



PF4SD Perspectives Series

**MAKING BLENDED FINANCE WORK
FOR SUSTAINABLE DEVELOPMENT: THE
ROLE OF RISK TRANSFER MECHANISMS**

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Six years after the private sector has been called upon to help deliver the Sustainable Development Goals (SDGs), the financing gap remains tremendously high and mobilisation figures – how much development actors mobilise from the private sector – remain stubbornly low. Mobilising commercial investment at the portfolio level can be an effective way to match the needs of small scale borrowers in developing countries, and channel the large amounts of capital held by institutional investors towards their sustainable development. Risk transfer mechanisms (RTM) can be one effective way to intermediate between recipient and provider.

Foreword

This paper is the first of a series of three *Development Co-operation Perspectives* dedicated to risk transfer mechanisms, to be published in 2021 and 2022, with support from the Swedish International Development Agency (Sida). The OECD is grateful to Sida for the support, expertise and insights and in particular, Karin Lindblad, Programme Manager and Jesper Skoglund, Senior Transaction Manager.

This first *Perspective* introduces the topic in the context of development finance providers and the SDGs. The second will look into how data and transparency can enable the use of risk transfer mechanisms (RTM) at larger scale, and the third one will investigate the role of regulation in depth.

This *Perspective* was written by Wiebke Bartz-Zuccala, Valentina Bellesi and Lasse Moller (OECD). It was informed by a series of interviews with relevant stakeholders and benefitted from input, feedback or reviews by Ilayda Atalay, Maurits Fliehe Boeschoten and Angelica Ortiz de Haas (FMO), Frank Benhamou (Barclays), Christopher Bredholt (Moody's), Pablo Sanchez Gonzalez (EIF), Karin Lindblad and Jesper Skoglund (Sida), Paul Horrocks (OECD), Cameron Khosrowshahi (USAID) and Madhur Mehta (MSPL Consulting). This *Perspective* was presented at an OECD PF4SD Live Talk held on 9 June 2021, which benefitted from interventions by Ross Ferguson (FCDO), Maurits Fliehe Boeschoten (FMO), Molly Whitehouse (Newmarket Capital), Luca Paonessa (PGGM) and Jesper Skoglund (Sida).

Key messages

- **Development finance providers must make development finance work harder to achieve impact.** They include donors (governments), their grant-providing aid/development agencies, bilateral development finance institutions (DFIs) and multilateral development banks (MDBs).
- **Development finance providers should support portfolio approaches such as credit risk transfer mechanisms (RTM)** that connect large-scale commercial finance supply with small scale borrower demand. They can use three entry points to mobilise commercial capital at scale with credit risk transfer mechanisms:
 1. *as originator*: DFIs and MDBs can offset or share credit risk – stemming from their lending operations – to or with commercial actors, thereby allowing DFIs and MDBs to do more;
 2. *as risk buyer*: Aid agencies, DFIs and MDBs can encourage and enable commercial financial institutions to do more in relevant geographies, regions and asset classes by taking on credit risks originated by commercial financial institutions;
 3. *as facilitator*: Donors and their aid agencies can provide grants and technical assistance (TA) for developing bankable RTM transactions jointly with the private sector or DFIs, also to signal to the market the possibilities of RTM.
- **DFIs and MDBs are well positioned to release credit risk from their balance sheets in order to finance additional projects.** In doing so, they can offset segments of their loan portfolio to commercial investors and focus on new lending. In order to facilitate the scaling of this type of transaction, donors – as owners of the DFIs and MDBs – should invest in having a better understanding of the impact of risk transfer on DFIs' and MDBs' balance sheets and the role of rating agencies, as well as ensure that the right incentives are in place for the DFIs and MDBs.
- **Development finance actors can increase the large footprint that commercial financial institutions have on the ground** by standing ready to take on board parts of their credit risks, share it with other commercial investors and enable financial institutions in the field to do more. Donors should invest in understanding the bottlenecks to increase the number of such transactions, including the lack of local regulation, limited availability of sufficiently large high-quality portfolios, as well as misaligned incentives.
- **Donors should assume their role as market builders in the RTM-for-development space.** They should seek to facilitate RTM transactions by providing grants and TA for the infrastructure or data requirements associated with RTM, and by building capacity on the lender or risk buyer side, e.g. with respect to the assessment of portfolio risk.

