



BLENDED
FINANCE
TASKFORCE

BETTER GUARANTEES, BETTER FINANCE

Mobilising capital for climate through fit-for-purpose guarantees

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ABOUT THIS CONSULTATION PAPER

This paper has been developed by the Blended Finance Taskforce. It identifies real opportunities to mobilise capital for climate action – with a focus on the \$2.4 trillion needed a year by 2030 in Emerging Markets and Developing Economies excluding China (EMDEs). The focus of this paper is on the use of guarantees as one of the most catalytic instruments available to unlock additional private capital for climate. Acknowledging that there will never be sufficient public or philanthropic capital to meet the funding needs in EMDEs, nor does there need to be, since climate-positive solutions are becoming increasingly investable.

Insights and recommendations are based on desktop research, analysis of public datasets, expert interviews and consultation with key stakeholders in two interactive workshops. The lead authors of this paper are Carolien van Marwijk Kooij, Jesse Hoffman and Jeroen Huisman (Blended Finance Taskforce) supported by Vidar Helgesen (Norwegian Expert Panel on Climate Finance), Catharina Dyvik, Eliza MacMillan-Scott, Emilie Wesseling, Katherine Stodulka, Moritz de Chaisemartin and Theo Gott (Blended Finance Taskforce).

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KEY MESSAGES

Mobilising capital for climate action is one of the most important levers to drive sustainable and inclusive growth while preventing catastrophic warming and protecting critical ecosystems. Much of this capital is needed for investment in low-carbon power systems, resilient infrastructure, regenerative agriculture and nature-based solutions in the Global South. Estimates vary, but at least \$2.4 trillion is needed each year by 2030 for climate action in Emerging Markets and Developing Economies excluding China (EMDEs).¹ Less than 20% of that is flowing in climate finance to EMDEs today. Capital from philanthropy and donor governments (directly or via development banks, climate funds and other intermediaries) will be insufficient to close this gap.

The good news is that much of this capital can come from the private sector into opportunities that are – or soon will be – commercially attractive as technology tipping points make these investments viable. The bad news is that capital is not yet moving fast enough or at the scale required. The current financial system architecture does not result in the risk-return models that put climate action at the heart of capital allocation. Achieving a 5x scale up in climate finance in the short term requires addressing two key barriers to unlock private capital:

- 1. Project pipeline:** Real economy investment opportunities in EMDEs are still poorly understood by the private sector. Project preparation facilities are too small, hard to access and largely disconnected from follow-on funding and de-risking mechanisms. Project finance volumes in low- and middle-income countries have dropped from \$91 billion in 2019 to less than \$60 billion in 2022.²
- 2. Cost of capital:** Financing is either unavailable, not easily accessible or unaffordable. International investors are often unfamiliar with EMDE stakeholders and don't have physical presence in these markets. This increases the perception of political and counterparty risk, even though data on adjusted risk-returns and actual default rates in EMDEs suggest that risks are often lower than investors might imagine.

These barriers are exacerbated by geopolitical, macroeconomic and exogenous risks including supply chain disruption, conflict, health crises and natural disasters. Exchange rate risk is especially costly to manage for foreign investors – specifically when revenues are in local currency and financing is foreign currency-denominated. Rising interest rates add to debt service obligations and can pull capital back to developed economies.

Scaling private capital in EMDEs will depend on overcoming the barriers of pipeline and risk, and driving changes to the financial system architecture.

Dedicated action is required to support project development for green and transition-aligned assets while reducing the cost of capital with better risk-sharing solutions. Blended finance instruments that use public capital to unlock private capital can help, often by tackling certain investment risks through guarantees, first-loss structures, currency hedging and technical assistance for project preparation (Exhibit 1).

Recent progress to reform the international finance system is already helping accelerate private capital mobilisation for climate by creating a greater institutional focus. This includes calls for a transformational increase in the amount of public capital committed to climate combined with a push for a more catalytic use of that capital to unlock multiples of additional investment in EMDEs. These reforms are often focused on multilateral development banks (MDBs) like the World Bank. As the main “blenders” of public and private capital, MDBs play a critical role in the international financial system, channelling donor funds into development and providing invaluable knowledge, capacity building and policy support in EMDEs. But they are only part of the solution. Reimagining the way public capital is used (including funds flowing through the MDBs) to unlock private capital for climate requires a broader look at the product offering and following principles for fit-for-purpose climate finance.

On average, MDBs mobilise less than 30 cents of private capital for every public dollar spent on climate (a mobilisation ratio of 0.3 to 1). Analysis of other public finance organisations indicates a similar trend – even the private sector focused development finance institutions (DFIs) often record mobilisation ratios which are less than 1:1.³

Low mobilisation ratios for catalytic capital (including public funds flowing through MDBs) are often linked to the type of financial instrument used. While mobilisation ratios across different pools of public capital are often difficult to measure and compare, risk-sharing mechanisms which can mobilise private capital for climate tend to be under-utilised. Guarantees are one example of a proven catalytic instrument that reduce an investor’s exposure to risks and can unlock private capital in EMDEs for low carbon infrastructure and other climate solutions. Guarantees can mobilise five times more private capital than other instruments like loans, yet they make up only 4% of MDB commitments (compared to ~70% of MDB climate portfolios being loans – a critically important instrument, but one with low mobilisation ratios).

Even with full implementation of suggested MDB reforms, a \$1.5 trillion finance gap may remain.

If reforms over the next five years lead to a tripling in climate finance from MDBs and DFIs, and if mobilisation ratios increase to \$1.50 of private capital for every public dollar on average, we estimate there will still be a climate finance gap of \$1.5 trillion a year in EMDEs. This means that reforms to the MDBs are crucial – but more will be needed to capture the full investment opportunities in EMDEs.

To meet the scale and urgency of the challenge, this paper advocates for a massive increase in the use of catalytic guarantees to mobilise private capital for climate. We propose three recommendations to achieve that goal:

1. **Include a climate mobilisation mandate** for public capital (with appropriate safeguards)
2. **Scale and accelerate access** to guarantees at existing institutions
3. **Develop new global green guarantee platforms** targeting higher mobilisation, lower transaction costs and a structural link to project preparation

This paper lays out recommendations to tackle barriers to access guarantees, explores the benefits of different guarantee structures and offers a set of design principles for better climate finance instruments including streamlining governance, allowing more flexibility in product structuring, better accountability and closer connection to national planning, local investors and pipeline development.



The paper includes a worked example, demonstrating what a fit-for-purpose green guarantee facility could look like. We estimate that a new global green guarantee facility designed using the principles set out in this paper could mobilise at least \$30 billion of private capital for climate in EMDEs with a \$1 billion grant funding commitment. These mechanisms can be applied both within energy as well as natural capital sectors including nature, food and agriculture sectors.

The impact of these recommendations would be significant – not least because they could be implemented relatively quickly. Developing new green guarantee facilities could take longer but can offer a blueprint for what fit-for-purpose climate finance vehicles in EMDEs should look like – helping drive broader reforms to tackle barriers to access de-risking products. This agenda is urgent. The instruments are available. Our priority must be scale and speed.



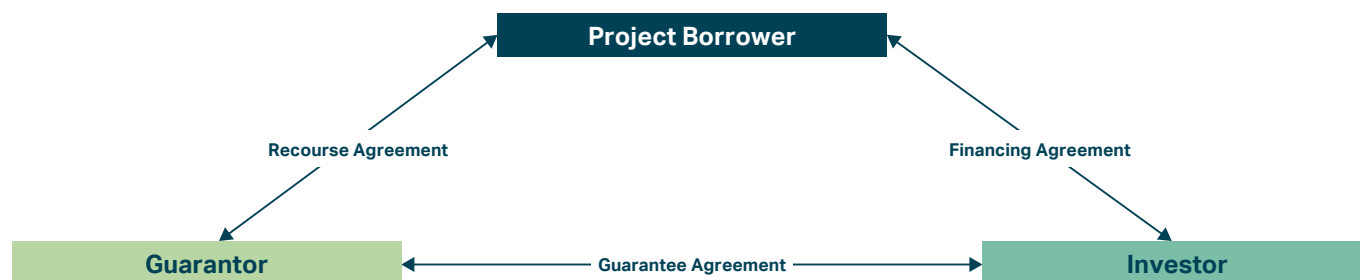
Exhibit 1: Introducing guarantees – A key blended finance instrument

		Risk									
		Macro		Credit/Commercial			Technical		Finance	Infra Specific	
		Political/ country risk	Currency risk	Credit risk	Liquidity risk	Demand risk	Construction risk	Operation risk	Access to capital	Lack of pipeline	Off-take risk
Instrument	1. Guarantees										
	2. Insurance										
	3. Hedging										
	4. Junior/subordinated cap										
	5. Securitisation										
	6. Contractual mechanisms										
	7. Results-based incentives										
	8. Grants										

Blended finance instruments use public (or philanthropic) development capital to unlock private finance for SDG-related investments. They address key risks faced by investors. Guarantees are one type of blended finance instrument which can address a variety of risks, including political/country risks as well as credit/commercial risks.

Guarantees transfer risks faced by investors to a guarantor. In this way they enhance the risk-return ratio of the underlying financial instrument, usually loans and sometimes equity.

Guarantees usually involve three parties in the transaction: the guarantor, the guarantee holder (the investor or creditor) and the client (the investee or debtor). The guarantor enters into the guarantee agreement with the guarantee holder, and into a recourse agreement with the client. In most structures, the guarantee holder pays fees to the guarantor in return for the service – aimed to remunerate the risk taken by the scheme. In case of materialisation of the guaranteed risk (for example, if a borrower cannot repay a loan), the guarantor makes payments to the guarantee holder that the client is unable to make.



Guarantees can vary in many ways, notably the risk they cover and the financing agreement or institution they are applied to.

In the context of development finance, the three types of guarantees most often used are:

- Credit guarantees** protect the lender from losses in the event of non- or late payment of debt obligations. These are often referred to as credit enhancement products. Credit guarantees are the most common type of guarantee and are issued by guarantors like GuarantCo – a PIDG company, the United States Development Finance Corporation (US DFC), as well as export credit agencies and several MDBs
- Risk guarantees** or political risk insurance protect investors against pre-defined political risks such as expropriation, currency inconvertibility, breach of contract, war and civil disturbance. The World Bank's Multilateral Investment Guarantee Agency (MIGA) is a main issuer of political risk guarantees, together with export credit agencies.

- Currency guarantees** protect the lender from losses due to fluctuations in exchange rates. These typically come in the form of 'hedges', which are forward agreements on a certain exchange rate between two parties and (unlike guarantees) tradable products on liquid markets. The need to tackle currency risk and the lack of products in the market led to the launch of The Currency Exchange Fund (TCX) by donors to offer solutions to manage currency risk in developing and frontier markets. Currency risk management mechanisms are becoming a higher priority in the broader development finance system reform agenda as they are key to mobilising international capital. At present, currency hedges for emerging markets and developing economies are often expensive as they incorporate high (perceived) macroeconomic risks³².

Other types of guarantees relevant in the context of scaling investments are liquidity extension guarantees, payment guarantees and performance guarantees – see the glossary for definitions.

01 MOBILISING \$2.4 TRILLION PER YEAR

Emerging Markets and Developing Economies excluding China (EMDEs) require ~\$2.4 trillion a year by 2030 for climate action.¹ Investment opportunities are in low-carbon energy solutions (~\$1.6 trillion), natural capitalⁱ (~\$0.4 trillion), adaptation (~\$0.2 trillion) and loss & damage (~\$0.3 trillion). These investments are critical for economic development, job creation and resilience in EMDEs. Under the right conditions, climate action is the growth and development story of the 21st century. Simultaneously, climate action in EMDEs is essential for meeting global targets on nature and climate. The chances of limiting global warming to 1.5°C are quickly declining with outsized impact on EMDEs. This includes more frequent and devastating fires, flooding, extreme heat and storms, disproportionately impacting the poorest and most marginalised communities.⁴

The lion's share of climate investment in EMDEs provides a clear investment opportunity. The good news is that climate action can be a major driver of growth, unlocking investment and new economic activity. New green economic sectors provide opportunities for economic development that create new jobs. Better food, cleaner air and increased access to energy are among other benefits of the transition.

But private capital is not flowing fast enough, nor at the required scale. Public capital from donor governments directly or via development banks, funds and institutions will be insufficient to close the gap. In 2019, there was around \$450 billion of climate-related investment in EMDEs. Reaching the \$2.4 trillion needed each year will require a fivefold increase from current levels.

This implies a 16% year-on-year growth rate between 2019 and 2030, an uptake compared to the last decade, when global climate finance grew by around 9% per year on average.⁵

Scaling public and philanthropic funding – although crucial – will not be sufficient to meet the finance challenge. The growing investment opportunity would also not be captured in this way. Public and philanthropic capital is scarce and needs to address a multitude of societal challenges. The estimate is that, of the \$2.4 trillion of yearly needs, at least \$1 trillion can come from private sources, both domestic and international.⁵ While momentum is building and private capital is starting to flow, it is not moving fast enough nor at the volumes required.










i Sustainable agriculture, afforestation and conservation, and biodiversity.

To scale private capital for EMDEs, key barriers need to be overcome, including the high cost of capital.

The cost of capital in EMDEs compared to developed economies presents a key barrier for investors to enter these markets – driven by real and perceived risks. This means climate investments that are viable in certain parts of the world (such as renewable power generation) are not viable in EMDEs. Different factors are driving the higher (perceived) risks and consequently, the cost of capital in EMDEs. These include political instability, regulatory and exchange rate risks, lack of familiarity with markets in EMDE and relatively undeveloped domestic financial markets (Exhibit 2).

Another key barrier is a lack of insight in and underdeveloped investable project pipelines. The set of real economy investment opportunities in EMDEs is still poorly understood by the private sector. Underdeveloped policy and regulatory environments for low-carbon investments and the market design of relevant climate sectors result in challenges not only in terms of cost of capital but also for project development. Limited institutional capacity and local supply chains create additional uncertainties around project delivery.

