

THE TRI HITA KARANA ROADMAP FOR BLENDED FINANCE:

Building Inclusive Markets Working Group



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Numerous influential organizations, leaders in the development finance ecosystem, contributed to addressing the specificities of local and international markets to support the establishment of an enabling environment to attract investments in developing and emerging markets. Capitalizing on the collective strength of the members' organizations, and leveraging the aggregated intelligence, this report aims to outline how blended finance can be used as a tool to accelerate inclusive sustainable market development, including the local financial market.

The Inclusive Markets Working Group Co-Chairs led this coordinated effort. Their guidance and ability to engage the THK members were key for the success of the Working Group efforts.

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- Diana Guzman, World Economic Forum
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All the members of the Inclusive Markets Working Group contributed to the publication of this report through their active participation and insightful comments and ideas. A full list of members is available in Annex 1.

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Finally, Marusa Rus from the International Chamber of Commerce was able to unify the narrative, the sub-themes and the inputs provided by the various organizations into one consolidated report, successfully summarizing complex and diverse information to make months of discussions available to the audience of the OECD Private Finance for Sustainable Development.



1. Introduction

Launched under the leadership of Indonesia, the **Tri Hita Karana (THK) Roadmap for Blended Finance** is an international shared framework for mobilizing additional commercial capital towards the UN Sustainable Development Goals. The THK establishes a shared value system among international partners on blended finance for development. Building on the Addis Ababa Action Agenda, the THK framework also establishes a common narrative among a variety of actors that seek improved outcomes for the broader blended finance agenda and documented development impact. Within the THK framework, blended finance actors are engaging in a coordinated effort to ensure the effectiveness and scaling up of blended finance operations. Five working groups are working towards good practices, mobilization, transparency, inclusive markets and impact. The groups have formulated work programs, and over the second half of 2019, the groups have explored challenges and opportunities for making blended finance work at scale and for greater impact in delivering sustainable development.

The Inclusive Markets Working Group (IMWG) kicked off its work in mid-June 2019, tasked to address the specificities of local and international markets to support the establishment of an enabling environment to attract investments in developing countries. In this context, the group considered blended finance a tool to accelerate inclusive sustainable market development, including the local financial market.

At the outset of its work, the IMWG agreed to investigate the following four areas of relevance to creating inclusive markets:

1. Enabling Environment
2. Local Capital Markets
3. Mapping Inclusive Market Vehicles
4. Early Stage Pipeline

The IMWG agreed to base its work on the following definition of “inclusive markets”:

“Inclusive markets are marketplaces that generate access to economic opportunities for all, and create shared prosperity across all social groups, sectors and geographic areas by focusing on long-

term sustainable development. Blended finance is a mechanism that enables and accelerates the creation of inclusive markets and deepening of existing markets.”

This paper provides a brief overview of the preliminary findings of the IMWG. The members of the group fully realize that it has only been possible to scratch the surface of the issues discussed. This is due to the limited time and the voluntary nature of the group’s work, but it also reflects how the inclusive market development is a dynamic process in which the involved actors constantly must adjust to changing national and international circumstances. In light of this, the last section of the paper includes suggestions on themes that deserve further attention as the ecosystem around blended finance and inclusive markets evolves.



2. Common Narrative and Definitions

As decided at the outset of the THK Roadmap discussions and in alignment with other THK working groups, the Inclusive Markets Working Group (IMWG) is anchoring the analysis in the OECD definition of blended finance: *“The strategic use of development finance for the mobilization of additional finance towards the SDGs in developing countries.”* The IMWG is thus limiting its analysis exclusively to concessional blended finance, which is only one of the tools to crowd-in and mobilize commercial investment towards SDG projects in developing countries. Concessional finance operations make riskier projects bankable and conducive to mobilization.

A crucial principle to follow when using blended finance for the development of inclusive markets is “sustainable market development”. Sustainable market development proposes there should be a clear vision of financial sustainability when deploying blended finance to create new markets or deepen/widen existing markets. In practice this means that concessional blended finance should not provide higher subsidies than are needed by following a minimum concessionally principle. Blended finance should be used only as a transitory measure to jumpstart markets until the private sector is able to take over.

As part of the shared value system, the Roadmap emphasizes that blended finance should be structured as to build inclusive markets. Development of inclusive markets can only be achieved by fostering better quality and higher quantity of blended finance, which will be achieved through four strategic goals as proposed by The Roadmap:

1. Promoting a sound enabling environment and investment climate,
2. Accelerating inclusive sustainable market development, including local financial markets, through local engagement and ownership,
3. Coordinate availability of information relevant for market making among policy makers, development finance providers, commercial investors and investees,
4. Clarifying, sharing and addressing the root causes for requiring blended finance in different markets.

The IMWG investigated how blended finance approaches can help create new markets and investment opportunities, and deepen and widen existing markets to reach underserved segments of the

population and create an economy with more diversified services and new investment opportunities. The IMWG analyzed opportunities and challenges in the use of blended finance. Based on examples and case studies, which take the broader view of blended finance, IMWG has distilled good practices and lessons learned and created a lean deliverable which will inspire stakeholders and optimize the future use of blended finance approaches.

The IMWG agreed to investigate the following four focus areas, which correspond to four strategic goals as set out by The Roadmap under the shared value of ‘structuring blended finance to build inclusive markets’:

1. Focus Area: Enabling Environment
2. Focus Area: Local Capital Markets
3. Focus Area: Mapping Inclusive Market Vehicles
4. Focus Area: Early Stage Pipeline

The THK Roadmap emphasizes the importance of an **enabling environment** that is conducive to stimulating inclusive and sustainable market development. The IMWG investigated key constraints preventing the development of inclusive markets and distilled good practices and lessons learned regarding key regulatory reforms. While macro risks, weak regulatory environments, lack of market transparency, and illiquid investments pose barriers to bringing private investment to developing countries, policy instruments such as reducing capital controls and streamlining company and collateral registration and ownership requirements may improve the enabling environment for blended finance transactions. Additionally, where government measures to regulate cross-border funds transfers have had a dampening effect on global investment flows, clarifying these rules to international banks would facilitate movement.

The THK Roadmap further emphasizes the need for inclusive sustainable development of **local capital markets** with a goal of expanding financing opportunities for borrowers, lenders, and investors. Financial inclusion is an important enabler of the SDGs. However, underdeveloped local capital markets and limited access to finance for banks, companies and segments of the population in developing countries remains a key challenge for unlocking new markets and facilitating new investments. The IMWG has investigated how blended finance approaches can support the inclusive sustainable development of local capital markets (including money markets) by exploring the roles of various stakeholders including national and sub-regional DFIs and development banks in mobilizing private sector investment by employing, replicating and scaling blended finance approaches. Based on

a number of case studies drawn from different regions the group investigated how blended finance can contribute to financial sector deepening and widening.

The THK Roadmap proposes the coordination of the relevant market making information for further development of blended finance. The IMWG undertook a **mapping** of inclusive market vehicles that used blended finance, providing an initial review and foundation for further analysis of these solutions to create more inclusive markets. The mapping leveraged Convergence's database of historical blended finance transactions, highlighting the prevailing regions, sectors, structuring approaches, and vehicle types.