Why donors should care about and implement risk transfer mechanisms

The mobilisation agenda – i.e. the internationally acknowledged ambition to unlock private sector finance to deliver on the Sustainable Development Goals (SDGs) – is now in its sixth year, more ambitious than ever before but, at the same time, lagging behind expectations. In 2019, donors mobilised USD 47.1 billion from the private sector, both at the project level, e.g. through guarantees and direct investments, and at the portfolio level, through shares in collective investment vehicles (OECD, 2021^[1]). While private finance mobilised by development finance interventions is on an overall positive trend, preliminary 2019 data signals a decrease with respect to 2018 – even before the hit of the global pandemic. This shows that private finance is far from bridging the SDG financing gap proxied at USD 3.7 trillion per year (OECD, 2020^[2]).

Scaling mobilisation from the private sector through transaction structures such as blended finance is crucial, and increasingly emphasis is placed on incentivising large scale institutional investors to enter SDG-relevant projects.

This approach can be delivered by aggregating projects to the portfolio level, thereby linking small-scale financing demand from entrepreneurs and small and medium enterprises (SMEs) in developing countries with large-scale supply of institutional investors' capital.

One such approach is credit risk transfer, which includes a subset of financial instruments that enable the transfer of assets – such as SME loans or infrastructure loans – or associated credit risks from the financing provider – i.e. lender or originator – to a third party in order to free up regulatory risk capital, mitigate credit risk to certain exposures (potentially freeing up room for new lending), or provide additional liquidity to the financing provider. Ultimately, such transactions allow the originator to do more – e.g. disburse more loans to women entrepreneurs, SMEs, infrastructure projects, or any other area of financing served by those financial institutions. Aptly termed, a ground breaking risk transfer transaction is called “Room2Run” (see next section) (African Development Bank, 2018^[3]).

Risk transfer mechanisms (RTM) are not new¹; however, they receive varying degrees of attention, and have even assumed centre stage during the financial crisis of 2008, where credit risks of subprime mortgage loans were transferred to capital markets at large scale. Since then, regulation has been developed for example in the European Union to guide this market and its potential². While RTM certainly demand thorough levels of transparency, prudence and capacity both on the originator as well as the investor side, they serve a variety of different purposes on the financial institution side as well as on the investor side.

- Financial institutions, including DFIs or MDBs, but also (local) commercial financial institutions that have a much larger exposure in the developing country context, can use RTM as a powerful lever to start, continue or even expand lending to borrowers such as entrepreneurs, SMEs, corporates or projects in the infrastructure space, for example.

¹ Neither so in the development finance context, where risk transfer in the form of securitisation of microfinance loans was a popular tool in the beginning of the 2000s, with seminal transactions going back to 2006 (KfW Development Bank, 2020^[27]). But also in the trade finance space, due to large scale and homogenous portfolios, RTM are regularly used also by development finance actors. Most recently, e.g. IFC invested into a synthetic securitisation of a trade finance portfolio issued by Crédit Agricole (Crédit Agricole, 2021^[28]).

² See for example [Securitisation: improving the financing of the EU economy - Consilium \(europa.eu\)](https://www.consilium.europa.eu/en/policies/securitisation/).

- In addition, from a supply side perspective, RTM can be an effective intermediation mechanism to enable large scale investors – both institutional investors as well as development financiers – access a dedicated exposure that they normally would not consider, due to ticket size mismatches, lack of due diligence knowledge, lack of local presence, high transaction cost or high perceived risks.

As such, RTM are not necessarily blended finance instruments; however, donors – via their development co-operation agencies and DFIs or MDBs – should step in and facilitate or invest in such transactions and hence unlock commercial lending at the project level or commercial investment at the portfolio level into sectors or geographies where they want to achieve development outcomes (see next section).

Donors can enable financial institutions – either development or commercial financial institutions – to do more of their day-to-day business and hence help underserved groups to access finance.

Ultimately, by donors stepping in and facilitating more lending to target borrower groups, such deal can become blended finance. Table 1 summarises the incentives for each party to engage in RTM.

