CENTER FOR GLOBAL DEVELOPMENT

# Taking Stock of MDB and DFI Innovations for Mobilizing Private Capital for Development

NEIL GREGORY


## Abstract

To support the 2030 Agenda, MDBs and DFIs have been asked to mobilize more private capital alongside their own investments in private firms. Mobilization volumes to date remain small, but progress has been made in developing new models that can attract different types of private investors at greater scale. From an historic focus on transaction-level mobilization from commercial banks, and issuing bonds to institutional investors, MDBs and DFIs have broadened the range of financial structures they use, and broadened the range of investors that they mobilize capital from, including institutional investors. Innovation and experimentation have occurred both at the level of individual transactions and at the level of portfolios of assets. Scaling up multi-asset mobilization involves a shift in business model from "originate to hold" to "originate to share." To further implement this model, MDBs and DFIs need to increase their capacity to originate assets, standardize asset terms and documents, pool assets in shared vehicles, share risk data, and be more strategic about selling assets. DFIs that do not currently do so can also mobilize private capital by issuing bonds.


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**Taking Stock of MDB and DFI Innovations for Mobilizing Private Capital for Development**

**Neil Gregory**
*Independent consultant*

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**CENTER FOR GLOBAL DEVELOPMENT**
2055 L Street, NW Fifth Floor
Washington, DC 20036

1 Abbey Gardens
Great College Street
London
SW1P 3SE

www.cgdev.org

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## Abbreviations

| | |
|---|---|
| AMC | Asset Management Company |
| AML | Anti-Money Laundering |
| CFT | Combating the Financing of Terrorism |
| DFI | Development Finance Institution |
| EMDE | Emerging Markets and Developing Economies |
| ESG | Environmental, Social and Governance |
| GEMS | Global Emerging Markets Risk Database Consortium |
| KPI | Key Performance Indicator |
| KYC | Know Your Customer |
| MCPP | Managed Co-Lending Portfolio Program |
| MDB | Multilateral Development Bank |
| PDM | Private Direct Mobilization |
| PPP | Public-Private Partnership |
| SDG | Sustainable Development Goal |
| SME | Small or Medium Enterprise |

# Preface

Hopes for the 2015 “billions to trillions” vision—trillions of dollars of private SDG investment mobilized by catalytic MDB and DFI support—have faded. Most SDG investment continues to flow to rich countries and MDBs still mobilize very limited private finance. Blended concessional and commercial finance has not proven scalable or a game changer. The urgent and daunting SDG finance needs, including for climate-related investment, require a serious rethink of MDB and DFI business and finance models, instruments, incentives, and willingness to collaborate.

In this timely paper, Neil Gregory takes a broad and deep look at the more innovative MDB and DFI mobilization models and assesses which are more widely replicable and scalable. Among other recommendations, Gregory makes the case for an evolution toward pooled asset vehicles that offer large, diversified SDG investment opportunities, with lower transaction costs, to institutional and other investors. This would benefit from standardization of asset terms and documentation (and possibly a common credit rating methodology) across MDBs, which has proven a difficult challenge. And he explores the pros and cons of an MDB move toward an originate to distribute model, which would free up MDB capital for more lending and allow MDBs to concentrate on their comparative advantage: origination of SDG investments.

The paper pulls together an impressive array of evidence and offers a comprehensive analysis of opportunities to boost MDB/DFI performance in mobilizing private finance.

Nancy Lee
Director of Development Finance and Senior Policy Fellow
Center for Global Development

## Key recommendations

- Create standardized MDB/DFI assets which can be aggregated and de-risked to create investment grade multi-asset portfolios for distribution to institutional investors.
- Adopt a common, market-based credit risk rating for MDB/DFI loans, to facilitate securitization and sale.
- Shareholders should give clear guidance to MDB/DFI management on the balance to be struck between originating higher risk assets in frontier markets to hold on the balance sheet and originating less risky assets which can mobilize more private capital into areas with high impact, such as climate.
- Redesign targets, incentives, fee structures, origination capacity to make an "originate to share" strategy financially and operationally sustainable.
- Increase origination activity, including upstream advisory and capacity building, and the use of platform companies to create new assets, with a focus on markets and countries with mobilization potential.
- Bilateral DFIs should leverage their shareholder equity by issuing thematic bonds backed by their portfolios, without sovereign guarantees; and consider issuing equity or hybrid capital (voting or non-voting) to private investors.
- Scale up work with clients to expand the issuance of green and social bonds and equity, and work with fund managers to package these assets into investible, risk-diversified portfolios for institutional investors.
- Make full use of credit insurance to expand capacity to offload risk and free up capital to support additional own account investments.

## Summary

Since 2015, when the SDGs and Paris climate change goals were adopted, a key component of the financing plan for achieving these goals has involved mobilizing more private capital to invest in emerging markets and developing economies (EMDEs) (Development Committee, 2015). To this end, MDBs and DFIs have been asked by their shareholders to expand their efforts to mobilize private capital alongside their own investments in private firms.[1] Mobilization volumes to date remain relatively small, totaling only $20.6bn of long-term finance mobilization from private investors in 2019 (MDB Task Force on Mobilization, 2021). But substantial progress has been made in developing new models that can attract different types of private investors at greater scale. From an historic focus on transaction-level mobilization from commercial banks, and balance sheet mobilization to institutional investors through bond issuance, MDBs and DFIs have broadened the range of

1 There is also renewed interest in the role of MDBs in mobilizing more private capital into sovereign lending, which was the original purpose of MDBs, but this is beyond the scope of this paper, which focuses on mobilization of capital for private firms.

financial structures they use, and broadened the range of investors that they mobilize capital from. In particular, they now have more tools available to mobilize capital at scale from institutional investors. This is well aligned with shifts in global financial markets, which have seen reduced appetite from commercial banks for EM risk (partly driven by regulatory changes), and increased appetite for long-term EM assets from institutional investors.

Innovation and experimentation have occurred both at the level of individual transactions (single asset mobilization) and at the level of portfolios of assets (multi-asset mobilization). Smaller DFIs can make greater use of **single-asset mobilization structures**, but these will always be limited in the scale of capital they can mobilize. Among the most important innovations are support for **client bond issuance**. Local currency bonds are well suited to mobilizing local pools of capital in low- and middle-income countries, while avoiding exposing the issuers to foreign exchange risk. For issuers who can bear such risks, bond issuance can also enable them to tap into foreign investment, particularly if they can comply with bond labels such as green, social, climate, sustainable.

Innovations in **multi-asset mobilization** have demonstrated the potential to mobilize private capital from institutional investors (pension funds, insurance companies, sovereign wealth funds, foundations etc.), and offer the best potential to mobilize trillions rather than billions in private capital. However, unless assets can be pooled across MDBs and DFIs, they are best suited to MDBs and larger DFIs that can assemble risk-diversified portfolios of $500m or more to share with institutional investors, either at the time of commitment or by selling down portfolio assets later; this also allows them to spread over a larger portfolio the cost of engaging with institutional investors and tailoring the choice of assets to include in portfolios to meet their appetites. MDBs also have greater capacity to de-risk portfolios by accessing concessional finance for blending or by taking more risk on their own balance sheets.

Scaled up multi-asset mobilization involves a **shift in business model** from "originate to hold" to "originate to sell (or share)." However, unlike investment banks that may have minimal holding periods, MDBs and DFIs can often add substantial value by holding assets for an initial period. This can include bearing and helping investees manage the construction and early operational risks of infrastructure projects; and the regulatory, environmental and social risks involved in greenfield investments. In order to continue to add value to portfolio companies, and to ensure implementation of good ESG performance and achievement of impact, MDBs/DFIs will often need to **retain some participation** in assets that they sell to private investors or retain their status as lenders of record while transferring asset risk. This will make the assets more attractive to private investors, who see value in the MDB/DFI continuing to supervise the asset, add value to the investee, monitor ESG risks and compliance, and monitor and report on environmental and social impacts. MDBs/DFIs will have to charge supervision fees sufficient to cover the costs of delivering these services, even where their investment size is much reduced. There is therefore a limit to how much of their portfolios that MDBs/DFIs can share with private investors without diminishing their role and their ability to recover their costs. Hence, an "originate to share" strategy is more scalable than moving all the way to "originate to sell."

A shorter portfolio holding period for a large part of the assets originated has implications for the way that an MDB/DFI recovers the costs of origination and supervision of assets, for its net income, and for its ability to add value to portfolio companies. It also has implications for the riskiness and volatility of the residual portfolio that the MDB/DFI continues to hold. Hence, if shareholders want MDBs/DFIs to go farther in this direction, they need to accept the consequences in terms of a riskier, more volatile portfolio, with less capacity to support high-risk, low return activities balanced by lower risk, higher return activities (since the latter are most likely to be sold to private investors). They also need to accept that MDBs/DFIs will charge higher appraisal and commitment fees to cover their origination costs upfront. In addition, the financial sustainability of the "originate and sell or share" model depends on how quickly the freed-up capital is deployed for new lending.

The scope to mobilize institutional capital at scale is also limited by the **risk profile** of MDB/DFI investments. Most private investors have limits on the amount of credit risk they will take, set either by regulators or by asset owners. Lower risk MDB/DFI assets tend to be in larger firms or more mature sectors or in middle income countries, or some combination of these parameters. It is harder to attract private co-investors for higher risk investments in smaller firms or in innovative sectors or in frontier countries, or some combination. Blended finance can help at the margin by reducing the riskiness of private investor tranches in transactions or portfolios. However, the scale of blended finance is too small to mobilize private capital at scale, or to take private capital to the riskiest markets and transactions.

This poses a **trade-off between different objectives** that shareholders set for them—to mobilize more private capital versus investing more in the most challenging places or types of investments. Shareholders and management need to understand that these two objectives cannot often be pursued in the same transactions. To mobilize more private capital, shareholders should be willing to allow MDBs and DFIs to concentrate a larger share of their origination activity in sectors and countries where investible opportunities are widely available, but private investment is insufficient to finance them all. For example, there may be scope to do much more climate mitigation and adaptation investments in middle income countries, especially in high-emitting countries committed to carbon transitions. This may require taking more portfolio concentration risk, which can be offset with insurance, other risk transfer mechanisms, or asset swaps. The shareholder pressures on multilateral institutions to be active in all borrowing member countries may constrain their ability to pursue greater concentration, which in turn will limit their potential for mobilization. This calls for honest discussion among shareholders on achieving the right balance between increasing mobilization, serving all member countries and increasing the share of activity in the poorest and most fragile countries where private investment is needed most. Bilateral DFIs, with one dominant shareholder, may find it easier to make a choice among these trade-offs, but still face conflicting pressures from different stakeholders within and beyond government.

There are significant operational and financial differences between a focus on full deployment of an MDB/DFI's own capital and a focus on mobilizing private capital. Where investment opportunities are scarce, MDBs and DFIs may feel pressure to deploy their own capital first unless appropriate targets and incentives are in place to prioritize mobilization of others' capital. To scale private capital mobilization, MDBs/DFIs need to see it as integral to their mandate, not something to be pursued only when own account capital is insufficient to finance the available pipeline. This should be reflected in corporate strategies, targets, scorecards, budgets and incentives.

To tap into institutional investor pools of capital, smaller DFIs should originate assets which can be pooled into **multi-MDB/DFI structures**, which can either be managed by DFIs themselves or by third party fund managers. It will be more efficient to de-risk assets, including through concessional blended finance, at the portfolio level than in individual transactions.

To scale mobilization, MDBs/DFIs will need to **originate more assets**, and distribute them efficiently to co-investors. Origination is costly and difficult, and in some markets and sectors it is constrained by the limited number of competent, large private firms to invest in, and by economic and policy conditions which limit the scope for profitable private sector activity. Some DFIs have the capacity to establish **platform companies** which can sponsor new firms in key sectors such as renewable energy. This addresses the challenge of generating sufficient dealflow by creating a company and a management team that can actively develop new assets for subsequent sale to private investors. For those institutions that have the capacity to do so, this is a promising area for expansion. For those that currently aren't able to do this, they may wish to reflect with their shareholders whether this is a capability they want to develop, so as to increase the pipeline of assets which can mobilize private capital.

Multi-asset structures like **funds and co-investment platforms** help with aggregation and distribution. Fund structures are still the most common way to aggregate assets for sharing with private investors, and can be used for both equity and debt investments. Funds can attract a mixture of investors, depending on the size, asset class and risk profile of the fund. The costs, complexity, and regulatory issues involved in establishing in-house fund management capacity make it feasible only for MDBs and larger DFIs. This can give them scope to pioneer funds in areas that may not yet attract private fund managers, and leverage of specialist skills of MDBs and DFIs, especially in originating assets in difficult markets, assessing and managing ESG risks, adding value to clients, and monitoring and reporting on impact. For smaller institutions, they are more likely to attract capital by outsourcing fund management to a private fund manager. The MDB/DFI can still play a key role in designing the fund and in sourcing assets for the fund. Managed portfolios are a complementary innovation which offer a lower-cost alternative to funds for debt multi-asset mobilization.

Some initial efforts have been made in the direction of **standardization of assets**, which reduces the time, cost and complexity of origination costs, and make it possible to assemble more comparable pools of assets that are easier for private investors to appraise. Common ESG and impact management standards have been adopted across most MDBs and DFIs, but there is much more to be done. Standardization should extend to due diligence processes, project documentation, project terms, impact measurement, and credit risk ratings. This can build on analysis of the terms of past contracts to converge on standard terms.[2] Actions that move MDBs and DFIs further towards common frameworks for these will simplify the task of mobilizing private capital, and facilitate the development of markets for EM loans and equities. So too will replicable transaction structures, which streamline the process of project structuring; these have been piloted in renewable energy projects, but could be extended to other sectors. MDB/DFIs should develop their own consistent credit rating methodology for their loans to replace the in-house methodologies they use today. This would complement efforts to share MDB/DFI loan risk data with credit rating agencies and private investors through the GEMS database in order to assess risk more accurately, which would lower risk transfer costs.

One of the most widely adopted innovations has been the use of **credit insurance**, either in individual transactions or in multi-asset structures. This offers a different way to mobilize private capital, by taking advantage of the balance sheets of insurance companies (including MIGA) to take the credit risk on MDB/DFI assets in an unfunded way. "Originate and insure" offers the same ability as other forms of mobilization to offer larger loan commitments to investees for the same commitment of MDB/DFI economic capital. MDBs and DFIs that do not yet make use of credit risk insurance could expand the commitment capacity of their balance sheets by doing so.

Most bilateral DFIs have not taken full advantage of the potential to mobilize private capital on their **balance sheet** by issuing bonds without sovereign guarantees, which leverage shareholder capital, in the way that MDBs do. Where allowed, this would be the most efficient way to mobilize private capital, although it would not introduce private investors to the risk/return profile of EMDE assets in the same way as single and multi-asset mobilization do. Local currency bonds can tap into domestic savings pools in low- and middle-income countries while contributing to capital market development, and enabling DFIs to increase their local currency lending. Some MDBs and bilateral DFIs have also brought private capital onto the balance sheet as equity or hybrid capital. This could be considered by a wider range of DFIs and MDBs, as suggested by the recent report to the G20 on capital adequacy frameworks (G20, 2022), and discussed in Attridge and Novak (Attridge & Novak, An exploration of bilateral DFIs' business model, 2022).

The challenge before MDBs and DFIs today is therefore less about further financial innovation, and more about the ability to replicate and deploy at scale the instruments and approaches which have been created and road-tested, particularly those that align with the investment appetites of

2 For example, Infraclear (www.infraclear.com) is a tech startup that uses machine learning to compile contract information and financial data on thousands of infrastructure projects agreements around the world to index, standardize and analyze the data and make it available to investors.

institutional investors. What can MDBs and DFIs do to build on the innovations of the past few years and scale up private capital mobilization?

