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INDONESIA

FINANCIAL SUPPORT FOR PUBLIC PRIVATE PARTNERSHIPS

GUARANTEE FUND AND WORLD BANK ASSISTANCE

THE WORLD BANK
Washington, DC

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The Government of Indonesia has expressed interest in the World Bank's help in determining best options for financing mechanisms to support PPP development. The Government would like to explore wholesale type approaches via the establishment of a guarantee fund with financial support from the Bank and other multilateral institutions. This note discusses how the fund and the Bank's support will best work, presentation of options, how this concept relates to the current work on risk management strategies, and relevant international experience.

1. Background

Indonesia will need to mobilize a relatively large amount of private capital into infrastructure development to be able to keep pace with investment needs to support its economic growth (6% annual). Available public money to allocate to infrastructure investments will be limited. The Government will need to make good use of its limited resources to leverage as much private capital as possible. Effective provision of risk mitigation support (including guarantees) by the Government of Indonesia in infrastructure projects would improve the credit worthiness and financiability of such PPP projects.

The World Bank can provide financial support to a government-sponsored guarantee facility for infrastructure projects. Such support would enhance the credit worthiness of the guarantee facility (piercing the sovereign ceiling if adequately structured), and would help establish needed standards for governance and safeguards practices in the management of such mechanism.

2. Establishing a fund

With adequate financial support, the Government can set up an earmarked mechanism (a fund) to help it manage some of the risks it chooses to assume in supporting privately financed infrastructure projects. Examples of risks the government might choose to assume include the risk that land for toll roads will cost more than expected, the risk that PLN will not meet its commitments to pay for power under power-purchase agreements with independent power producers, and the risk that tariff increases will not take place as initially planned. Agreements to bear such risks are often called **guarantees.**

Perpres 67 gives the Minister of Finance responsibility for deciding whether the government should provide government support, such as guarantees, to public private partnerships, and for managing the consequent fiscal risks. The Ministry is in the process of developing policies to implement these responsibilities.

The Government could establish a guarantee fund in several steps, at each of which it could choose to stop:

- First, it can determine a **maximum amount** it is prepared to lose under guarantees, without setting that money aside physically. This will simply imply the establishment of a specific allocation under the ordinary budget process.[1]

- Taking this a little further, the government can put that amount in a **separate account**, which might be called a contingent liability or guarantee account. This account would be overseen by the Ministry of Finance (debt management function), and could have some specific provisions safeguarding its use and application.

- The Government can then create a separate legal entity. This entity will still be a wholly government owned institution (guarantee company or guarantee fund). The government could contribute capital to this company, including the money in the contingency or guarantee account. The **guarantee fund** would then issue guarantees in its own name, so that the government's liability would be limited to the capital it had contributed to the fund.

Managing guarantees and other contingent liabilities does not require the establishment of any new account or fund. All governments manage the cash flows associated with at least some contingent liabilities using their consolidated account and standard cash-management procedures. Some governments, however, have created either separate accounts or separate legal entities to manage certain types of guarantee or contingent liability. Indonesia, for example, recently created the Indonesian Deposit Insurance Corporation to manage guarantees associated with government guarantees of bank deposits.

3. International Experience with Guarantee Funds for Infrastructure

Some governments with large PPP programs, such as those of Britain and some Australian states, pay close attention to the risks they assume, but the public sector's obligations are usually direct government obligations; there are usually no separate guarantees, and there is no guarantee fund.

Others governments, however, do use guarantee accounts or funds. In Colombia, for example, government agencies giving guarantees to private infrastructure investors must deposit funds in special accounts that are later used to meet all or part of the costs of guarantees that are called. The obligations are still those of Colombia, and if the funds in the accounts are insufficient to meet the liabilities, the government pays using its ordinary resources. But the contributions are set at a level designed to make it unlikely that the account will be exhausted.

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[1] Decisions on support that comes in the form of cash in the next budget year and that creates no future obligations can be made using ordinary budget processes. But decisions to provide support that commits the government beyond the next budget years require separate approval by the Minster of Finance.

At the national level, the Federal Government of Brazil has established a Guarantee Fund (separate legal entity) to support PPP transactions. The Fund's main thrust is to provide guarantees supporting payment obligations of public entities contracting delivery of public services with the private sector. The Fund has been initially established with a contribution by the Federal Government of 6 billion reals (US$2 billion). The contribution to the equity of the Fund was made with publicly traded shares from large state-owned enterprises (e.g., Petrobras, CESP, etc.). Given its legal character and independence from the ordinary budget process, the Guarantee Fund can provide support to multi-year payment commitments by government entities in PPP projects.

The advantages and disadvantages of creating separate accounts and separate legal entities probably differ from country to country. In Britain and Australia, governments have strong credit ratings and well-functioning systems of public management, and may feel no need to create separate institutions to manage the financial risks associated with PPPs. In Colombia, part of the rationale for the new guarantee accounts was to avoid budgeting problems that arose when guarantees were unexpectedly called. The requirement for government agencies to contribute to the accounts also ensures that the agencies face an immediate fiscal cost when they issue a guarantee, which reduces the incentives to use guarantees to defer expenditure. In Brazil, the main rationale appears to have been to overcome problems in the judicial system that can cause payments to government suppliers to be delayed for years. Some governments do not face the budgeting and judicial problems afflicting Colombia and Brazil and may find it easier to manage the government's cash flows in one portfolio that benefits from diversification rather than establishing a separate fund.

4. The Concept of a Government-Sponsored Guarantee Fund

As discussed in section 2, the government can provide a separate legal identity to the amount of public resources it has decided to allocate to support infrastructure PPPs. In this context, a Guarantee Fund is an independent financial institution whose assets constitute the guarantee of repayment of government entities' payment obligations under a public private partnership contract. It is an entity wholly owned by the Government whose total contingent liabilities are capped at the assets of the entity. Its objective would be to provide highly creditworthy guarantees to protect private investors and lenders from certain risks in private infrastructure projects, encouraging private investment in infrastructure, while helping to control and manage the government's costs and risks.