Table 1. Rationale for engaging in RTM

| | Originator | Facilitator | Risk Buyer |
|---|--|--|--|
| Development finance actor such as DFI, MDB or aid agencies | Resolve credit and risk constraints to free up capacity for new lending or to enable larger gross exposures. Help provide other actors understanding of the underlying exposures/markets | Enable development or commercial actors to create more impact – by lending more – and mobilise commercial finance at the balance sheet level | Building markets by enabling other to fund and encouraging (potentially through requirements or incentives) impact focused new lending |
| Commercial actor | Reduced credit risk, reduced risk exposure amounts, improved capital ratios, liquidity relief (in case of true sales) and capital for redeployment into new lending | Enable structuring of RTM transactions that can attract commercial investment at scale | Instant exposure to the referenced portfolio and no access to underlying set of clients (relevant for institutional investors), attractive risk adjusted returns; diversification of investments |

Source: Authors.

Due to the potential and the beneficial effects of RTM, these approaches have also been discussed and highlighted at international fora such as the G20 and the G7. In 2015, G20 Leaders endorsed the MDB Action Plan to Optimize Balance Sheets, highlighting the need for MDBs to maximise their impact through enhancing efficiency across their balance sheets (G20, 2015^[4]). This included measures related to capital efficiency, exposure exchanges, concessional windows, net income measures as well as mobilisation and risk transfer (Group of MDBs, 2017^[5]).³ Under the 2021 Italian G20 Presidency, Finance Ministers and Central Bank Governors reaffirmed their call on MDBs to make the best use of their resources and implement the 2015 G20 Action Plan (G20, 2021^[6]). Most recently, G7 Finance Ministers and Central Bank Governors, under the UK Presidency, stated that “all avenues should be explored to enable MDBs to efficiently and effectively use their resources” (G7, 2021^[7]).

³ While all such measures are relevant in the context of resource optimisation, this *Perspectives* focuses specifically on risk transfer.

The set of risk transfer instruments that can unlock commercial finance

RTM include a wide range of financial instruments that enable third parties to share credit risks with loan providers, ranging from securitisation, where this credit risk is tranching and structured to enable different layers of risk exposure for different types of investors, to portfolio guarantees (see Box 1 below for an overview of risk transfer mechanisms covered in this *Perspective*).

For the purpose of this *Perspective*, a number of risk transfer transactions in the development finance context have been investigated to depict specificities and derive general lessons on the potential of these transactions to attract commercial investors at scale. Thereby, development finance actors can play three main roles to mobilise commercial investors through risk transfer mechanisms: (1) as originators of loans (or risk sellers), (2) as investors into credit risks originated by other financial institutions (or risk buyers) and (3) as facilitators.

Box 1. An overview of risk transfer mechanisms in the development finance context

A wide range of mechanisms are available for development finance and commercial actors to share and transfer credit risks stemming from their respective loan portfolios. These include:

- *Securitisation*, including synthetic and true sale (e.g. collateralised loan obligations) – ex post credit risk tranching of a portfolio of underlying outstanding loans, whereby investors buy parts of this credit risk varying by the degree of subordination. Within such structures, first loss tranches provide credit enhancement, i.e. comfort to senior tranche investors.
- *Co-lending/syndication* approaches, i.e. loans by a group of lenders, whereby an arranger takes the lead in lending, including due diligence, administration etc. against a fee. Credit risk is shared across the group of lenders, whereby tranching is possible, i.e. first loss tranches can provide credit enhancement.
- *Guarantees*, i.e. a “legally binding agreement under which the guarantor agrees to pay part or all of an amount due on a loan, equity, or other instrument in the event of non-payment by the obligor (or loss of value, in the case of investment)” (Garbacz, Vilalta and Moller, 2021^[8]).⁴
- *Risk sharing facilities*, including funded (e.g. as syndicated loans) or unfunded approaches (e.g. as guarantees) – ex ante agreement to partially cover credit risk/share losses in case of default for a pre-defined portfolio of certain type of loan, e.g. Micro, Small and Medium Enterprises (MSMEs).

