KARSTEN WURTH (UNSPLASH)

The Action Plan for Climate & SDG Investment Mobilization

For Emerging Markets & Developing Economies

Annexes

CONVERGENCE
BLENDING GLOBAL FINANCE

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LIST OF ANNEXES

Annex A

Sources of investment: Domestic and cross border

Key Takeaways:

- Cross-border investment is needed to narrow the SDG Investment Gap, but the post-2008 capital requirements of developed country financial institutions, who control most of the world's financial assets, significantly limit those cross-border flows to LICs and MICs
- Commercial banks hold the greatest proportion of domestic financial assets in ODA-eligible countries. But much of those assets are not invested in productive endeavours (e.g., a lot of bank assets are government securities). Those banks should be prioritized when trying to mobilize domestic resources into SDG projects. And they are great conduits for channelling cross-border blended finance resources due to their huge market share.
- While international private investors are increasingly drawn to *purpose* impact-related investment themes and strategies, these investments mostly flow to developed countries since they present acceptable risk relative to unacceptably high perceived risk in LICs and MICs (and insufficient return premiums). Blended finance can use limited amounts of development funds to alter the risk-return ratio and mobilize private investment to developing markets at scale.

Blended finance structures are designed specifically to mobilize private investment across two dimensions, as summarised in Table A.1.

Table A.1: Main types of private investment to mobilize to the SDGs in LICs and MICs

Location of Financial Resources	Main debt investors	Main equity investors
Domestic Financial resources in LICs and MICs	• Banks • Microfinance Institutions	• Private equity • Public equity • Pension companies • Fund managers • Retail investors
Intentional financial investors - cross-border to LICs and MICs	• International banks • Insurance companies • Pension companies • Sovereign Wealth Funds	• Pension companies • Private equity • Public equity • Fund managers • Retail investors

- Domestic financial resources are insufficient to finance the SDGs – cross-border investment is absolutely required to narrow meaningfully the SDG Investment Gap
- In developing counties, banks and microfinance institutions invest almost exclusively within their domestic economies
- In developing counties, there is very low supply of equity
- A significant amount of domestic financial resources ends up invested in developed counties as (i) regulated organizations seek investments with risk ratings commensurate with their regulatory / fiduciary obligations (which are not available domestically) and (ii) investors seek superior risk-return investments available in developed counties
- The regulatory changes following the 2007-8 financial crisis has caused highly regulated financial institutions (e.g. banks and insurance companies) to be unable/unwilling to invest significantly in developed countries - very high capital requirements limit those cross-border flows.

Since 2012, global financial assets have grown around 6% per annum and amounted to $379 trillion in 2019, as estimated by the Financial Stability Board (See Figure A.1). But only around $14 trillion (4%) is located in ODA-eligible countries (excluding China)[1] (see Figure A.2).

Figure A.1: Growth in global financial assets (2021 Financial Stability Board)

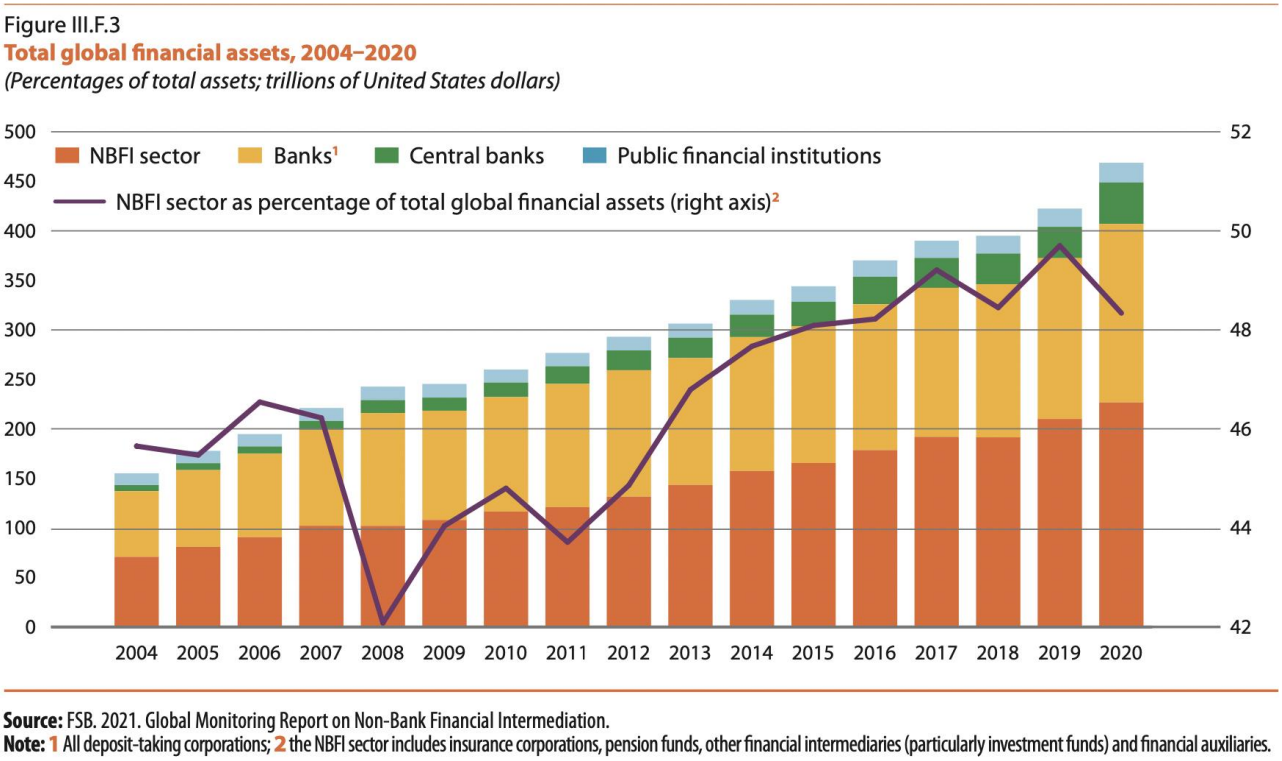
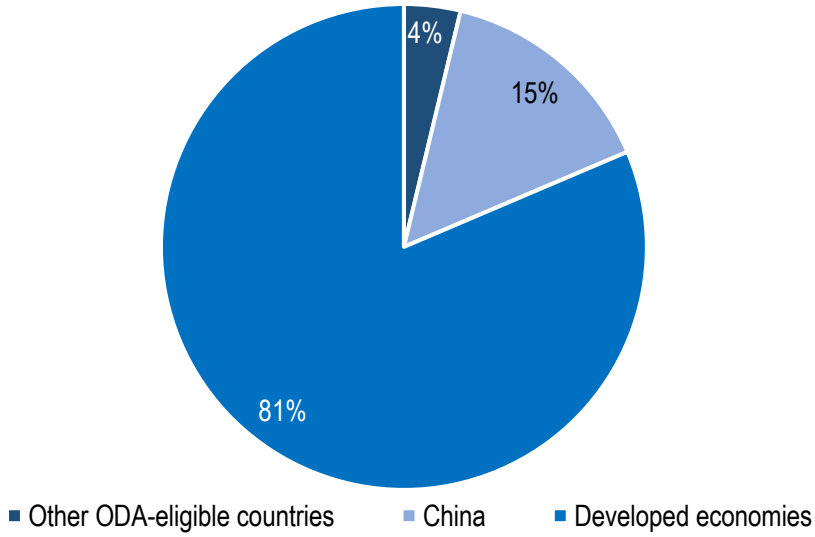


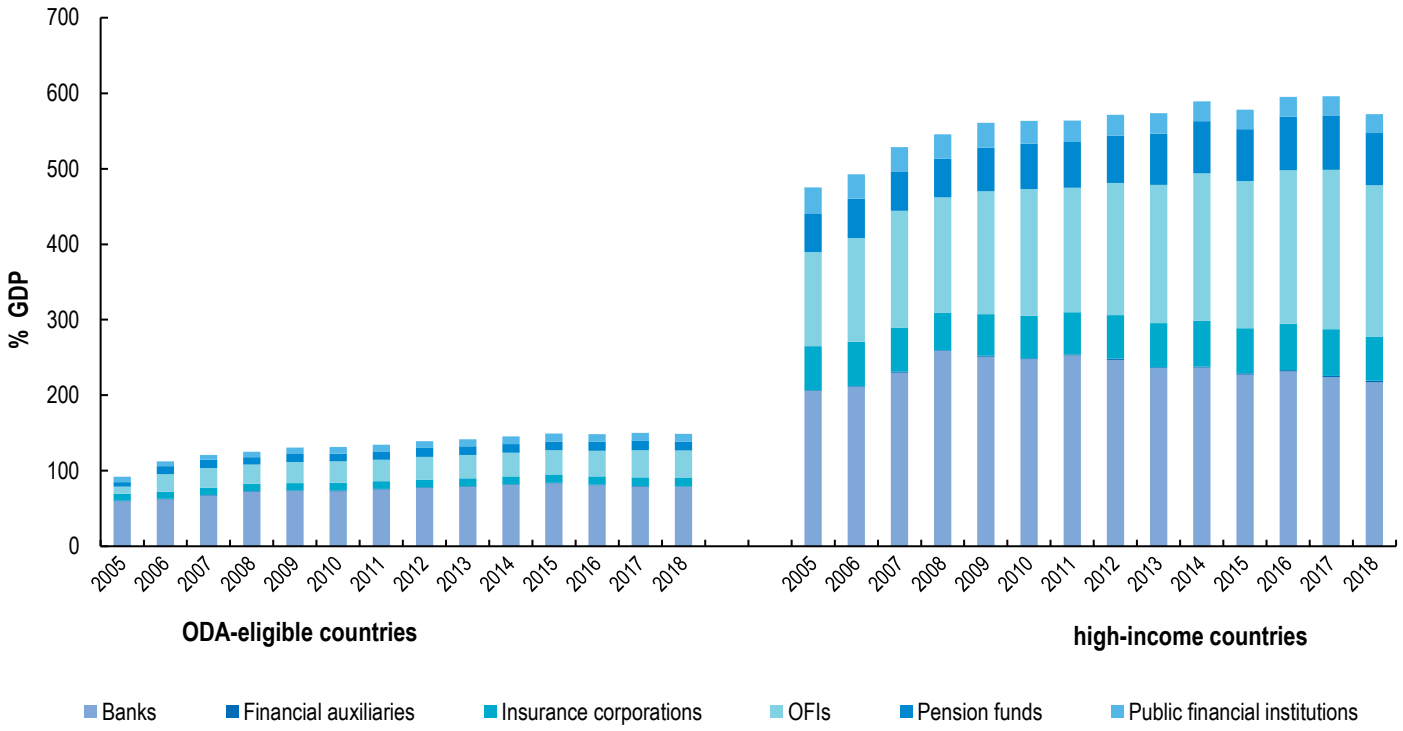
Figure A.2: Distribution of $379 trillion of global financial assets (2020 Financial Stability Board)



This huge imbalance is also evident if one compares the size of the economies. Figure A.3 identifies financial assets as a % of GDP is almost 600% in High Income Countries, compared to only 140% in LICs & MICs (ODA-eligible countries).

[1] China alone has around four times the amount of all financial assets located in the other 140 ODA-eligible countries.

Figure A.3: Distribution of financial assets by size of the economy, OECD Global Report



The Financial Stability Board and OECD analysis categorizes financial assets into four categories of asset owners:

1. Institutional investors (e.g. pension funds and insurance companies)
2. Banks
3. Public financial institutions and
4. Financial auxiliaries.[3]

Asset owners have varying degrees of freedom to implement investments in LICs and MICs. Pension funds, for example, are subject to quantitative portfolio restrictions relating to investment in certain asset classes (e.g. foreign investment). Insurance corporations face fewer quantitative investment restrictions and are more often subject to risk-based capital regulation, with investment in developing counties exceptionally capital-intensive.

Institutional investors own the largest share of global financial assets, at roughly $110 trillion of Assets Under Management (AUM), or nearly half of total global financial assets.[4] They also have considerable influence on companies and banks via their equity and voting rights, and generally adopt financing strategies based on long-term investment considerations. But to date, institutional investment in developing counties and blended finance has been low – Please see Convergence February 2021 Blended Finance & Institutional Investors Data Brief.

Commercial and investment banks had a total of $148 trillion in AUM in 2018, representing 39% of global financial assets. Banks play an important role by borrowing savings from individuals, companies, governments and other entities and providing loans. In this way, they ensure the availability of financing and fill the information gap between lenders and borrowers.

Asset managers hold $92 trillion in AUM, an increase over their $60 trillion holdings in 2009, accounting for just under a quarter of total global assets. The five largest asset managers by AUM are BlackRock, Vanguard, State Street, Fidelity and Allianz. Asset managers play the role of steward and fiduciary by pooling savings from large groups of investors, including consumers, companies and financial intermediaries.

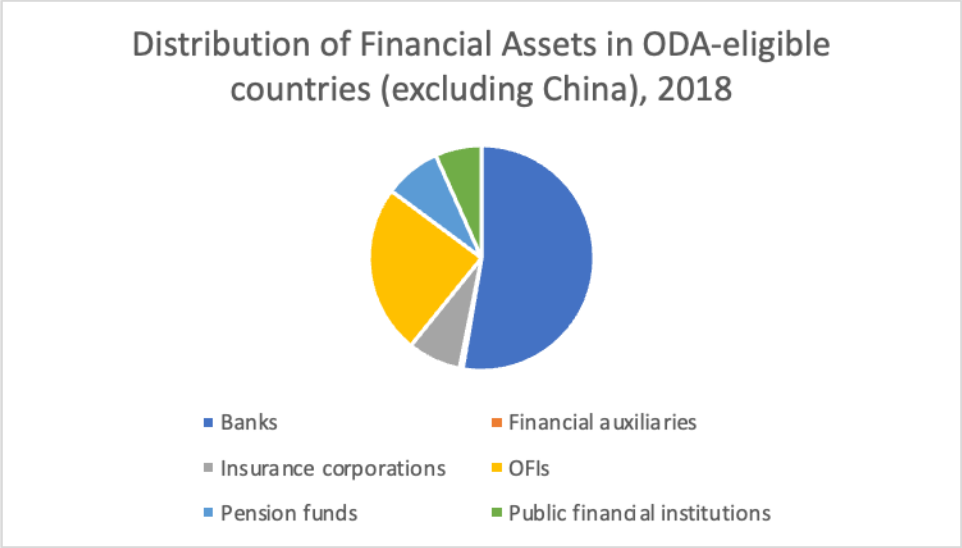
A.1 Domestic Financial Assets in LICs and MICs

Domestic private investments are usually the main source of an economy's fixed capital formation. Such investments can take the form of investment by private enterprises or finance from other sources channeled through financial intermediaries. Gross fixed capital, which among other things includes plant, machinery and infrastructure such as roads and railways, is an important determinant of an economy's productive capacity and thus vital to promote economic development.

Financial systems in LICs and MICs remain less developed than in OECD countries. The lack of breadth and depth of financial institutions reflects the problem of insufficient domestic financial assets. The low level of domestic financial assets in LICs and MICs diminishes the financial resources needed to finance the SDGs domestically.

A well-functioning financial sector can be a key driver of economic growth. The financial sector consists of three components: financial institutions, financial markets, and the regulatory framework managing institutions and markets. For LICs and LMICs, financial institutions such as commercial banks dominate the financial system, and the importance of financial markets (stock markets in particular) increases only with higher income levels (i.e., UMICs) (See Figure B.3). Individual SDG projects can range in size from $100 to $10 billion. Most projects less than around $5 million are financially arranged mostly by local financial institutions/intermediaries, projects of $5-50 million are financed by both domestic and cross-border institutions/intermediaries and projects in excess of around $50 million often financed directly by cross-border institutions/intermediaries. Good blended finance solutions aggregate private investment and development funds to these financial institutions/intermediaries who in turn finance the underlying projects. For example, in most LICS and LMICS, domestic banks are critical financial intermediaries to finance SDG projects.

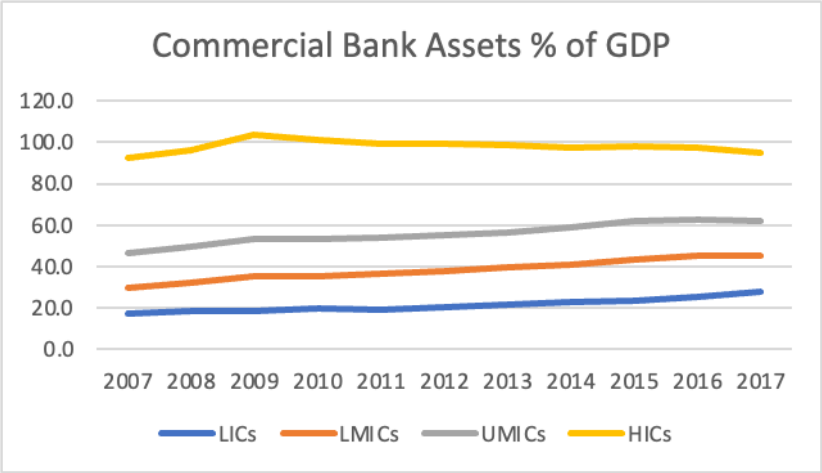
Figure A.4: Distribution of Financial Assets in ODA-eligible countries



LICs and MICs (excluding China) hold $15 trillion in AUM out of the total $379 trillion, or around 4% of total global financial assets (Figure A.4). Despite the large volume of AUM, the distribution of assets among LICs and MICs is itself uneven and the countries that have the largest financing gaps are not the countries with the largest share of assets.

The banking sector is also needed to expand local capital markets. However, the commercial banking sector's share of GDP is five times lower in LICs (roughly 20% of GDP) than in high-income countries (around 100%), as shown in Figure A.2. Regulatory banking restrictions imposed by many developing country governments can excessively favor government securities or require conservative portfolio requirements (Bank for International Settlements, 2019[14]).

Figure A.5: Commercial Bank Assets % of GDP (IMF International Finance Statistics)



As Figures A.5, A.6 and A.7 illustrate, in 2017, pension funds represented less than 20% of GDP in LICs and MICs and insurance companies less than 15%, compared to nearly 45% and 40% respectively in high income countries. In 2017, only one-third to one-half of the global population were covered by essential health services. Large informal sectors prevent financial systems from providing social protection**.** Informal employment represents 90% of total employment in low-income countries, 67% in middle-income countries and 18% in high-income countries (ILO, 2020).

Figure A.6: Pension Fund Assets % of GDP (IMF International Finance Statistics)

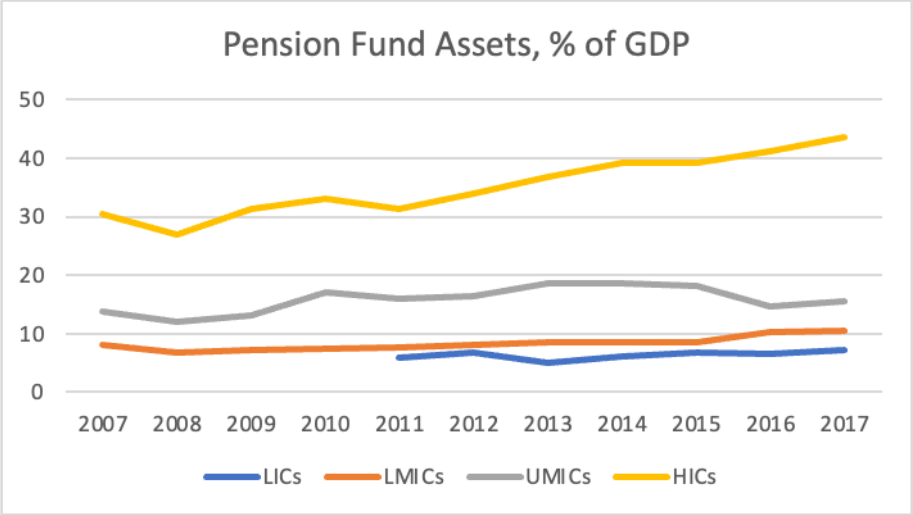
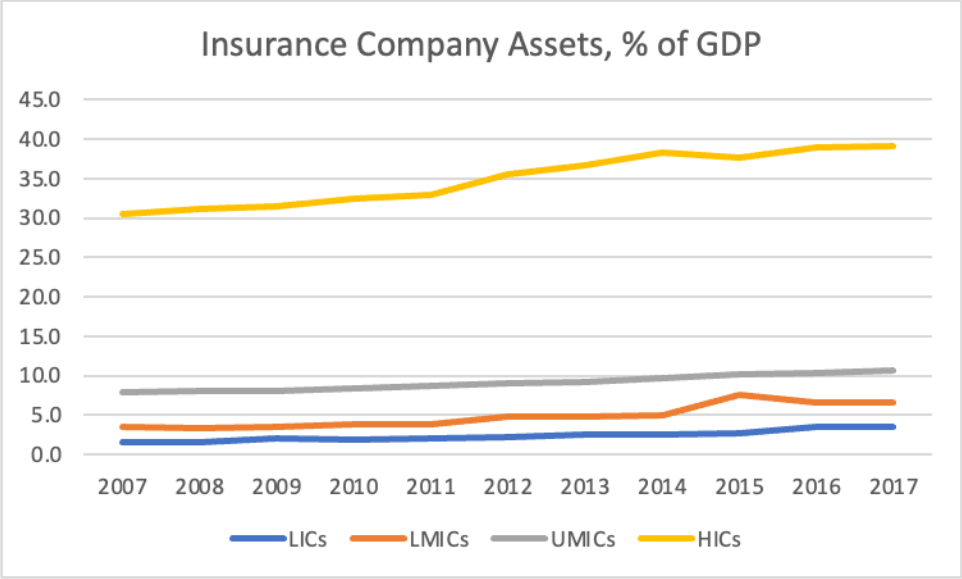


Figure A.7: Insurance Company Assets % of GDP (IMF International Finance Statistics)



In summary, Section A.1 identifies commercial banks are BY FAR the most important type of domestic financial institution and investor in developing counties. In the short and medium term, when (i) trying to mobilize domestic financial resources to SDG projects and (ii) identifying the most important local financial institutions to channel cross-border blended finance resources, commercial banks are in a league of their own. The only pathway to mobilization at scale is to prioritize and involve commercial banks.

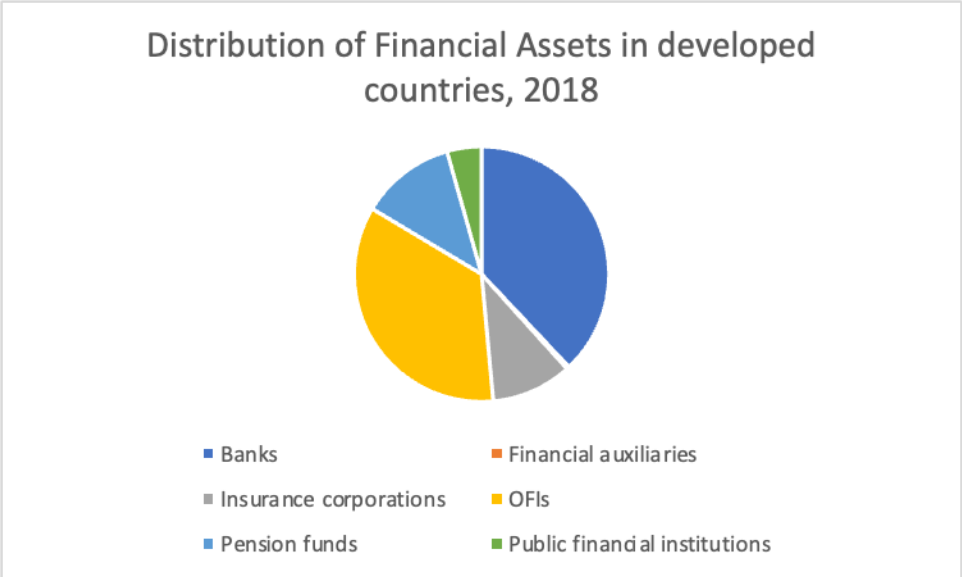
Blended finance solutions should also endeavour to keep pension fund assets and insurance company assets invested in developing counties, as opposed to prevalent practices of exiting LICs and MICs for (1) acceptable risk investments and (ii) superior risk-return investment opportunities. This is especially important when one considers the increasing FX debt exposure in developing counties – blended finance solutions that create risk-return profiles to keep domestic, local currency invested in the country should be prioritized. GuarantCo is an example of an excellent blended finance vehicle that achieves this objective.

A.2 International financial assets – Potential cross-border investment to SDGs in developing counties

Figure A.9 identify the theoretical supply of international financial assets that can be mobilised to LICs and MICs. In aggregate, at $379+ trillion AUM in developed countries, and with annual growth of around 5% (annual growth of around $15 trillion), it is clear this is the only significant sources of funding available to materially narrow the SDG Investment

Gap. **If only 7% of the annual growth could be mobilized to LICs and MICs, the SDG Investment Gap financeable by the private sector would be eliminated.**

Figure A.8: Distribution of Financial Assets in Developed Countries



Based on Convergence's historical deals database and interviews in 2020-21 leading up to this Action Plan, Convergence provides in Table A.2 the rank order of asset managers and asset owners that should be prioritized to mobilize investment to LICs and MICs for the largest impact:

Table A.2: Prioritization of international investors for blended finance transactions

Priority	Institutions
Top Priority	• Investors, asset managers and asset owners with a "*purpose*" investment mandate like Responsible Investment, Sustainable Finance, ESG Investment and Climate Finance. See Section 3.3. • Pension funds – debt • Foundations
Middle Priority	• Pension funds – equity • Family offices • Sovereign wealth funds • Banks – primarily for their asset manager roles originating and managing assets for other investors above
Low Priority	• Insurance company investment assets

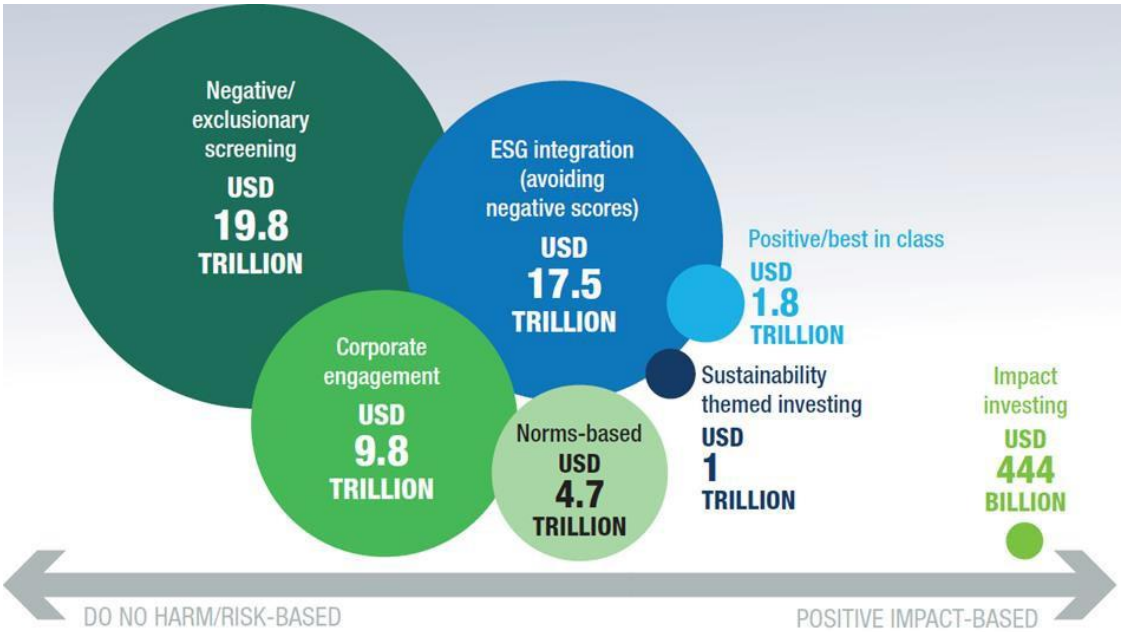
A.3 Seismic shift in private sector investment leading to increased demand for *purpose* and *impact* investment

Mobilizing around 0.6% of global financial assets annually to LICs and MICs would eliminate the SDG Investment Gap. But the reality is that private investors are not lining up to invest in high-risk *developing counties, fragile and conflict affected situations, LDCs, LICs, emerging markets and frontier markets*. These labels do not attract investment. Indeed, these labels imply HIGH RISK and cause investors to remain invested in their core markets in developed countries.

