



DEVELOPMENT COMMITTEE  
(Joint Ministerial Committee  
of the  
Boards of Governors of the Bank and the Fund  
on the  
Transfer of Real Resources to Developing Countries)

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**PROGRESS REPORT TO GOVERNORS ON SHAREHOLDING**

Attached is a final version of the document entitled “Progress Report to Governors on Shareholding” prepared by the World Bank Group for the October 14, 2017 Development Committee Meeting.



# **Shareholding Review: Progress Report to Governors at the Annual Meetings 2017**

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## **Introduction**

1. This report updates Governors on progress with shareholding discussions since the last report submitted to the Spring Meetings earlier this year<sup>1</sup>. The 2015 Shareholding Review Report to Governors<sup>2</sup> defined a Roadmap to Implementation of the Review ('the Roadmap') that was endorsed by Governors at the 2015 Annual Meetings in Lima. The Roadmap set out proposed work streams to prepare the ground for decisions on Selective and General Capital Increases<sup>3</sup> for both IBRD and IFC by the 2017 Annual Meetings.

2. While the focus of this report is the work that has been carried out on Selective Capital Increases to rebalance shareholding, the linkage with the parallel work on the financial needs of the World Bank Group is important and should be underlined at the outset. It remains the intention, as was the case in the Roadmap, to ask Governors to take a set of decisions on strengthening the capital positions of IBRD and IFC including possible selective and general capital increases in IBRD and IFC as a package to be agreed together. Building consensus on such a comprehensive and ambitious set of capital and shareholding decisions is a complex and challenging exercise. It has become clear that, notwithstanding the progress that has been made, including agreement on the Dynamic Formula and the Forward Look, it will take further time to complete the work than was envisaged when the Roadmap was agreed two years ago. This includes the time needed to complete more analysis, including for example an independent review of capital adequacy. The next opportunity to report to Governors with proposals for consideration will be at the Spring Meetings of 2018.

3. On the shareholding discussion, while there are differences to resolve, views have converged on some elements of the potential package as noted in this progress report. As reported to the Spring Meetings, on the basis of the technical work described in this report there is scope for potential Selective Capital Increases. Nevertheless, more work remains to be done in order to reach an agreement and this work will proceed on the basis that nothing is agreed until everything is agreed. Completing the 2015 Shareholding Review remains an urgent task and a timeline of work leading up to the Spring Meetings has been developed.

## **Context**

4. In 2010 Governors agreed a set of reforms that enhanced the voice and participation of Developing and Transition Countries (DTC) in the World Bank Group, notably through an increase in voting power, and realigned shareholding in line with economic weight and

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<sup>1</sup> "Shareholding Review: Progress Report to Governors at the 2017 Spring Meetings", March 24 2017, DC2017-0003

<sup>2</sup> "2015 Shareholding Review Report to Governors", September 28, 2015, DC 2015-0007.

<sup>3</sup> A General Capital Increase allocates shares to all members in proportion to their current shareholding and so does not change the distribution of shareholding or voting power. A Selective Capital Increase allocates shares selectively with the aim of adjusting the distribution of shareholding and voting power.

development contributions. Building on the steps taken in 2010, the 2015 Shareholding Review identified shareholding review principles that Governors endorsed at the Lima Annual Meetings:

- (a) Regular shareholding reviews will take place every 5 years based on agreed principles and a dynamic formula.*
- (b) The guiding principle for shareholding realignments is to achieve an equitable balance of voting power. This can be assessed by looking at the balance of voting power between country groups and/or under-representation country-by-country<sup>4</sup>.*
- (c) As a global cooperative, all voices are important. Where possible decision making is by consensus. All members have Basic Votes, protected in the constituent documents of the respective WBG entities.*
- (d) The smallest poor member countries shall be protected from dilution of their voting power.*
- (e) Shareholding brings both rights and responsibilities, and all shareholders have an interest in the long term financial sustainability of the WBG, including IBRD and IFC's AAA credit rating, contributing in line with their capacity to do so.*

5. Governors further endorsed additional formula guidance that was reflected in the work on the IBRD Dynamic Formula in 2016, specifically:

- (a) The formula should reflect and be consistent with the roles and responsibilities of shareholders in the WBG.*
- (b) The formula should be simple and transparent, producing results that can be readily understood and that are broadly acceptable to the membership.*
- (c) It should be based on readily available, timely and high quality data, and should capture broad economic trends avoiding excessive volatility.*
- (d) It will be based primarily on economic weight and the WBG's development mission, including measures of GDP and IDA contributions. Other variables that are consistent with this guidance may be considered.*
- (e) Shareholding Reviews will base their work on the output of the formula which will give clear guidance for adjustments in shareholding.*

6. In completing their work on the Dynamic Formula in Fall 2016, subsequently endorsed by Governors, Executive Directors recommended that it include two variables: a measure of Economic Weight with a weight of 80 per cent and a measure of contributions to IDA with a weight of 20 per cent. Economic Weight is measured by a five-year average of GDP, using a blend of Market Exchange Rates (60 per cent) and Purchasing Power Parity (40 per cent). IDA contributions are measured by a variable that combines the most recent three IDA replenishments with a weight of 80 per cent and earlier replenishments with a weight of 20 per cent. Donors contributing to IDA for the first time are provided with a booster to ensure that their contribution

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<sup>4</sup> The 2015 Shareholding Review Report to Governors noted that “there are different interpretations of equitable voting power, in particular whether to give priority to a fair balance of voting power country by country or between groups of countries” (DC 2015-0007 paragraph 40).

receives the full weight of the recent component of the IDA variable. A compression factor of 0.95 is applied to the overall formula results. As previously reported to Governors, the formula is intended as an important input for a realignment, not as the final outcome for such realignment.

7. Executive Directors further identified a package of commitments for the next stage of discussions that was submitted to Governors at the 2016 Annual Meetings:

- (a) A continued commitment to sustain the steps taken so far in voice reform and to the agreed shareholding review principles endorsed by Governors in Lima, aiming to build on (and not to reverse) the steps towards equitable shareholding over time.*
- (b) A commitment to use the dynamic formula, as described in this paper, to deliver voice reform in manageable steps with broad support from the membership. In order to balance the distribution of calculated shareholding between the smallest and largest economies we recommend using a 0.95 compression factor.*
- (c) A commitment to focus on rebalancing shareholding in the next phase of the Roadmap and not to discuss changes to the Board size, structure or regional composition.*
- (d) A commitment to the objective of producing a balanced outcome in the upcoming SCI that addresses under-representation of individual countries while avoiding excessive dilution. The formula will be used along with transparent share allocation rules which will be explored, including limits on dilution.*
- (e) A commitment to discuss the options in the next stage for a principles-based approach to forbearance in order to smooth shifts in shareholding in the collective interest of achieving a broadly supported outcome in terms of voting power.*
- (f) A commitment to explore a range of options including an increase in Basic Votes and additional share allocations to the smallest poor members as part of the upcoming SCI to ensure meaningful representation for all shareholders.*

8. The subsequent discussions of rebalancing shareholding have built on these three pillars which provide both context and guidance: the agreement on the Dynamic Formula and accompanying package of commitments; and the previously agreed shareholding review principles and formula guidance.

### **Technical preparations**

9. Since the 2017 Spring Meetings the shareholding database has been updated to include GDP data as of April 2017 and the pledges to IDA18. In addition, post 2010 shareholding data has been updated to reflect the final outcome of the 2010 Selective Capital Increase which was completed in March 2017. A revised Shareholding Simulation Model (SSM) based on this database was made available to Executive Directors and their staff along with the updated

underlying data. A parallel model to prepare illustrative simulations of a Selective Capital Increase for IFC, reflecting IFC's Membership and shareholding, was also developed. The discussions have so far focused on illustrative simulations of different options based on these models.

## Progress in Discussions

### (i) IBRD

10. One of the key issues for decision is the size of the SCI for IBRD. COGAM<sup>5</sup> has discussed illustrative simulations ranging from 200,000 shares through to 700,000 shares. With a larger allocation of shares, a significant adjustment of shareholding and voting power can be accomplished with greater use of a formula-based allocation as described in paragraph 11(a) and less use of other allocation rules. Conversely, with a smaller allocation of shares, a similar adjustment of shareholding and voting power calls for more use of allocations targeted at the under-represented. On the basis of discussions so far an allocation of 300,000 shares has emerged as a baseline for illustrative simulations of options, with some preferring to focus on a range of 200,000 to 300,000 shares and others viewing 300,000 shares as the minimum allocation necessary to generate sufficient adjustment and to support the Forward Look objectives.

