THE OECD DAC

BLENDED FINANCE GUIDANCE

OECD

Please cite this paper OECD (2021) *"The OECD DAC Blended Finance Guidance",* OECD Development Co-operation Directorate, Paris.

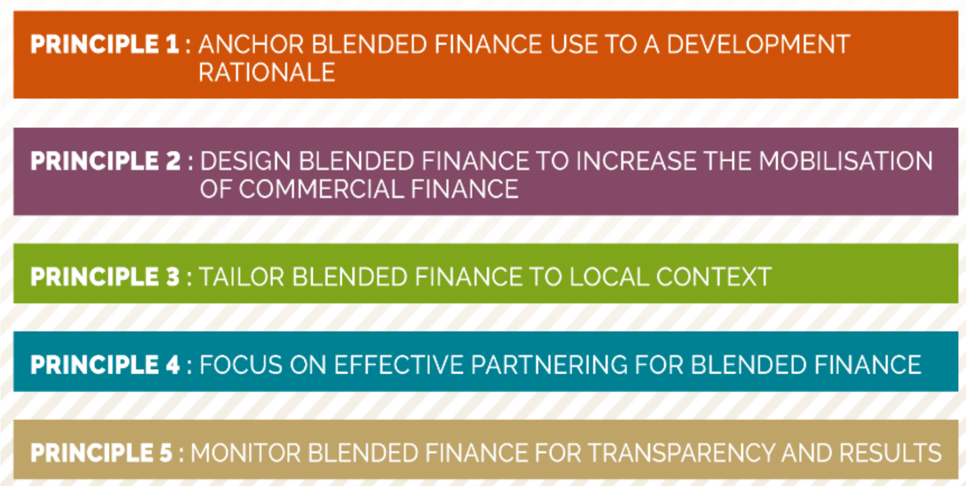
Foreword

Recovering from the current COVID-19 crisis and delivering the 2030 Agenda for Sustainable Development will require all sources of finance, public and private, to be mobilised at greater scale and speed. In developing countries, levels of domestic and external financing had already fallen short of the spending needs to achieve the Sustainable Development Goals (SDGs) and climate objectives before the crisis (OECD, 2020[1]). As official development assistance (ODA) plays an indispensable role in supporting responses to the COVID-19 crisis, members of the OECD Development Assistance Committee (DAC) pledged to "strive to protect ODA budgets" (OECD DAC, 2020[2]). At the same time, scarce concessional resources will need to be used even more strategically and effectively to catalyse and mobilise private sector resources at a larger scale. Against this backdrop, DAC members at the 2020 DAC High Level Meeting committed to "continue working to find ways to mobilise more official and private resources for sustainable development, including promoting more — and more effective — blended finance, with special attention to [least developed countries]" (OECD DAC, 2020[3]).

Blended finance is an innovative approach to financing sustainable development that aims to attract commercial capital towards projects that benefit society while also providing financial returns to investors. The OECD (2018[4]) defines blended finance as "the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries". Development banks and development finance institutions (DFIs) play a critical role in blending by deploying instruments and structuring mechanisms to mobilise the private sector. Multilateral development banks (MDBs) provide the largest share of private sector investments through dedicated private sector operations. However, a wider range of diverse actors are engaging in blended finance, from foundations and philanthropic investors to commercial actors, institutional investors, commercial banks, private equity and venture capital funds, hedge funds, and companies (OECD, 2018[4]).

Blended finance is still a relatively new financing approach in the development co-operation landscape. In light of the increasing risk of fragmentation in blended finance practices and governance, a common policy framework and understanding is crucial to ensure effectiveness. It is against this backdrop that DAC members, at the High Level Meeting on 31 October 2017, adopted the five Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals (hereafter the "Principles"), shown in Figure 1. Reflecting the development mandate of DAC members, the Principles aim to ensure that blended finance is deployed in the most effective way to address the financing needs for sustainable development by mobilising additional commercial capital and enhancing impact (OECD, 2018[5]). The Principles are a policy tool for all providers of development finance — donor governments, multilateral donors, development co-operation agencies, philanthropies and other stakeholders — to undertake blended finance approaches with high-quality standards. They were elaborated in close co-ordination with other international initiatives on blended finance such as the DFI Enhanced Blended Concessional Finance Principles for Private Sector Projects, which are targeted at the operational level (IFC, 2017[6]).

The OECD DAC Blended Finance Principles



Source: OECD (2018[5]), *OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals*, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf.

The Principles are embedded in the international development architecture and recognised as the de facto practice to follow when applying blended finance. The Principles have been referenced under a number of Group of Twenty (G20) and Group of Seven (G7) presidencies. Under the Canadian Presidency, G7 leaders committed to "work to implement the OECD DAC blended finance principles including promoting greater transparency and accountability of blended finance operations" (G7, 2018[7]). In the G20 Osaka Declaration, leaders recognised that blended finance "can play an important role in upscaling our collective efforts" (G20, 2019[8]). Under the G7 French Presidency in 2019, the G7 leaders further highlighted their support "to mobilize additional resources for development and help increase the impact of existing resources" and their support for "the implementation of the OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs" (G7, 2019[9]). Along with these declarations, the Principles also have shaped the blended finance policy context and discussions to advance blended finance best practices among partners such as the United Nations, the European Union and the World Economic Forum.

Following the adoption of the Principles by the DAC, the Blended Finance Guidance was developed to help donors put the Principles into practice. The Blended Finance Guidance was approved by the DAC in September 2020. All relevant, higher-level commitments made by DAC members in relation to development co-operation apply to blended finance in the same way they do to other financing approaches. These include, among others, commitments on ODA financing targets, leaving no one behind, development effectiveness and untying aid as well other DAC principles and standards, notably the Guiding Principles on Managing for Sustainable Development Results, the DAC Principles for the Evaluation of Development Assistance, and the DAC Quality Standards for Development Evaluation.

Acknowledgements

This publication was prepared by the OECD Development Co-operation Directorate (DCD) headed by Director Jorge Moreira da Silva. Paul Horrocks, Head of the Private Finance for Sustainable Development Unit, managed and led the work to develop this publication, with strategic leadership of Haje Schütte, Senior Counsellor and Head of Financing for Sustainable Development Division.

This publication was drafted by Valentina Bellesi and Faty Dembele. The core team responsible for drafting the underlying Detailed Guidance Notes included Wiebke Bartz-Zuccala (Guidance Notes on Principles 2 and 4); Irene Basile (Guidance Note on Principle 5); Valentina Bellesi (Guidance Notes on Principles 1 and 5); Priscilla Boiardi (Guidance Note on Principle 1 and 5); Faty Dembele (Guidance Note on Principle 3), Jarrett Dutra (Guidance Notes on Principle 4); Marie Fuchs (Guidance Note on Principle 2); Weronika Garbacz (Guidance Notes on Principles 3 and 5); Natalia Lemanska (Guidance Note on Principle 3); Astrid Manroth (Guidance Notes on Principles 2 and 4); Lasse Moller (Guidance Note on Principle 3); and Esme Stout (Guidance Notes on Principles 1 and 5).

The quantitative analysis relied on OECD statistics on private finance mobilised by official development interventions, kindly provided by Cécile Sangaré and Tomas Hos.

The authors would like to thank the following OECD colleagues who took the time to review and provide comprehensive feedback on the Detailed Guidance Notes: Rafael Duque Figueira, Thomas Boehler and Megan Grace Kennedy-Chouane.

The OECD is grateful for the support, expertise and insights provided by the following Senior Strategic Reviewers: Nancy Lee, Senior Policy Fellow at the Center for Global Development; Cameron Khosrowshahi, Director, Invest Initiative at USAID; Kay Parplies, Head of Unit, Investment and Innovative Financing at the European Commission; and Christian Novak, Professor of Practice at McGill University Institute for the Study of International Development.

The OECD is also grateful for the active contribution of experts during the physical and virtual workshops and consultations, including Gunnel Axelsson Nycander (Act Church of Sweden); Milena Bertram (Finance-in-Motion); San Bilal (European Centre for Development Policy Management); Louise Böhm (Entrepreneurial Development Bank, FMO); Tihana Bule (OECD); Alex Chirmiciu (European Bank for Reconstruction and Development); Nerea Craviotto and Jan Van de Poel (Eurodad); Andrew Davidson (Moody’s Investor Services); Amy Dodd (Development Initiatives); Yves Ehlert (European Development Finance Institutions); Andrew Hohns (Mariner Capital); Djedjiga Kachenoura (Agence Française de Développement); Megan Grace Kennedy-Chouane (OECD); Anja Kramer (KfW Development Bank); Theo Ib Larsen (Ministry of Foreign Affairs of Denmark); Alessandro Maffioli (Inter-American Development Bank); Astrid Manroth (OECD); Giulia Massobrio (International Trade Union Confederation); Nadia Nikolova (Allianz); Kay Parplies and Andreas Fischer (European Commission); Jesper Persson (European Investment Bank); Bettina Prato (International Fund for Agricultural Development); Julia Prescott (Meridiam); Kruskaia Sierra-Escalante (International Finance Corporation); Lori Scott (MacArthur Foundation); Drew Smith (Global Affairs Canada); Peter Sullivan (Citibank); Tim Turner (African Development Bank); Philippe Valahu (Private Infrastructure Development Group); Max von Bonsdorff

(Ministry of Foreign Affairs of Finland); and Mohan Vivekanandan and Alvino Wildschutt-Prins (Development Bank of Southern Africa).

The report also benefitted immensely from comments and insights sent by experts and practitioners during the various consultations, workshops and interviews undertaken by the OECD Secretariat, in particular the following organisations: the Act Church of Sweden, the Asabe Shehu Yar'Adua Foundation, the Asian Venture Philanthropy Network (AVPN), the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), the BC.lab (Colombia), Bangladesh University of Textiles, Cordaid Investment Management, Development Bank of Southern Africa (DBSA), Eurodad, European Centre for Development Policy Management (ECDPM), Finance & Sustainability (Italy), Frontier Markets, the Giti Group (Indonesia), the Health Finance Institute, the International Trade Union Confederation (ITUC), the Lady Lawyer Foundation, the Latin American Venture Philanthropy Network (Latimpacto), the Ministry of Finance of Mauritania, the Ministry of Foreign Affairs of Indonesia, the Ministry of Foreign Affairs of Greece, the Ministry of Foreign Affairs of Spain, the National Water Commission of Mexico, the Private Infrastructure Development Group (PIDG), Roots of Impact, Saïd Business School, SUED (Kenya), the Southern African Venture Capital and Private Equity Association (SAVCA), TXC Investment Management Company, the University of Oxford (United Kingdom), and the University of Dhaka (Bangladesh).

The OECD also thanks all participants attending webinars and consultation rounds.

The workshops and web-consultations conducted are listed here:

- **23 May 2019**: Physical one-day workshop on the Guidance Note on Blended Finance Principle 4
- **10 October 2019**: Physical one-day workshop on the Guidance Note on Blended Finance Principle 2
- **30 January 2020**: Physical workshop on the Guidance Note on Blended Finance Principle 5 (during OECD Private Finance for Sustainable Development Days)
- **15 April - 15 July**: Public written consultation on Blended Finance Guidance Notes on Principles 1-5
- **14 May 2020**: Web-consultation on Blended Finance Principles 2, 4 and 5 with the Latin American Venture Philanthropy Network (LatImpacto) – via Zoom
- **27 May 2020**: Web-consultation on the Guidance Note on Blended Finance Principle 5 – via Zoom
- **3 June 2020**: Web-consultation on the Guidance Note on Blended Finance Principle 1 – via Zoom
- **17 June 2020**: Web-consultation on the Guidance Note on Blended Finance Principle 3 – via Zoom
- **29 June 2020**: Web-consultation on the Guidance Note on Blended Finance Principle 3, specifically targeted to civil society organisations – via Zoom.

