



Unlocking Legal Pathways for Blended Finance

Case Studies and Global Insights

GAIL
Global Alliance of Impact Lawyers

About the Global Alliance of Impact Lawyers

The Global Alliance of Impact Lawyers (GAIL) is a global community of legal leaders who are using the practice of law to have a positive impact on people and the planet, and to accelerate the just transition. GAIL believes that lawyers are uniquely positioned to facilitate change and support the movement towards a more just and equitable system.

A key element of GAIL's work is to leverage the expertise of lawyers to accelerate the shift of corporate models and capital to make sure business can truly be a sustainable force for good.

About this report

This Report has leveraged the expertise of more than 40 lawyers from across 13 jurisdictions who have expertise in advising on blended finance structures, through a series of 8 blended finance working group meetings over the course of a year (2023 – 2024). Its aim is to support and facilitate an acceleration in the flow of capital for the good of people and the planet, in furtherance of the SDGs, by identifying and mapping the legal and regulatory barriers to blended finance and by sharing lessons, learnings and legal case studies from across the world.

In our view, blended finance will be critical to achieving a just transition. Through this Report, GAIL hopes to support the more effective use of blended finance and to enable the scaling of blended finance structures and instruments for positive social and environmental impact.

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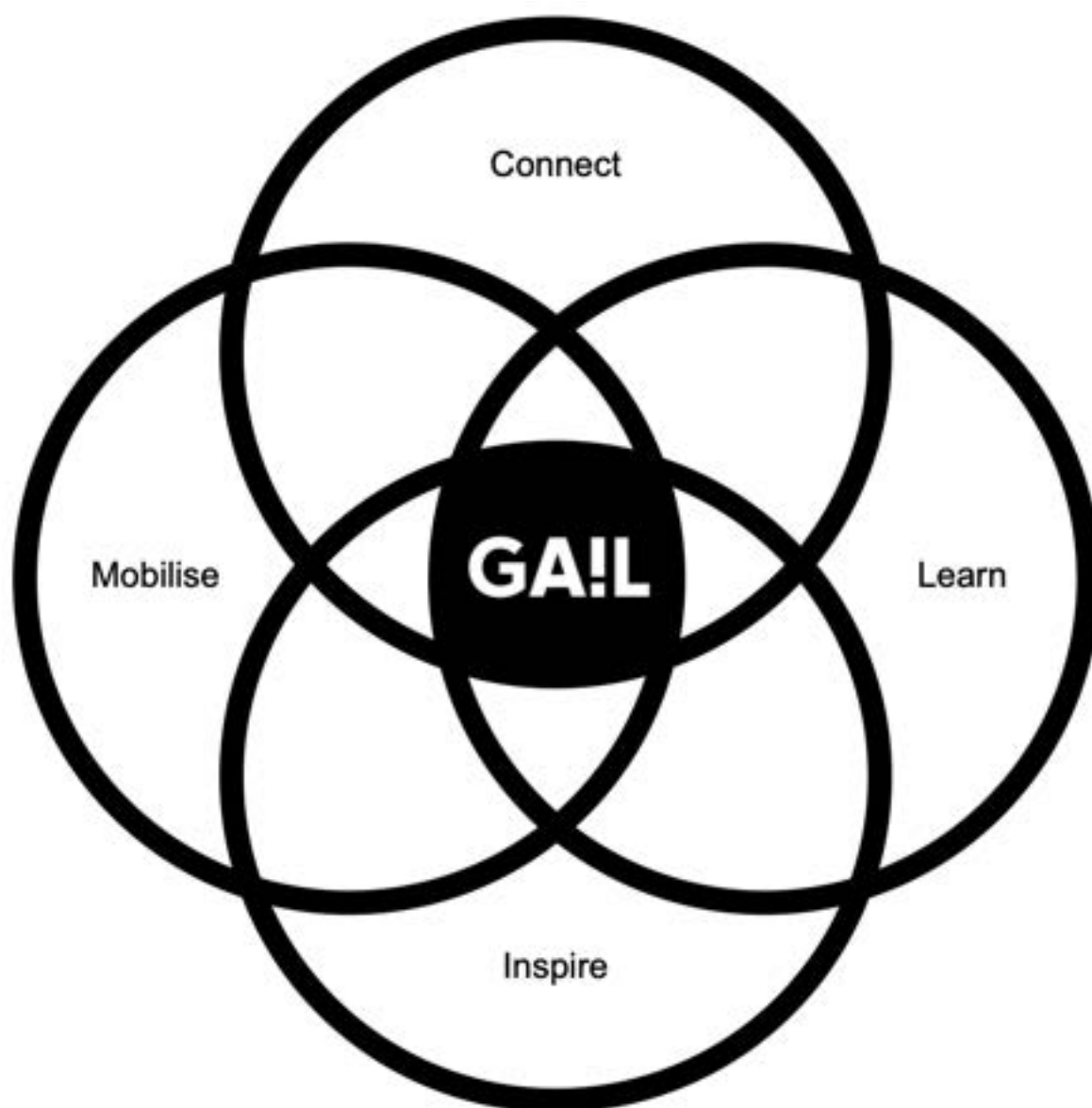
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Executive Summary

This Report examines the legal landscape for blended finance across different regions of the world.

