MOBILISING INSTITUTIONAL INVESTORS FOR FINANCING SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES

Emerging evidence of opportunities and challenges

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BETTER POLICIES FOR BETTER LIVES

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Please cite this paper as *OECD (2021), Mobilising institutional investors for financing sustainable development in developing countries: Emerging evidence of opportunities and challenges, OECD Publishing, Paris.*

This document is also available in the OECD document database under the document code DCD (2021)11

Abstract

This report was co-drafted by the OECD Development Co-operation Directorate and the Directorate for Financial and Enterprise Affairs. After a brief description of the volumes and allocation of assets of institutional investors globally as well as the trends (Chapter 1.), the report analyses the share of these investments allocated to developing countries based on a sample of institutional investors in 2017-18, as well as their main characteristics in terms of regional and asset class distribution (Chapter 2.). It subsequently looks at the main investment drivers and considerations of institutional investors when operating in developing countries, including the extent to which they seek alignment to ESG standards, SDGs or to collaborate with governments (Chapter 3.). Finally, the report looks at the potential of blended finance solutions to unlock institutional investment for development purposes (Chapter 4.).

Foreword

Institutional investors, such as pension funds, insurers and sovereign wealth funds, are significant players in the world's economy and their share in international markets has been constantly increasing, with investments in companies worldwide and as creditors of most governments in developed countries. With over USD 100 trillion in assets in 2019 in OECD countries alone, institutional investors potentially represent a major source of long-term financing to support sustainable growth in developing countries. Long-term finance plays a pivotal role in fulfilling physical investment needs across all sectors of the economy, including low-carbon infrastructure.

At the same time, the COVID-19 pandemic exacerbated the financing gaps for the implementation of the 2030 Agenda and the ambitious SDGs. While the pre-COVID-19 annual financing gap for the SDGs was estimated to amount to USD 2.5 trillion (UNCTAD, 2020[1]), it increased by 50% in 2020 and reached USD 3.7 trillion (OECD, 2020[2]). The financing gap exceeds by far development co-operation budgets worldwide. For reference, net ODA flows by members of the Development Assistance Committee (DAC) amounted to USD 161 billion in 2020 (OECD, 2021[3]).

In this context, mobilising institutional assets for sustainable development, in particular towards emerging markets, is more than never at the heart of the financing for development debate. A shift of only 3.7% of the USD 100 trillion of assets held globally by institutional investors towards sustainable activities in developing countries would be sufficient to fill the USD 3.7 trillion gap (OECD, 2020[2]). However, this requires a strengthened collaboration between private and official actors, including development finance providers, to ensure that appropriate tools (e.g. risk mitigation instruments) and standards are put in place to mobilise private capital for developing countries aligned with the SDGs. In particular, developing countries need long-term investors to help finance activities that support sustainable growth through resilient and low-carbon infrastructure and other key areas. Blended finance solutions have a role to play in this respect, especially to ensure that institutional assets mobilised for the benefit of developing countries are directed toward projects with expected sustainable development impact.

Source of information and coverage

This report shows the latest data available at the time of its drafting. Chapter 1. mainly relies on data collected by the OECD Directorate for Financial and Enterprise Affairs through its annual statistical exercises on pension funds and insurance companies. The subsequent chapters mainly build on the 2019 survey edition of the OECD annual survey of large pension funds and public pension reserve funds (OECD, 2019[4]). The 2019 edition included a special Addendum Questionnaire seeking additional information on the volumes and distribution of institutional investors' assets in developing countries ("quantitative questionnaire"), as well as on the main drivers of these investments and their propensity to align with the SDGs ("qualitative questionnaire"). More details can be found in Annex B.

Acknowledgements

This publication was prepared jointly by the OECD Development Co-operation Directorate (DCD) led by Jorge Moreira da Silva, Director, and the Directorate for Financial and Enterprise Affairs (DAF) led by Greg Medcraft, Director. It was co-ordinated by Cécile Sangaré and benefited from inputs and guidance from Julia Benn, as well as from Haje Schütte, Paul Horrocks and Olivier Cattaneo (DCD). It was drafted by a cross-Directorate team:

- Chapter 1: Romain Despalins, with guidance from Pablo Antolin and Mamiko Yokoi-Arai (DAF);
- Chapters 2 and 3: Tomáš Hos and Amélie Schmidt-Ott, with inputs from Faten Boukhchana and guidance from Cécile Sangaré (DCD);
- Chapter 4: Faty Dembele, Cécile Sangaré and Tomáš Hos (DCD).

This report relies on the answers to a survey targeting selected institutional investors. This survey was conducted by Joel Paula, Elsa Favre-Baron and Yael Regev (DAF) and benefited from inputs by Tomáš Hos and Cécile Sangaré for the inclusion of specific data requirements and questions related to institutional investment toward developing countries. It also benefitted from the support of Alice Golenko Lewkowitz for the statistical processing and quality assurance of the data, and of Ryad Selmani for the proofreading and final quality checking of the report.

The authors extend their thanks to all organisations providing data and insights to the report, and for external written contributions by Kees Bakker (ABP), Jan Kæraa Rasmussen (PensionDanmark) and Michael Kurdyla (International Finance Corporation) in particular.

Last but not least, this publication benefitted from the contribution of the Development Communications team.

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Executive summary

Main findings

Institutional investors – such as pension funds and insurance companies – are key participants in financial markets, holding more than USD 100 trillion of assets at end-2019 (see Chapter 1.). Most of these assets are invested in bonds and equities. The investments of institutional investors are usually regulated through quantitative investment limits – relatively common for pension funds – or a more principle-based approach, such as for insurance companies in many countries.

While the pre-COVID-19 annual financing gap for the SDGs was estimated to amount to USD 2.5 trillion (UNCTAD, 2020[1]) for developing countries, it increased by 50% in 2020 and reached USD 3.7 trillion. Reducing the financing gap for the SDGs requires shifting financial resources towards sustainable development, including from the private sector, as well as greater alignment of all the investment chain with the SDGs.

Institutional investors can help: shifting only 3.7% of their assets towards sustainable activities in developing countries would be sufficient to fill the USD 3.7 trillion gap (OECD, 2020[2]).

However, a survey conducted by the OECD on selected institutional investors confirmed their propensity to mainly allocate assets in stable and low-risk contexts (Chapter 2.). Only a small share of the global assets of institutional investors is allocated to developing countries, mostly to middle-income economies with well-developed investment climate and in the form of asset classes with a relatively low-risk profile and predictable returns.

- During 2017-18, **only 8% of total assets of the 36 pension funds included in the survey sample were allocated to developing countries**, mainly in Asia (68%) and in particular middle-income countries such as People’s Republic of China, India and Southeast Asian countries. Such assets were mostly held in the form of listed equity (57%) and fixed-income instruments (25%). Moreover, 85% of all assets allocated to developing countries were managed by merely four pension funds based in three countries, showing high concentration among a limited number of institutions.
- As regards insurance companies, the survey sample of 30 insurers suggests an even more cautious allocation decision making. **Only 2% of the assets of insurance companies in 2017-18 were allocated in developing countries, 90% of which in Asia**. Approximately two-thirds of these assets were held in the form of fixed-income instruments while the remainder was diversified mainly across listed equity, loans and cash deposits. Investment currency is also a central driver as regards the investment decisions of insurance companies.

Investment decisions by pension funds and insurance companies are largely influenced by risks associated with local corruption levels and political or macroeconomic instabilities. The availability of skilled workforce plays an important role too for all these actors, while investment opportunities constitute the main investment driver for pension funds (Chapter 3.). Interest rate levels also constitute an important driver. The current low interest rate environment in the OECD countries is a challenge for investors who

need to reorient their investment strategies towards more profitable asset classes and markets: there may lie an opportunity for emerging economies.

Mainstreaming sustainability considerations in the internal policies of institutional investors does not necessarily imply aligning their investment with the SDGs. Most surveyed pension funds and insurance companies showed a rather limited focus on development impact and environmental, social and governance (ESG) standards in their portfolio allocation decisions. Moreover, only half of institutional investors indicated to have aligned their internal policies to some extent with the 2030 Agenda and the SDGs. Still, mainstreaming the objectives of the Paris Agreement in their internal strategy, at least to some extent, was indicated by approximately two-thirds of the surveyed investors.

Collaboration between institutional investors and the public sector – be it governments of provider or partner countries, or multilateral organisations – remains sporadic. No more than a fifth of the surveyed institutional investors collaborate with provider countries' development co-operation agencies, development finance institutions (DFIs) or multilateral development agencies and collaboration with governments of the developing countries is even rarer. Still, when collaboration occurs, it concentrates on risk mitigation, co-financing, access to knowledge and advice or due diligence services. In contrast, development outcomes are not prioritised under such multi-stakeholder partnerships.

Blended finance is one option in the development co-operation tool box to mobilise institutional investors' assets toward developing countries. The use of risk mitigation instruments such as guarantees can contribute to lowering the perception of risks by institutional investors. However, development finance providers need to put more efforts to further mobilise institutional investors at scale in blended finance operations given their limited involvement so far. Finally, the mobilisation of local pension funds and insurance companies also plays an essential role in developing local capital markets and in providing local currency financing.

Main policy recommendations

- **Countries hosting large pension funds and insurance companies have a role to play in introducing greater flexibility in investment regulations and removing the micro and macro-economic barriers** – including the lack of transparency and information asymmetry on private investment – to unlock institutional assets at the global level and towards developing countries more specifically.
- **While it is necessary to encourage the scaling-up of institutional asset allocation towards developing countries, ensuring their sustainability through impact investment policies is equally important for the achievement of the SDGs.** Aligning the financial system – banking, capital markets and insurance – with sustainable development pathways requires the involvement of all actors, including international financial institutions, banks, institutional investors, market-makers such as rating agencies and stock exchanges, as well as central banks and financial regulatory authorities.
- **Blended finance can de-risk deals and enhance returns to crowd in capital from local or international institutional investors, but incentives from development finance providers are also needed to mobilise these actors at scale**. This includes efforts for aggregating multiple projects – e.g. through portfolio investment mechanism – to help achieve the needed investment ticket sizes, as well as to contribute to portfolio diversification for institutional investors.

  Finally, increased transparency of institutional investors' asset distribution is critical for building trust in the markets and, thus, unlocking financing towards developing countries. Transparency does not only build trust in the international development system, but it is also an important source of learning opportunities and inputs needed for evidence-based policies and informed partnerships for the SDGs.

1. Trends in global institutional assets

This chapter sets the scene by describing the general landscape of institutional investors. Section 1.1 shows the amount of assets that institutional investors hold, their evolution, and the way these assets are invested. Section 1.2 then describes the investment restrictions that institutional investors have to comply with and that may impact the allocation of these assets, focusing on pension funds and insurance companies.

1.1. Highlights on institutional investors and their investments

Overview of institutional investors and their size

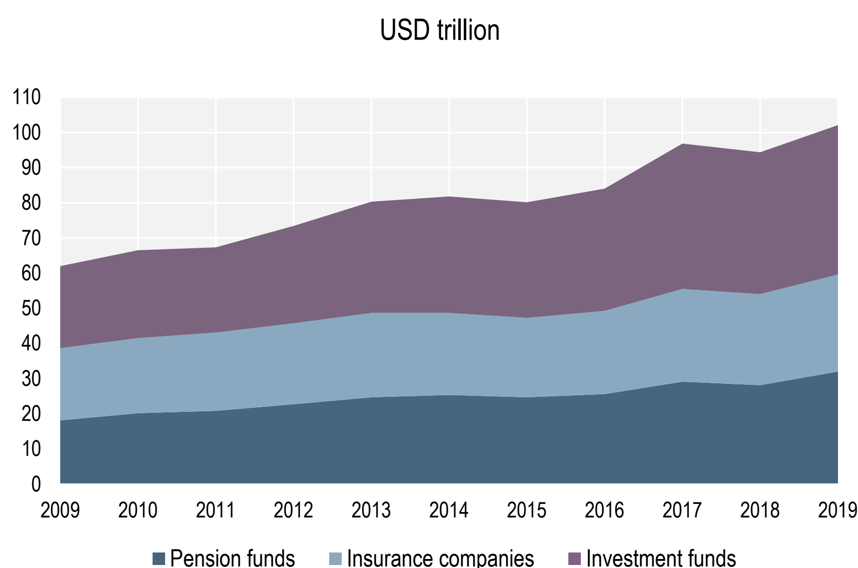
Institutional investors are one of the key participants in financial markets. They are legal entities pooling, managing and investing other people's money, usually acting as intermediary investors (Çelik and Isaksson, 2013[5]). This group of investors includes various institutions, such as pension funds, insurance companies and investment funds. Sovereign wealth funds and public pension reserve funds are sometimes considered as institutional investors too although they could be seen as the ultimate owner of the assets they invest.[1] Institutional investors differ from retail investors, also known as individual investors, who are physical persons purchasing and selling securities for themselves and who may not be professional investors.

As institutional investors cover various types of institutions, their missions towards their clients vary. Pension funds pool and invest people's contributions to finance future pension benefits (OECD, 2005[6]). Insurance companies collect premiums to cover policyholders against risks affecting their life, health, business or belongings. Insurance companies can also sell investment and savings contracts to individuals (e.g. unit-linked products, annuity contracts). Investment funds are financial intermediaries through which investors pool money to invest in financial assets or real estate. Investment funds give access to their clients to some financial assets through professionally managed portfolios, even at small amounts of capital (OECD, 2017[7]). Although their ultimate mission differs, institutional investors usually have the duty to act in the best interest of their clients or beneficiaries (ICGN, 2013[8]).

The amount of assets that institutional investors manage to fulfil their mission is relatively large and has been growing, exceeding USD 100 trillion at the end of 2019 in the OECD (Figure 1.1). Investment funds held the largest amount of assets at end-2019 (USD 42 trillion), followed by pension funds (USD 32 trillion) and insurance companies (USD 28 trillion). Investment funds may pool and invest money from individuals and other institutional investors (such as pension funds and insurance companies). A part of the assets of pension funds and insurance companies may therefore be counted under investment companies. Other institutional investors held lower but still significant amount of assets, such as public pension reserve funds with USD 6 trillion of assets at end 2018 (OECD, 2019[9]).

[1] Sovereign wealth funds serve as financial stabilisation funds and are *de facto* state ownership agencies (Çelik and Isaksson, 2013[5]). Public pension reserve funds manage assets of the government or social security schemes to support the financing of public pensions.

Figure 1.1. Assets of selected institutional investors in the OECD, 2009-19

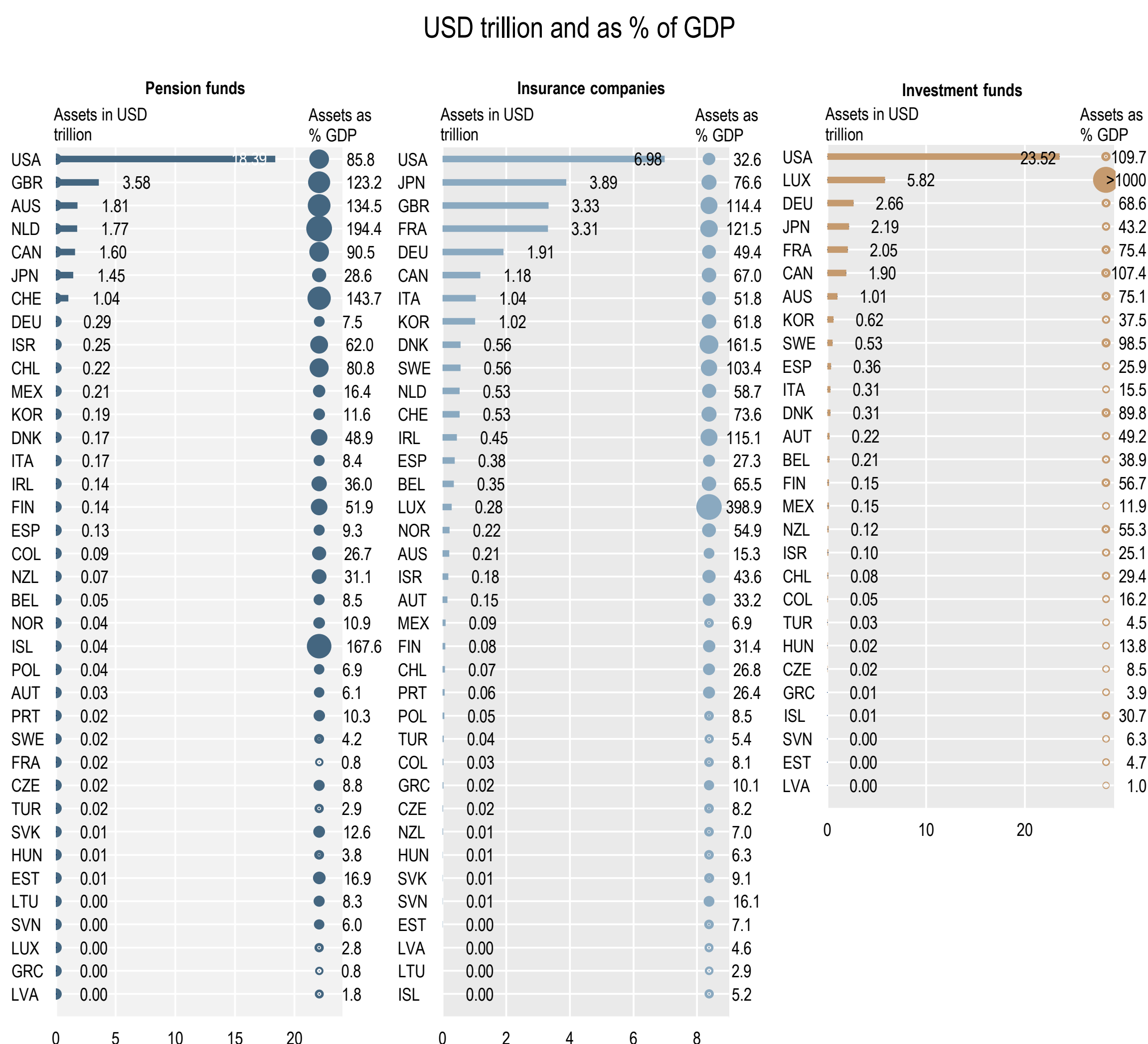


Note: Data on pension funds refer to the amount of their investments instead of their assets. While in general, the difference between assets and investments would be minimal, this difference may be more substantial in some cases, such as the United States, where claims of pension funds on the plan sponsors are considered as assets of the (defined benefit) plan but not as investments. Data on insurers refer to the assets of direct insurers. Data on investment funds include both their financial and non-financial assets. The total assets of investment funds cover all OECD countries except: Ireland, Lithuania, the Netherlands, Norway, Poland, Portugal, the Slovak Republic, Switzerland and the United Kingdom.
Source: OECD Global Pension Statistics; OECD Global Insurance Statistics; OECD Institutional Investors Statistics databases.

