supporting trade and investment since 1934

Development Finance Knowledge Exchange

Belgrade, Serbia, Thursday 5th October 2017

1. Background to the initiative

As part of its on-going outreach project, to share knowledge and expertise with the wider international financing community, the Berne Union organised a joint meeting with participants from the world of development finance, taking place in Belgrade on 5th October.

2. Meeting objectives

This is a new initiative, and as such, the primary objective is to develop a better understanding of business concepts amongst the participants – bilateral Development Finance Institutions *DFIs, Multilateral Development Banks (MDBs) Export Credit Agencies (ECAs) / insurers, private insurers and other stakeholders in financing / supporting projects with a development impact* – without presuming any specific outcomes.

The starting point is the identified financing gap in respect of the UN Sustainable Development Goals (UN SDGs) and the idea that an improved understanding of the different roles of the various institutions providing or facilitating funding for projects with a development impact can help better utilise available resources and contribute to bridging the financing gap for the UN SDGs.

This first meeting should serve as an open information exchange, providing an opportunity for participants to identify common interests/overlaps, and establish a framework for further cooperative dialogue.

A longer-term objective is for this established dialogue to contribute to the creation of an environment where the different institutions of the financing community can work together more easily.

3. Participants and structure

Participants were invited from multilateral and bilateral development banks, private insurance, reinsurance, multilateral and export credit agencies (ECAs).

An introductory presentation from Paul Mudde – a consultant in sustainable finance and insurance – provided the structural context to the discussion and provided an opportunity for participants to brainstorm topics for further attention in the ensuing discussions.

Following this, rotating breakout discussions took place in small, mixed groups, each led by a facilitator, and rotating after 45 minutes. Participants reconvened in the afternoon for feedback, further discussion of points arising and to agree on next steps for any follow-up.

A full list of participants is attached. The group discussions were facilitated by:

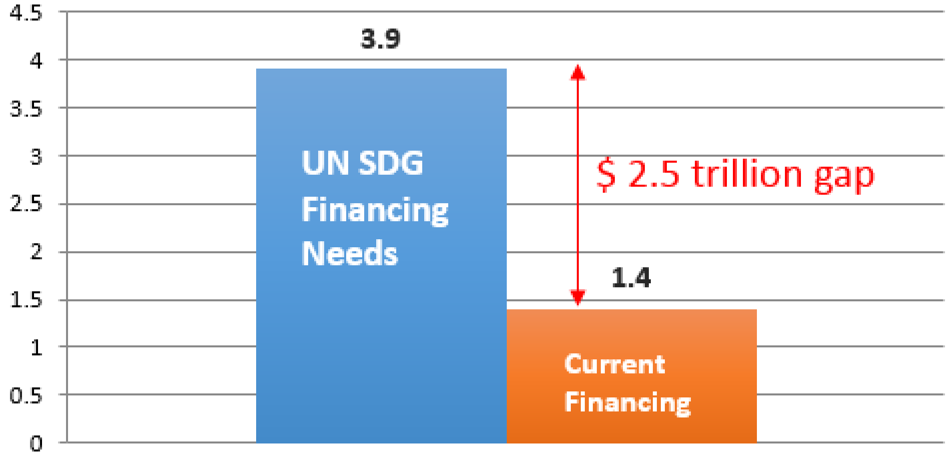
- **Vinco David** – Secretary General of the Berne Union
- **Andreas Klasen** – Professor of International Business and Head of the Institute for Trade and Innovation at the University of Offenburg
- **Paul Mudde** – Consultant, Sustainable Finance & Insurance

4. **The universe of development finance**

Paul Mudde presented an overview of the current landscape of DFIs and ECAs and provided various suggestions on enhanced cooperation between Berne Union members and DFIs. His power point presentation is attached to this report and briefly summarized below.

