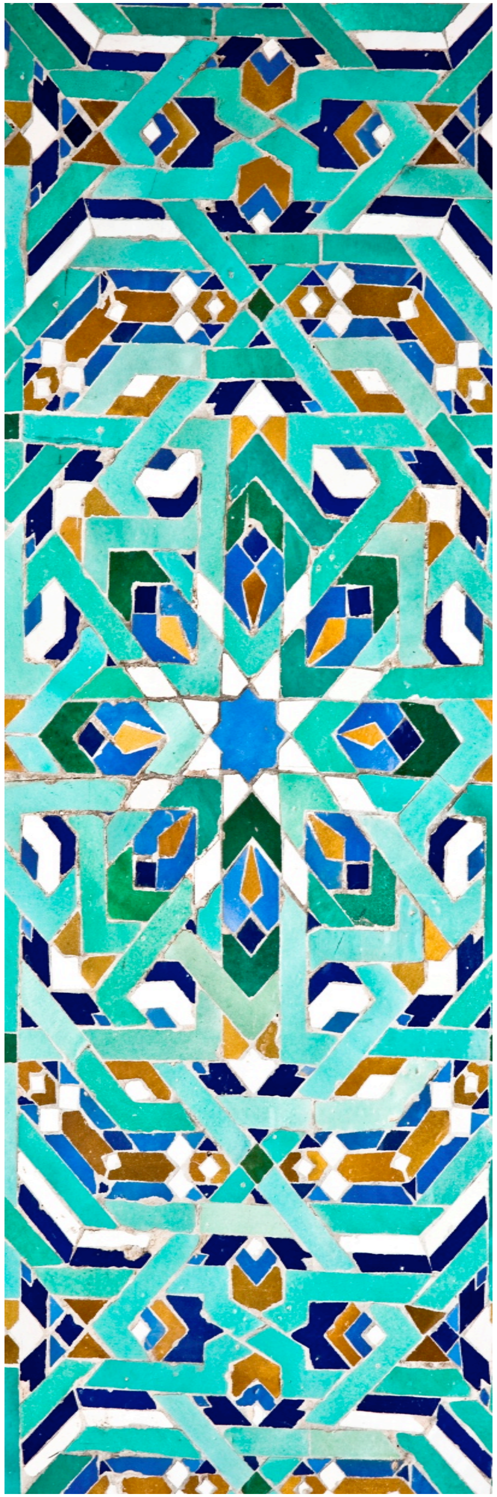

WORLD BANK GROUP
Finance & Markets
Global Islamic Finance Development Center

Mobilizing Islamic Banking and Institutional Investors for Infrastructure financing

OJK International Conference on Islamic Finance

"Infrastructure Financing: The Unleashed Potential of Islamic Finance"

Jakarta, Indonesia
Nov. 12-13, 2015

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Growing demand for infrastructure financing

- The need for long term funding to finance long term investment especially in emerging markets has been an increasing matter of concern across both international platforms and academic circles in the recent years.

- Public and private investments in infrastructure such as **transportation, power, water, and telecommunication** are positively related to sustainable economic development.

- The need for infrastructure financing:

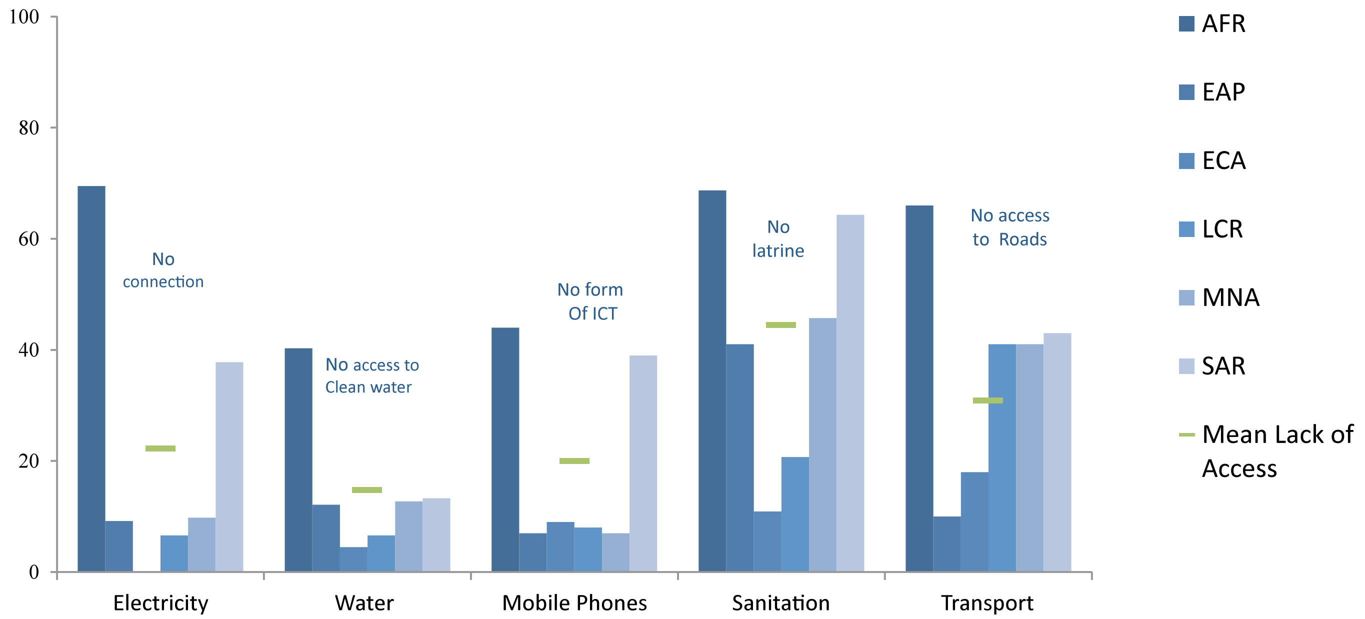
  - **$57 trillion** infrastructure investment is required to achieve the projected global GDP growth from 2012 to 2030 (Mc Kinsey, 2013)

  - **$14.4 – 15.7 trillion** USD infrastructure investment need from 2008 to 2020 for EM (Bhattacharyay et al., 2012)

  - Nearly **$1 trillion** USD infrastructure investment is required for MENA region from 2013 to 2020 (Estache et al., 2013)

Potential for long-term financing

Population Lacking Access to Basic Services by WBG Region (%)



Transport Data: Rural Access Index, 2007
Remaining Data: Regional Action Plans, Infrastructure Strategy Update 2012

- Estimations for 9 countries[1] (%60 of global GDP) show that they need annual investment of US$18.8 trillion in real terms by 2020.

- It is estimated that MENA region alone needs to invest between $75 and $100 billion in infrastructure annually for the next 10-15 years.

[1] *Brazil, China, France, Germany, India, Japan, Mexico, the United Kingdom, and the United States.*
Source: "Long -Term Finance and Economic Growth"; Group of Thirty; 2013.

Gaps and constraints for long-term financing is evident

- **Constraints on the future supply of long-term finance**
  - Long-term investors are increasingly becoming constrained in their ability to provide financing.
  - Long-term financing in many countries rests on a narrow range of instruments.
  - Cross-border capital flows have been driven by short-term, volatile lending.

- **Trends on the horizon are not supportive**
  - Bank deleveraging and new regulation (such as Basel III)
  - Fiscal consolidation
  - Aging populations

What makes infrastructure finance challenging?

- **Financial versus social returns.** Project may not be economically feasible but could have significant social benefits.

- **Complexity** of cashflow patterns, nature of projects, and number of different parties (financiers, suppliers, constructor, operator).

- Initial phase, i.e. construction phase has **high risk** as the project may not generate any cashflow.

- **Regulatory barriers.** New regulatory framework to market-based valuations and risk-based solvency standards is indirectly affecting the ability of institutional investors such as pension funds and insurers to invest in infrastructure and other alternative asset classes.

- **Monitoring challenges**. Lack of objective, high quality data on infrastructure and a clear and agreed benchmark, making it difficult to assess the risk in these investments to understand correlations with other assets.