The size of institutional investors varies widely across countries (Figure 1.2). The largest amounts of pension fund assets (in USD) are recorded in countries with a relatively long history of saving for retirement (e.g. Canada, the United States) or where participation in a pension fund has been mandatory or quasi-mandatory (i.e. according to collective labour agreements) for years (e.g. Australia, the Netherlands and Switzerland). The insurance industry is also especially large and developed in some of the largest economies (i.e. France, Germany, Japan, the United Kingdom and the United States). Investment funds are also most prominent in the United States, as well as in Luxembourg where a wide range of vehicles (e.g. UCITS, SIF, RAIF) is available (LFF, 2021[10]). By contrast, assets of institutional investors are relatively low (in USD) in a number of countries with small or recent financial markets (such as in the Baltic countries).

Figure 1.2. Assets of selected institutional investors in selected OECD countries, by country, 2019

USD trillion and as % of GDP



Note: The bars show the assets of institutional investors in USD trillion, while the bubbles show the size of their assets relative to the domestic economy (i.e. GDP). Countries are labelled with their ISO code, available on the United Nation Statistics Division internet page at the following address: http://unstats.un.org/unsd/methods/m49/m49alpha.htm. Data on pension funds refer to the amount of their investments instead of their assets. Data on insurers refer to the assets of direct insurers. Data on investment funds include both their financial and non-financial assets. Data on assets refer to: 2014 for investment funds in Latvia; 2016 for investment funds in Colombia and Denmark; 2017 for investment funds in the United States; 2018 for insurance companies in Canada, Korea and the Netherlands; and 2019 in all the other cases.
Source: OECD Global Pension Statistics; OECD Global Insurance Statistics; OECD Institutional Investors Statistics.

To understand the relative importance of institutional investors, the volume of their assets needs to be related to the size of the economy. In countries such as Iceland, assets of institutional investors may appear small in USD terms compared to other countries but may be high with respect to the size of the economy.[2] Even when compared to the size of the economy, large differences remain across countries and institutional investors. The amount of assets of institutional investors can range from few percentage points of GDP (e.g. pension funds in Greece) to levels exceeding the GDP (in five OECD countries for pension funds, six OECD countries for insurance companies and three OECD countries for investment funds). In the case of the latter, there is a need for a broader range of instruments in which they could invest their assets.

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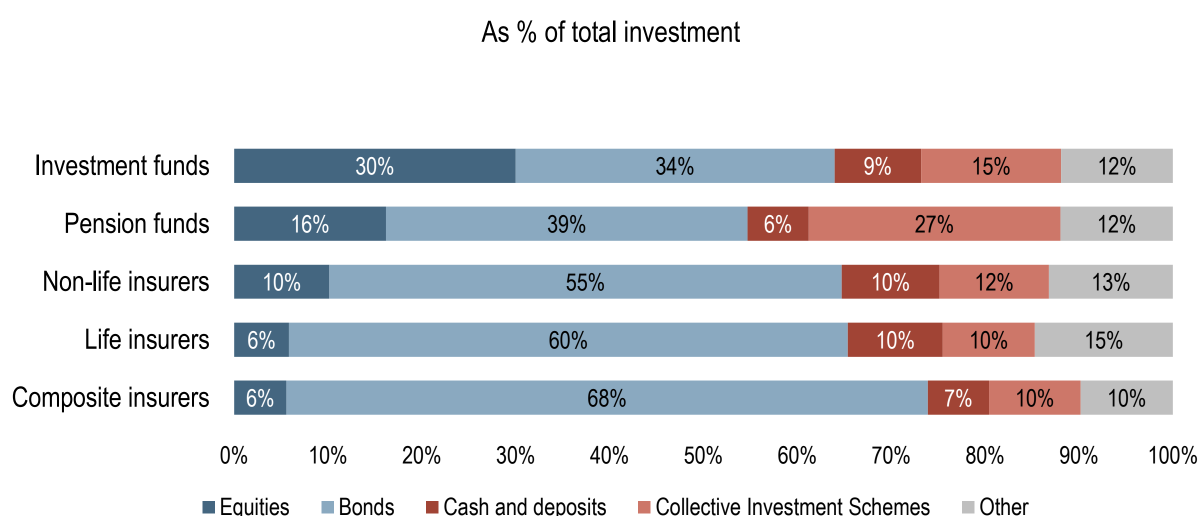
[2] Assets of Icelandic pension funds amount to 168% of GDP.

Asset allocation of selected institutional investors

While institutional investors have different asset mix policies, they usually tend to invest most of their assets in bonds and equities. These traditional instruments account for between over half (for pension funds) and nearly 75% (for composite insurers) of direct investments of institutional investors in the OECD on average (Figure 1.3). The overall exposure of institutional investors to bonds and equities may be even higher through their investments in collective investment schemes (which may in turn invest in these instruments). Pension funds are among those investing the most of their assets in collective investment schemes (over 25%).

Figure 1.3. Asset allocation of selected institutional investors in the OECD, 2019

As % of total investment



Note: The chart shows the average asset allocation of selected institutional investors in the OECD. This average is calculated over all reporting OECD countries. Data for insurance companies exclude assets linked to unit-linked products where risk is fully borne by policyholders. Composite insurers are insurers engaged in both life and-life insurance activities.
Source: OECD Global Pension Statistics; OECD Global Insurance Statistics; OECD Institutional Investors Statistics.

The split of investments between equities and bonds varies across institutional investors. Investment funds and pension funds tend to hold a larger proportion of equities than insurance companies. By contrast, insurance companies hold more bonds, especially companies engaged in life insurance activities partly (i.e. composite insurers) or solely (i.e. pure life insurers).

Institutional investors all hold a portion of their assets in cash, between 5 and 10% on average. Non-life insurers tend to have the largest proportion of assets in cash, probably as they have a shorter horizon and liability structure than other insurers (OECD, 2021[11]) and institutional investors such as pension funds. However, pension funds also have liquidity needs, to pay benefits to retirees for instance.

The asset mix of institutional investors also differs widely across countries (OECD, 2020[12]) (OECD, 2021[11]). For instance, the share of pension fund assets invested in equities ranges from close to 0% (e.g. in the Czech Republic) to over 80% in Poland in 2019. Likewise, the share of assets of life insurers in equities varies from close to 0% in a few European countries to nearly 45% in Denmark.

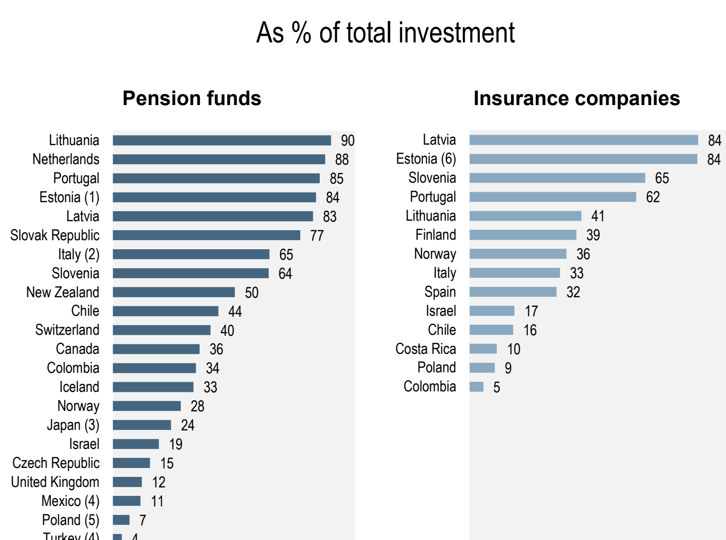
Various factors can influence the way institutional investors invest their assets. As already mentioned, some of these factors include the liquidity needs of institutional investors and their horizon or liability structure, which are inherently linked to their mission. Pension funds are rather long-term investors for instance.

The type of payments that institutional investors are ultimately expected to make to their clients (i.e. those they receive their funds from) can also influence the way assets are invested. Some institutional investors, such as pension funds and life insurance companies, may promise fixed investment returns, fixed benefits or pay-outs to their clients (OECD, 2015[13]). These institutional investors may try to match the level of the promise through their asset allocation. For example, some pension funds in the Czech Republic (namely transformed pension funds) mainly invest in bonds to receive a fixed income and ensure they can keep their promise of an annual non-negative nominal return towards their members (OECD, 2020[14]). Because of low and falling interest rates, some pension providers (such as in Denmark) and life insurance companies (such as in Switzerland) have increased their investments towards alternative investments, potentially as a search for higher yields to meet their liabilities (OECD, 2020[14]) (OECD, 2021[11]).

The way assets are invested also depends on the risk appetite and preferences of the ultimate investment decision maker. For example, members of defined contribution or personal pension plans and people holding unit-linked insurance contracts can choose how their contributions or premiums are invested, and bear the related investment risk in case of a downturn in financial markets. They can therefore have an impact on the way assets are invested overall in financial markets.

The decision to invest assets domestically or abroad may partly depend on the instruments available to institutional investors domestically. Pension funds and insurance companies with relatively small capital markets in the euro area tend to be those investing the most abroad among reporting countries(Figure 1.4). The domestic capital market of these economies may be too small to absorb savings in pension funds (Stewart, Despalins and Remizova, 2017[15]) and investment needs of insurance companies. A significant share of pension fund assets is invested within other countries in the Euro area (OECD, 2020[14]), limiting their exposure to foreign exchange risk.

Figure 1.4. Foreign investments of selected institutional investors, 2019



Note: (1) Data refer to mandatory plans only. (2) Data exclude unallocated insurance contracts. (3) Source: Bank of Japan. Claims of pension funds on pension managers are excluded. Data refer to outward investments in securities (i.e. investments by residents in shares and securities issued by non-residents overseas or in Japan). (4) Data refer to personal pension plans. (5) Data refer to open pension funds only. (6) Data refer to 2016.
Source: OECD Global Pension Statistics; OECD Global Insurance Statistics.

Institutional investors may also search for better risk-adjusted returns through foreign investments. Traditional financial theories, such as Modern Portfolio Theory, explain how a diversified portfolio allows

investors to lower their investment risk without reducing the expected return of the portfolio. Investment abroad may provide more investment possibilities (and hence greater portfolio diversification) and a geographical diversification of some risks (e.g. counterpart risk, political risk).

Foreign investments, however, also entail specific costs and risks that could hamper institutional investors from investing abroad. Institutional investors may face a foreign exchange risk if they invest in instruments issued in other currencies. When institutional investors (e.g. pension funds) hold assets denominated in another currency, changes in exchange rates may lead to a mismatch between assets and the liabilities they have in domestic currency (e.g. benefit payments to retirees). This foreign currency risk can be hedged (through forward currency contracts, currency futures contracts or currency options for instance) but it has a cost (OECD, 2017[16]). Investing abroad also requires knowledge of foreign markets, skills and expertise to assess the risk of foreign assets. This may be overcome through multiple approaches (which have a cost as well), such as investing in foreign funds, developing asset management teams in foreign countries, acquiring or partnering with foreign asset managers (PwC, 2015[17]).

Investment regulation may also be an important factor, driving or constraining investments of institutional investors, whether domestically or abroad.

1.2. Investment restrictions

This subsection touches upon the investment regulation of selected institutional investors, in particular pension funds and insurance companies.

The investments of pension funds and insurance companies are usually regulated, through quantitative investment limits or a more qualitative approach seeking to establish behavioural standards (Antolin, Laboul and Yokoi-Arai, 2015[18]).[3] Many countries have moved over the years to a principle-based regulation for insurance companies, and apply a prudent person principle, in accordance with Solvency II requirements in EU countries. This principle requires insurers to invest their assets considering the security, quality, liquidity and profitability of their portfolio as a whole, including diversification.[4] Insurance companies also usually have to comply with risk-based capital requirements. These requirements impose a higher risk charge for investments with a higher level of risk. This means that insurers have to hold more capital aside when they invest in a riskier instrument. Quantitative investment restrictions are currently more common and widespread for pension funds.

When countries set quantitative restrictions on the investments of pension funds and other pension providers, the limits are often more stringent on some specific instruments. Investments in some types of equities are capped in 19 out of 37 OECD countries, at least for selected pension plans (OECD, 2020[19]). Investment limits are usually stricter for unlisted equities than for listed equities, such as in Finland where company and industry-wide pension funds can invest up to 10% of their assets in unlisted equities but 50% in listed equities. Limits are also more stringent for bonds other than government bonds (e.g. corporate bonds). Some types of investments are even completely forbidden, such as direct investment in real estate for pension providers in Colombia, the Czech Republic, Italy, Japan (except for the Mutual Aid Associations), Lithuania, Mexico, Poland and Turkey although indirect investments in real estate may be allowed to some extent through structured debt (linked to real estate) or real estate investment trusts for instance.

Investment limits may vary by type of pension fund, like in Latin America. In Chile, Colombia and Peru, individuals can join different types of funds with different levels of risks. The share of assets that

[3] These two types of regulation (quantitative and qualitative) are not exclusive. Countries may apply a combination of both to ensure a more comprehensive management of investment risks of pension funds and insurance companies.

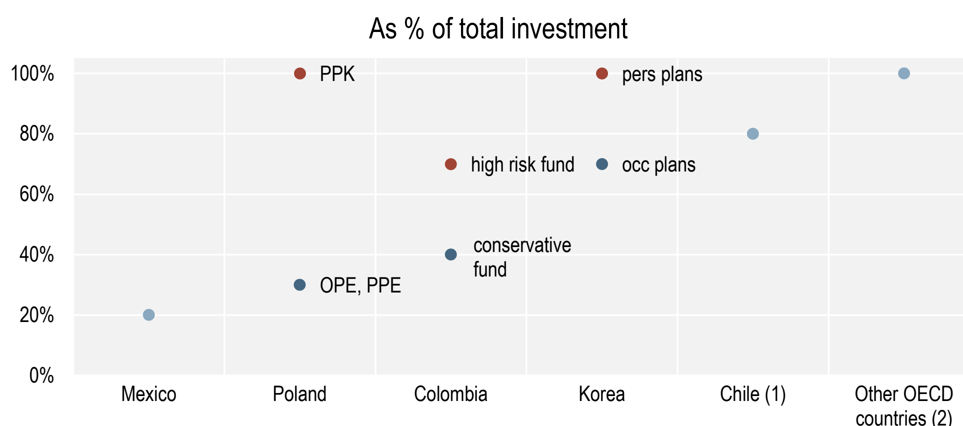
[4] Article 132 of the EU Directive 2009/138/EC.

pension funds can invest in equities is the lowest in the most conservative funds (limit of 5% for instance in Chile). This limit rises for riskier funds. Conversely, conservative funds are the ones that can invest the most in bonds, like in Chile where the fund E can invest up to 80% of its portfolio in government bonds. Mexico also used to have a multifund structure but moved towards 10 target date funds in December 2019: a Basic Initial Fund managing assets of plan members aged 24 or less, 8 funds with 5-year age brackets starting at 25 years old, and a Basic Pension Fund for plan members aged 65 or more. The asset allocation of these funds changes over time as their clients (i.e. members) age. The limits on investments in equities are higher for target date funds with younger members than for those with older members.

There are sometimes also floors on investments of pension funds in certain instruments. In Israel, old and new pension funds must invest at least 30% of their portfolios in earmarked bonds. In New Zealand, the KiwiSaver default investment fund option is required to invest at least 15% of the portfolio in growth assets.[5] There are also floors for investments in equity in Chile and Colombia.

