The Indonesian Infrastructure Guarantee Fund
Governance and Operation Report

The World Bank

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1. Executive Summary

This report describes in detail the IGF corporate governance arrangement and the key tasks the IGF needs to perform to fulfil the role which it has been assigned as discussed in the Design Report. The Report also comments on the organisational implications of the IGF’s task profile as well as on strategies to quickly enhance the IGF’s capability to manage the guarantee of Government’s PPP projects. From a broader perspective, the operational objectives of the IGF can be easily summarised as follows:

► Improve the management of Government’s contingent liability that could arise from infrastructure PPP projects
► Enhance creditworthiness of infrastructure PPP projects
► Educate market and respective contracting agencies regarding PPP and guarantee process in supporting infrastructure projects

The governance strategy aims to support IGF in ensuring that it will be able to convince external parties, especially local and foreign investors, that the IGF will be managed with the highest possible level of corporate governance. Because IGF is a new and unique organization, the Report aims to ensure that there are clear and effective working relationships between Board of Commissioners and Board of Directors supported by several special committees such as an audit committee and risk management committee. To also ensure that IGF could perform its duties as soon as possible, an outsourcing strategy was considered and discussed to speed up the development of IGF’s internal capacity.

To clearly understand the operational implications of these wider activities firstly requires a detailed understanding of the underlying business processes. We have provided our view on the business processes in section 3. Section 3 sets out in diagrammatic form the detailed tasks implied by the strategic aims contained in the Design Report, and subsequent sections describe the governance, credit and guarantee structures needed to support these tasks.

1.1 IGF Corporate Governance Strategy

Since IGF corporate governance strategy is a crucial element of the organization, the Report discusses all relevant aspects in order to achieve a good corporate governance practice of IGF. The Report discusses structure and requirements for both the governance structure and the management structure. In order to ensure that IGF will be managed as professionally as possible, we propose selection criteria and requirements for both BoC and BoD. To carry out IGF’s business activities, in the early years of its establishment, we propose an outsourcing strategy be applied for all functions in collaboration with a secondment strategy to fill the key contractor management’s roles in order to be ready for transition stage. The expectation is IGF will be able to conduct its business activities smoothly.
1.2 Management Contractor Requirements

The overwhelming conclusion drawn from the detailed operational requirements is that the IGF needs access to experienced professionals in specific PPP areas to efficiently perform its primary tasks, i.e. the evaluation and assessment of Contracting Agency (“CA”) PPP proposals, contract management, claim processing, fund management, and other back office functions. The skills needed to identify PPP transactions that are constructed along best practice lines and that are financially viable are specialist skills not easily adapted from other disciplines.

The outsourced functions will be managed by a Management Contractor with a direct reporting line to the Board of Directors. The Management Contractor should have an extensive track record in advising government entities on PPP transactions and managing a financial business entity as well as the capability to implement the transfer of knowledge mechanism. Naturally an active internal education process is required such that the IGF acquires these skills over the medium term and gradually takes responsibility for the core tasks.

1.3 Capital Management

The critical component to the success of the IGF in proving itself to be a viable addition to the Indonesian PPP market is the mechanism by which the Ministry of Finance (“MoF”) agrees to compensate the IGF for claims paid on behalf of CA entities that breach obligations. If this mechanism is efficient and free of overly bureaucratic processes, then:

► The market will have confidence that the IGF will have a sustained influence on the PPP market;
► CA entities will be incentivised to prepare PPP proposals in accordance with IGF guidance; and
► The IGF executives will have confidence in the long term viability of the financial model and as a result will be prepared to utilise debt capital to expand IGF coverage.

Key IGF executives will need to focus on securing the process by which the counter guarantee is provided. We recommend making the MoF a party to any guarantee that the IGF provides since this clearly sets out the IGF rights against the MoF if a claim occurs. We also recommend that the MoF identify an internal funding channel to tap into when the IGF makes a claim against the MoF obligations in the Guarantee. The MoF obligations will need to be “pay on demand” and without offset as well as with no capacity to dispute such claims with the IGF until the initial IGF demand is settled.

1.4 Form of Cover

Control of the actual liability exposure of the IGF is dependent on the clarity of the guarantee documents that can define the precise circumstances for a private sector counter-party to initiate a claim. Our position is that coverage must be linked to a process that has been reviewed and agreed by the IGF for any individual projects. The IGF’s analytical approval is based on the risk allocation that is proposed in the PPP agreement and the commercial principles contained in
the draft and final contracts. Therefore, it is our strong recommendation that IGF cover the exact CA obligations contained in the contract approved by IGF and nothing further. This approach will ensure that the IGF is always aware of the exact exposure from a particular PPP project.
2. IGF Corporate Governance Strategy

The IGF should be in a position to produce the desired influence on private sector investment in Indonesian PPP transactions. At the same time, the IGF should give its best efforts to ring-fencing fiscal risks and enhancing its creditworthiness. Hence, establishing a proper governing body that can support the growth of IGF is essential.

The proposed design of IGF governance and management structure is indicated in the following diagram. The area of governance structure comprising working relationships between the General Meeting of Shareholders (GMS), the BoC, the BoD and the special committee is shown in the turquoise rectangle, while the area of management structure comprising working relationships between the BoD and its line management is shown in the light green rectangle.

Figure 1 - High level IGF governance and management structure
2.1 General Meeting of Shareholders (GMS)

GMS is an IGF organ which has an authority not given to the BoC or BoD in accordance with the limits specified in the Limited Liability Companies Law and/or IGF’s articles of association. An example of this particular authority is the role in appointing BoC and BoD members. GMS also has the authority to approve annual reports which include ratification of financial reports and reports of the supervisory tasks of the Board of Commissioners. Another important authority of GMS is to determine the amount of money from the Government of Indonesia to be placed as equity capital of the IGF.

Since IGF will be 100% owned by the Government, as stated in the Government Regulation on IGF’s initial capital, the Minister of Finance (MoF) alone is sufficient to serve as the GMS of IGF. The MoF is to provide directions and guidance for the BoC and BoD, and monitor their performance. The solid line in the aforementioned diagram shows the authority of the GMS over the BoC and BoD.

2.2 Board of Commissioners

The BoC of IGF is the company organ tasked with providing general and/or specific supervision in accordance with the articles of association, offering advice, conducting supervision over the execution of BoC’s recommendation to the BoDs and provides input to the General Meetings of Shareholders. In the diagram, the dotted line between the BoC and the BoC represents the oversight role of the BoC over the BoD. It also shows that BoC do not involve in the daily operations of IGF.

