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Mobilizing Private Investment in Climate Solutions: De-risking Strategies of Multilateral Development Banks

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HIGHLIGHTS

- The climate crisis has heightened the urgency of increasing investment in low-carbon and climate-resilient development in developing countries. Multilateral development banks (MDBs) are well positioned to support climate-related investments in developing countries.
- Beyond their traditional lending, MDBs can reduce, transfer, or mitigate the risks associated with investments in developing countries under certain conditions, thereby mobilizing large volumes of additional private capital that otherwise would not be available. MDB "de-risking," therefore, can help reduce the climate investment gap.
- De-risking can also build trust among borrowers and financiers, create synergies, and support sector development.
- MDBs can de-risk at the portfolio level by transferring risk to private investors and at the project level by sharing risk with private investors.
- To replicate and scale de-risking, MDBs should use and expand financial innovation, learn from experiences, position de-risking as an instrument for sector development, promote cooperation among divisions within the MDB, and enhance data accessibility and transparency.

EXECUTIVE SUMMARY

Context

The gap in financing climate-related investments in developing and emerging countries persists due to project- and country-related risks that prevent private investors from investing. Increasing attention is being paid, as appropriate, to the strategic use of public resources to de-risk investments to catalyze private finance and mobilize additional capital for climate-related projects.

MDBs have expertise and financial tools for de-risking, but implementation at scale has yet to materialize. This paper addresses the following questions: What are the risks that inhibit private sector investment in climate projects in developing countries? What are the barriers that prevent MDBs from widely using de-risking instruments such as guarantees? Based on selected case studies, we seek to shed light on the lessons learned and tease out the salient features of innovative de-risking instruments and structures that MDBs can apply, replicate, and scale.

About this working paper

This paper focuses on the potential for MDBs to mobilize private capital at scale. MDBs are well placed to facilitate low-carbon and climate-resilient development as conveners, financiers, and project implementers at the nexus of the public and private sectors and the developing and developed worlds. Yet MDBs' potential to mobilize private finance for climate-related investments remains largely untapped.

The objectives of this paper are twofold:

- Provide insights into the innovative financial de-risking instruments and structures used by MDBs to catalyze private finance for climate investments.
- Determine the potential and conditions for replicating and scaling these mechanisms successfully, which would enhance the role of MDBs as "mobilizers" to narrow the climate investment gap.

This analysis highlights the risks that are preventing the private sector from investing in climate projects in developing countries as well as the barriers that thwart MDB efforts to scale de-risking. It does so through case studies of Room2Run, Impact Loan eXchange Fund I, RenovAr, and the Pacific Renewable Energy Program, which illustrate de-risking at the portfolio and project levels. From these cases, we identify features and characteristics that could be replicated and scaled in other contexts and draw lessons for improvement.

Findings

At the portfolio level, MDBs can respond to the constraints they face in expanding lending while establishing a new channel for private investors to invest in developing countries. De-risking can make new or previously illiquid asset classes available to a wider set of investors to invest in climate-related projects.

At the project level, MDBs can offer financial tools to manage political and regulatory risks. These can significantly improve the risk-return profile of climate projects and deploy additional private capital and know-how.

Enhanced data accessibility and transparency are needed for designing and deploying de-risking initiatives at scale. Potential investors have insufficient knowledge of performance data, which results in delays in designing de-risking initiatives. Although data on the credit history and probabilities of default in emerging markets exist, such information is available only to a subset of MDBs and development finance institutions (DFIs), creating inefficiencies and bottlenecks to scaling.

Partnerships with MDBs bring financial and nonfinancial additionality and benefits for de-risking. Here, additionality can be defined as the specific inputs brought by MDBs that do not exist from other sources of finance. Without the MDB, these investments would not have happened, and climate action would have been reduced.

We identify four proposals that MDBs and other financiers should consider when designing de-risking initiatives or scaling existing operations.

- Expand the use of financial innovation and encourage learning in partnership with other stakeholders—such as the developing country governments and their DFIs—to share lessons and conditions for scaling.
- Position de-risking as a mechanism for sector transformation by addressing risks from the entire life cycle of a project within a sector instead of a single asset and tapping into local knowledge, networks, and investors.
- Encourage an integrated institutional approach through greater collaboration within MDBs across sectors and units to provide a coherent approach to de-risking.
- Enhance data accessibility and transparency by increasing access to credit and probability of default data at a granular level to facilitate project design, assessment, and the decision-making process.

INTRODUCTION

Why de-risk?

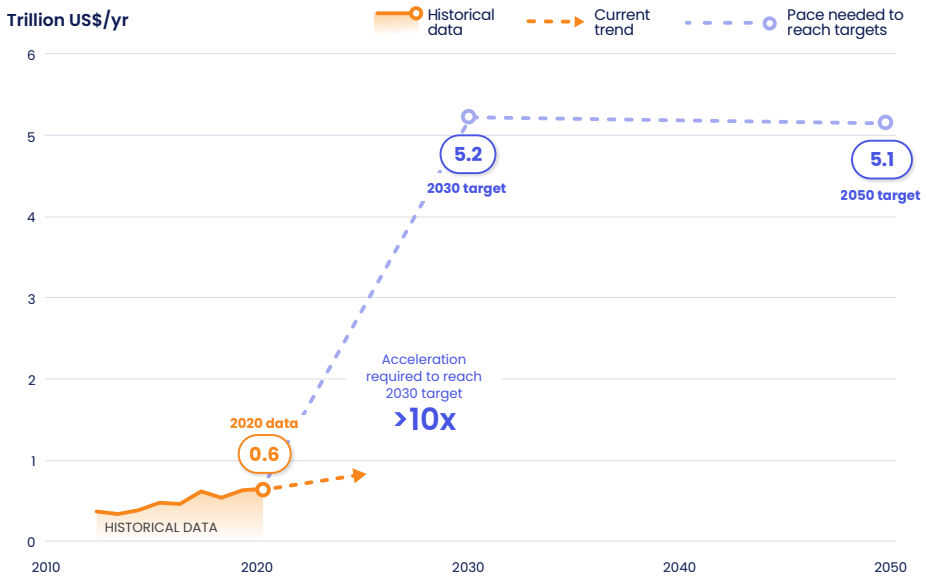
The climate crisis underscores the need to lessen the perceived and actual risks associated with climate-related investments and with developing and emerging countries. These risks include political risks from unstable political regimes, regulatory risks from weak legal frameworks or inconsistent enforcement of policies, capital market risks in less liquid financial markets, and technological risks associated with technology itself or its operation and management (Choi et al. 2022). These have resulted in underinvestment, creating a significant climate investment gap. To avoid the worst impacts of climate change, it has been estimated that annual climate finance flows of US$5.2 trillion will be needed by 2030 (Boehm et al. 2022) (Figure 1). Despite an increase in climate finance flows over the past decade, only about $600 billion were available in 2020, with the current rate of increase being insufficient to achieve a 1.5°C global warming scenario (Naran et al. 2022). Moreover, only a fraction of the climate finance flows go to developing countries, where governments have more limited budgets and capacity; thus, the need for additional investments continues to grow, particularly in the aftermath of the pandemic.[1]

The climate investment gap cannot be filled by public finance alone, such as that provided by governments, bilateral development finance institutions (DFIs), and multilateral financial institutions. Private investors hold $210 trillion in assets—roughly twice the gross domestic product (GDP) of the entire world (Georgieva and Adrian 2022)—and there is an increasing push to direct a significant portion of this capital toward climate mitigation and adaptation projects.[2]

However, climate investments in emerging and developing countries often do not offer the appropriate risk-return profile for private investors. Various country-, regulatory-, and technology-related risks lower the appetite for private investors, who may also lack knowledge of, or are unfamiliar with, the market in emerging and developing countries. The cost of acquiring the knowledge and relevant expertise to evaluate new projects might render financing less attractive or even impossible (Mohieldin et al. 2018). The resulting additional costs or increased risk premiums can potentially make the project nonbankable, or nonviable.

Therefore, public financial institutions are under increasing pressure to use their resources to "de-risk" investments and attract private finance that might not be available otherwise for these types of projects. De-risking involves reducing, transferring, or mitigating the risks associated with low-carbon and climate-resilient investments in developing countries to attract additional sources of financing. Various financial instruments (e.g., loans, equity, and guarantees) and structures (e.g., securitization, syndication, and fund of funds) can support this goal.

Figure 1 | **Climate finance is not flowing fast enough**



Source: Boehm et al. 2022.

The role of multilateral development banks in de-risking climate investments

As key players operating at the intersection of the public and private sectors, as well as the developing and developed countries, multilateral development banks (MDBs) are well positioned to act as facilitators of the global climate agenda and to support the necessary transition in developing countries. These are some of the characteristics of MDBs that facilitate de-risking for private investors:

- A **strong track record** in investment origination, project preparation, and technical assistance, which instills confidence in investors.
- **Direct working relationships with developing country governments**, which can help mitigate investors' uncertainty about the investment environment.
- **Knowledge of the investment and country risks**, which are often the primary drivers of risk premiums for private investors.
- A **capital structure** unique to their institutional setup that allows MDBs to operate in high-risk environments.
- **Diverse financial instruments**, such as guarantees, mezzanine financing, and syndication, as well as **project monitoring and safeguards**.
- MDBs are the **main source of multilateral climate finance**[3] in developing countries.

MDBs have acknowledged the significant role they can play as "mobilizers" of private capital in climate projects and have committed to increasing their lending and to facilitating private financing (WBG 2015). They endorsed the Joint Principles on Crowding-In Private Finance and adopted a "cascade approach" to prioritize private solutions wherever possible, tailor the MDB approach to specific opportunities in their member countries, and use concessional resources at discretion to avoid crowding out private capital (Cordella 2018). MDBs have also committed to collectively channel at least $65 billion annually by 2025 in climate finance[4] and to mobilize funding from private sector investors through various measures, including the provision of de-risking instruments (ADB et al. 2019).