**Exhibit 2:
Key demand and supply-side barriers for climate investments**

Demand-side barriers: underinvestment into project pipeline	Supply-side barriers: high real and perceived risks
 <p>Underdeveloped policy or regulatory environment for low-carbon investments; lack of long-term climate strategy</p>	 <p>Lack of insight on local market conditions and investment opportunity, driven by relatively undeveloped local financial systems and capital markets</p>
 <p>Limited market pressure to drive climate investment, driven by lack of effective carbon / greenhouse gas pricing and limiting existing market design:</p> <ul style="list-style-type: none"> Energy High concentration of state-owned monopolies Agriculture Mostly small businesses with relatively low margins, limited ability to invest, limited incentive to change business models Adaptation Lack of clear business case / market to drive investments 	 <p>Political instability and lack of and/or uncertainty around regulation, creating a weak investment climate</p>
 <p>Insufficient capacity and funding to support the development of investable project pipelines</p>	 <p>Exchange rate risks due to volatile local foreign exchange (FX) and a mismatch between hard currency loans and local currency revenues</p>
 <p>Lack of local supply chains, technical advisory and EPC capacity hampering project development and execution</p>	 <p>Lack of familiarity and data on EMDE markets which can lead to inability to estimate or overestimate risk</p>
	 <p>Lack of appetite from investors to make small, initial investments with high upfront costs, given pipeline uncertainty</p>

Sources – Songwe-Stern-Bhattacharya¹, Energy Transition Commission⁷, The Food and Land Use Coalition⁹, expert interviews with EMDE investors

Current macroeconomic headwinds are further increasing the cost of capital around the world and reducing climate investment in EMDEs. Coming out of Covid-19, many EMDEs are facing fiscal constraints following reduced government revenue due to the freeze in economic activity and higher than budgeted public expenditures.⁹ This has led to significant increases in both public and private debt.¹⁰ The war in Ukraine has further exacerbated the increase in global inflation.¹¹

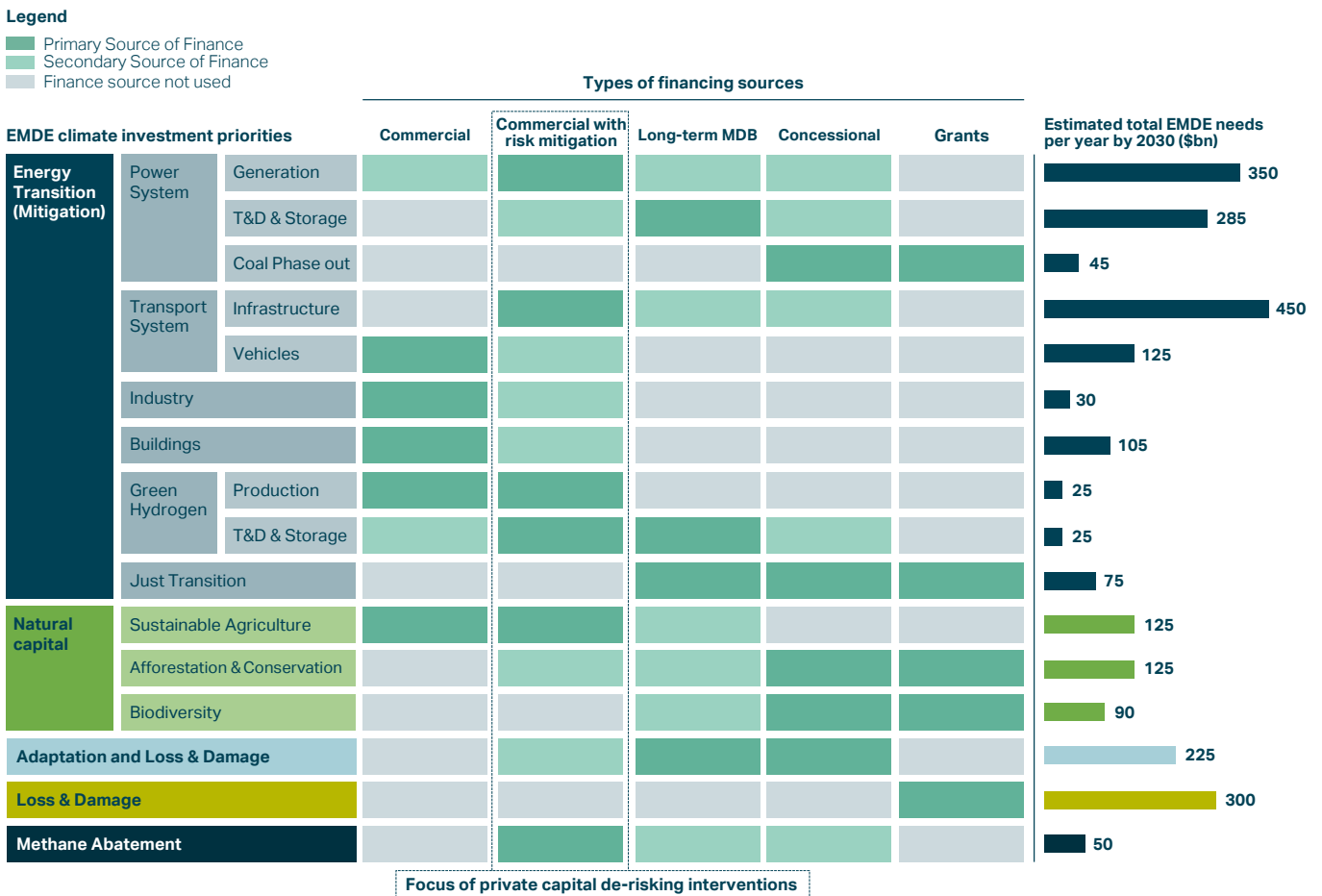
Rising international interest rates to curb inflation and increased geopolitical tensions further increase the costs of capital in many EMDEs. This leads investors to withdraw funds and causes interest repayments to soar, adding further fiscal pressure to EMDEs. In 2022, over \$70 billion flowed out of emerging market stocks and bonds, a magnitude similar to the outflows witnessed in March 2020 at the start of the pandemic.¹²

The consequences for EMDEs include rapidly rising local interest rates and depreciating currencies, adding further to inflation and debt burdens. Between 2020 and 2022, the average inflation rate in EMDEs doubled, to 10% per year. All of these factors add to the difficulties in repaying foreign currency-denominated debt obligations (often in US dollars). This has led credit rating agencies to systemically lower the sovereign credit ratings of EMDEs, which largely determine these countries' cost of debt. Since 2019, ~60% of EMDEs have experienced a rating downgrade.¹

Blended finance instruments can help overcome barriers through efficient risk-sharing mechanisms. Mobilising \$1 trillion of private capital yearly is inherently feasible.

Many investments for climate action in EMDEs are expected to have a viable business case and can therefore attract private capital. This is particularly true for investments in the energy sector and sustainable agriculture (Exhibit 3). Blended finance instruments can be deployed to overcome existing barriers to scaling private capital. These mechanisms facilitate the risk-sharing of supply-side risks, reducing the cost of capital. Examples include guarantees and first-loss tranches. These instruments can also help accelerate the build-out of domestic (financial) markets by overcoming risks of doing first-of-a-kind deals, securing offtake, and closing temporary gaps in business cases.

Exhibit 3: Importance of different types of capital per investment priority



Sources Blended Finance Taskforce, adapted from Songwe-Stern-Bhattacharya¹
 Notes Investment needs estimates exclude China.
¹Just transition programmes' includes targeted training of workers to enable a transition which ensures that no-one is left behind.

02 BETTER FINANCE

We need to reimagine the international finance system – especially the instruments used – to unlock \$2.4 trillion a year of climate capital in EMDEs. The current financial system architecture does not put climate at the heart of capital allocation and existing risk/return dynamics do not reflect the urgency of climate action, especially in EMDEs. A range of recommendations – from the roadmap set out in Songwe-Stern- Bhattacharya’s “Finance for Climate Action” report commissioned by COP27, the World Bank Evolution Roadmap, the Bridgetown Agenda, the Glasgow Financial Alliance for Net Zero (GFANZ), the G20 MDB Capital Adequacy Framework (CAF) and many others (like the Climate Policy Initiative and the Blended Finance Taskforce) – identify the barriers and potential solutions to transition to an international finance system which is fit for the scale and urgency of the challenges faced by an increasingly climate-vulnerable world.

As a large part of climate investments in essence has an underlying business case, setting the right incentives for increasing private capital flows into EMDEs is a crucial element of a fit-for-purpose finance system. This represents an important shift from the way MDBs and DFIs have traditionally operated. Achieving this will require a shift in the mandates and incentives to use public capital to mobilise private finance and following principles for fit-for-purpose climate finance described later in this chapter.

The existing roadmaps identify three main reform levers: increase the flow of public capital, use public capital more catalytically to mobilise private capital, and create and use (new) innovative finance models (Exhibit 4). Enabling levers to achieve these include new operating models, scaling the country-level approach, strengthening public-private cooperation and open-access finance data.

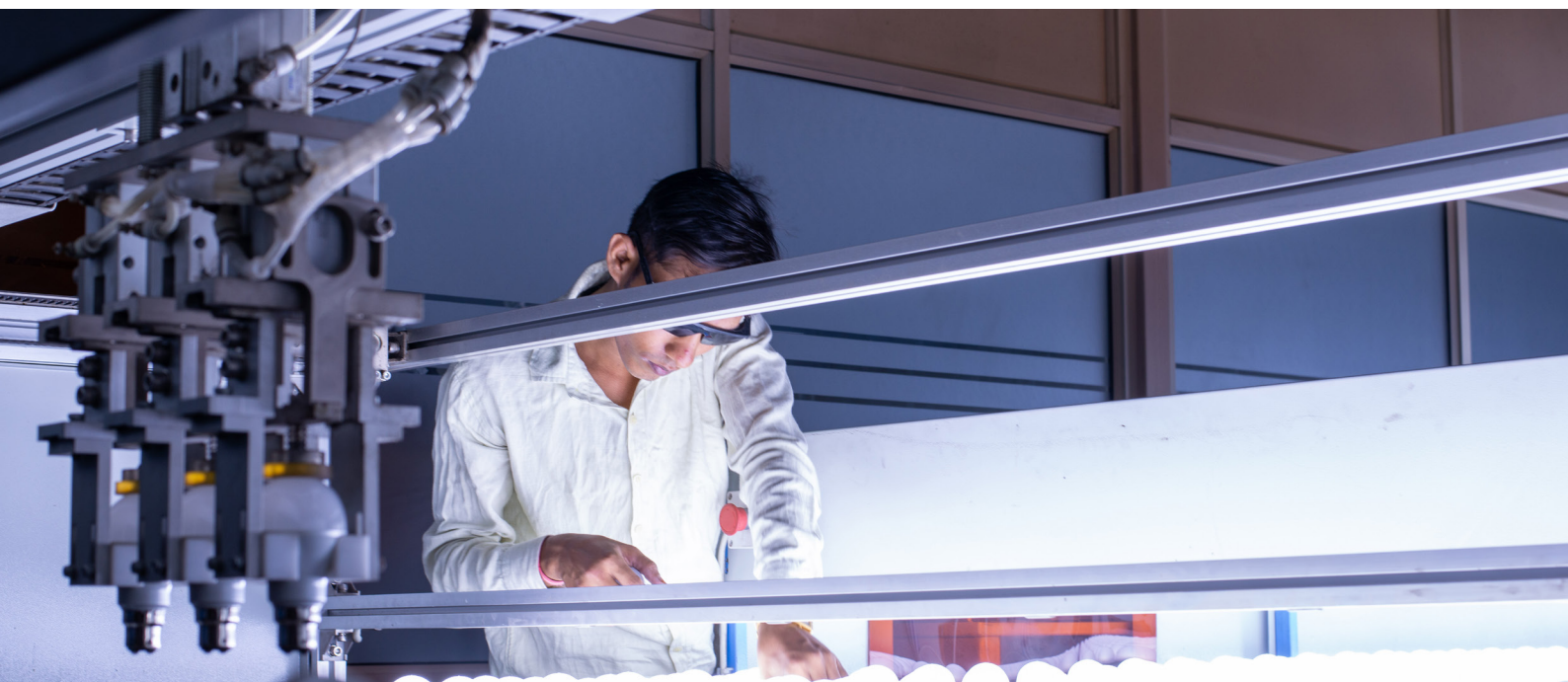


Exhibit 4:

Overview of international climate finance and MDB reform agendas

		1 Finance for Climate Action	2 World Bank Evolution Roadmap	3 Bridgetown Agenda	4 GFANZ actions to mobilise capital in EMDEs	5 G20's Review of MDB CAFs
Main levers						
Increase the flow of public capital	<ul style="list-style-type: none"> Use available capital more effectively & increase funding MDBs to redefine risk tolerance, make more use of callable capital, use SDRs & use financial innovations e.g. private sector risk transfers & guarantees Credit rating agencies to refine assessment 	✓	✓	✓	✓	✓
Use public capital more catalytically to mobilise private capital	<ul style="list-style-type: none"> Increase the use of concessional finance and catalytic instruments such as guarantees to mobilise private capital 	✓	✓	✓	✓	
Create & use innovative finance models	<ul style="list-style-type: none"> Innovation (e.g. disaster clauses) that increases access to existing and new finance sources (e.g. carbon markets for coal off) 	✓	✓	✓		
Enabling levers						
Define a new operating model	<ul style="list-style-type: none"> Set operational incentives & KPIs for private finance mobilisation and climate 	✓				
Scale the country-level approach	<ul style="list-style-type: none"> Move from project to country approach and step up government support on climate strategies & policy advice, Strengthen the investment climate & pipeline development efforts 	✓	✓			
Strengthen public-private collaboration	<ul style="list-style-type: none"> Much stronger collaboration between the private sector and DFIs on pipeline development, including joint project preparation leveraging the on-ground presence of DFIs 	✓	✓		✓	
Drive open access finance data	<ul style="list-style-type: none"> Accelerate economic & sectoral policy analysis, share credit risk methodologies & assessments Improve insight and transparency of investments in EMDEs 	✓	✓		✓	✓
Primary focus of recommendations						
Theme						
Sector						

Sources Songwe-Stern-Bhattacharya¹, Development Committee¹³, World Bank¹⁴, GFANZ¹⁵, G20s Independent Review of MDBs Capital Adequacy Frameworks¹⁶



While there are differences in scope and focus between the reform agendas, the common threads include the need to:

- **Increase the amount of public capital.** MDBs can increase their lending substantially by optimising their balance sheets, even within their current mandates and credit ratings (based on G20's CAF recommendations). They can redefine risk tolerance thresholds, make more use of callable capital and expand the use of financial instruments to increase lending capacity. The approach of credit rating agencies to MDBs needs reform, for example by redefining the status of callable capital. The Bridgetown Agenda calls for reforms to increase the MDB lending room by \$1 trillion over several years. Whether this requires additional changes to mandates and additional capital needs to be clarified. At the 2023 Spring Meetings, the World Bank proposed an increase in financing capacity of up to \$50 billion over the next 10 years.¹³
- **Use public capital more catalytically. MDBs as well as DFIs have the opportunity to mobilise** more private capital.^{3,17} In general, the mobilisation of private capital for every dollar of public capital can be increased, for example through scaling the use of catalytic instruments like guarantees and investing public capital in project preparation facilities. Although most agendas mention the need to use public capital more catalytically, there seems limited substantiation, for example on the required shift to the operating model as described below.

