DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
on the
Transfer of Real Resources to Developing Countries)

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A STRONGER WORLD BANK GROUP FOR ALL

FOR PUBLIC DISCLOSURE

Attached is a final version of the document entitled "A Stronger World Bank Group for All" prepared by the World Bank Group for the April 22, 2017 Development Committee Meeting.

A Stronger World Bank Group for All

Prepared by the World Bank Group

Development Committee

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Fiscal Year and Currency Equivalents

Fiscal year (FY) = July 1 to June 30

Acronyms and Abbreviations

AAAA	Addis Ababa Agenda for Action
AfDB	African Development Bank
AFR	Africa Region
ALPS	A-loan participations
AMC	Asset Management Company
AS	Advisory Services
BB	Bank budget
Bps	Basis points
COP21	2015 Paris Climate Conference (21th Conference of Parties)
DSC	Deployable Strategic Capital
EAP	East Asia and Pacific Region
ECA	Europe and Central Asia Region
EFI	Equitable Growth, Finance, and Institutions.
E/L	Equity to Loans ratio
ER	Expenditure Review
FCS	Fragile and Conflict Affected States
FCV	Fragility, Conflict and Violence
FDI	Foreign direct investment
GCI	General Capital Increase
GPG	Global Public Good
GW	Gigawatt
IaDB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
KM	Knowledge Management
LAC	Latin America and Caribbean region
LICs	Low-Income Countries
LMICs	Lower-Middle income Countries
MCPP	Managed Co-Lending Portfolio Program
MDB	Multilateral Development Bank
MIGA	Multilateral Investment Guarantee Agency
MNA	Middle East and North Africa Region
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PPP	Public-Private Partnership
PSW	Private Sector Window (IDA)
SAR	South Asia Region
SBO	Strategy and Business Outlook
SCI	Selective Capital Increase
SDGs	Sustainable Development Goals
URPS	Unfunded risk participations
VPU	Vice-Presidency Unit
WBG	World Bank Group

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A Stronger World Bank Group for All

I. Introduction

1. **The World Bank Group (WBG) is committed to playing a leading role in mobilizing and providing the financing needed to achieve the "Twin Goals" of ending extreme poverty and boosting shared prosperity in a sustainable manner, as well as the far-reaching and ambitious development agenda that the international community has set for 2030**. At the Annual Meetings in October 2016 Governors reviewed the "Forward Look" paper[1] which describes the critical role that the WBG can play in global economic development in the years ahead. The Forward Look also sets out a number of areas for action to create a "better WBG" that is fit for purpose and provides value for money for its shareholders. Management has devoted considerable energy to creating a more effective and agile institution that is focused on results, value for money and budgetary discipline. Progress on implementation of these actions is reported on in detail in a companion paper[2].

2. **The purpose of this paper is to continue the engagement with Governors on the financial capacity needed to deliver on the Forward Look, including to provide information on the work done in the course of the past six months**. This work has already been discussed with the Executive Directors of the IBRD and IFC and incorporates the advice received to date. The paper will focus on IBRD and IFC, as IDA's financial capacity has already been significantly strengthened with the completion of the IDA18 replenishment negotiations in December of 2016. In line with shareholder advice, the IDA18 agreement optimizes IDA's balance sheet so that every dollar of partner contributions will generate three dollars in lending capacity, compared to two dollars in IDA17. This will dramatically strengthen the ability of the WBG to support public sector development programs and tackle the most pressing challenges facing its low income country (LIC) clients. MIGA has also expanded its financial capacity through raising its reinsurance and overall guarantee limits.

3. **What is not yet addressed fully are the financial aspects of how the WBG can support the development challenges of middle income countries (MICs), the global public goods (GPG) agenda, mobilization of additional resources for development, and direct support to the private sector through IFC**. Furthermore, in LICs, as public sector development programs financed by a stronger IDA take effect, private sector investment opportunities will emerge and require financial support from IFC, which in turn will require a stronger IFC capital position.

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[1] See Forward Look – A Vision for the World Bank Group in 2030. DC2016-0008.
[2] See Forward Look – A Vision for the World Bank Group in 2030: Progress and Challenges. March 2017.

II. Why a Stronger World Bank Group

4. **The Forward Look process has set out a powerful vision for how the WBG can contribute to the global development agenda**. This agenda, which includes agreement on the Sustainable Development Goals (SDGs), the COP21 agreement on climate mitigation, adaptation and finance, the Addis Ababa Action Agenda (AAAA) and the Sendai Framework for disaster risk management, represents a trajectory shift in the global development dialogue. Operationalizing this vision requires awareness of global development challenges and needs, concerted efforts to create a better WBG, and the strengthening of WBG capacity to provide the financing needed to support the achievement of agreed goals.

