Global Business & Development Law Journal

Volume 18
Issue 1 *Symposium: Markets in Transition: Reconstruction and Development*

Article 18

1-1-2004

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This article discusses the role of the International Finance Corporation ("IFC"), an affiliate of the International Bank for Reconstruction and Development ("World Bank" or "IBRD"), in the area of project finance in emerging markets.

A short historical note is in order to assist the audience to better understand the role and functions of IFC. The World Bank and the International Monetary Fund ("IMF") were created as a result of the Bretton Woods Conference of 1944, when the soon-to-be victorious Allies decided that there must be a better way for countries to solve problems without war. In the same spirit, countries adopted the United Nations ("UN") charter in 1945. The World Bank commenced business in 1946.

The IMF and the World Bank were structured as part of the post-war international financial architecture. The World Bank's initial focus was to implement post-war reconstruction efforts in Europe and Japan. Its development activities began in the late 1950s, when decolonization started. The World Bank Group is today composed of five institutions three lend money, one provides political risk insurance, and one serves as an arbitration facility.

IFC, the second affiliated institution of the World Bank Group, was founded in 1956 by the shareholders of the World Bank as a separate legal entity, to allow the private sector to play a role in furthering economic development in developing countries. IFC invests in the private sector. The third affiliate of the World Bank Group, the International Development Association ("IDA"), was founded in 1960 and also has a separate legal status and shareholding. IDA lends to the least-developed countries. The fourth member of the World Bank Group, the Multilateral Insurance Guarantee Agency ("MIGA"), was establish in 1988 and also has an independent legal status and shareholding. The fifth member of the World Bank Group, the International Center for the Settlement of Investment Disputes ("ICSID"), facilitates arbitration and will not be discussed in this article.

The specific roles of the different World Bank Group institutions are: the IBRD lends to middle-income countries on the strength of a sovereign government guarantee, IFC invests in the private sector without any host government guarantee of its investment, and MIGA provides political risk insurance to private investors. IDA is known as the concessional loan window (or

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"soft" loan window) of the World Bank Group. MIGA provides political risk insurance through its guarantee contracts for debt and equity investments. IFC invests in private projects, while MIGA can insure private projects.

IFC's funding originates from its member countries through share subscriptions, and from international debt placements. There are 176 member countries, or shareholders, of IFC, and the five largest shareholders of IFC control a total of 45 percent of the shares. The United States controls approximately 24 percent, Japan 6 percent, Germany 5.5 percent, and France and the United Kingdom each control 5.1 percent. IFC's capital is fully paid in by member countries, unlike the capital of the World Bank, which is callable. IFC has a weighted voting system under its charter, known as the IFC Articles of Agreement. This may sometimes lead to observations by citizens of developing countries that IFC policies are skewed towards the prosperous countries. However, the Articles of Agreement of IFC provides for weighted voting, based on a particular country's number of subscribed shares. The number of shares which a country is entitled to subscribe to is determined by the size of its economy relative to the world economy. The larger the economy of a country, the greater its share of capital contribution to IFC. The charter documents of IFC and the World Bank were designed so that the countries with the larger capital contributions would have the greater say in determining policy. This differs from the UN, which is based on the principle of one country-one vote.

In addition to receiving share subscriptions from its member countries, the IFC borrows in the international capital markets and maintains an AAA rating. In 2003, IFC borrowed $3.5 billion in the international markets, comprising eight currencies. IFC constantly seeks to diversify its funding base. As the swap markets develop in many of the emerging markets, IFC is increasingly able to borrow in different currencies and to lend in currencies other than the major hard currencies.

IFC's mandate is to promote sustainable private sector development, and IFC's Articles of Agreement mandate that it fulfill its mission in conjunction with the World Bank. The World Bank plays a different role in development, because by its charter, it can only lend directly to governments, or to an entity other than the government with a host government guarantee. This government guarantee can support loans by the World Bank to a *para-statal* (a 100 percent government-owned corporation) or to a private project. The World Bank issued these guarantees only in the last few years for private infrastructure finance. With the exception of these partial guarantees, the World Bank finances governments and government-backed projects, and IFC finances private sector, privately-backed projects.

