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THE WORLD BANK

Washington, D.C.

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President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Materials
Lunch - Guarantee Action Plan [GAP] Group - June 5, 1996

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A. CLASSIFICATION

- ☒ Meeting Material
- ☐ Trips
- ☐ Speeches

- ☐ Annual Meetings
- ☐ Corporate Management
- ☐ Communications with Staff

- ☐ Phone Logs
- ☐ Calendar
- ☐ Press Clippings/Photos

- ☐ JDW Transcripts
- ☐ Social Events
- ☐ Other

B. SUBJECT: LUNCH: GUARANTEE ACTION PLAN (GAP) GROUP
VENUE: JDW'S PRIVATE DINING ROOM
CONTACT: BERNARD PASQUIER @ 30736
IN ATTENDANCE: JDW, FRANK, CONRAD, PASQUIER, LOMAX
(B) PASQUIER
*5/31 - CIHAT
EXC: ATSUKO

DATE: 06/05/96

C. VPU

Corporate

- ☐ CTR
- ☐ EXT
- ☐ LEG
- ☐ MPS
- ☐ OED
- ☐ SEC/Board
- ☐ TRE

Regional

- ☐ AFR
- ☐ EAP
- ☐ ECA
- ☐ LAC
- ☐ MNA
- ☐ SAS

Central

- ☐ CFS
- ☐ DEC
- ☐ ESD
- ☐ FPD
- ☐ FPR
- ☐ HRO

Affiliates

- ☐ GEF
- ☐ ICSID
- ☐ IFC
- ☐ Inspection Panel
- ☐ Kennedy Center
- ☒ MIGA

D. EXTERNAL PARTNER

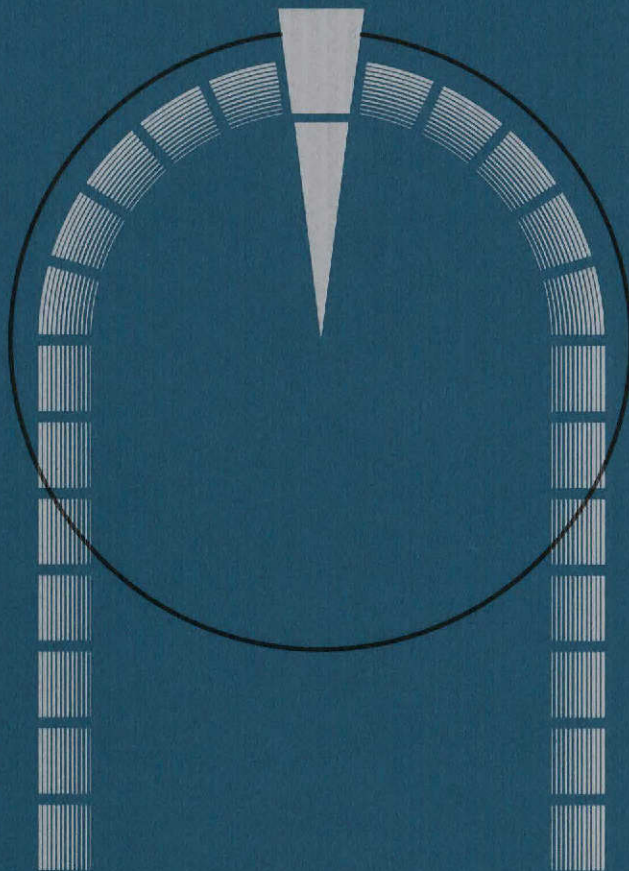
- ☐ IMF
- ☐ UN
- ☐ MDB/Other IO
- ☐ NGO
- ☐ Private Sector

- ☐ Part I
- ☐ Part II
- ☐ Other

E. COMMENTS:

THE WORLD BANK GUARANTEE

Catalyst for Private
Capital Flows



Project Finance Group
Cofinancing and Financial Advisory Services
September 1995

WORLD BANK GROUP INSTRUMENTS FOR PRIVATE SECTOR SUPPORT

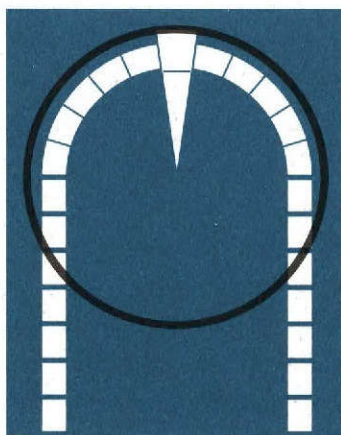
The International Bank for Reconstruction and Development (the Bank), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA) are the entities of World Bank Group which have instruments to support the private sector.

Funded mainly through borrowings on international capital markets, the Bank is the largest source of market-based loans to developing countries. IFC finances the private sector exclusively, through direct loans and equity investments, and syndicated loans under the IFC "umbrella," to private companies throughout the developing world. MIGA offers investors insurance against noncommercial risk and technical services to promote private investment flows to developing countries.

The Bank mainly lends to governments and government agencies, but it also makes loans to the private sector backed by the host government's counter-guarantee. Its outstanding loans total \$124 billion. The Bank can also provide guarantees to commercial lenders for public and private sector projects. Debt covered by outstanding Bank guarantees currently totals approximately \$1.6 billion.

Guarantees are intended to mitigate those risks which private lenders are not prepared to accept in particular project or country circumstances. When the Bank extends a guarantee it is required under its Articles to obtain a counter-guarantee from the host government. When the guarantee covers specific sovereign policy or contractual risks, the counter-guarantee demonstrates the commitment of the government to meet obligations entered into as part of the project.

The Bank's guarantee operations must be consistent with its assistance strategy for a country and are thus part of the broader dialogue and relationship the Bank has with its member countries. The appraisal of guarantee operations ensures that the project meets the Bank's standards.



THE WORLD BANK GUARANTEE

Catalyst for Private Capital Flows



Project Finance Group
Cofinancing and Financial Advisory Services
The World Bank
Washington, DC

SHARING RISKS WITH PRIVATE INVESTORS

With many developing countries increasingly interested in attracting private capital to projects, the Bank expects to make greater use of its guarantee power. World Bank guarantees are provided to private lenders and are most likely to be used for financing infrastructure, where the demand for funding is large, political and sovereign risks are significant, and long-maturity financing is often critical to a project's viability.

By covering risks that the market is not able to bear or adequately evaluate, the Bank's guarantee can attract new sources of financing, reduce financing costs, and extend maturities. The guarantee can be especially valuable where activities traditionally undertaken and financed by the government are being shifted to the private sector but where the government and its agencies remain involved, for example, as regulator, provider of inputs or buyer of outputs. The Bank's participation as guarantor can also facilitate the transparency of transactions.

The Bank's guarantee is intended to be catalytic. To this end, the Bank offers only partial guarantees, and risks are clearly shared between the Bank and private lenders. The Bank's objective is to cover risks that it is uniquely positioned to bear given its credit experience with developing countries and special relationships with governments. Other project risks are taken by private sector lenders and other partner institutions. The Bank's guarantee may be either for specified risks (the partial risk guarantee) or for all credit risks during a specified part of the financing term (the partial credit guarantee).

A *partial risk guarantee* covers specified risks arising from nonperformance of sovereign contractual obligations or

certain political force majeure events. A *partial credit guarantee* typically extends maturities beyond what private creditors could otherwise provide—for example, by guaranteeing late-dated repayments or providing incentives for lenders to roll over short-term loans.

BENEFITS OF THE GUARANTEE

The guarantee can work to the advantage of borrowers and host governments in many ways. In some instances, the guarantee can make projects possible which would otherwise not materialize.

By covering risks that the market would not bear, or would price prohibitively high, the guarantee lowers the cost of financing. More favorable regulatory treatment provided to lenders and investors—through reduced provisioning requirements, for example—also decreases the cost of financing.

Guarantees can also extend the term of lending beyond the period for which the market would normally lend—an essential consideration for infrastructure projects which require long-term debt in order to match debt service with revenues.

The flexibility of the guarantee allows private sponsors to choose the best financial structure for the project, i.e., the currencies and markets they borrow in and the interest rate (fixed or floating), to serve the needs of the project.

For a government, a partial risk guarantee reduces its contingent liability to the minimum required to make a project feasible; the private sector takes on all or a substantial part of the commercial risks. This contrasts with the traditional pattern where a government takes full responsibility for financing and thus bears the entire risk in a project.

PARTIAL RISK GUARANTEES FOR PROJECT FINANCE

Partial risk guarantees are particularly relevant in the context of the major worldwide shift toward privatization and private financing of infrastructure. Such guarantees cover specific government obligations spelled out in agreements with the project entity. They are most appropriate for “limited-recourse financing,” as in build-own-operate-transfer, build-own-operate and similar projects.

Partial risk guarantees ensure payment in the case of debt service default resulting from the nonperformance of contractual obligations undertaken by governments or their agencies in private sector projects.

Sovereign contractual obligations vary depending on project, sector and country circumstances. Typical government contractual obligations include:

- Maintaining the agreed regulatory framework, including tariff formulas.
- Delivering inputs, such as fuel supplied to a private power company.
- Paying for outputs, such as power purchased by a government utility from a private power company or bulk water purchased by a local public distribution company.
- Compensating for project delays or interruptions caused by government actions or political events.

Transfer risks may also arise for investors and lenders because of constraints in the availability of foreign exchange. Sources of transfer risk include procedural delays, adverse changes in exchange control laws or regulations, and general deterioration in macroeconomic conditions and foreign exchange reserves. A partial risk guarantee can cover such risks of foreign exchange transfer.

A partial risk guarantee is triggered by debt service default resulting from government noncompliance with one or more of its obligations as stipulated in agreements with the project company.

The Hub Power Project (Pakistan)

The Hub Power Project is one of the largest privately owned power projects being implemented on a build-own-operate basis in the developing world. Financing for the 1,292 MW project totals about \$1.8 billion. The financing structure (80% debt and 20% equity) includes approximately \$680 million in syndicated commercial bank loans. About \$320 million of this amount is insured by export credit agencies, the remaining \$360 million guaranteed by the World Bank and the Export-Import Bank of Japan. The project's revenues are secured through a long-term sales contract with the national utility, WAPDA.

The Bank is providing a partial risk guarantee against specific political risks on principal repayment of \$240 million, and the Export-Import Bank of Japan is providing an identical guarantee for the other \$120 million. The Bank's guarantee would be triggered if there were a debt service default that resulted from noncompliance by the Government of Pakistan with one or more of its obligations as specifically outlined in the legal agreements between the project company and the Government (or one of its agencies). One example would be if WAPDA's failure to pay the project company according to the terms outlined in the Power Purchase Agreement resulted in a payment default.

Other guaranteed risks include the performance of the fuel oil supplier (a Government-owned entity) and certain force majeure events defined in the project agreements.

The guarantee enabled Pakistan to tap previously unavailable long-term commercial bank credit to support a major private initiative in the power sector. It also helped attract large amounts of equity investment and export credit support, while opening Pakistan's power sector to private investment. Several additional projects supported by private investors are beginning to follow the path of the Hub Project.

<i>Financial closure</i>	<i>December 1994</i>
<i>Borrower</i>	<i>Hub Power Company</i>
<i>Instrument</i>	<i>Syndicated loan (limited recourse)</i>
<i>Amount</i>	<i>\$360m (\$240m World Bank guarantee, \$120m J-ExIm co-guarantee)</i>
<i>Maturity/grace</i>	<i>12 years/4 years</i>
<i>Interest rate</i>	<i>Floating, based on LIBOR</i>

Risks covered by guarantee

Performance of government-owned entities

- *Payment obligations of utility (revenue and penalties)*
- *Obligations to supply fuel (nonperformance)*
- *Central Bank obligation to provide foreign exchange*

Force majeure events

- *Changes in law*
- *Political events in Pakistan*
- *Specified natural events*

PARTIAL CREDIT GUARANTEES FOR LONGER MATURITIES

Partial credit guarantees cover all events of nonpayment for a designated part of a financing. These guarantees encourage extension of maturity by covering a part of a financing, usually the later maturities. In recent operations, the Bank covered late repayments, stretching the normal lending terms offered by the market. Another example is a contingent take-out facility, where the guarantee ensures continuity of financing. The need for such rollover guarantees arises if short-term financing (for the construction period, for example) is available but the prospects of rolling over such financing are uncertain.

Other structures can be explored to suit project requirements. The aim is to induce the market to take the maximum risk it can bear.

The Zhejiang Power Development Project (China)

Of the \$1.8 billion required for the project, a Bank partial credit guarantee helped China raise \$150 million equivalent in loans from commercial banks and insurance companies. This guarantee built upon the success of the Bank-guaranteed financing for the Yangzhou Thermal Power Project nine months earlier. The result was a lower borrowing cost with *less* guarantee coverage. The guarantee covers principal repayments between years 11 and 15 (for Yangzhou, principal repayments between years 10.5 and 15 were covered). The maturity and interest rate under the guarantee were significantly better than those available to Chinese Government agencies in the market. The Bank's guarantee covered 43% of the face value of the loan, 20% in present value terms.

A guarantee release option was included in the guarantee structure, giving lenders the option to cancel the guarantee in exchange for additional loan interest (equivalent to the guarantee fee for the canceled years so that China's cost of borrowing would remain unchanged). The option was designed to encourage lenders to re-examine China's credit and cancel the guarantee on a voluntary basis in exchange for a higher spread, thereby releasing unnecessary guarantee exposure for China.

