The World Bank Guarantee: Leveraging Private Finance for Emerging Markets

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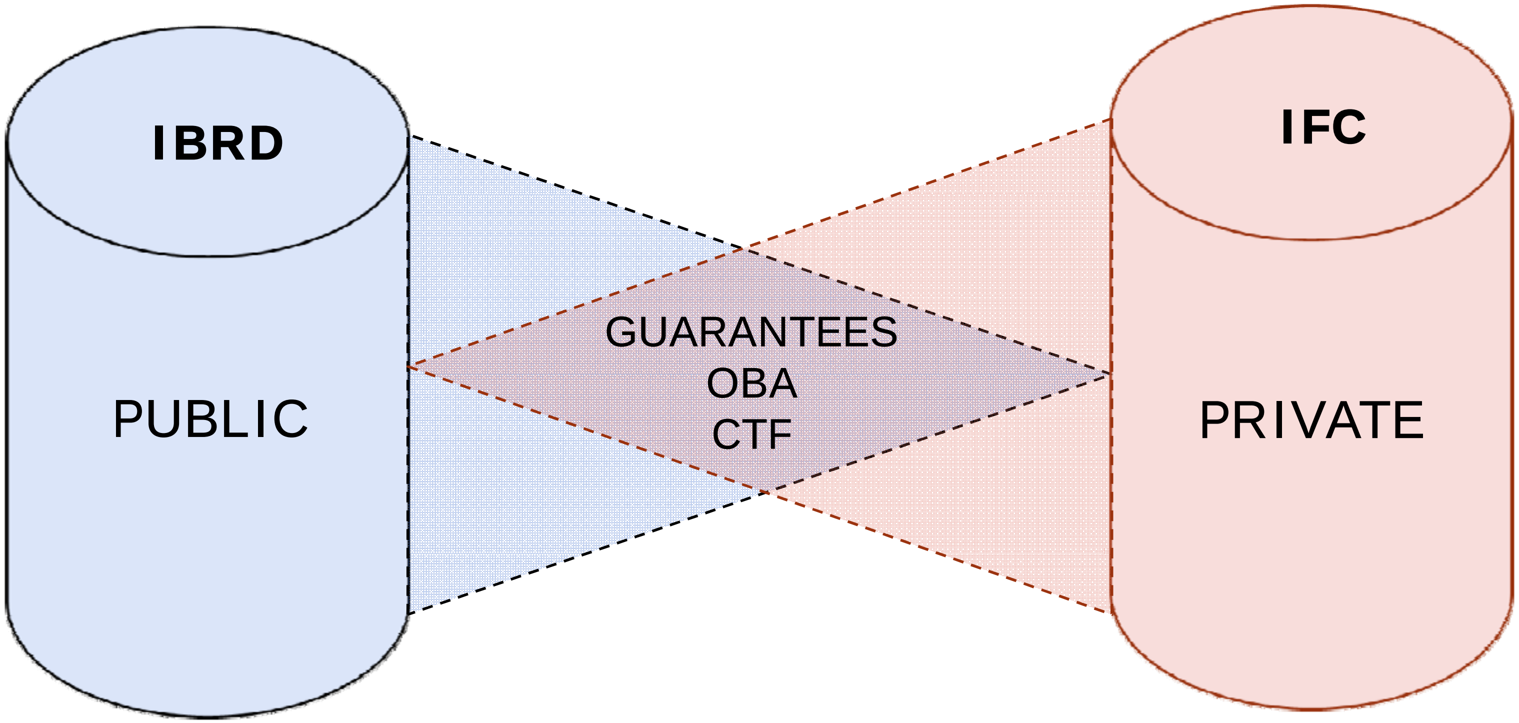
Why Guarantees?

