# FUTURE OF DEVELOPMENT BANKS

## Framework paper BNDES/CAF/IPD project

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# INTRODUCTION

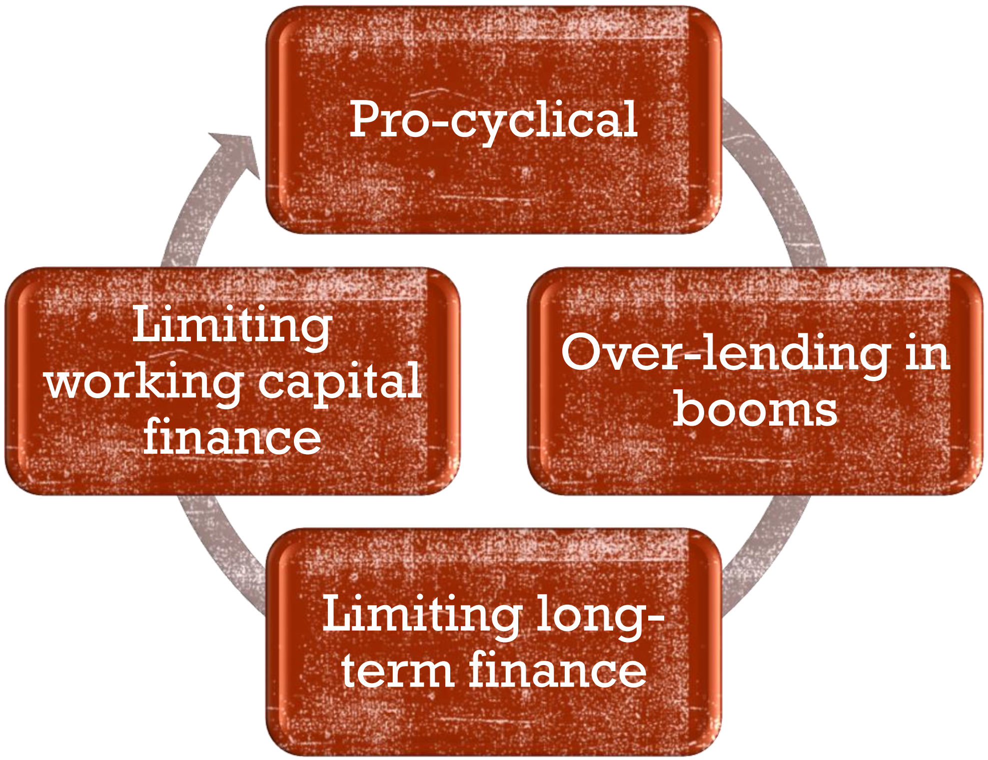
# CASE STUDIES

1. Brazil
2. Peru
3. Chile
4. Colombia
5. Mexico
6. Germany
7. China

- The project will focus on **second tier national development banks** (lend through other financial intermediaries, and not directly)
- It also includes cases of public sector banks active in **project financing for development** purposes (in infrastructure)