A Guarantee Fund could be financially supported by multilaterals and donors with strong credit rating, to enhance its capital and cover solvency and liquidity risks of such Fund. This would allow each PPP project utilizing a guarantee issued by the Fund to tap into cross-border as well as local debt markets. During an initial period (until evidence of calls on guarantees and payment performance is developed), the Fund should follow a prudent strategy with respect to leverage. The Fund should start with a 1:1 coverage ratio: one dollar of assets for every dollar of

contingent liability. Later once experience is accumulated the Fund should aim at leveraging its resources.

A Guarantee Fund will provide partial guarantees of selected risks faced by PPP projects and their lenders (payment obligation by a government entity, payment of a supplemental subsidy, delays in tariff increases, etc.). Clients of the Guarantee Fund would include lenders (local and foreign banks, bondholders) to companies undertaking infrastructure projects in Indonesia (other than companies majority-owned by the government); and possibly equity investors in those companies.

5. Benefits and Risks of the Guarantee Fund and Multilateral Backing

A guarantee fund would have potential benefits as well as risks for the government.

Benefits

Compared with the option of issuing guarantees directly, a guarantee fund may help the government in various ways. First, it may simplify the establishment of good governance. For example, while it would be possible to introduce high-quality financial reporting for a portfolio of guarantees issued directly by the government, the adoption of such reporting is would probably be quicker with a new entity automatically required to prepare its own set of accounts according to Indonesian private-sector generally accepted accounting principles. Enabled, a new entity might pay salaries high enough to attract staff with the relevant expertise. Additionally, the establishment of said entity could ease government monitoring of the performance of guarantees and therefore make it easier to hold managers accountable for the quality of their decisions. Second, the fund may promote efficient government use of donor resources by facilitating "wholesale" backing of the guarantees.

A further benefit; multilateral backing makes the guarantee fund's guarantees more creditworthy than they would be solely with GOI support. Without external backing, the fund's credit rating will be constrained by the Government's credit rating. With the backing of triple-AAA rated multilaterals, the fund could pierce the sovereign ceiling and achieve a triple-AAA rating itself. Thus, the multilateral-backed fund can do more to mitigate risks of concern to financiers, increasing the pool of financiers likely to consider Indonesian PPPs and reducing the price of the projects (in user tariffs or government subsidies) to Indonesia. More generally, donor support would enhance the credibility of the guarantee fund in the local and international markets.

Compared with relying only on project-by-project multilateral guarantees, multilateral backing of fund obligations, as a whole, is likely to lower transaction costs. Instead of multilateral and government having to agree on the details of each transaction, they would have only to agree on the parameters of the guarantee fund. This is particularly beneficial for small transactions.

Wholesale (fund) and retail (project-by-project) approaches are not, however, mutually exclusive. The wholesale approach could be used for risks up to a certain size, while certain large risks would be taken directly by the government and backed if appropriate by a project-specific multilateral guarantee.

Risks

The use of a guarantee fund also entails risks. Like other state-owned financial institutions, such a fund will tend to face multiple objectives (promoting infrastructure investment, being profitable, and responding to other political demands) and be only weakly accountable for the quality of its decisions. Because its job is to issue guarantees to promote infrastructure, it may opt to issue guarantees even when their total costs exceed benefits. Risks of decisions that favor infrastructure investment but subject the fund and the government to excessive costs and risks may be high because the real cost of taking on excessive risks may only be realized in the long term. The government could quickly lose its equity stake and, if it choose multilateral backing, be required to repay a significant sum to multilaterals.

Hedging Risks

- Legislating that the company (fund) should aim to make a rate of return commensurate with the risks it takes. Profits could initially be reinvested in the Fund to strengthen its credit worthiness and reduce amounts of external support.

- Requiring the company to report financial information to the government and the public that makes transparent its financial position including the risks

- Making the ministry of finance the shareholding ministry and the oversight body.

- Appointing experienced and highly regarded business people from the financial sector to the board of the company

6. Risk Management Strategy

The guarantee fund can help the government task manage risks associated with fiscal commitments that encourage private investment in infrastructure. In particular, some tasks would be delegated to the company, including decisions on providing certain guarantees and subsequent monitoring and reporting of the guarantees. For these guarantees, the Ministry of Finance could limit itself to monitoring of the guarantee fund and recording the government's total exposure and fiscal cost arising from the fund's guarantee portfolio. Moreover, a guarantee fund's singular focus may lend greater capacity to assess and monitor risks.

The GOI would likely be asked to offer undertaking and guarantees directly in addition to those offered by the Guarantee Fund in selected cases. For example, undertakings to make termination payments on a set of tolls roads and power plants could create exposure of several

billions of dollars—probably too large for a given closed guarantee fund. Thus the government could probably not delegate the whole function of providing public support to the Guarantee Fund; it would have to maintain capacity to offer guarantees and undertaking directly. However, establishing an earmarked institution to assume responsibility for the issuance of guarantees supporting government related risks in PPP projects would improve the management of these types of contingent liabilities and would add an important governance mechanism to the decision making of granting public support to infrastructure development.

7. World Bank support

Advisory Work

The World Bank can provide advice to the Government on the establishment of the guarantee fund. The World Bank is already providing advice to the Ministry of Finance in the design and development of the risk management framework when supporting PPPs (management of contingent liabilities) and could extend its program to include the Guarantee Fund. It could assist the government in the design and structuring of the Guarantee Fund (i.e., identifying and preparing initial projects, designing of suitable guarantee products for such assets size, composition, leveraging, etc,) and in the definition of its financial management and governance structure.

Financial Support

The World Bank can provide financial support for the government's infrastructure strategy in various ways. It could lend directly to the government or state-owned enterprises for projects that the government has decided should be financed publicly instead of privately, or for projects involving both publicly and privately financed investment. Alternatively, it could support publicly financed investment with partial-credit guarantees, which can cover a portion of debt-service defaults regardless of the cause of the defaults.

The Bank could also support privately financed projects with project-specific partial-risk guarantees that cover debt-service defaults caused by the breach of government contractual obligations to the projects. Those guarantees could be of risks not covered by the fund, but they could also be used to support the fund on a retail (project-by-project) basis. Annex 2 describes with more detail the use of such guarantees for individual PPP projects.