The key finding is that each jurisdiction is dealing with similar legal issues and is often coming up with similar legal solutions. But generally, such solutions are being developed in isolation to meet a particular need at a particular time. The legal frameworks are patchy and often unclear or untested on key issues.

Law and lawyers make a valuable contribution to advancing blended finance in all its contexts – whether as development or impact finance, multi-jurisdictional or local.

- All blended finance projects require a legal platform. Legal structuring and legal instruments and techniques are essential to achieve the fundamental objective of combining the right mix of financing – public, philanthropic and private – for social and environmental outcomes.
- The legal work on a project creates the basis for stakeholder cooperation, risk mitigation, efficient capital mobilisation, long-term sustainability, mission consistency and transparency. It enables the project to navigate complex legal and regulatory compliance frameworks.

This Report recommends that the legal community works on building a consensus on the legal principles to apply to blended finance transactions. An alignment of principles across jurisdictions will enable participants – investors, enterprises, public agencies or any other stakeholder – to have common expectations as to the principles defining how a blended finance structure will work, irrespective of the particular laws in a particular jurisdiction.

The Global Alliance of Impact Lawyers (GAIL)

is a community of legal leaders who are using the practice of law to have a positive impact on people and the planet, and to accelerate the just transition. In our view, blended finance will be critical to achieving a just transition.

“All blended finance projects require a legal platform. Legal structuring and legal instruments and techniques are essential to achieve the fundamental objective of combining the right mix of financing – public, philanthropic and private – for social and environmental outcomes.”

For this project, GAIL assembled a Working Group of GAIL members from each of the GAIL regions across Asia Pacific, Europe, Latin America, North America and the UK¹.

The Working Group's Observations in [Section 1](#) draw out common themes in the legal frameworks applying to blended finance – the legal vehicles and infrastructure that support it and the legal hurdles that need to be resolved, and highlight the types of structures used in different jurisdictions and their comparable features.

Working Group members also developed and contributed a number of Jurisdiction Overviews, Case Studies and Research Articles to this Report. These are set out in [Section 2](#), [Section 3](#) and [Section 4](#) of this Report.

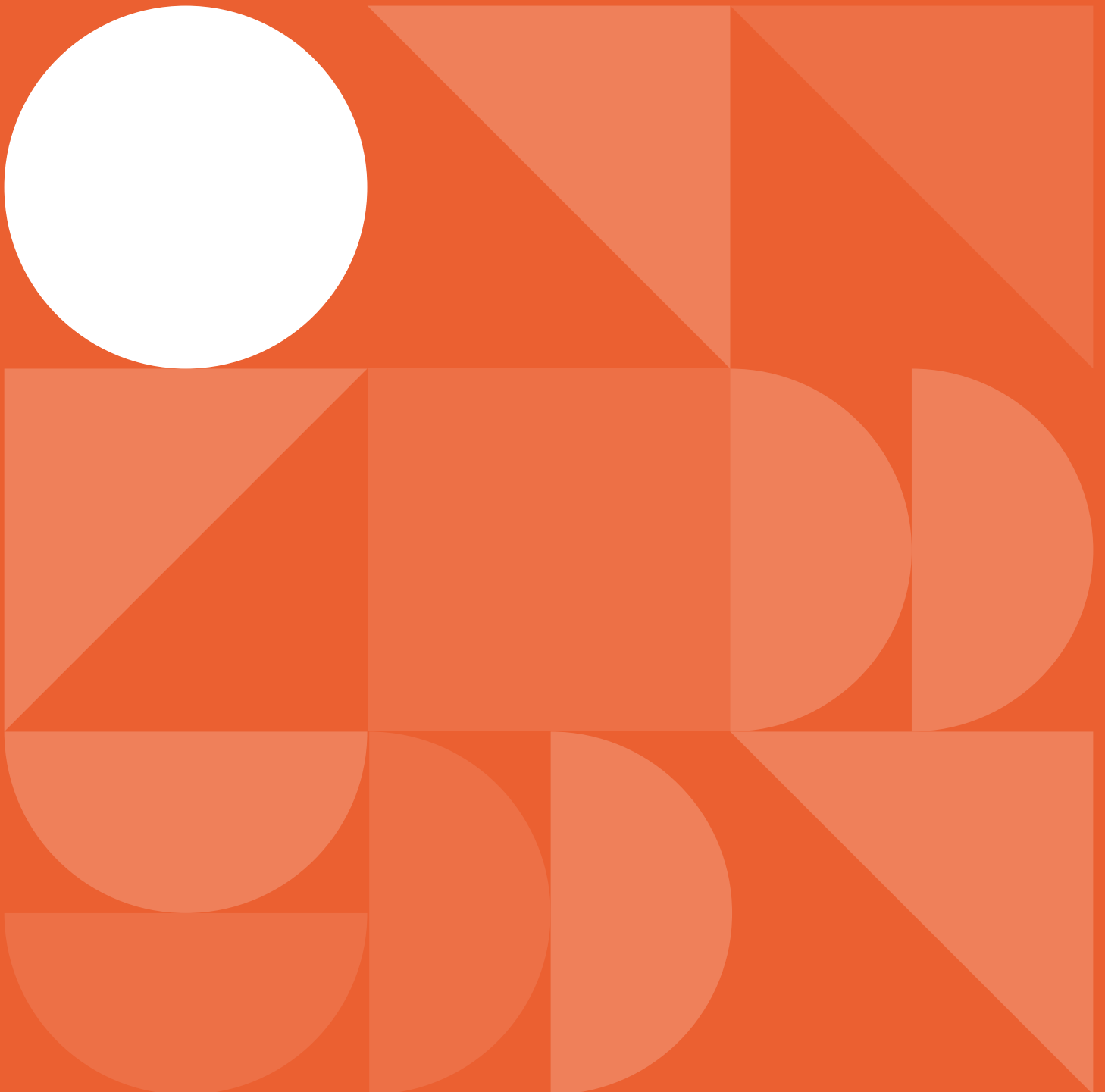
- **The Jurisdiction Overviews** give a snapshot of the main legal and tax issues for blended finance in those jurisdictions.
- **The Case Studies** cover a range of sectors – health, housing, energy, etc – and illustrate legal structures and instruments used in different jurisdictions. While there are some common approaches – e.g. funds and guarantees – there are also local variations and flavours.