A. Challenges to Development Objectives: Growth Slowdown and Rising Vulnerability

5. **The world has made impressive progress in reducing poverty and improving the lives of people in the course of the past 25 years**. The WBG has been an important contributor to this overall record of success. In 2015, the global extreme poverty rate dipped below 10 percent for the first time in history. Over the same period, life expectancy has increased by over six years, the share of children out of school has been reduced by close to 50 percent, and maternal mortality is down 44 percent. An important factor in these gains was the unprecedented economic growth in emerging markets that is now losing steam. The prolonged projected slowdown in global growth is likely to impede further progress, as could economic and financial shocks that are increasing in frequency and intensity. Slower growth, along with rising inequality within many countries, will have an inevitable and negative impact on the prospects for reaching both the WBG Twin Goals and the SDGs.

6. **Economic challenges are further compounded by a number of factors**. Over 200 million people worldwide lack gainful employment, a problem that is especially pronounced among the youth, and over 600 million jobs will need to be created by 2030 just to keep current employment rates constant. Two billion adults, of which 1.1 billion are women, lack access to finance; women also face significant inequality in terms of wages earned. Infrastructure is inadequate and under-financed, with an estimated US$1 trillion gap in the annual financing needed for emerging and low-income economies.

7. **In addition, vulnerability to shocks that are complex, interlinked and not constrained by borders is rising**. These include refugees, pandemics, climate change, and conflict and fragility. Such shocks are extremely costly – the economic cost of conflict, fragility and violence to the global economy was estimated at US$14 trillion in 2014[3]; the global cost of a moderate to severe pandemic is estimated at US$570 billion[4]. Left unaddressed, these cross-border challenges can grow and feed each other in vicious cycles that further weaken global stability. For example, there are 65 million forcibly displaced people in the world; 95 percent of

[3] Institute for Economics and Peace (2015) Global Peace Index.

[4] The Inclusive Cost of Pandemic Influenza Risk: Victoria Y. Fan, Dean T. Jamison, and Lawrence H. Summers NBER Working Paper No. 22137, March 2016.

these currently live in MICs and LICs. Refugees account for 20 percent of the population in some countries in the Middle-East and North Africa (MENA) region, putting enormous strain on already stretched economies and service delivery systems. If host countries cannot offer economic opportunities and basic services to these populations, they risk turning from a destination to a source of refugees, thus widening the issue.

8. **Early and effective global action with a particular focus on MICs is therefore both an imperative and a bridge to global economic opportunity**. Ensuring robust and tailored support to MICs in particular will be critical, both for reaching agreed goals and to support global economic growth. MICs are home to over 70 percent of the world's poor and 60 percent of the extreme poor. They generate over half of global CO_2 emissions and five of the top ten hotspots for Zoonosis (diseases that can be transmitted to humans from animals) are in MICs. At the same time they are engines of growth, contributing 75 percent of global GDP growth. They also serve as an expanding export market for both advanced economies and LICs. In 1990, MICs represented 12 percent of advanced economies' export markets. That share has doubled to 25 percent in 2015. For LICs, MICs represented 17 percent of their exports in 1990. That share has tripled to 50 percent in 2015. The private sector in MICs is increasingly a driver of investment in IDA countries, accounting for a growing share of global foreign direct investment (FDI) flows. In an increasingly integrated global economy, realizing the 2030 development agenda will require action across all country income levels.

B. A Better World Bank Group Positioned to Support the 2030 Agenda

9. **Through the priorities identified in the Forward Look, the WBG is becoming a more effective development institution**. Reforms of its operational, administrative and human resources policies and practices are making the WBG more efficient and agile. It is building up its knowledge management systems to deliver better services for clients, reducing bureaucratic roadblocks through simplification, and piloting new approaches through the "Agile Bank" initiative. The WBG is also harnessing its assets more efficiently by improving incentive systems and management of its staff, managing the budget for greater efficiency, and streamlining administrative services. Table 1 summarizes the Forward Look Results Matrix which a companion paper[5] details further.

[5] See Forward Look – A Vision for the World Bank Group in 2030: Progress and Challenges. March 2017.

Table 1. Forward Look Results Matrix

Theme	Good Progress	More to be done
Assisting All Clients	• Engagement in MIC reforms and lending maintained • Increase in WBG staff working on FCVs on track • New instruments for different client segments launched • Scaled-up IDA support arrangements defined	• Match equity to ambitions • Develop PSW pipeline • Develop IDA pipeline • Strengthen FCV pipeline
Mobilization	• Cascade approach to creating markets agreed • IFC AMC, and MCPP raising new resources • EFI partnering with IMF on domestic resource mobilization and illicit financial flows	• Scale up pipeline of bankable projects • Harmonize measurement of private capital mobilization across MDBs • Build staff skills
Leading on Global Issues	• Climate Action Plan and monitoring in place • Crisis response platform in place	• Increase share of operations with climate co-benefits • Build consensus on risk-based approach for crisis operations
Improving the Business Model	• Knowledge Action Plan in draft • Good progress on Agile Pilots and Administrative Simplification • People Strategy and its Implementation Plan approved • External funds better integrated in budget and planning	• Develop shared services delivery model • Agree and implement incentives for collaboration • Enhance knowledge products for clients

10. **The Forward Look builds on the reforms that have been implemented since February 2014, including the "Margins for Manoeuvre".**[6] These reform measures have helped to better utilize resources and strengthen IBRD's financial sustainability. On capacity, IBRD lowered its minimum equity to loans (E/L) ratio as a result of improved portfolio credit quality, allowing it to more efficiently utilize existing capital. On revenues, IBRD restored its commitment fee and increased the maturity premium on its loans. On costs, the Expenditure Review (ER) is delivering US$400 million in gross savings[7] by FY18, with US$225 million net Bank budget savings.

