DFIS AS FRONTIER OF THE FUTURE

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1. Future Of DFIs

A healthy, robust, and growing presence of the DFIs is essential for continued future sustainable development in a large part of the world.

- Global Development Banking essentially began with the creation of IBRD at Bretton Woods. They have had many successes, including the reconstruction of post war Europe and Japan, and many countries as they gained independence from colonialism, and recovered from regional conflicts.

- Thus post conflict reconstruction, and post colonial development became the genesis of Development Banking; and MDBs have since become a major GoTo Institutional Solution for Development and growth for countries climbing the development ladder.
• The Global Goals of Ending Extreme Poverty and Promoting Shared Prosperity are still unfinished — reducing the share of the global population living in extreme poverty to 3 percent by 2030, and increasing the income of the bottom 40% of the global population;
  ▶ for the first time in history this number dropped below 10% in 2016; **but**
  ▶ Hundreds still live on less than $1.90 per day;

• Achievement of Key development objectives penetration worldwide still has a long way to go—of Economic stability and growth, quality infrastructure, health, education, broad income/social equality and justice; e.g. 400m people have no access to primary health care.

• The MDBs along with the national DFIs are therefore the lifeblood of the global development architecture. They are the lead global development champions, coordinators and organizers. Therefore the role and future relevance of DFIs cannot be understated or underestimated in view of the unfinished agenda.
2. Key Attributes of Multilateral and National DFIs

Multilateral Development Banks—Important value generators

- **Unique Business Model**—Unique way to be able to raise wholesale long-term funds in a multiple of currencies at a very competitive AAA prices.

- **Creditworthiness Transfer**—Transferring the value of AAA creditworthiness and the price advantage to borrowing nations or institutions.

- **Institutional Capacity**—Large footprint, globally, regionally and Nationally.

- **Track Record**—IBRD 72 years, Asian Development Bank, —50 years, African Dev Bank 53 years, Inter American Dev Bank 58 years.
2. Key Attributes (Contd.)

• **Large Outstanding Stock**, of loans, guarantees, and specific purpose funds. More than half a trillion or more.

• **Convening Capacity** —Build Political consensus, advise on economic policy, Mobilizing financial resources, Setting International Standards/practices/ targets.

• **Knowledge Centers**. MDBs over a period of time become repositories of global sector technical knowledge and have the ability to geographically transfer and disseminate knowledge.
2. Key Attributes of Multilateral and National DFIs

National Development Banks—Development Multipliers.

- **Development Funding and Knowledge Cascade Effect.**
  Approximately 10 MDBs coordinate with around 58 NDBs and 84 Berne Union member Exim institutions in a vast network;

- **Financial Leverage.**
  MDB financing can be leveraged through NDBs to generate a bigger pool of development resources thus leading to a multiplier effect.

- **Deeper local Long term finance Markets.**
  By focusing on medium to long term finance, NDBs facilitate deeper and broader financial markets;
2. Key Attributes of Multilateral and National DFIs

- **Private Sector Participation.** NDBs can bring in local private sector players in both upstream capital and financing, as well as downstream subsidiary financing;

- **Local Knowledge.** NDBs have local sector and business practice knowledge;

- **Implementation capacity.** Existing local implementation capacity can be leveraged to handle a larger portfolio in the shortest cycle time;

- **Local Skill Development.** NDBs as they grow and successfully implement development program generate a pool of skilled development banking professionals.
3. Challenges and Constraints – Global And National Level DFIs

- **DFI Fatigue**—Has Development Banking hit a wall—DFI fatigue both at the contributor level and the beneficiary level?

- **Capital Shortfall**. Increasing DFI portfolio needs increasing Capital—but Capital is in short supply—choices need to be made—
  - geographical focus adjustment;
  - Sector focus adjustment;

- **Shareholder Preferences**—To be balanced with the beneficiary preferences;

- **Governance/Corruption Challenge Remains**

- **Implementation Efficiency** Continues to be a drag

- **Performance Assessment**—Input, Output, Outcome
4. Key Takeaways—MDBs--

What to do Better or Focus more?

A. Counterpart Assessment

- Macroeconomic Stability Essential—Interest rate, exchange rate and inflation stability is key for a healthy development banking environment;

- Political/Counterpart Stability a pre-requisite – In the absence of a stable counterpart, transaction agreements become a question mark;

- Counterpart Exchange Rate risk management Assessment critical — In MDB financing for national operations, exchange rate risk is a major unknown, and counterpart exchange risk management capacity through export incomes or other hedging options must be assessed;

- High Governance Standards and Low corruption culture to be the key focus in building counterpart programs;
4. Key Takeaways—MDBs (Contd.)

