CENTER
FOR
GLOBAL
DEVELOPMENT

CGD NOTE 382 | OCTOBER 2024

The MDB Ships Are Turning but Not Yet on Course: Results of CGD's Updated MDB Reform Tracker

Nancy Lee and Samuel Matthews

The comprehensive reform agendas for the multilateral development banks (MDBs) constitute the most ambitious effort to overhaul these institutions since their launch at Bretton Woods 80 years ago. The ambition is driven by the urgency and scale of development and climate challenges and by the recognition that MDBs, while currently underperforming in terms of the scale of finance, are uniquely placed to address those challenges. But ambitious agendas can and often do languish, especially at a time of global fragmentation, ongoing shocks, high debt, and tight fiscal constraints. The period ahead will determine whether MDBs and their shareholders can adapt to 21st century challenges or if new institutions must be conceived and created.

For these reasons, CGD built an MDB reform tracker as an independent, objective tool for assessing reform progress. We have updated the tracker as the reform agenda has taken shape and expanded. This third version of the tracker identifies 39 separate reform agenda items, grouped under six headings: (1) efficient use of capital, (2) adding new forms of capital, (3) expanding mandates and associated shareholder capital expansion, (4) reporting on impact (new in this version), (5) transforming country engagement, and (6) achieving a major expansion in private finance mobilization. Our focus is on specific reforms for which progress can be objectively evaluated or measured, rather than on broad reform objectives or aspirations. Progress is assessed for seven of the largest MDBs. Reform progress is scored as follows: 0=reform not being pursued; 1=announced intention to reform; 2=partial reform progress; 3=reform implemented.

This external tool complements internal efforts in the institutions themselves and in the G20 to chart and report progress, such as the forthcoming G20 MDB Roadmap developed under Brazil's G20 presidency.

Findings

Figure 1 shows clearly that it's way too early to declare victory in any reform category. The shares of reforms that have been fully implemented across the seven institutions range from 5 to 64 percent. For four of the reform categories, we see more partial progress or announcements of the intention to reform than completed reforms.