1. MDB/DFI management should agree on significantly higher but realistic mobilization goals with shareholders, consistent with overall investment strategy, addressable market, and institution size. Small DFIs should mostly pursue these goals by feeding assets into multi-DFI funds and structures. Shareholders should be clear on the trade-offs between mobilization and other objectives, such as investing more in frontier sectors and in fragile and conflict states. If mobilization is deemed the priority, strategies should lean into opportunities to mobilize at scale where it is more feasible (e.g., in climate mitigation in middle-income countries).
2. Smaller DFIs should explore mobilizing more private capital on the balance sheet, including private equity (with or without voting rights) and bond issuance without sovereign guarantee to leverage shareholder equity.
3. MDBs and DFIs should replicate and scale up the financial innovations that have proved successful in mobilizing institutional investor capital, including creating and managing funds and other collective investment vehicles; and making greater use of portfolio risk insurance and unfunded risk transfers to free up more investment headroom on the balance sheet.
4. MDBs and DFIs should collaborate to standardize the terms, standards, documentation and due diligence processes of loans. They should develop a common, transparent loan rating methodology consistent with market standards. They should also develop replicable project structures and documentation for a wider range of investment opportunities. They should work with regulators and credit rating agencies to promote market data standards and common analytical tools.
5. MDBs and DFIs should work together to make available to private investors more granular data on the credit risk profile of their loan portfolios (default and loss rates) and returns on their equity portfolios to enable private investors to more accurately assess the risks and returns of co-investments.
6. MDB/DFI Boards should review business models to ensure that increasing the mobilization ratio, and reducing the holding period of assets, is financially sustainable and aligned with management and staff incentives.
7. MDBs/DFIs should be more strategic about selling assets either singly or packaged into portfolios, making asset disposal part of the investment strategy at the time of commitment.

The innovations that MDBs and DFIs have undertaken since 2015 throw into sharper relief the remaining constraints on mobilizing more, and the limitations on how much they be expected to mobilize. It is now the time to expand the use of the innovations that have proved successful, addressing remaining constraints, and having honest conversations with shareholders and other stakeholders about the realistic prospects for scaling up mobilization.

## Introduction

Since 2015, when the international community adopted the 2030 Agenda and Paris climate change goals, mobilization of increased volumes of private capital into EMDE investments was seen as a key component of financing the investments needed to achieve these goals (Development Committee, 2015). At the same time, the importance of these goals to a sustainable future generated growing interest among large pools of capital—including pension funds, insurance companies, sovereign wealth funds, foundations, high net worth family offices—in investing sustainably, and for positive impact. But this interest has not translated into significant increases in private financing for climate change and development in low and middle income countries: according to estimates compiled from a range of official sources, private financing reached $342bn in 2021, out of total financing for development of $569bn (Kharas & Rivard, 2022), with China dominating activity.

G20 and OECD governments have given increased support to multilateral and bilateral development finance institutions, with a mandate to facilitate the mobilization of private capital for climate change and the SDGs (Development Committee, 2015). This includes a historic capital increase for IFC (only the second in its history), allocations from IDA to a Private Sector Window, increased financing for bilateral DFIs, creation of new bilateral DFIs (e.g., USA, Canada) and shifts in strategic direction at several DFIs. The G20 issued its "Hamburg Declaration" in 2016 calling on MDBs to increase mobilization by 25–35% by 2020, with a particular focus on low-income countries, where the external financing needs to achieve the SDGs and meet the Paris climate change goals are greatest (Doumbia & Lauridsen, 2019). As part of the 2018 World Bank Group capital increase, IFC committed to increasing its mobilization ratio[3] from 70% to 90%, and IBRD committed to a 25% mobilization ratio (World Bank Group, 2018). The 2021 G7 Impact Task Force drew attention to the role of MDBs and DFIs in facilitating the scale up of private finance for impact in EMDE, especially to support a just climate transition, and called for mobilization to be made an explicit goal of all MDBs (G7 Impact Task Force, 2021). This year, IDB Invest is in discussions for a capital increase based on a strategy (IDB Invest 2.0) which puts mobilization of private capital front and center. At the 2022 World Bank Group Annual Meetings, US Treasury Secretary Janet Yellen called for more ambitious mobilization efforts by the World Bank Group and other MDBs (Yellen, 2022), and the need for MDBs to do more to mobilize private capital for climate adaptation and mitigation investments has been a prominent theme at COP27.

We are now at the mid-point between 2015 and 2030, so it is timely to take stock of the progress so far by MDBs/DFIs in mobilizing capital for the SDGs and climate change. A simple examination of DFI mobilization volumes will show that there has not been a step change in volume: total MDB/DFI direct mobilization in low- and middle-income countries reached only $20.6bn by 2019, the most recent year for which data is available, a modest increase over the $16.5bn reported in 2017 (the first year

3 Ratio of commitments mobilized from private capital to the MDB's own account commitments.

of joint reporting)—which may reflect improved completeness of the data.[4] 9% of this ($1.9bn) was in low-income countries in 2019.[5]

### TABLE 1. MDB and DFI private direct mobilization (PDM) volumes in low- and middle-income countries, 2016 vs 2019

| Institution (Ranked by 2019 PDM) | 2016 Long-Term PDM ($bn) | 2019 Long-Term PDM ($bn) | 2019 PDM as % of Total for All Institutions Listed | 2019 PDM as % of Own Account (Non-Sovereign) Investments |
|---|---|---|---|---|
| IFC | 3.852 | 8.839 | 43% | 96% |
| EIB | 4.533 | 3.285 | 16% | 126% |
| EDFIs | NA | 1.809 | 9% | 18% |
| ADB | 0.459 | 1.727 | 9% | 58% |
| MIGA | 4.003 | 1.652 | 8% | 30% |
| World Bank | 0.584 | 1.102 | 5% | n.a. |
| AfDB | 1.088 | 0.849 | 4% | 75% |
| IDB Invest | 0.616 | 0.848 | 4% | 18% |
| AIIB | 0 | 0.453 | 2% | 35% |
| EBRD | 1.167 | 0.370 | 2% | 4% |
| ICD | 0.326 | 0 | 0% | 0% |
| **TOTAL** | **16.523** | **20.633** | **100%** | **n.a.** |

*Source:* Mobilization data: (MDB Task Force on Mobilization, 2021). Own account data: (Attridge, DFIs Stepped Up in Times of Crisis, 2021).

This has led many commentators to conclude that DFI efforts to mobilize private capital have been unsuccessful, and were perhaps unrealistic in the first place (Attridge & Gouett, DFIs: The Need for Bold Action to Invest Better, 2021) (Kharas & Rivard, 2022) (Lee & Cardenas, 2020) (Kenny, 2022). Economic and policy conditions, and the lack of investible firms, may be binding constraints on increasing the flow of private capital into many EMDEs.

However, the pandemic has disrupted DFI business in the past three years, making recent trends harder to discern.[6] An alternative assessment would acknowledge the limits to the potential for profitable private investments in many markets, but would also note that innovation generally follows an S-curve, with limited results in the early years as innovations are being created and rolled out, followed by an acceleration of results as innovations are mainstreamed and mature. To contribute to such an assessment, I take stock of the financial and process innovations that DFIs have undertaken since 2015 to mobilize more private investment, and assess the potential of

4 We use data jointly reported by the MDBs and DFIs. OECD reports higher numbers, because their methodology includes co-financing which we would define as indirect mobilization (see Annex for more on definitions).

5 Not all the MDBs and DFIs covered by the joint report publish own account commitments by country income category, but an analysis of 12 of them showed that in 2018 their ratio of mobilization to own account commitments was higher in low income countries than in middle income countries (Attridge & Gouett, DFIs: The Need for Bold Action to Invest Better, 2021).

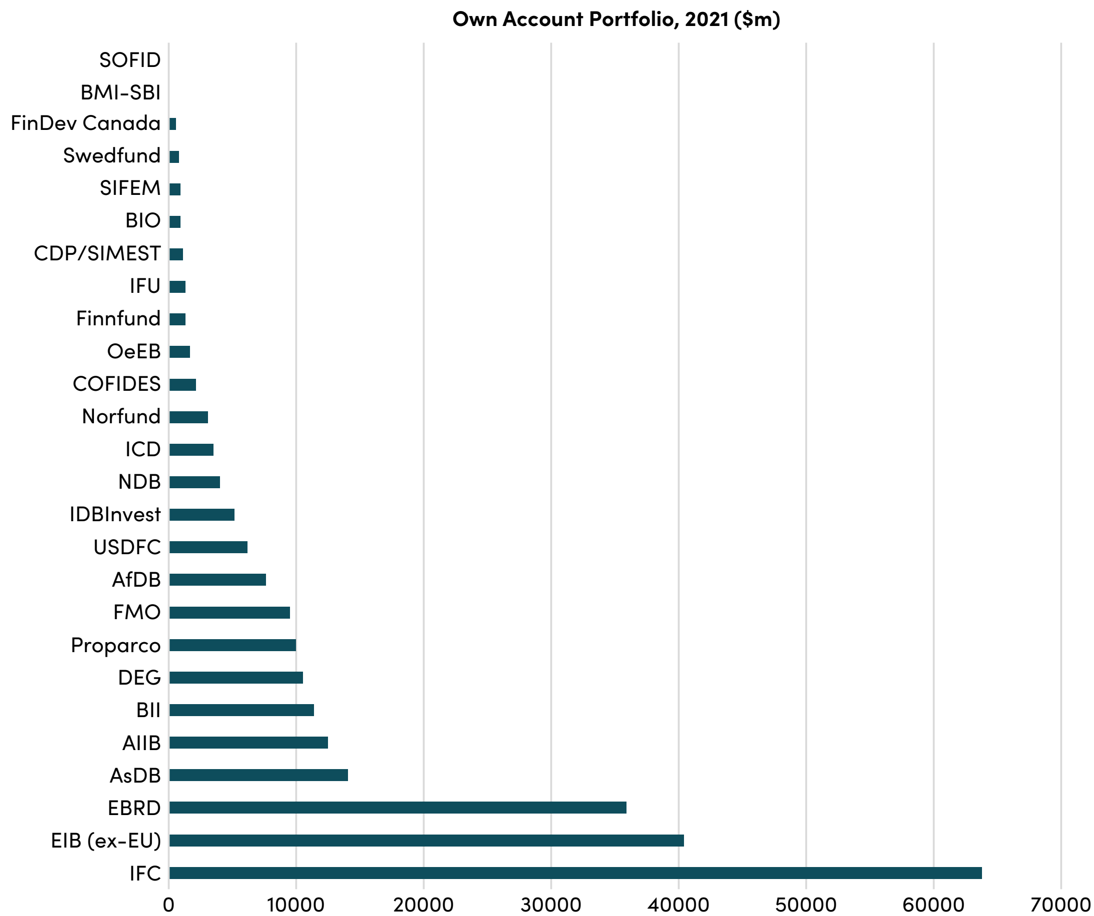
6 And has delayed the publication of MDB/DFI mobilization data for 2020 and 2021.

these innovations to generate significant increases in private capital mobilization volumes in the remaining years to 2030.

We look at the activities of 25 MDBs and DFIs with a combined investment portfolio of about $210bn:

- Multilaterals: IDB Invest, ICD, IFC and the private sector financing activities of AfDB, AIIB, AsDB, EBRD, EIB, NDB
- Bilaterals: the members of the EDFI group of DFIs, USDFC, FinDev

## FIGURE 1. MDB and DFI portfolio size, 2021




*Source:* MDB/DFI Annual Reports.

Because we are interested in the role of the MDB/DFI in bringing in private capital, we focus on private direct mobilization, in the MDBs' reporting terminology—that is, we are not interested in all private co-financing of MDBs/DFI investments, but only the financing for which an MDB/DFI played an active and direct role in bringing into the transaction. Not all of the innovations that we discuss in this paper are currently recognized in MDB/DFI mobilization reporting,[7] but all share

7 As footnoted throughout the report.

the characteristics of PDM in involving direct MDB/DFI activity to bring in the co-investor. Note that we do not include the use of MDB sovereign financing to mobilize private capital (e.g., World Bank guarantees). Nor do we look at the mobilization of public finance,[8] or co-financing by other MDBs/DFIs. We clarify some concepts related to mobilization in the annex.

MDBs are 100% government-owned, but leverage their shareholder equity by issuing bonds in public markets, which are mostly held by private investors. Some bilateral DFIs also have private shareholders, and some also issue bonds. We will call steps to bring in private capital to the equity base or to leverage the equity base with private debt "**balance sheet mobilization**."[9] Based on the resulting balance sheet size and structure, MDBs/DFIs have the liquidity and risk-bearing capacity ("economic capital") to make investments, in the form or equity, loans or other financial instruments, or issue guarantees, for their own account.

MDBs and DFIs may bring in private capital sources into investment transactions as part of the overall financing package for a client (which may be project or corporate finance). We will call this "**single asset mobilization**." Since larger investors may not want to invest one project at a time, DFIs may mobilize capital for a program or portfolio of transactions according to agreed parameters using various types of aggregation platform. We will call this "**multi-asset mobilization**."

After completing the financing of a transaction, the MDB or DFI may sell down some of its own risk exposure—either by a "true sale" of the asset or by structuring a transaction in which it passes on the risks and returns of the investment, but may remain the investor of record. This is sometimes called "**exit mobilization**" (Mobilist, 2021), and can be done for single assets or portfolios of assets.[10]

Conceptually, there is no difference between mobilizing private capital (in single or multi-asset formats) at the time investment takes place, or afterwards.[11] Hence, we should be careful not to double count the potential for mobilization at different times in the investment cycle (financing the transaction, and selling assets). In some cases (e.g., infrastructure projects) you may be better able to attract investors a few years after the original investment (when the upfront land acquisition and construction risks have abated), so selling down loans later may be easier than syndicating loans up front; likewise with project equity. But you cannot lay off the same exposure twice—the more you reduce your own account exposure in favor of co-financiers up front, the fewer assets you have to sell later.

8 Note that MDBs/DFIs include them in their reporting of PDM (private direct mobilization) because although they are public funds, they are typically managed on a commercial basis at arms' length from government. Some of the innovations discussed in this paper mobilize SWF money alongside private capital. As this is additional to official financing from governments, it seems sensible to consider it in scope as expanding the sources of capital to fund private investments in low- and middle-income countries.

9 Note that this is not part of the MDB/DFI mobilization reporting.

10 This is not included in the MDB/DFI mobilization reporting, which only includes mobilization within 12 months of commitment.

11 To illustrate, a DFI can provide a $100m loan to a client by lending $50m for its own account and syndicating a $50m loan; or by providing a $100m loan for its own account and subsequently selling down $50m of its loan exposure. Either way the DFI retains $50m exposure on its balance sheet, and the client receives a $100m loan.

At the limit, MDBs or DFIs could become financial arrangers, and either mobilize 100% of a financing plan upfront, or sell down 100% of the assets generated by the transaction as soon as possible after commitment (i.e., simply warehousing the assets temporarily). However, that could impinge on an MDB/DFI's ability to add value to the transaction as an investor (its additionality). It would also require changes to the business model, so that origination and mobilization costs are fully covered by upfront fees. We discuss this in more detail in the annex. For these reasons, most mobilization structures are designed to share the MDB/DFI exposure to an asset or a transaction, not wholly replace it ("originate to share" rather than "originate to distribute").

We assess the relevance of the innovations that have been introduced, based on their ability to address four fundamental challenges:

1. **Scalability**—MDB/DFI commitments are orders of magnitude too small relative to the scale of private financing required to achieve the SDGs and climate change goals. So the first priority is to find mobilization structures that can mobilize billions or tens of billions of dollars. Since most mobilization structures rely on some MDB/DFI exposure alongside private co-investors, innovations which scale up the financing and/or risk-bearing capacity of MDB/DFI balance sheets are also needed.
2. **Replicability**—can the structure/approach be adopted by multiple MDBs/DFIs?
3. **Investible by institutions**—since the largest pools of capital available for long-term investment are held by pension funds, insurance companies, foundations, sovereign wealth funds and other institutional investors, is the structure/approach suitable for investment by these institutions?
4. **DFI size—**since there is a huge difference in size between the largest MDBs and the smallest bilateral DFIs, we also note which innovations are implementable by large and by small institutions.

## Innovations in balance sheet mobilization

MDBs and DFIs can mobilize private finance on their own balance sheet by issuing equity or debt to private investors. Bond issuance allows MDBs and DFIs to leverage their shareholder equity, so expanding their investment capacity. Contributions to the equity base have a multiplied effect on the amount that MDBs/DFIs can invest, based on the ratio of economic capital required to back different types of loan and equity investments.

