On May 9, 2019, the Stanford Energy Sustainable Finance Initiative (SFI), in partnership with Bank of America (BofA) and the World Bank Group (WBG), hosted a workshop on blended finance. The workshop was held in recognition of the fact that flows of private capital into sustainable projects in developed and developing markets is not meeting global ambition toward the Sustainable Development Goals (SDGs). The day’s discussion was oriented around an investigation of the organization, structure and performance of blended finance vehicles. The goal was to identify models for success and drive toward a blueprint for a vehicle, based on research and analysis, with greater potential to increase the speed and scale of capital flows.

What follows is a summary of the discussion and next steps.

“There’s plenty of money out there, we just have to organize it.”

**SETTING THE STAGE**

*Blended finance* is defined as the use of catalytic capital from public or philanthropic sources to increase private sector investment in developing countries for global development impact. It is a structuring approach that allows different types of capital (whether impact oriented or commercial) to invest alongside each other while achieving their own objectives (e.g. financial, social). *Definition courtesy of Convergence.*
Catiana Garcia-Kilroy, Lead Securities Market Specialist, WBG kicked off the conversation with an overview of the WBG’s principles, challenges and opportunities with regard to blended finance. The five enhanced principles of blended finance are: 1) additionality; 2) crowding-in and minimum concessionally; 3) commercial sustainability; 4) reinforcing markets; and 5) promoting high standards. The main challenges WBG is encountering in making blended finance effective include: 1) lack of a standardized system or approach; 2) lack of a clear pathway to reach scale (e.g., which investments and countries; what type(s) of vehicles); 3) the need to solve investability challenges (e.g., information asymmetries); 4) the limits of blending (e.g. leverage of 1:2 on average, 1:4 at best); and 5) the need for blending strategies to better leverage local capital, which has the power to reduce information asymmetry and encourage political buy-in.

Catiana emphasized the challenges DFIs face in terms of reinforcing markets and encouraged the group to think about how blended finance can serve that purpose. She also stressed the need for blended finance to take an integrated scope, asserting that the best results occur when vehicles attack the following three elements in parallel: 1) policy and regulatory enabling environments (sector reforms as well as local financial markets); 2) specific project or program of relevance; and 3) political cycles in country. She posited that perhaps narrowing the scope of blended finance might help reach larger scale.

Vipul Bhagat, Global Client Leader, International Finance Corporation discussed IFC’s interest in figuring out how to scale the use of blended finance. The financing need for SDGs is enormous, to the tune of $4 trillion per year. IFC is one of the major players in the field with a $1.5 billion portfolio. There are numerous commitments and initiatives both at national and international levels, but individual activities and contributions will simply not suffice, yet the landscape remains highly fragmented without effective coordination. The question is how to work better together to scale up.

The IFC sees blended finance as a tool that mitigates risks and opens doors for projects and clients, catalyzing investment where it is needed most. Based on experience, IFC believes blended finance must be used as part of a broader strategy that includes regulatory and pricing reforms to achieve desired levels of leverage and impact. Further, successful deployment of blended finance requires a well-crafted risk/return allocation. Challenges remain for publicizing what blended vehicles can do and what they look like (e.g., even internally, blended finance vehicles are not categorized well at IFC and not many realize that the Amundi platform offers blended finance vehicles).

Thomas Heller, Faculty Director, Stanford Sustainable Finance Initiative raised a series of key questions for the group to consider and come back to throughout the day’s discussion, including:

1. Which definitions are most useful for us to consider blended finance?
2. What are the practices that we can use? Are there better ways institutionally for us to organize blended finance?
3. Where does this money actually move? And what is its impact?

