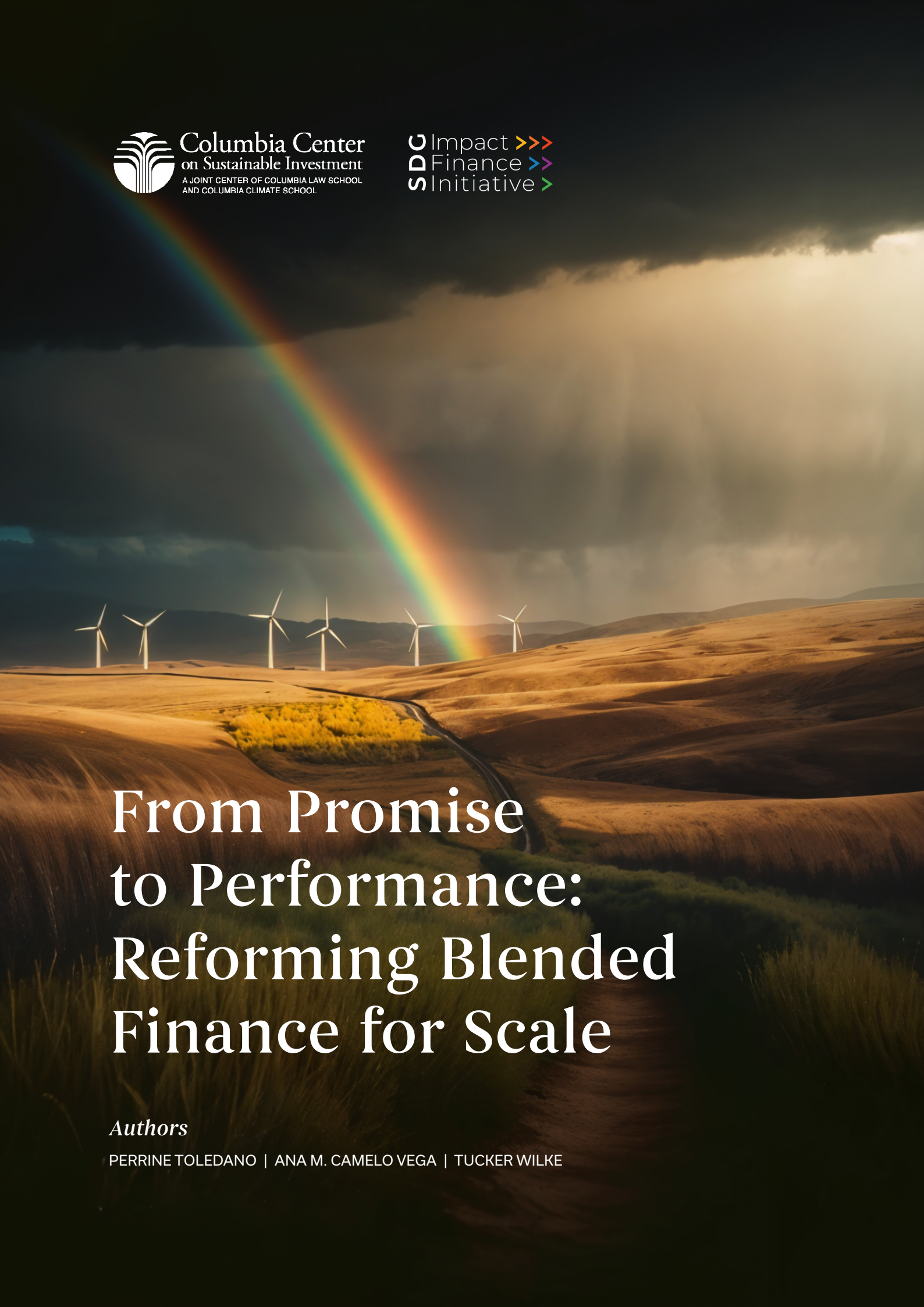

Columbia Center on Sustainable Investment
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SDG Impact Finance Initiative

From Promise to Performance: Reforming Blended Finance for Scale

Authors

PERRINE TOLEDANO | ANA M. CAMELO VEGA | TUCKER WILKE

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Definitions

a. **Blended Finance** refers to the strategic deployment of public and philanthropic capital to attract additional private finance for investments aligned with the Sustainable Development Goals (SDGs). While catering to different levels of risk tolerance, blended finance aims to mobilize market-rate-seeking capital by adjusting returns to match risk profiles that appeal to private investors who otherwise would not participate. In this study, we do not categorize Development Finance Institutions (DFIs) as private investors.

b. **Capital Adequacy Ratio (CAR)** is a measure of a bank's capital, expressed as a percentage of its risk-weighted assets, ensuring that it has sufficient capital to absorb potential losses and continue operations. It is crucial to maintaining the financial resilience of DFIs and Multilateral Development Banks (MDBs) that participate in SDG-oriented investments. The CAR is also a tool for instilling investor confidence. For example, DFIs often maintain a higher CAR than typical private banks, serving as a buffer that allows them to underwrite riskier, development-oriented projects without jeopardizing their financial health.

c. **Catalytic Capital** includes public and philanthropic funds used to attract private sector in EMDEs capital through concessional terms and risk mitigants.

d. **Enhanced Return on Investment** refers to strategies aimed at increasing the financial returns for private investors participating in SDG-aligned projects. This is accomplished by offering concessional (i.e., below market-rate) terms for funding provided by public or philanthropic sources. Examples include extended debt tenors, capped equity return, or long-term debt at below-market interest rates.

e. **Leverage Ratio** measures the amount of public and private commercial capital mobilized for every dollar of concessional capital in a blended finance transaction. It serves as an indicator of the efficiency of concessional resources in attracting additional funding.

f. **Liquidity** refers to the ease to convert investments into cash without significantly impacting their market price, which is often challenging for Emerging Markets and Developing Economies (EMDEs) investments due to lower market depth, higher volatility, and frequent economic or political disruptions.

g. **Mobilization Ratio** reflects the amount of private sector capital, particularly from commercial or institutional investors, successfully attracted to investment opportunities in EMDEs through risk mitigants and concessional terms.

h. **Prudential Regulations** in this context are regulations that require banks and insurance to adhere to sound financial standards ensuring financial stability. These regulations often limit investments in high-risk, below-investment-grade, and illiquid markets, restricting capital flow to EMDEs. In contrast, MDBs' and DFIs' lending practices are constrained by self-regulated financial governance focused on capital adequacy and AAA creditworthiness.

i. **Risk Mitigation** refers to strategies and financial mechanisms used to reduce or manage the investment risks that private sector actors may face, or perceive that they face, when investing in SDG-related projects. These strategies are designed to make such investments more attractive to private investors by improving the risk-return profile. Common risk mitigation techniques include credit guarantees, first-loss capital, insurance, and other risk-absorbing measures funded by public or philanthropic sources.

Abbreviations

AEs	Advanced Economies
AfDB	African Development Bank
CAR	Capital Adequacy Ratio
CCSI	Columbia Center on Sustainable Investment
CRA	Credit Rating Agency
DEG	Deutsche Investitions- und Entwicklungsgesellschaft (German DFI)
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
ECAs	Export Credit Agencies
EMDEs	Emerging Markets and Developing Economies
ESG	Environmental, Social, and Governance
FAST-P	Financing Asia's Transition Partnership
FI	Financial Institution
FMO	Dutch Entrepreneurial Development Bank
GAIA	Green Africa Infrastructure Accelerator
GDP	Gross Domestic Product
GEAPP	Global Energy Alliance for People and Planet
GEMs	Global Emerging Markets Risk Consortium Database
GIIN	Global Impact Investing Network
GFC	Global Financial Crisis
IC	Institutional Capital
ICC	International Chamber of Commerce
IDB	Inter-American Development Bank
IDB Invest	Private sector arm of IDB
IDH	Sustainable Trade Initiative
IEA	International Energy Agency
IFC	International Finance Corporation
IOSCO	International Organization of Securities Commission's
MDB	Multilateral Development Bank
MICs	Middle-Income Countries
MIGA	Multilateral Investment Guarantee Agency (World Bank Group)
MUFG	Mitsubishi UFJ Financial Group
NGO	Non-Governmental Organization
OECD	Organisation for Economic Co-operation and Development
SDGs	Sustainable Development Goals
SMEs	Small and Medium Enterprises
SMI	Sustainable Markets Initiative
TA	Technical Assistance
TAFs	Technical Assistance Facilities
UNEP	United Nations Environment Programme

Executive Summary

While blended finance continues to gain momentum, its potential to help close the Sustainable Development Goals (SDGs) financing gap in Emerging Markets and Developing Economies (EMDEs) is hindered by entrenched structural constraints. Without fundamental reform, blended finance will remain a niche tool, promising, but for now, not yet well positioned to be integrated with mainstream capital markets and conventional finance. This report draws on 65 expert interviews, a comprehensive literature review, and an attempt at simulated portfolio-level structuring. It diagnoses the systemic barriers holding back scale, proposes a path forward, and assigns clear roles and responsibilities to key actors across the ecosystem to drive meaningful reform.

Structural Opportunities and Priority Reform Areas

1. Enhancing Transparency and Standardization

A core constraint on scaling blended finance is the systemic lack of transparency. Data on pricing, capital structure, risk-sharing arrangements, and returns is either withheld under confidentiality agreements or presented in inconsistent formats, undermining comparability. This informational opacity creates uncertainty for investors, drives up transaction costs, and reduces overall market confidence. Furthermore, excessive complexity in deal structuring has introduced what stakeholders commonly describe as a 'complexity premium' translating transaction friction and design inefficiencies into a higher cost of capital.

To address this, full transaction-level disclosure should be required for all blended finance transactions. A centralized, open-access database capturing deal-level information—including financial performance, risk parameters, structuring templates, concessionality levels, and realized impact—should be developed to facilitate due diligence and improve market functionality. In parallel, standardized templates for reporting, term sheets, and key financial and impact metrics must be adopted across institutions to support data comparability and investment benchmarking. Aggregation platforms should be pursued by catalytic and private investors alike to introduce greater structuring efficiency into the system.

2. Advancing Regulatory Innovation and Accurate Risk Pricing

Blended finance is constrained by regulatory and institutional frameworks that misprice risk in EMDEs investments. Prudential regulations (e.g., Basel III, Solvency II), conservative credit rating methodologies, and outdated risk perceptions by private investors tend to reinforce risk aversion, even when real-world performance data suggests otherwise. This results in inflated cost of capital and restricted investment flows to otherwise viable opportunities in EMDEs.

Reform is essential. Both prudential rules and credit rating methodologies should be updated to reflect the risk-mitigating features of blended finance structures, including guarantees, subordinated tranches, and political risk insurance. While waiting for the reforms, private sector investors are invited to adopt a bottom-up strategy that begins with the company's business model, identifies specific geopolitical risk events that could affect it, and applies targeted mitigation measures. In line with this strategy, practitioners identified six effectiveness strategies to overcome institutional conservatism and invest in EMDEs through blended finance. First, risk mitigation tools must be more widely leveraged to address persistent real and perceived risks. Second, financial structures should be tailored to local contexts, including models that embed national ownership to reduce political risk. Third, engaging local financial institutions strengthens market knowledge, reduces costs, and enhances sustainability. Fourth, aligning blended finance with national priorities helps create a more stable enabling environment. Fifth, investors should adopt flexible definitions of bankability, recognizing that innovative models can become investable with the right structuring. Finally, strong fund managers and project sponsors are critical to navigating regulatory complexity, aligning stakeholders, and building credibility. Together, these approaches offer a bottom-up roadmap to mobilize private capital more effectively in EMDEs.

3. Strengthening Liquidity and Expanding Exit Options

A major deterrent for institutional participation in blended finance is the lack of liquidity and viable exit strategies. Most blended finance structures involve long-duration and illiquid instruments, and the absence of functioning secondary markets restricts capital recycling. In addition, development institutions frequently originate-to-hold assets on their own books, limiting both the broader circulation of captial and their ability to de-risk private capital.

Targeted reforms should include the creation of dedicated exit-enabling liquidity facilities, dynamic secondary markets, and infrastructure for asset transfer. There are very few mechanisms in the ecosystem and philanthropies have a key role to play to see them. MDBs and DFIs must be incentivized to originate-to-distribute, building up their capabilities to deploy securitization and co-financing at scale and strategically.

4. Building a Robust Project Pipeline

A recurring constraint across geographies is the shortage of bankable projects. Many proposals lack adequate structuring, risk mitigation, or alignment with investor requirements. This reflects a persistent underinvestment in early-stage project development, compounded by fragmented technical assistance (TA) mechanisms and limited coordination between financiers and implementing agencies.

To resolve this, significantly more emphasis must be placed on project preparation. This includes expanding and streamlining project preparation facilities, increasing TA funding for upstream design, and systematically involving private investors earlier in the project lifecycle to ensure financial viability and structural fit. Governments in EMDEs should integrate blended finance considerations into their development

strategies and pipeline generation efforts to create demand-led, bankable opportunities, as well as develop strategies to mitigate currency risk.

5. Fostering Additionality Through Market Standards and Strategic Interventions

Blended finance must be deployed in a manner that complements, rather than distorts, market dynamics. However, many transactions involve concessional support without clear demonstration of market failure or financial additionality. In some cases, competition among public actors leads to the erosion of the additionality principle, diminishing catalytic impact and deterring commercial replication.

To restore integrity and discipline, blended finance should be strategic, targeted, temporary, and subject to strict additionality and impact criteria, country platforms should be established to drive blended finance where it is needed, and additionality metrics should be clearly defined to guide project structuring. Moreover, coordination mechanisms of catalytic investors should ramp up to ensure coherence and complementarity across institutions throughout the project cycle, better alignment with country priorities, and the formation of pools of first-loss capital.

Who Must Lead and How

Scaling blended finance demands bold action from the institutions that hold power, capital, and influence across the financial system. This is not a time for minor fixes. Closing the gap requires a systemic reset, built on role clarity, coordinated action, and real accountability.

To unlock real impact, Advanced Economy (AE) governments must go beyond signaling support and embed blended finance into the operational mandates of the public institutions they govern. They have the leverage to push for systemic transparency, performance accountability, and mindset shift from development institutions. They must overhaul prudential regulations—particularly Basel III and Solvency II—that disincentivize bank and insurance investment in EMDEs, even when risks are well-managed. They also should seed pools of first-loss capital making catalytic capital largely more accessible than it is today.

Multilateral Development Banks (MDBs), Development Financial Institutions (DFIs) and other donor agencies (e.g. vertical and multilateral trust funds) must shift their institutional priorities from maximizing lending volumes to crowding in private investors. This requires publishing transaction-level data, streamlining operational processes, mobilizing their de-risking abilities, hiring additional adequate investment structuring capabilities, and incentivizing the creation of a secondary market by originating to distribute. The focus must shift from overengineered bespoke deals to scalable, replicable platforms that align with investor needs. These actions should be articulated in a private mobilization roadmap, providing required visibility to investors.

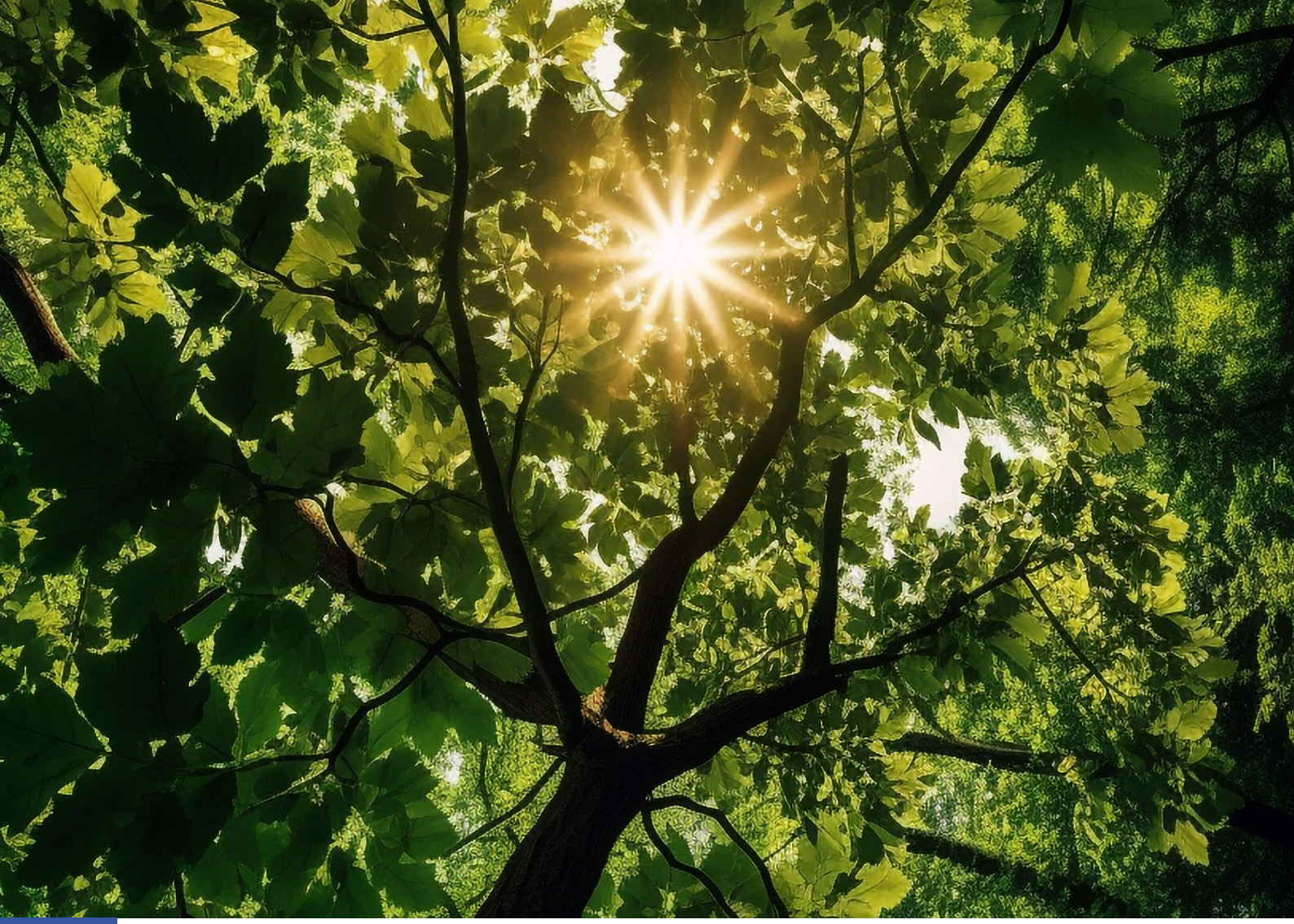
Private investors have to engage earlier and more strategically. Investors already involved in blended finance should co-develop standardized transaction templates, advocate for better data infrastructure, push for blended structures that reflect real (not perceived) risk, and communicate on successful investment strategies, enabling risk perceptions to adjust to realities over time.

EMDE governments play a critical role in setting the enabling environment. They must articulate how blended finance could align with national development priorities, fast-track permitting, developing country platforms, enhancing data transparency, and take initiatives to contain the currency risk. Enabling institutional and legal frameworks for bankable offtake agreements, and incentivizing partnerships with local financial institutions can dramatically shift the risk calculus for private investors.

Philanthropic foundations must embrace their role as ecosystem architects. Their concessional funding is often the only capital flexible enough to support high-risk, high-impact innovation. They can finance open data platforms, seed aggregation vehicles, and subsidize early-stage technical assistance. But more than that, they should demand rigor in impact and market outcomes, making concessional capital contingent on transparency, replicability, and financial additionality.

CRAs and export credit agencies (ECAs) must modernize. CRAs must develop new methodologies that reflect the realities of EMDEs and recognize blended finance and the de-risking power of MDB guarantees and first-loss capital. ECAs, meanwhile, should play a more active role in blended finance, collaborating with catalytic capital providers along the project cycle financing while expanding the coherence and completeness of guarantee packages to address multiple risks depending on specific project needs and project stages.

The obstacles to scale blended finance are structural, but they are not insurmountable. The evidence and recommendations outlined in this report point the way forward. Coordinated leadership across public, private, and philanthropic sectors, paired with the political will to implement reforms that align market incentives with development outcomes is now required. Only then can blended finance realize its promise as a powerful enabler of sustainable investment at scale.



Introduction

Over the past decade, blended finance has been widely promoted as a solution to mobilize private sector capital into Emerging Markets and Developing Economies (EMDEs). When effectively designed and deployed, blended finance can be a powerful enabler by leveraging public and philanthropic capital to catalyze much larger volumes of private investment. It offers a pathway to align commercial returns with development impact, channeling institutional capital toward critical sectors like clean energy, resilient infrastructure, and inclusive finance. In this way, blended finance holds the potential to help close the Sustainable Development Goals (SDGs) financing gap and mainstream impact investing across EMDEs.

