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Uncle Sam's Belt & Road: US throws down $60bn gauntlet to China

By Jackie Horne and Rashmi Kumar

The United States is shaking up its development finance model to issue a direct challenge to China's use of economic power to underpin its growing ascendency on the world stage.

David Bohigian, executive vice president of US development finance agency Overseas Private Investment Corp (OPIC), told *GlobalMarkets* that its expanded budget, remit and re-organisation would create the modern equivalent of the 20th century's Marshall Plan, which financed Europe's reconstruction after World War II.

Bohigian: new Marshall Plan

"What's revolutionary will be the private sector, development finance agencies and governments all working together on a scale the world has never seen," he said. "It's going to be all about leveraging private sector capital."

The re-organisation will create the International Development Finance Corp (IDFC) with an expanded budget of $60bn, up from $29bn. Bohigian said private sector investment was typically catalysed on a 2:1 ratio, potentially unlocking tens of billions more dollars. The agency will also be able to invest in equity for the first time, enabling it to share a project's risks and rewards.

More importantly, it has signed agreements with its Japanese and Australian peers and is negotiating one with India. Bohigian

Continued on back page

Spotlight on IMF as Lagarde refuses to pull Saudi visit

By Owen Sanderson and Elliot Wilson

IMF managing director Christine Lagarde risked international condemnation yesterday after she insisted she would go ahead with a visit to a Saudi Arabian investment conference amid claims that the Kingdom was behind the brutal murder of a journalist in Turkey.

Business leaders such as Richard Branson

Continued on back page

Bohogian photo © Courtesy of Milken Institute; James Gillham/StillMoving.net

Europe's push for greater global influence driving EIB-EBRD tie-up talks

By Elliot Wilson and Owen Sanderson

France is leading efforts to push Europe's two main development finance institutions closer together in order to increase the continent's geopolitical influence, *GlobalMarkets* understands.

In recent months, senior figures in Berlin and Paris have quietly called for the European Bank for Reconstruction and Development and European Investment Bank to join forces to boost their lending capacity, and to exert augmented European clout on the world stage.

German and French politicians have called for an expert group to be assembled, to look at a possible "full integration" of the two institutions, according to leaked documents.

Chakrabarti: focus on Africa

A source close to the European Bank for Reconstruction and Development, headed by Suma Chakrabarti, told *GlobalMarkets* that while a full merger

Continued on back page

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OUT OF THE WOODS

Seen and heard in the corridors of the Annual Meetings

•/ Unintended iron-y Bali — laid back, happy, relaxed. Except when the English arrive with stroppy demands on the local laundry system. In a scene reminiscent of John Cleese's comic hotelier Basil Fawlty, *OOTW* spotted an English gent in a three-star hotel lobby, clutching a wrinkled shirt and growing pucer by the moment. "What did you iron this with — your foot?" he demanded of a staffer, who responded with perfect reason that using the extremity of one's animate being to press a piece of cotton, was, frankly, a futile and silly idea. 1-0 to the Balinese.

•/ Love Jacktually Alibaba's pocket-sized founder Jack Ma was on good form in the main auditorium on Friday. Gently probed by World Bank president Jim Yong Kim about his magic formula for success and his ever-cheery demeanour, Ma said the trick lay not in IQ or EQ, but LQ. "Most important of all is our Love Quotient," he said, to widespread applause. "Don't think about what you will gain in order to succeed, but what you are willing to share — and willing to give up."

•/ Carnal Carney Sir Howard Davies summoned the spirit of St. Augustine when describing Mario Draghi's approach to rate hikes as a simple case of "make me chaste, but not yet". The venerable chairman of the Royal Bank of Scotland was less kind to Bank of England chief Mark Carney, describing the Canadian's lurching Brexit-driven rates strategy as a classic example of "*coitus interruptus*".

•/ Guinea foul Cash-strapped Papua New Guinea is mocked for importing 40 Maseratis to ferry foreign leaders around next month's APEC summit. The gleaming 'Quattroporte' sedans cost $100,000 apiece and can hit 240km per hour, but will be limited to trundling around Port Moresby's woebegone roads at a max speed of 80km/hr. But the real question for delegates in Bali forced to endure a patchy transport system and scrap over the occasional cab is: where's our Italian supercar?

•/ Gimme bus-shelter Speaking of which, the erratic bus "service" has been a pox on these meetings, with waiting times of up to 30 minutes in the baking sun. Spotting a captive market, the government sent out surveyors to query weary delegates in the searing heat. *OOTW* was asked for his spending plans in Bali, receiving in return a figurine of Shiva, the Hindi god of destruction and dance. What are they trying to tell us?

•/ Clutching at straws Ordering a fresh lime soda at the Nusa Dua Beach Club, *Out of the Woods* was heartened to see it served with one of those ocean-friendly bio-degradable paper straws — a move to hearten the European agencies behind the worthy $2.3bn Clean Oceans Initiative. Hotels are some of the worst climate-polluters, but it's great to see them, unprompted, doing their bit for the planet.

EMs prep defences against 'crazy' Fed

By Owen Sanderson

Emerging market countries are preparing their defences against rising US interest rates, as President Trump weighed in to brand the Fed "crazy" for hiking rates. Fed boss Jay Powell will likely shrug off his tempestuous boss and keep going, but investors and bankers alike see most emerging market countries as stronger than in previous tightening cycles.

"People here are saying the Fed needs to focus on what tightening means for Argentina or for Turkey or other countries, but the Fed was created by its own government and has a primary responsibility for domestic policy," said Randall Kroszner, professor of economics at the University of Chicago, and a former Fed board governor, speaking at the IIF Annual Membership Meeting in Bali. "If you look at countries that haven't been hit… they've got their macroeconomic house in order. For countries like Argentina and Turkey, the Fed is essentially saying that the shock is coming from you, not us."

Trump's comments were likely inspired more by falling US equity markets than concerns over emerging market debt sustainability — the US president has previous branded some of the more vulnerable countries "sh*tholes" — and he has previously described himself as a "low interest rate guy".

Jacob Frenkel, chairman of JP Morgan Chase International, said: "When I'm driving, and the road bends to the right, I turn the steering wheel to the right. That doesn't make me a 'right steering guy'."

Frenkel argued that hiking was right for the US economy, but acknowledged the risks to emerging markets, and said that they could not do much about it, except have defensive policies.

"If you ask yourself which countries in the emerging world did best in the most recent crisis, and see they're the ones with high capital, high liquidity, low leverage, responsible fiscal policy and flexible exchange rates, you get a clue about what EMs need to do."

Christopher Marks, head of emerging markets EMEA at Mitsubishi UFJ, said: "Countries are engaging earlier to manage spikes in refinancing, using tools like exchanges and liability managements, with support from the MDBs, which are increasingly offering guarantees to help the restructuring and reprofiling of debt. They're seeing that this can be a better use of their balance sheet than the traditional route of providing liquidity for specific projects."

Rob Drijkoningen, head of emerging markets debt at Neuberger Berman, said that emerging markets were much stronger than during the Asian crisis, pointing to fundamental reforms in larger markets like India and China, as well as small markets.

Powell: likely to keep raising rates despite Trump's outbursts

Inflation fears are back after 10 year break

By Phil Thornton, Thierry Ogier, Rashmi Kumar, Jackie Horne

After 10 years of being largely absent, inflation has returned to the worry list at the IMF-World Bank annual conference. Although this week's meetings have focused on immediate threats such as the simmering trade tensions between the United States and China and an emerging market debt crisis, there is a growing realisation among policymakers, senior bankers and analysts that rising price pressures could soon force central banks' hands.

"Inflation is going to be a problem over the next year," said the head of the investment banking division at a global bank. "This time next year it will be a worry but right now not enough people are concerned about it. We've had 10 years without it. But it's coming back and it could be a real issue."

JuanJosé Echavarría, governor of the central bank of Colombia told *GlobalMarkets*: "Everybody should worry about new inflation because economies are booming. It is a very tricky question, because for many years we did not have inflation at the international level. If you talk to the central bankers in the advanced countries, they keep telling you that they do not understand very well what is going on."

The immediate focus is on the US where President Donald Trump jolted markets this week with his verbal intervention on monetary policy, accusing the Federal Reserve of "craziness" for its programme of gradual interest rate rises. But Echavarría said the US economy was booming, the labour market was very tight, while on top of that Trump's expansionary policies fiscal policies would fuel growth.

Taimur Baig, managing director and chief economist, group research, at DBS Bank, said monetary policies were invariably going to tighten in this cycle despite signs that the growth cycle is near the peak. "But that does not exempt central banks from the need to continue normalising policy," he said. "It's a tricky balancing act. In a 12-month horizon, nobody is particularly bearish about growth, and the risk of inflation has risen because of oil, tightening and trade wars."

Robin Brooks, chief economist at the Institute of International Finance, said that emerging markets needed to keep an eye on wage inflation in the US, which might force Fed chairman Jay Powell to raise rates faster than markets expected. "Given how poorly risk assets behaved early this year when average hourly earnings grew above expectations, we see this as a potential risk event for EM in the near term," he said.

The trigger could come as soon as next month when October wage inflation data could show a spike. "What worries us from an EM perspective is that risk assets reacted poorly earlier this year," he said. "We therefore flag this as a near-term risk for EM."

World Bank chief executive Kristalina Georgieva told *GlobalMarkets* she was worried about the record $164tr global debt mountain. "With interest rates climbing up and dollar appreciation especially for economies that are burdened with dollar denominated debt, we already see that very troubling signs."

The IMF has played down the risk. Chief economist Maurice Obstfeld said at the launch of the Fund's world economic outlook this week that core inflation rates were "largely quiescent" thanks to robust policy frameworks ":anchoring" inflation expectations.

Claire Dissaux, head of global economics at Millennium Global, agreed saying lower growth across emerging markets meant there was "far less" inflation than during the last EM crisis. "Inflation expectations are also better anchored because fiscal discipline has improved since then too," she said.

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Success is a journey

Debt-laden African states ill-prepared for next crisis

By Thierry Ogier and Owen Sanderson

African countries that have issued high volumes of debt in recent years must now brace themselves for a potential bout of distress in the face of adverse external conditions, leading experts have warned.

Six countries were considered to be in debt distress at the end of last year — Chad, Eritrea, Mozambique, Congo Republic, South Sudan and Zimbabwe, according to the IMF. Another 15 countries fall into the category of "high risk of debt distress".

African countries issued a record $7.5bn in sovereign bonds in 2017, 10 times more than in the previous year. And they have issued or announced plans to issue more than $11bn in additional debt in the first half of 2018, according to the IMF.

"If you just take the first quarter of 2018, African countries have issued more Eurobonds than the total year of 2017," said Albert Zeufack, chief Africa economist at the World Bank. "There are a number of new risks that our countries need to equip themselves against."

FOREIGN CURRENCY

The share of foreign currency denominated debt has increased significantly to 60%. "This is roughly a two-fifths increase compared from 2010," said Zeufack.

"There are important risks emerging from the change in the composition of debt. Not only because of currency depreciation, but also because loans have evolved towards more non-concessional debt and non-traditional donors, more market-led debt," he said.

Eric LeCompte, executive director of Jubilee USA Network, said African markets were now much more connected to the rest of the world than during the previous financial crisis.

"The types of debt that different countries have today did not even exist in Africa 10 years ago. Africa will not be insulated from the next crisis," he said. "The poorest countries are already back in debt, and now we even see wealthier countries like Nigeria, Kenya which are dealing with serious debt issues."

Zeufack said African countries should strengthen their capacity to negotiate better terms on their loans. "Some countries have actually gone to market quite aggressively to invest in infrastructure. What is clear is that they should have, and could still negotiate better conditionality in these loans to finance infrastructure. The biggest issue is the cost of these funds, besides the debt to GDP ratio," he told *GlobalMarkets*.

Zeufack: our countries need to equip themselves against new crises

Meanwhile, a bank strategist has reported some improvements in African countries' debt management capacity some. "The quality of debt management in a number of African states has really improved. Everywhere you go you meet the young diaspora that have come home — people who've trained in London, Paris, and New York as bankers, who speak the language of the markets and investors," said Christopher Marks, head of emerging markets EMEA for Mitsubishi UFG.

"Ministries of finance are being more proactive in softening the impact of maturity spikes."

World Bank sparks row over 'too strict' labour rules

By Phil Thornton

The World Bank has been accused of supporting the dismantling of work regulations and of ignoring inequality in its analysis of the changing nature of work that was published at the Bank's annual meetings.

The report looks at the challenges workers face from technological innovations such as robots as well as the rise of the so-called "gig economy" that has meant fewer workers have the stability of a job for life.

In the foreword to the World Development Report 2019, bank president Jim Yong Kim said that developing countries would need to take rapid action to ensure they can compete in the economy of the future.

"They will have to invest in their people with a fierce sense of urgency especially in health and education, which are the building blocks of human capital to harness the benefits of technology and to blunt its worst disruptions," he said. "But right now too many countries are not making these critical investments."

He said the report challenged governments to take better care of their citizens and called for a universal, guaranteed minimum level of social protection. It could be done with the right reforms, such as ending unhelpful subsidies; improving labour market regulations; and, globally, overhauling taxation policies, he said.

However, the report itself says that while regulations address labour market imperfections, they often reduce dynamism in the economy. "When regulations are too strict and exclude many workers, especially young and low-skill people, firms find it difficult to adjust the composition of their workforces," it said.

Countries with strict labour regulations and specifically those with "burdensome dismissal procedures" tended to have smaller technology-intensive sectors. "More stringent regulations are also associated with lower entry and exit of firms — especially small firms — in industries in which labour moves more frequently between jobs," it said.

"When the rules applied to firms' hiring and dismissal decisions are too onerous, they create structural rigidities that carry higher social costs in the face of disruption."

