CARIBBEAN DEVELOPMENT BANK

PRIVATE SECTOR DEVELOPMENT POLICY AND STRATEGY

JULY 2017

CURRENCY EQUIVALENT

Dollars ($) throughout refer to United States Dollars (USD) unless otherwise stated.

ABBREVIATIONS

BMC	Borrowing Member Country(ies)
BOD	Board of Directors
CAPM	Capital Asset Pricing Model
CDB	Caribbean Development Bank
CGF	Caribbean Growth Forum
CSP	Country Strategy Paper
CTCS	Caribbean Technological Consultancy Service
DBI	Doing Business Index
DFI	Development Financial Institution
DFID	Department for International Development (UK)
DRS	Disaster Reduction Strategy
EaD	Exposure at Default
ECGC	Eastern Caribbean Credit Guarantee Corporation
EE	Energy Efficiency
ERM	Enterprise Risk Management
EU-CIF	European Union-Caribbean Investment Fund
FI	Financial Institution
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GEDI	Global Entrepreneurship and Development Index
GEPOS	Gender Equality Policy and Operational Strategy
IFI	International Financial Institution
LAC	Latin America and the Caribbean
LCS	Life Cycle System
LGD	Loss Given Default
LIBOR	London Inter-Bank Offer Rate
LTV	Loan to Value Ratio
MDB	Multilateral Development Bank
MW	Mega Watt
MSME	Micro, Small and Medium-Sized Enterprise
NPL	Non-Performing Loans
NRSRO	Nationally Recognised Statistical Rating Organisation
OCR	Ordinary Capital Resources
OECS	Organisation of Eastern Caribbean States
ORM	Office of Risk Management
OSF	Other Special Funds
PBO	Policy Based Operation
PCG	Partial Credit Guarantee
PD	Probability of Default
PPI	Private Participation in Infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PPMS	Project Portfolio Management System
PPP	Public-Private Partnership(s)
PRISM	Project Resource Interface for Systematic Management
PSD	Private Sector Development
RE	Renewable Energy
RMF	Results Monitoring Framework
RSM	Regional Support Mechanism
SEEC	Sustainable Energy for the Eastern Caribbean
SFR	Special Funds Resources
TA	Technical Assistance
TVET	Technical and Vocational Education and Training

TABLE OF CONTENTS

APPENDICES

EXECUTIVE SUMMARY

PRIVATE SECTOR DEVELOPMENT POLICY

Rationale and Goal

1. The rationale for the Private Sector Development (PSD) Policy of the Caribbean Development Bank (CDB) is rooted in the fact that development of the private sector is an essential pillar for achieving sustained economic growth and poverty reduction. The goal of the PSD policy is to contribute to the transformation of the private sector so that it is the major driver of economic and social wellbeing in the Region. A transformed private sector would create quality jobs for a growing working population, generate incomes and supply an expanded range of quality goods and services at competitive prices.

Objectives

2. The challenge confronting CDB is to create, in partnership with the public and private sectors, an environment that enables the private sector to achieve and sustain growth and international competitiveness. In this context the objectives of CDB's PSD policies are to:

(a) improve private sector operations of priority sectors by enhancing the inclusiveness and accessibility of finance;

(b) assist in the development of effective operational practices and procedures in private sector enterprises, facilitating the transition from informal to formal sector activities for female and male entrepreneurs and business owners;

(c) assist borrowing member countries (BMC) and private enterprises to develop policies and approaches that facilitate the integration of gender and diversity issues in private sector enterprise development;

(d) assist BMCs to develop appropriate legislative and regulatory frameworks and governance systems that facilitate inclusive private sector operations;

(e) foster the development of private sector organisations along with capital and financial market institutions which encourage inclusive PSD;

(f) assist BMCs in developing and implementing appropriate policies and strategies that foster inclusive growth, development and sustainability of the private sector; and

(g) increase the flow of direct long-term loans to private enterprises in BMCs, including private infrastructure providers.

Policy Principles

3. CDB has established five basic principles to guide private sector interventions. These principles are:

(a) **Additionality**: CDB's interventions must bring additionality to medium and long-term funds flowing to the private sector in the Region. This means that

CDB's funds must not displace private capital, nor substitute for funds that would otherwise be available on appropriate terms and conditions.

(b) **Catalytic Role:** CDB must serve as a catalyst for the involvement of other financial institutions (FIs). CDB interventions should contribute to enhanced financial intermediation and capital market development. This may include co-financing with other intermediaries, direct mobilisation of resources through loan syndication or credit enhancement.

(c) **Selectivity and Focus:** CDB is cognisant of several international finance institutions (FIs) and commercial entities operating within its BMCs and providing a range of services to the private sector. CDB will be selective in its interventions, focusing on areas where it can have development impact and comparative advantage.

(d) **Alignment:** CDB's support for PSD will be aligned to the strategic priorities of its BMCs and will be undertaken within the context of the Bank's core competencies, strategic priorities and Charter. CDB will, therefore, structure its private sector interventions to meet the specific circumstances of its BMCs.

(e) **Partnerships:** CDB's relatively small resource base and prudential exposure limits mean that partnerships/alliances with other financial institutions (FIs) operating in the Region will be an important component of CDB's private sector operations.

PRIVATE SECTOR DEVELOPMENT STRATEGY

4. This strategy sets out the framework for CDB's PSD activities for 2017 to 2020. Fostering PSD encompasses a broad range of interventions aimed at addressing the challenges that the regional private sector faces and catalysing the participation of the private sector in key opportunity areas. Thus, the development of this sector requires a comprehensive approach involving both public and private participation and utilising both sovereign and non-sovereign operations. In this sense a defining characteristic of this new strategy is the explicit recognition that support for the private sector involves the full range of lending and non-lending products, the skills, the strengths and the opportunities offered by both the private and public sectors.

5. Three strategic pillars or thrusts have been identified to form the core of the strategy:

(a) Improving the investment and business climate in the Region;

(b) Expanding infrastructure for inclusive economic and human capital development; and

(c) Promoting equitable enterprise development, especially in the micro, small and medium-sized (MSME) private sector.

6. The strategic pillars facilitate the development of a comprehensive framework for the Bank to support its BMCs to generate strong inclusive growth through PSD. This demands a shift in approach to view the private sector not only as a beneficiary of the Bank's support but also as a partner for development. Specifically, the Strategy:

(a) articulates that all Bank's operations support inclusive growth through PSD;

(b) maximises the impact of the Bank on PSD by harnessing both public and private sector operations;

(c) focuses the Bank's support on selected areas where CDB has appropriate capacity and demonstrated competitive advantage that can lead higher development impact; and

(d) recognises that, in light of the constraints facing the Caribbean private sector, both direct financial support to businesses and support for improving the business environment are required.

7. In operationalising the strategic pillars the Bank will take explicitly into account the cross-cutting issues identified. In particular, the Bank recognises that there is unequal participation of men and women in private sector enterprises. Persistent gendered occupational segregation and differential wages are pervasive in both formal and informal sector employment across the Caribbean. Women and youth in particular encounter significant barriers to participation in economic activities due to limited access to finance, assets and collateral. Therefore, the Bank will ensure that its interventions in the private sector will address these barriers and constraints through specific activities that enable equitable participation by female and male entrepreneurs and business-owners to the breadth of economic opportunities.

8. The PSD strategy could be summarised as follows:

The Bank will support PSD in its BMCs by fostering improvements in the investment and business climate, improving social and economic infrastructure for economic and human capital development and facilitating the development and growth of MSMEs and it will execute this strategy in the context of a comprehensive risk management framework.

The Strategy translates into:

- A focus on MSMEs using technical assistance (TA) and Intermediary Lending

- Financing infrastructure for economic and human capital development in the public and private sectors using TA, Direct Lending and Public-Private Partnerships (PPPs), as appropriate.

9. In the implementation of the strategy, the Bank will employ the full range of operational modalities and financing instruments at its disposal. Bank staff will systematically identify, analyse and assess available options and provide clear justification for the recommended instrument(s). These instruments and modalities will, most likely, be used in combination because of the complexity of the issues involved.

PRINCIPLES OF IMPLEMENTATION

10. A number of underlying principles or approaches will be adopted in implementing the strategy. These include ensuring that the strategy is appropriately resourced, incorporating partnerships/alliances with development partners, using Country Strategy Papers (CSPs) and sector strategies as the principal business platforms for Bank operations in support of PSD, investing more resources in analytical and advisory activities to address the business climate and

enabling environment and developing robust monitoring and evaluation systems to ensure that the strategy is effectively implemented.

1. INTRODUCTION

1.01 In 2003/2004 CDB developed a PSD Policy, Strategy and Operational Guidelines. The primary objective of this policy and strategy was to support interventions aimed at improving the global competitiveness of the Region's productive sectors, and to assist in repositioning the economies, in response to the effects of globalisation and liberalisation of markets. The Bank achieved only limited success in implementing the PSD strategy. It is important that CDB revise its policy and strategy in the context of the changed regional and international economic environments.