Source: Authors

⁴ Beyond guarantees, insurance products can also be used to mitigate credit risks. While the OECD Creditor Reporting System (CRS) does not distinguish between guarantees and insurance, there are certain differences between the two. Guarantees result in payment by a guarantor in the event of non-payment by a guaranteed entity to a third party, while insurance often includes specific conditions that need to occur before payment takes place, e.g. occurrence of an event, types of damage and losses, etc. For more details, see: (Garbacz, Vilalta and Moller, 2021^[8]).

Development finance actors can share their originated credit risk with commercial investors

MDBs and DFIs can free up risks from their balance sheets and subsequently increase lending in their area of expertise, i.e. sectors and geographies with strong SDG financing needs. MDBs and DFIs are uniquely equipped and well positioned to leverage their high-quality loan portfolios which are characterised by strong underwriting capacities, long track record, low default rates and their preferred creditor status (PCS) and use instruments such as securitisation but also co-lending approaches/syndication platforms⁵.

The African Development Bank (AfDB)'s Room2Run (R2R) transaction was the first-ever synthetic securitisation of an MDB's portfolio of private sector loans, which allowed the MDB to offset credit risk of USD 1 billion of private sector loans across Africa. It is expected that this frees up USD 650 million in capital for additional lending. Commercial investors include the Mariner Investment Group as anchor investors. The European Commission (EC) provided credit enhancement in the form of a credit risk guarantee on the senior mezzanine notes via the European Fund for Sustainable Development (EFSD) (African Development Bank, 2018^[9]).

Synthetic securitisations such as the R2R have significant advantages. First, they are flexible structures: securitising a loan portfolio into different risk tranches with varying degrees of underlying credit default risk, ensures the provision of specific risk/return attributes suitable for varying investor profiles. That is, senior tranche investors are repaid before junior or first loss investors. Moreover, investors get instant exposure to the referenced portfolio when investing in such structure, i.e. there is an immediate use of invested funds. Second, its synthetic nature allows the originator to remain the lender of record and keep relationships with borrowers, thereby maintaining control over the development objectives and impact of portfolio projects – which is crucial in light of MDBs' and DFIs' mandates. However, this type of transaction holds several limitations, mainly due to its structural complexity and the corresponding high transaction costs. The R2R transaction took about four years to be structured, was relatively small compared to the total balance sheet and required highly technical and legal expertise and a relatively homogenous loan portfolio, in this case from the private sector (GlobalMarkets, 2018^[10]; Humphrey, 2018^[11]; PRI, 2019^[12]).

Another case where an MDB acts as an originator and shares credit risk with private investors is IFC's Managed Co-Lending Portfolio Program (MCP), a pooled syndication arrangement allowing institutional investors to invest alongside IFC in emerging markets, for example in infrastructure projects⁶. The originated loans are set off into a structured debt fund, which matches the various risk-return profiles of different classes of investors. IFC holds the first loss tranche in its infrastructure loan portfolio. That is, losses of the underlying portfolio of infrastructure loans are attributed to the first loss tranche before the senior tranche. As a result, institutional investors such as Allianz Global Investors can invest at investment-grade in senior tranches, which are typically bonds or notes. In addition, the first-loss tranche is credit enhanced by a guarantee provided by the Swedish International Development Cooperation Agency (Sida). By creating diversified portfolios loans, the MCP allows investors to increase exposure – or get first-time entry – to this asset class in the SDG financing context, while not having access to the underlying clients (IFC, n.d.^[13]; IFC, 2021^[14]).

⁵ At the same time, as MDBs and DFIs may not necessarily be operating with a banking license, which implies a certain level of detailed data and analysis needed to sell credit risk.

⁶ Beyond the investment vehicle approach, the MCP provides two other risk sharing possibilities for different types of investors, including dedicated trust funds that IFC can set up to hold sovereign investors' funds (e.g. People's Bank of China) and unfunded structures, whereby IFC can lend for its own account and insurance companies (e.g. Munich Re) can provide credit insurance or risk guarantees (IFC, 2021^[14]).

