BRICS NEW DEVELOPMENT BANK AND CONTINGENT RESERVE ARRANGEMENT

Presentation to Parliamentary Committees

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INITIAL AGREEEMENT TO ESTABLISH BRICS INITIATIVES

On 27 March 2013, BRICS Leaders reviewed progress made by Finance Ministers in conducting a feasibility study on the **New Development Bank** and **Contingent Reserve Arrangement.** The Leaders made the following announcement:

> *"Following the report from our Finance Ministers, we are satisfied that the establishment of a New Development Bank is feasible and viable. We have agreed to establish the New Development Bank. The initial contribution to the Bank should be substantial and sufficient for the Bank to be effective in financing infrastructure.* ***We are grateful to our Finance Ministers for the work undertaken on the New Development Bank and direct them to negotiate and conclude agreements which will establish them****. We will review the progress made in these two initiatives at our next meeting in September 2013."*

SIGNING OF AGREEMENTS ESTABLISHING BRICS INITIATIVES

On 15 July 2014; at the Sixth BRICS Summit held in Fortaleza, Brazil; the BRICS Finance Ministers, signed the Inter-governmental Agreement and Articles of Agreement establishing the **New Development Bank**, as well as, the Treaty Establishing the **Contingent Reserve Arrangement**. The Leaders' declaration is as follows:

> *"The Bank shall have an initial authorized capital of US$ 100 billion. The initial subscribed capital shall be of US$ 50 billion, equally shared among founding members. The first chair of the Board of Governors shall be from Russia. The first chair of the Board of Directors shall be from Brazil. The first President of the Bank shall be from India. The headquarters of the Bank shall be located in Shanghai. The New Development Bank Africa Regional Centre shall be established in South Africa concurrently with the headquarters."*

NEW DEVELOPMENT BANK

The key motive for establishing the **New Development Bank** was the recognition of financing constraints that the BRICS member countries and other emerging market and developing countries (EMDCs) face in addressing their infrastructure challenges. The Bank will ***mobilize alternative sources of financing***, strengthen the cooperation among BRICS countries, and complement existing efforts by other development partners and International Financial Institutions (IFIs).

NEW DEVELOPMENT BANK PURPOSE AND INSTRUMENTS

i. The Bank's purpose will be to mobilize resources for infrastructure and sustainable development projects, public or private, in BRICS and other emerging economies and developing countries, complementing the existing efforts of multilateral and regional financial institutions for global growth and development.

ii. The NDB shall operate according to sound banking principles, providing support for infrastructure and sustainable development projects.

iii. Additionally the Bank will provide technical assistance for the preparation and implementation of projects to be supported by the Bank.

iv. The Bank will provide support, in the form of loans, guarantees, equity participation and any other financial instrument to, public or private projects in member countries.

v. The Board of Governors may approve operations in non-member emerging markets and developing countries.

NEW DEVELOPMENT BANK SALIENT FEATURES OF THE AGREEMENT

Table 1a: NDB Salient Features		
Founding Documents	1.1	The founding documents will consist of two agreements i) Inter-governmental Agreement - capturing the broad agreement on key principles regarding the bank; and ii) Articles of Agreement – capturing the technical specifications for the Bank's establishment. The Agreements have been completed and signed.
Membership	2.1	BRICS countries will be the only founding members of the Bank; however the articles provide for the inclusion of other United Nations members.
Authorised capital	3.1	The authorised capital of the Bank will be up to $100 billion. Authorised capital determines the extent the bank will be allowed to grow.
Subscribed capital	4.1	The subscribed capital will be $50 billion allocated to the founding members. This shall have paid-in and callable components. The size and frequency of instalments will be commensurate with the Bank's operational requirements.
Review of capital	5.1	The founding documents will have a provision for Review of size and structure of the capital.

