

**CHUMIR
FOUNDATION**
for ETHICS IN
LEADERSHIP

Merchant Bank

**A Proposal of the World Commission
on Forced Displacement**

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Letter from the Chairs

December 2018

The circumstance of a large and growing number of forcibly displaced persons in the world – and its destabilizing impacts – should lead us to consider carefully what it would take for the lives affected to be rebuilt – that is for the displaced to be re-integrated in community living. Damage to societal cohesiveness, lost economic output and the fundamental unfairness of wasted lives should force us to do so. Humanitarian care and maintenance is an essential first and basic need. But that alone is insufficient as a remedy for a population that has become idled and dependent. Whatever else might improve the situation, gainful employment of the working age displaced population is an essential element.

This realization has invigorated a paradigm for the leading edge of policy in response to displacement, that of ‘development’. That, in turn, requires investment. And, given the cumulative scale of the need and the very limited public resources available for development assistance, policy discussion turns to private sector participation. The location in the private sector of over 9 of 10 jobs in the world economy, of business operating capacities and savings – particularly surplus savings – underscores the case. The obvious gap in this picture is the lack of commercial conditions or of investment-ready proposals in most of the locations where jobs are required to address displacement. There is considerable evidence of willing private sector capital staying on the sidelines under current policies and practices, rather than engaging in developing locations.

The Chumir Foundation for Ethics in Leadership convened the World Commission on Forced Displacement to, as a central part of its overall mission of making recommendations to ameliorate the conditions, assess methods and mechanisms to optimize the application of private sector resources to investment in the challenging conditions for commercial activity in the locations of greatest need. Each market setting and, even each particular sector and venture, may need something different. Business investments are made one-at-a-time and are organized transactionally from the bottom up; and impediments can be discovered and pragmatically addressed in that process – contractually tying support considered reasonable to the commitment of the private sector investment it is designed to attract. Experience can, over time, permit a generalizing to policy provisions intended to create conditions in which more such transactions occur.

The role of the public sector in creating conditions in which productive private sector activity occurs is ubiquitous and time-honored. The expenditure of public community resources to facilitate – most frequently to de-risk – private sector activity is extensive from the most advanced (e.g. space and defense technology development) to the least developed markets (e.g. development assistance in the lowest income jurisdictions). The specific impediments, gaps, corrective techniques and available resources for the purpose differ. There must be a fair risk/reward evaluation of the public and private roles. But, we only delude ourselves if we embrace a development solution but fail to equip the market with the functionalities, capacities and resolve to perform – and the robustness to do so at target volumes of activity.

This Report sets out the reasoning and description for a dedicated new instrument – what we have called a ‘Merchant Bank’ – dedicated to reasonable public sector support of commercial investment.

Importantly, the potential exists for the proposed policy to benefit each of investors, donor countries, host communities and those forcibly displaced in direct economic terms, as well as to benefit all parties by the enhancement of stability and security. This adds up to a strong political case regardless of any other policy choices – including immigration policies.

On behalf of our colleagues who have joined deliberations over these ideas, we hope this Report contributes to a productive policy dialogue and commitment. We stand ready to help.

Respectfully submitted,



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World Commission
on Forced Displacement*



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A Merchant Bank – At a Glance

That 68.5 million people, largely faultless, are forced to flee from their homes and communities to find safety from violence, conflict or persecution – with tens of millions more poised to do the same from a mix of causes – is a human tragedy and a global management challenge. It imposes costs and burdens randomly on neighboring, poor communities; forgoes output from idled workers; brings diverse communities into clashing interfaces; fuels security risks from terrorist and criminal exploitation; and strains immigration tolerances. A concerted, development-led strategy might contribute more and cost less than relying principally on the treatment of symptoms.

Gainful employment of the working age displaced populations through development investment is a necessary element of any ‘solution’. Public institutions lack the funds. Commitment of a small proportion of available, even surplus, private sector capacities, would bring the necessary cumulative scale of commercial activity. However, currently, investment-ready projects, not capital, are missing. Challenging conditions for investment and gaps in market capacities in the target locations necessitate new activist methods and mechanisms for the purpose.

Limited public funds – that can be contractually tied to private sector investment commitments – should be strategically deployed to establish commercially tolerable conditions and projects – to reasonably ‘de-risk’ and address other impediments, as well as assist in devising policy accommodations for a meaningful volume of activity. These methods equally well serve the social purposes of employment of displaced and host populations, achievement of the Sustainable Development Goals (SDGs) and investment in clean energy and climate change driven adjustments in challenging market conditions.

A “Merchant Bank” is proposed – a publicly funded, transactionally nimble special purpose vehicle dedicated to the proactive search; feasibility assessment; holistic development; early stage financing; structuring; and reasonable de-risking of individual projects, sectors or locations, so as to create conditions for optimal private sector investment. Increased global economic growth; improved yields for investors; additional exports, employment and geopolitical influence for investor/donor countries; added jobs and improved fiscal revenues in for populations in target locations; eventual savings on humanitarian relief and security costs; and social externalities of individual self-sufficiency, community stability and cohesiveness would produce benefits for all involved. Further, immigration pressures can be dealt with separately and differently with improved living conditions in locations of initial or secondary displacement origination.

Table of Contents

Executive Summary *pg 2*

The Social Issue: An Overview *pg 4*

- **The Need: Economic Development to Employ Growing Numbers of Displaced Populations** *pg 4*
- **The Challenge: Mobilizing Private Commercial Investment in Difficult Market Conditions** *pg 5*
- **Existing Institutions: Missing or Inadequate Functionalities in the Market** *pg 6*
- **The Techniques: A Pragmatic, Transactional, Intermediating and De-risking Merchant Bank** *pg 8*

The Context *pg 9*

Market Gaps *pg 11*

A Response: A Merchant Bank *pg 12*

- **Purpose and Role** *pg 12*
- **The Strategic Use of Limited Public Funds to Facilitate Private Investment** *pg 13*
- **Graphic: Public / Private Intermediation Steps for Developmental Investment** *pg 15*
- **Key Characteristics** *pg 16*
- **Operating Activities – As and When Required** *pg 17*
- **Potential De-Risking Techniques** *pg 19*
- **De-Risking for Arbitrary Government Action** *pg 20*

Next Steps *pg 21*

Chumir Foundation for Ethics in Leadership *pg 23*

Executive Summary

This Report describes a development-led proposal to help address the situation faced by the ‘forcibly displaced’ – a special purpose vehicle to increase the investment of private capital in designated locations – a ‘Merchant Bank’. The objective is to serve important public policy goals through private sector commercial capital and activity engagement in venture and infrastructure investment in the challenging market conditions of lower income locations.

