

Development Co-operation Directorate
Development Assistance Committee**DAC Working Party on Development Finance Statistics****INCLUSION OF THE EFFORT IN USING PRIVATE-SECTOR INSTRUMENTS IN ODA:
EXPLORING FURTHER THE INSTITUTIONAL AND INSTRUMENT-SPECIFIC APPROACHES****WP-STAT Informal Meeting, 2-3 March 2015**
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This document is submitted for DISCUSSION under Item 3b of the draft agenda DCD/DAC/STAT/A(2015)2/PROV. Members are invited to provide their WRITTEN COMMENTS to the Secretariat by 20 March 2015 at the latest.

This note addresses the mandate from the December 2014 DAC High Level Meeting (HLM) to “urgently undertake further work to reflect in ODA the effort of the official sector in catalysing private sector investment in effective development”, and to “explore further the institutional and instrument-specific approaches that have been developed by members, and potentially other approaches, with the aim of concluding at our next [HLM] meeting”.

The note illustrates technical issues related to the operationalisation of the institutional and instrument-specific approaches, so as to achieve a better understanding of their implications, both qualitatively and quantitatively.

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INCLUSION OF THE EFFORT IN USING PRIVATE-SECTOR INSTRUMENTS IN ODA: EXPLORING FURTHER THE INSTITUTIONAL AND INSTRUMENT-SPECIFIC APPROACHES

I Introduction

1. On 16 December 2014, the DAC High Level Meeting (HLM) recognised that “the present statistical reporting system does not fully reflect the changing way in which members are engaging with the private sector, nor does it incentivise innovation”. The participants of the HLM therefore decided to **“urgently undertake further work to reflect in ODA the effort of the official sector in catalysing private sector investment in effective development”**, and to **“explore further the institutional and instrument-specific approaches that have been developed by members, and potentially other approaches, with the aim of concluding at our next [HLM] meeting”**.¹

2. This paper addresses the above **HLM mandate**.² It illustrates technical issues related to the operationalisation of the institutional and instrument-specific approaches, so as to achieve a better understanding of their implications, both qualitatively and quantitatively. The note only looks at measurement issues with regard to ODA. The measurement of the totality of official flows and flows mobilised through private-sector instruments will be discussed separately.³

3. The paper is structured as follows:

- Section II outlines the universe of instruments under consideration and clarifies terminology.
- Section III examines the issues related to the institutional approach, including the definition of a development finance institution (DFI) and comparisons between bilateral DFIs, international finance institutions (IFIs) and Public Private Partnerships (PPPs).
- Section IV examines the issues related to the instrument-specific approach and presents examples of how it could be operationalised by calculating grant equivalents for guarantees, mezzanine finance and equity participations.
- Section V concludes and suggests a potential way forward.

4. The paper is circulated **for discussion** at the WP-STAT Informal meeting on 2-3 March 2015, and **for written comments** which should reach the Secretariat by **20 March 2015 at the latest**. Members are invited to comment on the analysis in sections III-V and the questions raised in paragraphs 38, 69 and 74. Their feedback will form the technical basis for further discussions in the DAC.

1. Cf. <http://www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.pdf>, paragraph 13.

2. The paper builds on previous exchanges at the June 2014 and September 2014 WP-STAT meetings and the October 2014 DAC Senior Level Meeting (SLM). Cf. CD/DAC/STAT/RD(2014)3/RD3, DCD/DAC/STAT/RD(2014)3/RD5, DCD/DAC/STAT/RD(2014)3/RD6 and DCD/DAC(2014)49.

3. Cf. DCD/DAC/STAT(2015)8 for the measurement of private flows mobilised through the use of private-sector instruments by the official sector. Work on the measurement of the totality of official flows under TOSD will be pursued in the course of 2015 based on the HLM decisions. Cf. <http://www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.pdf>, paragraph 14 and Annex 3.

5. The paper is a methodological note, focussed on technical questions related to the statistical measurement of the donor effort involved in using private-sector instruments. The paper does not analyse in detail the incentive structures resulting from the implementation of either the institutional or instrument-specific approach, or alternative approaches. However, such questions will be posed to the DAC in a following step in order to ensure that any measurement is not only technically sound but also delivers towards the ultimate objective of creating appropriate incentives to provide more private-sector oriented development finance (removing any existing – and avoiding the creation of new – disincentives for the efficient use of private-sector instruments).

II Universe of private-sector instruments

6. The term “**private-sector instruments**” generally refers to loans, guarantees, mezzanine finance and equity provided to private enterprises. The term “**market-like instruments**” is broader in scope as it also covers cases where such instruments are extended to official (public) sector recipients. In the DAC discussions the two terms have been used interchangeably in the past, with “private-sector instruments” understood as referring to all financial instruments other than grants and sovereign loans, regardless of the classification of the recipient (private or public). This paper follows the same practice and uses the term in its broad sense.

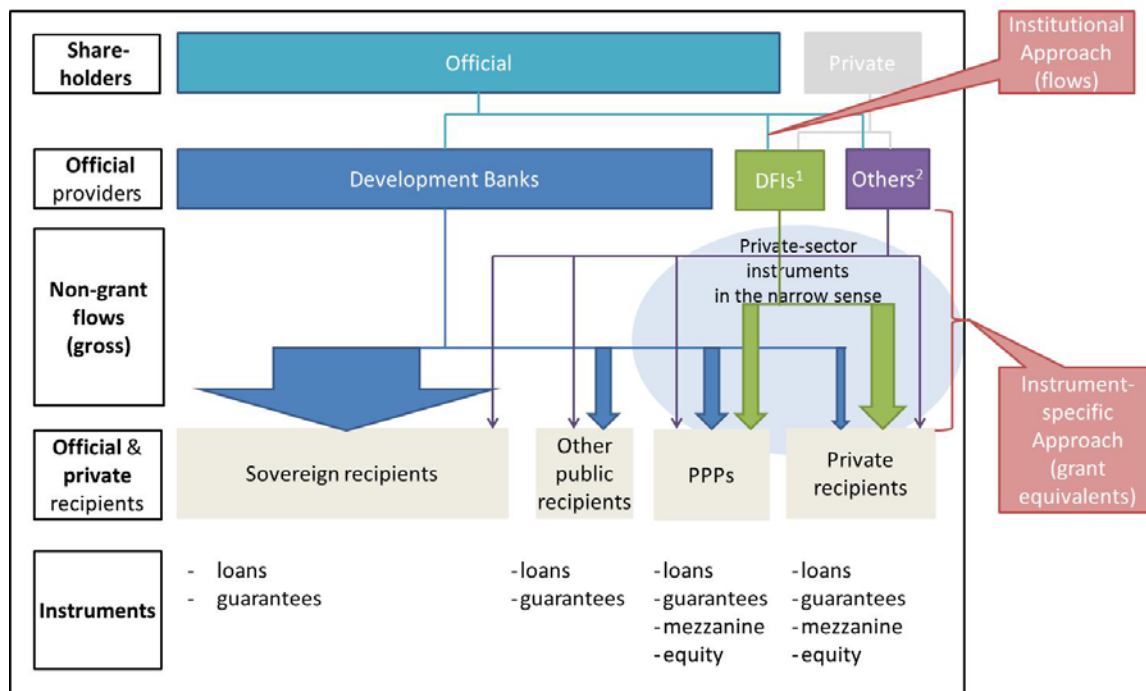
7. Figure 1 below depicts the universe of private-sector instruments in bilateral development co-operation⁴, with shape sizes indicating volumes. **Providers** include development banks and development finance institutions (DFIs) but also aid agencies, project finance and export banks or other financial intermediaries such as investment funds. Some financing is also provided directly by donor governments’ Treasury Departments rather than channelled through any independent institution. **Recipients** can be official⁵, private or Public-Private Partnerships (PPPs). DFIs only finance private sector recipients and PPPs, while development banks predominantly work with official sector recipients.⁶ However, overlaps exist as development banks also finance PPPs and – to a limited extent – private recipients. Information on the current coverage of private-sector instruments in DAC statistics is given in Box 1.

4. Private transactions i.e. those undertaken by firms or individuals from their own private resources remain outside the scope of ODA.

5. Official recipients include national governments (“the sovereign”) as well as regional or local governments and state-owned enterprises (“other public recipients”).

6. Note that this only applies to bilateral institutions. Several IFIs have mainstreamed their public and private operations and finance both public and private recipients. See table 2.

Figure 1. Private-sector instruments in bilateral development co-operation



¹⁾ Not all DFIs are wholly public and several are incorporated as PPPs. Austria's OeEB is fully private. For further detail see Table 1.

²⁾ Aid agencies, donor government Treasury Departments or other financial intermediaries such as Project Finance & Export Banks or Investment Funds.

8. In regards to the measurement of the effort by the official sector in using private-sector instruments, members have put forward two approaches: the institutional approach and the instrument-specific approach.

9. **The institutional approach** discussed so far looks at DFIs only. Under this approach, the donor effort would be measured on the basis of donor contributions (and potentially reinvested earnings) to and divestments from the DFI. The ODA measure would capture the transactions between the donor government and its DFI (see Figure 1), and have no link to the type of instruments, volume or concessionality level of finance extended by the DFI. The outflows from the DFI would be reportable under the new measure of Total Official support for Sustainable Development (TOSD).

