Blended Finance:

A Brief Overview

October 2019

Contents

Acronyms and Abbreviations

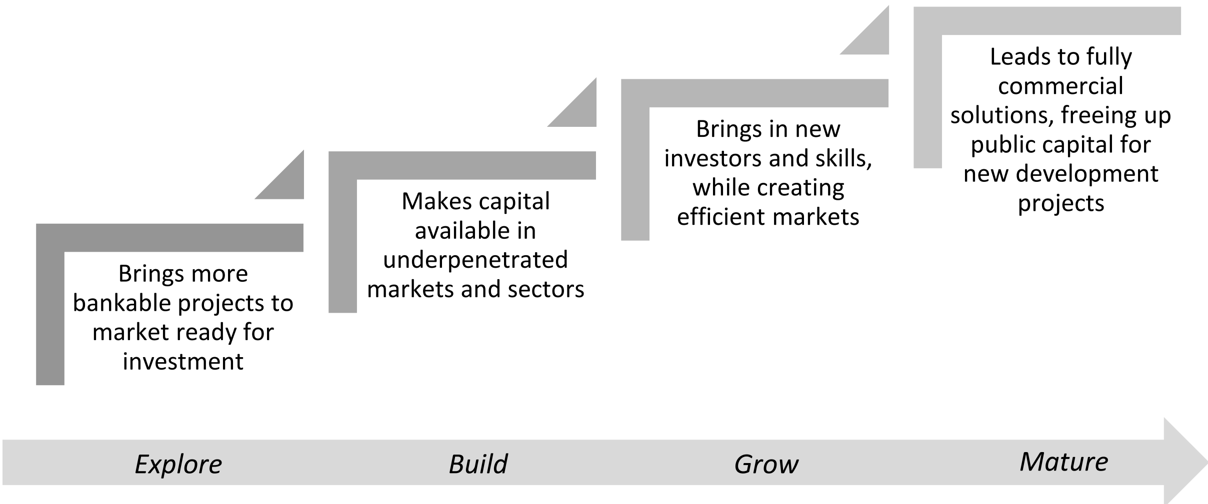
AAAA	Addis Ababa Action Agenda
ADB	Asian Development Bank
AfDB	African Development Bank
DFI	Development financial institution
EIB	European Investment Bank
IaDB	Inter-American Development Bank
IMF	International Monetary Fund
MDB	Multilateral development bank
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OECD-DAC	Organisation for Economic Co-operation and Development - Development Assistance Committee
SDG	Sustainable Development Goals
SDIP	Sustainable Development Investment Partnership (SDIP)
UN	United Nations
UNDP	United Nations Development Program
WEF	World Economic Forum

Introduction

It is generally agreed that public resources will not be sufficient to meet the investment gap required to achieve the Sustainable Development Goals (SDGs). According to estimates, there is currently an annual shortfall of USD2.5 trillion in developing countries (despite the combined amount of private capital flows, personal remittances, official development assistance (ODA) and private grants), which could work against achieving the SDGs in these countries.[1] In order to successfully move forward, bringing in private actors as partners in development is indispensable.

Increasingly recognized by the international community as a means to help bridge the funding gap to achieve the SDGs, blended finance aims at enhancing the quality of partnership between the public and private sector by maximizing synergies while setting clear impact targets towards sustainable development. By paving the way for participation in projects that are inherently too risky for more commercial capital to consider, blended finance helps extend the reach and effectiveness of development financial institution (DFI) investment in enhancing development impact and accelerating progress towards the SDGs. Blended finance is also pivotal in situations where a demonstration is required because the perception of risk is not aligned with actual risk. Its instruments can offer multiple unique attributes to investors where risk, financial and social returns, and protection against capital loss can be adjusted to meet their requirements (more on this in section 'Blended Finance Instruments and Its Application'). In other words, by improving the risk-return profiles of investments without distorting functioning markets, blended finance incentivizes and mobilises private capital in emerging and frontier markets, where public sector resources and donor funds are limited.

