OVE Office of Evaluation and Oversight

Corporate Evaluation

Evaluation of Guarantee Instruments at the IDB Group

IDB   IDB | Invest

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Washington, D.C. 20577
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RE-559-1
February 2022

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Inter-American Development Bank

Contents

Acknowledgements

This document was prepared by a team composed of Jose Claudio Pires (team leader), Gunnar Gotz, Regina Legarreta, Diego Del Pilar, Stefania De Santis, Melanie Putic, and the external consultants Ruben Lamdany, Kai Preugschat and Nadia Ramírez, under the overall supervision of Ivory Yong-Protzel (OVE Director) and Monika Huppi (Principal Advisor).

Acronyms and Abbreviations

ADB	Asian Development Bank
ADF	African Development Fund
AfDB	African Development Bank
AGF	African Guarantee Fund
BNB	Banco do Nordeste do Brasil
bps	Basis points
CGIF	Credit Guarantee and Investment Facility
DCMP	Debt Capital Markets Program
EIF	European Investment Fund
ESG	Environmental, social, and governance
FFF	Flexible Financing Facility
FI	Financial intermediaries
IBRD	International Bank for Reconstruction and Development (World Bank)
IDB	Inter-American Development Bank
IDB Group	Inter-American Development Bank Group
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation (currently IDB Invest)
IIRSA	Initiative for the Integration of the Regional Infrastructure of South America
IMF	International Monetary Fund
IPS	Paraguay Social Security Institute (for its Spanish acronym)

LAC	Latin America and the Caribbean
MDB	Multilateral development bank
MIGA	Multilateral Investment Guarantee Agency
MSMEs	Micro, small, and medium-size enterprises
NSG	Non-sovereign-guaranteed
OECD	Organization for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight
PBG	Policy-based guarantee
PCG	Partial credit guarantee
PPP	Public-private partnership
PRG	Partial risk guarantee
RSF	Risk sharing facility
SG	Sovereign-guaranteed
Sida	Swedish International Development Cooperation Agency
SMEs	Small, and medium-size enterprises
TFFP	Trade Finance Facilitation Program
TOC	Theory of change
XSR	Expanded Supervision Report

Executive Summary

This evaluation reviews the experience of the Inter-American Development Bank Group (IDB Group) with using medium- and long-term guarantees to support its clients during the period 2005 to 2020. This is the first evaluation by the Office of Evaluation and Oversight (OVE) of the guarantee instrument—an instrument that has the potential to mobilize private resources and has been in the tool kit of the Inter-American Development Bank (IDB) since its establishment (see IDB, 1996). The evaluation is delivered at a time when the IDB Group and its borrowers are looking for innovative ways to mobilize additional financing to confront the consequences of the COVID-19 pandemic, to meet the Sustainable Development Goals, and to comply with the Paris Agreement. The From Billions to Trillions initiative prepared jointly by several multilateral development banks (MDBs) aims to mobilize private financing for these goals (AfDB et al., 2015). This evaluation examines the extent to which the IDB Group has used guarantees to mobilize private resources and identifies the main challenges to the use of long- and medium-term guarantees. The focus is on guarantees as an instrument, and thus the evaluation does not assess the outcomes of projects and programs financed using guarantees.

During the evaluation period, clients used very few IDB Group guarantees. There have been recurrent calls by the G20 to the MDBs to expand the use of guarantees to mobilize more private resources. Still, guarantees from MDBs remain marginal relative to their lending. As for the IDB Group, while the number of guarantees approved in 2020 was the highest in its history, they still represent less than 4% of the more than US$100 billion in lending during the evaluation period. The IDB approved only five guarantees between 2005 and 2020, covering roughly US$1.2 billion. As with loans, IDB guarantees are offered to governments, as well as to sub-national or local government agencies with a sovereign counter-guarantee. During the same period, IDB Invest (and its predecessor, the Inter-American Investment Corporation, as well as the Opportunities for the Majority initiative and the IDB Group's Structured and Corporate Finance Department) approved 65 guarantee operations covering US$2.6 billion; these do not have a sovereign counter-guarantee and are thus referred to as non-sovereign guaranteed (NSG) guarantees. The average size of an NSG guarantee during the evaluation period was US$40 million, while the average Sovereign Guaranteed (SG) guarantee was US$240 million. A large number of guarantees were canceled and/or dropped during the evaluation period. For IDB, two of the five approved SG guarantees were canceled very close to their approval date. Five out of the 21 IDB Invest guarantees approved between 2016 and 2020 have also been canceled. In addition, OVE found that in the last 5 years, at least 44 IDB Invest guarantees under preparation were either dropped or put on hold and may not be submitted for approval. The most frequently mentioned reasons for canceling, dropping, or putting guarantees on hold were pricing issues associated with changes in financial circumstances that ultimately made the transaction not attractive for the client.

The IDB Group does not systematically measure resource mobilization. Data necessary to measure the contribution of SG guarantees to resource mobilization are not available. For some operations there is information on planned mobilization, but not for realized mobilization. Similarly, data for NSG guarantees are not reported at the project level, nor are they readily available in aggregate. To collect such data would require reporting by lenders and borrowers on the details of the actual financial transactions, as well as on what would have happened without the guarantee in terms of resources, costs, and tenor. This lack of information made it impossible for the evaluation to assess the overall contribution of guarantees to resource mobilization.

The evaluation found examples of IDB and IDB Invest guarantees that were helpful to the Group's clients although the overall demand for guarantees has remained low. For instance, in 2018, an IDB guarantee supported the Ecuadorian government's issuance of the first social bond in the region to finance a low-income housing project. The guarantee helped the government raise US$400 million (divided into one uncovered tranche and one fully guaranteed tranche), which the government considered would not have been feasible without the IDB support. In turn, between 2013 and 2017, IDB Invest guaranteed domestic currency loans from the Paraguay Social Security Institute to the Paraguayan banking system, which then on-lent these resources to priority sectors. Again, this transaction would not have been feasible without the IDB Invest guarantee. Notwithstanding these good experiences, the IDB Group, like most other MDBs, has seen a low use of its guarantees. While low client demand played a role, there are also institutional and structural factors that limit the use of the instrument.

The evaluation identified three main factors that limit the use of IDB Group guarantees: (i) borrowers (particularly on the sovereign side) usually prefer loans over guarantees because a loan consumes the same amount of their "borrowing envelope" as a guarantee but is less complicated to process; (ii) there is a lack of familiarity with guarantees within the IDB Group, including among staff, management, and the Executive Board; and (iii) many clients are not aware that the IDB Group can provide guarantees.

1) **The capital adequacy rules and pricing principles for SGs and NSGs guarantees are similar to those for comparable loans, leading borrowers to prefer loans over guarantees, since the latter have higher transaction costs.** Both IDB and IDB Invest require allocating the same amount of capital to a guarantee as they would for an equivalent loan to calculate the overall lending headroom and the borrower lending allocation. The rationale for this rule is that if a guarantee is called it would put the same amount of capital at risk as an equivalent loan, in addition to the exigencies of maintaining IDB's and IDB Invest's credit ratings. The capital allocation policy also drives pricing, as IDB Group policy calls for income neutrality, meaning that the return on capital across instruments is to be equalized. Thus, IDB's guarantee fee is based on the Ordinary Capital lending spread, which is set annually and is the same for all IDB borrowers—at this time, 90 basis points. IDB Invest uses market-based pricing for its guarantees, which is also the basis for its pricing on loans. The equivalency with loans has often led to guarantees not being financially attractive to borrowers, leading them to prefer direct IDB Group loans, which are already familiar instruments and have lower transaction costs (guarantees involve a third party thus requiring more complex documentation and higher legal costs).

2) **IDB Group management and staff have little familiarity with guarantees, and incentives favor working on loans that are better understood, simpler to process, and more likely to come to fruition.** Very few staff of IDB and IDB Invest are knowledgeable about the processes and documentation involved in providing a guarantee, and about its terms and conditions. Due to their very limited information on and experience in the use of guarantees, staff tend to favor working with loans instead. In addition, because of the necessary involvement of a third party, the risk of not reaching the signature stage is higher than for loans. In many ways, guarantees experience some of the challenges of an "infant instrument" in that they may need incentives for staff and clients to innovate and experiment with them before they become competitive with alternative instruments.

3) **The IDB Group is not known as a guarantee provider among potential clients (with the exception of the guarantees for trade financing under the Trade Finance Facilitation Program or TFFP).** Authorities in several member countries and private financial institutions that are in contact with potential clients do not know about the different guarantee products the IDB Group offers. The institution is generally perceived as a loan provider. The lack of awareness is more pronounced for IDB guarantees than for IDB Invest guarantees, which could be

explained by the fact that IDB Invest has granted many more guarantees than IDB. The only well-known guarantee product is the short-term trade finance guarantee of the TFFP. Although a comparison should be approached with caution given the particularities of the TFFP business (a standard product, similar-risk transactions, and less complex structures), some factors that facilitated expansion in the use of TFFP guarantees could potentially be transferable to IDB's guarantees business: a core team of product experts that are known by potential users of TFFPs, extensive dissemination and marketing of the product, standardized contracts and processes that reduce transaction costs, and a network of local and international banks that are familiar with the TFFP's mandate and practices.

On the basis of the findings of this evaluation, OVE makes the following recommendations:

To IDB

1) **Monitor and report on SG guarantees' resource mobilization and associated financial terms.** The key rationale for scaling up the use of guarantees has been that they could help mobilize private funding for development projects beyond what MDBs can provide, but not enough evidence is available to judge whether this would be the case for the IDB. IDB has issued less than ten guarantees and has not been collecting data on the resources mobilized and their financial terms in a systematic way. To establish whether SG guarantees could serve to mobilize additional funding, it is essential to systematically monitor and report on the amounts, cost and tenor of resources mobilized with the support of each SG guarantee, together with estimates, based on data provided by the clients of the terms and amounts the borrowers would have been able to access without the guarantee.

2) **Design and implement a time-limited pilot scheme which offers borrowers guarantees with a reduced impact on their country lending envelope.** Under this pilot, a guarantee issued to a borrower would be counted against the country lending envelope at a discounted rate rather than its full value. The objective of this scheme would be to facilitate the use of guarantees and generate the information needed by IDB and its clients to assess the benefits, challenges and potential of different modalities of SG guarantees. At the end of the pilot period the scheme would be closed, and its performance evaluated to establish whether and how the SG guaran-tee-instrument could be improved. Other MDBs have established similar arrangements (e.g., the African Development Bank and the World Bank)

and IDB has done son an ad-hoc basis (e.g., the 2018 guarantee to Ecuador). The pilot scheme could be funded by contributions from member countries, IDB capital or both.

3) **Designate a group of staff experienced in structuring guarantees to serve as focal point for SG guarantees.** These staff would act as resource persons inside and outside IDB for questions regarding guarantees and support clients and staff in the structuring and monitoring of SG guarantee operations. The group could also provide training to IDB staff and clients on the financial aspects of guarantees and disseminate information gathered through the implementation of the pilot. The guarantee resource staff would be given time to provide these advisory services on an as needed basis, while remaining in their regular working units.

To IDB Invest

1) **Monitor and report on NSG guarantees' resource mobilization and on their associated financial terms.** OVE found that data necessary to estimate the contribution of NSG guarantees to resource mobilization were not readily available, nor was information on the impact of the guarantee on the interest rate, tenor, and collateral requirements of the underlying transactions. To ascertain whether guarantees fulfill their expected potential to mobilize additional private sector resources, such data need to be systematically collected and reported. This information could then serve as a basis for the Board of Directors and Management of IDB Invest to decide whether and how NSG guarantees could be made more helpful to clients as well as for accountability purposes to ensure the instrument is not distorting the markets.

2) **Identify and incorporate key success factors from the TFFP model that can be adapted to the processing of long- and medium-term guarantees to enhance their attractiveness for clients.** The evaluation identified several operational features of the TFFP guarantee-program that could conceivably be adapted to the NSG guarantees to address some of the factors that currently constrain their use. Examples include (i) having a core team of product experts who are known by potential users of the program and by IDB Invest staff as the go-to contacts for advice and to handle the financial aspects of possible transactions; (ii) carrying out extensive dissemination and marketing; (iii) streamlining documentation and processes; and (iv) establishing a network of local and international banks that are familiar with the instrument's characteristics and practices.

01

Introduction

1.1 This evaluation reviews the experience of the Inter-American Development Bank Group (IDB Group) in using medium- and long-term guarantees to support its clients during the period 2005 to 2020.[1] This is the first evaluation conducted by the Office of Evaluation and Oversight (OVE) of the guarantee instrument—an instrument that has the potential to mobilize private resources and that has been in the tool kit of the Inter-American Development Bank (IDB) since the Bank's creation (see IDB, 1996). The evaluation is delivered at a time when the IDB Group and its borrowers are looking for innovative ways to mobilize additional financing to confront the consequences of the COVID-19 pandemic, to meet the Sustainable Development Goals, and to comply with the Paris Agreement. The From Billions to Trillions initiative jointly prepared by several multilateral development banks (MDBs) aims to mobilize private finance for these goals (AfDB et al., 2015).[2]

1.2 This evaluation looks at what factors have influenced the use of medium- and long-term guarantees. The evaluation examines separately the guarantees issued by IDB and by IDB Invest (and its predecessor organizations). It investigates demand and supply factors that are affecting the use of IDB Group guarantees and analyzes the available evidence on how guarantees have performed in terms of reducing borrowing costs and mobilizing resources for IDB Group clients (see Annex I for the more detailed evaluation questions). The evaluation focuses on the guarantees' processes, uses, and challenges, and does not assess the development outcomes of projects and programs financed using guarantees. The evaluation uses a combination of methods including interviews with stakeholders, data analysis, and review of documents from the IDB Group, other MDBs, and financial and academic institutions (see Box 1.1).

