



Managing the World Bank's Financial Risks

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Outline

1. What is the World Bank?
2. How is it managing financial risks?
3. Why do we care?



1. What is the World Bank?



WORLD BANK GROUP

- ▶ **189 member** countries
- ▶ Resident Executive Board of **25** constituencies
- ▶ About **16,000 staff** from more than 170 countries
- ▶ Offices in **over 130 locations**
- ▶ **5 institutions**: IBRD, IDA, IFC, MIGA, ICSID

Mission

- ▶ **End extreme poverty**
By reducing the **share** of the global population that lives in extreme poverty to **3 percent by 2030**
- ▶ **Promote shared prosperity**
By increasing the incomes of the **poorest 40 percent** of people in every country

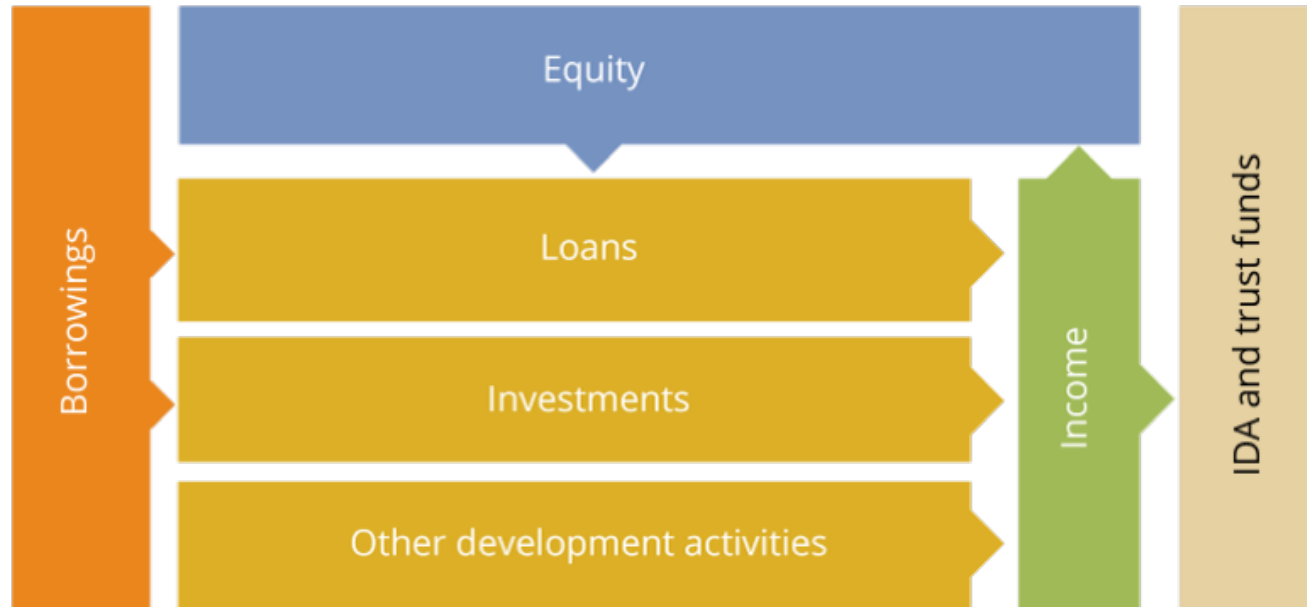


THE WORLD BANK

IBRD • IDA | WORLD BANK GROUP

- ▶ International Bank for Reconstruction and Development (IBRD)
 - ▶ Created in 1944
 - ▶ Global development cooperative
 - ▶ Provides financial products and policy advice
 - ▶ Clients are middle-income and creditworthy low-income countries
 - ▶ Coordinates responses to regional and global challenges
- ▶ International Development Association (IDA)
 - ▶ Fund for the world's 75 poorest countries, 39 of which are in Africa
 - ▶ Single largest source of donor funds for basic social services in these countries
 - ▶ Lends money on concessional terms.
 - ▶ Provides grants to countries at risk of debt distress
 - ▶ Provides debt relief

IBRD's Business Model



- ▶ Provided more than **\$500 billion in loans** since 1946, with shareholders paying in about **\$14 billion in capital**
- ▶ **AAA rating** since 1959 allows to borrow at low cost and offer MICs access to capital on favorable terms



2. Managing the World Bank's Financial Risks

Types of Risks the WBG is facing

- ▶ **Strategic Risk**
 - ▶ Are we doing the right thing?
- ▶ **Operational Risks**
 - ▶ Are we doing things right?
- ▶ **Risk in Operations**
 - ▶ Are we achieving our mission objectives and the best results?
- ▶ **Financial Risks**
 - ▶ Are we managing our financial resources well?

