CHAPTER 8

International Financial Institutions

Paradigms of Organizational Structures, Funding Structures and Innovative Funding Modalities

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Abstract

This article analyses the connections between organizational structures and funding structures for three different kinds of organizational paradigms: (i) organizational groups (e.g. the World Bank Group) composed of organizations with proper legal personality under international law and legal capacity under national law, (ii) organizations administering various resources and providing various financing modalities under one legal personality (e.g. the Asian Development Bank), and (iii) organizations established by a treaty which were not designed to leverage resources through callable capital (e.g. the International Fund for Agricultural Development or the OPEC Fund). Specifically, this article explores to what extent organizational structures and institutional and legal frameworks constrain the ability of institutions to enhance their impact, realize synergies, mobilize resources, and have access to capital markets. With reference to the exponential increases of capital and borrowings of multilateral development banks (MDBs), it is argued that these have become too big to fail. This finding is discussed in light of proposals that MDBs should substantially further expand their borrowings and lending without increase of their paid-in capital ratios. As shown, the solution cannot be that MDBs and rating agencies should weaken their criteria or that MDBs participate in advanced financial engineering. Also, the G20 should not be involved in determining the capital adequacy of MDBs as they are intrinsically conflicted in dealing with this matter. Rather, MDBs and other international financial institutions (IFIs) should open themselves to the participation of non-state actors (like export credit agencies and reinsurance companies), and explore new sources of funding which are not linked to an institution's capitalization (like securitization and the subordinated, hybrid debt recognized as equity, sponsoring schemes

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and match-making mechanisms). This would embrace innovation and offer new ways to enhance the overall impact of IFIs.

1 Introduction

MDBS and other IFIs may be considered from three different perspectives: as international organizations, as development institutions and as financial intermediaries. With a membership that “is for the most part reserved to States”, they were conceived as “financial intermediaries between private or official lenders or investors in capital exporting countries and private or public parties in countries who are importers of capital” for the common purpose of assisting “member countries in their development efforts”.1 They generally have a “dual character”.2 While as “subjects of international law, their rights and obligations arise from the applicable international law principles”, “they engage in financial transactions, which, despite their public purpose, are, by nature similar to market-based transactions” and “share many characteristics with the private-sector’s contracts”.3

IFIs need to be looked at in a holistic perspective as has been shown by this author in his book “Funds for Development”.4 In the following, the relationships between organizations organizational structures and their funding structures will be explored.

The paper will analyse three paradigms of organizational structures and related funding structures, both market-based and concessional, which have evolved over four generations.5

1. Organizational Groups (e.g., World Bank Group, African Development Bank Group, Inter-American Development Bank Group, Nordic Development Bank Group, Islamic Development Group) composed of financial institutions, generally established by a treaty with proper legal personality under international law and legal capacity under national law.

2. Financial institutions established by a treaty providing various types of financing and financing modalities under one legal personality (e.g. Asian Development Bank).

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1 Sureda 2005, 25.
2 Bradlow 2010, 1.
3 Ibid.
4 Droesse 2011a.
5 See Droesse 2011b, 6–33; See also Blokker and Schermers 2001.
3. Organizations established by a treaty that were initially designed as revolving funds and do not have the capacity to leverage resources through callable capital, such as the International Fund for Agricultural Development (IFAD) and the OPEC Fund.

The main thrust of this paper is to highlight the legal, financial and policy implications of organizational structure and its implications for the ability of IFIs to enhance their impact, realize synergies, mobilize resources and have access to capital markets.

There is widespread agreement in IFIs that revolving funds are no longer efficient mechanisms for funding (concessional) loans and need to be restructured or terminated for this reason. Such restructuring or termination may be achieved as a matter of policy in organizations which follow the second paradigm and administer a wide range of resources under one legal personality. However, a similar course of action entails particular challenges for institutions designed as revolving funds (e.g., concessional windows) that belong to organizational groups (i.e., the first paradigm) and for self-standing organizations which follow the third paradigm. The reason is that these organizations are international organizations with treaty foundation in their own right. Hence, any termination of such organizations or fundamental changes to their funding structures are matters of great complexity, given vested interests and the qualified majorities and quorum provisions required for their termination or amendment to their constituent agreements. Nevertheless, while these organizations are precluded by their constituent agreements to mobilize resources on capital markets against callable capital, their legal personality and high capitalization may still be the basis for them to have access to capital markets.

However, there are also fundamental challenges for IFIs following the first or second paradigm and providing financing on market-based terms as the ability of these organizations to mobilize resources on capital markets is intrinsically linked to the willingness of their members to provide the necessary paid-in capital. States are facing increasingly problems in providing the resources that are necessary for IFIs to substantially expand their financing. The solution to this predicament cannot be to substantially further erode the paid-in capital ratios of IFIs, or to weaken the standards of rating agencies, or for IFIs to engage in advanced financial engineering. Rather, IFIs should join forces with export credit agencies, reinsurance companies and other reputable private-sector entities by admitting them to full or partial membership. This will enhance their financial situation and risk-bearing capacity and enable them to engage in advanced financial transactions. In addition, they need to find innovative solutions for maximizing their existing resources through
changes to their operational and transactional profiles and explore new sources of funding which do not require the infusion of paid-in capital. The implications of securitization for increasing the headroom are being explored in this context. Moreover, the fact that rating agencies have recognized sub-ordinated hybrid capital as equity may offer entirely new funding opportunities for IFIs. However, even such mechanisms will not be sufficient to fund the transition of countries to a green economy or for facilitating the transition to the Fourth Industrial Revolution (4IR), as the required resources are so enormous that they can never be funded by public sources alone. Hence, for these and similar pursuits other funding mechanisms which are not linked to the infusion of paid-in capital are required.

2 Organizational Groups and Organizations Providing Various Financing Modalities

To be able to analyse the three paradigms of organizational structure highlighted above, it is essential to understand the intrinsic rationale for their creation.

2.1 Organizational Groups

The organizations belonging to organizational groups are mostly, but not necessarily, organizations with treaty foundation and international legal personality. There may be different reasons why organizational groups are established. In particular, this may be due to legal constraints in the constituent agreement of the organization sponsoring the establishment of the group or be done to supplement the activities of such organization, or for both reasons.

2.1.1 The World Bank Group

The rationale for the evolution of the World Bank Group is clearly one of legal constraint and exclusion. This relates to the establishment of the International Development Association (IDA), the International Finance Corporation (IFC) and the Multilateral Investment Guaranty Agency (MIGA) alike.

As regards IDA, the concessional arm of the World Bank Group, an amendment of its Articles of Agreement that would have enabled IBRD to make soft loans was deemed “just ‘too hazardous a procedure,’ because it might have opened discussions on the IBRD Articles and invited more amendments. Moreover, there was the fear of contagion expressed by IBRD at the time of the creation of IDA to be associated with a ‘soft lender’ in a single institution. Thus, IBRD and IDA were established as legally separate organizations under
separate intergovernmental agreements ‘to keep some distance between the two’.\(^6\)

Also, the creation of IFC was due to constraints resulting from the wording of the IBRD Articles of Agreement which did not allow the IBRD to provide financing without a sovereign guarantee. As IDA, also IFC “could have been created by relatively simple amendments to the Bank’s Articles of Agreement, but this procedure might have opened the floodgates to more controversial amendments [....]”.\(^7\) Instead, IBRD President Black pursued the establishment of IFC,\(^8\) which emerged in 1956 as the private-sector arm of the World Bank Group. However, also the IFC Articles contained constraints which were included to accommodate the concerns of the U.S., which was opposed to the IFC conducting equity investments.\(^9\) Thus, the IFC Articles had to be amended the first time already in 1961 to remove that prohibition.\(^10\)

While in the case of MIGA, earlier proposals envisaged an agency closely linked to the IBRD, MIGA was “designed to be an autonomous institution which will operate on its own account and within its own responsibility while maintaining a symbolic, but significant, link with the Bank”.\(^11\) MIGA is providing “political risk insurance (guarantees) for projects in a broad range of sectors in developing member countries, covering all regions of the world”.\(^12\) The “main differences between the IBRD/IDA guarantee products and the MIGA guarantees\(^13\) are that (1) the IBRD/IDA guarantees require a counter-guarantee of the host government, creating a direct contractual link with the host country relating to the project, while MIGA requires host country approval before

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6 See Droesse 2011c, 63 with further references.
7 Mason 2010, 79.
9 Glazer 1957.
10 The IFC Board of Governors then adopted an amendment to Section 2 of Article III of the Articles of Agreement of the Corporation allowing IFC “make investments of its funds in such form or forms as it may deem appropriate in the circumstances”. See IFC Board of Governors resolution No. 21 (1961).
13 The MIGA Convention provides for coverage of three generally accepted categories of commercial risk: “the currency transfer risk resulting from host government restrictions and delays in converting and transferring local currency earned by an investor, expropriation, and the risk of war and civil disturbance. The Convention adds to these traditionally covered risks the risk of breach or repudiation of a contractual commitment by the host government towards an investor [....]”. See Commentary on the Convention Establishing the MIGA 1985, 8.
issuing a guarantee”; also “(ii) MIGA pricing is tailored to the specific transaction, and (iii) MIGA may reinsure, while the World Bank does not sell down or syndicate its guarantee” and “the IBRD/IDA guarantees only directly cover debt instruments, while MIGA covers equity as well as debt instruments”.

2.1.2 Inter-American Development Bank Group

As the IBRD, also the IADB sponsored the establishment of a group of organizations, but there are fundamental differences between the World Bank Group and the IADB Group as regards the rationale of their creation.

IADB was “designed as a bank of regional cooperation and solidarity”, as is evident in its “principle that less developed or economically vulnerable borrowing countries would receive more favorable terms than the more developed countries”.\(^{15}\) Consistent with the above, the IADB Charter incorporates provisions on the Fund for Special Operations (FSO) that “was set up to service loan applications that absolutely required resources under concessional conditions”.

IADB evolved to an organizational group through the establishment of the Inter-American Investment Corporation (IIC) in 1989 and the Multilateral Investment Fund (MIF) in 1993, however, again the situation is very different from that of the World Bank Group.

IADB does not have a competence under its Charter to take equity. Given that its charter prevented the IADB “from engaging in venture capital investments with its own resources, there was no other alternative than to create an entity for this purpose”.\(^{17}\) Hence, following the failed initiative to create a regional finance corporation (COFIAL) in 1970s and the creation of a Venezuelan trust fund piloting support to medium-sized industry,\(^{18}\) President Ortiz Mena proposed in the early 1980s a scheme for a new entity providing “small amounts of seed capital that would be quickly recycled by selling shares in small and medium-size businesses to private investment funds”.\(^{19}\) In line with this proposal, the IIC was created in 1984.

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16 Ibid., 31. See Art. IV of the Agreement Establishing the Inter-American Development Bank which became effective in 1959, as amended.
18 Ibid. 137.
19 Ibid.
Unlike IBRD, IADB is not prevented, however, from providing loans and guarantees of loans without a sovereign counter-guarantee\(^\text{20}\) and effectively has conducted private sector operations ever since its establishment, with particular emphasis since its Ninth General Capital Increase in 2010.\(^\text{21}\) Thus, inasmuch as IIC provides financing to private-sector entities, it is supplementing\(^\text{22}\) the activities of the IADB rather than substituting for it.

As regards the MIF established in 1993, it “was conceived within the framework of the ‘Enterprise for the Americas Initiative’” to provide support “for innovative mechanisms designed to improve the climate for private investment, promote training for the labor force, and foster the development of small businesses”.\(^\text{23}\)

An evaluation carried out by the Office of Evaluation and Oversight of IADB (OVE) in 2012 showed that the various private-sector windows of IADB and the IIC and MIF had partially overlapping functions and were poorly coordinated\(^\text{24}\)

\(^{20}\) In accordance with Art. 11, Section 8 of the IADB Charter, it is for IADB to decide whether to require such a guarantee.

\(^{21}\) IADB conducted its private-sector activities initially through financial intermediaries and since 1994 through direct lending to private-sector entities. In 1994, IADB, “faced with a dearth of long-term fiancé avenues” relating to infrastructure investments, in particular, opened the door to private participation by authorizing direct lending to the private sector (IADB 2004, 3). IADB initially made little use of this additional operational capacity. Things only changed after the IADB Board of Governors raised in 2001 “the ceiling on private sector loans and guarantees to 10% of the amount of loans and guarantees outstanding” (IADB Board of Governors Resolution AG-09/01 “Lending to the Private Sector”) and, in particular, during the period covering the years 2004 to 2011 (IADB 2011b, 8). Moreover, consistent with the Cancun Declaration adopted by the IADB Board of Governors in 2010 (IADB 2011a, 5), the Ninth General Capital Increase of IADB (GCI-9) triggered a further expansion of IADB’s private-sector activities. Private Sector development was one of the core elements of the GCI-9 Agreement, which tied the capital increase to a series of reforms. In particular, the Report on GCI-9 (IADB 2010, 14) mandated IADB to adopt an integrated approach and adopt a strategy “to increase the development impact of private sector activities by capitalizing on the IDB’s comparative advantages in a manner consistent with its institutional goals” (IADB 2010, 15). The Report further mandated IADB to gradually increase the ceiling for IADB’s private-sector activities from 10 to 20 percent of total equity (Ibid.).

\(^{22}\) The Agreement establishing IIC is called “Agreement Establishing, for the Purpose of Encouraging Private Enterprises to Supplement Activities of the Inter-American Development Bank” (emphasis added).

\(^{23}\) IADB 2001,166.

\(^{24}\) See IADB 2013. While noting that IADB had taken action to implement the GCI-9 commitments, OVE concluded that IADB needed “a framework on which to base its strategy” and that the absence of such a framework had been “the major conceptual obstacle to IDB’s responding to the IDB-9 mandate to promote PSD as an instrument for development” (IADB 2013, 14). OVE made various suggestions for going forward, among which
Consistent with the recommendations of OVE, the Board of Governors of IDAB and IIC, each separately in accordance with their constituent agreement, authorized on 30 March 2015 “the transfer of operational and administrative functions and nonfinancial resources associated with [non-sovereign guaranteed] NSG activities from the [IDAB] to the IIC” and instructed “the Boards of Executive Directors and Management of the IDB and of the IIC to take all steps necessary to complete such transfer by January 1, 2016 or such later date as may be approved by the Boards of Executive Directors of the [IDAB] and the IIC”\(^{25}\). “The merge-out was undertaken to deliver on a renewed vision to foster development through the private sector, aiming at improving the development effectiveness of [IDAB Group’s] intervention in the region […].”\(^{26}\)

In 2016, IDAB went “through a self-described ‘startup’ year” as the merge-out pooled together “all private sector lending under the IIC umbrella to serve as a single-entry point for clients in the region wanting to access institutional financing and services.”\(^{27}\) In the context of the merge-out, IIC was rebranded as “IDB Invest”.\(^{28}\)

As regards the MIF, its mandates evolved and underwent substantial changes, as highlighted in a recent report of OVE.\(^{29}\) It became the innovation laboratory of IDAB, offering “the rest of the [IDAB] Group a platform for proof of concepts, experimentation, early-stage investments, and market solutions that can later be scaled by [IDAB], ’IDB Invest’ or external partners”.\(^{30}\) It is an important development that an MDB has incorporated such a laboratory in its organizational structure.

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26 Though the key documents related to the merge-out contain a wide range of objectives, three were highlighted throughout the process leading up to the merge-out:

- strengthening development effectiveness, development impact and additionality;
- maximizing the efficient use of resources; and
- maximizing the synergies between public and private sector activities". IDAB 2017, 2.


28 As part of the consolidation process of its private-sector development activities, IDB Invest “created value-added products and solutions” and “made its portfolio available to new sectors. As the focal point of IDAB for all private-sector operations, IDB Invest provides multiple financial products, such as loans, guarantees, equity investments and debt securities, as well as advisory services”. See IDAB Invest 2017, 28 and IDAB Invest 2018, 131.

29 See IDAB 2023.

30 IDB LAB, About.
2.1.3 African Development Bank Group

One major difference between the African Development Bank (AfDB) and the IADB is that AfDB may engage in equity investments that “include both direct participations in private and/or public-enterprises, and national and/or regional DFIs, and indirect participations through subscriptions to private equity funds and other funds and portfolio vehicles. They also include quasi-equity financing such as preferred stock, mezzanine financing, and convertible debt”. As the AfDB is able to take equity, it was not necessary to establish a separate organization for the purpose of providing such financing. However, the AfDB sponsored the establishment of the African Development Fund (AfDF) for the purpose of providing financing on concessional terms to the poorest African countries. The rationale for the establishment of the AfDF is related to the mobilization of resources and needs to be seen in the context of the AfDB’s opening itself for membership on non-regional countries. Thus, the relation of AfDB and AfDF membership is the reverse of what is applicable to IDA. While IBRD (and by implication) IMF membership is a requirement for IDA membership, in the AfDB Group, AfDF membership is for all non-regional countries a prerequisite for AfDB membership. In that sense, AfDF membership had for non-regional countries to a certain extent the character of an entrance fee. Unlike ADB, the AfDB also has admitted non-regional developing countries willing to pay that entrance fee (e.g. China and Korea).

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31 Development finance institutions.
32 AfDB. 2015, 25.
33 For the background on the establishment of the AfDF, see: Akin-Olugbade and Flory 2011, 402–403.
34 Art. 3 para. 3 of the Agreement establishing the African Development Bank provides: “Non-regional countries which are, or become, members of the African Development Fund, or which have made, or are making, contributions to the African Development Fund under terms and conditions similar to the terms and conditions of the Agreement Establishing the African Development Fund, may also be admitted to the Bank, at such times and under such general rules as the Board of Governors shall have established”. […] See Droesse 2011c, 92–96.
35 The AfDB group also comprises the Nigeria Trust Fund which was created in 1976 by agreement between the AfDB Group and the Nigerian Government. Its objective is to assist the development efforts of the Bank’s low-income regional member countries whose economic and social conditions and prospects require concessional financing. It is a self-sustaining revolving fund that only provides concessional loans. Its objective is to assist the development efforts of the Bank’s low-income regional member countries whose economic and social conditions and prospects require concessional financing. Its initial capital of USD 80 million was replenished in 1981 with USD 71 million. In 2008, the Federal Republic of Nigeria and the Bank agreed to a ten-year extension of the NTF. (See Nigeria Trust Fund. https://www.AfDB.org/en/about-us/corporate-information/nigeria-trust-fund-ntf, accessed 21 April 2022).
2.1.4 Nordic Finance Group

As the history of the Nordic Finance Group shows, the fact that organizations belong to a group does not imply that the various organizations of the group have coordinated governance structures or actually cooperate. The Nordic Investment Bank (NIB) and the Nordic Development Fund (NDF), which both have a treaty foundation, previously belonged to the Nordic Investment Bank Group. As has been shown by Haralz,\(^{36}\) while the NDF initially was meant to cooperate closely with the NIB, it “acquired the profile of a separate entity maintaining its own outside relations and conducting its own operations”\(^{37}\) and there was very limited cooperation, if any, between the NIB and the NDF.\(^{38}\)

The situation only changed to a limited extent after the NDF emerged in 2009 from the coma in which it had been placed in 2005 by the decision of the Nordic Finance Ministers to cancel the negotiation for a replenishment of the NDF and focus instead on concluding the operations of the Fund. However, the aforementioned decision effectively was never implemented as the NDF was resuscitated in 2009 and given a new set of functions relating to environmental protection.\(^{39}\)

The NIB, NDF and Nordic Environment Financing Corporation currently belong to the Nordic Finance Group.\(^{40}\) All three entities are established by a treaty which defines their governance structure. While each organization has its own institutional framework with its own executive head and its own board members and there are no institutionalized coordination mechanisms between the three institutions based on their establishing agreements, a Cooperation Council dealing with employment matters has been created based on executive action.\(^{41}\) A potential point for synergies is that all three

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36 Haralz 1999, 17.
38 As far as the relations between the Organization of Petroleum Exporting Countries (OPEC) and the OPEC Fund for International Development (OPEC Fund) are concerned, it cannot even be said that these form an organizational group. While OPEC members provide the core funding for the OPEC Fund both evolved as entirely separate organizations without any relevant interaction between these organizations.
39 Droesse 2011c, 66.
41 The Cooperation Council was created according to decision by NIB’s President on 5 June 2001, as amended by NIB’s President’s decision 17 November 2006, following submission of statements by Managing Directors of NDF and NEFCO. See NIB 2006 and NIB 2009.
institutions are located under one roof and have a strong environmental focus, but they have different functions and funding mechanisms.42

2.1.5 Islamic Development Bank Group

The Islamic Development Bank Group (IsDB), while much smaller than other MDBs (e.g., the World Bank, IADB, ADB and AfDB), is another example of institutional diversification.

