Preliminary Report Mobilising Institutional Investment for Africa’s Infrastructure

Assessment of Needs for African Infrastructure Guarantee Mechanism
November 2018
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<th>Full Form</th>
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<tr>
<td>AEGF</td>
<td>Africa Energy Guarantee Facility</td>
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<td>AfDB</td>
<td>African Development Bank</td>
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<td>AFIC</td>
<td>Aircraft Finance Insurance Corporation</td>
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<td>AIRB</td>
<td>Advanced internal ratings based banks</td>
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<td>AIGM</td>
<td>African Infrastructure Guarantee Mechanism</td>
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<td>ATI</td>
<td>African Trade Insurance Agency</td>
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<td>AU</td>
<td>African Union</td>
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<td>AUM</td>
<td>Assets under management</td>
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<td>BOOT</td>
<td>Build Own Operate Transfer</td>
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<td>CBN</td>
<td>Continental Business Network</td>
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<tr>
<td>CGIF</td>
<td>Credit Guarantee and Investment Facility (Asian financial guarantor)</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>DFI</td>
<td>Development Finance Institution</td>
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<td>EIB</td>
<td>European Investment Bank</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IIPP</td>
<td>5% Agenda’s Institutional Investor Public Partnership</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPP</td>
<td>Independent Power Producer</td>
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<td>KWF</td>
<td>Kinango Wind Farm [IF NO ANNEX TAKE OUT]</td>
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<td>KWh</td>
<td>Kilowatt Hour</td>
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<td>MCPP</td>
<td>Managed Co-Lending Portfolio Program</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>MW</td>
<td>Megawatt</td>
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<td>NEPAD</td>
<td>New Partnership for Africa’s Development (AU implementation agency for transboundary Projects)</td>
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<td>NPI</td>
<td>Non Performing Insurance</td>
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<td>OPIC</td>
<td>Overseas Private Investment Corporation</td>
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<td>PCG</td>
<td>Partial Credit Guarantees</td>
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<td>PCOA</td>
<td>Put Call and Option Agreement</td>
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<td>PPA</td>
<td>Power Purchase Agreement</td>
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<td>PRG</td>
<td>Partial Risk Guarantees</td>
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<td>PRI</td>
<td>Political Risk Insurance</td>
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<td>PSA</td>
<td>Power Sale Agreements</td>
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<td>SAPP</td>
<td>South African Power Pool</td>
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<td>SE4All</td>
<td>Sustainable Energy for All</td>
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<td>SIDA</td>
<td>Swedish International Development Cooperation Agency</td>
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<td>TANESCO</td>
<td>Tanzania Electric Supply Company</td>
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<td>TOSSD</td>
<td>Total Official Sustainable Support for Development (DAC initiative to include guarantees in reporting of development partners)</td>
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<td>UECCC</td>
<td>Uganda Energy Credit Capitalization Company</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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The recent “Africa rising story” has emphatically demonstrated that infrastructure development is fundamental to the continent’s sustained transformation, and AUDA-NEPAD is proud to contribute to this upward transformation process. Together with partners, we are confident that we can deliver the promise of AUDA-NEPAD’s ideal of putting Africa on the right path of sustainable development and inclusive growth.

Since the continent’s first ever Independent Power Producer (IPP) project in 1994; Ciprel power plant in Cote d’Ivoire, Africa has witnessed double digit growth in IPPs. It is worth noting by 2022 the installed generation capacity of energy in Africa will increase significantly. Specifically some of the countries in the North Africa region will be the major player in adding more capacity into its electricity-network. Additionally, access to available electricity, the rate of ICT penetration including mobile phone usage have all contributed to the ongoing development and economic transformation that most African cities, towns and rural areas are experiencing at the moment.

This transformational dynamic is the reason why the AUDA-NEPAD has influenced a Ministerial decision to establish a Continental Power Transmission for Regional Energy Market Trade in Africa. The envisaged system will allow these numerous IPPs to sell into the electricity-network of all the five power pools across the continent.

Similarly, the continent has witnessed a number of new toll-roads that are profitably in operations. The secrets of success of Africa’s roads -- Public-Private Partnerships -- reminds us that if projects are structured properly and there are transparent, consultative, and consistent decision making processes; backed by political commitment, then the African citizen is willing to pay reasonable toll-fees and related charges for the use of public infrastructure across our countries.

Indeed, despite the fact there are democratic and periodic government changes, the policy decision making in many countries has remained consistent in terms of infrastructure development in many African countries. We need to applaud and be proud of that!

This Report is special for AUDA-NEPAD as this is the 3rd report by the AU-NEPAD’s Continental Business Network (CBN). The work of the CBN is to continuously deliberate on how Africa can finance its infrastructure and how Africa’s infrastructure can be de-risked to attract investments from the private sector as well as to explore innovative measures and instruments to close the US$120 billion infrastructure gap on the continent.

In 2016, the CBN published the first report “NEPAD CBN Report on De-risking Infrastructure and PIDA Projects in Africa.” The report stated that the risks surrounding investments in Africa can be mitigated through improved project structuring and the use of effective risk mitigation with improved policy-environments from host governments and support from DFIs. The report also called for the need to mobilise Africa’s institutional infrastructure investment community, including African pension and sovereign wealth funds, as new sources of capital that should contribute significantly to meeting the financing gap.

Again in 2017, we convened key stakeholders responsible for investment allocation decisions and launched the “5% Agenda” as a campaign to increase the allocations of investments by African asset owners to African infrastructure from its low base of approximately 1.5% of their assets under management to an impactful 5%. A second report “Continental Business Network (CBN) 5% Agenda Report: Mobilising Domestic Pension and Sovereign Wealth Fund Capital for PIDA and other African Infrastructure Projects through Institutional Investor Public Partnerships (IIPPs)” was published.

However, despite the encouraging support to push through the 5% Agenda campaign, institutional investors for a number of reasons remain hesitant to increase their investments into Africa’s infrastructure, especially into trans-boundary infrastructure such as those projects enlisted in PIDA.

One of the outcomes from the 2017 CBN Dialogue was the lack of payment guarantees as a main obstacle to mobilizing institutional investment in Africa’s infrastructure. Therefore, from the AUDA-NEPAD vantage point we believe that the biggest confidence boost an institutional and long-term private investor can receive is in the form of a “payment guarantee” or “sovereign guarantee.”
As a result, to scale institutional investment in African infrastructure assets, there is the essential requirement for an effective African Infrastructure Guarantee Mechanism, which will ensure payouts to institutional investors in the event of payment defaults by project owners or operators.

For this reason, a strong need exists to engage all the providers of risk mitigation support, including the Development Finance Institutions (DFIs), development partners, and particularly the private sector, with the sole aim of having a frank and open deliberations on the establishment of an African aggregated guarantee mechanism that will tap into all the efforts that are being undertaken by the providers of existing risk mitigation instruments and initiatives. The ultimate goal will be for Africa to establish an “African Infrastructure Guarantee Mechanism” (AIGM) that can enable the immediate scaling up of institutional investment in Africa’s infrastructure. This “Big Infrastructure Guarantee Mechanism” will provide for significant financial guarantees as required for institutional investors to invest in Africa’s infrastructure and trans-boundary infrastructure projects.

An experts meeting held in Victoria Falls, Zimbabwe in July 2018, brought together a range of experts, including officials from the Finance ministries, DFIs and development partners as well as development practitioners; infrastructure experts; providers of finance; risk mitigation, and project preparation facilities; and private sector representatives.

The experts observed that there are a large spectrum of risk mitigation facilities that are available for infrastructure projects in Africa. Also it was further noted that the application process to access these guarantee instruments are complicated, and coupled with requirements that hinder most project owners from fully understanding and implementing the required processes to access the risk mitigation coverage.

The experts examined 4 Options to implement an effective African Infrastructure Guarantee Mechanism aimed at improving access to the risk mitigation instruments required for institutional investment in both national and trans-boundary infrastructure projects and other infrastructure investment vehicles (e.g., bonds, funds, companies, etc.). The 4 Option will be presented in the report.

In March 2019, AUDA-NEPAD held a session as part of the 3rd African Pension Funds & Alternatives Investment Conference in Mauritius which was well attended by an audience mostly composed of industry players (private pension fund administrators, trustees, asset managers, government pension funds and Development Finance Institutions).

The session was aimed at gauging the appetite of institutional investors for an AIGM and its financial potential as well as use the platform and consult on possible implementation strategies and concrete steps towards scaling up risk mitigation. AUDA-NEPAD will work with Development Partners in the development of similar initiatives such as the African Development Bank (AfDB) and its Co-guarantee platform with an emphasis on the infrastructure window for which component the AIGM strategy could be leading the mechanism.

But allow me to state that, whatever the acceptable option is, the message is clear - in order to entice institutional investors to invest significantly in Africa’s infrastructure, we need to create the enabling environment for them to structure rewarding, fair and profitable deals.

We need to calibrate our knowledge on how the investment community operates and understand the missing objective with the aim of aligning the public interests. Whilst the private and financial sector ought to be more pro-development in general, the institutional investment community (Africa’s Pension Funds) in particular need to be part of the designing of the infrastructure investment frameworks so their expectations can be incorporated.

In conclusion, I wish to reiterate once more that a coherent and coordinated approach from all stakeholders is required to address challenges around mobilizing institutional investment while limiting their risk exposure. I am confident that the establishment of the AIGM will be a significant milestone in accelerating investments into Africa’s infrastructure projects and the Programme for Infrastructure Development in Africa (PIDA).
**The Opportunity:** African pension funds have expressed interest in serving as anchor investors in African infrastructure, and Africa’s governments have endorsed a new implementation framework towards this end.

- **Africa’s infrastructure finance requirement:** The financing required by African governments for delivering on Africa’s infrastructure is estimated at over US$ 130 – 170 billion dollar a year. Institutional investors (pension funds, Sovereign Wealth Funds, insurance companies) are interested in increasing their investments in African infrastructure to meet their financial performance requirements as they are faced with low interest rate environments and infrastructure assets can potentially provide them with predictable inflation-adjusted cash flows that have low correlations with existing investment returns. The need for significant amounts of institutional investment in Africa is magnified by the reduced amount of available public funding and reduced bank finance available in today’s global infrastructure market.

- **Africa’s pension funds as anchor investors:** African institutional investors, now holding over US$ 500 billion in assets under management, are increasingly seeking to partner with African governments through the 5% Agenda’s Institutional Investor Public Partnership (IIPP), a framework proposed by African pension and sovereign funds to increase their allocations in African infrastructure investments to 5% of total assets under management.

- **Political Support for the 5% Agenda Institutional Investor Public Partnership:** Endorsed by African governments and Heads of State, the 5% Agenda IIPP is the basis for the new partnership with institutional investors to increase their allocations to African infrastructure as an investable asset class. As the Africa Union’s implementation agency for transboundary infrastructure projects (PIDA Projects), the NEPAD Agency is developing operational modalities for the implementation of the 5% Agenda.

**The Challenge - Scaling Risk Mitigation:** Worldwide guarantees and risk mitigation have been used to unlock access to institutional investment worldwide. Similarly Africa’s infrastructure requires access to effective risk mitigation to unlock institutional investment.

However, to date, the use of risk mitigation in Africa for its infrastructure projects is extremely low. For example, according to Reuters Thompson Project Finance League Tables, the total amount of guarantees provided worldwide by Development Finance Institutions (DFIs) in 2017 for infrastructure projects was only US$500 million and only provided by one single DFI, the World Bank Group. In contrast, Export Credit Agencies (ECAs) were reported as providing over US$ 8 billion in guarantees worldwide.

A pivotal opportunity is presented by the increasing role of private sector risk mitigation providers (including insurers, reinsurers, and brokers) in developing countries, including Africa. Reports have documented the increasing provision of risk mitigation from the private sector, with keen interest in developing risk mitigation solutions for investors (debt and equity) in Africa’s infrastructure.
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- Currently, there are about 60 insurers operating globally offering political risk insurance (PRI). The overall PRI market size is estimated to be around $8 billion, according to a recent study by KPMG.

- One insurance company reports that it has placed more than US$350 billion in coverage globally.

- Two insurance brokers have reported the ability to provide PRI for a single high-quality African infrastructure project of US$ 3 billion.

- Very importantly, the private sector is increasing its credit risk mitigation insurance products, and applying it increasingly to infrastructure projects.

Leading private sector insurers and brokers can be activated and scaled to unblock institutional investment for African infrastructure, leveraging targeted contributions from the public sector (such as first loss). In this way, “blended finance” can be enhanced with its sister mantra “blended risk mitigation.”

Market and Coordination Failures: The extremely low use of risk mitigation in Africa infrastructure projects is indicative of the complexity of the risk mitigation market and daunting challenge of using risk mitigation for African infrastructure projects.

Moreover the difficulty of securing risk mitigation increases significantly for large transaction given the need to coordinate with a larger number of risk mitigation providers in syndicating the risks (per agreed upon exposure levels).

The need to allocate the risk allocations for a large Africa infrastructure project between many risk mitigation providers is essential given the high perception of African risk, especially after the recent US$1 billion loss of the Chinese ECA Sinosure from a loan guarantee it provided to the Chinese Export-Import Bank for an African railway project.

Key factors impeding African access to risk mitigation relate to the complex and fragmented nature of the risk mitigation sector coupled with market perception of high risk, resulting in extensive market and coordination failures.

- In terms of the market structure, the risk mitigation sector is highly complex with hundreds of risk mitigation providers from the public and private sectors.

- Most risk mitigation providers are located in Europe, the United States, and Bermuda. While there are some public sector providers of risk mitigation in Africa, the existing levels of coverage are very small when compared with the scale and scope of required risk mitigation required for Africa’s infrastructure, especially the large transboundary PIDA Projects.

Moreover, each infrastructure project requires significant levels of highly sophisticated technical advisory in identifying how best to use risk mitigation instruments and which instruments might be suitable. The eligibility requirements and application processes vary greatly between providers.

There are a number of different kinds of products and coverages offered across the public and private sectors.

- The mechanism would need to address coordination and market failures for African infrastructure projects by providing: (1) technical advisory on how to structure projects so they are eligible for risk mitigation coverage; (2) financial advisory on ways to use risk mitigation instruments coupled with other credit enhancements so they can unlock access to institutional and other finance; and (3) the needed coordination and negotiation between various risk mitigation providers to secure the required risk mitigation for each project.

In essence, the risk mitigation market is extremely complex and there are large “market and coordination failures” that disadvantage Africa in sourcing effective streamlined sources of risk mitigation support for its infrastructure projects.

The Solution – Implement the “African Infrastructure Guarantee Mechanism”: A “market-making mechanism” is therefore needed to address market failures impeding access to adequate risk mitigation for Africa’s infrastructure projects. Project owners and investors require technical and operational support to secure the risk mitigation that will unblock access to institutional and other finance.

Given the market failures and the demand from African institutional investors and African government for additional African risk mitigation, the African Union and its implementing agency for transboundary infrastructure NEPAD, are advocating for the establishment of the “African Infrastructure Guarantee Mechanism” (AIGM) to enable the immediate scaling up of institutional investment in Africa’s infrastructure.
Next Steps: To move forward, providers of risk mitigation from the public and private sectors need to be engaged in open technical discussions on the optimal ways to implement AIGM as an aggregated risk mitigation delivery mechanism. AIGM will need to leverage the efforts currently being undertaken through existing risk mitigation instruments and initiatives as well as develop new risk mitigation solutions to uncovered risks impeding access to finance. The Africa Co-Guarantee Platform just launched at the Africa Investment Forum by the African Development Bank Group (AfDB) including five public sector risk mitigation providers will serve as a critical pillar of this new “blended risk mitigation” approach.5

Operational AIGM Plan: The first step is to engage public and private sector experts participating in the risk mitigation market and overall ecosystem in defining an actionable operational plan for AIGM. A key strategic objective is to define an operational AIGM Plan that can align incentives and processes to enable AIGM to serve as an African streamlined and effective “blended risk mitigation” mechanism. It will need to provide Africa’s infrastructure projects with cost-effective access to the significant risk mitigation required for institutional investment, especially for large transboundary regional projects.

The engagement of private sector risk mitigation providers interested in Africa will be critical in designing a strategy that catalyses the creation of an African market in specialist infrastructure risk mitigation syndications, scaling the commercial use of guarantees and risk mitigation instruments that meet the strict investment requirements of institutional investors.

Market-based Approach: A market-based approach would create an African market aggregating the sources of demand (infrastructure assets) and supply (providers of risk mitigation), crowding in existing providers of risk mitigation, global investment insurers, and credit enhancement leaders and instruments from private and public sector institutions.6

To be successful, AIGM will need to adhere to best practices for financial intermediaries and build on precedent for scaling risk mitigation. First and foremost, it will need to be managed by highly experienced infrastructure risk mitigation experts and brokers. There will need to be a transparent and technical structure that enables candid guidance and transparent input from advisory committees consisting of institutional investors, providers of risk mitigation, African government PPP professionals, commercial project developers, and providers of project preparation support.

Commercial Technical Platform: Finally, the design of AIGM will need to be informed by examples of other risk mitigation mechanisms that have been developed by the marketplace and are operating successfully. One such example is the Aircraft Finance Insurance Consortium (AFIC), established to enable the buyers of Boeing airplanes to easily access bank loans given the availability of non-payment insurance (NPI) that protect lenders from any debt defaults.

Implement in Pilot Projects: Therefore the next steps for AIGM development will be to discuss possible technical approaches and develop an effective operational plan can scale risk mitigation and expand coverage. Once an operational plan is implemented, a series of pilot projects will need to be conducted using the AIGM framework as proofs of concept demonstrating the value of AIGM and informing its scaled implementation.

Towards this end, the African Union Commission and NEPAD invite participants in the risk mitigation ecosystem (public and private sector) and the institutional investor community for their suggestions and participation in the development of a practical actionable AIGM plan to scale the required risk mitigation for African infrastructure.

For more information, please contact Mr. Symerre Grey-Johnson, Head, Regional Integration, Infrastructure and Trade, AUDA-NEPAD, email: symerreg@nepad.org
3rd Continental Business Network Dialogue on the Implementation of the AU-NEPAD 5% Agenda towards:

The Establishment of an African Infrastructure Guarantee Mechanism to Crowd in Institutional Investors (NASDAQ Marketsite, New York City, September 25, 2018)

The Continental Business Network (CBN) is an African Union Heads of State and government initiative intended to facilitate private sector engagement and leadership in essential continent-wide infrastructure projects, particularly the regional infrastructure projects under the Program for Infrastructure Development in Africa (PIDA). The CBN aims to crowd-in financing and support for Africa’s infrastructure projects by creating a platform for collaboration between public and private sector leaders.

The 3rd CBN Working Breakfast Dialogue held in partnership with Africa Investor, AfDB, UNECA and DBSA at NASDAQ on the 25th of September 2018, New York, mobilized high-level CEOs, institutional investors, pension funds, sovereign funds, insurance companies, development finance institutions and capital market leaders. The aim was to advance institutional investment in Africa’s infrastructure, with a focus on key success factors:

- Increasing institutional investment allocations and infrastructure co-investment partnerships;
- Developing investable project pipelines;
- Identifying innovative approaches to de-risking infrastructure investment; and
- Deepening Africa’s capital markets.

In his opening remarks, Hubert Danso, CEO and Chairman of Africa investor, said that the dialogue was designed to highlight the momentum of the NEPAD AU 5% Agenda as the foundational anchor for increasing long-term investment in Africa’s infrastructure:

The 5% Agenda is a partnership proposed by African institutional investors to facilitate increasing investment allocation to 5% of assets under management over the next 5 years. The will require a new Institutional Investor Public Partnership framework (IIPP). This approach is based on investment criteria used by pension and sovereign wealth funds. As a result, the 5% Agenda can help to create pipelines of bankable infrastructure assets coming to the market through this IIPP framework. To address political and other risks, this approach needs to include enhanced access to risk mitigation instruments. For this reason, we are here today to discuss the creation of an African Infrastructure Guarantee Mechanism designed to de-risk, motivate, and enable African pension funds, sovereign funds, and global institutional investors to responsibly increase their allocations to African infrastructure as an investable asset class."

The subsequent comments from the dialogue’s speakers confirmed high-level commitments from Africa’s public sector and development finance institutions in partnering with African and global institutional investors in de-risking their investments in Africa’s infrastructure. In his opening remarks, NEPAD’s CEO Dr. Ibrahim Mayaki explained the critical role of the CBN as an effective platform for candid exchanges between private sector infrastructure participants, public sector officials, and heads of states.

