KARSTEN WURTH (UNSPLASH)

The Action Plan for Climate & SDG Investment Mobilization

For Emerging Markets & Developing Economies

CONVERGENCE
BLENDING GLOBAL FINANCE

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LIST OF ACRONYMS & DEFINED TERMS USED IN ACTION PLAN

ACRONYM / DEFINED TERM	DESCRIPTION
Big 3 Rating Agencies	Fitch Ratings, Moody's Investor Service, and Standard & Poor's Global Ratings
Catalytic Capital	See Section 1.1
Catalytic Capital Facility	See Section 1.7
Catalytic Funding	See Section 1.1
Catalytic Funding Network	See Section 1.7
Catalytic Grants	See Section 1.1
Developed Countries	High-Income Country, as defined by the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC)
Developing Countries	Low and Middle-Income Countries
DFI	Development Finance Institution, like US Development Finance Corporation
EMDE	Emerging Markets and Developing Economy; for this Action Plan synonymous with low and middle-income countries (LMICs)
Investment Grade	A rating from a Big 3 Rating Agency of "BBB-" or better
Investment Mobilization Hub	Centralized and curated web site of key data and information required by private sector to increase investment in EMDEs – See Section 4
LIC	Low-Income Country, as defined by the OECD DAC. Includes least developed countries
MDB	Multilateral Development Bank, like International Finance Corporation
MIC	Middle-Income Country comprised of Upper-Middle-Income Country and Lower-Middle-Income Country as defined by the OECD DAC
NDB	National Development Bank
ODA	Official Development Assistance, as defined by OECD DAC
ODF	Official Development Finance, as defined by the OECD DAC
OECD	Organisation for Economic Co-operation and Development
UN	United Nations

EXECUTIVE SUMMARY

IMPORTANCE OF PRIVATE INVESTMENT MOBILIZATION TO ACHIEVE CLIMATE AND SDG OBJECTIVES

This Full Action Plan provides details, background, and rationale for climate and SDG investment mobilization for development, private investment, development finance, investment mobilization, and blended finance experts and practitioners. The core components of the Full Action Plan have been extracted to create a 25-page High Level Summary intended for policy makers, government leaders, and finance and investment executives.

The costs of inadequate progress on climate objectives[1] and the Sustainable Development Goals (SDGs) are multiplying, seven years after the Paris Agreement and SDGs were adopted in 2015. As the planet tips toward climate crisis, food insecurity accelerates in a broad swath of countries, a lingering global pandemic continues to affect health and economies, rocketing prices strain public budgets and global growth, and a potential Emerging Markets and Developing Economies (EMDEs) debt crisis grows.

Over the last several years, the annual investment required to achieve the climate and SDG objectives in EMDEs has grown from an estimated $3.9 trillion in 2014 to $4.5[2] trillion in 2022, while all Official Development Assistance (ODA), development finance, and private investment mobilization together generate just $240 billion[3] of investment per year in these countries. Despite the often-stated ambition to mobilize more private investment in communiques from many high-level public sector meetings, the development finance system has averaged only $44 billion[4] in private capital mobilization; this amounts to only 1% of the annual climate and SDG investment needs in these countries. As the risks from inadequate action build within the system, their associated costs to public and private sectors in the future threaten to overwhelm any incremental progress made so far, and far exceed the cost of addressing them today.

This global challenge does not require unachievable public financial resources. What is required is a more intentional strategy to deploy some of the existing development finance and climate finance resources. The Action Plan identifies the most efficient and effective approaches to strategically deploy some public and philanthropic sector Catalytic Funding on catalytic concessional terms alongside some regular Multilateral Development Bank and Development Finance Institution (MDB/DFI) financing commitments (deployed on non-concessional MDB terms) to mobilize significant amounts of private investment.

The more strategic and coordinated approach described in this Action Plan could increase annual MDB/DFI (net) investment commitments from around $140 billion to $230 billion and total private investment mobilized from around $44 billion to $286 billion – for an aggregate $530 billion in annual climate and SDG investment. The higher amount equals approximately 12% of annual climate and

1 The climate objectives identified in this Action Plan are those aligned with realizing the Paris Agreement and the climate-related SDGs.

2 See Annex N for a summary of the climate and SDG investment needs in low-income countries (LICs) and middle-income countries (MICs), including areas where private investment is most likely.

3 $240 billion annual amount derived as: (i) $140 billion of MDB/DFI annual financing commitments, (ii) one-third of the $170 billion of ODA considered to be allocated for investment, and (iii) $46 billion of total private investment mobilization reported by the OECD.

4 Average in 2016-20 reported by the OECD in its Amounts mobilised from the private sector for development 2022 report.

SDG investment needs in these countries (compared to current levels of around 5% of investment needs); see Section 6 for financial commitments possible through this Action Plan. This is all achievable in the next twelve months with simply a more strategic allocation of existing financial resources without any increases in:

i. MDB/DFI capitalization,
ii. Annual public-sector ODA and climate finance, or
iii. Annual philanthropic funding.

Increases beyond this level would require extra financial resources from the public sector and/or significant restructuring of the development finance architecture, which would likely only be possible in the long term.

The Action Plan is a roadmap to concurrently achieve:

- Public sector objectives such as the SDGs and the Paris Agreement, including the G7's Partnership for Global Infrastructure and Investment, the COP26 Climate Finance Delivery Plan and the G20 Sustainable Finance Working Group Roadmap,
- Private-sector "calls to action," including reports or recommendations from the Glasgow Financial Alliance for Net Zero (GFANZ), Impact Taskforce, Net-Zero Asset Owners Alliance (NZAOA), Global investors for Sustainable development Alliance (GISD), Sustainable Markets Initiative, and the Investors Leadership Network (ILN); see Annex P for list of reports reviewed to formulate this Action Plan.

At COP26[5] in October 2021, the United Kingdom Presidency, Canada, and Germany published a Climate Finance Delivery Plan with "ten collective actions" towards providing and/or mobilizing $100 billion of climate finance to EMDEs. At the G7 meetings in Germany in June 2022, G7 leaders announced the $600 billion Partnership for Global Infrastructure and Investment. Although high-level communiques such as these set the objectives and overall template for meaningful climate and SDG investment progress, they require a more concrete blueprint to achieve them. This Action Plan provides that blueprint for a step change in both public and private investment.

The Action Plan's five pillars are not a panacea that will solve every challenge in the developing world or address every issue requiring reform within the official development finance system. They are a set of pragmatic, achievable solutions agreed among a broad spectrum of private, public, and philanthropic organizations that seek to bind the current development finance and climate finance system closer together with the larger universe of private capital and market innovation needed to achieve the Global Goals.

The fundamentals of the global economy have changed significantly since the prevailing development finance system was created starting in the 1940s through the Bretton Woods Agreement and the institutions it created. The Action Plan recognizes the need to adapt to the changed fundamentals, and harness new resources, actors, and innovation. In the global economy of 2022, private investors now hold an estimated $410 trillion[6] in financial assets, with only $17 trillion (4%)[7] invested in EMDEs (ex-China). Most of these resources are invested in mainstream markets or safe financial instruments with limited real economy and SDG impact in EMDEs. As little as 1% of this sum would close the annual climate and SDG investment gap.

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5 The United Nations Climate Change Conference held in Glasgow in November 2021.

6 The Financial Stability Board's Global Monitoring Report (December 2021) estimated total global financial assets around $469 trillion, with around $410 trillion controlled by the private sector. The McKinsey Global Institute's The Rise and Rise of the Global Balance Sheet November 2021 Report estimates global financial assets at $510 trillion.

7 Estimated from Financial Stability Report data; (i) 81.5% in high-income countries, (ii) 14% in China and (iii) 4.5% in EMDES (ex-China).

As a number of large investor groups who helped write this Action Plan make clear, investor appetite for EMDEs assets is strong,[8] with the dominant investment themes of climate action and social and environmental returns alongside financial returns propelling more and more investors to consider shifting investment to EMDEs. But investment opportunities in EMDEs are perceived as high risk – usually beyond most mainstream investors' fiduciary and/or regulatory limits.

Increasing climate and SDG investment significantly requires a strategic **Action Plan that transforms non-fiduciary investment opportunities in EMDEs into fiduciary investment assets** through efficient and fair de-risking activities, thereby mobilizing private investors to invest in projects/investment assets they would otherwise not be able or willing to invest in. **As generations of global private citizens become increasingly interested in social and environmental returns for their savings, private sector investment represents the largest and most under-utilized global pool of capital for development and climate.**

The Action Plan describes a deeper collaboration centered around the development community working intentionally with the private sector to "de-risk" investment opportunities in EMDEs to within investors' fiduciary and regulatory risk thresholds – creating a greater universe of investment assets for investors to invest in at greater scale and impact. This deeper collaboration will address the two enduring constraints to greater long-term capital flows simultaneously: increasing the number of commercially investable climate and SDG projects, and the supply of capital willing and able to invest in these projects in EMDEs.

This strategy will not remove all risk in EMDEs for private investors, nor should it. Rather, it will allow private investors to collaborate with the development finance system to manage risk more effectively, bundle and standardize many projects together into portfolios that reduce risk further through diversification, and ultimately unlock scale-level flows of investment capital. Over time, this more integrated public-private-philanthropic "de-risking" partnership will reduce the perceived risk of investing in EMDEs as private investors learn to price and benchmark that risk, as has been shown in middle-income countries (MICs) from Colombia to Panama to Turkey. This will allow the private sector to scale investment flows with less and less de-risking assistance.

While this de-risking and mobilization collaboration has already begun, with 750+ blended finance transactions and $175+ billion[9] total investment to date, efforts have been piecemeal and will not achieve the scale necessary until it is mainstreamed and institutionalized within the development finance system. Absent that, actual and perceived risks in EMDEs will continue to lead to systemic underinvestment in the climate objectives and SDGs.

The Action Plan identifies how a small amount of public and philanthropic funds can act as a system-wide catalyst, combining strategically with MDB/DFI investments and private capital, to move the international system from $240 billion of total annual investment to $530 billion, with no new budgetary resources appropriated. The vast majority of development needs in EMDEs should continue to be funded by traditional ODA (e.g., grants). However, a small portion of ODA and climate finance funds should be focused more intentionally and flexibly on projects and sectors where private capital and innovation can be mobilized – economic sectors like clean energy, resilient infrastructure, industry, job creating growth capital, financial services, and agriculture.

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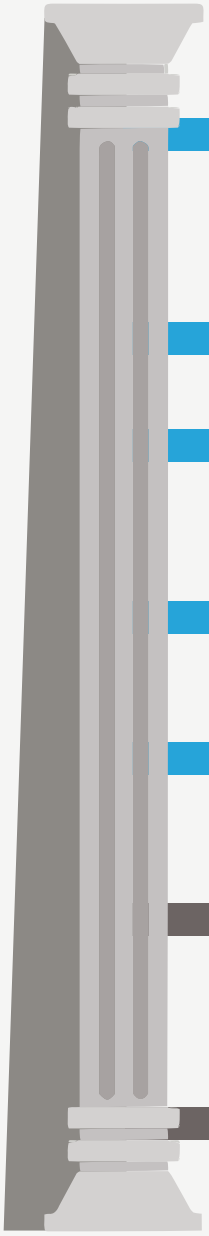
8 Subject to the investments meeting their fiduciary and regulatory investment obligations.

9 Based on Convergence Blended Finance Historical Deals Database.

Highlights of the Action Plan include:

- Public and philanthropic organizations should create a sizable pool of Catalytic Funding (estimated in the Action Plan at $13-15 billion per annum) that is awarded to the best investment mobilization proposals globally, crowding in the capacity, speed, and innovation of global and local developing country financial investors. This Catalytic Funding pool, earmarked from existing resources, must be a critical mass of unrestricted funds that can be deployed flexibly alongside investors. Several Catalytic Capital Facilities should be established and awarded by expert investment committees who are empowered to make decisions at the required speed of the market, with results frameworks that track measurable social and environmental impact.
- In order to achieve significant private investment mobilization, MDB/DFI shareholders must fully harness the tremendous comparative advantages these institutions have accumulated over half a century of experience –advantages and expertise that private investors require to co-finance in unfamiliar EMDEs. MDB/DFI shareholders should govern the institutions through a small set of Key Performance Indicators (KPIs) intentionally designed to align these institutions with the 2030 Agenda and make mobilization of private investment a core activity. The Action Plan estimates that net annual commitments from MDBs/DFIs could increase from $140 billion to $230 billion while maintaining prudent capital adequacy and their conservative (mostly) “AAA” credit ratings.
- Answering numerous calls from private investors for more reliable information on EMDEs to evaluate risk better, the Action Plan proposes a dedicated Investment Mobilization Hub (website) that consolidates the most important data, information, and resources required by investors to make investment decisions in unfamiliar countries, including curation of the best investment data and information, access to all Catalytic Funding sources and programs, and access to all investment assets created by mobilization / blended finance.
- An intentional effort to strengthen local capital markets and financial institutions in EMDEs so they can harness growing local pools of savings and channel cross-border investment to climate and SDG projects in their countries while innovating their own financial sectors.



Executive Summary of Action Plan:

FIVE PILLARS & TWO COMPLEMENTARY ACTIVITIES

PILLAR 1 **INCREASE THE SUPPLY OF CATALYTIC FUNDING: CROWD IN A LARGER UNIVERSE OF RESOURCES & INNOVATION**

Allocate some existing public and philanthropic financial resources to create a sizable and meaningful pool of flexible catalytic capital that can mobilize larger sums of private capital, focusing the sophistication and financial weight of global markets on climate and SDG investments and reducing growing pressure on public budgets and developing world indebtedness.

PILLAR 2 **MAKE MDBS & DFIS CATALYSTS OF MOBILIZATION**

MDB/DFI shareholders establish a set of KPIs for mobilization, to forge a deeper de-risking partnership with private actors to maximize their contributions to climate objectives and SDGs.

PILLAR 3 **MAXIMIZE INVESTABLE PIPELINE & IMPACT THROUGH MORE INTEGRATED DEVELOPMENT FINANCE & CLIMATE FINANCE SYSTEMS**

Strengthen operational collaboration between providers of Catalytic Capital, MDBs/DFIs, and private sector investors to create investment assets that meet investors' fiduciary requirements and investment mandates, building portfolios of investable financial assets.

PILLAR 4 **PROVIDE INVESTORS ACCESS TO THE BEST INVESTMENT DATA & MOBILIZATION RESOURCES THROUGH AN INVESTMENT MOBILIZATION HUB**

Improve enabling environment certainty and investment decision-making by establishing a Hub that curates the best investment data, platforms, and vehicles in one accessible resource.

PILLAR 5 **EMPOWER LOCAL CAPITAL MARKETS & FINANCIAL INTERMEDIARIES IN EMDES**

Deepen, broaden and improve the ability of domestic financial markets and local financial intermediaries in EMDEs to drive local savings and cross-border funds into climate and SDG projects.

COMPLEMENTARY ACTIVITIES

ACTIVITY A **LINK THE SUPPLY OF GLOBAL CAPITAL TO PRIORITY PROJECTS**

The increased supply of investment made possible through the Action Plan should be directed to high priority projects, such as (i) projects to achieve Nationally Determined Contributions (NDCs), (ii) projects identified by Just Energy Transition Partnerships (JETPs), (iii) high priority projects identified by developing country governments and country platforms, and (iv) projects aligned to Integrated National Finance Frameworks.

ACTIVITY B **IMPROVE INVESTMENT CLIMATE IN EMDES**

Donor governments and philanthropic foundations should disproportionately allocate their scare Catalytic Funding to blended finance vehicles in countries striving to improve the openness and transparency of their investment climates.

The five pillars would combine to directly increase climate and SDG investment significantly in the near and medium terms – the Action Plan identifies $530 billion of annual investment (see Section 6 for details).

The two complimentary activities are required to link the supply of capital to priority projects and decrease overall country risk in the medium term. They do not lead directly to increases in climate and SDG investment.

A broad group of experts from the development community and the private sector – all of whom have a strong interest in higher levels of climate and SDG investment in EMDEs – have contributed to this Action Plan. The collaborating organizations collectively think the Action Plan is an effective and affordable blueprint to realize the objectives laid out at COP26 and recent G7 and G20 meetings. It does so without requiring significant changes to the operations, resourcing, and mandates of MDBs/DFIs, donor governments, and private investors.

INTRODUCTION

IMPORTANCE OF PRIVATE INVESTMENT MOBILIZATION TO ACHIEVE CLIMATE AND SDG OBJECTIVES

The overarching objective of the Action Plan is to increase the number of projects in EMDEs to achieve the SDGs and Paris Agreement objectives by increasing investment to those projects. The Action Plan describes how to contribute to that objective by mobilizing a higher quantity and quality of total investment and private investment.

With the private sector in possession of so much of the investable capital, it is critical to understand the dynamics of potential private investment. The Financial Stability Board[10] estimates total global financial assets at $469 trillion, of which $410 trillion (87%) is controlled by the private sector and $59 trillion by the public sector. However, only around 4-5% of these assets are estimated to be deployed in EMDEs (ex-China). Therefore, it is critical to mobilize cross-border private investment to achieve the climate objectives and SDGs.

Despite the low level of deployment of private capital in EMDEs (ex-China), the private sector still dominates investment in these countries. Table I.1 summarizes the importance of cross-border private investment into EMDEs, and the comparatively low amounts of public sector flows. The World Bank reports net financial flows[11] (of debt and equity) to all EMDEs in the five-year period since the SDGs were adopted in 2015 at an average $996 billion annually, which is 22% lower than the $1,286 billion average in the four-year prior to the SDGs. Net debt flows have averaged $474 billion annually and net equity $522 billion. Of the net equity, $475 billion has been Foreign Direct Investment (FDI) and $47 billion portfolio investment. But China is by far the largest destination of these flows, accounting for around 40%, leaving only around 60% ($608 billion annually) for the other 140 EMDEs – See Figure I.1. The public sector (i.e., official creditors) accounted for only $78 billion of annual net flows to EMDEs on average – less than 10% of the total.