But fortunately for the development community, the private sector investment community is experiencing a revolution that is likely the most important development for LICs and MICs in the past 50 years. Investor appetite for "*purpose*" investment themes/strategies, such as *Responsible Investment, Sustainable Finance, ESG Investment, Impact Investment, Green Finance and Transition Finance* are leading investors to investments aligned with SDG projects. For the remainder of this Action Plan, we will refer to these types of investments as "*Impact Investments*".

The IFC and GIIN have reported in 2018-2020 how AUM for *Impact Investment* is growing at 25%+ per annum. As an example, a survey of the 75 largest asset managers found that 48% of investors are developing an approach to the SDGs. As this activity increases, a wide array of financing activities and strategies comprise the spectrum of *Impact investment*; ranging from funds that seek to do no harm (i.e., mitigate risks) to those that seek positive impacts based on their thematic or geographic focus (See Figure B.8). In the broadest sense, *Impact Investment* includes both a 'do no harm' objective and impact-based financing. Roughly 10% of *Impact Investment*, or $3 trillion, is defined as seeking to achieve positive impacts. $30 trillion out of $70 trillion assets under management (AUM) surveyed meet some "sustainability" criteria.

Figure A.9: Spectrum of Impact investment within private sector investment community, OECD
Source: Figure 10 of OECD Outlook Report



But these funds are flowing into investments located in developed countries – mostly due to (i) the perceived high risk of LICs and MICs, (ii) insufficient return premiums, (iii) lack of scale, (iv) lack of investment accessibility and (v) lack of liquidity/exit.

As well, the GIIN Survey identifies that almost 70% of private sector investors are concerned with "green washing" and "impact washing;" that is making unfounded claims of making impact.

The benefit of blended finance is not just the introduction of development funds to alter the risk-return, but also the introduction of development experts to mitigate green and impact washing risk. USAID, UK FCDO, the Norway Development Agency (Norad), the Gates Foundation and Swedish Sida are professional development practitioners. They will not allocate development finance funds without (i) a strong development impact thesis, (ii) tangible and measurable objectives, outcomes and outputs and (iii) an effective monitoring and reporting regime.

The development community has a fantastic opportunity to achieve the main objectives of the 2030 Agenda – to mobilise private sector expertise and investment to the SDGs in LICs and MICs. Blended finance is an excellent, implementable development tool to capture this opportunity.

In the past 24 months private investors have made significant progress to identify blended finance structures and transactions that mee their fiduciary requirements, and in principle, are prepared to finance (as debt and equity investments). This includes key observations from:

- Four private sector groups reports in 2021,
- Six webinars in 2021 with 100+ professionals from institutional investors – organized by USAID, UK FCDO and Convergence – where investors identified the four most effective blended finance structures that can mobilize their investment at scale (See Section E)

- Detailed engagement with 30 expert and interested asset owner and asset managers in 2022 to prepare this Action Plan

The significant key learnings from this engagement with private investors include:

- Significant private investor appetite for investment assets aligned to the following investment strategies: Environment, Social and Governance (ESG) Investment, Sustainable Finance, Responsible Investment, Climate Finance, Green Finance, Transition Finance, Impact Investment and SDG Investment
- Blended finance creates investible investment assets aligned to these investment strategies, as development organizations apply their development expertise and deploy catalytic funding
- Despite huge growth in private sector appetite for these investment strategies (growth of 30+ % per annum), investors remain invested in developed countries and are not investing in LICs and MICs. Private investors' fiduciary risk-return requirements restrict investment flows to developing counties
- Investors perceive investment in LICs and MICs without blended finance as (i) too high risk beyond their mandate and (ii) insufficient return premia to divest from developed countries into LICs and MICs. For example, the median sovereign risk rating of 145 LICs and MICs is S&P-equivalent "B" - very few institutional investors have any mandate to invest at that risk profile. And only 12% of LICs and MICs are Investment Grade - most equity investors won't invest in Non- Investment Grade countries.
- There is significant private investor appetite to invest in blended finance transactions, if the underlying investment assets (i) meet their investment criteria and 9ii) are aligned to the investment strategies described above
- Strong consensus the four blended finance structures identified in Annex 1 are the most effective structures to mobilize their capital into LICs and MICs
- Institutional Investors, including the Net-Zero Asset Owners Alliance, want to engage directly with the development community (e.g., donors) to identify blended finance transactions that work for both groups
- The Net-Zero Asset Owners Alliance has launched a "Call for Proposal" for blended finance transactions – actively encouraging asset managers / fund manages to present ideas
- Institutional investors have organized themselves in the Global Investors for Sustainable Development (GISD) Alliance, and they have called upon the donor community to act in concert to support blended finance solutions (See Annex 4)

Table A.3 reproduces Table 2.1 of the OECD Global Outlook of Financing for Sustainable Development 2021 Report (i.e., OECD Global Report). It provides a high-level summary of the financial resources available to narrow the SDG Investment Gap. Convergence has shaded the resources typically used in blended finance – resources shaded orange are public and philanthropic resources that have typically been used in nominal amounts to mobilize private investments (which are shaded green).

Table A.3: Financial resources available to finance the SDGs in LICs and MICs, Table 2.1, OECD Global Report

	Public Sector	**Private Sector**
Domestic within LICs and MICs	Tax revenue	Commercial investment
	Public resource rents and royalties	Private savings
	Public long-term debt (domestic)	Domestic private debt
	Public savings	Domestic philanthropy
	Sovereign Wealth Funds	Domestic remittances
		Sustainable impact investing
External Developer Countries	Official Development Assistance	Foreign Direct Investment
	Official Development Finance	Portfolio investment
	Other official flows	Other investment
	Public long-term debt (external)	Remittances from abroad
	Public guarantees (external)	International market Lending

	South-South co-operation	International philanthropy
	Triangular co-operation	Blended finance
	Climate Finance	Sustainable impact investing

The OECD Outlook Report reports external finance (e.g., cross border) to LICs and MICs for sustainable development equalled $2 trillion in 2018 (See Figure B.9)[2]. Private sector and public sector financial flows represent 85% and 15% of the flows:

- Annual aggregate cross-border flows have not increased over the past decade, and have averaged $1.9 billion over the past five years
- Foreign Direct Investment (FDI) accounted for 31% of the total – the highest flow for each of the past five years and likely the most important source of finance for economic development in LICs and MICs
- Remittances (26%) are the fastest growing and least volatile resource
- Other investment (OI) (19%) captures an array of private flows, mostly cross-border debt from the private sector
- Official Development Finance (the two blues comprising 15%) has been steady around $300 billion over the past five years. It is provided in two forms – bilateral (such as OECD DAC bilateral aid and DFI financing) and multilateral (such as World Bank)
- Portfolio investment (10%), along with FDI, tends to be the most volatile. It has averaged $244 billion over the past five years, but is expected to be negative in 2020, with the COVID 19 pandemic deterring minority equity investors.
- Despite the volatility, portfolio and other investment flows are an important contribution to sustainable development, complementing FDI. First, the presence of portfolio commitments and other investments means the receiving economy is integrated within global capital markets. Increased portfolio investment provides critical liquidity to investors. Equity and bank loans can each flow to businesses and projects that are conducive to sustainable development. Likewise, government debt can be used to fund sustainable public expenditure.
- Portfolio inflows to ODA-eligible countries in 2018 declined by half compared to the previous year, to $203 billion, and despite signs of a slight recovery, remained well below the 2012 peak.
- OI increased slightly in 2018 to $379 billion, then decreased in 2019. OI is driven by domestic factors, rather than external factors affecting all countries. Bank lending, the main component of OI, tends to be more strongly influenced by domestic pull rather than external push factors.

By design, FDI is the best form of private investment for the SDGs. First, investing in the SDGs requires a long-term time horizon, and as the most stable source of external private investment, FDI can provide that longer-term project horizon. A second advantage of FDI is that it can have a range of positive spill-over effects, such as transferring skills and technologies and providing access to international markets.

Figure A.10: Inflows of external finance to ODA-eligible countries, 2007-18, USD billions, OECD

[2] This Action Plan uses international financial resources and flows reported in 2018. This is the most recent year where the spectrum of ODA, MDB, DFI and other flows are reported in detail.

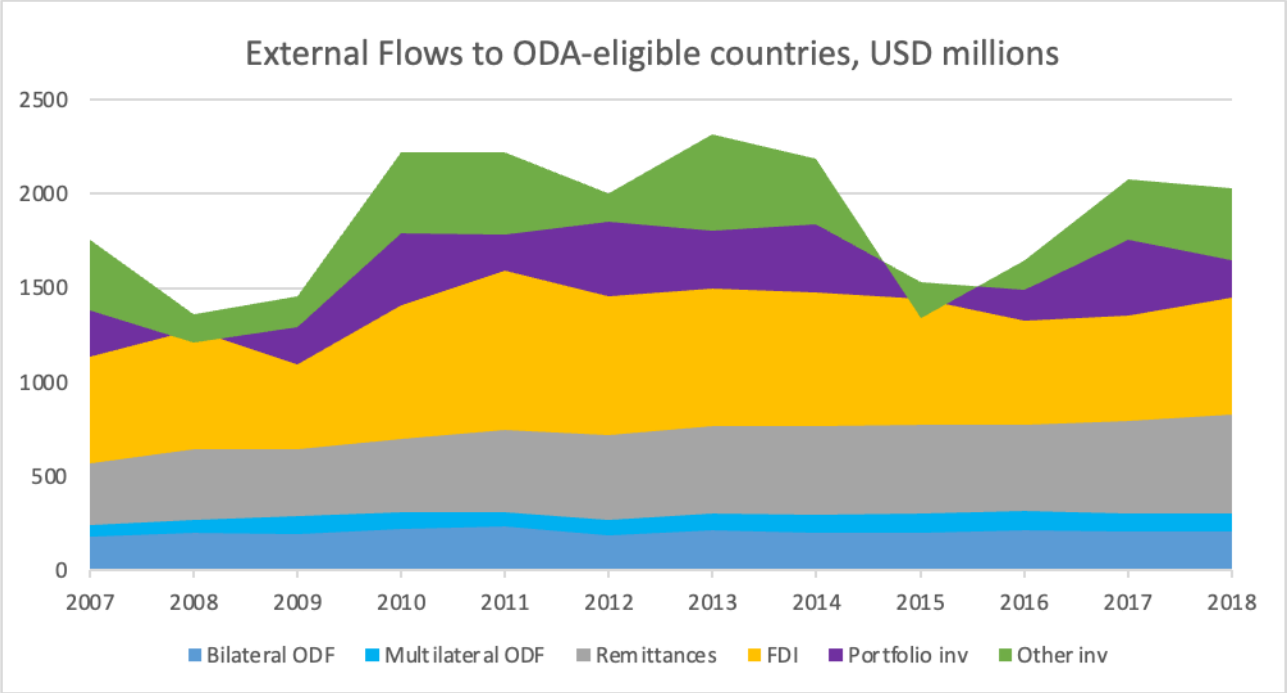
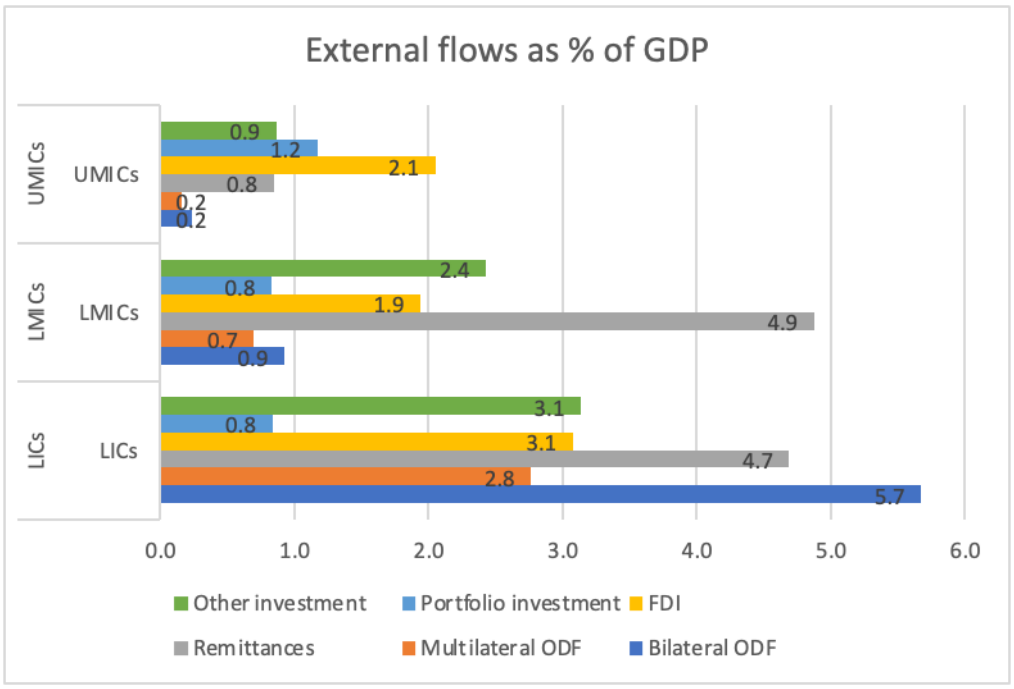


Figure A.10 identifies these external inflows by destination:

- UMICS, particularly in East Asia and Latin America & the Caribbean, receive the bulk of private investment. External inflows are more volatile in these country groups than in LICs and LMICs because they rely more on private investment and less on concessional development finance and remittances.
- LICs receive on average the largest external finance inflows relative to GDP, although in terms of absolute USD, these are relatively small. LICs also are more dependent on external finance inflows, but to different degrees for different components. The share of external private investment in GDP rises on average in parallel with a rise in national income, for instance, and the share of ODA gradually declines.
- LICs are more dependent on external finance inflows. Among regions, Sub- Saharan Africa and the Middle East and North Africa are the most reliant on external finance inflows. Notably, both regions experienced large inflows of portfolio investment as a share of GDP before the onset of the COVID-19 pandemic.
- Remittances are most prominent in LMICs. As a share of GDP, remittances (5%) are of similar importance to external private investment (4.7%). For some countries, remittances are a crucial source of income, amounting to about 30% of GDP.
- In UMICs, external private investment accounts for almost all external finance. Portfolio investment and other investment represented similar shares in 2018, at 0.8% and 1% of GDP, respectively. FDI made up 2.2% of GDP in 2018.

Figure A.11: External flows as % of GDP, 2018, OECD Global Report



Obviously, the COVID 19 pandemic has had a significant impact and the 2020 amounts will be significantly lower than the 2018-19 amounts. The OECD Outlook Report, written in the midst of the COVID-19 pandemic, states that "*all sources of financing are now under stress and external private finance to developing counties could collapse*[3]" and estimates "*a $700 million reduction of private capital inflows in 2020 compared to 2018 and 2019 levels*[4]" - a drop 60% larger than the drop after the global financial crisis of 2007-8.

[3] The OECD Global Outlook of Financing for Sustainable Development 2021 Report, Page 24.
[4] Ibid, Page 25

Annex B

Catalytic Capital annex

Box B.1: Catalytic Capital Consortium description of Catalytic Capital

Catalytic Capital Consortium description of Catalytic Capital

Catalytic capital is investment capital that is patient, risk-tolerant, concessionary, and flexible in ways that differ from conventional investment. It is an essential tool to bridge capital gaps and achieve breadth and depth of impact, while complementing conventional investing. Catalytic capital delivers impact and unlocks conventional investment in several ways.

Catalytic capital can take the form of debt, equity, or guarantees. Catalytic capital is an essential tool to support impact-driven enterprises and organizations that lack access to capital on suitable terms through the conventional marketplace. The aim of catalytic capital is to unlock impact and additional investment that would not otherwise be possible, strengthening communities, expanding opportunity and economic growth, and fueling innovation that advances the well-being of people and the planet, while laying the groundwork for mainstream investors to participate in transformative investments.

Catalytic capital can

- *help prove new and innovative products and business models*
- *demonstrate the financial viability of high-need geographies and populations*
- *establish a track record for new and diverse managers and*
- *grow small-scale efforts so they can attract conventional investment.*

Box B.2: Resources to learn about the use of Catalytic Capital to mobilize private investment

The following reports provide good background on the definition and use of Catalytic Capital to mobilize investment to the SDGs and Climate:

Catalytic Capital – Unlocking More Investment and Impact, Tideline, March 2019

How Donor Governments Blend, Convergence, May 2019

How DFIs Deploy Catalytic Capital, Convergence and Catalytic Capital Consortium, March 2022

Catalytic Capital Consortium

The State of Blended Finance 2021, Convergence, October 2021

Table B.1: Examples of Catalytic Capital Deployed by Public and Philanthropic Organizations

Expectation to Generate negative IRR	**Expectation to generate close to neutral IRR**	**Expectation to produce an MDB-like IRR or higher**
European Commission Blending Facilities (ex-EFSD)	US Development Credit Authority	International Finance Corporation
Green Climate Fund Private Sector Facility	Sida Guarantee Instrument	Private sector financing parts of AfDB, AsDB, IADB and EBRD
	Canada International Assistance Innovative Program	National DFIs, such as BII, DEG and Proparco
	Canada Climate Finance Funds	
	Finland Development Policy Instrument	
	European Commission EFSD	

Low-Cost Catalytic Capital should be deployed sparingly. There is already a vast supply of low-cost capital deployed through various public sector channels:

- OECD DAC members commit around $170 billion of Official Development Assistance annually, usually in grants, with around one-third allocated to investment and two-thirds to consumption-equivalent measures
- OECD DAC members and MDBs commit around $90 billion of subsidized loans to public sector borrowers (usually sovereign) – at long tenors with low interest rates around Libor plus 0.25% (average interest rate subsidy around 3% per annum)
- EIB provides around $10 billion of subsidized loans to the private sector in LICs & MICs
- But almost none of these three resources is deployed to mobilize private investment – the primary use is to provide low-cost funding to public sector entities to implement projects at affordable levels

In addition, Low-Cost Catalytic Capital usually distorts markets. In Climate, the best use of Low-Cost Catalytic Capital is to decrease the cost of implementing a Climate Mitigation Project or Climate Adaptation Project, where that Project that would otherwise not be pursued due to cost un-competitiveness to fossil fuels or inertia.

Both individual and aggregation approaches would be eligible for Catalytic Capital.

Table 3.3 summarizes the four most critical actors for successfully scaled blended finance solutions, and lists their main comparative advantage in blended finance structures.

Table B.2: Four main organization-types for successful blended finance structures at scale

Organization Type	Examples	Main comparative advantage
Arrangers of financial assets In this case, MDBs and DFIs	IFC, AfDB, FMO, EBRD, DEG	Strong ability to originate, arrange and manage good quality assets with good development impact Ability to hold speculative credit risk (e.g., B and CCC) for the medium term
Large private investors like pension funds insurance companies, and endowments (e.g., asset owners)	Allianz, Az, Prudential, CalPERS, Swedish Pension Companies	Provide scale investment, e.g., investment of $100+ million Ability to allocate lots of funds at reasonable interest rates if underlying risk is Investment Grade or close
Donors who can allocate development capital at below-market terms to create market-equivalent investment assets for private investors while ensuring development impact	USAID, UK FCDO, Sida, Global Affairs Canada, AFD, BMZ	Ability to allocate a small portion of their ODA budgets at catalytic terms to achieve impact and mobilize investors
Asset managers / funds managers who can create and manage blended finance structures, develop credible pipeline, and mobilize private investors		Ability to create and manage blended finance structures and build credible project pipeline Ability to mobilize institutional investors

Table X below identifies the list of 24 counties that are (i) amongst the Top 50 global carbon emitters and (ii) are Low and Middle-Income Countries. The nine countries highlighted in orange are countries where country risk is high (proxied by Non-Investment Grade sovereign rating) and emissions are high but not due to a domestic oil and gas industry. The list suggests the following about deploying Catalytic Capital in the short-term for the sub-set of LICs and MICs that are Top 50 emitters:

- Project-level risk is a much more substantial risk to mitigate than country risk – therefore, Catalytic Capital should be deployed more at project level compared to portfolio level
- Low-Cost Catalytic Capital is likely in high demand in LICs and MICs to address both climate Mitigation and Climate Adaptation.

A list of countries with increasing emissions would have a much higher collection of LICs and MICs with high country risk. Therefore, High-Risk capital should be deployed in the medium term at portfolio level to support Climate Mitigation and Climate Adaptation projects.

Table B.3: List of LICs and MICs with high carbon emissions, High Country Risk less of an issue and possibly Low-Cost Catalytic Capital More Important

List of LICS and MICs that emit material amount of world's carbon emissions

Rank of Global Emitters	Country	Share of Global Emissions	Income Level	Median Risk Rating
1	China	29.20%	UMIC	A+
3	India	7.09%	LMIC	BBB-
8	Iran	2.22%	UMIC	NA
10	Indonesia	1.48%	LMIC	BBB
13	Mexico	1.23%	UMIC	BBB
15	South Africa	1.09%	UMIC	BB-
16	Turkey	1.03%	UMIC	B+
22	Thailand	0.76%	UMIC	BBB+
23	Malaysia	0.74%	UMIC	A-
25	Ukraine	0.65%	LMIC	CCC
26	Kazakhstan	0.65%	UMIC	BBB
27	Egypt	0.61%	LMIC	B
29	Vietnam	0.58%	LMIC	BB
30	Argentina	0.56%	UMIC	CCC
31	Pakistan	0.50%	LMIC	B-
32	Venezuela	0.49%	UMIC	C
34	Iraq	0.45%	UMIC	B-
34	Nigeria	0.23%	LMIC	B
35	Algeria	0.44%	UMIC	NA
36	Philippines	0.35%	LMIC	BBB
38	Uzbekistan	0.31%	LMIC	NA
45	Turkmenistan	0.22%	UMIC	B+
47	Colombia	0.22%	UMIC	BB+
48	Bangladesh	0.21%	LIC	BB-

Countries highlighted in yellow have High Country Risk (Non-IG rating)

Annex C

Cases and examples of leading blended finance transactions

See examples of case studies at Convergence website here.

Table C.1 Illustrative description of two blended finance funds to mobilize private investors into MDB/DFI loans, at scale

Blended Finance Fund	Illustrative Description of Blended Finance Fund and Catalytic Capital

MDB & DFI Private Sector Loan Fund
 	
Fund to participate in loans to private sector borrowers.
 	
Loans arranged by MDBs/DFIs
 	
Flows C and D in Tables 6.1 and 6.2
	● Shareholders of MDBs/DFIs would establish KPIs that require the MDBs/DFIs to increase their origination and arranging capacities, and significantly increase the amount of senior loans provided to finance Climate and SDG projects
	● Private-sector lending MDBs/DFIs include IFC, EBRD, AfDB, AsDB, IDB Invest, IsDB, US DFC and most/all of the European DFIs
	● The MDBs/DFIs currently commit around $25 billion of senior hard currency loans annually to the private sector. As laid out in Tables 6.1 and 6.2, MDBs/DFIs could increase their origination and arranging capacities to $120 billion annually
	● MDBs would commit A-B loans to private-sector borrowers using their existing, well-known A-B loan approach. For the envisioned Fund, the ratio could be 25% A-loan and 75% B-loan: $30 billion of A-loans retained by MDB & DFIs and $90 billion of B- loans transferred to the MDB & DFI Private Sector Loan Fund
	● The A-loan and B-loan interest rates would be priced at market terms
	● The B-loans would be to good quality borrowers, but those borrowers will be located in the 140 EMDEs with high country risk ratings - individual loans would have implied risk ratings of mostly *"B"* and *"CCC"*
	● The B-loans would be transferred to the MDB & DFI Private Sector Loan Fund and capital from public and private sources could be raised as follows:
	  ○ Fund capitalized by three tiers of capital: (I) 80% Senior Notes rated "*BBB*" invested by private sector investors, (ii) 15% Mezzanine Notes likely rated "*B*" invested by MDBs, DFIs (and potentially more risk tolerant private sector investors) and (iii) 5% Junior Notes rated "*CC*" invested by providers of Catalytic Capital.
	  ○ $90 billion of B-loans annually would require around $4.5 billion of Junior Notes (subscribed by donor governments and foundations) and $13.5 billion of Mezzanine Notes (subscribed by MDBs/DFIs)
	  ○ Fund would have highly-qualified fund manager – role awarded through competition
	  ○ Senior Notes, Mezzanine Notes and Junior Notes would be formally rated and publicly listed; allowing all Notes to be priced and traded, increasing liquidity and reducing risk
	  ○ Formal rating and listing of notes will allow almost all private sector investors to invest in notes, broadening and deepening a global developing world investor base
	● Listing creates secondary market and allows all notes to be sold at market price – thereby freeing up mezzanine and donor junior capital to be re-cycled into the next cohort of transactions as noteholders elect to sell
	● Leverages the financial depth, transparency, and standardization of global financial markets to drive down risk and allow mobilization at scale.
	
	Technically, there would need to be two MDB & DFI Private Sector Loans Funds – one for Climate projects and one for SDG (Non-Climate) projects for the following reasons:

	● There are two discrete pools of donor Catalytic Capital, one for Climate and one for the SDGs (Non-Climate). For example, Developed Country concessional Climate Funds must be allocated to Climate projects only; no mandate to finance non-Climate projects. The junior capital in each of the two funds – Climate and SDG (Non-Climate) – would be subscribed by different sources. ● Private investors have high demand for Climate Finance, Green Finance, Net-Zero Finance and Sustainable Investment. The notes funding the Climate Fund will be subscribed by investors with those investment mandates. ● Annex W provides detailed terms for the proposed MDB &DFI Private Sector Loan Fund
MDB Public Sector Loan Fund Loans to public sector borrowers (sovereign and sub-sovereign). Loans arranged by MDBs/DFIs Flows A and B in Tables 6.1 and 6.2	Very similar to above, but with specific nuances relative to sovereign loans: ● The shareholders of public-sector lending MDBs would establish KPIs that require the MDBs to increase their origination and arranging capacities, and significantly increase the amount of public-sector loans ● The public-sector lending MDBs include IBRD, AfDB, AsDB, IADB Invest and EBRD ● The MDBs currently commit around $90 billion of senior hard currency loans annually to the public sector. As laid out in Tables 6.1 and 6.2, MDBs could increase their origination and arranging capacities to $200 billion annually, creating more investable transactions and portfolios of investable deals ● MDBs would commit A-B loans to public-sector borrowers using a revised A-B loan approach. For this Fund, the ratio would be 50% A-loan and 50% B-loan; $100 billion of A-loans retained by MDBs and $100 billion of B-loans transferred to the MDB Public Sector Loan Fund ● The B-loan interest rates, unlike the A loans, would be priced at market terms ● The B-loans would be spread across EMDEs, with an expected median risk rating of "*B*" ● The B-loans would be transferred to the MDB Public Sector Loan Fund and capital from public and private sources could be raised as follows: ○ Fund capitalized by three tiers of capital: (I) 85% Senior Notes rated "*BBB*" invested by private sector investors, (ii) 12.5% Mezzanine Notes likely rated "*B*" invested by MDBs and private sector investors and (iii) 2.5% Junior Notes rated "*CC*" invested by providers of Catalytic Capital. ○ $100 billion of B-loans annually would require around $2.5 billion of Junior Notes (subscribed by donor governments and philanthropies) and $12.5 billion of Mezzanine Notes (subscribed by MDBs/DFIs) ○ Fund would have highly-qualified fund manager – role awarded through competition ○ Senior Notes, Mezzanine Notes and Junior Notes would be formally rated and publicly listed; allowing all Notes to be priced and traded ○ Formal rating and listing of notes will allow almost all private sector investors to invest in notes, broadening and deepening a global developing world investor base ● Listing creates secondary market and allows all notes to be sold at market price – thereby freeing up mezzanine and donor junior capital to be re-cycled in next cohort of transactions as noteholders elect to sell ● Leverages the financial depth, transparency, and standardization of global financial markets to drive down risk and allow mobilization at scale. Similar to above, there would need to be two MDB Public Sector Loans Funds – one for Climate projects and one for SDG (Non-Climate) projects.

