Promoting Trade and Investment in Central and West Asia:

The Case for a Regional Trade Credit and Investment Guarantee Agency

24th Trade Policy Coordinating Committee Meeting

Tbilisi, Georgia – 19 June 2017

Roland Pladet, Principal Finance Specialist
Central and West Asia Department
Asian Development Bank

Contents

Draft Project Concept

- Regional trade credit and investment guarantee or re-guarantee agency
- Foster inter- and intra-regional trade and foreign direct investment (FDI)
- Access to pre-export and trade finance & FDI protection
- Beside Central and West Asia Other participants may include:
  - other trading and investor partner countries
  - non-state entities:
    - multilateral, regional and national development banks
    - export credit agencies (ECAs) and export-import banks (EXIM Banks)
    - private risk insurers and reinsurers (PRIs)
- Participation of PRIs facilitates public-private partnerships (PPPs)
- Possible PPP solution: multilateral re-guarantee agency with PRI as primary underwriter

Rationale: Why Central and West Asia?

- Regional challenges:
  - diversify economies
  - increased employment
  - development of non-traditional sectors
- Low intra-regional trade (excl. PRC): 6.5% of trade (2001-2016)
- Least access to trade and pre-export finance and FDI protection
- Inability to compete internationally
- Less potential for:
  - vertical (cross-border) business integration
  - horizontal (cross-border) product differentiation
  - development of non-traditional export sectors
  - development of small and medium enterprises (SMEs)
- Denial of vital role ECAs & EXIM Banks in OECD & other regions Asia

Rationale: Why CAREC?

- Mid-term Review CAREC 2020
  - adverse impacts since 2008 on GDP growth and trade across the region
- CAREC 2020
  - regional cooperation has become an imperative
  - necessity to focus on two strategic objectives:
    - expanding trade
    - improving competitiveness
  - infrastructure improvements must be supported by trade facilitation measures to directly impact intra- and inter-regional trade
- CAREC's 2006 Comprehensive Action Plan
  - developing innovative approaches to cooperative arrangements (incl. PPPs)

Rationale: Why a Multilateral Solution?

- Effective political risk mitigation associated with trade and FDI
- Enhanced governance structure & institutional capacity building
- International credit rating to help reduce financing cost due to:
  - lower sovereign ratings
  - non-rated sovereigns
- Operational synergies & cost efficiencies:
  - Economies-of-scale
  - Reduced overheads
  - Risk diversification and sharing
  - Permanent center of knowledge and expertise
  - Greater access to co- and re-insurance capacity
  - ‘Leapfrog’: cross-border mergers national ECAs in OECD since 1990s

Agency's Key Product Offering

- Short-term whole turnover credit insurance (< 2 years) allowing regional exporters and domestic suppliers to:
  - compete internationally by trading on an open-account basis
  - benefit from cost-effective protection against non-payment
  - target foreign and local buyers under pre-approved credit limits
- Medium-to-long-term supplier and buyer credits (> 2 years and < 15 years) allowing regional suppliers, contractors and service providers to:
  - submit bids for contracts for infrastructure projects
  - Compete directly with non-regional suppliers, contractors and providers who have access to ECA or EXIM Bank support
- Long-term political risk insurance (< 15 years) fostering intra- and inter-regional FDI

Expected Impact, Outcome and Outputs

- **Impact:**
  - Sustainable economic growth
  - Increased employment opportunities
  - Better Diversified Central and West Asia economies
- **Outcome:**
  - Improved international regional competitiveness
- **Outputs:**
  - Established multilateral ECA based on best market practice
  - Secured PRI participation and PPP solution

Potential ADB Role

- In role of CAREC Secretariat, ADB is well poised to help:
  - develop the project concept
  - structure, establish, and operationalize the Agency
  - engage PRI participation under a preferred PPP modality
- Subject to interest from eligible DMCs, ADB may:
  - provide financing support (subject to ADB approvals) for respective equity participations in the Agency
  - help mobilize financing support from other MDBs for similar participations from countries outside the ADB membership

Key Issues

- Arguments in favor of multilateral ECA solution instead of:
  - national ECAs:
    - Economies of scale
    - Credit rating of national ECA capped by sovereign rating
    - Enhance credit rating national ECAs through ‘fronting’ or ‘cut-through’
  - guarantee trust fund:
    - establishment of permanent regional institutional capacity
    - greater visibility as permanent institution to attract risk-sharing arrangements
- Re-guarantee Agency (e.g. AfricaRe) vs. Guarantee Agency (e.g. ATI)
  - make use of primary PRI underwriter IT systems, databases and networks
  - far more time-efficient and cost-effective implementation
  - Agency can become fully operational relatively fast