### Equity

Several European DFIs have minority private shareholdings, with FMO having the largest private share. This both mobilizes private capital to expand the equity base, where it can be leveraged by borrowing; and brings in commercial expertise to the Board. Private equity can be on equal terms with government equity, or can be a different (e.g., preferred) class, with or without voting rights. Some MDBs (e.g., AfDB) are exploring issuing hybrid capital which would strengthen their capital base, without diluting existing voting rights. The G20 Capital Adequacy Framework report (G20, 2022) calls on all MDBs to explore non-voting hybrid capital issuance.

**TABLE 2. Private sector equity in DFI balance sheets**

| Country | Institution | % Equity from Private Investors |
|---|---|---|
| Belgium | BMI-SBI | 33% |
| France | Proparco | 22% |
| Italy | CDP/SIMEST | 24% |
| Netherlands | FMO | 49% |
| Portugal | SOFID | 19% |
| Spain | COFIDES | 45% |

*Source:* DFI websites.

## Bonds

All MDBs and some DFIs (CDP/SIMEST, COFIDES, FMO, OeEB, Proparco, DEG) mobilize private capital to increase their investment capacity by issuing bonds. In most cases, the parent institution issues bonds and on-lends the proceeds to the private sector subsidiary, or undertakes private finance activities on the same balance sheet as sovereign lending. To maintain continued access to bond markets at low spreads, MDBs and DFIs manage their balance sheets and risk tolerances to maintain an investment grade rating. All MDBs hold the top AAA bond rating. This allows them to borrow at the lowest rates and for very long tenors. Among MDBs, only IFC issues bonds wholly dedicated to funding private sector investments. IFC has maintained a AAA rating since it started issuing bonds in its own name in 1989.[12]

**TABLE 3. Institutions issuing bonds mainly to finance private sector investments**

| Institution | Bond Rating |
|---|---|
| IFC | AAA |
| EBRD* | AAA |
| DEG | AA |
| OeEB | AA+ |
| CDP/SIMEST | BBB-/Baa3/BBB |
| FMO | AAA |
| COFIDES | BBB-/Baa3/BBB |

*Up to one third of EBRD financing is sovereign lending.
*Source:* MDB/DFI Annual Reports.

The G20 review of MDB capital adequacy frameworks (G20, 2022) argues that MDBs could lend more if they pursued less conservative risk management policies that allowed incremental increases in risk

12 It previously obtained debt funding through World Bank bond issues.

tolerance and leverage, as well as created opportunities for increasing available capital (outside of general capital increases). The potential is large for MDBs with callable capital, which is not given any value in most MDB capital adequacy frameworks.

Because MDB bonds are backed by the performance of the (conservatively managed) entire portfolio (as well as shareholder capital), they are both issued in large volumes and benefit from risk diversification. They therefore appeal to large institutional investors that would not be interested in taking project-by-project risk at small ticket sizes. Hence, balance sheet mobilization, like multi-asset mobilization, taps into a different investor segment than single asset mobilization.

Bilateral DFIs are mainly owned by governments, so issuing bonds with explicit or implicit government guarantees would offer no advantage over borrowing from the government, and would count against public sector borrowing limits. But issuing bonds backed only by the performance of the DFI's portfolio, without any sovereign guarantee, would mobilize private capital directly into the DFI, allowing it to expand its investment program. Such bonds could be labelled as green, social or sustainable bonds, or as impact bonds which offer investors clear impact targets and performance reporting, thereby tapping into different segments of investor demand than government bonds. Without a sovereign guarantee, they may not count against public sector borrowing limits, allowing DFIs to borrow more than they could from their parent government.

## Local currency bonds

Two key innovations have taken place since 2015. First, the expanded issuance of local currency bonds, now issued by IFC in over 50 low- and middle-income country currencies. By issuing highly rated (AAA or AA+) local currency bonds in smaller markets, MDB local currency bonds often offer the first highly rated alternative to government or government-guaranteed bonds in those currencies. They can help extend the yield curve by offering longer tenors. This helps mobilize both domestic and international investors into buying bonds in these currencies.

As low and middle income countries accumulate savings, so the assets of pension funds, insurance companies and sovereign wealth funds in these countries have grown rapidly, such that 20% of financial assets are now held in non-OECD countries (OECD, 2020), and non-OECD pension funds hold over $2 trillion in assets (OECD, 2021b). To match their liabilities, these asset pools seek local currency assets. Often, there are few high-quality bond issuers in the domestic market besides government, so MDB local currency bonds tap into an underutilized pool of savings.

The proceeds of these bonds can be swapped back into dollars (or whatever currency the MDB uses to manage its balance sheet) or can provide backing for local currency lending (with some limitations based on the cost of holding funds between the time a bond is sold and the time investments are made in the same currency). By providing local currency financing, MDBs reduce the currency risk facing borrowers, so making co-investments less risky.

## Green, social and sustainable bonds

Second, the marketing of green, social and sustainable bonds. These appeal to a growing class of sustainable investors that want to invest in bonds that are linked (through use of proceeds) to specific sustainable purposes. EBRD, EIB, IFC and the World Bank were among the first issuers of such bonds, and through IFC's leadership in the International Capital Markets Association (ICMA) it has shaped the emerging industry standards for such bonds. Over 10 years, IFC has issued over $10bn in green bonds in more than 10 currencies, with around two thirds issued in US dollars.

More recently, MDBs like IFC have been early innovators in offering sustainability-linked bonds (SLBs). Unlike bonds which track and report on use of proceeds, SLBs are general-purpose bonds where the sustainability commitment comes instead from a commitment to certain key performance indicators (KPIs) at corporate level. There is typically a financial incentive or penalty associated with meeting these KPIs. There is debate about how credible thematic bonds and SLBs are in improving sustainability outcomes, and the premium that investors are willing to pay for such outcomes is typically very low (Ul Haq & Doumbia, 2022). But by attracting investors that might not otherwise buy MDB/DFI bonds, these innovations are enhancing DFIs ability to mobilize private capital. Similarly, by issuing Islamic (sukuk) bonds, DFIs tap into an investor segment that would not invest in traditional bonds. IFC, ICD, AfDB have all issued Islamic bonds and worked with clients to issue such bonds.

## Assessment of balance sheet mobilization

When implemented with a risk management framework which governs the amount of leverage that it is prudent to undertake, bond issuance is the simplest, most cost-effective way to mobilize private capital from institutional investors. As shown by Table 3, most MDBs are able to issue investment-grade bonds, which provide low-cost financing. MDBs/DFIs then intermediate this to higher risk borrowers, allowing them to borrow at lower rates than they would if they issued bonds themselves. While there is little evidence of an enduring price advantage in issuing green, social and sustainable bonds, they can attract investors who would not otherwise have considered MDB/DFI bonds, so broadening the investor base. However, unlike single and multi-asset mobilization, or exit mobilization, MDB/DFI bonds do not introduce investors to assessment of the risk of the underlying assets, and so does not serve the same market development purpose of getting investors comfortable with the risk/return profile of these assets.

The large size of bond markets makes this form of mobilization scalable, and replicable across a wide range of institutions. It generates assets which meet the risk/return and liquidity profile required of institutional investors. Importantly, these investors would regard bonds issued by MDBs and DFIs in international markets as developed market exposures, rather than emerging market exposures. This greatly increases their appetite to hold them in their portfolio compared to emerging market assets.

Issuance of local currency bonds can help MDBs and DFIs expand their product range to include local currency loans, while contributing to local capital market development and tapping into a segment of local institutional investors that are often under-invested in domestic non-sovereign assets. Local currency bond issuance is only feasible for larger MDBs and DFIs, for three reasons. First, the costs of obtaining regulatory approval and issuing for the first time in a new market can more easily be absorbed by larger institutions. Second, the extra complexity of managing a balance sheet with borrowings in multiple currencies and varying maturities which may not be well matched with the assets on the balance sheet requires a strong treasury function, which smaller DFIs typically do not have. And thirdly, a larger flow of local currency lending and equity investing is needed to reduce currency and maturity mismatches.

MDBs all have frameworks in place which allow them to issue bonds, so green, social and sustainable bonds and local currency bonds are an extension of existing activity. DFIs face varying constraints on issuing bonds, with different regulatory frameworks. Some are treated as part of government, so further constraining their ability to borrow. Many bilateral DFIs have little or no balance sheet mobilization, and hold high levels of liquidity, suggesting that they are not generating as much investment capital from their shareholder equity as they could (Attridge & Novak, An exploration of bilateral DFIs' business model, 2022). Shareholders in these DFIs may want to examine the scope for relaxing some of these constraints to allow them to issue bonds without recourse to the sovereign, as a way to increase the mobilization of private capital and expand the investment programs of their DFIs. This can complement actions to increase mobilization of private capital as part of DFI investment programs.

The appetite from investors to hold hybrid capital in MDBs or DFIs has not been extensively tested. The few DFIs that do have private shareholders (e.g., FMO) have done so as regulated institutions, with conservative risk appetites. This may have helped attract private capital, but may limit their ability to add value to private investors by taking more risk. To attract private equity or hybrid capital without reducing MDB/DFI risk appetite, equity returns may need to be higher than what has been achieved in the past.

The growing market interest in sustainable and impact investment opportunities is leading to greater regulation of the labeling and standards required of investment products providing such opportunities, led initially by the European Union's Sustainable Finance Disclosure Regulation (SFDR). The strong ESG and impact management systems of MDBs and DFIs, and the disclosures already required of them as public institutions, positions them to take advantage of stronger market standards, and to offer compliant assets to sustainable and impact investors.

**TABLE 4. Summary assessment of key innovations in balance sheet mobilization**

| Innovation | Institution(s) | Transaction Sizes | Local or Foreign Investors? | Scalable? | Replicable? | Institutional Investors? | DFI Size? |
|---|---|---|---|---|---|---|---|
| GSS bonds | ADB, IFC, EBRD, EIB, IDBI | $100m–$1bn | Both | Yes | Yes | Yes—part of DM asset allocation | All MDBs and all but the smallest DFIs |
| LC bonds | ADB, AfDB, EBRD, IFC | $50m–$500m | Local | Yes | Yes | Local institutions | Larger MDBs and DFIs with strong treasury function and local currency lending/ equity investing |

## Innovations in single asset mobilization

For many years, MDBs and DFIs had a fairly limited menu of structures through which private capital could participate in co-investing alongside them. These were:

a. co-investments (equity or debt), where the private investment has no structural connection to the MDB/DFI investment, but benefits from the involvement of the MDB/DFI in the financing plan.[13] Co-investors free ride on the work done by the DFI to diligence and structure the transaction, and to supervise it while in the portfolio.

b. Parallel loans,[14] where the private investor adopts the same terms and conditions as the DFI, and may benefit from covenants requiring the DFI and parallel loans to be treated equally by the investee.

c. Agency loans, where the DFI acts as an agent for the co-investor in making the loan, but where the co-investor remains the lender of record.

d. Syndicated loans, where the DFI is both the agent and the lender of record for the loan, but co-investors participate in the loan, reducing the DFI's financial exposure.

e. Guarantees, where the private investor benefits from a DFI guarantee which reduces the investors exposure to certain risks—guarantees are typically limited to certain risks (e.g., political risk) (partial risk guarantees) or to a limited share of the total exposure (partial credit guarantees). Recall that since risk-bearing is the key dimension of mobilization, it is only the non-credit guaranteed portion of such loans that count as private capital mobilization.

13 Counted as Private Indirect Mobilization in the MDB/DFI methodology.
14 Counted as Private Indirect Mobilization in the MDB/DFI methodology.

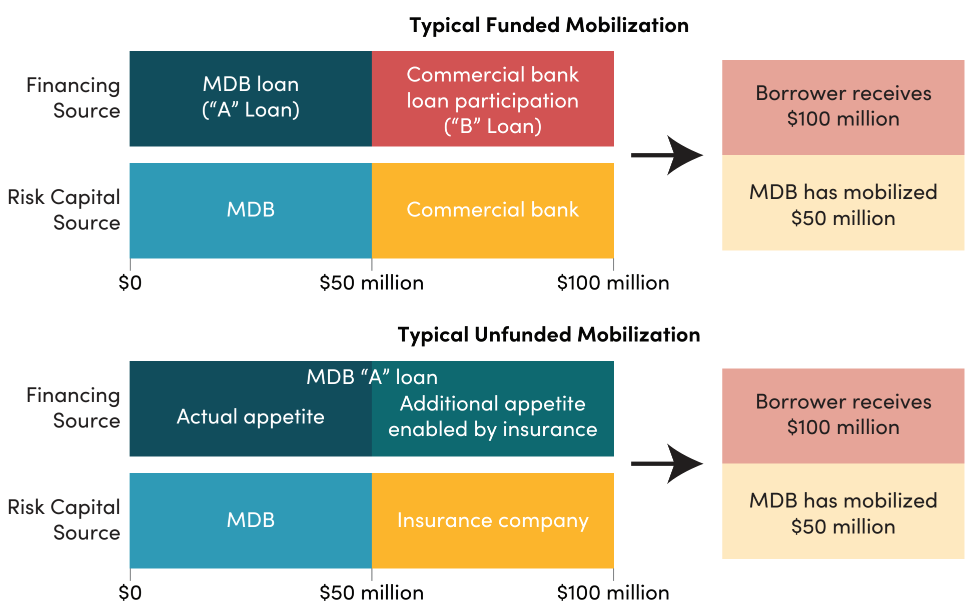
MDBs have traditionally mobilized such co-financing mainly from commercial banks through loan syndications and parallel loans. However, commercial banks have less appetite for EM assets under Basel III. Hence, there is more potential to scale up co-financing by bringing in institutional investors, who have larger pools of capital to invest, and are generally underweight emerging market assets.

Not all MDBs and DFIs use these well-established structures, mainly because they are too small to sustain a syndications desk, which requires maintaining relationships with a wide range of syndication partners. FMO, IDBI, IFC, DEG and Proparco are the most active in loan syndication.

## Unfunded risk transfers

MDBs and DFIs can free up their economic capital by buying credit risk insurance, or otherwise transfer some part of the financial risk to another party. This allows the MDB/DFI to expand its own account lending. A significant innovation in transaction level mobilization is the widespread use of unfunded risk transfers for individual loans (see Table 5 below). This deploys the capital of private insurance companies in place of the MDB/DFI to bear the risk of the asset, so is a form of mobilization.[15]

**FIGURE 2. Funded vs unfunded mobilization**




*Source:* (MDB Task Force on Mobilization, 2021).

15 It is recognized as PDM in the MDB/DFI methodology.

IFC's total stock of insured investments in June 2020 was $4.1bn. About 25% of ADB's single asset mobilization is in the form of credit insurance. In 2022 ADB signed a master insurance policy with 5 insurers to cover up to $1bn in financial institution loans. EBRD uses insurance to reduce its risk exposure in about one third of its operations, with total insured exposure of $950m in 2019. MIGA has reinsurance cover on 63% of its guarantee portfolio (within the Board mandated limit of 70%). Amongst bilateral DFIs, FMO makes the greatest use of unfunded risk transfers, for up to 50% of each transaction. USDFC reinsures part of the risk exposure when offering political risk insurance (PRI). FinDev aims to insure 50% of the risk on its loan portfolio.

## Guarantees

MIGA traditionally offered political risk insurance against a range of government non-performance. MIGA recognizes that it has captured much of the addressable market (project finance) for its current suite of guarantee products, especially in its priority countries and sectors (World Bank Group, 2020), as FDI flows are flat or declining in most low and middle income countries. It is therefore aiming to develop new risk-management products to broaden its reach, such as possibly supporting local investors.

As an example of a previous innovation, in 2010 MIGA introduced a simpler guarantee-like product focused on the non-honoring of financial obligations by governments or state-owned enterprises. The Breach of Contract product requires arbitration of claims, which delays settlement, making it less attractive to private investors than a comprehensive insurance which typically pays out immediately.