Yet, despite growing attention and innovation, it has not scaled meaningfully, and the SDG financing gap continues to widen. EMDEs account for a large share of global economic growth and opportunity, yet they receive only a fraction of the available capital. The mismatch is stark: trillions in global capital remain untapped for development needs precisely where they are most urgent. Blended finance risks stagnation without structural transformation. Mobilizing private investment at the scale needed requires a fundamental redesign of how blended finance mechanisms, stakeholders, and incentives are structured.

This report diagnoses the core systemic barriers preventing blended finance from scaling and proposes targeted reforms grounded in market realities and practitioner insights. It is

written primarily for private investors, but it contains specific calls to action for catalytic capital providers, policymakers, and development finance institutions. Drawing from practitioner experience, we identify five structural issues that continue to constrain the growth of blended finance: lack of transparency and standardization, institutional conservatism and risk mispricing, poor liquidity and exit strategies, insufficient attention to building up robust project pipelines, and overall weak market standards for additionality. Our recommendations aim to address these barriers and close the persistent disconnect between catalytic actors and private capital. We reframe blended finance as an ecosystem that requires coordinated action with clear identification of responsibility for leadership among AE governments, EMDE governments, MDBs, DFIs, philanthropies, private investors, CRAs and ECAs.

The report is structured as follows. Section I defines blended finance, its core objectives, and the diverse risk, return, and liquidity preferences of private investors that catalytic investors must accommodate. It also offers a diagnostic overview of current mobilization trends and the state of private capital engagement in blended finance.

The following five sections identify the main challenges and opportunities to scale blended finance. For each of them we provide a diagnosis, followed by our suggested reform path, and the respective role and responsibilities per stakeholder organized by relevancy.

Section II identifies enhancing transparency and standardization as the first and foremost opportunity to scale blended finance. Section III examines how to overcome institutional conservatism to unlock investment. We elaborate on how outdated risk perceptions, conservative credit rating methodologies and regulatory misalignments have compounded risk aversion among investors, limiting EMDE investment flows broadly and blended finance transactions specifically. Section IV focuses on how enabling liquidity and exit options is key to deploying and recycling capital at scale. Section V argues for an increased focus on the early-stage project preparation, ensuring a strong project pipeline to attract private investors. Section VI advocates for upholding additionality, as a key principle to bring market discipline while enabling impact. Section VII concludes, reiterating our key messages for actions.

Objectives, Methodology and Approach

Objectives

The core objective of this report is to diagnose the system-level design failures (i.e. regulatory, institutional, informational, and financial) that limit the effectiveness of blended finance in mobilizing private investment. Two guiding questions shape the methodological approach: 1) What are the persistent structural features of blended finance that limit private sector participation at scale? 2) What conditions must change to enable institutional capital to engage more meaningfully in blended finance transactions?

By combining literature review, stakeholder insights, and a data-informed modeling attempt, the mixed-method methodology aims to ground its findings in both what practitioners know from experience and what investors need to allocate capital to blended finance at scale.

Qualitative Research

The primary source of analysis is a series of in-depth semi-structured interviews with 65 stakeholders across the blended finance ecosystem. Interviewees include representatives from international and local commercial banks, asset owners and managers, impact investors, guarantee facilities, MDBs, DFIs, Development Cooperation Agencies, philanthropies, CRAs, ECAs, academia and Non-Governmental Organizations (NGOs).

They spanned five geographies: Africa, Asia, Europe, North America, and South America. A list of the interviewees for the report is in Annex III. However, it is not exhaustive, as several practitioners asked to remain anonymous so that they could speak freely. The specific interview questions were tailored to the interviewee's background, but generally they focused on the interviewees' experience with blended finance, the challenges they had faced, and the opportunities they saw for scale. These conversations provided the foundation for identifying the five structural barriers and developing the reform recommendations discussed in the report.

Quantitative Research

In parallel, the report sought to assess the investment case for blended finance using a machine learning–based portfolio simulation. The goal was to use data on the performance of blended finance transactions to simulate expected returns of an artificial blended finance fund or project based on its characteristics and historical performance. This information was meant to assess the viability of risk-return profiles of blended finance.

To accomplish this, we trained a neural network on past blended finance transactions, utilizing preprocessed data with features such as deal type, fund/project structure categories, the amount of concessional capital, market factors, and performance metrics like Internal Rate of Return, Distributions to Paid-in, and Total Value to Paid-In, to forecast the fund performance.

However, the effort revealed a critical barrier: data quality and availability.

To overcome this data gap, we pursued two primary data aggregation strategies. First, we consulted existing databases such as the Global Emerging Markets (GEMs) Risk Consortium Database—the world's largest credit risk database focusing on DFI finance in EMDEs, Convergence—the global network for blended finance, and Pitchbook—a leading platform for private capital markets analysis. Despite reviewing multiple databases, none offered the level of granularity, standardization, or reliability required to run a meaningful simulation. That said, GEMs and Convergence provide useful insights into the overall state of the market, and the characteristics of certain types of deals. They are used for that purpose in this report, keeping the limitations in mind.

Second, we engaged directly with public and private financial institutions active in blended finance to request access to internal, deal-level datasets. These discussions were crucial in mapping the data landscape and revealing how institutions classify and store investment data. Yet despite this progress, confidentiality barriers, fragmented documentation practices, and the lack of standardized reporting templates limited our ability to create a consistent, comparable dataset across transactions and institutions. We further discuss this challenge in Section II. Annex I provides a detailed overview of the model architecture and the data issues encountered, along with the full model code for replication by others with access to more complete data.

Implications of the Methodology

The findings of this report are grounded in lived practitioner experience and shaped by the systemic absence of investor-relevant data. This dual lens—qualitative depth paired with quantitative constraint—underscores a core theme: scaling blended finance is not just a matter of structuring better deals, but of redesigning the underlying system that governs information, incentives, and institutional behavior.

Section I

Introduction to Blended Finance and Private Sector Mobilization

Core objective of blended finance

Despite representing 40% of the global population and contributing 66% of global Gross Domestic Product (GDP) growth over the past decade, EMDEs continue to face a serous shortfall in SDG-related funding.[1] As of 2022, only 5% of the USD 489 trillion in global financial assets were held within EMDEs (excluding China), highlighting their limited domestic financial depth.[2] Meanwhile, global investors allocate only around 10% of their portfolios to EMDEs, representing a drop from 12% a few years prior and underscoring the persistent underinvestment in these markets relative to their economic importance.[3] Even within the realm of Environmental, Social, and Governance (ESG)-focused funds, EMDEs capture merely 6% of total allocations.[4] Many large and mainstream institutional investors completely avoid these markets, further exacerbating the capital shortfall in EMDEs.

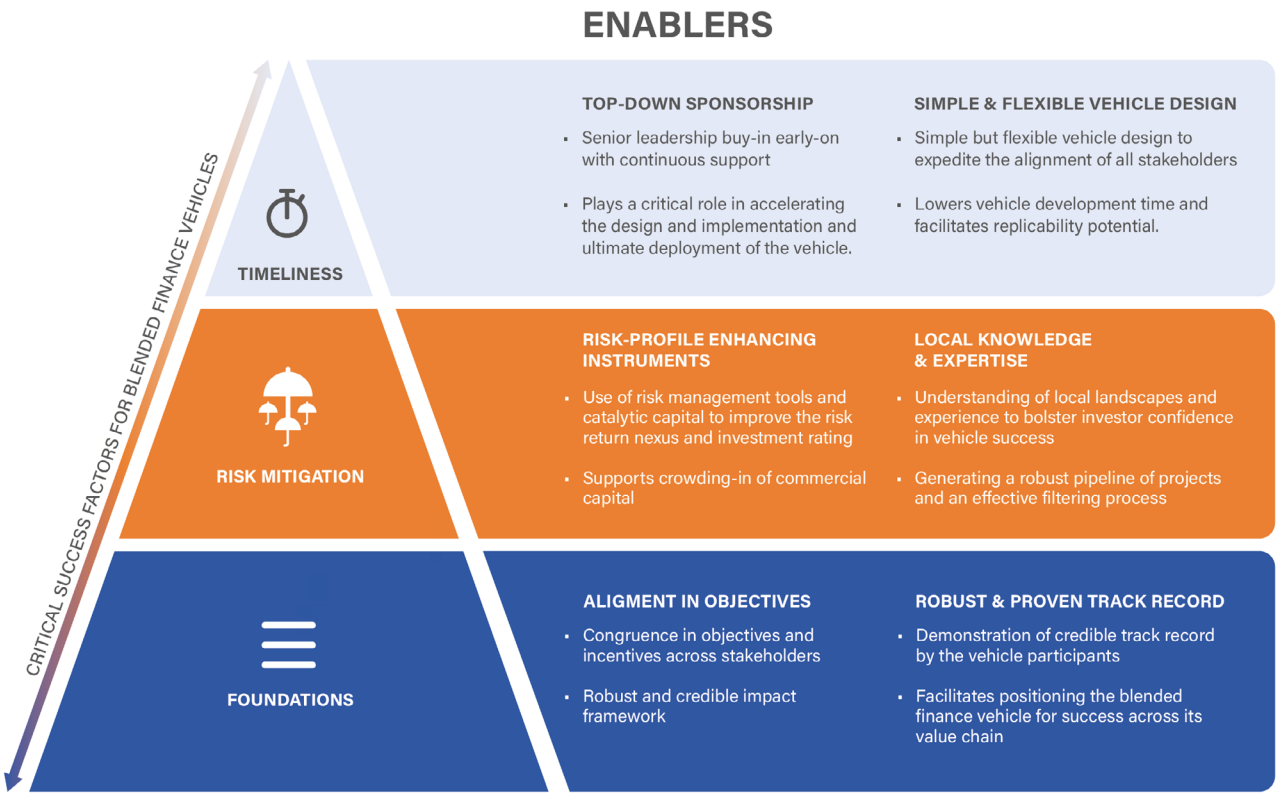
The barriers to mobilizing capital flows into EMDEs are numerous and multifaceted, as has been documented by multiple sources.[5] High risk perceptions, psychological biases, poor sovereign credit ratings, currency risks, limited knowledge, and inadequate capacity for due diligence all contribute to the reluctance of investors. Institutional mandates, strict risk/return objectives, and prudential regulations further constrain the ability of investors to engage with these markets, reinforcing the cycle of underinvestment.

Adding to these challenges, many institutional investors remain unaware of the substantial benefits EMDEs offer. Many developing economies are on a 'catch-up' trajectory, driven by favorable demographics, rising workforce participation, and increasing middle-class demand, converging toward productivity and income levels of AEs. For instance, earnings growth is expected to reach 19% in EMDEs (excluding China), nearly double that of AEs, during the 2025-2029 period.[6] Furthermore, EMDEs offer structural diversification that can generate uncorrelated returns, helping to reduce long-term portfolio risk.[7]

As noted in the Introduction, blended finance is increasingly seen as a promising way to overcome the above-mentioned market barriers so that private capital eventually flows without the need for subsidies. Yet the concept remains debated, with definitions and uses varying across institutions. For this study, we define blended finance as the strategic use of public and philanthropic capital to attract additional private investment aligned with the SDGs. By layering capital with different risk tolerances and return expectations, blended finance enables private investors' participation where they would otherwise stay out.

Successful blended finance vehicles are built on three key enabling layers: foundations, risk mitigation, and timeliness.[8] Strong foundations align stakeholder objectives, establish credible impact frameworks, and build on a proven track record. Risk mitigation tools, such as guarantees or first-loss equity, help improve the risk-return profile, supported by local expertise that strengthens project pipelines. Timeliness is driven by top-down sponsorship and simple, flexible deal structures that accelerate deployment and scale. Figure 1 illustrates this.

Figure 1: Blended Finance Success Elements



Source: ILN/SMI 2024.[9]

Within this structure, we distinguish between risk mitigation (i.e. market-based tools that reduce exposure to specific risks without altering project economics), and concessional finance that enhances returns through below-market capital.[10] Both mobilize private investment but differ in purpose, use, and financial implications.[11]

The blended finance market was stable in 2024, totaling USD 18.3 billion. This total is down from USD 23 billion in 2023, but continues the long-term growth in the market, with annual volume increasing by an average of USD 1.7 billion since 2020.[12] Large-scale climate finance deals drove this increase, with seven transactions exceeding USD 1 billion in 2023 and three in 2024.[13] Over the last couple of years, there has been an increased willingness among private investors to engage in blended finance models when structured to balance risks and returns effectively, underscoring the potential of leveraging private capital at scale when global institutions and private actors align on priorities and execution.[14]

A new wave of large-scale initiatives is transforming how capital flows into EMDEs, driven by bold action from governments and financial institutions. The United Arab Emirates has launched ALTÉRRA, a USD 30 billion platform, including a USD 5 billion Transformation Fund specifically designed to de-risk climate investments.[15] In Southeast Asia, Singapore's Financing Asia's Transition Partnership (FAST-P) is collaborating with the Asian Development Bank, Temasek, and others to mobilize USD 5 billion for green and sustainable infrastructure.[16] The Indo-Pacific Partnership for Prosperity, led by Global Infrastructure Partners and KKR, is bringing together public, private, and philanthropic actors to channel USD 25 billion into regional infrastructure.[17] Other major efforts (e.g. the GAIA Platform, supported by FinDev Canada, the Green Climate Fund, and MUFG, and the SDG Loan Fund,

backed by Allianz, FMO, Skandia, and the MacArthur Foundation) are each mobilizing over USD 1 billion to unlock private investment for SDG-aligned priorities, including climate resilience in emerging markets.[18] [19]

The challenge now lies in ensuring that this momentum is sustained and scaled. Mainstreaming blended finance with traditional finance to enhance the private capital mobilization demands a nuanced understanding of investors' diverse risk-return profiles and liquidity preferences. The following section unpacks these variations and examines their implications for the effective design of blended finance structures.

Understanding the private sector: Diverse risk, return, and liquidity preferences

Private sector actors, including banks, institutional investors, insurers, family offices, impact investors, and philanthropic foundations, operate under distinct risk-return expectations, liquidity requirements, and regulatory constraints. Their exposure to prudential regulation varies widely, influencing how and when they participate in blended finance. Macroeconomic shifts and interest rate cycles further shape their risk appetite and investment strategies.

Banks typically prioritize liquid, short-term investments to manage balance sheet risks and maintain the flexibility needed to meet near-term obligations.[20] This risk-averse posture makes them hesitant to engage in long-term commitments, such as those required for infrastructure-focused blended finance. This dynamic is especially pronounced in the U.S., where capital markets dominate long-term financing, unlike in Europe or Asia, where banks play a more active role in infrastructure lending in general and in EMDE markets in particular under the guarantee cover of ECAs.[21] Moreover, as discussed in Section III, Basel III prudential regulations significantly restrict banks' capital flows to EMDEs by requiring high capital charges for investments in EMDEs.

Institutional investors, including asset owners and asset managers, are not directly constrained by statutory regulations but are governed by fiduciary duty, typically interpreted as a mandate to maximize financial returns while minimizing risk.[22] They also require relatively liquid assets to meet withdrawal demands and enable portfolio rebalancing, making exit options a key consideration.[23] As such, they prioritize investments with strong risk-adjusted returns, aligned with their asset-liability duration needs, and often favor pre-structured pools of vetted opportunities.[24] Given their preference for liquidity and standardization, securitized structures are often the most effective way to channel institutional capital toward EMDE projects. Conversely, they are generally cautious about the illiquid and bespoke nature of many blended finance vehicles.[25]

Although typically cautious and constrained by prudential regulations (as outlined in Section III), insurance companies are increasingly engaging in blended finance as a strategy to invest in resilient infrastructure across EMDEs. These investments not only support the SDGs but also help expand insurance markets by lowering the cost of risk through improved resilience and affordability of premiums. One notable initiative is the Infrastructure Task Force of the Insurance Development Forum, a public-private partnership supported by the insurance industry and international organizations, which in 2024 released a blueprint to build a pipeline of investable infrastructure projects.[26] In parallel, insurers are also playing a role in enabling institutional participation in MDB-structured B-loans by insuring credit exposures to DFIs and MDBs. This strategy allows institutional investors to gain AAA-rated exposure while supporting high-impact projects in emerging markets.[27]

Driven by development and sustainability objectives, specialized impact investors and philanthropic foundations are generally more willing to participate in blended finance. However, this does not imply a blanket acceptance of below-market returns. According to GIIN's 2024 market survey, 74% of impact investors expect competitive, risk-adjusted returns.[28] Philanthropies, in particular, prioritize capital recycling and are increasingly exploring structures that offer upside potential in the event of outperformance. As a result, many are gravitating toward blended finance vehicles that embed mechanisms for recovery or windfall participation, aligning impact with financial sustainability.[29]

Structured to manage and grow wealth across multiple generations, family offices are not pressured to deliver quarterly returns or meet the same liquidity requirements as institutional investors. As a result, they can remain invested for extended periods, aligning with the long-term capital needs of blended finance investments in EMDEs.[30] Crucially, they are uniquely positioned to unlock early-stage capital for climate solutions and play a catalytic role in scaling blended finance due to their flexible mandates and direct control over capital, which allow them to move quickly into high-risk, high-impact opportunities, validating business models and reducing perceived risk for more conservative investors.[31]

Thus, while specialized impact investors, family offices, and some European or Asian institutions exhibit stronger impact-oriented commitments, the broader market—particularly in the U.S.—remains focused on financial returns.[32] This highlights the need for blended finance structures to deliver competitive returns while embedding impact in ways that resonate with investors' goals. Furthermore, the interest rate environment also plays a critical role in shaping investor appetite for EMDEs and illiquid assets: In periods of rising rates, investors demand higher returns to justify reduced liquidity, as yields from risk-free assets become more competitive. Blended finance structuring must consider these dynamics.

Despite the above-mentioned structural constraints in mainstream finance and regulation, three major trends are currently working in favor of blended finance. First, the shift in global trade dynamics and geopolitical realignments has created a persistently uncertain macroeconomic environment, one in which investors increasingly value illiquid assets that offer stable, long-term returns.[33] As a senior MDB official described, "*Due to factors such as climate change, volatility in financial instruments, higher interest rates, a rapidly changing regulatory space, and deglobalization, sustainability in returns in becoming more important to the private sector. The*

concessional part of blended finance offers an attractive option for these private sector players to get some resilience or locked in returns. A big advantage which was not there two years ago."

Second, private credit has seen exponential growth over the past 15 years, emerging as the fastest-growing segment in the financial system, and is expected to double in value over the next five years.[34] Third, European pension markets are transitioning from defined benefit to defined contribution schemes, a shift likely to have countervailing effects on investments in blended finance. While the winding down of defined benefit schemes in Europe may reduce allocations to higher-growth, riskier assets like those in EMDEs, defined contribution plans prioritize return enhancement and growth. This creates an opportunity to channel capital into EMDEs through blended finance.[35] The OECD also notes that this transition is driving a broader emphasis on risk diversification, further reinforcing the case for emerging market investments.[36]

Mobilization trends and progress

Private sector mobilization in blended finance is growing, but progress remains uneven. Leverage ratios (i.e. measuring the amount of commercial capital from public, philanthropic and private sources mobilized per dollar of concessional capital) are a common benchmark. Recent data shows increased leverage ratios and larger deal sizes, signaling stronger interest.

As of 2024 the average leverage ratio stood at USD 3.76 for all commercial capital, and USD 1.99 for specifically private sector capital.[37] Notably, over the past two years, the private sector has surpassed MDBs and DFIs as the largest source of commercial capital for blended finance.[38] This shift is a positive sign for blended finance's ability to attract private sector capital and decrease reliance on MDBs and DFIs. Larger transactions tend to attract higher leverage, as deals exceeding USD 100 million had a total average leverage ratio of USD 5.46, and USD 2.70 for private sector capital.[39] Moreover, commercial investor-led transactions outperformed the leverage ratio of those led by development agencies or NGOs. This underscores the demonstration effect of private sector-led structures. Geographically, Latin America and sub-Saharan Africa saw high leverage ratios, but actual private capital mobilization was more significant in East Asia and the Pacific, reflecting lower risk perceptions in that region.[40] The lack of a stronger demonstration effect in higher-risk markets raises important questions discussed in Section VI.

The mobilization ratio (i.e. measuring private finance mobilized per dollar of public finance committed) is another key metric. However, reporting on mobilization remains inconsistent, often lacks comparability, and is not always transparent (as discussed in Section II). Guarantees, in particular, are under-reported when not called, creating gaps in visibility. For example, until 2024,[41] the OECD only tracked actual claims, while MDBs included exposure to default in their reporting.[42]

Based on this evidence, "*concessional public finance is [still largely] leveraging non-concessional public funds to support private initiatives, with limited participation from de-risked private capital.*"[43] This remains a critical area for reform, as discussed in Section VI.