Key Issues

- Ensure complementarity with other regional MDB initiatives
- Eligibility and timing of admission of non-regional countries from Eurasian region, Middle East, South Asia, etc.
- Preliminary consultation of ADB DMCs' –in principle-interest
- Determination of minimum 'stop-go' number of interested ADB DMCs

Next Steps

- TPCC delegates to sound – in principle – interest
- Subject to minimum ‘stop-go’ number, ADB will:
  - conduct bilateral consultations
  - seek internal approval to conduct pre-feasibility study
- Subject to pre-feasibility, ADB will:
  - develop and finalize project concept
  - seek validation of project concept participating DMCs
  - seek internal project concept approval for transaction technical assistance and proposed financing support

Appendix A: Indicative Problem Tree

Effects

Constrains in industrial development & growth/diversification of economies

- Inadequate opportunities for development of more skilled labor intensive non-traditional sectors
- High reliance on relatively less skilled labor intensive traditional sectors
- High extra-regional labor migration due to low skilled labor employment opportunities dampening local consumption and demand

Problem

Lack of international competitiveness to: (i) trade on open account basis; (ii) bid on inter- and intra-regional supply, construction and service contracts; and (iii) attract inter- and intra-regional foreign direct investments

Causes

High reliance on less competitive and/or higher cost bank-intermediated trade terms or finance, such as cash in advance, cash against documents, or (confirmed) letters of credit (L/Cs)

- Threats to business/employment continuity and growth due to non-mitigated exposure to buyer nonpayment risks or business opportunities lost
  - Lacking or inadequately credit rated national ECAs / EXIM Banks
  - Underdeveloped private insurance and brokerage markets
- Relatively weak banking systems facing asset/liability management challenges, high non-performing loan ratios and inherently high risk and liquidity premiums
  - Underdeveloped capital and debt markets lacking width and depth
  - Lack of adequate financial sector transparency and governance

Appendix B: Example of Similar Project in Sub-Saharan Africa (African Trade Insurance Agency)

- World Bank (IDA) initiative in late 90s and became operational in 2001
- Built on platform of Common Market for Eastern and Southern Africa (COMESA)
- ATI is structured as a PPP:
  - Unique multilateral body which Treaty is open to membership by:
    - all 54 African Union (AU) countries
    - non-African countries
    - non-state members
  - ATI membership history shows that it is likely to further expand over time:
    - 2001: 7 countries (Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda and Zambia)
    - 2017: 5 additional members (Benin, DRC, Ethiopia, Madagascar and Zimbabwe) and 4 countries in process of completing membership (Djibouti, Eritrea, Liberia and Sudan)
    - ATI has no procurement restrictions to date
  - ATI also allows for non-state members:
    - AfDB, Africa Re, Atradius Group (Netherlands), COMESA, PTA Bank, SACE (Italy), UK Export Finance (United Kingdom) and ZEP Re
    - Atradius Group has been a corporate member of ATI since 2001 and has provided treaty reinsurance on ATI's whole-turnover credit insurance portfolio

Appendix B: Example of Similar Project in Sub-Saharan Africa (African Trade Insurance Agency)

- **Country capital contributions to secure balanced voting rights:**
  - ATI's authorized capital (paid-in capital by AU countries): $1 billion (at least 51%)
  - Larger economies (e.g. DRC, Kenya, Nigeria, Sudan): maximum $25 million
  - Smaller economies: minimum $ 7.5 million
  - Average expected contribution per country: $10 million
- **Leveraging ATI's underwriting capacity**
  - Initial 2001 structure was sub-optimal (no leverage; silos; cash-collateral, etc.):
    - paid-in equity: $1.3 MM
    - paid-in underwriting capital: $134 MM (held in trust accounts in London)
    - underwriting capacity: $134 MM (no gearing due to country silo constraints)
  - The 2007 restructuring converted underwriting capital into equity:

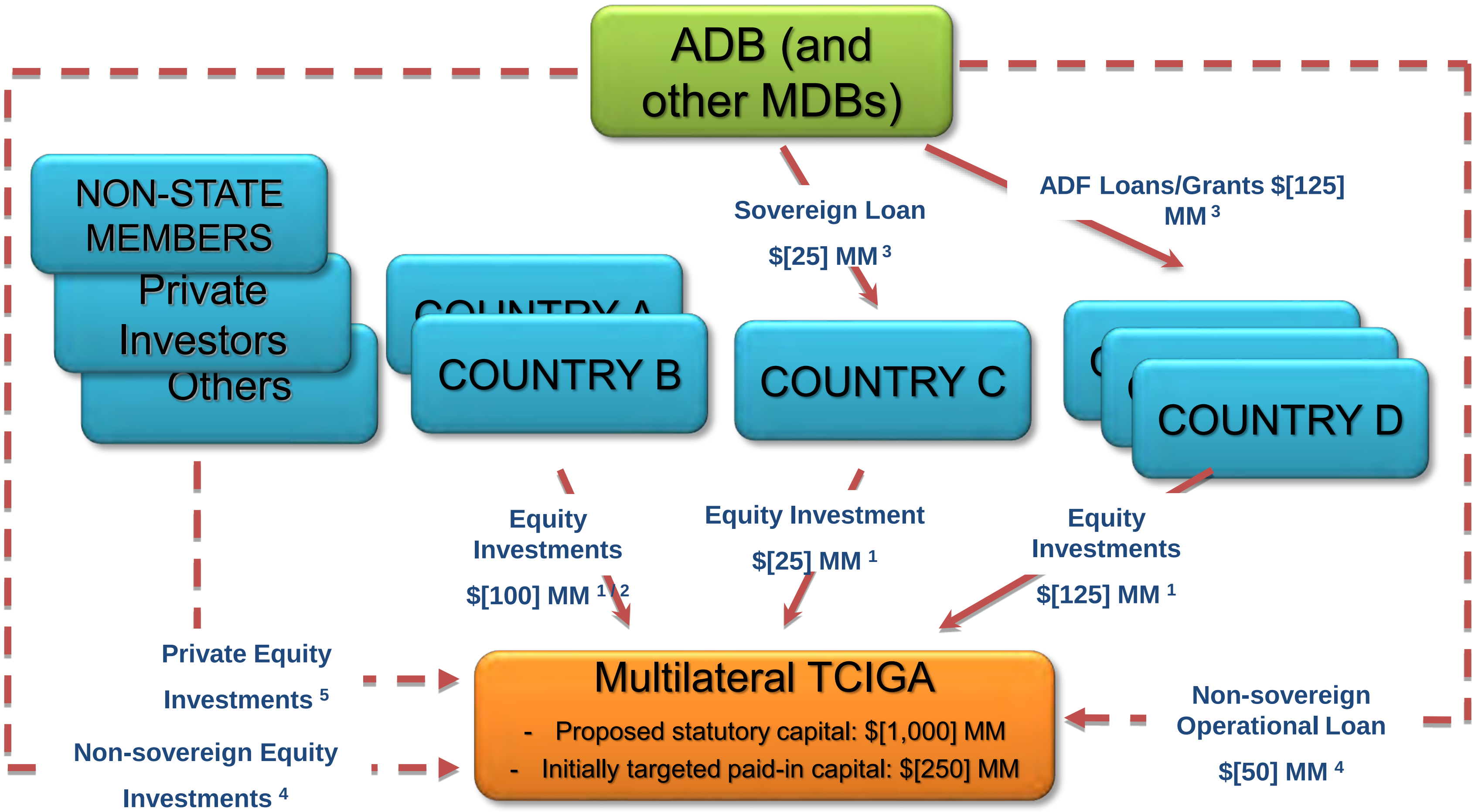
	2007	2017
paid-in equity (held in trust accounts in London):	$134 MM	$200 MM
net underwriting capacity (typical internal gearing of 1:3):	$400 MM	$600 MM
gross capacity underwriting capacity (typical 60% reinsurance):	$1,000 MM	$1,500 MM

Appendix B: Example of Similar Project in Sub-Saharan Africa (African Trade Insurance Agency)

- **Obtained S&P 'A' credit rating in March 2008**
- **Facilitated $17 billion in trade credit and FDI to date**
- **Effective preferred creditor status and political risk mitigation through a '*de jure*' (not '*de facto*') cross default with IDA**
  - **If an ATI member country were to incur a loss to ATI (i.e. political and sovereign risks), there is a legal obligation for that country to make ATI whole within 60 days after it has paid a valid claim**
  - **If not made whole, ATI will inform IDA (World Bank)**
  - **IDA will then allow the country to cure this situation within another 10 days**
  - **If not cured, IDA will have the right (not the obligation) to invoke:**
    - **a cross-default of its entire sovereign portfolio; and**
    - **suspend operations**
  - **Creates more favorable environment for traders, investors, financiers and underwriters to assume commercial risks associated with trade and FDI in Africa**

Appendix C: Option 1 – Project Structure

Replicating ATI: Trade Credit and Investment Guarantee Agency (TCIGA)



1 A member state's equity investment ranges between $[10] MM and $50 MM and will be determined in proportion to its GDP and is to be paid-in in full