According to Limited Liability Companies Law no. 40 issued in 2007, the minimum size of the BoC is one person. Therefore, the BoC can consist of only one individual. However, considering that the BoC must be of sufficient size to benefit from a diversity of viewpoints, skills and backgrounds, we suggest having more than one BoC member but not more than three, one of whom should be an independent commissioner.

In performing its oversight function, BoC will have the authority to obtain information pertaining to the Company from BoD. If necessary, members of the Board of Commissioners either individually or collectively have the authority to examine contracts, evidentiary documents, financial conditions, related party transactions and other information, or actions taken by the BoD in order to ensure that the BoD is performing its responsibilities well, in particular for ring-fencing and improving IGF’s creditworthiness. If the commissioners determine that the directors, individually or collectively, have taken action that is not in line with the Company’s vision, mission and Articles of Association, the commissioners can temporarily relieve directors from their authority and duties. Replacement of BoD and BoC members can only be done with the approval of a General Meeting of Shareholders.

The latest decision from the RMU regarding the number of BoC was discussed in the meeting with us on July 21, 2009. RMU decision was that the number of BoC members is two people – a chairman and a member. In regards to the decision making mechanism, the draft Article of Association as provided by our Team suggest the following:

1. All BoC decisions should be achieved through an acclamation process;
2. If not, the decision will be based on the majority (50% or more) of the votes;
3. In the case of both acclamation and majority voters can not be achieved, the Chairman of BoC will make the decision.

2.3 Board of Directors

The BoD is the main decision-making authority with members working closely with line management on day-to-day operations in order to achieve IGF objectives. The BoD's authority includes authority to act, enter into transactions on behalf of the company, and represent the company in court proceedings.

As previously depicted in the graph, in the early stage of IGF, the composition of the BoD may be better started with three members as follows:

1. President Director
2. Director of Operation and Risk Management
3. Director of Finance and General Affairs

The board members either individually or collectively, are responsible for the management of the Company and should act in the interests of the Company. In performing their responsibility, the BoD is supervised by the BoC. The President Director is the Chairman of the BoD and is responsible for leadership of the BoD, for proper organization and conduct of the BoD's function, and for the briefing of all BoD members in relation to issues arising at BoD meetings. The Director of Operation and Risk Management is mainly responsible for PPP’s contract assessment, contract management and claim processing. The Director of Finance and General Affairs is responsible for fund management, treasury and accounting, human resources management, and administration and general affairs to provide back-office support for the daily operation of IGF. In relation to the functions outsourced to a management contractor, the BoD is responsible for monitoring and evaluating this management contractor against pre-defined key performance indicators.

The latest decision from RMU was discussed with us team on July 21, 2009 meeting. The number of BoD, in the establishment stage will be two members. The President Director will act also as the Director of Operation and Risk Management. Since the arrangement is temporary, the meeting has agreed to maintain the BoD structure and qualifications in this report for BoD with three members.

2.4 Selection criteria for BoC and BoD

The credibility of IGF will be affected by both the soundness of the business model as well as the governance and processes internally in IGF or externally related to other decision makers. The selection process and criteria for BoC and BoD membership will be among the crucial factors. The following section discusses the proposed selection criteria for both BoC and BoD members of IGF.
2.4.1 Requirements for Board of Commissioners (BoC)

2.4.1.1 General requirements for BoC

The underlying regulation on BoC requirement for an SOE is Government Regulation No.45/2005 - Government Regulation on Establishment of State Owned Enterprise. BoC members must meet the following requirements:

a) BoC members are not allowed to serve a double function, i.e.
   a. as members of BoC of other SOEs, municipal government owned companies, private entities;
   b. in a role at a government institution;
   c. in other roles as stipulated in the regulations;
   d. in other roles which might cause conflict of interest.

b) BoC members are not allowed to hold a role in a political party and/or as a legislative candidate or member of a legislative body.

c) Term of office of a member of BOC is 5 (five) years but a member can be re-appointed for one further term.

2.4.1.2 Specific requirements for Board of Commissioners

a) Have extensive related working experience at the senior level managing banking, insurance or financial institute, government, regulatory body, or central bank

b) Outstanding leadership success in a complex organization with a diverse range of stakeholders

c) Excellent leadership skills and a proven track record of success in managing change

d) Strong commitment to infrastructure development in Indonesia

We envisage that the BoC will consist of one or two individuals that represent the interest of the Ministry of Finance (but without necessarily coming from the Ministry of Finance) and an independent commissioner.

2.4.2 Requirements for Board of Directors (BoD)

2.4.2.1 General requirements for BoD

The underlying regulation is Government Regulation No.45/2005 - Government Regulation on Establishment of State Owned Enterprises states that BoD members must meet the following requirements:

a) BoD members are not allowed to serve a double function, i.e.
   a. as members of BoD of other SOEs, municipal government owned companies, private entities;
   b. in a structural or functional role at a government institution;
   c. in other roles as stipulated by regulations;
   d. in other roles which might cause conflict of interest.
b) BoD members are not allowed to hold a functional role in a political party and/or as a legislative candidate or member

c) Term of office of a member of BOD is 5 (five) years but a member can be re-appointed for one further term.

2.4.2.2 Specific requirements for President Director

a) Hold an advanced university degree (master's degree or equivalent) in finance, accounting, business administration, or other related fields.
b) Have extensive related working experience at the senior level managing banking, insurance and/or operations in a financial institute, government or regulatory body, or a central bank with related experience in project finance investing being strongly preferred.
c) Have extensive related experience in Public Private Partnership (PPP) and project finance.
d) Have extensive knowledge regarding dispute resolution mechanism and regulatory system applied in the guarantee and insurance business.
e) Have extensive knowledge of emerging markets finance and economic development as well as an understanding of issues related to investment guarantee/insurance and foreign direct investments in emerging markets.
f) Have the ability to make forward-looking and practical decisions and to focus on the overall strategic framework for development;
g) Display a high degree of discretion, ethics, tact and sensitivity in handling confidential and sensitive information, along with the ability to maintain a high standard of personal integrity;
h) Be able to translate strategy into operational plans and results-oriented action.
i) Demonstrate outstanding leadership success in a complex organization with a diverse range of stakeholders.
j) Have a proven track record of building an organizational culture based on operational excellence, high-quality service and innovation

2.4.2.3 Specific requirements for Director of Operation and Risk Management

a) Hold an advanced university degree (master's degree or equivalent) in actuarial, business administration or finance.
b) Have extensive working experience in enterprise risk management, claim processing and contract management.
c) Be familiar with guarantee and insurance business processes.
d) Demonstrate strong client orientation, diplomatic skills, as well as sensitivity to social and cultural issues as they affect multilateral risk mitigation and investors going into developing countries.
e) Have a proven track record of establishing a conservative and risk-averse pattern of project finance investing.
2.4.2.4 Specific requirements for Director of Finance and General Affairs

a) Hold an advanced university degree (master's degree or equivalent) in accounting, business administration or finance. CFA is strongly preferred.