Annex D

How blended finance creates fiduciary investment assets in EMDEs

Key Takeaways:

- Blended finance seeks to mobilize private investment to investable and near-investable projects. Blended finance has not role for uninvestable projects
- Blended finance can mobilise private investment to investable projects that happen to reside in high-risk countries
- Blended finance can provide the credit enhancement and credit mitigation solutions that improve near-investable projects to become investable - and therefore investible by private investors
- With at least 80% of private actors investing only if they identify market-equivalent or market-beating investment opportunities, and premium returns being required to invest in unfamiliar asset classes, blended finance must create market-equivalent or market-beating returns to cause investors to divest out of developed markets and invest in LICs and MICs

D.1 Feedback from Private Investors to Development Community on cross-border investment to LICs and MICs

This subsection describes three recent sources of feedback from private investors relevant for donor-funded activities to mobilise investment to LICs and MICs. Section 4.1.1 describes feedback from the Global Impact Investing Network annual survey (294 investors) and the Global Investors for Sustainable Development Alliance (30 global institutional investors with $16+ billion of AUM). Section 4.1.2 summarizes feedback investors provided Convergence in 2020 in preparation of this Action Plan.

D.1.1 Global Investors for Sustainable Development (GISD) Alliance and GIIN Investor survey

Since October 2019, the UN Secretary General has convened 30 global institutional investors, with USD 16+ trillion of AUM, interested in allocating a portion of their investment to the SDGs (the GISD Alliance). In July 2020, the Alliance published its "Renewed, Recharged and Reinforced: Urgent actions to harmonize and scale sustainable finance" Report. Annex X summarizes the key blended finance and emerging markets excerpts from the GISD Alliance Report, while Table D.1 summarizes private sector investor feedback about investing in LICs and MICs and blended finance from the GISD Alliance and GIIN Investor Survey.

Table D.1: Highlights of feedback from private investors on investing in developing counties and blended finance

Organization and Report	Key excerpts and summaries relevant for this Action Plan
Global Impact Investing Network: Annual Impact Investor Survey 2020	• 294 investors – asset owners and asset managers – with $404 billion of AUM • 55% directed to developed markets and 40% allocated to emerging markets • Emerging markets investments performed similarly to developed market investments across asset classes • Around 44% of investors plan to increase their allocation in developing counties compared to 4% who plan to decrease • 37% of respondents claimed they would like to participate in / contribute to advancing blended finance vehicles in the next five years • Strong recommendations to increase blended finance to increase blended finance activity for investment in LICs and MICs
Global Investors for Sustainable Development Alliance: Renewed, Recharged and Reinforced: Urgent actions to harmonize and scale sustainable finance	• 30 major global institutional investors with an aggregate of $16 trillion AUM • Recommendations to increase SDG private investment globally, with a dedicated focus to emerging markets and LICs and MICs • **Be bold, act now: We must make better, faster and scaled use of blended finance**. • Mobilize private investment by making previously 'uninvestable' projects investable thanks to donor and concessional capital, and aggregating them to reach scale • COVID-19 will also increase the real and perceived risk of cross-border investments into

	emerging markets, depriving them of much-needed capital. Capital inflows into emerging markets have returned after historic portfolio outflows of almost $100 billion in March 2020, but whether investment confidence fully recovers is yet to be seen.[xxvii] Governments can take steps to reduce emerging market investment risk and catalyze private capital flows through effective risk mitigation and risk sharing. Stable and predictable policy frameworks are necessary but not sufficient; in many instances blended finance will also be needed. • **The public sector has a wide variety of tools available to mobilize private finance.** Deployed thoughtfully, commercial capital is responsive to guarantees, tax policies and targeted insurance subsidies (e.g. political risk insurance). Blended finance structures, in particular, have enormous unrealized potential to guide private investment to either domestic or international objectives at both the project and fund levels. National, regional, and multilateral development institutions as well as donors have yet to design and fund blended structures at scale, however. Furthermore, there is no authoritative 'hub' to facilitate sustainable blended finance transactions at scale, as there are in other areas of finance. Successful finance allows capital to be recycled and redeployed, increasing total capital mobilization for the SDGs.

D.1.2 Interviews with Investors

In 2020, Convergence engaged a group of 42 private investors in preparation of this Action Plan, and in March 2021 re-engaged a group of 36 asset owners and asset managers as research for this Action Plan. Tables D.2 and D.3 summarize the collective feedback on investing in developing counties and blended finance.

Although private investors identified there are many challenges to investing in LICs and MICs, the top five challenges are summarized in Table D.2. And Table D.3 summarises more granular feedback.

Table D.2: Institutional Investor Challenges to investing in LICs and MICs

#	Challenge	Description
1	High country risk	The OECD and World Bank categorize 141 counties as Low and Middle-Income Countries eligible for Official Development Assistance. The median sovereign risk rating is S&P-equivalent "B". Only 14 are Investment Grade. Using rating agency convention, private sector projects would have ratings 1-3 notches lower (e.g., weak Single B and CCC). Most debt and equity investor have no mandate to invest at this risk profile.
2	Market equivalent risk-return investment assets	Actual risk is high, and perceived risk is likely higher. Even the investors who can allocate investment to LICs and MICs identify the return available as not being commensurate with the risk. This causes them to continue to pursue investments in developed countries.
3	Access to investible product	Investors identify a scarcity of investment assets that meet their criteria. This is not limited to the other four challenges in this table, but also include liquidity, private markets versus public and pricing/valuation benchmarks.
4	Good quality asset managers	Most asset owners and institutional investors rely on one or two levels of asset management / financial intermediation. First, an asset manager that can create and manage a "fund" that meets their standards. And second, asset arrangers that can originate and arrange financial assets in LICs and MICs. Investors identify the lack of high-quality, experienced asset managers as a concern.
5	Regulation	Regulated financial institutions and asset owners, such as commercial banks and insurance companies, identify the capital requirements for high-risk investments in LICs and MICs as prohibitively high. With high capital charges, investors state they can achieve better return on capital by remaining invested in developed countries.

Table D.3: Most prevalent challenges to investing in LICs and MICs

	Domestic		**International (Cross-border)**	
	Debt	**Equity**	**Debt**	**Equity**
Typical type of organization	Local bank Microfinance institution	Private Equity Fund Manager	International bank Institutional Investor Impact Investor	Private Equity Fund Manager Private Equity Investor
Relative, realistic Importance for funding SDG projects in developing country	Very High	Low	Medium-High	Low-Medium
Main Reported Challenges – Importance identified by private investors				
Country Risk	Low-Medium	Low-Medium	High	High
Currency Risk	Low-Medium	Low-Medium	High	High
Transfer and Conversion Risk	Low	Low	Medium	High
Small size of transactions	Low	Medium	High	Medium

Limited number of investable deals	Medium	High	Medium-High	High
Underlying risk or risk-return of the financing opportunity	Medium	High	High	High
Lack of debt funding	Medium	Not Applicable	Not Applicable	Not Applicable
Lack of equity funding	High	High	Not Applicable	Medium - High
Lack of local currency funding	Medium	High	Medium	Not Applicable
Private Investors Preferred Blended Finance Solution from Development Organizations (Limited to Risk-Return)				
First Choice	Guarantee of borrower risk	More equity / capital in investing organization (fund)	Reduction in risk profile (e.g., from "B" to "BB")	Asset manager: More equity / capital in investing organization (fund) Asset owner: Good asset manager
Second Choice	Risk sharing of borrower risk	Asymmetric equity from donor in investing organization	Diversification across multiple countries, borrowers and currencies	Asset manager: Access to good equity investments
Third Choice	More equity / capital in lending organization	Mechanism to reduce exit risk in 5-8 years	Access to good debt investments with good asset manager	Asymmetric equity from donor in investing organization
Fourth Choice	Access to local currency funding or hedging (At viable price)	Mechanism to increase liquidity and exit during investment period	Currency risk mitigation	Mechanism to reduce exit risk in 5-8 years
Note: Convergence does not include straight subsidy as options since all organizations would like subsidy and difficult to ascertain validity.				

D.3 Private investors can finance commercially investable projects/companies, including near-investable projects that are risk mitigated

Private investors clearly identify they are only able to finance investable projects/companies, and near-investable projects with "credit enhancement" and "credit mitigation" solutions required at the project-level to improve a near-investable project to become investable. Blended finance solutions provide this credit enhancement. Table D.4 outlines the types of transactions blended finance should be used to support; specifically, transactions in Category 1 and 2, while foregoing transactions in Category III.

Blended finance can support transactions at one of two levels: the project level (e.g., a project or company) or the portfolio level (e.g., a pooled fund or facility). Section E provides elaboration.

Table D.4: Transactions that can benefit from blended finance

Transaction Category	Description	Blended Finance Solution
Category 1: Investable	Project is investable on commercial terms – *financial intermediaries are prepared to finance the project on normal, market-based terms with no external support required.*	Many investable SDG projects in LICs and MICs go unfinanced due to a lack of capital. Blended finance solutions increase the supply of capital available to financial intermediaries, thereby increasing the number of SDG projects that can receive financing get off the ground.
Category 2: Near-Investable	Project is mostly investable "as is," but requires a level of risk mitigation – *financial intermediaries require some risk mitigation to finance the project.*	Without some risk mitigation to make the project investable, these near-investable projects will not receive financing and will not be implemented. Examples could include an SME that has the necessary cashflows to obtain a loan but lacks the collateral to pledge to a domestic bank. Blended finance solutions can provide risk mitigation solutions to credit enhance transactions, transforming near-investable projects to investable initiatives.
Category 3: Uninvestable	Project is uninvestable, probability of failure and financial loss is unacceptably high - *financial intermediaries would require a full guarantee to finance the project.*	There are many projects financial intermediaries would determine to be uninvestable. Blended finance solutions are not intended to mobilize finance to these types of projects.

D.4 Blended Finance must create market-equivalent or market-beating risk-return investment profiles to mobilize private investors

Private investors allocate their debt and/or equity investment (i) using analytical/empirical investment models that determine risk levels and expected returns. Good blended finance solutions concurrently must solve at least one of the following two challenges (and ideally both at the same time):

- Increase the supply of investment that can be allocated to SDG projects in LICs and MICs and
- Alter the risk-return for the investment opportunity to improve the investment decision from a rejection to an approval.

The 2020 GIIN Investor Survey provides good analysis on investor decision making. First, 80% of private investors state they will only invest if they foresee a market-equivalent or market-beating investment opportunity. Only a very small minority of investors are prepared to allocate funds below market-equivalency. Second, to mobilize investors to a new asset class with limited experience, investors expect a premium return until they become regularized to the asset class.

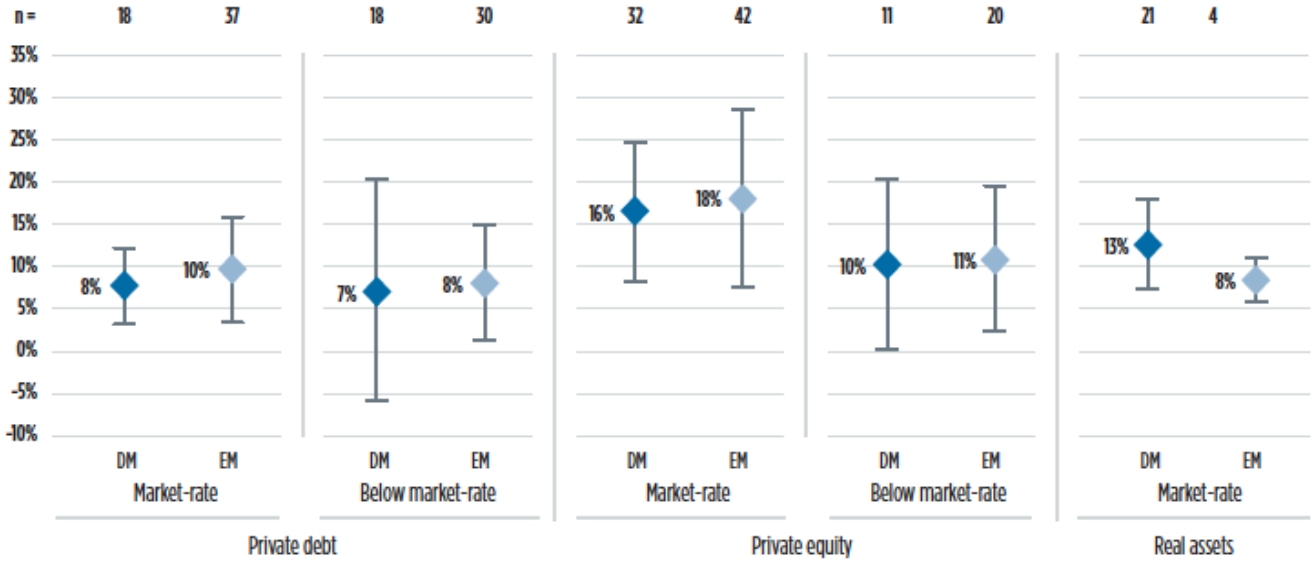
Figure D.1 reproduces the financial return information published in the 2020 GIIN Investor Survey. The data indicates (i) debt investors have earned a 2% premium for private debt deals in emerging markets compared to developed markets and (ii) equity investors have earned a 2% premium for private equity deals in emerging markets compared to developed markets.

Further, Figure D.2 from the same GIIN Survey indicates that 88% of private investors state that financial returns have met or exceeded their expectations (note this applies to all investments in developed and LICs and MICs – no disaggregated data).

Figure D.1: Average realized gross returns since inception for private markets investments, 2020 GIIN Survey

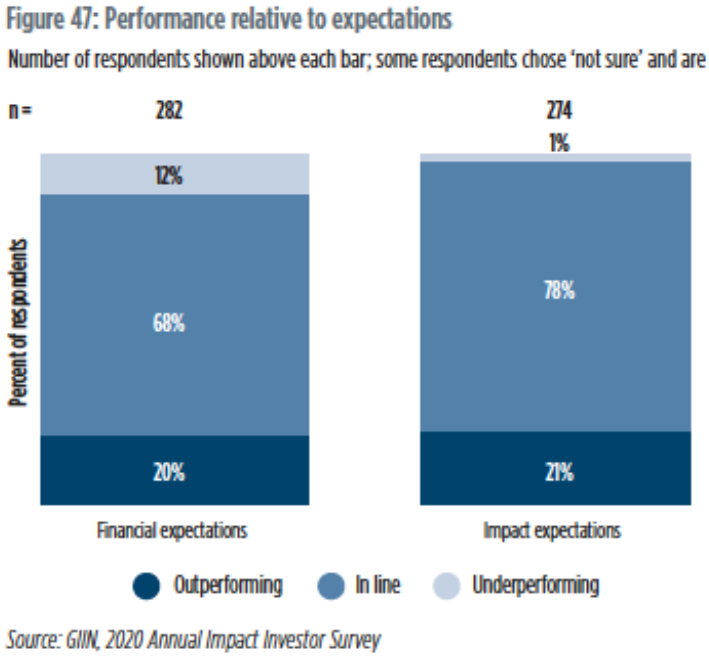
Figure iii: Average realized gross returns since inception for private markets investments

Number of respondents shown above each bar; year of first impact investment ranges from 1956 – 2019, with 2011 as the median year. Averages shown beside each diamond; error bars show +/- one standard deviation.



Source: GIIN, 2020 Annual Impact Investor Survey

Figure D.2: Actual performance relative to expectations, GIIN 2020 Survey



Source: GIIN, 2020 Annual Impact Investor Survey

Annex E

Four most effective and efficient blended finance approaches

(As determined through consultation with 100+ investors and 20+ ODA-donors in 2021)

Based on engagement and workshops amongst 100+ investors and 20+ donors in 2021, Convergence summarizes four blended finance structures that have the greatest potential to mobilize private investment at scale. They are also relatively easy to implement and standardize.

The first three are "portfolio level" blended finance solutions where (i) investment risk is diversified across many projects, companies, borrowers and countries and (ii) private sector investors are credit-enhanced structurally with private investment ranking senior to development funding contributed in a subordinates position.

Blended Finance Structure 1 blends debt investment from private investors and development funds from development agencies into a portfolio structure (e.g., a fund), and the fund in turn provides debt to investable projects located in (high risk) LICs and MICs.

Blended Finance Structure 2 blends equity investment from private investors and development funds from development agencies into a portfolio structure (e.g., a fund), and the fund in turn provides equity to investable projects located in (high risk) LICs and MICs.

Since Structure 1 and 2 approaches to date have resulted in small and medium-sized funds (typically less than $200 million total fund size), generally (a) they have not been implemented to date at scale and (ii) they have not mobilized institutional investors which seek vehicles of $500+ million. Less than 3% of blended finance vehicles have been in excess of $500 million. To mobilize institutional investors and at scale (e.g., $500+ million) requires (i) these funds to be established at $500+ million or (ii) by creating **Blended Finance Structure 3** – an aggregation vehicle akin to a "fund of funds" where private and development funds are co-invested and a fund manager allocates investment to multiple Structure 1 or Structure 2 blended finance vehicles.

These three structures require good, experienced fund managers acceptable to private investors to allocate the fund's capital to SDG projects. For example, Blackrock raised the $675 million Climate Finance Partnership Fund in 2021 – an excellent example of Blended Finance Structure 2. And IFC raised the $1.5 billion MCPP Infrastructure Transaction in 2018 – an excellent example of Blended Finance Structure 1.

Blended Finance Structures 1 and 3A are debt vehicles and Blended Finance Structures 2 and 3B are equity vehicles.

Blended Finance Structures 1 and 3A must have a critical mass of subordinated capital to mobilize private investment. The median sovereign risk rating (from Moody's, S&P and Fitch) of the [85] counties they rate amongst the [141] Low and Middle-Income Countries is S&P-equivalent ("B+"). Adding the OECD Export Credit Agency Ratings for the other 56 countries results in a median risk rating of "B" for the [141] countries. Accordingly, the majority of borrowers in Low and Middle-Income Counties will have formal or implied risk ratings of "B" and "CCC". In order to attract private investors into portfolios of debt where the median borrower is assumed to be around "B" requires around 20% formal subordination in these debt blended finance structures. The resulting implied risk rating for the senior private investors will be "BBB" or "BB". There is simply not enough catalytic concessional capital amongst ODA donors to capitalize one single tranche of subordinate funds using ODA resources only. Accordingly, the most optimal approach is to have three tiers of funding, with a mezzanine tier of 10-15% subscribed by MDBs and DFIs and a junior tier of [5]% subscribed by ODA-donors. The likely ratings of the mezzanine investments would be "B" or "CCC". This risk profile is consistent with MDB and DFI's mandate as witnessed by Table C.4. For example, the average risk rating of IFC's and EBRD's borrowers is "B". Therefore, the mezzanine investments would have a risk profile on par with the average risk ratings of most MDBs and DFIs arranging private sector loans.

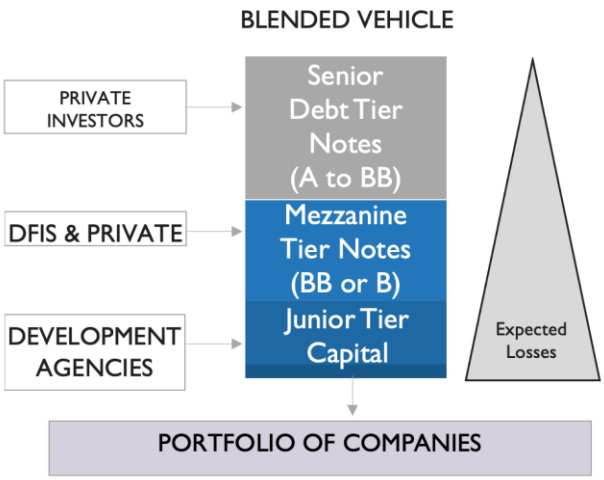
Blended Finance Structure 4 combines development funds from development agencies, and sometimes private investment capital, into a company/entity, and that company/entity extends guarantees to support:

- Investable projects in (high risk) LICs and MICs (e.g., AGF and GuarantCo) and/or
- Near-investable projects by providing credit enhancement for all or some risks, and all or portion of debt obligation (e.g., GuarantCo and MIGA)
- Private investment is mobilized primarily at the project level – either domestic capital or cross-border capital.
- This structure requires good quality, experienced management team to underwrite guarantees that achieve superior development impact and sufficient financial results consistent with funders' governance.

E.1 Structure 1: Blended Finance Vehicle to mobilize cross-border debt investment at scale (Portfolio)

Figure E.1: Illustration of Blended Finance Structure 1

1. Establish Blended Finance Vehicle with 2-3 capital tiers
2. Vehicle typically a fund with experienced fund manager
3. Vehicle invests in portfolio of debt investments (loans) rated BB- to B-.
4. Diversification (1-2 notch uplift) and subordination (1-6 notch uplift) reduces probability of default and expected losses for senior tier investors.
5. Senior tier notes can achieve investment grade rating (e.g., A or BBB) and mezzanine notes good-quality non-investment grade rating (e.g., BB)
6. Investment grade rating allows a large universe of investors restricted by investment grade mandate



- Assume portfolio of 100 loans to borrowers with "B" risk rating
- Portfolio diversification can enhance risk rating to "BB-"
- Assume portfolio funded by three tiers of capital: (1) Senior Notes for [75]%, (ii) Mezzanine Notes for [15]% and Junior for [10]%
- Can credit enhance Senior Notes to equivalent of "Investment Grade" "BBB" subject to enough Mezzanine and Junior
- Junior and Mezzanine must be sufficient to absorb at least (1) the "expected losses" in this case between "BB-" and "BBB" or 0.63% per year (i.e., 0.79% less 0.16%) plus (2) some unexpected loss
- Possible to achieve Investment Grade "BBB" for Senior Notes with a minimum of 15% of subordinate capital (for a 10 year tenor)

Rating	Annual Expected Loss
BBB	0.16%
BBB-	0.29%
BB+	0.48%
BB	0.75%
BB-	0.79%
B+	1.21%
B	1.87%
B-	1.89%

Diversification

Subordination

E.2 Structure 2: Blended Finance Vehicle to mobilize cross-border equity investment at scale (Portfolio)

Figure E.2: Illustration of Blended Finance Structure 2 (Junior capital funded as grant)

STRUCTURE 2:
BLENDED FINANCE VEHICLE PREFERRED BY EQUITY INVESTORS

1. Establish Blended Finance Vehicle with 2-3 capital tiers
2. Vehicle typically a fund with experienced fund manager
3. Vehicle invests in portfolio of equity investments in investee companies.
4. Prioritization of waterfall of distributions:
   1. First distributions to Class A until IRR of 0-5%
   2. Second distribution to Class B until IRR of 0%
   3. Third distribution up to grant amount from donor(s) – Donor instructs at outset where grant monies should flow if fund is successful – typically a classic ODA purpose
   4. Fourth distribution to capital providers by negotiation.
5. Waterfall prioritization for Senior Class A Shares: (i) reduces likelihood of losses, (ii) increases likelihood of achieving market benchmark and (iii) increases likelihood of high IRRs

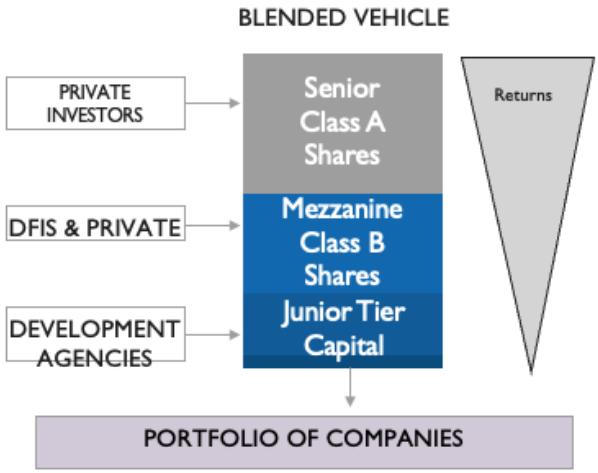
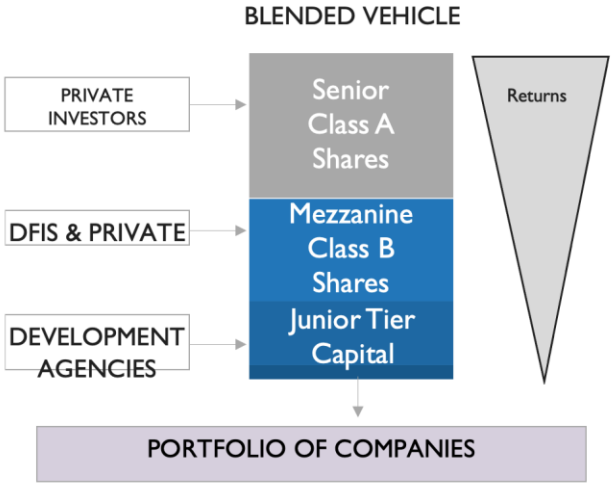


Figure E.3: Illustration of Blended Finance Structure 2 (Junior capital funded as equity)

1. Establish Blended Finance Vehicle with 2-3 capital tiers
2. Vehicle typically a fund with experienced fund manager
3. Vehicle invests in portfolio of equity investments in investee companies.
4. Prioritization of waterfall of distributions:
   1. First distributions to Class A until IRR of 0-5%
   2. Second distribution to Class B until IRR of 0%
   3. Third distribution to Junior Capital until IRR of 0%
   4. Fourth distribution to capital providers by negotiation.
5. Waterfall prioritization for Senior Class A Shares: (i) reduces likelihood of losses, (ii) increases likelihood of achieving market benchmark and (iii) increases likelihood of high IRRs



E.3 Structure 3: Aggregation Vehicles for scale mobilization – either debt or equity (Portfolio)

This structure is simply an aggregation of Structure 1 or Structure 2 approaches to create the scale required to mobilize institutional investors. For example, Structure 1 and Structure 2 blended finance vehicles have usually been for around $200 million. But institutional investors seek investment vehicles of $500+ million. An aggregation vehicle, such as a "fund of funds" can create the critical mass that attracts institutional investors.

E.4 Structure 4: Blended Finance Vehicle to mobilize debt investment (Project)

Blended finance structures consolidate funds from different sources and then employ those funds to support investable and near-investable projects located in developing counties.

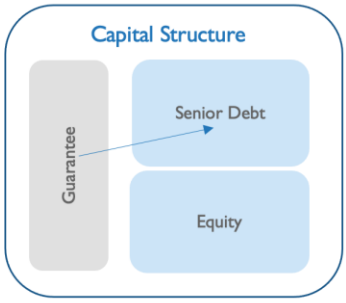
Figure E.4: Blended finance supports investable and near-investable projects

BLENDED FINANCE SUPPORTS BANKABLE AND NEAR-BANKABLE TRANSACTIONS - NOT UNBANKABLE

Transaction Category	Description	Blended Finance Solution
I) Bankable	Project is bankable on commercial terms	Many bankable SDG projects in developing countries go unfinanced due to a lack of capital. Blended finance solutions increase the supply of capital available to financial intermediaries, thereby increasing the number of SDG projects that can receive financing get off the ground.
II) Near-Bankable	Project is mostly bankable "as is," but requires a level of risk mitigation.	Without some risk mitigation to make the project bankable, these near-bankable projects will not receive financing and will not be implemented. Blended finance solutions can provide risk mitigation solutions to credit enhance transactions, transforming near-bankable projects to bankable initiatives.
III) Unbankable	Project is unbankable, probability of failure and financial loss is unacceptably high	There are many projects financial intermediaries would determine to be unbankable. **Blended finance solutions are not intended to mobilize finance to these types of projects.**

Figure E.5: Illustration of Blended Finance Structure 4

- Guarantee best deployed at project level to convert a "near-bankable" project to bankable
- Guarantor must be rated (Investment Grade, e.g., "A")
- Guarantee can be for 100% of debt obligation or less
- Guarantee can be for all risks, or sub-set of risks (e.g., political risks)
- Big 3 Rating Agencies cap credit enhancement uplift for partial guarantees to 2 notches (e.g., "B" risk can become "BB-")



- Proposition: Investors and project would benefit more from a 100% guarantee from an "A" listed entity (e.g., GuarantCo) more than from a "AAA" entity (e.g., development agency)

E.5 Indicative Terms

Table E.1 identifies indicative terms of Blended Finance Structures 1 and 2 that meet the requirements of institutional investors and development agencies.

