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UN-convened Net-Zero
Asset Owner Alliance

Call on Policymakers to Support Scaling Blended Finance

September 2022

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These organisations, initiatives and individuals support the Net-Zero Asser Owner Alliance's key asks to policymakers to create systemic change in the field of climate financing with the goal of accelerating climate action in emerging markets and developing economies. The Alliance appreciates their invaluable support.

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Sustainable Markets Initiative

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Context: filling the climate finance gap

The global economy must undergo an unprecedented socio-economic transition to avert catastrophic climate change. The latest IPCC report emphasises the urgency of climate change mitigation in order for greenhouse gas emissions to be halved and for the rise in global temperature to remain within 1.5°C, as per the Paris Agreement. This requires major investment in clean technologies, low-carbon infrastructure, sustainable business models, and adaptation measures. Significant capital is available, but it is not flowing in sufficient quantities, especially into Emerging Markets and Developing Economies (EMDEs). Urgent collaborative action is needed by all stakeholders to: (i) scale the necessary investments in the short- and medium-term; and (ii) address the systemic and regulatory barriers.[1]

Members of the UN-convened Net-Zero Asset Owner Alliance (the Alliance), 74 leading asset owners with US$10.6 trillion in assets under management as of September 2022 are united in the commitment to drive transition towards a 1.5°C world along no or limited overshoot pathways. Alliance members are eager to contribute to the necessary transition finance globally across high-, middle-, and low-income countries. Therefore, the Alliance actively collaborates with actors across the financial value chain to mobilise capital flows into climate solutions at the required scale and pace, with a particular focus on facilitating increased capital flows into EMDEs to fund the net-zero transition.

Blended finance: mobilising private finance

Institutional investors must integrate credit risk evaluations into their portfolio steering. In low- and middle-income countries, country and credit ratings are generally low. The average sovereign risk rating in these countries is "B-" or "Highly Speculative". This means that investment risk in these countries is often beyond the risk tolerances of asset owners within the Alliance and other institutional investors. For example, in consideration of relevant implications for risk capital charges, an "investment grade" risk rating (which corresponds to "BBB-" or above) is often required. This level of risk is a major deterrence for institutional investors to redirect their investment portfolios towards climate solutions in EMDEs.

To address this structural deterrence to investments, the Alliance strongly believes that 'blended finance' must play a significant role in mobilising the flow of climate capital towards where it is needed most and where it can generate further environmental and social co-benefits. Blended finance is a finance structure that leverages public and philanthropic capital to improve the risk profiles of investment opportunities in order to catalyse private-sector funding, particularly in EMDEs and innovative climate enterprises. These structures create a win-win situation for the public and private sectors. While the private sector benefits from an improved risk profile that meets requirements, the public sector (and the philanthropic community) achieves a multiplier effect. Public and philanthropic money serves as an incubator and leads to the scaling effects required for substantial

1 The Alliance acknowledges that the pursuit of net-zero demands a systemic transformation of the global economy, placing decarbonisation and climate adaptation firmly within the wider context of a just transition. In this respect, the "asks" put forward in this paper are envisioned as a support mechanism for the successful achievement of the UN's Sustainable Development Goals.

global impact. Over the past years, numerous good examples of blended finance success have been produced. Its use must now be normalised, standardised, and rapidly scaled.

With the firm conviction that partnerships are key in facilitating net-zero transition at scale, the Alliance published a Call to Action to asset managers to create blended finance vehicles. In presenting selected blended finance vehicles to interested Alliance members, the Call to Action allows for crucial knowledge sharing and capacity building with regards to blended finance structures. This is further enhanced by a collaboration with Convergence, the global network for blended finance. The Alliance encourages its members to use the resources and capabilities available to support the growth in net-zero investment solutions in their investment portfolios.

Workshop: moving forwards through dialogue

In line with the Call to Action, Alliance members recently convened a discussion in Berlin with leading international actors and thinkers in blended finance from across the public, private, and philanthropic sectors. The goal was to explore tangible and impactful measures and more meaningful collaboration for accelerating what remains an under-utilised solution to the climate finance gap, especially in EMDEs.

In November 2021 the Alliance published a discussion paper 'Scaling Blended Finance' that discussed the opportunities and the challenges of blended finance. The Scaling Blended Finance event in Berlin built on the findings of this paper to advance the dialogue with all stakeholders and to find solutions to the barriers.

The Alliance also recognises the body of knowledge that already exists on the subject, such as the asks to policymakers which were outlined in the Blended Finance, MDB Optimization, And Private Capital Mobilization paper published by the Sustainable Markets Initiative (SMI) and the Investor Leadership Network (ILN) in June 2022. GFANZ's statement on country platforms outlines a framework for building new architecture to mobilize finance to fund emerging markets and developing economies' clean transitions, including better use and deployment of blended finance, which complements this Call to Action.

Common ground: areas of emerging consensus

Participants from the public and private sectors reiterated the untapped potential of a blended approach to financing a net-zero transition, particularly in EMDEs. Public funds alone are insufficient to decarbonise the real economy.

The role of multilateral development banks (MDBs) and development finance institutions (DFIs) in actively driving private investment mobilisation and blended finance—beyond the current insufficient low levels—is crucial. Given their experience and expertise in EMDEs, coupled with their higher risk tolerance and their official mandate, these institutions are uniquely positioned to facilitate the conditions required by the private sector to scale investments in EMDEs.