1.02 PSD is an essential pillar for sustained economic growth and poverty reduction. The private sector[1] is recognised as a critical stakeholder and partner in economic development, through its contributions in many areas, including providing income, jobs, goods and services to enhance people's lives and help them escape poverty, facilitating food security, assisting in climate change mitigation and environmental sustainability and being a major source of fiscal revenue through taxes. It is estimated that micro, small and medium-sized (MSME) private sector enterprises – the sub-set that is the primary focus of CDB's private sector interventions – constitute between 70% and 85% of the number of private enterprises, contribute between 60% and 70% of Gross Domestic Product (GDP) and account for approximately 50% of employment.

1.03 The Region is seeing an emerging trend of Private Participation in Infrastructure (PPI) in such sectors as airports, roads, ports, telecommunications, electricity and renewable energy. According to World Bank data, ten BMCs received total PPI of USD6.8 billion between 1990 and 2015[2]. Many BMCs have successfully implemented complex infrastructure projects in partnership with global investors, financed by Multilateral Development Banks (MDBs) and commercial lenders. In 2014, CDB estimated that in excess of USD21 billion is needed in BMCs over the period 2015 to 2025, in order to upgrade the Region's infrastructure assets and services to acceptable levels[3]. This level of capital expenditure is beyond the fiscal capacity of BMCs, and new models are emerging, which are designed to unlock the financial and technical capacity of the private sector to improve the Region's infrastructure. Therefore, the development of the private sector is critical for supporting the development of infrastructure and an inclusive growth agenda in the Region.

1.04 CDB's Strategic Plan 2015-2019 (the Plan) identified two distinct but complementary development objectives – *supporting inclusive and sustainable growth and development and promoting good governance.* The Plan indicates that CDB's support for achieving inclusive and sustainable growth will be realised through investments in economic and social infrastructure, education and training, agriculture and rural development, private sector development, water and sanitation, environmental management, climate resilience, energy efficiency, renewable energy and disaster risk management. The Plan established that initiatives in these core areas will be identified through sector/thematic policies and assistance strategies and that existing sector and thematic policies and strategies will be reviewed and new ones developed. This is the setting in which the existing private sector policy and strategy has been reviewed and the new Private Sector Development Policy and Strategy developed.

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[1] The private sector is conceived as a basic organising principle for economic activity in a market-based economy where: physical and financial capital is generally privately owned; markets, competition and allocation and production are profit-driven; decisions are made and risk taken as a result of private initiative.

[2] World Bank PPI Database.

[3] CDB (2014) "Public-Private Partnerships (PPPs) in the Caribbean: Building on the Lessons of Early Experience,"

The Context of the New PSD Policy and Strategy

1.05 A number of issues and challenges define the context in which this new policy and strategy is being developed. Listed below are the most important elements of this context:

(a) The Bank's overarching goal of poverty reduction and the implications of this on policy.

(b) The development challenges facing the Region and how these are addressed in the Bank's Strategic Plan 2015-2019.

(c) The Bank's experience in implementing the existing policy and strategy. In 2009 the Bank contracted a consultant to review the 2003/2004 Private Sector Policy and Strategy. A number of lessons were identified in the study and these have been considered in preparing the current strategy. Appendix 1 provides a summary of the major lessons identified.

(d) The Bank's Sector Policies including the Gender Equality Policy and Operational Strategy (GEPOS) and the associated Country Gender Assessments.

(e) The Bank's OCR Policies and Operating Guidelines (December 2016).

(f) A Technical Guidance note on Integrating Gender Equality into Private Sector Development Operations (September 2016).

(g) The private sector activities of development partners, including other MDBs in the Region.

(h) The activities of commercial financial institutions (public and private) operating in the Region.

(i) The discussions and action plans prepared under the auspices of the Caribbean Growth Forum (CGF), launched in 2012. With CGF, Caribbean governments have initiated a structured, transparent and accountable process engaging all stakeholders with the objective of accelerating reform and change, to promote private sector led growth.

(j) A thematic study commissioned by the Bank in 2016, entitled *Micro-Small-Medium Enterprise Development in the Caribbean: Towards a New Frontier*, was designed to assess the status of the MSME Sector, highlight the critical development challenges and propose a structured approach to addressing those challenges confronting MSMEs.

(k) A thematic study commissioned by the Bank in 2014, entitled *Public-Private Partnerships (PPPs) in the Caribbean: Building on the Lessons of Early Experience*. The study highlighted the need for CDB to provide strong policy and technical support to BMCs, in partnership with MDBs, which led to discussions with other development partners and ultimately the creation in collaboration with the World Bank Group (WBG) and the Inter-American Development Bank (IDB) of the Regional Support Mechanism (RSM). The aim of the RSM is to support BMC governments to use Public-Private Partnerships (PPPs) to deliver resilient private sector-led infrastructure that underpins sustainable economic growth and equitable access to basic services.

(l) Other significant and ongoing research work such as the Global Competitiveness Index, Ease of Doing Business Reports and other regional consultative fora on PSD such as those funded under the Compete Caribbean Programme.

(m) Consultations with Regional Stakeholders based on a draft of the PSD Strategy.

1.06 In preparing the PSD Policy and Strategy a clear distinction is made between "policy" and "strategy". The new policy is structured with a clearly established *rationale* that is rooted in the fact that development of the private sector is an essential pillar for achieving sustained economic growth and poverty reduction. The *goal* of the policy is articulated, along with the basic *objectives* and the *core commitments.* The policy framework follows closely the existing policy but with major adjustments in the area of risk management to reflect the Bank's current approach to risk assessment and mitigation.

1.07 The strategy sets out the framework for CDB's PSD activities for 2017 to 2019. A defining characteristic of the new strategy is the explicit recognition that support for the private sector involves the full range of lending and non-lending products, the skills and the strengths and opportunities offered by both the private and public sectors. The challenge for CDB is to support the private sector in a coordinated and strategic fashion so that development impact is optimised. It will do so by deploying intervention strategically, focusing on CDB's strengths that can be leveraged through partnerships and the particular needs of its BMCs, taking into consideration country strategies and private sector needs. With its limited resource base in relation to other MDBs, CDB, needs to find the right space for its interventions within the private sector in order to maximise impact and viability. CDB will seek to partner with other MDBs, in both its lending and non-lending operations geared towards the development of PSD among BMCs.

2. PRIVATE SECTOR DEVELOPMENT POLICY

Rationale

2.01 Experiences throughout the developing world illustrate that inclusive economic growth[4] is the most powerful weapon in the fight against poverty. Development of a vibrant, efficient and innovative private sector is an essential component of long-term economic growth. The high indebtedness of the public sector and the need for the private sector to provide more of the goods and services required by society reflects the economic imperatives of contemporary Caribbean economy. Private enterprises also have a key role to play in combating poverty. Private enterprises, which include enterprises in all sectors of the economy, are the main source of jobs in the Bank's BMCs. Privately financed investments are increasingly driving the development of new, resilient infrastructure assets and services in BMCs. The rationale for CDB's PSD policy is thus rooted in the fact that development of the private sector is an essential pillar for achieving sustained economic growth and poverty reduction.

Goal

2.02 The goal of the PSD policy is to contribute to the transformation of the private sector so that it is the major driver of economic and social wellbeing in the Region. This translates to greater private sector investment and output. A transformed private sector would be internationally competitive and would create quality jobs for a growing working population, generate incomes and supply an expanded range of quality goods and services.

Objectives

2.03 CDB aims to create, in partnership with the public and private sectors, an environment that enables the private sector to achieve and sustain international competitiveness. In this context the objectives of CDB's PSD policies are to:

(a) improve private sector operations by enhancing the inclusiveness and accessibility of finance;

(b) assist in the development of effective operational practices and procedures in private sector enterprises, facilitating the transition from informal to formal sector activities for female and male entrepreneurs and business owners;

(c) assist borrowing member countries (BMCs) and private enterprises to develop policies and approaches that facilitate the integration of gender and diversity issues in private sector enterprise development;

(d) assist BMCs to develop appropriate legislative and regulatory frameworks and governance systems that facilitate inclusive private sector operations;

(e) foster the development of private sector organisations and capital and financial market institutions which encourage inclusive PSD;

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[4] Inclusive growth takes into account the distribution of incomes across the population and should be inclusive of the larger part of a country's labour force.

(f) assist BMCs in developing and implementing appropriate policies and strategies that foster inclusive growth, development and sustainability of the private sector, including the use of PPPs in the infrastructure and social sectors; and

(g) in partnership with other MDBs, provide long-term financing for viable and sustainable private sector projects in BMCs for the provision of public infrastructure services, including PPPs, with BMC governments.