1 This evaluation was launched in response to the interest of the Executive Directors of the Inter-American Development Bank (IDB) and of IDB Invest in the potential role of guarantees. These organizations, together with IDB Lab, compose the IDB Group. This evaluation focuses on IDB and IDB Invest, and, while these two institutions are separate legal entities and issue guarantees in their own right, for simplicity, this report refers to the Inter-American Development Bank Group (IDB Group) when a point it raises applies to both institutions.

2 Current levels of official development assistance alone will not suffice to raise the estimated US$4 trillion needed annually to achieve the Sustainable Development Goals (UNCTAD, 2014).

Box 1.1. Evaluation methods and information sources

OVE used a mix of methods and information sources to answer the evaluation questions and triangulate evidence.

Data analysis: An analysis of the aggregate portfolio was used to identify general trends and patterns of the instrument's use. Additional external and internal data were used to analyze processing times, the extent of financial sector development, and cost savings.

Interviews: OVE conducted 124 semi-structured interviews with stakeholders, including private sector clients (9), government counterparts (7), IDB Group Executive Directors (9), IDB Group country representatives (7), IDB Group management (34), project team leaders (20), other MDBs and regional development banks (14), specialized guarantee providers (11), credit rating agencies (4), commercial and investment banks (5), and other guarantee experts (4).

Document review: The evaluation analyzed the project documents of all guarantee operations and created a database of guarantee characteristics to identify patterns in the use of guarantees. In addition, IDB Group policies and legal frameworks on guarantees were also reviewed.

Literature review: In addition, the evaluation analyzed literature on guarantee instruments from other institutions, including evaluations from other MDBs, to identify differences, commonalities, and potential solutions in relation to the IDB Group's experience with guarantees.

1.3 The remainder of this report is organized as follows. Section II provides a general background on guarantees, including the definition and types of guarantees. It then presents a theory of change that underpins the guarantees and was used to guide the evaluation. Section III introduces the IDB Group's legal framework for guarantees and briefly overviews the actual use of guarantees at the IDB Group. Sections IV and V describe, respectively, the IDB and IDB Invest experience and assess the main constraints each faces on the use of guarantees. Section VI briefly discusses IDB Group's experience with other forms of guarantees, mostly for trade facilitation and as part of its portfolio management. Section VII provides an overview of comparator MDBs' experience with guarantees. Section VIII concludes and provides recommendations on how the IDB Group could make guarantees more helpful for its clients.

02

General Background on Guarantees

A. Definition and types of guarantees

2.1 A guarantee is a legal promise made by a guarantor to cover a borrower's debt or other type of liability in case of a default (Corporate Finance Institute, 2021). Guarantees fall within the broad category of risk-transfer instruments such as collateral, insurance, and derivatives (World Bank, 2009). They can cover a variety of transactions (e.g., bonds, loans, or payments to concessionaires) and different obligations (e.g., interest, principal). As opposed to loans, guarantees do not require funding when they are issued (but a guarantor may choose to set aside liquidity ahead of time to cover a potential call). Guarantee agreements specify the circumstances under which the guarantor would pay the lender and how the guarantor would recoup from the debtor the money it paid out (Humphrey and Prizzon, 2014). Typically, MDB guarantees also specify the remedies that would apply in case of a breach of other obligations such as environmental, social, and governance (ESG) safeguards.

2.2 Guarantees can vary in the type of risk covered, the currency, the level of coverage, and the underlying guaranteed instruments. Table 2.1 shows some of these potential differences. For example, with a partial credit guarantee (PCG), an MDB could cover 50% of the principal of a client's bond in case of default. Such a guarantee could be denominated in local or foreign currency, it could be associated with specific projects or not, and it could be covered by a sovereign counter-guarantee[3] or not (Humphrey and Prizzon, 2014).

Table 2.1. Common features of guarantees offered by MDBs to public- and private-sector entities

Feature	Examples	Definitions	Use within the IDB Group
Type of counter-guarantee	Sovereign	Also called a sovereign counter-indemnity. If the guarantee is called, the sovereign will be obligated to repay the amount disbursed to fill the call to the guarantor.	IDB
	Non-sovereign	The guarantee is not covered by the government if the guarantee is called	IDB Invest

3 In this report, guarantees covered by sovereign counter-guarantees are referred to as sovereign guaranteed (SGs) guarantees, and those without such counter-guarantees are referred to as non-sovereign guaranteed (NSGs) guarantees.

Feature	Examples	Definitions	Use within the IDB Group
Types of risk covered	Credit	Covers all categories of non-payment, political, and commercial risks.	IDB y IDB Invest
	Political (partial risk guarantee - PRG)	Covers the risk that a sovereign or public entity will not comply with contractual obligations agreed to with a private entity.	IDB
	Buyer	A standby letter of credit guarantees a bank's commitment of payment to a seller in the event that the buyer—or the bank's client—defaults on the agreement.	IDB Invest
		An advance payment guarantee that covers advance payments losses if a seller is unable to meet his or her obligations.	IDB Invest
	Performance	Covers monetary losses/expenses if a contractor fails to complete the project undertaken as specified.	IDB Invest
Coverage	Partial	Covers less than 100% of principal in present value terms.	IDB y IDB Invest
	Full	Covers 100% of principal in present value terms.	IDB y IDB Invest
Underlying operation type	Project-based	Associated with specific investment projects.	IDB y IDB Invest
	Policy-based	Provides risk mitigation to commercial lenders for debt service payment defaults by government; it is linked to a policy reform program.	IDB
	Portfolio of operations (risk-sharing facility, RSF)	Bilateral loss-sharing agreement between a guarantor and an originator of assets in which the guarantor reimburses the originator for a portion of the principal losses incurred on a portfolio of eligible assets.	IDB Invest
Currency	US$ or other foreign currency	Denominated in US dollars or other foreign currency.	IDB y IDB Invest
	Local currency	Denominated in local currency.	IDB y IDB Invest
Covered commitment instrument	Loans	Loans provided by a third party (e.g., a commercial bank).	IDB y IDB Invest
	Corporate bonds	Debt obligations issued by corporations to fund capital improvements, expansions, debt refinancing, or acquisitions.	IDB Invest
	Securitizations	Pooling of certain types of assets to be repackaged into interest-bearing securities (e.g., asset-backed securities).	IDB Invest
	Project bonds	Debt securities that are financed by the cash flows of an earmarked development project.	IDB Invest
	Governmental payment commitments	Regular payments[a] that the government must make, e.g., to a concessionaire for providing infrastructure	IDB
	Governmental bonds	Debt instruments issued by the government.	IDB
	Other debt instruments	Including, but not limited to, debenture, leases, mortgages.	IDB y IDB Invest

Source: OVE elaboration, based on several sources, including the Corporate Finance Institute, Investopedia, the International Finance Corporation and IDB Invest, and IDB product description notes.
Notes: This table does not present an exhaustive list of guarantee features and types, but rather a list of examples of common guarantee operational features. Also, the ability to offer certain features, such as domestic currency guarantees, depends on market circumstances. [a] Regular payments include direct and contingent liabilities.

B. Possible rationale underlying MDB guarantees

2.3 The literature points to several factors that could make MDB guarantees an effective instrument to mobilize private finance. Guarantees could help MDBs leverage their capital by helping them raise more private resources for development projects than would be possible through direct lending or through cofinancing (see, for example, OECD, 2021).[4] Guarantees may also enable an MDB to create conditions for its client to get access to funding in the local currency in a country where the MDB does not have a strong treasury presence. This is because, unlike for a loan, the MDB does not need to provide funds in the local currency unless the guarantee is called. By providing a guarantee, MDBs can facilitate the financing of projects that have been originated and structured by private banks or other market actors. From the MDBs' clients' standpoint, guarantees may help introduce them to capital markets, or serve to get international banks acquainted with them. Guarantees can uplift a bond's rating and attract a broader investor base. MDB guarantees can also be used to mitigate political risks in public-private partnerships (PPPs), particularly in projects with a long planning and construction phase.

2.4 Guarantees can help mitigate market failures and promote the development of financial markets. Asymmetric information creates different risk assessments that may hinder the development of financial markets. MDBs can help address these market failures by reducing the extent of asymmetric information as well as by mitigating political, regulatory, and performance risks (Pereira dos Santos and Kearney, 2018). In addition to offering coverage for nonpayment, MDBs are well positioned to guarantee against political risks, such as expropriation or restrictions on cross-border transfer, and to provide investors the comfort that a trusted partner is involved in monitoring performance. Thus, MDB guarantees may motivate international investors and banks to invest in emerging markets or in developing countries (or sectors in those countries) where they had not been previously involved; moreover, such guarantees could allow the borrower to attract financing on more favorable terms (Humphrey and Prizzon, 2014; Bandura and Ramanujam, 2019).

4 This would be the case if the guaranteed transaction raised more resources than the reduction in MDB direct lending due to the use of capital to back the guarantee, as explained below.

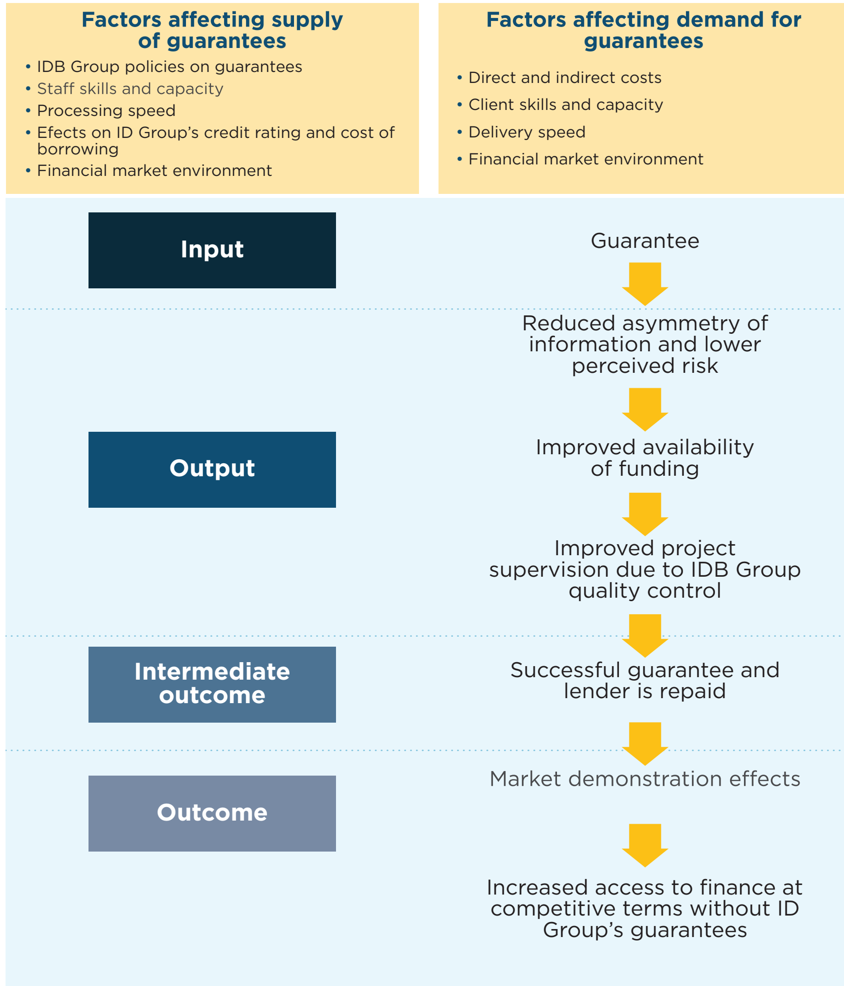
C. Theory of change

2.5 The features of guarantees presented above provide a basis to build a theory of change (TOC) for the use of IDB Group guarantees. This TOC serves as the framework to guide the evaluation. Figure 2.1 presents the main elements of the TOC. Whether or not a guarantee is issued depends largely on a set of demand-side and supply-side factors, shown in the yellow boxes in Figure 2.1. A guarantee will be requested by an IDB Group client when its perceived benefits (financial, reputational, etc.) are greater than its perceived costs (financial, administrative, reputational, etc.). Guarantees may reduce informational asymmetries and/or reduce the risk of a specific instrument in order to attract investors that would not have otherwise been willing or allowed to invest. The IDB Group then provides a guarantee (the input) covering some or all the risks. The lender's perception of a lower risk will enable the borrower to obtain additional and/or less expensive financing (the output), even after taking into account the IDB Group guarantee fees. An additional incentive for lenders to engage in the transaction might be that the IDB Group will provide continued quality control of the project and ensure high levels of ESG standards. A successful intermediate outcome would be that the guarantee expires without being called (i.e., the borrower fulfills its obligations in full and the IDB Group is not required to make any payments). In the long term, possibly after several such operations, some clients may build a track record and may be able to tap capital markets without multilateral credit enhancement—a successful final outcome thanks to a market demonstration effect. In certain situations, however, the continued and prolonged use of guarantees may be necessary to raise resources from international institutional investors that require very high minimum credit ratings.

Figure 2.1

Theory of change for the use of guarantees

Source: IDB, 2021 (Document RE-559).



