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View Point: The Big Watershed in Development & Climate Finance: What is being done and what is being overlooked?

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1. INTRODUCTION

This Viewpoint Note provides an overview of some of the most pressing current problems in global development and climate finance, and what actions the global community and key finance institutions are taking and not taking to deal with these issues. The main purpose of the Note is informative, with the intention to help readers orient themselves in the rapidly changing landscape of development and climate finance against the backdrop of these pressing global issues. The targeted audience is development finance colleagues active in the private and public sectors, whose interest relate to blended finance in a broad sense. It is written, however, in a manner that hopefully makes it accessible to a wider audience.

In recent years, the world has become increasingly afflicted by a series of crises, including climate change, pandemics, and geopolitical polarisation that cause inflationary pressures as well as energy, food and water shortages. The mounting debt difficulties in the developing world are once again constraining credit, particularly for low-income countries, at a time when investments for job creation and improved climate resilience are more needed than ever. On the other hand, institutional investors in the private sector, such as insurance companies and pension funds, administer a large share of the world's recurrent savings surplus, amounting to trillions of dollars. It is essential for achieving the UN 2030 Agenda and the Paris Climate Agreements to engage a substantial part of this vast pool of private institutional capital for funding of SDG- and climate related investment projects and actions.

The Note reports on some of the innovative methods, currently under discussion, to scale up the financing capacity of the multilateral development banks (MDBs)[ii], and explores new proposals, emanating from the Global South, on ways to raise finance outside of the Bretton Woods system. The Note offers thoughts on some critical aspects that should be given more prominence in the on-going global discourse on mobilisation of capital, such as domestic resource mobilisation and local currency finance. It also sounds a warning on the impending overdemand for concessional finance resources. The point is also made that the achievement of mobilisation volumes should not be overemphasized at the expense of giving sufficient attention to the amount of capital being actually engaged in investments and the ensuing results on the ground, including regional allocation, currency and debt sustainability aspects.

We begin by considering current levels of flows of finance. We then turn to the role of the MDBs and Development Finance institutions (DFIs) and some of the ways currently being considered to increase the financing capacities. These players tap into institutional savings through their large international bond market capital raisings. We then look at some of ways in which additional capital can be either channelled to the MDBs/DFIs, including novel forms such as hybrid capital, or else other new initiatives, such as those advocated by the Bridgetown Initiative. We then turn to an area that we believe is not currently receiving sufficient attention: domestic resource mobilisation and local currency finance in which finance is priced in local currency terms rather than in hard currency, thus avoiding exchange rate risks and attendant exacerbated debt overhangs afflicting many developing nations. Finally, after summing-up our observations on key themes, we offer our own viewpoints on the main topics and the road ahead.

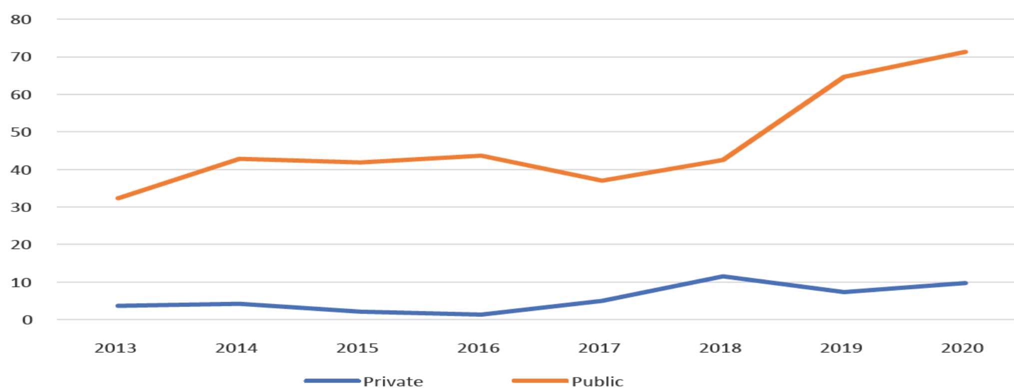
[ii] Under the concept "MDB" we include both public sector-focused MDBs engaged in sovereign lending (that nevertheless can have private sector arms engaged in non-sovereign lending and investments, such as the regional development banks) and multilateral institutions focused on private sector operations (such as IFC and IDB Invest). "DFIs" refers to bilateral development finance institutions that in the main are exposed to commercial risk (such as the EDFI group of European DFIs but also other institutions such as the TCX).

2. INSUFFICIENT FLOWS OF FINANCE: A SNAPSHOT

"*Is it realistic to expect the private sector to invest trillions of dollars in EMDEs?*"[1]

Our starting point is the current financing gap for climate and sustainable investment. Total financial flows from private sources (debt and equity) to low- and middle-income countries exceed those from the public sector (debt and grants). However, private flows are declining, and as far as climate finance is concerned, public sources far exceed private ones. As shown in Figure 1, while public flows of climate finance from advanced economies to emerging markets and developing economies ("EMDEs") grew to reach US$71bn in 2020, private flows at US$10bn fell well short of that volume.[2]

Figure 1: Climate Finance Flows, OECD to non-OECD (US$ billions)



Adapted from Lankes & Robins (2023): *Private capital for climate action,* page 5 (indicating Climate Policy Initiative as original source)

These numbers pale in comparison to the immense needs: an authoritative estimate indicates a need of additional spending in EMDEs (excl. China) rising to US$3tn per year over the 2019 - 2030 period (an increase from US$2.4tn to US$5.4tn) of which US$1.8tn represents additional investments in climate action, mainly in sustainable infrastructure, and US$1.2tn in additional spending to attain other SDGs[3]. EMDEs other than China will require external finance to the tune of US$1tn per year as from 2030[4], a major share of which would need to come from private sources[5]. The question then arises as to what role the international development finance community can play in making that happen.

Several high-profile proposals for dealing with these challenges have lately been proposed in international fora and in reports by international expert groups and think-tanks. Notable actors are the Group of 20, the Independent High-Level Expert Group on Climate Finance, the Bridgetown Initiative and internal working groups of the international finance institutions. The main common theme in the discourse is that the world needs to reform its development and climate finance order, as it is realised that finance must dramatically be scaled up over the next few years. This applies across the board, including finance provided through the MDBs, other DFIs as well as official and private sources. While the MDBs are called on to multiply their flows of finance by a factor of three in the next five years[6], particularly climate-related finance from private sources will have to increase many times over from current levels[7].

3. THE CONTINUING INDISPENSABLE ROLE OF THE MDBS

The MDBs do not just provide public finance, but also have an important role in the mobilisation of private financial resources. Here the main challenge is how to deal with the risks – actual and perceived – that are specific to EMDEs, in view of the risk-adjusted return that investors require, so that private capital can flow to underserved countries and projects. As emphasised in a recent report, it is not the lack of finance *per se* that is the main problem, but rather the scarcity of the right combination of finance, incentives, investable propositions and an appropriate institutional framework[8]. MDBs, DFIs and national development banks are key actors in this context, both as financiers in their own right, whether in the form of sovereign lending or provision of risk capital for the private sector, and as catalysts for third-party co-financing. Different risk-sharing methods can be used by these institutions in their efforts to mobilise private capital, which is further described in this Note. MDBs in particular – with their unique strengths as regards shareholding, capital base, preferred creditor status, and ability to originate, arrange, and package investable transactions across sectors and across diversified EMDEs[9] and absorb long-term risks – are indispensable to support this process.

3.1. Leveraging of MDBs existing capacity

A first means of mobilising greater resources is to consider how the existing capacity of the MDBs might be increased.

3.1.1. Capital adequacy framework of MDBs

Even though the MDBs are not bound by the capital adequacy standards that apply to commercial banks (such as the Basel III guidelines), owing to the fact that they fund their operations through borrowing on the international bond markets, they still need to back up their financial obligations with an "adequate" amount of own capital.[10] However, the MDBs have been criticised by the G20 and other parties in the development finance landscape for being too conservative and not maximising their potential in terms of investments for development. More effective utilisation of the capital already available with MDBs could significantly contribute to the scaling-up of financial flows to the developing world, as capital in staggering amounts is said to be unnecessarily held back due to inappropriate capital adequacy frameworks.

This state of affairs has been acknowledged by the MDBs themselves and picked up by the G20, as expressed in the MDB Action Plan to Optimize Balance Sheets (2015). The Action Plan itemises steps to be taken to ensure that MDBs use their resources to full capacity and step up efforts to catalyse private capital. MDBs are called upon to share risk in their investment operations with private investors, including through structured finance, mezzanine financing, credit guarantees, and hedging products.

There have since then been discussions among MDBs on how to scale up the use of capital and streamline balance sheets to meet the SDG and climate goals. A first move was the 2015 framework agreement among IADB, AfDB and the IBRD to carry out sovereign exposure exchanges among themselves to optimise their balance sheets (see section 3.1.2). The G20 has assumed a lead role in the MDB reform process, having commissioned an Expert Panel to carry out an independent review of MDBs' capital adequacy frameworks ("*Independent CAF Review*"), resulting in a report published in July 2022.[11] This was followed by the appointment of an Independent Experts Group that has recently published a Triple Agenda report in two volumes (2023), outlining how the MDBs can be strengthened.[12]

So far, the discussion on MDBs' capital adequacy has primarily been along the lines of releasing existing capital, which is currently held in reserve, and scale up MDBs investment operations across the board. New ways are presented to mobilise private finance through securitisations and other innovative types of risk transfer. However, the question arises as to the allocation of investments made possible by the freed-up capital, whether countries and projects perceived as risky, located in difficult environments with high developmental and climate priorities, are being served.

Recommendations of the Independent CAF Review

The *Independent CAF Review* makes five main recommendations that aim to free up significant volumes of reserved capital for new lending and investments by the MDBs.[13] The gist of the first two recommendations is to modify the approach to defining risk tolerance, and fully recognise the value of callable capital[14] by incorporating it into the MDB capital adequacy metrics. The third recommendation advocates an increased use of innovations – such as risk transfer instruments and raising of non-voting "hybrid" capital[15], notably "*Scale up the transfer of risks embedded in MDB loan portfolios to private sector counterparties by accelerating the development of funded and unfunded instruments*". The fourth recommendation calls for improved assessment by credit rating agencies of the financial strength of MDBs (to be facilitated by increased access to MDB data and analysis). The fifth recommendation concerns measures to strengthen the ability of MDB shareholder boards to effectively set the parameters of risk appetite and capital adequacy policies, and oversee their implementation. These recommendations are reflected in the Action Plan to Reform MDB Capital Adequacy, as formulated by the Panel.[16]

The implementation of these recommendations would create more employable capital by shifting risk exposure off MDB balance sheets to third parties, thereby mobilising financial markets as sources of capital and risk capacity. This could, in the opinion of the Panel, potentially create several hundred billion dollars in additional headroom for lending and investments, without posing a threat to the financial stability or the AAA credit rating of the MDBs[17].

The subsequent Triple Agenda report crystallizes the reform agenda into urging the MDBs to shift their operating culture from risk avoidance to informed risk taking[18].

3.1.2. Risk transfer techniques

Risk transfer involves MDBs making use of financial techniques to transfer risks to strengthen capital adequacy and increase lending headroom.

Risk transfer via exposure exchange

As mentioned above, MDBs have started to exchange sovereign exposures under a jointly developed framework.[19] An exposure exchange between MDBs provides capital relief by reducing the sovereign-guaranteed portfolio concentration of the parties. Statements by IDB and ADB[20] declare that such exchanges are a cost-effective way to improve capital adequacy ratios especially of the regional MDBs, whose portfolio diversification options are limited by the number of their borrowing member countries.

A first exposure exchange agreement (EEA) – between AfDB, IDB and IBRD was signed in December 2015 covering a combined synthetic[21] trade of exposures of US$6.5bn. This was followed by two bilateral agreements between ADB and IDB, signed in December 2020 and December 2022 respectively, covering a combined trade of exposures of US$2.5bn. In July 2023, ADB conducted an additional EEA transaction with AfDB of US$1bn. These exchanges of sovereign lending exposures help improve the participating MDBs' loan portfolio diversification, which is concentrated to a limited number of government borrowers, reducing risk-weighted assets (RWA) and releasing risk capital.

Risk transfer via securitisation

Securitisation involves the conversion of assets, particularly loans, into marketable securities, usually to raise cash through their sale to other investors. In theory, MDBs and DFIs can act as both originators and as investors in securitisations.

MDBs acting as originators

The developmental benefits of holding loan assets until maturity, which is the traditional MDB business model, are not evident (although clearly this has benefits to the stability of the lending institution). Moreover, MDBs are exhorted to act as originators to share risk and release capital. As such, there is a logic for shifting part of MDB portfolios from an "originate-to-hold" model to an "originate-to-share" model.[22]

Synthetic securitisations allow MDBs to optimise their balance sheet and free up capital[23] for new origination activities that reflect current investment priorities. However, such transactions are difficult to put in place, particularly in emerging and frontier markets where there is a lack of credit data and high political and economic risks and are likely to involve a lengthy and costly structuring process.[24]

In a synthetic securitisation by an MDB, the latter remains the lender of record and administers the loans also after a part of the risk has been transferred. As such, the MDB in question remains responsible for overseeing project implementation and follow-up of ESG commitments and eventual evaluation of development impact.