Dr. Mayaki noted how CBN provided a critical platform for the public and private sector to openly discuss how to effectively implement the 5% Agenda:

"The 5% Agenda means engaging pension funds, sovereign wealth funds and working together. There is nothing prescriptive about this. It’s a campaign on its own that enables us to solve issues that are linked to risk and issues that are linked to well-prepared projects. We have to work together to create investable assets in environments where doing business is a huge and daunting task."

Dr. Mayaki stressed the importance of being able to access guarantee and risk mitigation instruments in order to mobilize more capital for infrastructure throughout the African continent, and the imperative of creating new ways to implement this objective through candid, open, and focused public-private expert exchanges.
A notable announcement during the Summit was the need for an African Infrastructure Guarantee Mechanism (AIGM), a platform that could serve to scale access to risk mitigation for Africa’s infrastructure. The AIGM is intended to catalyse the creation of an African market in specialist infrastructure risk mitigation syndications, scaling the commercial use of guarantees and credit enhancements that meet the strict investment requirements of institutional investors.

The Dialogue placed great emphasis on the important role governments and development finance partners need to play in providing African and global institutional investors with a sustainable project pipeline of investable infrastructure refinancing and secondary market infrastructure investment opportunities to acquire, particularly through recycling and refinancing those brownfield assets currently in their balance sheets.

**PANEL: The 5% Agenda, infrastructure guarantee mechanism & de-risking infrastructure investment opportunities**

The panelists expressed profound remarks in support of the 5% Agenda and the establishment of guarantee mechanism, and they also provided innovative ways to de-risking infrastructure investment opportunities:

**Symerre Grey-Johnson, Head, Regional Integration and Infrastructure, NEPAD:**

“We are looking at the African infrastructure guarantee mechanism, we have commissioned a study, we have met with a number of experts, we will kick off a meeting in Victoria Falls to look at what sort of options this guarantee mechanism should look like.

The idea is that these investments in infrastructure will really allow us to bring on board pension and sovereign funds, insurance companies and so forth. I think in the opening today we heard a lot about risk and the need to de-risk Africa, and also the need to have the necessary instruments that will allow us to attract institutional investors to really scale up their investments from 1.5% in general, that’s really the thinking.”

**Elisabeth Pape, Minister Counsellor, Development, conflict prevention & sustaining peace, European Union Delegation to the United Nations:**

“So the goal is clear: to motivate Africa, the domestic pension funds, and other institutional investments to increase investments from the average of 1.5% to 5% over five years. Looking at foreign investors for instance, we know that in absolute terms only about 3% of the $10.3 trillion in assets held by pension funds in countries are invested in infrastructure while more than half of the investments are fixed in common cash.”

**Ingrid Cyimana, Strategic Planning, Partnership and Operational Quality Division, UN Economic Commission for Africa:**

“I want to start off by saying, in addressing this 5% agenda, that there are four givens: The one is that Africa can only develop through infrastructure, so that’s an absolute given. The second is that the real money lies with the institutional investors. Thirdly, is that, it’s accepted fact that only through the use of blended finance can we develop infrastructure scale on the African continent and when I say blended finance. I mean combining developmental funding support with private sector money.

And lastly, is that infrastructure assets are very much matching the portfolio mandate of the institutional investors. So those are the given.”

**Jonathan First, Head of Syndication Finance – Development Bank of Southern Africa:**

“"I want to start off by saying, in addressing this 5% agenda, that there are four givens: The one is that Africa can only develop through infrastructure, so that’s an absolute given. The second is that the real money lies with the institutional investors. Thirdly, is that, it’s accepted fact that only through the use of blended finance can we develop infrastructure scale on the African continent and when I say blended finance. I mean combining developmental funding support with private sector money.

And lastly, is that infrastructure assets are very much matching the portfolio mandate of the institutional investors. So those are the given.”
Ingrid Cyimana, Strategic Planning, Partnership and Operational Quality Division, UN Economic Commission for Africa: “So the immediate task now must be to leverage and unlock these opportunities by attracting more substantial FDI to see this process of development and enhancement in particular sectors including manufacturing, infrastructure, financial and boosting the overall trades.”

Elisabeth Pape, Minister Counsellor, Development, conflict prevention & sustaining peace, European Union Delegation to the United Nations: “So, there five key actions, the first one is boosting strategic investments and strengthening the role of private sector to improve on de-risking investments and projects via blending and the guarantees. And the NEPAD initiative, if properly planned, it seems to fit perfectly under this. And again growth for jobs in Africa will be very key objective in our partnerships. There will be no doubt, plenty of opportunities to reflect NEPAD initiatives.”

Charles (Chuck) Burbridge, Executive Director, Chicago Teachers’ Pension Plan: “I think what we see now is sustainable conditions for economic growth. There is a pipeline investment whether its infrastructure, private equity or even public equity. The pipeline is there, the businesses are there and now it’s a question of do we have the familiarity and the knowledge that we will say it’s a better use of our funds to go to Africa than it is in some other domestic opportunity that might have been presented before us. So the time is now, the opportunities are there and we have the relationships and the trust to put our money where our mouth is.”

Dr. Frannie Leautier, Chief Operating Officer, Trade and Development Bank: “Our portfolio is about 40% trade finance, 30% project and infrastructure finance. So we are created in 1995 and the African Development Bank is the founding partner and shareholder of our banks, so in the leveraging and crowding in, the bank has played its role in the creation of the Trade Development Bank. So when you look at our profile, for the last seven years it’s been at 3.3% non-performing loans in that environment, so you can see that we can deliver performance when we have the right instruments in place, how are we able to that? Through appropriate structuring, through appropriate functioning from the contractual side with the sovereigns and non-sovereigns, with the commercial entities as well, through our guarantees and insurance.”
Aldo Tembe, CEO, Moçambique Previdente, Mozambique:

“In our case in Mozambique, pension funds are a new reality but we first have to go into legisla-
tion itself. Our legislation in terms of investment doesn’t cater directly into infrastructure invest-
ment, it is more as we have to invest in government bonds, in that way we directly invest in gov-
ernment. On the other hand, most of our infrastructure projects are invested directly on entities;
you have the Chinese investing heavily in terms of railroads and ports as well. We are now in a
reform of our current pension fund law in terms of investments and the part of investment and
having more defined policy is what’s sought by pension funds itself but the opportunities are
there.”

Mamadou Mbaye, Executive Director, Energy Mining & Capital Raising, FONSIS:

“Infrastructure is, in terms of profile, bankable. It is the essential part of the asset allocation of
global investors because of the profile of cash flows, it is done in the right way.”

Richard Byarugaba, CEO, National Social Security Fund, Uganda:

“As the NSSF premier pension fund in Uganda, we largely invest in infrastructure bonds on the
Kenyan and Tanzanian market but we do recognise that if economies don’t grow there will be
problem with our memberships, so it’s a situation whereby we need to invest in infrastructure.

Henry Kyanda, CEO, Trust Secretary, Kenya Power Pension Fund:

“We are a pension fund of an electricity utility in Kenya. We invest primarily in Kenya. The power
pension fund is a marketing leader in terms of alternative investments. The traditional invest-
ments, pension funds are sizeable enough, currently standing at about $10b which translates to
18% of the GDP. So the environment and the money is there locally.”

Sarah Takaki, Senior Principal, Responsible Investing, Ontario Teachers’ Pension Plan:

“For infrastructure in particular, we have been investing directly in infrastructure for about 15 years, our infrastructure
portfolio is about 20 billion Canadian Dollars.”

Richard Gröttheim, Chief Executive Officer, AP Fonden 7 (AP7):

“We are Swedish government pension fund within the defined contribution of the Swedish sys-
tem which consist of a pay-as-you-go part and funded part, and we compete with a number of
private mutual funds, we have currently $400m which is half of the service and we are $60b un-
der management. And we are set up on a mutual fund.”

Sarah Takaki, Senior Principal, Responsible Investing, Ontario Teachers’ Pension Plan:

“For infrastructure in particular, we have been investing directly in infrastructure for about 15
years, our infrastructure portfolio is about 20 billion Canadian Dollars.”
Commenting on the Summit, Hubert Danso, CEO and Vice Chairman of Africa investor said: “We were delighted with the Summit participation and to be able to use Ai’s privileged position to facilitate partnerships between the world’s leading Pension and sovereign funds, development finance institutions and Africa’s capital market leaders on scaling investment to some of the most exciting infrastructure investment opportunities of our time.

“Summit delegates were updated on the Ai Infrastructure Co-investment platform, which is building strong momentum with projects pipeline counting several billions of dollars of Brownfield and green field opportunities.”

The Summit concluded with its prestigious annual Ai Capital Markets and Index Series Awards ceremony and a special presentation of the Ai Global Institutional Investment Personality of the Year Award to Ms. Arunma Oteh, Treasurer and Vice President of the World Bank Group.

Challenges:

Richard Byarugaba, CEO, National Social Security Fund, Uganda:
“The challenge has been finding the structures to invest, the structures to bring risk down, and the structures to even tap into the cash flows that are expected.”

Mamadou Mbaye, Executive Director, Energy Mining & Capital Raising, FONSIS:
“Guarantees actually, through risk sharing aspects, capital risk effect, leverage factors, represent a cost effective way to actually address the credit scarcity we are facing here in Africa. It’s a very efficient way of leveraging public money. That’s what we call blended finance. And that is the way of leveraging it and basically increasing the capacity. But this is the scope of the type of difficulties we may face in the continent if we don’t create or attract private investors to the field.”

Jérôme Lussier, Director, Investment Stewardship, Caisse de dépôt et placement du Québec (CDPQ):
“One of the issues that was singled out by many people we spoke with was the problem is not so much on availability of capital because it’s there, its earmarked, there is lot of money. It’s the lack of investment ready pipeline for the projects and the reason for that is that there tends to be very imperfect alignment between how the projects are developed and the expectations of large private investors.”

Henry Kyanda, CEO, Trust Secretary, Kenya Power Pension Fund:
“The challenge for pension funds we face as we are a pioneer, as I said, but I guess it’s what Dr Mayaki had said initially, that there is need for more dialog, there is need for education on pension funds and trustees. The opportunities are there, the returns are great but why aren’t pension funds investing in alternatives or infrastructure. My guess the issue is about education. The structures that are talked about in this forum and at other forums are quite complex for trustees to understand, so it becomes very difficult.”

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REPORT PART ONE:
Assessment of Africa’s Risk Mitigation Needs and Current Market
1.0 Background

On 18th September 2017, following the guidance and recommendation of NEPAD’s Continental Business Network (CBN) on de-risking large-scale infrastructure projects, under the leadership of H.E. Moussa Faki Mahamat, leaders from the public and private sectors collectively responsible for over US$ 20 trillion of investment capital gathered at NASDAQ in New York to officially launch the 5% Agenda. This initiative aims at developing a concrete and feasible roadmap to increase the investment of African institutional investors in African infrastructure from its low base of approximately 1.5% of assets under management (AUM) to 5% of AUM, with a focus on regional infrastructure projects as part of NEPAD’s key mandate.

Participants in the 5% Agenda Launch included the leaders of Africa’s pension and sovereign wealth fund community, officials from Development Finance Institutions (DFIs), global institutional investors, heads of African stock exchanges, infrastructure finance specialists, and CBN members.

In line with the 2014 Dakar Financing Summit resolution of African Heads of State on the imperative for private sector engagement in Africa’s infrastructure development and finance, the institutions at the 5% Agenda Launch recognized Africa’s imperative for advancing infrastructure and acknowledged the fact that institutional investors have emerged as a critical financing source to close the US$ 68 - 108 billion infrastructure finance gap in Africa.7

Moreover, African institutional investors have underscored their commitment to the 5% Agenda as a new partnership framework that can serve to engage and harness the capital and expertise of Africa’s institutional investment community. Consequently, a roadmap of required concrete actions was defined as the foundational basis required to mobilize African institutional investment in Africa’s infrastructure development and finance.

A business communiqué emanated from the launch of this initiative to engage key stakeholders at central Pan-African and international fora (e.g., AU Summit, G20, G7, World Bank Annual Meetings, Finance Minister Meetings, BRICS Summit, DFI forums, etc.).

The implementation of the 5% Agenda is expected to have the following impact:

- Increase the awareness of various stakeholders in the public and private sectors worldwide of the potential leadership role of African institutional investors and incentivize new enabling partnerships;
- Demonstrate the value of implementing the 5% Agenda to African national government officials, development partners, private sector professionals engaged in developing and investing in infrastructure, providers of services (equipment, services, risk mitigation);
- Identify the concrete required feasible steps to increase African pension and sovereign wealth fund investment in African infrastructure to 5% of AUM; and
- Define the institutional and coordination frameworks needed to set-up and implement required actions steps in investment (Co-Investment Platform for African Pension and Sovereign Wealth Fund in Africa infrastructure) and risk mitigation (African Infrastructure Guarantee Mechanism).

Despite the interest in investment in African infrastructure development and finance, there are still a variety of complex issues surrounding each specific infrastructure project impeding the mobilization of private capital and the achievement of financial close. The main concerns from the private sector are the risk of payment, and the lack of credible risk mitigation approaches and instruments to mitigate this first order risk.

This paper is a preliminary analysis of risks impeding investment in Africa’s infrastructure that need to be addressed to implement the 5% Agenda with an initial outline of an operational mechanism to improve access to existing risk mitigation capacity in the public and private sectors. The objective of the paper is to stimulate a discussion with public and private sector participants in Africa’s infrastructure development and finance to define actionable solutions required to access the scaled institutional and other long-term investment in Africa’s infrastructure envisioned in the 5% Agenda.

2.0 Africa’s Infrastructure Deficit

Despite a huge potential for investment, Africa continues to suffer from lack of investment in much needed infrastructure projects.8 The road access rate in Africa is only 34%, compared to 50% in other parts of the developing world. Transport costs are up to 100% higher than in other developing countries. Only 30% of the African population is estimated as having access to electricity, compared with 70 - 90% in other developing regions. Internet penetration is estimated at about 6%, compared to an average of 40% in the rest of the developing world. Africa’s largest infrastructure deficit is in the energy sector. Although 145 million Africans have gained access to electricity since 2000, over 645 million people still do not have access, giving an electricity access rate for African countries at just over 40%, the world’s lowest. Per capita consumption of energy in Africa south of the Sahara (excluding South Africa) is 180 kWh, against 13,000 kWh per capita in the United States and 6,500 kWh in Europe.
In 2014, the share of population in Africa with access to electricity was estimated at 47%, around half of 97% in Latin America and 89% in Asia. There are also stark regional differences, with access in North Africa around 98% (the highest) and 26% in East Africa (the lowest).

Recent studies by the African Development Bank suggest that the continent’s infrastructure needs amount to US$130 to 170 billion a year, with a financing gap in the range US$68 to US$108 billion. Recent high-level meetings, including the Dakar Financing Summit, have highlighted the urgent need to identify the barriers to investment in Africa’s infrastructure sector. It was at Dakar Financing Summit that experts agreed the perception of risk is one of the largest obstacles to raising finance from both the international and African financial community. This is made more complicated in the power sector where perceptions of credit risk are a major factor affecting the flow of investment. A recent report by McKinsey & Company suggests that Africa as a whole will require about US$490 billion of capital for new energy generation and another US$345 billion for transmission and distribution.9

3.0 The Investability of Africa’s Infrastructure

While there are many infrastructure projects across the African continent that require financing, few of these projects are considered “investable” or “bankable” by institutional and other long-term investors. The terms “investable” and ‘bankable’ are often used by investors to define assets that are.

This section uses assessments and statistics provided by the African Development Bank, “African Economic Outlook, Financing infrastructure: Strategies and Options,” 2018.


considered creditworthy with the ability and willingness to service principal and interest payments and/or deliver the required consistent level of financial returns. Infrastructure assets need to be investable legal entities, such as special purpose vehicles (developed using a project finance approach), infrastructure companies (including utilities), infrastructure bonds, and infrastructure funds. Ownership structures may be 100% owned by a single entity (public sector, private sector, non-profit organizations), joint ventures, Public-Private Partnerships (including concessions), and unlisted and listed entities (with diverse ownership structures).

Investability is determined by the risk profile and also the level of expected returns. Private investors often require higher rates of return than institutional investors. For example, a solar power project in an East Africa country might meet investment requirements, complete with adequate structuring and risk mitigation, but the returns may be too low for a private investor. However, this same project could be an attractive investment for pension funds. Therefore NEPAD’s 5% Agenda could help attract capital from institutional investors requiring less returns, thereby reducing the costs for infrastructure beneficiaries as well as boosting the amount of lower cost capital available to finance Africa’s infrastructure.

This section summarizes the key types of risks impeding the investability of Africa’s infrastructure for institutional and other long-term investors.10 The definition of risk is the “unpredictable variation of project or asset value to a private party,” the private party being an investor, developer or operator.11

3.1 The Wide Spectrum of Potential Risks Impeding Investability

Infrastructure projects are inherently complex, depending on a range of critical success factors, from an enabling environment with consistent policy, regulatory, and legal frameworks to creditworthy counterparties that can make timely and complete payments and the quality of the overall management of the service.

As a result, the literature cites a wide range of risks that impede the access of infrastructure projects to institutional and other long-term capital, covering political and credit risks as well as foreign exchange, project development, and procurement risk. The key major categories of risks that can impede access to investment are summarized below.

1) Traditional “Political” Risks12:

Political risk encompasses war and civil disturbance, expropriation and confiscation, and currency convertibility or transferability. Risks emanating from war and civil disturbance include damage to, or the destruction or disappearance of, tangible assets caused by politically-motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coups d’état, sabotage, and terrorism. Expropriation refers to a loss in the value of an investment due to the actions of a host government that results in a reduction or elimination of ownership rights to an investment. This includes outright nationalization and confiscation, as well as “creeping” expropriation, which refers to a series of acts over time which have an expropriatory effect.

Convertibility risk arises from the possibility that the project will be prevented from exchanging local currency to foreign currency by a policy action of the government that restricts access to foreign exchange (through the rationing or administrative allocation of foreign exchange). Transferability risk refers to the limitation of transferring foreign exchange out of the country.
2) Contractual and Regulatory Risks: Contractual and regulatory risks relate to the reliability and enforceability of contracts and other undertakings made by governments at the national and sub-sovereign level. Private sector participation in infrastructure projects in developing countries is enabled by these structured legal and financial agreements, which specify the rights and obligations of the different parties to a project, including the investors and the government. With infrastructure projects characterized by contracts that can span decades, investors face potentially significant risk from regulatory change, which can negatively impact project economics. Contractual and regulatory risks can arise in the form of breach of contract, changes in law, license requirements, approvals and consents, obstruction in the process of arbitration, and non-payment of a termination amount. For instance, regulatory risk is often cited as a problem by infrastructure companies in implementing agreed upon-tariff increases due to regulatory action or inaction.

3) Credit Risks (including demand risk): Credit risk is of particular concern to project lenders and bondholders. It refers to the risk that the cash flow generated by the project will be insufficient to meet its obligations as they fall due, i.e., the project will default on its debt obligations or be unable to provide the expected equity returns. Infrastructure projects in developing markets often face this risk due to the underdeveloped nature of the market, lack of payment capacity, or lower levels of expected payments. For example, power generation projects face the risk of delays in payment, partial payments, or no-payments from uncreditworthy state-owned utilities. Similarly, highway projects relying on revenues from tolls face payment risks resulting from low levels of traffic and/or non-payment. To address these issues, credit risk mitigation instruments can be structured to cover specific payment risks, covering agreed upon Power Purchase Agreements (PPAs) and minimum traffic revenue levels.

4) Foreign Exchange Risks: Another major risk faced by infrastructure projects in developing countries arises from the lack of availability of local currency financing. This is especially troubling as most project revenue streams in developing countries are denominated in local currency. If financing sources are foreign currency denominated, then the project is exposed to exchange rate risk due to the limited flexibility in raising local currency output prices (due to political and social constraints) in the event of a large local currency depreciation or devaluation, which can result in revenues which are insufficient to cover costs. There is major gap in available risk mitigation instruments for African countries, the exception being the Currency Exchange Fund (TCX).