Development finance actors can enable commercial financial institutions to do more by sharing risks

While MDBs and DFIs have an important role to play in lending additional finance to borrowers which would not be served otherwise, (local) commercial financial institutions have significant exposure, track record and knowledge of lending in developing countries. Development finance actors can enable those institutions to do more of their important work. That is, donors can share or buy credit risk with or from commercial/impact lenders' operations, thus incentivising them to lend more to projects with the greatest financing needs and highest development impact potential.

In 2019 the impact asset manager ResponsAbility securitised a portfolio of loans to microfinance and SME-focused financial institutions in emerging markets, thereby linking MFI loan demand with the capital market supply of commercial, impact and development investors. It is estimated that 81% of the MFIs' end-borrowers are women (ResponsAbility, 2019^[15]). The transaction is structured into three levels of risk and return (senior, mezzanine and junior tranches). OPIC, the former US DFI, invested in Class A Notes as the anchor investor, which at the same time is exposed to the lowest return as well as the lowest risk profile. Pension funds such as Alecta and impact investors such as Calvert Impact Capital hold mezzanine and junior notes. This set-up shows that return preferences of the commercial actors can result in those actors taking more risk on board than development actors. Such preferences must be understood from the outset when designing RTM.

The Asian Infrastructure and Investment Bank (AIIB) has set up a platform⁷ with Clifford Capital that transfers risk from infrastructure project finance loans disbursed by commercial banks such as Standard Chartered or HSBC to capital market investors on a continuous basis. The first securitisation transaction in 2018 included 37 senior syndicated loans to 30 infrastructure projects in Asia (Moody's Investors Service, 2021^[16]). Ultimately, such transactions can allow the participating banks to lend more by freeing up risk capital on their balance sheets.

Nasira is an FMO-managed risk-sharing facility (RSF) classified as a synthetic securitisation which guarantees loan portfolios of local banks and microfinance institutions in sub-Saharan Africa and countries neighbouring Europe. The RSF guarantees up to 95% of a future portfolio of loans, which have to follow pre-defined criteria in order to be eligible to be covered under the RSF. In doing so, the RSF enables local financial institutions to do more business and provide loans to underserved groups that they have not served before, for example because of too high risk perception, lack of track record, due diligence or risk knowledge. In the Nasira example, this includes borrowers that are for example young, female, migrant and COVID-19 affected entrepreneurs. Nasira benefited from a participation in second loss tranche of by the European Commission (EC) via its EFSD program, and the Dutch government's MASSIF Fund. As of May 2021, three transaction have been signed including USD 50 million for Equity Bank Kenya and USD 30 million for Bank Al Etihad in Jordan (FMO, 2021^[17]). A further example is CDC's first RSF with Absa Bank Limited, an African financial services provider which will have increased capacity to extend financing to microfinance and non-bank institutions, that ultimately on-lend to MSMEs and households across sub-Saharan Africa (CDC, 2021^[18]).⁸

⁷ Bayfront Infrastructure Capital <https://www.bayfront.sg/platforms>.

⁸ While risk sharing facilities are not new structures among MDBs, they are now starting to be increasingly used by bilateral DFIs as well.

Donors can unlock risk transfer mechanisms by facilitating knowledge building with technical assistance

Donors and their development agencies can facilitate the structuring of RTM transactions, by providing vital grants and technical assistance (TA) to develop bankable RTM transactions, conduct feasibility studies and build capacity in local financial institutions. Thanks to their presence on the ground, donor agencies and their network of partners can also help identify investment opportunities and facilitate engagement with relevant local stakeholders.

For instance, in the case of the RSF Nasira, the European Commission provided financial contributions for TA to strengthen the capacity of local financial institutions to better serve the targeted underserved groups via different interventions including digitalisation programs and improving credit risk functions in financial institutions (FMO, 2019^[19]). Another example is USAID's provision of TA to develop a securitised bond market in Armenia, including by working with local regulators to create an appropriate legal framework (OECD, 2018^[20]).

Moreover, the unlocking of commercial investors as risk buyers may also require capacity building as local investors may still be relatively new to risk transfer transactions and thus need knowledge, capacity and an enabling regulatory environment in place to invest in this asset class.

Donors can also play a crucial role as matchmakers and facilitators, by setting incentives for public, private and civil society actors to partner as well as by creating opportunities for actors to work together more effectively (Poole, 2014^[21]), e.g. towards shared approaches to analysing, managing and transferring risk.