The next stage of this project will focus on increasing market awareness of the legal options and opportunities for blended finance, extending the jurisdiction and case study research to other jurisdictions active in blended finance projects, and working out how the legal framework can better support non-financial capital and social and environmental concepts of value.

“The legal work on a project creates the basis for stakeholder cooperation, risk mitigation, efficient capital mobilisation, long-term sustainability, mission consistency and transparency. It enables the project to navigate complex legal and regulatory compliance frameworks.”

¹. GAIL Africa was launched as the newest GAIL region after the commencement of this project.

The Legal Perspective



“Blended finance is about sourcing and structuring the right mix of financing – public, philanthropic and private – to achieve social and environmental outcomes.”

Introduction

About the Global Alliance of Impact Lawyers

The [Global Alliance of Impact Lawyers \(GAIL\)](#) is a global community of legal leaders who are using the practice of law to have a positive impact on people and the planet, and to accelerate the just transition. GAIL believes that lawyers are uniquely positioned to facilitate change and support the movement towards a more just and equitable system.

A key element of GAIL's work is to leverage the expertise of lawyers to accelerate the shift of corporate models and capital to make sure business can truly be a sustainable force for good. This Report has leveraged the expertise of over 40 lawyers from 13+ jurisdictions who have expertise in advising on blended finance structures, through a series of 8 blended finance Working Group meetings over the course of a year (2023 – 2024). Its aim is to support and facilitate an acceleration in the flow of capital for the good of people and the planet, in furtherance of the SDGs, by identifying and mapping the legal and regulatory barriers to blended finance and by sharing lessons, learnings and legal case studies from across the world.

In our view, blended finance will be critical to achieving a just transition. Through this Report, GAIL hopes to support the more effective use of blended finance and to enable the scaling of blended finance structures and instruments for positive social and environmental impact.

What this project is about

Blended finance is about sourcing and structuring the right mix of financing – public, philanthropic and private – to achieve social and environmental outcomes.

This GAIL project is about understanding and improving the legal platforms that enable blended finance to succeed. We have been examining the legal features of blended finance that are common to multiple jurisdictions and also features from particular jurisdictions that are informative for the wider impact community.

Blended finance draws on many of the same legal structures, instruments and techniques that support commercial and public finance. But blended finance is driven differently. It is structured to achieve a targeted impact. It is not limited to financial returns or government policy. This results in a different mix of legal features and different legal requirements from traditional forms of finance.

This project seeks to outline that mix of legal features and requirements, to illustrate how they are currently being addressed in the legal arrangements for blended finance, and to identify possible improvements.



The five sections of this report

This Report has five sections.