03

Overall View of Guarantees at the IDB Group

3.1 Even though guarantees were contemplated as an instrument in the establishment documents for both IDB and the Inter-American Investment Corporation (IIC, currently known as IDB Invest), their use has been modest.[5] During the evaluation period—from 2005 to 2020—the IDB Group approved 70 long-term guarantees, covering about US$3.8 billion. This includes 65 NSG guarantee operations covering US$2.6 billion and 5 SG guarantees covering roughly US$1.2 billion. The average size of a NSG guarantee during the evaluation period was US$40 million, far below the average SG guarantee transaction volume of US$240 million (see Annex II for details). The total volume of guarantees represented less than 4% of the more than US$100 billion in IDB Group lending during the evaluation period.

3.2 Both IDB and IDB Invest have flexible policy frameworks for issuing guarantees. The IDB approved its first guarantee policy in 1995 (document GN-1858-2) and updated it in 2013 (document GN-2729-2). This update created the flexible guarantee instrument, explicitly allowing the issuance of PCGs and PRGs, for both investment projects and policy-based interventions. These guarantees can be offered to borrowing member countries, sub-nationals, and local governments with the same flexibilities provided under the IDB's Flexible Financing Facility (FFF) for SG loans.[6] IDB Invest (and previously IIC) offers guarantees subject to its operational policy, originally approved in 2007 (document CII/GP-15-8) and most recently updated in 2017 (document CII/GP-15-18). IDB Invest can offer tailor-made products subject to the same general legal, financial, and policy considerations applicable to IDB Invest loans.

3.3 The IDB Group offers a variety of guarantees. IDB offers guarantees with a sovereign counter-guarantee (referred to as SG guarantees) to the governments of borrowing member countries, to sub-national governments, and to public sector entities in member countries.[7] IDB Invest offers NSG guarantees to private- and public-sector companies in member countries but does so without a sovereign counter-guarantee (see Table 2.1 for details). Guarantees can differ by the type of risk covered (e.g., credit, performance, political), the currency denomination

5 In addition to the medium- and long-term guarantees that are the focus of this evaluation, IDB Invest also offers short-term guarantees under the Trade Finance Facilitation Program (TFFP). Guarantees have been also used in portfolio management. These experiences are discussed in Section VI.

6 IDB also had specific policies for political risk guarantees (document FN-552-1, 2000) and for local-currency PCGs without SG (document GN-2411, 2006) that guided the provision of NSGs through the IDB's private sector window before the 2016 "merge-out" of the IDB's and IIC's operations into a "new" IIC.

7 These guarantees have the applicable flexibilities provided for under the FFF for SG loans. See "Proposal for a Flexible Financing Facility for Ordinary Capital Sovereign Guaranteed Lending Operations. Revised Version" (document FN-655-1), and "Report of the Chairperson of the Budget and Financial Policies Committee" (document FN-655-2).

(e.g., domestic currency, US dollars, euros), the level of coverage (full or partial), and the underlying instrument being guaranteed (e.g., loan, bond). All guarantees from the IDB Group are subject to the same ESG requirements as loans.

3.4 There are differences in the recourse and security arrangements of the IDB (SG) and the IDB Invest (NSG) guarantees. Both IDB and IDB Invest have recourse to the underlying client. This means that if an IDB guarantee is called, the government (the counter-guarantor) would have to reimburse the IDB for any payments made under the guarantee.[8] The terms of the repayment are similar to those of a direct SG loan (document GN-2729-2). IDB Invest guarantees have recourse to the private client and may benefit from subrogation rights and access to courts as well as collateral arrangements, and they have recourse to foreclosure, as in private commercial transactions.

3.5 The capital rules of both IDB and IDB Invest require that the institutions allocate the same amount of capital for a guarantee as they would for an equivalent loan. The rationale for such a rule is that if a guarantee is called it would put the same amount of IDB Group capital at risk as would an equivalent loan. For the same reason, guarantees at the IDB are counted against the annual country approval amount (the country "lending envelope") on a one-to-one basis, meaning that using a guarantee or a loan for the same amount has the same impact on the country's lending envelope. Likewise, IDB Invest's guarantees count like loans in relation to its single-borrower and country exposure.

3.6 The principles used to determine the prices of SGs and NSG guarantees are similar to those applied to the pricing of the respective loans. IDB's guarantee fee is based on the Ordinary Capital lending spread, which is set annually and is the same for all IDB borrowers—at this time, 90 basis points (bps). The rationale for this pricing policy is the principle of net income neutrality with loans, meaning that operations that require the same amount of capital should generate an equivalent level of income (Humphrey and Prizzon, 2014; Pereira dos Santos and Kearney, 2018). IDB Invest follows the same pricing methodology for its guarantees as for its loans: it takes into account the risk (by looking at ratings and risk parameters) and benchmarks against comparable transactions; it also takes into account administrative and supervision costs. IDB Invest fees over the past five years have ranged between 50 and 450 bps per annum.

8 In the event the IDB needs to make a payment on behalf of a government under the guarantee, the amount paid by the IDB is converted into a loan that has to be repaid to the IDB by the respective government.

04

The IDB Experience with SG Guarantees

A. Portfolio description

4.1 During the evaluation period, IDB approved 5 SG guarantee operations in five countries. In fact, this is the entire amount of SG guarantees issued in IDB's history through 2020.[9] Of these, two were canceled or reformulated before expiration, one has been closed, and two are currently active. None of them has been called. Table 4.1 shows the country recipient, approval year, size, and status, as well as the planned and actual mobilization (according to the MDB methodology) based on information provided in project documentation and interviews.[10]

4.2 IDB guarantees had the main objective of promoting private sector financing at favorable terms for the underlying projects. Complementary objectives included promoting the mobilization of international resources toward the sector or country; familiarizing investors with new types of projects and markets; and generating learning opportunities for countries on financial markets and bond issuances. SG guarantees have been used to help governments enter new markets, innovate with thematic bonds (e.g., social bonds) or foster infrastructure investments through PPPs.[11] Staff and clients interviewed suggested that other areas where SG guarantees could be helpful in promoting private sector investment at better terms include guarantees in local currency, guarantees to sub-nationals and co-financing with state-owned banks.

9 Three more guarantee operations were approved during 2021. Two of the guarantees, for US$63.2 million and US$2.1 million, support the governments of Ecuador (EC-U0003) and Belize (BL-U0001), respectively, in the purchase and administration of COVID-19 vaccines. The third operation, a $400 million policy-based guarantee for Ecuador (EC-U0002), will combine the IDB's partial guarantee of a sovereign bond issued by the Republic of Ecuador with support for a policy reform program executed under the "Program for Development and Economic Recovery in Ecuador."

10 Per the MDB joint reference guide on the *mobilization* of private investment (World Bank, 2018a), mobilization as used in this evaluation refers to both direct mobilization (financing from a private entity on commercial terms due to the active and direct involvement of an MDB) and *indirect mobilization* (private entity financing provided in connection with a specific activity for which an MDB is providing financing without active or direct MDB role that leads to the commitment). Given the nature of guarantees, this evaluation considers all mobilization resulting from them as direct mobilization.

11 SG guarantees can be helpful to finance PPP operations under different circumstances. For example, a guarantee can lower the perceived risk of a project and thus make it bankable for private financiers. Guarantees can also help to attract bidders who would otherwise not participate, and ensure bids are based on comparable assumptions, resulting in a more competitive procurement for the project (PPP Knowledge Lab, 2017).

Table 4.1. IDB SG guarantee portfolio

Project	Year country	Guarantee terms (at approval)			Status	Mobilization	
		Amount (US$M)	Coverage[a]	Tenor (years)		Planned	Actual
Georgetown Solid Waste Management Program (GY0055)	2006 Guyana	2.5	100% of annual minimum payment obligation	11	Canceled because underlying transaction never materialized	0	0
Guarantee Program for the IIRSA Northern Amazon Hub (PE-L1010)	2006 Peru	60	100% of the annual payments for construction	20	Active	186[b]	186.8
Strengthening Macrofinancial and Fiscal Management I (PN-L1086)[c]	2012 Panama	350	100% of loan principal and interest	3	Closed; partially canceled	-	-
Financing Low-Income Housing in Ecuador (EC-U0001)	2018 Ecuador	300	100% of class A repack notes, 0% of class B notes	25	Active	375	100
Program to Support Productive Infrastructure Financing in Argentina (AR-L1281)	2018 Argentina	490	TBD once individual guarantees were approved	25	Reformulated as a lending operation	1,225	0

Source: IDB data warehouse and guarantee proposals.
Note: [a] Up to guarantee amount. [b] The guarantee covered annual payments of US$29.5 million for 15 years. To determine the value of the transaction net of interest payments, OVE calculated the net present value of those payments using 8.375% as the discount rate, yielding a value of US$246 million for the transaction (US$60 million was subtracted to arrive at the mobilization). The discount rate is equivalent to the coupon of a bond in US currency placed by the government of Peru in 2007 for 12 years. [c] Reduced to US$265 million over one year; partial cancellation followed the Republic of Panama's need to reprogram the money put toward payments. IIRSA = Initiative for the Integration of the Regional Infrastructure of South America; TBD = to be determined.

4.3 Only three out of 5 SG guarantees came to fruition, one of them thanks to an exceptional lending envelope incentive. Of the five guarantees, one was reformulated as an SG loan (Argentina) and another one was unsuccessful in attracting an adequate private sector partner for the project (Guyana). For the other three guarantees, there is some anecdotal evidence that the guarantees played a role in attracting financing on better terms, but the projects' monitoring and evaluation frameworks did not include information to measure the guarantees' financial additionality. The 2018 guarantee to Ecuador benefited from an exceptional envelope incentive that allowed the country to receive the guarantee on top of its original lending envelope.

4.4 Following are descriptions of all five SG guarantee operations:

a. The Georgetown Solid Waste Program (GY0055, 2006). This PRG was designed to cover minimum payment and early contract termination obligations of the government. By enhancing the credit quality of the transaction and promoting the interest of better-qualified private sector operators, it aimed to minimize the risk of bad environmental performance. The guarantee was ultimately canceled following the cancellation of the underlying project. This project was deemed unsuccessful in its project completion report, but the failure was not related to the nature of the financing structure.

b. The Guarantee Program for the IIRSA (Initiative for the Integration of the Regional Infrastructure of South America) Northern Amazon Hub (PE-L1010, 2006) of US$60 million. This program aimed at supporting the concession of a 160 km rehabilitated toll road to a private sector entity. The guarantee covers the annual payments for construction to be made by the government of Peru to the concessionaire totaling US$29.5 million per year for 15 years. The guarantee helped generate market interest in the transaction and helped support a project that as of 2019 had attracted aggregate investments of US$573 million (OSITRAN, 2019). The concession was awarded, and the road was rehabilitated and is operating. OVE estimated that this project mobilized the equivalent of US$186 million, making it the most effective SG guarantee ever in terms of resource mobilization. According to IIRSA and IDB accounts, the guarantee also contributed to the placement of the concessionaire's notes in the market (IDB, n.d.). This concession was one of the first of Peru's cofinanced concessions, which was the reason the government requested the guarantee. In subsequent concessions—including the Lima Metro, which is a cofinanced concession of approximately US$5.2 billion—the government no longer required guarantees, arguably due to good macroeconomic management and the improvement in the country's risk classification.

c. The Program to Strengthen Macrofinancial and Fiscal Management in Panama guarantee (PN-L1086, 2012). This policy-based guarantee (PBG) supported macroeconomic and financial sector reforms in Panama following the financial crisis of 2008, while enabling the government to refinance liabilities with commercial banks. As stated in the 2010–2014 Panama Country Program Evaluation (document RE-475-1), the programmatic policy-based guarantee enabled

Panama to extend the maturity of payments coming due. Moreover, by enabling the government to defer its loan obligations, this instrument also helped Panama comply with the fiscal constraints set by its Social and Fiscal Responsibility Law, smoothing the country's investment payment profile. In 2013 the PBP guarantee was reduced by US$85 million, and the remaining balance was canceled the following year in accordance with the final reprogramming needs of the country.

d. Financing Low-Income Housing in Ecuador project (EC-U0001, 2018). This guarantee aimed at covering the issuance of social bonds by the government of Ecuador. To achieve investment grade, given the country's risk level, the guarantee needed to cover at least 40%–50% of the value of the social bond. Accordingly, an issuance of US$600 million to US$750 million was expected. At the time of issuance, the market conditions had changed to the disadvantage of Ecuador and the actual issuance was for only US$400 million in social bonds, structured as an uncovered tranche of US$100 million and a US$300 million tranche fully guaranteed by IDB. The latter was made available to Ecuador outside of its lending envelope, providing the country with a significant incentive to use the guarantee, since doing so did not reduce its borrowing capacity. The bond issuance provided a positive signal to the markets during a time of declining access to the international financial markets, as well as positive press coverage on the first issuance of a sovereign social bond in the region.

e. Risk Mitigation Flexible Facility Project (AR-L1281, 2018). The guarantee aimed at mobilizing private sector financing for a PPP program to support various infrastructure projects in Argentina. The operation was approved in 2018 but was affected by environmental and integrity issues, deterioration in the country's financial conditions, and ultimately, a change in government in 2020. The new authorities requested that the guarantee be cancelled and that the resources be redirected to COVID-19 response through the Argentina Global Credit Program for Reactivation of the Productive Sector (AR-L1328).