11. Four potential allocation rules have been considered:

**(a) *An allocation in line with the formula.*** Each shareholder is allocated the proportion of the total shares issued equal to its calculated shareholding from the Dynamic Formula. An allocation in line with the formula moves shareholders incrementally from their current shareholding towards their calculated shareholding. Use of this allocation rule, for any given size of SCI, is likely to provide the smoothest adjustment as all countries receive an allocation in proportion to calculated shareholding. Under this rule, although each country would be allocated new shares, their relative shareholding would go up or down depending on the allocations to other countries.

**(b) *An allocation to under-represented.*** An allocation of shares only to countries that are under-represented relative to calculated shareholding, or a subset of them defined by setting a threshold. Such an allocation does not require subscription to shares by countries that are over-represented relative to calculated shareholding, although as a result they do not benefit from the smoothing effect of an allocation to all in line with the formula. A variation of this rule can add a "floor" under the shareholding of some under-represented countries that may move further away from calculated shareholding as a result of the rule.

**(c) *An equal allocation to all countries.*** An equal allocation to all countries is independent of whether countries are under- or over-represented and so does not adjust shareholding towards the formula calculations, as the same number of shares would be allocated to all. Rather, the distributional impact is similar to that of an increase in Basic Votes, tending to increase the shareholding of smaller countries relative to large countries.

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<sup>5</sup> Committee on Governance and Administrative Matters

(d) A “*Special Allocation*”. A special allocation could use some shares for a specific purpose not achieved by the main allocation rules. Illustrative simulations have been presented showing two options for using a Special Allocation: to adjust for cases of under-representation; and to offset dilution.

12. The illustrative simulations prepared since the Spring Meetings have helped develop the discussion of the impact of different allocation rules, as well as the tradeoffs involved in using them individually or in combination. There appears to be a convergence of views in favor of an allocation based largely on the Dynamic Formula. In such a scenario, the remainder of the allocation is likely to consist of an allocation to under-represented countries, either to all under-represented countries or to a subset of them or as a special allocation to the most under-represented. Unallocated shares could contribute to the outcome and this will be discussed further.

13. As noted in the introduction the agreement on the Dynamic Formula included a commitment to “...a balanced outcome in the upcoming SCI that addresses under-representation of individual countries while avoiding excessive dilution. The formula will be used along with transparent share allocation rules which will be explored, including limits on dilution.” The Shareholding Simulation Model applies limits on dilution of over-represented shareholders at the level of voting power. Where a limit is set, no shareholder’s voting power can fall below the limit. Members are allocated shares to prevent their dilution beyond the limit, and these shares are no longer available to reduce the under-representation of others. In other words, a limit on dilution constrains the potential upwards adjustment of under-represented shareholders.

14. In 2010, no specific limit on dilution was set. The highest dilution of a single shareholder was 12.4 per cent and 27 countries in total were diluted by more than 10 per cent. In the current review, there is an emerging view that a 10 per cent limit on the dilution of any country balances the aims of protecting individual countries and allowing adjustment for under-represented, although some chairs prefer to focus on a range of 5 to 10 per cent.

15. There is a long-standing commitment by Governors to protect the voting power of the smallest poor member countries from dilution (Smallest Poor Protection). While the automatic upward adjustment of Basic Votes under the Articles of Agreement provides significant protection from dilution of voting power, it may need to be supplemented by some additional share allocation to the smallest poor countries in order to protect their voting power fully. Discussion has focused on the definition of the countries to be protected and there is broad though not universal support for using the 2010 definition based on the World Development Indicators (WDI) classification of countries by income group, with two groups eligible for protection: *Low income countries* and *Lower middle income countries* with less than 0.4 percent IBRD shareholding.

16. Basic Votes were established at the inception of the IBRD to ensure adequate and fair representation of smaller members of the institution. Basic Votes are set in the Articles<sup>6</sup> as 5.55 per cent of total votes and distributed equally to all members. This means that a subscription increase of any member will automatically lead to a change in the number of Basic Votes for all members, in order to maintain total Basic Votes at 5.55 per cent of total votes.