Section II

Opportunity 1: Enhancing Transparency and Standardization

II. A. Diagnosis

Lack of transparency

Our research confirms that despite the OECD's including transparency in their *Blended Finance Principles for Unlocking Commercial Finance*, the ecosystem remains markedly opaque. Transparency is not just a normative ideal; it is foundational to building trust, enabling accountability, and mobilizing private capital at scale. Yet, across transactions, there is a striking absence of accessible, standardized data—particularly on pricing, risk allocation, and impact performance. This lack of visibility fuels uncertainty, distorts risk perception, and undermines investor confidence. The result is inflated costs of capital, constrained capital flows, and a blended finance market that continues to underperform its potential.[44]

Economic literature consistently highlights uncertainty as a major obstacle to investment.[45] In blended finance, limited visibility into financial structures exacerbates information asymmetries, deterring private sector participation and, in some cases, causing investors to withdraw entirely.[46] Similarly, a lack of data transparency hinders prudential regulators' ability to accurately assess the true risks associated with investing in emerging markets through blended finance or the other approaches highlighted in Section III, such as loan co-financing through DFI finance.[47]

A critical gap in transparency persists, not only regarding returns for private investors but also concerning the financial performance of the catalytic capital providers themselves. Limited data on loss and returns for concessional capital providers hinders the assessment of whether concessionality levels were justified, undermining the ability to ensure that subsidies are both efficient and effective.

For instance, as mentioned in Section I, while high leverage ratios are often cited as a measure of success in blended finance, many stakeholders cautioned that they sometimes reflect commercially viable projects that required minimal concessional support. In such cases, excessive subsidies may diminish financial additionality and contribute to the misallocation of scarce concessional resources.[48]

The lack of transparency in blended finance is further entrenched by the widespread use of confidentiality or non-disclosure agreements. While protecting commercially sensitive information is valid, confidentiality agreements are often overused, blocking access to disaggregated country- and project-level data. As one practitioner noted, "*the reason we do not have any specific impact data for the GEMs database or others is because of these contracts*." This undermines the ability to evaluate the effectiveness and value for money of blended finance in low-income settings.[49]

Claims of commercial confidentiality are frequently exaggerated and run counter to the position of many private sector actors who advocate for more transparency, including clearer classification of mobilized capital by type.[50] This opacity not only weakens accountability but also limits investors' ability to assess and price risk accurately by forcing them to rely on perception rather than data. Powerful actors, in turn, can exploit this ambiguity, as the CEO of an EMDE-focused investment firm put it, *"non-transparent markets engender abuse."*

The lack of transparency surfaced as a core challenge in our direct experience. As mentioned in the Methodology and detailed in Annex I, we attempted to simulate a portfolio to assess the risk-return dynamics of blended finance from a private investor's perspective. However, the exercise could not proceed due to a fundamental lack of accessible transaction-level data. Essential variables, such as realized returns, risk-sharing mechanisms, capital structure details, and exit pathways, were either absent, inconsistently reported, or withheld due to confidentiality restrictions.

Each existing database operates in isolation, with distinct focus areas and data formats, and none met the requirements for our modeling. The GEMs database lacks transaction-level detail and omits key variables such as concessional capital structures, risk-sharing mechanisms, and longitudinal performance metrics. Convergence's database offers only limited insight into project- and fund-level performance, especially regarding realized returns, cash flows, and risk indicators. PitchBook, while detailed on emerging market funds, does not reliably identify blended finance deals, making them indistinguishable from traditional investments. All three datasets continue to rely heavily on voluntarily submitted, self-reported information with no standardized format, further limiting their accuracy, comparability, and value for rigorous analysis.

This opacity amplifies the structural complexity already embedded in blended finance, making it harder to measure impact, align incentives, standardize processes, and structure deals effectively.[51]

Complexity Premium

While innovation is essential in blended finance, without disciplined design and oversight, it has bred the kind of complexity that now undermines its promise. In blended finance, the layering of bespoke structures, fragmented standards, and uncoordinated incentives has created a 'complexity premium'—a buffer to cover higher legal, advisory, and administrative costs. This premium does not reflect underlying economic risk; it reflects system friction that erodes private investor participation in blended finance. In markets where risk is already high, added complexity becomes a dealbreaker.

At the core of blended finance lies a multilayered capital structure that integrates varying levels of seniority, risk exposure, and return expectation (see Figure 2).

Figure 2: Common Capital Stack in Blended Finance

Tranche 1 Senior	The senior tranche is designed to target institutional investors who have traditionally higher returns expectations and lower risk tolerance. The senior tranche will often be reinforced by an effective risk rating, whether formal or by proxt, to improve buy-in from investors by inspiring confidence. The goal of the senior tranche is to offer stakeholders credible and robust risk-adjusted returns, while allowing them to benefir from diversification as well as the desired impact. The senior tranche may take shape in the for of equity or debt, depending on the fund mandate and scope.
Tranche 2 Mezzanine *(Not always necessary)*	If present, the mezzanine tranche is commonly designed to target DFIs, MDBs, and other providers of catalytic capital. Mostly guided by an impact mandate, these investors will generally seek moderate levels of return, be more risk-bearing, and provide longer-term patient capital. Some blended finance vehicles will not include the mezzanine tranche in their capital stack to maintain simplicity in the structure and expedite the fundraising process. The mezzanine tranche will also be determined by the level of protection required by senior investors.
Tranche 3 Junior	The junior tranche is designed to target philantrophic capital, including foundations and other institutions with concessional capital. These investors are heavily motivated by their impact agenda and are concerned primarly with capital preservation. It is often the case that junior investors play the first-loss role within the capital structure of blended finance fund and generally represent between 10-20% of the fund's total size. The specific magnitude depends on the fund's investment thesis and senior investor risk appetites. It is pivotal to ensure that junior investment capital is credible and reliable to be effective in attracting and mobilizing senior tranche investors.

Source: SMI/ILN.

Unlike standardized financial products, blended finance deals demand extensive due diligence to map out how risks and returns are distributed, an effort many institutional investors view as inefficient and resource-intensive. Given the range of stakeholders involved, each with different mandates and regulatory constraints, even basic deal terms can become a negotiation. This adds time, cost, and complexity to every transaction.

These challenges are compounded by the slow, process-heavy nature of public institutions, which often act as lead arrangers or providers of catalytic capital. For institutional investors used to streamlined dealmaking, long drawn-out timelines are a major deterrent. The Green Climate Fund, for instance, has an accreditation queue that can stretch up to three years.[52] Some investors report that a USD 250 million deal can take up to five years to close due to extended negotiations over risk mitigation terms.[53] These delays introduce inefficiencies that discourage early-stage involvement, with many investors opting to engage only once foundational hurdles are resolved, leaving critical funding gaps in the initial project phases.[54]

A prominent illustration of this complexity is the use of guarantees. According to a 2025 IMF analysis, because guarantees and insurance contracts often involve complexity, conditionality, or uncertainty, investors typically demand a premium (above fair value or risk-free rates) to compensate for these risks and analysis costs. Even the time required to evaluate these instruments contributes to higher expected returns.[55]

Even when MDBs do create structures aimed at simplifying access for institutional investors, complexity often re-emerges at the implementation level. The IFC's Managed Co-Lending Portfolio Program (MCPP) and the African Development Bank's (AfDB) Room2Run synthetic securitization were both designed to streamline investor exposure to emerging market credit.[56] While they lowered entry barriers for private capital, they demanded extensive internal resources, regulatory negotiations, and bespoke risk-sharing arrangements, making them difficult to replicate across institutions. MCPP's delegated origination fit IFC's model but does not translate easily elsewhere. Room2Run, though groundbreaking, required lengthy engagement with CRAs to confirm the effectiveness of its risk transfer.[57] These cases highlight a central tension: instruments that simplify participation for investors often remain deeply complex behind the scenes.

A contributing factor is the limited technical capacity among some key actors, particularly in areas requiring specialized structuring expertise. Structuring these deals requires fluency in non-traditional instruments, complex incentive design, and specialized legal arrangements. Yet many legal and investment teams within development finance institutions are trained primarily in conventional public lending.[58] As a result, they may lack the expertise needed to assess, design, or negotiate these layered structures effectively, making it harder to align interests with private investors, manage risk, or scale participation.

Moreover, the complexity does not end at the capital stack structuring level. It extends to the underlying assets themselves, which are often illiquid or unfamiliar, such as infrastructure, agriculture, or renewable energy in emerging markets.[59] Box 1 provides two examples of how tackling asset-level complexity through the creation of simple financing instruments (green bonds and private loans) can help crowd in private capital. This simplification requires extensive on-the-ground due diligence to lower transaction costs (legal, administrative, and compliance) of operating in nascent unfamiliar markets; an additional complexity to consider in structuring the blended finance structure.

BOX 1 – Practical Models Tackling Asset-Level Complexity

Launched in 2020, the AGRI3 Fund supports sustainable agriculture and forest conservation in regions facing high deforestation risks. Formed through a partnership among UNEP, FMO, IDH, and Rabobank—and later joined by the Global Environment Facility and the SDG Impact Finance Initiative—it tackles the dual challenge of perceived risk and limited investor experience. By offering guarantees and other credit enhancements to financial institutions, AGRI3 enables local lending through simple private credit by local financial intermediaries backed by technical assistance. This approach combines straightforward financial products, capacity-building, and environmental goals to make investment structures more accessible and effective.[60]

The Amundi EGO Fund, launched in 2018 by Amundi and the IFC, targets green bond markets in emerging economies. IFC provides a first-loss tranche to de-risk the portfolio, attracting institutional capital to otherwise overlooked markets. The fund's simplicity lies in its focus on standard green bonds, paired with robust support for local issuers to meet high-quality standards. This blend of risk mitigation and issuer engagement helps lower barriers for investors entering unfamiliar markets while advancing climate goals.[61]

B. Solutions

Thriving financial markets depend on three pillars: transparency, standardization, and liquidity.[62] We focus on the first two pillars in this Section and elaborate on the third in Section IV. These are not just technical features, they are market enablers as also recognized by the latest 2025 FCDO-commissioned report, which convened industry leaders to identify barriers and opportunities for mobilizing capital in EMDEs.[63] Equipped with them, blended finance can evolve into a mature marketplace, supporting the coordination of public and private sectors and capable of mobilizing private capital at scale.

Adequate Data Infrastructure and Transparency

Given that current disclosure practices fall short of enabling private investors to accurately assess risks and opportunities, proper data infrastructure must be developed for comparability, allowing investors to benchmark projects, price risks appropriately, and determine which segments of the capital stack offer the best risk-adjusted returns across countries, sectors, and asset types.[64]

Two key reforms are needed to support rigorous performance benchmarking and informed investment decisions. First, a single consolidated database should be established with active participation from the private sector to address fragmentation and improve data credibility. It should capture detailed information on capital structures, risk-sharing arrangements, and financial performance, to enable the evaluation of how concessional capital influences risk allocation, capital mobilization, and financial outcomes.

Second, the market needs harmonized reporting of key financial indicators, including internal rates of return, default and recovery rates, leverage ratios, and subsidy levels. These metrics must be applied consistently across instruments, sectors, and geographies to support benchmarking and enable risk-adjusted pricing. Some progress is underway. The publication of GEMs data is a positive step, as is the IFC publicly disclosing concessionality levels in its blended finance portfolio.[65] Yet these efforts remain the exception rather than the norm.

To build market confidence and unlock large-scale private capital, MDBs, DFIs, and fund managers must commit to quarterly, standardized, and disaggregated disclosures. This should include detailed cash flow data by tranche, effective fund-level and tranche-level returns, administrative and hedging costs, and time-series data on commitments, disbursements, and exits. Segmentation by region, sector, and transaction type is essential to enable meaningful analysis and replication of successful structures. Without this level of transparency, efforts to scale blended finance will remain constrained by information asymmetries and mispriced risk.

Greater Standardization and Aggregation Platforms

In parallel, the ecosystem must move toward greater standardization, aggregation, and simplification, while preserving the flexibility to adapt to diverse market conditions. Standardization should create a common framework for innovation and replication, not impose rigidity but enabling proven models to scale without starting from scratch each time. As a senior executive in development finance expressed, *"What we need now, more than anything else, is to achieve scale through standardization (and transparency and liquidity), more than more innovation in the form of highly bespoke but non-replicable transaction."*

A recent study led by the Sustainable Markets Initiative (SMI) and the Investor Leadership Network (ILN) emphasized the importance of harmonizing core elements such as fund structures, definitions of sustainable projects, and frameworks for both financial and impact returns.[66] Standardized structures, widely accepted across MDBs, DFIs, and private investors, would: i) reduce due diligence burdens by providing clear, pre-vetted risk-sharing mechanisms, ii) accelerate deal closure by eliminating the need for customized structuring, and iii) increase investor confidence by offering predictability and transparency in the financing models.

Aggregation platforms are designed to pool capital and projects around pre-agreed principles, standards, and metrics while allowing for multiple financial structures to be deployed according to needs. Capital aggregation and blending are usually done at the platform level with further capital mobilization on a project-by-project basis.[67] It offers a practical way to apply standardized approaches while enabling diversification benefits and 'complexity premium' reduction. A study of asset owners has revealed that aggregation platforms are reassuring because they enable the sharing of financial and operational risks, impact scaling and the pursuit of ambitious sustainability projects they couldn't fund alone.[68]

One example is the NeoT Offgrid Africa (NOA) platform, developed by Meridiam (majority shareholder), EDF, and Mitsubishi, which aggregates various forms of capital from multiple public and private sources to finance zero- carbon energy and mobility. A pioneer project consolidated thousands of solar receivables in Côte d'Ivoire into a single investment vehicle, supported by a

local currency guarantee from the AfDB.[69] As a platform, NOA can adapt its investment approach to various sectors and regions within Africa. This flexibility is less feasible with a single fund, which typically has a fixed mandate and investment criteria. This structure combined aggregation, risk mitigation, and local market adaptation, showing how blended finance can scale effectively.

Another prominent example is the FAST-P, which aims to mobilize up to USD 5 billion, was launched by Singapore in 2023 to accelerate decarbonization and promote sustainable infrastructure across Southeast Asia, beyond pilot investments.[70] Instead of negotiating bespoke blended finance structures for every project, FAST-P provides a centralized and pre-structured framework that pools public and private capital, allowing for rapid scaling of investments across a robust pipeline of projects.[71] It acts as an orchestrator, coordinator, aggregator, and enabler rather than a traditional fund manager. Ultimately, aggregation platforms can be beneficial for both capital contributors and recipients, as they offer flexibility and cater to various financing needs, thereby facilitating effective capital deployment and ensuring alignment of interests.

These examples showcase how beyond individual platforms, regional aggregation structures offer significant potential to unlock scale, reduce fragmentation, and enhance coordination in blended finance. By pooling projects and capital across multiple jurisdictions under a shared framework, these platforms enable diversification, streamline due diligence, and support the replication of investment models across markets. Rather than structuring transactions on a deal-by-deal basis, regional aggregation provides a pathway to build portfolios aligned with pre-agreed principles, metrics, and risk-sharing arrangements. This model also strengthens engagement with local institutions and regulatory contexts, helping to align international capital with domestic priorities. Moreover, regional platforms support risk diversification across countries and technologies, increase pipeline visibility, and create the conditions for more standardized documentation, covenants, and investor disclosures. In many cases, aggregation can also enable more advanced market-facing structures, such as securitization, which, as discussed in Section IV, also strengthens liquidity.

Convergence recently launched the Scale Private Investment Mobilization Project, aiming to standardize Private Investment Mobilization Models. This framework is designed to enhance the replicability of 12 distinct investment models, ultimately expanding the project pipeline and improving bankability at both the project and portfolio levels.[72] Similarly, British International Investment and the Boston Consulting Group have developed two tools to streamline and scale blended finance: a fund typology and a scorecard. The typology brings clarity by classifying funds based on purpose, risk, and investor profile, while the scorecard provides a consistent way to assess fund design against key objectives and best practices.[73] Together, they aim to reduce complexity, lower transaction costs, and attract more private capital to emerging markets. However, for being recent, the effectiveness and market acceptance of these initiatives remains to be seen.

Likewise, the launch of SCALED[74]—a public-private initiative set to debut in 2025 aimed at standardizing and accelerating blended finance deployment—signals growing momentum to institutionalize the infrastructure needed for scale. Emerging from the Hamburg Sustainability Platform, SCALED represents a coalition of governments, development banks, and major insurers committed to removing structural barriers to large-scale investment in sustainable development. By establishing a dedicated company to serve as a market-wide service provider, SCALED focuses on creating standardized financial vehicles and facilitating coordination among investors and asset managers. This approach marks a shift from bespoke, project-specific efforts to a more systematic

model designed to reduce transaction costs and expedite capital deployment. If successful, SCALED could become a foundational enabler for replicable blended finance vehicles, demonstrating that the necessary market infrastructure for scale is not only essential but now within reach.

To align investor and issuer incentives, blended finance structures should be designed to ensure replication by reducing complexity over time. As transaction frameworks become standardized, both recipients and investors should benefit from lower structuring costs and faster execution. That said, such standardization must remain pragmatic, and the various project stages, diverse risk profiles, and structural complexities of investments in EMDEs should be taken into account. With greater transparency on what works, the field should standardize, only customizing when strictly necessary.

C. Who must act

Stakeholder	What They Must Do
Governments (AEs & EMDEs)	- Set minimum disclosure requirements for publicly supported blended finance transactions. - Align public procurement and concessional funding with transparency mandates to drive market discipline. - Shareholder Governments: Align MDBs/DFIs internal incentives and governance structures to prioritize transparency as a strategic imperative for private sector mobilization.
MDBs / DFIs & Donor Agencies	- Leverage access to project-level information to disclose standardized transaction-level data, including pricing, risk-sharing mechanisms, concessionality levels, and impact metrics. - Support the development of open-access deal registries and centralized reporting platforms. - Pilot standardized term sheets, impact measurement frameworks, and reporting templates across key sectors.
Private Investors (Active in Blended Finance)	- Publicly advocate for transparent, comparable, and standardized deal documentation and use global platforms (e.g. COP, FfD, UNGA) to strengthen efforts. - Actively participate in the co-development of standardized reporting templates and data standards through investor working groups. - Share anonymized or aggregate data on blended finance transactions, including concessional terms, outcomes, and risk-sharing structure. - Engage with data providers and show interest in better data infrastructure regarding blended finance.
Philanthropic Foundations	- Provide catalytic funding to develop the public infrastructure needed for data transparency (e.g., platforms, registries, dashboards). - Use concessional capital to incentivize adoption of standardized reporting templates across the ecosystem. - Require transparency commitments as a condition for concessional support or technical assistance.
OECD and Coordination Platforms	- Convene MDBs, DFIs, CRAs, and private investors to build consensus and secure institutional commitments. - Lead the development of harmonized reporting frameworks and taxonomies for blended finance. - Monitor adherence to transparency standards and promote accountability across the ecosystem.
Data Providers / Market Intelligence Firms	- Establish a consortium to launch a pilot centralized investment intelligence platform focused on EMDE blended finance transactions. - Integrate and harmonize datasets using standardized formats and common taxonomies. - Prioritize core metrics such as credit performance, risk mitigation structures used, and mobilization ratios. - Pilot the application of machine learning models to blended finance datasets to identify risk-adjusted return benchmarks according to capital structure, country and sectoral characteristics.

Section III

Opportunity 2: Advancing Regulatory Innovation and Accurate Risk Pricing

A. Diagnosis

Perceived vs Actual Risk in EMDE Investments

While risk premiums vary by country, sector, and project, overall, EMDEs pay a higher risk premium on their investments compared to advanced economies.[75] Between 2012 and May 2023, developing countries paid, on average, 200 basis points more for international capital than developed countries, with regions such as Africa facing even higher costs.[76] This higher risk premium constrains the amount of capital they receive and is a barrier to scaling up blended finance specifically and EMDE investments more broadly. Such a high risk premium stems in part from significant real risks involved in investing in EMDEs. It is, however, also due to inflated perceptions of risks in EMDE factors.

