Organisation for Economic Co-operation and Development

DCD/DAC(2020)42/FINAL

Unclassified

English - Or. English

29 September 2020

DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE

Blended Finance Principles Guidance

17 September 2020

Further to the written procedure launched on 17 September 2020, no comments have been received from Delegations by 25 September 2020 deadline.
The Blended Finance Guidance is now considered approved by the DAC and issued as FINAL and declassified.

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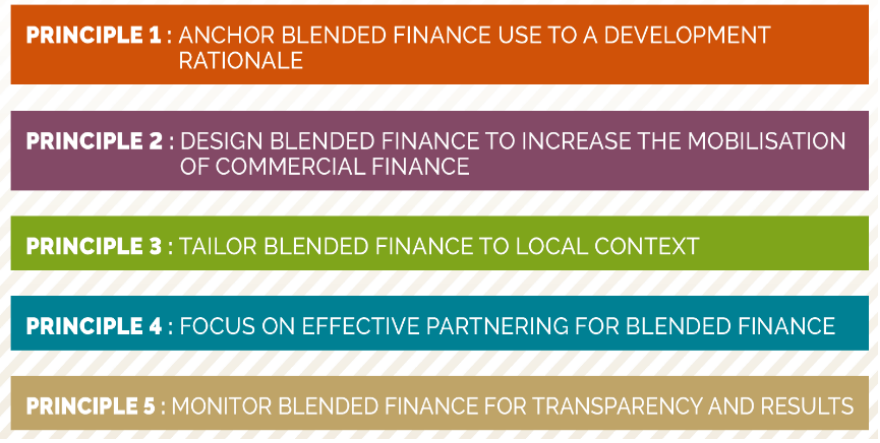
Blended Finance Principles Guidance

1. Executive Summary

1.1. Introduction to the OECD DAC Blended Finance Principles

1. **At the DAC High Level Meeting on 31 October 2017, Members of the DAC adopted the five OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs** (see Figure 1.1 below). Reflecting the development mandate of DAC donors, the Principles are targeted at the policy level, and aim to ensure that blended finance is deployed in the most effective way to address the financing needs for sustainable development, by mobilising additional commercial capital and enhancing impact. It should be noted that the OECD DAC Principles are a policy tool for all providers of development finance - donor governments, multilateral donors, development co-operation agencies, philanthropies and other stakeholders. The Principles were elaborated in close co-ordination with other international initiatives on blended finance, such as the DFI Enhanced Principles on Blended Concessional Finance for Private Sector Projects, which are targeted at the operational level (IFC, 2017[1]).

Figure 1.1. The OECD DAC Blended Finance Principles



Source: (OECD DAC, 2018[2])

2. **The OECD DAC Blended Finance Principles have been embedded into the international development architecture** and recognised as the de facto practice for countries, donors, organisations and actors to follow when applying blended finance. The Principles have been referenced under a number of G20 and G7 Presidencies. Under the Canadian Presidency, the G7 committed to "work to implement the OECD-DAC Blended Finance Principles including promoting greater transparency and accountability of blended finance operations" (G7, 2018[3]). In the G20 Osaka Declaration, leaders recognised that blended finance "can play an important role in upscaling our collective efforts" (G20, 2019[4]). Under the G7 French Presidency in 2019, the G7 further highlighted their support "to mobilise additional resources for development and help increase the impact of existing resources" and [support to] "the implementation of the OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs" (G7, 2019[5]). Along this, the OECD DAC Blended Finance Principles have shaped the blended finance policy context

and discussions with partners such as the United Nations (UN), the European Union (EU) and the World Economic Forum (WEF) in progressing blended finance best practices.

3. In light of unprecedented economic impact of that the COVID-19 crisis that is expected in to have on developing economies, and given the increasing financing needs, the OECD DAC Blended Finance Principles can also effectively inform donors when they are responding to the COVID-19 pandemic[1].

4. All relevant, higher level, commitments made by DAC Members in relation to development co-operation apply to blended finance in the same way as to other financing approaches. These include, amongst others, commitments on official development assistance (ODA) financing targets, the commitment on leaving no one behind, commitments related to development effectiveness, those related to untying aid, as well other DAC principles and standards – notably the Guiding Principles on Managing for Sustainable Development Results, the DAC Principles for the Evaluation of Development Assistance, and the DAC Quality Standards for Development Evaluation.

1.2. Purpose of the Guidance

5. This Guidance "overaching note" builds on underlying Detailed Guidance Notes drafted for each of the five OECD DAC Blended Finance Principles, as listed below:

- OECD DAC Blended Finance Principle 1: Detailed Guidance Note
- OECD DAC Blended Finance Principle 2: Detailed Guidance Note
- OECD DAC Blended Finance Principle 3: Detailed Guidance Note
- OECD DAC Blended Finance Principle 4: Detailed Guidance Note
- OECD DAC Blended Finance Principle 5: Detailed Guidance Note

6. The underlying Detailed Guidance Notes listed above will remain living documents, that the Secretariat will update in the future to reflect new developments in blended finance, other best practice examples, as well as incorporate new research, evaluation reports, and other knowledge, including from the OECD DAC Network on Development Evaluation (EvalNET)'s Working Group on Evaluating Blended Finance and the Community of Practice on Managing for Sustainable Development Results.

7. The Detailed Guidance Notes have been developed over the last three years through extensive consultation processes (listed in the acknowledgment page in the Annex) involving blended finance experts from DAC donors, development finance institutions, multilateral development banks, private investors and asset managers, partner countries, civil society organisation, and others. The Guidance Notes build on several OECD research pieces, namely results of the OECD Blended Finance Funds and Facilities Survey (Basile and Dutra, 2019[6]); (Basile, Bellesi and Singh, 2020[7]), reports on blended finance in Least Developed Countries (OECD/UNCDF, 2019[8]) in fragile contexts (Basile and Neunuebel, 2019[9]), sectorial deep-dive on Water and Sanitation (OECD, 2019[10]), Agriculture (forthcoming) and a paper on blended finance evaluation (Winckler Andersen et al., 2019[11]). Finally, the OECD DAC Blended Finance Principles should not be seen in isolation, as they are interconnected and build on a coherent principle- and value-based approach to blended finance. The Guidance Notes will be updated through ongoing policy research on critical policy topics for Blended Finance, such as COVID-19.

[1] A separate paper, presented as part of a DAC Meeting on the 15th of July 2020, discussed how the Blended Finance Principles should be best applied to support the recovery in the COVID-19 context.

8. The Guidance aims to outline policy recommendations, as well as practical steps and elements to be taken into account to facilitate understanding and good practice on the design and implementation of blended finance programmes. The Guidance also provides best practice examples (for illustrative purposes) and key references for blended finance implementers to follow. The ultimate objective of the Guidance is to contribute to enhancing the growth and improving the quality of finance that is mobilised and invested in sustainable development of developing countries.

9. This Guidance is structured as follows. First, the Guidance presents the blended finance context and latest trends. Second, it provides an introduction to the OECD DAC Blended Finance Principles and their policy context. Then, it summarises the core policy guidance for each of the five Principles, providing: (i) an overview of the Principle and relevant background; (ii) policy guidance; (iii) a checklist to guide implementation of the Principle; (iv) examples of best practice. Lastly, this Guidance concludes, outlining next steps.

1.3. How to make use of the Guidance

10. For an effective implementation of the Blended Finance Principles by the DAC, this Guidance should be complemented with the underlying Detailed Guidance Notes, which provide further background, evidence and tools to effectively engage in blended finance. The Detailed Guidance Notes also include examples to provide real case practices in the implementation of each principle. A checklist at the end of each Principle is provided in order to remind the user of the tasks that should be undertaken to implement each Principle.

11. Each Principle should be considered as a core element to address when approaching blended finance, with the underlying sub-principles providing further guidance. Thus, all Principles should be looked upon as a complete system. Within this system, each Principle provides guidance on the steps that be undertaken when examining or establishing a specific component of blended finance programs.

12. As blended finance is still a relatively new tool in the development co-operation toolkit and the blended finance environment is rapidly changing, new practices and approaches can develop quickly. The Detailed Guidance Notes will thus continue to be updated. It should be noted that the Guidance should not be seen as a replacement for effective due diligence, although it should assist in ensuring key elements are identified.

1.4. Guide Readership

13. This guidance note is primarily for policy makers and development finance actors interested in grasping the opportunities presented by blended finance.

14. As different actors in the development finance space have different levels of knowledge on blended finance, this paper provides an introduction to the five OECD DAC Blended Finance Principles and Guidance. Practitioners and other development finance actors can access further guidance in the Detailed Guidance Notes. This paper and the Guidance Notes can support development finance actors at different stages in their Blended Finance activities, for example:

- A Minister wishes to begin a blended finance program and would like to be aware of what are considered best practices in terms of delivery;

- A donor is considering of establishing a blended finance program. This paper and Guidance Notes provide the information necessary to undertake the analysis and evaluate whether a blended finance program is the optimal solution;
- A donor is committed to ensuring the delivery of a blended finance project and wishes to embed best practices. However, the operational staff involved has not had exposure to blended finance. This paper and Guidance Notes provide them with a roadmap on key elements such as how to engage with the private sector;
- A civil society organisation or think tank that wishes to monitor and analyse developments of the development finance system can use this paper and Guidance Notes to obtain quality guidance on how to assess often complex arrangements such as blended finance programs.

15. Finally, this Note and Guidance can also be used to support those actors that have well-established blended finance programs, but wish to further explore and develop a specific element, such as transparency or risk management.

2. Blended finance context and trends

2.1. Blended finance is an innovative approach to financing sustainable development

16. **Blended finance is an innovative financing approach in the development co-operation toolkit that aims to attract commercial capital towards projects that contribute sustainable development while providing financial returns to investors.** The OECD defines blended finance as the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries, where additional finance refers to commercial finance that does not primarily target development outcomes in developing countries, while development finance is public and private finance that is being deployed with a development mandate (see Figure 2.1 below). Development banks and development finance institutions (DFIs) play a critical role in blending by deploying instruments and structuring mechanisms to mobilise the private sector. Multilateral development banks (MDBs) provide the largest share of private sector investments through dedicated private sector operations. However, a wider range of diverse actors is engaging in blended finance, from foundations and philanthropic investors, to commercial actors, including institutional investors, commercial banks, private equity and venture capital funds, hedge funds, as well as corporations and SMEs (OECD, 2018[12]).

Figure 2.1. What is blended finance?



Source: (OECD, 2018[12])

2.2. Blended finance can bridge the investment gap widened by the COVID-19 crisis

17. **2020 marks the start of the Decade of Action to deliver the Sustainable Development Goals (SDGs) and climate objectives**, a call on all actors, public and private, to accelerate progress towards the collective commitment to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere. The start of the Decade of Action sounded an alarm, that progress towards meeting the SDGs remained slow and uneven.

18. **Blended finance was recognised as an important instrument in the toolbox to help bridge the investment gap for the SDGs, but for this to occur effectively would require a common framework.** Delivering the 2030 Agenda and climate objectives will require all sources of finance - development and commercial to be scaled up. Official Development Assistance (ODA) continues to play an indispensable role in financing the Sustainable Development Goals (SDGs) and leaving no one behind. However, ODA can be used more effectively in order to catalyse and mobilise private resources to finance sustainable development. Mobilising additional capital that would not otherwise support development outcomes is increasingly required to shift the trillions needed to achieve the SDGs. Blended finance is an approach aiming at attracting commercial capital towards projects that benefit society while providing financial returns to investors.

19. **The COVID-19 crisis risks triggering major setbacks in financing for sustainable development in developing countries**, where levels of domestic and external financing had fallen short of the spending needs to achieve the SDGs and climate objectives already before the crisis (OECD, 2020[13]). The increasing public spending to respond to the health emergency and economic crisis, coupled with the drop in global commodity prices as well as currency devaluations against the US dollar, further narrow down the fiscal space and exacerbate debt sustainability issues in developing countries. The COVID-19 crisis also caused massive private investment outflows from developing countries and a drop in remittances, resulting in major ripple effects on vulnerable and fragile economies and societies.

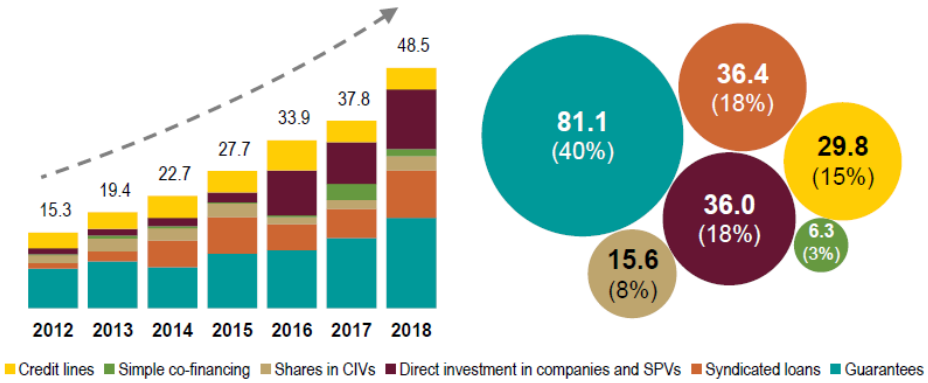
20. **Recovering from the COVID-19 crisis and delivering the 2030 Agenda will require all sources of finance to be mobilised at greater scale and speed** in developing countries. As Official Development Assistance (ODA) plays an indispensable role in supporting responses to the COVID-19 crisis, members of the OECD Development Assistance Committee (DAC) pledged to "strive to protect ODA budgets" (OECD DAC, 2020[14]). However, scarce concessional resources will need to be used even more strategically and effectively to catalyse and mobilise private sector resources at a larger scale.

