

# Chapter 4

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MIGA guaranteed the water treatment project in China. Photo by Roger Batstone.

# Recommendations

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## WBG Management

To overcome the current limitations of the delivery system of WBG guarantees and PRM instruments and enhance its use and development potential, IEG recommends the following to WBG senior management:

- 1. Take a strategic approach and make a decision on whether to maintain the existing organizational structure while addressing some of the important problems, or develop and propose an alternative organizational structure to the Board.**
- 2. Under any scenario, take action to introduce greater flexibility in the use of guarantee instruments in response to dynamic country and client needs and market developments by taking the following actions:**
  - Revising existing policies and regulations on guarantees to minimize supply-driven product restrictions where most needed and to allow product differentiation on the basis of value added.** Current policies and regulations contain supply-driven restrictions that do not eliminate overlaps yet tend to add to transaction costs and reduce the WBG's flexibility to respond to client needs. Processes that add value with respect to risk mitigation and safeguards need to be maintained and strengthened. The hierarchy of instrument principle has often conflicted with the preferences of market participants and has been a supply-driven approach to the deployment of instruments. Similarly, the product differentiations based on eligibility and mandate restrictions in the three institutions have also reflected artificial supply-driven product differentiation that is not client friendly. For example, restrictions such as IFC's constraints of not offering partial risk and full credit guarantees and MIGA's equity link have been associated with loss of business opportunities or higher transaction costs. A more rational approach would be to reduce the mandate/policy differentiations while emphasizing the distinct value the products add. Such an approach would, however, expand the opportunities for overlaps and therefore require enhanced coordination. Under any scenario, establishing the mechanisms for enhanced coordination should precede the greater flexibility in the product spaces of individual WBG institutions.
  - Ensuring that adequate incentives exist for staff to offer the full array of WBG guarantees and PRM products to private sector clients within a single menu of options.** The objective should be to enable the best product fit with the particular circumstances of the client. Marketing staff from each institution need to be more familiar with the products of the other institutions to provide clients with a full menu of options. IFC's extensive business development infrastructure suggests an important IFC role in the marketing of WBG risk-mitigation products. It has the broadest relationship with private sector clients as well as commercial banks—key drivers of PRI demand. IFC's Client Relationship Management System might provide a channel for coordinating marketing efforts across the WBG for products that reach the private sector. For such coordination to be effective, however, it has to be based on clear management and

staff incentives in IFC, in particular, incentives to promote the products of the Bank and MIGA.

- **Establishing more systematic links between advisory services and the deployment of WBG PRM instruments and other products, particularly in infrastructure, while keeping in mind the need to manage potential conflicts of interest.** Greater upstream engagement of WBG PRM products might be enhanced with closer links to Bank/IFC advisory services that are engaged in helping governments establish an appropriate regulatory framework and developing specific PPP transactions. IFC's corporate advisory services, which are helping governments design concession agreements and privatizations, for example, represent a potentially important mechanism to more systematically introduce WBG PRM products earlier in a project's development, such as during the bidding stage. IFC's corporate advisory services could, for example, systematically include in bidding packages the option for the winning bidder to choose from a menu of WBG products such as IDA/IBRD PRG, MIGA PRI, and IFC investments. Moreover, enhancing client opportunities to choose from a menu of WBG PRM products needs to be accompanied by a consistent approach to pricing of political risk among the WBG institutions.
- **Following a consistent approach to pricing PRM across its guarantee instruments to avoid potential distortions.** At present, the Bank has a distinct pricing structure that does not reflect risk or market conditions. The Bank's Operating Principle 8.30 requires that in financial intermediary lending, on-lending occur at or near market rates. The same logic should be extended to the pricing of IDA and IBRD PRGs, which also reach private sector clients. A consistent approach to the pricing of comparable risks would reduce the potential for distortions and enable WBG private sector clients to make rational decisions as to which WBG instrument best fits their needs. Consistent

pricing might also reduce the need for supply-side rationing of products through the hierarchy of instruments principle and instead allow the most appropriate product to be deployed. MIGA has developed a pricing system that reflects political risks as well as market conditions; this can serve as a basis for a more uniform pricing of political risk across the WBG.

- **Strengthening internal awareness of the guarantee instruments and the incentives and skills for their use and reducing transaction costs where possible, keeping in mind the importance of maintaining adequate processes and regulations for risk management.** Lack of staff incentives, inadequate skills, and poor familiarity with the products of the other institutions have prevented better exploitation of synergies downstream in marketing WBG products. Safeguards and fiduciary requirements in each of the three institutions generally add value and need to be maintained and strengthened, especially in light of their importance for mitigating financial, social, environmental, and ultimately political risks. But where feasible, inefficiencies and unnecessarily cumbersome procedures need to be reduced to minimize transaction costs for private sector clients.
- 3. If a new organizational structure is developed and proposed, consider at least three alternative perspectives for organizational realignment (client, country, and product).**
- Under the client approach, all products for private sector clients, including guarantees and PRM instruments, would be offered through a single window.
  - Under the country approach, the deployment of WBG guarantee and PRM products would be made according to country needs, under a management arrangement common for all three institutions.
  - Under the product approach, the bulk of guarantee/insurance products would be managed under one institutional roof.