Figure 1. Reform progress by category

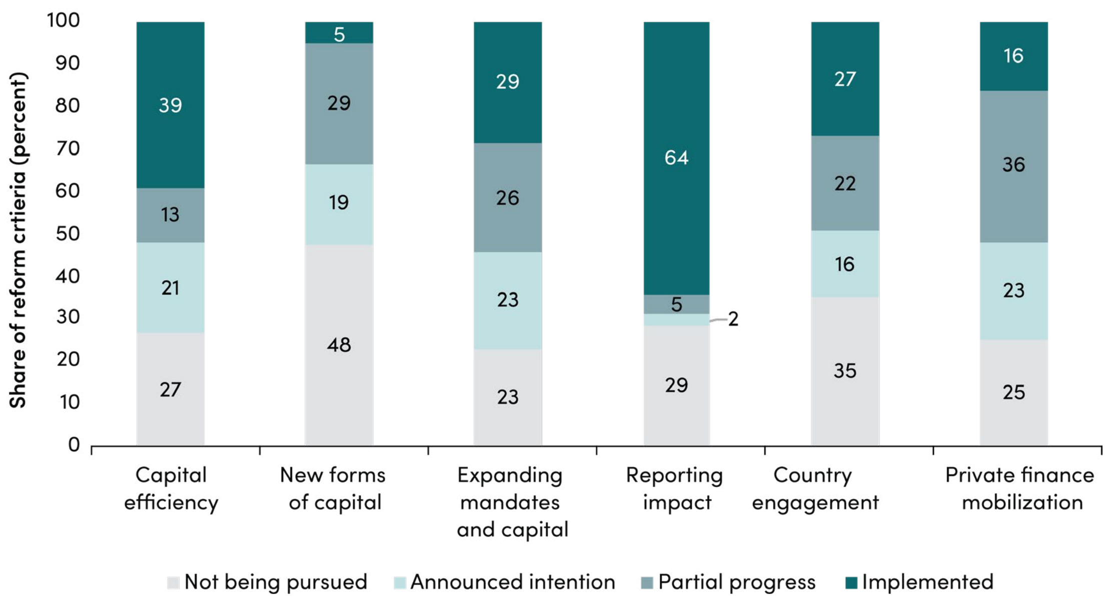
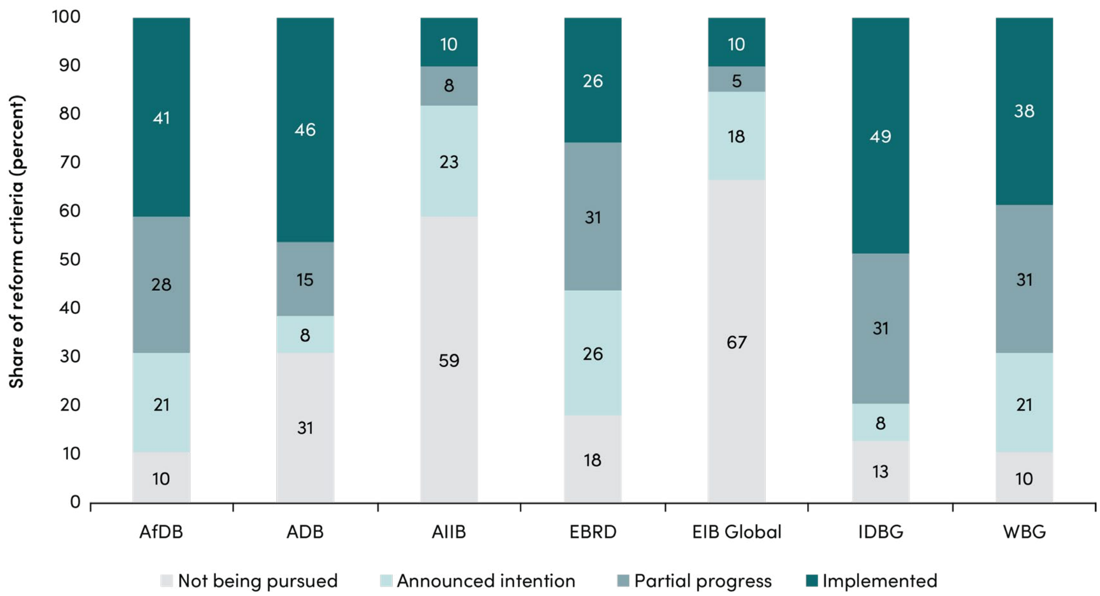


Figure 2 shows considerable variation in progress across institutions. The Inter-American Development Bank Group (IDBG) and Asian Development Bank (ADB) stand out with 46-49 percent of reforms implemented. For the African Development Bank (AfDB), European Bank for Reconstruction and Development (EBRD), and World Bank Group (WBG), an average of 35 percent of the reform agenda has been implemented.

These findings are not particularly surprising. These reforms are major changes that cannot be achieved overnight. The commitment of MDB leadership to reform varies across institutions. And reform also relies on bold action by MDB shareholders. Shareholders have been vocal in support of some reforms, such as using existing capital more efficiently. But thus far, they have not collectively made the decision that these institutions must be much larger, with significant increases in shareholder equity, to meet 21st century challenges, both country-specific and global.

Figure 2. Reform progress by institution



Key reforms

Aggregate categories hide important findings for individual reforms. Let's look at progress at a more detailed level for some of the most significant individual reforms. (Comprehensive information is available in the tracker itself.)

Leverage decisions lagging

The central finding of the capital adequacy framework (CAF) report is that MDBs can support more lending with their existing capital without endangering their credit ratings. That is, they can increase their leverage or lower their equity to loan (E/L) ratios. Giving value to callable capital subscriptions (which total nearly $900 billion across the major institutions) is at the core of this finding. Such capital can be called if an MDB is a risk of defaulting to its bondholders (which has never happened). We have seen G20-driven progress in producing analysis needed to underpin increases in leverage (e.g., clarification of institutional processes in the event of a call, and stress tests to assess the probability of a call).

But there has been much less progress in setting reduced E/L targets and actually increasing lending to conform to those reduced ratios. Three institutions have made changes in targets, but they have not reaped the potential gains of callable capital valuation. The World Bank Group just reduced its minimum E/L ratio to 18 percent from 19 percent and explicitly linked the shift to factors other than a change in its valuation of existing callable capital.

One measure of that potential lending headroom comes from a major credit rating agency. A new Fitch report estimates headroom based on a change in its own credit rating methodology that gives more value to callable capital. It finds that MDBs collectively could lend an additional $480 billion based on existing capital without jeopardizing their credit ratings.