Kim: "developing countries have to invest in their people with a fierce sense of urgency

But Nadia Daar, head of Oxfam International's Washington office said: "It is irresponsible for the World Bank to promote the deregulation of labour and the dismantling of the rights that workers have long fought for. The report downplays the severity of inequality and contradicts internationally agreed labour standards."

The report said that data showed that inequality in most emerging economies had declined or remained unchanged over the last decade.

Turkish banks lean on MDB tools for crucial funding

By Owen Sanderson

Multilateral development institutions have stepped in to provide support for Turkish banks with extensive hard currency debt and big wholesale funding needs to roll over in the wake of the plunge in the lira over the summer.

They have turned to funding instruments supported by institutions such as the European Investment Bank and the European Bank for Reconstruction and Development in order to access finance at below market levels, rather than borrow money directly.

State-controlled Vakifbank raised $300m of 10 year money through a diversified payment rights (DPR) securitization this week — a capital markets tool which uses offshore payment flows to secure the bonds and achieve investment grade. Vakifbank did not disclose who arranged the deal or who bought it, except that it was said to be an international investment bank.

Recent issues from other Turkish banks have often been taken down in part by EIB, EBRD and the World Bank's International Finance Corporation, which usually attach conditions to the financing such as on-lending to SMEs, female-owned business, or into deprived areas.

"MDBs have partnered with the Turkish banks on lots of new instruments," said Luca Lazzaroli, director general and deputy head of operations at the EIB. "Asset backed securities, domestic covered bonds, SME covered bonds, DPRs, all of these are relevant," he said. "At this point in time, markets are taking a cautious stance on Turkey, but the capital markets are not closed to DPRs."

"We use our internal pricing methodology based on expected losses," he added. "We do grade on credit criteria, but we don't operate like a bank. We lend long term, and don't need to reflect the trend in the market."

Hopes are high among investors that Turkey's troubles will ease soon, amid reports that Turkey and the United States have reached a deal on the release of evangelical pastor Andrew Brunson, who has been detained on terrorism charges — a move which led to US sanctions against Turkey. Brunson was due at a court hearing on Friday.

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Standing tall
Finance minister Carlos "Sonny" Domingez.

Philippines moves to keep growth on track

The Philippines is one of the fastest-growing economies in the world. But have infrastructure shortfalls, weak tax revenues and tight rules for foreign companies held the country back from even faster growth? Sonny Dominguez, the country's finance minister, intends to find out

By Matthew Thomas

The Philippines gets plenty of international press nowadays, but it is usually for the wrong reasons. Rodrigo Duterte, the country's president, is prone to unscripted, sometimes vulgar outbursts. The recent arrest of a political opponent drew sharp criticism. His prolonged campaign against drug use is, to say the least, highly controversial.

But what is not controversial is the economic miracle taking place in the Philippines. The country can now boast one of the fastest growing economies in the world. It grew by 6.7% in 2017, and the Asian Development Bank thinks it can achieve 6.4% growth this year and 6.7% in 2019. (These numbers are, however, down from earlier estimates.)

This growth is not, in itself, remarkable for the country. Between 2010 and 2016, the start and end of the administration of Benigno Aquino III, Duterte's predecessor, the country achieved average annual growth of 6.277%. The difference now is the sharp emphasis the government is making on converting economic growth into lasting change.

The most obvious attempts are in the development of infrastructure. Whereas Aquino struck a cautious tone, officially promoting public-private partnerships (PPPs) but erecting a number of checks and balances which slowed down approvals, Duterte has taken the direct approach. His infrastructure programme — known simply as 'Build, Build, Build' — has promised to swap hypothetical arguments for practical change.

The government has also pushed for a sweeping series of tax reforms, the first stages of which have already been approved by Congress. Carlos 'Sonny' Dominguez, the country's finance minister, sees these tax reforms as an essential policy to convert economic growth now into prolonged — and more equitable — growth in the future.

SONNY SIDE UP

Duterte made clear during the election that he did not consider himself an economist. "Why would I attempt to be a smart aleck if I am really not?" he said. "If I get to be president I would employ the economic minds of the country."

He appears to have kept his word, particularly with his appointment of Dominguez. When this correspondent talked to some of the most senior businessmen and bankers in the Philippines following Duterte's electoral victory in June 2016 — a time when much of the establishment were still unsure what to expect from the brash former mayor of Davao — the feedback on Dominguez was universally positive.

This was partly because he wasn't seen as a political figure. He had previously served in government, running the ministries of natural resources and agriculture during the presidency of Corazon Aquino. But his main reputation was earned in business. He worked as a senior executive across some of the biggest firms in the Philippines, including serving of chairman of Philippine Airlines, the country's flagship carrier.

This background has made Dominguez aware that it is businesses, rather than governments, that drive economic growth. As a result, the Duterte administration is taking a much more welcoming approach to foreign businesses.

The Foreign Investment Act, first signed in 1991, gives Philippine governments considerable leeway on what sectors they will allow FDI into, largely through the provision of a 'negative list' which rules out specific industries.

The negative list is updated every two years and often contains small tweaks. But the Duterte administration is planning a major transformation. Among those industries reportedly being opened up to foreign companies are construction of public works and internet services, two areas that address both the hard and soft infrastructure hurdles facing the Philippines.

But although it is clear that Dominguez respects the role of business, he is also a pragmatist. Whereas the Aquino administration put emphasis on PPPs to hit infrastructure spending targets, Dominguez takes a more open approach — appearing willing to do whatever it takes.

Dominguez made these priorities clear at an economic briefing in Manila on September 18, speaking to an audience of analysts, investors, chief executives and representatives from the multilateral lenders who appear so crucial to helping the Philippines realise its infrastructure spending targets. He told the audience that the government was keen on hybrid PPPs, where the government essentially takes the early funding burden but passes on completed projects to the private sector.

But Dominguez also noted the importance of bilateral links. China, which Duterte has undeniably courted since coming into office, has committed $9bn of investments and aid, Dominguez said. Japan, not to be left out, has offered up the same. South Korea has committed $1bn.

There is also major potential to get money from multilateral lenders, who see the chance for a clear win in the Philippines. On September 20, two days after Dominguez's speech, the ADB said it expected to lend $7.8bn, or around $2bn each year, between 2018 and 2021.

The Philippines growth story is not without risks. Inflation is rising, despite best efforts of the country's central bank. The looming trade war between China and the United States creates uncertainty for economies across Asia. The Philippine peso is one of the worst-performing currencies in Asia this year.

But the finance ministry, helmed by Dominguez, appears to be making the right moves to ensure that growth continues — even if it is Duterte who hogs the headlines. GM

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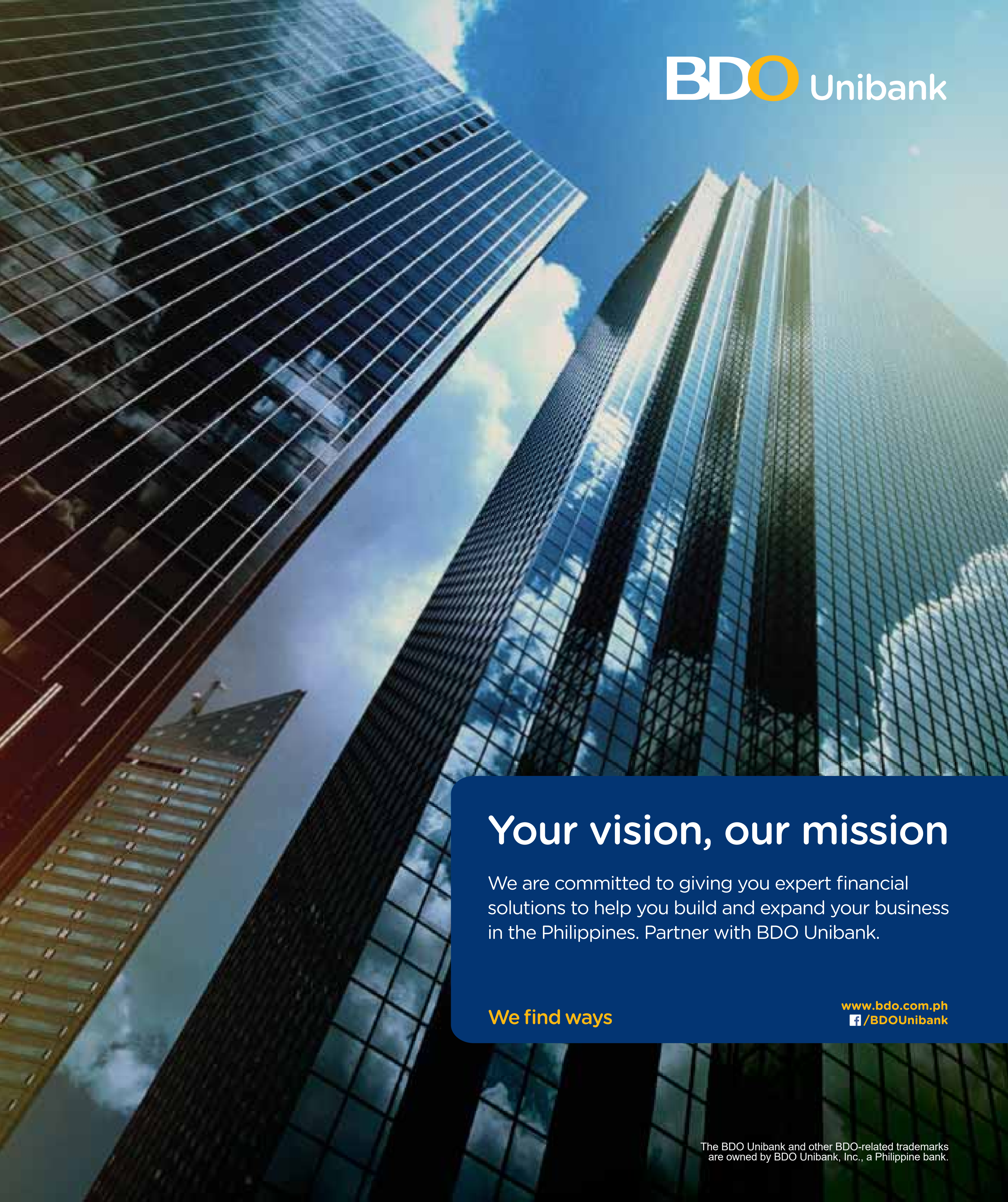

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Supranationals to copy African Development Bank's securitization breakthrough

Private investors are reluctant to co-invest with development banks in poor countries. A potentially exciting alternative is securitization, which allows investors to take slices in whole portfolios and could expand the MDBs' lending firepower

By Jon Hay

> "I believe the most fertile area is in the non-sovereign lending book"
> —Andrew Hohns, Mariner

It is a truism in development circles that engaging the private sector is critical to achieving the scale of investment needed to meet the Sustainable Development Goals.

The numbers of trillions in various estimates tend to become a blur but the UN's Sustainable Development Solutions Network reckons $5tr-$7tr a year until 2030. That compares with $11.8tr of total global bond issuance in 2017, according to Dealogic — making it look a tough target.

But compared with the multilateral development banks' capacity to lend, even $1tr a year is off the scale. The two largest MDBs, the European Investment Bank and World Bank Group, disbursed €58bn and $44bn last year, respectively.

No wonder progress towards the SDGs has been mixed. The proportion of families living on less than $1.90 a day has fallen since 2000 from 27% to 9%, according to the UN's latest progress report on the SDGs. But after a long decline, the number of undernourished people actually rose in 2016, from 777m to 815m, due to conflict, drought and disasters linked to climate change. More than 2bn people still lack even basic sanitation.

The 'From Billions to Trillions' vision paper put out by seven leading MDBs in 2015 laid heavy emphasis on crowding in private investment. That is indeed growing. Standard & Poor's, the rating agency, reported in September that the MDBs had claimed $164bn of private co-investment mobilised in 2017, above all by the EIB.

The trouble is, 97% of that went to high and middle income countries. "We believe it's because private sector investors find it too risky to go to low income countries," says Alexander Ekbom, analyst for MDBs at S&P in Stockholm. "The investment climate is tough when it comes to government concessions, the rule of law, transparency, regulation. You typically find risk sharing structures being less available or costly and official co-financings scarcer."

CLEANER ROUTE

These problems will take time to solve. But there is another, potentially very promising, route for the private sector to support MDBs without needing to invest directly in specific deals in poor countries — by taking slices of their risk through securitization. This enables the investor to benefit from a diversified pool of assets and to choose a certain level of risk.

The African Development Bank completed a trailblazing $1bn securitization in September, the first in the sector to involve private investors. Its peers are likely to follow suit.

The potential to make the MDBs' existing capital go further by recycling assets has barely been explored but the AfDB has shown that although the first transaction was difficult it can be done.

It has shed the mezzanine layer of risk on a $1bn portfolio of 40 loans to banks and project finance transactions, freeing up 65% of the capital so that it could make $650m of fresh loans. The assets stay on its balance sheet but are partially guaranteed by a fund managed by Mariner, a US hedge fund, and by Africa50, an infrastructure fund owned by African governments. The European Commission has taken a senior mezzanine slice of risk above them.