Section 1 – The Legal Perspective –

introduces the project and GAIL's objectives and methodology. It draws out the main themes of the Jurisdiction Overviews, the State of Play research and the Case Studies that follow, in terms of the legal landscape in which blended finance is applied and the legal structures and techniques that are used. This Section sets out the initial observations of the Working Group based on that material, and includes recommended next steps.

Section 2 – The State of Play – summarises the current critiques of blended finance that relate to its legal aspects, and includes an article analysing the impact on blended finance of one key EU regulatory aspect – AIFMD.

Section 3 – Jurisdiction Overviews – sets out the legal landscape for blended finance in several jurisdictions in different regions of the world, each contributed by GAIL members working in the relevant jurisdiction.

Section 4 – Case Studies – collects case studies contributed by GAIL members outlining particular blended finance projects in different jurisdictions, as well as a couple of illustrative institutional models that support blended finance.

Section 5 – Appendices – provides information about the Authors, Co-Authors and Editors of this Report, details of the Working Group and GAIL contributors to the project, along with a selected list of reference material

“In our view blended finance will be critical to achieving a just transition.”

the Working Group found useful and that are referenced in the Report

Why GAIL undertook this project

GAIL is a community of legal leaders who are using the practice of law to have a positive impact on people and the planet, and to accelerate the just transition.

In our view blended finance will be critical to achieving a just transition.

It is estimated that the United Nations' Sustainable Development Goals (SDGs) face an annual funding gap between USD 5 to 7 trillion². By their nature market forces will find solutions for climate change and other transitions that have a market impact. Commercial finance will adapt to respond to that market demand. However, those solutions will not be motivated by the same objectives as the just transition. Blended finance has the potential to guide the market towards the just transition.

As lawyers, we recognise that there are specific legal approaches and issues that need to be identified, addressed and shared for blended finance to be effective and scalable for a just transition.

2. <https://thegiin.org/blended-finance-working-group/>

Introduction

Law and lawyers make a valuable contribution to advancing blended finance in all its contexts.

- All blended finance projects require a legal platform. Legal structuring and legal instruments and techniques are essential to achieve the fundamental objective of combining the right mix of financing – public, philanthropic and private – for the social and environmental outcomes.
- The legal work on a project creates the basis for stakeholder cooperation, risk mitigation, efficient capital mobilisation, long-term sustainability, mission consistency and transparency. It enables the project to navigate complex legal and regulatory compliance.

Some legal vehicles and structures are more suited than others to support blended finance. Most blended finance requires additional thought on governance and decision making. The tax and regulatory analysis is different from commercial finance. The legal landscape is often based on commercial assumptions that do not sit well with blended finance.

GAIL undertook this project because it fits squarely within GAIL's focus on leveraging the expertise of lawyers to accelerate the shift of corporate models and capital to make sure business is truly a sustainable force for good. As far as we are aware, there is currently no publicly available legal analysis of blended finance of this kind with a multi-jurisdictional perspective, and there is no organisation as well placed as GAIL to analyse blended finance from a legal perspective across all of the GAIL regions.

There is a growing library of policy, financial and other studies of blended finance which we have drawn on and which has helped our work. A list of our key references is set out in [Section 5](#). Our report aims to add a global legal perspective to the existing commentary on blended finance.

Objectives

GAIL seeks to have a positive impact by identifying and working on the legal drivers and legal infrastructure that contribute to Impact outcomes.

For this project, the primary objective is to help put into place an effective, well-designed and streamlined legal framework for blended finance with (as far as possible) consistent principles across jurisdictions. That outcome will not be achieved through this project alone, but it is the vision that guides the project.

A key feature of the project has been to enable a collaborative exchange of information and lessons learned when structuring, designing and implementing blended finance instruments in different jurisdictions.

In particular, the project aims to identify and map the legal structures for, and barriers to, combining philanthropic, government and commercial funding to achieve positive impact, and to share lessons, learnings and case studies from a legal perspective to support and enable the use and scaling of blended finance instruments.

What we did – multi-jurisdictional, multi-sector

For this first stage of the project, GAIL assembled a Working Group of GAIL members from each of the GAIL regions across Asia Pacific, Europe, Latin America, North America and the UK³.

The Working Group selected a few jurisdictions that are representative of GAIL's global network and drew on the experience of lawyers within the network to map out the main legal and tax issues for blended finance in those jurisdictions, and to share case studies and examples.

The Jurisdiction Overviews set out in [Section 3](#) give a snapshot of the main legal and tax issues for blended finance in those jurisdictions.

Working Group members developed and contributed a number of Case Studies, which have been collected in [Section 4](#). The Working Group Observations in [Section 1](#) briefly comment on the Case Studies as a whole, highlighting some legal themes and features. The Case Studies cover a range of sectors – health, housing, energy, etc. – and illustrate legal structures and instruments used in different jurisdictions. While there are some common approaches – e.g. funds and guarantees – there are also local variations and flavours.