Unlike in the case of the IBRD, the rationale of such diversification was generally not related to legal constraints on the part of the IsDB to provide certain activities. This can be derived from Article 2 of the IsDB Articles of Agreement which defines the functions and powers of the IsDB in rather wide terms, referring to equity and infrastructure investments, loans to public and private-sector entities, promotion of foreign trade and provision of technical assistance and training facilities. While IsDB, when financing sovereign entities “requires a full sovereign guarantee or the equivalent”, it is also exposed to non-sovereign credit risk arising “from financing operations extended to projects, corporates, and financial institutions without explicit guarantees of concerned governments”.43

The organizations of the IsDB Group mostly supplement the activities performed by the IsDB. This is also true for the IsDB Institute.44 Moreover, also the creation of the other three organizations of the IsDB Group is intrinsically related to the fact that IsDB has supported since its inception private-sector development and the “importance of private sector as an engine of growth and its key role in eradicating poverty and fostering an inclusive society”.45

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42 *NIB* is offering long term financing to projects that improve productivity and benefit the environment of the Nordic and Baltic countries, while *NEFCO* finances sustainable green growth and climate projects globally, focusing on small and medium-sized projects with demonstration value and the *NDF* provides concessional financing (loans, grants, equity) for climate change and development projects primarily in low-income countries (Nordic Finance Group 2010, 1). The *NIB* is structured like as other market-based windows with intermediary functions and mobilizes money on capital markets against its equity base of approximately 8,369 million consisting of about 10.10% paid-in and the remaining callable capital. *NEFCO* which has an equity of EUR13, 4 million and accumulated reserves, income consists of their net interest income (on loans, debt securities and placements), their lending fees and other income, such as trust fund management fees. As regards the *NDF*, it was replenished on five occasions; the last two replenishments after its restructuring were in the amounts of EUR 330 and 350 million, respectively (*NDF* Governing bodies and capital 1971, 1–12).


44 On the establishment of the IsDB Institute in 1981 (then known as Islamic Research and Training Institute or *IRTI*), see Meenai 1989, 191–194 and *IRTI* 2019, 1–44.

45 *IsDB* 2016, 16.
The Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) was established in 1994 “to boost intra-trade among OIC member countries by providing exporters, banks, trade financiers and export credit agencies with Shari’ah-compliant export credit insurance and reinsurance facilities”.46

The ICIEC, which is referred to in Art. 1 of the ICIEC Articles of Agreement as a “subsidiary company”, enjoys autonomy and possesses international legal personality and legal capacity under national law. Under Art. 6 of the ICIEC Articles of Agreement, members are the listed original members and other OIC members admitted by the governors (member states may authorize any entity or agency to represent them). The IsDB owns half of the ICIEC’s shares.47 ICIEC provides Shariah-compliant export credit and investment insurance48 and does not require a sovereign guarantee.49

The Islamic Corporation for the Development of the Private Sector (ICD) is an international specialized institution established pursuant its Articles of Agreement50 and commenced its operations on 8 July 2000.51 While

46 Ibid. IDB Group Entities: Summary. The idea to establish ICIEC originated from an agreement between members of the Organization of Islamic Cooperation (OIC), mandating the OIC through IsDB to establish “an Islamic Insurance Company operating under Shari’ah principles, to provide insurance products for investments and export credits”. Hence, “[f]ollowing the Agreement, the Board of Governors of IsDB Group, at its 16th Annual Meeting held in Tripoli, Libya, in Sha’ban 1412H (February 1992), approved the Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), declaring its establishment.” see ICIEC Who we are, https://iciec.IsDB.org/who-we-are/, accessed 21 April 2022. As regards the Articles of Agreement, see ICIEC 2016.

47 Upon the establishment of ICIEC, the IsDB subscribed to 50,000 of the 100,000 share then available for subscription. See Art. 9 (1) of the ICIEC Articles of Agreement.

48 See ICIEC 2019 Annual Report, 9 with further details.

49 The business model is well summarized in the ICIEC financial statements as follows: “In accordance with the Articles of Agreement”, the Corporation is required to maintain and administer two separate funds: i. A Policyholders’ fund” \( \backslash n \) ii. A Shareholders’ fund. As an Islamic Insurance entity, the Corporation manages the Policyholders’ fund. According to the Islamic model of Wakala, whereby the Corporation acts as an agent for managing the technical insurance accounts on behalf of the Policyholders’, and investing the income from the insurance operations according to Mudaraba model. No wakala fee is charged to Policyholders’ fund by Shareholders’ fund. All expenses to run the Islamic insurance business are charged to the Policyholders’ fund at cost, without any administration fee levied by the Shareholders’ fund. The Shareholders’ fund is not entitled to a share in any surplus accruing to the Policyholders’ fund; any deficit in the Policyholders’ fund is covered from the Shareholders’ fund capital by way of a qard (loan) to be repaid from future surplus accruing to the Policyholders’ fund.” See ICIEC Financial Statements 2019, 9.


51 ICD Articles of Agreement 2012, Annex A.
ICD\textsuperscript{52} was created primarily to conduct “direct investments in small and medium-scale enterprises located in ICD member countries”,\textsuperscript{53} it adopted a wider focus which led to an overlap of ICD’s activities with those of IsDB.

The last member of the IsDB Group to be effectively established in 2008 was the Islamic Trade Finance Corporation (ITFC), which was created “with the primary objective of advancing trade among OIC Member Countries, which would ultimately contribute to the overarching goal of improving socioeconomic conditions of the people across the world”.\textsuperscript{54}

The ITFC was established for the specific purpose of consolidating the various trade financing activities which had previously performed by IsDB since its early days through various channels, inter alia through IsDB’s “Trade Financing Operations Programme (ITFO)”.\textsuperscript{55} Such consolidation was to “to increase the trade volume” in addition to “consolidating all of IDB’s trade finance activities under a single umbrella thus eliminating the overlapping and bringing greater efficiency to the delivery of trade finance services”, using “financial instruments that are Shariah compliant”.\textsuperscript{56}

ICIEC has a special position and special functions within the IsDB Group. Moreover, while also the IsDB is mandated to provide trade-financing, ITFC has since consolidated all trade finance businesses that used to be handled by various windows within the IsDB Group.\textsuperscript{57} However, in the past, there was in the IsDB Group substantial functional overlap and duplication of functions, in particular between the IsDB and ICD, which both are mandated to provide private-sector financing. ICD also had to battle with the fact that its credit rating was downgraded by Fitch from AA to AA-, “following material financial losses (totaling USD 107 million) incurred in 2017 as a result of

\textsuperscript{52} In accordance with Article 4 (a) of the ICD Articles of Agreement, the Corporation shall “assist, alone or in cooperation with other sources of finance, in the financing of the establishment, expansion and modernization of private enterprises, utilizing such financial instruments and mechanisms as the Corporation deems appropriate in each instance”. In accordance with Article 4 (b)–(e) of the said Articles of Agreement, the Corporation is to support enterprises by facilitating “their access to private and public capital, domestic and foreign including access to capital markets”, “stimulate the development of investment opportunities conducive to the flow of private capital, domestic and foreign”, “contribute to the development and diversification of financial products” and “provide technical assistance for the preparation, financing and execution of projects, including the transfer of appropriate technology”. See ICD Articles of Agreement 2012b.

\textsuperscript{53} ICD Articles of Agreement, Art. 5, 2(b).
\textsuperscript{54} ITFC: What is ITFC? 2018.
\textsuperscript{55} IsDB 2007, 1.
\textsuperscript{56} Ibid.
\textsuperscript{57} Ibid.
significant write-downs in the valuation of the bank’s equity investments”. Nevertheless, there were recently positive developments as ICD was able to return to the Sukuk markets after four years absence in October 2020. IsDB and ICD undertook to redefine and reset their relationships in response to the vision of the IsDB President and in accordance with their recent inter-agency agreement to the terms that had originally been envisioned for ICD.

In addition, there are other examples of organizational groups. As shown above, organizational groups vary greatly as regards their legal and governance and financial structures. These structures are intrinsically related to the funding mechanisms which can be used by each organization belonging to a group.

2.2 Organizations Providing a Wide Range of Different Financing Modalities under One Legal Personality

There is a number of IFIs which provide a wide range of modalities of financing under one legal personality. The ADB is the epitome of the above paradigm as it is mandated to provide both concessional and non-concessional financing, and in the latter category both sovereign and private-sector loans, as well as guarantee and equity investments.

There is a number of organizations which fall into this category, ranging from the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) to the European Investment Bank, the International Finance Corporation (IFC), and the Development Bank of the Islamic Countries (DBIC). These organizations provide a wide range of financing modalities under one legal personality, allowing them to cover various sectors and needs.

As stressed by the IsDB President, the signature of this agreement entailed agreement on a “clear accountability framework assigning roles and responsibilities between IsDB and ICD” under which “ICD will continue to make important contributions to the development of small and medium enterprises (SMEs)” under which “ICD will continue to make important contributions to the development of small and medium enterprises (SMEs) sector.” IsDB 2021.

Also the European Investment Bank forms a group with the European Investment Fund (which is very small in financial terms if compared with the EIF). The European Investment Bank established in 1958 has a special status as an organ of the European Community. It has been an important player in the European Project and is currently covered by the Treaty on the Functioning of the European Union which confers to the EIF international legal personality within the context of the EU. The EIF has a clear focus on market-based financing. The EIF evolved to a Group in 2000 when it acquired majority shareholding of the European Investment Fund which had been established in 1994. EIF is the EIF Group’s specialist provider of integrated risk finance to SMEs across the EU, EFTA and Candidate Countries, offering a spectrum of financing solutions to public and private sector intermediaries with the objective of enhancing SME finance and addressing market gaps. EIF fosters EU objectives in support of innovation, regional development, entrepreneurship, growth, and employment. See EIF. The Governance of the European Investment Fund.


58 FitchRatings 2018.
59 DDCAP Group 2020, 1.
60 As stressed by the IsDB President, the signature of this agreement entailed agreement on a “clear accountability framework assigning roles and responsibilities between IsDB and ICD” under which “ICD will continue to make important contributions to the development of small and medium enterprises (SMEs) sector.” IsDB 2021.
61 Also the European Investment Bank forms a group with the European Investment Fund (which is very small in financial terms if compared with the EIF). The European Investment Bank established in 1958 has a special status as an organ of the European Community. It has been an important player in the European Project and is currently covered by the Treaty on the Functioning of the European Union which confers to the EIF international legal personality within the context of the EU. The EIF has a clear focus on market-based financing. The EIF evolved to a Group in 2000 when it acquired majority shareholding of the European Investment Fund which had been established in 1994. EIF is the EIF Group’s specialist provider of integrated risk finance to SMEs across the EU, EFTA and Candidate Countries, offering a spectrum of financing solutions to public and private sector intermediaries with the objective of enhancing SME finance and addressing market gaps. EIF fosters EU objectives in support of innovation, regional development, entrepreneurship, growth, and employment. See EIF. The Governance of the European Investment Fund.
Bank (NDB)\textsuperscript{63} to the Council of Europe Development Bank\textsuperscript{64} and various sub-regional development banks. Under this paradigm, also organizations such as the Inter-American Development Bank (IADB), the African Development Bank (AfDB), the Islamic Development Bank (IsDB) and the European Investment Bank (EIB) may be comprised, which are legally entitled to administer a wide range of financial modalities, including private sector financing, but have for policy reasons sponsored the establishment of organizations which supplement their financing.

While it is common for financial institutions to provide both sovereign and private-sector financing, as well as guarantees, the capacity to conduct equity investments is a distinguishing feature among organizations in this category. As has been shown above, some organizations do not have the capacity to provide such financing. Moreover, only in some cases an express or implied authority is provided to organizations to provide trade-financing.

However, the most important difference between institutions in this category relates to their ability to provide financing on concessional terms. In this context, various cases can be distinguished.\textsuperscript{65} The establishment of concessional windows gives organizations the opportunity to engage with states and entities that are unable to borrow on market-based terms. However, there are IFIs which do not have concessional windows or provide concessional financing not from their own recourses but under mandates from another organization. As the different arrangements have been analyzed in detail by this author in his book “Funds for Development”, it would not serve any useful purpose to repeat in this occasion the detailed analysis provided by that book.

2.3 **Financial Institutions Without Formal Equity Base Established by a Treaty for Specific Purposes**

IFAD and the OPEC Fund for International Development (OPEC Fund) were both designed and conceived as revolving funds. Hence, unlike other IFIs,
their constituent agreements do not allow them to mobilize resources on capital markets against an equity base consisting of paid-in and callable capital. As this entailed for both organizations constraints to their effectiveness, they pursued institutional reforms allowing them to have access to capital markets.

2.3.1 IFAD

The establishment of IFAD was one of the major outcomes of the 1974 World Food Conference held in 1974. IFAD is, with the organizations of the World Bank Group, the only IFI which has the status of a specialized agency of the United Nations. Considering the special role of the OPEC countries in the establishment of IFAD, IFAD has classified its membership in three categories: lists A, B and C.

Prior to the fourth IFAD replenishment, there was no link between IFAD contributions and voting rights. As this was not conducive to mobilizing resources, a new vote allocation system was introduced in 1995 through an amendment to the IFAD Articles.

Consistent with Art. 4 of the Agreement Establishing IFAD (AEI), which predominantly covers contributions from states, traditionally “IFAD’s financial architecture has been centred on replenishment contributions and other non-reimbursable sources of funding (e.g., reflows from loans, income from treasury investments, and supplementary and complementary funding),” based on the embedded assumption that “over the long term, IFAD Members would be able and willing to continue providing financial support in grant form and at

66 The Conference resolved (Resolution XIII) that: “1. An International Fund for Agricultural Development should be established immediately to finance agricultural development projects primarily for food production in the developing countries; 2. All developed countries and all those developing countries that are in a position to contribute to this Fund should do so on a voluntary basis; 3. The Fund should be administered by a Governing Board consisting of representatives of contributing developed countries, and potential recipient countries, taking into consideration the need for ensuring equitable distribution of representation amongst these three categories and regional balance amongst the potential recipient representation.” See: World Food Conference 1974, 12–13.


68 Ibid., 464–466.

69 As may be seen from Art. 4 Sections 1 and 2 AEI, the resources of IFAD shall consist of: (I) initial contributions (of original and non-original members); (II) additional contributions (which the Governing Council may, based on a review of adequacy of resources, invite members to make to ensure continuity of the operations of IFAD); (III) special contributions from non-member States and from other sources; (IV) funds derived or to be derived from operations or otherwise accruing to the Fund.
a level allowing the Fund to maintain or increase its programme of loans and grants [....]”.

Nevertheless, it has been discussed at length already after the second replenishment of IFAD whether IFAD can mobilize resources other than those set forth Art. 4, Section 1 AEI. As shown by Kamau and Colaiacomo, “IFAD began its operations in 1977 after a very constrained process of raising the initial contributions that had been pledged”, most from its OPEC member states. The first IFAD replenishment was “difficult and protracted” and the “second replenishment negotiations went on for almost two and a half years and by the time these negotiations were completed, the initial agreed level of USD 1 billion had shrunk to USD 460 million”. This prompted IFAD’s General Counsel to constitute “a high-level committee of experts (HLEG) to assess alternative approaches to the ‘long term financial structure of IFAD’” that “should aim at making IFAD more ‘self-supportive financially’ and ensure that the future replenishments are conducted on a more predictable basis”.

In accordance with Art. 2 AEI, IFAD is only authorized to provide financing on concessional terms. However, as “resource mobilization is a broad concept that entails borrowing and raising funds from other sources outside the replenishment process”, the HLEG concluded that Art. 4 Section 1 is not exclusive and considered other sources of financing, such as special programs, trust funds and borrowing, for IFAD to close the financing gap and enable IFAD to fulfil its mandate. Notwithstanding the above, initially IFAD relied on the funding of its operations on the contributions of its members. As since IFAD9, the traditional funding sources (replenishment contributions, loan reflows and treasury income) “have not been sufficient to finance the desired POLG [program

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70 IFAD 2018, para 6.  
71 Kamau and Colaiacomo 2012, 477.  
72 Ibid., 477–478.  
73 Ibid., 478.  
74 Ibid., 481.  
75 Ibid. 481. HLEG committee further concluded that: “IFAD could be authorized to borrow capital from member governments, international financial organizations, commercial banks and capital markets. However, like other international financial institutions, borrowing from the capital market may require member governments’ guarantees in the form of callable capital”. To the extent that borrowing would require member states guarantees, the HLEG committee of experts felt that an “amendment to the Agreement Establishing IFAD would be necessary”. (Ibid., 481).  
76 There was a “steep rise in total core contribution pledges between the Seventh Replenishment of IFAD’s Resources (IFAD7) and IFAD8”; however, afterwards, contributions stabilized in IFAD9 and slightly decreased in IFAD10. See IFAD 2018, para. 8.
of loans and grants], additional sources of finance needed to be explored. Hence, IFAD has begun using debt to leverage its equity and narrow the gap, and has recently pursued a credit rating which gives IFAD access to capital markets (see below).

2.3.2 OPEC Fund

The origins of the OPEC Fund can be traced to the “Agreement establishing the OPEC Special Fund” in 1976 which reflected a concern “for flexibility, swift decision-making, maximization of use of existing resources, and a receptivity to innovation”. Created in January 1976 as a collective aid facility of OPEC member countries, in the form of an international account jointly owned by these countries and jointly administered by a ‘Governing Committee’ of which they were all members, the OPEC Special Fund was transformed to the OPEC Fund for International Development (OFID or OPEC Fund) based on a number of successive amendments culminating in the revision of the Agreement Establishing the Fund.

In comparison with IDA and IFAD, the aforementioned constituent agreement is more succinct and it affords additional flexibility. This relates to the fact that the functions of OFID are defined in wide terms, which enabled OFID in broad terms to “do all that its Board deemed necessary in assisting other developing countries. As a result, the OFID was the first international institution of its kind to combine balance of payments (BOP) support with project lending and to add to its direct assistance to governments the financing of other development agencies [.....]”. Moreover, it is special as it is only providing financial support to non-member countries.

Currently, the OPEC Fund is providing a range of services comprising public-sector lending, private-sector and trade financing and grants in support of

77 Ibid., para. 11.
81 Art. 2.02 of the OFID Agreement states: “The Fund is empowered to engage in all functions necessary or incidental to the carrying out of its objectives according to the guidelines to be issued for this purpose by the Ministerial Council and the Governing Board. It is, in particular, empowered to: a) provide concessional loans for balance of payments support; b) provide concessional loans for the implementation of development projects and programs; c) make contributions and/or provide loans to eligible international agencies; and d) finance technical assistance activities”.
operations in agriculture, education, energy, the financial sector, health, water and sanitation, transport, as well as multi-sector projects.\textsuperscript{84}

The resources of the OPEC Fund, which previously was structured as a revolving fund,\textsuperscript{85} were increased in four replenishments.\textsuperscript{86} However, as in the case of IFAD, such structure constrained its effectiveness. Hence, also the OPEC Fund sought a credit rating and access to capital markets (see below).

3 Implications of Organizational and Institutional Structures and Legal Personality

While not necessarily all organizations belonging to an organizational group are established by a treaty,\textsuperscript{87} in many cases they have a treaty foundation. One of the implications of the separate legal personality of the organizations belonging to a group is that these may have different membership structures and capital structures; relative shareholdings and voting rights of members and resource-mobilization mechanisms of the various organizations which form the group may differ as well. The governance structures of the organizations belonging to a group, may or may not be coordinated.\textsuperscript{88}

In organizational groups, the legal personality of each organization of a group shields all other organizations belonging to the group from legal claims against that organization. This is an effective mechanism for limiting the exposure to higher-risk transactions to the balance sheet of one organization of the group alone. Thus, regularly no material liabilities result, for example, for IBRD from IFC’s operations.


\textsuperscript{85} Art. 4.1 of the OFID Agreement provides: “The resources of the Fund shall consist of: 1) Contributions by Member Countries; 11) Funds received from operations or otherwise accruing to the Fund”.

\textsuperscript{86} As set out in OPEC Fund’s 2017 Financial Statements: “OFID commenced operations with a pledged and confirmed contribution of USD 391 from member countries. There were further replenishments in 1977 (USD391.5), 1980 (USD 655.5) and 1981 (USD 664.7) from member countries. [...] On June 16, 2011, the Ministerial Council approved the fourth replenishment in the amount of USD 1 billion (MC Decision No. 4(XXXI)) [...]”. OPEC Fund, 2017, 26.

\textsuperscript{87} E.g., the revised statute of the IsDB Institute (previously known as IRTI) was adopted by the IsDB Board of Governors. See: IsDB 2021. Statute of IsDBI.

\textsuperscript{88} See in detail Droesse. 2011c, 117–147.
However, the situation is different for organizations following the second paradigm which administer various operational modalities, including private sector financing and concessional financing, under one legal personality. In such a case, any exposure from concessional financing, private-sector financing, equity investments or guarantees, and any exposure from trust funds without legal personality administered by the organization concerned may entail, as a matter of principle, a material liability for the balance sheet of the organization administering such funds and activities under one legal personality. This may induce the organization concerned to adopt more conservative and risk-averse practices. On the other hand, the fact that the various financing windows of an organization (e.g., for sovereign and non-sovereign loans and market-based and concessional financing) are not isolated through a separate legal personality, potentially opens a wide field of synergies as coordination does not require agreements between different organizations but can be achieved based on executive action or as a matter of policy.

It is regrettable that many opportunities for exploiting synergies which the latter paradigm offers have not been adequately pursued. While MDBs and other IFIs have made some progress in mainstreaming public-private partnerships and scaling-up financing through private-sector participation, the core problem has not been addressed. It relates to the fact that institutional frameworks geared to the administration of different resources (public and private sector, concessional finance, trust funds, co-financing), which are currently still widely used, are more likely to support silo thinking than result in the exploration of synergies. Institutional frameworks should focus instead from

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89 While in principle, legal claims relating to a trust fund without legal personality are directed against the trustee, the liability of the trustee may be limited to the resources of the trust fund as a matter of practice. This approach was followed in the case of the Credit Guarantee and Investment Facility (CGIF) which provides “guarantees to local currency denominated bonds issued by corporations in the Region which paves the way for corporations to issue local currency bonds with longer maturities”. (CGIF. About US) While the CGIF was established as an ADB trust fund without international legal personality and legal capacity under local law (ADB 2010), it is stressed in all CGIF legal documentation that CGIF resources are separate and distinct from those of ADB. On that basis, CGIF was given by rating agencies a credit rating that is different from that of ADB and legal claims against the CGIF are not considered a material liability of ADB. See Standard and Poor’s Global, 2017.

90 For example, in the ADB, the termination of the ADF concessional loan window (see below) has created opportunities for enhanced cooperation. Synergies may be created inter alia through blended concessional finance that “can be used to unlock investment into sustainable development, especially from the private sector.” DFIs Working Group on Blended Concessional Finance for Private Sector Projects 2020.
a holistic perspective on outcomes rather than on resources and on facilitating synergies between different types of resources and operational modalities. One effective mechanism for enhancing synergies is the creation of umbrella operational frameworks for specific countries and sectors which comprise all resources and are administered to the extent possible on the same terms and conditions.\footnote{91 See Droesse 2011c, 165–167.}

In organizational groups, achieving synergies is more difficult, as a matter of principle, but not impossible. The World Bank Group stands for an organization that has created, with the One Bank initiative launched by President Zoellick, a conceptional framework for generating substantial synergies. The private-sector window created in IDA, which allows IFC and MIGA to leverage IDA’s resources and help mobilize sustainable private sector investment in the poorest and most fragile markets,\footnote{92 IDA: IDA-IFC-MIGA Private Sector Window.} may serve as an example.\footnote{93 Moreover, while in the case of IDA, a specific provision was included into the Articles of Agreement precluding that IDA may borrow from IBRD, loans from the IBRD are one of the regular funding modalities of MIGA. Moreover, to afford cost savings, administrative, legal and other services may be provided by one organization to other organizations of a group.} The importance of synergies is increasingly also realized by other MDBs and IFIs. Thus, IsDB, ICIEC and ICD recently signed in 2019 a cooperation agreement aimed at “mainstreaming group synergies”.\footnote{94 Given ICIEC mandate to support the exports of its member countries and to encourage the inflow of foreign direct investments, ICIEC anticipates great potential for complementarity with the product offering of ICD & ITFC. This agreement will support ICIEC to extend its Shariah Compliant Insurance Solutions and Services to back ICD and ITFC financing activities. ICIEC will also benefit from ICD and ITFC proven track record and experience in trade and project finance to customize and develop new products for beneficiaries in member countries. See IsDB 2019c.} Nevertheless, examples such as the private-sector window of IDA are so far still sporadic in nature and there is much room for further enhancement and amplification of such approaches.

It can be derived from the above that for the first and second paradigms both liability profiles of organizations and their potential for creating synergies are intrinsically related to their legal personality. As regards the organizations following the third paradigm, these are constrained by the parameters defined by their constituent agreements which do not allow them to mobilize resources against callable capital, but their legal personality and high capitalization may still allow them to have access to capital markets.
4 Hard and Soft Windows

4.1 Differences between Hard and Soft Windows

MDBs provide financing under hard and soft windows. Under hard windows, MDBs generally perform functions of financial intermediaries that resemble those of commercial banks in certain aspects. They borrow on capital markets against a capital base comprising paid-in capital and reserves, as well as callable capital subscribed by their member countries. Hard windows “are constrained in the amount of loans they can make only to the extent that their outstanding borrowings have reached nearly the same level as that of their existing capital resources [...].”\(^95\) Soft windows, on the other hand, require funding arrangements to cover the cost of concessional financing granted below market-rates and/or the cost of grants. Traditionally, they were structured as revolving funds irrespective of their legal structure.

4.2 New Dimensions of Discussion on Hard and Soft Windows

The traditional concepts regarding a distinction between hard and soft windows are challenged, in particular, on two grounds. While there are still many cases where the revolving-fund model is used,\(^96\) in the case of IFIs, this model is often no longer seen as an efficient financial instrument. Second, the traditionally rigid distinction between the market-based funding structures of hard windows and the revolving fund structures of concessional windows is increasingly seen as outdated.

In IFIs, the revolving-fund model has traditionally been used as the funding mechanism of choice for concessional windows. While the legal status of the concessional arm of the World Bank Group, IDA, is different from that of an organization like IFAD providing concessional financing, or a special fund like the Asian Development Fund of the ADB (ADF), the financial structures of these windows were similar in the past to the extent that they were based on the revolving fund model. Hence, in all three cases funding was obtained from members in the context of replenishments that were either conducted through external mechanisms (e.g., meetings of deputies or donors) or, like in the case of IFAD, conducted through the plenary body.\(^97\)

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\(^95\) Mistry, 18.
\(^96\) It is currently still largely used for grant giving organizations, as well as in the case of the climate funds (e.g. the Multilateral Fund for the Montreal Protocol, the Adaptation Fund and the Green Climate Fund) and for trust funds (like the Global Environment Facility) and for various other purposes.
\(^97\) Droesse 2011d, 280–283. For ADB, see Droesse 2012, for AfDB, see Akin-Olugbade and Flory and for IFAD Weill-Hallé, Licul, and García Villanueva.
Erquiaga has well explained the deficiencies of the revolving fund model in his financial history of ADB by comparing the financial structure of the Asian Development Fund (ADF) with that of ADB’s ordinary capital resources (OCR).98

It is a core problem of concessional windows structured as revolving funds that they can only pass monies received from donors to recipients at a rate of 1:1 or less (after deduction of administrative expenses and with some enhancement of commitment authority). Such funding structure is neither effective from a financial point of view as shown by Erquiaga, nor is it sustainable, as it does not allow organizations to have access to capital markets or to mobilize resources as and when and to the extent these are required. Furthermore, at times the so-called concessional loans turned out to be quite expensive for borrowers. While they carried low interest rates, the amount disbursed in convertible currency sometimes had to be repaid by the borrower under loan regulations in a different currency, i.e., in the currency of the donor contribution funding that loan. Where such currency substantially appreciated, repayment of the so-called “concessional loan” could involve very substantial costs for the borrowers. Finally, the whole system was led *ad absurdum* when for a certain period the rates of the now defunct LIBOR were lower than the interest rates on the so-called concessional loans.

Hence, as will be shown in further detail below, several organizations recently have taken action to terminate or restructure their concessional loan windows to be able to leverage resources on capital markets. Furthermore, the revolving fund model is particularly unsuitable for funding any loans on market-based terms. The recent changes to the financial structure of the OPEC Fund, which is providing financing on both concessional and non-concessional terms, need to be seen in this context.

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98 “While ADF equity capital is about double the size of the equity capital of OCR, ADF outstanding loans of D 29.1 billion were only about 54% the size of OCR outstanding loans (D 54.2 billion). This translated into a mobilization (leverage) ratio of loans and guarantees to equity capital of 3.1 for OCR, but only 0.9 for the ADF. The divergence in mobilization ratios was attributable to the fact that the ADF, which does not have a separate legal identity as a structured special window of ADB, is not able to issue bonds to support its lending”. Erquiaga 2016, 69. As further indicated by Erquiaga: “When the ADF was created, this inability to issue debt was not considered problematic as the low creditworthiness of ADF borrowers would have proved to be a constraint in convincing capital market investors to purchase bonds issued by a new entity for lending to these borrowers. This absence of financial leverage was now deemed suboptimal, particularly given the strong track record of regular ADF loan service payments. A leveraged approach was considered more efficient and effective in optimizing the management of concessional financing”. Ibid.
Finally, the approach to treat concessional and non-concessional windows as entirely separate and distinct is questionable on conceptual grounds. There is a "large middle ground between organizations’ concessional and non-concessional windows, which has not been sufficiently explored thus far".99 Moreover, there is much room for realizing synergies between concessional and non-concessional windows as has been shown above.

5 Restructuring of Soft Windows

Due to the deficiencies of the revolving fund structure and consistent with the G20 sponsored Action Plan aiming at the optimization of MDB balance sheets (see below), ADB pursued with the "Project Galaxy" a merger between ADF and OCR. Such merger combined (effective from January 2017) the ADF lending operations with the OCR balance sheet, thus retaining the ADF as a grant-only operation. This important innovation increased OCR equity from USD 18.3 billion to USD 53 billion. ADB continued to offer ADF countries concessional financing on the same terms and conditions as previously provided but through its OCR window, while the ADF would provide only grant assistance.100 This merger enhanced the efficiency of ADB’s concessional operations but it also entails certain legal risks. While previously under Art. 10.1 of the ADB Charter, ADF resources (i.e., special funds resources) were “held, used, committed, invested or otherwise disposed of entirely separate from” OCR resources, such strict separation between OCR and special funds resources no longer applies. As concessional loans are now funded from OCR equity, any arrears or defaults regarding such loans may have implications for ADB’s OCR balance sheet and, potentially, for the credit rating of ADB. Given the deterioration of the debt situation of many countries, the implications of this matter need to be carefully assessed.

IADB followed a similar approach as ADB and in “September 2016 the Governors approved a proposal to transfer the net assets of the former Fund for Special Operations (FSO) to the Ordinary Capital (OC) and to create a concessional lending instrument in the form of a blended loan where both legs of the blended operation would be financed from the OC. The proposal became effective on January 1, 2017”.

99 Droesse 2011c, 165. See also ibid. 211 and 296.
100 Project Galaxy has been described in detail by Erquiaga. This paragraph draws on Erquiaga’s description. See Erquiaga 2016, 68.
101 IADB. Concessional Resources: With further references.
From a purely financial perspective, a similar approach like that adopted by ADB and IADB, i.e., involving a merger of IDA and IBRD and the use of IDA resources, mostly in the form of loans, for increasing the IBRD equity, would have been the “most cost-effective solution”\(^{102}\) for the World Bank Group.

In the past, Shihata had reflected on a possible merger of IBRD, IFC, and MIGA “while restructuring IDA as an international trust fund administered by the resulting mega institution”\(^{103}\). The reason why a merger of IBRD and IDA or any approach to restructure or terminate IDA has never realistically been considered is related on the one hand to the fact that IDA is an international organization in its own right which possesses international legal personality and legal capacity under national law. Generally, any termination of an international organization or any merger of two organizations is a daunting task, given the resilience of international organizations against annihilation and the applicable qualified majorities which are a formidable obstacle to institutional reform\(^{104}\). Furthermore, any proposed merger of IDA and IBRD would meet tremendous obstacles due to vested interests of IDA members\(^{105}\).

Thus, rather than merging IBRD and IDA, IDA opted pursuing the issuance of a credit rating in preparation of bond issuances. While unlike IBRD, IDA

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\(^{102}\) As indicated by Humphrey in 2017: “The World Bank’s IDA has the most financial potential from a balance sheet merger, based on its D 154.7 billion in equity (most of it in loans). A merger would boost IBRD equity from D 39.4 billion to D 194.1 billion, resulting in space for several hundred billion dollars more in potential loan portfolio size.” See Humphrey 2017, 11. In comparison to 2017, IDA’s equity has substantially further increased, given the successful conclusion of the IDA 19 Replenishment negotiations.

\(^{103}\) Shihata 2001, 119.

\(^{104}\) In accordance with Art. VII Section 5 (a) of the IDA Articles of Agreement, the permanent suspension of IDA requires a “vote of a majority of the Governors exercising a majority of the total voting power”. In accordance with (c) of Section 5 mentioned above and subject to special arrangements which may be made for supplementary contributions of members, the assets of IDA would be distributed in such a case to members “pro rata in proportion to amounts paid in by them on account of their subscriptions”. Hence, it any different disposition would require the approval of all IDA members. Moreover, for using the assets of IDA for an infusion of equity in the IBRD and IBRD to commence to operate on concessional terms, an amendment to the IBRD Articles of Agreement would be necessary, which, in accordance with Art. VIII (a) of IBRD Articles of Agreement, requires approval by the IBRD Board of Governor and acceptance by “three-fifth of the members, having eighty-five percent of the total voting power”.

\(^{105}\) As stated by Humphrey: “Wealthy countries have a much higher ownership stake in IDA equity than at IBRD, due to their donations over the years. Merging the two windows would mean either increasing the voting share of wealthy countries at the new merged bank relative to borrower shareholders, or asking the wealthy countries to give up their ownership stake in IDA – both technically feasible options, but politically difficult”. Humphrey 2017, 11.
has no callable capital, Standard & Poors (S & P) gave IDA a AAA rating, i.e., the highest credit rating also given to the IBRD, based on its “strong business profile and extremely strong financial profile”\textsuperscript{106} A similar rating was given to IDA also by Moody’s\textsuperscript{107} which greatly increased IDA’s leverage to mobilize additional resources.\textsuperscript{108}

The first bond issued by IDA was sold within hours to institutional investors,\textsuperscript{109} which suggests a strong interest of capital markets in IDA bonds. Since then, IDA has issued various bonds, initially with a maturity of 5 years, and in 2000 IDA first priced its first “10-year USD benchmark” bond\textsuperscript{110} with a maturity of 10 years. As IDA was able to enhance its efficiency and impact by leveraging monies on capital markets, it was able to exceed its IDA 19 target despite the fact that U.S. had reduced its IDA contribution.\textsuperscript{111}

As regards the African Development Fund, the “High Level Panel convened by the AfDB president in 2006 recommended eliminating the division between AfDB and the AfDF in its January 2008 report, suggesting a merger of the two institutions and their boards”.\textsuperscript{112} Nevertheless, also in the AfDB Group,
neither a termination of the AfDF nor a merger of the AfDB and AfDF proved to be a realistic option in the past, for very similar reasons as highlighted for IDA above.

In 2016, the African Development Bank Group launched analytical work to assess the costs and benefits of either leveraging the African Development Fund, as done by the World Bank Group, or merging the Fund’s loan portfolio into the African Development Bank, as done by the Asian and Inter-American Development Banks. While so far, the AfDB Group has not yet received a credit rating for the AfDB, the AfDB Group is seeking “new and creative ways of mobilizing resources to support Africa’s transformation, especially by leveraging its own resources”, and the AfDB is engaged in a process of institutional reform and confirmed its “commitment to implementation of the One Bank vision in 2019” which emphasized “quality, delivery, and joint accountability”.

Nevertheless, as indicated by Birdsall in 2018, the AfDF was then “six to seven times smaller than the World Bank’s IDA in Africa” and it adds to its challenges that its reflows and equity bases are lower than for IDA. While AfDF donors committed in 2019 USD 7.6 billion for the fifteenth replenishment of the AfDF, it is necessary to seek new ways for “reinvigorating African concessional finance”, e.g. through the issuance of a “Big Bond” implemented through a new financing facility.

to tailor lending accordingly, operating as a single bank with a single board”.

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113 AfDB Financing Strategy. Also see AfDB’s Strategy for 2013–2022.
115 “First, IDA will continue to receive higher reflows to relend in each of the next several three-year replenishment periods. In the current period, reflows are projected to be almost D 20 billion to IDA and perhaps D 600 million to the AfDF; one reason is that IDA continues to receive reflows from China, India and other countries outside Africa that no longer borrow from IDA or borrow only limited amounts. Second, IDA now has its own AAA credit rating, separate from that of the IBRD, and for the first time has borrowed on the capital market. Its own borrowing of as much as D 25 billion will not necessarily increase every three years (the number of countries eligible for highly concessional lending should continue to decline), but other demands for concessional resources, for refugees, for natural disaster relief, possibly for debt relief could rise. But even if the amounts decline, they will be large compared to any possible borrowing by the AfDF, given that the ‘equity’ of the AfDF in terms of expected future reflows is so much smaller”. Birdsall 2018, 16.
117 See AfDB 2017. The “High-Level Panel on Transforming Trust in the AfDB Group into Influence” reviewed “market borrowing” as planned in IDA and ADB’s merger of AfD and OCR, but concluded that based on both approaches only a “modest increase” in the size
6 Transformation of the Funding Structures of IFAD and the OPEC Fund

It is an important development that IFAD and the OPEC Fund, while not designed to mobilize resources against callable capital, have both transformed their funding structures by seeking a credit rating and access to capital markets.

6.1 IFAD

In IFAD, a precursor to sovereign loans was the Spanish Food Security Co-Financing Facility Trust Fund approved by the Executive Board in 2010.¹¹⁸ In 2015, following a first borrowing from KfW,¹¹⁹ a “Sovereign Borrowing Framework” was put in place “setting out the parameters within which IFAD may borrow from sovereign states and state-supported institutions” which, however, did not “address the subject of IFAD borrowing from the financial markets through the issuance of bonds”.¹²⁰

The corporate evaluation of IFAD’s financial architecture prepared in 2018 concluded that IFAD’s financial architecture had failed “the test of financial sustainability” as it had “incurred financial losses every year since 2010” (except in 2017), resulting in an erosion of its retained earnings and capital base.¹²¹

¹¹⁸ IFAD 2018a, para 11. As shown by Kamau and Colaicomo, while the grant element of the trust fund allowed IFAD to onlend the resources of the trust fund on concessional terms, these did not become part of IFAD’s regular resources and could not, for that reason, be allocated through IFAD’s performance-based allocation system (Ibid. para. 102).

¹¹⁹ Ibid, para. 103: “The first sovereign borrowing after the Spanish Trust Fund was designed to help bridge the difference between the IFAD9 target PoLG and the financing level achieved from the replenishment. A sovereign loan of keep with number 400 million was obtained from KfW with the agreement of the Executive Board in September 2014.”

¹²⁰ IFAD 2015. The sovereign borrowing from “KfW and the Spanish Trust Fund has allowed IFAD to finance a larger PoLG [programme of loans and grants] than would have been possible by relying only on replenishment contributions, loan reflows and Treasury income. Sovereign lending was IFAD’s first step in introducing debt to leverage the equity in its balance sheet” (IFAD 2018, para 11).

¹²¹ IFAD 2018a, 97. It concluded that “four decades after its establishment, IFAD’s financial architecture require[d] important reforms. These reforms concern[ed] the mobilization of financial resources, the system for allocating financial resources, the financial products...
Under the eleventh Replenishment of IFAD (IFAD11), while Members’ replenishment contributions remained at the time “the foundation of the Fund’s capital and commitment capacity” (with a replenishment contribution target of USD 1.2 billion), borrowing from Member States and their institutions “was then fully integrated into the financial framework of the Fund for the first time.”  

Since then, IFAD has taken a similar course as IDA by obtaining a credit rating. IFAD was the first UN Fund to do so. In October, Fitch gave an AA+ rating to IFAD. While recognizing that “IFAD is inherently loss-making, owing to its business model”, Fitch considered that this “is offset by the paid-in contributions it receives from its member states”. S&P harmonized its rating with that of Fitch by giving IFAD an AA+ rating as well.

These ratings enhance IFAD’s ability to mobilize resources and are seen as a prelude to private placements. While IFAD does not appear to plan issuing bonds anytime soon, such course of action might be considered at a later stage.

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available to respond to the need and demand of borrowing Member States, the financial sustainability of the Fund as well as internal and external financial governance features”. (Ibid. 98) The said evaluation further recommended inter alia that IFAD conduct preparatory work for potential access to capital markets, stating. “Learning from the IDA case, it may not be strictly necessary for IFAD to be profitable to tap markets. However, a high credit rating is a condicio sine qua non and would in all likelihood require a restructuring of IFAD’s financial architecture, by addressing those factors that create uncertainty.” (Ibid., 99).

122 IFAD 2018b, para 4.
123 Fitch considered “IFAD’s ‘excellent’ capitalisation as a key rating strength”, primarily driven by [their] view that “IFAD’s equity/assets ratio will continue to far exceed the 25% ‘excellent’ threshold over the medium term” and “supported by the fund’s usable capital/risk-weighted assets (FRA) ratio, which also far exceeds the 35% ‘excellent’ threshold (end-2019: 75%)” (As of end-2019 this ratio was around 85%). While recognizing that “IFAD is inherently loss-making, owing to its business model”, Fitch considered that this “is offset by the paid-in contributions it receives from its member states”. (FitchRatings 2020b).
124 FitchRatings 2020b. See also and McLellan 2020.
125 IFAD 2020.
126 As highlighted by IFAD’s President: “With two positive ratings, we can mobilize more funds from various potential investors at a favourable cost. And this means we can do more to increase the incomes and food supply of the poor rural people who desperately need it. This is a prerequisite for building global stability and resilience”. IFAD. 2020.
128 Under IFAD’s business model and financial framework for the years 2022–2024, IFAD will combine it Integrated Borrowing Framework with “the adoption of key principles” to support IFAD’s financial sustainability as part of the revision of the existing procedures and definitions, and in addition, the Framework for Accelerated Repayments and Voluntary
6.2 **OPEC Fund**

The inherent problems of the revolving fund model have also manifested themselves in the case of the OPEC Fund. The fact that it was unable to have access to capital markets constrained its effectiveness. Hence, the OPEC Fund opted for a similar approach as IDA and IFAD, albeit with the difference that the OPEC Fund provides to a substantial extent financing on market-based terms. The high level of capitalization of the OPEC Fund enabled it to obtain a credit rating even though it cannot rely on callable capital to mobilize resources on capital markets.

In 2020, the Ministerial Council approved the Enhanced Management of OPEC Fund’s Capital Resources, which entails (i) the establishment of the Special Capital Resources (SCR) fund through an initial transfer of loan and treasury assets from the existing capital resources of the OPEC Fund; and (ii) the OPEC’s Fund’s existing capital resources being called Ordinary Capital Resources.129

Fitch rated the OPEC Fund on 29 July 2021 as “AA+ Outlook Stable” “based on the Standalone Credit Profile (SCP) of the institution” and, in particular, the “OPEC Fund’s ‘excellent’ capitalisation as a key rating strength” and their expectation that the fund’s equity/assets ratio, which was end-of 2020 around 91%, “will continue to far exceed the 25% ‘excellent’ threshold over the medium term”.130 A similar rating was given to the OPEC Fund also by S&P, which assigned the OPEC Fund an AA/A-1+ rating with a positive outlook.131

Hence, the capital structure of the OPEC Fund will resemble in the future that of ADB before the implementation of the project Galaxy when ADB leveraged resources on capital markets for its ordinary capital resources but the ADF was structured as a revolving fund to finance ADF loans and grants. As in line with Article 8 of the Agreement Establishing the OPEC Fund, the resources of the SCR must be held and managed entirely separately at all times from the OCR, any arrears or defaults on concessional loans do not affect the OCR balance sheet of the OPEC Fund or its credit rating.

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129 OPEC Fund 2021, 16.
130 FitchRatings. 2021c.
Market-Based (Hard) Windows

7.1 Conceptual Architecture of Market-Based Windows

The basic features of MDB capital structures are well known and do need to be explained for that reason in detail.

Mistry has well described the architecture of a hard window “which comprises the core ‘development bank’ in each institution” and has a “capital structure in two parts: cash capital and callable capital”.\(^\text{132}\) The “figment of confidence underlying the capital structure of MDBs is embedded in the notion of callable capital” which ensures “that each dollar lent is fully backed by a dollar of shareholder’s equity, given the 1:1 limitation on the loan assets to capital ratio”, even though “only a small fraction of the equity dollar in MDBs is paid-up front in cash”\(^\text{133}\).

MDBs effectively can only perform their intermediation function if they can offer financing on favorable market-based terms.\(^\text{134}\) Their ability “to leverage through their borrowings in international capital markets is significantly enhanced by their high credit standing”, which is influenced notably by their “strong equity capitalization”, i.e., equity to asset ratios that are higher than observed by commercial banks, as well as their “shareholder support through ‘callable capital’ and their ‘Preferred Creditor Status’”.\(^\text{135}\) As regards shareholder support, “[r]ating agencies tend to allow some proportion of this additional callable capital to count as actual capital, but it is less than 100 percent.

Previously, S&P only recognized the callable capital of sovereigns with the same credit rating as that of the multilateral lending institution (MLI) concerned. Thus, for MLIs aiming for an AAA rating, S&P only [made] allowance for callable capital promised by shareholders that have AAA S&P ratings”.\(^\text{136}\) However, in 2018, S&P broadened their “definition of eligible callable capital to include sovereigns rated at least equal to the MLI’s stand-alone credit profile (SACP)”, which is a composite rating combining the assessments on capital adequacy.

\(^\text{132}\) Mistry, 17.
\(^\text{133}\) Ibid., 22.
\(^\text{134}\) As stated by Humphrey: “The unique financial model of MDBs makes them extremely attractive for shareholders as it minimizes budgetary costs, but it means that the MDB has to be run in a way that ensure access to capital markets. Thus, MDBs have two sets of ‘principals’: the overt political and financial owners of the MDB (government shareholders) and the less obvious suppliers of liquidity essential for MDB operations (bond buyers).” Humphrey 2015b, 2.
\(^\text{135}\) Perraudin, Powell and Yang 2016, 8.
\(^\text{136}\) Ibid.
and funding and liquidity. Fitch, on the other hand, applies a “usable capital to risk-weighted assets ratio” under which “[u]sable capital includes shareholders’ equity plus a portion (10%) of callable capital subscribed by ‘AAA’/‘AA’ rated shareholders”. Under the criteria used by both S&P and Fitch, there is an intrinsic relationship between membership composition and credit rating of MDB members and the rating of the MDBs.

As the intermediation model is predicated on the ability of the financial intermediary to offer financing at preferential rates, the very sustainability of the financing offered by the intermediary is linked to their credit rating and may be seriously affected by any downgrade, in particular to Moody’s BA category, or other comparable categories, where “obligations are judged to have speculative elements and are subject to substantial credit risk”, or an even lower category.

While the credit ratings of the members of financial intermediaries are of great importance for their own credit rating, it is possible that a financial intermediary may have a higher credit rating than the average credit rating of its members, in particular, if the capitalization of the intermediary is increased to well exceed a risk-adjusted capital ratio of 23. This is confirmed, in particular, by the AAA-credit rating of IsDB which is higher than the average credit rating of its members. IsDB was able to obtain this rating as it has a stable capital structure and is one “of the strongest-capitalized MDBs with an equity-to-assets ratio of 39.6%”. Similar considerations also explain why the A+ credit rating of

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137 S&P Global 2018b, 2. On the SACP, see ibid., 5–7.
138 Fitch Ratings 2020a, 6.
139 Particular problems arise for borrower-dominated IFIs, such as some of the sub-regional development banks which do not have, or only very few, AAA-rated members, and otherwise only members which lower credit ratings. The importance of these ratings can be illustrated by a comparison of the East African Development Bank (EADB) and the West African Development Bank (BOAD). The East African Development Bank (EADB) was upgraded in 2015 by Moody’s from B to Baa3 (see EADB 2015). Still this rating is 9 notches lower on the Moody’s rating scale that their Aaa rating of MDBs (the previous B rating was 10 notches lower). At this rating, EADB so far has been constrained to issuing local currency bonds, which tend to be rated higher by rating agencies than bonds issued in international capital markets. (See Capital Intelligence: Foreign Currency and Local Currency Ratings). The West African Development Bank, on the other hand, has a Baa1 rating which is 2 notches higher than that of EADB, partially because it benefitted from a World Bank project of capital market development (World Bank: Report No: ICR 2565). (2013). It is able to issue bonds on international capital markets (See BOAD: BOAD issues the first African sustainability bond 2021).
140 Moody’s Rating Scale and Definitions.
141 Under S&P’s initial capital adequacy assessment, the risk-adjusted capital ratio is assessed as extremely strong if it is at 23% and above. See S&P Global Ratings 2018b, 16 (Table 10).
142 IsDB Investor Presentation 2019b, 14.
rating of the Corporación Andina de Fomento (CAF) by Fitch is higher than the average credit rating of CAF members.\textsuperscript{143}

So far, none of the MDBs or IFIs that follow the intermediation model have ever made a call and, in essence, that model is predicated on the assumption that it will never be necessary to make such a call. As has been recognized with regard to the World Bank, if “the callable capital were ever called in, it would effectively be a nuclear option – so devastating as to effectively destroy the Bank itself”.\textsuperscript{144} Therefore, “as a buffer for very serious stress periods” callable capital remains untested as S&P highlighted in 2017.\textsuperscript{145} Callable capital is “inferior to paid-in capital”\textsuperscript{146} as for some member governments their ability to pay in distress scenarios is limited and for others payment requires legislative action, which makes the timeliness of payment an issue. “Finally, the directors who vote to make the call are appointed by the governments to which the call is made, which makes it difficult to assess with certainty under what degree of stress a board would make a capital call and what effect the nonpayment of a capital call by one member government would have on other members”. For these reasons, and as indicated above, S&P does not view callable capital as a “substitute for paid-in capital”.\textsuperscript{147}

As prudence dictates that MDB borrowing and lending should be more appropriately “gauged against limits of readily useable capital; with capital increases being negotiated and concluded before borrowing or outstanding

\textsuperscript{143} Fitch stated in their 2019 Report that “CAF’s intrinsic credit quality” drove their AA-rating of CAF. FitchRatings, Corporacion Andina de Fomento (CAF). Full Rating report 2019. Moreover, they highlight in the said report: “Excellent Capitalisation: CAF’s equity/adjusted assets ratio averaged 30.4% from 2015 to end-December 2018, as sustained capital contributions and steady internal capital generation kept pace with growth. Its prudential framework requires a minimum total capital/weighted risks ratio (Basel II since 2007) of 30%. In practice, the reported ratio has been well above this minimum, reaching 41.1% in 2018.” (Ibid.). In 2021, the rating of CAF was revised to A+ (See FitchRatings 2021). It was indicated in this context by Fitch: “The solvency assessment balances the bank’s ‘excellent’ capitalisation with a ‘moderate’ risk profile. CAF’s equity/adjusted assets ratio was 28.6% as of end-September 2020, above the threshold for an ‘excellent’ assessment (25%). The average for this metric was 30% over 2015–2019. Fitch’s usable capital to risk-weighted assets (FRA) ratio, was 45% as of end-September 2020, also above the threshold for an ‘excellent’ assessment (35%).” See FitchRatings 2021.

\textsuperscript{144} Kapur and Raychaudhuri 2014, 3.


\textsuperscript{146} Ibid., 12.

\textsuperscript{147} Ibid.
loans approach the limits of usable capital"\(^{148}\) that notion is used in actual terms for determining when capital increases are required.

The ratings of MDBs do not only depend on their financial strength but also on their shareholders support which is affected, inter alia, if members deviate in raising capital from their historical share of paid-in to callable capital"\(^ {149}\). Hence, there is a limit regarding the extent to which MDBs and other IFIs can erode their paid-in capital ratios without effect on their credit rating.

Under their market-based windows, MDBs have to lend on market-related hard terms (hence the term hard-window); i.e., their interest charges must cover its own borrowing cost plus a spread or interest margin to cover its internal administrative and operating costs. Generally, MDBs provide loans with long maturities up to 20 years funded by borrowings with average life of about 5 years either with a fixed or variable spread (i.e., an interest mark-up over their own cost of borrowing).\(^ {150}\) While in the case of a variable spread the volatility of exchange rates is a risk of the borrower, the situation is different for loans with a fixed spread. In that case, the refinancing risk arising from this maturity mismatch is mitigated by the AAA-rating of MDBs which ensures a relatively stable funding cost. Any changes in funding cost will be passed on to the borrower through variable lending spread.\(^ {151}\)

In essence, the ability of MLIs to provide market-based financing is only constrained by the adequacy of their capital to sustain market-based borrowings. Thus, there is an intrinsic relationship between the unimpaired subscribed

\(^{148}\) Mistry 1995, 22. For the IBRD useable equity, see Word Bank Annual Report 2018 (Fiscal 2018), Table 27.

\(^{149}\) “This shareholder support is manifested in several ways. For shareholder governments that borrow from MDBs, they show their support by servicing their loans from MDBs in a timely manner, even in the event they do not service their commercial debt. For all shareholders, agreeing to cash capital subscriptions when needed and paying the capital subscriptions when due are tangible demonstrations of shareholder support. Conversely, deviating from the institution’s historical share of paid-in to callable capital by raising the share of callable capital (or, in particular, introducing callable capital into an MDB’s capital structure at a time when the global economy is only slowly recovering) could indicate a weakening of shareholder support, perhaps motivated by fiscal constraints that the shareholder governments themselves face.” (emphasis added) See S&P Rating Services 2009, 4.

\(^{150}\) See in detail Chris Humphrey 2014.

\(^{151}\) Memorandum from the World Bank President of 24 October 2019 on “IBRD Lending Rates and Spreads Applicable on or after October 1, 2019, 2” regarding the variable spread of the IBRD Flexible Loan product: “The pricing principle of IFI Variable Spread is to pass through changes in IBRD’s funding cost to Borrowers”. The said Memorandum defines on pp. 2 and 3 the various components of the IFI variable spread.
capital of MLI$s (as valued by each organization)\textsuperscript{152} and the operational limit of the financing (headroom) which can be provided by them. As and to the extent that an organization is approaching its headroom, an increase in capital is required, which can take the form of a general capital increase or special (selective) capital increase. While in the case of general capital increases all members are given the opportunity to subscribe to a proportionate amount of the capital stock, special (selective) capital increases change the equilibrium of power between the members of the organization. This is the main reason why they often face obstacles.

7.2 \textit{Capital Increases}

It is not possible to provide here a comprehensive review of the various capital increases of MDB$s. Rather, only some significant features, issues and developments relating to the general and special (selective) capital increases of MDB$s will be highlighted.

7.2.1 World Bank Group

7.2.1.1 \textit{International Bank for Reconstruction and Development}

In the IBRD, general and selective capital increases are closely related. Therefore, it is useful to see the history of IBRD’s general capital increases in conjunction with its selective capital increases. In this context, three periods can be distinguished.