Core Commitments

Mandate

2.04 Article 2 of the Agreement Establishing the CDB (the Charter) states that in carrying out its purpose the Bank shall mobilise additional resources for the development of the Region both internally and externally. Any intervention by CDB must be justifiable on development grounds. Article 15(d) of the Charter requires that, in considering an application for financing, CDB must pay due regard to the ability of the borrower to obtain financing elsewhere on terms and conditions that are considered reasonable for the recipient. The Charter also allows CDB to lend resources to a non-sovereign or without a sovereign guarantee and this is the basis on which the Bank interfaces with the private sector. It is against this background that CDB has established the following principles to guide private sector interventions:

(a) **Additionality**: CDB's interventions aim to bring additionality to medium and long-term funds flowing to the private sector in the Region. This means that CDB's funds should not displace private capital, nor substitute for funds that would otherwise be available on appropriate terms and conditions. Loan maturities, grace periods and pricing are important considerations in determining additionality. The test of additionality is the ability of CDB to mobilise new resources for PSD. CDB's participation in private sector projects should, therefore, enable the leveraging of resources from other lenders by:

(i) assuming the risk exposure to projects which, though not initially justified from purely risk/return considerations, merit CDB's participation in order to permit investment by the private sector to allow the socioeconomic benefits of the project to be realised;

(ii) offering finance for projects – provided they are sound financially and economically as well as being environmentally and socially sustainable – that would otherwise find difficulty in obtaining financing from other sources in a timely manner;

(iii) incorporating gender equality and diversity issues in the investment appraisal process;

(iv) offering longer term maturities for loans; and

(v) waiting longer, if necessary, for a return on equity and providing technical advice to ensure that projects are adequately leveraged and the appropriate systems are provided for implementation and management of projects.

(b) **Catalytic Role:** CDB will serve as a catalyst for the involvement of other FIs. CDB interventions should contribute to enhanced financial intermediation and capital market development. This may include co-financing with other intermediaries, direct mobilisation of resources through loan syndication or credit enhancement by, for example, providing guarantees.

(c) **Selectivity and Focus:** CDB is cognisant of several IFIs and commercial entities operating within its BMCs and providing a range of services to the private sector. CDB will be selective in its interventions, focusing on areas where it can have development impact and comparative advantage. Given CDB's small size and the need to carefully manage risks, CDB will place emphasis on working collaboratively with other development partners to achieve synergies and complementarities.

(d) **Alignment:** CDB's support for PSD will be aligned to the strategic priorities of its BMCs, as these are detailed in the respective CSPs, and will be undertaken within the context of the Bank's core competencies, strategic priorities and Charter. CDB will, therefore, structure its private sector interventions to meet the specific circumstances of its BMCs.

(e) **Partnerships:** CDB's relatively small resource base and prudential exposure limits mean that partnerships/alliances with other FIs (including MDBs) operating in the Region will be an important component of CDB's private sector operations. This includes technical and policy interventions in BMCs, as well as financing operations.

Policy Framework

General

2.05 CDB contributes to the financing of private sector projects related directly to economic development in its BMCs, particularly where risk perceptions constrain other FIs and direct investors. However, CDB will not invest in situations where overall economic conditions and the financial and legal environment are such that the investment is unlikely to succeed. Special attention is paid to ensure that interventions by CDB promote poverty reduction, social and gender equity and environmental protection.

2.06 In accordance with Article 15(b) of the Charter, CDB will not finance a project if the government of the territory in which the project is located raises an objection to it. In some cases, CDB may also require a government undertaking to provide the borrower with priority access to foreign currencies needed for servicing the loan.

2.07 In making an investment decision, CDB will take into account the economic circumstances in the country concerned and the policies of the member government as they affect PSD. In the evaluation of the projects it finances, CDB gives weight to their anticipated contribution to the general economic activity in the country concerned; the extent to which they would assist in overcoming obstacles to national development; their ability to reduce imports or earn foreign exchange; the introduction of new industries and techniques to raise productivity; the equitable expansion of employment opportunities for all; the contribution to gender equality, compliance with environmental legislative and regulatory guidelines; and the contribution of the project to economic cooperation and integration in the BMCs. The specific characteristics of the lending, in terms of exposure limits, loan maturities and security, will be determined on a case-by-case basis and will be guided by CDB's Ordinary Capital Resource (OCR) Financial and Risk Management Policies.

2.08 CDB will not normally provide resources to finance speculation in shares of existing enterprises. In special programmes, and where specific funds have been made available for the purposes, CDB will participate in the equity market through direct purchase, financing of the purchase of equities or by the provision of support guarantees. CDB will finance initial working capital and longer term inventory investments for new enterprises or for existing enterprises to which financing is provided directly or indirectly.

2.09 CDB may permit its resources to be used for restructuring the debt obligations of an existing enterprise where this is deemed necessary for improving the viability and competitiveness of the enterprise as it seeks to expand its operations through diversification of its output, capacity enhancement and efficiency improvement. This support will not be by way of as standalone facility but must form part of a broader CDB financing package.

2.10 In accordance with Article 35 of CDB's Charter, only economic considerations relevant to the purpose and functions of CDB will be brought to bear upon decisions of CDB in its private sector operations. CDB's evaluation of project investments focuses on financial, economic, technical, managerial, social, gender and environmental aspects of the investment. CDB is willing to assist applicants with loans to carry out necessary feasibility and economic studies, if it considers the project worthy of detailed investigation.

2.11 In its private sector operations, CDB may utilise its Special Funds Resources (SFR) in special circumstances. Particular attention will be given to institutions, the mandates of which focus directly on the social and economic needs of vulnerable groups (such as women, persons with disabilities and the poor) through the provision of opportunities for training and self-development. CDB will direct its efforts towards strengthening the capacity of these institutions to be sustainable and to efficiently deliver training and services to MSME and improve access to finance. CDB may also utilise SFR for certain activities in eligible countries related to development of PPPs.

Eligibility

2.12 In its private sector operations, CDB normally invests in enterprises that are owned and managed by the private sector. Public ownership will not, in itself, disqualify an enterprise from consideration for private sector financing from CDB, especially when CDB's involvement serves to foster PSD. However, in all cases of government ownership, the enterprise must be managed in a way that responds to market signals, enjoys operational autonomy from the government, and is subject to the country's commercial and corporate legislation.

2.13 In this context, CDB would finance business enterprises with significant government ownership that include, but are not limited to, the following:

(a) FIs that act as channels or vehicles to reach local private entrepreneurs, especially in the MSME sector. In these cases CDB has particular regard to provisions that ensure sound management, strong profit orientation and autonomous management;

(b) enterprises, including state-owned corporations, in the process of privatisation or in which the government has a policy of private sector ownership and control, but where private investors who are able and willing to participate cannot be found immediately.

(c) enterprises which are wholly owned by government but which operate with an acceptable level autonomy – for example public utilities; and

(d) joint ventures between governments and private investors, such as PPPs, where the underlying asset(s) remain under the ownership of the government, but are made available to a private sector entity under long-term contract.

2.14 CDB gives priority to the financing of private sector enterprises that are effectively controlled by nationals of its BMCs. Loans may be made to entities not effectively controlled by nationals in special circumstances. For example, when the size of the project being financed is so large and/or technologically complex that, in the opinion of CDB, nationally controlled private enterprises would not have the requisite financial nor technical capacity to implement the project.

2.15 Article 15(i) of the Charter requires that "in procuring services, and in facilitating financing for entities or enterprises in the private sector, the Bank shall pay due regard to the need to develop and strengthen undertakings, entities and skills of individuals belonging to the region." Private sector borrowers are covenanted to respect this obligation, especially in hiring and training staff and in choosing consultants and contractors.

2.16 Recipients responsible for procurement under private sector projects financed in full or part by CDB shall, unless otherwise agreed in the Financing Agreement, comply with provisions for private sector procurement in the applicable prevailing CDB procurement guidelines. CDB does not require private sector projects to comply with CDB's public procurement procedures and will permit the use of established commercial practices acceptable to CDB. CDB's General Procurement Considerations shall be the standard to determine the suitability of commercial practices.

Risk Management

2.17 CDB has an Enterprise Risk Management (ERM) Framework that it applies to risk assessment in all of its operations. In the case of the private sector (referred to in the risk management lexicon as non-sovereign borrowers) the ERM Framework has been used to establish portfolio limit thresholds and a risk-based pricing model based on an internally generated credit risk rating. The overarching objective of risk management in CDB's private sector operations is to ensure that these operations are assessed in the context of CDB's risk appetite framework. Details of how the ERM Framework will be applied in the 2017-2020 period for private sector operations is provided in the next Section dealing with the PSD Strategy.

3. PRIVATE SECTOR DEVELOPMENT STRATEGY

OVERVIEW

3.01 This strategy sets out the framework for CDB's PSD activities for 2017 to 2020. Fostering PSD encompasses a broad range of interventions aimed at addressing the challenges that the regional private sector faces and catalysing the participation of the private sector in key opportunity areas. Thus, the development of this sector requires a comprehensive approach involving both public and private participation and utilising both sovereign and non-sovereign operations. In this sense a defining characteristic of this new strategy is the explicit recognition that support for the private sector involves the full range of lending and non-lending products, the skills, the strengths and the opportunities offered by both the private and public sectors.