2 Member countries may fund their equity contributions from their own resources (e.g. Sovereign Wealth Funds of Azerbaijan, Kazakhstan and/or Turkmenistan)

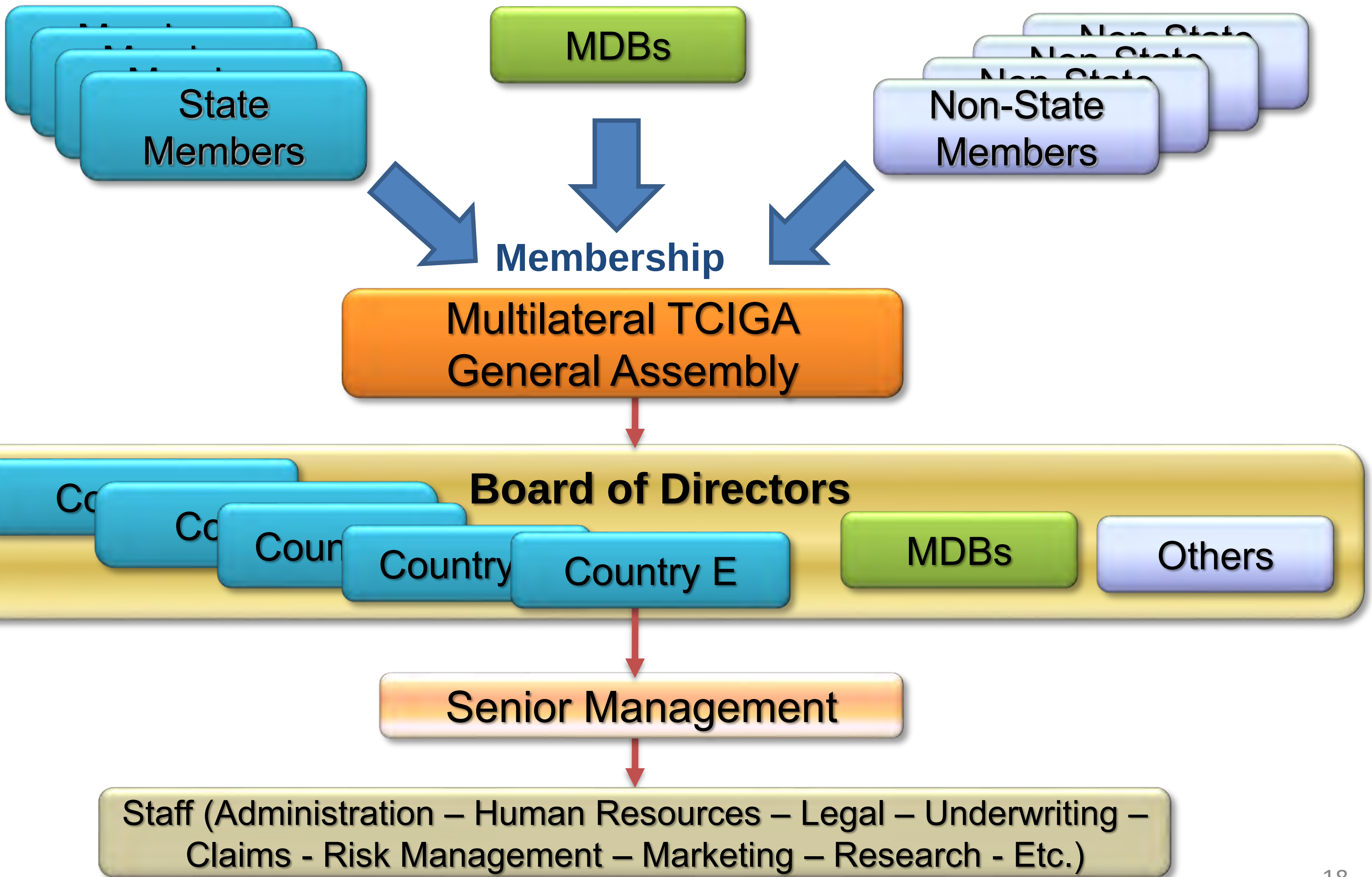
3 MDBs, such as ADB (and/or ADF), World Bank (and/or IDA) and/or IsDB may consider funding a member state's equity investment (as needed)

4 ADB (PSOD), IFC and/or EBRD may consider participating through non-sovereign equity investments and /or an operational loan to fund the Agency's start-up operations

5 Non-state members comprise bilateral, regional and national development banks, ECAs and EXIM Banks, private investors (including private risk insurance and reinsurance companies)