The 'non-honoring' product does not require arbitration, so is more predictable for investors. It is well-suited to public investment, or PPPs and concessions where government financial performance is guaranteed and central to the success of the investment. MIGA also innovated a product (Capital Optimization) to help developed market (DM) banks reduce the capital charge they have to bear for their stakes in emerging market (EM) banks. This enables DM banks to maintain their EM presence, which would otherwise be at risk from more stringent capital requirements in their home markets. However, it is hard to demonstrate clear causality between the deployment of the product and increased DM banks' exposure to EM banks. The non-honoring and capital optimization products accounted for most of the growth in MIGA's portfolio over the past 10 years, and now account for about 60% of MIGA's annual commitments.

MIGA has used its political risk insurance and guarantee instruments in support of a range of project bonds, including green bonds. It also offers guarantees on portfolios of loans as well as individual project equity tranches. MIGA is exploring guaranteeing government performance in delivering CO2 reductions, enabling the growth of the carbon credit market through risk mitigation. As noted by the G20 Capital Adequacy Framework report (G20, 2022), MIGA is able to insure assets of other MDBs, providing a further instrument to reduce the risk of MDB assets, including at a scalable portfolio level, enabling them to finance more for a given capital base.

USDFC has expanded its offerings of political risk insurance, covering similar space to MIGA, in addition to providing partial credit guarantees under a program (Development Credit Authority) transferred from USAID when USDFC was established in 2019.

Guarantees of government performance can also de-risk private loans to PPPs. ADB, AfDB and World Bank provide government payment guarantees in infrastructure PPPs, backed by government counter-guarantees. More generally, the sovereign finance programs of MDBs can provide partial credit and partial risk guarantees which de-risk private investments, making it easier to mobilize capital alongside MDB investments in the PPPs.

Following the tightening of bank capital requirements (Basel III) after the 2008 Global Financial Crisis, and the increasing burden of KYC/CFT/AML compliance, many European banks withdrew from their traditional role in financing international trade (International Finance Corporation, 2017). There was a recognition that shortage of short-term bank lending to finance trade transactions could inhibit private sector development. Starting with IFC, DFIs offered partial credit guarantees to confirming banks to cover their portfolios of trade finance loans to selected low- and middle-income countries. These instruments were critical to sustaining trade finance (and hence trade) to these countries during an era from 2009 onwards when tightening global financial regulation and integrity regulation (AML/CFT) made it increasingly onerous and less profitable for banks to finance trade with low-income countries. Since the counter-factual would have been a reduction in trade finance volumes, the additional trade finance risk which banks have taken as a result of these guarantee programs (i.e., the non-guaranteed portion of the exposure) are a new form of mobilization of private capital. In 2019, MDBs and DFIs mobilized $4.8bn in short-term finance (IFC, 2020). Starting in 2022, MIGA offers guarantees for short-term trade finance, in partnership with IFC. Unlike IFC's trade finance program, which predominantly works with private banks, MIGA is able to guarantee trade portfolios of state-owned banks.

Some MDBs also offer short-term supplier financing unrelated to imports/exports, with the same rationale: smaller business may find it difficult to access short-term credit needed to finance supply chain transactions. These also typically take the form of partial credit guarantees to local banks. In total, MDBs and DFIs mobilized $4.8bn in short-term finance in 2019 (MDB Task Force on Mobilization, 2021). Note that trade and supplier finance generally involves a revolving portfolio of short-term (3–6 month) loans, so it is difficult to make an apples-to-apples comparison to long-term project finance of mobilization based on new commitment volume.[16]

16 Short-term finance is recognized in the MDB/DFI methodology, but reported separately.

**TABLE 5. Forms of credit risk insurance**

| | | |
|---|---|---|
| No. of assets | **Single assets:** MDBs may pursue insurance for single assets on a standalone basis. The insurance contract includes terms and conditions relevant only to a specific borrower. Insurers refer to these contracts for individual borrowers or projects as "facultative" coverage. | **Multiple assets:** MDBs may pool multiple assets together under a single insurance agreement. The agreement may cover a specific set of borrowers or all projects that meet certain pre-negotiated criteria. Insurers refer to these as insurance "treaties." |
| Asset type | **New assets:** MDBs most commonly use credit insurance on new assets at the time of origination. Insurance can serve as a risk distribution tool alongside other funded mobilization products, like syndicated loans. | **Existing assets**: Insurance may be considered for existing assets already in an MDB's portfolio. Insurance on these assets can help MDBs free up capacity on their prudential internal risk limits, enabling them to consider new lending to clients, sectors or countries to which they already have significant exposure. |
| Asset tenor | **Short-term assets:** Insurance coverage on short-term assets related to trade finance represents the bulk of risk that insurers take in emerging markets. Nearly all insurance companies offer this service to MDBs and commercial banks. | **Longer-term assets:** MDBs are helping to grow the insurance market for longer-term assets like project finance and unsecured senior loans to financial institutions. A small but growing number of insurers are active in this space in emerging markets. |
| Insurance product | **Trade credit insurance:** Short-term trade receivables are covered by trade credit insurance, which usually covers a portfolio of buyers and pays an agreed percentage of an invoice or receivable that remains unpaid as a result of protracted default, insolvency.<br><br>**Political risk insurance:** Equity and debt investments are covered by insurers against political risks such as war and civil disturbance, expropriation and others. | **Comprehensive non-payment risk insurance:** Longer-term assets are covered by insurers' comprehensive non-payment risk insurance, which reimburses a lender if a borrower fails to make a payment for any reason. |
| Insurance instrument | **Credit insurance policies:** Credit insurance policies are the market standard that is used for most common types of insurance (e.g., life, auto, property, casualty). These insurance contracts require the insured party to file a claim, which insurers assess against the policy terms before making a payment. | **Unfunded risk participations:** Some MDBs use unfunded risk participation agreements, which serve the same function as insurance policies but are a more traditional financial instrument for banks. A bank sells off its risk exposure and is entitled to be paid by the buyer if a covered borrower fails to fulfill its payment obligations. |
| Arrangement process | **Direct insurer relationships:** MDBs are building direct relationships with insurance companies to solicit quotes and negotiate the best terms without the help of an intermediary. | **Via insurance brokers:** For more bespoke assets, MDBs may seek the support of insurance brokers to represent them in their search for the best insurance for their needs. |

*Source:* (MDB Task Force on Mobilization, 2021).

## Blended finance

Another new structure for mobilizing private capital through DFIs taking on more risk is blended concessional finance.[17] In these structures, DFIs take a higher risk position in the capital stack without as much (if any) additional compensation as private investors would require and/or accept a lower rate of return than other investors in the same position. Either way, they accept a lower expected risk-adjusted return than other investors. This lowers the risk and/or increases the prospective returns to other investor in the capital stack.

They may be able to do so within their balance sheet capacity and risk management frameworks agreed with their shareholders, or they may tap into off-balance sheet funds, such that losses or lower returns do not impact their balance sheet. In IFC's case, concessional funds come both from bilateral donors and from a Private Sector Window (PSW) of the World Bank's IDA Trust Fund, itself a pool of donor funds leveraged by issuance of bonds to private investors.

These concessional funds (which may be grants or low-interest loans, or simply capital with a higher risk tolerance) are then combined with either DFI "own account" and/or private co-investments. This leads to a question about whether the concessionality benefits the DFI or private co-investors. When it is the latter, it is an instrument to mobilize private capital by improving the risk-return profile of the co-investment. Indeed, the Enhanced Blended Concessional Finance Principles adopted by the DFIs includes as its second principle:

> "DFI support for the private sector should catalyze market development and the mobilization of the private sector" (DFI Blended Finance Working Group, n.d.).

However, an analysis by Convergence of 467 DFI transactions involving blended finance suggests that concessional capital leverages DFI "own account" capital more than private capital: for every one dollar of concessional finance, DFIs invest 3 dollars on average, and private capital invests one dollar. Only 25% of capital in concessional blended finance transactions comes from private sources (Convergence, 2022a). Thus, in many cases blended finance may enable DFIs to extend their financing beyond the limits of their own risk tolerance, rather than extending private co-financing.

There are many ways to structure blended finance:

a. Guarantees for specific risks with low or no premiums
b. Acting as counterparty to hedging mechanisms where market counterparties are unavailable (e.g., hedging forex risk)
c. Taking a subordinate position in the capital structure without equivalent additional compensation.

17 We will call it "blended finance" for short in the rest of this paper, but note that for some observers (e.g., OECD) "blended finance" means all combinations of public and private finance, i.e., all mobilization structures.

The key to all of these structures is that without the backing of concessional funds, these pieces of the financing plan would require high compensation to make them commercially viable—and in many cases there is no compensation high enough to persuade a private investor to take the risk (Schellekens & Mutambatsere, 2020).

This is an important aspect of structuring investments in frontier markets and sectors. It is difficult to price the risk or estimate the expected return for novel investments in new markets. Absent a track record which can be used to model the risk and price instruments, many investors will not be prepared to invest at any price. This is an example of what Kay and King call 'Radical Uncertainty' (Kay & King, 2020). In such a situation, even a DFI may find it hard to accept certain risks. Blended finance then enables transactions to proceed and aids "price discovery"—only through undertaking transactions can the actual risk-return profile of investments in new markets be discovered.

Some DFIs—including IFC—have developed very structured approaches to estimating the 'subsidy element' in blended finance transactions, and IFC reports that the average subsidy element from 2010–2020 was not more than 4% of project cost (IFC, www.ifc.org/blendedfinance, n.d.). This begs the question of why such a marginal change in the economics of the transaction makes the difference between the investment proceeding or not. The answer may be that it is not the 5% number that is critical, but the very wide confidence interval around that number—accepting that uncertainty is what makes the transaction proceed.

In this spirit, some DFIs—like BII—describe their blended financing as "catalytic"[18] rather than providing a specific level of subsidy. That is, its willingness to put money on the table absent any greater confidence in the risk-return profile is what enables the transaction to go ahead.

Blended finance is mostly focused on two very different types of impact: first, climate finance, where there are opportunities to invest in middle income countries, and where co-investors have appetite to invest if the project economics work (Development Committee, 2022). Two-thirds of blended finance commitments in the past three years have been for climate-related investments (Convergence, 2022b). However, unlike a carbon price which would provide an indefinite improvement in the investibility of climate-mitigation investments, blended finance can only provide a temporary subsidy. It is therefore best suited to innovative, first-of-a-kind activities, where there is a prospect of the financial returns to the activity improving over time (Lankes, 2021).

Second, low income, fragile and conflict states. Here, there is very little appetite for co-investment by private investors, so blended finance on the scale typically available is unlikely to be large enough to make a difference in mobilizing private capital (and massive subsidies to attract private capital to these places is unlikely to be the best use of public funds available for these states). The disappointing track record of the IDA PSW window, which has so far committed only $2.2bn from its inception in July 2017 through April 2022 (Kenny, 2022) can be linked to its focus on such countries.

18 Note that not all BII's investments under its Catalytic window involve private co-financing.

As Sony Kapoor (Kapoor, 2019) has notes, MDBs and DFIs are being pulled in two different directions—a "dumbbell stretch"—in being asked to mobilize more and to do more in low income, fragile and conflict states. For example, in approving IFC's 2018 capital increase, shareholders asked IFC to increase its share of investments in LICs and FCS to 40% of its portfolio by 2030, while also increasing its mobilization ratio from 70% to 90% (World Bank Group, 2018). You can do both, but not in the same places, creating a tension in where MDBs and DFIs focus their efforts. This needs to be explicitly discussed with shareholders and other stakeholders, and progress in increasing mobilization seen in the light of the implicit and explicit priorities that shareholders give to mobilization relative to other objectives (Andreassen & Brenton, 2022).

There is scope to make greater use of blended finance to make marginal improvements to the risk profile of middle-income country assets which would push them over the investibility threshold for institutional investors in OECD countries. But donors have mostly focused their concessional funding on blended finance for climate finance or for low income, fragile and conflict states.

Most concessional blended finance has been structured on a transaction-by-transaction basis, allowing granular assessment of the development and additionality rationale for its use. This doesn't lend itself to scale up, so more standardized structures are required (Lankes, 2021). Some DFIs have used concessional instruments at the portfolio level e.g., a first loss facility for a portfolio of commercial bank loans to SMEs, or a foreign exchange risk hedge for a portfolio of loans to a particular country (DFI Blended Finance Working Group, 2020). This reduces the transactions costs of structuring and negotiating blended structures, and by pooling risks, may lower the amount of concessionality needed compared to individual transactions. This approach has been used mostly for portfolios of small loans with similar characteristics, such as SME loans or trade finance.[19] Multi-asset approaches also lend themselves to accompanying technical assistance or market reforms to improve the risk profile of the underlying assets (One Climate Lab, 2021). We discuss multi-asset vehicles, with or without blended finance, later in the paper.

## Client bond issuance

MDBs/DFIs can help clients issue bonds, typically in local currency, to private investors, including local institutional investors. DFI involvement can range from being an anchor investor (since private investors may draw comfort from the DFI's participation), to participating in marketing the bond (offering representations based upon the DFI's own due diligence), to providing partial guarantees to improve the risk profile of the bond, which can result in a better rating for the bond (see Box 1). DFIs may be limited in how active a role they can take in marketing bonds, as they typically do not have broker/dealer licenses.[20] ADB, DEG, FinDev, IDBI, IFC, FMO, Proparco have all acted as anchor investors to help clients issue bonds. DEG encourages clients to issue bonds to refinance its loans.

19 Examples include the EBRD SME local currency program, EBRD and EIB FCFTA SME facilities and the IFC Small Loan Guarantee Program in IDA/FCS countries (DFI Blended Finance Working Group, 2020).

20 Only where the MDB/DFI plays an active role is it recognized as PDM in the MDB/DFI methodology.

IFC and EBRD also help their clients issue local currency bonds, supporting further development of local bond markets. For example, IFC's Green Bond Technical Assistance Program (GB-TAP) deployed $50m of grant funding which catalyzed $4bn of green bond issuance. MDBs and DFIs also have the skill set to provide second party opinions which are required for sustainability-linked bonds and can help with the design and monitoring of KPIs which are sufficiently rigorous and demanding. IFC has begun to play this role in some sustainability-linked bond issuance. MDBs could also use blended finance to pay for the cost of interest rate step-downs in impact targets are achieved, as suggested by Nancy Lee et al. (Lee, Glassman, Landers, & Ahmed, 2022).

Any time MDBs/DFIs invest equity in private companies, they strengthen their balance sheet and hence position them to issue more debt to private investors, whether as loans or bonds. This can be particularly important for regulated financial institutions, where their financial leverage is strictly limited by their equity base (tier 1 and tier 2 capital). IFC and BII have provided tier 2 capital to banks, which enables them to, among other things, issue bonds to private investors increase their capital base.[21]

**BOX 1. Bond issuance for Elazig hospital, Turkey**

## *Elazig hospital*

### *Development finance*

In 2017 Turkey issued its first green and social bond to finance a greenfield infrastructure project—the Elazig Integrated Health Campus. IFC invested EUR 80 million in an unenhanced and unrated tranche. EBRD and MIGA provided credit enhancement through risk mitigation mechanisms of political risk insurance in the form of a guarantee and liquidity facility. EBRD provided EUR 89 million liquidity facility to support construction and operational phases. MIGA provided a 20-year political risk guarantee to support investment-grade portion of the bond and a MIGA guarantee to equity investment in the project.

Both IBRD and EBRD are working with Turkey's Ministry of Health to build institutional and monitoring capacities.

### *Commercial finance*

The project was financed mostly through debt with debt to equity ratio of 80:20. The EUR 360 million project was financed through a EUR 288 million bond by ELZ Finance S.A. Credit enhancement by EBRD and MIGA led to Moody's rating the bond Baa2, which is two points higher than Turkey's sovereign debt rating. The high rating will encourage the investment from institutional investors. Through private bond placement the project was financed by development finance institutions such as Proparco and FMO, as well as by institutional investors like Commercial Bank of China, Intesa Sanpaolo, Siemens Financial Services, and Mitsubishi UFJ Financial Group (MUFG).

*Source:* (OECD, 2021a).

21 This would not be recognized in the MDB/DFI methodology unless the MDB/DFI was actively involved in the bond issuance.