3.02 Research work on Caribbean's MSME private sector has demonstrated that it is characterised by high informality and low productivity. Informality (non-compliance with tax, labour and regulatory requirements) is common in the Region, thereby limiting access to finance and legal services and undercutting the profitability of formal firms. Low productivity can be primarily attributed to the fact that the sector faces many barriers that impede investment, firm expansion, job creation, and sustainable growth[5]. It should also be noted that these constraints to private sector development disproportionately affect the entry of female entrepreneurs and business owners into the formal sector economic activities. The continued challenge facing the Region is how to harness the private sector in a manner that it becomes the engine of growth, given prevailing constraints of low productivity and the several barriers that impede investment. It is against this background that this revised strategy is developed to reflect changing demands and development needs.

STRATEGIC PILLARS

3.03 The challenge for CDB is to leverage its strategic interventions and investments for support to the private sector that creates development impact, focusing on CDB's strengths that can be leveraged through partnerships, while responding to the particular country strategies and private sector needs of the BMCs. CDB as a small MDB needs to find the right space for its interventions within the private sector in order to maximise impact and viability.

3.04 The context of PSD, as outlined in the Introduction, leads to the identification of three strategic pillars to underpin the Strategy:

(a) Improving the investment and business climate in the Region;

(b) Expanding infrastructure for economic and human capital development; and

(c) Promoting enterprise development, especially in the MSME private sector.

3.05 These strategic pillars call for CDB to utilise the capabilities of both its public and private sector operations to deliver synergistic solutions to the challenges that constrain private sector development in the BMCs. Appropriately used, the pillars are mutually reinforcing when applied to the private sector development issues in the Region. And they underscore the objectives of the Bank's Strategic Plan 2015-2019 by holistically promoting PSD using both sovereign and non-

[5] These include inadequate basic productive infrastructure (transportation, electricity, trade and integration policies); limited access to financial services and capital markets (bias towards short-term credit, small and medium-sized enterprises limited access to finance); low-skill levels of workers and management, which limits the agility needed for long-term sustainable growth and the ability to compete in increasingly globalised markets.

sovereign operations (see Figure 1). The pillars, taken together, are also fundamental in supporting economic diversification in BMCs by improving the environment for private sector investment.

3.06 The strategic pillars facilitate the development of a comprehensive framework for the Bank to support its BMCs to generate strong inclusive growth through PSD. This demands a shift in approach to view the private sector not only as a beneficiary of the Bank's support but as a partner for development. Specifically, the Strategy:

(a) articulates that all Bank's operations support inclusive growth through PSD;

(b) maximises the impact of the Bank on PSD by harnessing both public and private sector operations;

(c) focuses the Bank's support on selected areas where CDB has appropriate capacity and demonstrated competitive advantage that can generate higher development impact; and

(d) recognises that, in light of the constraints facing the Caribbean private sector, both transactional support to businesses and relational support to entrepreneurs are required.

3.07 The strategic pillars – "Investment and Business Climate" and "Infrastructure for Economic and Human Capital Development" – relate mainly to CDB's public sector operations but also make provision for selective private sector interventions that are consistent with the policy framework. The pillar – "Enterprise Development" deals more directly with CDB's private sector operations.

3.08 The Strategic Plan 2015-2019 identified that fiscal imbalances in many of the BMCs required "the implementation of policies to support private sector investment and participation in growth-oriented economic activities." To support this the Plan indicated that the Bank will support initiatives to assist BMCs to implement policy options that will help to create the enabling environment for private sector investments. These initiatives will include direct financing, risk mitigating guarantees and innovative financial instruments. To facilitate these initiatives the Bank will seek to access resources outside of its OCR (i.e. placed in Other Special Funds (OSF) resources) to overcome the exposure limitations imposed by the OCR risk management structures. It is anticipated that institutions (such as sovereign wealth funds) in member countries will be the most likely sources of such resources.

3.09 In operationalising the strategic pillars the Bank will take explicitly into account the cross-cutting issues identified. In particular, the Bank recognises that there is unequal participation of men and women in private sector enterprises. Persistent gendered occupational segregation and differential wages are pervasive in both formal and informal sector employment across the Caribbean. Women and youth in particular encounter significant barriers to participation in economic activities due to limited access to finance, assets and collateral. Therefore, the Bank will ensure that its interventions in the private sector will address these barriers and constraints through specific activities that enable equitable participation by female and male entrepreneurs and business-owners to the breadth of economic opportunities.

Pillar 1: Improving the Investment and Business Climate

3.10 Experience in business climate policy reform indicates that it is a complex and time consuming process since there are both market and government failures that have to be addressed. A focus of this work will be supporting public-private dialogue as a way to build trust among the actors, break the political barriers to growth and achieve consensus on medium-term agendas for fostering private sector led growth.

FIGURE 1: CDB PRIVATE SECTOR DEVELOPMENT STRATEGY

OBJECTIVE
Contribute to inclusive and sustainable growth and development in the Region through private sector development

GOAL
A private sector that is internationally competitive and is the major driver of economic and social wellbeing in the Region

Strategic Pillars	**Investment & Business Climate**	**Infrastructure for Economic & Human Capital Development**	**Enterprise Development**
Targeted Outcomes	**Addressing Laws & Regulations related to doing business and competitive constraints:** • Property Rights • Business Formation • Collateral Registries • Bankruptcy Procedures • Fiscal and Trade Policies **Improving the Financial Infrastructure:** • Legal & Regulatory Reform • Improving Credit Decisions • Improving access to finance • Widening range of Instruments	**Increased Investments in:** • Renewable Energy (RE) • Energy Efficiency (EE) • Transportation • Water & Sanitation (WS) • Climate Change Adaptation & Resilience • Education • Low & Middle Income Housing • **Utilisation of Public-Private Partnerships (PPPs)** in Transport, RE, EE, Water Supply & Sanitation	**Increase in # of PS Projects with development impacts:** • Increased credit and advisory services from FIs servicing MSMEs. • Improved governance, risk management and viability of FIs • Increased innovation and entrepreneurship
Instruments	• Policy Dialogue • Economic & Sector Work • Policy-Based Operations (PBO) • TA Grants & Loans	• TA • Investment Loans • Sector PBOs • Co-Financing • New Financial Instruments	• TA • Investment Loans W/O Sovereign Guarantees • Equity • Partial Credit Guarantees • New Financial Instruments

CROSS CUTTING PRIORITIES
Gender Equality Regional Cooperation and Integration Climate Change
Climate Finance Knowledge Management and Capacity Building

3.11 In support of the creation of a dynamic private sector, the Bank will widen its current assistance to BMCs to deepen their policy reforms in a bid to promote a more efficient and internationally competitive business environment. Included in such support will be interventions targeted at addressing key doing business and competitiveness constraints including barriers such as inadequate property rights, inadequate incorporation laws, insufficient collateral registries, inequitable access to financial services, ineffective bankruptcy procedures and cumbersome business regulations which adversely impact business development. With regard to MSMEs, policy support will include creating incentives for informal sector enterprises to migrate to the formal sector and the Bank will support the reform of private (and public) enterprises in terms of providing paid maternity, paternity and parental leave, part-time and flexi-time arrangements. The Bank will also support the introduction and/or the enhancement of social safety nets to prevent adverse effects of any policy reforms on vulnerable groups.

3.12 Currently there is considerable private sector assessment work being performed in the Region. The Ease of Doing Business Index (DBI), Global Competitiveness Index (GCI) and the Global Entrepreneurship and Development Index (GEDI) are examples. However, many of the Bank's BMCs are not covered in these assessments. The DBI does not include the British Overseas Dependent Territories, only five to six BMCs are covered by the GCI and the GEDI covers four BMCs. CDB can play an important role in facilitating the expansion of these assessments to include all of its BMCs, as it has done in the Compete Caribbean Programme[6]. In this way CDB can contribute to improving the quality of private sector policy while enriching data collection and availability in the BMCs[7].

3.13 Support will also be provided to develop sound, inclusive financial sectors and capital markets in BMCs, in line with the current work undertaken by the Bank and other development partners in the Financial Sector. Assistance will be provided towards strengthening financial infrastructure through institutional reforms, capacity building, and harmonisation, as well as use of information and communication technologies. In addition, the Bank will support efforts to improve resource mobilisation and credit decision-making (including establishment of credit bureaus), considered as vital for efficient functioning of the financial sector and improving equitable access to finance. This work will include support for the creation of an enabling environment for venture capital and angel investing networks on a regional basis.

Pillar 2: Expanding Infrastructure for Inclusive Economic and Human Capital Development

3.14 The Bank continues to support interventions in economic infrastructure mainly through interventions in the public sector. However, in view of the severe fiscal challenges faced by most of the BMCs, the Bank will also seek to support participation in infrastructure provision by the private sector in areas that contribute to inclusive economic development, while improving efficiency in the delivery of goods and services. Within the scope of its infrastructure sector policies, the Bank will promote private sector involvement in energy, transport, water supply and sanitation. This will include the provision of direct loans to private infrastructure providers under PPP contracts with BMC governments. In addition to financing infrastructure development, the Bank will support capacity building of national authorities and local governments, to plan, finance and manage

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[6] Compete Caribbean Programme – a multi-donor private sector development programme managed by the Inter-American Development Bank and focused on the development of knowledge products, business climate reform and development of business plans for innovative businesses and clusters. CDB's involvement in this programme has allowed non-members of IDB, such as the Overseas Dependent Territories and OECS members, to participate.