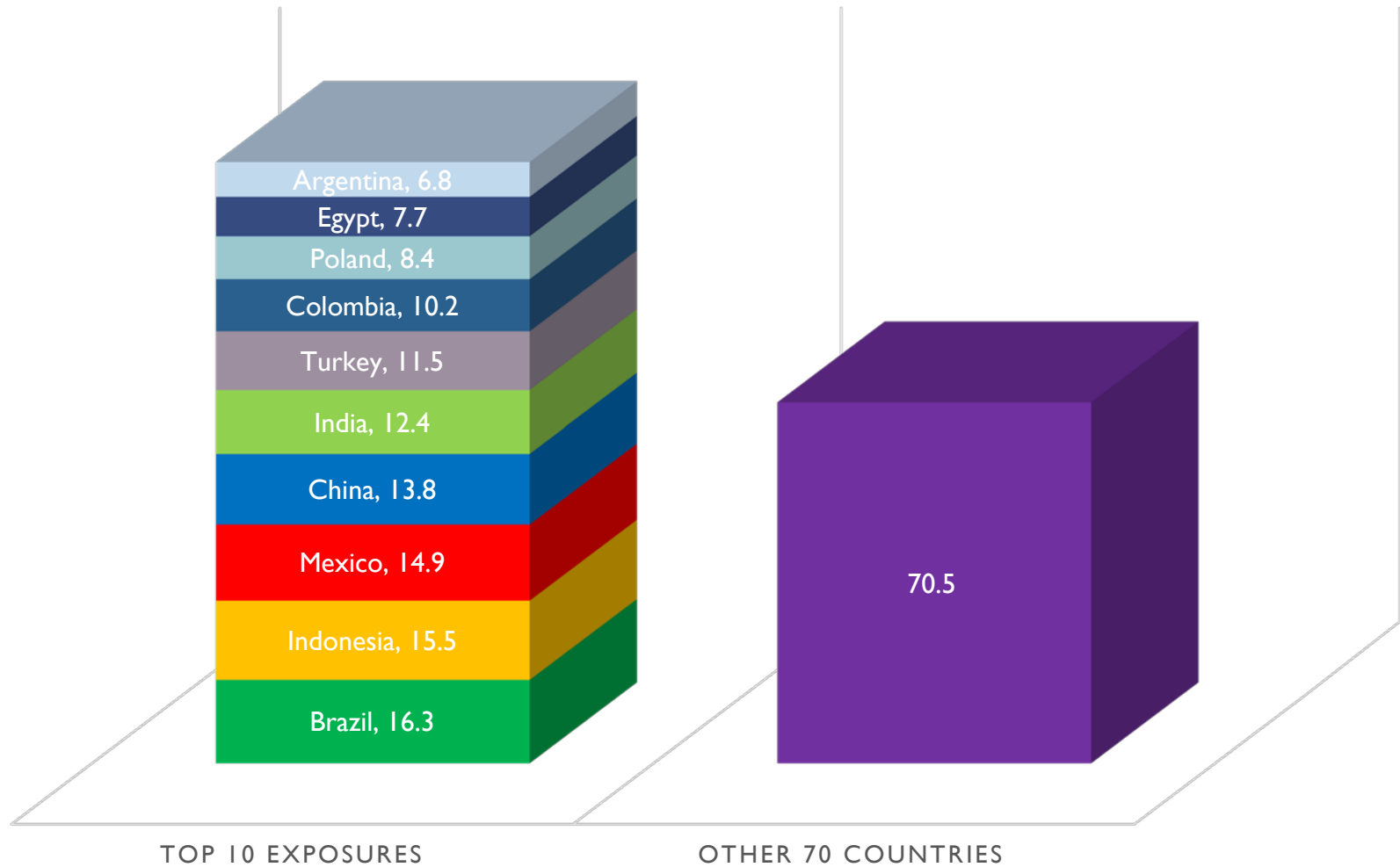
3 Lines of Defense



IBRD's Financial Risks

Type of Risk	How the Risk is Managed
Market Risk <ul style="list-style-type: none">-- Interest Rate Risk-- Exchange Rate Risk-- Liquidity Risk	<ul style="list-style-type: none">→ Interest rate derivatives to match the sensitivity of assets and liabilities→ Currency derivatives to match the currency composition of assets and liabilities→ Prudential minimum liquidity level
Credit Risk <ul style="list-style-type: none">-- Counterparty Credit Risk-- Country Credit Risk	<ul style="list-style-type: none">→ Counterparty credit limits and collateral→ IBRD's credit-risk-bearing capacity and individual exposure limits