Under the wholesale approach described above, the Bank's financial assistance would be designed to enhance the creditworthiness of all the guarantees provided by the company from day one. A partial credit guarantee of borrowing by the fund might be used to provide the support, but the most likely mechanism for the wholesale back-stop facility would be a **contingent loan to the guarantee fund** See Figure 1.

Under contingent loan option, the disbursement of the loan would be triggered by the projected of the guarantee fund to meet its obligations. Such inability could be triggered by:

- Solvency risks—the fund's payment commitments exceed the value of its assets
- Liquidity risks—the fund's liquid assets are not sufficient to meet its payments on time
- Legal risks—due judicial process to make good on claims to the defaulting government entity and to the guarantee fund take longer than expected.

The guarantee fund would pay a commitment fee to the Bank from loan effectiveness and, if the loan were triggered, would repay it on IBRD terms and conditions.

Figure 1 Guarantee Fund Structure

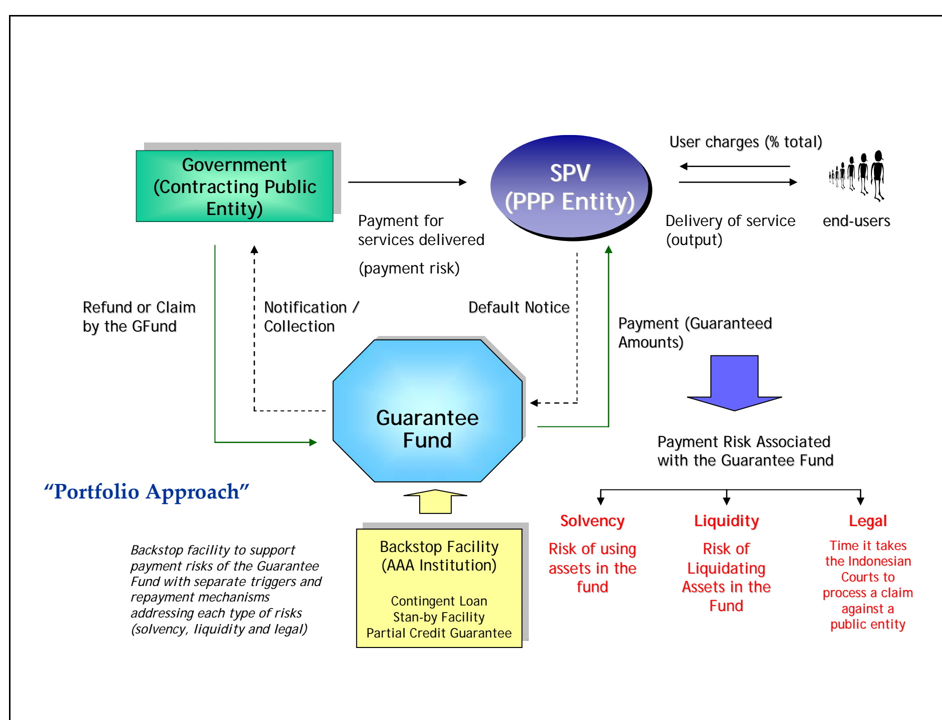

Figure 2

The World Bank is currently discussing a similar arrangement with the federal government in Brazil. Under the proposed arrangement, the World Bank would support the obligations of the federal guarantee company with a contingent loan or similar instrument.

In Peru, the World Bank approved an umbrella facility designed to simplify the approval of guarantees for a range of privately financed infrastructure projects. In contrast to the proposed arrangement, however, the Bank issues its own guarantees on project-specific basis; and Bank's appraisal and approval will be required for each guarantee to be issued. Other forms of Bank financial support for a guarantee fund are described in Annex 3.

8. Guarantee Fund's Finances and its Fiscal and Accounting Implications

Initially, the guarantee company would get its capital from the Government of Indonesia, as cash and other liquid assets (e.g., shares of publicly traded state owned enterprises, etc.). Later, it could get contingent capital from the World Bank in the form of the contingent loan. The contingent loan will represent the ability to borrow for immediate disbursement under the defined conditions of such contingencies (i.e., solvency, liquidity and legal risks). The liability side of its (economic) balance sheet would register present value of the guarantees it had issued.

The guarantee company would incur expenses in three categories:

- operating costs of administrative and analytical work;
- commitment fees on the World Bank's contingent loan or, if the loan were triggered, interest payments; and
- guarantee payments—most obviously, cash payments when guarantees were called but also increases in the present value of uncalled guarantees.

The guarantee fund could charge guarantee fees to the companies benefiting from guarantees or the government entity whose obligations were being guaranteed. If the fees were less than the cost of the guarantees, the government would subsidize the company, implicitly if not explicitly. To make subsidies explicit, the government could pay the guarantee fee where it was considered inappropriate to charge a fee to the beneficiary. (This approach is taken in Sweden, where the debt management office guarantees borrowing by state-owned enterprises and charges a guarantee fee to the state-owned enterprise, unless there are considered to be policy reasons for subsidizing the guarantee, in which case the fees are paid from the budget.)

The same approach could be taken to paying the cost of the World Bank's contingent loan. The guarantee company could offer guarantees with or without World Bank backing, charging more for the latter. Guarantee beneficiaries could then decide whether the extra protection justified the extra cost.

The fund's fiscal implications depend both on the nature and analysis of the guarantees. If the guarantee fund limited itself to guaranteeing commitments already made by a government-owned entity, it would not change the obligations of the public sector (the consolidated government entity). For example, if the fund guaranteed PLN's payments under a power-purchase agreement, the guarantee would not create a new obligation of the public sector (including PLN and the fund).[2] Whether it would add to the accounting obligations of the core

[2] It would increase the present value of the obligations, however, if the guarantee fund were less likely to default than the government entity whose obligation was guaranteed. This increase in present value is the counterpart of the value that the guarantee adds to the creditworthiness of the public sector's obligations.

government (the parent entity) would depend on how the government's accounting treated the fund and PLN.