NEW DEVELOPMENT BANK SALIENT FEATURES OF THE AGREEMENT CONTINUED

Table 1b: NDB Salient Features		
Shareholding	6.1	BRICS countries will maintain at least 55% of the voting shares of the Bank. At a later stage, the Bank will be open to any sovereign that wishes to join, subject to predetermined criteria.
	6.2	The intention to open the Bank up to other members will be clearly stated in the founding documents.
	6.3	The shareholding of non-BRICS countries will be capped both individually and collectively.
	6.4	No shareholding shall be made available to the private sector.
Governance	7.1	There will be three levels of governance, namely, Board of Governors, Board of Directors and Management
	7.2	The Board of Governors shall be at Ministerial level (Ministers of Finance); meeting annually.
	7.3	The Chair of the Board of Governors will be chosen on rotation; in line with the chairing of the BRICS formation.
	7.4	Each founding member shall nominate a representative to the Board of Directors. Initially the Board of Directors shall be a non-executive and non-resident body; meeting quarterly.
	7.5	The President shall be from the one of the founding members to be appointed on rotation. There shall be 4 Vice-Presidents, one from each of founding members (except for the one represented by the President)
Voting	8.1	Voting will be proportional to shares, where BRICS will have bigger voting power compared to non-BRICS.
Decision Making	9.1	Major policy decisions will be taken by the Board of Governors by consensus. The term "major policy" will be defined in the text of the agreement.

NEW DEVELOPMENT BANK AFRICA REGIONAL CENTRE

i. A Special Fund will be created within the Bank at the earliest occasion, with the participation of all founding members, for the purpose of helping project preparation and implementation. China will be the largest contributor.

ii. The bank shall have its principal office in Shanghai. The Articles of Agreement call for the establishment of the bank's Africa Regional Centre (ARC), in Johannesburg; this office is to be launched concurrently with the bank's headquarters.

iii. The ARC will be provide the primary operational interface between the New Development Bank (NDB) and the continent; striving to maximise the efficiency, effectiveness and impact of the Bank's operations in Africa. Additionally, it will be responsible for creating and maintaining the NDB's relationship with African states and regional bodies. Moreover the ARC will host project preparation capacity, to bring projects that the Bank is interested in funding to a "bankable" stage.

CONTINGENT RESERVE ARRANGEMENT

i. The BRICS Contingent Reserve Arrangement (CRA) is being established for the purpose of responding to short-term **Balance of Payments** (BoP) pressures.

ii. Countries experience BoP pressures when they have insufficient foreign reserves (**liquidity**) to meet current claims. This most commonly results in depreciation of the domestic currency (which may result in **inflation**) and the depletion of the countries' foreign reserves.

iii. International Monetary Fund is widely understood to provide support for nation states in the event of balance of payment shocks, however the increased **frequency** of these shocks has resulted in the development of **complementary networks** of country insurance and lending instruments.

CONTINGENT RESERVE ARRANGEMENT

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i. These country to country networks are more appealing than requesting the IMF's assistance for the following reasons:

   a) **Less conditionality:** the use of arrangements outside of the IMF is usually driven by a shared dissatisfaction with conditions attached to support programs;

   b) **Efficiency:** As they are not subject to approval by the Executive Board on the basis of advice from IMF management and staff, they can be more responsive provide insurance against shocks in a cost-efficient manner;

   c) **Sustained capital market access** Pooling resources can support ongoing access to international capital markets on better financing terms than might be possible in the absence of such arrangements..

ii. The CRA would serve as a precautionary measure to help the BRICS countries **forestall short-term liquidity pressures**, **provide mutual support** and **further strengthen global financial safety net** .

CONTINGENT RESERVE ARRANGEMENT

i. The CRA is a virtual pool of foreign reserves, similar to such regional financial arrangements as the Chiang Mai Initiative Multilateralisation established by the Asian countries.

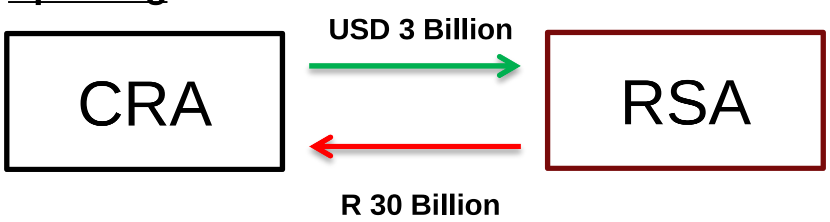
ii. BRICS countries will ring fence a portion of their country's reserves for the purposes of the CRA, and will only be required to transfer these reserves to another BRICS country, after the receipt and approval of a request.

iii. At the time of a request, each of the (providing) BRICS countries will engage in short term swap transactions with the country requesting support. These swaps should have no impact on the foreign exchange reserves of the providing countries because the swaps will involve exchanging US dollars for the local currency of the requesting country.