- Guarantees highly effective in specific circumstances.
- Engage private sector capital and expertise and mobilizes resources from *non Bank sources*.
- Efficient use of World Bank balance sheet/IDA allocations (significant leverage)
- Conserve scarce sovereign guarantee capacity.
- Facilitate innovation and specifically tailored solutions to meet client needs

Sources of "Innovation"



Two party ⟶ Three Party ⟵ Two Party

Benefits of Guarantees

For the private sector:

- Mitigates critical perceived political and regulatory risks
- Makes privatizations financeable by facilitating direct access to financial markets
- Catalyzes long term “off balance sheet” debt financing; thereby reducing the risk profile of the investment and overall capital costs

For the Government:

- Facilitates access to the international debt and capital markets on more favorable terms
- Helps to reduce risk premium of investors
- Could reduce contingent liabilities
- Can be additional to the IMF external debt ceiling
- Additional to the country lending program
- Creates market confidence through Bank leverage and track record
- Provides for risk sharing with the private sector
- Helps to catalyze private sector finance

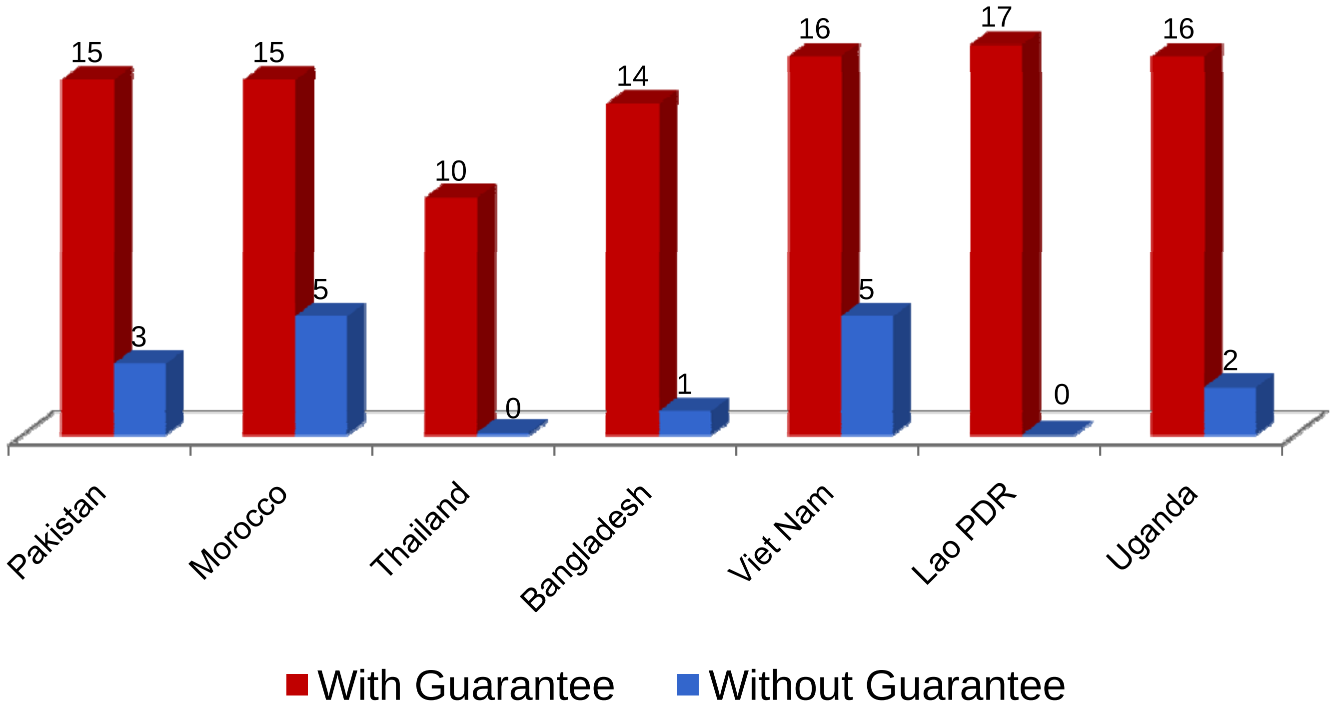
For the World Bank:

- Leverages Bank resources

Key Features of Bank Guarantees

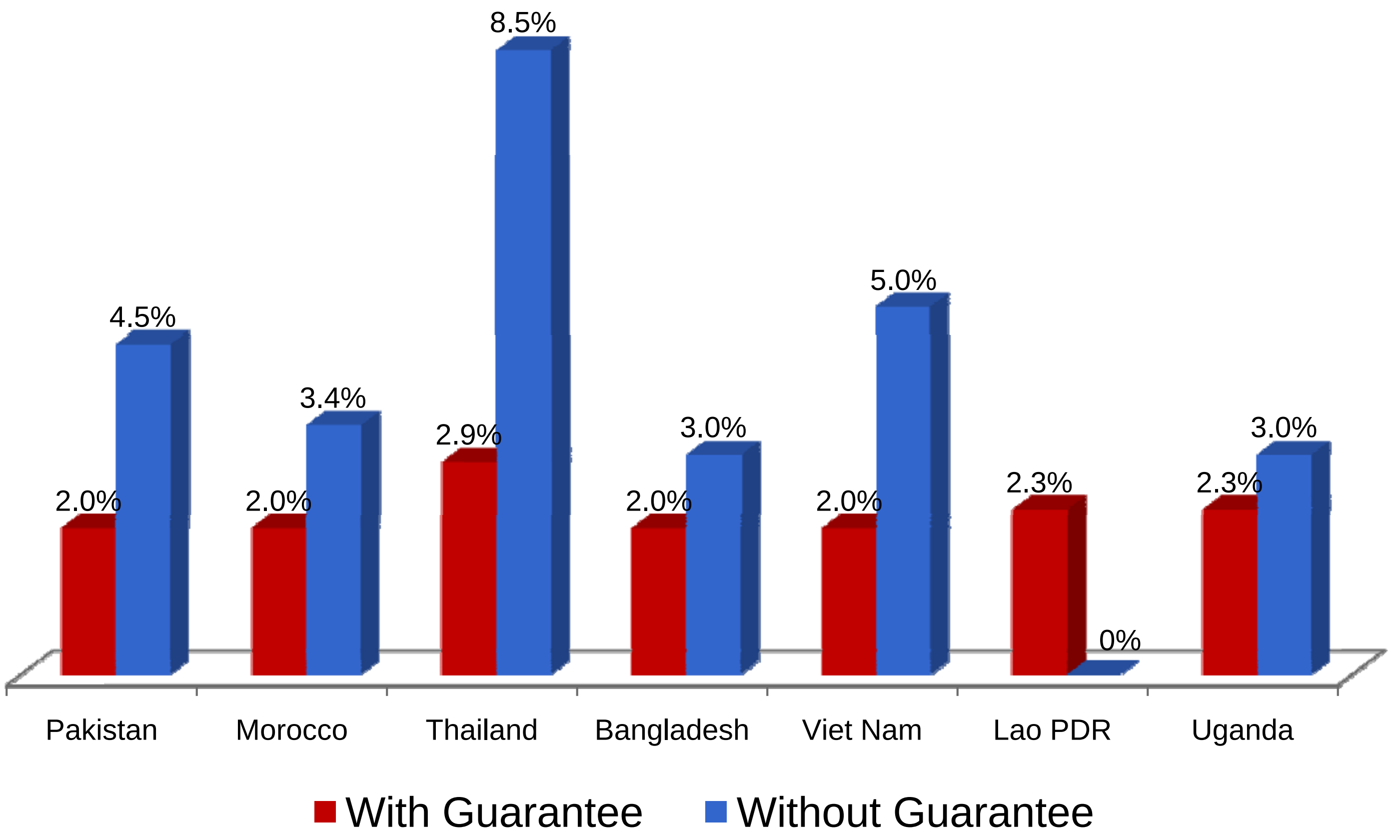
- **Rationale:** To help extend the reach of private financing by mitigating perceived risk and encourage private sector involvement in developing countries
- Available to all countries eligible for borrowing from IBRD /IDA
- Mobilize private sector participation and help catalyze financing with extended maturities and lower financing costs
- Guarantees provide support to lenders or project companies against a government's (or government entity's) failure to meet specific contractual obligations to a private or public project.
- Requires a counter-guarantee from Government (MOF)
- The guarantee is "Partial:" The Bank only assumes a portion of risk
- Flexible instrument: Different currencies (local, FOREX), available for all infrastructure sectors and variety of structures to fit the project and lenders needs
- Integral part of CAS/CPS

Guarantees help Extend Maturities…



(maturities in years)

...at the same time Reduce Spreads



Partial Risk Guarantees (PRGs) Role in support of Privatizations, Concessions and other PPP

World Bank Guarantees in Support of Privatizations / Concessions (cont.)

