Blended Finance Briefing Document

Summary

- Climate change is a growing and systemic threat to asset owners' core business.
- Risks in many emerging markets and developing economies remain significant, often making it difficult for financial institutions to lend or invest without breaching fiduciary or regulatory constraints. Due to the high perceived risk associated with certain types of investments, investors also require de-risking instruments to be able to invest in such markets.
- Policy measures such as aggregating capital, reforming global financial institutions and official development assistance, and building a pipeline of bankable projects can de-risk investments and allow for greater private sector contribution.

Key messages

- Major investment in clean technologies, low-carbon infrastructure, sustainable business models, and adaptation measures is required for greenhouse gas emissions to be halved and for the rise in global temperature to remain within 1.5°C. Beyond that threshold, the risks of severe climate and economic impacts increase significantly.
- Significant capital is available, but it is not flowing in sufficient quantities, especially into Emerging Markets and Developing Economies (EMDEs).
- Institutional investors must integrate credit risk evaluations into their portfolio steering. 88% of EMDE nations' credit risk is non-investment grade (BBB- or above), making investment in these nations beyond the risk tolerance of most Alliance members and institutional investors.
- Massive mobilisation of capital into EMDEs will only be achieved if donors, development banks, and private-sector financiers all cooperate to bring about systemic change in how private capital is deployed in climate and SDGs finance.
- Blended finance leverages public and philanthropic capital to improve the risk profiles of investment opportunities to catalyse private-sector funding, particularly in EMDEs and innovative climate enterprises.

Asks for policymakers

- **Scale and aggregate pools of concessional capital that create fiduciary investment assets**: To close the gap between high investment risk in EMDEs and investors' obligations to earn risk-adjusted returns, governments and philanthropies must create sizeable and flexible pools of concessional capital to de-risk investments and bring them within investors' risk limits.
- **Modernise the governance and business models of MDBs and DFIs to align with the SDGs and Paris Agreement**: Despite strong public commitments being made by numerous MDBs and DFIs to prioritise private capital mobilisation, efforts to catalyse private capital have not reached the required levels. Grant-funded technical assistance by MDBs and DFIs is needed at an early stage to secure a robust project pipeline.
- **Support accurate risk pricing by providing access to core credit risk data**: A systemic lack of reliable information about key issues, such as project risks, yields/returns and historic

defaults/losses, pushes private-sector investors to price the perceived risks at disproportionately high levels.

- **Prioritise thematic parameters in official development assistance**: The majority of donor funding currently requires investments to fit specific sectoral or geographic guidelines. Such restrictions reduce the potential pool of investible projects as well as the scale of respective blended finance vehicles. Attaching region-agnostic thematic parameters enabling easier access to official development assistance would help circumvent these barriers.
- **Make guarantees eligible for official development assistance**: Increasing the use of guarantees would assist in making the economic risk-return profiles for climate solutions and clean technology investments more attractive to private investors.
- **Build a pipeline of bankable projects**: Streamlining existing project pipeline facilities, increasing resources for new pipelines, and supporting country platforms to address upstream policy challenges and project development to help create more investment opportunities for the private sector.

Background

- Greater knowledge and experience is needed to give asset owners comfort that blended finance structures are an appropriate means to diversify investment portfolios into other regions, enhancing the asset mix of portfolios in line with fiduciary duty.
- **Positive collaboration between the public and private sector** has been cited as a key success factor in several leading blended finance case studies.
    - **The public sector actor's knowledge of and presence in local market can strengthen the operating model:** the Climate Innovation and Development Fund (CIDF) work with the Asian Development Bank (ADB) facilitated the development of a project pipeline and enabled collective engagement from investors.
    - **Regulatory support can accelerate projects, especially infrastructure projects**: when developing the Réseau Express Métropolitain, the Government of Québec's regulatory action allowed for additional capital to be unlocked which represented the uplift in tax revenues from the new infrastructure.
- MDBs and DFIs should **play an active role in driving private capital mobilisation** and blended finance, given their experience and expertise in EMDEs, their higher risk tolerance and their official mandates
    - 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;
    - Increase the use of demand-driven, standard-form guarantees – which have proven effective at mobilising private investment -- liaising across institutions to simplify the product offering to benefit borrowers and private counterparties.
    - Developing a set of templates or archetypes, as well as **standardised frameworks for financial returns and impact** can help reduce the incubation period and transaction costs which impede broad, and faster, deployment of blended finance vehicles.
- 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.

Resources

Scaling private capital mobilization: Call to action (2023)

With the goal of fighting climate change and delivering on the Sustainable Development Goals (SDGs), ten organisations—representing some of the largest financial institutions—jointly issue a Call to Action to Scale Private Capital Mobilization to heads of state, policymakers and MDB officials. The Call to Action recognises three key impediments to significantly increasing private capital mobilization: inadequate project pipelines, risks too high relative to returns, and data limitations and suggests specific policy solutions to address them.

Call to action on scaling blended finance (2022)

Policymakers must facilitate the scaling of blended finance structures to fund climate solutions if the world is to achieve both the Paris climate goals and the UN SDGs. In this call on policymakers the NZAOA details five asks to accelerate and scale blended finance.

Renewed call to action to asset managers for climate-focused blended finance vehicles (2022)

In the context of the persistent need for capacity-building and knowledge-sharing in this field, the NZAOA issued a renewed call to action to organise another set of presentations of blended finance product offerings and give visibility to the latest innovative vehicles.

Scaling blended finance (2021)

Asset owners face many obstacles to investing in climate solutions in emerging markets. The NZAOA Scaling Blended Finance discussion paper investigates these barriers, argues that blended finance vehicles can provide the necessary structures to help close the existing funding gaps in climate investment globally, and provides potential solutions for scaling blended finance globally.

Blended finance case studies (2024)

This booklet showcases thirteen successful examples of blended finance vehicles that can serve as templates for accelerating the design and deployment of future instruments. Developed by the Sustainable Markets Initiative and Investor Leadership Network, with support from Global Investors for Sustainable Development, the NZAOA, and GFANZ, this publication aims to harness the increased momentum behind blended finance.