



SPECIAL STUDY

EBRD Mobilisation of Private Finance

EvD ID: SS19-140

April 2020

EBRD EVALUATION DEPARTMENT



European Bank
for Reconstruction and Development

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Abbreviations

ABI	Annual Bank Investment
ADB	Asian Development Bank
AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
AMC	Asset Management Company
AMI	Annual Mobilised Investment
BEEPS	Business Environment and Enterprise Performance Survey
CAS	Central Asia
CEB	Central Europe and the Baltics
CIV	Collective investment vehicles
COO	countries of operations
DAC	Development Assistance Committee
DCF	Donor Co-financing
DFI	Development Finance Institution
E2C2	Energy Efficiency and Climate Change
EAA	Enhanced Approach to Additionality
EAP	East Asia Pacific
EC	European Commission
ECA	Europe and Central Asia
EDFI	European Development Finance Institutions
EEC	Eastern Europe and Caucasus
EFSD	European Fund for Sustainable Development
EIB	European Investment Bank
EIRR	Economic Internal Rate of Return
EM	Emerging Market
EPF	Equity Participation Fund
EPG	Economic Policy and Government
ESS	Energy Sector Strategy
ETC	Early Transition Countries
EU	European Union
EVD	Evaluation Department
FCY	Foreign Currency
FDI	Foreign Direct Investment
FG	Financial Guarantee
FI	Financial Institutions
FIT	Feed in Tariff
FLRC	First-Loss Risk Cover
FMO	Netherlands Development Finance Company
FOPC	Financial and Operations Policies Committee
FX	Foreign Exchange
GCF	Green Climate Fund
GFC	Global Financial Crisis
GET	Green Economy Transition
IBRD	International Bank for Reconstructions and Development
IDA	International Development Association

IDB	Inter-American Development Bank
IFC	International Finance Corporation
IPPF	Infrastructure Project Preparation Facility
IsDB	Islamic Development Bank
KPI	Key Performance Indicator
LC2	Local Currency and Capital Markets Development
LCY	Local Currency
LS	Loan Syndications
MCPP	Managed Co-Lending Portfolio Programme
MDB	Multilateral Development Banks
MEI	Municipal and Environmental Infrastructure
MENA	Middle East and North Africa
MFD	Maximising Financing for Development
MIGA	Multilateral Investment Guarantee Agency
MIS	Management Information System
MS	Manufacturing and Services
MSME	Micro, Small and Medium Enterprises
NDC	Nationally Determined Contributions
NFG	Non-financial Guarantee
NR	Natural Resources
ODA	Overseas Development Assistance
OL	Operating Leader
P&E	Power and Energy
PCS	Preferred Creditor Status
PD	Probability of Default
PDM	Private Direct Mobilisation
PFI	Participating Financial Institutions
PIM	Private Indirect Mobilisation
PPP	Public Private Partnership
PSW	Private Sector Window
PTI	Portfolio Transition Impact
RAROC	Risk Adjusted Return on Capital
RORC	Return on Required Capital
RSF	Risk Sharing Facility
SBI	Small Business Initiative
SCF	Strategic Capital Framework
SDG	Sustainable Development Goals
SEE	South Eastern Europe
SEMED	Southern and Eastern Mediterranean
SI3P	Sustainable Infrastructure Advisory Department
SIDA	Swedish International Development Cooperation Agency
SIP	Strategy Implementation Plan
SITG	Skin in the Game
SME LCYP	SME LCY Programme
SPV	Special Purpose Vehicle
SSF	Special Shareholders' Fund
SWF	Sovereign Wealth Fund
TC	Technical Cooperation

TCRS	TC Reporting System
TCX	Currency-Exchange Fund
TFP	Trade Finance Programme
TI	Transition Impact
TRP	Transport
TSS	Transport Sector Strategy
UK	United Kingdom
UN	United Nations
URP	Unfunded Risk Participation
US	United States
VFM	Value for Money
WBG	World Bank Group

Glossary

Additionality	Additionality is a determination of whether an intervention has an effect, when the intervention is compared to a baseline
Availability Payment	Availability Payments is based on the government "Offtaker" making regular payments to its private sector partner based on the availability of the contracted infrastructure at levels that exceed minimum standards.
Blended Finance	Blended finance involves the strategic use of development funds to improve the risk-return profile of investments to attract private capital
Capital Market	A capital market is a financial market in which long-term debt or equity-backed securities are bought and sold.
Catalysation	There is no formal definition of this parameter, but it refers to private investment that occurs on a broader scale than PIM as a consequence of DFI activity, but there is no fee or co-financing. Catalysation is supported by activities such as policy reform and demonstration effects.
Credit Lines	Credit lines consist of loans from banks such as MDBs to local banks referred to as Participating Financial Institutions, which then on lend debt to MSMEs
Debt	Debt finance is low risk low return as it is collateralised by project's underlying assets, cash flow priorities, or sponsor undertakings.
Development Finance Institutions	DFIs are specialised development organizations that are usually majority owned by national governments.
Equity	Equity is a high risk high return financial instrument structured at the project level as being "first in, last out", and it protects debt by absorbing losses.
Grants	Grants are a financial instrument that do not have a cost of capital and are often used by the public sector to cover essential enabling costs of policy; regulatory and institutional development; project preparation; underwrite revenues; and subsidise early stage private investment
Feed in Tariff	A FiT is a policy mechanism designed to accelerate investment in renewable energy technologies. It achieves this by offering long-term contracts to renewable energy producers, typically based on the cost of generation of each technology
Guarantees	Guarantees are used to reduce private sector project costs of funds by reducing risk by providing standby funding where availability is contingent upon defined low probability high impact negative events occurring.
Infrastructure	Infrastructure is the basic physical and organizational structures and facilities (e.g. buildings, roads, power supplies) needed for the operation of a society or enterprise.
Institutional Investor	An institutional investor is an entity which pools money to purchase securities, real property, and other investment assets or originate loans. Institutional investors include insurance companies, pensions, hedge funds, REITs, investment advisors, endowments, and mutual funds.
Investment funds	Investment funds or collective investment vehicles (CIVs) are structures that provide a way of investing money alongside other investors to benefit from the inherent advantages of working as part of a group.
Mezzanine	Mezzanine finance is medium risk medium return as it sits between debt and equity and it can encompass a range of financial instruments with alternative risk return profiles that are attractive to different types of investors
Monolines	A monoline is an insurance company that provides a single type of guarantee to issuers [of bonds], often in the form of credit wraps, that enhance the credit of the issuer.
Moral Hazard	Lack of incentive to guard against risk where one is protected from its consequences, e.g. by insurance, in instances where the insuree has some control over the insured outcome.
Multilateral Development Banks	MDBs are international institutions that provide financial assistance, typically in the form of loans and grants, to developing countries and projects to promote economic and social development.
Offtake Agreement	An agreement entered between a producer and a buyer to buy/sell a certain

	amount of the future production. It is generally negotiated long before the construction of a facility to guarantee a market for the facility's future production and improve chances of getting financing for the installation concerned.
Partial Credit Guarantee	PCG is a credit enhancement mechanism for debt instruments (bonds and loans). It is an irrevocable promise by the guarantor to pay principal and/or interest up to a pre-determined amount
Political Risk Guarantee	PRG is a type of insurance that can be taken out by businesses against political risk—the risk that revolution or other political conditions will result in a loss
Private Direct Mobilisation	PDM is characterised by clear material evidence, such as a mandate letter or fee, demonstrating the MDB's active involvement in the mobilisation of finance through its financial instruments and operations. PDM does not include sponsor financing.
Private Indirect Mobilisation	PIM is provided to a project financed by the MDB, but there is no material evidence of direct involvement of the MDB in raising the financing. PIM includes sponsor financing if the sponsor qualifies as a private entity.
Private Mobilisation	Private mobilisation is defined as private capital that is invested as a result of a public policy or financial intervention
Public Private Partnership	PPPs use SPVs which allocate risks to parties best able to manage risks based on a range of non-financial and financial instruments sourced from the government as offtaker, the private sector as supplier of project outputs, and MDBs as providers of funded and unfunded financial instruments.
Securitization	Securitization consists of pooling projects and instruments into SPVs and selling cash flows to third party investors as securities. These instruments are often structured on a vertical basis where different classes of investors can invest in different classes of instruments with specific risk return profiles
Skin in the Game	To have "skin in the game" is to have incurred risk (monetary or otherwise) by being involved in achieving a goal.
Special Purpose Vehicle	SPVs are special-purpose legal entities created to fulfil narrow, specific or temporary objectives. SPEs are typically used by companies to isolate the firm from financial risk.
Standby credit facilities	These facilities are structured as overdraft that can be drawn upon at any time up to a pre-determined limit.
Sustainable Development Goals	SDGs are a collection of 17 global goals set by the United Nations General Assembly in 2015 to be achieved by the year 2030.
Syndication	Syndication is an efficient way of reducing transaction costs to attract providers of debt financing, where the lead arranger organises due diligence, financial structuring and distribution. These facilities can be structured as standalone instruments, or as "B Loans", where MDBs retain "A Loans".
Unfunded Risk Participation	URPs are a type of off-balance-sheet transaction in which a bank sells its exposure to a contingent obligation to insurer. The URP allows banks to reduce their exposure to delinquencies, foreclosures, bankruptcies, and company failures. Participations are unfunded as there is no payment by the insurer until a defined event occurs.

Executive summary

Mobilisation of incremental private sector finance by the multilateral development institutions (MDBs) has always been formally at the core of their public purpose. In some it is explicitly established as a central objective; EBRD's Articles specifically do so, as do the founding Articles of the World Bank, IFC and other comparator institutions.

Several major recent developments have made mobilisation central to shareholder concerns and strategic and operational priorities for the MDB system. Estimates of incremental private sector investment needs for development priorities have soared; governments and the MDBs have made many ambitious and high-profile commitments such as the SDGs; and public resources are increasingly squeezed by demographics. Meanwhile the pool of potentially investible private funds has grown hugely; highly capable private investors are meeting financing needs once the exclusive domain of the MDBs; traditional MDB lending instruments have become less attractive in many markets and less relevant to potential new clients. Broader discussions about EBRD strategic priorities and its future role in the wider development architecture are underway in this very context.

It was also in this context that EBRD joined a 2015 commitment with other MDBs to increase mobilisation of private finance by 10 fold over time; in 2017 it joined a further MDB commitment to increase private sector mobilisation by 25-35% by 2020. But despite these ambitious commitments direct financing has long had overwhelming operational and strategic priority across the system. Mobilisation as originally understood – use of public balance sheets to leverage substantially greater private investment -- has for the most part had minimal systemic weight; including at the EBRD, and mobilisation has never been a strategic objective.

Against this background the Evaluation Department included an assessment of mobilisation at EBRD in its 2019 Work Plan. This resulting study seeks to contribute to Board and Management understanding, strategic thinking and operational decision-making about the Bank's role in mobilising additional private capital to support transition. Organisationally it begins by providing essential factual background, including details on the instruments used, and current MDB strategies, practice and outcomes; key findings of existing performance assessments and evaluations. The bulk of the paper then looks closely at mobilisation practices and issues specific to EBRD and its performance.

Finally, the paper identifies a range of findings, implications and potential action areas on key strategic and operational issues.

- Existing approaches will almost certainly not deliver the Bank's ambitious commitments to mobilise private investment for global priorities.
- There are real opportunities for the Bank to scale up mobilisation and expand its business in support of transition objectives by broadening its product range such as offering guarantees
- An intensified focus on private mobilisation would strengthen the Bank's institutional distinctiveness and competitive position.
- There are opportunities to make better use of existing capital and build out on existing core banking competencies
- An expanded range of instruments would create potentially powerful new performance metrics to improve internal incentives and external reporting

EvD's broad conclusion is that a Board/Management strategic reflection specifically through the lens of mobilisation is both relevant and necessary for EBRD at this point, would contribute to a fresh strategic and operational perspective, and help position EBRD for a successful future. Specific findings and conclusions include those summarised below.

Approach to Mobilisation

Mobilisation has no substantial institutional profile at EBRD. Operational priority goes to maximising use of own capital through Annual Business Investment (ABI). ABI competes against mobilisation and incentivises staff to minimise third party finance until internal targets or headroom constraints are reached. The indirect co-financing of Annual Mobilised Investment (AMI) is seen as competing with traditional lending for EBRD's margin.

The corporate scorecard has multiple competing objectives that in the main work against mobilisation and more effective and efficient use of EBRD's abundant capital. ABI is the main metric used to incentivise staff. It is based on the value of capital commitments of instruments such as debt, equity and guarantees. ABI suffers from a number of weaknesses as it does not account for risk adjusted returns on capital, it can be cancelled before funding is drawn; and it specifically excludes returns from instruments such as advice.

Management tends to discount return on capital when prioritising investments. Risk Adjusted Return on Capital (RAROC) is used as an ex ante measure to help screen projects, while a rolling three year average of Return on Required Capital (RORC) is an ex post measure that is part of EBRD's corporate scorecard. RORC is not directly linked to RAROC, it is unresponsive to change, and it is not used to incentivise staff in the same way as ABI. The combination of these factors undermines a more effective use of EBRD capital to support mobilisation.

The low corporate priority on mobilisation has also no doubt discouraged innovation in and expansion of the Bank's product and service offer, reducing its ability to respond effectively to opportunities outside of its traditional business. This would include reaching new clients and finding new pathways to financial additionality, especially in more advanced COOs.

Mobilisation Performance

EvD reviewed EBRD's mobilisation performance against accepted common MDB methodology on mobilisation that differentiates between private direct mobilisation (PDM), private indirect mobilisation (PIM), and catalysation. PDM refers to investments where MDBs obtain a fee for direct financing, and is typically comprised of B loans. PIM refers to investments where financiers co-invest with MDBs, typically through a parallel loan, and the MDB does not obtain a fee. There is no agreed definition of catalysation, but it refers to private investment that occurs on a broader scale than PIM due to Development Financial Institution (DFI) activity.

When EBRD refers to PDM, it is usually co-finance, measured by AMI and mainly dominated by B Loans, and thus essentially private. But since 2015 AMI and PDM started to diverge due to the rapid growth in public donor funding for climate finance, and its inclusion in AMI. PDM has been about 10% of ABI, which is proportionately low relative to other MDBs.

PIM is not a strategic priority as it cannot be directly attributed to EBRD actions, does not generate fees, or contribute to financial sustainability. EBRD's PIM accounted for about 90% of its total Private Finance Mobilised which is high compared to other MDBs. The amount of information that can be drawn from EBRD's management information system (MIS) with respect to catalysation of donor funds is limited. Based on information available leverage and catalysation are likely quite low.

Financial performance of mobilisation initiatives is briefly reviewed. A management review of syndicated B loans found that returns were profitable compared to other financial products offered by EBRD, and further returns could be captured by developing more complex innovative financial structures. **Evaluations and case studies across the MDBs confirm that mobilisation potential exists,** particularly for instruments such as grants and guarantees, but it is not yet being realised.

Findings on Four Key Evaluation Questions

1. How is mobilisation understood in EBRD?

There is no formal definition of mobilisation in EBRD and no operational strategy; familiar metrics such as ABI and AMI do not measure mobilisation. ABI is EBRD's key operational objective. While mobilisation is equated with AMI (which has been closely aligned with PDM and B Loans) this interpretation is very narrow. It misses the importance of alternative instruments such as advisory work and guarantees, or the support required from public direct mobilisation and blended finance. The relationship between AMI and PDM is now starting to break down, as B Loans become less attractive to investors and public sector donor funds increase in importance as a proportion of AMI.

2. Are mobilisation objectives clearly identified; are they relevant and well suited to COO circumstances and the institutional context of EBRD?

EBRD prioritises projects based on a range of targets in its Strategic Corporate Framework (SCF) scorecard. This includes targets for variables such as ex ante and ex post estimates of Transition Impact (TI) which provide guidance on strategic direction. Financial measures such as ABI, AMI, and RORC complement TI and help prioritise projects based on criteria such as financial sustainability and use of own capital and mobilised third party capital. Mobilisation is primarily captured by AMI, which suffers from a number of weaknesses.

AMI has a minimum target of about 10% of ABI, which can increase with demand. Traditionally, AMI has been determined by ABI volumes as it was based on an A loan (ABI) and a linked B Loan (AMI) structure. Demand for B Loans has been declining over time, and there are components of AMI, such as Unfunded Risk Participations (URPs) on existing banking assets, and public sector donor funds, which do not qualify as mobilisation. As a result, the mobilisation target is not clear, and not very challenging relative to the goal to increase it 20-30% by 2020. In contrast IFC targets an increase in mobilisation to 80% of total financing by 2030.

While management expresses concerns about low levels of return on bank capital, yield on capital is a secondary measure, relative to ABI, to prioritise the allocation of funds across instruments. ABI is not a good measure to optimise the allocation of capital as it does not take into account risk adjusted capital required to achieve targets

RAROC is a better financial measure than ABI as it focuses on risk adjusted returns on capital; but it is only used to screen projects rather than provide an incentive to pursue projects, it is discretionary, and it is biased against large projects because it is calculated on a gross basis before taking into account project processing and management cost. RAROC does not allow comparison across financial instruments and advice. RORC is an ex post measure of actual performance, but it is a lagging corporate measure and it is not used to directly incentivise staff.

EBRD's organization arrangements do not support a mobilisation focus. Private and public sources of mobilised third party finance are managed by separate departments (Loan Syndications and Donor Cofinancing) and report to different Vice Presidents and Board committees. Both are treated as back office functions where syndications, advice and guarantees partially funded by blended finance are not

actively marketed in competition with ABI. Within banking, bankers are responsible for both client management and loan processing, rather than acting as relationship managers. This arrangement reduces opportunities for EBRD to use specialist teams to offer more complex value added types of finance.

Very little information on mobilisation is available in EBRD's MIS. The TC Reporting System (TCRS) provides no information on unfunded instruments and figures on TC are difficult to find; reports tend to be of poor quality, and the TCRS cannot be interrogated at the country, sector, thematic or framework level.

EBRD has not started to consider how rates of leverage and subsidisation of donor funds might be measured to assess performance of donor funds and its own capital. Discussion of public TC has only extended so far to developing a methodology to show that blended finance is additional and justify use of public funds. There has been no discussion of how funding might be prioritised and allocated using mobilisation of third party funds and yield on capital as objective functions.

B Loans appear to have little beneficial value to commercial banks that are lending to projects located within the EU, and do not explicitly meet investor needs. Many banks seem to prefer to have a voice by entering into a parallel loan with the sponsor, rather than be represented by an MDB. There are issues about MDBs' ability to securitise their Preferred Creditor Status (PCS) and tax breaks and sell these benefits to third parties at scale, without degrading the value of these provisions.

3. Is mobilisation implemented effectively and efficiently?

Third party mobilisation (AMI) in recent years has been static (absolutely and relatively) as a proportion of ABI. Volumes of B loans have been trending down and growth in donor funds does not directly contribute to private investment. High volumes of PIM in EBRD's portfolio complicate efforts to substantiate claims of additionality, contribution and attribution due to the absence of credible evidence on causality.

Case studies show examples of EBRD projects using instruments such as guarantees or securitizations. Some have achieved high leverage of private relative to EBRD finance, but they are not developed at scale. The projects are more like pilots, or participations in projects initiated by other MDBs such as IFC, rather than established lines of EBRD business.

There are very few metrics to measure economic and financial efficiency of EBRD's mobilisation projects. Financial data on syndications relative to non-syndications indicates that income earning potential is high, relative to other instruments such as sovereign loans and traditional credit lines in FCY.

4. What have been the results of mobilisation initiatives to date?

EvD is unable to conclude much on results given the absence of a formal mobilisation strategy, performance targets, and baselines. The study identifies individual projects obtaining high leverage of private finance with a range of instruments and structures; but they are not developed in a structured way to realise mobilisation potential.

Opportunities for Improvement

The analysis suggests opportunities to enhance mobilisation in two areas. First, EBRD could develop and offer new types of markets and products. Expanding and diversifying EBRD's offer range would position it to move into new business areas; increase its institutional distinctiveness within the MDB community; and create paths to new competitive advantage. Second, there are opportunities to address internal/corporate impediments and build on existing strengths.

On markets and products:

- Design new securitised instruments that meet the needs and tap into the investible assets of institutional investors;
- Shift from an originate-and-hold strategy to an originate-and-distribute strategy;
- Strengthen the means to engage in early project development when risks (and value addition) are greater;
- Develop the domestic investor base by partnering with local development banks and investing in local insurance companies and restructuring pension funds so they can invest in private sector financial instruments.

EBRD could take the following actions to capitalise on these opportunities:

- Develop organizational capacity to provide a range of advisory and funded and unfunded instruments, based on a matrix organization structure that reflects demand and supply potential;
- Establish incentives and opportunities that encourage staff to innovate and maximise yield on capital, rather than ABI, supported by corporate, country and sector strategies.
- Country strategies and project pipelines present diagnostics, baselines and mobilisation potential;
- Country objectives for mobilisation could be metrics for PDM, PIM and Catalysation, and rates of subsidisation and leverage for donor and own finance across instruments and structures;
- Loan Syndications teams could help arrange the issuance of bank debt and bonds, possibly supported by partial credit guarantees, and LCY finance, independent of bank lending;
- Use of LCY could be increased by supporting existing agencies such as TCX or developing new capacity in-house or new entrants to provide treasury instruments such as swaps and LCY bonds, and partial credit guarantees for LCY instruments;
- Develop upstream advisory capacity within EBRD for project preparation and LCY financial market development, and pools of pre-committed finance along the lines of IFC's MCPPP finance and infrastructure funds.

Recommendations

1. **Prepare a detailed Mobilisation Approach or Initiative** for discussion with the Board, assessing where mobilisation can be used to support the attainment of TI and return on capital objectives. It should cover markets and associated instruments, including advisory services and guarantees, review existing MDB/DFI practices, and set out clear objectives and institutional responsibilities.
2. **Include mobilisation objectives and means in all corporate, country and sector strategies**, with details on baselines, target ranges and new metrics for mobilisation, types of instruments, expected volumes of blended finance and EBRD investment, and underlying levels of subsidisation and leverage.
3. **Include mobilisation target ranges in the Strategic and Capital Framework (SCF) and associated SIPs**, developed in accordance with financially sustainable yield on capital criteria in corporate and departmental scorecards. Quarterly reports to the Board, funding to ensure staff skills and an effective MIS should provide support.
4. **Upgrade MIS treatment of data on mobilisation and use of blended finance**, review policies for allocating capital and measuring project and corporate performance to ensure yield on capital calculations provide an accurate measure of performance across instruments, and types of investments

1. Introduction

1.1. Purpose of the Study

Evaluation Department (EVD) has prepared a thematic assessment of the mobilisation of third party funds by European Bank for Reconstruction and Development (EBRD) over the period 2014-2018. The study has been prepared at the request of the Audit Committee. The objective of the study is to contribute to Board and Management-level strategic thinking and operational decision-making about the Bank's future efforts to mobilise additional capital to support transition in its countries of operations (COO).

1.2. Rationale for Mobilisation

Mobilisation has always been a primary objective of EBRD, as defined by Article 2 of the Agreement Establishing the Bank, signed in 1990, which enjoins it '...to help [the economies of COOs] become fully integrated into the international economy...' including by '...mobilising domestic and foreign capital...'.

EBRD's mobilisation objective was given further impetus by the Paris Agreement in 2015 where developed economies were urged to mobilise \$100 billion per annum by 2020 to fight climate change, and Multilateral Development Banks (MDBs) committed to support this program. The United Nation's (UN) Sustainable Development Goals (SDG) reflected these goals, and they were approved in 2015 as part of the Addis Ababa Agenda, which highlighted the importance of private sector mobilisation.

In 2017 the MDBs issued a Joint Statement for Crowding in Private Finance during the G20 Summit in Hamburg committing to increase private sector mobilisation by 25-35% by 2020. The MDBs stated they would develop incentives for staff to mobilise more private finance and report jointly on results. These objectives were endorsed by the G20 Eminent Persons Group report on Global Financial Governance (the Tharman Review) issued in 2018. The G20 report stressed the critical role of MDBs and endorsed their target to mobilize additional private finance.

In line with these undertakings, EBRD's Board approved six transition qualities in 2017 that are fully aligned with the delivery of the commitments in the Paris Agreement and the global objectives set out in the SDGs and the Addis Ababa Action Agenda. In 2018, EBRD implemented an Enhanced Approach to Additionality, which is based on harmonised MDB standards to support private mobilisation. EBRD's Strategy Implementation Plan for 2019-2021 highlighted its alignment with SDGs and mobilisation.

1.3. Objectives of the Study

The evaluation contributes to a better understanding of mobilisation and how it supports EBRD's transition objectives and the SDGs. The following questions were used to guide the evaluation:

- How is mobilisation understood in EBRD? Are mobilisation objectives clearly identified and are they relevant and well-suited to COO circumstances and the institutional context of EBRD?
- Is mobilisation being implemented effectively and efficiently?
- What have been the results of mobilisation initiatives to date?
- Does experience suggest ways the effectiveness, efficiency and sustainability of the mobilisation initiatives can be improved?

On the basis of this analysis the evaluation identifies opportunities to improve future performance.

1.4. Evaluation Approach and Limitations

The evaluation reviews practices of MDBs to mobilize private finance in Chapter 2. A picture is developed of alternative mobilisation mechanisms, and strategies to deliver finance from direct and indirect sources. Mobilisation initiatives at other MDBs and the findings of previous evaluations are briefly summarised.

The study evaluates EBRD's mobilisation initiatives in Chapter 3. The report assesses the need for additional investment and financing in COOs. EBRD's definitions of mobilisation objectives, metrics and classification of public and private finance are reviewed. This information provides a basis for defining the scope of mobilisation outputs, operations, organization structure and staff, portfolio composition, and performance. The review considers the overall management of mobilisation, and the quality and accessibility of data. EBRD case studies of selected financial frameworks and projects are profiled. This information provides insights into how mobilisation is occurring in practice, and economic and financial performance to date.

The study reviews opportunities to increase mobilisation in Chapter 4. Critical risks and constraints on mobilisation are identified. Opportunities are discussed for EBRD to increase mobilisation by: (i) developing new markets and products; and (ii) revising the strategy, processes, organisation structure and staff incentives to support mobilisation efforts.

The main limitations of the study are the lack of a formal EBRD strategy for mobilisation of private finance, and the structure of the data collected and reported by EBRD. Reports are focused on projects directly financed by EBRD and there is a lack of time series and cross sectional data on how different sources of funds managed by EBRD and types of instruments are used to mobilise private finance. As a result, it is difficult to identify the types and levels of support provided to COOs to create the enabling environment for mobilisation, and measure the level of success. Further difficulties arise as most of EBRD's private finance is indirectly mobilised or catalysed, making it difficult to determine how its finance was additional, and supported incremental private investment.

The combination of these factors makes it difficult to ascertain how EBRD resources are being used to catalyse private finance by creating markets, multiplying (ie leveraging) the amount of private funds contributed to COO projects, or improving access to new sources of finance. As a result, the study is structured primarily as a strategic review, rather than a formal evaluation of EBRD's mobilisation performance. The focus of the analysis is identification of opportunities to strengthen EBRD's future operations to promote mobilisation, particularly from the private sector.

1.5. Structure of the Report

The balance of the report is structured as follows:

- Section 2: Mobilisation Context;
- Section 3: Evaluation of Mobilisation; and
- Section 4: Implications of Findings for Mobilisation Initiatives.

Appendices provide additional information:

- Annex 1: Definition of Mobilisation
- Annex 2: MDB Mobilisation Strategies;
- Annex 3: External Mobilisation Evaluations and Studies; and
- Annex 4: EBRD Mobilisation Evaluations and Case Studies.

2. Mobilisation Context

Key Facts

- Mobilisation is defined as private capital invested due to a public policy or financial intervention
- Private mobilisation is becoming an increasingly important priority for governments due to SDGs, infrastructure deficits, lack of growth following global financial crisis, and climate change
- Non-traditional private institutional investors have large amounts of capital to invest, but less than 1% is allocated to infrastructure due to inadequate project risk return profiles
- MDBs are seen by agencies such as G20 as playing a critical role intermediating finance and supporting mobilisation in emerging markets, but in practice it has been difficult to achieve
- There are a range of instruments that can be used by MDBs to modify risk return profiles and increase the level of funds mobilised from banks and non-traditional sources via capital markets
- MDBs have made limited progress increasing levels of mobilisation, and methods of defining and measuring additional private mobilisation are controversial
- MDBs are becoming more engaged in pursuing mobilisation, often with blended finance sourced from third party donors, but for most agencies mobilisation is not a key strategic objective
- Previous evaluations highlight the potential for increased levels of mobilisation, and confirm slow progress of MDBs realising this potential

2.1. Overview

In this section mobilisation is defined. The reasons why private mobilisation and credit enhancements using instruments such as blended finance are important is discussed. MDB and donor responses to mobilisation are briefly elaborated. The findings of previous evaluations on mobilisation are presented and critical issues and lessons impacting on performance are identified.

2.2. What is Private Mobilisation and Why is it Important?

For the purpose of this study, mobilisation is defined as: private sector capital that is invested¹ due to a public policy or financial intervention². The term refers to: (i) broader policy or market interventions that improve the enabling environment for investment (e.g. via policy interventions, technical assistance and advisory services), (ii) private sector resources invested directly in a project, or (iii) program private resources mobilized through financial intermediation.³

Mobilisation has become an important objective for governments due to factors such as the infrastructure deficit, impacts of the global financial crisis (GFC) on growth, climate change, migration, and the need to meet the SDGs by 2030. McKinsey estimated the world needs to invest an average of \$3.7 trillion in infrastructure assets every year through to 2035 to keep pace with projected GDP growth. This requirement could increase further by up to \$1 trillion annually to meet the UN's SDGs. These investments cannot occur unless effectiveness and efficiency of investment are improved and additional funds are mobilised.⁴

Public sector has normally led mobilisation efforts through direct financing, but it is constrained as sovereign debt has reached record levels and there are concerns about opportunity costs on

¹ In this study the focus is on money used to support investment in long life (>1 year) capital items, rather than short term trade finance

² This definition follows OECD, which defines mobilisation as the critical goal of blended finance (OECD Mobilisation of private finance and support for the 2030 agenda: Briefing on efforts to harmonise OECD and MDB measurement methodologies, 2018)

³ Climate Policy Initiative, 2015

⁴ Bridging Infrastructure Gaps, Has the World Made Progress? McKinsey Global Institute, 2017

the use of funds from these sources.⁵ Governments are trying to use public funds more effectively and efficiently, and tap unutilised sources of private finance and technology to meet policy objectives. Opportunities are being investigated for private sector funds to compliment and substitute for public sector finance in critical sectors such as infrastructure and provide the necessary conditions for micro, small and medium sized enterprises (MSMEs) to develop. In many cases, governments and donors are blending public and private finance to maximise opportunities to leverage private mobilisation.

The amount of private funds held by non-traditional sources of private finance such as institutional investors is substantial, and it was estimated to be about \$200 trillion in 2018.⁶ At present the level of institutional investment in infrastructure is insignificant, accounting for less than 1% of pension funds. Consequently, it is important to understand and mitigate the risks and constraints preventing private institutional investors from investing in sustainable infrastructure in emerging markets.

Surveys indicate the main risks constraining private investment in developing economies, particularly in SDG intensive sectors such as infrastructure, relate to: (i) political risk, (ii) credit risk; (iii) foreign exchange (FX) risk, (iv) liquidity and exit, (v) macroeconomic environment (inflation, public debt, trade barriers), and (vi) rule of law, contract enforcement and deal quality.⁷ These risks can potentially be mitigated though improvements to investment and financing enabling environments, better project designs, and the use of structured and blended finance.

Agencies such as the G20 see MDBs as a critical means to support private mobilisation by helping to “bridge the gap between the supply of finance seeking market rates of risk-adjusted return and the risk and return characteristics of infrastructure and other investments with important development impacts”.⁸

Box 1: SDG Private Investment Needs and MDB Contributions⁹

Financing the SDGs requires additional investment on a huge scale. Investment to support SDGs is estimated to be \$1.4 trillion in 2016. UNCTAD calculated an additional \$2.5 trillion pa in developing countries is required to 2030, of which \$1.0 trillion annually will be in infrastructure. In 2016 total official development assistance amounted to \$143 billion, indicating a requirement for a 10 fold increase in financing. It is envisaged this **increase in funding will come from the private sector and MDBs will play a central role catalysing these funds.**

MDBs can mobilize funds **directly through their own balance sheets, and indirectly by catalysing third party finance.** MDBs can **directly** catalyse private co-financing by **reducing political and creditor risk using guarantees and the extension of their preferred creditor status, or by reducing information asymmetries** by allowing private parties to rely on MDB's country, sector and project structuring knowledge. Alternatively, MDBs can **indirectly** mobilise private finance by improving the investment climate by influencing government decisions, or through **signalling or demonstrating financial opportunities** to third private parties.

These **MDB mobilisation efforts can have positive and negative outcomes.** There are risks MDBs may act as a substitute rather than a complement for the private sector, leading to **crowding out**. MDBs may **displace investments** that would have otherwise have occurred, or create risks of **moral hazard** by encouraging governments to invest in projects with low returns, delay reforms, or use loans to repay old debts. MDBs have high governance, social and environmental standards and monitoring requirements that create **large transaction costs** relative to private firms. **Evidence on the levels of MDB mobilisation from formal economic studies is mixed.** The findings indicate MDB mobilisation is more effective in high income countries with better credit ratings.

⁵ IMF Blog, Bringing Down High Debt, V Gaspar, L Jaramillo, April 2018

⁶ Better Finance Better World, Blended Finance Task Force, 2018

⁷ Hope or Hype? Attracting Investors to Emerging Markets and Developing Economies, IEG, WBG, 2018

⁸ Billions to Trillions? Issues on the Role of Development Banks in Mobilizing Private Finance, N Lee, CGD, 2017

⁹ Mobilisation effects of Multilateral Development Banks, IADB, 2018

MDBs are well positioned to increase the level of private financial investment in projects and programs in COOs, and help coordinate donor finance to support the attainment of these goals. While MDBs' balance sheets do not have sufficient capacity to enable them to directly mobilise the volumes of finance required to achieve the SDGs, nor would this be a shareholder objective, they can play a critical catalytic role supporting private investment. As a result, the G20 has asked MDBs to develop innovative ways of mobilizing finance by **creating an environment to access** non-traditional sources private finance and **strengthening leverage of private investment using MDB financial instruments**.

Box 2: Components of Mobilisation

Financial instruments are the primary units of mobilisation:

- **Grants** do not have a cost of capital and they are often used by the public sector to cover essential enabling costs of policy; regulatory and institutional development; project preparation; underwrite revenues; and subsidise early stage private investment;
- **Equity** investment is high risk high return and it is structured at the project level as being "first in, last out", and it protects debt by absorbing losses;
- **Mezzanine finance** is medium risk medium return as it sits between equity and debt and it can encompass a range of financial instruments with alternative risk return profiles that are attractive to different types of investors;
- **Debt finance** is low risk low return as it is collateralised by project's underlying assets, cash flow priorities, or sponsor undertakings;
- **Guarantees, insurance and derivatives** are unfunded instruments that can be used to lower private sector costs of funds by reducing risk by providing standby funding where availability is contingent upon defined low probability but high impact negative events occurring;

Financial structures can be developed using financial instruments:

- **Credit lines** consist of loans from banks such as MDBs to local banks referred to as Participating Financial Institutions (PFIs), which then on lend debt to MSMEs;
- **Investment funds** or collective investment vehicles are structures that provide a way of investing alongside other investors to benefit from diversification and economies of scale;
- **Securitization** consists of pooling projects and instruments into special purpose funds and selling their related cash flows to third party investors as securities, which can be diversified across multiple types of financial instruments;
- **Syndication** provides a means of reducing transaction costs to attract multiple MDB, development finance institutions (DFIs) and commercial lenders, where the lead arranger organises due diligence, financial structuring and distribution. These facilities can be structured as standalone instruments, or as "B Loans", where MDBs retain the "A Loans";

Institutions can draw upon a range of financial instruments and structures to develop various types of financial and infrastructure facilities:

- **Public-Private Investment Companies/Banks** that acquire shareholdings/ make loans on behalf of governments, in the private sector.
- **Infrastructure PPPs** can be developed at the project level using Special Purpose Vehicles (SPV). These SPVs allocate risks to parties best able to manage risks based on a range of non-financial and financial instruments.

Markets can be developed with institutions, structures and instruments to support the flow of local currency (LCY) and foreign currency (FCY) capital, and physical assets such as infrastructure through private and public capital markets.