Blended Finance Benefits by Stage



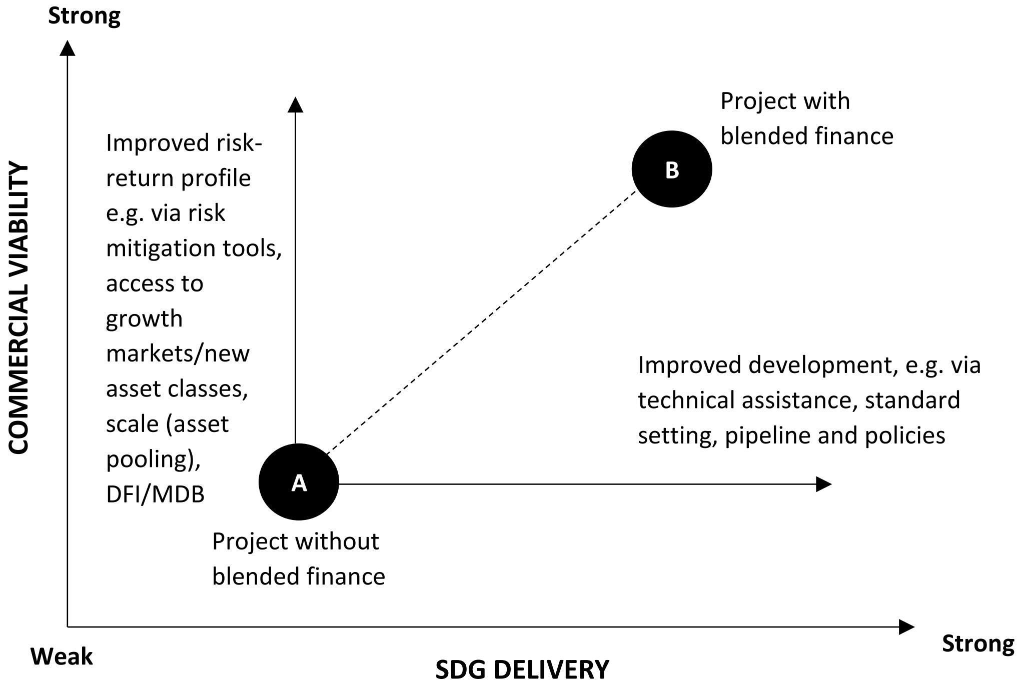
Life Cycle of Projects & Enterprises

[1] United Nations Conference on Trade and Development (UNCTAD)

Source: Blended Finance Vol.1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)

Beyond finance, blending can deliver much more than capital for achieving the SDGs-- the synergy between diverse actors from the public and private sector leverages strengths and capacities from each sector that can be applied in innovative ways to solve persistent development challenges, such as sharing local market knowledge and experience to bridge knowledge and capability gaps. Blended finance can also build local capacity to assist local markets and help shape policy and regulatory reform that will improve the local investment climate.

Blended Finance: Improving the Commercial Viability of SDG-Related Investments



Source: Better Finance, Better World, Blended Finance Taskforce in partnership with the Business & Sustainable Development Commission (BSDC) and SYSTEMIQ (2018)

Defining Blended Finance, its Key Characteristics and Concepts

Definition of Blended Finance

The introduction of blended finance has generated a strong interest in deploying its concept to address the sizable funding gap that have long hindered the successful implementation of the ambitious United Nations Sustainable Development Goals (SDGs) which was adopted in September 2015.

While the definitions of blended finance may vary in practice, they are largely complementary and share common attributes. At its core, blended finance uses public development finance to mobilise additional commercial capital, primarily from private sources, to help the international development community achieve sustainability goals. The novelty in blended finance is that it aligns investors and investment instruments for a common set of financial and impact objectives in line with the guiding principles set by the SDG framework.

The definition adopted by the United Nations (UN) in 2015 at the Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development refers to blended finance as "combining concessional public finance with non-concessional private finance and expertise from the public and private sector". The Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC)'s definition is much broader in scope, characterizing it as "the strategic use of development finance for the mobilisation of additional finance towards the SDGs in developing countries." Meanwhile, the Development Financial Institutions (DFI) Working Group defines blended finance as "combining concessional finance from donors or third parties alongside DFIs' normal own-account finance and/or commercial finance from other investors, to develop private-sector markets, address the SDGs, and mobilise private resources."

Definitions of Blended Finance

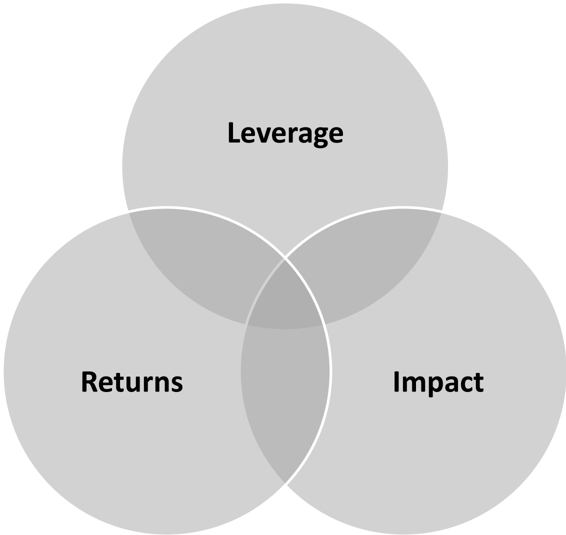
Financing that combines concessional public finance with non-concessional private finance and expertise from the public and private sector	*The strategic use of development finance for the mobilisation of additional finance towards the SDGs in developing countries*	*Combining concessional finance from donors or third parties alongside DFIs' normal own-account finance and/or commercial finance from other investors, to develop private-sector markets, address the SDGs, and mobilise private resources*
The Addis Ababa Action Agenda	**OECD-DAC**	**DFI Working Group**

Key Characteristics of Blended Finance

In essence, blended finance can be characterized by three main features:

- **Leverage:** The systematic and strategic use of development finance and philanthropic funds to mobilise and engage private capital at scale.
- **Impact:** Investments that deliver measurable social, environmental and economic impact.
- **Returns:** Market-based risk-adjusted returns for private investors that meets business goals and fiduciary duties.