Tom expressed the need to know much more about the vehicles through which blended financings are taking place. Specifically, the need to understand whether vehicles are governed as independent vehicles or if they are more like classic IFC structures. Blended finance governance and legal models require a lot of investigation to understand who gets what and who has what influence over what/which decisions. Collaborators matter too: working with a government’s finance department is very different than working with the climate department. Coordination remains difficult.
Using CPI’s map of climate finance flows, Tom emphasized that we have a better understanding of the source of climate finance, while very little is known about the targets of finance flows. Public money mobilized through investment is well known, while important elements such as carbon pricing, renewable portfolio standard (RPS), insurance, guarantees, and mandates in China are invisible in the chart. Transaction costs, pre-investment arrangements, risk return characteristics changed by public investment for private money are also not shown. Also missing are state lending/enterprises and private flows from emerging economies and R&D budget for carbon capture & storage (CCS), hydrogen, new technology for decarbonization. These omissions are to illustrate how much further research and analysis is still needed to strengthen our understanding of the landscape of climate finance.

Tom went into some detail on SFI’s and CPI’s work on China Green Finance. China has through its green finance committee issued a catalogue of 39 different categories that can be considered green. There are many questions raised by this program: How good is the reporting – and how much transparency is there? Who is doing the accounting? What is the quality of the China Green Bond Market? What is the economic productivity of China’s Green Finance Investments? What is the relationship between green and productivity? These questions raised in the context of China’s Green Finance Program parallel the type of investigation required to better understand the efficacy of current blended finance practices and to design effective blue prints for future vehicles with greater likelihood to achieve desired levels of impact.

EXAMPLE 1: CLIMATE FINANCE PARTNERSHIP (CFP)

John Morton, from the Aligned Intermediary who joined us by video and Marilyn Waite, Climate Finance Program Officer at the Hewlett Foundation walked us through their experience establishing the Climate Finance Partnership. The goal of the CFP was to design a flagship investment vehicle composed of a consortium of six entities - three foundations (Hewlett, Grantham Foundation, IKEA) and two countries (France, Germany) and Blackrock, that could be announced at French President Emmanuel Macron’s One Planet Summit. The specific emphasis on mobilizing large asset owners (pension funds, endowments, insurance companies, etc.) was particularly compelling to Marilyn at Hewlett. John stressed the value of having a high-profile convening (and endorsement, in this case from Macron) to drive action.

The CFP is not attempting to be a lever on policy, rather it will allocate capital into markets where policy is relatively stable. The CFPs key innovation is to purposefully and intentionally design a vehicle to meet the needs of the most conservative capital in the stack, that is, to get first time institutional investors to move into critical markets from a climate perspective. This seems simple but is rarely done. Key to delivering that innovation was having an intermediary to bring parties to the table and work through the difficult task of organizing several tranches of capital. CFP’s focus includes renewable energy, energy efficiency, energy storage and ultra-low emission or electrified transportation and mobility services.

The CFP is hoping to have final set of terms agreed either by this August or September. Outstanding issues include:

- What are the country income considerations?
- What is the proper reward for concessionary capital taking a first-loss position?
- Where should CFP play on the sectoral spectrum?
- Finalizing specifics around ESG and gender lens considerations
The CPF is, at times, outside of every party’s comfort zone – which is a good thing. Every party to the transaction brings its own interests and priorities – and because of that, there is a very strong temptation and urge to layer in several layers of priorities and requests. It has been necessary, at times, to remind people that capital mobilization is a primary goal.

The discussion surfaced some tension between achieving climate objectives and the possibility that the concessionary capital is ultimately in service of breaking down misperception and misunderstanding of risk and opportunity among private equity funds and their limited partners. Another key topic of discussion was the question of whether or not there is “plenty of debt”. CFP believes there is, Karen Fang from BofA and Shilpa Patel from ClimateWorks questioned that hypothesis based on their experience. More specifically, Karen shared that debt capital has been “shockingly limited” and that BofA has an innovative structure to warehouse debt to underwrite more green bonds worldwide, particularly in India.

At the time of announcement, CFP was aiming to raise $1B for this strategy. At this time, it’s unclear if they will get there.

Frédéric Samama, Deputy Global Head of Institutional and Sovereign Clients, Amundi Asset Management added another example to this session, the Amundi Planet Emerging Green One fund (EGO). The initiative started two years ago when IFC selected Amundi to address the need for capital for green projects in developing countries. Amundi teamed up with various players to decide on a single ESG policy. The fund closed one year ago and has won five awards. Returns are exceeding targets (5.5% actual compared to 5% forecasted).

Other global comments from the session were:

- The need to figure out Basel III, which is currently undermining institutional ability to deliver on the aspiration of blended finance. Policy considerations are critical. (Note: related Stanford research can be found here.)
- Academics can help with these efforts by doing proper studies of what worked and what didn’t work (case studies).
- In the emerging markets blending is required for many things – not just for the project itself, but also for the market (i.e. political risk). There is a lack of capacity in local governments to structure deals. Another challenge is getting new players involved.
- Infrastructure and renewable energy are sectors that have demonstrated scalability.
- The point of Blended Finance is to increase private investment in and not necessarily into, emerging markets (i.e. National/domestic actors are critical.)
- Blended Finance is about subsidies or scarce capital unlocking private capital that is agnostic to mission (distinct from impact investing); but it is generally the subsidy provider that sets the mission/agenda.
- The enabling environment – particularly through policy reforms – is a key success factor.

GLOBAL LANDSCAPE: WHAT WE KNOW

Joan Larrea, Chief Executive Officer, Convergence shared the network’s data and trends in blended finance. Convergence takes snapshots of transactions where money is mixed, it is not (yet) able to track project-level flows of capital. Convergence has tracked $127B+ mobilized since 2005, involving over 1,000 investors and 3,300 financial commitments. Regional trends show the majority of funds focused on lower-middle income countries, with upper-middle- and low-income countries sharing the other half of the pie. Energy, agriculture and infrastructure (non-energy) are the top sectors (so too financial services, but that’s hard to separate given
the actors involved in blending). The average deal size varies by sector, with energy, healthy and industry deals averaging over $500M.

Convergence tracks four blended finance archetypes: concessional debt or equity (68% of deals), guarantee & risk insurance (29%), design/preparation funding grant (15%) and technical assistance funding grant (38%). Development banks not typically deploying concessional capital. Convergence does not have data on where national governments are investing to support commercial projects (i.e. favorable terms, supportive policies, subsidies, etc.).

Key questions and comments raised in the discussion:

• Should blended finance be tracked according to quantitative objectives, and if so, who sets the objective(s)?
• The point of blended finance is to increase private investment in, and not into, emerging markets. The role of national banks is, therefore, critical.
• It would be helpful to incorporate Government subsidies into blended finance analyses.
• At this period in its evolution, Convergence’s database can be compared to work done at the IFC in the early 90s and the construction of an emerging markets database. This was at time when data was scarce, and IFC was the only data source for emerging markets. In the early years, people complained about the lack of specific types of information but despite its imperfections, the data was valuable and IFC ultimately sold the database to S&P.
• One of the big questions is how we achieve scale. Renewable energy (RE) is good – but RE, at least in middle income countries, needs less and less blended finance. For other issues, like water, blended finance could be a real gamechanger.
• We shouldn’t be limiting the definition of blending. For instance, BofA’s India project blending with its own money. This kind of activity isn’t captured in Convergence’s database.
• In the US, the perspective is so different. In the US, there’s a whole profession of subsidy chasers. SME finance only happens in the US that way.
• There’s a constant back and forth between scale and innovation. There are projects that may be very enticing in certain areas and with certain countries, but that might not always be applicable everywhere else.
• Convergence serves as the the best source for blended finance knowledge but a data gap persists. The limitations of Convergence’s data included a narrow interpretation of technical assistance and not capturing state-driven enterprises (particularly relevant to emerging countries) and local markets/stakeholders, etc.
• A narrative challenge persists - for the private sector to actively engage, it is crucial to have a good track record of what worked and what didn’t. Even internally IFC has problem categorizing its experiences on Blended Finance.