5) Project Development Risk: Despite many infrastructure investment opportunities in Africa and other developing countries, many projects struggle to attract capital. The problem is not just a lack of funding, but a lack of bankable projects. A project’s bankability can be determined only after establishing its feasibility in terms of social, economic, financial, technical, environmental, and administrative factors. Project development normally involves extensive technical studies (prefeasibility, feasibility, demand, engineering, environmental, social, and development impact) as well as the development of financial models (including stress testing), suitable contractual arrangements (legal vehicle, suppliers, construction, off-take payments, access to land, etc.) and the securing of permits and licenses. These project development activities need to be preceded by conceptualization, consensus building around a project’s purpose and initial design, and action plans. Such preparation is expensive and risky, over accounting for 2-12% of total project costs and taking 2-10 years to reach financial close. Project developers and commercial lenders are usually unwilling to bear the risk of preliminary assessment of bankability due to the costs involved and high level of risks.

In order to overcome the lack of well-packaged bankable projects, Project Preparation Facilities (PPFs) for infrastructure are an essential part of the broader project preparation landscape. According to a report prepared for the Infrastructure Consortium for Africa, of 67 identified potential PPFs, only 17 focus on infrastructure projects in Africa and only 12 are active. Most of the PPFs focus on later stage project cycle activities where there is good alignment with the operations and capabilities of most host institutions. The report also states that the greatest gaps in project preparation support are for private sector originated projects, for transformative regional projects, and for early stage government originated PPPs.

6) Procurement Risk: Procurement risk results from the perception by bidders that the substantial time and financial commitment required to bid for a project are too high when measured against the small chance of eventually winning the bid. Procurement rules are often complex and not cost-effective, which impairs the ability of many qualified organizations and experts to provide project development services. In addition, there is often lack of easy access to information on available expertise and services, so the ability to select the most appropriate experts is limited. Development institutions have also often protected themselves with extensive and lengthy procurement and transaction processes (including competitive bidding for small projects and “one size fits all” payment terms) resulting in large transaction costs that deter all but the largest companies, or small, specialized businesses that survive on donor contracts.
These procurement constraints often lead to projects bearing unduly high levels of risk, which in turn makes them non-bankable and susceptible to problems of contract renegotiation, regulatory failure / capture, corruption, etc. On a macroeconomic level, non-transparent procurement practices can also lead to enormous contingent liabilities. Projects that were not competitively bid can lead to actual liabilities. This affects the ability of national governments to support even worthwhile projects.

7) Legal Risk: Progress in developing infrastructure projects in African countries is often stymied by the lack of adequate “upstream” preparation. Even if funding is available for project preparation, the lack of a basic legal and regulatory enabling environment can stall project development.

8) Interest Rate Risk: Most projects in developing countries face interest rate risk arising from the fact that bank lenders are hesitant to provide long-term loans at fixed rates because their deposit base is short-term, and fixed-rate long-term funding is either unavailable or uneconomic. This creates a mismatch for projects and exposes them to potentially higher costs if short-term interest rates rise, as well as liquidity risk if refinancing the short-term debt is not possible due to changes in the risk perception of lenders or external capital market conditions.

9) Commercial Risk: Once the project has been completed and is demonstrated to be operating to specification, a new phase of risk begins, that of long-term operation. Even if many of the risks discussed above have been hedged, a level of commercial risk is likely to remain. Commercial risk includes the long term risks arising from the use of new technology, poor management affecting general project operations, operating cost overruns due to a rise in input prices, and larger than expected maintenance costs.

The above examples of risks demonstrate the wide spectrum of risks that can block the access of African infrastructure projects to institutional and other long-term providers of capital.

It is important to note that this wide spectrum of risks shapes the risk mitigation market place and how it works.

- Participants include highly skilled experts with relevant credit, legal, and financial expertise and deep knowledge of capital markets and risk mitigation options.
- In many cases, significant resources need to be spent in developing innovative bespoke risk mitigation solutions based on the specific characteristics of the infrastructure projects, including factors country, sector, ownership, payment sources, and service providers as well as defining acceptable arbitration modalities, triggers for pay-outs, etc.

Therefore employing risk mitigation instruments for African infrastructure projects to access institutional and other long-term finance, especially large transboundary projects, requires highly-skilled financial and legal experts, extensive time, and innovative bespoke solutions working with several risk mitigation providers.

4.0 Preconditions for the Use of Risk Mitigation Instruments

Often public discussion of guarantees assumes that risk mitigation can be applied to any infrastructure project irrespective of its structure or status. However, the providers of risk mitigation have due diligence requirements that are aligned with that of investors (debt or equity). To access risk mitigation instruments from both public and private providers of risk mitigation, projects need to be properly prepared based on the standard market requirements for investability.

Risk mitigation solutions include first and foremost the proper structuring and preparation of the infrastructure project. In fact, the best practice for infrastructure risk mitigation is using project finance techniques in structuring projects. The use of project finance techniques approach has been proven to result in lower default rates even in countries with higher macro economic volatility such as in Africa, as detailed in the next section.

4.1 Use of Project Finance techniques in project preparation: Investors preference for infrastructure projects that use project finance techniques is based on the analysis of decades of default assessments conducted by rating agencies.

In project finance, the payment of all debt and equity investors is from the cash flows of the project rather than the balance sheets of its sponsors. Non-recourse loans are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors.

As a Moody Investor default study states:

“While most project finance borrowers are highly leveraged, thinly capitalised special purpose vehicles with limited financial flexibility, project finance loans are structured to be both highly robust to a wide range of potentially severe risks, and also to minimise any post-default economic loss.... Average default rates calculated for the Study Data Set vary significantly by region – for example default rates for the Middle East, Africa and European regions are substantially lower than default rates for Latin America, North America and South East Asia. Two

The best practice for infrastructure project preparation is therefore the use of project finance techniques that embed extensive risk mitigation in the project structure and legal contracts.

It is important to note that the project preparation phase requires highly skilled financial advisors and lawyers that can properly structure the project. A recent survey of institutional investors and African project developers documents this requirement and the importance of using commercial project developers with successful track records.

4.2 Generic investability criteria: The market standard for the investability of an infrastructure project is largely based on the assessed quality and strength of its independent legal structure (Special Purpose Vehicle), management, and construction related suppliers and contracts, and revenues (documented in offtake agreements). For this reason, the project’s financial modelling (including stress tests), legal contracts, and management are key components in accessing its investability.
The rating agencies provide guidelines for infrastructure developers on the standard criteria used to evaluate infrastructure projects. Key investment criteria include: (1) ability to generate revenues that cover costs and enable attractive profits with creditworthy off-taker; (2) ability to secure the required land, required permits, and other preconditions for successful operation; (3) availability of risk mitigation for any political, regulatory, and/or demand risks; (4) high political and financial support from government(s) and development partners to offset financial viability issues, impediments, and risks; and (5) completion of the required technical studies, financial analysis and modelling (with stress tests), and adequate enforceable legal contracts.

Below is a summary of basic investability criteria based on the latest Moody’s Investor Service report on project finance rating criteria.

Table 1: Examples of Key Rating Factors for Project Finance Investments

<table>
<thead>
<tr>
<th>1. Business Profile</th>
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<tbody>
<tr>
<td><strong>a. Market Position</strong></td>
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<tr>
<td>Monopoly and sole provider of highly essential service over the debt term (AAA criteria).</td>
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<tr>
<td><strong>b. Predictability of Cash Flows</strong></td>
</tr>
<tr>
<td>Extremely high predictability of net cash flows with availability-like or guaranteed payments; and off-taker(s) have extremely strong credit profile(s), typically Aaa-equivalent.</td>
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<table>
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<tr>
<th>2. Operating Risk</th>
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<tbody>
<tr>
<td><strong>a. Technology</strong></td>
</tr>
<tr>
<td>Absence of or very limited exposure to a commercially proven technology/process with minimal if any moving components (AAA). The performance support provided by the original equipment manufacturer/vendor, warranty periods, and the structure and duration of long-term services arrangements, if any, that are in place to mitigate the risk of performance failures and their impact on the overall project economics.</td>
</tr>
<tr>
<td><strong>b. Capital Reinvestment</strong></td>
</tr>
<tr>
<td>No capital reinvestment exposure (AAA). Assessment of the nature of the asset reinvestment work required to maintain normal operations and the forecast cost of these capital expenditures relative to the forecast excess cash flow or additional debt capacity over the project’s debt term.</td>
</tr>
<tr>
<td><strong>c. Operating Track Record</strong></td>
</tr>
<tr>
<td>Excellent operating track record in top tier compared to industry norms for asset performance (AA).</td>
</tr>
<tr>
<td><strong>d. Operator and Sponsor Experience, Quality and Support</strong></td>
</tr>
<tr>
<td>Best-in-the-industry operator/sponsor with unmatched experience, extremely strong credit profile and an unparalleled track record of excellent performance and will unquestionably support the project in any capacity at any time (AAA). The credit quality of the operator and its experience with the asset type, working in the jurisdiction where the project is located, and providing services under a similar operating and maintenance contractual framework.</td>
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<table>
<thead>
<tr>
<th>3. Leverage &amp; Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>a. Debt service coverage</strong></td>
</tr>
<tr>
<td><strong>b. Project cash from operations/adjusted debt</strong></td>
</tr>
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</table>

It is important to note that institutional investors will sometimes require an investment grade credit rating of an infrastructure project by a credible rating agency.

4.3 Strategic selection of investors to improve project attractiveness: Another technique in the project preparation process to increase the attractiveness of the project to providers of risk mitigation and investors is the strategic selection of investors.

For decades the DFIs have created co-investment programs towards this end. Co-investment examples are provided below:

- Traditionally “A/B” loan structures have been used whereby the multilateral lends a portion of the total amount required (“A” loan) and syndicates the remainder of the loan to commercial lenders (“B” loan). The multilateral acts as the lender of record for the full loan and the private sector lenders receive the benefit of being under the umbrella (“halo effect”) of the multilateral. B loan participants therefore benefit from the multilateral’s preferred creditor status and thereby the A/B loan structure implicitly mitigates currency transfer risk for lenders.

- The IFC’s Managed Co-Lending Portfolio Program (MCPP) has raised US$7 billion from international investors, notably institutional investors by reducing risk through its syndications platform that creates diversified portfolios of emerging market private sector loans. In this facility, IFC and SIDA provide first-loss coverage on the portfolio by taking a junior tranche so that investors can take investment-grade exposure in a senior tranche.

DFI equity investments in infrastructure projects also have proven to reduce risk and increase a project’s attractiveness to providers of risk mitigation and investment.

**Local pension funds can also potentially serve as in-country strategic anchor investors that reduce risk (providing a “halo effect”), thereby increasing the project’s attractiveness to providers of risk mitigation and investment.** National governments are likely to consider the impact of any adverse regulatory or other action on the invested pension fund(s) and their retirees, therefore reducing the risk of the project.

Therefore the selection of co-investment partners is a critical strategic part of the project preparation and structuring process that may substantially reduce project risks, potentially increasing access to finance.

4.4 Project requirements to access risk mitigation: Often public discussion of guarantees assumes that risk mitigation can be applied to any infrastructure project irrespective of its structure or status. However, the providers of risk mitigation have due diligence requirements that are aligned with that of investors (debt or equity). To access risk mitigation instruments from both public and private providers of risk mitigation, projects need to be properly structured and perceived as “investable” in terms of basic credit fundamentals.

It is also important to note that public sector providers of risk mitigation often have added requirements in terms of amount of financial capitalization commitments and country ownership. For example, the US agency OPIC has announced a new program that can be used for African infrastructure projects, US$ 1 billion CONNECT AFRICA. However, to access this funding, the agency specifies the below criteria related to project ownership, track record, and capitalization:

- **“OWNERSHIP:** For a project to be eligible to apply for OPIC financing, it must include the meaningful involvement of the U.S. private sector, most often by significant ownership of the investment. For projects with government shareholding participation, 50% of the overseas venture should be held by firms or persons from the private sector, or less if it is contractually agreed that management will remain in private sector hands and there is a strong showing of direct U.S. involvement in other respects.

**TRACK RECORD:** All projects must be within the demonstrated competence of the proposed management, which must have a proven record of success in the same or a closely related business as well as a significant continuing financial risk in the enterprise. Historical financial statements are required to demonstrate a proven track record of success.

**CAPITALIZATION/LEVERAGE:** Investors must demonstrate their capability to contribute sufficient equity to the project so that excessive leverage does not jeopardize the project’s financial viability. Although the financial structure may vary with the nature of a specific business, the per cent of total project cost funded in debt, including OPIC’s loan, is typically limited to 50% for a new project, with the remaining 50% funded in equity capital, grants, or fully-subordinated debt capital. Higher leverage is possible if circumstances warrant (e.g., an expansion of a profitable borrower, or a project with a long-term off-take agreement, such as a power plant), though may not exceed 75% of project cost.”

Given the varying requirements of risk mitigation providers, a key issue encountered by infrastructure project owners and developers is the lack of information on available risk mitigation instruments, their coverage and costs, the complex eligibility requirements, and processes for accessing them.

**Given the complexity of accessing risk mitigation and investment eligibility requirements, securing risk mitigation for an infrastructure requires the support of a highly experienced financial advisor with deep knowledge of public and private sector risk mitigation instruments and ways to access them.**
5.0 Overview of Risk Mitigation Market and Instruments

The use of risk mitigation instruments is recognized as a pivotal resource enabling “multiplier effects” for public finance: Moving from “billions to trillions” can only be achieved by using risk mitigation techniques and instruments to crowd in private capital. As a result the public sector has stepped up its focus in developing more effective risk mitigation instruments and scaling up their use, developing partnerships between public sector entities and private sector providers, as well as new instruments and risk-mitigated investment vehicles. Just as the development finance world has moved to scale “blended finance,” the risk mitigation has moved to scale “blended risk mitigation.”

Therefore while the public sector discussion is often limited to discussions on public sector risk mitigation providers, it is critical to expand the discourse to “blended risk mitigation and guarantees” that crowd in the greater capacity of the private sector.

5.1 The expanding role of the private sector in the risk mitigation market

The private sector role has expanded significantly from complementing public insurance as reinsurers and co-insurers to often being in direct competition with public risk mitigation providers.

- Private insurers are in some cases explicitly competing with the public sector, citing in their marketing materials how they compare with public providers of risk mitigation. 29
- In some cases, project developers have reported that private sector providers can at times provide better pricing and quicker response times.
- The benefits of private sector instruments for banks are large, as insured loans may qualify for Basel III and reduce the lender’s funding costs provided certain requirements are met. 30

The opportunity to use risk mitigation instruments for Africa infrastructure has therefore greatly expanded as the private sector market in risk mitigation has increased in size and the kinds of roles, providing much greater capacity and flexibility in risk mitigation coverage.

Private sector providers of risk mitigation need to be engaged to explore how to tap into their capacity to supplement public sector instruments, using a “blended risk mitigation” approach.

5.2 The expanding African demand for risk mitigation instruments

Historically risk mitigation coverage used to be almost exclusively purchased by UK, European and US companies but private sector insurers are reporting that developing country entities that were previously the party of risk (i.e. the obligor) are now requesting risk mitigation coverage. The private sector has more flexibility to engage with African requests for risk mitigation as they have less stringent eligibility requirements.

Additionally developing country banks are beginning to have their internal credit models signed off by the respective regulators and become advanced internal ratings based banks (AIRB) and therefore able to use risk mitigation (notably comprehensive non-payment insurance) for regulatory capital relief. 31

The availability of risk mitigation instruments is therefore critical to Africa’s ability to develop local capital markets. African-based investors – from banks to pension funds and stock market participants – can be crowded in by the increased use of risk mitigation to create more investable African infrastructure assets.

Therefore the availability of risk mitigation to African investors is essential to the 5% Agenda objective of mobilizing pension fund investment for infrastructure as well as domestic resource mobilization and African capital market development.

5.3 Scope of risk mitigation instruments

While infrastructure discussions often group risk mitigation in the general term “guarantees,” the range of risk mitigation instruments are actually quite diverse with different coverages and features, with considerable technical and legal differences. This section provides a general overview of the wide range of risk mitigation instruments currently available to lenders and equity investors. In some cases, risk instrument coverage more than one kind of risk. The below categories provide examples of risk mitigation instruments designed to cover a range of specific and general risks that impede access to institutional and other private investment. 32

1) Political Risk Mitigation Instruments

These instruments mitigate risks caused by specified political risk events outlined in section 3.1 above. 33

- Political Risk Guarantees (PRGs) typically cover the full amount of debt owed to commercial lenders in private projects if the debt default is caused by political risks specified under the guarantee. In some cases PRGs can be used to cover equity investments. Political risk guarantees are offered by multilateral development banks and some bilateral agencies.
- Political Risk Insurance (PRI) or investment insurance can insure equity investors or lenders. Coverage is generally limited to less than 100 per cent of the investment, but may cover 100% of a loan. Providers of PRI include export credit agencies, multilateral and bi-lateral insurers, and private political risk insurers.

2) Contractual and Regulatory Risk Mitigation Instruments

Contractual and regulatory risk coverage is more complex to write compared to traditional political risk cover, as it relies on the legal documentation underly the specific transaction and the regulatory undertakings the government has given. Events that trigger a call of the guarantee have to be clearly defined, and typically the remedies specified in the contractual or regulatory documents have to be exhausted prior to receipt of payment from the guarantor. (In response to market concerns, a number of instruments provide payment against a guarantee at the time of proof of legitimate claim, thereby enabling debt service to continue while the dispute is going through the resolution process.) 34

Because of the specialized nature of these coverages, initially these contract breech instruments were written to address specific project requirements.
However, as familiarity with these instruments has increased, many of the risks are now being covered under a breach of contract policy. The Multilateral Investment Guarantee Agency’s Breach of Contract guarantee defines the product as: “...protect[ing] against losses arising from the host government’s breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (e.g., an arbitration) in the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host government, MIGA will pay compensation. MIGA may make a provisional payment pending the outcome of the dispute resolution mechanism.”35

In the context of regulatory risk, PRGs can also be used to backstop a government commitment that the regulatory framework defined previously is adhered to and not changed unilaterally. To illustrate, the World Bank’s PRGs “cover private lenders, or investors through shareholder loans, against the risk of a government (or government-owned entity) failing to perform its contractual obligations with respect to a private project.”36 A PRG for regulatory risk mitigation therefore addresses a specific gap in risk coverage that investors seek in countries where the sector is in the early stages of reform as well as creditworthiness issues with state-owned utilities.37

For example, if an African government provided a guarantee to a energy company for provisions in a legal agreement or payment obligation, the World Bank could then provide a PRG to backstop the government’s obligation to compensate for loss of revenues resulting from the specific defined risk.

3) Credit Risk Mitigation Instruments38

Credit guarantees cover losses in the event of a debt service default with no differentiation of the source of the risks that caused the default.

• Partial Credit Guarantees (PCGs) cover part of the debt service of a debt instrument regardless of the cause of default. A PCG helps improve the borrower’s market access and terms of its commercial debt. They typically have provided coverage for later maturity payments. The guaranteed coverage level may be structured so as to achieve a particular bond rating or to enable commercial bank lenders to participate in a project financing.

Full Credit Guarantees or Wrap Guarantees cover the entire amount of the debt service in the event of a default. In some developing countries, private monoline insurers have been active in issuing wrap guarantees for bonds issued by infrastructure project companies. InfraCredit Nigeria has been set up to provide such guarantees.

Comprehensive Non Payment Insurance is offered by select private insurance companies and public sector providers. If an insured enters into a contract, the policy is designed to cover the insured against any loss as a result of the other party failing to meet their contractual obligations. The insurers will expect the insured to always retain a certain proportion of the transaction uninsured (normally 10%) to ensure the insured still has an interest even after the payment of a claim to keep the insured and insurer’s interests aligned. For banks, the policy covers a failure of a borrower to make the repayment under the loan agreement whether protracted default or insolvency. There are a variety of optional covers: comprehensive non payment of private obligors (also referred to as trade credit insurance); contract frustration (non-payment by public obligors); non-honouring of letters of credit/guarantees (or other standard trade instruments); non-honouring of sovereign obligations/guarantees (includes government-owned and quasi-sovereign entities); and non-performance by counterparty under a contract (also known as non-delivery), which covers the performance risk on a counterparty.

• Export Credit Guarantees or Insurance cover losses for exporters or lenders financing projects tied to the export of goods and services. They are usually “tied” to the nationality of exporters or suppliers and sometimes to the project sponsors or lenders.

4) Non-Payment and Structured Payment Insurance for Project Finance Lenders

Project finance lenders are increasingly turning to non-payment insurance (NPI), also known as structured credit insurance, to facilitate access to debt. NPI covers banks and other financial institutions when borrowers fail to pay back loans, enabling project finance lenders to leverage the bank’s credit limit on the borrower and allow the bank to obtain capital relief to lend more money. While customized credit default derivative instruments are also available for project finance loans, the market and price of these tools make them less attractive to lenders.