2.3. Private finance mobilised through development finance is on the rise

21. **Blended finance has emerged in the broader development agenda as one important tool to mobilise private sector resources** and channel them into investment for sustainable development and climate action. Mobilisation of private finance has increased steadily over the years, and Development Finance Institutions (DFIs) have become increasingly important development finance actors to mobilise private investment. The proportion of ODA being allocated to DFIs is increasing in most donor countries, and if current trends continue, DFI financing will ultimately outstrip ODA (Spratt, O'Flynn and Flynn, 2018[15]); (CSIS, 2019[16]). However, it is not only DFIs that are mobilising private investments for sustainable development. Such efforts are undertaken by a range of development finance providers including MDBs, philanthropic organisations and donor governments, including multilateral donors such as EU institutions.

22. **OECD data show that private finance mobilised by official development finance interventions is on an upward trend and significantly accelerated in recent years.** In 2012-18, USD 205.2 billion was mobilised from the private sector, with USD 48.5 billion mobilised in 2018, thus a 28% increase with respect to 2017. Of all the blended finance approaches used to alter the risk-adjusted returns of investments and crowd in commercial finance, guarantees proved to be the instrument that mobilised most private finance from development finance, followed by syndicated loans and direct investment in companies and SPVs (OECD DAC, 2020[17]).

Figure 2.2. Amounts mobilised from the private sector by official development finance (2012-2018), by year and instrument



Source: (OECD DAC, 2020[17]), Amounts mobilised from the private sector by official development finance

23. **DAC donors, either through development agencies, DFIs or MDBs, are increasingly investing in blended finance funds and facilities.** According to the 2018

OECD Survey, blended finance funds and facilities represent a relatively small but fast growing part of the blended finance market. From 2008 to 2017, more than 195 new vehicles were established, with the respondent vehicles representing a total of USD 60.2 billion in assets under management in 2018. Governments, including development agencies, are the major investors in both facilities and funds. They are the largest provider of concessional capital, contributing 64% of the aggregate financing in blended funds and facilities (Basile and Dutra, 2019[6]).

2.4. For blended finance to work effectively, a common policy framework and increased transparency are essential

24. **Blended finance models still need to be improved in practice to achieve the 2030 agenda**. Despite the growth of the blended finance market, private finance is mostly being mobilised in middle-income countries, in sectors with a clear revenue stream, such as banking and financial services, energy and industry, mining and construction. For instance, OECD data show that only 5% of the private capital mobilised in 2017-2018 went to Least Developed Countries (LDCs) and nearly 6% targeted social sectors (such as water and sanitation, education and health) (OECD DAC, 2020[17]).

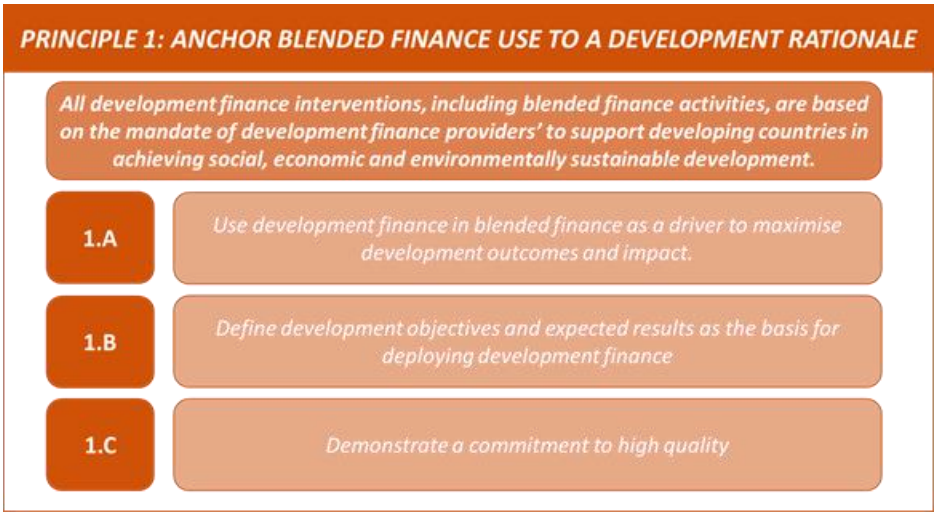
25. **There is currently very limited data on the size or shape of this market.** The OECD Survey on Blended Finance Funds and Facilities aims to gather a more comprehensive picture of the latest market trends in blended finance and to explore how their development impact is being tracked and evaluated. A lack of transparency, particularly on the commercial dimension, can undermine the use of blended finance and the potential for the market to grow.

26. **Against the background of increasing risk of fragmentation in blended finance approaches and governance, a common policy framework and understanding is crucial to ensure effectiveness.** This is why the OECD DAC Blended Finance Principles were endorsed at the DAC High Level Meeting in 2017 and are now further complemented with this Guidance. The OECD's efforts to elaborate guidance to make the use of blended finance more effective builds upon other initiatives to foster collaboration and co-ordination among actors active in this market, such as the multi-stakeholder platform Tri Hita Karana (THK) Roadmap for Blended Finance, as well as global networks such as Convergence and the DFI Working Group (THK, 2018[18]); (Convergence, 2020[19]) (DFI Working Group, 2018[20]).

3. Principle 1: Anchoring blended finance to a development rationale

3.1. Overview of Principle 1

Figure 3.1. OECD Blended Finance Principle 1



Source: (OECD DAC, 2018[2])

3.2. Principle 1: Policy Guidance

27. **Principle 1 focuses on the need to anchor blended finance use to a development rationale** so as to ensure that it is based on development finance providers' mandate to support developing countries in achieving social, economic and environmentally sustainable development. Principle 1 further specifies three sub-principles, as Figure 3.1 above shows.

28. **The imperative to anchor blended finance to a development rationale is at the core of the blended finance agenda** and it is recognised by the Tri Hita Karana Roadmap for Blended Finance (THK, 2018[18]). Likewise, the Kampala Principles of Effective Private Sector Engagement in Development Co-operation emphasise that effective partnerships with the private sector must focus on maximising development outcomes in line with the SDGs and national development priorities.

3.2.1. Sub-principle 1A - Use development finance in blended finance as a driver to maximise development outcomes and impact

Link blended finance to overarching development objectives, in line with the 2030 Agenda and climate objectives

29. Donors play a catalytic role in mobilising the private sector, and are mandated to achieve social, economic and environmentally sustainable development. To ensure this, donors should formulate the strategic ambition and policy objectives for blended finance, and link them to overarching development objectives.

30. **Donors' blended finance objectives should be rooted in international and regional agreements on sustainable development**. Examples of such agreements include, at the international level, the 2030 Agenda on Sustainable Development (United Nations General Assembly, 2015[21]) the Addis Ababa Action Agenda (AAAA) (United Nations,

2015[22]) and, at regional level, the Agenda 2063 (African Union Commission, 2015[23]), inter alia.

31. **When it comes to specific blended finance projects, implementing a robust Theory of Change (ToC) is a practical method for ensuring that interventions target the achievement of specific SDGs.** Before entering a blended finance operation, all actors should clearly understand and articulate how the particular investment is expected to lead to outputs, outcomes and eventually development impact. In setting development impact objectives and developing the theory of change, parties apply the Glossary of key terms in evaluation and results based management, adopted by the OECD DAC Network on Development Evaluation (EvalNET)'s, given its well-accepted, flexible and cross-thematic nature (OECD, 2002[24])[2].

Align the objectives of blended finance to local policy priorities

32. To the maximum extent practicable, the development objectives of blended finance should be aligned with development strategies of the partner country and linked to their SDG targets. Investors should work closely with partner countries to consolidate local ownership and capacity, respecting each country's policy space, absorption capacity, and ownership to implement policies for sustainable development (GPEDC, 2011[25]); (GPEDC, 2019[26]). Further information on how to align blended finance to local policy priorities is provided in the Detailed Guidance Note on Principle 3.

33. This is particularly important in fragile contexts and LDCs, where any external investments can shake uncertain resource equilibrium in societies at risk of conflict. **Blended finance providers operating in fragile contexts should thus ensure dialogue prior to launching blended investments**, to secure space for the expression of diverging interests, avoid an excessive weight of private commercial interests, and ultimately foster ownership by local actors (Basile and Neunuebel, 2019[9]). In conflict-affected settings, all actors involved in blended finance should consider the need for an effective implementation of the DAC Recommendation on the Humanitarian-Development-Peace Nexus, under a "do-no-harm approach" (OECD, 2019[27]).

Set clear and measurable development targets for blended finance funds and facilities

34. The 2018 OECD Survey on Blended Finance Funds and Facilities showed that while most respondents anchor their investment strategies to one or more SDGs, over a third did not formalise quantitative development targets, which may hinder the capacity of investors to capture their (intended and actual) contribution to the sustainable development objectives (Basile, Bellesi and Singh, 2020[28]).

35. While grounding the investment strategy to the SDGs is of fundamental importance**, blended finance vehicles should also anchor their activities to SDG targets.** For instance, while over 70% of blended finance vehicles target SDG 1 (ending poverty in all forms), not enough evidence is available on the extent to which they focus on specific targets, e.g. eradicating extreme poverty (target 1.1), or building the resilience of the poor and those in vulnerable situations (target 1.5). In fact, over a third of respondents did not formalise quantitative development targets, which may hinder the capacity of investors to

[2] Please note that, following the revision of the OECD DAC Evaluation criteria in 2019, a second edition of the Glossary is being produced and will serve as a useful reference point as it defines many terms used in the document – including intervention, results, output, outcome, and objective (OECD/DAC Network on Development Evaluation, 2019[73]).

capture their (intended and actual) contribution to the sustainable development objectives (Basile, Bellesi and Singh, 2020[28]).

Focus blended finance on sectors where it can achieve maximum development impact on the people and the planet

36. The achievement of the SDGs provides the rationale for the deployment of blended finance. However, **blended finance is not yet tackling all SDGs, but is mainly targeting sectors with investing opportunities and clear potential for revenue generation** (OECD/UNCDF, 2019[8]); (Convergence, 2019[29]). One of the objectives of blended finance is to reduce the (actual or perceived) risks for private investors to invest in a certain geography or sector, hence building a track record and demonstrating the viability of a transaction to ultimately develop new markets while benefitting those furthest behind. Blended structures may be needed initially to address the risk-return balance and bring the perception of risk down to its actual level, but also may serve to build a track record and gather experiences in uncovered jurisdictions or sectors, so as to gradually facilitate financially-sustainable investments in the future.

37. **Depending on the local context and project opportunities, blended finance providers may wish to prioritise SDGs that have the ability to catalyse other positive development effects while protecting the people and the planet. Proper prioritisation and sequencing** can accelerate progress toward sustainable development by facilitating the realisation of positive spillovers and limiting the impact of negative trade-offs without downplaying the importance of any specific SDGs. Blended finance providers should work with local actors to **identify the least financed sectors**, where there is the need to support the initial involvement of the private sector and in which the private sector can bring new solutions or expertise to tackle specific development challenges.

Deploy blended finance when more effective than other financing approaches, within the broader development co-operation strategy

38. **Donor governments should consider blended finance within a broader financing and development co-operation strategy and support its deployment where it is the most useful tool to achieve specific development outcomes and results**. Blended finance is one approach in a toolkit of development co-operation approaches. As such, it should be deployed when its comparative advantage and value-added relative to other tools is clear, based on ex ante assessments taking into account alternative financing approaches. The assessment of the effectiveness of the blended finance approach would need to consider both the expected development outcomes and a comparison in terms of "costs", including the fiscal implications for the partner country.

3.2.2. Sub-principle 1B - Define development objectives and expected results as the basis for deploying development finance

Set clear, mutually agreed and measureable development objectives with a coherent narrative

39. **The objectives and expected results of blended finance should be clearly articulated, measurable and communicated to all stakeholders at the outset of a project.** When objectives are not clearly identified and communicated at the outset, the project might end up not bringing the desired development outcomes.

40. **Donors need to clearly articulate the development rationale and share it with the private partner(s), as well as set clear reporting expectations.** On their side, private

partners should be asked to articulate their needs and understanding of what they expect from the partnership.

41. **Keeping an open dialogue and setting co-ordination mechanisms help to get a common understanding of objectives and expected results**, and to monitor their achievement and the effectiveness of the blended finance partnership.

Balance donors' and investors' expectations on development outcomes vis-à-vis financial risks and returns

42. In blended finance, public and private actors come together to work on areas of mutual interest that promote sustainable development. However, they approach this in the context of their own institutional and legal frameworks, and coherently with their shareholders' mandates. However, **if the right checks and balances are in place when structuring the blended finance deal, development objectives and private sector objectives can work in tandem towards a shared goal** (GPEDC, 2017[30])**.**

The development objectives and desired results should determine the selection of partners

43. Making desired development results the starting point in the decision-making processes can guide the selection of potential private sector partners and investments. **The decision to partner with the private sector should be rooted in a theory of change that establishes whether and how the private sector is best placed to help realise specific development results and contribute to leaving no one behind.** Partnerships should only be undertaken where there is a clear ex ante articulation of expected impact (further guidance on effective partnering can be found in the Guidance Note of Principle 4).