B. Factors affecting the use of IDB SG guarantees

4.5 OVE identified several factors that constrained the use of SG guarantees. Table 4.2 summarizes the key factors that, according to OVE interviews affected the supply of and/or the demand for IDB guarantees, mostly confirming the factors pointed out in the TOC (Figure 2.1). Some of the limiting factors are inherent to guarantee instrument (e.g., complexity due to multiple stakeholders), other factors are related to IDB policies that are common to other MDBs[12] (e.g., capital adequacy requirements) and finally others are within the direct control of Management (e.g., training and marketing).

Table 4.2. Factors that IDB staff and counterparts perceive to affect the use of SG guarantees

Factors affecting both demand and supply side	
• Cost of identifying and working with a suitable third party	
• Limited IDB capital (limited country envelope) to be allocated between loans and guarantees. • Slower appraisal and approval processes for guarantees than for loans. • Additional transaction costs.	
Factors affecting the supply of guarantees (IDB Group)	**Factors affecting the demand for guarantees (clients)**
• Prudent capital adequacy treatment of guarantees due to credit rating agencies' standards.	• Officials' limited experience with guarantees in some countries
• Reduced staff incentive to offer the instrument instead of a loan due to limited experience working with guarantees plus the above-mentioned limitations.	• Countries' credit standing and local financial market sophistication .
	• Government budget inflexibility in some countries, leading to hesitancy to provide a sovereign counter-guarantee to an off-balance-sheet item (e.g., a PPP-related guarantee).
	• Rating agencies' caps on the uplift a transaction can receive (e.g., Fitch at three notches)

Source: OVE, based on interviews during the evaluation process.

4.6 The supply of SG guarantees is limited by staff preference to work on loans rather than guarantees and a lack of staff incentives to use the instrument. Due to the low number of SG guarantee operations, experience with and knowledge about the instrument is very limited within IDB, which makes identifying and processing a guarantee more challenging and hence less attractive for staff than working on a loan. Some staff members mentioned a perception that professional incentives, resources and training for IDB staff to provide a guarantee are insufficient to make doing so attractive. Guarantees are perceived to require more work from staff and to have a higher potential for failure, as the transaction is also dependent on a third party. As mentioned above, two of the five approved SG guarantees were canceled shortly after their approval, and a third was reprogrammed as a loan.

4.7 The IDB's capital adequacy requirements and lending limits imply that guarantees crowd out loans on a one-to-one basis. The IDB follows the same prudent capital adequacy rules for

12 See Annex VII for findings from other evaluations related to guarantees by other MDBs.

guarantees as do most other MDBs aimed at protecting the institution's AAA credit rating. Basically, it allocates the same amount of capital to a guarantee as it does to a loan that creates a similar exposure. Similarly, SG guarantees are counted at par with loans for the purpose of the lending envelope. These prudential policies imply that guarantees crowd out loans on a one-to-one basis.

4.8 Key factors affecting the demand for guarantees involve country officials' lack of experience with the instrument, country financial systems development and credit standings, their budget approval processes, and the rating uplift cap by rating agencies. From interviews with countries' authorities, IDB country representatives and staff, and other experts, it became clear that SG guarantees are of interest only to a small group of clients. Under current policies, the pool of potential clients for an SG guarantee is rather small, as countries with good credit ratings do not need a guarantee while countries with lower credit ratings often lack the necessary market skills, institutional capacity, knowledge, and experience to use a guarantee. Many countries in Latin America and the Caribbean (LAC) do not require credit enhancements to access capital markets, and an IDB guarantee may end up costing just as much as the savings it may generate, especially because many rating agencies limit the uplift a guarantee can provide if it is not a full credit substitution.[13] A rough estimation of the country borrowing costs shows that for 10 out of 26 borrowing countries, a 2-notch rating uplift would generate savings of less than the current guarantee fee of 90 bps.

4.9 The evaluation also identified factors that affect both clients' demand for guarantees and IDB's supply of them. These include the cost of identifying and working with a suitable third party, the limited country lending envelope within which guarantees compete for space with loans; perceived slower appraisal and approval processes for guarantees than for loans; and the additional transaction costs of dealing with two counterparts instead of one. Box 4.1 presents a list of internal actions suggested by IDB Staff that could help to foster the use of guarantees.

13 Credit rating agencies cap the rating uplift that a transaction can receive based on an IDB guarantee, limiting the benefit of the guarantee. Each credit rating agency treats guarantees differently, yet all limit the uplift if the guarantee does not provide 100% coverage.

Box 4.1. IDB staff suggestions to increase the use of SG guarantees

When asked about potential solutions to increase the use of guarantees, IDB's staff pointed at various potential options.

Career incentives: Provide greater recognition of work on guarantees in performance reviews to help encourage staff with little expertise in guarantees to explore them as an option.

Statement from management in support of use of guarantees: Signal explicit support for guarantees by senior management to help promote the instrument.

Dedicated resources: Top up the budget of units working on guarantees (for a limited trial period) to allow staff to learn about the product.

Increased awareness: Raise internal and external awareness of the instrument (e.g. through specific training, more guidelines and more outreach) to change the perception that IDB is providing only loans.

Specialized teams: Expand in-house knowledge and dedicated services to allow for more efficient processing and an increase in the volume of guarantees (e.g. syndications team, including lawyers).

Changes in the fee structure: Change conditions for the instrument, e.g., allow for pricing based on the guarantee tenor instead of a flat price.

05

The IDB Invest Experience with NSG Guarantees

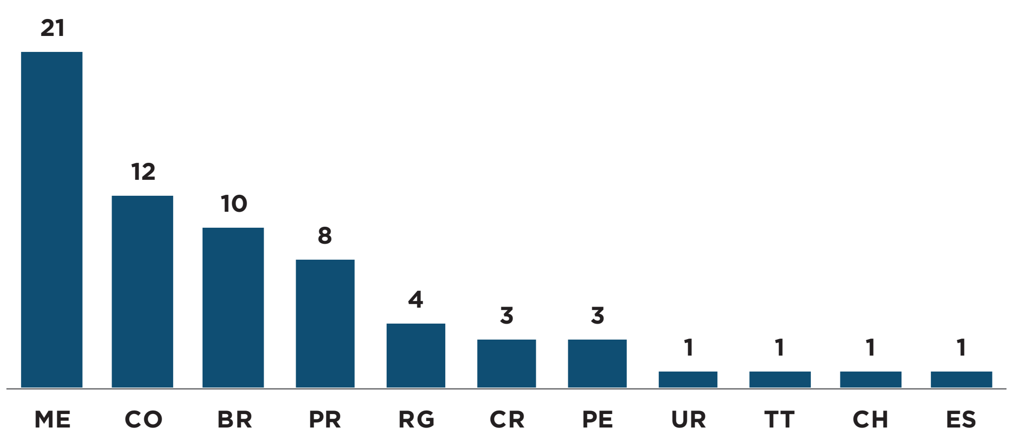
A. Portfolio description

5.1 Between 2005 and 2020, 65 NSG guarantees were approved by IDB private sector windows, covering US$2.6 billion.[14] NSG guarantees were approved for companies in 11 countries, with almost 80% in 4 and none in 15 borrowing countries (Figure 5.1). In interviews, financial sector experts mentioned the following factors as reasons for demand in these countries: the size and development of their financial sectors, know-how among financial intermediaries (FI) to participate in complex financial transactions, and the ability of IDB Invest to issue local currency guarantees in these countries. Using International Monetary Fund (IMF) data, OVE found a correlation between the number of guarantees approved in a country and that country's financial market development (see Annex IV for details).[15] Almost 80% of guarantees had a tenor of seven years or less, and the average coverage ratio was 63%. Between 2016 and 2020, 5 out of the 21 NSG guarantees approved by IDB Invest were canceled. Furthermore, over the same period, IDB Invest worked on at least 44 guarantees that have not yet reached approval, which means they were either dropped or have been on hold and possibly will not be submitted for approval.[16]

Figure 5.1

Number of NSG guarantee operations by country, 2005–2020

Source: OVE, based on IDB Group data warehouse.



Note: ME = Mexico; CO = Colombia; BR = Brazil; PR = Paraguay; RG = Regional; CR = Costa Rica; PE = Peru; UR = Uruguay; TT = Trinidad and Tobago; CH = Chile; and ES = El Salvador. In 15 countries, no NSG guarantees have been approved. See Annex II for split by IDB Invest and predecessors.

14 In 2016, the IDB private sector merge-out took effect, creating the IDB Invest. Since then, IDB Invest has approved 21 NSG guarantees, while the other 44 were approved by its preceding organizations: 9 by IIC, 22 by IDB's Structured and Corporate Finance Department, and 13 by its Opportunities for the Majority Department. Annex II presents information on the 65 NSG guarantees disaggregated by the corresponding issuing windows, each of which had different instruments, procedures, and business models.

15 To assess the correlation between the use of guarantees and financial market development, OVE used the IMF's financial market development indicator. The IMF indicator comprises three sub-indicators measuring financial markets depth, access, and efficiency.

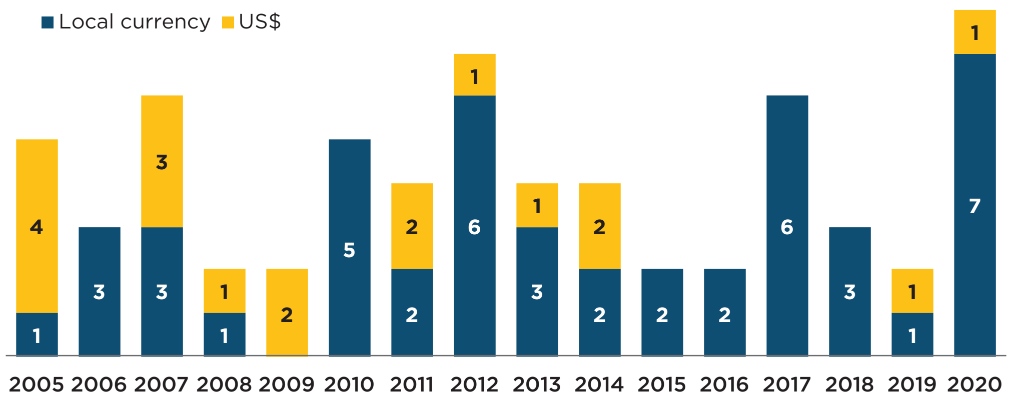
16 Pre-merge-out information on canceled, dropped, or on-hold guarantees was not available to OVE.

5.2 NSG Guarantees have mainly been issued in local currency (see Figure 5.2). IDB Invest offers local currency guarantees to its clients subject to its ability to mitigate the exchange rate risk. Overall, 72% of all NSG guarantees, and more than 90% of the post merge-out IDB Invest guarantees have been issued in local currency.[17] Before the merge-out, restrictions in the IDB Structured and Corporate Finance Department for NSG local currency loans meant that guarantees were a key instrument to support the private sector via local currency financing. IDB Invest can provide local currency loans but guarantees have the advantage that IDB Invest does not need funding in the local currency, unless there is a default. Annex III presents examples of IDB Invest guarantees structures and uses.

Figure 5.2

Currency denomination of NSG guarantees, 2005–2020 (Number of operations)

Source: OVE, based on IDB Group data warehouse and project proposals. See Annex II for split by IDB Invest and predecessors.



5.3 NSG guarantees have been used predominantly in the financial and energy sectors. Together, these two sectors account for 72% and 65% of approved operations by number and value, respectively (Figure 5.3). Most guarantees to financial institutions sought to finance microenterprises, renewable energy projects, and housing.[18] Figure 5.4 shows that 25% of the operations in the NSG portfolio (30% by value) focused on access to finance for micro, small, and medium-size enterprises (MSMEs), while 20% of the guarantees (22% by value) supported renewable energy or energy efficiency investments, and 15% of them (13% by value) supported the provision of mortgages.

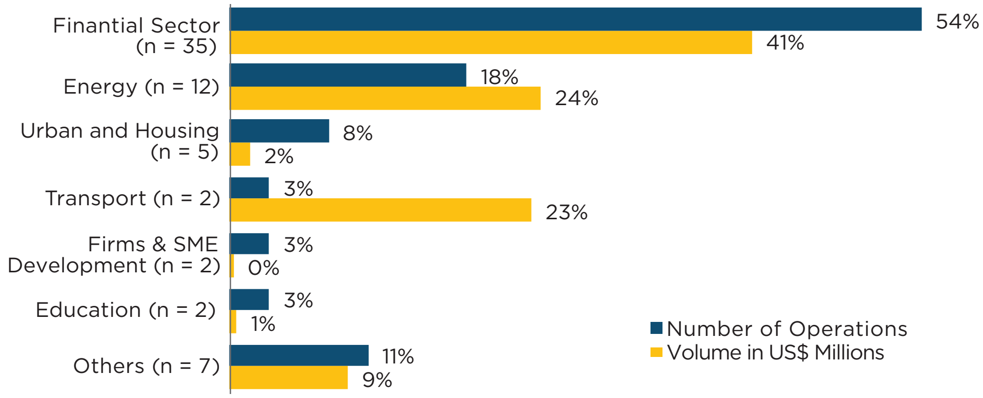
17 For pre-merge out figures, OVE reviewed project proposals to extract the information of guarantee currencies, as databases often reflected the currencies in which other instruments approved under the same project were denominated.

18 Guarantees are frequently labeled as a financial sector project because the guarantee is issued in favor of a financial institution. However, these guarantees have a variety of underlying objectives, including financing microenterprises and renewable energy projects. OVE assessed the projects based on their objectives and underlying asset based on the project proposals.

Figure 5.3

Sector distribution of guarantees by volume and number of transactions, 2005–2020

Source: OVE, based on IDB Group data warehouse. See Annex II for split by IDB Invest and predecessors.