- Tariff commitments
- Regulatory process
- Disconnection policies
- Interference in arbitration
- Non payments of Governments / agency bills
- Termination amounts
- Changes in law

…and as a result enhance privatization response

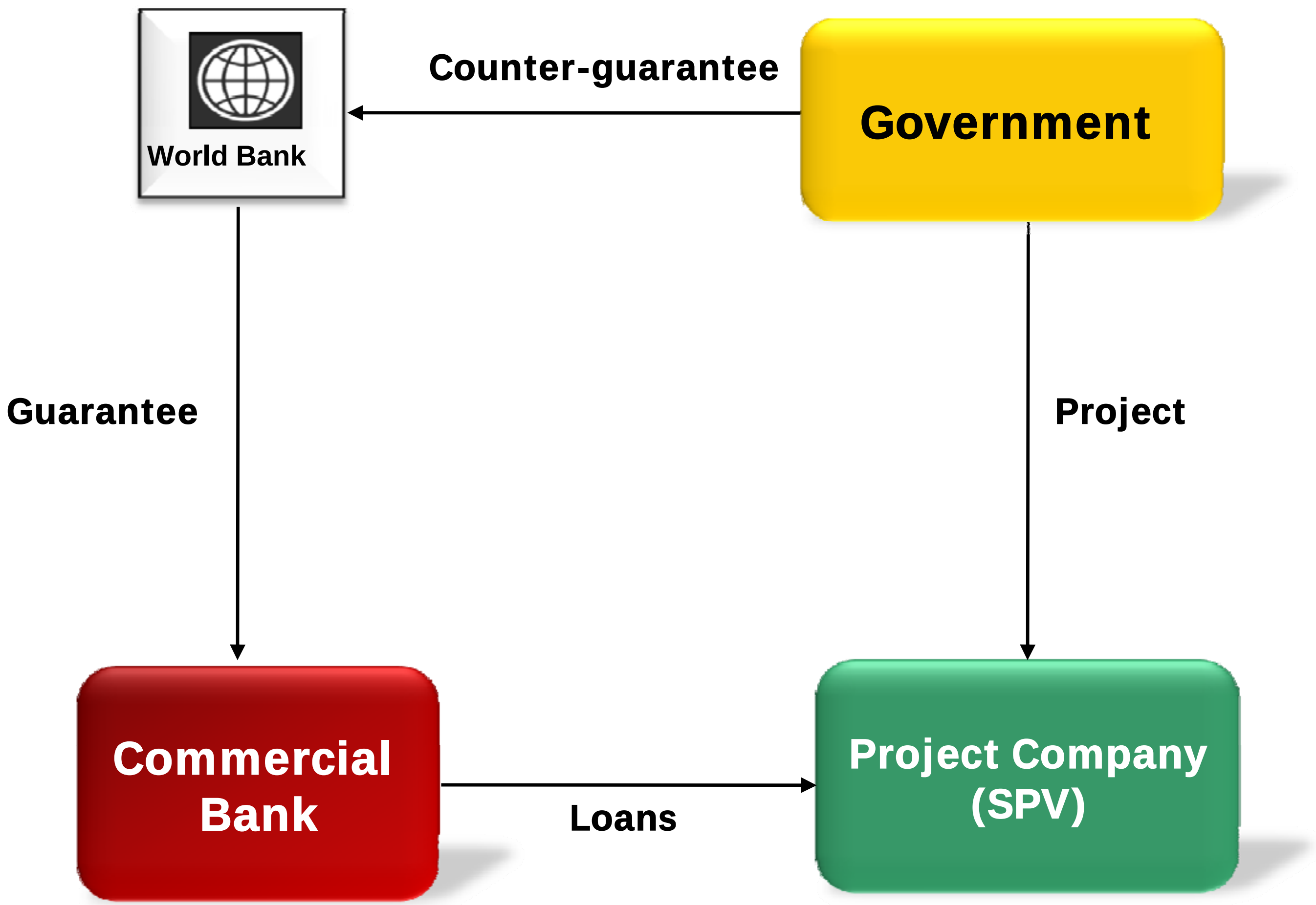
- Increased investment commitments
- More bidders
- Lower tariffs
- Increase in sale proceeds / concession fees for the government

