itf impact taskforce

JUST TRANSITION FINANCE

MOBILISING INSTITUTIONAL CAPITAL TO DELIVER A NET ZERO WORLD WHERE NO-ONE IS LEFT BEHIND

ACTIONS FOR MULTILATERAL DEVELOPMENT BANKS (MDBs) AND DEVELOPMENT FINANCE INSTITUTIONS (DFIs)

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Actions for MDBs and DFIs

Fulfilling the UN Sustainable Development Goals (SDGs) and transitioning to a world of Net Zero carbon emissions at the pace required – and in a way that's just and inclusive for all – requires trillions in capital every year.

A global transition to Net Zero that is inclusive and socially beneficial – i.e. a Just Transition – can only be achieved with a fundamental shift in financing. This summary highlights key actions that multilateral development banks and development finance institutions can take to help achieve a global Just Transition, based on the findings of the Impact Taskforce's report, 'Mobilising institutional capital towards the SDGs and a Just Transition'. The Impact Taskforce's recommendations build on consultations with over 170 finance, policy and thought leaders representing over 110 organisations in 38 countries.

WHAT IS A 'JUST TRANSITION' – AND WHY DOES IT MATTER?

The climate crisis is one of the defining challenges of our time. But there is growing consensus that a single focus on achieving net zero emissions is not enough.

↳ To be successful, climate action also needs to address the socio-economic impacts of moving to Net Zero – from potential job losses to rising household energy prices.

↳ It needs to be recognised that the impacts of climate change tend to disproportionately affect those in poverty and can exacerbate existing inequalities.

↳ To gain support and avoid social tensions or unrest, the transition to Net Zero needs to be fair – and seen to be fair – across regions and across the socio-economic spectrum.

A JUST TRANSITION NEEDS TO CONSIDER:

1 **Different climate transition and planet preservation strategies across sectors.**

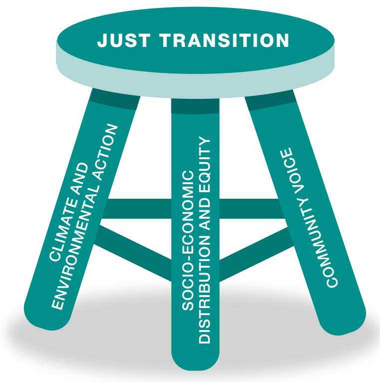
2 **Geographic disparities, needs and priorities at international, regional and national levels.**

3 **Affected, underserved and marginalised communities, households, workers and enterprises.**

THE THREE JUST TRANSITION ELEMENTS

Given the considerations above, there are three critical drivers of a Just Transition applicable across geographies, sectors, policies and investments. To be aligned with a Just Transition, actions should:

- Advance Climate and Environmental Action
- *AND* Improve Socio-economic Distribution and Equity
- *AND* Increase Community Voice



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Why development institutions are key to the Just Transition

- Multilateral development banks (MDBs), such as the World Bank, the European Bank for Reconstruction and Development, the African Development Bank and Asian Development Bank, or bilateral development finance institutions (DFIs) such as British International Investment (UK), DEG (Germany), and DFC (US), are set up to provide financing to fund projects that support social and economic development in emerging markets and frontier markets[1]
- Rapid progress is needed on a Just Transition throughout the world, but particular emphasis and effort needs to be put on social and environmental projects in emerging and frontier markets where the funding gaps are most pronounced. MDBs and DFIs are uniquely positioned to demonstrate and develop the investability of these markets for other investors
- MDBs and DFIs are usually government majority-owned and source their capital from national or international development funds or benefit from government guarantees. This creditworthiness enables them to raise large amounts of money on global capital markets and provide financing on competitive terms
- Their government backing and experience in emerging markets means MDBs and DFIs are able to go where the private sector currently cannot, creating investable pipelines, investment track records and – ultimately – functioning markets, so that private capital can follow

What development institutions can do to advance a Just Transition

ACTION 1: MAKE PRIVATE CAPITAL MOBILISATION A CORE OBJECTIVE

MDBs and DFIs have made substantial funding commitments towards the SDGs and Just Transition activities. MDBs alone committed $61.6 billion towards climate finance in 2020. But public monies alone will not be enough. These institutions can also use their status, networks and local market expertise to help mobilise private capital the $154 trillion held by institutional investors such as pension funds, insurers and foundations – which presents one of the most powerful means to deliver a Just Transition to Net Zero.