Build institutional incentive structures that promote public-private co-operation and balanced sharing of risks and returns

44. A central issue in the creation of shared objectives between the public and private sector is the development of the right incentive structures for the private sector. At the outset, the different mandates and objectives of public and private sector entities can create an imbalance between the achievement of the development rationale behind the investment, and the achievement of financial returns. While this is always a careful balance, it is worth constructing a **suitable incentive structure to ensure that the development rationale is in the foregrounded throughout the investment process**.

45. This could include **linking the financial returns to the achievement of specific development impact objectives** (EIF, 2020[31]), encouraging fund managers to have a personal stake and buy shares in the fund, or allowing co-investment of managers in funds to ensure optimum performance. **The impact-based incentive structure should be carefully designed and implemented to avoid unintended consequences.** With such structures, a credible impact measurement system, with a solid impact data collection system, is of crucial importance.

46. **In general, the best way to develop the right incentives structure is to co-create it with private sector partners, and where possible, partner countries stakeholders and end-beneficiaries** (DCED, 2017[32]).

Develop internal skills and capacities in the public sector necessary to effectively engage with private sector actors in blended finance

47. **Organizational capacity, including the technical expertise of staff to structure, manage, and execute transactions** has been recognised as one of the barriers that limited the adoption of blended finance across donors' organisations (OECD and WEF, 2015[33]).

48. Some donors developed internal policies to improve their private sector engagement approaches. For instance, in the case of USAID, the PSE policy is conceived as a first step within a broader cultural, operational and institutional transformation to expand their PSE activities. The PSE policy integrated the development of blended finance models that focus on both financial returns and development impact, as one of the several PSE approaches to be scaled up in the future (USAID, 2019[34]).

49. **It is also important that blended finance projects are accompanied by activities that support building local capacity, e.g. to negotiate, structure and deploy appropriate financing arrangements**. In contexts where limited blending currently takes place, such as LDCs and fragile countries, blended finance providers should also work with all stakeholders to maximise the sharing and transfer of knowledge and skills in partner countries (OECD/UNCDF, 2019[8]); (Basile and Neunuebel, 2019[9]).

3.2.3. Sub-principle 1C - Demonstrate a commitment to high quality

Encourage integrating Environment, Social and Governance (ESG) factors when selecting blended finance projects

50. Environmental, social and governmental (ESG) factors are used to analyse a (investee) company's prospects based on measures of its performance on environmental, social, ethical and corporate governance criteria (OECD, 2017[35]). **ESG factors can be used to screen potential partners and investments to exclude those that are underperforming or to assess the potential to improve their performance** (Boiardi, 2020[36])**.** Methodologies to screen sustainable investments and integrating ESG factors should be clear and transparent, e.g. in line with the EU taxonomy.

51. **Several internationally-recognised commitments to integrate ESG factors exist.** As shown by the 2018 OECD Survey on Blended Finance Funds and Facilities, the most common international commitments for ESG safeguards applied by these vehicles are **the IFC Performance Standards** (IFC, 2012[37]), the **Principle of Responsible Investing (PRI)** (PRI, 2006[38]) and the **Equator Principles** (EPA, 2019[39]). It is worth noting that some funds and investors apply their own proprietary tools or may adapt them on an ad-hoc basis, depending on the characteristics of each blending project and on the requirements of the investors involved (Basile, Bellesi and Singh, 2020[28]). However, **applying internationally-recognised commitments is preferable as it contributes to aligning to best practice.** The Detailed Guidance Note on Principle 1 provides an overview of the main sets of ESG safeguards.

52. **Donors should strive to implement the maximum level of ESG commitment practicable during the due diligence phase of the investment cycle**. Corporate structures and business models of potential partners should be screened, as well as the company's transparency standards.

Apply the highest level of responsible business conduct

53. **Donors should screen potential blended finance partners to guarantee that they abide to the highest possible level of responsible business conduct (RBC)[3].** From the outset of a blended finance investment, it is important to clarify responsibilities and allocate resources for monitoring of RBC practices throughout the project cycle. Implementation of RBC standards can support donors in better engaging with the private sector and ensuring that private sector partners act responsibly, according to international standards.

54. The **OECD Guidelines for Multinational Enterprises** (OECD, 2011[40]) and the **UN Global Compact** principles (Un Global Compact, 2004[41]) can guide donors in selecting blended finance partners with the highest possible levels of responsible business conduct. **They can also help donors support enterprises in developing countries in improving their RBC practices.** The OECD Guidelines for Multinational Enterprises include principles and standards in all major areas, including information disclosure, human rights, employment and industrial relations, the environment, bribery and corruption, consumer interests, science and technology, competition, and taxation (OECD, 2018[42]). To help implement the guidelines, the OECD also developed the **OECD Due Diligence Guidance for Responsible Business Conduct** (OECD, 2018[43]).

55. **These guidelines and principles must be considered at the ex-ante stage of an investment,** to ensure that the development rationale underpinning the intervention will be achieved in an ethical way.

Guarantee commitment to quality through transparency

56. Although more in-depth guidance on transparency can be found in the Detailed Guidance Note on Principle 5, it is worth noting that **high quality should be maintained throughout, including a commitment to learning from the results of previous blended finance operations.** Aside from the obligation to report to external stakeholders, and informing social and commercial performance management, the evaluation of blended finance interventions can help prioritise the right strategies moving forward (Winckler Andersen et al., 2019[11]).

3.3. Checklist to implement OECD DAC Principle 1

57. To assist DAC donors to implement recommendations laid out in the previous section in blended finance operations, a checklist is proposed below in Figure 3.2:

3 According to the OECD, "responsible business conduct (RBC) entails above all compliance with laws, such as those on respecting human rights, environmental protection, labour relations and financial accountability, even where these are poorly enforced. It also involves responding to societal expectations communicated by channels other than the law, e.g. inter-governmental organisations, within the workplace, by local communities and trade unions, or via the press. Private voluntary initiatives addressing this latter aspect of RBC are often referred to as corporate social responsibility (CSR)." (OECD, 2015[74]).

Figure 3.2. Checklist to implement OECD DAC Principle 1



Source: Authors

3.4. Example of best practices

Box 3.1. Good donors' practices on responsible business conduct

When providing support to private entities in the form of grants or loans, some donors developed screening and appraisal mechanisms that integrate some RBC elements. Development agencies of Austria (ADA), Denmark (DANIDA) and France (AFD), for example, published a list of criteria for exclusion of projects that they may not be financed because of ethical, environmental or social concerns. The Netherlands developed a methodology to screen applications that do not meet minimum RBC criteria. When applying for funding from the Good Growth Fund, a Dutch government fund providing funding to both national and local SMEs, companies need to meet eligibility criteria aligned with the OECD Guidelines. In Austria, every application for funding is subject to an appraisal by ADA on environmental, social and gender issues (ADA, 2017). Same goes for the Canadian development agency, which shares each application for funding with environment, gender equality and governance specialists. Assessment criteria include identification of risks and mitigation strategies, on themes such as "do no harm" as regards to human rights (Global Affairs Canada, 2017).

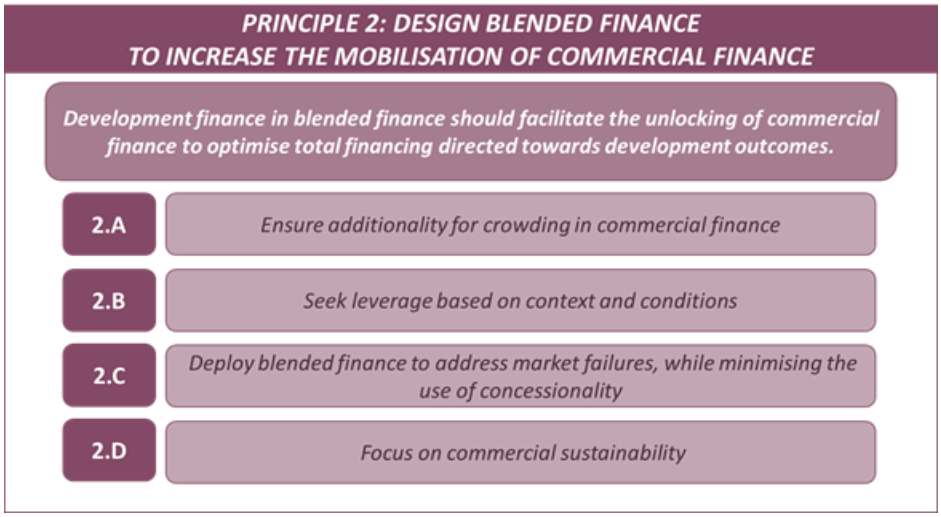
Only a few donors made due diligence a systematic process for assessing and addressing risks of adverse impacts that projects or partnerships may create. Among them, Norway's development agency (Norad) clearly communicates that grant applicants and recipients should act in accordance with the UN Guiding Principles and the OECD Guidelines, and only awards grants when it is feasible to conduct a proper due diligence of the applicant. DFID has also taken important steps to strengthen its own due diligence process and to ensure that suppliers meet RBC standards.

Source: (OECD, 2018[42]) Promoting and enabling responsible business conduct through development co-operation efforts, https://mneguidelines.oecd.org/Promoting-and-enabling-RBC-through-development-cooperation.pdf

4. Principle 2: Design blended finance to increase the mobilisation of commercial finance

4.1. Overview of Principle 2

Figure 4.1. OECD DAC Blended Finance Principle 2



Source: (OECD DAC, 2018[2])

4.2. Principle 2: Policy Guidance

58. Principle 2 bases its approach to designing blended finance to increase the mobilisation of commercial finance and, as Figure 4.1 above shows, further specifies four sub-principles focused on additionality, concessionality and mobilisation as well as commercial sustainability (a summary of core concepts is provided in the Annex and further elaborated in the Principle 2 Detailed Guidance Note).

4.2.1. Sub-principle 2.A - Ensure additionality for crowding in commercial finance

Blended finance interventions need to have both developmental as well as financial additionality

59. **Blended finance should not be deployed if it cannot create additional development impact or if the same development impact can be achieved without the blended finance intervention through existing public or private financing channels**. At the same time, there may be trade-offs between financial and development additionality in any given blended finance transaction. For example, if the primary objective of a blended finance transaction is to achieve a high mobilisation ratio of commercial finance, this may result in a focus of the intervention on more established markets and sectors.

Additionality needs to be ensured to minimise market distortion and prevent crowding out of private investment through blended finance

60. **Public finance should only be used to catalyse private finance through blended finance structures if there is a plausible degree of certainty that private investment is required** and is not be forthcoming on its own and that blended finance delivers additional

development outcomes over those delivered purely by the amount of public finance used for blending. Otherwise blended finance risks to unduly subsidise commercial finance and potentially distort markets as a result.

Ensuring additionality requires assessing it along both the development and financial dimension and encouraging harmonised approaches

61. In terms of both development and financial additionality, the incremental outcomes catalysed by a blended finance transaction beyond what public and private finance alone would be able to deliver needs to be clearly identified, e.g. through a clear theory of change that can be monitored through key performance indicators for development impact and additional amounts of private finance catalysed for financial additionality.

62. **Donors should encourage and facilitate a harmonised approach towards assessing additionality in development finance, including for blended finance**. To enable ex-post impact assessments for a selected sample of blended finance transactions, donors should request that ex-ante baseline data is collected on key results indicators and monitored during implementation.

4.2.2. Sub-principle 2.B - Seek leverage based on context and conditions

The design of blended finance transactions needs to be anchored in the transaction-specific development objective, taking into account context-specific drivers

63. Several context-specific factors influence the nature of additionality, concessionality, mobilisation and commercial sustainability in blended finance and need to be taken into account when designing a blended finance transaction. These drivers include:

- **Geography**: Blended finance has a higher additionality in countries where less commercial finance is currently available, such as in Least Developed Countries (LDCs) or fragile and conflict-affected situations (FCS). Further information on how to align blended finance to local priorities is provided in the detailed Guidance note on Principle 3.
- **Sector**: Sectors with established regulatory and investment frameworks, a track record of private investment and underlying financial sustainability are more conducive to attracting commercial finance, resulting in higher mobilisation with lower concessionality through blended finance. Higher risk sectors with untested sector frameworks, high financial risks and lack of track record of private investment may offer higher additionality through blended finance, while likely requiring higher concessionality and initially creating lower mobilisation.
- **Stage in the project cycle**: The risks in the early stage project development can require a relatively high share of concessionality, offering high additionality. However such level of risks may not be conducive to attract commercial investors at a large scale. During the construction phase, commercial finance can be mobilised from select investors willing to bear construction risk, such as commercial banks.
- **Market maturity**: Mobilisation can be higher in financial markets with partial market failures, such as failure to provide the required maturities, such as long-term debt finance, or certain products, such as securitisation or hedging instruments.

- **Financial instruments**: The financial instrument chosen for a blended finance transaction is based on the transaction's development objective and analysis of the drivers laid out above.

4.2.3. Sub-principle 2.C - Deploy blended finance to address market failures, while minimising the use of concessionality

Donors should identify the root causes and source of the market failure the blended finance programme should address

64. Because market failures harm market development as well as the emergence of self-sufficient financial markets, blended finance can serve as a tool to overcome the very market failures the commercial investors face, thus unlocking their financing potential. **The use of concessionality should only be justified if it addresses market failures and enables crowding in of commercial investors.**

65. It is thus **crucial for donors to understand the root causes of market failures in a given context** and streamlining blended finance efforts accordingly. Further engagement in the form of policy reforms and dialogue is likely to be needed to achieve a holistic approach to addressing market failures.

66. Donors should also ensure that blended finance is only used to address temporary market failures and that accompanying reform measures are undertaken to address the sources of market failures in a sustainable manner.