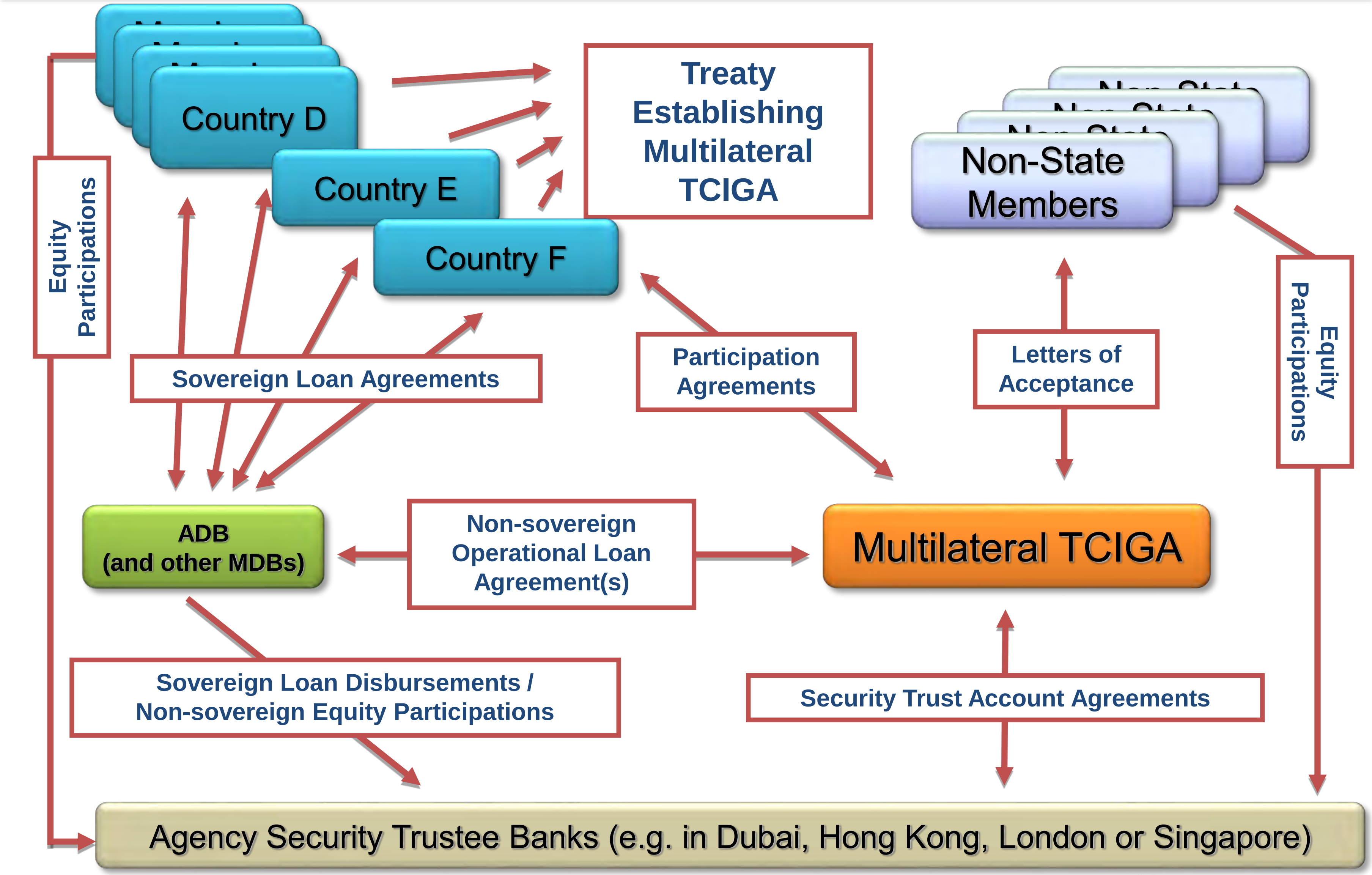
Appendix C: Option 1 – Organizational Structure

Replicating ATI: Trade Credit and Investment Guarantee Agency (TCIGA)



Appendix C: Option 1 – Organizational Structure

Replicating ATI: Trade Credit and Investment Guarantee Agency (TCIGA)



Appendix C: Option 1 – Underwriting Capacity

Replicating ATI: Trade Credit and Investment Guarantee Agency (TCIGA)

Re/Co-insured risk: Leverage up to 3-4 times

Multilateral TCIGA becomes a distributor of intra-regional trade credit and investment risks with access to quota share treaty and facultative reinsurance and coinsurance markets, potentially, increasing its underwriting capacity up to
$2,250 MM – 5,000 MM