Table I.1: *Aggregate net financial flows to EMDEs, 2011-20, USD (billion)* [12]

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Net financial flows, debt and equity	1,324.9	1,223.8	1,457.7	1,136.3	207.6	721.0	1,289.9	1,108.2	953.8	908.6
Percent of GNI (%)	5.7	5.0	5.6	4.2	0.8	2.8	4.5	3.7	3.1	3.0
Net debt inflows	717.2	587.7	814.8	539.8	–316.1	208.4	755.4	574.5	400.1	435.4
Long-term	405.0	468.5	447.6	394.7	171.6	243.3	433.4	352.4	372.3	419.4
Official creditors	39.1	34.3	30.7	47.8	49.2	62.3	56.2	81.3	64.0	128.6
World Bank (IBRD and IDA)	6.4	12.0	14.1	15.1	17.6	13.5	13.1	14.7	19.1	27.2
IMF	0.5	–8.4	–17.7	–7.2	4.8	5.0	3.6	30.9	21.6	46.5
Private Creditors	365.9	434.2	416.8	346.9	122.4	181.0	377.2	271.1	308.3	290.8
Bonds	150.5	225.7	172.7	174.8	74.9	120.1	289.1	203.6	255.2	280.1
Banks and other private	215.4	208.6	244.2	172.1	47.5	60.9	88.1	67.5	53.1	10.7
Short-term	312.2	119.1	367.2	145.1	–487.7	–34.9	322.0	222.2	27.8	16.0
Net equity flows	607.6	636.1	642.9	596.5	523.6	512.6	534.5	533.6	553.7	473.2
Net foreign direct investment inflows	603.8	538.8	572.8	512.7	502.4	467.9	467.7	496.5	505.7	434.5
Net portfolio equity inflows	3.8	97.4	70.1	83.8	21.2	44.7	66.7	37.2	48.0	38.7
Change in reserves (– = increase)	–457.4	–284.1	–523.3	96.9	607.1	274.9	–313.5	84.1	–189.3	–330.4
Memorandum item										
Workers' remittances	337.2	362.8	384.0	414.8	416.9	408.0	444.2	481.9	501.7	499.5

10 See footnote 7.

11 Net flows are calculated by identifying inflows and subtracting outflows, annually.

12 Tables reproduced from Table 0.1 and Figure 0.1 of World Bank International Debt Statistics 2022 Report.

Table I.2 and Annex A provide a simplified landscape of the main private sector financial institutions, investors, and channels to boost investment. The key is to increase the quantity and quality[13] of investment provided by investors, asset owners and asset managers (third and fourth columns) to the thousands of financial arrangers (fifth column) providing loans and equity investments to companies and projects in EMDEs. The financial arrangers can be funded directly by the investors/asset owners or indirectly by asset managers.

Figure I.1: *Aggregate net financial flows to EMDEs (ex-China), 2011-20, USD (billion)*

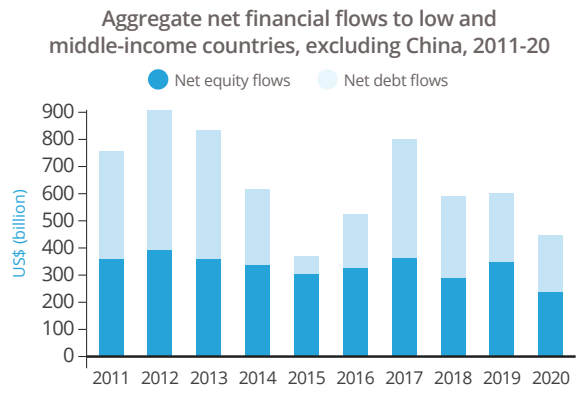


Table I.2: *Main private sector financial intermediaries who can invest in climate and SDGs in EMDEs*

Domicile of organization	Sector	Investor (asset owners)[14]	Asset managers[15]	Financial arrangers[16] of loans and equity investments in EMDEs
Cross-border, generally from high-income countries (HICs)	Private sector	Pension companies and funds (e.g., APG) Insurance companies (e.g., Allianz)	Equity fund manager (e.g., Blackrock) Debt fund manager (e.g., Blue Orchard) Hedge funds Insurance brokers	International banks (e.g., Standard Chartered) Private credit funds (e.g., Cordiant Capital and Kiva) Private equity funds (e.g., Bamboo Capital)
	Public Sector	Sovereign wealth funds (e.g., Temasek) MDBs (e.g., AfDB) DFIs (e.g., BII) Public sector pension companies and funds (e.g., CDPQ)		MDBs (e.g., International Finance Corporation) DFIs (e.g., US Development Finance Corporation)
Domestic in EMDEs	Private sector	Pension companies and funds Insurance companies	Equity fund manager (e.g., Old Mutual) Debt fund manager (e.g., 4G Capital Kenya)	Domestic banks (e.g., Eco Bank Togo) Microfinance institutions (e.g., Imon Tajikistan)
	Public Sector	Sovereign wealth funds (e.g., Fonsis Senegal) Pension companies and funds (e.g., PIC South Africa)		National development banks (e.g., Uganda Development Bank)

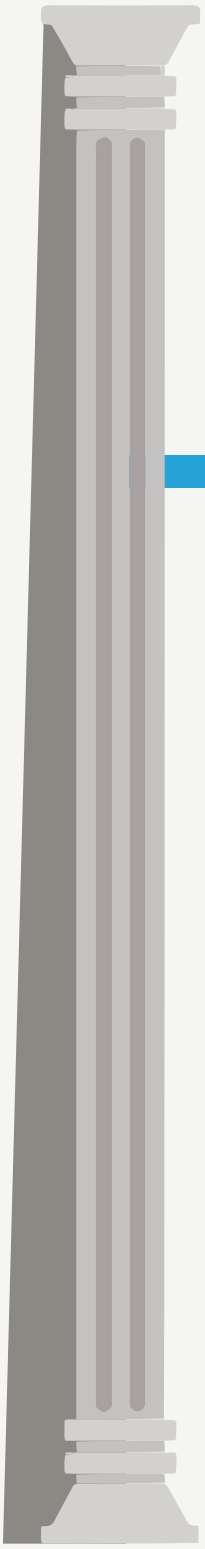
In the Action Plan, financial arrangers are institutions that provide loans and equity investments to companies and projects in EMDEs. In general, loan and equity investments of $5 million or less are provided by domestic financial arrangers (e.g., banks and microfinance institutions), while investments of more than $5 million are provided by both domestic and cross-border financial arrangers. The large majority of climate and SDG investment needs require financing amounts less than $5 million; therefore it is critical for blended finance to support domestic financial arrangers. Best practice blended finance solutions support or complement domestic financial arrangers, as opposed to disintermediating them (See Pillar 5 for analysis of domestic financial intermediation).

13 The quality of investment is comparably important as the quantity. The authors estimate around 85% of development finance from MDBs/DFIs is extended as hard currency debt, which is incongruent with debt sustainability. All other things being equal, equity is higher quality than debt, local currency than hard currency, and long-term than short-term.

14 Asset owners are loosely defined as investors in financial assets (e.g., debt and equity), where those financial assets are originated/arranged by third parties (e.g., an asset manager or financial arranger).

15 Asset managers are loosely defined as organizations intermediating investment from asset owners / investors to climate and SDG projects – either directly to organizations implementing the project or indirectly to financial arrangers.

16 Financial arrangers are loosely defined as organizations providing finance directly to the entity implementing the project(s), using its own funds and/or funds provided by asset owners, investors and/or asset managers.



PILLAR 1:
INCREASE THE SUPPLY OF CATALYTIC FUNDING: CROWD IN A LARGER UNIVERSE OF RESOURCES AND INNOVATION

OBJECTIVE: Create a critical mass of Catalytic Funding and a Catalytic Funding Network to mobilize private investment in a more integrated manner.

HIGHLIGHTS

- High country risk for most EMDEs means many investment opportunities are beyond the fiduciary and/or regulatory risk limits of most investors. For example, the median sovereign risk rating of the 141 EMDEs is Fitch-equivalent "B-". The large majority of debt investment opportunities in EMDEs have implied risk ratings at the equivalent of "B" Highly Speculative and "CCC" Substantial Credit Risk – beyond the fiduciary and/or regulatory risk limits of almost all private debt investors. The analytics and results for equity investments are similar; see Annex Q for more details.
- Of the $410 trillion of global finance assets held by the private sector, only 4-5% is invested in all EMDEs (ex-China).[17]
- To mobilize private investment at scale requires creating fiduciary investment assets within investors' fiduciary risk obligations to their retirees and shareholders and with market-equivalent risk-adjusted returns. A wholesale de-risking campaign is required, otherwise investors will remain mainly invested in lower-risk HICs, China and a few upper middle-income countries (UMICs).
- MDBs/DFIs currently finance projects in EMDEs, not to de-risk private investment.[18] Creating fiduciary investment assets at scale requires Catalytic Funding to take on risks beyond the fiduciary abilities/limits of private investors and MDBs/DFIs.
- If increasing total sustainable investment is the objective, the limited amount of Catalytic Funding allocated to date has been sub-optimal. Changes are required to allocate this scarce resource more strategically and collaboratively to achieve scale impact and investment. The Action Plan calls for creating a Catalytic Funding Network with public and philanthropic funds awarded to the best investment mobilization proposals.
- The Action Plan identifies how a critical mass of $13-15 billion of Catalytic Funding per year through 2030 could be allocated complementarily alongside MDB/DFI financial resources to increase total annual climate and SDG investment from $240 billion to $530 billion (See Section 6), including total annual private investment mobilization from $44 billion to $286 billion.
- All Catalytic Funding must adhere to good development impact, including the five OECD Blended Finance Principles and Guidance.[19]

17 See The Financial Stability Board's Global Monitoring Report (December 2021).

18 The Multilateral Investment Guarantee Agency (MIGA) is the only MDB governed to de-risk private investment, and reports only $1.7 billion of annual investment mobilization in EMDEs. See Page 44, Table A.4 of MDB Mobilization 2021 Report.

19 The OECD DAC members agreed to these five principles in 2018. Subsequently in 2021, the OECD Development Cooperation Directorate team led the blended finance community to publish five guidance notes – one for each principle.

1.1 DEFINITIONS, CHARACTERISTICS AND EXAMPLES OF CATALYTIC FUNDING

The large majority of development, development finance, and private investment experts agree on the need for a significant pool of Catalytic Funding to significantly increase long-term investment to fuel the transition to Net-Zero and drive the SDGs in the developing world. Annex B provides further details of the critical importance of Catalytic Funding, examples of Catalytic Capital, a good description of the Catalytic Capital Consortium as an example of a catalytic capital network, and a list of resources on Catalytic Capital.

Beneficially, only a small percent of the approximate $210 billion[20] of existing concessional development and climate funds allocated annually by the public sector and philanthropic sector for EMDEs is required. The Action Plan estimates around $16 billion per annum could form the foundation of $530 billion of total investment, including mobilizing $286 billion of private investment. The provision of around $16 billion per annum of flexible Catalytic Funding from donor governments and philanthropic foundations can have an outsized effect on the entire development finance system, tipping it firmly towards the investment mobilization required to achieve the Global Goals and stitching together a more integrated approach among private and public stakeholders.

For purposes of this Action Plan, **Catalytic Funding** is defined as financial resources deployed with three characteristics:

1. Deployed with the **intent to make a positive economic development, social, and/or climate impact in EMDEs** (e.g., aligned to the SDGs and/or Paris Agreement).
2. Deployed with the **intent to mobilize private investment** with financial additionality - mobilize one or more private investors to make a fiduciary investment that it would not otherwise make (e.g., credit enhance a loan from "CCC" risk to "BB"[21] risk to meet the investor's fiduciary requirements of "BB " level risk).
3. **Deployed at concessional terms** (e.g., non-commercial financial terms) – on financial terms a private investor and/or MDB/DFI is not able or willing to provide given their mandates.

Catalytic Funding generally comes in two forms:

1. **Catalytic Grants:** These funds are usually provided by a grantor (donor) to a grantee (beneficiary) to pay for inputs or achieve pre-agreed outcomes with no obligation/expectation the funds would be repaid to the grantor – usually contracted through a grant agreement. With Catalytic Grants, the provider (grantor) expects none or only some of the funds to be repaid. These financial resources generally meet the criteria of "concessionality" and ODA.
2. **Catalytic Capital:** Sometimes called concessional capital, these funds are generally deployed as an investment, accepting disproportionate risk and/or concessionary returns usually allocated to attract investment from the private sector. Catalytic Capital represents funds that private investors and MDBs/DFIs are typically not able or willing to provide given their fiduciary mandates or risk aversion. Catalytic Capital is ideally contracted in the form of a financial

20 Approximately $170 billion of ODA, $30 billion of concessional climate finance and $10 billion of philanthropic funds.

21 The implied risk ratings of most debt investments to the private sector in EMDEs are "B" Highly Speculative or "CCC" Extremely Speculative – beyond most investors' fiduciary risk limits.

instrument (e.g., loan agreement, equity investment, guarantee, insurance contract) or as a recoverable grant.[22] With Catalytic Capital, the provider takes on a risk-return combination beyond what private investors and MDBs/DFIs are able or willing to accept. There are two types of Catalytic Capital:

(i) **Risk-Reduction Catalytic Capital** deployed at a project or portfolio level to take on a risk that private investors and MDBs/DFIs are not able or willing to take. At a project level, this typically transforms a commercially "near-investable" project to become "investable". At a portfolio level, in the past ten years of good practice blended finance, this has increasingly taken the form of junior capital[23] in tiered blended finance vehicles. The Action Plan identifies the efficient use of this capital, such as bearing risk at the rating-equivalent of a "CCC" or "CC" rating" in junior investments in blended finance vehicles.

(ii) **Low-Cost Catalytic Capital** provided intentionally at a subsidized return, typically to lower the average cost of capital for a project/borrower – often deployed to reduce the cost of capital in a renewable power project to allow renewable electricity generation costs to compete with fossil fuel electricity. See Annex B for the most efficient use of this capital.

Best estimates indicate around $2-4 billion of Catalytic Capital is currently allocated annually in a fragmented way by donor governments and philanthropic foundations, with no agreed-upon strategy or objectives. Additionally, Convergence's data suggests around 70% of this funding is allocated through MDBs/ DFIs with limited private investment mobilization. Such uncoordinated approaches have not led to a meaningful increase in climate and SDG investment or private investment mobilization.

1.2 MOST IMPORTANT USES OF CATALYTIC FUNDING FOR MOBILIZING PRIVATE INVESTMENT

1.2.1 RISK-REDUCTION CATALYTIC CAPITAL

High country risk, both perceived and actual, is a primary investment barrier for investors in EMDEs, as articulated in multiple recent investor reports:

- Median sovereign risk rating of the 141 EMDEs is Fitch-equivalent "B-." Only 11% of the sovereigns are rated Investment Grade,[24] with 78% rated "B" (e.g., Highly Speculative)[25] or riskier.
- Using the Big 3 Rating Agencies' country ceiling conventions, most private sector debt investment opportunities are even riskier, with mostly implied ratings of "B" Highly Speculative or "CCC" Substantial Credit Risk.[26]
- Currency risk in EMDEs is very high. A 2011 European Bank for Reconstruction and Development (EBRD) study found the average LIC and MIC local currency had depreciated an average of 3.5% per annum relative to USD in the previous 20 years.

22 Good practice is to contract the risk capital in the form of a financial instrument.

23 Junior capital is a subordinate tier of capital in a fund or company that, among other things, serves to create a fiduciary investment asset for the investors in the more senior tiers of capital. For illustrative applications, please see Section 2.6.

24 Investment grade means a borrower or a security is rated "BBB-" or better by the Big 3 Rating Agencies – which translates into relatively low risk.

25 Ratings and definitions from Big 3 Rating Agencies – Fitch Ratings, Moody's Investor Services and Standard & Poor's.

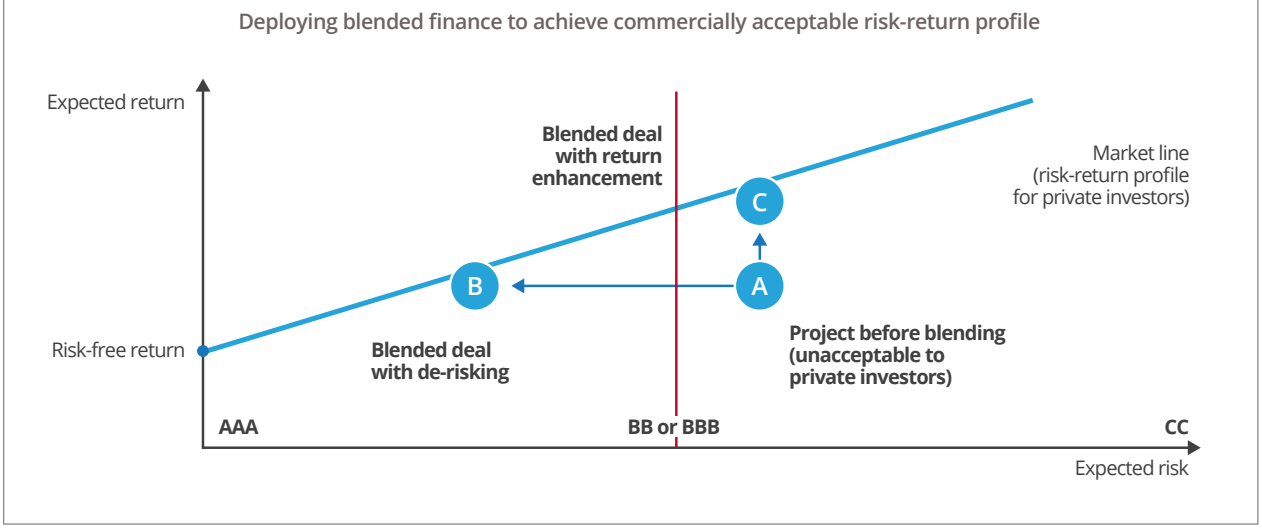
26 IFC's average risk rating is the equivalent of "B."

- Many projects, borrowers, and companies are perceived by private sector financial arrangers and investors as commercially non-investable or near-investable falling short of fiduciary obligation to be investable.[27]
- The high country risk, currency risk, and commercial risk causes the large majority of investment opportunities in EMDEs to fall outside the fiduciary and/or regulatory limits of most investors.