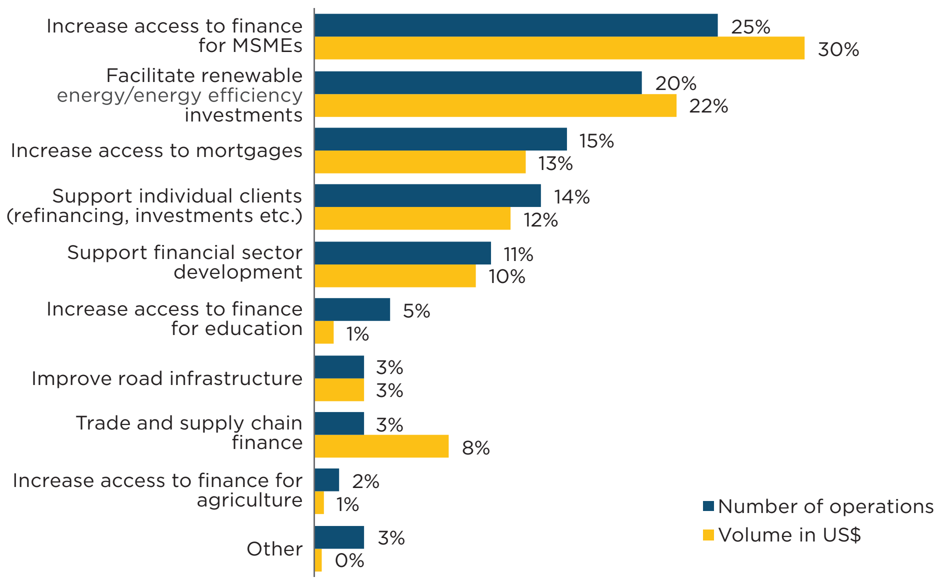


Note: SME = small and medium-size enterprise.

Figure 5.4

Distribution of guarantees by project focus, 2005–2020

Source: OVE, based on project documents.



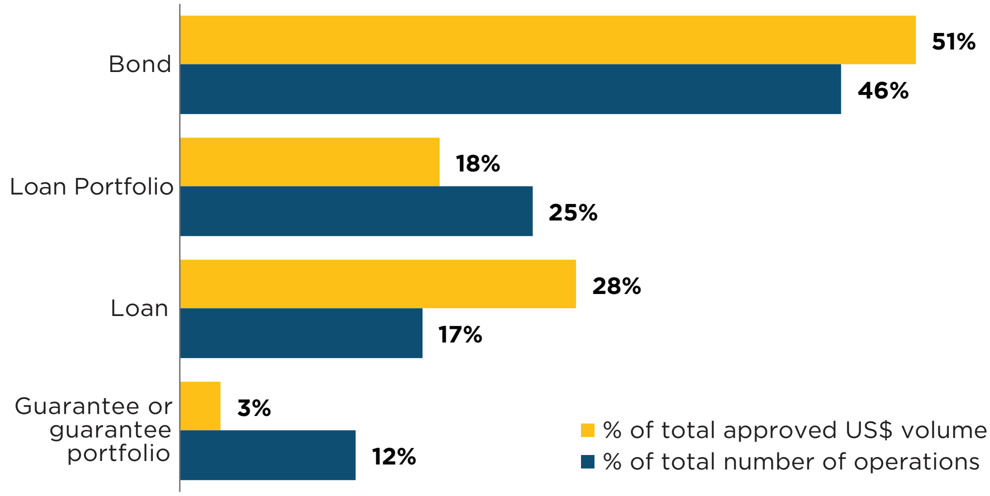
Note: MSME = micro, small, and medium-size enterprise.

5.4 Guarantees have been used predominantly to support issuance of bonds and to cover loan portfolios that promote on-lending facilities. IDB Invest and predecessors' guarantees were used to cover bond or debenture issuance in almost half of total operations (51% by value), while a quarter of the guarantees (18% by value) provided coverage to FIs' loan portfolios (Figure 5.5). About 17% of the NSG guarantees (28% by value) covered individual loans. Last, 3% of approved transactions (12% by value) were counter-guarantees.

Figure 5.5

Underlying transaction covered by NSG Guarantees, 2005–2020 (% total of number of operations and volume)

Source: OVE. See Annex II for split by IDB Invest and predecessors, by percentage of amount approved.



5.5 The IDB Invest guarantees portfolio differs somewhat from that of its predecessors. The average tenor of IDB Invest guarantees is 8 years, up from 5 years for its predecessors. By sectors, before the merge-out, the guarantee portfolio focused on the financial sector (49% of approved amount), while the IDB Invest portfolio is concentrated in the energy sector (41% of approved amount). Accordingly, the main type of clients changed from financial institutions (59% of operations) before the merge-out, to a more diverse type of clients - financial institutions now account for only 29%, while special-purpose vehicles[19] and large corporations account for 29% and 21% respectively. At the same time, projects have remained concentrated in four countries (Mexico, Colombia, Brazil, and Paraguay) throughout the evaluation period.

5.6 Between 2005 and 2020, 4 out of 65 NSG guarantees and RSFs have been called, all of them issued before the creation of IDB Invest. A called NSG guarantee requires an immediate payment by IDB Invest to the guarantee beneficiary. Other consequences of a called NSG guarantee are similar to those of an NSG loan in default. In addition to any subrogation right, IDB Invest would seek repayment from the borrower pursuant to a guarantee reimbursement agreement, and it may execute whatever collateral, liens, and other security it may have. The four called NSG guarantees (two guarantees and two RSFs, totaling US$32 million) were relatively small, innovative transactions in IDB's Structured and Corporate Finance Department and its Opportunities for the Majority Department. These transactions were riskier and much smaller than the average value of NSG guarantees (about US$40 million, see Annex II). OVE did not find direct evidence that the instruments themselves contributed to the default, although one of the Expanded Supervision Reports

19 A special-purpose vehicle is a legal entity created to fulfill narrow, specific or temporary objectives. They are typically used by companies to isolate the firm from financial risks related to a new project.

(XSRs) states that "it is also possible that the selection of a guarantee as the instrument to finance this operation allowed the client to assume a riskier MSME portfolio." With so few (and such small) operations, it is hard to compare NSG guarantees' default rates with those of NSG loans. Thus, there is no evidence—for NSG guarantees-—to support or reject the argument sometimes raised in the literature that the probability of a called guarantee is lower than the probability of a loan in default (see, for example, Humphrey and Prizzon, 2014).

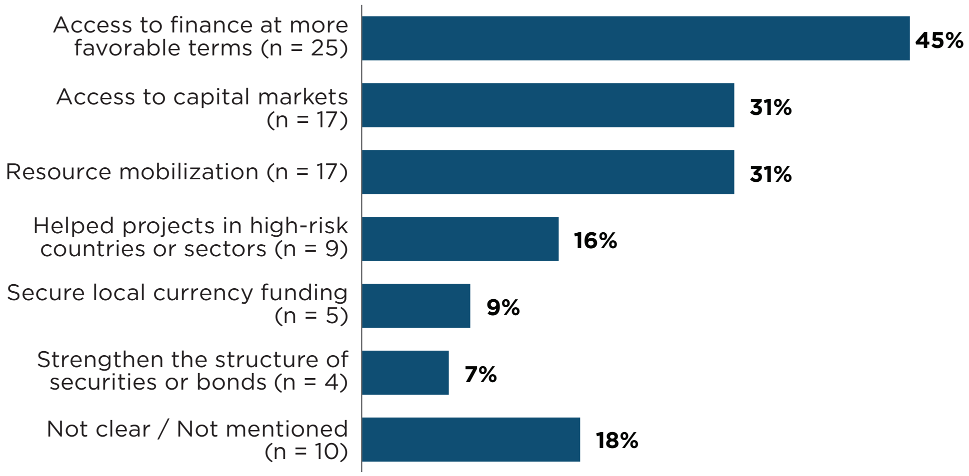
B. The financial additionality of NSG guarantees

5.7 Project documents commonly list as objectives for guarantee operations to support clients in accessing financing at more favorable terms and to mobilize financial resources (see Figure 5.6); however, ex post information to validate those claims is scarce. Some common constraints and risks that guarantees aim to attenuate are lack of information about countries, sectors, projects, and the specific borrower. Guarantees are also aimed at helping finance innovative projects whose risks are difficult to ascertain, such as renewable energy. While information to validate financial additionality is scarce, OVE reviewed available XSRs and conducted client interviews to look for evidence of additionality. OVE also estimated the extent of resource mobilization by NSG guarantees based on the information provided by project documents.

Figure 5.6

Cited additionality objectives of NSG guarantee proposals, 2005–2020

Source: OVE elaboration, based on IDB Invest project documents. Some projects have more than one additionality objective.



5.8 Data are limited, but available XSRs paint a mixed picture on financial additionality. Only 16 out of the 65 NSG guarantee-projects in OVE's evaluation portfolio have XSRs and only 13 of them have OVE validated information on additionality. For 8 of these 13 projects, XSRs found additionality to be satisfactory or higher.[20] The additionality of five projects was rated as partly unsatisfactory or unsatisfactory because they either attracted less financing than expected, were only partially carried out, or the XSR did not clearly show that the objective would not have been achieved without the guarantee. For the remaining three guarantees, there are no data related to the achievement of their additionality objectives (see Figure 5.7).

5.9 The most frequently mentioned additionalities of guarantees, according to XSRs, were longer and/or improved terms for funding, funding in local currency and/or support for novel instruments, but there are some shortcomings too. Four XSRs mentioned access to local currency funding as a key additionality of the guarantee operation An example is IDB Invest's partnership with the Paraguay Social Security Institute (IPS), Paraguay's largest pension fund and an important provider of short-term deposits in local currency in the Paraguayan banking system. Through this partnership, IDB Invest guaranteed the credit risk of local currency loans that IPS would make to local FIs institutions, who would then direct investments into selected sectors.[21] Five XSRs note that through the guarantees it was possible for clients to receive otherwise unavailable long-term funding. Six XSRs mentioned supporting an innovative instrument (e.g., a new bond type) and enabling a more competitive bidding process.[22] In contrast to these positive findings, three XSRs highlighted that the guarantee was not used (or was used to a lesser extent than planned) because its pricing turned out not to be attractive, sometimes due to changes in market conditions. It should be noted that the findings from the XSRs may not be fully representative of the entire portfolio because only operations that achieve early operating maturity require an XSR which was the case for 16 out of 65 approved NSG guarantees and only one IDB Invest-approved guarantee during the study period.

20 The XSRs rate the project's additionality on a four-point scale (excellent, satisfactory, partially unsatisfactory, and unsatisfactory). For more details, see "XSR Guidelines for IDBG Private Sector Operations".

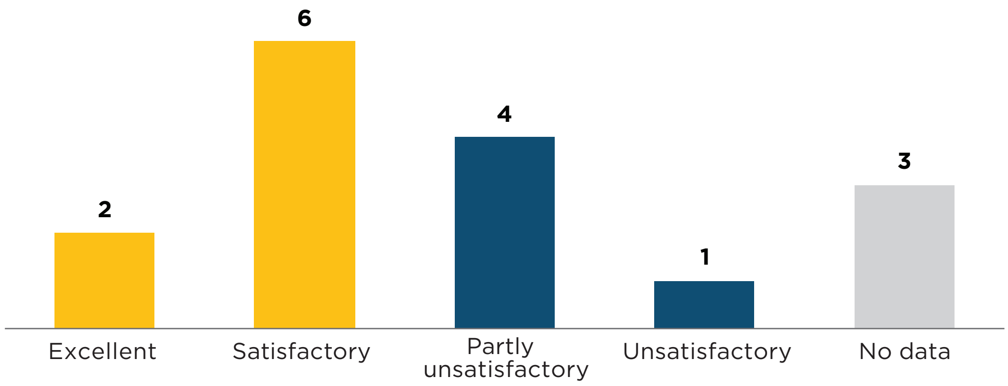
21 Under the IDB-IPS Agreement, five projects supported financial institutions with the objective of increasing access to finance for SMEs (four projects) and increasing finance for water and sanitation (one project); the sixth project supported a mobile network operator.

22 Two of these six XSRs mention that the innovation had been replicated, and one explicitly mentions that no one has followed the approach.

Figure 5.7

Financial additionality OVE's rating (number of validated projects, n = 16)

Source: OVE, based on project expanded supervision reports (XSRs).



5.10 In interviews, staff and clients indicated that a key motivation to use an IDB Invest guarantee was to obtain better financial terms when issuing a bond or a different security, mainly because of the expected rating uplift. Based on interviews with IDB Invest staff and nine clients,[23] NSG guarantees are especially attractive to clients that have a below-investment-grade rating and are seeking to expand the investor base for the issuance of a debt instrument and thereby lower the cost, extend the tenor, or reduce the collateral needed. A rule of thumb mentioned in interviews with clients is that for domestic currency issues, each 15% of guarantee coverage leads to a one-notch upgrade, so a guarantee with 45% coverage would lead to three-notch upgrade. For issuances in international markets, the rule-of-thumb is that a higher coverage, about 25%, is needed for a one-notch upgrade.[24]

5.11 A few NSG clients also indicated that the main financial additionality of guarantees was access to new forms of funding, but that the guarantees had not reduced their cost of funding. Some clients mentioned that the NSG guarantee enabled them to access types of funding that otherwise would not have been available, such as long-term funding and funding in local currency. Clients also indicated that guarantees helped them attract investors/lenders in higher numbers, helped them receive a stamp of approval for the transaction, and helped at least one client get access to other multilaterals. Despite these benefits and increased interest from investors, none of the interviewed clients considered that their all-in cost of funding (i.e., the cost of the loan plus the cost of the guarantee) had been significantly lower than the cost they would have faced from a comparable transaction without a guarantee.