Governments are invited to amend the objectives of MDBs and DFIs to make capital mobilisation and balance sheet investment equally important. Incentive mechanisms also need to be structured so that every mobilised dollar receives as much recognition as a dollar invested on an institution's own account.

As sole or majority shareholders of MDBs and DFIs, national governments can provide strategic direction by mandating greater ambition for these institutions around, and commitment to delivering, the SDGs and Just Transition outcomes.

1 The UNEP Finance Initiative estimates the funding gap for achieving the SDGs in emerging markets at USD 3.5 trillion per year, compared to USD 0.1 trillion in advanced economies.

ACTION 2: PROVIDE MORE INVESTMENT RISK SUPPORT IN TARGET EMERGING MARKETS

Although the level of investment is increasing, institutional investors continue to face real and perceived barriers to participating in emerging market transactions – such as macro and market risk, lack of liquidity and low credit ratings.

By deploying risk-mitigating instruments as part of a 'blended finance' transaction, MDBs and DFIs can help de-risk a transaction for other investors. This blended capital can help to direct large-scale private sector capital into opportunities in emerging markets that would otherwise remain on the side-lines.

Blended transactions can feature tried-and-tested tools such as:

Subordinated capital	Guarantees	Insurance	Syndication
Structured so a junior tranche (held by risk-tolerant or concessional capital providers such as MDBs or DFIs) absorbs losses first, giving the senior tranche (held by institutional investors) loss protection. This is the most widely-used blended finance tool for related investing vehicles	Provided on loans or other debt structures, the guarantor (e.g. an MDB or DFI) agrees to pay the investor or lender in the event that the investee or borrower cannot, in return for a fee. This can enable a proposition to attain the threshold investment-grade rating required by institutional investors	Can be used to cover specific risks (e.g. political, credit and non-payment) so that institutional investors can participate in an investment vehicle. Can also expand the balance sheet reach of MDBs and DFIs	By syndicating parts of their loans to third-party investors, MDBs and DFIs can allow institutional investors to benefit from their sourcing capabilities, market network and even their preferred creditor status

Securitisation
An MDB or DFI packages part of its loan portfolio then sells the loan cashflows as securities to investors (or synthetically transfers risk using credit derivatives). Institutional investors can select the securitisation tranche that matches their risk-reward requirements. This can free up substantial amounts of funding of MDBs' and DFIs' balance sheets, allowing them additional capital to reinvest.

Concessional and risk-tolerant capital is scarce so the market needs to be disciplined and use it only where it is needed to mobilise investors and where mobilisation multiples can benefit as many transactions as possible. Scrutiny is needed to see how its use might be reduced over time as data and track records are generated.

ACTION 3: HELP BUILD A STRONG JUST TRANSITION MANAGER ECOSYSTEM

As a tangible starting point for developing effective investment vehicles, the Just Transition Blueprint developed by the Impact Taskforce details how Just Transition considerations can be integrated into every stage of vehicle creation and management. MDBs and DFIs are uniquely placed to partner with asset managers and other capital markets ecosystem players to advance the design of replicable Just Transition vehicles using the Blueprint through:

Co-creation partnerships – Where institutional investors and impact players, including MDBs and DFIs, jointly design and sponsor the establishment of an investment structure with the objective of catalysing more capital towards a specific impact investment objective.

Co-management partnerships – Where different managers and complementary skills sets, e.g. a mainstream manager and a DFI, cooperate, aiming to provide a combined offering that is attractive to institutional investors, allowing a fund to scale rapidly.

Capacity-building support – MDBs, DFIs and other major impact investors can also help build the capacity of third-party asset managers pursuing Just Transition strategies by:

- Providing specific support to local, emerging and first-time fund managers that adopt the Just Transition Elements
- Incrementally increasing annual allocations to such managers
- Showcasing these managers to other investors

Among other interventions, MDBs and DFIs are invited to launch calls for proposals among asset managers for selected transactions meeting the Just Transition Elements to receive MDB/DFI anchor capital.