EXAMPLE 2: INFRASTRUCTURE DEVELOPMENT IN COLOMBIA

Clemente Del valle, CEO National Development Bank for Infrastructure of Colombia presented a case study of blended finance and toll roads in Colombia. The public-private partnership was purpose built to attract investment from the private sector into much needed road infrastructure to subsidize the cost of construction and reduce high preconstruction rates. The blended vehicle, FDN, mobilized capital from local and international banks, debt funds and capital markets, amounting to $2.3 billion of committed capital in three years. By 2019, 22% of capital was from institutional investors: rare for institutional investors to invest in infrastructure,
especially at such high spending levels. Investors were attracted to the project because Colombia provided local funding to development banks, enabling them to enter with dollars and pesos – and FDN provided trade enhancements (liquidity promises).

Key lessons:

- Similar to the CFP example, an intermediary helped mobilize more money.
- Blending took away or mitigated key financial risks and brought liquidity to projects. It created a clearing-house mechanism to eliminate demand risk from developers of generation projects (facilitating harmony between supply and demand.)
- Accelerating development in a relatively short amount of time with traditional institutions is challenging.
- FDN created new financial products: infrastructure bonds, loan portfolio securitization, co-investments with pension funds and CDPQ.
- Currently exploring whether it is possible to apply the FDN model to support entry of renewable energy in Colombia.

STRUCTURAL BARRIERS FOR ASSET OWNERS

Ashby Monk, Executive Director, Stanford Global Projects Center talked to the group about what is needed to fix capitalism and unlock capital for sustainable infrastructure. Ashby is like a great jam band – better live. Below is an attempt to summarize his key points:

- Blended finance is opportunity to insert innovation into organizations that traditionally avoid innovation.
- Blended finance combines multi-objective capital to reward investors on the upside and limit risk on the downside.
- Pension funds, sovereign wealth funds and endowments have enormous amounts of capital ($100 trillion) with potential to solve social and environmental problems but they need help innovating.
- Knowing what to do is not the same as doing what needs doing.
- Innovation is hard in pension world for good reasons: prudent person rule (peer risk), monopoly over assets (guaranteed survival), mediocre compensation (creative thinking not rewarded), poor governance (bureaucracy), consultant business (misaligned advice), and a focus on efficiency (often at odds with innovation.)
- What is it that long-term investors actually do? Their production function is: people + process + information + capital = more capital. The environmental enablers of this function are: culture, governance and technology.
- How can investors improve on their model?
  - Technology can help deliver better risk management and facilitate knowledge sharing.
  - Culture can help focus on longer time horizons, recruit top talent, and create a sense of accountability.
  - Governance can create new comparative advantages around people and processes.
MODELS FOR SUCCESS

Karen Fang, Managing Director, Head of Global Fixed Income, Currencies and Commodities (FICC) Cross Asset Trading & Optimization, Bank of America and Tom Heller, Faculty Director, Stanford Sustainable Finance Initiative led the group through a discussion of models for success. Bank of America’s Dan Letendre, Senior Vice President, CDFI Lending & Investing Executive and Jackie VanderBrug, Managing Director, CIO, Global Wealth Management helped kick-off the discussion by articulating how blended finance intersects with their business activities.

Dan analogized his activities in the CDFI lending and investing space to blended finance. Instead of ‘blended’ he calls his portfolio “subsidy capital”. His portfolio offers loans at lower rates (or higher risk) and also provides grant money for projects in low-income communities for affordable housing, health care and education. The allocation doesn’t necessarily result in capital loses, but it does have opportunity cost. Jackie discussed the bank’s private wealth clients’ interest in thematic investing and the potential for HNWs to participate in blended finance through the use of Donor Advised Funds.

Karen suggested two foundational questions for designing successful blended finance vehicles:

1. What is the content (i.e. sectors, geographies, risk/return expectations, technologies/projects and social/market/regulatory expectations)?
2. What is the wrapper (e.g., vertical traunching according to risk tolerance or horizontal traunching where time or impact goals bridge to success)?