Finally, the THK Roadmap identified **early stage pipeline** financing as a gap in the market which can be addressed through a blended finance approach. The Sub-Saharan Africa region is the biggest receiver of blended finance according to Convergence (2019). Yet, the lack of bankable projects remain a serious constraint for the region in achieving the SDGs. The group explored how to crowd-in additional project preparation funds, facilities and donors to create a market place for projects in early development stages and simultaneously foster collaboration among key stakeholders to connect early stage pipeline projects to the appropriate providers of development finance.



3. Focus Area 1: Enabling Environment

Brief: Legal and Regulatory impediments to Blended Finance

Focus area definition

The THK Roadmap emphasizes the importance of a regulatory environment that is conducive to stimulating sustainable market development. In Focus Area 1, IMWG investigates the key constraints hindering blended finance and suggests potential regulatory reforms to create a more enabling environment.

Introduction

A flourishing **investment climate** enables a better quality and quantity of blended finance. Besides issues in the international regulatory environment, building inclusive local markets is crucial in mobilising private sector investment, including improving local currency investment. To that end, national and sub-regional development banks can play a greater role in crowding-in private finance. In addition, local private and institutional actors should be involved in blended finance operations as local ownership of blended finance operations will contribute to its sustainable impact. Coordinated efforts should be undertaken in order to develop these markets.

The quality of the investment climate of a country is hugely influenced by the **legal and regulatory environment** that pertains there. It is important to both investors and potential investees: For investors it translates into a variety of investment opportunities and choice between myriad instruments while for companies seeking financing it ensures flexibility in financing terms. As blended finance comes in varied forms and often as a combination of guarantees/debt finance or equity finance, the possible barriers to this type of instrument also come from different sources.

Additionally, in the increasingly globalised and interlinked financial systems, it is important to recognise that the legal and regulatory environment from other jurisdictions can have a major impact on the provision of blended finance solutions in developing markets.

A. Legal and Regulatory impediments in the investee country

Mapping the current situation

Capital controls and/or foreign exchange controls can discourage foreign investors from investing in local projects or companies of investee countries as the possibilities to exit investments are limited. Further uncertainties regarding property rights, collateral ownership and movements plus inefficiencies in the legal mechanisms to resolve disputes are also discouraging foreign investors from entering markets and cannot be overcome by the banks and companies alone but can require root and branch reform of the legal and regulatory environment of the country.

Similarly, low levels of trust in the local currency (in the form of cash and securities) can have a detrimental effect on domestic markets by limiting the availability of local currency financing. Financing in foreign currency often leaves local companies with exchange rate risk and limited options for hedging. Concerns about the liquidity of local currency securities render them ineligible in secured lending transactions. These are significant deterrents for foreign investors. One area where there has been some policy progress in this regard is in FX hedging. The most successful model has been TCX, seed-funded by the FMO, the Dutch development agency, in conjunction with other DFIs, microfinance investment vehicles (MIVs) and international donors (now also with the involvement of the German and Dutch governments), with a mandate to provide FX-hedging instruments in illiquid emerging-market currencies.¹ Although there has been some criticism of the cost involved and the limited range and tenure of the hedging instruments offered, TCX has seen significant uptake of its products by private investors.

Another successful model is Frontclear. Frontclear has unlocked access to global private capital investment for EMDC banks by providing guarantees to cover counterparty credit risk, on the condition that local currency assets can be used for collateral management purposes. To-date, Frontclear has facilitated USD 980 million in interbank money market transactions including over USD 600 million in blended finance. Frontclear's capital structure is in itself blended, pulling together DFI investors, bilateral development funds and capital from the global insurance industry.

One area where regulatory frameworks are hindering blended finance investments is Infrastructure. A number of examples are summarised below:

¹ <https://www.fmo.nl/project-detail/56155>

- **For investors in infrastructure projects, the key risks in developing economies can be both political and macroeconomic, from fluctuations in the exchange and interest rates to a wide variety of political and regulatory uncertainties.**² Investors therefore often rely on the involvement of International Financial Institutions (IFIs) to mitigate political and economic risk. They recognise that IFIs can use their established relationships with governments should there be difficulties with the governance, legal or regulatory framework of a project. IFIs have played instrumental roles in facilitating large-scale and regional projects, where establishing good governance models in complex environments is crucial.
- **Some countries limit foreign investment into infrastructure projects,** as well as imposing restrictions on percentage shareholdings, for example in Vietnam.³
- **In Indonesia, for example, Dana Investasi Infrastruktur (DINFRA) is a new investment fund designed for infrastructure project financing:** It has significant potential for mobilizing funds for infrastructure, however, several issues needed to be resolved before insurance companies and pension funds could fully take advantage of the products DINFRA offers. Initially, there was no clear asset class classification for DINFRA products. Only recently, the authorities issued regulations clearly putting DINFRA in the eligibility list of these institutions. The Government also issued a new tax regulation, putting DINFRA on a level playing field with other asset classes. Yet, there is still no clarity around listing requirements and procedures for DINFRA. Without listing investment-linked products cannot be invested by insurance and pension funds. The Sustainable Development Investment Partnership (SDIP) is currently working on proposals and recommendations for the Indonesian government to rectify these issues.

Path forward

It is therefore crucial to address the fundamental issues that discourage private investors (both foreign and domestic) in developing economies. Blended finance may improve the risk-return profile of businesses to attract private investors and help build a pipeline of investment opportunities, but it will not resolve the underlying deterrents to private investments if they are embedded in the legal and regulatory frameworks of the country. This goes to the heart of the issue of sustainability of blended finance transactions. Significant barriers include macro risks (e.g., political, economic, and currency), weak regulatory environments, market transparency, and illiquid investments.⁴ Development money is often used to address the unfavourable perception of the risk/return metrics that many investors

² Judith E. Tyson, ODI, "Private infrastructure financing in developing countries: [five challenges, five solutions](#)," August 2018.

³ *Ibid*

⁴ CGAP Brief, "Navigating the Next Wave of Blended Finance for Financial Inclusion," August 2018.

have about developing countries. Investors often overestimate the risk of investing in most developing countries and underestimate the profit potential. However, even once this misperception is addressed, many developing country investments remain very risky.⁵ While donors and DFIs cannot mitigate all such risks, they can facilitate the development of inclusive financial sector policies and regulations and strengthen the capacity of supervisors, thus building investor confidence. Both the EBRD and Frontclear are very active in addressing shortcomings in money market regulations, like those limiting the enforceability of global standard documentation (e.g. GMRA and ISDA) that is essential to investor confidence.

Specific policy instruments that could improve the enabling environment for inclusive markets and increase the use of blended finance include reducing capital controls, streamlining company registration requirements, confirming collateral ownership and facilitating its movement, creating fiscal incentives (particularly for large investors such as pension funds), streamlining bureaucracy and red tape and strengthening rule of law and creditworthiness of Government counterparties.

An important point to also note is the potentially negative implications of the expansion of blended finance operations in countries where local governance and regulatory frameworks are ill equipped to deal appropriately with it.⁶ The rapid expansion of blended finance arrangements and the attendant proliferation of private actors in the development finance arena without due consideration of these broader regulatory implications may undermine the efficacy and sustainability of international development and reframe recipient countries' engagements with local communities and the global financial market more broadly.⁷ Oversight of blended finance is also likely to fall on domestic legal and regulatory frameworks. This can be challenging in countries where corporate governance regimes remain weak.