NPI insurance capacity has increased significantly over the past five years, with the one bank reportedly insuring a project finance loan of approximately $500 million. As project finance deals often require over US$1 billion and therefore require a syndication of banks and other lenders, NPI can be used to facilitate an individual bank’s participation in a larger transaction. The growth in the use of NPI for project finance is illustrated by its 10% project finance share of total 2015 NPI market in the United States, up from 4% in 2013.39

Typically, project finance lenders enter into a syndicate with other lenders to provide loans for infrastructure deals. NPI has given lenders the same lending capacity without involving other banks. Rather than having active partners, as is the case with a loan syndicate, the insurance policy merely provides a backstop, enabling lenders to act more independently.
The benefits of NPIs for project finance lenders include:

1. Risk appetite: NPI enables lenders to take on larger deal tickets and complete deals that would typically exceed the bank’s credit limits. It also enables the lender to manage obligor group, sector, or country risk concentrations.

2. Competitive advantage: By not involving other banks, NPI provides a competitive advantage. Clients are not introduced to your competitors. The insurance enables you to lend amounts that maintain relevance for sponsors and buyers that you may not have acting alone.

3. Revenue: Larger tickets equal larger upfront fees, meaning lenders with NPI behind them can increase their revenue.

4. Regulatory: NPI may help optimize the bank’s use of regulatory capital, with many jurisdictions allowing the policy to count as tier-one regulatory capital under Basel III rules, providing capital relief for banks.

NPI is an insurance contract rather than a straight guarantee. Like any insurance policy, there are conditions such as representations and warranties made by the insured bank and administrative responsibilities that the bank needs to meet to maintain coverage.

Failure to comply with these conditions can impair coverage. However, these risks are manageable and entirely within control of the insured lender.

According to a world leader in insurance, NPI is the most common method for banks to manage default risk except for the common practice of using bank syndications to other banks, employing unfunded or funded risk participations from other institutions. As demand for project finance increases, instigated by the need to fund critical infrastructure projects around the world, Marsh expects lenders to use alternative forms of risk transfer such as NPI to stay relevant in the project finance lending arena.

5) Foreign Exchange Risk Mitigation Instruments and Solutions

Efforts to minimize foreign exchange risk can be classified broadly within the areas of expanding options for local currency financing and approaches that attempt to deal directly with foreign exchange risks. Most DFIs seek to limit foreign exchange risk by facilitating local capital and bank market development thus improving access to local currency financing and eliminating the potential currency mismatch between a project’s revenue and its debt service.

However, this is a long and gradual process. When there is a market for local currency debt but the available debt is of insufficient maturity in the absence of protection from other risks, the public sector / donor agencies can intervene to assist infrastructure projects in mobilizing local currency debt through the following schemes:

- Local currency fund schemes facilitate local currency financing by providing additional security to lenders, diversifying project risks and reducing transaction costs. Typically such a fund uses its initial capitalization as a reserve fund and then issues bonds, using the proceeds to lend to infrastructure projects. It thus acts as an intermediary, facilitating supply of domestic capital market funds to infrastructure.

- Local currency credit enhancements include partial credit guarantees which mitigate specific credit risks. They help to extend the tenor of available local currency financing for the borrower by covering later maturity payments or a certain amount of debt service payments over the life of the credit or by using put options or a call of take-out financing.

- DFI local currency loans are also provided to infrastructure projects, although loans are most likely to be available in currencies where cross-currency swaps are available to hedge the DFI’s exposure. Some DFIs like the IFC also intermediate currency swaps to convert foreign currency loans to local currency.

In the absence of currency hedging instruments (e.g., forwards and options), foreign exchange risk can also be passed on to the host government or users of the service in the following ways:

- **Fixed Exchange Rates:** In theory such an exchange rate regime would remove foreign exchange risk from an infrastructure project’s owner.

- **Public Sector Lending in Local Currency:** In the absence of local long-term debt markets, local currency funding may be provided by the government through state-owned financial institutions. This form of public sector funding may also be used to leverage private financing when the loan from the government is subordinated and under some output-based scheme.

- **Exchange Rate Guarantees:** An alternative is for the government to guarantee the exchange rate for a specific project. This, however, is not a sustainable option as the government will not be able to hedge its exposure and in the event of devaluation, the guarantee will be one of multiple calls on the government’s foreign exchange reserves.

- **Tariff Indexes:** Agreements may be undertaken where the tariffs are adjusted by a single index, e.g., the foreign exchange rate or the local inflation rate. This helps to protect investors from cost changes as they are reflected in the output prices received via tariff adjustments.

- **Foreign Exchange Index:** Commonly developing country infrastructure projects financed with foreign currency debt can feature a license or contract that adjusts tariffs by a foreign exchange index. Such agreements shift the risk of devaluation from the project to its customers.

There are other risk mitigation approaches to reduce currency risk that have not yet been scaled.
For example, a liquidity facility could provide standby financing to enable a project to continue to meet its current debt service obligations while spreading the tariff impact of exchange rate changes over longer periods.

- Funding from the facility would be made available to the project when a devaluation (beyond a certain amount) is not immediately compensated by the agreed tariff adjustment formula and this negatively affects the project’s ability to service debt.
- The facility will be repaid over a number of years through phased tariff adjustments to return revenues to a cost-recovery level or by a special levy on consumers.
- Responsibility for the repayment would rest with the project sponsor or with the municipality, state or government.
- While a liquidity facility can smooth the impact of devaluation on project cash flows, the retail tariff should ultimately reflect the full cost of infrastructure service provision, including foreign currency financing costs.

New currency risk mitigation solutions are increasingly demanded by institutional investors, so there needs to be further efforts to expand such coverage.

5) Project Development Risk Mitigation Instruments

As discussed above, the literature reports that the most critical issue blocking investment is the lack of a pipeline of projects. The key cited issue is that many projects are not sufficiently developed due to the unacceptable risk of losing the significant level of development funds required to develop the project. In short, private project sponsors and investors are unwilling or unable to finance the project’s development costs and assume the risk of failure.

To overcome these hurdles, international development organizations have established dozens of initiatives to assist with infrastructure project preparation. Bilateral donor agencies have designed special programs to provide such support, as have European development finance institutions. Donors have also supported the creation of multilateral trust funds managed by the World Bank to focus on specific sectors or type of projects. The World Bank has also created several facilities that deal with different aspects of project preparation and finance. Examples of facilities that support project sponsors in preparing infrastructure projects include InfraCo Africa, DEVCO, World Bank’s Global Environmental Facility, African Capacity Building Foundation, etc. In Uganda, the Private Sector Foundation Uganda (PSFU) implements the Business Uganda Development Scheme (BUDS-DFID) project on behalf of the Office of the Prime Minister. BUDS-DFID is a cost-sharing project funded by DFID.

Its aim is to promote private sector growth, investment and employment opportunities by providing financial support for business development services (BDS), skills development including capacity building and capital investment related activities in the form of grants.

As noted earlier, ways to reduce project development risks are critical, especially for institutional investors. A common approach is to invest in an infrastructure fund and obtain risk mitigation at that level. For example, the equity investor Meridian has invested in African infrastructure funds using OPIC and private sector insurance. In some cases, insurance can be used to “pierce the sovereign ceiling,” thereby opening investment to international institutional investment.

6) Trade and Commercial Risk Mitigation Instruments

Export credit guarantees or insurance cover losses for exporters or lenders financing projects tied to the export of goods or services. Export credit guarantees or insurance cover some percentages of both political risk and commercial risk. Export credit agencies (ECAs) define commercial risks for export transactions to include bankruptcy or insolvency of the borrower or buyer, failure of the buyer to effect payment, failure or refusal of the buyer to accept goods, and termination of purchase contract.

ECAs provide insurance and guarantees for exports and investments abroad by home companies. They are either owned by the government, such as the Norwegian Guarantee Institute for Export Credits (GIEK), or are administered by an independent entity (e.g. Germany’s Foreign Trade and Investment Promotion Scheme (AGA), which is administered by a consortium of two private companies). Most agencies provide risk coverage for both commercial risks, such as insolvency or bankruptcy on the part of the buyer and termination or non-renewal of contracts and import licenses, and non-commercial risks, such as currency inconvertibility, expropriation, political violence, natural disasters, and force majeure. However, export credits are typically only one of several tranches involved in financing a project – they do not cover equity, for instance. Similarly, export credits do not usually support the entire project, therefore obliging project sponsors to pursue other instruments.

7) Interest Rate Risk Mitigation Instruments

A central problem faced by African countries (and developing countries in general) is lack of access to affordable, long-term funding, especially local currency financing for infrastructure projects. As a result, most African countries suffer from very high local interest rates, with the result that the debt service costs are too high for most projects. Local currency financing is vital, as it protects borrowers against the devaluation risk associated with borrowing in foreign currencies.

On-lending facilities play an important role in overcoming this impediment and reducing the cost of local currency financing for borrowers and project sponsors. By providing concessional financing at subsidized rates to local banks, the bank’s cost of capital is reduced.

This lower cost local currency capital can thus be on-lent to local borrowers at rates lower than what was previously possible. For example, the adb used local currency for on-lending to Philippine commercial banks at fixed rates, which thus had additional liquidity for lending, enabling them to make long-term loans with no currency or maturity mismatches. Other examples of on-lending facilities include the World Bank’s Tanzania Energy Development Assistance Program (WB TEDAP), the FDC’s On-Lending facilities, and the Government of Uganda’s Agricultural Credit Facility, which is intended to provide medium to long-term loans to projects engaged in agriculture and agricultural-processing on more favourable terms than are usually available from the participating financial institutions.
The commonest type of interest rate hedging used is interest rate swaps, and to a lesser extent interest rate caps, collars, and other instruments are used. However, these instruments are generally not available in Africa.

8) Decentralized Public Risk Mitigation Instruments

Increasingly risk mitigation is being provided at the African country, region, and continental level by a range of national, regional, and international organizations. As noted earlier, the African Trade and Insurance Agency (ATI) is a leading example of successful decentralized risk mitigation provider. Other examples include Nigeria InfraCredit, the IFC’s Country Scaling Solar programs, the Uganda Energy Credit Capitalization Company (UECCC), AFD’s ARIZ scheme, and the implementation of country Feed-in-Tariffs.

- **Nigeria’s InfraCredit** provides 100% local currency guarantees to enhance the credit quality of debt instruments issued to finance creditworthy infrastructure assets. InfraCredit’s guarantees act as a catalyst to attract investment from pension funds, insurance firms, and other long-term investors, thereby deepening Nigeria’s debt capital markets.

- **The Scaling Solar programme** is now operating in five African countries, using a range of World Bank risk mitigation instruments to enable scaled renewable energy finance.

- **Uganda Energy Credit Capitalization Company’s** main focus is to enhance the flow of private sector finance and investments to small scale, renewable energy generation and distribution projects and/or rural electrification projects in Uganda.

- **AFD’s ARIZ scheme** is a guarantee mechanism designed to provide better access to financing (mainly in Africa) tailored to risk securitization needs, including political risks or climate hazards.

- **Country Feed-in-Tariff (GET FIT) Programs** are further illustrations of bottom-up support for renewable energy level. These country level programmes address private sector concerns on the investability of renewable energy projects. The GET FIT concept is intended as a template which can be flexibly adapted to specific national contexts.

9) Global DFI Funds, First Loss, and A-B Loan Structures

Many multilateral banks, through their private sector departments or organizations, offer risk mitigated funding vehicles for infrastructure finance. Most recently, the IFC has developed funding vehicles such as the Managed Co-Lending Portfolio Program (MCPP) that has raised US$7 billion from international investors, notably institutional investors. MCPP reduces risk through its syndications platform that creates diversified portfolios of emerging market private sector loans. The MCPP platform leverages IFC’s origination capacity and deep market knowledge to source opportunities for third-party investors to co-lend alongside IFC on commercial terms. Investors include The People’s Bank of China, through SAFE, its State Administration for Foreign Exchange (2013), Allianz Global Investors (2016), AXA (2018), Eastspring Investments (2017), Hong Kong Monetary Authority (2017), Liberty Specialty Markets (2017), Munich Re (2017), and Swiss Re (2018).

MCPP Infrastructure offers an example of how a first-loss structure can be used to provide credit enhancement for institutional investors in order to achieve a target risk level on their portfolio. In this facility, IFC provides first-loss coverage on the portfolio by taking a junior tranche so that investors can take investment-grade exposure in a senior tranche.

The first loss splits the cash flows (principal and interest) from the portfolio of loans between the investors and IFC. IFC has in turn partnered the Swedish International Development Cooperation Agency (SIDA), which has agreed to share the risk with IFC on the first-loss tranche.

Traditionally “A/B” loan structures have been used whereby the multilateral lends a portion of the total amount required (the “A” loan) and syndicates the remainder of the loan to commercial lenders (the “B” loan). The multilateral acts as the lender of record for the full loan and the private sector lenders receive the benefit of being under the umbrella of the multilateral. B loan participants therefore benefit from the multilateral’s preferred creditor status and thereby the A/B loan structure implicitly mitigates currency transfer risk for lenders.

5.4 Providers of risk mitigation instruments: Risk mitigation providers include multilateral development banks and agencies, bilateral and national agencies, and private financial entities.

The breakthrough of market participation differs greater by type of risk mitigation provider:

- **DFIs:** The level of risk mitigation instruments provided through DFIs has historically been very low, and confined to Partial Guarantees (credit and risk). The exception is MIGA, part of the World Bank Group.

For example, the total amount of DFI guarantees for project finance infrastructure transactions accordingly Reuters Thompson was only US$500 million and only provided by one DFI, the World Bank Group. The regional development banks, including the African Development Bank, were reported as providing no guarantees for any project finance transactions in 2017.

**Export Credit Agencies (ECAs):** Traditionally the bulk of risk mitigation instruments has provided through Export Credit Agencies (ECAs) promoting their country’s exports.

Thompson Reuters reports ECAs as providing US$8 billion in guarantees to project finance transactions in 2017 with breakouts as follows: China’s China Export and Credit Insurance Corporation Sinosure (US$3.6 billion), Japan’s Export and Investment Agency NEXI (US$1.7 billion), South Korea’s Trade and Insurance Corporation Ksure (US$961 million), Italy’s Sace (US$700 million), Export-Import Bank of Korea - Keim (US$546 million), France’s Banque publique d’investissement Bpifrance (US$450 million).
Private Sector: The private sector insurance sector is extremely large, providing PRI and other risk mitigation products such as credit insurance and non-payment insurance (NPI), and large amounts of reinsurance and co-insurance to DFIs and ECAs.

To illustrate, in 2016 the private sector was estimated at insuring US$ 1 trillion in global cross-border trade, equal to 7% of total cross-border trade (US$14 trillion). In terms of a single infrastructure project, the potential capacity of the total private market (using reinsurance) is estimated at US$ 2.5 – US$ 3 billion.

These three groups of risk mitigation providers work together to form an entire “risk mitigation ecosystem,” consisting of reinsurance, co-insurance, syndications through treaties and facultative agreements. Notably the role of private sector risk mitigation providers has grown larger in scope and more varied in roles, demonstrating the capacity to provide not just reinsurance to the public sector, but also their own direct private sector instruments with no public sector participation, including in Africa.

This increase of the scale and scope of private sector risk mitigation instruments has introduced an opportunity to scale the amount of risk mitigation available for African infrastructure projects, especially the large transboundary PIDA Projects.

More details by type of provider are provided below.

### Major DFI providers are listed in the below table.

<table>
<thead>
<tr>
<th>Name</th>
<th>Coverage</th>
<th>Instrument Name</th>
<th>Instrument Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Bank: IBRD and International Development Association (IDA)</td>
<td>Political and comprehensive risk</td>
<td>IBRD Partial Risk Guarantee, IDA PRG, IBRD Enclave PRG, IBRD Partial Credit Guarantee, IBRD Policy-Based Guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>International Finance Corporation</td>
<td>Comprehensive risk</td>
<td>Partial credit guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>MIGA</td>
<td>Political risk</td>
<td>Investment guarantee</td>
<td>Political risk insurance</td>
</tr>
<tr>
<td>African Development Bank (AfDB)</td>
<td>Political and comprehensive risk</td>
<td>Partial risk guarantee, partial credit guarantee, policy based guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>ADB (including CGIB monoline)</td>
<td>Political and comprehensive risk</td>
<td>Political risk guarantee, partial credit guarantee, 100% bond guarantees</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>EBRD</td>
<td>Political and comprehensive risk</td>
<td>Political risk guarantee, trade finance facilitation program, SME guarantee facility, Municipal finance facility</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>Inter-American Development Bank (IDB)</td>
<td>Political and comprehensive risk</td>
<td>Political risk guarantee, trade finance facilitation program, SME guarantee facility, Municipal finance facility</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>European Investment Bank (EIB)</td>
<td>Political and comprehensive risk</td>
<td>Outside EU – political risk carve-out on guarantees for EIB loans, EIF credit insurance, enhancement, SME guarantee facility, Outside EU – Range of Equity / loan / microcredit guarantees, portfolio credit risk sharing, etc.</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>Name</td>
<td>Coverage</td>
<td>Instrument Name</td>
<td>Instrument Type</td>
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<tr>
<td>------------------------------------------------</td>
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<td>-------------------------------------------</td>
</tr>
<tr>
<td>Latin American Development</td>
<td>Comprehensive risk</td>
<td>Partial credit guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>Islamic Corporation for Insurance of Investments and Export Credits (ICIEC)</td>
<td>Political and comprehensive risk</td>
<td>Equity investment insurance policy, financing facility insurance policy, loan guarantees investment insurance policy, comprehensive short term policy, supplemental medium term policy, etc.</td>
<td>Investment and export credit insurance, reinsurance</td>
</tr>
<tr>
<td>Islamic Development Bank (ISDB)</td>
<td>Investment and export credit coverage</td>
<td>Direct investment guarantee, equity participation guarantee, loan guarantee, contractors equipment guarantee, specific non-commercial risks guarantee, etc.</td>
<td>Insurance</td>
</tr>
</tbody>
</table>


**Bilateral Agencies**

Bilateral or national agencies offering risk mitigation instruments can generally be classified into bilateral development agencies or export credit agencies (ECAs).

- Bilateral development agencies that provide risk mitigation instruments have development objectives similar to DFIs. Although ECA actions may further development, they exist to promote exports.
- ECAs have diverse organizational structures. Some ECAs may be part of their respective governments (UK), while others are structured as government agencies or as government programs administered by private entities (e.g., France, Germany). ECA programmes are usually tied to the nationality of exporters or suppliers and sometimes to that of the project developers or lenders, as their institutional objectives are primarily to serve their countries’ national interests.

