How to Maximize IFC’s Development Impact, Play a Catalytic Role, and Strengthen Collaboration with Other Institutions: The Joint IFI Action Plan for Central and Eastern Europe

How can IFC support its clients when their financing needs are much greater than what we can deliver? How can IFC maximize its development impact and play a catalytic role? How do you bring together large international financial institutions (IFIs) to provide €24.5 billion in financial resources to help a region weather a severe crisis? How do you assess market conditions and deploy these resources rapidly? This SmartLesson aims to answer these questions and, more importantly, provide a step-by-step approach so that IFC can replicate such efforts in the future.

Background

Excessive credit growth, large current account deficits, and external financing needs made the Europe and Central Asia (ECA) region particularly vulnerable to the global financial crisis in late 2008. During the crisis, some countries in the region went through sharp declines in stock markets, currency depreciations, and increases in sovereign credit default swap (CDS) spreads to near-default levels. Additionally, the crisis led to significant increases in small and medium enterprise (SME) and corporate bankruptcies and skyrocketing nonperforming loans in banks’ balance sheets.

The direct impact of the crisis on ECA’s financial sector was extensive. With liquidity shortages in both local and foreign currencies, banks faced capital constraints, higher costs of funding, heightened risk aversion, increased competition for deposits, and a stressed and limited interbank market.

The crisis could have threatened the economic and social fabric of the region. In this situation, if banks had started to trim their balance sheets, lending to the real economy, particularly to SMEs, would have been significantly reduced. The consequent reduced SME access to finance could have resulted in even more bankruptcies, with major social and political impacts.

During normal times, IFC manages to supplement its own investments with additional mobilization from the market. However, under market conditions at that time, mobilization using traditional methods was next to impossible; and market needs were much greater than IFC could deliver. There was, therefore, a need and an opportunity to strengthen cooperation among the largest IFIs investing and lending in ECA with the aim of fostering economic stability and ensuring continued support to the banking sector.

IFC played a key catalytic role in the Joint IFI Action Plan for Central and Eastern Europe, an unprecedented crisis response initiative launched by EBRD, the EIB Group, and the World Bank Group (IBRD, MIGA, and IFC) via a communiqué in February 2009. Collectively, these IFIs pledged to provide up to €24.5 billion in 2009 and 2010 to support the banking sector’s lending to the real economy.

1 Includes Central and Eastern Europe and Southern Europe and Central Asia.

2 Detailed information on the Joint IFI Action Plan for Central and Eastern Europe can be found at http://www.ifc.org/ifcext/about.nsf/Content/FinancialCrisis/Europe

3 European Bank for Reconstruction and Development.
4 European Investment Bank and European Investment Fund.
in this region. IFC pledged to provide up to €2 billion, intervening mainly through its crisis response initiatives, in order to complement its traditional financial markets investment and advisory services in the region.

As of the end of December 2009, the IFIs had committed €19 billion under the Joint IFI initiative and are largely on track to meet their pledge. As of the end of March 2010, IFC had committed approximately $1.4 billion under the initiative and has a pipeline of approximately $1.6 billion.

**Lessons Learned**

1) **Do your homework to build credibility and firm up your catalytic role.**

Before IFC contacted other IFIs, we did our homework to understand the market and to firm up IFC’s credibility and catalytic role with other IFIs. Western European banks play a key role in the financial sectors in ECA countries and have contributed to the private-sector development which this region enjoyed over the past decade. Banks, mainly from Austria, Belgium, France, Greece, Italy, and Sweden, have substantially increased their exposure to the region since the 1990s.

IFC analyzed 22 Western European (parent) banks that had more than 130 subsidiaries in the ECA region and came up with the following main findings: (i) ECA subsidiaries of a group of Western European parent banks have combined total assets of $920 billion; (ii) aggregate total assets of ECA subsidiaries

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**Box 1: What People are Saying About the IFI Joint Action Plan**

“A group of multilateral lenders on Friday [February 27, 2009] unveiled a lending package of up to €24.5bn ($31bn) to help central and eastern Europe’s battered banking systems weather the financial crisis. The Hungarian forint, Polish zloty and the Czech koruna gained against the euro after news of the package.”