B. The impact of international regulations on global investment flows

⁵ Sony Kapoor, "Billions to Trillions – a Reality Check," March 2019.

⁶ Celine Tan, "Creative cocktails or toxic brew? Blended finance and the regulatory framework for sustainable development," Chapter 13 in *Sustainable Trade, Investment, and Finance: Toward Responsible and Coherent Regulatory Frameworks*, Edward Elgar. Tan states that regulatory oversight of privatised services can be challenging in countries where public administrative structures and corporate governance regimes remain weak and under-resourced. Developing countries face significant legal support gaps when negotiating contracts with private investors and in designing regulatory regimes for foreign and domestic private investment, with many highly reliant on donors to supply the legal, policy and regulatory expertise needed to overcome these capacity deficits.

⁷ *Ibid*

Mapping the current situation

Anti-Terrorism and Anti-Money Laundering, together with Know Your Customer Regulations:

While the globalisation of investment flows has brought widespread benefits at home and around the world, governments are increasingly concerned with the potential for international payments to be diverted for the purposes of terrorism, especially since the September 11, 2001 terrorist attacks. In response to this potential threat, governments have introduced extensive additional and coordinated measures to regulate cross-border funds transfer, including charity and remittance payments as well as investment.

The Financial Action Task Force (FATF), an independent intergovernmental body that sets international standards and promotes implementation of measures for combating terrorist financing through its recommendations, introduced Recommendation 8 to address specific terrorist financing vulnerabilities and threats faced by the charitable sector. Recommendation 8 and its Interpretive Note (INR8) serve as an international policy standard that influences the domestic regulation of the foreign activities of charities.⁸

The difficulties of redressing the misuse of charitable resources occurring in another jurisdiction has prompted many countries to implement interventionist measures applied in the home jurisdiction to discourage or curtail opportunities for abuse once funds are transferred abroad.⁹ The approaches have been varied and are country-specific.

More stringent Anti Money Laundering & Counter Terrorist (AML) Finance and Know your Customer (KYC) regulation in advanced economies such as the United Kingdom can have a knock on effect on the freedom of charitable foundations and financial institutions to conduct operations in certain countries. For example, a charitable foundation that wishes to deliver a grant or an institution that wants to provide a first loss guarantee in a 'high risk' country in the eyes of the home regulator may run into difficulties. Material monetary flow from the financial institution in the home country would be under added scrutiny, adding to the cost of disclosure of the financial institution carrying out the transaction, making operations in these 'high risk' countries less viable. A lack of sophisticated AML and KYC companies in less developed countries also pose a barrier to financial institutions in highly regulated countries. As regulation in their home countries require stringent checks to be carried out, the financial

⁸ Dr. Natalie Silver, University of Sydney Law School, "Regulating the Foreign Activities of Charities: A Comparative Perspective," The Pemsel Foundation (2017). Link [here](#).

⁹ *Ibid*

institution can find the choice either to set up the functionality in their branches in said country at material cost; or to not offer the service.

These efforts potentially compound difficulties in the process of transferring capital across borders at low cost with ease.

Separately, institutional investors (such as pension funds and insurance companies) have fiduciary responsibilities and are subject to regulatory requirements. Globally, Solvency II has created limited appetite for infrastructure investment by insurance companies. This is because it requires high capital buffers for both long-term and higher-risk assets (both of which increase the capital that needs to be held for infrastructure assets.) These restrictions arise predominantly from international regulations. However, domestic or regional regulatory frameworks can impose further restrictions on local institutional investors.

The Global Financial Crisis (GFC) highlighted that conditions in the money market have a direct and immediate negative impact on the financing conditions for firms, especially SMEs. Being an essential source of bank funding, liquidity and risk management, money markets have a significant impact on the size of the balance sheet of financial institutions and the amount of credit they can extend in the real economy. Since the 2008 financial crisis, **remedial mandatory requirements include the posting of high quality hard currency** (e.g. USD and Euro) collateral in interbank transactions. Whilst this is a prudent measure by any standard, it is having the effect of increasing global financial segmentation since institutions in emerging markets have limited access to high quality hard currency assets and thus to sources of global investment.

At the EU-level, regulations also constrain insurance companies from outsourcing investment decisions and portfolio management to unregulated entities. This makes it difficult for European insurance companies to participate in transactions that are unregulated, including DFIs and the special-purpose vehicles used for project financing.

Correspondent Bank Accounts closure:

A number of international banks have closed the bank accounts of entities providing international remittances to high-risk countries such as Somalia, including money transfer organisations as well as international aid organisations. This is a consequence of increased pressure from the US regulator, which has imposed significant fines on banks that have not fulfilled their AML responsibilities. This has led some international banks to review their participation in international remittance operations and

to disengage from markets where the receiving market is not performing robust customer due diligence.

Even in situations where Banks are being reassured by the State Department that no enforcement action will be taken against them provided they carry out their own appropriate due diligence, many of the banks have taken the view that in such a broken and diverse regulatory environment they may still end up in court. Even if the banks are ultimately vindicated, it will cost them a lot of money and resources to fight the case and the risk/reward ratio does not add up to make it worth their while. This has the unfortunate consequence of effectively freezing the evolution of the digital payments system in these countries, where cash remains prevalent. Another unintended consequence of such draconian regulation is that while it has scared off established banks, it may lead to the flourishing of less legitimate agencies that will take advantage of the situation.

Path Forward

It is therefore desirable that the relevant bodies in the US and the EU clarify their position regarding international remittances to high-risk countries. This could be done by instructing the relevant banks that where they have complied with all regulations required of them no enforcement action would be taken and no fines meted out to them. Informal reassurances are insufficient. Such clarification will allow legitimate international banks to continue the much-needed business of international remittances to emerging and developing economies.

Separately, the evolution of the FinTech payment sector has had, and will continue to have, a positive impact on these legal and regulatory impediments. FinTech solutions for global settlements of FX transactions is one clear way of overcoming these obstacles. Again, these solutions should be replicable and sustainable in order to truly develop the market.



4. Focus Area 2: Local Capital Markets

Brief: Blended Finance as a Tool of Deepening and Widening of Local Capital Markets

Focus area definition

The Inclusive Markets Working Group is exploring the role of stakeholders, including national and sub-regional DFIs in mobilising private sector investment by employing blended finance solutions in order to support the sustainable development of local capital markets to expand financing opportunities for borrowers, lenders and investors.

Introduction

Blended finance interventions should target both the deepening and the widening of local capital markets. Deepening translates into greater access to the capital market for all and captures the dimension of inclusiveness of markets – with the ability to transact, clear and settle regularly and seamlessly being a key dynamic. Widening of capital markets signifies the expansion of financing choices for borrowers, lenders and investors with regards to currency, tenor and instrument. The potential of FinTech solutions and financial innovation to promote both of these dimensions should also be explored in this context.

Mapping the current situation

Within the existing landscape of blended finance interventions in the area of capital market development, a handful of characteristics can be identified as key elements of successful interventions.

There is a need for a market test to ensure the sustainability of any capital market development initiative. Interventions should target the development of the capital market infrastructure or its elements in a way that the change will remain once the intervention ends. A market test helps to avoid short term distortions in the targeted market. It also helps to address one of the recurrent criticisms that unfocussed blended finance can crowd out private sector activity. This also complements the principle of subsidiarity – where DFIs should focus exclusively on areas where there is no adequate offering from financial institutions and thus avoid any displacement effect.

