3 February 2025

The UK as a Climate Finance Hub

Unlocking capital from Institutional Investors towards Emerging Markets and Developing Economies

Contents

This report was first shared with the Minister for Development, Anneliese Dodds, on 14 October, 2024. The recommendations and views within the report represent the collected work of the industry working groups as at that date.

Executive Summary

Addressing climate change in Emerging Markets and Developing Economies (EMDEs) requires trillions of dollars of investment over the coming decades. The earlier these investments are made, the greater their effect on the mitigation and adaptation goals of the Paris Agreement, reducing exponentially larger future loss and damage requirements, and lowering the chances of broader systemic risks from climate change impacts.[1] Severe climate events are increasingly materialising worldwide, including in the UK, other developed countries, and EMDEs. The UK Government has a unique opportunity to restate climate leadership internationally and to bring the financial industry together to unlock investment opportunities that address climate and wider development challenges.

In recent years it has been acknowledged by donors that this increased investment, and the additional investment required to meet the global Sustainable Development Goals (SDGs), cannot be met by government and multilateral funding alone, and that mobilising private finance is essential in bridging this funding gap. This topic is only more pertinent given the ongoing negotiations regarding the New Collective Quantified Goal (NCQG) on climate finance set to be agreed at COP29 in November and updated Nationally Determined Contributions (NDCs), due in early 2025.[2]

Leading UK institutions, through the workstreams whose outputs have been synthesised in this report, and as part of their broader climate action, stand ready to offer their support and leadership to an Industry Steering Group that would coordinate efforts to unlock and mobilise increasing amounts of capital in order to meet this challenge.

The priorities of the new UK Government coalesce around this topic, underlining the propitious timing for action. The Prime Minister is clear on his plan for renewed climate leadership, while leveraging synergies that promote domestic growth. The Chancellor is championing pension reform to tackle waste and increase saver returns, while the Treasury has undertaken a review to secure the UK as the world's best place for transition finance.

A significant proportion of investors have made public commitments to address climate change and have started taking actions towards achieving them.[3] In implementing their net zero targets and assessing physical climate risks in their portfolios, investors have developed an increased awareness that addressing the systemic risks posed will only be achieved with increased financial flows to where they are most needed. It is now well understood that short term measures to reduce 'financed emissions' and physical climate risks in their discrete portfolios will have little real-world effect if capital is not made available to assist the transition and build resilience globally. Without adequate investment in EMDEs – which currently represent 70% of global emissions and include some of the most climate vulnerable regions – the global effort falters, posing systemic risks to the stability of returns and asset values globally, including values in UK institutional investors' portfolios.[4, 5] This exposes a major fault line in the current international financial architecture: the system is stacked against EMDEs, yet all stand to lose if an orderly transition is not facilitated globally.

1. *Independent High Level Expert Group on Climate Finance (2023). **A climate finance framework: decisive action to deliver on the Paris Agreement.** IMF (2023). **Global Financial Stability Report: Financial and Climate Policies for a High Interest-Rate Era.** LSE (2022). **Financing a big investment push in emerging markets and developing countries for sustainable, resilient and inclusive recovery and growth.***
2. *In 2015 at the signing of the Paris Agreement, it was agreed that the global community would agree a new set of Climate Finance goals – the New Collective Quantified Goal for Climate Finance (NCQG) by 2025. This goal is currently under negotiation, with aspirations to seek agreement at COP29 in Baku to substantially raise the ambition from the USD100bn per year by 2020 target originally set in 2009.*
3. *The **Net Zero Asset Managers Initiative (NZAM)** involves more than 325 signatories with USD57.5tn in Assets Under Management (AUM). **Climate Action 100+** involves more than 600 investor signatories. **The Paris Aligned Asset Owners** involves 57 investors representing USD3.3tn. **The Net Zero Asset Owners Alliance** involves 88 investors representing USD9.5tn.*
4. *Bolton, P., A.M. Kleinnijenhuis and J. Zettelmeyer (2024) 'The economic case for climate finance at scale', Policy Brief 09/2024, Bruegel. **Available here.***
5. *Aviva plc (2024). **The Tipping Point for Climate Finance.** Other research suggests a hypothetical global portfolio of 60% equities and 40% bonds would see its cumulative returns decline by nearly 40% over a 40-year period in a scenario where no additional climate policies are introduced (i.e. business as usual), in comparison to a climate-uninformed baseline.*

Beyond managing risk, there are substantial opportunities for profitable returns, as certain EMDEs and asset classes have notable growth potential.[6] There are commercial incentives behind this which present significant investment opportunities for the City of London and the broader UK and global financial system that intersects with it. The City is recognised as a hub for global capital mobilisation and a leader in sustainable finance. It should seek to leverage this expertise and position itself as the primary hub for global climate finance and sustainable development finance for EMDEs. The UK Government should then take this expertise to multilateral fora such as the G7, G20 and OECD to lead on the reforms required at global level. This would assist the UK Government in demonstrating its ambition to reclaim global climate leadership, rebuild trust with EMDEs, and unlock quality climate and nature finance to support sustainable growth both at home and abroad.

This positioning, well executed, could see trillions of pounds flow through the UK economy in the coming years. This would fuel domestic growth by increasing the already substantial annual contribution of the UK financial and professional services sector of GBP243bn in gross added value and GBP110bn in tax revenues.

Further, it could protect and add to the 2.4m high quality jobs in the sector.[7] Some other countries that have successfully implemented EMDE capital mobilisation initiatives have also used the opportunity to drive exports of their domestic climate solutions industries.

As other financial hubs are already advancing in supporting sustainable investments in EMDEs, immediate and coordinated leadership from both the UK Government and industry is essential. Strong public-private leadership is critical, as well as including voices from the EMDEs so they are heard and part of the process. There is immense potential for collaboration between Development Finance Institutions (DFIs) and institutional investors. Successful innovations from our European neighbours show that limited public funds can go further when public and private actors work together to create effective catalytic vehicles.

Examples include the Danish DFI IFU's Climate Investment Fund and SDG Fund, mobilising over USD2bn to EMDEs, with Danish pension funds providing the majority of capital and Danish industry positioned as a solutions provider for invested projects, bolstering exports.[8] In the Netherlands, pension provider APG provided a cornerstone investment of USD750m in the FCDO backed ILX fund of ~USD1bn, whose innovative model invests alongside MDB/DFI originated debt.[9] The Norwegian Climate Investment Fund, operated by DFI Norfund in partnership with pension fund KLP, will allocate ~USD1bn to EMDEs by 2026.[10]

Opportunities also exist to address cultural behaviours of decision makers and their advisors, for example, by better showcasing investment prospects and improving the availability of data. Ultimately, integrating a global perspective into institutional investors' strategic asset allocations – specifically by incorporating assets in EMDEs – is crucial to expanding long-term investments that support the transition in these markets.

This report outlines concrete actions that the UK Government and industry can take to bolster the country's sustainable finance leadership status while also boosting domestic economic growth. Key recommendations include:

- Investors' C-Suites must work with Government (led by HM Treasury and the Foreign, Commonwealth and Development Office) to provide the leadership required to kick start sector wide innovation and champion these issues on the international stage;
- Public and private actors must drastically deepen collaboration through targeted, programmatic work led by an Industry Steering Group (ISG) that coordinates efforts to build capacity in the ecosystem, enhance data and awareness, scale investment opportunities and mobilise capital commitments;
- Regulators must integrate EMDE considerations, and push for greater transparency domestically and internationally, to cement UK regulatory leadership in the field of transition finance. It was clear from the industry workstream discussions that there is a strong willingness from the private sector to engage in this effort, given the real opportunities and risks this topic presents to them and to the UK economy as a whole. Through the ISG (see box below), investors and wider participants are prepared to commit time and expertise to address the barriers, if the appropriate UK Government support is in place.

The report begins by outlining the detailed practical recommendations for the UK Government, industry and regulators in section 1. It then introduces the objective in section 2, and it details the benefits of mobilising private capital to EMDEs for both the UK agenda and for the financial industry in section 3. In section 4 it outlines the main barriers cited by practitioners before exploring successful solutions for mobilising private capital into EMDEs in section 5. As these barriers are progressively addressed and investment opportunities expand, integrating EMDE assets into institutional portfolios becomes a key condition for scaling long-term investments in these markets. In section 6, the report explores how to inform and influence key decision-makers to increase the flow of UK institutional capital into sustainable development investments in EMDEs.