Conduct an analysis of the drivers of concessionality in the context of operation

67. **Before deploying concessional resources in blended finance, an analysis of the drivers of concessionality should be conducted,** and should include:

- Identifying the gap in the financing structure that concessional finance can help close to mobilise commercial finance;
- Choosing a financial instrument that enables crowding in of commercial finance while minimising concessionality;
- Taking into account sectoral and geographical variables that undermine commercial investment;
- Assess the project cycle's influence on the level of concessionality required;
- Assess the degree of market maturity.

Enable equal access to donors' concessional funds

68. When deploying concessional funds, **establish fair and equal access procedures that all market participants, public or private, can understand the objectives, terms and conditions for accessing donors' funds**. This may include tendering processes and allocating finance to the institution proposing blended finance structure with the minimum need for concessionality.[4]

[4] Further details on this can be found on the Detailed Guidance Note for Principle 2.

Engage in a continuous dialogue with other donors to harmonise approaches on concessionality

69. **A continuous dialogue is necessary for fostering progress in moving towards harmonisation of principles to determine concessionality among development actors, including on reporting**. Co-ordination on blended finance programmes and transactions is crucial particularly when a concessional element is part of a programme. Structural co-ordination is needed beyond single transactions in order to avoid excessive reliance on concessional finance (see also (OECD, 2019[44])).

4.2.4. Sub-principle 2.D - Focus on commercial sustainability

Develop policy, sector and investment frameworks, in parallel to blended finance

70. Blended finance can only catalyse commercially sustainable markets if sustainable underlying market fundamentals are in place, namely sector policy and regulatory frameworks that allow for cost recovery of investments at risk-adjusted returns. Such **market fundamentals need to be developed before or in parallel to a blended finance through accompanying measures from development partners, such as technical assistance, budget support or results-based development finance**.

Facilitate local capital market development, with a focus on providing access to finance to underserved population groups

71. **To ensure commercial sustainability, the development of local capital markets needs to be facilitated as part of or in parallel to blended finance transactions.** Blended finance can contribute to capacity building through e.g. credit lines to local financial institutions as well as associated technical assistance facilities. Capacity building for capital market development can also be provided through parallel development interventions from other development partners. Further information on how to support local capital market development is provided in the detailed Guidance note on Principle 3.

72. **Sustainable markets need to be created to provide access to finance for underserved population groups**, such as women, remote and other vulnerable population groups, who may lack access to finance due to their lack of access to traditional collateral, their inability to provide repayment histories or their small transaction sizes.

Incorporating exit strategies in blended finance, both at the level of the transaction and at market level

73. Blended finance needs to be phased out once the investee generates sufficient cash flows and markets are developed enough to attract commercial investors. **Exit strategies need to systematically be included in the design of a blended finance instrument, both at the level of the transaction and at market level.** Observing the current practices of bended finance, systematic exit strategies are not yet reflected in many blended finance approaches and typically only limited formal exit structures are currently in place.

74. **Exit indicators should be defined within the due diligence of a transaction at the beginning.** Nonetheless, these triggers must be flexible enough to allow for the best suitable exit through continuous monitoring. A complete exit of the concessional investor is not feasible in each context and condition. Especially in the context of fragile states and least developed countries blended finance may only have temporary effects.

75. **Indicators for triggering a potential exit scenario can be distinguished into financial indicators as well as developmental indicators:**

- *Financial indicators* that can trigger an exit scenario include the stage of capital market development, return thresholds being achieved, available data on actual risks and loss rates vs initially perceived risks or private investor response to auction processes.
- *Development indicators* that can encourage an exit of blended finance include the achievement of the development objective on the positive side but also a significant gap towards the achievement of the target objective which may signal a failure by the private finance to achieve its targets. Further information on result metrics is provided in the Detailed Guidance Note on Principle 5.

4.3. Checklist to implement OECD DAC Principle 2

76. **To assist OECD DAC donors to operationalise Principle 2, a step-by-step approach is proposed** in Figure 4.2 below, focusing on steps to be undertaken at the level of the blended finance transaction in order to ensure additionality, mobilisation, minimum concessionality and commercial sustainability. The Detailed Guidance Note for Principle 2 further explains each step.

Figure 4.2. Checklist to implement OECD DAC Blended Finance Principle 2



Source: Authors

4.4. Example of best practices

77. Box 2 below provides examples of competitive approach that providers of concessional finance adopted. More case studies and best practice examples can be found in the Principle 2 Detailed Guidance Note.

Box 4.1. Examples of competitive approaches for blended finance used by donors

Some providers of concessional funds for blended finance adopted competitive approaches to test the market demand for the type of concessional finance required to achieve financial and development additionality through blended finance. Examples include:

- Global Affairs Canada: As part of its new 5-year CAD 1.6 billion ODA innovative finance program, the Government of Canada has launched an International Assistance Innovation Program (IAIP) which allows for ongoing submission of proposals for repayable concessional capital. The program defined eligibility criteria in the areas of sustainable development impact, financial and impact additionality, financial sustainability and minimum concessionality. While the program does not set targets by sectors, preference may be given to proposals addressing gender inequality, demonstrating greater additionality, showing financial returns for strong development impact, working in LDCs and FCS and with strong impact measurement capacity.

- European Commission (EC): As part of the European Fund for Sustainable Development and the EU's External Investment Plan, the EC has developed a new concessional guarantee instrument. The guarantee is implemented through development finance institutions who make proposals to the EC within given submission windows. In the first round, concessional guarantees have been made available for a total of EUR 1.5 billion guarantee funding under 5 windows: financing for MSMEs and agriculture; sustainable energy and connectivity; sustainable cities; digitalisation; and local currency financing. In the first round, 28 guarantee instruments have been committed.

- SECO Switzerland: SECO launched a call for proposal for technical assistance (TA) funds for impact investing. The objective of the TA funds are to reduce perceived risks and help build an investment pipeline that attracts private investment. The call focused on job creation and CO2 emission reduction and sought to seek innovative private sector solutions and private sector know how and achieve value for money through competition. Eligibility and award criteria included development impact, reliability of team and methods, level of outcome, co-financing, geography and additionality. On this basis, five impact fund managers were selected in the field of renewable energy, energy efficiency and SME support to receive and manage the TA funds.

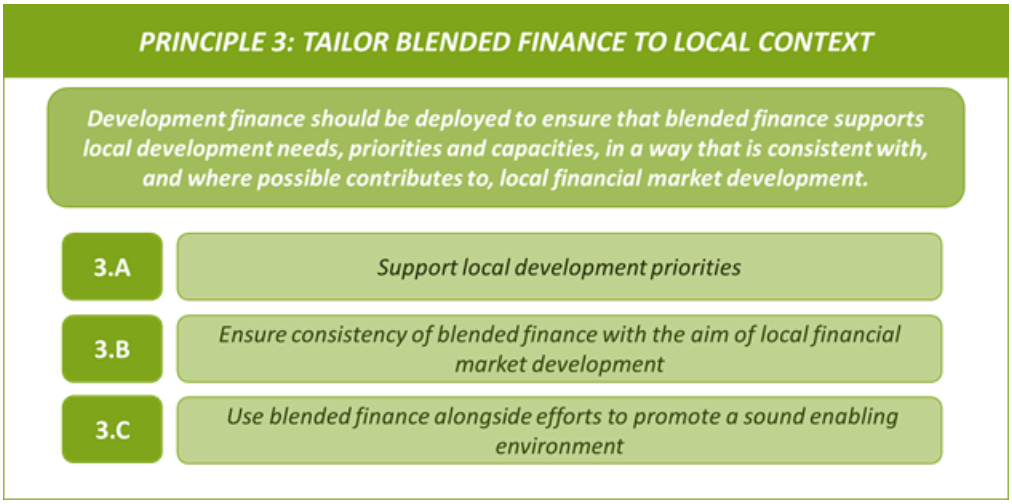
- MacArthur Foundation: As part of its impact investing allocation, the MacArthur Foundation has launched a first call for proposal for USD 150 million in investments to be made under its Catalytic Capital Consortium (C3) initiative in collaboration with the Omidyar Network and Rockefeller Foundation. The C3 initiative aims to make patient capital available for high impact investment propositions for all 17 SDGs. Over 100 proposals were received for a total financing volume of USD 3 billion and are currently being evaluated in a 3-step process. Evaluation criteria include the categories management factors, investment execution factors, impact execution factors, additionality, outcomes and capital gaps.

Source: (Global Affairs Canada, 2019[45]); (European Commission, 2017[46])

5. Principle 3: Tailor blended finance to local context

5.1. Overview of Principle 3

Figure 5.1. OECD Blended Finance Principle 3



Source: (OECD DAC, 2018[2])

5.2. Principle 3: Policy Guidance

78. The OECD DAC Blended Finance Principle 3 stipulates that blended finance needs to be tailored to the local context. Principle 3 outlines three sub-principles focused on local development priorities, local financial market development and sound enabling environment, as Figure 5.1 above shows.

79. Tailoring blended finance to local context is a pre-requisite for materialising efforts to achieve the highest development impact while protecting the climate and the environment as well as optimal returns in a blended finance transaction. It should therefore be a key objective for both investors and development stakeholders as emphasised in a variety of international statements. . In particular, the local dimension of blended finance is strongly connected to other OECD/DAC Blended Finance Principles.

5.2.1. Sub-principle 3.A - Support local development priorities

Ensure in depth stakeholder consultation

80. **In-depth and systematic consultation with local stakeholders** is advantageous for blended finance deals. It should be inclusive and where possible bottom-up in order to increase the range of partners involved at community level, as suggested by the Kampala principles (GPEDC, 2019[26]). Effective stakeholder consultation should not be perceived as a single event but rather as a process parallel to the whole investment. It should be noted that **a differentiated approach needs to be taken depending on the type of projects** as large infrastructure projects for example may require extensive consultations with different stakeholders, whilst in other cases, such as a direct investment in a SME, extensive consultations may be less applicable. Finally, local stakeholders typically include national authorities, various types of CSOs, local communities and beneficiaries but also local private actors. The Principle 3 Detailed Guidance provides steps and considerations to follow for effective stakeholder consultation.

Promote country ownership

81. Development finance providers are encouraged to ensure that blended transactions respect **national ownership and national development strategies** as stated in the Kampala Principles (GPEDC, 2019[26]). Including national actors at all stages of the project, as appropriate, and ensuring their position as co-owners can contribute to the success of the blended finance deals and enable the long-term sustainability of investments.

Understand local circumstances for desirable intervention

82. In line with the Kampala Principles, local actors should be part of both design and implementation efforts, as well as monitoring and evaluation of development interventions (GPEDC, 2019[26]). **A comprehensive local context assessment is necessary for structuring blended finance interventions**, for example when deciding on the level of concessional finance to enhance the risk/return ratio or aligning incentives with projects participants. In addition, designing the right type of deal requires to take into account several local dimensions. This helps inform the choice of instruments.

Understanding the local context is necessary for additionality

83. In-depth understanding of local needs and conditions is crucial for designing and implementing projects with high financial and development additionality. Currently, however, there is no one standardized way of conceptualizing and measuring additionality. **Although difficult investment environments may make blended transactions more challenging, they hold potential of high development additionality** while reaching underinvested sectors and locations, as well as underserved populations. Finally, difficulty of determining financial additionality of blended finance intervention depends primarily on assessing the local financial market and the type of financial instrument to be used. Further information on additionality is provided in the Detailed Guidance Note on Principle 2.

Ensure representation and effective communication on the ground

84. **Having a representation on the ground is often said to help identifying opportunities, supporting project preparation and establishing fruitful partnerships with financial, national and other local actors**. Multiple organisational designs are however possible, and the consequences of using each of them depends on a variety of settings e.g. regulations, investment strategy, mandate, balance sheet and fiduciary risk.

85. In order to anchor blended finance in local context and **deliver a more transformational impact on local markets, blended finance actors should look beyond single projects,** and where possible, coordinate their operations. A clustering of blended finance transactions (as opposed to focusing on project-level activities) may allow blended finance actors to achieve more systemic results on a given market.

5.2.2. Sub-principle 3.B - Ensure consistency of blended finance with the aim of local financial market development

Establish engagement and capacity building processes with local financial institutions

86. Engagement with local financial institutions is not only an added value in terms of accommodating local perspectives but it also constitutes **an opportunity for local capacity building and subsequently may contribute to a long-term economic development of local markets**. Local financial institutions are natural partners for development finance providers and their participation should be maximised (GPEDC, 2019[26]). Local financial

institutions can also help mobilise local finance and can thus provide local currency financing which is of a significant importance.

Focus on crowding in domestic finance

87. Involvement of local investors such as pension funds, investment funds, national development banks and individual investors in blended finance operations **provides opportunities for crowding in domestic finance in strategic sectors aligned with national development plans**. As acknowledged by the G20, "greater effort should be made to include local intermediaries and local pools of institutional capital in projects" (G20, 2017[47]). Blended finance actors may use different tools to crowd-in domestic capital and tap into local expertise in blended finance transactions. They may do so by opening new opportunities for co-investment, for example in first-of-a-kind investments in sectors so far underserved by domestic finance. **National and sub-regional development banks are also particularly well positioned for crowding in domestic-finance**, as highlighted in THK Roadmap for Blended Finance (THK, 2018[48]). They are an important provider of medium-to-high-risk funding for development objectives at terms that allow them to maintain their financial sustainability (OECD, 2020[49]).

Promote local currency financing

88. **Local currency financing is a key factor contributing to local financial market development**. Local currency risks are in many countries one of the key factor pushing international investors away from emerging markets. Devaluation of local currency means decreased potential profits for investors and difficulties in exit for international equity investors. As a result, hard-currency lending is still the prevailing norm for development institutions (TCX, 2018[50]). Possible mechanisms to mitigate local currency risks include cross-currency swaps, credit/risk-sharing guarantees or foreign-exchange forward contracts protecting its clients against long-term risk (further details can be found in the Principle 3 Guidance Note).

5.2.3. Sub-principle 3.C - Use blended finance alongside efforts to promote a sound enabling environment

Develop approaches resulting in demonstration effects and market creation

89. As highlighted under the THK Roadmap, '*'blended finance should help to accelerate inclusive sustainable market development, including the local financial market*'' (THK, 2018[48]). Blended finance provides an opportunity to contribute to local economic transformation and improve investments climate. It is therefore important for development finance institutions and other players involved in blended finance projects to develop approaches which **link deal-oriented blended finance project engagements with wider transformative objectives on local markets creation**.

Foster policy reforms addressing obstacles faced by private investors in the local context

90. A favourable investment climate is essential in attracting and retaining foreign and domestic investments. Through blended finance, development actors should ideally help to overcome investment barriers in local markets, especially barriers to commercial sustainability. As MDBs and DFIs are principally transaction-driven institutions, they could play an important role in strengthening their systemic and holistic understanding of local markets, as well as incentives and mechanisms to engage in broader transformational changes (Bilal, 2019[51]).

5.3. Checklist to guide implementation of Principle 3

91. To assist DAC donors to implement recommendations laid out in the previous section in blended finance operations, a checklist is proposed in Figure 5.2 below:

Figure 5.2. A checklist to guide implementation of Principle 3



Source: Authors

5.4. Example of best practices

Box 5.1. Local currency guarantee by the European Commission

Demand for local currency financing in many developing countries is far greater than supply. Loans are often denominated in hard currency. But by borrowing in hard currency the unhedged foreign exchange rate risk can cause serious problems to borrowers in the event of severe currency depreciation. Hedging solutions are often not readily available or are expensive.

Under the EFSD Guarantee, managed by the European Commission in the framework of the External Investment Plan, the EU aims make local currency financing more accessible for investors, and in the long run to strengthen local currency capital markets in the EU Neighbourhood and Sub-Saharan Africa. Out of 28 guarantees initially approved under the EFSD Guarantee there has been several programmes targeting local currency financing, including Local Currency Lending in Sub-Saharan Africa (managed jointly by KfW Group and AfDB), as well as African Local Currency Bond Guarantee Programme (KfW Group).

Source: (European Union, 2019[52])

6. Principle 4: Focus on effective partnering for blended finance

6.1. Overview of Principle 4

Figure 6.1. OECD DAC Blended Finance Principle 4



Source: (OECD DAC, 2018[2])

6.2. Principle 4: Policy Guidance

92. The OECD DAC Blended Finance Principle 4 stipulates the need to focus on effective partnering for blended finance. Principle 4 further specifies three sub-principles on the respect of different actors' mandates, a balanced and sustainable allocation of risks and the aim for scalability, as Figure 6.1 above shows.

93. **The need for effective partnerships in blended finance approaches is now more relevant and urgent than ever, in light of the COVID-19 pandemic** causing an unprecedented health, human and economic crisis and reversing progress towards the achievement of the SDGs.

6.2.1. Sub-principle 4.A - Engaging each party on the basis of their respective mandate

When engaging in blended finance, understand the mandates, objectives and risk-return profiles of each actor involved

94. **Blended finance approaches involve a wide and diverse set of actors, with different mandates, risk-return preferences and incentives**. They include actors pursuing, at different extents, either development or commercial objectives, or both (such as the case of DFIs). Blended finance actors are also characterised by diverse legal settings and organisational set-ups.

95. **As a starting point, it is thus important to understand the risk-return profiles of providers of concessional and commercial finance in blended finance based on their mandates.** The Detailed Guidance Note of Principle 4 further explores the objectives, roles and instruments of each type of blended finance actors, as well as their risk-return profiles.

6.2.2. Sub-principle 4.B - Allocate risks in a targeted, balanced and sustainable manner

Understand and assess the different types of underlying risks, in country- and sector-specific contexts

96. **Blended finance is a financial structuring approach that can address specific risks at different levels, namely the level of an institution or portfolio, program or project.** The Detailed Guidance Note for Principle 2 includes a typology of different types of risks (political, commercial, financial, and impact risk), including possible risk allocations and risk mitigation instruments.

97. **Risk declines in sectors and geographies that have seen repeat transactions thanks a track record and a proven framework.** This helps address risk perceptions and reduces uncertainty which should, in principle, also translate into a reduced share of concessionality. The Detailed Guidance Note for Principle 4 provides examples of risk allocation in the renewable energy and water sectors, as well as in specific country contexts, such as LDCs.

At each level of blending, different methodologies for risk assessments should be applied as a basis to determine the optimal blending instrument and concessionality level

98. Achieving balanced risk allocation in blended finance entails choosing the right financial instrument with minimum concessionality to achieve the appropriate risk-return profile to attract commercial investment. **Different methodologies for risks assessments should be applied, at each level of blending, depending on the degree of disaggregation of risks**. Explanations on each of the methodologies are available on the Detailed Guidance Note for Principle 2.

Bring in local entities so as to improve risk allocation in blended finance

99. **Local investors such as sovereign wealth funds and local pension funds can provide local currency finance to projects that generate revenues in local currency, thereby eliminating foreign exchange risk**, and are also well positioned to provide long-term finance. They are also better placed to understand, price and manage political risk in their country. Blended finance should therefore seek to catalyse investment from local investors in line with their regulatory requirements. In addition, national development banks and local commercial banks can also provide development finance through blended finance involving risk sharing mechanisms. Further information on how to crowd in domestic finance is provided in the detailed Guidance note on Principle 3.

Adjust the mix between concessional and commercial finance as risks evolve along different stages of the project lifecycle

100. Risk is dynamic and declines along the project cycle. **Different stages in the project cycle allow different combinations of risks and investors.** For instance, concessional funds are usually needed during the high-risk project development phase and to de-risk certain type of investors during the construction phase. Less concessionality is typically required during the lower risk-operating phase.

101. **Continuous monitoring offers opportunities to adjust the allocation of risks along different project lifecycle stages to those public and private investors best**

positioned to bear them. The Guidance Note provides a stylised overview of how risk profiles, the blending mix and investor base change over the project lifecycle.

Strengthen capacity in donor agencies to assess and verify balanced risk allocation in blended finance

102. **Capacity in donor governments and agencies to assess and verify balanced risk allocation in blended finance needs to be strengthened**, e.g. through in-house training, outsourcing, and access to risk models used by the arrangers of blended finance. A **concerted dialogue and culture amongst donors about risk management** in blended finance is recommended.

6.2.3. Sub-principle 4.C - Aim for scalability

Promote transparency and data availability, as well as knowledge sharing

103. Ongoing data challenges currently limit a more in-depth analysis and discussion of the mobilisation potential through blended finance in specific contexts. Market transparency and efficiency needs to be created by making available performance data available to all market participants. **Donors should promote transparency by working with stakeholders to make relevant data available to all market participants**, starting with historic loan performance data in the Global Emerging Markets (GEMs) Risk Database[1]. They should also continue working on transparent and harmonised reporting requirements for mobilisation of private capital by MDBs and DFIs, including for blended finance. Further information on the need for transparency is provided in the detailed Guidance note on Principle 5.

104. **Knowledge sharing can also contribute to achieving scale.** Given the relatively recent nature of blending for development finance, lessons learnt should be readily made available to all participants.

Set incentives for scaling up through appropriate and targeted mobilisation objectives for MDBs/DFIs

105. Setting mobilisation targets risks an excessive focus on countries and sectors where mobilisation is easiest, such as middle-income countries. This kind of leverage ratio will not allow to achieve the SDG investment needs. Donor governments as MDB/DFI shareholders should therefore consider **setting mobilisation objectives which include targets for mobilisation in different geographies, countries and sectors.**

Promote whole-of-government approaches and improved collaboration and co-ordination between MDBs and DFIs

106. While development agencies are usually supervised by the Ministry of Foreign Affairs or Development, DFIs, for example, are often under the purvey of Ministries of Finance (or Treasury Departments). This division can make it difficult to build a united approach. **A whole-of-government approach is essential to achieve co-ordinated and effective blended finance solutions.**

107. **Improved collaboration is also needed among and between DFIs and MDBs.** Donors need to incentivise and reward collaboration between MDBs/DFIs in blended finance through e.g. replication of successful structures, co-financing, joint new project design or collaboration in the context of global partnerships. Donors should also incentivise MDBs to collaborate in programmatic approaches to further enhance replicability and standardisation for private investors.

Make sufficient funding available for early stage project preparation to accelerate the creation of a pipeline of bankable projects, as well as for creating an enabling environment

108. **Creating pipelines of bankable projects and a conducive investment climate and regulatory environment at country level requires important pre-conditions for achieving scale.** Grants and technical assistance can be deployed in the early stages of project preparation to (i) create an enabling investment climate and regulatory reforms through advisory services; (ii) assist governments to develop SDG investment plans that identify opportunities for private investment early; (iii) finance project feasibility studies through (reimbursable) grants and (iv) provide early stage high-risk project development capital as well as project preparation facilities. Further information on the need for improving the investment climate in developing economies is provided in the detailed Guidance note on Principle 3.

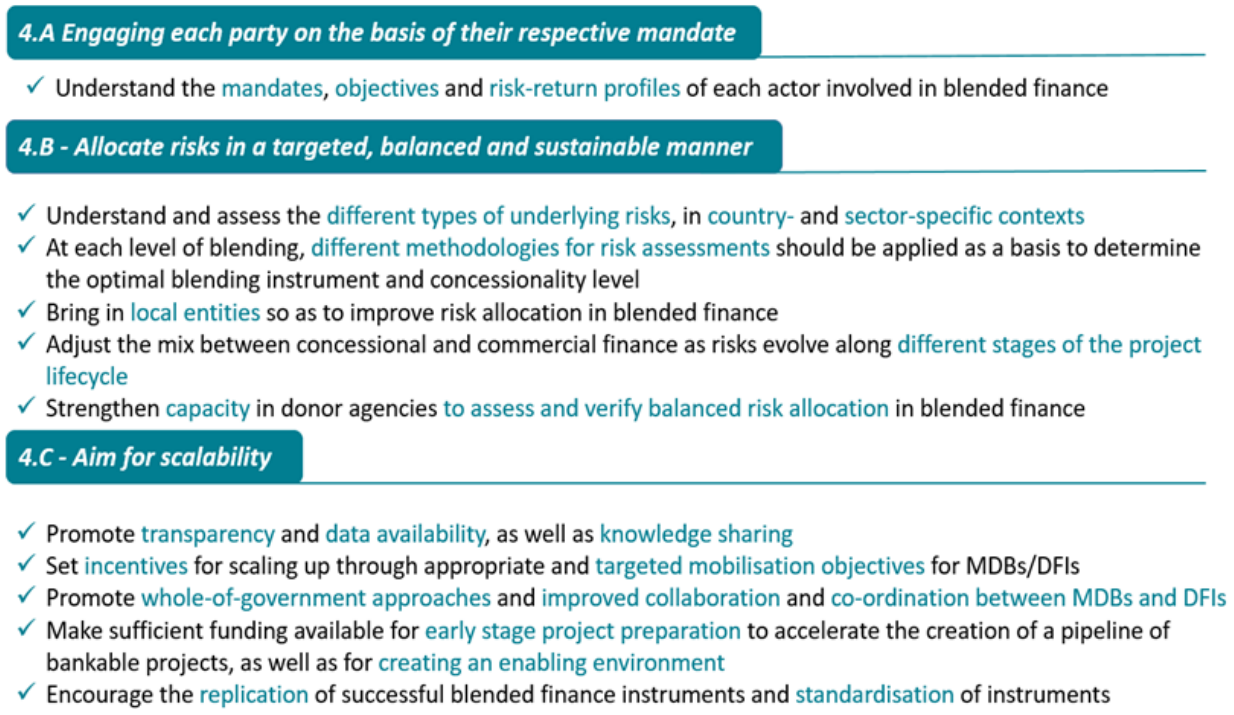
Encourage the replication of successful blended finance instruments as well as the development of new instruments that further enable standardisation and scale

109. DAC Blended Finance Actors should **encourage the replication of successful blended finance instruments as well as the development of new instruments that further enable standardisation and scale** – such as standardisation of guarantees, the use of market-based credit enhancement, fund-of-fund approaches and multi-MDB/DFI securitisation approaches.

6.3. Checklist to guide implementation of Principle 4

110. To assist DAC donors to implement recommendations laid out in the previous section in blended finance operations, a checklist is proposed in Figure 6.2 below:

Figure 6.2. Checklist to guide implementation of Principle 4



Source: Authors

6.4. Example of best practices

111. To date, limited alternative structures have been developed to take different risk profiles into account and match the declining risk profile of blended finance structures with various investor groups along the project lifecycle. The most eminent such structure is the Climate Investor One structure developed by FMO (see Box 6.1 below). While this structure has been piloted in the renewable energy sector, it is replicable in other sectors.

Box 6.1. Climate Investor One

Climate Investor One ("CIO") is a global investment vehicle founded in 2015 by Netherlands Development Finance Company (FMO) and Phoenix InfraWorks (as anchor sponsor/investor) to finance renewable energy projects in emerging markets globally.