During the period prior to 1984, nine increases in authorized capital stock were approved which increased the initial 100,000 shares allocated by the Articles of Agreement to 716,000 shares.\textsuperscript{153} The first such increase in the amount of USD 10,000,000,000, is interesting as it involved an increase of callable capital only; it was approved in 1959 by the IBRD Board of Governors to support the growth in IBRD operations.\textsuperscript{154} Prior to 1984, IBRD members were regularly eligible, to the extent that their IMF quotas increased as the result of a general quota review, for a selective capital increase in IBRD which aligned their IBRD shareholdings with their IMF quotas. In 1980, a first attempt was made to address the dilution of members’ basic voting rights in the context of IBRD capital increases through the allocation of membership votes.\textsuperscript{155}

\textsuperscript{152} While the constituent agreements of MDB$s define the operational limit in similar terms, their interpretation has varied. For details see Sureda 2005, 229–232. Moreover, matters are further complicated due to open issues on the determination of standard of value and maintenance-of-value obligations. For details see Mistry, 38–45 and Sureda, 229–229.

\textsuperscript{153} IBRD Technical Note: Past IBRD Capital Increases 1987.

\textsuperscript{154} IBRD 1959, Board of Governors resolution No. 128.

\textsuperscript{155} IBRD Technical Note: Past IBRD Capital Increases 1987, 21.
As regards the period from 1984 until 2000, the 1988 General Capital Increase of IBRD, which increased the authorized capital of IBRD by USD 74.8 billion, and an Additional Capital Increase fell into this period. During the above period, the parallelism between IMF general quota reviews and IBRD selective capital increases was increasingly decoupled. Rather, the focus moved to the question as to what extent IBRD members’ shareholdings can be aligned with their IDA contributions.

In 1984, the IBRD had a large selective capital increase which raised Japan, based on a 10% increase in its IMF quotas resulting from the Eights General Review of the IMF quotas, “to the position of second-largest shareholder of the IBRD”. While in the past, IBRD had followed the principle that “members’ shareholding in the IBRD should be parallel to their relative quotas in the IMF”, the 1984 SCI for Japan marked the beginning of the decoupling of the IBRD selective capital increases with IMF quotas. As some countries hinted that their continued high IDA replenishment contributions might be subject to adjustments in their IBRD shareholdings, the focus moved instead on a possible linkage between IDA contributions and IBRD shareholdings. In 1987, while “rejecting any explicit and direct link between IDA contributions and IBRD shareholdings, a majority of Directors was prepared to support special share allocations for certain members in conjunction with the IDA8 negotiations reflecting more broadly these members’ support to the World Bank Group [...]”.

The issue on whether there should be a linkage between IBRD members’ contributions to IDA and their IBRD shareholdings surfaced again during the

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156 IBRD 1988, Board of Governors resolutions Nos. 425 and 426.
157 Kapur, Lewis and Webb, 294.
158 In 1976, the IBRD had taken a first action to address the request of Japan first made during the IDA 5 replenishment negotiations (1975–77) that its IBRD shareholding should be harmonized with its cumulative contributions to IDA which were proportionately about twice as high as its IBRD shareholdings (Kapur, Lewis and Webb, 294). In case of Board of Governors Resolution No. 395 adopted on 30 August 1984, the principle that IBRD shareholding should be aligned with IMF quotas was partially dispensed with as the Executive Directors of the IBRD believed “that in calculating the special increases to be allocated only quota increases under the Fund Resolution in excess of 22.0833 percent of present quotas should regarded as special increases and that members be authorized to subscribe 50 percent of the shares as so calculated”. (See the preamble of IBRD Board of Governors Resolution No. 395). (See Technical Note. Past IBRD Capital Increases. 1987, para. 31) Hence, under Resolution mentioned above which increased the capital stock of the IBRD by USD 7 billion, IBRD members were only allowed to subscribe to 50 percent of the shares which they would have been entitled to receive in parallel with IMF quota increase.
159 Memorandum from the World Bank President B. B. Conable to the Executive Directors 1987, 1.
IDA 11 Deputies’ meetings, held in South Africa in June 1995 and in Washington D.C. in October 1995 when “several Deputies referred to the need to strengthen the linkage between IDA contributions and Bank shares”. At the 1996 Annual Meeting, the IBRD Executive Directors, noting the desire of Japan “to increase its subscription to the capital stock of the Bank by 33,230 shares”, recommended this to the Board of Governors authorizing such a subscription which “would increase Japan’s subscription from 93,770 shares or 6.15% of the authorized capital to 127,000 shares or 8.15% of the authorized capital”. Approval to that effect was given by the Board of Governors by Resolution No. 503 adopted on 14 June 1996.

Starting in 2000, discussions on IBRD selective capital increases were linked to IBRD governance reform. Following the Monterrey Consensus, discussion in the World Bank focused on voice reform. A variety of options were considered in the context of the voice-reform process, which was implemented in two phases. If anything, the voice-reform discussions underline the difficulties...
attached to any institutional reform. The changes which were eventually implemented came too late and achieved too little to address the concern of the transitional economies mentioned above.

A general capital increase and selective capital increase could only be implemented in 2018 after some of the U.S. concerns had been addressed, in particular those regarding IBRD loan pricing measures. Resolution No. 663 provided that the “authorized capital stock of the Bank shall be increased by 230,500 shares of capital stock”, such shares being available for subscription by all members of IBRD as specified in the table of the Resolution and on such terms as specified in para. 3 of the Resolution.

Further, Resolution No. 664 provided that the IBRD capital stock should be increased by additional 245,773 shares. As under Resolution No. 663, all IBRD members were entitled to subscribe the number of shares specified in Resolution No. 664, but in a different proportion than under Resolution No. 663.

7.2.1.2 International Finance Corporation

The initial capitalization of IFC was relatively higher than that of the IBRD, due to the fact that IFC provides financing without a sovereign guarantee. Hence, unlike the case of IBRD, where the paid-in portion of subscription payments initially was 20%, in the case of IFC payment for subscription had to be made in full by the original members and members admitted subsequently. While in the case of the IBRD, shareholdings were initially aligned with the IMF quotas, in the IFC, the shareholdings of the original members were in line with their IBRD shareholdings. This alignment was maintained in the early general

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164 IBRD Board of Governors, Resolution No. 663.
165 IBRD Board of Governors, Resolution No. 664.
166 The initial subscription of original members was payable in full in gold or U.S. dollars. See Art. 11, Section 3 (c) of the IFC Articles of Agreement.
capital increases, but was later applied flexibly. In connection with a proposal to increase the IFC authorized capital by 150,000 shares for the former Soviet Republics, an amendment to the IFC Articles was approved allowing the U.S. to exercise also in the future its *de facto* veto rights over IFC affairs.

IFC was only included in the voice reform discussion at a late stage. Also, in the case of IFC, the core problem that the shareholdings of various IFC members (e.g., China and India) are no longer consistent with their role in the world economy, was not resolved. As for IBRD, it was also proposed for the IFC to improve Board representation for the then "47 countries of Sub-Saharan Africa (SSA) on all four Bank Group Boards, so that three Executive Directors would represent the SSA countries, rather than two".

Notwithstanding the recognition of the crucial role of the private sector in financing the post-2015 development agenda, substantial problems arose in ensuring adequate provision of resources to IFC. One problem was that there was limited support for an increase of IFC’s authorized capital stock, in particular, in the U.S. which has a *de facto* veto right over decisions approving an increase in authorized IFC capital stock, irrespective of whether the U.S. participates in such increase.

Eventually, the IFC members, including the U.S., agreed in 2018 to a general capital increase and selective capital increases subject to reforms designed, in part, to address a longstanding concern for many U.S. policymakers: high levels of World Bank lending to uppermiddle income countries, especially China.

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168 *IFC* Board of Governors Resolution No. 196.

169 *IFC* Board of Governors Resolution No. 197.

170 Development Committee Discussion Note 2015, para 34.

171 In 2020, the IFC Board of Governors approved three important resolutions. The IFC Directors having determined “it would be desirable that each member be issued shares without any cash contribution”, the IFC Board of Governors resolved by Resolution No. 270 to increase the IFC authorized capital stock by the creation of 16,999,998 additional shares to “implement the conversion of a portion of the retained earnings of the Corporation into paid-in capital” (*IFC* Board of Governors Resolution No. 270: "2018 Conversion of Retained Earnings and General Capital Increase" adopted on 16 April 2020). IFC Board of Governors Resolution No. 271 provided for an increase of IFC’s authorized capital stock by 919,998 shares, each having a par value of one thousand United States dollars (D 1,000), and selective allocation of shares to members. Members included in the Table in para. 3 of Resolution No. 271 were authorized to subscribe up to the total number of shares indicated. (*IFC* Board of Governors Resolution No. 271 "2018 Selective Capital Increase" adopted on 16 April 2020, Para No. 5 (a), (c), (d) and (e)). Finally, a general capital increase, the first since 1992, was approved by the IFC Board of Governors by Resolution No. 272.
A condition for these capital increases was a further amendment to the IFC Articles which allowed the U.S. to maintain its de facto veto right despite the fact that it did not subscribe to an increase of IFC’s capital stock. The terms of the general and the selective capital increases were very favorable to the U.S. While similar issues also arose in other MDBs and IFIs, the IFI general and selective capital increases of 2020 show with particular clarity to which extent qualified majorities allow a single member (or a small group of member states) to shape the agenda of an organization.

### 7.2.1.3 Multilateral Investment and Guarantee Agency

The general capital increase of MIGA in 1988 is interesting as it was funded through a USD 150 million grant from IBRD, USD 150 million of paid-in capital and USD 700 million of callable capital. It has been so far the only general capital increase authorized by the MIGA Board of Governors and only involved very limited payment obligations for MIGA members. However, the MIGA Board of Governors increased by Resolutions Nos. 47 and 101, consistent with Art. 22 of the MIGA Convention, the maximum aggregate amount of contingent liabilities that may be assumed by the Agency first from 150 percent to 350 percent, and subsequently to 500 percent of the amount of the Agency’s unimpaired subscribed capital, reserves, and portion of its reinsurance cover determined by the Board of Governors.

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172 IFC Board of Governors Resolution No. 273: Amendment to the Articles of Agreement of the Corporation 2020, Art. 11, Section 2 (c) para 1.

173 As indicated by Nancy Lee and Mark Plant: “By the numbers alone, this is a great deal for the American people. No new US taxpayer dollars will go to the IFC, but under the terms of the deal the US remains the largest shareholder and the only country with veto power over the most important voting decisions. As with any multilateral financial institution, the capital the US has contributed in the past has been multiplied many times over by other shareholders and translated into much larger financial flows to developing countries”. Lee and Plant 2019, 42.

174 The capital increase was approved by MIGA Resolution of the Board of Governors No. 57.


7.2.2 Regional Development Banks and IFIs of Limited Membership

There have been shifts in the global financial architecture regarding the financing provided by international organizations. While until the “2008–09 global financial crisis, the World Bank was as large as the Inter-American, Asian and African banks combined, measured in terms of total capital to support ordinary lending”, the “financial crisis increased the demand for lending from all the banks leading to capital increases (‘recapitalizations’) in 2011 at all the legacy banks except the EBRD. The increases were relatively larger at the three regional banks than at the World Bank, probably reflecting the greater interest of their regional borrowers in their banks” and the creation of the AIIB in 2015 added further to the share of the regional banks in total MDB (paid-in) capital; they now constitute more than 50 percent of total MDB capital.177

Hence, “the long-run trend appears to be relatively faster growth of the regional banks, where the middle-income countries have a relatively greater role and greater sense of ‘ownership’”.178

The IADB, AfDB and ADB epitomize that trend because they each dramatically increased their authorized capital. In the IADB and AfDB, where membership initially was limited to the members of the Organization of American States (OAS) and African countries, respectively, their opening to new members was instrumental to their increase of capital. The IADB Charter, which initially had been amended to admit Canada to membership, was subsequently further amended to allow members of the IMF and Switzerland to join in accordance with general rules to be established by the Board of Governors.179 IADB initially amended the IADB Charter in 1976 to create an inter-regional capital stock180 but deleted the provisions introduced to that effect already nine years later by providing for an automatic merger of inter-regional capital and ordinary capital stock.181 In the context of nine increases in resources of the IADB, the IADB capital was increased to USD 170.9 billion.182

In the AfDB, the third general capital increase of AfDB or “GCI-3 (comprising the combined capital increases of 1979 and 1981) was very important as it entailed the admission of non-regional members into the shareholding of the AfDB, along with a substantial increase in the Bank’s capital base to over USD

177 Birdsall 2018, 4.
178 Ibid.
179 IADB 1972, Board of Governors Resolution AG-4/72.
180 IADB 1976, Board of Governors Resolution AG-9/76.
181 IADB 1987, Board of Governors Resolution AG-8/87.
182 IADB Capital and Funds under Administration. Cordell, Bandura and Fernandez 2021 call for a new capital increase of IADB.
“The decision to open the Bank’s capital to non-African participation proved very positive, in terms of membership and capital structure” and set the path for the AfDB capital to multiply on several occasions. Thus, the Fourth General Capital Increase of the AfDB (GCI-4) increased the authorized capital stock of the AfDB by 200%. It took place in 1987 and was governed by a Resolution of the AfDB Board of Governors of 1987. Under that Resolution, the authorized capital stock of the AfDB was increased from 5,400,000,000 U. A. to 16,200,000,000 U. A. by thecreation of 1,080,000 new shares of a par value of 10,000 U. A. each share. The new shares were allocated to regional and non-regional members in the proportion of 2:1. As of the fifth General Increase in Resources, the preparation of general capital increases had become inextricably entwined with a review of the governance, financial, policy and operational agenda of AfDB. The review of GCI-V was completed in 1998 when it was approved by Resolution of the AfDB Board of Governors. Under that Resolution, the authorized capital stock was increased from 16,200,000,000 U.A. to 21,870,000,000 U.A. by the creation of 567,000 new shares.

The authorized capital of the AfDB further multiplied during the six and seventh general capital increase. GCI-VI was approved by the AfDB Board of Governors on 27 May 2010. Under the Resolution adopted on that date, the authorized capital of AfDB was tripled through a 200% increase from U.A. 23,947,460,000 to U.A. 67,687,460,000 (then USD 100 billion) by the creation of 4,374,000 new shares, with a par value of ten thousand Units of Account (UA 10,000) for each share. The seventh, and, so far, last general capital increase, took place in 2019. Discussion on GCI-VII started in 2018. Following a detailed review of AfDB, GCI-VII was the largest in the history of the AfDB and catapulted the AfDB to USD 208 billion, equivalent. Thus, currently, the AfDB has the highest approved capital of all regional development banks.

As regards ADB, Erquiaga has given in his financial history of ADB a detailed account of the five general capital increases of ADB. The last of these increases (GCI-V) increased the authorized capital of ADB in 2009 by

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184 AfDB in Brief 2013, 10.
186 Ibid, para 1.
187 Ibid, para 2.1.
188 AfDB Board of Governors Resolution B/BG/2010/08 (2010).
189 Ibid.
190 ADBD 2019, 31.
191 Erquiaga 2016, 22.
200 percent to USD 165 billion. As in other organizations, ADB’s general capital increases became the forum to review in general terms ADB financial policies.

Finally, EBRD has gradually increased its number of shareholders from 40 shareholders at origin to 66 (predominantly European countries and two supranational institutions, the European Union and the European Investment Bank). During the fourth capital resources review in May 2010, EBRD’s shareholders decided to increase the bank’s authorized capital to €30 billion from €20 billion. However, this capital increase did not raise shareholders’ equity.¹⁹²

There are substantial differences between IFIs in their capital ratios as shown by S&P Global.¹⁹³ Some IFIs, such as the AIIB, are listed by S&P Global as having exceptionally strong capital ratios, while these are substantially lower, even though still strong, in most of the traditional legacy MDBs, i.e., the World Bank, IADB, AfDB, ADB, and EBRD. As regards IBRD, IADB, ADB and AfDB, their paid-in capital ratios were substantially reduced over time in the context of their general capital increases.

From a conceptual point, it is not necessary at all for members to provide paid-in capital in the context of an increase in capital. As shown above, there have been various cases where the callable capital alone was increased without members being required to provide paid-in capital. Moreover, in the case of the AfDB, also temporary increases of callable capital were approved for certain members.¹⁹⁴ Also, as has been shown, increases in authorized capital can partially be funded by the grant of an organization, or conversion of retained income or from reserves. As and to the extent that paid-in capital was provided, the paid-in capital ratio generally was during more recent capital increases in the range between 2% and 6%. Neither the above reduction in paid-in capital ratios nor the recent rapid expansion of IFI lending in the context of COVID-19 has been of prejudice to the AAA rating of the MDBs mentioned above, as rating agencies tend to give a lot of weight to the strong stakeholder support of these institutions.

As regards the special or selective capital increases, it appears that these have been more effective instruments for rewarding donors for their contributions

¹⁹² “€1 billion was transferred from reserves to paid-in capital, and callable capital increased by €9 billion. Callable capital stood at €23.4 billion, and paid-in capital at €6.2 billion as of March 31, 2013. The increase in callable capital became effective in April 2011 upon receipt of more than 50% of the necessary subscriptions. As of Dec. 31, 2012, 2.2% of the callable capital shares (€0.2 billion) remain ‘unsubscribed’”. Standards & Poors Rating Services 2013.
¹⁹³ S&P 2020b, 8–10.
¹⁹⁴ AfDB Board of Governors Resolution 2019, para 1.
to soft windows through special (selective) capital increases in the market-based financing window than for aligning the shareholdings of countries with their role in the global economy. For the latter, the qualified majorities required for any amendment of constituent agreements of international organizations are formidable obstacles of reform as these give sometimes one country, or a small group of countries, a veto right. Moreover, in some organizations, members can also exercise preemptive rights in cases of proposed selective capital increases, which conceptually are inconsistent with the very purpose of the selective increase aimed at increasing the relative shareholdings of some members.

The core problem is that the richer countries find it difficult to increase their capital commitments but do not allow emerging economies to increase their share. Against this background, the discussions on future capital increases have become a matter of substantial complexity as their main focus is on the measures to be taken by MDBs to maximize the availability of resources so as to avoid any major infusion of paid-in capital by their members.

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196 As highlighted by Kapur and Raychaudhuri: “The financial design of the IBRD required all member countries to contribute to the institution’s capital, with the caveat that poor countries (the borrowers) had to contribute less, but then also had commensurately less power. The two principles – that power came with a price and there were no free riders – ensured broad representation but strong creditor rights as well. Ironically, with the significant shifts in the balance of global power, the equity story of the IBRD faces a different ‘free rider’ problem today. In the past rich countries put brakes on IBRD capital increases because they did not want to the Bank to become so big as to crowd out private lenders and national agencies, whether private banks based in their countries or official Exim banks. Today, however, private banks are struggling. If the IBRD is to increase its lending substantively and in a manner that is financially prudent, it needs to increase its capital. Emerging economies are willing to put in capital to do so, but only if their ownership rights increase commensurately. However, the rich member countries have been disproportionately affected by the crisis and find it difficult to increase their capital commitments due to growing fiscal deficits. At the same time they are unwilling to let the emerging market member countries increase their share of capital that threatens the majority voting power of the rich countries”. See by Kapur and Raychaudhuri, 3–4.