The Three Pillars of Blended Finance



Source: Blended Finance Vol.1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)

Key Concepts

Additionality

The concept of additionality is an important element in the blended finance discourse. It refers to the added value of a specific form of finance, whether financially and/or socially, and plays an important role in demonstrating the rationale behind blending. Due to the lack of a universally agreed definition, approach or methodology to measure additionality, DFIs have different ways of evaluating it. For example, according to the EIB framework, an intervention is additional if it facilitates or enhances a project from the public development prospective beyond what is available on the market, or that is otherwise absent from the market, and does not crowd out other private sector actors. In other words, additionality ensures that interventions will complement or supplement existing financing possibilities and correct market failures, rather than compete with the private sector. At the IFC, the criterion is more used to ascertain whether the institution would do the activity anyway or if it is truly incentivized by the subsidy element. As a general rule, the two main components of additionality are as follows:

- **Financial additionality.** Financial additionality comes from the distinctive capital mobilized in the market by private and public institutions following the injection of ODA funding into blended finance.
- **Development additionality.** Development additionality allows for higher development results as a result of an intervention.

Together, it is the balance or the combination of both types of additionality that needs to be examined to provide a window into a blending project's true additionality and to ensure that ODA resources are not misused. However, as mentioned above, the absence of harmonization makes it difficult to assess and compare blending projects by different institutions and gain valuable insights.

Different Types of Additionality and Implications

Additionality	Financial Implications	Development Implications	Risks Involved
Financial only	Subsidy is required for project to commence	The development results/impact of the project can be attributed to the grant element. No changes in project design	It is difficult to calculate additionality
Development only	Subsidy is not required from a financial point of view	Development results improve as a result of blended operations better design	Quantifying the development impact can be difficult. How much improvement is required?
Development & Financial	Subsidy is required for project to commence	The development results/impact of the project can be attributed to the grant element and development results improve as a result of blended operations (better design)	Same as above
None	Unnecessary subsidy to the project	No improvement in development results	Waste of ODA resources

Source: Blended Finance: What it is, how it works, and how it is used, Oxfam, Research report. Pereira, J. (2017)

Leverage

Another fundamental concept in blended finance is leverage. In its simplest form, leveraging in the context of development finance is defined as the use of development finance and philanthropic funds to attract private capital into deals.[2] Since the leveraging of public funds to catalyse private commercial capital is at the heart of blended finance, the issue of "appropriate leverage" comes to play. An appropriate amount of leverage is context specific and varies across sectors, geographies, and the different stages of the investment life-cycle.[3] Without careful planning, excessive leverage can distort local capital markets and risks supporting projects that are unsustainable in the long

[2] Blended Finance Vol.1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)
[3] OECD-DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals, OECD (January 2018)

term, turning investments into ongoing public subsidies or projects set up to fail. Therefore, proper methodologies and mechanisms must be put into place to accurately measure and monitor leverage to determine successful mobilization in blending finance projects, with a clear-cut strategy for the eventual exit of development finance.

How Does Blending Work: Blended Finance Approaches and Instruments

Blended Finance Approaches

The three main approaches to blended finance include technical assistance, risk underwriting, and market incentives.[4]

Technical assistance grants (technical/operational expertise)

Technical assistance is an essential tool to attract private capital to development projects, allowing knowledge gaps to be addressed and new projects to be developed and technically accompanied (in kind or by a TA grant). Development funding can be used to provide targeted support in the form of advisory and consulting services for project preparation (especially early stage such as exploration studies), operational assistance, product development, skills training, transmission of working knowledge and other professional services to improve the business viability of investee projects or enterprises and thus enhance investment performance. In the blended finance context, technical assistance can be directly incorporated within a blended finance fund or facility, or operate as a separate entity. The advantage of technical assistance is the ability to highly leverage capital which can lead to substantial benefits, including:

- Greater project liability.
- Improved performance of investee enterprises, leading to enhanced investment performance.
- Enhanced local knowledge and capacity, which benefits across the full project cycle.
- Provide for upfront costs (e.g. project preparation), if projects do not achieve financial closing, which would otherwise have been covered by investors, thus increasing the willingness to invest and improve risk-return profile.
- Increasing the efficiency of local markets.

Risk underwriting (capital preservation)

Risk underwriting instruments can either improve the credit profile of companies and projects seeking to raise more or cheaper capital, or provide comfort to investors that they will be able to recover their investment or absorb smaller losses if events negatively impact their returns, effectively shifting the risk-return profile of an investment opportunity. Two of the most common types of risk underwriting tools are insurance policies and guarantees. Insurance policies are contracts issued by a third party agreeing to make a payment in the case of a particular event occurring, preserving the capital for the lender. The type of risks that may arise are manifold, all of

[4] Blended Finance Vol.1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)

which may impact on the value of the investment. In this way, they can reduce actual or perceived risks.

A guarantee is a formal assurance that if an undesirable event occurs, the guarantor will take action on behalf of the guaranteed party and assume responsibility. For example, a guarantee can be used to ensure that if a company fails to repay the lender, a development funder will cover part of the repayment. Guarantees can help to ensure that investors receive a minimum level of returns, or can limit an investor's losses if an investment underperforms expectations. 'First-loss' guarantees are one particular guarantee instrument which states that the development funder will absorb the initial losses associated with an investment. Donors have found these to be powerful tools.