A member of the Expert Panel for the *Independent CAF Review* has flagged for possible drawbacks of large-scale transfers of risk embedded in MDB loans to external parties. This is further described in the endnote[25].

The African Development Bank (AfDB) is at the forefront of applying financial innovations and entering into risk sharing partnerships with third party institutions in the private sector. The first transaction under AfDB's 'Room-2-Run programme, which closed in September 2018, is an interesting case in point. The initiative was launched on the basis of three objectives: (i) to manage AfDB's balance sheet and use its capital more efficiently; (ii) to mobilise financial resources (in this case, risk capacity) from primarily the private sector for developmental impact, while (iii) safeguarding AfDB's AAA and preferred creditor status.

Three successive risk transfers are briefly described in the Appendix, section A1 – AfDB's pioneering risk transfer transactions.

MDBs acting as investors

Transactions where MDBs act as investors or guarantors do not entail risk transfer from an MDB but rather the other way around, i.e. from a commercial bank to an MDB or other financial institution, whereby the commercial bank obtains capital relief which releases capacity for additional lending. If an MDB is involved (in the first instance IFC, IDB Invest or the private sector arms of other MDBs), the commercial bank may, as part of the negotiation process, be nudged to direct new lending to EMDEs. A brief description of this type of risk sharing is given in the endnote.[26] As will be discussed later, where this happens it is important that it is accompanied by a recycling of capital into other desirable activities.

3.2. Co-financing with MDBs – loan syndication arrangements

Commercial and official counterparties increasingly recognise that there are promising opportunities to work with MDBs[27]. However, the mobilisation efforts by MDBs have so for represented a relatively small share of the MDBs' assets. In 2020, 12 MDBs covered by the *Independent CAF Review* together

mobilised private finance of only 14 cents for every dollar of own-account investments, mostly through their private sector arms[28].

An interesting development in this context is the emergence of debt funds for institutional capital that enter into co-financing partnerships with MDBs. In 2022, Cardano Development launched the ILX Fund, which is an SDG-focused private credit fund that invests in private-sector "B-loans" arranged by leading MDBs and DFIs (i.e. loan-syndications that enable third-party investors to participate in the MDB's loan portfolios)[29]. The objective is to channel capital from institutional investors to be deployed as co-financing of syndicated loans originated and structured by MDBs and DFIs.[30]

3.3. Role of concessional and blended finance

3.3.1. Official concessional finance

The Finance for Climate Action report (2022) holds that concessional finance from bilateral donors is the most critical component of the commitment[31] by high-income countries to channel US$100 billion per year to developing countries to finance climate-related investments and actions, but points out that official concessional finance volumes remain low relative to the overall needs. The report therefore calls for donors to double bilateral climate finance to US$60 billion by 2025 from its 2020 level, and for a tripling of the annual flows from the MDBs and DFIs over the next five years[32].

Guarantees and insurance can be effective instruments for mobilisation of private sector finances into productive and inherently viable[33] climate-related investments in EMDEs. As part of the recommendation to make greater use of innovations to strengthen capital adequacy and lending headroom (see section 3.1.1), the CAF Review encourages MDBs to make greater use of donor guarantees. When supported by official development institutions in 'blended finance' structures, guarantees can be combined with a grant component that allows gearing of scarce aid funds.

However, climate-related events are increasingly viewed as "uninsurable". The Finance for Climate Action report (2022) therefore makes the case for establishing a bespoke "financing mechanism" dedicated to dealing with the uninsurable impacts of climate change.[34]

3.3.2. Sub-portfolios for enhanced reach of investments

Portfolios of public-private investment funds as well as sub-portfolios of MDB / DFI investments and loans to SDG- or climate related investments in frontier markets and fragile countries can be constructed and securitised, where the asset pool is divided into shares to be purchased by investors. Specific tranches of such asset pools could benefit from (selectively subsidised) credit enhancements to reduce the volume of capital reserving incumbent on investors. The construction of such sub-portfolios should preferably be "blind", where the names of the counterparties and projects are not known prior to inclusion in the securitisation reference pool (i.e. the underlying pool of asset exposures).[35] Blind pools operate on the basis of pre-agreed sets of selection criteria that determine the types of loans, industry sectors, and geographies that are eligible for inclusion in the portfolio to be securitised.

The experience of bilateral development guarantors such as Sweden is promising, as Sida has pioneered risk participation in sub-portfolios of MDBs and specialised guarantee vehicles (see endnote[36]) . Other Nordic bilateral guarantors (Denmark, Norway) are positioned to follow suit.

3.4. Distribution of investments made possible by freed-up capital

Significant development value can be achieved through redeployment of released capital by the MDBs. However, the question arises as to the impact and distribution of investments made possible by the unlocking of capital, as regards geography, sectors and types of projects within the purview of the

different MDBs. From a broader poverty-reduction perspective it is important that a substantial share of the freed-up capital reach sustainable development projects in difficult environments with high socio-economic impact. Credit enhancements and blended finance solutions – via external facilities and through MDBs' own blended finance set-ups – as well as subsidies from bilateral institutions can increasingly be drawn on to support such outcomes. Donors can also provide TA support for the development of securitisation structures with MDBs.[37]

4. ALTERNATIVE WAYS TO MOBILISE CAPITAL

The above discussion focuses on how the traditional international development finance architecture can be redesigned to make it work more efficiently and effectively. In parallel to this, there have also been proposals to set up other means of increasing capital flows. Whereas MDBs/DFIs use their subscribed (equity) capital – provided by member countries - to leverage debt in financial markets for on-lending, there has been consideration of finding alternative ways of mobilising capital, in particular through more efficient use of Special Drawing Rights.

4.1. Creation and reallocation of Special Drawing Rights (SDRs)

IMF's Special Drawing Rights (SDRs) are central bank reserve assets that can be used among IMF member countries as a medium of exchange. In addition to IMF members, SDRs can only be held and transacted by certain official entities - referred to as 'prescribed holders' - such as MDBs. In theory these could be used to mobilise additional capital.

4.1.1. Issuance and allocation of SDRs

As the SDR is not a currency in its own right, it cannot be used directly for purchases or imports, but it can be used directly to settle SDR-denominated debt (owed to another IMF member or to IMF's General Resources Account). Most importantly, an IMF member can trade its SDRs with another IMF member in exchange for hard currency (out of the latter's central bank reserves).[38] Moreover, IMF members have the possibility to voluntarily 'recycle' (i.e. on-lend or donate[39]) SDRs allocated to them to other members. In October 2021, the G20 pledged to recycle US$100 billion worth of SDRs from its members to vulnerable countries.

IMF creates liquidity in the global financial system through occasional[40] "general allocations" of SDRs to IMF members in proportion to their quotas in the IMF, which are related to the size of the GDP of the respective member countries. As a consequence of the present quota arrangements, the countries that are most in need receive a relatively small portion of general SDR allocations[41]. The situation can be partly redressed through voluntary on-lending or rechanneling of some of the SDR holdings by countries with strong external positions to low income and/or climate vulnerable countries.

4.1.2. Rechannelling SDRs via IMF Trusts

The IMF operates two facilities that can be used for recycling of SDRs: (i) the Poverty Reduction and Growth Trust (PRGT), and (ii) the Resilience and Sustainability Trust (RST):

- The **PRGT** is IMF's main vehicle for providing subsidised loans to low-income countries (LICs). The PRGT has thus far been funded by donors providing grants and concessional finance. IMF/PRGT has also received pledges of SDRs to be rechannelled via it, but the PRGT has up to now not distributed any SDRs to receiving countries.

- The **RST** is IMF's new[42] facility for provision of affordable long-term finance (20-year maturity with 10½ year grace period). It extends loans for purposes such as climate action and pandemic response (which critics say are outside IMF's mandate). In addition to LICs, also climate vulnerable middle-income countries as well as small states – including fragile island states – are eligible for support via the RST, comprising about three-quarters of the IMF's membership. The funding of RST is innovative, as it based on rechannelled SDRs.

4.1.3. Rechannelling SDRs via the MDBs

SDRs could be used to leverage private finance through the IMF trusts or the MDBs[43]. The lending capacity of MDBs can be significantly expanded if SDRs were rechannelled via them. AfDB has

designed a hybrid capital structure that will allow countries with excess reserves to lend SDRs to the MDBs that accounting-wise would be treated as equity[44]. The MDBs can leverage that hybrid capital/equity 3-4 times by borrowing from the capital markets at affordable pricing thanks to their triple-A rating. The hybrid capital model aims to preserve the SDR reserve asset characteristic. As such, the proposed mechanism would allow contributing countries to reclaim their recycled SDRs should they urgently need to tap their reserves for balance of payments purposes. AfDB will pay interest at a rate slightly above the SDR interest rate to the countries that lend SDRs[45]. The CFO of AfDB underlines that MDBs such as AfDB "*have the capacity to transform SDRs from static foreign reserves in developed economies into lending instruments to finance high-priority transformational development projects and substantially improve countries debt profile*".[46]

AfDB staff presented[47] this structure in February 2023 as a ground-breaking scheme to recycle SDRs outside the IMF, with higher gearing as compared to rechannelling via the IMF Trusts[48]. The scheme has transformational potential, particularly if the IMF would commence making more frequent allocations of SDRs, and a significant share of these allocations were recycled.

It should be noted, though, that any decision on a new allocation of SDRs requires support from an 85% majority at IMF's Board, which is politically difficult to achieve, and currently there is a legal blockage that hinders EU countries from recycling their SDRs outside the IMF, which has not yet been resolved.[49]

Further information is provided in the Appendix, section A 2 – *Note on IMF and SDRs*.

4.2. The Bridgetown Initiative

"The world is running out of time to fix its international financial system that is broken, outdated, infested with short-termism and downright unfair."[50]

The Bridgetown Initiative – or more formally *The Bridgetown Agenda for the Reform of the Global Financial Architecture*[51] – is arguably the first comprehensive set of proposals for reform of the global financial system that originates from outside the developed world. The Initiative (see Box 1), which was presented by the Prime Minister of Barbados at the COP 27 conference in Sharm El-Sheikh (November 2022), calls for the creation of new instruments and reform of existing institutions to finance projects that support the achievement of the SDGs and climate resilience, especially in vulnerable countries. In particular, the Initiative focuses on transforming how lending is made to developing nations in a climate crisis. The Initiative has generated considerable interest among the international development finance community. Some elements of the Initiative are in line with the parallel process driven by the G20 to reform the capital adequacy frameworks of the MDBs.[52]

4.2.1. Global Climate Mitigation Trust

To substantially help closing the finance gap for climate mitigation investments, the Bridgetown Initiative proposes the establishment of a Global Climate Mitigation Trust that would be seeded with reallocated Special Drawing Rights (see section 4.1). The Trust would use US$500bn of SDRs as security to borrow "at least US$500bn", denominated in the basket currencies of the SDR, and "kept rolling over". The interest rate payable by the Trust would correspond to the overnight borrowing rate as applied for exchange of SDRs for central bank reserve funds within the IMF system. Bridgetown envisions that the Trust would be able to offer finance at virtually the same terms as the cost of funds (indicated at the time at 2.4% p.a. in hard currency).

The Trust would extend loans to qualifying projects; a key criterion for loan approval would be how much and fast the project reduces global warming per each dollar lent by the Trust. There would be no country-specific allocations, and the Trust would lend directly to projects and not to governments.[53]. As such, the loans would be assets of the Trust, "taking climate mitigation off government balance sheets". The projects would likely comprise partnerships of Governments, communities, technology firms and private capital.[54]

The finance to be offered by the Climate Mitigation Trust "could draw in US$2.5 to US$5 tn of private savings into climate mitigation and social and economic transformation".[55] In light of the premise that the major share of the financing for climate-related investments will have to be sourced from the private sector[56], there is an implicit assumption that the Trust would frequently enter into co-financing arrangements with the private sector. However, this is not explicitly mentioned in the published Bridgetown documents, only that "private savings" (presumably asset managers of private capital) would be incentivised by the operations of the Trust "to find the right technologies and best social impact methodologies to transition the dirtiest processes wherever they may be"[57].

Box 1: The Bridgetown Initiative

Key elements of the Initiative:

1) Establish a Global Climate Mitigation Trust, which would be seeded with reallocated SDRs, to finance climate mitigation projects.
2) MDBs to implement the recommendations of the *independent CAF Review* and WB+MDBs to use increased headroom, increased risk appetite, new guarantees and the holding of SDRs to expand lending to governments by US$1 trillion.
3) Lower the cost of capital for climate adaptation through the MDBs and via a widening of the eligibility criteria for countries to borrow at highly concessional terms.
4) Inclusion of climate resilience and pandemic debt clauses in all international lending instruments, allowing for suspension of debt service and extension of loan maturities in case of emergencies/catastrophes.
5) New issuance by IMF of 500 bn SDRs, and reallocation of SDRs to support points1) and 2) above.
6) Grant financing of loss & damage (tightly defined).