197 This is applicable for example to the discussion on a new general capital increase of IADB. In this context, IADB is requested inter alia to “enhance its financial reach, including ‘sweating’ its capital by optimizing its balance sheet”, to be “instrumental in channeling private capital into development projects”, “consider innovative ways to help catalyze additional investments through the domestic resources of developing countries”, “establish local currency funds”, and consider operational and institutional reforms”. (See Runde, Cordell, Bandura and Fernandez, 4–5). Similar considerations also apply to a potential further capital increase of ADB.
8 Core Issues

In this overall context, some fundamental questions regarding the current market-based funding mechanisms of IFIs arise.

8.1 Too Big to Fail?
The increase in authorized capital of IFIs is best illustrated by the AfDB. In accordance with Art. 5, paragraph 1 of the Agreement establishing the African Development Bank, the initial authorized capital of AfDB was 250,000,000 units of account (U.A.), then defined as 0.88867088 gramme of fine gold. As shown above, the capital of the AfDB has increased in the course of seven general capital increases to the equivalent of more than 200 billion USD. This increase can only be characterized as exponential. As shown above, also the IBRD and the IADB, AfDB and ADB have mirrored, even though to a somewhat lesser extent, the exponential increase of AfDB’s authorized capital. The authorized capital of the IBRD, which was initially capitalized with USD 10 billion, has increased to USD 325 billion, and that of IADB and ADB, which were initially capitalized with USD 1 billion, has increased to, respectively USD 175 and 165 billion.

The borrowings of MDBs have sharply increased after the G20, at the 2015 November Antalya Summit, encouraged “Multilateral Development Banks (MDBs) to mobilize their resources, optimize their balance sheets, and catalyse private sector funding”. The “MDB Action Plan to Optimize Balance Sheets” which was endorsed at the Antalya G20 Summit has been regularly updated, and in accordance with the recommendations contained in that plan MDBs enhanced their lending. Moreover, substantial pressure is being exercised by the G20, mostly indirectly, on rating agencies to relax their criteria.

198 Mistry 1995, 28g.
199 G20 Leaders Communiqué: Antalya Summit 2015, para 10.
201 Humphrey, in his paper commissioned by the G24, criticized that “MDB operations do not come close to filling the gap between developmental needs and public and private sector financing” and that their rating methodologies have become “an increasing constraint on MDB operational capacity” as they are “weakening several key aspects of the MDB model, and hence restricting their potential to improve the lives of millions if not billions of the world’s poor”. (Humphrey 2015a, 1–2.) In addition, in 2016, Humphrey raised the question: “Could multilateral banks be lending an extra D 1 trillion?”, suggesting the World Bank could collectively lend the amount mentioned above, which [then] represented “a 2% increase on their 2014 portfolios”. (Humphrey 2016, 1.)
The MDBs, which already had increased their lending in previous years, have further expanded both their lending and borrowings. Thus, the World Bank Group announced in April 2019 that “given the unprecedent challenges that COVID-19 poses, the Bank Group expects to deploy up to USD 160 billion over the next 15 months to help countries protect the poor and vulnerable, support businesses, and bolster economic recovery”.\textsuperscript{202} Also, the other MDBs announced special measures to assist their members. Overall, as shown above, the various MDB assistance packages add up to more than 200 billion. As shown by S&P Global, the supranational debt totalled USD 1.43 trillion at the end of 2019, and it has further increased ever since.

The above shows how far the MDBs and other IFIs have come from their humble beginnings. It also shows, however, that the financial intermediation model espoused by the MDBs and other IFIs in a certain sense has become too big to fail. This finding has a variety of implications, inter alia, for the proposal that the IFIs should continue to draw on their alleged reserve capacity by further expanding their borrowing and lending programs without any further equity infusion.

It was warranted and appropriate that the MDBs assist their members in the COVID-19 pandemic. Nevertheless, and even though according to the “Fitch Ratings\textsuperscript{203} 2020c Outlook: Supranationals”, the “Rating Outlook for Supranationals is Stable”,\textsuperscript{203} there are some issues which are relevant to the discussion on whether MDBs and IFIs have a reserve capacity. Thus, Fitch also noted in their aforementioned outlook “the largest number of downgrades [of supranationals] in any given year”, as well as a negative outlook for six institutions, due to concerns about their credit quality.

In this context, also the results of a stress test S&P conducted in 2020 are relevant. S&P then tested the capital bases of multilateral lending institutions (MLIs) to three hypothetical scenarios of stress.\textsuperscript{204} The results of the stress tests suggested that “there won’t be significant rating pressure under any of the three scenarios”.\textsuperscript{205} Nevertheless, for IBRD, S&P concluded that already the lowest impact scenario could bring IBRD’s capitalization metric down to a level that could qualify for the same or a lower capital assessment, while

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{203} FitchRatings 2020c.
\item \textsuperscript{204} S&P Global 2020a.
\item \textsuperscript{205} Ibid, 4.
\end{itemize}
\end{footnotesize}
considering this finding as mitigated as IBRD was likely to receive parts of its recently agreed general capital increase in 2021 and could rely on a significant buffer of callable capital.\textsuperscript{206} It is also useful to reflect on the finding of S&P that “sovereign downgrade could erode the capital position” of multilateral lending institutions (MLIs), and “a very severe stress could put at risk the preferred creditor treatment (PCT) on which MLIs’ business models rest, altering some institutions’ credit profiles.”\textsuperscript{207}

While the above stress tests suggest that “MLIs have the capacity to weather the effects of the pandemic without significant erosion of their capital bases”, it is doubtful that MDBs have “[h]alf a [t]rillion in [d]ry [p]owder”,\textsuperscript{208} as stated recently, or a spare capacity for further lending of USD 750 billion, as argued in 2020\textsuperscript{209} about the same time when the above stress tests were made. It is a common trait of proposals as mentioned above and others like the one of Settimo,\textsuperscript{210} who explores options for MDBs to operate at a lower than AAA-rating, that MDBs should accept higher levels of risk and expand their operations without any further substantial infusion of paid-in capital from their members. Calls to that effect have constantly been made by the G20 since 2015 on political grounds. The G20 not only supports a further far-reaching so-called “optimization of MDBs balance sheets” and revised (i.e., softer) criteria by rating agencies, but in addition it also has encouraged MDBs to engage in

\textsuperscript{206} Ibid. Moreover, as set out by S&P, “scenarios 2 and 3 depict substantially higher stress levels […]” In addition to the increasing pressure on the entities already mentioned, African Development Bank, European Bank for Reconstruction and Development (EBRD), Council of Europe Development Bank (CEDB), Islamic Development Bank (IsDB), Black Sea Trade and Development Bank (BSTDB), Islamic Corporation for the Development of the Private Sector (ICD), and the Caribbean Development Bank would approach or go below our capital thresholds. In all cases, except for the IsDB, ICD, and BSTDB, the entities have an ample buffer of eligible callable capital that could reinforce their financial risk profiles should capital levels deteriorate. (Ibid., 5).

\textsuperscript{207} Ibid, 1. Furthermore, also the asset quality of the non-sovereign operations of MDBs has deteriorated in the context of the COVID-19 – pandemic. As indicated by Fitch, almost all “MDBs focused on non-sovereign operations” and some “sovereign-focused MDBs” (including ADB, AfDB and IADB) have granted debt payment suspension to non-sovereign borrowers, mostly to those that were current on their loan repayment but were facing short-term liquidity pressures”. (FitchRatings 2021a, 2.). It is indicated in this context by Fitch: “Only a few MDBs have considered as impaired part of their exposures subject to debt suspension. […] In Fitch’s view, there is a risk that considering these exposures benefitting from temporary suspension of payments as ‘performing’ may mask the full negative impact of the crisis on MDBs’ asset quality and only delay loan impairments”. (Ibid.).

\textsuperscript{208} Landers and Aboneaaj.

\textsuperscript{209} See Humphrey 2020a, 1 and 2020b. See also Landers and Aboneaaj 2021.

\textsuperscript{210} See Settimo 2019.
advanced financial engineering (e.g., through an exchange of their sovereign exposures) and has urged them to participate in debt-stop initiatives. If MDBs should give in to the G20 pressure, they may risk losing their AAA-ratings and hence their ability to leverage resources on capital markets on the most favorable terms.

The fact that the G20 believes that it is entitled to direct the MDBs without any legal basis is of concern in itself. However, it is questionable, in particular, inasmuch the G20 sees for itself a role in determining the capital adequacy of MDBs, because the very role of the G20 in this matter is highly problematic. The G20 is a political body which lacks the necessary independence and technical capacity for risk assessment and determining the capital adequacy of MDBs. It is also intrinsically conflicted in dealing with these matters as, even though never openly articulated, one of the main interests, if not the main interest of G20 members, is to minimize their own financial exposure and avoid the need for increases in authorized capital which may require an infusion of paid-in capital. Thus, the G20 should not be involved in the assessment of the capital adequacy of MDBs as a matter of principle.

Apart from the further erosion of paid-in capital ratios which is a corollary of proposals as mentioned above, they raise many other questions. These relate *inter alia* to the financial capacity of developing countries to serve such a rapid expansion of debt. Also, the question arises whether the crisis support by MDBs at times effectively aggravates rather than alleviates the debt problems of the poorest countries.

The President of the World Bank raised this question in 2019 at an IMF debt forum, where he stated: “We have a situation where other international financial institutions and to some extent development finance institutions as a whole, certainly the official export credit agencies, have a tendency to lend too quickly and to add to the debt problem of the countries”. He said the Asian Development Bank was “pushing billions of dollars” into a fiscally challenging situation in Pakistan while the African Development Bank was doing the same in Nigeria and South Africa.

Since the 2008 financial crisis, MDBs have increasingly been asked to provide crisis support to their members. However, while MDBs have a well-defined role in providing long-term capital for creating long-term productive assets, including economic infrastructure for human capital and education, and for matters such as climate change adaptation and mitigation and environmental

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211 Droesse 2021.
212 Reuters 2020.
protection, they were not conceived as crisis management institutions. This is a function which should be entrusted to a new institution yet to be established. The purpose of development finance is not primarily to provide general budget support or fill ‘financing gaps’, but instead investing in the highest quality of development assistance operations that will deliver tangible and sustainable benefits. This matter does not appear to be given sufficient consideration in the deliberations of IFI assistance to developing countries. As and to the extent that MDBs provide longer-term loans (e.g., with maturities of 10–15 years) for general budget support or funding short-term needs of their members, they expose themselves and their members to three types of risk. First, in such a case, there often is a drastic mismatch between the maturities of the loan which has to be repaid over a longer term and the short-term nature of the support provided by IFIs. Second, the fact that MDB-financing is not used for generating assets but for funding current expenditures makes it more difficult for recipients to repay their loans. Third, such repayment is further aggravated by the fact that MDBs burden developing countries with the volatility of exchange rates as they provide emergency support generally in US dollar under loans which have to be repaid in US dollars, rather than in local currency. As a corollary of the above, there are risks that a further rapid “explosion” of MDB financing could lead to a need for far greater debt relief or even debt forgiveness in the future. The discussion on the optimization of MDBs balance sheets has been driven, so far, by the G20.

To be clear, MDBs and other IFIs should avail themselves of opportunities to enhance their impact and free headroom for operational activities. However, to avoid that the next global financial crisis may be one triggered by the IFIs, it would be best to entrust the determination on a future “optimization” of MDBs’ balance sheets to an institution like the Basel Committee or to a committee with guaranteed independence and adequate technical capacity in dealing with these matters rather than entrusting it to the G20 which should not be involved in making determinations on the capital-adequacy of MDBs. Finally, to maintain their preferred creditor treatment, MDBs and other IFIs should resist any suggestions from the G20 or otherwise to participate with their own resources in debt stop or debt relief initiatives.

### 8.2 Ownership of IFIs

Traditionally, MDB and other IFI only admit states as members. Moreover, while so far private-sector entities, institutional investors and other stakeholders are consulted and involved in projects as recipients or in project implementation, their role does not need to remain limited to this role. Fact is that development finance institutions may be created by private-sector
entities and there is also no intrinsic reason as to why private-sector entities and other stakeholder should not be full members of IFIs.

It would serve no useful purpose to replicate the detailed discussion on this matter by this author. As shown, it may have major positive effects if reputable private-sector entities which meet the highest standards of accountability and transparency become members or shareholders of IFIs. The point which is stressed in this paper is that a paradigm shift is required which elevates participation of private-sector entities and other stakeholders to that of integral participants in the IFIs governance, funding and operational activities. As part of this paradigm shift, reputable export credit agencies (ECAs), reinsurance companies and similar entities should join forces with IFIs. Their full or partial membership in IFIs is an effective mechanism for enhancing the financial and risk-bearing capacity of IFIs and would allow them to expand their knowledge base and engage in new and advanced transactions. It would be advisable for MDBs to consider amendments to their constituent agreements to fully exploit the positive aspects mentioned above. Pending, or as an alternative to such amendments, IFIs may enhance cooperation with reinsurances companies, export credit agencies and other stakeholders through secondary governance structures established under umbrella operational arrangements by the organization’s governing bodies.

Membership/shareholding of private-sector entities in IFIs may be of particular interest for borrower-owned development banks, such as some of the sub-regional development banks in Africa. These often have members with relatively lower credit ratings and therefore only credit ratings that are many notches below the AAA ratings of the MDBs. Opening membership of private-sector entities has the potential to increase substantially the equity of a borrower-dominated IFI. As the total adjusted capital is the “main capital measure for calculating RAC [risk adjusted capital] ratios”, an increase in equity may have a positive effect on the rating of an institution as indicated above. Effectively, such positive implications may not only apply in those cases where the institution does not pay a dividend but in certain circumstances also

213 This is epitomized recently by J.P. Morgan which uses IFC’s Anticipated Impact Measurement & Monitoring (AIMM) framework, to perform an ex-ante assessment of J.P. Morgan’s Corporate and Investment Banking (CIB) transactions. See J.P. Morgan. Development Finance Institution and J.P. Morgan. Methodology.
214 Droesse 2020.
217 Droesse 2020, 375; Droesse 2011c, 164–165 and Droesse 2011d, 297.
if a dividend is paid. Humphrey has shown in his analysis of the “Trade and Development Bank”, which is a borrower-led African institution, that adding traditional equity investors in the ownership mix and offering them an actual financial return on their investment may be a “creative way of working to overcome the financial challenges posed by a borrower-led MDB in Africa”. Similar schemes might also be explored in other borrower-dominated development banks.

Unfortunately, the strong bias of rating agencies against membership of private-sector entities in IFIs entails serious constraints for involving non-state actors in the governance of IFIs. Such constraints are neither necessary nor are they justified. It appears that rating agencies are even more conservative than lawyers. While also lawyers used to focus exclusively on international and intergovernmental organizations established by a treaty, it is increasingly recognized in the legal community that new types of international organizations *sui generis* without a treaty foundation have emerged. It appears that among rating agencies such a recognition is still overdue and outstanding.

This is underlined by the focus of rating agencies on “supranational institutions” with a treaty basis and their “Assessment of the Components of Policy Importance”. Furthermore, their conclusion that an MLI is expected not to be able to fulfil its public policy mandate if a large part of its activities is fulfilled by private entities, is intrinsically flawed.

It would be desirable for rating agencies to recognize that membership of private-sector entities in international financial institutions is not to be penalized *per se* but may strengthen not only the capital basis of the institution but also desired outcomes. Even in those cases where private-sector entities are admitted as members and most or all operational activities of an entity are

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219 Humphrey (2019), 176 and 177.

220 Supranational institutions are defined “as those owned or established by governments of two or more countries. They are usually established by international treaties to pursue specified policy objectives and are generally not subject to commercial law. Multilateral lending institutions (MLIs) are a subset of this asset class. MLIs are usually established to promote economic development in their less-developed or regional member countries, facilitate regional integration, or expand cross-border trade”. S&P, is of the opinion that, “the participation of private shareholders in an MLI’s capital structure may also dilute its public policy role and affect its governance” because the goals of private and public shareholders may conflict, particularly in periods of stress. See: S&P Global, Supranationals: Special Edition 2020b, para 50.

221 Private-sector participation is classified in five categories from very strong to weak. In the latter category where a large part of the MLI’s activity is fulfilled by private entities, the “MLI is expected not to be able in the future to fulfil its public policy mandate through the credit cycle.” S&P Global 2020b, 51.
conducted by or through private-sector entities, a dilution of the public policy role of an IFI can be precluded through a variety of measures. This can be done *inter alia* by offering private-sector entities different categories of shares, by reserving decision-making in the plenary body of the organization to states only, by limiting private-sector representation in governing bodies of restricted membership, and by providing for qualified majorities, quorum requirements or voting rights which assure that all major decisions need to be approved by states. Where such measures are in place and the capitalization of the IFI is adequate, private-sector participation should not preclude a high credit rating, including a AAA-rating. In this context, it may give some hope that rating agencies have given CAF an A+ rating despite the fact that Series “B” shares of CAF can be subscribed *inter alia* by “private entities of Member Countries” and Series “C” shares may be subscribed “by legal entities or natural persons from outside the Member Countries”.

### 8.3 Preferred Creditor Treatment

Currently, MDBs and other IFIs benefit from a market practice known as Preferred Creditor Treatment (PCT). PCT “of the main IFIs is a longstanding puzzle in relation to sovereign lending”. It refers to the fact that sovereign borrowers typically continue to service their loans from MDBs even in the unlikely event that they default on other claims. This confers on the loans of MDBs a type of *de facto* seniority.

The justification for a continued preferred creditor status of MDBs, i.e., whether MDBs should legally be entitled to be given priority among individual creditors or classes of creditors in relation to the settlement of external debt, is currently being discussed. As shown by Martha, “general international law contains no compulsory standard of conduct requiring the preferential treatment of any external creditor”. Despite the lack of a strong backing for this principle in either general international law or constituent agreements of international organizations, great importance is attached to this principle by MDBs. While the principle of preferred creditor status goes back to the League of Nations, “the modern use of the term for MDBs, alternatively termed international financial institutions (IFIs) or multilateral lending institutions (MLIs), stems from the Paris Club renegotiations treatment of sovereign debt obligations to IFIs as exempt from rescheduling or default”.

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222 See Art. I.
223 Cordella and Powel 2019a, 4.
224 Martha 1990, 825.
225 Kotecha 2019, 274.
The rationale for the preferred creditor treatment is often seen in the fact that the bylaws of IFIs:

allow them to commit to (i) lend limited amounts at close to the risk-free rate under most circumstances, and (ii) refrain from lending until any unpaid arrears are cleared. This avoids the possibility of debt dilution, sets IFI lending aside from private lenders, and explains why, in many instances, the presence of IFIs adds value.226

The PCT227 has been called in question in some cases (e.g., when Greece fell into arrears with the IMF in July 2015)228 and is strongly criticized in the literature by some authors.229 Nevertheless, rating agencies have stressed the importance which this principle has for them and have clarified that an erosion of PCT could lead to lower rating of MLIs.230

All three rating agencies allow an uplift of the average borrower credit rating of MLIs based on their PCT for their sovereign operations. In the case of the IADB, “S&P reduces its estimate of the IDB’s risk weighted assets (and hence of the capital it must hold to achieve a given standalone credit standing) for this purpose by 10 percent”.231 Hence, for the sovereign operations of MLIs, the PCT has important implications for their credit ratings and by implication for the terms on which they can borrow on capital markets232 and which they charge...
to their borrowers. These are important reasons why PCT should be applied in the case of sovereign lending of IFIs.