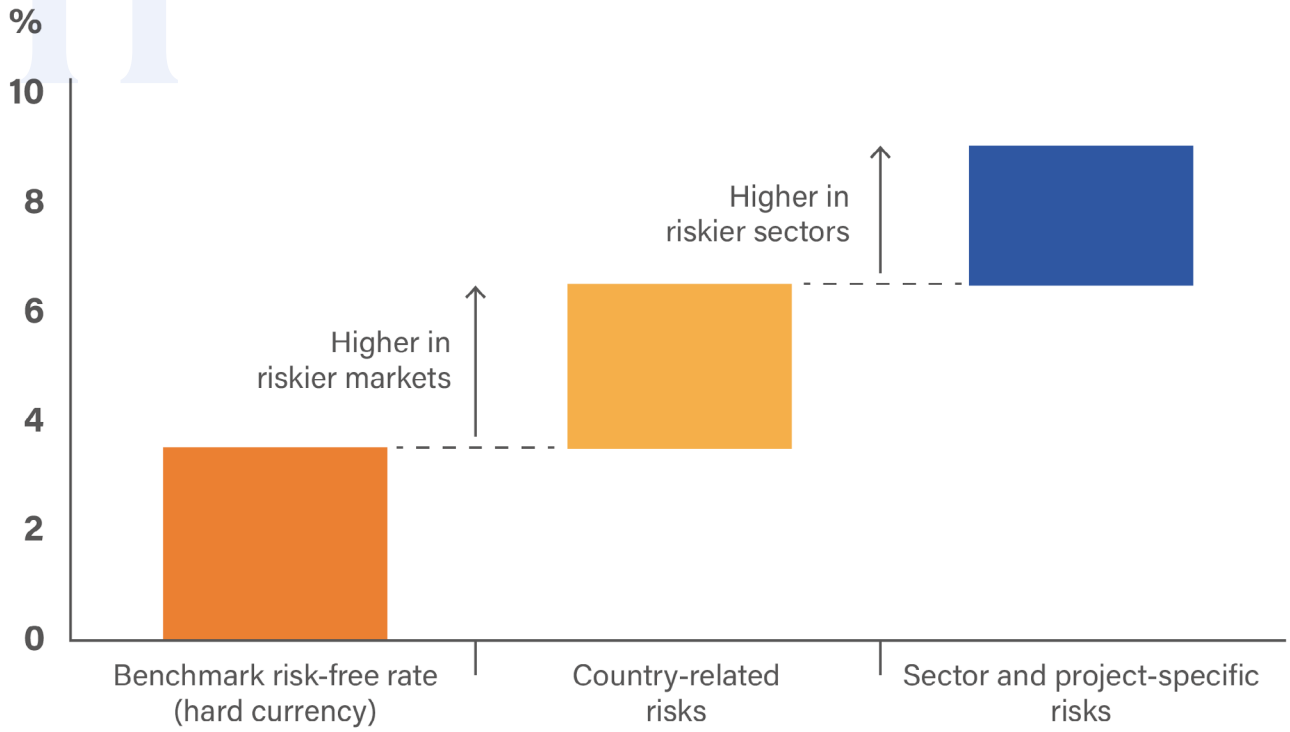
Efforts to scale up investments must address both these real and perceived barriers. Risks associated with EMDE investment fall into two broad categories: country risks that apply to all investments in a given nation, and project risks associated with the specific investment often added on top of the country risk.[77] Investors often cited sovereign, political, currency, and liquidity risks as their top concerns for investing in EMDEs.[78] Table 1 outlines these different risks.

Table 1: Top Investment Risks for EMDEs Cited by Investors

Risk	Description
Political	Includes the potential for war or civil conflict to disrupt profits and the potential for regulatory changes that impact a company's operations.[79] A clean energy project, for example, may face political risk of the government abandoning an offtake agreement made in advance of the project, leaving the project without a buyer for its energy.
Sovereign	Sometimes considered a sub-set of political risk, sovereign risk arises when a government is unable to repay its debt obligations and thus may take actions that threaten the national economic environment.[80] A sovereign in such a dire situation could conduct actions that threaten the profitability of the project, including expropriation of the project's owners and suspending access to foreign currency.[81]
Currency	Refers to changes in the exchange rate between local and hard currencies that can disrupt investor profits.
Liquidity	Investors may be unable to sell off assets quickly without experiencing significant declines in market price.
Project	Factors determining success of the project, including access to capital, bankable off-take agreements, stability of supply chain, and expected profits relative to debt.

Investors assess both project-level and macroeconomic risks to determine the overall risk of an investment. These risks are real and must be acknowledged to build a realistic and resilient strategy. Figure 3 shows how these combined risks affect the cost of capital.

Figure 3: Simplified illustration of the composition of the cost of capital



Source: IEA(2024), Reducing the Cost of Capital, IEA, Paris.

A core finding of our research, however, is that there is a misalignment between the real and perceived risks of investing in EMDEs. Experienced EMDE investors expressed this viewpoint most consistently, with one seasoned impact investor saying there is *"clearly a risk perception that is negative towards Africa and EMDEs, and if you look at the numbers, it is not justified."* The president of a different impact investment firm noted that their strategy targeting EMDEs was *"a response to what we saw on the ground, with perceived risk being a lot higher"* than actual risk. Stakeholders, including an economist from an insurance firm, senior officers at multiple DFIs, and an investor at an EMDE focused investment firm, all echoed this sentiment.[82]

This position aligns with a growing body of literature suggesting that the risks involved in EMDE investment are often overestimated by investors.[83] It also reflects the increased prevalence of data demonstrating the resilience of EMDE investments. World Bank data, for example, finds that the average non-performing loan rate in EMDEs in 2022 was just 3.24%, only 2.29% higher than the average in AEs.[84] For trade finance, the ICC states that from 2007-2022, Africa's default rate was 0.95%, lower than that of Europe, which was 0.97%.[85] Data from the GEMs database on MDB-backed projects, moreover, shows default rates for low-income countries and lower-middle income countries to be 4.4% and 6.3%, compared to 3.1% and 2.3% in upper-middle income and high-income countries respectively.[86] This finding led the database's organizers to conclude that the *"risk of investing in emerging market businesses is lower than commonly perceived."*[87] In project finance, Moody's finds the 10-year cumulative default rate for projects in EMDEs from 1983-2020 to be 8.4-8.9%, compared to 4.9% for non-EMDEs.[88] The narrow gap in default rates between AEs and EMDEs is further mitigated by strong recovery rates, as the GEMs data and Moody's data show recovery rates

for EMDE investments to be 79.2% and 72.4% respectively, which are as high or higher than the average for AEs, further limiting the downside risk to investors.[89]

Inflated perceptions of risk are also noticeable in the pricing and performance of blended finance risk mitigation tools. The Blended Finance Task Force finds, for example, that half the time, the cost of currency hedging is more than twice of what the future suggests it should have been.[90] They also find that for organizations such as Multilateral Investment Guarantee Agency, (MIGA), the expected loss provisions of political guarantees is often higher than the actual claims by a factor between 7 and 20.[91]

As previously noted, each dataset has clear limitations. Still, they collectively point to the same conclusion: the performance gap between EMDE and AE investments is narrower than commonly perceived. As one DFI CEO noted, while no single dataset is definitive, *"the direction of travel does provide hard evidence that perceived risk is more than real risk."*

The most likely source of this gap is investor unfamiliarity with EMDEs. Investors often favor markets that are geographically or culturally closer to home.[92] Most global investors are geographically removed from EMDEs, contributing to their frequent neglect, an effect amplified by risk aversion, where perceived threats outweigh potential returns.[93] The limited availability of reliable data further reinforces these perceptions, leaving investors with little basis to reassess risk (as highlighted in Section II). This leads to inflated risk perceptions, driven by three main investors' behavior types.

First, investors often rely on outdated perceptions of EMDE risk. As an EMDE-focused asset manager firm put it, *"people still have this idea that emerging markets are exposed to the original sin"* of having investments inevitably derailed by commodity shocks, currency swings, or political instability they are ill equipped to handle. While this was once true, the investor emphasized *"the reality is that EMDE companies have been operating in this environment for a long time, and they have developed strategies to deal with it."*

Second, limited understanding and information about EMDEs makes investor perceptions more vulnerable to factors unrelated to actual credit risk. The IMF finds that countries in sub-Saharan Africa pay a premium at issuance of their debt even after controlling for risk ratings.[94] The IMF cites 'structural factors' (i.e. limited financial development, high informality, weak budget transparency, and low institutional quality) that are not traditionally considered in risk ratings as the drivers of this risk premium. Yet weighting these structural factors remains subjective[95], and surveyed practitioners differed in their interpretation of these findings, with an MDB official seeing evidence of bias, while a CRA representative saw validation of risk.[96] Research, including from the AfDB, shows that sentiment-driven herding behavior often distorts African sovereign debt pricing.[97] This suggests that while some of the premium reflects real risks, unfamiliarity and perception gaps remain a major factor.

Third, investors' incomplete understanding of EMDEs prevents them from identifying attractive investments. Evidence shows that bond market investors treat sovereign debt in Africa as a single asset class.[98] This tendency overlooks the wide variation in EMDE performance and economic conditions. Some countries, for example, have dollar-pegged currencies or strong foreign reserves from extractive industries, making them less exposed to currency risk. Treating EMDEs as a single, high-risk category prevents investors from identifying lower-risk opportunities and tailoring strategies accordingly.

As such, investments in EMDEs are held back both by the real risks, and the lack of familiarity on behalf of investors, which leads them to overestimate those risks and increase the cost of capital.

Limitations of Conventional Risk Rating Systems

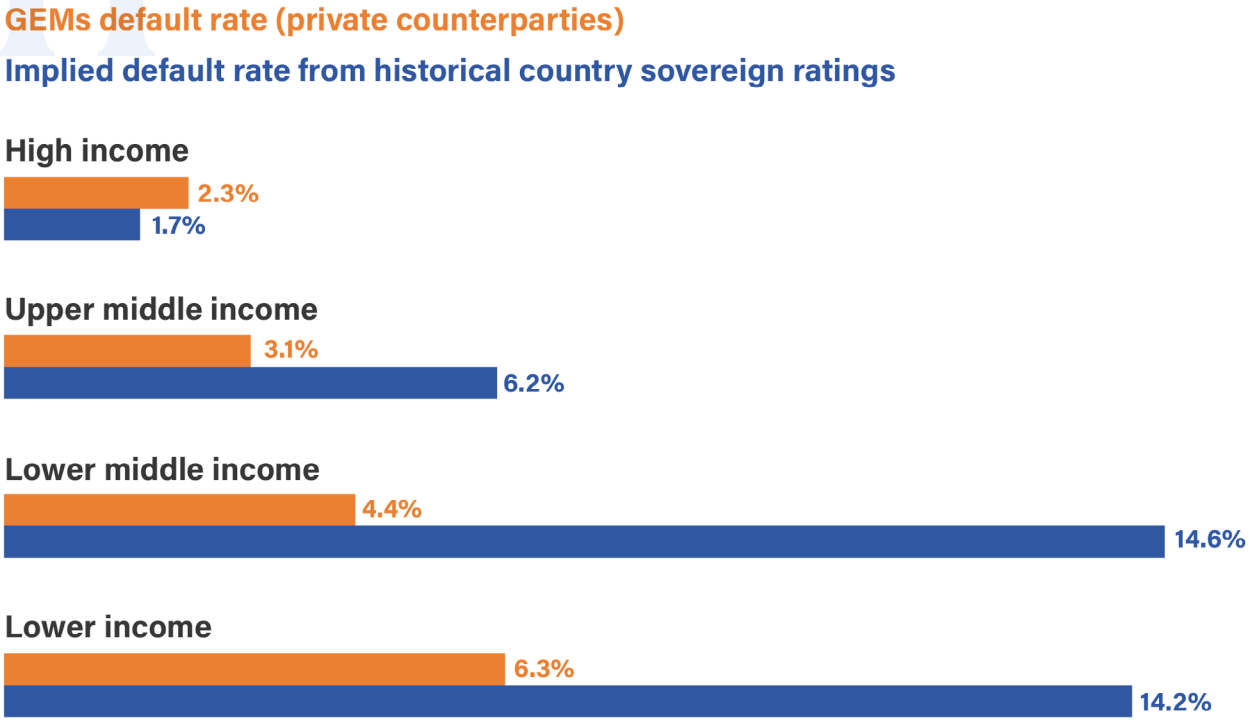
Current credit rating practices pose major challenges for EMDE investments seeking creditworthy ratings. While real risks in EMDE environments contribute to this, outdated models and structural conservatism within CRAs also play a role. As a result, ratings may not fully reflect actual risk and can unnecessarily restrict capital flows. Several factors limit the credit ratings EMDE projects can achieve.

To start, CRAs shifted towards providing more conservative ratings following the 2008 Global Financial Crisis (GFC).[99] Researchers generally link this shift to efforts by CRAs to rebuild their credibility after the GFC, and to stricter post-crisis regulations such as the Dodd-Frank Act in the United States and the establishment of the European Securities and Markets Authority.[100] Their results suggest that since more optimistic ratings engender more scrutiny, CRAs may lower their ratings "*beyond what is justified*" based on a company's fundamentals.[101] These effects have been found across US corporates, European FIs, and EMDE sovereigns, suggesting a system-wide depression of ratings.[102]

While research shows a general shift in CRA behavior after the GFC, ratings actions during the COVID-19 pandemic revealed stark regional disparities. In 2020, AEs received just six total downgrades from Moody's, S&P, and Fitch, compared to 125 in EMDEs.[103] Some gap is expected since AEs are typically more resilient to shocks, yet the scale is striking given that AEs contracted twice as fast as EMDEs and saw debt burdens rise by 11 percentage points more.[104] This raises questions about why AE ratings remained largely stable while EMDEs faced widespread downgrades.[105] The result is a particularly harsh ratings environment for EMDEs: of the 117 with public long-term credit ratings, only 12 now hold investment grade status.[106]

Low credit ratings for EMDE sovereigns are significant because of CRAs' continued use of the sovereign ceiling: the idea that no project or corporation can be rated above its sovereign. While this is no longer applied universally, empirical research shows it still plays a major role. Experts have found sovereign ratings to be a "*significant determinant*" of corporate ratings in EMDEs, even after controlling for firm and macroeconomic factors.[107] For instance, some studies show the ceiling continues to constrain bank ratings, particularly for banks rated close to the sovereign.[108] In project finance, S&P's 2024 report notes that fewer than 4 percent of rated transactions exceed the sovereign rating, and most of those required "*unconditional and irrevocable*" guarantees to do so.[109] In a post-GFC and post-pandemic environment where EMDE sovereigns have seen widespread downgrades, the persistent use of this ceiling further constrains their ability to secure investment-grade ratings. It may also lead to ratings that are overly punitive, as Figure 4 shows the average default rate for private counterparties in the GEMs database is significantly lower than the rate implied by the sovereign ratings, especially in lower-income countries.

Figure 4: Average Default Rate for GEMs database and Country Ratings



Source: IFC based on GEMs and S&P, October 2024.[110]

These country-level limitations are compounded for the infrastructure and project finance asset class specifically, through punishing rating methodologies. Moody's generic project finance scorecard, for example, shows that 30% of the rating for projects with amortizing debt is based on the debt service coverage ratio (DSCR), which is the ratio of net income in a given year to the debt service costs incurred in that year.[111] For their power generation project scorecard, DSCR accounts for 35%.[112] A DSCR of 1 implies that a project breaks even.[113] Under this methodology, any project with an expected DSCR below 1.4 is treated as 'junk grade' for this sub-factor, substantially dragging down its overall rating.[114] As such, projects that are minimally bankable or expected to break-even are relegated to functionally the same status as projects expected to operate at a loss. Only projects with extremely large expected profit margins (i.e. with income 40% above annual debt payments) are, by this metric, treated as creditworthy.[115]

When assessing infrastructure and project finance, moreover, CRAs often focus on whether these structures are effective at reducing the probability of default. They place much less emphasis on recovery values. Fitch, for example, issues separate recovery ratings that do not factor into credit ratings except for in "*limited circumstances*."[116] Moody's mentions a willingness to notch up based on expected recovery values, but neither of their generic project finance or power generation methodology documents discuss that process, though they note that these documents may not "*fully capture*" their consideration of recovery rates.[117] S&P issues recovery ratings that are separate from and do not impact issuance ratings for project finance.[118] The focus on default rates reflects investor priorities and data availability, but it overlooks the relevance of recovery rates for project finance and higher-risk EMDE transactions, which are underrepresented in CRA-rated assets. Evidence from Moody's shows that infrastructure often achieves higher recoveries, a resilience factor largely ignored in credit ratings.[119]

Conservative methodologies at the country and project level from CRAs stem in part from a lack of data in EMDEs, reinforcing the need for ecosystem-wide transparency (as explained in Section II). Models used by CRAs to rank and assess credit ratings are built for and calibrated on wealthy countries with thousands of data points and are thus more difficult to apply to data-constrained EMDEs.[120] One MDB official expressed concern that CRAs are using the best version of their model for AEs and *"retrofitting it to EM space."* While the absence of quantitative data could perhaps be compensated for with additional qualitative information, there is little evidence to suggest CRAs have such information, as none of the big three CRAs have presence on the ground in most EMDEs.[121] In response to the paucity of data, CRAs seem to, in the eyes of many stakeholders, err on the side of caution and give lower ratings.[122] CRAs themselves suggest that the disclosure of the GEMs data has been a huge leap ahead in terms of revealing the track record of MDB/DFI finance in EMDEs, but even this data is not disaggregated and complete enough to support an update of the CRAs' models.[123] As a seasoned EMDE investor and GEMs member summarized, "*GEMs only has 8,000 data points for private sector finance. That's too small [for CRAs]. But it's the best we have*."

An examination of one of Swedish International Development Cooperation Agency (SIDA)'s guarantee portfolios shows how conservative assumptions, reportedly grounded in CRA methodologies, can lead to excessive risk coverage and potentially inefficient capital deployment. Box 2 illustrates this.

Box 2: What the SIDA Guarantee Portfolio Reveals About Risk and Rating Assumptions

SIDA shared with us an anonymized loan report for one of the funds they guarantee. SIDA, like many state-backed guarantee providing organizations, often relies on CRA ratings along with its established framework to estimate Expected Loss, as a function of default probabilities.[124] We performed a simplified stress test to assess whether the 25% guarantee coverage exceeds the likely risk exposure. In a highly conservative scenario, where 100% of outstanding balances on loans in arrears and 50% of those on loans in non-arrears are assumed lost, total potential losses amount to less than 20% of the disbursed portfolio. In a more realistic scenario, assuming losses only on loans in arrears beyond 90 days, the loss rate falls to just 2.4%. While clearly a worst-case estimate, it is important to acknowledge that, as with any insurance product, guarantees are designed to cover unexpected losses. The presence of a low realized loss does not inherently mean the initial risk was overstated. Nonetheless, when guarantees are repeatedly structured with wide buffers, driven by strict adherence to CRA ceilings or insufficient market data, they may reflect or reinforce overly conservative assumptions. This can undermine their catalytic role by limiting the capital mobilized relative to the actual risk.

Together, these factors make it very challenging for sustainable development projects in EMDEs to achieve creditworthy ratings. As mentioned earlier, blended finance was designed, in part, to address this challenge by de-risking investments and in turn ostensibly improving credit profiles. In practice, however, blended finance has struggled to deliver on this promise. Several factors help explain these underwhelming results.

Notably, blended finance transactions and structures find it difficult to get rated by CRAs. Two related reasons are cited for this. First, blended finance projects are often built in countries with no sovereign ratings, in which case it is nearly impossible to obtain a rating from a CRA.[125] Second, CRAs do not have existing methodologies for blended finance transactions, given the novelty and often bespoke nature of these transactions.[126] As a result, they cannot rate them, at least at the speed required to get a project off the ground. In light of these issues, CRAs have begun engaging with blended finance projects and a handful of rated blended finance funds have emerged (e.g. the Emerging Africa Infrastructure Fund, which received a Moody's A2 foreign currency long-term issuer rating with a stable outlook when the underlying project ratings averaged B/BB).[127]

When CRAs rate blended transactions, their ratings often undervalue the innovative risk mitigation tools attached to the transactions: Ratings for blended projects still very rarely exceed the sovereign ceiling, despite the credit enhancement mechanisms often attached, which can significantly lower actual risks relative to the sovereign.[128] Since most EMDE sovereigns are rated below investment grade, this severely limits the ability of projects to achieve creditworthy ratings.[129] While there are individual examples of transactions exceeding the sovereign ceiling, such as the Elazig Hospital in Turkey, these instances remain rare.[130] So rare, in fact, that a senior executive involved in the project called it *"miraculous"* that the project was notched over the sovereign.[131] Making this more common will require more effective structuring of blended transactions to meet CRA requirements, and increased efforts from CRAs to develop methodologies that recognize the credit enhancement provided by blended transactions.

