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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September 21, 1999

ENHANCING IBRD'S FINANCIAL CAPACITY: NOTE TO THE DEVELOPMENT COMMITTEE

Attached for the September 27, 1999 meeting of the Development Committee is a background note on Enhancing IBRD's Financial Capacity: Note to the Development Committee for consideration under item 1.B of the Revised Provisional Agenda.

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Enhancing IBRD's Financial Capacity:
Note to the Development Committee

Over the past two to three years, Management and Executive Directors have devoted significant time and effort to discussions about the financial structure and income dynamics of the IBRD. When these discussions began in FY97, the concern was one of the long-term structural sustainability of the Bank's finances from a steady business as usual perspective. While there was a secular decline in the Bank's net income because of the run-off of old high priced loans, the demands on this income were growing due to the need to add to reserves and commitments by the Bank to development initiatives such as the HIPC and IDA. At the end of FY98, the Executive Directors took several actions to put in place a more resilient financial plan for the institution. These included revising the pricing structure of Bank loans, and additional interim measures such as reducing the waivers on loan charges that helped meet the near term demands on income arising from the need to sustain the financial capacity of the Bank.

In the midst of these discussions, a financial crisis erupted in East Asia and spread to the rest of the developing world. The demand for Bank loans surged, and the Bank responded. The global financial crisis also contributed to a sharp deterioration in the credit quality of the Bank's loan portfolio. The lending increase and the deterioration in the quality of the Bank's loan portfolio exerted pressures on the Bank's risk bearing capacity. Last year it became evident that the financial crisis was not going to subside quickly and would continue to impose strains on the Bank's financial capacity for some more time. Bank Management decided to take another look at its financial capacity and began this exercise by commissioning an external panel of experts to review the methodology for determining capital adequacy. The panel endorsed the capital adequacy tests used by the Bank, but cautioned that the Bank may be approaching the limits of its risk bearing capacity. It was in this context, that the Development Committee at its last meeting in April 1999, asked the Executive Directors to develop a set of long-term options to enhance the Bank's financial capacity.

The paper "Options for Enhancing IBRD's Financial Capacity" is a comprehensive document that was discussed by the Executive Directors on September 9, 1999. It reaffirms the conclusions of the paper, "Allocation of FY99 Net Income, Transfers from Surplus, and Waivers of Loan Charges for FY00", that the Bank meets its capital adequacy test and evaluates the implications of the various alternatives for enhancing the Bank's financial capacity for the different stakeholders in the institution. The Board in its deliberations concluded that the current capital structure of the Bank although sound placed limits on the Bank's capacity to respond to future demands, in terms of lending and transfers, especially when there was a deterioration in the external global environment. The Executive Directors also requested Management for a fuller elaboration of options and their implications.

Before proceeding further, the onus is on shareholders to decide how the Bank should operate in the context of the new international financial architecture and the global development targets. Management and Executive Directors have already had some discussions on a range of issues such as selectivity in lending, volume of lending net of repayments, concentration limits and the importance of net income transfers. More discussions are planned in the near term on the role of the Bank in the wake of a financial crisis (that affects many IBRD borrowers) and in poverty alleviation. The future finances of the Bank should reflect these discussions so that the Bank's financial capacity is consistent with operational requirements. Deciding on how the Bank should operate will help answer two questions that are related to any enhancement of financial capacity, viz., when the financial capacity of the Bank might be enhanced, and by how much. Of course, future trends in the external environment that are exogenous to the Bank, most notably the increasing globalization of markets and volatility of private debt flows, also have an important bearing on the timing of any enhancement in the financial capacity of the Bank.

As the Bank may be approaching the limit of its financial capacity, prudence dictates that this capacity be kept under close scrutiny in the context of unfolding global developments. At the same time it is necessary that the demands on the Bank, in terms of lending and transfers, and the financial capacity of the Bank remain closely aligned with one another. It is equally important to realize that the Bank's financial structure is relatively inflexible and that the lead time needed to enhance this capacity is fairly long. Consequently, Bank Management and the Executive Directors propose reporting to the Development Committee on the issue of the Bank's financial capacity on a regular basis.

As of 9/20/99

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IBRD Key Financial Indicators

(expressed in millions of U.S. dollars)

	Actual						Projected		
	FY 1994	*FY 1995*	*FY 1996*	*FY 1997*	*FY 1998*	*FY 1999*	*FY 2000*	*FY 2001*	*FY 2002*
A. Allocable Net Income	1,051	1,354	1,187	1,173	1,061	1,263	1,288	1,434	1,592
B. Equity Capital	23,135	25,896	23,532	22,891	22,482	23,782	24,863	25,586	26,309
C. Loans Outstanding (Including to IFC)	109,291	123,499	110,246	105,805	106,576	117,228	129,767	138,422	142,435
of which SSALs (Excluding to Korea)						*2,035*	*4,035*	*5,209*	*4,514*
D. Loans to IFC	863	934	791	599	454	350	279	217	170
E. PV of Guarantees	742	1,118	1,057	1,168	1,501	1,526	1,835	2,032	1,911
F. Loans Outstanding (C) less Loans to IFC (D) plus PV of Guarantees (E)	109,170	123,683	110,512	106,374	107,623	118,403	131,323	140,237	144,175
G. Provision for Loan Losses	3,324	3,740	3,340	3,210	3,240	3,560	3,948	4,214	4,330
H. Loans Outstanding (C) plus PV of Guarantees (E) less Provision for Loan Losses (G)	106,709	120,877	107,963	103,763	104,837	115,193	127,654	136,240	140,016
I. Equity Capital (B) to Loans (H) Ratio	21.7%	21.4%	21.8%	22.1%	21.4%	20.7%	19.5%	18.8%	18.8%
J. Share of High Risk Countries	18.8%	39.9%	35.8%	41.7%	53.3%	66.3%	66.7%	66.7%	67.0%
K. Usable Equity and Aaa, Aa Callable Capital to Risk Assets Ratio	150.1%	153.1%	178.0%	188.4%	141.6%	123.0%	112.0%	106.0%	104.2%