**Major bilateral risk mitigation providers are listed in the below table.**

### Table 3: Major Bilateral Providers of Risk Mitigation Instruments

<table>
<thead>
<tr>
<th>Name</th>
<th>Coverage</th>
<th>Instrument Name</th>
<th>Instrument Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export Development Canada (EDC) – Canada</td>
<td>Investment and export credit</td>
<td>Political risk insurance, contract frustration insurance, accounts receivable insurance etc.</td>
<td>Insurance</td>
</tr>
<tr>
<td>Agence Françoise de Développement (AFD) – France</td>
<td>Political and comprehensive risk</td>
<td>ARIZ single deal and portfolio guarantees</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Coface – France</td>
<td>Investment insurance and export credit guarantees</td>
<td>Export credit guarantees</td>
<td>Insurance and guarantees</td>
</tr>
<tr>
<td>Deutsche Investitions und Entwicklungsgesellschaft mbH (DEG) – Germany</td>
<td>Comprehensive coverage</td>
<td>Partial and full credit guarantees</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Foreign Trade and Investment Promotion Scheme (AGA) – Germany</td>
<td>Investment and export credit coverage</td>
<td>Investment and export credit guarantees</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Italian Export Credit Agency (SACE) – Italy</td>
<td>Investment and export credit coverage</td>
<td>Political risk insurance, buyer credit insurance, bond insurance etc.</td>
<td>Insurance</td>
</tr>
<tr>
<td>Japan Bank for International Cooperation (JBIC) – Japan</td>
<td>Political and comprehensive risk coverage</td>
<td>Political risk guarantee and comprehensive risk guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>Name</td>
<td>Coverage</td>
<td>Instrument Name</td>
<td>Instrument Type</td>
</tr>
<tr>
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<td>--------------------------------</td>
</tr>
<tr>
<td>Nippon Export and Investment Insurance (NEXI) – Japan</td>
<td>Investment and Trade coverage</td>
<td>Overseas investment insurance, export credit insurance, buyers credit insurance etc.</td>
<td>Insurance</td>
</tr>
<tr>
<td>Atradius Dutch State Business NV – Netherlands</td>
<td>Investment and export credit coverage</td>
<td>Investment insurance, export credit insurance and capital goods insurance</td>
<td>Insurance and guarantees</td>
</tr>
<tr>
<td>The Netherlands Development Finance Company (FMO) – Netherlands</td>
<td>Comprehensive risk coverage</td>
<td>Credit and partial credit guarantees</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Norwegian Guarantee Institute for Export Credits (GIEK) – Norway</td>
<td>Investment and export credit coverage</td>
<td>Political risk insurance, export guarantees, buyers credit, suppliers credit, etc.</td>
<td>Guarantee or insurance</td>
</tr>
<tr>
<td>PROPARCO - Private sector financing arm of Agence Francóise de Développement (AFD) - France</td>
<td>Investment coverage</td>
<td>Senior loans, equity, convertible bonds, guarantees</td>
<td>Guarantees, including local currency financing</td>
</tr>
<tr>
<td>Swedish Export Credit Guarantee Board (EKN) – Sweden</td>
<td>Investment coverage and export credit coverage</td>
<td>Investment guarantees, contract guarantee, production guarantee, credit guarantee</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Swedish International Development Cooperation Agency (SIDA) - Sweden</td>
<td>Coverage of credit and partial risks</td>
<td>Partial risk and credit guarantees</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Swiss Investment Risk Guarantee Agency (SERV) – Switzerland</td>
<td>Investment coverage</td>
<td>Political risk guarantee</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Swiss Export Risk Guarantee (ERG) – Switzerland</td>
<td>Export credit coverage</td>
<td>Predelivery (manufacturing) guarantee, Performance and bid bond guarantee</td>
<td>Guarantee</td>
</tr>
<tr>
<td>Export Credits Guarantee Department (ECGD) – United Kingdom</td>
<td>Investment and export credit coverage</td>
<td>Overseas investment insurance, export credit insurance, buyer credit guarantees, etc.</td>
<td>Guarantee and insurance</td>
</tr>
<tr>
<td>United States Agency for International Development (USAID): Development Credit Authority (DCA) – United States</td>
<td>Comprehensive risk coverage</td>
<td>Partial credit guarantees in the form of loan, loan portfolio, portable and bond guarantee</td>
<td>Debt guarantee</td>
</tr>
<tr>
<td>Export-Import Bank of the United States (EX-IM Bank) – United States</td>
<td>Political and comprehensive risk coverage</td>
<td>Political risk only coverage for project finance / structured finance transactions, export credit insurance, loan guarantee etc.</td>
<td>Loans, guarantees and insurance</td>
</tr>
<tr>
<td>Overseas Private Investment Corporation (OPIC) – United States</td>
<td>Political risk insurance, loan guarantee</td>
<td>Finance guarantees and insurance products</td>
<td></td>
</tr>
<tr>
<td>Swiss Export Risk Guarantee (ERG) – Switzerland</td>
<td>Export credit coverage</td>
<td>Predelivery (manufacturing) guarantee, Performance and bid bond guarantee</td>
<td>Guarantee</td>
</tr>
</tbody>
</table>

An African-focused approach is considered by many experts to be the most effective, given the need to fully understand the risks specific to the country, sector, and infrastructure project and develop the most effective risk mitigation project-specific solution. In this respect African risk mitigation providers such as the Africa Trade and Insurance Agency (ATI) have been considered very effective. However, ATI’s ability to provide risk mitigation for infrastructure projects is dependent on their reinsurance capacity as they are reported to be limited to a maximum transaction size of US$ 10 million on their balance sheet.

Therefore to address Africa’s infrastructure project risks, especially the large transboundary PIDA Projects, African risk mitigation providers need to be able to engage a large network of reinsurers to provide the required scale of risk mitigation coverage.

### Private Sector Providers of Risk Mitigation

As noted earlier, the private sector insurance sector is extremely large and growing. Over the last few years, the private sector market has been reported as becoming a “buyers market.” While private insurers tend to be highly sophisticated in risk assessment, they have relatively less leverage with host governments compared to public insurers. In these cases, private insurers may decide to partner with public sector providers.

The private sector provides political risk insurance against losses arising from a variety of sources including regulatory risk, breach of contract, expropriation, currency inconvertibility, and war and civil disturbance. Today, private political risk insurers are concentrated primarily in the UK, USA and Bermuda. However, several global insurers have opened offices in large developing country markets, such as South Africa and India.

### Political Risk Insurance

Currently, there are about 60 insurers operating globally offering political risk insurance (PRI).

---

### Table 4: Key African-Focussed Public Sector Risk Mitigation Providers

<table>
<thead>
<tr>
<th>Name</th>
<th>Support provided</th>
</tr>
</thead>
<tbody>
<tr>
<td>African Development Bank (including co-guarantee platform)</td>
<td>Partial guarantees (and potential for syndications through guarantee platform just launched at the Africa Investment Forum)</td>
</tr>
<tr>
<td>African Guarantee Fund for Small and Medium-sized Enterprises</td>
<td>Partial local currency credit guarantees and capacity development support</td>
</tr>
<tr>
<td>African Export-Import Bank (Afreximbank)</td>
<td>Guarantee Programmes (related to obtaining large contracts and support)</td>
</tr>
<tr>
<td>The Currency Exchange Fund (TCX)</td>
<td>Foreign exchange risk mitigation using long term local currency hedging instruments</td>
</tr>
<tr>
<td>Africa Finance Corporation (AFC)</td>
<td>Project development support, principal investing and financial advisory</td>
</tr>
<tr>
<td>Africa Trade Insurance Agency (ATI)</td>
<td>Covers political and commercial risks for a wide variety of trade and investment transactions</td>
</tr>
<tr>
<td>GuarantCo (PIDG)</td>
<td>Credit enhancement for local currency debt issuance</td>
</tr>
<tr>
<td>Geothermal Risk Mitigation Facility (East Africa)</td>
<td>Project development support and capacity building</td>
</tr>
<tr>
<td>InfraCredit (Nigeria)</td>
<td>100% credit guarantees</td>
</tr>
<tr>
<td>Uganda Energy Credit Capitalization Company (UECCC)</td>
<td>Technical and financial support for renewable energy infrastructure development in Uganda, considering partial risk guarantees</td>
</tr>
</tbody>
</table>

Examples of major private sector providers of PRI include: Chubb Commercial Insurance, Sovereign Risk Insurance Limited, Zurich Emerging Market Solutions, Lloyds Political Risk Insurance, The Hartford, Liberty Specialty Markets, Munich Re, and Swiss Re. Having a large number of active insurers in the PRI market creates significant competition giving buyers the ability to choose the right coverage for the right price among many offerings.

The overall PRI market size is estimated to be around $8 billion, according to a recent study by KPMG. One insurance company reports that it has placed more than US$350 billion in coverage globally. Two insurance brokers have reported the ability to provide PRI for a single high-quality African infrastructure project of US$3 billion.64

Credit Insurance: The private sector has also provided insurance that covers credit risk. As noted earlier, Non-Payment Insurance (NPI) is an important product especially for institutional investors that have very low risk tolerance and need to be protected from losses. Some insurance companies have focused on providing NPI in developed countries, and are now interested in exploring how to increase its use in developing countries, including African infrastructure projects or investment vehicles that invest in African infrastructure.

Historically, private sector bond insurers (monolines) have provided extensive financial guaranty insurance and related products that cover 100% of risk. Prior to the financial crisis that began in 2007, these firms insured a wide range of new issue and secondary market transactions, including infrastructure and project financings, local government issues, asset securitizations, structured finance transactions, and sovereign and quasi-sovereign debt. For many years, private sector monoline insurers provided guarantees against default for an estimated 50% of all U.S. municipal bonds and asset-backed securities.65 In addition, monolines were previously involved in insuring international and developing country securities in both the asset backed and infrastructure finance markets.

Given the global decline in private monoline capital, US monoline support of project finance and international transactions in developing countries has been curtailed. However, other monolines are reported as active in the market, with a growing interest in extending more coverage to infrastructure projects. Moreover, given the demonstrated ability of monolines to access institutional investment, public sector monolines have been launched in developing countries to provide 100% credit guarantees to local bonds (i.e., Asia Limited, Nigeria InfraCredit, ADB Credit Guarantees and Investment Facility - CGIF).66 Despite extensive efforts to the use of public or private monolines in developing countries, scale has not been achieved given the complexity, high investment cost, and extended time periods required to create new investment-grade legal vehicles that have sufficient capital and financial expertise to provide viable guarantees.

5.5 Low utilization of risk mitigation instruments & reported impediments: While there is a very large demand for risk mitigation instruments and a wide range of risk mitigation instruments offered by DFIs, ECAs, and the private sector, the actual utilization of risk mitigation instruments has historically been quite limited.

The difficulty of scaling risk mitigation has been recognized over decades. In fact, to incentivize the greater provision of risk mitigation by the public sector, the OECD launched the Total Official Sustainable Support for Development (TOSSD) initiative that would include risk mitigation instruments such as guarantees in the reporting of development institutions.67 This section examines the low utilization of risk mitigation instruments and the underlying reasons.

Despite the considerable innovation that has gone into developing the risk mitigation products discussed above, their market acceptance and aggregate value has remained relatively low compared with official loans and overall private flows. For example, the independent evaluation reviewing the World Bank’s experience with guarantee instruments during 1990-2007 concluded that the use of these products has fallen short of reasonable expectations. From1990 - 2007, MIGA only issued 897 guarantees for a total of US$16.7 billion, the World Bank issued 25 guarantees totalling US$3 billion, and the IFC approved 196 guarantee operations totalling US$2.8 billion.68

These public sector guarantees only totaled US$22.5 billion over 17 years, while annual private capital flows to developing countries increased from US$165 billion in 2001 to US$647 billion.69

The historically low utilization of guarantees relative to loans and equity by DFIs was documented in a study conducted by the Overseas Development Institute. The below table shows the percentage exposure of DFIs by instruments in 2009, breaking out equity, loans, and guarantees.
Despite extraordinary efforts and some success in increasing the use of risk mitigation, the use of risk mitigation is still extremely low compared with the huge demand. As noted earlier, the annual infrastructure financing gap in Africa is staggering (US$ 68 - US$108 billion a year) but the level of reported DFI guarantees is extremely low. The Thompson Reuters League Table reports only two African project finance deals for 2017 using public sector guarantees: the Cape Three Points Integrated Oil & Gas Plant in Ghana and the ACWA Power Plant in Egypt.

For decades development finance experts have stressed that DFI activities need to dramatically shift from direct lending to facilitating the mobilization of resources from the world’s largest private savings pools (international and domestic) for development-oriented investments. Experts agree that tapping into private capital can only be achieved through the wider use of risk mitigation techniques, including adequate project preparation and structuring, coupled with risk mitigation instruments and the improvement of national enabling environments.

Even UN member states have demanded an increase in risk mitigation since 2002, featuring dominantly in the policy exchanges and adopted resolutions of Financing for Development from the 2002 Monterrey Consensus to the 2015 Addis Ababa Action Agenda. The result is the current “Blended Finance” approach now being advocated by DFIs, often trumpeted as moving from “billions to trillions.”

Table 5: Total DFI and Bilateral Agency Portfolios: Equity, Loans, and Guarantees (% of total Portfolio)

<table>
<thead>
<tr>
<th>Bilateral/DFI Agency</th>
<th>Equity</th>
<th>Loans</th>
<th>Guarantees</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIO</td>
<td>38</td>
<td>62</td>
<td>0</td>
</tr>
<tr>
<td>CDC</td>
<td>96</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>COFIDES</td>
<td>94</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>DEG</td>
<td>42</td>
<td>57</td>
<td>2</td>
</tr>
<tr>
<td>Finnfund</td>
<td>45</td>
<td>53</td>
<td>2</td>
</tr>
<tr>
<td>FMO</td>
<td>45</td>
<td>51</td>
<td>3</td>
</tr>
<tr>
<td>IFU</td>
<td>53</td>
<td>44</td>
<td>3</td>
</tr>
<tr>
<td>Norfund</td>
<td>85</td>
<td>15</td>
<td>0</td>
</tr>
<tr>
<td>OeEB</td>
<td>47</td>
<td>42</td>
<td>11</td>
</tr>
<tr>
<td>PROPARCO</td>
<td>14</td>
<td>84</td>
<td>2</td>
</tr>
<tr>
<td>SBI</td>
<td>57</td>
<td>43</td>
<td>0</td>
</tr>
<tr>
<td>SIFEM</td>
<td>88</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>SIMEST</td>
<td>100</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>SOFID</td>
<td>0</td>
<td>83</td>
<td>17</td>
</tr>
<tr>
<td>Swedfund</td>
<td>64</td>
<td>36</td>
<td>0</td>
</tr>
<tr>
<td>EBRD</td>
<td>15</td>
<td>85</td>
<td>0</td>
</tr>
<tr>
<td>IFC</td>
<td>18</td>
<td>55</td>
<td>27</td>
</tr>
</tbody>
</table>


To ensure the success of this approach we need to confront the historic reasons why risk mitigation has not been able to scale and meet the demands of governments or the private sector.
5.6 Factors impeding effective use of risk mitigation instruments

The underlying reasons for low utilization of risk mitigation instruments are complex and encompass factors related to the market such as the lack of bankable projects as well as a range of internal DFI implementation issues, amongst others.\textsuperscript{73} The World Bank study reports that the use of risk mitigation instruments (guarantee products) has fallen short of reasonable expectations because of factors including (1) competition among institutions for the same clients; (2) weaknesses in the marketing of products that limit client awareness and choice; (3) limited internal awareness, skills or incentives to use guarantee instruments in relevant situations; and (4) inconsistent pricing.\textsuperscript{74} A more detailed assessment of the factors constraining the use of risk mitigation instruments is provided below.

Constraints related to the market

Lack of investable projects: While risk mitigation instruments facilitate the mobilization of private debt and equity capital, the borrower or project must be sufficiently “investable” to enable the providers of such instruments properly to assess risks, identify recourse measures as needed, and offer defined risk coverage. Furthermore, preparing infrastructure projects for private financing is a costly exercise for developing countries, which may not have adequate financial and technical expertise.\textsuperscript{75} The demand for risk mitigation instruments is therefore constrained by the limited availability of investable projects.

Lack of suitability of the debt/capital market environment: Use of risk mitigation instruments is affected by the absence of certain fundamentals that drive investment. These include the legal, institutional, and regulatory framework, a solvent banking system, honest administration, a stable macroeconomic situation, market size, the presence of bankable projects and good sponsors, sound banks, sound sub-sovereign entities, transparent accounting and budgeting, the presence of local savings seeking safe outlets, transparency in financial dealings, and the presence of credit ratings agencies.\textsuperscript{76} To achieve domestic financing for projects that are credit enhanced using partial credit guarantee products, it is essential that the provider be comfortable with the credit appraisal and financial administrative capacity of local financial institutions extending loans that are guaranteed. This lack of financial capacity in many developing countries limits the use of risk mitigation instruments.

Host country government understanding of risk mitigation benefits: While most governments are supportive of instruments that facilitate investment, they would typically prefer a loan rather than a guarantee facility, even when the guarantees are scored preferentially to loans (i.e., allowing them to access more support from the DFI). The process is more complex and is likely to require a sovereign counter guarantee. Therefore, lack of host country government understanding of the benefits of guarantee products as well as other risk mitigation instruments is a constraint to scaling up the use of risk mitigation.

Constraints related to DFI internal processes

Design of products and country limits: A central issue is how risk management processes are designed and implemented in public risk mitigation providers. Often the private sector operations in DFIs have to manage to “zero loss” guidelines, meaning that the expectation for each transaction booked is that there will not be any losses. In addition, official sector managers are often pressured to have high rates of return, reported as high as 23%. These policies and guidelines have the convoluted effect of pushing donors to compete against the private sector and each other for the least risky and most profitable deals, instead of implementing those transactions that the private sector cannot finance due to unacceptable risk or low profitability.\textsuperscript{77} Furthermore, country limits and budget performance reports do not differentiate according to the risk reduction produced by risk mitigation products or the benefits of leveraging official sector commitments by using guarantees to attract additional private sector capital. For example, in donor institutions a guarantee may count the same as a direct loan against a country limit (and against capital), even though loss experience with guarantees may be significantly less than with a loan. As country limits are a scarce commodity and need to be allocated between competing projects, this accounting treatment creates a very strong internal bias to allocate the country limit to direct loans, as direct loans produce more revenues than guarantees.

However, while guarantees produce less revenue, they may result in the country having access to more capital. This is a critical point, as developing countries benefit from private sector financing based on guarantees that leverage official sector capital, permitting the completion of large infrastructure projects that provide critical services such as electricity, roads, and water, with private sector capital.

Requirement of obtaining sovereign guarantees: The public sector windows of most DFIs require sovereign guarantees for issuing their instruments. Securing such guarantees is time consuming and usually must be done in the context of the DFIs larger lending and assistance program. The preparation and administration of such guarantees can require the same upfront effort as a loan product, with lower direct tangible benefits to the government.

Sovereign guarantees on private infrastructure projects can also meet resistance from governments because it adds to their contingent liability exposure and affects overall debt ceilings.\textsuperscript{78} In the case of certain sectors (e.g., the water and sanitation sector) guarantees must support undertakings by sub-sovereign entities. Many sub-sovereign governments lack the experience and ability to be able to negotiate the terms and conditions of these risk mitigation instruments. Also, some governments are unable to exert effective influence over issues such as national regulatory reform or changes in license conditions. For these reasons, a number of investors have indicated that they prefer to see this coverage backed by a counter guarantee from the central government.\textsuperscript{79}

Credit scoring: As noted above, when guarantees are scored by DFIs at parity with loans in an environment where lending is prioritized, guarantees are unlikely to be promoted or championed within the institution.
Treatment of foreign exchange risk in local currency guarantee schemes: DFIs have different policies for dealing with the contingent foreign exchange risks that may occur from providing local currency guarantees. Some DFIs require that in the event of a default and claim payment, the currency of the credit converts to hard currency based on the exchange rate in effect on the date that the transaction closed. The guarantor will then proceed to recover foreign exchange from the borrower in satisfaction of outstanding obligations. Others, for example the US Export-Import Bank, convert the claim amount to US dollars based on the spot rate in effect on the claim payment date. Many believe that the demand for local currency guarantees by DFIs is reduced significantly by denomining the amount that they are attempting to recover from the borrower (as the result of paying a claim) in hard currency.80

Capital allocation for credit guarantee obligations and concern regarding triple-A ratings of DFIs: With the exception of the World Bank treatment of low-income countries, DFIs often allocate capital on a 1:1 basis against the par value of their credit guarantee obligations as soon as those obligations are agreed and the underlying transaction has closed. Following the same policy on leverage for their guarantee operations as required for loans results in an economically inefficient use of DFI capital. DFI management is also concerned about the preservation of their triple-A credit ratings, which enable them to access cheap capital from the capital markets. Although experts and credit analysts have disputed the validity of this concern, its prevalence amongst internal risk management units within DFIs hinders the scaling of new risk mitigation programs.

High transaction costs: Development institutions have extensive and lengthy procurement and transaction processes resulting in large transaction costs. Legal costs are also reported as extremely high.81 Recording of guarantees in Development Assistance Committee (DAC) statistics: As noted earlier, the lack of credit given historically to development partners for risk mitigation has been a disincentive that the OECD TOSSD initiative is intended to address.

Lack of internal incentives: In an environment where DFI staff believes that lending is prioritized, guarantees are unlikely to be championed within the institution. The “lending culture” of development institutions first attracted wider attention through the so-called Wapenhans report in 1992 which crystallized the critique that the World Bank’s management information systems and incentives attached special importance to meeting quantitative lending targets and that other considerations, such as the quality of the projects, received less management attention or recognition via the internal career path. Such a culture continues to exist and could be part of the explanation for the failure of development institutions aggressively to develop alternatives to direct lending, such as guarantees.82 Furthermore most DFIs have broad mandates with an emphasis on development lending or private sector financing and, thus, risk mitigation instruments represent only a small proportion of a wide array of products and services on offer. Therefore, they have to compete for management attention and wider acceptance within the DFI country assistance process.