Table E.1: Indicative Structures for Blended Finance Vehicle

Topic	Debt Blended Finance Vehicle	Equity Blended Finance Vehicle
Blended Finance Vehicle Description	• A fund with three tiers of capital • Diversification of assets credit enhances risk by one or two notches from weighted average risk rating of underlying assets • Subordination of junior capital tiers enhances senior tier to Investment Grade or strong Non-Investment Grade (e.g., BB+)	• A fund with three tiers of capital • Diversification of equity investment reduces variability in return • Subordination of junior tiers and preferred returns for senior tier (i) reduces distribution to returns expected to be negative and (ii) increases expected IRR to premium to market-equivalent
Assets of Blended Finance Vehicle	• Senior debt: Bonds, loans and loan risk participations • Diversified across 50+ senior debt instruments in 25+ countries • Largest exposure no more than [3]% of portfolio	• Common equity: Shares in investees • Diversified across 10+ equity investments • Largest exposure no more than [12]% of portfolio
Fund Life	• 12-year life	• 12-year life, comprising 5-year investment period and 7-year divestment period
Entities financed in LICs and MICs	• Banks, microfinance institutions, Infrastructure projects, PPPs, telecommunications companies, FDI, mid-caps, SMEs, food processors, agribusinesses	• Banks, microfinance institutions, Infrastructure projects, PPPs, telecommunications companies, FDI, mid-caps, food processors, agribusinesses
Fund manager/asset manager	• Organizations of sufficient size, experience in managing debt funds and knowledge of LICs and MICs seen as bona fide manager by investors	• Organizations of sufficient size, experience in managing equity funds and knowledge of LICs and MICs to be seen as bona fide manager by investors
Originators, Arrangers and Managers of underlying assets	• Fund manager / asset manager described above • International commercial banks • Local banks in LICs and MICs • Private credit originators	• Fund manager / asset manager described above • High-quality, well-known fund managers operating in LICs and MICs
Senior Tier of Capital Structure Investors	• [65-85]% of capital structure, subscribed as notes • Preferred Investors are Institutional Investors (not MDBs and DFIs) • Target institutional debt investors (e.g., pension companies and insurance companies) • Likely risk profile: Investment grade (A and BBB) and BB+	• [50-75]% of capital structure, subscribed as Class A Shares • Preferred Investors are typical LP investors (not MDBs and DFIs) • Target pension companies and Limited Partners in PE funds
Second Tier of Capital Structure	• [10-25]% of capital structure, subscribed as notes/loans	• [10-25]% of capital structure, subscribed as Class B Shares

Investors	• Target institutional investors with "high yield" mandate, MDBs and DFIs • Likely risk profile: Non-Investment grade: BB to B-	• Target institutional investors with "high risk" mandate: Hedge funds, MDBs, DFIs, High Net Worth, Foundations
Third Tier of Capital Structure Investors	• [5-15]% of capital structure, subscribed as instrument(s) that work for ODA donors - notes, equity, grants and/or guarantees • Target private investors with "high yield" mandate, ODA donors, foundations, developing country governments and multidoor funds (e.g., Green Climate Fund) • Likely risk profile: Speculative Grade at B- or lower	• [5-15]% of capital structure, subscribes as instrument(s) that work for ODA donors - equity, grants and/or guarantees • Target private investors with "high risk" mandate, ODA donors, foundations, developing country governments and multi-donor funds (e.g., Green Climate Fund)
Typical Terms of Senior Tier Credit Enhancement via Junior Tier subordination	• Sufficient size and terms to credit enhance senior tier to target: A, BBB or BB+ • Second Tier and Third Tier capital are subordinate to Senior Tier in cashflows and security • Diversification across at least [35] debt assets in at least 10 countries • Weighted Average Risk Rating of Fund Loan Portfolio "B" or higher • Collateral: Ratio of Performing Loans to Senior Tier around [1.33] • Debt Service Coverage Ratio of [1.33] • Remuneration of Senior Tier [75] bp premium to comparable bond portfolio.	• Sufficient size and terms to improve risk-return for Senior Tier • Second Tier and Third Tier capital are subordinate to Senior Tier in cashflows and security • Diversification across at least [15] equity investments in at least 5 countries • Collateral: Ratio of Fund Portfolio Investments to Senior Tier around [1.33] • Distribution Waterfall of Cashflows to Investors: 1. All Returns to Senior Tier until Internal Rate of Return of Zero 2. Next Returns to Second Tier until IRR of Zero 3. Next Returns to Senior Tier until IRR of 8% 4. Next Returns to Third Tier until IRR of Zero 5. Next Returns to Second Tier until IRR of 8% 6. All remaining Returns distributed proportionately to all three tiers • Expected Remuneration of Senior Tier [200] bp premium to expected returns in developed countries.
Implied Returns for Senior Tier	• Assume fund management fees are 1% per annum • Assume the required interest rate to remunerate the Senior Tier would be the market equivalent of BBB plus 100 bp. At February 28, that would equate to 3.5% • In downside scenario, the Senior Tier would realize a loss of capital and/or returns in the event around 25% of loans went into default with 100% write off	• Assume fund management fees are 2% per annum • Assume the required Expected Rate of Return to mobilize private investors into Senior Tier would be 15% • In downside scenario, the Senior Tier would realize a loss of capital if 100% of Fund resources were deployed and the fund only realized around 85-90% of returned proceeds

	• In all other scenarios, the Senior Tier would recover 100% of tis principial and 3.5% interest rate • For comparison purposes, since inception in 2007, the leading emerging bond market benchmark (the JP Morgan Emerging Markets Bond ETF) has generated an average annual return of 6.15% since inception.	• To generate the 8% IRR described above, Fund returned procced would need to be around 180% of Fund size. • For comparison purposes, since inception in 200o, the leading emerging market equity benchmark (the MSCI Emerging markets Index) has generated an average annual return of 9.7% relative to 6.0% for its MSCI world benchmark. •
Implied Returns for Third Tier	• The Third Tier funders would incur a loss if around 10% of the loans went into default with 100% write-off	• The Third Tier funders would incur a loss if returned net proceeds were less than around 180% of Fund Size. That is, the Fund gross return would need to be 6% or higher for Third Tier to break even
Public or Private Markets	• For large vehicles, endeavour to create notes that can be public listed	• Possibility to list in public markets?

Annex F

Total investment and mobilization possible with Action Plan
See Section 6 of Action Plan

Total Annual Commitments

- Total Commitments: $530 billion comprised of $390 billion arranged by MDBs & DFIs and $140 billion arranged by private sector financial intermediaries
- Total Commitments to the public sector: $200 billion, all arranged by MDBs
- Total Commitments to the private sector: $330 billion comprised of $190 billion arranged by MDBs & DFIs and $140 billion arranged by private sector financial arrangers
- Of the $530 Total Commitments, only $50 billion would be arranged with no distribution to blended finance vehicles: $50 billion arranged and retained by MDBs and DFIs – debt and equity investments to private sector with Medium and High Financial Additionality which would likely not be of interest to private investors, e.g., local currency loans, mezzanine investments, Tier 2 subordinated. capital investment to financial institutions
- $530 billion of Commitments possible due to blended finance vehicles

Total Annual Debt Commitments

- Total Commitments: $470 billion
- Total Commitments arranged by MDBs & DFIs: $370 billion
- Total Commitments arranged by private sector financial arrangers: $100 billion

Total Annual Equity Commitments

- Total Commitments: $60 billion
- Total Commitments arranged by MDBs & DFIs: $20 billion
- Total Commitments arranged by private sector financial arrangers: $40 billion

Total MDB &DFI Commitments (net):

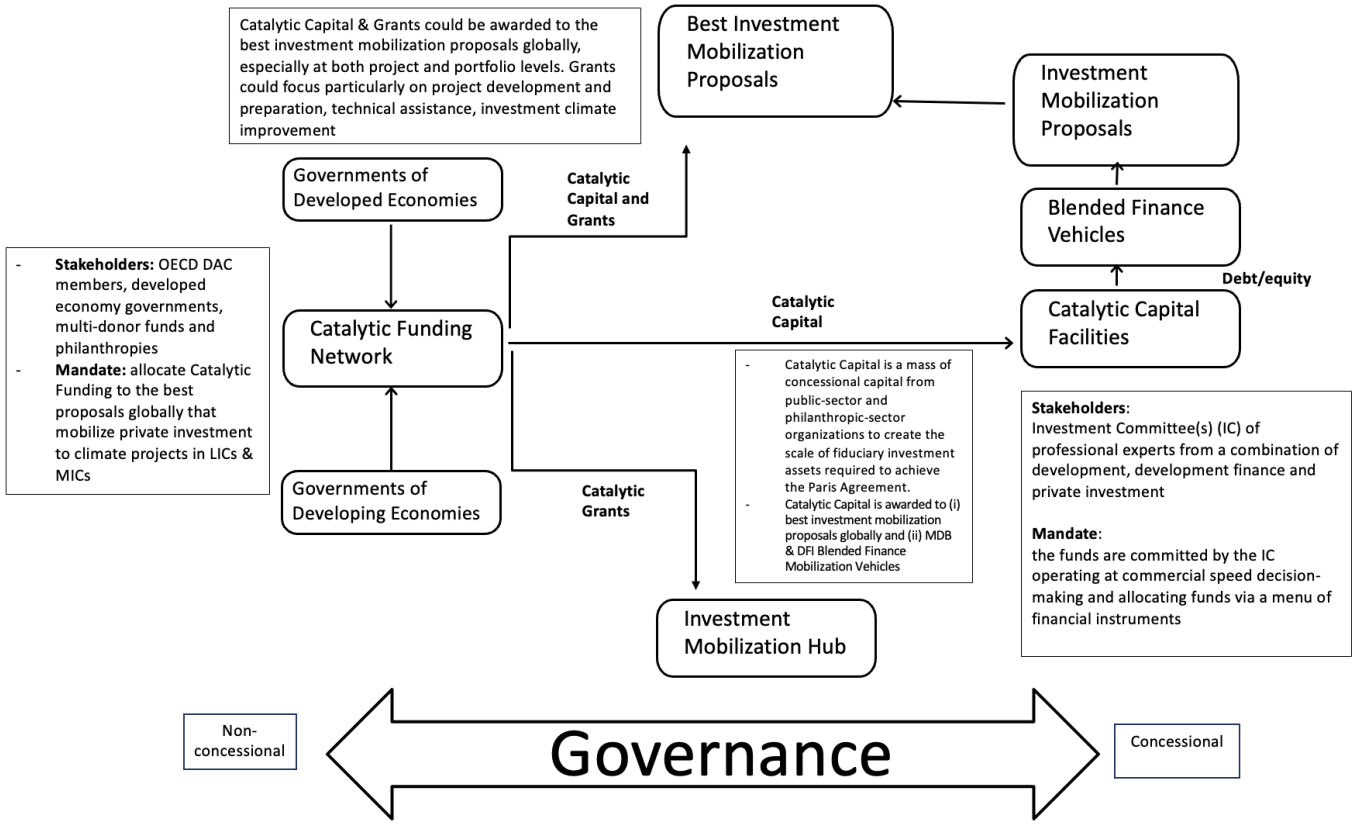
Flow	Net Senior investment	Mezzanine investment position
A	$40 billion	$5 billion
B	$60 billion	$7.5 billion
C	$12.5 billion	$5.6 billion
D	$17.5 billion	$7.9 billion
E	$5.0 billion	$2.3 billion
F		$11.3 billion
G		$6.0 billion
H	$50.0 billion	
Total	**$185 billion**	**$45.5 billion**

Table 6.1 in Section 6 provides a snapshot of the potential annual SDG & Climate Investment amounts segmented by type of investment flow. Total annual investment amounts would approach $530 billion – equal to 10-12% of the annual SDG and Climate Investment Needs. Moreover, as this more integrated development finance system crowds in additional private actors, the cost of de-risking would fall and share of investment needs would grow as private actors increasingly improved in assessing and benchmarking developing market risk. To achieve these amounts would require around $13.5 billion of Catalytic Capital from donors and $45.5 billion of mezzanine investment from MDBs and DFIs. This combined $59 billion of subordinated funding from donors and MDB/DFIs would mobilize a total of $286 billion of private investment in the following areas:

- Flow A: $34 billion to public-sector Climate debt investments arranged by MDBs - senior positions with expected fiduciary risk profiles of “BBB” risk (investment grade)
- Flow B: $52 billion to public-sector SDG (Non-Climate) debt investments arranged by MDBs - senior positions with expected fiduciary risk profiles of “BBB” risk (investment grade)
- Flow C: $30 billion to private-sector Climate debt investments arranged by MDBs and DFIs - senior positions with expected fiduciary risk profiles of “BBB” and/or “BB” risk
- Flow D: $42 billion to private-sector SDG (Non-Climate) debt investments arranged by MDBs and DFIs - senior positions with expected fiduciary risk profiles of “BBB” and/or “BB” risk
- Flow E: $12 billion to private-sector equity investments arranged by MDBs and DFIs - senior positions with expected fiduciary risk profiles
- Flow F: Two amounts for debt arranged by private sector financial arrangers: (i) $25 billion held by arrangers and (ii) $60 billion distributed to private investors in debt investments as senior positions with expected fiduciary risk profiles of “BBB” and/or “BB” risk
- Flow G: $32 billion to private-sector equity investments arranged by private sector fund managers - senior positions with expected fiduciary risk profiles

Annex G

Description of Catalytic Funding Network



Annex H

Proposed Catalytic Capital decision-making and commitment process

There are several approaches to create an effective and efficient process to assess proposals and allocate/award Catalytic Capital to the best proposals, as summarized in Pillar 3. This topic has been deeply discussed by the organizations collaborating on the Action Plan, but the parties agree the details would best be completed when there was agreement from a critical mass of organizations to collaborate. Therefore, this annex briefly describes the highlights of an effective and efficient approach to award Catalytic Capital, but other approaches/derivates are possible.

Potential providers of Catalytic Capital would join the Catalytic Funding Network where they agree to collaborate when allocating / awarding Catalytic Capital. Potential providers include, but are not limited to:

- Developed Country Governments allocating development, development finance and climate finance funds
- Developing Counties allocating concessional funds that mobilize investment to/within their countries
- Philanthropic foundations allocating development, development finance and climate finance funds
- Multi-donor funds, like Green Climate Fund

The Network Members prepared to allocate Catalytic Capital could hire a Network Manager who would, amongst other things, communicate calls for proposal for the award of Catalytic Capital for one of more of the five Use Cases described in Pillar 3.

The Catalytic Capital Providers and Network Manager could agree a process to communicate to organizations globally that they are prepared to allocate Catalytic Capital to the best proposals globally, similar to an auction process. The Network Manager and Catalytic Capital Providers could assess the proposals against the eligibility criteria and assessment criteria to identify the proposals which best meet development impact, climate impact and mobilization objectives. The top proposals would then be profiled to all the Providers of Catalytic Capital for their consideration. It is envisioned that a sub-set of the Catalytic Capital Providers would agree to commit Catalytic Capital to the best proposals. Approval and decision making would rest with each individual organization.

An enhancement of the above process would be for the Developed Country Government agree to establish one or several Catalytic Capital Facilities aligned to the five Use Cases. In this scenario, ideally the funders would agree an approval process where an expert investment committee would approve the award to the best proposals. The actual funding agreement (e.g., grant agreement, loan agreement, equity agreement or guarantee) would likely be entered by the individual funder, or allocated to an agent that would enter the financial commitment on behalf of multiple funders.

Annex J

MDB/DFI investment and business models, including rating considerations

Business Models and Financial Commitments (written in March 2022):

- Main MDBs provide around $130 billion of financing commitments (first row in Table 2.4), and the other MDBs and DFIs not represented in Table 2.4 provide around $10 billion for total commitments of around $140 billion. This equals around 3% of the annual Climate and SDG Investment needs in LICs & MICs
- MDBs finance both public sector (e.g., sovereign) projects and private sector projects, while DFIs finance only private sector projects. Table 2.4 identifies the main MDBs' total public sector exposure at $615 billion and total private sector exposure at $106 billion (around $86 billion of debt and $20 billion of equity). That is, total MDB Development Assets are around $721 billion – equal to about 4.5% of the GDP of the 139 LICs & MICs (*ex-China*)
- In general, MDBs finance public sector projects providing loans at subsidized interest rates (well below market)
- In general, MDBs and DFIs finance private sector projects by providing debt and equity priced at market (or near-market) terms[5]
- There are two types of main MDB assets: (i) $721 billion of Development Assets (e.g., loans and equity investments) and (ii) $380 billion of Non-Mission Assets (e.g., investments in high-quality Treasury Assets like bonds). The latter is funded by over-issuance of MDB bonds rated AAA with proceeds invested in AA and A securities to earn a small positive spread[6]
- The main MDBs are rated by Big 3 Rating Agencies as AAA with some exceptions (e.g., IDB Invest is rated AA+)
- MDBs are capitalised by: (i) 25% equity and (ii) 75% debt from capital markets at AAA interest rates while paying no taxes. MDBs' weighted average cost of capital is much lower than any private-sector financial institution
- Private sector loan arrangers (e.g., international commercial banks) often complain of unfair competition from MDB/DFIs, undercutting attempts to mobilize more private capital and expertise[7]
- Strong final performance for private sector loans – much higher Return on Assets compared to commercial banks due to extremely low cost of funds and low-risk assets
- Minimal transparency of financial performance of financial assets – investors and shareholders have called for the public release of the GEMS database of aggregated MDB/DFI track records as a public good to allow private investors to improve risk management

Mobilization:

- The MDBs and DFIs self-report that they mobilize around $20 billion[8] of private investment annually (Section 2.3)
- MDBs deploy their own capital with continuing low levels of private direct mobilization: (i) almost no mobilization in public sector loans and (ii) only around 40 cents of mobilisation for every dollar deployed for private sector operations

Aggregate of Financial Commitments and Mobilization:

- The total amount of MDB and DFI investment and mobilization is around 3% and 0.5%, respectively, of the $4.5 trillion annual Climate and SDG Investment Needs in LICs & MICs
- MDB and DFI investment amounts and private mobilization amounts are comparable to 2014 – before the SDGs and Paris Agreement

[5] EIB is an outlier – its pricing methodology results in interest rates below market

[6] IFC and EBRD, the two leading MDBs financing the private sector, have more Non-Mission Treasury Assets than Development Assets

[7] MDBs can easily out-compete commercial lenders based on their significantly lower cost of funds.

[8] This Report uses the MDB & DFI Mobilization of Private Finance Report where they self-report Private Direct Mobilization amounts of $20.6 billion in Table A.4 . A review of numbers reported in 2016-2019 show similar amounts.

Box J.1: Relevant highlights of ODI's All hands on deck: how to scale up multilateral financing to face the Covid-19 Report

- *The World Bank and the five largest regional MDBs[9] can expand lending by at least $750 billion (160% above current levels) without threatening their AAA bond rating, or as much as $1.3 trillion (nearly triple current levels)[10] if they are willing to risk a rating downgrade to AA+. See Table 1 below.*
- *Ramping up MDB lending does not require any new contributions from shareholder countries. What is needed is for MDBs to push their financing as far as possible within the constraints imposed by bond markets and credit rating agencies*
- *MDBs must leverage the financial strength they have built up. There is no point in development finance institutions having spare capacity at a time when all hands are needed on deck*
- *The capital structure of MDBs has three components: (i) paid-in capital, (ii) accumulated reserves and (iii) callable capital.*
- *[Callable capital is unique to MDBs. Effectively, it acts as a guarantee that, should MDBs ever run into financial difficulty, shareholders will contribute additional capital to ensure that bond investors are repaid. Callable capital has never been called in the history of any MDB.]*
- *MDBs hold $2–6 in equity (i.e., paid-in-capital plus reserves) for every $10 in outstanding loans – well above the $1–1.50 held by most commercial banks*
- *MDBs argue that expanding their loan book could threaten their AAA bond rating. In fact, this does not appear to be the case. Scaling up lending will not endanger the financial stability of MDBs. Standard and Poor's (S&P), the world's largest credit rating agency, undertakes its own capital adequacy calculation as one component of its MDB rating methodology. Following S&P's 2019 methodology and based on the most recent MDB data, it is possible to extrapolate the amount of outstanding loans each MDB can have while maintaining a AAA rating. These estimates leave a substantial margin for error, meaning that actual lending headroom is likely to be even higher.*

Table 1 Maximising multilateral development bank portfolios (US$ billions)

	ADB	AfDB	AIIB	EBRD	IBRD	IBD	Total
Current portfolio (2019)	109.1	26.5	2.1	33.2	195.9	96.5	463.3
Additional headroom for AAA rating	171.6	70.4	13.9	23.2	365.4	100.2	744.7
Additional headroom for AA+ rating	305.9	118.3	22.1	48.8	637.0	191.7	1,323.8

Notes: Current portfolio based on most recent financial data: December 2019 for AfDB, IBRD and IDB; September 2019 for AIIB, ADB and EBRD. Current portfolio includes loans, equity investments and guarantees. Source: Methodology based on Humphrey (2018), using data from 2019 MDB financial statements and S&P (2019).

[9] ODI: *African Development Bank (AfDB), Asian Development Bank (ADB), Asian Infrastructure Investment Bank (AIIB), European Bank for Reconstruction and Development (EBRD) and Inter-American Development Bank (IDB). This analysis only includes the 'non-concessional' lending windows of the MDBs, and does not include the donor-funded International Development Association (IDA) of the World Bank or the African Development Fund (ADF) of the African Development Bank.*

[10] ODI: *The above headroom analysis does not include the European Investment Bank (EIB), which is the largest MDB in the world but focuses about 90% of its lending within the European Union. By taking its highly rated callable capital into account, the EIB could increase its loan book ($522 billion in June 2019) by another $190 billion under a AAA scenario. Even if only a portion of that is directed to developing countries, it would be a substantial additional contribution. Targeting an AA+ rating would allow the EIB to expand its loan book by as much as $500 billion above current levels*.

- *Most of the major MDBs have a 1:1 lending limit: outstanding loans cannot exceed total subscribed capital (callable and paid-in) plus reserves. With the exception of EBRD, most MDBs are well within the statutory limits at the moment, but that would quickly change with the expanded lending proposed in this paper.*
- *The statutory limits were originally put in place at Bretton Woods in 1944 to reassure bond markets that didn't trust the newly founded World Bank. Nowadays the 1:1 limit has no relevance to modern financial markets and is simply a vestige of another time*
- *Ratings agencies and bond investors pay no attention to the statutory limits and focus instead on capital adequacy.*
- *It is time to relax or even abolish the statutory limits, as they simply confuse debates about MDB headroom and capital adequacy.*
- *Non-performing loans made by MDBs to government borrowers are almost nonexistent, hovering around 0.1–0.3% for the major MDBs, compared to 3–4% on average for commercial bank loans in Europe*

Financial instruments

Most MDB investments are hard currency loans that negatively impact the debt sustainability of developing countries. The IMF reports total debt in LICs & MICs (*ex-China*) at around $6.6 trillion, and the median sovereign risk rating is "B-". The World Bank and Big 3 Rating Agencies advise that developing countries can only sustainably absorb a certain amount of hard currency debt. For various reasons, cross-border debt into Developing Countries continues to be dominated by hard currency (compared to local currency). In general, MDBs and DFIs should maximise their effort to provide investment to support debt sustainability. MDB and DFI hard currency loans to LICs & MICs are very profitable and a shift to local currency loans would decrease MDB's loan net interest margins and profitability. However, MDB shareholders should introduce KPIs to increase the financial additionality of MDB financial assets and at least partially correct for the systematic oversupply of hard currency, senior loans by the MDB/DFI system. e.g., local currency loans, equity and mezzanine capital (see below).

For public sector operations, MDBs provide low-interest, subsidized loans – primarily to sovereign borrowers. Based on MDB current practices, it is near-impossible to mobilize private investment into these public-sector loans at these subsidized interest rates which would not provide a sufficient return for private investors versus other investments. However, if the MDB system were to return to IBRD's practices in 1960s-80s of providing A-B loans where the A-loan remains subsidized, but the B loan is priced at market terms (Financial Flow #1 in Table 2.1), investors would be interested in expanding their lending alongside AAA organizations that understand these markets. Rather than crowding out and undercutting the private sector with their low-cost operations, the MDB system could begin to mobilize investors. See Section 3.3 for further discussion.

Although the MDB financial products to public sector borrowers are straightforward, financial instruments offered to the private sector are more diverse – Table 2.5 summarizes the four main financial instruments deployed for **private sector operations**. See Section 2.4 for discussion of Financial Additionality.

Table 2.5: Financial Instruments deployed by MDBs and DFIs to finance private sector operations

Financial Instrument Description	Currency	Beneficiary Sector	Current Volume	Relative Financial Additionality
Category 1: Debt Instruments				
Senior Loans	Hard	Financial Sector	Very High – Core Business	Low
Senior Bonds	Hard	Financial Sector	Low	Low-Medium
Subordinated Loans	Hard	Financial Sector	Very Low	Medium
Senior Loans	Hard	Real Economy including infrastructure	Very High – Core Business	Low
Senior Bonds	Hard	Real Economy including infrastructure	Low	Low-Medium

Subordinated Loans	Hard	Real Economy including infrastructure	Very Low	Medium
Senior Loans	Local	Financial Sector	Low	High
Senior Bonds	Local	Financial Sector	Very Low	High
Subordinated Loans	Local	Financial Sector	Very Low	High
Senior Loans	Local	Real Economy including infrastructure	Very Low	Medium
Senior Bonds	Local	Real Economy including infrastructure	Very Low	Medium-High
Subordinated Loans	Local	Real Economy including infrastructure	Very Low	High
Category 2: Equity Instruments				
Direct Equity to Financial Institutions	De-facto Local	Financial Sector	Medium	High
Direct Equity to Real Economy	De-facto Local	Real Economy including infrastructure	Low	High
Equity to private equity funds	De-facto Local	Financial Sector	Low	Medium-High
Equity to private equity funds	De-facto Local	Real Economy including infrastructure	Medium	Medium-High
Category 3: Guarantee and Risk Participation Instruments				
Guarantees	Either	International Cross- Border: ● Financial Sector ● Real Economy / FDI	Very Low	Medium
Guarantees	Either	Developing Countries ● Banks ● Non-bank FIs	Very Low	Medium
Risk participations with local financial institutions' bearing risk on their loans to companies (e.g., SMEs)	Either	Developing Countries ● Banks ● Non-bank FIs	Very Low	High
Category 4: Other Instruments				
Trade Finance			Medium	Low-Medium
Political Risk Insurance			MIGA only	Medium
Mezzanine and junior investments in Blended Finance Vehicles to mobilize private investment in senior position	Both	Public Sector Private Sector	Very Low	High

Annex K

MDBs/DFIs: Financial additionality and capacity constraints

Financial Additionality

The mobilization steps detailed above would free up MDB and DFI capital to take on financial assets with higher financial additionality. The five financial assets listed in Table J.1, in principle, provide high and medium financial additionality for the SDGs and Climate.