At the same time, the levels of cross-sector understanding need to be enhanced if public lenders are to fully accept asset owners and asset managers as partners in climate finance.

Key asks: message to policymakers

Among the many suggestions and proposals presented during the workshop, five garnered particularly strong support. These "key asks" (described below) are directed to all international policymakers. However, they have special resonance for the Coalition of Finance Ministers for Climate Action given their political influence of this group's members and their broad representation across high-, middle-, and low-income countries.

1. Scale and aggregate pools of concessional capital that create fiduciary investment assets

To close the gap between high investment risk in EMDEs and investors' obligations to earn risk-adjusted returns, governments and philanthropies must create sizeable and flexible pools of concessional capital to de-risk investments so as to bring them within investors' risk limits. These pools of capital should come together from various catalytic capital providers from the donor and philanthropic community. Such pooling, if appropriately structured and allocated, could allow the best mobilisation ideas to gain easier and more transparent access to larger amounts of catalytic capital. To ensure that catalytic capital achieves maximum impact, additionality, and mobilisation, such pooled funding could be allocated to the best vehicles identified along pre-agreed criteria in a call for proposals. Diversifying risks across multiple projects aggregated in a multi-sectoral and multinational investment vehicle also allows scarce catalytic capital to be utilised effectively and efficiently to promote impact at scale.

2. Modernise the governance and business models of MDBs and DFIs to align with the Sustainable Development Goals and the Paris Agreement

Despite strong public commitments being made by numerous MDBs and DFIs to prioritise private capital mobilisation, efforts to catalyse private capital have not reached the required levels. The most recent annual mobilisation report[2] demonstrates only US$21

2 International Finance Corporation (2020). Mobilization of Private Finance by Multilateral Development Banks and Development Finance Institutions 2019. Washington D.C. p.42. ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/mobilization+of+private+finance+by+multilateral+development+banks+and+development+finance+institutions+2019

billion of private direct mobilisation. The institutions should be incentivised to maximise total investment, most importantly through mobilising private capital, while at the same time effectively deploying their own balance sheets.

MDBs and DFIs should be further steered to focus their efforts on promoting an enabling environment for private capital flows, as well as enhancing grant-funded measures for capacity building and for improving project pipelines together with domestic governments, fully harnessing their local knowledge, expertise, and sourcing networks, to which most private investors otherwise do not have access.

Grant-funded technical assistance by MDBs and DFIs is needed at an early stage to secure a robust project pipeline. By setting and accepting common standards for eligible projects, MDBs and DFIs can significantly contribute towards the creation of a global market of bankable projects—a necessary condition for scale.

Equally, the risk frameworks of DFIs and MDBs should be adjusted to generate greater additionality by increasing the type of financing currently undersupplied in the target markets (e.g. equity, including early-stage project development finance, and local currency financing). Establishing key performance indicators, especially targeting private capital mobilisation for the net-zero transition, would help bring focus to this issue.

3. Support accurate risk pricing by providing access to core credit risk data

A systemic lack of reliable information about key issues, such as project risks, yields/returns, and historic defaults/losses, pushes private-sector investors to price the perceived risks at disproportionately high levels. If asset owners and asset managers were to have access to details about the default and recovery rates experienced by MDBs and DFIs across sectors and regions over decades, such over-estimates could be avoided. Making public the Global Emerging Markets' Risk Database[3] would mark a significant step towards achieving an accurate pricing of actual risks. The availability of long-term, comprehensive track record data could further facilitate the rating of blended finance structures and crowd in more private capital investment.

4. Prioritise thematic parameters in official development assistance

The majority of donor funding currently requires investments to fit specific sectoral or geographic guidelines. Such restrictions reduce the potential pool of investible projects as well as the scale of respective blended finance vehicles, thereby disabling the scale and diversification that institutional investors are demanding. Attaching region-agnostic thematic parameters (for example, decarbonising energy or Paris-aligned activities) and enabling easier access to official development assistance (ODA) would help circumvent these barriers.

3 gemsriskdatabase.org/

5. Make guarantees eligible for official development assistance

Increasing the use of guarantees would assist in making the economic risk-return profiles for climate solutions and clean technology investments more attractive to private investors. Guarantees require less budget provisioning, and an increased use of this blended finance instrument could offer the potential of a significant multiplier effect. Guarantees not called on may allow for the creation of a secondary market for their future commercialisation. To date, however, the use of this financing instrument has been limited as guarantees are only counted towards ODA if called and utilised. Amending the OECD's rules on ODA to account for guarantees as ODA-eligible could incentivise a more extensive use of such guarantees.

Collaborative action needed

With this statement, the Alliance calls on finance ministers and policymakers (as the shareholders of the world's MDBs and DFIs) to support the above action points. These actions are urgently needed to optimally incentivise and utilise blended finance approaches at scale. In collaboration with Convergence and by establishing a dialogue with the members of the Coalition of Finance Ministers for Climate Action, the Alliance will also look for other ways to collaboratively advance the highlighted solutions with a view to accelerating mobilisation for the global, net-zero climate goals.

Massive mobilisation of capital into EMDEs will only be achieved if all stakeholders collaborate and make their contribution, and if established practices are revised.

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