— Financial Times, February 27, 2009

“Today’s announcement by the EBRD, EIB, and World Bank [Group] of a two-year €24.5bn package of support for banks in the region is a very important step in the right direction, in our view. It correctly identifies the financial sector as the epicenter of the current deleveraging process in much of the region.”

— Goldman Sachs, February 27, 2009

“A defining feature of IFC’s response [to the crisis] is based around partnerships with other DFIs [development financial institutions]. While cooperation has been more extensive than in past crises, there is considerable regional variation. Collaboration has been far more extensive in ECA than in other regions. At the initial epicenter of the crisis in the developing world, such collaboration (which IFC facilitated) sent an important signal to the market that IFIs collectively would take unprecedented joint action to avoid a systemic banking collapse.”

— Independent Evaluation Group (IEG) report sent to CODE,* November 2009

* Committee of Development Effectiveness of the World Bank Group Board of Executive Directors, whose mandate is to monitor and assess the Bank Group’s effectiveness in fulfilling its development mandate.
represented, on average, 20 percent of the total assets of these Western European banking groups; and (iii) in most ECA countries, the estimated loan market share of branches and subsidiaries of a group of Western European banks exceeded 50 percent, while in some countries it went beyond 90 percent of the total banking system (see Figures 1 and 2).

This analysis was central to the development of the Joint IFI Action Plan. It indicated that IFC would be able to reach the largest banks in the ECA region by focusing on a number of parent banks, thus enabling IFC to use its resources more efficiently and effectively. In addition, as illustrated in the lessons below, this analysis enabled IFC to define its engagement strategy, bring on board other IFIs and stakeholders, and rapidly assess market needs and process our investments.

2) Compare apples to apples.

In highly volatile markets and in financial crises, it is particularly important to differentiate and identify which countries are hit the hardest. Although all countries in the ECA region faced the challenge of the global financial crisis, it is extremely important to recognize that these countries differed significantly in terms of their financial vulnerability, their need for support, and their status with regard to European Union (EU) membership. We worked in close collaboration with our Financial Markets colleagues responsible for the ECA region, as well as the Corporate Strategy Department, to share market views and forecasts.

In addition, Western European banks with operations in the ECA region were very different from each other in terms of financial capacity and absolute and relative exposure to the ECA region. (Some banks have a large absolute exposure to the region, but their ECA exposure was fairly small relative to the entire banking group.) (See Figure 3 on the next page).

These efforts proved extremely useful in assessing market conditions, identifying opportunities for development impact by catalyzing substantial financing to avert a banking sector collapse in the ECA region, and, ultimately, in defining IFC’s role under the Joint IFI Action Plan.

3) Define IFC’s key additionality and build consensus.

Crisis situations require leadership and vision. Given market needs and IFC’s limited capacity to resolve a systemic banking sector crisis at the regional level, it was clear that IFC was not in a position to support every parent bank in every single ECA country.

Discussions with senior management and staff revealed that IFC should play a strong coordination and catalytic role in this initiative. In addition, it was determined from the outset that European institutions should drive a European initiative, while the World Bank Group (WBG) would take a supporting role, bringing added value in terms of global knowledge, expertise, product range, field presence, and capacity.

Figure 2: Aggregate Market Share of ECA Subsidiaries of Western European Banks (in % as of December 2007)

Sources: Bankscope and IMF
Note: Ranked from highest to lowest in cumulative market share for Group 1 & 2 banks.
One of the defining aspects of the initiative is that, even though IFC played the key catalytic role in launching the initiative, EIB and EBRD were expected to play major roles in terms of financing capacity. Unlike EBRD and EIB, which have a clearer regional mandate, IFC does not have the capacity to invest at the same levels, given IFC’s need to balance its regional commitments globally. IFC retained its core strategy, which is to focus on equity and quasi-equity opportunities and expansion of short-term trade opportunities to replace commercial trade lines. In addition, IFC is focusing on countries and areas with more difficult environments, including Ukraine, Russia, the Caucasus, and Central Asia.

