

RECENT DEVELOPMENTS AT IFC

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Remarks delivered at

**Seminar on Monetary and Financial Law
International Monetary Fund
May 8, 2002**

On behalf of IFC, I would like to say how pleased we are to have been invited to address such a distinguished audience. I would like to speak a little bit about IFC's history, for those of you who are not familiar with our operations, and tell you about our current operations and very recent developments. I will also weave into that the IFC Legal Department structure and how we serve our clients in the organization as well as our clients outside the organization such as our member countries and our private sector clients.

Because most of you are in Central Banks or Ministries of Finance, you may have a lot less familiarity with IFC than with our sister Bretton Woods institutions, the IMF and the World Bank, and therefore I will give you a little background information. As you all know, the IMF and the World Bank opened their doors for business in 1946. You have heard a lot about the IMF this week and probably know a lot about the World Bank (formally, the IBRD), and you know that the charter of the IBRD states that its mission is to promote economic development in its member countries and it must do so on the credit support of the host member government. What this means is that any extension of financing or credit by the World Bank has to be backed by a host government guarantee or be a direct loan to the government. About 10 years after the World Bank opened its doors for business, the member shareholders decided that the private sector also had a role to play in economic development, particularly in the lesser-developed member

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countries. IFC was therefore established and opened its doors in 1956 as a separately incorporated affiliate of the World Bank.

IFC's charter complements the IBRD's charter and work; in fact, our charter says that our role is to promote economic development in cooperation with the World Bank. In each member country the government notifies IFC which agency in the government is the official agency for communication with IFC, that is, the agency to which all communications from IFC should be addressed. In our case that's usually the Finance Ministry, but in some countries it is the Central Bank. This is similar to the procedure in the World Bank. Before I discuss some of the similarities further, let me just mention some differences. The capital of the World Bank, as you may know, is callable capital, which means that only a certain portion has been paid-in and each member country is then liable to pay in the uncalled capital, when it is called. The borrowing strength of the World Bank is really based on that uncalled capital.

In IFC's case, one important difference in our capital structure is that the member countries fully subscribe and pay-in their capital up front, so that no liability falls on a country for uncalled capital (because there is none).

I would like to read you IFC's mission statement. It is interesting to note that our mission statement was only adopted in the mid-1990s even though we have been in business since 1956. The reason that we found it necessary to articulate the mission statement in the mid 1990s is probably due to the tremendous amount of change at IFC, probably in the world, and certainly in the IMF and the World Bank, in the last 10 years and in particular the last 5 years.

Let me read you our mission statement. The overall mission statement of IFC is: "Poverty reduction through the private sector in order to improve people's lives". This furthers the belief that economic growth can help to mitigate poverty in our developing member countries. When I discuss recent developments at IFC later in this talk, particularly a new unit that we have formed recently to focus on SME development --

Small and Medium Scale Enterprises -- I would like to elaborate more on how this helps us to fulfill our mission.

Now, what are some of the changes over the last 10 years? Why have these changes happened? How have those changes affected our structure and what we do at IFC? Well, I am sure I don't have to tell all of you that beginning in the early 1990s most countries in the world began to privatize a lot of state-owned enterprises with the goal of freeing up the balance sheets of countries, so that the governments could devote more of their resources to their social sectors, which no lenders or investors would finance. One way that IFC got involved was through the private financing of what was formerly publicly-financed infrastructure. Beginning in the early 1990s and really maturing towards the late 1990s, and further refined fairly recently, IFC has been very involved in financing infrastructure projects. What are these?

These would be power plants, transport, roads, railways, water projects. IFC even financed a satellite project in one country a number of years ago. If you think back 15 years, all of these were in the public sector and therefore would have been financed off the government budget, often by borrowing from the World Bank under either a World Bank loan or an IDA credit. With different political imperatives in the last decade, with more sophisticated financing tools and with the private sector financiers both on the debt and equity side more willing to go into emerging markets and to take on these risks, IFC has served a very important catalytic function to put these deals together. IFC can invest on the equity side and on the debt side to show our support for these projects, which often are the first such projects in the country. There is a real "demonstration effect" to Wall Street and to the City of London that these deals can be profitable and that these deals are the way to go in the future. Hopefully this will assist our client countries so they can focus their financial resources on other under-served sectors, such as the social sectors, which the private sector in their own country or abroad would not normally finance because they are not profitable, in the classic income statement or balance sheet sense.