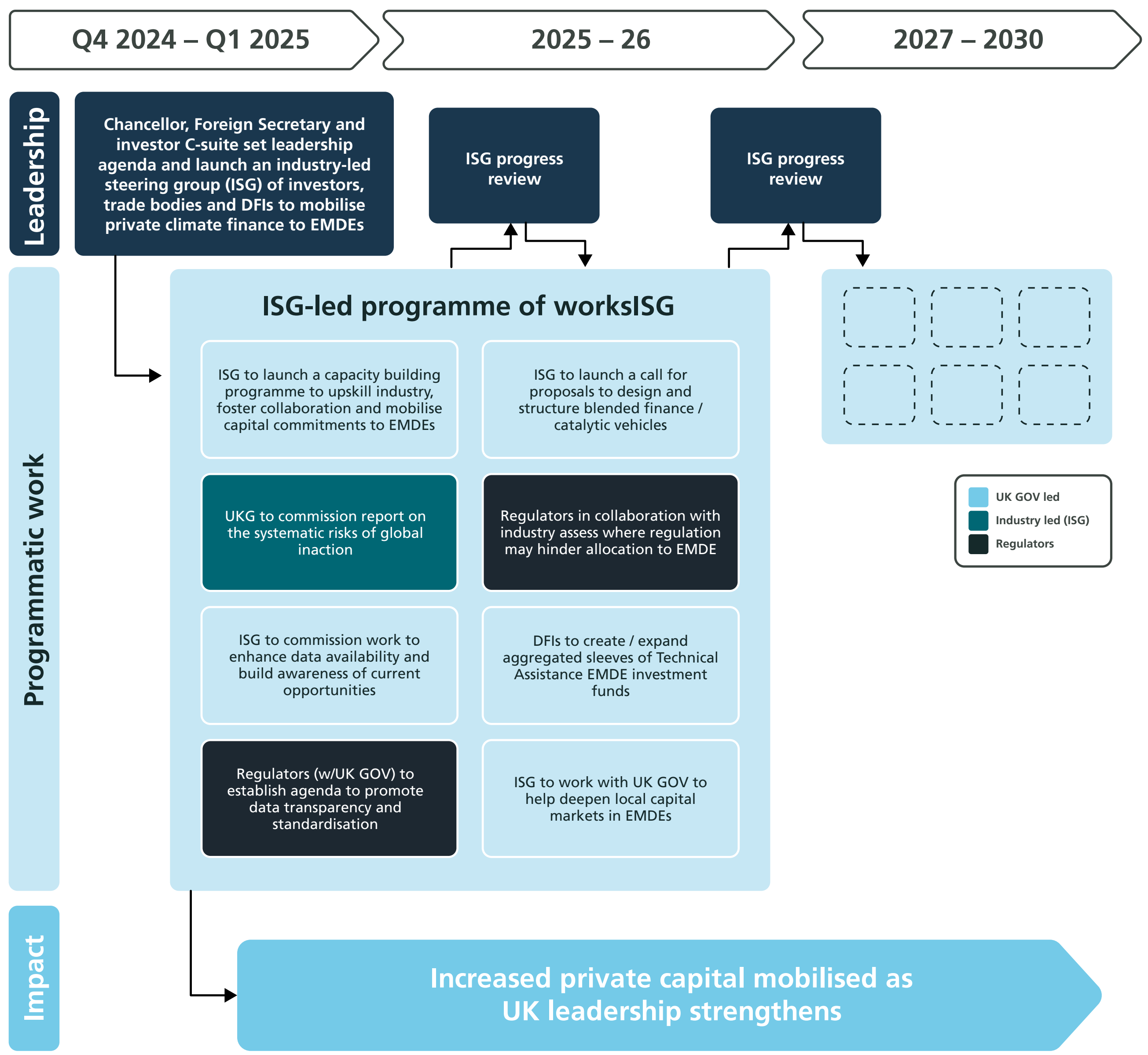
Industry Steering Group (ISG)

A board of industry experts led by the private sector, with the public sector (including DFIs) being positioned as facilitators. The Group would report into a Minister on a periodic basis and set up small and focused working groups tasked with taking forward specific initiatives where needed. Key stakeholders engaged through the process would include decision makers (trustees), asset owners, asset managers, consultants, insurers, credit rating agencies, trade bodies, law firms, wealth managers, regulators and Government departments among others.

6. FT (2024). ***The world should take notice – the rest are rising again.*** *The proportion of emerging economies in which per capita GDP is likely to grow faster than the US is on course to surge from 48 per cent over the past five years to 88 per cent in the next five.*
7. *TheCityUK (2024)* ***The Total Tax Contribution of UK-based financial and related professional services,*** *City of London (2023) State of the Sector, The CityUK (2024),* ***Key facts about UK-based financial and related professional services 2024***
8. *Investment Fund for Developing Countries (2024),* ***Danish SDG Investment Fund will contribute to fulfilling the 17 UN Sustainable Development Goals***
9. *https://apg.nl/en/publication/apg-contributes-to-responsible-investment-in-emerging-markets/*
10. *Norwegian ministry of Foreign Affairs (2023),* ***Norway's Climate Investment Fund and KLP invest in Indian transmission sector***

1 Industry Recommendations

Figure 1. Summary of recommendations with illustrative timeline



	Recommendation (what, why, who) Detail	Detail
1	Chancellor and Foreign Secretary to engage with industry CEOs, regulators and across UK Government to set leadership and direction, indicating: i. The opportunity to position the City of London as a climate and development finance hub, central to mobilising development finance into EMDEs as complementary to the UK Growth and mobilisation agenda ii. The importance of a global orderly climate transition for the UK Aim: Set direction and vision, provide actionable goals and architecture for implementation Stakeholders: UK Government and Industry C-Suite. Across Government, this includes HM Treasury (HMT), the Department for Energy Security and Net Zero (DESNZ), the Foreign, Commonwealth and Development Office (FCDO), the Department for Work and Pensions (DWP) and the Department for Environment, Food and Rural Affairs (DEFRA).	1. Chancellor and Foreign Secretary to convene CEOs/ Trustees of key UK asset owners and asset managers to underline the need for a top-down culture shift on addressing climate and development in EMDEs, to mobilise private capital to EMDEs and maintain the City's competitiveness: building capacity, innovating with products, partnerships and investments are key.[11] Chancellor to underline need to maintain leadership noting innovation in other jurisdictions. 2. Government and industry to establish an Industry Steering Group (ISG) combining investors, trade bodies and DFIs. Reporting to a Minister, the ISG would convene relevant actors under different workstreams to design and lead the implementation of the programmatic work set out at Government/C-suite level. 3. Investors and UK Government to explore high-level commitments (e.g. a new Lancaster House Accord) – call for the Government, along with other providers of catalytic capital, to make a strong GBP1-2bn a dditional allocation of catalytic capital over a 10 year period. Based on this, a lead group of investors could make a commitment to mobilise capital and undertake programmatic work to address barriers. 4. Industry encourages 'One HMG approach'. Delivering climate objectives and the wider SDGs complement the UK's domestic growth agenda. HMT, DESNZ, FCDO, DWP and DEFRA should collaborate with regulators, trade associations, and the finance community to support London as a transition finance hub. The UK should engage EMDE policymakers early and leverage its strong global relationships for effective collaboration.

11. HMT could consider framing this as a sixth pillar to the National Wealth Fund to establish London as the global finance transition centre, supported by a one-HMG approach working with EMDEs policymakers.

	Recommendation (what, why, who) Detail	Detail
2	Industry Steering Group (ISG) combining investors, trade bodies and DFIs to set a capacity building programme to upskill industry. Aim: Expand capabilities, foster collaboration and address cultural barriers of decision makers Stakeholders: ISG working with UK Government, DFIs, industry including frontline industry professionals, EMDE voices, trade bodies and regulators. Some actions specifically for DWP, the Prudential Regulation Authority (PRA) and insurers.	1. The programme would include workshops to strengthen private sector investment and DFI collaboration, with the view to upskilling both on the ways of working and points of access for the other. The program should ensure DFIs are well prepared to articulate risk/return requirements of institutional investors (decision makers such as frontline fund managers, pension fund trustees, risk officers, investment desks), and that investors are well aware of the opportunities for investment and collaboration (see also #4). 2. Host workshops to build the capacity of UK industry regarding emerging market infrastructure and private market investments, potentially using venues like the London Stock Exchange Group (LSEG) in conjunction with local stock exchanges from EMDE markets; law firms, workstream leads and the Institutional Investors Group on Climate Change (IIGCC). 3. Investment consultants to scale up capabilities of investment decision makers to effectively support institutional investors in EMDE transition finance. This will help decision makers to adopt frameworks to support robust decision making when strategically allocating to EMDEs (See example in Annex). 4. The Pension Regulator to update the "Trustee toolkit" learning programme and Trustee guidance with specific training to support informed decision making on EMDE investments. Trustees are often volunteers with non-finance backgrounds who use the toolkit as their main training guide, yet this currently includes no references to EMDEs.
3	ISG to mandate a platform convening investors, trade bodies and DFIs to enhance data availability and build awareness of current opportunities for EMDE investment. Aim: Address information gap and create awareness of investment opportunities Stakeholders: ISG working with UK Government, DFIs, industry including frontline industry professionals, EMDE voices, trade bodies, regulators and CRAs.	1. Socialise existing GEMs[12] database and coordinate industry feedback to the GEMs team on what further granular data should be made available, which would include probability of default, non-performing loans, default rates, recovery rates, returns achieved and deal flow, broken down by the country, sector and region. These findings reveal that investing in certain EMDE assets is less risky than commonly perceived, and more granular data will help build the investment case for EMDE investment with risk and investment committees. Private and public stakeholders (not already covered by GEMs) should be encouraged to contribute data where feasible. 2. Explore creation of a platform for EMDE investment opportunities for institutional investors with a consolidated database of performance statistics, as outlined above, to address perceptions of risk. This would underscore an opportunity for UK leadership, especially given the City's position. The scope of such a platform could also incorporate data on the relevance of investments to progress on impact (SDGs and climate action for example). 3. Engage asset managers to develop a suite of EMDE transition products[13] that cater to various requirements, including risk/return profiles, scale, liquidity, and cost in public and private markets. Additionally, involve investment consultants in evaluating EMDEs alternatives for their 'Buy' recommendations. The ISG to convene senior frontline leaders – individuals who can make decisions and drive innovation. Representatives from HMT and regulators should be involved to incorporate potential policies, credit rating, labelling, regulations, and incentives from the start.