Who was involved and who we consulted

During the first stage of the project, the Working Group consulted with a number of organisations and practitioners active in blended finance. (We note that nothing in this Report should be taken to have been authorised by or be the responsibility of anyone consulted by GAIL).

We would like to thank in particular for their help in guiding our work on the project:

- Convergence
- Big Society Capital
- FinDev Canada
- Allianz Global Investors
- Access – The Foundation for Social Investment

The authors and co-authors of this Report are listed in [Section 5](#). This includes the authors of each Jurisdiction Overview in [Section 3](#) and each Case Study in [Section 4](#). The members of the Working Group are also listed in [Section 5](#).

³. GAIL Africa was launched as the newest GAIL region after the commencement of this project.

What we plan to do next

This Report summarises GAIL's findings through the first stage of its blended finance project.

As noted in the Working Group Observations in [Section 1](#), our principal recommendation from this stage of the project is for the legal community to work on building a consensus on the key legal principles to apply to blended finance structures and transactions.

An alignment of principles across jurisdictions will enable participants – investors, enterprises, public agencies or any other stakeholder – to have common expectations as to the principles defining how a blended finance structure will work, irrespective of the particular laws in a particular jurisdiction.

There are a number of workstreams planned for the next stage of the project, which build on our work in this first stage of the project. These workstreams will focus on:

- increasing legal market awareness of the legal options and opportunities for blended finance,
- extending the jurisdiction and case study research to other jurisdictions active in blended finance projects, and
- working out how the legal framework can better support non-financial capital and social and environmental concepts of value.

These workstreams will be directed at developing:

- a statement of legal principles to guide the legal structuring of blended finance projects,
- legal toolkits, including blended finance legal primer to increase market awareness, and
- recommendations for best practice and regulatory reform.



Blended finance

Defining the scope of the project

Blended finance is a term of convenience that relates more to the objectives and sources of the financing than any particular category of financial instrument or market. For the purpose of legal analysis, the Working Group needed to draw some boundaries to define the scope of the project.

We did this by adopting a few defining principles and referencing a few different perspectives as outlined below.

Development and impact finance

As a practical matter, blended finance involving Development Finance Institutions (DFIs) and projects in developing countries – “**blended development finance**” – tends to involve different lawyers and a different kind of due diligence and documentation from the blended finance involving foundations and focused on local social enterprises and projects – “**blended impact finance**”.

This is not inherent in the nature of blended finance and there are many parallels and lessons to be drawn for impact finance from development finance and vice-versa.

However, for legal analysis it is helpful to consider each of these as a separate category of blended finance as the legal drivers and experience are distinct. The legal issues and the opportunities for legal improvement also differ. We have therefore identified and commented on each category separately in the Case Studies and in the Jurisdiction Overviews.

Criteria

We have adopted the definitions of blended finance used by Convergence and Big Society Capital as our touchstones.

Convergence⁴ is a global association of institutions and businesses dedicated to employing blended finance to drive capital to where it is needed most. Member institutions include private investors looking to diversify their portfolios, businesses seeking capital, as well as public agencies and philanthropic foundations looking to make their funds go further.

Convergence defines blended finance as:

*the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development*⁵.

It identifies the following four characteristics:

- Blended finance is a structuring approach, not an investment approach (like impact investing) or an instrument or end solution.
- It allows organisations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both).
- The main investment barriers for private investors addressed by blended finance are:
 - high perceived and real risk, and
 - poor returns for the risk relative to comparable investments.
- Blended finance creates investable opportunities in developing countries which leads to more development impact.

4. <https://www.convergence.finance/>

5. <https://www.convergence.finance/blended-finance>

This characterisation is more applicable to blended development finance (because of its emphasis on developing countries) but it is useful for blended impact finance as well.

Big Society Capital (BSC) is an independent financial institution in the UK with a social mission authorised and regulated by the Financial Conduct Authority (FCA). It is the UK's leading social impact investor, collaborating and investing with fund managers who invest in social enterprises and charities tackling social issues and inequalities in the UK. Since 2012, BSC has helped the social impact investment market grow tenfold to nearly £8bn⁶.

BSC's approach to blended finance focuses on its impact:

There are different types of capital, resources and support that can contribute to solutions for some of society's biggest challenges through a range of frontline enterprises. These resources come from multiple stakeholders with different requirements on their capital but with common impact objectives. Blended finance is an approach to finding the right mix of these resources to enable the greatest level of social impact...

Blended finance is an approach to combining risk-tolerant capital (referred to as 'concessional capital') with capital seeking market-rate returns (referred to as 'non-concessional capital') to address social and environmental issues, such as homelessness and climate change. Investors use blended finance as part of their toolkit to create impact whilst fulfilling their duties to internal and external stakeholders⁷.