I should mention here that one of the changes IFC has seen over the last few years is to focus more on our member countries as our clients. This also is in line with the World Bank's greater focus on the client. Fifteen years ago, IFC perhaps focused more on our private sector clients and less on the client country, because we were more focused on financing specific projects. Under James Wolfensohn, our President since the mid 90s, IFC is getting very involved in overall country strategies which the World Bank will formulate, often after discussion with the IMF. Thus, there is greater focus on the overall picture in each country of operations, not just on particular projects. IFC will still be lending or taking equity positions in private sector enterprises in the country, but these clearly fit into the country's overall economic and development schemes perhaps in a more coordinated way than they did in the past.

Let me now discuss IFC's operations. For those of you who want to know more about IFC, I would refer you to the IFC's website: www.ifc.org. The IFC annual reports are on the website and there is also plenty of information, plus names of IFC contact people. A list of IFC publications is also on the website, and you can order these from the website.

Back to IFC operations. We have 4 broad groupings. The first is more the traditional bread and butter of IFC, which I call "project finance". For those who are not familiar with the term, project finance is really a financial term rather than a legal term, although those of us who practice in the area of project finance have to understand the financial aspects in order to structure the legal aspects. Some of you may be asked to review BoT contracts in the legal department of your Central Bank or Finance Ministry if a government guarantee for a particular project has been requested by the private investor. In order to do this review, you will have to understand the project structure, how it works, how residual risks may rest with the government to back-stop some obligations of the project company if the government has been asked to give any kind of support. Traditional project finance means that the lenders to the entity, which is usually set up legally as a special purpose vehicle, will not permit the entity to carry out any other operations except for the specific operations being financed. For example, in the case of

a new power plant, a special purpose company would be incorporated, generally in the host jurisdiction of a developing country, and that company will have no other operations except for the construction, operation and maintenance of that power plant. The idea is that the lenders to that project, as well as the equity investors, only look to the performance of the project, e.g. to the cash flows of that project, to get their financial returns. In the case of lenders, to get repaid, and in the case of the equity investors, to get their return on capital and return of capital. Therefore, you can see how this would take the project off the government balance sheet.

In most of the projects which IFC finances, we don't do pure project finance without any recourse to sponsors of a project. Rather, the project structures involve limited recourse, and often elaborate legal structures are set up. Sometimes there may be guarantees of completion by project sponsors. In some cases project sponsors would not invest in a project except if there are government guarantees of the obligations of the offtaker; this would require a guarantee by the government to the project company. For example, where a state-owned utility, perhaps a state-owned electricity board, will be buying the power to be generated by the new company, the government might be required to guarantee the obligations of that utility to buy power. This has proved necessary to attract investors in some first-time projects and countries, because, for example, very often the energy sector has not been fully deregulated and the utility offtaker is not credit-worthy. Therefore, the project sponsor, which is often an international power generation company, would not do the deal without some kind of government support.

IFC, along with other lenders, structures its project-financed deals such that in the event loans are not paid back it would have recourse against the underlying assets of the project, through mortgages and pledges. Another form of security for the lenders is the establishment of various different bank accounts that would trap cash, which would be used to keep the project going. So again, in your capacity as central bankers, you may have to approve such structures, approve the maintenance of these accounts -- which may be onshore or offshore -- and therefore you may get involved in reviewing this kind of

project. But it is the hope that ultimately private sector infrastructure financing will take many projects off the government balance sheets.

The second important operational area for IFC is financial markets operations. IFC aims to promote more efficient financial intermediaries in developing countries, and we make loans to, and take equity investments in, financial institutions such as banks. These loans by IFC are often for on-lending purposes: perhaps to small and medium scale enterprises, perhaps for project financing activities in the country. Sometimes these loans may be to enable financial institutions to meet capital requirements for banks; we may structure the loan as a subordinated loan so it would meet tier capital requirements under the Basel accords. IFC also helps to promote the establishment of leasing companies and rating agencies in client countries. IFC can bring technical assistance, perhaps introduce as an equity partner a rating agency in the US or Europe. We also have invested equity in private equity funds which invest in emerging markets, and which generally promote small and medium scale enterprises. IFC invests directly in these funds, which bring technical and financial assistance to many enterprises where it would not be efficient for IFC to invest directly.

IFC also has a broad spectrum of advisory work. Encompassed in this is technical, financial, environmental and corporate governance assistance. Corporate governance is one of the newer initiatives which will be discussed later.

Perhaps the third group of IFC activities can be called IFC's "catalytic role" in attracting capital into emerging markets. This really involves the mobilization of additional capital flows into countries. When IFC receives approval from our board to invest in a project, it is often perceived by the private sector as a seal of approval of the project, because IFC does extensive due diligence for its own investments and understands emerging markets in general much better than private foreign investors and even sometimes investors in that country. By investing, IFC shows that we think it is a good company to invest in. I should just note here that one important difference between IFC's charter and the World Bank's charter is that IFC investments are subject to local

law in terms of any exchange controls in the country, whereas the World Bank loans are not. So IFC will have to get permission -- often through central banks or the bureau controlling inflow and out-flows of foreign exchange -- for repatriation of loans, equity investments, perhaps, taking a mortgage. Remember that it is the government which is entering into a loan agreement with the World Bank, but the government doesn't play a direct role as lender, borrower or guarantor in IFC projects.