Lack of technical skills within DFIs: The due diligence undertaken for deciding upon the use of risk mitigation instruments requires the application of technical skills in credit analysis, and the scoring of political, contractual, and regulatory risks. Some DFIs are reported as better equipped to undertake such analysis than others.83

Lack of equity coverage: There are limited risk mitigation instruments that provide coverage for equity holders. Thus, companies (especially local companies) investing equity into projects can sometimes only ensure their debt, leaving the general interests of their shareholders unprotected against non-commercial and political risk. However, the World Bank PCG can be structured to offer protection to the interests of equity investors by providing downside protection.

Retrenchment of Private Sector: Expansion of risk mitigation activity by DFIs requires private sector engagement. Financial crises and failed privatizations have soured the enthusiasm of many private sector companies and finance institutions.

Bailout Concern: The long history of “bailouts” has made policy makers wary of any type of guarantee arrangement that might encourage reckless private sector risk-taking at taxpayer expense.

Cross-Default Concerns & Government Focus (rather than private sector): If a country defaults on a donor-guaranteed obligation, the donor institution may be required by its operating rules of cross-default to shut down its entire program for that country, prohibiting any new lending and further disbursements under approved loans. Expanding risk mitigation programs would also mean increasing exposure to projects managed by the private sector, rather than working with governments with which DFIs have a long working relationship.84

Other Issues

Lack of Product Awareness: A number of market participants have stated that the low utilization of risk mitigation instruments is largely due to the limited awareness of risk mitigation instruments and understanding of how they work. This results in an uncertainty over the ability of these types of complex instruments to lower the cost of debt and/or equity, and actually serve to reliably protect investors.85 For risk mitigation products to be valued accurately by the capital markets and contribute to reducing the cost of financing, the contract documentation, dispute resolution, and claims processing procedures must be well defined with successful track records that are made publically available.

Need to create innovative applications for infrastructure: The risks impeding investment in African infrastructure are often very high, covering not just political issues but also payment risks. The current market in Africa is focused mainly on PRI rather than NPI. To meet the needs of institutional investors, the market will need to be motivated to develop new approaches that cover credit and payment risks.

In conclusion, the underlying reasons for historically low utilization of risk mitigation instruments are extremely complex. As with the provision of public finance, it is important to increase the mobilization of private sector providers of risk mitigation and develop innovative risk mitigation solutions applications that are considered reliable for investors. The new mantra that needs to be aligned with “blended finance” is “blended risk mitigation.”
5.7 The Essential Role of Private Sector in Scaling of Risk Mitigation Instruments: Private insurers first appeared in the early 1970s and became more active after the debt crisis. The private political risk insurance market experienced a dramatic growth in the 1990s with international investors enjoying a great breadth and depth of choices in the investment insurance market.

As noted in the earlier section, private insurers now compete with public sector providers and sometimes issue insurance with no public sector involvement. Experts note the special value-added of private insurers given greater flexibility and faster decision-making processes.

Also private insurers are closer to the market than public insurers, with global operations and relationships with wide spectrums of companies and investors. In-country offices also provide added ability to source potential projects. Public sector insurers often look to private sector insurers and brokers to source potential deals.

Another issue is the requirement for extensive technical expertise and re-sourcing to design the specific policy for an infrastructure project. Insuring an investment against political risk requires a proper and precise specification of those political or credit events that are to be covered under an insurance policy. Once the event occurs, coverage and the exact amount of insurance recovery cannot be in dispute.

Example: How MIGA uses private sector insurers to scale risk mitigation

Since 1997, MIGA has used reinsurance to leverage its investment guarantee capacity, manage the risk profile of its portfolio, and foster the growth of the private political risk insurance market. MIGA reports that it mobilized over $US 8 billion from public and private reinsurers over last three years. Whenever a project exceeds MIGA’s own capacity, the agency reinsures itself, through a syndication process, with private and public sector (re)insurance companies. MIGA’s main programs are treaty and facultative reinsurance.

Critical Roles of Private Sector Insurance Companies and Brokers

It is important to note the pivotal role of private insurers and brokers in aggregating the public and private sector risk mitigation providers for large infrastructure transactions. Their roles include the following:

- Identifying potential projects that require risk mitigation;
- Providing advisory support on investability requirements to access risk mitigation (“path to recovery” required);
- Assembling the public and private sector providers based on their eligibility criteria; and
- Negotiating the deal terms for the client and the risk mitigation providers (e.g., coverage, terms, pricing, triggers, etc.).

Examples of brokers and insurers that have successfully created large syndications of risk mitigation coverage for African infrastructure projects include Allianz, Marsh, Sovereign, and Risk Cooperative.

6.0 Critical Factors Enabling Scaled Risk Mitigation

The prior section on the risk mitigation industry coupled with expert interviews has enabled a preliminary identification of critical factors instrumental in scaling risk mitigation for African infrastructure.

The below table below presents preliminary assessments that will be tested and refined for the final version of this report.

<table>
<thead>
<tr>
<th>Critical Factor</th>
<th>Public Sector Capacities</th>
<th>Private Sector Capacities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ability to source “investable” transactions</td>
<td>• Relationships with public and private insurers, reinsurers, and brokers • Lack of country offices and low marketing budgets</td>
<td>• Over 60 insurers, most large companies with offices in developing countries and expansive client networks • Brokers with vast insurance networks and extensive experience in Africa • Ability to leverage current relationships with international pension funds and investors for African transactions</td>
</tr>
<tr>
<td>2. Ability to arrange large syndications to cover African infrastructure risks (one single transaction could be up to US$3 billion)</td>
<td>• Some DFIs have very low internal limits (US$10 million per transaction) • Slow decision-making processes reduce ability to broker deals (reliance on private sector brokers) • Often requirement for extensive due diligence and site visits</td>
<td>• Ability to make quick decisions with no site visits if deal is well-structured</td>
</tr>
<tr>
<td>Critical Factor</td>
<td>Public Sector Capacities</td>
<td>Private Sector Capacities</td>
</tr>
<tr>
<td>----------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>3. Ability to structure complex deals</td>
<td>• Staff often is not available to invest in the complex process of solving through the issues and solutions to a complex infrastructure project</td>
<td>• Brokers and insurers may be willing to dedicate resources and time to developing structuring options that are acceptable to insurers and reinsurers</td>
</tr>
<tr>
<td>4. Ability to cover investments irrespective of investment origin</td>
<td>• Eligibility often restricted to projects with home country investors and suppliers</td>
<td>• No eligibility requirements related to sources of funds or suppliers</td>
</tr>
<tr>
<td>5. Ability to cover projects that do not meet conditionality</td>
<td>• Eligibility often dependent on non-financial conditions</td>
<td>• Eligibility usually based exclusively on credit and finance terms</td>
</tr>
<tr>
<td>6. Ability to create new products that cover 100% credit risk</td>
<td>• Most public providers do not cover credit risk</td>
<td>• Private sector insurers offer full credit insurance which is needed by many institutional investors and motivated to develop Africa infrastructure as new market</td>
</tr>
<tr>
<td></td>
<td>• However, ability to provide first loss can be used in large insurance syndication</td>
<td></td>
</tr>
</tbody>
</table>

Source: Interviews with public and private providers of risk mitigation. Needs to be refined with further research.

### 6.1 Market and Coordination Failures Handicapping Finance Access for Africa Infrastructure

As noted in the prior section, there are large gaps that impede the ability of Africa’s infrastructure to access the required risk mitigation to meet the investability requirements of institutional and other investors. Key factors relate to the nature of the market itself that results in market and coordination failures especially with regard to the African infrastructure market.

The extremely low use of risk mitigation in Africa infrastructure projects is indicative of the complexity of the risk mitigation market, and daunting challenges of effectively using risk mitigation for any African infrastructure project.

Moreover, the difficulty increases significantly when the transaction sizes are large given the need to coordinate with a larger number of risk mitigation providers in syndicating the risks per agreed upon exposure levels.

The need to allocate the risk allocations for a large Africa infrastructure project is critical given the high perception of African risk and recent US$ 1 billion loss of the Chinese ECA Sinosure from a guarantee provided to a US$ 3.3 loan from the China Export-Import Bank to the Addis Ababa-Djibouti Railway Project.

The market and coordination failures for the risk mitigation sector are therefore very high in Africa. Contributing market factors include the following:

The risk mitigation market itself is highly complex with hundreds of risk mitigation providers from the public and private sectors. Most risk mitigation providers are located in Europe, the United States, and Bermuda. While there are some public sector providers of risk mitigation in Africa, the existing levels of coverage are very small when compared with the scale and scope of required risk mitigation required for Africa’s infrastructure, especially the large PIDA Projects.

The eligibility requirements and application processes vary greatly between providers. Each infrastructure project requires significant levels of highly sophisticated support in identifying how best to use risk mitigation instruments and which instruments might be suitable.

There are a number of different kinds of products and coverages offered across the public and private sectors.

Given the scale and nature of risks, the use of several risk instruments may be required for a single African infrastructure project.

For each product, a coordinating entity is required to align several providers for each risk mitigation policy in terms of coverage, payment terms, paths to recovery, and arbitration modalities.

In essence there are large “market and coordination failures” in the risk mitigation market that disadvantage Africa in sourcing effective streamlined sources of risk mitigation support for its infrastructure projects.

A “market-making coordination mechanism” is needed to close the market gap, providing guidance on market criteria and risk mitigation options, and providing the needed coordination between various risk mitigation providers for each project.

As a result, Africa needs to have an effective coordination mechanism for scaling risk mitigation for its infrastructure projects.

The next section set forth possible approaches to scaling the use of risk mitigation instruments for African infrastructure highlighting these critical factors.
REPORT PART TWO:
Defining Options for an African Mechanism to Scale Access to Risk Mitigation
7.0 Need for an African Infrastructure Guarantee Mechanism (AIGM)

As noted earlier in the report, the use of risk mitigation in Africa for its infrastructure projects has been extremely low. For example, according to Reuters Thompson Project Finance League Tables, the total amount of guarantees provided worldwide by Development Finance Institutions (DFIs) in 2017 for infrastructure projects was only US$500 million and only provided by one single DFI, the World Bank Group. In contrast, Export Credit Agencies (ECAs) were reported as providing over US$ 8 billion in guarantees worldwide.

Expert Consultations: To address these issues, in 2018 NEPAD organized the African Guarantee Roundtable Meeting as part of the Victoria Falls NEPAD Strategic Dialogue to bring together experts and various stakeholders to provide suggestions on ways to leverage risk mitigation and guarantee instruments.

Experts agreed that the African risk mitigation approach would need to:

- Utilise the risk mitigation instruments already available,
- Identify the risk mitigation gaps against institutional investment requirements, and
- Develop solutions that can scale the mitigation capacity and coverage needed to mobilize institutional and other investment to help address Africa’s huge financing gap.

Experts also stressed the need to improve ease of access to risk mitigation instruments, reducing transaction costs. It was noted that the application processes to access risk mitigation instruments are complicated with no uniform process.

While there are many important risk mitigation initiatives now being launched by DFIs and the G-20, the fact is that Africa is in immediate need of streamlined risk mitigation solutions that can be useful today in mobilizing institutional and other investment financing African infrastructure development and operation. The Africa Co-Guarantee Platform just launched at the Africa Investment Forum with five public sector risk mitigation providers will serve as a critical pillar of a new streamlined approach for public sector providers of risk mitigation.

Need for Blended Risk Mitigation: A pivotal opportunity is presented by the increasing role of private sector risk mitigation providers (including insurers, reinsurers, and brokers) in developing countries, including Africa. Reports have documented the increasing provision of risk mitigation from the private sector, with keen interest in developing risk mitigation solutions for investors (debt and equity) in Africa’s infrastructure. Leading private sector insurers and brokers can be activated and scaled, leveraging targeted contributions from the public sector (such as first loss). In this way, “blended finance” can be enhanced with its sister mantra “blended risk mitigation.”

In short, the private sector is needed to serve as a pivotal partner in scaling risk mitigation, expanding the current emphasis on “blended finance” to include a sister mantra - “blended risk mitigation.”

8.0 Identifying AIGM Implementation Options

The experts at the NEPAD meeting identified four options to implement AIGM and debated the advantages and disadvantages of each option. A summary of the options is as follows:

- **Option 1:** Create a new Facility that would providing institutional investors with 100% financial guarantees for their investment in Africa’s infrastructure assets (including project development and operation and other infrastructure investment vehicles such as bonds, funds, companies, etc.). This new African-focused guarantee facility could be developed based on best practices from similar 100% financial guarantees used in developed and developing countries to enable mainstream institutional investment into infrastructure. However, setting up a new large African guarantor would take very significant time and resources, especially for the scale required to cover Africa’s large infrastructure needs.

- **Option 2:** Crowd-in existing risk mitigation providers to implement a joint application process that would be managed by AIGM. While this option would reduce transaction costs, it does not address the issues of how to increase the lack in African risk mitigation coverage or the need to increase existing capacity for risk mitigation. Moreover, focusing on just this solution is risky as it may not succeed. (For example, the efforts of the Project Preparation Network to create a common application process for Africa’s Project Preparation Facilities have not yet been realized.)

- **Option 3:** Request existing risk mitigation providers to implement a joint application process that would be managed by AIGM. While this option would reduce transaction costs, it does not address the issues of how to increase the lack in African risk mitigation coverage or the need to increase existing capacity for risk mitigation. Moreover, focusing on just this solution is risky as it may not succeed. (For example, the efforts of the Project Preparation Network to create a common application process for Africa’s Project Preparation Facilities have not yet been realized.)

- **Option 4:** Create a technical brokerage platform to scale blended market-based risk mitigation. This option is aimed at using market incentives to catalyse the creation of an expanded African market in specialist infrastructure risk mitigation and reinsurance, scaling the commercial use of guarantees and credit enhancements that meet the strict investment requirements of institutional investors.

The approach implemented through this options would be to create a one-stop-market aggregating the sources of demand (infrastructure assets) and supply (providers of risk mitigation), crowds in existing public and private providers of risk mitigation, global investment insurers, and credit enhancement leaders and instruments from private and public sector institutions.
The approach implemented through this options would be to create a one-stop-market aggregating the sources of demand (infrastructure assets) and supply (providers of risk mitigation), crowding in existing public and private providers of risk mitigation, global investment insurers, and credit enhancement leaders and instruments from private and public sector institutions.

Participants would be encouraged to focus on specific African infrastructure transactions, expanding their relationships and partnerships through brokerage and reinsurance working with host governments, DFIs, development partners, and the private sector.

Comparison: The fourth blended market-based AIGM approach was considered the most effective and feasible option as it engages the providers of risk mitigation to address the challenges of mobilizing institutional investment through increasing coverage, developing reinsurance and brokering arrangements, and other risk mitigation partnerships as needed. The approach could possibly serve as a hybrid of the three above options above, catalysing the leverage of existing risk mitigation instruments and increasing ease of access while developing new risk mitigation solutions as needed. This option also has the potential to increase the scale and effectiveness of risk mitigation instruments based on the complexities and diverse range of African infrastructure assets that require institutional investment. For example, insurance companies have reported the critical use of first loss facilities for accessing institutional investment provided by a public sector entity as part of a risk mitigation structure.

However, the success of the all the four options – including the fourth blended scheme - would depend on: (1) the availability of investable projects and (2) the activation of incentives for the existing participants in the risk mitigation market across the public and private sectors. The four options are presented in the below table and assessed against the factors presented in the prior section. The fourth blended market-based option scored highest when evaluated against the risk mitigation factors outlined in the prior section, assuming the adequate provision of commercial incentives and investable projects.

### Table 7: Assessment of AIGM Options Against Critical Factors

(based on initial interviews)

<table>
<thead>
<tr>
<th>Critical Factor</th>
<th>Option 1: New 100% Facility</th>
<th>Option 2: One-Stop Referral System</th>
<th>Option 3: Joint Application Process</th>
<th>Option 4: Blended Market-Based System</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ability to source “investable” transactions</td>
<td>Delayed by long lead time to set up facility</td>
<td>Improves sourcing capacity</td>
<td>Delayed by long lead time &amp; risk of failure (different project risks &amp; provider internal requirements)</td>
<td>Greatly improved given private sector networks</td>
</tr>
<tr>
<td>2. Ability to arrange large syndications to cover African infrastructure risks</td>
<td>Delayed by long lead time/risk to raise capital</td>
<td>Improves syndication capacity</td>
<td>Delayed by long lead time &amp; risk of failure</td>
<td>Greatly improved given private sector networks</td>
</tr>
<tr>
<td>3. Ability to structure complex deals</td>
<td>Delayed by long lead time to set up facility</td>
<td>No impact (unless add expert staff)</td>
<td>No impact (unless add analytical staff)</td>
<td>Greatly improved given new innovative blended solutions (e.g., first loss)</td>
</tr>
<tr>
<td>4. Ability to cover investments irrespective of investment origin</td>
<td>Depends on owners &amp; rules</td>
<td>Depends on participants</td>
<td>Depends on participants</td>
<td>Ability to crowd in different market segments</td>
</tr>
<tr>
<td>5. Ability to cover projects that do not meet DFI conditionality</td>
<td>Depends on owners &amp; rules</td>
<td>Depends on participants</td>
<td>Depends on participants</td>
<td>Yes using private sector providers</td>
</tr>
<tr>
<td>6. Ability to create new products that cover 100% credit risk</td>
<td>Yes provided ability to raise sufficient capital</td>
<td>Limited (unless market creates new 100% credit guarantees)</td>
<td>No</td>
<td>Limited (unless market creates new 100% credit guarantees</td>
</tr>
</tbody>
</table>

Source: Interviews with public and private providers of risk mitigation.
The above simple comparison shows the potential significant benefits of undertaking a market-based blended risk mitigation approach (option four) that uses a commercial brokerage platform and mobilizes private sector providers of risk mitigation.

In short, the potential for activating the capacities, flexibility, and innovation of private sector providers of risk mitigation will yield greater benefits for African infrastructure by helping to increase the size of available coverage; the risks that are covered, and address the inherent complexities and requirements of large African projects, especially PIDA Projects.

**It is important to underscore that aid effectiveness can be improved by using the “blended risk mitigation” approach, targeting limited public resources to cover the risks unacceptable to the private sector that are required to access institutional investment.**

8.1 Identifying Critical AIGM Implementation Actions: For AIGM to succeed in scaling up risk mitigation, it needs to be designed and implemented based on the best practices and critical success factors related to the risk mitigation sector. Adopting new ways of public and private sector collaboration will pose inherent challenges. As noted in many initiatives such as the World Economic 2006 Report on how to mobilize DFIs for development, the major challenge for DFIs and their shareholder governments is to move towards a model that places private investment mobilization as central to the success of their development mission.

The decade old debate on how to scale “blended finance” provides keen insights on how to develop and implement AIGM so that it can deliver on scaling “blended risk mitigation” unblocking access to institutional investment.

Public and private providers of risk mitigation provided input into AIGM’s required design and approach noting challenges limiting African risk mitigation for infrastructure that need to be addressed. Key reported challenges included the following:

**Lack of investable African infrastructure projects:** In order to be eligible for risk mitigation instruments, Africa’s infrastructure projects need to meet the market investability requirements working with experienced project developers and transaction advisors. The public sector will need to work more closely with the private sector to invest projects are properly structured and developed.

**Insufficient risk mitigation capacity in public sector:** Given constrained limits on transactions, public sector providers have to include reinsurers to have enough capacity to mitigate African infrastructure projects. To illustrate, MIGA’s total risk mitigation issuance for all African projects (infrastructure and corporate) was 1 – 1.4% of the annual financing gap for Africa infrastructure. Africa’s risk mitigation agency ATI is reported to be limited to US$10 million per project on its balance sheet.

**Need to incentivise increased private sector risk mitigation with predictable financial returns:** For AIGM to succeed, there needs to be a credible business model that incentives participants to invest in delivering the required risk mitigation support and services.

**Need for extensive technical support in defining innovative blended risk mitigation solutions for each infrastructure project:** Developing an effective blended finance risk mitigation approach requires highly-skilled experts and dedicated teamwork for long time periods, often over many months. Many of the risks impeding investment will require a combination of different types of risk mitigation. It will be therefore be critical to engage highly skilled finance and risk mitigation experts working with targeted debt and equity investors and providers of public and private risk mitigation.

The above challenges need to be offset by the design of AIGM, with explicit mapping of risk and mitigants.

8.2 Critical Success Factors: Market experts also provided initial views on the critical success factors that would need to drive the AIGM approach, design, and governance:

1) **Provide Project Owners with best practice investability criteria**

The decades the issue has been the lack of investable projects. Providing project owners with clear guidance on the required project structure and design will increase their ability to develop suitable projects that can be investable and eligible for risk mitigation coverage. The standard project finance criteria used by the international project finance is required to ensure investability to institutional and other investors.