Despite these commitments, MDBs have yet to fully realize their potential to mobilize private finance for climate. For instance, in 2021, MDBs mobilized only $0.25 of private climate capital for every dollar of MDB investment, or $9.9 billion on $38 billion, in low- and middle-income countries (LMICs) (AfDB et al. 2022). MDBs primarily disburse climate finance to LMICs through loans (71 percent); only 3 percent is through guarantees, which are a proven instrument for mobilizing private capital (AfDB et al. 2022). The underwhelming performance of MDBs is a significant setback in the global effort to unlock private sector finance to deliver on the Paris Agreement and the Sustainable Development Goals (SDGs). Calls have been made for MDBs to shift from a traditional lender's role to becoming a mobilizer (IPCC 2022; Kenny and Morris 2021; Lee 2018; Mohieldin et al. 2018), but these calls have yet to be fully heeded.

The objectives of this paper are twofold:

- Provide insights into the innovative financial de-risking instruments and structures used by MDBs to catalyze private finance for climate investments.
- Determine the potential and conditions for replicating and scaling these mechanisms successfully, which would enhance the role of MDBs as mobilizers to narrow the climate investment gap.

In this paper, we examine the financial mechanisms and structures through which MDB interventions creatively de-risked and mobilized additional private finance for climate action in under-served sectors and regions. We explore several types of MDB de-risking approaches and focus on how these initiatives originate and operationalize, what specific design features contributed to the success, and which are the necessary conditions to scale such de-risking approaches. The findings and recommendations from this paper are aimed at practitioners from public and private financial institutions, policymakers and government officials in developed and developing countries, and academics with an interest in international climate finance.

Several landscape analyses, surveys, and studies have already been conducted on the topic of MDB mobilization of private finance for development and climate change (Attridge and Gouett 2021; IFC et al. 2023; OECD 2023). However, some of these focused on a specific de-risking approach, such as synthetic securitization (Gabor 2019; Humphrey n.d.; Kshetrimayum et al. 2019), whereas others have called for more research, data, and a systematic collection of case studies to inform the use of de-risking instruments at scale (Garbacz et al. 2021; Mabey et al. 2018; Mutambatsere and Schellekens 2020). This paper responds to these calls and complements the existing body of research on the topic.

Methodology

We use process tracing to examine how MDBs' financial de-risking initiatives for climate investments in developing countries are originated and operationalized. Process tracing identifies the mechanism whereby a set of independent variables (the characteristics and features of de-risking initiatives) contributed to producing an outcome (mobilizing additional private capital for climate projects in developing countries). Among different types of methodology, theory-building process tracing[5] describes a causal mechanism that is generalizable outside of the individual case to a bounded context (Beach and Pedersen 2013). Using this approach, we seek to detect a mechanism that contributes to producing an outcome across a bounded context of cases by focusing on recent MDB initiatives (launched post-2015) to mobilize private capital for climate investments. Our goal is to identify scalable features and necessary conditions for replication and scaling.

Through a comprehensive search of primary and secondary sources as well as through interviews with practitioners in both public and private sectors—including the Organisation for Economic Co-operation and Development (OECD), the Asian Development Bank, the World Bank, the Green Climate Fund, Calvert Impact Capital, Natixis, and various think tanks and civil society organizations, such as Convergence, Climate Finance Advisors, the Center for Strategic and International Studies, Stanford Sustainable Finance Initiative, and the NewClimate Institute—we carefully selected cases for our analysis that

- mandated mobilizing private finance through financial de-risking;[6]
- focused on climate change and sustainable development;
- launched post-2015, when the international community adopted the Paris Agreement, the SDGs, and the Addis Ababa Action Agenda, triggering concerted efforts to engage and mobilize the private sector in a strategic and proactive manner;
- featured an MDB as the main driver and architect; and
- overcame certain risks and barriers that had prevented private investments.

We focus on four cases: Room2Run, Impact Loan eXchange (ILX) Fund I, RenovAr, and the Pacific Renewable Energy Program (PREP). The cases feature a range of financial instruments and structures, including guarantees, syndication, and securitization.

Cases operate at two levels: the portfolio level and the project level (Table 1).

- At the portfolio level, MDBs transfer the risk associated with their assets to private investors and free up their lending capacity to undertake more or riskier projects. This approach can be in the form of synthetic securitization, in which investors purchase tranches of MDB portfolios while the assets remain on MDB balance sheets to ensure that sustainability standards are maintained. MDBs can also purchase private insurance to off-load the risk of a part of their portfolios. The Room2Run initiative of the African Development Bank (AfDB) involved both mechanisms. MDBs can also standardize and bundle their assets through syndication, transferring the risks of asset bundles to private investors to free up their capital for new lending. Such assets offer investors the opportunity to invest in regionally diversified SDG-related projects that benefit from MDB due diligence (Lee and Cardenas Gonzalez 2021). ILX Fund I does this by offering a diverse portfolio of development finance assets structured and arranged by various MDBs (see the Room2Run and ILX Fund I cases in "De-risking: How and under what conditions?").
- At the project level, MDBs can attract commercial investment directly by improving the risk-adjusted returns through risk mitigation tools and approaches. For example, MDBs can reduce risk by providing concessional finance (e.g., loans at lower-than-market interest rates or with longer maturities), partial risk guarantees to backstop public sector contractual guarantees, and partial credit guarantees to support longer loan terms, to mobilize domestic capital markets, and to reduce the cost of private debt. In this type of de-risking arrangement, public entities such as MDBs bear part of the risk in order to bring in private investors who would otherwise not be willing to invest in the project. This type of partnership between public and private investors, in which scarce public resources are strategically used to de-risk investment to mobilize additional private resources for climate investments, is also known as blended finance. Blended finance has been increasingly considered as one mechanism to mobilize the capital needed to achieve the SDGs and the climate agenda.

Table 1 | **Cases of MDB de-risking**

	NAME OF THE INITIATIVE	YEAR LAUNCHED/ FOCUS GEOGRAPHY	MDB/MAJOR ACTORS INVOLVED	MECHANISM
Portfolio level (transfer of risk)	Room2Run	2018/Africa	AfDB/ European Commission	Balance sheet optimization; portfolio risk transfer via synthetic securitization
	ILX Fund I	2022/emerging markets	MDBs and DFIs/ European Union, Germany, Netherlands, United Kingdom	Loan risk transfer
Project level (sharing of risk)	RenovAr	2016/Argentina	World Bank/Argentina	Series of guarantees, including a terminal guarantee by the World Bank
	PREP	2019/Pacific developing countries	ADB/New Zealand	Partial risk guarantee and letter of credit

Notes: ADB = Asian Development Bank; AfDB = African Development Bank; DFI = development finance institution; ILX = Impact Loan eXchange; MDB = multilateral development bank; PREP = Pacific Renewable Energy Program.

Source: WRI authors.

Limitations

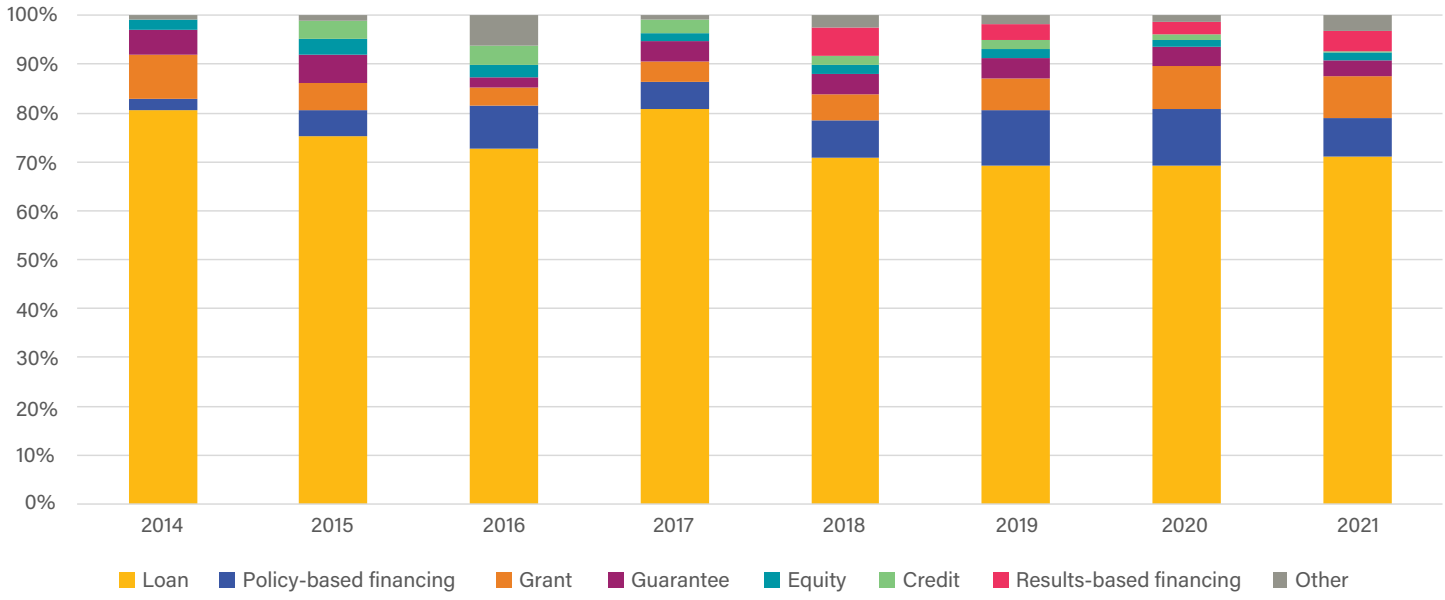
Scaling MDB de-risking activities entails discussing the degree of risk MDB shareholders are willing to let the banks take and the determination of rating agencies on how much MDBs can lend or how risk tolerant MDBs can be. These constraints are critical components when considering what is needed to shift the role of an MDB from a lender to a mobilizer. Also, considering the demand side of the picture (e.g., understanding what the private investors in developing countries need to de-risk the local investment environment) would also provide a more comprehensive understanding of the requirements for effective de-risking. These components, however, are beyond the scope of this paper.