12. See GEMs – Global Emerging Markets Risk Database Consortium of MDBs and DFIs (gemsriskdatabase.org)

	Recommendation (what, why, who) Detail	Detail
3		4. Engage with Credit Rating Agencies (CRA) – Convene to discuss how increased data availability can improve 'climate smart' ratings and how credit enhancement mechanisms are factored into the rating process.
4	ISG to launch a call for proposals to design and structure blended finance/catalytic vehicles, supported by UK Government but led by investors and DFIs. Aim: Establish new vehicles to mobilise EMDE investment Stakeholders: ISG working with UK Government, DFIs, UK Export Finance (UKEF), industry including frontline industry professionals, EMDE voices, trade bodies and regulators.	1. Building on the Prime Minister's recent announcement at the UN General Assembly of British International Investment (BII)'s GBP100m concessional capital facility, UK Government to call on the private sector to lead in the design and structuring of appropriate investment vehicles underpinned by the commitment of an additional GBP1-2bn over next 10 years, including where catalytic capital and credit enhancement can best be deployed.[14] This will not only foster competition and serve to crowd in more private sector capital, but also demonstrate how public sector capital can be used to maximise mobilisation from the private sector. Such a call could be undertaken in the context of an initiative to build out standardised, homogeneous blended finance vehicles to promote investment in EMDEs, at the heart of which would be mobilisation. It should be closely linked with the high-level commitment discussed above, as well as to international initiatives underway in this area.[15] Considerations: • Assess the catalytic vehicles that are best suited to different investment mandates, including scaling UK DFI investment capabilities through bond issuance; co-investment models like the ILX fund; aggregation vehicles such as investment funds or securitisation structures with credit enhancements (e.g. guarantees, first lost tranches); and/or vehicles to fund the local funders (funders in-country). • Aggregated credit funds should aim to be rated, once they reach a certain scale; to supply dis-aggregated risk and performance data to the extent possible/ useful.[16] • Each vehicle to actively consider listing to encourage liquidity, exits and attract new investment; or to establish a liquidity or warehousing facility for this purpose.[17] Given the costs, to consider offering grants (which could be returnable). • Encourage tighter collaboration between the MOBILIST program, BII and PIDG as well as UKEF, which has previously guaranteed bond issues. Given the structuring costs, to consider offering grants (which could be returnable) to support product design, listing, etc. • Take note of, and collaborate with, international initiatives underway in this area that will (a) drive further opportunities for harmonisation; and (b), create more investment opportunities for UK-based investors (see footnote (4) above).

13. These products differ from vehicles noted in the 'call for proposals' below in that they not necessarily require concessional or blended capital at the product level, but may incorporate aggregation or secondary market purchase of concessionally financed/ credit enhanced project finance
14. Could draw on lessons learned from COP26 in the lead up to COP30: The Call for Proposals launched by MOBILIST at which The CLEAR Fund (anchored by MOBILIST and PIDG) was announced
15. For example, IMCA | WCF (worldclimatefoundation.org)
16. Cognizant of confidentiality and commercial considerations
17. The existing MOBILIST programme would seem to align with this

	Recommendation (what, why, who) Detail	Detail
5	UK Government to commission report(s) on risks of inaction to the UK. Aim: Support the rationale Stakeholders: UK Government.	1. The report should model the systemic risk to the global financial system, and in particular to the UK and similar developed markets, including the impacts on UK-based investment of failed or delayed EMDE transition, with inadequate adaptation and resilience measures in place. It should also estimate the financial opportunities for the City of London as the 'Global Sustainable Finance Hub', and the impacts of missing this opportunity. The report should also scope what domestic and multilateral policies and regulations could support this and explore whether and how further engagement with ongoing reforms to create a Sustainable International Finance Architecture could help hasten removing any unnecessary barriers. A follow up report may be required if significant engagement is deemed necessary.
6	DFIs to make available/expand aggregated sleeves of Technical Assistance ('TA') for aggregated EMDE investment funds to support more venture capital (including debt) Aim: Support pipeline development in-country Stakeholders: DFIs, UK Government and ISG.	1. Government and DFIs could combine technical assistance (TA) resources from public and philanthropic sources and provide them to investment funds in EMDEs. This would support the development of the pipeline of investable projects in the most challenging EMDEs and sectors. Government can consider partnerships with domestic EMDE project development or industrial support agencies.
7	Regulators in collaboration with industry and UK Government should establish a common agenda to promote data transparency, harmonise standards, and address data issues across the system Aim: Enhance transparency, address risk perceptions Stakeholders: Regulators, ISG, UK Government.	1. Regulators to require disclosure by UK institutional investors of allocations to EMDEs and how they are assessing and addressing the systemic risks of (in) action, considering globally integrated value chains. This will prompt decision makers to consider asset allocation, allow for better data collection and monitoring over time and, allow for challenge if anomalies identified. 2. Regulators to harmonise Blended Finance Standards and enhance relevant data sharing by UK initiatives (BII, MOBILIST, PIDG), as part of a wider effort to simplify standards and reporting requirements.[18] Blended finance is seen as key to mobilising private capital for EMDEs but is often highly customised, with concerns about market distortion and subsidised returns. To scale its use effectively, there's a need for a standardised, scalable instrument with common impact reporting standards. This could lead to the creation of blended finance bonds, loans, and funds, with the UK potentially leading the effort. 3. Explore the relationship between EMDE sustainable investment and the definition of 'impact,' along with the metrics that support the impact thesis. Investing in EMDEs is arguably a significant way to achieve positive environmental and social outcomes.

18. *This will help to ensure that blended finance deliver the volume of private capital required and is not perceived by industry to distort the market. See also State of Blended Finance 2024, blended finance, state of blended finance - Convergence Resources \| Convergence*

	Recommendation (what, why, who) Detail	Detail
8	UK regulators and the Bank of England to address where regulation may hinder EMDE allocation Aim: Address regulatory barriers Stakeholders: Regulators, ISG, UK Government, Asset Owners. This includes PRA, the International Sustainability Standards Board (ISSB), the Bank for International Settlements (BIS), the International Association of Insurance Supervisors (IAIS), the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO).	1. Harness UK leadership on Task Force on Climate-related Financial Disclosures (TCFD) and transition planning, by incorporating EMDE nuance. Pressure to meet net zero targets is leading to a withdrawal of investments from EMDEs. The PRA must urgently send a strong signal to industry that transition investments are critical to reaching net zero. Further, Asset Owners and UK-led net zero frameworks can make explicit the need for funding global decarbonisation including through transition plans via global supply chains. 2. Assess and convene where regulation may hinder EMDE allocation (e.g. Solvency II/Basel). The adoption of proportionate ISSB disclosures in EMDEs, which the UK will eventually use, will go some way in addressing the reporting barriers that some sustainable finance regulations create for EMDEs. 3. Address barriers to securitisation structures. Securitisation offers investors scalable, diversified exposure to EMDE infrastructure loans, but regulatory barriers within the UK Solvency II Directive must be addressed to enable its development. 4. Champion an EMDE reform agenda globally, for example at BIS, IAIS, FSB, and IOSCO.
9	UK Government and industry-led program to deepen local capital markets in EMDEs, working alongside private sector Aim: Facilitate development of local (EMDEs) capital markets Stakeholders: ISG working with EMDE voices, UK Government, DFIs, philanthropies, industry including frontline industry professionals, trade bodies and regulators.	1. ISG to build out the investment case for investing in local vehicles serving domestic markets and local institutional investors and banks that facilitate long term investment as demand for long term savings and investment product increases. Policy driven initiatives, local entrepreneurs, private sector investors all call for greater scale in this area to boost availability of local currency instruments and decrease dependency on and exposure to hard currency. 2. UK Government to leverage FCDO embassy network to help convene actors on the ground and connect back to London. This will help provide the visibility and awareness of investment opportunities required that is currently lacking. This could involve maintaining a continuing programme of engagement with existing and emerging EMDE sector champions to foster awareness of local sectors and companies (e.g. existing examples exist in student housing in some regions). 3. UK Government to join and accelerate a set of existing international efforts to address local currency risks and market development at scale including TCX, work of Finance in Common Network and the Inter- American Development Bank (IDB) Brazil FX platform. 4. Engage with index providers and stock exchanges in the City of London and EMDEs with active capital markets to explore opportunities for accelerating and scaling public markets in EMDEs, such as creating sustainable development indices to attract institutional capital. This initiative could be led by MOBILIST and LSEG. 5. Fund data reporting solutions in EMDEs, given the barriers that growing sustainable finance reporting requirements in UK and abroad have created. 6. Establish platforms to drive investment in local vehicles serving domestic markets that facilitate long term investment, recognising the demand opportunity driven by demographic trends. Examples include PIDG initiatives in Nigeria and Pakistan.

2 Introduction – Objective of this report

The Foreign, Commonwealth and Development Office (FCDO) has called upon industry to convene and identify the barriers and opportunities to greater EMDE capital mobilisation from institutional investors. In the UK, institutional investors are predominantly made up of pension funds and insurance companies, though also include wealth endowments and foundations, wealth managers and family offices (these are often collectively referred to as 'asset owners'). UK asset owners control GBP5tn in investable assets, positioning them as influential players in capital markets. Investment demand originates from them, and in turn, asset managers design strategies to meet this demand. If asset owners increase interest in investments in EMDEs, asset managers would naturally adjust their strategies. This report underscores the need for collaboration between the UK Government and asset owners to overcome barriers and enable this shift. See Annex 2 for a summary of the significant asset pools within the UK, which represent sources of capital that could be directed, in part, to EMDEs.

While the barriers disincentivising further capital mobilisation to EMDEs have been extensively studied,[19,20] this report focuses on actions that the UK Government, institutional investors and other relevant stakeholders can take in the next 5-10 years for private investors to mobilise capital at scale. It sets a vision for tangible actions they can take in the short term to materialise medium term opportunities, and also actions that will deliver the required systemic change over the long term. While predominantly UK-focused, the work on climate solutions draws on views from EMDE based investors.

Defining EMDEs

EMDEs for the purposes of this report are defined as Lower Middle-Income Countries (LMICs) and Upper Middle-Income Countries (UMICs), as categorised by the OECD Official Development Assistance (ODA) list.[21] These countries account for a high proportion of global emissions. They have young populations, and industries with relevance to the decarbonisation of global supply chains (and UK finance). Critically, they offer viable projects for institutional investors to capitalise on commercially, though some may currently still require some donor support. As more private capital flows towards these countries, the more UK concessional finance can be made available to the Least Developed Countries (LDCs). Lessons from increasing investment in LMICs and UMICs will also provide a useful roadmap to channelling greater capital to LDCs where the needs for concessional funding and risk mitigation are broadly higher.

19. ODI (2024). Trillions or Billions? Reassessing the potential for European institutional investment in emerging markets and developing economies
20. IGCC (2023). Mobilising Climate Investment In Emerging Markets: Opportunities for Australian pension and superannuation funds
21. OECD (2024). ODA recipients: countries, territories, and international organisation

Investor Workstreams

The three underlying reports were composed by three workstreams combining views from institutional investors including asset owners and asset managers, as well as local DFIs and investment consultants, who often yield significant influence by informing pension board trustees.