Other forms of risk underwriting include currency hedges and interest rate swaps which can be used to smooth out volatility in the market and protect investors against excessive volatility and losses. Benefits of risk underwriting include:

- Making more development projects commercially viable, by shifting the risk-return ratio and reducing the cost of capital.
- Enabling development funders to support a larger number of projects than other instruments. Instruments such as guarantees and insurance policies typically require no immediate outlay of capital and only require funding when called, which will only happen in a proportion of cases. This enables a given pot of funding to be spread across multiple projects.
- The ability to respond to project needs and/or investor needs, to ensure funds are channeled into the highest impact sectors.

Market incentives (results-driven financing/price guarantees)

Market incentives aim to support investment in sectors which are high-impact, but in which normal market fundamentals do not exist. They are particularly important in market segments which require innovation around new products and services that address development outcomes, creating potential for commercial markets where they did not originally exist. They are generally structured as a guarantee for payments against products and services based on performance or supply, or in exchange for upfront investment in new or distressed markets. Examples include advance market commitments, awards, prizes, challenge funds, matching funds, and development impact bonds, among others.

Market incentives can provide investors with visibility on pricing and revenue in order to create new markets. For example, by guaranteeing the pricing of products above currently prevailing market prices, investors remove elements of market uncertainty by locking in a margin. This can encourage scaling production to naturally reduce overall pricing in the future. In such instances, visibility into financial returns enables investors to quantify the risks and make informed investment decisions. Market incentives can also be used to address capital intensive activities where investors provide upfront funding for development interventions and donors or governments repay them with a premium based on the outcomes of the intervention to help smooth out sometimes unpredictable grant flows when there is an immediate capital need. Benefits of market incentives include:

- Providing investors with visibility on pricing and revenue, removing market uncertainty.
- Smoothing out cash flows for development projects.
- Encouraging capital to move into sectors with high development impacts.

Source: Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)

Blended Finance Approaches: An Overview

Technical Assistance *(Technical/Operational Expertise)*	Technical assistance addresses the risks in new, uncertain and fragmented markets for investors. Costs and risks associated with exposure to new markets, technical uncertainty, and the inability to build a pipeline can be reduced through this mechanism, lowering the high transaction costs for investors and operational risks which often dissuade a commitment of funds.
Risk Underwriting *(Capital Preservation)*	Risk underwriting reduces specific risks associated with a transaction. This Mechanism provides direct compensation or assumes losses for specific negative events, addressing concerns of private capital providers related to macro and project/company specific risks to ensure capital is preserved.
Market Incentives *(Results-based Financing/Price Guarantees)*	Market incentives address critical sectors that do not support market fundamentals. This helps new and distressed markets that require either scale to be commercially viable or reduced volatility, by providing fixed pricing for products in order for private capital to justify committing to the sector.

Source: Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders, OECD (2015)

Blended Finance Instruments and Its Application

As discussed earlier, the risk-return profiles of investments in emerging and frontier markets often do not meet the expectations of commercial investors. To attract private capital, real or perceived enabling environment risks-- such as those related to the rule of law, corporate governance, and macroeconomic and political vulnerability-- must be managed, mitigated, or transferred to funders with a higher risk appetite (e.g. public or philanthropic funders). In this regard, blended finance instruments can be used to address many of the barriers limiting private capital from investing in developing markets or in high development impact projects or sectors.

Types of Risks Faced by Investors

Macro Risk	- **Political Risk:** Political decisions/events in the investment country negatively impacting the attractiveness of an opportunity - **Currency Risk:** The possibility of depreciation of local currencies against hard currencies (eg. EUR/USD) - **Macroeconomic and Investment Climate Risk:** Examples include markets with relatively low growth rates compared to peers as well as the lack of transparent regulatory, tax and legal systems, capital controls, tax barriers, and tariffs
Commercial Risk	- **Credit/Counterparty Risk:** The risk of default from borrowers on debt repayments - **Demand Risk:** Risk around commercial viability and sales - **Liquidity Risk:** The inability to exit/sell an asset when desired
Finance Risk	- **Access to Capital:** Risk of not being able to secure financing
Technical Risk	- **Construction/Operational Risk:** Risk of project not completing as planned or the asset does not perform as planned post-completion
Infra-specific Risk	- **Off-take risk:** Risk around being unable to secure long-term contractual commitment for purchase of a resource - **Lack of pipeline:** Challenge of being able to generate and develop investable projects or bring enough projects from concept to bankable stage

Source: “Better Finance, Better World”, Blended Finance Taskforce in partnership with the Business & Sustainable Development Commission (BSDC) and SYSTEMIQ (2018)

The table below illustrates the different types of blended finance instruments available and describes how they can shape the risk-return profile of an investment.