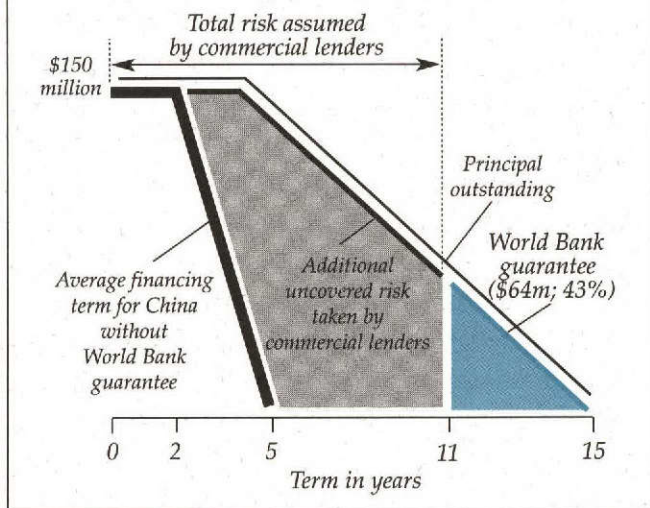
In addition, to the longer term and lower financing cost, the guarantee gave the provincial power company, the project beneficiary, the opportunity to have direct contact and access to the international financial markets and to be exposed to market practices in commercial borrowing. Similarly, commercial lenders had the opportunity to examine the power company's operations and the structural and regulatory features of the Chinese power sectors. Such exchanges should facilitate further diversification of financing sources for the sector, an important long-term goal for China.

<i>Financial closure</i>	<i>March 1995</i>
<i>Borrower</i>	<i>People's Republic of China</i>
<i>Instrument</i>	<i>Syndicated loan</i>
<i>Amount</i>	<i>\$150m equivalent (\$100m plus ¥5bn)</i>
<i>Maturity/grace</i>	<i>15 years/5 years</i>
<i>Interest rate</i>	<i>\$-Loan: Floating, based on LIBOR ¥-Loan: Fixed, based on long-term prime lending rate</i>

Zhejiang Power Development Project

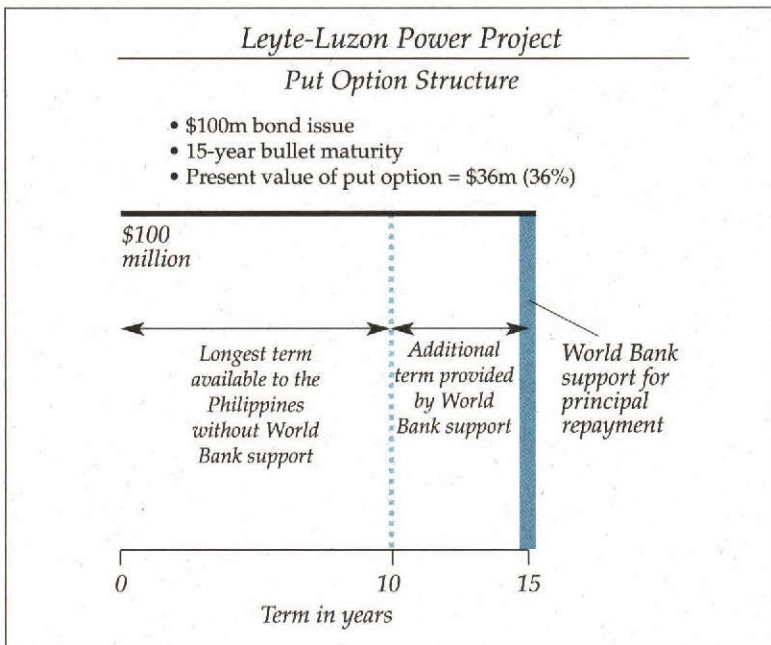
Guarantee Structure

- Present value of guarantee = \$30m (20%)



The Leyte-Luzon Geothermal Project (The Philippines)

Using an alternative to the normal partial credit guarantee structure, the World Bank supported a \$100 million bond issued by the National Power Corporation by providing the bondholders with an option to “put” the bonds (sell at par) to the World Bank for principal repayment at maturity at year 15. The proceeds, along with a direct loan from the Bank of \$227 million, will finance the \$1.3 billion project to expand the power production of the Leyte geothermal fields.



The 15-year bullet maturity is a significant improvement over the 10-year term previously available to Philippine borrowers in the international markets. The bonds, primarily sold in the US Rule 144a institutional investor market, helped to develop a new investor base for the country. This was

important both for the National Power Corporation and for the Philippines, given its substantial future infrastructure investment requirements and need to diversify borrowing sources.

The Bank's exposure was equivalent to 36% of the face value of the bonds (present value basis), significantly leveraging both Bank and Government resources.

<i>Financial closure</i>	<i>July 1994</i>
<i>Borrower</i>	<i>National Power Corporation</i>
<i>Instrument</i>	<i>Fixed-rate bond</i>
<i>Amount</i>	<i>\$100m</i>
<i>Market</i>	<i>Eurobond/US144a</i>
<i>Maturity</i>	<i>15 years (bullet)</i>
<i>Interest rate</i>	<i>9.75%</i>

A FLEXIBLE TOOL FOR RISK MANAGEMENT

The Bank's guarantee can be used flexibly for commercial debt financing for private or public entities in developing countries. Unlike MIGA, though, the Bank does not guarantee equity capital. Nor does it guarantee loans from other official multi-lateral financial institutions or export credit agencies.

Financial structure. Borrowers and lenders can choose the financing structure most appropriate for the project. The guarantee can thus enhance credit obtained through such instruments as public bond issues, private placements, and commercial bank loans. Borrowing may be in the currency and market best suited to meet the project's requirements. In practice, Bank guarantee operations use a mix of instruments, currencies, and markets.

Eligibility. The Bank's guarantee is generally available for projects in any country eligible for borrowing from the Bank, irrespective of whether the project is in the private or public sector.

The Bank may, however, at times limit the availability of guarantees in some countries, and restrictions apply to guarantees for public sector projects in countries undergoing debt restructuring.

Guarantees may be used only for mobilizing funds for new investment projects. Governments, government-owned entities, and privatized or private sector entities are all eligible to receive credit enhancement under the Bank's guarantee.

Relationship to Bank lending. The Bank can provide guarantees either on a stand-alone basis or in conjunction with a Bank loan. Stand-alone guarantees are important in privatization and private sector projects, where the govern-

ment may not wish to bear commercial risks. The Bank's guarantee is counted in the Bank's lending program to the host government, although the Bank is able to adjust a country's lending program to accommodate additional guarantees.

Counter-guarantee. The Bank's Articles of Agreement require a counter-guarantee from the host country government. When the Bank's guarantee covers the government's undertaking to a private sector project, the counter-guarantee is a further demonstration of the government's commitment to meet those undertakings. The counter-guarantee of the government to the Bank is normally an indemnity agreement, whereby the government indemnifies the Bank for any payments made by the Bank under its guarantee.

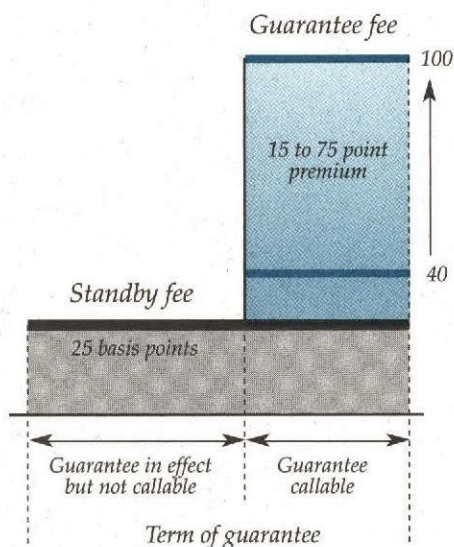
Extent of guarantee. Under a partial risk guarantee, up to 100% of principal can be covered. But the coverage—defined by the events agreed to trigger the guarantee—is set at the lowest level necessary to mobilize the financing, taking into account the nature and complexity of the operation. A partial credit guarantee, in contrast, covers only a portion of the financing, again set at the lowest level necessary.

FEES

The Bank charges two fees for guarantee cover: a standby fee and a guarantee fee. These fees are charged either to the borrower or lender on the amount covered under the guarantee.

The standby fee, applied during the period when the guarantee is in force but not callable, is currently 25 basis points per annum on the Bank's guarantee exposure, represented by the present value of the guaranteed amount at the first possible date of call.

The guarantee fee, applied during the period when the guarantee is callable, is currently in the range of 40–100 basis points per annum on outstanding debt covered by the guarantee—this consists of a base fee of 25 basis points plus an annual premium ranging from 15 to 75 basis points. The premium is determined case by case to reflect the level of coverage and thus the value to the borrower.



Depending on the structure of the operation, the Bank may require the guarantee fee to be paid up front or in installments. Any guarantee fee above 25 basis points is refunded to the government, so that the net cost of the guarantee is the same as the spread on a World Bank loan. The World Bank is a cooperative institution and maintains a policy of nondiscriminatory pricing among members.

STEPS IN A GUARANTEE OPERATION

Because neither IFC nor MIGA requires government counter-guarantees for their support, these institutions should normally be the preferred sources of World Bank Group support for private projects. However, the Bank's guarantee may be appropriate for large projects in the private sector that are considered high priority by the government and require resources beyond the level IFC can mobilize or MIGA can insure against—or that carry regulatory and policy risks the Bank is best positioned to guarantee against. The Bank guarantee therefore, should complement the efforts of IFC and MIGA.

Initiating an operation

Guarantee operations can originate through three different routes: (i) through the Bank's ongoing dialogue with the government on sectoral strategies, (ii) through identification of projects not specifically part of the dialogue but which fit in with the Bank's general country assistance strategy, and (iii) through initiatives taken by private sponsors and lenders in bringing relevant projects to the attention of the government and the Bank.

Sector dialogue. The Bank's long-term commitment to infrastructure development in its borrowing countries takes the form of a continuing dialogue, technical assistance and specific investments. Through this process, the most effective role of the private sector is continually discussed, leading to identification of types of projects that may be suitable for guarantees.

In some countries, the government may announce the priority sectors, projects and general procedures for projects in which the government will provide its own guarantee or counter-guarantee as well as the types of risk that may be

covered. Such announcements would indicate the government's policy on the appropriate use of guarantees—prospective projects utilizing a World Bank guarantee would, however, be individually reviewed by the Bank.

Specific projects. As mentioned above, from time to time, specific projects, whether part of the general dialogue or not, may also be identified as suitable for use of a World Bank guarantee through discussions between the government and Bank.

Private initiatives. Private sponsors and lenders are encouraged to discuss specific concepts or projects under development with relevant government ministries as well as the Bank (to discuss general guarantee principles and financing structures, please contact the Project Finance Group; to discuss the Bank's country assistance strategy or general country dialogue, please contact regional liaisons—contact numbers are listed on the last page of this brochure.)

Preparing contractual agreements for private projects

Key legal agreements, such as the concession or sales agreements between the government and the project sponsors, need to be prepared before the Bank's formal appraisal of a project.

Bank appraisal

Projects supported by guarantees are required to meet standard Bank appraisal criteria covering the technical, financial, economic, and environmental aspects of the project. The Bank's appraisal will also include an evaluation of the project's consistency with the government's sectoral policy objectives. If private lenders or other multilateral financial agencies that may be cofinancing the project

undertake their own appraisal, the Bank may accept such third-party appraisal if its quality is judged acceptable.

In addition, the Bank, sponsors, and government need to agree on a proposed guarantee agreement between the Bank and lenders, while the Bank and government must agree on the terms of the indemnification agreement to counter-guarantee the Bank.

Requesting financing proposals from the market

Once the nature and structure of the guarantee have been determined, the borrower may solicit proposals to lead-manage or underwrite the guaranteed transaction. The Bank and the government should be apprised of any possible changes in guarantee coverage that result from discussions between the borrower and potential lenders. Lead managers, underwriters and potential lenders should be made aware that the provision of a guarantee is subject to the approval of the guarantee transaction by the Bank's Executive Directors.

Negotiating terms and Bank Board approval

The borrowing entity, lead manager(s) or underwriter(s) of the transaction, host government, and Bank negotiate the final terms and conditions of the guarantee and the indemnity agreements. After the Bank and government agree on the indemnity agreement, under which the host government counter-guarantees the Bank, the Bank presents the proposed transaction to its Executive Directors for approval.

Timing

Since projects are brought to the Bank for consideration of the use of a guarantee at very different stages in the project cycle, the time required to process a guarantee varies. In practice,

guarantee processing has kept pace with the general development and financing of the project. The Bank fully expects this to continue. However, the preference is for Bank involvement at an early stage of a project. This allows processing of relevant information to proceed in parallel with normal project development. When projects are brought for consideration at a very late stage, allowance must be made for the Bank's appraisal process—as described above, appraisal can often be done quickly, and the Bank may accept third-party appraisals.

Procurement

For projects supported with a World Bank loan, the Bank normally requires international competitive bidding for all goods and services procured with the loan proceeds. In projects supported with the Bank's guarantee, however, the borrower is allowed the flexibility to procure goods and services using the proceeds of debt under the guarantee from suppliers of its choice—so long as procurement is economical and efficient.

Proceeds of the financing under the guarantee may be used for local and foreign exchange costs of goods and services required for new investment projects.

QUESTIONS AND ANSWERS

Successor to the ECO programs

How does this new guarantee differ from guarantees under the ECO program?

The guarantee, having evolved from the ECO program, is now a regular operational tool of the World Bank and replaces the ECO program. The guarantee is more flexible with respect to country eligibility and is not constrained by the coverage rules of the ECO program. The fee structure is also more flexible and market-based, and the approval procedures are more streamlined.