17. An increase in Basic Votes as a percentage of total votes would reduce the need for additional share allocations for Smallest Poor Protection, although it would require an Amendment

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<sup>6</sup> IBRD Articles of Agreement, Article V, Section 3 (a)(i).

of the Articles of Agreement. While the option remains open, there does not appear to be sufficient interest at this stage of discussions to recommend an Articles amendment.

18. COGAM has discussed approaches to forbearance, including both voluntary forbearance on a country by country basis and the option of principles-based forbearance, an approach under which the allocation rules would assume forbearance by countries based on agreed principles. This discussion established that forbearance based on principles is technically feasible although forbearance is generally thought to be a voluntary choice to be made by individual countries and other adjustments, including compression in the Dynamic Formula, serve the same purpose. It is intended to set the issue aside for now and come back to it at the end of the exercise if there is sufficient support to consider it again.

(ii) IFC

19. Historically, IFC shareholding has been linked to IBRD shareholding, reflecting their roles within the World Bank Group. Initial subscriptions were set in relation to IBRD shareholding in 1956 and for new IFC members subsequently. Over time, however, the distribution has diverged to some extent as capital increases have taken place at different times, members have joined at different times and IFC has issued additional shares that Members have been able to subscribe to. In other words, the link between the shareholding of the two institutions has been interpreted flexibly over time and shareholders have understood and accepted this.

20. In IFC (as in IBRD) voting power consists of Basic Votes (set at 5.55 per cent of total voting power) and Share Votes (one vote per share held). The value of each IFC share is \$1,000 and (in contrast with IBRD) shares are fully paid in. A majority of 80 per cent of the voting power is required to approve a capital increase for IFC (Article II Section 2(c)).

21. COGAM has held two discussions of IFC shareholding since the Spring Meetings with a particular focus on the different approaches to a potential Selective Capital Increase. Two broad options have been identified. One option would be to follow the approach taken in 2010 using consultations of countries on their interest in increasing their IFC shareholding, consistent with the overall aims of the exercise. A second option would be to pursue a rules-based allocation, applying share allocation rules to an agreed measure of under and over-representation. This would be on the lines of the approach currently being taken for IBRD where the Dynamic Formula agreed in 2016 provides a measure of over- and under-representation and informs the various potential allocation rules. However, there is not currently an equivalent formula for IFC. COGAM has considered the options of using actual and/or calculated IBRD shareholding as baselines for the exercise.

22. The discussion has established that there is support for the principle that IFC shareholding should be broadly aligned with IBRD, consistent with a one World Bank Group approach, although there is also interest in considering further how the distinct mandate of IFC with its focus on the role of the private sector in development should be reflected in shareholding principles. There is also flexibility on the pace of any convergence between the institutions' shareholding. There is a preference for transparent rules-based allocations of shares, but there is also a readiness to make use of a consultative approach provided it is also transparent and consistent with shareholding principles.

23. An informal consultation of shareholders on their interest in realigning shareholding in IFC within this overall framework is intended to inform next steps in this process.

## Conclusions

24. The shareholding discussions in IBRD and IFC have advanced with some convergence of views on certain topics as discussed in this report. Discussions have continued to reflect the collaborative spirit that has characterized the implementation of the Roadmap and have developed and refined the options for a Selective Capital Increase in line with agreed principles and commitments that meets the declared objective of “*a balanced outcome in the upcoming SCI that addresses under-representation of individual countries while avoiding excessive dilution.*” Nevertheless, as described in the introduction, further work, analysis, and discussion on the wider capital package is necessary before a comprehensive set of proposals, as envisaged in the Lima agreement, can be put to Governors for decision.

25. Executive Directors will continue their discussions on shareholding with a view to reaching agreement on a balanced set of proposals as part of this wider package. As noted at the outset, the elements of the shareholding package to be agreed, including the size of the potential SCI and the allocation rules are connected and will need to be settled together. Nothing is agreed until everything is agreed. We remain committed to the necessary work to bring discussions to a successful conclusion. We have a timeline of COGAM engagements that provides for further consideration of options and potential agreement on shareholding by Spring 2018. We invite Governors to take note of progress and endorse the continuing work.