Agency's Country Risk Limit = 3-5 times that country's paid-in capital

Risk portfolio diversification will allow Multilateral TCIGA to gear its own paid-in capital 3-5 times up to $750 MM - 1,250 MM

Total Paid-in Capital (initially $[250] MM) plus Reserves Multilateral TCIGA

COUNTRY A
$[50] MM

COUNTRY B

COUNTRY C
$[25] MM

COUNTRY D
$[15] MM

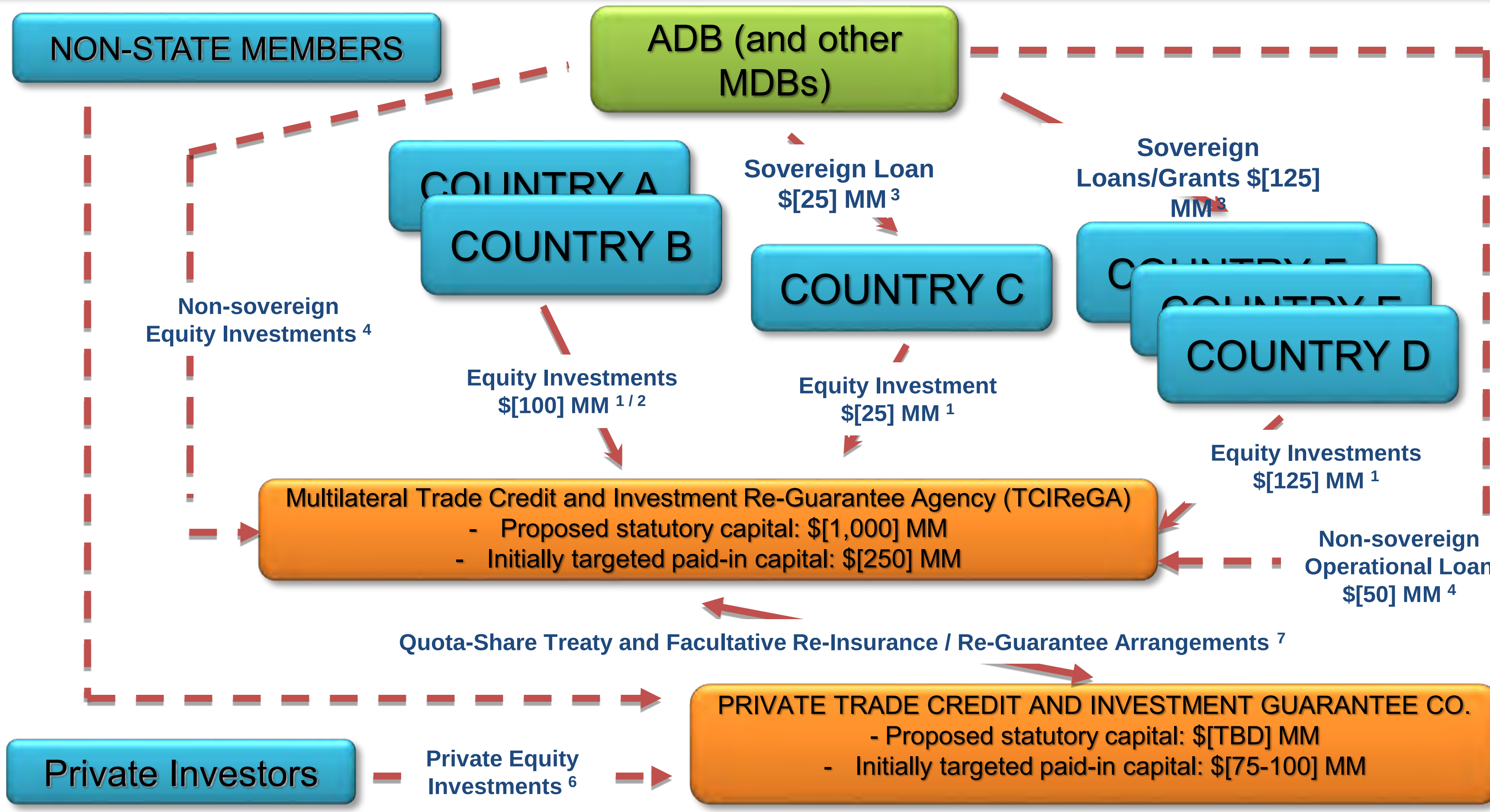
NON-STATE MEMBER EQUITY INVESTMENTS
$[TBD] MM

Sovereign Wealth Funds or Other Source of Funding $ [100] MM

ADB/MDB Sovereign Loans/Grants: up to $[150] MM

Others

Appendix D: Option 2 – Project Structure
Trade Credit and Investment Re-Guarantee Agency (TCIReGA)