Under the ECO program, the Bank limited its coverage for partial credit guarantees in any project to 50% of the present value of loan amount. Is there a limit on the amount of guarantee under the new guidelines?

There is no defined limit on the Bank's guarantee coverage. However, the Bank will aim to minimize its coverage, consistent with the needs of the project. In partial risk guarantees, the guarantee will cover loan repayments against specific, well-defined risks that other sources cannot reasonably cover.

Benefits of the guarantee

How do the terms and conditions of financing raised with the Bank's guarantee compare with what the borrowers can do on their own?

With the Bank's guarantee, it should be possible for a borrower to mobilize funds on terms and conditions significantly better than it could do on its own—including extensions of maturity and lower interest spreads. The borrower can also select—depending on the acceptability in the particular market—the

currency, interest rate basis (fixed or floating) and maturity to best match the project's requirements.

What are the provisioning requirements for commercial bank loans made under a Bank guarantee?

Depending on the banking regulations of each member country, commercial loans covered by a Bank guarantee may be exempt from country-risk provisioning requirements. For specific guarantee transactions, lenders should approach their banking regulatory authorities.

Can the guarantee cover loans made by nonbanking institutions?

Yes. Loans made by banking and nonbanking institutions could be covered under the guarantee.

Bank Group linkages

How does the Bank's guarantee differ from MIGA insurance?

There are a number of differences. MIGA can cover equity, shareholder loans and loan guarantees issued by equity holders; it can also cover loans by unrelated institutions, usually commercial banks, provided that a shareholder's investment in the project is also being insured by MIGA. Like other investment insurers, MIGA can provide broad coverage to investors against such risks as currency transfer, war and civil disturbance, and expropriation; it can customize these coverages to suit the particular needs of investors. MIGA can normally issue coverage within a few months of an investor's application since it does not enter into counter-guarantee arrangements with the host country government of the project. The Bank, by contrast, guarantees debt instruments—not equity—typically against payment default caused by specifically defined events for each project. It can provide

tailored coverage of specific risks. [For information on MIGA, please contact Christophe S. Bellinger, Chief of Guarantees, tel: (202) 473-6163.]

What are the differences between the Bank's guarantee and IFC's B-Loan?

The IFC B-loan differs significantly from the Bank's guarantee. IFC is the lender of record for the account of participants, who enter into individual participation agreements with IFC. All project risks, commercial and political, are assumed by the participants, but each participant does share in IFC's privileges and immunities as an international organization. IFC does not guarantee B-loan lenders, nor does it obtain counter-guarantees from host governments. The Bank's guarantee, by contrast, covers specific and agreed debt service risks borne by direct lenders. [For information on IFC B-loans, please contact Richard Parry, Manager, Syndications Division, tel: (202) 473-0398.]

Can IFC and MIGA also participate in funding a project that carries a Bank guarantee?

Yes. It would normally be expected that private sector projects requiring the Bank's guarantee would also involve one or more other providers of long-term financing, including export credit agencies and possibly IFC and MIGA. However, the Bank's guarantee will not cover any part of the financing originating from—or covered by—these or any other bilateral or multilateral institutions.

Since the World Bank requires a counter-guarantee from the government, doesn't the government end up guaranteeing private investors?

No. The Bank's partial risk guarantee is specifically designed to back only the obligations a government has given to an investor.

In typical projects, these undertakings would include no assurance of commercial success but only aspects under the government's control. By providing a guarantee against the failure of the government to fulfill these obligations, the Bank merely adds credibility to the project, allowing the investor to mobilize financing from international financial markets.

Country allocations

How is the volume of guarantees available to a country determined?

Generally, the potential use of guarantees is considered within the framework of the Bank's country assistance strategy—formulated jointly by the member country and the Bank. The Bank is willing to accommodate guarantee operations in its lending program to meet specific project needs if the project is consistent with the Bank's overall country assistance strategy. However, since the possibility of private commercial financing depends on specific market circumstances at a given time, it is not possible to forecast the volume of guarantees too far in advance. Nor will it always be possible to forecast in advance the pipeline of private sector projects that may require Bank guarantees.

How do guarantees count against a country's lending allocation from the Bank?

The Bank's project planning operates on a rolling three-year lending allocation for each of its borrowing countries—determined in consultation with the country, taking into account the Bank's risk-management strategy and the country's financing needs and economic performance. Recognizing the leverage of the Bank's partial guarantees, the Bank is prepared at times to let a country exceed its lending allocation to accommodate some additional volume of guarantees.

Legal issues

Are there cross-default provisions in the World Bank loan that accompanies the World Bank guarantee?

World Bank loans do not normally include cross-default clauses to loans from other creditors. The Bank may in appropriate cases include an optional cross-default provision in its loans for the project to the commercial loan guaranteed by the Bank. Such a clause allows the Bank to suspend disbursements or accelerate its loan if commercial lenders have exercised remedies under their loan.

If events of default occur during the noncallable period, can the Bank's guarantee be accelerated?

No. The Bank's guarantee cannot be accelerated before the call date initially negotiated under the guarantee agreement.

What laws will govern the Bank's guarantee of a commercial loan?

The Bank's guarantee normally will be issued under the same governing law as that of the underlying loan, as determined by the borrower and lenders.

Is the Bank's guarantee payable on demand?

Yes. The Bank's guarantee is generally payable on demand. But the Bank normally requires a grace period prior to payment in order to provide an opportunity to cure defaults. To avoid entangling the Bank in the substance of the contractual disputes between the parties in the case of partial risk guarantees, the Bank would require that project agreements contain appropriate dispute resolution procedures and, in such cases, that demands could only be made on the guarantee in the event the government failed to make a required payment in accordance with those procedures.

What subrogation provisions apply to the Bank's guarantee?

If a guarantee were called, the Bank would be entitled to stand in the place of the private lenders to seek reimbursement from the borrower. A specific provision on subrogation would clearly stipulate that the Bank would be entitled to exercise its rights of subrogation immediately, without waiting for lenders to be paid on any amount of the debt not guaranteed by the Bank.

CONTACTING THE BANK

The World Bank's guarantee program is implemented by the Project Finance Group, a division of the Cofinancing and Financial Advisory Services Department. Questions on the World Bank guarantee may be addressed to Nina Shapiro, Manager of the Project Finance Group, at the following numbers:

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COFINANCING AND FINANCIAL ADVISORY SERVICES DEPARTMENT

Hiroo Fukui

Vice President

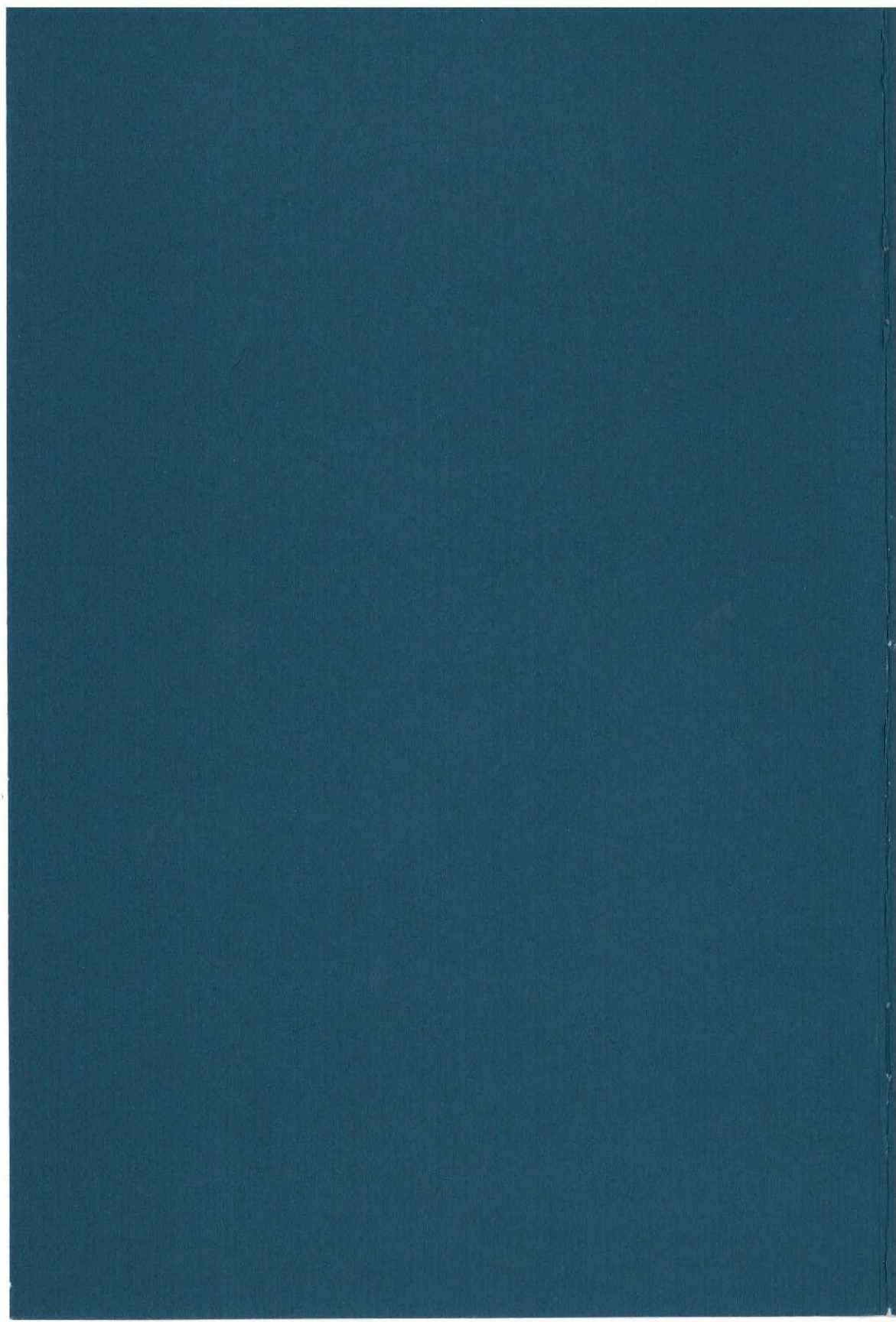
Ram K. Chopra

Director

WORLD BANK GUARANTEES 1994-95

World Bank guarantees played a significant role in catalyzing private capital flows to several large infrastructure projects in developing countries in 1994. Guarantees enable borrowers to tap international credit and capital markets at significantly improved terms, i.e., longer maturities and lower interest rates. They also can provide market access for some borrowers previously unable to tap these markets. Several Bank-guaranteed projects are under development for 1995, the majority of which are in the private sector.

<i>Project</i>	<i>Project cost (US\$)</i>	<i>World Bank guarantee</i>	<i>Maturity/ interest</i>	<i>Financial closure</i>
<i>Uch Power Pakistan (private sector)</i>	<i>\$650m</i>	<i>Partial risk, accelerable guarantee covering US\$60m syndicated loan.</i>	<i>To be determined</i>	<i>Expected 11/95</i>
<i>Ertan Hydroelectric II China (public sector)</i>	<i>\$2.9bn</i>	<i>Partial credit, accelerable guarantee covering principal during years 12-15 of \$150m syndicated loan.</i>	<i>15 years/ • \$ loan: LIBOR-based • DM loan: LIBOR-based</i>	<i>Expected 9/95</i>
<i>Jordan Telecommunications (public sector)</i>	<i>\$217m</i>	<i>Partial credit, nonaccelerable guarantee covering principal of US\$50m Eurobond/domestic issue.</i>	<i>To be determined</i>	<i>9/95</i>
<i>Zhejiang Power Development, China (public sector)</i>	<i>\$1.8bn</i>	<i>Partial credit, accelerable guarantee covering principal during years 11-15 of \$150m syndicated loan.</i>	<i>15 years/ • \$ loan: LIBOR-based • Yen loan: LTPR-based</i>	<i>3/95</i>
<i>Hub Power, Pakistan (private sector)</i>	<i>\$1.8bn</i>	<i>Partial risk, accelerable guarantee covering principal of US\$240m limited-recourse, syndicated loan (US\$120m J-ExIm co-guarantee).</i>	<i>12 years/LIBOR-based</i>	<i>12/94</i>
<i>Rockfort Private Power, Jamaica (private sector)</i>	<i>\$130m</i>	<i>The World Bank is providing a \$40.5m takeout funding commitment in year 5. Though a Bank guarantee, per se, was not used in this case, future projects of similar structure could utilize Bank guarantees.</i>	<i>N/A</i>	<i>10/94</i>
<i>Leyte-Luzon Geothermal Power, Philippines (public sector)</i>	<i>\$1.3bn</i>	<i>Partial credit coverage of principal through a put option at maturity of US\$100m Eurobond/US144a issue.</i>	<i>15 years/fixed</i>	<i>7/94</i>
<i>Yangzhou Thermal Power, China (public sector)</i>	<i>\$1.1bn</i>	<i>Partial credit, accelerable guarantee covering principal over years 10.5-15 of US\$120m equivalent syndicated loan.</i>	<i>15 years/ • \$ loan: LIBOR-based • Yen loan: LTPR-based</i>	<i>5/94</i>



Mr. Wolfensohn:

- This is a working lunch to brief you on the Guarantees Action Program (GAP) and to get your strategic guidance.
- R. Frank, D. Conrad, Bernard Pasquier (RF's advisor) and I (for Rachel) will be there.
- Richard explicitly asked that this session consist of this discreet group (I asked about inviting others such as I. Shihata) so that e.g. Mr. Conrad could freely express his (quite strong) views on the subject.
- You will have a chance to open this issue up at the June 19 Executive Committee, where guarantees will be on the agenda.
- Tab #3 is an elaboration of Tab #1 (Executive Summary).

