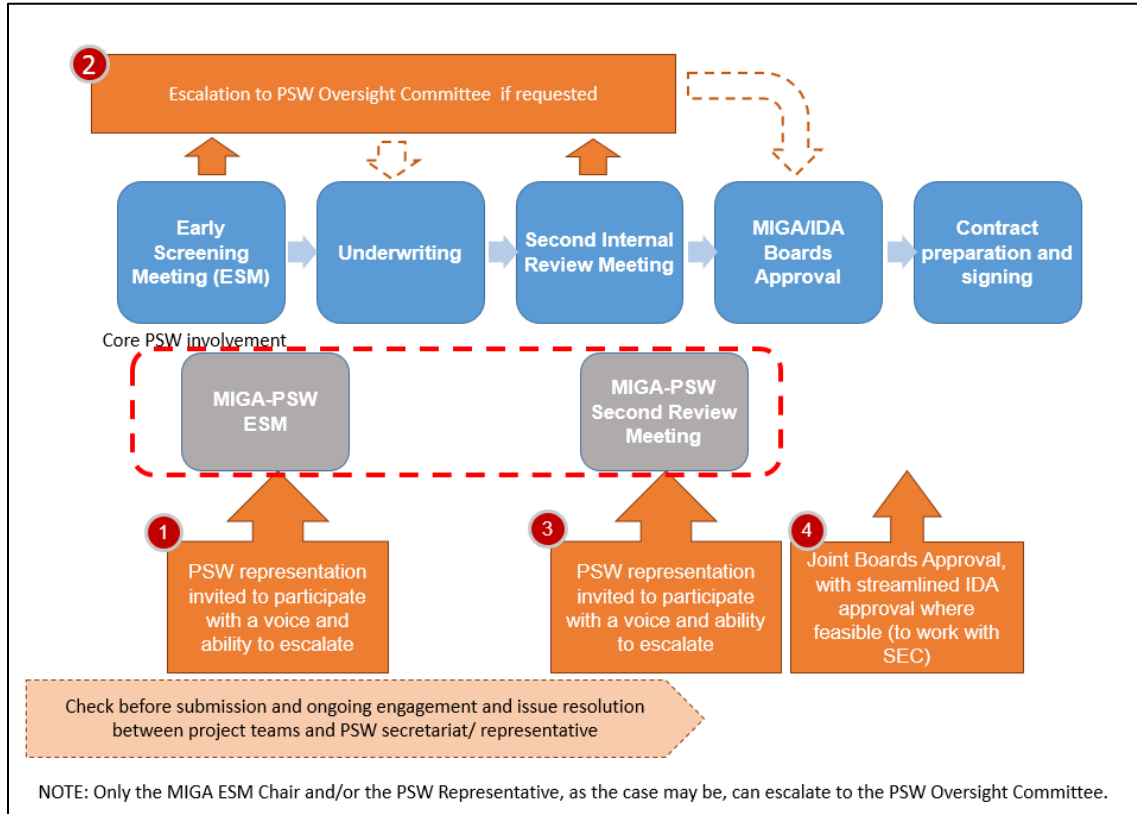
- Build on existing processes at IDA, IFC and MIGA to the extent possible.
- IDA, as the manager of PSW resources, will participate through its representatives in the facility-level review processes with the same information access as other reviewing members, and with a voice and the ability to escalate.
- An escalation mechanism is built into all facility-level processes that each party in the review processes has the right to escalate to PSW Oversight Committee in the event of disagreement on PSW use.