# CONTEXT

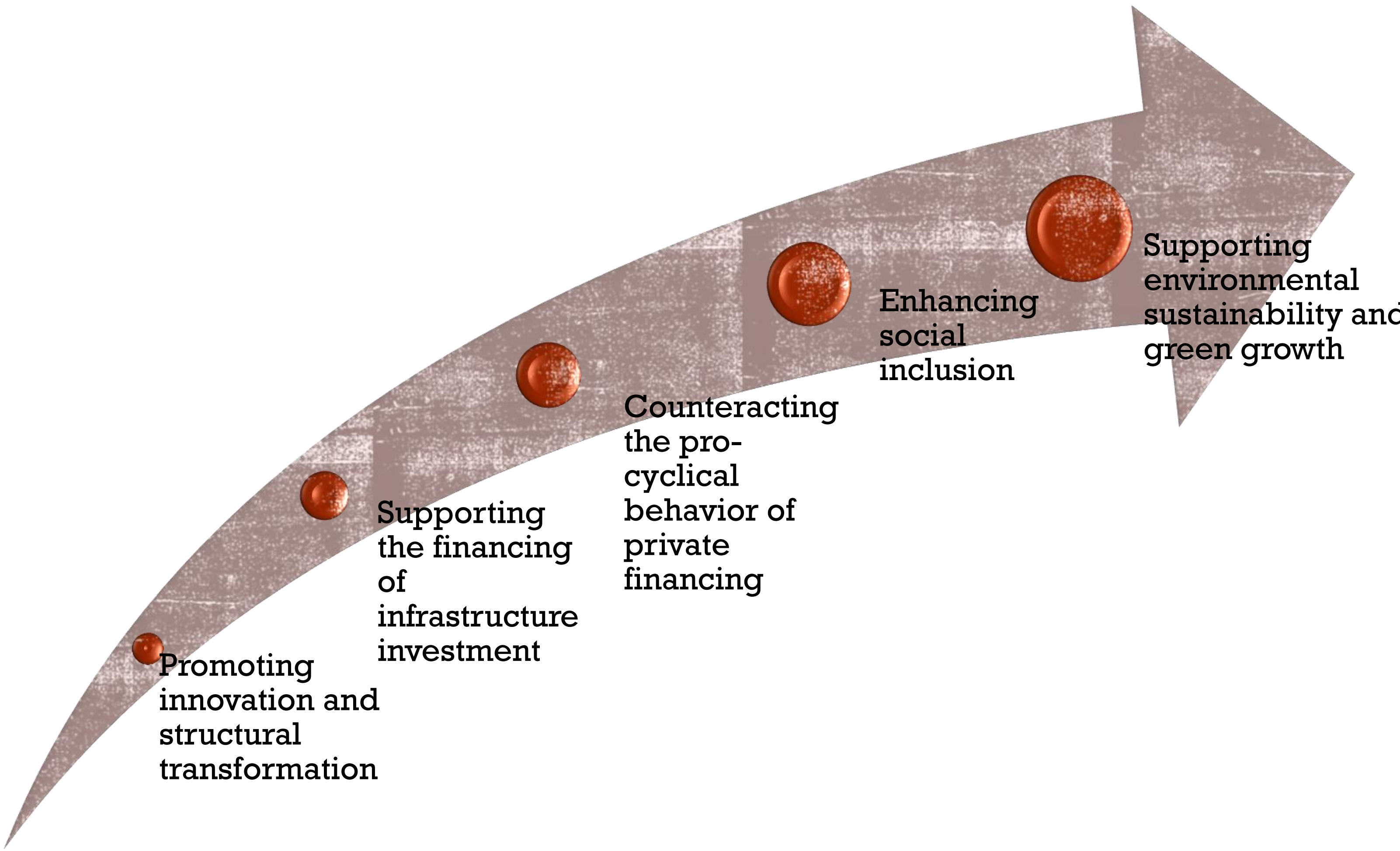
## LIMITATIONS OF THE PURELY PRIVATE FINANCIAL SYSTEMS




- The private financial system on its own cannot perform well to support the real economy
- The depth of the concerns about the financial sector, is illustrated by IMF Managing Director, Christine Lagarde recently stating: "*We need a financial system that serves society*"

# CONTEXT

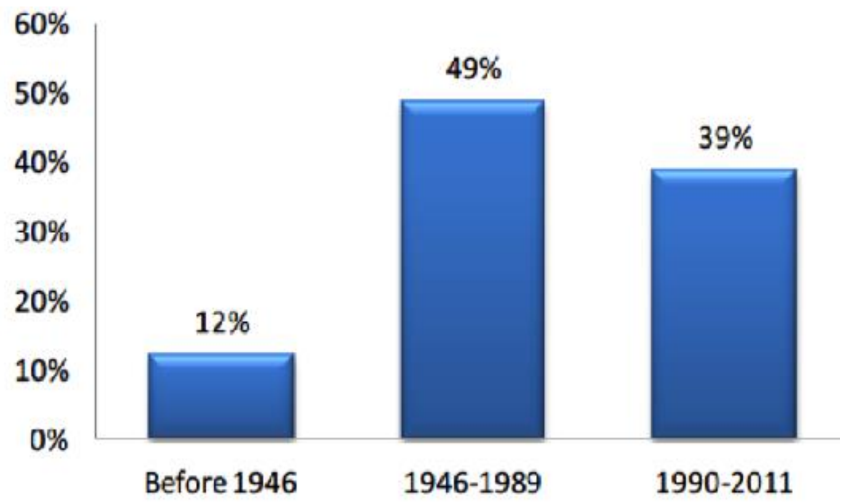
## POSITIVE ROLE OF DEVELOPMENT BANKS



# CONTEXT

There is renewed support for development banks, in the wake of the 2007/09 North-Atlantic financial crisis