MDBs have responded by making various undertakings, but in practice progress on mobilisation has taken longer to achieve than expected. Mobilisation is a complex concept, where a wide range of different financial instruments and structures can be used by MDBs to modify risks and returns accruing to investors (Box 2). Risk return ratios can be modified at the project, portfolio, institutional and market level, across countries, sectors and financial markets at various points in the project lifecycle (see Annex 1 for a more detailed discussion on the definition of mobilisation). Within this framework, MDBs have the choice of advising on the structuring and use of instruments, investing in unfunded (eg guarantees) or funded (eg debt or equity) instruments, and financing on a local currency (LCY) or foreign currency (FCY) basis.

2.3. Why are Advice, Guarantees and Capital Market Instruments Important Means of Mobilisation?

There are a range of ways that MDBs could pursue these types of mobilisation initiatives. Areas with high mobilisation potential include: (i) strengthening project pipelines and market offtake arrangements by providing advice; (ii) leveraging investment by increasing usage of low capital intensity guarantees, (iii) increasing the velocity of MDB capital by encouraging refinancing after firms get through the high risk construction phase, and (iv) designing investment opportunities that are attractive to institutional investors through the arrangement and issuance of investment grade capital market instruments.

Project preparation capacity within governments, based on effective timely advice, is critical to create a pipeline of bankable projects. This requirement is dependent upon effective infrastructure governance such as policy and strategic vision, coordination across government agencies, adequate cost benefit and value for money (VFM) studies for design and structuring, transparency and disclosure during procurement, accurate assessments of fiscal impact, climate and environment assessments, debt management, and staff capacity.

Within this framework, guarantees are attractive as they provide a contractual mechanism to reallocate risks from one party to another at relatively low cost. Traditionally these contracts are concerned with mitigating political and credit risks and they can be full or partial, and funded or unfunded. Guarantees can be linked to financial instruments such as equity, or subordinated debt, where payments are made to cover first or second tier losses and protect more senior payments in project cash flow waterfalls in structured finance facilities.

Guarantees can be categorised as non-financial or financial. Non-financial guarantees (NFG), or contractual guarantees, are often sourced from the public sector and typically they are used to strengthen offtake arrangements on the demand side for PPP infrastructure projects. In many cases, these NFGs have been supported by standby credit facilities that provide government offtakers with liquidity to mitigate risks of insolvency and provide time to resolve issues if they arise.¹⁰

Financial guarantees (FGs) are an important instrument to mobilise private finance on the supply side. FGs can be used in the context of either PPPs for infrastructure, or conventional MSME finance. FGs can target individual political and credit risks, and they use less capital and have shorter maturities than funded instruments such as grants and concessional loans, enabling guarantee capital to be more rapidly recycled across projects. Critically, FGs provide a means for private projects to access capital markets and tap into non-traditional sources of funding managed by institutions such as sovereign wealth funds (SWF), pensions and insurance companies.

¹⁰ In countries such as Brazil, Indonesia and the Philippines, special purpose PPP guarantee funds have been established to underwrite governments' PPP offtake and early termination payment obligations.

While benefits from guarantees can be significant, there are a number of costs and risks that need to be addressed to effectively use these instruments. Guarantees can increase transaction costs as a third party guarantor is required, and there may be concerns about MDBs crowding out private guarantors.

Moral hazard is a critical risk as it discourages insured parties from avoiding risk. As a result, most MDB guarantees provided to projects are partial¹¹ – they cover either: (i) one type of risk (usually political); or (ii) only a portion of the financing (such as longer dated debt tenors). This partial cover ensures both the insurer and insuree have incentives to minimise risks of negative events occurring.

In some cases, MDBs such as Multilateral Investment Guarantee Agency (MIGA) at the World Bank Group (WBG) provide project lenders a “Non-Honouring Guarantee”. This instrument provides a full wrap¹² covering non-payment by public sector offtakers of PPPs, and it is backed up with NFGs and an indemnity from the government so the public sector ultimately bears the costs of its non-performance.

Full wrap guarantees for PPPs were pioneered by monoline insurance companies in the United Kingdom (UK) in the 1990s¹³, and they were a structural innovation that helped create the market for PPP finance. The full wrap enabled project sponsors to close financing more easily, and in some cases move from financing projects with bank loans to issuing project bonds. These bonds were provided to large institutional investors in capital markets who wanted to invest in long term fixed rate LCY instruments, something banks could not easily provide. The full wrap enabled projects to be rated at the same level as the guarantor, rather than the project, creating opportunities to reduce finance costs below levels based on project risks.

The ability of a full wrap to enable projects to access capital market instruments such as project bonds is attractive for both project sponsors and commercial banks. The Basel III regulatory framework has made it increasingly difficult for commercial banks to hold long term illiquid assets such as infrastructure loans on their balance sheets. As a result, project sponsors and banks are being incentivised to sell long term infrastructure debt assets before they reach maturity, or refinance them through the issuance of capital market instruments such as project bonds.

Bond financing is attractive for project sponsors as it eliminates the cost of swaps to fix the interest rate, and the tenor of the bond liability can be set to match the life of the project asset. There is the potential for bonds to be issued in LCY capital markets, eliminating FX risks. Structured finance facilities can be designed that provide different categories of instruments with risk return characteristics that meet the needs of different classes of investors.

The main disadvantages of project bonds are the negative cost of carry during the construction phase on undisbursed funds, and their inability to deal with fluctuating levels of risk. In contrast to bank debt, project bonds are not suited to financing projects during the construction phase when project risks are growing over time, but they are well suited to the operating phase, when risks are stable. As a result, there is a natural fit between using flexible bank debt instruments during the construction phase, and then refinancing with more inflexible capital market project bonds once operations commence.

¹¹ Partial Credit Guarantees are irrevocable and guarantee timely payment, and they are unconditional but for the “limit amount”, normally a percentage of the principal amount of the guaranteed obligation. Best Practices in Public-Private Partnerships Financing in Latin America: the role of guarantees, WBG, 2012

¹² Full wrap guarantees are defined as being unconditional, irrevocable and cover 100% of each and every principal and interest payment of the guaranteed obligation in a timely manner. Best Practices in Public-Private Partnerships Financing in Latin America: the role of guarantees, WBG, 2012

¹³ Capital markets in PPP financing. Where we were and where are we going? EPEC, March 2010

These capital market instruments can be combined with non-traded instruments in structured finance arrangements that absorb higher levels of risks and return than the traded instruments. Additional risks can be managed through instruments such as unfunded risk participations (URPs) or techniques such as diversification. The subordination of high risk instruments' claims to project cash flows ensures the traded instruments exceed minimum risk return thresholds of institutional investors.

In many cases it can be difficult for third party investors to ascertain underlying risk in these complex capital market instruments. In these circumstances, there is often a need for financial arrangers to obtain a rating and maintain a residual interest in the instruments. This residual interest is referred to as "Skin in the Game" (SITG) and it helps minimise risks of moral hazard and ensures commitment by aligning incentives between investors and financial intermediaries.

2.4. MDB and Donor Responses to Mobilisation

2.4.1 Overview

MDBs are seen by agencies such as the G20 as playing a critical role achieving the SDGs as they can act as "political umbrellas" for private lenders,¹⁴ and support borrower countries in the following ways: (i) they can play a leading role in the preparation of policies on privatization, concessions, and PPPs; (ii) they can promote private investment in the infrastructure sector by absorbing part of the upfront risk and finance key bottlenecks in the project pipeline¹⁵; and (iii) their institutional mandates allow them to make financial commitments [to projects and programs] even in countries with high political risk.¹⁶ In particular, MDBs have implicit, and in many cases explicit, sovereign guarantees to mitigate project demand and repayment risks that are not available to commercial banks.

It was anticipated that supply side guarantees to private sector firms would be a major activity of the WBG when it was created in 1944. In practice, this activity has not materialised and the operations of the WBG and most MDBs have been focused on direct financing from their own balance sheets in FCY, and they have discouraged refinancing. In most cases, these MDB funds have been directed to governments rather than the private sector, and structured as senior debt that is collateralised with sovereign guarantees, and has tenors of 20-30 years. International Finance Corporation (IFC) was only established in 1957 to provide a window to finance private sector firms. As a result, mobilisation and private sector credit enhancement activities have not featured prominently in MDB strategies.

IFC is the largest MDB mobilising private finance. IFC developed the A/B syndicated loan structure, and it is the main instrument used by MDBs to mobilise private finance. Under this structure, the MDB retains the A Loan on its balance sheet and it is the lender of record for B loans that are syndicated to third party commercial banks. When there are high levels of political risk attached to large infrastructure projects, B loans are attractive to commercial banks as they can benefit from MDBs' preferred creditor status (PCS), which is a form of political risk cover embedded in the B loan instrument. B loans can also provide commercial investors with important tax advantages. Apart from Asian Infrastructure Investment Bank (AIIB), all the MDBs offer A and B loans. IFC also arranges B Loans for DFIs, without supporting A loans, but this operation is small scale and it does not appear to be replicated by other MDBs.

¹⁴ "Political Risk, Project Finance, and the Participation of Development Banks in Syndicated Lending," Journal of Financial Intermediation 21(2) (2012): 287–314. Hainz and Kleimeier 2012

¹⁵ Assistance can be provided to governments to identify and prepare projects, and develop institutional capacity to manage actual and contingent fiscal risks and liabilities

¹⁶ Infrastructure Finance in the Developing World, GGGI, S Gatti (2015)

Guarantees are the other instrument used by MDBs to mobilise private finance. These instruments are not common and MIGA only started to provide guarantees in the late 1980s following extended periods of low foreign direct investment (FDI) and a series of debt crises in developing countries. The main instruments provided by MIGA are political risk insurance to mitigate supply side risk, and more recently, credit enhancement through Non Honouring Guarantees to mitigate sovereign demand side risk. MIGA primarily (if not exclusively) denominates its guarantees in hard currency (FCY), as its traditional focus is supporting FDI in EMS. The use of guarantees has not been significant, and in 2013, less than 2% of the total funds mobilised by MDBs took the form of loan guarantees ¹⁷

In most cases, MDBs have been reluctant to take credit enhancement instruments and associated risks such as FX risk directly on their balance sheets due to concerns about the possible negative impact on their credit ratings and cost of capital.

Evidence from external evaluations of MDBs' mobilisation activities (see Annex 3) indicate that staff are often discouraged from using guarantees, refinancing projects, using LCY, or providing advice. Capital allocation rules for guarantees artificially inflate the amount of capital provisioned for guarantees relative to fully funded instruments, reducing reported levels of profitability. Staff incentives prioritise direct lending approvals, which discourage the use of guarantees as they are seen by bankers as complicating project preparation and they do not add value from an MDB financing perspective. Refinancing is discouraged as it is seen as reducing earnings relative to fixed costs of project preparation. LCY is discouraged as it is seen as unacceptably risky and has the potential to erode profitability of MDB operations that report on an FCY basis. Advisory work is discouraged through policies that prioritise investment returns ahead of advisory fees.

These circumstances have meant that most of the innovations in MDBs to support mobilisation are being developed with blended concessional finance and guarantees from third party sources accessed through direct donor funding, multi-donor trust funds or climate funds. At present levels of blended finance used by MDBs are relatively low, and in IFC they are about 3-4% of its project costs.¹⁸

2.4.2 *MDB Mobilisation Strategies*

A summary of mobilisation strategies for Asian Development Bank (ADB), AIIB, European Investment Bank (EIB) and WBG is provided in Annex 2. The summary shows that MDBs identify mobilisation as an important means of achieving development objectives, but with the exception of AIIB and WBG, it is not formally defined in an underlying strategy. ADB, EIB, and the WBG provide a full suite of grants, equity, debt and traditional guarantee instruments for political risk and partial credit, which can be issued to governments, and to a lesser extent private sector firms to support mobilisation.

The WBG has taken the most decisive steps amongst the MDBs to develop a mobilisation strategy and it approved its "Maximizing Finance for Development" (MFD) program in 2017. WBG's public sector arm (IBRD) and its private sector arm (IFC) aim to increase their respective mobilization ratios to 25% and 80% on average over FY19-30.

The MFD provides a comprehensive framework to systematically mainstream private mobilisation. The MFD shows how private mobilisation can potentially be scaled up by preparing Country Private Sector Diagnostics, establishing special purpose private funds and making innovative use of new instruments and structures. An ex ante Anticipated Impact Measurement and Monitoring (AIMM) system that is aligned with SDGs has been implemented for projects to enhance assessment of development

¹⁷ Guarantees for development A review of MDB operations C. Humphrey, A. Prizzon, ODI, 2012

¹⁸What is Concessionality and How is it Calculated?, IFC, 2019

impact. Operating Principles for Impact Management have been established by WBG to help guide strategy development at the portfolio and country level and are used for both Advisory services, and Investment services.

Under the MFD, the WBG introduced a “Cascade Approach” to prioritize the allocation of its resources and leverage its capital to mobilise private sector investment for growth and sustainable development. The MFD incentivises staff to use private finance for investment before drawing down public finance. If private finance is not sufficient, then the WBG may consider public sector finance, initially on a blended unfunded basis, before looking at fully funded public sector financing solutions sourced from WBG’s balance sheet.

Following the introduction of the MFD, IFC and MIGA established pre-committed pools of private sector funds to support mobilisation, and increased the focus on upstream advisory work. Under IFC 3.0 it will embed fully dedicated upstream teams in both global and regional industry departments, as well as functional areas, with a mandate and funding to provide upstream technical assistance, and a Global Upstream Director to provide support. These funds are allocated to instruments and investment themes that can potentially draw upon blended public sector guarantees and funds to leverage their capital:

- **Private Sector Window (PSW)** uses \$2.5 billion of blended public finance sourced from the sovereign International Development Association (IDA) 18 fund to enhance risk return profiles of privately financed projects. The PSW was established in 2017 for a 3 year period and it has four facilities and a Creating Markets Advisory Window:
 - **Risk mitigation facility in IFC** providing project-based guarantees (\$1 billion) to crowd in private finance for infrastructure projects in the form of: (i) liquidity support for SOE offtake obligations; and (ii) political risk insurance for debt and equity to mitigate exit risks;
 - **Blended financing facility in IFC** that uses debt, equity, mezzanine finance, and guarantees to mobilize private finance for MSMEs (\$600 million) to help make projects financially sustainable through the use of structures to mitigate risk through subordination, deferrals, provision of first loss, and longer tenors;
 - **LCY facility in IFC** to share currency risk (\$400 million). This facility will use existing facilities such as TCX, followed by counterparty credit risk transfer, non-deliverable swap and spot FX market, LCY pool funding, and outright open FX transaction;
 - **Guarantee facility in MIGA** political risk coverage in IDA countries (\$500 million); and
 - **Creating Markets Advisory Window**, which allows IFC to respond to increased demand for advisory services for upstream work to develop bankable projects and risk mitigation tools to attract private investment.
- **Asset Management Company (AMC)** attracts new sources of private equity from non-traditional sources which are invested in tracker funds that reflect various dimensions of IFC’s investment portfolio. AMC was established in 2009 and it has mobilised total external capital of about \$7.5 billion, which is invested in 13 AMC-managed funds and a single asset co-investment.
- **Managed Co-Lending Portfolio Programme (MCP)** is using a combination of debt and URPs to create portfolios of assets that mirror and track IFC’s debt portfolio. MCP is a “blind pool”, with investors committing funds for a set of future IFC loans. MCP has mobilised \$7 billion, of which:

- \$3 billion was sourced from **sovereign funds**
- \$2 billion was allocated to an **infrastructure fund** (MCPPI Infra), and
- \$2 billion to a **financial institutions fund** (MCPPI Financial).

MCPPI Infra is an infrastructure debt-syndication programme, which buys loans originated by the IFC, pools them in a loan fund, then structures them into two types of security – a higher-risk ‘first-loss’ tranche, which is retained by IFC, and a less risky ‘second-loss’ tranche suitable for institutional investors. MCPPI Infra is backed by public sector guarantees from the Swedish International Development Cooperation Agency (SIDA) to enhance its credit risk capacity. MCPPI Financial is an IFC balance sheet risk management tool where it sells down investment exposures to insurance companies using URPs.

- **Securitisation and syndication:** IFC has experimented with funds based on various securitization and structured finance products such as the Green Cornerstone Bond Fund that used multiple categories of subordinated equity to credit enhance the mobilisation of \$2 billion investment in green bonds.

Other MDBs are taking steps such as establishing SPVs to support securitization of structured finance products, but initiatives are ad hoc and impact to date has been limited. All three of the MDBs reviewed have developed specialist institutions that offer guarantee instruments similar to the private sector monolines to promote the issuance of project bonds for infrastructure that is funded via the capital markets, rather than through other commercial banks, but levels of operations are low.

Bilateral DFIs have been actively developing innovative institutions to support mobilisation (See Annex 1 for further details). A consortium of DFIs led by FMO has provided equity capital to special purpose entities administered by firms such as Cardano Development to address various types of market failure. Currency-Exchange Fund (TCX) was established to provide specialist FX-hedging instruments for private investors in EMs. Frontclear develops interbank money markets by providing payment guarantees. Guarantco supports infrastructure development through provision of LCY partial credit guarantees.

Guarantco is part of Private Infrastructure Development Group (PIDG), which is jointly owned by seven DFIs (including FMO), and IFC. PIDG provides a range of instruments such as grants for project preparation, and financial support for IFC Advisory Services, to develop PPPs, guarantees and long term funding through Emerging Africa Infrastructure Fund. About 70% of Guarantco’s guarantees are denominated in LCY, and it can provide cover for 15-20 years for bank debt or bonds issued in EMs. A good example of the type of projects supported by Guarantco is Acorn Holdings, which was a project bond used to finance student accommodation. The bond received a partial credit guarantee that enabled it to issue the bond on the London Stock exchange.¹⁹

FMO also directly supports entities such as the Climate Investor One (CIO) fund, which began operations in 2017 with capital of \$412 million. CIO focuses on renewable energy and it combines three separate facilities to spread the risk between the development stage, the construction stage, and the operations stage of a project’s lifecycle. CIO is directing most of its financing early in the project lifecycle and modifying the use of instruments over time to manage its risk exposure and maximise the potential for additionality. CIO is aiming for a leverage ratio of 1:9 direct financing to co-financing, compared to MDBs’ current ratio of about 1:1.

¹⁹ https://guarantco.com/gco/wp-content/uploads/2019/Documents/GuarantCo_CorporatePresentationQ42019_web.pdf

2.4.3 MDB's Mobilisation of Private Finance

Following the agreement of the Addis Ababa Agenda in 2015, the MDBs established a taskforce that prepared a common methodology to report on the level of private finance mobilised. The task force differentiated between public and private sources of co-finance, and it focused on private mobilisation. Public sector funding is not considered under the MDB Mobilisation framework.²⁰

The MDB definition of private co-finance is an investment made by a private legal entity that is: (i) carrying out or is established for business purposes; and (ii) it is financially and managerially autonomous from national or local government. In some cases, public entities that are organized with financial and managerial autonomy are counted as private entities.

Within this context, the MDB's definition of private mobilisation²¹ consists of two components:

- **Private Direct Mobilisation (PDM)** is characterised by clear material evidence, such as a mandate letter or fee, demonstrating the MDB's active involvement in the mobilisation of finance through its financial instruments and operations. PDM does not include sponsor financing; and
- **Private Indirect Mobilisation (PIM)** is provided to a project financed by the MDB, but there is no material evidence of direct involvement of the MDB in raising the financing. PIM includes sponsor financing if the sponsor qualifies as a private entity.

The MDB's private mobilisation methodology distinguishes between short and long term finance, countries by region and income level, and infrastructure and non-infrastructure sectors. Performance is measured on the basis of financial flows, rather than development impact. Attribution rules have been developed to avoid double counting where more than one MDB is involved in a transaction.

MDBs have prepared a series of joint reports using the common methodology, which shows that mobilisation has been static over the last three years. It was estimated the total amount of long-term co-financing mobilized²² in 2016 from private investors and other institutional investors was \$163.5 billion for that year. In 2017 this annual MDB mobilisation figure increased to \$167 billion, and then declined in 2018 to \$161 billion (Figure 1). PDM averaged about 30% of private mobilisation over this period. MDB mobilisation for infrastructure was about 44% of total mobilisation over 2016-2018 (Figure 2).

Figure 1: Total Private Finance, All COOs

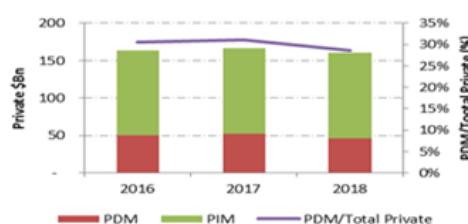
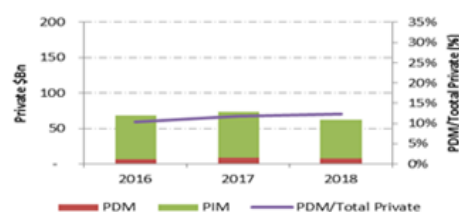


Figure 2: Infrastructure Private finance, All COOs



Source: Mobilisation of Private Finance by MDBs and DFIs, 2016-2018

²⁰ EBRD Management does report on Public Sector Funds in its Quarterly Performance Reports.

²¹ Mobilisation of Private Finance by Multilateral Development Banks and Development Finance Institutions, 2017

²² ADB Asian Development Bank; AfDB African Development Bank; AIIB Asian Infrastructure Investment Bank; EBRD European Bank for Reconstruction and Development; EDFI European Development Finance Institutions; EIB European Investment Bank; IDB Inter-American Development Bank; IsDB Islamic Development Bank; IFC International Finance Corporation; MIGA Multilateral Investment Guarantee Agency; WB World Bank; WBG World Bank Group

The MDBs note in their joint 2017 report that in addition to PDM and PIM, they “catalyse” private investment independent of actual financing, but this metric is not currently measured or reported. There is no formal definition of catalysation, but it refers to private investment that occurs on a broader scale than PIM as a consequence of DFI activity, but there is no fee or co-financing. Catalysation is supported by activities such as policy reform and demonstration effects. Catalysation impacts could potentially be large, as MDBs mobilise private finance through technical advice, support for policy reform, capacity building, demonstration effects, and other activities which open new opportunities for private investment, or trigger an investment response from private investors.

2.4.4 MDB Mobilisation Performance

A critical measure of mobilisation performance is the amount of additional private finance per unit of MDB public and/or private finance invested. To date, the MDBs have not disclosed the amount of public finance invested to mobilise private finance due to concerns about confidentiality of commercial data. Available evidence, based on measures of both public and private finance, indicates the leverage of MDB finance in total (public and private) is low (<1.0) (see Table 1).

Table 1: Summary of Mobilisation Data Sources and Implied Leverage Ratios

Source of Data	Basis	Sample	Leverage ratio
Blended Finance Task Force, 2018	Total Mobilisation	MDBs, excluding EIB EU Operations	1:0.7
Blended Finance Task Force, 2018	Direct Mobilisation	MDBs, excluding EIB EU Operations	1:0.4
DFI Working Group, 2014-2016	Total Mobilisation	MDBs and DFIs	1:1.3
DFI Working Group, 2017	Total Mobilisation	MDBs and DFIs	1:1.06
ODI Estimate	Total Mobilisation	MDBs and DFIs	1:0.75

Source: Blended finance in the poorest countries - The need for a better approach. Samantha Attridge and Lars Engen, ODI 2019

Overseas Development Institute (ODI) estimated that each \$1 invested by MDB and DFI mobilises on average \$0.75 of private finance for developing countries, but this figure falls to \$0.37 for Lower Income Countries in difficult sectors such as infrastructure (see Figure 3). These figures are very low, when compared to leverage ratios claimed by entities such as CIO Fund.

Figure 3: Sector Leverage Ratios by Country Income Group, nine selected MDBs and DFIs



Source: Blended finance in the Poorest Countries - The Need for a Better Approach. Samantha Attridge and Lars Engen, ODI 2019

These estimates are controversial, and representatives of the MDBs have developed alternative estimates of leverage that are much higher. In 2019, a paper prepared by staff from IMF and IDB calculated an MDB leverage ratio of about 1.0:7.0.²³ It seems this MDB study used a different denominator to the ODI/Blended Finance Taskforce studies, and looked at total mobilisation, rather than additional private finance. More generally, there is an ongoing debate in the development community about which classification systems should be formulated by international agencies to measure mobilisation and the requirements for standardising data collection and reporting systems.

2.4.5 Mobilisation, Blended Finance, Additionality, and the Need for Transparency

OECD has sought to address some of these concerns by developing an alternative definition to the MDBs for measuring mobilisation of private finance. OECD's mobilisation methodology does not differentiate between direct and indirect private finance, it doesn't count private finance in high income countries, it includes financing from non MDB DFIs, it focuses on instruments and structures rather than sources of finance, and it tries to measure contributions by all participants. Under the OECD definition, 50% of mobilised finance is assigned to the arranger, and 50% pro-rated to all other financiers that mobilised private finance by official actors. "In a nutshell, the OECD DAC methodology takes into account the role of all official actors involved in a co-financing arrangement, while the MDBs attribute private finance mobilised to the institution that receives the fee for mobilising private capital, often the lead arrangers/project developers."²⁴

OECD prepared a review of private sector mobilisation 2012-2017²⁵ and it concluded \$157.2 billion was mobilised over this period in total, which indicated an annual mobilisation figure of about 20% of the MDB estimates. OECD estimated that guarantees mobilised the most private finance (40% of the total), followed by syndicated loans (17%), direct investment in companies and project finance SPVs – (16%) and credit lines (16%). About 60% of the amounts mobilised in 2017 were invested in the energy and financial sectors. WBG's public sector IDA fund and MIGA were the main sources of guarantees, and they tended to be allocated to projects in Upper Middle Income Countries. MDBs mobilised 72% of private finance in 2017 compared to 28% from bilateral DFIs.

OECD has also developed a methodology for blended finance that measures and evaluates public sector funds used to mobilise private investment. OECD's methodology focuses on the magnitude of leverage derived from the use of public funds to mobilise private investment. This methodology contrasts with the MDB definition of blended finance, which focuses on measuring the amount of subsidy per unit of MDB project cost, rather than the amount of private sector mobilisation (Box 3). The IFI definition of concessional finance is further qualified, as it excludes grants from concessional co-investment with IFI's own investments.

Box 3: Alternative Definitions of Blended Finance

OECD–DAC Definition	IFI Working Group Definition
"The strategic use of development finance for the mobilisation of additional finance toward sustainable development in developing countries,"	"Combining concessional finance from donors or third parties alongside DFIs' (development finance institutions') normal own account finance and/or

²³ Mobilisation Effects of Multilateral Development Banks, C Broccolini et al, 2019

²⁴ Measuring Private Finance Mobilised for Development at the International Level, OECD, February 2019

²⁵ Amounts Mobilised from the Private Sector by Development Finance Interventions, Highlights from 2017, OECD, June 2019

<p>with 'additional finance' referring primarily to commercial finance." (October 2017)</p> <p>This definition focuses on the mobilisation of commercial finance, which is not currently being directed toward development-related investments, including all ODA, FDI, grants, trust funds, and others.</p>	<p>commercial finance from other investors, to develop private sector markets, address the SDGs, and mobilize private resources." (April 2017)</p> <p>The DFI definition refers to specific segment of DFI's operations that receive concessional financing as supplementary elements to enhance their potential.</p>
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Source: The IFC Blended Finance Operations Findings from a Cluster of Project Performance Assessment Reports, IEG, 2019

The OECD measure of blended finance, and its focus on leverage, is important as donors have expressed concern about the potential lack of additionality and the high risks of crowding out or unnecessarily subsidising private investors. EVD prepared a study on additionality (2018) which confirmed weaknesses with current MDB definitions. EVD noted in EBRD the definition encompasses financial additionality and non-financial effects such as lower risk or improved quality of outputs. The overlapping of additionality and impact, and the fact additionality is assessed early in project selection and design, meant its justification relies on judgement, rather than hard evidence, and can be difficult to verify.

In 2018 the MDBs sought to address these concerns by defining a set of principles on the use of blended finance.²⁶ These principles require MDBs to specify: (i) Additionality/Rationale for Using Blended Concessional Finance; (ii) Crowding-in and Minimum Concessional; (iii) Commercial sustainability; (iv) Reinforcing markets; and (v) Promoting high standards.

MDBs are starting to take specific actions to increase the level of transparency in the use of public funds to mobilise private investment, and strengthen the case for additionality. IFC announced that from 1 October 2019 it "will publicly disclose the estimated subsidy for each proposed project along with the justification for why it is necessary" and said the rule will apply to all of IFC's blended finance facilities.²⁷ IFC has established a governance structure for blended finance where dedicated staff is assigned responsibility for managing concessional funds in accordance with interests of donors, and approval committees are comprised of staff from WBG, and staff representing donor interests.

2.5. Issues and Lessons Identified by Previous Evaluations

Despite the high potential of advisory services and instruments such as a guarantees, structured finance, and increased donor finance to scale up mobilisation, MDBs have made relatively little progress in this area since the Addis Ababa Agreement was signed in 2015. On the other hand JP Morgan recently announced the establishment of a Development Finance Institution (JPM DFI), which intends to mobilise \$100 billion per annum in EMs.

The slow progress and controversy around the MDB's definition of mobilisation has arisen in part from its narrow focus. There is a lack of clarity on the definitions of PDM and PIM, which are complex, and measurement is not standardised across MDBs. Most mobilisation is categorised as PIM, which makes it impossible to provide a theory of change for mobilisation. There is a lack of data on the use of public sector funds to create the enabling environment for private investment. The MDB definition of mobilisation does not provide any information on the amount of leverage of private investment that can be achieved through different financial instruments and blended finance.

²⁶ DFI Working Group on Blended Concessional Finance for Private Sector Projects (2018).

²⁷<https://www.devex.com/news/opinion-in-blended-finance-transparency-and-rigor-must-rule-the-day-95776>

Methods of calculation of reported commitments are not clear, and evidence suggests actual levels of mobilisation are much lower than MDB estimates. Results reported by independent think tanks indicate that MDBs' levels of leverage of mobilisation are very low, being substantially less than 1.0:1.0 in low income countries and difficult sectors such as infrastructure and social services. Large differences between OECD and MDB estimates of mobilisation raise questions about the reliability of the parameters. The definitions of PDM and PIM provide very little information on performance of MDB mobilisation efforts. Critical information on levels of leverage of private finance per unit of public finance is not reported on the grounds of confidentiality. Most MDBs do not provide information on the level of donor subsidy attached to individual projects.

There is some innovation occurring in MDBs in areas such as bundling technical and financial support, and guaranteeing portfolios rather than individual projects, but activity is marginal. There is evidence of liquidity facilities being coupled with political, credit and construction risk guarantees and subordinated loans, but it tends to occur on an exceptional basis, and the structures are not commonly replicated. Bilateral DFIs have tended to be much more successful than the MDBs at developing innovative new financial structures and institutions to support mobilisation.

There has been a large amount of work undertaken by agencies such as McKinsey, MDBs, OECD, and ODI on how to implement the Addis Ababa Agenda and increase mobilisation. The findings of various evaluations are presented in **Annex 3** and the main points are as follows:

- **Availability of bankable projects** is a more important constraint than lack of finance.
- **Firm level advice and financing alone cannot create markets**, and there is a need for sustained policy dialogue and programmatic involvement to develop effective public sector institutions to administer markets
- Technical assistance and public sector capacity building for **project preparation** can promote strong project pipelines.
- There are opportunities to develop **innovative financial structures** to help accelerate pipeline development.
- **De-risking instruments** can play a pivotal role in catalysing private investment.
- There is a need for **new forms of risk mitigation instruments** to address risks associated with currency, refinancing, and social and environmental obligations.²⁸
- MDBs have made **limited use of guarantees** to date. From 2001-2013, project (non-trade) guarantees, for both public and private entities, totalled only 4.5% of MDB lending.²⁹ In comparison, it was estimated guarantees accounted for about 45% of private finance mobilised.³⁰
- **MDBs' balance sheets are conservatively structured** to maintain high credit ratings that minimise their cost of funds and maintain their competitiveness.
- **MDB staff incentive structures favour direct lending**, relative to guarantees and other credit enhancement products. Bankers' performance is primarily based on own finance annual business investment (ABI), which typically excludes guarantees.

²⁸ Credit Enhancement for Sustainable Infrastructure, International Institute for Sustainable Development, 2018

²⁹ Billions to Trillions? Issues on the Role of Development Banks in Mobilising Private Finance, N Lee, CGD, 2017

³⁰ More Mobilisation and Impact: Adapting MDB Private Finance Models, N Lee, CGD, 2018

- **MDB provisions for the use of capital tend to be inefficient.** There is evidence in some MDBs that guarantees consume the same amount of capital as debt, even though the amount of capital in the guarantee at risk may be only a small fraction of the amount of debt at risk.
- **The WBG's PSW had a mid-term review in October, 2018, which found the effectiveness of the sub-facilities was less than expected,** and only \$185 million of the total PSW (7%) had been committed. Where projects were implemented, the leverage ratio was roughly \$1 of public funding mobilizing to \$1 of private funding.³¹ This result suggests WBG has not done enough work developing the upstream enabling environment to properly utilise these instruments.
- **IEG evaluated five of 13 AMC sub-funds in 2018.** The evaluation found the AMC projects were relevant, but results were mixed. Two of five funds were "mostly successful", meeting development expectations of the Board and client investors. AMC was underperforming on expected returns compared to benchmarks, and it could better align unutilised capacity with IFC's strategic objectives.
- **Tracker funds in isolation do not provide institutional investors with the investment grade risk return profiles** required to meet their fiduciary responsibilities, and this appears to be one of the reasons why AMC performance is less than expected.
- **IEG prepared a review of WBG's PPPs in 2018.**³² IEG concluded PPPs can achieve SDG goals, but risks are significant. From 2012-2016 the number and value of PPPs under development fell by more than 50%. Non-traditional sources of private finance were not participating, and the level of institutional investor activity in new infrastructure deals was only 0.7% of total private participation in infrastructure investment in EMs. Government commitment to programs was critical for success.
- **These factors suggest that governments need to contribute greater SITG, and PPPs need to be supported by more robust designs** that address risks on the both demand and supply sides of projects.
- **Infrastructure development requires long time frames, relative to financing MSMEs through financial funds.** These long timelines need to be factored into the design of mobilisation funds and development of enabling conditions for mobilisation.

³¹ IDA 19 and the Private Sector Window: Time for Course Corrections, Nancy Lee and Karen Mathiasen, Center for Global Development, February 14, 2019,

³² Creating Markets: Are PPPs the Answer? IEG, WBG, 2018

3. Evaluation of Mobilisation

3.1. Overview

The evaluation is presented under the following headings: (i) Demand for Mobilisation; (ii) EBRD's Mobilisation Approach; (iii) Mobilisation Organization Structure and Staff; (iv) Mobilisation Approvals; (v) Mobilisation Performance; and (vi) Conclusions. The Evaluation draws upon international practices and experiences identified in Annexes 1, 2 and 3, and EBRD evaluations and case studies in Annex 4.

3.2. Demand for Mobilisation

Key Facts and Findings

- Achievement of SDGs requires high growth rates, which depend on high levels of investment
- Investment in COOs is low relative to other EMs, particularly East Asia and Pacific
- Low investment is driven by weaknesses in the investment climate, compounded by the impacts of the GFC in 2009
- Climate change and the need for regional integration are rapidly moving up countries' agendas, increasing expected demand for investment and finance.
- FDI is low and volatile, and FCY debt is high risk, reducing demand in COOs for this type of instrument
- LCY is increasing in availability, and interest rates remain low, indicating further strengthening of the investment climate and credit enhancement will be required to catalyse additional private investment in COOs.

Assessments such as EBRD's Transition Reports in 2015-16 (rebalancing finance) and 2017-18 (sustaining growth) note shortfalls in quality and quantity of infrastructure and overall levels of investment in COOs. The achievement of EBRD's Transition Impact (TI) goals, and by implication the SDGs, is closely linked to sustained high rates of growth in GDP driven by investment and secure access to foreign and domestic sources of capital. World Development Indicator (WDI) data shows investment as a proportion of GDP in COOs from 1990 was about 50% less than levels in comparable EMs (Figure 4).