The initiative leading to the Merchant Bank proposal has been the plight of the 68.5 million people who are forcibly displaced from their homes and communities by violence, conflict or persecution. Most are idled, and dependent on humanitarian assistance. They impose burdens on host communities and can affect local residents through job competition, under-cutting wages, impacts on prices of goods and services and pressures on public facilities and services in the locations where they are concentrated – involving net costs and stresses, at least for a period of time. Investment in connection with new arrivals, or preventatively at prospective points of origin, would alter supply/demand conditions. In all events, gainful employment of the displaced through sustainable development of economic activity is an essential element of any ‘solution’.

At the same time, it should be noted that the need addressed – the attraction of private sector commercial participation in activity and investment in challenging environments characteristic of lower income locations – is equally applicable to the service of other social goals such as the Sustainable Development Goals (SDGs), or the development of clean energy in the developing world where investment capital is inadequate. While the focus here is the ‘forcibly displaced’, the policy discussion – and perhaps the institutional implementation – might be either similarly focused, or designed to meet a variety of social policy objectives that private sector investment in comparably challenging market conditions – and the methods and mechanisms of a Merchant Bank – would serve. This document sets out the forced displacement context briefly before addressing the idea of a Merchant Bank. For a more complete discussion of the displacement issues, see the *Report of the World Commission on Forced Displacement*. (<https://ChumirEthicsFoundation.org/ReportofWorldCommission>)

The term ‘Merchant Bank’ recalls the British financial institutions that were vehicles for analysis, advice and investment, the latter for both its own and third-party client accounts. Such banks were holistic sponsors, transactional and case-specific in their roles. They conceived ventures, searched out opportunities, assessed risks and returns as well as sought accommodating economic environments, structured and packaged investment propositions, gathered required inputs and capacities, invested and oversaw implementation and operation of a business, as a profitable, commercially-sustainable undertaking. That is precisely what is needed in environments in which the market is deficient in the intermediating of capital, projects, expertise and other inputs – or where the setting makes an inherently sustainable venture too risky – to produce the economic activity and jobs to support a population. Not all the necessary activity to create commercial conditions will generally be attractive to private sector investment capital and operators. This is especially the case in the early stages of a project assessment in the target markets, which requires more time and effort and produces fewer successes than is the case for well-functioning, developed commercial markets – as they exceed the risk-bearing appetites of commercial investors. Some of the insufficiently served needs are of such importance or value to the public – including because of social benefits that are not captured by private investors, hence under-provided for by the commercial market – that the costs and risks to fill the deficiency or gap are appropriately borne by the public sector. This is true in the industrialized world for technology development, some social services or infrastructure and employment stimulating policy initiatives. The developing world faces different – and perhaps more – such deficiencies. The international development agencies and financial institutions fill some, but not all, of the fundamental gaps. The Merchant Bank is designed to be complementary and to fill the remaining gaps.

What follows is an analysis of the need, conditions and elements required for commercial investment in the targeted locations; the case for a public sector role to provide missing capacities; some specification of the functionalities envisaged for the Merchant Bank; the characteristics or culture and motivations called for in such a vehicle; and the principal design parameters of the proposed new entity. The motivation and management culture intended is unusual – featuring a risk tolerance required for the mandate; preference for investors from the private sector, taking on Merchant Bank successes in structuring a reasonable commercial investment proposal; flexibility as to methods and instruments; transactional nimbleness; ability to handle numerous small ventures as well as large ones, if that best suits the market; high quality and experienced talent capable of public policy and commercial assessments, as well as of adapting to local conditions and needs and collaborating with local parties and authorities. These characteristics are best accomplished in a new special purpose vehicle accountable to a distinct Board. Changing the characteristics of existing development financial institutions is difficult and not necessarily appropriate.

The Social Issue: An Overview

There are more than 68.5 million forcibly displaced people worldwide from violence, conflict or persecution. The number is expected to continue growing and to increase in duration with the stranded status becoming more intractable; and is occurring as borders are closed and political resistance to immigration rises. Policy must address the gainful employment of the displaced where they are stuck and where current market conditions and policies are failing to do the job.

The Need:

Economic Development to Employ Growing Numbers of Displaced Persons

A great many of the displaced are in the Global South, where most will, and may prefer, to remain, if viable lives are possible. Many communities harboring the displaced are economically stressed. There are anxious local populations in those locations, as well as in other communities to which the displaced seek to move in search of safety and livelihoods. Social cohesiveness and stability are threatened. It is in the immediate and long term interests of both the developed and developing world to address this continuing, growing and costly disruption, unfairness and risk. Durable economic development and significant additional employment and business opportunity in locations of large numbers of displaced are necessary elements of any 'solution'. Without a significant investment in commercial activity in population receiving and displacement originating locations, the burdens, global instability, hostility to the inflow of population, societal divisiveness, risks, costs and lost outputs of idle populations will increase. The unfairness, waste and risks of a population with few or no prospects remain.

**The Challenge:
Mobilizing Private Commercial
Investment in Difficult Market
Conditions to Achieve Gainful
Employment, Economic Growth
and Societal Benefit**

Some public capital is available to address the problem, but it is far too limited for the needs. Humanitarian aid is necessary and flowing, but is neither predictable, sufficient, nor designed to stimulate business activity and jobs; nor alone able to lead to gainful engagement of the displaced by market dynamics alone.