11. **The Forward Look reform agenda also builds on the WBG's considerable comparative advantages.** The institution brings a potent combination of country depth and global breadth, combines an unmatched analytical depth with its financing, and deploys public and private sector instruments as well as partnerships. It also leverages both knowledge and finance at scale. Its engagement model ensures that client countries drive and own reform initiatives and development investments. Its strong emphasis on accountability and a focus on

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[6] See Improving Margins for Manoeuvre – February 4, 2014. R2014-0012/1.

[7] Gross savings are counted against an Everything-Else-Being-Equal trajectory, i.e. what the budget would have been absent the Expenditure Review.

results enhance the development impact of its interventions. While no one of these strengths is unique to the WBG, few other institutions have the ability to mobilize them all at the same time.

12. **These strengths, together with a capacity to help countries build resilience and respond to crises, give the WBG a central role in development.** Because of the global reach of the WBG, its in-country presence, and engagement across the entire development spectrum, it is frequently called upon to convene diverse actors to solve local problems, connect partners across countries to tackle regional initiatives, and catalyze action on global agendas and global public goods. WBG staff work at the country level with governments and partners to ensure that approaches are well coordinated and contribute to national development priorities. They collaborate with civil society organizations, local communities, non-governmental organizations, and grassroots organizations to foster ownership, delivery, and feedback. They work with both the private sector and governments to create an environment conducive for the sustainable delivery of development outcomes through markets that serve both public and private interests.

C. Leveraging Development Finance

13. **Looking ahead, an important part of the WBG contribution to the 2030 development agenda is to mobilize private sector resources in support of these objectives**. This emphasis on mobilizing the private sector is linked to the recognition that public funding alone will never be sufficient to meet investment needs, as well as the fact that the private sector is the primary creator of jobs and growth. Attracting private investment will continue to require investments in the conditions that are critical for the private sector to thrive, including a business friendly enabling environment, strong institutions and sound regulations that balances public and private interests. Yet in most developing countries, markets are not fully developed. Perceptions of risk are often high, compounded by a lack of information, transparency, or limited price discovery. Investors have difficulty valuing new opportunities in developing countries, or are unable to price risk correctly. As a result, private capital does not flow at the scale required to meet the needs of the development agenda. Markets do not reach all segments of the population and so cannot be relied upon to ensure "no one is left behind."

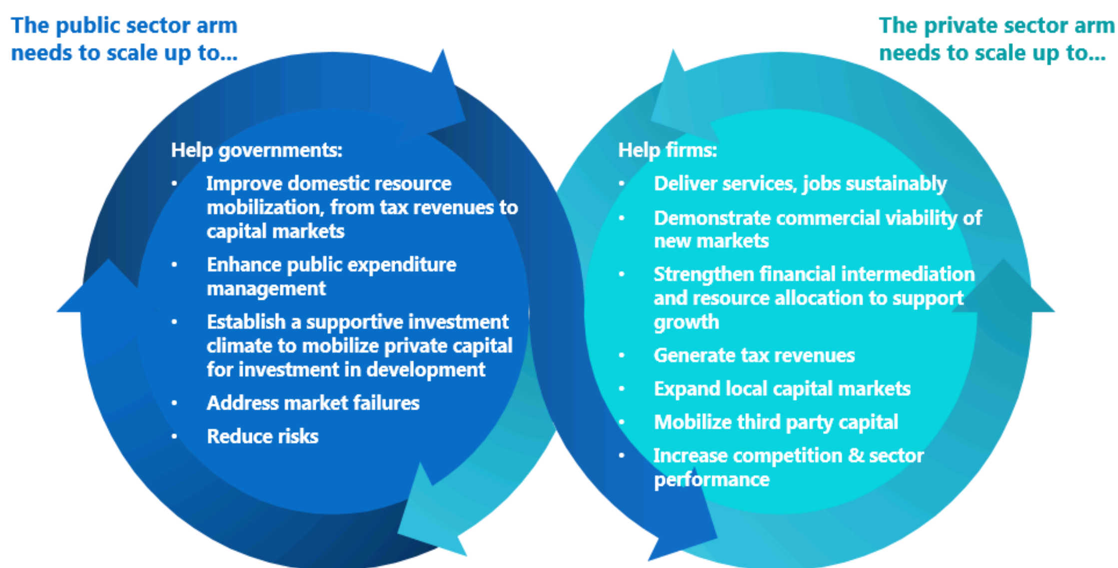
14. **Creating markets demands an intensified focus on achieving structural reforms that facilitate private investment, address market and institutional failures, or strengthen the rules governing competition**. Since the Forward Look, WBG Management has been developing its strategy for supporting the creation of markets that will enable scaled-up private sector investment. In late 2016 the Board endorsed IFC's "3.0 Strategy" (see Box 1) which focuses on creating and deepening markets. Because this strategy depends heavily on greater interaction between World Bank policy reform efforts, institution building, addressing market failures and IFC's advisory work and investment priorities for a particular country, successful execution of the strategy requires a much stronger IBRD and a much stronger IFC.