Blended Finance Instruments

Instrument	Description Instrument	Type	Description Type	Risks/Barriers Addressed
Direct debt or equity investment	Direct financial investment into a transaction or blended finance vehicle	Junior/Subordinated capital	Subordinated debt or Junior equity (including mezzanine). Losses on the value of the security are absorbed by the junior/subordinated tranche first	Multiple risks including off-taker risks, construction risks, credit risk etc.
		Catalytic Capital	Capital provided on commercial terms can be catalytic when used for demonstration effect	Access to capital, reputational risk
		Loan Syndication	A loan facility offered by a group of lenders, If MDBs/DFIs act as lender of record, international banks and institutional investors benefit	Transfer and convertibility risk, political risk, environmental and social risk

Instrument	Description Instrument	Type	Description Type	Risks/Barriers Addressed
			from their tax exemption, preferred creditor status, and immunities (A/B loan structure)	
		First-Loss Funding (including as grant or guarantee)	A position that will suffer the first economic loss if the assets below it lose value or are foreclosed on (can be provided through grant or guarantee)	By improving risk-return profile, first-loss can catalyse the participation of more risk-averse investors
Guarantees insurance	Generally, three party agreements, where a third party provides an extra layer of protection for the beneficiary of a service (protect against capital losses or provide credit enhancement)	Loan Guarantees	Loan guarantees can be complete or partial	Multiple risks including off-taker risks, construction risks, credit risk etc.
		Performance Guarantees	Issued by an insurance company or bank to a contractor to guarantee the full and due performance of the contract according to the plans and specifications	Completion risk / construction risk / technical risk
		Volume Guarantees	Tool to reduce risk associated with R&D and manufacturing of products	Demand risk / R&D risk
Insurance	Two party contracts between the insurer and the policy holder. The insurance provider promises to provide financial compensation in the instance of an event that results in a financial loss	Political risk insurance	Insurance against adverse government actions or war, civil strife, and terrorism. Provide a more stable environment for investments into developing countries, and to unlock better access to finance	Provide a more stable environment for investments into developing countries, and to unlock better access to finance
		Commercial/business insurance	To support operations against unexpected events. Typically agreed threshold for compensation for a given policy	Construction risks / operation and output risks / upstream resource-related risks
Hedging	Contractual instruments to help manage different types of risks faced by an investor or borrower	FX hedges/swaps	There are many promising blended finance solutions for reducing FX risk in developing countries (e.g. TCX), but cost and scale are still key problems	FX risk
Securitisation	Securitisation refers to the	Asset Pooling	Securitisation can create	Liquidity / time

Instrument	Description Instrument	Type	Description Type	Risks/Barriers Addressed
	process of transforming a pool of illiquid assets into tradable financial instruments (securities)		products that attract larger institutional sources of capital through aggregation and securitisation of underlying assets	horizon, scale, counterparty / off-taker / credit risk
Grants	A financial contribution with no expected repayment to for example support capacity building, provide strategic or technical support. Preparation facilities can improve project financial viability by offsetting high up-front transaction costs, reducing the uncertainty of a project becoming operational	Technical Assistance facilities (TA)	Advisory, assistance or training to the investee business or other value chain and ecosystem actors provided either pre- or post-investment	Access to capital, capacity development, reduce transaction costs, operational risks
		Project Prep Assistance	Grant or concessional funding provided specifically to deploy resources for early stage project exploration	Lack of bankable pipeline, lack of local intermediaries
Other contractual mechanisms	Various contractual and project finance arrangements to supports the development of bankable infrastructure projects	Off-taker agreements, Subsidies such as feed in tariffs and tax credit	An agreement between a producers and buyers of a resource to purchase or sell portions of future production. Used to secure financing of a production facility or buy the equipment needed to extract a resource (e.g. power purchase agreements (PPAs) in the energy sector)	Demand Risk, Financing risk (demonstrate bankable revenue stream)
Results-based incentives	Instruments that provide incentives and disincentives to achieve desired outcomes or results (tie at least a portion of payments to achievement)	Social Impact Bonds, Performance-based contracts	This type of financing is aimed at rewarding innovation and successful implementation of a project with clear climate benefits	Operation and output risks

Source: Better Finance, Better World, Blended Finance Taskforce in partnership with the Business & Sustainable Development Commission (BSDC) and SYSTEMIQ (2018)

Principles Governing Blended Finance

DFI Enhanced Principles for Blended Concessional Finance in Private Sector Projects

The DFI Enhanced Principles on Blended Concessional Finance for Private Sector Operations are strengthened and built on a set of principles first agreed by the DFI Working Group[5] in October 2013, with the objective of ensuring the effective and efficient use of concessional resources in private sector projects and avoiding market distortion or crowding out private capital[6]. The updated edition, released in October 2017, includes a set of guidelines[7] for each of the five principles, and addresses critical blended finance topics at the operational level by taking the perspective of implementing institutions. Among other items, the guidelines discuss the importance of blended concessional finance in addressing obstacles to positive market dynamics, processes that can be used to ensure minimum and time-bound use of concessional funds, and sound practices with respect to standards, governance and transparency.[8]

The five core principles, derived from the 2013 report[9] include:

- **Principle 1: Additionality/rationale for using blended concessional finance**

  DFI support of the private sector[10] should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector.

- **Principle 2: Crowding-in and minimum concessionality**

  DFI support to the private sector should, to the extent possible, contribute to catalysing market development and the mobilization of private sector resources.

- **Principle 3: Commercial sustainability**

  DFI support of the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must therefore be expected to contribute towards the commercial viability of their clients.