Risk-Reduction Catalytic Capital is undoubtedly the most important type of Catalytic Funding, both to overcome high country risk and to transform non-fiduciary investment opportunities into fiduciary investment assets. As detailed in this Action Plan, several private investor groups have clearly signaled a growing appetite for purpose investments in EMDES, subject to the investments meeting their fiduciary requirements to their retirees, shareholders, and regulators. However, in most cases, developing country risk is beyond investors' fiduciary obligations; very few investors are willing or able to invest in "B" and "CCC" risk in EMDEs. The Catalytic Capital advocated in the Action Plan will create fiduciary investment assets and increase investment across the full spectrum of EMDEs: LDCs, LICs, LMICs, and UMICs.

Figure 1.1 uses the Capital Asset Pricing Model from the private debt investment world to demonstrate how Catalytic Capital has been used effectively to de-risk debt investment assets to acceptable fiduciary levels for private investors. The best example of this approach is the IFC-Sida MCPP Infrastructure Project, which raised $1.5 billion of private investment from AXA, Allianz, and Prudential/East Spring. Please see Annex C for a description of that transaction and other leading blended finance examples.

Figure 1.1: *The need to de-risk investment opportunities in EMDEs to acceptable fiduciary levels to mobilize private investment*



27 The Action Plan uses the expression "commercially investable" to identify a project/company which a financial arranger finds acceptable for commercial risk purposes (e.g., the financing transactions is well structured for a financial arranger "on risk" for that country). For example, for an independent power project in Burkina Faso, Ecobank, African Development Bank (AfDB), HSBC, and Société Générale could analyze the same project and all agree it is "commercially investable." Since Ecobank and AfDB are "on-risk" for Burkina Faso they would be prepared to finance the project. But HSBC and Société Générale would likely accept the commercial risk, but risk rate the transaction relative to Burkina Faso's high-risk "CCC+" sovereign risk rating and decide they cannot finance a "CCC" transaction since it is beyond their fiduciary risk limit. That transaction is "commercially investable" for all four financial arrangers, but would not be financed by HSBC and Société Générale due to high country risk. If the same project was located in Botswana, which has a "BBB+" sovereign risk rating, all four would find the project "commercially investable" and would finance the project since they are all prepared to arrange financing for commercially investable projects in investment grade countries.

Figure 1.1 is a simplified version of Finance 101's Capital Asset Pricing Model. The upward sloping line represents the market-efficient line for debt investments. A debt investment that lies below the line is below-market and does not meet fiduciary obligations.

The large majority of debt investments in EMDEs would have an implied risk rating of "B" Highly Speculative or "CCC" Substantial Credit Risk. Debt investors can only invest in assets on the left side of their respective red line; all debt investors have the ability to invest in Investment Grade debt (e.g., debt investment assets rated "BBB" or better); many investors can invest some funds at "BB", and very few investors have the ability to invest in "B" and "CCC" rated assets.

However, the large majority of debt investment opportunities in EMDEs lie to the right of the red line – these investments do not meet investors' fiduciary obligations. De-risking is required to move the transactions from the right side of the red line to the left side to create fiduciary investment assets and mobilize private investments at scale – for example shifting a debt investment from Point A to Point B. Fortunately, there are 100+ examples of de-risking in Convergence's Historical Deals Database of blended finance transactions, with Annex E profiling the four most effective and efficient approaches agreed upon in 2021 by more than 200 OECD Development Assistance Committee (DAC) members, foundations, and investors.

Although Figure 1.1 depicts debt investment, similar logic is applicable for equity investment. The Convergence Historical Deals Database includes 50+ such equity transactions.

For purposes of clarity, Risk-Reduction Catalytic Capital does not need to be deployed on financial-loss terms. It simply needs to take on a risk profile that private investors and MDBs/DFIs are not able or willing to take. The financial remuneration can be commensurately high. Although Risk-Reduction Catalytic Capital to mobilize investors to EMDEs may need to be provided initially by public or philanthropic organizations, over time and as they invest, private sector investors will become more skilled at evaluating risk in developing markets, and their risk perceptions will fall, leading to a decrease in the level of Catalytic Capital required to de-risk investment opportunities to fiduciary levels.

1.2.2 LOW-COST CATALYTIC CAPITAL

Low-Cost Catalytic Capital should be deployed sparingly – with best use to transform an unaffordable project into an affordable project, such as transforming a high-cost renewable power project to be able to compete with fossil fuel electricity generation.

1.2.3 CATALYTIC GRANTS

Catalytic Grants have many good uses. Good examples of Catalytic Grants being deployed to mobilize private investment are the Rockefeller Foundation Zero Gap Program and the Convergence Design Funding Program – the latter has deployed $15 million of grants and mobilized $1.5 billion of investment.

1.3 ACTION PLAN DEPLOYS CATALYTIC FUNDING TO MOBILIZE PRIVATE INVESTMENT

Table 1.1 identifies the main investment barriers constantly identified by financial arrangers, investors, and asset managers and how the Action Plan addresses the challenge to successfully mobilize private investment at scale.

Table 1.1: *Primary investment barriers addressed by Action Plan to mobilize private investment at scale*

Investment barrier in EMDEs	Action plan solution
Many individual projects are assessed by Financial Arrangers to be commercially uninvestable or near-investable, falling short of the investable requirement.	Action Plan includes five activities and funding methods to increase the universe of commercially investable projects (Section 3.2). Action Plan includes Catalytic Capital to be awarded for project-level risk mitigation - transforming near-investable projects to become investable (Use Case 1 in Table 1.3).
High country risk means even projects assessed to be commercially investable by financial arrangers (who find the county risk acceptable) will be perceived by most investors and asset managers to be beyond their fiduciary limits due to high country risk.	Action Plan includes Catalytic Capital to be awarded to support the most efficient blended finance vehicles that mitigate country risk (Use Cases 2-4 in Table 1.3).
Currency risk is a major investment barrier for debt and equity investors, and often results in high risk to borrowers and beneficiary countries.	Action Plan includes awarding Catalytic Capital to reduce currency risk and boost investment aligned to debt sustainability (Use Case 5 in Table 1.3).
SDG and climate investment needs of most individual projects are typically small – usually below a minimum size threshold to attract cross-border investors and asset managers.	Action Plan has two solutions: 1. Supporting domestic financial institutions to increase their capacity to finance smaller projects (Section 5). 2. Awarding Catalytic Capital to support portfolio-level vehicles that provide investors with diversification and scale, and invest funds in smaller transactions (Use Cases 1-4 in Table 1.3).
Investors perceive the quality of many asset managers and financial arrangers active in EMDEs to be below their expectations compared to developed economies.	Action Plan awards a significant pool of Catalytic Capital to the best proposals globally. The increase in Catalytic Capital will attract investors, asset managers and financial arrangers to cross-over into EMDEs, increasing the quality of actors (Use Cases 1-5 in Table 1.3).
Stigma of emerging markets and frontier markets label impedes cross-border investment.	Catalytic Capital will be awarded to vehicles that create investment assets aligned to purpose investment themes in high demand by investors, such as ESG, climate finance, green finance, sustainable investment, and impact investing (Section 3.1).
Significant data, information, and knowledge gap of investors for EMDEs causes them to continue to invest in developed economies and not in EMDEs.	Action Plan creates an Investment Mobilization Hub with the main objective to increase total investment and private investment flows (Section 4).
Predominance of private market transactions deters investors who require/seek public market investments and inherent liquidity.	Catalytic Capital awarded in preference to blended finance vehicles that create publicly listed investment assets (Section 3.2).

1.4 MAIN APPROACHES FOR DEPLOYING RISK-REDUCTION CATALYTIC CAPITAL TO CREATE FIDUCIARY INVESTMENT ASSETS

There are myriad approaches for Catalytic Capital to be deployed in blended finance to create fiduciary investment assets. Table 1.2 provides a simplified comparison of the main "de-risking" approaches in blended finance. Of the three approaches, Approach 2 has been the most prevalent.

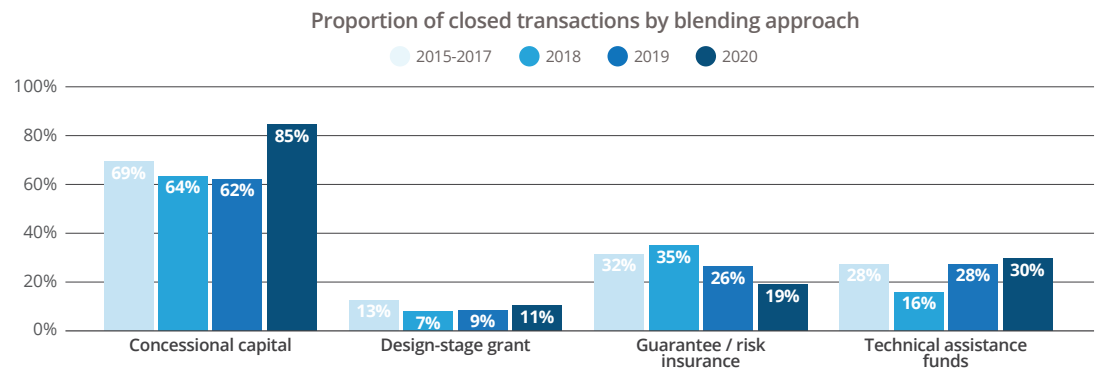
Table 1.2: *Comparison of main approaches using Risk-Reduction Catalytic Capital to create fiduciary investment assets in EMDEs*

De-risking approach	Relative benefits	Relative drawbacks
APPROACH 1: Direct guarantee/ risk insurance Direct issuance of guarantees and/or insurance by providers of Catalytic Capital	• Simple financing mechanism. • Efficiently bridges the gap between perceived high risk and actual lower risk. • Strong tool at project level. • Strong tool if the objective is Low-Cost Catalytic Capital as opposed to Risk-Reduction Catalytic Capital (e.g., a AAA or AA rated guarantee commands a very low cost of capital).	• OECD DAC donor governments and MDBs tend to be "AAA" and "AA" rated entities – when they issue guarantees it is credit-mitigation overkill relative to the need to create "BBB" and "BB" rated fiduciary investment assets in demand by investors. • The rating agencies allow for only a two-notch upgrade for partial guarantee (e.g., an amount less than 100% of the debt obligation). This means a "CCC" issuer can be credit-enhanced to "B-" only. • Insurance and bank regulators require guarantees to be irrevocable and unconditional to qualify for capital relief –donor governments and MDBs are reluctant to issue irrevocable and unconditional guarantees. • OECD DAC rules do not allow guarantees to count as ODA. • Developed country governments are reluctant to issue guarantees due to the open contingent risk. • Requires donor governments to have relatively sophisticated internal accounting systems to calculate expected loss and make budgetary appropriations. • Donor issued guarantees do not typically operate at the speed and flexibility the market requires.
APPROACH 2: Concessional capital: Direct or indirect deployment by providers of Catalytic Capital, often in junior positions in tiered blended finance vehicles	• Provides the dual objectives of i. lowering risk for private investors and ii. raising the monies required for investment. • Allows for creating investment assets with varying level of risk based on investor appetite, ranging from "A" Investment Grade to "CCC" Highly Speculative. • Achieves high financial additionality and low concessionality, and high leverage especially when MDBs/DFIs invest in mezzanine positions. • Creates good opportunity to generate positive internal rate of return for junior investors with very low cost of funding. • As markets develop and risks become transparent, allows MDB/DFIs and private investors to invest in junior tranches displacing donor governments. • Allows for investments to be rated, listed and traded. • Supports MDBs/DFIs to achieve the shareholders' mobilization objectives quite easily. • Follows a proven model in private investment over the past 30 years (e.g., Asset Backed Securities).	• Requires a funded commitment of donor capital. • To date, high fragmentation has led to unintended complexity. • Good practice implementation benefits from an expert investment committee which understands development, development finance, blended finance, private investment, and structured finance.

Table 1.2 (Continued...)		
APPROACH 3: Indirect guarantee/ risk insurance Support to guarantee-issuing intermediaries: Funding and guarantees from providers of Catalytic Capital	• Guarantee-issuing organizations can be capitalized and governed to achieve the "sweet-spot" rating of "BBB" or "A" required by fiduciary investors. • Donor funding and guarantees of these organizations can achieve a 3-7 times leverage: for every $1 of donor funding or guarantees the guarantee-issuing organization can issue $3-7 of outstanding guarantees and maintain its target risk ratings (from "AA-" to "BBB"). • Private sector led guarantee organizations can typically operate far quicker at the pace the market demands. • Easy to scale up existing organizations (e.g., GuarantCo and African Guarantee Fund) or support creation of new ones (e.g., Green Guarantee Company and Avana). • Guarantees can cover all risks, or some risks (e.g., transfer and conversion). • Allows donor governments to support through direct funding or guarantees. • Donor funding supports multiple cohorts of projects – potentially in perpetuity. • Attract investors to new markets with guarantee in short term – hopefully leading to market knowledge and investment without guarantee.	• Does not provide funding directly to project – requires investors (i.e., guaranteed organizations) to provide funding.

Convergence Historical Deals Database curates the world's largest database of blended finance transactions that have mobilized private investment over the past 15 years. Figure 1.2 replicates information from Convergence's State of Blended Finance 2021 Report aggregating around 700 transactions from the database. That data shows that Approach 2 (Concessional Capital in Figure 1.2) has been the most prevalent approach, present in around 70% of the transactions in the database. Junior investment in tiered vehicles has been the most common technique. Approaches 1 and 3 (Guarantees/risk insurance) have been the second most prevalent approach, present in around 30% of transactions.

Figure 1.2: *Most frequent blended finance archetypes*[28]



Although there are many examples of blended finance structures to de-risk and mobilize private investment, the organizations who collaborated to write the Action Plan agree that the most effective and efficient uses of Catalytic Capital are Approaches 2 and 3.

28 Source: Convergence State of Blended Finance 2021 Report.

Box 1.1: Tiered blended finance vehicles for debt

The underlying risk of most loans to private sector borrowers in EMDEs would have implied risk ratings of "B" and "CCC."

As identified in Annexes C and D, there are many examples of contributing a portfolio of these higher risk loans into a tiered blended finance vehicle with the vehicle capitalized by different tiers of investors depending on their risk tolerance. The typical ratio has been 80% of risk capital provided in a senior position and 20% provided in a junior/subordinated position. That is, with good diversification and around 20% of subordinated junior funds, a portfolio blended finance vehicle can usually attract around 80% senior investment from fiduciary investors.[29]

To date, in almost all cases the junior/subordinated capital (the riskiest portion) has been funded by providers of Catalytic Capital, such as ministries of foreign affairs, development agencies, ministries of finance, climate finance funds and philanthropic foundations using their concessional resources. While this 4x leverage is higher than the average for the development finance system as a whole,[30] it is still limited.

Analysis and modeling in Annex F show a leverage ratio of around 14-20x is possible with Catalytic Capital working in tandem with MDB/DFI investment in less risky, mezzanine capital positions. That is, a typical vehicle could have 80% senior, 15% mezzanine, and 5% junior. The implied risk rating of these mezzanine investments in debt blended finance vehicles are expected to be "B" – a risk well within the MDBs/DFIs' fiduciary limits.[31] This three-tier approach would dramatically boost leverage of concessional Catalytic capital, but requires MDBs/DFIs to invest in mezzanine positions. Absent such MDB/DFI mezzanine investment, leverage ratios will likely remain around 4-5 times and scale mobilization will not be achieved.

1.5 MOST IMPORTANT USE CASES OF RISK-REDUCTION CATALYTIC CAPITAL

In consultations for this Action Plan, a broad group of investors and donor governments engaged to ascertain generic "Use Cases" for Catalytic Capital to align the following three key investment mobilization objectives:

1. What are the best uses of Catalytic Capital to transform commercially uninvestable and near-investable projects to become commercially investable?
2. What are the best uses of Catalytic Capital to increase the supply of capital to the many financial arrangers that can provide direct financing (loans and equity investment) to commercially investable projects, since most investors and asset managers will not make direct loans and equity investments, but will provide financing to financial arrangers that will provide the direct financing?
3. What are the best uses of Catalytic Capital to mitigate currency risk, for the benefit of projects, investors, borrowers, and MIC and LIC governments?

Although there was general agreement that the four blended finance structures described in Annex E are likely the most efficient and effective structures to mobilize at scale, the parties agreed it is very important to create a network of organizations providing Catalytic Capital that could award these funds on a competitive basis to the best mobilization proposals – both existing solutions and new innovative solutions.

29 Fundraising success also includes other key ingredients, including market-equivalent risk-adjusted returns, plus a good fund manager to invest the portfolio's investment capital.

30 Most reviews of private investment mobilization of MDBs/DFIs find that $1.00 of MDB/DFI finance has mobilized $0.40 of private investment, that is, a 0.4 times leverage ratio.

31 IFC's average risk rating of its loan portfolio is "B" – identical to the expected risk rating/profile of the mezzanine investments in the four mega funds advocated in the Action Plan.

The group identified the five most important generic use cases to mobilize at scale, as summarized in Table 1.3. Use Case 1 awards Catalytic Capital for project-level risk mitigation to transform projects to become commercially investable. Use Cases 2-4 award Catalytic Capital for portfolio-level risk mitigation to increase the supply of investment for commercially bankable projects. Finally, Use Case 5 awards Catalytic Capital to mitigate currency risk at project and portfolio levels.

Table 1.3: *Five most important Use Cases of Risk-Reduction Catalytic Capital to mobilize private investment to EMDEs*

Use Case	Investment channel	Main risk to de-risk	Main use of Catalytic Capital	Illustrative examples
1	**Project-level risk mitigation:** Catalyzes loans and equity investments arranged by private sector and MDBs/DFIs and mobilizes private investment.	Improving commercial risk at project-level to investable	Many prospective loans and equity investments in EMDEs are assessed by financial arrangers as falling below their standard of commercially "investable." Typically, the commercial risk of investment is assessed as being unacceptable. For these projects, Catalytic Capital can be used for project-level risk mitigation to transform the project to become "investable."	In Convergence's database, 210 blended finance transactions have deployed catalytic capital at the project level. Examples include: GuarantCo and African Guarantee Company, as well as market-led insurance and/or financial guarantee products, such as Avana and Green Guarantee Company.
2	**Portfolio-level risk mitigation for loans to private sector borrowers:** Catalyzes loans arranged by MDBs/DFIs and private sector financial intermediaries and mobilizes private investment.	High country risk diversified at portfolio level	Catalytic Capital to support portfolio-level blended finance vehicles to raise capital, where the vehicle provides debt investments to multiple projects. Projects implemented on private sector basis (e.g., borrowers are private sector companies).	In Convergence's database, 143 transactions have been implemented with this approach. Good examples include the IFC-Sida Managed Co-Lending Portfolio Program Infrastructure, the African Development Bank – Newmarket Capital Room2Run transaction and the Green for Growth Fund. Private Sector Arranged Blended Finance Loan Fund(s) with three tiers of capital profiled in Section 3 would be a scale example.
3	**Portfolio-level risk mitigation for equity investments to private sector (and PPP) projects, companies, and financial institutions:** Catalyzes investments arranged by private sector and MDBs/DFIs and mobilizes private investment.	High country risk diversified at portfolio level	There is a systemic lack of common equity investment available to companies, financial institutions, and projects in EMDEs, limiting growth and development and jeopardizing sustainable finance. Catalytic Capital to support portfolio-level blended finance vehicles to raise capital, where the vehicle provides equity investments to multiple projects. Projects implemented on private sector basis (e.g., investees are private sector companies).	In Convergence's database, 129 transactions have been implemented with this approach. Three-tier private equity funds. See Section 3.