**DBs by Year of Establishment**
(percent of DBs)



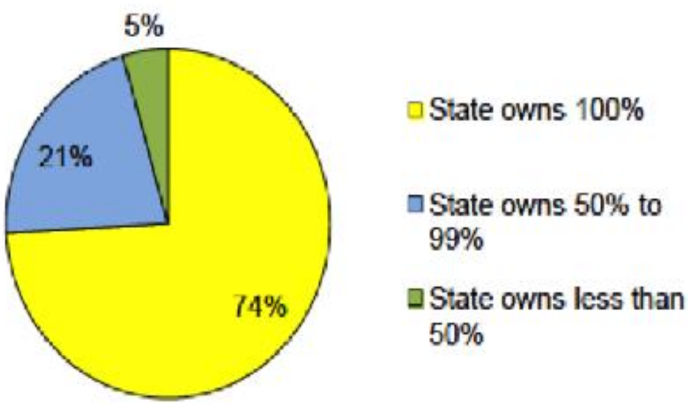

*"National development banks have been established in different periods after the WW II. Although almost half of national development banks (49%) were established…between 1946 and 1989, nearly two-fifths (39%) came into existence … between 1990 and 2011"*

**Chadrasekhar (2016)**

# KEY FEATURES OF NATIONAL DEVELOPMENT BANKS

# OWNERSHIP AND MANDATE

## OWNERSHIP
### Percentage of State Ownership in DBs




*Source: Luna-Martinez and Vicente, WB*

Typically, DBs are institutions owned, administered, and controlled by the government (state). The government provides the strategic direction of the DB and appoints their senior management and board members

## MANDATE
### Segments supported by selected NDBs

| | CDB (China) | KfW (Germany) | BNDES (Brazil) | JFC (Japan) |
|---|---|---|---|---|
| MSME | X | X | X | X |
| Agriculture | X | | X | X |
| Infrastructure | X | X | X | |
| Exports | | X | X | |
| Innovation | X | X | X | X |
| Green Economy | X | X | X | X |
| Internationalization | X | X | X | X |
| Capital Markets | X | X | X | X |
| International Financial Cooperation | X | X | | |

*Source: Ferraz, Além, Madeira (2016), p. 17*

53% of DBs are institutions with a narrow and specific mandate, while 47% of DBs are institutions with broader legal mandates and are expected to support a broader range of activities and sectors (Luna-Martinez and Vicente)

# BUSINESS MODELS AND CREDIT CONDITIONS

## BUSINESS MODELS
## Percentage of State Ownership in DBs

A total of 52% of DBs lend through a combination of first-tier and second-tier operations.

12% of NDBs only through second-tier. A large number of "second-tier-only" NDBs are located in Latin America.

(Luna-Martinez and Vicente, WB).

## CREDIT CONDITIONS
## Maximum Loan Term Offered by DBs

| Maximum loan term | Percent of DBs |
|---|---|
| Up to 5 years | 16% |
| 6 to 10 years | 29% |
| 11 to 15 years | 19% |
| 16 to 20 years | 22% |
| 21 to 25 years | 7% |
| 26 to 30 years | 6% |
| Total | 100% |

*Source: Luna-Martinez and Vicente, WB*

- 54% of NDB loans are over 10 years maturity.
- Credit at subsidized interest rates is a practice adopted by 50%.
- 73% offer loan guarantee products to partially offset the losses faced by a private financial intermediary when a customer defaults.

# REGULATION AND SUPERVISION AND SCALE

## REGULATION AND SUPERVISION

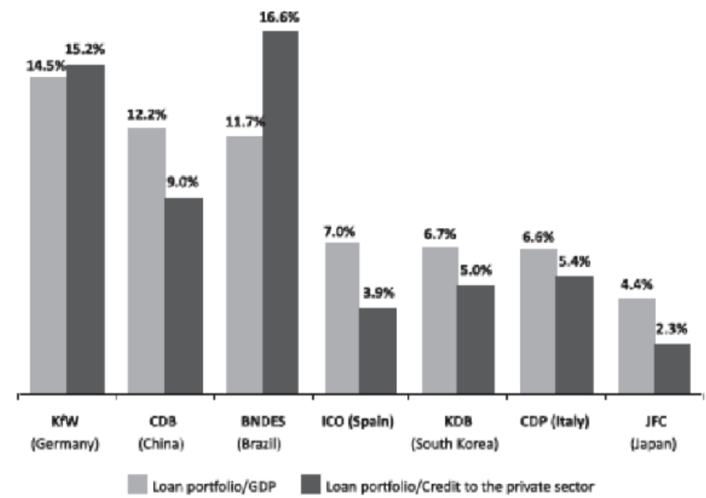
**76%** of DBs are regulated and supervised by the same institution that supervises private commercial banks in their countries