Most OECD countries do not set an overall limit to the share of assets that pension providers can invest abroad. Exceptions include Chile, Colombia, Korea (for occupational plans), Mexico and Poland (Figure 1.5). Other OECD countries may however expect pension providers to keep foreign investments at a prudent level (e.g. Germany).

Figure 1.5. Limit on foreign investments of pension providers in the OECD, 2019 (or latest year available)



Note: "OPE" refers to open pension funds; "PPE" refers to employee pension funds; "PPK" refers to employee capital plans; "occ" means occupational; "pers" means personal. (1) This data point refers to the joint limit for all funds (A to E representing different levels of risk). Each fund has a specific limit on foreign investments, ranging from 35% for Fund E to 100% for Fund A. (2) There may be some exceptions or some other requirements for some types of plans in some countries. In the Czech Republic, there is no specific limit on foreign investments of participation funds (although the currency risk has to be hedged), while transformed pension funds must invest at least 50% of the assets in the currency of the funds' liabilities. In Iceland, the foreign currency exposure of pension funds should not exceed 50% of accrued liabilities. See OECD (2020[19]) for more information on limits on foreign investments set for pension providers in each OECD country.
Source: OECD (2020[19]).

Whether investment regulations set or not an overall limit on the proportion of foreign assets in the portfolios, pension providers may only be allowed to invest in selected countries, geographical areas or financial markets. For example, Mexico allows pension funds to invest up to 20% of their assets only in countries considered as eligible. Finland allows unlimited investments in another OECD/EEA country but fully forbid company pension funds and industry-wide pension funds to invest in other countries.

[5] The KiwiSaver default investment fund option is required to invest at least 15% of the portfolio in growth assets (floor), but they cannot invest more than 25% of the portfolio in such assets (ceiling). The default was planned to change from a conservative to a balanced fund from June 2021.

The quantitative limit on foreign investment may apply to a specific foreign investment rather than to the overall portfolio of pension providers. For example, there is no overall limit in the proportion of assets that Swiss pension funds can invest abroad. However, pension funds in Switzerland cannot invest more than 10% of their assets in foreign real estate specifically.

Pension providers may be subject to other limits. Regulation may restrict investments of pension providers in a single issue or issuer, self-investments, the use of derivatives and the ownership of other companies.

Investment regulations of pension funds tend to have loosened over the years, including with respect to foreign investments. For example, Canada eliminated the limit on foreign investments in 2005. Mexico has progressively increased the number of eligible countries for foreign investments. This is in line with both:

- the OECD Core Principles of Private Pension Regulation, specifying that investments abroad by pension providers should be permitted subject to prudent management principles; [6] and,
- the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations, promoting free capital flows, inviting adherents to ease restrictions towards investments abroad while allowing them to lodge reservations reflecting existing restrictions for pension funds and insurance companies.[7]

Main policy recommendations

- **Greater flexibility in investment regulations of countries hosting large pension funds and insurance companies could help unlock institutional assets** at the global level while allowing institutional investors to achieve better risk-adjusted returns. Investment regulations should allow for risk diversification as appropriate, and ensure that institutional investors can invest in a way that is aligned with their nature, objectives and duty to act in the best interest of their clients.
- **Countries hosting these investors have also a role to play in removing micro and macro-economic barriers to increase the volume of institutional assets invested towards developing countries**. This includes for example addressing the lack of transparency and information asymmetry on private investment, as well as the regulation constraints which could prevent the allocation of assets in developing economies or particular segments of the economy.

[6] https://www.oecd.org/finance/principles-private-pension-regulation.htm

[7] http://www.oecd.org/daf/inv/investment-policy/codes.htm

2. How much is held in developing countries?

This chapter builds on the results of an OECD survey on selected institutional investors, which in its 2019 edition included supplementary questions on assets held in developing countries in 2017-18. It sheds light on the share of assets that selected institutional investors allocated to developing countries during this period, their main geographical and asset class distribution. Overall, the survey confirmed that only a small share of pension funds' and insurance companies' assets is held in developing countries. However, these assets constituted a significant source of financing for developing countries, with estimated new investment flows equivalent to 21% of ODA for the same year. Section 2.1 of this chapter looks at the asset allocation of pension funds while section 2.2 focuses on the asset allocation of insurance companies.

2.1. Pension funds' assets held in developing countries

Survey sample

In total, out of 41 funds that responded to the survey, 36 funds provided data on their investments in developing countries.[8] Most of these funds are mainly based in Europe while nine are located in Africa, the Americas and Oceania (Australia). Thirty-three of these funds are independently managed institutions regulated or backed by specific national legislation. One fund is a sovereign wealth fund and the remaining two pension funds (ABP and PGGM) are fully private. Furthermore, building upon the existing OECD typology of large pension funds (OECD, 2019[4]):

- Four funds [AP2 (Sweden), AP4 (Sweden), CPP Investments (Canada) and Chile's Pension Reserve Fund] are **public pension reserve funds**. Such funds hold reserves established by governments or social security institutions to support public pension systems, which are financed on a pay-as-you-go basis.
- The Norwegian Government Pension Fund Global (GPFG) is classified as **sovereign wealth fund**. Unlike the public pension reserve funds, sovereign wealth funds are usually set up by the government to achieve macro-economic purposes broader or different from supporting the pension system. The GPFG was established as a fiscal tool to underpin long-term considerations in the spending of government petroleum revenues (Box 2.1 on the GPFG).[9]
- The other 31 pension funds are considered other **large pension funds** (LPFs).[10]

All these funds are hereafter referred to as "pension funds".

Main trends and characteristics

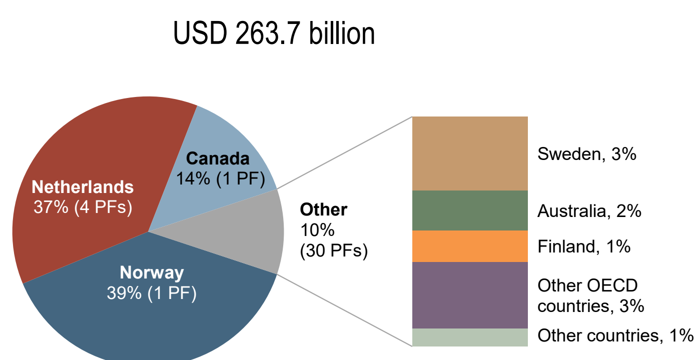
On average, the 36 pension funds reported to hold assets in developing countries worth USD 263.7 billion in 2017-18, representing 8% of their total assets globally. A vast majority (90%) of these assets were held by pension funds in Norway, the Netherlands and Canada (Figure 2.1). The top 4 pension funds of the sample in terms of asset volumes held in developing countries were GPFG, ABP, CPP Investments and PGGM. Together, they managed 85% of the total assets held in developing countries among the sample of pension funds (Figure 2.2).

[8] In the 2019 survey, information on asset allocation in developing countries was made available for 36 pension funds, most of which located in European countries. Fourteen of these pension funds provided these details through the Addendum Questionnaire, while this information was derived and estimated from the main survey questionnaire for 22 pension funds. Moreover, 21 pension funds provided inputs on their investment strategy and partnerships for development. See also Annex B.

[9] See also https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/government-pension-fund-global-gpfg/id697027/

[10] These pension funds include: ABP (Netherlands), Alecta (Sweden), APK (Austria), Birta (Iceland), BPI Vida e Pensões (Portugal), CBUS (Australia), Cometa (Italy), Fonchim (Italy), Fonte (Italy), GEPF (South Africa), Gildi (Iceland), Hostplus (Australia), KEVA (Finland), LSR (Iceland), LV (Iceland), New Zealand Super Fund, OYAK (Turkey), PBZ (Croatia), Pensija (Lithuania), Pensija4 (Lithuania), PensionDanmark (Denmark), PGGM (Netherlands), PME (Netherlands), PMT (Netherlands), Santander (Spain), Sentinel (South Africa), SP-Prevcom (Brazil), UniSuper (Australia), Valida (Austria), Varma (Finland), VBV (Austria).

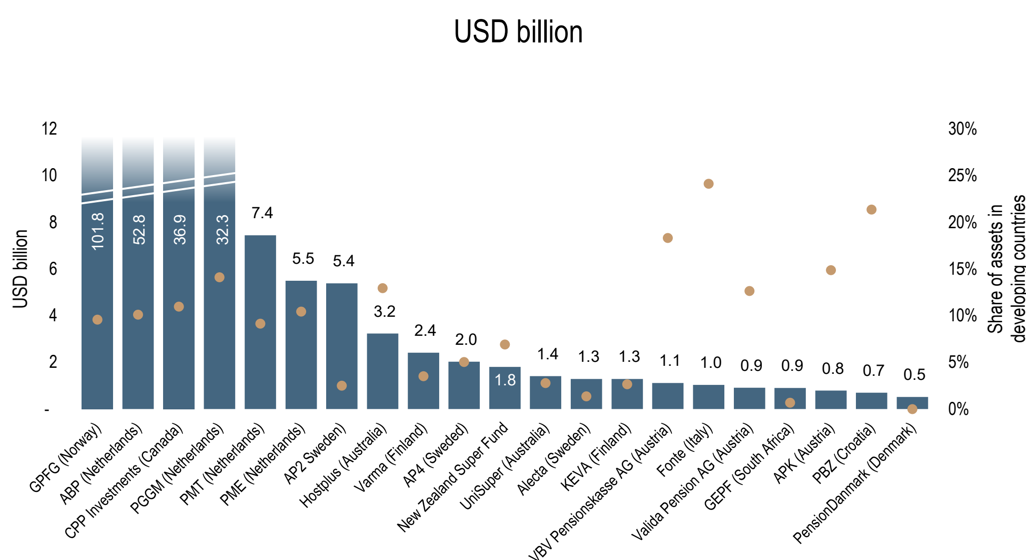
Figure 2.1. Origin of the assets held in developing countries by the pension funds in the sample, 2017-18



Note: Other OECD countries include Austria, Chile, Denmark, Iceland, Italy, New Zealand, Portugal, Spain and Turkey. Other countries encompass Brazil, Croatia, Lithuania and South Africa.
Source: Addendum to the OECD 2019 Survey.

Pension funds with the largest share of foreign assets in developing countries included Fonte (46%), PBZ (21%), the APK and VBV Pensionskasse (17% each). In absolute terms, however, these assets amounted to only USD 3.6 billion per year on average in 2017-18. In contrast, the share of assets in developing countries held by the largest four pension funds ranged from 10% for the GPFG and ABP to 14% for the PGGM (Figure 2.2).

Figure 2.2. Top 20 pension funds of the sample by assets in developing countries, 2017-18



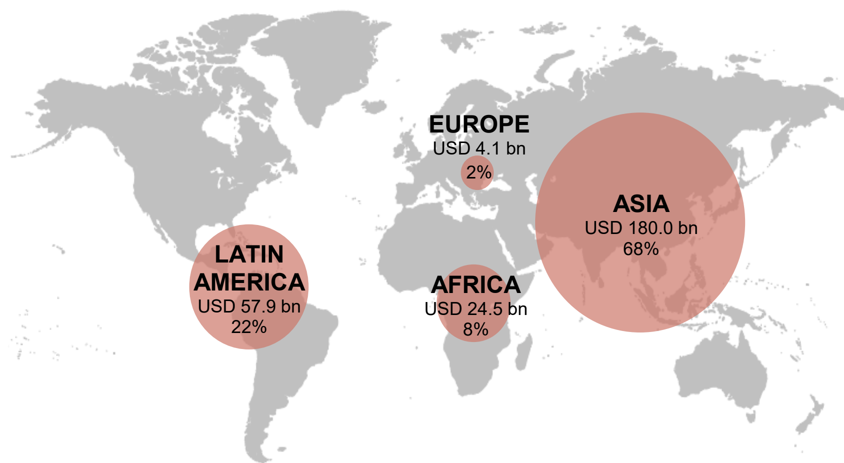
Source: Addendum to the OECD 2019 Survey.

Geographical distribution of pension funds' assets in developing countries

Overall, pension funds tend to diversify the distribution of their assets in developing countries across all regions. Eleven of the 36 pension funds (representing 56% of total assets in developing countries) administered investments in all four regions and 18 other funds (43%) did so in three regions. Only seven pension funds (1%) held assets in one or two regions (Figure 2.4).

However, pension funds' assets were essentially invested in developing countries in Asia (68%) and Latin America (22%). Over two-thirds (USD 180 billion) of these assets were allocated to Asia. Based on a review of financial statements and annual reports of selected pension funds, China (People's Republic of), India and Southeast Asia frequently appeared among the foremost countries of investment in Asia. Further, Latin America and the Caribbean were allocated 22% of pension funds' assets in developing countries (USD 57.9 billion), followed by Africa (USD 24.5 billion, 8%) and Europe[11] (USD 4.1 billion, 2%). In addition, 22 of the 36 funds in the sample allocated over 50% of their assets to Asian developing countries and only four funds did not have any asset under management in Latin America. Moreover, four funds allocated more than 80% of their assets to Africa. Together, these investments in Africa amounted to less than USD 2.7 billion though (Figure 2.3 and Figure 2.4).

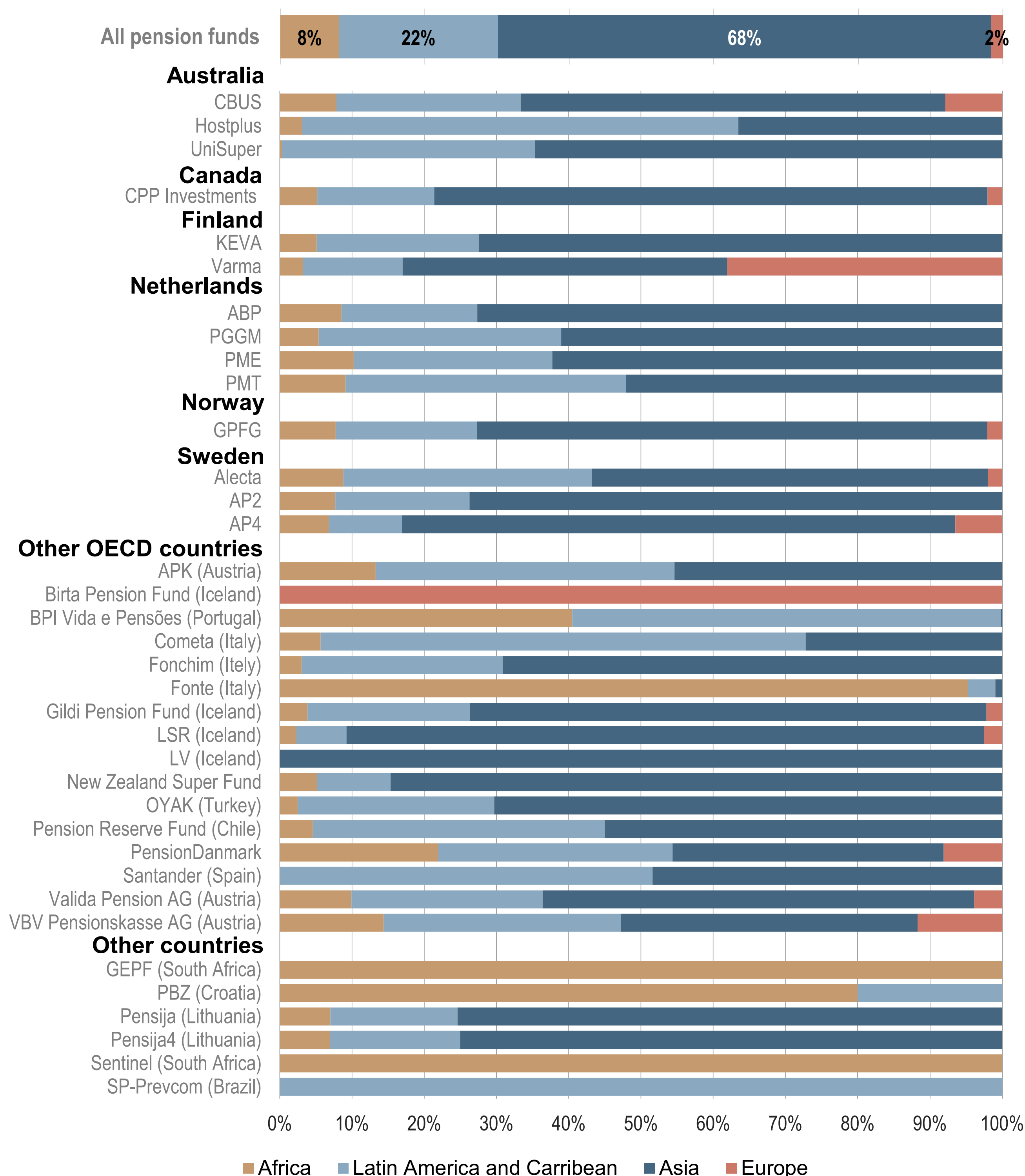
Figure 2.3. Regional asset allocation held in developing countries by pension funds in the sample, 2017-18



Source: Addendum to the OECD 2019 Survey.

[11] Developing countries in Europe include Albania, Belarus, Bosnia and Herzegovina, Kosovo, Moldova, Montenegro, North Macedonia, Serbia, Turkey and Ukraine.