Stylized Illustrations of Governance Process at the Facilities Level

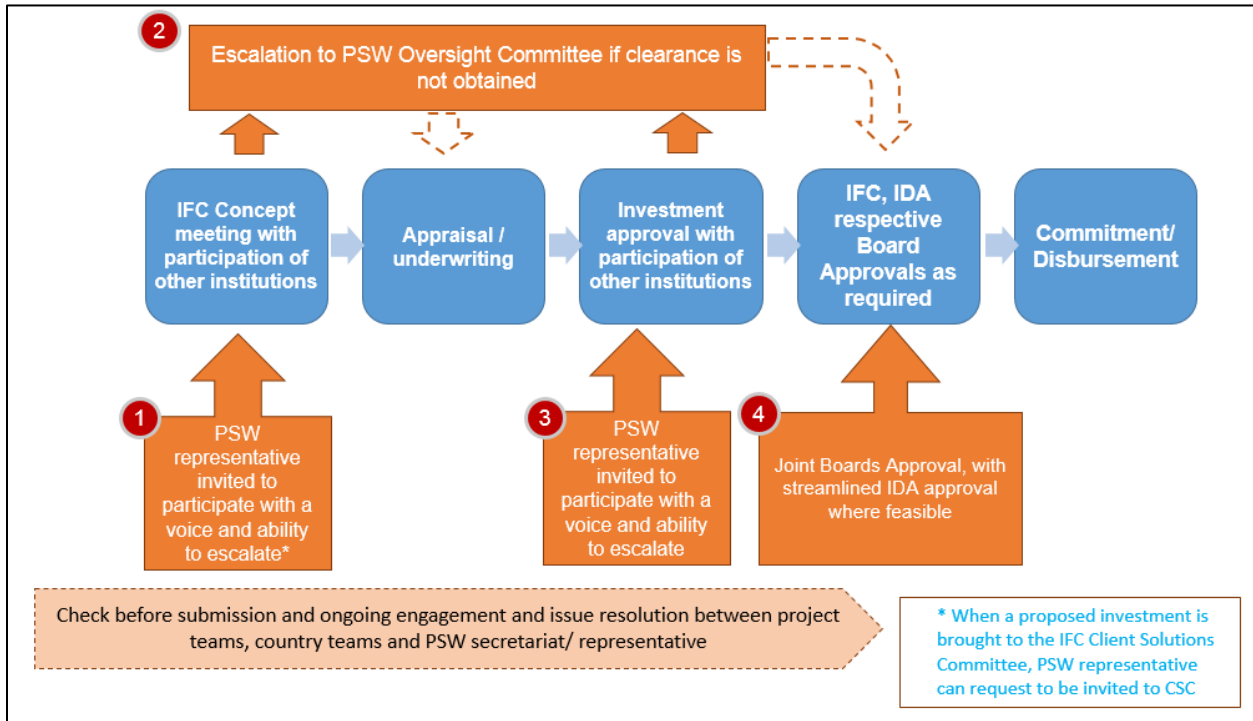
Blended Finance Facility



MIGA Guarantee Facility



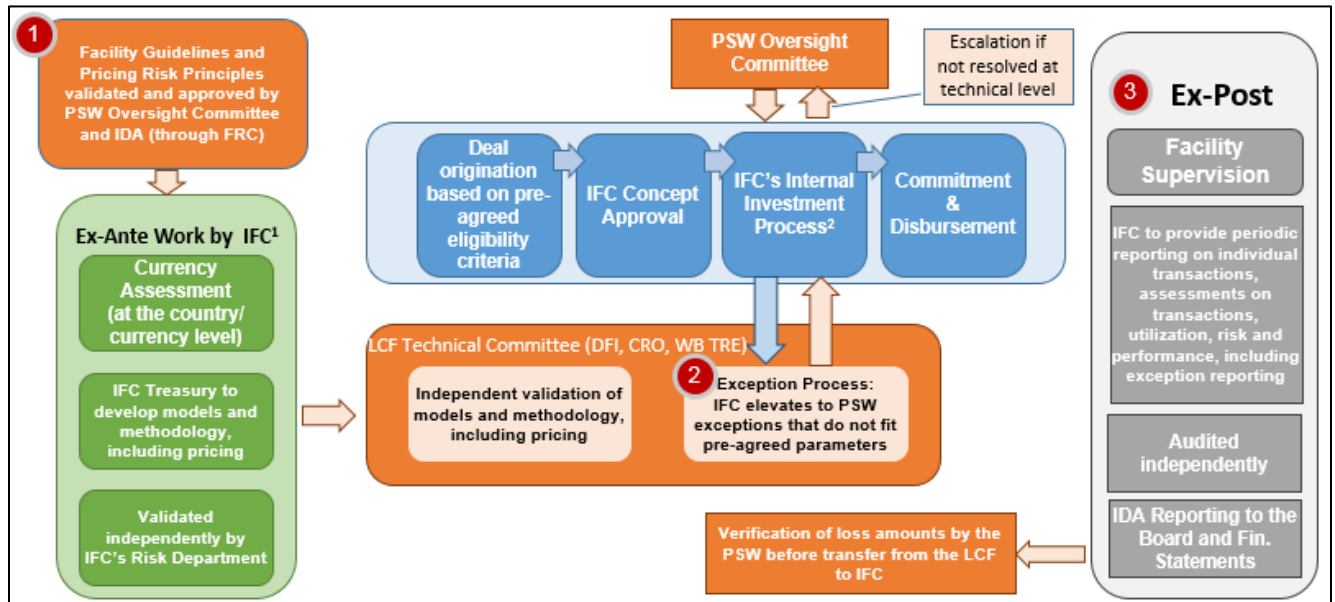
Risk Mitigation Facility



Local Currency Facility

To ensure the conflict of interests issues are properly addressed through arm’s length arrangements while balancing the needs to keep operational efficiency, the governance of the Local Currency Facility is organized through (1) upfront IDA Board approval of the use of PSW resources for the facility; (2) Pre-agreed Facility Guidelines between IDA and IFC to provide a delegation of authority to facilitate automatic cover of transactions that meet pre-agreed criteria up to pre-specified ceilings; (3) In the case of exceptions, the transactions are brought to IDA’s attention for review and decisions; (4) In all cases, IDA has the ability to consult World Bank Treasury, the Chief Risk Officer’s office and other third-party to provide necessary advisory services.

Local Currency Facility



Annex 7: Illustrative Examples of PSW Transactions

Risk Mitigation Facility Impact Example

1. The RMF facility is expected to provide a wide range of risk mitigation instruments to mitigate non-commercial risks in IDA-only and FCS countries. Although the instruments will be deployed across various infrastructure sectors such as power, water & sanitation, transport, and telecommunications, the example below is an illustration focused on the power sector and is intended to represent the challenges faced in many of these markets.
2. Many of these countries face similar challenges in the power sector: lack of adequate generation capacity, poor grid infrastructure, low availability of existing aging generation units, heavy reliance on imports and fuel oil-based generation, high transmission and distribution losses, low collection levels from customers and lack of cost reflective end user tariffs. The result is significant under-investment in the sector, an underdeveloped power sector and a financially weak offtaker, which may put significant strains on government finances. This often leads to a vicious circle that is difficult to break, given the private investors' high risk