Since 1956, IFC has been involved in project finance. When a conference such as this one discusses the term "project finance," it generally refers to private sector financing of large infrastructure projects, principally in emerging markets, on a non-recourse basis. Until the 1990s, this type of financing was not done often because most infrastructure projects in emerging markets were government related. From 1956 until the 1990s, prior to the activation of private financing of infrastructure in emerging markets, IFC engaged in mostly non-recourse financing of industrial and financial projects in emerging markets. Beginning in the late 1980s, IFC started financing private infrastructure projects in developing countries as well. The types of legal documentation used are fairly standard now for project financing. IFC enters into a loan agreement with the project company, which is almost always incorporated in the host country's jurisdiction in an emerging market. IFC might also enter into a subscription agreement in order to subscribe to shares in the project company and most likely would also enter into a completion agreement, or a project funds agreement, which is an agreement by the project's sponsor to provide the company with sufficient capital to complete the project. This completion agreement (or project funds agreement) enables IFC to avoid assuming completion risk. As a financier, IFC will take operational risk but not the risk of non-completion of the project.

IFC also generally requires a share retention agreement, which is the project sponsor's agreement that it will retain a negotiated number of shares—generally at least a controlling interest in the project—until repayment of IFC loan. These documents have been the core of IFC's standard documentation financing package.

However, in the 1990s, it seemed as though the whole world was being privatized. Market-based economies, or forms of capitalism, came more into vogue than state-controlled economics. IFC started getting involved in financing private infrastructure projects in the emerging markets, by developing a specialty in financing infrastructure projects in the 1990s. In order to tailor financing to these particular types of projects, additional documentation was developed to address the risks of these types of projects.

IFC provides loan and equity capital for viable projects by mobilizing capital from other sources, in several ways. For instance, IFC has a B Loan Syndication program. IFC's participation in a project gives a "good housekeeping" seal of approval to the project. Very often, an IFC Board approval to finance a project means that other lenders or potential equity investors will increase their interest in financing the project, because they know that IFC performed its due diligence.

IFC looks for good private sector projects, shares the same equity risks as other investors, and makes market-based loans. IFC cannot take a guarantee from the host government under its Articles of Agreement, and it can share the project risks only with other private investors. IFC's financing and presence in the deal reassures all parties—the local partners, the governments, and the foreign investors—and IFC calls this its "honest broker" role. The value-added by IFC is money to the project in the form of loans or equity, an intimate knowledge of the host county, and a different perspective. Probably seventy percent of IFC's staff are not from the United States, but rather are from seventy or eighty different countries. This gives IFC staff a very broad perspective. Since the host governments are shareholders of IFC, they have a greater trust in IFC than perhaps in a commercial bank. Because the private sector investor knows that

IFC is investing with them and that IFC shares the same risks, they have faith in IFC's objectives. The local partners in the project may sometimes see IFC as more friendly to their project and their objective of making money than the partners' own government.

One thing that is difficult for many individuals raised in the United States to understand is the deep suspicion of capitalism in many developing countries. Many governments of developing countries are also suspicious of foreign investors, and may believe that such investors are simply "profiteers" coming to the country for a brief stay, only to earn a lot of money and then leave. As a result of this suspicion, all the parties in the project must reach a delicate balance so they feel that the other party is actually sharing the same risks and is not going to try and take advantage of them. Some of these fears are based in fact, because unfortunately sometimes private foreign investors have tried to take their profits and run. Very often, the governments in emerging markets may have taxed heavily the only project that is occurring in their country. Distrust from all sides remains, but often for good historical reasons. Institutions such as IFC and other development agencies represented here today, such as the Asian Development Bank and the Overseas Private Investment Corporation, must serve as a catalyst to attract private money and provide a certain amount of political risk comfort to the investors. Also, development agencies need to show the host governments that the agencies will consider the government interests and structure a balanced deal. Therefore, when an investor requests IFC financing for a new project, IFC will analyze the deal to verify that all parties share equitably in the project. IFC believes that a good investment deal should balance out the interests of the investors, government, and the local community. For example, IFC may say that high management fees need to be reduced, or back-ended instead of front-loading them. All of this also assists country development.

