

Ministry of Foreign Affairs – (Department for Multilateral Cooperation and Climate Change, MKL)

Meeting in the Council for Development Policy 12 June 2018

Agenda item 5

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| 1. Overall purpose | For discussion and recommendation to the Minister |
| 2. Title: | Strategy for Denmark's Cooperation with the Asian Infrastructure Investment Bank (AIIB) |
| 3. Presentation for Programme Committee: | 4 April 2018 |

What is the AIIB?

AIIB is a young organisation with a mission to (i) foster sustainable economic development, create wealth, and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and (ii) promote regional co-operation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions. AIIB is the first global IFI established on the direct initiative of a non-Western country. The initiative was launched by China in October 2013 as a response to the severe finance gap for sustainable infrastructure in Asia, and AIIB started operations in January 2016.

Why does Denmark support AIIB?

AIIB's goal to create sustainable infrastructure aligns with the Danish priority to create inclusive and sustainable growth and development. This will be a potentially significant benefit for the climate and an opportunity for Danish competencies. By contributing to connectivity in Asia and between Asia and Europe, AIIB directly underpins the Danish interest in globalisation and connectivity, as stipulated in the Danish Strategy for Foreign and Security Policy. All the SDGs relevant for AIIB are also priorities in the "World 2030 - Denmark's Development Policy and Humanitarian Strategy".

Sustainable Development Goals relevant for AIIB

					
Affordable Clean Energy	Decent Jobs, Econ. Growth	Industry, Innovation, Infrastructure	Sustainable Cities, Communities	Climate Action	Partnerships for Goals

	DKK	2016	2017	2018	2019
Capital subscription Millions		202	101	95	95
Duration of strategy Millions		2018-2022			
Finance act code.		06.37.02.13			
	USD	2017	2018	2019	
AIIB operational budget, Mil		59.6	123.8	178-194	
AIIB loans, Billions		3.0	2.5-3.5	3.5-4.5	

What are AIIB's programmes?

AIIB's motto is "lean (efficient), clean (no corruption), and green". Key sectors for the Bank are energy, transport, water, and urban development.

What are the Danish priorities for working with AIIB?

- 1) to develop an efficient bank with high development impact;
- 2) to interpret "green" as broad as possible, strong preference for renewable energy;
- 3) to focus on the Bank conducting business in accordance with the highest due diligence standards, including on anti-corruption.

AIIB's 84 members:

48 regional members: Afghanistan, Australia, Azerbaijan, Bangladesh, Brunei Darussalam, Cambodia, China, Fiji, Georgia, Hong Kong (China), India, Indonesia, Iran, Israel, Jordan, Kazakhstan, Korea, Kyrgyz Republic, Lao PDR, Malaysia, Maldives, Mongolia, Myanmar, Nepal, New Zealand, Oman, Pakistan, Philippines, Qatar, Russia, Samoa, Saudi Arabia, Singapore, Sri Lanka, Tajikistan, Thailand, Timor-Leste, Turkey, United Arab Emirates, Uzbekistan, Vanuatu, and Vietnam. Prospective: Armenia, Bahrain, Cook Islands, Cyprus, Kuwait, and Tonga.

36 non-regional members: Austria, Canada, Denmark, Egypt, Ethiopia, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, and United Kingdom. Prospective: Argentina, Belarus, Belgium, Bolivia, Brazil, Chile, Ecuador, Greece, Madagascar, Peru, Romania, South Africa, Sudan, and Venezuela.

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Priority results

Sustainable economic growth in Asia.	Sustainable infrastructure (promoting green infrastructure and supporting countries to meet their environmental and development goals).
	Cross-country connectivity (prioritising cross-border infrastructure, ranging from roads and rail, to ports, energy pipelines, and tele-coms across Central Asia, and the maritime routes in South East and South Asia, the Middle East, and beyond).
	Private capital mobilisation (devising innovative solutions that catalyse private capital, in

Core information

Established	2016
HQ	Beijing
Biggest shareholders	China 30%, India 9%, Russia 7%, Germany 5%
President	Jin Lique (China)
Human resources	Ca. 130 professional staff. Expected in 2022 = 500
Financial resources	USD 100 billion capital. 20% paid-in, 80% callable.
Loans granted	2016 = USD 1.7 billion. 2017 = USD 3 billion
Denmark's shares	USD 369.5 million subscribed shares. (0.39%). 20% paid-in (ca. DKK 500 million), 80% callable.