4.2.2. Cost of capital – the need for expanded concessional finance

Bridgetown points out that developing countries borrow at an average of 14%, and with the private sector adding a risk premium, compounded with the fact that these countries' credit ratings are generally not investment grade, few investment projects are commercially viable in the developing world.[58] This is even more accentuated in the case of climate adaptation projects that do not produce cash flows. As such, most climate resilience costs[59] cannot be shifted to the private sector or third parties. The burden therefore rests on governments' balance sheets, where space is limited and the cost of capital is high; as a result, too little climate adaptation is being done. The solution suggested by Bridgetown is an expansion of highly concessional[60] finance by the MDBs to a circle of sovereign borrowers that is wider than the current group of IDA-eligible countries[61]. This "limited widening" of the eligibility for concessional finance would be for middle income countries that are climate-vulnerable and that would use the finance to invest in climate resilience and adaptation.

Bridgetown holds that MDBs can leverage their resources by an additional US$1 tn for on-lending to developing countries – "without anyone having to write a cheque" – if MDBs follow the recommendations of the *Independent CAF Review*, in particular with respect to increased risk appetite and inclusion of callable capital in MDBs' capital adequacy metrics[62]. MDBs should furthermore be allowed to hold re-channelled SDRs to create the liquidity needed – e.g. by using the SDRs to back up MDB bonds – to expand their operations.[63] (The latter point is an endorsement of AfDB's proposal on rechannelling SDRs via the MDBs – see section 4.1.3).

4.2.3. Natural disaster and pandemic debt clauses

Bridgetown furthermore advocates the inclusion of "Barbados-style"[64] climate resilience and pandemic debt clauses in all international lending instruments, including those held by multilateral and official agencies as well as private creditors, allowing for suspension of debt service in case of emergencies or catastrophes. Such clauses would suspend debt service – e.g. for two years, with a congruent extension of loan maturity – following the declaration by an independent agency that a natural disaster has occurred.[65] The suspended debt service would be paid back at the original interest rate, adding the accumulated interest to the principal, thus making the instrument "net present value neutral". Such clauses help averting a liquidity squeeze and a debt crisis when a country is tackling a natural disaster or pandemic, hence giving it breathing space to invest in rebuilding.

The UK[66] and France already offer Climate Resilient Debt Clause (CRDCs) in their direct bilateral lending to low-income countries and Small Island Developing States (SIDS) that are particularly vulnerable in the wake of severe climate shocks.

5. THE NEED FOR LOCAL CURRENCY FINANCING SOLUTIONS

"Debt sustainability requires debt predictability in local currency. MDBs should lead the way and innovate, to protect borrowers from currency risk. Development finance can do better"[67].

Whilst mobilising more public and private capital is essential, it is optimised where it takes the form of LCY, rather than FX, financing. At its heart this involves the pricing of investments in local currency, not hard currencies. The use of LCY pricing and finance is relevant for addressing three of the most pressing issues in global development finance: (i) the development of local capital and credit markets, thereby building greater local financing capacity and intermediating domestic savings to productive investments; (ii) greater debt sustainability by reducing a debt overhang caused by nominal exchange rate depreciation; and (iii) an associated reduction in the pressure on foreign reserves, freeing them up for other essential imports.

However, 80%-90% of DFI/MDBs loans are still provided in hard currency. This places the currency risks directly on the parties that can least afford it, in particular low income sovereign borrowers. Without urgent action, the unhedged currency exposure of developing economies may triple by 2030 from its already excessive current level of US$2 tn.[68]

Currency mismatches between the revenue and expenditure cash flows can have severe consequences for financial and economic viability at both macro and micro levels, particularly in countries without access to FX forward markets or where only prohibitively priced currency hedging products are available. Open currency exposure in lower income state budgets is typically many times larger than the budget for social expenditures, causing unpredictable debt levels in LCY terms (i.e. the currency in which the government receives its taxes).[69]

These issues are not addressed in detail in the on-going reform efforts for the MDBs but were picked up in the Roadmap that was presented as a follow-up to the Summit on a New Global Financing Pact in Paris (June 2023).[70] [71]

At a high-level there are several ways in which this problem can be addressed, but they all involve challenges and changes from the largely Business-As-Usual (BAU) current approaches. Whilst there has been a degree of experimentation in addressing currency mismatches it is important that the successful approaches are mainstreamed in day-to-day business.

The one thing that all approaches have in common is that financing is priced in LCY, rather than FX, taking away the currency risk from the investment. This can be achieved both through using LCY resources directly or through synthetic approaches such as currency swaps. Approaches that need to be considered are:

- Supporting finance from local private and public institutions.
- LCY capital raising by MDBs and DFIs which is on-lent to projects.
- Development of greater currency hedging capacity through expanding and building on the experience of TCX.
- A degree of absorption of currency risk by MDBs / DFIs themselves in risk sharing approaches.

5.1. Supporting domestic resource mobilisation from local private and public institutions

There is a range of approaches available for this, although much depends on what domestic credit and capital markets are capable of doing. Where they are able to provide the tenors that climate and other projects require, credit guarantees can be a way of mobilising LCY financing from local markets. However, in other instances funded approaches; for instance, utilising national development banks, will be more appropriate.

5.1.1. Credit guarantees

IFC[72], GuarantCo[73] and a few bilateral agencies offer credit guarantees that can be used for both cross-border and in-country LCY finance. The use of LCY guarantees allows commercial banks and MDBs/DFIs to provide LCY finance in markets where they cannot easily hedge currency risk to make direct loans themselves.[74] The opportunity to provide guarantees, however, requires the availability of long-term loans, which are likely to have only limited supply in most LICs and lower middle-income countries (LMICs).

GuarantCo and its parent organisation the Private Infrastructure Group (PIDG) support the establishment of credit enhancement facilities in selected countries (e.g. InfraCredit in Nigeria, and InfraZamin in Pakistan, with others to follow). These entities support long-term, LCY debt for infrastructure investment by issuing in-country credit guarantees.[75]

In Asia, the Credit Guarantee and Investment Facility (CGIF), which was established in 2010 as a trust fund hosted by the ADB, provides guarantees for LCY- denominated bonds issued by investment grade companies in ASEAN+3 countries[76].

However, this only really works where it is possible for local institutions to provide the required tenors, which will likely be easier through capital markets (assuming a yield curve exists) than through deposit dependent banks. Here national development banks, which finance themselves with patient risk capital and through local capital markets, rather than deposits, may be the best option.

5.1.2. Domestic financing solutions

The importance of domestic resource mobilisation (DRM) and local currency (LCY) financing can hardly be overstated as a basis for debt sustainability. The key sources of private savings are contracted pension and insurance funds, i.e. pools of long-term capital looking for long term investment opportunities. Countries such as Malaysia, which for many years has been successful in encouraging this, has reaped many benefits in terms of levels of domestic investment. Many countries could learn from this experience.

Broadening and deepening a low-income country's tax base can also reduce its dependency on aid and external borrowing. The Grantham Research Institute reckons that about half the incremental financing needed by EMDEs (excluding China) between 2019 and 2025 - about $650bn out of totally $1,300 bn - to support "an investment push to deliver on development and climate" could in principle come from DRM, subject to improved effectiveness of tax collection, closing of loopholes and other public resource mobilisation efforts.[77]

National development banks have unique knowledge of local markets, long-standing relationships with domestic private and public sector actors[78], and ability to provide finance in local currency. As such, they possess comparative advantages over multi- and bilateral banks, while competing with affiliates of foreign banks operating in the countries concerned. By issuing bonds in local capital markets and on-lending the proceeds, they can efficiently raise and intermediate local finance. Some of these entities (such as the development banks of Uganda and Rwanda) have access to international

concessionary funding with associated capacity building that help them develop climate-related investment portfolios[79].

Unlike commercial banks these institutions are not typically dependent on short term deposits and are therefore especially useful where commercial banks cannot provide longer term tenors in LCY. Many are established institutions and can be a focus for scarce human resources, particularly in the poorest countries. As their unit of account is LCY, and not in foreign exchange (FX), they do not face the same exchange rate risks that MDBs and DFIs do.

5.2. MDB/DFI LCY capital-raising

IFC sources local currency through LCY bond issuance and swaps with market counterparts, such as international banks, but also with local swap counterparties and peer multilateral institutions. An example of the latter is the ISDA Master Agreements entered into by five MDBs (AfDB, ADB, AIIB, EBRD and IFC[80]) for the purpose of conducting cross-currency swap transactions with each other, to facilitate LCY lending and bond issuance. By issuing local currency bonds, the MDB's can avoid currency hedging and create an asset class with AAA credit rating combined with frontier currency risk. The potential yield pick-up and asset diversification characteristics make it attractive for investors to acquire such bonds.[81]

5.3. Currency hedging

There has been some progress in creating currency hedging solutions. A number of DFIs are offering synthetic local currency loans, where there is no actual exchange of currencies (also referred to as 'non-deliverable swaps'). This means that the cash flows, despite being denominated in LCY, are settled in FX, while the debt service is fixed – i.e. priced - in LCY. As such, in a synthetic LCY loan, the (hard currency) Lender takes on the currency risk that emanates from the difference between the spot FX/LCY exchange rate and the contracted fixed rate offered to the Borrower. [82] Providers of synthetic LCY finance protect themselves against the currency risk by procuring derivatives on the forward FX market. If no FX forward exists in the market at an acceptable rate for the currency in question, then the alternative is to enter into a cross-currency swap with TCX. (The cost for the hedge, which can be considerable, is routinely passed on to the Borrower.)

EBRD, in line with its local currency strategy for the period of 2019 – 2024, has established a $500m SME Local Currency Programme that aims to develop local capital markets and encourage LCY lending in the countries it invests in. Under this programme, EBRD provides LCY funding or hedging, by entering into currency swaps with third party providers, such as the TCX. EBRD also implements other LCY programmes[83] supported by guarantees under the European Fund for Sustainable Development Plus (EFSD+) facility.

5.3.1. TCX and other hedging entities for LMIC currencies

The TCX Fund

The Currency Exchange Fund (TCX) is the most important development finance institution to date with a mandate to support cross-border LCY finance for investments in EMDEs. TCX provides long-term currency hedges for investors and projects in over 60 currencies of developing countries and frontier markets that either do not have swap and forward FX markets or where such derivatives are only available at unaffordable rates. As such, TCX acts as a market counterparty to off-load currency risk from hard-currency investors/lenders that would otherwise not be able to execute cross-border transactions in LCY.

The FX hedges come in the form of cross-currency swaps and forward contracts that enable TCX' clients ("swap counterparties") to provide their client borrowers with financing in local currency, while shifting the currency risk to TCX[84].

TCX enables its swap counterparties, such as DFIs and microfinance investment organisations, to provide off-shore credits in local currency to projects, financial institutions and corporate borrowers in EMDEs. In this way, projects can access long tenor debt, priced in LCY. This can be additionally attractive where FX is priced more cheaply than LCY; however, the extent to which this is realised depends on the cost of the hedge.

TCX itself can take neither credit risk nor hedge the currency risk that it assumes, as it must absorb and manage its open currency positions. It is notable, though, that in recent years, TCX has on-sold up to 50% of its onboarded currency risk to institutional investors. As such, TCX observes a growing interest in LICs/LMICs currency risk as an alternative asset class. However, large investors require large tickets and a steady supply before committing resources to a new asset class.[85]

TCX has jointly with EU Commission established the "EU Market Creation Facility – Pricing Component", which is a €160 million programme supported by EFSD+. The programme is designed to facilitate LCY debt finance in challenging markets in Sub-Saharan Africa (15 countries/ currencies) and the European Neighbourhood (three currencies/countries) by allowing TCX to offer a discount to its pricing for eligible transactions.[86]

TCX is getting more and more attention[87] in its function as a cross currency risk pool. It strongly advocates for the MDBs to gradually shift their lending from hard currency denomination towards (indexed) LCY loans[88]. The public-sector focussed MDBs could commit to a measured increase in direct currency exposure via LCY-denominated loans. This would have to be balanced against the need to safeguard their AAA-rating, which is seen as vital for raising funds on the capital markets on favourable terms that are passed on to the borrowing governments. However, the passed-on funds are almost exclusively denominated in FX, so the beneficial funding cost is easily eaten up and frequently turned into a major negative for the borrowers through unfavourable currency exchange rate movements. A solution could be to drastically increase the offer of hard currency loans indexed to local currency, especially as long-term finance, coupled with currency risk off-loading via hedging. In this context, TCX proposes to expand its hedging capacity to US$30bn (or more), based on a capital base of $5bn (up from current level of US$1.3bn), contingent on sufficient support from its owners and other stakeholders (including the MDBs).[89]

The G20-appointed Independent Experts, in their 'Triple Agenda' report, underline the importance of FX risk management and encourage the MDBs to expand off-shore hedging mechanisms and work with TCX so that the latter reaches "a scale commensurate with the challenge, allowing it to aggregate hedges of sufficient size to systematically sell down FX risk to capital markets. This may, for some geographies, require loss absorbing guarantees to set lower bounds on hedging losses."[90]

Further information on TCX is provided in the Appendix, section A 3 – Note on currency hedging via TCX.

