



Eurasian Development Bank

NEW
NON-REGIONAL
SHAREHOLDERS

INCREASE IN
PAID-IN
CAPITAL

INSTITUTIONAL
INVESTORS

NEW REGIONAL
SHAREHOLDERS

CHANNEL
SDRS TO
MDBS

LARGER
MDBS

PERPETUAL
SUBORDINATED
DEBT

	2023	2022	2021
TOTAL ASSETS	8,167,342	8,428,591	8,988,122
LIABILITIES AND EQUITY			
LIABILITIES:			
Loans and deposits from financial institutions	18	3,090,987	3,145,238
Financial liabilities at fair value through profit or loss			1,028,700
Deposits from customers	13	199,091	2,958
Debt securities issued	19	140,195	307,307
Other liabilities	20	2,661,484	3,030,079
Total liabilities	21	6,179,336	6,892,240
EQUITY:			
Share capital:			
Authorized share capital	22	7,000,000	7,000,000
Paid-in share capital	22	(5,484,300)	(5,484,300)
Reserve fund	22	1,515,700	1,515,700
Technical assistance fund reserve	22	146,220	146,220
Digital initiative fund reserve	23	23,731	21,137
Revaluation deficit for financial assets at fair value through other comprehensive income in Treasury portfolio	23	872	5,588
Revaluation (deficit)/ reserve for financial assets at fair value through other comprehensive income in Investment portfolio		(18,604)	(61,959)
Retained earnings		(9,269)	(3,520)
Total equity		1,988,006	2,132,051
TOTAL LIABILITIES AND EQUITY		8,167,342	8,428,591

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Capital in Multilateral Development Banks

Raising Capital and Enhancing MDBs' Capital Structure for the Benefit of Member States

Report 24/7

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MDBs contribute significantly to the international development agenda. Funding for member countries and regional connectivity projects depends largely on the ability to expand lending capacity of such MDBs. This paper covers the whole 'MDB family' of institutions, but highlights regional and sub-regional MDBs because of their specifics of raising shareholders' capital. The study discusses seven standard and novel options for increasing capital: (1) increasing existing shareholders' capital; (2) new regional shareholders; (3) new non-regional states; (4) attracting institutional investors; (5) larger MDBs' participation in a smaller MDB's capital; (6) rechanneling the SDRs to the MDBs' capital; (7) issuing perpetual subordinated debt available to the public. Based on case studies, we illustrate different capital enhancement strategies of MDBs that, in addition to raising capital, could lead to positive effects, related to improvement in credit rating, corporate governance, strengthening of financial position, and international status. Additionally we discuss capital optimization, which is complementary to capital expansion.

Keywords: multilateral development bank; international financial architecture; international financial institution; bank capital; development financing.

JEL: F33, F36, F55, G23, G24, P33.

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EXECUTIVE SUMMARY

Shareholders' capital provides the "fuel" for MDBs' lending operations. A financial institution should have an adequate amount of risk capital on hand to meet financial obligations in the event its assets deteriorate.

In the internal risk-based capital adequacy frameworks of the MDBs, available capital comprises paid-in capital and retained earnings and reserves, but excludes callable capital. Regulators recognize Common Equity Tier 1 (CET1) capital, which consists mostly of common shares, retained earnings, and accumulated reserves, and Tier 2 capital, which refers to subordinated instruments that provide loss absorption in a debt work-out scenario (G20, 2022).

MDBs contribute significantly to the international development agenda; therefore, strengthening their role and weight is at the top of the G20 agenda. New shareholder capital is highly efficient for expanding lending capacity. MDBs transform every shareholder's dollar into 3–4 dollars of lending on average. However, the potential of MDBs to finance development needs is limited by the size of shareholders' capital.

MDBs could be categorized by geography (global, regional, and sub-regional). Simply put, the 'MDB family' can also be described using a Football League analogy. Larger 10 MDBs (WB, AfDB, ADB, AIIB, CAF, EBRD, EIB, IDB, IsDB, NDB), with \$10+ billions paid-in capital, play in the 'Premier League' (mostly global and legacy MDBs). Regional and sub-regional MDBs are the part of the 'Championship' – an important but often overlooked segment of global development finance.