	partnership with other MDBs, governments, private financiers, and other partners).	Denmark's membership	Founding member. Voting power 0.6%
		Wider Europe Const.	UK, Poland, Switzerland, Sweden, Norway, Denmark, Hungary, Iceland, (Romania)

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**Strategy for Denmark's
Cooperation with
the Asian Infrastructure Investment Bank
(AIIB)**

2018 - 2020

1. Objective

This Strategy for the cooperation between Denmark and the Asian Infrastructure Investment Bank (AIIB) forms the basis for the Danish contributions to the organisation, and it is the central platform for Denmark's dialogue and partnership with the AIIB. It sets out Danish priorities for the AIIB's performance within the overall framework established by the Bank's own strategy. In addition, it outlines specific goals and results vis-à-vis the AIIB that Denmark will pursue in particular through its Constituency. Denmark will work closely with like-minded countries towards the achievement of results through its efforts to pursue specific goals and priorities.

Given that AIIB is a young organisation the organisation strategy is only for 3 year period. The Danish engagement with AIIB will be reviewed before the Board of Directors commence a discussion of capital increase.

2. The Organisation

2.1 Mandate and Mission

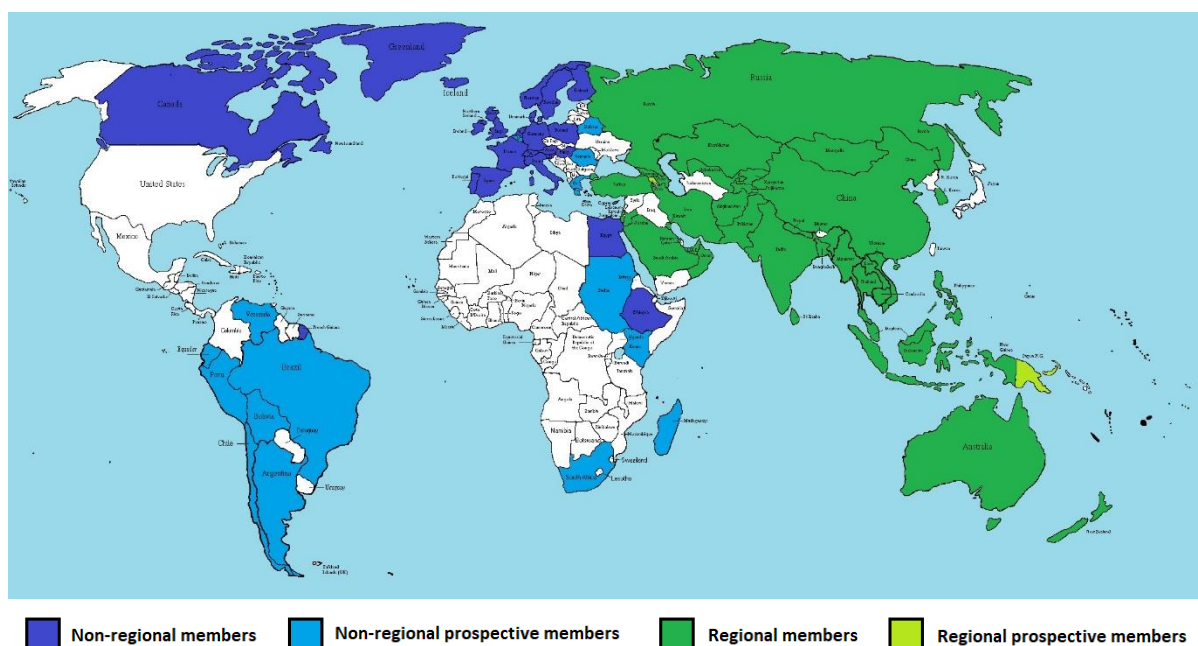
The initiative to set-up AIIB was launched in October 2013 by China as a response to the severe finance gap for sustainable infrastructure in Asia. The initiative was also fuelled by China's ambition as an emerging power and its frustration with global and regional financial institutions.

The overarching mission of the AIIB is to foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and promote regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions.

Denmark is a founding member of the Bank. This means that Denmark has higher voting rights and more a favourable position in the Constituency compared to newer members.