10. Since DFIs only represent one type of provider of private-sector instruments and exclusively service private sector recipients and PPPs, complementary methods would be required in order to cover the entire universe of private-sector instruments extended by both DFIs and other providers to private and official recipients alike (see Figure 1).

11. **The instrument-specific approach** would be applicable to all providers. Under this approach, private-sector instruments would be included in ODA in the same way as sovereign loans, i.e. ODA would account for the grant equivalents of such instruments. The approach rests on the assumption that methodologies for calculating the grant element can be established for all instruments and that only those instruments that are concessional (i.e. instruments with a positive grant element or with a grant element above a certain threshold) are eligible for inclusion in ODA. Just as with the institutional approach, outflows from providers would not be captured in ODA but under TOSD.

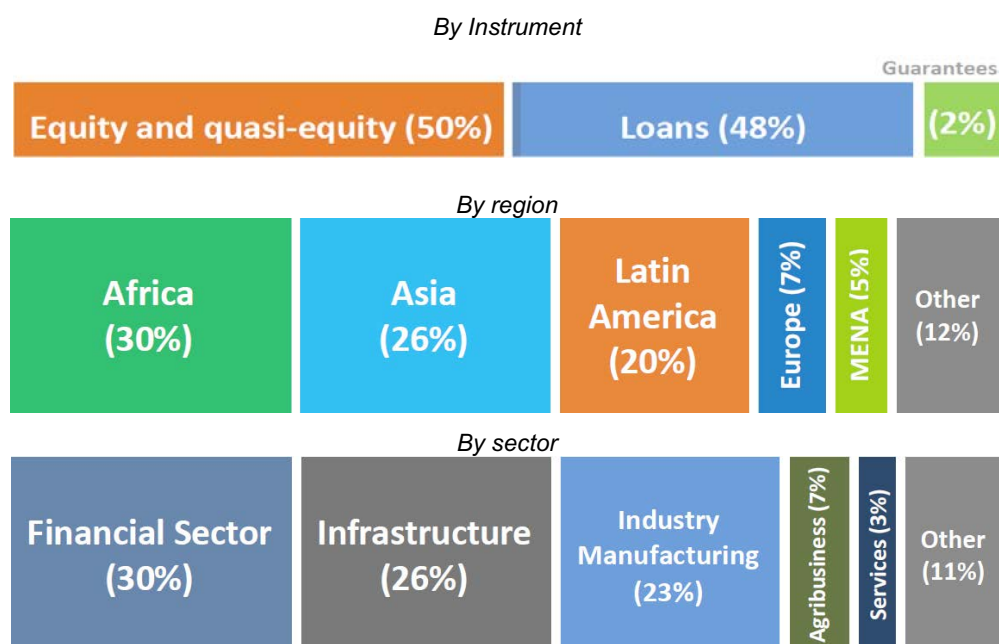
Box 1. Current coverage of private-sector instruments in DAC statistics

The coverage of private-sector instruments in DAC statistics has improved over the last few years but remains incomplete. The current ODA and OOF definitions provide weak incentives for reporting (e.g. no political traction for OOF, no recognition of guarantees, negative net entries for successful equity investments) and have led to differences in the reporting practices across members.

Important progress has been made on the reporting by DFIs – important, albeit not exclusive, delivery channel for private-sector instruments. Out of the 15 members of the Association of European Development Finance Institutions (EDFI), 10 already report on all and two others on parts of their operations in DAC statistics. In addition, the US reports on the operations of its DFI OPIC. Overall, USD 3.4 billion¹ of new commitments by DAC countries' national DFIs were reported in DAC statistics for 2013, of which USD 1.3 billion as ODA and USD 2.1 billion as OOF.

Divergences in reporting can be seen when contrasting these numbers with the financial statements of DFIs. According to their joint annual report, the 15 EDFI members alone committed EUR 5.8 billion in 2013. Equity and loans are the dominant instruments (see Figure 2). If DFIs outside of Europe and private-sector instruments provided by other institutions than DFIs are taken into account, total commitment volumes might have been more than double as institutions outside of Europe are significantly larger than their European peers.

Figure 2. EDFIs portfolios in 2013 (total portfolio of EUR 28 billion)



Source: EDFI Annual report 2013

1. Includes commitments by Proparco identified through a keyword search in France's reporting on AFD operations. Excludes OeEB's private flow commitments, which are not separately identifiable in Austria's reporting to the DAC (disbursements by OeEB amounted to USD 0.1 billion in 2013).

III. The institutional approach

12. The institutional approach has been developed by Norway, Switzerland and the UK in consultation with other members and selected DFIs. During previous discussions in the WP-STAT and the DAC, members' opinions diverged on the feasibility and desirability of the approach. Proponents of the approach argued in favour of a consistent statistical treatment of bilateral DFIs with international finance institutions (IFIs). Other members pointed to the reputational difficulties of introducing in DAC statistics a new in-donor cost category and argued in favour of a consistent statistical treatment across all financial instruments provided by all bilateral providers. More technical work was requested to further inform the decision-making process. This section thus intends to dissect the specific issues related to the institutional approach and seeks members' feedback on specific questions, listed at the end of the section.

Defining an ODA-eligible DFI

13. In order to implement the institutional approach, a clear definition is required for what constitutes an ODA-eligible DFI. Several members also support the development of *“safeguards to ensure that the activities of these institutions are credible and that they have a development mandate”*.⁷

14. Generally, DFIs are perceived as the private sector arms of bilateral development co-operation, i.e. official institutions that finance and invest in private sector entities in developing countries. Overlaps exist with other providers such as development banks, project finance and export banks or investment funds, i.e. some of the services that a DFI offers in one country may be offered by a non-DFI in another country. Table 1 below lists 16 institutions that may be referred to as DFIs. In addition, it includes JBIC and KEXIM because these institutions are providing (besides more export-oriented finance) some of the same products as DFIs in other countries, e.g. investment loans for developing countries. Depending on the definition chosen for a DFI, other institutions may also need to be considered as ODA-eligible institutions in this context.

15. Although official institutions, DFIs operate under private sector rules. Financing is provided to profitable enterprises at market or near-market terms, i.e. DFIs provide non-concessional finance.⁸ This serves two purposes: First, DFIs do not undermine existing (or potential) commercial finance but rather crowd in new finance; second, DFIs demonstrate actual commercial viability of private solutions in developing countries which can stimulate subsequent private investments. Besides these commonalities, DFIs vary considerably in their mandate and geographic coverage. Major differences furthermore exist in their ownership and governance structures.

16. **Ownership:** The ownership of DFIs is diverse. Some institutions are fully owned by official shareholders while others are set up as PPPs in which (sometimes various) official investors hold a majority. Two institutions stand out: Proparco, because not only does it constitute a PPP but also a North-South Partnership in which development banks from partner countries are also shareholders; and OeEB, which is fully privately-owned. For the purpose of DAC statistics, all institutions in which more than 50 per cent of the capital is owned by official shareholders are classified as official.

7. See UK discussion paper on the ODA eligibility of private sector instruments, September 2014, Cf. [DCD/DAC/STAT/RD(2014)3/RD6], paragraphs 23-24.

8. Some DFIs may, however, cross-subsidise certain products or provide concessional instruments on behalf of their governments, see paragraph 33.

Table 1. Tentative list of bilateral institutions to be considered under the institutional approach

DAC Member	DFI	Founded	Ownership	% official	% private	Current CRS reporting
<i>Australia</i>	-----					
Austria	OeEB	2007	Private ¹	—	100 %	Yes
Belgium	SBI	1971	PPP	63 %	37 %	No
	BIO	2001	Official	100 %	—	Yes
<i>Canada</i>	-----					
<i>Czech Republic</i>	-----					
Denmark	IFU	2001	Official	100 %	—	Yes
Finland	Finnfund	1980	PPP	92 %	8 %	Yes
France	Proparco	1977	PPP	70 % ²	30 %	Yes, partial
Germany	DEG	1962	Official	100 %	—	Yes
<i>Greece</i>	-----					
<i>Iceland</i>	-----					
<i>Ireland</i>	-----					
Italy	SIMEST	1991	PPP	majority	minority	Yes, partial
Japan	JBIC	1999	Official	100 %	—	No
Korea	KEXIM	1976	Official	100 %	—	No
<i>Luxembourg</i>	-----					
Netherlands	FMO	1970	PPP	51 %	49 %	No
<i>New Zealand</i>	-----					
Norway	Norfund	1997	Official	100 %	—	Yes
<i>Poland</i>	-----					
Portugal	SOFID	2007	PPP	60 %	40 %	Yes
<i>Slovak Republic</i>	-----					
<i>Slovenia</i>	-----					
Spain	Cofides	1988	PPP	54 %	46 %	No
Sweden	Swedfund	1979	Official	100 %	—	Yes
Switzerland	SIFEM	2005	Official	100 %	—	Yes
UK	CDC	1948	Official	100 %	—	Yes
USA	OPIC	1971	Official	100 %	—	Yes

¹⁾ OeEB benefits from official guarantees.²⁾ Of which 13 % are non-French.