b) Have extensive related working experience at the senior level managing banking, insurance and/or operations in a financial institute, government or regulatory body, or a central bank with related experience in project finance investing being strongly preferred.

c) Demonstrate sound financial analysis skills, including experience in analyzing and structuring projects, preferably in an infrastructure sector;

d) Have at least ten years of senior level experience in investments, international portfolio management, financial management including professional and oversight operations experience working in an investment management institution.

e) Be highly ethical and professionally astute with a track record of unassailable accounting and financial management practices.

f) Have experience in managing complex budgets and in developing and implementing new programs as well as in grant management, with experience in utility fees being highly desirable.
2.5 Special Committee

2.5.1 Audit Committee

As required by Minister of SOE Decree no. 117 of 2002, IGF must have an audit committee. The Audit Committee is responsible to the BoC and works closely with the internal audit department. The committee has a role in the following areas:
1. Oversight of accounting and financial reporting
2. Oversight of regulatory compliance
3. Monitoring of internal control process
4. Oversight of external auditor

It would be preferable for the audit committee to have a charter defining its role, responsibilities and code of conduct. To be independent of management, the audit committee should ideally be made up of external parties with an independent commissioner as the chairperson.

2.5.2 Risk Management Committee

Risk management is a series of procedures and methodologies to identify, assess, monitor and manage the risk arising from IGF’s operation. The main objective of risk management is to ensure that the risk that may arise from operational activities does not jeopardize the company as a going concern.

The Risk Management Committee is an organ at BoC level whose role is to provide recommendations to BoC on risk philosophy, risk appetite and risk tolerance as well as risk policy made by the BoD. The responsibilities of the Risk Management Committee can include the following:
- Evaluating risk management policy and its implementation
- Monitoring, evaluating and providing recommendations to management in performing risk management policy

2.6 Special Units / Functions to Assist President Director and BoD

2.6.1 Advisor and Management Contractor

IGF is to become the first and only SOE to introduce and manage Guarantee in PPP transaction in Indonesia. With limited experience in PPP transactions, we are of the view that expert involvement is required to ensure the early years of operation run smoothly and to help the PPP to grow. We recommend a secondment of professionals as advisors with expertise and experience in PPP transactions to support BoD. Countries that have experience in PPP such as the United Kingdom or Australia would have experts that can be seconded.
There are at least three main areas of expertise or experience that the advisors must have in order to ensure their effective support for IGF business process and for knowledge transfer: a) PPP sector experience, b) financial management experience, and c) contract management experience.

To support IGF’s daily business activities in its early years, we see an important role for a management contractor to assist in carrying out IGF’s business activities and to support the management in making correct business decisions. In our view IGF should outsource all its business functions including contract assessment function, contract management function, claim processing function, fund management function, treasury and accounting function, human resources function and administration and general affairs function. The management contractor will work closely with the Board of Directors as well as the advisor to manage IGF’s business activities.

Yet we consider such risks that could be occurred in the future when the contract is over and IGF initiates the establishment formal functions to conduct its business activities. We are of the view that the risk can be in form of difficulties in company's transition stage to the change company's structure, reporting lines and staffing strategies as well as the company's business culture.

To answer this potential risk, IGF should recruit and appoint numbers of key personnel in the beginning of the establishment stage, they will work in form of secondment personnel in the management contractor organization, shadow the management contractor’s work and thus be ready to take over the job when the contract is up. We have found that a secondment arrangement aligns the goals of the company with the management contractor and we expect that these personnel could fill the key positions on each function after the establishment of the formal business functions.

The outsourcing strategies should be carried out with a proper transfer of knowledge process. This process will address a smooth transition, enabling IGF to establish formal business function and internally conduct its business activities. The secondment personnel will be the agents of transition, who have significant roles for the process.

Discussion of the international advisor and management contractor will be further elaborated in the Selection of International Advisor and Management Contractor section.

Furthermore, as discussed in our Design Report, the involvement of a reputable consulting or contractor firm will influence the market perception of IGF’s processes, but in terms of credit rating, it will only make a partial contribution. In order to achieve a rating higher than the sovereign one, IGF must align itself with a global entity with an investment grade credit rating to provide such support. At the same time, IGF needs to demonstrate that it can efficiently provide guarantee services while maintaining a strong solvency position and gradually grow its capital over a 3 - 5 year period. This will demonstrate to potential global partners that the Indonesian PPP market is viable and that the IGF is a key and profitable participant.
2.6.2 **Internal Audit Unit/Department**

Internal audit is an important organ in a company. It helps the organization in achieving their stated objectives by analysing business processes, procedures, activities and control with the goal of highlighting deficiencies and recommending solutions. Internal audit is independent of the management and their operation. The solid line in the figure 1 above shows that functionally the internal audit department is responsible to the Audit Committee while the dotted line shows that the internal audit department administratively is responsible to the President Director.
2.7 IGF Human Resources Strategy and The Selection of Advisor and Management Contractor

2.7.1 Human Resource Strategy

We have also mentioned issues related to hiring a management contractor, which we will discuss in more detail in this report. The issues are as follows:

1. Availability of specific institution which has expertise and experience in managing IGF.
2. Cost efficiency and consideration regarding future staffing of IGF after the management contractor's period of duty has ended.
3. Relationship between IGF and the management contractor, in terms of management fee, supervision, and limitation of liability.
4. Administrative matters between IGF and management contractor, such as budget, reports, and audit and accounting procedure.
5. Risk of transition difficulties caused by full management contractor model at the end of the contract.

2.7.1.1 Cost efficiency and future staffing of IGF

IGF needs to consider cost effectiveness and transfer of knowledge from the management contractor to IGF. Outsourcing the entire range of functions to a management contractor in the early stage of the company's establishment is a sensible option. To be sustainable, the management contractor should also be responsible for transferring knowledge to IGF and creating sets of standard operating procedures and policies. The IGF will need to hire sufficient staff to implement all functions by the end of the third year.