AIIB	
Established	2016
HQ	Beijing
Members	84. 48 regional and 36 non-regional members
Biggest shareholders	China 30%, India 9%, Russia 7%, Germany 5%
President	Jin Liqun (China)
Human resources	Ca. 150 professional staff. Expected in 2022 = 500
Financial resources	USD 100 billion capital. 20% paid-in, 80% callable.
Loans granted	2016 = USD 1.7 billion 2017 = USD 3 billion
Denmark's share	USD 369.5 million subscribed shares. (0.39%). 20 % paid-in (ca. DKK 500 million), 80% callable.
Denmark's membership	Founding member. Voting Power 0.6%
Wider Europe Constituency	UK, Poland, Switzerland, Sweden, Norway, DK, Hungary, Iceland (Romania)

Regional and Non-Regional Member Countries



2.2 Organisation and Management

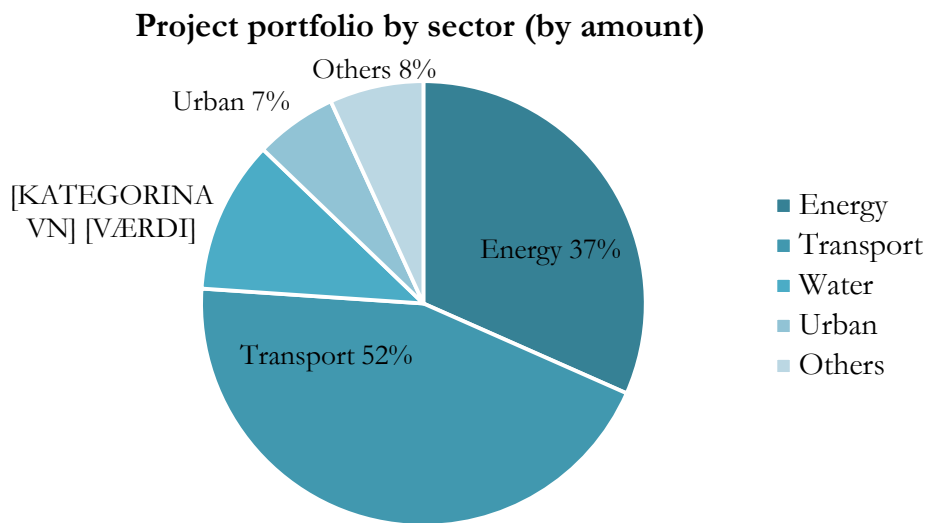
AIIB started operations in January 2016 and does not have offices outside of its head-quarter in Beijing. A President and five Vice Presidents lead the Bank.

Unlike other development banks, it has as part of its lean structure a *non-resident* Board of Directors that represents 12 constituencies. The Board of Directors meet four times annually and has a similar number of virtual meetings. The Board of Governors meet once a year at the Annual Meeting. The governor for Denmark is the Foreign Minister.

Denmark is part of the Wider Europe Constituency (European countries outside the Euro) and will be permanently represented in the constituency rotation until 2036 and get the Director position in 2034. UK, as the biggest member, always has a position as Director or alternate director. The Board work and collaboration within the Constituency is Denmark's main route towards influence in the Bank. Denmark has currently one second-dee in the bank and will continuously review the possibilities for secondments in order to strengthen our relationship with the Bank.

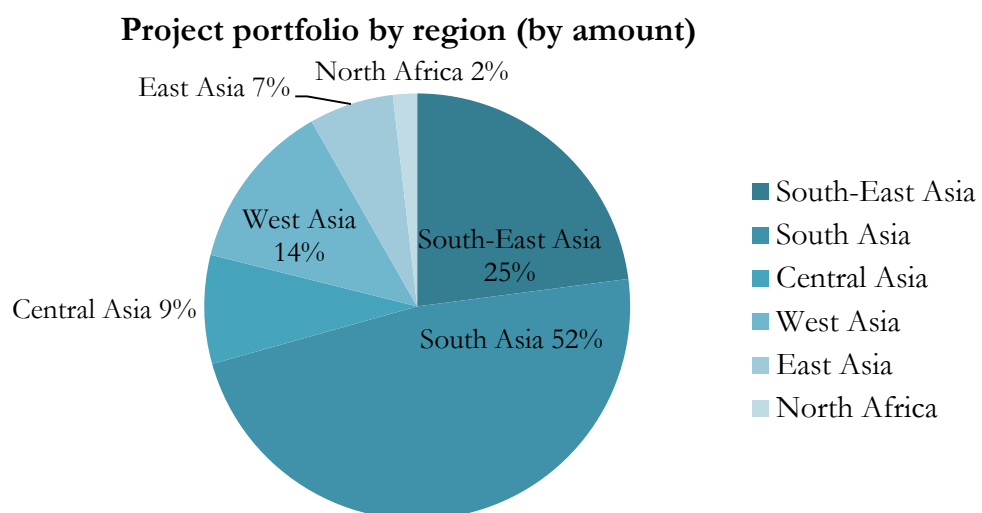
The regional (Asian) countries have 77.6% of the capital stock. The biggest shareholder is China with 31% of the shares and 27% of the votes. Most decisions require a simple majority but major decisions have to be approved by 2/3 of the votes. Most decisions are taken by consensus.