The guarantee fund would increase the public sector's fiscal obligations only when it created a new government commitment. For example, if the guarantee fund issued a minimum-revenue guarantee in its own name, the guarantee would create a new obligation of the public sector. The net fiscal effect would depend on whether the fund charged a fee for its guarantee and, if so, on the level of the fee.

If the World Bank gave the fund a contingent loan, the government would have to provide a counter guarantee. As in the case where the guarantee fund guaranteed a pre-existing obligation of the public sector, the government's counter-guarantee would not create a new obligation of the public sector.[3] Whether it would increase the accounting obligations of the core government would again depend on the government's fund accounting method.

Whether the commitment fee on the World Bank loan created a net cost for the guarantee fund would depend on whether the guarantee fund charged an additional fee on guarantees backed by the World Bank and whether there was sufficient demand for World Bank–backed guarantees. If the demand and the fee were sufficient, the contingent loan might have no net fiscal cost to the guarantee fund.

9. Next Steps

To implement the approach set out here, the following steps could be taken:

- Government decision on risk management strategy. May–June 2006.

- Determination of ceiling or cap (amount) of public sector resources allocated to support PPP infrastructure transactions. June–July 2006.

- Design and structure of the Guarantee Fund including governance, operating procedures and safeguards. Asset composition. June–September 2006.

- Design and structure of the backstop facility to improve credit worthiness of the Guarantee Fund. June–December 2006

- Credit rating of the Guarantee Fund. January 2007.

[3] As before, it would increase the present value of the public sector's obligations if the Bank's preferred-creditor status meant the government was less likely to default on a Bank loan than the guarantee fund was to default on its obligations to the private sector.

Indonesia: Guarantee Fund and Infrastructure Fund
Definition and Complementarities

Fiscal constraints impede the development of Indonesia's infrastructure stocks, badly needed to support dynamic economic growth. To address the shortfall in infrastructure investment and the desire to provide the domestic private sector with investment opportunities that will support the economic and social welfare of the people of Indonesia, the Government of Indonesia (GoI) is considering a program of initiatives intended to promote public-private infrastructure development in Indonesia. Two of these initiatives are a ***Guarantee Fund*** to channel and manage public money support for public private partnerships and an ***Infrastructure Fund*** to finance and mobilize additional private capital into infrastructure projects in Indonesia. These two initiatives are described in the table below in an effort to identify their key differences and complementarities.

	Guarantee Fund	**Infrastructure Fund**
Objective	To support [guarantee] payment commitments of government entities party to a PPP transaction (i.e., supplemental subsidies, power purchase agreements, etc.). It is a mechanism to help government in their risk management of contingent liabilities (increase efficiency and targeting of guarantees and ring-fencing government contingent liabilities).	To provide long term financing to infrastructure projects in Indonesia (private and PPP projects) via innovative financial products. It is an instrument to mobilize additional private capital (i.e., institutional investors, commercial banks, and other type of investors) into the provision on long term financing to infrastructure.
Concept	**Government Agency under the oversight of MOF**	**Private Financial Institution with initial government participation (private sector governance)**
Conditions	To improve structure and creditworthiness of the PPP project pipeline within	To finance creditworthy and strategically viable projects

	Guarantee Fund	Infrastructure Fund
	manageable credit risk limits for the GOI.	
Clients	Lenders and investors financing PPP projects in Indonesia	Private and PPP infrastructure projects in Indonesia
Currency	Focus on guaranteeing payment commitments in local currency but availability to support payment commitments in foreign currency if required	Focus on local currency financing but availability of cross-border financing as well. Capacity to mobilize both from local and international financial markets.
Products	Highly creditworthy partial guarantees of certain risks faced by PPP projects and their lenders (i.e., payment obligation by a government entity, payment of a supplemental subsidy, delays in tariff increases, etc.)	Long-term financing products such as: syndicated Loans partial Credit Guarantees to support a Bond issuance, securitization of project revenues, future flow of receivables, collateralized bond obligations, etc.
Capitalization	A government agency, whose assets constitute the basis for guarantees of government entities' payment obligations under public private partnership contracts. The entity's total contingent liabilities are capped at the asset size of the entity. Type of assets could include: ▪ Budget allocations ▪ Shares of tradable SOEs (e.g., PGN, Jasamarga) ▪ Other type of tradable fixed income securities	1. GoI/IFC equity 2. Multilateral Debt 3. Private sector debt 4. Private sector equity
Management	Government Agency under	Private sector management

	Guarantee Fund	**Infrastructure Fund**
	oversight of MOF	(Board Structure is a key governance issue)
Separate legal entity	Yes	Yes
Action Timing	Important in the project preparation stage when government advisors are structuring the PPP project and need to document and materialize the public sector risk allocation	Important in the project execution stage, including bidding process where available financing conditions will determine bid success (quantity and quality of bidders)
Complementarities	The infrastructure fund will benefit from improvements in the credit worthiness of PPP projects. Projects where public sector risk is adequately allocated and mitigated. The Guarantee Fund will make easier the leveraging function of the Infrastructure Fund while helping the GOI manage its risks.	
World Bank Group Role	1. Advisory (assist the government in the design and structuring of the Fund)	1. Advisory (assist the government in the design and structuring of the Fund)
	2. Financial ▪ IBRD Contingent Loan or Partial Credit Guarantee The GF is backstopped by AAA rated institutions to provide financial support to the guarantees issued by the fund to cover liquidity, solvency, and legal risks. This allows each PPP project to tap into both local and cross-border debt markets.	2. Financial ▪ IFC Equity ▪ IBRD Loan to the GOI to fund its equity ▪ IBRD senior debt to the Fund

Potential World Bank Project-by Project Guarantee Support for Indonesia

The World Bank (IBRD) can offer *two types of guarantees* to support public and private energy projects appraised by the World Bank. The Bank guarantees are ***debt guarantees*** covering commercial lenders; and "***partial***" to achieve risk sharing appropriate for specific project circumstances.