2) **Support the development of investable projects**

As noted earlier, risk mitigation cannot be applied to projects that are not properly structured and designed using project finance techniques. Risk mitigation instruments have limited usefulness if not backed by substantially enhanced project development capacities. Ill-prepared governments are likely to take on excessive levels of risk, followed by a rapidly depleting ability to deliver when the guarantees are called. As evidenced by many failed infrastructure projects, the resulting severe problems and political backlash can become counterproductive, undermining the perceived and actual usefulness of infrastructure investment. Lack of project development funds is therefore a key bottleneck.

3) **Leverage the private sector**

As noted earlier, for risk mitigation to be scaled in size and scope harnessing the needed flexibility and innovativeness to meet investment requirements, the AIGM approach needs to crowd in private sector providers as originators, co-insurers, reinsurers, and syndicators. The aim needs to be “blended risk mitigation,” leveraging the capacity of private sector risk mitigation.

As noted in the prior sections, the private sector has the willingness and ability to drive the scaling up of effective risk mitigation use for African infrastructure. Large projects, especially transboundary PIDA Projects present very complex financing challenges that will require specialized innovative technical solutions from experienced financial experts.
4) Ensure AIGM is operated on a commercial non-politicized basis

To leverage the private sector and achieve the needed scale and scope, its operation and governance needs to be based on market principles of transparency, technical evaluations, and commercial viability.

- Engage one or more insurance broker to provide the essential functions of project identification, structuring, aggregation, standardization, and problem solving.
- Brokerage costs can be provided through the commissions earned on insurance, enabling a no-cost or low-cost brokerage operation.
- Ensure AIGM governance protects it from political interference affecting risk mitigation decisions that could result in losses.

5) Ensure the inclusion of highly skilled experts to develop deal structures and viable paths for recovery

As noted, AIGM will need to engage highly skilled finance and risk mitigation experts to interface with targeted debt and equity investors and providers of public and private risk mitigation.

6) Provide incentives & performance metrics

As noted in the earlier section, many DFIs have been trying to transform themselves from being exclusive lenders to being market makers that mobilize meaningful levels of private sector finance. Navigating this transition from direct lender of official funds to innovative enabler of private investment requires a revolution in the culture and processes of development institutions, which have historically focused on transactions with government entities. AIGM can provide incentives and performance metrics to showcase DFI participation and also ways to leverage their impact working with private sector providers of risk mitigation and investment. Examples of performance metrics to consider are: Official Sector Leverage Indicators (measuring the amount of private sector risk mitigation and capital mobilized by each transaction); Transaction Effectiveness Indicators (such as transaction costs, time periods for approval, development impact, and client evaluations); and Capacity-Building Indicators (such as extent of project preparation technical and funding support, etc.).

Therefore the development of this market-based blended scheme option would require the use of a commercial technical platform that incentivises the intensive engagement of risk mitigation providers (public and private) and others in the risk mitigation ecosystem (e.g., reinsurers, brokers, financial advisors, risk mitigation experts, project developers, bankers, etc.).

9.0 The Way Forward - Next Steps

The above potential options for an African Infrastructure Guarantee Mechanism (AIGM) are examples of how the mechanism could operate. This preliminary outline of optional approaches is intended to facilitate a technical discussion between risk mitigation providers from the public and private sectors. It is critical that any initiative be complementary to existing instruments and processes, activating the incentives and processes that will enable increased risk mitigation capacity to significantly increase investment in Africa’s infrastructure. This section summarises the requirements and unique role of AIGM and next steps for developing a blended risk mitigation mechanism.

The political imperative & opportunity:

The urgency of action is agreed to by all stakeholders. The opportunity is also clear: The financing required by African governments for delivering on Africa’s infrastructure is estimated at over US$120 billion dollar a year. Institutional investors (pension funds, Sovereign Wealth Funds, insurance companies) are interested in increasing their investments in infrastructure to meet their financial performance requirements as they are faced with low interest rate environments and infrastructure assets can potentially provide them with predictable inflation-adjusted cash flows that have low correlations with existing investment returns. The need for significant amounts of institutional investment is magnified by the reduced amount of available public funding and reduced bank finance available in today’s global infrastructure market.

As noted earlier, the special leadership role of African institutional investors is also compelling: Currently holding over US$500 billion in assets under management, African institutional investors are increasingly seeking to partner with African governments through the 5% Agenda’s Institutional Investor Public Partnership (IIPP), a framework proposed by African pension and sovereign funds to increase their allocations in African infrastructure investments to 5% of total assets under management. Endorsed by African governments and Heads of State, the 5% Agenda IIPP is the basis for the n+!*ew partnership with institutional investors to increase their participation and allocations to African infrastructure as an investable asset class.

Using risk mitigation to unblocking access to finance: As stressed in this report, addressing risks is imperative to mainstream investment mobilisation for Africa’s infrastructure. Risk mitigation instruments and credit enhancements have been identified as an essential feature of the IIPP framework for institutional investors to meet their fiduciary investment requirements and mitigate real and perceived risks related to infrastructure development and construction, credit, currency, liquidity, and political interference.

The use of guarantees and risk mitigation instruments (such as PRI and non-payment insurance) have proved to be a critical success factor in unlocking access to institutional investment worldwide. Therefore, to scale institutional investment, there is the concurrent need to scale global African risk mitigation to address these perceived and real risks of African infrastructure.

As a result, in response to African institutional investors calls for additional African risk mitigation, the African Union (AU) and its implementing Agency for transboundary infrastructure NEPAD, are advocating for the establishment of the “African Infrastructure Guarantee Mechanism” (AIGM) that can enable the immediate scaling up of institutional investment in Africa’s infrastructure.
The unique role of AIGM in addressing market & coordination failures: As noted in the report, there are large gaps that impede the ability of Africa’s infrastructure to access the required risk mitigation to meet the investability requirements of institutional and other investors. The risk mitigation market is highly complex with hundreds of risk mitigation providers from the public and private sectors, with most providers located in Europe, the United States, and Bermuda. While there are some public sector providers of risk mitigation in Africa, the existing levels of coverage are very small when compared with the scale and scope of required risk mitigation required for Africa’s infrastructure, especially the large PIDA Projects.

Moreover, each infrastructure project requires significant levels of highly sophisticated technical support in identifying how best to use risk mitigation instruments and which instruments might be suitable. Given the scale and nature of risks, the use of several risk instruments may be required with several providers needing to align their coverage and payment terms for each instrument. Innovative approaches will need to be developed and scaled, aimed at mobilising the optimal amount of private sector support with limited targeted support from the public sector.

Africa needs to have an effective coordination mechanism for scaling risk mitigation for its infrastructure projects:

- There is a large market of African infrastructure projects
- There is a large supply of public and private sector risk mitigation instruments.

A “market-making mechanism” is needed to close the market gap, providing guidance on market criteria, risk mitigation options, and coordination. In essence AIGM will need to be explicitly designed and structured to address “market and coordination failures.”

To address these market and coordination failures, the “African Infrastructure Guarantee Mechanism” (AIGM) can serve as a coordination and risk mitigation brokerage function, leveraging existing capacity and catalysing the risk mitigation market to add in the missing scale and coverage required for institutional investors.

Next Steps: To move forward, providers of risk mitigation from the public and private sectors need to be engaged in open technical discussions on the optimal ways to implement AIGM as an aggregated risk mitigation delivery mechanism. AIGM will need to leverage all the efforts currently being undertaken through existing risk mitigation instruments and initiatives as well as develop new risk mitigation solutions to uncovered risks impeding assess to finance. The Africa Co-Guarantee Platform just launched at the Africa Investment Forum by AfDB including five public sector risk mitigation providers will serve as a critical pillar of this new “blended risk mitigation” approach.

The first step is to engage public and private sector experts participating in the risk mitigation market and overall ecosystem in defining an actionable business plan for AIGM. A key issue is to define how best to align incentives and processes so AIGM can operate as an African streamlined and effective blended risk mitigation mechanism providing Africa’s infrastructure projects with cost-effective access to the significant risk mitigation required for institutional investment, especially in the large transboundary regional projects.

The engagement of the existing private sector entities interested in Africa will be critical in designing a strategy that catalyses the creation of an African market in specialist infrastructure risk mitigation syndications, scaling the commercial use of guarantees and risk mitigation instruments that meet the strict investment requirements of institutional investors.

Define a practical market-based technical approach: A market-based approach would create a market aggregating the sources of demand (infrastructure assets) and supply (providers of risk mitigation), crowding in existing providers of risk mitigation, global investment insurers, and credit enhancement leaders and instruments from private and public sector institutions.

For AIGM to be successful, technical approaches will need to be defined that address the specific African challenges noted in this report. The approach will need to address the following market requirements:

- Lack of bankable projects eligible for risk mitigation: Need to increase the number of African infrastructure projects that are prepared and structured based on market investability criteria (also used by risk mitigation providers);
- Need to further activate interest and capacity of private sector (i.e., increase market incentives that can be activated to increase access to existing products, especially non-payment and credit insurance);
- Need to target public sector support where required to crowd in private sector (e.g., scale structures that use first loss to reduce risk for institutional investors, etc.);
- Develop and scale new risk mitigation products (i.e., based on input from institutional and other investors, develop “risk solutions” that expand coverage to risks that cannot be covered with today’s products); and
- Need to prove the model and build a successful track record with pilot projects (i.e., identify immediate African projects that can serve as a focal point for AIGM implementation).

AIGM structure: To be successful, AIGM will need to adhere to best practices for financial intermediaries and build on precedent for scaling risk mitigation. First and foremost, it will need to be managed by highly experienced infrastructure risk mitigation experts and brokers. There will need to be a transparent and technical structure that enables candid guidance and transparent input from advisory committees consisting of institutional investors, providers of risk mitigation, African government PPP professionals, commercial project developers, and providers of project preparation support.
Example of a market-based technical approach: The design of AIGM will need to be informed by examples of other risk mitigation mechanisms that have been developed by the marketplace and are operating successfully. One such example is the Aircraft Finance Insurance Consortium (AFIC),\textsuperscript{94}established to enable the buyers of Boeing airplanes to easily access bank loans given the availability of non-payment insurance (NPI) that protect the banks from any debt defaults.

Boeing explains the overall genesis and operation of AFIC as follows:

\begin{itemize}
  \item “As part of its charter to find the most efficient aircraft financing solutions for customers, Boeing Capital Corporation (BCC) engaged in new market development to bring insurance risk capital to aircraft finance.
  \item BCC collaborated with the private insurance company Marsh to facilitate the creation of the Aircraft Finance Insurance Consortium (AFIC) in 2017. It is important to note that the manager of the AFIC platform is a global brokerage firm with specified underwriters.\textsuperscript{95}
  \item AFIC consists of four insurers (Allianz, Axis Capital, Endurance/Sompo International and Fidelis) that issue an AFIC non-payment insurance policy (ANPI) to cover a lender’s credit, aircraft residual and jurisdiction risks.
  \item Marsh manages and administers the platform from business origination [the buyer of the plane].
  \item Due to the strength of the insurance companies, AFIC is an efficient source of financing those complements other new aircraft funding markets for Boeing. More than $1 billion of new airplane deliveries in 2017 were supported by AFIC. Given the early success of this new market, stable growth is projected over the years to come.”
\end{itemize}

Towards this end, over the next four months the African Union Commission and NEPAD invites participants in the risk mitigation ecosystem (public and private sector) as well as the institutional investor community for their suggestions and participation in the development of a practical actionable AIGM plan to scale the required risk mitigation for African infrastructure.

Source: Boeing website
ANNEX: Examples of Risks and Solutions from the African Energy Sector

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**ANNEX:**

Examples of Risks and Solutions in the African Energy Sector

This section provides an overview of the issues faced by African energy projects and the current options for risk mitigation. The focus on Africa’s energy sector is due to the urgent need for solutions on increasing access to finance.

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**1.0 Background**

In the power sector, a power plant that is owned by private investors is called an Independent Power Producer (IPP), which often rely on payments from utilities. They often sell all or most of their electricity to the utility (off-taker) at agreed-upon monthly payments established under a Power Purchase Agreement (PPA). As a result, the creditworthiness of the off-taker is critical for private sector investment in African power projects.

Unfortunately, the majority of African off-takers, especially in the power sector, are not deemed creditworthy by either African or international investors. Almost all the off-takers in Sub-Saharan Africa are owned by the state and operate as parastatal entities. The pension funds interviewed for this study that are currently exploring potential investment in the Africa power sector stated that they were not confident that utilities on the African continent are creditworthy off-takers at this time due to poor payment track records and issues with their balance sheets. Therefore private sector investors usually require some type of guarantee covering off-taker payments in order to invest in energy projects and related assets (e.g., funds, bonds, etc.).

The majority of IPP power projects in Africa have the same basic business model, relying on a PPA with the off-taker dictating the tariff at which the electricity is sold from the power project to the off-taker over a specified time period. For example, a 40 MW solar project in Ethiopia could have a 20-year PPA with the state utility selling electricity to the government at $0.09 per kWh. Investors into the project rely on the payment of principal (reimbursement of their investment) as well as their profits from the monthly payments paid by the state utility for the electricity generated and distributed to the grid to consumers and businesses. For this type of power project, the contract is based on an agreement with only one off-taker, so the sole source of revenue is one single off-taker.

The entire business model and revenue stream will rely on that one off-taker paying on time and the contracted amount. An example of the risk for investors is shown by a UK pension fund investment of £85 million into a wind project in East Africa in which the utility stops paying the contracted PPA payments to the project company. The wind farm will potentially run into liquidity issues and may not be able to remain operational, resulting in a loss of £85 million to the UK pension fund.

As a result, the creditworthiness of Africa’s off-takers and perceived ability to consistently meet monthly payment requirements is critical for obtaining investor confidence and financing for much needed energy investments across Africa. Due to a myriad of issues, utilities across Africa are perceived to have very high credit risk and therefore PPAs without credit enhancements are not seen to be ‘bankable’ by the majority of potential investors. This issue as to whether the off-taker will comply with the payment agreement in the PPA is called ‘payment risk’.

Another issue is that all PPAs have a termination provision in the PPA which will stipulate quite a large termination amount to be paid by the off-taker to the project company. The ability of the off-taker to pay this termination payment is also a concern for funders and adds to the risk profile of the asset.

**2.0 Credit and Payment Risk**

One of the major factors for investors looking at infrastructure projects in Africa is the creditworthiness of the “off-taker,” the entity responsible for paying service fees to the infrastructure provider. This can be a pivotal issue for many infrastructure projects where the project’s revenue is dependent on the future payback from a single entity.

Payment risk is the primary concern of institutional and other investors. If there are concerns with the creditworthiness of the entity responsible for making payments to the project company, there will be the need for a payment guarantee. For example, a road project may require a guarantee from the host government that it will pay back the road project company over a certain time period under a build, own, operate, transfer (BOOT) scheme.

A similar government guarantee may be required for a large fibre optic project where private investors financing the initial construction of the project will require guaranteed payments from the Ministry of Information, Communication and Technology over a defined time period to ensure that the project is financially viable.

There are a number of reasons why energy off-takers in Africa have creditworthiness issues. As noted earlier, most energy off-takers are state owned utilities that are currently not considered creditworthy off-taker by investors.

- **Cost-reflective tariffs**: Electricity tariffs remain very low and are heavily subsidised by the government. This is largely for political and social reasons as well as a lack of proper modelling as to how tariffs could be increased. As a result, there is a lack of cost-recovery. For example, if an IPP is selling electricity from their power plant to the grid at $0.10 kWh but the utility is selling this to the end consumer at $0.003 kWh, the service is provided at below cost. As a result, there has been pressure on governments to increase tariffs and create staggered pricing of tariffs based on different user categories (for example, residential and industrial users, low income and high income users, etc.).
• **Budget issues:** For the reasons stated above, utilities are not self-sufficient and rely heavily on government budgets for their survival. As a result, most utilities are unable to make commercial investments in order to increase their revenues. It also means that delays receiving budgets from central governments can disrupt their operations and cash flow, further aggravating poor balance sheets.

• **Payment collection issues:** Moreover, many utilities in Africa have difficulties collecting payment from electricity users. This can be due to an inability of customers to pay on time, inefficiency in regional offices, and unwillingness of companies and organisations to pay on time (this is largely true for government offices). There is an urgent need to digitalise billing, increase capacity, and as a result substantially increase utility revenues.

• **Technical issues:** Utilities also face poor grids and transmission lines which result in high losses of revenue. Another issue is a lack of technical capability in government institutions, which often need to rely on foreign governments and DFIs for technical assistance.

### 3.0 Risk Mitigants

The examples in the prior section demonstrate the essential precondition of risk mitigation to mobilize institutional and other private investment in African infrastructure development and operation. This section outlines examples of risk mitigation approaches.

#### 3.1 Sovereign Guarantees & Limitations

As noted in the previous section, the great majority of the state utilities in Africa have credit issues and therefore impede the mobilization of private investment absent the guarantees of creditworthy third parties. While many other factors also impede the development and investment in Africa’s energy and infrastructure sectors, the lack of creditworthy off-takers is considered the dominant investment bottleneck. Without credible off-takers, investors are unable to absorb the high payment risks and risk investment losses. In order to mitigate payment risk, investors therefore may ask creditworthy host governments to issue a sovereign guarantee that backs up the PPA. Usually the sovereign guarantee is a legal commitment from the host government’s Ministry of Finance, but sometimes the guarantees are limited to support letters. The guarantee would be paid out of the government’s budget and essentially underwrite the off-taker in the event that the utility defaults on the specified PPA payments.

To illustrate with a fictional example, a 50 MW wind farm in Nigeria has a PPA with the utility off-taker for 20 years. However, after two years the utility falls into serious financial trouble and has such a large backlog of payments due that it is unable to make its contracted PPA payments to the project company. Without a sovereign guarantee, there is very little that the IPP will be able to do apart from negotiating with the government and patiently waiting for payment. However, with a sovereign guarantee, the PPA will be backed up by the Ministry of Finance. In the event of payment default or delays, the government will be obliged to compensate the IPP out of their central budget based on the agreed upon terms in the sovereign guarantee.

An interesting use of a sovereign guarantee was for the NOOR 1 project in Morocco. The government issued a sovereign guarantee to the African Development Bank to cover the financial shortfall between low consumer payments and the higher payments due to the project company. The guarantee therefore covers the risk resulting from Moroccan Agency for Solar Energy paying more to the Project’s company than it receives from Moroccan electricity users.

While sovereign guarantees might seem the ideal solution for investors looking at infrastructure projects in Africa, the majority of governments are unwilling to issue them for various reasons. The main reason why sovereign guarantees are unattractive to African governments is because they become serious contingent liabilities for the government. The guarantee is essentially locking the government into a twenty-year agreement regardless of possible changes in government policies, the country’s economic health, or technology cost reductions. Energy prices could fall to levels far lower than what could be justified by the contracted PPA price.

Another main reason for the lack of sovereign guarantees is the impact on the country’s debt profile and increased financial vulnerability. It is also important to note that sovereign guarantees, even if issued, do not provide absolute certainty that the issuing government will pay the project company on time and for the entire contracted amount. Many African governments are not considered as creditworthy based on sovereign credit rating issued by rating agencies. For example, a credit risk advisor at AfDB explained that even when guarantees are in place, sometimes governments do not pay per the specified terms of the guarantee.

Therefore before relying on a sovereign guarantee, it is necessary to analyse the track record of the government, their financial ability and willingness to pay their obligations, and whether they have a history of paying guarantees. Some governments are known for always being prompt on payments, which makes it easier for them to secure loans and provide acceptable sovereign guarantees that unlock investment.

An example of an ineffective use of a sovereign guarantee is provided by the Songas Project in Tanzania. Songas utilises Tanzania’s domestic gas at the Songas gas field where it is processed and transported through a 225 Km pipeline to Dar Es Salaam where it is used in Songa’s 190MW Ubongo power plant. The project has a twenty-year PPA backed up by a sovereign guarantee. Adding an extra layer of protection, Songas is backed up by major government development banks. Globaleq has the majority ownership in Songas, with shareholding by two government development entities, CDC (UK) and Norfund (Norway). Despite having two major development funds involved and a sovereign guarantee issued for the project, Songas has encountered major payment issues.