A very important role that IFC plays in terms of mobilizing debt capital is through our syndicated B loan program. IFC makes an A loan for its own account and a B loan for the account of participant banks, with B loan funds from participant banks. Under this structure, IFC is the lender of record. The advantage to the commercial lenders and insurance companies which are the participants is that they benefit from the IFC "umbrella" that our member countries provide to us. This is an implicit political risk cover, and is often referred to as our preferred credit status, which is really a *de facto* rather than a *de jure* status. What this means is that IFC loans have never been included in any general moratorium on foreign debt repayment in a country. Our member countries have recognized that IFC, as a multilateral lender, continues to do good projects and to put new money into countries even if there is a debt moratorium, and therefore IFC cannot have our debt service obligations stopped.

One important new development in our B loan program is that IFC has recently started a web site for the B Loan participants, so that if they wish to make changes in their portfolio holdings of B loans that they can actually see what potential buyers there are. IFC likes to keep very close control over who these B loan lenders are, in order that we can assure member governments that we will be fulfilling our developmental role in the projects. So we had to make sure that legal documents governing the relationship between IFC and its participants reflected this new ability of participants to assign their participations after a certain period of time, and we have to have very firm controls over who the assignment can be to.

One last unit that I would like to mention is the IFC's financial operations department, which is the funding side of IFC. This department has become increasingly important over the last few years, looking for ways to raise debt for IFC because we fund ourselves not only by capital contributions from our member countries but more and more by raising funds in international capital markets. IFC has an AAA credit rating. An item which should be of interest to all of you is that all our debt obligations state that the obligation is not a financial obligation of any member country nor is it an obligation of the World Bank. It is actually IFC's credit status that it is being evaluated in the market place and we are subject -- as of course many of your countries are -- to the rating agencies and their very strict standards.

Finally, I'll mention the latest developments at IFC. The corporate governance activities of IFC have come to the forefront recently. In this regard, we support the activities of the World Bank and of our member countries in cleaning up the murkiness that perhaps is inherent in some corporate structures. I don't have to tell any of you this a phenomenon of not just emerging markets but certainly the developed markets as well. IFC's mandate is to operate only in the emerging markets and that's where our corporate governance activities are located. We provide advisory services to governments in the area of corporate governance, and also to private sector entities. For example: how to strengthen the role of board of directors, how to have codes of conducts for directors, how to draft corporate laws, etc. IFC has done a fair amount in Latin America on these issues. We helped Chile in this regard, about a year a year in a half ago, and they drafted a new corporate code and we helped point out provisions in other corporate laws that would help modernize the corporate law in that country. In addition, the corporate governance activities unit provides advice to other member countries through OECD and World Bank working groups. Our corporate governance activities unit also provides advice to IFC's corporate clients. When we make investments, there is a corporate governance score card that each of our bankers -- we called them IOs -- needs to complete because we want to make sure that the companies that we invest in adopt best practices. We often have to help those companies learn what is best practices and suggest ways to implement that.

As I mentioned earlier, IFC recently started the SME Department (Small and Medium - Scale Enterprise Department) because we realized that a key component of development is really small companies. This is not just a phenomenon in the United States and Europe but also in emerging markets -- that's where the growth will be, that's where the jobs will be. SME's have different kinds of financing and technical assistance requirements than big companies -- it takes a lot of hand-holding and technical assistance. As lawyers, you probably all have come across this -- it is just as much work often to do the documentation and due diligence for a very small project as it is for a very large project. This extra assistance is costly, and IFC has played a key role to mobilize funds to support this assistance. IFC's financial operations unit recently launched a partial credit guarantee program, where we will assist borrowers to raise funds, often in local currency. This will be an area of increasing importance.

Last but certainly not least, two developments are worth special mention. First, in the environmental area, IFC is very proud that the Dutch government has recently established a US\$40,000,000 trust fund to support IFC's activities in the reduction of greenhouse gases. This money will be used by IFC to invest in and alongside IFC projects. Second, it should be noted IFC also has a very important sustainability initiative. A very important theme in IFC now is that our projects need to be sustainable on an economic basis, financial basis, legal basis, environment basis and in a transparency and good governance basis.

Thank you for your attention, and hope that I have provided you with a greater understanding of IFC's work.

May, 2002

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