Source: EDFI Annual Reports 2013, DFIs' Annual Reports, internet research.

17. **Governance:** DFIs have been incorporated in various forms as companies, banks or funds. They generally operate as independent institutions. While the owners define the mandate and rules to which the institution has to adhere, oversight and management are delegated to a board of directors. By appointing (and withdrawing) board members, owners exert indirect control over a DFI without direct interference in day-to-day operations. The composition and profile of board members differ across DFIs and depend on national legal requirements, the ownership structure and shareholder preferences. The link to the public administration responsible for development policies can be strong or loose: Some DFIs are directly associated with the development or foreign policy strand of their governments (e.g. CDC), others have closer ties to their respective Treasury Departments (e.g. OPIC), while yet another group is owned by other state-owned enterprises either with a development mandate (e.g. DEG being owned by KfW) or without

such a mandate (e.g. COFIDES being majority-owned by ICEX Spanish Trade and Investment, The Institute of Official Credit and the National Innovation Enterprise). Most DFIs employ their own staff while some have outsourced some or all day-to-day operations to third parties (e.g. SIFEM).⁹

18. **Mandate:** A developmental objective is generally part of the mission statements of a DFI.¹⁰ Differences exist in the emphasis of domestic interests alongside of it. Some DFIs have no requirements to involve domestic players from their country in their operations. Others have obligatory co-financing requirements with domestic players or almost exclusively support national companies in their efforts to set up or extend subsidiaries in developing countries. A few also offer more traditional export credit or insurance services and in-donor country financing (e.g. import loans). Such activities are not ODA-eligible, even if they were provided on sufficiently concessional terms.¹¹ This raises the question of whether all official inflows in DFIs can be equally ODA-eligible or whether development activity coefficients should be established.

19. **Geographic coverage:** Some DFIs limit their operations to the poorest countries, e.g. while it is a condition for IFU's financial participation in a project that there is a private Danish co-investor, IFU only invests in countries with a per capita income below USD 6 238 (in 2013). Others focus on certain regions or restrict their interventions to ODA-eligible countries or more generally to developing and emerging countries, which may include countries that have graduated from the DAC List of ODA Recipients. A third category of DFIs operates worldwide covering both developing and developed countries (e.g. SIMEST). Similar to the question above, it would have to be decided whether all flows to such institutions should count as ODA or only a pro-rata attribution corresponding to the share of the DFI activities in ODA-eligible countries.

20. **Other criteria:** The UK has outlined several other potential eligibility criteria. These comprise of qualitative criteria, such as efficient balance sheet and cash management, appropriate evaluation and reporting structures or appropriate corporate governance standards. Another safeguard may also be considered to ensure responsible finance standards to avoid the over-indebtedness of private borrowers. In order to operationalise such criteria, both minimum standards and the process for their assessment would need to be agreed.¹²

Comparing bilateral DFIs with International Finance Institutions (IFIs)

21. International Finance Institutions (IFIs) are the private-sector arms of the multilateral development banks. Similar to bilateral DFIs, they provide financial products and related advisory services to private enterprises in developing countries. The private sector activities of IFIs tend to be smaller than their public sector activities. However, the classification of public and private sector operations may differ among IFIs. For instance, some IFIs with operations that focus on the private sector also offer municipal

9 . SIFEM does not have any employees beside a part-time board secretary. Investment management and day-to-day operations are delegated to a private investment advisory company that receives a fee for its services.

10 . For a description of how DFIs and IFIs address development challenges, cf. "International Finance, Institutions and Development Through the Private Sector, A joint report of 31 multilateral and bilateral DFIs", 2011 at http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/ifc+news/events/ifireport_sept2011.

11 . Cf. CONVERGED STATISTICAL DIRECTIVES, chapter 1, paragraph 17.

12 . See UK discussion paper on the ODA eligibility of private sector instruments, September 2014, Cf. [DCD/DAC/STAT/RD(2014)3/RD6], paragraph 24.

finance, and some have different definitions of precisely what the private sector includes in terms of relative level of state ownership, for example, in PPPs.¹³

22. **Institutional set-up:** Several private sector focussed IFIs have been established as dedicated, legally autonomous institutions. They are often part of a banking group in which official sector operations are offered by sister institutions within the group. Other IFIs provide both private and official sector finance in parallel. There are also cases in which there is a group structure that generally divides between private and official sector finance but some overlaps exist nevertheless in certain areas. For instance, the Inter-American Investment Corporation (IIC) and Multilateral Investment Fund are members of the Inter-American Development Bank Group and focus on private sector operations. The Bank itself – while predominantly providing official sector finance – also directly offers structured and corporate finance to private sector clients. (This set-up also exists on bilateral level in Germany. The German Development Bank KfW and the German DFI DEG are members of the KfW Banking Group. In principle, KfW focusses on official sector finance and DEG on private sector finance. However, KfW also offers some private sector finance directly, most notably in the area of microfinance and structured funds). Table 2 shows for selected IFIs whether they have integrated official and private sector operations or whether they have dedicated institutions that are solely servicing private clients.

23. **Ownership:** IFIs are owned by their shareholder countries, i.e. they are 100 per cent official. Capital subscriptions to IFIs constitute official equity investment in these institutions. However, shares are not freely tradable, i.e. the legal ownership is not readily transferable from one owner to another. Shareholder countries also do not expect any financial returns but consider their capital contribution as a sunk cost comparable to a membership subscription fee.¹⁴ In DAC statistics, capital subscriptions to multilateral institutions are thus assimilated to grants.

24. **Governance:** IFIs are governed by different board structures and voting arrangements between their member countries. The difference between bilateral DFIs and IFIs is the representation of both developed and developing countries in the governance bodies of most IFIs, i.e. the country in which an IFI operates also has a formal vote in the IFI itself. Over the past twenty years, the IFIs, particularly the World Bank Group, have undergone significant changes to further increase their accountability and transparency. Measures include an increase of the relative voting power of developing and transitional member states, the use of participatory consultation processes for developing operational procedures as well as the adoption of far reaching information disclosure policies. As a result, IFIs have more obligations than bilateral DFIs to formally interact with and be held accountable by their various stakeholders.¹⁵

25. **Mandate:** The IFIs' mandates with regard to private sector development, their instruments as well as the financial terms and conditions applied to them, are comparable to those of many bilateral DFIs. As a matter of fact, IFIs and DFIs often co-operate and invest jointly in the same projects. As multilateral

13 . Cf. "International Finance, Institutions and Development Through the Private Sector, A joint report of 31 multilateral and bilateral DFIs", 2011, page 19.

14 . While IFIs may not pay out dividends, financial compensations would have to be paid in the case of withdrawal or suspension of the membership of the donor in the institution or in case of liquidation of the institution.

15 . There are also many other specific arrangements in which IFIs are embedded in the international governance structure. For instance, membership in the International Monetary Fund and the IBRD are pre-requisites for membership in the IFC. Provisions in the IFC's articles ensure that the IFC board of directors is identical to that of the World Bank. The World Bank Group's president also serves as the IFC president. Both facilitate coordination of the two institutions' policies and operations. However, the distribution of voting power in the IFC board differs from that of the World Bank board because of the different patterns of ownership.

institutions, however, IFIs do not condition their operations to the participation of any national (domestic) stakeholders.

26. **Geographic coverage:** IFIs generally operate in their member countries. For the purpose of DAC statistics, a number of IFIs with activities in ODA as well as non-ODA eligible countries have been assigned an ODA co-efficient.

Table 2. Official and private-sector finance by selected IFIs

International Finance Institution (IFI)	Private sector finance	Official sector finance
Asian Development Bank (ADB)	x	x
African Development Bank (AfDB)	x	x
Black Sea Trade and Development Bank (BSTDB)	x	
CAF (Development Bank of Latin America)	x	
European Bank for Reconstruction and Development (EBRD)	x	x
European Investment Bank (EIB)	x	x
Islamic Development Bank Group		
• <i>Islamic Development Bank (IsDB)</i>		x
• <i>Islamic Corporation for the Development of the Private Sector (ICD)</i>	x	
Inter-American Development Bank Group		
• <i>Inter-American Development Bank (IDB)</i>	x	x
• <i>Inter-American Investment Corporation (IIC)</i>	x	
• <i>Multilateral Investment Fund (MIF)</i>	x	
World Bank Group		
• <i>International Finance Corporation (IFC)</i>	x	
• <i>Multilateral Investment Guarantee Agency (MIGA)</i>	x	
• <i>International Bank for Reconstruction and Development (IBRD)</i>		x
• <i>International Development Association (IDA)</i>		x

Comparing bilateral DFIs with Public Private Partnerships (PPPs)

27. Many DFIs are incorporated as PPPs, i.e. they have both official (public) and private owners, and their governance structures and mandates are comparable to those of many other (national or international) PPPs that are currently not denoted as DFIs (nor as IFIs). For example, the European Fund for Southeast Europe (EFSE) is an international PPP that “*aims to foster economic development and prosperity in the Southeast Europe region, including the European Eastern Neighbourhood region, through the sustainable provision of additional development finance.*”¹⁶ EFSE is owned by governments, DFIs and private investors. It is incorporated as an investment fund and is governed in the same way as several DFIs that are also incorporated as funds.