The paper acknowledges that it may be too early to determine the impact and effectiveness of these initiatives in mobilizing private resources. The selected cases, however, represent a significant departure from business as usual and require serious commitments from the MDBs. Launching new initiatives is more expensive than using existing ones (Pierson 2000), which makes the launch of these initiatives a significant milestone.

BARRIERS TO MORE MDB DE-RISKING

MDBs have a range of de-risking tools that reduce, share, or transfer the existing, potential, or perceived risks associated with climate investments in developing countries and mobilize private capital.[7] These tools include syndication, securitization, mezzanine financing, and guarantees. Guarantees, in particular, have been highlighted as having the most potential to bring in more climate finance from the private sector (Attridge and Gouett 2021; IATFD 2020; OECD 2020), having a multiplier effect that is 15 times greater than direct financing (Hourcade et al. 2021). However, MDBs have utilized guarantees for only around 3 percent of the overall $81 billion in climate finance they issued in 2021, and loans continue to be the primary financial instrument used (AfDB et al. 2022) (Figure 2).

Figure 2 | **Share of total MDB climate finance, by instrument type**



Source: Authors, based on Joint Reports on Multinational Development Banks' Climate Finance (2015–22).

There are several factors that prevent MDBs from using these tools more extensively.

AAA credit rating

Maintaining a AAA credit rating is a priority for MDBs, which allows them to borrow at low rates and lend to borrowing countries at below-market rates and longer tenors (20–40 years, depending on the country and lending instrument) (Pereira dos Santos and Kearney 2018). MDBs manage their finances to maintain AAA ratings from the three main rating agencies—namely, Moody's, Standard and Poor's (S&P), and Fitch, and to safeguard shareholder capital and strong and continuous access to capital markets (G20 Presidency 2022). As a result, MDB loans are core because they get repaid and enable the continued operations and financing of new activities while maintaining AAA ratings. However, loans tend to stay on their balance sheets until repayment, raising questions about the development benefits of holding loan assets and locking up capital that might be better used elsewhere (G20 Presidency 2022; Humphrey n.d.).

Capital accounting rules

Capital accounting rules require MDBs to book guarantees in the same way they would direct loans, which can result in a perceived loss of control over the use of funds. Additionally, providing guarantees for private sector operations may result in the same capital charge on their balance sheet as lending (Jarrett 2020). Because interest rates on credits are higher than guarantee fees, MDBs face internal disincentives to issue guarantees when they can instead offer a more straightforward loan (Galizia et al. 2021; Pereira dos Santos and Kearney 2018).

Originate-to-hold business model

For decades, MDBs have been using the same "originate-to-hold" model of extending loans that sit on their balance sheets for 20–30 years until repayment, but new types of financial instruments and financiers have emerged. This raises concerns about whether this model is the best use of capital that could be deployed elsewhere because that capital could be recycled more frequently to support more projects (G20 Presidency 2022; Humphrey n.d.).

Staff incentives

Staff incentives are not conducive to de-risking. Performance is largely measured by the volume of resources committed or disbursed, leading to a preference for direct financing rather than complementary mobilization of commercial resources (OECD 2021; Pereira dos Santos and Kearney 2018).

Complexity

De-risking products can entail high transaction costs and lengthy preparation between the different stakeholders. As pointed out in the "De-risking: How and under what conditions?" section, designing and deploying de-risking initiatives such as securitization can take four to five years. Furthermore, MDBs provide partial guarantees to mitigate moral hazard, in which some risks are covered but others are not, leading to time-consuming negotiations and delaying approval (Pereira dos Santos and Kearney 2018).

Borrowing envelopes

Borrowing envelopes are determined by MDBs as a way of distributing resources proportionally to their member based on their sizes and stakes (Pereira dos Santos and Kearney 2018). Pricing and accounting policies for guarantees reduce the borrowing envelope, and guarantees pay the same rate as loans; however, countries still need to find other financiers to fund particular projects. In addition, the host governments may not always be willing to provide counter-guarantees, and most borrowers perceive guarantees as costlier than loans.

Despite these barriers and constraints, MDBs have designed and used de-risking tools. In the next section, we assess de-risking mechanisms recently launched at the portfolio and project levels that involve partnering with private investors to deploy more capital to climate projects in developing countries.

DE-RISKING: HOW AND UNDER WHAT CONDITIONS?

In this section, we present several case studies that illustrate how MDBs can effectively mitigate risks in portfolios and investments while also spurring private capital for climate investments. Specifically, we examine two examples of portfolio-level de-risking (Room2Run and ILX Fund I) and two examples of project-level de-risking (RenovAr and PREP). Each case is analyzed through four key lenses: the risk challenge being addressed, the de-risking mechanism employed, mobilizing elements that contribute to the case's success, and any challenges and setbacks encountered along the way.

Portfolio-level de-risking

Portfolio-level de-risking refers to the practice of MDBs transferring the risks associated with their assets to private investors, thereby freeing up their lending capacity to take on more risky or ambitious projects.

Room2Run

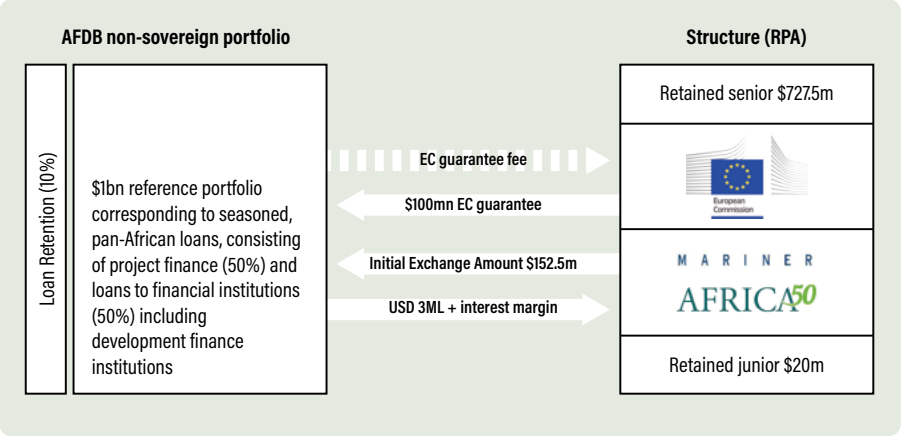
Risk challenge. Aware of the rating constraints but keen to see MDBs expand their lending, in 2015 the Group of Twenty (G20) began calling on MDBs to optimize their balance sheets (G20 Research Group 2015), acknowledging the potential inefficiencies of the originate-to-hold model. Furthermore, MDBs were encouraged to evaluate instruments that share risks with private investors to mobilize more resources for global development efforts.

De-risking mechanism. Room2Run was launched by AfDB in 2018 in response to the G20 Action Plan to Optimize the Balance Sheets of MDBs.[8] It is the first synthetic portfolio securitization between an MDB and private sector investors, allowing the transfer of credit risk associated with loans in their portfolio to capital market investors, freeing up capital for new lending.

Though widely used by commercial banks, synthetic securitization had not been used by MDBs. Securitization allows banks to transfer to capital market investors the credit risk associated with loans in their portfolio, and private investors can diversify their portfolios. As these transactions can be accomplished for portfolios and not just individual loans, capital for new lending can be freed up at scale.

In Room2Run, transactions are constructed in senior, mezzanine, and junior tranches on a $1 billion portfolio of pan-African loans. AfDB retains the junior and senior tranches, and the mezzanine tranche of risk is shifted to private investors (e.g., International Infrastructure Finance Company [IIFC] II and Africa50 Infrastructure Fund).[9] By doing so, the amount of risk capital that AfDB must hold gets reduced. The European

Figure 3 | **Simplified structure of Room2Run**



Notes: All dollar amounts are in U.S. dollars. AfDB = African Development Bank; EC = European Commission; RPA = receivables purchase agreement.
Source: Structured Credit Investor, https://www.structuredcreditinvestor.com/.

Commission provides additional credit protection in the form of a senior mezzanine guarantee, creating space for more lending at AfDB (Figure 3).

In Room2Run, the tranching strategy was designed to achieve multiple objectives. First, it aimed to minimize the amount of capital that AfDB would need to hold while also offering opportunities to diversify private investor investment portfolios. Second, it sought to limit the overall cost of the transaction by partnering with other investors. Third, it endeavored to align with the pricing expectations of investors. Finally, it aimed to ensure that AfDB still had an incentive to effectively monitor and manage the credit risk of the loans (Kshetrimayum et al. 2019). The tranching strategy strikes a balance between these objectives.

Mobilizing elements. Room2Run allowed AfDB to provide $650 million of new development lending in Africa without requiring additional capital from shareholders. AfDB committed to redeploying this freed-up capital into renewable energy in Sub-Saharan Africa, including low-income and fragile countries (AfDB 2018). Room2Run is considered successful because there have been zero losses so far on the portfolio, and investor interest in current and future deals in Sub-Saharan Africa is strong (G20 Presidency 2022).

Four elements stand out:

- The flexible structure offered tranches with varying degrees of risks, rewards, and maturities to appeal to a variety of investors.

- The synthetic nature allowed AfDB to remain the lender of record, maintaining control over the development impact objectives of portfolio projects, which is crucial considering MDB and DFI mandates.
- The senior mezzanine guarantee provided by the European Commission reduced the risk of the senior mezzanine tranche, rendering the risk-return profile adequate for the capital market.
- AfDB and S&P Global Ratings successfully came up with a novel approach to account for the fee paid by AfDB involving S&P reevaluating and adjusting the risk-weighted assets (RWAs).[10]

Room2Run illustrates that MDBs can successfully launch, coordinate, and implement synthetic securitization transactions to extend the range of investments available to institutional investors in developed countries.