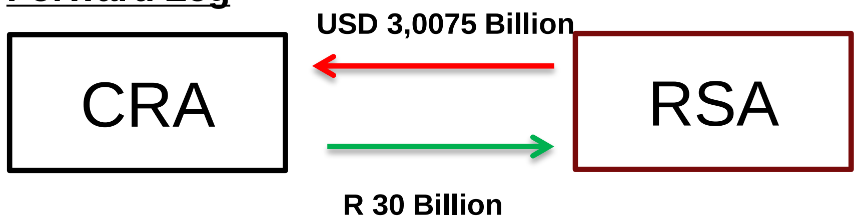
iv. Thus, the primary effect will be a temporary change in the composition, and not necessarily the level of reserves. Furthermore, the requesting country will pay a fee for utilisation of the CRA, which will be Libor plus a margin, thus the returns earned on the reserves should not be compromised in any way.

CONTINGENT RESERVE ARRANGEMENT MECHANISM

Spot Leg



Forward Leg



i. Assuming: a) the 1USD = ZAR10.00 b) a 6 month transaction c) interest charge of 0,5% per annum; which is Libor of 0.41% and a risk spread 0,09%.

ii. In the scenario above South Africa requests CRA support to the value of US$3 billion. The parties will enter into a swap transaction, at an agreed **spot rate** (current value) and agree terms of redemption at a **forward rate** (future value). In this scenario it is agreed that the exchange rate on the forward leg will be 1USD = ZAR10,025. This means that the swap transaction yields the CRA members a profit of USD0,0075 per dollar.

iii. It is important to note that South Africa's contractual obligation is to provide the CRA states with USD3.0075 billion on the date of execution of the forward leg even though the actual exchange rate on that date is 1USD = ZAR10,90.

CONTINGENT RESERVE ARRANGEMENT SALIENT FEATURES OF THE AGREEMENT

Table 2. Contingent Reserve Arrangement Salient Features	
Total size and commitments	The initial size of the CRA will be US$ 100 billion, with individual commitments as follows: China – US$ 41 billion; Brazil, Russia, and India – US$ 18 billion each; and South Africa – US$ 5 billion.
Drawing limits	Drawing limits will be determined by countries' commitments times a multiplier. China will have a multiplier of 0.5 (US$20.5 bn) ; Brazil, Russia and India of 1(US$18 bn); and South Africa of 2 (US$10 bn). South Africa benefits the most, relative to its contribution.
Governance: two-tier system	There will be a two-tier system of governance: A Council of CRA Governors (consisting of Ministers of Finance and/or Central Bank Governors); will be responsible for major decisions; a Standing Committee of senior officials – from the Reserve Banks or Ministries of Finance – of member countries; will address executive level and operational matters.
Voting and decision-making	All decisions at the Governors Council shall be taken by consensus. Most decisions of the Standing Committee will be taken by consensus. Requests for i) drawing and ii) for renewals of drawings, and iii) operational and procedural aspects of swaps shall be decided by voting.
Voting Simple majority means 50% + 1 vote	Weighted simple majority with basic votes: Voting power is calculated according to a two-part formula: i) 5% of voting shares are distributed evenly amongst members; and ii) remaining portion is distributed according to contribution. In the event of a withdrawal by a "middle member"
IMF Link	Parties to the CRA agreement may request 30% of their total drawing limit without an IMF programme.

FINANCIAL IMPLICATIONS

i. The documents establishing the New Development Bank were finalised in Fortaleza, on 15 July 2014. As things stand, no budgetary provision has been made for it in the 2014 Medium Term Expenditure Framework (MTEF). Several options are being explored for funding; including a budget request for the upcoming 2015 MTEF.

ii. The Bank's founding documents prescribe that the payment of the US$2 billion shall be made in 7 instalments. The first payment shall be due 6 months after the depository receives the last instrument of ratification. Current indications are that this will be within a year.

iii. The Contingent Reserve Arrangement will not require South Africa to transfer any resources before the receipt and approval of a request. Once a request is received the Reserve Bank will exchange a sum of its dollar reserves in exchange for an equivalent sum of the requesting party’s domestic currency. An MOU is being negotiated between the Reserve Bank and National Treasury.

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