2.7.1.2 Relationship between IGF and management contractor

Despite management contractor involvement in IGF operational area, the BoD needs to supervise their work and compare their performance using well-defined terms of reference stipulated in the contract between IGF and the management contractor. For contract assessment function, contract management function, and claim processing function, the decision will be made by the Director of Operation and Risk Management, while fund management function, treasury and accounting function, human resources function, and administration and general affairs function will report to the Director of Finance and General Affairs.
2.7.1.3 Administrative matters between IGF and management contractor

The IGF should include management contractor fee in company annual budget and state this clearly as management consultant expenses in the company’s income statement. All administrative matters between the IGF and management contractor should be clearly defined and in line with company policies. After management contractors perform their activities, they should report to Board of Directors which will evaluate their performance against the key performance indicators. In the long run, as IGF grows and the transfer of knowledge process begins to take place, IGF could establish internal functions and its own departments to take over the management contractor role. This action, of course, can be taken after considering the cost-benefit of keeping the management contractor or establishing an internal department.

2.7.1.4 Risk of transition difficulties caused by full management contractor model at the end of the contract.

As we mentioned earlier, the identified risk of transition difficulties at the end of the management contractor contract could be mitigated by hiring personnel and assign them in form of secondment personnel in to some key positions on management contractor organization, shadow management contractor works and thus be ready to take over the work when the contract is up. By conducting this strategy and carried out with a proper transfer of knowledge process, we expect that IGF could smoothly establish its formal function and will be able to internally conduct its business activities at the end of management contract. The assigned personnel will become the agents of transition that significantly affect the process.

2.7.2 Selection of International Advisor and Management Contractor

Engagement of a reputable firm and experienced advisors is necessary to develop internal technical capacity of IGF in managing guarantee of complex PPP transaction. In the Governance report, we proposed two types of external expertise supports to IGF: a) secondment of experienced international experts that will act as Advisors to the BoD, b) management contractor responsible to Director level to help manage IGF’s entire business process.

The engagement of the international expert is necessary to bring selected and relevant international experience to IGF. As the possible source of international experience, IGF may utilize experts from Victoria Partnership, MIGA, or UK Partnership. In order to get this international support, we propose that the IGF management discuss a possible bilateral agreement between the Government of Indonesia and the respective international counterparts. Alternatively, IGF, through the Ministry of Finance might discuss how IGF could hire this international expert by tapping into the donor funded program related to infrastructure and PPP such as AUSAID Indonesia Infrastructure Initiative (IndII) or the PPIAF grant.
2.7.2.1 Brief Terms of Reference – International Advisor for IGF

a. Background
The Government of Indonesia establishes an Infrastructure Guarantee Fund (IGF) with an objective to attract private investment in provision of public infrastructure through Public and Private Partnership. IGF will have several characteristics such as: a) it is a financial guarantor, meaning it can not perform the obligations of a Contracting Agency (CA), b) IGF only provides guarantee in respect of PPP projects, meaning it will not cover wider government actions or provide a blanket guarantee to PPP investors, c) IGF's business process is independent of government policy, meaning it will focus specifically on providing efficient and sustainable guarantee contracts. In the long run, the IGF will serve as the sole conduit for all PPP guarantee provisions in order to help manage the Government’s contingent liabilities, and it should also enhance the creditworthiness of PPP projects.

b. Purpose of engaging the international PPP Advisor
The objective of engaging an experienced international advisor are a) to support IGF in translating PPP and guarantee best practices in other countries to ones that are applicable and relevant to Indonesia's specific circumstances, b) to advise IGF's Board of Commissioners (BoC) and Board of Directors (BoD) related to IGF's business process and strategic decisions, c) to facilitate IGF collaboration with international partners such as multilateral agencies such as World Bank’s MIGA, ADB, PPP centres such as Partnership Victoria and UK Partnerships and international reinsurance companies. The other important role of this international advisor is to develop internal capacity of IGF in providing sustainable and efficient guarantee supports.

c. Criteria of the international PPP Advisor
The ideal candidate of the international advisor should have at least the following qualifications:
- Have more than ten years of PPP related experience including a managerial position at a related international organization such as a guarantee unit of Multilateral Agencies or PPP centres such as Partnership Victoria and UK Partnership;
- Hold a finance, engineering, legal or actuarial degree from a reputable university;
- Possess experience in reviewing large PPP transactions in toll road, power, water supply or transportation sectors;
- Have an understanding of progress and issues of PPP in developing countries.

d. Activities of the international PPP Advisors
The following section sets out tasks to be undertaken by the international PPP advisor (the Advisor). The assignment is for three years with possible extension depending on needs.

- Finetuning of IGF business process
In the establishment phase of IGF, through technical assistance provided by the World Bank, IGF will be equipped with several documents covering the organization and business design, business process and operation, and governance aspects. In addition, several relevant templates will be devised based on ones developed by international PPP centres such as
Partnership Victoria and UK Partnership. The international PPP advisor is required to finetune and update the business process and procedures of IGF based on lessons learned from IGF’s early interactions with domestic and international private sectors as well as the contracting agencies (CAs).

- **Providing strategic advice to IGF’s BoC and BoD**

The IGF organization structure consists of governance and management structure in terms of BoC and BoD. The BoD is in charge of day-to-day management of IGF while the BoC has the duty of overseeing and providing advice to the BoD. The Advisor will provide strategic advice to both the BoC and the BoD in terms of governance arrangements of IGF and in terms of the business aspects. For example, the Advisor should assist the BoC in establishing the required special committees such as internal audit, risk management and others to support IGF’s good governance practices, or in engaging third parties - e.g. consulting firm in developing other governance tools useful for IGF such as the Management Charters and IGF’s comprehensive GCG strategy.

- **Facilitating international partners for IGF**

As stated in the IGF Design Report, in order to enhance the creditworthiness of PPP projects, IGF must align with a global entity with an investment grade rating. The advisor should facilitate the collaboration of IGF with multilateral agencies such as the World Bank and ADB, reinsurance companies, and rating institutions.

- **Enhancing IGF internal capacity**

One of the most important roles of the Advisor is to provide formal training and on-the-job training for IGF local staff in the areas of PPP, project assessment, claim management, and others. IGF will assign their dedicated staff to work closely with the Advisor in an effort to speed up the capacity building process.

**e. Deliverables**

The advisor should provide BoC and BoD with advice as needed. The advisor will lead and facilitate the engagement process with international partners as well as being responsible for the engagement of a consulting firm to develop some specific and detailed deliverables. In addition, the Advisor is required to develop several strategic documents such as plan for establishment of IGF special committees including the risk management committee, plan to engage international partners such as MIGA, ADB or other reinsurance companies, and plan to boost capacity of internal staff.