[7] The DBI, GCI and GEDI collect and analyses data related to efficiency and effectiveness of the business climate and regulatory environment for private sector development in the respective countries.

infrastructure projects. In its choice of infrastructure interventions, the Bank will prioritise the adoption of economically viable cleaner and proven technologies towards transitioning to green growth. The Bank will promote a gender perspective in the development of infrastructure and access to services, to assist BMCs to more fully take into account the differential needs of women and men.

3.15 The Bank will also promote increased access to quality social services, but will remain selective with a principal focus on education and training as a means to enhancing human capital development for PSD. With the view of tackling youth unemployment, the Bank will continue to focus on investment in higher education and vocational training to better match the supply of and demand for skilled workers. The Bank would continue to support the enrolment of women and girls in non-traditional fields to allow for better employment and earning opportunities.

3.16 The Bank will support interventions in agriculture. In its public sector operations the Bank will focus on improving land use by funding for drainage, flood and irrigation works. In the private sector operations, funding will be provided, through intermediary lending, to male and female agricultural operators to optimise the increased production possibilities resulting from the improved infrastructure. To complement these intermediary loans the Bank will use TA resources to train stakeholders in advanced agricultural production techniques.

3.17 The Bank will support sustainable energy (SE) development in the BMCs. This is a key dimension for achieving increased energy security in BMCs, given their over-reliance on imported fossil fuels. In addition to the fact that the promotion of SE aligns well with the international focus on sustainable development (including increased Climate resilience), in many BMCs, it is also considered a critical part of the energy sector transformation, which is necessary for unleashing robust economic growth in most BMCs. Consequently, the Bank has identified the promotion of RE and EE as a priority in context of energy security being established as a cross-cutting theme its Strategic Plan 2015-2019. Further, increased utilisation of RE and EE options, holds the potential for contributing to the stabilisation, and (in some cases) the reduction of the cost of energy for the productive sector and the poor.

3.18 Attendant to the needed legislative and regulatory reforms, it has also been recognised that, investments in RE and EE to achieve the afore-mentioned targeted transformation, must come from the private sector. However, various barriers have been identified which historically deterred such private investments. In response, one of the Bank's energy sector strategies focuses on the development of suitable mechanisms/instruments in form of special facilities and programmes to address many of the identified barriers, and to unlock private investments in RE and EE. One example is the CDB GeoSmart Initiative which seeks to unlock private investment in geothermal energy development using the PPP model[8]. In addition, with assistance from CDB and other international agencies, some regional governments have achieved successes in implementing privately financed utility-scale RE projects, for example in Jamaica. Lending to MSMEs for RE/EE frequently targets women who often work in their businesses from home and are highly dependent on energy for cooking, baking, sewing and similar tasks.

[8] In the GeoSmart Initiative, a pool of suitable grant, and loan resources appropriate for the various stages of GE development is being mobilised to overcome specific barriers to the introduction of private capital. Another instrument that is being tested is, the Sustainable Energy for the Eastern Caribbean (SEEC) Programme that targets EE and RE investment in public sector facilities. This is a blended facility consisting of grant funding (from EU-CIF and UK-DFID) and CDB OCR, and also includes a component which is testing an EE line of credit (provided through DFIs) for MSMEs.

Public Private Partnerships

3.19 A PPP is defined as ***"a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risks and management responsibility, and remuneration is linked to performance."*** It is anticipated that the major avenue for supporting private sector participation in economic infrastructure will be through PPPs. The Bank will promote PPPs and support BMCs' efforts to establish policy, regulatory and sector systems that provide a strong framework for private participation, as well as safeguards for taxpayers and consumers. It will also support BMCs in building capacity to design and manage PPP programmes and projects. CDB will work to ensure that PPPs are correctly structured for risk mitigation and risk sharing. The Bank will also seek to establish mechanisms to relieve governments of the high cost of project preparation, from concept development through to transaction implementation. CDB will also support BMCs through the provision of long-term funding for PPP projects in the infrastructure sectors.

3.20 CDB's involvement in PPP will be predicated on the Bank building the capacity to effectively manage a PPP programme. This capacity building started (in March 2015) with the formation of the Regional PPP Support Mechanism (RSM) in cooperation with the Inter-American Development Bank (IDB), the Multilateral Investment Fund (MIF), the World Bank Group (WBG) and the Public-Private Infrastructure Advisory Facility (PPIAF). The RSM strengthened the enabling environment for PPP investments by:

(a) Capacity building among BMC government employees through PPP Boot Camps;

(b) Providing hands-on support to national PPP programmes and projects; and

(c) Developing a Caribbean PPP Toolkit as a modular learning tool covering key areas of PPP theory and practice. The Toolkit was completed in early 2017.

3.21 The Bank is also involved, together with development partners, in establishing a Regional PPP Unit – the design for which is one of the outputs of RSM. It is envisaged that the Regional PPP Unit will support the development and implementation of PPP projects in the Region by both supporting governments to implement PPP policies and identify PPP projects (i.e. the "upstream activities) and managing the detailed transaction preparation and implementation. CDB will be the primary implementing institution for the Regional PPP Unit.

3.22 There is an emerging trend in the Region for PPI, involving investments by global private infrastructure operators in PPP projects with BMC governments. Most BMCs are pursuing Renewable Energy (RE) projects as PPPs, for example in Jamaica.[9] Many of these infrastructure investments are financed by MDBs, in partnership with regional commercial banks. With the correct risk allocation and an appropriate enabling environment, infrastructure PPPs are proving attractive to global investors and financiers. Two of CDB's strengths are trust from its BMC governments, as well as a deep knowledge of the regional infrastructure sectors. Given these strategic strengths CDB will, in cooperation with MDBs, seek to develop early stage infrastructure projects that show strong developmental features, with a view to providing direct loans to BMC governments, or to private operators of infrastructure services.

[9] Jamaica's Office of Utility Regulation (OUR) has successfully implemented a series of "Renewable Energy Auctions" which have resulted in over 100 Megawatts of new wind and solar capacity added to the national grid, most of which has been through PPPs.

3.23 CDB's support for PPPs may include the financing of the public sector component of the investment or the direct provision of loan financing to private operators in PPP contracts. Appropriate risk mitigation measures along with internal controls to avoid conflict of interest situations will be implemented in circumstances where CDB is involved in providing both advisory services and investment financing. CDB's evaluation criteria for financing the private sector in PPPs will include appropriate risk transfer and mitigation, regulatory maturity and transparency of the transaction process to locate the private investors. CDB's involvement with PPP financing will be in collaboration with development partners and will focus on the priority sectors of energy, transportation, water supply and sanitation.

Pillar 3: Enterprise Development

3.24 While a good business climate and access to quality social and economic infrastructure are key for the private sector to flourish, this strategy also has enterprise development as a direct objective. In this regard, the Bank will prioritise support to MSMEs, including female-owned businesses, and this support will be mainly in the form of technical assistance and intermediary lending.

3.25 In 2015 CDB commissioned a thematic study on micro, small and medium enterprises (MSMEs) in the Caribbean. The study had two broad purposes:

(a) To assess the status of the MSME sector based on a review of the sector in eight of CDB's borrowing member countries – Antigua and Barbuda, Barbados, Belize, Guyana, Jamaica, St. Lucia, Suriname and Trinidad and Tobago; and

(b) To highlight critical MSME development challenges and to propose a structured approach to addressing these challenges.

The Study resulted in a 2016 publication entitled *"Micro-Small-Medium Enterprise Development in the Caribbean: Towards a New Frontier"*.

3.26 There were four major findings identified in the study:

(a) There are significant weaknesses in the regional life cycle system of financing. (LCS). The LCS refers to the ability of the financial system to meet the changing financial requirements of an enterprise as it grows from micro entity to a large enterprise;

(b) There are substantial gaps in the Policy and Regulatory Frameworks;

(c) There is weak technical support for MSMEs; and

(d) There are major weaknesses in the regional innovation systems.

3.27 To address these constraints, the study made the following recommendations and these are an intrinsic part of this strategy:

(a) Improve MSME access to finance;

(b) Refocus the regulatory and policy frameworks toward increased efficiency and effectiveness;

(c) Strengthen the institutional support frameworks; and

(d) Nurture innovation in the MSME sector.

3.28 CDB's financial intermediary lending has been the major modality for providing resources to MSMEs. Approximately 85% of total private sector commitments are through intermediary lending compared to around 11% in equity investments and 4% in direct loans.

