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Impact of the Asian Infrastructure Investment Bank

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Thailand's current infrastructure needs are well known to policymakers. The development of urban and inter-city rail links, telecommunication networks and renewable energy projects are some of the areas in need of investment, as identified by government agencies.

Much of the infrastructure development over the next decade will be capital-intensive, meaning that funding from the Asian Infrastructure Investment Bank (AIIB) could assist in developing Thailand's various projects.

The AIIB is a new multilateral development bank, initiated by China, with a stated purpose to "foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors". At its first meeting in January, the bank's board of directors adopted a number of policies on financing, pricing and procurement. These policies provide an outline of how the AIIB will select projects to invest in, and the form these investments will take.

The AIIB's Articles of Agreement, signed by representatives of 57 member states, is the basic constitutional document from which the AIIB's governing bodies, such as the board of governors, the board of directors and the president, derive their operational authority. Article 11 permits the AIIB to carry out its investment activities by participating in direct loans, making equity investments and guarantees, and undertaking other forms of investment activities.

The Operational Policy on Financing, which was adopted by the board on Jan 17, outlines the bank's financing policies. Among other things, it sets out the following conditions that must be satisfied for the AIIB to invest in a particular project:

The project must have clearly defined development objectives consistent with the bank's stated purpose, and those objectives must permit appropriate evaluation of the project's impact;

The project must provide for specific productive activities necessary to meet development objectives;

Alternative sources of finance, particularly private capital, must not be available for the project on terms and conditions that the AIIB considers reasonable; and

The project must comply with the other requirements of the operational policy and other AIIB policies.

Broadly, the AIIB's financing activities can be broken down into sovereign-backed financing and financing that is not sovereign backed. Sovereign-backed financing means either a loan to a member or a loan that has been guaranteed by a member. It also means a guarantee that covers debt-service defaults resulting from government failure to meet a specific obligation in relation to the project or from a borrower's failure to make a payment under the loan, and is accompanied by an indemnity by the member to the AIIB. Non-sovereign-backed financing is basically any financing that does not fall within the definitions outlined above.

In determining whether to grant sovereign-backed financing, the AIIB will assess whether the project's impact on the member's fiscal sustainability is acceptable. The bank will place significant weight on debt sustainability analyses conducted by the International Monetary Fund and the World Bank. It will also assess whether the project contains acceptable oversight arrangements that provide reasonable assurances that the proceeds will only be used for the stated purposes of the financing.

The policy also outlines terms and conditions that must be included in the transaction documents for loans, including specific remedies, external debt reporting, and adherence to the general conditions as stipulated by the AIIB board from time to time. Significantly, the AIIB will not generally require specific security from a loan recipient that is a member, though it may require security if it is required by a co-financier. Loans to non-members may require security.

The policy provides the AIIB with significant leeway when granting non-sovereign-backed financing, although it explicitly states that market-based principles will be applied. Loans may be granted to project companies on a limited-recourse basis or directly to the project company's sponsor (usually, the majority shareholders of the project company). The policy stipulates that loans will be based on standard template term sheets, loan agreements, and other relevant financing documentation.

Provided that the investment conditions are acceptable, the policy permits direct equity investments from the AIIB to either public- or private-sector companies. This form of investment may be particularly beneficial if the registered share capital of the project company must exceed a certain threshold.

Thailand has ambitious infrastructure goals that it aims to achieve in the next decade, and meeting these goals will require substantial capital investments. The AIIB is a potential source of funding for these projects, particularly when private capital is insufficient. In addition, since the AIIB will be investing in infrastructure throughout Asia, Thailand stands to gain from the knock-on effects of improved infrastructure in neighbouring countries.

As the AIIB begins the process of approving investment plans for projects, it will be important to watch how the policy is implemented in practice.

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