**f. Timeframe of the assignment**

IGF requires the support of international advisor for one year with a possible extension for a further year.
2.7.2.2 Brief Terms of Reference - Management Contractor (MC)

a. Background
The Government of Indonesia will establish an Infrastructure Guarantee Fund (IGF) with the objective of attracting private investment in provision of public infrastructure through Public and Private Partnership. The IGF will have several characteristics such as: a) it is a financial guarantor, meaning it can not perform the obligations of a Contracting Agency (CA), b) IGF only provides guarantee in respect of PPP projects, meaning it will not cover wider government actions or provide a blanket guarantee to PPP investors, c) The IGF’s business process is independent of government policy, meaning it will focus specifically on provision of efficient and sustainable guarantee contracts. In the long run, IGF will provide a sole conduit for all PPP guarantee provisions in order to help manage Government’s contingent liabilities, and it should also enhance the creditworthiness of PPP projects.

IGF management structure consists of President Director, Director of Operation & Risk Management, and Director of Finance and General Affairs. These management positions will be selected using the internal government appointment processes. For the first three years of IGF operation, the management will be supported by a Management Contractor team.

b. Purpose of engaging a Management Contractor
The main objective of engaging an experienced management contractor is to carry out functions of IGF in terms of contract assessment, contract management, claim processing, fund management, treasury and accounting, human resources, and administration and general affairs. This role includes conducting analysis and assessment to provide recommendations to the BoD. The other objective of engaging a management contractor is to transfer skills and related knowledge to IGF staff.

c. Criteria of the Management Contractor
Management Contractor team should consist of the following:
- Actuarial expert with more than 10 years of experience in insurance or guarantee industry;
- Project management expert with more than 15 years of experience in managing infrastructure projects;
- Financial expert with more than 10 years of experience in medium to big scale fund management with a thorough understanding of Indonesia’s investment policy

d. Activities of the Management Contractor
- Contract assessment:
  - Assessment of proposed project risk allocation
  - Assessment of the proposed procurement process
  - Assessment of the financial impact of a particular guarantee on IGF or on the Government
• Issuance of in-principle coverage that describes the range of Government / CA obligations to be covered, guarantee fee and key compliance criteria.
• Active involvement in PPP project final negotiation to finalise the guarantee agreement.
• Project monitoring - to detect early signs of trouble in the project such as:
  o Missed deadlines on construction stages;
  o Construction costs running materially higher than expected; and
  o Financial difficulties of sub-contractors.
• Claim assessment:
  o Identify whether there is a contract breach
  o Identify financial loss
• Fund management including treasury activities
• Accounting, taxation, and financial reporting
• Training and capacity building
• Management reporting
• Other matters as requested by IGF

e. Deliverables

The Management Contractor should produce a quarterly report for the Management and the PPP Advisor regarding the performance of IGF and possible issues facing IGF

f. Timeframe of the assignment

IGF requires the support of the Management Contractor for three years with a possible extension for another year.
3. Description of Key Business Processes

The section describes the detailed business processes of IGF. There are five main business processes and several other general processes. The main processes include educating the market, project assessment, project monitoring, claim processing, and financial management. The other general processes include human resource management, IT, and administration matters.

3.1 Overall Business Process Map

Figure 3 - IGF’s overall business process

The above diagram summarises our view of the key operational tasks that the IGF will perform as the core elements of its role in the process of implementing PPP transactions. We have not specifically detailed the more basic activities that all Indonesian companies need to perform as this would complicate the report without providing significant information to the RMU.
3.2 Project Assessment Tasks

One of the key issues that is continually raised in PPP jurisdictions throughout the world is the cost and time required to navigate the PPP EOI and Tender processes. As a result, it is important for the growth of the Indonesian PPP market to make the tendering process as efficient as possible. We thus recommend a two-stage process by which the IGF assesses whether it will offer cover to PPP transactions: (i) providing an “in principle guarantee” during the beginning of the tender process and (ii) providing guarantee after the preferred bidder is selected.

3.2.1 Business Case Initial Assessment

Figure 4 – Business case assessment

This first stage is at the point a CA entity has completed a comprehensive business case for a project and wishes to engage with the private sector, via an EOI or ROI process. The IGF will review:

- The proposed risk allocation matrix;
- The commercial principles documentation and draft contracts; and
- The process that the CA intends to use in selecting the successful bidder including the evaluation plan and guidelines that the CA will issue.
This analysis serves two key purposes: firstly, it allows the IGF to reject projects where the risk profile is unacceptable or the commercial structure is underdeveloped and secondly, it permits the IGF to vet the proposed tender process and test the evaluation methodology to maximise the likelihood of an efficient evaluation.

3.2.2 Preferred Bidder Final Assessment

Figure 5 - IGF final assessment for a guarantee agreement

The second evaluation step occurs at the point where a preferred bidder has been selected and the CA wishes to proceed to negotiate and sign the contract. The key focus here is on CA compliance with the business case principles already submitted and thus the final negotiated contract needs to be carefully checked against the business case material already submitted. This analysis is specifically looking for areas where the risk allocation of the negotiated contract diverges from that set out previously. This could include the CA taking on additional obligations or giving additional guarantees that could have significant financial consequences.

The IGF also has a role to play in reviewing the process by which the preferred bidder was chosen to test whether the evaluation principles were adhered to. It is possible that the IGF may find that the process was so badly flawed that it recommends a re-tendering process be started.
3.3 Project Monitoring

Guarantee facilities offered by the IGF are concrete obligations and as such need to be monitored to ensure that the IGF allocates an appropriate level of capital and charges fees commensurate with the estimated level of risk.

3.3.1 Extraordinary Project Review

The most obvious situation where a review is indicated is in the event that there is an active dispute. The guarantee document will require that the IGF be informed whenever a dispute arises over the obligations of the CA. While the IGF will not intervene, it will have the right to inform the Ministry of Finance and warn the CA if it believes a CA is failing to fulfil the obligations that the IGF is guaranteeing.

The IGF on the basis of the review adjusts the charge to and allocation of capital for the claim risk.
3.3.2 Periodic Project Review

PPP transactions require the private sector to provide periodic reports on the progress and status of the project. We recommend that the IGF also receive these reports since they will often contain early warning signs on possible future areas of dispute or inadequate performance on both sides of the contract. This data is useful background if the IGF is assessing a disputed claim.
3.4 Claim Management Tasks

While a key aim of the IGF is to provide the private sector with an efficient and timely mechanism for pursuing action on government contract breaches, this aim does not abrogate the IGF’s duty to thoroughly assess each claim. The assessment process can be divided into two main sections: an initial evaluation of the validity of the claim followed by a detailed analysis of the financial impact.

3.4.1 Claim Processing

The claim review process is based on an extensive analysis of the actions of both parties up to the point the claim is submitted. This includes:

- Review of the obligations documented in the contract against the current transaction position
- Analysis of the process followed by the CA and the PPP company in resolving the dispute, in particular to determine whether all options in the contract were followed.

