Scaling Private Capital Mobilization:

Call to Action to heads of state, policymakers and multilateral development bank officials

A growing number of global financial institutions, including participants in the Net-Zero Asset Owner Alliance (convened by the UN Environment Programme Finance Initiative and the Principles for Responsible Investment), the UN-Convened Net-Zero Banking Alliance, Africa Investor, Convergence, the Glasgow Financial Alliance for Net Zero (GFANZ) Capital Mobilization Workstream, Global Investors for Sustainable Development (GISD) Alliance, Institutional Investors Group on Climate Change (IIGCC), the Investor Leadership Network (ILN), Sustainable Markets Initiative Blended Finance Task Force (SMI), GI Hub Private Sector Advisory Council (GI Hub), are committed to contributing to a global just transition. This Call to Action builds on their previous recommendations for specific policy measures, as well as recent welcome actions from Multilateral Development Banks (MDBs). Financial institutions also hope that the ongoing dialogue with the MDBs to drive forward the process of transformation will gather further momentum in the months ahead.

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I. Context

There is overwhelming agreement on the urgent need for a significant increase in investment in Emerging Markets and Developing Countries (EMDCs) to achieve the UN Sustainable Development Goals (SDGs) and the Paris Agreement goals, including a just energy transition. There is a gap of more than USD 4 trillion per annum in the investments required to meet these objectives.[1] This gap needs to be closed urgently. This is consistent with the UN Secretary-General's call for an SDG Stimulus of at least USD 500 billion per year,[2] including by strengthening the role of Multilateral Development Banks (MDBs) in scaling up affordable long-term financing.

Many expert bodies and government leaders have called for effective evolution of these institutions, as illustrated most notably in the Triple Agenda report by the Independent Expert Group (IEG) commissioned by the G20.[3]

There is strong momentum to implement the measures needed to mobilize private capital as highlighted by several recent initiatives led by MDBs, including the World Bank's Private Sector Investment Lab and its broader evolution roadmap.

The Call to Action recognizes this momentum and is intended to reinforce and build on these calls. It is fully recognized that the public sector and MDBs need to continue to play a crucial role in the just energy transition and in achieving the SDGs. But their resources are limited. Unlocking investment from the private sector will be critical to attaining these objectives. However, these investors are constrained given the risk-return profiles they face in EMDCs, which in many cases, are not consistent with their underlying fiduciary duties and regulatory constraints.

Private financial institutions stand ready to work with governments and all stakeholders to constructively boost private capital mobilization, supporting long-term sustainable growth and a just transition. They aim to further increase their expertise to invest in EMDCs and enhance their contributions to infrastructure development.

But systemic change is essential. Inspired by and drawing on the New Financial Pact Summit, The Bridgetown Initiative, The Africa Climate Summit, the G20 Capital Adequacy Framework (CAF) review, the Political Declaration of the SDG Summit[4] and the G20-comissioned IEG's Triple Agenda, there is an imperative for a deeper and more strategic collaboration between the private sector, heads of state, governments, and the MDBs to scale private investment to help close the huge climate and SDG financing gaps.

This is a pivotal year with the SDG Review and UNFCCC's Global Stocktake, representing a watershed opportunity for collaboration to accelerate SDG and climate investment.

Getting this right is a global imperative. It offers a significant opportunity for EMDCs, global institutional as well as philanthropic investors, MDBs and Development Finance Institutions (DFIs), and governments alike, to unlock an unprecedented and urgently required flow of private capital to assist accelerating the development and decarbonization of EMDCs and the whole world.

Private financial institutions welcome the important initiatives already underway. But further actions are urgently needed to deliver the scale of finance needed for a transition that is fair, inclusive, and at the pace required to deliver on global climate goals.

1 Developing countries face USD 4 trillion investment gap in SDGs | UN News
2 "Guterres calls for G20 to agree USD 500 billion annual stimulus for sustainable development" | UN News
3 Volume 1 and 2 of the IEG Report can be found here: MDB Evolution to Transformation: Volume 2 of the IEG Report | Center For Global Development | Ideas to Action (cgdev.org)
4 Political Declaration of the SDG Summit

II. Overcoming investment barriers

There are three key impediments to significantly increasing private capital mobilization: inadequate project pipeline; risks too high relative to returns, and data limitations.

Institutional investors urge actions in the following areas:

Building a pipeline of bankable projects: The upstream project preparation pipeline is woefully inadequate, with very limited numbers of bankable projects, limiting opportunities for the private sector to invest. To address this challenge, it is necessary to **streamline existing project pipeline facilities, and boost new pipelines by increasing resources, and support country platforms to address upstream policy challenges, as well as project development.**

Mitigating risks: Policy, commercial, macroeconomic, and political risks in many EMDCs remain significant, often making it difficult for financial institutions to lend or invest without breaching fiduciary or regulatory constraints. To address this, **public institutions should continue to expand the quantum, quality, availability, and accessibility of instruments that enable appropriate and effective risk management and mitigation (e.g., guarantees)**, acknowledging the need for additional public and concessional funding globally. In allocating such funds, where suitable, **catalytic capital from multiple sources may be aggregated to leverage synergies and efficiencies.** In addition to having a broader menu of replicable financing structures and instruments for risk management, the public institutions' ability to act as junior and mezzanine partners, as needed, with the private sector, can also be supported.

- **Foreign exchange risk** is a key element for foreign investments in EMDCs. Instruments for hedging are usually short-term, and expensive, or not available at all. It is important to **explore and implement measures in the near term to increase the availability of hedging instruments that are cost-effective,** particularly where the inability to mitigate FX risk is a binding constraint to the private sector's ability to invest.