Figure 4: Investment By Region, 1990-2016



Source: WDI: EAP = East Asia Pacific; ECA = Europe and Central Asia; MENA = Middle East and North Africa

This low rate of investment is driven by weaknesses in the investment climate, compounded by the impacts of the GFC in 2009. Climate change and the need for regional integration are rapidly moving

up countries' agendas, increasing expected demand for investment and finance. In 2015 the Paris Agreement was signed by 196 countries which committed to pursue investment programmes that will hold the increase in the global average temperatures to well below 2°C above pre-industrial levels, and agreed to Nationally Determined Contributions (NDCs) targets to achieve these goals. NDCs will require substantial investment in renewable energy, and the electrification of transport systems, particularly in cities. Similarly, large investments will be required for development of sustainable land use. Governments in COOs have been pursuing strategies to promote regional integration under initiatives such as the Belt and Road Initiative to help stimulate growth and generate revenue to support these programs.

A critical issue underpinning the achievement of the SDGs, climate change and regional integration programmes is the identification of ways to finance these investment needs. Governments in COOs have reduced investment significantly following the GFC, which has led to relative declines in GDP, tax revenue and public sector debt servicing capacity. It has been difficult for the private sector to finance the investment shortfall in areas such as infrastructure as markets do not correctly price the associated cost of natural resources or social and environmental risks. Pricing deficiencies are compounded by high levels of fixed operating costs and sunk investment costs for infrastructure that make financing risks unacceptably large for private firms.³³ These pricing deficiencies and investment risks can be overcome by developing PPPs, but this activity requires sustained commitment and investment on the part of the government, and it is not yet common in most COOs.

Domestic finance will have to play a central role in the development of investment programs. Flows of foreign capital to COOs are an important component of domestic finance; while levels of FDI are comparable with other EMs, they are still small and volatile.³⁴ FCY borrowing is subject to large and frequent devaluations that make this source of finance high risk for borrowers. The levels of LCY non-financial sector debt in COOs have increased markedly over the last decade, from 42% of GDP in 2007 to 61% in 2010. Corporate debt in COOs relative to GDP is comparable with countries such as Germany or the United States (US)³⁵. Credit spreads in COOs (Figure 5) have compressed due to low interest rates associated with high levels of liquidity arising from policies such as Quantitative Easing (Figure 6).

Figure 5: Interest Margin by Region, 2000-2016

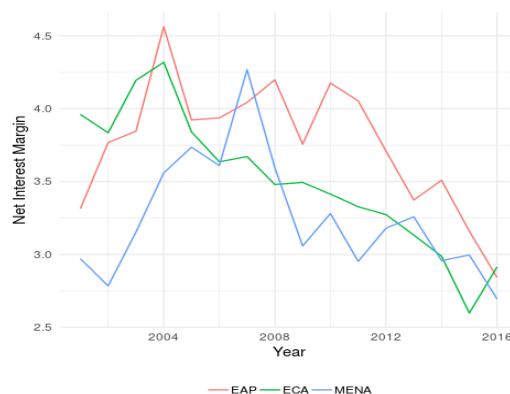
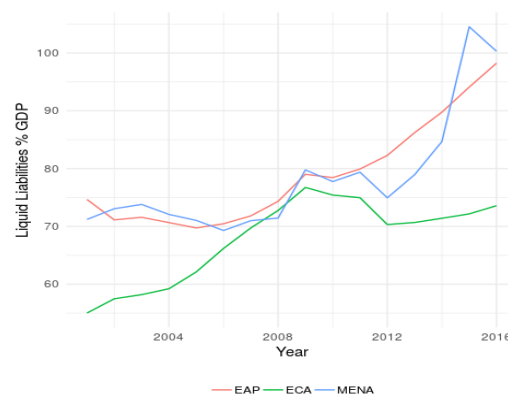


Figure 6: Liquidity by Region, 2000-2016



Source: WBG Financial Development and Structure Dataset

These developments confirm the need for additional investment in COOs, particularly in sectors

³³ Infrastructure investment, the cost of capital, and regulation: an assessment, D Helm, Oxford Review of Economic Policy, October 2009

³⁴ Regional Economic Prospects in the EBRD Regions, November 2018

³⁵ Regional Economic Prospects in the EBRD Regions, November 2018

such as infrastructure. Efforts to mobilise finance to enable this investment need to be pursued in tandem with initiatives to strengthen investment climate, project pipelines and credit enhance financing structures so project financial instruments are attractive to private investors.

3.3. Elements of EBRD's Approach to Mobilisation

Key Facts and Findings

- Annual Bank Investment (ABI) is the main indicator of EBRD financial performance and it measures volumes of direct own financing
- Annual Mobilised Investment (AMI) is a secondary measure of financial performance and it focuses on third party (mobilised) co-financing that generates revenues for EBRD's own account
- EBRD is not capital constrained and it prioritises direct financing ahead of indirect co-financing to retain profits
- EBRD is using blended finance from donors such as European Union (EU) to increase mobilisation through both direct financing, and co-financing
- EBRD does not have a mobilisation strategy at the corporate level and country and sector strategies are largely silent about mobilisation
- Mobilisation is one of four thematic priorities identified by the Board in 2018, but analyses of opportunities provide little guidance or likelihood of increased levels of mobilisation
- Mobilisation is primarily a support function administered by Loan Syndications (B Loans) and Donor Co-financing (blended finance) departments, and they do not play a direct role in project origination

3.3.1 Overview

In this section, the definitions of mobilisation outputs and the metrics used by EBRD to classify public and private finance and measure, incentivise and report on mobilisation performance are reviewed. This information provides a basis for defining the scope and scale of EBRD's approach to mobilisation, and its organization structure and staff.

3.3.2 EBRD's Definitions of Mobilisation Outputs

EBRD's main measures of mobilisation outputs to support investment are ABI and AMI, which are both comprised of private and public sources of finance, which reduces their relevance for mobilisation.

ABI was introduced in 2014 as EBRD's primary financial performance metric and it measures the level of direct own-financing from both private and public sources. ABI is defined as the volume of commitments made by EBRD during a particular year, and it replaced a previous indicator, Annual Business Volume. ABI includes new commitments (less any amount cancelled or syndicated within the year), restructured commitments and trade finance amounts issued during the year and outstanding at year-end.³⁶ The volume of ABI approved, relative to the target, is the main measure on departmental scorecards used to incentivise staff, and it is the primary determinant of other measures of performance in the corporate and departmental scorecards.

AMI was introduced in 2014 as a new metric and it is EBRD's primary measure of indirect co-financing from both private and public sources. AMI is defined as the volume of commitments from entities other than EBRD made available to the client due to its direct involvement in mobilising external financing during the year. AMI primarily consists of B loans syndicated to commercial banks, and public sector sources of donor finance managed by EBRD. In 2018, AMI's definition was updated to include

³⁶ EBRD Data Governance Navigator

URPs and secondary sales of A Loans. Financing is classified as AMI when EBRD has a mandate letter and it receives a fee. AMI is part of EBRD's corporate and departmental scorecards and a minimum volume target is specified of about 10% of ABI, which is low compared to targets of MDBs such as IFC.

EBRD records External Finance, which is a measure of private and public sources of co-finance (B Loans, URPs, parallel finance) at the time of project signing. Parallel external financing is not regularly tracked after signing as there is no contractual relationship, making it difficult for EBRD to obtain information on this parameter.

ABI, AMI, External Financing, PDM and PIM are regularly reported to the Board in documents such as the Quarterly Performance Report. Components of AMI are presented in the following special purpose annual reports:

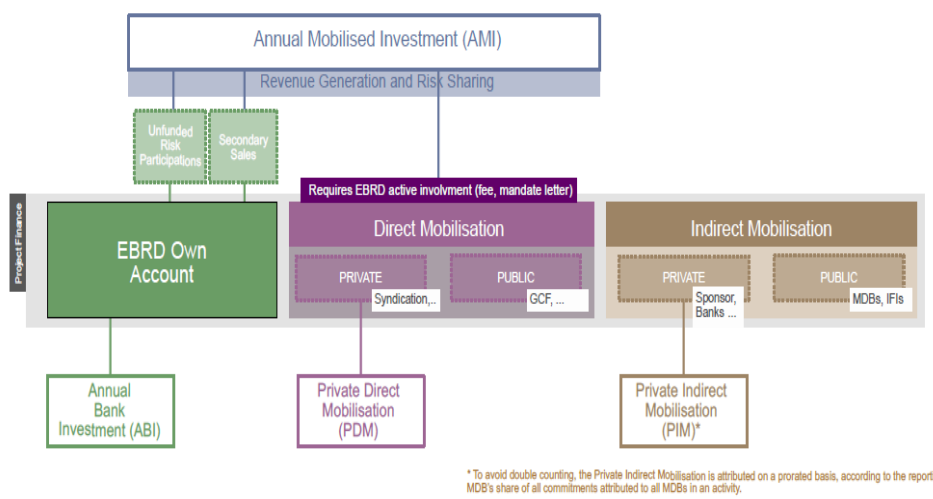
- AMI private sector loan syndications (including Parallel Loans, B Loans and URPs) are presented to Financial and Operations Policies Committee (FOPC) on an annual basis in the **Loan Syndications Report**.
- AMI public sector donor finance (including grants and concessional loans) and other donor funded instruments (not included in AMI) is presented to the Budget and Administrations Affairs Committee in the annual **Grant Co-Financing Report**.

EBRD reports externally against PDM and PIM in the annual joint MDB report on private sector mobilisation, and the first report was issued in 2017.

External Finance, PDM, PIM, and catalysation, as defined by MDBs, do not form part of EBRD Board scorecards used to incentivise staff.

The relationship between these different measures of mobilisation is presented in Figure 7.

Figure 7: EBRD Definitions of Annual Mobilisation



Source: FOPC on Enhancing Delivery – Mobilisation, July 2018

3.4. Mobilisation Approach

3.4.1 Overview

EBRD is mandated to pursue TI through its interventions, while ensuring they meet requirements for sound banking and additionality:

- TI can be achieved at the project and portfolio level and it is oriented towards objectives such as developing competitive markets by supporting privately financed firms;
- **Sound banking** requires project returns to be commensurate with the risks; and
- **Additionality** reinforces concepts of innovative use of finance, crowding in private sector, and in some cases mobilisation is equated in bank documents with additionality.

The definitions for TI, bankability and additionality have been evolving through time, and they are not directly linked to mobilisation of private investment. In 2016, the Board approved the following TI qualities that guide the formulation of development priorities: (i) competitive, (ii) green, (iii) inclusive, (iv) resilient, (v) integrated; and (vi) well governed. These TIs broadly support SDGs, and are expected to become increasingly aligned over time. At the time of project preparation, projects are assigned an ex ante expected TI (ETI) score, which must exceed a minimum threshold defined in the bank scorecards, before it can be considered for finance.

Bankability at the project level is based on Risk Adjusted Return on Capital (RAROC), which is used by management as an ex ante guide of yield on capital for project selection. RAROC is based on an expected risk-adjusted return for debt and guarantee transactions defined as income (margin and fees) less expected loss (average credit loss expected to be incurred), divided by the allocated required capital as per Bank's Capital Adequacy Policy. RAROC is a discretionary input in management review processes for project screening and selection and it is indicative as it is based on a gross margin that does not include operating and overhead costs.

The calculation of RAROC on a gross basis biases this measure to favour small projects (ie MSMEs), relative to large projects (i.e. infrastructure). This result arises as preparation and operating costs per project are similar, irrespective of size, making actual net returns to large infrastructure projects significantly greater than MSMEs. There have been suggestions from management this bias is based on the view that TI is higher for small businesses. It is not clear why TI would be greater for MSMEs than large projects such as infrastructure, which tend to have high SDG impacts. In some cases it has been suggested that in smaller Early Transition Countries (ETC), there are no larger infrastructure projects and it is necessary to support SMEs. In these cases, there is no competing infrastructure projects, and no need for biased estimates of financial return towards small projects.

Additionality is used as a further screening criteria that acts as an input in decision making when management is preparing project proposals for EBRD financing for presentation to the Board. In 2018, an "Enhanced Approach to Additionality" (EAA) was approved by the Board that provides guidance to staff on how to justify/substantiate project additionality that has specific relevance to mobilisation. The EAA differentiates between financial and non-financial additionality:

- Financial additionality comes from financial structuring, mobilisation through A/B loan structures and parallel financing; and
- Non-financial additionality is derived from risk mitigation, policy and regulation, capacity development and project preparation.

Additionality is primarily viewed as a qualitative requirement for a new investment to be eligible for EBRD finance, rather than a quantitative measure of the amount of additional private finance caused by EBRD.

3.4.2 Corporate Strategy Framework and Objectives

EBRD's corporate strategic scorecard has multiple competing objectives that in the main, work against effective and efficient use of EBRD capital and mobilisation

EBRD sets out its high level strategic objectives in its Strategic Capital Framework (SCF) for a period of five years that is approved by the Bank's Board of Governors. The Strategy Implementation Plan (SIP) sits within the SCF and it defines EBRD's annual operational and financial objectives for a rolling three year period through a budget and corporate scorecard approved by the Board. The SIP presents the following key performance indicator (KPI) targets for 2019:

- Minimum average ETI for new projects of 63;
- Minimum Portfolio Transition Impact (PTI) of 65;
- Range for ABI of €9.6 - 10.6 billion;
- Minimum share for ABI of non-sovereign of 80%, and Green Economy Transition (GET) of 38%;
- Floor for AMI of €1.0 billion (about 10% of ABI);
- Combined floor for ABI and AMI set at €10.5 (SIP document) billion;
- Number of operations within a range of 385 to 440;
- Range for disbursements of €6.7 to 7.9 billion; and
- A three year rolling average of the Return on Required Capital (RORC) of at least 3.5%.

The EBRD scorecard is **balanced, which implies indicators are equally weighted**. In practice, ABI is prioritised ahead of other targets, as it is the main determinant of TI indicators, and it is seen as a better measure of performance than other financial measures such as RORC. Measures such as ETI, PTI, GET, and AMI are a direct function of ABI. For this reason, ABI is the primary financial metric used to incentivise bank staff. It is based on the value of capital commitments of instruments such as debt, equity and guarantees. ABI suffers from a number of weaknesses as it does not account for risk adjusted returns on capital, it can be cancelled before funding is drawn; and it specifically excludes returns from instruments such as advice.

Management tends to discount return on capital when prioritising investments in its corporate strategy framework. RAROC is not included in the corporate and departmental scorecards. RORC is an ex post measure of EBRD's profit, per unit of capital (i.e. yield on capital) defined in the corporate scorecard. RORC is based on annual change in Total Members' Equity, before Net Income Allocations and newly paid-in capital contributions, divided by the opening Required Capital. RORC is seen by EBRD as being too volatile to be used as a primary indicator of its financial performance. To help ensure efficient use of capital in the medium term, the scorecard defines a three year rolling average minimum portfolio target. The rolling average reduces the responsiveness, and effectiveness of the use of EBRD capital.

In theory, a focus on yield on capital measure such as RORC should create incentives for EBRD to innovate and consider all instruments with high mobilisation potential such as advice and guarantees. These instruments can potentially generate high profits, relative to low levels of capital committed to deliver these outputs. In practice, these incentives to minimise capital per unit of profit, leverage EBRD's capital do not materialise in decision making due to the focus on ABI.

The focus on ABI, coupled with low capital utilisation rates (in 2017 capital utilisation rate was 70%) results in ABI competing and substituting for AMI, as EBRD does not want to pass ABI margin on to third parties.

Mobilisation is further undermined by the use of AMI, which is not an effective incentive to support mobilisation. AMI is expressed as a minimum financial amount (about 10% of ABI), and traditionally this figure has been driven by risk management considerations, rather than mobilisation. B Loans provide a means to pass on excess demand for finance and associated risks to third parties. Similarly, URPs provide a means of divesting excess concentrations of risk in sectors or countries experiencing economic difficulties.

In recent years, the relationship between ABI and AMI has started to break down. There has been rapid growth in funds used to finance sovereign operations (part of ABI), and growth in public sector funds managed by EBRD (part of AMI), raising questions about the continued relevance of these metrics to mobilisation. The grant component of AMI has grown in importance in EBRD's operations post GFC, and about two thirds of these funds are sourced from the EU. In the future it is expected the EU will make greater use of financial instruments such as guarantees. In 2019, there will be an increase in unfunded guarantees from the EU of about €250 million for projects in EEC and SEMED, primarily for GET.

3.4.3 Country and Sector Strategies

The country and sector strategies do not provide guidance on expected levels of mobilisation, or how it might occur.

Country strategies are presented in terms of opportunities to strengthen TI qualities, which are prioritised on the basis of a top down analysis of government and EBRD objectives by EPG and a bottom up analysis of untapped transition business opportunities by Banking. Country diagnostics draw on a range of methodologies and best practices for assessing obstacles to TI. There is little information provided on investment needs at the country level and no information on the purpose, scale, scope and source of finance expected to be mobilised from the public or private sectors to achieve specific goals within a defined time period.

The energy sector is an important source of private infrastructure investment for EBRD, mainly in renewable generation. EVD prepared an evaluation of the Energy Sector Strategy (ESS) in 2018 that found it did not incorporate anything specific on resources (financial, human, technical assistance) so there was no counterfactual that could be used to assess performance. The new ESS for the period 2019-2023 approved in December 2018 is largely silent about the level of technical assistance used and the type and amount of private finance that will be mobilised under the strategy.

Transport is mainly developed with sovereign finance. A Transport Sector Strategy (TSS) for the period 2020 – 2024 was approved by the Board in May 2019. The TSS noted most co-financing is mobilised from other MDBs or commercial banks on a club basis for large infrastructure PPPs, and it is not treated as AMI. The TSS expected the upgrading of the Infrastructure Project Preparation Facility (IPPF) to the Sustainable Infrastructure Advisory Department (SI3P) in 2018 would help support development of new privately financed transport infrastructure PPPs, but there was little information provided on how this operation will be resourced and operated.

The MEI is a small but growing sector for infrastructure finance. The MEI Sector Strategy (MSS) for 2019-2024 was approved in April 2019. The overall objective of the MSS is to promote the growth and development of enhanced, accessible, sustainable municipal and environmental infrastructure in all of EBRD's COOs. The MSS intends to promote diversified and innovative financing structures to address

funding gaps and harness private capital. Mobilisation and the use of blended finance are flagged as important priorities, and used as the basis for presenting illustrative KPIs. Similar to the TSS, there are no benchmarks or targets used to inform the analysis.

A Financial sector strategy (FSS) was approved for the period 2016-2020. The FSS focused on how EBRD would support COOs economic recovery from the GFC. Small Business Initiative (SBI) and GET were expected to be important drivers of these initiatives. Development of capital markets and LCY financing are priorities, although in practice volumes of LCY financing for EBRD as a whole are low (about 20% of ABI). The financial sector strategy noted EBRD will scale up its use of blended finance so it can remain engaged in an environment of accommodative monetary policy and expansion of concessional lending by some MDBs.

Investing in financial institutions' senior and covered bonds and participation in arranging and investing in structured finance transactions (such as Asset Guaranteed Bonds and securitisations) is expected to become more mainstream activities of the Bank. EBRD was exploring the increased use of a Risk Sharing Facility (RSF) that could be used to provide capital relief to Participating Financial Institutions (PFIs). Asset securitization, and hybrid and subordinated debt were re-emerging in some COOs but in many countries the FSS noted that legal frameworks were not sufficiently robust to support these types of structured transactions.

In November 2018 a Local Currency and Capital Markets (LC2) Strategy was approved. The objective of LC2 is the development of local capital markets and broader use of LCY, mainly through the provision of policy advice and investments in instruments such as covered bonds. EBRD does not act as an arranger and underwriter in [publicly listed] capital markets instruments and prefers to act as an investor, limiting opportunities to capitalise upstream enabling environment work.

3.4.4 Cross Cutting Thematic Priorities

The SIP drew upon work streams in 2018 that looked at four cross cutting thematic priorities: (i) enhancing mobilisation of finance; (ii) enhancing the level and impact of equity, (iii) increasing proportion of non-sovereign transactions, and (iv) maintaining the high share of small projects in EBRD's operations.

Similar to the country and sector strategies, these documents provide little guidance on instruments, methods, or expected future volumes of private finance mobilised by EBRD.

A. Enhancing Mobilisation of Finance

Management prepared analyses that were presented to the Financial and Operational Policies Committee (FOPC) in July and December 2018 that elaborated on ways to promote mobilisation through co-financing. In December 2019, Management presented to the Board on Impact Investing and Mobilisation.

These analyses considered initiatives such as developing equity and debt funds, tracker and directional portfolios, and increasing use of enablers such as first loss cover for portfolios, and country risk cover. Management indicated an intension to blend EU grants and other donor instruments with its own financing. At the same time, management noted there were several constraints on mobilisation such as EBRD's focus on TI in difficult markets, the intention to scale up use of LCY in markets where partner investors could not access these funds, and uncertainty around the availability of loans suitable for syndication as B loans.

Management noted B loans are dependent upon a small number of large projects, and many were sourced from Turkey in recent years, and were unlikely to be repeated in the near future. There is a

limited pool of investors in B loans, and despite repeated approaches, institutional investors have not been willing to participate in these instruments without credit enhancement. The asset class risk/reward balance; absence of rating; lack of liquidity; and asset-by-asset monitoring requirements have proven to be significant obstacles to institutional investment in B loans.

EBRD is supporting the development of specialist impact investors such as Cardano Development, which may invest in its B Loans, but there has been limited success to date, in part because of a lack of data on the underlying projects due to commercial restrictions. Management has explored the feasibility of implementing a synthetic securitization (ie transfer of risk, but not ownership, using URPs) of A loans along the lines of African Development Bank (AfDB). Management concluded the business case for divesting its existing loans using these structures was weak as EBRD has excess capital and it does not need to sell down margin and income.

EBRD was exploring the possibility of setting up a structured tracker URP facility with a counterparty investor, to attract new capital along similar lines to IFC's MCPP. Management expressed concerns that EBRD's return on capital is not sufficient after passing part of its margin onto third party co-financiers, indicating that blended finance was necessary to support mobilisation. Management indicated its ambition to increase EBRD's AMI from just over €1.0 billion in 2017 to €1.75 billion by 2021, but the source of growth is not clear.

Given the various constraints, these analyses broadly concluded that mobilisation should be based on a business as usual model. B loans would continue to be the main driver of mobilisation, and there were few opportunities for growth in co-financing existing or new investments outside this instrument. In the presentation in December 2019, management introduced the idea of possibly selling down some of its portfolio of brownfield assets to support impact and mobilisation objectives.

B. Enhanced Equity Approach

In January 2019 Management provided the FOPC with an update on its strategic review of EBRD's equity operations. The update noted that in 2016 EBRD's Equity Participation Fund (EPF) closed, with €350 million sourced from two SWF. The EPF has a similar structure to IFC's AMC, a target return of 15% and it tracks a 20% slice of EBRD's new direct equity investments. Despite substantial marketing efforts, management noted there was a lack of investor interest in EPF due to the high risk low reward profile of equity investments in COOs, and it did not support scaling up this model. In regard to direct equity investments, management noted the focus would be on quality rather than quantity. These factors meant mobilisation is not a priority of the equity strategy.

C. Increasing Proportion of Non-sovereign Transactions

In December 2018 management provided FOPC with a strategic review of opportunities to adjust downwards EBRD's sovereign share of ABI. As of December 2017 sovereign loans accounted for 23% of ABI, from a low of 7% in 2007. While mobilisation was not referred to as an objective in this analysis, the actions proposed were generally supportive. The programmes of strengthening the enabling environment for private investment, and scaling back sovereign lending should promote mobilisation. Offsetting this result, EBRD will need to make significant investments in project preparation to capitalise on these reforms, and it is not clear where these resources will be sourced.

D. Small Projects

In January 2019 management provided FOPC a strategic review of opportunities for EBRD to strengthen its engagement with small projects (under €10 million investment). Small projects tend to have higher ETI than other private projects, but they are resource intensive, and have high non-

performing loans (NPLs). These projects represent on average 60% of the total number of EBRD financings and 10% of ABI. The focus on ABI (which does not capture risk) and bias in RAROC (which favours small investments) appear to be primary determinants of this structure.

The SBI accounts for 50% of EBRD's small projects, and it consists of three components: (i) credit lines; (ii) RSF and Venture Capital Investment Program; and (iii) Direct projects. The SBI program is operating at breakeven overall, and direct financing was loss making.

The large number of small projects is a primary determinant of EBRD's operating costs, and they are not being offset by attractive returns, or a reduction in required capital. As noted previously, it is hard to discern the reason why ETIs should be higher for MSME projects relative to larger infrastructure projects, raising questions about the extent mobilisation is being optimised through the use of biased screening criteria to allocate capital to these projects.

Management recommended in a recent review that credit lines to SMEs be expanded using blended finance, and SBI RSF guarantees be extended to more advanced countries such as Turkey and Ukraine, and the SEMED region. This programme is unlikely to have a material impact on mobilisation as credit lines have low leverage ratios, MSMEs is a difficult sector, and most RSF guarantee operations are occurring in less advanced COOs, limiting potential for this initiative to scale up mobilisation.

3.5. Mobilisation Organization Structure and Staff

The organization structure for directly mobilising ABI consists of two main components:

- EPG takes the lead on preparing country diagnostics and strategies, and reviewing and monitoring the case for TI and additionality at project level; and
- **Banking departments**, which are organised by sector and take the lead originating and processing ABI project frameworks and transactions, and making the case for TI, bankability and additionality.

The organization structure for indirectly mobilising AMI consists of two main components:

- **Loan Syndications (LS)** team is responsible for seeking new private sector co-financing partners for B loans, working with Banking to structure the transactions, issuing and managing the B loan portfolio, and it is taking the lead on the scaling up of mobilisation of private AMI using instruments such as URPs; and
- **Donor Co-financing (DCF)** is responsible for managing the public sector donor relationships such as the EU, individual governments, multilateral climate funds such as Green Climate Fund (GCF), and other multilateral funds. DCF takes the lead mobilising donor funds from these agencies.

There are also several departments that play a supporting advisory role, and are not directly involved in financing investments:

- **LC2**, with further resources from departments such as the Legal Transition Team, provides support to Banking on the development of an enabling environment for LCY financing;
- **E2C2** sits in banking and provides advice to banking departments on the design of GET related projects; and
- **SI3P**, which is located in Sustainable Infrastructure in banking, and primarily focuses on providing advisory services for preparing public and private sector infrastructure projects for investment.

LS, LC2, E2C2 and DCF departments act in a supporting role to EPG and banking departments and do not originate direct mobilisation opportunities. LS reports to VP Finance; LC2 and DCF report to Vice President Policy and Partnership; and E2C2 and Banking departments report to VP Banking. SI3P is part of banking, but it is very small and still in start-up mode.

The numbers of staff directly involved in mobilisation of AMI as a proportion of total Bank staff is small, with LS having 7 staff, LC2 having 24 staff (of which 7 are seconded or are short term consultants) and DCF 32 staff. SI3P have 4 professional staff that administer pools of consultants for public and private sector consultants,

3.6. Mobilisation Approvals

Key findings:

- Growth in ABI approvals has been flat over the period 2013-2018
- ABI is dominated by non-sovereign FCY debt, and it does not capture returns from instruments such as fees from advisory services
- ABI by region is unstable, whereas by sector departments it has been relatively constant over time, indicating funding allocations are supply driven
- There has been little change in the type of instruments, and currency over the evaluation period, indicating innovation is low
- About 10% of ABI is investment grade, indicating most of these assets require credit enhancement to be made attractive to institutional investors
- AMI approvals has been flat over the period 2013-2018, accounting for about 10% ABI
- The volume of B Loans has been declining over time, and the scope of AMI has been broadened to include the sale of A Loans and use of URPs
- Public sector donor funding is included in AMI and these volumes have been growing over the last 2-3 years, partially compensating for the decline in the volume of B Loans

3.6.1 Overview

In this section, the volumes of ABI and AMI are reviewed to determine levels of mobilisation outputs.

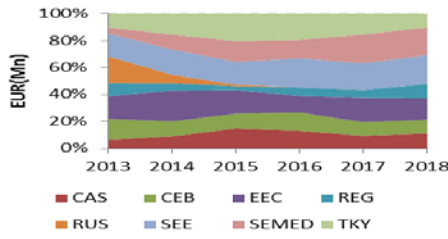
3.6.2 Annual Bank Investment

ABI encompasses EBRD's own funds, and it does not include third party donor resources. Growth in ABI has been relatively flat in recent years (about 2% pa), in part because of competition from high levels of liquidity in LCY markets. This liquidity has encouraged high levels of prepayments and cancellations, especially in Russia and in Central Europe. In tandem with delays in the disbursement of signed projects, particularly in the public sector,³⁷ these developments have left EBRD with significant capital headroom.

There has been significant churn in the regional allocation of ABI over the last five years, with investment in Russia stopping in 2014 in favour of SEE, SEMED and Turkey (Figure 8). In comparison, the allocation of ABI by sector departments has been relatively stable indicating departmental allocations are not responsive to changes in demand. Financial Institutions (FI) department accounts for about 30% of ABI, followed by Transport (TR), Power and Energy (PE), Natural Resources (NR), MEI and Manufacturing and Services (MS) - each accounting for about 10% of the portfolio (Figure 9).

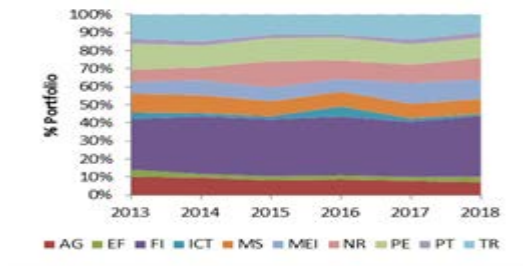
³⁷ Strategic Review, 22 March 2019.

Figure 8: ABI by Region (% Approvals)



Source: DTM

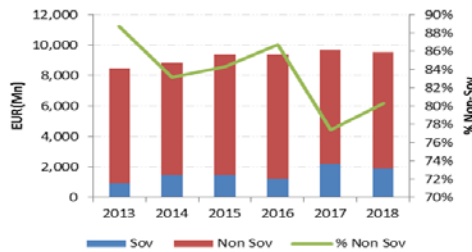
Figure 9: ABI Sector Department (% Approvals)



Source: DTM

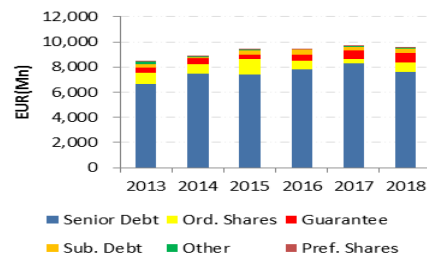
About 80% of ABI is non-sovereign (Figure 10), it is structured as debt (Figure 11), and as noted previously about 80% is denominated in FCY. Apart from the growth in sovereign financing from a low base, these arrangements have also been stable over time indicating low levels of innovation.

Figure 10: ABI by Type of Transaction



Source: DTM

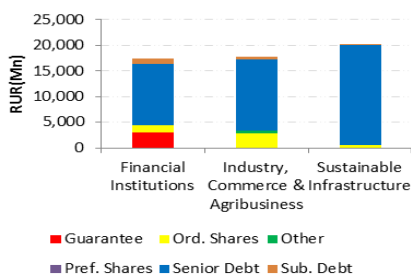
Figure 11: ABI by Instrument, 2013-2018



Source: DTM

FI department is the main provider of structured finance products such as subordinated debt and un-funded guarantees (Figure 12). A critical determinant of the volume of potential EBRD co-finance is the underlying quality of the assets (Figure 13). These results indicate about 10% of the portfolio is investment grade, and capable of being re-intermediated to third parties such as institutional investors without the use of credit enhancements.

Figure 12: ABI by Sector & Instrument, 2013-2018



Source: Business Performance Navigator

Figure 13: Investment Grade Assets (% Portfolio), 2016-2018



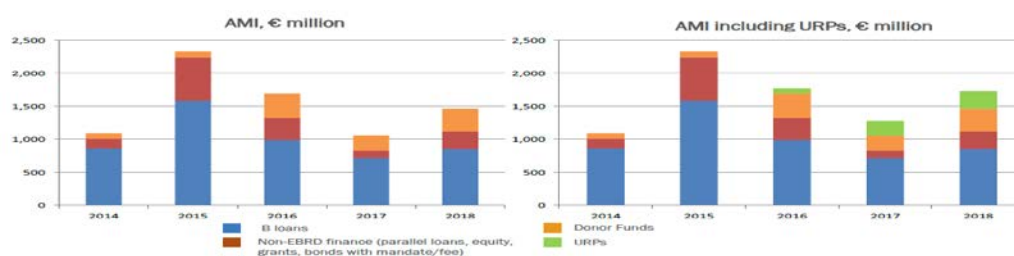
Source: Business Performance Navigator

3.6.3 Annual Mobilised Investment

(i) Private Mobilisation

Volumes of B loans (Figure 14) have been declining in recent years. Similar to other MDBs, there are suggestions that EBRD's PCS has limited value to commercial banks, particularly within the European Union (EU), and they can access similar tax breaks to EBRD through other means.

Figure 14: Annual Mobilised Investment



Source: Loan Syndications Report for 2018

In comparison, URPs have started to increase since 2016 from a low base of €225-250 million. URPs encompass instruments such as guarantees and insurance. URPs are mainly used to restructure risk return profiles of EBRD's existing assets for portfolio management purposes. On occasion, URPs are being used by EBRD to support mobilisation by improving the attractiveness of new investments, typically on a subsidised (blended) basis.

(ii) Public Mobilisation

Similar to URPs, public sector donor funding started to grow from 2015. This growth is driven by the inclusion of donor funds in AMI from 2015, and growth in funds following the increase of EU contributions and access to the Green Climate Fund (GCF) amongst other factors. EBRD is an active manager of funds and it works with about 50 donors, primarily governments and multilaterals. EBRD's use of donor funds increased significantly following the GFC.

In 2018, donor contributions were €583 million, and they were managed through 218 funds. About 71% of donor funds were non reimbursable grants, mainly from the EU, and 21% was structured as reimbursable concessional financing sourced predominantly from the GCF. The ratio of the donor funds use represent 43% of operations (by number) in EBRD's active portfolio and it was equivalent to about 3-5% of ABI by volume (ABI does not include donor contributions).

These figures indicate fund management is highly fragmented, and mobilisation is not a priority. At least 61% of donor funds are being used to subsidise individual projects, primarily with investment grants. About 3% of donor funds use in 2018 was in form of First Loss Risk cover on deal by deal basis.

3.7. Mobilisation Performance

This section reviews the performance of EBRD's mobilisation efforts under the following headings: (i) outcomes - portfolio; (ii) outcomes - projects; and (iii) financial returns. Case studies presented in **Annex 4** are used to help highlight particular points, lessons and issues at the project level.

Key Findings:

- Mobilisation effectiveness over the period 2013-2018 was flat - PDM / ABI averaged 10% pa
- PIM is not targeted or reported internally by EBRD, but its proxy, Non-EBRD finance / Total Finance over the period 2013-2018 fluctuated around 55%
- Project case studies indicate mobilisation potential exists but it is not yet being fully realised
- Staff are constrained by lack of incentives, policies and systems to support mobilisation efforts
- There is a lack of data on public direct mobilisation (donor funds) as EBRD's TC Reporting System is not linked to banking MIS, and it cannot aggregate data, and provide insights on COO investment capacity and effectiveness of EBRD catalysation efforts
- Case studies provide evidence mobilisation potential exists but it is not yet being fully realised

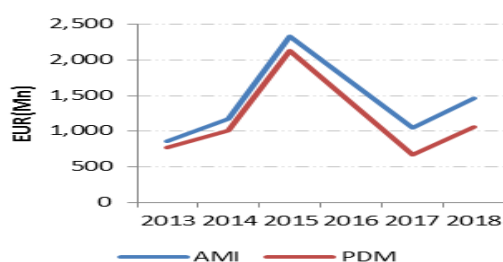
3.7.1 Outcomes - Portfolio

Outcomes are reviewed in the light of EBRD's intentions to promote PDM, PIM and catalysation.

(i) Private Direct Mobilisation

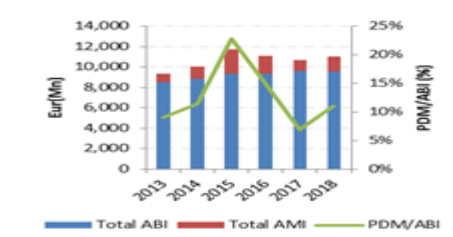
Until 2015, most AMI was comprised of B Loans and most of these loans qualified as PDM³⁸. EBRD primarily acts as an investor, rather than an advisor or arranger of projects, limiting opportunities for PDM from sources other than B loans. The relationship between AMI and PDM started to break down from 2015 onwards when public sector finance became a more important component of ABI and AMI (Figure 15). Overall, AMI and PDM as a proportion of ABI over the last 6 years has been about 10% (Figure 16) indicating effectiveness at directly mobilising private finance is broadly static.