**78%** of DBs are required to comply with the same standards of prudential of private commercial banks or any other private financial institution

(Luna-Martinez and Vicente, WB)

## SCALE, ABSOLUTE AND RELATIVE TO ECONOMY

## DFI Loan Portfolio and Representativeness 2013 (%)




The largest loan to GDP ratio is that of KfW, fairly closely followed by CDB and BNDES

# FINANCIAL INDICATORS AND FUNDING

## FINANCIAL INDICATORS
## Structure and economic and financial performance of selected DFIs-2013

| | CDB (China) | KfW (Germany) | BNDES (Brazil) | JFC (Japão) | CDP (Italy) | CDC (France) | ICO (Spain) | KDB (S.Korea) |
|---|---|---|---|---|---|---|---|---|
| Assets (US$ billions) | 1,331.3 | 619.7 | 363.4 | 260.4 | 242.4 | 190.7 | 136.3 | 131.1 |
| Loan Portfolio (US$ billions) | 1,162.3 | 528.8 | 263.5 | 222.8 | 137.6 | n.d. | 95.0 | 87.9 |
| Net profit (US$ billions) | 13.0 | 1.7 | 3.6 | (2.9) | 3.1 | 2.5 | 0.1 | (1.3) |
| Low Delinquency rate (%) | 0.48 | 0.13 | 0.01 | 2.98 | 0.20 | n.d. | 5.30 | 3.10 |
| Return/assets (%) | 1.02 | 0.27 | 1.01 | (1.13) | 1.29 | 1.33 | 0.08 | (1.01) |
| Return/equity (%) | 15.07 | 6.21 | 15.34 | (6.84) | 14.00 | n.d. | 1.76 | (8.85) |
| Number of employees | 8,468 | 5,374 | 2,859 | 7,361 | 1,440 | n.d. | 310 | n.d. |
| **Year of Foundation** | **1994** | **1948** | **1952** | **2008[b]** | **1850** | **1816** | **1988[c]** | **1954** |

*Source: Além and Madeira (2015), p. 110*

Additionally, according to the WB, **53%** of NDBs had a ROA exceeding the average of their banking systems

*(Luna-Martinez and Vicente, WB)*

## FUNDING
## Funding Features of DBs

| Features | Yes | No |
|---|---|---|
| Does your institution take deposits from the general public? | 41% | 59% |
| Can your institution borrow from other financial institutions or issue debt in local markets? | 89% | 11% |
| Does your institution receive direct budget transfers from the government? | 40% | 60% |
| Does the government guarantee your institution's debt? | 64% | 36% |

*Source: Luna-Martinez and Vicente, WB*

- **89%** borrow from other financial institutions or issue debt on local capital markets.
- **40%** receive budget transfers from the government
- **64%** receive government guarantees