Reader's guide

Structure and purpose of the Blended Finance Guidance

The Blended Finance Guidance outlines policy recommendations as well as practical steps and elements that should be considered to facilitate the design and implementation of blended finance programmes. The Guidance also provides good practice examples (for illustrative purposes) and key references for blended finance implementers to follow. The ultimate objective of the Guidance is to contribute to enhancing the growth and improving the quality of finance that is mobilised and invested in sustainable development of developing countries.

This Guidance first presents the blended finance context and latest trends. It then introduces the OECD DAC Blended Finance Principles and their policy context and summarises the core policy guidance for each of the five Principles. For each, it provides an overview of the Principle, policy guidance, a checklist to guide implementation of the Principle, and examples of good practice.

This Guidance Overarching Note builds on underlying Detailed Guidance Notes drafted for each of the five Blended Finance Principles:

- OECD DAC Blended Finance Principle 1: Detailed Guidance Note
- OECD DAC Blended Finance Principle 2: Detailed Guidance Note
- OECD DAC Blended Finance Principle 3: Detailed Guidance Note
- OECD DAC Blended Finance Principle 4: Detailed Guidance Note
- OECD DAC Blended Finance Principle 5: Detailed Guidance Note

Not only is blended finance changing quickly, but innovative financing instruments are being deployed and thus, new practices and approaches can also develop quickly. These five underlying Detailed Guidance Notes will be updated to reflect new developments and best practice examples in blended finance, as well as to incorporate new research, evaluation reports and other knowledge, including from the OECD DAC Network on Development Evaluation (EvalNet) Working Group on Evaluating Blended Finance and from the Community of Practice on Managing for Sustainable Development Results.

The Detailed Guidance Notes have been developed over the last three years through extensive consultation processes (detailed in the Acknowledgments) that involved blended finance experts from DAC donors, DFIs, MDBs, private investors and asset managers, partner countries, civil society organisations, and other participants of the OECD DAC Community of Practice on Private Finance for Sustainable Development. The Guidance Notes further build on prior OECD research, namely results of the 2018 survey on blended finance funds and facilities in Basile and Dutra (2019[10]) and Basile, Bellesi and Singh (2020[11]); "Blended Finance in the Least Developed Countries 2019" (OECD/UNCDF, 2019[12]); and "Blended finance in fragile contexts: Opportunities and risks" (Basile and Neunuebel, 2019[13]); detailed sectoral work on water and sanitation (OECD, 2019[14]) and a forthcoming work on agriculture; and an OECD Development Co-operation Working Paper on blended finance evaluation (Winckler Andersen et al., 2019[15]).

Target audience

This overarching Guidance Note is primarily for policy makers and development finance actors interested in seizing the opportunities presented by blended finance while following good practice approaches.

As different actors in the development finance space have different levels of knowledge and engagement on blended finance, this Guidance Note introduces the five OECD DAC Blended Finance Principles and Guidance. Practitioners and other development finance actors can access further technical guidance in the Detailed Guidance Notes. This Note aims to support development finance actors at different stages in their blended finance activities, for example:

- A minister wishes to begin a blended finance programme and would like to be aware of what are considered best practices in terms of delivery.
- A donor is considering establishing a blended finance programme and would like to undertake an analysis and evaluate whether a blended finance programme is indeed the optimal solution.
- A donor is committed to ensuring the delivery of a blended finance project and wishes to embed best practices, although the operational staff involved might not have had exposure to blended finance.
- A civil society organisation or think tank wishes to monitor and analyse developments of the development finance system or assess results of often complex arrangements such as blended finance programmes.

Finally, this Guidance and the Detailed Guidance Notes can also be used to support those actors that have well-established blended finance programmes but wish to further explore and develop a specific element, such as transparency or risk management.

How to make use of the Guidance

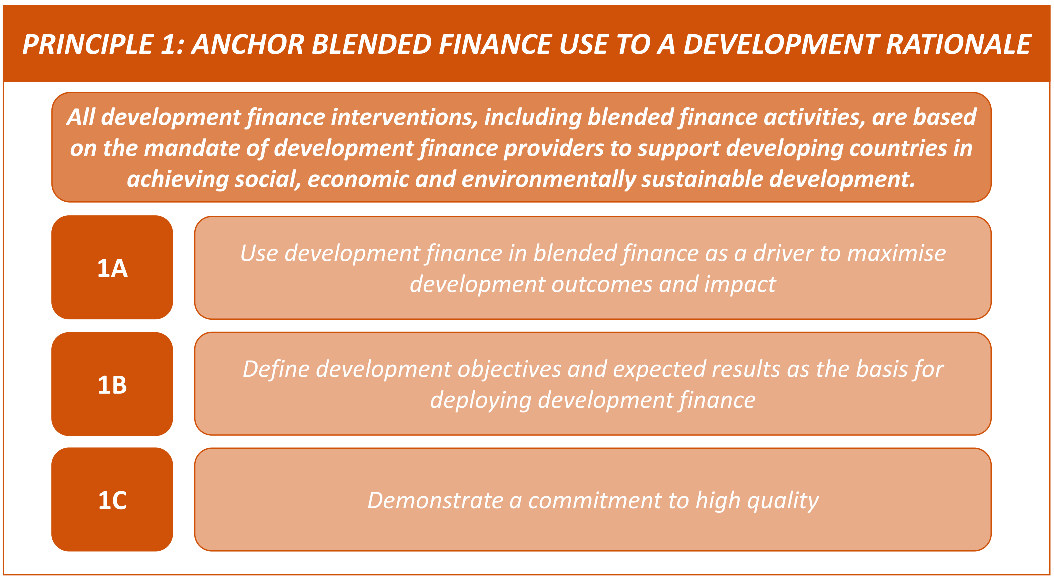
For effective implementation by the DAC of the Blended Finance Principles, this Guidance should be complemented with the underlying Detailed Guidance Notes, which provide further background, evidence and tools to effectively deploy blended finance approaches. The Detailed Guidance Notes also include examples that show real case practices in the implementation of each Principle. The discussion of each Principle also concludes with a checklist to remind the user of the tasks that should be undertaken to implement that Principle.

Each Principle should be considered as a core element to be addressed when approaching blended finance, with the underlying sub-principles providing further guidance. Thus, the Principles and Guidance Notes should not be seen in isolation, as they are interconnected and build on a coherent principle- and value-based approach to blended finance.

It should be noted as well that the Guidance should not be seen as a replacement for effective due diligence, although it should assist in ensuring that key elements are identified and addressed.

Principle 1: Anchor blended finance use to a development rationale

Figure 1. OECD DAC Blended Finance Principle 1



Source: **Invalid source specified.**, OECD DAC Blended Finance Principles, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf

Policy guidance

The OECD DAC Principle 1 focuses on the need to anchor blended finance use to a development rationale. The imperative to anchor blended finance to a development rationale is at the core of the blended finance agenda and is recognised by the Tri Hita Karana (THK) Roadmap for Blended Finance (Tri Hita Karana Sustainable Development Forum, 2018[16]). Likewise, the Kampala Principles on Effective Private Sector Engagement in Development Co-operation emphasise that effective partnerships with the private sector must focus on maximising development outcomes in line with the Sustainable Development Goals (SDGs) and national development priorities.

Sub-principle 1A - Use development finance in blended finance as a driver to maximise development outcomes and impact

Link blended finance to overarching development objectives in line with the 2030 Agenda and climate objectives

Donors can play a catalytic role in mobilising the private sector and are mandated to achieve social, economic and environmentally sustainable development. To ensure such roles and mandates, donors should formulate the strategic ambition and policy objectives for blended finance and link them to overarching development objectives.

Donors' blended finance objectives should be rooted in international and regional agreements on sustainable development. Examples of such agreements include, at international level, the United Nations (UN) 2030 Agenda on Sustainable Development (UN, 2015[17]) and the Addis Ababa Action Agenda (UN, 2015[18]) and, at regional level, Agenda 2063 of the African Union (2015[19]).

As concerns individual blended finance projects, implementing a robust theory of change ensures that interventions target the achievement of specific SDGs. **Before entering into a blended finance operation, all actors should clearly understand and articulate how the particular investment is expected to lead to outputs, outcomes and eventually development impact.** In setting development impact objectives and developing the theory of change, parties should apply the EvalNet Glossary of Key Terms in Evaluation and Results Based Management, given its widely accepted, flexible and cross-thematic nature (OECD, 2002[20]). [1]

Align the objectives of blended finance to local policy priorities

To the maximum extent practicable, the development objectives of blended finance should be aligned with development strategies of the partner country and linked to its SDG targets. Investors should work closely with partner countries to consolidate local ownership and capacity, respecting each country's policy space, absorption capacity and ownership to implement policies for sustainable development (OECD, 2011[21]; GPEDC, 2019[22]). Further information on how to align blended finance to local policy priorities is provided in the Detailed Guidance Note on Principle 3.

This is particularly important in least developed countries (LDCs) and fragile contexts where external investments can upset already delicate resource equilibrium in societies at risk of conflict. Blended finance providers operating in fragile contexts should ensure dialogue prior to launching blended investments to secure space for divergent interests to be expressed, avoid an excessive weight of private commercial interests, and ultimately foster ownership by local actors (Basile and Neunuebel, 2019[13]). In conflict-affected settings, all actors involved in blended finance should consider the need for an effective implementation of the DAC Recommendation on the Humanitarian-Development-Peace Nexus, under a "do no harm" approach (OECD DAC, 2019[23]).

Set clear and measurable development targets for blended finance funds and facilities

The results of the OECD Survey on Blended Finance Funds and Facilities showed that while most respondents anchor their investment strategies to one or more SDGs, over a third did not formalise quantitative development targets, which may hinder the capacity of investors to capture their (intended and actual) contribution to the sustainable development objectives (Basile, Bellesi and Singh, 2020[11]).

While grounding the investment strategy to the SDGs is of fundamental importance, blended finance vehicles should also anchor their activities to SDG targets. For instance, while over 70% of blended finance vehicles target SDG 1 (ending poverty in all forms), not enough evidence is available on the extent to which they focus on specific targets — e.g. eradicating extreme poverty (target 1.1) or building the resilience of the poor and those in vulnerable situations (target 1.5).

Focus blended finance on sectors where it can achieve maximum development impact on people and the planet

Blended finance is not yet targeted to all SDGs but now mainly targets sectors with investing opportunities and clear potential for revenue generation (OECD/UNCDF, 2019[12]; Convergence, 2019[24])**.** One of the objectives of blended finance is to reduce the (actual or perceived) risks for private investors to invest in a certain geography or sector, hence building a track record and demonstrating the viability of a transaction to ultimately develop new markets while benefitting those furthest behind. Blended structures may be needed initially to address the risk-return balance and bring the perception of risk down to its actual level. They also may serve to build a track record and gather experience in uncovered jurisdictions or sectors so as to gradually facilitate financially sustainable investments in the future.

Depending on the local context and project opportunities, blended finance providers may wish to prioritise SDGs that have the ability to catalyse other positive development effects while protecting people and the planet. Proper prioritisation and sequencing can accelerate progress toward sustainable development by facilitating the realisation of positive spillovers and limiting negative trade-offs without downplaying the importance of any specific SDGs. Blended finance providers should work with local actors to identify the least-financed sectors, in which the private sector can bring new solutions or expertise to tackle specific development challenges.