© Atsuko 6/4/96

Mr. James D. Wolfensohn

Jim,

Re: Review of Guarantees Program
Guarantees Action Plan (GAP)

We have completed our diagnostic phase of the Bank's Guarantees Program and I would like to share the preliminary findings and recommendations.

The Guarantees Program should not be viewed as just one of several Bank financial instruments or products, but as an integral part of a key, broader strategic issue for the Bank. The universal endorsement of private sector investment as the key to achieve sustainable growth leading to poverty reduction challenges us to clearly define the Bank Group's role within this new paradigm. The Bank's role has been shifting sharply from one of financing state-owned enterprises and projects to helping governments create the policy and regulatory framework to attract private capital. Beyond this role, a priority objective of the group should be to serve as a catalyst for market capital going into private sector projects. Even with the huge and growing private capital flows, the Bank Group is being increasingly called upon to provide a catalytic role – particularly in the private sector infrastructure and nature resources (oil, gas, mining) areas. While private sector firms have identified large scale, commercially viable investments and are being welcomed by host governments, only a small fraction of projects are getting financed because of the sovereign or governmental contractual risks.

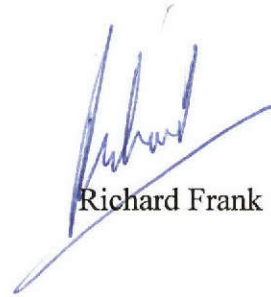
This intersect between the private and public sectors is currently the most acute bottleneck for more private investment and offers the Bank a unique role and opportunity. The Bank's guarantee program – particularly the partial risk product to reduce noncommercial risks on suppliers of long-term debt – can fill a critical niche, particularly for countries beginning the transition from public to private sector-led growth.

Against this promise and need, the results to date are very disappointing. Since being mainstreamed in September 1994, only 4 guarantee transactions have been concluded. Of these, only two were in the critical area of facilitating market finance for private sector projects. (Both involved partial risk guarantees in the same sector and country – investments in power, Pakistan.)

The GAP team and I, with the participation of Don Conrad, have examined the current program and reached general agreement on five major areas of constraints, the problems and solutions. The attached note sets out the summary diagnosis and the preliminary recommended solutions. Some of the recommendations will focus on near-term actions – such as in the area of policies and processing. Others involve medium-term actions, such as revising financial policies. The most fundamental recommendation is to create a new facility that would allow Bank financial capacity to be used off-balance sheet to give the Group the ability to guarantee selected risks without the need for central government counter-guarantees, to permit adequate leveraging, and to open the prospects to use guarantees in IDA countries. Ibrahim Shihata recently proposed this approach and I have established a small Bank Group team to work with him to prepare a concrete proposal by end-June. Since the facility would be created in the form of a Trust Fund with capitalization from Bank income, we should bear this option in mind during the upcoming discussions on the allocation of FY96 net income.

→ Tab #2

The next steps on the Guarantees Action Plan are to present the findings and recommendations for discussion at the Executive Committee on June 19. The GAP submission will be accompanied by an implementation plan that could be pursued if the recommendations are adopted.



Richard Frank

cc: Managing Directors
Mr. I. Shihata
Ms. R. Lomax
Ms. A. Horiguchi
Mr. D. Conrad

Archives -
Guarantee
Meeting
Brief

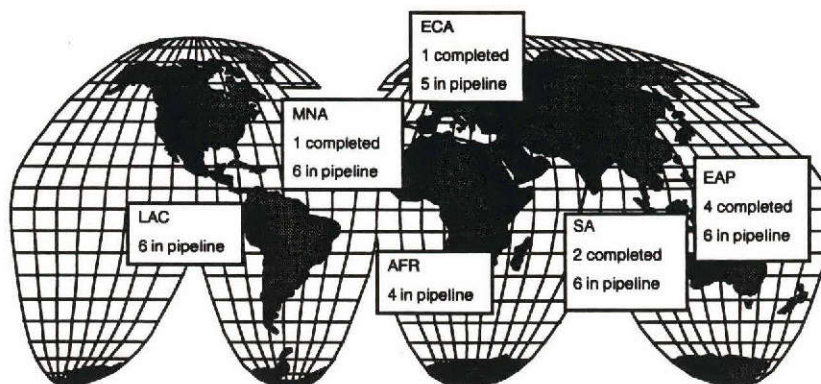
Guarantee Program

	Completed Operations	Pipeline
▲ Projects	8	33
▲ Guaranteed Amount	\$838m	\$3.9b
▲ Project Cost	\$10.9b	\$23.3b
▲ Project Size	\$200m-\$2.9b	\$55m - \$4.0b
▲ Private/Public	2/6	29/4

Sectors: Power, Water, Transport, Oil & Gas Pipelines, Trade

1

Guarantee Operations Regional Breakdown - July 1996



2

Guarantees

▲ Partial Risk

- Covers government contractual obligations (regulation, payment, force majeure, transfer risk)
- For private sector

▲ Partial Credit

- Covers debt service for fixed period (late maturities, take-out, revolving)
- For public or private sector

3

SKILLS REQUIRED

Project
Analysis and
Structuring/
Risk Allocation

Structuring of
Guarantee
Coverage

Market
Financing
Strategy

Negotiation of
Guarantee and
Intercreditor
Agreements

4

Guarantees: Advantages

- ▲ To the Government
 - Mobilizing private investment
 - Sharing risks
- ▲ To the private sector
 - Opening-up markets
 - Backing gov. obligations for long-term debt
- ▲ To the World Bank
 - Catalytic role
 - Leveraging credit
 - Promoting WBG synergy

5

Processing of Guarantees

- ▲ Agreement by Government and World Bank on use of guarantee for project
- ▲ Satisfactory appraisal and financial structuring by sponsors and co-lenders (review by Bank)
- ▲ Completion of negotiations, project and guarantee agreements among Bank, sponsors, Government and lenders
- ▲ Indemnity by Government to World Bank

6

Constraints: Government

- ▲ Private sector participation
- ▲ Project finance complexity
- ▲ Need for credit enhancement
- ▲ Requirement for counter-guarantee
- ▲ Effect on lending program

7

Constraints: Region

- ▲ Linkage to CAS
- ▲ Lending program/incentives
- ▲ Skills for private project finance
- ▲ Resources

8

For Development of Program...

- ▲ CAS - clarity on role of guarantees
- ▲ Lending program (incentives/Bank exposure)
- ▲ Streamlining of processing
- ▲ Authority and budget for central Guarantee unit to manage transactions
- ▲ Regional approval of sector/project/coverage
 - Project teams to include regional expertise
- ▲ Flexibility for structuring; i.e. Enclave Projects
- ▲ Guarantee Trust Fund for new applications

9

Challenges

- ▲ Responsiveness to market
- ▲ Technical Assistance to Government on project finance
- ▲ Development of pipeline (private initiatives and concessions)
- ▲ Effective coordination with Regions, IFC, MIGA
- ▲ Structuring of guarantee instrument for different client credits and market access

10

June 3, 1996

Guarantee Program Background Note

Guarantees are the Bank's newest and potentially most powerful instrument to catalyze market finance for private sector projects. (For consistency with Articles, Bank guarantees are counter-guaranteed by host governments.) The guarantee instrument is an outgrowth of the T. Clausen initiative in the 1980s to promote cofinancing with commercial banks (B-loans). Twenty-four B-loans were approved, five of which involved Bank guarantees. B-loans were replaced by a new guarantee program in 1989 which was strictly limited by country eligibility (middle income, no recent debt restructuring history). Under this program, a number of guarantees were prepared but only one operation was completed.

In September 1994, the Board approved "mainstreaming" guarantees – removing country restrictions and emphasizing a new form – partial risk guarantees.

Guarantee Types

Partial Credit – Coverage of all risks on a portion of debt service to senior lenders – usually the later maturities.

Partial Risk – Coverage of non-commercial risks – especially government performance – on debt servicing to senior lenders.

Guarantees are seen as particularly effective ways to catalyze long-term debt in project or country situations where non-commercial risks loom large, especially for infrastructure projects. Types of coverage most critical – government performance on contractual undertakings and foreign exchange convertibility risks.

Operations

Guarantees Completed (1994/95) - Seven since inception, four since mainstreaming.

Five partial credit guarantees totaling \$570 million for public sector projects with a cost of \$7.3 billion.

Two partial risk guarantees totaling \$315 million for private sector projects with cost of \$2.6 billion.

Medium to High Prospects

Twenty-six projects with a guarantee coverage of over \$2 billion for projects costing in the range of \$12-15 billion. Another two dozen projects are at an early stage of consideration. Over half of the projects in the pipeline would involve IFC and/or MIGA as well as a Bank guarantee.

June 3, 1996

GUARANTEES ACTION PLAN (GAP)Summary Preliminary Findings and Recommendations

IBRD Articles. The need for a counter-guarantee from the government and the one-to-one gearing ratio seriously constrain the program's attractiveness. Some governments are reluctant to provide counter-guarantees because of the possible impact on the country's overall credit-worthiness, the fact that guarantees reduce the country's borrowing capacity with the WB in the same way loans do and, finally, a reluctance to take on liability for the success of private sector projects. When the guarantee coverage is directed at contractual obligations, these are often with state or municipal authorities and a central government counter-guarantee would go against the current trend to decentralize accountability to state and local governments.

→ *The creation of a Guarantee Fund in the form of a trust fund, mentioned at the IBRD net income meeting, would alleviate both constraints and facilitate guarantees in IDA-only countries. Ibrahim Shihata is leading a group on this topic. The definitive proposal would be ready by end-June.*

Mr Shihata's proposal attached.

IBRD Financial Policies. The policies applied to guarantees are restrictive and discriminatory, even within the one-to-one gearing ratio. Financial management can be considered as generally very risk-adverse in the case of guarantees. IBRD current financial policies treat guarantees as loans when calculating a country's total exposure, making no distinctions on the risk profile of a given guarantee transaction. (The probability of call under a partial risk guarantee is always assumed to be 100%). Since partial risk guarantees are strictly limited in the types of coverage provided, a risk weighting of substantially less-than-full coverage assumed in the case of IBRD loans seems in order. Existing policies for IBRD guarantees in IDA countries *de facto* precludes any transaction, even though the objective risk of such transactions may be well below the country's sovereign risk, and IDA countries need credit-enhancement most.

→ *A working group, led by Brian Wilson and assisted by external consultants, is looking at the issue of risk in general and at the framework of guarantees in particular. We are working on some interim measures to increase the attractiveness of guarantees, through a lesser risk weighting, to be revisited once the conclusions of the working group are known. In addition, we are working on a Board paper on the use of IBRD loans and guarantees for enclave projects in IDA countries (you might recall that this paper was promised during the Chad CAS discussion). Another project, Nam Theun power in Laos, raises urgently the "enclave" issue. We are also meeting with the Bank's auditors to assess how to best adapt our financial policies with regard to provisioning policies without endangering our AAA rating.*

Operational Policies. There is still ambivalence in the Bank about the usefulness and purpose of guarantees. This translates into an internal debate on the role of guarantees (do they facilitate transactions or promote regulatory reforms). Task managers complain about the lack of clarity and the vacillation on key policies. While getting regulatory frameworks right is a key objective of the WBG, operational staff ask that guarantee transactions should not become the instruments to achieve sector reforms. Testing each proposal at a central level (Operations Committee) for policy compliance is very cumbersome, given that the private sector sponsors need early indications, in principle, of the Bank's willingness to provide a guarantee.

→ *We would declare that guarantees are not instruments of conditionality for policy and regulatory reforms. With respect to the links between guarantees and the status of reform in specific sectors, the East Asia Region is working on an approach of defining ex-ante which sectors are eligible for guarantee operations for a given country (or for given states within a country) that look very promising and could become the basis for "best practice", and extended Bank-wide. This would imply developing a system of early "green lights" for processing guarantees that would be immensely helpful to guide project developers, financiers, and governments interested in Bank guarantees. Additionally, the CAS framework may provide a good opportunity to identify "open sectors" for guarantee operations.*

Processing and Decision Making. Processing procedures for guarantees are more cumbersome and time-consuming than that for investment loans, with the Bank-wide Operations Committee reviewing and approving each transaction, or the Operations Policy Committee taking up narrow policy issues. The lack of clear responsibility for the guarantee program has led to a lack of ownership at both the staff and management levels. The coordination between the Bank, IFC and MIGA needs to be improved (the Morocco power project and Manila transport are examples of the disruption from lack of coordination). There is, on one hand, a need for giving more decentralized decision-making to the Regions on the Bank side. On the other hand, there is also a need for central guidance with a World Bank Group dimension. Solving these problems is a complex endeavor, not only because guarantees are the only product linking the Bank directly with private sponsors, but also because IFC and MIGA offer similar products to the same customers.

→ *While we have not yet come to closure with a set of final recommendations, we are looking at two measures on processing and decision making: (1) Improve the accountability and incentives within the existing structure. This would amount to decentralize to the Regions the decision making authority regarding guarantees, as in the case of investment loans. Issues requiring Bank senior management guidance or Bank Group synchronization would be referred to a small forum empowered with both operational guidance and policy authority. (2) Adopting a pro-active client approach and better exploit the WBG synergy. This would create a WBG "unit" responsible for marketing "enhancement products", in essence integrating the Guarantee Division in the Bank with IFC's Syndication Division. This would facilitate the marketing of these WBG*

products in a fully coordinated fashion, and make the best use of existing resources and relationships with players in the market.