# THE ROLES OF NATIONAL DEVELOPMENT BANKS

# 1. COUNTER-CYCLICAL LENDING

## Especially for Supporting Investment and Sustained

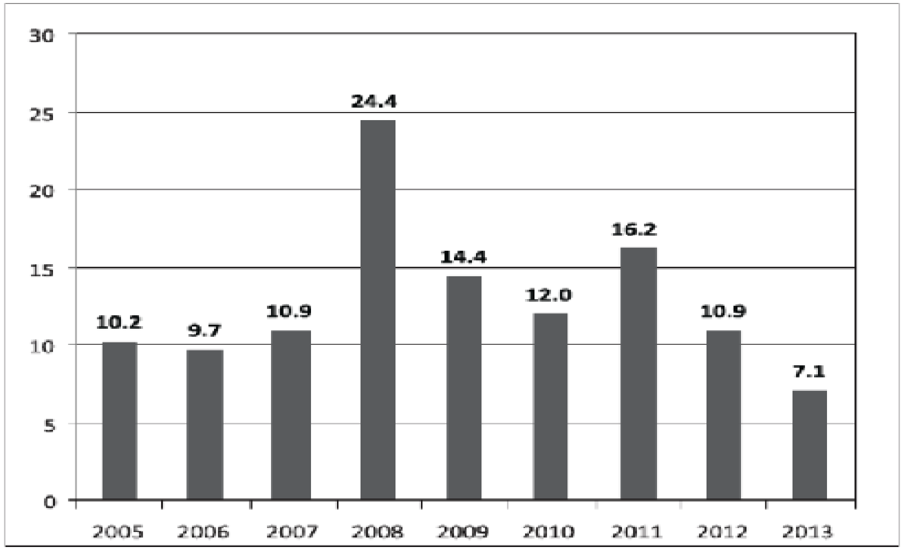
- NDBs increased their lending from **US$1.16** trillion to **US$1.58** trillion dollars between the end of 2007 and the end of 2009.

- This increase in lending of **36%** was larger than the 10% increase in private bank credit given in these countries.

- NDBs increased lending to old and new customers who had faced difficulties in refinancing their loans or receiving new lines of credit.

(*Luna-Martinez and Vicente, WB)*

**Average Growth of the Loan Portfolio of some DFIs from the sample*(%)**

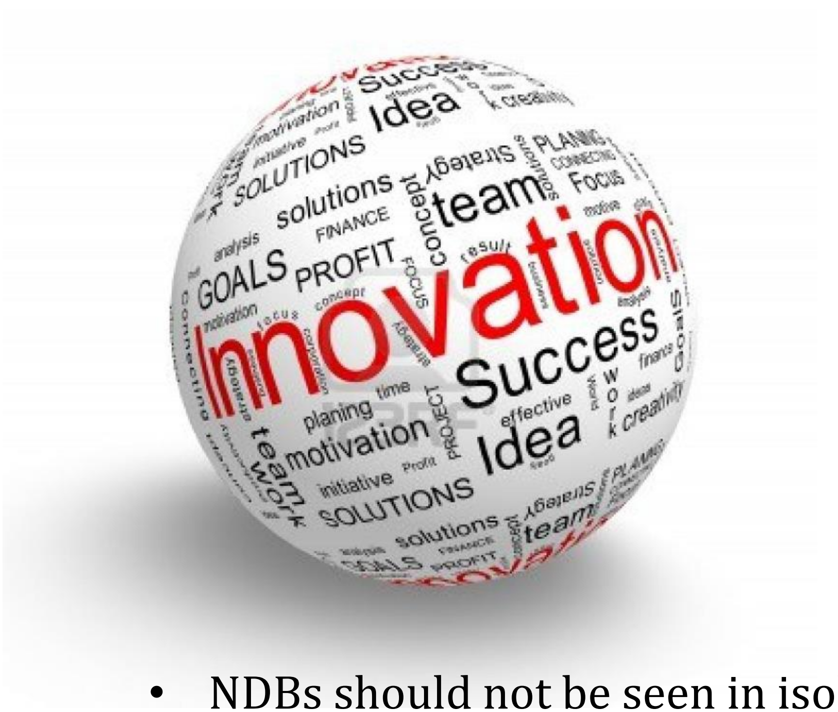



Source: Annual Reports. * Geometric averages of the growth rates: BNDES, CDB, KfW and KDB.

*Source: Além and Madeira (2015)*

# 2. PROMOTING INNOVATION AND STRUCTURAL TRANSFORMATION

**Which are inherent to dynamic economic growth; diversification and promotion of supply chains and innovation**




There is a growing consensus that national development banks have to prioritize their role in **fostering of innovation and structural transformation** in national economies.

An important aspect to underscore is the need for **close collaboration between the government and the private sector** to help design the best strategy to define the right targets for structural transformation and to achieve it most effectively.

- NDBs should not be seen in isolation. Its success also depends on the **coordination between national economic policy** to foster development and its funding.

# 3. ENHANCING FINANCIAL INCLUSION

- SMEs consistently report having severe obstacles in their access to finance in comparison to larger firms, which **limit their production capacity and ability to grow**.
- There is agreement about the important role that national development banks do and should play in **providing access to financing for SMEs and microenterprises** (including family agriculture), especially but not only long-term credit.
- NDBs should play an important role to **assist implementation of national development strategies** to improve financial inclusion in those sectors traditionally excluded from the formal financial sector.
- Although lending to micro and SMEs is risky, experience has shown that it can be done on a commercially viable basis.