A related but different question is whether MDBs and other IFIs should also be able to assert preferred creditor status in relation to their private sector operations with regard to access to foreign currency.

IFC managed to avail itself of that limited PCT regarding access to currencies,\(^\text{233}\) consistent with Art. VI, Section 6 of the IFC Articles of Agreement which provides for the freedom of IFC assets from restrictions. Similar provisions are contained in the constituent agreements of other MDBs.

Nevertheless, from a policy-point of view it is questionable whether the limited PCT mentioned above is still justified. First, the need for such limited PCT may be questioned, as Moody’s has concluded that both deposit freezes and private-sector external debt moratoriums which remain “the two quintessential forms of transfer and convertibility risk”, both remain less frequent than sovereign defaults.\(^\text{234}\) Second, unlike for sovereign operations, the more limited PCT for access to currencies which MDBs and other IFIs enjoy in relation to their private-sector operations is generally not taken into consideration for their credit rating.\(^\text{235}\) Third, the question arises whether it is justified to give MDBs a general preference as regards access to currencies over other senior lenders. MDBs effectively have dispensed with that limited PCT in certain cases at their own volition, as it made collaboration with other senior lenders impossible or very difficult. As they have concluded deals with lenders like the US Exim which give these pari passu treatments,\(^\text{236}\) it may be questioned whether it is still justified that MDBs claim in their private-sector operations preference as regards access to currencies over other lenders.

Furthermore, as will be discussed in further detail below, MDBs exchanged their foreign exchange exposures to avoid the penalty applied by MDBs for

\(^{233}\) In this regard, IFC states on its website: “As a multilateral development institution, IFC enjoys a de facto Preferred Creditor Status. This means that member governments grant IFC loans preferential access to foreign currency in the event of a country foreign exchange crisis. The Preferred Creditor Status therefore mitigates transfer and convertibility risk for IFC and its B Loan participants.

As is the case for the World Bank and other multilateral development institutions, Preferred Creditor Status is not a legal status, but is embodied in practice, and is granted by the shareholders of IFC (over 180 member governments). The Preferred Creditor Status of IFC has received consistent universal recognition from entities such as bank regulators, the Bank of International Settlement, rating agencies, and private PRI providers’. See IFC Preferred Creditor Status”.

\(^{234}\) Moody’s 2020b, 1.

\(^{235}\) S&P state in relation to IFC.

\(^{236}\) Cohen 2020, 1–6.
portfolio concentration.\textsuperscript{237} While by engaging in advanced financial engineering, they managed to increase the headroom for their operational activities, MDBs have opened in doing so a range of other issues relating, in particular, to the applicability of PCT to the exchanged exposures. In the absence of a firm legal basis, the ability of MDBs and other IFIs to assert PCT and ensure repayment of their loans is largely based on their relationship with their members. As will be further discussed below, there is a risk that in their attempt to avoid the penalty for credit concentration, MDBs may have overstretched their position and have weakened the acceptance of the PCT system.

**IFIs** “should be wary about the amounts they lend” as large “packages funded from IFI balance sheets lent to countries that do not have the incentives to repay may well end in failure”.\textsuperscript{238} Cordella and Powell discuss whether there are limits to the amounts for which MDBs can claim preferred creditor status relating to the total amounts lent to a country.\textsuperscript{239} However, the question should better be addressed in the overall context of the share of a country’s foreign debt which an MDB or other IFI holds. If an MDB would hold most of a country’s foreign debt, it is difficult to argue that the MDB should enjoy PCT in respect of that debt. How can MDBs claim PCT if the most part of a country’s foreign debt is senior?

As shown above, PCT does not have a firm legal basis and is, in essence, guaranteed as a market practice. Hence, it would be advisable for MDBs to exercise constraint in claiming PCT, particularly, in “expanding preferred creditor treatment beyond [their] own resources”.\textsuperscript{240} There is a risk that by overreaching their position (e.g., through the exchange of their foreign exposures), MDBs may potentially undermine the PCT system, with potentially far-reaching implications.

### 8.4 Debt Relief or Debt Suspension Initiatives

Finally, the question whether MDBs and other IFIs should participate in debt-relief initiatives has been discussed for a long time and has been raised in the context of the Heavily Indebted Poor Countries (HIPC) Initiative\textsuperscript{241} and the Multilateral Debt Relief Initiative (MDRI).\textsuperscript{242} These generally did not involve

\textsuperscript{237} S&P Global Ratings 2019, 3.
\textsuperscript{238} Cordella and Powell 2019a.
\textsuperscript{239} Ibid. See also Cordella and Powell 2019b.
\textsuperscript{240} Cordella and Powell 2019a.
\textsuperscript{241} IMF 2021, 1.
\textsuperscript{242} IMF 2017.
debt-relief granted by MDBs and other IFIs. As the HIPIC Initiative and MDRI are extensively documented in the literature, in the context of this study only reference is made to the recent G20’s Debt Service Suspension Initiative (DSSI) proposed in 2020 and the “G20 Common Framework for Debt Treatments beyond the DSSI” adopted in 2021.

While debt levels were high before the crisis, the COVID 19 pandemic “is pushing debt levels to new heights [...] as countries seek to mitigate the health and economic effects of the crisis, while revenues are falling due to lower growth and trade, together raising debt burdens”.

The DSSI was launched in the context of the COVID 19 pandemic which resulted in a global economic collapse. It meant that bilateral official creditors were, “during a limited period, suspending debt service payments from the poorest countries (73 low- and lower middle-income countries) that requested the suspension”. It temporarily eased the financing constraints for these countries and helped address immediate liquidity needs but did not mean that existing debt sustainability problems in some of these countries would be resolved.

The G20 initially “urged” MDBs to participate in the DSSI which offers “a temporary suspension of ‘official sector’ or government-to-government debt payments to 73 countries”. However, this was not pursued due to the opposition of rating agencies.

243 However, a different approach was adopted in the case of ADB as the cost of debt relief to Afghanistan was funded from ADF resources. An amendment to the ADF Loan Regulations was required for this purpose. “Written consent from every ADF donor [was] obtained for the amendment of the ADF Regulations to allow the use of ADF resources (except the set-aside resources) for debt relief”. ADB 2008, 9 (para. 29).

244 IMF 2021, 1–29.

245 Ibid.

246 Ibid.

247 The Action Plan adopted at the virtual G20 Meeting of 15 April 2020 asked “multilateral development banks to further explore the options for the suspension of debt service payments over the suspension period, while maintaining their current rating and low cost of funding”. It called on the MDBs for “a swift implementation of the emergency response packages adopted by the World Bank and Regional Development Banks” amounting to over USD 200 billion and for a discussion on “the role of MDBs after the pandemic crisis, as they will have a key role to play to facilitate the recovery from the crisis and restore strong, sustainable, balanced and inclusive growth for developing countries”. As reported by Reuters, the President of the World Bank said that “the Bank, the IMF and other multilateral lenders were exploring options for suspending their debt service payments while maintaining high crediting ratings on their bonds”. See G20 2015.

248 Fitch have made it clear what the consequences of such a course of action would be. As reported by Bloomberg: “Fitch Ratings warned that multilateral development banks could see their credit ratings suffer if they let the poorest nations suspend sovereign debt
Hence, MDBs did not participate in the DSSI. Instead, they increased their financing, including concessional financing, to DSSI-eligible countries. As indicated by the World Bank, from "April 2020 through June 2021, the World Bank committed USD 36.3 billion in financing for countries participating in the G-20 Debt Service Suspension Initiative (DSSI) – of which USD 11.8 billion was in the form of grants" and “disbursed USD 20.9 billion – including USD 5.6 billion in grants – to these countries. The total disbursement amount is roughly seven times the USD 3 billion in debt-service repayments received from DSSI countries.”249 Those resources were made available to enable the poorest countries to meet their obligations, including the payments which were due to the MDBs.

The “Common Framework for Debt Treatments beyond the DSSI” jointly endorsed in November 2020 by the G20 and Paris Club is an “an agreement of the G20 and Paris Club countries to coordinate and cooperate on debt treatments for up to 73 low-income countries that are eligible for the Debt Service Suspension Initiative (DSSI)”. A detailed analysis of the Common Framework has been provided by Fitch.250 As for the DSSI, the IMF and other IFIs were exempted from participating in the common framework. However, the IMF and World Bank were given in October 2020 a mandate by the Development Committee to “review the debt challenges of low-income countries and propose actions to address their fiscal and debt stress on a case-by-case basis and were encouraged to explore customized solutions for middle-income countries as well”.251

Overall, the debt situation of many developing countries has deteriorated during the COVID-19 pandemic, and it is quite doubtful whether they will be able to repay their MDB and IFI debt. Also, it cannot be a sustainable solution in the long run that MDBs expand their lending to allow countries in debt-distress to service their own loans. Thus, it appears quite likely that there will be a renewed demand for restructuring of MDB and IFI debt in the future, possibly using similar approaches as under the HIPC Initiative and MDRI. The big question in this regard relates to the extent to which states will be prepared to allocate new and additional funds for that purpose.

249 World Bank 2021b.
250 FitchRatings 2021b, 3.
251 Development Committee Communiqué 2020, 1.
9 New Funding Mechanisms

9.1 Constraints of Current Funding Mechanisms
The current market-based funding structures of MDBs and other IFIs are intrinsically constrained in two respects.

First, the international community “is pushing MDBs to do more to achieve international goals – filling the yawning infrastructure gap, improving social services and addressing global problems such as climate change, migration and pandemic disease”, but unfortunately “the generosity of MDB member countries has not matched these ambitious goals”. Against this background, and giving the financial constraints of states in providing a major infusion of paid-in capital to MDBs for substantially extending the scope of their operations, other options for increasing the headroom of IFIs are being considered.

Second, it is a significant constraint for the effectiveness of MDBs and other IFIs that they still rely predominantly or exclusively on funding from their member states. They often have not even made an effort to attract substantial funding from sources other than their members. One of the reasons for this is that for attracting funding from outside resources, IFIs and Funds often need to implement substantial changes to their rules, procedures and practices. As doing so may be a painful process, MDBs and other IFIs tend to remain within their comfort zone.

9.2 New Mechanisms for Increasing Headroom
To increase headroom and availability of resources, various new mechanisms have been created. These relate, inter alia, to (i) synthetic securitization, (ii) exposure exchange agreements, and (iii) subordinated, hybrid capital.

9.2.1 Synthetic Securitization
The Room2Run may be seen as an interesting example in this category. It was the “first-ever synthetic portfolio securitization between a multilateral development bank (MDB) and private sector investors, pioneering the use of securitization and credit risk transfer technology in a new segment of the financial markets.” The transaction, which received a PRI [Principles of Responsible

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252 Humphrey 2018.
253 On the difference between synthetic and true-sale securitization, see Orçun 2017.
254 Africa50. Room2Run Synthetic Securitization.
Investments] Award for 2019 shifted the “mezzanine risk on a USD 1bn portfolio of pan-African loans to private investors”.255

In essence, the “deal functions like an insurance policy provided by investors on a chunk of AfDB loans”, freeing up “space for the AfDB to make USD 650 million more in loans, without requiring further capital from shareholders”.256 In this context, Humphrey discusses various mechanisms for scaling up similar mechanisms for use by MDBs.257 The potential of further amplifying approaches as mentioned above needs to be explored.

9.2.2 Exchange of Foreign Exposures
In addition, MDBs have started engaging in advanced financial engineering by exchanging their sovereign exposures. As the other initiatives aimed at a so-called “optimization” of MDBs’ balance sheets, also this initiative was triggered by the G20.258

This tool was presented in 2015 by the World Bank as an “innovative framework agreement for an exchange of sovereign exposures that will collectively optimize their balance sheets for greater development effectiveness”.259 The President of the World Bank stated that this “innovative agreement” improved

255 “By absorbing losses on the mezzanine tranche of the portfolio, the transaction [reduced] the risk weight on the bank-retained senior portion of the structure, and hence the risk capital that the bank must hold. AfDB is then able to recycle this released capital, enabling D 650 million of new development lending in Africa”. See PRI Awards 2019 case study: Room2Run 2019, 7–32.
256 Humphrey 2018.
257 Humphrey stresses that this type of synthetic securitization “differs from the sorts of securitizations that helped cause the financial crisis in important ways. Most notably, the loans themselves stay on the books of the AfDB – hence the AfDB has every incentive to ensure they are good projects and to engage in strong oversight. By contrast, commercial banks prior to the global crisis could actually sell off loans (like mortgages) to an investor and get rid of them entirely – hence they had little incentive to ensure those loans were high quality”. See Humphrey 2018.
258 G20 2015.
259 It was indicated in this context: “The sovereign exposure exchange agreement is a risk management tool collaboratively developed by the major Multilateral Development Banks (MDBs). This initiative was launched in October 2013 by the World Bank Group’s International Bank for Reconstruction and Development (IBRD) and endorsed by the MDB heads following a meeting of the G8 Ministers of Finance. Unlike commercial financial institutions, which diversify their loan portfolio across thousands, and sometimes millions, of borrowers, the MDBs lend to their sovereign shareholders. The resulting asset concentration reflects the strength of the relationship between MDBs and their borrowers, but it also requires MDBs to hold additional capital”. See World Bank, Press Release: Development Banks Working Together to Optimize Balance Sheets 2015, 1.
collective financial capacity and development effectiveness.\textsuperscript{260} Furthermore, also ADB offered similar explanations when introducing in 2020 a framework for exposure exchanges by exchanging on a pilot basis four country exposures.\textsuperscript{261} It stated that exposure exchange is “a powerful and cost-effective way to improve the capital adequacy and creditworthiness of regional MDBs, whose portfolio diversification options can be otherwise limited”.\textsuperscript{262}

As MDBs “may have to extend large amounts of financing to a country or a private entity in difficulty” and “therefore generally have high levels of single counterparty concentration, especially compared to commercial banks”, to a certain extent, concentration risk is a corollary of the “public interest mission”.\textsuperscript{263} “Concentration risk arises from an uneven distribution of loans to countries (single-name concentration) or through an unbalanced allocation of loans by region (regional concentration).”\textsuperscript{264} Both single-name concentration and regional concentration may entail substantial risks and are therefore considered by rating agencies, such as S&P, according to their “Risk-Adjusted Capital Framework Methodology”.\textsuperscript{265}

To avoid the penalties for concentration risk applied to MDBs,\textsuperscript{266} various MDBs consider that “[e]xchanging exposures provides an opportunity when two or more MDBs face different country concentrations; MDBs can reduce concentration risk by swapping exposures among themselves and thus rebalancing their portfolios”.\textsuperscript{267}

\begin{thebibliography}{9}
\bibitem{260} Ibid.
\bibitem{261} ADB 2020.
\bibitem{262} Ibid.
\bibitem{263} FitchRatings, 2020a.
\bibitem{264} Belhaj 2016, 79.
\bibitem{265} S&P 2020b.
\bibitem{266} The penalties which are applied by MDBs on that account are set out by Moody's in their score cards and are illustrated as follows: “For example, we may assign a score of Baa to a supranational institution whose development asset portfolio primarily consists of exposure to sovereigns that have strong credit quality (i.e., low A equivalent, incorporating preferred creditor status and credit protections) but with concentration risk that is characteristic of the Ba scoring category”. See Moody’s 2020a, 9.
\bibitem{267} They further indicated in this context: “Reducing concentration risk releases capital that can either be used to improve capital adequacy or support additional lending. An MDB EEA can have a similar impact on lending headroom as a capital increase, although in the case of the MDB EEA additional lending headroom is created by freeing up existing capital through balance sheet optimization, rather than through an injection of fresh capital”. See Belhaj 2016, 80. A series of simulations have been conducted to demonstrate their approach (Ibid, 80–82.).
\end{thebibliography}
The Exposure Exchange Agreements (EEAs) between MDBs seek to achieve “a synthetic exchange of a portfolio of credit exposures”\textsuperscript{268} Under the EEA, the “portfolios of exposures exchanged in the EEA between any two MDBs are equal in notional dollar values and in risk-weighted amounts at the time of the initial exchange”\textsuperscript{269} “When the loans of a borrowing country included in an EEA transaction are placed in non-accrual status, the Provider of Protection on that exposure is obligated to compensate the Originating MDB under the EEA”.\textsuperscript{270} “Following a non-accrual event, the Provider of Protection would pay compensation to the Originating MDB for lost interest based on the EEA interest rate, which for the first EEAs has been defined as the sum of six-month Libor plus 75 basis points”.\textsuperscript{271}

While schemes as mentioned above have the potential of adding additional headroom for lending, they raise a number of fundamental issues.

First, already now, MDBs have in some cases imprudent and unsustainable single-name and regional concentration levels. The move of MDBs to advanced financial engineering by exchanging their foreign exposures is likely to aggravate this situation.

Second, a number of MDBs have explicit provisions in their constituent agreements to the effect that all their resources need to be used for the development of the developing member countries in their region.\textsuperscript{272} As the Buyer of Protection remains under the EEA the lender of record, regional MDBs such as ADB will probably argue\textsuperscript{273} that an exchange of foreign exposures is legitimate.

\textsuperscript{268} “Under the EEA, there is a synthetic exchange of a portfolio of credit exposures of equivalent credit risk and dollar amount: one MDB assumes the credit risk on a portfolio of borrowing countries from another MDB in exchange for passing on the credit risk on a different portfolio of borrowing countries to the other MDB. In the event of a non-accrual event of one of the exchanged exposures, the MDB that has agreed to provide protection under the EEA (the Protection Provider) would compensate the Originating MDB for non-payment. There is no transfer or removal of loans from the Buyer of Protection’s balance sheet: the Buyer of Protection remains the lender of record, and there is no impact on the borrower/lender relationship”. Belhaj, 82.

\textsuperscript{269} Ibid., 83.

\textsuperscript{270} Ibid.

\textsuperscript{271} “If a non-accrual event on an underlying sovereign exposure in the EEA transaction occurs and has not been resolved by the end of the agreed EEA period, the Provider of Protection remains responsible for the payment of the compensation amount agreed under the EEA for that country exposure until a resolution of the non-accrual event takes place. This continued coverage, however, is limited to the country in non-accrual and does not automatically extend to the entire EEA portfolio”. Ibid., 84.

\textsuperscript{272} E.g., ADB Charter 2001, Art. II.

\textsuperscript{273} Both ADB and IDA decided not to make available for review Board documents regarding the exchanges of foreign exposures concluded by them on a pilot basis.
for this reason and for the benefit of regional developing countries as it frees up capital for their development. Nevertheless, the fact remains that regional MDBs potentially will assume liabilities, even though on the basis of synthetic transactions, for billions of US dollars of debt from nonregional countries without having any control over such debt.