Multilateral FX guarantee entity

A 'policymaker note'[91] published by NIFTYS in 2021 proposed the establishment of a multilateral International Currency Fund (ICF) that, similar to TCX, would create markets in currencies for long durations for which no private market exists. The ICF would be a treaty-based international organisation capitalised with a mix of paid-in and callable capital and build on the expertise of TCX.

In a recently published paper, the Special Envoy to the Prime Minister of Barbados has, in the same vein as the preceding ICF proposal, advocated that a new multilateral entity be set up – perhaps as a joint agency of the MDBs and the IMF – to offer FX guarantees to facilitate the financing of green

transition projects in EMDEs. The proposal departs from the observation that even though there is a forward FX market available to some large industrialising emerging economies (such as Brazil, India, Indonesia, Mexico, South Africa, and others), in contrast to the majority of developing countries that do not have such access, the hedging costs include a substantial excess risk premium or "overpayment" in relation to the actual currency risks. The author of the proposal holds that a joint multilateral FX guarantee agency would be in a position to offer hedging solutions at half the current market cost, with no need for subsidies.[92]

IDA PSW - local currency facility

The Local Currency Facility of the World Bank/IDA's Private Sector Window (PSW) bears some resemblance to the TCX/EU Market Creation Facility in that both facilities offer subsidies to lower the cost of local currency hedging. The IDA PSW is deployed through four sub-facilities[93]. When making an FX-based investment, IFC can access the PSW Local Currency Facility to obtain a currency swap into LCY for the total amount of the IFC investment[94] at a subsidised swap rate, with IFC earning its normal rate of return [95]. IFC has made use of this facility on several occasions, making its LCY loans viable for client borrowers or investees.

5.4. LOCAL CURRENCY LOAN PRICING BY MDBS

The most radical of all solutions would be for the MDBs themselves to absorb a degree of currency depreciation risk by pricing loans in LCY and absorbing any losses out of own capital. Any losses arising could be funded out of separate funds provided by willing shareholders and other donors.

At first consideration this looks very unattractive. However, one way to address this would be to only absorb the *real* as opposed to *nominal* exchange rate depreciation costs. In many instances, a nominal exchange rate depreciation is merely off-setting a price or inflation differential – where this is exact there is no movement in the real exchange rate. It can be argued that this is often just the market reacting to poor macroeconomic management (and to subsidise it could create moral hazard). Where, however, the exchange rate depreciation is greater than the inflation differential a real exchange rate depreciation occurs. This is likely to occur in, say, poorer countries with deteriorating terms of trade. In fact, several countries actually have appreciating real exchange rates at the same time as nominal exchange rate depreciation (that is, the nominal rate has not depreciated to fully offset the differential in prices).

Such an approach would clearly have to work within limits, but it might be considered in the case of poorer countries at the greatest risk of real exchange rate depreciation.

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6. SUMMARY OBSERVATIONS ON KEY THEMES

Looking ahead, there are a number of key themes that can be observed in the on-going debate. Some of these would appear to be less controversial and have relatively wide-spread support amongst the development finance community. Others, however, are much more controversial.

6.1. Continued MDB reform process

The push for reform of the MDBs and an accelerated use of different risk-sharing methods is gaining momentum, driven by the G20[96] and the COP process, and is likely to boost MDB investment capacities and mobilisation of private finance. The MDBs seem to (cautiously) pay heed to the calls for shifting their operating culture from risk avoidance to informed risk taking.

It was recently reported in media[97] that the World Bank, as a response to the calls for reform, is working with shareholders and rating agencies to make it feasible to expand WB's lending by a significant amount without affecting its AAA status. This would be possible thanks to callable capital that would be specifically pledged by a group of "willing shareholders" to repay sovereign loans for countries in default.

6.2. Risk transfers to support the presence of commercial banks in EMDEs

Risk transfers via securitisation or guarantees can and should be used more frequently by MDBs as a tool to alleviate capital reserving constraints of commercial banks. MDBs can offer capital relief for Basel III-constrained banks that are securitising some of their loan books. By supporting or investing in the securitised portfolios, MDBs would be in a position to induce the banks to finance SDG-aligned investments in EMDEs, including infrastructure and climate-related projects.

Opportunities for institutional investors would be created in the process, via de-risking (on near commercial terms) of securitised tranches so that they match investors' risk/return requirements. As an alternative or complement to investing, MDBs and development partners can offer credit guarantees on specific risk layers (or specific tranches of issued securities in the case of true sale securitisations), ideally complemented with technical assistance to issuers.

6.3. MDBs and DFIs to stem the off-loading of currency risk

The MDBs and DFIs face pressure from other members of the global development finance community to change their lending practices and make a concerted effort to stem the build-up of huge FX debt overhangs afflicting LIC/LMICs. As mentioned in section 5.3.1 , a possible solution could be to drastically increase the offer of FX loans indexed to local currency, especially as long-term finance, coupled with currency risk off-loading via hedge providers such as TCX.

TCX has embarked on an ambitious expansion path and is likely to be able to support a significantly expanded portfolio of swap transactions, going forward, which would open up the possibility of offering sizeable EMDE currency risk bundles to institutional investors. Nevertheless, in view of the huge FX debt overhangs accumulated over the years, there is a pressing need for the MDBs and DFIs to step in alongside TCX to stem further off-loading of exchange rate risk on lower income countries.

6.4. Official guarantors to step forward

Bilateral institutions and blended finance initiatives can add significant value in supporting the catalysing efforts of MDBs. From a developmental perspective it is essential to enhance the reach of sustainable investments that are made possible by the freed-up capital. As the positive experience with official development guarantees shows, this would be a suitable area for bilateral donors to engage in.

Building on precedents, bilateral donors and official guarantors should thus be called on to step up their cooperation with MDBs to create substantial headroom for new investments in challenging environments by off-taking risk on sub-portfolios of loans that meet pre-agreed developmental criteria.

Against the backdrop of increasing budgetary constraints, donors are likely to progressively favour unfunded guarantee-based approaches, not only for the benefit of MDBs and DFIs but also directly targeting private capital (e.g. in layered fund structures). Such progression would be greatly helped by a modification of the ODA reporting procedures within the OECD/DAC, as current metrics do not allow direct ODA assessment of guarantees and risk capacity contributions.

As outlined in the previous CEPA Viewpoint[iii], another area where MDBs and DFIs can have great impact is to provide finance for development and construction of greenfield projects in the infrastructure, energy, and industrial sectors. This is where there are acute financing gaps, while there is little shortage of finance for operational projects. Once projects are operational, development finance should exit[98], permitting institutional and commercial capital to take over, and thus allowing for a faster recycling of capital. The participation of local institutions, such as national development banks[99], would be facilitated if there were a sufficiently large portion of LCY in the refinancing.

6.5. Proliferation of de-risked public-private funds

De-risked investment funds are becoming more frequent, particularly in the public-private sector, where DFIs/MDBs take first loss layers positions to cover part of the risks that investors are not willing or able to take[100].

In the public sector, the International Finance Facility for Education (IFFEd) and the Innovative Finance Facility for Climate in Asia and the Pacific (IF-CAP) exemplify novel forms of risk transfer, where donors can contribute to either a grant or guarantee window to support sovereign lending to respectively the education sector and climate investments.[101]

Both facilities work through MDBs as implementing partners. Repayment guarantees by respectively IFFEd and IF-CAP will free up MDB capital currently set aside as risk buffers for exposures to sovereign member states. IFFEd's innovative combined guarantee and grant mechanism served as a model for ADB's design of IF-CAP[102]. While IFFEd will issue portfolio guarantees in support of education-related investments by a number of participating MDBs, IF-CAP operates via a Guarantee Trust Fund, managed by the ADB, that will issue guarantees to ADB for synthetic risk transfers to create headroom for new climate finance in both the sovereign and non-sovereign sectors.[103] The facilities will also use grants to soften the financing terms that the participating MDBs can offer.

Other facilities to engage private capital based on similar financing partnerships, making use of de-risking instruments such as grants and guarantees, are on the drawing board[104].

[iii] How the typical DFI business model should be revised to better promote the engagement of institutional capital in the financing of operational projects is the subject of a previous CEPA Viewpoint: *The New Build Back Better (B3w) Initiative* (2021), at https://www.cepa.co.uk/news-insights/view/the-new-build-back-better-b3w-initiative.

6.6. Proposals presented by the Global South

There is a trend among some influential developing countries and actors toward looking for an alternative to the Bretton Woods system, which they feel is no longer fit for purpose to deal with the current climate and economic realities of the developing world. The set of proposals presented under the Bridgetown Initiative (see section 4.2) is getting widespread traction in the Global South.

6.7. Growing demand–supply gap of concessional finance

The proposals presented under the Bridgetown Initiative presuppose a significant increase of concessional finance for development and climate action. The MDB reform process is expected to release already existing capital resources and shareholders' back-up commitments, and engage increasing volumes of private institutional capital, but is also likely to require additional concessional finance in significant amounts for de-risking purposes.

There is an impending squeeze in multilateral and concessional finance to meet dramatically increasing demand. As such, there are concerns about sufficient levels of concessional resources available for these purposes, in view of the plethora of competing demands for concessional and ODA resources to deal with the global challenges.

Notable factors that contribute to the growing demand–supply mismatch are (among others):

- Calls for increased concessional finance for the broader range of WB operational countries – not just IDA countries[105].
- Concessional finance being raised in significant amounts for the IDA Crisis Facility, expansion of the IDA Private Sector Window, and replenishment of IDA (IDA 21).
- New climate finance initiatives, and facilities such as IFFEd and IF-CAP will consume aid funds.
- Decision at COP-27 to set up a Loss and Damage Fund to compensate particularly vulnerable nations that are suffering from climate change, and, more recently, decision at COP-28 to operationalise the Fund.
- Call by IMF on countries in strong positions to replenish subsidy resources in the Poverty Reduction and Growth Trust (PRGT)[106].
- Official donors and guarantors are increasingly expected to fund loss-absorbing tranches, subsidise guarantee fees, and buy down hedging costs.

While a boost in rechannelling of SDRs is likely to happen, there are other initiatives that are currently being prepared for further discussion, such as the proposal for a general capital increase of MDBs (those that have binding headroom constraints), removal of statutory limits on lending by MDBs, and the plan to set up a Global Challenges Funding Mechanism, as a platform to facilitate for investors to contribute funds that can be leveraged by MDBs for scale and impact, as proposed by the Triple Agenda report.[107]

The constantly increasing hard currency debt burden and the risk this causes to low and middle income countries is increasingly recognised. A significant expansion of institutions with a development mandate that offer currency hedging products is strongly recommended by different expert groups. A high-level expert group mandated by the EU advocates that a sizeable EU-led sustainable finance LCY facility be set up. Such a facility would bring added value by providing local currency in a cost-effective manner, by issuing LCY-denominated bonds and on-lending the funding to public and private intermediaries for sustainable investments in LICs and LMICs).[108]

Other proposals at the idea stage are a new Green Development Bank; SDR-denominated bonds to be issued by the World Bank[109]; a fresh issue of SDRs to help seed a Climate Mitigation Trust (see

section 4.2.1); and a new multilateral entity to be set up to pool currency risks and offer foreign exchange guarantees (see section 5.3.1).

In view of the current, overlapping, global crises and rapidly rising demand for concessional finance, there are voices that call for global taxes and levies to be introduced, such as carbon border tax; tax on financial transactions; shipping levies[110], and biodiversity credits (similar to carbon credits). The proceeds would be used to help countries deal with climate change, and can counteract the growing gap in the financing of loss and damage from natural disasters.

7. VIEWPOINTS

We provide our own thoughts and viewpoints below, grouped by main topics: Our point of departure is that we agree with the general sentiment, as expressed in recent international development fora and publications, that a watershed has been reached in the development finance arena, where business-as-usual is not a workable option any longer, as radical measures are necessary by key actors and institutions to meet the formidable challenges ahead.

7.1. Mobilisation of capital

- It is clear that the hoped-for substantially increased flows of development and climate finance would have to come mainly from the private sector. Although it should be remembered that such commercial finance ultimately needs to be repaid, so it is essential that such projects are commercially viable.
- The increased number of public-private investment funds – i.e. risk-diversified asset pools - can be a partial solution to the mobilisation conundrum. However, realism of expectations is called for when setting volume targets, particularly for transactions in LDCs.
- The current drive to optimise MDBs' balance sheets and other measures (e.g. increased use of guarantees and access to hybrid capital) hold the promise to release significant volumes of MDB development finance, but does not directly address the issues of debt sustainability and mobilisation of domestic resources in lower income countries.
- The aggregate volume of capital offered should not be the sole measure of achievement, but also impact, regional allocation, currency and debt sustainability aspects. The achievement of mobilisation exercises should not only, or even not primarily, be judged by the amount of capital pledged by financiers, but by the amount of capital actually engaged in investments and the ensuing results on the ground.
- When an MDB or DFI supports a securitisation by a commercial bank, the latter should ideally handle SME finance and/ or trade finance to build asset pools that can easily be securitised, and at the same time be an investment bank that can engage the freed-up capital in long-term investments with clear developmental benefits.