"I believe we will see a follow-on transaction within 12 months," says Andrew Hohns, CEO of Mariner Infrastructure Investment Management in New York. "There will be a

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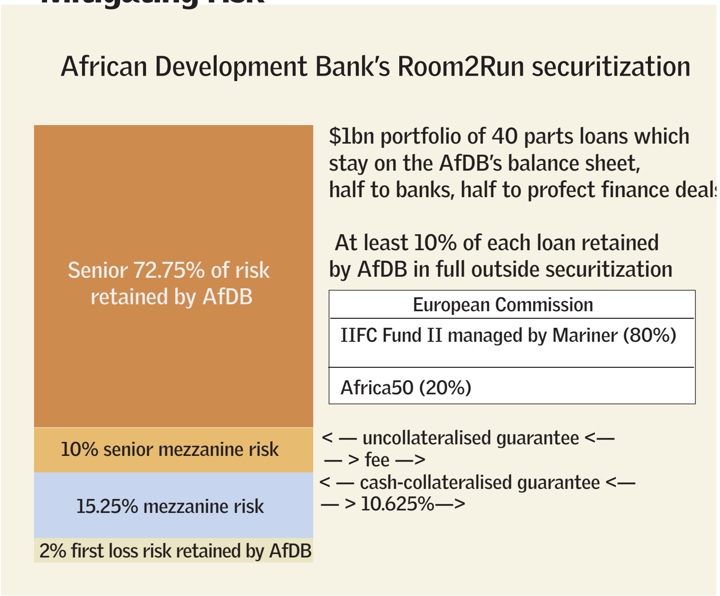
> "We are looking to see to what extent we could securitize part of our portfolio"
> —Alain Godard, EIB

very significant amount of interest on the part of other MDBs to unpack the deal, identify the best practices and specialisations for their balance sheets. Though you may only see one or two transactions in the next six to 18 months, you could well see five to eight in the next 24 months as the big wheels of these organisations turn to internalise this technology.”

MORE COMING

Some MDBs are already working on specific portfolios. “The potential to expand it is huge,” says Juan Carlos Martorell, co-head of structured solutions at Mizuho, which arranged the AfDB deal. “For other MDBs this is a very interesting technique. They are transferring risk at a price which is competitive to enhance their capital metrics. The fact that the rating agencies have been involved and assessed the merits of the transaction means that the first mover has created a path for other MDBs to follow.”

Mitigating risk


African Development Bank's Room2Run securitization
$1bn portfolio of 40 parts loans which stay on the AfDB's balance sheet, half to banks, half to profect finance deal
At least 10% of each loan retained by AfDB in full outside securitization
Senior 72.75% of risk retained by AfDB
European Commission
IIFC Fund II managed by Mariner (80%)
Africa50 (20%)
10% senior mezzanine risk
< — uncollateralised guarantee <—
— > fee —>
15.25% mezzanine risk
< — cash-collateralised guarantee <—
— > 10.625%—>
2% first loss risk retained by AfDB

> "The potential to expand it is huge"
> —Juan Carlos Martorell, Mizuho

The rating agencies have decided how much capital relief to give AfDB, according to their models, which determine whether it can still be rated triple-A.

S&P, which has the most quantitative approach, took a long time to decide how much capital relief to give the AfDB. But Ekbom says: “When we developed the process we did it with the intention of being replicable. We don’t treat one institution differently from another.” Whether a second deal could be processed more quickly would depend on how complex it was but Ekbom says: “I would hope that, as with anything we do in life, doing it the second time would be quicker than the first time. Not necessarily every MDB will do one but there will be a couple more coming.”

Hohns says he believes the other MDBs are now at the stage of willingness to explore securitization, even if not at the stage of readiness.

“We are looking to see to what extent we could securitize part of our portfolio,” says Alain Godard, director-general of risk management at the EIB in Luxembourg.

The influence of the AfDB’s transaction need not be confined to development banks. “It’s something that can maybe be replicated across the continent,” says Olivier Eweck, director of AfDB’s syndication and technical services department in Abidjan. “We hope it will open the door for commercial banks in Africa to structure this type of transaction.”

SUBSTANTIAL GAIN

The AfDB itself is determined to go further, hoping to scale up securitization and try other techniques. It was already leading the way on risk transfer in 2015, when it engaged in a three-way deal with the World Bank and Inter-American Development Bank to exchange $4.5bn of each of their sovereign risk exposures. Each got a better diversified portfolio and could hence make more loans.

Deals between MDBs and other public sector entities make sense because all involved understand the issues to begin with and are willing to collaborate. Since then, a few other transactions have been attempted and a smaller number completed.

A couple of years ago, the EIB guaranteed some of the World Bank’s exposure to the Ukrainian government. “They wanted to do more lending in Ukraine but were up against their limit,” says Godard. The EIB and World Bank are now working on some further bilateral exchanges of sovereign exposures that have become inconveniently large.

But involving private investors is a bigger prize. Asked how much in future balance sheet optimisations could add to an MDB’s balance sheet capacity, Tim Turner, the AfDB’s chief risk officer, says: “I think 40%-50% is not unreasonable. The rating agencies have cautioned us that we need to move at a prudent pace and learn from experience so we are experimenting with several pilot transactions.”

The AfDB will sign a credit insurance deal this year on loans to the financial sector.

PIONEERS TO ENCOURAGE OTHERS

The sovereign assets held by MDBs often yield too little to be attractive to private investors, who can buy most countries’ government bonds if they want to anyway.

“I believe the most fertile area is in the non-sovereign lending book,” says Hohns. “It’s hard to get precise figures but I would estimate the MDBs have $200bn-$300bn of non-sovereign loans. Private investors are best suited to take exposure to seasoned risk rather than construction risk so broad securitization of their non-sovereign, non-construction loans could create perhaps 60%-80% of further capacity for the MDBs to lend.”

So far, this is theoretical. Few investors are willing to do what Mariner and Africa50 have done, which requires not just familiarity with synthetic securitization but a hearty risk appetite and willingness to spend months working on a deal, including weeks of asset-by-asset due diligence.

But Martorell thinks bees will start to arrive at the honeypot. “You probably need to have investors who can invest in size like Mariner, that can do $150m to $200m,” he says. “There are five or six investors who can do that and regularly do synthetic deals. Initially they will assess the asset class and issuer, but if they like the issuer and do due diligence I think they will be interested.”

The due diligence will also become less intense the more investors build up experience with the asset class and the larger and more granular securitized portfolios become.

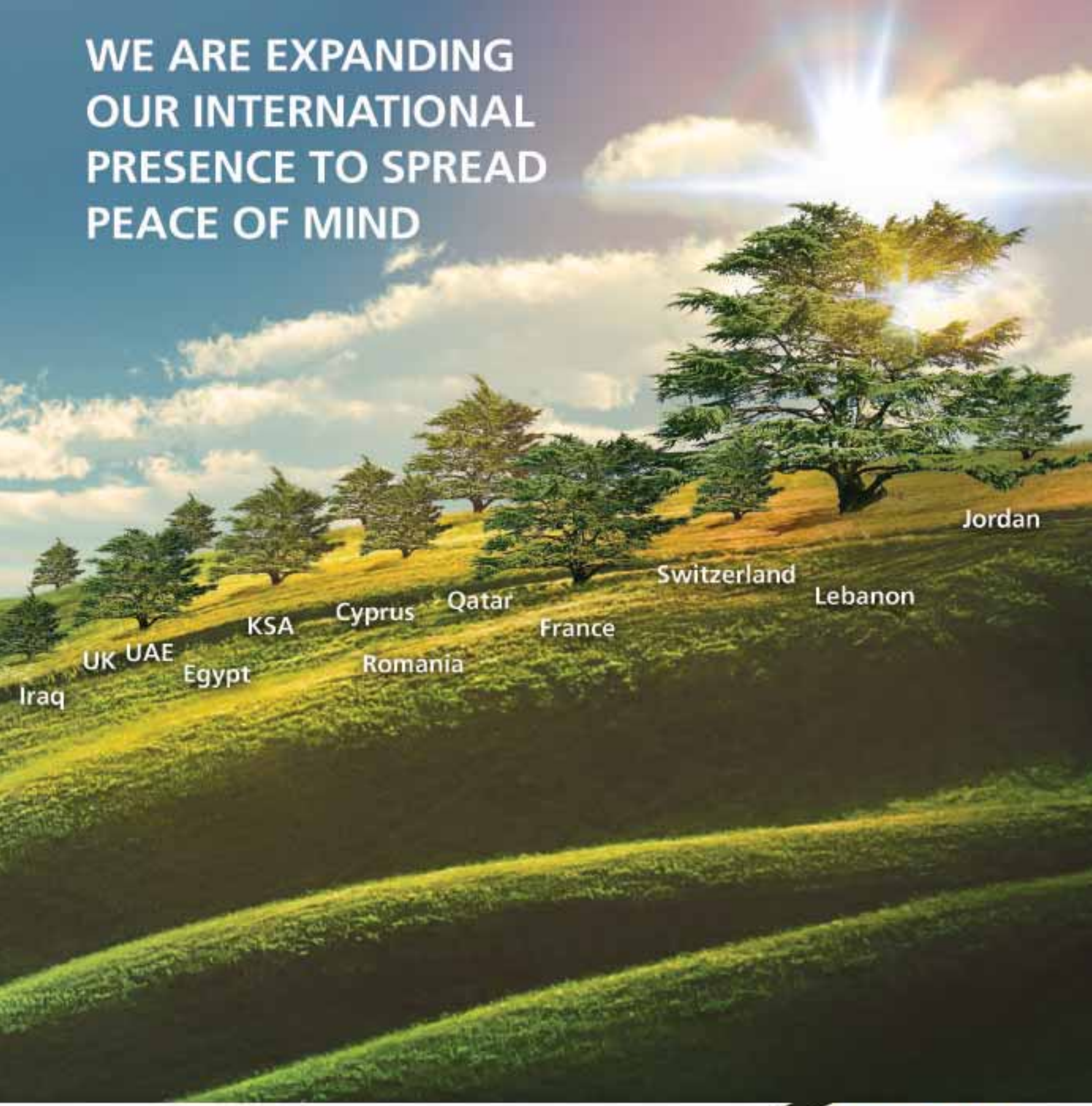
DATA COMFORT

Getting private investors comfortable with these risks is something Godard at the EIB has been building up to for a decade since he started a database called GEMS to track the credit performance of emerging market development loans. About 20 MDBs and national agencies are now sharing their information through GEMS and they are discussing how to open it to the private sector.

Borrowers’ names are already encrypted in the database and searches are not very precise to protect borrowers’ privacy. But Godard is still convinced GEMS could be a crucial guidebook for investors, letting them know the territory is safe.

The EIB is working with Dutch pension funds on setting up a new fund to co-finance loans with MDBs including the EBRD, IFC and AfDB.

“Data is one of the three barriers investors have before investing,” says Godard. “They will be using the GEMS data to assess the risk/return. That’s why these pension funds are interested. They see that what they thought would be costly in terms of risk in these markets is not that costly in view of the experience we have.” GM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Helping the sea to fight climate change

A compelling recent example of the EIB's role as a "crowding-in" bank is its support for the Althelia Sustainable Ocean Fund (SOF), the first close of which was announced in September

Jonathan Taylor, EIB: "Our emphasis on the blue economy is not at the expense of support for the green economy"

The EIB is a cornerstone investor in this $100m fund, which is dedicated to making pioneering impact investments in marine and coastal projects. This in turn will help to build resilience in coastal ecosystems and underpin sustainable growth in the so-called blue economy, which is defined as all economic sectors that have a direct or indirect link to the ocean. The OECD has forecast that by 2030, the blue economy could outperform the growth of its global counterpart in terms of value added and job creation.

The imprimatur of the EIB's support as a fund investor is critical in sectors traditionally regarded by other lenders as unbankable. "The idea is to help to build momentum by typically taking 20% of a fund, which then gives others the confidence to invest," says Martin Berg. He is Head of the Environmental Funds and Climate Finance Policy Unit at the EIB in the Equity, New Products and Special Transactions Department. This has been responsible for channelling the EIB's investment into several funds dedicated to sustainable development. One example is the Land Degradation Neutrality Fund (LDNF), which is expected to become operational in the coming weeks and has been developed in partnership with the United Nations Convention to Combat Desertification (UNCCD) and the Agence Française de Développement. LDNF will target projects in areas like sustainable commodities and agriculture, helping to combat desertification, in line with Sustainable Development Goal (SDG) 15.

Oceans: A Common Good

In the context of the blue economy, initiatives such as the Althelia Fund are helping to channel much-needed investment into areas such as fisheries, which have historically been regarded by commercial banks as too risky. Supporting enhanced efficiencies in fisheries could increase profits in the sector by 115% to $51bn, according to some studies. Given that more than 90% of people whose livelihoods depend on fishing live in developing countries, the impact of this increase on job creation, living standards and poverty alleviation is self-evident.

As an example of the sort of initiative that could help to address each of these social ills, Berg points to the economic benefits that could be generated by supporting micro-enterprises fishing for lobsters in Belize. All too often, he says, those operators are able to export only lobster tails, because they lack the storage or freezing facilities to make the rest of the resource commercially marketable. The result is considerable wastage, with the unused parts of the lobster thrown back into the sea.

Promoting Partnerships and Risk-sharing

Berg says that an important feature of the Althelia SOF is the support it has received from the US Agency for International Development (USAID) in the form of a risk-sharing guarantee of up to 50% of losses incurred by investors. According to USAID, its Development Credit Authority (DCA) facility will "allow private capital to flow, at scale, towards financing sustainable business models in the ocean economy by providing loan guarantees directly to portfolio investments in the SOF."

Another notable way in which partnerships are supporting the SOF is in the endorsement it has had from several influential non-government organisations (NGOs). "It's impossible to please all the NGOs," says Berg. "But from a reputational risk perspective our technical team draws comfort from the support given by Conservation International and the Environmental Defence Fund to initiatives such as the SOF."

Life Below Water

Understanding of the full significance of the environmental as well as the economic role played by the world's oceans is a relatively recent phenomenon. Aside from the biodiversity they sustain, the contribution made by the oceans to combating the impact of climate change is a function of their role as a carbon sink, a natural reservoir that absorbs and stores the atmosphere's carbon. It is now estimated that oceans may concentrate as much as 50 times more carbon than the atmosphere, putting them in the front line of the planet's defence against climate change.