Each workstream was tasked with a question to explore with investors:

1. **Enabling Environment (see section 4)**

   Chaired by Aviva Investors

   Question: What are the key constraints that can be addressed?

   How investors make decisions is influenced by key elements of the environment in which they operate, including regulations, the role of the credit rating agencies, and data availability.

2. **Investment Opportunities (see section 5)**

   Chaired by the Private Infrastructure Development Group (PIDG)

   Question: What is the scope to extend existing vehicles, and develop and optimise new vehicles, to drive capital mobilisation into EMDEs?

   Institutional investors are not a homogeneous group. Nonetheless, vehicles that aggregate, diversify and distribute risk could be of broad appeal.

3. **Influencing Investor Allocations (see section 6)**

   Chaired by Mercer

   Question: How can we inform and influence key decision-makers, such as pension fund trustees, with a view to expanding allocations that make it easier to invest in emerging markets?

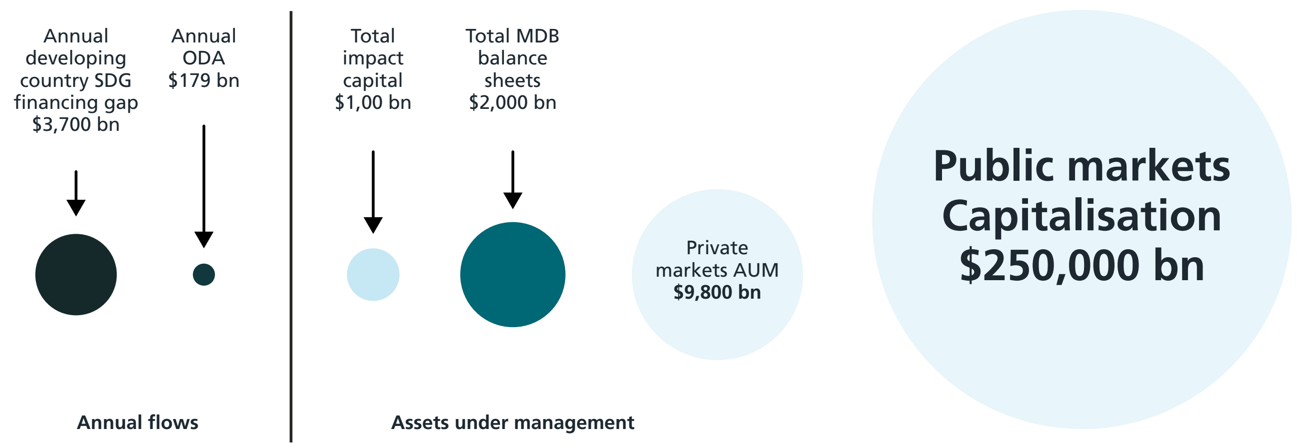
   Investment decisions must follow allocations.

3. The Opportunity – The UK as the leading climate finance hub

The latest figures by CPI's Global Landscape of Climate Finance, shows that average annual climate finance flows reached almost USD1.3tn in 2021/2022 globally. This is almost twice the average reported in 2019/2020, but still represents only 1% of global GDP, and a fraction of the climate finance needed which increases steadily from USD8.1tn in 2021/2022 to USD9tn in 2030.[22] It is also less than the total support for fossil fuels in 2022, which the OECD puts at USD1.4tn. Notably, the bulk of these funds are directed toward developed markets and China, leaving a significant gap in EMDEs, where support is most urgently needed.

Sustainable development goals cannot be met by government and multilateral funding alone, and mobilising private finance is essential in bridging this funding gap. This issue is particularly salient given the live negotiations regarding the NCQG set to be agreed at COP29. Emerging Markets and Developing Economies excluding China require USD2.4tn in climate and nature investment annually by 2030, of which USD1tn is expected to come from private sources.[23] This presents substantial investment opportunities for the City of London, the UK economy and investors across a range of sectors and asset classes.

Figure 2. Development Finance vs scale of global private and public markets



Source: MOBILIST[24]

When the scale of meeting the SDG financing gap or just the climate financing gap is compared to the scale of "impact finance" or the DFI / MDB balance sheets, it is clear that the broader global capital markets, both private and public, need to be accessed at scale. However, this is not currently happening at anything close to the scale required. The challenge for donor countries with scarce and constrained ODA budgets is to better play a catalytic role in addressing this current market failure.

While investment needs are massive, the cost of inaction – i.e., the cost of failing to address the climate finance gap – would be much higher, with recent estimations totalling USD1,266tn against a 1.5C scenario between 2025 and 2100.[25, 26] These estimates will continue to increase with every year of delayed action, posing a systemic risk to the global financial system that would affect the value of institutional investors' portfolios and ultimately, their beneficiaries including British citizens. Crucially, in response to the Financial Markets Law Committee's guidance on climate change and pensions, UK Sustainable Investment and Finance Association (UKSIF) emphasised that climate change presents significant financial risks and should be factored into the fiduciary duties of pension trustees, as part of standard investment practices for both long- and short-term horizons. This means that trustees should consider climate change as a financial factor across all investment time horizons to fulfil their responsibilities to beneficiaries effectively.[27]

22. CPI (2023) *Global Landscape of Climate Finance 2023*
23. Independent High Level Expert Group on Climate Finance (2023). *A climate finance framework: decisive action to deliver on the Paris Agreement.* Required EMDE investment figures exclude China
24. MOBILIST (2023) *Development finance through public markets: Originate to demonstrate*
25. Climate Policy Initiative (2024). *The Cost of Inaction*
26. BlackRock (2021). *How to finance the net zero transition in emerging markets*
27. UKSIF (2024). *Pension Fund Trustees and Fiduciary Duties: Decision-making in the context of Sustainability and the subject of Climate Change*

Opportunities for the UK economy

The City of London is uniquely positioned to become the leading hub for mobilising climate finance into EMDEs, channelling significant capital through the UK to promote domestic and international sustainable growth.

The City and the broader UK financial services sector boasts a distinct advantage in market infrastructure, with the presence of English law, key organisations like the Climate Bonds Initiative, the International Capital Markets Association (ICMA), and the Financial Conduct Authority (FCA)'s role in setting standards. The depth of the UK's pool of capital, size of the asset management industry, the London Stock Exchange, global investment banks, and the world's largest insurance market and the associated market-leading skillsets further complement its investment offerings. There are three principal drivers behind this:

Firstly, by positioning itself at the centre of global sustainable finance, significant additional capital could be channelled through the UK, bringing direct employment, tax revenues, capital and capacity benefits through the financial and professional services (FPS) industry, which accounts for around 12% of the UK's economic output and employs over 2.4m people – one in every 13 employees in the UK.[28] This agenda also heavily aligns with the Government's plans for pension reform, aimed at tackling waste and increasing saver returns in the pensions system, and the Treasury's Transition Finance Market Review (TFMR), set up to secure the UK as the world's best place for raising transition capital.[29]

Secondly, unlocking large-scale climate and nature finance would support the UK Government's ambition to regain its climate leadership and strengthen its partnerships with EMDEs, while supporting practical, "real world" solutions.

Thirdly, it is an opportunity for the UK's development finance vehicles to leverage their own expertise, raise their international profiles and to further drive mobilisation of private sector investment into EMDEs.

28. *TheCityUK (2024)* ***The Total Tax Contribution of UK-based financial and related professional services,*** *City of London (2023)* ***State of the Sector,*** *The CityUK (2024),* ***Key facts about UK-based financial and related professional services 2024***
29. *HM Treasury,* ***Pensions Investment Review: Call for Evidence (2024).*** *HM Treasury (2023),* ***Transition Finance Market Review***

Opportunities for investors

For UK investors, EMDEs present significant growth potential and portfolio diversification opportunities. These economies represent 86% of the global population and nearly 70% of global CO_2 emissions, figures that are expected to rise.[30, 31] They also accounted for 50% of global GDP in 2023, and 67% of global GDP growth in the prior decade.[32] Historically and prospectively, EMDEs show higher growth rates than advanced economies and also account for nearly all the world's incremental future energy demand.[33]

Further, some asset classes and regions within EMDEs have fared relatively well against Developed Markets, while innovative financial instruments are opening new investment avenues. In credit, EMDE infrastructure performance has been strong, with low default, high recovery rates and only marginally higher loss rates when compared to developed markets, whilst delivering a substantial return premium.[34] In an increasingly multipolar world, these opportunities strengthen the case for geographical diversification through investment in EMDEs.

For 'universal owners'[35] like pension funds who hold globally diversified portfolios and invest in companies with globally integrated value chains, investing in local infrastructure or early-stage private equity in EMDEs can spur in-country GDP growth, which, in turn, can enhance the value of their global holdings through positive externalities. Those 'externalities' get captured by the universal shareholder, in part, through their globally diversified public market equity holdings. In contrast, failing to support EMDEs in making just energy transitions would hinder pension funds' ability to meet their financial liabilities through the end of the century.

Additionally, investments in EMDEs can be shown to be more impactful, allowing investors to meet increasing demands for sustainable investments from their ultimate beneficiaries. The International Energy Agency (IEA) estimates that every dollar invested in clean energy in EMDEs (excluding China) will result in 12 tonnes of emission reductions in 2035, 30% more than in advanced economies.[36] These investments also contribute to broader sustainable development goals, such as poverty alleviation and improved access to healthcare.

Asset owners and their advisers may struggle to justify diversification and positive impact investments due to concerns about perceived risks and varying returns. To overcome these challenges, regulatory changes and incentives are essential. This report highlights the need for a robust engagement program involving pension fund trustees, asset owners and managers, The Pensions Regulator (TPR), the Department for Work and Pensions (DWP), and investment consultants. Together, they can design solutions that address long-term systemic risks associated with not investing in EMDEs and manage perceptions of risk in these areas. Clarity is needed for pension fund trustees, and with appropriate incentives that drive asset owner demand, asset managers can also develop additional products to support the transition in EMDEs.