A key metric of any blended finance solution is that it should be replicable and scalable. The focus needs to be on leverage rather than supporting a specific transaction for the benefit of a single beneficiary. The role of national and sub-regional DFIs in mobilising private financing towards the SDGs could lie, among others, in their ability to leverage upon their proximity to domestic resources including local institutional investors to kick start product development– potentially through targeted guarantees, as well as anchor or co-investment.

Targeted DFI participation in capital market transactions should promote “trust”. At the same time, the capacity of DFIs to support blended finance interventions is finite and their facilitative role should not be seen as permanent. An intervention does not need to be permanent, but should be intended to move the market in the right direction from a capital market development standpoint. The DFI role in market development should diminish over time as the effectiveness of market financing increases. This is why, in addition to the investment itself, many projects or transactions also involve complementary measures such as capacity building and training.

This should include addressing issues that discourage private investors in the first place. While DFIs cannot mitigate all macro risks, weak regulatory environments, illiquid investments, and market transparency, they can facilitate the development of inclusive financial sector policies and regulations and strengthen the capacity of supervisors, thus building investor confidence. Without these capacity building activities, blended finance will not resolve the underlying deterrents to private investments and will thus affect the sustainability and scalability of blended finance projects.

Strengthening the use of local currency and diversifying financing options in both foreign and local currency contribute to a more resilient and inclusive financial market. Local capital markets in the broad sense include the money market, the debt capital market, the equity capital market as well as hedging instruments such as derivatives and capital market infrastructure.

Path forward

It is important to harness the opportunities borne from the surge in impact investing in the last decade. Impact-focused Fintech companies have played a pivotal role, alongside microfinance firms, DFIs and others, in promoting financial inclusion. The more impact investors embrace private debt as a catalyst for scale, the more Fintech companies will succeed in their mission to promote financial inclusion across developing and frontier markets. According to an April 2018 report from the Global

Impact Investing Network, private debt is the most popular asset class in impact investment portfolios. However, most Fintech balance sheets are free of borrowing or leverage.¹⁰

¹⁰ <https://impactalpha.com/impact-fintechs-need-private-debt-not-private-equity-to-fuel-their-social-mission/>

CASE STUDY 1: Fintech Investment

Zoona – Mobile Money System in Zambia

Context

Zoona is a Fintech company that provides money transfers, bill and bulk payments, and most recently, savings and credit services in Zambia and Malawi. In 2009, Zoona was a digital financial services disruptor that demonstrated that an agent-led model with a powerful technology payments platform could be successful and diversify into other financial services and countries. It received critical initial grant funding from USAID and Deutsche Investitions und Entwicklungsgesellschaft to support a payments pilot for smallholder cotton farmers. The grant enabled Zoona to develop its payments platform and secure a central bank payments license. Later, after securing critical private sector debt and equity investors alongside a DFI, Zoona received more grant funding to develop a savings product.

Impact

It has now processed over \$2 billion in transactions, and has an active customer base of 2 million.¹¹ It has been recognised by The Nike Foundation and The Unreasonable Group as one of the top ten Start-Ups best positioned to take girls out of poverty by helping them become entrepreneurs.

Lessons Learned

What differentiates Zoona is its network-based approach. They have built a network of emerging local entrepreneurs and small businesses as well as larger business.

Replicability and Scalability

What differentiates Zoona is its network-based approach. They have built a network of emerging local entrepreneurs and small businesses as well as larger business.

DFIs, impact investors, and traditional venture capital firms are already investing in Fintech companies, albeit to a limited extent. Blended finance has the potential to allow Fintech companies in developing countries to scale quickly by providing risk-mitigating capital and support.

¹¹ CGAP, “Navigating the Next Wave of Blended Finance for Financial Inclusion,” August 2018. Link [here](#).

CASE STUDY 2: Strengthening Market Structures

Frontclear – Building a repo market in Kenya

Context

In March 2016, Commercial Bank of Africa (the largest privately-owned Kenyan bank with representation in Kenya, Tanzania, and Uganda) and Standard Bank of Southern Africa (the largest African bank by assets with a footprint across 20 African countries) executed a USD 25 million cross-currency repo transaction. The transaction was executed under a Standard International Swaps and Derivatives Association (ISDA) agreement between the two counterparties and assumed transfer of legal ownership of the collateral instruments - a step-up from the Kenyan 'horizontal repo', which is based on a pledge of security and does not furnish the same comfort towards mitigating credit risk, nor does it ensure the wider benefits of a liquid repo market. Frontclear issued a guarantee to SBSA to cover any residual credit risk on the transaction. The guarantees were in turn counter-guaranteed by KfW, a AAA-development financial institution, and were complemented by a technical assistance program run by Frontclear (FTAP).

From these relatively modest bilateral arrangements, Frontclear is now undertaking a much more ambitious and targeted counterparty risk guarantee mechanism with multiple private sector participants in Uganda and Kenya to promote secondary market activity amongst domestic counterparties. Under the Umbrella Guarantee Facility (UGF) or "Tradeclear", multiple financial sector participants sign up and pay a fee to Frontclear who guarantee the risk of counterparty failure in specific market products.

Impact

The focus is initially in repo with potential expansion to cover money market and FX transactions. Previously banks with excess local currency deposits lent the balances at very low rates to the Central Bank whilst those banks seeking local currency funds needed to access the Central Bank window at penalty rates – leading to a serious fragmentation of the market. By stepping in to guarantee counterparty credit risk from repo transactions, Frontclear will reduce the fractured nature of the market, reducing the spread between borrowing and lending rates, build trust between counterparties, and improve market capacity through improved industry standard documentation.

Lessons Learned

A blended solution can lead to the convergence of borrowing and lending rates and therefore an increase in the efficiency of capital markets.

Replicability and Scalability

"Tradeclear" ticks all the boxes as regards market tests, building trust and targeting genuine improvements to market conditions. It is a prime example of an initial intervention that moves a market in the right direction. All banks joining Tradeclear also participated in extensive capacity building provided by Frontclear, thereby reinforcing the sustainability of the project. Tradeclear is not intended to be a permanent feature in the market. As market participants build trust in

transacting with each other, its role could decrease. Equally, there is considerable scope to evolve to a much wider product selection should the market demand it.

CASE STUDY 3: Corporate Sustainability Bond

Natural Rubber Production – supporting green growth in Indonesia¹²

Context

The Tropical Landscapes Finance Facility (TLFF) aims to finance local projects and companies in Indonesia that are focused on green growth and sustainable rural livelihoods. In February 2018, TLFF completed its inaugural transaction, a landmark \$95 million long-dated sustainability bond to finance sustainable natural rubber production across heavily degraded concession areas in the Jambi and East Kalimantan provinces of PT Royal Lestari Utama (RLU – a Joint Venture between the Barito Pacific Group and Michelin). Michelin, the global tire manufacturer, will act as an off-taker of at least 75% of future production and USAID's Development Credit Authority (DCA) provided a partial credit guarantee.