Figure 2.4. Regional distribution of assets held in developing countries by pension funds included in the sample, 2017-18



Source: Addendum to the OECD 2019 Survey.

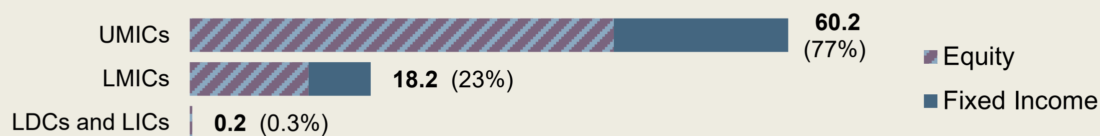
Box 2.1. Government Pension Fund Global (GPFG)'s investments in developing countries

The Government Pension Fund Global (GPFG) is the sovereign wealth fund of Norway. Initially established to shield the economy against oil revenue volatility, the GPFG ensures long-term management of income from Norway's oil and gas resources in the North Sea, thus preserving its wealth benefits for future needs of Norway's pension system. While the Norwegian Parliament and the Ministry of Finance laid down rules for the management of the fund, the day-to-day administration of the GPFG assets is delegated to Norges Bank Investment Management (NBIM), a special purpose entity of Norway's central bank. In a nutshell, NBIM's investment policy aims at ensuring the funds' steady growth and continuity through seeking the highest possibly return against moderate risk and maximum environmental and social sustainability.

In terms of assets allocated in developing countries in 2017-18, the GPFG was by far the largest pension fund in the survey sample (Figure 2.2). An analysis of investment-level data offers the following insights on its investment behaviour:

1. Almost all country-allocable assets were held in upper-middle income countries (UMICs; 77%) and lower-middle income countries (LMICs; 23%). Only negligible amounts were allocated to the least developed countries (LDCs) and other low-income countries (LICs).

Figure 2.5. Income group distribution of GPFG country-allocable assets in 2017-18, USD billion



2. Over three-quarters (77%) of country-allocable assets were concentrated in four MICs, namely China (People's Republic of), India, Brazil and Mexico. Further, a total of USD 4.9 billion were held in the form of bonds emitted by MDBs, such as EIB, CAF, IBRD, IFC, AsDB, EBRD, AfDB and IADB.

Figure 2.6. Sectoral distribution of GPFG investments and their potential contribution to the SDGs in 2017-18, USD billion

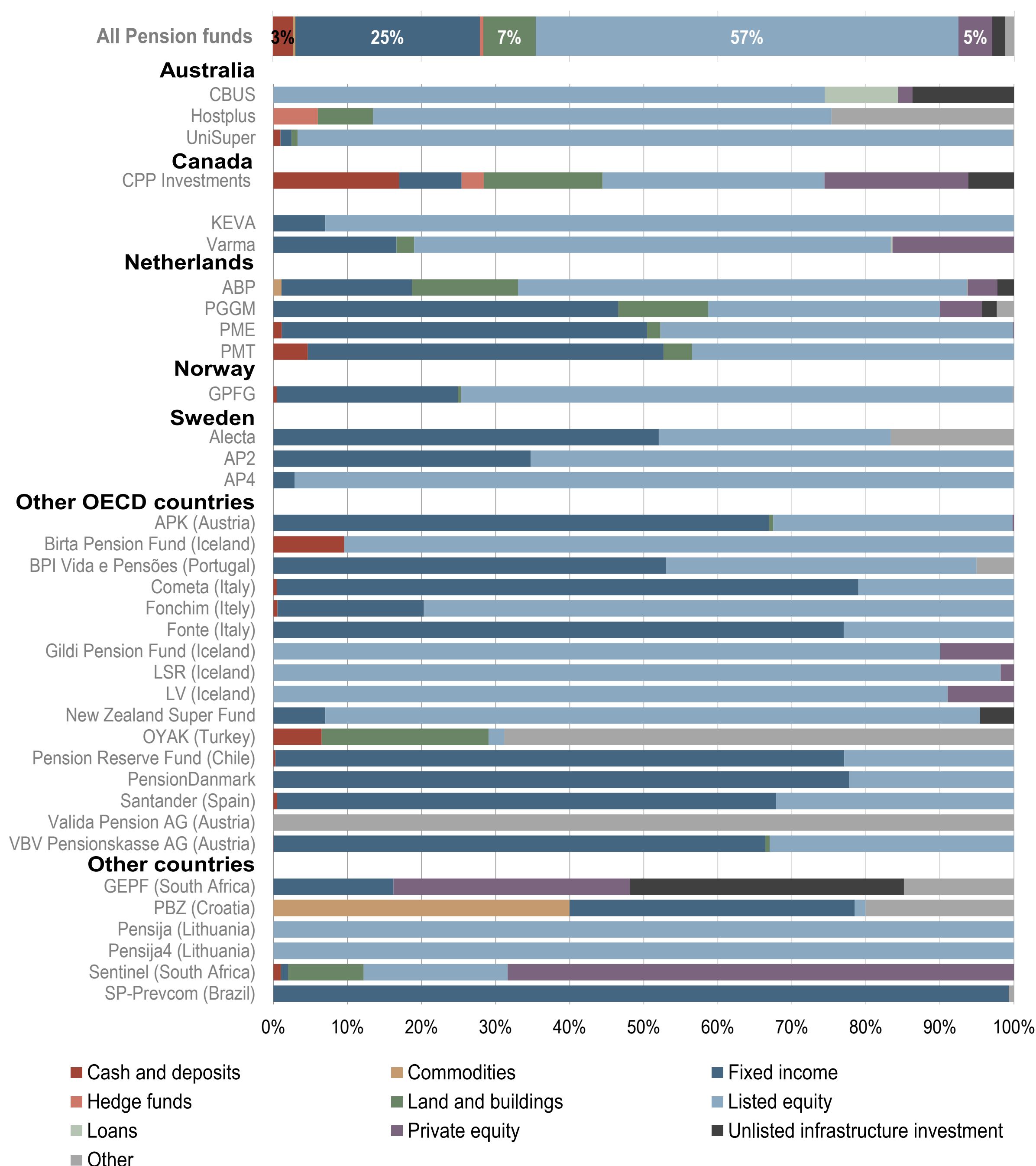
3. Around 40% of GPFG assets in developing countries are allocated to production sectors, notably industry, mining (including oil and gas), trade and construction, followed by government and MDB bonds (31%) and banking and financial services (21%). Infrastructure sectors (i.e. energy, telecommunications, water and transport) accounted for 5% of GPFG assets in developing countries. This sectoral distribution demonstrates the potential of GPFG investments supporting developing countries in achieving the 2030 Agenda, and the SDGs 7, 8, 9, 11 and 17 in particular.

Note: Analysis presented in this box only concerns GPFG's assets in developing countries and bonds subscribed to multilateral organisations with a development agenda. Source: (NBIM, 2021[20]).

Main asset classes held in developing countries

Similarly to the global trend described in Chapter 1. , pension funds allocate most of their assets in developing countries in the form listed equity (57%) and fixed-income instruments (25%). Other assets are in the form of land and buildings (7%), private equity (5%), cash and deposits (3%) and unlisted infrastructure investment (2%).

Figure 2.7. Asset class distribution in developing countries by pension funds included in the sample, 2017-18

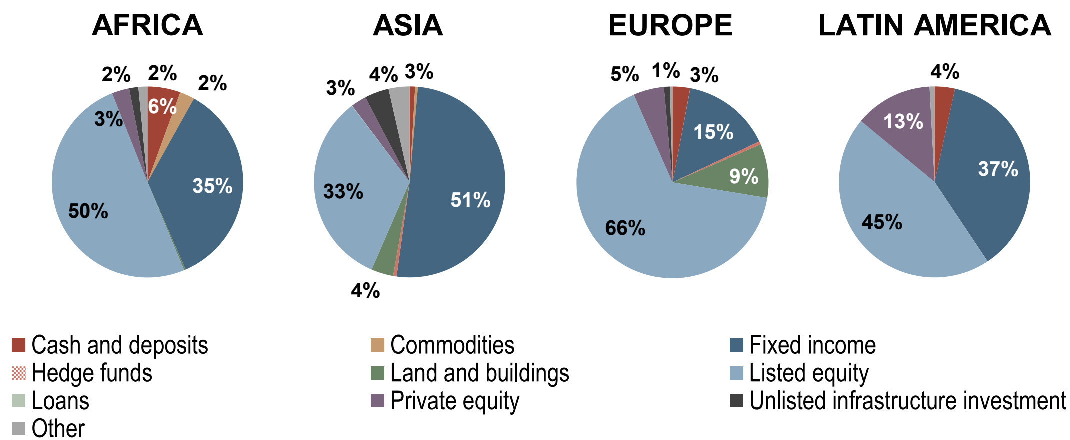


Source: Addendum to the OECD 2019 Survey.

Furthermore, while listed equities were predominantly held by pension funds located in the Nordic countries and Australia, fixed income was the most used asset class among funds in Austria, South European countries and the Netherlands. Assets in the form of land and buildings were mainly held by pension funds based in Turkey and Canada. Private equities were held by merely 10 pension funds and unlisted infrastructure investment by 6 pension funds only. Commodities, hedge funds and loans appear to be the least common asset classes used in developing countries.

Moreover, listed equities and fixed income accounted for more than 80% of assets allocated to each region, but the instruments that pension funds favoured varied across regions (Figure 2.8). While listed equities represented the greatest shares of total asset allocated to developing countries in Europe (66% of regional total) and to a significant extent also in Africa (50%) and Latin America and the Caribbean (45%), fixed income was the main asset class held in Asia (51%). Further, private equity was mainly invested in Latin America and the Caribbean (13%) and to a lesser extend also Europe (5%). Most assets in the form of unlisted infrastructure investment were allocated to Asia (4%), followed by Africa (2%) and Europe (1%).

Figure 2.8. Regional and asset class distribution of assets held in developing countries by pension funds in the sample, 2017-18



Source: Addendum to the OECD 2019 Survey.

2.2. Insurance companies' assets held in developing countries

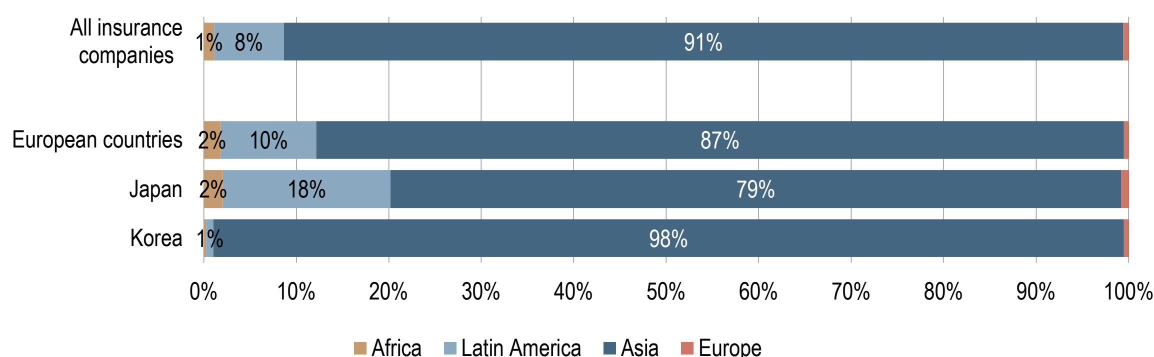
Thirty insurance companies based in ten countries provided details on assets allocated in developing countries. Fourteen of these investors were based in Korea, five in Japan, three in Finland, two in Portugal and the remaining six in other European countries (France, Italy, Netherlands, Slovenia, Sweden and Switzerland). Furthermore, nine companies provide life insurance (including annuities), 12 non-life insurance, and eight a mix of both and one other kinds of insurance. For confidentiality reasons, the analysis below does not provide any disaggregation by insurance company (see also Annex B).

Together, the 30 insurance companies included in the sample held 2% of their total assets (USD 36 billion) in developing countries, compared to 8% for pensions funds (section 2.1)**.** On average, the share of assets in developing countries in total assets was the highest (4%) in the case of Korean insurance companies.

Compared to pension funds, a large majority (91%) of insurance companies' assets in developing countries were held in Asia (Figure 2.9). Only USD 0.6 billion (2%) of assets under management in

developing countries were held in Africa or Europe. The strong focus on Asian developing countries was driven particularly by Korean insurance companies: 98% of their assets in developing countries were allocated to Asian markets. Although European and Japanese insurance companies allocated a large majority of their assets to Asian markets too (87% and 79% respectively), these investors managed significant shares of their assets also in Latin America and the Caribbean (10% and 18% respectively) and to a lesser extent also Africa (2% each).

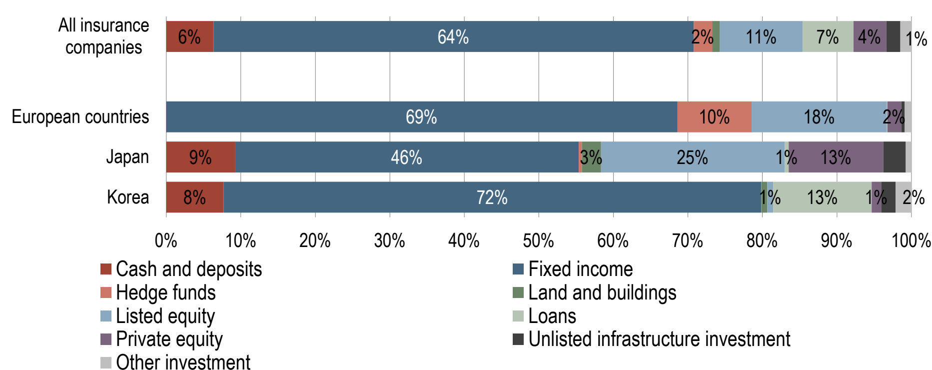
Figure 2.9. Geographic allocation of assets held in developing countries by insurance companies in the sample , 2017-18



Source: Addendum to the OECD 2019 Survey.

Almost two-thirds (64%) of insurance companies' assets in developing countries were in the form of fixed income. Listed equities accounted for 11% of their investments toward developing countries, followed by loans (7%), cash and deposits (6%) and private equity (4%). While bonds were invested to the greatest extent by Korean insurers (72% of their assets in developing countries), listed and private equities played an important role among Japanese and European investors (38% and 20% respectively). In addition, Korean insurance companies allocated 13% of their assets in developing countries in the form of loans, whereas European insurers invested 10% of their assets to hedge funds. Thirteen per cent of assets allocated in developing countries by Japanese insurance companies represented unlisted infrastructure investments (Figure 2.10).

Figure 2.10. Asset class distribution in developing countries of insurance companies in the sample, 2017-18



Source: Addendum to the OECD 2019 Survey.

Box 2.2. The Managed Co-lending Portfolio Program (MCPP): Linking Institutional Investors to Responsible Credit Opportunities

By Michael Kurdyla, Strategy Lead at the International Finance Corporation

Facing tremendous financing gaps to achieve the UN Sustainable Development Goals by 2030, many members of the global community are looking to institutional investors as a potential source of additional capital. As a collective, institutional investors hold trillions of dollars in assets under management. Reallocating just a small fraction of these funds to impact-driven investing opportunities could spur huge progress towards meeting the SDGs. New financing sources are needed now more than ever as the COVID-19 pandemic enlarges these gaps for developing economies.

For more than six decades, the International Finance Corporation (IFC), the private-sector arm of the World Bank Group, has been building bridges between investors and firms in need of capital and creating more opportunities for private investment in developing economies. Since its foundation, IFC has attracted almost USD 100 billion from a broad cross-section of global investors and lenders through its debt syndication programme into loans that target positive social, economic and environmental impact across 115 countries.

Institutional investors have clear potential to be part of the solution, but they lack viable means to access responsible investing opportunities at scale. What is often missing is the bridge for their huge pools of capital to flow into development projects. In the last decade, IFC has ramped up efforts to develop new syndication products to reach new partners, including institutional investors. The Managed Co-Lending Portfolio Program (MCPP), is a hallmark of this innovation, creating a platform for institutional investors to participate in impact-focused credit opportunities in IFC's pipeline. In eight years, MCPP has raised over USD 10 billion, enabling 11 insurers and other partners to join IFC in contributing to the achievement of the SDGs.

The MCPP is based on a standardised co-investment process that, over time, builds for a partner a diversified portfolio that mimics IFC's own portfolio. IFC has tailored the platform using three unique structures that cater to the various business and regulatory needs of different types of partners. Public sector investors participate via dedicated IFC trust funds. Private institutional investors establish an investment vehicle and contract with IFC to originate transactions under a B Loan, the same structure used to syndicate to commercial banks. Insurance companies use unfunded structures to provide IFC with credit coverage on loans.

For a variety of investment partners, MCPP provides an efficient, low-cost way to make a large capital allocation and then leverage IFC origination to create a diversified pool of new loans over time. Automatic deployment enables investors to follow IFC's own account business origination wherever IFC goes, offering unparalleled global portfolio diversification. MCPP returns track those of IFC's overall debt portfolio and benefit from IFC's historically proven high recovery rates, with limited correlation to other assets. Through MCPP loans, investors benefit from IFC's world-class environmental, social and governance standards and impact measurement frameworks, and every project delivers tangible progress toward the SDGs.