Significant surplus private sector savings exist –and this is where by far the largest global potential capital source for investment and job creation is located. Public funds should be strategically deployed in support of conditions for the engagement of private commercial core business capital and activity in investment in locations of significant development need. Without this, the required levels of economic activity to gainfully employ local and displaced populations in the locations where there are large numbers of displaced persons (and many more poised to move) – and the enhanced global growth potential such investment would bring – are simply not possible. The reallocation of surplus capital that is in the developed world, where it frequently earns low and negative returns in money markets, to these target locations, where needs are large and higher yields, within limits, are possible, would benefit all interests through global economic growth and, specifically generate:

- better investment returns, exports and related jobs for the capital source countries;
- added jobs, income and fiscal improvement for the capital receiving jurisdictions from production, that would not otherwise be undertaken in the advanced industrialized economies⁽¹⁾;

As well as:

- positive social externalities of improved stability and security for both country groups;
- savings, over time, of humanitarian and security costs; and
- reduction of migration pressures by the improved conditions in locations that would otherwise be a primary or secondary source of displaced populations – assuming, of course, that the cause of flight is reasonably addressed, which would more likely be the case if private sector investment conditions were being met.

(1)

Macro-economic conditions also affect the investment climate in targeted locations. Lenders expect low and middle income countries to perform within fiscal deficit and debt levels that support price and exchange rate stability. To the extent these countries bear un-reimbursed costs of hosting displaced populations, loan covenants can trigger lender demands for austerity measures that adversely and counter productively affect the investment climate. Loan conditions could be proactively used as a variable to encourage desired policies of host jurisdictions in the treatment of uninvited arrivals. Similarly, excess savings and low interest rates remove the policy option of reducing interest rates to stimulate investment and reduce excess savings. A 'liquidity trap', whereby added financial resources do not remedy an underlying slow economy ('secular stagnation'), can reduce investment, growth and productivity. Reallocation of some capital to higher yields would contribute to improved global economic conditions. Migration can be a factor in allocating economic resources in a way that enhances productivity significantly, contributing to global efficiency, economic potential and output. At a minimum, policy coordination is called for to optimize results.

However, the locations involved are difficult places for commercial investment to occur – and since 2008, and until this past year, there has been a significant outflow of capital from the developing world despite the needs and opportunities, with capital even moving to negative returns in the developed world⁽²⁾. That is the context of the challenge.

**Existing Institutions:
Missing or Inadequate
Functionalities in the Market**

Individual venture and infrastructure investments are how most private sector commercial capital and activity would move from savings surplus locations, to low and middle income developing economies. Risk/return and operating requirements of commercial investors, real and perceived, are not currently satisfied sufficiently in the targeted locations. Exhorting private sector capital to take higher risk will not work. Simply providing assistance to the displaced and expecting the economic dynamics in their locations to engage them in gainful activity has not absorbed anywhere near sufficient numbers of the potential workforce of the stranded populations to permit viable living conditions for those displaced. A more activist, risk-taking and holistically responsible instrument of public policy is required if development and private sector involvement, bringing capital, technology, operating know how, management and business networks of the scale needed, in challenging locations and conditions, are all to occur.

What is missing most particularly to spur private investment is an intermediary that:

- takes responsibility and is motivated to proactively, holistically sponsor – from conception, to feasibility, to de-risking, to mobilization of the ingredients for inherently sustainable commercial undertakings – on a case by case basis as needed;

(2)

Data demonstrates some patterns and shortcomings of capital flow to developing economy locations in the recent past as follows:

- The global stock of capital is reported at \$250 trillion; non-financial companies in the S&P 500 hold \$1.7 trillion of it; (doubling since 2008); European counterparts hold \$1.1 trillion (up 70% since 2008). Since 2010, S&P 500 companies have allocated 113% of the amount spent on capital investments to share buybacks and dividends, up from 38% in 1990 – not what companies prefer to do with their capital. This all suggests savings availability;
- Developing world greenfield investment fell 4% in 2015 (20% in Africa), even as mergers & acquisitions flows to those markets grew by 61%; but the total of \$700 billion FDI in those countries was still only half what it was in 2008 – evidencing disinvestment in the developing world;
- FDI as a percentage of the stock of capital formation is twice as important in emerging markets as in developed ones, particularly following the shrinking of debt capital after the 2008 crisis. Financial institutions narrowed their focus: domestic credit as a percentage of GDP is 36% in Africa, 45% in Latin America and 135% in OECD countries; and public equity markets that account for 42% of investment in the US and 35% in Europe, finance only 15% in emerging markets; and
- Greater attention should be paid to remittances to developing countries which received \$480 billion in 2016, representing 60% of private capital inflows and a potential source of private capital.

An OECD survey in mid-2017 reports some overview of the capital allocations.

- “The results of the survey indicate that during 2012-2015 USD\$81.1 billion was mobilized from the private sector, mainly through guarantees for which the amounts mobilized represented 44% of the total. They also show that most of the amounts mobilized supported projects in middle-income countries (77%), especially in Africa which was the main beneficiary region (30%). Finally, the results highlight that a large share of the amounts mobilized went to the banking (33%), energy (25%) and industry (14%) sectors, and 26% of the total contributed to combating climate change.” Private sector capital evidences a disinclination to invest in the most challenging of the developing economies (only 7% of investment in developing countries went to less developed countries and 3% to other low income countries). (See OECD July 2017 Amounts Mobilized from the Private Sector by Official Development Finance Interventions)

- promotes this development mobilization with maximum private sector investment, but co-invests when needed to catalyze a deal and/or support fair risk/reward terms that are both commercial and fair in the public interest;
- channels public funding and facilitates fair policy accommodations to establish commercial conditions for ventures and infrastructure investments, both generally and for particular undertakings;
- where possible, uses services and offerings of existing institutions to mobilize and/or de-risk individual ventures; and
- follows-on with the prospect of pooling and selling the publicly-funded, unbundled, de-risking arrangements in capital markets, drawing private sector capital from this additional market segment as well to the risk absorption task.

A more activist, risk-taking and holistically responsible instrument of public policy is required

Social impact capital should find opportunities in the projects of the Merchant Bank and innovative developments in these funds should form part of its thinking.

Without intending criticism, existing development finance institutions generally meet market needs that can be satisfied by practices that operate within certain constraints. They:

- respond to project proposals – they tend to not themselves holistically conceive, initiate, sponsor and fund feasibility assessments;
- prefer and facilitate the more promising, and low risk ventures;
- follow motivational schemes to put institutional funds to work, rather than to turn viable projects over to private sector investors;
- avoid the most risky, time-consuming, lower success rate prospects more typical of ventures in the most needy locations – and decline the more risky pre-commitment tasks of design, feasibility assessment, holistic sponsoring and de-risking roles – that would constitute a more strategic use of limited public funds to facilitate private sector investment in target locations.