The key sectors for the Bank are Energy, Transport, Water and Urban development, as apparent from the chart below.



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The bulk of AIIB's operations will be in South Asia where there is a big need and the largest populations reside. Loans to China are expected to be minimal and only non- or sub sovereign.



The Bank can lend outside Asia provided that it supports connectivity with Asia or it is for a global public good and that the loan significantly benefits Asia. The ceiling for non-regional loans is 15%.

3. Key Strategic Challenges and Opportunities

¹ Numbers are based on approved projects in 2016-17 and the pipeline of projects as March 2018.

Even though the build-up of the Bank has been very fast, with the first loan already given after less than 6 months of operation, the first 5 years are considered a start-up phase. In this phase the organisation, strategies and policies are being developed, while the Bank simultaneously builds its loan portfolio and (from 2018) starts to borrow on the capital markets. The aim is that all of the Bank's core institutional infrastructure, policies, guidelines, capacities, and competencies as required to deliver will be in place by 2020, and deployed and further developed as the Bank scales up its activities. Just after the inauguration of the Bank an Environmental and Social Framework (ESF) of international standard was approved. The declared goal of the Bank is to live up to the highest international standards. Gender issues are part of the ESF and is a particular focus for Denmark and its Constituency. Denmark wants to ensure that gender is mainstreamed into the bank's business operations, incl. financing, internal organisation and monitoring and evaluation framework.

3.1. Asia's Challenges

A few major trends will continue to drive regional infrastructure demand.

First, many Asian economies will continue to require significant investment for development while transitioning to low carbon economies. Power outages remain a serious problem in many Asian countries and over 400 million people in Asia still lack access to electricity. Improved energy access can catalyse higher economic growth in many medium- and lower-middle-income countries. Providing sustainable energy would require countries to prioritise investments in renewable energy, smart grids, and energy efficiency. An encouraging trend is that the cost of renewables has come down significantly during the past few years. A more mature renewable technology, together with sufficiently low tariffs to benefit economies, underscores the importance of stable long-term financing, which development banks are well placed to provide. The next step will be to help countries to scale-up the provision of energy from renewable sources quickly.

Second, infrastructure will also be required to support sustainable urbanisation. Between 2018 and 2050, more than 1 billion Asians will move into urban areas. This will require immediate large-scale high-quality investments in sustainable infrastructure to ensure that the urban centres being built today do not lock-in the wrong solutions. Investment in urban transport systems is particularly important. Substantial investments will also be required in water, sewage, and waste treatment (including waste to energy) as well as in combatting air pollution to foster improved living conditions. There is also a need to bolster the resilience of cities against potential adverse impacts of climate change resulting in more frequent hurricanes, floods, and other natural disasters.

Third, regional integration and expanding intra- and inter-regional trade will require greater investments in connectivity and cross-border infrastructure. Since the financial crisis, global trade growth has recovered only slowly. However, it is projected to pick up.

The WTO expects global trade volume to grow by at least 3.2 percent in 2018 after an estimated 3.6 percent in 2017, a strong rebound from 1.3 percent in 2016. The Asia region is expected to register the highest trade growth in 2017 and 2018. Trade in the Sub-continent, the Middle East and intra-Asia is also expected to grow faster than in other regions over the medium term. Furthermore, the Belt and Road Initiative (BRI) and other regional initiatives will catalyse many trade and connectivity related projects.

Finally, taking account of development needs and the impact of climate change, the Asian Development Bank projects that Asia will need to invest \$1.7 trillion per year between 2016 and 2030 in infrastructure, which is significantly higher than the earlier estimate of \$881 billion recorded in 2015.

The next few years will provide a window of opportunity for International Financial Institutions (IFIs) active in Asia, in partnership with other stakeholders, to work towards resolving the “infrastructure paradox”. Under this paradox, long-term institutional investors’ search for yield remains unmatched by infrastructure investment offers owing to market frictions (lack of proper infrastructure return benchmarks, lack of trustworthy valuations, and high fees, etc.).