The ultimate aim of the analysis is for the IGF to form its own independent view of whether the breakdown in the contract is due to the CA breaching its obligations or whether the private party is predominantly at fault. The guarantee contract will enable the IGF to request all
information that it believes necessary to assess a claim, and we recommend that the IGF make active use of this capacity to ensure that any decision is based on an understanding of all the circumstances that have triggered the dispute. This particular function of the IGF will require skilled PPP legal resources.

During the claim assessment process the IGF should notify both the CA and the MoF and provide a final opportunity for these entities to remedy the breach of obligation.

3.4.2 Claim Payment

Figure 9 - Claim payment

An important element of PPP contracts in respect of financial obligations is the duty of all parties to act in good faith to minimise the impact of any untoward event. Once the IGF has concluded that a claim by a PPP company is valid, the next step is to review the financial impact claimed and confirm the benefit that the IGF will pay.
We note that in general significant breaches will lead to a government default termination since such breaches indicate an irreparable breakdown in the relationship between the CA and the private sector. Accordingly, we expect that testing the claim amount will involve reasonably complex analysis using the financial model. The IGF will need access to some industry expertise when reviewing the actions taken to minimise the termination costs.

For non-termination claims, the IGF will require extensive documentation on the losses claimed detailing:

- The contract clauses under which the claim has been lodged;
- Documents that substantiate additional PPP co expenditure, such as invoices from contractors or requests from the CA for additional work;
- Reports from technical consultants for claims under Material Adverse Effect (MAE) or compensable enhancement provisions;

Finally, we note that in accepting a particular claim amount as due and payable, the IGF should automatically send a letter of demand to the Ministry of Finance noting that the IGF has validated the claim amount and will pay on behalf of the CA and that the counter-guarantee is being called. This minimises the time needed for the MoF to make its review and finalize the repayment.
3.5 Capital Monitoring

Figure 10 - Routine capital position testing

As the IGF grows and expands its capital base via leverage and its coverage via risk-based pricing, regular analysis of its projected financial position becomes critical. We recommend that this discipline be instilled in the IGF's operational structure from its establishment so that a culture of proactive financial control is the norm within the IGF.

We accept that in the early years where the IGF relies solely on equity and reserves 100% of the termination value, such capital projections will be relatively simple, but we note that development of a robust management system is essential to the long-term financial health of the IGF. This will require the development of sophisticated financial models, as well as the presence of experienced insurance professionals in key financial management positions.
3.6 Educational Tasks

Figure 11 - Educating the market

The initial steps for the IGF to take in creating an efficient PPP processing system are focussed on ensuring that both the private and public sector participants in PPP transactions understand the role of the IGF. This will require the IGF to summarise the analytical approach it will use to assess project proposals and clearly describe the information that both government and private bidders will need to supply as part of the assessment process. We recommend that the IGF then run a number of briefing sessions for both sides of the PPP market before accepting applications. This will minimise the likelihood of CA entities submitting poorly prepared projects and then wasting time on restructuring the projects to meet IGF standards.

We emphasize that the education function of the IGF is not static. Since PPP markets, participants and regulations change, the IGF needs to monitor developments and assess whether its analytical processes need to be updated. Clearly communicating how the changing environment impacts on PPP processes and expectations is a key process for the IGF.
4. Potential international support for IGF

The purpose of this section is to assess market conditions and identify potential facilities to support IGF at the operation stage. As we mentioned earlier in the Design Report, there are several steps that IGF should take prior to engaging international partners – basically IGF should show that it has a solid business model supported by a clear claim reimbursement process from MoF to IGF.

With respect to the international partners, there are some possible areas of support that they could provide to IGF:

1. Partial risks guarantee to cover projects during the construction and operation stages to cover investors against government obligations in the PPP contract.
2. Contingent credit / seed capital to the government - as a stand by loan for IGF that it can draw down if needed to cover large claims or to expand project coverage.
3. Reinsurance of IGF coverage by international insurance / guarantee providers

4.1 Coverage Gap

There are two main types of potential international support for IGF in respect of the coverage gap - i.e. after the first spade coverage, (i) guarantee support for PPP project and (ii) a callable and stand-by contingent loan from Multilateral agencies. The first of these is applicable for the short-term period and the second is for mid and long-term period.

The follow-up coverage of the PPP projects could come from Ministry of Finance or state budget or from Multilateral agencies such as the World Bank or ADB. Follow-up coverage from the Ministry of Finance is possible but it will not contribute significantly in increasing IGF’s rating. As stated earlier in the Design Report, IGF could increase its rating by collaborating with foreign financial institutions with ratings substantially higher than of Indonesia's sovereign rating. Institutions such as the World Bank Group and ADB are AAA rated institutions and could become the providers of the follow-up coverage, i.e. at the construction and operation stage.

MIGA, for example, can provide coverage against breach of contract by CAs after the first spade coverage. The breach of contract coverage protects against losses arising from the host government's breach or repudiation of a contractual agreement with the investor. In the event of such an alleged breach or repudiation, the investor needs to be able to invoke a dispute resolution mechanism (e.g. arbitration) set out in the underlying contract and obtain an award for damages. The investor may file for a claim if, after a specified period of time, payment is not received. If this scheme were to be implemented, MIGA could be involved in the earlier stage of the PPP process by providing advice, e.g. through the previously discussed international advisor.
4.2 Contingent Loan and Backstop Facility

Lenders, such as the World Bank and ADB, also have various financing instruments including one that allows a country to draw down the loan in a flexible way. The current application of this kind of loan is for natural catastrophes, downturns in economic growth, or adverse changes in commodity prices or terms of trade, but the IGF or the Government could discuss the possibility of supporting IGF using a more flexible financing scheme through an Infrastructure Deferred Drawdown Option (DDO) or as part of the Development Policy Loan DDO.

4.3 Partnering

The long term plan is that after 2-3 years of efficiently managing the IGF under a risk-based capital apportionment strategy, the IGF results will demonstrate a strong equity return, respectable organic growth in capital and a significant solvency margin. The IGF will then be in a strong position to seek global partners as a mechanism for leveraging the IGF with international capital. The strategic aim of this process is to facilitate the IGF in achieving a rating higher than the Indonesian sovereign rating (possible only with support from a global partner) and as a result IGF cover has the potential to improve the credit rating of a PPP transaction above that of the Indonesian Government.

We note that the partnering envisaged here is completely separate from the proposal to have MIGA provide gap coverage in the early years of IGF operations. The MIGA arrangement is a mechanism to provide broader coverage, not a form of capital partnership. We envisage the MIGA coverage winding down as the IGF coverage capacity expands.