## Client equity listings

A UK initiative funded by FCDO, Mobilist focuses in bringing more companies to listed equity markets, where they can attract capital from private investors. Public listings provide the liquidity that many investors seek in their equity portfolio. Mobilist both takes anchor stakes in companies and equity funds to help them successfully complete an IPO, either in developed or EMDE markets. For example, it invested $40m equity in Thomas Lloyd, a clean energy power company, which listed on the London Stock Exchange. Mobilist provides technical assistance and capacity building for local stock exchanges on which firms can list. It also works with asset owners to address their constraints to investing in frontier market listed equities. FinDev has also invested in IPOs as an anchor investor.

## Asset sales

MDBs and DFIs may hold loans to maturity or sell part or all of them to other investors after some time. They typically hold equity investments for long periods (e.g., an average of 8 years for IFC), but may sell some or all of their equity stakes earlier.[22] Sometimes this is done opportunistically, but it can also be part of a mobilization strategy to "originate to distribute" (full sale of the DFI-held asset) or "originate to share" (partial sale of the DFI-held asset). When the holding period is less than a year, it is known as warehousing.[23] This can be helpful in enabling the transaction to reach financial close earlier, with the work of finding co-investors happening afterwards. Asset sales which happen after a longer period may attract investors who wouldn't have invested at the time of original commitment, because the risk/return profile of the asset has changed over time. This may be due to progress in the underlying business (e.g., an infrastructure project moving from construction to operations phase). In the case of infrastructure, the risk profile changes significantly once the asset is beyond the construction phase and in operation. Then, it may become attractive to institutional investors looking for assets with steady long-term returns, but who would not be willing to take construction risk. It may also be due to the additionality that the MDB/DFI brings to the business while it holds the asset. This is particularly relevant to greenfield investments, such as new infrastructure, or creation of a new asset, where DFIs may be better placed to manage regulatory and policy risk up front. Private investors may be further attracted to these assets where the MDB/DFI is retaining a portion of the asset, so that the private investor benefits from the MDB/DFIs continued supervision and additionality.

The scope for asset sales is limited by four factors: DFI role; cost recovery; risk profile; and market conditions:

i. **Role:** part of the value addition of MDB/DFI involvement in an investment happens over the extended period when the asset is in the portfolio. The MDB/DFI will supervise the financial and ESG performance of the asset, and monitor and report on its impact. MDB involvement

22 Only asset sales in the same year as commitment are recognized as PDM under the MDB/DFI methodology.
23 Asset sales within 12 months of commitment are recognized as mobilization in the MDB/DFI methodology.

provides risk mitigation to other investors through preferred creditor status or in more intangible ways. MDB/DFI continue to add value to investee companies through ongoing engagement and advice, and by providing a 'seal of approval' which can help attract other investors and business partners, and improve relations with government. Outright asset sales bring this value addition to an earlier conclusion, so may not be desirable from the perspective of shareholders (who want to see this value addition), and from the perspective of the investee company and co-investors (who benefit from the value addition). To allow continued value addition, MDBs/DFIs may resort to partial asset sales or synthetic sales (i.e., unfunded risk transfers, described above), so that they continue to be engaged—that is "originate to share" rather than "originate to distribute."[24] However, if their residual stake is too low, there is danger of loss of attention by the MDB/DFI. More importantly, it becomes more difficult to cover the costs of supervision, monitoring, reporting and investee engagement.

ii. **Cost Recovery:** MDBs/DFIs incur substantial costs in business development, origination and structuring of new investments. This includes extensive ESG and integrity due diligence, impact assessment and measurement. They incur additional costs in supervising, monitoring and reporting on assets while they are in the portfolio. Some of these costs are recovered from investees through upfront fees (mandate, appraisal, commitment fees), but some of the costs are recovered over the holding period of the asset, through supervision fees and the spread between capital cost and loan interest in the case of loans. In the case of equity, equity appreciation is expected to cover these costs. If much or all of the loan or equity is sold early, the MDB/DFI can recover less of its costs in this way.[25] So, to make asset sales financially sustainable, MDBs/DFIs would have to recover more of their costs through upfront fees.

iii. **Risk Profile:** Private investors may have limitations on how much risk they are prepared to take. In the case of banks, pension funds, insurance companies etc. these may be set by financial regulations. For asset managers, this may be set by the investment strategy agreed with asset owners. Most MDB/DFI loans to emerging market firms are riskier than private investors' thresholds. For example, IFC average loan risk is equivalent to about BB-, lower than the BB/BBB threshold for most private investors. Hence, MDBs/DFIs may need to offer some kind of credit enhancement to improve the risk rating of loan they wish to sell, or hold the loans until the riskiness of the underlying business has been reduced (e.g., for infrastructure, post-construction; for other industries, as the investee company grows and matures). Since MDB/DFIs will be better able to find buyers for better performing assets, it implies that the residual portfolio that the MDB/DFI retains will have a worse risk/return profile than the assets that it originated. This will have implications for the capital backing required for the portfolio, reducing the balance sheet leverage, as well as making annual net

24 For example, IDB Invest's 2.0 strategy is to "buy and share" assets.

25 Private purchasers of loans typically have a higher cost of capital, so are willing to pay less for the loan (i.e., demand a higher spread), so it may be difficult to sell loans at a price that captures the full value of the loan if held to maturity.

income more volatile. So, shareholders will have to be comfortable with the risk implications of this mobilization strategy.

iv. **Market Conditions:** The market for buying secondary equity and debt in EMDE is thin and concentrated in a few sectors and countries. In many countries and industries, there may be few or no financial buyers, so DFIs have no choice but to hold loans and equity positions until a trade buyer can be found. When investors are "risk-off," they are less likely to buy EM assets in general, and illiquid EM assets in particular.

Norfund has recently adopted a strategy of divesting its equity and loan assets within 3–5 years of origination. It builds this expectation into the original investment decision, with the aim of creating assets that are saleable. This includes structuring equity investments in ways which trigger exits, including convertible shares and preference shares.

## Assessment of single-asset mobilization innovations

These innovations have expanded MDB/DFIs ability to finance individual transactions, especially riskier transactions. However, the capacity of MDB/DFIs to structure bespoke transactions (e.g., when using blended finance) limits the potential for scale up. With limited administrative budgets, the capacity to generate a multiple of existing annual transaction volumes is not feasible (Gregory, 2016).

Institutional investors rarely have the capacity to invest in single assets, so these innovations do not help MDBs/DFIs tap into their pools of capital. None of these innovations rely on the use of blended finance to reduce the risk profile of the assets in any systematic way, although blended finance may be used in conjunction with them as needed to make projects investible by private investors. With the exception of B-bonds, which are designed to tap into foreign investors who would benefit from B loan protections, the other innovations can be used to mobilize local as well as foreign investors. This makes them able to increase the amount of local currency financing that MDBs/DFIs can provide.

The innovations listed in Table 6 are not dependent on unique characteristics of particular institutions, so there is scope to replicate them across more MDBs and DFIs. B-bonds, and client bond and equity issuance create tradable assets which can mobilize capital from investors that would not invest in traditional MDB/DFI mobilization products.

Single asset unfunded risk transfers enable MDBs/DFIs to tap into capital from insurance companies that was previously not exposed to EM private financing risk. Unfunded risk transfers can also reduce the risk profile of investments for the MDB/DFI, enabling them to expand their financing of riskier markets and clients. This can be particularly valuable for MDBs/DFIs whose investment volumes are limited by risk exposure limits rather than capital availability, for example single borrower or single country limits.[26] Single-asset transactions can be undertaken by smaller DFIs as well as larger institutions, although the larger flow of transactions from larger institutions will spread the fixed costs of developing relationships with private investors across a larger number of institutions. Smaller DFIs will need the help of investment banks who have these relationships, whereas larger MDBs may be able to do more of this work themselves. Larger MDBs and DFIs also have an advantage in acting as anchor investors in client bond and equity issuance, both because they can afford to take larger stakes, and because they have a stronger reputation and profile in the market.

**TABLE 6. Summary assessment of key innovations in single asset mobilization**

| Innovation | Institution(s) | Transaction Sizes | Local or Foreign Investors? | Scalable? | Replicable? | Institutional Investors? | MDB/DFI Size? |
|---|---|---|---|---|---|---|---|
| B-bonds | IDBI | \$60m–\$250m | Foreign (US) | Limited extent | Only in US market | Larger bonds only | All sizes |
| Single asset credit risk insurance | ADB, IFC, FMO, IDBI, DEG, EBRD, MIGA | \$20m–\$500m | Either | Yes | Yes | Yes—taps into insurance company balance sheets | All sizes |
| Single asset sales | ADB, IFC, IDBI, EBRD | \$10m–\$500m | Either | Limited extent | Yes | No | All sizes |
| Client bond issuance | ADB, AfDB, IFC, FMO, Proparco, DEG, IDBI, EBRD | \$50m–\$200m | Either | Yes | Yes | Larger bonds with investible credit ratings only | Larger MDBs and DFIs |
| Client equity issuance | BII, FinDev | \$10m– \$100m | Either | Yes | Yes | No | MDBs and DFIs that invest in equity |

## Innovations in multi-asset mobilization

Most private capital is managed by large institutional investors—pension funds, insurance companies, sovereign wealth funds. They do not have the capacity to co-invest with DFIs in specific transactions, but are looking for larger assets or bundles of assets—typically with a "ticket size" of \$1bn or more (Bhattacharya & et al., 2022) which they can appraise more simply (e.g., by relying on credit ratings). Since 2009, DFIs have started to bridge this funding gap by creating investment platforms where institutional investors can invest in bundles of DFI assets—either by committing capital in advance, or by buying existing assets. These bundles may receive credit ratings, or institutions may find the ticket size large enough to be worth doing due diligence on the risk/return profile of the assets. In the case of committing capital in advance, the institution does due

26 These limits may be imposed by regulators where DFIs are subject to national financial regulation, or self-imposed to maintain credit ratings where MDBs/DFIs issue bonds.

diligence on the risk/return track record of the DFI. In some cases, blended finance is used to reduce the credit risk to the private investor, as discussed above.

When mobilization mostly meant syndicating individual projects to banks, custom-structured project finance of infrastructure worked. Commercial banks maintained the capacity to appraise individual assets. But to tap into institutional investors, you need scale and standardization of assets so that investors can model the risks (or rely on credit agency ratings), value the assets, and invest in a slice of a fairly homogeneous portfolio. Often, they have limits to the riskiness of the assets they can hold (OECD, 2021a). At the same time, they can take longer-term positions in assets, which matches well the long-term nature of infrastructure investments.

This creates a role for the MDBs in bridging the gap between the supply of investible assets and the demand from institutional investors. Through their ability to originate a diverse set of transactions and structure, package and aggregate them MDBs can de-risk investments and transform individual projects into marketable, standardized securities.

## Investment funds

The first model for this is the investment fund. MDBs and DFIs have for many years invested in funds managed by private General Partners, who do the deal sourcing, screening and portfolio management.[27] Most of these have been private equity funds, and occasionally private debt funds and public equity/bond funds. The DFI involvement in selecting fund managers, structuring the fund and supervising its performance can encourage private investors to become limited partners in the fund. Reflecting this, many general partners in frontier markets with limited investor interest work hard to attract DFIs as anchor investors to their funds, as the key to attracting other investors.[28]

Recently, some DFIs have taken a more active role in creating new funds which are designed by the DFI and then bid out to a private asset manager to manage. For example, in 2012 ADB created the Asia Climate PPP fund, which aimed to raise $1bn of equity from private investors for climate investments in the region; ADB also took a 25% equity stake in the general partner, Asia Capital Partners. In 2018 IFC designed the Emerging Green One Fund (EGO fund) which has raised $1.42bn from institutional investors to invest in green bonds. IFC selected Amundi to manage the fund. IFC and others invested in a junior tranche, which reduces the risk on the senior tranche, enabling institutional investments (IMF, 2022).

27 IFC claims to have given birth to the Emerging Market fund category, with the Korea fund in 1984.

28 Note that MDB/DFI investments in funds managed by third parties are not included in the MDB/DFI reporting as Direct Mobilization, because the MDB/DFI is not actively soliciting the private investor contributions to the fund (which is usually prohibited by financial market regulations).

DFIs can also make fund investments more attractive to limited partners by taking a higher risk position in the capital stack, either taking the risk on their own balance sheet or using concessional blended finance. In the case of the EGO fund, IFC and other DFIs invested for their own account in a junior tranche representing 10% of the fund size, to reduce the risk to institutional investors in the senior tranche. In this way, it attracted broad interest from European and Middle Eastern institutional investors, mobilizing nearly $2bn.

Similarly, Proparco, JBIC and DEG partnered to structure the Climate Finance Partnership, selecting Blackrock to manage a fund of $500m launched in 2021, with France (AFD) and Germany (KFW) and private philanthropies investing in a $100m junior tranche which reduces the risk on the senior tranche. FMO created the $900m Green Growth Equity fund, managed by an Indian fund manager, Eversource. The Dutch government, through FMO, provides subordinated equity (Prasad, Loukoianova, Feng, & Oman, 2022). AfDB created the Africa 50 Fund to finance private infrastructure projects in Africa. In addition to mobilizing private investment into its equity base, it aims to achieve an investment grade credit rating so that it can mobilize private investment by issuing bonds. In this way, it aims to raise $100bn leveraging an equity base of $10bn. It also has a project development component, funded by concessional finance.

AIIB invests in funds which buy infrastructure loans from banks that finance the initial construction phase, then sell to the fund when the infrastructure is operational. At this stage, the assets in the fund are attractive to institutional investors. The first fund was managed by Bayfront in Singapore (70% owned by government of Singapore) that bought loans from 22 commercial banks. Similar funds are being explored in India and other countries with large enough markets for infrastructure loans.

## Privately managed funds with DFI assets

With support from the Dutch government through FMO, ILX, a Dutch fund manager, has recently launched a fund which buys loans from European DFIs and MDBs, and aggregates them into a larger, more diversified fund than any single DFI could construct. This has mobilized $1bn of private capital from three Dutch pension funds. Similarly, FMO is addressing the lack of secondary market for DFI equities by creating a secondary equities fund. This will buy mature equities from FMO and other DFIs. It aims to establish a track record and improve the availability of data on the performance of EM equities. This may reduce the discount that investors demand on EM secondary equities. Funds like these which can aggregate assets originated by multiple MDBs/DFIs offer a pathway for smaller DFIs to mobilize private capital.

## DFI managed funds

Until IFC launched its Asset Management Company (AMC) in 2009, DFIs had not played the role of GM themselves.[29] This role has legal and regulatory implications. IFC's AMC offers both equity and debt funds, scaled to attract institutional investors. Some have been thematic (infrastructure, financial institutions) and some regionally focused (Africa-Latin America fund). All mobilized private capital from institutional investors. AMC was originally structured to operate at arms-length from IFC and its Board, so that it could act as a fiduciary on behalf of its investors. This was critical in attracting private capital, but adds an extra layer of cost.[30] Since 2009 AMC has mobilized $8bn from 55 institutional investors. Going forward, AMC is expected to focus on passively-managed "tracker funds" which participate in all eligible IFC equity investments, which will reduce fund management costs.

The IFC funds have been structured to co-invest on the same terms and conditions as IFC own-account investments. IFC has to offer all of its new investments to relevant funds for co-investment (to avoid cherry-picking), but the Fund manager is allowed to cherry pick and not take every investment opportunity (to safeguard against being forced into investing in sub-commercial deals that IFC may have pursued for development impact reasons). Similarly, EBRD, created an Equity Participation fund in 2015 for co-investments across its investment portfolio. However, it only raised funds from two sovereign wealth funds, and no further funds have been launched. Regional development banks face greater portfolio concentration in a few countries than IFC, and originate a smaller volume of assets each year, so it is more challenging for them to assemble risk-diversified portfolios of assets on a large enough scale to attract institutional investors.

Other DFIs have also created equity funds as general partners with institutional investors as limited partners. In 2016, ADB created and managed the Leading Asia's Private Infrastructure Fund with funding from JICA. IFU, the Danish DFI, manages several funds, including the SDG Investment Fund, created in 2018 with 6 investors from among the largest Danish pension funds. However, it has struggled to invest its modest corpus of $100m, only committing 46% after 3 years (OECD, 2021a). Proparco is in the process of obtaining regulatory approval to be a general partner.

A hybrid model has been developed by FMO, where a private fund manager is advised on asset selection by FMO Investment Management, special entity wholly owned by FMO. FMO has mobilized over $1bn for debt funds managed in this way. For example, FMO created Climate Investor One in 2015, comanaged with Phoenix Infraworks, and raised $850m for climate investments (OECD, 2021a).

29 Private investments in MDB/DFI managed funds are counted as Private Direct Mobilization in the MDB/DFI reporting methodology.

30 When first established, IFC AMC was a separate legal subsidiary, with its own CEO and Board. It has since been merged into IFC, due to subsequent legal and regulatory developments, but continues to make investment decisions at arms-length from IFC's investment decisions.

DFI funds can also be structured to blend concessional finance with commercial finance (from the DFI or elsewhere), so that the blending of individual transactions becomes the responsibility of the DFI managing the fund, rather than involving investors or concessional funders in each project decision. For example, Climate Investor One includes a Development Fund structured to include a first loss provided by the Dutch and US governments, which enabled it to raise capital for the risky infrastructure project development phase (Convergence, 2020).

## DFI managed portfolios

To avoid the cost of a fund structure, in 2013 IFC also developed a debt co-investment platform, MCPP, which offers the same benefits of investing in a portfolio of IFC transactions without creating a separate fund. Like its AMC Funds, investors commit capital upfront, with clear non-discretionary rules on how that capital is committed alongside IFC's own loans.[31] IFC has been successful in raising $10bn in capital from 11 institutional investors by 2022. MCPP also created an unfunded version of the platform, in which insurance companies share credit risk on a portfolio of new loans. Since 2013, IFC has mobilized $3.5bn from 13 insurers (World Bank Group, 2020).

The limitation in replicating Fund and Managed Portfolio platforms comes from the scale of the investment pipeline. When investors want to commit $1bn at a time and want to see their commitments invested within 12–18 months, it is only feasible for a DFI with a multi-billion-dollar pipeline of loans each year. Among European DFIs, only FMO has successfully launched a fund based on its own investment pipeline. IFC is now developing a platform to aggregate, warehouse and subsequently securitize loans from multiple MDBs and DFIs (Development Committee, 2022).

When these mobilization platforms first developed, the key challenge was to convince institutional investors that co-investing with a DFI would offer commercial financial returns, and that they wouldn't be saddled with sub-commercial investments taken on for development reasons. The first version of MCPP included a first loss tranche from SIDA, to reduce the perceived risk to private investors. Later versions have been able to attract capital without needing a first loss tranche. IFC's AMC and MCPP models have proved that this it is possible to get institutional investors comfortable with the risk profile of a diversified portfolio of EM assets originated by DFIs.

The key to success has been the ability to create a large enough asset pool to offer risk diversification, and to allow investors to review the past loss rate of comparable DFI assets. Increasingly, as institutional investors grow more interested in investments with ESG screening and/or positive impact, the ability to offer asset portfolios which are managed in line with global ESG/impact standards such as the Equator Principles and the Operating Principles for Impact Management have been an additional selling point for these platforms.

31 Like MDB/DFI managed funds, private investments in these portfolios count as Private Direct Mobilization under the MDB/DFI methodology.

## Platform companies

Some equity-focused DFIs have created holding companies which originate and manage portfolios of assets in a particular industry. For example, Globeleq is a company owned 70% by BII and 30% by Norfund, which invests in power investment companies in Africa. Norfund also developed a holding company, SM Power, which invests in renewable energy companies; it exited in 2021 through a trade sale to a listed company, netting $1.17bn. Selling equity and offering debt in these companies to private investors provides another method of giving private investors exposure to a portfolio that is diversified by country, if not by industry.[32] Norfund is developing a new company to invest in climate projects, mostly in MICs, which aims to invest $1bn, to be later sold on to private investors.

BII has a long history of establishing companies. Recently, it has used this capability (which is rare among DFIs) to create platform companies to invest in multiple renewable energy projects. In 2017, it established Ayana Power to develop green infrastructure in India. BII contributed the initial $100m of equity and appointed the management team and independent board of directors. Additional equity was contributed by the Indian government's NIIF (National Infrastructure Investment Fund) and private European investor Lightsource BP. But 2021, Ayana had 1140MW of renewable power under development, and expects to develop an additional 1.25–1.5 GW of new capacity a year. In 2018, BII established Gridworks as the sole shareholder, as a platform to develop companies providing solutions to the transmission and distribution infrastructure needed to support distributed renewable power provision. For example, Gridworks created Moyi Power, which builds, owns and operates solar utilities in the Democratic Republic of Congo (Lamy & Choudhury, 2022).

## Portfolio sales

MDBs and DFIs can sell off portions of their loan or equity portfolios to private investors. This substitutes private capital for DFI capital.[33] This is a form of "originate to distribute" or "originate to share" at a wholesale level, and therefore better suited for mobilizing larger institutional investors. Like DFI-managed portfolios, the challenge is the size and diversity of assets which can be packaged for sale. Regional development banks and DFIs have less scope to offer large, risk-diversified loan or equity pools to the market—their investments are concentrated in fewer countries or sectors. In the case of a regional bank like AfDB, there is significant correlation between the performance of the countries it invests in, as they are all from the same region and share many characteristics (e.g., dependence on commodity exports, vulnerability to climate shocks).

Portfolio sales are subject to the same limitations as single asset sales—they may impinge upon the MDB/DFI role, and they may require changes to the way that origination costs are recovered.

32 This is not recognized as PDM in the MDB/DFI methodology.

33 Only asset sales within the same year as original commitment are recognized as PDM in the MDB/DFI methodology.

## Portfolio risk insurance

MDBs and DFIs can also arrange insurance cover for some of the risk exposures in their investment portfolio. This will then free up MDB/DFI capital to make additional investments. The insurance company is thereby putting its capital at risk in place of the MDB/DFI, which is a form of mobilization.[34] MIGA has made extensive use of this approach, obtaining reinsurance on much of its guarantee portfolio. EBRD, FMO, IFC, IDBI, DEG have used this approach on a more selective basis, for example when running up against country or sector exposure limits. FMO took insurance on its portfolio from Allianz. Under the Juncker Plan, EIB received credit risk guarantees from the EU budget for loans and equity investments under the European Fund for Strategic Investments that it manages.

Synthetic asset sales are effectively the same as portfolio insurance, in that they transfer the credit risk on a pool of assets to a private insurer, while the MDB/DFI remains the lender of record. AfDB's "room to run" synthetic portfolio securitization used asset default swaps to transfer the risk of a portfolio of 45 private sector loans (mostly to financial institutions) in 16 countries to private investors (Risk Control, 2019). It involved an EU guarantee which reduced the credit risk of the tranche held by insurance companies. This freed up $650m of lending headroom. However, portfolio size is important here. There are fixed costs to preparing a securitization transaction, which may only be worth incurring for a large portfolio size.[35] At the same time, AfDB also arranged $500m of portfolio credit insurance from the Africa Trade Insurance Agency, which covers about 25 of total AfDB non-sovereign loan exposure. Depending on market conditions, this may be more or less cost-effective than the securitization approach (Galizia, Perraudin, Powell, & Turner, 2021). The G20 Capital Adequacy Framework report draws attention to the scope for portfolio risk insurance to stretch the financing capacity of MDB balance sheets, and calls for G20 guidance on their use (G20, 2022).

## Credit risk ratings and data

A common theme of all these multi-asset mobilization structures is that they provide the scale and risk diversification that institutional investors seek (G7 Impact Task Force, 2021). As part of the due diligence process, investors are given confidential access to information on the risk-return profile of the assets in the portfolio, based on historical performance of MDB/DFI portfolios. This data can be useful in getting investors comfortable with the risk-return profile of EM assets in various sectors (e.g., infrastructure), although it is difficult to abstract from the de-risking effect of MDB/DFI participation in these investments, to infer the risk-return profile of comparable investments without MDB/DFI involvement. Nevertheless, the G20 and OECD have repeatedly called for MDBs

34 It is not recognized as PDM in the MDB/DFI methodology unless it occurs in the same year as the commitment.

35 In 2022 AfDB replicated the Room to Run transaction for $2bn of sovereign risk in its sovereign lending portfolio, with 3 UK insurance companies, and a UK government partial credit guarantee.

to share more risk-return data with private investors to increase private investment in EMs (OECD, 2022). Several MDBs pool their loan risk data (default rates, loss given default) in a joint Global Emerging Markets Risk Consortium database (GEMS). The G20 has recently restated its call to make this database accessible to private investors (G20, 2022), as has the OECD (OECD, 2022).

To be useful for risk modelling, GEMS data needs to be quite granular at the country/sector/time level. Once you slice the data to this level, you may be left with too few observations to draw inferences of the risk profile with any degree of statistical power. Hence, it is important to increase the number of observations—and DFIs have a key role to play here, by being willing to invest in underinvested sector/country combinations, thereby generating additional data points. In addition, standardization of assets will increase the number of comparable data points, and bringing in data from a wider range of public and private institutions can also help (again, with an understanding of how few transactions there have been in some sector/country combinations to date). Also, the GEMS database only covers loan transactions, for which it is possible to calculate default rates and loss given default. There remains a lack of data on the performance of MDB/DFI equities. Since these are mostly illiquid assets, which are held for long periods, it is not possible to "mark to market" the value of these equities. Hence, the performance is only observable on the infrequent occasions when MDBs/DFIs sell equities. This also creates a long lag in the performance data—with holding periods averaging around 7–8 years, the equity returns on sales in 2022 reflect the performance of equities acquired around 2015.

A more systemic approach to getting private investors comfortable with the risk profile of MDB/DFI assets could involve a joint effort by MDBs and DFIs to establish common credit ratings for all MDB/DFI loans. The use of a common yardstick to communicate the credit risk of MDB/DFI assets would overcome the opaqueness of current practices, where each MDB/DFI assesses its own credit risk using proprietary methodologies and ratings.

## Assessment of multi-asset mobilization

Multi-asset mobilization offers good prospects for attracting capital from institutional investors. The key to its implementation is having a large enough pool of assets to offer risk diversification and to meet the risk/return appetites of institutional investors. Structuring loan portfolios in ways which create an investment grade senior tranche will attract a wider range of institutional investors. This may require concessional blended finance in some cases, but in other cases the return on the junior tranche may meet the hurdle rate for DFIs to invest in it.

Whatever the structure, investor appetite will lean towards the lower risk segments of MDB/DFI portfolios, with higher risk segments remaining on the institution's balance sheet. This has implications for the overall risk-return balance of the institution, and for the volatility of income.

Hence, a limitation on multi-asset mobilization will be the institution's own appetite for an own account portfolio that is smaller, less diversified, and more concentrated in riskier assets that are of less interest to private investors. Large MDBs like IFC have often justified continuing to invest in larger firms and in middle income countries on the grounds that the safer assets so generated provide portfolio balance for riskier investments in smaller firms in frontier markets.

To pursue these approaches to mobilizing institutional investors, MDBs and DFIs need to engage closely with interested investors and tailor the structures to meet their appetites. This can be a costly and time-consuming exercise. Hence, these approaches are best suited to larger MDBs and DFIs who can offer larger pool of assets, especially those that either have access to concessional finance for blending or can take more risk on a portion of their own balance sheet. Likewise, co-lending programs like MCPP are only feasible for institutions with a large and diversified flow of new loan commitments. For smaller institutions, selling (parts of) loans to a multi-DFI platform could be a way to achieve scale and diversification. Such a platform could be managed by a private fund manager (as in the case of ILX) or by a consortium of DFIs. Replication of existing structures which have attracted institutional investor funds will also reduce the time and complexity of structuring of follow-on funds. Once a structure has proved acceptable to the market, MDBs and DFIs should focus on replicating the structure at regular intervals.

Portfolio insurance has proved a popular instrument for many MDBs and DFIs because it mobilizes insurance company capital in a more straightforward transaction, which can be executed at any size of portfolio (or even single assets, as discussed above).

Funds can attract a mixture of investors, depending on the size, asset class and risk profile of the fund. The costs, complexity, and regulatory issues involved in establishing in-house fund management capacity make it feasible only for larger MDBs and DFIs; for smaller institutions, they are more likely to attract capital by outsourcing fund management to a private fund manager. The MDB/DFI can still play a key role in designing the fund and in sourcing assets for the fund.

Few MDBs and DFIs currently have the mandate and capacity to establish platform companies. Hence this model is arguably under-utilized. It addresses part of the challenge of generating sufficient dealflow by creating a company and a management team that can actively develop new assets for later sale to private investors.[36] For those institutions that have the capacity to do so, this is a promising area for expansion. For those that currently aren't able to do this, they may wish to reflect with their shareholders whether this is a capability they want to develop, so as to increase the pipeline of assets which can mobilize private capital.

36 It does not overcome the challenge of difficult economic and policy conditions which may limit the viability and profitability of private investments, whoever develops them.

**TABLE 7. Summary assessment of key innovations in multi asset mobilization**

| Innovation | Institution(s) | Transaction or Fund Sizes | Scalable? | Replicable? | Institutional Investors? | MDB/DFI Size? |
|---|---|---|---|---|---|---|
| Portfolio sales | IFC, BII | \$100m–\$1bn | MDBs and larger DFIs | Yes—with adjustments to business model | Yes, may need structuring to meet investment grade | MDBs and larger DFIs |
| Portfolio insurance | ADB, FMO, IFC, MIGA | \$100m–\$1bn | Yes | Yes | Yes—taps into insurance company balance sheets | All sizes |
| Privately-managed funds of DFI assets | FMO, ILX | \$1bn | Yes | Yes | Yes—pension funds invested in ILX fund | All sizes |
| DFI-designed funds | IFC, DEG, EIB, FMO, AfDB, Proparco | \$500m–\$2bn | Yes | Yes | Yes | Larger MDBs/ Dfis with capacity to design funds |
| DFI-managed funds | IFC, EBRD, FMO, IFU, DEG | \$500m–\$2bn | MDBs and Larger DFIs | Larger MDBs/ DFIs | Yes | Larger MDBs/ Dfis with capacity to manage funds |
| Co-lending programs | IFC | \$500m–\$1bn | Yes, for larger DFIs/MDBs | Larger MDBs/ DFIs | Yes | MDBs and larger DFIs |
| Platform companies | BII, Norfund | \$100m–\$1bn | Yes | Larger DFIs with authority to take management control | Larger companies only | DFIs with authority to sponsor companies |

## Mobilization enabling processes

A long-standing complaint of private investors is that it is costly and slow to co-invest with DFIs (Blackrock Investment Institute, 2021) (McHugh, 2021). Process innovations to streamline the co-investment process can therefore be expected to increase the amount of private capital that DFIs are able to mobilize (Lankes, 2021) (Bhattacharya & et al., 2022).

A first step was to align investment practices across DFIs. This reduces the transactions costs for co-investments among DFIs, but also reduces the information costs for private investors working with different DFIs on different transactions. The first important step was the harmonization of ESG risk management practices, through the adoption of the Equator Principles. Based on IFC's Performance standards, these harmonize the ESG risks that DFIs and private project-finance banks assess and monitor. Over 100 DFIs, MDBs and private banks have adopted the Equator Principles, leading to greater consistency in ESG risk management.

A second step is to harmonize legal documentation and due diligence processes. Here, the most progress has been made across DFIs, with IFC creating Master Cooperation Agreements with multiple MDBs/DFIs and other financial institutions[37] which standardize due diligence and legal documentation. IFC reports that over $10bn in financing has been arranged using the agreements. A private firm, Infraclear, has created a searchable database of project finance legal documentation and financial terms, which provides the knowledge base for greater harmonization.

Of course, harmonization across institutions with different ownerships and subject to varying amounts of national regulation is not a simple process, and the bureaucratic resistance to adopting processes 'not invented here' can be strong.[38] Hence, strong leadership from common shareholders across the institutions (notably, the G20) will be needed to drive harmonization forward.

In addition to harmonization across DFIs, it is also helpful to harmonize project processes and documentations across multiple investments offered by a single DFI. This is the approach taken by IFC's Scaling Solar program (Cole, Masko, & Zochowski, 2021). Recognizing the need and opportunity for large numbers of solar power projects in Africa, where governments often have limited capacity to manage tendering processes for private IPPs, IFC developed a cookie-cutter approach, starting in Zambia in 2015. This allowed governments to bid out multiple solar power projects with standard contract terms and documentation. Alongside this, IFC offered standard financing packages available to winning bidders with minimal restrictions ("stapled financing"). The ability to bid for multiple projects, with DFI financing already lined up, lowered the transactions costs and reduced the uncertainty for private investors, thereby mobilizing more capital into solar power investments. The Scaling Solar program has now been replicated in six countries in Africa and Central Asia. The same principles have been applied to other areas of infrastructure investment where projects can be standardized, including wind, water and urban transit projects (Development Committee, 2022).

Multi-asset mobilization becomes easier with greater asset standardization, which can form the basis for securitization and creation of risk-diversified pools of similar assets. Just as standardization of mortgage terms in the US by Fannie Mae allowed banks to focus on loan origination and securitize mortgage assets in deep capital markets, so standardization of MDB/DFI loans offers much greater potential for scale-up than expanding the flow of single-asset mobilization transactions.

37 IFC's Master Cooperation Agreement currently covers 35 financial institutions, including 2 MDBs and 14 DFIs.

38 For example, note that only 3 of the 9 MDBs (IFC, NDB and IsDB) have adopted the shared Master Cooperation Agreement since IFC created it in 2008.

### BOX 2. How to enable further securitization of infrastructure assets

While the US and European mortgage markets are about 70% securitized, less than 1% of infrastructure loans have been securitized. Why can one real asset class be so securitized, while another is not?

The history of securitization of US mortgages offers a few insights. The first is the presence of Fannie Mae and Freddie Mac as the default buyers of loans from US banks. But they instituted an under-recognized innovation that is instructive. In the 1980s, they started to define standard loan acceptance criteria (along with limits). The creation of such standards rapidly led to a bifurcation in the market between a "conforming mortgage" and a "non-conforming mortgage." It immediately coaxed lenders around the US to want to write loans that "conformed," and that they could therefore securitize and get off their balance sheets. This led to a sustained growth in volume and has made it easier for US home buyers to obtain mortgages.

Of course, this ended badly in 2008 with the Global Financial Crisis. But even here, the relevant lesson to perhaps be drawn from the Global Financial Crisis is that the deviation from standards led to the undoing of the market. For, it was the creation of non-standard CDOs and credit default swaps (CDS) that led to an explosion of volume that was no longer based on fundamentals.

So what does this mean for infrastructure? Infrastructure professionals' instinctive reaction is that each project is different, each loan is different, and each market is different. But in fact, the same credit committees, law firms, MDBs and DFIs have been developing projects and lending across markets for decades. There are tacit standards that investors have been using for decades. Infraclear has started using natural language processing and semantic analysis to tease out these standards. They are developing products that allow a credit officer or a risk manager to be able to scan thousands of agreements, and compare force majeure triggers across projects. They are able to go further and say "37% of projects are in flood zones, but only 19% have force majeure protection for a flood."

Such analytics and the resulting standardized data can facilitate simpler securitization. Institutional investors can rapidly scan portfolios, price risks, and even hedge the anomalies. While it took Bayfront Infrastructure nearly 3 years to securitize a portfolio of 37 loans, the use of such standardized data and analytics could significantly accelerate this process.

A World Bank study (Jobst, 2018) noted that with standardized data, the Solvency 2 capital charges for holding infrastructure loans could fall by up to 65%. This could result in a 25% increase in returns for infrastructure investors and make securitization a highly attractive proposition.

*Source:* Giridhar Srinivasan, *Infraclear.*

## Constraints to scaling up private capital mobilization

There are several constraints which limit the current mobilization activity of MDBs and DFIs, which occur in different institutions.

### Mandate

Some MDBs and DFIs have a greater strategic focus on low income, fragile and conflict states. This limits their ability to generate investments with a risk-return profile attractive to private investors. Blended finance to de-risk and/or enhance the returns to these investments may help a little, but the marginal contribution that most blended finance transactions make to prospective investment returns will not be enough to encourage private investors into these markets. Shareholders should accept that for the medium term, these countries will have limited mobilization potential.

Conversely, MDBs and DFIs are being asked to invest more to address climate change; this mandate can open up large scale opportunities to originate investments, especially in high-emitting, lower risk middle income countries, using blended finance to bring private returns closer to social returns (absent a carbon price). Institutional investors are under pressure to invest more in climate assets (both for mitigation and adaption), and impact investment funds are collecting larger pools of capital available for climate investments. For MDBs and DFIs with a mandate to do more in climate investing, there is scope to raise their ambition to mobilize private capital.

Some MDBs and DFIs have placed more emphasis on mobilization in corporate strategy, while others have focused on fully deploying their own capital. Because returns to unutilized capital are low, there is a natural incentive for MDBs and DFIs to prioritize own account commitments over mobilization. Hence, institutions which find themselves with excess capital (e.g., EBRD due to limitations on which countries it can currently invest in) tend to place less priority on mobilization (EBRD Evaluation Department, 2020). If shareholders want them to mobilize more private capital, then they need to work through their Board representatives to counterbalance this tendency and give clear direction to a management to prioritize mobilizing private capital. OECD has recently called on MDB/DFI shareholders to give a clearer mandate to the institutions they own to prioritize mobilization (OECD, 2022). This relates back to the challenge of pipeline development—a stronger investment pipeline will more quickly exhaust capital availability, and thus bring alignment between maximizing the use of own capital and mobilizing third party capital.

MDBs/DFIs also need a clearer mandate to exit their investments more quickly, with adjustments to the business model to permit it (see below). There needs to be clarity on the length of time needed for the MDB/DFI to provide its additionality, and either a willingness to entrust continued impact and ESG compliance to the client, rather than rely on continued portfolio supervision, or use of synthetic sales and risk transfers to enable the MDB/DFI to continue to play that role. To achieve this, management should incorporate specific discussion of exit timeline and strategy into the investment approval process, rather than assuming the default of 'buy and hold' as is the practice in most DFIs today.

## Business model

(a) **Fees.** MDBs and DFIs have mostly organized their business to maintain financial sustainability through the fees and income they earn on loans, and capital gains on equity. Mobilization offers different opportunities to generate fees from clients or co-investors, but reduces the ability to earn fees and income on "own account" investments. For MDBs and DFIs to do more mobilization, they need to adapt their business model to ensure that "originate to distribute" activities are financially sustainable, and incentives for deal teams are balanced between committing own account capital and mobilizing third party capital. For example, volume targets in corporate scorecards and for team and individual performance awards should treat own account and mobilization volume equally, as is the practice at IFC. Also, some revenue from asset sales may need to flow back to business units to pay for the running costs of the investment business in the same way that supervision fees and loan spreads often do.

(b) **Portfolio balance.** Greater mobilization upfront and asset sales later will also affect the risk profile of the MDB/DFI own account portfolio. Since lower risk assets are easier to mobilize or sell, the residual portfolio will be more concentrated in higher risk assets. Historically, MDBs have managed the risk and volatility of their portfolio by balancing lower and higher risk assets. A higher mobilization ratio would imply a higher risk portfolio, and more volatile net income. This means that more shareholder capital would be required relative to the portfolio size, reducing the balance sheet leverage.

(c) **Origination.** The traditional business model of structuring bespoke transactions using proprietary documentation and frameworks does not lend itself to scale up. There are not enough investment bankers and project finance lawyers in the MDBs/DFIs to scale the investment business in this way, and hiring more staff would reduce profitability, even if it is not constrained by limited shareholder appetite for larger staffing and budgets, and limited availability of donor funds. Scaling therefore requires a shift in origination towards larger volumes of standardized assets which can be processed and mobilized with less complexity and greater speed. As this paper has shown, MDBs and DFIs have performed well as innovators. The challenge now is to move beyond one-off innovations and to replicate and scale the innovations that have potential to attract private capital in multiples of existing volumes.

(d) **Operations.** MDBs/DFIs that have do not already have the capacity in place would need to upgrade data systems, investor reporting and regulatory compliance to meet the demands of co-investors. For institutions that are not currently regulated, compliance with financial regulations imposes new operational requirements. DFIs may develop these capacities through single-asset mobilization before attempting multi-asset mobilization.

## Regulatory and accounting treatment

Different MDBs and DFIs face different regulatory regimes; some of these inhibit mobilization activity. Notably, regulators may require institutions to be licensed to undertake some mobilization activities, such as promoting client bond issuance. Shareholders and management should consider the pros and cons of obtaining regulatory approval for financial intermediation activities. This is a bigger step for MDBs, which are not generally subject to national financial regulation, than for DFIs, which are often regulated entities already.

Government accounting practices may limit DFIs ability to issue bonds in their own name, as it may be counted against government debt limits. Conservative accounting policies in some institutions like the World Bank require guarantees to have the same capital backing as a loan, so discouraging borrowing countries from utilizing guarantees. Similarly, in the case of USDFC, government accounting practice requires equity investments to be accounted the same as a grant. Instead, accounting treatment should recognize that not all guarantees will be called, and not all equities will be a total loss, and reduce the capital backing required accordingly.

## Scale

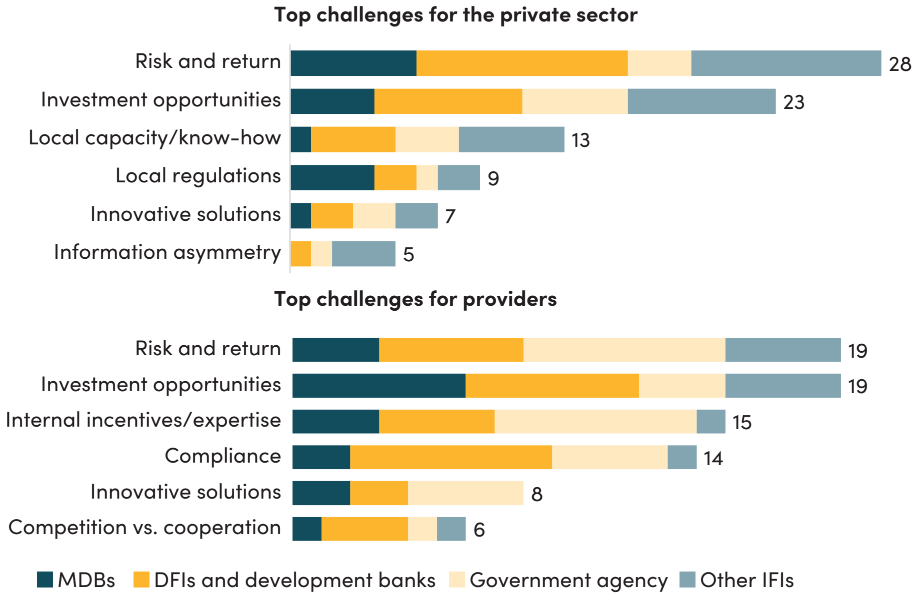
Smaller DFIs to not generate enough volume of new assets each year to mobilize at scale. Small investment programs make it hard to cover the fixed costs of syndication desks, fund or other platform structures, securitization, etc. In addition, small portfolios offer less risk diversification, and smaller ticket sizes for mobilization transactions. This limits the ability to offer attractive assets—in terms of size and risk profile—to institutional investors.

Scale limitations can be overcome by collaboration across MDBs and DFIs to aggregate assets and to manage mobilization collectively. This can either be done by the MDBs/DFIs themselves, or by a private asset manager (e.g., ILX, Blackrock). To facilitate this, MDBs and DFIs should further pursue initiatives to standardize their assets, through adoption of common standards (e.g., Equator Principles, Impact Principles), common documentation, common loan terms, and common credit risk ratings.

## Pipeline

For MDBs and DFIs that have put in place mobilization programs that have proved effective (e.g., loan syndication programs, funds), the biggest constraint to scaling them up is their ability to originate new assets to put through these programs (Lankes, 2021) (Bhattacharya & et al., 2022). A 2022 OECD survey of both DFIs and private investors identified lack of investment opportunities as a key challenge to increasing mobilization (OECD, 2023) (see Figure 3 below).

## FIGURE 3. Top challenges affected private capital mobilization




*Source:* 2022 OECD DAC Survey on Providers' Portfolios.

Generating new investment opportunities is a competence which few institutional investors possess, so DFIs that have that capacity have a natural complementarity with institutional investors. Some of the difficulties in building a pipeline of assets that can mobilize private capital is related to mandate, business model and scale—MDBs/DFIs may be focused on investing in assets where investor appetite is limited, or they may not have a capital base or cost structure that easily scales up new business generation. But some of it is related to the ability of MDBs and DFIs to identify, qualify and structure assets with a risk-return profile acceptable to commercial investors—a topic beyond the scope of this paper. MDBs and DFIs with a strong field presence are usually better able to originate assets. Some bilateral DFIs partner with private companies from their home country to identify investment opportunities.

Even with the best origination capacity and streamlined processing, MDBs and DFIs still face limitations in the "addressable market" in many countries. In low-income countries, the constraint may be too few productive, formal sector firms of the size that they can invest in (Ciani, et al., 2020). In low- and middle-income countries, it may be too few sectors open to private investment, especially in infrastructure, healthcare and education. In some countries, it may be due to competition from local state-owned or private banks offering cheaper credit. The causes and consequences of these limitations are also beyond the scope of this paper. But both these constraints call for realism on how far MDBs and DFIs can generate larger investment pipelines in the near future.

Since there is a disconnect between the desire to see MDBs and DFIs mobilize more capital and the opportunities they can generate in some countries and sectors, shareholders should be more willing to "double down" and allow MDBs and DFIs to concentrate a larger share of their activity on a more limited set of countries and sectors where investible opportunities are widely available, such as climate investments in middle income countries, for example (Songwe, Stern, & Bhattacharya, 2022). This will allow for replication of proven structures and standardization of assets, reducing transactions costs. This may require taking more portfolio concentration risk, which can be offset with insurance or asset swaps. The shareholder pressures on multilateral institutions to be seen to be active across all member countries may constrain their ability to pursue greater concentration, which in turn will limit their potential for mobilization. This calls for honest discussion among shareholders on the trade-offs between increasing mobilization and maintaining portfolio breadth.

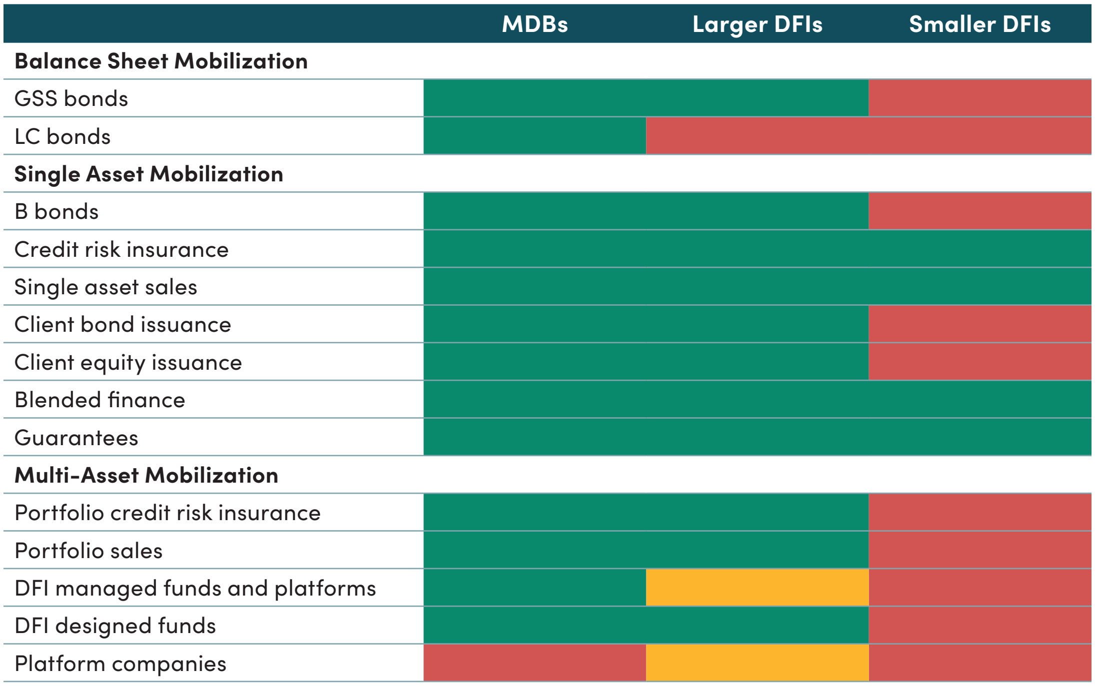
## Conclusions and recommendations

Substantial progress has been made since 2015 in utilizing different forms of financial engineering to mobilize different types of private investors. From an historic focus on transaction-level mobilization from commercial banks, and balance sheet mobilization to institutional investors through bond issuance, MDBs and DFIs have broadened the range of financial structures they use, and broadened the range of investors that they mobilize capital from. In particular, they now have more tools available to mobilize capital at scale from institutional investors. This is well aligned with shifts in global financial markets, which have seen reduced appetite from commercial banks for EM risk (partly driven by regulatory changes), and increased appetite for long-term EM assets from institutional investors.