- **Design and scale new financial instruments which build financial stability in climate-vulnerable countries.** New instruments can help to increase resilience by protecting against specific risks and/or creating access to revenue or finance. For example, the Bridgetown Agenda suggests that all financial instruments should include natural disaster clauses that suspend debt service payment in case of crisis to create financial headroom in times where this is most needed.

A change in the operating model is one of the key enabling levers required. The operating model of institutions which deploy public capital needs updating. MDBs and other institutions should integrate climate and private capital mobilisation at the heart of their organisations, through mandates and associated operational incentives. In this way, they can accelerate the development of project pipelines via country and sectoral transition plans, strengthen collaboration with private sector players and drive open-access finance data, specifically the GEMs database (see Glossary for definition).

Principles for fit-for-purpose Climate Finance

The trillions that will be spent on climate action in the next decade represent a unique opportunity – not just for bigger but also for better climate finance flows. The system should build on what is working and be honest about what is not, to help transition to solutions which are demand-driven, equitable and which integrate systemic thinking. Providers of climate finance can work together across the public, private and philanthropic sector to support a more inclusive and accountable climate finance ecosystem.

A shift in the design and operating model of existing and new climate finance facilities is needed to use public capital more optimally. Available public capital will be insufficient to reach a five times scale-up of capital for climate action. Catalytic use of public capital is essential to mobilise private capital and reach the required scale. New facilities present an opportunity to provide a way forward to more catalytic use of public capital and higher mobilisation ratios. However, also existing institutions such as the MDBs and DFIs should aim to adopt principles for fit-for-purpose climate finance to guide changes in their operating models.

Barriers to access climate finance need to be reduced. An efficient, representative and transparent international finance system is critical to ensure inclusivity and avoid unintended consequences. While awareness and leadership around this agenda is growing, reducing barriers to access and inclusivity are not yet at the heart of climate finance decision-making. Often, civil society participation and engagement with community stakeholders is lacking, leading to poor outcomes. Participation can often be treated as a formality, rather than a powerful means to shape fit-for-purpose policies and programmes. Moreover, “consultation” is often considered a sufficient condition for participation, without considering different models to drive real involvement and ownership.

Any new and existing climate finance vehicle should follow principles for fit-for-purpose climate finance to overcome barriers to access. These principles provide a foundation for making design choices and designing shifts in operating models that lead to inclusiveness, representativeness and transparency. Exhibit 5 lays out 6 principles for fit-for-purpose design of climate finance facilities.



Exhibit 5:
Key principles for fit-for-purpose climate finance

01

Transparency

Provide insight into finance sources, outcomes and practices. Clearly specify sources and types of funding. Create transparency on cost, returns, and expected and realised losses in regular reporting processes. Share practices for others to learn.

02

Demand-Driven

Ensure the design and deployment of climate finance instruments and programmes are demand-driven, responding to end-users, domestic markets and political structures. Establish robust and inclusive governance principles that allow for agile capital allocation and respond to community and financial sector demand. Ensure objectivity, efficiency and equality in capital allocation decision-making processes such that products and projects are responding to the needs of those most affected by climate change.

03

Minimum Concessionality

Use catalytic instruments to unlock, not replace commercial solutions. Deploy public capital to mobilise private capital when projects have an underlying business case. Ensure additionality by avoiding crowding out private capital, and limiting moral hazard. Price instruments based on market rates and methodologies where possible, and only deploy subsidies where needed under strict conditions to avoid market distortion.

04

Holistic Product Offering

Take a holistic approach to accelerating climate action, integrating complementary mechanisms where needed. Ensure seamless integration of multiple elements needed to finance projects, such as between project preparation funding, guarantees and private capital providers to improve effectiveness and avoid siloed solutions.

05

Climate Justice

Implement green accountability mechanisms that result in ownership for those affected by climate. Shift the decision-making power to go beyond consultation to create ownership within countries and communities. Ensure inclusiveness through the representation of affected communities in capital allocation decision-making and execution. Include effective feedback loops to adapt to changing needs and/or tackle poor outcomes to avoid unintended consequences across the life cycle of the programme.

06

Build Markets

Accelerate development of local real economy and financial sectors. Use domestic deployment mechanisms where possible. Include explicit focus on building local (financial) markets and capacity through on-the-ground presence and explicit incentives for investors and project developers.



03

BETTER GUARANTEES

Public and philanthropic capital is scarce and needs to address a multitude of societal challenges; ensuring it is used efficiently is key. More capital from private investors is required to meet the scale of climate investments needed in EMDEs. The ongoing reform agenda is critically important to this goal. But it will take time to (re)design the financial system architecture such that it can respond to current challenges and help develop new investment opportunities linked to the new economy. In the meantime, providers of public capital – and their intermediaries – should prioritise the use of catalytic instruments with higher private finance engagement and mobilisation to unlock the urgent climate capital needed in EMDEs in the short term.

Mobilisation ratios can provide a useful measure of the efficient use of public capital, but reporting is limited. Mobilisation ratios are defined as the amount of private finance mobilised for every dollar of public commitment that led to private investment. While they can provide useful insights, reporting on mobilisation ratios for public finance is not always consistent, transparent or easily available. For example, guarantees which are “unmaterialised” (i.e. they have not been called because there was no default) do not give rise to official financial flows, and therefore do not always appear as a commitment in climate finance reporting. For example, the OECD tracks realised claims while MDB reporting tracks exposure in their joint reporting on climate finance. This means care should be taken in comparing data from different sources. Despite imperfect data availability, various reports and deal announcements do report on mobilisation ratios, such as by the Overseas Development Institute (ODI) and US Development Finance Corporation (US DFC).³

Our analysis shows that MDBs and DFIs mobilise less than \$1 of private capital for every dollar of public capital. We provide an additional approach and insight, focusing specifically on mobilisation between instruments for climate investments.

Our analysis is based on the climate finance commitments of six major MDBs (ADB, AfDB, IADB, EIB, EBRD and the World Bank) between 2016-2020, using the MDB joint reports on climate finance and the OECD private capital mobilisation database (see Technical Annex A for more information on methodology).^{18, 19} The analysis shows that the on average \$28 billion of public climate finance deployed by these MDBs each year mobilised only \$9.1 billion in additional capital from private investors.

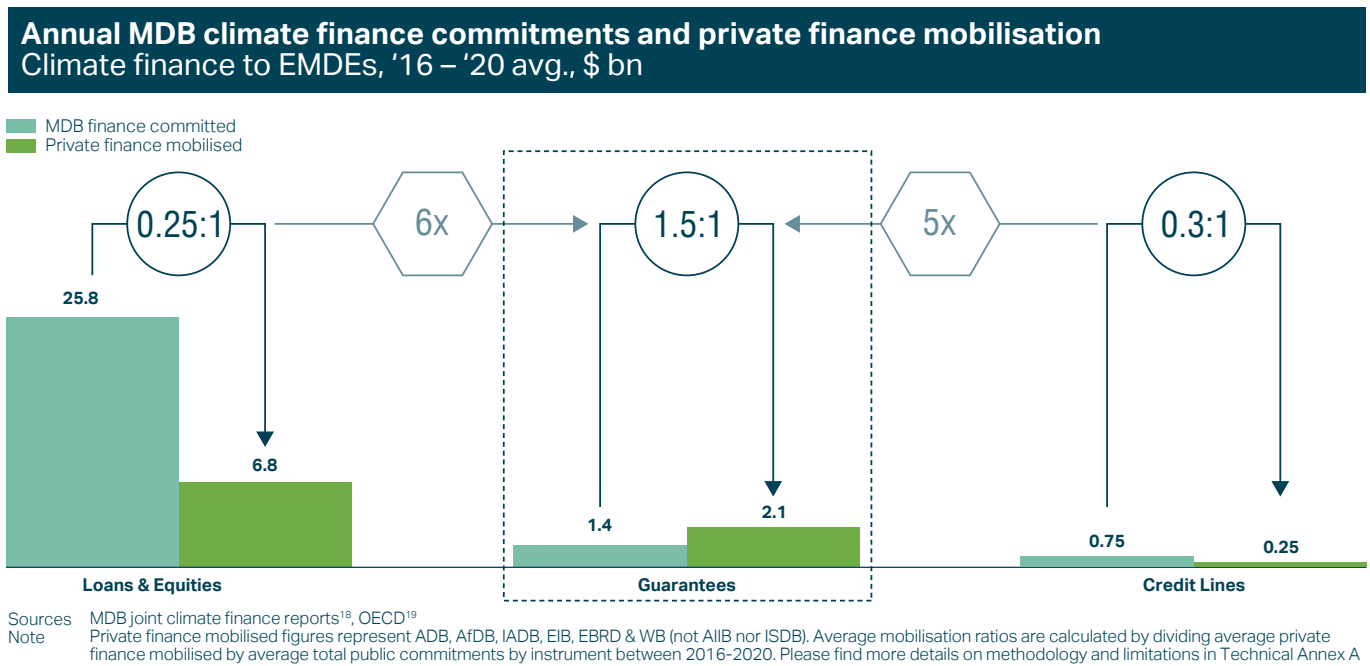
This implies an average mobilisation ratio of 0.3 to 1. As expected, DFIs – which are set up to support private sector development in developing countries – perform a bit better, but still mobilise less than \$1 of private capital for every public climate dollar. Recent analysis from ODI finds that a group of DFIs (Norfund, Proparco and British International Investment) had mobilisation ratios of around 70 cents of private capital to the dollar between 2018 and 2020, although this was across their entire operations – not just climate finance.³

Our analysis illustrates that mobilisation varies by financial instrument, with guarantees outperforming loans and credit lines (Exhibit 6). Our analysis of MDB climate finance mobilisation ratios includes loans and equity, credit lines and guarantees. Although we were unable to split private finance mobilised for loans and equity, loans account for approximately 90% of commitments within this categories. Loans mobilise private capital at only 25 cents per dollar of public capital. While playing a key role in the development finance system, they are the least catalytic instrument in scope. Equity typically plays a more catalytic role. Guarantees show the highest mobilisation ratios, on average mobilising \$1.5 of private capital for every dollar of MDB capital and outperforming the average mobilisation ratio of loans and equities by 6 times. However, guarantees represent just 4% of total commitments in the analysed data. While the mobilisation impact of guarantees is clear, we should be careful in making comparisons between instruments that are quite different in nature.

The instruments inherently differ in how they work and the methodology to measure private finance mobilisation differs between instruments. Technical Annex A provides more explanation of these differences and implications for the analysis.

While mobilisation ratios are a useful measure of efficient use of public capital, they should be considered alongside other conditions to create the correct incentives. Private finance mobilisation is naturally easier in commercially viable sectors and countries in which investors are already interested, given the more limited geopolitical (perceived) risk. In general, “high additionality” investments with high social or environmental returns and/or significant unfamiliarity of risks have lower private finance mobilisation rates.²⁰ This typically applies to countries with less-developed regulatory regimes or in new sectors/asset classes. Measuring mobilisation ratios as a tool to assess public capital deployment should be considered for those sectors in which private investors can and should come in, which holds for the majority of climate investments.

Exhibit 6:
Mobilisation ratios by financial instruments



With the right safeguards, a significant scale-up of guarantees can help mobilise more private capital.

The catalytic potential of guarantees has an inherent logic: guarantees transfer risks faced by investors to a guarantor, which changes the risk-reward profile of investments and reduces the cost of capital. This has two important consequences. First, it lowers financing costs for borrowers, making finance more widely available and affordable. Second, it reduces the risk weight of investments and associated capital that an investor needs to set aside on the balance sheet, creating more financial headroom. This allows financial institutions to do more with the capital they have.

Guarantees help reduce the gap between real and perceived risks and drive (financial) market development.

Perceived risks in EMDEs often seem higher than actual risks, which may discourage investors from investing in EMDEs relative to developed economies. This is despite the analysis by Moody's which shows that actual default rates of project finance loans are similar between EMDEs and developed economies – suggesting that risk premium differential is overstated.²² Guarantees can help address this information asymmetry, reducing uncertainty and enabling more accurate estimations of risks in future projects. To illustrate, expected loss provisions of guarantees are typically higher than actual claims by a factor between 7 and 20.^{21, 23}

Guarantees can help to create local real economy and financial markets.

By enhanced risk sharing, guarantees enable more private investment into markets previously perceived as having unattractive risk-return profiles. This includes sectors like energy, industry, food, agriculture and nature. Guarantees help build a track record and trust among borrowers and financiers, stimulating domestic capital markets. Because of this long-term impact on market development, the need for risk-sharing tools like guarantees should decrease over time. This indirect, catalytic effect is not accounted for in private finance mobilisation tracking but is fundamental to the power of guarantees.

Although guarantees can be highly effective, they are not the solution to every financing problem and should be used with the right governance and diligence. Guarantees cannot resolve underlying real-economy drivers of project costs and revenues to make projects commercially viable. Nor do they fundamentally address weak legal and political environments or internal (human capital) business challenges. Project development and capacity-building funding are therefore needed in combination with guarantees. In addition, purchasing a guarantee comes at a cost to investors, which may reduce their margins relative to other investment opportunities. Finally, guarantees can create moral hazard. For example, when a bank has a loan portfolio guaranteed, it may exert less effort in screening and monitoring borrowers. Chapter 4 discusses safeguards to minimise this.