4.4 Reinsurance and syndication

For the medium to long-term, IGF could also further support the PPP process by attracting or collaborating with international reinsurers or guarantee providers, through, say, a syndication process. For a syndication process, IGF could follow the following steps:

- IGF holds preliminary discussions with some potential reinsurers / guarantee providers on a no-name basis.
- IGF obtains information regarding indicative available capacity and premium rates and informs the CA accordingly.
- CA authorizes IGF though a mandate letter.
- Related project documents and transaction documents are finalised, prior to the signing of contract of reinsurance and contract of guarantee.

The following table summarizes various instruments available in the market related to guarantee and PPP projects that could be utilized after the first spade cover. The IGF management should familiarise itself with these types of options in order to engage in a collaborative manner with the institutions whether in the form of partnership, reinsurance or syndication.
Table 1: Various risk mitigation products

<table>
<thead>
<tr>
<th>TYPE OF RISK MITIGATION INSTRUMENT</th>
<th>EXPLANATION / RISK TO COVER</th>
<th>PROVIDERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Credit Guarantees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.1 Partial Credit Guarantee (PCGs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.2 Full Credit Guarantee or Wrap Guarantee</td>
<td>Full credit guarantee covers the entire debt service in the event of a default, normally obtaining debt terms similar to those of the guarantor</td>
<td>Creditworthy guarantors, multilateral development banks and bilateral development agencies, Monoline insurers or some multilateral agencies</td>
</tr>
<tr>
<td>B. Export Credit Guarantees or Insurance</td>
<td>Export credit guarantees cover losses for exporters or lenders financing projects. These instruments cover both political and commercial risks</td>
<td>Export Credit Agencies (ECAs)</td>
</tr>
<tr>
<td>• Arbitration award default</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Partial risk guarantees (PRGs)</td>
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</tbody>
</table>

- **Arbitration award default**: Cover losses arising from a government's non-payment when a binding decision or award by an arbitral or judicial forum cannot be enforced.

- **Partial risk guarantees (PRGs)**: Cover a wider range of political and regulatory risks than PRI. They typically cover government contractual obligations, i.e. losses due to a government's non-payment of its obligations under a contractual undertaking, where the coverage depends on the specific obligations contractually agreed to for a project by the host government. Besides the traditional political risks, they may cover:
  - Government contractual payment obligations (such as termination payments)
  - Government action or inaction with a material adverse impact on the project (i.e. a change in laws, regulations, taxes, or incentives)
  - Contractual performance of public counterpart
  - Frustration of arbitration.

- **Multilateral insurance agencies**: Multilateral development banks and bilateral development agencies.
<table>
<thead>
<tr>
<th>TYPE OF RISK MITIGATION INSTRUMENT</th>
<th>EXPLANATION / RISK TO COVER</th>
<th>PROVIDERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partial Credit Guarantee and Guarantor of record</td>
<td>Combines financial guarantee and other financing in bond transactions</td>
<td>Inter-American Development Bank (IDB)</td>
</tr>
<tr>
<td>Partial Credit Guarantee (PCG) for Pooled Finance</td>
<td>A pooled municipal bond issued to finance water and sanitation projects by providing a PCG covering 50% of the principal repayment</td>
<td>India’s Tamil Nadu State Development Credit Authority</td>
</tr>
<tr>
<td>Privatization guarantees and “brown field” project support</td>
<td>PRG/PRI for privatization transaction</td>
<td>The World Bank (WB)</td>
</tr>
<tr>
<td>Complementary guarantee combining PRG/PRI</td>
<td>Combination between PRG and PRI in a infrastructure project</td>
<td>World Bank’s MIGA and private political risk insurers</td>
</tr>
<tr>
<td>Corporate finance with PRG / PRI</td>
<td>Combination of project financing and PRG/PRI to cover country political risks</td>
<td>World Bank’s MIGA + ECAs</td>
</tr>
<tr>
<td>Guarantee Facilities</td>
<td>Setting up guarantee facilities by providing contingent credit or seed capital to the government</td>
<td>Multilateral development banks and bilateral development agencies</td>
</tr>
</tbody>
</table>
5. Accounting policy

The financial statements of IGF must be prepared under Indonesian generally accepted accounting principles established by the Indonesian Institute of Accountants and, where applicable, in line with prevailing financial service industry practices and accounting and reporting guidelines as prescribed by the related regulatory authorities and the Capital Market Supervisory Board.

The Indonesian Statement of Financial Accounting Standards (SFAS) does not specifically regulate the accounting rules for guarantee industry. Therefore, the accounting rules for IGF can be adopted from other industry accounting rules as long as the nature of the business transaction is covered therein.

Specifically with the reporting of contingent liabilities, the accounting rule to be used for such reporting is Statement of Financial Accounting Standards (SFAS) No.57, “Estimated Liabilities, Contingent Liabilities, and Contingent Assets”. This Statement applies to financial instruments (including guarantees) that are not carried at fair value.

SFAS No.57 requires the management to make estimates and assumptions that affect the reported amounts of assets and liabilities and to disclosure contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period.
6. Credit Protocols for the IGF

6.1 Capital

To be a credible financial guarantor, the IGF needs to be always in a position to be able to meet calls on the full portfolio of guarantee instruments that it has issued. In general, financial entities that offer guarantee type facilities do not hold equity capital equal to their full liability exposure. Instead they have access to a mix of debt and equity funds set on the basis of a thorough numerical analysis of the likely claim incidence and intensity. Naturally this approach requires sufficient data to be able to confidently set capital amounts and capital mix at optimal levels.

6.2 First five years

We do not believe there is sufficient data for the IGF to initially adopt a risk-based approach in setting capital requirements. Therefore, we recommend that the IGF has access to a callable capital equal to the calculated maximum claim liability to which it is exposed for the first five years of operations. This will give it time to collect sufficient data on claim experience to adopt a risk-based approach. We recommend dividing the capital mix strategy into two phases:

1) Pure Equity Capital

Until the mechanism by which the IGF recoups guarantee payments from CA entities or the Ministry of Finance has been efficiently implemented and tested, we believe the IGF will not have a reasonable expectation as to the timing and level of recovery it will achieve. On this basis the IGF will not have sufficient confidence in its projected financial position to access debt type facilities to pay guarantee claims. In other words, uncertainty over the timing and amount of the repayment of the claim would be a problem and this would have to be settled through the internal repayment mechanism.