28. In current DAC statistics, international investment funds such as EFSE may be classified as ODA-eligible PPPs on the Annex 2 List of ODA-eligible international organisations. In previous deliberations, the WP-STAT has differentiated between unstructured funds (with only one share class) and

16. See www.efse.lu.

structured funds (with different share classes with different risk profiles). Equity investments in unstructured funds are treated in the same way as direct equity investments. In order to be reportable as ODA they need (i) to be provided by an official agency, (ii) be invested in an ODA-eligible country or multilateral institution, (iii) be primarily development-oriented and (iv) be concessional.¹⁷ For structured funds such as EFSE, the WP-STAT agreed in 2012 that only equity investments in the form of first-loss shares are considered sufficiently concessional to be reportable as ODA, while investments in mezzanine shares were considered commercial in nature and therefore not ODA-eligible (regardless of their development aims).¹⁸

29. Due to the overlaps and commonalities between several DFI and non-DFI PPPs, any definition of ODA-eligible flows under the institutional approach may thus also affect the desirable treatment of PPPs.

Defining ODA-eligible transactions

30. Different DAC members who have expressed their support for the institutional approach suggested different options as to what may be ODA-eligible transactions between a donor and its DFI. Norway restricted its proposal to capital contributions, i.e. DFI equity, while Switzerland suggested counting all flows (in the form of equity, loans and funds managed by the DFIs on behalf of their governments) as well as net forgone distributions (i.e. reinvested earnings).¹⁹ The former would be congruent with the current treatment of IFIs in DAC statistics. The latter would go beyond it.

31. **Capital Subscriptions:** DFIs largely operate on a self-sustaining basis, i.e. capital contributions from governments are generally limited to their initial capitalisation. Most of the older and mature DFIs have not received any additional share capital in years or even decades but built their equity base by reinvesting earnings. Accumulated earnings are significant in some institutions, so these DFIs distribute all or parts of their annual profit to their shareholders. According to their annual reports, only Swedfund, Norfund and JBIC received new capital contributions in 2013. At the same time, several DFIs paid dividends to their shareholders. (See table 3.)

32. **Other Contributions and Support:** Besides capital contributions, governments may also refinance their DFIs at preferential terms, e.g. Switzerland provides an interest-free loan to SIFEM. Under the institutional approach it would therefore have to be decided whether and how such support would be accounted for in ODA. It also poses the question of whether, and how, to value unfunded government contributions to DFIs, namely guarantees. This question has not been discussed in the past because of the blanket exclusion of guarantees in a flow-based statistical system, but it is relevant today following the introduction of the grant equivalent measurement of donor effort.²⁰

33. **Fiduciary funds:** DFIs are also managing funds as trustees on behalf and on the account of their governments against a fee. These funds represent neither a financial nor legal exposure to them (off

17. Cf. [DCD/DAC(2013)15/FINAL], section I.A.3.1, paragraph 183 and section I.2, paragraph 16.

18. Cf. [DCD/DAC/STAT/M(2012)2/PROV], paragraph 7.

19. Cf. [DCD/DAC/STAT/RD(2014)3/RD5], page 2.

20. Since DFIs are regulated financial institutions that need to provision so-called economic capital (immobilised equity) as a function of the risks they absorb, governments can either provide large amounts of equity or assume part of the risk by issuing a guarantee, thus lowering economic capital requirements for the DFI. This question would be particularly important to Austria as OeEB has been established without any official capital contribution. However, the political and commercial risks involved in the projects of OeEB are covered by sovereign guarantees issued by the Government of Austria. Other DFIs, e.g. the Dutch FMO, also benefit from guarantees for a minor part of their portfolio.

balance-sheet operations). All costs and returns are directly born by the government. Such funds are usually earmarked for a specific purpose, can take the form of any financial instrument, and are often provided at concessional terms to the ultimate beneficiary. Since these funds are merely transiting through DFIs without an effect on their accounts, it would seem most appropriate to subject them to the same approach as all other funds from official providers (other than DFIs).

34. **Dividends:** The proposals presented by members foresee that dividends would be treated as negative ODA. Under the approach, capital investments in and divestments from DFIs are basically treated in the same way as any other equity under current reporting rules, i.e. on a net flow basis. It therefore also causes some of the same issues. Institutions that need additional capital because they are still growing or experience financial distress, caused by external and internal reasons alike, would generate positive ODA. Mature DFIs that are successful and generate reflows to their shareholders would produce negative ODA. Since several DFIs are PPPs, public shareholders are also not independent in deciding on whether to reinvest or distribute profits. To mitigate the risk of generating negative net ODA over the lifetime of a DFI, reflows could be capped at the amounts of initial capital contributions.

35. **Reinvested earnings:** Some members have argued in favour of counting in ODA the amount of reinvested earnings while other members have declined the idea, pointing out that funds that are distributed in the form of dividends and subsequently reinvested would also not generate any additional net ODA (zero sum game). Forgoing the opportunity to realise profits and invest them elsewhere is, however, considered an effort towards development by others. However, donors only forgo this opportunity temporarily while they stay entitled to their share of all cumulated earnings that correspond with their ownership share in the DFI. Not distributing these earnings in a given year is compensated by an increase of the donor-owned assets in the same year (i.e. increase in equity). On the other hand, if the DFI generates losses, its equity and thus the donor-owned assets decrease. It could therefore be argued that the donor effort equals the losses a DFI incurs rather than its (reinvested) earnings. If a DFI does not have sufficient equity to cover all losses and stay solvent, their owners need to inject fresh capital. Consequently, such capital contributions would be reportable as positive ODA (see paragraph 31).²¹

Estimating ODA volumes under the institutional approach

36. What the institutional approach implies in numbers depends on the treatment of the variables explained above. Table 3 gives some retroactive estimation for the year 2013 assuming full ODA eligibility of the named institutions and all their activities. If only capital contributions would have been ODA-eligible, additional EUR 618 million would have qualified as ODA. The increase would have been attributable mainly to Japan and Norway. If reinvested earnings would have also counted in ODA, EUR 995 million would have been added, spread over a wider set of donors. At the same time, dividends amounting to EUR 436 million may have counted as negative ODA. Overall, EUR 1.2 billion could have been reported as additional ODA by counting in ODA capital contributions *plus* reinvested earnings and *minus* dividends paid by DFIs. This corresponds to an increase of 1.2 % of 2013 ODA from EUR 101.5 billion to EUR 102.7 billion.

21. Another angle to look at reinvested earnings is from a financial perspective. Profits are the result of income minus costs. Income is irrevocably connected to the financial terms of the products extended by a DFI. The higher the prices charged, the higher the income, and the higher the profit that can be reinvested. In other words, all other things equal, the most expensive DFI scores the highest ODA. This seems contradictory to the beneficiary perspective. It is also at odds with the rationale adopted for measuring the donor effort in official sector lending, i.e. the softer the terms, the higher the provider effort and hence the higher the ODA.

37. Generally, overall amounts are largely linked to Japan and the US. If JBIC or OPIC would not be considered (fully) ODA-eligible, volumes would drop steeply. OPIC is an interesting example as it demonstrates the full life cycle of a mature institution. If the US were to report on OPIC according to the above criteria, it would have reported negative ODA of EUR 308 million in 2013. Since OPIC has already returned money to the U.S. Treasury for 36 years, this would have represented only one entry in a long legacy of negative ODA from OPIC which in total surmount all capital contributions ever made to OPIC.

Table 3. Estimated capital contributions, reinvested earnings and dividends of bilateral institutions (in 000 EUR)

Country	DFI	Estimated capital contribution by donor country since inception (1)	Estimated capital contributions by donor country in 2013 - A -	Estimated reinvested earnings 2013	Estimated reinvested earnings 2013, donor country pro-rata share (2) - B -	Estimated dividends 2013, donor country pro-rata share - C -	Additional ODA A + B - C
Austria	OeEB	0	-	1,820	0	-	0
Belgium	SBI	22,407	-	55	34	?	34
	BIO	n.a.	-	8,500	8,500	?	8,500
Denmark	IFU	154,468	-	9,676	9,676	-	9,676
Finland	Finnfund	127,986	-	2,702	2,489	-	2,489
France	Proparco	239,400	-	34,500	19,665	yes	19,665
Germany	DEG	627,852	-	78,265	78,265	-	78,265
Italy	SIMEST	84,855	-	6,988	3,564	3,230	334
Japan	JBIC	9,387,270	476,266	437,447	437,447	1,443	912,270
Korea	KEXIM	4,981,880	-	50,843	50,843	?	50,843
Netherlands	FMO	19,557	-	128,000	65,280	3,021	62,259
Norway	NORFUND	1,009,140	142,113	38,947	38,947	-	181,060
Portugal	SOFID	7,499	-	(992)	(595)	-	0
Spain	Cofides	21,148	-	10,352	5,557	2,587	2,970
Sweden	Swedfund	5,600	45	(10,416)	(10,416)	-	45
Switzerland	SIFEM	877,085	-	(24,374)	(24,374)	-	0
UK	CDC	916,190	-	156,531	156,531	-	156,531
USA	OPIC	36,316	-	117,924	117,924	426,000	(308,076)
SUM (3)		18,518,652	618,424	1,082,549	994,721	436,280	1,176,820
<i>in % 2013 ODA</i>			0.63%		1.02%	0.45%	1.20%

(1) Estimations based on share capital and share premia, no consideration of other reserves. (Exception FMO: Addition of special purpose reserve containing the allocations of risk capital provided by the State to finance FMO portfolio of loans and equity investments.) Attribution to donor country based on per cent of ownership. In the absence of detailed information, equal attribution of share premia over all shares.

