NEPAD-OECD AFRICA INVESTMENT INITIATIVE

Africa Risk Mitigation Initiative for Infrastructure Financing

March 2009

This paper was distributed as part of the documentation at the Annual Meeting of the Infrastructure Consortium for Africa (ICA) held in Rome on 9-11 March 2009 in the context of Italy's G8 Presidency. It was jointly prepared by Filippo Scammacca (First Counsellor and Head of the Financial Department of the Italian Directorate-General for Development Cooperation - Ministry of Foreign Affairs) and Karim Dahou (Senior Economist, OECD Investment Division; Executive Manager, NEPAD-OECD Africa Investment Initiative) to inform the discussions in a special session on risk mitigation for investment in infrastructure. This session was intended to support the development of a risk mitigation initiative for infrastructure financing to be hosted by the African Development Bank (AfDB).

Africa Risk Mitigation Initiative for Infrastructure Financing

Background

High-level of actual or perceived risk and lack of access to finance

The volume of official development assistance and of other resources mobilised by development finance institutions (both multilateral and bilateral) and African governments is insufficient to meet the continent's needs in infrastructure enhancement. Simultaneously, raising long-term debt and equity to finance infrastructure projects in Africa is a challenge, and an even greater one now that the financial crisis has diminished inflows to the continent as well as the appetite for risk among many private financiers.

For the private sector, long lead times and high capital costs often result in low financial returns on investment in infrastructure projects. Low returns when balanced against risk considerations, can hinder the implementation of projects across all sectors. When essential infrastructure and customer affordability are to be taken into account, the private sector is often deterred from investing due to high-levels of actual or perceived risks.

This is even more of an issue in Africa, where the higher costs and longer delays of doing business seem to increase the risks of investing in infrastructure in comparison with other regions. Furthermore, despite a decade of growth, the numerous reforms carried out by the continent are still not fully reflected in the investors' perception – this has led the G8 to support the improvement of Africa's image as a "continent of opportunity."[1]

Actually, these risks-related aspects add to the pressure already exerted by the lack of access to foreign or domestic lending for refinancing purposes. The vast majority of African countries still do not have foreign currency debt ratings (Nigeria was the 14th African country to be rated by Standard and Poor's in 2007), and only a very few have ratings of at least BB-[2], which provide access to international financial markets. At the same time, whilst African financial markets are growing at a steady pace, they are still predominantly narrow and illiquid.

Wide array of risks and coverage instruments

In addition, the actual levels and kinds of risks may vary widely from one country to another. While the regulatory risk is the most critical issue in some particular countries, others are more vulnerable to currency fluctuations; others again are more exposed to the risk of corruption or political interference, renegotiation or bailout, political or financial instability.
Finally, there has been a considerable increase in the array, number and sophistication of risk mitigation instruments over the past few years. Such instruments can be classified under three main categories: (i) credit guarantees cover losses in the event of a debt service default regardless

---

[1] See: G8 Heiligendamm Summit Declaration: *Growth and Responsibility in Africa* (8 June 2007), Paragraph 30.
[2] Standard and Poor's gives a BB- rating (fitted for long term direct investments) to South Africa, Mauritius, Botswana and Nigeria, while Ficthe in Sub-Saharan Africa gives the same rating to South Africa, Nigeria, Namibia and Lesotho.

of the political or commercial nature of the risk (and origin of the default); (ii) export credit guarantees cover losses for exporters or lenders financing projects tied to exports; and (iii) political risk guarantee or insurance cover losses caused by specified political risks. But today there are new types of instruments covering a wider variety of risks. Among the most cited by private investors in developing countries context, the currency risk, the regulatory risk and the subsovereign risk are now covered by specific mechanisms (for a non-comprehensive list of instruments and mechanisms, see annex…).

Broad Category of the Availability of Instruments

	Credit guarantee	Export credit guarantee or insurance	Political risk guarantee or insurance
Sovereign debt			
Political risk	X	X	X
Commercial risk		X	
Corporate debt			
Political risk	X	X	X
Commercial risk		X	
Equity investment			
Political risk			X
Commercial risk			

Source: PPIAF, Review of Risk Mitigation Instruments for Infrastructure Financing and recent Trends and Developmentsn 2007, the World Bank.

The potential of a Risk Mitigation Initiative for infrastructure financing in Africa

This overview highlights the potential usefulness of a Risk Mitigation Initiative (RMI) for Africa, which would provide different kind of stakeholders (in particular public and private investors in infrastructure) with advisory and brokerage services. Accurate risk evaluation and coverage of viable African infrastructure projects could facilitate the mobilisation of private capital through transferring certain risks from project financiers to creditworthy third parties (guarantors and insurers) that have a better capacity to absorb them.