Challenges and setbacks. Although synthetic securitization can unlock capital for new lending, it comes with high transaction costs. Room2Run, for instance, took nearly four years to set up and required technical and legal expertise as well as a relatively homogeneous loan portfolio to attract private investors (Humphrey n.d.; PRI 2019). The transaction also required official support from the European Commission in the form of additional credit protection to finalize the deal. In the future, deals may be done without official support and entirely on a market basis, but this would require investors and rating agencies to become more comfortable with this type of deal (Humphrey n.d.).

ILX Fund I

Risk challenge. Given the widening climate investment gap, the role of MDBs in mobilizing climate finance and tapping into private capital has been actively explored, particularly with institutional investors because their long-term investment horizon aligns well with many climate projects. Despite an increased focus on climate performance and portfolio diversification, institutional investors are slow to change the way they operate (EYGL 2021). The OECD estimated that less than 1 percent of global pension fund assets are allocated directly to infrastructure investment, including climate projects (Croce 2011). Investors face various barriers, including unfamiliarity with climate-related sectors, emerging and developing economies, and the need to comprehend regulations and evaluate risk-adjusted returns. They also look for reputable partners to mitigate legal; environmental, social, and governance (ESG); and political risks and select high-quality investments (Amorim 2022).

De-risking mechanism. Launched in 2022 with a $750 million commitment from Dutch pension provider APG,[11] ILX Fund I serves as an investment platform that addresses four themes: energy access and clean energy, sustainable industry and infrastructure, inclusive finance, and food security.[12] Codesigned by Cardano Development, which has experience establishing innovative emerging market funds such as The Currency Exchange Fund (TCX) and GuarantCo,[13] the fund aimed to establish $1.05 billion in commitments from leading Dutch pension funds to build a diverse investment portfolio within three years (Pers. Comm. Eurlings 2022).

The modality for mobilizing private capital stands out in this fund because MDBs and DFIs originate and structure syndicated loans for institutional investors to co-invest (Figure 4). MDBs use their expertise and the strength of their balance sheets and credit ratings to reduce overall project risk. They provide institutional investors with a diversified portfolio, which spreads risk across regions and sectors. MDB financing is therefore seen as a stamp of approval, providing investors with additional confidence to invest (Meltzer 2018; Pereira dos Santos 2018). In return, MDBs get the capital relief they need for existing exposure and transactions.

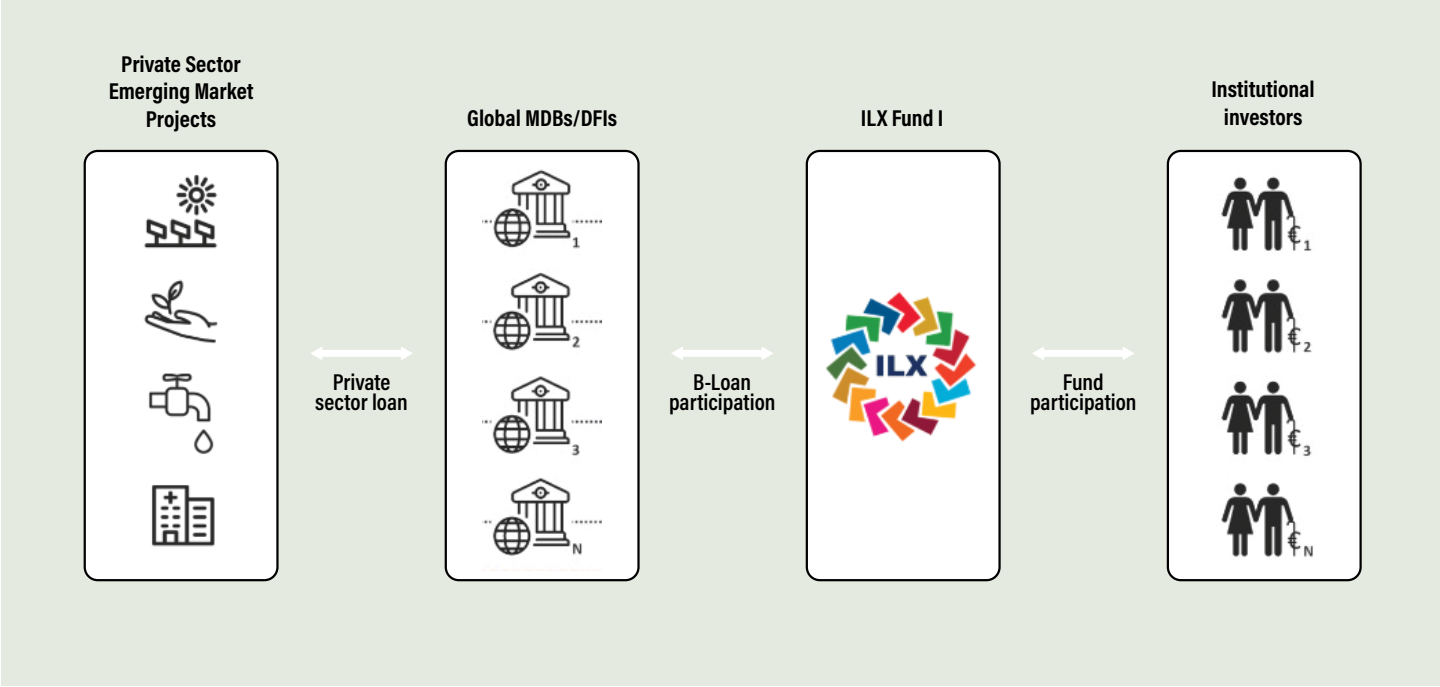
The A/B loan structure is at the core of how ILX Fund I operates. In an A/B loan structure, the MDB acts as the lender of record, providing a portion of the loan for its own account (A loan) with the loan balance funded by the B loan participation, typically with a commercial bank or institutional investor. ILX invests in B loans. Principal and interest on the loan are paid to the lender and then are distributed on a pro rata basis. This structure allows private investors to participate in MDB loans while benefiting from the same preferential status as an MDB or DFI, increase deal flow through the MDB's risk mitigation and origination capacity, access MDB structuring and restructuring skills, and benefit from ESG safeguarding. Therefore, B loans can mobilize a larger amount of debt than would otherwise be possible with a project loan.

Mobilizing elements. ILX Fund I reached its target of $1 billion in commitments within six months of announcing the fund's launch. Although this milestone cannot serve as the sole indicator of success, it does show the ability to mobilize institutional capital. ILX Fund I tackles several barriers that institutional investors face and creates headroom in MDB balance sheets in the following ways:

- **Partnering with leading MDBs/DFIs.** This lowered investors' perceived and real risks resulting from information asymmetry, unfamiliarity with the market and reporting practices, and the lack of a strong pipeline. It offered the diversification and scale sought by institutional investors.
- **Providing a straightforward co-financing approach.** ILX Fund I does not rely on MDB/DFI guarantees, first loss, or concessional capital. ILX Fund I operates based on the principle that blending is not for all investment types and should be reserved for specific situations—where (temporary) public intervention is absolutely necessary to attract private capital—to avoid distorting the market (Pers. Comm. Eurlings 2022).
- **Attracting the largest pension fund in Europe, APG, and securing its cornerstone investment.** It was critical to ensure that the fund can form partnerships with leading MDBs/DFIs. The fund's architects believed it was essential to establish credibility and size to engage with MDBs effectively.

Challenges and setbacks. The launch of ILX Fund I took five years, during which time negotiations, contract agreements, and partnerships with MDBs/DFIs were established. The initial grant funding in 2017 from Germany, the Netherlands, and the United Kingdom played a crucial role in this process.

Figure 4 | **Structure of ILX Fund I**



Notes: DFI = development finance institution; EM = emerging market; ESG = environmental, social, and governance; ILX = Impact Loan eXchange; SDG = Sustainable Development Goal.

Source: ILX Fund, https://www.ilxfund.com/.

The lack of data accessibility and transparency regarding credit performance in emerging markets has been identified as a barrier to scaling approaches such as ILX Fund I. Improved data accessibility would accelerate investor decision-making (see "Key considerations for MDBs to move from lender to mobilizer"); ILX Management faced challenges in obtaining relevant data such as credit performance, which is not readily available to private investors (Pers. Comm. Eurlings 2022).

Project-level de-risking

Project-level de-risking refers to the strategy employed by MDBs to enhance the risk-adjusted returns of investment by utilizing various risk mitigation tools and approaches, thereby attracting commercial investment directly to the project.

RenovAr

Risk challenge. Argentina, despite its high potential for renewable energy, has struggled to finance renewable energy and increase its share of the energy mix. The country has faced macroeconomic crises and policy uncertainties, which have reduced its creditworthiness, and past energy policies have created an unfavorable investment environment for renewables. The unreliability of the exchange rate created a disincentive for international investors, as profits would diminish when attempting to transfer them back to the investor's home country (Pers. Comm. Woollands 2023). The artificially low price of energy, with subsidies not reflecting the true cost of energy generation, has further complicated matters (Kurdziel et al. 2020). Due to elevated risk levels in the country, the capital market, and the energy sector, Argentina has limited funding capacity from local sources and lacks access to external long-term financing.