B. Implementation Capacity Assessment

- Quality of Implementation Agency key determinant of success — Financial Strength, Track Record in successful Implementation, experienced management;

- Ownership and management flexibility required;

- Private sector co financing or participation in implementation to be actively pursued--Private Sector Lead Role in Participation to be emphasized

- Continuity of Loan Origination and implementation at MDBs to be ensured.—Staff Continuity through the project cycle is important for successful project implementation.
4. Key Takeaways—MDBs (Contd.)

C. Products and Services

• **Financial Intermediary Operations** to be encouraged to achieve deeper and wider penetration, with wider client outreach, private sector participation, and geographical coverage, e.g., exports, SMEs, agriculture, renewable energy, energy efficiency, municipal finance;

• **Creation of Centers of Excellence in Counterpart countries** in the fields of education, science, technology, research;

• **Financing for Investment in Services projects** to be explored including consulting, research labs, IT; Digital Payment systems, phone banking;

• **Innovation financing like venture capital, early stage financing** to be developed. Intellectual Capital to be valued as equity in innovative projects
5. Some Recommendations for National DBs/DFIs

A. Type of DB/DFI- Preferred Characteristics

• A DB should preferably be created with a special law (or a special section of existing law) as a non-deposit taking banking institution.
  
  o Under the law, the DB should be subject to prudential banking regulations like capital adequacy ratio, foreign currency exposure, related party lending, single/large borrower exposure limits, as applicable to a non-deposit taking bank;

  o The DB should be based on modern professional governance principles, in the appointment of Board Members and the management team through professional qualification, experience and independence criteria, modern accounting (IFRS) and auditing guidelines, risk management practices and public disclosure, accountability and transparency policies.
5. Some Recommendations for National DBs/DFIs

- The DB should be supervised by the banking supervisor as per DB law;

- The DB should be capitalized primarily by cash (more than 50%), with the rest in marketable Government bonds. Private shareholders should be welcome on basis of the DB mandate;

- The DB should hire professionally qualified and experienced staff, provide them market competitive salaries and benefits, and appropriate incentives for excellent performance;

- The DB should be prohibited from lending to SOEs, and from government directed lending to specific enterprises;

- The DB should be prohibited from lending below their cost of funds. Any government directed subsidized lending for development purposes, the budget should directly up front compensate DB;
5. Recommendations for National DBs/DFIs

B. Products and Services

- The DB should mobilize and provide competitive priced loans primarily on a wholesale basis through a financial intermediation window to banks, leasing/factoring cos, rural cooperatives and other MFIs to on lend affordable medium to long term credit to private enterprises;

- Direct lending should be provided only in the case of significantly larger projects requiring project finance solutions.

- Credit risk sharing products and collateral enhancement programs should be offered on a wholesale basis to retail banks to enhance the bankability of micro and startups;

- Similarly early stage financing/venture capital for technology or innovative startups should be provided using an innovation financing window.
5. Recommendations for National DBs/DFIs

- The DB should also provide specialized services where feasible:
  - Create one stop shop to provide lender and funding choices for SMEs: MSMEs should have a “one stop shop” to find out about all their borrowing options, choice of funding providers, and no available “arrangers or brokers” to find best options to facilitate this process.
  
  - Have a Technical Advisory window to assist MSMEs and entrepreneurs to prepare bankable credit application packages
  
  - Facilitate creation of a Credit information Database for MSMEs: Credit history of new MSME borrowers should be freely available, as their financing is not always through the formal commercial banks, thus restricting their access to sufficient loans.
6. Key Advantages of National DBs/DFIs

What do we gain by having DBs?

• A national DB using a banking model can leverage its capital to mobilize long term funding from other banks or multilateral institutions (as compared to development funds limited to their capital contributions). Thus a DB can have a bigger development footprint.

• It facilitates medium and long term resource mobilization from the market as well as directly from IFIs and bilateral sources

• In wholesale/special products lending it is operationally much more efficient for a “Bank” to deal with other retail banks or NBFIs in the system, establish credibility and banking relationships, and launch banking products.
6. Key Advantages of National DBs/DFIs

- It enables operation of a professional institution with full independent corporate governance including accounting, auditing and risk management practices, and transparency and disclosure rules, and thus reduces the likelihood of ongoing political interference.

- It enables recruitment and professional career development of banking professionals as development bankers with both professional banking skills and development banking insights and visions.

- It enables payment of professional salaries and requisite incentives to staff, and enhances quality and productivity of a dedicated institution.

- It builds confidence among the economic stakeholders that there is a capable institutional ally in assisting in the access to finance solutions.