Source: OECD, 2014. "Private Financing and Government Support to Promote Long-term Investments in Infrastructure", Analytical Report. Paris, France

Banks’ share of infrastructure financing is increasing in recent years…

Regional composition of project finance

	Loans (€m)		Bonds (€m)		% Bonds vs. Loans	
	2014	2013	2014	2013	2014	2013
North America	62,720	29,143	15,565	15,402	20%	35%
Europe	51,064	32,238	15,100	11,842	23%	27%
Latin America	13,763	8,162	4,931	3,870	26%	32%
Asia Pacific	60,306	51,843	4,091	2,166	6%	4%
Middle East Africa	27,166	26,637	1,899	2,454	7%	8%
Total	**215,019**	**148,021**	**41,584**	**35,735**	**16%**	**19%**

Sector composition of projects financed by bonds – global in 2014

Sector	€m	%
Oil & Gas	15,000	36%
Infrastructure	14,952	36%
Power	9,047	22%
Social Infrastructure	1,212	3%
Petrochemicals	1,188	3%
Telecoms	186	0%
Total	**41,584**	

Source: PFI Thomson Reuters, Financial League Tables
http://www.ifre.com/?&m=0&src=http://www.ifre.com/hybrid.asp?typeCode=68&pubCode=1&navcode=386

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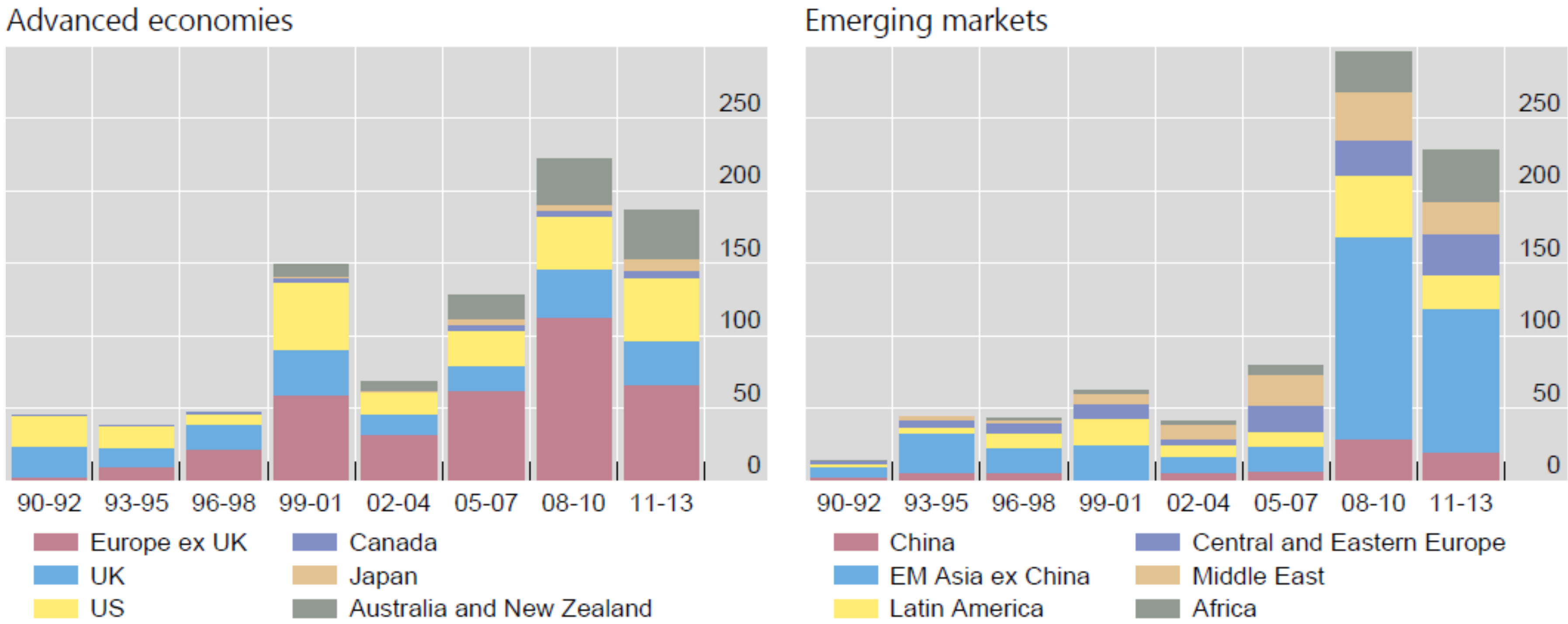
Bank loans for infrastructure projects are in many cases extended by a syndicate of banks rather than a single bank.