30. *Goldman Sachs (2024),* ***Emerging Markets, Global Impact: Driving Sustainable Growth.***
31. *Patrick Bolton, Alissa M. Kleinnijenhuis and Jeromin Zettelmeyer (2024),* ***The economic case for climate finance at scale.***
32. *AXA Investment Managers (2024),* ***Is it time for investors to reassess emerging markets?***
33. *IEA (2023),* ***World Energy Outlook 2023***
34. *Feedback from investors that fed into the report. The Global Emerging Markets Risk Database (GEMs) Consortium (2024) –* ***available here*** *– discloses the default and recovery statistics of investments in EMDEs, which could provide information and confidence to the private sector for investing in emerging markets.*
35. *UNEP FI (2011) –* ***Universal Ownership – why environmental externalities matter to institutional investors***
36. *IEA (2023),* ***Scaling up Private Finance for Clean Energy in EMDEs***

4. The challenge – Setting an enabling environment for EMDE investment

Several key themes emerged through the interviews and discussions held when preparing this report. It is clear that there are cultural, regulatory and structural challenges to increasing EMDE investment.[37] Collaboration between different actors, particularly industry, Government and DFIs is weak compared to some European counterparts, which limits the number and awareness of catalytic investment opportunities.

The UK must urgently look to peers, deepen collaboration and understand that the UK domestic growth agenda and mobilising private capital at scale to EMDEs go hand in hand.

The main barriers can be categorised into four main themes: 1) investment vehicle/product mismatch, 2) investor limitations, 3) investor biases and cultural factors, and 4) enabling environment barriers which include regulatory constraints and the role of credit rating agencies.

Figure 3. Barriers constraining EMDE investment

Barrier category	Additional detail
Investment vehicle/ product mismatch (attractive risk, return, liquidity, scale)	• Not enough vehicles/projects with the right characteristics (risk, return, liquidity, time horizon and/or scale) required to fit their mandates. • Not enough vehicles that are taxonomy aligned/transition aligned • Lack of appropriate indices that track assets that align with the UN SDGs or the Paris Agreement in EMDEs. • Investment in EMDEs may entail additional sources of risk such as currency risk, political risk, counterparty credit risk, reputatial (environmental, social and governance) risks. These factors increase the discount rate for EMDEs investments impacting investment valuations. These vary across asset classes, region, sector and investment vehicle. • Potentially higher costs when on-the-ground presence is required to structure and monitor underlying projects.
Investor limitations	• Knowledge and resources: A shortfall in technical expertise and dedicated capacity; competing demands on time for decision makers and/or lack of time in governance processes; client appetite; restrictions on what is known to make returns; lack of conception of risk of financial system collapse; unintended consequences of net zero targets, lack of consideration of non-diversifiable systemic risks or steps needed to mitigate. • Lack of historical and forward-looking data: data (past performance, defaults, recovery rates, correlations, etc) is crucial to come up with assumptions of future expected returns. When data exists, heightened sources of uncertainty may render historical data less relevant to set forward-looking expectations. Knowledge, data and transparency concerns are often higher in private markets assets vs public capital markets. • Data and information gaps on available opportunities to invest: Institutional investors are often unaware of the alternative opportunities to invest in EMDEs.
Investor biases and cultural factors	• Cultural factors such as status-quo bias, heightened risk perception vs actual risk, apathy to issues 'far away'. Recent research by the Overseas Development Institute (ODI) underlines the significance of cultural barriers compared to regulatory considerations.[38] • Risk aversion from decision makers such as board trustees and from the investment consultants informing their views, who often prefer to consider investments they are more familiar with, often linked to the regulatory framework under which they operate and a degree of familiarity bias from some decision makers. • Competitive pressures in Defined Contribution (DC) pension providers whereby there has been a focus on reducing investment fees to the lowest possible level. • Narrow interpretations of fiduciary duty may fail to incorporate risks of inaction. UKSIF emphasised that climate change presents significant financial risks and should be factored into the fiduciary duties of pension trustees.[39]

37. ODI (2024). Trillions or Billions? Reassessing the potential for European institutional investment in emerging markets and developing economies

38. ODI (2024). Trillions or Billions? Reassessing the potential for European institutional investment in emerging markets and developing economies
39. UKSIF (2024). Pension Fund Trustees and Fiduciary Duties: Decision-making in the context of Sustainability and the subject of Climate Change

Barrier category	Additional detail
Enabling environment barriers	**Regulatory barriers:** • Regulatory barriers to insurance companies and banks through Solvency II and Basel III. For example, capital charges in UK and EU solvency regulation for non-OECD infrastructure assets are not aligned with actual credit performance of the asset class.[40] • Unintended consequences of TCFD, transition planning and other sustainable finance guidance may lead to divestment from EMDEs to reach net zero targets, especially as EMDEs grapple with increased international/UK reporting requirements.[41] • Charge caps for defined contribution pension schemes, and a funding regime that is perceived to support low risk approaches for defined benefit pension schemes. • Most impact reporting standards vary across vehicles, leading to fragmentation. **Government biases:** • National investment approaches shaping local regulations, often overlook the global, interconnected nature of systemic risks. • Narrow interpretations by some Treasury departments in developed countries may consider capital invested abroad as "capital flight", that is, the large-scale exit of financial assets. **Poor collaboration between institutional investors and MDB/DFIs:** • DFIs can be better prepared to understand investment mandate requirements of institutional investors. The latter can gain awareness of DFIs activity. • MDBs/DFIs can be perceived to compete with the private sector, at times taking insufficient risks and/or crowding out private investors. • Their private sector mobilisation, at just 0.6x per USD, remains too low.[42] • Perception (real or actual) that blended finance lacks transparency, and can encourage poor decision-making on investments. **Rating Agencies:** • Project ratings are often capped at country ratings (country rating ceiling), which can disincentivise capital when a country is poorly rated. • Credit enhancement mechanisms (guarantees, insurance etc.) may not necessarily improve overall ratings as they often only protect against losses post default, thus only addressing the Loss Given Default (LGD) parameter of ratings, and not the Probability of Default (PD) parameter. The latter may be better addressed through enhanced data and context.

40. ODI (2024). **Trillions or Billions? Reassessing the potential for European institutional investment in emerging markets and developing economies**
41. As found in interviews by MOBILIST and the World Benchmarking Alliance. MOBILIST (2022). **Drivers of Investment Flows to Emerging and Frontier Markets.** WBA (2024). **Investing sustainably in emerging markets – a call to action**
42. IFC (2022). **Mobilisation of Private Finance by Multilateral Development Banks and Development Finance Institutions in 2020 and 2021**

Development of sustainable finance regulations

Regarding the rapid development of sustainable finance regulations in recent years, it is worth noting that these have not always adequately accounted for EMDE considerations. Examples include climate-related financial disclosures, transition plan frameworks and fund labelling regimes. A key consideration here is that many of the sustainability reporting frameworks in use globally have been designed with developed markets in mind. This leads to EMDEs having to abruptly adapt to regulation that has evolved over decades in developed markets, and an inadvertent withdrawal of investments from EMDEs by investors seeking to achieve net-zero within discrete financial portfolios.

As EMDEs establish the infrastructure needed to provide investors with decision-useful information, it will be important to ensure requirements are proportionate and tailored for regional circumstances. The ISSB Standards, which are intended to serve as a 'global baseline' for climate-related financial disclosures, could be adapted for use in EMDEs, including through the adoption of streamlined, proportionate standards that differentiate between 'mandatory' and 'advanced' requirements in the first instance. Through the UK's role in IOSCO and its own commitment to adopt and implement ISSB S1 and S2, it is well placed to encourage a continued focus on capacity building to support the rollout of consistent, comparable and verifiable disclosures in EMDEs.

Regulatory barriers also present a challenge for insurers' investment pools. These issues not only require decisive action from the PRA but present an opportunity for UK leadership including with peers such as through the G7 or G20 and working with the Bank of England through the Network for Greening the Financial System (NGFS) and multi-lateral regulatory fora.

5 Investment opportunities – Learning and progressing from what is working

Despite the multiple barriers stated above, the financial industry thrives on innovation, and there are now concrete examples of scalable investment opportunities that have worked in mobilising private institutional capital to EMDEs. There are also some aspirational areas where further progress is needed to address some of the challenges.

The investable universe in EMDEs includes both public and private market assets. Public markets involve sovereign and corporate bonds (both 'labelled' or not), listed equity, and securitised structures (typically debt). Private market assets include private equity and private debt investments, infrastructure and real assets project finance (both debt and equity), and venture capital (both debt and equity). When considering allocations to EMDEs, different types of investors have varying preferences or mandate restrictions that dictate their choice of asset classes.

Publicly traded instruments – listed, rated, transparent, regulated, and with impact tracked by published standards–face fewer barriers for institutional investors as they are structured, underwritten, distributed, and traded by investment banks. There are significant flows across public EMDE markets (both equity and debt). For example, there has been over USD3tn of EM corporate and sovereign bond issuance in the past six years, and the stock of outstanding bonds (face value) exceeded USD4tn at YE2023 (JPM data).

Labelled bonds – such as green, social, sustainable, and sustainability-linked bonds – could be an increasing source of capital for investment in the real economy as credibility concerns are addressed. They offer investors an accessible means to support Sustainable Development Goals (SDGs) in EMDEs. For those investors limited to public market investments, effective stewardship – for example, through collective initiatives like Climate Action 100+ – could also drive impact. This also applies to sovereign bonds, as new tools for investor engagement, such as the ASCOR project[43], are emerging.

However, the allocation of capital in public markets is skewed toward larger markets driven by the influence of market capitalisation-weighted indices. In Emerging Market indices designed to track public markets in these economies, this concentration often limits broad investment in EMDEs as they focus on larger, deeper, more stable markets. For example, as of September 2024, the MSCI Emerging Markets Index allocates 81% of its weight to just five countries: China (28%), India (20%), Taiwan (18%), South Korea (10%), and Brazil (5%).[44] Furthermore, there is a case to be made that no existing public market index adequately tracks assets that align with the UN SDGs and the Paris Agreement's goals in EMDEs. Therefore, increasing asset allocation against existing benchmarks may divert capital from EMDEs and their sustainable development.