IFC looks for sound environmental and social management in a project. Ken Hansen mentioned earlier that one political risk is change in environmental laws. IFC attempts to set standards for environmental performance because this makes a project sustainable. A key tenet of IFC is that its projects must be "sustainable" from the perspective of environmental and social performance, corporate governance, and financially.

IFC offers a full range of financial products, loans, equity, and quasi-equity instruments, which include hybrid instruments such as convertible debt, warrants, options, or anything the investor and the IFC team can create that will "work" legally in the host country. IFC also has a superb product line in highly sophisticated derivative products.

I was involved in a pre-privatization investment by IFC in a small, former communist country in Eastern Europe. The country privatized the telephone company, and IFC considered making an investment in the corporatized telephone company in order to demonstrate faith in the company and its business plan. The business proposal was for IFC to receive convertible, redeemable, preferred shares. Holding this type of equity instrument would suit the business objectives of enabling IFC to stay in the investment post-privatization or to exit, depending on the desires of the new private-sector investor. As an IFC lawyer, my job was to make sure that the company's charter and local law permitted the issuance of convertible, redeemable, preferred shares. Local counsel informed me that the charter and local law did not permit this, and these types of shares were unknown in the country. However, he mentioned that their legal system followed the civil law tradition, which permitted a convertible bond instrument. IFC therefore then structured the transaction as a convertible bond, which had all of the same economic benefits and risks as convertible, redeemable, preferred shares. Legally, however, it was a bond. These are some of the interesting aspects for a U.S. lawyer who works in emerging markets. This was actually the first bond that was ever issued in that country, and despite the antiquated legal system, the company issued two beautiful, classy engraved bonds—No. 1 and No. 2—to evidence the IFC debt.

IFC also does resource mobilization, which involves syndications of participations in IFC loans. This is the B Loan Program where IFC is the lender of record, and commercial banks participate in the IFC B Loan. Legally, IFC must disburse funds under the B Loan only to the extent that the commercial banks actually fund the B Loan. The B Loan lenders therefore have the advantage of the IFC's privileges and immunities, which are legal privileges written into IFC's charter. Under the terms of IFC's Articles of Agreement, each member country signatory thereto must enact into local law, and demonstrate to IFC, that these privileges and immunities are effective under local law. Since IFC is tax exempt under its Articles of Agreement, and IFC is the legal lender of record on the entire IFC loan, the loan is exempt from withholding tax. Additionally, IFC enjoys the same status as all other multilateral development banks—preferred creditor status. This is a main attraction for B lenders to IFC. This "privilege" is not legal, only *de facto*.

The preferred creditor status permits the multilateral development banks to continue lending to good projects in emerging markets amidst a macro-economic crisis. For example, Argentina imposed currency controls after the severe financial crisis in 2001. However, Argentina reaffirmed (as did Venezuela in the same situation) its intention to service the debt of the multilateral institutions first. Thus, Argentina first allocated its foreign exchange in the country to certain preferred creditors who are vital to the country's recovery—among them the multilateral development banks.

The advantage to IFC B Loan participant banks is that preferred creditor status prevents them from inclusion in mandatory private sector debt rescheduling. Multilateral institutions have, in effect, indicated to governments that, "we will continue to lend to you, even in crisis situations, and even when no commercial lenders will lend to you, so long as you keep servicing our outstanding debt on a good, underlying investment. If the underlying borrower company has enough local currency to service our debt, and brings that local currency to the Central Bank, the Central Bank will agree to externalize the debt payments as preferred creditors to the multilateral development institutions."