Deploy blended finance when this is more effective than other financing approaches within the broader development co-operation strategy

Donor governments should consider blended finance within a broader financing and development co-operation strategy and support its deployment where it is the most useful tool to achieve specific development outcomes and results. Blended finance is one approach in a toolkit of development co-operation approaches. As such, it should be deployed when its comparative advantage and value-added relative to other tools are clear, based on ex ante assessments taking into account alternative financing approaches. The assessment of the effectiveness of the blended finance approach should consider both the expected development outcomes and a comparison in terms of “costs”, including the fiscal implications for the partner country.

Sub-principle 1B - Define development objectives and expected results as the basis for deploying development finance

Set clear, mutually agreed and measurable development objectives with a coherent narrative

The objectives and expected results of blended finance should be clearly articulated, measurable and communicated to all stakeholders at the outset of a project. When objectives are not clearly identified and communicated at the outset, the project may not bring about the desired development outcomes.

Donors should clearly articulate the development rationale and share it with the private partner(s) and also set clear reporting expectations. The private partner(s) should, for their part, be asked to articulate their needs and understanding of what they expect from the partnership.

Keeping an open dialogue and setting co-ordination mechanisms help arrive at a common understanding of objectives and expected results as well as monitor their achievement and the effectiveness of the blended finance partnership.

Balance donors' and investors' expectations on development outcomes in relation to financial risks and returns

In blended finance, public and private actors come together to work on areas of mutual interest that promote sustainable development. However, they approach this in the context of their own institutional and legal frameworks and in coherence with the mandates from their shareholders. However, if the right checks and balances are in place when structuring the blended finance deal, development objectives and private sector objectives can work in tandem towards a shared goal (European Development Days, 2017[25]).

The development objectives and desired results should determine the selection of partners

Making desired development results the starting point in decision-making processes can guide the selection of potential private sector partners and investments. **The decision to partner with the private sector should be rooted in a theory of change that establishes whether and how the private sector is best placed to help realise specific development results and contribute to leaving no one behind.** Partnerships should only be undertaken where there is a clear, ex ante articulation of expected impact. Further guidance on effective partnering can be found in the Detailed Guidance Note on Principle 4.

Build institutional incentive structures that promote public-private co-operation and balanced sharing of risks and returns

A central issue when creating shared objectives for the public and private sectors is developing the right incentive structures for the private sector. At the outset, the different mandates and objectives of public and private sector entities can create an imbalance between the achievement of the development rationale behind the investment, on one hand, and the achievement of financial returns, on the other. While this is always a careful balance, it is worth constructing a suitable incentive structure to ensure that the development rationale remains a primary objective throughout the investment process.

A useful inclusion could be linking the financial returns to the achievement of specific development impact objectives (European Investment Fund, 2021[26]), for instance by encouraging fund managers to have a personal stake and buy shares in the fund or allowing co-investment of managers in funds to ensure optimum performance. **The impact-based incentive structure should be carefully designed and implemented to avoid unintended consequences.** With such structures, a credible impact measurement system, with a solid impact data collection system, is of crucial importance.

In general, the best way to develop the right incentive structure is to co-create it with private sector partners and, where possible, partner countries stakeholders and end-beneficiaries (Donor Committee for Enterprise Development, 2017[27]).

Develop the internal skills and capacities necessary in the public sector o effectively engage with private sector actors in blended finance

Organisational capacity, including the technical expertise of staff to structure, manage and execute transactions, is recognised as one of the barriers that limited the adoption of blended finance across donor organisations (OECD/World Economic Forum, 2015[28]).

Some donors developed internal policies to improve their private sector engagement (PSE) approaches. For instance, in the case of the United States Agency for International Development, or (USAID, the PSE policy is conceived as a first step within a broader cultural, operational and institutional transformation to expand the agency's PSE activities. The PSE policy integrated the development of blended finance models that focus on both financial returns and development impact as one of the several PSE approaches to be scaled up in the future (USAID, 2019[29]).

It is also important for blended finance projects to be accompanied by activities that support building local capacity, e.g. to negotiate, structure and deploy appropriate financing arrangements. Where limited blending currently takes place, such as LDCs and fragile contexts, blended finance providers should also work with all stakeholders to maximise the sharing and transfer of knowledge and skills in partner countries (OECD/UNCDF, 2019[12]; Basile and Neunuebel, 2019[13]).

Sub-principle 1C - Demonstrate a commitment to high quality

Encourage integrating environmental, social and governance (ESG) factors when selecting blended finance projects

Environmental, social and governance (ESG) factors are used to analyse a(n) (investee) company's prospects based on measures of its performance on environmental, social, ethical and corporate governance criteria (OECD, 2017[30]). **ESG factors can be used to screen potential partners and investments to exclude those that are underperforming or assess the potential to improve their performance** (Boiardi, 2020[31])**.** Methodologies to screen sustainable investments and integrate ESG factors should be clear and transparent, e.g. in line with the European Union taxonomy.

There are several internationally recognised commitments to integrate ESG factors. As shown by the 2018 OECD Survey on Blended Finance Funds and Facilities, the most common international commitments for ESG safeguards applied by these vehicles are the **International Finance Corporation (IFC) Performance Standards** (IFC, 2012[32]), the **Principles for Responsible Investment** (PRI Association, 2006[33]) and the **Equator Principles** (Equator Principles Association, 2020[34]). It is worth noting that some funds and investors apply their own proprietary tools or adapt them on an ad hoc basis, depending on the characteristics of each blending project and on the requirements of the investors involved (Basile, Bellesi and Singh, 2020[11]). However, **applying internationally recognised commitments is preferable as this contributes to aligning to best practice.** The Detailed Guidance Note on Principle 1 provides an overview of the main sets of ESG safeguards.

Donors should strive to implement the maximum level of ESG commitment practicable during the due diligence phase of the investment cycle. Corporate structures and business models of potential partners should be screened, as well as the company's transparency standards.

Apply the highest level of responsible business conduct

Donors should screen potential blended finance partners to guarantee that they adhere to the highest possible level of responsible business conduct (RBC).[2] From the outset of a blended finance investment, it is important to clarify responsibilities and allocate resources for monitoring of RBC practices throughout the project cycle. Implementation of RBC standards can support donors in better engaging with the private sector and ensuring that private sector partners act responsibly according to international standards.

The OECD Guidelines for Multinational Enterprises (OECD, 2011[35]) **and the principles of the UN Global Compact** (2021[36]) **can guide donors in selecting blended finance partners with the highest possible levels of responsible business conduct.** They can also help donors support enterprises in developing countries improve their RBC practices. The OECD Guidelines for Multinational Enterprises include principles and standards in all major areas, including information disclosure, human rights, employment and industrial relations, the environment, bribery and corruption, consumer interests, science and technology, competition, and taxation (OECD, 2018[37]). To help implement the guidelines, the OECD also has developed the **OECD Due Diligence Guidance for Responsible Business Conduct** (OECD, 2018[38]).

These guidelines and principles must be considered at the ex ante stage of an investment to ensure that the development rationale underpinning the intervention will be followed in an ethical way. Box 1 provides examples of good donor RBC practices.

Guarantee commitment to quality through transparency

Although more in-depth guidance on transparency can be found in the Detailed Guidance Note on Principle 5, it is worth noting here that a **high transparency should be maintained throughout, including a commitment to learning from the results of previous blended finance operations.** Aside from the obligation to report to external stakeholders and informing social and commercial performance management, the evaluation of blended finance interventions can help prioritise the right strategies moving forward (Winckler Andersen et al., 2019[15]).

Checklist

The checklist in Figure 3 is presented to assist DAC donors to implement recommendations set out in this section in their blended finance operations.

Figure 2. Checklist to implement OECD DAC Blended Finance Principle 1

1A Does the project maximize development outcomes?

- ✓ **Does the project focus on sectors where maximum development impact can be achieved?**
- ✓ **Does the project build incentives that promote public-private co-operation hence balancing expectations on development outcomes vis-á-vis financial risks and returns?**
- ✓ **Are the necessary internal skills and capacities developed in order to effectively engage with private sector actors?**

1B Does the project articulate blended finance objectives?

- ✓ **Does the project link with overarching development objectives, in line with the 2030 Agenda and the Paris Agreement?**
- ✓ **Does the project align with local policy priorities?**
- ✓ **Is blended finance the most effective financing approach within a broader development co-operation strategy?**

1C Does the project commit to high quality standards?

- ✓ **Does the project align ESG safeguards to existing international standards (e.g. IFC Performance Standards)?**
- ✓ **Are partners and projects screened according to RBC practices? (OECD Guidelines for Multinational Enterprises)**
- ✓ **Does the project uphold reporting obligations and promote transparency in each phase of the investment cycle?**

Source: Authors.

Example of good practices

Box 1. Examples of good donor practices on responsible business conduct

In connection with providing support to private entities in the form of grants or loans, some donors have developed screening and appraisal mechanisms that integrate some RBC elements. The Austrian

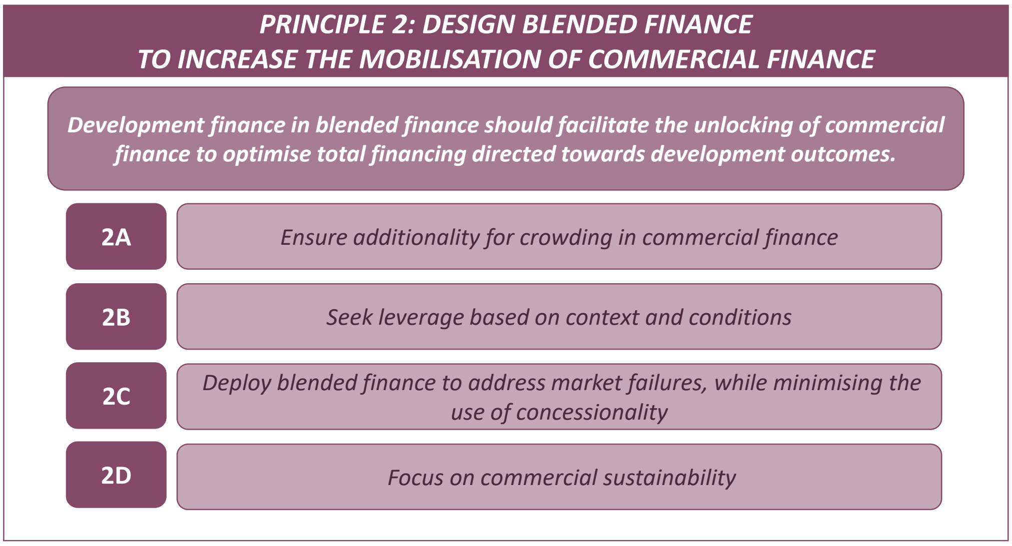
Development Agency, (ADA), Denmark's development co-operation, or Danida, , and the French development agency, Agence Française de Développement, , for example, published a list of criteria for exclusion of projects that may not be financed due to ethical, environmental or social concerns. The Netherlands developed a methodology to screen applications that do not meet minimum RBC criteria. Companies applying for funding from the government's Dutch Good Growth Fund, which provides funding to both national and local small and medium-sized enterprises, must meet eligibility criteria aligned with the OECD Guidelines. In Austria, every application for funding is subject to an appraisal by ADA on environmental, social and gender issues (Austrian Development Agency, 2015[39]). The same is true for the Canadian development co-operation agency, which shares each application for funding with environment, gender equality and governance specialists. Assessment criteria include identification of risks and mitigation strategies on themes such as "do no harm" as regards to human rights (Global Affairs Canada, 2019[40]).

Only a few donors have made due diligence a systematic process for assessing and addressing risks of adverse impacts that projects or partnerships may create. Among these, the Norwegian Agency for Development Cooperation clearly communicates that grant applicants and recipients should act in accordance with the UN Guiding Principles and the OECD Guidelines and only awards grants when it is feasible to conduct a proper due diligence of the applicant. The United Kingdom Department for International Development has also taken important steps to strengthen its own due diligence process and ensure that suppliers meet RBC standards.