The specifics of raising shareholders' capital by the smaller regional and sub-regional MDBs differ significantly from global MDBs. Their potential to finance development needs is limited by the size of shareholders' capital. The present study discusses six options for increasing shareholders' capital of regional and sub-regional MDBs, and suggests an additional novel option for discussion (Picture A).

↓ Picture A. Options for increasing shareholders' capital of the MDBs



Source: the EDB.

The most straightforward option of enhancing the lending capacity of the MDBs is to inject capital from existing shareholders. The result of the capital increase of the MDB is strengthening of its financial position, while maintaining control and voting power. Capital increase by shareholders demonstrates their willingness to support a MDB over the long term. This is an acute issue for regional and sub-regional MDBs that are managed by developing countries only.

1

“the most straightforward option”



BADEA

Arab Bank
for Economic
Development
in Africa

Since its inception in 1974, BADEA has never borrowed and has been fully funded by shareholders' equity. Its capital increased from \$231 million in 1975 to \$5.6 billion, at the end of 2023 via several rounds of capital increases — all paid-in. The rating agencies have given very strong credit ratings (S&P AA, Moody's Aa2 as of end-2023), underpinned by the extraordinary support of BADEA's shareholders through capital increases and the introduction of callable capital.

Regional and sub-regional MDBs have a strong opportunity to increase importance in their region compared with others by attracting new regional members into its capital structure. New regional members could enhance the MDB's capital base and hence lending capacity, promote strong regional ownership, diversify and decrease risks of the loan portfolio, mitigate geographic concentration, strengthen the international status of the MDB, and increase its credit rating.

2

“The attraction of new regional members might be challenging”

The attraction of new regional members might be challenging, as most regional MDBs operate in a lower-income environment. This translates into a high level of risk and lower credit rating of member countries, resulted in a higher cost of funding.



DEVELOPMENT BANK
OF LATIN AMERICA

CAF is an example of successful regional membership expansion. The membership expansion was a critical component of CAF's strategy to improve its access to capital markets. CAF was founded by six Andean countries, and now it has 21 member states, including 19 regional countries from Latin America and Caribbean. CAF's membership expansion has allowed to reduce the concentration of its loan portfolio, and increase its lending capacity. By the end of 2023, it had a shareholders' capital of \$14.7 billion, which increased from \$2.8 billion in 2004.

Membership expansion by non-regional countries (that will not borrow) could lead to a substantial increase in subscribed capital. This is particularly attractive for MDBs seeking to improve their credit ratings in order to access cheaper funding from bond markets. It is a promising option for MDBs to introduce various classes of shares to new members with different degrees of participation in the decision-making process.

3

“Membership expansion by non-regional countries can help access cheaper funding from bond markets”

Sub-regional MDBs in Africa and Latin America have non-regional non-borrower shareholders, such high-income donors as Germany, France, the Netherlands, and Belgium as shareholders. In addition to paid-in capital,

non-regional high-income shareholders could contribute callable capital. The rating of MDBs improves if the callable capital is provided by a country with a high rating. The advantage of shareholders like China and India is that they bring access to new sources of finance.

Non-borrower high-income shareholders could have own views on development and operations that may differ from those of regional MDB. This may include demanding stricter environmental, social, gender or procurement policies, and lending restrictions to avoid financial problems.



AIIB members have grown from original 57 members to 109. As of now, the AIIB includes sovereigns that are rated Triple-A by Fitch, S&P, and Moody's, and has a stand-alone credit profile of "AAA". At the end of 2023, shareholders' equity increased to \$21.4 billion from the original \$17.7 billion in 2016; loans increased to \$21.9 billion from \$10 million in 2016.

4

"The model of capital increase due to institutional investors can be effective for MDBs with high profitability"

An MDB could invite institutional investors such as commercial banks, pension funds, insurance companies, and other financial institutions to become shareholders. The BOAD, EADB, and TDB offer 'B-class shares' with less voting power for development finance institutions, other publicly owned institutions, and private financial institutions.

The model of capital increase due to institutional investors, especially commercial banks, can be effective for MDBs with high profitability. The business model generally is placed in trade finance and does not always coincide with the development agenda.

Entry of institutional investors can have a number of positive effects beyond capital expansion, including improving the quality of governance and the accountability of MDBs. At the same time, there are negative aspects associated with the risks of diluting the effects of governance and downgrading of ratings. There is also a trade-off between the development agenda and profit-driven motives.



The TDB is the foremost example of non-sovereign investors' participation in MDB capital. The TDB has 18 institutional investors, of which 14 are regional pension and insurance funds as well as banks. The TDB created dividend-paying Class-B shares in 2013. The Class-B shareholders could only contribute to paid-in capital, while Class-A shareholders contributed paid-in as well as callable capital. The high level of TDB profitability ensured the attractiveness of investments. Return on equity before the launch of B shares in 2008–2012 averaged around 11% per annum.

Global and regional/sub-regional MDBs could derive meaningful positive effects from capital cooperation. The global MDB can expand its presence in a region through the regional and sub-regional MDB. In turn, the latter receives strong financial and operational support. This allows it to expand its lending activity and become a more efficient bank.

5

“MDBs could derive meaningful positive effects from capital cooperation”

Local knowledge of regional and sub-regional MDBs provides a logical conduit for global MDBs to reach out to end-customers, including medium and large non-sovereign borrowers, by efficiently leveraging its scale.

Global MDBs as shareholders with AAA-rated shareholders’ capital are extremely valuable for the regional and sub-regional MDB’s credit rating. Highly rated MDBs could also play an important role in speeding up the capacity-building processes by contributing to operational policy and administration, loan standards, and financial policy. MDBs’ cooperation is not limited to capital participation. Cooperation can also take place through loans, equity, and risk participation. MDBs could also mobilize debt capital from global MDBs’ shareholders.

One challenge may be a decrease in shareholders’ motivation in the development of the regional and sub-regional MDB and its further capitalization, due to the emergence of a strong investor.



In 2022, the EIB supported the BOAD’s capital increase, thanks to which the EIB’s share in equity increased from 0.4% to almost 1%. The purpose was to increase its financing of projects. The EIB’s capital increase should also support its external rating by raising the share of highly rated equity investors. It is anticipated that the EIB will also have a positive influence on the policy and integrity standards of the BOAD.

Rechanneling Special Drawing Rights could be an option for increasing MDBs’ capital. On May 2024, the IMF approved the proposal to expand permitted use of SDRs by authorizing their use in the acquisition of hybrid capital issued by prescribed holders (official entities approved by the IMF to hold SDRs).

6

“It will be both crucial and fair to expand the IMF list of SDR prescribed holders”

The AfDB and IDB have developed a proposal under which member countries may channel SDRs as hybrid capital contributions to help expand their lending capacity. SDR allocation across countries tends to be inverse to countries’ development needs. Larger quotas are held by advanced economies, which are the least likely to need them.

SDRs could be used to provide capital injections not only to global but also to regional and sub-regional MDBs. For that purpose, it will be both crucial and fair to expand the IMF list of SDR prescribed holders. The list currently includes only 13 development and other multilateral institutions, most of which are MDBs managed by advanced economies. This list does not include smaller borrower-led MDBs.

7

“The issuance of “perps” by MDBs represents a non-conventional approach to capital increase”

Challenging times call for out-of-the-box solutions. We put on the table for discussion an issuance of “perps” by MDBs as a non-conventional approach to capital increase. Perpetual subordinated debt is a type of relatively high-risk bond usually without a certain maturity date. *De facto*, perpetual bonds usually have a maturity date which is more than 10 years. They rank lower in priority to other debts in the case of default. The price of perpetual subordinated bonds is somewhat higher than the price of ordinary ones.

According to the Basel III standard, perpetual subordinated bonds could form part of Additional Tier 1 Capital when specific conditions of issuance are met. In practice, it is often included in Tier 2 Capital as supplementary capital. Issuing public perpetual debt, available both to institutional investors and the general public, could strengthen ties between a development bank and citizens of its member states.

Optimization of the Capital Adequacy Framework

Optimization of the use of capital is complementary to capital expansion. They both may effect greater lending in the short term, while MDBs negotiate capital injections with shareholders and other potential investors. There are several possible options for capital optimization: risk appetite adjustment; risk transfer options to the private sector; risk transfer options among MDBs; restricting budget support operations by MDBs; integrating a prudent share of callable capital into capital adequacy metrics. The last one is still under consideration to determine the appropriate methodology.