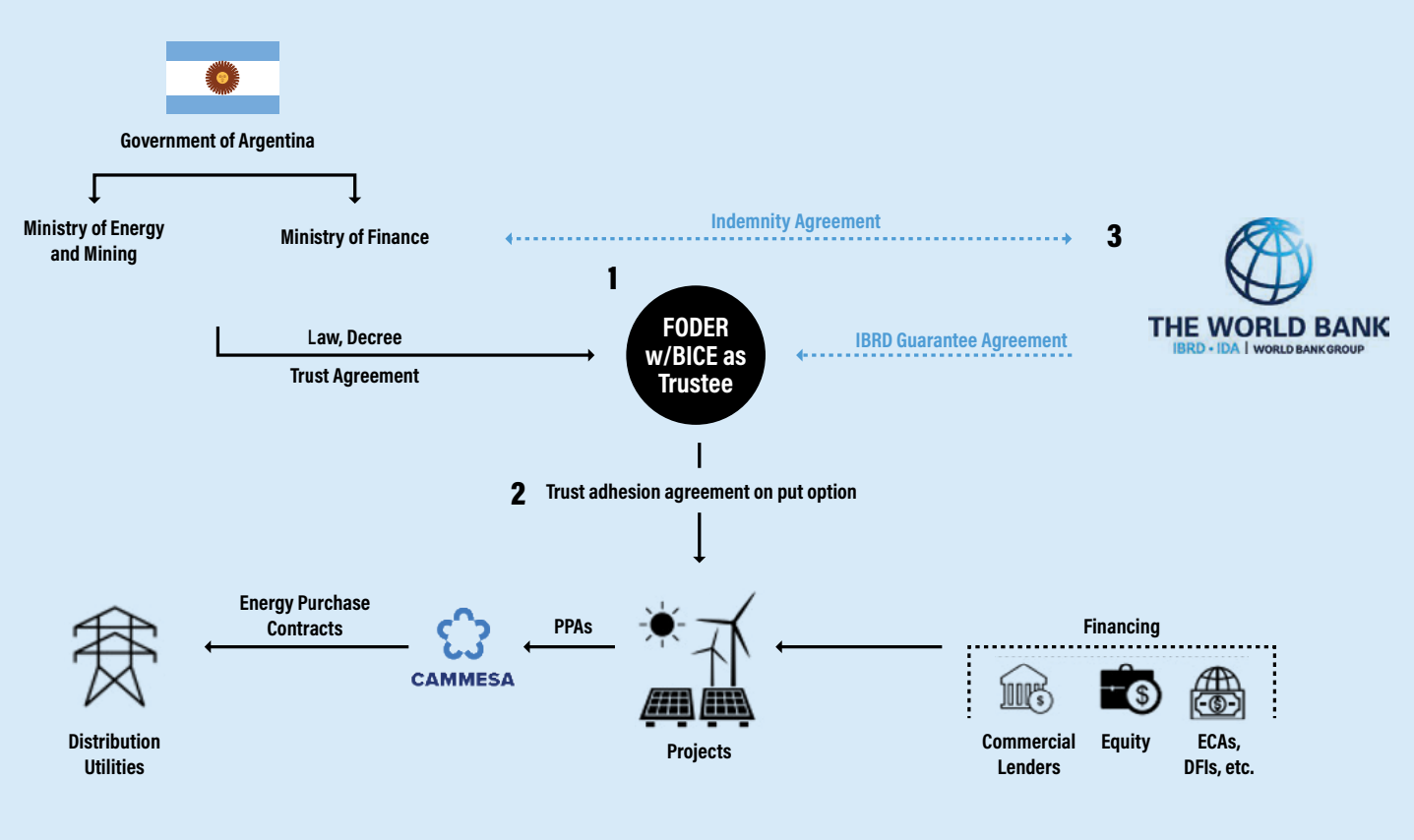
The government's attempts to promote renewable energy have not been very successful. For instance, the Renewable Energy Generation Program (Programa de Generación Eléctrica a Partir de Fuentes Renovables, also known as "GENREN") was launched to encourage the provision of electricity from renewable sources through supply contracts. However, due to Argentina's high indebtedness and constrained access to foreign finance, investors could not obtain the necessary guarantees, resulting in only 10 percent of roughly 1,000 megawatts (MW) in projects being completed under the program (González Jáuregui 2021).

De-risking mechanism. In early 2016, Argentina's government called on both the World Bank and International Finance Corporation (IFC) to advise on structuring and implementing a new tender to develop renewable resources. The IFC team advised on the overall attractiveness of the program for private investors, and the World Bank team devised a risk mitigation structure throughout preparation. Together, the World Bank and IFC advised the government based on international experience, with a focus on ensuring a balanced project risk allocation between the private and public sectors, minimizing public sector support, and ensuring success of the program in the market (WBG 2018).

As a result, the RenovAr ("To Renovate") initiative was launched in 2016—Argentina's first auction-based renewable energy program. Its aim is to build capacity and expand renewable energy, with a target of increasing the share of renewable energy production from 2 percent in 2016 to 20 percent by 2025. RenovAr was designed to address the barriers of poor access to long-term funding sources and perceptions of high country and sector risks. A decisive feature of RenovAr is its comprehensive, multilevel approach to mitigating country risks for investors and developers (Figure 5). It addresses risks with three mechanisms:

- The Fund for the Development of Renewable Energy (Fondo para el Desarrollo de Energías Renovables; FODER) was set up by the government to provide guarantees to the Wholesale Electricity Market Clearing Company (Compañía Administradora del Mercado Mayorista Eléctrico; CAMMESA). CAMMESA is the national utility company administrating the wholesale electricity market and is the offtaker for the renewables auctions and signatory to power purchase agreements (PPAs). FODER ensures compliance with the PPAs signed between the successful bidder (independent power producer [IPP]) and CAMMESA. If CAMMESA fails to reimburse the seller for generated electricity, FODER issues the remaining payments on its behalf.
- A put option (investor's right to sell the project) allows IPPs to transfer projects to FODER in case CAMMESA fails to pay for the supplied energy. In this case, generators are entitled to receive compensation from FODER. IPPs can trigger the put option if the government changes the guarantee framework without the developers' consent or if FODER or the government fails to comply with the arbitration. This guarantee is especially aimed at mitigating inherent country and policy risks (Menzies et al. 2019).
- The World Bank Group (WBG) backstops FODER in case the government cannot back up the repayment guarantees established through FODER. As the first payment guarantee by the WBG at a program level, this indirectly mitigates country risks and reduces risks and financing costs for IPPs (WBG 2018). For the guarantee to be triggered, the

Figure 5 | **Financial structure of RenovAr**



Notes: BICE = Banco de Inversión y Comercio Exterior (Bank for Investment and Foreign Trade); CAMMESA = Compañía Administradora del Mercado Mayorista Eléctrico (Wholesale Electricity Market Clearing Company); DFI = development finance institution; ECA = export credit agency; FODER = Fondo para el Desarrollo de Energías Renovables (Fund for the Development of Renewable Energy); IBRD = International Bank for Reconstruction and Development; PPA = power purchase agreement.

Source: WBG 2018.

sequential backstop of the put option obligation that is provided by the Ministry of Energy and Mining, Ministry of Finance, and earmarked treasury notes would need to fail first, making it unlikely that the guarantee will be called (IFC n.d.).

Mobilizing elements. RenovAr has successfully conducted four international public tenders since its launch in 2016, awarding more than 2,400 MW of renewable energy projects, primarily wind and solar. The program has attracted more bids than expected, with the first round aiming for 1,000 MW but receiving over six times that amount (IFC n.d.).

With the PPAs valued in U.S. dollars and FODER backed by the state and the World Bank, the government hopes to kick-start the renewable energy sector despite economic or political difficulties. The government views the guarantee system as working well (Menzies et al. 2019), with CAMMESA's issuance of support payments having had no issues. Renewables have increased their share of the energy mix, growing from 2.0 percent in 2016 to 6.1 percent in 2019 and 12.3 percent in 2020 (BNamericas 2021).

RenovAr's success can be attributed to two main factors:

- An innovative, multilayered financial de-risking mechanism provided protection for investors. Given the country's difficult macroeconomic conditions, the challenge that RenovAr needed to address was investors' unwillingness to develop renewable energy projects there. The $480 million termination guarantee scheme offered by the WBG was particularly critical (Menzies et al. 2019). Argentina's track record of policy reversals and noncompliance with contracts led investors to be wary of governmental guarantees alone (Alford 2017; IFC n.d.; World Bank 2022).
- Strong government support and interest supported the design and implementation of RenovAr. High-level government engagement also enabled IFC to provide swift assistance in creating a framework for private sector participation in renewables within six weeks (IFC n.d.).

Challenges and setbacks. RenovAr's design is considered a success. It was successfully launched in a format that has never been attempted in the country before based on the active involvement and collaboration from IFC/International Bank for Reconstruction and Development (IBRD) and the government. The initial auction rounds, for example, were largely oversubscribed (IFC n.d.).

Yet de-risking mechanisms put in place were not enough when considering the outcome. Although RenovAr's auction rounds attracted investors and project developers, the targets for private capital mobilization and renewable energy deployment were not met. By December 2021, only 32.6 percent of the target for private capital mobilized was achieved ($4.3 billion by December 2021 as the target), and the target for renewable energy generation capacity was only 57 percent achieved (1,638 MW by December 2021 as the target) (World Bank 2022).

Argentina's target was to produce 20 percent of the country's electricity from renewable sources by 2025. Although there is a positive development, the rate of deployment has been slow and inconsistent due to factors including Argentina's 2018 economic crisis, high inflation levels, shifting priorities from changes in administration, the inefficient grid system, and the impacts of the COVID-19 pandemic. The cost of repatriating profits out of the country remained burdensome (Pers. Comm. Woollands 2023). Therefore, though RenovAr's design considered political and technological risks, it did not sufficiently address these other risks. Delays in signing PPAs also occurred due to local investors' difficulties in securing long-term financing and components that needed to be imported (Pers. Comm. Woollands 2022). Some argue that the price levels obtained through RenovAr auction rounds did not fully reflect the overall country risk levels (Menzies et al. 2019). Additionally, the country's electricity transmission network has been identified as a limiting factor because more than 5,000 kilometers of new transmission lines are required to connect commissioned renewable energy capacity expansions (Kruger et al. 2018).