7.2. Local currency finance and risk mitigation

- The ramp up of FX-denominated climate and SDG funding into developing and fragile economies will generate huge unhedged currency risks which no economy, particularly unsophisticated ones in fragile and conflict affected situations, can manage effectively.[111] As such, the MDBs and DFIs should make a concerted effort to stem the off-loading of currency risk on the lower income sovereign borrowers, in particular those countries that are most vulnerable to currency volatility and debt distress.
- The idea that MDBs should cover some of the additional debt service costs for FX-denominated sovereign debt, caused by exchange rate depreciation, deserves consideration, particularly in cases of depreciation in real terms of an LIC's currency. This could perhaps be limited to coverage of the difference between nominal and real exchange rate depreciation, and would require analysis of further measures to limit any impact on the credit rating of the MDBs concerned, such as the soliciting of shareholder/donor support.
- The critical role of DRM and LCY finance is picked up in several recent reports (see endnote71) but it is not sufficiently emphasized and worked out. Growing pools of domestic contracted private savings, which can be intermediated to commercial opportunities, is vital to this. National development banks, which unlike commercial banks are not dependent on deposits, can play a vital role in providing long term LCY denominated debt finance, particularly in poorer countries.

- Local currency credit enhancement facilities avoid the need for FX hedges and operate in partnership with commercial financial institutions, thus strengthening domestic credit and capital markets (but their operation in a specific country is contingent on a minimum level of maturity of institutions and regulation). The different LCY schemes have collectively so far not achieved a significant scale-up of LCY finance in EMDEs, though.
- The reality is that in many development contexts, guarantees will not be able to mobilise debt of sufficient tenor for many of the required long-term investments – particularly from deposit dependent commercial banks that face considerable liquidity risks in providing long term debt. A potential solution to this problem is to work through local national development banks, which can leverage their paid in equity capital with bonds issued on the local capital market.
- There are strong reasons for supporting an expansion of the role that TCX is performing, viz. providing cross currency hedging solutions for a broad array of developing country currencies, notwithstanding hedging costs and high nominal interest rates for indexed LCY debt. There is a pressing need for also the MDBs and DFIs to step in here, alongside TCX.
- The expansion target of TCX is highly ambitious but reflects what is needed, while acknowledging that this has to be gradual process over a number of years (leading up to 2030). The observed appetite of specialised capital market actors to invest in FX risk sold down by TCX is encouraging.
- In a longer-term perspective there is merit in the idea to lift the FX hedging function to a multilateral level, at least for cross-border transactions in the public sector, to benefit from economies of scale and multilateral status so that the cost of currency hedging can be lowered.[112]
- An elevated credit rating – typically in the AA – AAA range – can be less of a rigid target for the private sector arms of the MDBs, as compared to their core public sector operations. The latter are about funnelling long-term finance to borrowing countries more cheaply than these governments can raise themselves. By contrast, private sector operations should be about more than providing just cheap capital – and thus risking the crowding out of the private sector – since a main added value that the MDB's private sector arms and the DFIs bring to the table is about creating markets, for which an elevated credit rating is not necessary *per se*.

7.3. Role of concessional and blended finance

- It is important that leaders in the development finance community defend the concept of using public funds to de-risk private sector projects via advocacy to a wide audience. On-boarding with staff at aid agencies and ministries, as well as buy-in with civil society and the general public/taxpayers, needs to be built. The narrative that large scale engagement of the private sector is indispensable, and that blended finance can add significant value by supporting the catalysing efforts of the MDBs and DFIs, needs to be made compelling by ensuring that it is done with transparency and reporting of development results.
- From a broad poverty-reduction perspective it is important that a substantial share of the freed-up capital reach sustainable projects with high socio-economic impact in difficult environments. Credit enhancements and blended finance solutions – through MDBs' own blended finance set-ups or via external initiatives – and subsidies from bilateral institutions can be drawn on to support such outcomes.
- Facilities such as IFFEd and IF-CAP represent novel forms of risk transfer support that can serve as blueprints for financing partnerships with the MDBs in social infrastructure, global public goods, climate adaptation and other prioritised sectors.
- The Sida portfolio guarantees to MDBs (ADB, IDB and IFC) are interesting examples of how the use of bilateral development guarantees, via risk transfer, can reduce concentrated MDB exposure to free up capital for new sovereign (ADB, IDB) and private sector (IFC) lending.
- In view of the growing role of guarantees in development finance, the disbursement volume of ODA should not be the only 'performance indicator' for donors, e.g. in OECD-DAC reporting,

but also the volume of risk-bearing assumed (i.e. provisioning for latent disbursements to meet calls under issued guarantees).

7.4. Raising finance outside of the Bretton Woods system – the Bridgetown Initiative

- The Bridgetown Initiative provides a fresh, yet holistic perspective. It is part of the current global dialogue on climate finance, and is attuned to the on-going G20-driven process to massively expand MDB finance by reforming the capital adequacy metrics. However, the staggering mobilisation amounts, while expressing what is needed, appear to be unrealistic to achieve within the very aggressive timeframes indicated.
- The procedure for allocating US$500bn worth of SDRs as seeding for a Global Climate Mitigation Trust, as proposed under the Bridgetown Initiative, is bound to be controversial. There seems to be no pre-feasibility study undertaken, or other foundation available in the public domain, to underpin the Bridgetown assumption that private sector funds of US$2.5- 5 trillion could be leveraged by the proposed Climate Trust.[113]
- Bridgetown makes a strong case for widening the criteria for developing countries to be eligible for highly concessional finance (such as IDA eligibility). The criteria need to be further elaborated, though. Similarly, there is a demarcation issue to be resolved as to which countries are to benefit from the Loss and Damage Fund[114].
- Debt suspension in cases of natural disasters and pandemics, as advocated by Bridgetown and pioneered by UK and France, make sense as they enable borrowers to direct more of their limited resources towards disaster relief and resilience.
- While Bridgetown's FX Guarantee proposal concerns local currency solutions, it does not elaborate on the critical issues of domestic resource mobilisation, fiscal reform, or public financial management.

7.5. Rechannelling of SDRs

- The plan for rich countries to lend or donate SDRs to lower income countries holds promise, as it aims at creating FX resources to finance in-coming external investments in both the public and the private sector, thereby creating monetary and fiscal space that is badly needed by many countries.
- To rechannel SDRs via the MDBs, with AfDB pioneering a hybrid capital scheme, could potentially have a greater impact than the alternative route via the IMF Trusts, as an MDB can gear the SDRs. AfDB's scheme thus potentially has transformational potential, particularly if the IMF would commence making more frequent allocations of SDRs, and a significant share of these allocations were recycled. This, however, is contingent on political and legal deadlocks being resolved.

7.6. Demand-supply gap in concessional finance

- There is a growing mismatch between demand and supply of concessional finance, since in addition to low-income countries, also middle-income countries increasingly require concessional climate finance.
- Global taxes and levies to fund Loss and Damage, provided they can be collected and distributed in a feasible and equitable manner, will help but probably not be sufficient to close the funding gap.

7.7. Post-COP28 update & the road ahead

Following the recent G20 Leaders' Summit in New Delhi, the annual meetings of the World Bank and the IMF in Marrakech, and, more recently, the UNFCCC COP 28 in Dubai that ended on 13 December 2023, we summarise below the main takeaways from COP28:

The key outcome of the COP28 summit – labelled "The UEA Consensus"– is the agreement to *transition away* from all fossil fuels, with the goal of net zero global emissions of CO_2 by 2050. The agreement has been touted as "historic" as it is the first time that fossil fuels in general (not only coal) are addressed in a concluding COP text. However, the agreed text - known as a "global stocktake"[115] - has been criticised for not including an explicit commitment to phase down, let alone phase out, all fossil fuels but merely "calling" on countries to "transition away from fossil fuels in energy systems".[116]

Other main elements of the COP28 agreement include:

- Agreement to establish a framework for the Global Goal on Adaptation (albeit without any explicit financing targets, timelines or pledges).
- Operationalisation of the earlier agreed Loss & Damages fund, to be hosted by the World Bank (at least for an initial period of four years), with donor countries pledging $792 million to the fund as an initial capitalisation.
- Commitment by some 120 countries to double the annual rate of energy efficiency improvements (from around 2% to 4 %) every year until 2030, and triple the installed renewable energy capacity (to at least 11,000 GW).

A notable gap in the text is the absence of quantified financing targets. Nonetheless, at the end of the summit, the "commitment counter" on the COP28 website indicated that $85 billion had been pledged to support climate action and build resilience globally.[117] A selection of financing announcements made by official and private sector parties at side events of the conference are briefly described in the Endnote[118].

Not much seems to have been discussed about debt restructuring, local currency finance and domestic resource mobilisation, judged from the scarce information on these topics in media reporting from the summit.

It will be interesting to see how the key actors in the global development finance community will live up to expectations, going forward; i.e. the urgent need to reform the global financial system and produce tangible results. All stakeholders will need to step up their game to achieve more progress, with COP29 in November 2024 - dubbed the "finance COP" - as the next port of call. It should be noted, though, that climate finance is not the prerogative of the COP process only. More concrete action is likely to be taken in other fora such as the G20 summits, the IMF/ World Bank meetings, and by the multi- and bilateral actors themselves as well as the private sector.

APPENDIX A: AFDB'S PIONEERING RISK TRANSFER TRANSACTIONS

The key feature of the first transaction (2018) under 'Room-2-Run' is the transfer of the mezzanine risk on a pool of 47 existing AfDB loans via synthetic securitisation[119] to a private alternative investor (Mariner Investment Group), the Africa50 platform and the EU-backed European Fund for Sustainable Development (EFSD+). The reference pool of assets consists of US$ 1bn worth of "seasoned" loans from AfDB's private sector lending book in various African countries, sectors and currencies, with an average maturity of 6 years.[120] The transaction freed up $650 million in new lending. The initiative has been hailed as path-breaking and an example for other MDBs to follow, but questions have been raised about the high fees and the prolonged negotiating period.

This was followed the same year by a second transaction, involving a US$ 500m credit insurance deal with the African Trade Insurance Agency (ATI), which transferred risk on AfDB's portfolio of non-sovereign financial sector operations.

More recently, in October 2022, AfDB announced that it had entered into a risk transfer partnership - referred to as the 'Room-2-Run Sovereign' transaction - with the UK's Foreign, Commonwealth and Development Office (FCDO) and a group of private London-based insurers. The deal concerns risk transfer on a $2 bn portfolio of sovereign loans to 11 African Governments, releasing lending headroom of a similar amount. The risk transfer is split 20%-80% between three private insurers (AXA XL, HDI Specialty and Axis Specialty) that absorb a first-loss risk up to $400m and the UK's FCDO covering second loss up to $1,600 million, thus constituting a total cover of $2 bn.

FCDO and AfDB agreed that new lending, made possible by the freed-up capital, would be dedicated to climate finance and split evenly between adaptation and mitigation. This is reportedly the first time that commercial investors take risk on an MDB portfolio of sovereign loans[121]. One of the private sector participants in the transaction points out that it "demonstrates the significant risk bearing capabilities of the insurance market when collaborating with a MDB and the potential that insurance products can provide for increased development-focused lending". [122]

APPENDIX B: NOTE ON IMF AND SDRS

The SDR's value is based on a basket of five major international currencies (the US dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound). The value of the SDR is set daily by the IMF on the basis of fixed currency amounts of the five currencies, and the daily market exchange rates between the currencies included in the SDR basket.

The SDR represents an interest-bearing reserve asset (SDR holding) and a corresponding interest bearing liability (SDR allocation) vis-à-vis IMF's SDR Department. Interest is earned on holdings and incurred (charged) on allocations. Interest earned and interest charged net each other out as long as the country's cumulative holding is equal to its cumulative allocation. Countries that use their SDRs (by exchanging them for currencies) will hold fewer SDRs than their cumulative allocation and therefore need to pay interest at the SDR interest rate on the difference. Conversely, countries holding more SDRs than their cumulative allocation will earn interest.[123]

The country that accepts traded SDRs (against providing currency) then holds the SDRs as a potential claim vis-à-vis other IMF members to the effect that, if and when it needs hard currency, it can exercise its right to ask yet another member to do a similar exchange[124]. The exchanges of SDRs are generally carried out on a voluntary basis. However, the IMF has the option to activate the 'designation mechanism' which will legally require IMF members with strong external positions to purchase SDRs from those with weaker positions. As such, the designation mechanism provides a backstop to the liquidity and reserve asset character of the SDR[125]. In sum, an SDR allocation to an IMF member (as "Participant" in IMF's SDR Department) is an unconditional injection of reserves and liquidity to the central bank of that country, without the country incurring any transaction costs or debt.