Box 1. Building a Better IFC: Efficiency and Realigment Measures

IFC introduced a new organizational structure on January 1, 2017 to enhance its ability to execute its new 3.0 strategy, particularly with respect to maximizing development impact and ensuring greater organizational efficiencies. The main levers for enhanced organizational performance and impact include: (i) a stronger focus on analysis to identify public and private sector engagements that bring about market and sector-level impact as well as better assessments of *ex ante* development impact; (ii) a more strategic approach to partnerships, including to help shape and set standards for all MDBs on blended finance; (iii) VP-level units for Risk and Portfolio to support both new and existing business models and to create supporting infrastructure for a strategy that focuses more on newer, untested markets; (iv) an enhanced corporate strategy function that will align resources with the strategic direction of the organization; and (v) efficiency initiatives to streamline operational support to transaction teams, strengthen the career framework for staff, and enable redeployment of resources within operations to client-facing functions.

15. **These efforts will require countries to improve their policies, build credible institutions, and focus on implementation capacity using available instruments**. These include country dialogue, analytical products, development policy lending, and sector investment lending (see Chart 1). To private sector clients, IFC and MIGA's global presence, due diligence processes, and ability to structure solutions gives confidence in the viability of a market. Working together, the WBG not only supports reform, but also gives confidence that those reforms will result in increased investments. Through demonstration effects, these investments will in turn "crowd in" more capital.

Chart 1. Working Together to Strengthen Support for the Public and Private Sectors



16. **Meeting the challenge of unlocking historically risk-averse private pools of capital to respond to development needs will be critical to the task of meeting agreed goals**. This is a challenge the WBG is well positioned to address. No other instititìon is able to combine the diagnostic capability, global knowledge, local footprint and convening power with the capacity to put its own capital at risk and mobilize others. Through the "Cascade" approach and IFC 3.0, the WBG has committed to leverage its full capabilities systematically and at scale (see Box 2). This shared capacity will be put to use to respond to large infrastructure financing gaps, meeting critical funding needs for small and medium sized enterprises (SMEs), providing much needed capital for agribusiness, building local capital markets to strengthen domestic resource mobilization, supporting diversification of countries impacted by commodity price volatility, expanding access to health care systems, supporting reconstruction of countries impacted by conflict, and ultimately creating jobs.

Box 2. Adopting a Cascade Approach to Decision-making on Infrastructure Financing

Despite the roughly US$1.5 trillion spent annually by developing country governments, the US$112 billion financed via public-private partnerships (PPPs), and US$80 billion contributed by MDBs in 2015, a significant infrastructure gap remains. Closing this infrastructure gap must include: a significant improvement in public sector performance and increased commercial financing.

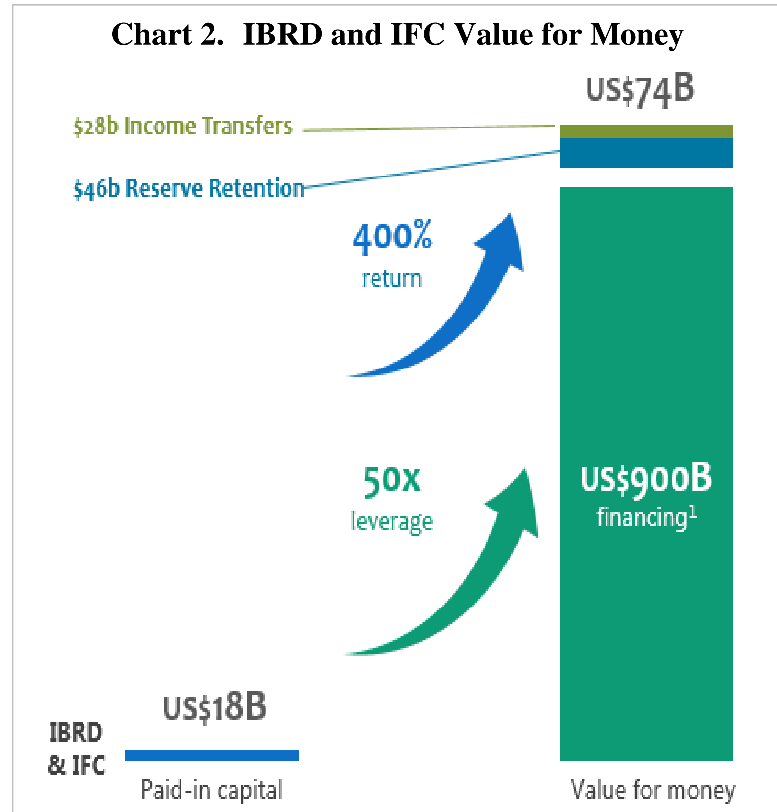
The WBG is leading an ongoing discussion among MDBs on a hierarchical approach to investment decision – the "cascade". The basic approach follows these steps:

1. Prioritize cost-effective commercial financing;
2. Where commercial financing is not cost-effective or viable due to perceived risks or market failures, focus support on addressing these market failures through reforms to strengthen country and sector policies, regulations, and institutions;
3. Where risks remain high and raise the cost of commercial capital beyond that which can be afforded by project or corporate revenue generation, explore the potential for lowering the financing cost by deploying concessional and public resources in risk-sharing instruments;
4. Where commercial financing is not cost-effective or viable despite sector reform and risk mitigation, public and concessional resources will be applied.

III. Strengthening the Financial Capacity of the World Bank Group

17. **The investments that shareholder have made to date in IBRD and IFC have proven to provide exceptional value for money (see Chart 2)**. Since inception shareholders have provided a total of US$18 billion of paid-in capital to IBRD and IFC (in contrast, total shareholder commitments in IDA add up to US$250 billion). This, in turn, has yielded US$900 billion of financing for development, US$46 billion in funds retained for reserves, and US$28 billion in income transfers to IDA and other grant funded programs. Both IBRD and IFC have relied mostly on internal income generation to build capital, with about 75 percent of current capital being self-generated and only one quarter coming in the form of paid-in capital from shareholders.

Chart 2. IBRD and IFC Value for Money



18. **The Forward Look has recommendations to make the WBG a better organization capable of meeting today's challenges.** At the same time IBRD and IFC's current equity is not sufficient to meet the aspirations that shareholders set out in the Forward Look. With only 155 months left to achieve the SDGs (equivalent to about two IBRD project cycles), it is becoming urgent to ensure that both IBRD and IFC have the financial capacity to do so.

A. Towards a Stronger IBRD

19. **Strengthened financial capacity is important for allowing IBRD to contribute to the 2030 development agenda at a level commensurate with its capability and potential.** IBRD needs adequate financial firepower to promote structural reforms and transformative investments, turn good advice into policy actions by overcoming political economy obstacles and demonstrating commitment to the long-term success of reforms which often are the foundation on which private sector investment and confidence rests, respond to shocks of different types and origins, and support new IDA graduates. Recent bottom-up demand survey indicates that client demand could reach US$ 36 billion per year for IBRD lending in FY16 prices.

20. **IBRD has already implemented a number of measures to strengthen its financial sustainability framework**. The commitment to fully fund administrative expenses from business revenues is on track. By FY18, all equity income is expected to be used to expand lending or support other development activities. In addition to a 20 basis points (bps) general price increase and the introduction of maturity premium in FY10-11, IBRD implemented further price differentiation by maturity in FY15. These measures led to a combined increase of contractual spread by 20-70 bps. A 25 bps commitment fee was restored in FY15, also increasing loan spread income. Through these measures IBRD's interest spreads have increased approximately three-fold for longer maturity loans since the 2008 crisis and are now at their highest level in fifty years. To optimize capital utilization, IBRD lowered its policy minimum equity/loan ratio from 23 to 20 percent in FY14 to reflect better portfolio credit quality, allowing shareholder capital to support a larger volume of development lending while remaining financially prudent.[8] IBRD has also developed and implemented an Exposure Exchange framework with MIGA within the WBG, as well as externally with the Inter-American Development Bank (IADB) and the Africa Development Bank (AfDB), helping all of the institutions to improve the diversification of their portfolios and thus use capital more efficiently.

21. **To ensure adequate IBRD lending capacity, a package to further strengthen the current level of equity is necessary**. Such a package could consist of a combination of the levers which have already been mobilized since FY14, including loan pricing, administrative expenses, income transfers to IDA and other development objectives, and also a capital increase.

22. **The Board has discussed a number of price increase options**. Management has presented the impact of a general price increase, of differentiated price increases by maturity, instrument, borrowing category and limit, and of mixed loan charges measures. The Board has also considered the consequences of increasing prices on the competitiveness of IBRD relative to the market, and to other multilateral development banks (MDBs). The impact of loan pricing increase on boosting IBRD's usable equity is significantly affected by the income allocation formula. For example, assuming the IDA18 transfer formula is extended into the future, unless the additional income from loan pricing increase is excluded from the allocation formula, only 50-60 percent of the income impact would pass through to reserves to build usable equity.

23. **Business Reviews inform the strategic planning process and will help continuously improving practices beyond the Expenditure Review (ER)**. The ER itself is on track, delivering US$400 million gross savings by FY18, with US$225 million net Bank Budget (BB) savings reflected in the FY18 budget trajectory after 25 percent reinvestment in new priorities. The IDA budget anchor continues to be achieved each year and the IBRD anchor will be reached by FY18. The relative share of the BB allocated to operational units and programs increased from 54 percent to 57 percent between FY16 and FY17, and is projected to rise to 58 percent in FY19.

