

GLOBAL INFRASTRUCTURE FACILITY

FIFTH ADVISORY COUNCIL MEETING, WASHINGTON D.C., APRIL 20, 2017

Summary of Proceedings

The Fifth Advisory Council (AC) Meeting of the Global Infrastructure Facility (GIF) was held in Washington, DC, on April 20, 2017. It was attended by representatives of 35 Advisory Partners (APs), nine Technical Partners, five Funding Partners and three Beneficiary Partners, in addition to a number of observers and speakers. **Joaquim Levy, Managing Director and World Bank Group Chief Financial Officer**, co-chaired the meeting with **Julie Monaco, Citibank, Managing Director and Global Head of Public Sector Coverage**. The meeting featured updates on ongoing activities and initiatives, a panel discussion on Construction Risk, and country presentations by three Latin American countries. The meeting was followed by three breakout sessions on a variety of topics.

Opening Remarks

In his opening remarks Mr. Levy welcomed all participants, including representatives from BNP Paribas, FDN, MetLife, and Santander, the GIF's newest APs, and representatives of India, Jordan and the Philippines who recently began a one-year rotation as Beneficiary Partners to the GIF. He expressed appreciation for the guidance received from APs on the development of GIF initiatives. He updated AC participants on the World Bank's new approach that addresses capital constraints by giving initial consideration to private financing sources before pursuing public financing options. He referred to ongoing work to estimate the size of the overall infrastructure pipeline and acknowledged both the size and diversity of the GIF's growing portfolio.

Ms. Monaco, in her opening remarks, welcomed the positive engagement of the AC members in developing the GIF's activities, noting that they all shared a common interest in getting infrastructure financed in the capital markets at lower cost, thus making it scalable and replicable. She pointed out that public-private collaboration could create innovative solutions that could ease constraints and attract new institutional investors to emerging economies. She highlighted, as an example, Citi's role in the issuance of the largest Latin American infrastructure bond for the new Mexico City airport, and the need to address exchange risk and construction risk to unlock private capital to make it scalable.

A. GIF Updates and WBG updates

Jason Lu, Acting Head of the GIF, gave a brief update on the GIF's operations and project portfolio and pipeline. He also discussed progress to date on the proposed GIF *Downstream Financing Window* and *Project Assessment Tool* since the last AC meeting. **Michael Bennett, Lead Financial Officer of the World Bank Treasury**, together with **Robert Cessine of Morningstar**, presented an update on the *Infrastructure Debt Index*, while **Marcelo Giugale, Director, World Bank Treasury**, discussed progress on the *Asset Recycling initiative*.

Mr. Lu noted that the GIF's portfolio had grown significantly in recent months and that, as of April 2017, the GIF had approved 20 projects across the world, a large proportion of which were concentrated in the Energy and Transport sectors. Mr. Lu also reported that the GIF had another 8 projects in its active pipeline and about 45 leads across more than 30 countries in diverse sectors. He pointed out that the GIF was bringing multilateral development banks together to provide coordinated and systematic support to client governments, not only on project-specific issues, but also on sectoral issues which the private sector often

had difficulty in addressing. Mr. Lu pointed out that the design for the GIF's proposed *Downstream Financing Window* had been further modified, taking into account the APs' valuable feedback at last October's AC meeting. A new instrument, the Foreign Exchange Liquidity Facility, was added to the initial offering to address the currency mismatch constraint. He explained that this instrument would provide a contingent loan facility that could be drawn on to prevent projects from defaulting on US dollar-denominated debt due to local currency devaluations. Mr. Lu explained that the business plan of the Downstream Financing Window was being finalized and the facility was expected to be in operation in the next 12-15 months. He further noted that the *Project Assessment Tool* was under development, with the first batch of pilots expected to be launched between July and October 2017.