Even private sector funds, specifically gathered for investment in the locations of displaced populations, go unused as a result of higher risk and absence of fulfillment of what are reasonable public sector functions, namely: to create viable conditions for commercial investment particularly in the areas of greatest need, if social purposes served are sufficiently important. Some social benefits are not captured by a project investor.

**The Techniques:
A Pragmatic, Transactional,
Intermediating and De-risking
Merchant Bank**

An innovative and nimble ‘Merchant Bank’ is needed to conceive, de-risk, professionally assess, finance, and develop projects that address realistically identified impediments in pragmatic ways – including by more effectively applying public and private sector resources and techniques where each is appropriate – and, doing so on fair risk/reward terms for both public and private interests. The process of mobilizing ventures brings out the real needs and facilitates the design of effective, varied and innovative solutions. Not all needs are best addressed in the same way, nor by financial instruments that lower the blended cost of capital – which does not compensate in the case of a significant loss; and is a windfall in the absence of a loss. (Only a pooled portfolio is potentially effectively protected by a blended lower cost of capital.)

The use of public funds to draw private sector investment is assured by contractual arrangement that links the de-risking to the commitment of private sector activity and funding.

Experience will permit some generalized de-risking arrangements supporting scaled-up development. This de-risking is the developing world counterpart of certain technology development and innovation de-risking in the developed world when the risks exceed commercial tolerance but the activity is considered to be in the public interest. Governments in developed countries frequently absorb the risks of technology development, purchase the products embodying the resulting technology and leave rights of further use in the developers’ hands. The developing world risks and absorption techniques are different for the most part, but the policy concept of risk absorption for public interest purposes is much the same⁽³⁾.

⁽³⁾ De-risking is routinely done by governments in developed economies when different risks, e.g. technology development, are considered too high for commercial capital to generate optimal activity, or meet sectoral need. This is seen in U.S. space and defense and health technologies, EU technology and support programs, Canadian tax incentives in resources and Japanese risk absorption in manufacturing automation. It is seen in plant location incentives and public sector laboratories. The proposed de-risking here is a developing economy counterpart.

The Context

The forcibly displaced represent less than 1% of global population. Public development funds, if all dedicated to the building of infrastructure in developing markets, would cover only 10-15% of that sectoral requirement. If only 3-5% of private sector institutional liquid capital was reallocated to the Global South, it would fund the gap for some years to come – a shift that would not materially alter capital formation elsewhere⁽⁴⁾.

It is noteworthy that:

Over 9 of 10 jobs globally are in the private sector.

Governments are poor today, even where economies are rich – Governments hold wealth that is 17% less than GNI, after deducting debt; the private sector holds assets that are 500% of that measure.

The private sector is flush with excess savings at low, and still negative, yields, but they are not applied to investment in locations required to address forced displacement, even when materially higher yields are projected for such ventures.

Private commercial capital moves largely through investment in individual ventures in its core or familiar business activities. It is necessary to pragmatically identify the impediments and de-risk the context and/or undertakings, on a case by case basis

⁽⁴⁾

In the UN Report, Financing for Development 2017 (and again in 2018) – multilateral institutions are reported to disburse \$70 billion (USD) and draw \$50 billion in co-financing annually. Developing world infrastructure requires \$1 trillion annually. This annual public development financing of \$120 billion would, if dedicated exclusively to infrastructure, cover 10 – 15% of the annual requirement.

As for the 3 to 5% of private sector liquid capital as being sufficient to fund the \$1 trillion annually, the rough calculation is reasoned as follows:

- \$115 trillion (USD) of assets are under institutional management. Given liability profiles, some \$80 trillion is available for long term assets;
- 60% of the liabilities of these private sector institutions are long term in character (greater than 10 years), permitting long term investments;
- Only 25% of the assets are currently placed in long term (illiquid) investments – only 3% are in infrastructure – leaving 35% of the \$115 trillion, or \$40 trillion available for such reallocation;
- 3 to 5% of the difference between the 60% capacity for long term investment and the 25% currently in such commitments (35% of \$115 trillion = \$40 trillion) would represent \$1.2 to 2.0 trillion, fully funding the annual investment requirement for infrastructure development in the developing world for some years. By the time the capacity might fall below \$1 trillion annually, a market for such assets would have developed, drawing additional capital to that investment category.

as needed, to commercially reasonable levels for such investments. Exhortation to have private capital take more risk has not worked and will not work.

Low income locations are characterized by conditions that will not always permit commercially-viable ventures, such as:

- physical plant and infrastructure that are very deficient;
- industry experience that is narrow;
- skills and education levels that are low;
- absence of rule-of-law, as well as incidents and perceptions of corruption;
- populations and governments that are poor, fiscally and structurally weak; and
- unemployment, public debt and fiscal deficits that are high.

Development assistance will remain necessary in many circumstances.

Market Gaps

The market on its own is not attracting the cumulative private investment required in the challenging target locations. This is due to a number of factors:

- Limited commercial venture proposals are developed that are focused on the target locations
- Few investors take responsibility for conceiving suitable ventures, holistically sponsoring and ensuring all required steps and elements, public and private, for feasibility and implementation
- Risks that are beyond commercial tolerance
- Structural or policy impediments
- Unreliable operational performance; uncertain compliance with transaction terms or standards; capricious use of political authority; and corruption
- Insufficiency of devices and institutions that intermediate public sector facilitation funds with private sector investment for specific individual projects, particularly where the intended ventures are too small to be appropriate for the public entity
- Local authorities lack the capacities to negotiate fair transactions and manage an oversight role
- Existing development financial institutions are sometimes limited in their ability to support private party investment:
 - Some are more geared to helping governments establish improved social and economic conditions
 - Others are not designed or motivated to sponsor projects – i.e. conceive, assess feasibility, facilitate, develop and de-risk individual commercial transactions – and replace themselves with private sector capital
 - Generally, they do not take the risks that would be necessary, including the spending on early feasibility assessment stage needs of projects

A Response: A Merchant Bank

The needed capital exists but more focused and activist methods and mechanisms are required to bring private investment to bear and potential projects to identification and fruition.