Table 1.3 (Continued...)				
Use Case	**Investment channel**	**Main risk to de-risk**	**Main use of Catalytic Capital**	**Illustrative examples**
4	**Portfolio-level risk mitigation for loans to public sector borrowers (sovereign and sub-sovereign):** Loans arranged by MDBs and mobilizes private investment	High country risk diversified at portfolio level	Catalytic Capital to support portfolio-level blended finance vehicles to raise capital, where the vehicle provides loans to multiple projects. Projects implemented on public sector basis (e.g., borrowers are public sector entities).	MDB Public Sector Blended Finance Loan Funds with three tiers of capital. See Section 3.
5	**Currency risk mitigation:** Catalyzes loans and equity investments arranged by private sector and MDBs/ DFIs and mobilizes private investment.	High currency risk - at both project and portfolio level	FX risk is present in the large majority of debt and equity investment in EMDEs. In general, cross-border equity investors are reluctant to invest in EMDEs since they are vulnerable to depreciation of the local currency against their target investment in hard currency (e.g., USD and Euro). For example, a 3% per annum depreciation for a fund with a 10-year life would lead to a 30%+ depreciation in currency value, which is very difficult to make up based on commercial returns. Similarly, debt investors seek returns in their target hard currency and tend to lend in that hard currency. This creates high currency risk for the borrower, and then high credit risk for the lender. Moreover, the lack of common equity investment generally leads to more debt investment than ideal, and when in hard currency, this exacerbates debt sustainability issues.	The Currency Exchange Fund (TCX) LYFT Program African Local Currency Bond Fund EBRD SME Local Currency Loan Program

1.6 AMOUNT OF CATALYTIC FUNDING REQUIRED

1.6.1 CATALYTIC CAPITAL

The amount of Catalytic Capital required is a direct function of the ambition of the Action Plan. The authors propose, initially, a semi-ambitious Action Plan that would optimize and fully deploy the existing $340 billion of balance sheet capital at the main MDBs, and would require only a small portion of the annual concessional development finance and climate finance resources for de-risking. Using these constraints/resources, the Action Plan could more than double total climate and SDG investment from around $240 billion per annum to $530 billion. Based on reasonable estimates this

would require around $16 billion of Catalytic Funding comprised of $13.5 billion of Catalytic Capital and $2.5 billion of Catalytic Grants (See Section 6).

In sum, the Action Plan estimates $13.5 billion of Catalytic Capital, complemented by $45.5 billion of MDB/DFI mezzanine investments, can mobilize around $286 billion of private sector investment. **The $286 billion in private capital mobilization would be 6.5 times the current mobilization of the entire development finance system in a typical year (estimated by the OECD to be around $44 billion) and 14 times the average direct mobilization reported annually by the MDBs/DFIs.**

The Action Plan estimates the total commitments would be split around 40% for climate and 60% for the SDGs non-climate). The resulting $210 billion annual climate investment is twice the $100 billion developed countries' target in the Climate Finance Delivery Plan.

A larger pool of Catalytic Capital above $13.5 billion would likely achieve lower leverage results, since the base case of the Action Plan is premised on the MDBs maximizing their contributions with existing capital and maintaining their mostly "AAA" ratings. A smaller pool would not meet the challenge, but would still be beneficial compared to the current situation.

1.6.2 CATALYTIC GRANTS

Since the Action Plan is most focused on the main challenge of creating fiduciary investment assets that mobilize private investment, and given the myriad uses of Catalytic Grants (much of which is not about mobilizing private investment), the authors have not analyzed in depth the need for Catalytic Grants. A reasonable estimate is that around $2.5 billion of Catalytic Grants annually would be a good complement to $13.5 billion of Catalytic Capital.

1.7 GOVERNANCE AND ALLOCATION OF CATALYTIC CAPITAL

Experience and feedback from many parties demonstrates that the governance and allocation of Catalytic Capital is just as important as the amount and terms of Catalytic Capital. The past decade provides numerous examples that the best value-for-money for Catalytic Capital is through open, transparent, competitive calls for proposals. See the SDG Impact Finance Initiative description and criteria as a current, good practice example.

The four largest sources of Catalytic Capital are likely to be:

1. HICs (e.g., OECD DAC members) deploying a small portion of their ODA and ODA-like funds.
2. HICs deploying a meaningful portion of their climate finance funds.
3. Multilateral funds/organizations deploying a tangible portion of their budgets, such as Green Climate Fund (GCF), Global Environment Facility (GEF), and Climate Investment Funds (CIF).
4. Philanthropic foundations.

Secondary sources could include LIC and MIC governments and corporates using some of their ESG-like funding.

The Action Plan proposes providers of Catalytic Funding establish and join a Catalytic Funding Network summarized in Sections 1 and 3 and Annex G. HIC governments should agree to allocate their Catalytic Capital as follows:

- All governments join the Catalytic Funding Network, with governments encouraging other providers such as philanthropic foundations and LIC and MIC governments to join the Network; see Annex H for more information on the proposed decision-making and commitment process for Catalytic Capital Facilities.
- Governments should deploy Catalytic Capital through several Catalytic Capital Facilities.
- Each Facility would address one or multiple of the use cases identified in Table 1.3. Each Facility would need a minimum amount estimated at $500 million annually to drive mobilization at scale efficiently and at the lowest cost.
- A reasonable and recommended approach could include climate finance funds from developed countries committed to Facilities pursuing climate objectives and ODA and ODA-like monies contributed to Facilities pursuing SDG objectives.
- The governance and decision-making of each Catalytic Capital Facility should be streamlined, providing maximum operating efficiency with investment decisions taken at the speed of the market by a 6-9 person investment committee comprised of development, development finance, and private investment experts subject to pre-agreed Terms of Reference.
- The Facilities should be supported by a Facility Manager appointed on a competitive basis. The Facility Manager would manage the calls for proposals, assess the proposals relative to pre-agreed criteria, and support the investment committee. The Facility Manager would also communicate with the Network to ensure the proposals approved by the Investment Committee are profiled to Network members for possible co-funding.

As a first choice, other prospective providers of Catalytic Capital (e.g., philanthropic foundations, multilateral funds, and LIC and MIC governments) would be requested to contribute funds directly to the Catalytic Capital Facilities. As a second choice, if they are not able or willing to contribute to the Facilities, they could join the Network, in which each member agrees to commit a specific amount of Catalytic Capital each year to proposals that best meet their interests, and commit those amounts on an a-la-carte basis to projects approved by the Facilities' investment committees.

1.8 TARGETS FOR THE CATALYTIC CAPITAL FACILITIES

Similar to MDBs/DFIs as proposed in Pillar 2, organizations providing Catalytic Capital should govern those funds with KPIs. The Action Plan recommends the providers of Catalytic Capital establish targets for optimum leverage, financial additionality, development and climate impact, and minimum concessionality. Indicative KPI targets for the facilities could include:

- In aggregate, raise at least $10 billion of Catalytic Capital per annum for the first five years.
- Achieve 10+ times leverage ratio of private finance mobilized to Catalytic Capital.
- Award 35%+ of Catalytic Capital to support mobilization to climate.

- Award 30%+ of Catalytic Capital to support mobilization to LICs and LDCs.
- Award 20%+ of Catalytic Capital to support domestic financial intermediation.
- Award 30%+ of Catalytic Capital to support project-level blended finance vehicles that transform near-investable projects to become investable.
- Award 30%+ of Catalytic Capital to support projects in public markets.

1.9 POTENTIAL SOURCES OF CATALYTIC CAPITAL

A relatively small amount of flexible Catalytic Capital (the Action Plan calls for $13.5 billion), programmed alongside the MDB/DFI system and private investors, has the potential to significantly jump start private investment mobilization. Stakeholders should begin with the creation over the next six months of one or more Catalytic Capital Facilities of minimum size.

Short-term fundraising

In the short term, roughly the next six months, the main potential sources of Catalytic Capital from HIC governments, multi-donor funds, and philanthropic foundations could include:

- A portion of the $63 billion of bilateral and multilateral funds provided annually to climate finance – See OECD 2021 Climate Finance Provided and Mobilised by Developed Countries Report.
- Some of the funding pledged at COP26.
- A portion of the $600 billion G7-led Partnership for Global Infrastructure and Investment.
- A portion of the commitments to multi-donor funds, such as commitments to Green Climate Fund (GCF), Global Environment Facility (GEF), Climate Investment Funds (CIF), and the Global Infrastructure Facility (GIF).
- A portion of the Special Drawing Rights created by the IMF in April 2022 in its Resilience and Sustainability Trust facility.
- Philanthropic foundations – this OECD Report estimates foundations allocate $9 billion per annum to EMDEs. 20% (e.g., $2 billion) per annum could be possible.

Medium-term fundraising

In the medium term, six months to two years, the most likely source of funds would be:

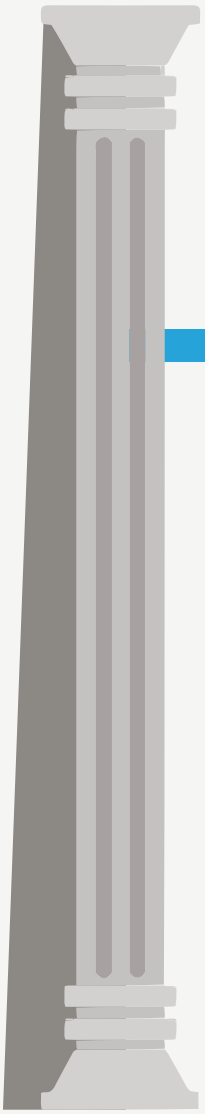
- A percent of ODA allocated for mobilization for the entire 2023-2030 period.
- A percent of developed country climate finance funds could be allocated for mobilization for the 2023-2030 period.
- A percent of the G7-led $600 billion Partnership for Global Infrastructure and Investment.
- Some repatriated and/or repurposed government funds and some of the donor funds contributed to the trust funds established at the MDBs (See Table 1.4). Convergence estimates there is almost $50 billion of donor funds, some of which has been idle/dormant for years. The World Bank Group (WBG) has the largest amount ($40 billion) in 50+ funds. A simple agreement between the donors and the WBG would free-up some funds to be repurposed as Catalytic Capital.

- A portion of International Development Association (IDA) funds allocated as Catalytic Capital for IDA-eligible countries.[32] For example, a portion of the $2.5 billion IDA Private Sector Window currently available exclusively to the WBG.
- MDB/DFI profits – possibly 33% of annual profits allocated to this pool. This approach is already used at IFC and EBRD (net income allocations).
- Unused MDB/DFI capital – if the MDBs/DFIs are not able to fully deploy their capital in development assets by [2025], the shareholders could re-direct excess capital to Catalytic Capital.
- Corporate contributions from financial institutions and real-economy companies.

Table 1.4: *List of MDB trust funds that could be repurposed as Catalytic Capital*

Source	Amount
World Bank Group	$40 billion
Asian Development Bank	$680+ million
African Development Bank	$500+ million
InterAmerican Development Bank	$740+ million
EBRD	$500+ million
Islamic Development Bank	$400+ million

32 Countries with less than $1,200 GDP per capita. See World Bank Group definition.



PILLAR 2:
MAKE MDBs & DFIs CATALYSTS OF MOBILIZATION

OBJECTIVE: Align MDB & DFI[33] objectives with the 2030 Agenda and a changed global economy.

HIGHLIGHTS

- MDBs and national DFIs have huge comparative advantages that should be fully realized to increase their contributions to climate objectives and SDGs.
- Shareholders should decide how to align and modernize MDBs/DFIs to the 2030 Agenda. The Action Plan identifies how shareholders could govern these organizations with KPIs.[34] These include arranging higher quantity and quality of financing, distributing as much exposure as practical to investors and optimizing their capital by holding assets with high financial additionality (e.g., higher development/climate impact and riskier assets than private investors are able or willing to hold).
- Many financial assets arranged by MDBs/DFIs (e.g., individual loans and equity investments) will have high risk beyond the fiduciary limits of most private investors, therefore these assets should be distributed to blended finance vehicles that de-risk and mobilize private investment.
- For tiered blended finance vehicles, MBDs/DFIs should invest in mezzanine investments alongside donor governments and philanthropic foundations in riskier junior positions – this will maximize private investment mobilization and optimize scarce Catalytic Capital.
- MDBs should collaborate in their private investment mobilization activities – each is too small to achieve scale, but scale can be achieved through collective action.
- The Action Plan identifies how existing capitalization of MDBs/DFIs, complemented by around $13.5 billion of Catalytic Capital per annum, can increase aggregate MDB/DFI investment and mobilization from around $160 billion per annum to $530 billion[35] (See Section 6).

The main MDBs were established starting in 1945. Since then, MDBs/DFIs have accumulated strong comparative advantages (e.g., financial arranging skills, engagement with governments, asset management, institutional capacities, and track records) required to achieve the climate objectives and SDGs after 50+ years arranging and investing in EMDEs.

33 The organizations collaborating to write the Action Plan have engaged with MDBs/DFIs to formulate the Action Plan, but have not asked staff or management of the MDBs or DFIs to endorse the Plan. Pillar 2 is drafted to reflect the ambition of the MDBs' "Billion to Trillions" 2015 report, fully aligns with their existing mandates/operations, does not require any capital increases or changes to their foundations documents, does not suggest they take on risks they are not already bearing on their balance sheets, and has been drafted to ensure the MDBs/DFIs can maintain their AAA risk ratings.

34 LIC and MIC governments could govern their national development banks with similar objectives and KPIs.

35 In general, MDBs could increase their annual financial commitment and balance sheets by a further 50% if the shareholders decided to govern them as "AA" rated versus "AAA" rated financial institutions. See Annex R for a brief comparison of the pros and cons of this approach.

However, since the time most MDBs/DFIs were established, there have been considerable changes in EMDEs and the global financial system. Public sector financial flows to EMDEs used to account for around two-thirds of all capital flows, but today the situation is reversed with private sector flows making up the large majority. Global financial assets have increased from around 125% of global GDP to over 400%, with around $410 trillion controlled by the private sector. Domestic financial markets in EMDEs have grown significantly in size and sophistication, presenting an opportunity to empower the developing world to chart its own responsible future through deeper financial integration

For many private investors interested in investing in EMDEs, but unfamiliar with the risks in these markets, partnering with MDBs/DFIs is an important risk mitigant. However, MDBs/DFIs pursue business models nearly identical to when they were established and have not been modernized for maximum alignment with the 2030 Agenda (see Annex J). Based on review of G7, G20, and other reports, it is clear the shareholders of these organizations want MDBs/DFIs[36] to play a more significant role in the 2030 Agenda. MDBs/DFIs could become catalysts of greater deal flow, larger investable portfolios, and private capital mobilization if the organizations are modernized and governed to prioritize these objectives.

Section 2 summarizes effective and efficient adjustments to MDB/DFI business models agreed by the organizations collaborating on the Action Plan to align with the 2030 Agenda and significantly increase total investment. The adjustments

- (i) Distill advice from a number of stakeholders, including a number of large private investor groups dedicated to global impact,
- (ii) Do not require any new capitalization of the MDBs/DFIs, and
- (iii) Leverage their existing comparative advantages.

The adjustments would create a more integrated public-philanthropic-private approach to boost climate and SDG investment. All recommendations are subject to the overriding caveat that MDBs/DFIs are first and foremost in the development business – therefore, all financial commitments must pass traditional development impact tests.

The Action Plan calls on MDB/DFI shareholders to establish strategic and operational KPIs (summarized in Section 2.9). MDBs'/DFIs' financial contributions would be through three types of financial commitments:

1. Originate and arrange financial assets in high demand by private investors, and distribute them to blended finance vehicles / investors.
2. Invest in mezzanine positions in blended finance vehicles (as outlined in Sections 1 and 3), leveraging scarce Catalytic Capital and creating significantly more investment assets that meet the fiduciary obligations of private sector investors.
3. Originate and arrange financial assets in low demand by investors, but having high financial and developmental additionality, and holding those assets on their balance sheets.

36 The section focuses on national DFIs owned by HICs and MDBs, but similar approaches are warranted for national development banks owned by LIC and MIC governments (e.g., Uganda Development Bank).

The first two commitments are designed intentionally to increase financial commitments in EMDEs and de-risk investment assets to within fiduciary limits for investors (e.g., reduce investment risk from "B" and "CCC" ratings to "BBB" and "BB" ratings) thereby allowing a far larger quantum of private capital to invest alongside MDBs/DFIs. They also leverage the accumulated structuring expertise of the MDBs/DFIs to create a larger universe of investments that would not be investable by the private sector on their own. Private investors often have a minimum investment amount (e.g., $50-100 million for institutional investors) that is routinely higher than the typical individual transaction in EMDEs. By aggregating multiple smaller transactions into larger portfolios, MDBs/DFIs can grow investor appetite while spreading risk across a wider number of transactions. The third action would fill critical market gaps in EMDEs where private sector interest is currently low, but where need and additionality are high.

2.1 IMPORTANCE AND COMPARATIVE ADVANTAGE OF MDBs/DFIs TO CONTRIBUTE TO THE CLIMATE OBJECTIVES AND SDGs

MDBs/DFIs are essential development channels to achieve the climate objectives and SDGs in EMDEs. Their accumulated expertise in evaluating and making investments with demonstrated impact in EMDEs is unparalleled, and their footprint and visibility make them critical actors and partners. The MDBs'/DFIs' comparative advantages are presented in Table 2.1. See Annex J for more analysis on the MDB/DFI business model, mobilization amounts and main statistics.