In his update, **Mr. Bennett** informed participants that the World Bank's Treasury had continued its work with Morningstar to establish an *Emerging Markets Infrastructure Debt Index*, giving investors a tool to benchmark their investments and thus attract greater liquidity to the infrastructure sector. **Mr. Cessine** explained that the Emerging Markets Infrastructure Index was a sub-index and sub-portfolio of the multi-currency Morningstar Global Bond Infrastructure Index, representing 139 bonds out of a total of 1,100 bonds in the global index -- all investment-grade, fixed-rate, corporate or quasi-sovereign bonds. He further explained that the portfolio had a market value of \$92 billion in market volume (one-third of the global index) by 73 issuers in physical and social infrastructure sectors. The EM Infrastructure Debt Index is scheduled to be launched in July to September 2017. Mr. Cessine noted that, at 6 percent, the EM Index performed better than the global index (5 percent) and demonstrated the best risk-return ratios of all Morningstar's benchmarks over the last 10 years.

Mr. Giugale provided an update on the *Infrastructure Loan Refinancing Facility (ILRF)* which uses donor funds to encourage private investors to finance the prepayment of World Bank infrastructure loans to state-owned enterprises, thus freeing up capital for more infrastructure lending and encouraging private financing for brownfield infrastructure in emerging markets. He noted that the ILRF was envisaged as the first step in a broader paradigm shift in how funding from the World Bank and donors could be combined with private capital to finance infrastructure projects. Set up as a special purpose vehicle, the ILRF will refinance selected outstanding IBRD loans and issue two-tranches of instruments, an Investment Tranche (senior tranche) and a Donor Tranche (first loss tranche). The pool of assets that could be refinanced through the ILRF includes outstanding IBRD loans in USD to State Owned Enterprises in the infrastructure sector, including energy, transport and water sectors. The ILRF has passed through internal World Bank consultations since the last AC meeting. In May 2017, the Bank is expected to launch the "Proof of Concept" of the ILRF among key stakeholders.

B. Panel Session on Construction Risk

A panel session entitled *Managing Construction Risk in Infrastructure in Emerging Markets and Developing Economies* was moderated by Jordan Schwartz of the World Bank. The panel was comprised of experts with diverse perspectives. **Andrew Davison** of **Moody's** explained that based on Moody's database of 6,500 projects which represented 2/3 of all projects closed in the past 33 years, the observed trend was that marginal annual default rates fell over time from financial close. While construction risk was higher during the early stages of the project, it was not completely different, and when cumulative default rates were considered in aggregate, construction risk did not undermine the integrity of the asset class. **John Scales** of **HDR**, a US engineering firm active in emerging economies and reflecting the perspective of the engineering industry, defined construction risk as the probability and

frequency of occurrence of a defined event, and the magnitude of the consequences of that occurrence. He identified some of the elements that engineering firms deal with frequently, including climate, finance, existing conditions, the political nature of the project, quality of design, construction methodology, environmental issues, technology and interface. He stressed the importance of financiers building strategic partnerships with designers, engineers and contractors for more successful outcomes.