Donors should investigate and address the main road blockers to scale risk transfer mechanisms

Donors should provide coherent fit-for-purpose incentive structures to their development finance actors

In order to scale the use of RTM in the context of blended finance, for all parties involved, from originator to investor, donors should work towards ensuring that the right incentives are in place. Thereby, the role of donor governments as well as incentives varies with the three different entry points they have into RTM outlined above. Two important areas stand out:

1. In order to enable MDBs and DFIs to capitalise on their strong underwriting capacities for instance by securitising segments of their lending portfolio, questions around incentives to mobilise commercial investment, excess liquidity, the effects of securitisation on institutional credit ratings⁹ as well as a future pipeline of so-called bankable projects¹⁰ have to be addressed. For example, the R2R transaction was driven by a dedicated management, as well as a constrained balance sheet that did not allow for further lending without a capital injection.¹¹

⁹ The impact of the use of RTM on MDBs' and DFIs' credit profile depends significantly on the size and effectiveness of the RTM relative to the total debts or assets, and also the new lending activities emerging from free-up capacity (Moody's, 2020^[29]).

¹⁰ While the R2R transaction works with an underlying private sector portfolio, the majority of MDB lending is vis-à-vis the government sector, which creates additional challenges in terms of attractiveness to commercial investors. See e.g. (Humphrey, 2018^[11]).

¹¹ It should be noted that DFIs and MDBs often operate without capital requirement and credit risk constraints that are imposed to commercial banks for example by Basel regulation.

Moreover, DFIs, MDBs and development agencies may be incentivised to engage in new lending and have performance indicators based on new volumes disbursed, which then drives the focus away from transactions relating to existing portfolios as in the case of securitisation. Another consideration is that excess capital and the preference to maintain profitable loans as a source of income on balance sheets can lead to the conclusion that risk transfer in the form of securitisation is not an option (EBRD, 2020^[22]).

Coherent incentives must be set by shareholders that prioritise mobilisation of private finance in order to turn any request for stronger use of risk transfer mechanisms into practice.

At the same time, not all MDBs and DFIs will be able to undertake such activity, for example because of their institutional set up.

2. To act as investor or risk facility provider requires that donors have the incentives, capacity, mandate and institutional set-up to issue risk sharing instruments including various forms of guarantees, which needs commitment to create appropriate governance and institutional capacity (Garbacz, Vilalta and Moller, 2021^[8]). Liquidity instruments such as ordinary loans are typically more straightforward, also from an underwriting capacity perspective. Similarly, donor governments and their development finance actors should investigate opportunities to work directly with the private sector, for example by acting as anchor investor in special purpose vehicles (SPVs) securitising SME-loan portfolios from a commercial lender or with a risk sharing facility as in the Nasira case. Here, the European Commission brought vision, flexibility and risk optimising approach to get the programme off the ground. Risk transfer mechanisms can allow local financial institutions to do more, but donor governments must have the right levers in place to make it happen, and turn from a funder into an enabler.

Donors should facilitate a conducive regulatory environment and work effectively with rating agencies as well as regulators

For an effective use of RTM in the developing country context, local regulation is crucial to significantly scale the use of this instrument, in particular with respect to securitisation. Such transactions require the facilitation of an enabling environment, including capable supervision on the regulatory side. In Europe, securitisation is highly regulated¹², which enables a level playing field for actors in the space. Donors should ensure that future efforts on understanding the levers to facilitate the uptake of RTM in the context of development finance should include structured outreach to and inclusion of local supervisory and regulatory authorities.

Moreover, in the context of securitisation with MDBs and DFIs, the role of rating agencies should be carefully assessed and discussed. Donors must engage to understand the impact of rating agencies on MDBs' and DFIs' incentives to securitise. For example, different rating methodologies view capital adequacy and creditworthiness of MDBs and DFIs in very different ways (Humphrey, 2021^[23]).¹³

¹² Please see further here <https://www.esma.europa.eu/policy-activities/securitisation>.

¹³ The rating issue will be explored in further detail in the third *PF4SD Perspectives Series* on RTM.