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APPENDIX C: NOTE ON CURRENCY HEDGING VIA TCX

TCX functions as a cross currency risk pool for development finance and commercial investors in LICs/LMICs. Since 2017, it has a track record of about 5,000 hedging transactions in over 70 currencies. With a current capital base of $1.3 bn, TCX has over the years reached a sufficient critical mass to be able to absorb long-term currency risks on a sustainable basis, by off-setting a global range of currency risks against each other. TCX has to date hedged approximately $5 bn worth of LCY-denominated loans to borrowers in lower income countries. TCX has also covered the currency risk on a large number of LCY-denominated bonds. TCX has realized a modest profit since inception, in keeping with its business model.

TCX is owned by its users, i.e. DFIs and micro finance organisations (altogether 25 shareholders).

Cross-currency hedging products are agreements between two parties to exchange two currencies at a specific time in the future. TCX offers two types of hedging products:

i. Forward contracts are agreements to purchase or sell a set amount of a foreign currency at a specified price and at a predetermined time in the future. Typically, with this product a client sells a single, local currency, fixed amount and in return receives a fixed amount in US dollars from TCX at an exact date in the future.

ii. Cross-currency swaps are products under which two parties agree to exchange multiple fixed amounts (normally a future stream of loan principal repayments and interest amounts) denominated in two different currencies. Usually the client agrees on selling local currency amounts to TCX, which in exchange pays US dollars. A cross-currency swap can be described as a series of forward contracts bundled together.

Under a cross-currency swap, TCX commits to compensate its swap counterparty for a loss that it may suffer as a result of the depreciation of the local currency, held by the counterparty, against the US dollar or euro.

These hedging instruments enable Lenders to offer LCY- indexed loans and transfer the associated currency risks to third parties like TCX. As loan repayments are indexed to their local currency, Borrowers receive the benefit of a predictable debt service that is not influenced by fluctuations in the exchange rate.[126]

In addition to currency risk TCX also addresses the second major barrier to LCY financing, viz. interest rate risk, as the interest rate paid on a local currency leg of a cross-currency swap can be either floating (i.e. moving in line with a benchmark interest rate) or fixed.

TCX normally only offers ‘non-deliverable’ products where all cash flows, despite being denominated in LCY, are settled in USD. (‘Deliverable contracts’, where all cash flows are in local currency, are available upon request and only for specific currencies.) The range of hedge products includes inflation-linked cross-currency swaps. (TCX’s products are further described at www.tcxfund.com/products/.)

The Triple Agenda report opines that TCX “is too small to support the envisaged scale-up, can be prohibitively expensive in high-risk environments and leaves significant residual transfer and convertibility risk”[127].

APPENDIX D: LIST OF MAIN DOCUMENTS & STUDIES CONSULTED

Andrews D (2020): SDR Allocations to Support Low-Income Countries, CGD Note

Asian Development Bank (2023): Establishment of the Innovative Finance Facility for Climate in Asia and the Pacific Financing Partnership Facility, Institutional Document

Bhattacharya A et al (2022) Financing a big investment push in emerging markets and developing economies for sustainable, resilient and inclusive recovery and growth, Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science, Brookings Institution

OECD (2020): Blended Finance in the Least Developed Countries

Boosting MDBs' investing capacity: An independent review of multilateral development banks' capital adequacy frameworks (2022), G20

Climate Policy Initiative (2023): An Innovative IFI operating model for the 21st century: A road map

Fink C, Lankes H P, Sacchetto C (2023): Mitigating foreign exchange risk in local currency lending in fragile states, International Growth Centre.

IEG/World Bank Group (2021): The World Bank Group Experience with the IDA Private Sector Window - An early-stage assessment

High-Level Expert Group on scaling up sustainable finance in low- and middle-income countries, mandated by EU Commission - Preliminary findings & recommendations (2023)

Humphrey, C (2022): AfDB's new Room2Run highlights opportunities and questions about MDB risk transfer, ODI Insights

Humphrey, C & Prizzon, A (2014): Guarantees for development - A review of MDB operations, ODI

Lankes H P & Robins N (2023): Mobilizing private capital for climate action and growth in the Global South - T20 policy brief, G20

Le Houérou P & Lankes H P (2023): Mustering the private sector for development and climate in the Global South: Is it realistic?, FERDI

No time to lose - The Bridgetown Initiative and the transformation of the global financial architecture - a briefing note for the Parliamentary Network on the World Bank and IMF, spring 2023, Washington DC, Hon Liam Byrne MP, Chair

Oteh A, Karsenti R, Nelson E, Humphrey C, ODI (2022): Reforming capital adequacy at MDBs, ODI Insights

Persaud A (2022a): The Bridgetown initiative, explained, https://unclimatesummit.org/opinion-the-bridgetown-initiative/

Persaud A (2022b): Breaking the deadlock on climate: The Bridgetown Initiative, https://geopolitique.eu/en/articles/breaking-the-deadlock-on-climate-the-bridgetown-initiative/

Persaud A (2023): Unblocking the Green Transformation in Developing Countries with a Partial Foreign Exchange Guarantee (published in Climate Policy Initiative (2023): An Innovative IFI operating model for the 21st century)

Songwe V, Stern N, Bhattacharya A: (2022): Finance for climate action: Scaling-up investment for climate and development, London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science

Plant M: The challenge of reallocating SDRs (2021), CGD Note

The Education Commission (2018): IFFED International Finance Facility for Education - Design proposal with technical annexes

The Triple Agenda - Report of the independent experts group (2023) – Strengthening Multilateral Development Banks – mandates, mechanisms, Volume 1, G20

The Triple Agenda - Report of the independent experts group (2023) – A roadmap for better, bolder and bigger MDBs, Volume 2, G20

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END NOTES

[1] Question posed in Le Houérou & Lankes (2023): *Mustering the private sector for development and climate in the Global South: Is it realistic?*

[2] Lankes H P & Robins N (2023): *Mobilising private capital for climate action and growth in the Global South, G20 Task Force 5 - Purpose & performance: Reassessing the global financial order*

[3] *The Triple Agenda - Strengthening Multilateral Development Banks*, *Report of the independent experts group*, vol. 1 (2023), p.13.

The *Financing a big investment push* study by Bhattacharya et al from 2022 uses figures in the same ballpark, setting an incremental annual financing target for EMDEs (excl. China) of $1,300 bn to be reached by 2025) and $3,500 bn to be reached by 2030. [Source: Bhattacharya A, Dooley M, Kharas H, Taylor C (2022), p. 7]

[4] Songwe V, Stern N, Bhattacharya A: (2022): *Finance for climate action: Scaling-up investment for climate and development*, p. 5

[5] In the opinion of the independent experts group (IEG), appointed by the G20 and under the chairmanship of N.K. Singh and L. H. Summers, non-concessional finance should provide the bulk of the incremental finance, since much of the spending would be for sustainable infrastructure that can generate financial returns, thus reducing the need for concessional funds. [Source: The Triple Agenda, report of the IEG, volume 1 (2023), p.27]

The report by the IEG further suggests that $0.5 trillion of additional annual official external financing by 2030 be mobilised via "the international development finance system", to be divided into one-third in concessional funds and two-thirds in non-concessional official lending. An equivalent amount of $0.5 trillion in private capital could also be mobilised, thus making up a total of $1 trillion in external financing by 2030. [Ibid. p.13]

[6] Songwe V, Stern N, Bhattacharya A: (2022), p. 10

[7] Bhattacharya et al (2022): *Financing a big investment push in emerging markets and developing economies for sustainable, resilient and inclusive recovery and growth*, p. 54

[8] Le Houérou & Lankes (2023), pp. 5, 11

[9] Convergence (2022): The action plan for climate & SDG investment mobilization for emerging markets & developing economies, p. 35

[10] Oteh, Karsenti, Nelson, Humphrey, (2022): *Reforming Capital Adequacy at MDBs*

[11] Boosting MDBs' investing capacity: An independent review of multilateral development banks' capital adequacy frameworks (2022) [referred to as Independent CAF Review in this report]

[12] The Triple Agenda - Strengthening Multilateral Development Banks, Report of the independent experts group, vol. 1 (2023): Mandates, mechanisms; vol. 2 (2023): A roadmap for better, bolder and bigger MDBs

[13] The five main recommendations of the Panel are:

1. Redefine the approach to risk appetite in capital adequacy frameworks;
2. Incorporate uplift from callable capital into MDB capital adequacy frameworks;
3. Implement innovations to strengthen MDBs capital adequacy and lending headroom;

- 3a Endorse MDB consideration of non-voting capital classes (paid-in equity or hybrid) to contribute to available capital.
- 3b Scale up the transfer of risks embedded in MDB loan portfolios to private sector counterparties by accelerating the development of funded and unfunded instruments

- 3c Encourage shareholder guarantees of sovereign repayments on loans related to cross-cutting priorities.

4. Assess the methodologies and engagement of Credit Rating Agencies ("CRAs"); and
5. Improve the enabling environment for capital adequacy governance.

[14] Callable capital functions as stand-by extraordinary shareholder support/guarantee, ensuring that holders of MDB bonds will be repaid in case of MDB insolvency. It is recognised by CRAs and included in their credit risk assessments of MDBs. As of 2020, the 15 MDBs covered in the *Independent CAF Review* had more than US$1.3 trillion in subscribed capital, of which about US$1.2 trillion (91%) in the form of callable capital. (IFC and IDB Invest do not have access to callable capital.) No MDB has ever called its callable capital.

In the present internal capital adequacy frameworks of MDBs, available capital comprises paid-in capital, retained earnings and reserves, but excludes callable capital. In view of this, the *Independent CAF Review* underlines that callable capital has considerable financial value that should be incorporated in the capital adequacy calculations of MDBs. [Source: *Independent CAF Review*, recommendations #2 - #2A.]

[15] Hybrid capital has loss-absorption features similar to equity but without any voting rights. It could potentially be provided by existing official shareholders and possibly also by private investors (perhaps in the form of subordinated debt instruments provided by foundations, philanthropic investors or even commercial investors, depending on the terms offered).

[16] The Multilateral Development Banks Challenge Fund has awarded grants to finance a series of studies to support the realisation of the recommendations of the CAF Review. The overall goal of the MDB Challenge Fund (funded by philanthropic capital) is to accelerate MDB financing for the SDGs and the Paris Climate Agreement, in line with the recommendations of the G20 *Independent CAF Review*. [Source: https://mdbchallenge.com/]

[17] Oteh, Karsenti, Nelson, Humphrey (2022)

[18] The Triple Agenda, report of the IEG, vol. 2 (2023), p. 14

[19] This initiative was launched in October 2013 by the World Bank, and endorsed by the MDBs concerned, following a meeting of the G8 Ministers of Finance. [Source: World Bank Press Release on 2015-12-22: *Development Banks Working Together to Optimize Balance Sheets*]

[20] https://www.iadb.org/en/news/idb-executes-exposure-exchange-agreement-asian-development-bank; https://www.adb.org/news/adb-idb-scale-exposure-exchange-new-1-5-billion-agreement

[21] The exchanges are 'synthetic' in the sense that they do not entail the actual transfer or removal of loans from the balance sheet of the respective MDBs.

[22] Independent CAF Review, p. 35

Also see CEPA Viewpoint: *The New Build Back Better Initiative* (2021) regarding the advantage of MDBs/DFIs exiting once (infrastructure) projects are operational.

This is in sync with the approach of the Climate Investor One facility of operating three sub-funds for the respective main stages of a project's lifecycle: development, construction, and operations.

[23] The metrics used in MDBs' current models for calculating required capital include Basel risk-based capital ratios, Standard & Poor's Risk Adjusted Capital ratio, and various capital utilization ratios. [Source: *Independent CAF Review*, p. 17]

[24] It appears that only one MDB securitisation of the Room-2-Run type has been done so far.

[25] Humphrey (2022): AfDB's new Room2Run highlights opportunities and questions about MDB risk transfer. Three of the drawbacks mentioned in this report are:

i. The cost of transferring the risk of sovereign loans to commercial counterparties may be greater than what the MDB earns on the loans;

ii. If guarantees from development agencies are used, this could give the donor governments concerned undue influence in steering an MDB's lending; and

iii. MDBs should exercise caution in sharing their preferred creditor status with private investors, as it represents the unique status of MDBs as non-commercial development 'cooperatives', which could be problematic if an MDB were to scale up risk transfers systematically as a substitute for shareholder capital.

As for the first issue, this is less of a problem in connection with non-sovereign loans. As for the second issue, this risk should not be exaggerated, as there is broad alignment between MDBs and bilateral donors on development priorities. As illustrated in IFC's MCPP programme, criteria on portfolio selection can be based on probabilistic outcomes rather than detailed pre-descriptions. (Cf. the concept of 'Sida-eligible loans', which was applied in the IFC-Sida structure for MCPP Infra, where there was an expected share in the range of 50%-70% of the portfolio that would benefit from the Sida guarantee.)