Scaling Green Guarantees

Guarantees for investments in EMDEs are already offered, but more scale seems needed to mobilise \$2.4 trillion per year. Both private and public institutions issue guarantees.ⁱⁱ Public guarantee providers include export credit agencies (ECAs), multilateral trade insurance providers and development finance institutions. ECAs are the main providers of guarantees, and issued roughly \$53 billion of medium and long-term export credit guarantees/insurance, and another \$34 billion of guarantees and insurance to support cross-border investments in EMDEs in 2022.²⁵ ECA guarantees specifically cover contracts that support respective domestic economy, and do not necessarily have a (sustainable) development focus. Analysis of other key public providers of credit risk guarantees, political risk insurance and currency hedge providers for investments in EMDEs (Exhibit 7) shows that existing facilities do not have the size and scope to address the finance gap for climate action in EMDEs. The analysis focuses on credit, political and currency risks as key risks faced by investors. In total, we estimate that public providers issue more than ~\$100 billion of guarantees and currency hedges for investments in EMDEs per year, with various multilaterals and development institutions issuing roughly ~\$13 billion per year.²⁶ Based on scarce and scattered data available, we estimate that ~30% of the ~\$100 billion has a climate focus.²⁷ This represents only a fraction of the investments that might require de-risking from the overall \$2.4 trillion investment need.

Exhibit 7:

Illustrative landscape of key public guarantee and currency hedge providers to EMDEs

Provider	Annual Commitments	Climate Mandate	Selected risk type covered			Currency Focus
			Political	Credit	Currency	
<i>Non-exhaustive</i>	Insurance Volume (\$mn)	Target % of investments				Foreign, local, both
MIGA	5000	35%		Sovereign		Foreign
TCX	1400					NA
DFC	1300	30%				Both
AFD	800					Both
IFC	720	35%				Both
ADB	500					Foreign
IDB Inter-American Development Bank	400					Foreign
IBRD	400	35%		Sovereign		Foreign
IDA	250	35%		Sovereign		Both
GuarantCo	200					Local
Sida	150					Foreign
European Bank	150					Foreign
Green Guarantee	0	100%				Foreign

Note This analysis excludes EIB, as their activities focus on European countries (~90% of total commitments). This analysis also excludes guarantees issued under the European Fund for Sustainable Development Plus (EFSD+) guarantee program. The analysis focuses on credit, political and currency risks as key risks faced by investors. Guarantees (and hedge products) can also cover other risks than political, credit and currency risks. The Currency Exchange Fund (TCX) offers hedge products rather than guarantees.

Source Annual reports of referenced institutions

ii Our analysis focuses on guarantees provided by public organisations. In 2022, key private players represented by Berne Union (the export credit and insurance industry association) issued ~\$33 bn of guarantees and insurance supporting investments in EMDEs. This coverage is indicative, but not comprehensive.

Practical examples show that there is a need to scale and improve access to guarantees. Guarantees are successfully deployed in practice already. For example, Sunfunder Inc, received a Sida loan portfolio guarantee. Sunfunder Inc is a specialised private finance intermediary that offers loans to solar energy sector companies in Sub-Saharan Africa through different funds. The guarantees allow Sunfunder to expand operations and improve access to finance, especially in riskier markets. Climate Fund Managers (CFM) offers another good example, proving the value of replication to reduce transaction costs of structuring risk-sharing solutions like guarantees get to scale quickly and unlock institutional capital. CFM launched the “Climate Investor One” fund for renewable energy in 2017 and “Climate Investor Two” for water and oceans in 2021. Both are blended funds for Africa, South East Asia and Latin America, with aggregate capital commitments of \$1.8 billion to these two themes. These structures use a mix of public and private-sector funding, commitments from DFIs and an export credit agency guarantee from Atradius (the Dutch ECA) to mobilise institutional capital. The guarantee on the senior equity tranche enabled several pension funds and banks to invest. These initiatives represent private-sector-led solutions which could be replicated to unlock additional large-scale capital for climate-focused investments in EMDEs.

More and urgent intervention is needed to reduce transaction costs and times to access guarantees – ensuring new funds can unlock capital for climate solutions. A good example is the Vumbuzi Multiplier Impact Fund launched by SouthBridge Investments dedicated towards reforestation and land restoration in Africa to restore over 128 million hectares of degraded lands across 34 countries on the continent. It employs an innovative model that leverages grant money from philanthropic sources to free financing on the capital market and blends with debt financing from DFIs and commercial investors. A guarantee instrument would allow commercial investors to invest in the fund, especially covering investment risks on the community and SME part of the portfolio.

Another example is the AFRI Climate & Transition Fund (ACT Fund) launched by ARM-Harith Infrastructure Investments. The ACT Fund will invest into greenfield and brownfield clean energy and integrated climate-beneficial infrastructure thereby expanding the pipeline of investable sustainable infrastructure projects via blended finance mechanisms. By providing technical assistance, deploying equity and subordinated debt with a partial credit guarantee and by arranging the exit of hard-currency equity, the ACT Fund offers a unique product offering across asset classes which helps mobilise pension funds (domestic and international). Accelerating access to these products can have outsized impact to mobilise capital at pace and scale in EMDEs.

Several barriers limit the overall scale-up of guarantees. A key barrier for MDBs, as well as other DFIs, in deploying guarantees is the lack of institutional and financial incentives and the relative instrument complexity of guarantees over loans. This perpetuates a lack of experience and appropriate legal and financial capabilities to structure guarantees, and also limits awareness on the investor side. For investors seeking to access guarantees, the main barriers include insufficient flexible, demand-driven guarantees, a lack of pipeline of commercially viable projects, and lengthy processes with regard to deal approval and claim payments.

Addressing these barriers will be critical to make mechanisms fit for purpose and increase the use of guarantees for private sector actors, both domestic and international. Fit for purpose facilities follow the design principles as outlined in chapter 2. Exhibit 8 presents key potential actions to overcome specific barriers to scaling guarantees at existing and new institutions. For new mechanisms, strong engagement at the design phase with the private sector will ensure new mechanisms are fit-for-purpose and demand-driven. EMDE government leadership is needed to ensure alignment with national planning and more holistic product offerings. Finally, linking project preparation and technical assistance with de-risking solutions like guarantees is essential.

Exhibit 8:

Potential actions to overcome barriers to scale guarantees

I.	Align Incentives	<ul style="list-style-type: none"> • Include private finance mobilisation as one of the targeted outcomes for MDBs and DFIs • Create incentives for donor countries to scale guarantees through giving more credit in ODA
II.	Streamline Processes	<ul style="list-style-type: none"> • Simplify and streamline deal processes
III.	Improve (local) capabilities and data	<ul style="list-style-type: none"> • Prioritise training and recruitment to develop internal (financial and legal) expertise to issue guarantees • Include local footprint or project origination requirements for (foreign) investors
IV.	Offer market-driven and efficient guarantees	<ul style="list-style-type: none"> • Allow for the flexibility to offer and structure different products
V.	Connect to National Planning	<ul style="list-style-type: none"> • Link risk-sharing instruments to long-term national and sectoral planning with clarity on where guarantees are needed
VI.	Connect to Pipeline Funding	<ul style="list-style-type: none"> • Create structural link between guarantee and project preparation facilities • Scale grants for project preparation

- I. Align incentives.** The governance at MDBs and DFIs and the broader financial architecture in which they operate provide limited incentives to deploy guarantees. The incentives steer towards using loans instead. Internal accounting rules require MDBs to hold the same provisions for guarantees as they would for loans. This is driven by their preferred creditor status and credit rating agency methodologies, even though guarantees are rarely called in practice. In addition, loans are often more profitable, as interest margins in loans tend to be naturally higher than fee premia for guarantees covering a loan. Including private capital mobilisation as one of the targeted outcomes for MDBs and DFIs (with appropriate safeguards and enabling measures) would transform incentives and human capital required to interface with the private sector. In addition, guarantees do not count as Official Development Assistance (ODA) for donor countries, except when called.ⁱⁱ The OECD Development Assistance Committee private sector instruments group (DAC PSI) is currently negotiating to adjust the ODA-eligibility, which could create more incentives.
- II. Streamline processes.** Transaction timelines of guarantees can be long. In addition, claims pay-out procedures are often perceived as burdensome and lengthy, reducing the power of guarantees and discouraging investors. Simplifying governance and clarifying processes with investors can accelerate deal processes, for example, by pre-qualifying investors (with set eligibility criteria), and working with framework agreements can increase scale and speed.
- III. Improve capabilities and data.** There is limited expertise to provide guarantees at development (finance) institutions, driven by a lack of incentives and product complexity. There is also limited data on the performance, magnitude and scope of guarantees in EMDEs. Institutions should prioritise hiring and training people with private sector experience with (credit) risk assessment and financial and legal structuring, ideally staffed at local offices/hubs. To improve local capabilities on the investor side, stimulate pipeline development, and foster the long-term market-creating effect of guarantees, mechanisms can include local footprint or project origination requirements for (foreign) investors. Finally, all providers should more extensively track and share more data on the performance of guarantees to improve capabilities.
- IV. Offer market-driven and efficient guarantees.** Currently, the strict mandate and governance of existing guarantee providers (and MDBs specifically) hamper flexibility and innovation. Guarantee providers could be more demand-driven. This refers to the ability to offer and structure products to best meet the needs of private investors, depending on the segment addressed and market creation opportunities targeted. More efficient guarantees are needed to make sure only residual risks which the private sector cannot bear are covered, reducing moral hazard. This requires a mandate and governance that allows for flexibility in product offering. It also incentivises guarantee originators to be actively involved in finding and developing deals.

ii Note that some issuers of development guarantees argue that the current practice of not counting guarantee exposure as ODA is sensible, as guarantees should be cash flow neutral by design and including the full exposure as ODA might reduce donor's grant-based ODA contribution.

- V. Connect to national planning. Clearly linking guarantee mechanisms to long-term national and sectoral planning targets will align financing solutions to country development priorities. This will reduce transition risk and therefore give confidence to project developers and investors. MDBs and DFIs could further support EMDEs to formulate effective development and climate strategies, increase institutional capacity and define sector investment plans (e.g. Nationally Determined Contributions Comprehensive Development Plans and Integrated Resource Plans) with clarity on where guarantees and other risk-sharing instruments would be needed.
- VI. Connect to pipeline funding. As a standalone instrument, guarantees do not directly tackle demand-side barriers that limit pipeline development. More guarantee capacity for climate projects in EMDEs will therefore not help if the pipeline of projects is insufficient. Real and perceived risks create barriers to entry and limit the presence of international private investors in EMDEs. This lack of presence in turn leads to higher transaction costs to develop projects, creating a vicious cycle. Effectively scaling guarantees will require more and better accessible project preparation funding, with appropriate safeguards to avoid compromising impact and quality.

Exhibit 9:

Case study – Private Infrastructure Development Group Technical Assistance (PIDG TA)



Private Infrastructure
Development Group
Pioneering infrastructure changing lives

The PIDG is an established blended finance vehicle, offering various financing solutions for private investors under one roof. PIDG works across the project lifecycle, developing innovative solutions with public and private partners to de-risk projects, promote sustainable development and combat poverty. PIDG is an early-stage project developer to generate bankable deals and mobilises private capital at scale. USD1.9bn ODA invested in PIDG has resulted in access to sustainable infrastructure for c.225m people and mobilised USD25bn from the private sector and \$40bn overall through c.\$5bn investments commitments. Over 50% of the 211 projects have been in Least developed Countries and over 50% in fragile and conflict affected states.

PIDG TA can finance upstream work as part of public private partnership or support other PIDG facilities at each investment stage. PIDG's development arm – InfraCo – can share the risks of project development at early stage and equity investment in infrastructure projects and companies. This complements PIDG's credit solutions: GuarantCo – PIDG's guarantee arm, and EAIF – a blended finance attracting commercial banks and insurers and offering long term debt. The group is also involved in setting up local credit enhancement facilities to unlock domestic capital at scale, having being instrumental in the set-up of InfraCredit Nigeria and InfraZamin Pakistan and more recently a similar facility in East Africa.

A key success factor is that PIDG is one specialised group with multiple solutions, offering significant synergies to unblock infrastructure financing, with several cases of projects, companies and sectors that received investments from various PIDG facilities at different stages. As such PIDG is an established example of how a project development facility and a specialised local currency guarantee arm under one roof can unlock significant level of private capital through strategic origination.

Source PIDG³⁰

04 CALL TO ACTION

A more catalytic use of public capital is urgently needed to unlock \$2.4 trillion for climate investment in EMDEs.

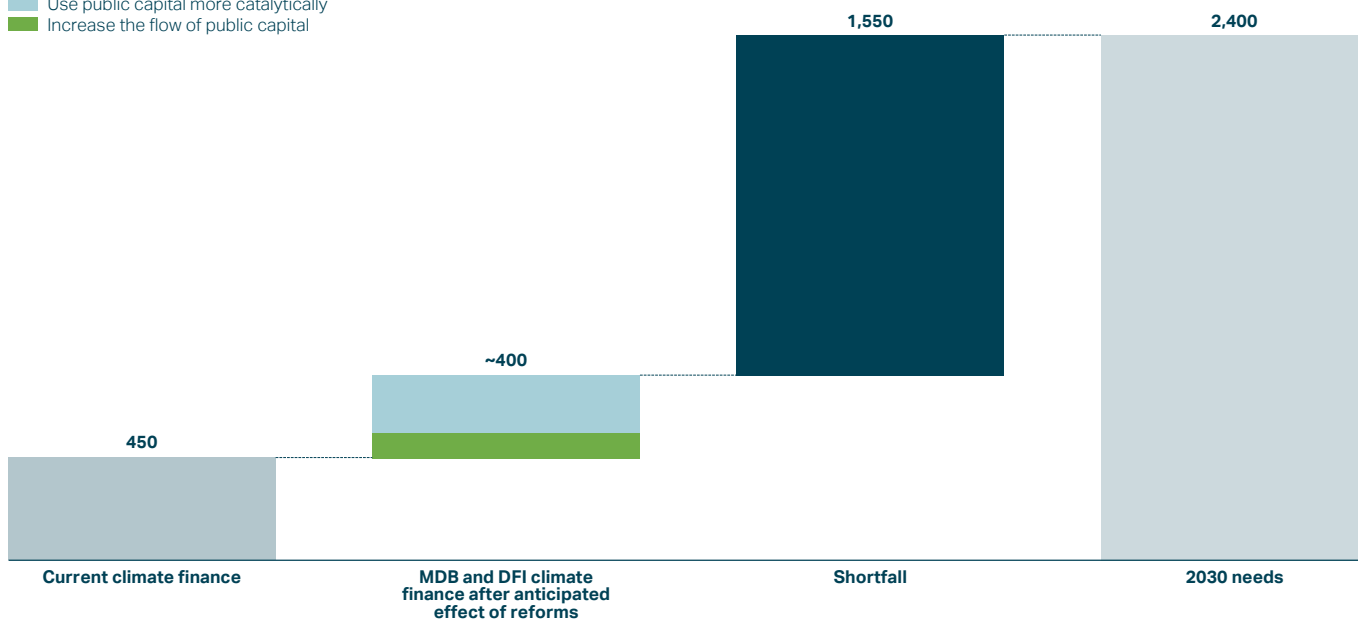
There are real economy commercial opportunities in the majority of climate investments needed in EMDEs, for example in renewable energy (infrastructure), transport, forests and sustainable agriculture. Investments in these sectors increasingly have solid business cases with attractive economic returns – at times higher than in developed markets. However, private capital is not flowing fast enough, nor at the required scale. Reforming the financial system architecture is critical to put climate at the heart of capital allocation mandates and integrate mobilisation into the MDB and DFI operating models. The currently proposed reforms alone are unlikely to meet the annual levels of capital required. Even if climate finance from MDBs and DFIs were to triple in the next five years (from \$60 to \$180 billion per year),¹ and average mobilisation of private capital increased from 30 cents for many institutions to \$1.5 of private capital for every public dollar on average, we estimate that there would still be a ~\$1.5 trillion annual funding gap for climate action in EMDEs.