Since blended finance infrastructure transactions benefit from additional protective provisions, one would expect them to receive recovery assessments higher than those for traditional infrastructure. When blended finance transactions do receive a CRA recovery rating, however, it is often lower than those from traditional infrastructure.[132] This is due in part to the limited data in blended finance, which prevents deviations from the base recovery rate.[133] This result suggests the same dynamic established above: limited data as the core barrier to blended finance, and a seemingly overcautious approach from CRAs given that limited data.

The shortcomings of rating agencies outlined in this section do not imply any willful wrongdoing from CRAs. Indeed, the most favored explanation for these shortcomings from stakeholders is that, like any for-profit business, CRAs respond to incentives. There are many. Reputational risks and regulations after the GFC incentivized them to err on the side of caution in their ratings. The significantly larger amount of revenue they receive from rating wealthier countries incentivizes them to devote more resources and attention to those markets. As a former CRA official described in an interview, *"CRAs allocate resources to where they make the most money. They make very little money from Africa, so they allocate very little resources there and take shortcuts such as the sovereign ceiling. As such, as complex new blended finance schemes are developed, CRAs are not going to allocate a ton of resources to rate each new one."*

Moreover, while the analysis above suggests that CRAs may be overly harsh with ratings in EMDEs, it does not suggest that EMDEs lack reason for caution. The investment environment in lower-income countries is often constrained by policy and regulatory frameworks that are not entirely conducive to private sector participation. Ratings, to an extent, reflect those conditions. Yet, those difficult conditions are precisely why tailored

investment structures and innovative approaches such as blended finance are needed, and why the failure of conventional risk models to capture these nuanced structures is an issue.

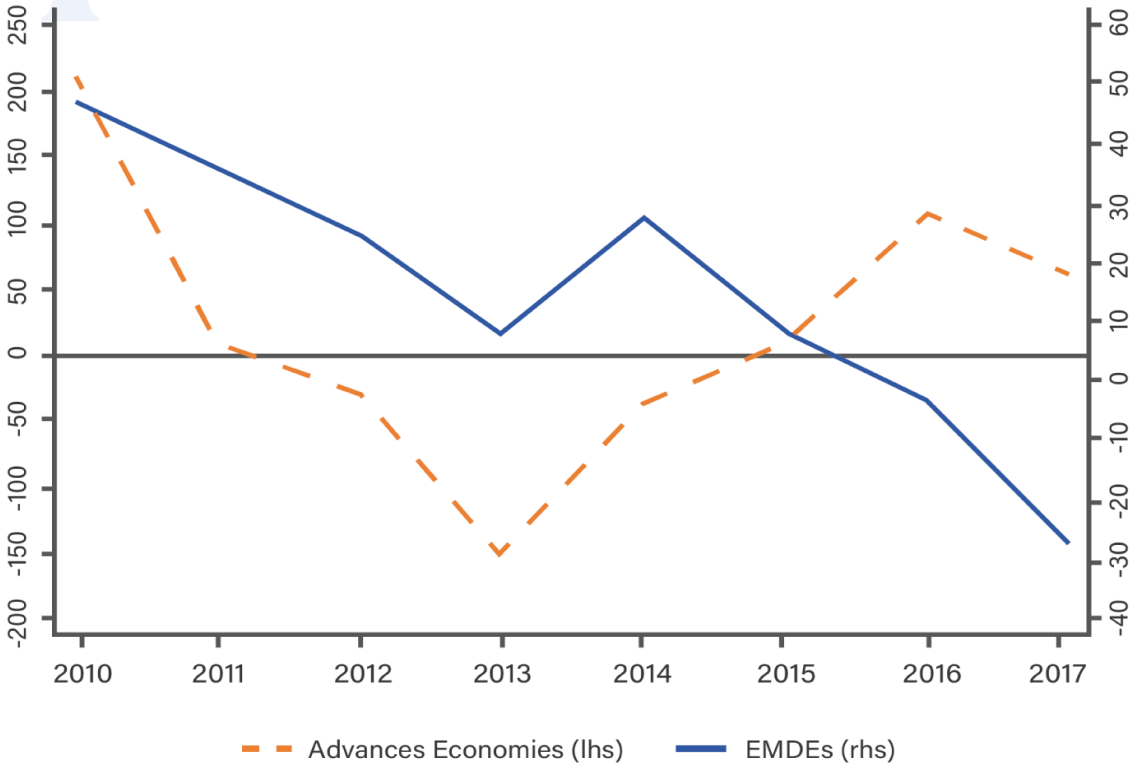
Challenges with mainstreaming blended finance are not limited to CRAs' role. For instance, an UNCTAD study found conflicting evidence in the literature regarding the existence of bias in CRA ratings against EMDEs, but regardless held that *"financial markets consider much more than ratings when making pricing and investment decisions, so there is no guarantee that a narrow focus on addressing rating bias will result in lower borrowing costs and better access to global capital markets for developing countries*."[134] Practitioners similarly held mixed views on how much influence CRAs have. While opinions did not align strictly by stakeholder type, interviewees from banks and institutional investors generally viewed CRAs as a more significant barrier than those from impact-focused or specialized firms. One banker described CRAs as *"gods"* in the industry, and another called their disengagement *"the biggest barrier"* to scaling blended finance. In contrast, an EMDE-focused impact investor noted they had not used CRAs in a decade, and a philanthropic investor said that during fundraising efforts in Africa, credit ratings never came up.[135] This stark discrepancy likely reflects the presence of CRA ratings in regulations governing banks, as discussed below.

Fortunately, the political momentum for addressing these issues is growing. In September 2023, in the Paris Pact for People and the Planet (4P), 16 heads of states committed to establish and implement a roadmap with CRAs, regulators, governments and investors to improve the accuracy of credit ratings and country risk assessments.[136] 4P plans to establish a coalition to implement this commitment, though available details on its progress are scarce. The private sector has also begun pushing for more transparent and advanced ratings approaches, such as through the B20's Finance & Infrastructure Policy Paper At the 2024 G20 Summit in Brazil. [137] Moreover, CRAs are showing openness to make models evolve. One example is their expansion of rating methodologies for supranational institutions recognizing portfolio risk transfer criteria after their engagement in assessing the 2018 Room2run synthetic securitization led by the AfDB.[138]

Limitations Imposed by Prudential Measures

Post-crisis regulations, as previously noted, have unintentionally constrained capital flows to EMDEs. The volume of finance flowing to EMDEs in the decade following the GFC, particularly from banks in the US, UK, and EU, dropped precipitously.[139] While some of this decline reflects post-crisis deleveraging, Figure 5 shows that US bank lending to EMDEs continued to fall even after overall lending recovered, including to other AEs.[140] While not conclusive, this trend suggests the drop in lending to EMDEs is unlikely to be explained simply by cyclical factors. By penalizing banks for EMDE exposure, current regulations restrict access to affordable capital, making it harder for EMDEs to prove creditworthiness and shift investor perceptions.

Figure 5: US Banks' Cross-Border Lending to AEs and EMDEs (USD billions)



Source: Center for Global Development, 2018.[141]

Under Basel III, bank capital requirements are tied to the risk-weighted average of assets, which is directly influenced by credit ratings assigned by CRAs, as illustrated in Table 2 for corporate exposures.[142]

Table 2: Risk weights for banks' exposure to corporates by credit rating under Basel III

Risk weight table for corporate exposures juristictions that use external ratings for regulatory purposes						
External Rating of counterparty	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	Below BB-	Unrated
"Base" risk weight	20%	50%	75%	100%	150%	100%

Source: Basel Committee on Banking Supervision.[143]

Due to persistently low CRA ratings for EMDEs since the GFC, and the application of sovereign ceilings, EMDE corporates rarely achieve investment grade status. Furthermore, Basel III regulations limit how much banks can rely on their internal models by capping the capital relief achievable compared to standardized approaches.[144] Thus, even if a bank conducted its own due diligence and concluded that CRAs were overly conservative in their assessment of an EMDE project, they would still be required to hold substantial amounts of capital to compensate for the CRA's estimated risk.

These regulations embed CRA ratings into the core of the global financial system. While CRAs claim to offer only advisory opinions, the central role their ratings play in Basel rules, directly influencing banks' capital requirements regardless of internal assessments, contradicts this. This does not mean CRAs are the sole barrier, but underscores how investors, CRAs, and regulators collectively reinforce a system that limits capital flows to EMDEs.

As with CRAs, prudential regulations pose even greater challenges for infrastructure project finance in EMDEs, where limited funding and complex contract structures make securing credit ratings particularly difficult and costly.[145] Under Basel III, the standard risk weights for project finance are 130% for the pre-operational phase and 100% for the operational phase, extremely high numbers that make project finance very costly for banks.[146] A managing director from a large European bank forcefully noted, *"these regulations have destroyed benefits of project finance and long-term infrastructure loans. We have a good track record in developing countries that has been wiped out by the standard approach that has been put on to banks."*

While Basel regulations apply to banks, other prudential frameworks similarly restrict EMDE investment, particularly in infrastructure. For example, the EU's Solvency II regulations regulating insurance impose a 49% capital charge on infrastructure projects in non-OECD countries, nearly double that for OECD counterparts.[147] The consistently strong track record of infrastructure, including in EMDEs, has led to calls to change these requirements.[148]

World Bank research finds, for example, that a capital charge for Solvency II based on actual credit performance of project loans in EMDEs would be 25% lower, and for high quality project finance in EMDEs (defined as those with PPPs), it would be 33% lower than the current rate.[149] In 2020, the European Banking Authority created the Infrastructure Supporting Factor, which provides a 20% regulatory capital discount for eligible investments in infrastructure.[150] Eligibility, however, is contingent on showing the relative safety of the investment.[151] EBA's most recent report on implementation of the Infrastructure Supporting Factor does not discuss geographic spread, so it remains unclear whether it can be applied to EMDE investments.[152] While these initial adjustments from regulators are a positive sign, more comprehensive steps are urgently needed.

Given the punishing risk weights of this regulatory regime, stakeholders from banks expressed that they will almost always require additional risk provisions, such as guarantees or insurance, common in blended finance, to make EMDE investments viable.[153] It therefore undermines the eventual transition from blending to market-rate finance, the need for which is discussed in Section VI. In the immediate term, however, this still presents a problem because regulations do not always recognize available risk mitigation tools.[154] Basel's current regulations provide no capital relief for investing alongside MDBs and often do not recognize the risk mitigation provided by common MDB products and guarantees that do not meet strict requirements of 'unconditionality' and 'ability to pay out in a timely matter.'[155] The current capital allocation regulations also require treating senior loans with first-loss guarantee as though they are *pari passu* guarantees, thus not considering the de-risking effect of the first-loss tranche.[156]

Another area of prudential regulations with significant ramifications for blended finance is securitization. Since securitization was considered to have played a role in causing the GFC, Basel III and European Solvency II regulations significantly increased the capital charge for securitized investments, rendering such investments very expensive.[157] These harsher regulations present two issues for blended finance.

First, most pressingly, blended finance transactions often employ the same tiered risk structure found in securitization. Regulators may therefore consider blended finance transactions to qualify as securitization, and subject to the requisite high capital charge, even when the assets themselves are not securitized.[158] At present, there is not yet clarity from European regulators regarding which blended finance transactions constitute securitizations and which do not.[159] This lack of clarity creates significant time and legal fees to work around, with that cost and the potential for a higher capital charge likely deterring investment and serving as a barrier to scaling up blended finance.[160]

Second, these prudential regulations constrain blended transactions that actively employ securitization. Securitization is often mentioned as a crucial yet currently underutilized tool for scaling up blended finance (see Section IV).[161] The limited use of securitization in blended finance cannot be fully attributed to regulatory barriers, but high capital charges associated with securitized transactions are certainly a contributing factor. Ongoing discussions in the EU may result in a relaxation of these capital requirements, though the outcome of these reforms remains uncertain.[162]

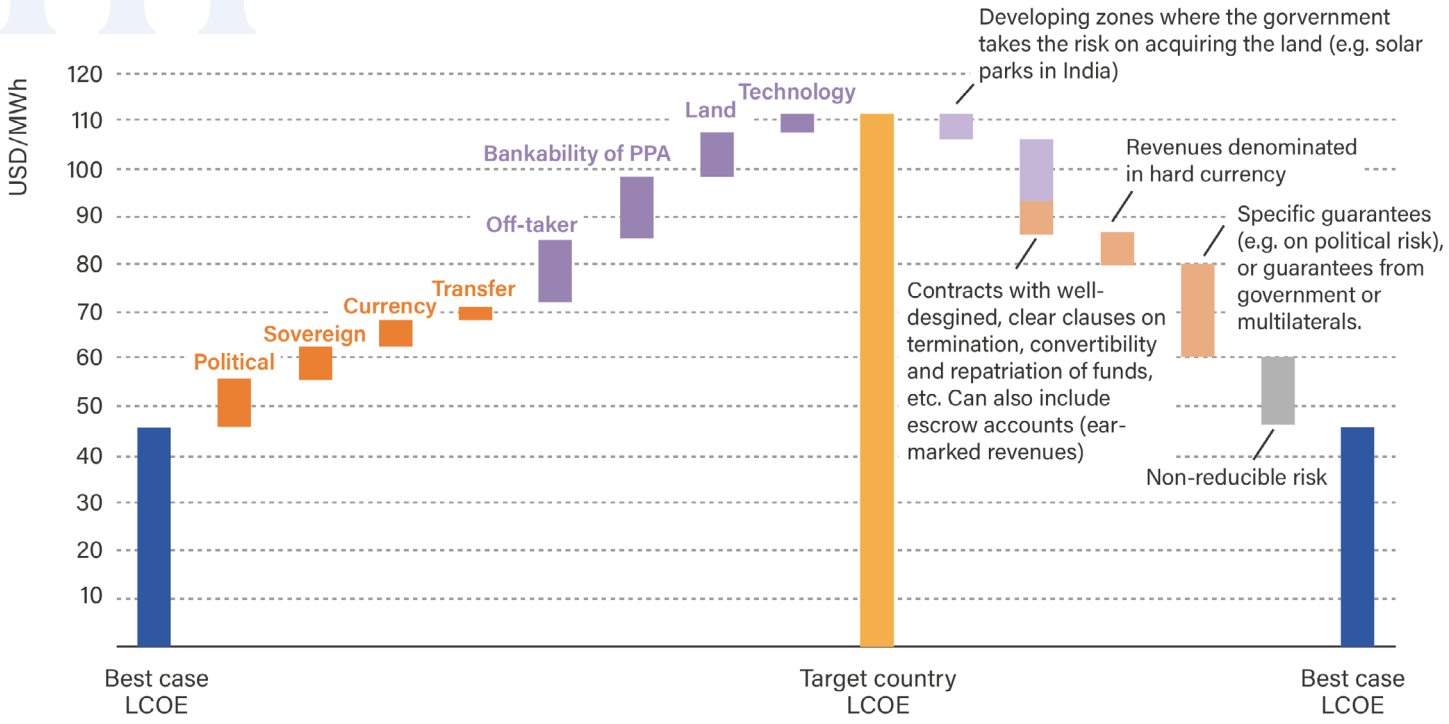
The latest UN Financing for Development paper emphasizes aligning prudential measures with global development goals through multilateral collaboration, capacity building, and blended finance mechanisms.[163] Enhancing regulatory frameworks in EMDEs through technical and institutional support is needed, as is fostering international cooperation to harmonize measures and attract private investment.

B. Solutions

Strategies for Private Investors to Better Assess and Address Risk

To better address real and perceived risks in EMDEs, investors should move beyond the conventional top-down approach—which assumes uniform vulnerability to country risk. Instead, they should adopt a bottom-up strategy that begins with the company's business model, identifies specific geopolitical risk events that could affect it, and applies targeted mitigation measures.[164] Figure 6 illustrates this approach, showing the contribution of specific country and project risks to the cost of capital for a renewable energy project, measured in levelized cost of energy (LCOE), and providing examples of targeted strategies for reducing those specific risks. While initially more time-intensive, this approach avoids blanket risk classifications and enables a more nuanced, project-specific assessment within each investment context. By identifying and addressing discrete risks, it expands the pool of potentially viable investments, helping close the gap between perceived and actual risk, and supporting the scale-up of blended finance. As one experienced EMDE investor noted, *"I do not think that there are risky countries. Risk can be structured away."*

Figure 6: Illustrative Disaggregation of Country and Projects Risks for Cost of Capital



Source: IEA, 2024.[165]

In light of this approach, practitioners have identified six bottom-up strategies to successful invest in EMDEs through blended finance.

First, investors should make use of available tools to address risks present in EMDE investments. Several agencies offer investment guarantees to manage risks, including political, credit, sovereign, and currency risks. The World Bank's MIGA, which focuses on political guarantees, leads the way with annual guarantee commitments totaling over USD 5 billion, significantly larger than other organizations.[166] This number will continue to increase, as in 2024, as the World Bank pledged to triple MIGA's political risk guarantee annual capacity to USD 20 billion by 2030 through one marketplace across the group.[167] Their extensive balance sheet is particularly notable given that they are self-sustaining organization, and as such their ability to take on risk is constrained by capital adequacy models.[168] MIGA achieves this in part through a uniquely comprehensive risk assessment and management framework. They also make considerable use of peer learning networks, such as the Berne Union and GEMs consortium, through which institutions exchange data on credit risk, performance, and risk assessment frameworks.[169] These networks help them "*accurately price and issue guarantees,*"[170] further emphasizing the competition between access to transparent information and the ability to engage in 'high-risk' markets.

Sovereign-backed guarantee organizations, such as ECAs, tend to have flexibility to underwrite riskier projects.[171] One ECA representative exemplified this, saying "*We are active in many emerging markets, and typically have quite a high risk appetite. We committed USD 2 billion in Angola last year, USD 2 billion in Egypt, we're even doing business in Ukraine.*" When asked if they were evidence that the risks are not as if as commonly perceived, they responded "*Look at our statement. We have generated millions and millions for [our government] through our insurance premiums.*"[172]

For currency risks, entities such as The Currency Exchange Fund (TCX), rated AA3 by Moody's,[173] have demonstrated the effectiveness of hedging, as TCX found that pooling currencies into a portfolio can reduce risks by 75%.[174] Their success, however, is concentrated among microfinance and SMEs.[175] Limitations remain for larger and longer-term investments such as infrastructure.[176]

The success of these organizations demonstrates the viability of these tools to manage risks involved in EMDE investments. As perceived risk aligns with real risk, they will become more affordable.

Second, risk mitigation must be enhanced with practical, context-specific, and market-aligned strategies tailored to the realities of EMDEs. This includes deploying blended finance tools such as guarantees and concessional loans in models like the owner-offtaker approach, which stabilizes revenue streams through long-term contracts from the very party owning a stake in the project. A gas compression plant in Senegal, for example, had the country's national electricity company, SENELEC, act as a minority shareholder and the offtaker of the generated electricity. Two officials from different organizations involved in the project interviewed for this report emphasized that SENELEC's dual role in ownership and procurement provided reassurance to private investors, with one saying it "*made all the difference*" in rendering the project viable. When the owner-offtaker is a national entity, it also helps ensure that projects remain resilient to political shifts and shield against political risk effectively.

Third, strong local partnerships must be prioritized. Blended finance initiatives should prioritize building up and involving local financing partners and intermediaries, such as in Amundi EGO Fund and Agri3 Fund (mentioned in Box 1), or in the Sustainable Landscape Guarantee Programme launched in 2018 in India by the Rabo Foundation and USAID, seeking to de-risk agriculture investments by two local financial institutions.[177] The eco.business Fund, managed by Finance in Motion, exemplifies how a well-structured initiative can go beyond traditional de-risking to drive market transformation by engaging with local financial institutions to provide tailored, performance-based financing and capacity-building for sustainable SMEs in agriculture, forestry, fisheries, and tourism, linking improved loan terms to measurable environmental outcomes.[178]

This type of approach benefits project investors and local actors. Investors can lower management fees by delegating responsibilities in terms of identifying the robust investment pipeline, country-specific legal analysis of the financing environment, and dispute settlements. Local financial markets gain exposure to riskier investments than their usual investment in risk-free assets. To facilitate this, governments, fund managers, DFIs, and MDBs, should actively support domestic financial institutions and investors in blended finance initiatives. Strengthening local financing mechanisms will reduce dependency on external capital, mitigate currency risks, and enhance the long-term sustainability of infrastructure and development investments in EMDEs.[179]

Fourth, alignment with national priorities and strengthening of the enabling environment. Blended finance investors may choose to engage actively in policy dialogue with governments to align blended finance initiatives with national development and climate strategies. This engagement can help remove barriers such as unclear regulations,

inadequate incentives, and misaligned risk-sharing mechanisms. In turn, it provides risk mitigation beyond what the blended finance structure can provide and paves the way for the phasing out of blended finance needs.[180] It is similarly important to collaborate with governments to require or promote benefit-sharing arrangements in infrastructure projects. When well-designed and properly managed, these arrangements can effectively ensure that communities impacted by such projects receive tangible benefits. Providing direct advantages to local communities not only helps ensure fair treatment but also fosters local support, which can, in turn, accelerate project development.[181]

This alignment can also occur at the sub-national level. The Urban Resilience Fund (TURF), for example, a blended finance fund created by Meridiam, the Rockefeller Foundation and the Private Infrastructure Development Group, collaborates with city officials in Africa to identify challenges and create infrastructure solutions.[182] The fund focuses on developing essential infrastructure outlined in city resilience plans, ensuring they provide meaningful benefits as part of an overall resilience strategy.[183]

Fifth, there must be openness to new models of bankability. Traditional financing models in power plant investment often require a 'bankable PPA' to consider an investment viable.[184] They therefore often dismiss newer distributed energy models outright, since those projects frequently have several different small offtakes but lack one meaningful bankable PPA. Pentagreen, a partnership between HSBC and Temasek, however, overcame this barrier in Vietnam's solar industry by developing a bespoke credit scoring framework using available credit information on the many offtakers to assess the overall risk of the solar projects and the risk diversification across offtakers.[185] This paved the way for success in the investment. Importantly, this case is not an exception, as an internal study conducted by Pentagreen found that 5-10% of supposedly 'non-bankable' projects in the markets they operate in Asia could actually be bankable with better structuring and risk mitigation.[186] Openness to these new methods of assessing bankability is therefore crucial for investors to unlock the significant potential of EMDE investments.