23 OVE conducted nine semi-structured interviews with clients, covering eight NSG transactions (two interviews were conducted on the same project with different parties). Four of the assessed transactions were IDB Invest transactions, the other four transactions started prior to the merge-out. Finding a knowledgeable interviewee on the client side was a major challenge because in many cases the people involved in the transaction had left their respective institutions. Also some team leaders had left the IDB Group, making it hard to identify and contact suitable interview partners on the client side.

24 As mentioned above, each credit rating agencies treats guarantees differently, and potential uplifts depend on the specific characteristics of each guarantee operation.

Two clients claimed to have faced higher costs, which led them to consider abandoning the guarantee. Reportedly, these clients continued with the operation because the transactional costs and the reputational risk of abandoning the collaboration with IDB Invest was too high at that point (and they valued their relationship with IDB Invest); but they indicated that they would not consider another guarantee transaction in the future.

5.12 OVE estimates that the median resource mobilization of NSG guarantees was 1 to 1 over the period reviewed.[25] In 18 cases (about 31%), the guarantee coverage was less than 30%, implying a high rate of resource mobilization (an average leverage of more than 2 to 1). Another 21 guarantees (36% of the total) had a risk coverage of 50% or more, implying a 1 to 1 leverage. Finally, 12 guarantees (about 20%) had a risk coverage of 100% and therefore did not mobilize additional resources (see Annex IV). IDB Invest staff involved in some of these operations indicated that in hindsight it may have been possible to provide less than 100% coverage, but they could not have known this in real time. In other instances, full coverage guarantees were used when resource mobilization was not an objective, for example, to provide local currency funding when IDB Invest could not provide local currency loans.

5.13 IDB Invest does not have a readily available database that systematically tracks resource mobilization by project or instrument. Only 2 out of 16 XSRs provided concrete figures on resource mobilization, indicating that resource mobilization is not systematically assessed. In interviews with IDB Group staff it became evident that there are few efforts to measure mobilization, that data are scarce, and that most managers lack data on the actual extent of mobilization for their projects.[26] Information on the parameters that led to more or less mobilization in different transactions is critical to distill lessons and design better guarantee products.

5.14 In summary, interviews, XSRs, and other data sources suggest that while the outputs of guarantees outlined in the TOC often materialized, achievement of outcomes is less certain. The guarantees afforded clients access to funding not otherwise available or to a larger investor base (output level). However, this increase on the supply side of the financial transaction rarely seems to have led to lower costs for IDB Invest clients (after accounting for the guarantee fee), and in some instances, due

25 OVE estimated the extent of resource mobilization of NSG guarantees based on the information provided in their project proposals, available for 58 out of 65 projects (for details see Annex IV) This is consistent with data provided by IDB Invest, which makes small changes in projects that involved bond issuances to adjust for final bond issuance and PCG amounts. OVE recalculated IDB mobilization rates of IDB Invest data as guarantee amount / mobilized amount, to make them consistent with OVE's approach.

26 In 2021, IDB published data on the planned private co-financing as per approval documentation, however the database is lacking data on the actual mobilization.

to changes in market conditions, the guarantee's additionality vanished after approval. In terms of resource mobilization the evaluation found that four out of five approved NSG guarantees mobilized some private resources. Interviews and XSRs showed that guarantees can help establish instruments that are novel to a certain market (e.g., a certain bond type) and have indeed created a market demonstration effect (confirmed in two XSRs), yet only a few NSG guarantees try to support completely novel instruments (outcome level).

C. Factors affecting the use of IDB Invest guarantees

5.15 NSG guarantees are a niche instrument that can be useful in specific circumstances. For example, in interviews clients and staff mentioned that a partial guarantee of a bond is attractive for borrowers that are just below investment grade, as moving the bond to investment grade can attract more demand from institutional investors and lower costs. Also, external stakeholders, IDB staff and government officials mentioned that guarantees could be helpful to finance PPP investments, particularly during the construction phase.[27]

5.16 Clients reported that under current circumstances NSG guarantees are less appealing than NSG loans (Table 5.1). Among the factors associated with the limited use of NSG guarantees are pricing, perceived high transaction costs, complexity and, until recently, processing times. In interviews, clients explained that often, financial terms were not sufficiently attractive to compensate for costly and lengthy processes. They noted that IDB Invest guarantees' attractiveness is susceptible to changes in market conditions that lead to changes in pricing.[28] As mentioned before, out of the 21 approved IDB Invest guarantees in OVE's evaluation portfolio (approved over 2016–2020), 5 have been canceled so far. The most frequently mentioned reasons for canceled, dropped, and on-hold guarantees were pricing issues and changing financial circumstances that ultimately make the transaction not attractive for the client. Furthermore, because there are more actors involved, guarantees typically require more legal documentation than loans, and often require external legal counsel. Until 2017, the processing times of guarantees were

27 Similar arguments can be found in Pereira dos Santos and Kearney, 2018; Bandura and Ramanujam, 2019; and WEF, 2016 for discussions on the use of guarantees for PPPs and infrastructure.

28 This is in line with findings from other studies that argue that the private sector typically relies on precisely timing its investments to maximize returns under a specific set of market conditions. The long processing times of IDB Invest guarantees create a mismatch between private sector needs and institutions' ability to provide finance to meet these needs (Venugopal at al., 2012).

four months longer than for loans. More recently the difference has become negligible, but it may take some time for clients' perceptions to change (see Annex II for details).

Table 5.1. Perceptions of IDB Invest staff and clients of factors affecting the use of NSG guarantees

Factors affecting both demand and supply sides	
• Identifying and working with a suitable third party.	
• High legal costs because the irrevocability of guarantees requires a very comprehensive contract to cover IDB Group policies.	
• Higher transactional costs due to limited experience with and knowledge regarding the instrument.	
• Increased complexity due to having a third party involved.	
• Perception that processing times for guarantees are longer than for loans.	
Factors affecting the supply of guarantees (IDB Group)	**Factors affecting the demand for guarantees (clients)**
• Credit rating agencies' standards require conservative capital adequacy and liquidity treatment of guarantees.	• Guarantees are attractive only to clients with certain credit ratings and/or in certain market contexts.
• Addressing potential ESG breaches once a contract is signed can be challenging.	• The triggering of a guarantee by an ESG breach limits the attractiveness/irrevocability of the guarantee for some investors.
• Complexity and workload of guarantees is higher than for loans, and they often don't come to fruition, reducing the incentives for staff to offer the instrument. For instance, applying IDB Invest policy requirements (use of proceeds, integrity, ESG) while maintaining liquidity of the instrument is more complex for a bond guarantee than a loan that requires only a bilateral agreement.	• IDB Invest is perceived as a loan provider, not a guarantee provider.
• Training and guidelines for guarantees are not readily available, making the provision of guarantees more complicated.	• Pricing is not always attractive to clients.

Source: OVE, based on interviews with stakeholders.

5.17 While essential for IDB Group and applied to all operations, ESG safeguard requirements can generate uncertainty for the beneficiary of the guarantee. Guarantee beneficiaries (e.g., bond investors) have sometimes been deterred from relying on an IDB Invest guarantee out of concern that it could be terminated for a breach of ESG requirements, even if the project was financially and economically progressing as intended. IDB staff and clients confirmed in interviews that explaining to investors how ESGs are applied and the remedies in case of a breach was a time-consuming process. These trust- and communication-related constraints are less prevalent with direct lending, which takes place in a bilateral relationship (IDB Invest with the borrower) in which clients know that IDB Invest loans come with certain policy requirements.

5.18 IDB Invest guarantees are not widely known by FIs in borrowing countries. Some clients that had received loans in the past and some large international banks that operate in LAC were not aware that IDB Invest offers guarantees. This is important because many, and perhaps most, of the guarantee operations are originated with the clients and their bankers, rather than with IDB Invest staff. Unless FIs are aware of the guarantee instrument, they will not consider it as an option when designing a financing package for their clients.

5.19 There are also supply-side constraints on the use of guarantees, particularly related to IDB Invest processes and lack of staff training. Clients and IDB Invest staff indicated that they were not familiar with NSG guarantees and that they understood them to have higher transaction costs than NSG loans. A majority of staff interviewed reported that many of their colleagues did not know how guarantees work and were not aware of the internal processes they involve (except for staff working explicitly on a guarantee).[29] A majority also said they believed the likelihood of completing a guarantee transaction was lower than that of completing a loan transaction, and consequently they prefer working on loans. In interviews, staff indicated that they were unsure of how to guide clients through a guarantee process and that they would not know who in IDB Invest would be the right point person to do this. The IDB Invest legal team is now preparing contract templates for certain project types and jurisdictions but working on NSG guarantees often implies learning-by-doing for IDB Invest staff and all parties involved. IDB Invest still lacks standardized guidelines or manuals, but staff is developing training courses on innovative instruments such as guarantees. In interviews, IDB Invest staff often mentioned that working with clients on guarantees required more "hand-holding" than working on loans.

5.20 OVE received several suggestions from IDB Invest staff as to possible solutions to the above-mentioned constrains. These suggestions—listed in Box. 5.1—point to some accrued experience from the implementation of guarantees even if it is currently dispersed around the institution and not readily available to all IDB Invest staff.

29 OVE interviewed 29 IDB Invest staff including operation team leaders and staff in the legal, finance, and strategy departments.

Box 5.1. IDB Invest staff suggestions to increase the use of NSG guarantees

When asked about potential solutions to increase the use of guarantees, IDB Invest's staff pointed at various potential options.

Career incentives: Greater recognition in performance reviews could encourage staff with little expertise in guarantees to explore them as an option.

Statement from management in support of use of guarantees: More explicit support from senior management could help promote the instrument

Piloting of new approaches: More pilots and openness to trial-and-error approaches could help make the instrument better. Such activities would also help improve the guarantee policy in order to incorporate country-specific contexts.

Creation of a separate guarantee fund: Some IDB Invest staff as well as experts from other institutions indicated that a separate guarantee fund such as the Credit Guarantee and Investment Facility (see Section VI for details) could be a way to overcome barriers such as being historically focused on loans.

Increased awareness: Finally, a vast majority of interviewees thought that promoting more internal and external awareness of guarantees would be crucial. This could be done, for example, through specific training on guarantees, more guidelines and knowledge sharing on what IDB Invest has already developed, and more outreach focused on guarantees to change the perception that IDB Group is providing only loans.

06

Other Uses of Guarantees at the IDB Group

6.1 This section reviews the IDB Invest and IDB experience with using other types of guarantees. In particular, it looks at the short-term trade guarantees provided by IDB Invest under the TFFP and the IDB Invest Debt Capital Markets Program (DCMP), as well as IDB experience with purchasing third-party guarantees to cover part of its own portfolio. While these guarantee operations are not the focus of this evaluation, lessons can be drawn from the Group's experience with them.

A. IDB Invest guarantees under the TFFP

6.2 The TFFP was launched in 2005 and provides loans and guarantees to local banks to finance portfolios of eligible trade transactions.[30] TFFP products are different than the long-term SGs and NSG guarantees that are the focus of this evaluation: they are smaller (about US$2.4 million on average over January–September 2021); they are shorter-term (averaging 180 days over the past 6 years); they consist of high-frequency, standardized transactions with streamlined administrative requirements; and they are generally processed in only a few days (OVE, 2016). The fees for the TFFP guarantees have averaged 125 bps per annum over the past 6 years.

6.3 Since its inception, the TFFP has provided guarantee cover for over US$5 billion supporting significant and growing trade-related transactions, and it has afforded the region's banks and their small- and medium-size corporate clients greater access to international trade finance markets. The number and volume of transactions has been growing, for example, from US$84 million in 2016 for 57 guarantees to US$637 million for 85 guaranteed transactions in 2020. Due to the very short-term nature of trade finance (most guarantees have tenors of less than a year), the actual aggregated contingent liabilities outstanding for IDB Invest at any point in time are much lower than the annually processed volume. For instance, at year-end 2020 the maximum potential risk of outstanding TFFP guarantees amounted to US$250 million (less than half the processed volume). Overall, there is an aggregate maximum authorized limit for outstanding TFFP guarantees of US$1 billion at any point in time.

6.4 Guarantees from the TFFP are much better known in the market than other IDB Group guarantee instruments. Interviews with clients, financial institutions, and IDB staff clearly showed that the TFFP guarantees are much more widely known and used instruments than other guarantees of the IDB Group.

30 The discussion on the TFFP guarantees is based on Annex V, which describes the program and draws lessons that could be useful to improve the design and increase the use of the long-term IDB Group guarantees.

6.5 While the products are very different, there are some features of the TFFP guarantees program that could be considered to improve the design of IDB and IDB Invest medium- and long-term guarantees. Although the lessons should be taken with caution given the particularity of the TFFP business (a standard product, similar-risk transactions, and less complex structures), some factors that facilitated the expansion in the use of TFFP guarantees may be transferable to the guarantees business:

a. A core team of product experts who are known by potential users of TFFPs, as well as by IDB Group staff, as the go-to contacts for advice and to handle the financial aspects of possible transactions. These experts are located in a single unit in IDB Invest under the responsibility of the head of trade and supply chain finance.

b. Extensive dissemination and marketing of TFFP products. These efforts were important to make the program well known in the LAC region and within the IDB Group.

c. Streamlining of documentation and processes. TFFP's standardized contracts and processes reduced transaction costs for both IDB Invest and borrowers. Standardization would be much more difficult to achieve for long-term guarantees than for TFFP transactions, as the underlying transactions are much more different from each other.

d. Establishment of a network of local and international banks that are familiar with the TFFP mandate and practices. IDB Invest identified financial institutions in the region and outside the region that were interested in and well placed to be partners for the TFFP program. Eventually, this led to the establishment of a network of issuing and confirming financial institutions that have been actively using TFFP guarantees.

