
Best Practices of Development Banks : view from the private sector

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Citi Public Sector Group

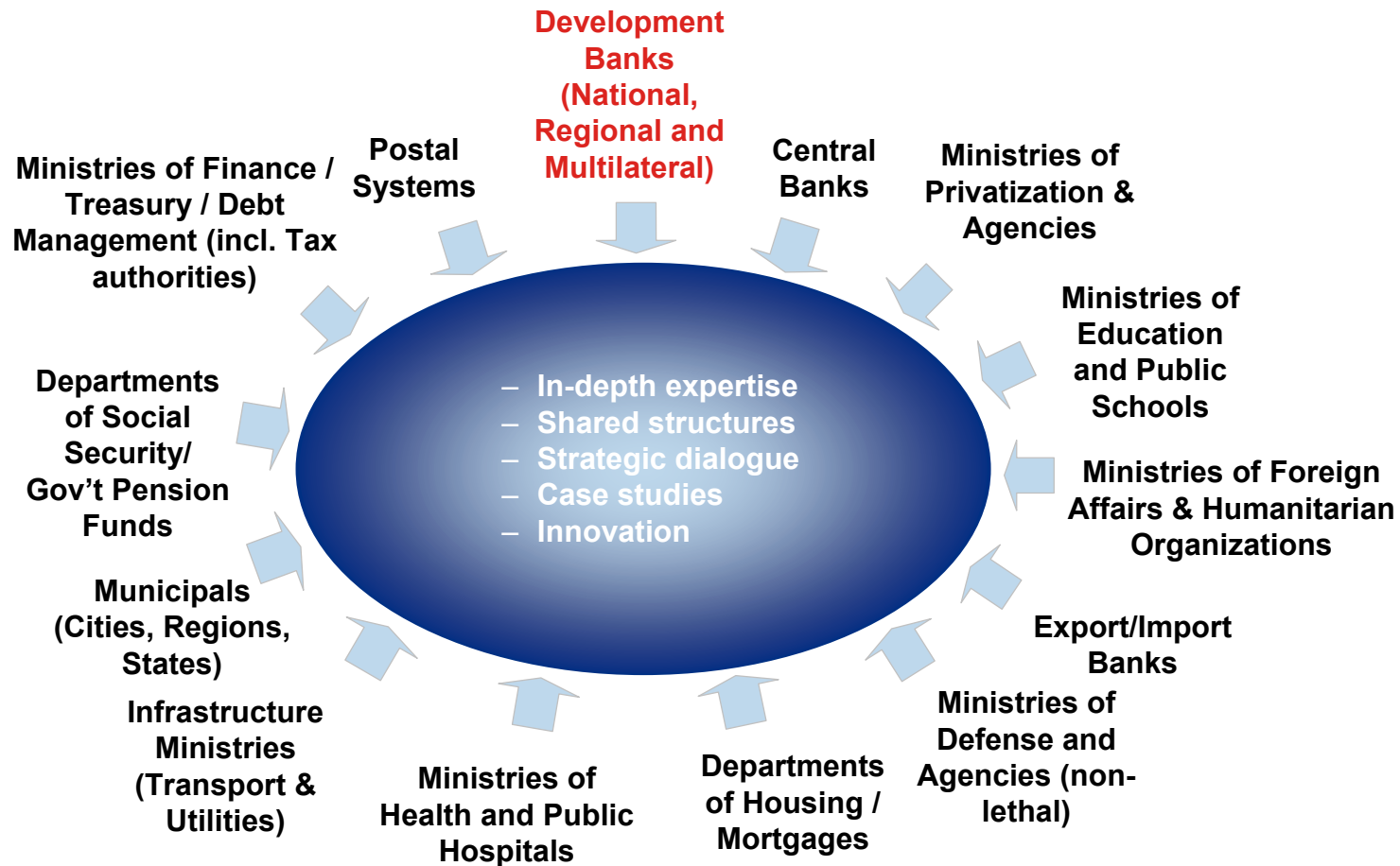
The creation of the public sector group aims at better serving a broad range of clients in the public sector.