Infrastructure-related syndicated project loans

In billions of US dollars[1]



[1] Total amount of project finance through syndicated loans in shown regions and economies for the industries listed in footnote 12.

Sources: Dealogic; BIS calculations.

Source: Ehlers, Torsten. "*Understanding the challenges for infrastructure finance*" (2014).

Banking financing of infrastructure projects

Bank loans have some key advantages over bonds or other structured financing solutions:

Monitoring Function. Debt holders serve an important monitoring role in the project and banks tend to have the necessary expertise;

Customized Cashflows. Infrastructure projects need a gradual disbursement of funds and bank loans are sufficiently flexible; and

Smoother restructuring. Infrastructure projects are relatively more likely to require debt restructurings in unforeseen events and banks can quickly negotiate restructurings among each other, whereas the restructuring of bonds, for instance, is complex and time consuming.

Source: Kirshner, Jodie A., *Legal Implementation and Management of Infrastructure Financing Models: Trade-Offs between Risk and Maturity* (August 4, 2015). Bank for International Settlements Working Paper No. __ (2015), Forthcoming. Available at SSRN and Ehlers, Torsten. "Understanding the challenges for infrastructure finance." (2014).

Key risks in bank financing

Asset – Liability mismatch. Financing of long-term illiquid projects with short-term liquid liabilities.

Exposure to Financial Stability in economic distress.

Pricing risk. How to price long-term unquantifiable risks? Excessive uncertainty which is difficult to price upfront.

Re-pricing risk. Bank would not commit very long-term and the project would need refinancing at future stage.

Limited Expertise. The complexity and duration of projects means that local banks in many developing countries lack the technical capacity or willingness to enter into these projects, and where they do they tend to be junior members of a syndication.

Source: Kirshner, Jodie A., *Legal Implementation and Management of Infrastructure Financing Models: Trade-Offs between Risk and Maturity* (August 4, 2015). Bank for International Settlements Working Paper No. __ (2015), Forthcoming. Available at SSRN

Islamic financial instruments have certain features which have potential to effectively support long-term financing, and economic growth and development

- **Participatory and risk-sharing financing**
- **Emphasis on materiality (asset-based)**
- **Real Sector Financing**
- **Socially Responsible Financing**
- **Notion of Economic and Social Justice**

G30 Working Group on Long-term Finance – Policy Recommendations

- I: Ensure investors are better able to take a long-term horizon in their investment decisions.

- II: Create new intermediaries and instruments geared toward the provision of long-term finance.

- III: Develop debt and equity capital markets in order to promote a broad spectrum of financing instruments.

- IV: Ensure that cross-border flows support the efficient global allocation of capital to long-term investment.

- V: Strengthen systemic analysis when setting future regulatory policy.

Leveraging Islamic Banks for Long-term Financing

- Islamic banks acting as asset managers or specialized fund managers managing portfolio of infrastructure projects.
- Enhancing risk-sharing and asset-based financing through development of capital markets and securitization markets.
- Provide liquidity through tradeable shares or securities of specialized funds.
- Attracting conventional and Islamic institutional investors, i.e. pension and insurance funds through development of new product meeting their risk-return requirements and enhancing liquidity.
- Developing enabling environment for robust financial intermediation through enhanced transparency, governance, and regulatory environment.
- Financial awareness and literacy of core principles of risk-sharing financing, i.e. Islamic finance.

Thank You

For your further questions please contact:
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