Concessional Capital

There is a difference between blended development finance and blended impact finance in their emphasis on concessionality.

Blended development finance focuses on how the concessional capital fits with the market capital. Development financiers structure the transaction so that the concessional capital is a contribution that is beyond what is available, is otherwise absent from the market, and does not crowd out the private sector. There must be a need for concessional capital, but it should crowd-in the private sector with the minimum level of concessionality⁸.

Concessionality is the driving structuring principle and is reflected in the legal approach – in the due diligence, in the grant terms, in the principles underlying default, remedy and exit and in the relative rights and obligations of the concessional and non-concessional funders.

In blended impact finance, the structuring focus is on the impact. This is a difference of nuance and emphasis. Impact financiers will still seek to maximise the efficiency of their concessional capital. But they can be more flexible in their view of what is catalytic – for example, it may simply be demonstrating the viability of the risk/return analysis by acting as first mover. They are open to a broader range of sources of finance. And they tend to take a lighter approach to due diligence and documentation, tailoring them to fit the context of the target impact.

6. <https://bigsocietycapital.com/about-us/>

7. <https://bigsocietycapital.com/our-approach/social-lending/our-approach-to-blended-finance/>

8. <https://www.ifc.org/en/what-we-do/sector-expertise/blended-finance/how-blended-finance-works#principles>

This carries through to the legal analysis. The different stakeholders involved, the way in which the target impact is defined, measured and monitored, and the decision-making structures put around it, can lead to different legal structuring and documentation.

Minimum characteristics

As a further guide for scoping, when collecting Case Studies, the Working Group adopted a set of minimum characteristics. For a project or transaction to be classified as “blended finance” it must, at a minimum:

- seek to achieve an expressly articulated social or environmental impact
- blend two or more types of financial capital – government/public, philanthropic, commercial – at least one of which is “public” or “concessional” in some way, in order to de-risk other financial capital
- deliver the targeted impact through a social enterprise or other impact-focused operating legal structure
- measure and report on the impact outcomes.

“Concessionality is the driving structuring principle and is reflected in the legal approach – in the due diligence, in the grant terms, in the principles underlying default, remedy and exit and in the relative rights and obligations of the concessional and non-concessional funders.”

Those characteristics are broad enough to capture a wide range of blended finance projects and entities in different jurisdictions and sectors and employing different structures, including for example DFI infrastructure projects, impact funds, tandem and hybrid structures⁹, and bespoke transactions.

“Public” includes tax credits or relief.

“Concessional” includes impact capital, whether impact-first or financial-first.

We also included debt or equity products that have been designed for blended finance projects (such as, for example, the AgDevCo mezzanine debt facilities designed for sustainable investment and the MCE recyclable guarantee supporting loans in emerging markets).

9. Tandem structures combine nonprofit and for profit entities through legal arrangements that bind them together, using governance structures or contracts that enable them to operate with a high degree of cooperation and coordination: <https://www.brombergerlaw.com/post/choosing-the-right-model-for-your-nonprofit-for-profit-hybrid-business-venture>

Legal context

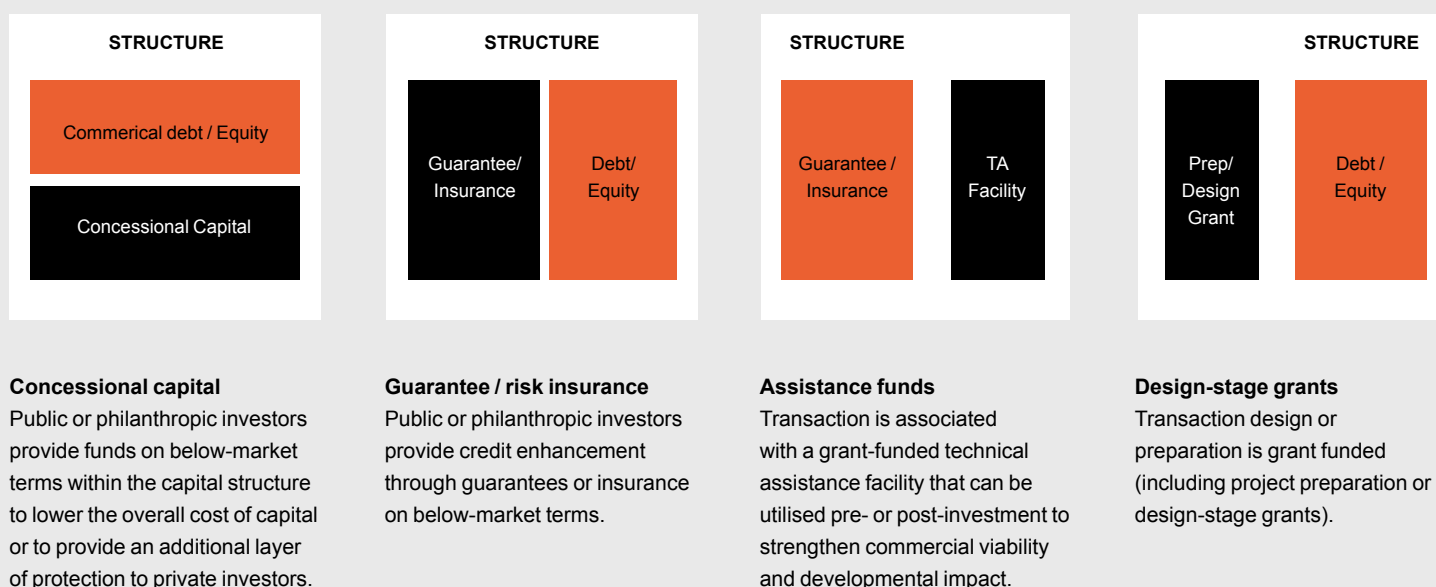
This Report has been prepared in the context of the experience and studies of existing blended finance markets, institutions and practitioners.