Source: (OECD, 2018[37]), *Promoting and Enabling Responsible Business Conduct through Development Co-operation Efforts: Stocktaking of Initiatives by Donor Agencies and National Development Financing Institutions*, https://mneguidelines.oecd.org/Promoting-and-enabling-RBC-through-development-cooperation.pdf.

Principle 2: Design blended finance to increase the mobilisation of commercial finance

Figure 3. OECD DAC Blended Finance Principle 2



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Policy guidance

The OECD DAC Principle 2 is based on designing blended finance to increase the mobilisation of commercial finance. Its four sub-principles focus on additionality, concessionality, mobilisation and commercial sustainability. A summary of core concepts is provided in the Annex and further elaborated in the Detailed Guidance Note on Principle 2.

Sub-principle 2A - Ensure additionality for crowding in commercial finance

Blended finance interventions should have both developmental as well as financial additionality

Blended finance should not be deployed if it cannot create additional development impact or if the same development impact can be achieved without the blended finance intervention through existing public or private financing channels. At the same time, there may be trade-offs between financial and development additionality in any given blended finance transaction. For example, if the primary objective of a blended finance transaction is to achieve a high mobilisation ratio of commercial finance, this may result in the intervention being focused on more established markets and sectors.

Additionality needs to be ensured to minimise market distortion and prevent crowding out of private investment through blended finance

Public finance should only be used to catalyse private finance through blended finance structures if there is a plausible degree of certainty that private investment is required and is not forthcoming on its own and that blended finance delivers additional development outcomes over those delivered purely by the amount of public finance used for blending. Otherwise, blended finance risks unduly subsidising commercial finance and potentially distorting markets as a result.

Ensuring additionality requires assessing it along both the development and financial dimensions and encouraging harmonised approaches

In terms of both development and financial additionality, the incremental outcomes catalysed by a blended finance transaction beyond what public and private finance alone would be able to deliver need to be clearly identified, e.g. through a clear theory of change that can be monitored with key performance indicators for development impact and additional amounts of private finance catalysed for financial additionality.

Donors should encourage and facilitate a harmonised approach towards assessing additionality in development finance, including for blended finance. To enable ex post impact assessments of a selected sample of blended finance transactions, donors should request that ex ante baseline data are collected on key results indicators and monitored during implementation.

Sub-principle 2B - Seek leverage based on context and conditions

The design of blended finance transactions needs to be anchored in the transaction-specific development objective, taking into account context-specific drivers

Several context-specific factors influence the nature of additionality, concessionality, mobilisation and commercial sustainability in blended finance and need to be taken into account when designing a blended finance transaction. These drivers include:

- **Geography**: Blended finance has a higher additionality in countries where less commercial finance is currently available, such as in least developed countries (LDCs) and fragile contexts. The Detailed Guidance Note on Principle 3 provides further information on how to align blended finance to local priorities.
- **Sector**: Sectors with established regulatory and investment frameworks, a track record of private investment, and underlying financial sustainability are more conducive to attracting commercial finance, resulting in higher mobilisation with lower concessionality through blended finance. Higher-risk sectors with untested sector frameworks, high financial risks and the absence of a track

record of private investment may offer higher additionality through blended finance, while likely requiring higher concessionality and initially creating lower mobilisation.

- **Stage in the project cycle**: The risks in the early stage of project development can require a relatively high share of concessionality, offering high additionality. However, such a level of risks may not be conducive to attract commercial investors at a large scale. During the construction phase, commercial finance can be mobilised from select investors willing to bear construction risk, such as commercial banks.
- **Market maturity**: Mobilisation can be higher in financial markets with partial market failures such as failure to provide the required maturities, for instance long-term debt finance, or to provide certain products, for instance securitisation or hedging instruments.
- **Financial instruments**: The financial instrument chosen for a blended finance transaction is based on the transaction's development objective and analysis of the aforementioned drivers.

Sub-principle 2C - Deploy blended finance to address market failures, while minimising the use of concessionality

Donors should identify the root causes and source of the market failure that the blended finance programme is to address

Because market failures harm market development and hinder the emergence of self-sufficient financial markets, blended finance can serve as a tool to overcome the very market failures the commercial investors face, thus unlocking their financing potential. **The use of concessionality should only be justified if it addresses market failures and enables crowding in of commercial investors.**

It is thus crucial for donors to understand the root causes of market failures in a given context and streamlining blended finance efforts accordingly. Further engagement in the form of policy reforms and dialogue is likely to be needed to achieve a holistic approach to addressing market failures.

Donors should also ensure that blended finance is only used to address temporary market failures and that accompanying reform measures are undertaken to address the sources of market failures in a sustainable manner.

Conduct an analysis of the drivers of concessionality in the context of operation

Before deploying concessional resources in blended finance, an analysis of the drivers of concessionality should be conducted and should include:

- identifying the gap in the financing structure that concessional finance can help close to mobilise commercial finance
- choosing a financial instrument that enables crowding in of commercial finance while minimising concessionality
- taking into account sectoral and geographical variables that undermine commercial investment
- assessing the project cycle's influence on the level of concessionality required
- assessing the degree of market maturity.

Enable equal access to donors' concessional funds

When deploying concessional funds, establish fair and equal access procedures so that all market participants, public and private, can understand the objectives, terms and conditions for accessing donors' funds. This may include tendering processes. Finance should be allocated to the institution proposing the blended finance structure with the minimum need for concessionality. The Detailed Guidance Note on Principle 2 provides further details.

Engage in a continuous dialogue with other donors to harmonise approaches on concessionality

A continuous dialogue is necessary for fostering progress towards harmonisation of principles to determine concessionality among development actors, including on reporting. Co-ordination on blended finance programmes and transactions is crucial, particularly when a concessional element is part of a programme. Structural co-ordination is needed beyond single transactions in order to avoid excessive reliance on concessional finance. See, also, OECD (2019[14]).

Sub-principle 2D - Focus on commercial sustainability

Develop policy, sector and investment frameworks in parallel to blended finance

Blended finance can only catalyse commercially sustainable markets if sustainable underlying market fundamentals are in place, namely sector policy and regulatory frameworks that allow for cost recovery of investments at risk-adjusted returns. Such market fundamentals need to be developed before or in parallel to the blended finance project through accompanying measures from development partners, such as technical assistance, budget support or results-based development finance.

Facilitate local capital market development, with a focus on providing access to finance for underserved population groups

To ensure commercial sustainability, the development of local capital markets needs to be facilitated as part of or in parallel to blended finance transactions. Blended finance can contribute to capacity building, for instance through credit lines to local financial institutions and associated technical assistance facilities. Capacity building for capital market development can also be provided through parallel development interventions by other development partners. Further information on how to support local capital market development is provided in the Detailed Guidance Note on Principle 3.

Sustainable markets need to be created to provide access to finance for underserved population groups, such as women and remote and other vulnerable population groups who may lack access to finance due to their lack of access to traditional collateral, their inability to provide repayment histories or their small transaction sizes.

Incorporate exit strategies in blended finance, both at the level of the transaction and at market level

Blended finance needs to be phased out once the investee generates sufficient cash flows and markets are developed enough to attract commercial investors. Exit strategies need to systematically be included in the design of a blended finance instrument, both at the level of the transaction and at market level. In the current practices of bended finance, indications are that systematic exit strategies are not yet reflected in many blended finance approaches and typically only limited formal exit structures are currently in place.

Exit indicators should be defined within the due diligence of a transaction from the start. Nonetheless, these triggers must be flexible enough to allow for the most suitable exit through continuous monitoring. A complete exit of the concessional investor is not feasible in each context and condition. Especially in LDCs and fragile contexts, blended finance may only have temporary effects.

Indicators for triggering a potential exit scenario fall into two categories, financial indicators and developmental indicators:

- Financial indicators that can trigger an exit scenario include the stage of capital market development, return thresholds being achieved, available data on actual risks and loss rates versus initially perceived risks, and private investor response to auction processes.
- Development indicators that can encourage an exit of blended finance include achievement of the development objective on the positive side accompanied by a significant shortfall in achievement of the target objective, which may signal a failure by the private finance to achieve its targets. Further information on result metrics is provided in the Detailed Guidance Note on Principle 5.

Checklist

The checklist in Figure 5 is presented to assist DAC donors to operationalise Principle 2, focusing on steps to be undertaken at the level of the blended finance transaction in order to ensure additionality, mobilisation, minimum concessionality and commercial sustainability. The Detailed Guidance Note on Principle 2 further explains each step.

Figure 4. Checklist to implement OECD DAC Blended Finance Principle 2

2A Does the project ensure development additionality?

- ✓ **Does the project set out its development objective, additionality and theory of change?**
- ✓ **Are market failures clearly identified?**
- ✓ **Is the intervention co-ordinated with the ecosystem?**
- ✓ **Are development impacts monitored and evaluated?**

2B, 2C Does the project ensure financial additionality?

- ✓ **Does the project identify the main financing gaps?**
- ✓ **Does the chosen financial instrument ensure minimum concessionality?**
- ✓ **Is the target mobilisation determined according to the context?**
- ✓ **Do you have a clear view on how to exit once commercial markets are functioning?**

2D Does the project ensure commercial sustainability?

- ✓ **Are adequate policy, sector and investment frameworks developed?**
- ✓ **Does the project ensure coherent approaches among all stakeholders?**
- ✓ **Do you have a clear understanding of how to monitor and facilitate market development?**
- ✓ **Is the blended finance transaction not being deployed in well-functioning commercial markets?**

Source: Authors

Examples of good practices

The examples in Box 2 describe competitive approaches that providers of concessional finance have adopted. The Detailed Guidance Note on Principle 2 provides additional case studies and best practice examples.

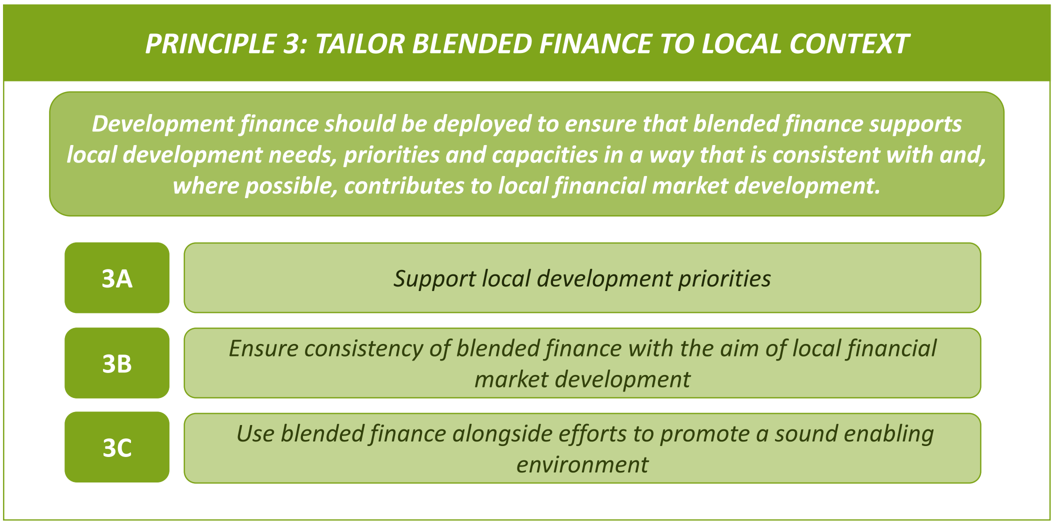
Box 2. Examples of competitive approaches used by donors for blended finance

Some providers of concessional funds for blended finance adopted competitive approaches to test the market demand for the type of concessional finance required to achieve financial and development additionality through blended finance. Following are some examples.