- Citi created the Public Sector Group in 2005, as a specific industry group within Global Banking
- Team of bankers dedicated solely to serving the needs of governments globally
- In priority countries, a Senior Government Banker has been appointed to serve as a single point of contact for all strategic discussions across products with key government decision makers



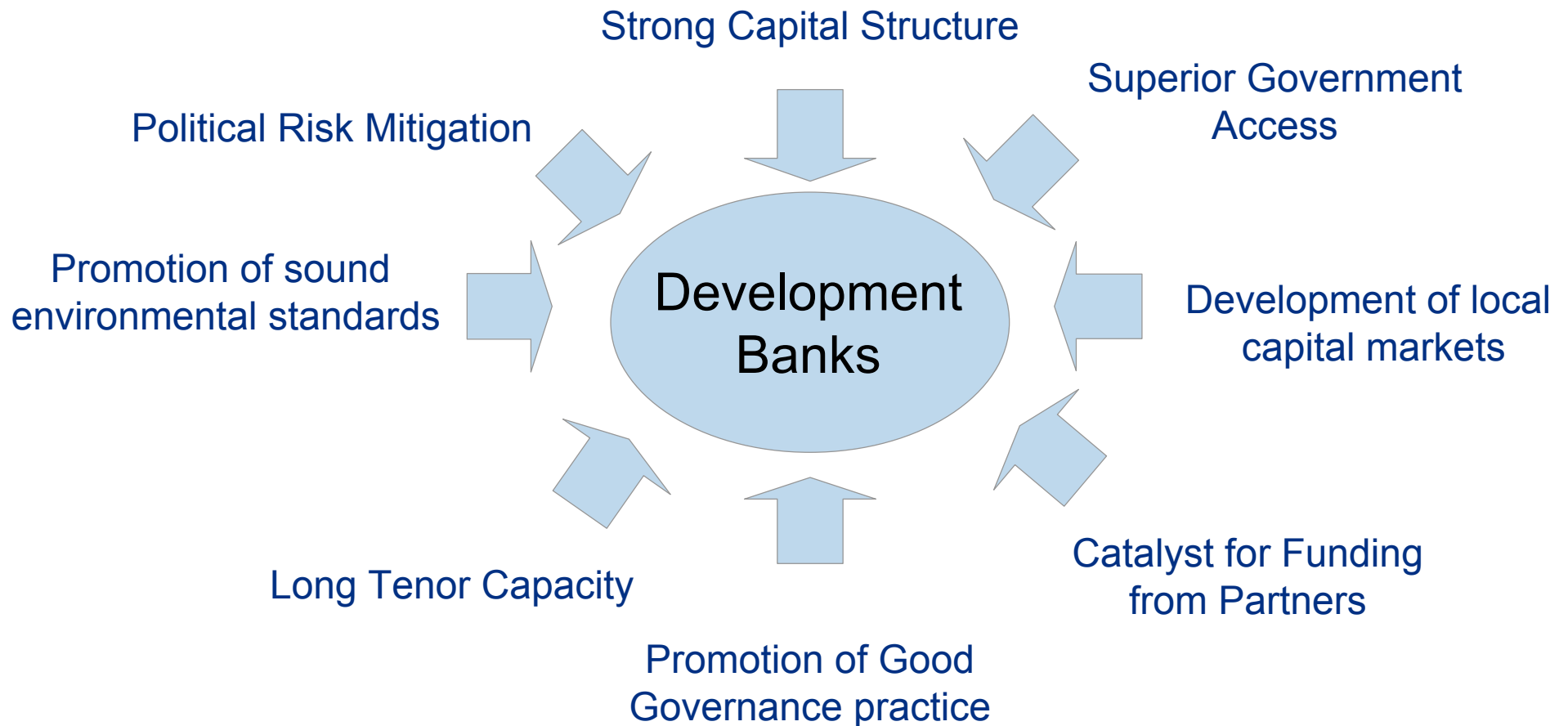
Comprehensive Coverage of the Public Sector

Strategic dialogue initiated with key public sector clients globally.