1 A member state's equity investment ranges between $[10] MM and $50 MM and will be determined in proportion to its GDP and is to be paid-in in full

2 Member countries may fund their equity contributions from their own resources (e.g. Sovereign Wealth Funds of Azerbaijan, Kazakhstan and/or Turkmenistan)

3 MDBs, such as ADB (and/or ADF), World Bank (and/or IDA) and/or IsDB may consider funding a member state's equity investment (as needed)

4 ADB (PSOD), IFC and/or EBRD may consider participating through non-sovereign equity investments and /or an operational loan to fund the Agency's start-up operations

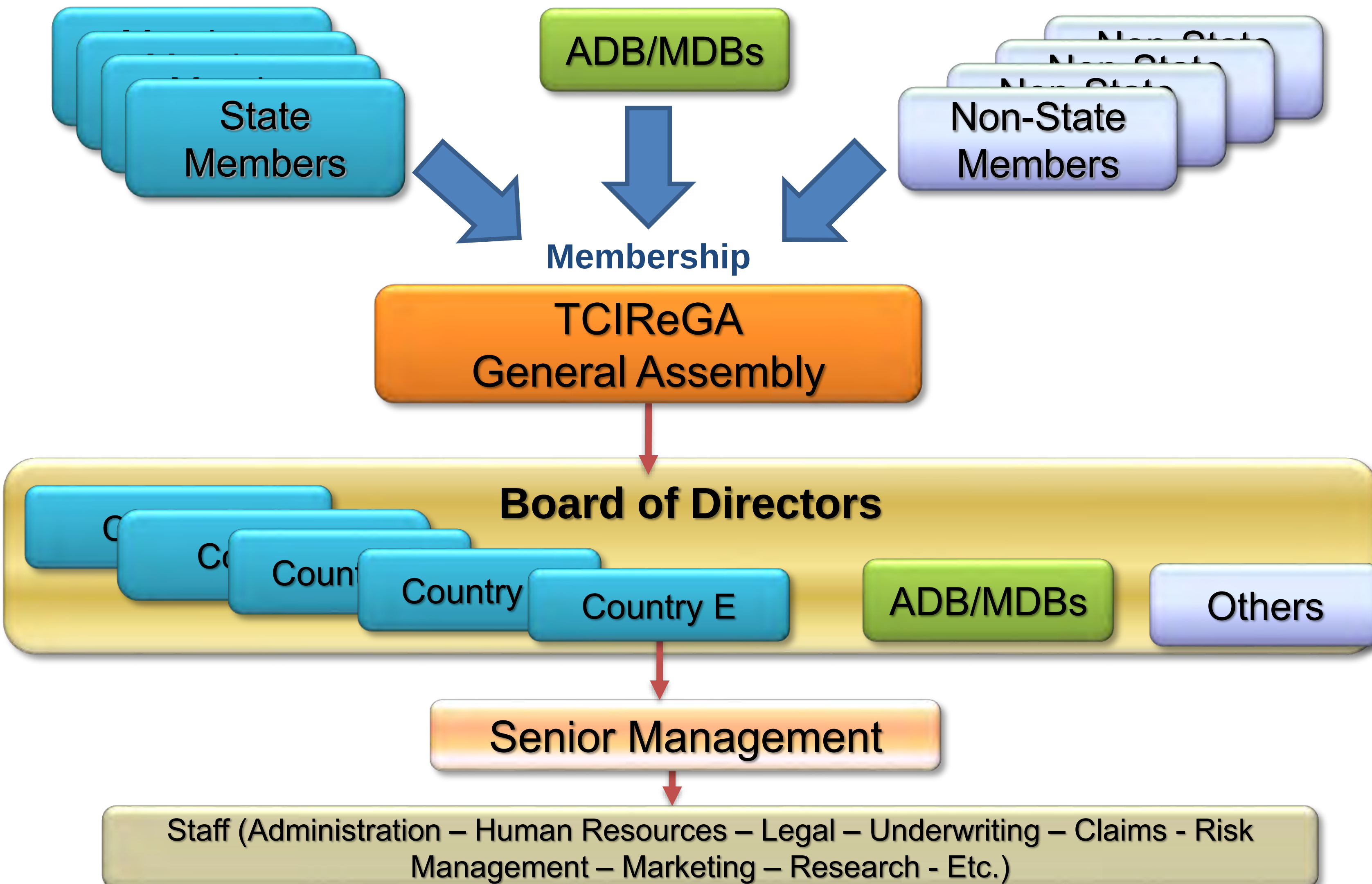
5 Non-state members comprise bilateral, regional and national development banks, ECAs and EXIM Banks