3.2. AIIB’s Relevance

AIIB has identified three areas of particular relevance:

- Sustainable Infrastructure. Promoting green infrastructure and supporting countries to meet their environmental and development goals.
- Cross-country Connectivity Prioritising cross-border infrastructure, ranging from roads and rail, to ports, energy pipelines and telecoms across Central Asia, and the maritime routes in South East and South Asia, and the Middle East, and beyond.
- Private Capital Mobilisation. Devising innovative solutions that catalyse private capital, in partnership with other MDBs, governments, private financiers and other partners.

4. Priority Areas and Results to be Achieved

Denmark will through an active engagement, especially at the Board of Directors, promote development policy priorities, foreign policy goals, and strategic Danish commercial interests.

4.1. Relevance for Danish Development Strategy and the Strategy for Foreign and Security Policy

The SDGs are important for AIIB and its *raison d’être* is to raise capital for development – the Bank has a special emphasis on mobilisation of private capital. The Bank primarily works with Goal 7 (energy), 8 (jobs and growth), 9 (industry, innovation and infrastruc-

ture), 11 (sustainable cities), 13 (climate) and 17 (partnerships) – all are priorities in the “World 2030 – Denmark’s Development Policy and Humanitarian Strategy”.

AIIB’s goal to create sustainable infrastructure aligns with the Danish priority to create inclusive and sustainable growth and development. AIIB aims to make the huge infrastructure investments in Asia, including Belt and Road, greener and support higher investment standards in Asia. This will be a potentially significant benefit for the climate and be an opportunity for Danish competencies.

Finally, by contributing to connectivity in Asia and between Asia and Europe, AIIB directly underpins the Danish interest in globalisation and connectivity, as stipulated in the Danish Strategy for Foreign and Security Policy.

4.2. Lean, Clean and Green

Denmark has along with the other shareholders fully endorsed the Bank’s motto “lean (efficient), clean (no corruption) and green”. These are also the three main Danish priorities:

- to develop an efficient bank with high development impact;
- to interpret “green” as broad as possible and with a strong preference for renewable energy;
- to focus on the Bank conducting business in accordance with the highest due diligence standards, including on anti-corruption.

The Lean vision is to create a bank where shareholders get more for less. It will be constant challenge to keep the Bank’s lean structure. Also, the Board, including Denmark, has a special obligation to give due consideration to the importance of developing a more efficient bank that other international institutions, as well as national Chinese institutions, can draw lessons from.

However, the AIIB’s exclusive focus on investment lending and not policy loans means that comparing its administrative effectiveness and efficiency with other MDBs is not a straightforward operation. In addition to investment lending, most other MDBs have a mandate to serve as repositories of knowledge on development and to provide policy based lending for medium and longer term reform. They also support institution building and the development of public sector efficiency over the longer term. AIIB will not replicate all these very resource intensive functions of other MDBs. Although the Bank will aim to be a centre of excellence in its priority areas. Still, AIIB have to rely on close collaboration with other MDBs.

What green means will be intensely discussed in the board. Within energy, it will for some members mean support to “clean coal” while others prefer only to support renewable energy. Denmark should interpret “Green” as broad as possible to ensure that all loans contribute to a greener Asia and with a strong preference for renewable energy solutions.

Denmark will also try to ensure that climate considerations are taken in all sectors, not only energy.

Chinese investment banks have had reputational issues and it was therefore during the negotiation phase important for especially potential Western members to be reassured that the Bank would conduct its business in accordance with the highest due diligence standards, including on anti-corruption. Denmark will continue to focus on this.

4.3. Relevance in Relation to the Development of Global Power Structures

AIIB is the first global IFI that has been established on the direct initiative of a non-Western country². This is significant and AIIB could contribute to encouraging China to continue to engage multilaterally within a rule based international order.

In addition, AIIB should contribute to improving the efficiency of other international organisations through healthy competition and by showing how to get things done to scale in Asia. AIIB is not, as some envisaged before the establishment, an adversary to the Bretton Woods Institutions, it is complementary actor. AIIB should cooperate with other MDBs to enhance the value added of the International Financial system.

The AIIB's entrance has underscored the need for coordination of policy between the development banks to ensure consistency. It is important that Denmark speaks the *same language* in all the development and investment banks, but *with different accents* in respect of different mandates of the banks and different Constituency configurations.