Staffing and Skills. Private project finance skills are in short supply in the Bank, which has traditionally dealt with the public sector. In the central guarantee transaction division, only 5 of the 15 staff have the training and/or experience to conduct complex project structuring and negotiations with sophisticated sponsors and banks. In the Regions, the number of staff with the background to perform these tasks is also very limited. This will quickly become a major bottleneck once we have solved the problems mentioned above. Our ability to attract staff from outside is also limited given our remuneration package (no bonuses).

→ *Options under consideration include extensive training, transfers from IFC to the guarantee unit, and applying the pay scale currently used in Treasury to facilitate external recruiting.*



Record Removal Notice

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Document Date 15 April, 1996	Document Type Memorandum			
Correspondents / Participants To: James D. Wolfensohn From: Ibrahim F. I. Shihata				
Subject / Title Leveraging a small part of Bank resources to expand Guarantees of Private Loans - A New proposal				
Exception(s) Attorney-Client Privilege				
Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by S. Thompson</td><td>Date February 14, 2025</td></tr></table>	Withdrawn by S. Thompson	Date February 14, 2025
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THE WORLD BANK GROUP GUARANTEES PROGRAM

PRELIMINARY RECOMMENDATIONS

Background.

Private sector led development is seen as the key to economic growth and the alleviation of poverty. Developing countries need to attract scarce private investment in areas like infrastructure and natural resources projects to develop their potential. Private investments in infrastructure have a large development impact. Not only do they improve the supply of one of the key factors supporting economic growth, but they also create fiscal space, thus allowing countries to devote a larger portion of their scarce resources to human capital. In a world where sovereign lending is expected to decline at the expense of non-sovereign lending for the foreseeable future, it is vital for the WBG to be catalytic and leverage private investment. While the WBG's financial role will be to continue providing direct loan and equity finance through IFC and the Bank's intermediary lending operations, its larger role will be as a catalyst for market finance. International private capital flows have outstripped official aid flows, although there is concern that, because those flows remain concentrated on a small number of countries, the Bank Group should play a central role in broadening and increasing private flows to low-to-medium income countries.

The World Bank Group Guarantees Program, launched through the Mainstreaming of Guarantees in 1994, was designed to meet these objectives, leveraging the instruments available under IFC and MIGA. However, the program results have not only been well below internal expectations, but also far below the level that the potential beneficiaries of the guarantee program (private investors and governments) believe is feasible. The global surge in infrastructure demand in emerging economies, requiring over \$165 billion of annual investment, and the prospective large-scale investment in the oil and gas sectors as well as in minerals, points to a large potential demand for WB guarantees as a key catalytic investment.

Main Issues.

A review of the Program reveals that the reasons for its lackluster performance are numerous and complex. They fall basically into five broad categories:

- **IBRD Articles.** The need for a counter-guarantee from the government and the one-to-one gearing ratio seriously constrain the program's attractiveness. Some governments are reluctant to provide counter-guarantees because: (i) of the possible impact on the country's overall credit-worthiness; (ii) guarantees draw down the country's allocation from the WB in the same way loans do and, (iii) finally, a reluctance to take on liability for private sector projects. In addition, when the guarantee coverage is directed at contractual obligations, these are often with state or municipal

authorities, and a central government counter-guarantee would go against the current trend to decentralize accountability to state and municipal governments.

- **IBRD Financial Policies.** These policies are restrictive and discriminatory against guarantees, even within the one-to-one gearing ratio. IBRD current financial policies treat guarantees as loans when calculating a country's total exposure, making no distinctions on the risk profile of a given guarantee transaction. (The probability of call under a partial risk guarantee is always assumed to be 100%.)
- **Operational Policies.** There is still ambivalence in the Bank about the usefulness and purpose of guarantees. This translates into an internal debate on the role of guarantees (do they facilitate transactions or promote regulatory reforms). Task managers complain about the lack of clarity and the vacillation on key policies. While getting regulatory frameworks right is a key objective of the WBG in the CAS, guarantees are not the appropriate instruments to achieve these reforms.
- **Processing and Decision Making.** Processing procedures for guarantees are more cumbersome and time-consuming than that for investment loans, with a Bank-wide Committee reviewing each transaction. The lack of clear responsibility for the guarantees program has led to a lack of ownership at both the staff and management levels. The coordination between the Bank, IFC and MIGA need to be improved (the Morocco power project is a good example). Solving these problems is a complex endeavor, not only because guarantees are the only product linking the Bank directly with private sponsors, but also because IFC and MIGA offer similar products to the same customers.
- **Staffing and Skills.** Private project finance skills are in short supply in the Bank, which has traditionally dealt with the public sector. In the central guarantee transaction division, only 5 of the 15 staff have the training and/or experience to conduct complex project structuring and negotiations with sophisticated sponsors. In the Regions, the number of staff with the background to perform these tasks is also very limited.

IBRD ARTICLES OF AGREEMENT

While changing IBRD Articles of Agreement would permit the restructuring of the Guarantee Program in an effective fashion, it would open a number of issues among shareholders that are unlikely to be resolved in an acceptable time frame. This section reviews the two key structural constraints of the Guarantee Program and examines one option to alleviate these constraints in the framework of the existing Articles.

Counter-guarantee. The need for a counter-guarantee from the government stems from the Bank's Articles of Agreement which prevents the Bank from making or guaranteeing

any loan to an entity other than a member country, unless the country on whose territory the project is located fully guarantees the servicing and repayment of the loan. In accordance with this Article, the WB provides guarantees to private sector investors only if it receives a counter-guarantee from the country where the project is located. This has crucial implications on the speed at which the transactions are processed, and more importantly, on the attractiveness of the program for the governments. Several governments have argued that such a requirement is inconsistent with the basic principle that should guide private investment, a fair sharing of risks and profits and their efforts to reduce their exposure to commercial ventures. Governments have also expressed the concern that the need to provide a counter-guarantee could have an impact on the overall country credit-worthiness. Several governments have been reluctant to approve guarantee transactions, in part because the potential benefits of guarantees in leveraging public resources and developing local capital markets are not well understood.

The requirement for a counter-guarantee is likely to become an increasingly important constraint where the federal or central government role is being reduced in favor of shifting the responsibility and resources to provincial or municipal authorities for such services.

The One-to-one Gearing Ratio. IBRD financial policies are governed by “the one-to-one gearing ratio” under which there must be at least one dollar of statutory capital (paid-in capital, surplus, reserves, and callable capital) underpinning every dollar of disbursed outstanding loans, callable guarantees and loan participations.

From a Government perspective, guarantees are in direct competition with loans for access to World Bank resources because guarantees reduce the country’s borrowing capacity with the World Bank in the same way loans do. From the Bank’s side, guarantees are counted as loans in its lending program to a given country. Both country officials and Bank managers are faced with difficult choices when discussing guarantees in the allocation of scarce Bank resources. The leverage of both the Bank’s and the governments’ resources that the Guarantee Program was designed to achieve has not materialized because of the accounting mechanism for guarantees that flows from the one-to-one gearing ratio. In many respects, the statutory requirements of the IBRD balance sheet is ill-adapted to guarantees. This issue can be addressed in part only by modifying the Bank’s financial policies, as discussed below.

Recommendation. The Bank Group should establish a Guarantee Fund in the form of a trust fund for guarantee operations (similar to the European Investment Fund created by the European Investment Bank to issue guarantees). This proposal would also respond in part to the suggestion of the Bretton Woods Commission that a joint Bank/IFC fund be created to finance private infrastructure projects. The creation of this fund, mentioned at the IBRD net income meeting, would alleviate both constraints. Ibrahim Shihata is leading a group on this topic. The definitive proposal would be ready by end-June. Such a Trust Fund, requiring no amendment of the Articles, could be funded from the net

incomes of IBRD, IDA, IFC and MIGA. It could issue guarantees without requiring counter-guarantees, as appropriate.

Theoretically, the trust fund could be created by the Executive Directors and transfers from net income would be effected by the Board of Governors. The Guarantee Fund would issue guarantees of private loans using a gearing ratio of 5:1. All Bank, IFC, MIGA and IDA member countries would be eligible beneficiaries. A portion of the Bank's and other participating institutions' net income would be transferred each year to the Fund. Bilateral agencies and private sector enterprises could also be invited to participate in the fund. Transfers of the order of \$200 million per year would allow the issuance of guarantees totaling approximately \$5.5 billion over a 5-year period. Through this mechanism, the Bank Group would expand its support of private sector finance in all borrowing countries (including IDA) without increasing its liabilities or amending its charter. A Guarantee Fund of this type could also provide reinsurance to MIGA's political risk guarantees.

These recommendations will deal with the following issues.

- *How are the shareholders likely to react to such a proposal ? How would the decision making process under the trust fund be made consistent with the Bank Country Assistance Strategy in a given country ?*
- *How would the market perceive such a fund ? Would the guarantee fund provide sufficient comfort to private investors seeking protection from possible Government non-performance ? How would this trust fund be differentiated from the IFC B-loan program ? Is there any appetite from the private sector to participate in such a trust fund ?*
- *Can this trust fund be managed by the Bank without incurring the risk of consolidation of the Trust Fund financial statements with those of the Bank ? Would the participation of the private sector create legal issues related to possible conflicts of interest ?*

IBRD FINANCIAL POLICIES

IBRD Financial Policies are restrictive and discriminatory against guarantees, even within the one-to-one gearing ratio. Under guarantees, exposure is represented by the present value of the guaranteed amount from the first callable date. The IBRD treats the probability of call under a guarantee as 100%, making no distinctions on the objective risk profile of a given guarantee transaction or between partial risk and partial credit guarantees. A partial risk guarantee, where IBRD would guarantee (and the Government counter-guarantee) a small fraction of the overall project risks (for example, expropriation and the Government performance under a supply agreement), would result in the same

exposure as a disbursed loan to a public enterprise where completion and commercial risks are being fully assumed by IBRD.

Recommendations. A working group, led by Brian Wilson and assisted by external consultants, is looking at the issue of risk in general and at the framework of guarantees in particular. We are working on some interim measures to increase the attractiveness of guarantees, to be revisited once the conclusions of the working group are known. The final recommendations will deal with the following issues:

- *Counter-guarantees are treated by both the Bank and the IMF as contingent liabilities when calculating a country's external debt. In practice, this means that the counter-guarantee will impact a country's public borrowing capacity only when called, the same way that a loan will impact the borrowing capacity only when disbursed. Is this consistent with the way counter-guarantees are accounted for on IBRD's balance sheet?*
- *Is there any established practice in the financial sector with respect to the accounting of partial risk guarantees against balance sheet exposure ?*
- *Is there any scope for changing the way guarantees are accounted for, in particular with respect to the individual country limits ?*

Guarantees in IDA Countries. While IDA countries represent a large potential market for guarantees, they are not eligible for IBRD guarantees at this time because of credit-worthiness issues. Guarantees are marketed in countries that need credit enhancement least, and which in many cases may resist giving counter-guarantees to the Bank.

The policy states that the Bank should not make new commitments that result in additional exposure (whether loan or guarantee exposure) to a country that it currently regards as not creditworthy for IBRD lending (i.e. IDA-only countries) unless at least one of the following conditions is met: (1) a third party, normally a foreign corporate entity which is judged IBRD creditworthy, provides a counter-guarantee; or (2) a security is established which in effect covers IBRD risk of default by the government in case the government cannot make good on its counter-guarantee.

Our review of IBRD policies with respect to enclave projects in IDA-only countries shows that these policies were designed for IBRD lending (rather than for guarantees). The surge in private capital flows towards developing countries over the last decade has been accompanied by significant developments in the field of project finance and structuring. For example, some projects (based on their security arrangements) are rated more highly by the market than the country, reflected in its sovereign rating, in which they are implemented. Also, the risks taken by IBRD under a partial risk guarantee in a project where a private sector sponsor has invested considerable resources are fundamentally different than the risks under an IBRD loan to a public enterprise. Both

these factors strongly suggest that there is a need to revisit existing policies with respect to IBRD guarantees in IDA-only countries.

Recommendations. We are working on a Board paper on the use of IBRD loans and guarantees for enclave projects in IDA countries (you might recall that this paper was promised during the Chad CAS discussion). We are also meeting with the Bank's auditors to assess how to best adapt our policies without endangering our AAA rating.

The new policies would aim at allowing, on a case-by-case basis, to provide IBRD partial risk guarantees to projects in IDA-only countries, provided that the following conditions are met:

- *The project is consistent with the CAS, and the overall economic performance of the country is satisfactory;*
- *The project is implemented by a private sector sponsor, which is committing at least 25% of the total project costs in equity;*
- *The revenues generated by the project are denominated in foreign exchange, and the security arrangements under the project are satisfactory; and*
- *The amount guaranteed by the Bank do not exceed 20% of total project costs.*

OPERATIONAL POLICIES

There is still ambivalence among Bank management and staff about the usefulness and potential for guarantees. The Mainstreaming of the Bank's Guarantee Program was launched in 1994. Some have argued that this ambivalence is impossible to overcome without major surgery, because it stems from the culture of an institution that for 50 years has dealt exclusively with the public sector and where suspicion with respect to the private sector remains deeply rooted. The WB Guarantee Program suffers from a number of operational difficulties stemming from the way it is managed.

Transaction vis-a-vis Policy Reform. Some staff see using guarantees to advance policy reforms as incompatible with the processing of guarantee transactions. Furthermore, guarantee transactions are driven by private sector sponsors and do not easily fit in the multi-year country program and budgets which are based on a binary relationship between the Bank and the governments. At the same time, the role of guarantees in advancing credibility for policy or regulatory reform is a key objective.