After the crisis in Argentina, IFC was one of the first lenders to restart a private lending operation. In addition, financial institutions under IFC's B Loan are given the same protection. No B lender under IFC's B Loan "umbrella" has been subject to mandatory debt rescheduling under a moratorium.

IFC invests in a broad range of sectors, such as finance, insurance, infrastructure, oil, gas, primary metals, and education. The project sponsors who seek financing from IFC are local, foreign, or both because IFC is a multilateral organization and the world's largest source of private sector finance for emerging markets. (It has 176 countries as shareholders and twenty-four board members from those countries.) IFC does not impose any mandatory arrangements, so equipment does not have to be sourced from any particular countries or follow a particular "nationality." The only restriction is that equipment cannot be sourced from the few nonmember countries of the World Bank.

IFC strives for innovation and to meet its customers' demands in terms of financial products. Loans are made generally in hard currency, of the borrower's choice. IFC recently made some local currency loans, but such loans depend on the availability and depth of swap markets in the host country. For example, there is a lot of demand for Mexican Peso loans due to borrower concerns about matching the currency of their debt with the currency of their revenues. IFC can make Peso loans because of a strong U.S. Dollar/Mexican Peso swap market. But in many other countries that have less developed financial markets, IFC cannot provide local currency loans due to lack of active swap markets.

IFC also makes equity investments but tends to be a passive investor due to interpretations of a charter restriction against exerting management control over an enterprise. IFC generally does not vote at shareholders meetings, except if there is a jeopardy situation or its vote is necessary. Many private sector sponsors welcome this lack of interference in management decisions.

IFC provides another advantage to project sponsors through its equity investments. Some emerging markets fear domination by foreign investors. As a result, there are rules on how much of any investment can be held by foreigners in specific sectors. Countries sometimes categorize IFC as a local investor, which encourages foreign sponsors because they know that IFC provides the foreign investor perspective.

IFC is also active in providing risk management products to clients, such as swaps, options, forward contracts, and various types of hedging deals. IFC acts as an intermediary for its emerging market clients by using its AAA credit status to bring the benefits of the available derivative products in developed markets. A new, up and coming product is the IFC partial credit guarantee. In structured finance transactions, IFC would guarantee a certain percentage of the loss, determined as a business matter—e.g., the first loss position or a later position. The financial experts quantify what type of guarantee IFC can offer to reduce the risk enough to enable the borrower to obtain a higher credit rating. IFC offers this product in connection with bond issues of local currency in the local market. The issuer can approach the local rating agencies and state that the risk is reduced x times so the issuer should receive a higher, perhaps an investment grade rating from a rating agency. These bonds can then be sold easily on the local markets. This is important because of the development of local currency financial markets. One major risk factor on private infrastructure financing is that revenues are in local currency, but debt is raised in hard currency. It is vital to finance as much as possible of a project in local currency because there is no devaluation risk. By developing local capital markets, IFC performs a key developmental function.

IFC has many investments in independent power producers which are generation projects, an increasing number in distribution projects, and even transmission projects.

IFC also finances a large amount of transportation infrastructure, including toll road developments, ports, and privatized airlines. Water, which is a utility, is a more difficult sector to finance. To deal with this challenge, IFC is now looking at sub-sovereign municipal finance. This is an area that requires a lot of creativity. IFC finances a lot of other infrastructure, such as telecommunications, information technology, and agribusiness.

Finally, to highlight IFC's environmental and social standards, IFC has contributed to upgrading development in developing countries by setting high standards. IFC's environmental and social standards for loans to projects in the developing world have recently been adopted, through the Equator Principles, by a substantial number of large, international commercial banks.

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