The transaction has significant environmental and social impacts, aligning to the IFC Performance Standards and the SDGs. The RLU project seeks to develop less than half of the 88,000 ha Industrial Forestry Plantation concessions as commercial rubber plantation that will transform a degraded area and provide thousands of long term sustainable local jobs, while protecting the wildlife and forests areas within the concessions and developing community partnership programs with Indigenous People and local communities that will drive long term social benefits to the surrounding areas.

Impact

The transaction was Asia's first corporate sustainability bond, with an innovative multi-tranche class structure that appeals to investors with diverse risk-return and tenor requirements. Class A notes, comprising \$30 million, were rated Aaa by Moody's and subscribed by institutional investors from Asia, such as life insurance companies.

With USAID DCA partial credit guarantee, this bond issuance is a unique concrete example of medium/large-scale blended finance for land use sector globally.

Lessons Learned

Perception of risk in investment for land use sector is still very high, at a time where it is critical to act fast and invest in responsible and sustainable projects on the ground, especially in countries like Indonesia and Brazil, where the land use sector is one of the main contributor to the carbon emission.

Development Financial Institutions (DFIs) plays an important role in providing risk capital/balance sheet to unlock the necessary long-dated capital and lower interest rate that will enable the economic transition to low carbon and sustainable development.

Replicability and Scalability

Scalability potential is exponential for such a partnership between corporates, development institution and commercial investors to unlock the necessary investment required for the low

carbon and sustainable development activities. The role of DFIs/development agencies to lead and guide the private sector may serve to normalize the “business unusual” way forward, which serves to invest in long term commercial projects with clear environmental and social impacts.

CASE STUDY 4: Increasing access to financial services

Private Agricultural Sector Support (PASS) Trust – financial sector deepening in Tanzania

Context

Investments in agriculture are notoriously perceived as risky in developing countries, and Tanzania is not an exception. Since 2000, PASS has been committed to provide access to financial services for smallholder farmers in Tanzania by applying a combination of guarantee products, mezzanine finance and business development services, and PASS is thus creating new debt markets for a risky asset class through a range of risk-mitigating instruments.

Impact

Financial sector deepening. PASS has contributed to financial sector deepening through expansion of access to financial services for segments of the population who do not have access to finance themselves. In 2018 alone, PASS guaranteed 15,564 business proposals benefiting 196,873 farmers (27% female). Since 2000, almost one million agricultural entrepreneurs have benefited from PASS guaranteed loans. Farmers served by PASS have increased harvest, productivity and income relative to non-served farmers, and have enjoyed reduced level of input cost for financial services (e.g. double the amount of loans and a lower interest rate by 5%).

Employment. The impact on employment is mixed. Investments made possible by the guaranteed loans, especially in SMEs, may in some cases create jobs, but the investments generally lead to higher labour productivity and do not always lead to higher labour input per unit product within the SME. Manual labourers are generally replaced by fewer, but more qualified personnel.

Lessons Learned

Institutional sustainability. PASS is ensuring additionality by serving a risky and underserved market. As such, PASS can pass the “market test”, as it does not appear that PASS is crowding out or displacing private sector players in the field. However, the banks have not yet taken up the role that PASS plays. PASS’ share of loans to farmers has increased, so the traditional bankers and credit institutions’ dependency of PASS is relatively high. The financial institutions are predominantly financing clients with a PASS guarantee. The case illustrates that the benefit of having institutions like PASS act as a guarantor and agricultural finance knowledge centre for the banks may result in complacency, i.e. banks not being inclined to develop in-house capacity and taking on a higher share of the risk. If PASS is to fulfil its ultimate development goal - to no longer be needed as a service provider – there is a need to ensure that the banks gradually build up more knowledge and take on a larger share of the risk. The introduction of a portfolio guarantee instrument works as an incentiviser to this effect, as the banks are required to conduct their own business plan analysis and hence requires some degree of knowledge of the agricultural sector.

Financial sustainability. The level of financial sustainability of PASS is relatively high compared to most other guarantee schemes. At the same time, PASS is still losing money on its core business, even considering that it is a development institution. High operational cost and a sharp increase in the overall volume of non-performing loans are the main culprits. The case illustrates that monitoring of financial risks (non-performing loans, exchange rate risks, concentration risks at the level of banks and clients) and constantly minimising operational cost are key factors to the success of any organisation like PASS with respect to financial sustainability.

M&E and data collection. The case illustrates the importance of collecting data in an adequate and systematic way. Lack of quality data makes it difficult to measure financial results and development impact (e.g. on employment) and it make it difficult to improve the interventions of PASS. M&E of financial and development impact as well as data analysis for day to day operations and strategic policy making can only be successful if a digitalization of operations takes place.

Replicability and Scalability

The PASS institution. Further growth of PASS is possible through

- expansion of portfolio guarantees and institutional guarantees (rather than individual and group loan guarantees that imply a growing burden on staff). Portfolio guarantees also work to incentivise banks to take over the operations in the long run without PASS;
- attracting additional capital, increasing agreed leverage with partner banks and lowering the guarantee percentage for recurring PASS clients;
- applying FinTech solutions in order to increase efficiency at the client-PASS interface, in data entry and management in the PASS system, in communications with the banks, and in monitoring and evaluation of progress and social impact;

The development impact of PASS could be enhanced by considering specific labour enhancing policies, such as a focus on value chains where increased employment (hired external labour) is an important effect of investment.

The PASS model. The PASS institutional model can be replicated elsewhere. However, it is key to consider and articulate the exit strategy in advance. This will entail ensuring that the right incentives are in place for the partner financial institutions to take over operations on market terms once the intervention ends.

CASE STUDY 5: GET Fit Uganda¹³

Context

Since early 2013 a team within Trinity International LLP has been engaged by the German development bank, KfW, to act for the Government of Uganda (“GOU”), Uganda Electricity Transmission Company Limited (“UETCL”), the Ugandan Electricity Regulatory Authority (“ERA”) and a donor group led by KfW in relation to the Global Energy Transfer Feed-in-Tariff (“GET FIT”) program in Uganda.

GET FIT’s goal is to support the development of small (typically 1MW to 20 MW) renewable power projects. These projects offer a host of benefits beyond merely being renewable and providing a large cumulative capacity. For example, they provide a granular portfolio of distributed power generation assets; staggered electricity supply growth, which can be more manageable for the utility compared to large projects adding generation capacity in large increments, opportunities for newer and smaller developers, including local developers, to gain experience; low environmental and social impact, and so on.

Impact

The success of GET FIT Uganda is proven by results. The programme currently supports fourteen hydro projects, two solar PV projects and one bagasse project, and is on track to support a cumulative capacity of 150MW – 170MW, or in the region of 20% of Uganda’s existing installed capacity.

Lessons Learned

Challenges

The development time and costs incurred in relation to smaller projects, in particular in relation to contract negotiations and satisfying lender requirements, can be very similar to those incurred on much larger projects. In turn this can render the development of smaller projects uneconomic for developers, and an unwarranted burden on the finite resources of host Government stakeholders.

In relation to grants to GET FIT – supported project, somewhat uniquely the GET FIT Uganda grants are tied to the attainment of the donors’ development goals: 50% of the grant is paid on attaining the commercial operation date, and thereafter 10% is paid per year for five years assuming that energy delivery targets are met. This presented some unique challenges: in particular, creating a bankable grant agreement and associated lenders’ direct agreement, which in turn required the documentation, balancing the need for lenders to acknowledge the expected grant income in the financial model against donors’ desire to refuse to fund and/or to seek reimbursements if certain adverse circumstances arise such as bribery.