Figure 15: AMI and PDM



Source: DTM

Figure 16: ABI, AMI and PDM



Source: DTM

A review of the MDB mobilisation data indicates EBRD accounts for a relatively small proportion of Infrastructure, compared to other MDBs.

(ii) Private Indirect Mobilisation

EBRD's Strategic Review in 2018/19 did not consider PIM under the heading of Mobilisation. PIM is not a management priority as it cannot be directly attributed to EBRD actions, and it does not generate fees and contribute to financial sustainability. PIM is included in the joint MDB report on mobilisation, and it accounts for about 90% of Total Private Finance mobilised by EBRD. This PIM figure is high compared to other MDBs, where the average is about 70%. Similar to PDM, infrastructure accounts for a relatively small share of PIM, compared to other MDBs.

The main measure of third party co-finance monitored in EBRD's Quarterly Performance Reports is External Finance, which includes both public and private sector finance. As public sector funding

³⁸ In some cases public sector agencies such as FMO can invest in B Loans, breaking the link between B loans and PDM.

accounts for a relatively small proportion of external finance (Figure 17), it provides a reasonable indicator of trends and changes in composition of PIM. Volumes of external finance have been growing since 2013. Most external finance is contributed to EBRD projects in the form of equity, followed by parallel loans and more recently, by bonds (Figure 18).

Figure 17: External Finance by Source, 2013-2018

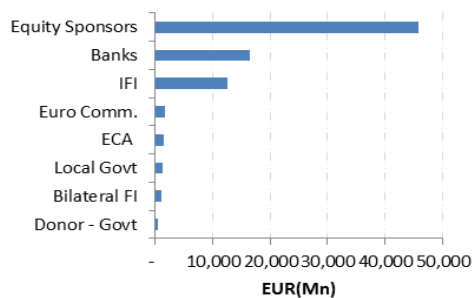
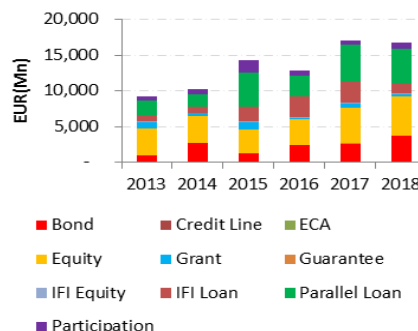


Figure 18: External Finance by Year and Type Instrument, 2013-2018



Source: DTM

Source: DTM

Most external finance over the last six years was raised in Turkey, with the lowest volumes in Central Asia (CAS) and South Eastern Europe (SEE) (Figure 19). EBRD finance as a proportion of total finance has been broadly constant since 2013 at 55% (Figure 20).

Figure 19: Non-EBRD Finance by Region and Type Instrument, 2013-2018

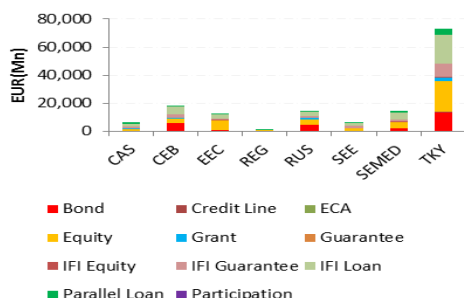
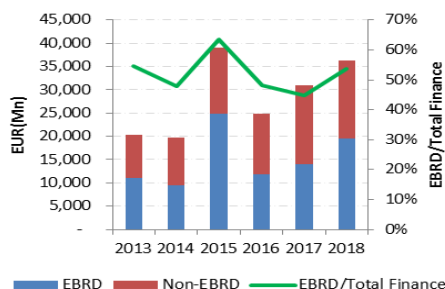


Figure 20: EBRD and Non EBRD Finance by Year, 2013-2018



Source: DTM

Source: DTM

(iii) Catalysation

MDBs' mobilisation measurement and reporting framework does not consider catalysation. As a result, information on investment climate, or project pipelines is omitted from mobilisation reports. In practice, Public Direct Mobilisation (ie Donor Fund Mobilisation) will be the main driver of mobilisation in total, but it is not captured in the MDB's Mobilisation measurement framework, which only reviews private finance. In EBRD's Grant Co-financing Report, grants are reported in accordance with volumes allocated on an anecdotal basis to different TI qualities, but there is no attempt to measure rates of leverage and subsidisation, per unit of donor funds. Many of the difficulties calculating these ratios are arising as the grant and banking MIS are not linked.

As grants account for 3-5% of ABI, and 61% of grant funds are used for specific projects, rather than portfolios of projects, and in many cases structured as investment grants to improve

affordability, rather than develop upstream pipelines or structured products to leverage finance. These factors indicate the amount of mobilisation of PIM using these donor funds must be quite low, indicating that catalysation is low.

3.7.2 Outcomes - Projects

As mobilisation is not a specific strategic target of EBRD, a set of previous evaluations and case studies was selected to conduct a more in depth review of drivers of performance of different mobilisation instruments and structures (See Annex 4). The case studies were selected through a purposeful sample of projects that are pursuing mobilisation, even though it was not the primary goal in most cases. The categories of instruments and financial structures reviewed consisted of: (i) Grants; (ii) Equity; (iii) Guarantees; (iv) Syndications; and (v) Securitisation³⁹.

The case studies provide evidence that mobilisation potential exists but it is not yet being fully realised:

- **Grants** have high potential for leverage if used upstream for policy advice and project preparation, rather than investment grants;
- **Equity and mezzanine** finance can play an important role in financial structures that rely on subordinated financial instruments to enhance the investment attractiveness of more senior financial instruments that might be attractive to institutional investors;
- **Guarantees** have high potential, but EBRD lacks systems and staff and it is mainly using these instruments in ETCs that have little capacity to use them;
- **Syndications** are a proven method of mobilising third party finance, but opportunities are limited by the specific requirements of these projects, in the form of large investments and high levels of political risk that are needed to make the B Loans attractive to investors; and
- **Securitisation** has high potential for supporting mobilisation, but further work is required to develop structures that use LCY and make better use of EBRD capital on a project lifecycle basis.

3.7.3 Financial Returns

EBRD prefers to act as an investor and does not normally act as an advisor, apart from arranging the issuance of B Loans, and more recently, preparing PPPs for tender.

Investment returns from interest on debt, and equity returns are the main sources of profits to support mobilisation through direct financing. Returns on direct financing of debt are low as interest rates are artificially depressed by quantitative easing, and in some COOs are now close to zero. Similarly, returns on equity have been volatile and close to zero in recent years, mainly due to adverse FX movements. These developments indicate better rates of return may be achieved by developing services that support mobilisation indirectly from third parties such as guarantees, syndications and advisory services.

Guarantee returns from the SBI RSF are reported to be low, in part because it is limited to working in ETC markets that are not suited to these complex forms of financial instruments. All PFI loans have to be reviewed and approved by EBRD, substantially increasing transaction costs, and reducing demand and its

³⁹There was an intention flagged in the Approach Paper for this study to use country strategies and URPs as case studies, but mobilisation as a concept does not feature in these documents and instruments. Credit lines were not considered as most external studies indicate mobilisation leverage ratios are very low, relative to other instruments and financial structures.

margins. EBRD has developed a portfolio based guarantee facility in Bosnia-Herzegovina, but it is small and operating under challenging conditions.

In comparison to other MDBs, EBRD does not offer political or partial credit guarantees, and lacks capacity to offer these instruments, making it expensive to administer small guarantee facilities.

EBRD is currently developing capacity to support EU's European Fund for Sustainable Development (EFSD) Guarantee programme, and this may provide it with capacity and opportunities for economies of scale to make more use of bank credit guarantees.

Most mobilisation fees are generated through syndications of B Loans, contracting URPs for risk management and managing donor funds:

- **An analysis of debt prepared for FOPC in 2018⁴⁰ found income earning potential from syndicated loans** is relatively high compared to other EBRD financing instruments. The FOPC paper concluded there are opportunities for EBRD to take more risk for better returns, and there are opportunities to improve returns with more complex innovative project financial structures.
- **Returns from URPs are reported by management to be low** as it entails the transfer of margin and the main benefits from these instruments arise from the avoidance of losses on projects that have performed less favourably than originally forecast, rather than increasing returns. Part of the reason for these low returns appears to be derived from the original financing structure and pricing, which were never designed with URPs in mind, and the risk premium was not properly priced in the original structure.
- **Data on fees collected for management of donor funds is not readily available** as it is not a KPI and it is not presented in Quarterly or Annual Reports, but returns are reported to be attractive.

Returns from EBRD's PPP advisory services at this point are low, but are due to ramp up, as 12 PPP projects have been mandated and a number of these projects are nearing financial closure. As a result, SI3P will soon be collecting significant revenues that can be used to reimburse seed funds from Special Shareholder Funds. At present, SI3P returns are not paid into a revolving fund, but it is the next logical step to make the facility responsive to market demands, generate financing opportunities for EBRD, and enable it to contribute towards mobilisation goals. More generally, there appears to be significant scope to free up restrictions on the provision of commercial or quasi-commercial advice by EBRD staff embodied in EBRD's Client Contribution Policy, which discourages staff from generating a profit on this type of service. Similarly, EBRD has not developed policies on charging clients in its COOs for fee based services.

These findings suggest that mobilisation activities such as securitisation and advisory services can be profitable for EBRD, relative to traditional debt and equity operations. Offsetting this result, mobilisation is constrained by an absence of incentives, lack of capacity for staff to use low capital intensity instruments such as advisory services and guarantees, and opportunities to add value by structuring and securitising financial instruments.

3.8. Conclusions

Based on the preceding analysis, the following answers can be provided to the original evaluation questions on EBRD performance mobilising third party private finance:

⁴⁰ FOPC Presentation: Update on Income Generations, 23 April 2018

- **How is mobilisation understood in EBRD?**

There is no formal definition of mobilisation in EBRD, there is no operational strategy, and metrics such as ABI and AMI do not measure mobilisation. In EBRD mobilisation is equated with AMI, which has been closely aligned with Private Direct Mobilisation (PDM) and B Loans. This interpretation of mobilisation is very narrow, and it does not acknowledge the importance of alternative instruments such as advisory work and guarantees, or support required from public direct mobilisation and blended finance. The relationship between AMI and PDM is now starting to breakdown, as B Loans become less attractive to investors and public sector donor funds increase in importance as a proportion of AMI.

- **Are mobilisation objectives clearly identified and are they relevant and well-suited to COO circumstances and the institutional context of EBRD?**

EBRD prioritises projects on the basis of targets for a range of variables in a score card in the SCF. This document includes targets for variables such as ex ante and ex post estimates of TI which provide guidance on strategic direction. Financial measures such as ABI, AMI, and RORC complement TI and help prioritise projects based on issues such as financial sustainability and use of own capital and mobilised third party capital. Mobilisation is primarily captured by AMI, which suffers from a number of weaknesses.

AMI has a minimum target of about 10% of about ABI, and it can be increased if there is demand.

Traditionally, AMI has been determined by ABI volumes as it was based on an A loan (ABI) and a linked B Loan (AMI) structure. Demand for B Loans has been declining over time, and there are components of AMI, such as URPs on existing banking assets, and public sector donor funds, which do not qualify as mobilisation. As a result, the mobilisation target is not clear, and not very challenging relative to the undertaking made to the G20 of an increase of 20-30% by 2020. IFC is aiming at increasing its mobilisation ratio to 80% of total financing by 2030. ABI is the primary corporate objective and it directly competes against mobilisation, and incentivises staff to crowd out third party finance until internal headroom constraints are reached.

While management expresses concerns about low levels of return on bank capital, yield on capital is a secondary measure, relative to ABI, to prioritise the allocation of funds across instruments.

ABI is not a good measure for optimising the allocation of EBRD's capital as it does not take into account risk adjusted capital required to achieve targets, it can be cancelled before funding is drawn; and it specifically excludes returns from instruments such as advice

RAROC is a better financial measure than ABI, as it focuses on risk adjusted returns on capital, but it is only used to screen projects rather than provide an incentive to pursue projects, it is discretionary, and it is biased against large projects as it is calculated on gross basis before taking into account project processing and management cost. RAROC does not allow comparisons across financial instruments and advice. RORC is an ex post measure that provides a measure of actual performance, but it is a lagging corporate measure and it is not used to directly incentivise staff.

Management focuses on ABI as it is seen as an important source of profit but it is not clear this assumption is correct. There is a risk the prioritisation of ABI works against EBRD's financial sustainability objectives by encouraging management to focus on short term cash generation goals, at the expense of achieving medium term goals that maximise the yield on capital. There appears to be a significant opportunity for EBRD to substantially increase returns and mobilisation if it started using a measure of the yield on capital as a metric to help appraise initiatives such as provision of advisory services, guarantees as well as fully funded instruments such as debt and equity. Ideally this metric should be based on net profits, relative to shareholder capital, rather than total capital,

This potential for generating high returns from mobilisation is underscored by JPM Morgan⁴¹ announcement in early 2020 that it had established a Development Finance Institution (JPM DFI) to help spur additional private investment into emerging markets by pursuing projects that support SDGs. JPM DFI will seek to originate assets for the purpose of distribution to market participants with the aim of mobilizing capital and formalizing development finance as a traded asset class.

EBRD's organization arrangements do not support the attainment of mobilisation targets. The private and public sources of finance are managed by separate departments (LS and DCF), they report separately to different Board committees and VPs, and they are both treated as back office functions that are not involved in origination. As a result, AMI does not map onto clear objectives, it is not under the control of any single department, and it is not actively marketed by banking. Within banking, bankers are responsible for both client management and loan processing, rather than acting as relationship managers. This arrangement reduces opportunities for EBRD to use specialist teams to offer more complex value added types of finance.

There is very little information available in EBRD's MIS on Public Direct Mobilisation or PIM, making it difficult to interpret the factors driving EBRD's PDM. The TC Reporting System (TCRS) does not provide any information on unfunded instruments, the figures on utilisation of TC are difficult to find, and the MIS cannot be interrogated at the country, sector, thematic or framework level. DCF lacks authority, data and resources to ensure reports prepared by banking department on the use of funds is high quality. Significant investment is required to enable EBRD to record its participation in the EU's EFSD Programme, and plans to develop this capacity are still at an early stage. There are no plans to put in place systems to record EU guarantees issued to third parties, making it difficult to measure program performance at the country or sector level. Weaknesses in the Bank's MIS are limiting opportunities to offer more complex facilities to borrowers such as derivatives, and structured securitisation products.

EBRD has not started to consider how rates of leverage and rates of subsidisation of donor funds might be measured. The discussion on public TC has only extended as far as developing a methodology for demonstrating that blended finance is additional, and there is a plausible case for use of public funds. There has not been any discussion on how these funding allocations might be prioritised and allocated using mobilisation and yield on capital as objective functions. Commercial confidentiality requirements have restricted the amount of information available on public blended finance being used to subsidise private returns. The banking MIS and TCRS are not linked making it impossible to derive granular estimates of rates of leverage, and subsidisation. This lack of information makes it difficult to draw conclusions on VFM on the use of these funds.

Benefits of B Loans appear to have little value to the commercial banks' lending to EBRD projects located within the EU, and these instruments do not explicitly meet investor needs. It seems in most cases the commercial banks would prefer to have a voice by entering into a parallel loan with the sponsor, rather than be represented by an MDB. In many respects, a B Loan represents an asset that MDBs already have and can pass on to commercial borrowers, rather than a financial instrument that has been designed to meet investors' needs in areas such as the provision of capital relief. There are issues about MDBs' ability to securitise its PCS and tax breaks and sell these benefits to third parties at scale, without degrading the value of these concessions from EBRD's borrowing countries.

Overall, EBRD's prioritisation of ABI works against the attainment of mobilisation objectives. Mobilisation only tends to be pursued when projects are too large for MDBs (in which case B loans are used), or when EBRD portfolio concentrations at the country, sector or obligor level need to be reduced (in

⁴¹ <https://www.jpmorgan.com/global/news/2020-DFI-Announcement>, January 2020

which case URPs are used to transfer risk to a third party). In all cases, B Loans need to be backed up with an A Loan, which is typically denominated in FCY, and has limited demand in many COOs.

- **Is mobilisation being implemented effectively and efficiently?**

The evaluation findings indicate effectiveness in mobilisation (of AMI) over the last six years has been static in both absolute, and relative terms as a proportion of ABI. While volumes of B Loans are typically lumpy and hard to forecast, the trend in the last five years has been downwards, and it has only been offset by growth in URPs (a balance sheet management instrument) and public sector donor funding, which do not contribute directly to mobilisation, as defined by the MDBs. At present there is no methodology for calculating leverage and subsidisation ratios for EBRD capital, or donor capital, and no data is being collected for this purpose, to improve estimates of effectiveness and efficiency.

The high volumes of PIM in EBRD's portfolio further complicates efforts to substantiate claims of EBRD's additionality and contribution and attribution to PIM due to the absence of credible evidence on causality. Procedures and organisational arrangements to support the justification of additionality and absence of crowding out of private investment could be strengthened. The case studies provide some insights, indicating that B Loans are relevant and useful, but the conditions when these circumstances occur is quite limited. The A/B loan structure would benefit from a review to determine if the type of cover implicit in this instrument can be updated and made more relevant to investors.

The case studies provide examples of EBRD projects that have been structured as guarantees or securitizations. Many of these projects have achieved high leverage multiples of private relative to EBRD finance, but they are not developed systematically at scale. The projects are more like pilots, or participations in projects initiated by other MDBs such as IFC that have formal mobilisation strategies, rather than established lines of EBRD business. EBRD requires formal strategies and performance metrics to help place these initiatives in a coherent framework that clearly targets mobilisation and learns from its results.

There are very few metrics available to measure efficiency of EBRD's mobilisation projects. Financial data on syndications relative to non-syndications indicates that income earning potential is high, relative to other instruments such as sovereign loans and traditional credit lines in FCY. EBRD has been finding it difficult to offer competitively priced finance in markets which have been distorted by quantitative easing and high volumes of liquidity in LCY deposits. Mobilisation provides EBRD with opportunities to benchmark pricing against the market and add value by structuring instruments that meet the needs of sponsors and other commercial co-financiers, but indicators and systems need to be developed to support this operation.

- **What have been the results of mobilisation initiatives to date?**

In the absence of a formal mobilisation strategy, baselines and performance targets for mobilising different categories of private finance, it is difficult to assess results. The study clearly identifies projects that use a range of instruments and structures to mobilise private finance at high rates of leverage, but these initiatives are not developed in structured manner to fully realise mobilisation potential.

4. Implications of Findings for Mobilisation

Summary of Constraints and Opportunities:

- Governments' ability to stimulate private mobilisation is constrained by issues such as limited borrowing capacity, political and macro-economic instability, and lack of capacity to develop infrastructure and secure property rights
- Institutional investors and commercial banks' ability to invest in infrastructure and MSMEs is constrained by high levels of risk, and regulatory requirements to invest in investment grade assets
- EBRD can potentially help resolve these issues but it is constrained by risk aversion, incentives that discourage innovation, and lack of capacity to provide new instruments
- EBRD can add value by focusing on upstream and early stage activities where potential for additionality, leverage and yield on capital is greatest
- EBRD can develop new products that meet investor needs, shift from a strategy of originate and hold to originate and distribute, and develop LCY investor capacity
- EBRD can develop FX, guarantees and other hedging instruments to support LCY financing
- EBRD can develop the domestic investor base, and create pools of blended finance for investment
- EBRD can acknowledge mobilisation as a primary objective, incorporate it in strategic documents
- EBRD can separate ABI and AML into public and private components, and collect data on both internal and external mobilised finance
- EBRD can strengthen the development of project pipelines by providing advisory services, and develop MSME financial markets
- EBRD can develop a range of funded and unfunded products, supported by a matrix organisation structure where relationship managers are rewarded on the basis of yield on capital rather than ABI
- EBRD can strengthen procedures for allocating and managing blended finance
- EBRD staff can be incentivised on the basis of market based/ financially sustainable medium term yields on capital, rather than short term volumes of ABI approvals

4.1. Overview

In this chapter the evaluation answers the question: “does experience suggest ways to improve the effectiveness, efficiency and sustainability of the mobilisation initiatives?” Critical issues and constraints on mobilisation are set out. Potential opportunities for EBRD to enhance performance within this framework are identified and the possible implications of implementing these options are discussed.

4.2. Critical Issues and Constraints

EBRD, along with the other MDBs, has agreed to increase private mobilisation by 20-30% by 2020, and to increase private sector mobilisation 10 fold over time. MDB's performance mobilising capital is far short of requirements to meet development objectives such as SDGs or climate change. MDBs currently mobilise less than \$1 of incremental private capital per \$1 of MDB capital across their whole portfolios; this ratio needs to more than double over the next decade just to meet the SDGs.

Private capital cannot flow at scale in markets where there is political instability, weak legal systems, government decision-making processes are unpredictable and there is currency volatility. As a result, host governments have a primary role to improve local investment conditions. Governments need to develop programmes to build institutional capacity, strengthen policies and regulatory frameworks and ensure transparent operations in their markets. Governments need to demonstrate credible commitment to programs.

Governments' lack capacity to develop project pipelines. Few countries have infrastructure development agencies which can coordinate effectively across policy, planning, project development, and financing. Most project de-risking occurs at the project level, rather than higher up in the fiscal

management system where synergies can be realised across projects, and macroeconomic and fiscal risks can be systematically managed by the government.

Project preparation tends to be heavily biased towards project engineering designs, rather than developing broader sector strategies that look at expected demand and both physical capacity and likely sources of financing. There is often a large gap between the technical designs and the capacity of the projects to mobilise sustainable sources of finance. In many cases, projects are financed with FCY, when project offtake arrangements are denominated in LCY, creating project structures that are not investment grade and financially sustainable.

Prospective investors are subject to a wide range of constraints participating in sectors such as infrastructure and MSMEs. International institutional investors often have limited access to information and they are concerned that returns are too subsidy dependent and do not justify risks associated with government commitment. Potential investors are often subject to specific regulatory and institutional constraints, which limit their ability to participate in infrastructure, or high risk venture capital activities. These institutions often have regulatory fiduciary responsibilities to invest in investment-grade assets.

Banks are subject to even more stringent regulatory constraints than institutional investors under Basle III. These regulations make it difficult for banks to finance projects with long tenors, particularly when they are located in EMs and revenues are denominated in LCY. Further issues arise for MSMEs where property rights and collateral systems are often not clearly defined and non-performing loan rates are high. The legal frameworks for instruments such as asset securitization, and mezzanine finance are not sufficiently robust to support these types of structured transactions. Financial systems are often shallow and illiquid, and do not support the intermediation of finance for long term investments in publicly traded capital market instruments.

EBRD's potential to help resolve these issues is not yet being fully realised. EBRD does not treat mobilisation as an explicit objective, instruments are often not fit for purpose, and internal incentives, procedures and systems discourage mobilisation and the use of unfunded instruments such as advisory services and guarantees. B loan structures are dependent upon A Loans and in many cases it appears they are based on benefits that commercial banks already possess. PCS and tax exemption benefits have limited ability to be traded in the market at scale and can be difficult to manage once they are issued. EBRD's syndicated B loans are not based on a detailed assessment of methods that can be used to mitigate project risks and design financing structures that are attractive to both COOs and private investors.

Guarantees offered by EBRD tend to be small in scale, conservatively structured and unattractive to investors, often being based on FCY, and subject to complex project by project approval and non-transparent and slow claim procedures. In most cases, EBRD only uses guarantee products in markets such as ETCs which have the least capacity to utilise these instruments, compared to middle and upper income countries such as Poland or Hungary. Guarantee facilities often have excessive transaction costs as they are approved on a project rather than portfolio basis, and require the approval of the guarantor as well as the investor and the investee. Cover is not standardised across projects, increasing transaction costs by making it difficult to use these instruments in financial structures and assign them to multiple parties through syndications. Guarantees need to provide investors with certainty by clearly defining coverage of risks that address their concerns, paying on demand, and providing rapid and costless exits through clear assignment provisions.

Part of the reason for EBRD's lack of engagement with guarantees stems from provisions in its articles of establishment. Article 11, 1, (iii) states part of EBRD's role will be "facilitating access to

domestic and international capital markets by private sector enterprises ...through the provision of guarantees, where other means of financing are not appropriate, and through financial advice and other forms of assistance". There are suggestions this provision has been construed by the Bank as an implicit prioritisation of direct funding ahead of mobilising capital market instruments.

This interpretation of Article 11, 1, (iii) ignores the caveat "where other means of financing are not appropriate", and the opportunities that maybe realised by offering instruments such as partial credit guarantees for LCY financing of bonds, relative to FCY of debt instruments. As noted in a recent statement by the IMF⁴², FCY debt can create serious risks for the financial sustainability of projects and countries. In many cases, project bonds may provide superior terms to senior bank loans.

EBRD staff lack incentives, and in many cases the opportunity or capability to pursue mobilisation goals. Staff is rewarded for ABI loan approvals, rather than project TI or yield on capital. An excessive focus on ABI prevents management from generating returns from low capital intensity activities such as advisory services or guarantees that provide opportunities to leverage both EBRD's balance sheet and support mobilisation.

EBRD staff do not have incentives to manage its balance sheet effectively. EBRD has preferred to use funded rather than unfunded instruments such as guarantees, and focus on FCY rather than LCY. There is a bias towards small low profit MSME projects, relative to larger infrastructure projects. In general, there are less opportunities to mobilise MSME investment at scale, relative to large infrastructure projects, and shortfalls in investment needs tend to be seen to be greater for infrastructure, especially in lower income countries. These factors indicate that TI would not be compromised by re-balancing the Bank's balance sheet towards larger projects, and it would help increase mobilisation and return on capital.

EBRD typically holds financing through to maturity. Most of EBRD's financing additionality comes in the early stages of a project, when private financing is difficult to obtain. Additionality is low during the operational phase, when the pool of potential investors is much larger, and EBRD could exit relatively easily and develop new projects.

Blended finance can play an important role enhancing the design and structuring of new instruments, but there are persistent concerns about lack of data and the case for additionality that limit donor incentives to provide subsidised finance. Most EBRD blended financing is provided on a project basis, where upstream support is piecemeal. Grant funds are primarily used to subsidise projects, rather than develop an upstream enabling policy and institutional environment and sustainable pipelines of projects. Procedures need to be developed that ensure the business case for allocating blended finance is clearly presented, reviewed and agreed by representatives of donors and EBRD, and it is straight forward to validate and monitor performance and report on value for money.

4.3. Opportunities for EBRD to Enhance Mobilisation Performance

4.3.1 Overview

The review of opportunities to enhance mobilisation falls within two categories: (i) what new types of markets and products can be offered; and (ii) how can EBRD create an internal environment to capitalise these opportunities.

⁴² <https://www.ft.com/content/b53468f0-4e46-11ea-95a0-43d18ec715f5?shareType=nongift>

4.3.2 What Markets and Products?

(i) Focus on Upstream and Early stage Finance

EBRD can focus the use of grants on upstream enabling environment support, and designing financial structures that support mobilisation, rather than directly subsidising projects' capital costs using investment grants to improve affordability. EBRD can accelerate technical project-preparation by providing advice and significant financial support to governments either in the form of blended finance (grants) or sovereign loans. These funds can be used to fund development of the enabling environment, project preparation, risk mitigation and pricing, and provision of guarantees for output payment and early termination to investors and financiers using cost recovery principles. Ideally governments should share in these costs to ensure commitment (through SITG) and a shared vision of expected outcomes.

EBRD can focus on crowding in early stage lifecycle financing when project risks are greatest. EBRD can provide direct financing in the form of equity or loans to investors for early-stage development, and subordinated risk instruments to mitigate risk during the operating period. There are opportunities to support MSMEs' efforts to access LCY by strengthening collateral and payment systems to reduce transaction costs and mitigate credit risks. FINTEC in areas such as Blockchain and mobile banking can be supported as they are likely to transform the finance sector over the next decade.

(ii) Design New Financial Instruments that Meet Needs of Investors

There is a mismatch between the products being offered by EBRD and the financial instruments required by investors, especially financial institutions. There is a need to design structured financial instruments that reflect institutional investors' requirements in areas such as minimum risk characteristics (ie investment grade), liquidity in capital markets, and standardisation of instruments. EBRD can develop new securitised instruments that are tailored to meet investor demand across the full risk return spectrum.

To maximise opportunities for mobilisation, EBRD can shift from the current "originate and hold" approach to "originate to distribute" strategy. This shift would increase EBRD's financial additionality over the project cycle by speeding up the rate of recycling capital, and relieving constraints on new lending and the need for capital replenishment. New instruments can be designed that can be easily syndicated to third party investors such as partial credit guarantees. EBRD can support these efforts by acting on a best endeavours basis, supporting local arrangers and in some cases possibly offering underwriting services.

(iii) Increase Use of LCY

EBRD can follow the example of agencies such as TCX and scale up the use of FX- and interest rate hedging instruments to investors in EMs. While TCX's business model maybe too volatile for EBRD to develop in-house, as it could potentially put its "AAA" credit rating at risk, it can continue to provide TCX with additional capital, and credit lines that can be used to maintain operational liquidity.

EBRD could potentially establish a range of organizations that are similar to TCX and its parent Cardano Development and specifically strengthen LCY markets. These new entities could possibly be structured as subsidiaries, address different types of market failures, and compete to create a market to properly price these services. There are a number of precedents for this type of operation such as ADB's Credit Guarantee and Investment Facility (CGIF), and the multi donor owned Guarantco. This entity provides credit enhancement instruments in the form of partial guarantees for LCY loan financing or bond issuance in sub-Saharan African countries, and it has been able to use partial credit guarantees as a substitute for treasury instruments.

Partial guarantee instruments are unfunded, and they potentially provide EBRD with a means to mitigate risks associated with LCY financing. There appears to be a mismatch between how EBRD approaches risk on the asset side of its balance sheet, and how it funds those assets. On the asset side, only 10% of the portfolio is investment grade, indicating high levels of risk are being assumed. On the funding side, 80% of its liabilities are denominated in FCY, indicating a very low tolerance to risk. There appears to be a middle ground where lower levels of asset risk were balanced against slightly higher levels of FX risk. Alternatively, EBRD could retain the same risk profile for assets and liabilities, but make greater use of partial credit guarantees to mobilise LCY products on the asset side of its balance sheet, where operations are not constrained by FCY restrictions in EBRD's financial policies.

(iv) Develop the Domestic Investor Base for Infrastructure Assets and Pools of Pre-committed Finance

As noted in the G20 Principles for Quality Infrastructure, Principle 1, there is a need for MDBs to partner with local development banks and develop a deep domestic institutional investor base that intermediates LCY domestic savings into local asset classes, including infrastructure. There are opportunities for EBRD to develop capital markets, and support regulatory reform in areas such as pensions and their eligible investments. There is potential for EBRD to invest in institutions such as insurance companies to help develop capacity to invest in these new LCY markets.

IFC has achieved a significant amount of success mobilising institutional funds through MCPP, particularly for finance, using a combination of syndication, securitisation, structured finance, and blended finance that are attractive to institutional investors. Similarly, the CIO offers an interesting example of how structured financing principles can be brought to bear by blending finance, and focusing on additionality in the early stages of the project lifecycle.

4.3.3 How Can EBRD Support Mobilisation?

(i) Mobilisation Objectives

On the basis of the findings of this evaluation, it seems clear that mobilisation and the pursuit of other EBRD TI and financial sustainability objectives are not mutually exclusive, and mobilisation should be considered as a complementary central feature of all strategic initiatives. EBRD's strategic outputs can be defined in terms of both TI quality, and the quantity of finance mobilised to provide measurable indicators of change in COOs over time.

Within this framework, ABI and AML and can be split into public and private components to enable accurate measurement of PDM, PIM, and catalysation. Consideration can be given to adapting OECD's mobilisation and blended finance methodologies to develop new indicators to measure mobilisation of private and public finance and leverage rates for internal and external sources of finance across instruments, sectors, and countries. Rates of subsidisation can be routinely calculated and reported. Underpinning this arrangement a set of Cascade Principles can be developed along the lines of the WBG's MFD strategy to help establish resource allocation priorities across instruments and projects.

(ii) Country Strategies and Project Pipelines

Country ownership at the highest levels of government is critical for success of mobilisation strategies. Even when there is strong country engagement, large complex projects have long project lead times of 4-5 years just to reach the tender stage, let alone financing and investment. Country strategies can play a central role assessing the potential for implementing mobilisation programmes, setting goals and target ranges for mobilisation, developing project pipelines and measuring progress. These strategies

can be based on diagnostic assessments of latent demand, political support, other MDB programs, and institutional capacity to implement mobilisation programmes.

In line with G20's Quality of Infrastructure Investment Principles, these analyses can provide inputs for preparing VFM assessments that properly cost risk on a whole of life project basis. Baselines and targets can be formulated that can be used to help prioritize initiatives and monitor performance. WBG has developed INFRASAP as a diagnostic tool to support MFD for countries or regions that look at infrastructure gaps and capacities, and public and private sources of finance to fill these gaps. EBRD may want to consider developing a similar tool.

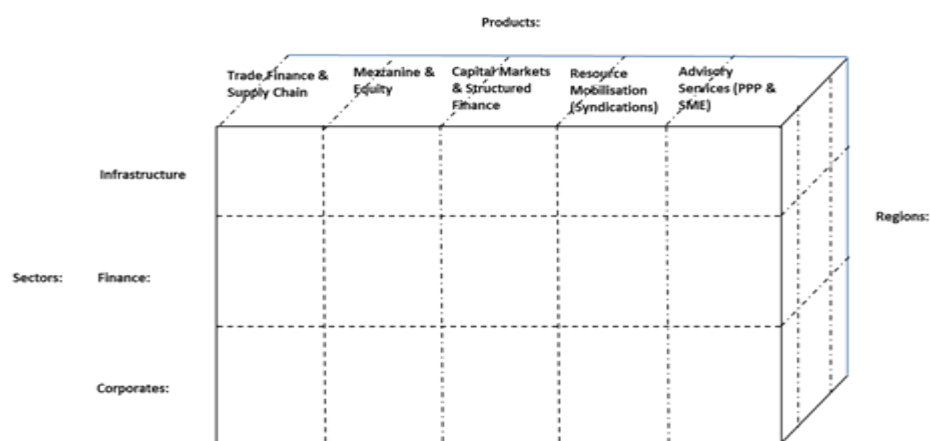
(iii) Institutional Structure and Capacity

EBRD can potentially provide a full range of unfunded and funded instruments including advisory services, unfunded guarantees, structured finance, syndication and securitisation operations. These services and instruments can be provided on a standalone basis, or EBRD can package them into complex structures that are used to originate projects from conception through to financial exit.

To realise the full potential of these mobilisation opportunities, EBRD will need to make changes to its internal governance and incentive structures to set new targets, develop systems to track and measure progress, and procedures to coordinate across divisions. New institutional capacity is required in areas such as banking and risk management to scale up the provision of these new services.

A new organization structure within banking operations can potentially be adopted, along the lines being considered by other comparable MDBs such as IDB (Figure 21). Under this structure bankers in sectors act as relationship managers with governments and corporates in COOs who are not limited to providing debt and can draw upon a range of products offered by specialist financing teams. Bankers in product teams would in turn form relationships with potential partners and investors. This matrix structure can potentially be replicated across regions, and scaled according to demand for particular products within a region. New staff may be required with specialist skills in structuring complex products and working with institutional investors in capital markets.

Figure 21: Illustrative Organization Structure



Source: EVD, based on discussions with IDB

There may be opportunities to rebalance staff more towards the development of infrastructure, rather than FI, potentially using FI structuring skills. Similarly, there could be opportunities to pilot more complex products with high mobilisation leverage potential in more advanced countries such as Poland or

Hungary, before rolling them out in less advanced ETC markets. Project preparation and arrangement services for capital markets instruments can be scaled up.

New organisation arrangements can be established for blended finance to ensure it is transparently allocated on the basis of expected leverage, with an emphasis on creating project pipelines, rather than single projects using investment grants. Auction principles can potentially be used to help define allocation principles for blended finance. Public sector funding should be managed in transparent centralised funds and the amount of public funds invested in privately financed projects disclosed. Special purpose committees can be established, with representation of donors and bankers, to review projects that require blended finance. Bankers should be required to prepare business cases in a competitive environment where mobilisation levels, subsidy and leverage ratios, are important criteria used to review and approve funding allocations.

Competitive procedures such as auctions can potentially play an important role maximising opportunities for VFM in the use of donor funds. Under these arrangements contracts for frameworks of TC assignments can be tendered to the market, and consultant payments can be linked to the delivery of outputs, or in some cases achievement of outcomes. These types of procedures for results based financing have been used successfully in areas such as public sector research and development, and could easily be transposed into high risk development financing environments.