# 4. INFRASTRUCTURE

- NDBs are suited for infrastructure financing, as they can provide **long-term financing**. NDBs can finance at relatively low cost (often have high credit ratings) so they can borrow relatively cheaply on capital markets.

- Following the crisis, private banks have reduced the maturity mismatch and new regulation seems to be forcing them to do so even further. Therefore**, banks are reducing the supply of long-term private financing** for infrastructure projects.

- This limitation of private lending, combined with the **massive need for infrastructure** in the emerging and developed world, strengthens the case for enhanced financing by NDBs.

- NDBs can play a **catalytic role** as they continue to move toward developing an appropriate mix of traditional long-term loans with **other financial instruments** to achieve project closure, such as equity investments, guarantees or partnerships.

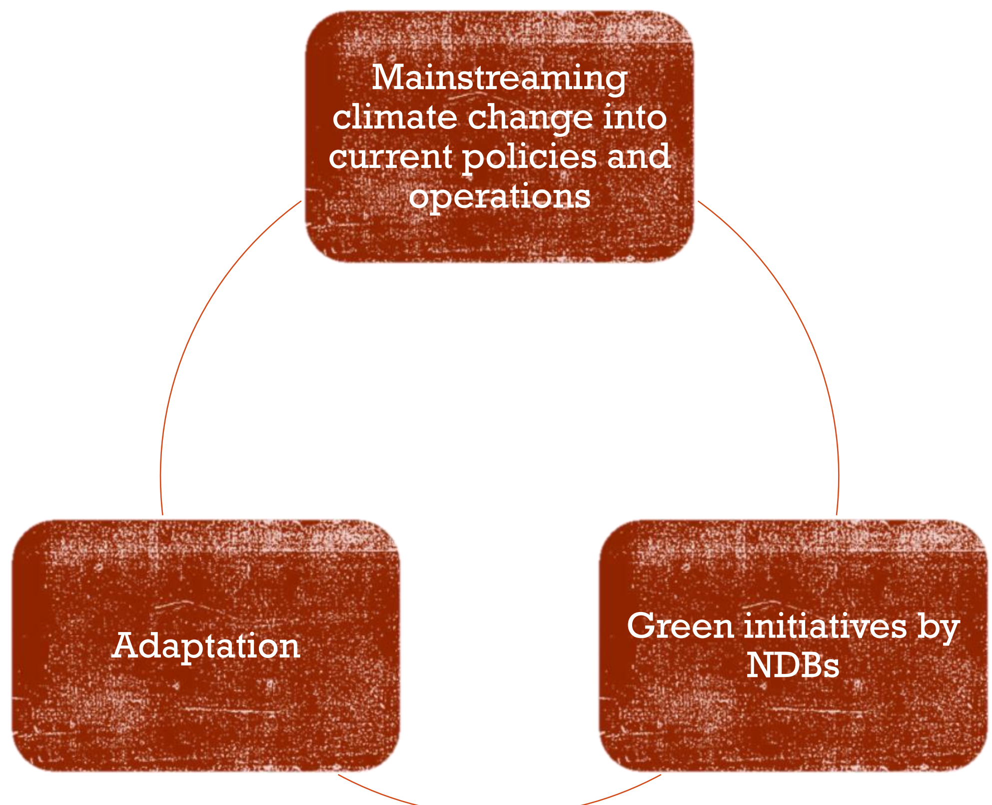
# 5. FINANCING THE PROVISION OF GLOBAL PUBLIC GOODS

- An important area of engagement for the NDBs in the coming decades relates to **combating climate change.**

- NDBs can help **mobilize additional funding**, design the necessary policy frameworks, and implement effective projects that can showcase the viability of certain green investment.

- NDBs bring the advantages of **accumulated expertise, administrative efficiencies, and convening power**, they can play an important role.

**Elements for a strategy for the NDBs to combat climate change could include:**



# TERMS OF REFERENCE FOR CASE STUDIES

# TERMS OF REFERENCE CASE STUDIES

1. Overarching view
2. The role of DB in the diversification and promotion of supply chains and innovation
3. Financing "green" businesses, climate change and energy efficiency
4. Infrastructure
5. Countercyclical role of DB
6. Support to micro and SME

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