According to the United Nations Conference on Trade and Development (UNCTAD) the UN's Sustainable Development Goals (SDGs) require an estimated $3.9 trillion a year. With only around $1.4 trillion currently available, <u>there is a financing gap of $2.5 trillion per year.</u>

Estimated annual investment needs & UN SDG Financing Gap in U$ trillion



Source: Unctad Investment report 2014

An overview was shown of the external sources of finance available for developing countries. This concerns both private and official (i.e. public) capital flows. Public flows include:

(1) Official Development Assistance (ODA)
(2) Other Official Flows (OOF)
(3) concessional and (4) non-concessional loans from Multilateral Development Banks

OOF concerns official finance provided by individual governments / bilateral donors (or through their agencies) and includes non-concessional loans from bilateral development banks, untied investment loans from ECAs and EXIM banks, and officially supported export credits. Although official finance is provided by different organizations with different mandates (i.e. for DFIs: development of developing countries and for ECAs: promoting exports and investments) it is important to realize that both DFIs and ECAs have an important developmental impact.

Some of the 'official capital flow' is constituted by concessional ODA provided by bilateral DFIs, or in the form of a concessional loan from a MDB. Other official flows, including *inter alia*, export credits, financing from eximbanks and untied investment loans are non-concessional, but still capable of providing developmental impact and can contribute towards SDGs. MDBs and some public sector lending bilateral DFIs provide in addition to concessional loans sovereign loans at preferential interest rates. These loans are reported as OOF by bilateral DFIs and as non-concessional loans by the MDBs.

Equally so with private sources of capital from e.g. commercial banks, FDI, equity investments and non-bank loans (bonds). Guarantees are not separately reported in the OECD DAC system. It is likely that a substantial share of the private flows reported to OECD DAC is backed by official guarantees from ECAs, some DFIs and MDBs and specialised multilateral insurers such as MIGA, ATI and ICIEC.

An ODAS grant is a form of development finance with the highest form of official support (i.e. highest form of subsidised development finance). Commercial bank loans without ECA cover are not officially supported and do not benefit from any subsidies. Between these two there are various forms of official finance – development finance and ECA supported finance – with different levels of official support.

Meeting the financing needs of the SDGs requires a transformation of development finance (broadly construed) in order to crowd in other sources of capital. There is an institutional interest in looking at alternative ways of achieving development finance other than off the direct balance sheet of DFIs. Mobilisation of private capital and public non-developmental sources of capital (e.g. ECA insurance capacity, EXIM bank loans, funds from sovereign wealth funds) is high on the agenda of the international aid community. At the moment, both the OECD DAC and the MDB community are working on developing a common system to measure mobilisation.

A critical element is the mobilisation of non-development sources of capital. While the focus of MDBs and OECD DAC is on mobilizing private capital (in particular through project finance for public private partnership projects (PPPs), it is important to also recognise the potential for other forums of official – non-developmental – financing to be applied towards development goals. This includes, among others, ECA export credits and ECA untied investment loans / guarantees.

It is important to consider both the principle of crowding in of private sources of finance, but also that of avoiding crowding out other official sources of finance. A better alignment of various forms of official finance can contribute substantially to bridging the UN SDG financing gap.

ECAs are complimentary to the market in various ways. Private insurers are part of the commercial market. Both MDBs and DFIs operate also complementary to the market and can provide guarantees, but a number of internal and external factors hinder greater use of these. Most DFIs and MDBs are primarily direct lenders. Looking at the medium/long-term (MLT) exposure of Berne Union members alongside business exposure of bilateral and multilateral development banks there is a high overlap, which therefore presents a great opportunity for cooperation. A huge amount of extra capital can be mobilised through risk transfer of a portion of this exposure, not just within communities, but also across them.

A lack of bankable projects is one of the biggest challenges at present. Here ODA can play an important complementary role. ODA could be used to develop bankable projects (i.e project development) In this way, ODA can contribute very effectively to the achievement of the UN SDGs. The DFI community should be careful to use ODA to support private sector projects, because it may crowd out other forms of finance that require less official support.

Instead of crowding in additional capital ODA could de facto replace other forms of financing and in this way it would not contribute to bridging the financing gap of the UN SDGs.

Paul finished the presentation by identifying 20 potential areas for cooperation amongst DFIs and Berne Union members involved in financing projects in and trade with developing countries. These are listed at the end of the presentation slides.

This was the starting point for small group discussions designed to explore possible risk sharing structures and practical elements of information sharing.