(iv) Capital Allocation, Performance Targets and Reporting Arrangements

Relationship managers can be incentivised on the basis of market based/ financially sustainable medium term yield on capital, rather than short term volumes of ABI approvals. This approach would help incentivise staff to prioritise co-financing ahead of direct financing by scaling up structuring, syndication, guarantee and advisory operations. EBRD can potentially achieve high amounts of leverage and return on capital by using small amounts of risk capital (equity and mezzanine finance) and blended finance to catalyse large amounts of private capital, ideally in the form of capital market instruments such as LCY project bonds.

Policies and rules governing the use of specialist instruments such as guarantees will need to be reviewed, with a view of updating budget and capital allocation mechanisms and performance monitoring arrangements. New MIS are required for data collection, tracking and reporting of mobilised finance, both internally to EBRD, and externally from public and private sources. Many of these support functions can potentially be brought in from third parties, until demand for particular services is confirmed. Procedures can be developed so that reports on mobilisation are prepared for the board on a quarterly basis.

Annex 1: Definition of Mobilisation

1. Overview

Mobilisation is concerned with the use of public funds to leverage private investment. As a result, mobilisation can be equated with blended finance, which is concerned with determining how public and private funds can be optimally combined to maximise the amount of private investment relative to public investment. There is a continuum of financial instruments that can be used to mobilise private finance, ranging from unfunded guarantees through to fully funded grants, equity and debt. Each blended finance instrument has strengths and weaknesses. Guarantees or insurance are much less capital intensive than grants, and have high potential for leverage, but the low level of capital intensity can create liquidity risks which can act as a constraint on investment.

Figure A1.1: Mobilisation Finance Instruments and Risks

Instrument	Macro		Credit/Commercial		Technical			Finance	Infra-specific	
	Political/ Country Risk	Currency Risk	Credit Risk	Liquidity Risk	Demand Risk	Construction Risk	Operating Risk	Access to Capital	Lack of Pipeline	Offtake Risk
1. Guarantees										
2. Insurance										
3. Hedging										
4. Subordinated Debt										
5. Securitization										
6. Contractual Mechanisms										
7. Results Based Incentives										
8. Grants										
9. Equity										
10. Debt										

Source: Adapted from *Better Finance Better World, Blended Finance Task Force, 2018*

2. Financing Instruments and Structures

There are many examples of how alternative financial instruments and structures can be used to promote private investment, although there is very little information available on their effectiveness, and in many cases there is limited availability of instruments. Climate Policy Initiative (CPI)⁴³ conducted an analysis of clean energy projects and found that risk mitigation instruments such as guarantees and insurance are less frequently offered than direct investment and there are major gaps in local currency financing, early stage risk financing, and vehicles that aggregate projects, especially small ones.

⁴³ Blended Finance in Clean Energy: Experiences and Opportunities, CPI, 2018

Figure A1.2: Definitions and Examples of Mobilisation Finance Instruments

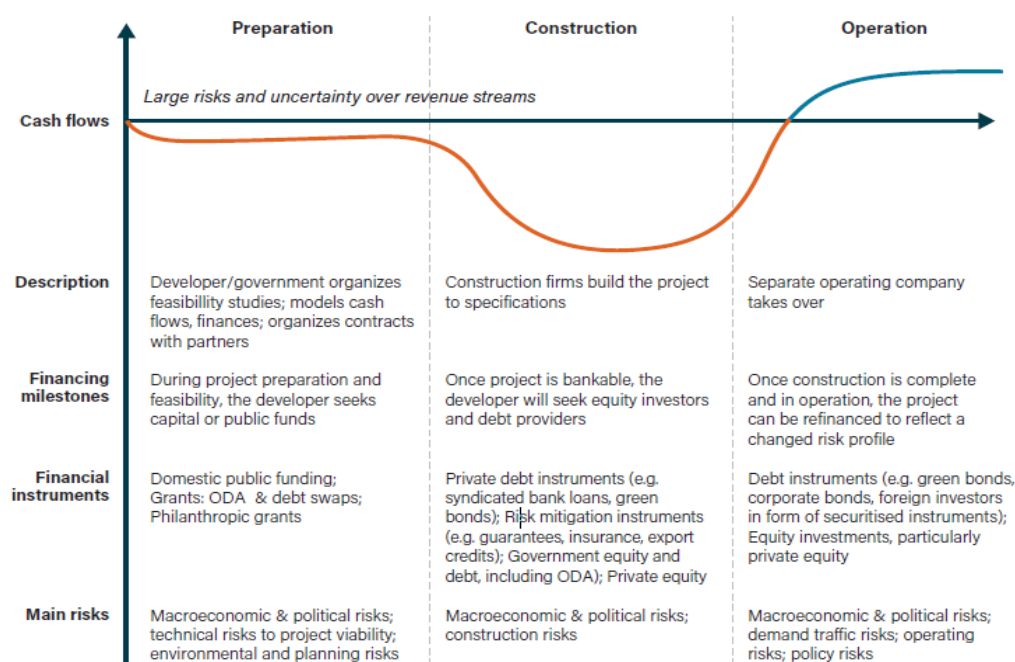
Instrument	Description	Example
1a. Non Honouring guarantee	Multilateral Investment Guarantee Agency's (MIGA) non-honouring of financial obligations (NHFO) coverage provides credit enhancement in transactions involving sovereign and sub-sovereign entities, and state-owned enterprises (SOEs). NHFO protects the lender against losses resulting from a failure to make a payment when due under an unconditional financial payment obligation or guarantee.	MIGA is the primary provider of non-honouring guarantees and they are not commonly provided by other MDBs.
1b. Full or comprehensive credit guarantees	Cover the full value of a project's senior debt for all risks. Cover is typically available for projects that are already relatively low-risk, with the objective of raising the rating of those projects to investment grade, enabling more risk-averse investors such as pension funds to participate in the project financing.	Historically these types of guarantees were provided by "monoline" insurers. Providers of such guarantees are relatively few, and include some development finance institutions (e.g. EIB), Export Credit Agencies, and MIGA's guarantees regarding 'non honouring of financial obligation'.
1c. Partial credit guarantees (PCGs)	Tailored to the project, they cover loss in case of default up to a certain proportion of a project's senior debt. This cover may be on a first loss or pari passu basis. First loss guarantees absorb the first percentage of loss given default: that is, they reduce the risk of loss from a lender's perspective in a similar way to subordinated debt. Pari passu guarantees absorb a defined percentage of any loss—that is, reduce the size of loss, but not the risk.	Most development finance institutions can provide partial credit guarantees, for example the World Bank, or the EIB's Project Bond Initiative, which can offer both subordinated debt or partial credit guarantees. GuarantCo specializes in providing partial credit guarantees in local currency, to enable local financial institutions to participate in project financing (also reducing currency-related risks).
2a. Political risk insurance	Protect the project sponsor and/or lender from loss due to political risks. These may include the risk of expropriation, political violence such as war or civil disturbance, or transfer or convertibility risk, and breach-of-contract risks.	Offered by several development finance institutions, including MIGA

2b. Insurance or contingent credit lines against natural disasters	Protect from loss due to natural disaster, or alternatively, provide a contingent credit line to finance needed investments.	Provided by several development finance institutions or in some cases, private providers. Examples include index-based weather derivatives, or the World Bank's Catastrophic Risk Deferred Drawdown Option.
3. Currency swaps or forward contracts	Swaps or forward contracts to hedge against fluctuations in currency or commodity prices. Currency swaps in particular are often available only for a limited range of widely-traded currencies.	Commercial banks and the Currency Exchange (TCX), a donor-funded initiative that provides currency swaps for a wide range of currencies.
4. Junior / Subordinated capital	Subordinated (debt) or junior (equity) protects senior investors by taking first losses on the value of the security i.e. if something goes wrong, the most junior / subordinated tranche will be paid out last.	EIB and the Project Bond Initiative. EBRD and Project Meadow
5. Securitization	Securitisation refers to the process of transforming a pool of illiquid assets into tradable financial instruments (securities).	B Loans can be regarded as a form of securitization.
6. Results Based Incentives	Instruments that provide incentives and disincentives to achieve desired outcomes or results (tie at least a portion of payments to achievement), including social impact bonds and performance-based contracts. This type of financing is aimed at rewarding innovation and successful implementation of a project with clear climate benefits.	Government of Norway and its REDD program. Output based aid
7. Contractual Mechanisms – Revenue (e.g. feed-in tariffs or off-take agreements)	Contractual and project finance arrangements to support the development of bankable infrastructure projects including public and private off-taker agreements, subsidies such as feed-in-tariffs, and tax credits.	EBRD – Egypt Renewable Power Program
8. Grants (especially for technical assistance)	Capital which is paid in without any expected repayment or compensation over a fixed period of time. It could include money for technical assistance or project preparation to bring a project to bankability. Grants can be critically important for pipeline development,	Most MDB projects

	especially in less mature sector and riskier geographies, creating significant (if often hard to measure) crowding in of private capital	
Source: Adapted from https://pppknowledgelab.org/guide/sections/20-third-party-risk-mitigation-and-credit-enhancement , Better Finance Better World, Blended Finance Task Force, 2018		

The risk profile of assets changes over its life and blended finance instruments can be combined at specific stages in a project’s lifecycle to address changing risks. As a rule, risks are greatest during project preparation and construction, and then fall substantially once operations are established and cash flows become positive.

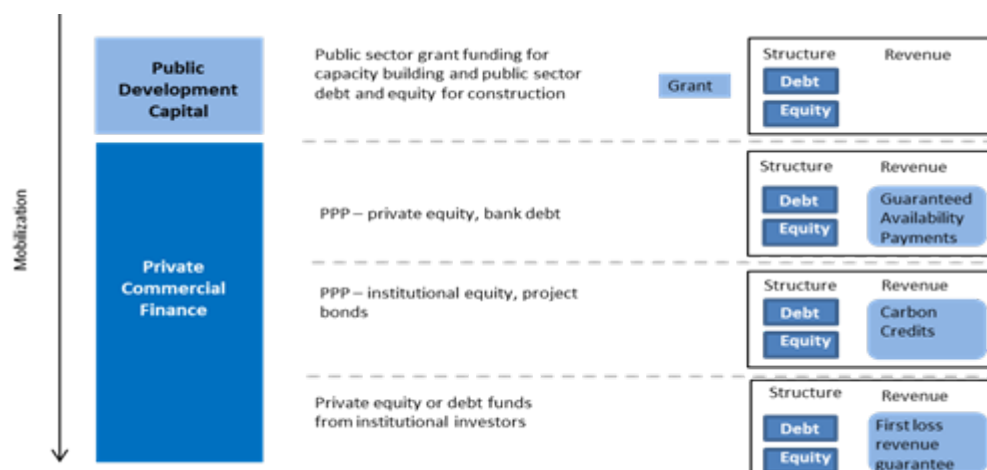
Figure A1.3: Risks and Financing Considerations across Illustrative Project Lifecycle



Source: Bhattacharya, A. [et al.], 2016. Delivering on Sustainable Infrastructure for Better Development and Climate Change. Washington: Brookings Institution

As a result of this changing risk profile, governments have tended to provide grants during the early stages of project development, and then fully fund and operate facilities with sovereign debt. Governments are increasingly financially constrained and seeking ways to use public funds better, and tap into private sector sources of finance. As a result, governments have been looking at ways to increase the use of unfunded public sector guarantees to mobilise private finance over the life of projects. The precise structure will vary by stage of lifecycle and the nature of risks in a sector. In sectors such as transport it may be necessary to provide availability payments on the demand side, and carbon credits coupled with first loss guarantees in sectors such as renewable energy.

Figure A1.4: Mobilisation Finance and Revenue Structures



Source: EVD

In addition to designing blended financial structures at the project level, there are opportunities to develop structures at the portfolio level, as part of funds, at the level of the market (e.g. carbon credits, feed-in-tariffs and other renewable energy subsidies for clean energy), or at the market development stage (e.g. project preparation support facilities).

Table A1.3: Different Levels of Mobilised Finance

Type of Mobilised Finance	Description	Example:
Project Level	Public and private capital is blended within a single project or company's financial structure	Elazig Turkey PPP
Fund Level	Public or private investors pool resources to be invested in multiple projects or companies	Climate Investor One/ Currency Exchange Fund (TCX)
Fund-of-Funds	Funds that invest in other funds	Equity Participation Fund
Facility (institutional level)	A long term or permanent institution that is set up or modified to blend finance	IFC Managed Co-Lending Portfolio Program (MCP), Guarantco
Market Level	Market mechanism that blends public subsidies to encourage private participation	Egypt Feed in Tariff (FIT)
Project preparation/support financial intermediaries	Public support for project preparation and financial intermediaries to mobilise private finance	Infrastructure Project Preparation Facility/ Small Business Initiative – Risk Sharing Facility

Source: Better Finance Better World, Blended Finance Task Force, 2018

3. Structured Finance to Manage Multiple Risks over Project Lifecycle - Demand

The Indonesia Infrastructure Guarantee Fund (IIGF) provides an example of a project support facility established at the national level to underwrite its public-private partnerships (PPP) programme. The IIGF was created in 2009 by the Indonesian Ministry of Finance as a state owned enterprise to improve the creditworthiness and quality of PPP infrastructure projects in Indonesia. IIGF provides guarantees for financial obligations of public contracting agencies that participate in PPP contracts. Risks covered by IIGF include: (i) Inability and unwillingness of the public contracting agency to pay; and (ii) Early termination or project default due to government action/inaction such as: changes in law, expropriation, currency inconvertibility and non-transfer, and force majeure affecting the contracting authority

4. Structured Finance to Manage Project Specific Risks - Supply

There are opportunities to develop funds that address specific risks. Cardano Development is a Dutch development financial institution that has established several special purpose entities including Currency Exchange Fund (TCX), Frontclear, Impact Loan eXchange (ILX) and Guarantco.

- **TCX** is a cooperative owned by Multilateral Development Banks (MDBs) that aims to reduce currency (FX) risks to borrowers by providing MDBs with access to local currency (LCY). TCX acts as a market-maker in currencies and maturities not covered by commercial banks or other providers. TCX adds value to MDBs due to its ability to diversify risk and achieve economies of scale in managing FX risks.
- **Frontclear** works to improve liquidity for short to medium term (up to 1 year) interbank transactions by providing credit guarantees to cover banks' counterparty credit risks.
- **ILX** is setting up an Emerging Market (EM) private credit fund that will invest in a diversified portfolio of loan participations originated and structured by bilateral and multilateral Development Finance Institutions (DFIs). These hard currency denominated loan participations provide medium and long-term finance to projects and companies across core sectors, such as: infrastructure, renewable energy, agribusiness, manufacturing and financial institutions.
- **GuarantCo** is a specialist provider of LCY credit guarantees for infrastructure projects in emerging economies that enable infrastructure projects to raise debt finance.

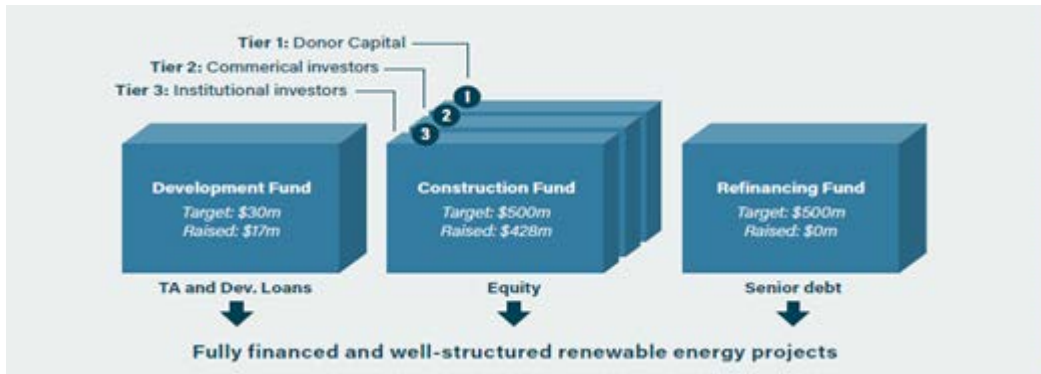
5. Structured Finance to Manage Multiple Risks over Project Lifecycle - Supply

The Climate Investor One (CIO) fund provides an example of blending to address lifecycle risk. CIO was developed by Netherlands Development Finance Company (FMO) and Phoenix Infracore, and it began operations in 2017, with capital of \$412 million. CIO focuses on renewable energy and it combines three separate facilities to spread the risk between the development stage, the construction stage, and the operations stage of a project. CIO blends different types of instruments within and between each facility to provide an investment exposure which suits the appetite of different commercial investors.

The CIO-Development Fund makes use of donor funding for technical assistance and development loans to finance 50% of the early stages of project preparation (technical, social and environmental due diligence, permits, land acquisition, and power purchase agreement). The CIO-Construction Equity Fund converts the donor funding to equity, and finances 75% of the construction stage, using equity at commercial rates. The equity structure is comprised of 2 layers where 40% is sourced from DFIs and 40% is sourced from Private Equity/commercial investors. The balance of 20% is funded by donors that provide a first loss, and guarantees to reduce the cost of finance. Lastly, the CIO-Refinancing Fund is a pooled

facility that uses tiered instruments such as subordinated debt that is attractive to institutional investors to refinance 40% of construction finance. Climate Investor One is expected to mobilise at least \$2.0 billion by 2020, and yield an indirect mobilisation ratio of 1:9 across the three project life stages of development, construction and operations.

Figure A1.5: Climate Investor One structure



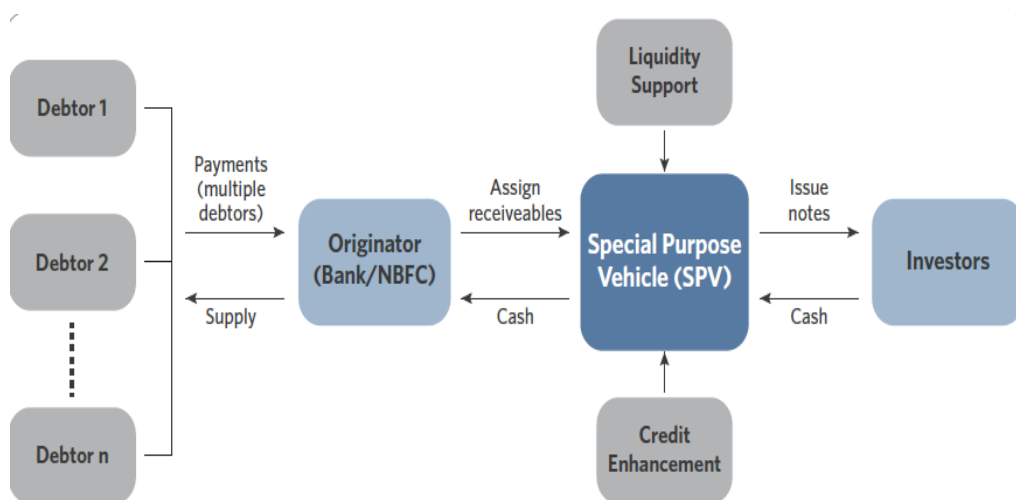
Source: Better Finance Better World, Blended Finance Task Force, 2018

6. Structured Finance and Securitization - Supply

Securitization is an important means of accessing capital markets by attracting new classes of investors and recycling bank capital. In developed markets, banks tend to focus on providing debt during the origination phase of projects. Once projects are operational and cash flows are stable, banks can free up bank capital for new projects by shifting loans off their balance sheets to institutional investors in the capital markets through techniques such as structured finance and securitization. ..

Banks can securitize assets by: (i) converting pools of cash flows associated with existing loan portfolios to investable securities that are then sold in the market; or (ii) they can go directly to capital markets and issue bonds that are used to develop new projects or retire existing loans. The use of capital market instruments can be facilitated by increasing the credit rating by: (i) providing greater levels of protection against default such as liquidity support; and (ii) using risk transfer mechanisms such as Credit Default Swaps (CDS).

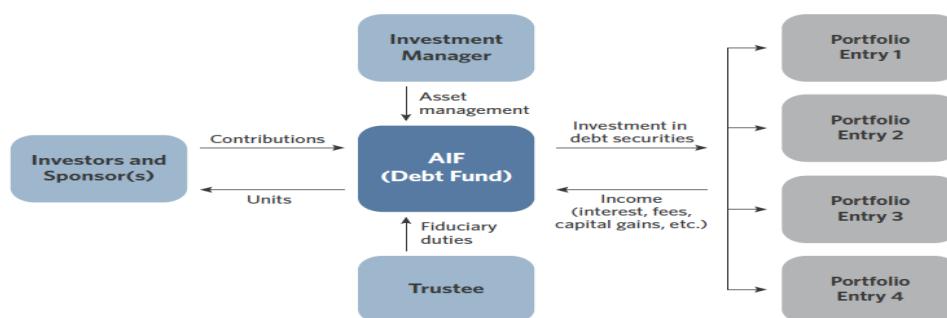
Figure A1.6: Securitization Process



Source: From Banks to Capital Markets: Alternative Investment Funds as a Potential Pathway for Refinancing Clean Energy Debt in India, Climate Policy Initiative, 2019

In general it is difficult to develop markets for CDS due to long delays associated with bankruptcy and liquidation proceedings. Credit guarantees provide investors with protection against defaults or delays in payments. Alternative Investment Funds (AIFs) can potentially overcome some of these constraints. AIFs are investible pools of funds that can invest in assets that comply with criteria in a pre-specified mandate. AIFs have a high degree of flexibility in the types of assets in which they invest, and they have been used to invest in early stage SMEs, private equity funds and hedge funds that use complex trading strategies and leverage to achieve returns. AIFs have a sponsor that is required to have a minimum commitment (shareholding), they are established as limited liability companies, often under a trust structure, no more than 25% of funds can be invested in a single project, and they are closed ended, and can be listed on a stock exchange. AIF can potentially be established to invest in bonds issued by infrastructure project sponsors in sectors such as renewable energy.

Figure A1.7: Alternative Investment Funds



Source: From Banks to Capital Markets: Alternative Investment Funds as a Potential Pathway for Refinancing Clean Energy Debt in India, Climate Policy Initiative, 2019

AIF can potentially be credit enhanced by sponsors that offer partial credit guarantees, creating diversified portfolios of assets, and minimising concentrations of risk by reducing the size of individual investments in a portfolio.

Annex 2: MDB Mobilisation Strategies

1. Asian Development Bank

ADB is primarily a lender of development loans, mainly to sovereign borrowers, and its private sector window accounts for about 14% of its operations. ADB has no clear targets for A/B loans, the utilization of guarantees, and risk transfer techniques. ADB offers both Political Risk Guarantees and Partial Credit Guarantees to projects but utilization has been limited over the past 30 years. At year-end 2015, ADB's total guarantee exposure was \$1.407 billion (less than 2% of the overall portfolio). About half of the approved guarantees were fully or partially cancelled. Most guarantees covered sovereign, sub sovereign or corporate loans and they were used to develop the financial sector (SME loans) and support climate related (infrastructure) financing. Project finance guarantees for PPPs have not been common.

As part of ADB's Asian Bond Markets Initiative it supports the **Credit Guarantee and Investment Facility (CGIF)**, which was established in 2010 by 10 countries of the Association of Southeast Asian Nations (ASEAN), China, Japan, Republic of Korea and ADB. CGIF provides credit guarantees for local currency denominated bonds issued by investment-grade companies in ASEAN+3 countries. CGIF's general bond guarantees aim to enable companies to successfully issue local currency bonds with longer maturities and reduce their dependency on short-term foreign currency borrowing. The guarantees are irrevocable and unconditional commitments by CGIF to cover 100 per cent of principal and interest payments.

In 2017, ADB established the multi-donor **Asia-Pacific Climate Finance Fund (AClIFF)**, which bundles ADB support for a variety of different financial risk management products through one facility. These products include the transfer of risks associated with proven technology, deployment of innovative financial instruments such as climate project bonds, investments in adaptation, and insurance for extreme weather events.

2. Asian Infrastructure Investment Bank

AIIB developed a comprehensive mobilisation strategy for infrastructure that was published in February 2018 (Table A2.1). AIIB intends to prioritize its activities and products based on their relative impact on Private Capital Mobilisation.

AIIB's strategy differentiates between **Upstream (working with governments on policies and institutional capacity)**; **Midstream (designing and preparing projects)**; and **downstream (direct financing and de-risking to attract third party finance)** (Figure A1.1). AIIB proposes to start from the downstream by building partnerships, originating transactions and building the team (**Activity 1: AIIB Partners**), and to expand gradually towards the mid-stream space where it will actively develop a project pipeline (**Activity 2: AIIB Leads**) and then upstream space to deliver on the long-term objective of creating markets (**Activity 3: Creates Markets**).

Table A2.1: Infrastructure Financing Gap: MDB Role and AIIB's Role

Reasons for the gap	MDB role	AIIB's role
Upstream:		
National policy context: - Tariff and regulatory framework and implementation; - Land acquisition; - Policy uncertainty; - Transparency of contract award process.	Capacity building; concessional finance; grants; policy analysis and advisory.	Limited role. Partnership with other MDBs and bilaterals and private organizations.
International coordination: cross-border investments and cross-border benefits require policy coordination.	Capacity building; concessional finance; grants and assistance with international coordination.	Limited role.

Midstream:		
Project design: Unsatisfactory risk and economics allocation. Risks include: - Cross border/country/contract risk. - Currency risk: availability, convertibility and transferability; - Construction risk.	Project preparation funding support; government and project advisory work. Direct funding, guarantees, hedging products.	Moderate – Active role. Ability to leverage new balance sheet. Support project structuring (including selective support to governments with AIIB Special Fund).
Project preparation: Weak technical project preparation.	Project preparation funding support; government and project advisory work; technical support.	Moderate role.
Investor readiness: - Lack of familiarity with developing market infrastructure sectors; - Excessive risk sensitivity.	Investor education (conferences/meetings), risk defeasance products, direct lending.	Active role. Ability to leverage new balance sheet.
Lack of standardization of documentation and process.	Coordinate with other lenders and MDBs to standardize instruments to the extent possible.	Limited role. Activity confined to deal-related matters only where it enables market creation (see Activity 3, below).
Downstream:		
Lack of long term capital for emerging market infrastructure (debt and equity).	Direct funding, create products and structures to facilitate private sector participation.	Active role. Ability to leverage new balance sheet. Ability to provide debt and equity.
Need for credit enhancement (eg: political risk insurance (PRI); extended political risk insurance (EPRI); and comprehensive guarantees) to attract commercial capital.	Due to their preferred creditor status, MDBs have the ability to develop credit enhancing instruments.	Active role. Develop instruments that other MDBs offer and where possible refine them to make them more user friendly.
Limited appetite for emerging market infrastructure risk.	De-risk by assuming risks MDBs are better positioned to manage or mitigate.	Active role. Bridge the gap between equity sponsor and commercial bank risk tolerance.

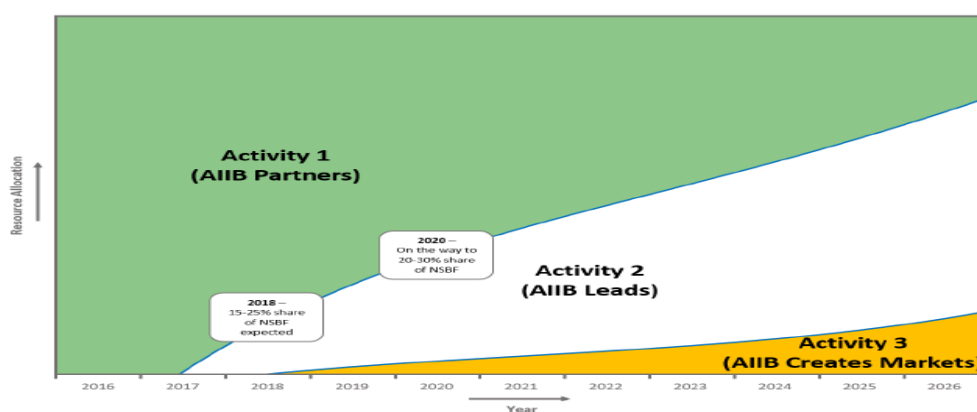
Source: Mobilizing Private Capital for Infrastructure (Technical Note) February 2018

Initially AIIB will provide debt, equity, guarantees, and other innovative mechanisms such as risk sharing facilities. The Bank intends to conduct an analysis of the relative mobilisation impact of product offerings and to prioritize them accordingly, as the strategic planning process continues. The instruments AIIB will offer and the markets it will participate in will increase in complexity with time and experience. The debt and equity teams will be separate and ring-fenced if the Bank is considering debt and equity investments for the same transaction.

Debt will be the primary focus and AIIB will consider LCY where feasible. AIIB will partner with sponsors and take minority equity investments. AIIB will invest in funds, including MDB and private sector managed funds. AIIB may consider setting up a platform for its own investments to attract institutional investors for AIIB managed funds.

AIIB intends to offer traditional MDB guarantees to address cross-border and/or country risk, and will explore the potential of offering products such as Political Risk Insurance (PRI), Extended Political Risk Insurance (EPRI) and comprehensive cover. AIIB is contemplating offering “A/B” loans. AIIB is considering ways to make its guarantee instruments user-friendly, and to facilitate refinancing, by considering structural enhancements (such as first-loss tranches). AIIB will selectively consider enhancing sovereign guarantees in high debt burden countries, and in future it may evaluate the potential to offer equity PRI, and to share demand risk for public-private partnerships (PPPs).

Figure A2.1: AIIB's Evolving Focus on Activities



Source: Mobilizing Private Capital for Infrastructure (Technical Note) February 2018

Indicators will be developed for monitoring non sovereign backed financing, private capital mobilisation, and status of activities 1:3. Capacity building will be undertaken to develop a culture and skills base, supported by incentives to pursue mobilisation objectives.

3. European Investment Bank

EIB was established by the European Union (EU) in 1958 and it finances operations to bring about European integration and social cohesion. In 2000 the EIB Group was created and it is comprised of EIB and the European Investment Fund (EPF), the EU's venture capital arm that provides finances and guarantees for small and medium enterprises (SMEs). The EIB is the EIF's majority shareholder, with 62% of the shares.

EIB is the world's largest international public lending institution and about 90% of lending is made to EU member states, with the balance being allocated to about 150 "partner countries" (in southern and eastern Europe, the Mediterranean region, Africa, Asia, Latin America, the Caribbean and the Pacific). EIB uses its AAA credit rating and funds itself by raising equivalent amounts on the capital markets. EIB does not have a formal mobilisation strategy, but it is an important part of its operations, and it provides both funded and unfunded instruments. Similar to most other MDBs, EIB provides a full suite of equity, debt and guarantee instruments.

EIB guarantees can cover risks of projects, or loan portfolios to make them more attractive to other investors, or to provide economic and regulatory capital relief. EIB provides guarantees for senior and subordinated debt, either in a standard form or as a debt service guarantee similar to that offered by monoline insurers. Beneficiaries can be large private and public projects or partner intermediaries providing financing to medium-sized enterprises.

EIB provides Project Bond Credit Enhancement (PBCE) in the form of a subordinated instrument—either a loan or contingent facility—to support senior project bonds issued by a project company for infrastructure projects. As a subordinated instrument, PBCE is designed to increase the credit rating of the senior bonds, not to extend the EIB's AAA credit rating to the project. PBCE can disburse a subordinated tranche in one of two ways:

- Funded PBCE: Loan provided to the project company from the outset.
- Unfunded PBCE: A contingent credit line that can be drawn if the cash flows generated by the project are not sufficient to ensure senior bond debt service or to cover construction cost overruns.

The PBCE is targeted at projects in areas of trans-European networks of transport, energy, and broadband/information and communications technology (ICT).

EIB benefits from European Union (EU) guarantees that can be used to scale up facilities such as European Fund for Strategic Investments (EFSI). EFSI is an EU program managed by EIB, and it is specifically designed to mobilize private finance for countries in the EU. EFSI was launched in late 2014 following the global financial crisis (2008-09) and sovereign debt crisis (2011-12), and it is Pillar 1 of the Investment Plan for Europe (IPE). EFSI addresses investment gaps by supporting infrastructure investment and improving SME access to finance. EFSI consists of an EU portfolio guarantee of EUR16 billion provided to the EIB Group and a capital contribution from the EIB of €5 billion. These resources increase the risk-bearing capacity of the EIB Group, allowing it to finance additional operations which address market failures with an expected value of €60.4 billion.

EIB is structuring funds using instruments such as **portfolio guarantees** that can be issued to financial institutions to support medium sized businesses and infrastructure projects. EIB is one of 11 accredited finance institutions active in the Neighbourhood Investment Platform that supports the EU programs in its neighbouring countries and it is participating in the European Fund for Sustainable Development (EFSI).

EIF is active in the SME sector in EU countries and its activity is centred upon two areas, venture capital and guarantees:

- EIF's venture capital instruments consist of equity investments in venture capital funds and business incubators that support SMEs, particularly those that are early stage and technology-oriented;
- EIF's guarantee instruments consist of guarantees provided to financial institutions to cover credits to SMEs.

Both instruments implemented by the EIF for SMEs are complementary to the Global Loans provided by the EIB to financial intermediaries in support of SME financing. In many cases these guarantees are highly subsidised.

4. World Bank Group

4.1 Overview

WBG is comprised of three sub-agencies: (i) Public sector International Bank for Reconstruction and Development (IBRD); (ii) Private sector operations through International Finance Corporation (IFC); and guarantee operations through Multilateral Investment Guarantee Agency (MIGA).

WBG developed a formal mobilisation strategy, the **Maximizing Finance for Development (MFD) program**, in 2017 which provides a comprehensive framework to systemize and mainstream private mobilisation. The MFD shows how private mobilisation can potentially be scaled up by establishing special purpose funds and making innovative use of new instruments.

The MFD acknowledges that **financing alone will not be sufficient to achieve the SDGs and reforms are needed within COOs to improve the investment climate**, and create new investment and financing opportunities. The MFD highlights the importance of the Hamburg Principles⁴⁴ which stress the centrality of government actions to improve the investment climate, strengthen domestic financial markets, promote sound financing practices for debt sustainability, improve governance and strengthen project pipelines,

⁴⁴ http://www.bundesfinanzministerium.de/Content/DE/Downloads/G20-Dokumente/principles-on-crowding-in-private-sector-finance-april-20.pdf?__blob=publicationFile&v=2

based on robust public investment planning to accommodate expanded financial resources. Public finance maybe required initially to develop policy, regulatory and institutional reforms to remove constraints and mitigate risks that limit private sector participation.

Under the MFD, the WBG introduced a “Cascade Approach” to prioritize its efforts to leverage the private sector for growth and sustainable development.⁴⁵ The MFD incentivises staff to use private finance for investment before drawing down public direct finance from WBG’s balance sheet. If these reforms are not sufficient, then the WBG may consider public sector finance, initially on a guaranteed or blended basis, before looking at fully funded public sector financing solutions.

4.2 Public Sector Blended Finance

The Private Sector Window (PSW) of the WBG’s International Development Association (IDA), which is an IBRD fund for the world’s 75 poorest countries, is an important element of MFD. This program expanded the role of IDA from financier of policy and public-sector projects, to one of catalyst of private financing. The 18th Replenishment (IDA18) in 2017 received a record \$75 billion commitment, of which \$2.5 billion was allocated to the PSW on the grounds private sector was central to the achievement of the SDGs and IDA18 goals. It was envisaged these funds would mobilise \$6-8 billion in private sector investments in the poorest countries by de-risking investments at the country and project level. De-risking would be achieved by IFC’s efforts to strengthen the enabling environment, and scale up project preparation through advisory services. At the same time, de-risking at the transaction level would be pursued by transferring risks to IDA, IFC or MIGA.

The PSW is comprised of four facilities: (i) Risk Mitigation Facility - \$1,000 million (which would be comprised of non-sovereign guarantees for liquidity support and/or political risk insurance for infrastructure PPPs); (ii) Blended Finance Facility - \$600 million (for MSMEs); (iii) MIGA Guarantee Facility - \$500 million (for reinsurance of risks such as breach of contract); and (iv) Local currency facility (LCY) - \$400 million (provided by IFC).

4.3 IFC

- IFC Strategy

In line with MFD, the cascade, and the PSW, the IFC 3.0 Strategy was approved in 2017. The central premise of Strategy 3.0 is that IFC will work more closely with IBRD than in the past to unlock private investment. The three components of this strategy are: (i) creating new markets, (ii) developing innovative ways to mobilize capital and mitigate risk, especially in the poorest and most conflict-prone countries, and (iii) implementing a private sector-first approach at the WBG level. In 2018, IFC’s shareholders agreed to a \$5.5 billion capital increase and a suspension of IDA transfers. The IFC 3.0 strategy aims by 2030 for it to invest \$25 billion a year from its own balance sheet and an additional \$23 billion from third-party investors—for a total of \$48 billion.