Benefits of Working with Development Banks

Working with Development Banks offers superior Government access, mitigation of political risk and development of innovative solutions for clients in Emerging Markets

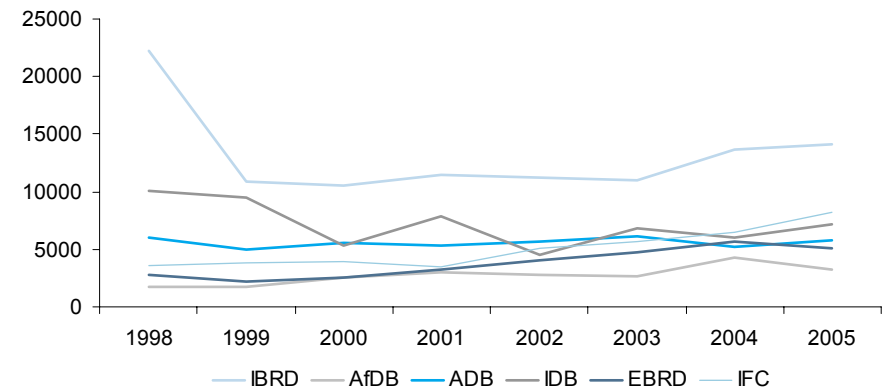


Challenges Faced by Development Banks

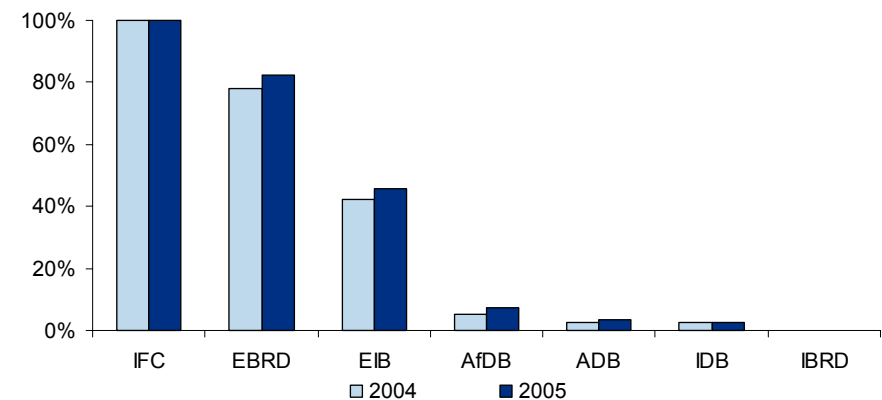
Development banks are facing reduction in demand for lending from traditional clients

- Development Banks face challenges in their traditional lending activities :
 - Increase in private capital flows to emerging markets have reduced the demand for financing from MDBs and regional development Banks
 - The development of domestic financial markets has reduced the scope of activities of national development Banks
- National development Banks have suffered from poor governance and political interference
- More stringent banking regulations have forced development banks to operate on a viable and sustainable basis
- With the liberalization of financial markets, the risk of development banks competing with the private sector has increased
- Development Banks had to find a new raison d'être
 - Non-lending services and advisory while financing can be provided by private sector
 - Catalyst of private sector financial flows where political risk is high
 - Innovative financial products
 - Mobilizing new resources for development

MDBs Lending Volumes



Increased Focus on Private Sector

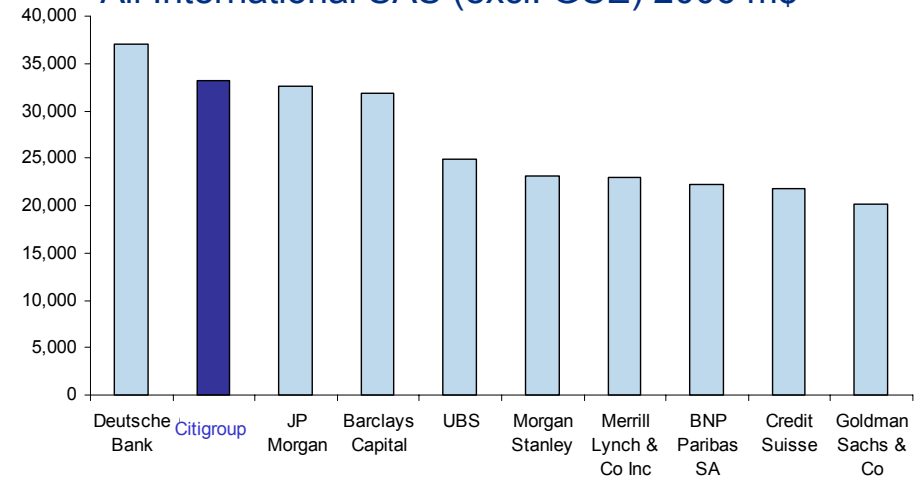


Strong Partnership with Development Banks

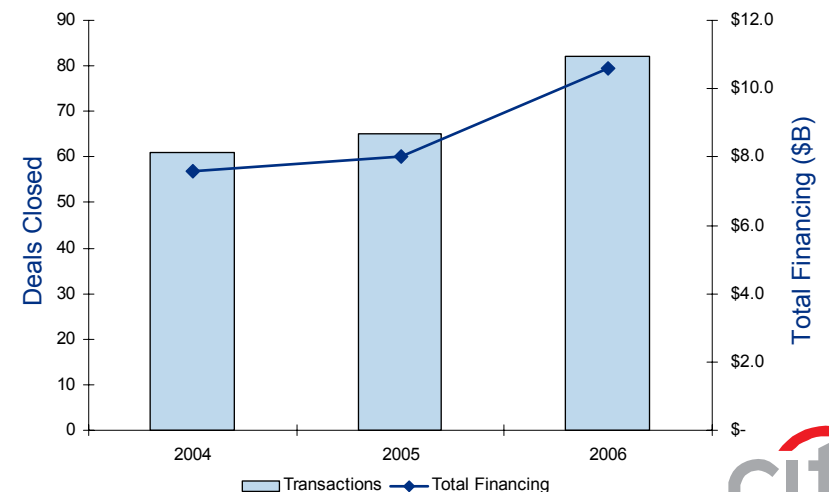
Citigroup is a long-time partner of Development Banks on both sides of their balance sheet.

- Traditionally, Citi is a strong partner of development banks to help them achieve their funding needs
- Successful track record with MDBs and regional development banks around the world
- Pioneer in local currency financing for development banks around the world
- Citigroup is the undisputed leader in developing local currency issuance for development Banks in Asia
- In Central and Eastern Europe, Citigroup co-arranged the first three Russian Rouble bond issues for EBRD based on MosPrime, totalling Rouble 17.5 billion
- EAF originates, structures and executes financings with the involvement of Official Agencies (e.g. ECAs and MDBs). EAF manages a diversified portfolio worth over \$14 billion globally and, in 2006, closed 82 transactions in excess of \$10.6 billion
- Development Banks leverage on Citi's leading role in Export and Agency Finance (EAF) to originate assets and promote development in EMs

All International SAS (excl. GSE) 2006 m\$



Citi Export and Agency Finance transactions



Citi's Global Presence

With its global footprint, Citi is the natural partner of multilateral, regional and national development banks.