More broadly, the size of the blue economy is such that it makes a very considerable contribution to global economic activity – much of which is concentrated in under-developed regions. Globally, the market value of marine and coastal resources is estimated at $3tr per year, or about 5% of global GDP.

It is against this backdrop that the EIB has reiterated its support for the sustainable development of the blue economy as a key priority, in accordance with SDG 14 (Life Below Water). "SDG 14 dovetails with the strategy we had been pursuing in any case, which is to put more emphasis on the blue economy," says Jonathan Taylor, EIB Vice-President in charge of climate and environment. "This is not at the expense of our support for the green economy, but as a complement to it."

Taylor says that, beyond initiatives such as its investment in the Althelia Fund and the provision of facilities for borrowers such as the Caribbean Development Bank (CDB), the EIB is engaged in a number of other programmes to support the blue economy. Foremost among these is the initiative which was announced at the Oceans Conference organised by the EU in Malta in 2017 to develop a set of Sustainable Blue Economy Finance Principles. This 14-point framework is a commitment to promote SDG 14, set out ocean-specific standards without duplicating existing guidelines for responsible investment, and comply with IFC performance standards and EIB environmental and social principles and standards.

These principles are backed by a coalition of large institutions including Althelia Ecosphere, Aviva Investors, the BPCE Group, Seventure

The Nile, which since 2008 has been a notable beneficiary of the Mediterranean Hot Spots Investment Programme (MeHSIP)

Partners, Willis Towers Watson and the World Bank, alongside the EIB and the European Commission. This makes the agreement a compelling example of a multilateral partnership designed to pool resources and expertise in order to address the challenges presented by sustainable development.

The Clean Oceans Initiative

The size of this challenge explains why the creation of partnerships and the use of co-investment and guarantee models is critical if the formidable financing requirement is to be met. A significant example of a partnership targeting marine protection is the agreement being signed this week between the EIB, Germany's Kreditanstalt für Wiederaufbau (KfW) and the French Agence Française de Développement (AFD) to establish the Clean Oceans Initiative.

Richard Amor, Head of the EIB's Implementation and Business Development Unit in the Global Partnerships Department, says that the EIB/KfW/AFD Clean Oceans Initiative is committing at least €1.5bn over the next five years to support viable, sustainable projects targeted at decreasing pollution levels in the world's oceans. These will make a decisive contribution to reducing marine litter – especially plastics – as well as untreated wastewater discharge.

The initiative will build on the institutions' strong track record of underpinning projects that reduce marine pollution by providing long-term loans to private and public sector borrowers with a view to crowding-in like-minded private sector investors. In line with the EIB's broader sustainability finance agenda, it will deploy technical assistance to advise on the development and implementation of viable projects. The initiative will also provide investment grants and explore innovative financing structures in support of private enterprises joining the battle against marine pollution.

The EIB/KfW/AFD initiative will be global in nature, but with a particular focus on projects in riverine or coastal areas in developing countries in Asia, Africa and the Middle East.

Inside the EU, meanwhile, the three institutions may look to complement the initiative by backing innovative projects in the plastics and biotechnology sectors that support the transition towards a regenerative circular economy minimising wastage from diminishing natural resources.

"Protecting the oceans from pollution is one of the major challenges we face, requiring a co-ordinated and targeted international response. We have therefore joined forces with the European Investment Bank to launch the Clean Oceans Initiative to pool and expand our respective activities," announced the CEO of KfW, Klaus Braunig, recently.

Local Challenges; Local Solutions

Partnerships are also being explored by the EIB as a way of helping local companies in regions most seriously vulnerable to degradation of oceans to pursue innovative ways of addressing the challenge. Amor points to the example of a company exploring ways of collecting plastic on the surface of the ocean off the coast of Latin America and Africa. This is then recycled into flat-packed ground-sheeting and walls for use in refugee camps and other temporary structures. In other words, this is an example of a classical circular economy initiative turning an environmental nuisance into a social benefit.

"It is a wonderful initiative and precisely the sort of project that we would like to be financing," says Amor. "It is essential that we help to build capacity on the ground and allow local enterprises to take ownership of marine protection projects, applying a local solution to a local problem."

One reason the formation of partnerships is especially important in the blue economy is that consumers don't need to get their feet wet to cause considerable damage to the oceans. Unsettling evidence of this is the apparently inexorable rise in plastic waste deposited in the world's oceans. According to a report launched by the Ellen MacArthur Foundation at the World Economic Forum at Davos in 2016, about a third of the world's plastic now ends up in fragile ecosystems such as the world's oceans. If nothing is done to prevent the oceans from being used as a dumping ground, at current rates there will be more plastic by weight than fish in the sea, according to the Ellen MacArthur report.

Source: Friends of Europe/flickr © some rights reserved

Richard Amor, EIB: "Effective marine protection begins on land"

Cleaning up the Nile

Given that as much as 90% of the plastic that ends up in the oceans is disgorged by 10 rivers, it is little wonder that projects addressing river pollution at their source are being prioritised by the EIB. "Effective marine protection begins on land," says Amor.

One of these 10 rivers is the Nile, which since 2008 has been a notable beneficiary of the Mediterranean Hot Spots Investment Programme (MeHSIP). This provides direct technical advice and support to promoters for the preparation of investment projects in the water and environmental sectors in Egypt, Jordan, Lebanon, Morocco, Palestine and Tunisia. The EIB has also been working for several years alongside KfW, Agence Française de Développement (AFD) and the Egyptian government on a €300m project to improve waste collection and water treatment in the Delta Region of Egypt.

"By removing a significant amount of plastics from wastewater effluent, this is having a very real and tangible positive impact on sectors such as tourism and fisheries," says Luca Lazzaroli, deputy head of operations at the EIB. He notes that more than 500,000m^3 of water is expected to be treated and cleaned daily as a result of this project. As the water is then discharged into the Nile and ultimately into the Mediterranean Sea, this will improve water quality for almost 7 million people.

Alongside the provision of technical and financial support for projects to combat the degradation of oceans, a critical component of the EIB's marine protection programme is monitoring, measuring and communicating the results of these initiatives. "Impact measurement is a key focus for us," says Lazzaroli, adding that for every marine project, the EIB is analysing a series of key indicators with a view to quantifying the waste extracted and treated.

Goldfajn: Fiscal reforms crucial for sustainable recovery

Exclusive GM interview

Brazil's central bank governor Ilan Goldfajn tells *GlobalMarkets* he is determined to push through the pension reform that would prevent the fiscal deficit spiralling out of control

By Thierry Ogier

After several weeks of market volatility, Brazil's government and central bank have been trying to restore market confidence amid emerging market jitters. Their method? "We don't overreact to short term shocks," Ilan Goldfajn, central bank governor, told *GlobalMarkets* in an exclusive interview at the bank's office in São Paulo.

The central bank has just revised its GDP growth forecast to 1.4% from 1.6%. But Goldfajn insists that in spite of its sluggish growth, the Brazilian economy still has a pretty good line of defence. "Our balance of payment is relatively well behaved," he says. "We only have a small 0.8% current account deficit. We do have FDI flows of around 3.5% of GDP although it used to be 4.5%, but it is still much higher than the current account deficit."

In spite of turmoil on the foreign exchange market, reserves are still at a very high level of $380bn, or the equivalent of 20% GDP, he says. "The government does not have a lot of dollar-denominated debt. We are actually long in dollars. The financial system is very resilient and we have relatively low inflation. All of this gives us quite a bit of a buffer," he says. Indeed, inflation is well behaved and slightly below the official target of 4.5%.

INFLATION PRIZE

Nevertheless, the fiscal vulnerability still needs to be dealt with as soon as possible. "We are well placed in terms of balance of payments, in monetary policy but we still need to consolidate fiscal reforms, including the pension reform," he says.

"I believe that the issue will be addressed. The sooner the better. The sooner you address it, the better the chances we have low inflation and low interest rates and a sustainable recovery. Reforms can offer a better opportunity to keep inflation low and for neutral interest rates to be lower so that the economy can recover in a sustainable way," he says.

The Temer government, which was appointed after the left-wing president Dilma Rousseff was impeached in 2016, has an honourable reform record. Henrique Meirelles, who was finance minister at the time, convinced Congress to pass a budget spending cap, which prevents real increases in public expenditures for at least 10 years. "The spending cap underscores the necessity to approve the pension reform," says Goldfajn. An important labour reform that reduces employers' costs was also approved. In addition, several other microeconomic reforms were promoted by the central bank, such as a cut in subsidies from the national development bank (BNDES) and a new system of electronic guarantees.

PENSION REFORM

Meanwhile, the widely unpopular pension reform has remained problematic, especially with a general election looming. "This government has tried to approve it several times. Last year it was almost ready to approve it. It had enough votes (in Congress). But then you had some political instability in May, and the government was not able to approve it," says Goldfajn. "This year, we tried several times, but the proximity to the elections prevented it from being approved." Brazilians were due to go to the polls on October 7 in the first round of voting of the presidential election. At time of going to press, the two frontrunners were the far-right candidate Jair Bolsonaro, a former army captain, and a left-wing contender, Fernando Haddad, from former president Lula's Workers Party. Lula himself has been in jail since April after he was sentenced to 12 years for corruption. A runoff is scheduled for October 28.

The reform is still ready to be voted on in Congress. It would bring savings of some 1.4% of GDP, says Mario Mesquita, chief economist at Itaú Unibanco, Brazil's largest private bank. It may not be sufficient to clear the primary fiscal deficit immediately, but it would prevent the fiscal deficit spiralling out of control.

Most presidential candidates have largely dodged the issue during the electoral campaign. "They do not want to elaborate so much on fiscal adjustment right now, because this is not a popular issue — not in Brazil, nor anywhere else," says Mesquita. "But I spoke to the economic advisers of most candidates. They may have different approaches, but none of them denies the importance of the fiscal issue."

The main threat, according to him, is not the risk of insolvency, like in Argentina or in Greece, but of a return of inflation. "Brazil will not become like Greece because we owe our debt to ourselves, basically (there is only a small part of the debt which is denominated in dollars)," he says. "What Brazil may become is 'old Brazil', meaning an inflationary Brazil. We do have a very serious problem. If reforms are not implemented, the end result will be inflation — possibly double digit. It would be a very aggressive way to do the adjustment."

But so far, people like Ilan Goldfajn have been in office to make sure that this will not happen. "What's the expression?" he says with a smile. "Keep calm, and keep walking..." GM

> *"Reforms can offer a better opportunity to keep inflation low and for neutral interest rates to be lower so that the economy can recover in a sustainable way"*
>
> *—Ilan Goldfajn*

SUSTAINABLE AND RESPONSIBLE CAPITAL MARKETS

Finance can no longer stand by

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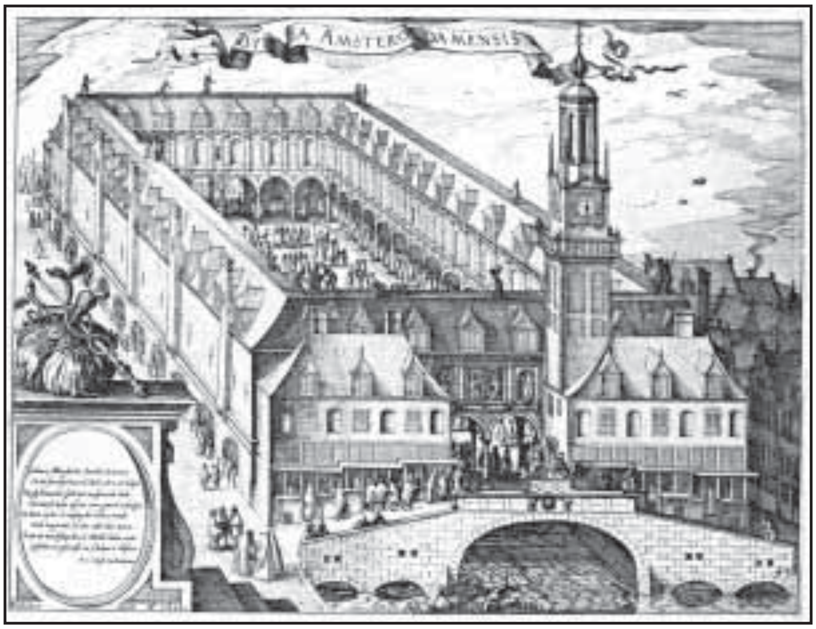
Impact joins risk and reward as third axis of ESG investing

Environmental, social and governance investors have done a fine job of making their approach accepted and now mainstream in a money-driven industry. Along the way, they started saying it was all pragmatic, not about principles. That was a fiction, and under the pressure of climate change, it is being replaced with a more rounded philosophy. **Jon Hay** reports.



The original bourse in Amsterdam, where ethical issues were recognised as part of investing

What was arguably the first stock exchange was set up in a courtyard in Amsterdam in the early 17th century, to facilitate trading shares in the Dutch East India Co.

"You could already indicate that, given my religion, I do not want to finance ships that only carry soldiers to kick the living daylights out of people far away," says Maarten Biermans, head of sustainability policy at Rabobank in Utrecht. "Then 100 years later the Quakers in England said, we won't do guns and slaves. The whole notion of introducing non-financial indicators is literally as old as investment."

The argument might seem twee to some, but is compelling. If Europe's early mercantile capitalists saw a place for ethics in investment decisions, what is different about today's society or markets that should rule them out?

Yet while modern markets set great store by upright conduct and respecting the law, ethical choice has been sidelined.

The usual history of responsible investing is that it began with ethical funds excluding sin stocks like alcohol, tobacco, pornography and weapons.

Then it moved on to taking a holistic view of each company's environmental, social and governance characteristics and integrating it into the investment decision. ESG is seen as an extra guide to corporate health, so poor ESG performers need to offer more risk-adjusted return to justify buying them.