5. **Outcome of the discussions**

Pragmatic approaches to risk sharing

Participants agreed that **capacity building across all the sub universes of international finance is critical**. In order to achieve this, we need to adopt an open and pragmatic approach to engaging with counterparts. This starts with improving understanding, moving to practical information sharing and then finally we may begin to start building some working models for risk sharing.

In the first instance, it is helpful to begin to **build an accessible resource of knowledge on the potential from public and private resources**:

- the types of risk different institutions take on
- the stage of involvement
- capacity for financing, capacity for risk
- types of products provided and other tools available
- targeted amount of blended finance

But we must **understand the environment we work in**:

It is clear that **not every ECA/MDB/DFI is the same**. Each works within different mandates and have interests in different regions and types of projects. The same is true for private market participants, although often for different reasons. We need to bear in mind that:

- National content restrictions for ECAs vary considerably, even within the OECD.
- Amongst MDBs there a lot of differences in capabilities, depending on the operating environment and in some ways influenced by the historical context of the institution's establishment.
- Non-OECD institutions now account for the largest volumes of export credit support and a considerable volume of development capital
- Each institution works under its own regulatory environment, which varies between and within countries.
- Blending (using ODA to improve the risk return profile of a project), by definition, involves finance under two different regulatory environments.

Begin with a practical focus

Given the complex environment and the different competing factors we should not attempt to construct a theoretical framework or begin with extensive attempts to standardise or formalise approaches. Rather, we should **work on concrete cases, which can inform an informal 'best practice' approach to cooperation**.

Through sharing and exploring existing cases, we can begin to develop new models, which others can learn from and apply. There are some potentially fruitful avenues here. For example, if we look at sector specific issues – e.g. energy sector – where there are good examples of risk sharing already in place, we can explore how much of these can be used as a template for future.

What are the **pain points of risk sharing? – how can we minimise these with better communication and information sharing?**

A number of trivial, but significant practical questions arise:

- Who are the appropriate persons to speak to? – what is the entry point for approach and engaging with a particular institution, and how much does this vary?
- Do we have enough data?
- Can we share more?
- What, when and how?

One of the objectives of this outreach initiative is to **connect together the right group of individuals within the international development institutions and ECAs and private insurers**, to try to establish a group with the resources and motivation to better open up their respective institutions to the rest of the community.

Information sharing

The motivation here is to **avoid duplication**, while at the same time establishing a better understanding of the risks involved and the parties taking these on.

In a complex transaction – or even a simple one! – **there is a multitude of compliance documentation, due diligence and other preparatory work** relevant to the transaction as a whole:

E.g.: Credit / country risk info, project finance due diligence reports, ESG, CSR, AML, KYC
Some of these (e.g. ESG assessments) present a great opportunity to avoid duplication of work, especially when this is carried out by external consultants.

Others (KYC/AML) may still require individual due diligence, and it is recognised that different participants have different interests, requirements, limitations etc. At the same time there are opportunities to better align various KYC/ AML requirements, which could assist in reducing operational costs for DFIs, ECAs and ultimately the projects in developing countries that are supported others.

However, even if secondary analysis must be carried out, **information sharing should at very least provide a head start and ensure that both sides are working on the same terms**. While there are some minor differences in ESG regulations, the essence is more or less the same and cooperation here is certainly possible.

The **benefits of sharing information extend not just to the financing institutions** (in terms of greater efficiency time and cost reduction), **but also to the client side** – be it the project sponsor, exporter etc. as these participants are saved from repeatedly providing the same information in different formats for the various pieces of fact finding.

It is acknowledged that sharing in-house assessments presents a risk of liability for the content. However, this is not an insurmountable challenge. While most participants agreed that an information sharing framework is not necessary, in these circumstances, **a suitable framework for non-disclosure agreements and clear definitions of liability can allow the shared information to do as much work as possible**, without exposing any institution to undue legal risks. It was also mentioned that commercial banks, DFIs, MDBs and (re)insurers familiar with syndication cofinancing or co-reinsurance processes know very well how this liability issue can be managed in a satisfactory way.

At the other end of the scale to formal frameworks, there is the possibility that credit officers/underwriters could exchange views on a more informal basis. The main point is that **willingness to openly engage with all counterparties is always worthwhile**.