- **Partial Risk Guarantee (PRG)** covers specific government obligations for commercial lenders to ***private investment projects*** and thereby catalyze the mobilization of private financing for private infrastructure development projects (green-filed/expansion) and/or privatization/concession projects.
- **Partial Credit Guarantee (PCG)**[1] covers a portion of debt services, typically as to commercial borrowing (loans, bonds) by the Government, its agency or a public sector entity to fund ***public investment projects*** including public financing components of public-private projects.

Major advantages for the Government in the use of World Bank guarantees include:

- **Improve commercial debt terms**: Partial guarantees by the triple-A rated World Bank would lower the credit risk of debt (either project finance debt or public borrowing) and enable the borrower to borrow with a longer maturity and at lower interest rate costs than otherwise, making commercial debt more suitable for infrastructure projects.
- **Facilitate private participation in infrastructure**: World Bank PRG backstopping government obligations would make private infrastructure projects more bankable and enhance competition at bidding, resulting in lower infrastructure tariffs/higher concession fees.
- **Create leverage in CAS**: World Bank's Country Assistance Strategy (CAS) envelope for the country would be increased by 75% of Bank guarantee commitments, thus, compared with direct World Bank loans, guarantees would generate leverage for the given amount of CAS support by the Bank.

Previously the World Bank supported developing country infrastructure projects mostly by providing its guarantee on a project-by-project basis.

Possible candidate projects for World Bank guarantee support for Indonesia may include the following:

A. Partial Risk Guarantee for Private Power Generation Projects:

World Bank PRGs have helped attract private investors for Independent Power Producer (IPP) projects by covering specific country risks such as traditional political risks[2],

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[1] The World Bank (IBRD) also offers **Policy-Based Guarantees (PBG)**, which are for fiscal support and cover a portion of debt services for commercial borrowing of the Government under Development Policy Lending (DPL) program.

[2] These are currency inconvertibility/transfer restriction, civil disturbance, expropriation /nationalization.

legal/regulatory risks, and the risk of government/public entities not fulfilling contractual payment obligations. Based on investor consultation conducted by the GOI in 2004 assisted by the World Bank, ADB and JBIC, it is apparent that certain GOI undertaking would be sought by foreign financiers (private equity investors/lenders and multilateral/bilateral guarantors/lenders) as to contractual payment obligations of PLN under a long-term *Power Purchase Agreement* as PLN's financial viability is perceived to depend on GOI actions as regards its subsidy payments to the PLN and President decree on retail power tariffs that PLN is allowed to charge[3].

The scope of risk coverage under PRG would be subject to these **specific obligations of the government** being included in the contractual framework of the project, and may differ depending on country, sector and project circumstances. By covering risks that private financiers cannot control and therefore are not willing to take, Bank PRGs make projects bankable, resulting in lower infrastructure tariffs for the country.

PRG is for a specific *commercial debt* incurred to realize private project/concession; would only be triggered to the extent that debt service default is the result of the failure by the government to pay an amount due under the terms of project documents, provided that such an event/s is specifically covered under the PRG. Provision of Bank Guarantees requires a counter-guarantee of the government (a member country). PRG fees are payable to the Bank by private sponsors of the project/concession and are priced low, resulting in lower infrastructure tariffs[4].

Offering of Bank PRG during the Bidding: The offering of a Bank PRG[5] to all the bidders on a non-exclusive basis during the pre-bidding consultation stage prior to their submission of proposals is generally recommended. This would increase the number of serious bidders and thereby increase competition and improve bidder proposals. Bank requires a prior request for a PRG from the government to offer a PRG to bidders.
Large-scale infrastructure projects for which the GOI expects to attract private financiers, especially foreign investors/lenders, would best be prepared/appraised on a project-by-project basis.

- The Government and the Bank will agree on an infrastructure project/s for which the use of IBRD PRG will be explored, including types of Government undertaking for the

[3] In other countries, Government undertaking is often spelled out under an *Implementation Agreement* and under *Government Guarantee* signed between the Government and the private sponsors/project company of the IPP (and also under *Direct Agreements* between the Government and the lenders). *Please refer to the Jordan IPP project example on page 4.*
[4] Bank currently charges private project sponsors/project company up-front one-time fees (Initiation Fee of the higher of 0.15% or US$100,000, Processing Fee of up to 0.5%, and Front-end Fee of 0.25%); Standby Fee of 0.25% p.a. and Guarantee Fee of 0.55% p.a., which are priced low (vs. pricing of other multilaterals when without a counter-guarantee) and therefore would be translated into lower infrastructure tariffs for the same fiscal risk to that extent.
[5] Such offering will be in the form of an expression of interest (and indicative term sheet); and the actual provision will be subject to due diligence, compliance with applicable Bank policies and other requirement and approvals of the Bank Management and the Board.

project that the Bank would agree to backstop and the maximum amount of PRG support[6]

- The Government will prepare the project for bidding (including specific details of its undertaking) and offer the availability of IBRD PRG to all the bidders at the time of bidding to enhance bidding framework[7]
- Upon the selection of the private sponsor by the Government and negotiation of key Government project documents, and upon the selection of lenders by the private sponsor, the Bank will conduct due diligence together with the lenders and appraise the project, structure PRG in detail and issue PRG for the lenders.

Box 1: Jordan (Ba2/BB), Amman East Power Project (bidding in 2005)

The project is a 280-450MW gas-fired power project and is being tendered currently. The project will be implemented under an *Implementation Agreement* with the Government; sell power to a state-owned NEPCO, transmission company, under 25-year *PPA*; NEPCO will source gas from Egypt for delivery to the project, which is envisaged as tolling agreement (i.e. energy conversion with NEPCO). The cooling water will be provided under a *Water Supply Agreem*ent by the Water Authority of Jordan; and the land will be leased under a *Land Lease Agreement with the Ministry of Finance*.

The Government of Jordan (GOJ), under *the Government Guarantee*, guarantees due and punctual performance of Jordanian parties under various project agreements (IA, PPA, WSA, LLA and any other agreement with the GOJ) including foreign exchange availability/convertibility/transferability. The Bank has been asked by the GOJ to provide an IBRD PRG, which is proposed to cover the GOJ's obligation to pay termination amounts in the event of early termination due to breach by the GOJ or an event of political force majeure (including change in law). IBRD's letter of expression of interest was included in addendum to RFP, including summary indicative terms, so that bidders can make proposals reflecting the availability of the PRG. The GOJ conducted bidding in December 2005 and despite security concern for the region received 3 proposals from international/local consortia, and the GOJ just announced the winning bid.