PREP

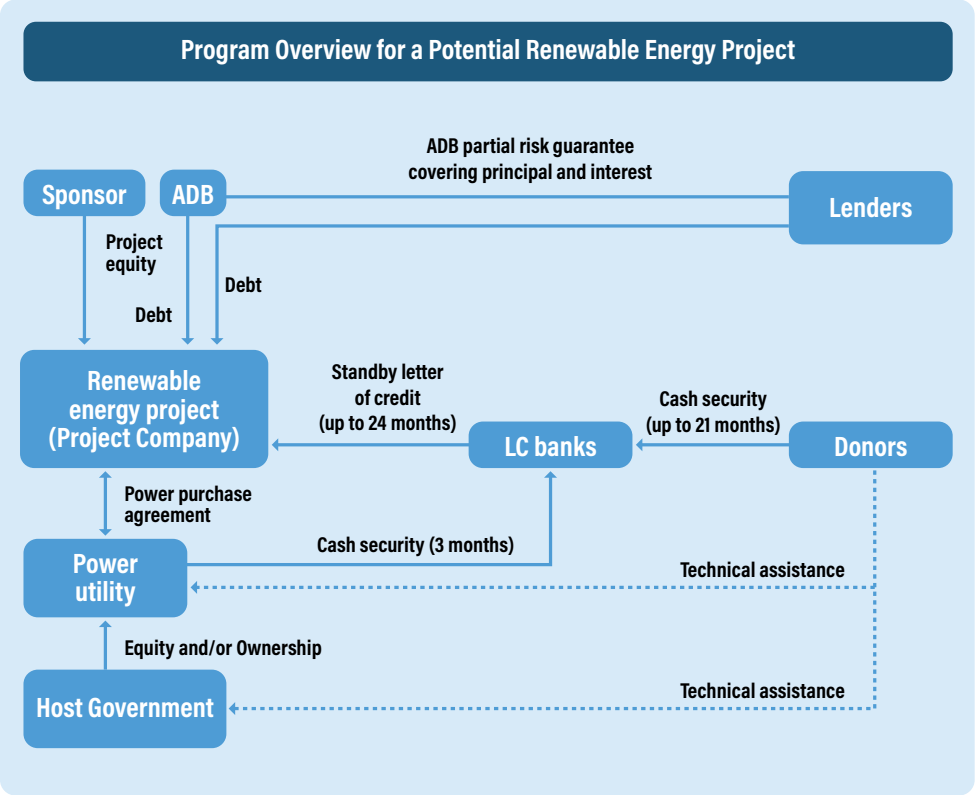
Risk challenge. The Pacific Small Island Developing States (SIDS) mostly rely on imported fuels, leading to high and unstable energy costs. To address this issue and achieve energy security and sustainable development, many Pacific SIDS have set an ambitious target of reaching up to 100 percent renewable electricity generation between 2020 and 2030 (Burrell et al. 2021). However, the structural transition to renewable energy infrastructure requires significant investments, involving private sector investment for operations and ownership.

Private sector investors who have explored renewable project opportunities in the Pacific are often discouraged by small project size, poor financial performance of power utilities, uncertainties over foreign currency availability and convertibility, perceived political risk, and low capacity of governments and utilities for engaging the market and preparing bankable PPAs (ADB 2019; Burrell et al. 2021). Many islands struggle to establish predictable long-term revenues and mitigate possible events with an appropriate regulatory framework (Shah 2022). Timely payment is another challenge to infrastructure financing that relies on government offtake obligations (Pereira dos Santos 2018). Delayed or inconsistent payments increase uncertainty around the project's cash flows, further compromising the risk-return assessment.

Although the private sector often relies on sovereign guarantees to backstop the offtake obligations of power utilities, Pacific developing countries are unable to provide government-backed guarantees for various reasons. These reasons include the obligation counting as a contingent liability and adding to debt, the lack of headroom within MDB-mandated debt ceilings, or the transaction costs for establishing a guarantee being too high because of the small scale of many transactions (ADB 2019).

De-risking mechanism. Approved by the Asian Development Bank (ADB) in 2019, PREP provides an umbrella facility of up to $100 million of financing support that aims to reduce the risks for private investment in renewable energy in Pacific SIDS (Figure 6). PREP is one of the outputs of the Pacific Renewable Energy Investment Facility (PREIF), approved by ADB in 2017 to support ADB investment in sovereign renewable energy projects in the Pacific Island member countries. PREIF identi-

Figure 6 | **Structure of PREP**



Notes: ADB = Asian Development Bank; LC = letter of credit.

Source: ADB 2019.

fied a donor-backed guarantee program as critical to reducing risks and promoting private investment in the Pacific energy sector (ADB 2021). PREP was established to play this role, with the following four components, each led by different participants (see Figure 6):

- **Partial risk guarantee.** The guarantee covers risks related to currency, contractual obligations, and political instability, with ADB allocating $50 million.
- **Direct loan.** The loan provides up to $50 million to support a private sector IPP borrower, with ADB seeking to co-finance and, where appropriate, use third-party concessional financing. Where ADB cannot finance a loan in local currency, a partial credit guarantee may be made available to the IPP instead of a direct loan.
- **Letter of credit (LC).** An LC is a credit enhancement tool to mitigate the nonpayment risk; it provides liquidity to project sponsors. Issued by a local bank, it supports up to 24 months of power payments payable by the power utility under the PPA if the power utility fails to pay. The first 3 months of power payments in the LC are provided by the power utility as a first loss component, and the remaining months are cash backed by donors. The government of New Zealand and the Asia-Pacific Climate Finance Fund approved $3 million and $4.5 million, respectively.
- **Technical assistance for project origination and transaction advisory support.** This can be used to assist the government in preparing the IPP tender process and/or to screen projects to lower risks.

The implementation of PREP spans over 20 years, starting from April 2019 and ending in April 2039.[14] ADB aims to establish a model that can be duplicated for the urban and transport sectors throughout the Pacific Island countries (CGTN 2019).

Mobilizing elements. PREP provides a range of credit enhancement mechanisms, systematic internal collaboration, and a programmatic approach that covers the entire energy supply chain and sector development. The following elements contribute to PREP's successful mobilization:

- Tailoring risk mitigation instruments to match the type of projects that created incentives for private investors.
  - As the planned projects are small-scale (PREP is designed for a maximum of $10 million in any combination of loans and guarantees per project), ADB uses an LC issued by a local bank to fill the financing gap. This is applicable primarily to small-scale projects with short construction/development durations, which are more easily managed.
  - ADB does not require any counter-guarantee from governments; acknowledgment suffices. Requiring counter-guarantees would have created an additional burden and risk for the borrowing government. This makes ADB guarantees more palatable from the government's point of view (Pers. Comm. Burrell 2022).
  - Lending in local currency represents a huge advantage for borrowing governments. Borrowers are hesitant to borrow in U.S. dollars because of the currency risk, and PREP offers an instrument to lend in local currency.
- PREP was developed through an integrated approach within ADB that brings together knowledge and expertise across the organization. Clients benefit from the collaboration between sovereign and nonsovereign operations and between knowledge and operations. But it also means there needs to be a clearly understood division of labor: the Pacific Department (PARD) of ADB leveraged its close relationship with the Pacific power utilities and Private Sector Operations Department (PSOD) processed guarantees and project financing. PSOD and PARD worked together to implement PREP and identify pipeline transactions, and PARD, PSOD, and ADB's Office of Public-Private Partnership manage technical assistance to develop upstream capacity.
- Rather than focusing on a single project, PREP was designed as a comprehensive approach to transforming the sector. PREP's anchor project in Tonga illustrates how such an approach can create a well-functioning renewable energy market in the country. Competitively tendered under PREP, this pilot project is a 6 MW solar power project and part of ADB's approach to facilitating Tonga's clean energy transition. Before turning to energy production, ADB utilized grants from the Green Climate Fund ($29.9 million) and Australia ($2.5 million) to install a battery energy storage system; this ensured that the intermittent electricity generated from solar panels and wind power could be stored and used overnight without affecting the grid. Since establishing solar panels would only work with the right grid stability, this sequencing was key (Pers. Comm. Burrell 2022). ADB's $3 million loan will support a private sector investment of $8.4 million for capital expenditure consisting of debt and equity (Burrell et al. 2021). It is a public-private partnership (PPP); the value for money is expected from running a transparent and competitive tender process and from a holistic approach utilizing different funding sources from partners to establish the entire process of renewable energy production, transmission, and storage.

Challenges and setbacks. PREP faces unique implementation challenges due to the specific geographic characteristics of the region, and the pandemic has caused delays in importing necessary components and personnel. However, despite setbacks, the Tonga project is reaching its financial close, which sets a benchmark for future power-generation PPP transactions in the region (ADB 2019; Pers. Comm. Burrell 2022). The program has attracted interest from private sector investors and power utilities, and several potential projects are in discussion and in the pipeline with a similar structure as PREP (Pers. Comm. Ling 2023).

FINDINGS

In this section, we focus on lessons learned from exploring MDB de-risking approaches at both the portfolio and project levels. Our analysis has shown that MDBs have the tools to de-risk and mobilize additional private investments for climate impact in developing countries. We will also identify common features and highlight what is currently missing or needed to scale MDB de-risking practices.

At the portfolio level, Room2Run and ILX Fund I demonstrate how de-risking strategies can free up capital in MDB balance sheets, creating new resources for them to allocate to climate projects. In turn, a new channel can open for private investors to invest in developing country assets. Securitization allows the investment risk to be parceled out to different participants in the deal to match their respective levels of risk appetite. B loans enable private investors to access direct impact lending opportunities while enjoying the same preferential status as MDBs' own

loans. These approaches could create a pipeline of new nonsovereign origination that escapes the usual constraints placed on MDB lending by rating agencies, making a new or previously illiquid asset class available to a wider set of investors.