About four years ago, the cutting edge view in responsible investing circles — including at the Principles for Responsible Investment organisation, which functions as the discipline's Vatican — was that responsible investing was not about ethics, which were faintly old-fashioned. ESG investing was important, but justifiable entirely in terms of better financial outcomes.

This was a great narrative. ESG investors could look the hardest-nosed client in the face and declare: if you put your money with us, you aren't going soft and won't give up a penny, versus regular investing.

This remains the orthodoxy, holding sway as the responsible investing movement has risen to its greatest heights. The global Paris Agreement commits the world to making finance flows sustainable; the European Union has launched a fleet of policies that come close to enforcing RI.

Under the shelter of this selfish definition of ESG, the PRI redefined investors' fiduciary duty to their clients. The old view that investors should only consider their customers' financial wealth was slung out, and replaced with a duty to take account of ESG concerns.

LOOKING AFTER NUMBER ONE

Many voluntary initiatives are now moving finance in a sustainable direction. One of the highest profile is the Taskforce on Climate-related Financial Disclosure.

The TCFD wants all securities issuers and investors to declare how climate change is going to affect their business, long term, and what they are doing about it. This should help investors see the risks and move their capital from hands which are going to lose money from climate change to others which know how to make money. The transition to a clean economy will be accelerated and the risk of catastrophic asset price collapses should be lessened.

In modern ESG style, market forces — investors seeking their own enrichment — will bring this change about, if given the right information.

All involved in sustainable finance urgently wish the TCFD success. But its being valuable and vital does not mean it is sufficient. Investors thinking more about climate change and adapting to it will move the economy in the right direction. But there is no economic or scientific reason to believe they will move it far enough, fast enough.

Consider small island nations — Fiji for example. The rational ESG investor might decide: climate change is going to get worse; Fiji is on the front line of sea level rise and bad weather; I'm going to move my money to higher ground. A solar park in Arizona, perhaps.

This might be the right decision for the investor's clients; a harsh rationalist might even argue it was right for the climate; but it certainly wouldn't be welcome in Fiji. It raises the prospect of ESG-aware investors being in the forefront of capital flight that magnifies the damage of climate change.

"The TCFD flipped over the usual question of what is a company's impact on the environment to what is the impact of the environment on the company," says Biermans. "Now we have the risk departments of financial institutions starting to pay attention — that's a real win. However, we should not lose sight of the original question: what is the impact of the company on the environment? These are all tools to make sure that financial markets are more aligned with the challenges of climate change, but that doesn't mean you just move away and let everybody fend for themselves."

Real estate investors, practising ESG, can move their money to properties in the top half for energy efficiency. But that will not ensure these buildings are green enough to cut emissions to a sustainable level.

"The current two dimensional ESG approach of risk and reward, as developed in part by the PRI, will not get us to 2C or the Sustainable Development Goals," says Gavin Power, chief of sustainable development and international affairs at Pimco in New York. "I know within the PRI governance and executive there have been a lot of discussions about moving it to the impact space, which is the third dimension and frontier."

REDISCOVERING IMPACT

Like many terms in ESG, “impact” has a contested meaning.

The Global Impact Investing Network tracks a highly diverse $230bn market of social and environmental impact finance that lies outside conventional listed securities markets. The average deal size is $3m. Two thirds of the investors seek market returns for the risk, the rest positive returns below market rate. But mainline financial institutions largely ignore it.

Nevertheless, in mainstream markets, impact is becoming respectable.

The word has been embraced by the green and social bond market, to describe the environmental or social effects of the projects to which proceeds are allocated. Investors study these and report to clients on the “impact” their money has had. Some call green bonds impact investments.

In March, the PRI produced a guide for asset owners: How to Craft an Investment Strategy. The 26 page booklet contains some striking passages. Without directly telling asset owners what to think about ESG, the document hints very heavily that those that do not agree with five propositions may consider it “a warning sign that [their] strategy has a short shelf life and will need to be re-evaluated”.

Point 2 in the catechism is “Is positive real world impact an explicit part of your primary objective for investment results?”

On the next page, a diagram shows how, out of three investments with equivalent risk and return, some investors might prefer the one with the best impact. Most green bond investors would put themselves in this category.

A second diagram shows how investors with impact as a “primary objective” would prioritise this “even at the potential expense of risk and return”.

Without wanting to make a bold statement, the PRI is clearly guiding investors to think once again about the real world effects of their investment choices — essentially, morality.

“We are really on the brink of a pretty radical sea change in impact investing generally and in fixed income specifically,” says Power. “The old ethical field evolved into ESG and we are now seeing that moving into impact, where investors are looking for some intentional outcomes from how they invest.”

Behind this change is the urgency of climate change and the prominence of the Paris Agreement and the Sustainable Development Goals, which the financial sector is called on to assist.

“What bankers and investors realise is that doing good is coming within their time horizons, within the tenors of their loans and investments,” says Roland Mees, director of sustainable finance at ING in Amsterdam. “The door is closing with regard to climate change. If we do not take certain urgent actions now we will lose the opportunity to reach the 2°C scenario.”

BRIDGING THE GAP

Obviously, governments are responsible for filling the gap between what society needs and what markets will finance. But if investors are allowed to engage the ethical parts of their brains once again, there may be much they can do to help.

Christoph Klein, a former credit hedge fund manager and managing director at Deutsche Asset Management, now runs a start-up multi-asset manager, ESG Portfolio Management, in Frankfurt. “ESG allows me to work on the triple win,” he says. “To reduce the risk of the portfolio, to see opportunities for enhancing returns, and the third point, to enhance stakeholders’ lives. If we can have a positive impact for many people involved, I’m happy to spend extra time in analysis and engagement.”

Banks and other service providers are keen to assist. “We have had clients coming with two or three of the SDGs and saying ‘can you help us find stocks and bonds that have a positive impact regarding these?’” says Marcus Pratsch, head of sustainability research at DZ Bank in Frankfurt. “‘Can you provide a portfolio where it’s highlighted which company is contributing to which SDG?’”

> **“If we go towards 10C of warming, we are close to extinction, and risk and return have no meaning”**
> Wolfgang Kuhn, ShareAction

DZ’s environmental, economic, social and governance (EESG) research and rating system includes an impact analysis, covering how sustainable are the effects of the issuer’s products.

Green loans, in which companies can pay lower interest if they hit sustainability targets such as an ESG rating, can be used with impact in mind.

“We are willing as a bank to do green loans with the big mass of smaller companies,” says Mees. The margin reduction could get companies working on sustainability. “People need a motivation to do things, an incentive to go through the hassle. If they can be nudged then they tend to get on the move.”

Investors are not going to become charities. Equally, as Wolfgang Kuhn, a former bond investor now at the ShareAction NGO, puts it: “If we go towards 10C of warming, we are close to extinction, and risk and return have no meaning.”

Between the imperatives to make money and to save the planet, there is not one formula for correct action. There are choices.

“People need to understand that by investing you make judgements, in a way about life and death,” says Kuhn. “These judgements need to be explicit and people need to be courageous and stand for something. By boiling it down to risk you can’t capture the complexity of the world and what we are trying to preserve.” GM

Silence is not golden: bond investors try to find their voices

Many bond investors now say they engage with borrowers on ESG issues. Companies are noticing, and a virtuous circle is beginning to turn. But much of the conversation is still very gentle and diffuse, and not concentrated at the point of capital raising. As **Jon Hay** reports, more ambitious engagements to change whole industries lie in the future.

When assessing the progress of environmental, social and governance investing, there are often two apparently contradictory levels. Investors that have signed the Principles for Responsible Investing now manage $80tr of assets — more than enough to have saved the world, one might think. Yet the same dirty old economy throbs on.

This disconnect pops up in subsectors of responsible investing. Engagement — which means speaking to organisations you invest in about their ESG performance — is the second PRI Principle. All signatories are committed to doing it.

But bond issuers and buyers say ESG issues hardly crop up in the dialogue when capital is raised. From one perspective there has been great progress — from another, little.

Engagement is important for many reasons. Investors can sell the bonds of companies or governments that are ESG villains, or buy them more reluctantly. But that is like whispering behind someone's back.

Successful borrowers have hundreds of investors, and won't notice one or two slipping away. Weak borrowers have bigger problems. If their spreads widen, they will put it down to credit difficulties. The market signals will reach the borrower only slowly and indistinctly.

"Excluding an issuer probably isn't the most effective way of trying to achieve change," says Maxime Molenaar, a responsible investment officer at Actiam, the Dutch asset manager. "It's a last resort. It makes more sense to try to influence the company beforehand."

As in every walk of life, making a fuss works — or at least, has a better chance than accepting things meekly.

Especially if the complainer is prepared to back up words with action. "From our sales feedback we are starting to see that institutional investors, for example Dutch pension funds or big insurance companies, sometimes don't want to invest in corporate bonds anymore if the ESG rating is too low," says Xiaofei Guo, a banker in ING's sustainable markets team in Amsterdam.

Investors who tell an issuer about their concerns may find it smartens up its act.

"Selfishly, dollars and cents-wise, the pace of environmental change is up, the pace of social change is up, the risks are a lot higher over the medium and long term for a lot of credits we invest in," says Scott Mather, CIO of core US strategies at Pimco in Newport Beach. That means from a risk-reward perspective, Pimco believes engaging is "pretty obvious".

Both parties can win from the interaction. The issuer learns something about what its investors care about. And if it makes ESG improvements astutely, it could boost its value in the eyes of the investor, and perhaps in absolute terms.

CROSSING OVER

Traditionally, engagement was the preserve of equity investors. Shareholders' voting and ownership rights give them an explicit say in how companies are run, even if most just tamely follow management's lead.

Seasoned bond investors used to doubt whether they even had a right to question companies they invested in. Making demands of governments still sits ill with most bond investors.

But norms have begun to shift. "Three or four years ago, nine out of 10 treasury departments would not have been involved in sustainability presentations about the company," says Othmar ter Waarbeek, head of corporate bond origination at Rabobank in Utrecht. "They weren't even aware sustainability ratings existed. That has now completely changed and most treasuries have embraced sustainability. I've certainly attended roadshows where these questions are being answered very specifically. Ninety-five percent of issuers are outside the danger zone, at least for now, but it is waking them up to start incorporating ESG as part of their treasury policy."

"There is tremendous untapped potential for fixed income investors to encourage issuers to scope out the risk and opportunities they face"

—Scott Mather, Pimco

Two of the biggest European corporate bond issuers, German car companies, confirmed to *GlobalMarkets* recently that for the first time, they were now getting ESG questions on normal bond roadshows.

"There is tremendous untapped potential for fixed income investors to encourage issuers to correctly scope out the risk and opportunities they face," says Mather.

Yet market participants still tend to see ESG in bond markets as being about green bonds.

In financial institution roadshows for ordinary bonds "it's not that often ESG comes up," says Jasper van Balen, head of financial institutions origination at Rabobank. "It's not on the top of mind of most investors to challenge the travelling team on their sustainability. However, within the scope of green bonds, you can clearly see bondholders becoming more vocal in saying what they are looking for."

Themed financings seem to give bond investors a licence to talk. They often get very detailed about what they like and don't like about a green or social bond framework.

"The big discussion is impact," says Crispijn Kooijmans, head of public sector origination at Rabobank. "It's hard, even harder for social bonds, but that's the key topic. The asset managers, fund managers, pension funds want data they can show to their stakeholders."

But if investors are content to engage only on green and social bonds, it will have limited effect. They are a tiny share of the debt market, and come from issuers who already think about sustainability.

Also, the issuer chooses how the engagement takes place. Green bond proceeds are directed to a certain portion of its business. But investors gain no special insight into the rest of its activities.

Green bond investors increasingly consider an issuer's overall ESG performance, as well as just the earmarked assets. But they could apply that approach also to issuers not issuing green bonds.

"Institutional investors don't want to invest in corporate bonds anymore if the ESG rating is too low"

—Xiaofei Guo, ING

Little by little, some degree of engagement by bondholders is becoming normal.

Sergey Dergachev, head of emerging market corporate debt at Union Investment in Frankfurt, says it remains a "very nascent topic" in EM debt, though ESG has been gaining traction rapidly in the last three years. But Union is enthusiastic. "We meet with management, we talk about ESG and if there are some issues which we feel can lead to financial or reputational risk, we address it to management," says Dergachev.

The question then becomes: are bondholders engaging in the most effective way — and are they being as forthright as they might?

The PRI's guidebook on bondholder engagement, published in April, recommends a highly organised approach in which the investor has specific goals, concentrates on carefully chosen names in the portfolio, and joins forces with other investors where possible.

Actiam is right on the money here. It focuses on three issues: climate, water and land. The ESG team develops engagement ideas. When companies violate Actiam's goals, its engagement committee, which includes the CEO, can start a 'responsive engagement'. If the company doesn't make enough progress, it can be excluded from all portfolios. Volkswagen was dropped after its emissions cheating scandal, when Actiam felt it was not dealing with the issues fast enough.

But many investors engage in a more informal, unstructured way, using their opportunities to meet companies as best they can, and saying as much as they dare.

TWO PRONGS MAY BE BETTER

Big fund managers now have engagement specialists, usually in the ESG team. They often engage with issuers as holders of both equity and debt. As Molenaar says: "We are not making any distinctions between whether we have exposure on the equity or bond side — the issues we address are the same either way."

However, this unified approach could blunt the edge of bondholder engagement. If an investor's ESG analysts meet a company's head of corporate social responsibility, they are likely to get time to say a lot. The message will be relayed to management at some stage.

But not all corporate boards listen to their heads of CSR. Engaging directly with the CEO, CFO or treasurer may have more bite. And that is likely to require the equity and debt investment specialists to do it separately, at the point when the company is asking for their money.