Avenues for cooperation

Local currency financing: there is a strong developmental objective to developing liquidity in local capital markets. Despite a number of positive initiatives from various parties, local currency financing hasn't really taken off in the way that it could (or needs to), not because of risk, or even lack of willingness, but rather because of a lack of understanding and lack of trust in the local markets and financial institutions.

This is an area where MDBs in particular can add value, given their wide network of on-the ground agents and their existing cooperation with local banks (through among others credit lines) and knowledge of local markets.

Halo effects: ECAs in countries with credit ratings below investment grade sometimes encounter problems competing with AA rated ECAs – exporters suffer, potentially at the expense of the overall project. There is perhaps an opportunity here for DFIs / MDBs, or other forms of development finance to benefit the end project by helping ensure access to finance for the most competitive suppliers and at the same time contributing to a level playing field, within the scope of *The Arrangement*.

Similarly, smaller ECAs often face challenges extracting recoveries from some countries – another area where the MDBs with government contacts could help.

Participants briefly discussed how to **better involve capital markets investors.** This is a still very nascent area and although participants considered it an important long-term project, they also agreed that it is prudent to concentrate first on better engaging those who are already working heavily in emerging markets. Despite this, these developments can only stand to benefit from greater cooperation and better clarity on the complementary role of private and official finance at large.

Framework agreements: Participants observed that in both the ECA sphere and that of development finance, there already exists extensive cooperative agreements around cofinance, reinsurance coinsurance and other frameworks. It makes sense to **look at the details of each group's framework agreements** and see what we can learn and whether there is enough commonality to **devise an arrangement, which could cross both the worlds**.

Transparency of communication is another area, which needs work. We should seek to create this as a building block for improving trust and data collecting processes (whether these are under the aegis of the OECD, the BU or wherever else) in order to ensure the information we share is comparable. Equally, in projects with multiple counterparties there is often a benefit to working jointly to communicate the value of the outcomes.

The 'client' is the project

Having begun by acknowledging the different mandates and operating environments of the institutions involved in financing developing countries we come full circle to look at how we can unite these in common interest. All parties seek to serve their clients, whether these are exporters, importers or governments. Taking a joint approach we can see that **for the benefit of all parties, the client is in fact the transaction or the project**.

We must understand how to make this possible.

6. Next steps for follow up

Initiative should continue as an institutional dialogue

The concept of bringing together private credit insurers, ECAs and development banks to a professional, non-institutional, pragmatic discussion platform has a clear value. This platform could facilitate a structural dialogue among DFIs, ECAs/ EXIM banks and other insurers.

No such forum for this type of professional exchange currently exists.

Previous initiatives, involving the Berne Union and others, have touched upon similar topics, but none have so far engaged input from across the whole financing community.

All participants agreed that the discussions would benefit from greater involvement from the bilateral DFI community and in future meetings there remains an open invitation for participation from this side of the industry.

These initial discussions in Belgrade have confirmed an appetite to continue the project as an institutional dialogue. We take the groundwork established in this meeting, as well as the outputs from previous initiatives, involving the Berne Union, and others, as the starting point for future dialogues.

Informing wider policy discussions

There is an acknowledged complexity and delicacy in dealing with a topic, which has some inherently political aspects. The Berne Union is explicitly concerned with providing a forum for professional exchange; necessarily so, because of the wide diversity of members participating. By limiting the discussions in Berne Union meetings to practical business matters we are able to successfully learn from each other and support the industry as a whole.

This philosophy is equally extended to this outreach project. Both in the defined objectives and in the discussions as were, we have intentionally avoided areas where we have no influence, and maintained a doctrine of ‘pragma over dogma’.

However, while there is no objective to influence these discussions, a better knowledge of the business of all participants could provide a positive input by helping to i*nform* some of the on-going policy level discussions to promote an alignment in outcomes with the overall agenda for SDGs.

Summary

The *Development Finance Knowledge* exchange has been an important and constructive first step to further engagement across the community financing developing countries. We are grateful to all attendees for their open and active participation and hope to continue to provide an opportunity to advance knowledge, understanding and cooperation amongst the industry.

Participants of the meeting in Belgrade