perception of these sectors. While existing WBG risk mitigation instruments have been successfully used in many power projects to support Independent Power Producers (IPP's), there is a clear demand for more, to support acceleration of energy investments across the sector value chain (i.e. generation, transmission and distribution) in the target markets, while doing so in a way that minimizes the impact on sector costs and affordability, thereby increasing the potential for success of these investments.
3. For example, Haiti's power sector is badly underserved and requires additional reliable grid-based electricity supply to support economic growth. As a result, industrial and commercial customers have gone largely off-grid, thereby hampering new economic activity. The expansion of grid-based power generation could be an efficient way to expand access to power in Haiti and, in particular, provide cost-effective and reliable electricity to support the competitiveness of the country's burgeoning labor-intensive manufacturing industry. Such a project would also support the improvement in the electrical utility's financial sustainability. With the support of the RMF to mitigate offtaker and other government risks (e.g., transmission risk), IFC could consider supporting the expansion of grid-based generation in Haiti. Through its country based work, IDA is heavily engaged in supporting reforms to Haiti's power sector, however, the country's limited fiscal space and limited IDA envelope may make it difficult to utilize existing instruments to support a significant expansion in power generation capacity.
4. Pioneering IPPs in many IDA-only and FCS countries bring to the forefront the significant challenges faced by investors: the lack of track-record of the government, regulator and off-taker often represents a significant challenge for private investors and lenders to overcome by themselves. While IFC has ongoing engagements in several pioneering IPPs in IDA-only and FCS markets, including Afghanistan, Mali, and Sierra Leone, we expect the RMF will allow for a significant expansion of IFC's high impact investments into challenging IDA-only and FCS markets such as the Mano River region in West Africa, among others.