PRG was proposed in two alternative structures up to US$50 million: (i) standard PRG covering commercial lenders of one limited-recourse debt tranch for its full maturity (guaranteed amount would decrease via loan amortization); or (ii) PRG covering a loan to be extended by the project company to the GOJ upon the occurrence of GOJ default in its payment obligations (i.e., amount due upon termination but not paid would be deemed to become a short-term loan under the IA), which was structured especially for bidders that may use its balance sheet to finance the project.

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[6] Bank PRG would normally support one debt tranch of a limited-recourse project debt. The existence of the Bank PRG support would provide comfort to equity investors as well as other multilateral/bilateral guarantors/financiers to the same project.

[7] Such offering will be in the form of an expression of interest (and indicative term sheet); and the actual provision will be subject to due diligence, compliance with applicable Bank policies and other requirement and approvals of the Bank Management and the Board.

Box 2: Vietnam (B1/BB-), Phu My 2-2 Project (2002)

The project is a 715MW gas-fired power project which is implemented under *a BOT Contract* with the Government of Vietnam (GOV); sells power to a state-owned EVN under 20-year *Power Purchase Agreement* (PPA) and sources indigenous gas from a state-owned PV under 20-year *Gas Supply Agreement* (GSA)[8]. The GOV issued RFP for the Phu My 2-2 BOT power project with draft key contracts. Given that legal and regulatory frameworks were perceived uncertain or undergoing changes and Vietnamese agencies were perceived to lack creditworthiness as contractual counter-party, bidders emphasized needs for GOV guarantees covering key risks including performance and obligations of Vietnamese contractual parities during the pre-bidding consultation. Subsequently, GOV requested the World Bank and the Bank agreed to provide an IDA PRG for the project; and the availability of the PRG (up to $75 million; with indicative terms) was communicated to all the bidders as part of RFP Addendum. The GOV received six competitive bid proposals from international consortia; and the price of electricity proposed were much better than those being negotiated. The winning consortium (EdF, Sumitomo Corporation, TEPCO) confirmed the Bank that the IDA PRG was to be indispensable to obtain necessary project debt financing.

The IDA PRG guarantees commercial lenders against default in scheduled debt service payments[9] from the government's failure to meet its payment obligations under *the BOT Contract* and *Government Guarantee* (where the GOV guarantees the performance of Vietnamese contractual counterparties including EVN and PV as well as currency convertibility/transferability among others). The IDA PRG excludes coverage of government obligations arising in connection with project company event of default. The total financing requirements of US$480 million (including $80 million contingency) was financed $140 million by equity and $340 million by debt ($240 million direct loans from ADB, JBIC, Proparco; and $100 million commercial debt covered $75 million by IDA PRG and $25 million by ADB PRG[10])

B. Guarantees for the financing of Sizable Pipeline Projects

Sizable domestic pipeline projects such as the East Kalimantan-Central Java pipeline project (with estimated project cost of US$1.2 billion) would require government support one way or another. Given the current requirement of majority ownership by local parties and generally small balance sheet of local entities, realistic financing options may include the following, which are not mutually exclusive.

B-1. Partial Credit Guarantees for GOI:

World Bank PCGs covering part of debt services have helped governments and public entities to raise commercial debt either from the international capital markets or the banking market to finance major energy projects. PCG can be structured flexibly to suit the requirements of specific debt instrument and the market conditions; and would typically cover later date payments to encourage the extension of debt maturity. The pricing for a partially-Bank-guaranteed financing would reflect the hybrid credit risk of the top-rated (AAA) World Bank and the borrower's own credit (e.g., Indonesia is rated B2/B+) and specific guarantee coverage.

[8] GSA is back-to-back with the Gas Sales and Purchase Agreement between PV and a BP-led upstream gas consortium.
[9] IDA PRG is non-accelerable; IBRD PRG could be accelerable.
[10] ADB PRG was in the form of the Guarantor of Record, where ADB fronted private insurers.

Provision of Bank PCG requires a counter-guarantee of the government (a member country) as to the amount guaranteed (which is not necessarily the face amount of debt). PCG fees are payable by the borrower to the Bank[11].

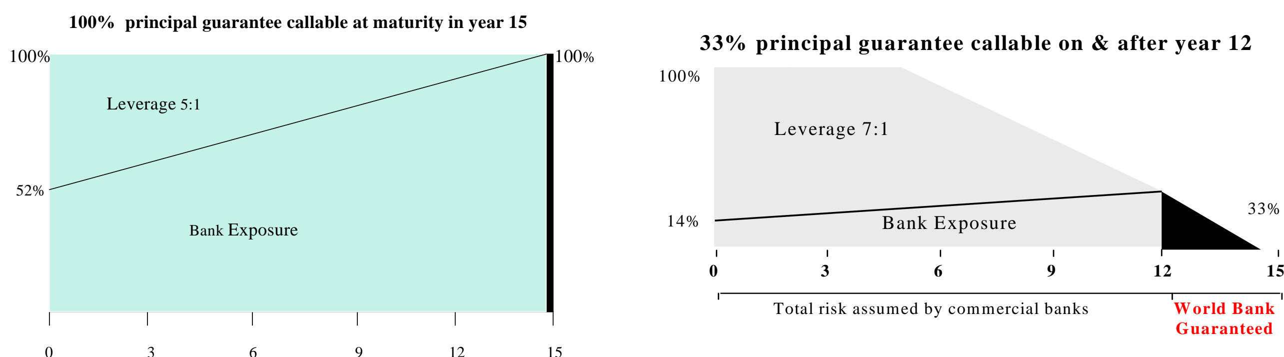
Box 3: Sample Structures of World Bank PCG

Issue of bonds with a bullet maturity:
PCG covers 100% of the principal payment at the maturity *on a non-accelerable basis.* (i.e., Bond investors will take the credit risk of the borrower for interest payment: If there is debt service default, the Bank as the guarantor will pay only the principal amount and only on the scheduled maturity date - guarantee call date - and not before[12]).
Case example: PCG for EGAT of Thiland (1998)

Loan with principal amortization:
PCG covers the scheduled principal payment from year *x* on an accelerable basis on and after year *x*.(i.e., Lenders will take the credit risk of the borrower for both interest and amortizing principal repayment up to year *x*: If there is debt service default, the Bank as the guarantor will pay only the principal amount scheduled to be outstanding on year *x* on that date - guarantee call date - and not before.) . Please refer to figure 1 for case sample.