5. Budget

Denmark has subscribed to USD 369.5 million (0.39%) AIIB shares of which 20 % is paid-in and the rest are callable assets. The paid-in capital will be paid in five instalments of USD 14,780,000. 85% of the paid-in capital is counted as ODA under OECD/DAC rules.³

Capital subscription	2016	2017	2018	2019
Million DKK*	202	101	95	95

*Amount vary according to USD fluctuations.

The AIIB has not yet used up the headroom for lending provided by the paid in portion of the shareholders capital. However, the Board has approved that AIIB starts issuing bonds in 2018 in order to become a well-known actor in the international financial market. There are no plans for further capitalisation of the AIIB, but there is a statutory obligation for the Board to consider capitalisation every 5 years.

² Japan, co-founder of the ADB, is in this context considered a "Western country".

³ The percentage that can be counted as ODA can change, if significant changes occur with AIIBs membership and/or portfolio.

AIIB - Indicative ranges for Financing, Headcount and Budget	Financing, USD billion	Headcount, prof. staff	Budget, USD million
2017	3 (15 projects)	130	59.6
2018	2.5-3.5 (15-20 projects)	230-250	123.8
2019	3.5-4.5 (20-25 projects)	320-350	178-194

6. Risks and Assumptions

It was important for AIIB's financial viability and an important sign of confidence in the Bank's governance that the Bank received the highest rating from all the three major international credit rating agencies in the summer of 2017.

Still, AIIB is a young organisation, and in a build-up process some uncertainty exists as to the future effectiveness, efficiency and impact of the organisation.

The Bank has developed an elaborate risk framework to take account of financial risk, contextual risk, programmatic risks and institutional risks. The risk situation is discussed at all Board meetings.

6.1. Risk Assessment and Mitigation

Contextual risks

Risk factor	Likelihood	Impact	Risk response	Background to assessment
Lack of capacity to deliver high impact projects	Medium	High	AIIB has until now predominantly been cofinancing. The Bank is currently building its capacity so that in the near future, it will be able finance/ develop its own projects and deliver directly on its strategic goals.	Good bankable projects are always in high demand.

Programmatic risks

Risk factor	Likelihood	Impact	Risk response	Background to assessment
Inadequate ability to achieve transformational change.	Medium	Medium	Continued focus on innovation and improved management. Continued focus on recruiting and keeping the right talent. Collaborate with other MDBs with instruments suited to address constraints to transformation associated with policy, institutions or regulation.	One of AIIB's key strengths is to be flexible and innovative. This is required to achieve transformational change.

Institutional risks

Risk factor	Likelihood	Impact	Risk response	Background to assessment
Attracting high quality staff to Beijing is a priority and is perhaps the Bank's largest institutional challenge.	High	High	Constant attention by management to ensure that the Bank is an attractive working place. Denmark's Constituency is following this issue very closely.	A relatively modest compensation package, esp. for staff with family, makes it difficult to attract esp. mid-career staff. Although air quality is improving fast in Beijing, attracting and maintaining staff especially when the Bank is longer new is cause for concern.
Major mismanagement of funds or corrupt practises in AIIB will have serious negative impact on the reputation of AIIB and its members.	Low	High	AIIB has professional financial management systems, controls and staff in place. High attention to due diligence measures and risk manage-	AIIB's clear stance on corruption was a key factor for European countries to join the Bank. Management's commitment to zero tolerance to corruption

			ment.	is key to building AIIB's fiduciary reputation as a prudent and diligent IFI.
Lack of proper management of the Bank will hamper efficiency and impact.	Medium	Medium	AIIB is managed by experienced and respected international professionals and is under close scrutiny by the Board.	The fast expansion of the Bank means that there is an increased risk of mistakes and lack of proper management.

Political risks

Risk factor	Likelihood	Impact	Risk response	Background to assessment
Although AIIB is not a political institution, the risk of political controversy in the Board cannot be excluded. Since the Board is non-resident, there is increased risk of misunderstandings.	Low	High	AIIB has professional Board that works constructively. A lot of emphasis has been put on good governance and proper conduct of the Board. Important to develop trust btw. Management and Board and within the board.	All members of AIIB have a common interest in safe-guarding their investment in the Bank and thus in the proper governance of AIIB. Board discussion are frank and open, which is supported by frequent informal discussions.
That the biggest shareholder will use AIIB directly for its own political purposes	Low	Medium	AIIB is managed by experienced and respected international professionals and is under close scrutiny by the Board.	China has a strong interest in showing that it can host a well-functioning IFI.