

A Multipronged Integrated Approach to the Development of Securities Markets:

The Deep Dive¹

Multilateral Development Banks (MDBs) have programs in place to support efforts by emerging markets economies (EMEs) to develop their local securities markets. These programs range from providing advisory services to participating as guarantors or even investors in specific transactions or instruments that could have a catalytic effect in the market. Experience has shown that these interventions are more effective when they are delivered as an integrated package, where all types of services (whether advisory or direct market operations) are aligned to achieve a common objective and designed to support and complement each other.

Starting in 2013, the World Bank Group (WBG) has sought to strengthen its impact to help develop local bond markets through a multipronged integrated approach known as the **Deep Dive Initiative (DDI)**. Through the DDI, the WBG provides full support to EMEs as they build local currency bond markets (LCBMs) that can help address large scale financing needs in strategic sectors. Initially the DDI has focused on infrastructure and housing financing. These two sectors show large financing needs that traditional funding sources are not be able to meet. Bond markets can help to mobilize new sources of funding, particularly from institutional investors.

In this context, the DDI is effectively bringing together WBG advisory and investment expertise on capital markets development with sector expertise (such as infrastructure and housing) to ensure that capital markets interventions are aligned with the specific needs of the relevant sector (whether housing or infrastructure). Thus, countries are presented with an integrated solution to a financing need, which encompasses advisory services, products and investments that leverage and reinforce one another. The DDI is a flexible approach which can be used to address other strategic sectors, depending on the priorities of specific governments.

Advisory services

As part of the DDI, WBG advisory services in one country may include work in different areas of securities markets:

- Non-government bond markets -advice focuses on identifying and addressing key obstacles to issuing and investing in local currency non-government bonds, ranging from advice on issuance regulations and procedures to facilitate access to markets, issues that affect price formation (development of a yield curve, mechanisms to enhance liquidity, transparency requirements, development of credible credit ratings), strengthening of market infrastructure (such as trading platforms, or clearing and settlement), investment regulations for

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institutional investors, and capacity building of different stakeholders (regulators, other public authorities and market participants).

- Government bond markets –advice focuses on assisting the authorities on developing liquid government bond markets (for example through the development of a yield curve, a system of primary dealers, etc.), as an important precondition for the development of nongovernment bond markets. Work on government bond markets can be complemented and supported with advice to country authorities on the development of debt management strategies and strengthening debt management capabilities.
- Equity markets – help build equity markets to address broader aspects of capital markets and finance like infrastructure and housing and other key needs including for enterprises of various sizes.
- Non-banking financial institutions -advice can include developing housing, pensions and insurance, and investment funds, all of which are central to capital market development, as users of the market and the key agents driving capital market development.
- Corporate governance –advice can also cover strengthening the governance of regulators and institutions that make up the securities markets and related NBFIs, including issuers, exchanges, and investment banks. In addition, many infrastructure providers are state owned companies and WBG governance team can help improve their attractiveness as borrowers in local bond markets, helping them raise funds needed to provide infrastructure services.

Much of the advisory work done in one market segment--to strengthen regulations and regulators, market infrastructure, capacity building for market participants and the securities industry--overlaps with and benefits another.

Direct Market Operations

Securities market advisory services are significantly strengthened when complemented by direct market interventions like those provided by the WBG. Linking advisory services with investment operations, with appropriate conflict of interest procedures in place, is a core focus of the DDI.

As advisory services work with the authorities to remove obstacles for local bond markets development, the WBG can:

- Issue local currency bonds or provide credit enhancements to bonds issued by domestic issuers, which increases the supply of high quality paper, helps attract more local investors into the market, builds investor confidence, and increases market liquidity. Through its direct participation in the market, the WBG develops and demonstrates quality market practices like disclosure and pricing.

- Provide hedging, liquidity, and guarantee facilities which enhance comfort, increase liquidity, and encourage engagement by a wider range of market participants.
- Invest in local institutions (e.g., securities firms, rating agencies) and debt and equity funds that increase institutional capital and ability to support transactions, raise market liquidity, and demonstrate and push for needed market reforms.
- Initiate and/or invest in funds that invest in local capital markets. For example, the WBG supported the creation of a frontier equity market fund that invests in local frontier equity markets, separate but parallel to the WBG advisory work. IFC is a core investor in the fund.