Bank PCG can guarantee local currency debt if there is additionality for such guarantee provision by the Bank (vs. guarantee by the government). Bank can offer its PCG to private or semi-private entities if the government agrees to provide its counter-guarantee to the Bank for such borrowing.

Figure 1: Case example of PCGs for the Government of China (1994-96)



[11] The Bank will charge the public sector borrower one-time Front-end fee of 0.25%; Standby Fee of 0.25% p.a. against the *present value* of undisbursed guarantee amount (e.g. a loan with an availability period); and a Guarantee Fee of 0.5% against the *present value* of the disbursed guarantee amount at the earliest guarantee call date. In the case of guarantees in support of bond issuance, the Bank will collect Fees in a single up-front lump-sum amount charged on a *present value* basis.
[12] The guarantee may also cover interest payments such as later payment(s), or defined number of payments on a rolling *non-reinstatable* basis to mitigate liquidity concern if any.

B-2 Partial Risk Guarantees for Private Financing Components.

Indonesia's notable gas pipeline project with private participation has been PT Transportasi Gas Indonesia (Transco 1), which was benefited from the existence of creditworthy Singapore gas off-takers under a long-term (20-year) off-take contracts to make the project financeable.

As to pipeline projects to transport gas for domestic uses, given the yet-small portion of non-power gas use in Indonesia, it is indispensable for the GOI to explore guarantee/credit enhancement mechanism for the PLN payment risk to enable financing of gas pipelines as well as that for upstream gas field development. PGN is said to have fronted PLN gas off-take risk for one pipeline project (where PGN de fact served as guarantor for financially precarious PLN), but the financial capacity for yet-small partially-privatized PGN to repeat such transactions without deteriorating its own credit rating would likely be limited.

World Bank PRG can cover government obligations (e.g. guarantee for contractual performance under an off-take agreement; provision of a liquidity under defined trigger events, etc.) for a pipeline project to enhance the financeability.

Box 4: West Africa gas Pipeline Project (2005)
Innovative PRG to support sponsor financing for a major gas pipeline project

The project includes the construction of a 678km cross-border pipeline to provide Nigeria gas to power plants in Ghana, Benin and Togo in West Africa. Gas will be sources from two existing oil-producing joint ventures between Nigerian National Petroleum Corporation (NNPC) and international developers (ChevronTexaco, Shell, and Elf); N-Gas Ltd. was formed by NNPC, CevronTexaco and Shell for the purchase, transportation and sales of gas; West Africa Gas Pipeline Co. (WAPCo) was formed by NNPC, ChevronTexaco, Shell and a state-owned Ghana company to build, own, operate and transport (under contract with N-Gas); Volta River Authority (VRA) in Ghana concludes a GSA with N-Gas and accounts for the largest gas purchaser. The Government of Ghana (GOG) under a Government Consent and Support Agreement guarantees to N-Gas and WAPCo the performance obligations of VRA under the GSA and its direct agreement.

The new pipeline was projected to cost US$590 million and financed through equity and shareholder loans. Bank (IDA) provided PRG ($50 million) together with MIGA ($75 million) and a private insurer (125 million; substantially reinsured by OPIC) covering payment obligations of the GOG upon early termination of the GSA, in the form of complementary guarantees (i.e. pro rata allocation of claims among co-guarantors). In the event a termination payment is due and not paid to WAPCo, IDA share of the termination payments would deem to be a loan from WAPCo to the GOG, where repayment is covered under the IDA PRG. Such guarantees have enabled the sponsors to make investments in the pipeline.

It is recommended that the offering of government support (public financing component; guarantees) including the potential availability of World Bank guarantees, should be communicated to all the bidders on a non-exclusive basis during the pre-bidding consultation stage prior to their submission of proposals to enhance competition and ensure such public support be reflected in bid proposals.

Potential World Bank support for a Government-Sponsored Guarantee Facility

World Bank can support a Government-sponsored guarantee facility for infrastructure projects in different manners depending on:

- Types of infrastructure projects to be supported by the facility (e.g., public projects[1] with commercial debt financing; private projects, etc.)
- types of investments to be supported by the facility (e.g., equity investments; debt investments: public entity debt; private corporate debt; limited-recourse project finance debt)
- types of risks the Government intends to undertake (directly towards infrastructure projects and/or indirectly through the facility) and types of guarantees intended to be issued by the facility (e.g., credit risk guarantees; political risk guarantees)

World Bank support would be in the form of its standard financial instruments for IBRD countries which will require counter-guarantee from Indonesia:

- IBRD loan: which may be disbursed up-front and over the implementation period subject to standard IBRD loan terms.
- IBRD "contingent" loan: the only difference from a normal IBRD loan is that disbursement occurs only upon the occurrence of pre-determined trigger events; IBRD will retain its right for cancellation as in other IBRD loans[2]
- IBRD Partial Risk Guarantees (PRG): *covers commercial debt*[3] of private infrastructure projects, as to debt service defaults caused by the breach of ***government contractual obligations*** toward such projects (i.e. a wide range of *political risks* depending on specific government undertaking for each private project).
- IBRD Partial Credit Guarantees (PCG): *covers commercial debt*, as to ***portion of debt service defaults*** regardless of causes of such default to the extent such credit risks are taken by the government[4].

Modality of World Bank support could vary, depending on the objective of the guarantee facility. Following please find some modalities of World Bank support to Guarantee Facilities using partial risk guarantee instruments:

A: World Bank provision of PRG to backstop PRG issued by the guarantee facility

This approach may be suitable when targeted sectors are well-defined; projects are of small size and Government undertaking for such private projects are well-defined standard political risks (i.e. appropriate for corporate debt financing).