- Each of the organizational realignments may bring higher benefits than the existing structure in terms of lower transaction costs, better client focus, and higher efficiency, but each also entails significant uncertainties and risks in terms of loss or marginalization of some products, conflicts of interest, and reduced flexibility to respond to changes in the external environment. The assessment of alternatives for organizational realignment should take into account efficiency aspects, conflict-of-interest implications, effective coordination within the WBG, and responsiveness to private sector clients' and countries' needs.

**4. If the current organizational structure is maintained, direct management of each individual WBG institution to improve the delivery of its own guarantee/insurance products.**

### **MIGA Management**

- **Proposing to MIGA's shareholders amendments to its Convention to remain relevant and meet its market potential.** Constraints imposed on MIGA by its 1985 Convention need to be reconsidered so that MIGA can better serve its developing country members and clients. The most notable constraint is the inability to insure stand-alone debt (with no equity participation), and existing assets, and local and foreign investors among others. Although amending the Convention is likely to be a lengthy process involving shareholder approval and ratification from members, it would be important for MIGA to take the necessary steps now to retain its relevance in the future.
- **Considering, in the meantime, alleviating several constraints derived from its operational regulations and policies.** Several changes to MIGA's Operational Regulations to add new eligible investments and risks can help MIGA develop new products and meet evolving market demands. Several changes in policy and MIGA's Operational Regulations are being discussed internally.
- **Increasing its responsiveness to market demand by addressing internal weak-**

**nesses that reduce efficiency and slow responsiveness without lowering MIGA's financial, social, and environmental standards.** These include organizational issues in

staffing, performance review, and incentives as well as consideration of matters such as inflexibility on guarantee contract terms and conditions. However, efficiency in its underwriting process must not come at the expense of quality, risk mitigation, safeguards, and development impacts of the projects it insures.

- **Improving its client relationship management, including aftercare, to enhance MIGA's value added and increase client retention.** Improving client relationships could be the most cost-effective marketing that MIGA could undertake to increase its business volume. Managing client relationships requires a focused and coherent business development plan implemented by a staff with expertise in the guarantee business and/or financial markets.

### **Bank Management**

- **Maintaining and promoting the PCG instrument as a countercyclical tool to leverage government access to commercial funds and extending such access to IDA countries.** PCGs remain a potentially important instrument to help well-performing countries that do not have full access to commercial markets by introducing them to markets and improving the terms of initial transactions. They can also provide countercyclical assistance to countries whose access to markets is temporarily restricted. At the same time, PCGs can substitute for direct Bank lending and can reduce the Bank's leverage in some situations. More discussion and clearer guidance on the merits of PCGs vis-à-vis direct lending in various circumstances should be developed in the Bank. Given the growing number of IDA countries that fit the profile of well-performing countries with restricted access to markets, the option of a PCG instrument should be extended to IDA countries. Current incentives in the Bank promote direct Bank lending rather than leveraging of private commercial finance, yet PCGs can have significant development impact and additionality in the right circum-

stances. They should be more thoroughly considered in the CAS process.

- **Taking several measures to enhance the use of Bank PRGs.** Although the market for Bank PRGs will remain narrow because of the nature of the product, PRGs remain the only instrument the Bank has to directly support private investment projects, and Bank lending cannot substitute for them. They provide a unique means of PRM because of the Bank's close relationship with governments, sector knowledge, and policy dialogue on private sector development, and they can be deployed to enable transactions that would otherwise be perceived as too risky. Important measures for enhancing their use are creating awareness among Bank staff of the potential use and benefits of PRGs and building necessary skills; developing a marketing strategy that encompasses both governments and the private sector to better identify situations in which the role of a PRG can make a difference; and streamlining processing steps to reduce both internal disincentives to working on PRGs and transaction costs for private sector clients while ensuring that crucial measures for social and environmental safeguards and risk management are maintained and strengthened.

### IFC Management

- **Mainstreaming its guarantee products through its operations departments in the same manner that its equity and loan products are deployed.** IFC's Treasury has been instrumental in innovating and spreading innovation. The Treasury is decentralizing, beginning to put senior staff in the field. However, mainstreaming needs to be led by the industry and regional departments, which have the incentives and resources to scale up the use of the instruments in response to evolving client needs. IFC needs to develop the skills and capacity in its operational departments to offer a broad range of guarantee products.
- **Assessing the extent to which it can bring its guarantee products closer to meeting Basel II—and regulatory requirements in general—so that the guarantee beneficiaries can use IFC products more effectively for capital, provisioning, and exposure relief.** A great deal of the demand for guarantee-type instruments derives from financial institutions' needs for relief on capital, provisioning, and exposure requirements. In this context, IFC should review its guarantee products to assess the extent to which they can be tailored to better meet Basel II and regulatory requirements for the above purposes.
- **Revisiting its approach to RSFs to increase flexibility and improve the attractiveness of the product.** The rigid approach to structuring RSFs has limited IFC's ability to fully exploit the benefits of partnering with local and international financial institutions. This rigidity and high transaction costs have discouraged utilization of the instrument. More flexible structures should be considered to make the product more attractive to partner financial institutions. IFC has accumulated the data and the experience to give it the comfort needed to simplify processes and to give flexibility to partners to use their strengths while strengthening those processes intended for risk management and social and environmental safeguards.
- **Scaling up successful models in energy efficiency, education, and capital market development based on the use of guarantee structures.** IFC has developed models based on guarantee structures in the areas of energy efficiency, SME financing, education, and capital market development. Limited replication has taken place so far. IFC needs to assess its experience with these products, simplify, standardize, and bring them closer to market practices to enhance prospects for scaling up in line with its programmatic approach.