We believe that the fund should rely on equity capital until at least three claims have been settled and the performance of the CA entities and the Ministry of Finance in repaying the IGF claims advanced has been assessed. There is a clear incentive for the Ministry of Finance/CA entities to promptly pay the outstanding amounts to the IGF given that the IGF will charge interest on the unpaid amount from the date the IGF claims back the payment. The rate or interest will be based on the mix of capital used by the IGF in paying the original claim, so clearly the more rapidly the IGF can leverage its initial capital, the lower the cost.
2) Increasing Leverage

Once the IGF has confidence that the mechanism implemented to recoup guarantee payments provides certainty as to the level and timing of the repayment, it will be in a position to borrow against the Ministry of Finance payments. This will both reduce the cost of capital of the IGF and allow it to cover more projects. We recommend gradually expanding the leverage, as the ability to effectively process and analyse submissions from CA entities is just as important a limit on the speed with which cover can be expanded as the availability of capital. The following expansion of leverage would be prudent, with more rapid expansion possible based on good CA performance and increased capacity:

- **Initial Expansion**: 50:50 gearing, permitting a doubling of the number of projects guaranteed
- **First Step-up**: 75:25 gearing, permitting an additional doubling of the number of projects than can be guaranteed

The debt sourced should be a short-term floating rate working capital facility since the gap between claim by the IGF and payment by the Ministry is not a defined term, though it is meant to be as soon as possible.

### 6.3 Year 5 onwards

At this point we believe that the IGF should have sufficient data to assess the claim experience and produce statistically viable estimates of:

- The likelihood of a claim occurring in each year of a PPP project term;
- The average size of the claims made;
- The events that trigger claims and the delay between event occurrence and the actual claim against the IGF;
- The time delay between demand and payment from the Ministry of Finance.

With this data the IGF can start to model its business on a more rigorous quantitative approach. The core of this approach is that with reasonable statistical estimates of claim incidence and cost, the IGF need not match the maximum possible claim with callable capital (either as equity or committed debt facilities). The IGF will be able to estimate the expected cost of providing guarantees to the various CA entities and leverage the capital held and provide guarantee facilities to the level of the expected call on cash funds rather than up to the theoretical maximum call.

This will require construction of a more sophisticated model that encodes estimates of claim likelihood and size distributions and projects the fund cash flows forward under a variety of capital scenarios. The key tests for an assumed level of capital are:

- With all claims and repayments at the expected level, the model should show a return on capital equal to the base case requirement for the fund;
• With all claims and repayments set at the upper 95% confidence limit, the fund should be solvent for the next three projected years.

6.4 Contract Variations

It is very unlikely that a 30+ year PPP contract will run to the expiry date without either party looking to enhance the arrangement. The contract should provide clear principles on which variations and compensable enhancements are to be evaluated, but the IGF must have final say on whether the agreements struck conform with its requirements on risk allocation and ultimate credit exposure. The IGF will be named in the contract as a party that must provide sign-off on any variation negotiated or the guarantee will be voided.

6.5 Investment Policy

A valid claim could eventuate at any point during the life cycle of a PPP transaction and with short notice to the IGF. This requires the IGF, particularly during the early years where claims are paid solely from its cash reserves, to adopt a conservative investment approach to guarantee fund availability. The key elements of this conservative investment approach are:

• Matching the currency of the obligation: if the contract is $US denominated, then the IGF should hold sufficient deposits in $US to minimise foreign currency risk.
• Investments should initially be in callable deposits or similarly liquid bank or government securities.
• As the IGF increases capital leverage and is able to access rolling debt facilities to pay claims, the investment horizon can be expanded, but the overall modified duration of available cash reserves should match the predicted modified duration of claim experience

6.6 Control of Credit Policy

The implementation and monitoring of the IGF credit position is naturally a proactive process with input required from the risk management team, the investment team and the PPP processing team. Key inputs into the feedback process are:

• Projected capital growth and the extent of demand for IGF guarantee facilities;
• Market interest rate volatility
• Claim and guarantee fee payment experience
• Projected running costs.

The process by which this information is analysed is indicated in Diagram 3.6. Ultimate responsibility for the expansion and allocation of the limited IGF capital rests with the Director of Finance, with the financial controller assuming day to day management of the IGF asset and liability position.
7. Guarantee Instruments

The core principle of the IGF guarantee structure is that the guarantee is solely in respect of obligations of the CA in respect of a signed contract. Wider government and project risks will be expressly excluded. This means that to claim under a guarantee, a private sector party to a PPP will need to demonstrate that the CA has breached an obligation explicitly documented in the contract presented to the IGF during the analysis process. Since any changes to the contract that have been agreed post IGF review will not be covered by the guarantee, it is essential to append to the guarantee the contract form agreed to by the IGF.

7.1 Phases of the guarantee instruments

The form of the guarantee instrument implies two distinct phases:

1. From preferred bidder to contract close: At this point the actual transaction deed is not active, and thus the CA has not assumed any of the obligations therein. We recommend that at the point a private sector entity is named the preferred bidder, the CA sign a process agreement with that entity that sets out:
   a. The issues that need to be negotiated prior to signing the contract;
   b. The actions that both parties will take to reach contract close;
   c. The timetable both parties will follow to reach contract close;
   d. The bid costs charged to date and an estimate of the remaining costs to contract close.

Point d. is important because the benefit payable to the preferred bidder in the event the CA breaches the process deed will be payment of the bid costs to date.

2. Form contract close: the concession contract will clearly set out
   a. the obligations of the CA,
   b. the process to follow in the event of a dispute, and
   c. the mechanisms to be used to calculate any compensation payments due to the private sector.

Our experience suggests that most contract breaches will lead to compensation mechanisms that use the base case financial model to calculate the payment due to private party. It will therefore be a requirement that the base case model, together with comprehensive instructions on running the model, be supplied with the signed contract to the IGF.
7.2 Counter Guarantee

The ability of the IGF to claim back from the Ministry of Finance its guarantee payments made in respect of contract breaches by CA entities is an essential part of the entire structure. This means that the mechanism which establishes this right must be legally and procedurally flawless. If there is any reasonable doubt over the process by which the IGF is reimbursed, then the IGF will not be viewed by the private sector as a viable counter-party and the likelihood of attracting credible partners diminishes.

We recommend that a schedule to the IGF guarantee documents confirms that the Ministry of Finance has approved the IGF recommendation to cover the project and approved the risk cover detailed in the guarantee and as a result warrants that it will pay on demand any claims from the IGF without offset or dispute. In the MoF confirmation letter, a clause should be included regarding the need of timeliness of the Ministry of Finance’s response to any claim requests from the IGF. The guarantee schedule must be signed by Ministry of Finance personnel with the appropriate power for it to bind the Ministry for payments equal to the maximum termination value payable.