Table K.1: Financial additionality of MDB and DFI financial instruments: Medium and High Financial Additionality

Financial instruments	Level of Financial Additionality	Description
Common equity	High	In general, the most under-supplied form of financing in developing countries is equity. Equity represents likely less than [12%] of MDB and DFI aggregate exposure. MDBs and DFIs could significantly increase their equity finance. Not only would this boost the most under-supplied form of finance in developing countries, but it would increase the creditworthiness of hundreds of recipient financial institutions and real-economy companies. This in turn will increase the ability of those entities to raise debt and equity from private investors (and MDBs and DFIs). As the creditworthiness of these entities increases through higher equity capitalization, it will likely lead to deeper capital markets in developing countries: (i) these entities will be more creditworthy to issue bonds and (ii) these entities will take on governance models (through MDB and DFI part-ownership) that can put them on a path to raise equity in capital markets and operate responsibly
Local currency loans	High	MDBs and DFIs do not take open currency risk in their loan portfolios. That is, they will only issue local currency loans when they can fund themselves or hedge the currency risk. But (likely) less than 10% of MDB and DFI loans to the private sector are denominated in local currency. This hard currency lending leads to huge FX risk for borrowers - most acute for infrastructure projects and SMEs who earn their revenues in local currency. MDB and DFIs could increase their local currency loans for infrastructure and SME projects – including taking a limited amount of open currency risk
Quasi-equity	Medium	For many reasons, a large number of companies in developing countries cannot be financed by conventional common equity (e.g., very high levels of informality). For many companies, mezzanine capital is a more effective form of financing (e.g., loans with equity-like features). The financial additionality of mezzanine capital, like common equity, is generally much greater than the current stock of hard currency senior loans
Tier 2 capital for banks and microfinance institutions	High	The banking and microfinance sectors are systemically under-capitalized. This translates into a significant under-financing of the real economy, especially SMEs. Increasing tier 2 capital to banks and MFIs would produce good quality assets for MDBs and DFIs, bolster capitalization and increase risk capacity for loans to SMEs and mid-caps
Mezzanine and Junior investment in blended	High	See Mobilization structures below in Section 3

finance structures		

Capacity Constraints

Table K.2: Main factors constraining MDB investment

#	Factor	Description	Comment
1	Credit rating of MDB	The Big 3 Rating Agencies effectively establish the hard limit of balance sheet exposure for an MDB. See Annex X.	Simplification for MDBs: To maintain their "AAA" rating: Public-sector finance MDBs like IBRD can hold sovereign loans equal to [6-7] times their shareholders' capital. Private-sector finance MDBs like IFC can hold debt and equity investment equal to [4] times their shareholders' capital. If shareholders' governed the MDBs to a "AA' rating, in general, they could achieve an extra 50% leverage.
2	Shareholders' capital	Primarily the amount of equity on balance sheet from shareholder governments(i.e., paid in capital plus retained earnings). Secondarily, there is also callable capital from shareholder governments.	The main MDBs currently have around $385 billion of shareholders' equity (e.g., paid-in-capital plus retained earnings) – See Table 2.4. Callable capital is in addition to this balance sheet amount.
3	Debt on MDB balance sheets	The amount of debt an MDB can issue is restricted by (i) shareholders in the MDB statutes, (ii) shareholders by the risk rating they want the MDB to maintain, (iii) credit rating methodologies and (iv) investor demand.	In general, MDBs issue public debt and DFIs do not issue public debt.
4	Risk of Development Assets	MDBs have three main types of risk: (1) sovereign loans, (ii) private sector loans and (iii) private sector equity investments.	Table 2.8 is extracted from Fitch's MDB Rating Methodologies and demonstrates the relative risk of MDBs' main assets. For example, Fitch methodology has an equity investment five-times riskier than a loan to a "BBB" borrower.
5	Governance by shareholders	Governance by shareholders can be applicable at three levels: 1. Foundational: The statues of the MDB or DFI can restrict the balance sheet size, usually by placing a limit such as (i) maximum Assets to Equity ratio or (ii) maximum Debt to Equity ratio 2. Governors: In addition to foundational restrictions, the Board of Governors can impose additional limitations, such as instructing Management to maintain a "AAA" rating 3. Board of Directors (policies): The Board of Directors may approve Risk Management	To the best of the authors' knowledge, the only meaningful governance restrictions are foundational ones embedded in the foundational documents of the organization. The recommendations in this Action Plan assume that the Governors of the MDBS and DFIs would be prepared to amend these foundations restrictions, if they found the benefits to LICs and MICs outweigh the costs.

		Policies that restrict the operations and balance sheet assets 4. Board of Directors (projects): The Board holds the right to not approve transactions proposed by Management.	
6	Ambition of Management	Management teams generally operate well within the confines of effective limits established through governance and the Big 3 rating Agenise.	For example, in 2020 the World bank Group management team has proposed a Corporate Scorecard to its board of Directors that does not include any meaningful mobilization targets. And the IFC's Development Assets are around one-third the size possible given its capitalization. The WBG mobilization metric was proposed by Management. And the IFC management team has decided to have a larger Treasury Assets portfolio than Development Assets Portfolio.
7	Amount of commercially acceptable investments	The MDBs and DFIs claim there are not enough commercially investable projects. The MDBs and DFI have been capitalizes to earn positive expected returns on capital, varying from break-even returns to private-sector commercial returns, therefore should only be committing funds to projects where they expect to generate those returns.	UNCTAD estimates that actual total investment is equal to around 30% of annual Investment Needs MDBS and DFI make around $90 billion of loan commitments to public-sector projects annually and $45 billion of investment commitments to private-sector projects annually. Amounts equal to 2% and 1% of annual SDG and Climate Investment Needs in LICs and MICs.. The proposed Action Plan calls to increase investment and mobilization from 3.5% to around 10% of Investment Needs. The 6.5% increase is equal to around 10% of the annual Gap. The Action Plan proposes to allocate Catalytic Funding tot eh best global proposals, with a strong likelihood that the breadth of thousands of financial arrangers who could access the catalytic Funding should lead to an increase in funded projects, and over time, a change in the perception of commercially investable projects.

Table 2.8: Fitch Risk Weights by Asset Class

Risk Weights by Asset Class (%)

Loans, guarantees, treasury assets	
AAA	0
AA	20
A	30
BBB	50
B-BB	100
CCC and lower	150
Equity participations	250
Other assets	100

Source: Fitch Ratings

Factors limiting MDBs and DFIs to increase local currency debt that contributes to Debt Sustainability

MDB Risk Policies are recommended by MDB Management teams and approved by shareholders. Current MBD currency policies and/or practices result in MDBs bearing no open currency risk for their debt portfolios. MDBs lend in hard currency (e.g., USD), requiring the borrower and the beneficiary country to bear the FX risk. (IFC and EBRD also issue bonds in local currency and use the bond proceeds to make local currency loans or enter currency swaps with organizations like TCX to make local currency loans. MBD shareholders could consider how much of their capital can be exposed to open FX risk to increase Developing Countries' debt sustainability. A reasonable initial approach could allow open currency risk of up to 15% of the MDB's loan portfolio. This would cause the MDBs to factor the expected local currency depreciation risk into the loan interest rate. The EIB and European Commission have trialed this approach successfully over the past 20 years - see the independent End-Term Review of the ACP Internment Facility, which praises the financial additionality of the local currency lending. The local currency would be covered by 1.8.1 since local currency loans would be a High Financial Additionality asset.

Annex L

Need for better and curated low and middle-income country investment data

A lack of investment risk and return data for investment in Low and Middle-Income Countries (e.g., Developing Countries) impedes private investment (See Box 1 for recent descriptions from three investor groups representing around 125 investors).

Debt investment

The default risk barometers for "country risk" for Developing Countries are the sovereign risk ratings from Fitch, Moody's and Standard & Poor's. The Big 3 Rating Agencies rate [85] of the [141] Developing Countries: median risk rating of Fitch-equivalent "B+" and only 11% of developing country sovereigns are rated Investment Grade (e.g., BBB- or better). Extrapolating from the OECD's Export Credit Agency country risk classification for the other [56] counties not rated by the Big 3 results in an implied median risk rating for all Developing Countries at Fitch-equivalent "B". Ratings in this range are considered "*Highly Speculative with material default risk*" – See Box 2.

Box 2: Big 3 rating agency description for issuers rated "B"

Fitch	*Highly speculative: 'B' ratings indicate that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.*
Moody's	*Highly speculative: Obligations rated B are considered speculative and are subject to high credit risk.*
S&P	*High risk: An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation*

In addition to ratings, the Big 3 Rating Agencies publish annually tables that report the actual historical default rates and Losses Given Default to allow investors to use this data in their investment models. Unfortunately, "B" rated issuers have an annualized default rate (using history from both developed and developing countries) of around 6% per year. For example, a ten year loan to a "B' rated borrower would have an implied default risk of 60%.

The Big 3 Rating Agencies follow a methodology that the country risk rating forms a "**country ceiling**" for debt obligations issued by non-sovereign borrowers. Accordingly, most sub-sovereign public sector entities and private sector organizations in Developing Countries would have implied risk ratings in the B+ to CC range. See Box 3.

Box X: Fitch Ratings description of Country Ceilings

Country Ceilings are expressed using the symbols of the long-term issuer primary credit rating scale and relate to sovereign jurisdictions also rated by Fitch on the Issuer Default Rating (IDR) scale. They reflect the agency's judgment regarding the risk of capital and exchange controls being imposed by the sovereign authorities that would prevent or materially impede the private sector's ability to convert local currency into foreign currency and transfer to non-resident creditors — transfer and convertibility (T&C) risk. They are not ratings but expressions of a cap for the foreign currency issuer ratings of most, but not all, issuers in a given country. Given the close correlation between sovereign credit and T&C risks, the Country Ceiling may exhibit a greater degree of volatility than would normally be expected when it lies above the sovereign Foreign Currency Rating.

Foreign Currency Ratings additionally consider the profile of the issuer or note after addressing T&C risk. This risk is usually communicated for different countries by the Country Ceiling, which caps the foreign currency ratings of most, though not all, issuers within a given country.

The end result of the Big 3 ratings mythologies, sovereign risk ratings, country risk ratings and the default/loss tables are that very few investors have the ability to invest in debt to sovereign and non-sovereign borrowers in most developing countries.

Equity investment

The most important "emerging markets" equity index has been the MSCI Emerging Markets Index. But half of the "emerging markets" countries in this index are not "developing counties" as determined by the development community. And one when looks at the weighting of the MSCI Emerging market Index, only 15% of the value is invested in "developing countries (ex-China)".

ODA eligible countries in MSCI EM Index (13)	Non-ODA eligible countries in MSCI EM Index (12)
Brazil, China, Colombia, Egypt, India, Indonesia, Malaysia, Mexico, Peru, Philippines, South Africa, Thailand, and Turkey	Chile, Czech Republic, Greece, Hungary, Korea, Kuwait, Poland, Qatar, Russia, Saudi Arabia, Taiwan, and United Arab Emirates

History of MSCI Emerging Markets Index

CUMULATIVE INDEX PERFORMANCE – NET RETURNS (USD)
(SEP 2006 – SEP 2021)

ANNUAL PERFORMANCE (%)

Year	MSCI Emerging Markets	MSCI ACWI	MSCI World
2020	18.31	16.25	15.90
2019	18.42	26.60	27.67
2018	-14.57	-9.41	-8.71
2017	37.28	23.97	22.40
2016	11.19	7.86	7.51
2015	-14.92	-2.36	-0.87
2014	-2.19	4.16	4.94
2013	-2.60	22.80	26.68
2012	18.22	16.13	15.83
2011	-18.42	-7.35	-5.54
2010	18.88	12.67	11.76
2009	78.51	34.63	29.99
2008	-53.33	-42.19	-40.71
2007	39.42	11.66	9.04

INDEX PERFORMANCE – NET RETURNS (%) (SEP 30, 2021)

	1 Mo	3 Mo	1 Yr	YTD	ANNUALIZED 3 Yr	5 Yr	10 Yr	Since Dec 29, 2000
MSCI Emerging Markets	-3.97	-8.09	18.20	-1.25	8.58	9.23	6.09	9.15
MSCI ACWI	-4.13	-1.05	27.44	11.12	12.58	13.20	11.90	6.43
MSCI World	-4.15	-0.01	28.82	13.04	13.14	13.74	12.68	6.42

FUNDAMENTALS (SEP 30, 2021)

	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI Emerging Markets	2.24	15.07	12.55	1.92
MSCI ACWI	1.79	21.48	17.65	2.96
MSCI World	1.73	22.81	18.68	3.20

INDEX RISK AND RETURN CHARACTERISTICS (SEP 30, 2021)

	Turnover (%) [1]	ANNUALIZED STD DEV (%) [2] 3 Yr	5 Yr	10 Yr	SHARPE RATIO [2,3] 3 Yr	5 Yr	10 Yr	Since Dec 29, 2000	MAXIMUM DRAWDOWN (%)	Period YYYY-MM-DD
MSCI Emerging Markets	7.99	19.40	16.66	16.95	0.46	0.54	0.39	0.45	65.25	2007-10-29—2008-10-27
MSCI ACWI	3.33	18.20	14.65	13.47	0.68	0.84	0.85	0.37	58.38	2007-10-31—2009-03-09
MSCI World	2.65	18.46	14.81	13.43	0.70	0.86	0.90	0.38	57.82	2007-10-31—2009-03-09

[1] Last 12 months [2] Based on monthly net returns data [3] Based on NY FED Overnight SOFR from Sep 1 2021 & on ICE LIBOR 1M prior that date

Annex M

GEMS database: Convergence summary of GEMS April 2021 report

The MDBs and DFIs release initial report on Global Emerging Markets (GEMS) Loan Default Data

This Note was updated following a Convergence discussion with EIB on October 29, 2021

Background

Links:
GEMS web site
Subject report

In April 2021, 11 of the leading MDBs and DFIs released an initial report on their aggregated database of payment defaults on their (i) private sector and (ii) sub-sovereign public sector loan portfolios. The report covers the portfolio of loans originated in 2001-19 and covers an aggregate of:

- Euro 270 billion loans to 7,619 private sector counterparties (but only Eur 225 billion in Middle and Low-Income Countries – other Eur 45 million in HICs) is and
- Eur 68 billion of loans to 700 sub-sovereign counterparties

Although the GEMS consortium has 24 members, only 11 of them agreed to contribute their data to the released report so the report suffers from not having the data from a significant part of the MDB and DFI community.

Participating GEMS members	GEMS members who decided to not participate
EIB	African Development Bank
IFC	Inter-American Development Bank
EBRD	BSTDB
Asian Development Bank	AFD
FMO	International Investment Bank
US DFC	IBRD (World Bank)
Islamic Development Bank	KfW Development Bank
Council of Europe Development Bank	IFAD
IDB Invest	MIGA
GuarantCo	DEG
BOAD	Central American Bank for Economic Integration (CABEI)
	New Development Bank

The GEMS database includes shared information on loan risk ratings, counties of borrower, sovereign risk ratings, borrower internal rating (at time of signing and migration over time), actual default rates, and actual losses (e.g., defaulted loan amount minus recoveries). The MDBs and DFIs do not share loan interest rates.

Important to note that GEMS data is almost exclusively for loans, and almost all for those loans will be for secured loans. Accordingly, one would expect actual losses given default will be much lower for GEMS loans than Big 3 (e.g., S&P, Moody's and Fitch) rating agency published data for bonds.

The GEMS database is available to risk management staff at the MDBs and DFIS, but not other staff.
The GEMS database is only available to MDBs and DFIs, and not the owners of the MDBs and DFIs.

Aggregate Loan Portfolio Disclosed in Report

- Eur 7.8 billion of the MDB's 338.7 billion of loan exposure is to LICs (and LDCs). Or 2.3%.
- Eur 144.8 billion is to "Finance" (e.g., financial institutions). Or 42.8%.
- 3% of infrastructure exposure is to LICs (and LDCs).
- Average private sector loan is Euro 35.5 million
- Median loan recipient was located in an Upper Middle Income Country
- The ratio of loan private sector counterparties in High Income Countries to Low Income Countries was 1145:421. Or for every one loan to a counterparty in LICs (including LDCs) the MDBs/DFI had 2.7 loans in High Income Countries. Or for every Euro they lent in LICs (&LDCs) they lent Eur 6.5 in High Income Countries).
- They collectively lent $7.0 billion to counterparties in LICs & LDCs over the 20 year period to 2019 – or $350 million per year.
- It is likely EIB and IFC loans account for [50-66]% of the Euro 240 million of loans to private sector in Report.

Default Rates

This section focuses only on loans to private sector borrowers – not sub-sovereign.

Annual Payment Default Rates:

- 3.7% for private sector
- Of which: 2.6% for financials and 3.5% for infra and 4.9% for other

S&P Default rates for same period:

- BB has been 0.58% and B has been 3.12%

The MDBs and DFIs report Annual Payment Default Rates of 3.7% (for the private sector). This default rate is further broken down as: 2.6% for financials, 3.5% for infrastructure borrowers and 4.9% for other.

Comparing the MDB and DFI default rates to comparable data reported by S&P for its global corporate borrower data for the same 10 year period (see Page 7-9), S&P report a 0.58% default rate for "BB" borrowers and 3.12% default rate for "B" borrowers. On average, the MDB & DFI loan portfolio defaulted at a rate comparable to S&P-equivalent "B" rated borrower. The best-performing sub-portfolio was financial institutions (e.g., mostly banks) which defaulted at 2.6% per annum – comparable to S&P-equivalent of around "B+"

Granularity of Defaults

The GEMs Master Scale is the common language regarding the creditworthiness of GEMs member institutions' lending counterparties (borrowers): it is a 1-year Probability of Default (PD) rating scale built partially based on GEMs observed default rates.

So for example, a GEMS Master Scale rating of Gs1 would map tot eh S&P equivalent of BB+. And a rating of Gs2 to BB, and so on. See GEMS reported information compared to S&P using one-year actual probabilities of default.

GEMS Master Scale Probabilities of Default	S&P Default Data

GEMs Rating	PD (in %)
GI 1	Investment grades PDs from credit rating agencies (CRA) reports
GI 2	
GI 3	
GI 4	
GI 5	
GI 6	
GI 7	
GI 8	
GI 9	
GI 10	
Gs 1	1.3374
Gs 2	1.4490
Gs 3	2.0626
Gs 4	2.7432
Gs 5	3.4840
Gs 6	4.6082
Gs 7	7.0004
Gs 8	Worse sub-investment grades PDs from CRA reports
Gs 9	
Gs 10	
D	100.0000

S&P Rating	Prob Default	GEMS equivlaent
AAA	0	
AA+	0	
AA	0.01	
AA-	0.02	
A+	0.04	
A	0.05	
A-	0.07	
BBB+	0.12	
BBB	0.21	
BBB-	0.24	
BB+	0.48	1.34
BB	0.68	1.45
BB-	1.21	2.06
B+	2.07	2.74
B	5.76	3.48
B-	8.73	4.61
CCC+		7.00
CCC or lower	NA	

Comparing the granular GEMS data to the S&P data:

- Borrowers rated Gs1-Gs3, which maps to the S&P equivalent of BB+ to BB- defaulted at a higher rate than S&P's Global comparables.
- Borrowers rated lower than Gs3, which maps to the S&P equivalent of B+ or lower, defaulted at a lower rate than S&P's Global comparables

Possible inference?:

- The MDBs and DFIs tend to lend to the best financial institutions in a country (e.g., the best banks in Kenya), the top tier corporates and projects, important infrastructure projects and landmark PPPs.
- It is likely that the ratings of the loans to private sector borrowers, at time of origination, are 1-2 notches below the sovereign.

If these two points are accurate, then:

- Private sector borrowers located in countries where the sovereign is rated Investment Grade, BB+ or BB: The actual default have been slightly higher than one would expect simply using the S&P Global data
- Private sector borrowers located in countries where the sovereign is rated BB_ or lower: The actual default rates have been quite a bit lower than one would expect simply using the S&P Global data

To be clear, this data comparison is for payment defaults only.
Actual losses incurred by MDBs and DFIs, although not released in this Report, have been significantly lower than S&P comparisons for four reasons:

(i) secured loans when compared to unsecured bonds,

(ii) more patience in the creditors (MDBs and DFIS ae prepared to work out a loan for years compared to bondholders that would realize a loss much quicker and move one) and
(iii) the MDB "halo" effect that includes higher efforts from companies, shareholders and governments to work harder to resolve an MDB/DFI loan compared to a bond and
(iv) preferred creditor status where MDBs benefit from FX preference relative to bondholders.

Implications for Private Investment Mobilization and Blended Finance??

Initial Report very important for defaults to private borrowers.

Although this initial Report only focuses on loan defaults, it is silent on two very important other metrics: (i) loan margins and (ii) actual losses. For example,

- In its most recent annual report, IFC (e.g., the most active lender to private sector borrowers in developing countries) reported an average loan interest rate of Libor plus 4.1%
- A review of IFC loan losses over the past decade indicate actual losses are around [60] bp per year. Lower at EIB and EBRD.

If the IFC interest rates and loan losses are indicative of the MDB and DFI private sector loans, then the private sector loan portfolio[11] is readily transferable to private investors, likely at a significant profit. No need for concessional capital from donors.

The actual default rates for loans to private sector borrowers in counties where sovereign is rated BB or lower have been considerably lower than expected when compared to S&P Global data.

The GEMS data likely show the more significant comparative advantage of MDBs and DFIs to originate and arrange loans to private sector borrowers in countries where sovereign is rated BB or lower, compared to countries where sovereign is rated BB+ or better.

Other interesting MDB & DFI loan portfolio information

- Eur 270 billion of loans over a 20 year period implies, on average, the MDBs extended Eur 13.5 billion of loans annually to private sector borrowers. This is equal to around 33% of the Euro 40 billion of private sector financing extended annually by all MDBs and DFIs, but also equal to only around 0.3% of the annual SDG Investments required estimated by UNCTAD.
- The average private sector loan was Eur 35.5 million signalling the MDBs and DFIs primary business model of extending large loans- mostly in Middle Income Countries
- Over the 20 year period, Eur 7 billion was disbursed to LICs (&LDCS) – an average of Eur 350 million per annum
- For every Euro of loans extended in LICs, they extended Eur 6.5 in HICs.

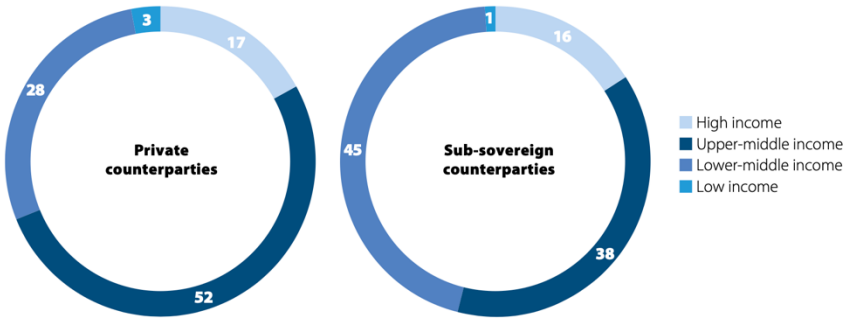
[11] Technically, the performing loans / accrual loans.

Excerpts from GEMS Report (copy and paste from GEMS Report)

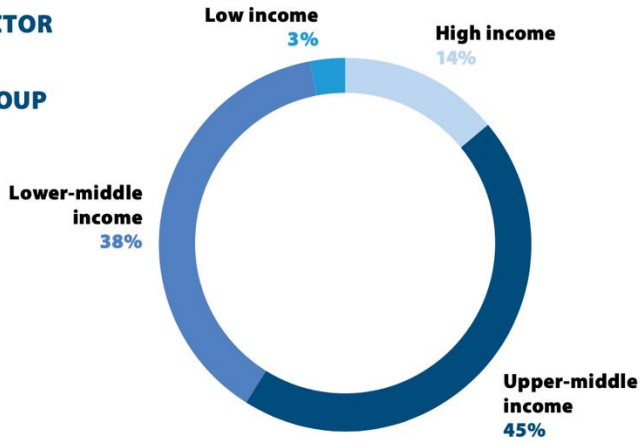
DATASET COMPOSITION BY 2019 WORLD BANK GROUP COUNTRY INCOME GROUPS

Country income groups	# Counterparties	Total exposure in billions (€)
Private counterparties		
High income	1 145	45.5
Upper-middle income	3 647	141.8
Lower-middle income	2 406	76.1
Low income	421	7.0
Total	7 619	270.3
Sub-sovereign counterparties		
High income	178	11.0
Upper-middle income	252	26.1
Lower-middle income	215	30.6
Low income	55	0.8
Total	700	68.4

EXPOSURE BY 2019 WORLD BANK GROUP COUNTRY INCOME GROUPS IN BILLIONS (€, IN %)



DISTRIBUTION OF INFRASTRUCTURE SECTOR EXPOSURE BY 2019 WORLD BANK GROUP COUNTRY INCOME GROUP



ANNUAL DEFAULT RATE BY COUNTERPARTY TYPE FOR 2001-2019

Year	Private	Sub-sovereign
2001	4.3%	5.3%
2002	7.3%	3.9%
2003	6.0%	3.1%
2004	4.0%	2.3%
2005	3.0%	1.6%
2006	3.9%	2.8%
2007	3.7%	2.1%
2008	3.2%	1.9%
2009	4.6%	3.1%
2010	4.3%	3.3%
2011	2.8%	0.3%
2012	2.6%	1.7%
2013	2.4%	3.7%
2014	4.1%	0.8%
2015	3.1%	1.6%
2016	3.4%	2.5%
2017	2.7%	0.5%
2018	2.6%	1.1%
2019	3.4%	1.1%
Average[9]	**3.7%**	**2.3%**

ANNUAL DEFAULT RATE BY SECTOR FOR PRIVATE COUNTERPARTIES FOR 2001-2019

Year	Financials[10]	Infrastructure[11]	Other
2001	2.6%	4.1%	5.1%
2002	6.1%	8.1%	7.7%
2003	2.7%	9.5%	7.0%
2004	4.6%	2.7%	3.9%
2005	2.7%	4.4%	2.8%
2006	4.1%	1.7%	4.3%
2007	3.9%	4.4%	3.3%
2008	2.2%	2.5%	4.4%
2009	3.5%	2.6%	6.5%
2010	2.9%	0.3%	7.3%
2011	1.3%	2.9%	4.1%
2012	1.6%	1.7%	4.0%
2013	0.4%	2.4%	4.3%
2014	1.6%	4.0%	6.7%
2015	1.2%	2.6%	5.5%
2016	2.1%	4.3%	4.3%
2017	1.4%	4.0%	3.2%
2018	1.2%	2.7%	4.2%
2019	3.1%	2.3%	4.9%
Average[12]	**2.6%**	**3.5%**	**4.9%**

ANNUAL DEFAULT RATE FOR INFRASTRUCTURE AND NON-INFRASTRUCTURE SECTORS FOR 2001-2019

Year	Infrastructure	Non-infrastructure
2001	4.2%	4.5%
2002	6.1%	6.9%
2003	7.2%	5.1%
2004	2.7%	3.9%
2005	3.7%	2.5%
2006	1.5%	4.1%
2007	3.6%	3.4%
2008	2.6%	3.1%
2009	2.4%	4.8%
2010	1.0%	5.0%
2011	2.3%	2.5%
2012	1.7%	2.6%
2013	3.2%	2.4%
2014	3.5%	3.7%
2015	2.7%	3.0%
2016	3.8%	3.2%
2017	3.5%	2.1%
2018	2.4%	2.4%
2019	2.2%	3.5%
Average[15]	**3.2%**	**3.6%**

DATASET COMPOSITION BY COUNTRY-SPECIFIC INCOME GROUPS[3]

Country group	# Counterparties	Total exposure in billions (€)
Private counterparties		
EEA[4]	863	33.2
EEA/OECD[5]	1 557	79.4
EMDE-A[6]	6 807	237.6
EMDE-B[7]	5 476	170.1
OECD	1 232	68.1
Non-OECD	6 387	202.2

S&P Data (from 2021 Report)

Global Corporate Annual Default Rates By Rating Category (%)

	AAA	AA	A	BBB	BB	B	CCC/C
1981	0.00	0.00	0.00	0.00	0.00	2.33	0.00
1982	0.00	0.00	0.21	0.35	4.24	3.18	21.43
1983	0.00	0.00	0.00	0.34	1.16	4.70	6.67
1984	0.00	0.00	0.00	0.68	1.14	3.49	25.00
1985	0.00	0.00	0.00	0.00	1.50	6.53	15.38
1986	0.00	0.00	0.18	0.34	1.33	8.45	23.08
1987	0.00	0.00	0.00	0.00	0.38	3.13	12.28
1988	0.00	0.00	0.00	0.00	1.05	3.68	20.37
1989	0.00	0.00	0.18	0.61	0.73	3.40	33.33
1990	0.00	0.00	0.00	0.58	3.57	8.56	31.25
1991	0.00	0.00	0.00	0.55	1.69	13.84	33.87
1992	0.00	0.00	0.00	0.00	0.00	6.99	30.19
1993	0.00	0.00	0.00	0.00	0.70	2.62	13.33
1994	0.00	0.00	0.14	0.00	0.28	3.09	16.67
1995	0.00	0.00	0.00	0.17	0.99	4.59	28.00
1996	0.00	0.00	0.00	0.00	0.45	2.91	8.00
1997	0.00	0.00	0.00	0.25	0.19	3.52	12.00
1998	0.00	0.00	0.00	0.41	0.82	4.64	42.86
1999	0.00	0.17	0.18	0.20	0.95	7.31	33.82
2000	0.00	0.00	0.27	0.37	1.16	7.71	35.96
2001	0.00	0.00	0.27	0.34	2.98	11.56	45.45
2002	0.00	0.00	0.00	1.02	2.90	8.20	44.44
2003	0.00	0.00	0.00	0.23	0.59	4.07	32.93
2004	0.00	0.00	0.08	0.00	0.44	1.45	16.30
2005	0.00	0.00	0.00	0.07	0.31	1.75	9.09
2006	0.00	0.00	0.00	0.00	0.30	0.82	13.33
2007	0.00	0.00	0.00	0.00	0.20	0.25	15.24
2008	0.00	0.38	0.39	0.49	0.81	4.11	27.27
2009	0.00	0.00	0.22	0.55	0.75	11.03	49.46
2010	0.00	0.00	0.00	0.00	0.58	0.87	22.83
2011	0.00	0.00	0.00	0.07	0.00	1.68	16.42
2012	0.00	0.00	0.00	0.00	0.30	1.58	27.52

	AAA	AA	A	BBB	BB	B	CCC/C
2013	0.00	0.00	0.00	0.00	0.10	1.65	24.67
2014	0.00	0.00	0.00	0.00	0.00	0.78	17.51
2015	0.00	0.00	0.00	0.00	0.16	2.42	26.67
2016	0.00	0.00	0.00	0.06	0.47	3.76	33.17
2017	0.00	0.00	0.00	0.00	0.08	1.00	26.56
2018	0.00	0.00	0.00	0.00	0.00	0.99	27.18
2019	0.00	0.00	0.00	0.11	0.00	1.49	29.76
2020	0.00	0.00	0.00	0.00	0.93	3.52	47.48

Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.