(2) Net income minus dividends times bilateral shareholding (%). If no information on dividend pay outs was available, assumed full reinvestment of net income. Assumed equal attribution of earnings over all shares.

(3) SUM calculated without consideration of losses incurred by SOFID, Swedfund and SIFEM.

Source: Annual Reports 2013.

Questions for discussion on the institutional approach

38. **Members are invited to comment on the analysis in paragraphs 13-37 (signalling any omissions or inaccuracies) and respond to the following questions.**

Q.1 - List of institutions and estimations.

Members are invited to suggest institutions to add to or remove from the tentative list of bilateral institutions to be considered ODA-eligible under the institutional approach in Table 1. They are further invited to review the estimates in Table 3 (rough calculations based on publically available information) and provide additional information to i) validate the figures for 2013 and ii) calculate figures for a longer time series, e.g. since 2000.

Q.2 - Eligible activities and geographies.

Members are invited to comment on whether all inflows to DFIs could be considered ODA-eligible or whether there is a need to apply co-efficients based on the activities conducted by the DFIs? If there is a need to distinguish between ODA-eligible and non-eligible activities of DFIs, should the distinction be along the development purpose (primary versus complementary purpose), the types of recipients (direct finance of enterprises in developing countries versus financing and insuring domestic companies that invest in a developing country), concessionality (concessional versus non-concessional) or any other or a combination of these criteria? Should there be an eligibility co-efficient with regard to ODA-eligible countries, i.e. only count in ODA the transactions between the donor and its DFI pro-rata to the share of the activities of the DFI in ODA-eligible countries?

Q.3 - Eligible transactions.

Which transactions should be counted under the institutional approach, i.e. how to treat (i) capital contributions, (ii) other contributions, (iii) fiduciary funds, (iv) dividends, and (v) reinvested earnings? Should all reflows be counted as negative ODA over the lifetime of a DFI or should reflows be capped at initial investment amounts?

Q.4 - Other eligibility criteria.

Which other criteria or safeguards may need to be introduced? How can such criteria be measured and assessed? Are their national (or international) standards to build on?

Q.5 - Mutual benefit.

Several DFIs have a dual mission of supporting private sector led growth in developing countries as well as supporting the access of their own domestic private sector in these fast growing development markets. Should there be a differentiated treatment for DFIs that provide unconditional finance and those that condition their finance to the involvement of domestic stakeholders?

Q.6 - Consistency across different providers.

How to ensure consistency in the reporting between DFIs and other bilateral providers offering private sector instruments? Should DFIs and ODA-eligible PPPs be subjected to the same eligibility tests?

IV The instrument-specific approach

39. Several DAC members have previously expressed their preference for assessing the donor effort involved in the provision of private-sector instruments at an activity level, i.e. instrument by instrument, in sync with the measurement of loans to official (public) recipients. They argue in favour of a consistent treatment of official and private-sector instruments as well as between different types of bilateral providers. Other members have expressed their doubts on the feasibility of the approach and pointed to the different risk involved in private versus official sector operations as well as to technical challenges to estimate these risks.

40. Since the donor effort involved in providing private-sector instruments is to a large extent about absorbing risks no one else is willing to take and/or at returns that are not considered adequate for a given level of risk, it is indeed valorising this risk-absorption that is at the core of the measurement. Providers of private-sector instruments assess risks upfront to (i) decide whether they are able and willing to absorb them, (ii) how much they are required to provision (estimated cost of risk), and (iii) how to subsequently price the instrument, which also includes an estimation of the concession required if the pricing is below market rates.

41. The approach rests on the assumption that only instruments that are concessional in character, i.e. instruments provided below market rates, are ODA-eligible. It thus implies developing a concessionality test for such instruments which can be used to assess (i) whether an instrument is concessional, and (ii) how concessional it is. Due to the importance of risk in assessing concessionality, this section starts with a classification of different types of risks. It subsequently looks at options for calculating grant equivalents for loans to private borrowers, guarantees, mezzanine finance and equity. Questions for members' feedback are summarised at the end of the section.

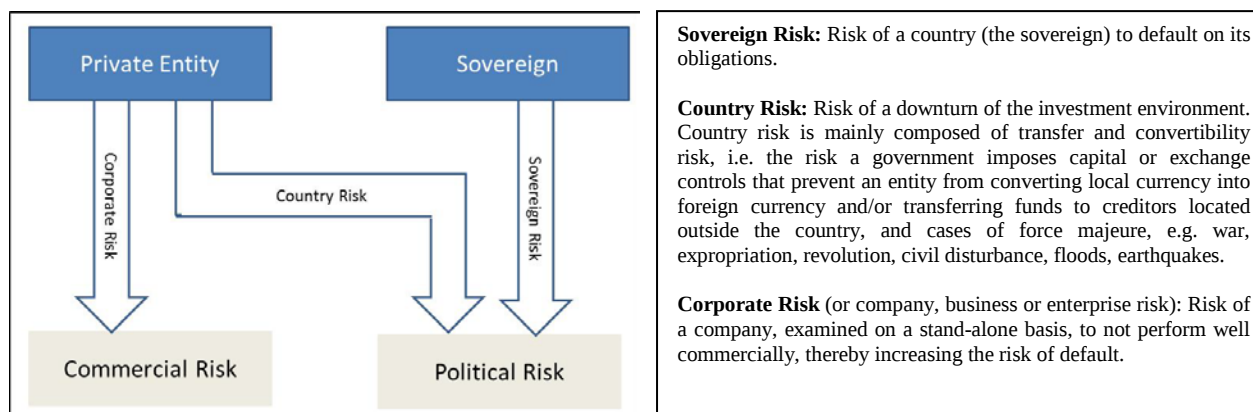
Sovereign versus non-sovereign risk

42. Following the agreement to change the ODA measurement for loans from net flows to risk-differentiated grant equivalents at the HLM, some members pointed out that the risk adjustment factors adopted relate to official (sovereign) risk, i.e. not to the risks relevant when dealing with the private sector.²²

43. **Types of risk:** Whether the counterpart to a transaction is official (public) or private makes a difference – the sources of risk for the provider are conceptually different (see Figure 3). Furthermore, official counterparts need to be differentiated between the sovereign (the state on national level) and sub-sovereign entities (regional or local governments and state-owned enterprises). Whether the latter pose the same risk as the sovereign or need to be treated differently depends on the specific structure of a transaction. If the sovereign is formally or in effect guaranteeing the sub-sovereign entity, i.e. it takes over liabilities in case of default, the provider of the instrument basically absorbs sovereign risk. However, if the sovereign is not required to assume the liabilities in case of sub-sovereign default, the provider assumes non-sovereign risks – just as he would if guaranteeing, lending or investing in a private sector entity.

22. However, neither the current Reporting Directives nor the 2014 HLM communiqué formally differentiate between loans extended to official or private-sector recipients.

Figure 3. Risk Classification by type of recipient



44. **Risk correlation:** Different types of risk entail different risk premia in principle. However, location matters. Sovereign risk does impact the risk associated with a private entity for two reasons: (i) there is a close correlation between sovereign risk and country risk; and (ii) country risk is often the single most important risk when investing in private sector entities in developing countries.

45. **Reason (i)** results from the fact that the unique, wide-ranging powers and resources of a national government can affect the financial, operating and investment environments of entities under its jurisdiction. Past experience has shown that defaults by otherwise creditworthy borrowers can stem directly from a sovereign default, or indirectly from the deterioration in the local macroeconomic and operating environment that is typically associated with the weakening or default of a sovereign. This is why some rating agencies use sovereign ratings as ‘ceilings’ for the rating of non-sovereigns in the same country, i.e. the risk associated with a private entity in a given country is considered at least as high as the sovereign risk of that country. Even those rating agencies that do not apply a ceiling, only exceptionally rate non-sovereign entities better than their respective sovereign governments. If they do so, rating differentials are generally small.²³

46. **Reason (ii)** is a consequence of (i). Since the country risk in developing countries is higher than in developed countries, the relative importance of the corporate risk decreases. This is due to the cumulative character of country and corporate risk. An entity with high corporate risk may have a probability of default as high as 50 per cent. In a zero risk country environment, this equals the overall counterpart risk. In a high risk environment 50 per cent of investments may already default for political reasons. If 50 per cent from the remaining half additionally defaults for commercial reasons, the overall probability of default increases to 75 per cent – to which corporate risk has (only) contributed 25 per cent.

47. As a consequence, the risks involved in guaranteeing, lending or investing into private sector entities in developing countries are at or somewhat above sovereign risk levels. The use of sovereign risk premia to calculate the grant equivalents of finance provided to private sector recipients could therefore be considered a very conservative proxy (or floor) as it generally underestimates the risks and thus the donor effort involved. However, it could be seen as a starting point for further refinement at a later stage.