- **Principle 4: Reinforcing markets**

[5] The group of DFIs include the African Development Bank (AfDB), the Asian Development Bank (AsDB), the Asia Infrastructure Investment Bank (AIIB), the European Bank for Reconstruction and Development (EBRD), European Development Finance Institutions (EDFI), the European Investment Bank (EIB), the Inter-American Development Bank Group (IDBG), the Islamic Corporation for the Development of the Private Sector (ICD), and the International Finance Corporation (IFC)

[6] DFI Working Group on Blended Concessional Finance for Private Sector Projects: Summary Report, October 2017

[7] For more detailed information on guidelines, refer to "DFI Working Group on Blended Concessional Finance for Private Sector Projects: Summary Report", October 2017

[8] DFI Working Group on Blended Concessional Finance for Private Sector Projects: Summary Report, October 2017

[9] Private Sector Development Institutions Roundtable: DFI Guidance for Using Investment Concessional Finance in Private Sector Operations, March 2013

[10] These principles would also apply to other commercially-oriented enterprises addressed by the non-sovereign operations of the DFIs.

DFI assistance to the private sector should be structured to effectively and efficiently address market failures, and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.

- **<u>Principle 5: Promoting high standards</u>**
  DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity, and disclosure.

DFI Enhanced Projects for Blended Concessional Finance in Private Sector Projects

1. Additionality/rationale for using blended concessional finance
2. Crowding-in and minimum concessionality
3. Commercial sustainability
4. Reinforcing markets
5. Promoting high standards

OECD-DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals

Serving as a policy tool for all providers of development finance, these set of principles were shaped by key players from the private sector, civil society and governments to establish a common framework on best practices in blended finance. The OECD-DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals were approved at the DAC High Level Meeting on 31 October 2017.

The principles give a clear definition and provide a five-point checklist[11] to ensure blended finance meets accepted quality standards and achieves impact, based on a development mandate promoted by DAC members. The goal is to ensure that blended finance is deployed in the most effective way to

[11] For more detailed information, refer to "OECD-DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals", OECD (January 2018) or visit www.oecd.org

tackle the financing needs for sustainable development as set out in the Addis Ababa Action Agenda (AAAA), by mobilising additional commercial capital and maximising impact. The principles also support the development of effective policies and facilitate accountability. They include:

- **Principle 1: Anchor blended finance use to a development rationale.**
  All development finance interventions, including blended finance activities, are based on the mandate of development finance providers to support developing countries in achieving social, economic and environmentally sustainable development.
    - Use development finance in blended finance as a driver to maximise development outcomes and impact
    - Define development objectives and expected results as the basis for deploying development finance
    - Demonstrate a commitment to high quality

- **Principle 2: Design blended finance to increase the mobilisation of commercial finance**
  Development finance in blended finance should facilitate the unlocking of commercial finance to optimise total financing directed towards development outcomes.
    - Ensure additionality for crowding in commercial finance
    - Seek leverage based on context and conditions
    - Deploy blended finance to address market failures, while minimising the use of concessionality
    - Focus on commercial sustainability

- **Principle 3: Tailor blended finance to local context**
  Development finance should be deployed to ensure that blended finance supports local development needs, priorities and capacities, in a way that is consistent with, and where possible contributes to, local financial market development.
    - Support local development priorities
    - Ensure consistency of blended finance with the aim of local financial market development
    - Use blended finance alongside efforts to promote a sound enabling environment

- **Principle 4: Focus on effective partnering for blended finance**
  Blended finance works if both development and financial objectives can be achieved, with appropriate allocation and sharing of risk between parties, whether commercial or developmental. Development finance should leverage the complementary motivation of

commercial actors, while not compromising on the prevailing standards for development finance deployment.

- Enable each party to engage on the basis of their mandate and obligation, while respecting the other's mandate
- Allocate risks in a targeted, balanced and sustainable manner
- Aim for scalability

- **<u>Principle 5: Monitor blended finance for transparency and results</u>**

  To ensure accountability on the appropriate use and value for money of development finance, blended finance operations should be monitored on the basis of clear results frameworks, measuring, reporting on and communicating on financial flows, commercial returns as well as development results.

  - Agree on performance and result metrics from the start
  - Track financial flows, commercial performance, and development results
  - Dedicate appropriate resources for monitoring and evaluation
  - Ensure public transparency and accountability on blended finance operations.

OECD-DAC Blended Finance Principles for Donors

OECD
BETTER POLICIES FOR BETTER LIVES

1. Anchor blended finance use to a development rationale
2. Design blended finance to increase the mobilisation of commercial finance
3. Tailor blended finance to local context
4. Focus on effective partnering for blended finance
5. Monitor blended finance for transparency and results

Challenges and the Way Forward

While many DFIs are scaling up efforts in increasing their ability to deliver blended finance, the absence of a universally agreed definition of blended finance and its key concepts, in addition to the lack of a common and harmonised results framework, performance measurement, product standards, and data collection have made it difficult to achieve the necessary scale and desired impact that it offers to support the fulfilment of the SDGs. As a result, calculating, reporting, and monitoring the actual magnitude and development impact of blended finance is difficult and up for debate. Moreover, blended finance often lacks transparency and accountability, with insufficient information made available to the public.