- Global Affairs Canada: As part of its new, five-year CAD 1.6 billion (Canadian dollar) official development assistance innovative finance programme, the government of Canada has launched an International Assistance Innovation Program , which allows for ongoing submission of proposals for repayable concessional capital. The programme defines eligibility criteria in the areas of sustainable development impact, financial and impact additionality, financial sustainability, and minimum concessionality. While the programme does not set targets by sector, preference may be given to proposals addressing gender inequality, demonstrating greater additionality, showing financial returns for strong development impact, working in LDCs and FCS, and having strong impact measurement capacity (Global Affairs Canada, 2019[41]).
- The European Commission (EC): As part of the European Fund for Sustainable Development and the European Union (EU) External Investment Plan, the EC has developed a new concessional guarantee instrument. The guarantee is implemented through development finance institutions that submit proposals to the EC within given submission windows. In the first round, concessional guarantees were made available for a total of EUR 1.5 billion in guarantee funding under five windows: financing for micro, small and medium-sized enterprises and agriculture; sustainable energy and connectivity; sustainable cities; digitalisation; and local currency financing. In the first round, 28 guarantee instruments have been committed (European Commission, 2017[42]).
- The State Secretariat for Economic Affairs of Switzerland (SECO) launched a call for proposals for technical assistance TA) funds for impact investing. The objective of the TA funds is to reduce perceived risks and help build an investment pipeline that attracts private investment. The call focused on job creation and CO_2 emission reduction and sought out innovative private sector solutions, private sector knowhow and achieving value for money through competition. Eligibility and award criteria included development impact, reliability of the team and methods, level of outcome, co-financing, geography, and additionality. On this basis, five impact fund managers were selected in the field of renewable energy, energy efficiency and small and medium-sized enterprise support to receive and manage the TA funds.
- The MacArthur Foundation: As part of its impact investing allocation, the MacArthur Foundation has launched a first call for proposal for USD 150 million in investments to be made under its Catalytic Capital Consortium (C3) initiative in collaboration with the Omidyar Network and Rockefeller Foundation. The C3 initiative aims to make patient capital available for high-impact investment propositions for all 17 Sustainable Development Goals. Over 100 proposals were received for a total financing volume of USD 3 billion and are currently being evaluated in a three-step process. Evaluation criteria include the categories management factors, investment execution factors, impact execution factors, additionality, outcomes and capital gaps (MacArthur Foundation, 2019[43]).

Principle 3: Tailor blended finance to the local context

Figure 5. OECD DAC Blended Finance Principle 3



Source: **Invalid source specified.**, OECD DAC Blended Finance Principles, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf

Policy guidance

The OECD DAC Blended Finance Principle 3 stipulates that blended finance needs to be tailored to the local context. Its three sub-principles call for a focus on local development priorities, local financial market development and a sound enabling environment.

Tailoring blended finance to local context is a prerequisite to achieve the highest development impact while also protecting the climate and the environment and optimal returns in a blended finance transaction. It should therefore be a key objective for both investors and development stakeholders, as numerous international statements underscore. In particular, the local dimension of blended finance is strongly connected to other OECD DAC Blended Finance Principles.

Sub-principle 3A - Support local development priorities

Ensure in-depth stakeholder consultation

In-depth and systematic consultation with local stakeholders is advantageous for blended finance deals. This should be inclusive and, where possible, bottom-up in order to increase the range of partners involved at community level, as suggested in the Kampala Principles (GPEDC, 2019[22]). Effective stakeholder consultation should not be perceived as a single event but rather as a process that parallels the whole investment. **A differentiated approach also needs to be taken according to the type of project.** Large infrastructure projects, for example, may require extensive consultations with different stakeholders while in other cases, such as a direct investment in a small and medium-sized enterprise, extensive consultations may be less applicable. Finally, local stakeholders typically include national authorities, various types of civil society organisations, local communities and beneficiaries but also local private actors. The Detailed Guidance Note on Principle 3 provides steps to follow and considerations to make for effective stakeholder consultation.

Promote country ownership

Development finance providers are encouraged to ensure that blended transactions respect national ownership and national development strategies, as stated in the Kampala Principles (GPEDC, 2019[22])**.** Including national actors at all stages of the project, as appropriate, and ensuring their position as co-owners can contribute to the success of the blended finance deal and enable the long-term sustainability of investments.

Understand local circumstances for desirable intervention

In line with the Kampala Principles, local actors should be part of both design and implementation efforts as well as monitoring and evaluation of development interventions (GPEDC, 2019[22])**.** A comprehensive local context assessment is necessary for structuring blended finance interventions, for example when deciding on the level of concessional finance to enhance the risk-return ratio or aligning incentives with project participants. In addition, several local dimensions need to be taken into account in designing the right type of deal. This helps inform the choice of instruments.

Understanding the local context is necessary for additionality

In-depth understanding of local needs and conditions is crucial for designing and implementing projects with high financial and development additionality. Currently, however, there is no single standardised way of conceptualising and measuring additionality. **Although difficult investment environments may make blended transactions more challenging, they offer the potential of high development additionality while reaching underinvested sectors and locations and underserved populations.** The financial additionality of a blended finance intervention is determined primarily by assessing the local financial market and the type of financial instrument to be used. The Detailed Guidance Note on Principle 2 provides further information on additionality.

Ensure representation and effective communication on the ground

Having representation on the ground is often said to help identify opportunities, support project preparation and establish fruitful partnerships with financial, national and other local actors. Multiple organisational designs are, however, possible, and the consequences of using each of these depend on a variety of conditions such as regulations, investment strategy, mandate, the balance sheet and fiduciary risk.

To anchor blended finance in local context and deliver a more transformational impact on local markets, blended finance actors should look beyond single projects and, where possible, co-ordinate their operations. Clustering blended finance transactions (rather than focusing on project-level activities) may allow blended finance actors to achieve more systemic impact on a given market.

Sub-principle 3B - Ensure consistency of blended finance with the aim of local financial market development

Establish engagement and capacity building processes with local financial institutions

Engagement with local financial institutions is not only an added value in terms of accommodating local perspectives but it also constitutes an opportunity for local capacity building and subsequently may contribute to a long-term economic development of local markets. Local financial institutions are natural partners for development finance providers and their participation should be maximised (GPEDC, 2019[22]). Local financial institutions can also help mobilise local finance and can thus provide local currency financing which is of a significant importance.

Focus on crowding in domestic finance

Involvement of local investors such as pension funds, investment funds, national development banks and individual investors in blended finance operations provides opportunities for crowding in domestic finance in strategic sectors aligned with national development plans. As acknowledged in a Blended Finance Taskforce paper for a G20 brainstorming session, "Greater effort should be made to include local intermediaries and local pools of institutional capital in projects" (Oppenheim and Stodulka, 2017[44]). Blended finance actors may use different tools to crowd-in domestic capital and tap into local expertise in blended finance transactions. They may do so by opening new opportunities for co-investment, for example in first-of-a-kind investments in sectors so far underserved by domestic finance. National and sub-regional development banks are also particularly well positioned for crowding in domestic-finance, as highlighted in Tri Hita Karana Roadmap for Blended Finance (Tri Hita Karana Sustainable Development Forum, 2018[16]). They are an important provider of medium-to-high-risk funding for development objectives at terms that allow them to maintain their financial sustainability.

Promote local currency financing

Local currency financing is a key factor contributing to local financial market development. Local currency risks are in many countries one of the key factor pushing international investors away from emerging markets. Devaluation of local currency means decreased potential profits for investors and difficulties in exit for international equity investors. As a result, hard-currency lending is still the prevailing norm for development institutions (TCX, 2018[45]). Possible mechanisms to mitigate local currency risks include cross-currency swaps, credit/risk-sharing guarantees or foreign-exchange forward contracts protecting its clients against long-term risk (further details can be found in the Detailed Guidance Note on Principle 3).

Sub-principle 3C - Use blended finance alongside efforts to promote a sound enabling environment

Develop approaches resulting in demonstration effects and market creation

As highlighted in the Tri Hita Karana Roadmap for Blended Finance, "blended finance should help to accelerate inclusive sustainable market development, including the local financial market" (Tri Hita Karana Sustainable Development Forum, 2018[16]). Blended finance provides an opportunity to contribute to local economic transformation and improve the investment climate. **It is therefore important for development finance institutions and other players involved in blended finance projects to develop approaches that link deal-oriented blended finance project engagements with wider transformative objectives on local markets creation.**

Foster policy reforms addressing obstacles faced by private investors in the local context

A favourable investment climate is essential to attract and retain foreign and domestic investments. Through blended finance, development actors should ideally help to overcome investment barriers in local markets, especially barriers to commercial sustainability. As multilateral development banks and development finance institutions are principally transaction-driven institutions, they could play an important role by strengthening their systemic and holistic understanding of local markets and establishing incentives and mechanisms to engage in broader transformational changes (Bilal, 2019[46]).

Checklist

The checklist in Figure 7 is presented to assist DAC donors to implement the recommendations in this section in their blended finance operations.

Figure 6. Checklist to implement OECD DAC Blended Finance Principle 3

3A Does the project support local development initiatives?

- ✓ **Does the project include an effective stakeholder consultation process throughout the investment cycle?**
- ✓ **Is the project developed in line with national development strategies and does it include national actors as co-owners at all stages?**
- ✓ **Are additionality assessments conducted based on local considerations, including a comprehensive understanding of local market structure, political environment and sector characteristics to help to identify local market failures?**
- ✓ **Is the organisational setting suitable to ensure regular communication and good oversight of the project on the ground?**
- ✓ **Is the project benefiting from local monitoring thanks to effective local partnerships? Are local partnerships helping to originate new relevant deals in line with local priorities?**

3B Does the project support local market development?

- ✓ **Does the project contribute to increase capacity of local financial institutions?**
- ✓ **Does the project seek to involve local investors? Does it actively seek to provide opportunities for crowding in domestic finance in strategic sectors aligned with national development plans?**
- ✓ **Does the project promote local currency financing as a key factor contributing to local financial market development?**

3C Does the project support promotion of a sound enabling environment?

- ✓ **Is the project designed to offer demonstration effects and more broadly contribute to attracting further investment?**
- ✓ **How is the project contributing more broadly to a favourable investment climate that is essential to attracting and retaining foreign and domestic investments?**

Source: Authors

Examples of good practices

Box 3. The European Commission: An example of a local currency guarantee

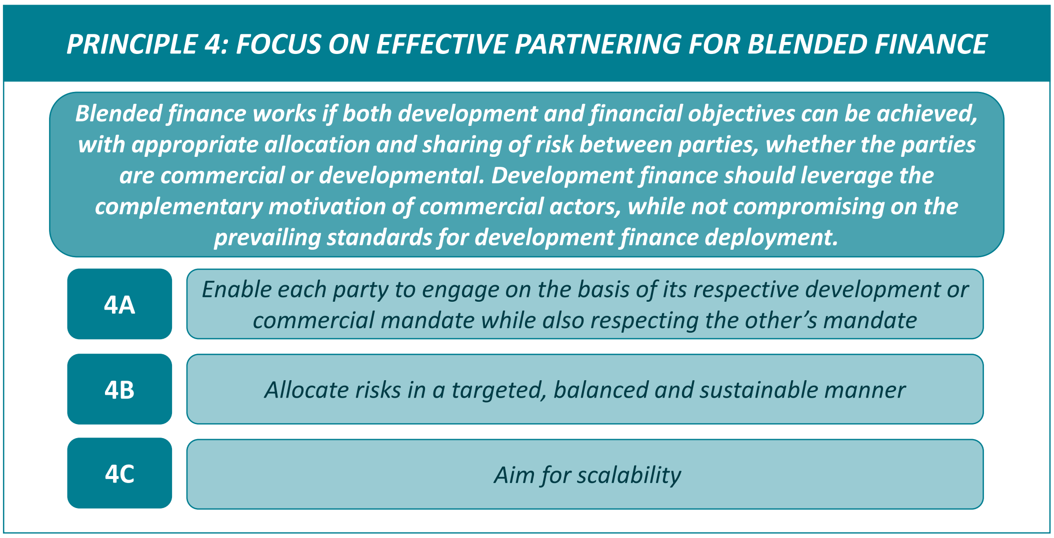
Demand for local currency financing in many developing countries is far greater than supply. Loans are often denominated in hard currency. But by borrowing in hard currency, the unhedged foreign exchange rate risk can cause serious problems for borrowers in the event of severe currency depreciation. Hedging solutions are often not readily available or are expensive.