Improving data accessibility and risk assessment: While risks are generally high, the perception of these is even higher, as reflected in ratings. To address this, we urge **enhanced and speedy access to the Global Emerging Markets Risk Database (GEMs),** building on the progress underway, and initiate a close collaboration with the private sector to augment the database.

III. The role of MDBs in mobilizing private capital

MDBs must play a pivotal role in each of the above areas, but this is only possible with efforts to strengthen collaboration between MDBs and the private sector, building on the progress in recent years. Private financial institutions welcome the work of several MDBs to advance elements of these recommendations but believe that more holistic and effective approaches are needed to harness the potential scale of private finance and call on MDB shareholders to deliver the changes needed to realize this ambition. These recommendations include:

To improve bankable deal flow, MDBs should:

- Develop a more collaborative approach to project preparation and development, including **engaging the private sector earlier in project lifecycles, and enabling MDB-operated project preparation facilities to be available to the private sector.** For example, the Global Infrastructure Facility (GIF) should be significantly expanded and made directly accessible to private institutions, including by creating a special window specifically for the institutional sector, which investors can have recourse to at early stages of project development.
- **Expand policy assistance to governments and related institutions to help support a conducive enabling environment** and make projects more investable; technical assistance to public and private sectors can also play an invaluable role.

To help address longstanding risks and investment barriers in order to catalyze private investment, MDBs should:

- **Make private capital mobilization (PCM)**[5] **a central objective of their operations,** particularly in middle-income countries, while continuing to focus on providing concessionary funding, especially for low-income countries.
- **Establish ambitious PCM targets that aim to significantly increase the PCM ratio** from the current low levels today, MDBs mobilize only around 0.6 dollars in private capital for each dollar they lend on their own account.[6] This ratio can be increased dramatically[7] within the next three to five years. Unlocking such private investment flows at scale is central to closing the existing investment gap.[8] Such targets would, for example, encourage MDBs to focus on early-stage project development, and to use and develop further risk management instruments such as guarantees.

To develop a more collaborative relationship between MDBs and the private sector, reinforcing the cascade principle to ensure appropriate focus on the "additionality" of MDB financing, MDBs should:

- Use their balance sheets more effectively, informed by consultations with rating agencies. To create additional balance sheet capacity and crowd-in institutional investment, **MDBs should, where appropriate, move from an originate-and-hold to an originate-and-distribute model,** creating structures that are familiar to institutional investors.

5 Balance sheet investments by MDBs and DFIs should not be counted as "private" capital in the narrow sense.

6 The Triple Agenda, page 12, Strengthening-MDBs-The-Triple-Agenda_G20-IEG-Report-Volume.pdf

7 Projections of the PCM ratio that is attainable vary considerably. For example, the Triple Agenda suggest an average mobilization ratio of 1.5–2, while Convergence's database suggest that every dollar of concessional capital has mobilized on average USD 4.1 in commercially priced capital, of which just under half (USD 1.8) on average has been sourced from private sector investors.

8 For example, according to the findings of the Triple Agenda, an additional USD 260 bn of MDB financing and assuming a PCM ratio of 2 would unlock USD 500 bn in incremental private finance per year for EMDCs by 2030.

- **Increase the use of demand-driven, standard-form guarantees, liaising across institutions** to simplify the product offering to benefit borrowers and private counterparties.[9] Guarantees have proven effective at mobilizing private investment, and MDBs should address both demand-side and supply-side barriers to their further scaling. Where appropriate, MDBs should offer first-loss guarantees and portfolio-level guarantees to enable institutional investment at scale.
- **Work collaboratively with governments, the private sector, and DFIs in the context of country platforms,** like Just Energy Transition Partnerships (JETPs). Country platforms potentially provide a way for all stakeholders and financing partners in countries' transition strategies to work holistically and collaboratively towards those transition objectives.

Philanthropic investors are playing an increasingly important role in helping catalyze private investments. **There is a need to address regulatory or legal impediments that currently limit the scope of philanthropy in mobilizing private capital** and for the MDBs to regard such investors as key partners.

To improve data transparency and risk assessments:

- In addition to making GEMs publicly available, **MDBs and rating agencies should work together more closely regarding assessment of risk in EMDCs.** Such engagement would allow rating agencies to better inform the development of their rating criteria and enable them to best recognize the impact of innovative financing structures and risk mitigation efforts on the MDBs' ratings and ultimately on EMDC investment ratings.
- **There should be more uniformity across MDBs in assessing risk and definitions regarding defaults and recoveries should be aligned** for adequacy and consistency with rating agencies and investors.
- Adequate and timely credit risk data should be further enhanced as the universe of data users and providers is widened, thereby **fundamentally transforming GEMs 2.0 into an effective asset allocation tool for EMDCs**.
- In the context of a better assessment of risks, it is also worth considering how **regulators and standard setters can work more closely with MDBs and the private sector** to ensure capital requirements reflect actual risk profiles and the effectiveness of risk mitigation mechanisms.

This Call to Action urges the heads of state, policymakers and MDB officials to lead in boldly implementing the systemic changes needed to mobilize the private capital required to limit global warming to 1.5°C in the medium-term, achieve a just transition and help deliver on SDGs. This will be transformative for the world.

9 The Triple Agenda recommends scaling guarantees to 25% of MDB portfolios by 2030.

This Call to Action draws on the following publications of private financial institutions

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Sustainable Markets Initiative *et al*. (2021). *Mechanism to Scale Private Sector Investment in Sustainable Projects.* a.storyblok.com/f/109506/x-/67d5c4f2d6/smi_scaling-priv-invest_report_oct2021_vfinalv3.pdf

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