Nikhil de Victoria Lobo of **Swiss Re**, representing the insurance industry, pointed to the fragmentation of insurance products designed to address different discrete events during the construction phase, often ignoring the stages before and following construction. He proposed that there was scope for better risk management if all the different insurance products were packaged into a single insurance policy with comprehensive coverage thus simplifying what is otherwise a convoluted landscape. Questions were raised about the cost implications of such comprehensive coverage. **Maureen Harrington** of **Standard Bank**, in presenting a lender's perspective, noted that a bigger challenge for lenders seeking to scale up private investment in infrastructure in Africa is related more to the lack of creditworthy off-takers on the continent. She noted that pre-completion guarantees from sponsors was a key risk mitigation tool. Other risk mitigation tools used by African banks include different products through the EPC contract such as delay damages to cover OPEX and CAPEX and equipment warranties, and also the possibility of an EPC contractor wrapping the risks. Ms. Harrington stressed the importance of developing trust with reliable engineering companies and ensuring that associated infrastructure linked to the project, but to be implemented by the government or other parties (e.g., gas supply infrastructure for a power station) is actually completed. **Matthew Jordan-Tank** of the **EBRD** provided an overview of an innovative EBRD risk mitigation product, jointly developed with MIGA and applied to the recently closed Euro 300 million Elazig Hospital in Turkey. It involved an unfunded \$89 million liquidity line from EBRD which provides a debt service reserve account with a quick-disbursing facility that enables continued construction during contractual disputes for up to 48 months. This enabled the project to achieve a rating uplift two notches above Turkey's sovereign ceiling to investment grade. This then allowed the project to access a wider group of bond investors. MIGA provided political risk insurance cover, including cover for transfer inconvertibility, expropriation and breach of contract. **Macky Tall** of **CDPQ**, a Canadian pension fund manager, stressed the importance of assessing risks based on the specific circumstances of a project, and of ensuring that projects have strategic value to the country to avoid the political risk that they become white elephants. Contrary to popular opinion, Mr. Tall pointed out, institutional investors did not avoid greenfield risk, and frequently undertook huge CAPEX exposure in greenfield projects, and also in large brownfield projects such as a new terminal in an existing airport.

C. Country Infrastructure Programs - Focus on Latin America

As part of the GIF's mandate to support the mobilization of private investment in infrastructure markets around the world, the AC meeting included country presentations by three Latin American countries at different stages of PPP market development. Panelists from **Argentina**, **Colombia** and **Peru** presented the recent improvements to the PPP programs in their countries along with their medium-term project pipelines. Panelists included **Clemente del Valle**, **President, Financiera Desarrollo Nacional (FDN), Argentina**; **Pablo Quirno**, **Chief of Staff, Ministry of Finance, Colombia** and **Carlos Ganoza Durant**, **Chief of Staff, Ministry of Economy and Finance, Peru**. The session was moderated by **Gaston Asteslano**, **Senior Operations Advisor, Inter-American Development Bank**. Through the presentations and follow-up questions, the common key success criteria identified included well-planned, defined and established institutional and legal frameworks, along with the ability to generate high quality, bankable project

pipelines. Common challenges included foreign exchange risk, the lack of depth of local capital markets and ongoing need to generate high quality projects. The panelists also made clear the significant investment required over the coming years with US\$298.5bn of pipeline expected across the infrastructure sectors, with a focus in transport US\$178.5bn and energy US\$35.1bn.

- **Colombia:** After a long period of experimenting with concessions, Colombia has spent the last six years implementing a number of important changes in order to increase the mobilization of private capital for infrastructure investment: (i) *Regulatory Framework* including a new, refined PPP Law and Infrastructure Law; (ii) *Institutional Framework*: creation of FDN and Agencia Nacional de Infraestructura (ANI) as independent and highly specialized institutions shielded from political cycles and corruption; (iii) *Standardization*: a standardized contract and bidding process to facilitate delivery of over 30 projects in a short period of time; and (iv) *Financial Support*: as part of FDN's remit to attract private sector financing, FDN also provides direct financing and credit enhancement including to a major US\$641m international bond issuance. These changes have resulted in the successful 4G road infrastructure program –32 projects with a total investment of US\$ 18bn with 31 projects already awarded and 8 having reached financial close. As an example of the significant PPP pipeline, ANI's Plan Maestro de Transporte Intermodal indicates an investment of US\$33.9bn to 2025 for just the transport sector.
- **Argentina:** Following the technical sovereign default of Argentina in 2014 and in view of the US\$250bn for infrastructure investment, Argentina has spent the last 12 months focusing on its return to the international financial market. For example, the government has removed capital and repatriation restrictions, implemented a tax amnesty scheme, and created an investment & trade promotion agency. Likewise, besides floating the exchange rate and rebuilding monetary reserves, the government, using a widespread subnational wave of political support, established a cross party political consensus to enact a new PPP Law (2016) with accompanying Regulatory Decree (2017). The resulting PPP Legal Framework creates a centralized PPP Unit based in the Ministry of Finance. Argentina's pipeline includes US\$169bn of investment in infrastructure including US\$48bn in roads and US\$34 billion in the energy sector.
- **Peru:** Following the award of 76 PPPs between 2004 and 2016, Peru has invested the last year months in updating its legal and institutional PPP framework in order to generate higher quality projects, with a greater degree of comfort for the state, and a faster route to market to benefit both public and private sectors. The changes include strengthening the independence of the PPP project development agency Proinversion through appointment of independent members to the Board of Directors; gives a clearer role to Ministry of Economy and Finance (MEF) in the PPP cycle; includes anticorruption provisions; and improves the capacity and performance of sector and subnational PPP agencies. Also, for the first time in Peru, medium term infrastructure plans have been produced. The two-year horizon *PPP Portfolio* includes investments of US\$14.6bn mainly focused on transportation (US\$9.6bn) and energy (US\$1.1bn).