For the purposes of the legal analysis, that has allowed us to frame our work by reference to several different drivers of legal structuring and documentation:

- **deal typologies** – a broad categorisation of blended finance projects and transactions, and the legal building blocks they use
- **jurisdictional drivers** – features that separate the legal landscape for blended finance in one jurisdiction (or family of jurisdictions) from another
- **industry critiques** – there is constant evaluation of the blended finance markets, highlighting areas where change or improvements are required

Deal typologies

Convergence has identified four deal archetypes for blended finance¹⁰.



Convergence identified these archetypes in the context of blended development finance, but they can also apply in the impact finance context.

10. <https://www.convergence.finance/blended-finance>

Legal context

Most of the Case Studies relate to the first archetype – the “concessional capital” deal – and they illustrate a number of different ways in which the capital can be pooled into a fund or a legal structure that aligns the capital as separate streams. See in particular the discussion in [Section 1](#) on Legal Structures and Techniques. The elements in the archetypes can be combined. It is not uncommon, for example, for a blended finance project to combine concessional capital and a guarantee or risk insurance (see, for example, the [Resilience and Recovery Loan Fund Case Study](#) discussed in [Section 4](#)).

Those archetypes are useful in identifying the different types of legal building blocks used in blended finance. The discussion in [Section 4](#) highlights a range of commonly used legal vehicles and instruments and locates where those legal vehicles and instruments might be used in each of Convergence’s four archetypes.



Jurisdictional drivers

The types of blended finance projects in a particular jurisdiction are of course very much driven by the socio-economic circumstances of that jurisdiction and the locations where the project is to be undertaken.

They are also influenced by the legal frameworks in the jurisdictions involved in the project. This will determine the types of legal vehicles, instruments and other building blocks that are available. It will affect the kind of legal issues that arise for negotiation, and how they are addressed. Sometimes a jurisdiction will be chosen for a project because the legal framework is more responsive to the needs of the project, for example where the regulatory regime for capital raising is well-established and preferred by funders.

The Jurisdiction Overviews in [Section 3](#) outline the different legal frameworks in a selection of relevant jurisdictions examined by the Working Group. The Overviews indicate how the legal frameworks sometimes drive similar solutions and sometimes divergent solutions. In particular:

- there are some underlying legal themes that are common across jurisdictions, including those with very different legal frameworks, such as the tension combining charitable and for-profit funding – the legal solutions may be different, but the problem is similar;



- there are some families of jurisdictions, such as the common law jurisdictions derived from Anglo-American jurisprudence, where similar legal issues arise and they are addressed in similar ways, such as fiduciary duties;
- there are many projects – particularly in blended development finance and also sometimes in blended impact finance – where there are multiple jurisdictions involved and the differing legal frameworks can present complications.

All of this is helpful in guiding where there may be opportunities for further development and improvement of the legal platforms for blended finance. While it is always necessary to be sanguine about transposing a legal idea or instrument from one jurisdiction to another, the process is greatly helped by understanding where there are (and are not) similarities in legal theme or legal family.

Industry critiques

Development finance

Blended finance has been part of development finance for many years – long enough for several iterations in the best practice guidelines of leading DFIs and long enough for several industry critiques to develop.

Some industry commentators have expressed frustration that blended finance has not become more widespread and more popular with commercial lenders.

The **Global Impact Investing Network** (GIIN) has commented that:

...despite its potential, blended finance remains underutilised.

Key challenges include difficulty in structuring blended finance vehicles due to their complex and bespoke nature; issues with aligning expectations among various stakeholders; and lack of available risk capital.

