FAST-Infra

FAST-Infra Technology Enabled Platform

Concept: To sponsor the development of a new technology-enabled end to end platform. It would offer a combination of an open securitization marketplace along with a suite of technology tools to accelerate review, structuring, monitoring, reporting, and risk management of sustainable infrastructure projects in emerging and developing countries. The note below explains why we should create such a platform, and how we might go about developing it.

Challenges:

Securitization:

There is no deep, liquid market for infrastructure loans. Around $3 trillion of project finance loans[1] sit on bank balance sheets. Securitization offers a way for banks to recycle capital and for institutional investors to buy diversified, liquid portfolios. For European insurance companies seeking to invest in emerging market infrastructure, securitization could reduce Solvency 2 capital charges by 15%. Yet, infrastructure remains perhaps the largest asset class that has not yet been securitized.

IFC's Managed Co-Lending Portfolio Program (MCPP) and Bayfront Infrastructure[2] have pioneered innovative approaches for securitization. But it is difficult for other institutions to replicate or join them. MCPP is a passive co-investment platform captive to IFC. Most banks and institutional investors don't have the scale or origination capacity to replicate it. While Bayfront's ownership is broader, it remains focused on commercial infrastructure loans in Asia.

Both MCPP and Bayfront are effectively structured secondary pools that are somewhat captive to the sponsoring institutions. To enable a wider set of banks and institutional investors to participate, we need a more open, rules-based marketplace.

Little use of modern technology:

It took Bayfront 1.5 years to set up and structure the first pool of 37 loans. Document review, structuring, loan administration, and reporting is still done manually and remains cumbersome. Bayfront's experience points to a second systemic problem in project finance: there are no modern, commonly used technology tools.

Project development, structuring, negotiation, risk management, record keeping, and performance and regulatory reporting are still done by hand. Each party conducts their own legal review of documents, builds their own models, and conducts their own analysis. There are no commonly used technology tools such as Blackrock's Aladdin or cloud computing platforms used in many other industries.[3]

The lack of such platforms leads to high transaction costs, duplication, and poor outcomes. Parties spend 8-12% of project costs developing projects. Nearly 90% of technically viable projects that are initiated by good sponsors,

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1 Source: IJ Online

2 Background on IFC's MCPP is here. Background on Bayfront is here

3 Blackrock's Aladdin platform provides a dashboard that allows asset managers to get a macro level view of risks down to the details of a single trade. It is a single system, with a single database and a single set of models. It can be used for scenario planning, risk analysis, forecasting, and hedging. Over 200 asset management companies use the platform to manage and monitor $18 trillion in assets.

Cloud computing platforms—including data storage and software tools—provided by Microsoft Azure, IBM Cloud, Amazon Web Services and Google Cloud are widely used by thousands of companies.

never reach financial close. 50% of projects get renegotiated[4]. A recent study found that 65% of projects financed by banks that claim to adhere to the Equator Principles, are not in compliance with the principles[5]. Regulatory reporting for infrastructure (especially around Solvency 2) is difficult and time consuming. Central bankers worry that real estate and infrastructure are illiquid, black boxes. And with good reason: nearly 20% of sovereign fiscal crises were triggered by invoking contingent liabilities for infrastructure projects and related state-owned enterprises. On average, each event cost 1-3% of GDP, with the largest having cost 15% of GDP[6].

Proposal:
Members of FAST Infra come together to create a more open architecture CLO platform. This would be enhanced by a suite of technology tools.

- The platform would be governed by rules, e.g., for underwriting, disclosure, transparency, performance reporting, etc.
- Having rules would make it easier for any bank or underwriter to understand the criteria and elect to offer loans or invest in CLOs
- It could be housed at an exchange (e.g., Singapore, London, Luxembourg).
- The rules would be set by founding members of the platform and the exchange.

The platform would house a suite of technology tools and data:

- A searchable database of projects' terms, conditions, and performance
- Tools for rapid contract review, portfolio hedging, and CLO pricing
- Tools to reduce the frictions associated with performance monitoring and reporting (e.g., monitoring environmental and social risks, real-time contract risk management, Solvency 2 reporting)
- Risk management tools (structuring and hedging tools for natural catastrophe risk management, tools to evaluate guarantees)

Some of these tools need to be developed, while others (e.g., for CLO pricing) could be "off the shelf". Any bank, underwriter or institutional investor could rent these tools from the exchange, and then use them to conduct their own independent analysis. The exchange could become both a marketplace and a cloud computing platform for the infrastructure sector.

Impact:
The combination of a securitization platform/ exchange along with the use of a common technology platform customized for infrastructure could make a transformational impact.

- <u>More capital can flow into emerging markets:</u> Having widely known rules (instead of bespoke, bilateral agreements) will reduce the time it takes to structure a new CLO, and allow smaller banks and banks in emerging markets (who may lack the expertise to structure LP agreements) to offer their loans. Emerging market loans could become a small part of an OECD-focused portfolio, without materially affecting the portfolio's credit profile.

- <u>Deepens lending capacity:</u> Many banks in emerging markets are unable to issue at long tenors. But if they can use the technology tools and easily understand the criteria for takeout financing, they can warehouse deals with reasonable certainty that they will be able to sell their exposure. This is a key requirement of Basel IV. Borrowers for projects in emerging markets can start to get longer tenors (albeit with some refinancing risk).

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[4] Sources: *Leading Practices in Governmental Processes Facilitating Infrastructure Project Preparation,* G-20 Global Infrastructure Hub, 2019; *Construction: The Next Great Tech Transformation*, McKinsey & Co., *July 2017;* World Bank Global Infrastructure Facility; IFC; InfraClear analysis

[5] "Equator Principles requirements missing for most projects, finds new BankTrack study", BankTrack, August 11, 2020

[6] "Fiscal Costs of Hidden Deficits: Beware—When It Rains, It Pours" by Bova, Ruiz-Arranz, Toscani, and Ture, IMF, 2016

- Project finance + portfolio risk management: If the exchange sets performance reporting standards, it will make it easier to compare, measure, and hedge risk at a portfolio level. E.g., if an insurer can rapidly determine how many projects lack cover for a flood, the underwriter could offer a portfolio-level hedge. Even if project agreements have structuring flaws, these could be fixed at the portfolio level.

- New asset classes: As issuance grows, investors will be able to compare projects and sculpt CLOs, e.g., a global solar CLO, a global wind CLO.

- Standardization across life cycle: As the platform gathers momentum, banks will structure project finance loans with a view to securitizing them. This will gradually drive standardization and consistency of project agreements.[7]

- Marketplace to attract new technology: The exchange could become a marketplace to attract new, third-party technology tools for monitoring, pricing, structuring, etc.

Next steps: We would like to validate these ideas with the FAST Infra working group. For those who are interested in participating, we would propose to work with them to:
- Assess and determine the strategic options
- Secure funding and investment for the development of the platform
- Build out the tools and technology platform
- Negotiate with one or more exchanges to determine the rules, governance, and standards
- Launch and underwrite the initial CLOs

Opportunities: We expect there will be opportunities to
- Invest in the platform/ exchange
- Invest in technology providers
- Sell tools (such as CLO pricing tools) on the platform
- Be a bank that offers loans to be sold/ securitized
- Secure an underwriting mandate
- Invest in CLOs that are structured

[7] E.g., if the exchange decrees that project agreements need to be made public in order to be securitized, then a project finance bank lending to a new project will insist that governments cannot keep documents confidential.