

Blended Finance, MDB Optimization and Private Capital Mobilization

Recommendations for Policymakers



INVESTOR
LEADERSHIP
NETWORK



**Sustainable
Markets
Initiative**

BLENDING FINANCE, MDB OPTIMIZATION AND PRIVATE CAPITAL MOBILIZATION:

Key Recommendations for Policymakers

In 2021, both the Sustainable Markets Initiative and the Investor Leadership Network, along with other key private sector organization such as GFANZ, called for an urgent focus by policymakers on ways to rapidly scale up the mobilization of private capital in emerging markets via blended finance¹. The recommendations presented here represent accelerated momentum around achieving this goal through various official channels, including inclusion in the G7 Carbis Bay Communique², the G20 Finance Ministers Communique in February 2022³, and recent statements by US Treasury Secretary Janet Yellen⁴. Though the scaling of this kind of investment has long been a significant development challenge, the urgency of the climate crisis requires immediate action on this front to reduce existing emissions in the developing world, ensure the primacy of clean energy in the future development of countries in emerging markets, and to ensure critical funding for adaptation and resilience for those countries both most vulnerable and least responsible for the worst effects of climate change.

To achieve these goals and the SDGs more broadly, there is an urgent need for a quantum increase in private investment in emerging markets and developing economies.

- Huge new investments are needed in sustainable infrastructure, especially in the energy sector to support the global low-carbon transition—globally an additional USD 2-2.5 trillion annually for the next three decades. The gap is most acute in small and medium-sized developing economies, but even many of the largest emerging economies are seriously constrained.
- The challenge was striking even before Russia’s invasion of Ukraine, which with the dramatic supply disruptions and the surge in prices further underlines a sharply accelerated need to invest in green energy.
- Public sector resources everywhere are limited. Hence private sector will be needed more than ever to play a critical role. The resources of the private institutional sector are large: estimates suggest that AUM globally by private institutional investors exceed well over 900 times those of the World bank and all other multilateral development banks combined.
- There is collective recognition that mobilizing greater levels of private capital to address the climate emergency and achieve the SDGs urgently requires a range of specific measures and reforms.
- To that end, this note summarizes five recommendations that, if advanced by the G7 and G20 leaders, would help sharply accelerate the mobilization of private capital. These recommendations reflect the views of several DFIs, philanthropic organizations, family offices, and institutional investors belonging to the Sustainable Markets Initiative (SMI), Investor Leadership Network (ILN), Glasgow Financial Alliance for Net Zero (GFANZ), and Global Investors for Sustainable Development Alliance (GISD).
- These organizations and institutions request the G7 and G20 leaders to emphasize the critical need to implement the following recommendations (including via the forthcoming G7 and G20 summit communiqués).

¹ See the SMI’s white paper, [Seizing a New Bretton Woods Moment](#) and the ILN’s Investing in [Emerging and Frontier Economies](#).

² <https://www.g7uk.org/wp-content/uploads/2021/06/Carbis-Bay-G7-Summit-Communique-PDF-430KB-25-pages-3.pdf>

³ <https://g20.org/wp-content/uploads/2022/02/G20-FMCBG-Communique-Jakarta-17-18-February-2022.pdf>

⁴ <https://www.reuters.com/business/finance/yellen-urges-development-banks-mobilize-private-capital-g7-infrastructure-push-2022-04-29/>

KEY RECOMMENDATIONS

I. OPTIMIZE MULTILATERAL DEVELOPMENT BANKS' BUSINESS MODEL AND TOOLKIT

The MDBs have vast amount of knowledge and expertise but they cannot undertake the needed investments on their own. They just do not have the resources, and they must harness large pools of private capital. This in turn requires a change in their incentive structure and business models, so that the focus shifts away from the aim of maximizing MDB finance to mobilizing maximum amount of total capital (public and private). They should focus on acting as catalyst for private capital.

To modify their incentive structure to place private capital mobilization as an important mandate, action needs to be taken in the following areas:

MDBs that provide non-sovereign lending should:

1. Use their balance sheets more effectively, moving from an originate-and-hold to an originate-and-distribute model.
2. Pursue greater co-financing and co-investing with the private sector rather than competing with it.
3. Revise risk appetite frameworks to support greater risk-taking with financial products (including by taking mezzanine and convertible debt positions) over low-risk senior positions.