Purpose and Role

A Merchant Bank is proposed. A new global, regional and local organization and structure with appropriately distributed capacities; flexibility as to methods and instruments; and skills designed to:

- serve all DFIs and market players to increase their reach and impact in mobilizing development and private sector participation – national governments, multilateral development institutions, and philanthropic organizations would seem to be most appropriate as shareholders;
- avoid disturbing needed traditional roles of existing institutions – the Merchant Bank is designed to be additive and complementary, growing the businesses of existing institutions;
- serve as an agent of change with a different corporate culture – a new entity, a relatively small and nimble entrepreneurial organization, with free-standing management, a catalytic role and the ability to attract top caliber professional talent;
- collaborate with local and regional authorities, investors, institutions and market players to share and jointly implement strategy by location; and
- identify ventures that are operationally commercially sustainable, suited to the conditions and the work force of the local population and the displaced. The businesses are to be without preconception as to sector (goods, services, or infrastructure) or project size. The mission is that of sponsoring ventures through the full cycle from concept, to specific projects, to implementation.

A Merchant Bank to de-risk and attract private sector investment in challenging conditions.

A new organization and vehicle with dual capacities performing:

PUBLIC Functions

- selection and full assessment of, and persistence in, conceiving, assessing and developing ventures in conditions that take longer and succeed less often than in more developed markets;

- focus on locations and ventures that need the boost of this activist instrument of development;
- address impediments, de-risk ventures, sectors or locations as appropriate;
- advise and assist on reasonable policy accommodation, on fair risk/reward terms; address the specific needs to create commercial conditions; undertake feasibility assessments; develop local capacity to negotiate and implement a plan; and potentially, if little else is possible, on assistance for sub-commercial ventures;
- absorb and support a risk profile in its commitments and portfolio appropriate to its purposes;
- take holistic responsibility for all requirements;
- establish platforms for addressing the 'rule of law' category of risks; and
- draw maximum private sector participation, replacing its own involvement in transactions.

PRIVATE Functions

- intermediate among, and combine all, the elements of a venture to develop an investment proposal and commercial terms and conditions;
- catalyze projects by co-investing in businesses on terms it considers helpful to secure private sector commitment and provide a fair risk/reward profile for commercial investors; and
- serve the public interest by efficient and effective commercial operations of ventures once established (protecting against intervention by non-commercial policy or political demands in such projects).

DUAL Functions

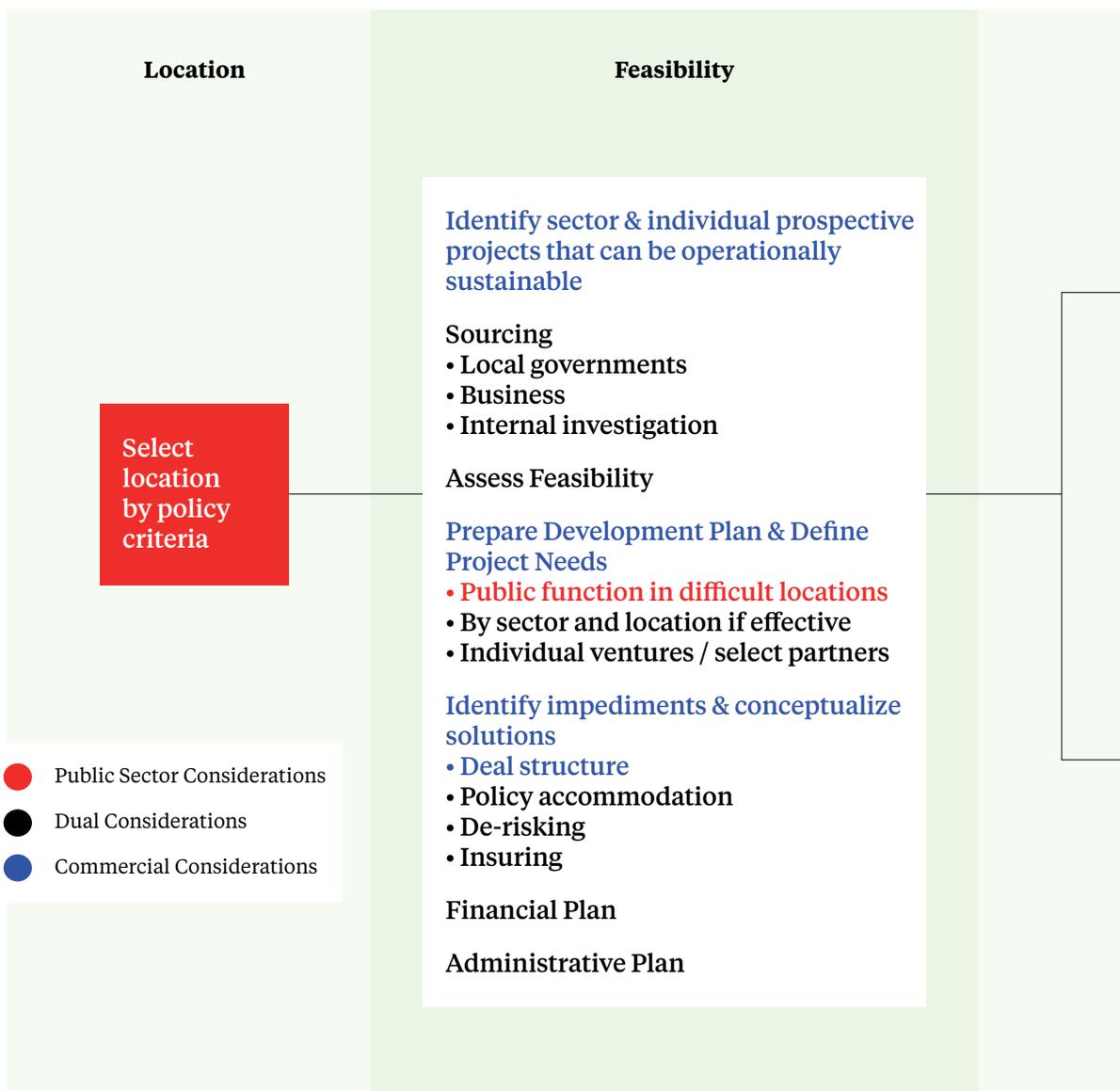
- negotiate and structure investment transactions that meet both public interest and private commercial standards;
- readiness and ability to invest in the ventures it defines as commercial so as to help conclude a transaction and/or defend limits of reasonable concessions in public support reflective of a fair risk/reward balance in the public interest, even while seeking to maximize private sector investment.