3.29 The Bank's support for MSMEs will take three forms:

(a) **Improving Access to Finance**: The Bank will work towards increasing the availability of long-term finance for MSMEs working with national DFIs and other eligible FIs. The Bank will strengthen the governance structures, risk management systems and financial architecture of national DFIs in an effort to improve their viability and lessen their dependence on subsidies from governments. The Bank will also seek to widen its engagement with and explore the feasibility of emerging funding mechanisms such as crowd funding and angel investing. In this context the Bank will review its lending policies with respect to FIs to ensure that these policies are appropriate for the institutions and the financial sector. The Bank will also specifically target the issue of women access to finance as part of its broader attempt to remove the barriers that challenge the involvement of women in private sector enterprise development.

(b) **Capacity Building**: The Bank will support capacity building within critical institutions that promote PSD, as well as to MSMEs themselves. CDB will also assist with the development and execution of programmes aimed at enhancing the regulatory environment for institutions that deliver services to MSMEs, as well as facilitating entrepreneurship and innovation. The Bank will seek to address the factors that underlie the low productivity of MSMEs, and will support multi-pronged initiatives to boost local enterprises, competitiveness and integration in the supply chain, including female-owned businesses. In this regard, the Bank will support BMCs' effort to strengthen the quality of business development and financial services with a view to creating incentives for informal businesses to move to the formal economy, recognising that female and male-owned businesses face different barriers to participation. As part of the efforts to encourage entrepreneurship and innovation, the Bank will explore avenues for the supporting the growth of MSMEs in sectors identified as having growth potential for economic diversification such as the creative industries. The strengthening and refocusing of the Caribbean Technological Consultancy Services (CTCS) will be an important component of this support. CDB will also continue support for the Compete Caribbean Programme. The Bank will promote client support for digital and financial inclusion for women as suppliers in value chains and as entrepreneurs, to strengthen their participation in productive sectors.

(c) **Trade Facilitation:** In order to promote the Caribbean's trade both regionally and globally, the Bank will provide support for trade development initiatives. The Bank will support private sector interventions that focus on efforts to provide effective trade support services for goods and services through improving access to information on exporting intra-regionally and to Europe under the Economic Partnership Agreement. It will also support initiatives that make trade related information easily accessible to business enterprises. These interventions will be in collaboration with development partners.

Gender Equality and Women's Economic Empowerment

3.30 The Bank acknowledges that economically women still lag behind men in the Caribbean. Based on qualifications, job descriptions and job responsibilities, on average female workers earn less than their male peers. Furthermore, women-owned businesses tend to be located in low productivity and growth sectors. The constraints that women face include, but are not limited to:

(a) Gender-stereotypic subject selection in technical and vocational education and training (TVET) and at universities, leading to a distribution of skills that is disadvantageous to the economic advancement of women and results in occupational segregation of the labour market.

(b) Gender-based discrimination.

(c) Lack of affordable care for dependents (children and the elderly).

(d) Workplaces that are still not conducive women's needs e.g. with regard to sexual harassment policies, paid maternity, paternity and parental leave, part-time, flexi-time and flexi-place arrangements, appropriate sanitation facilities.

(e) Lack of security to access credit and financial products and services, due to lack of ownership of land and other assets.

(f) Lack of access to technical assistance, business development services and market information, including domestic and international trade related and/or industry specific information.

(g) Lack of financial and business management skills due to limited training and skills development opportunities, including flexible provision of skills for employment programmes.

3.31 The following strategies will be pursued to empower women economically as part of its PSD strategic direction. Some of these have already been identified:

(a) Increasing financial literacy.

(b) Adjusting financial products to women's needs e.g. via lines of credit offering loans to households with high dependency ratios, which are often female headed.

(c) Business advisory services to female entrepreneurs and business owners.

(d) Gender sensitisation and gender mainstreaming of DFIs.

(e) Reform of private and public sector organisations to provide paid maternity, paternity and parental leave, part-time and flexi-time arrangements, and child care services.

(f) Digital and financial inclusion for women as suppliers in value chains and as entrepreneurs.

(g) Support for the educational enrolment of women and girls in non-traditional fields.

Risk Management

3.32 The Bank's Office of Risk Management (ORM) has developed a risk based limit framework for non-sovereign entities. The framework has three components – credit risk rating, exposure limitations and risk-based pricing.

3.33 **Credit Risk Rating:** ORM will assign an internal CDB rating to a non-sovereign entity based on the corresponding public rating issued by one of the three big nationally recognised statistical rating organisations[10] (NRSRO). Where an entity is not rated by one of the NRSROs, ORM will derive a rating from a secondary source such as the Caribbean Credit Rating Agency (CariCRIS) but will adjust this down two notches on CDB's internal rating scale. In the absence of primary or secondary ratings, ORM will derive an internal in-house rating utilising a combination of measures including:

(a) Completing an independent credit analysis focusing on an entity's quantitative factors – financials, projections, assumptions, ratios etc.;

(b) Qualitative assessment focusing on management, strategy, external factors etc.;

(c) Completing an industry benchmark analysis;

(d) Utilising a proxy from a comparable entity; or

(e) A combination of any of the above.

3.34 The ORM internal rating scale will serve as the single source for issuing these ratings. In the event that an internal rating cannot be derived from any of the above, ORM will reserve the right to assign the lowest rating of "CCC" on the internal scale. Non-sovereign borrowers will not be assigned a rating that exceeds the rating of the country or sovereign where they are domiciled, based on the methodology. The internal rating is used as the basis for determining the individual entity exposure limit.

3.35 **Exposure Limits:** CDB will, in keeping with its Risk Appetite and Limits Framework (December 2014) and its OCR Policies and Operating Guidelines (December 2016), restrict the proportion of its non-sovereign exposure (defined as loans, plus derivatives, plus guarantees less portions adequately secured) to private sector borrowers in its portfolio to 43% of available capital. Loans approved to any single direct or indirect private sector project shall be limited to 6% of available capital. As at December 31, 2016, the single exposure threshold for a non-sovereign borrower stood at $28.9 mn.

3.36 **Risk-based Pricing:** CDB will use a risk-based pricing model to determine the interest rate that will be applied to non-sovereign borrowers. The internal rating system outlined above is the foundation for the risk-based pricing model thus aligning loan pricing with expected credit risk. The risk-based pricing framework will involve the alignment of loan pricing to cover funding costs, operating costs, a risk premium and a margin based on a targeted minimum return, depending on the project and/or institution.

Fees and Other Loan Terms

3.37 In addition to the risk-based pricing that CDB applies to private sector entities, certain fees are also applicable:

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[10] Moody's Investors Services, Fitch Ratings Inc. and Standard and Poor's Rating Services.

(a) Commitment Fees: CDB will levy a commitment fee of 1% per annum on the undisbursed portion of a loan made from a date 60 days after signature of the Loan Agreement. In the case of FIs, a commitment fee of 0.25% per annum will be levied on the undisbursed portion of a loan from a date 60 days after signature of the Loan Agreement.

(b) Front-End Fee: CDB will charge a front-end fee up to the equivalent of 1% on all loans made in its ordinary operations to the non-financial private sector. One half of the fee, based on the amount of the loan applied for, is payable prior to project appraisal and the remainder on loan approval. The deposit is refundable if the project is not recommended or approved, but is retained by CDB if the loan is approved.

(c) Such other fees as may be customary for private sector transactions.

3.38 Other loan terms for CDB's OCR for private sector borrowers include the following:

(a) Contribution to Project Costs: In the case of direct lending to private sector projects, the proportion of project costs financed by CDB shall be restricted to not more than 40%.

(b) Grace Periods: Grace periods are determined on the basis of the project's projected cash flow and the borrower's ability to repay from other sources, but in any case will not exceed five years.

(c) Maturity: The maximum maturity of loans, inclusive of the grace period, is determined on the basis of the project's expected cash flow and the borrower's ability to pay from other sources but, in any case, will not exceed:

(i) 14 years for direct private sector borrowers; and

(ii) for lines of credit, three years longer than the projected weighted average terms of the sub-loans to be made from the resources provided.

3.39 CDB will require its commitments to be adequately secured. However in situation I which the cash flows of the project are sufficient, CDB may accept a facility on an unsecured basis.

3.40 **Retroactive Financing:** Retroactive financing is the reimbursement by CDB, after the satisfaction of conditions precedent to first disbursement of a loan, of payments made by a borrower prior to the approval of the loan. Retroactive financing will be permitted for direct capital projects and loans to financial intermediaries. Retroactive financing for direct capital projects will be limited to expenses incurred within 12 months prior to the date of approval of the loan by CDB's BOD, or from the date of the request for the loan to the date of such approval, whichever is shorter. Retroactive financing for loans to financial intermediaries will be limited to sub-loans approved by the financial intermediaries for processing from CDB's resources within 12 months prior to the date of approval of the loan by CDB's BOD, or from the date of the request for the loan to the date of such approval, whichever is shorter. In both cases:

(a) the amount of retroactive financing sought and the period over which retroactive financing is sought must be justified;

(b) retroactive financing will be limited to 20% of the amount of the loan; and

(c) expenditure for which retroactive financing is sought must meet all eligibility criteria under the loan agreement.