23. For more explanations see “Understanding Ratings Above The Sovereign”, a blog posted by Standard & Poor’s, one of the three big international rating agencies under:
<http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316664774>

Loans to private sector borrowers

48. Technically, the methodology developed for counting in ODA the grant equivalent of a sovereign loan can be applied for measuring the donor effort involved in lending to private borrowers. This could either (or initially) be done using the same risk-adjusted discount rates as for official lending for the reasons given above, or using more refined risk-adjustment factors that additionally differentiate between different levels of corporate risk.

49. **Risk of market distortions:** Questions arise however on the desirable level of concessionality in private sector lending. While the 2014 HLM has set strong incentives to provide highly concessional finance above defined minimum thresholds to developing countries, the opposite approach may actually be desirable for lending to private sector entities in these countries. This is due to the risk of market distortions. Markets rest on competition to be efficient. Official sector interventions in private markets should therefore not undermine fair competition, e.g. by providing preferential access to concessional finance to some while precluding other companies. DFIs pay close attention to such market discipline which is also why most of their finance is provided on non-concessional terms.

50. **Need to limit concessionality:** The use of concessions (subsidies) in private-sector lending therefore needs to be well justified with an explanation why the concession is indispensable and the potential risk to markets is considered tolerable. Potential examples include interventions that create new markets or crowd in new finance or arrangements that ensure equitable access to subsidies, e.g. business plan competitions. When extended, concessions in lending to private borrowers should be transitory and be kept to the (necessary) minimum to make private sector solutions feasible. Rather than incentivising highly concessional finance by defining minimum concessionality thresholds, it therefore seems more desirable to define safeguards to rule out any excessive use of subsidies when engaging with private-sector entities.

Guarantees

51. Guarantees can cover sovereign or non-sovereign risks. When guaranteeing a non-sovereign transaction, guarantees often (only) cover the country risk while the corporate risk is assumed by the private investor. So while the beneficiary of such a guarantee is a private entity, the risk that is covered is political risk (e.g. political risk insurance). Applying a sovereign risk premia to these instruments is therefore appropriate. (Note that with the notable exception of OPIC, DFIs usually do not provide but are themselves beneficiaries of political risk insurance.) Guarantees can also cover a mixture of (components of) country and corporate risks. Applying the sovereign risk premia in these cases would be imprecise but – as has been argued in paragraph 44 to 47 – could still be used as a proxy.

52. Guarantees and other contingent liabilities are unfunded instruments, i.e. there is no financial flow from the provider to the recipient unless and until a claim is made. This has resulted in guarantees being excluded from the flow-based DAC statistics. In order to valorise guarantees under a grant equivalent based ODA measure, the existing methodology for loans could be adapted by:

- considering the annual premium asked by the guarantor for issuing the guarantee as the “interest rate” for the guarantee, and
- constructing the discount rate based on the applicable costs components of the discount rate used for loans, i.e.
 - No application of a funding cost component because guarantees are unfunded instruments, i.e. no liquidity is provided.

- Application of an administrative cost component because guarantees have to be administered like any other instrument. The DAC has previously used 1 per cent as proxy for this component.
- Application of risk premia corresponding to the purpose of a guarantee which is the absorption of risk.

53. In other words, the discount rate for guarantees would be the same as for loans less the funding cost component (but readjusted for an allowance for administrative costs which is implicitly included in the IMF base rate used as the proxy for funding costs). Table 4 shows the resulting discount rates for guarantees when applying the same risk premia for LDC/LICs, LMICs and UMICs as for sovereign loans and adding 1 per cent as proxy for administrative cost.

Table 4. Risk-differentiated discount rates for guarantees

	LDC/LIC	LMIC	UMIC
Risk premia	4%	2%	1%
Administrative costs	1%	1%	1%
Composite discount rate	5%	3%	2%

54. Tables 5 and 6 illustrate the resulting grant equivalents if the methodology is applied to guarantees. Table 5 compares the outcomes for LDCs/LICs, LMICs and UMICs for a guarantee with a maturity of 10 years if the guarantee is provided free of charge. Table 6 shows the outcomes if the same guarantee is extended against a fee of 2.0 per cent p.a. This rate corresponds to the fee IBRD charges for its partial risk guarantees – which cover private lenders against the risk of a sovereign or sub-sovereign entity failing to perform its obligations with respect to a private project – in IDA countries for maturities of less than 12 years.²⁴

24. For more details on IBRD and IDA guarantee pricing see:
<http://siteresources.worldbank.org/INTGUARANTEES/Resources/IBRDandIDAguaranteepricingFY14.pdf>

Table 5. Grant Equivalent Calculation for Guarantees using risk-adjusted discount rates – NO Guarantee Fee
*(Guaranteed amount of USD 1 million, guarantee fee 0.0 % p.a., maturity 10 years, discount rates differentiated by income groups)**

Date	Period (p)	Six-month factor at 5.0% (1.05) ^p	Six-month factor at 3.0% (1.03) ^p	Six-month factor at 2.0% (1.02) ^p	Risk-adjusted approach LIC/LDC - discount rate of 5.0% - (USD thousands)					Risk-adjusted approach LMICs - discount rate of 3.0% - (USD thousands)					Risk-adjusted approach UMIC - discount rate of 2.0% - (USD thousands)														
		Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total	Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total	Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total													
01/01/2013					1000.0		0.0	0.0	0.0		1000.0		0.0	0.0	0.0		1000.0		0.0	0.0									
01/07/2013	0.5	1.02	1.01	1.01	1000.0		0.0	0.0	0.0		1000.0		0.0	0.0	0.0		1000.0		0.0	0.0									
01/01/2014	1	1.05	1.03	1.02	1000.0		0.0	0.0	0.0		1000.0		0.0	0.0	0.0		1000.0		0.0	0.0									
01/07/2014	1.5	1.08	1.05	1.03	1000.0		0.0	0.0	0.0		1000.0		0.0	0.0	0.0		1000.0		0.0	0.0									
01/01/2015	2	1.10	1.06	1.04	1000.0		0.0	0.0	0.0		1000.0		0.0	0.0	0.0		1000.0		0.0	0.0									
01/07/2015	2.5	1.13	1.08	1.05	1000.0	62.5	0.0	62.5	55.3		1000.0	62.5	0.0	62.5	58.0		1000.0	62.5	0.0	59.5									
01/01/2016	3	1.16	1.09	1.06	937.5	62.5	0.0	62.5	54.0		937.5	62.5	0.0	62.5	57.2		937.5	62.5	0.0	58.9									
01/07/2016	3.5	1.19	1.11	1.07	875.0	62.5	0.0	62.5	52.7		875.0	62.5	0.0	62.5	56.4		875.0	62.5	0.0	58.3									
01/01/2017	4	1.22	1.13	1.08	812.5	62.5	0.0	62.5	51.4		812.5	62.5	0.0	62.5	55.5		812.5	62.5	0.0	57.7									
01/07/2017	4.5	1.25	1.14	1.09	750.0	62.5	0.0	62.5	50.2		750.0	62.5	0.0	62.5	54.7		750.0	62.5	0.0	57.2									
01/01/2018	5	1.28	1.16	1.10	687.5	62.5	0.0	62.5	49.0		687.5	62.5	0.0	62.5	53.9		687.5	62.5	0.0	56.6									
01/07/2018	5.5	1.31	1.18	1.12	625.0	62.5	0.0	62.5	47.8		625.0	62.5	0.0	62.5	53.1		625.0	62.5	0.0	56.1									
01/01/2019	6	1.34	1.19	1.13	562.5	62.5	0.0	62.5	46.6		562.5	62.5	0.0	62.5	52.3		562.5	62.5	0.0	55.5									
01/07/2019	6.5	1.37	1.21	1.14	500.0	62.5	0.0	62.5	45.5		500.0	62.5	0.0	62.5	51.6		500.0	62.5	0.0	55.0									
01/01/2020	7	1.41	1.23	1.15	437.5	62.5	0.0	62.5	44.4		437.5	62.5	0.0	62.5	50.8		437.5	62.5	0.0	54.4									
01/07/2020	7.5	1.44	1.25	1.16	375.0	62.5	0.0	62.5	43.3		375.0	62.5	0.0	62.5	50.1		375.0	62.5	0.0	53.9									
01/01/2021	8	1.48	1.27	1.17	312.5	62.5	0.0	62.5	42.3		312.5	62.5	0.0	62.5	49.3		312.5	62.5	0.0	53.3									
01/07/2021	8.5	1.51	1.29	1.18	250.0	62.5	0.0	62.5	41.3		250.0	62.5	0.0	62.5	48.6		250.0	62.5	0.0	52.8									
01/01/2022	9	1.55	1.30	1.20	187.5	62.5	0.0	62.5	40.3		187.5	62.5	0.0	62.5	47.9		187.5	62.5	0.0	52.3									
01/07/2022	9.5	1.59	1.32	1.21	125.0	62.5	0.0	62.5	39.3		125.0	62.5	0.0	62.5	47.2		125.0	62.5	0.0	51.8									
01/01/2023	10	1.63	1.34	1.22	62.5	62.5	0.0	62.5	38.4		62.5	62.5	0.0	62.5	46.5		62.5	62.5	0.0	51.3									
sum=									741.8					833.2						884.5									
Grant element =					(1000-741.8)/1000 = 25.82%					Grant element =					(1000-833.2)/1000 = 16.68%					Grant element =					(1000-884.5)/1000 = 11.55%				
Grant equivalent =					(1000*0.26) = 258.2					Grant equivalent =					(1000*0.167) = 166.8					Grant equivalent =					(1000*0.12) = 115.5				

* Risk-adjusted discount rates = 1% administration cost component + risk adjustment factor of 1% for UMICs, 2% for LMICs and 4% for LDCs and other LICs.