IBRD Country Exposures (in billion USD)



Types of Country Credit Risk

- ▶ IBRD's mandate is to take **only sovereign credit risk** in its lending activities.
- ▶ Estimating **idiosyncratic** risk and stand-alone **concentration** risk
 - ▶ IBRD's exposure
 - ▶ Borrower's expected default to IBRD (ratings)
- ▶ Three distinct types
 1. **Idiosyncratic** risk
 2. **Correlation** risk
 3. **Concentration** risk
- ▶ Estimating **correlation** risk
 - ▶ Modeling the potential factors that could impact borrowing countries simultaneously

Managing Concentration Risk

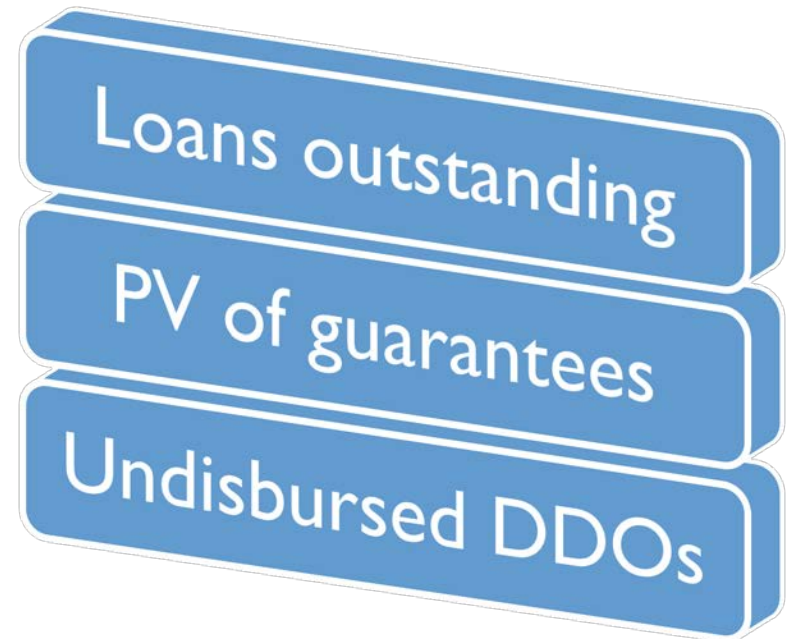
▶ Portfolio Concentration Risk

- ▶ Arises when a small group of borrowing countries account for a large share of loans outstanding
- ▶ A key concern for IBRD