Sixth, strong fund managers and project sponsors are necessary. Experienced fund managers with specific contexts bring valuable expertise in navigating local regulatory landscapes, assessing market conditions, and structuring financial mechanisms that optimize returns while mitigating operational, financial, and political risks. Strong project sponsors are essential for aligning financing parties, ensuring coherent project design, and securing legally robust contracts that enhance predictability. As an Engineering Procurement and Construction project sponsor explained, *"their role is particularly critical in structuring guarantees that qualify for capital relief, which requires features such as legal enforceability and credit rating substitution."* Their leadership underpins both the credibility and long-term viability of the project.

These six elements, while not being a comprehensive blueprint, synthesize essential insights from seasoned EMDE investors and serve as a practical guide for those seeking to navigate these markets more effectively.

Reforms to Enhance Risk Ratings

In order for blended finance to scale, and for EMDEs to have the opportunity to demonstrate their investment viability, credit ratings must be reformed to more fully incorporate risk and recovery enhancements, such as debt seniority and currency insurance. Enabling this reform requires contributions from several actors throughout the blended finance ecosystem.

More broadly, the credit rating system should be reformed to instill confidence in and ensure fairness of ratings. In interviews, several stakeholders, acknowledging the perception of a bias against EMDEs from CRAs, emphasized the importance of addressing factors behind this perception. One possibility would be publishing the qualitative and quantitative components of credit ratings separately within the same report, particularly in high-potential but undercapitalized markets.[187] This reform could help investor's understanding and enhance transparency to help refute accusations of bias.

At a regulatory level, the International Organization of Securities Commission's (IOSCO) Committee on CRAs has minimal EMDE representation, with no African countries and only two Latin American countries represented.[188] In addition to ensuring EMDE representation on this committee, some call for a new global super regulator of CRAs, on which EMDEs have adequate representation, which would be tasked with ensuring the comparability of global ratings.[189] Finally, the creation of regional credit rating agencies, such as the recently created African credit rating agency[190] could be very useful in capturing the nuances of local risk profiles and emphasizing "*development-driven credit assessment frameworks*"[191] tailored to the region's contexts. While investors interviewed dismissed the idea that they could rely on such assessments for their investment decisions (at least for now), they could influence the behavior of the big three CRAs down the line.

Reforms of the Overly Conservative Prudential Regulations

Prudential regulations should be reformed to facilitate private capital mobilization in EMDEs. This includes reforming the risk weights provided by the regulations to better align with the historical performance of investments such as infrastructure or co-investment with MDBs and clarifying instances when banks can use an internal ratings-based approach.[192] Regarding blending finance, the prudential regulations should be updated to more fully recognize the risk mitigation provided by instruments such as guarantees and first-loss tranches. Finally, even before changing the regulations, clarity is needed on whether blended finance structures are counted as securitization for the purpose of risk weights.

C. Who Must Act

Stakeholder	What they Must Do
Governments (AEs)	- Reform prudential regulations including Basel III and Solvency II to more accurately reflect the realities of EMDE investments. - Push for increased transparency among CRAs and include EMDEs in CRA regulatory bodies.
CRAs	- Incorporate the risk-mitigating features of blended finance (e.g., guarantees, seniority, currency hedging) into ratings. - Increase transparency by disclosing the qualitative and quantitative components of credit ratings. - Engage with regional credit rating agencies and consider context-specific risk assessments to improve accuracy and fairness.
Private Investors	- Learn from successful EMDE investors on how to most effectively identify and structure EMDE investments. - Adopt bottom-up risk assessment strategies that focus on specific project risks rather than generalized country risk. - Use available risk mitigation tools (e.g., guarantees, hedging instruments) more proactively. - Embrace innovative models of bankability (e.g., multi-offtaker arrangements, owner-offtaker structures). - Engage with local financial institutions and intermediaries to enhance market intelligence and execution.
Governments (EMDEs)	- Strengthen regulatory, legal, and permitting frameworks to reduce uncertainty and improve the bankability of sustainable investments. - Support regional CRAs and advocate for their representation in global regulatory discussions to ensure methodologies reflect local realities. - Enhance domestic data availability and disclosure standards to improve transparency and enable more accurate risk assessments by CRAs and investors.
MDBs/DFIs & Donor Agencies	- Increase data transparency to ensure private investors, CRAs, and regulators have the information to make accurate assessments as discussed in Section II. - Use resource and influence to engage with CRAs to develop rating methodologies that better recognize the impact of these innovative instruments as discussed in the "Call to Action on Private Capital Mobilization" published at COP28 in Dubai.[193] - Provide technical assistance and support to domestic financial institutions to strengthen local capital markets.

Section IV

Opportunity 3: Strengthening Liquidity and Expanding Exit Options

IV. A. Diagnosis:

No clear exit pathways

Liquidity remains a critical obstacle to scaling blended finance. In the absence of clear exit pathways or mechanisms for reallocating capital, investors are often locked into long-term, bespoke transactions. Unlike traditional capital markets, where standardized instruments allow for active secondary trading, blended finance structures are typically negotiated privately and designed for 'buy-and-hold' investors.[194] This rigidity clashes with the operational realities of institutional investors, who must manage portfolio liquidity, rebalance exposures, and adapt dynamically across asset classes and geographies. As confirmed by multiple stakeholders, the result is a self-reinforcing cycle: limited liquidity deters private capital, which in turn prevents the development of vibrant secondary markets and stalls price discovery.[195]

No infrastructure for liquidity

A major challenge in blended finance is the lack of tradable instruments, due to the bespoke nature of transactions and absence of standardized legal frameworks (as discussed in Section II). This makes it difficult to pool, securitize, or confidently trade these investments. As a result, investors face inconsistent terms, complex risk structures, and unclear pricing, leading to a market that is both illiquid and opaque.[196]

The challenge is compounded by the limited use of asset transfer mechanisms. Investors must either hold their position until maturity or attempt bespoke secondary sales—an approach that is operationally costly and commercially unattractive. Similarly, surveyed stakeholders consistently identified the limited capital recycling frameworks among MDBs and DFIs to impact liquidity strategies in the blended finance ecosystem. These institutions 'originate-to-hold' and not to distribute.[197] This prevents them from offloading portions of their portfolios to institutional investors, reducing the potential for scaling investments while locking in capital on their balance sheets, constraining their ability to reinvest in new projects. Lastly, local financial and capital markets in EMDEs are generally not deep, limiting the potential for local exits.[198]

Even if structural barriers were resolved, going back to Section II, the lack of transparent pricing and reference data would persist and as a result institutional investors would still default to conservative assumptions and overprice liquidity risk.[199] This opacity undermines confidence and stalls the development of a functioning secondary market.

B. Solutions

To move blended finance from a series of bespoke deals to a scalable marketplace, a deliberate strategy to build liquidity is essential. This includes developing robust secondary markets, standardizing instruments, and implementing exit-enabling mechanisms such

as multi-fund liquidity facilities, offering partial redemption guarantees. Blended finance interventions should be structured with well-defined time horizons, ensuring a gradual transition toward fully commercial financing as projects mature. This approach prevents long-term dependency on concessional capital and fosters sustainable market development.

Predictable liquidity options

Predictable liquidity options such as redemption guarantees and liquidity extension guarantees allow investors to accept longer tenors. A leading example is the Octobre Liquidity Guarantee Facility, created by Cardano Development and Innpact with support from the Gordon and Moore Foundation and the SDG Impact Finance Initiative. The OLGF allows redemptions within 10 business days, activating only when liquidity is constrained—minimizing cost while offering downside protection.[200] This structure enables investors to participate in impact funds without breaching internal liquidity requirements and helps build the broader market infrastructure needed for scale. The OLGF serves as both a practical liquidity tool and a market-building innovation, paving the way for a platform that could eventually support multiple funds across geographies.[201] Another example comes from GuarantCo, set up by the PIDG, which provides multi-year liquidity-extension guarantees and partial credit guarantees for local projects, often up to 20-year tenors.[202] These guarantees provide beneficiaries with the flexibility to either maintain their investment or exit by passing their stake on to another lender or to GuarantCo.[203] There are overall very few examples of such facilities.

A Need to Shift Toward Originate-to-Distribute

Moreover, a more dynamic 'originate-to-distribute' approach is needed—one in which DFIs and MDBs design assets from the outset for future syndication, transfer, or securitization once they reach maturity. It generally requires an ability to warehouse assets during early-stage origination, applying common structuring and disclosure standards, and preparing them for eventual syndication or transfer to institutional investors. Once vehicles prove viable, these institutions should actively facilitate asset transfers to private investors through structured roadshows, transparent data rooms, and pre-agreed syndication terms. This not only enables capital recycling but also gives institutional investors credible entry and exit points, reducing perceived risk and improving portfolio liquidity. Box 3 presents two leading models of the 'originate-to-distribute' approach.

Box 3 – From Origination to Distribution: Tools to Mobilize Private Finance

Co-financing

Co-financing allows MDBs to share financial risks and responsibilities with private investors, development agencies, and commercial banks by syndicating loans. The MDB provides a direct loan to the project sponsor (A-loan) and syndicates a portion to commercial lenders (B-loan), while remaining the primary lender. The borrower repays the MDB, which in turn pays the B-lenders. This structure offers borrowers favorable MDB terms and gives commercial lenders benefits like Preferred Creditor Treatment (PCT),[204] reduced political risk, and lower administrative burden. The limited or nonexistent use of concessional

funding makes this a powerful approach. For instance, the IFC has mobilized over USD 60 billion in B-loan syndications.[205]

Similarly, ILX is one of the leading platforms channeling institutional investor funds towards these loans. In early 2022, ILX launched its first fund, ILX Fund I, with an initial commitment of USD 750 million from APG, Europe's largest pension fund manager, on behalf of ABP and bpfBOUW. Achmea Investment Management later contributed USD 300 million on behalf of Pensioenfonds Vervoer, bringing the total commitments to USD 1.05 billion. Following this, in 2024, ILX converted ILX Fund I into an USD 1.5 billion evergreen and launched its second fund, ILX Fund II, with commitments from Danish pension providers Sampension and AkademikerPension, further expanding its investor base and assets under management.[206] The evergreen fund, at the request of investors, includes a liquidity provision to the effect that the investors can stop participating in newly originated loans by ILX but will stay on the hook for existing loan participations they have thus far committed to.[207]

Some institutional investors doubt the effectiveness of the PCT, especially since credit rating agencies do not consistently view it as credit-positive. As a result, they see MDB loan pricing based on PCT as undervalued and may seek additional insurance to manage perceived risks—raising transaction costs. For example, Aegon Asset Management offers an insured credit strategy backed by highly rated insurers, providing dual recourse to both collateral and insurers. This helps reduce credit risk and enhance yields, making such investments more attractive to cautious institutional investors.[208]

Securitization

Securitization reduces financing costs for the originating bank by transforming loans into a diversified, credit-enhanced portfolio that is off the bank's balance sheet. This lowers the overall risk, making the portfolio eligible for higher credit ratings and allowing the bank to offer more favorable lending terms.[209]

Securitization allows banks and borrowers to access a broader investor base, including those requiring investment-grade and liquid assets, while also freeing up regulatory capital to support more lending. For MDBs and DFIs, securitizing assets can significantly enhance capital efficiency, enabling them to scale up their annual investment volumes, as noted by the G20.[210] This is particularly true for those with a large private sector loan portfolio.

Once assets are consolidated into a shared platform, they can be warehoused and structured through a multi-tranche capital stack, with concessional or public capital absorbing first-loss risk. Senior tranches can then be issued as standardized, rated notes with defined maturities and income streams, suitable for institutional investors and tradable through mainstream financial infrastructure. When combined with transparent metrics and pricing mechanisms, this approach introduces a clear pathway to scale, liquidity, and eventual exit.

There are two main types of securitizations: true sale and synthetic. In a true sale, the originator (e.g., a DFI) removes assets from its balance sheet, pools them, and sells them to a Special Purpose Vehicle (SPV). The SPV then issues securities to investors, who earn interest from the underlying assets. This frees up capital for the originator to finance new, including sustainable, projects. Portfolios are usually divided into risk-based tranches, with the first-loss tranche being often concessional. In a synthetic securitization, the assets stay on the originator's balance sheet, but credit risk is transferred to third parties via credit derivatives, insurance, or guarantees, which maintains oversight and project quality.[211] While these are the most common types of securitizations, a mobilist paper argues that

there are variations and that DFIs can play multiple roles "*acting as originators, investors in securitization platforms, equity investors in individual transactions, guarantors of specific tranches, and debt investors in asset-backed notes.*"[212]

In this context, a notable example of securitization is the IDB Invest's efforts in Latin America and the Caribbean. In 2024, IDB launched a landmark synthetic securitization transaction that transferred risk from a USD 1 billion portfolio of non-sovereign-guaranteed loans to private investors.[213] EBRD is now emulating the model.[214] This initiative helps the bank free up balance sheet space to enable more development lending, while also promoting increased private sector involvement in Latin American infrastructure projects. Additionally, it improves risk distribution by lowering the IDB's exposure to particular sectors and countries.

Securitization carries potential risks and costs for MDBs/DFIs if not properly structured, so it is essential that these institutions and their shareholders clearly understand the strategic rationale behind such transactions. They must define when and why securitization is appropriate, ensuring it is used as part of a long-term capital strategy rather than a short-term fix. Additionally, because most MDBs/DFIs lack the asset volume to support standalone true-sale securitization programs, greater reliance on securitization will likely require pooling assets across institutions or with private sector partners.[215]

Foundational infrastructure

Liquidity does not require high trading volume, but it does demand predictable, rules-based exit mechanisms aligned with institutional investors' liability structures.[216] This requires foundational infrastructure: standardized documentation, risk-sharing templates, performance benchmarks, and centralized registries to support asset pooling and price discovery. An experienced EMDE equity investor emphasized that, for them, finding exit strategies has not been difficult, saying *"it is an active market and we have not found a lot of trouble."* This suggests that the activity required to create exit options already exists, it just needs to be standardized and packaged in a form to align with the needs of institutional investors.

Demand Signal and Proactiveness

Institutional investors also have a role to play. By signaling clear demand for exit-enabling structures, engaging early with fund sponsors, and co-developing standardized tools, they can help shape investable products. Rather than waiting for a mature secondary market, large asset owners alongside MDBs/DFIs, can co-anchor liquidity facilities or investment platforms pooling funds ready to participate in securitization or co-financing programs, driven by MDBs/ DFIs.

An example is Bayfront Infrastructure Management, founded in 2019 as a 70/30 joint venture between Clifford Capital Holdings and the Asian Infrastructure Investment Bank. Based in Singapore, Bayfront's mission is to invest in and distribute infrastructure debt across Asia and the Middle East. It offers investors access to a diversified portfolio of project and infrastructure loans spanning various sectors and regions through the issuance of Infrastructure Asset-Backed Securities. Its business model involves acquiring and warehousing infrastructure debt, and then structuring, executing, and managing securitizations or other distribution channels targeted at institutional investors.[217]

Blended finance will only become liquid and scalable if both public and private actors are

willing to co-invest in the systems and tools that enable it. Notably, a joint effort of public and private sectors is needed to contribute to building the depth of the local financial markets through the blended finance fund design. Mature local sovereign funds and local pension funds can be integrated into the capital pool, as is the case for the Public Investment Corporation of South Africa[218] and the Permodalan Nasional Berhad, a Malaysian sovereign wealth fund.[219] This kind of capacity building through partnerships can enable them to gain interest in buying out mature projects emerging from blended finance fund exits.

C. Who must act

Stakeholder	What They Must Do
Governments (AEs & EMDEs)	Shareholder Governments: Require from MDBs and DFIs to integrate 'originate-to-distribute' models into their private sector mobilization strategies.
MDBs/DFIs	- Shift from 'originate-to-hold' to 'originate-to-distribute' model. - Design transactions with future syndication, transferability, and securitization in mind. - Invest in secondary market infrastructure: standardized documentation, performance benchmarks, registries. - Partner with other donor agencies (e.g. multilateral trust funds, vertical funds) to create and deploy liquidity guarantees. - Act as anchor participants in new secondary market structures. - Build up the capacity of local institutional investors, aiming at enabling local exits.
Philanthropic Foundations	- Provide concessional capital to capitalize liquidity guarantee facilities enabling exits (e.g., Octobre Liquidity Guarantee Facility). - Support the development of multi-fund liquidity platforms and co-guarantee syndication tools. - Fund legal and operational frameworks to make liquidity instruments enforceable and scalable. - De-risk first pilots of exit-enabling mechanisms to crowd in private investment. - Collaborate with MDBs/DFIs and other donors to standardize secondary-market enabling risk-sharing structures and pricing methodologies.
Private Investors	- Signal demand for exit-enabling structures and predictable redemption options. - Co-develop standardized frameworks for deal documentation and disclosure. - Partner with development actors to co-anchor fund-of-funds, warehousing platforms, or structured co-investment vehicles.
Fund Managers (Active in Blended Finance)	- Create partnerships with local institutional investors to create the conditions for their takeover as assets mature.

Section V

Opportunity 4: Building a Robust Project Pipeline

V. A. Diagnosis

Lack of a Bankable Pipeline

Private investors assess blended finance opportunities based not only on immediate profitability but also on the potential for future deal flow, scale, and long-term returns.[220] When a transaction requires heavy upfront effort, they need a strong reason to engage, typically either outsized returns or a replicable model. Without that, one-off deals rarely justify the entry cost. Replicability is especially critical in emerging areas like climate adaptation and biodiversity, where markets are still forming.[221] A visible pipeline increases the likelihood of investor commitment by signaling that early investments in due diligence and expertise will unlock scalable opportunities.

According to Convergence, 21% of investors found identifying an investment pipeline to be more difficult than expected, citing a lack of bankable opportunities as a key constraint.[222] At its essence, bankability reflects whether a project is practical, feasible, and financially viable for the investor.[223] Bankable projects stem from clear and consistent revenue streams, a stable regulatory framework, and proper risk allocation mechanisms that increase investor confidence.[224]

Insufficient Attention to Project Preparation and Early Stage Investment

Many projects fail to achieve bankability due to gaps in preparation, such as incomplete feasibility studies, poorly structured contracts, insufficient technical expertise, inadequate alignment with investor requirements, and permitting issues. Undefined roles between stakeholders often lead to delays in financing decisions. Renewable energy projects, for instance, reflect this: when projects are deemed non-bankable, in 45% of the cases it is due to insufficient project readiness, 25% due to inadequate financial structure, 12% corresponds to project size considerations, 10% to insufficient alignment with the SDGs, and 8% due to limited track record.[225] These shortcomings create a disconnect between project developers and financiers, leaving promising opportunities underfunded and unrealized.

Despite the availability of catalytic capital at later stages, early-stage investment remains insufficient, contributing to a shortage of bankable projects.[226] Many of these challenges are exacerbated by the fact that technical assistance (TA) is predominantly provided post-investment, with only 25% of TA funding targeting the early stages of project development, compared to a 61% post-investment.[227] Without feasibility studies, risk assessments, legal structuring, and capacity-building at the outset, projects struggle to meet investor requirements, reinforcing the gap between available capital and investable opportunities.

Notably, underscoring the broader ecosystem misalignment diagnosed in the introduction, MDBs and DFIs often compete with philanthropic organizations for the same limited pipeline of investment-ready opportunities, prioritizing the scaling of established projects over the development of new ones.[228] This overlap can divert attention from the required approach to creating a more robust and scalable pipeline.