The MCPP's ground-breaking partnership approach has linked institutional capital with hundreds of unique opportunities to make a direct impact on to the world's most pressing development challenges. As IFC and the rest of the development community help countries overcome the effects of the global COVID-19 pandemic, platforms like the MCPP will be essential to re-awaken investment flows and bring together the public and private sectors to support a resilient recovery.

3. What are institutional investors' main investment drivers and considerations in developing countries?

Closing the financing gap towards achieving the SDGs does not only require the mobilisation of additional private capital towards sustainable solutions in developing countries but also better alignment of these investments with the SDGs. This chapter analyses institutional investors' investment strategy and behaviour toward developing countries. While section 3.1 describes the main motivations for and barriers to institutional investors' asset investment toward developing countries, section 3.2 examines the extent to which these institutional investors align their investments with the SDGs. Finally, section 3.3 provides insights on institutional investors' approach to collaboration and partnerships for better development outcomes.

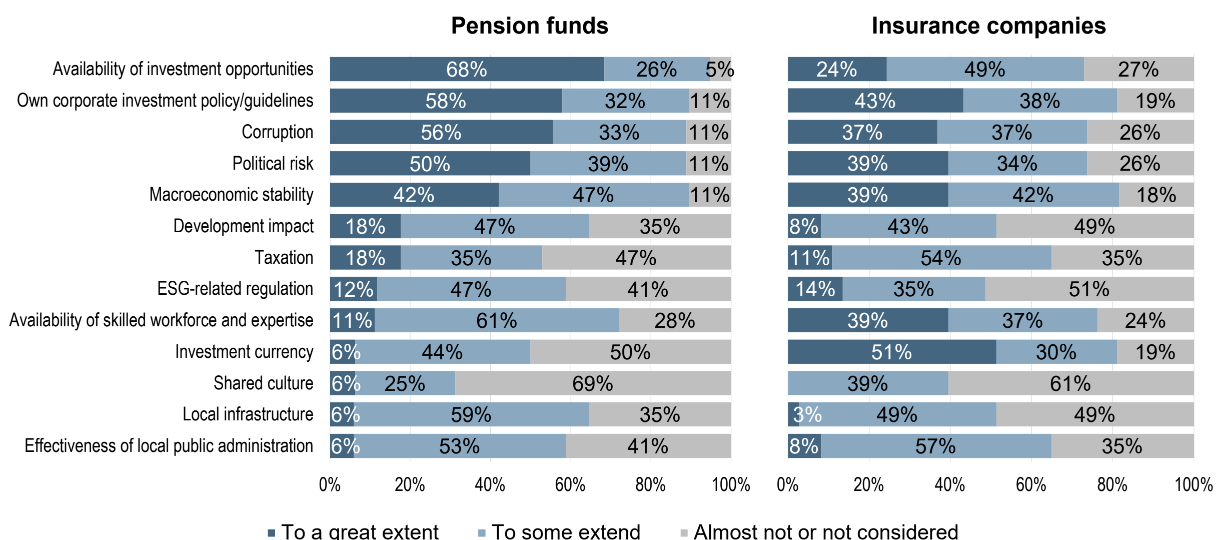
3.1. Main drivers of institutional investors' investment decisions in developing countries

Aside from institutional investors' own corporate investment policy, the availability of investment opportunities and risk associated with corruption and political and macroeconomic developments are the most significant investment drivers of pension funds and insurance companies (Figure 3.1). For approximately 90% of the surveyed pension funds and 75% of insurance companies, the availability of investment opportunities in developing countries, their own internal investment policies, local corruption levels, political risk and macroeconomic stability are all key factors taken into account when making investment decisions. Moreover, for more than 70% of pension funds and insurance companies, the availability of skilled workforce locally plays an important role too.

The survey also highlighted some differences between pension funds and insurance companies as regards the criteria taken into consideration when investing in developing countries. The availability of local infrastructure and the development impact of their investments play an important role for more than 65% of the surveyed pension funds, as opposed to 52% of the insurance companies. By contrast, compared to pension funds, a majority of insurance companies pay particular attention to taxation, currency risks and the effectiveness of local administration.

Shared culture and environmental, social and governance (ESG) regulations seem to be of less importance for a large share of the institutional investors. Sixty-nine per cent of pension funds and 61% of insurance companies do not consider shared culture of much influence on their investment decisions. Further, 51% of insurance companies and 41% of pension funds do not consider ESG regulations (including availability of ESG indicators) as a significant driver of their investment decisions in developing countries. Section 3.2 below suggests that ESG considerations have been mainstreamed by these institutions but do not necessarily influence their investment decisions at the level of individual operations.

Figure 3.1. Main drivers of investment in developing countries by institutional investors in the sample



Source: Addendum to the OECD 2019 Survey.

3.2. Sustainability considerations in investment policies

Globally, institutional investors are increasingly inclined to integrate the principles for responsible investment in their investment policies, although development impact and ESG regulations are not their main investment drivers (Figure 3.1). While institutional investors manage trillions of assets worldwide as shown in chapter 1. of this report, only a small share of these assets (6% on average in 2017-18) is allocated to developing countries. Shifting these trillions of assets towards the implementation of the SDGs requires investors' capital to be mobilised in a sustainable manner and to developing countries (USAID, 2020[21]). In parallel, there is also a growing awareness among clients on how their savings are invested (OECD, 2020[22]) (OECD, 2019[23]). Over 4,000 organisations representing more than USD 80 trillion in assets under management, including pension funds, insurers and investment managers, have signed the UN Principles for Responsible Investing (UNPRI, 2021[24]). This shows the increasing engagement of such institutions towards responsible investment, including the achievement of the SDGs and so-called "social impact investing". (See also Box 3.1.)

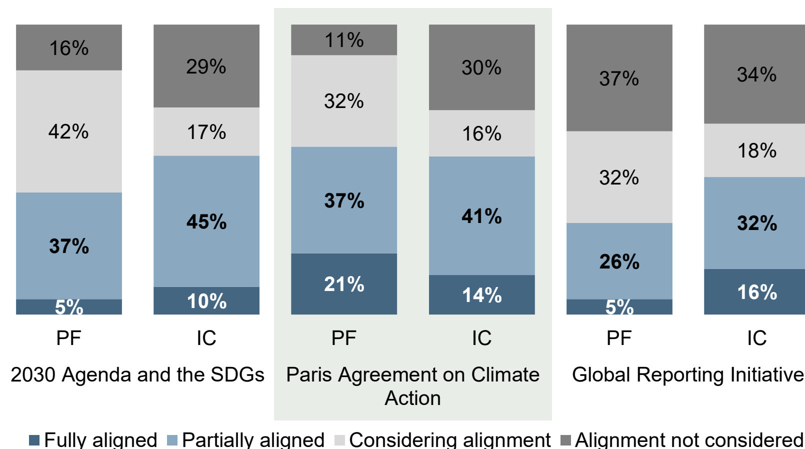
In recent years, ESG considerations have been largely taken into account by institutional investors overall, including in order to align their investment policies with the SDGs. Investors commonly use ESG factors to improve long-term risk-adjusted returns and create long-term value in companies, but also to integrate the social impact investing perspective into their investment policy (OECD, 2020[22]). Indeed, the survey confirmed that pension funds and investment companies holding assets in developing countries are generally perceptive of the need to align their investment policies with international agendas, such as the 2030 Agenda and the Paris Agreement. As shown in Figure 3.2 around half of the institutional investors indicated to have aligned their general investment policy with the Paris Agreement on Climate Action or the 2030 Agenda, with 32% of pension funds and 16% of insurance companies considering doing so in the future. In addition, 55% of the surveyed insurers considered their investment policy to be fully (10%) or partially (45%) aligned with the 2030 Agenda and the SDGs, compared to 42% of the pension funds. Moreover, participation to Global Reporting Initiative seemed to be less a priority for a large share of institutional investors, with 37% of pension funds and 34% of insurance companies not even considering this initiative when responding to the survey. Still, seven pension funds[12] and 12 insurance companies expressed interest in evidence-based dialogue on SDGs and sustainable development more broadly. Finally, beside the UN Principles for Responsible Principle, some respondents also indicated their adherence to the OECD Guidelines for Multinational Enterprises, UN Guiding Principles for Business and Human Rights and the UN Global Compact.

Box 3.1. Highlights on Kyobo Life

Kyobo Life, based in South-Korea, indicated in the survey that all its developing country assets are allocated to Asia. In its sustainability report 2019, Kyobo Life reported according to the Global Reporting Initiative (GRI), and as its first Korean signatory also towards the ten principles of the UN Global Compact. Kyobo Life engaged in activities to achieve seven selected SDGs, amongst which SDG 1 (no poverty), SDG 4 (quality education) and SDG 9 (industry, innovation and infrastructure). Example activities towards those goals are supporting poor farmers in Vietnam by providing seeds and farming tools, the construction of twenty houses and four libraries in deprived areas in Vietnam, as well as social responsible investments (SRIs).

[12] Including Birta Pension Fund, CBUS, New Zealand Super Fund, Ontario Teachers' Pension Plan, PensionDanmark, Santander and SP-Prevcom.

Figure 3.2. Institutional investors' alignment with international initiatives



Note: "PF" stands for pension funds, while "IC" for insurance companies.
Source: Addendum to the OECD 2019 Survey.

Although ESG standards have been increasingly mainstreamed by institutional investors, this framework is subject to many criticisms and does not necessarily imply SDG alignment at the level of individual investments. For example, in the ESG rating framework, high environmental (E) scores do not necessarily imply low-carbon emissions[13]. Further, only half of the signatories of the Principles for Responsible Investment (PRI) mention the SDGs in their reporting, and only 10% of them provide details on how they actually integrate the SDGs in their investment strategy (Novethic, 2019[25]). Therefore, obstacles that prevent from aligning finance with the SDGs could include:

- The lack of transparency regarding sustainable finance, mostly due to the proliferation of the sustainability principle in various standards. Currently, there are over 185 sustainable finance initiatives (PC4S, 2020[26]), both public and private, with no translation of the SDGs into simple metrics applicable to all investors.
- The lack of accountability with regard to non-financial returns and policy incoherence, due to missing or wrong incentives and fragmented regulations. A better collaboration between public authorities and the financial sector could help strengthen institutional investors' positive impacts on sustainable development.

3.3. Collaboration with government and public stakeholders

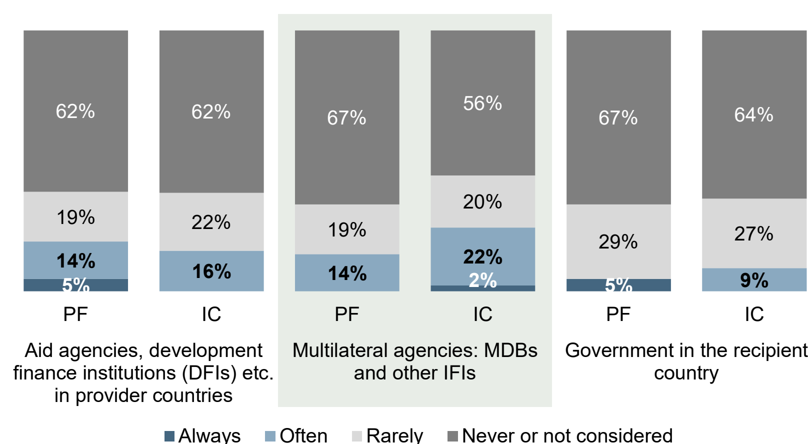
In order to invest in developing countries, institutional investors need investment opportunities and a shield against economic and political risks. Therefore, should more assets be allocated to developing countries, the public sector – both locally and internationally – has an important role to play in improving developing countries' business climate, developing bankable investment projects, and providing the necessary de-risking solutions. Multi-stakeholder collaboration is therefore critically needed to unlock institutional investors' assets for the SDGs.

However, **collaboration between institutional investors holding assets in developing countries, local governments and development co-operation providers is still rather sporadic.** Almost two-

[13] The E score captures metrics such as renewable energy management, resource use, water output and management, impact on ecology, and biodiversity as well as carbon footprint, although it does not prioritise carbon footprint or intensity.

thirds of the surveyed institutional investors indicated to never work with official actors when investing in developing countries (Figure 3.3). Still, some pension funds and insurance companies do seek partnerships with key development actors, such as development co-operation agencies and development finance institutions in the provider countries (19% of pension funds and 16% of insurance companies) or the multilateral agencies (14% of pension funds and 24% of insurance companies). This is clearly less the case with governments in developing countries as only 5% of pension funds and 9% of insurance companies indicated to partner with them.

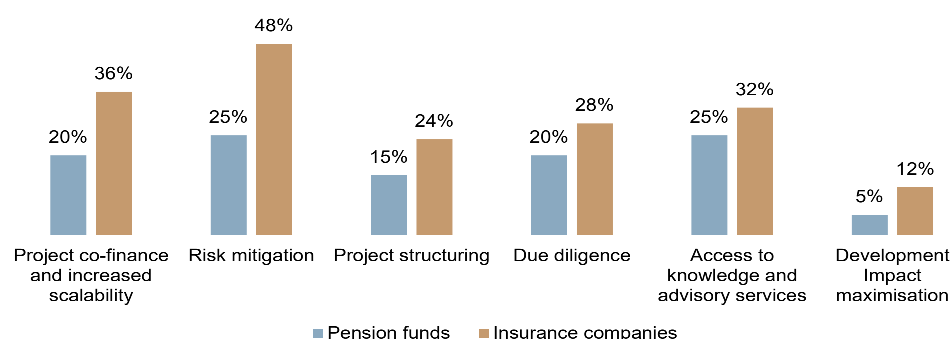
Figure 3.3. Collaboration with the official sector



Note: "PF" stands for pension funds, while "IC" for insurance companies. "Not considered" includes institutional investors that only responded to the qualitative questionnaire of the Addendum to the OECD 2019 Survey. Source: Addendum to the OECD 2019 Survey.

Risk mitigation services, co-financing and access to knowledge and advice constitute the main motivations for collaboration with official agencies (Figure 3.4). A quarter of pension funds that already work with the official sector to some extent indicated to seek such partnerships in order to mitigate investment risk or access knowledge and advisory services (25% each), followed by project co-finance and due diligence (20% each). For insurance companies, risk mitigation (48%), project co-finance (36%) and access to knowledge and advisory services (32%) were the most important reasons for seeking collaboration with the official sector. On the contrary, maximisation of the development impact was sought by the fewest insurance companies (12%) and pension funds (5%).

Figure 3.4. Purpose of partnership with official agencies



Note: This chart only represents institutional investors which collaborate with the official sector at least rarely (Figure 3.3).
Source: Addendum to the OECD 2019 Survey.

Partnerships with local government institutions in recipient countries or international finance institutions can represent an efficient way for pension funds and insurance companies to invest in long-term assets and projects. As demonstrated by the Global Infrastructure Facility (GIF, 2021[27]), the Sustainable Development Investment Partnership (SDIP, 2021[28])[14], IFU's special funds (Box 4.2) or the IFC MCPP (Box 2.2), institutional investors engage in platforms with other peer investors and governments to invest more efficiently in long-term assets.

Box 3.2 Investing in sustainable development by ABP

by Kees Bakker, Risk Manager Investments, ABP

Who we are

ABP is a private pension fund based in the Netherlands, serving the employees of the Netherlands' government and the national education system. With total assets of EUR 399 billion (USD 471 billion) in 2018, ABP is one of the largest pension funds globally with investments allocated all over the world, and in an increasing fashion also in developing countries. The foremost motivation for investing in emerging economies are portfolio diversification with associated yield returns and sustainability considerations.

Portfolio diversification

Emerging markets have been dramatically evolving over the past few decades, offering a growing number of investment opportunities with a long-term potential for returns. Unhedged investments in emerging markets also provide exposure to foreign exchange fluctuations, working as an important portfolio diversifier while benefitting from real effective exchange rate appreciation. In this context, ABP manages its investment strategies in emerging markets as a combination of in-house and externally managed portfolios, ranging from top-down, bottom-up, core, focused, smallcap and midcap strategies as well as a dedicated China A-share Fund.

Sustainability considerations

Private debt and equity as well as local government bonds offer the potential to contribute to sustainable development in the developing countries. In this context, ABP maintains a number of safeguards to ensure its investments have a positive effect on sustainable development, such as:

- Due diligence process and monitoring mechanisms to identify, prevent and mitigate actual and potential adverse impacts of ABP investments for the society, with ESG-related risks at its heart;
- Exclusion of bonds emitted by governments subject to sanctions by the European Union or the United Nations;
- Exclusion of investments in companies directly involved in the production, sale or distribution of anti-personnel mines, cluster munitions, chemical, biological or nuclear weapons, and tobacco products.

Collaboration with development finance providers and other actors

ABP engages with development finance institutions (DFIs) to increase the sustainability profile of its investments in developing countries. Not only does ABP actively use the IMF and WB data and analysis to strengthen its investment decisions, but it also seeks contact with bilateral DFIs and the multilateral community to identify debt-funding opportunities for projects in developing countries. By 2025, ABP aims for 20% of its assets to make a measurable contribution to the Sustainable Development Goals, also in developing countries. To this end, ABP seeks to collaborate with other investors, for example via the SDI Asset Owner Platform.

[14] SDIP is a global independent platform of 42 public, private and philanthropic institutions with the shared ambition to scale finance for the SDGs and overcome the barriers hindering private investments in emerging and developing countries. Moreover, the fund engaged in partnerships, such as the Net-Zero Asset Owner Alliance, a group of institutional investors from around the world that committed to transitioning to carbon-neutral investment portfolios by 2050.

Main policy recommendations

- While it is necessary to encourage the scaling up of institutional asset allocation towards developing countries, **ensuring their sustainability through impact investment policies is equally important for the achievement of the SDGs**.
- In particular, **the international community should step up efforts towards the development of a global sustainable finance market**, e.g. through a common understanding of sustainable finance, associated with a global set of sustainability reporting standards to ensure comparability and transparency. This requires aligning the financial system – banking, capital markets and insurance – with sustainable development pathways. It necessitates the involvement of all actors, including international financial institutions, banks, institutional investors, market-makers such as rating agencies and stock exchanges, as well as central banks and financial regulatory authorities.

4. Potential of blended finance to unlock institutional investments towards developing countries

Blended finance is emerging as a solution to help bridge the SDGs investment gaps and de-risk deals to crowd in capital from local and international institutional investors. However, according to the 2020 OECD Blended Finance Funds and Facilities survey, pension funds and insurance companies represent only 4% of the assets under management (AUM) of the respondent vehicles. More efforts are required to meet institutional investors' mandates and attract them at a larger scale in blended finance operations. This chapter analyses how blended finance can be used to unlock institutional investments towards developing countries. Section 4.1 presents the context and existing frameworks on blended finance, while section 4.2 gives an overview of the potential and use of blended finance solutions to unlock institutional investment for sustainable development. Finally, section 4.3 presents a series of examples of blended finance transactions involving institutional investors.

4.1. Context and existing framework

Why unlocking institutional investment is more than ever needed?

In the wake of the COVID-19 crisis, the scissor effect of SDG financing – increasing needs and declining resources – has been magnified (OECD, 2020[2])**.** Given the magnitude of the shock, official development assistance (ODA) will play an important role for many developing economies. However, increased domestic spending in provider countries could result in constraints for ODA in the coming years, although DAC members have jointly declared to "strive to protect ODA budgets" in 2020 (OECD DAC, 2020[29]). Raising more domestic revenues in developing economies is therefore critical, but the COVID-19 pandemic is likely to further reduce the fiscal space needed to mobilise these resources. Mobilising private finance for sustainable development is, therefore, becoming more critical than ever before for developing countries to meet growing financing needs. However, this may also be more challenging in the short term given the risk aversion in the market related to developing countries, as demonstrated by the record of private sector outflows in the wake of the COVID-19 crisis in 2020 (IMF, 2020[30]).

Institutional investors constitute key potential partners in this respect and have the capacity to fill a significant portion of the investment gap, given the trillions of assets they hold worldwide (Chapter 1. and Chapter 2.). As SDG financing gaps are the largest in developing countries, greater capital allocation from institutional investors in these markets could significantly contribute to finance the SDGs. In addition, institutional investors typically have a long-term outlook due to the nature of their liabilities and filling SDG financing gaps will require patient capital (OECD, 2018[31]). Finally, whilst institutional investors allocate funds across assets, usually through a diversified set of financial instruments (e.g. government, corporate or green bonds), in the current low interest rate environments, developing countries could hold the promise of higher returns (in particular through higher interest and premium rates).

Interestingly, a distinction can be made between international institutional investors and local institutional investors, which can both contribute to develop local capital markets. International institutional investors are typically best placed to take operating risks in established markets while local institutional investors have a better understanding of the local investment landscape, allowing them to take operating risks in developing countries (OECD, 2020[32]). Another benefit from attracting local institutional investors, such as sovereign wealth funds and local pension funds, is the opportunity to provide local currency finance to projects that generate revenues in local currency.

How can blended finance contribute to attract institutional investors toward developing countries?

Blended finance is emerging as a solution to help bridge the SDGs investment gaps widened by the Covid-19 crisis and help attract institutional investors toward developing countries. The OECD defines blended finance as the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries. "Additional finance" refers to commercial finance, directly mobilised by development finance interventions in a blended finance structure, which would not be directed towards development-related investments otherwise. Blended finance can help to catalyse much-needed additional resources and can be used, among other purposes, to bridge infrastructure investment gaps in developing markets, finance small and medium-sized enterprises in the "missing middle" gap in developing countries as well as address market failures that prevent developing countries from financing their development needs (OECD, 2018[31]).

Blended finance can de-risk deals and enhance returns to crowd in capital from local or international institutional investors. Risks and barriers to investment in developing countries are often too high for institutional investors' commercial risk-return profiles. Potential risks include a lack of collateral, foreign exchange risk and country risk, high transaction costs related to deal sizes, weak governance and

regulatory environment, lack of depth and breadth of local capital markets and lack of liquidity - all of which are exacerbated by the ongoing COVID-19 crisis. Ultimately, actual and perceived risks from institutional investors in developing countries hinder the growth of private investment in these markets.

In this context, blended finance can be an effective approach to cover the risks that the private sector cannot mitigate (such as political, market or regulatory risk), as well as in areas where no or limited market solutions are available (through, for example, insurance or guarantees). MDBs, DFIs as well as provider governments are important actors offering risk mitigation. Blended finance involves the use of different financial instruments that can be used alone or together to address unfavourable risk-return profiles of investment in developing countries (0 for further details on the range of blended finance solutions and mechanisms).

However, institutional investors remain for now the least important type of investors of blended finance vehicles. A wide range of actors is engaging in blended finance, from foundations and philanthropic investors to commercial actors. However, according to the *2020 OECD funds and facilities survey*[15], pension funds and insurance companies accounted for USD 2.5 billion or 4% of the total capital in blended finance funds and facilities.

More efforts are required to attract institutional investors at a larger scale in blended finance operations. First, development actors such as MDBs, DFIs and provider governments are the key facilitators in the mobilisation effort and stronger incentives to mobilise institutional investors at scale could contribute to raise much-needed additional resources for developing countries. Second, the complex financial engineering in blended finance operations, with multiple stakeholders involved with various mandates, as well as the lack of standardised mechanisms can also prevent institutional investors from engaging in blended finance transactions. It should also be noted that foreign institutional investors often have limited operational presence in developing countries, making deal due diligence and monitoring processes more challenging. Third, institutional investors often look for large investments but few projects in developing countries have sufficient scale to warrant a sizeable investment. Aggregating multiple projects (e.g. through a portfolio or syndication approach) can therefore help achieve the required critical mass, as well as contribute to portfolio diversification. Finally, the lack of investment-ready project pipelines highlights the need for enhanced investment preparation capacities within governments and development institutions. More and better data and improved transparency on the effective investment risks and potential returns to be expected in developing countries could also contribute to shift institutional investors' perceptions in developing countries.

Why do we need a framework to promote effective blended finance operations involving institutional investors?

Although blended finance holds the promise of yielding substantial additional finance in developing countries, it needs to be carried out effectively. At its 2017 High Level Meeting, the OECD Development Assistance Committee (DAC) adopted a set of five Blended Finance Principles for Unlocking Commercial Finance for the SDGs, serving as a call to action to deliver quality blended finance (OECD DAC, 2018[33]). In September 2019, the DAC also adopted the Blended Finance Guidance, a policy tool to help donors put the Principles into practice (OECD, 2021[34]).

[15] See more at https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/blendedfinancefundsandfacilities.htm.

Figure 4.1. OECD Development Assistance Committee Blended Finance Principles

Source: (OECD DAC, 2018[33]) OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the SDGs, https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/guidance-and-principles/

The OECD DAC Blended Finance Principles can help take up the challenge of mobilising institutional investors for the SDGs.[16] While Principle 1 ensures that blended finance is properly anchored to a development rationale, Principle 2 refers to the need to design blended finance to increase the mobilisation of additional commercial finance (e.g. from institutional investors). Principle 3 highlights the need to crowd in domestic finance through the involvement of local investors such as local pension funds, investment funds, national development banks and local individual investors. Mobilising local institutional investors that have a detailed understanding of the local investment climate provides an opportunity to support local strategic sectors aligned with national development plans. Principle 4 emphasizes the importance of enabling each party to engage on the basis of their respective development or commercial mandate (as in the case of pension funds and insurance companies), while respecting the other's mandate in blended finance transactions. Finally, Principle 5 focuses on monitoring blended finance for transparency and results to ensure accountability on the appropriate use and value for money of development finance.

As underlined in Principle 5, the availability of transparent data on blended finance activities is critical to build the necessary trust in the markets and mobilise more commercial actors for development, such as institutional investors. The new statistical measure Total Official Support for Sustainable Development (TOSSD) represents a major framework for promoting transparency in this area. The first TOSSD data release (on 2019 flows) confirmed its potential to capture information on blended finance activities and the amounts they mobilised from a broader range of actors, including emerging countries (Box 4.1 below).

Finally, the mobilisation of institutional investors is key but whenever development finance is used, development outcomes and impact must be transparently managed and measured. In March 2021, the DAC approved the OECD/UNDP Impact Standards for Financing Sustainable Development (IS-FSD). The IS-FSD provide a framework for donors, domestic finance institutions and their private sector partners

[16] In September 2020, the DAC approved the OECD Blended Finance Guidance which provide a framework for implementing policy recommendations, as well as practical steps to facilitate understanding and good practice on the design and implementation of blended finance programmes. It also provides best practice examples (for illustrative purposes) and key references for blended finance implementers to follow, including for institutional investors.

to make financial decisions and manage projects in ways that generate a positive impact on sustainable development, and improves the transparency of development results (OECD/UNDP, 2021[35]).

Box 4.1. Total Official Support for Sustainable Development (TOSSD): a new statistical measure for the SDG Era

What is TOSSD and how is it being developed?

TOSSD is a new measure for the SDG Era, including to capture the amounts mobilised from the private sector by blended finance mechanisms. TOSSD is a new statistical framework, specifically designed to measure resources for sustainable development and for the SDGs. It tracks official i) cross-border resource flows to developing countries and ii) global and regional expenditures, in support of development enablers, International Public Goods and to address global challenges. It also includes the resources mobilised from the private sector by official development finance interventions. It is designed to provide a coherent, comparable and unified system for tracking SDG-relevant investments that can inform the international community about how the SDGs are being financed globally and at the partner country level.

An international open, inclusive and transparent process for developing the TOSSD measure. Following the recognition of TOSSD in the Addis Ababa Action Agenda in 2015, an International Task Force composed of statistical experts and development policy specialists from emerging and developed economies, recipient countries, as well as international organisations was established in July 2017. The main objective of the Task Force has been to develop TOSSD Reporting Instructions, which define the main statistical parameters (definitions, measurement methods, taxonomies) of the framework. The OECD currently hosts the Secretariat of the Task Force and maintains the TOSSD database.

How will TOSSD help tracking support to blended finance approaches?

Filling critical data gaps and valorising the amounts mobilised from the private sector by official development finance. No sustainable development will be possible in developing countries without the mobilisation of additional resources for the SDGs, including from institutional investors such as pension funds and insurance companies. By making data available on blended finance activities and the amounts they mobilise, TOSSD supports a more informed discussion on the allocation of global resources for sustainable development and a more coherent and integrated implementation of the SDGs.

In addition, **TOSSD pillar I brings further transparency on all officially supported resource flows to developing countries in support of the SDGs.** These do not only include financial flows extended by provider countries and multilateral organisations in support of sustainable development, but also SDG-aligned investment from sovereign wealth funds and public pension funds.

TOSSD data

In March 2021, the first comprehensive set of TOSSD data on 2019 activities was published. Around 90 providers reported their support to sustainable development to the TOSSD framework in the first regular data collection round in 2020. The data are available in the TOSSD database (https://tossd.online/).

See more at: https://www.tossd.org/.

4.2. Overview of blended finance solutions to unlock institutional investment for sustainable development

Recent trends on mobilised private finance, including from institutional investors

In recent years, development finance providers have ramped up their efforts in mobilising private finance for the SDGs, including from institutional investors. According to OECD statistics, official development finance interventions by bilateral and multilateral development finance providers mobilised approximately USD 253 billion of private finance for development outcomes between 2012 and 2019 (OECD, 2021[36]). Private mobilisation generally followed an upward trend since 2012, its highest level so far having been reached in 2018 with USD 50.7 billion (Figure 4.2). The private investors mobilised do not only include banks and other financial institutions, private companies, asset managers but also institutional investors (Box 2.2 and Box 4.2). However, the level of details in reporting on mobilisation data remains currently limited for confidentiality reasons and prevents the OECD from providing further breakdown by type of private investors (section 4.3 for recent initiatives aiming at mobilising institutional investors toward developing countries).

Two-third of private finance was mobilised by multilateral organisations, in particular through direct investment in companies (35%) and guarantees (29%). Multilateral organisations mobilised 74% of total private finance, 62% of which refers to interventions of the MDBs and the remaining 12% to activities of other multilateral organisations, such as the EU Institutions and the multilateral climate funds. Twenty-six per cent of private finance was mobilised by governments' Development Finance Institutions (DFIs), development co-operation agencies and other bilateral vehicles working with the private sector. Almost two-thirds of private finance was mobilised through direct investment in companies / special purpose vehicles (SPVs; 35%) and guarantees (29%), followed by syndicated loans (13%), credit lines (10%), shares in collective investment vehicles (CIVs; 8%) and simple co-financing arrangements (4%).

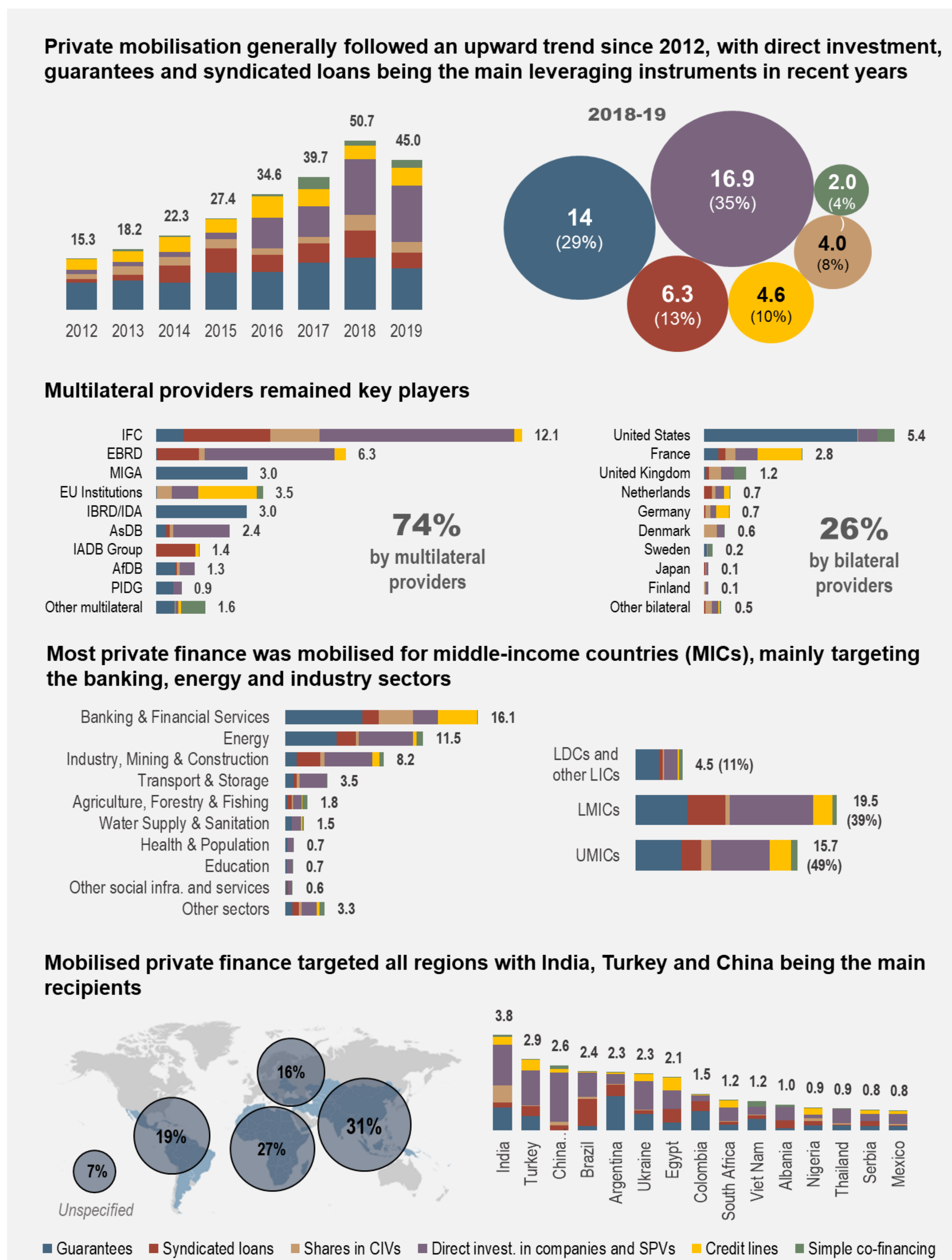
Mobilised private finance in 2018-19 was highly concentrated on projects targeting three main sectors, including the banking and financial services (34%), energy (24%) and industry, mining and construction (17%) sectors. Social infrastructure and services, including education, health and population, water and sanitation and other social infrastructure and services accounted for only 7% of total private mobilisation.