Examples of Risks Covered by PRGs…

- Breach of Government or parastatal obligations
- Regulatory risk
- Changes in law / decrees / regulations
- Political force majeure (including War, Revolution and Expropriation)
- Transferability & convertibility of foreign exchange
- Frustration of Arbitration
- Backstop of Government Subsidies (e.g. Minimum Revenue Guarantees)
- Natural Force Majeure relating to government / parastatals obligations

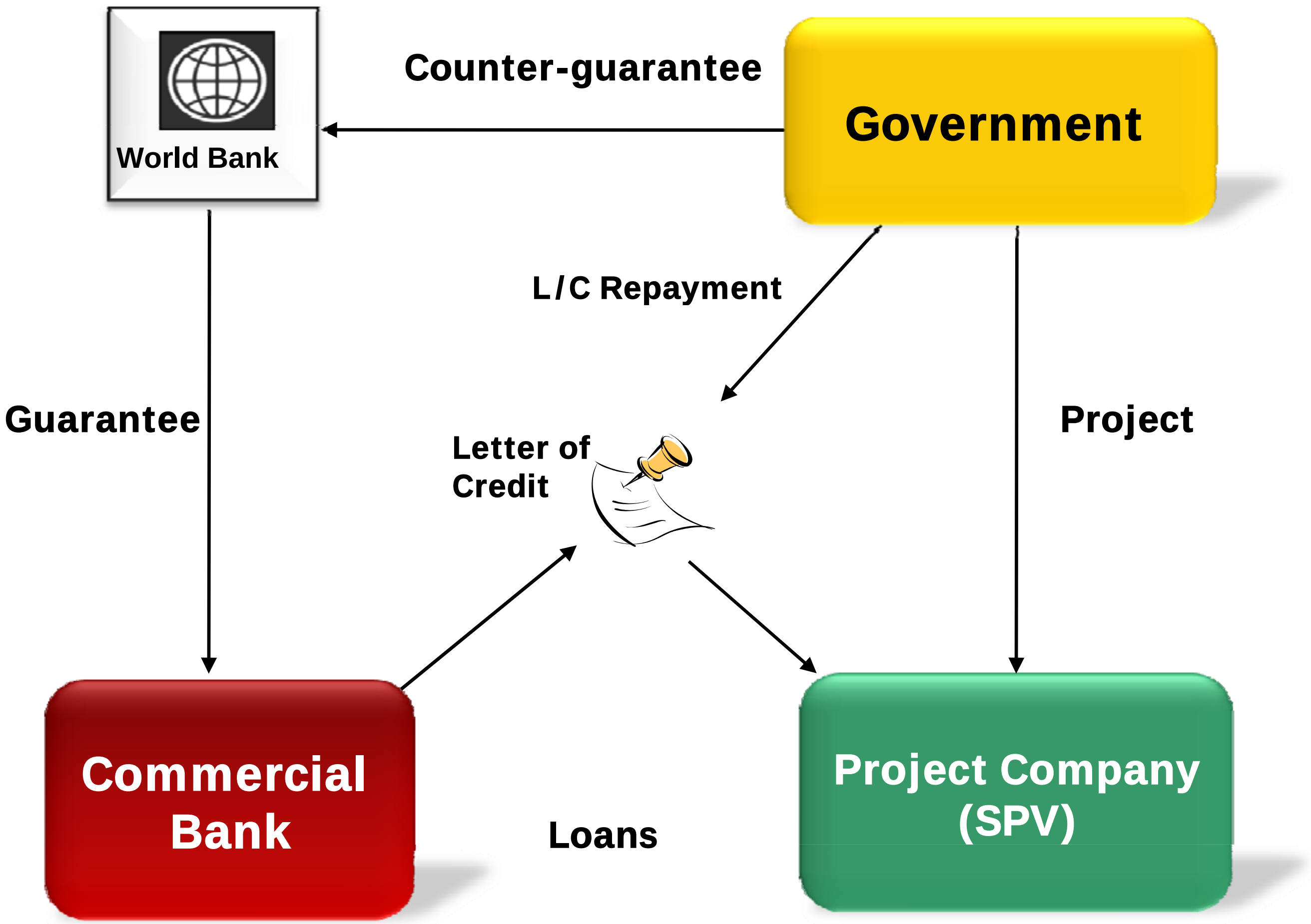
PRG Structures

1. Lender Guarantees