Under the European Fund for Sustainable Development (EFSD) Guarantee, managed by the EC in the framework of the External Investment Plan, the EU aims to make local currency financing more accessible for investors and to strengthen local currency capital markets over the long term in the European Neighbourhood and sub-Saharan Africa. Among the 28 guarantees initially approved under the EFSD Guarantee, several programmes target local currency financing, including the "Local Currency Lending in Sub-Saharan Africa" (managed jointly by KfW Group and the African Development Bank) and the African Local Currency Bond Guarantee Programme (KfW Group).

Source: European Union (2019[47]), *Summaries of the EU External Investment Plan Guarantees*, https://ec.europa.eu/international-partnerships/system/files/181213-eip-28-guarantees-brochure-final_en.pdf

Principle 4: Focus on effective partnering for blended finance

Figure 7. OECD DAC Blended Finance Principle 4



Source: **Invalid source specified.**, OECD DAC Blended Finance Principles, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf

Policy guidance

The OECD DAC Blended Finance Principle 4 stipulates the need to focus on effective partnering for blended finance. Its three sub-principles underscore the importance of respecting different actors' mandates, a balanced and sustainable allocation of risks and the aim for scalability.

The need for effective partnerships in blended finance approaches is now more relevant and urgent than ever in light of the COVID-19 pandemic, which is causing an unprecedented health, human and economic crisis and reversing progress towards the achievement of the Sustainable Development Goals (SDGs).

Sub-principle 4A - Engage each party on the basis of its respective mandate

When engaging in blended finance, understand the mandates, objectives and risk-return profiles of each actor involved

Blended finance approaches involve a wide and diverse set of actors with different mandates, risk-return preferences and incentives. These include actors pursuing, to different extents, either development or commercial objectives or both (as in the case of development finance institutions). Blended finance actors are also characterised by diverse legal settings and organisational setups.

As a starting point, it is thus important to understand the risk-return profiles of providers of concessional and commercial finance in blended finance based on their mandates. The Detailed Guidance Note on Principle 4 further explores the objectives, roles and instruments of each type of blended finance actor as well as their risk-return profiles.

Sub-principle 4B - Allocate risks in a targeted, balanced and sustainable manner

Understand and assess the different types of underlying country-, context- and sector-specific risks

Blended finance is a financial structuring approach that can address specific risks at different levels, namely the level of an institution or portfolio, programme or project. The Detailed Guidance Note on Principle 2 includes a typology of different types of risks (political, commercial, financial, and impact risk) including possible risk allocations and risk mitigation instruments.

Risk declines in sectors and geographies that have seen repeat transactions thanks to a track record and a proven framework. This helps address risk perceptions and reduces uncertainty, which should, in principle, also translate into a reduced share of concessionality. The Detailed Guidance Note on Principle 4 provides examples of risk allocation in the renewable energy and water sectors as well as in specific country contexts, such as least developed countries.

At each level of blending, different methodologies for risk assessment should be applied as a basis to determine the optimal blending instrument and concessionality level

Achieving balanced risk allocation in blended finance entails choosing the right financial instrument with minimum concessionality to achieve the appropriate risk-return profile to attract commercial investment. **Different methodologies for risks assessment should be applied at each level of blending, depending on the degree of disaggregation of risks**. The Detailed Guidance Note on Principle 2 explains each of the methodologies.

Bring in local entities to improve risk allocation in blended finance

Local investors such as sovereign wealth funds and local pension funds can provide local currency finance to projects that generate revenues in local currency, thereby eliminating foreign exchange risk, and are also well positioned to provide long-term finance. They are also better placed to understand, price and manage political risk in their country. Blended finance should therefore seek to catalyse investment from local investors in line with their regulatory requirements. In addition, national development banks and local commercial banks can also provide development finance through blended finance involving risk-sharing mechanisms. The Detailed Guidance Note on Principle 3 provides additional information on how to crowd in domestic finance.

Adjust the mix between concessional and commercial finance as risks evolve along different stages of the project life cycle

Risk is dynamic and declines along the project cycle. Different stages in the project cycle allow different combinations of risks and investors. For instance, concessional funds are usually needed during the high-risk project development phase and to de-risk certain types of investors during the construction phase. Less concessionality is typically required during the lower-risk operating phase.

Continuous monitoring offers opportunities to adjust the allocation of risks along different project life cycle stages to those public and private investors best positioned to bear them. The Detailed Guidance Note on Principle 4 provides a stylised overview of how risk profiles, the blending mix and investor base change over the project life cycle.

Strengthen capacity in donor agencies to assess and verify balanced risk allocation in blended finance

Capacity in donor governments and agencies to assess and verify balanced risk allocation in blended finance needs to be strengthened, e.g. through in-house training, outsourcing, and access to risk models used by the arrangers of blended finance. A concerted dialogue and culture among donors about risk management in blended finance are recommended.

Sub-principle 4C - Aim for scalability

Promote transparency and data availability as well as knowledge sharing

Ongoing data challenges currently limit a more in-depth analysis and discussion of the mobilisation potential through blended finance in specific contexts. Market transparency and efficiency need to be created by making performance data available to all market participants. **Donors should promote transparency by working with stakeholders to make relevant data available to all market participants**, starting with historic loan performance data in the Global Emerging Markets Risk Database. Donors should also continue working on transparent and harmonised reporting requirements for mobilisation of private capital by multinational development banks (MDBs) and development finance institutions (DFIs), including for blended finance. The Detailed Guidance Note on Principle 5 provides further information on the need for transparency.

Knowledge sharing can also contribute to achieving scale. Given the relatively recent nature of blending for development finance, lessons learned should be made readily available to all participants.

Set incentives for scaling up through appropriate and targeted mobilisation objectives for MDBs and DFIs

Setting mobilisation targets risks an excessive focus on countries and sectors where mobilisation is easiest, such as middle-income countries. This kind of leverage ratio will not enable the SDG investment needs to be met. **Donor governments as MDB and/or DFI shareholders should therefore consider setting mobilisation objectives that include targets for mobilisation in different geographies, countries and sectors.**

Promote whole-of-government approaches and improved collaboration and co-ordination between MDBs and DFIs

While development agencies are usually supervised by the ministry of foreign affairs or development, DFIs, for example, are often under the purview of finance ministries (or treasury departments). This division can make it difficult to build a united approach. **A whole-of-government approach is essential to achieve co-ordinated and effective blended finance solutions.**

Improved collaboration is also needed among and between DFIs and MDBs. Donors need to incentivise and reward collaboration between MDBs and DFIs in blended finance, for example by replicating successful structures, co-financing, undertaking joint new project design or collaborating in the context of global partnerships. Donors should also incentivise MDBs to collaborate in programmatic approaches to further enhance replicability and standardisation for private investors.

Make sufficient funding available for early stage project preparation to accelerate the creation of a pipeline of bankable projects and to create an enabling environment

Creating pipelines of bankable projects and a conducive investment climate and regulatory environment at country level requires important preconditions for achieving scale. Grants and technical assistance can be deployed in the early stages of project preparation to create an enabling investment climate and regulatory reforms through advisory services; assist governments to develop SDG investment plans that identify opportunities for private investment early on; finance project feasibility studies through (reimbursable) grants; and (iv) provide early stage, high-risk project development capital and project preparation facilities. The Detailed Guidance Note on Principle 3 provides further information on the need to improve the investment climate in developing economies.

Encourage the replication of successful blended finance instruments as well as the development of new instruments that further enable standardisation and scale

DAC blended finance actors should encourage the replication of successful blended finance instruments and the development of new instruments that further enable standardisation and scale such as standardisation of guarantees, the use of market-based credit enhancement, fund-of-fund approaches, and multi-MDB and multi-DFI securitisation approaches.

Checklist

The checklist in Figure 9 is presented to assist DAC donors to implement recommendations set out in this previous section in blended finance operations.

Figure 8. Checklist to implement OECD DAC Blended Finance Principle 4

4A Engage each party on the basis of its respective mandate

- ✓ Do you have a clear understanding of the mandates, objectives and risk-return profiles of each actor involved in blended finance?

4B Allocate risks in a targeted, balanced and sustainable manner

- ✓ Do you understand and assess the different types of underlying risks, in country- and sector-specific contexts?
- ✓ Are different methodologies for risk assessments applied at each level of blending as a basis to determine the optimal blending instrument and concessionality level?
- ✓ Does the project bring in local entities to improve risk allocation in blended finance?
- ✓ Does the project adjust the mix between concessional and commercial finance as risks evolve along different stages of the project life cycle?
- ✓ Does the project strengthen capacity in donor agencies to assess and verify balanced risk allocation in blended finance?

4C Aim for scalability

- ✓ Does the project promote transparency, data availability and knowledge sharing?
- ✓ Are incentives set for scaling up through appropriate and targeted mobilisation objectives for MDBs and DFIs?
- ✓ Are whole-of-government approaches and improved collaboration between MDBs and DFIs promoted?
- ✓ Does the project make sufficient funding available for early stage project preparation to accelerate the creation of a pipeline of bankable projects and create an enabling environment?
- ✓ Is the replication of successful blended finance instruments and standardisation of instruments encouraged?

Source: Authors.

Examples of good practices

To date, limited alternative structures have been developed to take different risk profiles into account and match the declining risk profile of blended finance structures with various investor groups along the project life cycle. The best-known such structure is that of Climate Investor One, developed by the Netherlands Entrepreneurial Development Company (FMO) (Box 4). While this structure has been piloted in the renewable energy sector, it is replicable in other sectors.

Box 4. Climate Investor One

Climate Investor One (CIO) is a global investment vehicle founded in 2015 by the Netherlands development finance company, FMO, and Phoenix InfraWorks (as anchor sponsor-investor) to finance renewable energy projects in emerging markets globally.

CIO comprises three investment funds tailored towards an integrated financing approach covering all stages of a project life cycle, i.e. from development and construction to operations. The following three investment funds target a total commitment of USD 1 billion at final close.

Development Fund: At early project stage, CIO provides financial, technical, environmental, social development and structuring support through this fund. The fund attracted donor capital, namely a contribution of EUR 30 million from the European Union Thematic Blending Initiative for "delivering access to affordable, sustainable, reliable and modern energy".

Construction Equity Fund: CIO aims to reduce the complexity associated with multi-party negotiations by using this fund for equity financing of the construction phase. The fund’s target size is USD 500 million, which is expected to be raised from commercial and institutional investors with the following layered structure:

- 20% Tier 1 capital, a first-loss tier from donors
- 40% Tier 2 ordinary equity from commercially oriented investors such as FMO and other DFIs
- 40% Tier 3 capital, i.e. preference shares from institutional investors such as export credit agencies and pension funds.