▶ Managed through

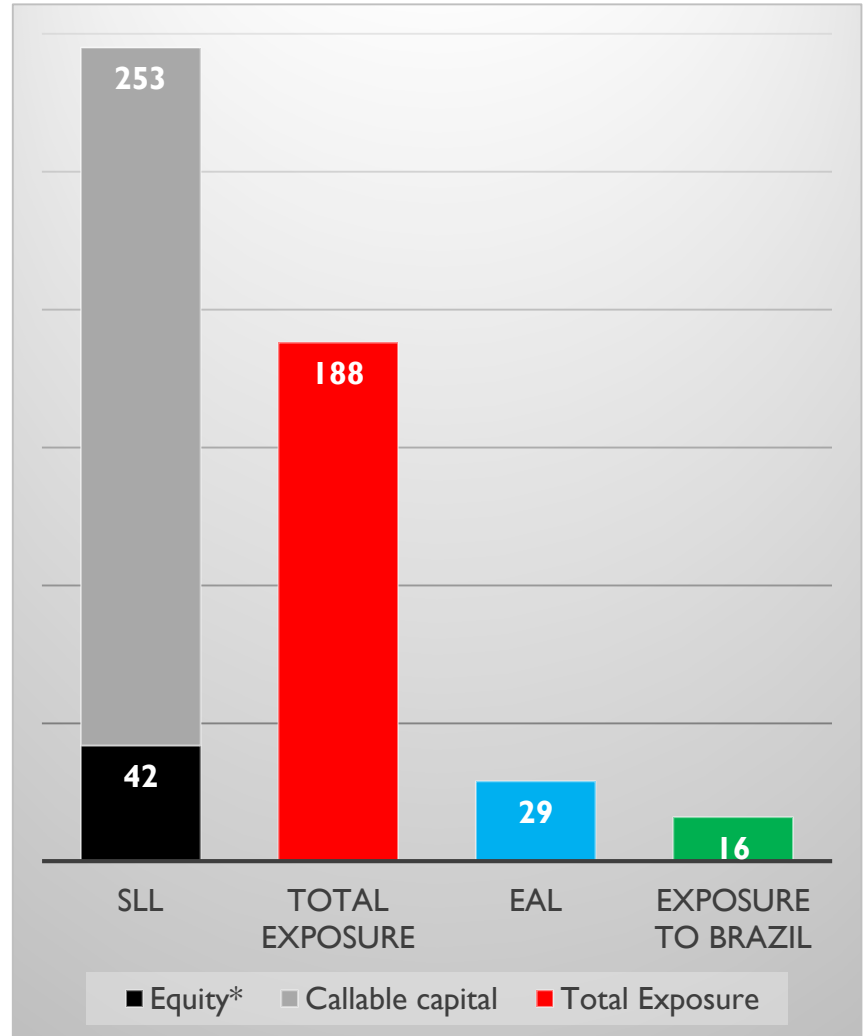
- ▶ **Exposure Limit**
- ▶ **Equitable Access Limit**
- ▶ **Single Borrower Limit**

Exposure Limit



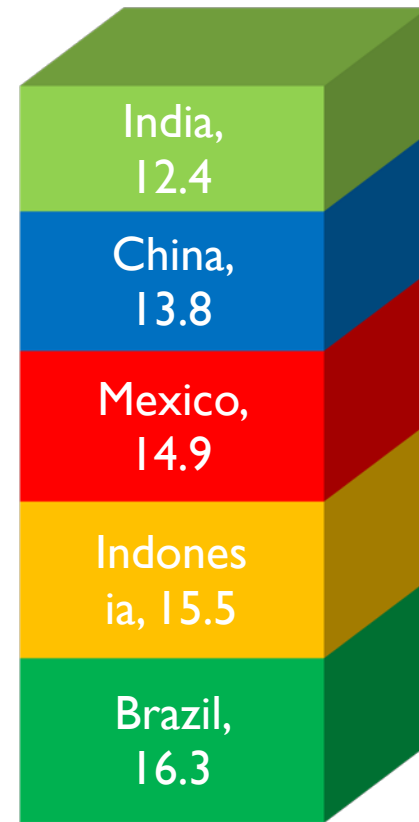
Currently non-binding limits

- ▶ **Equitable Access Limit (EAL)**
 - ▶ Equal to 10% of IBRD's SLL
- ▶ **Statutory Lending Limit**
 - ▶ Sufficient resources available to meet IBRD's obligations to bondholders in the highly unlikely event of substantial and historically unprecedented losses on IBRD's loans.



Single Borrower Limit (SBL)

- ▶ SBL caps max exposure to IBRD's most **creditworthy** and **largest** (population, GDP) borrowing countries
- ▶ SBL for **India**: \$20 bn
- ▶ SBL for **China, Mexico, Indonesia, Brazil**: \$19 bn