Implementation of these actions requires their adoption by a majority of shareholders of MDBs (forthcoming G7/G20 meetings would be a key fora), followed by a vote of the Boards of individual institutions, and internal policy change

For all MDBs:

1. Use part of their balance sheets to develop/expand instruments to mitigate excessive risk faced by the private sector, including by an enhanced use of guarantees.
2. Push standardization of guarantee instruments across MDBs and DFIs to lower transaction costs, reduce uncertainty and help directly stimulate private capital flows (good precedents for this exist already).

Implementation: Support from G7/G20; institutions' Board vote

For all MDBs that work directly with host-countries:

1. Double-down on supporting governments in improving integrated multi-sectoral planning; legal, regulatory, and policy environments; institutional capacity; and macroeconomic fundamentals.

Implementation: MDB internal policy

To ensure a strong and credibly sustainable project pipeline:

1. MDBs should scale-up project preparation/pipeline development and procurement efforts with emerging markets governments; this is where pipelines of investable opportunities for the private sector in public service infrastructure are bottlenecked.

Implementation: MDB Boards' decision; Internal policy change

To accelerate the flow of capital and reduce the gap between real and perceived risk for institutional investors:

1. Make the **GEMs database** and other related information transparent and public—historic losses of MDBs are materially lower than those estimated by ratings agencies.

Implementation: Board decision; internal policy change; would be markedly facilitated by recommendation by G7/G20 exhortation

2. **The Global Infrastructure Facility** should be spun out of the World Bank as an independent facility with expanded capabilities for project origination, preparation and structuring.

Implementation: Agreement between members of G20, as well as other existing donors of GIF, and the World Bank Board

While some of the reforms will take time to implement fully, others, especially those relating to availability of information can be implemented quickly—within a year-- and have high near-term impact on private capital mobilization.

II. INSTITUTE A GUARANTEE POOL

To ameliorate risk for institutional investors in the short term:

1. Institute a large pool of funds to provide first-loss guarantees and flexible insurance schemes to deal with key risks and to help mobilize private capital to scale. This action can be taken in the near-term with quick, substantial payoffs.

The pool—USD 50 billion to begin with—can be set-up in part by the rechanneling, as pledged, by G20 of a part of their SDR allocation made last year.⁵ Such a guarantee pool should be managed by a consortia of DFIs possibly in consultation with and MDBs and the private sector.

Implementation: G7/G20 agreement

III. SIGNIFICANTLY ENHANCE THE ROLE OF BILATERAL DEVELOPMENT FINANCE INSTITUTIONS (DFIS)

Throughout the G7, G20, and beyond.

The MDB reforms while critical will take time. The climate crisis requires bold and fast action. Therefore, the power of bilateral DFIs—which are also more agile-- needs to be unleashed immediately, which can yield large dividends in the near-term in terms of mobilizing private investment.

1. Need to supercharge DFIs by increasing their core capital and as a conduit for greater amounts of concessional finance to significantly expand the availability of blended finance solutions to catalyze private investment.
2. Expand technical assistance, including for project preparation for private sector initiatives and to support innovative partnerships with private investors.

Implementation: G7, G20, CHOGUM, national governments

⁵ The pool, suitably utilized, can be leveraged at least 10-fold to help mobilize at least USD 500 billion over the next 3-5 years

IV. ENCOURAGE STRONGER PARTNERSHIPS BETWEEN PHILANTHROPIC AND FAMILY OFFICES WITH MDBS AND DFIS

There is a significant amount of capital that can be directly mobilized by philanthropy and family offices, should they be enabled to have stronger, more innovative partnerships with the private sector.

1. Address regulatory or legal impediments to stronger partnerships (e.g., in the United States, allow climate change spending to be charitable under IRS rules).

Implementation: Recommendation by G7/G20; national governments; Boards and internal policy change

V. GREATER MOBILIZATION OF DOMESTIC FINANCE

In many emerging markets, there are pools of domestic private capital that can be mobilized quickly.

1. In addition to the measures noted above, especially with regard to the regulatory environment, further development of domestic capital markets will provide comfort to, and enable greater collaboration with, external capital.
2. Enhanced tax incentives as well as tax exemptions and capital relief will help stimulate for private investment.

Implementation: G7/G20 recommendation; national governments; enhanced advice by IMF, MDBs

THESE RECOMMENDATIONS ARE INFORMED AND SUPPORTED BY:

