The Tri Hita Karana Roadmap for Blended Finance

Practices Working Group

Governance of Blended Finance

17 June 2020

Acknowledgements

This report is based on discussions and contributions by a wide range of blended finance actors and members of the THK Practices Working Group. It compiles their inputs, insights and good practices into a comprehensive stock-taking of governance frameworks for blended finance. While this paper does not reflect the views of any particular institution, it does testify to the shared ambition to show-case a range of governance practices among donors/national governments and development financiers, including multilateral development banks (MDBs), in hopes of providing inspiration to practitioners and stimulating the expert debate on the state of play in governance of blended finance today.

The author would like to thank all working group members for their active participation and collaboration. The European Commission, members of the DFI Working Group on Blended Concessional Finance, JICA and Global Affairs Canada deserve special thanks for their case studies and time spent in fruitful discussions.

I. Introduction

Blended finance (BF) is widely perceived as a key development finance tool to help address challenges associated with mobilizing additional investment for the Sustainable Development Goals (SDGs) in their final decade.

In practice, the OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs represent the gold standard and consensus among stakeholders ranging from donors, multilateral development banks (MDBs), development finance institutions (DFIs), philanthropies and the private sector. The Principles serve to ensure that BF providers deploy blended finance instruments in a way that meets accepted quality standards and achieves impact.

To bring the Principles to life, the OECD spearheaded the Tri Hita Karana Roadmap for Blended Finance in 2018, rallying stakeholders around implementation in five action areas (depicted below). This paper contributes to action area "Practice", chaired by Convergence, the European Commission and the European Investment Bank, and focuses on governance of blended finance.

The paper is structured in the following way. After a short introduction on the importance of good governance frameworks for blended finance, it presents lessons learned pertaining to good governance frameworks designed and applied by two key groups of stakeholders: **donor agencies and development financiers (MDBs/DFIs)**.

Why good governance?

By subscribing to the OECD Blended Finance Principles, all actors in the blended finance marketplace pledged to transpose them into institutional and operational frameworks: in short, to establish a system of ***good governance*** for blended finance.

The primary reason for this is accountability, both ***horizontal*** towards the international community and ***vertical*** vis-à-vis donors and/or shareholders. When it comes to the former, stakeholders have an obligation to keep enhancing transparency in the use of blended finance in order to demonstrate their contribution to the financing of SDGs. In the latter case, the use of concessional funds provided by donors needs to be monitored to ensure that they are deployed in line with the Principles, i.e. that they maximize additionality, use the right level of concessionality to avoid crowding out the private sector, and so on. This is to avoid potential system-wide implications for markets that could arise if blended finance providers were to stray from the jointly agreed standards and use blended finance in a way that distorts them. Concerns in this respect tend to include:

- Balancing financial incentives and development objectives;
- Possible unnecessary allocation of oversized subsidies to private investors;
- Potential creation of barriers to entry for commercial players ("crowding out");
- Debt (un)sustainability;
- Transparency, accountability and monitoring/evaluation;
- Negative demonstration effects[1];
- Insufficient development impact.

With this in mind, we present this paper to showcase institutional-level and project-level frameworks for good governance that various blended finance providers have put in place.

- On the **institutional level**, we refer to strategic documents (Action Plans; operational manuals), institutional set-up (e.g. decision-making bodies, checks and balances) as well as human resources dedicated to the management of blended finance operations;

- On the **project level,** we examine the approval process for blended finance transactions, focusing on specificities of these vis-à-vis regular operations (e.g. checklists, tailor-made analyses or approaches to monitoring/evaluation that are specific to BF, etc).

II. Donor agencies

As national governments and their development arms (henceforth "donor agencies") have played a crucial role in defining and endorsing the OECD Blended Finance Principles, they work to ensure that the use of concessional funds allocated to blended finance instruments adheres to the high standards that the Principles embody.

They primarily do so by providing independent oversight and quality assurance at almost every step of the way.

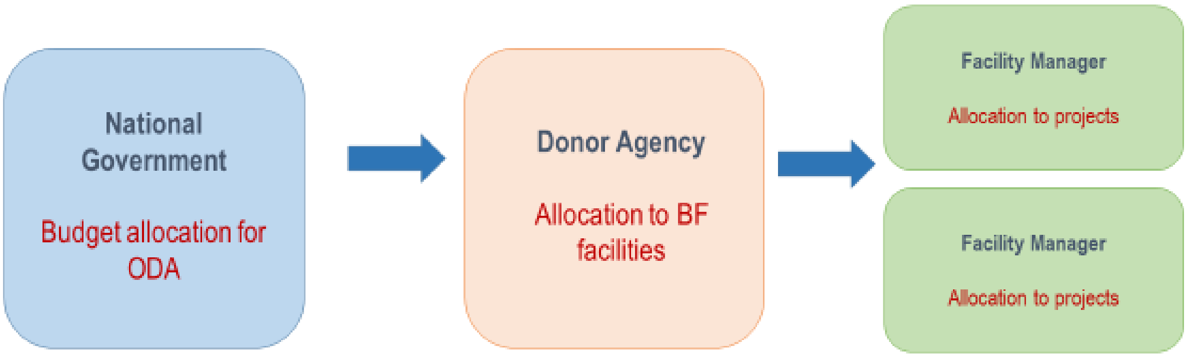
On the **institutional level,** there are two prevailing models for good governance of blended finance among donors:

1. **Direct model:** donors engage in blended finance deployment without an intermediary. Some OECD DAC members operate via an aid agency in the absence of a DFI, such as Australia, Czech Republic, Japan, Korea, Luxembourg, Slovakia and Slovenia. As such, their monitoring and evaluation strategies for blended finance operations are subjected to oversight by the ministry in charge of development cooperation, often the Ministry of Foreign Affairs. Other DAC members, like Canada, channel some blended finance directly and some via intermediaries.

2. **Delegated model:** donor agencies themselves do not deploy blended finance instruments. Instead, they delegate this authority to intermediaries with a proven track record of mobilizing additional – most often private – financing for development. According to this logic, donor agencies earmark concessional funds to facilities that are managed by others and monitor its use, as depicted in the figure below.

[1] OECD Topic Guide, 2014. Blended Finance for Infrastructure and Low-Carbon Development.

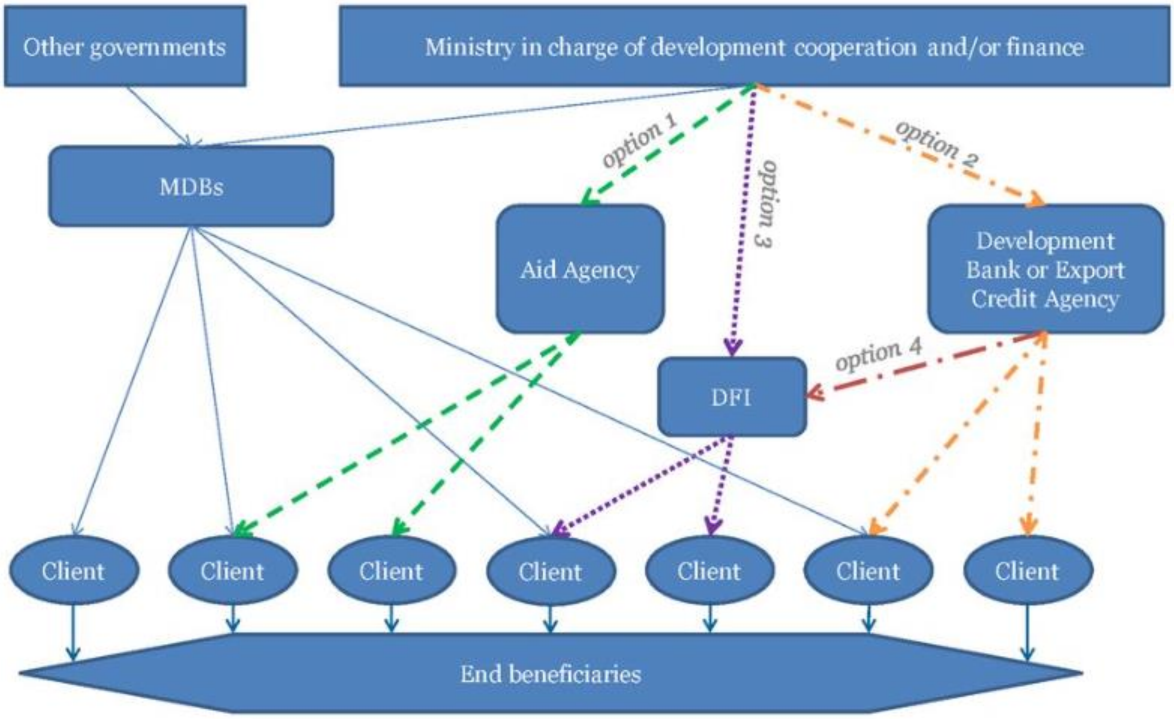
Often, donors channel their concessional funding via (national) DFIs. While DFIs are also monitored by the government, it is usually a ministry different from the one in charge of development cooperation, for instance the Ministry of Finance, which is the primary shareholder. Hence, DFIs and donors usually agree on blended finance oversight and evaluation in comprehensive delegation agreements to strike a balance between financial obligations and commitment to development impact. Donors can also delegate to multilateral development banks (MDBs).



In the delegated institutional setup, the top priority is to strike a balance between the incentives of the different actors involved. As the counterparty for the donor agency is often a multilateral development bank (MDB) or a development finance institution (DFI), it is key to acknowledge that in these institutions, the public interest intervention logic focused on development impact coexists with the need to pursue opportunity-driven projects initiated by private sector partners in order to meet targets for signatures and disbursements. This poses challenges for donors because the information needs that they have with regards to the use and performance of their concessional funding may be perceived as increasing the administrative burden by duplicating existing procedures, which can overload operational staff and create barriers for entry for certain classes of clients. Moreover, MDBs'/DFIs' existing ex ante and ex post project assessment frameworks, and monitoring and evaluation systems, are often not well-equipped to incorporate additional oversight from donors on top of shareholders. For the MDB/DFI response to these dilemmas, and for the "how to " of ensuring effective donor involvement in decision-making on BF instruments, see section II of this report.

It is common to **combine** direct and delegated governance approaches: for instance, the UK's Department for International Development (DfID) provides ODA funds for blending both directly and through its bilateral development finance institution (DFI), the CDC Group. The full spectrum of BF governance choices for donors is presented in the figure below.[2]

[2] OECD, 2019. Blended Finance Evaluation – Governance and Methodological Challenges.



As a general rule, the longer the chain of intermediation and/or delegation, the greater the complexity of exercising the oversight function by the donor (government) as the originator of the concessional funds. While the ministries tend to have close relationships with e.g. donor agencies, there are more degrees of separation between the government and the DFIs and even more between the government and the MDBs, which have multilateral shareholding.

On the **project level,** donors' appraisal and monitoring/evaluation mechanisms for blended finance projects differ from regular ODA ones primarily by focusing on additionality, mobilization/leverage and long-term financial sustainability. Many donors design their blended finance facilities around the OECD Principles, which can double up as the facilities' development objectives and selection criteria for projects (see case study of Canada's IAIP).

The most important "new" element in donors' ex ante analysis for BF projects is the consideration of minimum concessionality. For instance, the European Commission has incorporated this commitment to avoid crowding out into the EU budget financial regulation and the 11th European Development Fund (EDF) financial regulation, which both stress that financial instruments – including the blended ones – should address market failures or sub-optimal investment situations which have proven to be financially viable but have not given rise to sufficient funding from market sources.[3]

Consequently, the grant share in blended instruments can be quite modest. For example, in the EU-Africa Infrastructure Trust Fund blending facility, the average grant share is 2.28% (i.e. grant as a proportion of the total project cost) though for individual projects, it ranges from as low as 0% to as high as 20%.[4]

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[3] European Commission, 2015. Guidelines on EU Blending Operations.

[4] OECD Topic Guide, 2014. Blended Finance for Infrastructure and Low-Carbon Development.

Case study of a direct institutional approach: JICA and Canada

Japan and Canada are both blended finance frontrunners and among the first donors to offer blended (including debt and equity) instruments to the private sector directly.

JICA is the world's largest bilateral aid agency that administers all Official Development Assistance (ODA) programs including (i) technical cooperation, (ii) grant aid, (iii) ODA loans, and (iv) Private Sector Investment Finance in an integrated manner.

Blended finance is managed within the agency's emerging PSIF (private sector investment finance) portfolio. The PSIF criteria include[5]:

Direct provision of blended finance marks a learning process for JICA. It has accumulated experience via co-financing private sector projects, for instance with the International Finance Corporation (IFC) or the Asian Development Bank (ADB) and by establishing a revolving fund focused on the water sector which seeks to mobilize private finance through the use of blending.[6]

As many others, JICA complements the direct governance approach with the delegated one. For instance, the agency has a $US 1.5 billion blended finance credit line with the Asian Development Bank.

[5] JICA, 2019. Private Sector Investment Finance.
[6] JICA, 2018. Public Private Partnerships and Partnership with the Japanese Private Sector.

Canada's International Assistance Innovation Programme (IAIP)

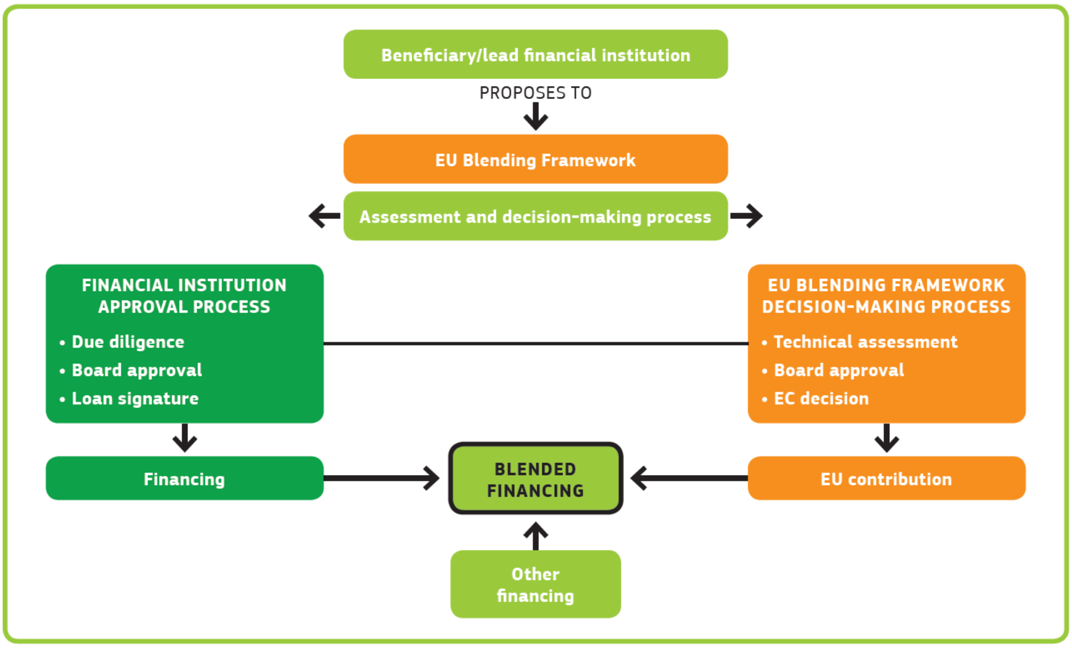
Canada offers funds for blending through vehicles such as the International Assistance Innovation Programme (IAIP). In 2018, Canada allocated US$ 900 million over a 5-year period to "build markets to benefit the underserved" through blended finance. The package will include debt (repayable contributions); guarantees; equity, and non-repayable grants. The IAIP will make investments in line with the OECD Principles and will prioritize initiatives that demonstrate these selection criteria: sustainable development impact, additionality, financial sustainability and minimum concessionality. The IAIP also has a transversal focus on gender equality.

IAIP has a dedicated team of about 20 people who evaluate proposals on a case by case basis. Lessons utilized in the selection process often come from climate finance work, e.g. the Green Climate Fund. The ultimate test is the ability to demonstrate "return on development impact".

Source: interview with GAC staff, GAC's webpage for the International Assistance Innovation Program.

Case study of a delegated institutional approach: European Commission

The European Commission has a unified **EU Blending Framework** with a **Board** responsible for providing opinions on all blending operations. Chaired by the Commission, the Board consists of representatives of the European External Action Service (EEAS), the EU Member States as voting members, and financial institutions as observers. The Board meets two to four times per year, and the meeting is organised back to back with the respective *financing instrument committees* whenever possible. To complete the picture, technical assessment meetings are held to review and discuss the pipeline of projects to ensure coordination at the earliest possible stage, e.g. on geographical balance and political/thematic objectives. Project proposals can be submitted by lead financial institutions as well as beneficiaries.



How to exercise donor oversight once a BF project is off the ground? Monitoring and evaluation are of utmost concern to donors as mentioned earlier in the account of complexities associated with long delivery chains. The European Commission takes care to maintain its involvement in these later stages of the project lifecycle:

UNIT/ENTITY	TASK	OUTPUT
Lead financial institution	Primary responsibility for monitoring and reporting according to contractual obligations Should contact the EU Delegation upon monitoring missions (where joint monitoring missions are possible)	Regular monitoring missions and progress reports
EU Delegation, DG DEVCO/NEAR Headquarters	Participate in joint monitoring missions Receive, review and approve periodic reports from lead financial institution; ensure appropriate monitoring and progress against objectives and indicators defined for the project Perform pre-financing payments (when relevant); manage information related to the financial statements received on the fiduciary account (e.g. decommitments in case of reflows or repayments) (see Annex 9) Initiate proposals for results-oriented monitoring projects	Payments Corrective actions Decommitments in case of generated reflows or repayments
DG DEVCO/NEAR Headquarters	Participate in selection of projects to be proposed for results-oriented monitoring	Results-oriented monitoring reports

The EU Blending Framework and associated governance processes have last been upgraded in 2014 based on recommendations made by the EU Platform for Blending in External Cooperation (EUBEC) and by the European Court of Auditors (ECA).[7]

III. Development financiers

While development financiers are firmly committed to delivering on all SDGs, each has a unique mandate that sets strategic direction for the use of blended finance. For some, the spotlight is on poverty reduction, for others, on climate action. Their system of prioritization is based on their mission, legacies, shareholder interests and client demand.

Most MDBs and DFIs have made significant headway in recent years to integrate the good practices inherent in the OECD Principles in their existing governance frameworks for BF. However, they have also elaborated more specific DFI Enhanced Principles for Blended Finance, which cater to their status as development financiers and – for the most part – banks. These reflect expectations by the international community for MDBs and DFIs to mobilize additional finance for the SDGs, in the spirit of the "Billions to Trillions" narrative. In this respect, the DFI Principles are primarily concerned with the strategic use of BF to mobilize additional *private sector financing* for the SDGs.

The DFI principles constitute the core of MDBs' and DFIs' approach to governance of blended finance, and they are presented in the figure below.

[7] European Commission, 2015. Guidelines on EU Blending Operations.

Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations

Rationale for Using Blended Concessional Finance

- DFI support for the private sector should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector. Blended concessional finance should address market failures

Crowding-in and Minimum Concessionality

- DFI support for the private sector should, to the extent possible, contribute to catalyzing market development and the mobilization of private sector resources and minimize the use of concessional resources

Commercial Sustainability

- DFI support for the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must contribute towards the commercial viability of their clients. Level of concessionality in a sector should be revisited over time.

Reinforcing Markets

- DFI support for the private sector should be structured to effectively and efficiently address market failures and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.

Promoting High Standards

- DFI private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity, and disclosure.

To operationalize the DFI principles, MDBs/DFIs have incorporated independent decision reviews or separate decision-making bodies for blended finance into existing governance frameworks for all investments. To minimize conflicts of interest (e.g. beneficiaries having a say on the fate of their projects via donor-driven committees), development financiers have designed detailed processes to ensure that rules are observed and imposed restrictions on information-sharing. These features enable donors who provide MDBs/DFIs with concessional funds for blending to exercise their oversight role without compromising the integrity of the decision-making.

On the **institutional level,** there are at least three main models for governance of blended finance:

1. **Embedded model:** regular operational staff are responsible for structuring both the concessional finance and any additional DFI own-account finance but follow special policies and independent reviews with respect to the use of concessional donor tranches.
2. **Dedicated model:** special blended concessional finance investment staff manage concessional funds, often for specific donors or for certain sectors and represent blended concessional finance issues in approval committees.
3. **Parallel model:** A separate/dedicated blended concessional finance investment unit with investment staff covers all blended concessional finance investments, possibly with dotted line representatives in different operating departments. Staff in these units are often paid for by donors and may report to management outside of the investment departments.

On the **project level,** MDBs and DFIs also have different approaches to decision-making on individual blended finance operations:

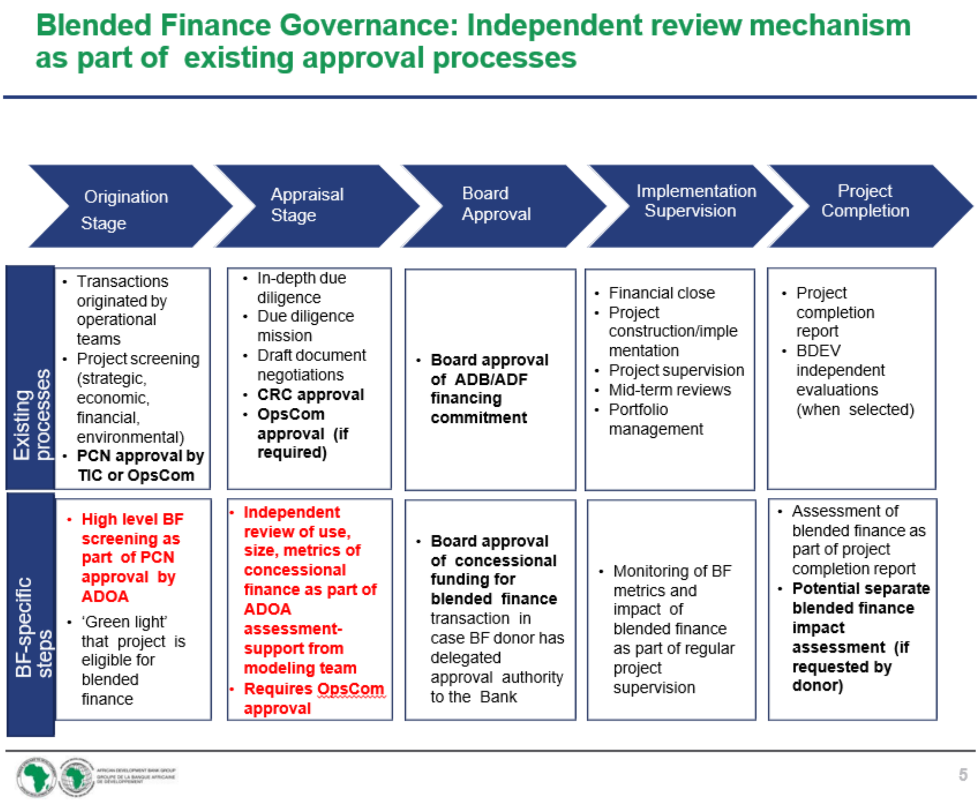
1. Separate teams represent the interest of the concessional funds, including when a project faces financial difficulties.
2. Single teams but separate input by concessional finance program specialists.
3. Separate decision-making bodies for concessional funds.
4. Single decision-making bodies, but separate review or input by concessional finance teams or donors, or independent advisory committee appointees.

MDBs and DFIs have made considerable progress on implementing these governance frameworks and took stock in the 2019 report of the DFI Working Group on Blended Concessional Finance for Private Sector Projects.[8] In general, extensive efforts have been made to provide appropriate independent input and oversight, for instance with dedicated teams or departments. Staffing of teams that oversee blended finance is also being refined, with integration of more experts specialized in blending and BF training for investment officers. Furthermore, the principles are now explicitly addressed in formal project approval processes, for instance via checklists embedded in the decision-making processes at appraisal stage.

Going forward, MDBs and DFIs need to continue sharing their experiences and fine-tuning best practices in their governance of blended finance both in terms of **institutional frameworks** and **project-level processes**.

Case study of an institutional approach: African Development Bank (AfDB)

Conceptually, AfDB has adopted a system-level solution for the governance of blended finance by incorporating blended finance-specific elements in its Additionality and Development Outcomes Assessment Framework (ADOA). While ADOA provides a general framework for ex-ante development impact assessment of private sector operations, additional analyses are now being conducted to ensure adherence to the blended finance principles (see below):[9]

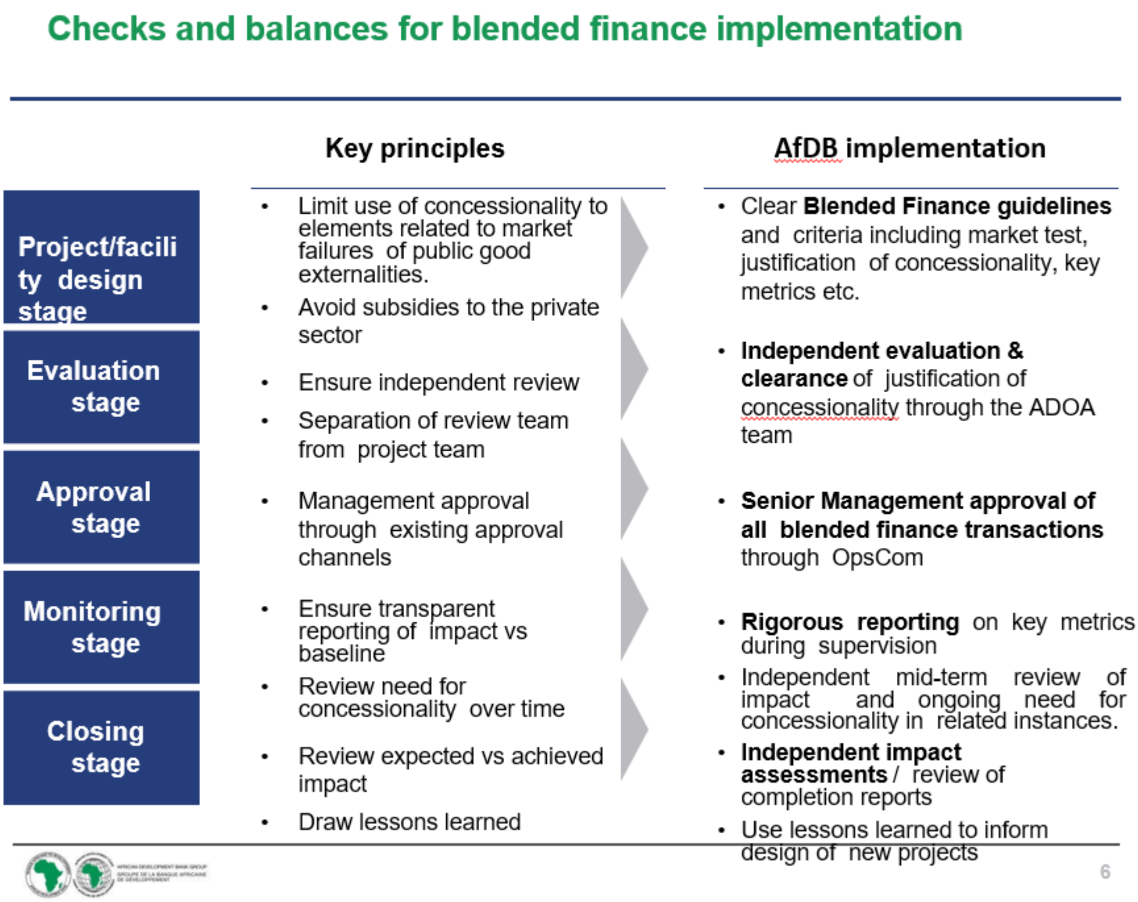


[8] DFI Working Group on Blended Concessional Finance in Private Sector Projects, 2019. Joint Report, October 2019 update.

[9] Obtained from AfDB staff participating in the DFI Working Group on Blended Concessional Finance in Private Sector Projects.

ADOA has been developed in the AfDB's Development Research Department's (EDRE), established in 2007. EDRE focuses on research and analysis on priority social and economic development issues that support the Bank's policy and operations agenda.[10]

In terms of implementation, AfDB has a centralized Blended Finance Taskforce chaired by the Director of Delivery and Impact. AfDB considers it crucial to ensure independent input and review at all stages of the project lifecycle.[11]



Case study of the project-level process: European Bank for Reconstruction and Development (EBRD)

The EBRD seeks to ensure that concessional funds – including co-investment grants and guarantees, amongst other instruments – are blended with its own finance and private sector investment in a way that facilitates the transition to sustainable market economies. In 2017, almost 70 per cent of blended concessional finance in private sector operations targeted green growth.

According to its 2015 guidelines for the use of concessional finance, EBRD employs blended finance checklists in the project approval process, and it uses independent input and oversight for blended

[10] AfDB – Macroeconomics Policy, Forecasting and Research.
[11] Obtained from AfDB staff participating in the DFI Working Group.

finance operations. This includes a full set of BF-specific project requirements and parameters for approval. The project approval process is summarized below.[12]

Project idea

- Relevant committee – Operations Committee (OpsCom)
- Document for approval - Concept Review Memorandum (CRM)
- Only basic project idea, with indicative project cost and first proposal on EBRD BF structure

Donor Engagement

- Approach to prospective donors/concessional co-investors handled by the Donor Co-Financing Team together with operational team.
- The Strategy and Policy Committee approves creation of new fund(s) for use of concessional finance.
- These funds, called 'Special Funds', are then approved by the Board. May be facilities or project specific funds

Due diligence

- Parties involved – operational leader (Banking), economist, risk officer, legal, grant finance officer (if appropriate); No formal committee structure
- Scope of work relevant to BF - effective project preparation work, including rationale of the blending structure and compatibility with the guidelines for the use of concessional finance (BF)

Final Approval

- Relevant committee – Operations Committee (OpsCom)
- Document - Final Review Memorandum (FRM)
- By this stage a full set of project parameters are presented for approval
- Includes a concessional finance (BF) checklist in line with the non-Technical Assistanec Grant Guidelines

Board Approval

- Relevant approval body – EBRD Board of Directors
- Summary of concessional finance (BF) checklist is presented as part of the project document for approval by the Board

Pre-Concept Review Memorandum requirements	Concept Review Memorandum requirements	Final Review Memorandum requirements
• Operations teams from Banking and Donor Co-Financing may discuss with relevant donors. If detailed structuring is at this stage there is a requirement to ensure consistency with the Guidelines.	• Broad rationale for the use of concessional finance • Expected size of the grant/BF and its design • How the proposed structure addresses the sustainability requirements • Envisaged degree of concessionality, along with likely source(s) of funding (indicative only)	• Project teams should complete, with the support of relevant sector economists and other relevant departments, the concessional finance Checklist • FRM documents should include the concessional finance checklist as an Annex

Case study of the project-level process: European Investment Bank (EIB)

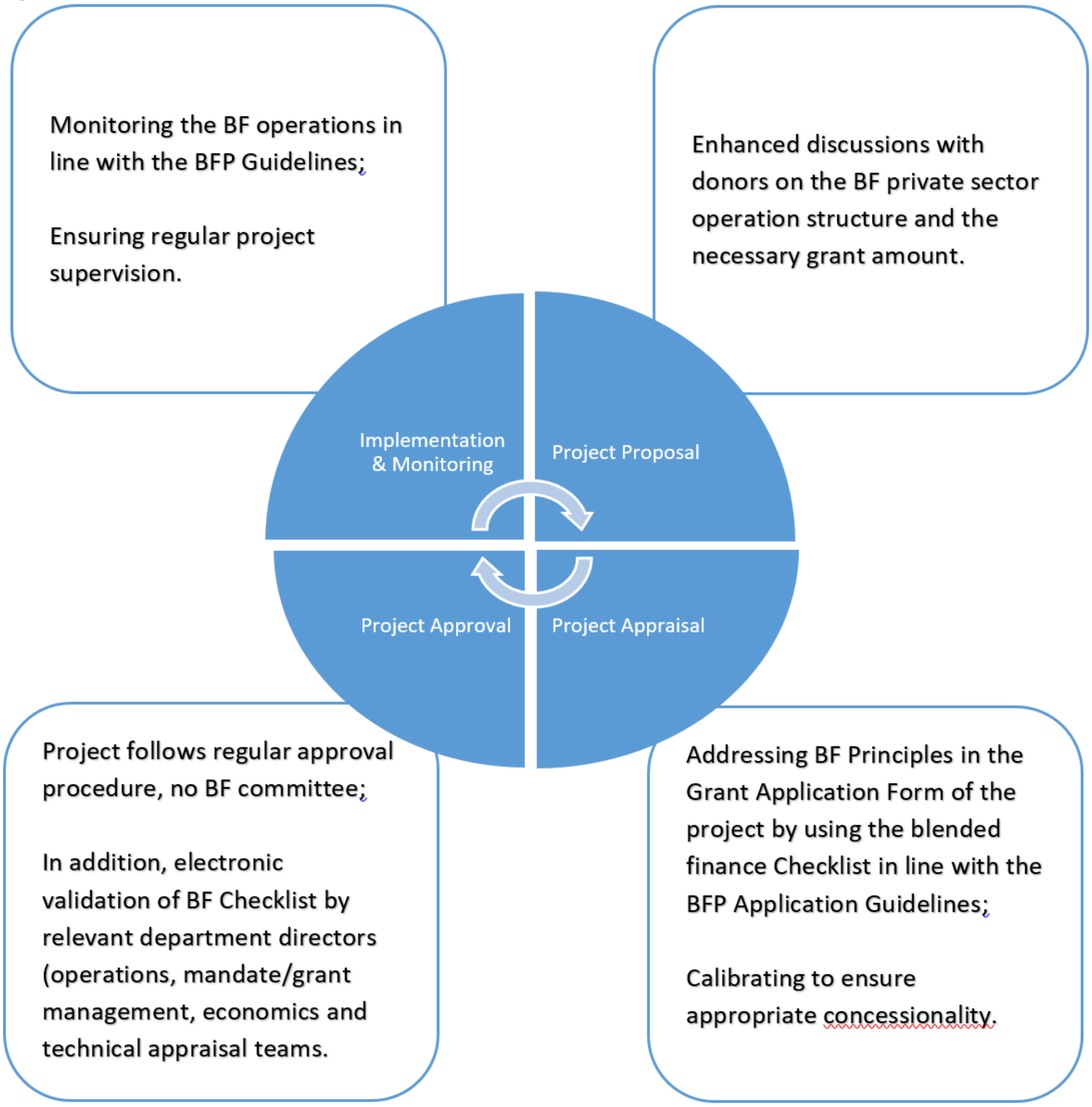
The EIB as the "EU bank" deploys blended concessional finance operations in tandem with the European Commission or with one of the EU Member States with the aim to contribute to the strategic development goals of the partner countries outside the EU. The EU contribution contracted with the EC is the largest single source of grant finance for EIB mandates and it is managed largely through the EU Blending Facilities and its numerous regional / thematic investment platforms (like Neighbourhood Investment Platform or Africa Investment Platform). To accommodate other donor grant money, various donor partnerships (like Economic Resilience Initiative Fund (ERIF) or Luxembourg Climate Finance Platform) were established. Grant contributions towards private sector are deployed usually through financial instruments (layered fund operations or partial portfolio guarantees) thus unlocking additional financing

[12] Obtained from EBRD staff participating in the DFI Working Group.

for development by reducing (real or perceived) risk.). The requests for the grants and justification of their use are typically requested via a Grant Application Form (GAF).

To reflect the BF principles, the EIB has incorporated a BF checklist along the side of the GAF that pertains to blended concessional finance projects for the private sector outside the EU. This element is additional to the Article 19 procedure embedded in the EIB's Statute, which compels the EIB to request the EC's opinion on all financing operations.

Additional elements to the EIB project cycle for Blended (concessional) Finance (BF) private sector operations



IV. Conclusion

Conscious of dynamic developments in the BF marketplace, this paper recognizes the importance of continued commitment to refinement, which is particularly pertinent in the area of good governance, and to regular stock-taking of BF governance approaches.

On the one hand, **efficiency** will require institutions to minimize overlaps and duplications, particularly in project approval processes, to ensure that investment decisions on BF can be made flexibly without too much red tape. Down the line, this may lead donors to gravitate either to direct governance models for BF, or to simplified delegated agreements with DFIs. Among development financiers, parallel models may prevail if donors demonstrate willingness to dedicate expertise and resources, at least during the startup phase, to fully differentiate the governance of blended finance projects from own account finance. Alternatively, MDBs/DFIs – especially those with leaner staffing – can graduate from embedded models of BF governance to dedicated ones, via capacity building on BF among investment officers and establishment of specialized committees.

On the other hand, **transparency** will compel BF providers to keep enhancing oversight. In MDBs/DFIs, this could generate tensions between providers of donor resources and Boards that represent the institutions' shareholders. Looking ahead, development financiers will need to strike a delicate balance – for instance, by transitioning from BF checklists to upgraded frameworks for assessing additionality and development impact to reflect the unique features of blended finance projects. At the same time, donors might seek to improve coordination among the ministries / agencies involved in international development (foreign affairs/development) and DFI/MDB governance (finance) to project coherent positions.

With this in mind, the next iteration of this paper should examine not only the progress among donors and development financiers, but also good practices among philanthropies and in the private sector to allow for a full comparison.

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