There is still an internal debate on the role of guarantees; do they facilitate transactions or promote sector reforms. Both the external consultants and the internal review concluded that Task Managers face uncertainty in determining the degree of policy reform required to process a particular transaction. Bank staff have differing level of understanding as to

the link between policy reform and guarantee operations, and Bank management has been unsuccessful so far in providing effective guidance. This uncertainty slows down transaction processing and confuses private sector sponsors because issues, including policy issues, are often resolved on a case by case basis.

Clearly, the Bank should only guarantee operations in countries (or regions) where it feels that the policy and regulatory framework are sufficiently advanced, and/or where the commitment of the authorities to maintain or improve the frameworks is adequate. This analysis is central in making the risk of providing a partial risk guarantee acceptable. The Bank should not pursue guarantee transactions where it feels that this risk is too high. However, guarantee transactions are not as well suited as loans to improve regulatory frameworks because of two key differences: first, loans provide leverage with the Governments because the Bank can withhold disbursements if certain agreed actions are not implemented, which is not the case for guarantees which are irrevocable obligations; secondly, while the Bank typically guarantees a small portion of the project financing package, it frequently finances the bulk of the investment in the case of a loan.

One suggestion on how to manage the link between guarantee transactions and reform is to use the Country Assistance Strategy (CAS) to provide the basis for establishing a “green light” for processing guarantees in given sectors where the Government has demonstrated sufficient commitment to policy reform. Once a sector is determined to be eligible (i.e. “open for business”), guarantee transactions could be processed by staff without revisiting the issue of policy reform.

Recommendations. We would declare that guarantees are not instruments of conditionality for policy and regulatory reforms. With respect to the links between guarantees and the status of reform in specific sectors, the East Asia Region is working on an approach of defining ex-ante which sectors are eligible for guarantee operations for a given country (or for given states within a country) that look very promising and could become the basis for “best practice”, and extended Bank-wide. This would imply developing a system of early “green lights” for processing guarantees that would be immensely helpful to guide project developers, financiers, and governments interested in Bank guarantees. Additionally, the CAS framework may provide a good opportunity to identify “open sectors” for guarantee operations.

PROCESSING AND DECISION MAKING

Processing procedures for guarantees are more cumbersome and time-consuming than that for investment loans, with a Bank-wide Committee reviewing each transaction. The lack of clear responsibility for the guarantee program has led to a lack of ownership at both the staff and management levels. The coordination between the Bank, IFC and MIGA need to be improved (the Morocco power project is a good example). There is, on one hand, a need to delegate decision-making to the Regions on the Bank side. On the other hand, there is also a need for central guidance with a World Bank Group dimension. Solving these problems is a complex endeavor, not only because guarantees are the only

product linking the Bank directly with private sponsors, but also because IFC and MIGA offer similar products to the same customers.

Processing Procedures. Internal procedures for processing guarantee transactions are more cumbersome than for loans, with two additional Committees (the Pricing Committee and the Operations Committee) reviewing guarantee transactions.

Internal procedures for processing guarantees reflect the ambivalence of the institution with respect to the guarantee product. The decision-making process for guarantees is not only more complex than for loans, it is also loosely defined, requiring task managers to improvise. This lack of clarity works as a disincentive for staff to process guarantees and is confusing for the clients. The Bank senior management is more involved in the processing of guarantees than in the processing of loans (while loans are approved at the Regional level, the Operations Committee has been reviewing guarantee operations). Some observers have suggested that specific criteria should be agreed upon and communicated to all potential participants, inside and outside the Bank, regarding where, for what purpose, for what types of risks and under what conditions Bank guarantees will be available. Others have suggested that a Guarantee Review Committee should meet early in the process to review a preliminary term sheet and grant an “approval in principle” for guarantee transactions. While central review of policies issues at times may be required, this should be handled by a lighter structure than the Operations Committee. Review and negotiations of country and sector policy issues should be separated from the guarantee transaction by staging them sequentially.

Accountability. Operational responsibility, between the Department in charge of promoting/advising the use of guarantees (CAP) and the Regions which control both the inclusion of guarantees in the Country Assistance Strategy and the resources to process them, is fragmented. There is no single senior executive responsible for the guarantee program or a dedicated allocation of funds for guarantees.

There are basically two lines of thought with respect to the management of the guarantee program. The first argues that the Mainstreaming of Guarantees happened too early. Without clear objectives and specialized staff to process guarantees, the Regions are unable to allocate the resources necessary for the development of the program. The Bank should explicitly recognize that the program is still in transition. It should not try to force private sector guarantee projects to fit closely in the lending programs, but rather establish a more efficient, business-like approach that is responsive to private sector needs, at least until a sufficient volume of deals can be completed. A senior executive should be assigned to spearhead and oversee the implementation of the program. The second school of thought argues that the guarantee program will only succeed if it is fully embedded in the Country Assistance Strategy and managed by the Operational Departments, which are responsible for the relations with member countries. Specialized expertise should, to the extent possible, be decentralized to ensure maximum dissemination of the specialized knowledge in project finance.

Coordination between IFC and MIGA. Guarantees are the only product where the Bank has a direct relationship with the private sector. It is fundamental for the credibility of the Bank Group with the private sector that the Bank's guarantees be marketed in a coordinated fashion with the IFC B-loans and the MIGA insurance, which are often offered to the same private sector companies on the same projects. The pricing of these products should be coordinated on a case-by-case basis.

In some instances, the Bank and IFC have approached project sponsors in an uncoordinated fashion to promote partial risk guarantees, loans and syndication products. This has created confusion both inside the WBG and with project sponsors and governments, and has affected the credibility of the WBG with the financial markets. The pricing of guarantees (between 40 to 100 basis points, with the Bank refunding to the Government the portion of the guarantee fee above 25 basis points) adds to this confusion as private sponsors and governments at time view the IBRD as a relatively inexpensive option. Several observers have pointed out the need to have both IFC and MIGA represented in the Committee reviewing potential guarantee transactions at an early stage in the process, so that pricing policies can be coordinated and rules of engagement agreed upon.

Recommendations. While we have not yet come to closure with a set of final recommendations, we are looking at two measures on processing and decision making: (1) Improve the accountability and incentives within the existing structure. This would amount to decentralize to the Regions the decision making authority regarding guarantees, as in the case of investment loans. Issues requiring Bank senior management guidance or Bank Group synchronization would be referred to a small forum empowered with both operational guidance and policy authority. (2) Adopting a pro-active client approach and better exploit the WBG synergy. This would create a WBG "unit" responsible for marketing "enhancement products", in essence integrating the Guarantee Division in the Bank with IFC's Syndication Division. This would facilitate the marketing of these WBG products in a fully coordinated fashion, and make the best use of existing resources and relationships with players in the market.

SKILLS AND INCENTIVES

Skills and Incentives. There are no incentives for Staff to process guarantee transactions. In addition, neither World Bank staff nor management are well versed in project finance, creating a risk-averseness to a new, complex product. Private project finance skills are in short supply in the Bank, which has traditionally dealt with the public sector.

In the central guarantee transaction division, only 5 of the 15 staff have the training and/or experience to conduct complex project structuring and negotiations with sophisticated sponsors. In the Regions, the number of staff with the background to perform these tasks is also very limited. Task managers have few incentives to process guarantees: they are largely unfamiliar with the intricacies of project finance; they possess no authoritative manual or matrix on how and when to seek guarantees; they are

dealing with Governments which are ill-informed about the benefits of guarantees; they are unfamiliar with dealing with or assessing private sector operatives; and finally, they are not rewarded when trying to overcome the above constraints. Some observers have pointed out that the Guarantee Program should be managed as a transaction oriented unit, staffed by individuals with experience in international project finance and limited recourse lending. These skills are currently very scarce in the Bank and need to be pooled to ensure that a critical mass of specialists can be made available to develop a given transaction. The WB legal department has actually created a specialized unit to deal with guarantees, recognizing that the legal skills required are fundamentally different than those needed for traditional Bank loans. Other observers have argued that the World Bank should “farm out” the Guarantee Program to WBG organizations more familiar with private sector requirements, project finance and credit enhancement techniques such as the IFC and MIGA.

Recommendation. Staffing and skill mix will quickly become a major bottleneck once we have solved the problems linked to incentives and procedures. Our ability to attract staff from outside is also limited given our remuneration package (no bonuses). Options under consideration include extensive training, transfers from IFC to the guarantee unit, and applying the pay scale currently used in Treasury to facilitate external recruiting.

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: May 30, 1996

TO: Distribution

FROM: Philippe Benoit, EXC

EXTENSION: 81779

SUBJECT: GAP: Working Group Suggestions To Improve the IBRD Guarantee Program

Below is a summary of the suggestions received from members of the Working Group to improve the efficacy of the IBRD Guarantee Program:

1. **Clarify the Product:** The Bank should establish clearer and detailed policies for guarantees to enable private sector sponsors, lenders, governments, and Bank staff to better understand the product. Areas for clarity include: (a) the risks that can be covered; (b) the pricing policy; (c) the impact of guarantees on the country's exposure to IBRD and its lending allocation; and (d) the link between policy reform and guarantees.
2. **Streamline Processing:** The Bank should implement streamlined processing procedures that allow the Bank to provide speedy decisions to sponsors regarding the Bank's willingness to participate in a proposed transaction, and speedy guidance to staff and external partners on novel and other issues that arise in the course of preparing projects. This could be implemented by delegating to the regions authority for processing guarantees, and establishing a light central unit to address policy issues and to assure Group coordination.
3. **Increase Flexibility:** The Bank should administer the guarantee in a more flexible manner, to better conform to the requirements of private sector operations, while promoting the interests of member countries. Possible areas for greater flexibility include: (a) the Bank's administration of the policy reform link; and (b) whether the Bank should require an underlying government payment obligation.
4. **Staffing:** The Bank needs to improve the skill level of staff involved in guarantee transactions, which require different skills from traditional Bank work. This includes hiring new specialized staff, redeploying existing staff within the Group and providing specialized training to existing staff.
5. **Marketing:** The Bank Group should undertake a marketing campaign directed at private and public clients to inform them of the structure and advantages of the guarantee product.

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6. **Support to Governments:** The Bank should increase the support it provides to governments to enable them: (a) to establish an appropriate enabling environment and (b) to procure financial, legal and other advisors for particular transactions.
7. **Cost Recovery:** The Bank should implement a program to charge fees to recover its costs in preparing guarantee transactions, including any fees paid to outside counsel and other advisors retained by the Bank.
8. **Group Coordination/Integration:** The Group needs to improve coordination among IBRD, IFC and MIGA in offering their similar products for transactions. The Group should establish an integrated IBRD/IFC/MIGA window, and supporting unit, to coordinate the Group response on these operations.
9. **Alternative Funding Structure:** The Bank should establish a separate trust fund or other vehicle to improve its flexibility in structuring guarantees to meet the needs of the transaction and to reflect the risks presented by the instrument. Areas for flexibility include: (a) more liberal gearing ratio than the 1-to-1 ratio specified in IBRD's Articles; (b) flexibility to forego the sovereign counter-guarantee required by IBRD's Articles; and (c) greater flexibility to employ IBRD guarantees in IDA-only countries. Alternatively, resources could be given to MIGA or IFC to augment their capacity to issue guarantee/insurance coverage.

Mmes./Messrs. Conrad, Frank (EXC); Shilling (OPRDR); Parry (CTFSY); Shapiro, Babbar (CAPPF); Oppen (FPIFP); Ljung (SAIEF); Duvall (LEGCF); Wackman (EMTIE); Roger (PSD); Colaco (EAPVP); West (MIGGU); Pasquier, Varkie (EXC)

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World Bank: Pipeline of Guarantee Operations

1. AFRICA REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPE STAFF
NAMIBIA: Export Processing Zone (NA-PA-43349). GON is sponsoring an EPZ for private sector participation in Walvis Bay and other select locations. The region is in active discussion with the GON on privatization issues in sectors such as toll roads and water.	GON is requesting a Bank Guarantee to support private sector loans to the EPZ.	IEPS, which defines scope of Industrial and Urban Development Project in Walvis, is under way, and the preparatory work on the potential guarantee for desalination project will be handled separately.	TBD	A.Grudzinska/ T.Sugai
SOUTH AFRICA: Maputo Corridor (ZA-TA-45043) (Private Sector). Rehabilitation and expansion of new toll road from South africa to Port of Maputo in Mozambique.	The guarantee option will be provided to the potential bidders.	South Africa will counter guarantee the risks associated with the road in Mozambique, IDA. A presentation on the guarantee will be held for the bidders in mid-May.	FY97	J. Ahmad/ D. Baughman T. Sugai
SOUTH AFRICA: Port Elizabeth Water (ZA-TA-44313) (Public Sector). Port Elizabeth Municipality will construct water and sanitation delivery system and provide the service for the low income community.	Along with recommendations on water sector reform, Bank has been assisting the municipality and the government in tapping the private sector finance with the Bank's partial-credit guarantee for about USS55 million..	While the guarantee instrument was identified as an effective tool, the municipality is in a process of setting up an institutional framework to carry out the project.	FY97	J. Ahmad/ D. Baughman T. Sugai