S&P Default tables

Table 9

One-Year Global Corporate Default Rates By Rating Modifier (%)

	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	C
1981	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	3.28	0.00	0
1982	0.00	0.00	0.00	0.00	0.00	0.34	0.00	0.00	0.70	0.00	0.00	2.86	7.04	2.22	2.33	8.33	2
1983	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.37	2.17	0.00	1.59	1.25	10.00	5.26	6
1984	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.45	0.00	0.00	1.64	1.49	2.17	3.57	8.33	2
1985	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.67	1.49	1.37	2.63	13.11	8.33	1
1986	0.00	0.00	0.00	0.00	0.00	0.00	0.78	0.00	0.79	0.00	1.82	1.19	1.16	4.73	12.16	17.07	2
1987	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.84	1.33	5.95	6.98	1
1988	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.34	2.02	4.50	10.00	2
1989	0.00	0.00	0.00	0.00	0.00	0.00	0.58	0.90	0.80	0.00	0.00	0.00	2.04	0.43	7.80	5.00	3
1990	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.76	0.00	1.10	2.82	3.06	4.50	4.89	12.26	22.58	3
1991	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.83	0.75	0.00	3.77	1.12	1.05	8.72	16.25	32.43	3
1992	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.72	14.93	20.83	3
1993	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.96	0.00	1.30	5.88	4.17	1
1994	0.00	0.00	0.00	0.00	0.46	0.00	0.00	0.00	0.00	0.00	0.00	0.87	0.00	1.84	6.67	3.13	1
1995	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.65	0.00	1.57	1.12	2.77	8.08	7.50	2
1996	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.66	0.56	2.37	3.74	3.85	8
1997	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.37	0.35	0.00	0.00	0.00	0.41	0.72	5.34	14.58	1
1998	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.27	1.06	0.67	1.06	0.73	2.61	7.56	9.46	4
1999	0.00	0.00	0.00	0.36	0.00	0.25	0.28	0.00	0.28	0.31	0.55	1.34	0.91	4.24	10.45	15.60	3
2000	0.00	0.00	0.00	0.00	0.00	0.24	0.58	0.00	0.26	0.89	0.00	0.82	2.08	5.83	10.08	11.61	3
2001	0.00	0.00	0.00	0.00	0.57	0.25	0.00	0.24	0.49	0.28	0.52	1.22	5.65	5.84	17.32	22.63	4
2002	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.10	0.88	1.08	1.59	1.79	4.84	3.27	10.23	19.85	4
2003	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.20	0.54	0.51	0.98	0.28	1.73	5.34	9.52	3
2004	0.00	0.00	0.00	0.00	0.00	0.24	0.00	0.00	0.00	0.00	0.00	0.67	0.53	0.46	2.36	2.84	1
2005	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.17	0.00	0.38	0.00	0.51	0.79	2.66	2.96	9
2006	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.39	0.00	0.50	0.55	0.82	1.57	1
2007	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.32	0.24	0.19	0.00	0.90	1
2008	0.00	0.00	0.44	0.41	0.32	0.21	0.60	0.19	0.61	0.72	1.23	0.66	0.68	3.16	3.48	7.63	2
2009	0.00	0.00	0.00	0.00	0.30	0.40	0.00	0.42	0.19	1.13	0.00	1.05	0.98	6.02	10.91	18.25	4
2010	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.85	0.37	0.57	0.00	0.75	2.16	2
2011	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.20	0.00	0.00	0.00	0.42	1.29	4.55	1
2012	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.79	0.61	1.45	3.56	2
2013	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.26	0.77	0.83	4.72	2
2014	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.19	0.33	2.78	1
2015	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.26	0.22	1.77	2.04	4.31	2
2016	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.15	0.00	0.23	0.00	1.10	0.93	2.33	10.76	3
2017	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.22	0.00	0.42	0.44	2.89	2
2018	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.95	2.09	2
2019	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.38	0.00	0.00	0.00	1.18	0.68	3.31	2
2020	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.55	0.00	1.98	1.86	2.11	6.85	4
Average	0.00	0.00	0.01	0.02	0.04	0.05	0.07	0.12	0.21	0.24	0.49	0.68	1.21	2.07	5.76	8.73	2
Median	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.34	0.71	1.53	4.12	6.92	2
Standard deviation	0.00	0.00	0.07	0.09	0.13	0.11	0.20	0.28	0.34	0.41	0.88	0.81	1.62	2.01	4.88	7.35	1
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Maximum	0.00	0.00	0.44	0.41	0.57	0.40	0.78	1.10	1.45	1.37	3.77	3.06	7.04	8.72	17.32	32.43	4

Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.

S&P defaults for comparable 20 year period

	BB	**B**	**CCC**
2001	298	1145	4545
2002	290	820	4444
2003	59	407	3293
2004	44	145	1630
2005	31	175	909
2006	30	82	1333
2007	20	25	1524
2008	81	411	2727
2009	75	1103	4946
2010	58	87	2283
2011	0	168	1642
2012	30	158	2752
2013	10	165	2467
2014	0	78	1751
2015	16	242	2667
2016	47	376	3317
2017	8	100	2656
2018	0	99	2718
2019	0	149	2976
	57.74	**312.37**	**2,662.11**

Annex N

Climate and SDG investment needs in low and middle-income countries

In 2022, international development cooperation is focused on achieving the UN Sustainable Development Goals (SDGs) (Figure A.1). Prior to the pandemic, UNCTAD estimated the size of the investment needed to achieve the SDGs in LICs and MICs in its 2014 World Investment Report, and has updated its analysis annually in its World Investment Reports and SDG Investment Trends Monitors. UNCTAD uses a "bottom up" approach to identify the investment needs across ten sectors (Table A.1), estimating total annual investment needs (in 2014) at around $3.9 trillion, with actual investment levels at $1.4 trillion, leaving an annual SDG Investment Gap of $2.5 trillion; $500 billion for Least-Developed Countries (LDCs) & Low-Income Countries (LICs) and $2 trillion for Middle-Income Countries (MICs). The largest sector investment gaps are (i) $370-690 billion for Power and (ii) $380-680 billion for Climate Change Mitigation.

Despite the international and cross-sectoral support in principle of the SDGs and the 2030 Agenda, the SDG Investment Gap remained around $2.5 trillion up to 2020. Since the onset of the COVID-19 pandemic, the OECD estimates in its Global Outlook on Financing for Sustainable Development 2021 Report the Gap has likely widened by at least $700 billion towards $3.2 trillion. That is, actual investment levels are only around 25% the levels required during the pandemic. To be consistent with most development literature, this Action Plan refers to the SDG Investment Gap as $2.5 trillion.

Figure A.1: The Sustainable Development Goals.

The Action Plan is dedicated to analyzing the use of blended finance to mobilize private investment to finance the SDGs and Paris Agreement objective in LICs and MICs. (See Box A.1 for OECD definition of blended finance). Blended finance, as practiced in 2016-2021, is focused almost exclusively on financing private sector operations. As such, it is important to understand the Investment Gap for those SDGs and sectors where private financing is most plausible. UNCTAD extrapolates the private sector investment contributions experienced in High Income Countries (HICs) to estimate potential private sector investment in LICs and MICs in its annual SDG Investment Trends Monitor. UNCTAD estimates potential private sector investment at $1.3 trillion annually (and public sector investment at $1.2 trillion) to fill the $2.5 trillion SDG Investment Gap. The sectors with the largest potential for private investment are Power ($370 billion

potential), Agriculture and Food Security ($225 billion), Transport ($165 billion), Climate Change Mitigation ($135 billion) and Telecommunications ($130 billion)[12].

Box A.1: OECD Definition of Blended Finance

The OECD DAC members agreed in 2018 the OECD definition of blended finance as "the strategic use of development finance for the mobilization of additional finance towards sustainable development in LICs and MICs." The OECD definition has three important components:

1. "Development finance" is the breadth of Official Development Finance, that is, the $150 billion committed annually by OECD DAC members and the +/- $100 billion deployed annually by IFIs, MDBs and DFIs
2. "Mobilize" suggests the intention of mobilizing additional finance that would otherwise not flow, implying a level of financial additionality and
3. "Additional finance" is meant to include finance and investment that would otherwise not flow to the SDG projects in developing counties. It can be public, philanthropic or private investment – but with a significant emphasis on private investment.

Two examples of a blended finance transactions using the OECD definition:

- Sida issues a guarantee to a private investor which in turn invests debt in a project in Burkina Faso
- The European Commission provides a guarantee to KfW Development Bank for KfW to provide equity in Malawi

The definition covers "development finance" committed at market, near-market and below-market terms.

Note: The broad OEDC definition is problematic since it covers standard MDB and DFI activity; for example, where Norfund provides financing to a private sector project. As an example of the confusion, ODI's April 2019 Blended Finance Report used a dataset that is 92% traditional DFI finance and only 8% concessional development funds.

Convergence's data in this Action Plan covers only a sub-set of the broad OECD definition – the core of blended finance where development funds are allocated at below-market terms for the purpose of mobilizing private investment.

In 2022, Developed Countries focus (i) international development cooperation budgets on achieving the UN Sustainable Development Goals (SDGs) and (ii) a significant amount of public-sector financial resources for achieving Climate (the Paris Agreement) objectives. Prior to the pandemic, UNCTAD estimated the investment requirements to achieve the SDGs in the [141] Low and Middle-Income Counties (LICs & MICs) in its 2014 World Investment Report, and has updated its analysis annually in its World Investment Reports and SDG Investment Trends Monitors. UNCTAD uses a "bottom up" approach to identify the investment needs across ten sectors (Table A.1), estimating total annual investment needs (in 2014) at around $3.9 trillion, with actual investment levels at $1.4 trillion, leaving an annual SDG Investment Gap of $2.5 trillion. In addition, UNCTAD estimates:

- Around $1.33 trillion (around 53% of the Gap) can be implemented by the private sector
- Around $1.17 trillion (47% of Gap) can be implement by the public sector of those 141 countries

Despite the international support of the SDGs, the SDG Investment Gap remained around $2.5 trillion up to 2020. Since the onset of the COVID-19 pandemic, the OECD estimates (in its Global Outlook on Financing for Sustainable Development 2021 Report) the Gap has likely widened by at least $700 billion to $3.2 trillion. That is, **actual investment levels are only around 25% the levels required**.

Table A.1: Estimated Financing Needs and Investment gaps to achieve the SDGs, UNCTAD WIR and Investment Trends Monitor

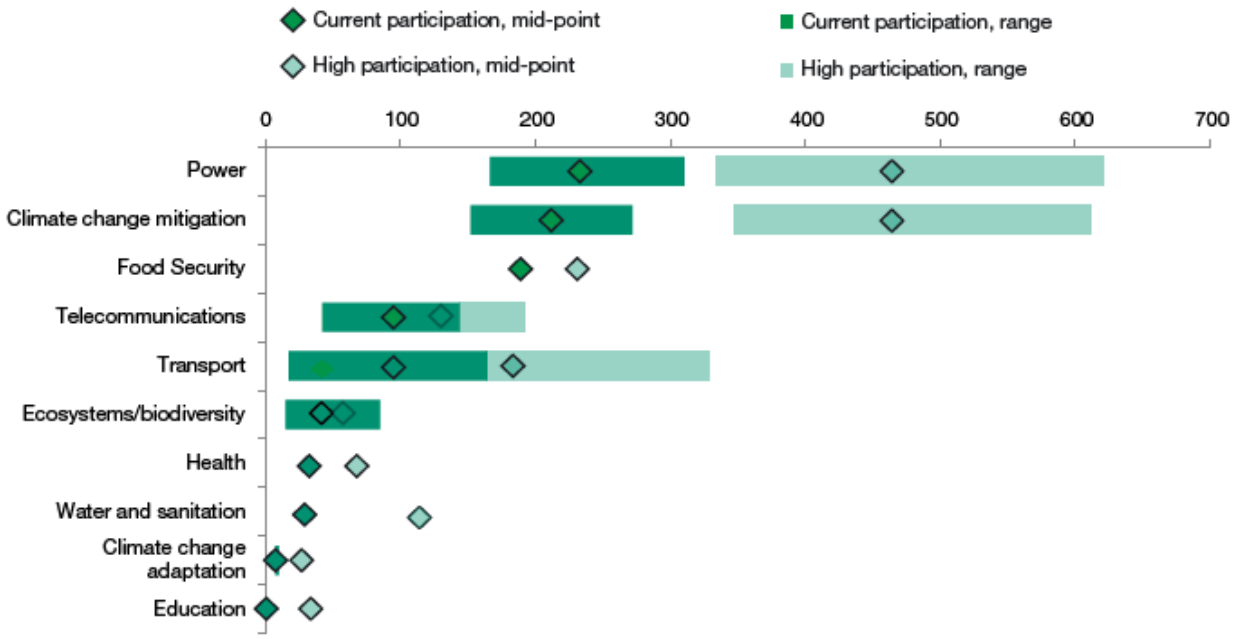
[12] The sectors identified as having the largest ***Public Sector Investment*** needs are Climate Change Mitigation ($395 billion), Education ($215 billion) and WASH ($160 billion).

Table 1: Sector Investment Gaps in Developing Countries - Reproduction of 2014 World Investment Report (Chapter IV)						
Sector	**Investment Description**	**Current Investment**	**Total Investment Required**	**Investment Gap**	**Potential Contribution from Private Sector**	**Potential Contribution from Public Sector**
Power	Generation, transmission and distribution of electricity	260	630-950	370-690	370	160
Transport	Roads, airports, ports and rail	300	350-770	50-470	165	95
Telecommunications	Infrastructure (fixed lines, mobile and internet)	160	230-400	70-240	130	25
Water and Sanitation	Provision of water and sanitation to industry and households	150	410	260	100	160
Agriculture and food security	Agriculture, research, rural development, etc..	220	480	260	225	35
Climate change mitigation	Relevant infra, renewable energy generation, R&D of climate friendly technologies, etc..	170	550-850	380-680	135	395
Climate change adaptation	Cope with impact of climate change in agriculture, infra, water management, coastal zones etc..	20	80-120	60-100	25	55
Eco-systems including biodiversity	Conservation and safeguarding ecosystems, marine resource management, sustainable forestry, etc…		70-210		70	
Health	Infar investment, eg., new hospitals	70	210	140	75	65
Education	Infra investment, e.g., new schools	80	330	250	35	215
TOTAL		1400	3900	2500	1330	1170

Table A.1 and Figure A.2 provide a good illustration of the potential for private investment mobilisation. Blended finance should endeavour to mobile private investment at scale to move actual investment from the dark green diamonds to the light green diamonds.

Figure A.2: Potential private sector contributions to SDG Investment Gap, UNCTAD WIR and Investment Trends Monitors

Figure IV.4. Potential private-sector contribution to investment gaps at current and high participation levels
(Billions of dollars)



Source: UNCTAD.
Note: Private-sector contribution to investment gaps calculated using mid-points of range estimates in table IV.2. The higher participation level is the average private-sector investment shares observed in developed countries. Some sectors do not have a range of estimates, hence the mid-point is the single estimated gap.

For Climate only, most experts estimate an annual investment need in LICs and MICs around $1 – 1.5 trillion – around half to be implemented be the public sector and half by the private sector.

Annex P

List of main reports published in 2020-2022 reviewed for the Action Plan

At November 8, being compiled.

Annex Q

The country risk challenge: High country risk beyond investors' fiduciary mandates

Key Takeaways:

- There is a high level of perceived and actual risk in LICs and MICs amongst private sector investors, who are commonly concerned by country risk, developing country macroeconomic/systemic risk, currency risk, liquidity and exit risk.
- Most debt investors have no mandate to invest in Highly Speculative investments with ratings of "B" or worse, and many equity investors will only invest in companies/projects where the country risk is the equivalent of sovereign Investment Grade ratings (e.g., BBB- or better)
- The median sovereign risk rating of 141 developing counties is Fitch-equivalent "B" with only 14% of sovereigns rated Investment Grade
- Using rating agency and commercial investor conventions, the "best" private borrowers are usually 1-2 notches lower risk rating compared to sovereign in these countries
- Therefore, debt and equity investors have not mandate to invest in most LICs and MICs. If the development community would like to see private investment at any scale to significantly narrow the SDG Investment Gap, risk mitigation provided by blended finance is required to mobilize cross-border investment.

This Section C summarizes the perceived and actual high risk of LICs and MICs. This translates into most investors not being able to invest debt or equity in most developing counties without a form of risk mitigation (e.g., blended finance). Given the risk profile of LICs and MICs, it is not realistic to think private investors will invest en masse at the quantities required to significantly narrow the SDG Investment Gap. Blended finance solutions that alter the risk-return ratio, deployed strategically, are required to mobilize at scale. And a benefit tot eh development community is that actual risk levels have been shown to be lower than perceived risk levels over the past 20 years.

C.1 Summary of Big 3 Rating Agencies ratings scale and definitions

Table C.1 summarizes the Big 3 Rating Agencies scales and definitions.

Table C.1: Big 3 Rating Agency Risk Ratings scale and definitions

Figure 4: Major credit ratings agencies: Ratings scales and definitions

	Moody's	S&P	Fitch
Investment grade	**Aaa**	**AAA**	**AAA**
	Highest quality, subject to the lowest level of credit risk	Extremely strong capacity to meet financial commitments, highest rating	Lowest default risk, exceptionally strong capacity for payment of financial commitments and highly unlikely to be adversely affected by foreseeable events
	Aa	**AA**	**AA**
	High quality and are subject to very low credit risk	Very strong capacity to meet financial commitments	Very low default risk, very strong capacity for payment of financial commitments and not significantly vulnerable to foreseeable events
	A	**A**	**A**
	Upper-medium-grade and are subject to low credit risk	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances	Low default risk, strong capacity for payment of financial commitments but more vulnerable to adverse business or economic conditions
	Baa	**BBB**	**BBB**
	Medium-grade and subject to moderate credit risk and may possess certain speculative characteristics	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions	Low default risk, adequate capacity for payment of financial commitments but adverse business or economic conditions are more likely to impair this capacity
Speculative grade	**Ba**	**BB**	**BB**
	Speculative and are subject to substantial credit risk	Considered highest speculative grade by market participants	Elevated vulnerability to default risk, particularly in the event of adverse changes in the business or economic conditions over time; however, business or financial flexibility exists which supports the servicing of financial commitments
	B	**B**	**B**
	Speculative, and are subject to high credit risk	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments	Material default risk is present, but a limited margin of safety remains; financial commitments are currently being met but capacity for continued payment is vulnerable to deterioration in the business and economic environment
	Caa	**CCC**	**CCC**
	Speculative, of poor standing and are subject to very high credit risk	Currently vulnerable and dependent on favourable business, financial and economic conditions to meet financial commitments	Default is a real possibility
	Ca	**CC**	**CC**
	Speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest	Currently highly vulnerable	Default of some kind appears probable
	C	**C**	**C**
	Lower rated and are typically in default, with little prospect for recovery of principal or interest	Currently highly vulnerable obligations and other defined circumstances	Default is imminent or inevitable, or the issuer is in standstill

Source: Fitch Ratings, Definitions of Ratings and Other Forms of Opinion, August 2012. www.fitchratings.com/web_content/ratings/fitch_ratings_definitions_and_scales.pdf; Moody's Investors Service, Ratings Symbols and Definitions, June 2012, www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004; Standard & Poor's, Standard and Poor's Rating Definitions, June 2012, www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245335682757.

Form an investor perspective, risk ratings translate into a level of risk estimated by the expected probability of default. Investment Grade issuers (e.g., AAA, AA, A and BBB) have a very low expected probability of default and non-Investment Grade Issuers (e.g., BB+ and lower), also known as Speculative Grade, have a tangible expected probability of default. Table C.2 and Annex X reproduce Fitch's most recent probability of default tables.

Table C.2: Summary of Fitch Probability of Default (10-year cumulative default rates)

Risk Type	AAA	AA	A	BBB	BB	B	CCC or lower
Sovereign	0	0	3.83%	3.43%	4.08%	13.37%	31.58%
Private Sector	1.41%	0.08%	1.33%	2.92%	7.90%	12.63%	39.25%

C.2 Country Risk

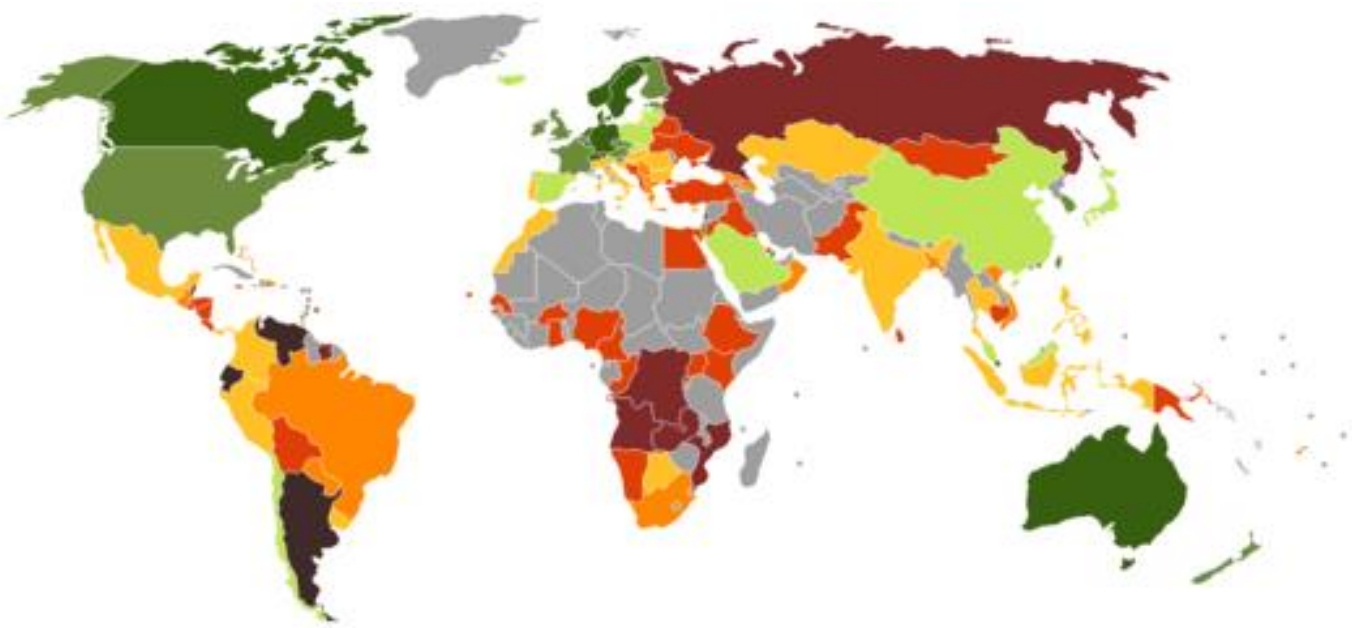
As depicted in Table B.3, there are two main sources of private investment to be mobilized to the SDG projects in LICs and MICs: domestic financial resources already located in LICs and MICs and international financial resources that can be invested cross-border. Section 2 identifies the high country-risk in developing counties that minimizes cross-border international investment into LICs and MICs at very low levels.

The reality is that the leading global proxies of developing country risk used by the investment community are the sovereign ratings of the Big 3 rating agencies – and they rate those countries as very risky. Of the 141 ODA-eligible "LICs and MICs," 86 are rated by Fitch, Moody's and/or S&P, while the OECD Export Credit Country Classification System rates an additional 37 countries not rated by the Big 3. Figure C.1 provides a map of sovereign risk ratings, while Figure C.2 demonstrates the distribution of countries to High Risk Categories:

- Of the ODA-eligible countries: Only 17 (14% of the countries) are rated **Investment Grade** (i.e., BBB- or better), while 16 (13%) are rated **Speculative Grade** (BB+, BB and BB-) while 92 (75%) are rated **Highly Speculative Grade** (i.e., B+ or lower). The median rating is "B" – **Highly Speculative Grade**. Indeed, one-third of the countries are rated "CCC+ or lower."
- Of the 78 LDCs, LICs and LMICs: Only 5 (6% of the countries) are rated **Investment Grade** (i.e., BBB- or better), while 6 (8%) are rated **Speculative Grade** (BB+, BB and BB-) while 67 (86%) are rated **Highly Speculative Grade** (i.e., B+ or lower). The median rating is "B-". One-third of the countries are rated "CCC+ or lower."

Figure C.2 is derived using (a) the median sovereign risk ratings of the 85 countries rated by the Big 3 Rating Agencies (e.g., median rating of "B+") and (b) the OECD ECA country risk ratings for the other 56 countries. The median implied sovereign risk rating is S&P-equivalent "B", only 14% of the countries are rated Investment Grade ("BBB-" or better), 13% are rated Non-Investment Grade *Speculative* ("BB") and 73% rated Non-Investment Grade *Highly Speculative* ("B+" or lower). Most private sector borrowers will have implied ratings 1-3 notches lower than the sovereign, therefore the majority of investment opportunities in LICs and MICs are "B" or "CCC" - *Highly Speculative*. Simply, country risk in the majority of LICs and MICs is too high for most debt and equity investors to invest.