- IFC Instruments

Foreign currency (FCY) debt is the primary instrument used by IFC to pursue its development objectives. IFC is active in the syndications market, and B loans to eligible financial institutions are the traditional syndication instrument. Under this arrangement IFC will always retain a portion of the loan for its own account (A Loan), and it sells B loan participations in the remaining portion of the loan. Under this structure IFC is the lender of record and B loan participants benefit from IFC’s preferred creditor status. IFC commits to the participants to allocate payments pro-rata between the A and B Loan. As a result, IFC

⁴⁵ See Appendix 1 for further details on the MFD

cannot be paid in full until all participants are paid in full. Similarly, a default to a participant will be a default to IFC.

In response to the global financial crisis (GFC) and scaling back of cross border operations by international banks, IFC began syndicating parallel loans to Development Finance Institutions (DFIs) and other participants that were not eligible to invest in B Loans. Under this approach, IFC acts as arranger—and can also act as administrative agent— to identify investments, perform due diligence, and negotiate loan documents in cooperation with parallel lenders. IFC is primarily providing this service to other DFIs.

IFC has also structured a small number of A Loan Participations, where it has partially sold A Loans to commercial banks or other financial institutions.

IFC is using increasing amounts of blended finance over time to help it contribute to the achievement of the SDGs. The rationales for using blended finance were: (i) creating markets; (ii) reaching underserved beneficiaries; (iii) addressing mispriced environmental externalities; and (iv) addressing affordability.

Underpinning IFC 3.0 Strategy, it scaled up, or established a series of syndicated privately co-financed funds to tap into non-traditional sources of private sector finance:

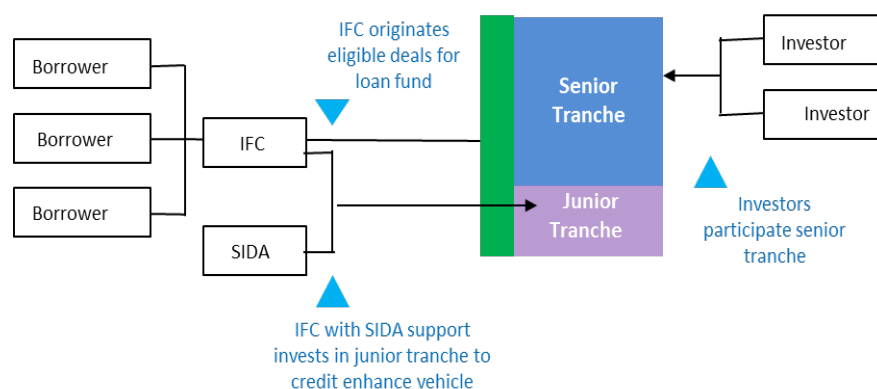
- IFC has attracted new sources of private equity through its **Asset Management Company (AMC)**. AMC was established in 2009 and by 2017 it had mobilised total external capital of approximately \$10.1 billion, with \$6.3 billion in commitments in 13 AMC-managed funds. AMC is a wholly owned subsidiary of IFC that was established to manage all capital funds invested in emerging markets. The AMC manages capital mobilized by the IFC and third parties such as sovereign or pension funds, and other development financing organizations. Despite being owned by IFC, the AMC has investment decision autonomy and has a fiduciary responsibility to the four individual funds under its management. AMC aims to mobilize additional capital for IFC investments as it can make certain types of investments not available to IFC. The AMC sub funds consist of:
 - **IFC Capitalization (Equity) Fund**, established with \$1.275 billion in 2009 makes equity and equity related investments in systemic banks in developing economies,
 - **IFC Capitalization (Subordinated Debt) Fund**, established with \$1.725 billion in 2009 makes subordinated loans to systemic banks in developing economies,
 - **IFC Financial Institutions Growth Fund**, established with \$505 million in 2015 makes investments in financial institutions across global emerging markets;
 - **Africa Capitalization Fund**, established with \$182 million in 2011, makes equity and equity related investments in banking institutions throughout Africa;
 - **IFC Global Infrastructure Fund**, established with \$1.2 billion in 2013 makes equity and equity related investments in companies focused on power, transportation, water, telecommunications, oil and gas midstream and downstream;
 - **Women Entrepreneurs Debt Fund**, established with \$115 million in 2016, provides senior loans to commercial banks for on lending to women owned SMEs in developing countries;
 - **China-Mexico Fund** established with \$1.2 billion in 2014 makes equity, and equity related and mezzanine investments in privately held companies in Mexico;

- **FC African, Latin American, and Caribbean Fund**, established with \$1.0 billion in 2010 makes equity and equity related investments in companies across Sub-Saharan Africa, Latin America and the Caribbean,
 - **IFC Middle East and North Africa Fund**, established with \$162.4 million in 2015 makes equity, and equity related and mezzanine investments in companies across the MENA region;
 - **IFC Emerging Asia Fund**, established with \$693 million in 2016 makes equity, equity related and mezzanine investments in companies across emerging markets of Asia;
 - **IFC Catalyst Fund**, established with \$418 million in 2012, makes investments in private equity funds, platform companies, and co-investments in climate related projects;
 - **IFC Global Emerging Markets Fund of Funds**, established with \$800 million in 2015, makes investments in private equity funds, secondaries and co-investments in emerging markets.
- IFC has raised private debt through its **Managed Co-Lending Portfolio Programme (MCP)** that is **using URPs to crowd in institutional investors**. As of 2018, the MCP has raised \$7 billion from eight global investors. Funds are allocated to infrastructure (35%), financial institutions (33%), and Real sector (27%). The MCP typically builds a loan portfolio for an investor that mirrors the portfolio IFC is creating for its own account—similar to an index fund. MCP investors and IFC sign upfront administration agreements determining the makeup of the portfolio based on agreed eligibility criteria. Investors' pledge capital upfront and then as IFC identifies eligible deals, investor exposure is allocated alongside IFC's own participation in line with the terms of the agreement. Depending on the type of investor, the MCP can offer a variety of structures:
 - **Sovereign investors** can establish a dedicated trust fund, where IFC signs borrower loan agreements on its own account and as implementer on behalf of the investor for the trust fund;
 - **Institutional investors** can establish an investment vehicle and contract with IFC to originate transactions and participate in B loans;
 - **Insurance companies** can establish an unfunded structure that provides IFC with credit insurance and shares in project risks.

In certain situations, IFC and partners can provide loss coverage on the MCP facility by taking a junior tranche so investors can take investment-grade exposure in a senior tranche. The first loss splits the cash flows (principal and interest) from the portfolio of loans between IFC and the investors. These structures have been used to establish the following MCP funds:

- **MCP-Partners** tracker investment vehicles mobilised sovereign \$3 billion of funds from China using an index portfolio and trust fund structure;
- **MCP-Infrastructure** mobilised \$2 billion from investors such as insurance companies in B loans by providing an index portfolio fund with credit enhancement such as first-loss coverage where IFC takes a junior tranche so that investors can take investment-grade exposure in a senior tranche IFC has in turn partnered with the Swedish International Development Cooperation Agency (Sida), which has agreed to share the risk with IFC on the first-loss tranche.

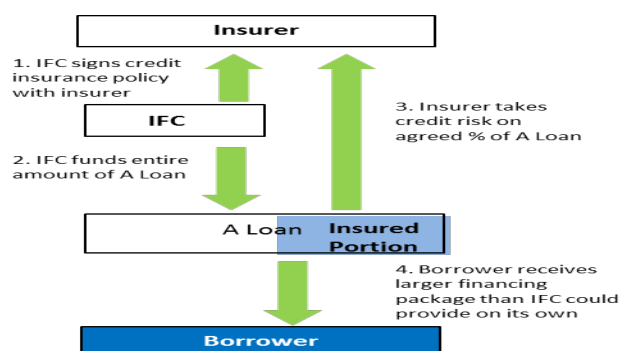
Figure A2.2: MCPP Infrastructure Structure



Source: IFC

- o MCPP-Financial Institutions has mobilised insurance companies as URP providers on a pre-qualifying portfolio⁴⁶ to attract third party co-financiers.

Figure A2.3: MCPP Financial Institutions



Source: IFC

In 2017, MCPP Financial Institutions formed a partnership with two insurance companies, Liberty Specialty Markets and Munich Re, to bring in \$1 billion of unfunded credit risk exposure that will support \$2 billion of IFC senior loans to developing country banks. Under this arrangement IFC signs an administration agreement with the insurer on how the portfolio will be structured. IFC then identifies eligible transactions to build a portfolio that mimics IFC's own portfolio, and manages the investments in line with decisions taken for IFC's own account.

- IFC has recently created the **Green Cornerstone Bond Fund (GCBF)**, which provides a platform to channel funds from global institutional investors to climate bank financing in the developing world. Under this facility, the Government of Luxembourg agreed in 2018 to provide GCBF with EUR1 million for a technical assistance program managed by IFC to complement the Amundi Planet Emerging Green One Fund—the world's largest targeted green bond fund focused on emerging markets. The fund will buy green bonds issued by banks in Africa, Asia, the Middle East, Latin America, Eastern Europe, and Central Asia. The facility has a value of \$2 billion and IFC will invest

⁴⁶ IFC also has the ability to provide this credit mobilisation facility on a standalone basis to projects, rather than on a portfolio basis.

up to \$325 million. Amundi will raise the rest of the \$2 billion from institutional investors worldwide and provide its services in managing emerging-market debt.

4.4 MIGA

MIGA offers political risk insurance (PRI) and credit enhancement guarantees for long term debt and equity investments. These instruments help protect foreign direct investments in emerging economies against political and the following non-commercial risks: (i) currency inconvertibility and transfer restrictions; (ii) government expropriation; (iii) war, terrorism and civil disturbance; (iv) breaches of contract; and (v) non-honouring of guarantees. In April 2019, MIGA and EBRD signed a Memorandum of Understanding that envisages greater cooperation and the use of the institutions respective financial projects in joint projects. A similar agreement was signed by ADB and MIGA in May 2019.

In addition to traditional PRI, in recent years MIGA has expanded its credit enhancement products to cover non-honouring of sovereign financial obligations and non-honouring of financial obligations of state-owned enterprises. This support has been highly concentrated in infrastructure, agribusiness, manufacturing, and services sectors, rather than financial sectors, and exposure in fragile states over the period 2007-2012 was only 10%. As part of the IDA18 replenishment, the World Bank created a \$2.5 billion PSW to catalyse private sector investment in IDA-only countries, with a focus on fragile states. Half of these funds will be used in a MIGA Guarantee Facility to provide shared first-loss on guarantees and risk participation akin to reinsurance.

Annex 3: External Mobilisation Evaluations and Studies

In 2012 Bretton Woods Project prepared an analysis of “Leveraging Private Sector Finance”. The study reviewed how World Bank Group (WBG) uses the concept of leverage and notes it is similar in concept to “additionality”. The study focuses on financial leverage and the extent public funds and institutions are used to mobilise private lending. The WBG defines leverage as “the ability of a public financial commitment to mobilise some larger multiple of private capital for investment in a specific project or undertaking.” IFC often refers to leverage, and calls it “mobilisation”, which is defined as: “financing from entities other than IFC that becomes available to clients due to IFC’s direct involvement in raising resources.”

There are no agreed measures, but leverage is usually expressed as a ratio, though there are different ways of defining leverage ratios. The ratio most commonly used by WBG is: Public or publicly backed investment: private investment. This ratio needs to be interpreted with care as it cannot always be assumed that public investment causes the additional ‘leveraged’ private investment. It is necessary to consider: (i) whether the private investment would have happened anyway?; and (ii) whether the project achieves the aims of the public institution initiating the support?

The three main instruments used to achieve leverage are loans, equity and risk management products.

- The four main types of loans at IFC are: (i) investment loans; (ii) syndicated loans; (iii) financial intermediary (FI) loans; and (iv) concessional loans. IFC can make investment loans for up to 25% of project costs, whereas there is no requirement for FIs to raise or contribute up to 75% of funds, indicating there may be no leverage with FI Loans. Similarly, leverage is likely to be low with concessional loans, as the amounts of money are small, and the focus is not on mobilising additional third party funds;
- It is difficult for EBRD to show financial leverage with equity as it is taking minority shareholdings. The establishment of IFC’s Asset Management Company (AMC), is slightly different, as it has control of private equity investments. AMC invests alongside IFC, and encourages investments from other partners, it does not set any requirements for other partners to provide any minimum percentage of the total investment; and
- WBG provides a range of risk management products, including: (i) risk sharing products where borrower sells part of the risk to IFC; (ii) partial credit guarantees, where IFC pays a first loss up to a certain amount; (iii) political risk insurance, which MIGA provides to foreign companies; (iv) catastrophe insurance, which is linked to weather related insurance; and (v) hedging products such as IFC hedges against currency movements.

Similar to concessional and FI loans and equity, it is difficult to measure leverage associated with risk management products. **There is a trade-off between high rates of leverage, and declining levels of influence over private sector, reducing likely financial additionality.** Leverage may not be well targeted, as it is fundamentally project driven, rather than reflecting national priorities. There can be problems of moral hazard, and transparency and accountability are low.

In 2012, European Investment Bank (EIB) and European Commission (EC) launched Project Bond Initiative (PBI) and Project Bonds Credit Enhancement (PBCE) framework. These initiatives were launched to help meet the European Union’s (EU) infrastructure investment needs, at a time when bank regulatory frameworks were constraining bank long tenor financing. Bond financing had become difficult to achieve since 2007/8 as the monoline insurers (who previously guaranteed bonds issued by project

companies) were significantly less active, and projects were not investment grade, and therefore attractive to institutional investors.

Under the PBI EIB provided eligible infrastructure projects with PBCE in the form of a subordinated instrument – either a loan or contingent facility – to support senior project bonds issued by a project company (Senior Bonds). The funded loan would be structured as a mezzanine debt tranche, and the unfunded instrument consisted of a long-term, irrevocable and revolving letter of credit.

The core benefit of PBCE was the improvement to credit ratings of the Senior Bonds, thereby widening access to sources of finance and minimising the overall funding costs. The PBCE differed from monoline cover as it was partial, and it could not be more than EUR200 million or 20% nominal value of the bonds. The purpose of the facility was to improve project rating rather than extend EIB's AAA rating.

Figure A3.1: Funded PBCE

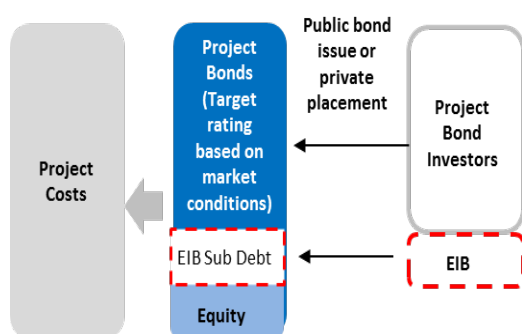
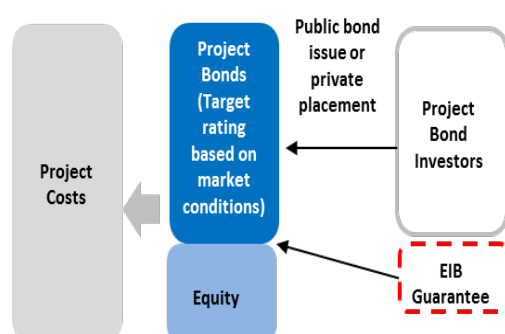


Figure A3.2: Unfunded PBCE



Source: An outline guide to Project Bonds Credit Enhancement and the Project Bond Initiative, EIB, 2012

The Pilot Phase of the PBI was targeted at projects in the areas of trans-European networks of transport (TEN-T), energy (TEN-E), and broadband / information and communication technology (ICT). This testing phase was supported by €230 million of EU budgetary resources. These funds would be used by EIB as a first loss, and enable EIB to provide €750 million of PBCE. EIB would be involved with multiple project bidders at an early stage so bids reflected EIB terms for PBCE. EIB also worked with procuring authorities to help them develop project bond structures.

As of 31 July 2015, 7 transactions had been supported with a total PBCE amount of €612 million, which enabled the issuance of over €3.7 billion in bonds. The €230 million allocated from the EU budget had been deployed in full. By sectors, most of the signed project bond credit enhanced projects were transport projects in the road (2) and port (1) sectors, and energy projects (3), followed by broadband (1).

In 2015 the EC prepared an evaluation of the Pilot Phase of the PBI. The assessment looked at: (i) added value and additionality, compared to other instruments; (ii) impact on EU project bond market; (iii) the achieved multiplier effect relative to the EU budget; and (iv) competitiveness of project bonds. The evaluation concluded the facility was relevant and the EU contribution in the risk sharing mechanism was seen as essential to develop the initiative and allowed EIB to target riskier and larger transactions and to widen the investor base. PBCE had enabled all of the projects to achieve financial close, and helped develop the project bond market. The expected number of projects had reached financial close, and the level of leverage relative to the EU budget was 18.6, which was fully in line with expectations. The overall expected leverage, which included projects signed at EIB own risk, was 30.3, which was well above expectations. Project bonds proved to be more efficient than bank debt in most cases. The evaluation concluded that going forward the Project Bond Credit Enhancement product was clearly needed by the market.

WBG prepared a study in 2012 of Best Practices in Public-Private Partnerships Financing in Latin America: the role of guarantees. The study found Non-Financial or Explicit contract guarantees provided by the public sector in concession or PPP contracts had been most effective in achieving the bankability of projects. Chile had the most complete scheme of explicit guarantees in contracts, and the design may be extended to other countries. Full wrap guarantees were very important for the financing of PPP projects, where sponsors were able to access the capital markets. Financial guarantees can be highly effective in capital markets if they have:

- **Minimum underlying rating – credit quality:** This requirement meant well-structured projects, able to resist stress scenarios, which have proven to be amongst the success stories in PPP finance.
- **Thorough due diligence:** The financial guarantors devoted qualified teams to the structuring of PPP projects, and always required independent studies performed by expert external advisors.
- **Legal documentation:** The intensive involvement of expert counsel in guaranteed transactions meant well-structured and thorough legal documentation, which defined and protected the rights of the parties and complied with local and/or international law and local securities market regulation.
- **Interactive credit process:** Financial guarantors apply hands-on, experienced management to each transaction which interacts permanently with the credit officers, ensuring that credit issues arising during the structuring process are dealt with on a timely manner and result in well structured transactions.
- **Surveillance team and practices:** At financial closing, once the guaranteed obligations have been placed to the market, a surveillance team of the financial guarantor takes over and maintains an ongoing and long term relationship with the project company and its sponsors, readily available to ensure that there is an open communication channel at all times between lender and borrower.
- **Flexibility and single counterparty for future changes:** The financial guarantors, through the constant interaction during the phase of surveillance, are a readily available counterparty to discuss and implement changes to the financing that are invariably needed in the life of a project, due to its dynamic nature. As opposed to having to deal with a bank syndicate, or worse, a diverse array of institutional investors, the project sponsor has a single counterparty to negotiate needed changes.

Financial guarantees (full or partial) are not an effective response when banks seek liquidity rather than protection against projects' risks. Banks create financial structures to guarantee the repayment of loans that incorporate trusts, escrow accounts; that capture project revenues in a timely manner. The use of financial guarantees is required when institutional funds provide resources through the acquisition of bonds or structured notes issued in capital markets.

Governments pledged tax revenues from payroll tax, the vehicle ownership tax and vehicle license plate fees to collateralise offtake payments. Instability of these revenues has meant it was necessary to substantially over collateralise bank loans

Partial Credit guarantees do not assume construction risk, whereas bank loans assume this risk. This issue is important as the main constraint in greenfield PPP Projects are the risks incurred during the construction stage. Construction risks need to be mitigated sufficiently so that the "underlying" rating of the investment degree level (BBB-) with the builder and sponsor's guarantees; and if it is necessary, with third parties' liquid guarantees or the sponsor's contingent equity.

Credit ratings help provide investors an expert opinion about project risks, and the rating permits a comparison of risks across sectors and industries, but it is usually not enough for the investment analysts to recommend investment, particularly during the construction phase of a project where the most complex and numerous risks exist.

- The lack of time and specialized knowledge by investors to understand PPP project risks normally prevents them from investing in debt from PPP projects, leaving projects with only one source of financing: traditional bank project loans.
- Financial guarantees are the key element to solve this problem. Financial guarantors understand project risks and have expert professionals with experience in identifying, mitigating and monitoring project risks.
- Because the financial guarantor assumes risks of the PPP project when granting its guarantee, putting its balance sheet at risk, its approach to risk is much more thorough than the rating agencies, which only provide a service but do not incur losses, other than reputation, in case their assessment of risk is incorrect.

McKinsey prepared an analysis in 2016 on how to mobilise private sector financing for sustainable infrastructure. The report identified six initiatives with high impact that were feasible, and they all relied upon MDB support.

- **Scale up investment in project preparation and pipeline development.** MDBs can move upstream and help governments to set priorities and create a realistic pipeline, and prepare feasibility studies for project financing structures that are attractive to investors such as institutions. Establish common legal and design standards, and project preparation and procurement documentation to reduce transaction costs. MDBs can take minority equity positions along the lines of IFC's InfraVentures unit and DIFID's publicly funded but privately managed InfraCo. IFC has established a PPP Advisory Unit that is funded by donors and works closely with national PPP Units;
- **Use development capital to finance sustainability premiums.** Use development capital to pilot the business case for sustainable-infrastructure investment, especially in middle income countries, and demonstrate to the private sector there are profitable opportunities. For example, India successfully developed an energy efficiency trading scheme with MDB support.
- **Improve the capital markets for sustainable infrastructure by encouraging the use of guarantees.** These instruments are underused for sustainable-infrastructure finance. **In 2014, only 5% of climate finance from MDBs went to guarantees,** with the rest being distributed through loans, grants, equity, and other instruments. Guarantees are well suited to crowd in and leverage sustainable infrastructure investment as they can be precisely targeted and adapted to policy and regulatory risks in areas such as Feed in Tariffs (FITs) for renewables. Guarantees can reduce total project costs by reducing the cost of capital, relative to the cost of the insurance fees;
- **Encourage the use of sustainability criteria in procurement.** Look at whole of life costs, and measures such as reductions in greenhouse gas (GHG) emissions and water use, rather than least cost construction costs when evaluating bids.
- **Increase syndication of loans that finance sustainable-infrastructure projects.** Syndications can help MDBs to reduce balance sheet exposures and recycle capital for new investments. Syndication can be increased by raising the amount of infrastructure finance for projects. Alternatively, MDBs can pool a portfolio of assets and offer a more diversified exposure. **EBRD**

has the highest percentage amongst MDBs of its portfolio dedicated to sustainable infrastructure at 14%. IFC has the highest syndication ratio at 41%.

- **Adapt financial instruments to channel investment to sustainable infrastructure and enhance liquidity.** Effective use of financial instruments can reduce transaction costs or due-diligence requirements, mitigate risks to provide more certain cash flows, and provide additional liquidity that makes it easier for financiers to get in and out of investments. Land value capture models used to develop transport infrastructure can be adapted for use in non-traditional sectors such as healthcare. Green bonds where issuers guarantee payments, and tax credits, can be useful mechanisms to reduce transaction costs and change risk return profiles for projects.

OECD prepared an analysis in 2016 of how countries could mobilise US\$100 billion pa of climate finance by 2020⁴⁷. OECD had prepared a preliminary aggregate estimate of public and mobilised private climate finance flows in 2013-14. Public and private finance mobilised by developed countries for climate action in developing countries reached US\$62 billion in 2014 compared to US\$52 billion in 2013. The analysis concluded the US\$100 billion pa target depends on three key factors: (i) **the level of public finance in 2020**; (ii) **the way in which it is allocated between projects** aimed at mobilising private climate finance and those which do not; and (iii) **the private-public ratio** with which public finance is able to mobilise private climate finance.

- **OECD estimated that levels of levels of public climate finance** – bilateral and multilateral – would be close to US\$67 billion by 2020. These funds would be channelled through MDBs, climate funds and UN special bodies. ECAs were expected to further contribute to mobilisation of public funds. It was expected larger shares of climate-related finance would emerge over time in development finance portfolios, particularly in climate-sensitive sectors such as energy, transport, agriculture and water. These investments would have important co-benefits for other SDGs.
- **Allocation of funds to private projects.** The ability of public finance and policy interventions to effectively mobilise and catalyse private investment is dependent on country and market conditions (or “enabling conditions”) that influence levels of investment flows in general. Within this setting, governments have a range of public finance and policy intervention options to increase private sector investments in climate-relevant activities in developing countries. **Public interventions might mobilise private finance directly (mainly the case of public finance at the project- or fund-levels), or have a more catalytic effect over time (through capacity building and climate policies).** There is a need to direct resources to those countries where they are most likely to be effective (ie those in need), as well as those countries that have capacity to absorb resources (ie efficient use of public resources).
- **The ratio of public to private finance mobilised** is a critical determinant of amounts of climate finance mobilised. MDBs have pledged to increase this ratio over time. **Factors that would increase the private: public ratio include a focus on climate mitigation rather than adaptation using established technologies, instruments that reduce private investor risk profiles (equity, guarantees, blending and loan syndications), countries with low sovereign risk and conducive enabling environments.** Private: public ratios are likely to be lower in countries where public funds are allocated to non-income generating capacity development and policy development, reliance on grants and concessional loans, and politically unstable countries with under developed private financial sectors and capital markets.

⁴⁷ 2020 Projections of Climate Finance Towards the USD 100 Billion Goal, OECD, 2016

In 2017 UNCTAD prepared an analysis of opportunities to scale up finance for SDGs. MDBs were expected to play a central role in mobilising private finance, but a limiting factor was their conservative financing approach and narrow equity capital base. As shareholders were unwilling to scale up capital, MDBs needed to explore new ways of enhancing their lending capacity and tapping into new sources of finance such as institutional investors.

The report noted that for the seven largest pension funds in the world, 76% of the total portfolio was in liquid assets, and less than 3% in infrastructure. Central Banks and Sovereign Wealth Funds (SWFs) also invest primarily in low-yield short term liquid assets. Infrastructure has a long maturity that increases perceptions of risk, and there are often complex regulatory issues that increase screening and monitoring costs. Institutional investors face fiduciary rules according to which they cannot invest in projects that are below investment grade, which is the case for most developing country projects. Basle III regulatory requirements have similarly constrained banks to lend in short term liquid assets.

MDBs are seen as providing a mechanism to address these issues, but at present their funding capacity is limited. In total the WBG and the three main regional MDBs lent in aggregate US\$77 billion in 2016, compared to the \$64 billion lent by EIB. In addition to direct lending MDBs can indirectly mobilise private finance by creating markets and providing financing instruments that better share risks between creditors and borrowers, and over time. They can also help mitigate informational deficiencies facing the private sector by assisting governments to screen and prepare projects.

A number of proposals have been developed to scale up MDB operations. The report of the Inter-agency Task Force on Financing for Development 2017 highlights two channels: (i) access international capital markets; and (ii) attract private capital as co-investors in development-oriented projects, by providing guarantees and other instruments to cover different sorts of risk, technical assistance, and best practices, to ensure alignment with broader developmental goals. The main constraint on MDBs accessing capital markets is their narrow equity base. MDBs can increase equity through new capital contributions or increasing levels of retained earnings. In recent years, MDB shareholders have been using profits to replenish concessional finance reserves and trust funds that are used as a source of blended finance.

An alternative to raising capital might be to relax MDB capital requirements to increase leverage. ADB and IADB merged their balance sheets for concessional and non-concessional finance to increase equity capital. WBG's concessional Internal Development Association (IDA) fund obtained its own rating, which was then used to raise additional resources in capital markets. IADB implemented loan swaps with other MDBs to reduce portfolio concentrations in high risk assets. MDB loans can be sold to private investors, or they can design, implement and supervise projects, but not actually own the underlying loans. A growing trend has been the establishment of joint investment platforms in which MDBs and private financiers are partners in investment projects. In this partnership, the MDBs provide resources such as technical expertise (for project design, preparation and monitoring), guarantees and insurance, while the private sector contributes financial resources to the project. Examples of joint platforms are EIB's Joint Assistance to Support Projects in European Regions (JASPERS); the WBG's Global Infrastructure Facility (GIF), in which the bank co-invests by providing technical expertise and facilities; and EBRD's Equity Participation Fund (EPF).

Other initiatives involve the creation and/or management of special funds with multi- or single donor support focused on infrastructure development, and the aim of attracting private investors:

- **IADB's Infrastructure Fund (InfraFund)** to facilitate investment through identification and preparation of bankable projects, and the **Regional Infrastructure Integration Fund**, in which

IADB provides technical assistance for the development of integration projects in the Latin America and the Caribbean region;

- **ADB's Leading Asia's Private Sector Infrastructure Fund (LEAP)**, which provides co-financing to non-sovereign infrastructure projects and seeks private sector participation through different modalities, including PPPs, joint ventures and private finance initiatives;
- **Africa 50** with strong sponsorship of AfDB, aimed at developing bankable projects and attracting private capital from long-term institutional investors; and
- **New Partnership for Africa's Development (NEPAD) Infrastructure Project Preparation Facility (NEPAD-IPPF)** which has AfDB as a trustee serving as legal owner, holder and manager of the fund

UNCTAD noted the MDBs had prepared an analysis of PDM and PIM in 2016 which indicated that for each dollar of their direct financing, there was another dollar of indirect private co-financing. Within this total, leverage ratios varied substantially across MDBs, with EIB having a ratio of 1.4 for indirect private co-financing to direct bank disbursements, whereas IADB and AfDB had ratios 0.2-0.3. This difference was attributed to easier lending conditions in Europe. It was noted that leverage ratios could be increased substantially through the use of risk mitigation instruments. Less than 5% of MDB financed infrastructure projects benefited from the use of these instruments. A review of DFI financing policies indicates there are opportunities for MDBs to increase their own debt: equity ratios, and still preserve their "AAA" ratings.

Asian Infrastructure Investment Bank (AIIB) has established provisions in its articles where it can establish special funds that provide non-concessional funds that can be leveraged at higher levels than the parent's balance sheet, providing a means of scaling up infrastructure investment. These funds will have the ability to adopt at least a 15 year time horizon for equity investments, compared to the 7-8 years of most private equity firms and MDBs. The funds do not seek controlling or majority stakes, and financing can take the form of direct equity investment (in ordinary shares of a firm or project); quasi-equity investment (preference shares, convertible bonds, other hybrid instruments) and fund investment (fund-of-funds). It is envisaged these funds could help act as "first-mover" or "cornerstone" investors to mobilize additional financing from other (international and domestic) public and private sector sources. In principle, funds can be sourced from both AIIB and one of its special funds to support the same project.

Independent Evaluation Group (IEG) at the WBG provided a series of lessons learned in response to the MFD program in 2017.⁴⁸ The review noted WBG had a long history of trying to leverage private finance. The main development that was new under MFD was an explicit commitment toward a more structured approach to considering private sector options and the level of ambition in the attempt to mobilize private sector capital — moving from billions to trillions. IEG had prepared a range of evaluations on issues such as PPPs, competitiveness and jobs, capital markets, SMEs, and reform of business regulations to improve investment climate. A common finding of private sector involvement is that it is not a "silver bullet". Engaging with the private sector requires improving upstream conditions for investment to take place. Countries need to have clear objectives on where they want to involve the private sector and skills to identify and prepare projects. Other prerequisites for tapping the private sector are access to finance (including functioning capital markets), the rule of law, and macro stability.

⁴⁸ Opinion: The World Bank has engaged the private sector for a long time. Here's what we've learned. Caroline Heider, 24 October 2017

Dedicated units within government are often critical for engaging with the private sector, and maintaining momentum, but in many countries there are capacity gaps to perform this function. There is a need for stable policies and sector reforms that provide predictable taxation, business regulations, and tariffs. Sector programs can often run into political resistance that slow down reform. It is necessary to get early and comprehensive stakeholder commitment from both the government and the public. There is a need for innovation to overcome high transaction costs.

Policy reforms to make a more predictable investment climate can be coupled with de-risking instruments provided by third parties to provide project returns that meet the investment requirements of institutional investors. IFC and SIDA launched the MCPP-2 (MCPP Infrastructure) in 2016 as a platform to mobilize private funds for infrastructure investments in emerging markets, with limited success so far in terms of deployments.

ADB's Independent Evaluation Department (IED) prepared an analysis in 2017 of opportunities to boost its mobilisation capacity and the role of credit enhancement products. The study found ADB was primarily a lender of development loans, particularly to sovereign borrowers. The utilization of guarantees, A/B loans, and risk transfer operations by ADB had been modest over the past 30 years. About half of the approved guarantees were fully or partially cancelled. Most guarantees covered sovereign, sub sovereign or corporate loans and they were used to develop the financial sector (SME loans) and support climate related financing. Project finance guarantees for PPPs were less common. The reasons for cancellations included replacement by other guarantee providers that offered comprehensive cover (ADB offered only partial guarantees), the inability of ADB to participate in the MIGA cover for equity investments in a high-risk market, and a failed privatization

ADB had achieved limited success in deploying its non-sovereign A/B loan product, and many of the loans approved were subsequently cancelled. Of all ADB's credit enhancement products (CEPs), partial credit guarantees (PCG) were the most effective in mobilizing third-party financing. The demand for "classical" political risk guarantees (PRG) for medium and long-term debt financing had been quite low. Extended political risk cover, including breach of contract, is mainly used in project finance transactions, but preference is given to comprehensive guarantees, except in high-risk and fragile countries where there is potential demand for political risk coverage. **The deployment of ADB risk transfer operations that provided insurance over ADB loan exposure to non-sovereign borrowers was more successful, mainly because this product did not compete with ADB lending.**

IED identified potential gaps in the CEP market. Market respondents perceived comprehensive guarantees to be the most important product in the global CEP market and the one with the highest mobilisation impact for projects with medium to long term financing requirements. PCGs are needed for: (i) financing in LCY; (ii) payment risks for sovereign borrowers in relatively high-risk markets; and (iii) payment risks for sub-sovereign borrowers, state-owned enterprises, and private sector borrowers (including commercial payment risks in project finance transactions). ADB could play an important complementary role in all these areas. A special focus area could be trade and investments between developing nations and cover for international or domestic capital market transactions. These reforms needed to be carefully sequenced and properly resourced in country strategies and programs.

A wide range of issues had inhibited the use of CEPs. There were several external factors such as the lack of market familiarity with ADB guarantees, and the limited market value for the risk mitigation effects of A/B loans. Within ADB there was a lack of bankable projects, and while PPPs were important, for the foreseeable future most transport and water sector projects were likely to continue to be funded with sovereign loans. ADB had no clear targets for the utilization of guarantees, A/B loans, and risk transfer instruments. CEPs were not well integrated into ADB's country strategy and operations. ADB's system of

measuring mobilisation leads to the reporting of unrealistically high mobilisation figures. The incentive system did not encourage the utilization of ADB products that would have optimal mobilisation and developmental impact for its member countries. Participation requirements in ADB's CEPs were inflexible, political risk cover did not encompass equity, there was a limited number of staff involved in guarantees and syndications, and IT systems were inadequate to manage CEP operations.

IED recommended that ADB's guarantee operations be separated from lending operations and cover sovereign and non-sovereign operations. Consideration should be given to extending guarantee coverage to equity and establishing a dedicated guarantee pool or fund. The mobilisation measurement framework should distinguish between co-financing (financing contributed by all third parties) and mobilisation (financing catalysed by ADB). There should be a program of internal and external capacity building to raise awareness of benefits of guarantees. Country strategies should discuss opportunities to mobilise non-traditional sources of finance using CEPs, develop capacity within governments to manage contingent liabilities, and improve access to LCY. IT systems should be developed within ADB to support the use of CEPs.

World Research Institute (WRI) prepared a review of MDB guarantees in 2017 and concluded the use of URPs by MDBs has been extremely limited for the following reasons⁴⁹:

- Accounting rules require the full loan amount guaranteed to be retained on the balance sheet, which locks in capital that could otherwise be given out in loans;
- Complexity of adding guarantees to the finance mix leads to longer processing times; and
- Lack of in-house knowledge and human resources.