Exhibit 10: Illustrative climate finance projections and shortfall

Climate finance flows in EMDEs following anticipated reform agenda

\$ bn

- Use public capital more catalytically
- Increase the flow of public capital



Sources Songwe-Stern-Bhattacharya¹
 Note Scope: EMDEs excluding China. Method: For this worked example, additional financing from and mobilised by MDB and DFIs is assumed to be ~\$400 billion. This consists of (i) \$120 billion of additional public capital and (ii) \$260 billion of private finance mobilised from current and additional public capital deployed assuming a mobilisation ratio of 1:1.5.



Guarantee mechanisms can be instrumental in mobilising private capital for climate action in EMDEs – both to achieve intended reforms and to further bridge the finance gap. More catalytic use of public capital will be needed to achieve intended reforms and to further bridge the remaining gap. Given their highly catalytic nature, guarantees can play an important role. We recommend three ways of scaling the use of guarantees that can be pursued in parallel.

01

Include mobilisation mandates for climate for public capital

Accelerate reforms to include a climate mobilisation mandate for public capital (with appropriate safeguards). Donor countries should work to include mobilisation targets for climate in the mandates and operational incentives of MDBs and other agencies and institutions that manage and deploy public capital, including bilateral DFIs. EMDE governments should advocate for these mandates and be part of their design as a critical way to unlock private capital in EMDEs. International and domestic investors and project developers should advocate for the same.

02

Scale and streamline access to guarantees at existing institutions

Institutions which already offer guarantees can have an outsized impact by accelerating access to these products. This means streamlining application processes, ensuring the right institutional and regulatory incentives to offer guarantees, building technical expertise and capabilities, optimising guarantee products for greater efficiency and building links with national planning. Creating more holistic product offerings, including links between project preparation and guarantee solutions will be an essential part of this.

03

Develop new global green guarantee platforms

Develop new global green guarantee facilities which target capital mobilisation for climate, have low transaction costs and include a structural link to pipeline development. New facilities can offer additional scale and fit-for-purpose design and can offer a blueprint for better risk-sharing products to accelerate market and system reform.

RECOMMENDATION 1

Include a climate mobilisation mandate for public capital

Embedding private finance mobilisation for climate investments in the mandate, associated operational targets and the culture of MDBs and DFIs – with the appropriate safeguards – helps to mobilise more private capital. MDBs and DFIs are central in the international finance system. MDBs jointly have ~\$1.8 trillion of outstanding commitments. Including mobilisation as one of the target outcomes of public capital would transform the use of instruments and stimulate the use of guarantees. It would create incentives to also bring in the talent required to interface with the private sector.

Currently, only a few MDBs and bilateral DFIs have private finance mobilisation as part of their mandate. Within the group of MDBs, only the International Finance Corporation (IFC) has a mission statement that includes “encouraging the growth of private enterprise in developing countries”, by “mobilising other investors”. For bilateral DFIs, it is more common to have an explicit focus on mobilisation in their mission statement. For example, Proparco and US DFC have this explicit focus. Both these institutions perform relatively well in terms of private finance mobilisation.³ To our knowledge, no MDB or bilateral DFI has explicit (institutional) targets or operational incentives to mobilise private finance.

The current reform agenda does not yet specify fundamental changes in MDB operating models, which is required to drive change. To use public money more catalytically, EMDEs and donor countries should drive further reform of the MDB operating model and implement changes in their respective bilateral DFIs. We identify eight key topics for consideration when including a mobilisation mandate for climate for public capital:

- 01 Include mobilisation in mandates.** Embed private finance mobilisation for climate investments in the mandate and/or mission of MDBs and DFIs.
- 02 Implement appropriate safeguards.** Increased use of catalytic instruments cannot be at the expense of reducing concessional finance for the most vulnerable countries and especially in cases where private sector mobilisation is not possible or desirable. It is key that targets and performance indicators are set only for commercially viable investments that require de-risking, and that development objectives remain central.

- 03 Set targets for mobilisation and climate investments.** These can be set for the next three, five and ten years, increasing in ambition. Setting these targets should follow comprehensive analysis around:
 - a. The design of a targeting framework that recognises differences in mobilisation potential and desired outcomes across countries and project types. Segmentation of applicable sectors and regions is key.
 - b. Financial additionality, as higher mobilisation targets might push investment into safer territory and might have perverse incentives to take risks that private investors can bear themselves. This needs to be avoided through appropriate measures in governance and product specifications.
 - c. Risk implications, revenue impact and balance-sheet capital requirements.

- 04 Adjust performance indicators.** Integrate mobilisation indicators in scorecards and considerations of career advancement of individual officers. This is needed to align incentive systems, and thereby operational outcomes, with mobilisation objectives. As with targets, additionality metrics should be considered alongside mobilisation indicators to help ensure development additionality.

05 Consider the impact on return expectations. Increasing the use of catalytic instruments such as guarantees might be less lucrative for MDBs and DFIs relative to issuing loans. Such impact needs to be evaluated and the impact on Return on Equity (ROE) needs to be taken into account. If lower ROE is expected, shareholder expectations need to be aligned such that MDBs and DFIs can scale up the mobilisation of private finance.

06 Invest in human capital. Acquire the talent needed for mobilisation activities and change the institutional culture to focus more on private sector mobilisation. For example, develop skills to deploy guarantees, hire relevant legal and financial expertise, and strengthen collaboration with the private sector.

07 Follow a holistic approach. Situate mobilisation efforts in an integrated approach that includes policy support and capacity development, alongside financing.

08 Increase and improve reporting. For example, following the OECD DAC rules for private finance mobilisation.



RECOMMENDATION 2

Scale and accelerate access to guarantees at existing institutions

Proven mechanisms should be scaled with additional capital. The primary rationale for scaling mechanisms at existing institutions is to build on the experience gained and to use available human capital and institutional structures. This should result in faster deployment of funds compared to building new facilities from scratch. The impact of scaling existing mechanisms is conditional on whether respective institutions implement actions to make guarantees more attractive and accessible. For example, by streamlining governance, allowing more flexibility in product structuring, and being more closely connected to pipeline development (see also chapter 3).

Existing guarantee facilities with a mandate for climate investments in EMDEs can be scaled with additional capital. Examples include MIGA, GuarantCo – a PIDG company, The Currency Exchange Fund (TCX) and the Green Guarantee Company. Scaling could happen through a simple, unconditional capital infusion in the form of increased share capital or grants. Additional capital creates the capacity to issue more guarantees within the current organisation and/or allow these institutions to invest in (local) human capacity or in new products for new market segments. Analysis of growth paths of existing funds and expert interviews suggest that a billion-dollar scale of annual guarantee deployment can be achieved within one to three years. Any such capital increase should consider the principles for fit-for-purpose climate finance (chapter 2), especially creating structural links to mechanisms that scale the pipeline of available investable projects.

When providing capital to institutions with a broader mandate, the capital could be earmarked for guarantees for climate investments in EMDEs.

The key benefit of scaling a guarantee facility at existing institutions is that it can deliver targeted instruments using existing institutions' capabilities and expertise to deliver capacity at speed. Examples are export credit agencies, bilateral DFIs and MDBs. For several of these organisations, developing and increasing the use of fit-for-purpose guarantee instruments would require a change of mandate to be more focused on climate, incentives to be geared to mobilisation, and geographic focus to be targeted to EMDEs. Additionally, MDBs and DFIs may have to build out their technical and legal capabilities. As is well documented, the main product they currently provide is loans, so they typically have limited experience with guarantees. Building up expertise will take time and could be linked to broader reforms around mobilisation and improved interface with the private sector.

Improving access to guarantees could help to further increase the potential for scaling existing guarantee mechanisms. The potential for scaling existing guarantee products is limited by the absorption capacity of issuing entities. Few existing facilities have the ability to absorb multi-billion-dollar capital increases in their current form. For example, an illustrative \$1 billion of additional capital for GuarantCo would represent a 3.5x increase in size.²⁸ Existing providers can also take action to increase the deployment of guarantees with the capital they have by addressing barriers discussed in chapter 3. Providers can streamline processes for deal approval and claim payments. They can become more market-driven by allowing for flexibility and innovation in product offering and structuring, getting rid of rigid governance structures and strict mandates. Creating incentives and a culture for practitioners to be more entrepreneurial and actively source and help build deals could increase overall guarantee deal volumes.

Initial progress to scaling existing mechanisms is already being made by new programmes like the EFSD+.

The European Fund for Sustainable Development Plus (EFSD+) guarantee programme is set to increase the guarantee issuance by European financial institutions towards investments in EMDEs.

The EFSD+ guarantee programme has a capacity of \$40 billion to be deployed between 2022 and 2027 towards SDG-related investments. It will use the global arm of the European Investment Bank and various other European development finance institutions as implementation partners. Under this programme, the EU has already approved over \$6 billion of credit guarantees for 40 investment programmes in Sub-Saharan Africa, Latin America and Asia Pacific. The scope includes but is not limited to climate, and guarantees will likely be applied on a portfolio or facility level than on a project level. Two examples of approved guarantees are:

1. **GreenCo Africa.** The guarantee supports the expansion of the power offtake activities within Southern Africa
2. **The EBRD-ILX partnership.** The EU guarantee will enable ILX to co-invest with EBRD with the same risk-return profile in investments in EMDEs on green, digital projects and financial inclusion.



RECOMMENDATION 3

Develop new global green guarantee facilities with structural link to project preparation

New green guarantee facilities are needed to achieve the required scale of capital for climate action. A key advantage of new facilities is that they can be structured to serve as models of fit-for-purpose climate finance. Such facilities may provide an example of a broader change in the international finance system. If correctly designed, new facilities may represent an efficient and catalytic use of public capital and accelerate the mobilisation of capital for climate action.

New green guarantee facilities can be instrumental in reaching the required scale of capital for climate action in EMDEs. Analysis of the key guarantee and currency hedge providers for investments in EMDEs (chapter 3 - exhibit 7) shows that existing facilities lack the size and scope to support the full capital requirements for climate action in EMDEs. The overall annual volume of guarantees issued by public providers in support of investment in EMDEs is estimated at roughly \$100 billion per year.²⁶ A significant scale-up is likely required to support the required increase in capital mobilisation from private investors. A guarantee facility with an explicit climate focus addresses an additional gap, as current providers do not have a specific climate focus and expertise.

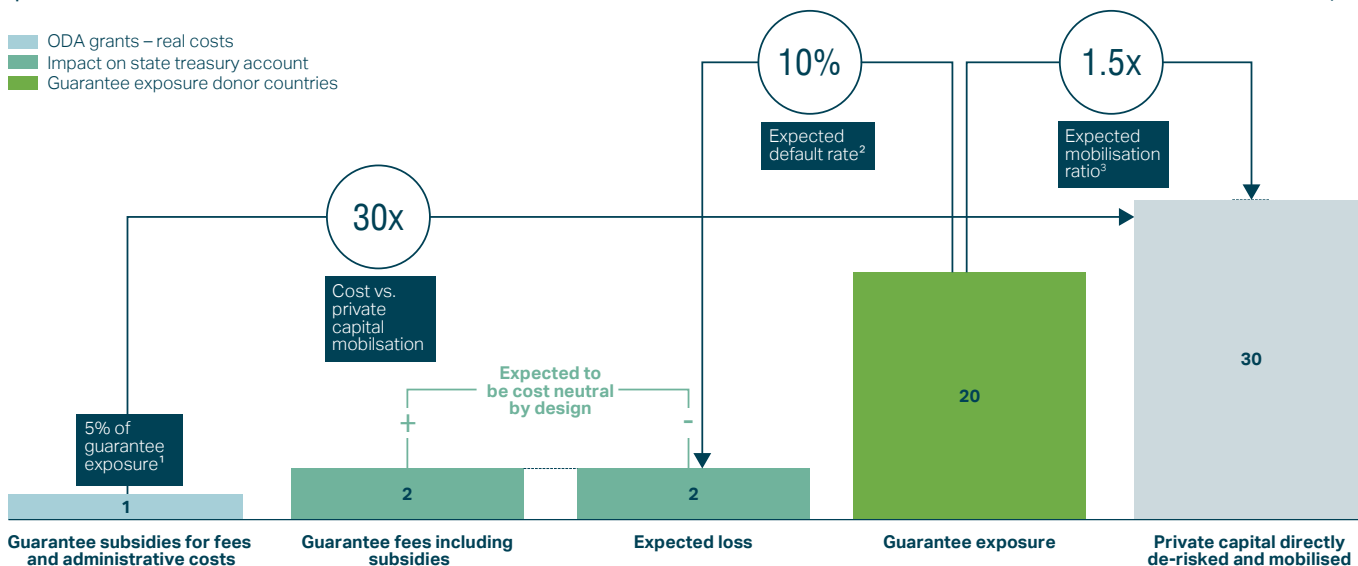
The design of new green guarantee facilities can provide leading examples of fit-for-purpose climate finance vehicles in EMDEs – inspiring broader international finance system change. There are several existing barriers to access and to seize the maximum potential impact of existing guarantee facilities. These include lengthy and complicated processes with regard to deal approval and claim payments, insufficient demand-driven guarantees that meet the needs of EMDE countries and investors, and an underdeveloped pipeline of commercially viable projects. A new facility can help overcome these barriers by streamlining governance, allowing more flexibility in product structuring, and being closely connected to national planning, local investors and pipeline development.