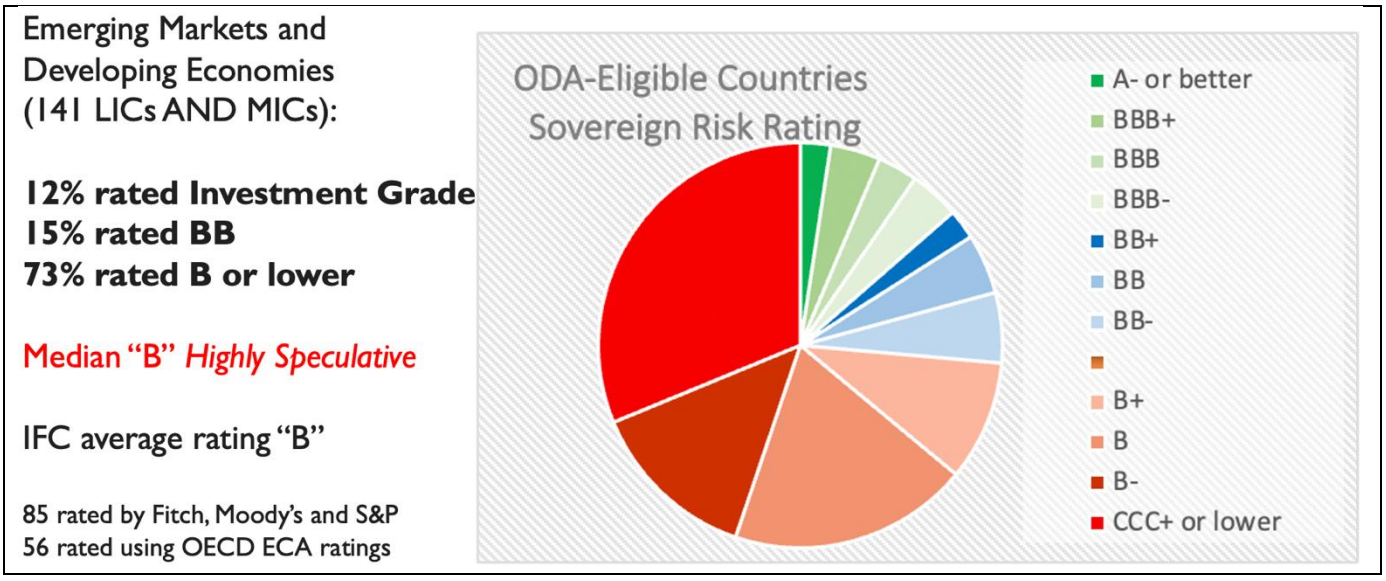
Figure C.1: Risk Rating Map of All Countries, Standard & Poor's, 2019



Countries by Standard & Poor's Foreign Rating (March 2019)

AAA	AA	A	BBB	BB	B	CCC/CC	SD/D

Figure C.2: Country Risk Rating Distribution of 141 ODA-eligible Countries, Moody's S&P, Fitch and OECD



Tables C.3 and C.4 translates these letter ratings into the simple English and the critically important risk analytics that private debt investors deploy when making Investment decisions:

- Investments at the equivalent of "B" – the median ODA-eligible country risk rating – are seen as having "***material default risk present***" and
- The expected annual probability of default for a "Non-Investment Grade" investment is 3.1% compared to 0.18% for an Investment Grade Risk.
- That is, all other things being equal, an investment in a Non-Investment Grade bond is 17 times more likely to default compared to an Investment Grade bond.

Table C.3: Definition and description of obligors/issuers (e.g., countries and companies) rated "B"

Rating Agency	**Definition for "B" rated issuer**	**Annualized expected probability of default**
Moody's	*Obligations rated B are considered* ***speculative and are subject to high credit risk***	4.1%
Standard & Poor's	*The obligor currently has the capacity to meet its financial commitment on the obligation.* ***Adverse business, financial or economic conditions will likely impair the obligor's capacity*** *or willingness to meet its financial commitment on the obligation*	3.7%
Fitch	***Material default risk is present, but a limited margin of safety remains****. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.*	3.6%

Table C.4: Implied annual probability of defaults by risk rating, Standard and Poor's (2020)

Risk Rating	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BB B-	BB+	BB	BB-	B+	B	B-	CCC
Annual Probability of Default	0.07	0.03	0.07	0.06	0.08	0.09	0.10	0.18	0.26	0.53	0.68	1.18	1.88	2.98	3.59	5.84	12.46

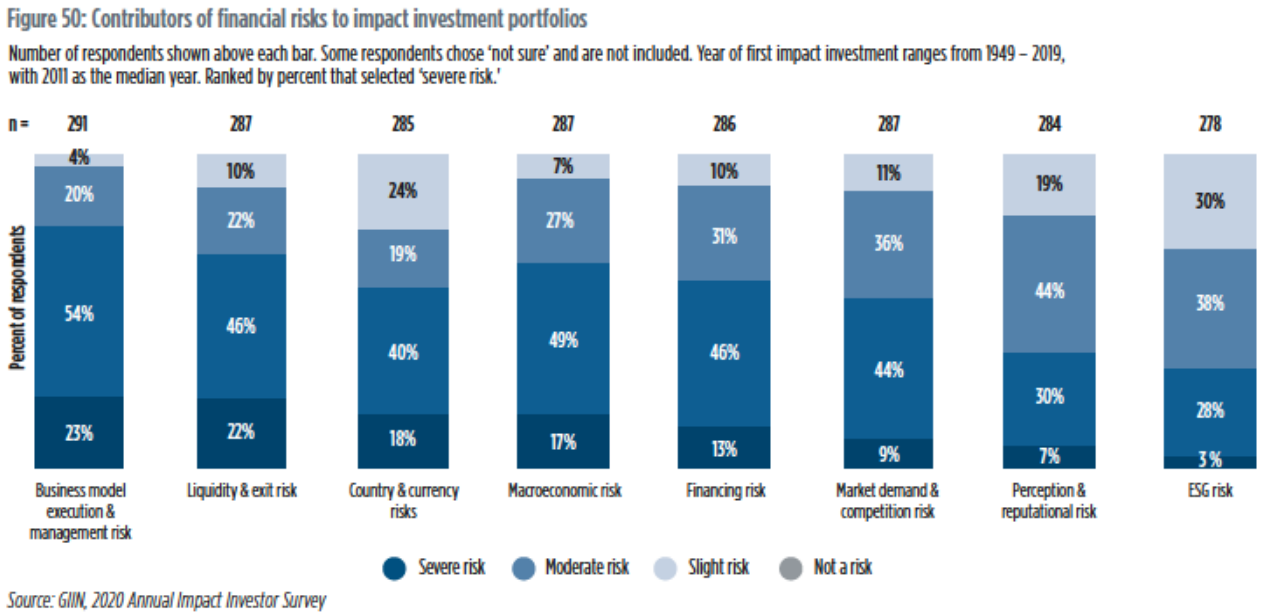
These high-risk sovereign ratings, and implied country risk ratings, have two immediate consequences for potential cross-border private sector investors:

- Debt Investors: The majority of debt investors have a mandate to invest in Investment Grade-only investments, and the large majority have no mandate to invest in Highly Speculative investments with ratings around "B". Table C.4 presents Standard and Poor's Global Corporate Average Cumulative Default rates. Using the five-year default rates, a BBB has an implied expected annual probability of default of 0.27% while a "B" has a 3.7% probability of default – that is, an indicative debt investment in a median-risk developing country has around 14 times higher probability of default relative to a low-end Investment Grade investment.
- Equity investors: Many equity investors will only invest in companies/projects where the country risk is considered to be acceptable. With investors using a country's sovereign risk rating as the proxy for country risk, and Investment Grade rating (e.g., BBB- or better) the cut-off. Only 14% of LICs and MICs are rated Investment Grade; therefore, equity investment at any scale is not possible in most developing counties without blended finance.

C.3 All risks in LICs and MICs

In its 2020 Annual Impact Investor Survey, the Global Impact Investing Network surveyed its members managing more than $15 trillion of Assets Under Management. GIIN asked members to identify the main risks they evaluate prior to making an investment (see Figure C.3). Three of the Top 5 risk identified are overwhelmingly present in the large majority of developing counties: (1) liquidity and exit risk, (ii) country & currency risk and (iii) macroeconomic risk.

Figure C.3: Contributors of financial risks to impact investment portfolios, GIIN 2020 Survey



Source: GIIN, 2020 Annual Impact Investor Survey

Although the IMF and IIF estimate Global Financial Assets around $400 trillion, only 4% of the assets are invested in the 140 LICs and MICs (excluding China). The primary reasons are:

- Those 140 countries have very low amounts of domestic financial wealth and domestic financial intermediation and
- High country risk of LICs & MICs precludes most international investors from investing in those countries due to fiduciary obligations

To further illustrate this high country risk, Table C.4[13] below reproduces the weighted average borrower risk ratings for the major MDBs active in LICs and MICs. For example, (i) the average risk rating for IBRD's sovereign loan portfolio is "B+" and (ii) for IFCs' private sector portfolio loan is "B" – both *Highly Speculative*.

Table C.4: MDB average debt risk ratings

Exhibit 6

AfDB still has some of the weakest borrowers among Aaa-rated supranationals

(Weighted average borrower rating, 2020)

	WABR
European Investment Fund	Baa1
Nordic Investment Bank	Baa2
European Investment Bank	Ba1
Asian Infrastructure Investment Bank	Ba2
Asian Development Bank	Ba3
International Bank for Reconstruction and Development	B1
African Development Bank	B2
International Development Association	B2
International Finance Corporation	B2
European Bank for Reconstruction and Development	B2
Islamic Development Bank	B3
Inter-American Development Bank	B3

Source: Moody's Investors Service

In general, the country risk of most debt and equity investments in LICs & MICS will be too risky for the large majority of investors. Fortunately, development finance and blended finance has 25+ years track record demonstrating acceptable investment risk in LICs and MICs (See GEMS database). Perceived risk on an ex ante basis has been higher than the actual risk on an ex post basis. The blended finance solutions identified in this Executive Summary bridge this gap, and over time, investors will see an actual lower risk materialize thereby requiring less public and philanthropic catalytic funds over time.

[13] Table reproduced from Moody's report for African Development Bank.

Annex R

MDBs: Net benefit to governing MDBs to AA versus AAA risk rating

There are numerous positives and negatives of governing the MDBs with a "AAA" rating compared to a "AA" rating. Form a shareholder perspective, the main positives are (i) in general, the MDBs could hold an extra 50% of Development Assets, (ii) the MDBs could hold financial assets with higher financial additionality (e.g., loans to LICs and LMICS compared to UMICs, higher risk borrowers, equity and local currency loans) compared to relatively lower financial additionality (e.g., hard currency senior loans). There is no discernible negative impact on the MDBs - the main negative accrues to the shareholders and debt investors) in the theoretical increase in MDB solvency risk.

The main balance sheet / business model considerations for MDB shareholders include:

- In general, an AA MDB can underwrite and hold around 50% more financial assets compared to a AAA
- The risk profile of financial assets held by an AA can be higher than for a AAA: that is, more equity versus debt, more local currency debt versus hard currency debt and more LIC exposure compared to MIC exposure
- The theoretical default risk for an AA versus a AAA is higher

The income statement impact would be positive – the higher debt service cost would be nominal, and the extra 50% of assets would generate enough net profits to offset any increase in debt service costs

Substantial benefits accrue to the Developing Countries, the SDGs and Paris Agreement objectives by governing the MDBS subject to an AA rating compared to AAA. For purposes of comparison, Table X lists the major MDBs, G7 countries, G20 countries, OECD DAC members and major international financial institutions by credit rating, with following summary:

- All major MDBs are rated AAA
- Only 43% of G7 member countries rated AAA
- Only 20% of G20 countries rated AAA
- Only 33% of OECD DAC member countries rated AAA
- No major private sector financial institutions rated AAA

The most substantial benefits of governing the MDBs to an AA rating versus a AAA rating include:

- Increases ability to achieve the SDGs and Paris Agreement objectives
- Increases ability to provide higher development impact – quantity and quality
- On average, should be able to increase their annual commitments and assets by around 50%
- Increases ability to provide financial instruments with much higher financial additionality than USD senior debt, e.g., equity, mezzanine capital, local currency debt and junior positions in Blended Finance Mobilization Vehicles
- Increases ability to take SME risk and open currency risk
- Increases ability to fund LICS and LDCs

The financial impact on the MDB will likely be either positive, or in worst case neutral. The negative impact will be an increase in MDBs' cost of borrowing – a reasonable estimate would be 0.1% (10 basis points) increase in interest rates annually. This increase in borrowing costs will easily be offset with an approximate 50% increase in financial assets, all of which are expected to earn returns in case of the MDB's cost of borrowing. MDBs managed at an AA rating will not impact their ability to access capital markets.

The only meaningful negatives of managing an MDB as an AA versus a AAA accrue to investors in MDB bonds and tot eh MDB shareholders:

- Theoretical increase in probability of default for debt investors. Tables X and Table Y (many thanks to Fitch rating Agencies) are Fitch's tables showing the actual default rates of sovereign and corporate issuers since 1990 (similar data are available for longer periods and from other rating agencies, but the other data are very similar – so we use the Fitch data for simplicity). The rating agency data has no evidence that AA sovereigns of corporates have

higher probability of default that AAAs. As of February 27,2022, the secondary market bond yields for corporate debt have the following 10-year yields: AAA at 2.75% and AA at 2.79%. That is, investors require a 0.04$ premium annually to hold AA bonds versus AAA bonds.

- Investors have LOTS of appetite for AAA and AA bonds. AAA and AA issuers have equal access to capital markets. If priced at market rates, AAA and AA issues will be highly over-subscribed.
- Theoretical increase in likelihood MDB shareholders needing to increase capitalization due to credit deterioration.

Ratings of MDB shareholders and other major financial institutions

Rating[14]	AAA	AA	A	BBB	Non-Investment Grade
MDBs					
G7 (3 of 7 rated AAA)	Canada Germany United States	France United Kingdom	Japan	Italy	
G20 (4 of 20 rated AAA)	Australia		Saudi Arabia	India Mexico	Argentina Brazil South Africa Turkey
OECD DAC (10 of 30 rated AAA)	Denmark European Union Luxembourg Netherlands Norway Sweden Switzerland	Austria Belgium Czech Rep Finland Ireland Korea	Iceland Poland Slovak Rep Slovenia Spain	Hungary Portugal	Greece
Major Financial Institutions		Bank of America Credit Agricole HSBC Royal Bank of Canada	BNP Paribas Banco Santander Barclays Citicorp JP Morgan Mitsubishi UFJ Société Generale	Deutsche Bank	

[14] Median risk rating from Fitch, Moody's and S&P. Source Trading Economics at February 27, 2022

Annex S

Debt sustainability in EMDEs

Although the $3 trillion annual SDG Investment Gap is not large relative to the $400 trillion of global financial assets, it is large relative to the domestic debt absorption capacities of the [141] Low and Middle-Income Countries. Annex 1 provides key excerpts from the World Bank's International Debt Statistics 2002 Report. Some highlights:

- The World Bank estimates the **combined external debt stock of LICs & MICs (ex-China) is $6.6 trillion in 2020**.
- The Debt to GNI ratios of LICs & MICs (ex-China) is 41.5%; much lower than High Income Countries, OECD countries and G7
- This debt is predominantly in public sector (Convergence estimates around 70% is public sector and 30% private sector)

To finance the SDGs and Climate objectives sustainably, the Development Community cannot simply finance and mobilize hard currency debt at significantly higher levels. The World Bank and the Big 3 Rating Agencies advise that, a certain point, a country's debt and debt service obligations become too high. And the country will default and/or be downgraded.

A **reasonable approach to increase significantly sustainable investment** includes increasing:

1. The breadth and depth of domestic financial intermediation in LICs and MICs
2. Domestic investment to SDG and Climate projects – in both debt and equity
3. Cross border debt investment to the public sector – in both hard currency and local currency (where possible)
4. Cross border debt investment to the private sector - in both hard currency and local currency (where possible)
5. Cross border FDI in the private sector
6. Cross-border Portfolio Investment (equity) in the private sector
7. Increasing MDB investment and private investment mobilization

Sustainable SDG and Climate investment in LICs and MICs requires:

- A substantial increase in investment
- A balance between investment from domestic resources and cross-border resources
- A balance between debt and equity investment (e.g., FDI and portfolio investment)
- A balance between hard currency debt and local currency debt
- A balance between public-sector debt and private-sector debt

END

ADDITIONAL INFORMATION

Need for Blended Finance Solutions to Mobilize Investment at Scale to LICS and MICs

The OECD has the most generous estimate of the amount of private investment mobilized by Official Development Finance interventions at $[48] billion. The MDBs self-report they mobilize $20 billion (See Private Direct Mobilization in Table A.4 of Mobilization of Private Finance Report). To mobilize a significant amount of private investment, let's say $250+ billion, requires substantial changes to the status quo. The investment assets created by mobilization must have three critical components:

1. **De-risking investment assets to fit within the fiduciary investment requirements of investors:** Country risk in LICs and MICs is very high relative to most private investors' investment mandates. The median sovereign risk rating of the 141 countries is S&P-equivalent "B" – the majority of debt investment opportunities have implied risk ratings of "B" *Highly Speculative* and "CCC" XYZ – far riskier than most investor's mandates of *Investment Grade* ("BBB" or better) and "BB" *Speculative*. The only way to mobilize private investment at sale across the 141 LICs and MICs is to de-risk investments into eh "BB" and Investment Grade range. Similar de-risking is required for equity investment.
2. **Creating market-equivalent risk-adjusted return investment assets:** Investors have fiduciary obligations and can only invest in investment assets that meet or beat market norms
3. **Investment assets should be aligned with *purpose* investment mandates:** In general, investors are reluctant to invest in most of the LICS &MICs for a variety of reasons – high country risk, high perceived corruption risk and low knowledge. The investment assets must be attractive for them to disinvest in developed markets and investing emerging markets and developing economies. In addition to creating risk-adjust returns that meet their absolute risk requirements, investment should meet the criteria of their purpose investment strategies: ESG Investment, Climate Finance, Green Finance, Sustainable Investment, Impact Investing, etc.. the benefit is that all assets financed by MBD, DFIs, ODA and Climate Finance are for projects//uses fully aligned with these purposes.

The IMF estimates only 4% of the $400 trillion of Global Finance Assets are invested in LICs and MICs (ex-China). Mobilizing $250 billion per year is only around 0.06% of these assets. Creating investment assets that meet the three criteria above will be able to mobilize the required investment.

Most private investors cannot invest in LICs and MIC's at the scale required without (i) a risk profile that meets their fiduciary investment risk requirements (e.g., "BBB" or "BB" for most debt investors) and (ii) a market-equivalent, risk-adjusted return. Fortunately, over the past [15] years, 700+ blended finance transactions have been implemented mobilizing $150+ billion of investment from all sources by addressing the risk-return challenge. In 2021, many ODA-donors, philanthropic foundations, investors and asset managers collaborated to identify the four most effective and efficient blended finance approaches that should be standardized to mobilize private investment at scale (See Section E.2).

As an illustration, Table E.1 summarizes the investment characteristics required (or preferred) by private debt investors

Table E.1: Illustrative Private Debt Investor Requirements and Preferences

Investment Requirements	Investment Strong Preferences
• Must meet fiduciary risk and risk-return criteria: For debt investors, generally "BB" or better risk profiles and market-equivalent risk-adjusted returns • Must meet regulatory requirements • Ability to value investment	• Liquidity: Publicly-listed with secondary market • Formal rating by Big 3 Rating Agency • Most investors seek Investment Grade ratings ("BBB" or better), some prepared to invest in Non-IG Speculative ("BB") and very few for Highly Speculative ("B" or lower)

• No or limited public sector involvement in investment decision making and asset management	• A qualified asset manager / fund manager (e.g., IFC in public sector or Blackrock in private sector) • Portfolio approaches over project investments (e.g., diversification) • Holding less than 20% of transaction exposure

E.1 Sources of Catalytic Funding available to mobilize private investment

The main public sector funds, to both invest and mobilize private investment, include:

1. Balance sheets of MDBs – Around $365 billion of shareholders' equity
2. Balance sheets of DFIs – around $[80] billion shareholders' equity
3. Public sector funding in multi-stakeholder organizations, such as Green Climate Fund, Global Environment Facility and Climate Investment Funds
4. Official Development Assistance - in 2021 around USD 175 billion (around one-third directed to investment and two-thirds non-investment - e.g., humanitarian assistance and consumption grants)
5. ODA-like funds, such as Sida's Guarantee Programme and Canada's International Assistance Innovation Programme – estimated around $2 billion annually
6. Paris Agreement "Climate Funds" from Developed Countries' Ministries of Finance (See the list here derived by COP26 Presidency)

The current main annual commitments from the sources include:

- MDB sovereign loan commitments at $90 billion (equal to 2% of annual SDG and Climate Investment Needs)
- MDB and DFI private sector debt and equity commitments at $30-40 billion (equal to 0.7% of annual SDG & Climate Investment Needs)
- MDB and DFI mobilization (e.g., Private Direct Investment) around $20 billion (equal to 0.5% of annual SDG & Climate Investment needs)
- ODA donor mobilization is estimated by the OECD around $15-20 billion
- In total, aggregate investment from MDB sand DFIs equal around 3% of actual SDG Investment Needs, and they mobilize around 0.5% of investment needs

In addition to the public sector funds identified above, the OECD estimates philanthropic foundations represent another big pool of potential funding, around $11 billion annually

Quality: In general, long-term investment that does not burden the country and its organizations (e.g., public sector, financial institutions, real economy companies, infrastructure projects, SMEs, citizens and taxpayers) with high debt burdens and FX debt burdens are preferrable to short-term investment that burdens the country and its organizations with debt and FX debt burdens. Table E.2 identifies most important sources and types of funds to invest in LICs and MICs. The table is presented in a reasonable (but arguable) cascade of financial types that produce high quality, sustainable investment in a country (raking is on a relative basis):

- Rows highlighted in green have high relative sustainability (e.g., High Financial Additionality)
- Rows highlighted in yellow have medium relative sustainability (e.g., Medium Financial Additionality)
- Rows highlighted in orange have low relative sustainability (e.g., Low Financial Additionality)
-

Table E.2: Sources and types of funds to invest in the SDGs, Climate and Infrastructure

Rank	Source and type of funds	Example	Increase Country Debt Burden?	
			Total	Hard Currency
1	Cross border – grants: Free cross-border funds from donors (e.g., ODA and ODA-like providers and philanthropic foundations)	USAID grant to Department of Education Mozambique	No	No
	Cross-border – remittances: Free cross-border funds from persons	Tajik worker in Russia sends funds home for investment	No	No
	Developing country – grants: Free domestic funds from foundations	Mo Ibrahim Foundation grant to Kenyan health sector	No	No
	Developing country public finance (using taxpayer funds)	Rwanda Government public investment in renewable energy	No	No
	Developing country private finance- equity	Nigerian investor invests equity in renewable energy project	No	No
	Cross-border Foreign Direct Investment (equity)	Nestle makes FDI investment in agro processor in Burkina Faso	No	No
	Cross-border portfolio investment (equity)	Blackrock Private Equity Fund invests 20% ownership in Angolan hospital operator	No	No
2	Developing country public finance (using local currency debt)	Malawi government makes kwacha loan to private medical diagnostics comply	Yes	No
	Developing country private finance – local currency debt	Ecobank Tanzania extends shilling loan to water treatment facility	Yes	No
	Cross-border public finance - local currency debt	IFC extends cedi loan to Ghana electricity transmission company	Yes	No
	Cross-border private finance - local currency debt	HSBC extends naira loan to Ethiopia bakery	Yes	No
3	Developing country public finance – hard currency	Mali government provides Euro loan to manufacturing facility	Yes	Yes
	Developing country private finance – hard currency	Equity Bank Kenya provides USD loan to private hospital	Yes	Yes
	Cross-border public finance - hard currency debt	IFC extends USD loan to Ghana electricity distribution company	Yes	Yes
	Cross-border private finance – hard currency debt	Citibank provides USD loan to Senegal food processor	Yes	Yes

Current levels of Investment and Mobilization by Official Development Finance

Key Takeaways:

- MDBs and DFIs have been established as the main development tool to finance the private sector in LICs and MICs.
- Although mobilization of private investment is discussed a lot within the development community, this has to lead to tangible governance and performance for private investment mobilization at MDBs and DFIs. The MDBs and DFIs pursue very similar business models in 2021 to 2001 – largely allocating their own capital to private operations in UMICs and LMICs.
- MDBs and DFIS mobilize very low levels of private investment – for 2018 they claimed "direct private investment mobilization" of $40 for every $100, i.e., leverage ratio of 0.4. Similar levels to 2001.
- If OECD DAC members prioritize private investment mobilizations, this has not transferred into the governance models and Key performance Indicators of MDBs and DFIs
- In 2014-16 when eh development community adopted the SDGs and 2030 Agenda, blended finance, where development funds are allocated at below-market concessional terms to mobilize private investment, rose in prevalence of discussions. But this discussion has not been realized in actual higher levels of mobilization
- If the development community wants more SDG projects to be implemented in developing counties, then the blended finance has demonstrated itself to be a good tool. But the status quo is not working. A strategy, more funding and higher collaboration is required.

The development community established MDBs and DFIs as the primary development tool to finance the private sector in LICs and MICs. The World Bank shareholders established IFC as its private sector finance arm in 1956, with MIGA following in 1988. National DFIs were established in the 1970s; for example, the Dutch government established FMO in 1970.

Generally, during the period 1960-2000, (i) DFIs and the private sector operations of MDBs have provided finance to the private sector and (ii) Ministries of Foreign Affairs and development agencies allocated ODA and the World Bank and the sovereign operations of MDBs provided funding to public sector operations. Mobilization of private investment in this period was a tertiary business, with very few of these organizations having meaningful mobilization targets and activities (with the exception of MIGA which is expressly about mobilization). Section 6 describes mobilization activities of the DFIs and Section 7 the Development Agencies.

In the 2010-20, blended finance, where development funds are allocated at below-market concessional terms for the purpose of achieving development impact and mobilizing private investment, started to become more prevalent, in principle[15]. The theoretical importance of blended finance as a development tool increased significantly in 2015 when the United Nations member countries signed "Transforming Our World: The 2030 Agenda for Sustainable Development", effectively creating the 2030 Agenda. The key investment mobilization objectives of the document and the 2030 Agenda are reproduced in Table F.1.

Table F.1: UN Transforming Our World: The 2030 Agenda for Sustainable Development

Document Reference	Investment Mobilization

[15] One could argue that blended finance has become a more prominent part of the development toolbox as the development community has increased its attention on mobilization while the DFIs and private sector operations of the MDBs continue to emphasize allocating their own capital with low levels of third-party mobilization. See Sections 6 and 7.

Means of Implementation – Paragraph 39	The scale and ambition of the new Agenda requires a **revitalized Global Partnership** to ensure its implementation. We fully commit to this. This Partnership will work in a spirit of global solidarity; in particular, solidarity with the poorest and with people in vulnerable situations. It will facilitate an intensive global engagement in support of the implementation of all the Goals and targets, bringing together governments, the private sector, civil society, the United Nations system and other actors and **mobilizing all available resources**
Means of Implementation – Paragraph 41	We recognize that each country has primary responsibility for its own economic and social development. The new Agenda deals with the means required for implementation of the Goals and targets. We recognize that these will include the **mobilization of financial resources** as well as capacity building and the transfer of environmentally sound technologies to LICs and MICs on favourable terms, including on concessional and preferential terms, as mutually agreed. **Public finance, both domestic and international, will play a vital role in providing essential services and public goods and in catalysing other sources of finance. We acknowledge the role of the diverse private sector, ranging from microenterprises to cooperatives to multinationals, and that of civil society**
Means of Implementation – Paragraph 43	We emphasize that international public finance plays an important role in complementing the efforts of countries to mobilize public resources domestically, especially in the poorest and most vulnerable countries with limited domestic resources. **An important use of international public finance, including official development assistance (ODA), is to catalyse additional resource mobilization from other sources, public and private.**
Goal 13a (Climate Action)	Implement the commitment undertaken by developed country parties to the United Nations Framework Convention on Climate Change to a goal of mobilizing jointly $100 billion annually by 2020 from all sources to address the needs of LICs and MICs in the context of meaningful mitigation actions and transparency on implementation and fully operationalize the Green Climate Fund through its capitalization as soon as possible
Goal 17 (Revitalize the Global Partnership for sustainable Development)	<u>Finance</u> 17.1 **Strengthen domestic resource mobilization**, including through international support to LICs and MICs, to improve domestic capacity for tax and other revenue collection 17.3 **Mobilize additional financial resources for LICs and MICs from multiple sources** 17.4 Assist LICs and MICs in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and address the external debt of highly indebted poor countries to reduce debt distress <u>Multi-stakeholder partnerships</u> 17.16 Enhance the Global Partnership for Sustainable Development, complemented by multi-stakeholder partnerships that **mobilize and share knowledge, expertise, technology and financial resources,** to support the achievement of the Sustainable Development Goals in all countries, in particular LICs and MICs

The foundational structure of the official development community has been in place, with limited change, for more than 35 years. Generally, the structure consists of a myriad of organizations that support the SDGs in LICs and MICs by providing funding, indirectly or directly, to support public sector and private sector projects.