Shareholder guarantees gaining support

We've seen more progress here. Donor governments find the notion of contributing to guarantee funds that free up MDB capital and multiply their own funds (up to six times) an attractive proposition. Three MDBs have set up sizable portfolio guarantee funds, with the European Investment Bank (EIB) Global's guarantee fund by far the largest.

Enthusiasm for hybrid capital but slow issuance

This is another CAF report recommendation with major leverage potential: hybrid capital issuances that can be multiplied 3 to 6 times in lending capacity. Four institutions are at some stage of pursuing issuances to private investors or shareholders or both. But *only one, the AfDB, has actually issued* to private investors—with strong uptake by investors. This achievement has the dual impact of adding to capital and mobilizing private Sustainable Development Goal (SDG) investment at scale. The effort to give shareholders the opportunity to use special drawing rights (SDRs) to purchase such assets has been led by the AfDB and the IDB, but so far has met resistance from central banks.

All have expanded mandates to include global challenges as well as development

This is the one reform that has been adopted by all seven institutions. All have formally integrated climate in some form in their missions. And some have incorporated global challenges more broadly—defined to include, for example, pandemic response and resilience.

Available capital and concessional finance not yet adjusted for expanded mandates

By contrast, no institution has formally undertaken the analysis needed to assess the additional finance needs associated with climate and other global challenges. Nor has any quantified the additional capital and concessional resources necessary to meet those needs.

Numerous reports, including the Independent Expert Group's report to the G20, have offered specific scenarios for filling SDG and climate finance gaps. They find that substantial increases in MDB shareholder capital and grant resources are essential, even if existing capital is used more efficiently, private finance rises significantly, and developing country governments raise a lot more revenue.

But shareholders have not taken up such analysis in capital decisions for individual institutions. Capital increases for EBRD and IDB Invest have recently been approved (and for AfDB in the form of callable capital), but global challenges were not the principal drivers. The critical negotiations this year for replenishment of the International Development Association (IDA), the World Bank's concessional window for poor countries, and for the African Development Fund next year, will reveal the extent to which donors are willing and able to add finance capacity on a scale commensurate with both development and climate needs.

One other worrisome finding concerns a fundamental building block of well-founded shareholder decisions on the adequacy of capital for different MDBs: the CAF report recommendation that MDBs should work together to develop and report standardized capital adequacy metrics so that shareholders have a common basis to judge capital constraints. This should not take a long time; nor is it different from what commercial institutions are required to do by their regulators. Yet so far, no such report has been published.

Impact reporting improving

The MDB reform agenda must focus as much on how additional finance is used as on the volume of finance. To assess effectiveness and to allocate finance based on results, stakeholders need strong measurement and regular reporting of impact. For this version of the tracker, we added basic questions about impact transparency. Do institutions regularly report ex ante (projected) and ex post (actual) development and climate impact (outputs and outcomes) at the project, country, and institutional or corporate level? Do institutions set impact targets so that shareholders/donors know the impact objectives that will be funded by additional resources?

The good news is that most institutions—five of the seven—do report impact at the project level, disaggregated where possible by gender. And four institutions systematically report country-level impact. Country-level reporting is critical to ensure that individual projects and programs are adding up to significant gains and to sectoral and systemic change.

Setting corporate impact targets, including for climate and other global challenges, is also key for assessing value for money. Three institutions—the AfDB, ADB, and WBG—set impact targets or expected output/outcome values with baselines at the corporate level. And the IDBG plans to do so as well.

Action uneven on more country-friendly engagement

A major part of the reform agenda is a set of actions that the MDBs can take to be better partners to their country clients. This encompasses making MDB processes faster and less burdensome (the "plumbing"), supporting country-owned platforms, and better aligning financial product offerings with country needs.

A sample of these reforms shows implementation by only a minority of institutions:

- Three out of seven MDBs have set and published targets for shortening processes for project development and approval.
- None report annually on their finance commitments designed to support country-owned platforms like Just Energy Transition Partnerships (JETPs).

- Only two currently deploy debt pause clauses, such as climate-resilient debt clauses, in their own loan contracts.
- Two institutions treat sovereign guarantees in country borrowing limits based on capital at risk, not nominal exposure.