CIO comprises three investment funds tailored towards an integrated financing approach covering all stages of a project life cycle i.e. from development, construction to operations. The investments funds targeting a total commitment of USD 1 billion at final close are:

i) Development Fund (DF): At early project stage, CIO provides financial, technical, environmental, social development and structuring support through this fund. The fund attracted donor capital, namely an EU contribution of EUR 30 million from the EU Thematic Blending Initiatives "Delivering access to modern, affordable and sustainable energy".

ii) Construction Equity Fund (CEF): CIO aims to reduce the complexity associated with multi-party negotiations associated with typical project finance delays by equity financing the construction phase using the CEF. Target size for the fund is USD 500 million expected to be raised from commercial and institutional investors with the following layered structure:

- 20% Tier 1 capital, a first-loss tier from donors;
- 40% Tier 2 ordinary equity from commercially oriented investors such as FMO and other DFIs;
- 40% Tier 3 capital i.e. preference shares from institutional investors such as Export Credit Agencies and pension funds.

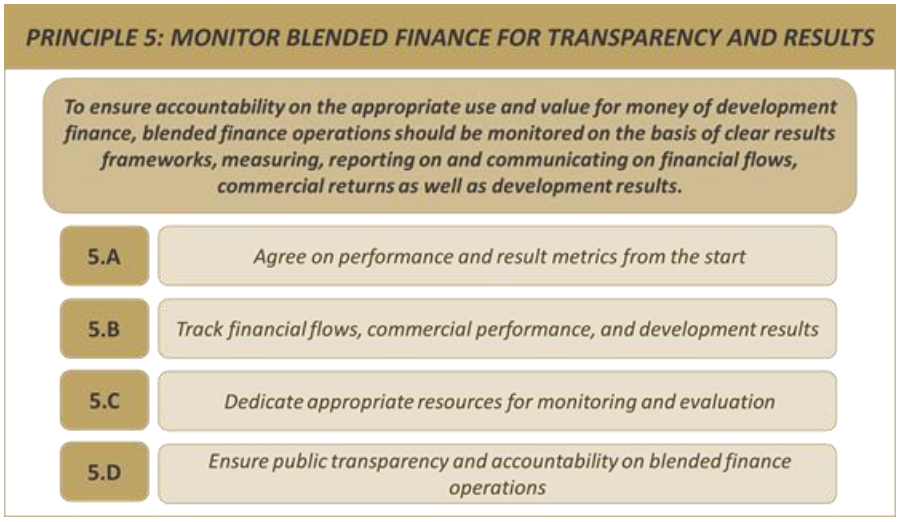
iii) Refinancing Fund: target size of USD 500 million by way of refinancing of up to 50% of equity with long-term senior debt to leverage equity returns during the operational phase. This fund would allow mainstream commercial investors such as commercial banks and pension funds to invest in operating projects that have been developed through the development and construction equity funds.

CIO is managed by a dedicated fund manager Climate Fund Managers ("CFM"), a joint venture between FMO and Phoenix. CIO had raised USD 462 million for the development fund and Construction Equity Fund by its second close in December 2017. Fund-raising for the Refinancing Fund can only commence once projects develop through the first two funds are nearing the operational phase.

7. Principle 5: Monitor blended finance for transparency and results

7.1. Overview of Principle 5

Figure 7.1. OECD DAC Blended Finance Principle 5



Source: (OECD DAC, 2018[2])

7.2. Principle 5: Policy Guidance

112. The OECD DAC Blended Finance Principle 5 pertains to the monitoring of blended finance for transparency and results. Principle 5 further specifies four sub-principles focused performance and results metrics, monitoring and evaluation and transparency, as Figure 7.1 above shows.

113. Transparency is the key building block of Principle 5. **Transparency** should not be seen as an end goal in itself, but rather **as an enabler of accountability, learning and trust.**

114. **Increased transparency can lead to strengthened trust** among blended finance players, which include a wide variety of stakeholders, from the public and private sector, in both donor and partner countries, which might not be traditionally used to working together. **Enhanced transparency also leads to stronger accountability towards stakeholders**. Accountability should be conceived both *upstream*, i.e. towards stakeholders (donors, finance providers, asset managers, etc.), and *downstream*, i.e. towards the local actors that the blended finance transaction, as a development cooperation tool, intends to serve. As blended finance regularly involves the use of scarce concessional resources, and often managed by private actors, the bar on accountability requirements needs to remain high. As blended finance is still a relatively young tool in the development co-operation landscape, **fostering learning and knowledge sharing** is key to assess when and how blended finance should be deployed.

7.2.1. Sub-principle 5.A - Agree on performance and result metrics from the start

Adopt a theory of change for a blended finance mechanism as a whole

115. In order to ensure blended finance is used effectively as a development co-operation tool, the first step for donors, both logically and chronologically, is to agree from the outset on expected development objectives and results and how they will be achieved, with all stakeholders involved. **Before entering a blended finance operation, all actors should clearly understand and articulate how the particular investment is expected to lead to outputs, outcomes, and eventually development impact**, as per the EvalNet's Glossary of Key Terms in Evaluation and Results Based Management[5]. **A more comprehensive application of a theory of change, particularly at outcome and impact level, would allow for identifying more transformative effects of blended finance**, by clearly articulating the causal links, mechanisms and assumptions at play. The Detailed Guidance Note for Principle 5 provides a visualisation of the results chain, where definitions are marginally adapted to the investment logic, rather than a generic development intervention.

Reach an initial agreement on reporting for results, using a common set of key performance indicators

116. Fragmentation of reporting practices remains a challenge for both donors looking for comparability across financial intermediaries, as well as private actors who need to meet varying reporting requirements. At present, too much variation exists in the way that key concepts, such as additionality and impact are used, which renders comparison extremely difficult. It is thus possible that while organisations managing blended finance operations claim to measure impact, they may sometimes conflate it with outcome or even output (Basile, Bellesi and Singh, 2020[7]).

117. Harmonisation becomes particularly important in the measurement of blended finance initiatives, compared to other development co-operation modalities, as blending involves a variety of entities with more diverse legal settings. Some harmonisation initiatives among blended finance actors already exist. For instance, in 2013, 25 international financial institutions agreed to work towards harmonising their development result indicators to reduce variations in data and the reporting burden on clients, and to facilitate learning, through the **Harmonized Indicators for Private Sector Operations (HIPSO)** initiative (HIPSO, 2020[53]). Another notable example is the **Global Impact Investing Networking IRIS+ tool**, which offers a catalogue of empirical metrics to monitor and measure impact. However, despite these attempts, widespread agreement on performance metrics has become urgent and crucial to avoid fragmentation and, potentially, poor data (IRIS+ System, 2020[54]).

118. Moreover, while some blended finance investments directly target poor households, individuals and businesses, others indirectly target poverty reduction, through their contribution to market creation or changes in the market in ways that benefit the poor. Many blended finance providers, both public and private, lack credible and practical means to identify whether poor beneficiaries profit (or suffer losses) from proposed and selected investments, and, if so, how much blended finance impacts poverty reduction and the aim to leave no one behind. To address this challenge, the **Tri Hita Karana (THK) Impact**

[5] Please note that, following the revision of the OECD DAC Evaluation criteria in 2019, a second edition of the Glossary is being produced and will serve as a useful reference point as it defines many terms used in the document – including intervention, results, output, outcome, and objective (OECD/DAC Network on Development Evaluation, 2019[73]).

Working Group developed practical guidance, through a checklist, for the assessment of the impact of blended finance on the poor[6]. The checklist offers a set of questions and screening considerations for the *ex-ante* assessment of the expected impact on the poor, as well as what can and should be measured in *ex-post* assessment of the actual impact (Tri Hita Karana Roadmap for Blended Finance, 2020[55]).

119. **Besides agreeing on *what to measure*** (i.e. which indicators underlying which objectives)**, it is crucial for DAC members to understand *how to measure*, in terms of data collection and the assurance process to be put in place by financial intermediaries**. Data collection tools used in evaluation of blended finance include benchmarking, survey and/or interviews with end beneficiaries, survey with clients, monitoring data, etc. Donors should encourage, to the maximum extent possible, data collection tools involving final beneficiaries. The process of impact measurement and management should also embrace qualitative data, as a way to capture complementary information that cannot otherwise be measured and to better contextualise the interpretation of quantitative figures.

Adopt a common monitoring and evaluation framework

120. Blended finance comprises various instruments and modalities, and monitoring and evaluation (M&E) will be critical for establishing an evidence base about 'what works in which context'. In blended finance, there is a significant variety in evaluation practice, including access to financial resources for evaluation, evaluation capacity, and degree of independence (Winckler Andersen et al., 2019[11]). For instance, the 2018 OECD Survey on Blended Finance Funds and Facilities shows that not all managing organisations have a clearly identified M&E function, with funds frequently leaving the M&E responsibility with each investment manager.

121. **Evaluation plans should be independent and based on international best practice. They should consider and engage all actors engaged in a blended finance operation, including financial intermediaries**, such as DFIs and asset managers, as well as, whenever possible, with intended beneficiary groups. This should include defining roles and responsibilities for all actors for data collection, with due considerations for reporting burdens. **Local actors should be part of both design and implementation efforts, as well as monitoring and evaluation of development interventions** (GPEDC, 2019[26]).

122. Moreover, past evaluation of blended finance reveal governance and methodological challenges in evaluating such highly intermediated financing approaches (Winckler Andersen et al., 2019[11]). The EvalNet Working Group on Blended Finance Evaluation, co-ordinated by Denmark, Germany, Norway and the OECD Secretariat, is currently working to address challenges related to evaluating blended finance. By end of 2020, this work aims to (i) establish a shared understanding of blended finance evaluation concepts and terms; (ii) explore how to evaluate development; and (iii) develop a shared understanding of evaluation of different blended finance instruments, including unintended effects, such as market distortions. Upon the completion of this work, Evalnet plans to continue with additional work to support more and better evaluations of blended finance initiatives.

[6] https://www.thkforum.org/project/a-checklist-for-assessing-the-impact-of-blended-finance-on-the-poor/

7.2.2. Sub-principle 5.B - Track financial flows, commercial performance, and development results

Ensure more financial transparency, while avoiding the pitfalls

123. In order to assess the effectiveness and efficiency of blended finance operations, the financial and development performance of all parties should be assessed against predefined and agreed upon metrics. This encapsulates not only financial flows and commercial returns, but also results achieved against development objectives.

124. Civil Society Organisations (CSOs) and other blended finance stakeholders, such as partner countries, have for a long time indicated the lack of transparency in blended finance operations and other private sector interventions. The transparency deficit owes in large part to the myriad legal and organisational obligations of actors involved in blended finance. It can also stem from the lack of capacity in some organisations to collect data and measure impact, as well as lack of dedicated budget to monitoring and evaluation. Insufficient oversight over blended finance initiatives may expose public sector funding to potential criticism.

125. In September 2018 DAC members agreed to define methodologies for measuring the amounts mobilised from the private sector by official development finance interventions (DAC Working Party on Development Finance Statistics, 2018[56]). Still, **DAC members need to ensure that these methods are embedded in all blended financial operations they support**. Collectively, DAC members need to actively encourage all financial intermediaries to adhere to this common transparency standard, including by the private sector arm of multilateral and bilateral DFIs.

126. **Transparency also entails some risks, which should be properly acknowledged by all stakeholders and mitigated.** A potential obstacle to enhancing transparency of blended finance transactions pertains to the claims of commercial confidentiality of information, especially by private actors. To some extent, this may be an unfounded argument, as real trade secrets are generally not inscribed in contractual agreements or financial flows (OECD and DANIDA, 2018[57]). The International Aid Transparency Initiative (IATI) standards, for instance, have made allowances for sensitive reporting situations including, inter alia, commercial information. For example, there is the option for partners to exclude some or all details of an activity in order to protect those involved. However, the benefits from disclosure of sensitive information to the market as a whole may outweigh the costs to individual entities, but only if all entities are subject to the same requirements (IFRS, 2019[58]).

Promote better reporting on development results, improving data collection and quality assurance processes

127. The 2018 OECD Blended Finance Funds and Facilities Survey shows that, while impact indicators are widely adopted, in reality, too little development performance data is collected ex post or taking into account the voice of end beneficiaries. Direct investees are by far the most common source of development impact information: 81% of funds and 63% of facilities rely on declarations from their client companies or financial institutions. The Survey further underscores that many financial intermediaries assess and communicate on their impact rather loosely (Basile, Bellesi and Singh, 2020[7]).

128. The DFI's enhanced principles on blended concessional finance in private sector projects (DFI Working Group, 2018[20]) refer to promoting high standards (principle 5). In practice, with regards to evaluation, this means that DFIs/MDBs apply the same standards to projects involving blended concessional finance as to other operations. To promote

consistency among MDBs, the Evaluation Cooperation Group (ECG) defined 'Good-Practice Standards for the Evaluation of Private Sector Investment Operations' in 2001 and revised it four times since (ECG, 2006[59]). European DFIs have recently made significant steps forward in enhancing their collective reporting on both direct and indirect development results (EDFI, 2020[60]).

129. Altogether, best practice involving tracking of development performance should distinguish between sources of information, including their provenance and any potential associated bias. Added to this, it is important to reiterate the need for both qualitative and quantitative information, as diverse and complementary sources enable the emergence of more robust evidence base through triangulation. Having disaggregated data is particularly important, for instance, gender-disaggregated impact results data should be made available. More integrity should be sought when analysing development results at various levels in the results chain: input, activities, outputs, outcomes and impacts. Robust methods of data collection and calculation are paramount to support this, although it is only realistically achievable if a common framework of understanding emerges; this will prevent confusion in terminology and allow for genuine comparison. DAC members should thus promote deontological ethics for the feeding, calculation and communication of development results among financial intermediaries entrusted with development finance.