[26] The 'Marco Polo Three' securitisation is an example of an MDB acting as investor in a synthetic risk transfer with the private sector. In this transaction, the IFC provides a five-year $182 million mezzanine guarantee to Crédit Agricole on a $4bn-equivalent reference portfolio, comprising about 1,300 emerging market trade finance exposures. As part of the deal, Crédit Agricole has committed to redeploy freed-up regulatory capital of $600 million over four years to new lending in social infrastructure and sustainability-linked sectors in EMDEs, including health, agriculture, telecommunications and local industries loans. [Source: Structured Credit Investor Capital Relief Trades (SCI-CRT) Awards 2021. The Marco Polo Three transaction was chosen as the Impact Deal of The Year]

[27] *Independent CAF Review*, page 33.

[28] *Independent CAF Review*, footnote 12 (quoting the MDB Task Force on Mobilization (2021) as source.)

[29] The ILX Fund's business concept of inviting institutional investors to pool funds for co-investing pari passu via MDBs' B-loans is similar to the concept used by IFC's MCPP program (whose first phase was launched already in 2013), with the difference that the ILX Fund will partner a number of different MDBs (such as the private sector arms of regional MDBs) and DFIs (FMO, BII and others), and focus on the SDG-related 'investment themes' of energy access and renewable energy, sustainable industry and infrastructure, inclusive access to finance, and safeguarding sustainable food security.

Another difference is that the ILX Fund does not make use of blended finance (such as the IFC-Sida MCPP Infrastructure, which makes use of a partial donor guarantee, sharing the risk with IFC on the first loss layer), increasing the chance that projects perceived as risky and located in difficult environments, but with high developmental and climate value, would not be served

[30] The first iteration of the Fund – ILX I – will have exclusively Dutch pension funds as investors. In June 2022, it was announced that the ILX Fund had reached its $1 bn fundraising target, as Vervoer of the Netherlands joined two other Dutch pension funds (ABP and bpfBouw) in investing in ILX I. [Source: impactInvestor, 2022-06-21]

[31] The $100 bn commitment was originally agreed in Copenhagen at COP15 in 2009, and then endorsed in subsequent COP agreements.

[32] Songwe V, Stern N, Bhattacharya A: (2022), p. 6

[33] This Note uses the expression 'inherently viable' as denoting a project or company which is commercially investable in itself, i.e. with a strong business case, but due to external factors such as country risk or deficient regulatory environment, it is outside the internal risk limits of commercial investors (without credit enhancement).

[34] Songwe V, Stern N, Bhattacharya A: (2022), p. 61

[35] Cf. IFC-MCPP which builds "blind" pools for investors, where the allocation of assets (i.e. new B-loans to SPVs, is rules-based. As such, the expected portfolio outcomes are probabilistic.

By contrast, if MDBs would allow investors to pick and choose the assets they want, this might bring about pools of loans that primarily meet the sectoral or financial criteria of private investors rather than a selection based on a balance between financial and developmental outcomes. [Reference: Gabor, Daniela (2019): Securitization for Sustainability – Does it help achieve the Sustainable Development Goals?, page 14.]

[36] Sida has entered into three guarantee agreements with respectively IFC; ADB; and IDB.

(i) Over the period 2015- 2016, Sida and IFC jointly developed a model where institutional capital is invested through the MCPP programme alongside IFC in infrastructure projects. The IFC-Sida MCPP Infrastructure structure makes use of a partial Sida guarantee, where Sida is sharing risk with IFC on the 10% first loss layer (i.e. the equity risk on the debt funds). Sida counter-guarantees IFC in projects related to renewable energy and investments in LICs/LMICs ("Sida-eligible" projects). Sida's maximum guarantee coverage is $ 57 million. (A feature to note is that there is no subsidy of Sida's guarantee fee.)

IFC-MCPP builds "blind" pools of B-loans for new infrastructure projects in the private sector that are co-financed by IFC A-loans. IFC stands as Lender-of-Record for both the A- and the B-loans. The B-loans are aggregated into SPVs, whose credit-enhanced shares are taken up by investors such as insurance companies (one SPV debt fund per investor). The allocation of loans is rules-based, and the expected portfolio outcomes are probabilistic.

(ii) In 2016, Sida guaranteed a $155 million portfolio of existing ADB sovereign loans. The purpose of the guarantee was to expand ADB's regional lending headroom under a reform agenda of inclusive growth, environment/climate and enhanced poverty focus. The Sida guarantee allowed ADB to increase its lending capacity from its ordinary capital resources by $500 million over 10 years. ADB's portfolio quality and diversity was thus improved by replacing existing loan exposure with AAA-rated exposure to Sweden. This was the first time a risk transfer arrangement had been applied to sovereign loan portfolio of an MDB. [Source: ADB News Release 2016-10-03]

(iii) In 2020, the IDB negotiated a guarantee with the Government of Sweden through Sida, to cover losses for up to $100 million stemming from Brazil's sovereign exposure to enable the IDB to increase lending in other countries. The Sida portfolio guarantee of $100m, signed in May 2020, enables IDB to increase lending of $300m, to be distributed to three borrowing countries (Bolivia, Colombia and Guatemala).

Sida has also issued re-guarantees of transactions originated by respectively GuarantCo and the African Guarantee Fund, increasing the guarantee capacity of these two institutions.

[37] Example: The Paris-Aligned Securitization Pilot being structured by IDB Invest with funding from the MDB Challenge Fund.

[38] Plant M (2021): The challenge of reallocating SDRs

[39] The SDR is only exchangeable with the five currencies that make up the SDR currency basket, viz. US Dollars, Euros, Pound Sterling, Yen, and Renmimbi. These five currencies meet the 'export' and 'freely usable' criteria set by the IMF for inclusion in the SDR basket. Any donation of SDRs would need to be converted into one of these currencies in order to be invested.

[40] Decisions on General Allocations of SDRs are taken every five years, unless there is an "unexpected major development" that warrants an allocation outside of the five-year cycle. An example of the latter is the general allocation in the record volume of SDR 456 bn ($650 bn), which took place in 2021 to boost global liquidity in the wake of the Covid-19 pandemic.

[41] To change the rules would require consent by 85% of the votes of IMF members; since the U.S. holds 16.5% of the votes, its view is decisive.

[42] The RST was approved by IMF's Executive Board in April 2022; IMF's Managing Director announced its operationalisation in October 2022.

[43] Songwe V, Stern N, Bhattacharya A: (2022), p. 62

[44] In the first instance, AfDB would leverage a portion of the $100 billion of SDRs already pledged by G20 advanced economies to support more vulnerable countries. For the proposal to go ahead, the AfDB requires at least five donor countries to contribute in equal amounts.

[45] *No time to lose - the Bridgetown Initiative and the transformation of the global financial architecture* - briefing note for the Parliamentary Network on the World Bank and IMF, spring 2023, Washington DC, Hon Liam Byrne MP, Chair

[46] Interview with the CFO of AfDB, Ms Hassatou Diop N'Sele, on 2022-05-22, published at https://www.afdb.org/en/news-and-events/interviews/leveraging-power-special-drawing-rights-how-developed-countries-can-help-boost-africas-development-51910

[47] In in an informal briefing to IMF's Executive Board on 2023-02-14.

[48] Plant M (2023): A Valentine's Day Gift for the AfDB's Campaign for SDR Recycling, CGD Blog Post

[49] Ibid.

[50] UN chief and Barbados Prime Minister call for urgent action to transform broken global financial system, 2023-04-26

[51] https://www.foreign.gov.bb/the-2022-barbados-agenda/

In July 2022, Prime Minister Mottley convened a high-level retreat in Bridgetown, Barbados, which resulted in the Bridgetown Initiative.

[52] Bridgetown's initial proposals were subsequently expanded and presented to the Summit on a New Global Financing Pact in Paris (June, 2023), and were to be further discussed at the COP 28 in Dubai in November 2023.

[53] This in contrast to the two existing IMF Trusts – the Poverty Reduction and Growth Trust and the Resilience and Sustainability Trust – that lend funds to IMF member governments.

[54] Persaud (2022a): *The Bridgetown initiative, explained*, published at https://unclimatesummit.org/opinion-the-bridgetown-initiative/

[55] Persaud (2022b): Breaking the deadlock on climate

[56] "With the help of our Global Climate Mitigation Trust then, mitigation can be funded primarily by the private sector." [Ibid.]

[57] Persaud (2022b)

[58] Persaud (2022a)

[59] Such as costs for defences against sea-level rising, salinity intrusion and floods, more resilient road and bridge infrastructure and water conservation.

[60] Bridgetown/Professor Persaud does not define 'concessional finance', but it is assumed that IDA terms are being referred to. (A range of concessional terms can in principle be applied; for example, OECD/DAC uses steps of concessionality expressed as 35%, 50% and 80% relative to market terms).

[61] Persaud (2022b)

[62] Ibid.

[63] Ibid.

[64] Barbados has successfully issued two bonds with natural disaster clauses.

[65] Persaud (2022b)

[66] UK Export Finance (UKEF) was the first export credit agency in the world to introduce CRDCs into its loan agreements, as announced at COP27 in November 2022. [Source: *Building a more shock resilient financial system: Climate resilient debt clauses* – UK-hosted side event at the Summit on a New Global Financing Pact. Paris, 22 June 2023]

[67] Often repeated phrases in LinkedIn-postings by the CEO of TCX, Ruud Brouwer.

[68] Information obtained from TCX.

[69] Cf. the 'HEAR ratio' constructed by TCX, which expresses a country's currency risk in terms of its average annual budget for health and education: HEAR ratio = (notional open FX position expressed in LCY) / ((education budget + health budget)/2). [Source: https://www.tcxfund.com/hear/]

[70] Proposed roadmap to build on key milestones of the international agenda as a follow-up to the Summit on a New Global Financing Pact (2023), p.7: "The IMF, the World Bank and the TCX Fund are invited to examine (1) options to better cover foreign exchange risk in low income and emerging economies in order to facilitate private investment, building on the experience of the TCX and other existing models; (2) concrete steps to increase the provision of local currency financing for projects and corporates with revenues in local currency."

[71] Among recent studies dealing with MDBs and mobilisation of private capital, the importance of local currency finance - especially for infrastructure projects - is highlighted in i.a. Le Houérou & Lankes (2023), and in Fink C, Lankes H P, Sacchetto C (2023): *Mitigating foreign exchange risk in local currency lending in fragile states.* The management of FX risk is discussed in Volume 2, p. 43 of the Triple Agenda report, as the report underlines the need for expanded off-shore hedging mechanisms, with particular reference to TCX, and the critical role of DRM and LCY finance is further accentuated.

[72] While IFC provides local currency guarantees, when a guarantee is called, the client will generally be obligated to reimburse IFC in US dollar terms. [Source: Humphrey & Prizzon (2014): *Guarantees for Development - A Review of MDB Operations*, Table 2, note 4, page 16.

[73] In contrast to TCX, GuarantCo bears credit risk and seeks to avoid FX risk by guaranteeing infrastructure projects that are financed in the same currencies as their revenues.

[74] Humphrey & Prizzon (2014), p. 27

[75] Climate Policy Initiative (2023): An Innovative IFI operating model for the 21st century: A road map, p. 75

[76] https://www.cgif-abmi.org/about-us/

'ASEAN+3' consists of the 10 members of the Association of Southeast Asian Nations plus China, Japan, and the Republic of Korea.

[77] Bhattacharya A, Dooley M, Kharas H, Taylor C (2022): Financing a big investment push in emerging markets and developing economies for sustainable, resilient and inclusive recovery and growth, p.9

[78] OECD (2020): Blended Finance in the Least Developed Countries, section 5.11.2

[79] Ibid.

[80] https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=18179

[81] Source: LinkedIn posting by Ruurd Brouwer (2023-10-20).

[82] In other words, while the unit of account for the transaction is the local currency, the unit of settlement can be FX, such that the amounts receivable and payable for debt service (principal and interest), indexed to the local currency, are converted to FX using the current exchange rate on the respective cash flow dates (i.e. the spot LCY/FX exchange rate).

[83] Such as the 'Boosting Renewable Energy Programme', under which EBRD issues guarantees to local commercial banks to enable them to co-finance renewable energy projects alongside EBRD, and the 'EU Municipal Infrastructure and Industrial Resilience Programme'. Both programmes are targeting countries in the EU Southern and Eastern Neighbourhood.

[84] https://www.tcxfund.com/products/

[85] Currency risk is sold either via cross-currency swaps or on the back of investment grade bonds indexed to local currency. [Source: Information obtained from TCX.]

[86] https://www.tcxfund.com/projects-initiatives/eu-market-creation-pricing-facility/

The specific purpose of the EU Market Creation programme is to increase access to synthetic LCY debt investments, to be provided by EFSD's partner institutions such as the European DFIs for eligible borrowers based in Sub-Saharan Africa and the European Neighbourhood, and to address medium and long-term funding requirements in the wake of the Covid-19 pandemic.