While mobilised private finance was rather equally distributed over all regions, only 11% targeted Least Developed Countries (LDCs) and other low-income countries (LICs). Asia received the largest share of the private amounts mobilised (31%), with India, China and Vietnam being the main recipients in that region. 27% benefitted Africa, especially Egypt, South Africa and Nigeria, followed by developing countries in Latin America and the Caribbean (19%), most notably Brazil, Argentina and Colombia, and developing countries in Europe (16%), such as Turkey, Ukraine and Albania. Middle-income countries (MICs) received most of country-allocable mobilised private finance (89%), with the LDCs and other LICs accounting only for 11% of the total.

Still**, in light of the huge volume of assets globally available, the amounts mobilised from the private sector remain largely insufficient to fill in the SDG financing gap.** One of the reasons for this is the relatively nascent collaboration between institutional investors and development finance providers in blended finance approaches (section 3.3), while investors show increasing appetite for exploring investment opportunities in emerging markets where interest rates may offer higher returns than in OECD countries currently (Halland, 2021[37]). Some development finance providers have set up pooled fund vehicles to crowd in capital from institutional investors such as the IFC MCPP (Box 2.2) and IFU SDG investment funds (Box 4.2). However, such initiatives are still in their infancy and are worth exploring by a broader range of development banks and institutions.

Figure 4.2. Amounts mobilised from the private sector by official development interventions

USD billion, 2018-19 average



Source: (OECD, 2021[36]).

Box 4.2. Highlights on institutional investment for sustainable development: the case of PensionDanmark

By Jan Kæraa Rasmussen, Head of ESG at PensionDanmark

Engagement in blended finance for sustainable development

PensionDanmark has been involved in three blended finance funds managed by the Danish Development Finance Institution IFU, namely the Danish Climate Investment Fund, Agribusiness Fund and SDG Investment Fund. PensionDanmark's total commitment in the SDG Investment Fund was almost EUR 100 million. By the beginning of 2021 some two-thirds have been invested in 45 projects in Sub-Saharan Africa, South America, developing Asia and Ukraine.

Investment strategy: example of the SDG Investment Fund

From 2018, the SDG Investment Fund has total commitments of some EUR 650 million from IFU (40%) and Danish private investors (60%). PensionDanmark has a stake of 8.23% in the Fund and a seat in the Fund's Investment Committee. The Fund strategy is to be an active minority investor in equity and equity-like instruments with particular focus on renewable energy, agribusiness, infrastructure, water and sanitation, industry and service as well as the financial sector. Project countries must be included in the DAC List of ODA Recipients.

So far, 29 SDG targets have been identified by the investment partners and 17 key performance indicators (KPIs) were reported in the first impact assessment. More will be added as data availability improves. This is key for success, since there is common belief that "you get what you measure".

Initial investment returns (up to 6%) are distributed to the private investors in the fund first, followed by a catch up and preference for IFU.

Main challenges and recommendations

Even though PensionDanmark has been engaged in two earlier funds managed by IFU and therefore has experience with sourcing and partnerships in LDCs and emerging economies, the main challenge has been the development of a pipeline of bankable projects, rather than the availability of financial means. Reaching the third year of the SDG Investment Fund's life-time, only 46% had been contracted to active investments. Shaping successful investment opportunities therefore requires joint efforts of all parties involved:

- Local sourcing capacity and partners in the local communities are critical for scaling projects to the minimum size that is needed for fund investments. Sometimes the latter is done in the form of microfinance to (often female) entrepreneurs in joint ventures with local financial institutions.
- Local governments and business communities need to be more aware of financing possibilities from blended finance.

DFIs, MDBs and other blended finance vehicles should recognize the need for appropriate project development capacity, and be open for involving international developers throughout the project pipeline.

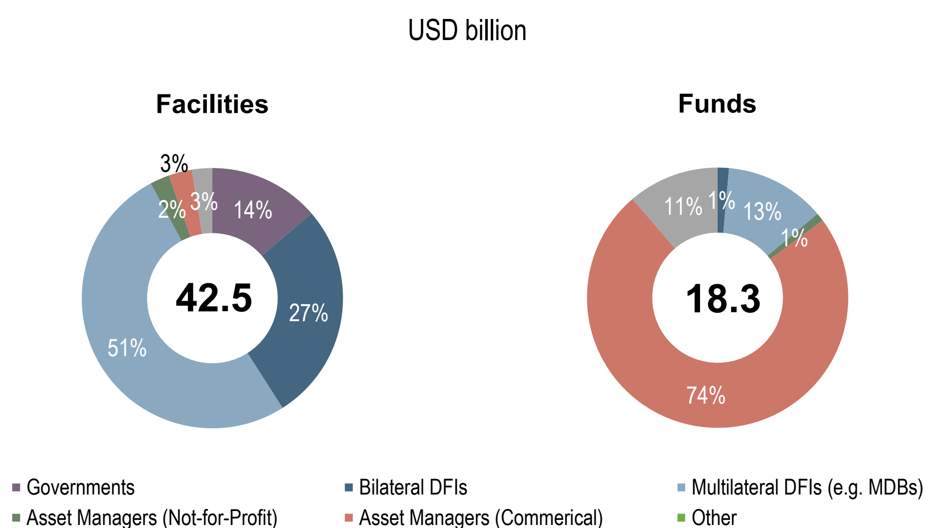
The role of institutional investors in blended finance funds and facilities

Looking more closely at blended finance vehicles, which are one of the primary channel of blended finance flows, **the profile of investors across blended finance funds and facilities varies significantly**. Unlike facilities, which are mainly invested by governments, blended finance funds have a broader set of investors including pension funds and insurance companies. Structured blended finance funds are one example where provider governments can typically use concessional finance in a first-loss position and provide a risk cushion which helps to attract commercial investors, such as institutional investors.

Governments, foundations, development finance institutions or non-profit asset managers are some of the key players deploying concessional capital to blended finance transactions (Figure 4.3). Public, private, and philanthropic organisations typically provide either concessional or commercially-priced capital to blended finance transactions. Commercial asset managers mostly provide commercial capital to blended finance transactions, whilst insurance companies, and pension funds nearly exclusively commercial capital (Basile and Dutra, 2019[38]). It should be noted that blended finance needs to focus on models that optimise the mobilisation of commercial finance, while minimising the required concessional finance. In addition, development finance providers need to think critically about how best to use their scarce resources and get the balance right between mobilisation at scale and development impact.

Figure 4.3. Blended finance funds and facilities' investors, 2018

USD billion



Source: (Basile and Dutra, 2019[38]), Blended Finance Funds and Facilities: 2018 Survey Results, https://dx.doi.org/10.1787/806991a2-en

4.3. Examples of blended finance transactions involving institutional investors

As shown in section 4.2, the mobilisation of private investment, in particular from institutional investors, has remained limited. However, this section aims to shed light on recent blended finance initiatives that have mobilised institutional investors at scale. It provides detailed information on their financing structure, including the source of development and commercial finance, as well as the instrument used and the development impact achieved. These examples can serve as an inspiration for future transactions to be replicated and scaled up to help fill the increasing SDG financing gap in developing countries.

The Women's Livelihood Bond

Development Finance

In 2017, the Impact Investment Exchange (IIX) launched one of the world's first listed bonds with an impact mandate, called the Women's Livelihood Bond (WLB). IIX first announced the creation of a WLB at 2014 Clinton Global Initiative (CGI) Annual Meeting. In 2015, IIX began to design the bond and by 2016 it began fundraising. Designing of the bond was financially supported by Rockefeller Foundation grant and Japan Research Institute. To structure the bond, IIX first had to create a pipeline of projects which fit into the bond objective. They used their database and partner network to find women-led businesses. Initially, they selected six businesses in four countries, but due to changes provided financing only to three in three countries.

To mobilise commercial capital for women's empowerment in Southeast Asia, the WLB leveraged three blended finance mechanisms:

- early-stage grant funding to support the two-year design process;
- a partial guarantee on the underlying loans (50% guarantee provided by USAID, which itself obtained a grant from Australia's Department for Foreign Affairs);
- a small first-loss capital tranche contributed by IIX.

Commercial finance

Commercial finance partners, DBS Bank and ANZ Banking Group, came in to work on structuring of the bond, advising on client preferences, coupon rate and investment terms. DBS Bank and ANZ also worked to place and issue the bond, creating the needed SPV, preparing investor memorandum and setting the pricing. DBS Bank and ANZ also played an important role in fundraising with DBS Bank contacting institutional investors in Europe, while ANZ Banking Group contacted those in Australia and the United States.

Challenge

Empowering women is crucial to achieve SDGs. Access to finance for many social enterprises, which work to empower women, is often a challenge.

Solution

The WLB was reported as a structured fund in the OECD Blended finance funds and facilities survey. It is one of the first listed bonds (or debt securities) and a unique impact investing opportunity for the Asian market as it is listed and quoted on the Singapore Exchange (SGX).

Impact

The WLB represents an innovative application of a traditional financial instrument to the impact investment sector, which seeks to bridge the current gap between the SDGs and global financial markets. The proceeds were targeting a group of high-impact social enterprises that have undergone rigorous financial and social due diligence. The WLB has enabled each of the three selected borrowers to support women's empowerment in Southeast Asia through sustainable livelihoods by providing critical services, including access to finance, access to income generating assets, and access to skills. The WLB is targeting 500 thousand direct beneficiaries, approximately 70% of which would be women (i.e. USD 385 thousand total female beneficiaries).

Source: (Convergence, 2018[39]).

The Trade and Development Bank's experience in leveraging domestic capital from institutional investors

Development Finance

The Trade and Development Bank (TDB) is a multilateral, treaty-based financial institution offering both infrastructure and trade finance. As part of a reform in 2013, the Bank embarked on a new plan to diversify its funding base, which provided an opportunity for the Bank to blend public and private funding on both the asset and liability side. The Bank decided to introduce a new class of shares aimed at institutional shareholders. With the introduction of those shares (Class B), which deliver cash dividends, the Bank embarked on finding suitable investment partners through private placements.

*Commercial fi*nance

The institutional investors were attracted not only by the financial returns but also by the reforms the Bank had undertaken to strengthen its investments. For example, while not formally regulated by any central bank, the Bank adopted and continues to benchmark itself against global best practices. TDB's strategy to diversify its shareholder base through the introduction of Class B shares has resulted in a strong increase in the institutional shareholding of the Bank over the past few years (from 5.8% in 2010 to 24.5% in December 2019). By 2020 almost USD 225 million have been invested in TDB's Class B shares.

TDB has also been able to achieve a capital base blending both public and private funds, local and global. Class B shareholders include several African pension funds and insurance companies as well as non-regional institutional shareholders. As of 2021, the Bank has 18 investors, including institutional investors. It includes many multilateral institutions like OPEC Fund and the Arab Bank for Economic Development in Africa (BADEA). Denmark's International Fund for Developing Countries (IFU) was the first European fund to invest in 2019 and by 2020 it doubled its equity investment to USD 40 million. The latest investor to join was Djibouti's Caisse Nationale de Sécurité Sociale (CNSS).

Challenge

Capital increase comes in the context of the need for innovative development financing for DFIs to achieve 2030 Agenda.

Solution

The capital increase has allowed the Bank to extend further financing and hence deliver more development results and impact. The Bank has been able to expand to West Africa, which contributed to diversify its portfolio and become more resilient to external shocks like the Covid-19 pandemic.

Impact

As a result of the increased investment, including from central banks and institutional investors, the governance of the Bank has continued to improve while it maintained its privileged multilateral status. According to TDB, the capital increase was meant to allow the Bank to have a stronger sustainable and development impact as half of TDB's projects are linked to the SDGs.

Source: (TDB, 2020[40]), (TDB, 2020[41]) and (TDB, 2020[42]).

Climate Investor One

Development Finance

The Climate Investor One (CIO) is a global investment vehicle founded in 2015 by the Netherlands Development Finance Company (FMO) and Phoenix InfraWorks to finance renewable energy projects in emerging markets globally. CIO is managed by Climate Fund Managers (CFM), a joint venture between FMO and Phoenix. 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 three investment funds are targeting a total commitment of USD 1 billion at final close. First stage is covered by the Development Fund. The fund aims to attract donor capital i.e., grants of up to USD 30 million. In projects which are successful, the donor capital would be converted into equity which would be bought up by the CIO fund.

Commercial finance

The two funds that are financed partly through commercial finance are the Construction Equity Fund and the Refinancing fund.

- The Construction Equity Fund (CEF): the 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 other investors such as Export Credit Agencies and pension funds.
- The Refinancing Fund: with a 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.

CIO 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 developed through the first two funds are nearing the operational phase.

Challenge

Financing of renewable energy projects in developing countries is challenging often due to the lack of supportive regulatory frameworks for private investment, lack of expertise, challenge of bringing in new investors or prolonged negotiations with financiers.

Solution

CIO follows the project through different steps to ensure the success of the project. They provide support at an early, middle and final stage, stepping in to resolve the biggest challenges project face at each stage. At early project stage, CIO provides financial, technical, environmental, social development and structuring support through this fund. It focuses particularly on specific requirements projects usually struggle to

complete because of lack of finance like securing permits and land titles, concluding power purchase agreements and conducting environmental and social impact assessment. In the next stage of the project CIO reduce the complexity associated with multi-party negotiations associated with typical project finance delays by equity financing the construction phase using the CEF. Finally, CIO brings in new capital through refinancing fund which 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.

Impact

CIO currently supports nine projects which will lower the cost of clean electricity to consumers in developing countries by 9-18%. As a result, 300 MW of renewable energy will be deployed, reducing carbon emissions by 600kt per year.

Source: (The Global Innovation Lab for Climate Finance, 2020[43]).

Elazig Hospital

Development Finance

In 2017 Turkey issued its first green and social bond to finance a greenfield infrastructure project – the Elazig Integrated Health Campus. IFC invested EUR 80 million in an unenhanced and unrated tranche. EBRD and MIGA provided credit enhancement through risk mitigation mechanisms of political risk insurance in the form of a guarantee and liquidity facility. EBRD provided EUR 89 million liquidity facility to support construction and operational phases. MIGA provided a 20-year political risk guarantee to support investment-grade portion of the bond and a MIGA guarantee to equity investment in the project.

Both IBRD and EBRD are working with Turkey's Ministry of Health to build institutional and monitoring capacities.

Commercial finance

The project was financed mostly through debt with debt to equity ratio of 80:20. The EUR 360 million project was financed through a EUR 288 million bond by ELZ Finance S.A. Credit enhancement by EBRD and MIGA led to Moody's rating the bond Baa2, which is two points higher than Turkey's sovereign debt rating. The high rating will encourage the investment from institutional investors. Through private bond placement the project was financed by development finance institutions such as Proparco and FMO, as well as by institutional investors like Commercial Bank of China, Intesa Sanpaolo, Siemens Financial Services, and Mitsubishi UFJ Financial Group (MUFG).

Challenge

Turkey is facing an unequal access to health care, with the number of hospital beds below OECD average. This is exacerbated by new health challenges like the rise of the non-communicable diseases such as cancer and diabetes and the increase in substance addiction.

Solution

Building of the Elazig hospital campus is one part of the Turkish government strategy to improve healthcare services.

Impact

The main developmental impact of this project was initially to improve access to healthcare for 1.6 million people in eastern Anatolia and provide more than 1,000 new hospital beds. The project also aimed to have a strong economic impact by employing 2,000 people during construction period. At its completion, the project employed 4,500 people, with 40% of them being women.

Source: (EBRD, 2017[44]) and (EBRD, 2017[44]).

Amundi Planet Emerging Green One (EGO) Fund

Development Finance

Amundi Planet Emerging Green One (EGO) fund is the largest targeted green bond fund for emerging markets. Of USD 1.42 billion raised, IFC committed USD 256 million. Additional cornerstone investors have been brought in, namely EIB, EBRD and Proparco.

Commercial finance

To ensure the interest from institutional investors the EGO fund created a senior tranche which represents 90% of the whole portfolio and a 10% mezzanine and junior tranche in USD and EUR to absorb first losses. Proparco is currently the largest investor in the mezzanine tranche. The average rating of the bond and portfolio rating is BB+ and sovereign green bond investment is capped at 30%. Amundi (an asset manager) successfully fundraised with many institutional investors from Europe and the Middle East. These include pension funds like Alecta, AP3, APK Vorsorgekasse AG, ERAFP, insurance companies like Crédit Agricole Assurances, LocalTapiola General Mutual Insurance Company, and asset managers.

Challenge

According to IFC, there are USD 29 trillion of investment opportunities in emerging markets. Much of this investment needs to involve private investors. In addition, supporting local bond issuance can contribute to develop local debt capital markets.