Table 2.1: *MDB/DFI strengths and comparative advantages*

MDB: Public sector operations	MDB: Private sector operations	DFI: Private sector operations
• Preferred Creditor Status for debt. • Strong track-record of arranging and managing public-sector loan portfolios with low losses – attractive to private investors. • Strong relationship with public sector authorities to pursue reforms. • Low-cost loans to reduce cost of financing and cost of implementing projects.	• Preferred Creditor Status for debt. • Strong track-record of arranging and managing private-sector loan portfolios with good returns – attractive to private investors. • Supporting Foreign Direct Investment. • Investing in the domestic financial sector.	• European DFIs have comparative advantage making equity investments – attractive to private investors. An example is Norfund, with 78% of development assets as equity and the majority in LICs and LDCs. • One shareholder makes for easy governance and operational changes.

The main MDB financing activity to date has been providing hard currency loans to public sector and private sector borrowers; these financial assets are in the highest demand by private investors. In addition, private sector investors highly regard the MDBs' asset performance and asset management skills and have shown a healthy appetite to co-invest in these assets. As a result, the MDBs are well-positioned to be a more effective channel to provide and mobilize the investment required to fund the SDGs and climate goals.

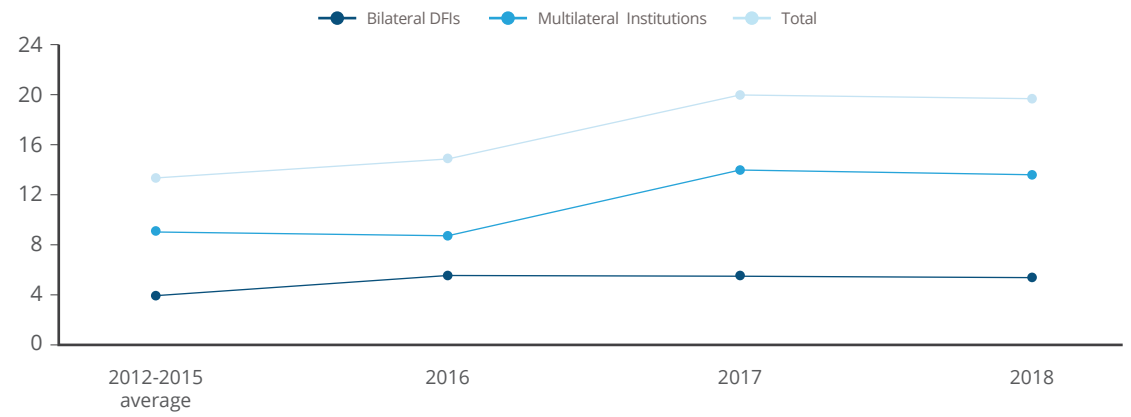
2.2 CURRENT MDB/DFI PRIVATE INVESTMENT MOBILIZATION ACTIVITIES

MDBs/DFIs self-report private investment mobilization in their annual Mobilization of Private Finance Reports (summarized in Figure 2.1 and Annex J). In the most recent edition for 2019, the MDBs/DFIs reported aggregate private direct mobilization of $20 billion. This annual amount has slightly increased between 2016-2019 from around $16 billion to $20 billion.

This continuing low level of mobilization, especially in contrast to the $4.5 trillion in SDG and climate investment needs in EMDEs, signifies that private investment mobilization continues to be a tertiary activity for the MDBs/DFIs. A review of the landmark Billions to Trillions: Transforming Development Finance 2015 Report concludes that very little progress has been made in the past seven years, with no clearly communicated objectives or targets for mobilization.

Even in 2022, MDBs/DFIs have established very few tangible mobilization objectives and targets. For example, the World Bank Corporate Scorecard indicates that private direct mobilization is a Tier 3 (of three) objective, and that the scorecard does not have a target/objective – the metric is only monitored. Further, the level of private direct mobilization reported for 2020 was $11.7 billion, equal to around 0.25% of climate and SDG investment needs in EMDEs. Section 2.9 recommends mobilization become a KPI for MDBs/DFIs so that rather than work in direct competition with private investors, the MDB/DFI system can shift to a more collaborative model to harness their resources and expertise.

Figure 2.1: *Aggregate MDB/DFI private investment mobilization*[37]



2.3 MDB INVESTMENT LIMITS TO ADHERE TO BIG 3 RATING AGENCY METHODOLOGIES AND AAA RATINGS

Several critical factors, described in Annex K, constrain the amount of investment possible by the MDBs. The hard limit for each MDB is effectively established by a combination of its balance sheet capital, the Big 3 Rating Agencies' methodologies, and the target risk rating for the MDB. An analysis of the Big 3 Rating Agencies' methodologies suggests:

- To maintain a "AAA" rating, the maximum leverage of MDB's balance sheet equity is generally between 4-7 times (4 times for MDBs extending finance to the private sector like IFC, and 6-7 times for MDBs extending finance to the public sector like IBRD). The total maximum potential development assets the main MDBs could hold on to their balance sheet as per this methodology, confirmed by the rating agencies methodologies, is around $2.1 trillion. They currently hold around $721 billion – an actual to potential development assets ratio of only 35% (see Annexes J and K).

37 Source: 2021 Overseas Development Institute (ODI) Report: "Development finance institutions: the need for bold action to invest better", Authors' calculations for figure based on OECD data and MDB Mobilization of private finance report (IFC, 2019).

- Based on reasonable conservative assumptions (e.g., average life of typical financial commitment), this total balance sheet capacity translates into around $250 billion of annual potential financial commitments compared to current annual commitments of about $140 billion.
- If shareholders targeted an "AA" rating instead of "AAA", MDBs could provide even more finance without requiring capital increases – an additional 50% of investment annually or another $125 billion in commitments per year.

2.4 MDBs/DFIs SHOULD FULLY DEPLOY THEIR CAPITAL IN DEVELOPMENT ASSETS

MDBs systemically under-deploy their capital as shown through numerous development and academic articles. One of the most straightforward recent studies is the ODI's April 2020 All hands on deck: how to scale up multilateral financing to face the Covid-19 crisis report; see highlights reproduced in Annex J. The report describes how the MDB community on average deploys only around 40% of its balance sheet capital in development assets.

The Action Plan recommends shareholders require the MDBs to deploy their capital as much as possible in development assets, adhering to Rating Agency constraints, to fulfill their development mandates. For example, a KPI for MDBs/DFIs could be that 90%+ of balance sheet capital be deployed in development assets. All other things equal, this could lead to a 100% increase in MDB/DFI annual development finance commitments. That is, an extra $110 billion of MDB/DFI investment (net) commitments annually without any additional capital from shareholder governments.

2.5 MDBs/DFIs SHOULD PURSUE HIGHER PRIVATE INVESTMENT MOBILIZATION AS A CORE, PRIMARY ACTIVITY

Based on the reports listed above, including the annual MDB Mobilization Report, private investment mobilization by MDBs/DFIs has been a secondary or tertiary objective and has been stagnant around $20 billion annually over the past five years. Private investment mobilization is around 15 cents for every $1 of MDB/DFI investment and around 40 cents for every $1 of MDB/DFI investment for private sector operations. It is close to zero for public sector operations.

The MDBs' strongest comparative advantage is arranging and managing hard currency senior loans in developing markets in which private investors have strong appetite to invest but are hesitant because of high country risk. For this asset class, MDBs should be governed as mobilizers of private investment, using their accumulated expertise to originate and arrange senior loans that can be transferred to private investors. This practice will free up MDB/DFI financial and human resources to take on the investment assets that present the highest levels of financial additionality in EMDEs, while concurrently crowding in private investors into riskier EMDEs where they are more comfortable investing alongside a proven, experienced MDB/DFI partner.

Table 2.2 summarizes MDBs'/DFIs' main development assets. Current mobilization ratios of only 0.15 significantly under-represent the mobilization potential. For example, the IFC-Sida Managed Co-Lending Portfolio Program Infrastructure produced an excellent 9:1 ratio of private sector investment to Catalytic Capital.

Table 2.2: *MDB/DFI development assets: Ability to mobilize private investment*

Asset	MDB: Private sector operations	DFI: Private sector operations	Comment
Public sector (sovereign) loans	Low as per current approach, but high as advocated in Section 2.6. High in blended finance vehicles.	NA	Subsidized interest rate on sovereign loans is far below market interest rates. Returns are not attractive for private investors. Loan tenors are very long relative to market practices. See Pillar 3 or description on how to mobilize private investment into MDB public sector loans.
Hard currency loans to private sector borrowers	High	81%	MDBs/DFIs state they price these loans at or close to market terms. MDBs/DFIs report high net interest margins, reasonable default rates, and low losses. Most attractive asset class for private investors.
Local currency loans to private sector borrowers	Medium	6%	Few investors are interested to take open currency risk. MDB/DFI origination of local currency loans is low.
Direct equity investments	Low - Medium	6%	Expected and actual rates of return often below private investors' expectations and requirements. Some (e.g., IFC and UK BII) could likely mobilize.
Portfolio (fund) equity investments	Medium - High	6%	MDBs/DFIs participate on same terms as other market investors (e.g., general partners and limited partners). In principle, could attract private investment.
Other		1%	

The Action Plan estimates the main MDBs/DFIs could arrange $390 billion of investment assets each year. They would retain around $185 billion on their balance sheets and transferring around $205 billion to blended finance vehicles that would mobilize private sector investment and spur local ecosystems in the developing world to create more investable projects to meet investor demand.

2.6 MDBS/DFIS SHOULD COLLABORATE TO CREATE LARGE, BLENDED FINANCE VEHICLES THAT WILL MOBILIZE PRIVATE INVESTMENT AT SCALE

The most relevant precedent of an MDB mobilizing at scale is the IFC-Sida MCPP Infrastructure Program, which successfully raised $1.5 billion of private investment from Axa, Allianz, and Prudential/ East Spring by using a portfolio strategy to bundle many projects, reduce risk, and achieve scale. Subsequent to the successful fundraise of that program, many investors have asked for the program to be replicated by the IFC or other MDBs.

The indicative funds described in Flows A-D in Tables 6.1 and 6.2 take that well-received IFC-Sida program structure and scale it up in the following ways:

- In principle, replicate the IFC-Sida program into an open platform in which all MDBs/DFIs would arrange A-B loans to private sector borrowers and transfer the B-loans to blended finance funds, recycling public capital continually so it can be re-deployed as private capital is crowded in.
- Fully harness the most significant comparative advantages of MDBs/DFIs, namely their ability to originate, arrange, and package investable deals across all sectors and all EMDEs.
- Create standardized investment assets to meet the demand from private investors for investment assets arranged by MDBs/DFIs. This simultaneously addresses both supply and demand by increasing the supply of investable assets and portfolios of assets while accelerating appetite by reducing investment risk.
- Maximize the leverage of donor governments' Catalytic Capital, resulting in leverage ratios of potentially 16 times (versus current leverage ratios around 4 times).
- Procure formal risk ratings from the Big 3 Rating Agencies for all notes issued by the envisioned funds – indicatively "BBB" for the Senior Notes, "B" for the Mezzanine Notes and "CC" for the Junior Notes.
- Develop a standardized approach that reduces uncertainty and increases liquidity for investors, creating a demonstration effect for all future blended finance vehicles and their risk ratings.
- Produce publicly listed and publicly traded notes that open investment to all investors globally, increasing transparency and liquidity.
- Allow noteholders, including donors invested in Junior Notes and MDBs/DFIs invested in Mezzanine Notes, to eventually sell their notes to private investors at fair market prices, recycling public capital for further use.
- Reduce the need for MDB/DFI shareholders to continually replenish their capitalization, since significantly higher volumes of loans will be directly funded by the private sector and not weigh down MDB/DFI balance sheets.

2.6.1 MDBs/DFIs SHOULD INVEST IN MEZZANINE INVESTMENTS OF BLENDED FINANCE VEHICLES TO CREATE FIDUCIARY INVESTMENT ASSETS

As discussed in Section 1, the fiduciary obligations of most private sector debt investors require Investment Grade risk (i.e., "BBB" or better) or strong Non-Investment Grade risk (e.g., "BB"). But the risk profile of most debt investment opportunities in most EMDEs will be much lower: median sovereign risk rating is "B-" and the majority of debt investment opportunities will have implied risk ratings of "B" and "CCC".

As identified in analysis of 750+ blended finance transactions, tiered blended finance vehicles with around 80% senior capital and 20% subordinated capital create fiduciary investment assets that mobilize private investors into the senior positions. However, there is not enough concessional Catalytic Capital to mobilize private investment at scale at only a 4:1 ratio. MDB/DFI investment in mezzanine positions[38] of three-tiered blended finance vehicles alongside junior Catalytic Capital positions will maximize the benefit and leverage of donor governments' Catalytic Capital, thereby allowing scarce donor funds to achieve around a 16-times mobilization ratio compared to typical 4-times currently. The resulting risk profile of the mezzanine investments in debt vehicles is expected to be "B" or "CCC", fully consistent with MDB's mandate from their shareholders.[39]

The Action Plan identifies that around $45 billion of MDB/DFI mezzanine investments, combined with $13.5 billion of donors' concessional Catalytic Capital, would be required to create around $286 billion of fiduciary investment assets for the private sector.

2.7 MDBs/DFIs SHOULD PURSUE HIGHER FINANCIAL ADDITIONALITY

Financial additionality is a centerpiece of development finance that is well described in the MDB's Harmonized Framework for Additionality on Private Sector Operations 2018 Report and summarized in Box 2.1.

Box 2.1: *Financial additionality for MDBs*

The 2012 Principles to Support Sustainable Private Sector Operations define additionality as follows:

"MDB support of the private sector should contribute that which is beyond what is available, or that which is otherwise absent from the market, and should not crowd out the private sector. The shared principle of additionality often delivers, among other things:

- Financing that is not provided by the market
- Risk mitigation and/or risk sharing
- Improved project design
- Better development outcomes
- Environmental, social, and governance standards

KEY TAKEAWAYS

- Financial additionality is central to the engagement of MDBs with the private sector. All MDBs apply the concept of additionality to their private sector operations.
- For most MDBs, additionality is included in founding charters, articles of agreement, key operating principles, or strategy documents.
- In 2012, MDBs endorsed five common principles which aim to guide their engagement with the private sector to achieve development goals consistent with their mandates. The first of these principles is additionality, reflecting the centrality of this concept in MDB operations. The other principles are crowding in, commercial sustainability, reinforcing markets, and promoting high standards.
- Additionality is an important aspect of determining MDB value addition in a private sector operation, and MDBs should always seek to provide financial and/or non-financial additionality.
- These principles were reinforced in the 2013 DFI Guidance for Using Investment Concessional Finance in Private Sector Operations and the 2017 Enhanced Principles for Blended Finance.

38 MDBs/DFIs usually subscribe to the same senior tranche as private investors, resulting in the need for a very large junior tranche of donor Catalytic Capital to mobilize private investors – the three-tier approach is much more effective and efficient.

39 And consistent with MDB's current risk profile – IFC's average loan risk rating is "B".

In Annex K, the authors provide a subjective assessment of the relative financial additionality of MDB/DFI financing commitments in EMDEs, primarily using the first point in Box 2.1: Financing that is not provided by the market. For example, local currency debt, mezzanine capital, and equity are under-supplied in EMDEs and critically needed by businesses and projects alike. However, those assets represent less than 15% of MDB/DFI aggregate assets, with the other 85% in hard currency loans.

MDB/DFI financing in hard currency exposes the unhedged borrowers and LIC and MIC governments to significant FX risk, and exacerbates debt sustainability challenges; see Annex S for analysis. MDBs/DFIs should endeavor to maximize the percentage of their debt in local currency, and maximize private sector investor participation in hard currency loans (in high demand by investors).

Using the Financial Additionality levels described in Annex K, reasonable financial additionality KPIs could include a minimum of 50% of capital deployed in high financial additionality assets.

2.7.1 MDBs/DFIs SHOULD INCREASE FINANCING IN LICs AND LMICs

More than 85% of the value of MDB annual financial commitments and balance sheet exposure is for MICs, with UMICs representing more than 50%. Reasonable KPIs to ensure a healthy level of support for LICs and LDCs, and manage against an over-concentration in UMICs, could include a minimum of 35% of capital to support exposure in LICs and LDCs, and a maximum of 30% of Capital to support exposure in UMICs.

2.8 MDBs/DFIs SHOULD STRONGLY SUPPORT DOMESTIC FINANCIAL INTERMEDIATION IN EMDEs

A major challenge to climate and SDG investment is the systemic lack of finance for projects that are less than $10 million. These amounts should be provided by a more robust domestic financial intermediation function that also improves domestic capital markets.

Domestic financial intermediation in EMDEs is much narrower and shallower than in HICs. Deeper, broader, and more robust financial intermediation must be supported in EMDEs if they are to gain the tools to advance their own development journey responsibly. At the same time, MDBs/DFIs have significant comparative advantages for investing in local financial sectors. A reasonable KPI is for a minimum of 20% of Catalytic Capital to be deployed to support domestic financial intermediation.

See Pillar 5 or a deeper analysis of the critical impact of strengthening domestic financial intermediation.

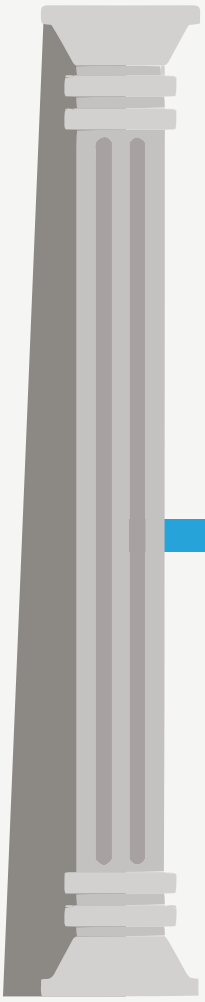
2.9 MDB/DFI PROPOSED KPIs

Shareholders of MDBs/DFIs should govern these organizations with KPIs, suggested in Table 2.3 below, to maximize their financial contributions to climate objectives and SDGs in EMDEs and accomplish the objectives outlined in the Action Plan. The KPIs are expected to lead to a significant increase in investable pipeline and total climate and SDG investment to around $530 billion, as summarized in Tables 6.1 and 6.2.