A new green guarantee facility could mobilise \$30 billion of private capital with \$1 billion of grant capital.

To validate the potential impact of a new facility, we worked through an example of a facility offering unfunded government-backed guarantees (see Exhibit 11). The next sections of this chapter contain more detail about design principles and choices, such as funded and unfunded mechanisms. The example shows that \$1 billion of grant funding for guarantee fee subsidies and the platform operational expenditures could enable \$20 billion of guarantee commitments. The \$20 billion could mobilise at least \$30 billion of private capital (depending on the coverage rate, hence the mobilisation ratio of guarantees). The commitments result in financial exposure for the countries backing the facility. However, this does not result in a financial (out)flow unless guarantees are called. Following an assumed expected default rate of 10%, the \$20 billion commitment would entail ~\$2 billion of expected losses which would be a liability on the state treasury account. By design, the expected losses are covered by the guarantee fees. This means the overall cash flow of the facility is expected to be neutral, except for the \$1 billion for subsidies and administrative costs. As a final note, this example only covers direct mobilisation. It does not cover indirect and permanent effects on future other capital transactions of similar nature – a key rationale to deploy guarantees.

Exhibit 11:

Worked example of an unfunded state guarantee mechanism: \$30 billion in private capital could be mobilised with \$1 billion of grant funding



Sources: Sida²³, CPI³⁰
 Note: Guarantee subsidies can be used for premiums as well as to cover part of the operational costs. If subsidies are not provided for operational costs, guarantee fees cover expected losses + operational costs
 1: A 5% ratio of fee and/or operational cost subsidies to guarantee exposure is assumed, based on 10 years of Sida guarantees, Sida²⁴
 2: Based on 11% weighted average default rate of solar projects across 40 EMDE markets, based on Climate Policy Initiative analysis³¹
 3: Based on the BFT guarantees mobilisation analysis of MDB climate finance 2016-2020

The example in Exhibit 11 reflects the potential impact of unfunded guarantees, which means no capital provisions are held for possible claim payments.

An alternative to unfunded guarantees are partially funded guarantees. In such a mechanism, some level of capital is reserved against the risk exposure on the guarantor’s balance sheet. If the above example would apply to a capitalised fund offering partially funded guarantees, the facility would likely need at least \$2 billion of paid-in capital to provision for expected losses based on a \$20 billion guarantee exposure. Under this variation to the above example, the facility would then “leverage” (the extent to which the guarantor can issue guarantees greater than its capital reserves) by ten times.

A key challenge for any new finance facility is accelerating time to scale. As with all new facilities, it takes time to establish a new facility and to reach scale. For example, it took nearly two years to set up the Green Guarantee Company and it took GuarantCo, a PIDG company, 10 years to reach a guarantee portfolio of \$1 billion. The time to scale can be accelerated by strong political and institutional focus as well as by gathering best practices from existing mechanisms. Human capital is another key constraint, but one that can be mitigated – by outsourcing some functions temporarily, or permanently, or co-guaranteeing with existing institutions like the Guarantee Facility of IFU (Denmark’s DFI) is currently piloting with Sida.

Exhibit 12:

Case Example - Development agency Sida offers unfunded guarantees backed by the Swedish state



The performance of the Sida guarantee instrument shows that the public cost of mobilising significant amounts of additional capital could be even lower than in our worked example. Sida has managed to mobilise ~\$2.7 billion in private and public capital at a cost of ~\$50 million over ~10 years in the form of grants for fee subsidies and part of the administrative costs. This implies a public cost to private capital mobilised rate of 55x. The expected losses are covered by fee premiums, including fee subsidies, which are deposited into the state guarantee service account. Historically, real losses have been lower than expected losses. This implies the real costs to the Swedish state are limited to the ODA grants, less the difference between expected losses and real losses received in the form of fee premiums. In practice public capital thus was effectively utilised to mobilise at a rate higher than 1:55.

Source Sida²⁹



Design choices for a new green guarantee facility

The principles for fit-for-purpose climate finance (described in chapter 2) need to be translated into design choices for new green guarantee facilities.

There is not one version of a fit-for-purpose new green guarantee facility. The most suitable design will depend on the desired focus of the facility, and preferences in deciding between design trade-offs and donor requirements. Exhibit 13 provides an overview of key design features and considerations for policymakers and practitioners (Technical Annex B contains a longer list of design features, descriptions, considerations and possible options).

The mandate of the new green guarantee facility should allow for flexibility of focus over time to ensure it is responding to the needs of EMDEs and investors.

Design choices can either be stipulated in the facility's mandate or left for the facility to work out in its strategy within certain guardrails. Some choices, like the capital structure and rules for decision-making, will need to be clearly defined upfront. Others, like the choice of specific products offered, risk coverage and level of pricing, can be further detailed in the fund strategy or at a project level. A mandate that allows the facility to adapt its strategy allows it to be more agile, adapting to changes in the market.



Exhibit 13:
Key design features and considerations for a new facility

Design Choices	Considerations
I. Strategic Link to Pipeline Development	The project pipeline of bankable projects can be enhanced by an integrated project preparation facility, providing support and resources for project preparation and development. A structural link to project preparation facilities ensures sufficient and impactful bankable projects but necessitates additional funding.
II. Facility Set-up	Facilities can be set up and run by one country, or by multiple countries. Single-country setups offer simplicity in governance and decision-making, particularly for facilities offering unfunded guarantees. Multilateral facilities enables great catalytic potential and collaboration among diverse experts.
III. Governance	Governance can be independent from public control or involve more political processes. Independent governance results in more inclusive, transparent and efficient decision-making, fostering innovation, entrepreneurship and market responsiveness. Some public control, with strong political connections, can enhance successful implementation and coordination with receiving countries.
IV. Capital Structure	The capitalisation choice affects size, credit rating and governance. An unfunded facility leverages size and credit rating on national account backing but entails political involvement and challenges for deal approval and claim payment in multilateral setups. A funded facility with provisions for losses on its own balance sheet offers independent and flexible governance but may be less effective in leveraging public capital.
V. Strategic Focus	The level of focus on a geography, income group, real economy sector or risk impacts flexibility, capacity and expertise. Narrow focus allows the building of expertise and capacity whereas a broader focus provides more flexibility to cater to the project or investors needs but requires various capabilities for the guarantee facility and may affect risk management performance. <i>Guarantee types:</i> Guarantees applied to different products have varying transaction costs, sizes, target investor types and added value. Project-level guarantees create markets but have higher costs and smaller scale. Bond-level guarantees enable greater scale. Portfolio, balance sheet, and fund guarantees provide financial headroom but may not always attract new capital to greenfield investment. <i>Currency:</i> The choice between offering local currency guarantees and foreign currency guarantees depends on the borrower's specific needs and objectives. Local currency guarantees are most appropriate for a borrower that receives revenues in local currency and attracts local investors. They help to create local capital markets and prevent further increase in international debt burdens on EMDEs. Foreign currency guarantees work best for a borrower that wants to access international capital markets and is willing to borne the exchange rate risk.
VI. Coverage Level	The coverage amount of a guarantee determines risk levels and the suitability for different investors and projects. Partial credit guarantees, typically ranging from 50% to 70% coverage, offer advantages like mitigating moral hazard, reducing lender fees, and higher mobilisation ratios. Conversely, full or high coverage can attract additional investment segments, such as institutional investors interested in local currency.
VII. Pricing	The pricing of guarantees impacts investor types, guarantee additionality, and how guarantees are managed. Market-based pricing ensures risk-adjusted returns for investors are not considered as subsidies, and incentivise investors to carry risks they can bear themselves. This reduces moral hazard and safeguards financial additionality. Fee subsidies can complement market-based pricing to enhance guarantee access, but require rigorous due diligence and applicability criteria to avoid unjustified concessionality.

Upfront design choices to establish a new green guarantee facility include a strategic link to pipeline development, facility set-up, governance, and capital structure. Creating a fit-for-purpose global guarantee facility requires those design choices to be made in line with the principles outlined in chapter 2. Given the core objective is to mobilise more private capital, strong collaboration with the private sector in the design phase is highly recommended. Below we outline some of these upfront design choices.

I. Strategic link to pipeline development

The new global guarantee facility should be explicitly connected to project preparation facilities. For guarantee facilities to have maximum impact, there needs to be a strategic link to the project pipeline. Guarantees can support pipeline development by driving local presence, but as a standalone instrument do not directly address key demand-side barriers.

New guarantee facilities should therefore have a structural link with project development facilities, for example through shared project pipeline databases and frequent interaction. Current facilities might require additional funding to scale. Therefore, public capital commitments for the new guarantee facility should also include commitments earmarked to project pipeline facilities.

II. Facility set-up

A bilateral set-up provides simplicity in decision-making whereas a multilateral facility increases potential facility size. A key consideration for the capital structure of a new guarantee facility would be whether it is set up and run by one country, or by multiple countries. While bilateral facilities may be simpler to set up and be able to maximise the catalytic potential of unfunded guarantees, multilateral structures may enable a larger scale of the guarantee facility and can combine a broader range of expertise from the facility's different participants.

III. Governance

Ensuring inclusive, transparent and efficient decision-making while allowing the facility to operate in an agile, market-driven way.

Decision-making rules that ensure objectivity and independence from political processes are typically considered to result in more inclusive, transparent and efficient decisions. A more independent facility is better suited to stimulate innovation, entrepreneurship and responsiveness to market needs. This needs to be combined with transparent goal-setting and reporting on outcomes to ensure accountability for decisions made. The governance of any new guarantee mechanism should aim to reduce barriers to access by reducing transaction costs and streamlining processes without compromising on due diligence.

IV. Capital Structure


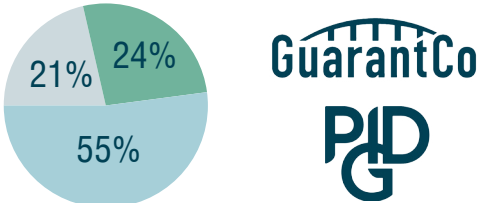
Limiting the amount of paid-in capital through optimal use of public balance sheets / state accounts. Paid-in capital refers to upfront capital provided into the facility that can be used to provision for expected losses of guarantees and as a liquidity facility to pay out any called guarantees. The more paid-in public capital, the lower the ratio between private capital mobilised and public capital. State treasury accounts / balance sheets can be used to back guarantee exposure, reducing the need for paid-in capital. The most extensive variant of this is an unfunded mechanism, which has no paid-in capital and fully relies on the state balance sheet. This structure seems more suitable for a mechanism that is backed by one country than a multilateral facility backed by multiple countries.

The funding level of guarantees is related to the capital structure of a new facility, which in turn has implications for its credit rating, possible leverage of paid-in capital and options for a multilateral structure. Exhibit 14 sketches two archetypes we consider attractive for new facilities.

- **Unfunded facilities – optimising the use of state treasury accounts.** For donor countries seeking to manage their own facility, a facility offering unfunded state guarantees is an attractive set-up. An 'unfunded' facility without paid-in capital can optimally leverage the credit rating and size of governmental national accounts. This approach involves highly efficient use of public capital. No public funds need to be used to pay in capital. It is not completely risk-free, however. The state treasury / balance sheet is exposed to the guaranteed amount and liable for claim payments in the event of default. This means state treasuries are likely to require close engagement with the issuing agency, including the risk assessment and credit policy. Additionally, guarantee exposure has an effect on the government's finances and borrowing capacity. Such a bilateral set-up can still work in close cooperation with other facilities to improve the overall international finance ecosystem. For example, by co-guaranteeing with other institutions, as Sida and US DFC have done.
- **Partially funded facilities – limiting paid-in capital while ensuring efficient and reliable transaction mechanisms.** There are complexities for a multilateral facility to offer unfunded guarantees backed by different governments given the nature of unfunded guarantees. Different state treasuries might have different credit ratings and risk appetites, making guarantee allocation a complex design choice. This may complicate market trust in claim pay-out procedures. In the case of a multilateral set-up, a partially funded facility is a more attractive alternative. Such a facility needs an appropriate capital structure and governance to achieve optimal credit rating and high leverage of paid-in capital.

Exhibit 14:

Funding structure of guarantees and implications for capital structure and facility set-up

	Unfunded state guarantees provided by a platform	Partially funded guarantees provided by a capitalised fund
Capital Structure & Example 		
Description	<ul style="list-style-type: none"> A facility without paid-in capital (i.e. platform) which offers unfunded state guarantees backed by callable capital on respective state treasury accounts Claim payments made from state treasury accounts 	<ul style="list-style-type: none"> A facility with paid-in and callable capital which offers partially funded guarantees (i.e. capitalised fund) Claim payments made by own balance sheet facility
Credit Rating	<ul style="list-style-type: none"> Depends on donor country sovereign ratings and; The credibility of rapid reimbursements of claims from state accounts or e.g. a dedicated liquidity facility 	<ul style="list-style-type: none"> Depends on the leverage set by Board of facility, meaning the ratio between guarantee exposure and capital on the balance sheet The paid-in capital will improve the credibility of rapid reimbursement of claims
Options for Multilateral Structure	<ul style="list-style-type: none"> A specialised agency/platform sources, assesses and prepares approval for deals Guarantee exposure allocated through: <ul style="list-style-type: none"> Fixed, predetermined percentages on the portfolio level; or Individual deals allocated to specific country according to risk-appetite 	<ul style="list-style-type: none"> Multilateral partners provide predetermined amounts of paid-in and/or callable capital, and/or debt facilities Partners collectively agree on mandate, risk tolerance and governance
Considerations	<ul style="list-style-type: none"> Requires grant capital for new platform set-up Catalytic use of public capital given no paid-in capital is required – in case a dedicated liquidity facility is used for claim payments, leverage will decrease Less agile structure because of dependency for risk assessments and payouts on individual states 	<ul style="list-style-type: none"> Share of paid-in capital may reduce leverage (compared to unfunded) depending on level of callable capital and debt, and risk tolerance Fund structure with own balance sheet allows to be more agile, efficient and market-driven as reliance on government is less

Sources Sida²³ GuarantCo – a PIDG company²⁸

The strategy of new green guarantee facilities will include choices on the type of risks covered, target risk segment, coverage, eligibility, currency and pricing. Although it is helpful for the facility to have a broad mandate, strategic focus will help build in-house capacity and expertise, especially in the early years. In addition, new guarantee facilities are most catalytic when they are explicit on the real economy sector and segment of risk they can target. This means being clear on what investors the facility targets with what products. The facility strategy can define initial choices in terms of geographical and sectoral focus, and set direction for key guarantee product specifications and eligibility for guarantee applications.