Centre for Clean Air Policy (CCAP) prepared a study in 2017 on Mobilizing Private sector Investment in Support of Nationally Determined Contributions (NDCs). The study noted that previous MDB evaluations indicated the need for comprehensive frameworks that: (i) supported investment climate through technical assistance and building national capacity to develop project pipelines; (ii) provision of finance on a least concessionality basis to avoid risks of distorting markets, and developing de-risking instruments to mitigate legal, currency and construction risks; and (iii) strengthening delivery channels for climate finance such as the MDBs and climate funds should be based on properly aligned incentives and transparent, efficient and predictable processes, data collection and monitoring. MDBs can make greater use of risk mitigation instruments such as guarantees, insurance, equity and subordinated debt. MDB's can expand the use of FX guarantees, such as those provided by TCX. MDB's should consider revising equity capital rules that limit the deployment of guarantees, and developing inhouse capacity to manage risk.

In 2017, a joint paper was prepared by representatives of the European Commission (EC), OECD, European Development Finance Institutions (EDFI), Convergence and TCX on "the Need to Reduce FX Risk in Development Countries by Scaling Blended Finance Solutions. Foreign exchange (FX) risk is a major constraint on sustainable development in developing economies. Over 90% of cross-border debt to low- and lower middle-income countries is denominated in foreign currency (FCY), exposing unhedged borrowers to currency mismatch between local currency (LCY) revenues and foreign currency debt. Almost 100% of equity flows are exposed to FX risk. Regulatory reforms have proven to be a slow path to increased financial intermediation in LCY, and MDBs have been reluctant to provide LCY debt. As a result, most borrowers are forced to borrow in FCY and they are vulnerable to even small shifts in the FX rate and their ability to service debt. Research indicates that annual depreciation rates

⁴⁹ INSIDER: Expanding the Toolbox: A Glimpse at a New Generation of MDB De-Risking Approaches, WRI, 2017

have averaged over 4% for developing countries over the past 25-40 years, and this shift is sufficient to cause financial distress. Depreciations of greater than 15% over a 12-month period are quite common in developing countries.

Blended finance is seen as a high potential means of achieving the SDGs, and four high impact methods were identified:

1. **Credit enhancement and risk-sharing instruments to facilitate domestic capital being invested in domestic projects.** Organisations like **GuarantCo and the Credit Guarantee and Investment Facility (CGIF)** have proven instruments, issuing guarantees that allow borrowers to gain access to local currency capital at sustainable terms.
2. **Credit enhancement and risk sharing instruments to facilitate cross-border debt and equity investment.** Vehicles like the **Sida Guarantee Instrument** and the **IFC–Sida Managed Co-lending Portfolio Program (MCP)** allow investors and lenders to benefit from a full or partial guarantee from an investment grade guarantor.
3. **Currency risk hedging instruments to improve the management and allocation of FX risk.** **TCX** has underwritten around \$5 billion of currency risk in more than 50 developing countries over the past decade, allowing around 3-5 million SMEs to access local currency financing at viable rates. **TCX** has earned a positive return – although with high volatility from its business model. The **MIGA Guarantee Instrument cross-currency swap arrangement** allows borrowers to swap out of FX debt obligations into local currency obligations.
4. **Financing and guarantee instruments that bear FX risk.** The European Investment Bank–European Union ACP Facility is the best-known sizable program within the DFIs where the lender takes open currency risk and charges a premium to cover FX losses. After 10 years of financing around €600 million in loans, the cumulative FX premium has been around five times greater than FX losses.

WBG is taking steps to support actions to mitigate FX risk and the current IDA replenishment includes a new Private Sector Window, which is expected to provide approximately \$500 million to assist IFC provide LCY financing. Similarly, the new European Fund for Sustainable Development (EFSD) allocated European Union aid to reduce FX risk in developing countries. Increased public sector investment in blended finance instruments would likely have a positive impact on reducing the incidence of sovereign debt defaults and restructurings. **Scorecard objectives of MDBs should include targets to increase the percent of financing in local currency or hedged foreign currency**

Centre for Global Development prepared a paper “More Mobilizing, Less Lending”, in 2018. The paper noted MDBs were essential actors to mobilise private finance for development, but noted that levels of mobilisation were low and fell well short of the Addis Ababa undertakings. A 2016 report found that \$1.50 of direct and indirect mobilisation occurred for every \$1 of MDB private finance, and the ratio for direct mobilisation it was 40c for every dollar of MDB private finance. These ratios reflect current business models and staff incentives that favour profitable lending and maintenance of AAA risk ratings. Capital increases will not change mobilisation ratios required to achieve the SDGs. As a result, a new business model is needed for MDBs which is given scope to assume more risk and improve targeting of its support.

The paper proposes that MDBs establish **special purpose vehicles (SPVs) that are designed to target highly catalytic uses—such as early stage finance for SMEs and high-risk project tranches for infrastructure in middle income countries.** These SPVs could be capitalized from both public and private sources, and a single SPV could potentially serve multiple MDBs. These SPVs would not require large amounts of capital as they are addressing risks at the margin, and incentives can be designed to

specifically reflect mobilisation rather than lending targets. In some cases, the focus of operations could be on guaranteeing portions of portfolios rather than individual projects.

ODI prepared a paper on Private infrastructure Financing in Developing Countries, Five Challenges, Five Solutions, in August 2018. The paper notes the importance of infrastructure for growth, the size of infrastructure deficit estimated by G20 to be \$1.5 trillion pa, and the need for most of these funds to be sourced from the private sector. It further notes that private-finance flows to developing countries have declined since the 'taper tantrums' of 2014 and because of regulatory changes under Basel III and Solvency II. MDBs have responded by stepping up traditional lending and TC, and introducing innovations in areas such as project-preparation facilities, the co-financing of funds and de-risking for private investors. **Despite these efforts, private finance has not been galvanized at anything like the levels required, despite the availability of large pools of capital potentially available.**

There is reasonable consensus about the main barriers to investment: (i) lack of 'bankable' projects; (ii) difficulty of managing political and macroeconomic risk; and (iii) mismatch between the instruments being offered and the needs of institutional investors. The paper presents five sets of recommendations to address these constraints: (i) IFIs should shift their business model from "hold to maturity" to "originate to distribute"; (ii) accelerate and increase the scale of the pipeline of bankable projects; (iii) **syndication** (multiple sources of finance) **and securitization** (combining assets into portfolios to create new classes of assets that can be sold to different classes of investors) need to become the predominant financing models for infrastructure; (iv) need to **develop fit for purpose hedging instruments** for investors to mitigate FX and political risks, possibly developed with public subsidies; and (v) **development of pension and insurance markets** in middle income countries (MICs) would provide an attractive source of LCY financing for infrastructure.

ODI prepared a paper "Championing sustainable and innovative finance for development" in November 2018. The paper provides an evaluation of the Currency Exchange Fund (TCX) that was established in 2007 by a group of development finance institutions (DFIs). TCX provides LCY hedging instruments to mitigate foreign exchange (FX) risks associated with financing projects. TCX acts as a market maker and it has hedged almost \$6 billion worth of development finance in LCY since its inception. TCX is seeking to grow the size of its portfolio to achieve economies of scale and increase diversification, supporting larger and longer tenor transactions.

FX risks are one of the major constraints to achievement of the SDGs. TCX helps mitigate FX risks by offering foreign-exchange forward contracts and currency swaps in developing market currencies. TCX currently provides services in more than 70 countries and holds positions in each of their respective currencies. TCX normally offers non-deliverable products, where all cash flows are denominated in LCY, but are settled in USD. As a result, TCX creates a 'synthetic' LCY loan. Deliverable contracts, where all cash flows are in LCY, are available upon request, but only for specific currencies.

Diversification enables TCX to offset losses in some currencies with gains in others. For most transactions, TCX receives local currency and pays out hard currency, usually USD dollars. This means it accumulates local-currency risk as a result of its normal operations. Since 2013, TCX has been able to offset an increasing amount of its accumulated currency risk, by working with its shareholders to hedge the obligations of their LCY bond issuance, paying out in LCY and receiving FCY. This has reduced TCX's LCY exposure in some markets, allowing it to use its capital base more efficiently.

TCX creates value by providing hedging instruments and structuring advice that reduce investment risks, particularly for infrastructure in developing economies. Historically, TCX focused on

MSME, supporting the achievement of SDGs by supporting climate action and poverty reduction through job creation and growth. TCX contributes to financial stability by providing pricing certainty and reducing FX risks at the project level. TCX promotes the deepening of local capital markets by supporting offshore and onshore local-currency bond issuance and by pricing products that extend local yield curves.

Offshore LCY bonds are an attractive new asset class for international investors, as they offer a higher rate of interest (derived from the LCY interest rate) coupled with the low credit risk of an IFI, in addition to a well-regulated offshore jurisdiction.⁵⁰ TCX has contributed to the deepening of local bond markets both offshore and onshore in the following ways.

- First, it has teamed up with its shareholders, international financial institutions, to issue LCY bonds in offshore markets. While TCX does not issue the bonds itself, it plays a central role by hedging the IFIs' local-currency payment obligations (coupon and principal payments).
- Second, TCX partners with specialist funds that help local companies to issue bonds in their onshore, domestic markets. One example is the African Local Currency Bond (ALCB) Fund, for which TCX has hedged a significant amount of currency risk.
- Third, the pricing transparency that TCX provides has a secondary effect of 'market deepening', or increasing the range of financial services available on that market, as its pricing information allows the creation of long-term yield curves, which act as market benchmarks.

OECD prepared an analysis of requirements to evaluate Blended Finance in 2019 and how it could be used to leverage private finance to meet the SDGs. Blending can combine financing from varied public and private sources through a mixture of financial instruments.

- **Blended finance pursues both development and commercial objectives**, underlining its hybrid character, operating between public and private spheres. Blending may be justified as a response to different types of problems. For example, it may be used as a means of addressing **market failures** and to **improve the risk-return relationship** of investment projects. This hybrid character of blended finance creates difficulties measuring effectiveness and value added.
- **Because different development agencies have different mandates, blended finance is used in different ways by these organizations.** MDBs are banks that incentivise staff to approve and disburse money. **These incentives can create competitions between MDBs to approve allocated funding, which can contribute to inadequate project pipelines across MDBs.** As managers' performance within MDBs is assessed on the basis of approved funds, they are less motivated to conduct ex ante evaluations of project proposals and assess ex post development outcomes. As a result, the objectives and incentives of the MDBs will be very different to the objectives of donors of blended finance.
- **In many cases there is a low level of transparency of the use of public funds, relative to direct public sector oversight**, creating risks of misallocation, or corruption in procurement. Financial information on blended operations is not systematically disclosed on the grounds of commercial confidentiality. The involvement of intermediaries such as fund managers in the implementation of blended finance presents a further complication in promoting transparency. A completely decentralised monitoring system may increase the risk of fragmentation and poor data quality. These mixed incentives and lack of transparency create special challenges for monitoring and evaluating the outcomes and impact of blended finance.

⁵⁰ Black, S. and Munro, A. (2010) Why issue bonds offshore? BIS Paper No. 52. Basel: Bank for International Settlements

- **Blended finance instruments led by multi or bilateral public investors such as MDBs can rely on pre-existing monitoring and evaluation units, whereas private managers are less likely to have such in-house competence.** Despite efforts to harmonise monitoring and reporting procedures across MDBs, there continues to be a high level of diversity across organizations in how these functions are applied and how metrics are compiled and reported.
- **Evaluations will vary across different types of financial instruments** as outputs, outcomes and impacts cannot be analysed without considering the inputs used to achieve these outcomes. Ideally, alternative situations should be compared with and without blended finance – both set in the same context. In many cases it will be difficult to establish control groups, and it will be necessary to rely on baselines, benchmarks, case studies, and quantitative and qualitative analysis to identify causal relationships, relevance, additionality and impacts.
- **Additionality can be difficult to measure** and typically it refers to additional finance mobilised and the additional development impact achieved. Financial additionality is not a guarantee for development additionality. Both kinds of additionality are required to justify the use of blended finance. The OECD review referred to the EVD study on additionality (2018) which noted that additionality encompasses financial additionality and impacts such as lower risk or improved quality of outputs. The overlapping of additionality and impact, and the fact that additionality is assessed early in project selection and design, meant its justification tends to rely on a judgement call, rather than hard evidence.
- **Blended finance should be efficient and not act as a subsidy** that leads to unnecessary extra profit for beneficiaries that crowd out other investors. If the aim is to reduce the perceived (high) risks for private investors, it can be achieved by providing information, participating in the management of the project, and providing guarantees, equity, or subordinated loans. Evaluations need to be clear about the problem that is being addressed and the way the selected instrument will address that problem. Projects need to be continuously monitored to determine the level of concessionality required from blended finance over time to continue to meet objectives.

The Blended Finance Taskforce issued a report in 2018 looking at how the use of development funds to mobilise additional private finance for investment in the UN Sustainable Development Goals (SDGs) – can be deployed more effectively. The taskforce identified four key SDG-investment systems of: (i) food and land use; (ii) cities; (iii) energy and materials; and (iv) health and wellbeing. The taskforce concluded:

- The \$50 billion blended finance market had doubled in size over the previous 5 years, driven by investment in clean energy, and could double again over the next three to four years to support the achievement of the SDG goals by 2030;
- Infrastructure and debt funds had delivered attractive long term returns and offered risk reduction benefits from diversification;
- MDBs and DFIs have a critical role to play scaling up blended finance and can do so by more than doubling the current private: public leverage ratios of 1:1 by increasing the scale of private sector operations and increasing leverage ratios from 2:1 to 4:1;
- Blended finance can complement mechanisms such as green bonds and One Belt, One Road (OBOR) funds, to support policies and institutional capacity initiatives to develop project pipelines and tap into international capital markets;

At present institutional investors such as pension funds allocate less than 1% of assets under management to infrastructure in emerging markets. This figure needs to increase to 3-4% by 2030 to

deliver the SDGs. While perceptions of risk remain high, in actual terms, returns from infrastructure have been strong relative to other asset classes. Blended finance instruments such as guarantees and insurance can provide an important mechanism to use development capital from public sources to de-risk private investments.

There is a strong business case for blended finance in sectors such as clean energy which has already been benefiting from blended finance for many years. The sustainable land use sector, which offers one of the most powerful ways to address the SDGs but has so far seen very little in the way of private investment due to inherent challenges, particularly around scale, project bankability, revenue models where the cash flow is delayed and a lack of market mechanisms to monetise returns (e.g. a carbon price for avoided greenhouse gas emissions from preventing deforestation)

Many (high) middle income countries such as China, Malaysia and Mexico – with sovereign grade ratings provide conducive enabling environments without the need for concessional finance. Blended finance instruments, structures and pooled funds offer a way for investors to participate in clean energy investments in countries with riskier policy environments, that have lower credit ratings and/or technologies and business models do not have a track record.

Climate Policy Initiative (CPI) concluded that South and South East Asia and Sub Saharan Africa had the greatest clean energy investment potential. Together, eight countries had an estimated potential of \$369 billion by 2030. The main risks are associated with volatile currencies, offtakers that lack credit worthiness, insufficient scale and lack of liquidity. There are also lifecycle risks in early stages associated with policy and permits. Risk mitigation instruments such as hedging, guarantees and insurance are required to address these concerns. Similarly, these early stage risks need to be aggregated and securitised to investors. Innovative blending structures such as aggregating investments into layered funds or tradeable securities, or hedging LCY with TCX, are increasingly attracting long term capital from institutional investors.

Sustainable land use activities seek to protect the climate by avoiding or mitigating deforestation, the degradation of land and carbon-intensive agriculture, while providing safeguards to meet the growing needs for food production and protecting habitat for biodiversity. It offers one of the most powerful ways to address the SDGs. Globally, new food and agriculture systems are estimated by the BSDC to provide a market opportunity of US\$2.3 trillion by 2030, of which forest and ecosystem services are estimated at US\$365 billion a year. Yet it has so far seen relatively little in the way of private investment. Investment could be much higher with the use of blended finance to tip the scales and make major sustainable land use opportunities more investable for the private sector

Creating Markets to Leverage the Private Sector for Sustainable Development and Growth, IEG, 2019 IFC's new corporate strategy (IFC 3.0) focuses the institution on creating markets and mobilizing private capital. Creating Markets has been part of the World Bank Group's development agenda for at least the last 15 years. The strategy is based on a Country Private Sector Diagnostics tool (CPSD) introduced in 2019. The CPSD provides comprehensive and systematic country level analytics to identify key constraints and opportunities for market creation in future Country Partnership Framework (CPF) processes. The strategy will draw upon a new Anticipated Impact Measurement and Monitoring (AIMM) framework, which assesses projects for their contribution to market creation.

The evaluation was designed to provide lessons for the new strategy and it based on 16 case studies in three sectors in nine countries. The case studies indicated that IFC's support was based on four channels: (i) fostering innovation; (ii) generating demonstration effects; (iii) enhancing skills, capacities and governance structures at firm level; and (iv) supporting integration into value chains.

The evaluation assessed the success of market creation activities from IFC's interventions through two sets of indicators: (i) increased size or reach of markets, enhanced competition, lower prices, enhanced environmental sustainability and market resilience standards; and (ii) provision of sustainable market access to the poor.

Based on the evaluation case studies, IFC's market creation efforts had resulted in increased size or reach of markets, often for small and medium enterprises. But liberalization and greater private sector participation did not necessarily go hand in hand with price reductions, and improved access. In addition to IFC's investments and advisory services, MIGA's guarantees have contributed to enhancing market reach and access, and to increasing competition. By mitigating political risks, MIGA's guarantees encouraged entry into difficult markets by foreign investors who often bring financial resources, modern technologies and access to export markets.

The case studies confirmed the fact that markets are not created by firm level advice or investments alone. Countries require enabling environments that include: (i) effective public sector institutions with predictable administration of regulations and contracts, and experience working with the private sector; (ii) availability of physical infrastructure. IFC initiatives were more likely to be successful if: (i) there was local presence; (ii) policy dialogue; and (iii) programmatic involvement. There was a need have an appetite for risk and a long term engagement horizon, as reforms can take up to 10-15 years. Monitoring and evaluation (M&E) provisions are needed to understand and analyse how market creation affects the poor and underserved.

Annex 4: EBRD Mobilisation Evaluations and Case Studies

4.1 Grants

Evaluation Department (EVD) prepared an evaluation of EBRD's Infrastructure Project Preparation Facility (IPPF) in 2018. The IPPF was a special purpose project preparation facility that was established by EBRD to prepare public and private sector infrastructure projects and provide policy dialogue. IPPF used a framework approach to form two pre-qualified consultant teams that could be rapidly mobilised for project preparation. The IPPF was financed through the Board's Special Shareholders Fund (SSF) and it provided a mix of grants for public sector projects, and project preparation fees that would be recovered from private investors in Public Private Partnerships (PPP). The establishment of IPPF was premised on the need to bridge the infrastructure gap and mobilise additional funds, particularly from the private sector, to achieve the United Nation's Sustainable Development Goals.

The IPPF's performance differed significantly across the sovereign and non-sovereign windows, with 27 public sector projects being prepared, compared to 2 non sovereign PPPs at the time of evaluation. In part this result was due to different cost recovery arrangements, with public sector projects being developed for free using grants, while governments were expected to pay 10% of PPP projects costs. As PPPs are large complex projects, these cost recovery arrangements discouraged governments from developing projects as PPPs. IPPF was located in a banking department, where there were strong incentives to prepare and finance projects as rapidly as possible, creating a bias towards approving the financing of public sector projects, even though disbursements were low. Further problems arose as IPPF grant funding was allocated on a gap filling basis, and it was not possible to determine the value for money (VFM) from public investments (grants) relative to amounts of public or private finance mobilised. Terms of reference for consultants were too narrow, and focused on project preparation, rather than developing upstream institutional capacity within governments to develop and manage infrastructure projects.

The evaluation recommended that IPPF make greater use of readiness assessments at the country level that were prepared using VFM principles, and seeking to standardise project preparation methodologies, upstream institutional capacity to develop fiscal capacity, project preparation and monitoring and risk management capabilities. To support these activities, it was recommended that a new PPP unit be established that was not incentivised on the basis of annual business investment (ABI), and developed an advisory services model that charged for outputs on a fee for service and grant basis, and was based on a clear business case reviewed and approved by the Board..

4.2 Equity

EVD prepared an evaluation of EBRD's Equity Operations in 2017. The study found EBRD had used equity investments since its founding to catalyse co-investment and firm-level performance improvements to contribute to wider transition impact. Equity holdings – both direct and in private equity funds -- accounted for 15-20% of EBRD's portfolio from 2005-2016. Investment levels were ramped up post-crisis in line with an increase in lending. The "Stuck in Transition" report of 2013 argued for greater use of instruments such as equity to pursue institutional objectives. Declines in the competitiveness of EBRD debt post-crisis, and a lack of equity in countries of operation (COOs), reinforced this view.

While equity operations remained significant, equity returns have been low and deteriorating in recent years, and the current portfolio presents numerous issues of concern. Direct equity, accounted for 76% of the equity portfolio, and returns were poor. EBRD Management has intensified its focus on its equity business in recent years, and introduced several initiatives to strengthen performance. An Institutional

Investment Partnership (IIP) was established as an in-house fund of funds in 2016, intended to attract large long-term institutional investors such as sovereign wealth funds (SWFs). An Equity Participation Fund (EPF), the first of an anticipated series of IIP sub funds, achieved first closing in September 2016 having raised €350M from two SWFs. In 2017 Management presented an “Enhanced Equity Approach (EEA)” intended to elevate the strategic profile of equity and set out broad directions for higher performance and value creation. The focus of this EEA was improvements in transition impact, rather than mobilisation.

The evaluation recommended that the institutional and resourcing arrangements for portfolio development and management be clarified. Staff should be incentivised to manage equity using carried interest principles. It was proposed that IFC’s Asset Management Company structure be reviewed by management as it appeared to have a number of important mobilisation benefits, particularly in regard to the transfer of risky equity assets to a special purpose subsidiary with a dedicated staff. Management did not support this proposal as it was seen as “cherry picking” the best equity assets, and diluted effective strategy implementation.

4.3 Guarantee Facilities

4.3.1 *Small Business Initiative – Risk Sharing Facility*

(j) Project Description

In 2003 EBRD approved the Medium Sized Co-Financing Facility (MCFF) to cover Early Transition Countries (ETC), Western Balkans and Ukraine. The MCFF was designed to help local Partner Financial Institutions (PFI) increase lending volumes to SMEs by reducing credit risks through the provision by EBRD of unfunded guarantees. In 2015, the MCFF was renamed the Risk Sharing Framework (RSF) and established as a regional facility. The MCFF was then integrated with the Direct Investment Facility, and the Direct Lending Facility, and the three instruments formed the Small Business Initiative (SBI). SBI is designed to provide an integrated toolbox of products for SME support. Operational standards and procedures have been harmonised to improve effectiveness in serving SMEs, and improving efficiency to reduce costs. SBI is now comprised of five pillars: (i) Pillar 1 – financing through PFIs, based on SME credit lines; (ii) Pillar 2 – co-financing with PFIs using instruments such as the RSF; (iii) Pillar 3 – Direct financing facilities (DFF) for small businesses; (iv) Pillar 4 – Business Advice; and v) Pillar 5 – Policy Dialogue.

4.3.2 *Project Structure*

The EBRD RSF guarantee reduces the amount of capital required by PFIs to support sub-loans, and if required, it provides them with access to Technical Cooperation (TC) grants for training PFI staff in credit assessment, and sub-projects with funds for project preparation, and investment grants. The RSF benefits from first loss risk cover from the SSF for subprojects in the SEMED and Western Balkans regions.

Risk participations can be up to 65%, although in practice almost all participations have been for 50% of the sub-loan amount. Each sub-loan can be up to €20 million with EBRD’s risk participation limited to €10 million. The tenors of sub loans can be up to 10 years for corporate debt, or 15 years for project finance. Sub loans can be denominated in \$, €, or local currency (LCY).

The risk participation is provided to the PFI by EBRD under a RSF Agreement and it can be on either a funded or unfunded basis. The funded facility is similar to a syndicated loan where EBRD is the B-lender, and the PFI funding is treated as co-financing. The unfunded facility is similar to an unconditional and

irrevocable payment obligation by the EBRD, and it is treated as Annual Bank Investment (ABI). Sub-borrowers are individually approved by EBRD and the Board has delegated authority to management for exposures less than €20 million. PFIs conclude loan agreements with the sub-borrowers and administer and monitor the sub-loans.

The basis of EBRD's remuneration depends on the type of facility. Under a Funded RSF EBRD receives interest and pays the PFI an administration fee. Under the Unfunded RSF, EBRD collects a percentage of the net interest margin (difference between the sub-loan interest rate and PFI's cost of funds on the guaranteed amount). Mobilisation and leverage are not formally measured or targeted, but seem to be significant.

4.3.3 Current Situation

Pillar 1 is profitable, and Pillars 2 (including RSF) and 3 are not profitable, but the amounts involved are small. The Board approved delegated headroom of €100 million for the RSF on 4 May 2017 and it was increased to €150 million in 2018. Utilisation for the year up to June 2018 was €44.9 million and it was concentrated in SMEs in ETCs. In 2018, 14 RSF deals with a value of €22 million in ABI were signed and 20 RSF PFIs were active. The RSF was expanded geographically in 2018 with new agreements signed in Latvia, Jordan, Tunisia and Uzbekistan. Growth in number of projects and ABI is expected to accelerate over the next few years as new framework agreements start to deliver sub-projects. In 2018, management decided to increase the number of RSF projects and scale back DFF due to greater levels of efficiency and better financial outcomes (less impairments). In 2019, there is an intention to expand the RSF to more attractive markets such as Turkey, Ukraine, SEMED and possibly some EU member states.

4.3.4 Portfolio Risk Sharing – BIH Unicredit Bank Mostar

(i) Project Description

In April 2019 the Board approved a Portfolio Risk Sharing (PRS) product in the form of an unfunded financial guarantee that was provided by EBRD to Unicredit Bank Mostar (UBM), a bank incorporated in Bosnia and Herzegovina (BiH). The aggregate amount of EBRD's exposure will be up to €10 million equivalent. Banks in Central Eastern and South-Eastern Europe are relatively liquid, but increased capital requirements, especially under the new Basel rules, limit their ability to deploy liquidity into new SME lending. The facility is a pilot of the PRS, as it is the first SME portfolio guarantee issued by EBRD, and it will enable UBM to utilise capital released under the project to expand SME lending in BiH.

TIs were expected to be derived from: (i) support for resilience of UBM by obtaining capital relief; and (ii) competitiveness by enabling UBM to use the released capital to expand its SME lending operations. Additionality was derived from the innovative structure of the facility. Sound banking was ensured by EBRD only covering 50% of an existing portfolio, leaving 50% with UBM as skin in the game, and the use of a first loss instrument provided by Government of Norway.

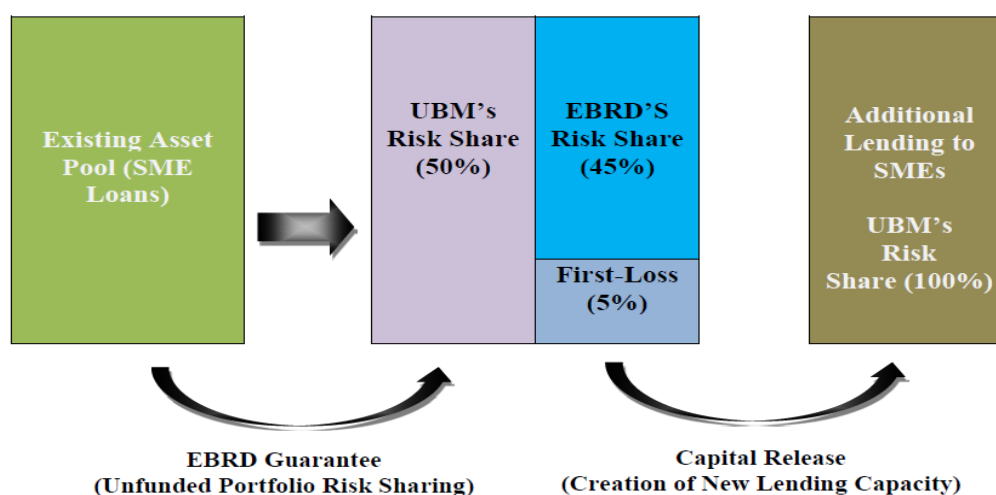
(ii) Project Structure

The PRS is targeted at a Tier 1 partner financial institution (PFI) and it covers up to 50% of a portfolio of SME Loans selected by EBRD on the basis of pre-defined eligibility criteria. Projects needed to have a remaining maturity of 2 years, and the outstanding amount of any loan could not exceed €500,000. The cover consists of an irrevocable and unconditional commitment by EBRD to provide a timely payment in the event of default. EBRD will reimburse UBM for 50% of the realised credit losses (principal only) within the Portfolio (vertical tranching) for no more than two and a half years, which is the maximum of time for

the Portfolio to be fully amortised. The structure of the transaction will include a first-loss cover in the form of donor co-investment grants, which will reduce the risk of the EBRD in the structure by up to €1 million equivalent. The project is indirectly supported by SSF funds, which are being used for the overall PRS product development, in particular the legal support by an outside counsel and previous support in the design of the product.

The facility is conservatively structured due to a lack of performance data that can be used to calibrate the model used to develop the overall financing structure. Two alternative analytical approaches were used to derive the expected portfolio probability of default (PD) and the expected loss (EL) from the sample portfolio. One used a rating transition matrix based on UBM's historical loan portfolio data to simulate portfolio rating composition to estimate portfolio PD. The other was to run an internally developed stochastic model with the sample loan portfolio using S&P's all corporate cumulative default rate table (1981-2017) and portfolio correlation assumptions. The models were then stress tested to assess the impact of severe economic shocks. Based on the results of the analysis it was concluded that with the 10% first loss cover, EBRD's risk position has a BBB range (PD 4.0) which was an acceptable risk based on the return provided.

Figure A4.1: Distribution of risk and creation of new lending capacity



Source: Board Approval Document, 2019

4.3.5 SME Local Currency Programme

(i) Project Description

The SME Local Currency Programme (SME LCYP) has a total value of \$500 million and it aims to develop capital markets and improve SME access to local currency (LCY) lending in its countries of operations (COOs). The Programme is the result of an expansion of the EBRD's Early Transition Countries' (ETC) Local Currency Programme, launched in 2011. The Programme combines EBRD capital, donor resources, and policy dialogue to provide eligible companies with access to affordable funding and acceleration in reforms to develop local currency intermediation and local capital markets.

The SME LCYP is designed to reduce the cost of interest rates on local currency (LCY) loans to SMEs by providing a first loss risk-sharing arrangement. Lower costs will support the development of more resilient SMEs, enhance competitiveness, and promote inclusiveness.

The facility is financed by donors to the ETC Multi-Donor Fund, the US Treasury, Switzerland SECO, Japan, and EBRD's SSF. Funds are only available in COOs that commit to improving their policy and regulatory environments with technical cooperation led by EBRD's Local Currency Capital Market (LC2) team. Projects supported include capacity building at central banks to develop the monetary policy frameworks necessary to deepen LCY markets, assessment and development roadmaps for local currency money markets, and development of the legal and regulatory framework to support capital market and risk management instruments.

(iii) Project Structure

Countries must confirm their willingness to support reforms of their respective capital markets, to improve the conditions for LCY lending. Under the Programme, donor commitments are used to provide a first-loss risk guarantee of the SME LCYP projects. This cover reduces associated risk costs and enables the EBRD to provide financing to SBI-eligible borrowers in local currency at competitive rates.

The SME LCYP is based on separate windows for the SEMED and ETC regions and \$3 million was allocated in total to these windows in 2018. This support mainly applies to transactions made under the following SBI facilities: (i) Financial Intermediaries Framework; (ii) the Risk Sharing Framework; and (iii) the Direct Financing Framework for SMEs. SBI eligible borrowers can also access these funds indirectly under the Financial Intermediaries Framework.

(iv) Current Situation

The Programme is currently active in 14 countries that signed the Memoranda of Understanding (MoU): Albania, Armenia, Azerbaijan, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Morocco, Serbia, Tajikistan, Tunisia, Ukraine and Uzbekistan.

As at end-September 2018, \$61.2 million had been mobilised from donors (including Japan, Switzerland, the United States, the ETC Fund and the SSF) to support the SME LCYP. Based on available resources, this allows the fund to provide risk cover for a portfolio of \$476.4 million (based on a 12.5% ratio of donor funds to portfolio), a mobilisation ratio of almost 8X.

4.3.6 European Fund for Sustainable Development (EFSD) Guarantee Programme

(i) Overview

In 2017, the European Commission (EC) launched the European Union's (EU) External Investment Plan (EIP) and its key policy goals are to:

- Contribute to achieving the United Nations (UN) Sustainable Development Goals (SDGs) while tackling some of the root causes of irregular migration;
- Mobilise sustainable investments with the aim of improving economic and social development; and
- Strengthen public and private partnerships for development and crowd-in private sector investment.

The geographic scope of the EIP includes EU Eastern (EEC), Southern (SEMED) and sub-Saharan Africa Neighbourhood. EIP's main priorities include providing support to farmers and people running businesses

in the agriculture sector, developing sustainable energy and connectivity, supporting sustainable cities, digitalization, and local currency financing.

The EIP aims to increase the scale and impact of EU external development finance by leveraging private sector investments. The EIP is based on three pillars:

- Pillar 1 is the new European Fund for Sustainable Development (EFSD) which combines existing Blending Facilities (€3 billion) and a new unfunded a new unconditional, irrevocable, at first demand guarantee facility (€1.54 billion).
- Pillar 2 is for technical assistance to develop bankable projects, improve the investment climate and attract private sector investors.
- Pillar 3 relates to policy reform combined with structured political dialogue targeted at improving the overall investment climate.

The guarantee in Pillar 1 is a key new feature of the EIP, and it is designed to augment traditional grants and mobilise private investment by reducing risk and providing liquidity. The allocation of concessional funds needs to be based on market prices and used to crowd in (rather than undermine) the private sector. The EU will maintain an open architecture for these blended and guarantee instruments and they are open to 13 international financial institutions (IFIs) and development finance institutions (DFIs). The EC has adopted a portfolio approach under the EFSD to provide IFIs and DFIs with more autonomy in project selection and avoid an approval process at project level, which is typical under the EU blending facilities.

This new approach underpins the EC's proposal for the future Neighbourhood, Development and International Cooperation Instrument (NDICI) that will govern EU support for EU external policies from 2021 to 2027. This new approach is a pilot and it is likely to lead to a substantial scaling up (in particular in the form of unfunded guarantees) from the EC in support of EU external policies from 2021 under the EFSD + scheme. It is envisaged that a similar scheme will be rolled out for Invest EU, which deals with support provided to countries within the EU. No EFSD funds have been mobilised to date.

EBRD has worked closely with the EC since the design phase of the EFSD. As a result, five Proposed Investment Programmes (PIPs) from EBRD received a total allocation of €265 million from the new guarantee program that was approved by the EU in 2018 (Table A4.1). This proposed framework has been revised since approval, as some of the proposed products are not viable and have been deleted.

Under the original allocation, each PIP will typically consist of 3-7 sub projects, although some PIPs will have up to 25 projects. In most cases guarantees will be specific to individual projects, rather than portfolios. Guarantees will be denominated in Euros and mainly be used to support senior debt that may be structured as A or B loans, or parallel loans when guarantees are passed onto third parties. EBRD was also allocated €16 million for technical assistance for project preparation and implementation as well as policy dialogue. The EFSD Guarantee will be implemented by EBRD in most cases as partial first loss risk cover (FLRC). In the majority of programmes the first loss cover will be for EBRD's benefit as well as for third party co-financiers and it will cover up to 20% losses at portfolio level and up to 30% at the project level. Given the typical 20% first loss risk cover, the amount of the underlying EBRD loan transactions of €265 million supported EU may exceed €1.0 billion, including the guaranteed amounts provided by third party lenders (ie leverage of 5X).

Table A4.1: Original Indicative Financing Plans for the five EBRD PIPs, 2018.

PIPs € million	EFSD Guarantee	EBRD ABI	Non-EBRD financing from the private and public sector	Total project costs	Total number of Projects
Financial inclusion	30	110	290	400	15
Digital Transformation Platform	35	70	280 (70 for EIB)	350	7
Sustainable Logistics and Interconnectivity	50	167	83	250	3
Energy efficiency and sustainable cities	100	257	498	755	25
Framework to scale up Renewable Energy	50	250	250	500	5
Total	265	854	1,401	2,255	55

Source: EFSD Guarantee Programme Submission to RiskCom, 2019

EBRD direct financing will be recorded as ABI and it will primarily be structured as senior debt. Recording of non-EBRD financing from the private and public sector will be considered in a broader sense than the usual EBRD Annual Mobilised Investments (AMI), including: (i) project sponsors' equity; (ii) commercial banks' financing; and (iii) other IFIs financing.