While mobilising capital to EMDEs is crucial across all asset classes, private markets in climate-related sectors face the greatest barriers, yet can have the greatest potential for impact, particularly in infrastructure, where they provide fresh capital to new sub-investment grade low carbon and resilient development, where public capital markets do not. Typical barriers include lack of aggregation of assets to attractive investment size and risk diversification for institutional investors along with a lack of track-record, data and insufficient risk adjusted return profiles. Individual projects often have relatively small investment sizes, and institutional investors such as pension funds face insufficient resources to run due diligence on the assets and develop a pipeline.

43. See: https://www.ascorproject.org/
44. MSCI (2024). MSCI Emerging Markets Index (USD)

To this end, the report highlights concrete examples of successful, scalable solutions facilitating institutional capital investment in private market assets. These examples showcase ongoing investment opportunities that have effectively mobilised private capital from institutional investors into EMDEs. See Annex 1 for more detail on some of these alternatives.

Figure 4. Vehicles mobilising institutional capital to support climate goals in EMDEs

Underlying asset class	Example fund and Manager/ GP
Equity	IFU SDG fund (Danish DFI and Danish Pension Funds); SEACEF (Clime Capital); DFCD (Dutch Fund for Climate and Development); EMCAF (AllianzGI and the European Investment Bank); Alterra
Debt incl. securitisation	Bayfront Infrastructure Capital I, II, III etc (Bayfront Infrastructure Management); DFCD (Dutch Fund for Climate and Development), Emerging Markets Transition Debt (Ninety One)
Infrastructure equity including project finance	Climate Finance Partnership (BlackRock); Climate Investor 1,2, 3 (Climate Fund Managers); Emerging Market Climate Action Fund (AllianzGI); Alterra; REPP 1 and 2 (Camco)
Infrastructure debt including project finance	PIDG's Emerging Africa and Asia Infrastructure Fund (Ninety-One); ILX Fund (ILX); ImpactA Global; PentagreenCapital; Alterra
Venture capital (equity and/ or debt)	GAWA Capital, CRAFT climate resilience fund; Alterra; Spark (Camco)

** This list is not exhaustive; it focuses on contributions from participants in the workstream.*

With the launch of various Long-Term Asset Fund (LTAF) structures in the UK and European Long-Term Investment Fund (ELTIF) structures, there could be newer vehicles accessing private market opportunities in EMDEs. This could be further advanced through UK initiatives like the Mansion House Compact for pensioners' investments in private markets in the UK and also outside the UK. Under this compact, leading pension schemes have agreed to allocate 5% of their assets to investments that support long-term economic growth, such as LTAFs and other illiquid assets.

Based on consultation with both investors and investees in this field, the following observations were drawn:

There are multiple opportunities to invest in infrastructure debt, but greater funding is needed at the equity and junior capital tranches, as well as more funding to support initial (and riskiest) stages of project development

- The investment vehicles that have been the most enduring and successful over a sustained period to date, have focussed on debt, largely in infrastructure.
- Private Equity funds focused on EMDEs are increasingly emerging at scale. Larger funds typically require minimum investments of USD30m and often use a fund-of-funds structure to aggregate smaller projects and improve access. These sub-funds are generally managed from major financial centres like Kenya, Nigeria, South Africa, and the UK, which might lead to less attention being given to other countries.
- Providing more venture debt, to projects in the range of USD1-10m, and Technical Assistance support, could help projects become more investable, and an aggregation vehicle catering to this need would be beneficial. Many investees face a critical phase known as 'the valley of death,' where they struggle to raise expansion capital while scaling their enterprise. Many find it simply too challenging to attract further investment from DFIs and MDBs.

Collaboration between MDBs/DFIs is crucial to address data and information gaps:

- Debt funds, including MDBs and DFIs, with longer track records have collected data on default and recovery statistics which could help challenge the inflated perception of risk in EMDEs. Expanding access to open data from more sources, beyond the Global Emerging Markets Risk Database Consortium (GEMs database), would further bridge the gap between actual and perceived risk.
- Many institutional investors are unaware of existing investment vehicles and opportunities in EMDEs, highlighting a clear knowledge gap. Similarly, DFIs lack sufficient awareness of capital seeking investment in these regions or net-zero assets. Additionally, investors are not widely aware of the range of UK Government initiatives, such as funding programs or trade missions.

Simplicity, liquidity, standardisation of impact metrics and solutions to mitigate currency risk are needed to continue to scale investment opportunities

- Simplicity is key to achieving scale in capital mobilisation. Relying on bespoke transaction structuring for specific sectors or individual projects won't suffice. A straightforward, standardised approach is more likely to drive scale, enhance transparency, boost confidence, increase liquidity, lower transaction costs, and foster competition in the financial sector.
- Impact reporting standards differ widely among finance providers (including MDBs, DFIs, Export Credit Agencies, and private investors), resulting in inconsistent monitoring of Health, Safety, Environment, and Social Management (HSES) and often overlooking positive impacts. While high reporting standards in EMDEs are costly, the benefits of investing in climate resilience and SDGs are not well captured. Standardising and simplifying impact reporting would improve data consistency, reduce the burden on investees, and enhance confidence in investment impacts, potentially reducing disincentives for investing in EMDEs.
- Currency risk is a major issue for investments in EMDEs. The funds listed in figure 4 above do not offer effective local currency solutions, resulting in overlooked domestic finance sources, underdeveloped domestic capital markets, and borrowers bearing the risk of hard currency exposure, which can be problematic if the domestic currency depreciates.
- Listing specific instruments or vehicles on a stock exchange can increase investor access and visibility but does not directly create liquidity. While public listings, like those for Fiji's green bond[45] or Acorn Holding's dual-listed green bond[46], can support arguments for greater EMDE allocations, they can be resource-intensive and expensive. Liquidity also depends on additional factors, such as active markets by investment banks and brokers and the availability of pricing and performance data on platforms like Bloomberg.

The role of concessional capital

The structures listed in Table 2 (except for the ILX Fund) have received 'patient' (long horizon) seed capital and structuring from DFIs/MDBs, benefiting from blended finance to varying degrees.

While blended finance can effectively mobilise capital into high-risk markets, it is sometimes criticised for lacking transparency, for extended times when deploying investment, and potentially encouraging poor investment decisions, especially when first-loss capital is involved. It's important to recognise that not all projects, asset classes, or regions, require catalytic support. In fact, such support can sometimes crowd out private investment by distorting prices when the financing requirement can be fully covered from commercial sources. Therefore, not all capital mobilsed for EMDEs needs to rely on blended finance approaches, indeed, to meet the scale required to address climate change, concessional capital should be judiciously allocated to the highest risk and most catalytic opportunities.

In cases where concessional support is needed to catalyse further private investment, greater UK institutional investment could be mobilised by aggregation vehicles and blended finance arrangements. To increase investment in EMDEs, catalytic capital must be strategically deployed to effectively drive private sector mobilisation. This should be the primary focus when structuring funds that aggregate smaller investments. The design of these aggregation vehicles will vary based on the level of ambition, as well as the specific financing solutions needed for the underlying investments.

45. UNFCCC (2017) *Fiji launches first developing country green bond to fight climate change*
46. *Acorn dual-lists green bond program on LSE's International Securities Market*

Two important considerations emerge:
- Investments in the least developed and low-rated markets, or those with technology risks, will require a higher risk tolerance and a larger buffer of catalytic capital.
- When returns are uncertain, but the development impact is strong, there is a greater need for catalytic capital to position the investment for sustainable bankability and attract private sector funding.

Examples from Denmark (IFU SDG Fund) and the Netherlands (Dutch Fund for Climate and Development, DFCD) demonstrate that this approach is feasible. While there is no one-size-fits-all solution, well-designed blended finance vehicles have shown promise in mobilising private capital at scale. Successfully replicating and scaling these models depends on a number of factors including the ambition level, the availability for concessional/catalytic capital, and the target market. Generally, more resources are needed for less developed areas, and different solutions will be necessary to achieve varying scales of investment, such as USD100m, USD500m, or over USD1bn.

Barrier category	Potential solutions
Product match (attractive risk, return, liquidity, scale)	• Aggregation via investment funds or structured finance vehicles (e.g., securitisation vehicles pooling assets and issuing securities backed by them) • Credit enhancement mechanisms supported by concessional funding: guarantees, subordinated debt, insurance, reserve funds or liquidity facilities, etc. • Vehicles that provide more venture debt, to projects in the range of USD1-10m, and Technical Assistance support
Investors' limitations	• Open platform aggregating investment opportunities • Publication of DFIs'/MDBs' statistics, as well as performance data from commercial vehicles
Investor biases and cultural factors	• Direction and leadership 'from the top' • Capacity building anchoring on data and processes that are robust • Training and influencing decision-makers • Simplify and standardise the reporting of 'impact' and development benefits • Provide case studies
Enabling environment barriers	Regulation: • Regulators, prudential authorities and Government to purposefully review aspects of regulation domestically and internationally • Greater data availability can be crucial to inform regulators, for example in setting capital adequacy requirements (e.g., Solvency II treatment of non-OECD infrastructure assets) Government biases: • Emphasise global, interconnected nature of climate systemic risks Poor collaboration between Institutional investors and MDB/DFIs: • Capacity building and collaboration • Expand knowledge of UK Government entities initiatives (MOBILIST, PIDG, BII, Climate Finance Accelerator) and explore avenues for collaboration Credit Ratings Agencies: • Convene and deliberate on ways in which greater data availability can further contribute to the integration of climate factors into ratings Index providers: • Support development of new indices that track assets that align with the UN SDGs or the Paris Agreement in EMDEs

6 Influencing investor allocations

As barriers are progressively addressed and investment opportunities continue to expand, a necessary condition for scaling long-term investment in EMDEs is the integration of assets in EMDEs into institutional investors' strategic asset allocations (SAA) or 'policy portfolios' (see 'Influencing Strategy Asset Allocations' section below). The allocation to investment in EMDEs can be included in various target allocations, such as dedicated EMDE public or private equity/debt, EMDE infrastructure, or climate solutions and impact-focused allocations.