Other reforms are moving forward faster. Six institutions have agreed to, or are working on, mutual recognition of procurement and environmental, social, and governance (ESG) standards that meet shared principles. And five have made progress toward streamlining access to guarantee products and toward increasing guarantees as a share of commitments. The World Bank Group, in particular, has made this a priority and has set a target for a major increase in its overall guarantee volume to $20 billion by 2030.

Not enough clarity on scale of ambition for increased MDB mobilization of private finance

No reform area is more important than boosting MDB performance in mobilizing private finance. Both borrowing and non-borrowing shareholders view this MDB role as critical for growth and job creation as well as achieving the SDGs. It is equally clear that a major change in MDB performance will only be possible with significant changes in the model for non-sovereign transactions.

Two basic bellwethers of change are: (1) whether ambitious mobilization targets are set, and (2) whether there is a conscious institutional shift to an “originate to distribute” model for non-sovereign transactions so that MDBs can transfer the risks of portfolios of performing assets off their balance sheets to the private sector. The latter holds promise for achieving the private finance mobilization at scale that has not emerged from transaction-by-transaction approaches, even deploying blended finance.

We found that two institutions set targets for private finance mobilization per dollar of their own commitments. The ADB’s target is ambitious at 2.5 dollars of mobilization per dollar of own-account commitment. The target ratio for IDB Invest is 1.7-2.0 to 1. Three other institutions are setting targets or expected values for volumes of mobilization finance: AfDB, EBRD, and the WBG. But the level of ambition is hard to judge because the own-account commitment comparator is not defined. Other institutions do not set targets, making it hard to assess their aspirations for additional private finance mobilization.

Two MDBs are explicitly pursuing an originate-to-distribute model: the AfDB has already offloaded the risk of two large portfolios in its two Room2Run transactions; and IDB Invest has a new institutional strategy, supported by a capital increase, with this as a central goal. Others, like the World Bank, have announced their intention to do so.

One other test of mobilization commitment is an institution’s willingness to make available data to help private investors correctly assess risk and risk-adjusted returns in the developing world. Using the power of their own data would help fill information gaps and help build markets. The Global

Emerging Markets (GEMs) database includes credit performance data for thousands of MDB and development finance institution (DFI) sovereign and non-sovereign transactions over decades across the developing world. Progress in expanding access to that data has been slow, but four institutions are leading the way by releasing their own probability of default and loss given default data, in some cases more disaggregated than GEMs reports: the ADB, EBRD, IDBG, and WBG.

Finding and staying on the new course

Our new tracker, like the previous versions, shows much variation across reforms and institutions. While it could be argued that reform agendas will vary by institution, we would counter that the set of reforms assessed here is widely applicable and warranted.

As we noted for the last version of the tracker, the variation in performance holds promise. Reforms that are possible for one institution should be possible for others. In fact, they can benefit from each other's experience. This record reinforces the notion that many reforms would be easier and quicker if the institutions moved forward together.

The analysis also points up the need for MDB leadership and shareholders to find means for sustaining reform progress over a broad set of actions and over the medium term. This should happen partly in the G20 as the best forum for assessing progress across institutions. At this point, it makes sense to formally empower a standing body like the IFA Working Group to track and assess progress on a well-defined, specific set of actions like those laid out in our tracker and to raise issues with performance as necessary to the G20 deputy and ministerial levels. Focus and momentum must not be lost as G20 presidencies change.

But oversight must also happen in individual institutions. Standing bodies are needed to maintain supervision of these transformational changes. Board approval of a roadmap at one point in time will not suffice. And implementation cannot simply be left to management. Shareholders need to share and drive many of the key decisions and actions.

NANCY LEE is a senior policy fellow and director for Sustainable Development Finance at the Center for Global Development.
SAMUEL MATTHEWS is a research associate at the Center for Global Development.

Suggested citation:
Nancy Lee and Samuel Matthews. 2024. "The MDB Ships Are Turning but Not Yet on Course: Results of CGD's Updated MDB Reform Tracker" CGD Note 383. Washington, DC: Center for Global Development. https://www.cgdev.org/publication/mdb-ships-are-turning-not-yet-course-results-cgds-updated-mdb-reform-tracker

CENTER FOR GLOBAL DEVELOPMENT
www.cgdev.org