B. IDB Invest DCMP

6.6 The DCMP was established in 2017, granting management delegated authority for certain transactions in the capital market.[31] The initial volume of the program was US$600 million, and it was expanded in 2019 to US$1 billion (document CII/PP-409). In debt capital markets conditions can change quickly, and hence, the authority delegated by the Board of Directors to Management is a key advantage of the DCMP, as it allows for a faster approval process (document CII/PR-853). As a measure

31 Debt capital markets are markets in which entities raise funds through the issuance of debt securities such as corporate bonds, municipal bonds, agency bonds, government bonds, commercial paper, and asset-backed notes.

of risk mitigation, approvals can be delegated only for projects with a high impact score[32] and a volume below US$100 million. PCGs are eligible instruments of the program, alongside anchor investments, warehouse lines, and A/B bonds.

6.7 Guarantees play a more important role in the DCMP than in IDB Invest in general (or IDB) yet guarantees are still less frequently used than other solutions. Out of 22 transactions approved through the end of 2020, only 5 were guarantees (22.7%), and only US$90 million of the approved US$725 million was for guarantees (12.4%). Even though PCGs are seen as a potential solution for many needs (see Table 6.1), their use is still low. For example, warehouse credit lines are deemed suitable for only two out of five scenarios, yet the instrument was used roughly as often as guarantees, in four transactions for US$130 million. Anchor investments[33] were a far more utilized tool, being used in 10 out of 22 projects, covering US$363 million, even though PCGs would have theoretically also been an option for all of these situations. In interviews, IDB staff indicated that the faster processing speeds of these transactions have been key in making guarantees more attractive. Experts from other MDBs with similar programs that allow for delegated authority from the board highlighted ease and speed as key benefits. By the same token, the experience also shows that even with an expedited approval process, guarantees are still not the favored instrument.

Table 6.1. DCMP instruments and their potential application

	PCG	Anchor investment	Warehouse line	A/B bond
Thematic bond	X	X	X	X
Sustainability-linked bond	X	X		X
Transition bond	X	X		X
Corporate structured issue	X	X	X	X
Risk transfer solution	X			

Source: IIC, 2021 (document CII/PP-409).

C. Third-party guarantees and other risk transfer operations

6.8 Purchasing guarantees from a third party could be an efficient way to leverage IDB Group's capital. The Swedish International Development Cooperation Agency (Sida) offers a balance sheet guarantee, which

32 A DELTA (Development Effectiveness Learning, Tracking, and Assessment tool) score of 8.0 or higher is required.

33 Anchor investments support a bond issuance by committing to purchase a total or partial portion of a debt issuance.

uses Sweden's high credit rating to release headroom in the balance sheet of lenders. In 2020, the IDB purchased a guarantee from Sida covering US$100 million of loans, which freed IDB capital and reduced IDB's exposure to the borrowers whose loans were covered by the Sida guarantee.[34] Pursuing similar opportunities with other bilateral donors would allow the IDB Group to continue leveraging its expertise as a loan provider and IDB's regional knowledge and close relationship with governments, while also mobilizing resources. While not entirely comparable to that of the IDB Group given the type of product it offers, the experience of the World Bank Multilateral Investment Guarantee Agency's (MIGA) suggests that there may also be potential for other MDBs to purchase guarantees or insurance from private investors - MIGA re-insured about US$11 billion of its US$13 billion in guarantees (MIGA, 2020). According to interviews with Asian Development Bank (ADB) staff, the ADB is also moving in the direction of purchasing insurance and guarantees from the private market to cover part of its loan portfolio, thereby freeing resources to increase lending.

34 The Sida guarantee covered loans to Bolivia, Colombia, and Guatemala (IDB, 2020). Sida charges a much lower guarantee fee than the IDB because it relies on IDB's due diligence and does not have the costs of preparing and supervising the operations. Sida also issued a balance sheet guarantee for a loan portfolio of the ADB totaling US$155 million.

07

Other MDB's Experiences with Guarantees

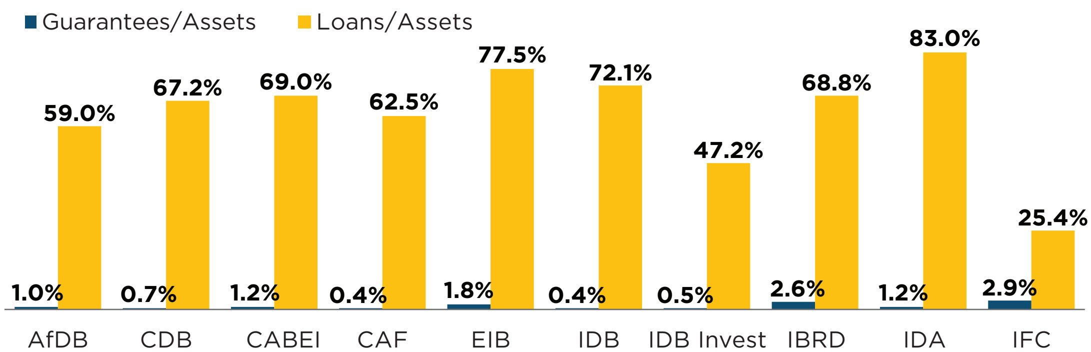
7.1 This chapter presents the experience of other MDBs in using guarantees, to identify differences, common challenges, and potential solutions. The analyzed MDBs include the World Bank Group, the ADB, and the African development Bank (AfDB).

7.2 Most development banks are chartered to provide guarantees, but with few exceptions, this instrument represents a very small portion of their operations. Figure 7.1 shows that the IDB Group is not unique in having guarantees make up only a fraction of its portfolio. Among comparator MDBs, the highest ratios in 2018 were those of the International Bank for Reconstruction and Development (IBRD, aka the World Bank) and of the International Finance Corporation (IFC), at almost 3%. In the same year, the IDB and IDB Invest had issued guarantees equivalent to about 0.5% of total assets. Between 2005 and 2020, the World Bank issued five SG guarantees to IDB borrowing countries (Argentina, Colombia, Haiti, and Peru), the same number issued by the IDB during that period.

Figure 7.1

Selected MDB guarantees to assets and outstanding loans, 2018

Source: S&P, 2019.



Note: IDB Invest guarantee amount (US$17.1 million) differs from the published version of the Standard & Poor's (S&P) report (which reported zero outstanding guarantees for the Corporation). The number was corrected by OVE based on IDB Invest Financial Statements and confirmed by S&P. AfDB = African Development Bank; CDB = Caribbean Development Bank; CABEI = Central American Bank for Economic Integration; EIB = European Investment Bank; IBRD = International Bank for Reconstruction and Development (World Bank); IDA = International Development Association; IFC = International Finance Corporation.

7.3 With few exceptions, other MDBs offer guarantee products similar to those of the IDB Group. Most MDBs offer public clients PCGs and PRGs. In addition, some allow PCGs and PRGs to be structured as PBGs. To private clients, MDBs also offer PRGs, PCGs, as well as other tailor-made products, without requiring a sovereign counter-guarantee (see Table 7.1).

Table 7.1. MDBs guarantee products

	SG			NSG	
	PRG	PCG	PBG[a]	PRG	PCG
ADB	X	X	X	X	X
NDB	X	X		X	X
AfDB	X	X	X	X	X
CAF		X			X
	PRG	PCG	PBG[a]	PRG	PCG
EBRD				Tailor-made products	
EIB		X			X
IDB	X	X	X		
IDB Invest				X	X
IBRD & IDA	X	X	X		
IFC					X

Source: OVE elaboration, based on Pereira dos Santos and Kearney, 2018.
Note: [a] PCG or PRG can be structured as a policy-based guarantee (PBG). Original table (2018) has been simplified and CAF added. Many MDBs offer other guarantee products identified in the original table and, in some cases, partial credit guarantees can be tailored to cover up to 100% of projects' costs.
ADB = Asian Development Bank; AfDB = African Development Bank; CAF = Development Bank of Latin America; EBRD = European Bank for Reconstruction and Development; EIB = European Investment Bank; IBRD = International Bank for Reconstruction and Development (World Bank); IDA = International Development Association; IFC = International Finance Corporation; NDB = New Development Bank.

7.4 Like the IDB Group, other MDBs exercise prudence with respect to capital adequacy provisions for guarantees, driven by the goal of maintaining their excellent credit ratings. All comparator MDBs have policies requiring that their guarantees occupy the same space, in terms of provisioning, as loans. This policy is driven by the need to ensure that capital would be available if the guarantees were to be called, and by the requirements of credit rating agencies (Pereira dos Santos and Kearney, 2018).[35] MDB guarantees have been called very few times, but they have reputational risks beyond those of loans. MDBs can stop disbursements of loans as soon as a project faces severe risks such as a looming default, but this is not the case with guarantees because of their irrevocability. The most frequently mentioned case of a default is a World Bank PBG for the government of Argentina, which was triggered in 2001.

35 At the Third G20 Finance Ministers and Central Bank Governors Meeting, held on July 9 and 10, 2021, it was agreed to launch an independent review of MDBs' capital adequacy frameworks, to maximize their development impact by making "the best use of available resources, while preserving their preferred creditor treatment and current ratings." One of the focus areas of this review will be the MDBs' capital treatment of credit guarantees versus traditional loan instruments on their balance sheets and whether the current approach reflects the relative credit risk of these instruments (see G20 Italia 2021a and 2021b). More recently, in a *Financial Times* article, Leslie Maasdorp, the chief financial officer of the New Development Bank, called on other MDBs to increase their leverage ratio, even if it could lead to a downgrade of their credit ratings (Maasdorp, 2021).

7.5 The pricing of guarantees is similar across MDBs and broadly equivalent to the pricing of loans. Because capital requirements for guarantees are the same as for loans, their pricing is set at an equivalent level.[36] The price of a guarantee has three components—a front-end fee, the guarantee fee, and the standby-by fee—that are combined in different ways. Like the IDB, the ADB currently does not charge front-end fees, but the World Bank (IBRD) and the AfDB charge a small front-end fee. The guarantee fee typically applies only to the disbursed amount of the guaranteed underlying instrument. The guarantee fees of the ADB, AfDB, and IDB are charged on the nominal exposure, while IBRD charges are calculated on the net present value of the exposure. The difference could become significant if the instrument covered by the guarantee (e.g., a commercial loan) disburses slowly and the guarantee has a long tenor. The IDB and the AfDB are the only institutions that have a uniform guarantee fee, independent of the client or tenor. For the undisbursed amounts a standby fee is charged, which is currently 50 bps at the IDB, 25 bps at IBRD and AfDB, and 15 bps at ADB. For NSG guarantees, MDBs typically use market-based pricing, as used for NSG loans.

Table 7.2. Current pricing of SG guarantees in MDBs

	BID	BIRF	BAsD	BAfD
Guarantee fee in basis points (bps)	**90 bps**	**50–165 bps** (depending on average maturity and country group)	**50–70 bps** (depending on average maturity and country group)	**80 bps**
Method to calculate guarantee fee	Charged on the callable amount	PBG/PCG: present value of exposure; PRG: maximum disbursed and outstanding amount	Charged on the callable amount	Charged on the callable amount
Standby fee	Equal to credit fee (**50 bps**), charged on the difference between the maximum guarantee amount and actual guarantee amount	Same level as commitment charges on a loan (**25 bps**)	USage of guarantee fee (**15 bps**); charged on undisbursed principal	Same level as commitment charges on a loan (**25 bps**)
Front-end fee	Current inspection and supervision fee (**0 bps**)	**25 bps** charged on the full guarantee exposure	Applicable front-end fee (**0 bps**)	**Up to 100 bps** on the full guarantee exposure

Source: OVE elaboration, based on Pereira dos Santos and Kearney (2018) and updated with information from the banks' websites.
Note: ADB = Asian Development Bank; AfDB = African Development Bank; bps = basis points; IBRD = International Bank for Reconstruction and Development (World Bank); PBG = policy-based guarantee; PCG = partial credit guarantee; PRG = partial risk guarantee.

36 See dos Santos, 2018; IDB, 2013 (document GN-2729-2), paragraphs 3.17 and 3.18; and World Bank, 2018b.

7.6 The World Bank and the African Development Fund (AfDF)[37] created incentives for the use of SG guarantees by reducing their impact on countries' lending envelopes. Under this incentive scheme, guarantees consume only 25 cents on the dollar out of a country's lending envelope—that is, a 1-dollar guarantee reduces the amount available for the country to borrow by only 25 cents. The World Bank scheme was available for all guarantee operations, but since July 2020, it is only available for IDA and IBRD financed private-sector project-based guarantees. For risk management purposes, the World Bank still calculates country exposure based on the full value of guarantees, and it stops the incentive scheme if a country approaches the corresponding country exposure limit. The ADF incentive is provided only to its least creditworthy members, which is feasible because the ADF is funded by donor grants and does not borrow in capital markets.