V B. Solutions

Early-Stage Project Development and Risk Financing

Building a steady pipeline of bankable projects in EMDEs requires a coordinated approach: strong preparation, early risk financing, enabling policies, and committed stakeholder engagement. In the riskiest early phases, grants, internal funds, and technical assistance are vital for feasibility studies, pilot designs, and validation. Catalytic capital at this point helps generate the data, credibility, and capacity needed to move from concept to investment-ready. This is where blended finance platforms should go beyond mobilizing private money. Their real strategic value lies in supporting early pipeline development—providing flexible capital, revolving funds, and targeted support to turn high-impact ideas into scalable, investable ventures.

A strong example is Climate Investor II's Development Fund (DF), which supplies early-stage capital to de-risk projects through feasibility studies, environmental and social assessments, and technical design. By covering these high-risk, pre-financial-close activities, the DF reduces uncertainty and builds investor confidence for later-stage engagement. Once a project reaches bankability, CII's Construction Equity Fund (CEF) steps in with implementation capital, closing the financing gap and enabling smooth transition from planning to execution. This integrated model accelerates structuring, attracts private investment, and demonstrates how catalytic capital can drive scalable, blended finance solutions.[229] Importantly, support at the pre-investment phase should be temporary and structured for leverage. This means using revolving facilities, risk-sharing tools, or clear transition paths to commercial funding. Conservation International Asia-Pacific's Natural Climate Solutions Technical Assistance Facility exemplifies this approach, recycling developer repayments to sustain a pipeline of investable projects.[230]

Making early-stage development a strategic priority is essential. These phases are often overlooked, seen as too risky, too small, or too fragmented for institutional investors. This is why public development banks, donors, and catalytic funders should expand project preparation facilities that offer technical guidance tailored to local needs and sector realities. That includes helping developers align with investor expectations, navigate regulatory landscapes, and design projects built for scale.[231] Building a feedback loop between investors and project developers is indeed very important. Project preparation should not occur in a vacuum; rather, it should be informed by an understanding of what types of structures and metrics investors require. Establishing co-design mechanisms—where private investors are engaged in shaping the risk allocation, capital structure, and performance indicators of emerging projects—can significantly increase the likelihood of financial close. While this engagement might not come naturally from mainstream private sector investors, family offices with higher risk tolerance and with growing interest in emerging markets could potentially bridge the gap.[232]

Technical Assistance Facilities (TAFs) play a crucial role in designing investment projects for maximum socio-environmental impact, mobilizing co-investors, and reducing investment risks by strengthening the capacity of project developers. While all sectors would benefit from it,

the agriculture sector is where most investment funds focused on climate-smart agriculture rely on grant-funded TAFs (USD 3–10 million) to provide the necessary expertise and ensure effective project implementation.[233] Additionally, TAFs can enhance impact monitoring and evaluation; in climate-smart agriculture, for instance, they can ensure accurate assessments of resilience improvements and emissions reductions, often leveraging cutting-edge tools like remote sensing.[234] There are also facilitator and accelerator programs. Facilitator programs help reduce information asymmetry by identifying investment-ready opportunities, conducting sector scans, and connecting businesses with suitable investors.[235] Accelerator programs go a step further, integrating capacity-building efforts to address specific gaps in investee businesses, thereby enhancing their ability to attract investment.

Addressing Structural Barriers to Bankability and Scale

Moreover, to maximize the efforts of TAFs, facilitators and accelerators, structurally addressing the currency risk is particularly important, as a principle at a development agency focusing on Africa explained, *"We are the most risk-taking organization I can think of, and our investment committee is still asking us to do more on currency risk mitigation. That's structurally what the challenge is, you need to almost be willing to lose that money."* Given the salience of currency risk, EMDE governments should consider developing mechanisms such as foreign exchange hedging facilities or local currency guarantee programs to protect investors from volatility (alongside sound monetary policies).[236] By the same token, strengthening local capital markets by expanding domestic bond markets and encouraging institutional investors' participation can reduce dependence on foreign financing. EMDEs that have effectively increased clean energy investment, such as India, Brazil, and South Africa, have primarily depended on domestic capital sources.[237]

Brazil illustrates how targeted policy interventions can enhance the effectiveness of blended finance by addressing key investor concerns such as currency risk and access to credit. The government, in partnership with the IDB and the World Bank, launched the Eco Invest Brasil program, which includes a blended finance mechanism to provide long-term financing in local currency.[238] By offering foreign exchange hedging solutions and reducing capital costs for green projects, this initiative lowers risk for investors and borrowers, making sustainable infrastructure investments more viable.

National development banks (NDBs) can also be critical in addressing the currency risk as well as building the pipeline. As such, collaboration with them should increase on the part of catalytic investors and in particular MDBs. Leveraging their deep knowledge of national contexts, established relationships with domestic stakeholders, and ability to align projects with local development policies, collaboration with NDBs can help solve structural problems that hamper the development of a robust pipeline. The IDB-BNDES collaboration illustrates this point: In June 2024, IDB and Brazil's Brazilian Development Banks (BNDES) completed a landmark foreign exchange deal that converted a USD 437.5 million loan from USD to Brazilian Real at favorable terms, reducing currency risk and supporting private investment. It was the first such transaction by an MDB for a state-owned borrower.[239]

Ultimately, the solution is not only about generating a greater volume of projects, but also enhancing their quality and bankability. This means embedding climate and impact considerations into financial modeling from the outset, creating clear pathways to scale (e.g., through aggregation, securitization or replication), and identifying exit strategies that give investors clarity on liquidity. Projects that are designed with these elements in mind are far more likely to secure long-term, scalable financing and contribute meaningfully to climate and development goals.

C. Who must act

Stakeholder	What They Must Do
Governments (AEs) & Philanthropic Foundations	- Shift technical assistance toward pre-investment stages. - Fund revolving or repayable TA facilities that recycle capital and create long-term pipelines. - Capitalize early-stage blended finance vehicles.
MDBs/DFIs & Donor Agencies	- Establish and scale project preparation and development facilities to provide early-stage funding, technical assistance, and risk-absorbing support for project developers. - Support EMDEs countries in lowering the currency risk by providing local hedging solutions, local currency financing solutions, and strengthening monetary policy tools - Coordinate closely with governments and private investors to align financing structures with pipeline priorities and country investment plans.
Governments (EMDEs)	- Streamline permitting, procurement, and land-use approvals to reduce early-stage risk. - Ensure regulatory clarity around incentives, offtake agreements, and currency arrangements to enhance project bankability. - Empower and capitalize NDBs to build pipelines, offer local currency financing, and partner with international actors on blended transactions. - Proactively leverage coordination platforms such as the NDC Partnership[240] to strengthen policy frameworks, advance regulatory reforms, and improve project preparation and pipeline visibility.
Technical Assistance Providers (Including Accelerators and Facilitators)	- Provide targeted upstream support to project developers in legal structuring, financial modeling, and risk analysis. - Develop sector-specific guidance to address unique barriers in energy, agriculture, infrastructure, etc. - Coordinate with MDBs/DFIs and donors to ensure TA is linked to downstream funding pathways.
Project Developers	- Engage early with investors, through facilitators and accelerators, to align on metrics, risk allocation, and financing structure. - Improve documentation, including revenue models and ESG performance.
Private Investors	- Engage with TA providers in co-design of projects to ensure bankability. - Signal preferred structures and performance indicators. - Family offices: Leverage risk appetite to invest and support early -stage development.

Section VI

Opportunity 5: Fostering Additionality through Market Standards and Strategical Interventions

VI. A. Diagnosis

Even with greater transparency, better-aligned risk perceptions, improved liquidity, and stronger project pipelines, blended finance will not achieve its intended purpose unless it delivers true additionality—mobilizing capital that would not otherwise flow and delivering impact that would not otherwise occur. Additionality is the core justification for strategically using scarce concessional resources. Without it, blended finance risks becoming an exercise in financial engineering rather than a tool for structural transformation.

Few Market Standards for Additionality

While additionality is a cornerstone of blended finance, the term is often used loosely, leading to confusion and dilution of its meaning. To restore clarity and discipline, it is helpful to distinguish between key dimensions of additionality that blended finance should demonstrate. In Figure 7 we propose a simple typology intended to provide a conceptual map without collapsing important nuance.

Figure 7: Three Types of Additionality in Blended Finance

Type of Additionality	Definition	Example
Developmental	The transaction achieves SDG-aligned outcomes that would not have occurred without blended finance.	A renewable energy mini-grid is built in an underserved rural area due to concessional terms.
Financial	Private capital would not have participated without the concessional support.	A first-loss guarantee enables institutional investors to enter a risky EMDE infrastructure deal.
Systemic	The intervention leads to broader market changes, demonstration effects, or replication.	A new risk-sharing facility crowds in local banks and catalyzes further similar structures.

Source: Prepared by Authors.

These categories are not mutually exclusive. Many high-impact transactions combine all three. However, distinguishing between them can help actors assess where and how blended finance is truly catalytic, and where it may be displacing private capital, distorting the market, or not addressing a development priority. Currently, there are few market standards to ensure that concessional capital is crowding in, rather than crowding out, private investment.[241]

Competition Erodes all Forms of Additionality

Competition rather than collaboration is shaping the ecosystem, leading to fragmentation and duplicative efforts, at odds with additionality quest. Competition exists within each institutional group: among MDBs and DFIs,[242] within philanthropic organizations,[243] and

notably between DFIs and development agencies in shareholder governments, where collaboration remains strikingly lacking. Interestingly, MDBs/DFIs also compete with ECAs, despite having originally distinct mandates, such as financing large-scale projects in infrastructure, energy, and industry.[244] Annex II provides an overview of the characteristics of these institutions. Crucially, in this context of limited collaboration between catalytic investors, accessing catalytic capital remains a persistent bottleneck in blended finance transactions.[245] Practitioners often face fragmented and opaque processes when trying to secure risk-absorbing capital. Even when funding is available, it typically involves approaching multiple donors individually, each with their own terms, creating friction and delays. As a major asset manager noted, *"We need to find a way to create more cohesiveness across first-loss investors in catalytic capital... I could have one pool from four countries instead of having to knock on the doors of four different countries. That to me would be a really big game changer."*

Additionality is Insufficiently Driving MDB/ DFI's Behaviors

MDBs and DFIs, in particular, have not prioritized transactions with strong demonstration effects, those that could lower informational and perceived risk barriers and unlock private investment at scale.[246] The incentives shaping public finance institutions often run counter to their stated goal of market transformation.

Moreover, MDBs and DFIs contributed about 45% of commercial commitments to blended finance deals in 2024, acting more as direct investors than facilitators of private sector involvement.[247] Since 2022, they have provided approximately USD 18 billion to blended finance transactions, with about 80% of that financing committed on commercial terms.[248] From 2019 to 2022, they were the leading source of market-rate capital to blended finance, though they have been eclipsed by the private sector in the past two years.[249]

Only 37% of DFIs have private sector mobilization targets, and members of the Association of European DFIs collectively mobilized just 1% of their combined balance sheet size. MDBs and DFIs continue to underutilize risk mitigation instruments and over-rely on senior debt, despite concessional commitments accounting for 27% of blended finance flows. Guarantees make up only 4% of MDB commitments, compared to 70% allocated to loans.[250]

MDBs often collaborate with philanthropic organizations to provide concessional financing, helping to de-risk MDBs' senior positions in blended finance. This is notwithstanding MDBs often having trust funds available from shareholder governments to provide concessional funding to these projects (albeit that these sovereign trust funds often come with stringent eligibility requirements).[251] Furthermore, MDB guarantees are often backed by indemnification agreements that require sovereigns to reimburse the institution if a project fails. These contingent liabilities can put significant pressure on public finances and deter governments from seeking MDB support, especially in fiscally constrained environments. Such practices reflect how current institutional priorities (preserving credit ratings and profitability) can conflict with the developmental mandate of mobilizing private capital for sustainable impact. [252]

VI B. Solutions

Selective deployment of blended finance, targeted concessional terms and risk mitigants supported by data transparency, stronger project structuring leading to affordable cost of capital, financing coordination along the project cycle, and a private sector mobilization roadmap on the part of the MDBs/DFIs can realign actors around developmental, financial and systemic additionality.

Tailored Use of Blended Finance for Developmental Additionality

Blended finance should be deployed selectively and not considered as a panacea. In the lowest-income countries, the immediate need is foundational public investment to create the conditions for private capital. Excessive concessional support in these contexts risks fostering dependency and distorting incentives and should be avoided. Among the countries for which blended finance is the strategic mode of intervention, there is a need to distinguish between low-income countries (LICs) and middle-income countries (MICs). LICs—and underserved populations within MICs —often require concessional instruments such as grants, first-loss capital, and embedded technical assistance to strengthen institutions, improve regulatory frameworks, and build essential infrastructure. In contrast, MICs, with more developed financial systems, can benefit more from market-aligned tools like guarantees or credit enhancements that address specific risks in sectors such as climate technology.[253]

The pursuit of additionality in blended finance should be led by host country governments to ensure alignment with national priorities. Governments are best positioned to define what constitutes additional impact and should foster alliances that pool capital from donor countries, MDBs/DFIs, private investors, and philanthropies under a cohesive investment framework. One potentially effective mechanism for this is through well-designed country platforms which are government-led coordination frameworks that bring together public and private actors to align financing flows with national priorities.[254]

Strong Project Structuring for Financial Additionality

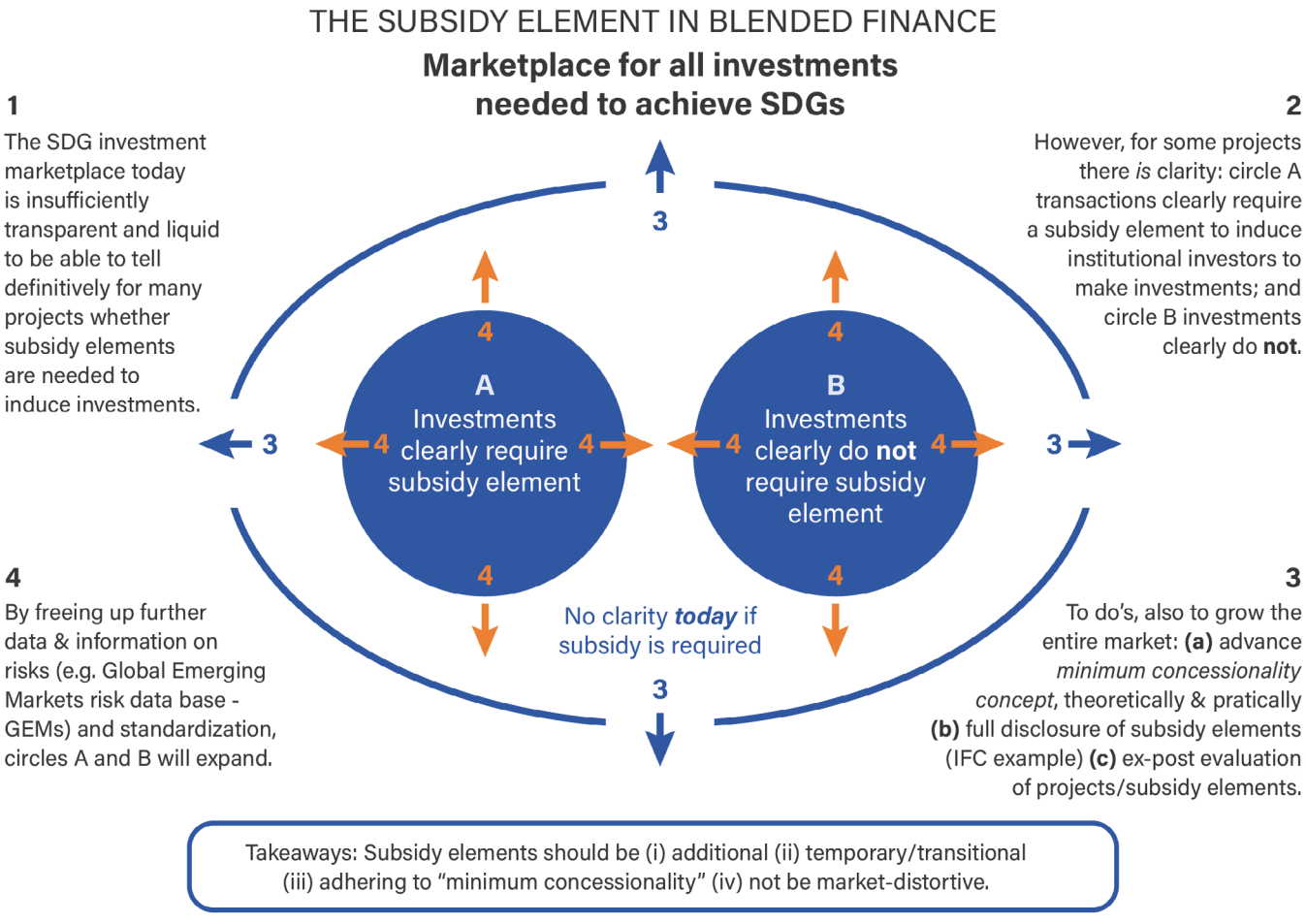
In the high-cost capital environment of EMDEs, a key test of additionality in blended finance is whether concessional funding genuinely reduces financing costs. Well-structured deals are essential to ensuring that costs are efficiently managed and risks appropriately allocated. When financing arrangements are designed with care, they help catalytic investors maintain affordability for end-users, support viable cost-recovery models, and avoid unsustainable debt burdens. This not only strengthens financial resilience at the project level, but also enhances the likelihood of achieving long-term development goals.[255]

For this reason, risk mitigation instruments should be priced as close to market rates as possible, with concessional terms reserved for cases where private capital would not

otherwise be viable. Crucially, risk should be shared to align incentives and ensure private actors retain meaningful exposure. Partial risk-sharing models—where commercial investors bear a fair share of risk—promote disciplined investment, reinforce additionality, and prevent the crowding out of capital that would have been deployed regardless.[256] Moreover, as explained to us in interviews by catalytic investors, blended finance structures must also allow adaptive flexibility, enabling reduction in concessionality based on improvement of market conditions, project risk and investment performance.[257]

However, ensuring additionality drives project structuring demands standardized metrics and robust transparency to assess whether concessional capital is effectively mobilizing investment that would not have occurred otherwise, particularly in underserved markets. While defining common robust frameworks for additionality is a difficult task,[258] this task cannot even start without higher data transparency and standardization in the system as illustrated in Figure 8; which reinforces our core recommendation, exposed in Section II.

Figure 8: Understanding whether the subsidy element is additional and not market-distortive requires more data transparency

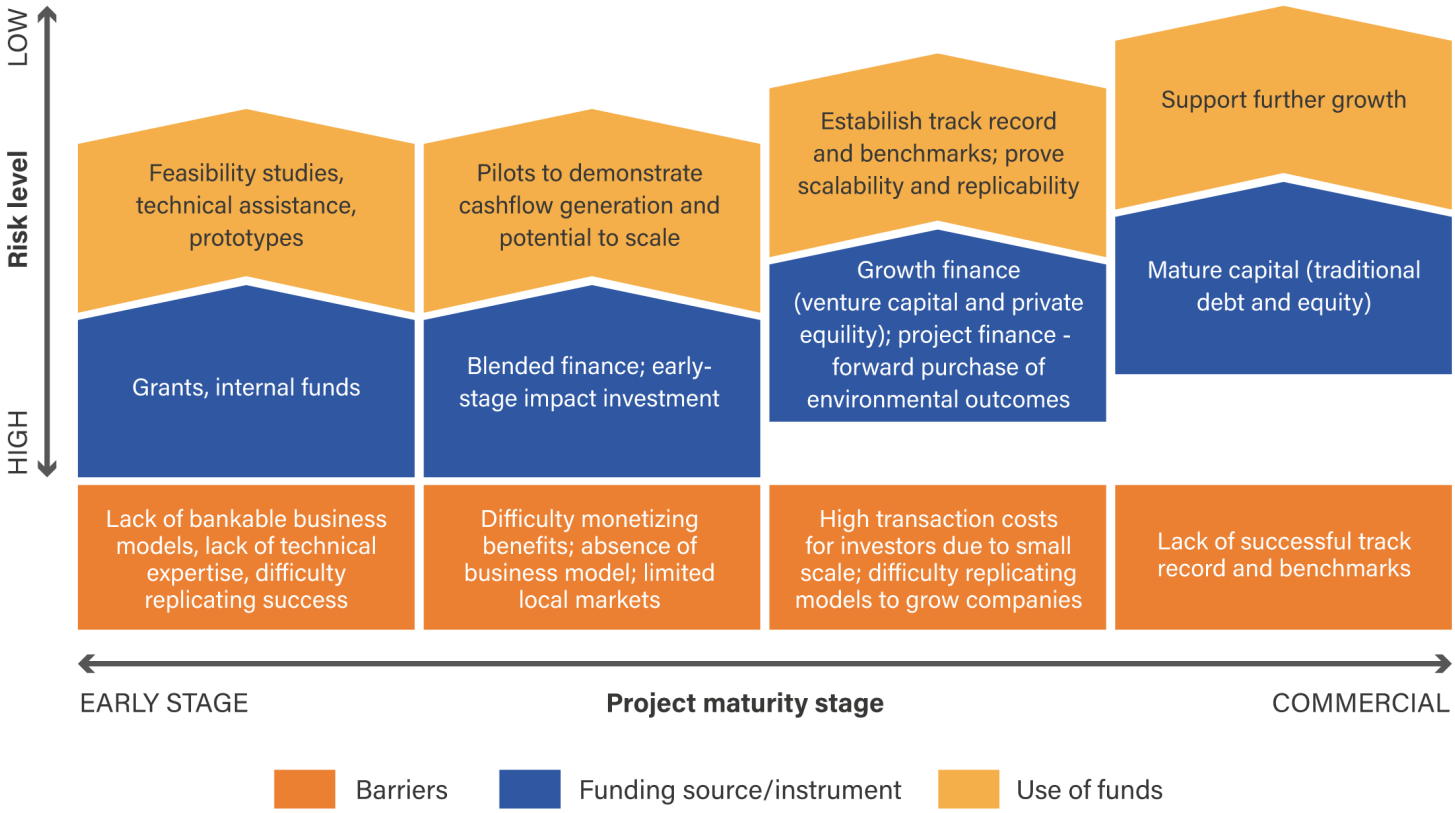


Source: Route 17.