This section describes the actors that hold sources of additional long-term institutional capital and examines entry points across the investment decision process to effectively influence increased allocations into EMDEs.

Relevant sources of additional long-term institutional capital into EMDEs

Not all UK institutional investors have the capacity to invest in EMDEs, or in instruments that are offered in private (rather than public) markets. The key sources of long-term institutional capital into EMDEs are most likely to come from Defined Contribution (DC) pension schemes and insurers' investment pools. These types of investors have specific characteristics that make them more likely to allocate capital to EMDEs. See Annex 2 for a summary of significant asset pools within the UK, which represent sources of capital that could be directed, in part, to EMDEs.

Defined Benefit (DB) pension schemes

Trust-based – Defined Benefit pension schemes that are open to new members represent a total opportunity of c. GBP300bn today, while Local Government Pension Schemes represent a total opportunity set of c. GBP354bn today. Most DB pension schemes are closed to new members, with some on a de-risking path, focusing on buy ins and buyouts (transferring assets and liabilities to insurers). Increased investment in EMDEs is likely limited to the few open schemes. Local Government Pension Schemes (LGPS) have faced pressure to invest locally in UK productive assets yet are a potential source of further investment into EMDEs.

Defined Contribution (DC) pension schemes

Trust-based – Defined Contribution (Master Trust) pension schemes, where consolidation brings economies of scale alongside professional trustees, represent a total opportunity set of c. GBP435bn today. Historically focused on reducing costs, DC schemes have prioritised passive strategies, limiting private market investments. The cost barrier is influenced by charge cap requirements and low costs to attract employers to their schemes, meaning only small allocations could be made to expensive asset classes in private markets, whilst their complex structures may make small allocations unfeasible. However, growing DC assets and planned changes to the Value for Money (VFM) framework are encouraging more private market investments, including potential investments in EMDEs, as assets grow through contributions from 20m UK members.

Life Insurers

Life insurance – annuity businesses with a focus on Bulk Purchase Annuities bring a total opportunity set of c. GBP682bn today. Growth in Bulk Purchase Annuities is driving growth in life insurance assets, with DB pension liabilities expected to reach nearly GBP1tn by 2030. Potential Solvency II reforms could enable more investment in sub-investment-grade assets, opening opportunities in EMDEs. Direct investments in EMDEs may also increase, especially if backed by guarantees from Developed Market entities (e.g., GuarantCo, Green Guarantee Company, other insurers).

Non-life insurers

The majority have investment flexibility but must balance liquidity needs and regulatory capital charges. There is a small but growing trend of investing in private market assets, though the focus remains on lower-risk, higher-quality investments, with no specific mention of increased EMDE exposure.

Influencing Strategic Asset Allocation

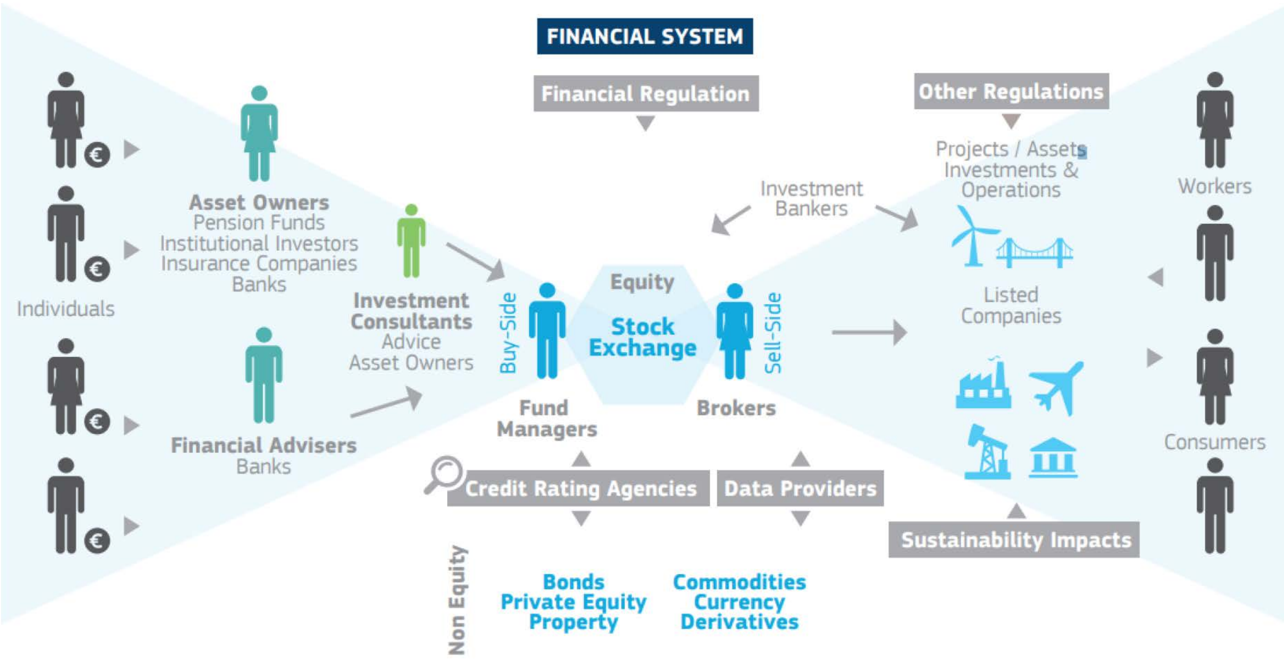
Portfolio managers review their investment mandates to ensure they meet their investors' requirements. The investment mandate considers key factors such as risk tolerance, return objectives, liquidity needs, time horizon, tax considerations, legal and regulatory concerns, and unique investor preferences, including sustainability goals, for each investment strategy.

The Strategic Asset Allocation (SAA), also known as the policy or reference portfolio, serves as the foundation for long-term planning, setting the overall portfolio target allocation per asset class and region, and periodically rebalancing the portfolio back to these targets. It is designed to meet an asset owner's investment objectives while considering constraints and risk tolerance, as outlined in investment mandate. Thus, the SAA is a central component of pension scheme trustees' and insurers' investment teams' decision-making process, and the primary driver of value creation.

The allocation of assets in EMDEs among the top seven UK pension funds ranges from 1% to 10%, and less than 1% of all UK pension funds overseas portfolio is allocated to Africa.[47] Investment consultants play a vital role in guiding SAA decisions for asset owners, particularly for those with small teams and limited resources. This mean they have the potential to be key influencers in promoting the shift towards increased allocations to EMDEs within SAA or reference portfolios.

Engaging with decision-makers, investment consultants, and service providers in the allocation process is crucial for promoting capital investment that supports sustainable development. This engagement should encompass a comprehensive understanding of the financing needs of EMDEs while highlighting the investment opportunities these markets offer. Institutional investors and their advisors need to be well-acquainted with the risk-return dynamics of underlying investments and their potential impact on climate change mitigation and sustainable development. Figure 6 highlights actors involved in the decision-making process. Purposefully engaging all actors – Government departments, regulators, asset owners, asset managers, decision makers (trustees), investment consultants, insurers, credit rating agencies and trade bodies – on the risks of inaction, could underscore the importance of mobilising further capital to EMDEs.

Figure 6. Summary of key stakeholders in the investment value chain



Source: Aviva Investors, European Political Strategy Centre

47. ODI (2024). Trillions or Billions? Reassessing the potential for European institutional investment in emerging markets and developing economies

Role of investment consultants

As highlighted above, investment consultants play a vital role in influencing investment decisions made by institutional investors. They provide advice, recommendations, and expertise to help clients make informed investment choices. The industry's influence on investment decisions can be seen in several ways:

1. Investment Research and Analysis
2. Asset Allocation and Portfolio Construction
3. Manager Selection and Due Diligence
4. Risk Management and Monitoring
5. Regulatory Compliance

Investment consultants typically charge fees for their services, which can be based on various factors such as assets under management, the complexity of the engagement, and the scope of services provided. As noted in a previous section of the report, integrating EMDE considerations into 'Asset Allocation and Portfolio Construction' will be important in supporting increased private capital flows into EMDEs.

This is likely to require working with investment consultants, including across the following areas:

- Continued internal development of staff to build awareness of the issues and common misconceptions regarding investment in EMDEs.
- Establish package of training materials to support institutional investor decision makers in the area of setting strategic asset allocation.
- Develop robust processes to advise on funds with limited track records in the area of EMDE transition, impact and sustainable finance.
- Support institutional investors to articulate risk/return requirements.

Role of credit rating agencies (CRA)

The importance of the CRAs has risen, in part due to their direct usage in the setting of capital requirements and the desire to achieve scale in investments via securitisation. For assets and issuers in EMDEs, poor provision of data and limited information that the CRAs use to calibrate their own models, can often affect ratings. Support to EMDEs to improve their data may directly feed through to more accurate ratings. In response, CRAs could increase resources to deepen their data and understanding of assets in EMDEs. While CRAs are not tasked with supporting the SDGs, their influence for further capital mobilisation is substantial. They have an opportunity to engage with industry and regulators to explore how credit ratings are disincentivising EMDE investments, and to explore ways to complement historical information and metrics that might be useful in working through their barriers, particularly when credit enhancement (such as guarantees, insurance) are present.

Decision maker remuneration

Remuneration can influence decision maker behaviour, and the decisions made. The remuneration of UK pension scheme trustees can vary depending on the specific scheme and its governing documents. Lay trustees are not usually paid for the work they do but may be paid expenses. Professional trustees do receive a fee for their services. The fee can be based on various factors such as the size and complexity of the scheme, the time commitment required, and the level of expertise and experience of the trustees. Remuneration of investment teams at insurance companies typically comprise base salary, performance-based bonuses often relative to the reference portfolio, long-term incentives and profit sharing. Across the asset owner and asset management industry, remuneration structures that take into account achievement of long-term strategic objectives (rather than solely short-term performance) could be more aligned with capital flows into EMDEs. Directly linking remuneration to increased allocations to EMDEs is expected to come with a number of challenges. However, incentives in the form of regulation, such as reducing capital requirements for assets that facilitate sustainable development goals with low market and liquidity risks, are expected to be a more effective means of aligning interests.