The third major issue relates to the implications of the scheme on the preferred creditor treatment. In this regard, it may be argued, as in relation to the exchange of four exposures between ADB and IADB approved on a pilot basis,\textsuperscript{274} that the exchange will be “synthetic” in that it does not entail the actual transfer or removal of loans from either MDB’s balance sheet and consequently does not change the relationship between the original lender and the borrower. Hence, the original lender will still be the point of reference for the PCT. Nevertheless, conceptually, any swap of foreign exposures, has implications for the relationship of MDBs and other IFIs with their members, which is crucial to the PCT. As any exchange of foreign exposures requires approval of the governing bodies of the organizations involved, it will most likely become known to borrowers that the original lender bought protection regarding their loan and will be compensated in the case of non-accrual status of that loan. In cases where a country is unable to service all its MDB loans, will this not have an influence on the decision of countries regarding the loans they want to service? Hence, the question may be asked whether exchange-of-exposure-schemes as mentioned above may have the potential of undermining the PCT system, which, as such, does not have a firm legal basis.

Fourth, in connection with the above, the question arises regarding the implications of an exposure-exchange scheme in case of another major global financial crisis where potentially a number of countries may not be able to service their MDB loans. The last global financial crisis has shown the far-reaching implications which advanced financial engineering may have and such implications should also be carefully evaluated in relation to the foreign exposure exchange scheme.

9.2.3 Subordinated Hybrid Capital
It is a very important development that rating agencies have accepted subordinated (hybrid) capital instruments to be included in the calculation of total adjusted capital of IFIs. To qualify for such inclusion, “a hybrid instrument must be able to absorb losses, demonstrate an ability to do so over time, and provide additional protection to the MLI’s senior creditors while the MLI

\textsuperscript{274} ADB 2020.
remains current on its obligations toward them”.275 Moody’s has well explained its “general approach to assigning equity credit for hybrid instruments (including shareholder loans) issued by non-banks”. Where hybrid instruments are material and Moody’s considers them relevant, Moody’s “assigns equity credit and makes related financial statement adjustments”.276 Its “methodology applies to convertible and non-convertible hybrids issued by insurance companies finance companies, securities industry market makers, securities industry service providers, asset managers and non-financial corporations globally”.277 In assessing the amount of equity credit, Moody’s considers in particular “whether the hybrid will be available to absorb losses when needed, which relates to its maturity” and, in this context, “the timing of the hybrid’s redemption, the replacement security’s features, and the expected evolution of the issuer’s capital position over time”.278 Up to 100% of the subordinated debt may be recognized as equity. “Examples of hybrid instruments that may qualify for equity credit include redeemable shares where the MDB retains significant control over the ability to redeem and over the timing of any redemption; and subordinated debt facilities that would qualify for equity credit under [Moody’s] cross-sector methodology”.279

The issuance of subordinated, hybrid debt may give MDBs new opportunities to increase their capital. The question may be asked whether the pricing of subordinated (hybrid) debt may be an inherent constraint to the implementation of such a scheme as hybrids generally “are high-yielding because they are subordinated debt instruments whose rating is on average 2–3 notches lower than the same issuers’ senior debt”.280 While these additional costs may have to be passed on to the borrowers of MDBs, this funding cost potentially might be blended with that from other sources of funding of MDBs. Moreover, it is conceivable that there may be entities that are prepared to take a position in subordinated, hybrid debt even without the higher yield of such debt due to its subordination to other senior debt. Subordinated hybrids issued by MDBs may offer private-sector or even civil society investors a less risky means of “social” or “activist” investing in areas such as the environment/climate change, green technologies, development of micro/small and medium-size enterprises, health innovation, among others. The “markets” for development-related

276 Moody’s 2018, 1.
277 Ibid. 3.
278 Ibid.
279 Moody’s Investors Service 2020a, 7.
280 Trigo 2019. 10 Questions to Understand Corporate Hybrid Bonds. BNP Paribas.
investing are diversifying, reflecting a wider spectrum of combinations of public and private goods and services and an attendant diversity in relevant financial models/structures. Hence, potentially a new market might be emerging for subordinated, hybrid debt. In this context, uniform pricing of MDB subordinated, hybrid debt and MDB lending may be less meaningful. Thus, pricing would not necessarily preclude a scheme as indicated above.

The biggest advantage of issuing subordinated, hybrid debt relates to the diversification of the equity base of MDBs. This mechanism is fundamentally different from those applicable in the case of increases of authorized capital in three respects. First, it does not require MDBs and IFIs to go through the excruciatingly difficult and extended process of negotiation with their members regarding increases of authorized capital. Second, it does not require a capital infusion of member states. Third, it does not entail changes to relative shareholdings of members, which are a common feature not only in the case for special (selective) capital increases which are expressly designed to change members relative shareholdings and voting rights, but also in case of general capital increases (in the latter case, all members have the opportunity to subscribe to a proportionate part of the capital increase, but some may not be able to do so for financial or other reasons, which decreases their relative shareholdings and corresponding voting rights). This makes them attractive to members as smart mechanisms for mobilizing capital, but it also makes IFIs less dependent on the whims of their member states in providing capital increases. However, it is precisely for this reason that mechanisms as those mentioned above are likely to be viewed critically at least by some states\footnote{The position of the Trump Administration may serve as an example. As indicated by Hay, J. Global Capital; London (Jan 13, 2019); “Hopes of a thriving new market for securitizations by multilateral development banks hit a hole in the road in December, when the US Treasury said it disapproved of them and would seek to stop them”. It was stated that the US would seek, as part of its reform agenda for the MDBs, to “reverse the trend toward complex and expensive derivatives, the securitization of assets, and exposure swaps that circumvent governance”.
} which view capital increases as golden opportunities to extract concessions and impose conditionalities on MLIs. As the increased independence, which this new funding mechanism entails, reduces the leverage of states in making the infusion of new capital conditional on substantial changes to policies of MDBs and other IFIs, it is likely to be opposed for that very reason.
9.3 Institutional and Financial Transformation of IFIs

There are three ways how IFIs may be transformed into multi-stakeholder institutions. The first one is to allow non-state actors to become members or shareholders of IFIs. In that case, representation of non-state actors in the governing bodies of the IFI is a corollary of their membership, respectively, their shareholdings. Second, in those cases where membership is limited to states (and, possibly, international organizations), it is possible to define representation arrangements which give a voice to non-state actors. Third, it is possible to introduce multi-stakeholder features for international organizations by putting in place secondary governance structures. As has been shown above, in either case it is possible to ensure that membership of non-state actors does not dilute the policy mandate of the institution.

While transforming international organizations, including IFIs, into multi-stakeholder institutions may involve substantial benefits, such course of action is indispensable, in particular, for institutions or funds seeking to facilitate the transition of countries to a green economy. In that case, required resources are so high that they can never be financed through traditional public-sector funding mechanisms. Indeed, in the case of the transition of countries to a green economy, innovative ideas are more important than money and active involvement with a wide range of stakeholders is of crucial importance. Hence, to be effective, any institution or fund seeking to facilitate the transition of countries to a green economy needs to be structured as a multi-stakeholder institution. Given the reduction of the cost of renewables, it is overall possible to mobilize resources for that purpose by offering bankable projects to the private-sector, institutional investors and other stakeholders for investments in the green economy.

The situation is similar for institutions seeking to facilitate investments in the Fourth Industrial Revolution and scaling 4IR technologies (artificial intelligence, robotics, the Internet of Things, autonomous vehicles, 3-D printing, nanotechnology, biotechnology, materials science, energy storage, and quantum computing).

282 At the 2021 World Economic Forum, the green transition was discussed as an “D 50-trillion investment opportunity.” (DW 2021) IRENA has shown that until 2050 for energy transition alone an investment worth D 131 trillion (D 4.4 trillion a year) is required, notably for substantially increasing the share of renewables in the global energy mix. However, it was indicated in this context that the “sources of funds are not the problem per se, given that ESG (environmental, social and corporate governance) is the fastest-growing asset class and that several pandemic stimulus packages have a strong green focus”. See Arab News 2021.

283 Schwab 2016, 1.
Moreover, new approaches are also required for filling the huge financing gap in basic infrastructure in emerging and developing countries (EMDCs) “of the order of USD 1 trillion per year between now and 2030”. This is another area where required investments are so large that they can never be met by public funds.

**MDBs** and **IFIs** can mobilize additional resources by maximizing the availability of internal resources. This might involve a review of IFIs policy-based lending and the question to what extent MDBs should effectively provide general budget support to their member countries even though they were not designed to provide such support. It may involve a review of the maturities of MDB loans and may imply that MDBs shift their activities to a greater extent to trade financing and other transactional profiles with shorter maturities. However, the core issue is that for the transition to a green economy, facilitating 4IR, filling the huge infrastructure gap and other related matters, main resources need to come from the private sector and institutional investors. This has implications for institutional frameworks for MDBs facilitating such pursuits as they need to give the private sector and institutional investors a voice in decision-making. Moreover, it will entail dramatic changes for the role and the operational modalities of MDBs and IFIs. Rather than loans with up to 20 years of maturity, short-term-bridge financing and seed-financing, as well as venture capital and innovation hubs will be of prime importance. Moreover, rather than from MDBs and other IFIs, the main funding for pursuits as mentioned above will come from the private-sector and institutional investors.

While trillions of USD are required for these purposes, the money *per se* is not the problem as IRENA has recognized when it showed for energy transition alone an investment worth USD 131 trillion is required until 2050. The situation is similar as regards filling the infrastructure gap. “Private investors – notably the roughly USD 100 trillion in institutional investor resources– would be able to help fill this gap, as infrastructure assets offer the kind of opportunities these investors seek”. The very magnitude of the required investments requires for MDBs new funding mechanisms, including mechanisms as described below that are not linked to the capital base of MDBs.

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284 Humphrey 2018, 7.
285 Ibid., 7.
286 Humphrey discusses for filling the infrastructure financing gap arrangements relating to projects bonds, securitization of infrastructure debt, MDB syndication arrangements and other related arrangements. Ibid. 14–29.
9.4 Sponsoring Mechanisms Not Linked to Capital

Given the fact that the paid-in capital ratios of MDBs are unlikely to increase substantially, it is necessary to explore new funding mechanisms not linked to the subscribed paid-in and callable capital of MDB members and the headroom for their operational activities.

MIGA is interesting in this context as it is funded through a combination of subscribed capital and sponsorship. While it was initially envisaged to fund MIGA entirely through sponsorship arrangements, such arrangements play now only an important supplementary role. As indicated by Shihata, “even if the applicable limit of MIGA’s guarantee capacity is reached, the Agency will still be able to underwrite investments sponsored by member countries under the additional ‘Sponsorship Trust Fund’ facility”.

Similar sponsoring schemes could also be implemented by other MDBs. While in MIGA the sponsoring schemes are mostly used for high-risk activities to avoid that these become a burden for the balance sheet of MIGA, similar schemes might be given a wider application.

The Report of the G20 Eminent Expert Group on Global Financial Governance proposed multiplying “private capital by adopting system-wide approaches to risk insurance and securitization” and to develop “system-wide political risk insurance and expand the use of private reinsurance markets”.

The Group also suggested that the “MDBs should, as a system, leverage on MIGA as a global risk insurer in development finance” and build on “MIGA’s existing risk insurance capabilities to take on risk from the MDB system as a whole, and achieve the benefits of scale and a globally diversified portfolio.”

While the substantive proposals of the Eminent Expert Group deserve full support, it may be questioned whether it would be advisable to create a monopoly for risk related matters in MIGA. As an alternative, it might be considered to

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287 Shihata 1988, 149. As stated in the Commentary to the MIGA Convention: The mechanics of sponsorship are as follows: A member proposing to the Agency the guarantee of an investment will incur a loss-sharing contingent obligation in the amount of the guarantee sponsored by it. Premiums and other revenues attributable to sponsored guarantees will be accumulated in a separate trust fund called the Sponsorship Trust Fund. The administrative expenses and payments on claims related to sponsored investments would be paid out of this Fund. After depletion of the Fund, any loss incurred on a sponsored guarantee would be shared by all sponsoring members’ in proportion to the sponsored amount. See MIGA Commentary on the Convention: Establishing the Multilateral Investment Guarantee Agency 2010, 22–23.


289 Ibid, 39.g.

290 Ibid.
mainstream reinsurance and other risk-related activities in all MDBs through institutionalized cooperation (involving full or partial membership) with reinsurance companies and other stakeholders as proposed above. In the view of this author, this would be a much better option.

9.5 Other Mechanisms
In the case of MIGA’s sponsoring arrangements, MIGA acts as the administrator of the sponsored funds. However, it is not necessary for MDBs and IFIs to assume such a role. There are a number of other innovative mechanisms which they can adopt which are not linked to their capital base.

Girishankar states that “four types of innovative mechanisms (private and solidarity mechanisms, public-private partnerships and catalytic mechanisms) make up the international landscape”. As shown by him, there are a flurry of proposals and ideas for each of these mechanisms, but his proposal requires elaboration regarding the question on how to create synergies between different mechanisms (in particular, between private mechanisms and the other three mechanisms that rely on public funding). Moreover, funding is not the only issue. There are a range of other matters where the availability of resources is not the problem as such and where ideas are more important than money. As shown, this relates, in particular, to the transition to a green economy and support to 4IR.

In this context, in the literature a range of “development-oriented instruments” is being discussed and interesting examples are given where such instruments have been implemented and for a range of “commercially-oriented public instruments”. MDBs should explore options regarding such mechanisms to supplement their regular financial instruments, including mechanisms which are not dependent on their capitalization and the paid-in capital of their members. In doing so, they can charge fees for their services (e.g., on similar terms as MIGA in the context of sponsoring arrangements) and they can use such new mechanisms in connection with their regular

291 “Private mechanisms involve private-to-private flows in the market and in civil society. Solidarity mechanisms support sovereign-to-sovereign transfers and form the backbone of multilateral and bilateral ODA and other official flows (OOF). Public-private partnership (PPP) mechanisms leverage or mobilize private finance in support of public service delivery and other public functions, such as sovereign risk management. Catalytic mechanisms involve public support for creating and developing private markets (inter alia by reducing risks of private entry)”. Girishankar, (1).

292 Große Puppendahl, Byiers and Bilal, 14–31.

293 Ibid.
market-based and concessional modalities of financing to upscale or supplement their regular modalities of financing and their activities.

While it is not possible to analyze the aforementioned instruments in any detail, specific reference to matchmaking mechanisms needs to be made as there are many instances where such mechanisms can be used.\textsuperscript{294} MLIs should explore the full potential of such mechanisms which are particularly important because (i) major resources can be mobilized through such mechanisms (e.g., for undertakings such as the transition of countries to a green economy), and (ii) the operational expenditures of such mechanisms can entirely be funded by the private sector and institutional investors.

Given the reduction of the price of renewables, investments in the green economy are viable on purely economic grounds. As financial resources are available, it may generally suffice if MDBs and other IFIs facilitate investments in the green economy by matching the needs of states and public and private entities for funding with the interest of the private sector and institutional investors to invest in bankable projects regarding the transition to a green economy. Clearly, in some countries it will not be possible, however, to offer bankable project. In such cases, it may be possible to make projects bankable by including a first loss tranche or waterfall mechanism.\textsuperscript{295}

The World Green Economy Organization in Dubai\textsuperscript{296} has pioneered such a concept by organizing matchmaking meetings to which a great variety of stakeholders are invited. As the transition to a green economy involves a great variety of stakeholders, WGEO is organized as a fully-fledged multi-stakeholder institution. The activities of WGEO are implemented through entities participating in the seven platforms of WGEO.\textsuperscript{297} While WGEO targets smaller projects in the range between 20 and 50 million USD and is still in the initial phase of its activities, the approach adopted by WGEO is conceptually sound and innovative. There is no reason why similar concepts should not work at a larger scale.

\textsuperscript{294} Ibid.
\textsuperscript{295} See Droesse 2011d, 248–249.
Conclusion

As has been shown in this study, the organizational structures, institutional frameworks, and funding structures of IFIs and funds are intrinsically related. Whether different types of operations and financing are provided through institutions belonging to a group that are endowed with international legal personality and legal capacity under national law or under one legal personality by an organization administering different types of resources and providing different types of financing, has many legal implications for their governance structures, voting rights, and their funding mechanisms and operational modalities. As shown, special problems arise in the case of organizations which were not designed to leverage resources on capital markets against paid-in and callable capital. However, irrespective of their legal structures, IFIs need to respond to the same challenges. They need to find ways to maximize their impact by leveraging new resources and they need to find new ways to increase synergies between their various financing windows or the organizations forming an organizational group. To meet these objectives, they need to open themselves for participation by a wide range of stakeholders.

IFIs and export credit agencies, reinsurance companies and other stakeholders should join forces through coordination of their activities. An institutionalized participation of such and other stakeholders through full or partial membership would offer a very effective solution to achieve the above purpose. It would not only enhance the financial and risk-bearing capacity of IFIs but also their knowledge base and ability to engage in advanced transactions, in particular if it is accompanied through staff secondment and consultations at all levels.

The environment in which MDBs and other IFIs are operating is changing quickly and dramatically. The traditional financial intermediary model is intrinsically linked to the credit ratings of MDBs and other IFIs and their ability to leverage their capital base to mobilize resources on capital markets. However, states find it increasingly difficult to substantially increase their paid-in capital. The recognition of subordinated, hybrid debt offers in this context important new opportunities for MDBs and IFIs to expand and diversify their equity base. Also, securitization may offer opportunities for MDBs to free up resources. However, caution is required for MDBs to engage in advanced financial engineering or to further erode their paid-in capital ratios because in doing so they might lose their AAA-credit rating and undermine the financial strength in the long run.

The transition to a green economy and 4IR will fundamentally change the manner how MLIS conduct their business. One the one hand, such transition...
offers many opportunities to maximize the availability of internal resources. On the other hand, it involves financial demands of such magnitude that these can never be met through public-sector funding alone. This as such is not a problem per se as investments in the green economy and 4IR are viable on purely economic grounds. However, it requires that MDBs and other IFIs substantially change their strategic outlook and modus operandi. Hence, it is necessary to look for new financial paradigms that are not linked to the capital base of IFIs.

The sponsoring scheme of MIGA can be one example as it is not linked to the capital base of MIGA. However, while MIGA acts in this scheme as the administrator of the funds under that scheme, this is not intrinsically necessary and there are other ways for MDBs to enhance their impact. Any organization seeking to facilitate the transition to a green economy, to be effective, needs to be structured as a multi-actor and multi-stakeholder institution. Thus, changes in governance structures are a necessary corollary of the required changes in funding structures.

In addition to sponsoring mechanisms, MLIs should explore the potential of “development-oriented instruments” and “commercially-oriented public instruments”. Particular attention should be given in this context to matchmaking mechanisms because these have the potential of mobilizing major resources for the transition to a green economy, and operational funding for such activities can come entirely from the private sector and institutional investors.

Hence, it is necessary for IFIs to explore new financing mechanisms and open themselves to the participation of other stakeholders. Moreover, irrespective of their legal structures, all funding windows need to embrace innovation and seek new ways to enhance their impact.

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