Refinancing Fund: The target size of this fund is USD 500 million by way of refinancing of up to 50% of equity with long-term senior debt to leverage equity returns during the operational phase. This fund would allow mainstream commercial investors such as commercial banks and pension funds to invest in operating projects that have been developed through the Development and Construction Equity Funds.

CIO is managed by a dedicated fund manager, Climate Fund Managers, a joint venture between FMO and Phoenix. CIO had raised USD 462 million for the Development Fund and Construction Equity Fund by its second close in December 2017. Fundraising for the Refinancing Fund can only commence once projects developed through the first two funds are nearing the operational phase.

Source: (The Global Innovation Lab for Climate Finance, 2020[48]), Climate Investor One, https://www.climatefinancelab.org/project/fmo-climate-development-finance-facility/#

Principle 5: Monitor blended finance for transparency and results

Figure 9. OECD DAC Blended Finance Principle 5

PRINCIPLE 5: MONITOR BLENDED FINANCE FOR TRANSPARENCY AND RESULTS	
To ensure accountability on the appropriate use and value for money of development finance, blended finance operations should be monitored on the basis of clear results frameworks, measuring, reporting on and communicating on financial flows, commercial returns as well as development results.	
5A	*Agree on performance and result metrics from the start*
5B	*Track financial flows, commercial performance and development results*
5C	*Dedicate appropriate resources for monitoring and evaluation*
5D	*Ensure public transparency and accountability on blended finance operations*

Source: **Invalid source specified.**, OECD DAC Blended Finance Principles, http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf

Policy guidance

The OECD DAC Blended Finance Principle 5 pertains to the monitoring of blended finance for transparency and results. Its four sub-principles focus on performance and results metrics, monitoring and evaluation, and transparency.

Transparency is the key building block of Principle 5. Transparency should not be seen as an end goal in itself, but rather as an enabler of accountability, learning and trust.

Increased transparency can lead to strengthened trust among blended finance players, which are stakeholders from the public and private sectors in both donor and partner countries that traditionally may not be accustomed to working together. **Enhanced transparency also leads to stronger accountability towards stakeholders.** Accountability should be conceived both upstream, i.e. towards stakeholders (donors, finance providers, asset managers, etc.) and downstream, i.e. towards the local actors that the blended finance transaction, as a development co-operation tool, intends to serve. Blended finance regularly involves the use of scarce concessional resources that are often managed by private actors and thus, the bar on accountability requirements needs to remain high. Also, as blended finance is still a relatively young tool in the development co-operation landscape, fostering learning and knowledge sharing is key to assess when and how blended finance should be deployed.

Sub-principle 5A - Agree on performance and result metrics from the start

Adopt a theory of change for a blended finance mechanism as a whole

To ensure blended finance is used effectively as a development co-operation tool, the first step for donors, both logically and chronologically, is to agree from the outset on expected development objectives and results and how they will be achieved, with all stakeholders involved. **Before entering a blended finance operation, all actors should clearly understand and articulate how the particular investment is expected to lead to outputs, outcomes and eventually development impact**, as articulated in the OECD (2002[20]) EvalNet Glossary of Key Terms in Evaluation and Results Based Management. **A more comprehensive application of a theory of change, particularly at outcome and impact level, would allow for identifying more transformative effects of blended finance by clearly articulating the causal links, mechanisms and assumptions at play.** The Detailed Guidance Note on Principle 5 provides a visualisation of the results chain, where definitions are marginally adapted to the investment logic rather than a generic development intervention.

Reach initial agreement on reporting for results using a common set of key performance indicators

Fragmentation of reporting practices remains a challenge for both donors looking for comparability across financial intermediaries and private actors who need to meet varying reporting requirements. At present, too much variation exists in the way that key concepts such as additionality and impact are used, which renders comparison extremely difficult. It is thus possible that while organisations managing blended finance operations claim to measure impact, they may sometimes conflate impact with outcome or even output (Basile, Bellesi and Singh, 2020[11]).

Harmonisation becomes particularly important in the measurement of blended finance initiatives compared to measuring other development co-operation modalities, as blending involves a variety of entities with more diverse legal settings. Some harmonisation initiatives among blended finance actors already exist. For instance, in 2013, 25 international financial institutions agreed to work towards harmonising their development result indicators to reduce variations in data, lessen the reporting burden on clients and facilitate learning through the Harmonized Indicators for Private Sector Operations (2020[49])initiative. Another notable example is the Global Impact Investing Network IRIS+ system tool, which offers a catalogue of empirical metrics to monitor and measure impact (Global Impact Investment Network, 2021[50]). However, despite these attempts, widespread agreement on performance metrics has become urgent and crucial to avoid fragmentation and, potentially, poor data.

Moreover, while some blended finance investments directly target poor households, individuals and businesses, others indirectly target poverty reduction through their contribution to market creation or changes in the market in ways that benefit the poor. Many blended finance providers, both public and private, lack credible and practical means to determine whether poor beneficiaries profit (or suffer losses) from proposed and selected investments and, if they do profit, how much blended finance impacts poverty reduction and the goal to leave no one behind. To address this challenge, the THK Impact Working Group developed practical guidance, in the form of a checklist, for assessing the impact of blended finance on the poor. The checklist offers a set of questions and screening considerations for the ex ante assessment of expected impact on the poor as well as what can and should be measured in ex post assessment of the actual impact (THK Impact Working Group, 2020[51]).

Besides agreeing on what to measure (i.e. which indicators underlying which objectives), it is crucial for DAC members to understand how to measure in terms of data collection and the assurance process to be put in place by financial intermediaries. Data collection tools used in evaluation of blended finance include benchmarking, surveys and/or interviews with end-beneficiaries, surveys with clients, monitoring data, etc. To the maximum extent possible, donors should encourage data collection tools involving final beneficiaries. The process of impact measurement and management should also embrace qualitative data as a way to capture complementary information that cannot otherwise be measured and to better contextualise the interpretation of quantitative figures.

Adopt a common monitoring and evaluation framework

Blended finance comprises various instruments and modalities, and monitoring and evaluation (M&E) will be critical for establishing an evidence base about what works in which context. In blended finance, there is significant variety in evaluation practice including in access to financial resources for evaluation, evaluation capacity and degree of independence (Winckler Andersen et al., 2019[15]). For instance, the 2018 OECD Survey on Blended Finance Funds and Facilities shows that not all managing organisations have a clearly identified M&E function, with funds frequently leaving the M&E responsibility with each investment manager.

Evaluation plans should be independent and based on international best practice. They should consider and engage all actors in a blended finance operation, including financial intermediaries such as development finance institutions (DFIs), asset managers and, whenever possible, intended beneficiary groups. This engagement should include defining roles and responsibilities for all actors for data collection, with due consideration for reporting burdens. **Local actors should be part of both design and implementation efforts as well as monitoring and evaluation of development interventions** (GPEDC, 2019[22])**.**

Moreover, past evaluation of blended finance reveals governance and methodological challenges in evaluating such highly intermediated financing approaches (Winckler Andersen et al., 2019[15]). The EvalNet Working Group on Blended Finance Evaluation — co-ordinated by Denmark, Germany, Norway and the OECD Secretariat — is currently working to address challenges related to evaluating blended finance. This work aims to establish by the end of 2020 a shared understanding of blended finance evaluation concepts and terms; explore how to evaluate development; and develop a shared understanding of evaluation of different blended finance instruments, including unintended effects such as market distortions. Upon the completion of this work, EvalNet plans to continue with additional work to support more and better evaluations of blended finance initiatives.

Sub-principle 5B - Track financial flows, commercial performance and development results

Ensure more financial transparency, while avoiding the pitfalls

To assess the effectiveness and efficiency of blended finance operations, the financial and development performance of all parties should be assessed against predefined and agreed metrics. This includes not only financial flows and commercial returns but also results achieved against development objectives.

Civil society organisations and other blended finance stakeholders, such as partner countries, have long noted the lack of transparency in blended finance operations and other private sector interventions. The transparency deficit is due in large part to the myriad legal and organisational obligations of actors involved in blended finance. It can also stem from a lack of capacity in some organisations to collect data and measure impact as well as the lack of a dedicated M&E budget. Insufficient oversight of blended finance initiatives may expose public sector funding to potential criticism.

In September 2018, DAC members agreed to define methodologies for measuring the amounts mobilised from the private sector by official development finance interventions (OECD DAC, 2018[52]) . Nonetheless, DAC members need to ensure that these methods are embedded in all the blended financial operations they support. Collectively, DAC members need to actively encourage all financial intermediaries to adhere to this common transparency standard, including by the private sector arm of multilateral and bilateral DFIs.

Transparency also entails some risks, and these should be properly acknowledged by all stakeholders and mitigated. A potential obstacle to enhancing transparency of blended finance transactions pertains to the claims of commercial confidentiality of information, especially by private actors. To some extent, this may be an unfounded argument, as real trade secrets are generally not inscribed in contractual agreements or financial flows (OECD/DANIDA, 2018[53]). The International Aid Transparency Initiative standards, for instance, have made allowances for sensitive reporting situations including, among other things, commercial information. For example, there is the option for partners to exclude some or all details of an activity to protect those involved. However, the benefits from disclosure of sensitive information to the market as a whole may outweigh the costs to individual entities, but only if all entities are subject to the same requirements (IFRS Foundation Advisory Council, 2019[54]).

Promote better reporting on development results, improving data collection and quality assurance processes

The 2018 OECD Blended Finance Funds and Facilities Survey shows that while impact indicators are widely adopted, in reality, too little development performance data are collected ex post or taking into account the voice of end-beneficiaries. Direct investees are by far the most common source of development impact information, with 81% of funds and 63% of facilities relying on declarations from their client companies or financial institutions. The survey further underscores that many financial intermediaries assess and communicate on their impact rather loosely (Basile, Bellesi and Singh, 2020[11]).

The enhanced principles on blended concessional finance in private sector projects, developed by the DFI Working Group (2018[55]) , refer to promoting high standards (Principle 5). In practice, with regards to evaluation, this means that DFIs and/or multinational development banks (MDBs) apply the same standards to projects involving blended concessional finance as they do to other operations. To promote consistency among MDBs, the Evaluation Cooperation Group defined and published *Good-Practice Standards for the Evaluation of Private Sector Investment Operations* in 2001 and has revised it four times since (Evaluation Cooperation Group, 2006[56]). European DFIs have recently taken significant steps forward in enhancing their collective reporting on both direct and indirect development results (EDFI, 2021[57]).

Altogether, best practice involving tracking of development performance should distinguish between sources of information, including their provenance and any potential associated bias. In addition, it is important to reiterate the need for both qualitative and quantitative information, as diverse and complementary sources enable the emergence of a more robust evidence base through triangulation. Having disaggregated data is particularly important: For instance, gender-disaggregated impact results data should be made available. More integrity should be sought when analysing development results at various levels in the results chain of input, activities, outputs, outcomes and impacts. Robust methods of data collection and calculation are paramount to support this, although it is only realistically achievable if a common framework of understanding emerges that would prevent confusion in terminology and allow for genuine comparison. DAC members should thus promote deontological ethics for the feeding, calculation and communication of development results among financial intermediaries entrusted with development finance.