2. EAST ASIA AND PACIFIC REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
LAO, PDR: Nam Theum Power II (LA-PA-4206) (Private Sector). Construction of a reservoir and dam, three units of generators totaling 618MW and 140km of 230kv transmission line. The project sells power to Thailand's state-owned EGAT. Sponsors are Lao PDR, Transfield Corp., EDF, Italian-Thai Develop Co., Jasmine Int'l Public Co., Phatra Thanakit. The financial advisor is S.G. Warburg. Total cost is US\$1.2 billion.	Lao PDR is an IDA-only country, but since off-taker is Thailand's state-owned EGAT, this project could be structured as an enclave project. Lao PDR's equity investment may be funded by an IBRD loan. Preliminary financing plan calls for US\$194 million commercial loan; IFC 'A' at US\$50 million, IFC 'B' loan up to US\$100 (possibly 50)million, and a Bank guarantee to support commercial loan.	Lao PDR has requested Bank assistance and the Bank has asked the government to carry out studies in the areas of environment and macroeconomic impact of the project. Decision regarding Bank's participation will be taken after review of the results of the studies. Management decision regarding the provision of an IBRD guarantee under an enclave structure is being sought.	FY97	J. Sopher/ S. Babbar
PHILIPPINES: Private Sector Infrastructure Devlpmt. (PH-LL-39070) (Private Sector) (1) A Framework Agreement between GOP and the Bank for use of Bank's partial-risk guarantees to support private investment in infrastructure projects and concessions in power, water, and toll roads; and (2) development of an Infrastructure Fund for debt financing of infrastructure projects.	(1) Bank's partial-risk guarantee on government obligations for priority infrastructure investments, and (2) Bank loan for Government equity participation in Fund.	Roundtable discussions in Dec. 94 and Mar. 95 have been held among GOP, the Bank, commercial banks, sponsors and institutional investors on the most effective vehicles to support infrastructure investment. Identification of key projects is now required for Bank support and the clarification of legal requirements on guarantees for the private sector.	TBD	J. Shivakumar/ A. Mody
PHILIPPINES: Light Rail Transport, #3 (LTR3). (Private Sector). Being developed on a build-lease-transfer approach, with lease payments based on minimum traffic expectations. Project cost: \$750 million.	Bank's partial risk guarantee to back government obligations to the project.	A preappraisal mission in Mar. 96.	FY97	J. Sopher/ A.Mody

3. SOUTH ASIA REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
INDIA: Private Power Dvlpmnt. (IN-PA-10477) (Private Sector). A Framework Agreement between GOI and the Bank for use of Bank's partial-risk guarantees to support private investment in power projects.	Bank's partial-risk guarantee on government obligations in support of power projects in various states.	Guarantee framework for the Power Sector has been endorsed by GOI and has been distributed to potential developers and financial institutions	TBD	J. Chassard F.Manibog/ F. Mazhar
PAKISTAN: Power Transmission Guarantee (PK-EC-44791) for the construction and maintenance of Pakistan's first transmission line on a BOT basis.	Partial-risk guarantee for US\$50 million Standby Facility.	The Bank is currently exploring the possibility of guarantee support for this US\$700 million transmission project sponsored by National Grid of the UK, alongside ADB and ECGD.	FY97	C. Gavino/ F. Mazhar
PAKISTAN: Freight Transport (PK-PA-10518) (Private Sector). A private sector group to establish a freight operating company and obtain access rights to use Pakistan Rail's tracks to transport fuel oil from Karachi to newly constructed private power generation plants. The freight company will transport the fuel under a Fuel Oil Transport Agreement with Pakistan State Oil (PSO). <i>Project size is under consideration and may also include commercial cargo.</i>	Bank will assist the Government in: (i) implementing a private sector freight access policy; (ii) defining the role of Private Power & Infrastructure Board (PPIB); (iii) retain consultants to prepare tender documents, launch a bidding process, evaluate bids, negotiate project agreements, and select the winning consortium; (iv) a partial risk guarantee would be offered in the bidding package on an optional basis.	The PPIB is administering the selection of a project company through competitive bidding. Consultants for PPIB are in the process of being <i>appointed</i> . A better definition of possible risk coverage under the proposed guarantee will be made following the appointment of consultants. Upon clearance of the Operations Committee a Guarantee Term Sheet will be issued to a group of banks bidding for the role of lead debt arranger.	FY97	J. Tillman/ R.Al-Bader
PAKISTAN: Uch Power (PK-EC-40547) (Private Sector). Construction of a 568MW gas-fired power project in Baluchistan, fueled by natural gas from the under-utilized Uch gas field. Main Sponsors are Tenaska(U.S.), Midland Electricity, and General Electric. Total project cost : US\$630 million. Financial Adviser is Citibank.	Bank partial-risk guarantee for US\$75 million of commercial cofinancing. Another 20% of financing will come from equity; 10% from the PSEDF and US\$75 million from IFC B loans and US\$40 million from IFC A loan.	Sponsors have mandated Deutsche and ABN-AMRO as financial arrangers. Project documents have been negotiated with GOP. MOP has been prepared for joint Board. Presentation with IFC on May 14. Debt and Guarantee Agreements are currently being negotiated with lenders and the Indemnity Agreement with GOP. Intercreditor issues have been resolved with US EXIM and commercial lenders.	FY96	P. Ljung/ F. Mazhar R. Wong

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4. EUROPE AND CENTRAL ASIA REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
POLAND: Power Rehab Projects (PL-PA-40816) and (PL-PA-45201) (Public Sector). Rehabilitating and environmental retrofitting of two high-priority power generating plants selected from the recently completed least-cost investment study for the Polish power industry. Total project cost for the two plants: US\$515 million.	Provide IBRD loan and partial-credit guarantee for up to US\$250 million. The balance of funding to come from internal generation and the National Fund.	Implementation plans are being carried out to include development of an environmental assessment and participatory approach from local community. Preliminary market sounding of commercial banks have been made, and there is positive interest from the authorities for the partial-credit guarantee. Detailed financial analysis of the 2 borrowers is also currently being carried out.	FY97	R.Benmessaoud/ R. Wong
RUSSIA: Russian Commercial Guarantee (RCG) (Private Sector) Promote mobilization of private sector working capital for Russian agriculture by guaranteeing commercial companies against specific political risks. The project will be implemented by the Guarantee Administration Unit (GAU) which will be established by the GOR for the purpose of administering the sale of guarantee coverage.	Partial risk guarantee for up to US\$300 million input guarantee against government interference, military action, war and civil disturbance. To facilitate the supply of inputs to Russian farmers, producers and processors in deferred payment terms.	Preappraisal has been completed. Resubmission to OC in April/May 1996.	FY96/97	L. Engstrand/ K. Banerji

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RUSSIA: Petroleum Joint Venture (RU-EC-43435) (Private Sector). Development of the North Priobskoye oil field in Western Siberia including construction of oil wells and associated surface infrastructure. Total cost : US\$3.2 billion, of which US\$2.0 billion would come from project cash flow generation, and remaining US\$1.2 billion to come from Amoco and Yuganskneftegas (YNG), the 2 Sponsors under an unincorporated joint venture.	Bank's partial-risk guarantee and/or loan for up to US\$500 million. The guarantee would cover commercial loans while the Bank loan would fund YNG's equity. IFC is considering A&B loans totaling \$100-150 million. The Russian govt. has agreed to a partial risk guarantee for this project.	Amoco and YNG have jointly mandated Lazard and Morgan Stanley as financial advisers. MOF is considering the proposed Bank guarantee arrangements. The Bank is assisting the financial advisers in preparing a preliminary information memorandum (PIM) for market soundings to test the receptivity of the international commercial banks to extending loans under a Bank guarantee. The IM distribution is delayed because the Production Sharing Law that was passed is inadequate to protect the interests of international oil companies. The Bank and the sponsors have completed a second draft of the preliminary guarantee term sheet. The sponsors are planning initial meetings with the GOR to gauge their support.	FY97	C. McPherson/ E. Wang
RUSSIA/UKRAINE: Sea Launch Project (7E-EC-44233) (Private Sector) A joint venture between Boeing (40%), Energia of Russia (25%), Kvaerner of Norway (20%) and Yuzhnoye of Ukraine (15%) to launch commercial earth communication satellites from a mobile launch platform near the equator in the Pacific Ocean. Russia and Ukraine will jointly produce the rockets.	Provide US\$100 million partial risk guarantee to cover limited political risks associated with the export of rockets from Russia and Ukraine. GOR and GOR will each issue a US\$100 million counter guarantee to backstop the Bank's exposure. EBRD is reviewing the project for possible participation. The Legal Department has certain concerns which are being addressed.	IM submitted to Operations Committee which met on Mar. 6. Pre-appraisal mission to Russia and Ukraine in Feb. 96. Russian and Ukraine officials supportive of the project. The Russian MOF is said to have hired an American international Law firm to assist them in negotiation. Appraisal missions to Ukraine and Russia will probably be in late May. Anticipated Board date in third quarter 96.	FY97	O. Ruhl A. Watkins/ E. Wang A. Mody
UKRAINE: Pre-Export Guarantee Facility (UA-PA-9113) (Private Sector) Establishment of a Guarantee Administration Unit to sell insurance against government performance risks to private entities serving Ukrainian agricultural enterprises.	Partial risk guarantee for up to US\$170 million to back government performance risks to facilitate commercial financing for private entities.	Appraisal is completed. Targeted Board date June 1996.	FY96	M. Lundell & A. Watkins/ K. Banerji

5. LATIN AMERICA & THE CARIBBEAN REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
ARGENTINA: Water Supply & Distribution System (AR-PA-6046) (Private Sector). The GOA is planning to invite private participation in its provincial water supply and distribution systems. The Govt. is seeking technical assistance for this deregulation process. The objective is to put in place a guarantee frame work consistent with its policy objectives leading possibly to one or more guarantee operations.	Bank's partial-risk guarantee to back govt.'s contractual and regulatory obligations.	Govt. to confirm specific identified projects for guarantee operations.	FY97	Y. Katakura/ A. Mody A. Joshi-Ghani
BRAZIL: Gas Sector Development (BR-PA-6549) (Private Sector) Project scope is yet to be finalized but is expected to consist of developing the gas field in Bolivia, constructing the pipeline from Santa Cruz to Sao Paulo, establishing a distribution network, and building a power plant. Total cost is about US\$4 billion. Developing this project is a joint venture consisting of ENRON in consortium with YPFB (& Morgan Grenfell as financial adviser) on the Bolivian side, and Petrobras in consortium with Tenneco, British Gas, & BHP Petroleum (& First Boston as financial adviser) on the Brazilian side.	Bank's partial-risk guarantee to back Petrobras & Brazilian government contractual obligations.	Preliminary discussion was held with Petrobras in Feb. 95. Joint meeting between LAI&3 was held and identified a guarantee operation for the project under a package project structure between Brazil and Bolivia. The governments have not requested assistance from the Bank. Mar. 96, ENRON has hired its own financial advisers to pursue private financing supported by guarantee.	FY97	N. De Franco/ S.Babbar E.Wang

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COLOMBIA: Tobla Grande-Puerto Salgar Tollroad (CO-PA-39082) (Private Sector). Private sponsors will be selected through a competitive bidding process. Total project cost: US\$180 million.	A possible guarantee to support private sector financing of US\$70 million. The guarantee could be structured either: (i) as a "roll-over" guarantee for medium-term (5-8 years) financing mobilized by the investors in the domestic and international markets; or (ii) a Partial Risk cover for specific government obligations to mobilize foreign financing. The guarantee option will be provided in the bidding documents.	Agreement reached with Government (MOF and MOPW) on the use of Bank's guarantee. The Government has selected advisors to begin pre-qualification of targeted sponsors.	FY97	J. Irigoyen/ S. Babbar
MEXICO: Natural Gas and Power (MX-PA-34160) (Private Sector). The GOM is undertaking deregulation of transport, storage, and distribution of natural gas. The Govt. is seeking technical assistance for this deregulation process. The objective is to put in place a guarantee framework consistent with its policy objectives, leading possibly to one or more guarantee operations.	Bank's partial-risk guarantee to back government contractual and regulatory obligations <i>is being considered</i> .	Govt. to confirm specific identified projects for guarantee operations.	FY97	J. Halpern/ A. Mody P. Vieillescazes
PANAMA: Infrastructure Guarantee - Thermal Power (PA-PA-45354) (Private Sector). Development of country's first private power project to be bid competitively.	Partial risk guarantee by Bank and IDB to support access to commercial lenders. Assistance in the bidding preparation process with an offer of partial guarantee as an option.	Government will decide how the guarantee should be incorporated into the final bidding documents.	FY98	J. Halpern/ S. Babbar T. Sugai
PERU: Power Generation Market Expansion (PE-PA-8042) (Private Sector) 300MW private power project to be bid competitively. Bank and IDB to offer partial risk guarantees to potential sponsors.	Partial risk guarantees to facilitate access to commercial financing. Assistance in defining framework for infrastructure financing.	Detailed definition of project's commercial structure underway; received (Jan. 96) Government request for guarantee.	FY97	E. Zolezzi/ S. Babbar D. Baughman

6. MIDDLE EAST & NORTH AFRICA REGION

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
LEBANON: A wali-Beirut Water Conveyor (LB-LL-41114) (Private Sector). Construction of a water conveyor to tunnel water from Juan, with a treatment plant at Khalde, to supply water to Beirut. Total cost is estimated at US\$150 million. The project is structured on a BOT basis with private sponsors. Regional Water Authority will be the off-taker.	Partial risk guarantee of at least US\$50 million to mobilize commercial bank financing. Guarantee would cover sovereign contractual obligations.	CDR is in the process of appointing consultants for preparation of RFP who are expected to be on board by May 96. Appointment of consultants underway. IEPS meeting held on April 10, 1996. Letter requesting guarantee from GOL not yet received.	FY97	J. Saghir/ A. Joshi-Ghani
LEBANON: Power Sector Restructuring and Transmission (LB-PA-36087) (Private Sector) (a) Investment component covering the transmission expansion program, including transmission lines, underground cable and substations; (b) institutional development as defined in LSDP. Total project cost: US\$542 million.	Bank loan and partial-credit guarantee totaling US\$150 million. The guarantee would be for a bond issue or a syndicated commercial loan issued by GOL for the state-owned power utility.	Decision was taken at FEPS meeting not to proceed with the guarantee at present	FY97	R. Skelton/ A. Joshi-Ghani R. Wong