[87] E.g. in discussions within G20 and, most recently on the sidelines of the WB/IMF annual meetings in September 2023.

[88] TCX also proposes to establish a trust fund for provision of 'portfolio return guarantees' where TCX is the guarantee beneficiary. TCX would be guaranteed a minimum yearly return on defined concessional hedge portfolios that would be built based on eligibility criteria, to be agreed with donors. Through this instrument, the affordability of hedging currency risks would be improved thanks to TCX being able to offer concessional pricing.

TCX will also step up its cooperation with MIGA, Frontclear and other specialized insurance and guarantees providers to expand the scope of currency risk hedging by offering also deliverable products and substitutes for cash-collateral requirements [Source: Information obtained from TCX]

[89] The mentioned proposals are included in a Note that TCX submitted to the G20 Working Group on the Global Financial Architecture, and which were subsequently been picked up in the Triple Agenda report.

[90] The Triple Agenda, report of the IEG, vol. 2 (2023), p. 43.

As for onshore hedging, the experts recommend the MDBs to: (i) provide technical assistance for local money market development; (ii) establish an MDB shared onshore FX-LCY treasury platform to act as an interface between onshore markets and international investors, and (iii) offer more local currency options to clients to increase local demand for FX hedging and to build domestic markets. [Ibid., p. 44]

[91] Kapoor S, Kapoor D, Hirschhofer H, Kleiterp N (2021): A multilateral solution to hedging currency risk in developing country finance, NIFTYS

[92] Persaud A (2023): Unblocking the Green Transformation in Developing Countries with a Partial Foreign Exchange Guarantee

[93] The four IDA PSW facilities are:

1. Local Currency Facility (LCF) to provide long-term local currency IFC investments in IDA countries where capital markets are not developed, and market solutions are not sufficiently available. The LCF transactions are typically structured as direct FX swaps.
2. Blended Finance Facility (BFF) to blend PSW support with IFC investments across sectors with high development impact, including SMEs, agribusiness, health, education, affordable housing, infrastructure, climate change mitigation and climate adaptation. The BFF facility supports senior loans, equity and first loss structures.
3. Risk Mitigation Facility (RMF) to provide project-based guarantees without sovereign indemnity or counter guarantee to crowd-in private investment in large infrastructure projects. The RMF transactions are typically structured as liquidity support guarantees.
4. MIGA Guarantee Facility (MGF) to expand coverage through shared first-loss guarantees and risk participation via MIGA reinsurance.

The MGF guarantee facility is managed by MIGA, whereas the other three facilities are managed by IFC. [Source: https://ida.worldbank.org/en/financing/ida-private-sector-window/what-is-ida-private-sector-window]

It should be noted that the use of IDA funds to de-risk private sector projects is controversial.

[94] IEG/World Bank Group (2021): The World Bank Group Experience with the IDA Private Sector Window - An Early-Stage Assessment, Box 4.2, p. 24

[95] Ibid, p. 29. The IEG assessment found that the PSW swaps had been priced at less than the amount required to cover the expected losses.

[96] It should be noted that the G20 does not include important donor countries, such as the Netherlands and the Nordic countries.

[97] Financial Times, 2023-07-18: *World Bank to stretch every dollar with new lending measures*. The article mentions the target of expanding WB lending of up to $30bn over 10 years, backed by $5 bn callable capital as guarantee.

[98] The extent of early exits would be contingent on the management and shareholders of the MDBs/DFIs accepting the risk and profitability implications of such a business model. See CGD Policy Paper (April 2023): *Taking stock of MDB and DFI innovations for mobilizing private capital for development*, by Neil Gregory.

[99] National development banks typically extend finance in local currency, and can also offer concessional finance, which is important to a range of climate-related projects. [Source: Songwe V, Stern N, Bhattacharya A: (2022), p. 55]

[100] High-level expert group on scaling up sustainable finance in low- and middle-income countries - mandated by the European Commission (2023), p. 7

[101] IFFEd contributors would only pay in 15% of their guarantee commitment to capitalize the facility, with a contingent commitment covering the remaining 85%. This allows for increased leverage on paid-in capital. If the paid-in capital falls below the 15% threshold because of arrears, IFFEd calls for the contingent capital to restore the required floor within a specified timeframe. IFFEd has received a preliminary AAA rating due to the high ratings of its target contributors. [Source: *Independent CAF Review*, p. 37]

Sida announced in December 2022 that it would provide a loan portfolio guarantee of SEK 2.8 bn (US$200 million) to IFFEd for the purpose of unlocking affordable finance for LICs to support education of the world's most vulnerable children. The UK foreign secretary announced at the 28th General Assembly of the UN that UK will contribute up to £180 million of support to IFFEd, incl. to £95 million in grants and paid-in capital, and a contingent guarantee of up to £85 million.

[102] Asian Development Bank (2023): Establishment of the Innovative Finance Facility for Climate in Asia and the Pacific Financing Partnership Facility, footnote 24

[103] ADB/IF-CAP will enter into financing partnerships with official bilateral and multilateral institutions and other financing partners (e.g. e.g., philanthropies, foundations, and other private sources) that are willing to provide funded or unfunded guarantees or risk participations. The partner institutions would provide guarantees to the ADB, in parallel with the IF-CAP Trust Fund to cover payment defaults in respect of one or more synthetic sub-portfolios of ADB sovereign loans. This will release part of the capital currently allocated to that sovereign portfolio. With the released capital, ADB can then enter into a number of new sovereign and non-sovereign climate mitigation and adaptation projects across Asia and the Pacific. [Source: ADB (2023)]

[104] Such as the Green Guarantee Company and the International Guarantee Trust Fund for Renewable Energy (iTrust) that is being developed by Greenmap (launched at COP26).

[105] Following the meeting between US President Biden and Indian Prime Minister Modi on 2023-06-22, their joint statement highlighted mobilization of concessional financing at the World Bank to support all developing countries as a key objective in the evolution roadmap. [Source: Matiasen, Karen (2023): Key Takeaways from the Paris Declaration on MDBs CDG Blog

[106] Statement by IMF's Managing Director at the third meeting of the G20 Finance Ministers and Central Bank Governors in Gandhinagar, India (2023-07-18).

[107] This would be a vehicle that would target investors who, while looking for a yield, also have an interest in supporting the global climate and SDG agendas, and being associated with the MDBs. The GCFM vehicle would acquire hybrid capital bonds issued by the MDBs, allowing investors to earn a rate of return while supporting particular MDB programmes, to be selected out of a broad range of investment themes and geographies. The group of investors could include sovereign wealth funds, foundations, impact investors and even commercial businesses wishing to be associated with distinct global impact areas.

The GCFM could either buy hybrid capital in a number of MDBs, or initially target only one MDB. The legal form of the GCFM is still to be determined; one idea suggested in Volume 1 of the report is to ask the WB to host it under separate governance arrangements. [Sources: The Triple Agenda, report of the IEG, Vol. 1 (2023), p.16, and Vol. 2 (2023), pp. 49-51]

[108] High-level expert group on scaling up sustainable finance in low- and middle-income countries, mandated by EU Commission (2023), p.8

[109] Central banks could buy an SDR-denominated bond, earn interest on it, and trade it between each other and the 15 other 'prescribed holders' (as defined by the IMF) — thus ensuring its liquidity. Furthermore, the bond could be SDR-denominated but cash-settled (with dollars or euros), which would simplify and streamline its use as a reserve asset. [Proposal presented in an article published in the Financial Times on 2023-01-26: '*The Magic of an SDR-denominated bond – How to funnel stagnant SDRs where they're actually needed*' by S. Paduano and B. Setser.

[110] Shipping levy (as championed by France, Bridgetown and others): This would be global levies on greenhouse gas emissions in the shipping sector as an innovative source of climate financing, to make the shipping sector carbon-neutral.

[111] Hirschhofer, H. (2017): Development Finance 2.0 - Improving conditions for local currency financing

[112] While the ICF proposal (see section 5.3.1) explicitly states that it would build on TCX, the Bridgetown proposal for an FX guarantee vehicle advocates that a new entity be set-up from scratch. However, this begs the question of why a new organisation should be established instead of building on the existing, successful, TCX Fund. It would be more rational to scale-up an existing institution with a proven track record rather than inventing the wheel all over again by launching a new entity in an already over-crowded landscape.

[113] The 2.4% p.a. interest rate, which the Trust is presumed to be able to borrow at (for hard currency funds), is stated by Bridgetown to correspond to the overnight borrowing rate as applied for exchange of SDRs for central bank reserve funds within the IMF system. However, If the Trust borrows at 2.4% it will need to re-lend at more than 2.4% by adding a spread to cover administration costs (leaving aside a profit margin, assuming that the Trust would be non-profit).

Also, any leveraged co-financing from the private sector is bound to be more expensive than the 2.4% p.a. (in hard currency) envisioned interest rate on loans from the Trust.

[114] The modalities of the Loss & Damage Fund are to be agreed at COP28 in December 2023.

[115] A global stocktake, as part of the COP process, will take place every five years, with the first-ever stocktake concluded at COP28. [Source: https://unfccc.int/topics/global-stocktake/about-the-global-stocktake/why-the-global-stocktake-is-important-for-climate-action-this-decade]

[116] The Guardian, 2023-12-13: *Cop28 landmark deal agreed to 'transition away' from fossil fuels*

[117] https://www.cop28.com/en/

[118] EBRD and the EU announced a new package of guarantee support of up to €1 bn for green investments (details are still to be disclosed).

- Japan announced a commitment to support the hybrid capital model developed by AfDB and IDB, which will allow countries with excess reserves to lend SDRs to the MDBs in support of bond issuances to fund climate- and SDG-related investments. France announced its commitment to support such facility through a guarantee, and Spain and the UK indicated their willingness to further explore this avenue. [Source: COP28 Finance Day press release – 231204; https://www.cop28.com/en/news/2023/12/COP28-Finance-Day-unlocks-innovative-financial-mechanisms]
- 73 countries have been reported as joining UK and France in calling for all creditors to offer climate resilient debt clauses in their direct lending to lower income countries.
- The UK announced a package of £484 million worth of investments, of which £391 m is earmarked for the Private Infrastructure Development Group (PIDG) [Source:

https://www.gov.uk/government/news/uk-generates-billions-in-climate-finance-and-first-crdc-in-africa]

- A blended finance partnership between the U.S. and a number of Nordic countries was announced under the label The Investment Mobilization Collaboration Agreement. IMCA aims to promote greater cooperation among the partners on investment pipelines, create blended finance vehicles and mobilise finance to be invested within these vehicles. [Source: https://pub.norden.org/cop28/-december-4-mobilizing-climate-finance.html]
- IDB and Sida signed a Letter of Intent to work jointly to finalise a guarantee partnership, which aims to significantly expand the funding capacity of Amazonia Forever, an IDB Group umbrella programme aimed at fostering biodiversity and accelerating sustainable development in the Amazon region. The intention is to increase IDB's lending capacity for the programme by $450 million through supporting innovative finance models such as Amazon bonds, debt-for-nature swaps, and bio-economy loans. [Source : https://www.iadb.org/en/news/idb-and-sweden-boost-amazonia-forever]
- The Green Climate Fund and FMO signed an agreement at COP28 to provide a USD 180 million investment to the &Green Fund.
- The Managing Director of IMF stated that diverting the [7] trillions of dollars by which the world subsidises fossil fuel production each year, and putting an implicit price on carbon emissions, would generate the vast amounts of cash needed to tackle the climate crisis. While implementing a direct (explicit) global carbon tax is challenging for technical and political reasons, the IMF, WB, OECD and the WTO have set up a taskforce to examine the different carbon prices that are implied in countries around the world by their carbon policies and regulations. [Source: The Guardian, 2023-12-07: *Carbon pricing would raise trillions needed to tackle climate crisis, says IMF*]

[119] AfDB, as the originator, transfers the default risk on a defined portion of its loan book by means of a credit protection contract (similar to a credit default swap) to the investors, leaving the underlying exposures in the ownership and thus on the balance sheet of the originator.

[120] At the time of closing, the value of the reference pool corresponded to about a fifth of AfDB's US$ 5.6 bn portfolio of outstanding non-sovereign loans.

[121] Humphrey (2022)

[122] AfDB Press Release on 2022-10-20: African Development Bank, United Kingdom and London market insurers enter new risk transfer partnership for climate action

[123] https://www.imf.org/en/About/FAQ/special-drawing-right, and CGD Note/D. Andrews (2020).

There have been calls for replacing the existing dual interest rate system, which penalizes SDR utilization, with a single interest rate to be paid by members on unutilized SDRs. [Source: Songwe V, Stern N, Bhattacharya A: (2022), p. 63]

[124] Source: Plant (2021)

[125] Andrews (2020): SDR Allocations to Support Low-Income Countries

[126] Information obtained from TCX.

[127] The Triple Agenda, vol.1, p. 42