6 Private investors (including private risk insurance and reinsurance companies)

7 Multilateral TCIReGA enters into quota-share treaty and facultative re-insurance / re-guarantee arrangements with private primary underwriter (e.g. taking 100% PRI and up to 80% CRI)

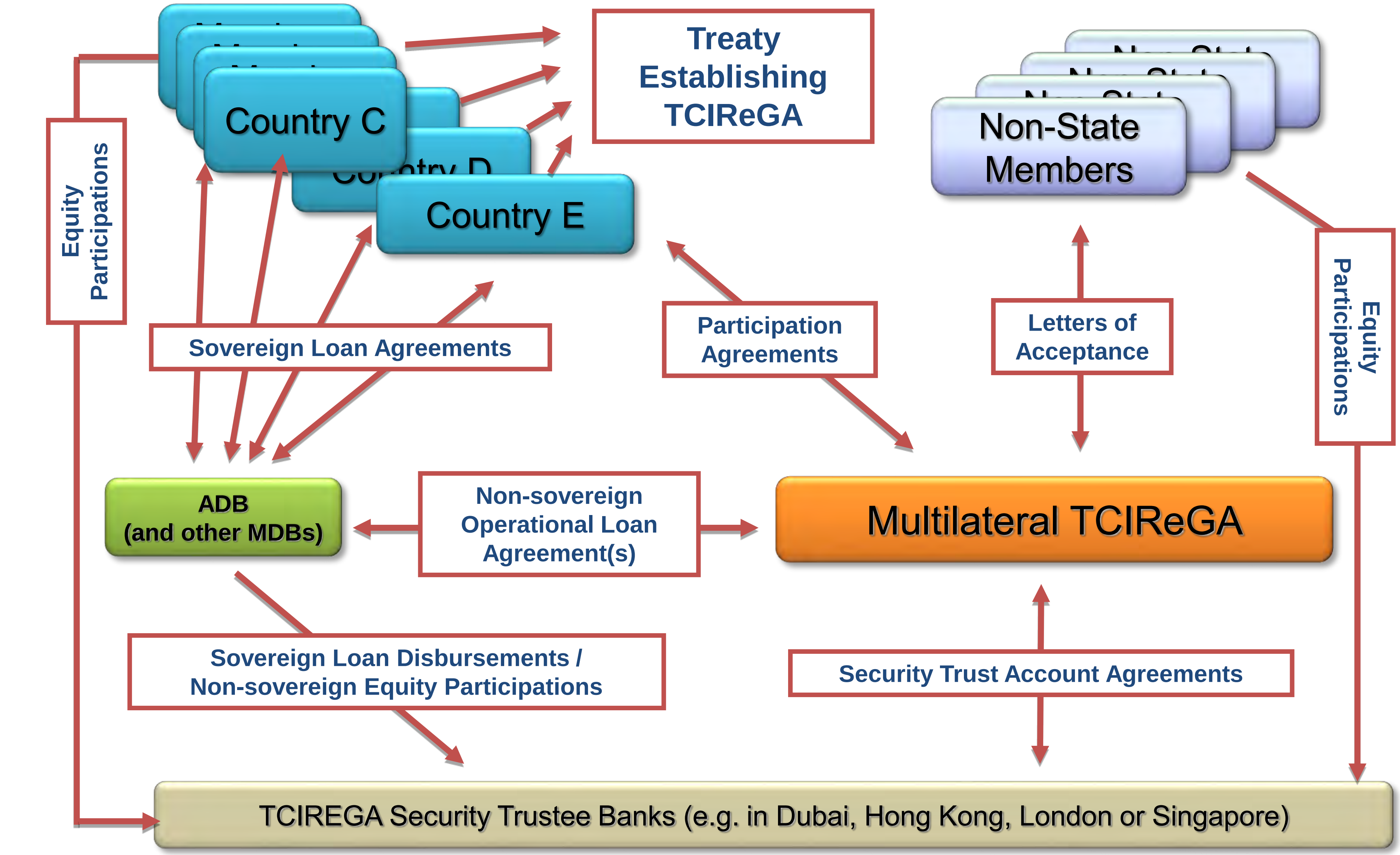
Appendix D: Option 2 – Organizational Structure

Trade Credit and Investment Re-Guarantee Agency (TCIReGA)



Appendix D: Option 2 – Legal Structure

Trade Credit and Investment Re-Guarantee Agency (TCIReGA)



Appendix D: Option 2 – Underwriting capacity

Trade Credit and Investment Re-Guarantee Agency (TCIReGA)