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Annex

Case studies – investment opportunities

The ILX Fund

The ILX Fund is an SDG focused emerging markets private debt fund designed to provide institutional investors access to investment opportunities in a diversified portfolio of private debt investment opportunities originated by MDBs and DFIs in emerging markets. It is managed by ILX, a fund manager. The ILX Fund I has mobilised USD1.05bn in commitments from pension funds, which will be coinvested pari-pasu in syndicated loans offered by MDBs and DFIs. This includes USD750m from Dutch pension provider APG, on behalf of its pension fund clients ABP and bpf. One of the attractions is the legal, ESG and political risk mitigation as a result of co-investing with MDBs and DFIs but also a fund manager who can source and offer an investment strategy which has a low correlation with typical emerging market bond indices, thus providing diversification benefits. The fund does not use blended finance.

Source: Trillions or billions? Reassessing the potential for European institutional investment in emerging markets and developing economies; ODI

The SDG Loan Fund

The SDG Loan Fund is one of the largest blended finance funds in the market to date. The fund aims to promote the SDGs in EMDEs, targeting investment in agribusiness, financial inclusion and renewable energy. Allianz Global Investors manages the fund, and the Investment Management company of the Dutch Entrepreneurial development bank (FMO) originates FMO loans and manages the loan portfolio. FMO keeps the higher of USD10m or 20% of each loan the Fund participates in on its balance sheet. Through a blended finance model, the fund has mobilised USD1.1bn of investor capital including from Allianz Global Investors, and Skandia. The fund benefits from credit enhancement in the form of (1) USD111m first-loss investment from FMO in the form of Class B shares and (2) FMO's investment benefits from a USD25m first loss guarantee from the MacArthur Foundation. Institutional investors hold USD1bn in class A preference shares that are senior to FMO's class B shares. The fund will be invested as participations in FMO originated loans.

Source: Trillions or billions? Reassessing the potential for European institutional investment in emerging markets and developing economies; ODI

PIDG's Emerging Africa & Asia Infrastructure Fund (EAAIF), managed by Ninety One

Founded in 2001, the EAAIF was initially dedicated to meeting infrastructure needs in Africa. It has since expanded its geographical scope, including the Levant (in 2019) and South and South East Asia and the Pacific (in 2023). Managed by Ninety One, EAAIF has an active loan portfolio of USD1.35bn and has funded over 110 projects since 2002. The fund is rated A2-Stable by Moody's. The fund aims to deliver stable investment returns, tangible benefits to people, planet and wider economies with measurable sustainable development impact. In addition, the fund has a strong focus on funding energy transition across its target markets. EAAIF received USD395m of anchor equity capital from the governments of the UK, Switzerland, Netherlands and Sweden. Retained earnings of over USD160m have been recycled back into the fund and EAAIF has successfully concluded 8 rounds of debt raising with a mix of DFI, commercial lenders and institutional lenders with a total value of USD1.7bn. The Fund is in the process of completing another round of financing of up to USD250-300m. As of August 2024, the EAAIF portfolio consisted of 64 borrowers from 20 countries in 9 infrastructure sectors. The fund's largest sector exposure is to the power/energy sector at 53%. These loans are mainly to Independent Power Producers (IPPs) and within this sector, the EAAIF's exposure to renewable energy projects has risen to 72%. Renewable energy loans have been focused on Hydro, Solar PV, Wind and Biomass. In 2023, 100% of EAAIF's commitments to energy generation were to renewables. EAIF's focus on renewables since 2002 has grown to provide a generation capacity of more than 1000MW of power to the African continent (30 RE IPP projects financed). It recently financed the first EV public bus concession in Senegal, West Africa.

Source: Ninety One.

2. Annex

Identifying UK Asset Owners' decision makers

This table below summarises significant asset pools within the UK, which represent sources of capital that could be directed, in part, to EMDEs.

High-level asset pool	Asset pool	Context	Approximate assets under management	Allocation to EMDEs	Relative risk appetite	Decision makers	Decisions owned by decision makers	Regulator
Pensions	Trust-based – Defined Benefit (Closed to new members and accrual, in de-risking mode)	Most schemes on derisking path, adopting prudent investment strategies. Common endgame is to transfer scheme assets and liabilities to an insurer via a bulk purchase annuity (BPA, also referred to as buyout). There is a current debate on the relative merits of buyout vs running off the scheme.	GBP1,200bn (includes hybrid schemes)[48]	Low	Low	Mix of lay trustees and professional trustees, with professional trustee representation across a majority of DB schemes[49]	Strategic Asset allocation; Investment manager selection (using advisers).	The Pensions Regulator
	Trust-based - Defined Benefit (Open to new members and/or accrual)	Schemes typically have a long-term allocation to growth assets to generate return to keep contribution rates affordable. A small number of schemes make up a significant share of this market.	GBP300bn[50]	Medium (typically through public equity and debt)	Low / Medium depending on covenant strength and funding level			
	Trust-based – Defined Contribution (Workplace schemes)	Growing asset pool with long-term investment horizons driven by contributions from c. 20m UK members. Trend for workplace pension schemes to be consolidated into Master Trusts.	GBP435bn[51]	Medium (typically through public equity)	Medium / High, but focus on liquidity and cost		Composition of default option and range of self-select funds (using advisers).	
	Trust-based – Defined Contribution (Master Trust)					Master Trust trustees – typically professional		
	Contract-based pensions (GPPs etc.)		GBP170bn[52]			Independent Governance Committees (insurer led)		Financial Conduct Authority
	Local Government Pension Schemes	Schemes typically have a long-term allocation to growth assets to generate return to keep contribution rates affordable. Scale is increasingly being generated through pooling of assets.	GBP354bn[53]	Medium (typically via public equity and debt)	Medium	Committees and Officers – typically not professionals	Strategic Asset allocation; Investment manager selection (using advisers).	The Pensions Regulator
	Pension Protection Fund	Compensation scheme for failed employers (with reduced benefits) and low-risk investment strategy.	GBP33bn[54]	Low	Low	Board and Investment Committee – professional	Strategic Asset allocation; Investment manager selection (using advisers).	n/a

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High-level asset pool	Asset pool	Context	Approximate assets under management	Allocation to EMDEs	Relative risk appetite	Decision makers	Decisions owned by decision makers	Regulator
Life insurance	Annuity (including bulk purchase annuities (BPA))	Growing asset pool, driven by bulk purchase annuity activity as workplace DB schemes move towards buyout.	GBP682bn[55]	Low	Low / Medium	Board and Investment Committee –professional	Strategic Asset allocation; Investment manager selection (advisers not commonly used). Direct investments also possible including those directly originated (and can be a source of asset differentiation key to BPA bidding/ competitiveness).	Prudential Regulatory Authority
	With-profits / Unit linked	Products that offer both insurance coverage and investment exposure. Range of products with different risk tolerances to suit different policyholder requirements.	GBP1,339bn[56]	Low	Medium	Policyholders	Policyholders typically choose funds based on pre-agreed target asset allocation. Changes to strategic/tactical asset allocation likely to require multiple approvals.	Prudential Regulatory Authority and Financial Conduct Authority
Non-life Insurance		Typically, short-term investors with liquidity requirements in respect of policyholder claims and other obligations.	GBP185bn[57]	Low	Low	Board and Investment Committee –professional	Strategic Asset allocation; Investment manager selection (advisers not commonly used).	Prudential Regulatory Authority
Endowments and Foundations		Typically, long-term investors seeking a return above inflation, and alignment with mission.	GBP120bn[58]	Medium (typically through public equity)	Medium / High	Board and Investment Committee – typically not professionals	Strategic Asset allocation; Investment manager selection (using advisers).	Charity Commission
Family Offices		Variety of strategies depending on the financial situation, goals, risk tolerance and time horizon of family.	GBP4bn[59]	Medium (typically through public equity)	Medium / High	Investment Committee	Strategic Asset allocation; Investment manager selection (using advisers).	Not regulated
Wealth Managers		Variety of strategies depending on the financial situation, goals, risk tolerance and time horizon of the individual's wealth being managed.	GBP1,200bn[60]	Medium (typically through public equity)	Medium / High	Individuals	Investment manager selection (using advisers).	Financial Conduct Authority

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Annex

Illustrative framework to support institutional investors in increasing strategic allocations to EMDEs

	UK investors with strategic allocations to EMDEs	UK net-zero investors
Advocate for transition When engaging with policy makers, industry initiatives, asset managers or investee companies, advocate for action…	… that supports sustainable development across EMDEs in the expectation of improved risk-adjusted returns over the long term (by supporting long term value creation and capital preservation).	… that supports a successful transition in EMDEs and globally in the expectation of improved risk-adjusted returns over the long term (by mitigating climate-related risks and increasing climate-related opportunity set).
Commit assets Build demand signals by publicly committing…	… a portion of the EMDE allocation towards climate solutions that support the transition to a low carbon and resilient economy.	… to align assets towards a net zero goal, which recognises regional decarbonisation requirements, incorporating an allocation to climate solutions.
Align policies Align policies with respective commitments…	… articulating desired impact outcomes alongside awareness of the need for a broad transition, accounting for nature loss, physical risks and adaptation, engaging in a circular economy and supporting principles of equality for sustainable development.	
Collaboration When collaborating with stakeholders, …	… share relevant learnings from investing in EMDEs, building on successful approaches.	… share relevant learnings from decarbonisation across Developed Markets and how this might be applied to EMDEs.
	… collectively engage policymakers to promote the development of local carbon markets and relevant taxonomies.	
De-risk investments Increase opportunity set of appropriately de-risked investments…	… by clearly articulating investor's own risk/return appetite (including liquidity) and, building on collaborations with other providers of capital (e.g. Development Finance Institutions), develop investment solutions that will crowd in private market capital at scale.	
Report Increase transparency and disclosure by reporting…	… progress relative to respective commitments and steps being taken to meet those commitments over time. Report on impact KPIs and outcomes.