24. **Significant progress has also been made on income allocation since the Annual Meetings in 2016**. On November 15, the Board approved, for the first time, a formula approach for IBRD income support to IDA18. For transfers beyond IDA18, the Board has started

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8 See Improving Margins for Manoeuvre – February 4, 2014. R2014-0012/1.

discussing a comprehensive income allocation formula covering future transfers to IDA as well as other development objectives.

25. **In addition to loan pricing, administrative expense and IDA transfers, Management has continued to explore further balance sheet optimization measures to stretch the efficiency of its existing capital**. For example, the Bank is exploring the potential for implementing or expanding innovative measures, such as special private placement bonds, third-party guarantees and loan sales. Given their opportunistic nature and potential issues with scalability, such innovations, however, could not be a substitute to regular capacity-enhancing measures. While the Bank continues to explore the possibility of more exposure exchanges with different entities, the scope for further expansion appears limited at this stage. In addition, Management has considered the suggestion from some shareholders that there is room to lower the minimum equity to loans (E/L) ratio. It considers the current capital adequacy framework to be robust and the 20 percent minimum E/L ratio an appropriate prudential ratio to manage capital needs to minimize risk of call on capital and maintain strength of the Bank's AAA rating in the current risk environment.

26. **Finally, a capital increase would directly boost IBRD’s usable equity**. Paid-in capital increase can be generated through a general capital increase and/or a selective capital increase. Another distinct advantage of capital increase, in comparison to internal measures, is that in addition to boosting usable equity through the paid-in portion, a capital increase, through callable capital, will also significantly raise IBRD’s Statutory Lending Limit.

27. **A stronger IBRD supported by a package of available measures would allow WBG to significantly scale up its contributions towards the 2030 agenda**. Management has discussed with Executive Directors detailed technical analysis of the nature and dynamics of the main financial levers to enhance IBRD’s financial capacity, including a pricing increase, a comprehensive income allocation framework, continued budget discipline, and a capital increase, as well as illustrative scenarios of using these levers to support a stronger IBRD.[9] These were calibrated at levels that, based on current projections, would be sufficient to support the various target lending scenarios through FY30 without the need for further equity-boosting measures during this period beyond the package being discussed. However, the future is highly uncertain, particularly with regard to market interest movement, borrower credit condition changes, and client demand for IBRD support. Experience since the 2010 capital increase, where actual demand turned out to be significantly higher than originally anticipated and interest rates significantly lower than original market expectation, has highlighted that in order to avoid subsequent capital increases in short succession, there may be merit in provisioning for downside market conditions or targeting an ambitious lending scenario in estimating capital needs. In addition, a larger package that supports higher lending would, *ceteris paribus*, generate greater revenues and could provide additional resources for income allocation to support other shareholder priorities such as crises response or GPGs. Management will continue to explore different combinations of options, including further balance sheet optimization measures, and

[9] A background note requested by the Executive Directors provides additional technical information on IBRD’s capital needs, including on the levers available to address capital needs (e.g. increase loan prices, cutting administrative expenses, reducing transfers to IDA and a capital increase) and various scenarios for combining these levers.

discuss these scenarios with Executive Directors in coming months with a view to identifying combinations of measures that best meet the expectations of shareholders.

B. Towards a Stronger IFC

28. **As the only MDB with a sole focus on private-sector investments, IFC's business and financial model is inherently riskier than that of public sector-focused MDBs**. Moreover, as IFC does not have access to callable capital, or to the highest level of preferred credit treatment, IFC's triple-A rating is significantly dependent on its financial strength.

29. **To ensure that IFC has the financial capacity to respond to the ambitious 2030 agenda, it is necessary for IFC to have sufficient Deployable Strategic Capital (DSC), which is the capital available for future commitments, over and above that required for the current portfolio**. Thus, annual investment commitments that IFC can sustain depend crucially on capital adequacy as reflected in its DSC. With the endorsement of the Board, IFC has established a target range of 2-10 percent for DSC, representing a clear expression of its risk appetite. As at the end of FY16, IFC's DSC was 4 percent, driven by a significant increase in commitments, cumulative IDA transfers and volatility in equity markets. This represents a substantial decline compared to a DSC of over 30 percent just before the global financial crisis of 2007-08. Having DSC at the 30 percent level allowed IFC to respond to the financing needs of its clients during the crisis when access to finance was seriously curtailed.

30. **DSC has a number of interconnected drivers.** They include: (a) portfolio size and composition, which in turn depend on: (i) commitment levels and product mix; (ii) portfolio reflow (e.g. repayments, prepayments, equity sales); (iii) share of equity versus debt investments; and (iv) share of IDA/FCS versus MIC investments; (b) capital charges – which vary by asset class, commensurate with the level of risk involved; and (c) profitability or net income, and income retained net of designations and transfers, which determines capital available. As such, the level of IDA transfers impacts IFC's DSC.