Table 6. Grant Equivalent Calculation for Guarantees using risk-adjusted discount rates – WITH Guarantee Fee
*(Guaranteed amount of USD 1 million, guarantee fee 2.0 % p.a., maturity 10 years, discount rates differentiated by income groups)**

Date	Period (p)	Six-month factor at 5.0% (1.05) ^p	Six-month factor at 3.0% (1.03) ^p	Six-month factor at 2.0% (1.02) ^p	Risk-adjusted approach LIC/LDC - discount rate of 5.0% - (USD thousands)					Risk-adjusted approach LMICs - discount rate of 3.0% - (USD thousands)					Risk-adjusted approach UMIC - discount rate of 2.0% - (USD thousands)				
					Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total	Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total	Guaranteed amount outstanding (Exposure)	Exposure Reduction	Guarantee Fee	Total Exposure Reduction+ Fee	PV Total
01/01/2013					1000.0		10.0	10.0	9.8	1000.0		10.0	10.0	9.9	1000.0		10.0	10.0	9.9
01/07/2013	0.5	1.02	1.01	1.01	1000.0		10.0	10.0	9.5	1000.0		10.0	10.0	9.7	1000.0		10.0	10.0	9.8
01/01/2014	1	1.05	1.03	1.02	1000.0		10.0	10.0	9.3	1000.0		10.0	10.0	9.6	1000.0		10.0	10.0	9.7
01/07/2014	1.5	1.08	1.05	1.03	1000.0		10.0	10.0	9.1	1000.0		10.0	10.0	9.4	1000.0		10.0	10.0	9.6
01/01/2015	2	1.10	1.06	1.04	1000.0		10.0	10.0	8.9	1000.0		10.0	10.0	9.2	1000.0		10.0	10.0	9.4
01/07/2015	2.5	1.13	1.08	1.05	1000.0	62.5	10.0	72.5	64.2	1000.0	62.5	10.0	72.5	67.3	1000.0	62.5	10.0	72.5	69.0
01/01/2016	3	1.16	1.09	1.06	937.5	62.5	9.4	71.9	62.1	937.5	62.5	9.4	71.9	65.8	937.5	62.5	9.4	71.9	67.7
01/07/2016	3.5	1.19	1.11	1.07	875.0	62.5	8.8	71.3	60.1	875.0	62.5	8.8	71.3	64.2	875.0	62.5	8.8	71.3	66.5
01/01/2017	4	1.22	1.13	1.08	812.5	62.5	8.1	70.6	58.1	812.5	62.5	8.1	70.6	62.7	812.5	62.5	8.1	70.6	65.2
01/07/2017	4.5	1.25	1.14	1.09	750.0	62.5	7.5	70.0	56.2	750.0	62.5	7.5	70.0	61.3	750.0	62.5	7.5	70.0	64.0
01/01/2018	5	1.28	1.16	1.10	687.5	62.5	6.9	69.4	54.4	687.5	62.5	6.9	69.4	59.8	687.5	62.5	6.9	69.4	62.8
01/07/2018	5.5	1.31	1.18	1.12	625.0	62.5	6.3	68.8	52.6	625.0	62.5	6.3	68.8	58.4	625.0	62.5	6.3	68.8	61.7
01/01/2019	6	1.34	1.19	1.13	562.5	62.5	5.6	68.1	50.8	562.5	62.5	5.6	68.1	57.1	562.5	62.5	5.6	68.1	60.5
01/07/2019	6.5	1.37	1.21	1.14	500.0	62.5	5.0	67.5	49.2	500.0	62.5	5.0	67.5	55.7	500.0	62.5	5.0	67.5	59.3
01/01/2020	7	1.41	1.23	1.15	437.5	62.5	4.4	66.9	47.5	437.5	62.5	4.4	66.9	54.4	437.5	62.5	4.4	66.9	58.2
01/07/2020	7.5	1.44	1.25	1.16	375.0	62.5	3.8	66.3	45.9	375.0	62.5	3.8	66.3	53.1	375.0	62.5	3.8	66.3	57.1
01/01/2021	8	1.48	1.27	1.17	312.5	62.5	3.1	65.6	44.4	312.5	62.5	3.1	65.6	51.8	312.5	62.5	3.1	65.6	56.0
01/07/2021	8.5	1.51	1.29	1.18	250.0	62.5	2.5	65.0	42.9	250.0	62.5	2.5	65.0	50.6	250.0	62.5	2.5	65.0	54.9
01/01/2022	9	1.55	1.30	1.20	187.5	62.5	1.9	64.4	41.5	187.5	62.5	1.9	64.4	49.3	187.5	62.5	1.9	64.4	53.9
01/07/2022	9.5	1.59	1.32	1.21	125.0	62.5	1.3	63.8	40.1	125.0	62.5	1.3	63.8	48.1	125.0	62.5	1.3	63.8	52.8
01/01/2023	10	1.63	1.34	1.22	62.5	62.5	0.6	63.1	38.8	62.5	62.5	0.0	62.5	46.5	62.5	62.5	0.6	63.1	51.8
sum=									846.4					944.8					1000.6
					Grant element = (1000-846.4)/1000 = 15.36%					Grant element = (1000-944.8)/1000 = 5.52%					Grant element = (1000-1000.6)/1000 = 0.00%				
					Grant equivalent = (1000*0.15) = 153.6					Grant equivalent = (1000*0.055) = 55.2					Grant equivalent = (1000*0) = 0.0				

* Risk-adjusted discount rates = 1% administration cost component + risk adjustment factor of 1% for UMICs, 2% for LMICs and 4% for LDCs and other LICs.

55. Table 5 shows that the grant equivalent varies significantly for the three country income groups. USD 285 200 would become reportable in ODA in principle if the guarantee was extended for investments in the poorest countries posing the highest risk to the guarantor, while only USD 115 500 would become reportable if the guarantee was extended for investments in UMICs. However, under an additional minimum grant element requirement for LDCs/LICs of 45 per cent, the guarantee provided to LDCs/LICs – although provided free of charge – would not be considered concessional enough to be eligible while the guarantees to LMICs and UMICs would still be just above the eligibility thresholds of 15 per cent and 10 per cent respectively.

56. If the same guarantee was extended at 2.0 per cent p.a., i.e. at IBRD terms, the grant equivalents would be significantly lower for LDCs/LICs and LMICs, since the provider is partly compensated for its effort (see Table 6). The remaining effort may not be considered ODA-eligible either, if the minimum concessionality threshold of 45 per cent for LDCs/LICs and 15 per cent for LMICs were to be applied. The lower-risk guarantees to UMICs would be considered cost-recovering and not generate any ODA.

57. The calculation examples are simplifications to demonstrate the technical feasibility of the approach. They could be further fine-tuned and adapted to actual guarantee payment schemes as required. The exposure used could be gross (full amount the guarantor will pay if the risk covered materializes) or net (gross exposure minus amounts collateralized or reinsured).

58. The calculation presented above derives from the grant equivalent calculation method used for loans. There are also proposals on alternative measurement methods including a price of guarantee approach.²⁵ Earlier simulations by the Secretariat based on this approach resulted in additional ODA of USD 186 million in 2011. This corresponded to 8.2 per cent of the gross exposure of USD 2.3 billion reported for 2011 by bilateral DAC members in a survey on guarantees conducted by the Secretariat.²⁶

Mezzanine Finance and Equity

59. Mezzanine finance and equity investments are financial instruments that are subject to the same country risk but assume a higher corporate risk than loans. This is due to the fact that, in the event of default, providers are served only after senior lenders have been fully repaid. Mezzanine finance providers are next in line while equity holders come last. The exact risks taken depend on the financial structures. Mezzanine finance in particular can take a myriad of forms reaching from structures that have very similar risk profiles as senior loans to structures that are hardly less risky than equity.

60. Providers use elaborate methods to calculate expected losses for each of the cases individually. However, uncertainty remains an inherent part of the assessment, i.e. it cannot be modelled away even in the most sophisticated systems. Calculating expected losses is always an informed estimation, not an exact science. For the purpose of the DAC, it therefore seems justified to make additional assumptions to simplify reporting.

25. Cf. [DCD/DAC/STAT/RD(2014)3/RD3], page 10 for proposals made by the UK.

26. For the survey, see Mirabile, M., J. Benn and C. Sangaré (2013), “Guarantees for Development”, OECD Development Co-operation Working Papers, No. 11, OECD Publishing.
<http://dx.doi.org/10.1787/5k4071x5b8f8-en>. For the ODA estimation by the Secretariat if a price of guarantee approach would have been applied in 2011, see and [DCD/DAC(2014)3], page 8.