Document standardisation process

In Uganda the project document standardisation process started by taking documents from some earlier projects in Uganda, which had not been subject to ‘usual’ rigorous project finance standards, then working with Government stakeholders in relation to what would be required from them on

¹³ <https://www.trinityllp.com/get-fit-to-power-africa-a-ugandan-case-study/>

project-financed projects, and thereafter taking the resulting documentation through what turned out to be a very lengthy stakeholder consultation process including input from DFI lenders (including FMO) and other law firms. This commenced with documentation for hydropower, in relation to which Trinity processed several hundred individual stakeholder comments before finalising the standard forms.

Replicability and Scalability



5. Focus Area 3: Mapping Inclusive Market Vehicles

Introduction

This mapping exercise provides an initial review and foundation for further analysis of blended finance solutions for creating more inclusive markets. As outlined throughout this report, “inclusive markets vehicles” are those that reach underserved segments of the economy (individuals, companies, investors, etc.) that have limited or no access to markets or financing opportunities. Blended finance is one tool for mobilizing additional financing for the creation of inclusive markets.

This mapping leverages Convergence’s database of historical blended finance transactions to provide a high-level analysis of blended finance transactions aligned to inclusive markets that have been financed and launched to date. Convergence has identified approximately 500 blended finance transactions that have reached financial close across multiple sectors, regions, and development themes. There have been more than 1,100 unique organizations that have provided 3,700 financial commitments to these structures.

Methodology

Convergence curates and maintains the largest and most detailed database of historical blended finance transactions to help build the evidence base for blended finance. Information is collected primarily from credible public sources such as press releases, as well as information sharing agreements and data validation exercises with Convergence members and partners. Given the current state of information reporting and sharing, it is not possible for this database to be fully comprehensive, but it is the best repository globally to understand blended finance scale and trends.

Convergence captures information on blended finance transactions that have reached financial close and are aligned to three high-level criteria: (i) financing is earmarked for SDG projects in developing countries, (ii) concessional capital is deployed on below-market terms, and (iii) there is mobilization of one or more additional private sector investors. Per Convergence’s State of Blended Finance report¹⁴, there are as many as 15 blended finance definitions publicly available, which collectively describe

¹⁴ Convergence (2019). The State of Blended Finance Report 2019.
<https://www.convergence.finance/resource/13VZmRUtiK96hgAvUPk4rt/view>

blended finance as a mechanism, approach, instrument, and/or asset class. Convergence focuses exclusively on blended finance to catalyze private investment.

Summary of Relevant Data

Based on an initial assessment of the database, Convergence has collected information on 88 blended finance transactions that are aligned to creating more inclusive markets. These vehicles represent nearly US\$20 billion in total capital earmarked for SDG projects in developing countries. There is a significant range in total transaction size across the transactions, from a minimum of US\$1.6 million to a maximum of US\$3.8 billion. The median transaction size has been US\$73 million and the average transaction size has been US\$232 million.

Convergence provides an initial analysis of these transactions by vehicle type, focus sector, target region, and structuring approach (i.e., “blended finance archetype”) in the sections below. Convergence can also provide analysis of transaction / project sponsors as well as both concessional and commercial capital providers active in blended finance for inclusive markets. Convergence has recently added fields on intended impact (e.g., target direct and end beneficiaries) and impact measurement (e.g., reporting frequency). As applicable, Convergence can benchmark inclusive market trends to trends seen across the entire blended finance dataset.

Initial Analysis of Convergence Data

Sector

To date, blended finance transactions aligned to inclusive markets have been primarily focused on the financial services sector (e.g., access to financial services). 38% of transactions aligned to inclusive markets have focused on this sector, compared to 24% across all blended finance transactions. The most active sub-sectors include microfinance (15 transactions) and capital markets (8 transactions). Frontclear and The Currency Exchange Fund (TCX) are indicative examples of capital markets solutions.

The second largest proportion of transactions aligned to inclusive markets have been focused on the energy sector, representing 20% of relevant transactions. An indicative example is the Accugas IV term loan facility, which mobilized debt financing from five local commercial banks through a US\$50 million Debt Service Reserve Account (DSRA) guarantee from GuarantCo, enabling the company to construct a new gas pipeline in Nigeria. It should be noted that financial services and energy are the two most common focus sectors across all blended finance transactions captured in Convergence’s database.

Region

Sub-Saharan Africa has been the most commonly targeted region by blended finance transactions aligned to inclusive markets. Within Sub-Saharan Africa, the most targeted sub-regions have been Southern Africa (28% of transactions), followed by East Africa (25% transactions), Central Africa (16% of transactions), and West Africa (15% transactions). Note that transactions may target one or more subregions and regions. West Africa has seen the largest average transaction size, at nearly US\$4 billion, due to several large energy infrastructure projects.

Blended finance transactions aligned to inclusive markets have also included South Asia (22% of transactions) and Southeast Asia (15% of transactions). Compared to across all blended finance transactions, there have been relatively few transactions aligned to inclusive markets in Latin America & the Caribbean: only 12% of inclusive markets transactions versus 17% across all blended finance transactions.

Structuring Approach (“Blended Finance Archetype”)

Convergence has identified four common blended finance archetypes: (i) concessional capital within the capital structure, (ii) risk mitigation on the capital structure (e.g., guarantee, risk insurance), (iii) design-stage grants to commercial vehicles, and (iv) funds for technical assistance alongside commercial investment. Each blended finance transaction in the Convergence database deploys one or more of these structuring approaches.

The most common blended finance archetype is the use of concessional capital within the capital structure, which accounts for 53% of transactions aligned to inclusive markets. More notably, risk mitigation has been a relatively common structuring approach for transactions aligned to inclusive markets: 48% of inclusive markets transactions versus 33% across all blended finance transactions. Technical assistance funds are often used alongside other structuring approaches (e.g., concessional capital within the capital structure, risk mitigation on the capital structure).

Vehicle Type

Convergence identifies six common blended finance vehicles: bonds / notes, companies, facilities, funds, impact bonds, and projects. Funds are the most common type of vehicle for blended finance, although funds account for a relatively smaller proportion of blended finance transactions aligned to inclusive markets (38% of inclusive market transactions versus ~50% overall). Instead, blended finance transactions aligned to inclusive markets have been much more likely to be facilities, bond / notes, and projects. These vehicles range from 13-18% of inclusive market transactions.

Blended facilities and blended projects have been the largest average blended finance transactions aligned to inclusive markets at US\$429 million and US\$404 million, respectively. Bonds and notes have been relatively small, with an average transaction size of US\$53 million.



6. Focus Area 4: Early Stage Pipeline

Brief: Blended Finance Targeting Early Stage Projects in Sub Saharan Africa

Focus area definition

To address the lack of bankable projects in Sub Saharan Africa (SSA) and foster collaboration among key stakeholders to connect owners of early stage projects to the appropriate providers of development capital in order to successfully unlock SSA's pipeline potential.