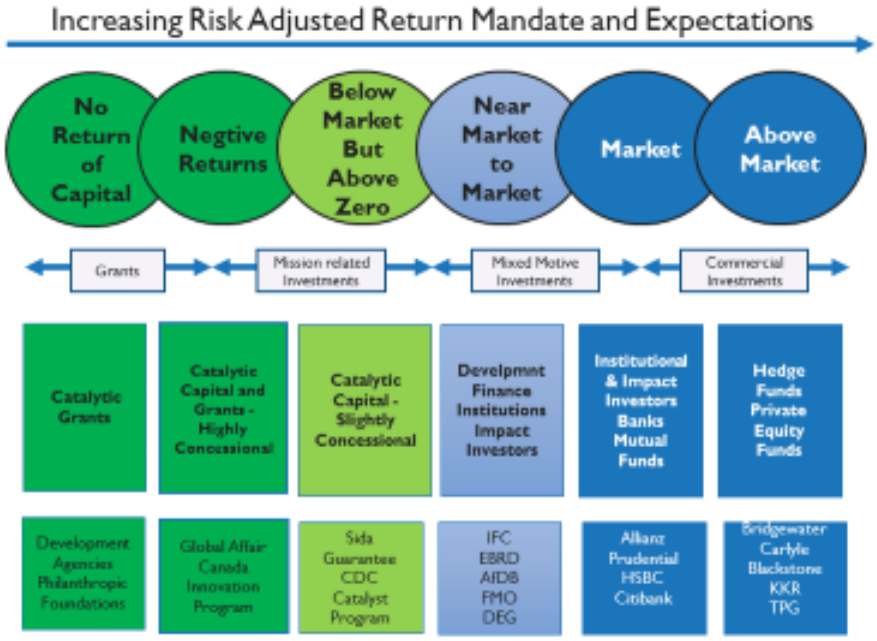
Figure F.1 provides a stylized mapping of the funds deployed in innovative development finance mechanisms. Sources of development finance are depicted in green and light blue as follows:

- Fully Concessional (e.g., Negative 100% Internal Rate of Return) – No Return of Funds/Capital: Generally, international governments and development agencies (e.g., OECD DAC members) and philanthropic foundations.

Deploy grants and technical assistance with no requirement or expectation of return of funds; for example, ODA funds.

- Highly Concessional (e.g., Negative IRR) – Expected Loss of Capital: Generally, international governments and development agencies (e.g., OECD DAC members) and philanthropic foundations. Deploy risk capital with an expectation that they will lose a portion of the capital.
- Slightly Concessional (e.g., Positive IRR, but below market) – Expected Preservation of Capital: Generally, international governments and development agencies (e.g., OECD DAC members) and philanthropic foundations. Deploy risk capital with an expectation that the capital will be preserved any may generate a positive return.
- Non-Concessional (e.g., Positive IRR, near market) – Expected Preservation of Capital and a positive return at market or near-market rates: Generally, MDB and DFI capital deployed in private sector operations. Deploy risk capital with an expectation that the capital will be preserved and generate a market return.

Figure F.1: Stylized Mapping of Concessional and Non-Concessional Financial Resources in Blended Finance



F.1 Primary Stakeholders in the Mobilization Agenda

Table F.2 identifies the key stakeholders for mobilization and blended finance

- Column 3 provide a summary description of their importance for mobilisation
- Column 4 shows the instruments they deploy in innovative development finance mechanisms on concessional (below-market) terms
- Column 5 shows the instruments they deploy in innovative development finance mechanisms on non-concessional (below-market) terms

Table F.2: Key Stakeholders for Private Investment Mobilization

Column 1 Stakeholder	**Column 2 Examples**	**Column 3 Mobilisation of Private Investment**	**Column 4 Instruments deployed at below market terms (concessional)**	**Column 5 Instruments deployed at market or near market terms (non-concessional)**
LICs and MICs				
Governments	Government of Rwanda	Medium	Grants and guarantees	N.A.
National Development Banks	Trade & Development Bank	Medium	Guarantees	Financial instruments (debt,

	Uganda Development Bank			equity and guarantees)
Domestic Financial Institutions and Investors	Commercial banks Microfinance institutions Insurance Companies Pension funds	High	N.A.	Financial instruments (debt, equity and guarantees)
Developed Countries				
Governments and their development agencies (e.g., 30 OECD DAC members)	European Commission German BMZ Japan JICA	High	Bilateral and multilateral aid Bilateral grants, contributions to multilateral institutions, sovereign loans, and Private Sector Instruments	Guarantees
International Finance Institutions for public sector	World Bank (IBRD and IDA)	Medium	Grants, sovereign loans and guarantees	N.A.
International Finance Institutions for public sector	IFC MIGA	High (Systemically underutilized)		
Multilateral Development Banks	African Development Bank	High (Systemically underutilized)	Sovereign loans	Financial instruments, e.g., debt, equity and guarantees
National Development Finance Institutions	Netherlands FMO	High (Systemically underutilized)	Sovereign loans	Financial instruments, e.g., debt, equity and guarantees
Regional Development banks	Trae & Development bank of Eastern Africa West African Development bank (BOAD)	Medium (Systemically underutilized)		
Multilateral Institutions	United Nations, European Union, International Development Assistance,	Mixed	Grants Sovereign Loans Blended Finance	

Multi-donor funds	Green Climate Fund Global Environment Fund GAVI, the Vaccine Alliance	Medium	Grants	
Philanthropic Foundations	Gates Foundations Rockefeller Foundation	Medium	Grants and financial instruments	Financial instruments
International Financial institutions and investors		High		Financial instruments
NGOs		Low	Grants	N.A.
Both – Developed and LICs and MICs				
Project Sponsors		High	N.A.	Financial instruments
Service Providers		Low	N.A.	N.A.

The best estimate of the aggregate amount of finance provided and mobilized by the Official Development Finance Community is Total Official Support for Sustainable Development (TOSSD) - launched by OECD DAC members in 2017.

Box F.1: Total Official Support for Sustainable Development

Total Official Support for Sustainable Development (TOSSD) is a new international standard for measuring the full array of resources in support of the 2030 Agenda. It is designed to monitor all official resources flowing into LICs and MICs for their sustainable development, but also private resources mobilised through official means. It also measures contributions to International Public Goods – up to now "invisible" in development finance statistics – that help countries reach their Sustainable Development Goals.

Total official support for sustainable development (TOSSD) is a new international statistical measure that provides a complete picture of all official resources and private finance mobilised by official interventions in support of sustainable development and the SDGs. It consists of two pillars: cross-border resources to LICs and MICs (pillar I) and support to international public goods and global challenges (pillar II).

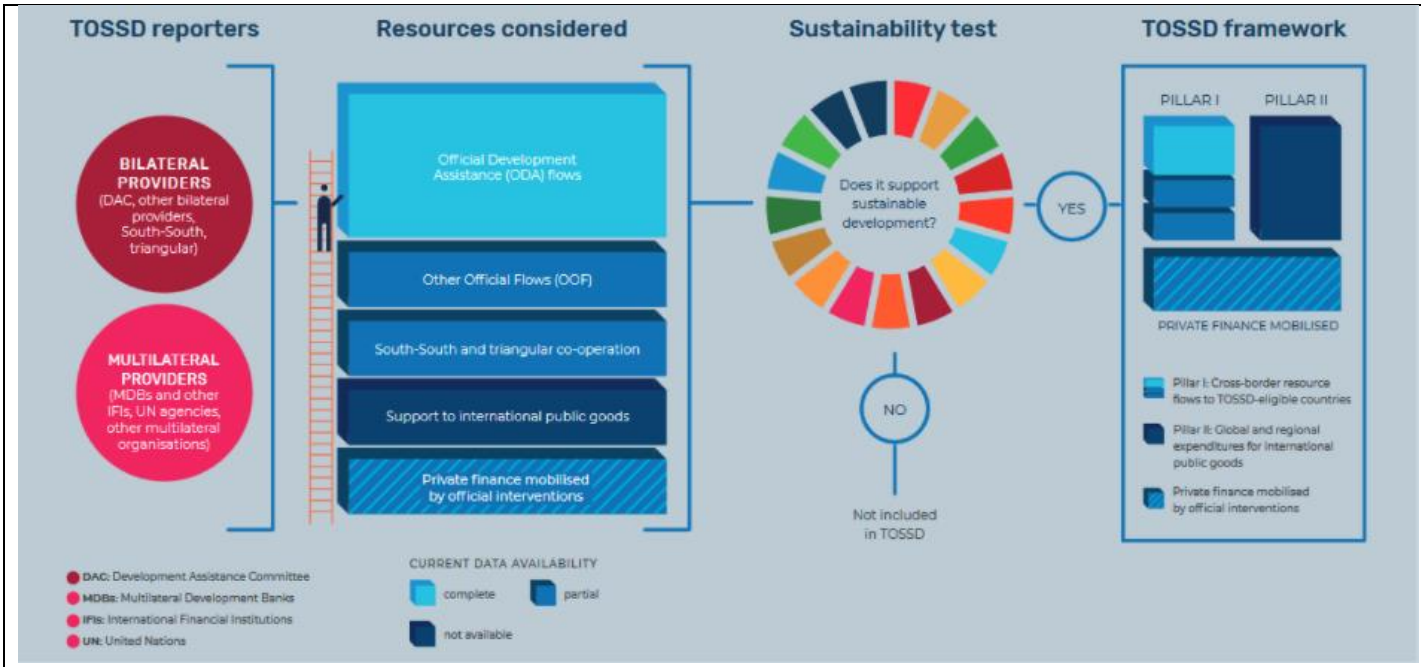


Figure F.2:

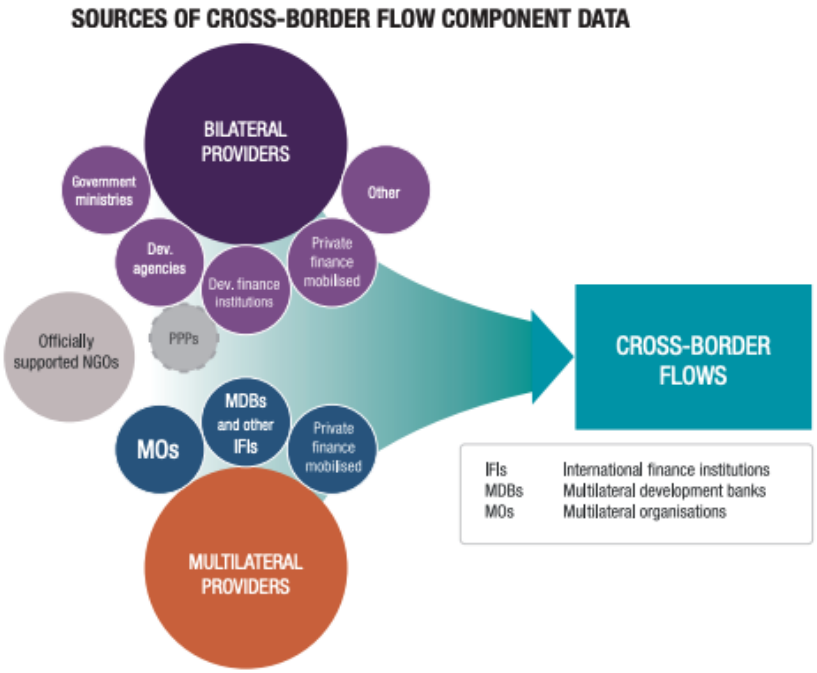
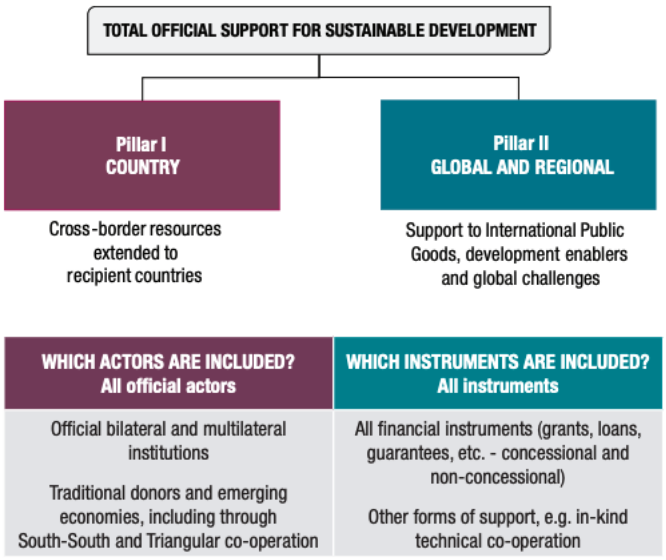


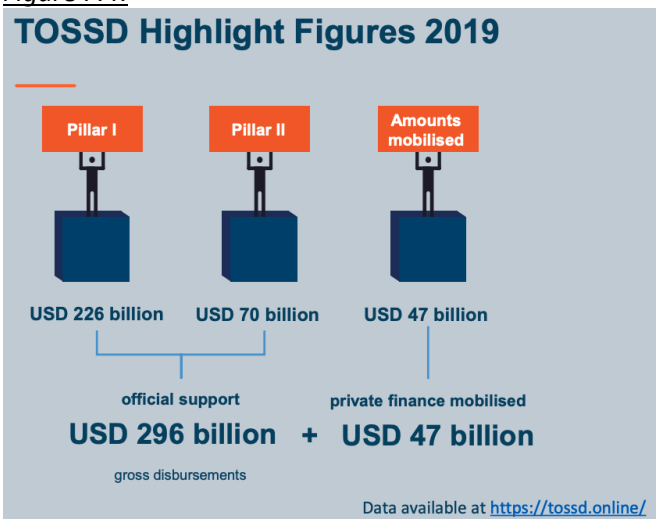
Figure F.3:



The most recent attempt of the OECD to quantify TOSSD analysed 2019 flows to estimate the following amounts:

Pillar 1 Cross-border resource flows to TOSSD-eligible countries	USD 226 billion
Pillar 2 Global and regional expenditures for international public goods	USD 70 billion
Private Finance Mobilized (Almost all mobilization from Pillar 1 and not Pillar 2)	USD 47 billion
Total	USD 343 billion

Figure F.4:



The OECD has attempted to map TOSSD across all sectors and SDGs as demonstrated in Figures F.5 and F.6.

Figure F.5:

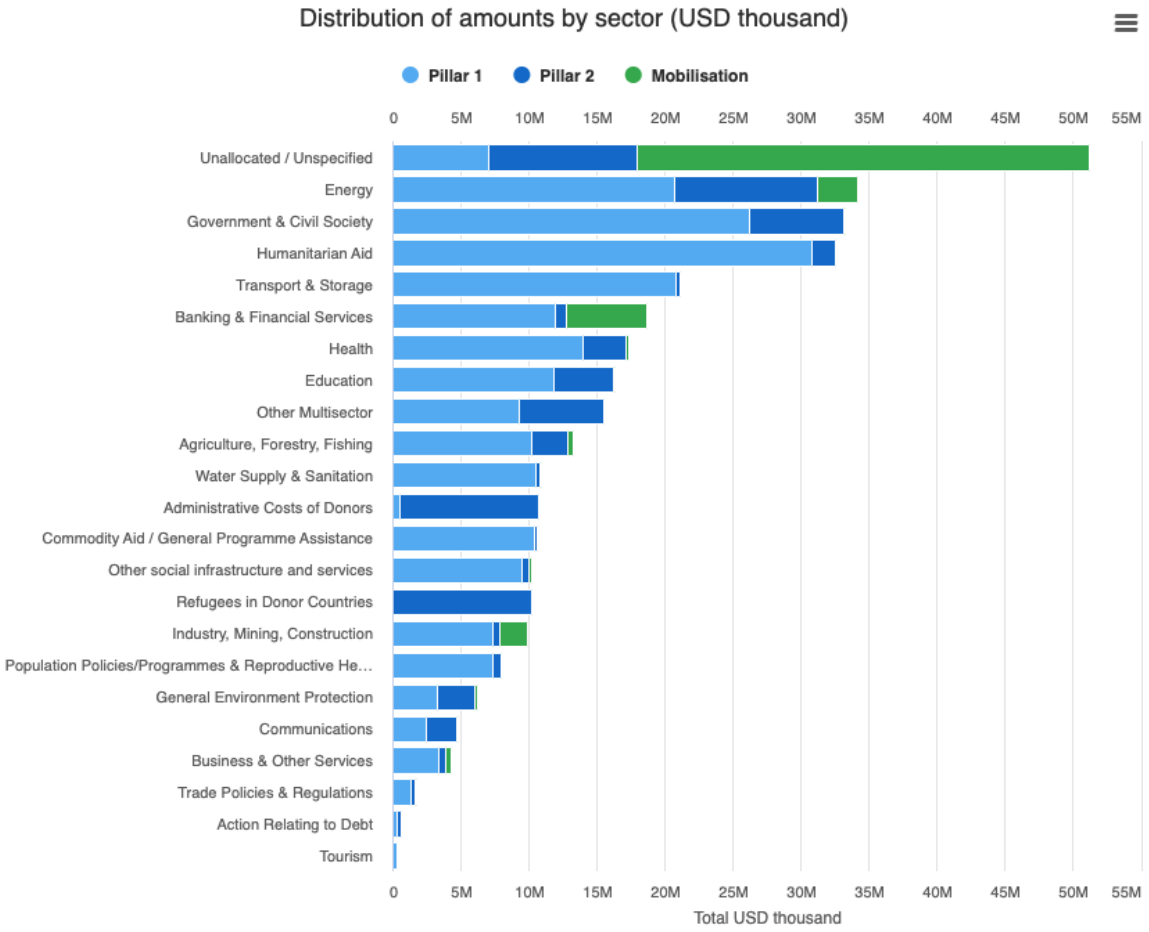
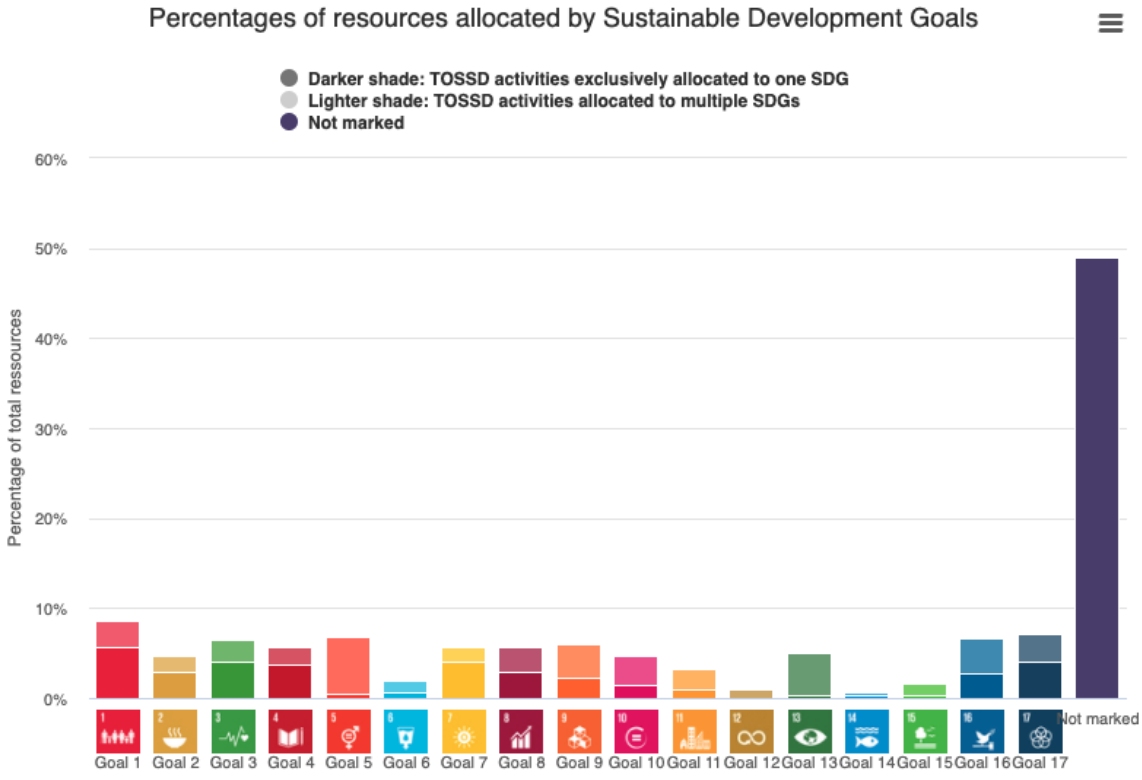

Distribution of amounts by sector (USD thousand)
Pillar 1
Pillar 2
Mobilisation
0
5M
10M
15M
20M
25M
30M
35M
40M
45M
50M
55M
Unallocated / Unspecified
Energy
Government & Civil Society
Humanitarian Aid
Transport & Storage
Banking & Financial Services
Health
Education
Other Multisector
Agriculture, Forestry, Fishing
Water Supply & Sanitation
Administrative Costs of Donors
Commodity Aid / General Programme Assistance
Other social infrastructure and services
Refugees in Donor Countries
Industry, Mining, Construction
Population Policies/Programmes & Reproductive He…
General Environment Protection
Communications
Business & Other Services
Trade Policies & Regulations
Action Relating to Debt
Tourism
Total USD thousand

Figure F.6:


Percentages of resources allocated by Sustainable Development Goals
Darker shade: TOSSD activities exclusively allocated to one SDG
Lighter shade: TOSSD activities allocated to multiple SDGs
Not marked
60%
50%
40%
30%
20%
10%
0%
Percentage of total ressources
Goal 1
Goal 2
Goal 3
Goal 4
Goal 5
Goal 6
Goal 7
Goal 8
Goal 9
Goal 10
Goal 11
Goal 12
Goal 13
Goal 14
Goal 15
Goal 16
Goal 17
Not marked

F.2 Multilateral Development Institutions

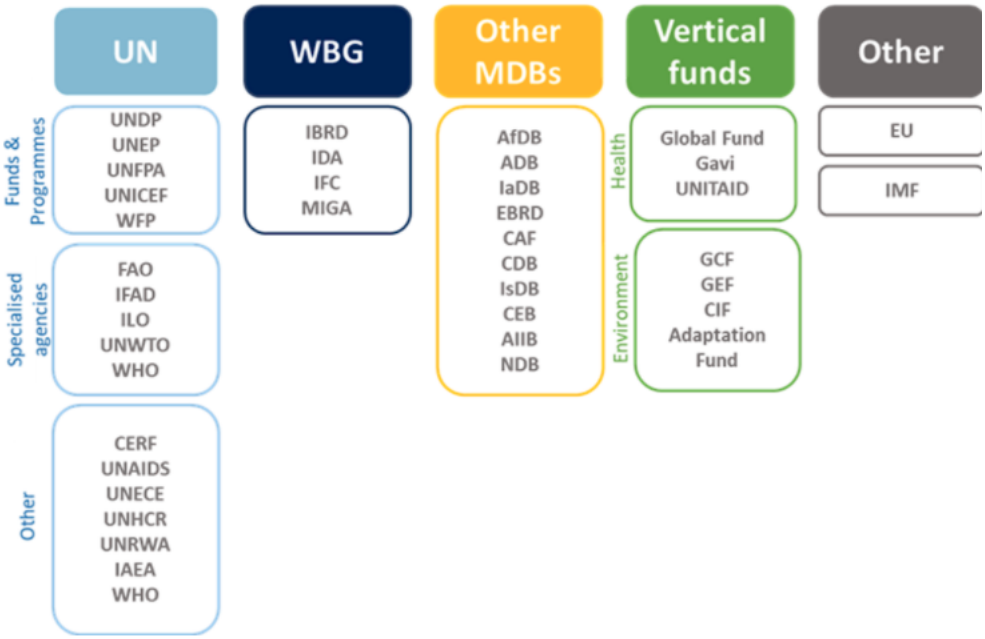
Multilateral development institutions can be broadly classified into four categories:

1. United Nations Development System (UNDS),
2. Multilateral development banks (MDBs),
3. Vertical funds and
4. Other organisations with specialised mandates or particular governance models, such as the International Monetary Fund (IMF) and the European Union (EU).

In the past 30 years, there has bene a proliferation of multilateral institutions as summarised in Figure F.7 below and Annex 1. Although they share broad characteristics, the organisations within each category can be further distinguished by their various mandates, governance structures and operational models.

Figure F.7: Multilateral Development Finance Institutions

Figure 1.1. **Overview of the main organisations forming the multilateral development system**



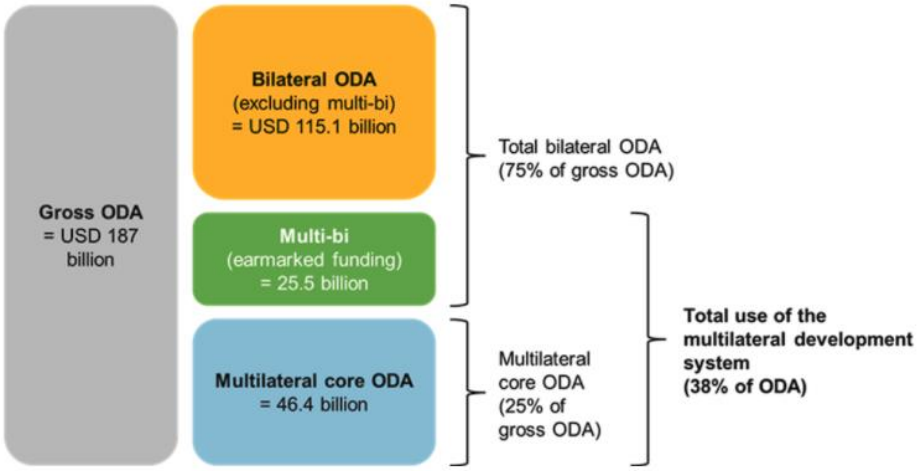
Source: Authors' design based on (OECD, 2020[1]), "OECD DAC Annex 2 - List of ODA-eligible international organisations", available at https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/annex2.htm.

These multilateral institutions have become an increasingly important part of the international development finance architecture as summarised in Figure F.8.

Figure F.8: Importance of Multilateral Development Institutions in International Development

Figure 1.3. **More than one-third of all ODA is channelled through the multilateral development system**

DAC countries' and other official providers' bilateral, core and non-core (earmarked) multilateral ODA, 2018



Note: Disbursements, in USD billion.

Source: Authors' design and calculations based on (OECD, 2020[4]), "Creditor Reporting System", https://stats.oecd.org/Index.aspx?DataSetCode=crs1.

DELETION 3 (MDBS AND DFIS)

Box 2.1 Private Investment Mobilization by Official Development Finance
The six reports cited below identify that all official development finance mobilizes around $40 billion[16] of private investment to LICs & MICs annually: (1) around $20 billion through conventional development finance from MDBs and DFIS, (ii) around $12 billion through catalytic, concessional funds from OECD DAC members and (iii) around $8 billion from other concessional sources. Implementing the actions described in the Action Plan is expected to increase private investment mobilization to $[286] billion per annum in the medium-term (e.g. by 2030) . Six relevant reports: 1. Mobilization of Private Finance by MDBs and DFIs 2019 Report identifies MDBs and DFIs mobilize around $20 billion of direct private investment annually over 2016-19[17] 2. The DFI Working Group on Enhanced Blended Concessional Finance Reports identify a combination of their regular capital and around $1.2 billion of concessional funds from donors mobilizes around $1.4 billion of private investment annually over 2016-19. 3. The ODI Development Finance Institutions: the need for bold action to invest better 2021 Report identifies MDBs and DFIs mobilize around $20 billion of private investment per annum 4. Convergence's State of Blended Finance 2020 Report identifies aggregate blended finance investment volumes around $12 billion per annum 5. The 2020 OECD Blended Finance Funds and Facilities Report identifies around $20 billion of private investment mobilization annually

[16] The $30 billion captures investment mobilized by MDBs, DFIS and donor funded blended finance vehicles where the investor faces underlying private sector finance project/borrower risk. The amount does not include other amounts others would place in the "mobilization" bucket, such as vanilla and green bond issuances by MDBs and DFIs where the investor faces MBD and DFI risk (e.g., AAA issuers).

[17] Please note the MDB and DFI mobilization amounts do not include the private indirect mobilization claimed in the Mobilization report as it is difficult to fully attribute that as an additional outcome of MDB/DFI finance. Those funds are exceptionally important, but are co-investment from project sponsors and third-party financial intermediaries that co-finance the projects MDBs and DFIs finance. Most MDBs and DFI only finance [35]% of a project, requiring co-investment for the other [65]%.

6. The OECD Amounts Mobilised from the private sector by official development finance interventions (2018-19) Report identifies around $45 billion of mobilization