

MULTILATERAL LENDING IN THE FORMER SOVIET UNION

by

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Background

There are a number of multilateral development banks ("MDB's") that are active in the countries of the former Soviet Union ("FSU");¹ however, the two most active are the International Finance Corporation ("IFC") and the European Bank for Reconstruction and Development ("EBRD"). The EBRD is active exclusively in the FSU whereas the IFC is active in developing countries world-wide. The author has been a counsel in the Office of the General Counsel of the EBRD and has acted as outside counsel to the IFC. This article is based, in part, upon that experience.

Although both the IFC and EBRD are involved in various activities to assist developing countries, this article will be limited to private sector financing, including project finance. For purposes of this article, project finance is defined as financing provided to private sector borrowers for projects where the expected repayment of the loan will come primarily from cash flow generated by the completed project.

The lending activities of the IFC and EBRD in their respective areas of operations are quite extensive, and anyone requiring project financing, or financing for the modernization or expansion of an existing project in the FSU, should consider obtaining part of the financing from the IFC or EBRD. A brief description of the IFC and EBRD follows.

The IFC

The IFC with its headquarters in Washington D.C. is part of the World Bank Group and was founded in 1956 to, *inter alia*, provide financing for private sector projects in the developing world, and it is the largest multilateral source of loan and equity financing for such projects. Its operations are world-wide with its Europe and Central Asia Region covering the FSU, but also including Turkey where an IFC field office is located.

The 177 member countries of the IFC include both developed as well as the developing countries in which the IFC operates. According to its Articles of Agreement, the IFC is to assist private investors in the establishment, improvement or expansion of private enterprises "where private capital is not available on reasonable terms"²; however, the IFC has been flexible and has financed a broad range of projects having varying degrees of risk and potential to attract private capital.

The EBRD

The EBRD has 60 member countries,³ including the countries of the FSU and many developed countries, a number of which are located outside of Europe. In that its operations

¹ Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Georgia, Estonia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Serbia and Montenegro, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

² International Finance Corporation Articles of Agreement as amended April 28, 1993 ("IFCAG"), Article I (i).

³ The European Community and European Investment Bank are also members.

are limited to the FSU, and in that a large number of the member countries of the EBRD are from outside of Europe, the EBRD's name is somewhat of a misnomer. In fact, the country making the largest share capital contribution and therefore the largest member/shareholder in the EBRD is the United States. However, the headquarters of the EBRD is located in London, and the driving force behind the creation of the EBRD was the French President Francois Mitterand. Also the European Union and the European Investment Bank are the only members of the EBRD which are not individual countries. All of which provides the EBRD with a strong European connection.

The EBRD was formed in 1990 as the FSU was in the process of dissolution, and the mission of the EBRD is "to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiatives in the central and eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics."⁴ With regard to the private sector, the EBRD is mandated to "promote, through private and other interested investors, the establishment, improvement and expansion of productive, competitive and private sector activity, in particular small and medium-size enterprises."⁵

Although the EBRD has a similar restriction to the IFC with regard to not providing financing where "the applicant is able to obtain sufficient financing or facilities elsewhere on terms and conditions that the bank considers reasonable",⁶ it is also required to "apply sound banking principals to all its operations."⁷ In any event, similar to the IFC, in practice the EBRD has provided financing to a broad range of private sector projects involving varying levels of credit risk and varying potential to attract private capital.

Preferred Creditor Status

There are a number of reasons that the IFC and EBRD are in a position to provide financing at below market rates, including that there are no dividend or other payments to the their members on the member's paid in share capital, and under the respective agreements with the host governments, their operations in Washington and London, respectively, are tax free (including tax free salaries for their employees which reduces their labor costs). In addition, in that country members of both entities are also the countries in which the EBRD and IFC operate, they have agreements with all such countries to be treated as preferred creditors, which entitles them to benefits not available to commercial lenders, such as tax free status, and no restrictions on the convertibility of local currencies related to loan repayments or the transfer of funds into or out of such countries.