Table 2.3: *Proposed KPIs to align governance of MDBs/DFIs with the 2030 climate and SDG investment agenda*			
	Objective	**Metric**	**Expected impact**
Priority objectives aligned to total commitments and mobilization: Targeting a significant increase (double+) amount of provided and mobilized finance			
A	Increase annual business volume commitments	Minimum increase in financial commitments from 2019 levels: i. 50% by 2023, ii. 100% by 2024, and iii. 200% by 2028.	Increase MDB/DFI annual financial commitments from around $140 billion currently to $420 billion per annum by 2028. The total commitments of around $420 billion would be beyond the MDBs'/DFIs' current balance sheet capacity estimated at around $250 billion annually – thereby obligating them to act as true mobilizers: transferring the extra $170+ billion to private investors and creating both investable pipeline and scale level mobilization.
B	Maximize deployment of shareholders' equity in development assets	Minimum 90% of capital[40] deployed in development assets.	Will double annual financial commitments and double/triple portfolio of development assets.
C1	Increase private investment mobilization by crowding in the private sector to share and spread risk	Target 1:1 public : private ratio of public sector A-B loans. Target 1:3 public : private mobilization ratio of private sector loans.	Double the amount of public sector loans – doubling public sector investment. Quadruple the financial volume of commitments to private sector.
C2		Minimum of 20% of Capital deployed in Mezzanine Investment (in blended finance vehicles mobilizing private investment).	Drives the creation of investable asset portfolios for the private sector, maximizing their participation and driving deal pipeline. Levers donor governments' scarce Catalytic Capital. A main driver for increasing aggregate climate and SDG investment from around 3.5% of actual investment needs to 10-12%.
Secondary objectives aligned to higher financial additionality and general climate and SDG investment needs			
D1	Increase financial additionality of development assets	Minimum 35% of Capital deployed in LICs and LDCs.	Increase investment in LICs and LDCs beyond current low levels.
D2		Maximum 30% of Capital deployed in UMICs.	Reduce the amount of Capital holding UMIC assets – leads to UMIC assets transferred to blended finance vehicles.
D3		Minimum 50% of Capital deployed in high financial additionality assets.	Increases investment in assets with high financial additionality, such as equity, local currency loans, and mezzanine investments in blended finance vehicles.
E1	Optimize key sector support	Minimum 35%[41] of Capital deployed in climate finance assets.	Ensures a healthy percent of capital supports Paris Agreement objectives. Should lead to easily achieving the $100 billion annual Climate Finance Delivery Plan.
E2		Minimum of 20% of Capital deployed in domestic financial intermediation.	Ensures a healthy percent of Capital supports domestic financial sector improvement.

40 Capital is defined as balance sheet shareholders' equity. The Big 3 Rating Agencies each have a different methodology to calculate the amount of capital required by an MDB to hold portfolios of assets. Fitch has the easiest to understand. Annex K describes Fitch's capital adequacy approach and showcases how the KPIs could transform an indicative balance sheet for the IFC.

41 In its Climate Change Action Plan published in 2021, the one tangible climate finance commitment made by the WBG is "achieving 35 percent in climate finance for the entire WBG, as an average over the five years 2021-25." The 35% of Capital uses the 35% metric, but expands it to advocates that 35% of the WBG's balance sheet capital should be deployed in development assets for climate finance, as opposed to simply 35% of annual flows.



PILLAR 3:
MAXIMIZE INVESTABLE PIPELINE & IMPACT THROUGH MORE INTEGRATED DEVELOPMENT FINANCE & CLIMATE FINANCE SYSTEMS

OBJECTIVE: Optimal deployment of Catalytic Capital in conjunction with MDB/DFI and private sector investment.

HIGHLIGHTS

- The most important ingredient to significantly increase climate and SDG investment in EMDEs is Catalytic Capital that de-risks investment opportunities and creates fiduciary investment assets that mobilize private sector investment.
- Catalytic Capital will likely be systemically under-supplied relative to the need; therefore, it should be optimized through collaboration in a Catalytic Funding Network.
- As a public good, Catalytic Capital should be awarded to the best mobilization ideas sourced globally through competitive calls for proposals.[42]
- The Action Plan identifies five critical use cases for Catalytic Capital, and identifies how to award this funding for optimal results.
- Catalytic Capital should prioritize creating publicly listed and traded investment assets. This will open investment in EMDEs to virtually all investors globally, and over time, increase the supply of capital and decrease the cost of capital.

Section 3 focuses on the "how" of mobilization—the most optimal approaches for providers of Catalytic Capital, MDBs/DFIs and private investors, to collaborate with three intentions:

(i) Increase climate and SDG investment with high development impact, climate impact, and financial additionality;

(ii) Create investable projects, investment assets, and portfolios of investment assets to attract private investment at scale; and

(iii) Maximize the benefit of a limited amount of Catalytic Capital.

The solutions advocated in Section 3 stem from recommendations provided by investors and experts in leading mobilization and blended finance reports published in 2021-2022, and several years of blended finance workshops bringing together many public and private stakeholders.

42 Akin to auctioning scarce Catalytic Capital to best uses.

3.1 COORDINATION AND FUNDING TO INCREASE THE NUMBER OF COMMERCIALLY INVESTABLE PROJECTS

Financial arrangers of individual loans and equity investments in EMDEs can only invest in projects, companies, and financial institutions that represent acceptable commercial risk, and fit within their fiduciary risk limits. However, the large majority of debt investment opportunities are perceived by financial arrangers as commercially uninvestable or near-investable – falling short of the fiduciary need to be commercially investable. And even when assessed to be commercially investable, given perceived high country risk in EMDEs (e.g., median "B-" sovereign ratings from Big 3 Rating Agencies) and country risk ceiling convention, those commercially investable projects will have implied risk ratings of "B" and "CCC", beyond the fiduciary risk limits of most debt investors. MDBs/DFIs and providers of Catalytic Capital must collaborate with governments and the domestic and global private sector to increase the universe of commercially investable projects.

The Action Plan is explicitly designed to concurrently increase the universe of commercially investable projects and increase the supply of total and private investment to those commercially investable projects. The Action Plan envisions allocating Catalytic Funding to five core activities that contribute to creating commercially investable projects:

1. Award Catalytic Grants to project preparation facilities, conditional on the managers of those facilities being subject to ensuring a strong percent of the projects achieve commercial investability and attract financing.
2. Award Catalytic Funding to project developers who develop projects to become commercially investable.
3. Allocate Catalytic Grants to LIC and MIC governments to support project preparation implementation teams.
4. Award Risk-Reduction Catalytic Capital to project-level risk mitigation solutions.
5. Exceptionally, commit Low-Cost Catalytic Capital for important climate mitigation and climate adaptation projects to enhance affordability (e.g., renewable power projects to compete with fossil fuel projects).

Public sector Catalytic Funding from LIC and MIC governments should be allocated to these five core activities. This will ensure those funds are deployed towards increasing the universe of commercially investable projects in that government's country. Indeed, ODA funds could be supplied to LIC and MIC governments, who in turn would use them to create a large universe of investable projects.

3.2 ALLOCATING CATALYTIC CAPITAL COMPETITIVELY TO THE BEST PROPOSALS GLOBALLY

Table 3.1 identifies how to allocate Catalytic Capital optimally to achieve maximum value for money. Experts agree Catalytic Capital should be awarded to the best proposals based on competitive calls for proposals. The process is akin to an auction to identify which mobilization or blended finance proposals can achieve the maximum development and/or climate impact and mobilize the highest amount of private investment using the least amount of concessional Catalytic Capital. Evidence over

the past five years clearly indicates that (i) private sector financial arrangers, project sponsors, asset managers, and investors and (ii) public sector MDBs/DFIs and NDBs, project sponsors, and financial arrangers have many great ideas for this scarce resource, and an auction-like process will ensure that the best ideas get funded.

Box 3.1 provides a summary of how the $672 million Blackrock Climate Finance Partnership, a blended finance equity fund, was supported by blended finance from inception and was able to mobilize (after three years of development) more than $530 million of private sector investment to climate in EMDEs. Convergence could list more than 150 of such transactions, but the median transaction size of those transactions is only $65 million, with very low amounts of private investment mobilized. Unfortunately, the Climate Finance Partnership is a rarity, as very few blended finance vehicles have raised more than $500 million of private investment.

For purposes of clarity, all uses of Catalytic Capital by donor governments in blended finance should adhere to the five OECD Blended Finance Principles. As example, they should include analytical process and benchmarking to ensure:

1. Strong development impact and/or climate impact.
2. Strong financial additionality.
3. Minimum concessionality – Catalytic Capital should be deployed to mobilize private investors to make an investment they would otherwise not be able/willing to make (e.g., financial additionality) and not to subsidize private investors.

***Box 3.1:** Blended finance vehicle funded through competitive calls for proposals – Blackrock Climate Finance Partnership*

At COP26 in November 2021, Blackrock announced the successful financial close of the $673 million Climate Finance Partnership – a blended finance private equity fund with two tiers of capital:

i. $130 million in Catalytic Capital from France, Germany, Japan, and four foundations that mobilized
ii. 18 private investors.

Blackrock expects that the fund will invest in 15+ climate projects in EMDEs.

The project received seed funding in April 2019 to help develop the project towards first close 2.5 years later, with the funding awarded through two competitive calls for proposals: the Global Affairs Canada – Convergence Global Emerging Markets Design Funding Window and the David & Lucile Packard Foundation.

A good current example of several donor governments and philanthropic foundations collaborating to award Catalytic Funding to best proposals assessed through a competitive call for proposals is the SDG Impact Finance Initiative Design Funding Window. Objectives, eligibility criteria, assessment criteria, and amounts are clearly communicated, and grants are awarded to the winning proposals as determined by a professional investment committee.

Table 3.1 identifies the five most important use cases of Catalytic Capital. The Action Plan estimates a total of $13.5 billion of Catalytic Capital annually could serve as the foundation for total climate and SDG investment of $530 billion annually.

Table 3.1: *Awarding Catalytic Capital to mobilize private investment through competition (aligned to Table 1.3)*			
Use Case	**Investment channel in EMDEs**	**Indicative organizations expected to submit proposals for Catalytic Capital**	**Description of how to award Catalytic Capital transparently, fairly, and with maximum value-for -money**
1	**Project-level risk mitigation:** Catalyze loans and equity investments arranged by private sector and MDBs/DFIs	Financial arrangers, domestic and cross-border MDBs/DFIs Insurance brokers: e.g. Texel and Tysers	Catalytic Capital for this use case should be awarded competitively through calls for proposals akin to an auction. There are many examples of project-level risk mitigation, including MIGA's credit and political risk guarantees, GuarantCo's guarantee products and Africa Guarantee Fund's guarantees. While these entities mitigate project-level risk, they all manage larger regional and global portfolios of aggregated projects. Catalytic Capital could be awarded to market-led entities that can provide more comprehensive project-level risk mitigation that mobilize private investment at the project level. Catalytic Capital should be awarded to support solutions that can leverage balance sheets and aggregate portfolios, replicating mitigation across many projects - like the Green Guarantee Company that would provide guarantees to a portfolio of green bond issuances and loans across the developing world. Over the past five years, the insurance market has increased its interest and participation in investment mobilization and blended finance. The available capital in the insurance market is considerable and many insurance products can be tailored to specific climate risks such as crop failures and other climate events. In November 2022, Convergence, Tysers, and Texel will publish a report that identifies the potential of this market. This pool for Catalytic Capital is likely to spawn many new blended finance solutions that improve project and portfolio-level risk.
2	**Portfolio-level risk mitigation for loans to private sector borrowers:** Catalyze loans arranged by MDBs/DFIs and private sector financial intermediaries	MDBs/DFIs: e.g., IFC, EBRD, AsDB, AfDB, IsDB, IDB Invest, US DFC, European DFIs Financial Arrangers: e.g., Société Générale, Bank of America, HSBC, Natixis, Standard Chartered Bank, Ecobank, Cordiant Capital, Blue Orchard Asset Managers	Catalytic Capital for this use case should be awarded competitively through calls for proposals akin to an auction. Catalytic Capital awarded for Use Case 2 could be open to all potential portfolio-level solutions proposed by MDBs/DFIs, financial institutions, intermediaries, asset managers, and asset owners who are interested to originate, arrange, and invest in senior loans.[43] The availability of this sub-pool of Catalytic Capital will also attract new market entrants into both i. the origination/arrangement of loans and ii. committing capital to the blended finance vehicles. Providers of Catalytic Capital should ensure one or more of the vehicles be publicly listed, like the MDB/DFI-led funds described in Section 2.6, creating liquidity, a broader investor base, transparency, and lowering risk. Based on feedback from asset managers and investors collaborating on this Action Plan, there is an expectation that blended finance vehicles and funds proposed under Use Case 2 will have a geographic and/or sector focus. That is, although diversification in portfolio vehicles is a significant benefit, it is likely easier to mobilize debt investors by region (e.g., Sub-Saharan Africa) or theme (e.g., renewable energy). This caveat is also relevant for Use Case 3.

43 If MDB/DFI shareholders move forward with the large funds identified in Section 2.6, and donors provide the Catalytic Capital required to make those funds successful, then MDBs/DFIs would not need access to any more Catalytic Capital for Use Case 1.

Table 3.1 (Continued...)			
Use Case	**Investment channel in EMDEs**	**Indicative organizations expected to submit proposals for Catalytic Capital**	**Description of how to award Catalytic Capital transparently, fairly, and with maximum value-for -money**
3	**Portfolio-level risk mitigation for equity investments to private sector (and PPP) projects, companies, and financial institutions:** Catalyze investments arranged by private sector and MDBs/DFIs	Asset Managers: e.g., Blackrock, TPG, Carlyle, CVC, KKR MDBs/DFIs: e.g., IFC, EBRD, IDB Invest, US DFC, European DFIs	Catalytic Capital for this use case should be awarded competitively through calls for proposals akin to an auction. Catalytic Capital awarded for Use Case 3 should be open to all MDBs/DFIs, financial institutions, intermediaries, asset managers, and asset owners who are interested to originate, arrange, and invest in equity and quasi-equity investments. The impact of this sub-pool could be highly catalytic to bring top-tier fund managers to developing country ecosystems that systemically lack credible intermediaries that can originate, develop, and finance credible transactions. A good recent example is the Blackrock Climate Finance Partnership – a blended finance fund with an 80:20 capital structure of private dollars to public. The Climate Finance Partnership was able to attract BlackRock as the fund manager around the time the French and German governments committed to provide Catalytic Capital (the Japanese Government and two foundations subsequently committed Catalytic Capital as well).
4	**Portfolio-level risk mitigation for loans to public sector borrowers (sovereign and sub-sovereign):** Catalyze loans arranged by MDBs	MDBs only: e.g., IBRD, ADB, AfDB, IsDB, IADB	Catalytic Capital for this use case should be collaboratively co-designed by donor governments, MDBs/DFIs, and investors. See Section 2.6. If MDB shareholders decide not to pursue the A-B loan program for public-sector projects advocated in Section 2.6, then there would be no need for Catalytic Capital for Use Case 4 and the funds could be allocated to other use cases.
5	**Currency risk mitigation:** Catalyzes loans and equity investments arranged by private sector and MDBs/DFIs	Financial arrangers, investors, asset owners, asset managers, MDBs/DFIs	Catalytic Capital for this use case should be awarded competitively through calls for proposals akin to an auction. TCX is the best-known blended finance vehicle to mitigate currency risk. TCX has a balance sheet capitalization of around $1.4 billion and arranges around $2 billion of currency swaps annually. A limited amount of Catalytic Capital earmarked for FX risk is expected to stimulate a large number of innovative solutions and products to address this major developing market risk.

3.3 ALLOCATING CATALYTIC CAPITAL TO SUPPORT MDB/DFI LOAN PORTFOLIOS (USE CASE 4)

Section 2.6 describes good examples of allocating Catalytic Capital in collaboration with MDBs/DFIs to mobilize private investment to portfolios of B-loans arranged by MDBs/DFIs. If MDB/DFI shareholders do not implement KPIs that require them to arrange significantly higher volumes of loans, then the Catalytic Capital for the funds proposed in Section 2.6 would not be required and all Catalytic Capital could be awarded to support loans and equity investments arranged by the private sector.

3.4 DEPLOYING CATALYTIC CAPITAL TO ACHIEVE SCALE MOBILIZATION

Convergence's State of Blended Finance 2021 Report found that the median size of blended finance vehicles was $65 million over the past five years. Extensive feedback from global institutional investors indicates their minimum target investment size is typically $50-100 million. A Convergence study found that very little investment has been mobilized from institutional investors for many reasons, including small transaction sizes.

The development finance and climate finance system must increase average blended finance transaction sizes to attract institutional investors. Based on feedback from investors, the development community should deploy a healthy amount of Catalytic Capital to create blended finance vehicles of $500+ million in size. For example, the IFC-Sida MCPP Infrastructure Program attracted $1.5 billion of commitments from three investors – each allocating $500 million – and the Blackrock Climate Finance Partnership attracted $500+ million of private investment. But both transactions are unicorns that are the exceptions rather than the norm.

In general, there are two ways to award Catalytic Capital in Use Cases 1-4 to achieve blended finance vehicles of more than $500 million:

1. Support individual interventions in which the aggregate facility size is $500+ million. Examples include the IFC-Sida MCPP Infrastructure transaction, the Blackrock Climate Finance Partnership, Climate Fund Managers' Credit Fund, and Allianz Global Investors' Emerging Market Climate Action Fund.
2. Support innovative "aggregation" structures that combine individual transactions or portfolios into larger groupings that spread risk across many deals and achieve the scale to attract investors. This approach has the added benefit of creating investable deal flow from the supply side by aggregating single transactions that cannot mobilize investment on their own (too small) into larger portfolios that spread and lower risk across an investable portfolio of projects. Examples include Bamboo Capital's SDG 500 Fund, a $500 million macro "fund of funds" that raises funds to be injected into six smaller blended finance vehicles – each around $100 million. This "aggregation" approach can produce results that benefit all parties:
    - i. A donor can allocate its development funds to a small vehicle that pursues specific development impact results.
    - ii. The fund manager of the macro aggregation fund could be a traditional, mainstream fund manager that will attract larger investors (e.g., one of the Top 50 global asset managers, like Blackrock).
    - iii. Institutional investors are able to invest in the larger $500 million facility to meet their minimum investment criteria.
    - iv. The fund manager of the micro fund making investments in EMDEs would usually be an "impact" fund manager with experience in impact investing in EMDEs.