MIGA Guarantee Facility Impact Example

5. In IDA-only and IDA-eligible FCS countries, investment insurance capacity is scarce because of risk perceptions and actual loss experience. These factors deter private market reinsurers from offering sizeable amounts of coverage and limit options available to investors seeking to insure their investments. A shared first loss facility would support investments and provide much needed capacity to projects. In the meantime, the PSW's risk participation as reinsurer would enable the provision of large scale long-term solutions where currently these are unavailable or insufficient.

6. As an example of impact of first loss support, MIGA is working with a regional bank based in Nairobi to bolster their regional operations in South Sudan. The economic situation in South Sudan is very strained due to the country's difficult fiscal and external position caused by the volatility of oil production and exports, as well as government war spending. MIGA's proposed guarantees – enabled by MIGA and PSW shared first loss that provides private sector reinsurers an additional layer of risk mitigation and draws them into the transaction as well - will offer support to a sector under severe pressure and lend comfort to the investors through its coverage. This then allows continued support to the bank's clients, which includes in large part job-supporting SMEs.

7. As an example of support by way of risk participation, there is significant need for experienced partners in delivering innovative solutions for large scale long-term projects for instance in power or infrastructure, in more challenging environments. MIGA brings forward this experience and its ability to work with project sponsors that are commercial lenders and equity investors, as well as reinsurers which provide risk mitigation. As part of an international consortium of technical and financial partners, MIGA is often called upon to support large scale transformational projects at significant exposure amounts and at long tenors against the risks of expropriation, transfer restriction and inconvertibility, war and civil disturbance, and breach of contract. However, given the scale of these projects, MIGA may need additional guarantee capacity beyond that provided by its private reinsurance partners. The MIGA Guarantee Facility would be perfectly suited to offer such capacity to support required guarantees and significantly enhance the WBG's ability to support big transformational projects in IDA-only and IDA-eligible FCS countries.

Local Currency Facility Impact Example

8. The LCF facility is expected to be a valuable risk mitigation tool for IFC clients/projects in some of the world's most challenging operating environments, as well as a tool to promote the development of local capacity and capital markets. Take as an example an agriculture seed distribution business. Seed distributors often need to import planting seeds on credit terms from global agribusiness entities--creating a USD liability for the local seed distributor. The use of credit is necessary due to the fact that the local distributor will, in turn, often need to extend credit to its farmer customers for the duration of the growing season until income from the harvest can be used to pay the distributor for the seeds. Beyond the credit risk that the distributor takes with respect to the farmers, it also takes on significant additional financial risk, as it needs to repay a USD liability to the global seed supplier with local currency revenues earned from its farmer clients. Unfortunately, market hedging instruments are often not available in the poorest

markets, especially for smaller clients deemed less creditworthy, so there is seldom a way to manage effectively this risk, leaving the distributor highly vulnerable to currency valuation changes.

9. In this situation, IFC could assist the local seed distributor by providing a term loan to replace the credit line that the distributor has with its global seed supplier. This term loan would provide financing for the duration of a crop cycle or two and, critically (with the LCF), could be provided to the distributor in local currency, thereby significantly mitigating the distributor's currency risk. IFC could provide the local currency loan through an agreement with a local commercial bank, which are often the lowest cost source of local currency liquidity. A key challenge, however, is that local counterparties often do not meet IFC Treasury's counterparty credit criteria, which normally would prevent IFC from being able to enter into a swap agreement with such entities.