- Citigroup's expansive footprint provides its clients unique access to opportunities in over 100 countries around the globe
- Citigroup's unparalleled market expertise, customer relationship commitment and integrated solutions, combined with its global accessibility, make it the premier investment bank for all corporate finance needs...anywhere



Top 10 Best Practices of Development Banks

1. Develop a vision
2. Implement sound governance and focus on results
3. Crowd in the private sector
4. Focus on Infrastructure
5. Build an inclusive financial sector
6. Contribute to Global Public Goods and sound environmental standards
7. Promote local currency financing
8. Innovate
9. Use capital wisely and Actively Manage ALM
10. Adopt best practices of the private sector for internal management

Develop a Vision

Development Banks have to develop a strategic vision.

- With the liberalization of capital markets and increased capital flow, Development Banks have to develop a vision of their mission in order to avoid competing with the private sector
- All MDBs have developed a comprehensive strategy of the mission and purpose
 - World Bank with the Strategic compact and the concept of knowledge bank
 - laDB has developed a strategic vision assessing its comparative advantage and its strength and weaknesses
 - EBRD has committed to focus on frontier countries, moving further East and South, promote energy efficiency and continue to strengthen the partnership with the private sector
- National development Banks are also better defining their mission
 - KfW developed the KfW Kompass focusing on SMEs, Housing, Environment and Growth and international development
 - AFD has adopted a 5-year strategic plan
- Developing a vision is particularly important for national development banks in order to assess the financial market failures they need to address, and to avoid the risk of either competing with the private sector or engaging into unsustainable lending practices
- The evolution of the role of development banks can lead to transformation and privatization (example of the Development Bank of Singapore)

Implement Sound Governance and Focus on Results

Independence from the government in day to day running of operations is a key success factor.

- In the past, a number of national development banks had poor risk management systems which led to much lower loan recovery rate than those of commercial banks
- This situation has led to the reorganization and restructuring of a number of development banks
- Best practice include :
 - Robust counterparty risk management practices
 - Transparency of loan policy
 - Accountability of management and independent audit system
- One model is to diversify ownership by including foreign development institutions in the capital of development banks : this is the case for instance of Development Bank of Kenya owned by the government of Kenya, FMO, CDC, DEG and IFC
- MDBs have recently focused on results measurement and monitoring instead of measuring results through annual lending volumes
- MDBs are now publishing an annual report on results measurement (Common Performance Assessment or COMPAS)
- Independent Evaluation Offices have been created in MDBs and OECD development agencies operations are reviewed under the OECD-DAC Peer review System
- Knowledge transfer is essential for National Development Banks to build their own result measurement systems

Crowding in The Private Sector

Crowding in the private sector is a critical mission of Development Banks through co-financing and co-investment.

- In order not to compete with private banks, Development Banks need to provide the extra mile necessary for the private sector to be involved in long term financing
- Most MDBs have developed syndication programs to leverage commercial banks resources
 - B loan programs by IFC, EBRD, ADB, IDB and FMO
 - MDBs share risk with participants who benefit from preferred creditor status
 - Program enables loans with longer tenor and better pricing
 - Useful instrument to finance corporate and infrastructure projects
- Private sector is moving from traditional B-loans to framework risk sharing agreements
 - Citi signed in October 2006 a US\$ 540 million risk sharing facility with FMO aimed at providing loans to small and medium sized companies in lower income countries
 - Under this facility, FMO guarantees up to 65% of the risk in loans originated by Citi via its global network
 - Partnership covers local currency financing
 - Benefits : leverage on Citi's global client network, true local currency guarantees, efficiency and standardization, best practices (KYC/ALM)

CDC does Africa Fund with Citi

Development Banks can leverage the experience and resources of the private sector

Citigroup has joined forces with one of Africa's leading private equity groups to invest at least \$ 200m in the continent, the biggest bet to date on the future of African growth businesses