31. ***Portfolio size and composition***. IFC's portfolio composition across asset classes and products (trade finance, senior and subordinated debt, and equity) impacts DSC, in accordance with their relative risk. To illustrate – capital allocation is 20 percent for IFC's long-term debt investments in MICs, 25 percent for such investments in IDA/FCS and as much as 65-80 percent for equity investments. A lower share of equity investments would result in a lower capital allocation, thus enhancing DSC, while a higher share of investments in IDA countries will lower DSC due to: (a) the higher risk of such investments requiring a higher capital charge, and (b) lower income due to the higher costs and lower returns associated with investments in riskier countries.

32. **Portfolio composition itself can evolve over time depending on strategic asset allocation, development needs and market opportunities, as well as ambition.** IFC seeks to maintain an appropriate amount of capital for respective amounts held of each asset class in its portfolio depending on the level of risk involved. Given a mandate to price its investments in

accordance with the market, for debt investments IFC supplements a market-based approach with a risk-based pricing framework which ensures that IFC earns a sufficient risk-adjusted return on capital. On the equity side, IFC invests at valuations based on market conventions while at the same time seeking additionality and development impact. IFC also seeks to earn a return on each asset class in its portfolio commensurate with the level of risk involved. It is worth underscoring that IFC is a patient investor and usually exits its equity investments only when its development mandate is complete, which requires it to tie up capital for extended periods of time, thus reducing available DSC.

33. ***Profitability/Net Income***. With respect to profitability/net income, and its impact on DSC, IFC's ability to generate profits has been key to its ability to grow its capital base and its portfolio. Roughly 90 percent of IFC's net worth comes from retained earnings, which are supported by a highly-diversified portfolio of debt and equity investments and investments in the liquid assets portfolio. IFC's income model is by definition volatile given its sensitivity to movements in equity and foreign exchange markets, as well as to default risk.

34. ***IDA Transfers***. The level of IDA's transfers together with amounts committed, also impacts DSC. For the IDA18 Replenishment, IFC's Board approved a revised designation framework in November 2016 which includes a revised sliding-scale formula, minimum capital adequacy thresholds for designations to Advisory Services (AS), as well as establishing an order of prioritization for designations. The lower undertaking for IFC's contribution to the IDA18 replenishment was compensated partially with the expectation for increased AS designations to support IFC's growing investments in IDA/FCS. Should the IDA transfer formula revert to its pre-IDA18 levels, and IFC generate adequate net income, transfers to IDA could be as high as US$4 billion through 2030, with a corresponding impact on IFC's DSC, offsetting gains from net income to a significant extent.[10]

35. **IFC's risk appetite and ambition to expand in IDA/FCS will be calibrated by its DSC**. For IFC to further deepen its engagement in IDA/FCS markets, going beyond the de-risking facilities of the IDA18 Private Sector Window, IFC will still need to put its own capital at risk to finance the "de-risked" transactions in accordance with its capital adequacy framework.

36. **Considering that the current DSC ratio is close to an all-time low, a downturn in emerging markets would significantly compromise IFC's ability to grow, while a major stress event could put IFC's AAA rating at risk**. The main levers through which IFC can increase financial capacity are profit generation, asset allocation across product types and geographies, calibration of IDA transfers and a capital increase from shareholders. Meaningful strengthening of financial capacity is essential to protect IFC against shocks, allow IFC to grow much faster and support its push into more challenging markets and projects. Given the limited cushion in the current level of DSC and significant income volatility as explained above, without additional capital IFC would be compelled to exercise significant caution in growing its annual commitments especially in equities and IDA/FCS since such investments pose higher risk and are more capital intensive.

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[10] See Memorandum to the Board of Directors: A Revised IFC Approach to Designations, November 15, 2016.

37. **Importantly, ability to deploy its own capital also impacts ability to mobilize.** IFC has over the years demonstrated significant expertise and success in optimizing the use of its own equity capital by mobilizing and catalyzing 3rd party capital to invest alongside its own account investments. This is in effect a way for IFC to efficiently leverage its capital even further than possible on its own balance sheet. As an innovator in mobilizing outside capital, IFC has the highest mobilization ratios among MDBs, driven by a full suite of products and platforms including: B-loans, parallel loans, the Managed Co-investment Portfolio Program (MCPP), the Asset Management Company (AMC), A-loan participations (ALPS) and unfunded risk participations (URPS). It must be noted, however, that IFC's ability to attract outside investors critically depends on IFC having "skin in the game" through its own direct investments. As such, mobilization and own account investments go hand-in-hand.

C. Impact of a Stronger World Bank Group with Scaled-up IBRD and IFC

38. **The WBG has a strong track record of delivering development impact on the ground.** For example, over the past three years (FY14-16), through WBG-supported operations:

- 20 million farmers were provided with agricultural assets and services;
- 60 million people and SMEs obtained financial services
- 75 million people received new or improved electricity service;
- 20 million students benefitted from improved education;
- 320 million people received essential health and nutrition services;
- 60 million people got access to an improved water source;
- 45 million people got access to improved sanitation facilities;
- 92 countries strengthened public management system;
- 35 countries institutionalized disaster risk reduction as a national priority;
- and more.