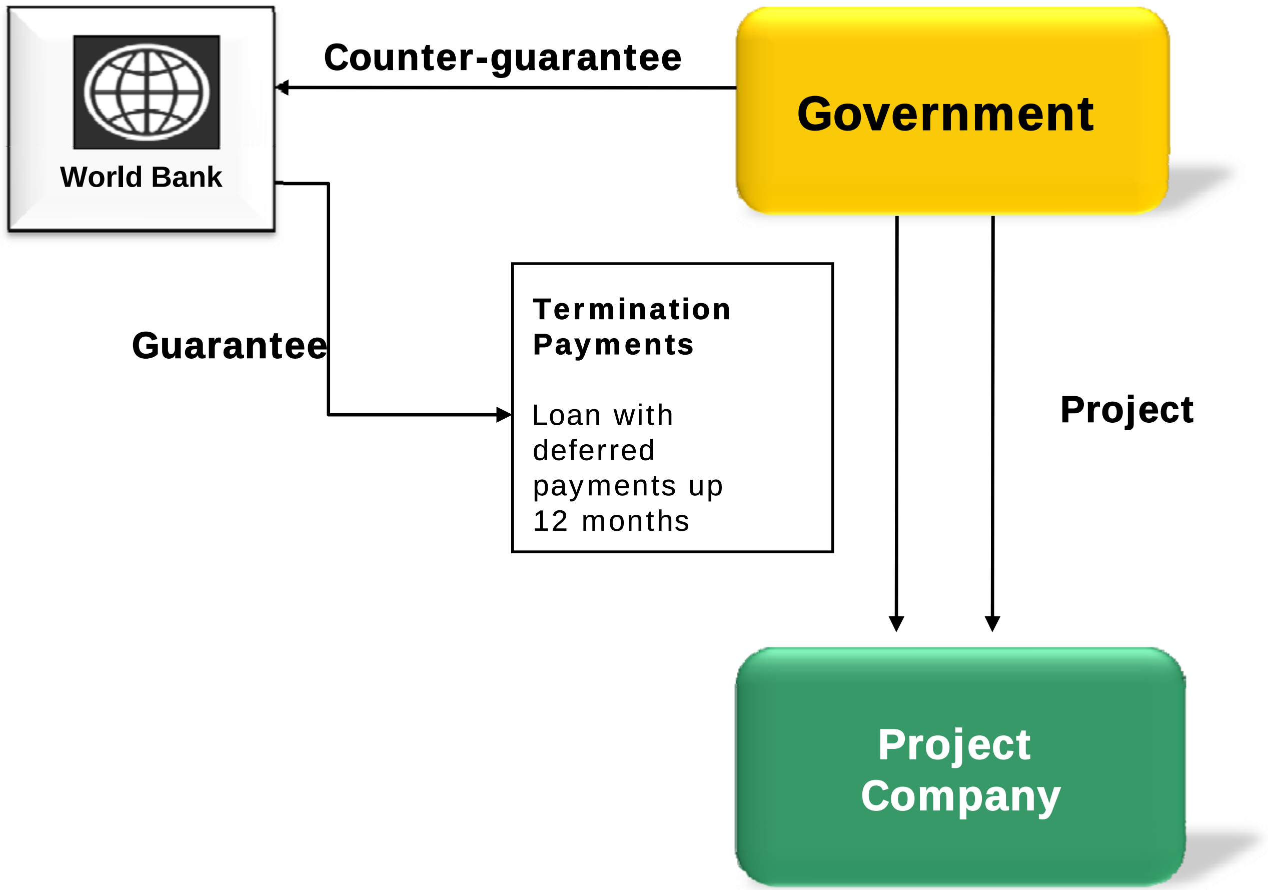
2. Project Company Guarantees

a. Letter of Credit (L/C) Structure



2. Project Company Guarantees

b. Guaranteed Deferred Shareholder Loan



Case Study:

IBRD Partial Risk Guarantee
Albania OSSH Electricity Distribution Privatization

Albania OSSH Electricity Distribution Privatization

- **PRG aimed at mitigating key perceived investors risks:**
    - Changes in Government policy causing a change in the Regulatory Framework