Financial times

- Citigroup has joined forces with one of Africa's leading private equity groups to invest at least US\$200 million in the continent, the biggest bet to date on the future of African growth businesses
- CDC, a private equity investor owned by the UK Government and formerly known as the Commonwealth Development Corporation, will commit US\$100 million to a dedicated Africa fund, managed by Citigroup's private equity arm. Citigroup will match CDC dollar for dollar
- Interest in African private equity has been spurred by large profits for backers of Celtel, a pan-African telecoms group that sold in 2005 for US\$ 3.4 billion
- Citigroup is the biggest name to launch a pan-African fund in a region where private equity is dominated by quasi-governmental development finance institutions, mainly from Europe, and specialist emerging markets funds

Focus on Infrastructure

Infrastructure needs around the world have pushed development banks to refocus on this segment.

- Infrastructure has traditionally been a priority sector for development banks. From 1994 to 2005, nearly 90% of China Development Bank lending operations was directed towards infrastructure
- Historically, 70% of infrastructure investments in developing countries were funded through the public sector
- With infrastructure investment needs estimated at 5.5% of developing countries annual GDP, the private sector will take a greater role in infrastructure investment
- In 2003, the World Bank has issued an infrastructure action plan to reverse the decline in lending to infrastructure lending in the 1990's. The objective is to double infrastructure lending to reach US\$ 10 billion in 2010
- Development banks need to leverage public and private resources in order to meet infrastructure needs
- Development Banks need to use the full range of instruments available for infrastructure finance

Lending instruments

Bank debt
Debt capital markets
Derivatives
Development bank loans
Local currency
Mezzanine and convertible debt
Index linked
Junior debt

Credit enhancements

Partial credit guarantees
Local currency guarantees
Risk sharing facilities
Refinancing guarantees
Securitizations

Infrastructure – Alignment of Their Mandate

Development Banks can play an essential role in facilitating the introduction of the private sector to public infrastructure.

- Can play an important role
 - Capacity to make projects ultimately sustainable for the private market
 - Not to compete with the private sector, but rather come into projects that may not otherwise get done
- Assume segments of risk that the private sector does not accept. May relate to
 - Capital structure
 - Currency
 - Tenure
 - Performance
- Early stage development and advisory role
- The most successful policy banks have remained current with developments in the private sector market ... e.g. EBRD

Building an Inclusive Financial Sector

Promoting small scale projects (microfinance and SMEs) is essential to achieve the goals of poverty reduction.

- Microfinance and SME can make a significant contribution to developing the private sector, create jobs and reduce poverty
- World Bank, through its support of CGAP has been a pioneer in developing microfinance
- All development Banks are entering microfinance and SME financing
- Partnership through local banks is critical for Development Banks to access final clients
- Citigroup has a strong track record of success partnering with Development Banks
 - BRAC securitization with FMO and KfW : first micro-credit securitization
 - Risk sharing agreement with OPIC on microfinance

“The most ambitious big bank in this area [microfinance] is Citigroup...Citi's biggest contribution, though, is its belief that microfinance can become a valid, profit making business. If it is right, the other big banks will also pile into the market--and so will investors.”

The Economist, November 2005

Focus on Global Public Goods

Development Banks operations need to achieve more than financial results.

- Due to their public sector nature, Development Banks are focusing on project with externalities and promoting global public goods
- Development Banks are particularly active in the fields of the environment and good governance
- KfW launched the Housing, Environment, Growth program in 2006 to promote CO2 reducing investments. In 2006, EUR 7.3 billion subsidized loans were committed under the CO2 building and rehabilitation program and the housing modernization program. In addition, EUR 2.2 billion were committed for low-energy and passive houses
- Caisse des Dépôts et Consignations in France has taken a leading role in promoting Carbon trading in France and in Europe
- AFD is focusing on the promotion of global public goods in emerging markets. It can offer soft loans for projects which include a positive environment impact in particular on carbon emissions
- Development Banks are also promoting sustainable development (Ecuador principles sponsored by IFC), good governance and anti-corruption
- Development Banks can rely on private sector experience in AML/KYC to promote best practices