With the engagement strategy defined, IFC sought to build consensus with other IFIs on the need for coordinated action. IFC senior management and staff held a number of meetings and discussions with other World Bank Group institutions, EIB, EBRD, the European Commission, and other stakeholders. During these exchanges, IFC shared its analysis and sought to establish a common understanding on the best way to achieve greater development impact through strengthened IFI collaboration. These efforts, along with the deteriorating economic conditions in a number of ECA countries, led to WBG President Robert Zoellick’s involvement and his suggestion to issue a communiqué with EBRD and EIB.

By presenting the conclusions and results of this research, we were able to make the case with our IFI and WBG counterparts that a large joint initiative was needed to tackle the issue. We were also able to bring together both the IFIs that addressed the issue through financing as well as institutions such as the European Commission and the International Monetary Fund (IMF) that were tackling it through the government side.

We found that staff empowerment with strong senior management support was critical to engage with other stakeholders and build consensus. In addition, it was valuable to involve at an early stage the respective IFC relationship managers for these IFIs, who were able to provide important input on the relationship and mandates (countries, product range, etc.) of each IFI.

4) Create innovative coordination mechanisms to engage other stakeholders.

The Joint IFI Action Plan aimed at using IFI financing as a catalyst by engaging other stakeholders and mobilizing financial resources to the region. This includes collaboration not only with banking groups but also among IFIs, home–host country authorities, and other stakeholders.

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*Sources: Bankscope and Bloomberg
Note: CDS data as of March 31, 2009. Assets data include total assets by majority-owned subsidiaries or branches operating in ECA countries as of Dec 31, 2007. % total assets indicates the percentage of total ECA subsidiaries assets relative to the parent (group level) total assets.*
IFIs had a coordinated business development approach with banks. IFIs sent a joint letter to banks (signed by all three IFIs) explaining the initiative and outlining a standard agenda for the meetings. Banks were extremely receptive to discussing the business plans and the financing needs for their ECA subsidiaries with the largest IFIs operating in the region. Beyond joint needs assessments, we had a case in which we increased our shared operational work, such as joint due diligence.

From March through May 2009, the IFIs met 17 banking groups with subsidiaries in the ECA region. The resulting joint analysis and needs assessment guided the IFIs’ operational work according to each institution’s mandate as well as geographical and product remit.

Strengthened IFI collaboration includes sharing information and building relationships. IFIs shared information (e.g., market analysis, economic forecasts, and committed and pipeline investments with banks), so we used our time efficiently and effectively. The IFIs and banks saved a significant amount of time through the joint discussions on parent banks’ business plans for their ECA subsidiaries. The competitive nature of this joint consultation process allowed IFIs to efficiently and quickly collect information from banks, while at the same time increasing the understanding among IFIs on their complementarities in terms of products and regional activities.

IFI sought to complement their financing with efforts to coordinate national support packages and policy dialogue among key stakeholders in the region, in close collaboration with the IMF, the European Commission, and other key European institutions (financial institutions, home and host country regulators, central banks, and others). This coordination, known as the European Bank Coordination initiative (informally known as the Vienna initiative), is a novel public-private platform for coordination in the field of policy dialogue and crisis management and has leveraged incentives for European integration both at the macro-political and micro-business level.

**Conclusion**

The Joint IFI Action Plan for Central and Eastern Europe is an unprecedented initiative that can be easily replicated. The disciplined approach followed for the development and implementation of the Joint IFI Action Plan provided strong efficiency gains so that IFC staff could focus on development impact. This includes coordinating responses by individual IFIs, catalyzing action and investment from other stakeholders, and providing targeted support to the sectors and countries most affected during a systemic crisis.

The WBG fosters collaboration between its institutions to increase development impact, and the Joint IFI Action Plan also led to strengthened collaboration within the WBG, mainly between IFC and MIGA. MIGA went to the board in March 2009 specifically to present its programmatic approach under the initiative. In addition, the IFC/MIGA joint team received a MIGA Executive Vice President award in recognition of outstanding teamwork in this initiative. These efforts led to a new working relationship between IFC and MIGA, allowing IFC to cross-sell MIGA’s products and present a broader range of products to its clients.

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6 Collectively, these banks control more than 50 percent of the local banking sector in 11 ECA countries.