Closing Remarks

In his closing remarks Mr. Levy thanked speakers and participants for their useful contributions and helpful guidance on topics of great importance to the GIF's mission. He welcomed, especially, the concrete suggestions for addressing construction risk and promised to explore them further. Ms. Monaco noted that in addition to construction risk, solving for currency risk would be paramount to unlocking private

capital in emerging economies; this had been a topic of special interest for Citibank, which would be following up its ongoing work in that area. Mr. Levy thanked Ms. Monaco for her dynamic co-chairmanship over the past and welcomed **Macky Tall** of **CDPQ**, her successor as co-chairman of the Advisory Council for the next year.

Breakout Mini-Sessions

Following lunch, breakout mini-sessions were held for more in-depth discussions on topics relating to the GIF's objective of promoting investment in infrastructure in emerging countries.

1. *Comprehensive Insurance Coverage for Construction Risk: Bringing the Infrastructure Pipeline to Market.*

This mini-session was introduced and moderated by **Diane Damskey**, Adviser, Office of the Managing Director and CFO, World Bank. **Cindy Paladines**, Economist and Young Professional, Office of the Managing Director and CFO, World Bank explored some of the dimensions of the emerging market infrastructure pipeline data based on a study being undertaken to understand the infrastructure financing gap from a project perspective. **Joseph DiRubbio**, Head Engineering Large Risk Corporate Solutions of Swiss Re discussed ways in which insurance companies can help manage construction and other risks to attract new private capital towards emerging market infrastructure and bring more of the pipeline to financial close.

Mr. DiRubbio identified several inefficiencies in traditional insurance offerings for infrastructure projects, including fragmented and uncoordinated coverage, a lack of transparency, and liquidity implications of long claims processes. He described a comprehensive coverage product developed by Swiss Re that aimed to provide a package of coverage across the lifecycle of a project and minimize the need for separate policies for different project parties. He noted that comprehensive coverage required coordination among all project parties and a pilot project was needed to test this approach. Session participants suggested that the MDBs could play a coordination function during the pilot project. Participants also noted that pilot projects would help clarify the cost implications of comprehensive coverage compared to traditional insurance policies. Mr. DiRubbio also presented parametric insurance coverage, which pays out a set amount based on a specific event trigger that is verified by a third party. An example of parametric coverage in the renewable energy sector was presented, where coverage was provided for wind levels for a wind farm. Mr. DiRubbio explained that parametric coverage reduced the time between the event and a payment, and had a simpler claims process than traditional insurance due to the third-party verification of the policy trigger.