7.7 Some MDBs have created dedicated institutions to provide NSG guarantee products exclusively. These institutions include MIGA (created by the World Bank Group, 1988), the Credit Guarantee and Investment Facility (CGIF, established by ADB trust fund, 2010), the European Investment Fund (EIF, established by the European Investment Bank, 1994), and the African Guarantee Fund (AGF, see Box 2.4).[38] Some of these institutions chose to leverage their capital more than the corresponding lending MDBs, even if this leads to a lower credit rating. An AA guarantee is less problematic for these guarantee-only MDBs because they often provide a similar credit rating uplift as would a AAA guarantee (because a AA guarantee may suffice in the client's domestic markets for an uplift to AAA of a local-currency instrument, for details, see Annex VI). Clearly, the choice of greater leverage and a lower credit rating would have deleterious effects on a lending MDB (such as the IDB and IDB Invest) because it would lead to higher borrowing and lending interest rates, however, a specialized guarantee provider would rarely need to fund itself (only if a guarantee is called).

37 The ADF is the concessional window of the AfDB Group. ADF it is fully funded by donors and therefore does not need to be concerned with credit ratings and borrowing costs.

38 Specialized guarantee providers have also been present in some developing countries worldwide, especially in Africa and Asia, since the 1950s and 1970s, respectively. Annex VI analyzes the work of selected regional guarantee providers AGF, CGIF, GuarantCo, and InfraCredit (Nigeria).

Box 7.1. The African Guarantee Fund

The African Development Bank (AfDB) and other donors established the off-balance-sheet African Guarantee Fund (AGF) in 2011, targeting specifically small and medium-size enterprises. The AGF is owned by the development agencies of Denmark (20%), Spain (11%), and France (8%), and by Germany's KfW bank (34%), the Nordic Development Fund (10%), the Danish Investment Fund for Developing Countries (9%), and the AfDB (8%) (Fitch, 2020). By the end of 2019, eight years after its creation, AGF had issued a cumulative US$1.1 billion in guarantees to 161 partner financial institutions in 40 African countries. About 20% of its portfolio is reinsured by other development agencies such as Sida or the U.S. International Development Finance Corporation, facilitating a high capital leverage. The AGF is rated AA- globally by Fitch (AAA by various local agencies). AGF's fees vary significantly across different types of guarantees and comprise a facility fee and a utilization fee (OECD, 2021).

Source: OVE elaboration, based on AGF, 2019.

7.8 The specialized guarantee provider of the World Bank Group, MIGA, has been able to issue far more guarantees and leverage its capital much more than other MDBs and the other World Bank Group institutions (the IBRD, the IFC, and the International Development Association). In 2020, MIGA issued nearly US$4 billion in new guarantees in support of 47 private sector projects (MIGA, 2020). Several factors explain MIGA's performance. First, MIGA does not borrow funds and derives its shadow credit rating from the standing of its key shareholders and the IBRD (see Fitch, 2020 and World Bank, 2009), which affords it greater flexibility in its capital policies. Second, MIGA's employees are experts on guarantees because the institution is focused exclusively on guarantees. Third, the price of its guarantees is set based on a transaction-specific risk assessment and not a uniform fixed rate (Pereira dos Santos and Kearney, 2018). Fourth, it is able to leverage its capital by reinsuring large parts of its portfolio. This has allowed MIGA to leverage its subscribed capital of US$1.9 billion to an underwriting capacity of US$29 billion. The outstanding guarantee portfolio in 2020 was US$22.6 billion (MIGA, 2020), a leverage of 1 to 12, compared with the IDB's 1 to 1 leverage (see Annex VI). Finally, MIGA's guarantees cover only certain of the transactions' risks (principally political risk), which allows it to issue guarantees with more favorable terms.

7.9 Although the expectation has been that MDB guarantees would serve as a tool to mobilize private capital, there is scant information to show whether this expectation has been borne out. Data on resource mobilization of guarantees is very scarce and, at best, accessible only from within each one of the MDBs.[39]

39 The most commonly cited source of information on the resource mobilization of guarantees is data compiled by the Organization for Economic Co-operation and Development (OECD, 2019) (see, for example, IDB, 2019; Betru and Lee, 2017; Hansen, Rand, and Andersen, 2020; OECD, 2021). The OECD's methodology measures the amounts mobilized by guarantees as "the full nominal value of the instrument (e.g., the underlying loan) to which

7.10 Independent evaluations conducted in several MDBs identified constraints similar to those identified in this OVE evaluation that limited the use of guarantees. The evaluations (ADB, 2017; EBRD, 2020; World Bank, 2009, 2021) found that the MDBs were set up as lending institutions and, consequently, staff lacked the required knowledge and expertise about guarantees. The evaluations also found that staff incentives were focused on commitment volumes and not on resource mobilization, which in fact was not being tracked. Complex and time-consuming processing was identified as a challenge, and the long processing time was reported as a leading reason for clients to drop guarantees. Guarantees were not being promoted to clients and often were not part of the country strategy conversations (see Annex VII for more details).

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the guarantee relates, regardless of the guarantee's coverage" (OECD, 2020b). MDBs use a different methodology, which is better aligned with their goal of making more resources available to clients. Under the MDB methodology, only the non-guaranteed portion of the transaction counts as resource mobilization (because the guaranteed portion would be offset by a parallel reduction in direct lending by the MDB because of its impact on the MDB's capital and the borrower's lending envelope). Therefore, the OECD numbers are not good estimates of the actual or potential resource mobilization by MDBs according to their own definitions.

08

Conclusions and Recommendations

8.1 There has been little use of guarantees by the clients of MDBs, in spite of recurrent calls by the G20 and others to expand the use of guarantees as a way to leverage MDBs' capital by mobilizing more private resources for developing and emerging market economies. There are structural impediments to a rapid increase in the use of guarantees, at least under the current policy framework.

8.2 Despite the low usage of guarantees there is widespread agreement that they can be useful to clients for certain market niches. Clients and staff, as well as FIs and credit rating agencies, corroborate that there are niches where SG and NSG guarantees could be useful. For example, a partial guarantee of a bond for a borrower that is below but close to investment grade could move the bond to investment grade and attract significantly more demand. Similarly, a SG guarantee could be helpful to finance a PPP investment, particularly during the construction phase. Also, IDB Invest guarantees could support clients to raise domestic currency financing with third parties in countries where the IDB Group does not have deep treasury operations.

8.3 The IDB Group does not systematically measure resource mobilization from guarantees. Data necessary to estimate the contribution of SG guarantees to resource mobilization are not available. For some operations there is information on planned mobilization, but not for realized mobilization. Similarly, data for NSG guarantees are not reported at the project level, nor are they readily available in aggregate. To collect such data would require reporting by lenders and borrowers on the details of the actual financial transactions, as well as on what would have happened without the guarantee in terms of resources, costs, and tenor. This lack of information made it impossible for the evaluation to assess the overall contribution of guarantees to resource mobilization.

8.4 The capital rules and pricing policies for SGs and NSG guarantees are similar to those for the respective loans, leading borrowers to prefer loans over guarantees, since the latter have higher transaction costs. For the IDB Group, guarantees and loans occupy the same space in a client's lending allocation—that is, a guarantee reduces one-to-one the amount of IDB Group loans available to a borrower. Under these circumstances, most borrowers prefer taking a loan rather than requesting a guarantee, which is a product they are less familiar with. The capital allocation policy also drives the pricing, as IDB Group policy is to equalize the return on capital across both instruments. Often, this leads IDB Group's clients to prefer loans over guarantees due to the higher transaction costs and complexity of the latter. Because there are more parties involved, guarantees take longer to negotiate and require more, and less standardized, documentation than similar loans. Preparing and negotiating the guarantee package is more likely to require external legal counsel for the IDB Group as well as the client, and to be spread over several jurisdictions. These requirements can add substantially to the transaction costs.

8.5 IDB Group management and staff have little familiarity with guarantees, and incentives favor working on loans, which are better understood, simpler to process, and more likely to materialize. Very few staff in IDB and IDB Invest are knowledgeable about the processes and documentation involved in providing a guarantee, or about their terms and conditions. Due to their very limited information on and experience in the use of guarantees, staff have few incentives to work on guarantees. In addition, because of the necessary involvement of a third party, the risk of not reaching the signature stage is higher than for loans. For instance, for every approved guarantee transaction from IDB Invest, there are two such transactions that have not reached approval to date. For IDB, two out of the five approved SG guarantees were canceled shortly after their approval date. These numbers explain why managers and staff prefer to work on loans rather than on guarantees, which have a higher risk of not materializing. In many ways, guarantees experience some of the challenges of an “infant instrument” in that they may need incentives for staff and clients to experiment with them before they realize their full potential.

8.6 The IDB Group is not known as a guarantee provider among potential clients (with the exception of TFFP guarantees for trade financing). Authorities in several member countries and private financial institutions that are in contact with potential clients do not know about the different guarantee products the IDB Group offers. The institution is, by and large, perceived as a loan provider. The lack of awareness is more pronounced in regard to IDB guarantees than those of IDB Invest, which could be explained by the fact that IDB Invest has granted many more guarantees than IDB. The only well-known guarantee product is the short-term trade finance guarantee of the TFFP. Although lessons should be taken with caution considering the particularity of the TFFP business (a standard product, similar-risk transactions, and less complex structures), some factors that facilitated the expansion in the use of TFFP guarantees could be transferable to the medium- and long-term guarantees business: a core team of product experts who are known by potential users of TFFPs, an extensive dissemination and marketing of the product, standardized contracts and processes that reduced transaction costs, and a network of local and international banks that are familiar with the TFFP's mandate and practices.

8.7 Some other MDBs facing challenges similar to those of the IDB Group have set up subsidiaries or parallel organizations that are mainly (and sometimes only) focused on guarantees. For example, the World Bank, the AfDB, and the European Investment Bank have created MIGA, the AGF, and the EIF, respectively. These organizations face fewer constraints regarding credit ratings, since in most cases the guarantee business is subsidized directly or indirectly by the MDB's shareholders or other donors, and they have therefore been able to develop a more active guarantee business.

8.8 OVE did not find evidence to support changes in the current IDB Group's capital allocation and pricing policies. These policies are driven by the requirements of credit rating agencies as much as by the prudent risk management that characterizes the IDB Group and other MDBs. Any change in these policies and practices (independent of arguments about historical experience and probabilistic models) would trigger a review of the IDB rating and could affect its standing in capital markets.

8.9 On the basis of the findings of this evaluation, OVE makes the following recommendations:

To IDB

1) **Monitor and report on SG guarantees' resource mobilization and associated financial terms.** The key rationale for scaling up the use of guarantees has been that they could help mobilize private funding for development projects beyond what MDBs can provide, but not enough evidence is available to judge whether this would be the case for the IDB. IDB has issued less than ten guarantees and has not been collecting data on the resources mobilized and their financial terms in a systematic way. To establish whether SG guarantees could serve to mobilize additional funding, it is essential to systematically monitor and report on the amounts, cost and tenor of resources mobilized with the support of each SG guarantee, together with estimates, based on data provided by the clients of the terms and amounts the borrowers would have been able to access without the guarantee.

2) **Design and implement a time-limited pilot scheme which offers borrowers guarantees with a reduced impact on their country lending envelope.** Under this pilot, a guarantee issued to a borrower would be counted against the country

lending envelope at a discounted rate rather than its full value. The objective of this scheme would be to facilitate the use of guarantees and generate the information needed by IDB and its clients to assess the benefits, challenges and potential of dif-ferent modalities of SG guarantees. At the end of the pilot period the scheme would be closed, and its performance evaluated to establish whether and how the SG guaran-tee-instrument could be improved. Other MDBs have established similar arrange-ments (e.g., the African Development Bank and the World Bank) and IDB has done son an ad-hoc basis (e.g., the 2018 guarantee to Ecuador). The pilot scheme could be funded by contributions from member countries, IDB capital or both.

3) **Designate a group of staff experienced in structuring guarantees to serve as focal point for SG guarantees.** These staff would act as resource persons inside and outside IDB for questions regarding guarantees and support clients and staff in the structuring and monitoring of SG guarantee operations. The group could also provide training to IDB staff and clients on the financial aspects of guarantees and disseminate information gathered through the implementation of the pilot. The guarantee resource staff would be given time to provide these advisory services on an as needed basis, while remaining in their regular working units.

To IDB Invest

1) **Monitor and report on NSG guarantees' resource mobilization and on their associated financial terms.** OVE found that data necessary to estimate the contribution of NSG guarantees to resource mobilization were not readily available, nor was information on the impact of the guarantee on the interest rate, tenor, and collateral requirements of the underlying transactions. To ascertain whether guarantees fulfill their expected potential to mobilize additional private sector resources, such data need to be systematically collected and reported. This information could then serve as a basis for the Board of Directors and Management of IDB Invest to decide whether and how NSG guarantees could be made more helpful to clients as well as for accountability purposes to ensure the instrument is not distorting the markets.

2) **Identify and incorporate key success factors from the TFFP model that can be adapted to the processing of long- and medium-term guarantees to enhance their attractiveness for clients.** The evaluation identified several operational features of the TFFP guarantee-program that could

conceivably be adapted to the NSG guarantees to address some of the factors that currently constrain their use. Examples include (i) having a core team of product experts who are known by potential users of the program and by IDB Invest staff as the go-to contacts for advice and to handle the financial aspects of possible transactions; (ii) carrying out extensive dissemination and marketing; (iii) streamlining documentation and processes; and (iv) establishing a network of local and international banks that are familiar with the instrument's characteristics and practices.

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