In order to capitalise on blended finance successfully, a common language and understanding must, first and foremost, be agreed upon and shared. It is important for all stakeholders (especially private sector players such as institutional investors and the likes) to have a clear understanding of what instruments are readily available, and how to incorporate them into financial structures to shift the investment risk-return profile to attain more favourable terms. The development and subsequent implementation of transparent methodologies and metrics to assess additionality and to ensure that securing positive developmental outcomes is at the core of decision making processes, are key requirements for a successful and effective blended finance sector.

To this end, effective coordination and collective action is needed to merge and standardize the ever-evolving approaches and methodologies currently adopted by blended finance practitioners. DFIs play a significant role in the mainstreaming of blended finance in terms of sharing capabilities and providing the necessary risk frameworks for working with the private sector in market environments by assuming a leadership role. Drawing from their experiences, DFIs should also prioritize knowledge sharing and making better use of lessons on the advantages of blended finance while acknowledging and addressing its pitfalls.

Appendix 1:

Initiatives Undertaken by DFIs to Promote Blended Finance

DFI Working Group on Blended Concessional Finance for Private Sector Projects

In April 2012, a group of DFIs decided to identify the set of general principles that MDBs can use to support the private sector in a way that is sustainable and ensures additionality of their operations. This resulted in the MDB Principles to Support Sustainable Private Sector Operations and led to the adoption of the five core principles (DFI Principles for Blended Concessional Finance in Private Sector Projects) in October 2013, that guide MDBs' engagement with, and support of, the private sector, so as to achieve development goals consistent with their mandates.

To help ensure the effective and efficient use of concessional resources in private sector projects, and avoid market distortion or crowding out private capital, the MDB Heads at their October 2016 meeting called for efforts to build on and further strengthen the principles for the use of concessional finance in private sector operations agreed by the DFIs in 2013. As a result, the DFI Enhanced Principles for Blended Concessional Finance in Private Sector Projects was launched in October 2017, with the commitment of furthering the dialogue and knowledge-sharing on blended concessional finance.

OECD-Development Assistance Committee (OECD-DAC)

The OECD-DAC is a forum which consists of many of the largest providers of aid. It has 30 members, with six participating countries and observer members comprising of six DFIs including ADB, AfDB, IaDB, IMF, UNDP and World Bank.[12]. Its mandate is to promote development cooperation and other relevant policies which will contribute to the implementation of the 2030 Agenda for Sustainable Development.

Its efforts in progressing blended finance best practices is evidenced by the establishment of the OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs in October 2017, which have gained widespread acceptance and have also been referred to in the G7

[12] For more detailed information, visit http://www.oecd.org/dac/development-assistance-committee/

commitment on innovative financing for development agreed in Canada.[13] In the near future, the OECD-DAC has pledged to work on more detailed guidance for policy makers to support the implementation of the Principles by providing best practice examples, support the development of effective policies and facilitate accountability.

Tri Hita Karana (THK) Roadmap for Blended Finance

The Tri Hita Karana (THK) Roadmap for Blended Finance is an international unifying framework that covers a broader range of public or private support for private sector projects for development beyond the use of concessional finance. Under the leadership of the Government of Indonesia and the OECD with contributions from major partners from various governments, DFIs and private sector actors, civil society organizations and think tanks, the Roadmap was launched on the side-lines of the International Monetary Fund (IMF)/World Bank Meeting at the Tri Hita Karana Sustainable Development Forum on "Blended Finance and Innovation for Better Business Better World" in Bali, Indonesia on 11 October 2018.

The THK Roadmap establishes a shared value system, and the terms of reference that enable collective action among a variety of actors that are required to deliver on the SDGs. The goal is to achieve together an outcome that is greater than the sum of the organisations represented, by mobilising and better-targeting additional resources for sustainable development.

Shared Values for Ensuring Effective Blended Finance

- Anchor blended finance into the SDGs
- Commit to using blended finance to mobilise commercial finance
- Design blended finance to move towards commercial sustainability
- Structure blended finance to build inclusive markets
- Promote transparency when engaging in blended finance

Source: Tri Hita Karana Roadmap for Blended Finance

Moving forward, key partners are expected to turn the Roadmap into action. This entails five key areas[14]:

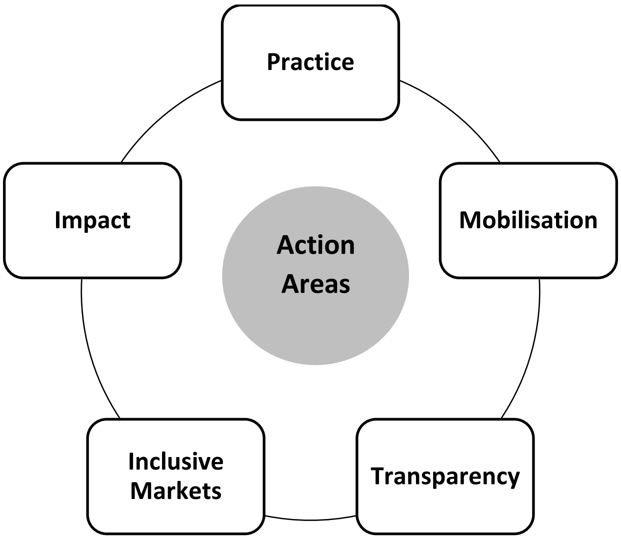
- **Practice**: **Translate the common narrative into good practice**