    - Non-compliance with pre-agreed regulatory framework by the Regulator
    - Limited track record of regulatory agency
    - Albania’s energy sector in early stages of reform
- Key risks covered under PRG includes non compliance by the Regulator and change or repeal by GoA of pre-agreed framework regarding *distribution tariff formula, Retail Public Supply tariff formula and the Compensation Mechanisms.*
- Timely approval of tariffs

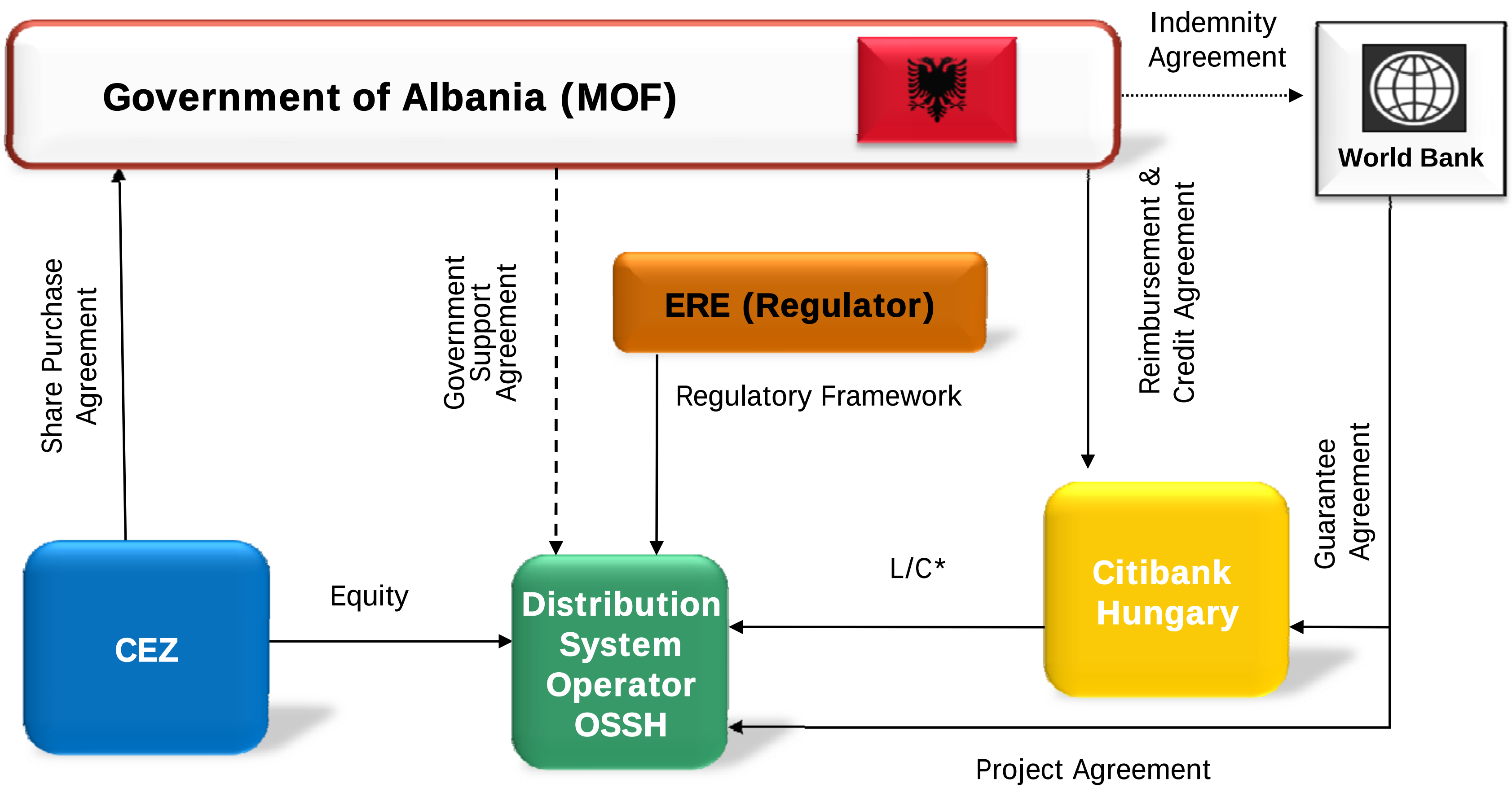
- **The Letter of Credit (L/C) Structure (in a nutshell):**