10. Through the LCF, however, IFC would be able to provide a USD dollar funding to the local commercial bank that would be attractively priced due to IFC's low USD funding costs, with the LCF covering the risk of default by the local bank. The local bank would then provide IFC with the needed local currency to lend to the seed distributor. Typically, a local bank would take the USD lent to it by IFC and lend to other customers in its market with a need for financing (say a major exporter), thus allowing it to match its USD liability to IFC with a USD asset. Theoretically, the local bank could lend directly to the seed distributor in local currency, but major banks in less developed markets tend not to be comfortable with the credit risk of such entities, particularly in the SME and agriculture sectors.

11. So through this operation, the local bank receives USD funding from IFC in order to meet the USD lending needs for its USD-based clientele in return for low-cost local currency financing that IFC can use to finance its agribusiness client. The value-added of the LCF in this example is, therefore, the ability to extend IFC Treasury's counterparty credit risk appetite to clients that may not be attractive to local lenders and which would otherwise not be able to access local currency on reasonable terms. This type of operation is also prudent in that all entities involved are matching their assets and liabilities in the relevant currencies. Finally, the process of working through the financing structure with local banks allows IFC/IDA—through the benefits LCF—to contribute to the development of human capacity and capabilities in developing local hedging markets.

Blended Finance Facility Impact Example

IFC/GAFSP and World Food Program Collaboration: Patient Procurement Platform

12. World Food Program (WFP) is the food aid arm of the United Nations system. Food aid is one of the many instruments that can promote food security. WFP delivers life-saving food assistance to more than 80 million people by distributing around US\$1.2 billion worth of food commodities such as maize, wheat, rice, and soybeans, among others, in 75 countries. In 2008, it started an initiative titled "Purchase for Progress (P4P)" where WFP sought to buy locally produced food commodities for regional distribution either directly from local smallholder farmers via farmer cooperatives or via traders. From 2008 to 2013, WFP piloted this initiative in 20 countries and contracted to buy 400,000 metric tons of locally produced commodities valued

at US\$177 million, while investing US\$168 million for capacity building efforts. However, this initiative has identified several critical problems, one of which is farmers' limited ability to expand farming due to lack of access to finance.

13. Following this successful initiative over the last five years and to significantly scale up the purchases from farmers, WFP plans to set up the Patient Procurement Platform ("PPP") which would allow the aggregation of significantly higher volumes of output from traders that typically do not buy from smallholder farmers today. Local banks hesitate to finance farmers due to lack of conventional collateral: however, with off-take agreements issued by WFP or its selected contractors, it would enable smallholder farmers to use the offtake agreements from these parties as collateral and therefore increase access to the formal banking sector.

14. As a pilot initiative, IFC plans to establish a US\$21 million Value Chain Financing Facility to cover WFP's initial target countries including Tanzania, Rwanda and Zambia, which can potentially support 100,000 farmers directly. If successful, WFP plans to roll out this initiative with IFC in 25 countries by leveraging its purchasing demand of US\$750 million to support over 1.5 million farmers, with possible support from the PSW.

15. The proposed project consists of (i) the establishment of IFC's investment project (initially risk sharing facilities in three countries in FY16 with GAFSP Private Sector Window Support for first loss coverage of the RSFs; (ii) the establishment of a Risk Fund of to cover credit risk, crop risk, and price risk; and (iii) farmer extension services with support from advisory services.

SME Ventures Expansion

16. The PSW could catalyze the expansion of IFC's SME Ventures program. PSW support would enable the launch of new FCS-Focused SME funds focused on Myanmar; and, an additional Fund covering Mali, Burkina Faso, Côte d'Ivoire, Benin, Ghana, Cameroon, DRC, Gabon, Uganda, Madagascar, Comoros, and Senegal. These funds are not only focused on nascent markets for private equity/risk capital funds, but they are also expecting to invest a significant portion of their capital into SMEs that are at the smaller end of the scale, and thus carry more risk (i.e., ticket sizes of >US\$250-350K). Moreover, these funds will include some seed investments in start-ups, which involve more operational/financial risk and longer gestation periods. Both of these funds would also involve collaboration with the World Bank Group's Finance and Markets Global Practice, in order to enhance the regulatory environment for risk capital funds in these nascent markets.