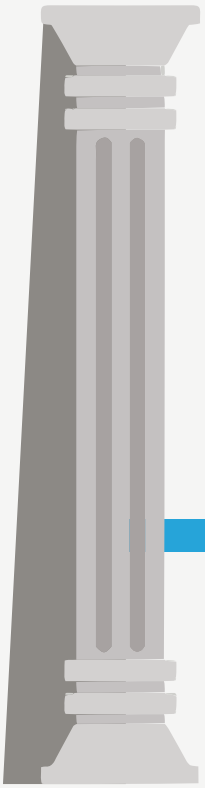
3.5 BLENDED FINANCE TO CREATE PUBLIC MARKETS INVESTMENT ASSETS

Public markets are deeper than private markets and are considered more transparent by investors. To date, almost all development finance, blended finance, and mobilization transactions have been completed in private markets, which limits the scope of potential investors. Experts agree on the need to increase the number of blended finance and mobilization transactions completed in public markets. This will open up participation to a greater number of prospective private sector investors, broadening the investor base. The Action Plan includes specific actions to increase investment transacted in public markets – both in EMDEs and international capital markets – to provide more standardization, transparency, and access for investors.

The UK FCDO Mobilist Program and the USAID INVEST initiative are good examples of development community and blended finance initiatives producing investment products that meet the investment asset requirements of mainstream private investors. As an example, in December 2021, MOBILIST provided an anchor investment to support the successful listing of the Thomas Lloyd Energy Impact Trust on the London Stock Exchange. Unfortunately, this transaction continues to be a unicorn in the blended finance/mobilization investment world.

The Action Plan was designed to support blended finance vehicles that create investment assets that can be listed in public markets as follows:

- When allocating Catalytic Capital, the providers of Catalytic Capital and the investment committee should prioritize vehicles that can be publicly listed.
- The blended finance funds described in Sections 2 and 3 could be listed on one or more exchanges. For debt vehicles, this would lead to the senior notes, mezzanine notes, and junior notes being formally rated and formally traded in secondary markets.
- A good portion of the Catalytic Capital described in Section 2 (in partnership with MDBs/DFIs) should be awarded to support mobilization in the public markets.



PILLAR 4:
PROVIDE INVESTORS ACCESS TO THE BEST INVESTMENT DATA & MOBILIZATION RESOURCES THROUGH AN INVESTMENT MOBILIZATION HUB

OBJECTIVE: Create a centralized Investment Mobilization Hub for investors that contains the best investment data and mobilization resources.

HIGHLIGHTS

- Many private investor groups identify poor access to data, information, Catalytic Funding sources, and investment assets as significant barriers to investing in unfamiliar EMDEs.
- The Action Plan calls for the creation of a centralized Investment Mobilization Hub to increase investor knowledge and investor access to investment assets available in EMDEs.
- The Hub could be established and curated by a Hub Manager whose main KPI is to increase private sector sustainable investment in EMDEs.

4.1 AVAILABILITY OF BEST INVESTMENT AND MOBILIZATION DATA AND INFORMATION

The transaction-centric work in Pillars 1-3 alone will not lead to the level of mobilization required to achieve the Global Goals. It must be paired with a shift in investors' risk perceptions of EMDEs. That change can be accelerated by curating and making available the best available information and data. See Annex L for more details.

More than 200 large investors interested in sustainable investing and climate action in EMDEs have written about the critical importance of credible data when evaluating investments in riskier, more opaque markets outside their comfort zones. Investors' requests for better investment data are clearly described in three reports published in late 2021 and replicated in Box 4.1. In the absence of reliable data, which is endemic in EMDEs, investors typically default to the sovereign risk rating of the country(ies) they are investing in, using it as a proxy for country risk and avoiding Non-Investment Grade countries, which accounts for 88% of EMDES. Investors advise this reality will not change without greater availability of reliable investment data that investors can use to evaluate and benchmark risk.

Box 4.1: *Private investor groups' recommendations to improve risk-return data for investors (key excerpts)*

Global Investors for Sustainable Development Alliance (30 investors and companies)

Increasing private finance mobilization: Recommendations for development banks and the global development community (October 2021)

The challenge:
Investors have limited access to data of investment performance – both debt and equity – in EMDEs. Most credit rating agency reports aggregate debt investment in developed countries with debt investment in EMDEs, which is not very helpful when assessing EMDEs only.

Recommendations:
The GISD Alliance recommends that the global development community consolidate key data/knowledge of investing in EMDEs and make this data/information available to investors universally. A non-exhaustive list includes:

- Broaden the Global Emerging Markets (GEMS) database for MDB/DFI senior loan track record (i.e., default rate, recovery rate) to private sector borrowers in EMDEs – good data for risk, defaults, and losses.
- Develop similar information for direct equity and portfolio/fund equity investments.
- Expand reporting on impact and transparency and ensure that blended finance facilities strengthen the quality of monitoring, evaluation, and, ultimately, sustainable development impact.
- Ensure that further work on standards and measurement tools can be supported by joint initiatives between MDBs/DFIs and the private sector.

Net-Zero Asset Owners Alliance (200+ organizations; $60+ trillion AUM)

Scaling Blended Finance Report (November 2021)

The challenge:
Lack of data transparency. The development community typically assesses the perceived investment risk in EMDEs to be higher than the actual risk, especially for debt transactions. However, data to dispel this assumption is not yet available to private investors. Lack of data translates to difficulties for investors to underwrite EMDEs investments. For private equity (PE) investments, the lack of a robust or comprehensive historical track record (especially in more frontier markets), demonstrating sufficient returns compared to developed markets, deters investment.

Recommendations:
Greater data disclosure would close the gap between perceived and actual risk. Track records have been disclosed by DFIs (on an individual and confidential basis), when exclusivity for vehicles was granted, allowing investors to assign appropriate risk ratings (and expected returns) to transactions.

Investor Leadership Network (12 institutional investors)

How blended finance can make the most of public funding Report (October 2021)

Recommendations:

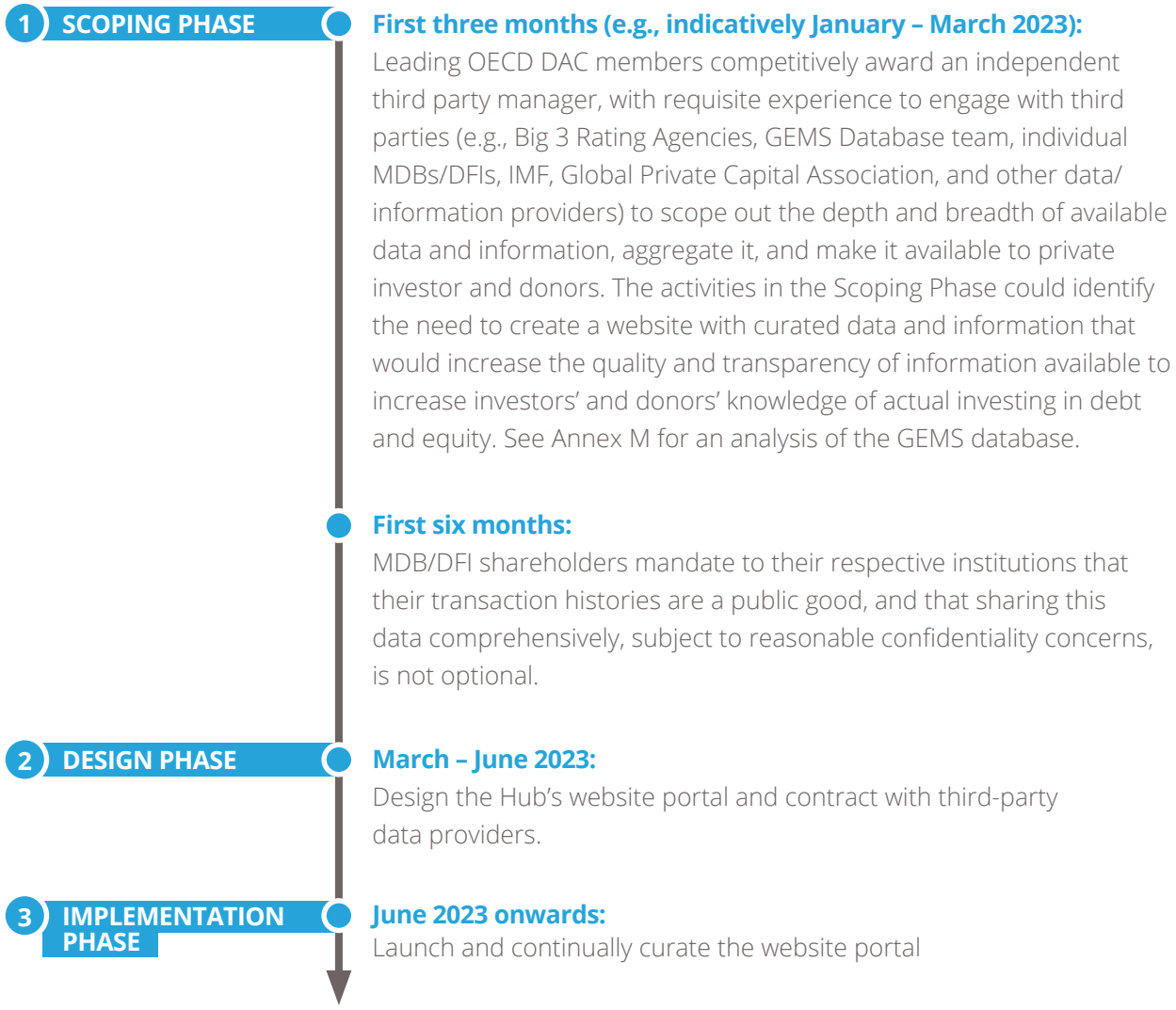
- Recognize the range of risks that private investors are simply unable or unwilling to take on, and explore what can be done to mitigate them.
- Make the risks linked to any project more transparent, and discuss them with investors at the earliest stages of the process.
- Educate the private sector and raise comfort levels, for instance, by providing more data and track records from past transactions and from the emerging market investing environment, and by sharing MDBs' expertise.
- Give the private sector full access to emerging market risk data and information.
- Encourage closer interaction between philanthropic organizations and the private sector, and employ measures to obtain greater access to specific data sources so that the private sector can better assess risks.

MDBs/DFIs have the deepest investment transaction histories in EMDEs, and a special duty to aggregate and share reliable data from their experiences. They have collaborated to create an incredibly useful dataset – the Global Emerging Markets Risk Database (GEMS). Unfortunately, the GEMS consortium has not made the database available to private investors, and has often been held up by confidentiality issues around data anonymity that are eminently solvable in the age of Big Data, in which millions of companies share massive quantities of data daily.

The Action Plan recommends the development community create a comprehensive online Investment Mobilization Hub, funded by Catalytic Grants, for information to improve access to the best risk and return data available for investing in EMDEs, including GEMs. There will be at least four benefits of better data reliability and availability that should accrue to climate and SDG investment:

1. Institutional investors, impact investors, asset managers and financial arrangers will have increased access to better information, which suggests the actual risk has been lower than the perceived risk, should increase private investor confidence over time and reduce their reliance on public "de-risking".
2. The data and information will give the shareholders and management of the MDBs/DFIs better knowledge of development finance risk to take better governance decisions as they own, govern, and direct the MDBs/DFIs.
3. The data and information will help OECD DAC members efficiently and cost-effectively allocate limited Catalytic Capital to blended finance/mobilization activities without undue subsidization of the private sector. For example, donor governments that issue guarantees can more accurately calculate guarantee fees and coverage of expected losses to reflect market realities. Similarly, organizations that calculate expected losses in funded risk participation for blended finance facilities can more accurately size their capital contributions.
4. The data and information will help the OECD DAC members in their deliberations over ODA rules, such as private sector instruments, guarantees, and whether loans in blended finance should quality as ODA.

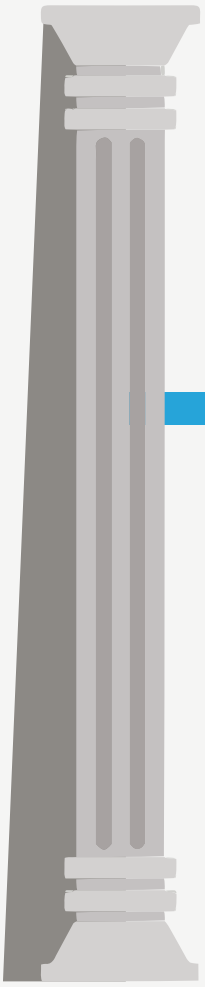
The Hub project could have three phases:



4.2 ACCESSIBILITY TO MOBILIZATION AND BLENDED FINANCE RESOURCES

The Investment assets produced by blended finance must be accessible to prospective investors in a user-friendly fashion. Pillars 1-3 will create fiduciary investment assets that should mobilize investors if the investors are aware of the opportunity. The Action Plan calls for Catalytic Grants to be made available to create a website marketplace at the Hub in which:

- The availability of Catalytic Funding is communicated transparently to all interested parties.
- Competitive calls for proposals are communicated to all potentially interested parties.
- Investment assets produced by blended finance and development finance are described to prospective financial participants, with directions on how to gain access to the investment opportunity in both primary and secondary markets.
- All relevant data and information for blended finance are available.



PILLAR 5:
EMPOWER LOCAL CAPITAL MARKETS & FINANCIAL INTERMEDIARIES IN EMDEs

OBJECTIVE: Improve, deepen, and broaden domestic capital markets and financial intermediation.

HIGHLIGHTS

- The large majority of climate and SDG investment projects in EMDEs are less than $5 million, and many will be implemented by private sector companies located in EMDEs.
- To achieve the SDGs and climate objectives, it is imperative to improve, deepen, and broaden domestic financial intermediation in EMDEs, allowing more local developing world savings to be invested and more cross-border investment to be channelled through them into the real economy.
- The Action Plan calls for a targeted campaign to improve and empower local capital markets and financial intermediaries by increasing their risk capital, increasing their funding, and providing significantly higher amounts of local currency financing to curtail the massive and building FX exposure.
- The Action Plan advocates:
  - (i) A minimum percent of MDB/DFI Capital[44] should be invested in domestic financial intermediation, and
  - (ii) Catalytic Capital should be allocated to mobilize private investment through domestic financial intermediation.

Financial assets in EMDEs (ex-China) are currently estimated at $17 trillion,[45] and are expected to grow significantly. Many climate and SDG projects will continue to be too small for global investors, and must be undertaken by corporates, SMEs, and households in these countries. Those entities require financing in relatively small amounts that are provided most efficiently and sustainably by local financial intermediaries.

Unfortunately, these intermediaries suffer a systemically low level of capitalization and lack wholesale local currency funding. Explicitly supporting the scaling of domestic financial intermediation will spur these local financial systems to elevate resources and innovation, increasing the supply of local bank and MFI financing to projects and crowding in new actors to develop and structure more projects to meet the supply of finance.

44 Capital is defined as the aggregate of paid-in-capital and retained earnings on the balance sheet of the MDB, and does not include callable capital.

45 See footnote 7.

A centerpiece of donor and MDB/DFI collaboration should be to empower local financial systems to drive more domestic savings into real economy investments that advance climate objectives and the SDGs, and channel cross-border investment. An example is the World Bank program to deepen local capital markets and donor support to establish institutional investor consortiums in Kenya, South Africa, and other countries. The local consortium work is promising because it drives a deeper integration between global and local investors, allowing them to combine their strengths and mitigate their weaknesses. For example, global investors are often unfamiliar with developing markets, which leads to risk-averse behavior.

However, if they have a local investor as a partner, that risk threshold falls. Local investors often don't have the same capacity and track record of investing as the MDBs and DFIs, and they benefit significantly from close collaboration with the MDBs and DFIs that impart that expertise. To date, however, these interventions have all been fragmented and piecemeal, and need to be elevated and institutionalized as a cross-cutting theme across all pillars.

Two significant components of the Action Plan would drive this kind of change in a more systematic way:

1. Shareholders of MDBs/DFIs should agree upon specific KPIs, such as:
    - i. Minimum of 20% of MDB capital deployed for domestic financial intermediation.
    - ii. Minimum of 50% of MDB capital deployed in high financial additionality assets, such as equity and Tier 2 capital in financial institutions, local currency loans, and SME risk-sharing, all leading to improving sustainable domestic financial intermediation.
    - iii. Minimum of 35% of capital deployed in LICs and LDCs. This is the most effective and efficient way for MDBs/DFIs to take exposure in LICs and LDCs is through financial institutions. Therefore, an explicit KPI to do more in these countries will lead to more support to financial intermediaries.
2. Competitive calls for proposals for allocating Catalytic Funding should score domestic financial intermediation blended finance vehicles as a priority.

SECTION 6:
TOTAL INVESTMENT POSSIBLE WITH THE ACTION PLAN

The Action Plan envisions maximizing climate and SDG investment in six types of primary financial flows, as summarized in Tables 6.1 and 6.2. In five out of the six cases, an explicit strategy of transferring assets to blended finance vehicles allows a more integrated development finance community to apportion risk more effectively, create investable portfolios of transactions for the private sector, and crowd in the strengths of a wider universe of financial actors.

Total annual investment amounts could approach $530 billion, equal to 10-12% of the annual climate and SDG investment needs. Moreover, as this more integrated development finance system crowds in additional private actors, the cost of de-risking would fall over time and the private share of investment would grow as private actors increasingly grow their knowledge of investing in EMDEs. Ambition beyond this level of investment would require higher funding into development finance and climate finance organizations and other improvements that could only be implemented in the medium-term. The Action Plan focuses exclusively on what is possible within the existing system that can be fully realized in the short-term (twelve months) and has not addressed those possible medium-term enhancements.

To achieve these amounts would require an estimated $13.5 billion of Catalytic Capital from donor governments and philanthropic foundations allocated flexibly towards private investment mobilization (See Section 1) and $45.5 billion of mezzanine investment from MDBs/DFIs. Annex F provides details of the amounts summarized in Tables 6.1 and 6.2.