These focus areas do not need to be set in stone as the facility strategy and product offering can be adapted based on increased expertise, capacity and market demand.

V. Strategic Focus

The new global guarantee facility can choose real economy focus to enable specialisation and the build-up of expertise. Guarantee solutions for energy and other infrastructure projects may be different to agriculture or nature-based solutions. Expertise to evaluate the viability of solutions and the optimal guarantee product structure and scale – as well as the link to other required de-risking solutions – can also be tailored to support broader climate-focused sectors.

Credit risk and currency risk are the most logical risk types to focus on for a new facility. This is a design choice that could be made either upfront or as part of the facility strategy. Key risks that are suitable to manage with guarantees are credit and political risks. MIGA has a long experience in efficiently managing political risk given their unique position as part of the World Bank Group. A new global green guarantee facility founded by donor countries would be unlikely to have the same ability to manage political risks as MIGA does from within the World Bank Group. As explained in chapter 3, scaling capital for climate action likely requires additional scale and accessibility of credit risk guarantees. There is a limited amount of climate-specific credit risk facilities, making this a logical focus for a new guarantee facility.

Currency risks are often best managed through hedges. Providers like The Currency Exchange (TCX) offer hedges specifically for investments in EMDEs, mainly to DFIs and MDBs. TCX could be scaled to increase the amount of currency hedges available. However, market-priced currency hedges are often too expensive for investors as they incorporate high (perceived) macro-economic risks. Moreover, half the time the cost of hedging is twice what the future tells us it should have been³². This suggests that perceived risks may be higher than actual risks. Therefore, there could be scope for an additional large-scale currency guarantee facility that is able to address that excess risk-premium

The facility could start with a defined country focus, and a selective product offering, expanding over time. In terms of focus, the new facility could on five to ten countries with similar risk profiles initially, but gradually expand markets as the facility builds expertise and grows. Similarly, it could start building a selection of products to clearly attract investors, and expand and adjust as markets change. This could include both investment-level as well portfolio/fund-level guarantees. Another option to consider is guarantee structures to transfer portfolio risk between investors like the Room2Run structure with AfDB. An important focus area could be domestic investors by offering guarantees in local currencies. Domestic investors have better access to projects given their local expertise and market understanding, which can improve the distribution of guarantees. Local currency guarantees are also core to develop local capital markets and limit dependence on international financial markets.

VI. Coverage Level

The coverage level is best not restricted – while following principles to reduce moral. Coverage level refers to the extent to which the guarantee covers the (financial) obligations of the underlying investment. A high coverage likely attracts more investors. The risk of moral hazard drives more limited coverage ratios to maintain an appropriate amount of risk with the private investor. As a general principle, guarantors tend to look for the level of coverage that enables a transaction that otherwise would not occur, while leaving a reasonable amount of risk with the private investor. If the pricing of guarantees is market-based, the investor seeks a coverage level to keep fee premiums low and margins reasonable. The 'optimal' level of coverage depends on the deal specifics, such as the risk segment of investment (greenfield vs operational), guarantee type and currency. In some cases, this means that only 50% coverage is needed, such as for the first Orange Bond issued through IIX. There have also been cases in which 100% coverage was justified in a first-of-a-kind issuance. These requirements are likely to change as markets mature. To illustrate, the first time GuarantCo, supported a bond issuance in Vietnam, they provided 100% coverage, the second time 75%, and the third only 50%.

VII. Pricing

Pricing should be market-based, subsidies can be allocated on a case-by-case basis from allocated, dedicated funding. As a general principle, pricing should be market-based to ensure efficient and equitable use of public capital, and to avoid market distortion. Guarantee fees should be set to cover expected loss and operational expenses. On a case-by-case base, the facility can allow the guarantee holder to pay a fee that is lower than the estimated cost (expected loss and administrative costs) to the facility. Such a subsidy can be granted in case the payment capacity of the guarantee holder is insufficient to cover the risk-based fee, but the development additionality of the investment is considered high. While this might bring additional development impact, it can also create moral hazard. Clear and transparent guidelines are needed to ensure fair and justifiable allocation. Subsidies should come from a separate pot of grant funding, and should not be used to make claim payments.

05 NEXT STEPS

Coordinated leadership

Scaling private capital into low-carbon, nature-positive, resilient investment opportunities in Emerging Markets and Developing Economies (EMDEs) is fundamental to accelerate climate action and drive sustainable and inclusive growth. Using public finance instruments that reduce risks faced by investors and support market development is one of the best levers to unlock and scale private investment. Scaling the use of guarantees is a key priority to narrow the multi-trillion-dollar annual climate funding gap in EMDEs.

This paper is a call to action to increase the ambition and effectiveness of public capital. It recommends that the international finance community takes action to:

1. Accelerate reforms to include a climate mobilisation mandate for public capital (with appropriate safeguards)
2. Scale and improve access to guarantees at existing institutions
3. Develop new global green guarantee facilities targeting higher mobilisation, lower transaction costs and a structural link to project preparation

Turning this ambition into reality will require:

- **Coordination on system reform:** Leaders should put mobilisation at the heart of the international financial system reform agenda, using the WB/IMF Annual Meetings as a catalyst for action; EMDE governments and private finance can advocate strongly for these reforms with support from philanthropy and civil society to drive high ambition
- **Collective funding commitments:** Coalitions of countries can commit to capitalise a new global green guarantee facility to accelerate massive private investment for climate
- **Effective public-private-country cooperation:** Public institutions should work with EMDE governments and private sector practitioners to ensure existing and new instruments are fit for purpose, market-driven and efficient
- **Reimagining product offering:** Practitioners developing catalytic instruments and new climate finance solutions should develop a more connected set of product offerings especially to link project prep funding to de-risking mechanisms and integrate green accountability into design
- **Cross-sector ambition:** Ensuring climate finance solutions include a focus on sectors beyond energy is key; learning from what has worked to unlock capital for infrastructure to apply to sustainable agriculture and nature-based business models in EMDEs will help accelerate capital mobilisation across the whole spectrum of climate solutions
- **Deepening local markets:** The success of blended finance vehicles depends on early engagement with the private sector to build pipeline, relationships and capacity – increasing physical presence of international investors in EMDEs to ensure the lasting impact of public interventions to mobilise capital for climate



06 GLOSSARY

Blended finance	The strategic use of catalytic capital (public or philanthropic) to mobilise additional private capital for SDG-related investments – often through the use of de-risking mechanisms like guarantees, insurance, currency hedging, first-loss capital or technical assistance
CAF	See MDB Capital Adequacy Framework
Concessional finance	Finance on better terms than available through ordinary market mechanisms (e.g., interest rate, tenor)
Cost of capital	The calculation by an investor or company of the minimum return necessary to justify making a capital investment. Cost of capital is determined by a risk assessment of the investment and the opportunity cost of investing the capital in another project of similar risk. For a company, the cost of capital encompasses the cost of both equity and debt, weighted according to the company's preferred or existing capital structure
Credit line (or line of credit)	A pre-set borrowing limit that a borrower can draw on at any time that the credit line is open. It is a guarantee that funds will be made available, but no financial asset exists until funds are drawn.
Credit rating	A credit rating is a quantified assessment of the creditworthiness of a borrower in general terms or with respect to a financial obligation, often by a specialised agency. Credit ratings determine whether a borrower is approved for credit as well as the interest rate at which it will be repaid. In the context of guarantees, a credit rating agency can assign a credit rating to guarantees based on the ability of the guarantor to honour payments under its guarantees. This is driven by the availability of liquidity and expectation of timely payout. This rating typically caps the ability of the guarantor to leverage its capital.
DFI	National and international Development Finance Institutions (DFIs) are specialised development banks or subsidiaries set up to support private sector development in developing countries. They are usually majority-owned by national governments and source their capital from national or international development funds or benefit from government guarantees. This ensures their creditworthiness, which enables them to raise large amounts of money on international capital markets and provide financing on very competitive terms
EMDEs	Emerging Markets and Developing Economies, excluding China for the purpose of this report
Export credit agency (ECA)	A private or quasi-governmental institution that acts as an intermediary between national governments and exporters to issue export insurance solutions and guarantees for financing. It exists to facilitate domestic companies' international exports. Most countries have ECAs or investment insurance agencies that provide loans, loan guarantees and insurance to help eliminate the uncertainty of exporting to other countries
First-loss tranches	Type of financial security or investment that bears the highest risk in a structured financial transaction. The first-loss tranches are the first ones to absorb any losses or defaults that may occur within the investment, creating protection for other tranches or investors.
G20	The G20 or Group of 20 is an intergovernmental forum comprising 19 countries and the European Union (EU). It works to address major issues related to the global economy, such as international financial stability, climate change mitigation, and sustainable development. The G20 is composed of most of the world's largest economies finance ministries, including both industrialised and developing nations; it accounts for around 80% of gross world product, 75% of international trade, two-thirds of the global population and 60% of the world's land area

GEMs	The Global Emerging Markets Risk Database Consortium is one of the world's largest credit risk databases for the emerging markets operations of MDBs and DFIs to support investment and development. It pools data on credit defaults on the loans extended by GEM members, the migrations of their borrower's ratings and the recoveries of defaulted projects. This database is only accessible to their members, which are exclusively MDBs and DFIs, and not to private investors.
Grant	A financial contribution, often given with a purpose to achieve certain outcomes, without expected financial repayment
Guarantee	A risk-sharing instrument that provides protection to one party in case the other party fails to perform. It is an agreement where a third party (i.e. the guarantor) commits to pay the investor/lender/seller should the investee/borrower/counterparty be unable to do so. Guarantees can result in a higher credit rating for the lender and better interest rates for the borrower by transferring the risk associated with doing business with high-risk borrowers/ sectors/ geographies or extending credit during times of financial uncertainty.
Hard currency	Hard currency refers to money that is issued by a nation that is seen as politically and economically stable (e.g., the US dollar or the euro). Hard currencies are widely accepted around the world as a form of payment for goods and services; development finance is often offered in hard currency (not local currency) which can create exchange rate risk where revenues from a project are in local currency but loan repayments must be made in hard currency. Currency hedging instruments can be used to manage this risk
Hedges	A hedge is a trade contract that is made with the purpose of reducing the risk of adverse price movements. Currency hedges are agreements between two parties to exchange two currencies at a specific time in the future
Leverage	In finance, leverage refers to the use of debt to increase returns on an investment. On an institution level, this refers to ratio of (debt) liabilities against its paid-in capital. In this report and in the context of guarantee facilities, leverage means the extent to which the guarantor is able to write guarantees greater than (i.e., "leverage") the amount of capital that the guarantor has on its balance sheet for the possible liabilities coming from claims.
MDB	Multilateral development banks (MDBs) are supranational institutions set up by sovereign states, which are their shareholders. Their remits reflect the development aid and cooperation policies established by these countries. They have the common task of fostering economic and social progress in developing countries by financing projects, supporting investment and generating capital for the benefit of all global citizens. MDBs also play a major role on the international capital markets, where they raise the large volume of funds required to finance their loans – often in local currency
MDB Capital Adequacy Framework (CAF)	Independent Review of MDB Capital Adequacy Frameworks submitted to G20 finance ministers in 2022. Capital adequacy is the statutory minimum reserves of capital which a bank or other financial institution must have available – in other words this is the shareholder capital set aside to meet financial obligations even if some borrowers don't pay them back. The financial risks posed by MDB operations are very different from those of commercial banks because of their official standing and development mandate, so they cannot simply apply commercial bank capital adequacy standards such as the Basel III guidelines. But based on the evidence, the review panel concluded that government shareholders, MDB management and credit rating agencies have overestimated the financial risks facing MDBs by underestimating their unique strengths. The panel proposes several measures to update capital adequacy policies and make more efficient use of MDB capital without posing a threat to MDB financial stability or their AAA credit rating
Mobilisation ratio	Measure to assess the extent to which a public financial intervention leads to private investment, defined as the amount of private finance directly mobilised for every dollar of public commitment. In other words, it is the ratio of private capital invested or lent into a project or fund divided by the associated public/ philanthropic capital commitment that led to the private sector investment – typically by providing some form of risk-sharing. The underlying assumption is that the private sector would not have invested without the involvement of the public/philanthropic funding, so there needs to be a demonstratable causal link between the public/philanthropic commitment and the private investment.

Pari passu	On equal terms. In the context of guarantees, it means that the guarantor has equal rights to the borrower's assets in the event of default, without any preferential treatment compared to other senior debtors. This will secure acceptable risk and adequate compensation for the guarantor.
Project preparation facility	Organisations, initiatives or institutions that help develop bankable, investment-ready projects, typically from a project's concept, design or scoping stage up to the financial close. A project preparation facility may provide technical and/or financial support. See also "Technical assistance"
Sovereign credit rating	An independent assessment of a country's creditworthiness i.e. the risk of a country going in default and not being able to pay its debt obligations. The rating shows the level of risk associated with lending to the country and is applied to all government bonds issued, defining the risk premium. Credit rating agencies that evaluate countries (notably Fitch, S&P & Moody's) consider various factors including political environment and economic status. For that reason, the sovereign credit rating is typically used to determine the minimum return requirements for project finance or corporate bonds in respective country
Technical assistance (TA)	A mode of (typically grant-funded) support that facilitates the preparation, financing and execution of development projects and programs. It helps countries and companies build capacity, especially to build bankable project pipeline.
World Bank Group	Group of development banks including the World Bank, the International Finance Corporation and the Multilateral Investment Guarantee Agency (MIGA). The World Bank consists of two organisations: the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD).