Bond investors are by no means the poor relations here. "There's something unique about the fixed income market that means investors do have opportunities for influence," says Mather. "Big issuers need to keep coming back to market."

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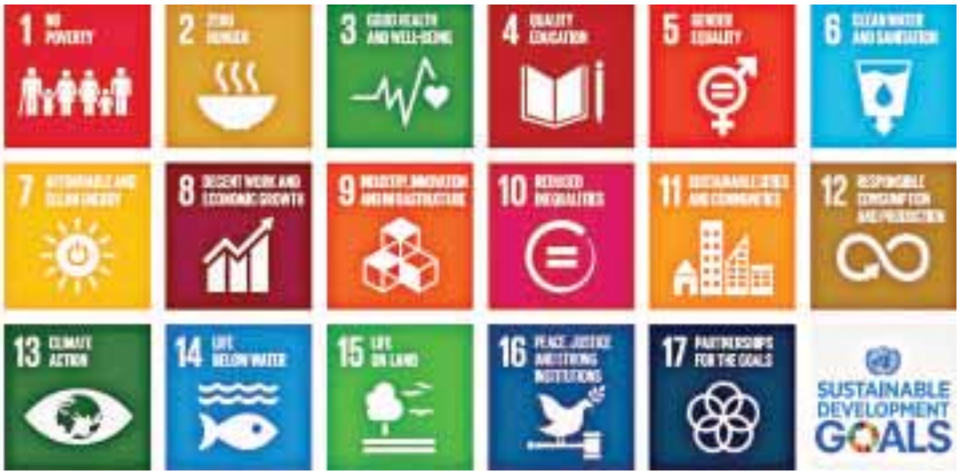
Sustainable Development Goals show their worth for investors

The UN's Sustainable Development Goals (SDGs) were not specifically designed for finance, something that perhaps helps to explain their popularity among responsible investors, institutions and borrowers. But this does not mean that factoring them into investing decisions is easy, reports **Jasper Cox**


1 NO POVERTY
2 ZERO HUNGER
3 GOOD HEALTH AND WELL-BEING
4 QUALITY EDUCATION
5 GENDER EQUALITY
6 CLEAN WATER AND SANITATION
7 AFFORDABLE AND CLEAN ENERGY
8 DECENT WORK AND ECONOMIC GROWTH
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
10 REDUCED INEQUALITIES
11 SUSTAINABLE CITIES AND COMMUNITIES
12 RESPONSIBLE CONSUMPTION AND PRODUCTION
13 CLIMATE ACTION
14 LIFE BELOW WATER
15 LIFE ON LAND
16 PEACE, JUSTICE AND STRONG INSTITUTIONS
17 PARTNERSHIPS FOR THE GOALS
SUSTAINABLE DEVELOPMENT GOALS

It took less than 90 seconds for the eight-storey Rana Plaza complex to collapse in 2013, causing more than 1,000 people to die.

The building, near Dhaka in Bangladesh, housed garment factories used by global brands. Before the accident, cracks had been found in its concrete pillars, but workers still flooded in on the day of the disaster.

The catastrophe sharpened minds on the link between large Western firms and working conditions in poor countries.

When socially responsible investors decide how to spend money wisely, it can be difficult to sift through the myriad risks and pitfalls. Factory collapses are further down the list of priorities than topics like climate change prevention.

But the United Nations' Sustainable Development Goals (SDG) offer a broad framework, identifying priorities across the entire world. One of the targets within SDG 11 (see list of SDGs) is to "support least developed countries, including through financial and technical assistance, in building sustainable and resilient buildings utilising local materials," something clearly relevant to the Bangladesh disaster.

"The Rana Plaza collapse caused a lot of reputational damage for companies who had garments being produced by those garment workers," says Carly Greenberg, senior ESG analyst at Walden Asset Management in Boston. "That this is explicitly recognised within the SDGs should be a signal to investors: this is something that matters for any of our companies who have supply chains in developing and the least developed countries."

The SDGs came into force in 2016 with a 15 year timespan, after being adopted at a UN summit.

"This is the first ever statement from global governments that this is where we want to be and this is where we want businesses to be along with us by 2030," says Greenberg. "That's never existed before, where you have such a clear statement from every country in the world."

And this gives them some weight among investors.

"They feel like they've got this universal relevance and applicability," says Catherine Howarth, chief executive of ShareAction, a charity promoting sustainable investing, in London. "That very universal quality gives them a kind of credibility."

Those working in the responsible investment sector found the SDGs' predecessors, the Millennium Development Goals, more focused on the public sector and the developing world. The SDGs bring corporate and financial players more firmly into the picture.

Of course, timing has also played a part in their take-up: the SDGs emerged as responsible investing was moving into the mainstream.

Compared with other frameworks, the SDGs have also gained traction because they capture impact as well as risk: rather than investors simply treating environmental, social and governance problems as detrimental to returns, the goals ask how much good a portfolio is doing.

"It changes the focus from integration of environmental, social and governance factors to the outcomes and the impact on society at large of our asset allocation, active management, engagement and advocacy activities," says Alison Schneider, director of responsible investment at Alberta Investment Management Corporation (AIMCo) in Edmonton.

But for all their worth, the SDGs are still rarely the primary tool used in the responsible investing sector.

HOW TO INVEST IN THE SDGS

Walden, which Greenberg sees as a first mover in this area, is the socially responsible investment arm of Boston Trust & Investment Management Company — a firm with $8.4bn of assets under management.

It uses the SDGs as a complement to its work: evaluating whether ESG factors could harm a firm's stock performance, and wielding its shareholder power to prod companies to up their game.

And while ShareAction has connected its recent workforce disclosure initiative — aiming to make companies more transparent about how they manage and look after their staff — to SDG 8, it would stand on its own merit.

But doing an SDG audit can help investment firms work out where they are not paying enough attention.

In 2016 Walden mapped its shareholder engagement activities to the SDGs. It found that some of its efforts did not particularly relate to them, as the goals do not focus much on the governance pillar of ESG. But it was able to match its work to 11 of the 17 goals.

"It was also a good opportunity for us to do a critical thinking exercise to evaluate which goals are most important to our clients and whether we were doing enough to address these goals," says Greenberg.

Where it found gaps, it assessed whether it could do more and is now working on developing an engagement strategy for them. Meanwhile, there are other considerations to make when investing with the SDGs.

One is how extensive horizons should be when examining assets. Walden aims to take a holistic view of firms through the goals, looking at their operational exposure, supply chains and lobbying activities, an approach Greenberg says is not adopted by everyone.

And for large investors, using the goals as a lens through which to view their overall exposure rather than focusing on specific holdings may be the best approach.

AIMCo manages Alberta's sovereign wealth fund as well as most public pension plans for the province, and it invests in thousands of companies. Schneider says the firm looks at the SDGs from an "overarching perspective across the portfolio rather than a company-by-company perspective" to work out, for example, the percentage of alternative energy exposure in its portfolio.

Some have considered the SDGs as only relevant for certain investors with a more direct approach,

Continued on page 21

Where are the Asian investors?

Asia's green bond investor base is bigger than many bankers think.

However, it is still not big enough. **Matthew Thomas** reports.

By 2050, 18 million Bangladeshis will lose their homes as a result of rising sea levels. Sixty four million Asians will be pushed into poverty for every 10% rise in food prices, a widely-predicted consequence of climate change. Hundreds of millions are at risk of flooding.

These numbers, all from the Asian Development Bank (ADB), make sobering reading. The ADB has promised to double its own climate financing budget for Asia Pacific to $6bn by 2020. But it says at least $40bn is needed each year to help countries in the region adapt to climate change. Where is the rest of the money going to come from?

Part of it will come from the bond market. Regulators in the region are keen to become hubs for green financing, aware that the road to green is lined with gold. Asian issuers are getting in on the act, too. In 2016, green, sustainable and social bond issuance in Asia ex-Japan hit $37.75bn, more than 12 times higher than the year before, according to Dealogic. In 2017, that figure edged up slightly to $39.13bn. (So far this year, however, the market is on track to post smaller overall volumes.)

The missing piece of the puzzle is a local investor base. Asian investors have lagged behind in signing up to the Principles for Responsible Investment. There are few dedicated SRI bond funds based in Asia.

"Asian investors don't care about colour; they care about yield," says a Hong Kong-based DCM banker. This is a common refrain. But there are two reasons why the region's investor base may be more receptive to socially responsible investing.

First, interest is growing, albeit slowly. Japan's national pension fund has upped its ESG mandate. Korea's sovereign wealth fund has committed $300m to ESG investments. Credit Suisse and UOB have launched a $55m impact investing fund. In March, Amundi joined forces with International Finance Corp to launch Amundi Planet — Emerging Green One, a $1.42bn closed-end fund investing in green bonds from emerging market banks.

Amundi's fund plans to be fully invested in green within seven years and 10%-15% of its money is already invested in green bonds, says Maxim Vydrine, deputy head of emerging markets debt at the asset manager.

Second, high net worth investors in Asia are becoming more interested in socially-responsible investing, boosting demand from private banks and family offices. This is being driven by a generational shift, as the old guard hands over the reins.

"The next generation of green and ESG-savvy investors are now rising to prominence and taking over their family office funds and/or their holdings with various private banks," says Winston Tay, head of Asia debt syndicate at ING. "They want to back companies that make a good environmental and social impact and given that their numbers are rising every year in Asia, they will collectively soon form a significant investor class in this space."

Private banks are taking notice. UBS launched a portfolio investing exclusively in green stocks and bonds in January and rolled it out in Asia Pacific in April. By the end of June, assets under management in the region had passed Sfr100m ($100.6m).

Big funds stand ready. Venn Saltirov, a credit analyst in Blackrock's Asian team, says his firm is "well positioned to offer dedicated hard currency Asian green bond funds", although that will only happen as the market grows.

SHOW ME THE MONEY

However, the shift towards broader ESG investing, will not necessarily lead to more green bond investment. Fund managers say a lot of investors see ESG as simply one of many boxes to tick, often placing no greater emphasis on environmental factors than others.

"There is some role for it, but in Asia there is a pretty meagre pool of investors that are seeking only green bonds," says Adam McCabe, head of Asian fixed income at Aberdeen Standard Investments.

Nor has enough work been done by regulators to encourage a green bond investor base in Asia Pacific, in stark contrast with all the policies designed to boost the issuer base.

The Monetary Authority of Singapore launched a grant scheme for green bonds in June 2017, to subsidise the costs of external review. The Hong Kong Monetary Authority followed a year later. But is this the right area for regulators to focus on?

"When we talk to potential issuers, the cost of third party review, which is covered by the grant, is not the main hurdle"

—Herry Cho, ING

"It definitely provides the right signal to show that the regulators are encouraging the development of the green bond market," says Herry Cho, head of sustainable finance, Asia Pacific, at ING. "But when we talk to potential issuers, the cost of third party review, which is covered by the grant, is not the main hurdle."

Regulators would to better to encourage investors, fund managers say. Capital relief would prompt more investment from banks and insurers. Withholding tax breaks on Asian local currency deals would help lure fund managers.

Bankers, investors and analysts agree that the sustainable growth of Asia's green and SRI market is going to depend not just on a large issuer base, but on a diverse investor base, too. There have been some steps in that direction, but there is still a long road ahead.

"The green bond investor base can't just be confined to Europe," says Anand Subramanian, head of sales in Asia at DZ Bank. "The growth of Asian issuers and investors is going to have to go hand-in-hand." GM

Silence is not golden/ESG

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Roadshows for bond issues involve one-on-one meetings with big investors such as Pimco and group meetings or calls for the rest. The latter may give the investor maximal clout. If a senior executive is asked a question about ESG in front of a room full of investors and cannot give a satisfactory answer, the result is magnified. More investors may be unimpressed — and the company will have a keen incentive to make good. So far, it is hard to find market participants who say that investors ever use this power.

Dergachev says Union does use conference calls for engagement sometimes — but ESG issues are rarely mentioned on EM bond roadshows. Union is careful to take into account the mentality and culture of the issuer, partly because it, too, wants a long term relationship.

SEEKING AMBITION

Another kind of action that remains marginal in bond markets is concerted engagement campaigns, where investors go on the offensive to pressure companies to change.

Since 2014, Boston Common Asset Management has been leading a group of shareholders that has grown to 100, with $2tr of assets, calling on banks to examine the risks they face from climate change and seek opportunities to ameliorate it. The world's top 60 banks are targeted, and over 80% now engage with the investors. Banks are publicly scored and ranked. The investors' latest report found "some progress" but also "urgent shortcomings".

Why does this kind of work not exist in the bond market? Wolfgang Kuhn plans to find out with a pilot project for ShareAction, the responsible investing NGO. Kuhn, former head of European fixed income at Aberdeen Asset Management, wants to interview two dozen asset owners and bond managers, to find out how far they would go in action on climate change.

His model is Climate Action 100+, a huge shareholder engagement launched in December 2017 that now has $29tr of backing. It is directed at 100 companies that are among the world's biggest greenhouse gas emitters.

Halfway through the project, Kuhn says: "It's not going to be easy to activate bondholders. I see a lot of hesitation towards pushing companies very hard. Some investors have very strong views and are happy to express them, but there is a hesitation to tell management what to do, which I find surprising, because it is your money." GM

Sustainable development goals

Continued from page 19

like private equity firms or thematic funds. But Greenberg dislikes this attitude. "It's a cop out, it's a way for investors to escape even looking at the goals," she says. "Because the SDGs are so ambitious, it is very important for investors to support them in whatever way they can."

This includes those in fixed income.

"The SDGs are a framework that is relevant across asset classes, and I hope we'll see more emphasis over time on bonds in particular," says Howarth.

But the SDGs have flaws for investors too.

A GOOD ENOUGH FIT?

One more general downside may be their longevity. How can anyone know for sure what the most pressing issues for the world will be in 2030, the end-date for the SDGs?