2. *Pension Investment in Emerging and Frontier Markets' Infrastructure Assets: Recent Trends, Future Pathways.*

This mini-session was chaired and moderated by **John Finnigan**, Director, Head of Development Organizations at **Citi**, GIF. Presented by **Nicolas J. Firzli**, Director-General & Head of Research, **World Pensions Council** and **Joshua Franzel**, President/CEO, **Center for State and Local Government Excellence**, the session sought to explore how pension investors surmount institutional constraints to investing in emerging market infrastructure. They noted that for the foreseeable future pension investment would continue to come largely from industrialized nations. OECD countries have \$32 trillion

pension assets now, to reach \$44 trillion in about 10 years; however, EMDE countries (excluding sovereign fund) pension assets only total \$2-2.5 trillion today, and are expected to grow to about \$5 trillion in 10 years. They pointed out that a quest for yield has been driving the recent interest in EMDE investment. In 1985-2007, the average pension fund manager earned 9%-11% per annum. 2007-2016 is a tougher timeframe and, on average, pension funds earned 4%-5% per annum gross. Counting administration and investment fees, the net return is barely 3%, roughly equal to CPI inflation. This is occurring precisely when the pension deficit is rising as baby boomers retire. Two-thirds of the biggest investors in infrastructure are pension funds, with a majority being Canadian and Australian. Infrastructure investment provides long-dated returns, which are good for asset-liability matching, and regular predictable returns that are bond-like and can partially hedge against inflation. Furthermore, the ESG dimension satisfies trustees, labor organizations and policy makers. Finally, non-listed, physicals asset are perceived as more real than paper-money, especially after 2007.

Messrs. Firzli and Franzel further explained that CIOs of pension funds try to allocate their assets by matching them with their liabilities. They suggested that two key factors that CIOs look at, especially with non-listed asset such as infrastructure, are political/legal risk (including institutional risk, regulatory and policy framework, government non-payment/non-repatriation risks) and economic return. Asset allocations of US pensions in 2015 was 52% equities, 24% bonds, 16% alternatives, 6% real estate. The ideal infrastructure sub-sector for pension investors is transportation, which typically accounts for 50-70% of pension funds' exposure to infrastructure, especially modern rail and rolling-stock, well-located airports that can be improved & expanded, and some highways; Energy and Mining rank second with about 25-30% of total exposure, with energy transportation and storage, and renewables/ESG-driven infrastructure going strong. Water, wastewater and social infrastructure are relatively less preferred, given pressures on government and tariff structures. Overall, infrastructure assets in emerging markets are generally viewed as risky. Even the Canadian funds which have invested more in emerging markets, non-domestic exposure remains low, and that outside North America is even lower. An example is the Alberta Province Public Pension & Sovereign Wealth Fund: of the \$90.2 billion in assets under management, only 36% is non-domestic and, overall, only 22% outside North America.

3. PPP Contractual Provisions: Getting to Common Standards.

This mini-session was moderated by **Matt Bull**, Senior Infrastructure Finance Specialist at the **Global Infrastructure Facility** and was presented by **Christina Paul**, Infrastructure Lawyer, the **World Bank**, together with **Tim Conduit** and **Fleur Clegg** of the law firm of **Allen & Overy**. They gave an overview of the WBG's overall initiative on Recommended PPP Contractual Provisions since its inception and discussed the objectives and contents of the new version of the Report, including two appendices developed by the GIF and how they relate to their companion piece. They noted that the complexity and sophistication of PPP transactions often means that considerable time and expense is involved in preparing and finalizing PPP contracts. This had led to calls to standardize the provisions in such contracts. As such, a number of countries (including the United Kingdom, India and South Africa), had developed complete standardized PPP agreements for different types of infrastructure projects.

Against this background, the WBG published the **Report on Recommended PPP Contractual Provisions, 2015 Edition** which sets out language for eight selected provisions typically encountered in PPP agreements (Force Majeure, Material Adverse Government Action, Change in Law, Termination Payments, Refinancing, Lender Step-in Rights, Confidentiality and Transparency as well as Dispute

Resolution). Building on this 2015 version and in response to industry feedback received on its contents, a further iteration of the Report has been prepared in cooperation with the international law firm of Allen & Overy LLP, with publication expected in late-spring 2017. The GIF is preparing guidance to adapt the recommended contractual provisions and the drafting notes contained in the Report's second edition for bond financing and corporate financing. The session discussed potential implementation routes including dissemination strategies and possible use in GIF activities.