At the project level, MDBs structure de-risking mechanisms with specific management techniques for the known and predefined political and regulatory risks, significantly improving the risk-return profile of climate projects. In RenovAr, the terminal guarantee offered by IBRD provided the final push for investors to overcome negative risk perceptions. The LC structure in PREP helped reduce uncertainty about the project's cash flows while also providing a runway for the project participants to fix the underlying cause of the delayed or outstanding payments. ADB did not ask for any counter-guarantee from the host government and provided the local currency option.

Demand for enhanced data accessibility and transparency is high. Room2Run is costly, partly owing to market participants' insufficient knowledge of historical credit performance (G20 Presidency 2022). In negotiations of risk transfer transactions, the lack of benchmarking to market prices was a significant cause of delay (Kshetrimayum et al. 2019). The same applies to ILX Fund I, for which four years of data collection were required to build a business case (Schepers 2023). Credit history data in emerging markets exist in rating agency databases and the Global Emerging Markets Risk Database Consortium (GEMs), the world's largest default and loss database for the emerging market business going back to 1988, by 24 MDBs/DFIs. However, GEMs membership is restricted to MDBs and DFIs, and it is not accessible to outsiders, including to private investors (Pers. Comm. Eurlings 2022). In 2021, GEMs issued its first public report on credit default statistics for private and subsovereign lending based on data from 11 member institutions. However, the default data are not disaggregated by country, region, country income group, sector, or type of credit instrument, and recovery rates are not provided; thus, it is impossible to assess how many of these defaults were resolved without loss of capital. Potential private creditors require more detailed analysis to help them assess risk in their own lending decisions (Lee et al. 2021). This is a significant barrier to institutional investors who are willing to invest and need to know about the creditworthiness of each market to assess risk and price it.

The cases studied demonstrate the financial and nonfinancial additionality that partnering with MDBs brings to the table. Without MDBs, these investments would not have happened, and the climate impact would have been reduced. ILX Fund I secured, among others, the largest pension fund in Europe, making it sizable and credible to engage with leading MDBs in a structured partnership. MDBs play a critical role in originating and arranging quality SDG loans, and they remain responsible for overseeing project implementation and integrity. For Room2Run, AfDB is the originator, and the European Commission provided a guarantee to complete the transaction. For RenovAr, IBRD's terminal guarantee sealed the deal for private investors. The intangible and nonfinancial positive effect of having an MDB, or "halo effect," is indicative of MDBs' reputation as trustworthy intermediaries.

KEY CONSIDERATIONS FOR MDBS TO MOVE FROM LENDER TO MOBILIZER

Based on our assessment, we propose that MDBs take the following actions to broaden their utilization and scaling of de-risking approaches to catalyze private investments for climate impact:

- **MDBs should continue to explore and utilize de-risking mechanisms at both the portfolio and project levels.** They should also collaborate with other stakeholders, such as governments, private sector actors, and DFIs, to share knowledge and costs, avoid duplication, and ensure investments reach their intended scale and purpose in countries. This can involve sharing data and information on successful de-risking approaches as well as conducting joint training and capacity-building initiatives for investors and project developers. By working together, MDBs can enhance their impact and effectiveness in mobilizing private sector finance for climate action.
- **MDBs, together with governments and project developers, should design de-risking initiatives that focus on sector development instead of individual asset development.** A comprehensive approach can have a transformative impact. The experience of initiatives such as PREP's pilot project in Tonga and RenovAr in Argentina illustrate how such an approach can create a functioning renewable energy market. In Tonga, PREP developed a pipeline of renewable energy projects that include generation, transmission, and storage and ensured they were aligned with the country's development priorities. In Argentina, RenovAr's PPP model for an auction jump-started the country's renewables market and has been replicated in subsequent auctions. By replicating these approaches, MDBs can promote long-term impacts and create sustainable markets for climate investments.

- **Integrated solutions and increased collaboration within MDBs across sectors and units can lead to a more efficient and coherent approach to providing de-risking instruments.** This can also help overcome one of the barriers to doing more de-risking—namely, the complexity involved in designing de-risking approaches. By bringing together expertise from different units, MDBs can create synergy and streamline the process, ultimately facilitating more effective de-risking efforts. In the cases of PREP and RenovAr, different departments within MDBs worked together to cut down silos and coordinated closely, with the departments playing roles based on their strengths and expertise. They also instituted a core practice of information sharing, which itself helps lower risk. This approach can be replicated and expanded upon to develop a more integrated approach to climate finance within MDBs.
- **To catalyze private investments for climate impact, MDBs should increase access to and transparency of credit and default data at a more granular level than currently available.** This will enable better risk assessments, pricing, and evaluations, and it can help reduce risk premia. MDBs can also expand access to the GEMs database and publish data and analyses on MDB finances to enhance trust and decision-making by MDBs and the private sector. By doing so, MDBs can encourage private sector involvement in climate finance by providing the necessary data and tools to assess and mitigate risk.

CONCLUSION

Most MDBs began operating at times when there were few alternative sources of long-term finance for their targeted clientele. Therefore, their default approach has been to fully fund and hold loans to maturity, which is highly capital intensive. Due to internal and external constraints that limit their lending capacity, increasing attention is being paid to mobilizing private capital for climate projects. MDBs are exploring innovative de-risking mechanisms at portfolio and project levels. Through these innovative approaches, MDBs are working to leverage their financial resources more effectively and to mobilize private capital for climate projects in developing countries. As MDBs continue to demonstrate the effectiveness of various de-risking instruments and approaches and actively share lessons learned from failed attempts, practitioners will gain a better understanding of de-risking. This, in turn, can increase the incentives and potential demand for de-risking.

Follow-up assessments that measure the impact of MDB de-risking initiatives in terms of private sector mobilization and sector development would be useful in evaluating the effectiveness of these approaches. Additionally, it would be valuable to compare these initiatives with similar de-risking initiatives in countries with similar political and investment environments to determine how replicable these approaches are. Comparing these initiatives with similar initiatives that do not involve MDBs could also provide insights into the unique role that MDBs play in de-risking activities. By conducting these assessments, we can better understand the potential for scaling up MDB de-risking practices and expanding their impact on climate finance in developing countries.

ABBREVIATIONS

ADB	Asian Development Bank
AfDB	African Development Bank
BICE	Banco de Inversión y Comercio Exterior (Bank for Investment and Foreign Trade)
CAMMESA	Compañía Administradora del Mercado Mayorista Eléctrico (Wholesale Electricity Market Clearing Company)
DFI	development finance institution
ECA	export credit agency
EM	emerging market
ESG	environmental, social, and governance
FODER	Fondo para el Desarrollo de Energías Renovables (Fund for the Development of Renewable Energy)
GDP	gross domestic product
GEMs	Global Emerging Markets Risk Database Consortium
G20	Group of Twenty
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IFI	international financial institution
IIFC	International Infrastructure Finance Company
ILX	Impact Loan eXchange
IPP	independent power producer
LC	letter of credit
LMICs	low- and middle-income countries
MDB	multilateral development bank
OECD	Organisation for Economic Co-operation and Development
PARD	Pacific Department
PPA	power purchase agreement
PPP	public-private partnership
PREIF	Pacific Renewable Energy Investment Facility
PREP	Pacific Renewable Energy Program
PSOD	Private Sector Operations Department
RAC	risk-adjusted capital
RACF	risk-adjusted capital framework
RPA	receivables purchase agreement
RWA	risk-weighted asset
S&P	Standard and Poor's
SDG	Sustainable Development Goal
SIDS	Small Island Developing States
TCX	The Currency Exchange Fund
WBG	World Bank Group

GLOSSARY

A/B loans: A/B loans are a type of financing structure commonly used in project finance, particularly in the context of international development. These loans are often provided by international financial institutions (IFIs) such as the World Bank, regional development banks, or other multilateral agencies. In an A/B loan structure, two separate loans are issued for a specific project or program. The IFI retains a portion of the loan for its own account (the "A loan") and sells participations in the remaining portion to eligible private lenders (the "B loan"). This structure enables commercial banks, investment funds, and other private investors to access direct impact lending opportunities while enjoying the same preferential status as the IFI.

additionality: Additionality generally refers to the property of an activity that adds something new to the context when compared to a baseline. For MDBs, their interventions to support private sector operations are additional if they contribute beyond what is available in the market and do not crowd out the private sector. Additionality can be defined by financial and nonfinancial inputs to enable investment to happen, make it happen faster than it would otherwise, or improve its design and/or climate impact.

blended finance: There is no single definition of blended finance, but it is generally known as a structuring mechanism that strategically uses public and/or philanthropic capital to catalyze additional private capital and increase private investment.

cascade approach: This framework aims to align public and private sector investments to achieve the SDGs. It was introduced by the WBG in 2017 to leverage private sector resources and expertise to address development challenges. To maximize the impact of scarce public resources, the cascade first seeks to mobilize commercial finance, enabled by upstream reforms where necessary. Where risks remain high, the priority is to apply guarantees and risk-sharing instruments. Official and public resources are involved only where market solutions are not possible through sector reform and risk mitigation.

credit standing: MDBs play an important role in international financial markets, raising money by issuing bonds and on-lending to their borrowing member countries. The ability of MDBs to leverage through their borrowing in international capital markets is significantly enhanced by their high credit standing. The business model followed by MDBs requires that they maintain a high credit standing. For this reason, rating agency assessments of MDBs are important considerations in MDB decision-making.