Introduction

Investors argue that the main reason private capital is not flowing to developing countries is due to the lack of bankable or investment ready projects. Private capital shy away from early stage investments to develop projects to investment ready or bankable projects due to the high risk involved in these stages of the projects. A recent survey conducted by the Sustainable Development Investment Partnership (SDIP) and its partners highlighted that there is an estimated \$2.35 billion available in the coffins of just 47 project preparation facilities and funds surveyed with approximately \$800 million available exclusively for project development support in Africa.

The SDIP Africa Hub is focused on connecting owners or sponsors with projects in the early development stages or where there is a gap in their project preparation funds with the development capital funds and facilities. The objective is to support the project owners and sponsors to advance their projects towards bankability and in the process, to develop a systematic approach and platform for projects owners and funders to create a sustainable flow of SDG projects that are commercially attractive to enable private capital to flow at the scale that is needed to address the urgent development needs in the continent.

Mapping the current situation

The SDIP Africa Hub, a neutral platform where public and private sectors collaborate to address regional financing challenges and mobilize capital to advance sustainable development in Sub Saharan Africa, conducted a comprehensive assessment of the Africa infrastructure pipeline for blended finance opportunities, creating a pipeline of 85 projects from different sectors and countries from across the continent. Among the different challenges affecting project bankability in Africa includes

access to project development finance and technical support to develop projects efficiently and effectively.

As mentioned before, the SDIP Africa-Hub, in collaboration with USDA, DBSA, the Infrastructure Consortium for Africa (ICA) and Atkins Acuity, conducted a survey on the sources of capital available for project preparation in Sub Saharan Africa (including project preparation facilities). Results of the study were included in the [Insights on Project Preparation and Development Capital Mapping](#) report and launched at the Africa Energy Investment Forum in 2018. The results highlighted the funding gaps and/or overlaps which needed to be addressed to enable more effective and comprehensive support to develop a better prepared and more sustainable pipeline of projects in Sub-Saharan Africa. As part of the key findings, the study identified that most of the facilities support projects in later stages of development, with only a limited number of facilities funding projects at earlier stages, such as pre-feasibility stages; providing an opportunity for more donors and funds to be active in the earlier stages to increase the pipeline of projects approaching financial close.

Solution-oriented approach to Unlock Projects

The Hub has prepared a series of touch points throughout 2019 to advance a solution-oriented approach to unlock projects in the development stages in order to foster an SDG pipeline for Africa and transforming the way development financing is activated in the Continent. The meetings took a practical approach by holding in-depth advisory discussions following a pitching session from a select group of early stage project owners or developers with strong sustainable development impact struggling to find project development support or to fill the funding gap. Thus, building on tangible project examples, the Hub ensured project owners to receive expert input from project funds and facilities in terms of what is required to unlock the project to receive project development funds and to take the project to a bankable stage. Through this approach, the solutions assessment process is grounded on the actual needs of the existing projects.

The objective is to advance early stage projects in the pipeline through the development cycle by effectively connecting them with Project Preparation facilities, funds, donors and other sources of capital identified through the mapping exercise.

SDIP Africa hub held a number of project preparation market places on the margins of high-level events throughout 2019. Market places were held during the Africa Energy Market Place (AEMP) of the African Development Bank in June, the WEF Africa in September and the Africa Investment Forum in November 2019.

Projects that were presented at the various above-mentioned market places are captured in the table below.

Project name	Project description	Country	Sector	Project Stage	Funding gap
Village Corps -Ghana	40MW biomass project with proprietary farmed feedstock	Ghana	Energy	Feasibility	\$1.5 million
NIOKI - GREEN ENESYS	2.8M Solar Pholovoltaic (PV) power plant. A mini-grid to be constructed in Niokio for power distribution. Pilot project for a larger programme of at least 15 mini-grids in Mai Ndombe using solar, biomass and storage	Democratic Republic of Congo	Energy	Pre-feasibility	\$515k
Njoro Kubwa Integrated Water supply project	Bulk Water Infrastructure 145 km) for <ul style="list-style-type: none"> • Irrigation for animal feeds and other Grains • Water supply potable domestic livestock consumption • Intensive livestock farming and meat processing 	Kenya	Water	Pre-feasibility	\$3.6 million
AiIM Hydroneo	AiIM Hydroneo has the rights to develop, finance, build, own and operate a number of small, run of river hydropower plants The most tangible opportunities in the pipeline are 4 projects 2 in Cameroon and 2 in Guinea	Cameroon & Guinea	Energy	Feasibility	\$1.7 million
PWV15 Road project	PWV 15 is a 35 5 km long, planned north south freeway for which preliminary designs were completed over the years 1981 to 1996	South Africa	Transport	Pre-feasibility	~\$ 2 million
Water transfer project	A transboundary multipurpose water resources development project on the Orange Senqu River Basin shared between Lesotho, South Africa, Botswana and Namibia;	Lesotho / Botswana	Water	Feasibility EIA	EURO 3 million
Gabon Road	780 km road which is an essential and critical asset for Gabon as it allows the movement of people and goods through 5 of the country's 9 provinces	Gabon	Transport	Feasibility	\$1.9 million

Virunga Power:	Small HYDROPower & Rural Utility Portfolio OPPORTUNITY	Tanzania	Energy	Pre-feasibility underway . Funding required for feasibility studies	\$3 million
School's Water and Agriculture Programme Africa (SWAP Africa)	<p>The School's Water and Agriculture Programme Africa (SWAP Africa) provide</p> <ul style="list-style-type: none"> • A supply of clean water • Self sufficiency in vegetables and associated produce for the school • Income generation through produce sales to surrounding communities • Education of pupils in the skills of growing, marketing & selling of agricultural produce, leading to self-sufficiency & Employment for surrounding communities <p>To date all 120 schools installed have run the project successfully.</p>	Eswatini & Lesotho	Education /Water/Agriculture	Pre-feasibility	\$ 29 750 000

Among participants in the rooms were regional development banks, local/national development finance institutions, project preparation facilities, government representatives from Ghana and Congo, private investors and commercial financiers. Following the pitching sessions, the audience got the opportunity to raise questions or comments to project developers for better understanding of their value proposition and financing needs. This collective approach to project financing allows project developers to gather feedback on the commercial viability and improvements to make from institutions from along the financing value of chain.

Path forward

The next steps include the following:

- The SDIP Africa Hub is following up on the ongoing discussions between the project developers and event participants with the goal to draw key learnings from these sessions and expected outcomes or needs.
- Align key stakeholders and decision makers (donors, development banks, commercial financiers and project developers) on the actionable solutions at hand that can accelerate project preparation and unblock the growing amount of early stage pipeline in Sub Saharan Africa;
- Support early stage projects moving along the project development cycle, as examples that can improve understanding on how PPFs can better support projects going forward.

Deliverable

Final report to be presented at a major event (World Bank IMF Spring Meetings) with the key learnings on best practices from this practical and experimental process and the key solutions identified to unblock early stage pipeline and transform capacity development. The report should ideally be endorsed by SDIP Members, THK inclusive markets working group and other relevant groups such as the G20, for which effective project prep and pipeline development is a priority

CASE STUDY 6: African Local Currency Bond (ALCB) Fund¹⁵

Context

The African Local Currency Bond (ALCB) Fund provides anchor investment and technical assistance to first-time or innovative local currency bond issuances from financial institutions and companies operating in developmental sectors in African countries. As of June 2017, the ALCB Fund had invested in 18 bond issuances across 14 companies in nine countries, including Botswana, Ghana, Kenya, Cote D'Ivoire and Zambia. The ALCB Fund was initially designed, capitalized, and managed by the German Development Bank, KfW. After two years of operation, KfW determined that the ALCB Fund was ready to scale and hired a fund manager in 2015. The fund manager, Lion's Head Global Partners (LHGP), was responsible for implementing an institutional upgrade and growing the Fund. The Fund is currently fundraising equity and senior debt, and has successfully raised capital from various developmental and impact investors.