VI Coordination Along the Project Cycle for Financial and Systemic Additionality

Delivering on additionality requires coordinated action across the financing ecosystem, with each catalytic investor leveraging its comparative advantage to support different stages of the project cycle while ensuring transition to commercial takeover when projects mature. Figure 9 illustrates the evolving risk dynamics, financing needs, and structural barriers from early feasibility studies to full commercial deployment in agriculture. For example, MDBs and DFIs should work closely with both public and private guarantee providers, particularly ECAs given their strong credit ratings and sizable balance sheets, to design integrated guarantee packages that address project-specific risks at each stage.[259] This has been recognized by the Berne Union and Finance in Common.[260]

Figure 9: Private Finance Mobilization at Various Stages of Restoration Project Development



Source: World Bank.

Box 4 illustrates how coordination among catalytic investors could look like.

Box 4: A Blueprint for Further Ecosystem Collaboration

Launched at COP26, the Global Energy Alliance for People and Planet (GEAPP), anchored by three philanthropies (the Rockefeller Foundation, IKEA Foundation and Bezos Earth Fund) offers a replicable model for effective blended finance. By convening philanthropies, MDBs, DFIs, governments, and private sector partners through a common platform GEAPP shows how shared missions, pooled resources, and aligned governance can reduce duplication and improve coordination. Its approach to capital deployment, leveraging local partners and streamlining operations, demonstrates that cross-institutional collaboration can work in practice. Similar models should be adopted more widely to tackle fragmentation and enhance the impact of climate and development finance.[261]

Strategic coordination among catalytic providers would also provide a pooled first-loss facility, capitalized by shareholder governments and donor institutions, would stabilize risk absorption, reduce political volatility exposure, and streamline capital mobilization for high-impact projects.[262] Embedded within a broader platform, as suggested by ILN and SMI, such a facility would streamline access, reduce transaction costs, and improve the predictability needed for private investors to engage at scale.[263] As a surveyed asset manager emphasized, *"Pools of capital would have to go hand in hand with data transparency so we don't use too much first-loss."* This recommendation also aligns with the Hamburg Sustainability Platform's (HSP) proposed actions.[264]

MDBs/DFIs' Private Sector Mobilization Roadmap for Systemic Additionality

Shareholder governments should direct MDBs and DFIs to evolve from transactional project financiers with lending volume objectives to proactive market-makers—institutions that create investable opportunities, reduce barriers to entry, and crowd in private capital at scale. This shift requires clear standards governing the use of risk and concessional capital to ensure it attracts, rather than displaces, private investment. At the same time, financial discipline must remain a core principle, guiding the strategic deployment of public resources for maximum impact.

MDB and DFI instruments (e.g. AAA rated bonds, co-financed B loans, securitizations, junior tranches, and guarantees) can mobilize private capital in EMDEs if deployed transparently, priced appropriately, and aligned with high additionality goals. A common mobilization roadmap should guide their use, balancing institutional creditworthiness, local financing costs, and private sector constraints while giving stakeholders the clarity needed to engage effectively. When discussing this issue, an executive at an international bank emphasized *"MDBs giving consistent visibility on what they are going to do is crucial. Banks are going to get very frustrated if they keep bringing them projects and they keep hearing no."*

Table 3 summarizes and compares MDB strategies along various objectives that matter to their risk-taking ability, the barriers to investment, and the cost of capital in EMDEs.

Table 3: Summary of MDB approaches depending on the type of private sector mobilization

Assumption: Underlying Asset is Debt	Subsidization and/ or Derisking by MDBs (not considering other roles, e.g. origination)	Increase Private Investors' Knowledge of EMDEs > Reduced Perceived Risk	Increase Private Investors' Knowledge of DFI Finance > Reduced Perceived Risk	Increase Liquidity of MDBs	Risk Transfer (assets or risk of the assets moving from MDB balance sheet to private investor's balance sheet)	Risk Weighted Mobilization (private investors exposed to counter party risk directly)	Complexity Premium?	Investors Being Mobilized
AAA bonds	N/A	N/A	A little	✓	Weak	Weak	Easy and liquid	Standard bond investors
Co-financing of B - loans (e.g.: ILX)	N/A	N/A	✓	N/A	NA	✓	As much as any illiquid fund	Institutional investors investing in private funds and with relatively high risk appetite
Insured credit on B loans (e.g.: AEGON)	N/A	NA	✓	N/A	N/A	✓ (insurer is exposed)	As much as any illiquid fund	Institutional investors investing in private funds
True Sale Securitization (e.g.Room2Run)	Possible	Depends on the tranche	Depends on the tranche	✓	✓ (to bond holders)	✓ (less than B loans)	Depends on the tranche but all liquid	Standard bond investors
Synthetic Securitization (insurance on part of the portfolio of MDBs) (Ex: IDB, EBRDXX)	Possible	N/A	✓	N/A	✓ (to insurance)	✓ (less than B loans)	Can be very strong if not turned into simple securities in a second phase	Specialized insurance investors
Blended finance interventions (e.g. first loss and guarantees)	Possible	Depends on private investors' approach	✓	N/A	N/A	N/A	Can be strong	Institutional investors investing in private funds

VI C. Who must act

Stakeholder	What They Must Do
Governments (AEs)	- Reform internal incentive structures at MDBs/DFIs to reward private sector mobilization efforts. - Support revisions to capital adequacy and accounting rules that currently disfavor guarantees[265] and risk-sharing instruments. -Require consistent application of additionality metrics and transparent reporting from institutions they fund. - Coordinate around a pool of first-loss capital.
MDBs/DFIs	- Adopt clear additionality standards that define when concessional capital is justified and under what terms. - Prioritize high-additionality transactions that demonstrate potential to catalyze private investment at scale. - Shift from senior debt to risk mitigation instruments, including partial guarantees and first-loss capital. - Deploy instruments such as AAA bonds, securitization, B-loan co-financing, and blended finance interventions through a visible roadmap for private sector mobilization. - Assist EMDE countries in building well-designed and well-governed country platforms.
Governments (EMDEs)	- Through country platforms: i) Ensure that concessional finance is directed to genuinely underserved areas, avoiding dependence or distortions, and ii) Integrate blended finance into national development strategies to align external finance with local priorities.
Private Investors	- Accept meaningful risk exposure to align interests and preserve market discipline in risk-sharing structures. - Engage in rigorous due diligence and help shape bankable, impact-oriented investments in high-risk sectors.
Philanthropic Foundations	- Collaborate with DFIs, MDBs, and peers to avoid duplication and focus efforts on underserved, high-impact areas. - Help create and promote shared standards for defining and measuring additionality. - Act as neutral conveners to bridge public and private actors and share lessons across the ecosystem.
ECAs	- Collaborate with DFIs and MDBs to develop comprehensive guarantee packages tailored to different risk layers and project stages, along the line of the announcement by the Berne Union and Finance in Common. - Standardize their approach to blended finance, creating replicable frameworks as in the MUFG-NEXI decarbonization collaboration in Asia.[266]

Section VII

Conclusion

Investments in EMDEs drive market transformation and reinforce the conditions necessary to attract further capital. By fostering competition, mitigating first-mover disadvantages, enhancing workforce capabilities, and strengthening enabling environments, including transparent market practices, streamlined regulations, and robust local currency markets, blended finance can fuel a self-reinforcing cycle of growth and innovation.[267] Acknowledging these mechanisms can help stakeholders design interventions that maximize both financial returns and long-term market development. This report makes one thing clear: the barriers to scale are not conceptual; they are structural, systemic, and solvable. The question then becomes how and by whom.

Our research endeavor has aimed to address these questions through intense consultations, a rigorous review of the literature, and targeted quantitative analysis. The findings point to three core conclusions:

VII

1. A fully functional blended finance ecosystem lies in enshrining transparency, standardization and liquidity to scale private capital mobilization effectively, transforming from opaque, bespoke deals to a functioning investable marketplace. This requires clear disclosure of transaction terms, harmonized reporting practices, and the design of replicable instruments that reduce complexity and enable aggregation. Establishing viable exit pathways and fostering secondary markets will further align blended finance with institutional investor needs and unlock capital at scale.
2. Blended finance ought to be firmly embedded within international and national development strategies, ensuring concessional capital is strategically deployed not merely to attract and de-risk individual projects but to systematically create scalable and investable markets. This, in turn, reduces long-term reliance on public and concessional funding. Key to this undertaking will be structurally addressing local currency challenges through deliberate efforts to develop local capital markets, local financing and local hedging solutions.
3. Overcoming institutional conservatism and misaligned incentives is essential. AE governments have a key role to play to make it happen. They should instruct MDBs/ DFIs to aim for private sector mobilization as a strategic priority. This should be complemented by the adoption of streamlined financial instruments and the sharing of transparent, standardized deal data to boost private investors' familiarity with blended finance, DFI finance, and EMDEs. Likewise, regulatory frameworks such as Basel III and Solvency II must be recalibrated to reflect actual EMDE risk, recognize the credibility of blended finance tools, and lower capital charges that unjustifiably penalize investment. In turn, CRAs must modernize outdated methodologies and embrace more representative, data-informed assessments of EMDE investment risk. This will go a long way towards reducing the gap between perceived and actual risks.

This transformation will only succeed if it is coordinated. No single institution can scale blended finance alone. But together, through shared norms, transparent standards, aligned incentives, and catalytic interventions, this ecosystem can evolve from a patchwork of innovation to a marketplace of global consequence.

As blended finance continues to evolve, so must the tools to assess its real-world effectiveness. A future research agenda should prioritize portfolio-level simulations, regional and sectoral analyses, and rigorous evaluation of outcomes for end beneficiaries, especially on dimensions like affordability and access. Critically, these insights depend on improved data infrastructure. Initiatives that should be led by international bodies or networks (e.g. Glasgow Financial Alliance for Net Zero) that aim to standardize and democratize access to transaction-level data will be essential.

Blended finance is not intended to eliminate all risks or serve as a permanent solution to financing challenges. It is not a panacea. However, when applied strategically and decisively, it can transcend its niche status and become a powerful catalyst for economic transformation, fostering long-term sustainable development and resilience on a global scale. Blended finance interventions must explicitly target genuine market failures, rely on data-driven approaches to dismantle outdated assumptions, and prioritize sustainable models that can eventually stand on their own.

Annexes

Annex I: A Quantitative Framework for Modeling Expected Returns and Risk in Blended Finance

Authors: François Ferraro, Leyu Zou, Ajay S. Jagdish

Overview

Based on our initial qualitative findings regarding the perceived barriers to blended finance, we created a quantitative framework, centered on a neural network for return prediction and supplemented by several risk layers, to estimate and compare expected returns for blended finance investors versus conventional projects. This framework not only forecasts return using historical blended finance transactions and key project characteristics, but also evaluates risk through measures like expected loss, present value, and Risk-Adjusted Return on Capital (RAROC). A stress testing module applies market shocks to gauge how blended finance structures might mitigate downturns, while GARCH fits historical returns data to forecast volatility under varying market conditions.

Though we were unable to train the model due to a lack of access to training data, we present the model as a tool for usage in analytical settings for investors who do have access to transaction-level blended finance data. In blended finance, the integration of different capital types, especially concessional and commercial funds, is crucial, as each type carries its own risk-return profile. Therefore, for a manager wishing to compute their own return on a project/fund, we would recommend incorporating a mathematical layer that disaggregates the predicted performance into distinct tranches, and allocates risk-adjusted returns according to the specific conditions and priorities defined for the vehicle.

Detailed description

The overall goal of our quantitative analysis is to predict the expected returns of an artificial blended finance fund or project based on its characteristics and historical performance. To achieve this, we train a neural network (based on machine learning) on past blended finance transactions, utilizing preprocessed data with features such as deal type, fund/project structure categories, the amount of concessional capital, market factors, and performance metrics like Internal Rate of Return (IRR), Distributions to Paid-in (DPI), and Total Value to Paid-In (TVPI) to forecast the overall fund performance.

More specifically, the neural network is a multilayer perceptron (MLP) regressor, which means it has several layers of interconnected nodes that progressively transform the input features into an output prediction. It includes two hidden layers of 50 neurons each, with ReLU as the activation function, and is trained to minimize mean squared error using the Adam optimizer. In practice, it uncovers relationships between fund/projects attributes and returns, then leverages those learned patterns to predict future outcomes. The output is a trained neural

network model that can predict future fund returns based on unseen data that can answer key questions such as what specific characteristics of a project/fund drive its return potential.

Alongside the neural network, we've introduced several modules for a more comprehensive risk evaluation of any given project or fund. First, a 'risk layer' processes financial inputs such as cash flows, probabilities of default, loss given default, and discount rates, to generate pivotal metrics like expected loss, present value (adjusted for default risk), and RAROC, all of which are crucial for assessing performance and comparing against traditional benchmarks. Next, a back testing module applies stress factors (for example, a 20% market shock) to simulate adverse scenarios and reveal how a project or fund holds up under challenging conditions. Finally, a GARCH model uses historical returns data to project volatility, which can refine predictions and inform broader risk assessments by accounting for market fluctuations.

This model framework allows us to:

- Compare the predicted returns with sectoral benchmarks, and to conduct detailed scenario analyses, such as stress tests that simulate adverse market conditions to calculate expected losses, default risks, and present values.
- Assess how the concessional capital (such as the first-loss equity) can impact the performance of the fund/project and of each tranche (senior or junior tranche) by conducting various simulations with different concessional capital percentages.
- Assess whether the first-loss is disproportionately thick as compared to the risk/return profiles of the fund/ project
- Improve the understanding of risk/return profiles of blended finance investment to facilitate portfolio capital allocation.

The Results

To secure the right data, we pursued two main approaches. First, we looked to databases like Convergence and Pitchbook to populate our models. While these platforms provided useful insights, they each had shortcomings. Convergence lacked project- or fund-specific returns, and Pitchbook did not clearly distinguish blended finance from traditional initiatives, so we could not reconcile Pitchbook and Blended finance. We tried to use Pitchbook's information on funds in emerging markets as proxies but the cash flow information was very inconsistent and not usable. Second, we tried to obtain granular data from public and private financial institutions that invest in blended finance. These discussions deepened our understanding of the sector and highlighted potential data sources for future resources, but we were unable to gain access to enough of their database to run the model.

By integrating comprehensive, granular data from various sources, our quantitative analysis should highlight the performance gap between blended finance and traditional investments while demonstrating that the blended finance structure can mitigate perceived risks, ultimately offering a more favorable risk-return profile for investors. Unfortunately, the lack of available data prevents us from conclusively showing the benefits of blended finance.

Annex II: Characteristics of Development Finance Actors

Aspect	MDBs	DFIs	Philanthropy	ECAs
Mandate	MDBs' core mission is to promote economic and social progress in EMDEs by financing projects, supporting investment, and mobilizing capital. Outside of the private sector windows, their portfolio is mostly made of sovereign loans.	DFIs are specialized financial entities designed to stimulate private sector growth in developing economies. These can be bilateral or multilateral.	Philanthropy leverages funding, expertise, and partnerships to drive sustainable development and social progress in underserved regions.	ECAs' primary mandate is to promote national exports by mitigating trade risks through financing, guarantees, or insurance.
Mission-driven	Yes	Partially	Yes	Not necessarily
Funding Structure	Paid-in capital, callable capital	Shareholder capital	Endowment and private wealth, donations, charity	Government backing and budget allocations
Typical Instruments	Sovereign loans, project finance, policy-based loans	Direct investments, credit enhancements, bonds	Grants, recoverable grants, impact investments	Trade finance, buyer/supplier credits, insurance
Risk Appetite	Lower risk, long-term sustainability focus	Medium risk, market-building focus - depends on the DFI with some being more prone to taking risks than others.	Medium to high risk tolerance, impact-driven	Low-to-medium risk, export-driven
Speed & Flexibility	Slowest, structured due diligence	Slow to moderate speed, some bureaucratic hurdles depending on the DFI	Fast, flexible funding	Moderate speed, tied to national interests
Example Institutions	World Bank, ADB, IDB, AfDB, EBRD, NDB	IFC, IDB Invest, KfW, FMO, DEG, CDC Group, Proparco	Gates Foundation, Rockefeller Foundation, Children's Investment Fund Foundation, Bezos Earth Fund	US EXIM, Euler Hermes, UK Export Finance, Bpifrance

Source: Authors based on OECD[268], Convergence[269], UN.[270]

Annex III: List of Expert Interviewees for the Report

- Andres Garcia, IDB Invest
- Andrew Steel, Sustainable Strategies
- Avinash Persaud, Interamerican Development Bank
- Benjamin Attia, Allied Climate Partners
- Binny Prabhakar, African Development Bank
- Christian Deseglise, HSBC
- David Savage, World Bank Group
- Deniz Harut, Agri3
- Elvira Lefting, Finance in Motion
- Emmanuel Beau, Oncapital
- Erich Cripton, CDPQ
- Frederic Berney, Igravity
- Frederic Samama, Amundi
- Gary Forster, Publish What You Fund
- George Nijborg, Aegon Asset Management
- Gregor Cigut, European Investment Bank
- Heidi Yip, Blackrock
- Huib-Jan de Ruijter, FMO
- Inchan Hwang, Strategic Climate Capital
- Jasper Siegfried, Lions Head Global Partners
- Jennifer Loewen, Euler Hermes
- Jenny Koh, 3iadvisory
- Jens Wirth, KFW
- Jessica Attard, Cambridge Institute for Sustainability Leadership
- Joost Zuidberg, Cardano Development
- Julie Ansidei, Blackrock
- Kobi Weinberg, CREO
- Lara Twellmann, Euler Hermes
- Lasitha Perera, The Development Guarantee Group
- Leticia Ferreras Astorqui, Allianz
- Lisa Genasci, ADM Capital
- Lori Kerr, Findev Canada
- Luke Bettesworth, HSBC
- Manfred Schepers, ILX
- Marcus Svedberg, Folksam
- Mili Fomicov, Imperical College UK
- Naci Can, Calik Energji
- Nawar Al-Ebadi, SIDA
- Nazmeera Mola, Ninety One
- Osaruyi Orobosa-Ogbeide, Africa Finance Corporation
- Patrick Nussbaumer, UBS Optimus
- Paul Horrocks, OECD
- Paul James, Publish What You Fund
- Ramkumar Narayanan, Taemo Solutions
- Rob Drijkoningen, Neuberger Berman
- Ruzgar Barisik, Nextbillion
- Ryan Wagner, BII
- Sam Sherburn, GFANZ
- Shreejesh Ghimire, NMB Bank Ltd
- Simon Marchioni, Global Infrastructure Advisors
- Stephen Macharia, FSD Africa
- Susana Lopez, Climate Fund Managers
- Susheel Bhujel, NMB Bank Ltd
- Sylvain Goupille, Octobre Earth
- Thierry Déau, Meridiam
- Thomas Venon, Center for Development Studies
- Tomo Ishikawa, MUFG
- Tristan Knowles, Asian Development Bank

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