INSTRUMENTS AND MODALITIES

3.41 In the implementation of the strategy, the Bank will employ the full range of operational modalities and financing instruments at its disposal. Bank staff will systematically identify, analyse and assess available options and provide clear justification for the recommended instrument(s). These instruments and modalities will, most likely, be used in combination because of the complexity of the issues involved.

(a) **Policy Dialogue**: The Bank will work with all stakeholders to create a forum for dialogue between government(s) and the private sector to identify reforms that promote inclusive growth. Public-private dialogue fora are not only a means to identify policy reform agenda, but will also help create trust among the players. The Bank will seek to catalyse successful dialogue among PSD actors, including building capacity on PSD cutting-edge knowledge and best practices.

(b) **Economic and Sector Work**: The Bank's economic and sector work will inform the policy dialogue and development of the country strategies. In particular, the Bank will ensure that country strategies[11] explicitly take into account private sector development issues.

(c) **Policy Based Operations**: The Bank will use PBOs at both the macro and sector levels to encourage the macroeconomic and sector reforms required to support private sector development and to facilitate the adoption of environmental and social safeguards, such as gender equality. Sector PBOs will be used in instances where the policy and institutional environment in the sector – for example, transport, energy, agriculture- is not conducive to successful project implementation and operation. The old adage "you can't have good projects in a bad policy environment" is particularly relevant in social and economic infrastructure projects if only because of the relatively large sums involved.

(d) **Technical Assistance Grants and Loans**: Technical assistance (TA) interventions will be used to identify the policy and institutional reforms required, to design the reform methodologies and to build capacity to institute and sustain the reform required to address private sector development constraints. TA support to help integrate gender equality and diversity issues in PSD will be specifically targeted. TA loans and grants will also be of particular relevance to support capacity building of national authorities and local governments, to plan, finance and manage infrastructure projects. TA will also be used to fund the PPP support facility and to assist in the design and preparation of infrastructure projects in the public sector. CDB TA involvement will ensure that the investments adhere to sound environmental, social and corporate governance standards; and the private sector support activities of the Basic Needs Trust Fund programme at the micro level will be explicitly recognised.

(e) **Investment Loans**: These would be used for both the traditional public sector infrastructure projects and PPP projects. Co-financing with development partners and other FIs will be an important feature of these investment loans. CDB would

[11] As documented in the results-based Country Strategy Papers (CSPs).

apply the risk management framework developed by ORM as part of its due diligence while appraising investment loan applications. The exposure limits as determined by the entity's rating and the risk based pricing will be especially considered. If the operation involves co-financing with other MDBs, CDB will attempt to ensure that its pricing is competitive with the co-financing partner(s) but will reserve the right to apply its own pricing and risk management procedures at all times.

(f) **Intermediary Loans**: CDB will continue to use intermediary lending to support MSME access to finance. Most of the intermediary lending would be directed to state-owned DFIs though CDB would seek to expand its client base to private FIs. In the case of the state-owned DFIs CDB would be prepared to provide intermediary loans without a sovereign guarantee if CDB is satisfied that the entity has the financial strength and integrity to satisfy key performance benchmarks. In these instances, as in the case of private entities, CDB would apply the risk management framework developed by ORM.

(g) **Equity/Quasi Equity Instruments:** Within the Caribbean for several reasons loan financing is preferred over equity thereby contributing to financial systems being essentially bank-based. A greater effort is required to develop the equity market as part of an overall programme to enhance capital market development. Current work is ongoing in the Region to enhance access to finance that includes support for equity financing, improving the venture capital ecosystem and support for angel investing networks. Opportunities are being created for CDB to contribute to improving the regional capital markets through venture capital and private equity operations by complementing work being done by other development partners. The Bank will consider the feasibility of participating in private equity funds focused on small and medium enterprises subject to acceptable investment management and rates of return.

Exploring Additional Instruments

3.42 The Bank also proposes to investigate the feasibility of introducing additional instruments, such as credit guarantees and equity arrangements, with the objective of improving access to finance for MSMEs. In this context CDB has encouraged the establishment of the Eastern Caribbean Small and Medium Enterprises Credit Guarantee Corporation (ECGC), with support from the World Bank (Box 1), and is examining the most appropriate way to support the participating governments in fully realising the benefits of the institution.

3.43 In the context of procedures and processes, the Bank has recently done a major review of its operational policies and procedures and produced a comprehensive Operational Policies and Procedures Manual (OPPM). The OPPM is prepared in five volumes and is designed as an on-line document that facilitates rapid access by staff and clients to all of the Bank operational policies and procedures. With the recent enhancements of the Project Portfolio Management System (PPMS) [now renamed Project Resource Interface for Systematic Management (PRISM)] the Bank has to review the OPPM and update the policies and procedures making them consistent with PRISM. The Bank also has to develop a method to ensure that OPPM is continuously updated.

Box 1: Eastern Caribbean Small and Medium Enterprises Credit Guarantee Corporation

The Eastern Caribbean Credit Guarantee Corporation (ECGC) was established in March 2017 when the enabling act was assented to by Heads of Government at a meeting of the Monetary Council of the Eastern Caribbean Central Bank (ECCB). The purpose of ECGC is to provide credit risk mitigation to participating financial institutions in order to increase the ability of MSMEs to access loans. It will accomplish this by providing partial credit guarantees (PCGs) to qualifying enterprises. A major advantage of PCGs is that they combine a subsidy element with market-based arrangements for credit allocation thus leaving less room for distortion of the credit market than more direct forms of intervention.

The Participating Governments in the ECGC are Anguilla, Antigua & Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, Saint Lucia, and St. Vincent and The Grenadines. Most of the countries have tabled the relevant legislation in the national parliaments. It is anticipated that the participating governments would each contribute USD2.0 million to the capital of ECGC.

PRINCIPLES OF IMPLEMENTATION

3.44 A number of underlying principles or approaches will be adopted in implementing the strategy. The Bank will support the reform of private (and public) enterprises in terms of providing paid maternity, paternity and parental leave, part-time and flexi-time arrangements. The Bank will also support the introduction and/or the enhancement of social safety nets to prevent adverse effects of any policy reforms on vulnerable groups. Some of these have been mentioned earlier, but are brought together here for clarity and emphasis.

(a) **Resourcing the Strategy**: For the strategy to be effectively implemented it must be adequately resourced. This means that the Bank will not attempt to implement any aspect of the strategy until it is satisfied that it has put the necessary human and financial resources in place. For example, it would not engage in PPP financing until the proposed Caribbean PPP Unit is established in collaboration with the development partners. More generally, the Bank will conduct a Workforce Requirements Study to determine the most appropriate institutional arrangements and skills needed to implement the strategy. The Bank will ensure that the Private Sector Development Unit in the Projects Department is adequately staffed and appropriately structured to ensure effective implementation of the Strategy. The Bank will implement enhanced credit review and decision-making procedures to expedite the decision-making process for non-sovereign transactions. It will also utilise consultants with specialist skills and partner with other institutions with experience in private sector operations.

(b) **Partnerships**: CDB's relatively small resource base and prudential exposure limits mean that partnerships/alliances with development partners and other FIs (including multilaterals) operating in the Region will be an important component of CDB's private sector operations. Indeed, many of the PSD activities in the strategy would be implemented with partnerships. Some of these partnerships will be implemented using Trust Fund arrangements.

(c) **The Bank's Country Strategies**: BMCs are at different stages of development, and faces varying challenges and opportunities from country to country. The Bank's support, therefore, will be tailored to the needs and development stages of individual countries. This will be done by anchoring the Bank's support on country-driven national development plans prepared with the participation of all stakeholders.

Country priorities are then translated into CSPs, which will serve as the principal business platforms for all Bank operations in support of PSD in BMCs.

(d) **Sector Strategies**: The type of intervention made for PSD development in the various sectors will be determined by the sector strategies that the Bank has developed or is in the process of developing. Similarly, how the cross cutting priorities are applied when implementing the PSD Strategy would be guided by the policies and strategies developed by the Bank in these areas. For example, the Bank will utilise the Technical Guidance note for Integrating Gender Equality into PSD Operations.

(e) **Knowledge-Intensive Activities**: Continuing improvements in the regional investment climate and enabling environment require policy and institutional reforms based on reliable evidence and objective analysis. The Bank, therefore, will invest more effort in analytical and advisory activities, and policy dialogue with BMCs. In deploying this initiative, the Bank will strive to avoid situations of potential conflict of interest. In cases where the provision of advisory services to clients has the potential to conflict with the role of the Bank as financier or to put at risk the Bank's credit through moral hazard, for example, in the case of non-sovereign operations, a firewall arrangement will be put in place to separate the Bank's advisory activities from lending operations to the same clients.

(f) **Sovereign Financing Operations**: Sovereign financing operations will continue to serve as an important means for supporting PSD, in view of the importance of improving the investment and enabling environment and infrastructure development.

(g) **Non-Sovereign Operations**: Direct private sector lending will provide an important channel for the Bank's support to PSD in BMCs. Non-sovereign operational transactions will be conducted under this strategy, which will be managed in conformity with the Bank's Risk Management Framework. In this direct lending modality the Bank will focus primarily, though not exclusively, on PPP operations and financing in the energy and transport sectors.