Solution

EGO Fund has provided a new kind of investor-friendly vehicle to fund sustainable projects in emerging markets, focusing on local financial institutions.

Impact

The fund has deployed USD 2 billion to emerging markets. Because of its long timescale until 2025 and large size, the fund is expected to increase the capacity of emerging markets as well as to increase the scale of sustainable finance in emerging markets.

Source: (Imperial College Business School, 2020[45]).

The Climate Finance Partnership (CFP)

Development Finance

In January 2019, the Climate Finance Partnership (CFP) was announced, which aims to direct capital into climate-related projects in developing countries. The Partnership brings together BlackRock, the world leader in asset management, Agence Française de Développement (AFD), the German Ministry for the

Environment and the Hewlett and Grantham foundations. The fund consists of the first loss tranche of USD 100 million which will be financed by France and Germany each contributing USD 30 million. The Hewlett Foundation and the Grantham Foundation, will also contribute to this tranche.

AFD Group has been identified as the operator capable of implementing this partnership for France. AFD will provide knowledge of climate issues in emerging countries and expertise in the field: environmental and social expertise, tools for measuring the impacts (carbon footprint assessment) as well as climate taxonomy (project eligibility will be determined based on the Common Principles adopted by multilateral development banks).

Commercial Finance

The CFP is structured as an investment fund managed by BlackRock, who will use the first-loss tranche to mobilize at least USD 400 million from institutional investors. BlackRock will be in charge of making the investment decisions, in accordance with the established investment policy.

Challenge

There is a need to increase the number of climate-related projects in low and middle income countries and to increase the amount of private financing for these projects.

Solution

The CFP plans to invest between USD 500 million and USD 1 billion in climate change mitigation projects in emerging countries. The funds will be invested in climate infrastructure in Southeast Asia, Latin America and Africa. This includes the production of renewable energy, energy efficiency in residential, commercial and industrial sectors, energy storage, and low-carbon transport services.

This project, like all projects monitored by AFD Group, will be subject to the same environmental, social and governance standards. These standards will apply to BlackRock and any other fund managers. Through its subsidiary, Proparco, AFD will be part of the fund's consultative committee to ensure the proper implementation of the investment policy. The most important points of this policy that pertain to governments cannot be amended without approval from France and Germany.

Impact

For public donors, including France and AFD, this an opportunity for the large-scale mobilization of private savings and the chance for a significant global asset manager to handle investment projects for climate action and to benefit Africa.

Source: (Convergence, 2018[46]), (Reuters, 2020[47]) and (Candid, 2020[48]).

Main policy recommendations

- **Blended finance can be used to shift the risk perception of institutional investors,** while enhancing their expected returns through the use of risk mitigation instruments by development finance providers. Despite its potential to unlock institutional assets for the SDGs in developing countries, blended finance remains a relatively new tool in development co-operation. While many development finance providers have well-established blended finance programmes using for example guarantees and loan syndications (Box 2.2), more efforts are needed to explore the full potential of such mechanisms.
- **Greater incentives from development finance providers should also relate to increased efforts for aggregating multiple projects and mobilise institutional investors at scale** – e.g. through portfolio investment mechanism (Box 4.2) – to help achieve the needed investment ticket sizes, as well as to contribute to portfolio diversification for institutional investors. As a result, it is crucial to ensure that the incentives structure of development finance institutions (DFIs) and multilateral development banks (MDBs) are aligned with the objective of mobilising institutional investors at scale.
- **The lack of bankable projects in developing countries is often cited by institutional investors as one of the key constraints to invest in these markets.** There can be a lack of data, information or capacity to properly identify and evaluate market opportunities for institutional investors, as well as a lack of a clear pipeline of projects that are commercially viable and investor-ready. One way to address this issue is to support technical assistance programs aiming at supporting local projects to become investment ready, which could be supported by donors as well as DFIs and MDBs.
- **Furthermore, it remains essential to provide a framework ensuring effective use of blended finance.** The OECD DAC Blended Finance Guidance is a policy tool to help all providers of development finance — provider governments and agencies, multilateral providers, philanthropies and other stakeholders — to put the Blended Finance Principles into practice and effectively design and implement blended finance programmes (OECD, 2021[34]). The use of development finance to mobilise institutional investors should, therefore, convey clear development outcomes. In March 2021, the DAC approved the Impact Standards for Financing Sustainable Development (IS-FSD), which provide a framework for donors, domestic finance institutions and their private sector partners to make financial decisions and manage projects in ways that generate a positive impact on sustainable development, and improves the transparency of development results (OECD/UNDP, 2021[35]).
- **Finally, increased transparency of institutional investors' asset distribution is critical for building trust in the markets and, thus, unlocking financing towards developing countries.** So far, only little information is available on the individual investments of these institutions (volumes, distribution). This critically limits the knowledge sharing on the investment opportunities in emerging markets. Transparency does not only build trust in the international development system, but it is also an important source of learning opportunities and inputs needed for evidence-based policies and informed partnerships for the SDGs. In this context, the new broader statistical framework – Total Official Support for Sustainable Development (TOSSD) which brings transparency on all officially-supported activities for sustainable development – can shed light on institutional investors' activities. TOSSD captures both investments undertaken by sovereign and government-backed pension funds and insurance companies in developing countries, as well as the amounts mobilised from private investors by blended finance solutions (Box 4.1).

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Annex A. Overview of blended finance instruments and mechanisms

Blended finance involves the use various financial instruments and different blending mechanisms to address unfavourable risk-return profiles of investment in developing countries. Interestingly, blended finance can be used at both end of the risk/return spectrum as it can be used to de-risk projects (for example through the use of guarantees or grant funding) or to enhance returns (for example using subordination mechanisms allowing to compensate the high risks taken by commercial investors).

Below is a brief overview of the main blended finance instruments which can be used to crowd in commercial capital and used together in a single blended finance transaction:

- **Direct investments:** Direct investment instruments (such as equity and debt) provided on concessional terms can make a project more attractive to commercial investors by supporting the investee's financial sustainability.
- **Debt instruments:** Credit lines (for example to local financial institutions) from a DFI/MDB can facilitate the mobilisation of additional commercial capital. In addition, project companies and corporate entities can issue bonds in order to raise long-term debt finance. As a reminder, fixed income instruments are the dominant asset class for pension funds. Bonds can benefit from a credit enhancement from a DFI/MDB which could allow to give a boost to their credit rating and thereby increase commercial investors' confidence. Similarly, bonds can benefit from the use of first loss tranches (as a risk cushion) by development finance institutions provided to institutional investors without previous experience in emerging market debt.
- **Mezzanine instruments:** DFIs/MDBs can take an intermediary role in blended finance by investing in the middle (mezzanine) tranche of subordinated funds to provide an additional risk cushion for senior institutional investors.
- **Guarantees and insurance:** 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. Guarantees usually provide protection against either political or commercial risks.
- **Hedging:** Multilateral organisations and currency exchange funds capitalised by donor countries can help hedging against foreign exchange risk, thereby providing long-term local currency in developing countries
- **Grants and technical assistance:** Grants and technical assistance facilities can provide a pool of resources to ensure well-structured deals come to the market.

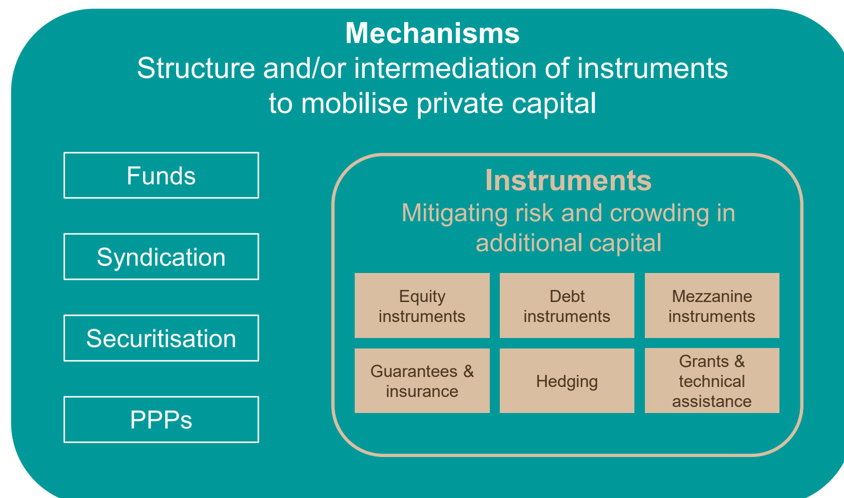
Below is a brief overview of the main blended finance mechanisms which can be used to structure or intermediate various financial instruments:

- **Funds and facilities:** A fund is a pool of capital which can be comprised of a mixture of development and commercial resources that provides financing to direct investees (e.g. projects or companies) or indirect investees (e.g. through credit lines or guarantees) that provide on-lending. Funds can be structured in two ways: either in a flat structure where risks and returns are allocated equally to all investors (all investors are *pari passu*) or in a layered structure where risks

and returns are allocated differently across investors. A facility is an earmarked allocation of public development resources (sometimes including support from philanthropies), which can invest in development projects through a range of instruments.

- **Syndication:** Syndicated loans are provided by a group of lenders, typically a mix from public and private sectors and MDBs usually take the role of lead arrangers with the private sector engaging as a B-loan provider. The due diligence capabilities and reputation of the public sector arrangers (i.e. the MDBs) contribute to boost investor confidence and reduce transaction costs.
- **Securitization:** Institutional investors such as pension funds and insurance companies are typically looking for long-term investments of assets with moderate risk but reliable return profiles, which can position them well to invest in securitisation structures of MDB/DFI operating assets
- **PPPs:** Public-private partnerships (PPPs) are collaborations between public and private entities in which risks, returns and financing are negotiated among the partners.

Figure A.1. Blended finance instruments and mechanisms



Source: (OECD, 2018[31]), Making Blended Finance Work for the Sustainable Development Goals, https://dx.doi.org/10.1787/9789264288768-en

Annex B. Response rate to the Addendum of the OECD 2019 survey

Table B.1. Pension funds included in this report analysis

Investor residence	Investor name	Invest or type	Qualitative questionnaire	Assets held in developing countries, 2017-18 average, MUSD	Source of financial data
Australia	AustralianSuper Pty Ltd	LPF	YES	n/a	Addendum
Australia	CBUS	LPF	YES	2	Addendum
Australia	Hostplus	LPF	YES	3,230	Addendum
Australia	UniSuper	LPF	YES	1,408	Addendum
Austria	APK	LPF		786	Main questionnaire
Austria	Valida Pension AG	LPF	YES	908	Addendum
Austria	VBV Pensionskasse AG	LPF	YES	1,112	Addendum
Brazil	SP-PREVCOM	LPF	YES	276	Addendum
Canada	CPP Investments	PPRF	YES	36,910	Addendum
Canada	Ontario Teachers' Pension Plan	LPF	YES	n/a	Addendum
Chile	Pension Reserve Fund	PPRF		388	Main questionnaire
Croatia	PBZ	LPF		698	Main questionnaire
Denmark	P+, the Pension Fund for Academics	LPF	YES	n/a	Addendum
Denmark	PensionDanmark	LPF	YES	518	Addendum
Finland	KEVA	LPF		1,283	Main questionnaire
Finland	Varma	LPF	YES	2,409	Addendum
Iceland	Birta Pension Fund	LPF	YES	26	Addendum
Iceland	Gildi Pension Fund	LPF	YES	67	Addendum
Iceland	Lifeyrissjodur Starfsmanna Rikisins	LPF	YES	n/a	Addendum
Iceland	LSR	LPF		311	Addendum
Iceland	LV	LPF		323	Main questionnaire
Italy	Cometa	LPF		265	Addendum
Italy	Fonchim	LPF		25	Addendum
Italy	Fonte	LPF		1,033	Addendum
Lithuania	Pensija2	LPF		9	Addendum
Lithuania	Pensija4	LPF		21	Main questionnaire
Netherlands	ABP	LPF	YES	52,820	Addendum
Netherlands	PGGM	LPF		32,300	Main questionnaire
Netherlands	PME	LPF		5,498	Main questionnaire
Netherlands	PMT	LPF		7,448	Addendum
New Zealand	New Zealand Super Fund	LPF	YES	1,804	Addendum
Norway	GPFG	SWF		101,838	Addendum
Portugal	BPI VIDA E PENSÕES	LPF	YES	36	Main questionnaire
Russian Federation	JSC N-s PF OTKRITIE	LPF	YES	n/a	Addendum
South Africa	GEPF	LPF		899	Main questionnaire
South Africa	Sentinel	LPF		218	Main questionnaire
Spain	Santander	LPF	YES	15	Addendum
Sweden	Alecta	LPF		1,286	Addendum

Investor residence	Investor name	Invest or type	Qualitative questionnaire	Assets held in developing countries, 2017-18 average, MUSD	Source of financial data
Sweden	AP2	PPRF	YES	5,380	Main questionnaire
Sweden	AP4	PPRF		2,030	Addendum
Turkey	OYAK	LPF		163	Main questionnaire
TOTAL	**41**			**263,743**	

Note: Qualitative inputs on pension funds' investment behaviour are sourced from a specific questionnaire hosted by the 2019 edition of the OECD survey on pension funds and insurance companies. Data on pension funds' asset allocation are primarily sourced from a special Addendum integrated in the 2019 edition of the OECD survey, and complemented with inputs gathered through the main survey questionnaire (in the case of pension funds which only responded to the main questionnaire, indicating to hold assets to Africa, Latin America, "Other Asia" or "Other Europe"). LPF stands for Large Pension Funds, PPRF for Public Pension Reserve Funds and SWF for Sovereing Wealth Funds.

Table B.2. Insurance companies included in this report analysis

Investor residence	Investor name	Investor type	Qualitative questionnaire	Financial data
Canada	Manulife Financial	Life	YES	
Finland	Fennia Group including Fennia Mutual Insurance Company and Fennia Life Insurance Company	Life and Non-Life	YES	YES
Finland	LocalTapiola	Life and Non-Life	YES	YES
Finland	Sampo Group	Life and Non-Life	YES	YES
France	BNP Paribas Cardif	Life and Non-Life	YES	
France	Credit agricole assurances	Life and Non-Life	YES	YES
France	Groupe Macif	Life and Non-Life	YES	
France	Societe Generale France		YES	
Italy	UnipolSai Assicurazioni SpA	Life and Non-Life, Reinsurance	YES	YES
Japan	Aioi Nissay Dowa insurance Co.,Ltd.	Non-Life	YES	YES
Japan	MEIJIYASUDA LIFE INSURANCE COMPANY	Life and Annuities	YES	
Japan	Mitsui Sumitomo Insurance Co.,Ltd.	Non-Life	YES	YES
Japan	Nippon Life Insurance Company	Life	YES	YES
Japan	Sumitomolife Insurance Company	Life	YES	YES
Japan	Tokio Marine and Nichido Fire Insurance Co. Ltd.	Non-Life	YES	YES
Korea	ABL Life	Life	YES	YES
Korea	AIA Life Insurance Co. Ltd	Life	YES	YES
Korea	AXA General Insurance	Non-Life	YES	
Korea	BNP Paribas Cardif life Korea	Life and Non-Life	YES	
Korea	DB life	Life	YES	
Korea	DB non-life insurance	Non-Life	YES	YES
Korea	Hanwha General Insurance	Non-Life	YES	YES
Korea	Hyundai Marine & Fire Insurance	Non-Life	YES	YES
Korea	KB	Life	YES	
Korea	KB Insurance	Non-Life	YES	YES
Korea	KDB	Life and Annuities	YES	YES
Korea	Korean Reinsurance	Reinsurance	YES	YES
Korea	Kyobo Life Insurance	Life	YES	YES
Korea	Kyobo Lifeplanet Insurance Company	Life	YES	
Korea	Lina Life Insurance Company	Life	YES	
Korea	Meritz Fire & Marine Insurance	Non-Life	YES	
Korea	MetLife Insurance Co. of Korea, Ltd.	Life	YES	

Investor residence	Investor name	Investor type	Qualitative questionnaire	Financial data
Korea	MG non-life Insurance	Non-Life	YES	YES
Korea	Samsung	Life	YES	YES
Korea	Samsung Fire and Marine	Non-Life		YES
Korea	Seoul Guarantee Insurance	Non-Life	YES	YES
Korea	The K non-life insurance	Non-Life	YES	
Korea	Tongyang Life Insurance	Life	YES	YES
Netherlands	ASR Nederland NV	Life and Non-Life	YES	YES
Portugal	Ageas Portugal	Life and Non-Life	YES	YES
Portugal	Europ Assistance - Companhia Portuguesa de Seguros, S.A.	Non-Life, Reinsurance	YES	YES
Slovenia	Vzajemna, d.v.z.	Non-Life	YES	YES
Sweden	Alecta pensionsförsäkring, ömsesidigt	Life	YES	
Sweden	AMF	Life	YES	YES
Sweden	Swedbank Försäkring AB		YES	
Switzerland	Vaudoise Assurances	Life and Non-Life	YES	YES
TOTAL		**46**	**45**	**30**

Note: Financial details on assets allocated in developing countries are not presented in this table due to high data sensitivity.