While some goals are likely to remain relevant, others may not, and new challenges will emerge.

Howarth disagrees that the timeline is a concern: she says the 15 year shelf-life is "long enough that the world can make some serious meaningful progress on those goals in that timeframe but short enough that in the history of human civilisation we can evolve them".

As the SDGs are not specifically tailored to business, they do not provide an exact guide to corporate responsibility. For example, one source of public anger towards certain companies relates to aggressive tax practices. "Ultimately an awful lot of people feel that the number one thing companies ought to do to be responsible is pay their fair share of tax," says Howarth.

But this is not prominent in the SDGs. And it is not clear how one would hold assets which relate to SDGs 16 and 17, although Schneider says core responsible investment activities such as engaging with policymakers and collaborating with peers can work towards advancing these goals. Schneider, like Greenberg and Howarth, is a member of the SDG advisory committee for the UN Principles for Responsible Investment (PRI).

Yet paradoxically, the cause of the incomplete synchronisation between the UN's SDG agenda and the financial sector is also why the goals have become so useful for investors and companies.

They help investors look to broader horizons when allocating capital. This is trickier than sticking to more familiar areas of ESG, but if asset holders really are dedicated to making the world a better place, this type of exercise is entirely necessary. GM

SDG-themed bonds

Issuers are increasingly seeing value in the SDGs too, and are incorporating them within green and social bond frameworks.

"When we structure the frameworks we work on and when we design investor presentations, there's a clear need for alignment to the SDGs," says Vlad Mitroi, vice president, sustainable markets at ING in Amsterdam.

Mitroi has noticed some issuers using the SDGs as more of a complement to the green, social and sustainability bond principles and guidelines of the International Capital Market Association (ICMA). But others use the SDGs more centrally. For example, HSBC's SDG bond framework links use of proceeds to seven of the goals.

BBVA recently published a bond framework linked to the SDGs and issued the first one from it earlier this year. Ángel Tejada, director in the Spanish bank's DCM-green sustainable bond group in Madrid, says this was because the goals are "clearly emerging as the dominant framework" for organising investment for impact.

Meanwhile, Caja Rural de Navarra says its decision to link a bond framework to the SDGs was mainly due to investor demand.

"We think that investors are willing to get a more harmonized classification of positive environmental and social impacts and SDGs provide such a common and broadly accepted taxonomy," says Miguel García de Eulate, the Iberian lender's head of treasury and capital markets in Pamplona.

Tejada also points to an ICMA mapping exercise as a reason his bank had chosen the SDGs. The body recently detailed how the SDGs could align to its principles and guidelines.

"It's something that issuers really find useful because it allows them to think about their own investments at the company level," says Mitroi.

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Hob and spoke: the Indonesia start-ups that morphed into an Asian giant

By Chris Wright

> 'We have always had the same passion. How do we leapfrog this country into prosperity and equality?'
>
> —Aldi Haryoprato, CEO of GoPay

GoPay may be one of the impressive entrepreneurial ventures in southeast Asia, but this multi-billion success story can trace its origins back to a pot in a village and a motorbike in a city.

Two men who studied together at business school in Indonesia forged their distinct journeys with the same aim — to use finance and technology to enable millions of people leapfrog out of rural and urban poverty into prosperity.

Ten years ago, Aldi Haryopratomo was working for Kiva, a San Francisco-based nonprofit with an online lending idea, and had been touring around Vietnam and Indonesia on a motorbike looking for microfinance banks.

He realised that what communities needed to escape poverty came down to the most basic thing — affordable access to pots and pans. In Indonesia a pot that would cost Rp300,000 ($40) in a store in the city was twice that price in the village because they could only ever be bought on credit.

With costs so prohibitive, villagers could not afford enough pots, and so would take turns using them. In response, in 2009 he founded Mapan, a social enterprise that leverages the power of communities to enable housewives in rural Indonesia to buy basic necessities in an affordable and reliable manner.

A group of women led by a trusted community leader form an Arisan, a rotating savings and loan group for the village. The members would take turns to make the payment, meaning at the end of each month one person gets their item, and after a number of months everyone receives one.

There is no interest, just commission to the person, usually a woman who leads the Arisan. Demand has flourished and within three years, one million families in 120 cities were using Mapan.

TIME AND MONEY

Meanwhile, Aldi's college friend Nadiem Makarim had started a revolution in Indonesia's cities. The inspiration came from the traffic-clogged streets of Jakarta, Indonesia's capital where the best way to get around is on motorbikes known as ojek that serve as taxis.

Ojek drivers were spending all their time looking for customers and ojek customers were spending all their time looking for bikes. The idea of GoJek, which he founded in 2010 with just 20 drivers, was to build a platform that would link them together. In Makarim's words, the key was to find people with time and no money and connect them with people with money and no time.

GoJek is one of Indonesia's modern success stories. The original 20 drivers became recruiters, and the operation's reach steadily expanded to the point that its green-helmeted drivers are now a ubiquitous sight in Jakarta and Indonesia's other big cities.

GoJek swiftly and successfully branched out into food delivery and other areas.

By 2014, the firm was able to raise $1.5bn in a fundraising round whose participants included Temasek, KKR, Tencent, Warburg Pincus and JD.com.

It is the most valuable start-up in Indonesia, the flag-bearer among southeast Asian unicorns alongside Grab, its closest equivalent and rival, which is Singapore-based but also aiming most of its resources at Indonesia. Like Grab, GoJek then developed a payment wallet GoPay, initially just to pay for GoJek's own services, but then for payments more broadly.

POOR TO MIDDLE CLASS

By now fully established in different fields — Makarim in the cities and Haryopratomo at the rural level — it occurred to them they could work together. "We have always had the same passion," says Haryopratomo. "How do we leapfrog this country into prosperity and equality?"

So they piloted a programme in Jogjakarta, Java, in November 2016, where they would bring the two together directly into a family. The husband would be a GoJek driver and his wife would be an Arisan leader. GoJek would bring in income, Arisan a method of using it effectively and responsibly.

Haryopratomo says one family went from earning Rp1m to Rp10m in three months. "It was crazy. They went from poverty to middle class, like that. When you see things like that you start thinking maybe one plus one creates more than two, because it helps families more holistically."

Makarim had been looking for ways to build GoPay beyond its basic origins and in December 2017, GoJek announced an audacious triple acquisition in financial services and technology. It bought Kartuku, Indonesia's largest offline payments processing company; Midtrans, the biggest online payment gateway; and Mapan.

Haryopratomo, who is chief executive of the merged GoPay business, acknowledges that integrating a three-sided merger will not be straightforward but says the route to success will be to ensure each team is empowered to do what they do best. The idea is that the business has several free-standing verticals, but customers can move between them.

SPIRIT OF INDONESIA

Having worked its way into Indonesia's heartlands, it is easy to see why GoJek, and by extension GoPay, has attracted interest from some of the world's smartest investors. Indonesia offers immense potential: 260m people with a median age of 28, a growing middle class, and a population that is largely unbanked.

The widespread appearance of affordable smartphones is crucial to the whole GoPay/GoJek model, although there is acceptance that not everyone is tech savvy just yet: one quirk of the GoJek/GoPay alliance is that you can use a driver as a deposit-accepting ATM, handing money to them in order to top up your balance.

For the future, it would be natural for GoPay to follow GoJek in to Vietnam, though it has not yet done so; that is the clearest fit in Asia, with a high population, similar demographic and even greater adoration of motorbikes. For the moment, the focus of the whole operating is the individual, millions of them, creating a bigger ecosystem.

Aldi, very much a patriot and an optimist, also believes there is a spirit of community that is distinct to Indonesia. "We're not just going to use what happens elsewhere and put it here," he says. "We always focus on: What is unique about Indonesia that we can put together and scale?" GM

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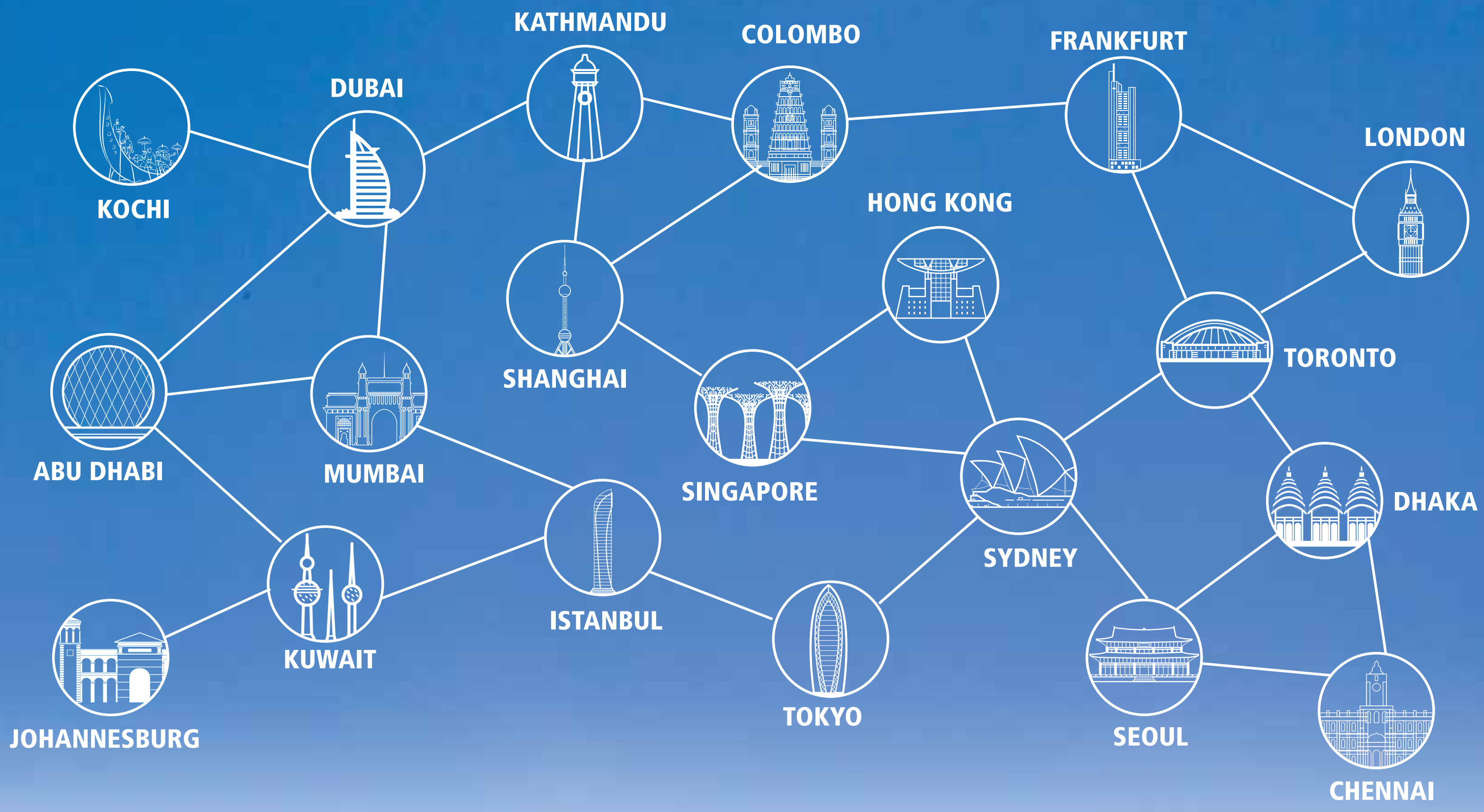

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World Bank urges LatAm countries to tackle state debt

By Thierry Ogier

Rising interest rates in the United States have intensified the need for Latin American countries to take action to tackle their high debt levels, the World Bank's senior official in the region has warned.

"The time to step up the pace of fiscal adjustment has come," said Jorge Familiar, the World Bank's vice president for Latin America.

The Bank's latest regional report noted that the poor fiscal situation had barely improved over the last year, with 29 out of 32 countries projected to show a negative overall fiscal balance in 2018. "External public debt has surpassed 60% of GDP for the region as a whole, with six countries having debt ratios above 80%," it said.

"Net capital inflows to the region have fallen dramatically since early 2018, bringing once again to the fore the risks faced by Latin America and the Caribbean." The report said some large economies such as Brazil and Argentina had to address pressing fiscal concerns as the international environment was turning bleaker.

Familiar said the region had "progressed a lot in terms of good macroeconomic management. If you look at what happened in the past six years, there has been a growth slowdown, but the region has held up very well," he said. "Markets have given time to the region to adjust gradually. But now, it is a fact that time to step up the adjustment has come."

Although some progress has been made, Familiar noted that "expectation and speed of normalisation of monetary policy in developed economies is increasing". Countries in the region need to adjust "while foundations for growth are built and the most vulnerable are protected," he said.

Familiar (l) and Valarde (r): World Bank has called for debt reduction but Peru says it follows prudent policies

GOOD FUNDAMENTALS

"There are a lot of emerging markets with good fundamentals," said Julio Velarde, the Peruvian central bank governor in an interview with *GlobalMarkets*. He said countries of the Pacific Alliance, including Peru, had registered a consistently better macroeconomic performance than their counterparts from the Atlantic coast thanks to their prudent macroeconomic policies over the past 15 years.

"Paraguay would also be a good case study," said José Cantero, the country's central bank governor. "We are aligned with countries such as Chile, Peru and Colombia. We are following their experiences. It is an inspiration for us: we are very close to getting investment grade from credit rating agencies."

Paraguay has just reported a 6.2% year on year GDP growth in the second quarter, including a 17% push in investment, while its public deficit is capped at 1.5% of GDP due to a stringent fiscal responsibility law.

"We need to stick to macroprudential policies to contain scenarios that could be harmful for the future. Argentina has contained the currency crisis and that is a good sign for the region," he said.