TOP 5 EXPOSURES

Probable losses vs. Unexpected losses

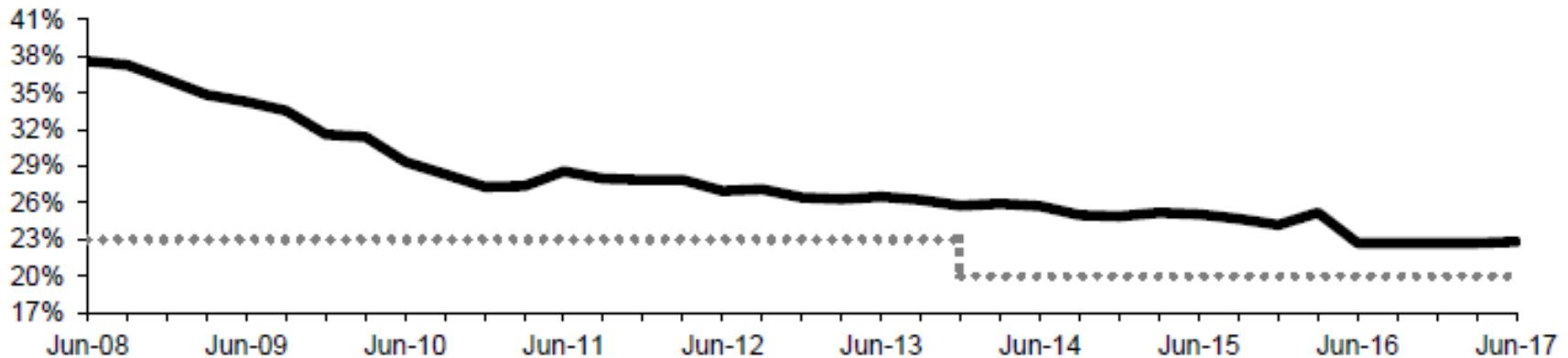
▶ Loan Loss Provisioning

- ▶ is calculated by taking into account
 - ▶ IBRD's exposure
 - ▶ Expected default frequency
 - ▶ Assumed loss in the event of default (severity)
- ▶ → LLP covers probable losses

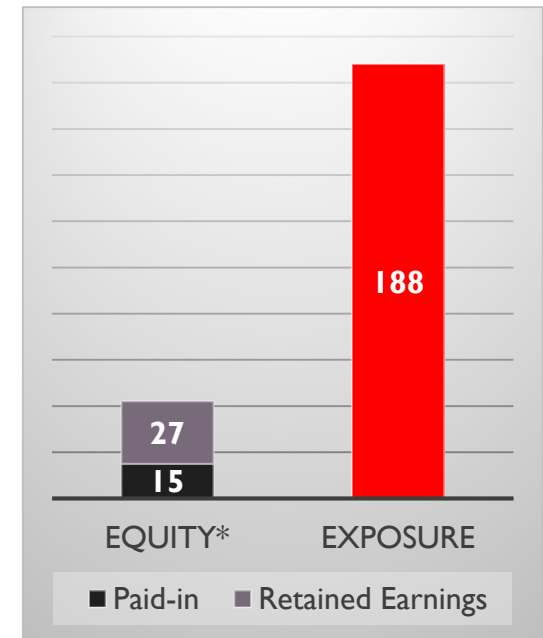
▶ Risk Modeling: Input:

- ▶ Country Ratings
 - ▶ Covariance risks
 - ▶ Loan portfolio distribution
 - ▶ Exposure concentration
- ▶ Estimate size of potential non-accrual shock
- ▶ → Capital to cover unexpected losses

Capital Adequacy: Equity-to-Loans Ratio



- ▶ IBRD holds capital to cover the credit, market and operational risks inherent in its operating activities and financial assets.
- ▶ **Country credit risk** is the most important risk covered by IBRD's equity.





3. Why do we care?

Standard & Poor's on IBRD (April 17, 2018)

Major Rating Factors

Strengths:

- A 'aaa' stand-alone credit profile, reflecting our assessment of the bank's extremely strong business profile and very strong financial profile
- Unsurpassed franchise value, supported by 189 member countries, and expected continued treatment as a preferred creditor
- A risk-adjusted capital ratio of 22% after adjustments as of June 2017, buttressed by \$36.9 billion of callable capital from 'AAA' rated member countries
- Prudent financial management and policies

Issuer Credit Rating

Foreign Currency

AAA/Stable/A-1+

“Investors snap up first International Development Association bond” (FT, April 17, 2018)





- ▶ \$7.5 billion increase in paid-in capital to IBRD
- ▶ Projected annual lending capacity to increase from about \$15bn to \$25bn

Summary

1. What is the WB?

- Development Cooperative
- Finance + Advice to MICs & LICs
- IBRD Business Model + Leverage

2. Financial Risks?

- Types of Risks
- 3 Lines of Defense
- Managing Country Credit Risk

3. Why do we care?

- AAA rating
- Transformation of IDA
- Capital Increase



Thank you

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