Most of Africa's capital markets are still in a nascent state, with infrequent private issuances being generally reserved to large financial institutions. There is a lack of a "credit culture" in virtually all markets, in terms of investment process, credit ratings and risk-based pricing. First-time issuers are often not aware of the opportunity to raise funds in the bond market, or find transaction costs and disclosure requirements prohibitive compared to deal size. Intermediaries lack deal experience; documentation required to inform and protect investors is often deficient; and marketing to investors does not meet minimum standards. As a result, investors prioritize well-known "names" and incumbents while avoiding credit analysis in unfamiliar sectors.

Impact

Bayport Botswana is the first credit provider in Africa, and the first payroll lender in the world, to receive the Client Protection Certification from the Smart Campaign. The certification means that Bayport Botswana's policies and practices uphold the Smart Campaign's seven Client Protection Principles, which cover areas like pricing, transparency, fair and respectful treatment and prevention of over-indebtedness. The success of the first investment and Bayport's adoption of constructive processes, including SMART certification as well as new pro-poor products, led the ALCB Fund to agree to a second investment in 2015. The second investment was for a BWP 20M (USD 2M) five-year amortization bond. In 2016, the Fund entered a third investment of BWP 30.5M (USD 2.8M) with a tenor of seven years. The seven-year bullet bond was ground-breaking—the longest-term funding in the Botswanan market and within weeks another asset manager had secured similar funding.

Lessons Learned

Replicability and Scalability

¹⁵

https://assets.ctfassets.net/4cgqlwde6qy0/1XjeLpd2txJwbxQI0jaYMj/ba2d34c1478612cb48f0a5aa2995e70d/Convergence_The_African_Local_Currency_Bond_ALCB_Fund_2017_1.pdf



7. Possible future areas of work

As mentioned in the introduction, the IMWG has only been able to do an initial analysis of a few selected themes regarding the role of blended finance in creating inclusive markets. Realizing therefore, that the covered themes only represents an early treatment of issues related to inclusive market creation, the IMWG has identified themes that deserve further work. These themes include the ones listed below, some of which are initially addressed in this paper.

FinTech: Obviously, it is the buzzword of the moment but there is a real opportunity here to use FinTech solutions to address many of the issues identified. For instance, the evolution of the FinTech payment sector would have a positive impact on the legal and regulatory impediments to blended finance in the case of international remittances. Another example of how FinTech is useful in this regard is bridging institutional gaps in the case of counterparty credit risk (e.g. Frontclear in Uganda and Kenya). However, the idea that one-off, bespoke FinTech solutions will develop markets should be avoided; they of course need to be replicable and sustainable.

Social Impact instruments: Innovative instruments that address social issues are an avenue worth exploring, especially in the context of the Sustainable Development Goals. Social impact bonds, while in their infancy, are an excellent example of a financial instrument that has sustainable impact. It is a nascent market, even in the UK, but the EBRD has recently invested in a development impact bond (DIB) in the West Bank and Gaza. It should be noted however DIBs and SIBs are not liquid instruments and there are issues regarding the monitoring of their effectiveness.

Domestic pension funds and other institutional investors. Domestic pension funds have an important role to play in generating long-term financial resources and facilitating the growth of capital markets. Ideas are emerging that domestic pension fund resources may be directed towards SDG financing. There is, however, a lot of complexity to using pension systems to support financing of the SDGs. It would be useful to take a closer look at some of the risks, challenges and opportunities of using domestic pension funds to finance sustainable development goals.

Inclusive markets creation vehicles. The work of the IMWG has scratched the surface of the possible vehicles to stimulate the expansion of existing markets and the creation of new markets. It would be useful to develop a more systematic overview of the possible vehicles. In response to the challenges

around small project size, a special interest is expressed in aggregation vehicles and in the blended finance structure to make these viable.

Legal and regulatory impediments. The IMWG has discussed legal and regulatory impediments at a general level, e.g. "trust in local currency", "capital controls" and "anti-money laundering regulations". It would be useful to dig deeper and extract concrete examples of legal and regulatory impediments at a country level and sector level.

Innovative financing approaches. One example of an innovative financing approach that could be worth investigating a bit further is humanitarian financing for refugees, where an example appears in a collaboration between Red Cross and the World Bank. Could blended finance be used for humanitarian finance and if so, how?

Donor's role in early stage pipeline. The IMWG work on early stage pipeline has prompted the question of the role of donor agencies in this important area. What are the donor agencies' thinking in relation to early stage pipeline? Why do they seem to be missing in the room?

Country Financing Roadmap. There is a double-challenge in relation to the fact that developing countries on the one hand are prompted to develop country financing roadmap which is a long term plan aligned with the national development plan to finance sustainable development with the right mix of capital, and on the other hand are in need of financing development projects here and now in order to reduce the inequality gap and create inclusiveness. How to address this double-challenge?

LDCs and sector challenges. It is documented that private capital mobilised through blended finance approaches is very limited in LDCs and in certain sectors, particularly social sectors. How to deal with this challenge? What does it take for blended finance approaches to reach markets and segments of the population who are most in need?



Annex 1: Full List of Members

Co-Leads

Diana Guzman, **World Economic Forum**

Frode Neergaard, **Ministry of Foreign Affairs of Denmark**

Nikolaus Schultze, **International Chamber of Commerce (ICC)**

Members

Alan Rousso, **European Bank for Reconstruction and Development (EBRD)**

Alejandro Diaz Loyola, **Convergence**

Alvino Wildschutt-Prins, **Development Bank of Southern Africa (DBSA)**

André Kүүsvek, **European Bank for Reconstruction and Development (EBRD)**

Anja Kramer, **KfW**

Arnfinn Jacobsen, **United in Diversity**

Bettina Prato, **IFAD-SAFIn**

Borbala Siklos, **European Bank for Reconstruction and Development (EBRD)**

Chris Clubb, **Convergence**

Deniz Harut, **Standard Chartered**

Jim Turnbull, **European Bank for Reconstruction and Development (EBRD)**

Karin Lindblad, **SIDA**

Kate Galvin, **European Bank for Reconstruction and Development (EBRD)**

Kate Schweigart, **Rare**

Ketut A. Kusuma, **World Bank**

Kruskaia Sierra-Escalante, IFC, **DFI Concessional Blended Finance Working Group**

Lasse Møller, **Seconded of the Danish government to the OECD**

Laura Sennett, (former) **African Development Bank**

Manuela Fulga, **World Economic Forum**

Marusa Rus, **International Chamber of Commerce**

Meizani Irmadhiany, **Royal Lestari Utama, Indonesia**

Mohan Vivekanandan, **Development Bank of Southern Africa (DBSA)**

Paolo Domondon, **Rare**

Paul Barbour, **Multilateral Investment Guarantee Agency (MIGA)**

Valeria Orlando, **Rare**