EBRD's systems do not currently allow tracking of the impact on capital and provisions of partial guarantees, however a forthcoming IT project (effective year end 2019) will address this issue, but only for partial guarantees over EBRD loans. Guarantees provided by EBRD to co-financiers will need to be booked in the current system, making use of the existing functionality. Loan Ops and Financial Accounting will need to set up and test these new products and it may require additional resources.

(ii) *EFSD Guarantee structures*

There are two possible scenarios for structuring the guarantee: (i) it covers the EBRD's exposure (Figure A4.2), or (ii) it covers the risk of third parties (Figure A4.3).

- Structures where the EFSD guarantee covers only the EBRD's exposure

Scenario (i): EBRD uses the guarantee cover for its own exposure, while keeping a portion as Skin in the Game (SITG) required by the EC.

This structure can be used for both corporate finance and project finance transactions. EBRD could syndicate part of its financing to commercial lenders in an "A/B" lending structure with the EBRD as the lender of record. The guarantee can be used to cover the counterparty risk on a loan to a Partner Financial Institution (PFI). This structure is envisaged for all PIPs, except for the Framework to scale up Renewable Energy (the RE PIP).

Scenario (ii): Pari-passu Guarantee on a portfolio of MSME sub-loans. In this case, the guarantee would reduce the risk of part of an existing portfolio or of a new portfolio. The EBRD takes 50% of MSME portfolio risk pari-passu with the PFI and benefits from a first loss guarantee from the EFSD.

Figure A4.2: EBRD uses the guarantee cover for its own exposure

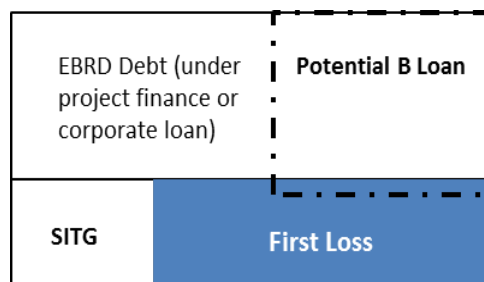
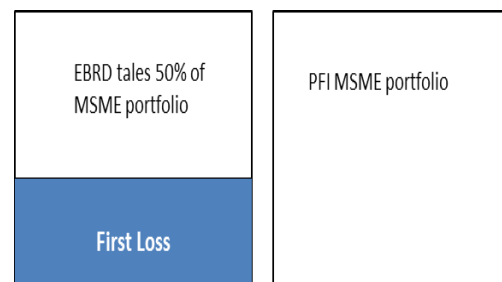


Figure A4.3: Pari-passu Guarantee on a portfolio of MSME sub-loans

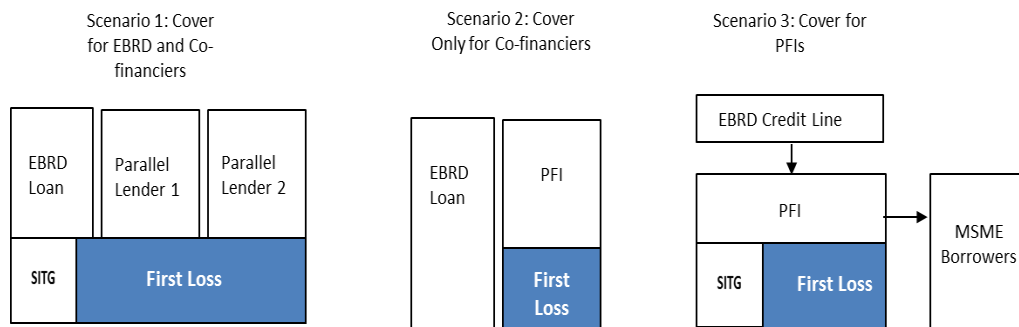


Source: EFSD Guarantee Programme Submission to RiskCom, 2019

- Structures involving third parties

There are three possible scenarios (Figure A4.4):

Figure A4.4: Guarantees with Third Parties



Source: EFSD Guarantee Programme Submission to RiskCom, 2019

Scenario (i): in addition to covering EBRD's exposure, the EFSD Guarantee also covers commercial banks or other co-financiers' exposures, including in a project finance structure with other DFIs. The EFSD Guarantee takes the first loss and any remaining losses are shared pari-passu between EBRD and the partner lenders. SITG would apply only to EBRD debt. Such structure is envisaged for the EE & SC PIP, SLIG PIP and DTP PIP.

Scenario (ii): the EBRD does not benefit from the EFSD Guarantee, which is entirely focused on mobilising investment and crowding in the private sector, by covering the losses of the partner co-financiers only. In the majority of cases, the guarantee will cover 20% of the exposure (first loss) of the co-financiers (e.g. commercial lenders), which may lend in parallel to the EBRD or under an "A/B" structure where only the B-lender benefits from the guarantee.

Scenario (iii): For Intermediated Lending, the guarantee can be used where credit enhancement support is needed. The guarantee will provide a first loss risk cover (FLRC) of up to 20% for sub-loans extended by the PFI to MSMEs (and only up to 80% of each loan, payable only on write-off or equivalent).

(iii) Legal Framework and Key Legal Documents

EBRD will sign a Guarantee Agreement with the EC for each PIP, and the following agreements with co-financiers.

Where the EFSD Facility supports EBRD's exposure and/or exposure of B lenders, the EFSD Guarantee will cover a portion of EBRD's and/or B lenders' risk arising from a loan. This might be reflected in the EBRD Loan Agreement with the final beneficiaries.

Where the EFSD Facility supports co-financiers lending through a parallel loan structure, EBRD will be required to sign back-to-back Guarantee Agreements with the parallel lenders. In such cases, EBRD will be required to sign inter-creditor agreements with the parallel lenders.

All of the five EBRD PIPs have corresponding technical co-operation funds provided by the Neighbourhood Investment Platform (NIP). EBRD will sign five separate contribution agreements with the EC for the technical assistance, and sign grant agreements with the Bank's clients and/or consultancy agreements financed with the technical assistance.

It is proposed that projects featuring EFSD guarantees be approved according to the regular EBRD procedures applicable to all other projects, (i.e. by OpsCom for stand-alone projects and projects under frameworks exceeding €25 million or by the SBIC/Delegated approvers for projects under frameworks not exceeding €25 million).

4.3.7 Selected Project Risks

[The following risks were identified in the June 2019 paper prepared by Management for RiskCom:

Capital Relief: There is a risk that EBRD/other financial institutions cannot claim capital relief if the contractual terms of the guarantees do not meet requirements by regulators. Most guarantees under the EBRD PIPs are partial guarantees, which are not capable of providing significant capital relief. Furthermore, most of these instruments are structured as a risk reduction tool, as opposed to one for achieving capital relief.

Pricing Risk: It is envisaged there will be a single price for a given PIP based on the expected risk (or credit loss). There is a risk the pricing of the EFSD guarantees may not be commercially viable as the parameters are still under negotiation.

Payment Risk: Even though the EC refers to the EFSD Guarantees as on demand guarantees, it has been clarified, during the course of negotiations that the shortest payment period that can be offered by the EU is 30 days. There may also be an out-of-pocket risk as the EBRD will have a legal obligation to pay the third party under the terms of the EBRD/third party guarantee regardless of whether it has received funds from the EC under its guarantee.

Currency risk: The EFSD Guarantee does not involve significant exposure to market/currency risk for the EBRD. The only such case is when there is a difference between the currency of the underlying loan and the currency of the associated guarantee (e.g. the loan is in local currency or USD, while the guarantee is in EUR). In such a case, the EBRD will have to convert the guarantee fees paid by the third party into EUR to pay the EC.

IT Risk: The EFSD Guarantee Programme requires an operational ability to record and process guarantees both in favour of the EBRD and issued back to back by EBRD in favour of co-financiers. The software systems of the Bank are able to do this already, but **DTM enhancement is required to enable recording of the EFSD guarantee product usage in any given investment transaction.**

EBRD's systems do not currently allow tracking of the impact on capital and provisions of partial guarantees. A forthcoming IT project (effective year end 2019) would address this but only for partial guarantees over EBRD loans. **The IT project will not be able to book and report back-to-back guarantees - the pass through of EU guarantees is specifically out of scope for the project.** Guarantees provided by EBRD to co-financiers will need to be booked in the current system, making use of the existing functionality. **Loan Ops and Financial Accounting will need to set up and test these new products and may require additional resources.**

Governing Law. Irish law will be the governing law for the facility.

4.3.8 Resource Implications

Under this pilot programme with 5 PIPs and approximately 45 individual projects, the intention is that implementation of the programme will be managed mainly by existing staff in Banking, OGC, Credit, OCCO and VP3. Future programmes such as Invest EU and EFSD + will require additional resources from the start of the implementation period in 2021.

4.4 Syndication

4.4.1 Oyu Tolgoi

(i) Project Description

In February 2013 the Board approved a loan of \$1.4 billion in favour of Oyu Tolgoi (OT), a company incorporated in Mongolia. Rio Tinto Plc was the majority shareholder, and the Government of Mongolia had a 34% shareholding in OT. The facility was comprised of an "A Loan" portion of up to \$400 million for EBRD's own account, and a "B Loan" portion of up to \$1 billion for the account of participants. The project was expected to be EBRD's largest syndicated loan to date and pricing was benchmarked by a large group of commercial lenders via a Request for Proposals (RFP).

The loan would be used to develop the OT copper and gold deposit in the Gobi region of Mongolia, which is the largest undeveloped deposit of its kind in the world. Commercial production from an open pit was expected to start in the first half of 2013. Development of an underground mine was underway and production was expected to start in 2016. All production was destined for Chinese smelters and concentrate would be transported by truck to the Chinese border, where the transfer of title would occur. The project was expected to generate revenues equivalent to one third of Mongolia's GDP and budget revenues, and more than 50% of national exports by 2020. The project was the largest FDI and financing package agreed in Mongolia at that time.

Transition impact (TI) potential was derived from, inter alia:

- Private sector development, by supporting the largest FDI transaction in Mongolia to date, resulting in a substantial increase in private sector participation in the mining industry, reaching 60% after the financing;
- Transfer and dispersion of skills from a leading international mining operator, which would introduce new block-cave mining technology, finance the construction and operation of 2 mining schools, train 3,300 people, and Mongolian nationals would account for 60% of the construction work force and 75% of mining operations;
- Market expansion through backward linkages to local suppliers and contractors and by supporting the development of Mongolian SMEs. EBRD intended to partner with OT to implement a 5 year Local Business Development program; and
- Setting standards for corporate governance and business conduct in areas such as environmental and social standards.

Additionality was derived from the terms of the loan, which had a tenor of 12 and 15 years, compared to 5 years for commercial loans in Mongolia at that time. More than 20 commercial banks were considering participation in the project, most of whom had no experience or exposures in Mongolia. EBRD participation was important to mitigate political risk. EBRD had undertaken policy dialogue and its ESS standards were required for its participation, setting a new standard in the Mongolian mining industry.

(ii) Project Structure

Total project cost was estimated to be \$19.7 billion, and \$13.74 billion would be financed by equity and the balance of \$6.00 billion by debt. By 31 December 2012, \$8.2 billion of equity and shareholder loans had been invested, primarily to complete the open pit mine and a concentrating facility. Capex items that remained to be funded at a cost of \$6.86 billion included the development of the underground mine and supporting infrastructure, and upgrading the concentrator. An uncovered commercial bank tranche of up to \$2.0 billion had been pre-approved at the time EBRD's Board approved the OT Loan.

The EBRD A loan had a tenor of 15 years, and the B Loan 12 years, with a 7 year grace period. The EBRD loans were part of a \$4 billion financing package that would include:

- An equivalent A/B loan from International Finance Corporation (IFC);
- Parallel loans from:
 - Export Development Canada (EDC, up to \$750 million),
 - Export Import Bank of the United States (US Exim, up to \$300 million), and
 - Australian Export Finance and Insurance Corporation (EFIC, up to \$100 million);
- Up to \$1 billion from commercial banks benefitting from a political risk cover by Multilateral Investment Guarantee Agency (MIGA); and
- An uncovered commercial banks tranche.

The indicative maximum amounts of the EBRD and IFC A/B loans would only be required if the MIGA cover was not ultimately available. All of the senior debt ranked parri passu and held a common security package. The loan was limited recourse project finance and it benefited from a debt service undertaking (DSU) from Rio Tinto until project completion targeted for mid 2021. The DSU covered debt service repayments becoming due, and it was subject to a political risk carve out. Rio Tinto had a credit rating of

A- (stable) with S&P and Fitch and A3 with Moody's. The project had a portfolio classification of private, an Environmental rating of A, and transition potential was rated excellent.

(iii) Current Situation

The development of the underground mine was delayed due to ongoing shareholder discussions. In February 2014 the Board reapproved the facility on a no objection basis, for a further 1 month, as it had been unsigned for 12 months. In April 2014, the project was reapproved for a period of 9 months. In December 2014, the project facility was re-approved for a third time. The project was signed in December 2015, three years after loan approval.

The final EBRD loan structure approved in December 2015 consisted of a \$400 million A loan and a \$822 million B loan. There were 15 B lenders. The total project cost had increased to \$22.3 billion and the total financing package was \$4.4 billion involving IFC A/B loans, (\$1.2 billion), ECA loans (\$1.3 billion), and commercial bank tranche covered by MIGA (\$0.7 billion). The full commitment of \$4.1 billion occurred in 2016, with a final maturity for the B loans of 2030, and repayments starting in December 2020. The underground mine is expected to be completed and operational in 2022. Financial completion is not expected to occur before 2025.

4.4.2 Turkish Hospital Facilities Management PPP Program

(i) Overview

In September 2014, the Board approved the Turkey: Hospital Facilities Management Framework. The Framework consisted of up to €600 million debt or equity financing for EBRD's own account to participate in up to 8 hospital facilities management projects, each with a different concessionaire. EBRD loans under the Framework could comprise an "A Loan" portion for the Bank's own account and a "B Loan" portion for the account of commercial bank participants, to be determined on a case by case basis.

The Framework supports Turkey's Ministry of Health (MOH) in preparing and delivering a large scale hospital facilities management PPP programme covering up to 60 facilities across Turkey for total investment costs of €12.0 billion and the delivery of 50,000 beds. This programme was being implemented in stages, and in Phase 1, 16 hospitals, with an investment value of €6.0 billion had been tendered. EBRD's Framework was expected to participate in the financing of up to eight of these projects, representing about 10% of Phase 1 capital needs (and ultimately 5% of the entire programme once it had been fully rolled out). The indicative list of sub-projects that would be financed by EBRD consisted of five hospitals in Anatolia.

The main transition rationale for the Framework was the creation of critical mass demonstrating how hospital facilities management PPP projects can be commercially financed. Following the implementation of the Framework, subsequent projects within the PPP programme were expected to be financed commercially – without IFI or donor support.

(ii) Project Structure

The hospital facilities management PPPs were structured as Private Finance Initiative (PFI) contracts, where payments from the government are structured as Availability Payments (APs). The projects were scheduled to have three years construction and 25 years operations for facilities management only (including hard and soft services). Clinical services remained the sole responsibility of MoH. Post construction, the concessionaire would receive quarterly APs from MoH for the hospital building and facilities and monthly Service Payments (SPs) for various support services such as cleaning, catering,

laundry, waste, parking, imaging, laboratories and sterilisation. APs accounted for about 75% of the revenues used to service the debt. A market testing mechanism was included in the agreements to rebalance costs every five years. Foreign exchange (FX) rate risk for the APs was addressed at tender date by specifying the foreign currency rate at that time which became the minimum rate for the APs throughout the term of the concession. APs are adjusted quarterly for FX fluctuations in excess of inflation through a foreign currency adjustment mechanism.

MoH was the grantor of the PPP contracts and it was expected the successful sponsors would establish a special purpose vehicle (SPV) that was financed by EBRD and other commercial banks. The lenders security package would include traditional non-recourse provisions such as pledge of shares, accounts receivable, bank accounts, insurance policies, hedging agreements, subordinated loans, mortgage over land and a negative pledge on buildings and infrastructure. In addition, MOH would provide compensation for early termination, and Funder's Direct Agreement with the lenders providing step in rights.

MOH was seen as a good credit risk as Turkey was rated BB+/Negative by S&P, the economy was growing, and MOH had a total budget of about €15 billion (€7-8 billion in direct annual budget and about €8.5 billion in a revolving fund). The total APs and SPs for the entire hospital PPP programme (net of costs avoided on obsolete beds that would be closed by MOH once the PPP programme was rolled out in full) would represent, at its peak, no more than 6% of the public sector healthcare budget (with an average of 3.5%). In addition, PPPs were expected to generate significant savings for the government. Under Turkish law, any MOH default would be treated as a default of the Republic of Turkey.

(iii) Project Extension

In June 2016 the Framework was extended by €350mn as it was expected the original Framework would be fully utilised by the end of 2016. EBRD would limit its total allowable exposure under the Framework to €800 million. At that time EBRD had provided A and B loans to three PPP hospitals.

- Adana Hospital PPP (OpID: 45707): €215 million A/B loan to ADN PPP Saglik with €115 million A and €100 million B. In addition, €5.6 million credit limit was utilized for an interest rate swap.
- Etlik Hospital PPP (OpID: 44166): €256 million A/B loan to Ankara Etlik Saglik with €125 million A and €131 million B.
- Konya Hospital PPP (OpID: 47083): €148 million A/B loan to ATM Saglik with €68 million A and €80 million B.

The primary purpose of the extension was to diversify funding sources, and attract institutional investors. The first sub-projects under the extension were expected to be the financing of a further three facilities under a green bond issued by the Elazig Hospital PPP, a standard loan to a PPP hospital and an EBRD equity investment that would mobilise infrastructure funds into a vehicle owning three Turkish PPP hospitals. The loans and bonds would have tenors of up to 20 years, unfunded construction loans would have tenors of 2-4 years, and the operating loans tenors of 16-18 years. EBRD expected to exit its equity investments at year 8 through IPO or exercising put options.

(iv) Elazig Hospital

In June 2016, at the same time as the submission of the extension, the Board considered and approved the financing of the Elazig Hospital PPP. The financing was provided to an SPV that was owned by a subsidiary of Meridiam Infrastructure Fund and several other sponsors. The SPV had been contracted by MOH to develop a PPP hospital. The Project Company was awarded a 28 year concession by the Turkish Ministry of Health to design, build, finance, equip, and maintain an integrated hospital campus in Elazig

with 1,038 beds - Elazig Integrated Health Campus PPP with an estimated capital cost of €400 million. The sponsors intended to finance the hospital with a €320 million 20 year amortising senior secured project bond under an 80:20 debt to equity ratio.

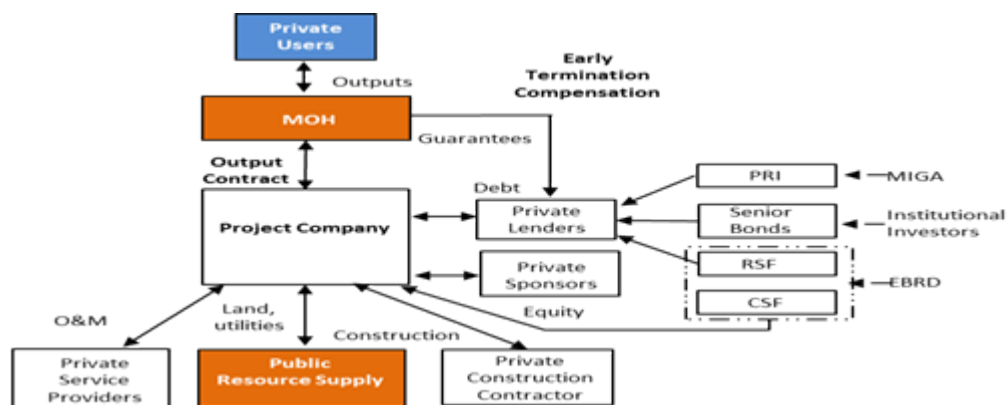
EBRD's support was designed to mobilise international institutional investors by providing credit enhancement to develop an investment grade green project bond. EBRD's facility was comprised of 2 sequenced and non-overlapping contingent unfunded debt facilities to support construction and operations in amounts of up to: (i) €49 million for a Construction Support Facility (CSF); and (ii) €80 million for a Revenue Support Facility (RSF). The transaction was very innovative as it was the first time EBRD had offered such as instrument, it was the first time that a Turkish PPP hospital would be financed by institutional investors, and it was the first time a green bond had been issued under the program.

EBRD's financing was provided together with political risk insurance (PRI) from MIGA. The CSF was designed to credit enhance the construction contractor during the Construction Period of the Project. The RSF complemented MIGA insurance by servicing debt payments to bridge MOH and MIGA obligations or prepaying bondholders in an event of default. The RSF would be available from the scheduled commercial operation date start until scheduled final repayment of senior bonds. RSF availability would only start after the CSF availability had expired and it was expected to have an approximate tenor of 17 years.

If the CSF was drawn, the funds would be used by the SPV to meet the construction company's obligations. In the event the RSF was drawn, the facility would be repaid through payments from the MOH either before or after project termination and be supported by claims under PRI cover for MOH's Breach of Contract. The RSF liquidity mechanism was needed to bridge the financing gap between when MIGA was submitted a claim for non-payment, and the arbitration process was completed and the arbitral award confirmed MOH's breach of contract. It was estimated it could take 2 - 3 years to complete the arbitration process. EBRD's Credit Enhancement Facilities enabled the project to obtain a rating the investment grade rating needed for institutional investors to invest in the green bond.

The CSF was secured by EBRD through the security documents that provided it with full recourse to the construction company under a guarantee and letter of credit. The construction company was rated BBB- (investment grade). The RSF was secured by: (i) a cure payment or compensation on termination received from MOH; (ii) the MIGA insurance payments, where coverage included failure of government to honour obligations under contractual agreements and subsequent failure to honour an arbitral award; and (iii) the normal security provided to non-recourse projects. The structure is illustrated in Figure 4.5:

Figure A4.5: Structure of the Elazig PPP Hospital



CSF = Construction Support Facility; O&M = Operations and maintenance; PRI = Political Risk Insurance; RSF = Revenue Support Facility
 Source: EvD based on EBRD data

(v) Current Situation

In February 2017, Management provided the Board with an update on Turkey's Hospital PPP Programme. EBRD had financed seven hospital projects (about €510 million), and mobilised €875 million through B loans. The Elazig project had a project cost of €360 million and it was financed by sponsor equity and privately placed, fully amortising senior secured bonds of €288 million that were rated Baa2, two notches above Turkey's sovereign rating. The project bonds were issued in December 2016. The bonds were issued after the failed coup attempt and a down grading in Turkey's sovereign rating to Ba1, which is below investment grade. The bond was issued in three tranches and credit enhancements were applied to the first two tranches, and IFC invested in the unenhanced tranche.

Additionally, EBRD provided €89.0 million worth of two unfunded standby liquidity facilities during construction and operations to cover any default from the EPC contractor and MoH, respectively:

CSF: had a value of €36.5 million (15% of the EPC contract) unfunded credit facility provided to the Project Company on behalf of the EPC contractor. The CSF is designed to provide significant liquidity; with the proceeds of drawing to be applied by the Project Company to pay any cash shortfall for liquidated damages, meeting any EPC replacement costs and compensation in case of termination due to EPC contractor's fault during the Construction Period.

RSF: Subordinated unfunded liquidity facility in a form similar to a debt service reserve facility sized at a maximum amount of €52.5 million but never exceeding 50% of the outstanding enhanced bond notional. The proceeds of drawing to be applied by the Issuer to pay (i) scheduled interest and principal due on the bonds; (ii) Issuer's maintenance corporate costs (iii) in case of Project Agreement termination and acceleration of the bonds, to prepay bondholders subject to the maximum designed cap.

The projects third credit review was prepared in early 2019. Construction was completed in July 2018, operations were functioning in line with specification and MOH was making availability payments. The CSF had been released at 31 July 2018 and the RSF became effective at that time. While debt cover ratios were less than originally forecast due to depreciation of the Turkish Lira, which in turn had triggered additional VAT tax payments arising from negative equity, the financial position was still robust. A new payment mechanism has been developed to replace the original "escalating floor" under the availability payment formula (which could increase but never decrease) with a fixed euro-denominated cap and floor, or "euro corridor", which will remain unchanged over the concession term. The floor ensures that senior debt is securely repaid based on contractual ratio requirements and that sponsors can expect a reasonable return for good performance.

4.4.3 *Trans Adriatic Pipeline*

(i) Overview

In June 2018 the Board approved a financing facility in favour of Trans Adriatic Pipeline AG (TAP). The facility consisted of a senior loan of up to €1.2 billion, comprised of an A Loan of up to €400-500 million for the Bank's account, and a B Loan portion of up to €700-800 million for the account of participants. The loan is a project finance facility with limited credit support from TAP's sponsors.

The facility will be used to finance the construction of 878 km pipeline infrastructure across Greece, Albania and the Adriatic Sea. TAP will connect the Trans-Anatolian Pipeline (TANAP) with the Italian natural gas network of Snam Rete Gas (SRG). TAP is one of the pipelines that form the Southern Gas Corridor (SGC) and it will bring gas from the Shah Deniz field in Azerbaijan to Europe for the first time in 2020. The project had an environmental category rating of A, and while 20,900 plots of land would be

affected by the project, there had not been any resettlement requirements. Construction of the project commenced in mid-2015 and the construction phase was expected to be completed in Q4 2019 for receiving first gas in 2020.

The expected transition impact (TI) of the Project was based on: (i) Resilient and (ii) Integrated with other projects along the SGC. TAP would facilitate integration of regional gas markets, diversification of supply routes, strengthen energy security and introduce flexibility into the markets of South-Eastern Europe (SEE) within a regulatory framework in line with best practices. The Project supports the EU's Third Energy Package in Greece and Albania, and provides regulatory benefits in SEE, and the Balkans. The Project provides a foundation for Albanian gas market and connects the country to an important infrastructure corridor in Europe. The Project would contribute to the reduction of the carbon intensity and energy mix in the end-user markets, notably in the Greek and Bulgarian power sectors.

Additionality was derived from: (i) Terms: unprecedented long tenor and largest syndication in the SEE region; (ii) Attributes: EBRD prior SGC experience, E&S performance requirements, TC assistance; (iii) Conditionality: Supplemental Lenders Information Package (SLIP) disclosure, Environmental Social Action Plan (ESAP).

(ii) Project Structure

The loan is part of a larger €4.0 billion project finance debt package that includes facilities from the European Investment Bank (EIB) and three ECAs (SACE of Italy, BPI France and Euler Hermes of Germany) and a senior shareholder loan. EBRD's financial model assumed a Debt-to-Equity ratio of 75:25 and interest rate hedging for 75% of the debt, both pre and post-Financial Completion. Société Générale was the financial advisor to TAP and it managed the syndication of the anticipated €4 billion debt package consisting of €1.4 billion in ECA facilities and an estimated €1.2 billion in so-called "uncovered facilities" that include, inter alia, an EIB Guaranteed Facility, an EBRD B Loan and possibly a commercial facility.

The A and B Loans would have a tenor of up to 16.5 years, and were based on senior amortizing limited recourse loans. The date for first gas will determine the start of the repayment period and it will be between March 2020 and March 2021. Depending on the first gas nomination, the grace period of the Loan can vary between 1.5 and 2.75 years. Repayments will be in quarterly instalments in accordance with a sculpted repayment schedule. The proposed financing aimed to mobilise an EBRD B Loan amount of up to €800 million, potentially one of the Bank's most significant mobilisations for a single transaction and the largest syndication in the SEE region to date. The final allocation of commitments between the facilities could only be confirmed when the syndication process was completed by end of July 2018. Some 20 banks from OECD countries plus China and with ratings ranging from BBB-/Baa1 to A+ were approached.

The primary source of collateral was a 25 year Gas Transport Agreements (GTA) where payment will be made on a ship-or-pay basis. The Lenders would benefit from comprehensive debt service guarantees (DSG) from the sponsors during the construction and operating periods if there are trigger events such as non-payment under the GTA. A TC assistance of up to €290,000 has been provided by EBRD that was sourced from the Special Shareholders' Fund ("SSF") to support the development of Albgaz's legal and regulatory capacity.

(iii) Current Situation

The total project value is currently estimated to be €5.35 billion, and construction is expected to be completed in 2020. EBRD provided an A Loan of €500 million and a B Loan of €500 million. A total of 16 banks participated in the syndication of the B loan

4.5 Securitisation

4.5.1 Project Meadow

(i) Overview

In November 2017 the Board agreed to invest up to 5% of total net asset value (capped at \$100 million) in favour of Emerging Green One (the "Fund"), a fixed-income sub-fund of Amundi Planet. The Fund has a layered capital structure and it was planning to raise up to \$2 billion, including \$1.8 billion of senior shares and the balance in junior shares. The operation would enable the Fund to invest in publicly listed and rated bonds issued by financial institutions (FIs) in IFC's emerging market member countries, including all of the EBRD countries of operations (COOs) other than Greece and Russia.

The Fund was jointly established by Amundi Asset Management (Amundi) and IFC. Amundi, is Europe's largest asset manager with €1.3 trillion assets under management and it is 70% owned by Credit Agricole. Amundi was the first asset manager to launch an actively managed green bond fund in Emerging Market (EMs). It was the first fund focusing on investing in green bonds issued by private sector financial institutions.

The Project is expected to lead to increased resilience to climate change, reduction in greenhouse gas ("GHG") emissions and improved environmental standards, in line with international objectives, complementing the Bank's Green Economy Transition ("GET") approach. A secondary objective of the financing was the development of the Green Bond market in the EBRD region. Mobilisation was also an objective, and a benchmark was established of 3X EBRD investment amount to be invested in EBRD COOs.

The Project would benefit from an EBRD Green Bond TC Programme which was established to contribute to the development of Green Bonds aligned with the Green Bond Principles in the EBRD region. It was envisaged funding for the first component of the TC Programme would be provided by the EBRD Shareholder Special Fund (SFF).

Expected project benefits were as follows:

- The transition impact from: (i) development of environmentally sustainable economies in EBRD's COOs, supporting climate change mitigation, adaptation, and other environmental projects; and (ii) development of new capital markets instruments for most FIs in EBRD's COOs, diversifying funding and enabling financing of green projects by increasing Green Bond supply.
- Additionality was defined in terms of mobilisation of commercial investors at a target allocation rate of a multiple 3X EBRD's investment. The TC Programme would focus on capacity building and green bond origination; and EBRD's membership in the Fund's Scientific Committee would give it the ability to reinforce the integrity of the environmental and social ("E&S") profile of the Fund.
- Sound banking was demonstrated by expected gross yield of 5%, based on a 4% return from the senior shares, and a 9% yield on the junior shares.

(iii) Project Structure

IFC was the lead arranger, and EIB and Proparco were co-investors, alongside other commercial co-investors. EBRD agreed to invest up to \$95 million in Senior Class Shares and up to \$5 million in Junior Class Shares. The fund has a number of unusual features. As the fund was based on debt, full drawdown occurs at closing, compared to an equity fund where drawdown occurs on an investment by investment basis. The junior shares are disaggregated into two tranches of classes 1 and 2. Initially, the junior shares are unfunded, and then funded with retained dividends. The junior equity provides a first loss buffer and does not provide a guaranteed return. EBRD's Senior Class Shares will be gradually redeemed after the investment period (7 years). EBRD's Junior Class Shares will be automatically reinvested and repayment is expected to occur after the run-off period (12 years).

(iv) Current Situation

Total Project Value is currently \$1.392 billion and EBRD finance is €65 million that is structured as senior debt. [A \$30 million facility was cancelled]. None of the loan was syndicated

4.5.2 Regional: Framework for Development of a Secondary Market for Maturing Infrastructure PPPs:

(i) Overview

In April 2015 the Board approved a Framework in favour of maturing PPP projects across the Bank's countries of operation (the "Framework"). The Framework consisted of up to €650 million debt and/or equity financings for EBRD's own account to participate in maturing PPP projects that have been substantially completed, with a focus on the development of secondary markets for PPPs. Each investment would be in the form of debt or equity instruments to support the development of a secondary market for PPPs projects. Each sub-project would be presented individually for approval to the Board of Directors.

A Framework was adopted as support to single projects would not have provided the necessary momentum to sustain the PPP program. The availability of an active secondary PPP market is expected to attract more investors to the regional PPP markets by providing Sponsors with a potential exit route that would allow them to dispose of their equity interests once a project is mature. It will allow Sponsors to maintain an efficient debt structure throughout the life of a PPP project and take advantage of better financing terms as the project risk reduces or attractive market opportunities arise, such as capital market developments. Through its participation in project bond issues, the Bank would support new ways of financing infrastructure investments by providing long term funding and at the same time supporting development of local capital markets.

Bond financing plays a significant role in some PPP markets worldwide (e.g. Canada), project bonds are still in their infancy in Europe, and especially in emerging European markets. In the current market conditions, with limited long term financing provided by commercial banks, bond financing can play a very useful role in bridging the financing gap for infrastructure investments. Through newly arranged PPP debt refinancings done via issuance of project bonds the Bank will actively support the development of local capital markets in the countries and encourage long-term private sector involvement, especially by institutional investors.

As the public fiscal space tightens and the ability of commercial banks to provide long-term financing shrinks under the new regulatory environment the need for an increasing role of capital markets in providing long-term finance, is a key topic at the G20 and policymakers worldwide. Despite this high

profile, progress in developing this market has been slow. Many pension funds and insurance companies still consider infrastructure as an emerging asset and the infrastructure debt is viewed as an even newer asset class. There is a need to develop transparent and robust structures to attract institutional investors to finance infrastructure projects in emerging European markets. This is the area where the Bank can play vital role through this Framework

(ii) Project Structure

The Framework was targeted at Special Purpose Vehicles (SPVs) or Project Companies for infrastructure PPP projects in the Transport and Municipal and Environmental Infrastructure (MEI) sectors. The Framework team had identified 25 projects that could potentially be refinanced under the Framework, of which 21 were in the transport sector. It was expected that 5-10 projects would be financed by the Bank under this Framework during the period 2015-2019.

The framework consists of a facility of up to €650 million in the form of debt or equity (or quasi-debt or quasi-equity) instruments to support the development of a secondary market for maturing PPP projects across the Bank's region, through the acquisition of equity interests (as a minority investor), and/or the newly market-arranged refinancing of senior and junior loans in the Project Co, or through acquisition of bonds newly issued by the Project Co. The Bank will acquire up to 25% equity share in a Project Co. The Bank's participation in junior and/or senior newly issued debt facilities will not exceed 35% of total debt facilities (per project) or 20% of a bond issue. Bonds participation will have to be in investment grade bonds only. In case of newly issued debt instruments or capital market transactions/project bonds, it is assumed that EBRD's contribution will be capped at a maximum of €150 million.

(iii) Current Situation

The Framework was approved in June 2015, for senior debt of €500 million and €150 million equity. The first sub-projects to be financed by the Bank under the Framework were for Project Pannonia, consisting of two minority equity stake purchases in Hungary, in the M6 Duna and M6 Tolna PPP projects. Both projects were structured as PPPs based on availability payments. These projects were approved by EBRD's Board in June 2015 and the financing facilities consisted of a combination of equity and debt. Together, both facilities amounted to up to €33.0 million. Transition impact was derived from market expansion, and setting standards of corporate governance. Additionality was derived from the attraction of institutional investors such as Aberdeen equity fund. Both sub facilities are currently disbursing.

In 2017, the Board approved financing under the framework for Airport Holding Company (AHK) for the acquisition of Budapest Airport, which had been awarded a 75 year asset management agreement in 2005 to upgrade and operate the airport. EBRD's AHK facility consisted of up to €150 million alongside other institutional investors. It will be part of a financing package of up to €1.32 billion, split between a privately placed senior note institutional facility of up to €500 million and a banking facility of up to € 820 million, to refinance existing debt facilities maturing at the end of 2018. EBRD participated in the institutional facility, and it was expected that the Banking Tranche would be refinanced within 2 years with a publicly listed bond. This bond would be the first time privately placed senior notes had been used in Hungary to refinance infrastructure.

On 26 March 2019 the Board approved a loan in favour of DCT Gdansk S.A. (the "Company"), a joint stock company incorporated in Poland to operate and manage two deep sea container terminals and the acquisition company, Holbrook Sp. z o.o., a limited liability company incorporated in Poland ("Bidco") through which the acquisition of a 100 per cent of the Company. The EBRD loan consisted of a senior secured facility up to €46.25 million. The loan is co-financed by other commercial lenders, who jointly with EBRD will provide a syndicated loan of € 382.5 million. The total cost of the project is €1.3 billion.