Peru's Velarde said he was not really concerned about the impact of the trade war between the US and China on his country. "The potential could be huge, but it has so far proved very limited in effect. Maybe there will be some sort of agreement that will limit the damage," he said.

What's happening Sunday, October 14

9:00am – 10:30am
Meeting: WBG
(By Invitation only)
with: V20 Ministers
Location: BNDCC2,
Pecatu 1/2

10:00am – 11:00am
Meeting: WBG
(By Invitation only)
with: Arab Governors;
with **Jim Yong Kim**
Location: BNDCC1,
RoomSingaraja 1

12:00pm – 1:00pm
Meeting: WBG
(By Invitation only)
African Governors;
Jim Yong Kim
Location: BNDCC2,
Room Tanjung Benoa

3:00pm – 3:30pm
Press Briefing:
Fund/Bank/IPT
Location: Westin-BICC,
Room: Nusantara 1/2

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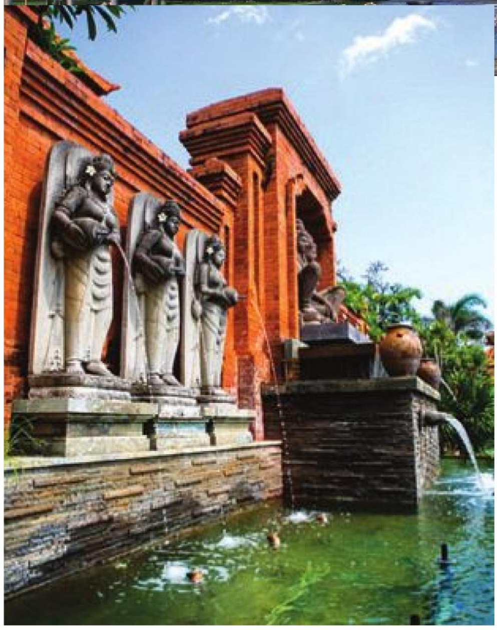
Down Time



1.00pm – 3.00pm
Reception
Hosts: **Executive Board, KfW Bankengruppe**
Location:
Taman Bhagawan,
Jl. Pratama No. 70,
Benoa, Nusa Dua,
Bali

By Invitiation.
With pre-registration (you will be asked to present your registration card for admittance)

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Companies must learn to collaborate to shelter from climate change

By Jon Hay

The advance of global warming, highlighted by the Intergovernmental Panel on Climate Change's report this week, not only demands that the private sector accelerate efforts to cut carbon emissions. Companies must also adapt to the changing climate — and this will involve interacting in new ways, experts have told *GlobalMarkets*.

The IPCC's report *Global Warming of 1.5°C* re-emphasises what those alert to climate change already knew: if the world warms another 0.5°C from its present level, already 1°C above pre-industrial levels, it will cause severe consequences. At 2°C of warming the effects are far worse. If the Paris Agreement commitments are kept, the world is on track to heat by 3°C by 2100.

Although much of the corporate sector now recognises this immense challenge, it has done little yet to reshape the economy. "The major barriers are the very human tendency to not like change, and also there are vested interests in the current economic system," said Pedro Faria, strategic adviser to CDP, the carbon reporting platform.

Adapting to climate change is widely seen as harder for companies than trying to mitigate it — meaning cut their emissions. Energy efficiency brings an early monetary return, but building flood defences is pure sunk cost — until the storm comes. Sharing those costs may help.

"Companies need to start to work pre-competitively on some of these issues," Faria said. "Think of the floods in Thailand [in 2011]. The world's biggest IT companies and car manufacturers were highly exposed to companies in a flood area. They could have avoided that, if they had realised that risk and worked together to reduce it."

Chris Brown, global head of environment at Olam International, the Singapore-based food commodities group, explained "pre-competitive" collaboration as "trying to identify what best practice looks like". The competitive part, he added, was "how well we implement".

In Tanzania, where Olam has an irrigated coffee farm, it has set up a water users' association for the local river basin, to help the community manage this shared resource efficiently and fairly.

The Sustainable Apparel Coalition, a trade body, is creating an institute to fund development of shared programmes to improve the clothing industry's environmental impact. Since this includes water efficiency, it will have an adaptation benefit.

THE final word

International co-operation now more important than ever

By Günther Bräunig

© Rob Murray

KfW was founded on November 18 1948 to finance the reconstruction of Germany. Seventy years later, the challenges that face us as a promotional bank have grown larger still. Nothing less than the future of our planet is at stake. We are lucky enough to live in a time that will determine our planet's future. The world of tomorrow will emerge when the international community strives to reduce CO_2 levels, when companies decide to invest in the digital transformation, when families build energy-efficient homes, and when political forces join together to address the root causes of migration.

We live in an era that calls for role models. We would call such people forward thinkers. These may be people or institutions that think ahead, dare to try new approaches and lead the way for us all — start-up entrepreneurs, builders, innovative enterprises, charities and not least trailblazing governments. They need support to help them bear the risks they have assumed.

> “*Nothing less than the future of our planet is at stake. We are lucky enough to live in a time that will determine our planet's future*

A promotional bank like KfW is a political instrument of the German Federal Government — particularly in terms of implementing economic, development and climate policies. KfW's history is closely intertwined with the history of the Federal Republic of Germany: Kreditanstalt für Wiederaufbau (translated Loan Corporation for Reconstruction) was founded to finance the reconstruction of Germany with funds from the European Recovery Program (also known as the Marshall Plan).Over the past decades, we have been contributing to developing Germany as one of the most successful economies worldwide with a strong export-oriented Mittelstand. And we are aware of this: economic success induces responsibility. As soon as in the 1960s, we broadened our scope by managing the financial co-operation with developing countries on behalf of the Federal Government and in doing so built up and deepened our expertise in the field of international co-operation.

ENERGY EFFICIENCY

By providing reduced-interest loans, guarantees, equity investments and grants, we promote areas relevant to the future, to ensure the proper course is set. This is why we direct our products towards increasing energy efficiency, solidifying Germany as a hub of innovation and protecting the global climate. Today KfW promotes modern energy supply worldwide as a key requirement for development. It supports its partner countries in creating and modifying energy systems as a central measure for climate protection. Specifically, environment and climate-related financing now makes up 43% of our business volume.

But we strive for more, as global challenges, such as poverty reduction, climate protection and mitigation of refugee crises, grow in importance. Our commitments to financial co-operation with developing countries and emerging economies are increasing accordingly, with a focus on projects to address the root causes of migration.

The focus on sustainability has always been one of KfW's key features — in business, in its operations and as an employer. As far back as the end of the 1950s, we financed our first environmental protection measures, a relatively unknown topic at the time. Today, KfW is one of the most important players in environmental and, in particular, climate financing both nationally and internationally: we provided some €280bn to this key area in the past 10 years. My goal in my capacity as CEO is to add substance and life to the concept of the promotional bank of the future — transparently and with measurable impact.

RESPONSIBLE FINANCE

Today, we can be thankful and proud as we look back on 70 years embracing responsibility for our society and our planet. We can benefit from the experience KfW has acquired. As a modern, efficient and customer-focused promotional bank, we are now in a position to make an economic impact — both in Germany and internationally.

However, the endeavour of responsible finance is at its best when forces join. This is why promotional banks often partner up with each other — a most recent example being the Clean Ocean Initiative launched by KfW and EIB, and backed by our French partner AFD. KfW is part of networks of promotional banks in Europe as well as on a global scale, such as the IDFC (International Development Finance Club consisting of 23 promotional banks). Promotional banks worldwide do increasingly co-operate and this is more important now than ever before. I am convinced that the challenges the world is facing today can be met only by a vigorous international co-operation of all actors concerned. It is thus equally important to implement sustainable policies and to set the right incentives in motion in the real economy.

KfW is ready for tackling the current challenges and takes responsibility as a reliable partner: in Germany, in Europe and around the world.

Dr Günther Bräunig is Chief Executive Officer of KfW.

GM PICTURE OF THE DAY

EIB-EBRD

Continued from cover

remained a more distant possibility, France, in particular, was keen to find ways for the two development banks to "work together even more closely", he said. "We are obviously ready to work with any initiative which is in the best interests of our countries of operations."

He added that enhanced co-operation and co-ordination was most likely to happen in the countries where the two institutions work, and where private-sector projects have the greatest existing and potential overlap. The most obvious regions are North Africa, where both banks wield significant influence, and sub-Saharan Africa where they could soon find themselves in more prominent roles.

Werner Hoyer, the president of the EIB, played down suggestions that the outfits would be more forcibly merged by apparatchiks in Brussels, Berlin, Frankfurt, and Paris.

He pointed out that while the EIB was a pure European Union-owned, funded and backed lending institution, its London-based peer was influenced by shareholders from outside the single market. "There is no one from Russia, Kazakhstan or the United States who is fooling around inside our budget," he said.

'LAND GRAB'

He added pointedly that there was a "land grab" going on at the highest level, with agencies and individuals "trying to convince the top EU authorities that they have a strategic and central long-term role to play in Europe".

Others said it was crucial for European agencies and countries to work together to give the region a stronger voice on the world stage. Michael Ellam, global head of public sector banking at HSBC, said China was winning the game of soft financial diplomacy, and that Japan and Korea were championing their own global infrastructure-building initiatives.

He added: "Even the Europeans with this idea of more alignment between the EIB and EBRD are looking to scale up their efforts."

To some bankers and policymakers, Europe is a region that has lost its sense of direction and purpose, and which struggles to restore growth, permanently exit quantitative easing (QE) and normalise interest rates.

German finance minister Olaf Scholz said that if Europe was to remain relevant, it had to work together, "otherwise we will not be successful in a world of 10 billion people, which is where we'll be in this century. Discussions about Europe can be childish. In real democracies and real life, you have to discuss things and [work] together."

Saudi

Continued from cover

and the head of the Uber Dara Khosrowshahi rushed to pull out of the event, leaving Saudi Arabia's flagship business conference, the Future Investment Initiative, in tatters. World Bank President Jim Yong Kim will no longer attend the summit.

Branson has suspended talks over a $1bn investment in Virgin's space travel operations. Uber has substantial investments from SoftBank's Saudi-backed 'Vision Fund' and from the Saudi sovereign wealth fund directly.

Asked directly whether she would cancel her visit, Lagarde said that human rights and freedom of information were "essential rights", adding: "Horrifying things have been reported and I am horrified."

"But I have to conduct the business of the IMF in all corners of the world and with many governments. When I visit a country, I always speak my mind. You know me, I do. At this point in time, my intention is not to change my plan and to be very attentive to the information that is coming out of the next few days. I speak my mind."

A growing number of executives have distanced themselves from Saudi Arabia's business ventures amid outrage over the disappearance of Saudi journalist Jamal Khashoggi. Turkish intelligence reportedly has audio and video recordings from inside the Saudi consulate in Istanbul where Khashoggi's Saudi captors can be heard interrogating, torturing, and ultimately murdering him. Saudi Arabia has vehemently denied that it was involved.

AL MEETINGS
ndon
NAL MONETA
K GROUP
Lagarde: 'I always speak my mind'

PAYDAY PROMISE

Saudi Arabia has 2.79% of the votes on the board of the International Bank for Reconstruction and Development — the World Bank institution — the same as Russia, which has a population more than four times larger. It has 2.02% of IMF votes.

International business leaders still listed on the conference advisory board include Tidjane Thiam, chief executive of Credit Suisse, which applied for a Saudi banking licence over the summer, Blackstone boss Stephen Schwarzman, Siemens president Joe Kaeser, and SoftBank CEO Masayoshi Son.

Former media partners of the event including the Financial Times, CNN, CNBC, the New York Times and Bloom-berg have also deserted it. The conference is due to take place at the Riyadh Ritz-Carlton, the hotel in which Saudi crown prince Mohammed bin Salman detained 200 businessmen, officials and members of the royal family for months.

International bankers have been hoping for a big payday from the Kingdom of Saudi Arabia. The prized IPO of state oil firm Aramco has been shelved, but the sovereign wealth fund has been raising large dollar loans to fund the purchase of a stake in Sabic, the state petrochemicals company.

US Belt and Road

Continued from cover

envisaged that once the IDFC was formally up-and-running in about a year, the agencies could create synergies by sharing their project pipelines and financing structures.

This is what developing countries have long craved. Speaking at the Institute of International Finance conference, former Nigerian finance minister Ngozi Okonjo-Iweala said the sector did not deliver because it was too fragmented with scores of agencies all operating different templates.

HALO EFFECT

Rather than criticise China's Belt and Road Initiative (BRI) directly, Bohigian suggested five key factors countries needed to consider to ensure they were aware of a project's "life time costs" rather than just its up-front ones. He listed these as: will the project erode sovereignty; does it meet world-class environmental standards; will local labour be deployed to enhance a country's skill set; is the procurement process transparent; and is the project being built to last?

He added that competition between agencies would be good for countries if they all operated within these parameters, adding that good projects created a halo effect bringing in even more investment.

China's vice minister of finance, Zou Jiayi, countered that BRI was "different from the Marshall Plan". She said: "It's a development initiative based on market forces and mechanism in line with market rules."

She emphasised that projects needed to be cost-effective and affordable for the countries in question. She also underlined that the Chinese government attached a lot of importance to debt sustainability. "We are the creditor and stakeholder so it's our money," she added.

She said the central government was improving BRI by strengthening its macro supervision of debt sustainability issues while continuing to allow it to be financed in a "decentralised and commercial way" through lenders such as the state-owned China Development Bank.

Michael Ellam, global head of public sector banking at HSBC, said the US initiative could be driven by commercial as well as geopolitical goals. "Lots of emerging market cities are looking to take a 'second mover advantage' and leapfrog older technology, so it could mean financing smart city technology built by the US tech firms."