In addition, the group highlighted the following questions and foundations that will be key to the design of successful blended finance vehicles:

• Understanding the different types of blended finance and their relative efficacy and efficiency to effect specific impact or policy goals. (e.g., capital sources, subsidies and mandates, organizational structures and cultures, local resource base, various financial instruments, etc.)
• Understanding the drivers for scale in each impact segment or geography or capital source.
• More investigation of opportunities that fit into a fixed income bucket.
• Exploring the opportunity to create secondary markets (e.g., ABS, DAFs, etc.)
• The role rating agencies could play in unlocking the global international debt market.
• Legal frameworks are critical to the equation – successful models will require policies that create conditions for work and/or leveraging finance to create policy reforms.
• Pursuit of alignment to drive more projects and capital into vehicles. Intermediaries can be helpful in bringing together unlikely bedfellows and keeping them at the table.
• The field needs to do a better job of telling stories more often and more effectively.
• The field should contribute data in service of better storytelling and categorization.
• Key to success will be understanding and overcoming organizational barriers. Many of the organizations involved in blended finance have very different cultures and systems. This can be a problem and reinforces the need for aligned intermediaries to translate styles and smooth edges.
• A clear definition of objectives is key and terminology matters.
Specific models to consider included:

- US War Bonds in WWII
  - Government offers credit enhancement or first loss
- An open-ended private sustainable infrastructure fund with specific sector focused projects

Common challenges included:

- Financing need for SDGs is enormous, to the tune of 4 trillion/year. The gap between demand and supply was particularly felt when Vipul pointed out that even IFC, one of the major players in the field, is limited to having a $1.5 billion portfolio. There are numerous commitments and initiatives both at national and international levels, but individual activities and contributions will simply not suffice. The landscape, however, remains highly fragmented without effective coordination.
- No agreement on having specific definitions. To some terminology matters while to others it’s a constraining factor.
- Data gap – Convergence serves as the best knowledge management platform for BF with certain limitations (narrow interpretation of technical assistance, not capturing state-driven enterprises and local markets/stakeholders, etc.)
- Narrative challenge – for the private sector to actively engage, it is crucial to have a good track record of what worked and what didn’t. Even internally IFC has problem categorizing its experiences on BF. A seminal initiative/high-level political commitment is needed.

LOOKING AHEAD TO APEC 2019

Tom Heller, Faculty Director, Stanford Sustainable Finance Initiative and Svetlana Klimenko, Lead Financial Management Specialist, World Bank Group concluded the day with an articulation of next steps working toward the Asia-Pacific Economic Cooperation meetings in Santiago in November 2019. We articulated the following desired deliverables and schedule.

- **Summer/Fall 2019**: SFI will research questions raised in the workshop and produce a thought piece that includes a collection of case studies and a blueprint for a blended finance vehicle based on our findings regarding optimal structure, governance and scale.
- **Summer/Fall 2019**: Karen offered to put together slides further expanding on her “open-ended private sustainable infrastructure fund” idea and how it would work from BofA’s perspective.
- **September 2019**: The group expressed a desire to reconvene to debate, discuss and refine the blueprint.
- **At APEC**, we discussed the following possibilities:
  - A presentation for global leaders on what’s required to assemble capital from different sources into different capital stacks, including a discussion of how policy can facilitate success.
  - Announce the creation of a new private investment vehicle focused on a few areas that need higher risk premium and trancheing where all attendees commit small portion of assets.
  - Propose solutions for the organizational barriers standing in the way of working together to efficiently to churn out vehicles and projects.
Ask for commitment from world leaders to a few impact indicators (i.e., what they’ll do as guarantors and acknowledgment that it is acceptable within their fiduciary duty to investment in SDG projects.)

Challenge countries to come up with budgetary or regulatory commitment as offer to institutional investors in the room.

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