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Table 6.1: *Possible public and private investment and mobilization amounts with Action Plan*

Investment flow	Financial arranger	Debt or equity	Investment recipient	Investment sector	Total commitment arranged by MDB or DFI	Total commitment arranged by private sector	Arranged commitment retained by mdb or dfi	Arranged commitment retained by private sector	Transferred to blended finance vehicle			
									Total	Private sector senior investment	MDB mezzanine investment	High-risk catalyst capital
Financial commitments transferred to blended finance vehicles									Public sector mix:	85%	12.5%	2.5%
									Public sector mix:	80%	15%	5%
A	MDB	Debt	Public	Climate	80.0		40.0		40.0	34.0	5.0	1.0
B	MDB	Debt	Public	Non-climate	120.0		60.0		60.0	52.0	7.5	1.5
C	MDB & DFI	Debt	Private	Climate	50.0		12.5		37.5	30.0	5.6	1.9
D	MDB & DFI	Debt	Private	Non-climate	70.0		17.5		52.5	42.0	7.9	2.6
E	MDB & DFI	Equity	Private	All	20.0		5.0		15.0	12.0	2.3	0.8
F	Private sector	Debt	Private	All		100.0		25.0	75.0	60.0	11.3	3.8
G	Private sector	Equity	Private	All		40.0			40.0	32.0	6.0	2.0
	Subtotal				**340.0**	**140.0**	**135.0**	**25.0**	**320.0**	**261.0**	**45.5**	**13.5**
Financial commitments arranged and retained by MDBs & DFIs (not transferred to blended finance vehicles)												
H	MDB & DFI	Both	Private	No blending	50		50					
Total commitments					**390.0**	**140.0**	**185.0**					

A and B Public Sector loans arranged by MDBs: $200 billion of commitments: $100 billion A-loans retained by MDBs and $100 billion B-loans transferred to Blended FInance Vehicles.

C and D Private Sector loans arranged by MDBs & DFIs: $120 billion of commitments: $30 billion A-loans retained by MDBs and $90 billion B-loans transferred to Blended Finance Vehicles.

E Private Sector equity arranged by MDBs & DFIs: $20 billion of commitments: $5 billion retained by MDBs & DFIs and $15 billion transferred to Blended Finance Vehicles.

F Private Sector loans arranged by private sector arrangers: $100 billion of commitments: $25 billion retained by arrangers and $75 billion transferred to Blended Finance Vehicles.

G Private Sector equity arranged by private equity firms: $40 billion of commitments Blended Finance Vehicles.

H Private Sector loans and equity arranged by MDBs & DFIs not transferred to Blended Finance Vehicles - High Financial Additionality

Table 6.2: *Description of financial commitments described in Table 6.1*					
Financial flow type	**Rows in Table 6.2**	**Exposure transferred to a blended finance vehicle?**	**Primary finance**	**Blended finance approach to create investment assets within fiduciary obligations of private sector investors**	**Estimated amounts in Action Plan**
Public sector loans arranged by MDBs	**A and B**	**Yes.** See Section 3.2	MDBs would amend their public sector loan commitments to A-B loan structures, with 50% A-loans retained by MDBs and 50% B-loans transferred to blended finance vehicles.	Donor government and MDBs/DFIs would provide subordinated funding to blended finance vehicle to de-risk investment portfolios within fiduciary risk limits to mobilize private sector debt investors.	MDBs could increase public sector loan commitments from approximately $90 billion currently to $200 billion: $100 billion in A-loans retained by the MDBs and $100 billion in B-loans transferred to blended finance vehicles.
Private sector loans arranged by MDBs/DFIs	**C and D**	**Yes.** See Section 3.3	MDBs/DFIs would provide (mostly) hard currency senior loans to private sector borrowers as 25% A-loans and 75% B-loans. The B-loans would be transferred to blended finance vehicles.		MDBs/DFIs could increase private sector loan commitments to $120 billion: $30 billion A-loans retained by the MDBs/DFIs and $90 billion B-loans transferred to blended finance vehicles.
Private sector equity arranged by MDBs/DFIs	**E**	**Yes.** See Section 3.4	MDBs/DFIs would increase equity commitments, retain 25% of each commitment and transfer 75% to blended finance vehicles.	Same as above, but to mobilize private sector equity investors.	MDBs/DFIs could increase their equity commitments to $20 billion: $5 billion retained by MDBs/DFIs and $15 billion transferred to blended finance vehicles.
Private sector debt arranged by private sector financial intermediaries	**F**	**Yes.** See Section 3.5	Private sector arrangers (e.g., commercial banks) would arrange loans to private sector borrowers, retain 25% and transfer the other 75% to blended finance vehicles.	Donor governments and MDBs/DFIs would provide subordinated funding to blended finance vehicles to create de-risked investment portfolios within fiduciary risk limits to mobilize private sector debt investors.	Private sector arrangers could arrange $100 billion of loans, retaining 25% ($25 billion) and transferring 75% ($75 billion) to blended finance vehicles.
Private sector equity arranged by private sector	**G**	**Yes.** See Section 3.5	Private sector equity funds would raise conventional private equity funds, with a blended finance structure similar to Blackrock's Climate Finance Partnership where the capital structure is 80% senior investors and 20% subordinated investors.	Same as above, but to mobilize private sector equity investors.	Private equity fund managers could arrange $40 billion of private equity funds with an 80:20 blended finance structure.
Private sector debt and equity arranged by MDBs/DFIs but not transferred	**H**	**No.** Arranged and held exclusively by MDBs/DFIs.	Unlike the cases above, these loans and equity investments are deemed to be not attractive to private investors, but have high financial additionality. Retained by the MDBs/DFIs - not transferred to investors.	None.	MDBs/DFIs could arrange $50 billion of financial assets retained on their balance sheets and not transferred to blended finance vehicles. Assumed to be: $40 billion debt $10 billion equity
Total			**Total amount of debt and equity committed to climate and SDG investment annually**		**$530 billion**

COMPLEMENTARY ACTION A: LINK SUPPLY OF GLOBAL CAPITAL TO PRIORITY PROJECTS

OBJECTIVE: Align supply of investment produced by Catalytic Funding in the Action Plan to high priority projects in EMDEs

HIGHLIGHTS

- The Action Plan focusses on increasing the quantity and quality of supply of investment for EMDEs. But this increased supply should be directed to high priority projects, such as projects to achieve NDCs.
- The providers of Catalytic Capital, the Catalytic Capital Facilities, the manager, and the investment committees should agree to objectives and KPIs to ensure Catalytic Capital is awarded to support high priority projects.

Most of the Action Plan describes how to create fiduciary investment assets that would mobilize private investment to climate and SDG investment in EMDEs. Although the Action Plan describes how to significantly increase this investment, it is likely there will continue to be a systemic under-supply of investment in EMDEs. Therefore, it is imperative to maximize the likelihood this increased investment will be channeled to projects of high importance for the Paris Agreement and SDGs. This section describes the best pathways to maximize the amount of investment flowing to these high priority projects.

Table A.1 describes non-exhaustive examples of projects, companies, and financial institutions of high importance in EMDEs.

Table A.1: *High priority projects in EMDEs to achieve the SDGs and climate objectives*

Description	Rationale
Projects, companies, and financial institutions aligned with NDCs	A Nationally Determined Contribution (NDC) is a climate action plan to cut emissions and adapt to climate impacts. Each Party to the Paris Agreement (e.g., signatory EMDEs) is required to establish an NDC and update it every five years. The UN Framework Convention on Climate Change provides documents relevant to the NDCs, along with a registry of NDC submissions by country (see, for example Kenya). Projects aligned to achieving a country's NDCs are to be prioritized by Catalytic Capital.
Projects, companies, and financial institutions identified by Just Energy Transition Partnerships (JETP) and Country Platforms	JETP and country platforms are important projects that should be prioritized by Catalytic Capital. JETPs were announced at COP26, with South Africa identified as the "launch" country. Similar JETPs are intended in other countries, like India, Indonesia, and Viet Nam. Country platforms are government-led coordination bodies that establish a center of gravity for governments and partners to make sense of complex political, social, and economic realities, agree on shared priorities, and solve collective action problems. Country platforms for development cooperation promote the following principles: • Country ownership and development effectiveness through a high-level steering group led by Presidents or Prime Ministers and comprised of senior multilateral and bilateral donor officials, implementing partners and representatives of civil society to contribute to a national development plan, collective sense-making of the context, resource mobilization, dialogue, mutual accountability, and troubleshooting.

Table A.1 (Continued...)	
Description	**Rationale**
	• A sector level led by government ministers who assemble their own core sector groups of technical experts, operational partners, and societal stakeholders to determine sector policy, resource flows, and "who's doing what where". • A secretariat level led by the Ministry of Planning and staffed by domestic and international experts with analytic, convening, and troubleshooting roles to administer the steering and sector levels and facilitate the achievement of overall development goals.
Projects, companies, and financial institutions aligned with WBG Country Partnership Frameworks	The WBG's Country Partnership Framework (CPF) aims to make its country-driven model more systematic, evidence-based, selective, and focused on the Bank's twin goals of ending extreme poverty and increasing shared prosperity in a sustainable manner. Used in conjunction with a Systematic Country Diagnostic (SCD), the CPF guides WBG's support to a member country. A SCD informs each new CPF. The aim of the SCD is to identify the most important challenges and opportunities a country faces in advancing towards the twin goals. This is derived from a thorough analysis and informed by consultations with a range of stakeholders. Projects aligned to CPFs are to be prioritized by Catalytic Capital.
Projects, companies, and financial institutions aligned with African Union national and regional economic communities development priorities (e.g., Agenda 2063: The Africa We Want)	AGENDA 2063 is Africa's blueprint and master plan for transforming Africa into the global powerhouse of the future. It is the continent's strategic framework that aims to deliver on its goal for inclusive and sustainable development and is a concrete manifestation of the pan-African drive for unity, self-determination, freedom, progress, and collective prosperity pursued under Pan-Africanism and African Renaissance. Agenda 2063 identifies key Flagship Programmes which can boost Africa's economic growth and development and lead to the rapid transformation of the continent. The genesis of Agenda 2063 was the realization by African leaders that there was a need to refocus and reprioritize Africa's agenda from the struggle against apartheid and the attainment of political independence for the continent, which had been the focus of the Organisation of African Unity (OAU), the precursor of the African Union; and instead to prioritize inclusive social and economic development, continental and regional integration, democratic governance, and peace and security, among other issues aimed at repositioning Africa to becoming a dominant player in the global arena. Projects aligned to Agenda 2063 are important projects to be prioritized by Catalytic Capital.
Projects prioritized by publicly-funded project preparation facilities	There is a myriad of project preparation facilities globally. For example, the Project Preparations Facilities Network is a network of funding facilities and institutions dedicated to developing sustainable infrastructure in Africa through improving project preparation, working to increase the number of viable, well-prepared, investment-ready infrastructure projects. Projects advancing from publicly funded project preparation facilities are to be prioritized by Catalytic Capital.

The Action Plan must include pathways to ensure a strong linkage between the supply of Catalytic Capital and these priority projects. In principle, limited Catalytic Capital should be skewed to increase the supply of investment channeled to these priority projects. The Action Plan proposes this to be achieved at the initial phases of designing the Catalytic Capital Network and Catalytic Capital Facilities, in which the Network's calls for proposals and the Facility's allocation of Catalytic Capital are weighted towards supporting blended finance vehicles that will mobilize investment to these projects.

Possible modalities include ensuring that:

- Calls for proposals managed by the Network include explicit priority to these high priority projects.
- Calls for proposals have assessment criteria providing high weightings to blended finance vehicles that mobilize investment to these projects.
- 33-50% of Catalytic Capital committed by a Catalytic Capital Facility supports blended finance solutions targeting these priority projects.
- One or more investment committee members for a Catalytic Capital Facility are directly involved in initiatives supporting priority projects.
- The Hub has a section fully dedicated to identifying all the initiatives that identify high priority projects, and as best as possible, identifies the inventory of high priority projects in search of finance and investment.
- Catalytic Capital provided by LIC and MIC governments should be channeled to support project-level blended finance solutions to improve these projects from "commercially near-investable" to "commercially investable" – ensuring domestic government funds are channeled to these high priority projects. ODA grants and loans can be used as LIC and MIC government contributions to project-level blended finance solutions for these priority projects.

COMPLEMENTARY ACTION B: IMPROVING INVESTMENT CLIMATE IN EMDEs

OBJECTIVE: Ensure Action Plan supports EMDEs to improve their investment climate and enabling environment.

HIGHLIGHTS

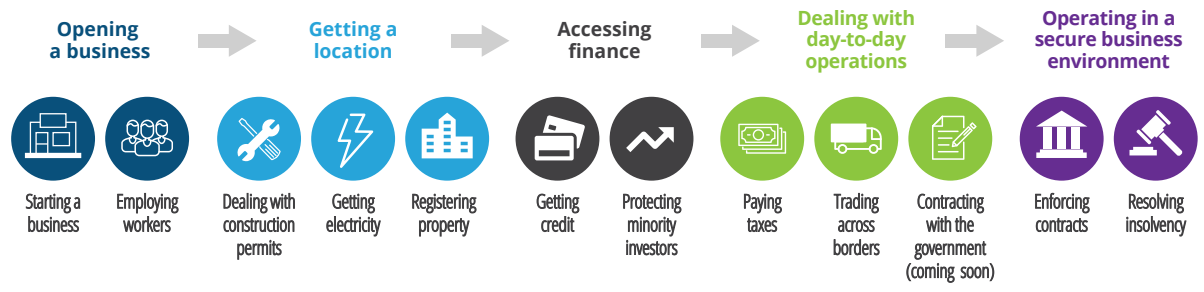
- The Action Plan identifies how Catalytic Capital and blended finance can create fiduciary investment assets optimally, by addressing high country risk in EMDEs. But sustainable finance and investment in the long-term requires improved investment climates and country risk ratings.
- Catalytic capital should be allocated in alignment with countries pursuing improvements to their investment climates.

Catalytic Capital and blended finance are required for many EMDEs since the actual and/or perceived country risk is high. Fitch Ratings provide a good description of country risk and its country risk assessment methodology, with three main drivers of country risk:

- Political risk index evaluates the risk of a sharp change in government policy and broader political stability.
- Economic risk index assesses the degree to which the country balances effectively non-inflationary growth, contains fiscal and external deficits, and maintains manageable debt ratios.
- Operational risk index quantitatively compares the challenges of operating in 205 countries worldwide, relatively.

The World Bank Doing Business Report was a hallmark annual report providing deeper insights for the equivalent of Fitch's Operational Risk Index measuring a country's absolute and relative performance across 12 metrics (see Figure B.1 below). The World Bank will replace this legacy report with its new Business Enabling Environment Report, expected in 2023.

Figure B.1: *Improving Investment Climate*[46]



46 Source: World Bank Doing Business Report.

Another hallmark report proving an indicator of country risk is Transparency International's Corruption Perceptions Index.

The World Bank Group, IMF, MDBs and OECD DAC members, among others, systemically work with LIC and MIC governments to improve their investment climate in a myriad of activities.

In principle, all else equal, Catalytic Capital should be skewed towards countries with leading reforms to improve the investment climate and country risk. MIC and LICs should also graduate from being the beneficiary of scarce Catalytic Capital once its investment climate and country risk has improved to the extent investors are no longer impeded by high country risk. For example, although China and Malaysia are still MICs on the OECD DAC list, they are rated A+ and BBB+, respectively, by the Big 3 Rating Agencies.

The Action Plan could include controls to ensure a strong linkage between the supply of scarce Catalytic Capital and investment climates. In principle, scarce Catalytic Capital should be allocated to countries that are actively pursuing improvements to their country risk and investment climate, and not allocated to the few EMDEs whose well-above-average country risk profiles do not impede private investment. Illustrative examples could include:

- An exemptions list for countries that Catalytic Capital funders think should not benefit due to those countries' poor reform efforts, or other activities.
- An obligation for beneficiary countries to sign a reforms agenda to be become and continue as a beneficiary of Catalytic Capital.
- Ensuring one or more Investment Committee members for the Catalytic Capital Facility have expertise on investment climates and connections to efforts to improve country risk and investment climate.

This need to improve the investment climate and enabling environment should be addressed in the design of the Catalytic Capital Network and the Catalytic Capital Facility prior to launch of the Network and Facility.

CONCLUSION

The fundamentals of the global economy have changed significantly since the prevailing development finance architecture was first created through the Bretton Woods system in the 1940s. This Action Plan recognizes the need to adapt to those changing fundamentals and harness new resources, actors, and innovations to establish a new status quo consistent with present market realities.

Today, public and private sector investment in EMDEs often occur in silos, crowding each other out rather than reinforcing each other's comparative advantages. If the world seeks to chart a more sustainable climate and SDG pathway, this must change. With development assistance budgets limited and global debt levels approaching all-time highs, SDG and climate goals cannot be achieved through public sector investment alone.

This Action Plan calls for a strategic mobilization and de-risking strategy to crowd in innovation and private sector resources. There has never been such strong engagement and appetite from private investors to invest in faster-growing EMDEs. Private sector stakeholders are displaying a tremendous ambition to engage and allocate their investment capital to purpose investments like ESG, green finance, climate finance, sustainable investment, and impact investment. ESG and similar mandates have therefore become windows through which meaningful mobilization of the private sector to EMDEs can occur. However, the perceived and actual risks of investing in most EMDEs are often beyond the fiduciary and regulatory risk limits of most private sector investors. In at least four separate reports, investors have signaled that creating investable assets under these themes would propel more investors to consider shifting more allocations to EMDEs.

To capture this opportunity, a deeper, more strategic collaboration between public and private sectors is needed to shift the international system towards mobilization and achieve the required scale. This deeper collaboration would simultaneously address the two enduring constraints to greater long-term capital flows to EMDEs: increasing the number of investable projects and the supply of investment willing and able to invest.

This strategy would not remove all risk in EMDEs for private investors, nor should it. Rather, it will allow private investors to collaborate to a greater degree with the development finance system to manage risk more effectively, bundle and standardize projects into portfolios that reduce risk further, and ultimately unlock scale-level flows of investment, estimated at $530 billion annually. Moreover, the Action Plan would do this all through a relatively minor re-directing of existing resources towards more efficient collaboration with the private sector rather than requiring new budgetary appropriations.

All activities identified in the Action Plan can be implemented in the short term and could lead to $530 billion of annual climate and SDG investment – around 10-12% of annual investment needs in EMDEs.