61. In the September 2014 WP-STAT meeting, Germany proposed the following simplifications for calculating a grant equivalent for equities:

- Assume an 8 to 10 year maturity and grace period (bullet repayment).
- Assume an interest rate of zero (although dividends and exit gains might occur).
- Use the same risk-adjusted discount rates as for sovereign loans (although actual risk is higher).

62. The proposed maturity reflects the general average of equity investments in development.²⁷ This approach furthermore builds on the idea that the obvious underestimation of income is offset by a similar underestimation of risk (costs). As possible earnings in the future such as exit revenues and dividends are based on the performance of the entity, there are no fixed interest rate claims by the donor for its equity investment. This is not to say that the provider does not expect any income; its realisation and the amounts are just uncertain. To compensate for the likely underestimation of reflows, no discount rate increase is applied that would capture the riskier nature of the equity investment as compared to sovereign loans. With these assumptions, a grant equivalent for equity investments could be calculated in analogy to the methodology for loans.

63. Considering that equity investment by DFIs is done on market-terms (actual or perceived), actual income may very well surpass the compensatory effect of the risk underestimation. To adjust for this imbalance the approach may be complemented with qualitative criteria on concessionality. This would mean that a provider would first have to justify that the investment is concessional in character, while the above formula would only be used to calculate the ODA amount for those equity investments deemed ODA-eligible. To allow for innovation, these criteria should not be too prescriptive. However, previously agreed-upon criteria, such as the eligibility of first-loss tranches in investment funds, may form a positive list to which providers could easily revert.

64. Mezzanine finance that has similar features to equity could be treated in the same way. Mezzanine finance that has more debt character, e.g. with contractually fixed maturity and target return, could simply be subjected to the grant equivalent calculation for loans. This would miss the risk differences between these instruments but could form a start for further refinements at a later stage.

65. A more elaborate approach could foresee a calculation based on expected returns (as reported by providers) and discount rates that are adjusted for the additional risk taken. While the return expectation will be subjective, they do form the basis for the investment decision by the provider. Further risk-adjustment may be based on market-data where available or could – at least initially – be approximated in a simplified way. A simple adjustment could be done by increasing the applicable discount rate for mezzanine finance and equity according to the increased risk. Table 7 shows an exemplified matrix, assuming an additional risk premium for mezzanine risk of 1 per cent and equity risk of 3 per cent. These numbers are merely meant for demonstrative purposes. Actual values would have to be discussed and justified further.

27. This period is cited in several annual reports of DFIs as the target investment period for equity stakes. It also corresponds to average maturity of most closed-ended funds of 10 to 12 years.

Table 7. Example of risk premia differentiation for loans, mezzanine finance and equity

	LDC/LIC	LMIC	UMIC
Loans (official and private)*	9%	7%	6%
Mezzanine finance	10%	8%	7%
Equity	12%	10%	9%

* Rates correspond to the 2014 HLM decision for (sovereign) lending.

Estimating ODA volumes under the instrument-specific approach

66. It is difficult to estimate the potential amount of grant equivalents of all private-sector instruments in the absence of a uniform database. If the USD 1.3 billion ODA commitments by DFIs reported by DAC countries in 2013 had an average grant equivalent of 25 per cent and no minimum concessionality threshold would have been applied, only USD 325 million would have been reportable under a grant equivalent system. If DFIs that have not reported to DAC statistics and other non-DFI providers would have committed a similar amount at similar concessionality levels, another USD 325 may have been reportable in 2013. In total, based on these assumptions, ODA originating from private-sector instruments could have decreased by 50 per cent in 2013, i.e. from USD 1.3 billion reported on commitment basis to USD 750 million on grant equivalent basis. However, the interpretations of what constitutes ODA private sector commitments under the current system differ across the membership, which is why the numbers need be reviewed in greater detail. For instance, Sweden and Belgium have reported a total of USD 0.9 billion government contributions to their national DFIs as ODA in 2013 while other member countries have reported on DFI outflows.²⁸

67. Actual concessionality levels may have also been very different than the assumed 25 per cent. In principle, DFIs should generate very little if any grant equivalents since they are operating on market or near market terms. DFI-managed fiduciary funds, however, and particularly those funds deployed by non-DFI providers may have been more concessional. It is particularly the latter that invest where risks are highest and/or returns are particularly low, i.e. when risk-return profiles of recipients or projects are not sufficient for a DFI to take it on its own balance sheet, let alone for commercial private investors to be interested.

68. Further data collection and calculations are required to better assess the potential volumes under the instrument-specific approach. However, based on the initial considerations above, it can be assumed that the implementation of the approach does not imply any major ODA increases but could be done rather volume-neutral.

28. For more information, cf. [DCD/DAC/STAT(2014)5], paragraph 41, 42 and Annex 5. See also the results of the Secretariat's review of DFIs' portfolios and reporting in [DCD/DAC/STAT(2012)8].

Questions to the instrument specific approach

69. Members are invited to comment on the analysis in paragraphs 42-68 and respond to the following questions.

Q.7 - Calculation of grant equivalents.

Members are invited to comment on the presented methodologies and underlying assumptions for calculating grant equivalents for (i) loans to private borrowers, (ii) guarantees, (iii) mezzanine finance and (iv) equity participations.

Q.8 - Derivation of risk-adjusted discount rates

Which discount rates should be applied in the calculation of the grant equivalents? Could the existing sovereign risk premia be considered as initial and/or minimum discount rates applicable for all private-sector instruments? Should there be further risk adjustments based on a differentiation of corporate risk? If a risk adjustment is desirable, how could appropriate risk premia be derived?

Q.9 - Applicability of minimum concessionality thresholds

Should minimum concessionality thresholds be applicable for counting in ODA the donor effort involved in providing private-sector instruments?

Q.10 - Safeguards to prevent market distortions

Are there safeguards required to prevent market distortions through the provision of official concessional private-sector instruments?

Q.11 - Confidentiality of data

ODA eligibility implies an obligation to report on the finance provided in DAC statistics in a transparent manner, including the terms and conditions of the instruments for inclusion in the CRS database.²⁹ What would be required to ensure an appropriate treatment of confidential data related to private clients?

Q.12 - Simulations

Would members be able and willing to provide additional information on the way they engage with the private sector in development co-operation to allow for more specific simulations and the effect the approach would have on ODA?

V Conclusions and way forward

70. Technical feasibility: Sections III and IV above suggest that both the institutional and the instrument-specific approaches are in principle technically feasible but would need further elaboration (decisions on operational issues and development of potential safeguards) before they could be

29. This principle applies to ODA reporting in general, i.e. it is independent of the chosen approach. However, in the instrument-specific approach, such data would directly affect ODA figures, which it would not do in the same way under the institutional approach.

implemented. The instrument-specific approach could technically be implemented on a stand-alone basis since it covers all activities and providers while the institutional approach requires a complement in order to allow for the complete coverage of the entire universe of private-sector oriented providers and activities. This complement could either be the instrument-specific approach or another alternative if available. In the case of the coexistence of the two approaches, additional specifications may be required to ensure statistical consistency in the applied definition of donor effort.

71. Further improvements on DAC statistics: Both the institutional and the instrument-specific approaches represent options for the valorisation of the effort involved in providing private-sector instruments in ODA. Both would need to be complemented by the TOSD measure to additionally valorise the overall financial volumes generated through private-sector instruments. A politically attractive TOSD seems particularly important for acknowledging the important contribution of non-concessional finance which may not be valorised in ODA under the instrument-specific approach.

72. Volumes: The preliminary volume estimation given in the paragraphs 36-37 and 66-68 suggest that the donor effort involved in using private-sector instruments is small in comparison to total ODA. Thus, overall ODA figures will not change significantly whichever approach or combination of approaches may be adopted for the measurement of the donor effort involved in the provision of private-sector instruments.

73. Way forward: This paper is a first iteration of the technical issues around the institutional and instrument-specific approaches. The assessment of the technical feasibility and suggestions by the WP-STAT will form the basis for a subsequent discussion in the DAC on policy level (e.g. with regard to the incentive structures provided under the different approaches). Successive iterations both on technical and policy levels are foreseen in the course of the year and should ensure that the HLM is able to conclude on the inclusion of the effort in using private-sector instruments in ODA in early 2016.

74. Members are invited to comment on the conclusions and next steps as outlined in the paragraphs 70-73 above and respond to the following questions.

Q.13 - Coexistence of the institutional and instrument-specific approaches

Members are invited to comment on the technical feasibility of implementing the institutional and instrument-specific approaches in parallel. If both approaches were to coexist, what rules may need to be applied to (i) ensure statistical consistency across different providers of private-sector instruments within a country as well as across countries; and (ii) avoid double-counting when changing from one approach to another, e.g. by first counting the capital contribution to a DFI in ODA under the institutional approach and then counting the grant equivalents backed by these contributions when shifting to the instrument-specific approach?

Q.14 - Alternative approaches

Members are invited to suggest for further consideration any alternative approaches on measuring the donor effort involved in extending private-sector instruments.