The Tanzanian state-owned utility TANESCO has been in substantial arrears in its payments to SonGas despite threats by Songas to turn off the power plant.
3.2 Examples of Alternatives to Sovereign Guarantees

Given the complexities surrounding sovereign guarantees and the unwillingness and/or inability of many African governments to issue them, various solutions have emerged. This section of the report will outline and assess the various solutions. It is worth noting that all of these solutions can be used together to enhance a project’s credit enhancement and risk profile.

3.2.1 Government Letters of Support: In some countries where sovereign guarantees are not provided by host governments, a substitute means of government support has been provided through government letters of support. This is basically a signed letter from the government stating that they will support the project and commit to the agreements between the project owners and the government, covering the terms of the PPA and other critical government policies and/or actions.

Government letters of support enable governments to assure project owners and developers of their commitments, which in turn are used to mobilize investment. However, many infrastructure developers state that they have limited confidence in letters of support as sufficient standalone risk mitigants. Therefore, while government letters of support can be useful as part of a large bundle with other guarantees, they do very little to protect projects against payment defaults or a change of policies by host governments. An example of the inefficiency of ‘letters of support’ can be seen in Kenya where the government will not issue sovereign guarantees and instead issues what it calls, ‘strong letters of government support’. The government issued a letter of support for the Kinangop Wind Farm (KWF) in central Kenya. The US$144 million 60.8MW project was owned by KWF, a consortium of Norwegian private equity firm Norfund, South African asset manager Old Mutual, and Sydney-based Macquarie. Despite the ‘strong letter of government support’, local opposition to the project meant that it was eventually cancelled. It was placed in receivership and ended up as a subject of an International Chamber of Commerce arbitration. As a result of similar experiences like this, many project developers do not see any value in these letters and require a substantially more comprehensive credit guarantee

and/or risk mitigation in order to gain the confidence of investors.

The IMF, tasked with managing the debt and credit commitments of developing countries to avoid debt crises, also has policies that serve to constrain the issuance of sovereign guarantees in many countries. Also because a sovereign guarantee is seen as a liability on a government’s balance sheets, it can negatively impact on the country’s ability to attract capital from domestic and international markets, also impacting its sovereign credit rating.

For example, when the IMF and donors assess how much to lend a country, they will take into consideration how many guarantees the government has issued. Studies by the IMF have shown that when an economy is vulnerable to an economic downturn, excess government liabilities, including sovereign guarantees, can contribute to a national financial crisis.98

The IMF has also pointed out that governments can be poor at managing their contingent liabilities and monitoring debt levels. If a government issues a series of PPAs for renewable energy projects and guarantees them, this can lead to substantial increases in the country’s contingent liabilities. This will increase the country’s debt and potentially jeopardize the potential for future projects in that country, as the government no longer has the ability to issue more guarantees. In addition, a major concern for many African countries is that investors will reduce the amount they are willing to lend. This has led to many African countries prohibiting the issuance of sovereign guarantees.

3.2.2 Escrow Accounts: One risk mitigation mechanism used to protect project developers and investors is the establishment of liquidity escrow accounts so that if there are any payment default issues, this does not impact the cash flow of the project and ultimately bankrupt the whole project company. A liquidity escrow account enable the project to receive cash flow payments on time even if the off-taker stopped making payments, enabling the project to continue operations.

For example, AfDB is currently negotiating with the member states of Ruzizi III to establish an escrow account that will cover the project’s running costs. This escrow account will therefore avoid one country not paying its share and thus leading to dispute and hampering the project’s operation.

Despite escrow accounts serving a very practical purpose for infrastructure projects, they have been misused in cases where funds have been stolen. Another issue with escrows is inadequate funding from the host government(s). For example, if the host government(s) does not replenish the account, it breaks the agreement with the project owner, thus making the whole mechanism useless as a risk mitigant, with potential detrimental impact on the project and its investors.

3.2.3 Partial Credit and Risk Guarantees: Other common risk mitigation options are Partial Risk and Credit Guarantees, championed by the World Bank Group and also by other DFIs such as the African Development Bank (AfDB), USAID, and SIDA. Such instruments are growing in use. For example, project finance legal expert Norton Rose recently stated: “Clients are increasingly seeking World Bank guarantee coverage of non-debt-service-related government payment obligations not only in favour of private entities but also foreign public entities, where such payment obligations require credit enhancement if the project is to be bankable.”100

The World Bank’s guarantee policy requires that any project supported by a guarantee must contain comprehensive dispute resolution procedures. Therefore if a dispute arises, the government’s obligation needs to be explicitly detailed. In recent reforms, the World Bank has sought to differentiate between partial risk and partial credit guarantees and also use them as hybrid products based on the nature of risks for each project. Their utility for attracting new sources of finance is underscored, such as pension funds and Sovereign Wealth Funds.

The World Bank guarantees require the counter guarantees of host governments, which some host governments are not willing to provide. If the World Bank can subject host governments to cross-default clauses and suspension of disbursement on all projects funded through the Bank. As a result, the host government has a powerful incentive to abide by its contractual commitments and to undertake the policy, thus increasing confidence from investors.
While the DFI partial credit and risk guarantees have done a great deal to help unlock financing for much needed infrastructure projects in Africa, they are not without their issues. One major issue is that they are not cheap and off-takers perceived to have high credit risks have a high premium. While cost might be less than private sector insurers and there is a higher chance the guarantee will be issued by an DFI, the payment for guarantees means that projects are more expensive. As a result, developers and investors will require a higher tariff, which plays back into the argument that the whole industry is unsustainable at present with non-reflective consumer tariffs.

Another issue with the DFI partial credit and risk agreements is that they can often be tied to financing from that institution which can affect the competitiveness of private sector lenders to operate in the African infrastructure market. Also, given the huge infrastructure funding gap, there are only so many projects the DFIs and development partners can support and therefore there is an urgent need for greater risk mitigation capacity in the marketplace.

3.2.4 Put Call Option: A more recent solution to gain ground is the Put Call and Option Agreement (PCOA). This mechanism allows the project owner to exit the project and recover the investment if the PPA terminates early.

PCOAs can work two ways. If the termination of the PPA is due to a default by the off-taker, then the project owner can exercise the ‘put’ option, which obliges the host government to buy back the plant, or shares in the project company, at a level which will at least cover the outstanding date. The government is all also protected because there will be clauses in the agreement which gives the off-taker or government the right to use the ‘call option’ to require the project owner to sell their shares or assets to the government. As a result, both parties have some kind of protection, which can raise the confidence of investors.

To make the PCOA even more effective, for some of the early adopters of the agreement, there have been added layers of credit enhancements to further boost the confidence to investors. In the next section there is a case study outlining how a PCOA together with other credit enhancements managed to successful get a the Azura Edo power plant financed despite perceived high credit risks. The World Bank is reportedly very excited about this achievement to reach financially close despite difficult conditions, and is looking at how they can roll out the model for other infrastructure projects across Africa.

Despite the early success of the PCOA in enabling a few difficult projects to reach financial close, there remains concerns about the ability for governments to buy back the assets. The concern relates to the difficult economic situations in many African countries.

Concerns will also arise about whether the project has become a non-operating entity, if the government will be able to operate the project profitably, or sell it on to a third party.

4.0 Case Studies

The above issues are evidenced in actual transactions in African and worldwide. This section provides two case studies that illustrate risk impediments and solutions.

African Case Study: Azura-Edo Power Plant (Nigeria)
The Azura power plant project is a 450-500 MW gas-fired open cycle power plant located in the North Eastern outskirts of Benin City in Edo, Nigeria, with an estimated project cost of US$877 million. It is part of a 2,000MW IPP facility being developed near Benin City in Edo State, Nigeria. Energy projects in Nigeria have long suffered from payment defaults and contractual issues with the state utilities.

As a result, Nigeria has deteriorated rapidly into a power crisis that has crippled the economy and led to serious losses. Nigeria’s power plants have a combined capacity of around 6000 MW but usually runs at 3000 MW but roughly 35% of the power generated is either lost in transmission or given away. Tariffs are often set too low and distributors often fail to bill correctly or are simply not able to collect at all. The failure for bills to be collected properly, plus the inability for utilities to pay leads to distressed balance sheets and an inability for the utilities to borrow or raise financing. And in the end, around 42% of the Nigerian population have no access to power.

In order to turn around the situation, the Nigerian Government called for investors to structure the project so it could be investable and secure the required private sector funding. As a result, over 20 major investors were brought together to find ways to structure the project. The principal equity investors include Amaya Capital, American Capital Energy & Infrastructure, and Aldwych International. A variety of public and private lenders are providing US$622 million of debt finance. They include IFC, Netherlands Development Finance Co, foreign banks (Standard Chartered and South Africa’s Rand Merchant Bank), and Nigeria’s state-owned Bank of Industry (which is providing funds in Naira to cover the project’s local currency costs).

The Azura-Edo Project has been structured in a unique way, enabling it to reach financial close in January 2016. This was done by providing a unique form of insurance: a ‘put call option’ agreement negotiated with the Nigerian Ministry of Finance. This put call option releases Azura-Edo from selling electricity to the state if the Nigerian Bulk Electricity Trading does not pay for the power it takes or if the supply of gas is cut off. If this happens, Azura-Edo can force the government to buy the plant from its investors through a standard arbitration process. The agreement also outlines the value of the plant if such a situation arises. This put-call option has now become a template for projects across Africa and is being used by several investors to develop projects. It is expected that this form of put call option will change the game in the energy sector and bring many more much needed energy projects to financial close. The key to the put call option is that both government and investors will benefit from it, which makes it more favourable than a sole government guarantee.

Azura-Edo also benefits from an extra layer of protection from a World Bank partial risk guarantee which states that if the utility defaults, the investors can immediately claim US$117 million through a letter of credit from a commercial bank. The Bank would then set about getting the rest of the money back and it is entitled to pause or cancel any of the loans or projects in the country until the dispute is settled.
The investors of the Azura-Edo also obtained additional political risk insurance from the World Bank’s Multilateral Investment Guarantee Agency (MIGA), which will cover as much as US$420 million in losses from war, terrorism or civil disturbance from repatriating profits from the plant. OPIC also provided an extra US$20 million in political risk coverage. This is a good example of the put call option being used with a range of partial risk guarantees and political risk insurance to create a holistic package to gain investor confidence and achieve financial close.

**International Case Study: Thames Tideway Project (UK)**

While there is quite a pressing need for guarantees and risk mitigation in Africa, it is important to point out that developed markets also need guarantees and risk mitigation to support infrastructure projects. However, most off-takers in developed countries have strong credit ratings so there is little need for sovereign guarantees. A good example of this is the Thames Tideway Project which required innovative and generous guarantees from the British government in order to access finance from pension funds.

The project illustrates many risk issues for infrastructure projects in developed countries. For example, the British government is about to launch a series of reforms, which will make it easier for pension funds to invest in infrastructure. One of the reforms, which is expected to be announced in the autumn, is to make it easier for several pension funds to pool their assets together. Interestingly, the biggest issue in the UK at the moment is the lack of projects to invest in.

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**Exhibit 1: The Map of the Thames Tideway Project**

A major issue deterring UK pension funds investing is that investment is asked for in early-stage development, creating too much uncertainty given their strict investment requirements and low risk appetite. British infrastructure funds have publicly stated that they would be more willing to invest in large energy projects if the government undertook some of the risks. This was the case for the ‘Thames Tideway Tunnel’, which put all the risks of the project such as the flooding of London subway off balance sheet and will essentially be backstopped by British taxpayers.

The approach used for financing the project is unusual, encompassing many risk mitigation supports from the British government. Unlike most projects, the investors will receive an income from the first day paid for by Thames Water’s 15 million customers. At the same time, the risks of construction, cost overruns, accidents, or any other incidents as well as financial risks, such as global collapse in credit, will be borne by taxpayers because the government is acting as guarantor. If the project exceeds the insurance level, the government support agreement will cover the extra costs. If the project cannot raise debt due to unforeseen reasons, then the Secretary of State will provide a back-up temporary liquidity facility under the Market Disruption Facility Agreement. In the event of costs overruns, the government will inject equity in order to cover the additional costs. If insolvency occurs, the government will step in and take over the debt and equity instruments giving certainty that the project will not go bankrupt.

Therefore the Thames Tideway Project illustrates the government risk mitigation interventions in a developed country to engage the private sector and capital. The need for public support is especially true for institutional investors who are more risk averse than other types of investors. While some critics of the project suggested that it might be cheaper for the government to own and develop the project itself, the British Treasury’s analysis concluded that if Thames Valley Water developed and managed the project it would end up being a far less efficient project.

In Africa, this is even more of an issue where pension funds are needed to boost the infrastructure sector but are often unwilling to invest in projects that are in development (greenfield projects) due to uncertainties during construction phase.
5.0 Examples of Infrastructure Initiatives

This section will outline a few initiatives that are using one or several of the mechanisms outlined above to increase investment in infrastructure in Africa and reduce risks.

Scaling Solar

The “Scaling Solar” initiative provides a holistic, one-stop shop for investors and developers by using the whole suite of World Bank products to de-risk large scale solar projects. Frustrated by the lack of progress in the African solar market despite massive potential, the World Bank Group set up scaling solar to provide a streamlined process for the development of solar projects in Africa. They initially identified four key problems with the solar sector in Africa: limited institutional capacity, inability to scale due to time consuming development processes, lack of competitively tendered projects, high transaction costs, and high perceived risks due to poor credit utility off-takers. All these problems served to drive up costs and tariffs. As a result, the World Bank Group set out to streamline the process and de-risk solar projects for investors.

The first step in the Scaling Solar process is for the team to conduct all the technical studies, lobby the government, and choose the most suitable land, which will be offered to the international market through a competitive tender. All the tender and project documents will be drawn up by the World Bank in order to eliminate negotiating. World Bank finance will be available to the tender winners but not compulsory. The aim is to get projects from concept to operations within two years. Due to intense competition, African governments only end up working with top tier high quality solar companies. The winner of the project will be also able to utilise World Bank credit and risk partial guarantees against off-taker credit risk, political risk insurance, and foreign currency hedging, substantially de-risking the project for investors.

The first of IFC’s scaling solar tenders took place in Zambia where they opened up with two large-scale projects. Italy’s Enel won the bid to build the US$40 million 28-MW Mosi-a-Tunya PV plant in the Lusaka South Multi-Facility Economic Zone. They are entering into a 25-year PPA with the state owned utility ZESCO.

The other project was won by a consortium of French Firm Neoen SAS and US-based First Solar to build a 45-MW solar plant. The winning bids were some of the lowest tariffs seen in the world: Neoen / First Solar bid 6.02 cents per kWh and Enel bid 7.84 cents per kWh. Both projects utilised partial risk guarantees against the credit risk from the off-taker and also political risk products from MIGA.

African Energy Guarantee Facility

The Africa Energy Guarantee Facility (AEGF) has the stated objective of providing risk mitigation and credit enhancement solutions to facilitate and increase private sector involvement in the African energy sector. The facility is a partnership between the African Trade Insurance Agency (ATI), the European Investment Bank (EIB), and Munich Re. The initiative, launched in March 2018, is the first dedicated reinsurance for renewable energy projects in Africa. The facility provides agreements of up to 15 years.

The way AEGF will work is that EIB will issue guarantees to Munich Re, one of the world’s largest and best-rated reinsurers, and then MunichRe will reinsure ATI. Receiving coverage from AEGF is not tied to any conditions related to finance and is open to any developer. There are only three conditions: the project must comply with the UN initiative Sustainable Energy for All (SE4All), have an EIB approved environmental and social impact assessment, and meet EIB procurement standards. The facility will offer insurance against sovereign or sub-sovereign non-payment under a PPA, breach of contract, currency inconvertibility, war, civil unrest and arbitration award default. Given the long tenor of the insurance, which the private insurance market is yet to offer, AEGF support will provide needed support to investors in renewable energy projects in Africa.

Africa GreenCo

Another innovative initiative is being led by Africa Greenco, a start-up that is aimed at developing an intermediary off-taker platform that trades power, thereby eliminating the need for sovereign and other guarantees. The platform, still in development, will utilise African power pools to provide IPPs with a creditworthy intermediary off-taker. Normally a IPP will only have one off-taker and therefore is very limited in options to whom it can sell its electricity. As noted earlier, due to the low credit ratings of most utilities in Africa, it is difficult to gain the confidence of investors when there is only one off-taker because if it defaults for whatever reason, the project would suffer serious financial losses.

In order to address this ongoing issue impeding investment into Africa’s renewable energy sector, African Greenco will utilise the power pools to offer IPPs a one-stop credible off-taker with a high credit rating, thereby helping the IPP to mobilize early-stage development investment. One of the benefits of this initiative is that Africa GreenCo will then have a choice of off-takers to choose from and not be tied down to one buyer, given several off-takers in Africa’s power pools.

After conducting a comprehensive feasibility study, Africa Greenco decided that the South African Power Pool (SAPP) would be the most suitable region in which to start operations. For example, if an IPP was to build a 50MW solar farm in Zambia, instead of just having an off-taker agreement with a Zambian utility, they could have a lead off-taker agreement with African Greenco, which would buy all their electricity. Africa Greenco would then sell it on to off-takers in the region through Power Sale Agreements (PSA). Obviously, this would only work with a well-developed power pool with efficient transmission lines.

If the state utility in Zambia had financial issues or a surplus of energy, Africa Greenco could utilise the power pool to sell the electricity to a utility in Zimbabwe. Africa Greenco also gives the off-taker more options as they can buy from different IPPs making the market more competitive and less vulnerable to disputes. To be operational, Africa Greenco requires a large investment in transmission lines and developing power pools. However, it could provide a ground-breaking platform, giving a new sustainable risk mitigation solution to the renewable energy and infrastructure sector in Africa.
Another interesting element of Africa Greenco is that African governments will have a stake in the operation, giving them a vested interest in the platform. The initiative also plans to streamline the development process for IPPs wishing to set up in the regions, therefore reducing risks and development costs for stakeholders. By becoming the main off-taker, the fiscal burden on the host governments will be reduced, leaving more funds available for infrastructure development and increasing much needed investment into the African power sector. The initiative is a very promising example of how the power sector can avoid the need for sovereign guarantees, creating a more dynamic power market, and subsequently unlocking and mobilising new financing channels for IPPs.

**Exhibit Two: The Conceptual Framework of Africa Greenco**

![Exhibit Two Diagram]

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7. Recent studies by the African Development Bank suggest that the continent’s infrastructure needs amount to US$130 to 170 billion a year, with a financing gap in the range US$68 to US$108 billion. See “African Economic Outlook, Financing infrastructure: Strategies and Options,” 2018.

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TCX was founded in 2007 by a group of development finance institutions, microfinance investment vehicles and donors to offer solutions to manage local currency risk in developing countries. TCX offers currency risk protection for 15 years or longer in almost 80 frontier and emerging market currencies, with coverage ranging from less than US$1 million to US$150 million.


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For example, see Willis website: https://blog.willis.com/2015/11/guide-to-comprehensive-nonpayment-insurance-for-financial-institutions/

The law firm White & Case states: “The introduction of the capital requirements and risk weights under Basel III may result in significant changes to capital charges from which financial institutions will seek relief. In addition to conventional credit protection products, financial institutions may also consider using NPI. NPI, despite being an insurance product, may qualify as a form of credit risk mitigation under the CRR provided that the relevant conditions thereunder are satisfied.” Ingrid York, Richard Blackburn and Luke O’Leary, “Non-payment insurance: a regulatory capital solution,” Butterworths Journal of International Banking and Financial Law, May 2018. https://www.whitecase.com/sites/whitecase/files/files/download/publications/non-payment-insurance-a-regulatory-capital-solution.pdf

Implementing the AirB approach is one step in the process to becoming a Basel II-compliant institution. Basel II is a set of international banking regulations that expanded the rules for minimum capital requirements established under Basel I, provided a framework for regulatory review, and set disclosure requirements for assessment of capital adequacy.


Matsukawa and Habeck, “Review of Risk Mitigation Instruments.”

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The source for information in this section is Marsh: https://www.marsh.com/us/services/political-risk/four-benefits-non-payment-insurance.html

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For information on such programs, see the guide for project sponsors of infrastructure projects in Africa at: http://www.ppfiaf.org/sites/ppfiaf.org/files/publication/ICA%20Guide%202006%20-%20Infra%20Project%20Preparation%20-%20ENG.pdf


Loans may be made by the lender to the exporter so that the exporter can allow deferred payments by the importer in a developing country (“supplier’s credit”), or loans are made directly by the financial institution to the importer, normally through a bank in the developing country (“buyer’s credit”).
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