Unleashing Opportunity by Unlocking Private Investment in International Infrastructure

The Wilson Center's Wahba Institute for Strategic Competition (WISC) launched a study group comprising leaders in the financial sector who explored how to close the multi-trillion-dollar infrastructure funding gap in emerging markets and developing economies (EMDE).

There are a variety of ways Development Finance Institutions (DFIs) and Multilateral Development Banks (MDBs) can activate private capital support for EMDE infrastructure investments. The traditional focus has been on transaction-level mobilization from commercial banks and equity investors, along with balance sheet mobilization by issuing bonds. There is even greater opportunity to mobilize capital at scale from institutional investors. The study group offers the following recommendations to bolster global opportunities, strengthen the rule of law, and expand American exports to advance US national security and foreign policy objectives. Most recommendations can be enacted by MDB/DFIs without further authority. Administrative or legislative action may help enable and encourage those recommendations marked with an *.

Transactional-Level Mobilization from Commercial Banks and Equity Investors

- **Capital Treatment.** Instituting higher required capital levels following the 2007-08 financial crisis led to a scaling back in commercial EMDE lending. Uncertainty regarding pending increases in capital standards inhibits expanded lending. In addition to clarity and stability in regulations, clear guidance on preferable capital treatment for infrastructure lending when in tandem with DFIs and MDBs would unlock additional leading.*
- **Longer Tenors.** Higher capital and liquidity requirements mean commercial banks have less appetite for longer-tenure lending. MDB/DFIs providing tenors that are much longer than commercial tranches, with a principal grace period during the commercial tranche period, would activate greater bank lending.
- **Streamline Reviews.** Streamlining environmental reviews to avoid the need for multiple reviews of a single project would make EMDE investments more attractive, as would expediting the approval process.
- **Offset Costs of Higher Standards.** US contractors typically have much higher standards, making their overall bids higher cost and therefore less competitive. Grant funding to offset such higher costs would enhance competitiveness of US offerings and interest in participation by US entities.* Government agencies should redouble efforts to encourage procurement processes that incorporate the benefits of high standards.

- **Enhance Tools for Addressing Currency Risk.** Enhancing the ability to mitigate currency risks is a primary avenue to greater activation of private investment. Helping countries develop programs that offer a currency swap from the government is one option. Another is MDB/DFI issuing greater local currency bonds to enable them to de-risk projects through increased local currency lending while also developing local capital markets. Funding and risk participation agreements from local institutions could be another route to channel local liquidity into infrastructure investments in the local currency.
- **Expand and Broaden Risk Coverage.** Increasing insured coverage of debt to 100% (assuming equity participates in project risk) would attract broader private participation.* Coverage could reduce over time if certain conditions are met and lenders gain comfort in the external risk factors. First-loss tranches and credit enhancements or liquidity lines to limit risks related to the level of toll-paying traffic on a transportation project or the solvency of the entity contracting to consume energy from an energy project can activate greater private participation.* Including products and services from allied countries in Export-Import Bank country-of-origin requirements would better position allied action.

Mobilization from Institutional Investors

- **Lender of Record Structure.** Greater use of a model the International Finance Corporation (IFC), Inter American Development Bank (IDB) and other MDB/DFIs call B Loans or Bonds could better tap the institutional market. Once an MDB/DFI originates a loan, it remains the lender of record, retaining a portion (the A Loan) and selling participations in the remainder to investors. This gives comfort to investors because the borrower cannot default on them without also defaulting on an MDB/DFI. Investors also find value in having the MDB/DFI monitor and report on environmental and social impacts.
- **Portfolios of Loans.** MDB/DFIs bundling loans into portfolios and then selling participation in the portfolio to investors allows investors to diversify risk. Even if some assets don't perform, the larger portfolio of assets can still deliver an attractive return. It is more efficient to de-risk assets (including through concessional blended finance) at the portfolio level rather than in individual transactions. Portfolios could be tailored to target areas of investor appetite. Maintaining a pipeline of opportunities would enhance investor interest.
- **Assuming Construction Period Risk.** MDB/DFIs helping investors manage the construction and early operational, regulatory, environmental, and social risks of greenfield infrastructure projects would attract more investors.
- **Enhance Infrastructure Asset Class.** Standardizing MDB/DFI assets and adopting a common, market-based credit risk rating for MDB/DFI loans would facilitate securing them and selling them to investors.

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