Global Emerging Markets Risk Database Consortium (GEMs): Established in 2009 as a joint initiative between the European Investment Bank and IFC, GEMs has grown to include 24 MDBs and DFIs as members. It is one of the world's largest credit risk databases for the emerging market operations of its member institutions. It contains data on credit defaults on the loans extended by consortium members, the changes in their clients' credit ratings, and the recoveries on defaulted projects. For lower-income countries, fragile and conflict states, and frontier markets, GEMs often contains the most exhaustive database of credit data, both in number of data points and length of coverage. GEMs data inform members about the level of risk they are taking, the probabilities of default, and other elements that are needed to reduce the uncertainty surrounding an investment decision.

guarantee: A guarantee is a promise by one person to take responsibility for another person's obligations if the latter defaults or fails to perform on his/her obligations (e.g., a failure to meet loan repayments or redeem bonds or an expropriation of an equity stake). Thus, a guarantee backstops payments, whereas insurance products are solely intended to compensate for loss. MDB guarantees seek to improve financing conditions for projects and help attract investment in borrowing countries. They tend to target risks that the private sector is normally not well suited to assess or manage (e.g., political and/or commercial risks related to credit, regulatory or contractual). These guarantees are mostly partial so that the risks are shared between the bank and private lenders.

halo effect: This is the intangible positive effect of having a multilateral institution involved in the transaction. MDBs play three roles as credible "independent brokers" that are not directly related to their financial role as credit enhancement providers: MDBs are a trusted and independent third party that provides a "seal of quality" to projects, they intermediate the relationship between relevant stakeholders and local authorities, and they are influential entities in negotiations when projects run into problems. The halo effect is a recognition of the positive spillovers of MDB activities and of their reputation as trustworthy intermediaries.

lender of record: A lender of record is a financial institution or entity that assumes legal responsibility for a loan or debt transaction and administers the loan. If an MDB is a lender of record in A/B loans, as far as B loans are concerned, there are positive effects for members of the pool because an MDB's privileged creditor status applies to loans granted as part of the B loan program.

letter of credit (LC): An LC issued by a commercial bank can be drawn by the sponsors to settle unpaid invoices, servicing the debt and other costs and allowing continued unfettered operations. The amount so drawn is converted into an MDB-guaranteed loan between the government and the LC-issuing bank with a fixed term. If the government does not reimburse such within the fixed term, then the LC issuing bank can call on the MDB guarantee. This structure reduces uncertainty around the project's cash flows while also providing a runway for the project participants to fix (with the assistance of the MDB) the underlying cause of the delayed or outstanding payments.

mezzanine financing: Mezzanine financing is a capital resource that sits between (less risky) senior debt and (higher risk) equity within the capital structure. It has both debt and equity features. In blended finance, structured funds can be established involving a subordinated first loss equity tranche and one or several mezzanine and senior equity and/or debt tranches.

multilateral development bank (MDB): An MDB is an IFI that provides financial assistance and development expertise to countries for the purpose of promoting economic growth, reducing poverty, and addressing developmental challenges. MDBs are typically established through international agreements among multiple countries and operate on a multilateral basis. In this way, MDBs can be considered a subset of DFIs, which are specialized financial institutions that provide long-term financing and support for development projects and initiatives. DFIs can include multilateral, regional, and bilateral development banks and financial institutions.

risk-weighted assets (RWAs): In evaluating MDB credit standing, S&P relies on the risk-adjusted capital (RAC) ratio. The RAC ratio equals forecast common equity divided by the MDB's RWAs. To be judged by S&P as having a strong capital position, an MDB must maintain a RAC ratio greater than a given target value. If the level of common equity is given, this requires that the MDB limit its RWAs. S&P's measure of RWAs equals a weighted sum of assets, with weights dependent on rating and jurisdiction.

securitization: Securitization is a financial process in which financial assets, such as loans, mortgages, or receivables, are pooled together and transformed into tradable securities. Securitization allows financial institutions to convert illiquid assets into tradable securities with distinctive risk-return profiles that can be sold to private investors. For example, given their underlying risks, infrastructure projects do not typically create the cash flow characteristics that institutional investors prefer or are inscribed in their mandates. The securitization of infrastructure loans would create both highly rated, low-return tranches suitable for conservative pension funds or asset managers and lower-rated, higher-return tranches suitable for investors with higher risk appetites, such as hedge funds.

syndication: Syndication means more than one lender is involved, working together to pool funds for the borrower. There can be many benefits, from spreading or mitigating the risk to diversifying the funding pool of the client. Syndicated loans are loans provided by a group of lenders (called a "syndicate") who work together to provide funds for a single borrower. The main objective is to spread the risk of a borrower's default across multiple lenders, thus encouraging private investment. A syndicated loan arranged by an official institution may include financing from the market through the A/B loan structure.

tranche: This refers to a portion or slice of a financial instrument, such as a loan, bond, or mortgage-backed security, that is divided into distinct parts based on certain characteristics or terms. Each tranche represents a separate class of securities with its own unique features and may have different risk-return profiles. Tranches are commonly used in structured finance to create securities that appeal to different investor preferences and risk-tolerance levels. The senior tranches are considered less risky but offer lower returns, whereas the junior tranches carry higher risk but potentially higher yields. By separating the underlying assets into different tranches, issuers can tailor securities to meet the demands of different investor groups.

ENDNOTES

1. It has been estimated that the COVID-19 pandemic has cost developing countries an estimated 5 percent of their gross domestic product (GDP) in 2020, unraveling decades of development achievements and pushing at least 100 million people back into extreme poverty (Mahler et al. 2020).

2. The role of private investors in renewable energy, for example, is critical in bridging the gap to provide a stable and sustainable supply of electricity. They can provide much-needed external financing, technology, and efficiencies through competitive tendering.

3. According to the 2021 Joint Report on Multilateral Development Banks' Climate Finance, MDBs provided over $82 billion in climate finance in 2021, much more than that coming from dedicated climate funds (AfDB et al. 2022).

4. This goal has already been met, with MDB climate finance totaling over $82 billion in 2021—yet it is still far short of the $5.2 trillion investment gap.

5. There are three variants of process tracing: theory testing, theory building, and explaining outcome. For more explanation, see Beach and Pedersen (2013).

6. We focus on financial de-risking in this paper, acknowledging the important signaling role that policy de-risking plays in the broader scheme of private sector mobilization and market building for climate investments. Policy de-risking takes place when policy measures provide a risk mitigating effect. Examples include policy reform, setting standards, policy research, technical assistance, and policy-based finance. Policy de-risking is a critical part of the MDB toolbox. However, for the purpose of this paper, we focus on financial de-risking that avoids or reduces the risk associated with projects via financial measures.

7. All MDB founding charters contain references to guarantees.

8. MDBs operate by leveraging a rather narrow equity capital base by borrowing at low cost in international capital markets. Therefore, the rating agencies' perception of an MDB's credit quality constrains how much the MDB may lend for a given level of capital. Recognizing the constraint that MDBs face to maintain their ratings, the G20 encouraged MDBs to optimize their balance sheets and increase lending to infrastructure investment, climate change, and other pressing areas without damaging credit ratings. In 2016, the G20 presented an Action Plan on the 2030 Agenda for sustainable development that promoted the mobilization and responsible use of all sources of financing, including private financing to achieve SDGs, continuing to encourage the optimization of MDB balance sheets.

9. The IIFC serves as a flexible counterparty to global infrastructure lenders to enhance capital management in the context of increasingly stringent financial regulations. Africa50 is an infrastructure investment platform that invests in projects that combine public and private sector funding. It focuses on national and regional projects in the energy and transport sectors (Kshetrimayum et al. 2019).

10. A key challenge for the AfDB in implementing Room2Run was clarifying with S&P what risk weights it would assign to the tranches in the deal that the AfDB would retain. The agency ultimately agreed to a mini-RACF (risk-adjusted capital framework) approach in which the risk weights employed in the RAFC are themselves applied in deducing the RWAs for the senior tranche in the deal that an MDB would typically retain. Extensions and clarifications of this mini-RACF approach would further boost the scope for use of synthetic securitization such as Room2Run by other MDBs (Kshetrimayum et al. 2019).

11. APG invests on behalf of pension fund clients Stichting Pensioenfonds ABP and bpfBOUW.

12. ILX Management B.V. is also part of Cardano Development, a multimanager with over a decade of experience in establishing and managing innovative emerging market funds.

13. TCX was founded in 2007 by a group of DFIs, specialized microfinance investment vehicles, and donors to offer solutions to manage currency risk in developing and frontier markets. These solutions consist of financial instruments such as swaps and forward contracts that enable TCX's investors and clients to provide their borrowers with financing in their own currency while shifting the currency risk to TCX and being protected from currency volatility.

14. It has been proposed that the program implementation period should be extended to April 2041.

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ABOUT WRI

World Resources Institute is a global research organization that turns big ideas into action at the nexus of environment, economic opportunity, and human well-being.

Our challenge

Natural resources are at the foundation of economic opportunity and human well-being. But today, we are depleting Earth's resources at rates that are not sustainable, endangering economies and people's lives. People depend on clean water, fertile land, healthy forests, and a stable climate. Livable cities and clean energy are essential for a sustainable planet. We must address these urgent, global challenges this decade.

Our vision

We envision an equitable and prosperous planet driven by the wise management of natural resources. We aspire to create a world where the actions of government, business, and communities combine to eliminate poverty and sustain the natural environment for all people.

Our approach

COUNT IT

We start with data. We conduct independent research and draw on the latest technology to develop new insights and recommendations. Our rigorous analysis identifies risks, unveils opportunities, and informs smart strategies. We focus our efforts on influential and emerging economies where the future of sustainability will be determined.

CHANGE IT

We use our research to influence government policies, business strategies, and civil society action. We test projects with communities, companies, and government agencies to build a strong evidence base. Then, we work with partners to deliver change on the ground that alleviates poverty and strengthens society. We hold ourselves accountable to ensure our outcomes will be bold and enduring.

SCALE IT

We don't think small. Once tested, we work with partners to adopt and expand our efforts regionally and globally. We engage with decision-makers to carry out our ideas and elevate our impact. We measure success through government and business actions that improve people's lives and sustain a healthy environment.