ACTION 4: SHARE RELEVANT PERFORMANCE DATA

MDBs and DFIs hold a large volume of relevant emerging markets data, including on performance. Sharing data with investors, asset managers and rating agencies can fundamentally change the flow of capital to emerging markets. As well as helping to increase amounts invested, a greater flow of data can reduce the risk premium demanded on emerging market securities. This is turn can potentially provide billions in savings to entities seeking to raise capital in these markets.

MDBs and DFIs' long-term data and track record in emerging markets can assist institutional investors in their own risk assessments. It can also help to challenge the perception of an inverse relationship between social or environmental impact and financial return. MDBs and DFIs are therefore encouraged to share relevant performance date where possible from a commercial sensitivity perspective.

ACTION 5: CONSIDER SELLING MATURE ASSETS TO INSTITUTIONAL INVESTORS

In many target markets, the lack of size and investment pipeline is a barrier to institutional investment. One way for MDBs and DFIs to address this is by selling some of their more mature and well-performing assets – e.g. through portfolio syndication or securitisation structures – to institutional investors (alongside other interventions to create viable private participation via the creation of investable assets). This can:

- Allow institutional investors to step into performing assets with a track record
- Free up the MDB's or DFI's balance sheet to take on other impact opportunities
- In the case of private assets (e.g. private equity, debt or infrastructure), create deeper functioning secondary markets in targeted jurisdictions, increasing investor confidence that there is sufficient access and liquidity

Securitisation allows private investors to get access to MDBs' and DFIs' portfolios and participate in the deals they originate and manage, which is otherwise generally not possible as private investors cannot invest directly in MDBs.

Examples of Just Transition investments

There are multiple examples of investments aligned with a Just Transition already on the market. Detailed case studies of select investment propositions, as well as further examples of investments on the market, are available here.

Asset class hierarchy			Vehicle	Case study	Examples
Alternatives	Private equity	**Private equity** (Note: Forestry included herein, however, often included in real assets depending on investor allocation buckets)	**Private equity fund** (direct)	**LeapFrog**: Emerging Consumer Fund III	• **DPI**: African Development Partners III • **New Forests**: Tropical Asia Forest Fund • **TPG**: Rise Fund II
Alternatives	Private equity		**Fund of funds**	N/A	• **AllianzGI**: AfricaGrow Fund • **Credit Suisse**: Climate Innovation Fund
Alternatives	Private debt	**Private debt**	**Private debt fund**	**Ninety One**: Africa Credit Opportunities Fund 2 **responsAbility**: Access to Clean Power Fund	• **FMO/NNIP**: Emerging Markets Loans Fund • **BlueOrchard**: InsuResilience Investment Fund • **Triodos IM**: Triodos Microfinance Fund
Alternatives	Real assets			**Actis**: Energy Fund 4	• **Ninety One**: Emerging Africa Infrastructure Fund • **Africa Finance Corporation**: Infrastructure Climate Resilient Fund
Alternatives	Real assets	**Real estate**	**Real estate fund**	**IHS**: IHS Fund II SA	• **Divercity**: Urban Property Fund • **Schroders**: Schroder Capital UK Real Estate Impact Fund
Fixed income		**Bonds**	**Bond fund**	**BlueOrchard**: Schroder International Selection Fund BlueOrchard Emerging Markets Climate Bond fund (CBF)	• **Amundi/IFC**: Amundi Planet Emerging Green One • **IFC**: Masala bond programme (Note: Alternative structure)

MDBs and DFIs are critical actors in accelerating large-scale mobilisation of private institutional capital in order to finance a Just Transition in emerging markets. This has implications for the business models of these institutions, with the opportunity to expand project pipeline capabilities, de-risking and the range of investment tools that these institutions can deploy. By taking the actions listed here, DFIs and MDBs can materially strengthen institutional involvement in the investable opportunities in emerging markets that are key to achieving a Just Transition.

For other Just Transition Finance Action Summaries in this series and case studies of financing vehicles that can help deliver a Just Transition, visit www.impactinvest.org/just-transition-finance/