Sub-principle 5C - Dedicate appropriate resources for monitoring and evaluation

Empower the internal capacity for learning and accountability

Most blended finance actors lack internal capacity when it comes to monitoring and evaluation systems (Basile, Bellesi and Singh, 2020[11])**.** The THK Working Group, for instance, identified resource constraints as a bottleneck when it comes to transparency in blended finance operations (THK Transparency Working Group, 2020[58]). Similarly, the Global Impact Investing Network has found that 25% of impact investors did not have the resources to hire wholly dedicated impact management and measurement (IMM) staff (Global Impact Investing Network, 2017[59]). More recently, over 50% of the surveyed impact investors indicated that the supply of professionals with IMM skills is insufficient (Mudaliar et al., 2019[60]). Most importantly, only a small proportion of their IMM capacity — 16% — is supported through donor funding.

It is important to highlight that the allocation of development assistance often comes with a provision to dedicate a percentage of the total budget to monitoring and evaluation. Similarly, DAC members could consider dedicating a ring-fenced amount to evaluation when making an investment for blending purposes. For instance, the Children's Investment Fund Foundation reserves 5% of the programme budget to assess results down to the beneficiary level.

Enhancing clarity on the respective roles of (ex ante) impact assessment; environmental, social and governance (ESG) due diligence; monitoring; and (ex post) evaluations would be beneficial for all blended finance stakeholders. Each of these roles fulfils a different function and requires a different set of skills, and therefore, it may be advisable to ensure some degree of separation in organisational charts. Nonetheless, for smaller financial players, these roles are often merged and overlap with investment responsibilities. DAC members could contribute to fostering linkages between key market enablers that are responsible for ESG certifications, IMM and evaluation in order to promote mutual understanding and cross-fertilisation among these fields.

Promote collaboration as integral to the partnership

Better harmonisation of approaches to monitoring and evaluation could lead to a cost reduction, both for asset managers and client investees. One example in this direction it the Mutual Reliance Initiative agreed between the European Investment Bank; the French development agency, Agence Française de Développement; and KfW, which allows the institutions to use each other's supervision and monitoring systems to reduce the administrative burden on partner countries (European Investment Bank, 2021[61]) Similarly, blended finance partners can consider engaging in joint and collaborative evaluations that offer a range of opportunities — for mutual capacity development and learning among the partners, for building participation and ownership, for sharing the burden of work, for increasing the legitimacy of findings, and for reducing the overall transaction cost for investors and investees alike (OECD, 2006[62]). The Detailed Guidance Note on Principle 4 provides further information on effective partnerships.

Apply differentiated approaches to monitoring and evaluation

In line with best practice, donors could consider setting up differentiated approaches to monitoring and evaluation of their blended finance operations. This could entail establishing basic requirements for all blended finance transactions and more robust and sophisticated frameworks destined for those blended operations geared towards larger transformative impact, in high-risk environments or with high learning potential. Such differentiation of approaches could allow for larger cost efficiency.

Sub-principle 5D - Ensure public transparency and accountability on blended finance operations

Establish the enabling conditions for transparency

Information on the implementation and results of blended finance activities should be made publicly available and easily accessible to relevant stakeholders, reflecting transparency standards applied to other forms of development finance in line with the principles of the Busan Partnership for Effective Development Co-operation (OECD, 2011[21]), the OECD DAC (2019[63]) Guiding Principles on Managing for Sustainable Development Results and the OECD DAC (2010[64]) Quality Standards for Development Evaluation. The Detailed Guidance Note on Principle 4 also focuses on the need to promote transparency on performance data to all market participants to scale up blended finance. In addition to accountability, external communication on blended finance performance is instrumental in mobilising further commercial capital by improving the availability of market information and the quality of risk assessment for the efficient pricing of investments.

The process of evaluation of blended finance should be independent in its function from the decision-making, delivery and management process. Impartiality contributes to the credibility of evaluation and the avoidance of bias in findings, analyses and conclusions. It also provides legitimacy to evaluation and reduces the potential for conflicts of interest.

Enable policy learning through accumulation of evidence and lessons learned from monitoring and evaluation

DAC members should apply the same standard to evaluations of blended finance operations as they do for more traditional development co-operation modalities. In particular, they should actively encourage financial intermediaries to apply such standards by ensuring the same rigour in terms of conducting evaluations and publishing their findings. DAC members should strive to share all evaluations performed by their bilateral DFI and private financial intermediaries in the OECD DAC Evaluation Resource Centre, or DEReC (OECD, n.d.[65]) . An indirect and fragmented dissemination of evaluation findings and lessons learned may hamper the credibility of the overall evaluation, especially when the underlying report is not fully disclosed.

Blended finance is a relatively new approach in development co-operation and rapidly gaining attention among policy makers in OECD and developing countries alike. Against this background, **the production and dissemination of evidence are critical to understanding the relevance and effectiveness of blended finance.** Moreover, a systematic review of existing evidence with a focus on achieved results by various blended finance instruments would be an important contribution to the further discussions on the potential role and relevance of blended finance for the achievement of the Sustainable Development Goals (Winckler Andersen et al., 2019[15]).

Checklist

The checklist in Figure 11 is presented to assist DAC donors to implement recommendations set out in this section in their blended finance operations.

Figure 10. Checklist to implement OECD DAC Blended Finance Principle

5A Agree on performance and result metrics from the start

- ✓ Does the project adopt a theory of change for a blended finance mechanism as a whole?
- ✓ Was the initial agreement on using common key performance indicators for reporting on results adhered to?
- ✓ Does the project adopt a common monitoring and evaluation framework?

5B Track financial flows, commercial performance and development results

- ✓ Does the project ensure financial transparency while avoiding the pitfalls?
- ✓ Does the project promote better reporting on development results, improving data collection and quality assurance processes?

5C Dedicate appropriate resources for monitoring and evaluation

- ✓ Does the project empower the internal capacity for learning and accountability?
- ✓ Does the project promote collaboration as integral to the partnership?
- ✓ Are differentiated approaches applied to monitoring and evaluation?

5D Ensure public transparency and accountability on blended finance operations

- ✓ Does the project establish the enabling conditions for transparency?
- ✓ Does the project enable policy learning through accumulation of evidence and lessons learned from M&E?

Source: Authors.

Examples of good practices

Box 5 provides an example of best practice on measuring results about financial and development additionality of a blended finance facility. The Detailed Guidance Note on Principle 5 outlines additional examples, as does the working paper for the OECD by Basile, Bellesi and Singh (2020[11]).

Box 5. The United Nations Capital Development Fund (UNCDF): Measuring results about financial and development additionality

The UNCDF, a blending facility that is part of the United Nations (UN) Development Programme, is the UN's capital investment agency for the world's 48 least developed countries (LDCs). As a hybrid development and financing agency, it deploys capital grants, loans and guarantees to both public and private entities mainly targeting local markets in LDCs, where the needs are the greatest. With its unique capital mandate and financing instruments, UNCDF offers "last mile" finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development (UNCDF, 2018[66]).

UNCDF's approach to measuring results attempts to capture both financial and development additionality through a formal theory of change and an Integrated Results and Resources Matrix that sets out a series of performance indicators, tracked on an annual basis (UNCDF, 2014[67]). To capture its financial additionality, UNCDF regularly measures the additional finance that investees raise both as a result of UNCDF's support at the investment level and as the additional catalytic capital that arises from any follow-on finance that is indirectly mobilised by local actors as a result of the models and capacities originally supported by UNCDF. To measure its development additionality, UNCDF tracks a number of indicators that capture contributions to development results at both the investee level as well as at the policy or market system level.

In UNCDF's work in local development finance, financial additionality is measured *inter alia* by estimating the success of UNCDF-supported local governments in increasing mobilisation of their own resources. Development additionality is tracked through the number of local infrastructure projects completed by UNCDF. Catalytic impact is assessed by improvements in local governments' abilities to allocate, mobilise and invest their capital for investment. It is important to note that such interventions include both programmes designed to achieve scalable systemic impact, for example a new way of delivering climate finance at the local level, as well as individual standalone investments. The direct benefit of the investment may be limited, but its overall objective is the demonstration effect and associated policy and regulatory technical assistance towards the systemic impact. For each individual revenue-generating investment in its local development finance work, UNCDF operates a "dual key" investment committee which independently assesses financial and development outputs for each operation and ensures that a theory of change is in place against which to measure eventual impact.

Any numbers-based measurement system has inherent limitations, but UNCDF's results are also validated and further explored via an independent evaluation unit, which makes use of theories of change at both the organisation and individual programme levels to design and conduct theory-based, mixed-method process and outcome evaluations examining questions of interest organised according to the UN/OECD criteria. Evaluators are tasked with validating the financial results that are reported by UNCDF investees, as well as exploring more deeply aspects of development additionality around improved capacity of partner organisations and the relevance and results of programmes and instruments at the beneficiary level. Evaluators also investigate UNCDF's contributions to market and system development using techniques such as contribution analysis and process tracing, taking care to recognise alternative drivers of change in what are by definition complex policy and market systems. In doing so, UNCDF follows the relevant norms and standards for evaluation developed by the United Nations Evaluation Group as well as more specific guidance around measuring market development for the poor that has been developed by bodies such as the Consultative Group to Assist the Poor and the Donor Committee on Enterprise Development.

Source: Andrew Fyfe and Heewoong Kim in Basile, Bellesi and Singh (2020, p. 39[11]), "Blended Finance Funds and Facilities - 2018 Survey Results Part II: Development performance", https://doi.org/10.1787/7c194ce5-en.

Annex A. Core concepts

- **Additionality**: In general terms, additionality of a development finance intervention can be defined as providing additional financial or non-financial input, resulting in additional development outcomes that would not have materialised without the intervention and which thereby contributes to amplified development impact. Additionality features two key components:
    I. **Financially additionality** refers to transactions extended to an entity which cannot obtain finance from the private capital markets (local or international) with similar terms or quantities and for similar developmental purposes without official support or to an entity that mobilises investment from the private sector that it would not have otherwise invested.
    II. **Development additionality** refers to the development impact of the investment that would not have occurred without a partnership between the official and the private sector.
- **Mobilisation:** The OECD defines mobilisation as the ways in which specific mechanisms stimulate the allocation of additional financial resources to particular objectives ("direct mobilisation"). It implies a causal link between private finance made available for a specific project and the official flows that were used to incentivize them. Mobilisation is easily auditable, attributable and measurable vis-à-vis time of commitment/financial close.
- **Concessionality**: In quantitative terms, OECD defines concessionality as a measure of the "softness" of a credit reflecting the benefit to the borrower compared to a loan at market rate. Concessional finance is used to lower the risk for private investors and/or enhance returns to unlock commercial finance that would otherwise not be forthcoming.
- **Commercial sustainability:** In the blended finance context, commercial sustainability refers to the long-term financial viability of transactions and sectors. Once commercial sustainability is achieved in a project or market, blended finance should no longer be deployed.

Source: OECD DAC (2020[68]), *Blended Finance Principle 2 Detailed Guidance Note: Revised Note Following Public Consultation,*http://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/principle-2/Principle_2_Guidance_Note_and_Background.pdf.

Notes

[1] Please note that, following the revision of the OECD DAC Evaluation criteria in 2019, a second edition of the Glossary is being produced and will serve as a useful reference point as it defines many terms used in the document – including intervention, results, output, outcome, and objective. See OECD DAC Network on Development Evaluation (2019[70]) at https://www.oecd.org/dac/evaluation/revised-evaluation-criteria-dec-2019.pdf .

[2] According to the OECD (2015[69]), responsible business conduct OECD (2015[69]) "entails above all compliance with laws, such as those on respecting human rights, environmental protection, labour relations and financial accountability, even where these are poorly enforced. It also involves responding to societal expectations communicated by channels other than the law, e.g. inter-governmental organisations, within the workplace, by local communities and trade unions, or via the press. Private voluntary initiatives addressing this latter aspect of RBC are often referred to as corporate social responsibility". See https://www.oecd.org/investment/toolkit/policyareas/responsiblebusinessconduct/.

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