In turn, all of these operations can help highlight the need for additional reforms in the legal or regulatory framework, regulatory practices or even in industry practices.

Leveraging with End Users

As mentioned, another key benefit of the DDI lies in the provision of an integrated solution to funding for a strategic sector such as infrastructure or housing financing, via capital markets. Engagement with end users is critical to ensure that the markets are providing a solution to these needs. In practice this is achieved through participation of the WBG staff directly involved in the strategic sector for which funding is sought along with the capital markets team. For example, at the start of the DDI, the infrastructure and housing teams have been the main focus, along with the securities markets advisory teams. Other sector teams would be incorporated depending on the strategic sectors defined by the country as a priority.

Participation of the sector teams brings key insights into the challenges faced by the respective sector, which is critical to providing an impactful integrated solution to the country. For example, in the context of infrastructure financing, experience shows that capital markets would not be able to solve financing needs unless they are imbedded into a robust up-stream and down-stream framework for PPPs, and with solid option of bank and even often development bank financing to ensure proper risk layering. The latter would broaden the opportunities to leverage the capital markets financing in particular in the transition from greenfield to brownfield. As a result, on the advisory side the DDI can encompass advice in connection with the development of an efficient PPP framework to support private sector involvement in infrastructure financing, and capacity building for the national infrastructure agency to ensure the development of a robust pipeline of bankable projects. On the capital markets side, the advice would in turn ensure that the issuance framework supports development of infrastructure products, and that institutional investors are allowed to invest in them. In addition, it could also encompass capacity building to existing infrastructure development banks to strengthen financing options. On the transaction side, the DDI can encompass the participation of the WBG as guarantor of specific instruments or even as an investor in a local development bank as a way to strengthen financing options and align instruments with institutional investors' appetite.

Deep Dive Approach Pilot: Colombia

The WBG is piloting the DDI in Colombia. Colombia was chosen for four reasons: (i) there were strong financial needs in infrastructure and housing that neither the government nor the banks were able to meet, (ii) it already had a sufficiently developed bond market and institutional investor presence; (iii) empowered and motivated counterparties existed, and (iv) the development of a non-government bond market program was underway.

The Colombia Deep Dive aims to create the conditions needed to mobilize institutional funds through the capital markets to finance USD 26 bn of toll roads (which is known as the G4 program). Traditional funding sources from domestic banks, the government, and multilaterals is not sufficient to provide this funding.

Delivering the DDI has involved nine units across the WBG working together on complementary elements of the program. The initiative requires a wide range of WBG products and services: advisory services, financial and financing expertise and products, and the WBG's convening capabilities. In practice it has covered:

- Advisory operations to develop local bond markets:
 - Non-government bond markets advisory services: The WBG securities markets advisory team has provided advice on a wide range of issues aimed at facilitating issuance of infrastructure bonds. Specifically, team advice included the development of a streamlined issuance regime for professional investors; advice on prudential regulations to increase banks' capacity to finance the construction phase of infrastructure projects, and to improve mutual and pension funds investment regulations. The team has also provided significant support to the national infrastructure development bank (FDN) for the design and rating of a model infrastructure project bond; applying best practices on infrastructure project bonds and different types of credit enhancement instruments. An ongoing project is supporting the FDN on capacity building for institutional investors (insurance and pension funds) to fund infrastructure through equity and debt instruments.
 - Government Bond Market Advisory Services: The WBG Treasury is working with the Ministry of Finance and Public Credit to strengthen debt management operations; while the securities markets advisory team is delivering targeted work to build a more liquid government bond market yield curve and to deepen the money market.
- IFC Transactions and Treasury: IFC has agreed on an equity investment in FDN and credit enhancement of bonds issued under the 4G program. Transactions are expected to materialize over the coming months.
- End Users: The IFC infrastructure team has been providing advice to ANI (the concession agency) on a new PPP model and standard contract for 4G concessions. Support would also be given to FDN on structuring pipeline of PPPs.



The WBG is in the process of scaling up this approach. Implementation is initially being considered for one country per region. This would allow the WBG to gain additional insight and strengthen the approach prior to its application in other areas. Cooperation from other multilateral development banks would be welcome as a means to further enhance the support provided to countries. The DDI is planned to become the “modus operandi” for WBG projects in other strategic sectors for growth and poverty alleviation (e.g. climate change, urban development and small business financing).