Enhanced skills in risk mitigation might also contribute to a better management of Sovereign Credit Guarantee– which is in general a precondition not only to project financing but also to long term private investments–and an improved management of public finances.

It could help African governments in assessing their exposure to some specific categories of risks and thus pave the way for the reform of their investment frameworks. It may also encourage public lenders to more systematically utilise coverage instruments and use scarce ODA resources for leveraging private investment in infrastructure. It is likely to increase the willingness of both domestic and foreign private financiers to engage into infrastructure projects in Africa. It could finally assist coverage institutions as well as rating agencies in assessing the economic soudness of a project and the creditworthiness of the borrower.

Risk evaluation and risk mitigation, as a hedge towards additional private financing in African infrastructure, might be beneficial for several kind of stakeholders:

- Partner Governments: main responsibles for improving the business climate and the ability to leverage private investments;
- Donors: could better channel ODA towards projects that might catalyse private investments in African infrastructure and reduce transaction costs;
- Private investors: corporate strategies could rely on a more objective evaluation of the risk around specific and viable infrastructure projects in Africa;
- Export Credit Agencies (ECAs): could improve the delivery of risk mitigation instruments for infrastructure projects in Africa;
- International and national development organizations: could develop coherent partnerships with other public and private stakeholders;
- Independent rating agencies: could contribute to assessing the risk connected to infrastructure projects.

Risk mitigation is commonly practiced by MIGA, IBRD, IFC as well as by development agencies and by Export Credit Agencies (ECAs) and Investment Insurance Agencies. The proposal is not to set up a new risk mitigation/coverage instrument, but to support Africa Development Bank/Nepad by setting up a brokerage facility to help catalysing private finance by seeking out the best and most cost-effective risk mitigation solutions on a project by project basis.

Some OECD instruments such as the *Principles for Private Sector Participation in Infrastructure* or the *Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones* as well as other tools or indicators used by independent rating agencies can also provide a good reference for risk evaluation.

Enhancing AfDB's capacity to use coverage mechanism and catalyse private investment for infrastructure financing

The African Development Bank (AfDB) will host the Africa Risk Mitigation Initiative (ARMI) for Infrastructure Financing. It should enhance the AfDB capacity to use coverage mechanisms in its portfolio of infrastructure projects. The Initiative fits well with the AfDB's strategy for Public-Private Partnerships in infrastructure financing and will contribute to the development of a Pilot Guarantee Facility planned for the replenishment of the African Development Fund in 2012.

ARMI will reinforce project preparation at upstream and downstream levels through providing risk evaluation and coverage services for specific projects. It can be used for national as well as regional projects and will help better tailoring public as well as private participation in infrastructure projects.

ARMI will serve for information building and knowledge sharing purposes on the one hand, and provide operational brokerage services on the other hand. It will help public and private investors to better assessing the risks specific to certain sectors or contexts as well as the numerous coverage instruments available in the market. It will also help finding tailored solutions for specific projects.

ARMI should therefore increase the AfDB's capacity to use coverage mechanisms and increase private participation in infrastructure projects.

Expected deliverables

1. Appointment of 2 lead experts and one support staff person at the African Development Bank. The experts would build information and knowledge capital on risk evaluation and coverage instruments, and provide risk mitigation brokerage services to African countries, ICA members and private investors. They would also enhance AfDB's capacity to leverage private investment for infrastructure financing, through public private partnerships, thanks to a dedicated technical assistance trust fund.
2. Amendment to the Italian technical assistance Trust Fund in order to use the existing liquidity for financing the lead Italian expert as well as the other professional staff person, the delivery of analytical activity and training to the AfDB and African Ministries of Finance, and the evaluation of risks related to infrastructure project.
3. Organisation of an international debate on risk mitigation with relevant donors, African governments and international financial institutions.
4. Collecting information on risk evaluation and risk mitigation and making this knowledge available in the ICA web site.

Activities	
Technical assistance (to include possible secondment from Italy) funding for 2 years. The purpose of the TA will be to provide risk mitigation advisory services to both public and private clients as well as capacity building and training to Ministries of Finance and the Africa Development Bank.	
International conference on risk mitigation. The conference will aim reach agreement on the usefulness of current products and whether new ones are needed, and to create awareness among donor and partner countries.	
Information management. The ICA website will host more information on risk mitigation products and how to access them.	
Due diligence fund. To support TA activities	
Evaluation To be performed by an independent external consultand	