(h) **Monitoring and Evaluation**: The implementation of this strategy will be undertaken across the Operations Area of the Bank. A Results Monitoring Framework (RMF) and Key Performance Indicators will be established on a medium-term basis to provide benchmarks for monitoring and evaluation of the Bank's operations in support of PSD in its BMCs. The objective is to identify and define indicators that can be used to monitor the implementation and results of the PSD strategy. Selection of indicators is influenced, *inter alia*, by relevance, whether it can be clearly defined and measured and data availability. A draft RMF is provided at Appendix 2.

LESSONS LEARNED DURING IMPLEMENTATION OF THE EXISTING PRIVATE SECTOR DEVELOPMENT POLICY AND STRATEGY

In 2009 the Bank contracted a consultant to review the 2003/2004 Private Sector Policy and Strategy. A number of lessons were identified in the study and these have been considered in preparing the current strategy. The more important lessons are identified below:

(1) Existing Private Sector Development Strategy is too broad: The existing PSD strategy contained too many strategic elements. Given CDB's relatively small asset base compared to other MDBs, it was felt that CDB's ability to achieve significant impact in so many areas was limited.

(2) Private sector is not homogenous: The private sector within CDB's BMCs does not represent a homogenous group. Instead, it is a complex, multi-dimensional environment including local and foreign-owned enterprises, male and female-owned MSMEs and formal and informal operations. As a result, 'one size fits all' approaches and interventions to private sector development are discouraged. Instead, careful business and governance analyses, and flexible design and delivery models, are necessary on a project-by-project basis to ensure effective and sustainable private sector development initiatives.

(3) Small capital base relative to other MDBs limits the Bank's private sector risk exposure: While direct lending to the private sector is still considered to be relevant, CDB's OCR exposure in respect of a single direct private sector loan, is limited to 2.5% of its capital (defined as paid-up capital, ordinary reserves and unallocated net income less provisions plus receivables from members). Based on this policy, at December 31, 2016, the maximum loan permitted to a single private sector enterprise was approximately $25.4 million. As a result, direct private sector lending has been restricted, resulting in a small number of transactions. In the energy and mining sectors there is scope for direct lending above this ceiling.

(4) Unconventional loan pricing structure: Unlike other MDBs, CDB's pricing of its loans is not LIBOR-based. LIBOR-based pricing facilitates transparent price adjustment of the spread over the LIBOR base to reflect risk on a case-by-case basis, improving predictability in forecasting for borrowers. In addition, the existing risk premium of 2% above the sovereign rate charged by CDB, is considered unacceptable for the pricing of private sector risk. The existing pricing structure has also made participation in syndicated loan transactions difficult.

(5) Restrictive security requirements: For government-owned development finance institutions, CDB lending policies require that the loan be supported by the guarantee of the government. In the current economic circumstances, where several of the BMCs face debt challenges, opportunities for the provision of such guarantees are limited. This significantly impacts the DFIs ability to borrow from CDB, and hence CDB's ability to effectively channel resources to MSMEs.

(6) CDB's review process impedes the desired response time by the private sector: There is the perception that CDB's existing processes is not well suited for direct private sector lending, given the high level of risk associated with

such lending and CDB's capacity to manage such risks. CDB's decision-making structure and associated response times is considered an impediment to lending to private sector clients and does not allow for the level of flexibility required.

(7) Need to broaden the range of financial intermediation: Financial intermediation has proven to be a cost effective and efficient way of channelling CDB's resources to MSMEs. As at December 31, 2016, the loan portfolio outstanding to public and private financial intermediaries amounted to $205.9 million. These lines of credit have targeted key economic sectors including agricultural and industrial credit, MSMEs, as well as for student loans schemes, and mortgage financing, targeting lower and lower-middle income families. In 2011, by Board Paper BD 6/10, CDB approved funding for a consultancy to evaluate CDB's financial intermediary lending activities and to recommend and develop a clear time-bound action plan in relation to future financial intermediation. The findings indicated that financial institutions lending remains an important source of long-term development funding for MSMEs, mortgages and student loans and CDB needs to broaden its range of financial intermediaries to include non-traditional financial institutions. The Consultancy also suggested that the security options for intermediary lending needed to be reviewed.

(8) CDB's risk appetite restricts Direct Private Sector Lending: CDB experienced varying levels of success with respect to direct private sector lending, some successful, while others have been affected by technical and operational issues resulting in an inability to service debt. The level of supervision and technical expertise required during and after implementation to resolve such issues were not always readily available to CDB given prevailing resource constraints. In addition, CDB has been unable to approve a significant number of deals with a risk profile consistent with the Bank's risk appetite and operating structure.

(9) There is a need for comprehensive Private Sector Development programming: One-shot, isolated interventions addressing issues of private sector development as independent variables have proven to be less effective than comprehensive programmes in CDB's BMCs. Feedback from the sector also suggests that country and local ownership of private sector development was felt to be critical to ensuring equitable and sustainable results.

(10) The need for evaluation and impact of Private Sector interventions is important: The existing PSD strategy does not include a mechanism for the evaluation and review of its private sector operations, lending products or TA instruments. Given CDB's results-based approach to its developmental activities, improving the effectiveness of current and future private sector development programming, in particular through more systematically pursuing and tracking performance and results achieved, will be increasingly important.

(11) Collaborations with other MDBs to increase development impact: Given CDB's relatively small resource base, the Bank needs to better leverage its TA

resources by forging stronger and new alliances with development partners in order to maximise impact within its BMCs.

(12) Need to establish separate TA Allocations for the private sector: TA resources to support the private sector are not programmed separately within CDB, and funding for this activity has to compete with other priority areas all seeking funding under the component for capacity-building.

APPENDIX 2

RESULTS MONITORING FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT POLICY AND STRATEGY

Strategic Pillar/Expected Outcomes	Outcome Indicator	Output	Output Indicator	Activities	Assumptions
Investment and Business Climate: Legal and Regulatory Reform appropriate to PSD: • Property Rights • Business Formation • Collateral Registries • Bankruptcy Procedures • Fiscal and Trade Policies Improved Financial Infrastructure: • Legal and Regulatory Reform • Credit Decision Making • MSME access to finance • Widened Range of Financial Instruments	**All indicators sex disaggregated when feasible.** **Change in:** • **Doing Business Indicators**: Ranking; Distance to Frontier Score; Ease of Doing Business Index; Time to Start a Business; Direct compliance cost saving. • Private Investment % GDP • Credit to Private Sector (% GDP) • Private credit to MSMEs as percentage/total credit; LTVs; NPLs Number of MSMEs with improved access to financial services as a result of CDB's interventions/ • Bank Capital to Assets ratio (%).	• Economic and Sector Work • Macroeconomic PBOs • TA Loans and Grants	• No. CSPs Prepared/Updated • No. of relevant Policy Papers/ Sector Papers • No. and Value of macroeconomic PBOs • No. and Value of TA Loans and Grants directed to Investment and Business Climate and Financial Sector Reform	• Develop CSP Programme • Identify/develop programme for policy/sector papers • Develop Workforce programme for effective resourcing of PSD Strategy	• Resources available for TA – both from SFR and Trust Funds • Governments committed to policy and institutional reforms

RESULTS MONITORING FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT POLICY AND STRATEGY

Strategic Pillar/Expected Outcomes	**Outcome Indicator**	**Output**	**Output Indicator**	**Activities**	**Assumptions**
Access to Social and Economic Infrastructure: • RE and EE • Climate Change Adaptation and Resilience • Education and Training • Low/Middle-Income Housing • PPPs in Transportation and Energy	**All indicators sex disaggregated when feasible.** • Energy Cost as percentage of Household Expenditure • RE as percentage total energy output • % Population with Improved Sanitation Facilities • % Population living in vulnerable areas • Net Enrolment rates • Percentage of population in adequate housing • PPP in conventional or RE projects (no. and MW)	• TA Loans and Grants • BNTF Projects • Sector PBOs • Investment Loans • PPP Investments • TA Loans and Grants • Investment Loans	• No. and Value of TA loans/g rants /BNTF Grants for RE/EE; Climate Change/Education and Training • No. and Value of Sector PBOs • No. and Value of Investment Loans • No. and Value of PPP Transactions • No. and Value of TA loans/Grants in transport and energy sectors No. and value of Investment loans	• Implementati on of enhanced PPMS. • Establish PPP Programme. • Establish PPP Project Development Fund	• Governments accept PPP programme; • Adequate financial resources available • CDB's Risk Management objectives met
Enterprise Development • Credit and advisory services to Financial Institutions servicing MSMEs	• Value of credit made available to Private sector • Beneficiaries of TA targeted to MSMEs	• Intermediary Loans • Contributions to ECGC	• No. and value of Intermediary loans • No. and amount of guarantees using PCGs from ECGC	• Support for the establishment of ECGC	• Governments support ECGC programme • Risk Management Objectives for Investment and intermediary loans met