Local Currency Financing

Local currency financing is a key new trend in Emerging Markets and an area where development banks can add significant value in partnership with the private sector

- Development Banks clients, particularly those with limited balance of payment needs, have a strong interest in local currency lending
- Many MDBs are now active in local currency financings and some are more advanced than others
- World Bank only lends in local currency when there is a mature swap market. It does not enter into back to back operations
- Other MDBs (e.g. EBRD, IFC, ADB) have been more active in local currency financing, entering into back to back operations where funding in local currency is on-lent for development projects. EBRD has been at the forefront of innovation, particularly in Russia
- National development banks are starting to issue in local currencies (KfW, AFD, FMO)
- They are different approaches to raising local currencies :
 - Funding from local banks
 - Use of swap market when it exists
 - Local debt capital markets
 - Credit enhancement structures as guarantees
 - Issuance by Development Banks and on-lending
- With its global front print and presence in 100 countries, Citigroup is ideally positioned to help Development Banks tapping local currency markets

Innovative Financing

In order to meet their client needs, Development Banks are exploring new form of innovative financing.

- With the rise in private capital to emerging markets, Development Banks need to innovate in order to remain relevant and provide risk mitigation mechanisms
- Innovative financing needs to address main vulnerabilities of emerging and poor countries
 - Commodity risk : example AFD offers loans which amortization schedule is linked to the evolution of the price of cotton
 - Foreign exchange risk : Number of reports have called for development banks to offer FX risk mitigation for projects with local currency proceeds (Camdessus Report)
 - MDBs can assist the private sector to provide FX and Interest Rate hedging to emerging market borrowers (e.g. cover of pre-settlement exposure or extension of tenors)
 - Credit enhancement through monolines
 - Islamic finance
 - Securitization
 - Carbon Credits

Leverage Capital Base and Actively Manage ALM

Development Banks are usually highly capitalized and could better leverage their capital.

- High capitalization and support of key shareholders is supporting AAA credit rating of large multilateral development banks
- Development Banks usually have low leverage and high capital adequacy
- Development Banks can use more actively their capital by using guarantees to attract private investors
- Tools include
 - Partial credit guarantees
 - Political risk guarantees
 - First loss guarantees
 - Risk sharing agreements between Development Banks and Commercial Banks
 - Development Banks started using securitization to actively manage their portfolio
- KfW experience : In the past six years, KfW has securitized a volume of more than EUR 100 billion in SME and housing loans in more than 60 transactions
- IFC is planning to execute a securitization transaction using a portion of IFC's senior loans. The transaction is expected to be the first of an on-going program of securitizations.
- National Development Banks active internationally are looking at securitizing some of their Emerging market loan portfolio

Use Best Practices of The Private Sector

Private sector can bring efficiency to development banks internal operations.

Strategic

Procurement Card
Shared Service Centres
Worker Remittance
Treasury Vision

Financial

Liquidity & Investments
Securities Lending
Global Custody
Trade Finance



Operational

Payments
Collections
Stored Value Cards
Trade Services

Conclusions

Win : Win

Official agencies should catalyze and leverage relationships with private sector, not compete.

Leverage Citi's presence on the ground

- Private sector banks, such as Citigroup, have the on-the ground presence and client relationships which can be leveraged by official agencies through coordinated efforts.

Scaling up

- Capital markets are growing; liquidity is immense. Citigroup's infrastructure can allow an extension of markets with support from agencies.

Sounds environmental standards

- Citi is a key promoter of the Equator Principles. This is another area of synergy with MDBs to promote best practices in environmental standards.

“Additionality”

- Official agencies offer enhanced terms making possible transactions that are not available in the private sector alone by increasing transaction size and tenor.

2 + 2 = 5

- Clients benefit from the expertise and knowledge of the official agencies and the private sector working in partnership, strong communication is critical.

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