Due to the special status of the IFC and EBRD, they are able to provide financing in situations that may be less attractive to commercial lenders in that the IFC and EBRD are able to lend at lower interest rates while dealing with higher levels of risk.

Project Criteria

With regard to project financing, the IFC and EBRD have in general similar project criteria which are as follows:

⁴ Agreement Establishing the European Bank for Reconstruction and Development dated 29 May 1990 ("AEEBRD").

⁵ AEEBRD Article 2(i).

⁶ AEEBRD Article 13(vii).

⁷ AEEBRD Article 13(i).

- The project must be in a member developing country.
- The project must be technically sound.
- The project must have good prospects of being profitable.
- The project must benefit the local economy.
- There must be significant equity contributions to the project from the borrower or sponsor.
- The project must be environmentally and socially sound.

Extent of IFC and EBRD Participation

IFC – In general, the IFC limits the amount of debt and equity financing that it will provide for any project. For new projects it will provide a maximum of 25% of the estimated project cost (possibly 35% for small projects). For expansion project, the IFC may provide up to 50% of the project cost, provided that such amount does not exceed 25% of the amount of the capitalization of the project company.

EBRD – In general for new projects, the EBRD funds up to 35% of the total project cost, and with regard to established companies 35% for expansion projects. In addition, typically the EBRD requires at least a one third equity investment by investors. Appropriate in-kind equity contributions are acceptable.

The Investment Proposal

The investment proposal to be submitted to the IFC or EBRD should provide a general overview of the project, including plant and equipment, costs and financing, marketing and environmental issues and should include the following:

- A general description of the project.
- Backgrounds and business experience of the investors and management and arrangements for third party expertise if necessary for the project.
- Production and sales, including production volumes, projected prices, marketing program, potential markets and competitors.
- Plant and manufacturing process, including manpower, sources of raw material, production and sales costs, proposed plant size and location, and potential environmental issues and solutions.
- Project costs, including a breakdown of total project costs, proposed equity investment, financing package and type of financing being applied for (loan, equity or combination thereof), and projected financial information regarding profitability and return on investment.
- Timetable, including time to completion (commencement of commercial production), and a breakdown with regard to time to completion of the various stages, i.e., project

preparation, commencement of construction, testing and commencement of commercial production.

The IFC and EBRD review and approval process

The IFC and EBRD have similar procedures for the review and approval of project finance proposals, and the basic stages are as follows:

- The applicant submits the application for financing containing the investment proposal, and upon preliminary review additional information may be requested such as a feasibility study or business plan.
- If the IFC or EBRD is interested in proceeding, a team will be set up usually consisting of a senior investment officer, junior investment officer, lawyer, and possibly an area or industry specialist.
- The team will meet with the project sponsors, visit the site and evaluate the technical, financial and economic aspects of the project.
- The team will submit its recommendation to its headquarters for preliminary and then final approval.
- The applicant may be required to provide additional information during the review process.
- After final approval at the management level, and prior to going to the board of directors for final approval, the legal department, usually with the assistance of outside counsel, will prepare the appropriate financing documentation.
- The applicant and its attorney will review the documentation and after agreeing with the IFC or EBRD regarding any revisions, the documentation will be finalized.
- The project will then be submitted to the IFC's or EBRD's board of directors for approval.
- After approval by the board of directors, the financing documentation will be executed by the IFC or EBRD and the applicant.
- Funds will then be disbursed in accordance with the financing documentation.
- Starting with the disbursement of funds, the IFC or EBRD will monitor the investment by consulting with management, visiting the site, reviewing quarterly progress reports and period financial reports.
- Once the loan has been repaid in full and the IFC or EBRD sells its equity stake, if any, the IFC or EBRD will consider its financing of the project to be closed.

Conclusion

Both the IFC and EBRD are very active in locating suitable projects for financing in order to fulfill their missions as set forth in their formation documents, and they have a good

deal of flexibility in structuring loans on terms and conditions that might not be available from a commercial lender. Therefore, a potential investor interested in investing in the countries of the FSU, or improving or expanding an existing project, would be well advised to consider possible partial financing by the IFC or EBRD when it is structuring its project financing package.