7.2.3. Sub-principle 5.C - Dedicate appropriate resources for monitoring and evaluation

Empower the internal capacity for learning and accountability

130. Most blended finance actors lack internal capacity when it comes to monitoring and evaluation systems (Basile, Bellesi and Singh, 2020[28]). For instance, resource constraints as a bottleneck when it comes to transparency in blended finance operations was identified by the Tri Hita Kirana (THK) Working Group (THK Transparency Working Group, 2020[61]). Similarly, the Global Impact Investing Network's found that 25% of impact investors did not have the resources to hire wholly dedicated Impact Management and Measurement (IMM) staff (GIIN, 2017[62]). More recently, over 50% of the surveyed impact investors indicated that the supply of professionals with IMM skills is insufficient (Mudaliar et al., 2019[63]). Most importantly, only a small proportion of their IMM capacity is supported through donor funding (16%).

131. It is important to highlight that the allocation of development assistance often comes with a provision to dedicate a percentage of the total budget to monitoring and evaluation. Similarly, DAC members could consider dedicating a ring-fenced amount to evaluation when making an investment for blending purposes. For instance, The Children's Investment Fund Foundation, reserves 5% of the programme budget to assess results down to the beneficiary level.

132. **Enhancing clarity on the respective *roles* of (ex-ante) impact assessment, Economic, Social and Government (ESG) due diligence, monitoring and (ex-post) evaluations would be beneficial for all blended finance stakeholders.** Each of these *roles* fulfils a different *function*, requires a different set of skills, therefore it may be advisable to ensure some degree of separation in organisational charts. Nonetheless, for smaller financial players, these roles are often merged and overlapping with investment responsibilities. DAC members could contribute to fostering linkages between key market enablers that are responsible for ESG certifications, IMM and evaluation in order to promote mutual understanding and cross-fertilisation among these fields.

Promote collaboration as integral to the partnership

133. **Better harmonisation of approaches to monitoring and evaluation could lead to a cost reduction, both for asset managers and client investees.** One example in this direction it the Mutual Reliance Initiative (MRI), agreed between EIB, AFD and KfW, which allows the institutions to use each other's supervision and monitoring systems to reduce the administrative burden on partner countries (EIB, 2013[64]). Similarly, blended finance partners can envisage to engage in joint and collaborative evaluations, that offer opportunities for mutual capacity development and learning between the partners, for building participation and ownership, for sharing the burden of work, for increasing the legitimacy of findings and for reducing the overall transaction cost for investors and investees alike (OECD, 2006[65]). Further information on effective partnerships is provided in the detailed Guidance note on Principle 4.

Apply differentiated approaches to monitoring and evaluation

134. **In line with best practice, donors could consider setting up differentiated approaches to monitoring and evaluation of their blended finance operations.** This could entail establishing basic requirements for all blended finance transactions, and more robust and sophisticated frameworks destined for those blended operations geared towards larger transformative impact, or in high-risk environments, or with high learning potential. Such differentiation of approaches could allow for larger cost-efficiency.

7.2.4. Sub-principle 5.D - Ensure public transparency and accountability on blended finance operations

Establish the enabling conditions for transparency

135. Information on the implementation and results of blended finance activities should be made publicly available and easily accessible to relevant stakeholders, reflecting transparency standards applied to other forms of development finance in line with the Busan Principles of Effective Development Co-operation (OECD, 2011[66]), the OECD Guiding Principles on Managing for Sustainable Development Results (OECD, 2019[67]), and Evaluation Quality Standards (OECD DAC, 2010[68]). The Detailed Guidance Note on Principle 4 also focuses on the need to promote transparency on performance data to all market participants to scale up blended finance. Besides accountability, external communication on blended finance performance is instrumental in mobilising further commercial capital, by improving the availability of market information and the quality of risk assessment for the efficient pricing of investments.

136. **The process of evaluation of blended finance should be independent in its function from the decision-making, delivery and management process.** Impartiality contributes to the credibility of evaluation and the avoidance of bias in findings, analyses and conclusions. It also provides legitimacy to evaluation and reduces the potential for conflict of interest.

Enable policy learning through accumulation of evidence and lessons learnt from monitoring and evaluation

137. **DAC members should apply the same standard to evaluations of blended finance operations as they do for more traditional development co-operation modalities.** In particular, they should actively encourage financial intermediaries to apply such standards by ensuring the same rigour in terms of conducting evaluations and publishing their findings. DAC members should strive to share all evaluations performed

by their bilateral DFI and private financial intermediaries in the OECD DAC Evaluation Resource Centre (DEReC) (OECD, n.d.[69]). An indirect and fragmented dissemination of evaluation findings and lessons learnt may hamper the credibility of the overall evaluation, especially when the underlying report is not fully disclosed.

138. Blended finance is a relatively new approach in development co-operation and rapidly gaining attention among policy makers, in OECD and developing countries alike. Against this background, **the production and dissemination of evidence is critical to understanding the relevance and effectiveness of blended finance**. Moreover, a systematic review of existing evidence with a focus on achieved results by various blended finance instruments would be an important contribution to the further discussions on the potential role and relevance of blended finance for the achievement of the SDGs (Winckler Andersen et al., 2019[11]).

7.3. Checklist to guide implementation of Principle 5

139. To assist DAC donors to implement recommendations laid out in the previous section in blended finance operations, a checklist is proposed in Figure 7.2 below:

Figure 7.2. Checklist to guide implementation of Principle 5



Source: Authors

7.4. Example of best practices

140. Box 5 below provides an example of best practice on measuring results about financial and development additionality of a blended finance facility. Further examples are included in the Detailed Guidance Note of Principle 5 as well as in (Basile, Bellesi and Singh, 2020[28]).

Box 7.1. How UNCDF, a blending facility part of the UN Development Programme, measures results about financial and development additionality

The United Nations Capital Development Fund (UNCDF) is the UN's capital investment agency for the world's 48 least developed countries (LDCs). As a hybrid development and financing agency, it deploys capital grants, loans and guarantees to both public and private entities mainly targeting local markets in LDCs, where the needs are the greatest. With its unique capital mandate and financing instruments, UNCDF offers 'last-mile' finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development (UNCDF, 2018[64]).

UNCDF's approach to measuring results attempts to capture both financial and development additionality through a formal theory of change and an Integrated Results and Resources Matrix (IRRM) that sets out a series of performance indicators, tracked on an annual basis (UNCDF, 2014[65]). To capture UNCDF's financial additionality, UNCDF regularly measures the additional finance that investees raise both as a result of UNDCF's support at the investment level as well as the additional 'catalytic' capital that arises from any follow-on finance that is indirectly mobilised by local actors as a result of the models and capacities originally supported by UNCDF. To measure its development additionality, UNCDF tracks a number of indicators that capture contributions to development results at both the investee level as well as at the policy or market system level.

In UNCDF's work in local development finance, financial additionality is measured inter alia by estimating the success of UNCDF-supported local governments in increasing their mobilisation of own resources. Development additionality is tracked through the number of local infrastructure projects completed by UNCDF. Catalytic impact is assessed by improvements in local governments' abilities to allocate, mobilise and invest their capital for investment. It is important to note that such interventions include both programmes designed to achieve scalable systemic impact, for example a new way of delivering climate finance at the local level, as well as individual stand-alone investments. The direct benefit of the investment may be limited, but its overall objective is the demonstration effect and associated policy and regulatory technical assistance towards the systemic impact. For each individual revenue-generating investment in its local development finance work, UNCDF operates a "dual key" investment committee which independently assesses financial and development outputs for each operation and ensures that a theory of change is in place against which to measure eventual impact.

Recognising the limitations inherent in any numbers-based measurement system, UNCDF's results are also validated and further explored via an independent Evaluation Unit, which makes use of theories of change at both the organisation and individual programme levels to design and conduct theory-based, mixed-method process and outcome evaluations examining questions of interest organised according to the UN/OECD criteria. Evaluators are tasked with validating the financial results that are reported by UNCDF investees, as well as exploring more deeply aspects of development additionality around improved capacity of partner organisations and the relevance and results of programmes and instruments at the beneficiary level. Evaluators also investigate UNCDF's contributions to market and system development using techniques such as contribution analysis and process tracing, taking care to recognise alternative drivers of change in what are by definition complex policy and market systems. In doing

so, UNCDF follows the relevant norms and standards for evaluation developed by the United Nations Evaluation Group as well as more specific guidance around measuring market development for the poor that has been developed by bodies such as the Consultative Group to Assist the Poor and the Donor Committee on Enterprise Development.

Source: Andrew Fyfe and Heewoong Kim, UNCDF, from (Basile, Bellesi and Singh, 2020[7]).

8. Conclusion

141. This paper lays out guidance for DAC blended finance actors on the five OECD DAC Blended Finance Principles based on emerging good practices and from a review of selected case studies.

142. Overall, the OECD DAC Blended Finance Principles result from a truly collaborative effort by the wide range of stakeholders active in the blended finance landscape. Public consultation have been undertaken to allow interested stakeholders to provide feedback and ensure that all voices and experiences are heard (Annex A provides the list of experts and organisations actively involved in the various rounds of consultations). As the principles are being widely discussed, the OECD aims to ensure that the guidance provided are being adhered to over the coming years. To support this objective, each Detailed Guidance Note provides a checklist to ensure effective implementation. This paper is therefore complementary to the Detailed Guidance Notes and should be used in tandem. The Detailed Guidance Notes will remain living documents, that the Secretariat will update to reflect key findings from relevant research work, evaluation reports and other knowledge emerging in the blended finance space.

143. Suggested next steps for the OECD to ensure implementation include undertaking pilot studies with DAC donors who express interest in the topic and in reviewing their blended finance operations in a developing country. After a series of pilot studies, the goal would be to further embed the OECD DAC Blended Finance Principles into donors' activities and ensure that these can be reviewed and lessons learnt drawn.

Annex A. Acknowledgements

This paper was prepared by the OECD Development Co-operation Directorate (DCD), headed by Director Jorge Moreira da Silva. Paul Horrocks, Head of Private Finance for Sustainable Development Unit (DCD) managed and led the work to develop this publication, with strategic leadership of Haje Schütte, Senior Counsellor and Head of Financing for Sustainable Development Division.

This paper was drafted by Valentina Bellesi and Faty Dembele. The core team responsible for drafting the underlying Detailed Guidance Notes included: Wiebke Bartz-Zuccala (Guidance Notes on Principles 2 and 4), Irene Basile (Guidance Note on Principle 5), Valentina Bellesi (Guidance Notes on Principles 1 and 5), Priscilla Boiardi (Guidance Note on Principle 1 and 5), Faty Dembele (Guidance Note on Principle 3), Jarrett Dutra (Guidance Notes on Principle 4), Marie Fuchs (Guidance Note on Principle 2), Weronika Garbacz (Guidance Notes on Principles 3 and 5), Natalia Lemanska (Guidance Note on Principle 3), Astrid Manroth (Guidance Notes on Principles 2 and 4), Lasse Moller (Guidance Note on Principle 3) and Esme Stout (Guidance Notes on Principles 1 and 5).

The quantitative analysis relied on the OECD statistics on private finance mobilised by official development interventions, kindly provided by Cecile Sangaré and Tomas Hos.

The authors would like to thank the following OECD colleagues who took the time to review and provide comprehensive feedback on the Detailed Guidance Notes: Rafael Duque Figueira, Thomas Boehler and Megan Grace Kennedy-Chouane.

The OECD is grateful to the support, expertise and insights provided by the following Senior Strategic Reviewers: Nancy Lee, Senior Policy Fellow at the Center for Global Development; Cameron Khosrowshahi, Director, Invest Initiative at USAID; Kay Parplies, Head of Unit, Investment and Innovative Financing at the European Commission and Christian Novak, Professor of Practice at McGill University - Institute for the Study of International Development.

The OECD is also grateful for the active contribution of experts during the physical and virtual workshops and consultations, including: Gunnel Axelsson Nycander (Act Church of Sweden), Milena Bertram (Finance-in-Motion), San Bilal (European Centre for Development Policy Management), Louise Böhm (Entrepreneurial Development Bank, FMO), Tihana Bule (OECD), Alex Chirmiciu (European Bank for Reconstruction and Development), Nerea Craviotto and Jan Van de Poel (Eurodad), Andrew Davidson (Moody's Investor Services), Amy Dodd (Development Initiatives), Yves Ehlert (European Development Finance Institutions), Andrew Hohns (Mariner Capital), Djedjiga Kachenoura (Agence Française de Développement), Megan Grace Kennedy-Chouane (OECD), Anja Kramer (KfW Development Bank), Theo Ib Larsen (Ministry of Foreign Affairs of Denmark), Alessandro Maffioli (Inter-American Development Bank), Astrid Manroth (OECD), Giulia Massobrio (International Trade Union Confederation), Nadia Nikolova (Allianz), Kay Parplies and Andreas Fischer (European Commission), Jesper Persson (European Investment Bank), Bettina Prato (International Fund for Agricultural Development), Julia Prescott (Meridiam), Kruskaia Sierra-Escalante (International Finance Corporation), Lori Scott (MacArthur Foundation), Drew Smith (Global Affairs Canada), Peter Sullivan (Citibank), Tim Turner (African Development Bank), Philippe Valahu (Private Infrastructure Development Group), Max von Bonsdorff (Ministry of Foreign Affairs of Finland), Mohan Vivekanandan and Alvino Wildschutt-Prins (Development Bank of Southern Africa).