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08

TECHNICAL ANNEX

A. Mobilisation ratios – methodology and limitations

Introduction

Mobilisation ratios are defined as the amount of private finance directly mobilised for every dollar of public commitment that led to a private investment. The higher the ratio, the more catalytic the instrument. While they can provide useful insights, reporting on mobilisation ratios for public finance is not always consistent, transparent or easily available. We aim to provide an additional approach and insight, focusing specifically on mobilisation between instruments for climate investments.

Scope of the analysis

We create mobilisation ratios for the sub-set of data which is comparable between sources, which leads to the following scope:

- **MDBs:** Asian Development Bank (ADB), African Development Bank (AfDB), Inter-American Development Bank (IADB), European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD) and the World Bank Group (WBG)
- **Sector:** climate finance
- **Geographical coverage:** low-and middle-income countries, including China
- **Instruments:** loans and equities, guarantees and credit lines
- **Years:** 2016-2020

Methodology and sources

In the absence of one comprehensive data source that contains both commitments and private finance mobilised for multiple institutions across different instruments, we combine two data sources to calculate mobilisation ratios:

For commitments: Joint report on MDBs climate finance. Reports used cover data from 2016-2020.

- For guarantees, this report assumes commitments are the gross exposure to guarantees.

For private finance mobilised: OECD.Stat (2023). Mobilisation. Online database consulted in March 2023.

- Reporting is based on “DAC methodologies for the amounts mobilised from the private sector by official development finance interventions”, which can be found here.
- This includes finance from private sector only, not from DFIs operating on commercial terms.

The two data sources don't map perfectly in terms of instrument classification, which has three implications.

1. The available OECD data does not provide a separate breakdown of loans and equity within financial structures involving loans and equity investments. Consequently, we aggregate different instruments to present a comprehensive category “Loans and Equity. Specifically:

- For commitments, we combine “Investment loans” and “Equity”.
- For private finance mobilised, we combine “Direct investments in special purpose vehicles”, “Syndicated loans” and “Shares in collective investment vehicles”.

2. Grants are excluded given they are not part of the OECD database

3. Policy-based financing and result-based financed are excluded from the analysis of MDB reporting as these mechanisms involve sovereign borrowings from MDBs and do not directly mobilise private finance.

Comments on the methodology:

1. Our methodology considers the exposure to guarantees a public commitment, in line with the approach MDBs report on guarantees. The OECD data does not consider the exposure as a commitment, as they do not represent a financial flow unless 'materialised'. Opinions vary on the best approach. If public commitments were only the claim payments, mobilisation ratios of guarantees are much higher than the ones we present.
2. The analysis uses the OECD definition of direct private capital mobilisation. The analysis does not consider capital adequacy ratios (or balance sheet leveraging).
3. It is hard to do a like-for-like assessment of the different instruments given their inherent different nature, and consequently, the differences in OECD methodologies for private finance mobilised as well as our mobilisation ratio methodology. For example, for loans and equity, the values of commitment and private finance mobilised are mutually exclusive, while for guarantees the commitment is also counted as part of private finance mobilised.
4. In the OECD methodology, the full value of the underlying instrument covered by the guarantee is considered as private finance mobilised, regardless of the coverage rate (i.e. the commitment). The mobilisation ratio is therefore essentially the inverse of the coverage; the higher the coverage, the lower the mobilisation ratio. A 1.5 mobilisation ratio implies a ~70% coverage and a 100% coverage rate implies a 1:1 mobilisation ratio.

Limitations

- The analysis faces several limitations, mainly because two different data sources were not set-up or intended to be compared by design.
- Although we cover the key instruments, the instrument scope is not fully comprehensive
- The scope of MDBs included in both datasets does not match perfectly. The instrument-level data from the MDB reports are not available at an institutional level. This means that the instrument-level data includes the ADB, AfDB, IADB, EIB, EBRD and the WBG, as well as the Asian Infrastructure Investment Bank (AIIB) and the Islamic Development Bank (IsDB). The OECD does not provide climate finance data for the AIIB and the IsDB. This is not considered a major limitation since the total climate finance commitments of respective banks are small in relation to the other banks.
- There is uncertainty around definitions of climate finance between sources and we cannot guarantee the investments included match perfectly. Given OECD data is based on surveys from MDBs though, the scope is likely similar to the MDB reporting.
- For years 2016 and 2017, the MDB reports only provides global climate finance commitments, including to high- income countries, and does not differentiate between income group. Assumptions were made to create the share of MDBs in total climate finance based on the following years.
- China is part of the analysis. Both data sources cover low-and middle-income countries so China is naturally included as an upper-middle-income country.

Even though the analysis has limitations, we believe the overall results are relevant and valid in providing evidence as to how much private finance is mobilised by MDBs on average and how this differs per instrument.

B. Term sheet for guarantee facilities








Decision Level	Topic	Consideration	Option (non-exhaustive)	
Facility	Mandate	Design choices can either be stipulated in the facility's mandate or left for the facility to work out in its strategy within certain guardrails. A mandate that allows the facility to adapt its strategy allows it to be more agile, adapting to changes in the market. Certain guardrails in the mandate are likely needed to ensure the facility is fit-for-purpose (see principles in chapter 2).	<i>Description of the mission of the facility and boundaries for what it can and cannot do</i>	
	Capital Structure	The capitalisation choice affects size, credit rating and governance. An unfunded facility leverages size and credit rating on national account but entails political involvement and challenges for deal approval and claim payment in multilateral setups. For this reason unfunded structures are less suitable for a multilateral set-up. A funded facility with provisions for losses on its own balance sheet offers independent and flexible governance but may be less effective in leveraging public capital.	<input type="checkbox"/> Unfunded – no paid-in capital, callable capital only <input type="checkbox"/> Partially funded – limited amount of paid-in capital supplemented with callable capital <input type="checkbox"/> Funded – sufficient paid-in capital to fund operations	
	Facility Manager	A management agency will be needed to conduct daily operations. Governance choices will determine the role and responsibilities of the facility/fund manager. Hiring an existing facility/fund manager gives the benefit of using existing expertise. Setting up a new agency takes more time, but could allow for more specific governance, skills and mindsets of people.	<input type="checkbox"/> Existing facility/fund manager <input type="checkbox"/> New facility/fund manager	
	Pricing	Market-based pricing aims to provide risk-adjusted return, minimising moral hazard and preventing the use of public capital from subsidising investor risks. Market-based pricing may also include a fee subsidy mechanism. Such a subsidy can be granted in case the payment capacity of the guarantee holder is insufficient to cover the fee, but development additionality of the investment is considered high. Pricing can also be set at concessional rates. This could potentially unlock a larger share of investments but runs the risk of moral hazard and market distortion as described above.	<input type="checkbox"/> Market-based <input type="checkbox"/> Market-based with subsidy facility for selected cases <input type="checkbox"/> Concessional	
	Size		<i>Paid-in capital:</i> The amount of upfront capital put in by donors and any additional capital attracted from the market. A higher amount of paid-in capital will give more confidence in the abilities of the facility to meet its obligations while lower amounts of paid-in capital are more effective uses of public capital. The required/optimal level will be dependent on the expected risks and losses of the facility, the availability of callable capital from donors and the target for yearly commitments.	<input type="checkbox"/> \$...
			<i>Target commitments per year:</i> The amount the facility targets to commit through guarantees per year. It will be dependent on the expected risks and losses and the amount of paid-in / callable capital.	<input type="checkbox"/> \$...

Decision Level	Topic	Consideration	Option (non-exhaustive)
Facility	Focus	<i>Sector:</i> A wide sectoral focus is more inclusive and open to changing market needs, while a selective focus drives capacity and network-building of the facility.	<input type="checkbox"/> Climate <input type="checkbox"/> Energy / Nature <input type="checkbox"/> Specific sector (e.g. power, agriculture, forests)
		<i>Geography:</i> A wide geographic focus improves position for risk diversification while a selective focus drives local capacity building and improves distribution and risk assessment.	<input type="checkbox"/> All EMDEs <input type="checkbox"/> Specific region/ continent <input type="checkbox"/> Specific countries
		<i>Risk Type:</i> A wide array of risk types that can be covered provides more flexibility to cater to the project or investors' needs, while a narrow focus allows the building of expertise and capacity.	<input type="checkbox"/> Political <input type="checkbox"/> Credit <input type="checkbox"/> Currency <input type="checkbox"/> Liquidity <input type="checkbox"/> Technical <input type="checkbox"/> Off-take
		<i>Financial instrument:</i> Project-level guarantees can attract new capital sources but are typically relatively small and tailored on a case-by-case base. Instrumental to create markets but comes with higher transaction costs. Portfolio/fund/balance sheet guarantees can enable more scale and allow financial institutions to grow exposure to a particular sector or region, without breaching regulatory and capital limits. While attractive for scaling impact, these are less efficient in attracting new investors.	<input type="checkbox"/> Project finance loan <input type="checkbox"/> Bond <input type="checkbox"/> Investment portfolio <input type="checkbox"/> Fund
	Eligibility	The type of investors / borrowers/ projects that can receive benefit from the offered guarantees	
		<i>Investor type:</i> A pure focus on private investors creates focus in terms of network and capabilities and enables higher private finance mobilisation for the facility. Private investors are not one uniform category, and more specific choices may be made for institutional investors, commercial banks and/or private funds. Institutional investors have a small risk appetite and are subject to more stringent regulation and fiduciary duty to their clients. Commercial banks are key providers of project finance loans, are typically able to take more risks and can more easily access new markets. Also including public investors like MDBs and bilateral DFIs as eligible can enable more mutual learning on increasing catalytic capital and allow respective banks to recycle their capital more efficiently.	<input type="checkbox"/> Private <ul style="list-style-type: none"> • Institutional investors • Commercial banks • Private funds <input type="checkbox"/> Public <ul style="list-style-type: none"> • MDBs • DFIs • Countries
		<i>Currency:</i> Local currency guarantees are most appropriate for a borrower that receives revenues in local currency, and are preferred when a key objective is to attract local investors to create local capital markets and not further increase international debt burdens on EMDEs. Foreign currency guarantees work best for a borrower that wants to access international capital markets.	<input type="checkbox"/> US Dollar <input type="checkbox"/> Euro <input type="checkbox"/> EMDE currencies
		<i>Project:</i> Type of borrowers to which the guarantee applies. Focusing on privately developed projects is likely more additional, but may exclude impactful publicly run projects.	<input type="checkbox"/> Public <input type="checkbox"/> Private <input type="checkbox"/> Public and private

Decision Level	Topic	Consideration	Option (non-exhaustive)
Facility	Governance	<i>Control:</i> Facility can be set up independent from government decision-making processes or involve more political processes. Independent governance results in more inclusive, transparent and efficient decision-making, fostering innovation, entrepreneurship and market responsiveness. Public control, with strong political connections, enhances successful implementation and coordination with receiving countries.	<i>Description of the rules of decision-making and governance bodies of the facility</i>
		<i>Risk Assessment:</i> Assessment of expected losses of potential guarantee deals and associated guarantee fees performed in-house is likely more lean while external assessment may add a higher degree of objectiveness to the process.	<input type="checkbox"/> Inhouse capability <input type="checkbox"/> Contracted to independent external party
		<i>Impact Assessment:</i> Assessment of environmental and social performance of investments against pre-defined standards performed in-house is likely more lean while external assessment may add a higher degree of objectiveness to the process.	<input type="checkbox"/> Inhouse capability <input type="checkbox"/> Contracted to independent external party
		<i>Funding allocation:</i> Defines the rules of how guarantee deal approval is made. More competitive allocation may encourage submission of high-quality proposals and provide guarantees to projects with the greatest financial viability and impact. Incentives to the facility to actively source deals may contribute to building local sectoral markets.	<i>Description of the rules of decision-making and governance bodies specific for funding allocation</i>
		<i>Transparency:</i> Describes how insight into finance sources, outcomes and practices has to be provided. See principles for fit-for-purpose climate finance (chapter 2).	<i>Description of the rules of transparency, including regular reporting</i>
Transaction	Size	The amount of the underlying financial instrument that is being guaranteed.	\$...
	Coverage	The coverage amount of a guarantee determines risk levels and suitability for different investors and projects. Partial credit guarantees, typically ranging from 50% to 70% coverage, offer advantages like mitigating moral hazard, reducing lender fees, and higher mobilisation ratios. Conversely, full or high coverage can attract additional investment segments, such as institutional investors interested in local currency.	<input type="checkbox"/> Full (100% of underlying instrument) <input type="checkbox"/> Partial (<100% of underlying instrument)
	Fees	The charged fee depends on the chosen pricing mechanism (see above) and may include a grant-based fee subsidy.	\$...
	Tenor	Duration of the guarantee agreement typically depends on the duration of underlying obligations, for instance in project finance - the tenor of the bank loan.	# years
	Security / Collateral	Describes the securities or collateral provided to the guarantor. Higher demand on security provided decreases risks for the guarantor but increases remaining risk with the investor and project.	<i>Description of securities provided to guarantor, e.g. pari passu with senior debt, subordinate or specific collateral</i>

C. Overview of current initiatives to scale the use of guarantees

Annex: list of ongoing climate related guarantee initiatives

	 Civil society climate expert	 COP28 UAE	 NATURE FINANCE	 Bridgetown Initiative	 iTrust	 Atlantic Council	 CLIMATE POLICY INITIATIVE
Description	Proposing the creation of a global green guarantee for investment in EMDEs through a public call for action .	Catalyse capital into EMDEs by providing incentives and risk mitigation at portfolio and investment level	Introducing sustainability-linked sovereign debt to incentivise positive outcomes, reduce costs, and enhance risk sharing	Establishing an agency that acts counter-cyclically, reduce FX hedging costs , hedging half the risk half the time	Fast-tracking guarantees for liquidity or county-level risk for long-term investors, who are awarded PPAs in participating programmes.	Offering up to 100% guarantees on non-currency risks for EMDE investors.	Launching a credit guarantee facility in collaboration with two or more MDBs
Focus	Climate (Energy) & Nature	Climate (Energy)	Nature	Climate	Nature	Climate	Energy
Scale	n/a	n/a	n/a	n/a	n/a	\$500 billion eq. over 10 years	n/a
Managed by new agency	n/a	✓	n/a	✓	✓	✓	✗