39. **Building on this track record, a stronger WBG with scaled-up IBRD and IFC would be able to make a significant contribution towards the Twin Goals and the 2030 agenda.** What the WBG would be able to deliver would be commensurate with the strength of its financial firepower. As an example to illustrate the range of potential, if IBRD and IFC are adequately resourced to respond to demand, and assuming a stable IDA at levels reached for IDA18 and the continued organic growth for MIGA, the WBG would have the capacity to commit US$100 billion a year, or US$1.2 trillion cumulatively, of its own resources between 2019 and 2030. A WBG with this level of financial firepower would be able to catalyze and mobilize private sector resources at scale, potentially attracting US$1.8 trillion private sector resources, thus truly delivering on the billions to trillions objective.

40. **More specifically, a WBG with this level of firepower would be able to make substantial impact on development priorities such as GPG agenda**, potentially delivering US$50 billion per year of climate-related projects, including direct financing and leveraged co-financing.[11] For developed countries, this would represent a quarter of the US$100 billion

[11] Per the methodology agreed for capturing the contribution that MDBs would make towards international climate financing.

Copenhagen climate finance target. At the same time, the WBG under this illustrative scenario would be able to deliver approximately US$100 billion per year of infrastructure-related projects, including direct financing and catalyzed private resources. This would represent up to 10 percent of the infrastructure gap of emerging and developing countries. While delivering scaled-up financing to clients, a stronger IBRD and IFC would also be able to generate higher income, potentially augmenting concessional grant resources for development priorities. Box 3 illustrates, using concrete examples, the incremental results a package of measures calibrated to support a WBG of this scale could potentially achieve in return. The real impact and value of a stronger WBG that can stabilize, influence, leverage, convene, create markets, and respond to unexpected shocks would however be more far-reaching. Working across all client segments, ensuring transfer of knowledge and experience, mainstreaming joint solutions and creating markets, a stronger WBG would be able to make critical contributions towards achieving the "Twin Goals" and the SDGs.

Box 3. Illustrative incremental impact of a package of measures that supports a stronger WBG with US$100 billion per year financing capacity

A package of equity-boosting measures that strengthens IBRD and IFC and in turn supports a stronger WBG, for instance with US$100 billion per year own financing capacity, would generate US$900 billion in incremental resources, own and leveraged, towards the 2030 development agenda. Listed below are illustrative results that these US$900 billion could generate if invested in for example, health, education, urbanization, sustainable energy, water and sanitation, and roads:

- Displace 1,250 GW in coal-fired power plant capacity, three times the installed coal-fired power generation capacity in the US, or 80 percent of the total installed electric power in China; or
- Finance safely managed drinking water for 1.3 billion people in rural areas plus 1 billion people in urban areas; and safely managed sanitation for 1 billion people in rural areas plus 1.6 billion in urban areas; or
- Construct 900,000 km of two lanes standard paved national roads, or constructing 4.5 million km (or more) of paved rural roads, or graveling and rehabilitating more than 10 million km of unpaved roads; or
- Provide a basic urban upgrade package (road paving, new thoroughfares while minimizing resettlement, public street lighting, community facilities, storm water drainage etc.) to the entire population currently living in the world's slums (up to 1 billion); or
- Bring the following health benefits, assuming a US$70 billion dollar investment leveraging US$700 billion in additional domestic resources:
    - 37 million lives saved by averting preventable maternal and child mortality in LMICs (bringing maternal and child mortality to the SDG targets)
    - 105 million more babies breast-fed
    - 65 million cases of child stunting averted
    - 91 million cases of wasting treated
    - universal child immunization with 10 essential vaccines
    - universal preparedness and response against pandemic threats; or
- Buy schooling for:
    - the 420 million children in LICs and MICs that, under current trends, will not be on track to learn the basic primary school skills in 2030; plus
    - six years of secondary school for 110 million children in LICs and for 60 million children in LMICs, that is, 20 percent of the children not on track to acquire basic secondary-level skills in 2030; or
- Achieve the SDG of universal access to energy by 2030, that is, provide 2.5 billion people (the forecast population needing to be electrified by 2030) with high quality electricity services, i.e., 24-hour supply in urban areas and eight-hour supply in rural areas plus support 350 GW of solar capacity.

IV. Questions for the Development Committee

41. **This paper provides an update on the work carried out to date by Management and Executive Directors regarding the financial capacity of the WBG.** Management will continue to refine its analysis in coming months with a view to reverting to the Development Committee at its next meeting in October. At that time Management plans to present Governors further work

on how shareholders may go forward to strengthen the financial capacity of IBRD and IFC in order for the WBG to best play the role envisioned in the Forward Look. Management's view as informed through its interactions with the Executive Directors is that this is best done through the presentation of a menu of options. Management seeks the guidance of Governors on two questions:

- Do Governors agree with the role envisioned for the WBG to support the international community in financing its agreed development objectives?

- Do Governors support an approach whereby Management would present for further discussion a menu of options for strengthening the equity base of IBRD and IFC, including the consideration of a capital increase?