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MOROCCO: Jorf-Lasfar Power (Tranches 3 & 4) (MA-PA-xxxx) (Private Sector). Construction on a BOT basis of 2 x 330MW coal fired power generation plants (adding to the existing installed 660MW plants). Sponsors, ABB and CMS Energy were selected through an competitive process. A well negotiated tariff curve should yield substantial benefits for the Moroccan economy and consumers (an indicative retail tariff of 5¢/kwh is mentioned). Jorf Lasfar is the first IPP ever in Morocco. Total project cost: \$1.33 billion (including lease back of existing installed capacity).	The Jorf Lasfar project is not yet part of the Bank's lending program for Morocco. However, MNI is in the opinion that there is a case for bank guarantee support, in view of: (i) the risks associated with the novel structure of the project, (ii) of the untested framework for IPP operations in Morocco, (iii) of the Moroccan country risk perception in the international financial markets and (iv) of the Bank's interest in the successful completion of the project from its involvement as a downstream transmission project with ONE. The Bank guarantee, if any, would be on a "stand-alone" basis, i.e. not associated to any direct Bank loan.	On a total debt financing requirement of US\$880 million, the project sponsors have requested financing proposals for a US\$200 million LT commercial bank loan from international banks in the US and Europe. Simultaneously, consistent with the private sector support policy of the Bank Group, GOM is seeking an offer from IFC for debt financing support of the above US\$200 million, both on its own account (A-Loan) and from commercial sources (B-Loan syndication umbrella). The Bank guarantee will only be requested to fill the financing gap of the project beyond what IFC is able to mobilize (amounts and terms), depending on commercial lenders' ability to absorb Morocco's governmental performance failure and transfer risks.	FY97	J. Larrieu/ P. Vieillescazes A. Joshi-Ghani
MOROCCO: Industrial Infrastructure (MA-PA-40893) (Private Sector). Development of a concession basis [BOT or BOO] or four export-oriented industrial parks. Total estimated project cost: US\$130 million.	Partial-risk guarantee of up to US\$50 million to support commercial bank financing.	The MOI has addressed a letter requesting guarantee support from the Bank. The MOF is currently reviewing the feasibility of a counter-indemnity. Preselection of consultants to the GOM completed.	FY97	H. Alavi/ P. Vieillescazes
MOROCCO : Natural Gas Network Development (MA-PA-5509) (Private Sector). Construction (on a BOT or BOO basis) of a 240km gas pipeline between the GME pipeline and Mohamedia. Prequalified Sponsors to be selected competitively. Total estimated project cost: US\$180 million.	A partial-risk guarantee of up to US\$50 million to support commercial financing and to back off-taker (ONE) obligations. IFC may also participate both as investor and lender. EIB and ECAs may also cofinance the project.	The MOEM has expressed a strong interest in discussing further the BOT/BOO concept associated with an IFC participation and using a partial risk guarantee for the commercial bank loan portion of the financing. A revised IEPS incorporating the use of a Bank partial risk guarantee has been approved. The govt. is preparing bids for the selection of financial advisors.	FY97	A. Ferroukhi/ P. Vieillescazes A. Joshi-Ghani

7. CFSPF PROJECTS ON HOLD

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPS STAFF
DOMINICAN REPUBLIC: 250MW Private Power (DO-PA-7011) (Private Sector). Total cost : US\$300 million. Govt. to issue bidding document to attract qualified power investors to finance, build, own and operate 250 MW plant.	Bank is providing a partial-risk guarantee of US\$60 million to assist bidders in raising the long-term debt required by the project. IDB is proposing a parallel guarantee of US\$75 million. Bank is also providing a US\$30 million loan for technical assistance and transmission investments. IFC and MIGA may participate with any potential bidder by offering financial support/insurance or advisory services.	Project processing (loan and guarantee) put on hold pending elections and government commitment to sector reform.	TBD	M. Osorio/ D. Baughman
MEXICO: Integrated Hazardous Waste Management (MX-PA-7730) (Private Sector) Contractual government compliance guarantees to be issued in favor of long-term lenders to privately-sponsored hazardous waste management (collection, disposal, storage) projects. Total project costs: \$380 million (including a Bank guarantee of \$100 million).	Bank's partial-risk guarantee to back government contractual and regulatory obligations.	Project on hold.	FY97	P. Vieillescazes

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8. CFSPP COMPLETED PROJECTS

PROJECT	BANK/IDA SUPPORT	CURRENT STATUS/ISSUES	BOARD DATE	TASK MANAGER/ CAPPF STAFF
CHINA: Yangzhou Thermal Power (CN-PA-3641) (Public Sector). Construction of a coal-fired thermal power plant with 2X600MW generating units and erection of two 500KV transmission lines. Total project cost: US\$1.1 billion.	A Bank loan of US\$350 million as well as a partial-credit guarantee on later maturities(years 10.5 to 15) to support a US\$120 million (USD and Japanese yen) equivalent 15 year commercial bank and an insurance company amortizing loans. This is the first World Bank project in China supported by a Bank guarantee.	Guaranteed loans signed in May 94. Lead managers for the USD tranche were Bank of Tokyo, Dresdner, and J.P.Morgan. Nippon Life was lead for the Yen tranche.	Approved March 94	V. Mastilovic/ K. Shimazaki T. Matsukawa
CHINA: Zhejiang Power Developmt. (CN-PA-3642) (Public Sector). Three 600MW coal-fired units; the addition of 400km of 500kv transmission lines and substations; and reinforcement of urban distribution networks. Total project cost : US\$1.8 billion.	A Bank loan of US\$400 million and a partial-credit guarantee on later maturities (years 11 to 15) to support a US\$150 million equivalent (USD and Japanese yen) 15 year commercial bank and insurance company amortizing loans.	Signed Mar 95. Lead managers for the USD tranche were BOA, Fuji, Daiwa, Norinchukin and Korea First. Yasuda F&M was lead for the Yen tranche.	Approved Feb 95	B. Trembath/ T. Matsukawa K. Shimazaki
CHINA: Ertan Hydroelectric II (CN-PA-3507) (Public Sector). Second phase of the construction of a 240 meter high dam and underground powerhouse complex with an installed capacity of 3,300 MW in Sichuan province. Total project cost : US\$2.9 billion.	A Bank loan of US\$400 million. Bank partial-credit guarantee (years 12 to 15) for 15 year commercial bank cofinancing of US\$150 million equivalent (two tranches of USD/DM).	Signed Sep. 95. Lead managers for both tranches were 12 Japanese banks, BOA and KDB.	Approved August 95	N. Berrah/ T. Matsukawa K. Shimazaki
JAMAICA: Rockfort 60 MW Private Power (JM-PA-7476) (Private Sector). A BOO structure with the project company entering into PPA with the utility and an implementation agreement with the govt., which is backing the performance of the utility. Total project cost : US\$130 million (debt of US\$91 million, and equity of US\$39 million). Sponsors are 3 U.S. firms : a Niagara-Mohawk Electric subsidiary, US Energy Corp. and International Energy Finance.	Bank is providing a take-out funding commitment, backing a five year commercial bank guarantee of low cost bond funding available through Puerto Rico. These funds carry below LIBOR interest rates given their U.S. tax-advantaged status. IDB is sharing the take-out financing with the Bank, on the same terms. MIGA is providing political risk insurance to the sponsors.	Financial closure in Oct. 94, and construction has begun. Commercial operation is scheduled for 96.	Approved Aug. 94 (Original Board Jul. 92)	S. Babbar D. Baughman

JORDAN: Telecommunication (JO-PA-5322) (Public Sector). Expansion of the infrastructure relating to telephone services (i.e. adding new switching equipment, associated power, transmission links, etc.) Total project cost of US\$228 million.	Bank loan of US\$20 million. In addition, partial-credit guarantee in support of a US\$50 million 7 year bond issue including an equity feature.	The bond issue was successfully launched on Sep. 12, 95 and reached financial closure on Sep. 27, 95. Lead underwriters were Paribas Capital Markets and ANZ Grindlays Bank.	May 94 Approved	M. Mustafa/ F. Mazhar
PAKISTAN: Hub Power (PK-EC-10451) (Private Sector). Construction of oil-fired steam power station of 1,292MW (4 X 323MW) as the first private sector BOO power project in the country. Sponsors are Xenel, National Power, IHI, Mitsui & Co, K&M. Total project cost : US\$1.8 billion. Lead Banks are City Bank, Bank of Tokyo, Sakura Bank and Credit Lyonnais.	Bank loan of US\$146 million through the Private Sector Energy Dev. Fund, (cofinanced by USAID, NIB, France, Italy, Japan, and UK);. and Bank partial-risk guarantee to support US\$240 million commercial loan, in parallel with JEXIM-guaranteed commercial loan of US\$120 million.	Financial closure in Jan. 95.	Approved Nov. 94. (Original Board Oct. 91)	P. Ljung/ S. Babbar
PHILIPPINES: Leyte-Luzon Geothermal Power (PH-PA-4607) (Public Sector). Expansion of geothermal field; construction of a 440MW generator and transmission lines. Sponsored by NPC. Total cost : US\$1.3 billion.	Bank loan of US\$217 million. In addition, Bank issued a Put Option at par at maturity to enhance investment of a US\$100 million 15 year bond issue. Other cofinancing from JEXIM and Swedish Board for Investment & Technical Support.	Financial closure achieved in June 94. Underwriter was Morgan Stanley.	Approved Apr 94	F. Mazhar R.Al-Bader

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April 17, 1996

Mr. James D. Wolfensohn
President
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COPY

Dear Jim:

It has been several months since we last met, and I thought I would take the occasion to comment upon a subject which I suspect is still dear, and probably painful, to your heart -- the lack of strength and continuity of a "guarantee" initiative. Perhaps, Jim, the reason why it does not work, after so many intelligent and well-meaning people both inside and outside the Bank have worked on it for over 20 years, is because: (a) it is not a good idea; (b) it is a good idea, but is unworkable given the legal/prudential constraints under which the Bank group operates; (c) the staff has insufficient expertise in project finance; (d) it is not necessary. Or, all of the above plus some others.

I am not about to write you a long memorandum about this subject. Let me simply make the point that a guarantee initiative, in all of its iterations, was supported inside the Bank group for one of four reasons: there was a constraint of Bank callable capital; or it was thought of as a way to reduce the Bank's concentration or risk exposure in a given country; or it was an effective vehicle to "leverage" the Bank without having to borrow a lot of money; or IFC was looking for a way to leverage its lending and investments given the constraints in its Articles. These were the "insider" reasons for considering guarantees. To the extent that these are not now believed to be real problems, the impetus and motivation for a guarantee initiative dissipates.

The impetus for a guarantee initiative from the perspective of commercial banks and the private corporate sector, however, was, and is, quite different from the foregoing and is based on quite different motivations and incentives. For the purposes of this note, however, it is not necessary to describe them. You know them all too well.

Why do I write to you? Simply to suggest that the question "why do guarantees not work" may not be the right question. Instead, I suggest we might ask, "what is the pressing problem we now are trying to solve through a guarantee program" or, "what is it we are trying to achieve, and why." I think the answer is "leverage," both in its financial and comfort level aspects.

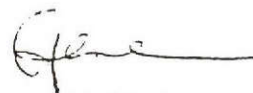
Mr. James D. Wolfensohn
April 17, 1996
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I will get to the bottom line quickly and directly, Jim. I do not believe you will be able to get a significant guarantee program off the ground, with all its excellent advantages of leverage, prudence and comfort, unless you seriously consider forming a separate institution -- an affiliate of the World Bank (a World Bank bank) -- which is financed in the inter-bank depositary markets (its capital could come from a World Bank investment) where deposits are not backed by the World Bank's callable capital and which can lend, invest and guarantee with the liquidity backing of a lender of last resort from a central bank or banks just like any other commercial bank. It is simply inappropriate to issue World Bank guarantees, carried on its balance sheet, which are financed in the bond markets and, worse, are backed on a non-leveraged, one-to-one basis by scarce government callable capital. Very inefficient and a waste of callable capital which counts against the lending program and for which a staff trained mainly in development economics gets no credit. I am convinced that setting up and staffing an affiliate will jump-start a guarantee program, effectively integrate the operations of IFC and the World Bank, motivate the staff, and, perhaps most important, create a banking structure which will not constantly be at odds with the "culture" of the Bank.

A word about culture. The so-called culture of the Bank did not develop in a vacuum. Rather it reflects the constraints, legal and prudential, of the World Bank group. These constraints are far more invasive and deep rooted than those of any other development bank, and while the staff may not be able to articulate it readily, their response, subliminal or otherwise, reflects those constraints. It is not irrational or mean-spirited, nor as some have suggested, is it based on parochial "turf" protection considerations. My instinct is that you should not, and indeed, probably cannot, change that culture. Indeed, trying to change that culture without fully understanding exactly how and why it has developed and its positive aspects has caused a lot of heartache to previous Presidents. You can, however, modify the legal structure of the Bank group so as to free up a highly motivated, dedicated and very smart staff to use their wisdom and skills to best advantage. If you and your colleagues might give some thought to the creation of an entity of the sort I have suggested, I suspect you will find a whole new world opening up in terms of people's motivations and incentives.

Please excuse the directness of the letter, Jim. Let's talk if you would like.

Kindest regards,



Eugene H. Rotberg