The report also benefitted immensely from comments and insights sent by experts and practitioners during the various consultations, workshops and interviews undertaken by the OECD Secretariat, in particular the following organisations: the Act Church of Sweden, the Asabe ShehuYar'Adua Foundation, the Asian Venture Philanthropy Network (AVPN), the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), the BC.lab (Colombia), Bangladesh University of Textiles, Cordaid Investment Management, Development Bank of Southern Africa (DBSA), Eurodad, European Centre for Development Policy Management (ECDPM), Finance & Sustainability (Italy), Frontier Markets, the Giti Group (Indonesia), the Health Finance Institute, the International Trade Union Confederation (ITUC), the Lady Lawyer Foundation, the Latin American Venture Philanthropy Network (Latimpacto), the Ministry of Finance of Mauritania, the Ministry of Foreign Affairs of Indonesia, the Ministry of Foreign Affairs of Greece, the Ministry of Foreign Affairs of Spain, the National Water Commission of Mexico, the Private Infrastructure Development Groups (PIDG), Roots of Impact, Saïd Business School, SUED (Kenya), the Southern African Venture Capital and Private Equity Association (SAVCA), TXC Investment Management Company, the University of Oxford (United Kingdom), and the University of Dhaka (Bangladesh).

The OECD also thanks all participants attending webinars and consultation rounds.

The list of workshops and web-consultations conducted is summarised below:

- **23 May 2019**: Physical one-day workshop on the Guidance Note for Blended Finance Principle 4
- **10 October 2019**: Physical one-day workshop on the Guidance Note for Blended Finance Principle 2
- **30 January 2020**: Physical workshop on the Guidance Note for Blended Finance Principle 5 (during OECD Private Finance for Sustainable Development Days)
- **15 April - 15 July**: Public written consultation on Blended Finance Guidance Notes on Principles 1-5
- **14 May 2020**: Web-consultation on Blended Finance Principles 2, 4 and 5 with the Latin American Venture Philanthropy Network (LatImpacto) - Via Zoom
- **27 May 2020**: Web-consultation on the Guidance Note for Blended Finance Principle 5 – via Zoom
- **3 June 2020**: Web-consultation on the Guidance Note for Blended Finance Principle 1 – via Zoom
- **17 June 2020**: Web-consultation on the Guidance Note for Blended Finance Principle 3 – via Zoom
- **29 June 2020**: Web-consultation on the Guidance Note for Blended Finance Principle 3, specifically targeted to Civil Society Organisations (CSOs) – via Zoom
- **On-going**: written consultation with OECD Working Party on Responsible Business Conduct, as well as written consultation with members of the Tri Hita Karana (THK) Roadmap for Blended Finance

Annex B. Core Concepts

- **Additionality**: In general terms, additionality of a development finance intervention can be defined as providing additional financial or non-financial input resulting in additional development outcomes that would not have materialised without the intervention, thereby contribution to amplified development impact. Two key components of additionality are:
  I. **Financially additionality** refers to transactions extended to an entity which cannot obtain finance from the private capital markets (local or international) with similar terms or quantities

and for similar developmental purposes without official support, or if it mobilises investment from the private sector that would not have otherwise invested.

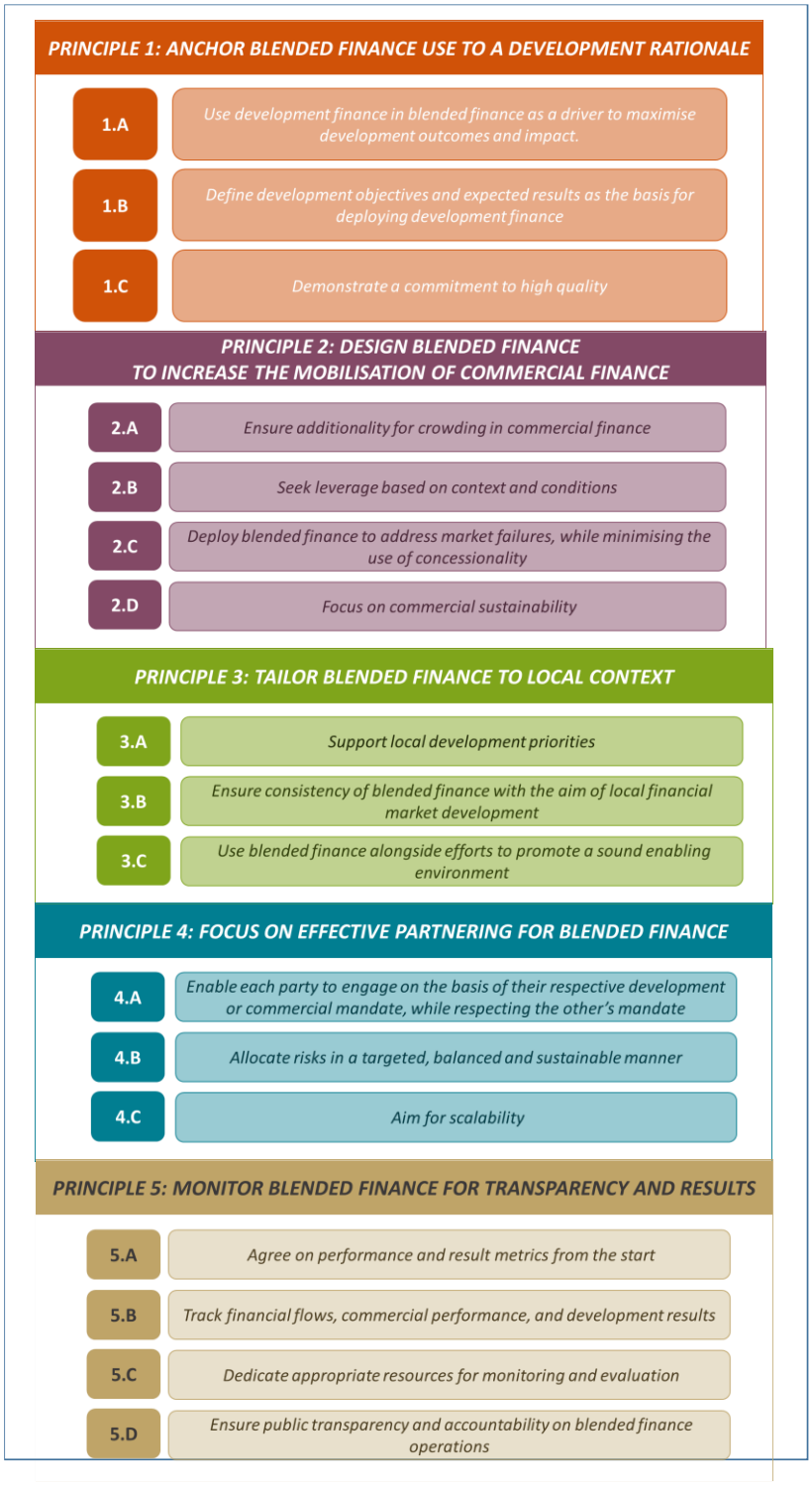
II. **Development additionality** refers to the development impact of the investment that would not have occurred without a partnership between the official and the private sector.

- **Mobilisation:** OECD defines mobilisation as the ways in which specific mechanisms stimulate the allocation of additional financial resources to particular objectives ("direct mobilisation"). It implies a causal link between private finance made available for a specific project and the official flows that were used to incentivize them. Mobilisation is easily auditable, attributable, and measurable vis-à-vis time of commitment/financial close.[7]
- **Concessionality**: In quantitative terms, OECD defines concessionality as a measure of the "softness" of a credit reflecting the benefit to the borrower compared to a loan at market rate. Concessional finance is used to lower the risk for private investors and/or enhance returns to unlock commercial finance that would otherwise not be forthcoming.
- **Commercial sustainability:** In the blended finance context, commercial sustainability refers to the long-term financial viability of transactions and sectors. Once commercial sustainability is achieved in a project or market, blended finance should no longer be deployed.

Source: OECD DAC Blended Finance Principle 2 – Detailed Guidance Note, http://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/principle-2/Principle_2_Guidance_Note_and_Background.pdf

[7] http://www.oecd.org/dac/stats/principles-for-mobilisation.pdf

Annex C. Blended Finance Guidance at a glance



1.A Does the project maximize development outcomes?

- ✓ Does the project focus on sectors where it can achieve maximum development impact?
- ✓ Does the project build incentives that promote public-private co-operation hence balancing expectations on development outcomes vis-á-vis financial risks and returns?
- ✓ Are the necessary internal skills and capacities developed in order to effectively engage with private sector actors?

1.B Does the project articulate blended finance objectives?

- ✓ Does the project link with overarching development objectives, in line with the 2030 Agenda and the Paris Agreement?
- ✓ Does the project align with local policy priorities?
- ✓ Is the blended finance project the most effective financing approach within a broader development co-operation strategy?

1.C Does the project commit to high quality standards?

- ✓ Does the project align ESG safeguards to existing international standards (e.g. IFC Performance Standards, PRI, etc.)
- ✓ Is the process of screening partners and projects according to RBC practices applied? -> OECD Guidelines for Multinational Enterprises
- ✓ Does the project uphold reporting obligations and promote transparency in each phase of the investment cycle?

2.A Does the project ensure development additionality?

- ✓ Does the project determine development objective, additionality & theory of change?
- ✓ Are market failures clearly identified?
- ✓ Is the intervention co-ordinated with the eco-system?
- ✓ Are development impacts monitored and evaluated?

2.B/C Does the project ensure financial additionality?

- ✓ Does the project identify the main financing gaps?
- ✓ Does the chosen financial instrument ensure minimum concesionality?
- ✓ Is the target mobilisation determined depending on the context?
- ✓ Do you have a clear view of how to exit once commercial markets are functioning?

2.D Does the project ensure commercial sustainability?

- ✓ Are the adequate policy, sector and investment frameworks developed?
- ✓ Does the project ensure coherent approaches amongst all stakeholders?
- ✓ Do you have a clear understanding of how to monitor and facilitate market development?
- ✓ How do you ensure that the project is not being deployed in well functioning commercial markets?

3.A Does the project support local development initiatives?

- ✓ Does the project include an effective stakeholder consultation process throughout the investment cycle?
- ✓ Is the project developed in line with national development strategies and including national actors at all stages of the project, as co-owners?
- ✓ Are additionality assessments conducted based on local considerations, including a comprehensive understanding of local market structure, political environment and sector characteristics to help to identify local market failures?
- ✓ Is the organizational setting suitable to ensure regular communication and good oversight of the project on the ground?
- ✓ Is the project benefiting from local monitoring thanks to effective local partnerships? Are local partnerships helping to originate new relevant deals in line with local priorities?

3.B Does the project support local market development?

- ✓ Does the project contribute to increase capacity of local financial institutions?
- ✓ Does the project seek to involve local investors? Does it actively seek to provide opportunities for crowding in domestic finance in strategic sectors aligned with national development plans?
- ✓ Does the project promote local currency financing as a key factor contributing to local financial market development?

3.C Does the project support promotion of sound enabling environment?

- ✓ Is the project designed to offer a demonstration effect and more broadly contribute to attract further investment?
- ✓ How is the project contributing more broadly to a favorable investment climate that is essential in attracting and retaining foreign and domestic investments?

4.A Engaging each party on the basis of their respective mandate

- ✓ Understand the mandates, objectives and risk-return profiles of each actor involved in blended finance

4.B - Allocate risks in a targeted, balanced and sustainable manner

- ✓ Understand and assess the different types of underlying risks, in country- and sector-specific contexts
- ✓ At each level of blending, different methodologies for risk assessments should be applied as a basis to determine the optimal blending instrument and concessionality level
- ✓ Bring in local entities so as to improve risk allocation in blended finance
- ✓ Adjust the mix between concessional and commercial finance as risks evolve along different stages of the project lifecycle
- ✓ Strengthen capacity in donor agencies to assess and verify balanced risk allocation in blended finance

4.C - Aim for scalability

- ✓ Promote transparency and data availability, as well as knowledge sharing
- ✓ Set incentives for scaling up through appropriate and targeted mobilisation objectives for MDBs/DFIs
- ✓ Promote whole-of-government approaches and improved collaboration and co-ordination between MDBs and DFIs
- ✓ Make sufficient funding available for early stage project preparation to accelerate the creation of a pipeline of bankable projects, as well as for creating an enabling environment
- ✓ Encourage the replication of successful blended finance instruments and standardisation of instruments

5.A Agree on performance and result metrics from the start

- ✓ Adopt a theory of change for a blended finance mechanism as a whole
- ✓ Reach an initial agreement on reporting for results, using a common set of key performance indicators
- ✓ Adopt a common monitoring and evaluation framework

5.B Track financial flows, commercial performance, and development results

- ✓ Ensure more financial transparency, while avoiding the pitfalls
- ✓ Promote better reporting on development results, improving data collection and quality assurance processes

5.C Dedicate appropriate resources for monitoring and evaluation

- ✓ Empower the internal capacity for learning and accountability
- ✓ Promote collaboration as integral to the partnership
- ✓ Apply differentiated approaches to monitoring and evaluation

5.D Ensure public transparency and accountability on blended finance operations

- ✓ Establish the enabling conditions for transparency
- ✓ Enable policy learning through accumulation of evidence and lessons learnt from monitoring and evaluation

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