Donors should understand the role of and facilitate access to data and information in order to inform risk perceptions

As indicated, RTMs pose significant information and data challenges to potential investors that need to understand an existing portfolio of loans (in the case of e.g. securitisation), or future loans (e.g. in the case of risk sharing portfolio guarantees). This includes not only an assessment of the credit risk i.e. the characteristics relating to each and every borrower, but also the lending methodologies and technologies, as well as the financial structure and tranching of the SPV.

For commercial investors it is crucial to have access to granular portfolio data, such as the historical track records of similar exposures in order to understand the probability of default, as well as recovery rates of the underlying assets, and market level information to benchmark the transaction.

Such data can then be used to move from perceived risk perception to real risk assessment needed to inform investment decision making. Therefore, donor governments should (1) ensure that existing data that could help to facilitate more commercial investment via risk transfer mechanisms are made available at the market level, so the information asymmetries are removed. While recent potentially insightful data from the GEMs database – which captures historical default rates, recovery rates and losses from MDBs and DFIs towards public, private and sovereign counterparts – has been publicly released, this is only at an aggregate level (not project) without meaningful data points such as recovery rates that put default rates into perspective (European Investment Bank (EIB), 2021^[24]).¹⁴ Moreover, (2) donors should work towards a better understanding of, as well as cooperating on risk assessment methodologies and tools. For instance, assessing portfolio risk in the context of portfolio guarantees is resource and capacity intense, and requires specialist knowledge. Such risk management tools may be developed jointly by a group of donors or DFIs so that others, for example donors and their agencies that are relatively small or new to the blended finance context can benefit from existing efforts. In the context of development finance, such tools serve a common goal i.e. to enable more lending to those who need it.

Donors should understand and leverage commercial actors preferences to get their buy-in

The OECD DAC Blended Finance Principles highlight that each party in a blended finance transaction brings a different mandate to the table, which includes commercial and development motivations. Donor governments considering setting up or expanding RTM models should take such preferences into account early in the project conception and design phase, in particular if the intention is to mobilise commercial finance at scale. Beyond addressing risk preferences of the private sector, return expectations of commercial actors should be considered. Given relatively higher cost of capital of commercial financiers that do not benefit from government backing, those actors have a preference for a meaningful return on investment. Clearly, the risk-return relationship must be balanced. While reluctant to take on board excess and unknown risks, commercial actors are seeking financial return opportunities. However, as the senior tranche of structured vehicles is associated with lower return than the mezzanine or junior tranche – albeit relatively lower risk – senior exposure is sometimes not attractive for the private investors.

¹⁴ More information on the methodology and time span behind the calculation approach of the default rates could be added to the picture.

It remains the responsibility of the donor to understand the different expectations, and carve out the most conducive role, including in the relationship with commercial actors.

Donors should try new routes for mobilising at scale while enabling risk transfer mechanisms to ultimately deliver development impact

Donors should create an enabling environment that provides enough flexibility to innovate, test and experiment. While this may be true in general, this holds for scaling up the mobilisation of private finance in particular. While the topic has been high on international agendas for more than half a decade, mobilisation figures are sobering. In addition to more of the same that works in terms of mobilisation, donors should establish new trajectories by enabling others to do more at scale, for instance with the use of RTM. This portfolio approach also responds to the private sector needs in terms of larger ticket sizes. At the same time, mobilisation is never an end in itself. In the context of RTM this also implies, for example, the any new lending capacity stemming from credit risk sharing or transfer should be redeployed towards the SDGs. Donors should make sure that the design of RTM is strongly motivated by a development rationale, in line with the OECD DAC Blended Finance Principles (OECD, 2017^[25]). When working with partners from public and private sectors, donors should be guided by the OECD/UNDP Impact Standards for Financing Sustainable Development to optimise their positive contribution to the SDGs, promote impact integrity and avoid impact washing (OECD DAC, 2021^[26]). While there is significant capacity to mobilise through RTM, questions for example around impact measurement and attribution – who of the partners is enabling how much impact – will also be important going forward.

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Further reading

- Eighteen East Capital (2021), [MOBILIST – The Exit-Mobilisation Opportunity in Africa](#)
- Eighteen East Capital (2020), [A Sustainable Development Certificates Framework](#)