[13] G7 (2018), *Charlevoix commitment on innovative financing for development*, https://international.gc.ca/world-monde/international_relations-relations_internationales/g7/documents/2018-06-09-innovative_financing-financement_novateur.aspx?lang=eng

[14] For more detailed information, refer to Tri Hita Karana Roadmap for Blended Finance, or visit http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/Tri-Hita-Karana-Roadmap-for-Blended-Finance.pdf

- **Mobilisation:** Accelerate mobilisation of private commercial finance.
- **Transparency:** Build on efforts to facilitate transparency in the use of blended finance.
- **Build inclusive markets:** Addressing specificities in the local and international investment climate.
- **Impact:** Promote measurement and monitoring of the impact of blended investments towards the SDGs.

Tri Hita Karana Roadmap for Blended Finance: Action Areas



Source: Tri Hita Karana Roadmap for Blended Finance

Supporters of the Roadmap include Canada, Indonesia, Swedish International Development Cooperation Agency (Sida), Development Bank of Southern Africa (DBSA), Blended Finance Taskforce, Convergence Blended Finance, Sustainable Development Investment Partnership (SDIP), World Economic Forum, the OECD, as well as the DFI Working Group.

Blended Finance Taskforce

The Taskforce consists of a group of roughly 50 experienced practitioners and experts, from across the finance, business, development and policy community. The Blended Finance Taskforce members act in their personal capacity. The Taskforce is responsible for the "Better Finance, Better World" consultation paper that outlines the business case of blended finance as a driver of global growth.

The Taskforce Action Programme, which contains eight core workstreams, underscores an ambitious plan to increase mainstream private investment for the SDGs, and is a call to action based on the findings of the Taskforce's flagship report.

Blended Finance Taskforce: Programme of Eight Key Initiatives

- **Mobilisation:** Provide a clear, ambitious proposition on MDB/DFI mobilisation targets in line with the requirements of the Paris Agreement and the SDGs.
- **Investor club:** Form a high ambition club of institutional investors and asset managers, willing to commit to sustainable infrastructure targets (e.g. 2% by 2020 and 5% by 2025).
- **Regulatory disincentives:** Support the launch of a standardised development guarantee and accelerate amendment to financial regulations (e.g. Solvency II and Basel III) which currently disincentivise investment in emerging markets and infrastructure.
- **Infrastructure data:** Drive greater access to data on infrastructure performance (including historical MDB/DFI data) as a public good to help build infrastructure as an asset class.
- **Blended finance vehicles/instruments:** Double capacity for long-term FX hedging instruments to support deepening of local capital markets; profile existing blended finance vehicles to support scale up.
- **Private intermediaries and incubators for pipeline:** Work with investment platforms, incubators and foundations to seed new blended finance intermediaries (e.g. 20 by 2020) to drive project pipeline and ensure innovation as well as scale, especially in frontier markets.
- **Investment for priority sectors:** Dramatically scale private investment for resilient cities, sustainable land-use (+ ocean plastic, energy access) by developing blended finance strategies for high-impact sectors.
- **Blended finance capacity in developing countries:** Create a network of blended finance funds and initiatives to share knowledge and build capacity to drive sustainable growth and deliver the Paris Agreement and the SDGs.

Source: www.blendedfinance.earth

Sustainable Development Investment Partnership (SDIP)

Hosted by the World Economic Forum and the OECD, SDIP brings together leading institutions engaged in blended finance activities. Membership currently consists of 42 institutions representing a cross-section of banks, investment funds, pension funds, development finance institutions, foundations, governments, and multi-lateral development banks. Since its inception in 2015, SDIP has put in place a solid foundation to mobilize and scale blended finance in sustainable investments in developing countries. Moving forward, SDIP will continue to help scale and mainstream blended finance, with emphasis on engaging local communities in the African and ASEAN regions, and additional leading organizations (including those from other sectors) will be invited to join the SDIP community as the Partnership develops.

SDIP's Multi-Pronged Approach to Blended Finance

- **Project Investment Review Group (PRG):** Present live projects that lend themselves to blended finance solutions to the membership for potential funding and/or de-risking.
    - SDP has established a pipeline of 75 projects; 25 of these have been reviewed by its members, who have helped improve terms for several projects under final negotiation.
- **Scaling Blended Finance Mechanisms:** Identify, scale and replicate blended finance mechanisms and instruments that are effective in bringing projects to a financial close.
    - SDIP has showcased 14 financing models, with efforts underway to replicate and scale the most effective of these.
- **Regional Engagement on Blended Finance:** Support t Through its regional hub concept, SDIP is able to implement blended finance at the local level. Each hub is formed of an engaged community of local institutions (including local representatives of global institutions) able to provide specific insight into regional challenges, share best practices, and support governments on how to finance project pipelines effectively.
    - SDIP has launched the Africa Hub, with offices established in Abidjan and Johannesburg; an ASEAN Hub is being explored.
- **Policy Guidance.** Support the development and implementation of frameworks that will encourage systematic adoption of blended finance best practices.
    - SDIP collaborated with the OECD DAC on blended finance Principles and Principles for Sustainable Infrastructure.