1. Under L/C structure the PRG is designed to provide risk mitigation through a standby L/C facility opened by a governmental entity in favor of the project company.
2. The project company is entitled to draw on the L/C upon a cash flow shortfall resulting from a government/regulatory non-compliance of its contractual undertakings to the project company as set out in a Government Support Agreement which is backstopped by the PRG.
3. In the event of a drawing under the L/C by the project company, the government's repayment obligation to the L/C bank of the amounts drawn is guaranteed by the PRG under a Guarantee Agreement concluded with the L/C bank.

Albania OSSH Electricity Distribution Privatization: Guarantee Terms

- PRG backstops repayments of principal and interest by Ministry of Finance of each L/C drawing
- Triggering mechanism: Breach of Regulatory Framework or delays in approval of tariffs
- Letter of Credit (L/C)
  - *Issuer:* Citibank Hungary
  - *Beneficiary: OSSH* Distribution System Operator
  - *Amount:* EUR 60 million
  - *Validity Period: 6* years
  - *Repayment:* Ministry of Finance within 12 months following each drawing. The L/C would be reinstateable for each repaid amount.

Albania OSSH Electricity Distribution Privatization: Project Structure



* Letter of Credit

IBRD and IDA Guarantees
Fee Charges (in basis points) for FY10

	Fee Type	IBRD			IDA
		PRG	PRG Enclave	PCG and PBG	PRG
Upfront Charges (one-time fees)	**Front End Fee**	25 bp (on the maximum exposure under the guarantee)			N/A
	Initiation Fee[1]	15 bp on the guaranteed amount or USD 100,000 (whichever is higher)		N/A	15 bp on the guaranteed amount or USD 100,000 (whichever is higher)
	Processing Fee[1, 2]	A maximum cap of up to 50 bp of the guaranteed amount		N/A	A maximum cap of up to 50 bp of the guaranteed amount
Recurring Charges	**Guarantee Fee**	50 bp per annum (on guaranteed amount)	200 bp per annum	50 bp per annum (charged on the present value of the guarantee exposure)	75 bp per annum
	Standby Fee	N/A			0 bp[3]

1 For all Private sector borrowers, i.e. only applicable to Partial Risk Guarantees.
2 Determined on a case by case basis, Exceptional projects can be charged over 50 bps of the guaranteed amount.
3 Equivalent of Commitment Charge on IDA Credits in FY2010.

Thank you !!

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