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[1] Including public-funded components of private projects.

[2] If commitment is to be made irrevocable by IBRD to make its contingent loan support credible in the market, commitment fee to IBRD will apply.

[3] World Bank guarantees support only ***debt*** provided by private financial institutions.

[4] PCG normally supports debt of the Government/public entities but may be able to support debt of private entities if counter-guaranteed by the Government.

- The Government and the Bank will agree on specific infrastructure sectors/types of projects to be supported under IBRD PRG, including:
    - Types of Government undertaking that the Bank would agree to backstop
    - Total size of PRG support[5]
- The Government and the Bank will agree on details of the planned guarantee facility (as above, including detailed terms and transaction documents for guarantees to be issued by the facility where PRG covers the payment obligations of the facility to the guarantee holder.);
- The Bank will issue its PRG on a no-objection basis for each proposed issuance of a PRG by the facility.

Box 1: Russia, Coal and Forestry Sector Guarantee Facility (2000)[6]

The Federal Center for Project Finance (FCPF) was established by the Government of Russia (GOR) as a 100% state-owned enterprise, and is authorized to issue guarantees under its name, ***acting as agent of the GOR***[7]. Bank supports a US$200 million Guarantee Facility to help coal and forestry enterprises to finance the fixed and working capital assets via ***back-stopping the FCPF's claim payment obligations***.

FCPF would issue guarantees against a discrete list of government performance and political risks[8] to various commercial creditors (under loans, deferred purchase agreements, financing lease, etc.). The GOR would enter into *an Indemnity Agreement* with the Bank; FCPF would enter into *a Project Agreement* with the Bank and process guarantee applications in compliance with operating procedure and eligibility criteria set out in the *Operations Manual* agreed with the Bank, monitor, mitigate and prevent the occurrence of risks that could give rise to guarantee claim payments. Eligible loans are of the amount not exceeding US$ 10 million; eligible borrowers are with federal/regional government ownership not exceeding 25%. FCPF would request no-objection from the Bank in respect to its proposed issuance of a FCPF guarantee. IBRD PRG would cover the payment obligations of FCPF to the guarantee holder and be callable upon non-payment by the FCPF of settlement amount[9]. The Bank project was subsequently cancelled prior to the issuance of any guarantees.

B: World Bank provision of PRG for each infrastructure project under a facility approach

This approach may be suitable when projects are of small-to-medium size and the Government has prioritized and conducted initial due diligence to develop a well-defined pipeline projects. "Facility" approach of the World Bank intends to streamline the approval process of each guarantee operation.

- The Government and the Bank will generally agree on infrastructure sectors/pipeline projects to be supported under IBRD PRG, including:

[5] It should be noted that there is no fund disbursement to the facility; a guarantee commitment fee would apply for the whole facility amount.
[6] This facility was eventually not used by Russia and the facility was recently cancelled.
[7] A joint stock company established pursuant to the authority granted by the GOR. Its guarantee obligations are not "funded".
[8] The covered risks comprise: currency inconvertibility/transfer restriction; expropriation; war or civil disturbance; seizure of goods or restriction on import, sale user or export; issuance or cancellation of taxes; imposition or increase of taxes; and interference in the carriage of goods.
[9] This facility is modeled after insurance and the guarantee holder would be required to secure a settlement agreement on a final binding arbitral ward establishing FCPF liability to pay damages to the guarantee holder.

    - Sector eligibility
    - Types of Government undertaking that the Bank would agree to backstop
    - Total size of PRG support[10]
- The Government will prepare individual private infrastructure projects for bidding (including the decision on details of its undertaking)[11]; preliminary appraise the projects and request the World Bank to issue IBRD PRG for each on demand
- The Bank will appraise each project, structure PRG in detail and issue PRG for each project debt.

Box 2: Peru, Guarantee Facility Project (2005)[12]

The project is to establish a US$200 million guarantee facility to provide IBRD PRG to Peru's future infrastructure projects. ProInversion is Peru's Private Investment Promotion Agency and, in agreement with the Government of Peru (GOP), has identified a pipeline of 15 infrastructure projects, for which the GOP prepares to provide its undertaking and which are potentially eligible to the Guarantee Facility, with the aggregate project costs of about US$1.5 billion.

The *Guarantee Facility Agreement* between the Bank and the GOP/the Ministry of Economy and Finance (MEF) sets out key understanding[13]; and the *Guarantee Facility Guidebook* approved by the Bank lays out key implementation process to be followed by Inversion for the screening, pre-appraisal, due diligence and approval. At each of the evaluation process, ProInversion will be required to obtain a no-objection from the Bank. The decision to provide a PRG, in the amount up to US$50 million, to a specific project will be taken by the Bank (management[14]) following normal Bank appraisal guidelines (including environmental and safeguard). Risk coverage under individual PRG will be decided on a case by case basis depending on the scope of Government undertaking for individual projects and among the risks traditionally covered by IBRD PRG[15]; IBRD documents (*Indemnity Agreement* with the GOP, *Project Agreement* with the sponsor, *Guarantee Agreement* with the creditors) will be concluded for each PRG to be issued.

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[10] It should be noted that there is no fund disbursement to the facility nor any commitment on the part of the Bank, as the "facility" is only a framework of understanding between the Government and the World Bank.

[11] World Bank PRG requires that the goods and works financed by the guaranteed debt shall be procured with "due attention to economy and efficiency", which can generally be met if private project sponsors are selected by competitive bidding.

[12] for details, please see PAD Report No: 31106-PE.

[13] As this Facility is in the nature of a memorandum of understanding, the Bank will not charge front-end fee nor commitment fee till the approval of individual PRG. So far there has been no project prepared and appraised to the stage of Bank review/approval.

[14] by the Bank President through Operations Committee review and Managing Director approval.

[15] i.e., change in law, failure to meet contractual payment obligations, foreign currency convertibility/transferability, expropriation, obstruction of an arbitration process, non-payment of a termination amount or an arbitration award, failure to issue licenses, approvals and consents in a timely manner.