Different instruments will be suited to different MDBs/DFIs. In particular, multi-asset approaches are best suited to larger MDBs/DFIs who have bigger, more diversified asset pools to share with private investors. For smaller DFIs, cross-DFI platforms, whether managed by the DFIs themselves or by a private fund manager, offer potential to increase mobilization. Multi-asset approaches are also better suited to mobilize capital from pension funds, sovereign wealth funds and insurance companies. Credit risk insurance and unfunded risk transfers offer a complementary way to mobilize insurance company capital. Client bond issuance is well suited to mobilizing local pools of capital in low- and middle-income countries, while avoiding exposing the issuers to foreign exchange risk. For issuers who can bear such risks, bond issuance can also enable them to tap into foreign investors, particularly if they can comply with bond labels such as green, social, climate, sustainable.

Finally, there is enormous upside from adopting new technologies to create new data standards. This could transform the entire project cycle by accelerating project development, enhancing portfolio and operational risk management, and simplifying the securitization of loans.

**TABLE 8. Heatmap of relevance of innovations to different types of institutions**




The challenge before MDBs and DFIs today is therefore less about further financial innovation, and more about replicating and deploying at scale the instruments and approaches which have been created and road-tested, subject to the size, capacity and regulatory constraints of each MDB and DFI.

1. MDB/DFI management should agree realistic mobilization goals with shareholders, consistent with overall investment strategy, addressable market, and institution size. Shareholders should not expect small DFIs to do much mobilization on their own, but they should feed assets into multi-DFI funds and structures. For larger DFIs and MDBs, shareholders should be clear on the trade-offs between mobilization and other objectives, such as investing more in SMEs or in fragile and conflict states, and be more willing to lean into opportunities to mobilize at scale (e.g., in climate mitigation in middle income countries).
2. Smaller DFIs should explore mobilizing more private capital on the balance sheet, including private equity (or hybrid capital with or without voting rights) and thematic bond issuance without recourse to the sovereign to leverage shareholder equity.
3. MDBs and DFIs should replicate and scale up the financial innovations that have proved successful in mobilizing institutional investor capital, including creating and managing funds and other collective investment vehicles; and making greater use of portfolio risk insurance and unfunded risk transfers to free up more investment headroom on the balance sheet.

4. MDBs and DFIs should collaborate to standardize the terms, standards, documentation and due diligence processes of loans. They should develop a common, transparent loan rating methodology consistent with market standards. They should also develop replicable project structures and documentation for a wider range of investment opportunities.
5. MDB/DFI Boards should review business models to ensure that increasing the mobilization ratio, and reducing the holding period of assets, is financially sustainable and aligned with management and staff incentives.
6. MDBs/DFIs should be more strategic about selling assets either singly or packaged into portfolios, making asset disposal part of the investment strategy at the time of commitment.

Since 2015, the appetite of investors, especially institutional investors, for co-investments with MDBs and DFIs has only increased, driven by the increased attention among stakeholders to the role of finance in achieving the Paris climate change goals and the SDGs. At the same time, there is increased appetite for assets with strong ESG standards and strong impact management and measurement. MDBs and DFIs mostly have good ESG and impact management and measurement systems in place (as shown by their alignment with the Equator Principles and Operating Principles for Impact Management). This is a key selling point that MDBs and DFIs can use in attracting more capital from institutional investors.

The innovations that MDBs and DFIs have undertaken since 2015 throw into sharper relief the remaining constraints on mobilizing more, and the limitations on how much they be expected to mobilize. This is now the time to double down on the innovations that have proved successful, addressing remaining constraints, and having honest conversations with shareholders and other stakeholders about the realistic prospects for scaling up mobilization.

# Annex. A conceptual framework for understanding MDB/DFI mobilization of private capital

DFIs aim to increase financing of private enterprise activity in low- and middle-income countries. They can do this to a limited extent by making "own account" investments from their capital base, mainly (but not entirely) funded by governments. But from IFC's founding in 1956, it was recognized that they could achieve much more if they bring in—"mobilize"—private capital alongside their own capital (IFC, Articles of Agreement, 2020). It has also long been recognized that there is a risk of DFIs displacing private investors instead.

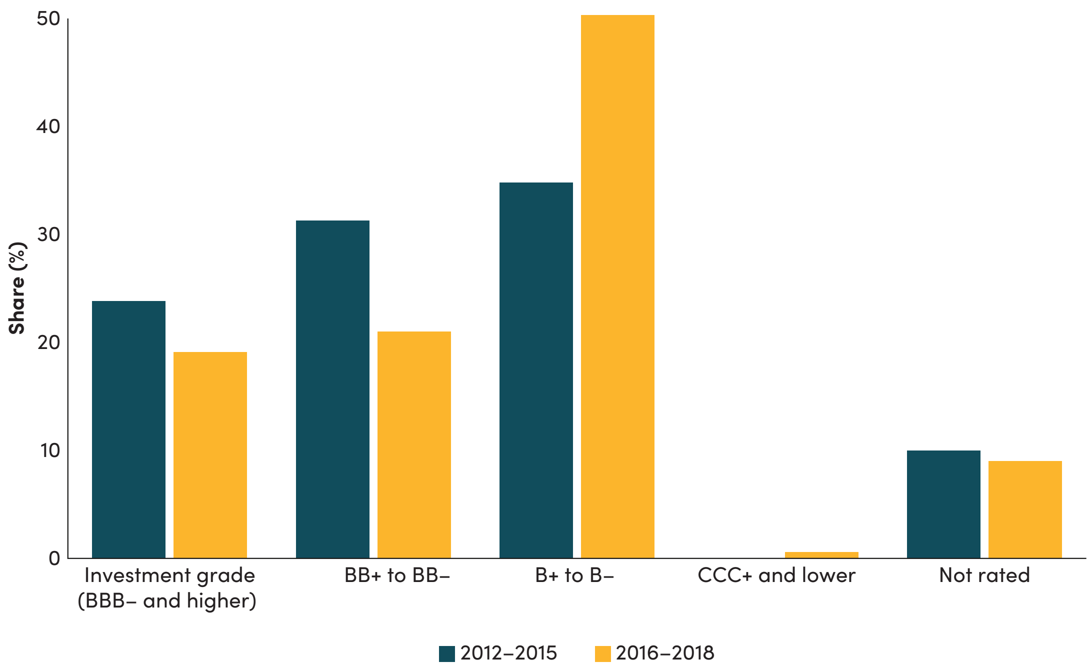
## Crowding out vs crowding in

In economic terms, DFIs seek to be complementary to, rather than substitutes for, private investment. Or as it is commonly rephrased, to "crowd in" rather than "crowd out" private investment. Complementarity ("crowding in") happens when private investment increases as a result of the DFI activity (IFC, Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operations, 2018).

It should be noted that crowding in is only possible in a limited set of circumstances. There is a set of countries (broadly equivalent to OECD countries) and sectors where the risk to private investors and the ease of investing are low enough that private investors will invest in a wide range of activities without the need for any activity by DFIs. At the other end of the spectrum, there are countries and sectors which are so risky or difficult to invest in that few private investors are unwilling to invest, even with the involvement of DFIs. So "crowding in" can only happen in those countries and sectors where DFIs can make the difference to private investors' willingness to invest.

Investors typically screen investments by country risk before considering specific investment risk, and may have regulatory or internal risk management limits on investing in countries below a certain sovereign bond rating (used as a proxy for macro risk). Hence, most DFI mobilization happens in countries which have a sovereign bond rating of at least B–, and more goes to countries with 'investible' ratings of BBB– or better. There is some evidence of a shift in mobilization towards lower sovereign risk ratings (Attridge & Gouett, DFIs: The Need for Bold Action to Invest Better, 2021)—see Figure 4.

**FIGURE 4. Share of amounts mobilized, bilateral DFIs, by beneficiary sovereign credit rating, 2012–2018**




*Source:* (Attridge & Gouett, DFIs: The Need for Bold Action to Invest Better, 2021).

## Cashflow vs risk-bearing

We need to distinguish between two dimensions of what an investor provides when it invests. One dimension is cashflow—dollars transferred from the investor to the investee. A second dimension is risk-bearing—accepting various risks that may lead to future cashflows from the investee to the investor being larger or smaller than expected. In simple transactions, the two dimensions go together. If I make a loan to you, I both transfer money, and take the risk that you may not pay me back. But many financial structures unbundle the two dimensions. For example, guarantees and insurance take risk on an entity without providing cashflow unless the guarantee is called or a claim made on the insurance; conversely, a bank providing a line of credit to an SME which is fully guaranteed by a third party provides money to the SME, but does not take any risk.

When we consider the mobilization of private capital by DFIs, which are we interested in—the provision of cashflow, or the provision or risk-bearing? We argue that risk-bearing is the key dimension. In a world of fiat (and digital) money, risk-free transfers of money accomplish little. What investees need are counterparties that will accept the risks in making these transfers. Firms do not go out of business, or fail to expand, because no-one has money to provide to them. They do so when no-one will take the risk of doing so. Hence, in MDB/DFI reporting on mobilization (MDB Task Force on Mobilization, 2021), the amounts reported are those for which the MDB/DFI has the commercial risk exposure, rather than those for which it provides cashflow: guarantees and unfunded risk instruments are counted, but loans fully guaranteed by a third party are not. Likewise, partial risk guarantees are counted based on the amount of risk exposure that the MDB/DFI is taking, not the full amount of the loan being guaranteed.

## Mobilization vs catalyzation

A longstanding role of MDBs and DFIs is to improve the conditions for private investment in EMDE (IFC, Articles of Agreement, 2020). This includes supporting policy and regulatory reforms and financing complementary public investments (e.g., in infrastructure) or 'upstream activities' (e.g., a steel mill that enables manufacturing), which enables and encourages greater private investment. Arguably, macro level interventions can lead to a much higher impact on future private investment levels than interventions directly with specific private investments.[39] Conceptually, the measure of this is termed "private capital catalyzed." In practice, it has been difficult to credibly measure this metric, because of the difficulty of specifying and measuring the counterfactual—how much investment would have happened without the intervention? But some MDBs and DFIs report on partial estimates of "private capital catalyzed."[40]

"Private capital mobilized" is a subset of these activities, defined by the MDBs and DFIs themselves (MDB Task Force on Mobilization, 2021) as private co-financing of investments in which MDBs/DFIs participate. This is subdivided into two categories:

a. Private Direct Mobilization (PDM) - where the MDB or DFI has an active and direct involvement in bringing in private capital (typically in the context of completing a financing plan for an investment activity).
b. Private Indirect Mobilization (PIM)—other private co-financing which the MDB or DFI was not involved directly with. It can be argued that all private investors benefit to some extent from participation of an MDB/DFI in a financing plan (due to their extensive due diligence, rigorous supervision, or political risk mitigation from their involvement), which may have some influence on these investors participating.

We focus in this paper on MDB/DFI innovations to increase PDM.

The definition of "private" can also be fuzzy, since the source of capital may have some government involvement, e.g., a financial institution with some government shareholding. Conversely, some wholly public sources of capital may behave like private investors, seeking only a risk-adjusted financial return without public policy objectives -many Sovereign Wealth Funds and state-owned

39 For example, IFC advice to the Chinese government on creating collateral registries enabled millions of SMEs to get access to billions of dollars of finance from Chinese banks—a much greater impact on financing of Chinese SMEs than any IFC investment activity.
40 For example, Broccolini et al. find incremental private bank lending in the three years following an IDBI syndicated loan, in a ratio of 7:1 (Broccolini, Lotti, Maffioli, Presbitero, & Stucchi, 2019).

Insurance Companies and Pension Funds are organized this way. So they are indistinguishable in their behavior from private capital. Hence, the MDB/DFI definition of private capital is expanded to include public institutions investing commercially in the same way as a private investor, so long as they have business objectives and autonomy from government in their decision making (MDB Task Force on Mobilization, 2021).

## Limits to mobilization

Why do co-lenders want DFIs to retain involvement in transactions (or in investment portfolios?). DFIs have innate and learned characteristics which lower the investment risk for all parties. First, they may have some degree of "preferred creditor status" which means they are likely to get paid first in the event of a foreign exchange shortage. More broadly, investees and governments don't like to default or otherwise treat DFI investors badly, as it would impinge on their ability to seek financing later, and cause reputational damage as DFIs are visible financial institutions with powerful shareholders. This DFI risk "umbrella" requires the DFI to retain a certain level of involvement in the transaction to provide comfort to co-lenders.

Second, co-investors benefit from DFI management of the investment, from negotiating the deal through supervision of the asset while in the portfolio (from a financial and/or impact performance perspective), to managing exits (for equity) or debt work-outs (if needed in the case of non-performing loans). If the DFI involvement is too low (not enough "skin in the game") co-financiers worry that they won't perform these roles with sufficient diligence. There is thus a limit to how leveraged DFIs can be at the transaction mobilization level, just as there is a limit to how much you can leverage equity in a balance sheet.

Likewise, the investee may want to retain DFI involvement, in order to maintain the benefits that flow from it—access to DFI knowledge and expertise, reputational enhancement, preference for dealing with one lead investor, etc. As a result, in most mobilization activities, DFIs will need to put some of their own capital at risk, and to retain their exposure to the investment over the longer term. This limits how much they can mobilize relative to their own investment activity.

Increases in the capital base of existing institutions increase their capacity to mobilize private investment, as most mobilization requires the DFI to invest alongside the private investor—either *pari passu* or in a more junior position in the capital stack. This was a key argument of IFC's capital increase in 2019—its first since 1992 and only the second since its founding in 1956: it needed a larger capital base in order to mobilize more private capital (World Bank Group, 2018).

There is also a limit to the share of a transaction that the DFI can afford to mobilize. DFIs incur expenses in sourcing, appraising and structuring new investments, and supervising them while in the portfolio. In the case of loans, they can recoup this through fees paid by the borrower, or by a higher loan spread. If the DFI recoups the full loan preparation cost in upfront fees it would make their services less affordable, so they often price their loans to recoup some of the upfront costs over the life of the investment. This means that the client pays more for the loan in return for lower initial fees. However, if the DFI subsequently sells off part the loan at face value, it reduces the amount of loan interest in receives to cover its costs. Similarly, DFIs may charge supervision fees to cover monitoring costs. If these fees are linked to the loan size, then selling part of the loan reduces the fee income to cover the monitoring costs. In the case of equity investments, DFIs are not typically able to charge fees to investees, but expect to recover upfront and ongoing supervision costs through subsequent capital gains. The more equity they sell down, and the sooner they sell it, the less they stand to earn from capital gains.

If DFIs become more intentional about originating assets to sell down later ("originate to distribute") they may need to modify their fee structure to recover more of their loan preparation costs upfront. In the case of equity, selling out early will only be financially sustainable if investors are willing a higher equity price than the DFI paid after a short period. This may be possible if the DFI participation adds value to the investee or changes other investor perceptions of the value of the equity (e.g., the DFI involvement provides a "seal of approval" on the quality of management, financial integrity, ESG performance etc.).

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