The Strategic Use of Limited Public Funds to Facilitate Private Investment

The limited public funds available need to be channeled and strategically deployed to facilitate commercial transactions rather than investing Merchant Bank funds directly in a project – with co-investment in commercial projects contemplated when helpful to getting a transaction done and/or to avoiding excessive support being expected. (Co-investment is anticipated to be more frequent in the early stages of the Merchant Bank).

The intention is that public funds be directed to where private capital cannot be made to go. This initiative is focused on proactive commercial investment mobilization that the market, including its public institutions and pooled investment funds – even gathered for developing areas – are largely not doing. This is a classic case of social gains that are not captured by private investors, and, hence, resources to the activity being under allocated. A public/private initiative along these lines seems increasingly to be required as serving the economic, social and political interests of both developed donor and developing/recipient host communities, as well as the affected individuals.

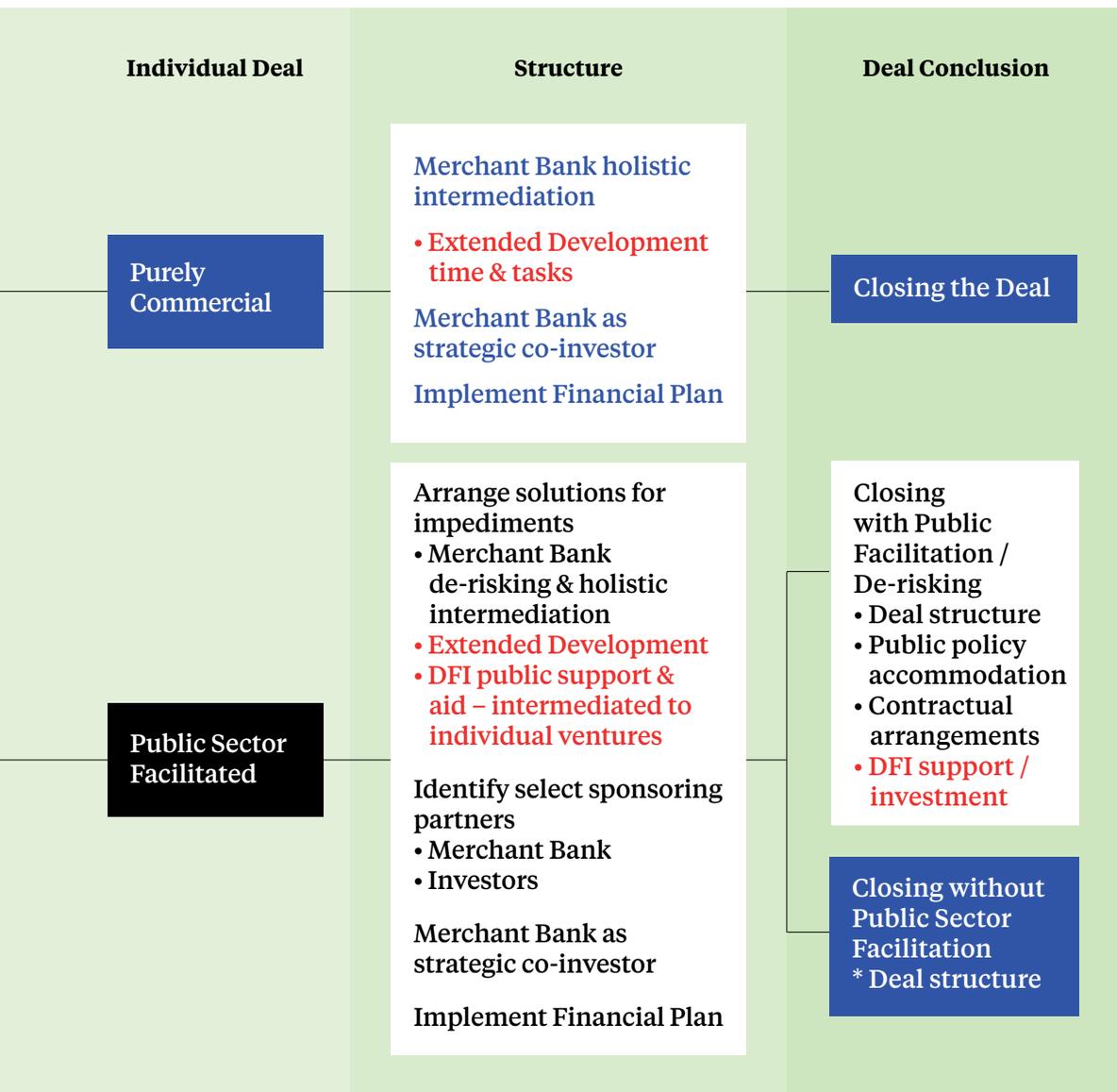
A Merchant Bank, a special purpose vehicle responsive to the conditions and market deficiencies, is a worthwhile additional capacity to optimize the opportunities for investment in challenging low income locations.



It would represent meaningful positive and constructive action on the North/South political relationship and involve attendant geopolitical influence for the participants; while immigration policy would be managed separately as a matter of national interest and choice. Social cohesiveness, reduction of migration and savings of humanitarian and security costs would be expected. A more widely shared responsibility for a 'solution' and self reliance for the displaced would be a result.

Graphic: Public / Private Intermediation Steps for Developmental Investment

The roles of the public and private sector and the dual considerations of the Merchant Bank, acting proactively and holistically, are set out below:



Key Characteristics

To recap, the Merchant Bank, in order to perform the functions envisaged, would feature:

- an activist and holistic capacity dedicated and determined to find and structure, to the extent possible, commercially sustainable transactions in a manner tailored by awareness of, and engagement in local needs and conditions; equipped with access to world class professional, business and industrial skills for a sector, project, or market by being part of a local/regional/global entity – and benefiting also from pooled diversification of de-risking arrangements and portfolio risk profiles;
- the credibility to intermediate or ‘negotiate’ between investors and governing authorities for fair risk/reward public interest development assistance and policy adjustments necessary to make a venture commercially viable. Equally, the capacity to understand the commercial needs, structures, disciplined environments, and activities i.e. dual public policy and commercial culture and roles, separately and distinctly applied;
- the authority and capital to commit to de-risking and commercial investing, accounting appropriately for each, but separately for effective accountability and control for the different functions; while mandated and motivated to maximize private sector engagement;
- a motivational structure for dedication and persistence to the mission despite the longer development periods, fewer transactions that materialize in the circumstances, and rewards reflecting the attracting of private sector capital (i.e. others) to ‘do the deals’;
- a professional organization that is responsible for ensuring the arrangement of all elements – and selection of participants where needed – for commercial viability of identified ventures;
- structure that separates the public interest and commercial decision-making to avoid conflicts of interest – the public interest can join the commercial venture; the commercial parties would have no role or authority over support decision-making as that would involve allocating public resources to support commercial interests.

Changing corporate culture of a large established organizations is extremely difficult. The characteristics – risk profile; capacity for innovative and flexible transactions, as well as for small or large ventures, as best suit the different market conditions; and the mission of maximizing private sector engagement and investment – all require senior and experienced management. This is best accomplished by a new organization.

Operating Activities – As and When Required

The Merchant Bank would be nimble, responding to the needs of a transaction addressing the needs for a sector, location or individual venture.

Definition of geographic focus

- Localities that have high public interest need and difficult conditions for commercial investment, e.g. high numbers of displaced – or poised for displacement – populations; but sufficient governmental capacity or support to transact with foreign direct and local investment
- Guided by public policy, this approach can be applied equally to achieving private sector investment for SDGs, clean energy policy or infrastructure goals as well – or to projects that serve more than one of these goals at the same time

Engagement with stakeholders

- Engage local stakeholders including government, industry, finance, labor, and NGO groups to serve local needs, identify and build support for projects and attract potential partners
- Work with institutions dedicated to development and to the targeted purposes

Evaluation of local economy

- Evaluate the local economies of priority regions for strategic and operational opportunities
- Labor force demographics – both indigenous and displaced
- Existing industries with an eye toward any synergistic clusters
- Local and regional infrastructure opportunities and constraints
- Local and broader market demand and access
- Supply chain and input markets

Ranking of priority industries

- Identify target industries for each locality that are prospectively operationally sustainable

Establish argument for transaction

- Investment thesis/rationale including identification of risks and mitigation strategies

Lead due diligence

- Evaluate investment thesis, risks and opportunities
- Studies to include business, market, technical, legal, environmental, political and standards due diligence

Identification and solicitation of commercial investors

- Identify interested commercial investors

- Solicitation of targeted commercial partners with a clearly defined investment thesis that addresses all needed transaction ingredients and plans to fill gaps
- Documentation of financial models, due diligence, recommended financing package(s), risk mitigation strategies, and strategic plans
- Gather all elements required for a sustainable venture, sector and/or location and co-invest as helpful to its realization and/or to enforce fair limits on concessions or de-risking

Assembly and negotiation of capital structure

- Lead development of transaction structure among concessional/aid/philanthropic sources, if needed for commercial viability and reasonable
- Integrate commercial party participation, laying off the investment on private sector investors to the extent possible
- Remove impediments, de-risking an undertaking as fair in the public interest
- Employ best practices and tap capital markets for social impact financing as a method of expanding access to private capital and managing risk-bearing by the Merchant Bank – tailor financing and remain flexible and open to innovation

This effectively minimizes the use of public resources and the use of Merchant Bank capital, while maximizing the likelihood of launching the projects and the role of private capital.

Manage/lead execution

- Transaction documentation
- Funds Flow
- Closing execution

Portfolio management of those ventures in which it participates

- Serve as portfolio manager as helpful following closing
- Oversee project completion and monitor operations
- Track project management milestones, financial results, and operator management reporting
- Source private sector funds for de-risking by pooling risk absorption arrangements of numerous – and sectorally, geographically and operationally diverse – projects, with requisite risk profiling and mitigation, such as first-loss guarantees, for sale in private sector capital markets⁽⁵⁾

⁽⁵⁾

Lest securitization with the private sector seem more theoretical than real, it is noteworthy that exactly that is just starting to occur in the development finance field. In late September 2018, the African Development Bank 'sold' \$1 billion of a mezzanine loan portfolio risk, and freed-up \$650 million of capital for fresh loans. A private fund and an African governmental fund provided some guarantees and the European Commission purchased a senior tranche. A data base shared among multilateral development banks (MDBs) documenting risks will increasingly simplify what is now a demanding due diligence – while also confirming lower than perceived risks attach – both facilitating private sector participation. Earlier, sale of portfolio holdings between public sector MDBs had been undertaken to better diversify their portfolios for which the origination had understandably produced more focused risk; and a similar 'sale' was carried out internally by the World Bank Group to create more room for MIGA, its insurance affiliate, to initiate additional insurance transactions. (See: Global Capital, Jon Hay <https://www.globalcapital.com/article/b1b976d81q63cz/infrastructure-needs-unfilled-despite-big-promises>)

Potential De-Risking Techniques

The techniques for de-risking are intended to vary with the impediments found in the process of developing and assessing a prospective venture. The intention is to remain flexible, creative and nimble in finding pragmatic solutions to real impediments. The Merchant Bank would take calculated and appropriately higher risks than existing Development Financial Institutions for the public good.

As examples of de-risking, the Merchant Bank could:

- own and lease business assets, with the lease payments by the operator being suspended on the occurrence of stipulated events;
- grant the investor a periodic ‘put’ of the assets/business, such as infrastructure investment, to permit a project to extend the amortization periods so as to achieve lower market user costs that the local market can bear, while offsetting the greater risk that a payback extension involves (and the commercial need for shorter payback periods in more risky locations), by an agreed formula for a periodic exit option at the investors’ choice;
- promote any reasonable potential policy accommodations by authorities that might apply to a sector, location or individual venture;
- organize conventional risk-modifying, and/or innovative financing of all categories – potentially using existing services, offerings and institutions so as to be additive, not substitutional; these could be: conventional insurance, guarantees/ first loss financing, subordination of funding, or some reasonable financing concessional provision;
- provide an exchange rate hedge, perhaps a mechanism the IMF might operate, particularly for longer payback ventures and less stable exchange rate jurisdictions; or maturity-matching facility;
- organize a more favorable capital and regulatory treatment of certain asset classes which are more resilient to crisis and credit defaults, such as the infrastructure projects. The current IDI (Infrastructure Data Initiative), supported by the G20 Infrastructure Working Group, aims at evidencing the robustness of infrastructure projects through data analysis based notably on the GEMs (Global Emerging Markets database);
- share risk, particularly in the early period, and in unfamiliar jurisdictions, by co-investing with private investors and reassuring those investors by its presence in future dealings with other parties and governmental authorities. Such co-investment would be solely commercially-guided, protecting the venture against inappropriate non-commercial policy or political pressures. Separately, a pari passu equity interest in favor of the Merchant Bank, up to some modest capped yield – or its participation in returns after a hurdle rate is received by the commercial investors – to compensate for some project development cost might be appropriate and help with the perceived public/private risk reward fairness;
- absorb risk by its direct activities – i.e. early-stage project search/identification, feasibility sponsoring and venture development/structuring;

- open a secondary opportunity for attracting private capital to the Merchant Bank related initiatives by tapping additional and different private sector capital pools by securitized offerings of de-risking arrangements, as well as capitalizing on lower actual than perceived losses/risks on investments in the areas and activities contemplated to expand that market. These offerings might well require some risk-shaping in securitization (e.g. some first loss guarantees), or, perhaps, securitization with a senior and junior tranche, with only the latter being backed by a guarantee. This would stretch the impact of public capital further.

**De-risking for Arbitrary
Government Action**

Private sector investors seek assurances regarding anti-corruption, enforcement of agreements, compliance with standards and the reasonable and transparent exercise of public regulatory, administrative and political authority. Such assurance is particularly needed in the case of projects with long payback periods, and high dependence on government commitments and regulation.

This project proposes establishing an international protocol under which local regulatory discretion, contract enforcement, standards compliance to avoid reputational risks for an operator and administrative authority would be delegated to a trusted international body (perhaps a tripartite body representative of the local authority, the Merchant Bank and a regional development or international business body) that would enforce rule-of-law and corruption avoidance, backed by insurance should the local authority breach the covenant.

Next Steps

Merchant Bank Founding Parties Convene interested governmental, philanthropic and institutional parties – with local, regional, and international capacities – to create a Merchant Bank.

Mobilization Identify and develop first projects demonstrating the methodology and gaining experience with its operation.

Capitalization Strategies To fill the market gaps the Merchant Bank must do what the existing institutions do not do. While not duplicating what services and products can be sourced from others, it is central to the filling of the gaps that the Merchant Bank be equipped to act without being restricted to what the existing development financing institutions provide. Without significant capitalization, the constraints set by the current institutions would continue to define the market services. The Merchant Bank should have no sectoral or size preconceptions, the market should dictate what is sustainable. The most talented management would find limitation to an advisory role less appealing.

Initial capitalization options reflect the strategy:

- \$2 billion would launch a significant undertaking and attract the most senior talent. Commitments could be ‘callable’ funding with no significant funds being used unless worthwhile investments are concluded.
- \$200 Million would initiate an important demonstration and/or single market project, or a range of small to mid-sized projects.
- \$10 - \$20 Million would support a few select small pilot projects to demonstrate the methods and the role of the Merchant Bank and host governments in such cases.

The Chumir Foundation for Ethics in Leadership is a non-profit foundation that seeks to foster policies and actions by individuals, organizations and governments that best contribute to a fair, productive and harmonious society.

The Foundation analyzes contemporary issues that it selects as subjects of societal importance; and facilitates open-minded, informed and respectful dialogue among a broad and engaged public and its leaders to arrive at recommendations for public policies and actions that aim at community betterment.

In this project, the Foundation has convened the **World Commission on Forced Displacement**, a diverse international group of experienced policy and political figures under the Chairmanship of H.E. Heinz Fischer. The Commission has been advised by a world wide **Steering Committee** of scholars and practitioners overseeing research, analysis of past experience and proposing contemporary solution-oriented policies. The Foundation and Commission have addressed overall best practices for dealing with forced displacement. It has devoted considerable attention to the issue of gainful employment for those displaced as well as to the needs, benefits and methods of drawing the private sector into an investment role as part of a development-oriented response to the challenges of forced displacement. It has, in a separate Report, (<https://ChumirEthicsFoundation.org/ReportofWorldCommission>) made recommendations on other aspects of policies regarding displacement: those to be accorded protection and support; the fair sharing of the burdens to which displacement gives rise; a constructive public narrative permitting more solution-oriented political action; the responsibilities of all involved to address the ultimate objective of inclusion and rebuilding of lives of those affected; and the use of modern technologies to best accomplish the goals. All of these elements are considered in the context of the effective support of development and transitioning of those affected from humanitarian dependency to self sufficiency.

The Commission initiative follows a global conference, the 'Congress of Vienna 2015', organized by the Foundation to consider new ideas for public interest responses to significantly destabilizing situations in the world community. For more information about the Foundation, please visit www.ChumirEthicsFoundation.org.

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The **World Commission on Forced Displacement**, convened by the **Chumir Foundation**, is a global gathering of a diverse group of experienced policy and political figures under the Chairmanship of H.E. Heinz Fischer and advised by a global Steering Committee of scholars and practitioners. Their mission has been to examine the current plight and destabilizing impacts of 68.5 million, and growing numbers, of forcibly displaced people and to recommend practical solution-oriented policies and actions for the various parties involved. The Commission makes six principal recommendations.

A central recommendation is that of a development investment policy aimed at gainful employment of the forcibly displaced and those in their host communities. This is seen as essential to any durable 'solution'. Private sector investment is necessary for a meaningful scale of response to the challenge. A 'Merchant Bank' is proposed—mandated to make strategic use of limited public sector funds to develop and de-risk business conditions for venture and infrastructure projects, permitting large amounts of private sector capital to be invested, in challenging market conditions. This reallocation of capital is both manageable in magnitude and method and expected to be beneficial for donors, investors, host communities, those displaced and societies at large.

The other principal recommendations address best practices and international standards to protect, foster development, and encourage two-way behavior to advance the prospects of ultimate inclusion in communities for all forcibly displaced people seeking to rebuild their lives that were disrupted by conditions beyond their control. Risk and burden-sharing; best technologies for facilitation of support, services and opportunities; and initiatives for better informed public opinion and social cohesiveness are principal aims of these recommendations.