On top of this, the challenge of shifting mindsets remains. The misconception that impact first investing, and patient capital, can be utilised in limited investment areas, such as official development assistance, or by development agencies, continues to be a barrier for expansion of private investment in these initiatives.¹¹

At the **GSG Global Impact Summit 2023** Nick O'Donohoe, CEO of the UK's DFI, **British International Investment** (BII), commented that

“Some industry commentators have expressed frustration that blended finance has not become more widespread and more popular with commercial lenders.”

blended finance hasn't delivered what was originally hoped.

There's too high an expectation from commercial partners that risk will be taken away by a government entity waving a magic wand.¹²

BII comments on their website that:

Blended finance solutions are useful for taking a flexible approach to risk, but they are complex, difficult to structure, standardise and scale.¹³

These concerns have been reflected in anecdotal comments made by members of the Working Group in our consultations. Particular comments include:

- DFI requirements are now too inflexible and restrictive
- DFIs are too conservative and too slow – they will take senior debt rather than equity, they have unreasonable 200 page due diligence forms, and they limit their mandates to certain geographies leaving gaps in the market
- Blended finance needs standard, streamlined documents

11. <https://thegiin.org/blended-finance-working-group/>

12. <https://www.pioneerspost.com/news-views/20231006/the-editors-post-blended-finance-woes-upbeat-gsg-summit-winds>

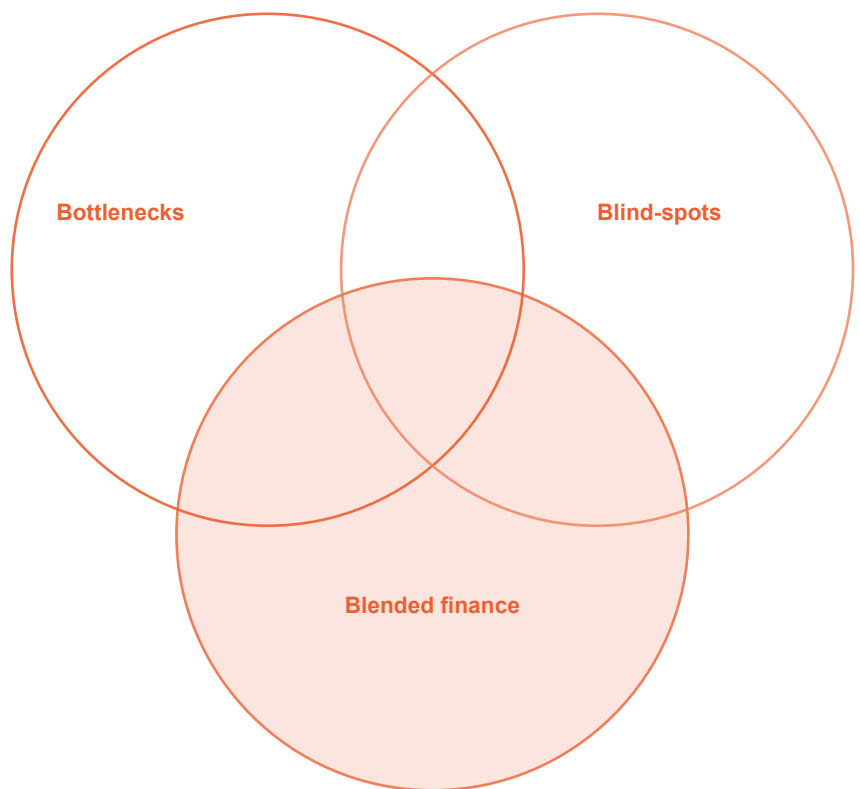
13. <https://www.bii.co.uk/en/news-insight/insight/articles/driving-development-with-flexible-capital/>

Triple B Framework

The Triple B Framework has a more fundamental critique and defines blended finance in a way that goes beyond different types of financial capital. It has been developed by **Dr Gillian Marcelle** and **Resilience Capital Ventures**, an advisory firm in the blended finance space working on capital raising, deal origination and guiding the business activities of commercial start-ups and social ventures¹⁴.

Dr Marcelle argues that the capital needed to move to an economic system based on sustainable production and consumption is being misaligned and poorly mobilised due to structural and process barriers and cognitive blind spots, including group think arising in the finance industry from persistent gendered, racial and ethnic homogeneity.

She suggests that in countries where business and capital market ecosystems are weak, non-financial forms of capital may even be more important than financial capital.



The Triple B Framework – “**bottlenecks, blind spots and blended finance**” – defines blended finance as:

an investment strategy that deploys financial capital in combination with other forms of capital — knowledge, political, social, cultural, network and relationship — using systematic processes¹⁵

It has been articulated primarily in relation to blended development finance but is applicable more broadly.

It is particularly significant for the legal analysis because it means that many of the usual legal building blocks – and the preferred forms of documentation – are at best inadequate and most likely misdirected.

14. <https://www.resiliencecapitalventures.com/thought-leadership/mobilizing-and-deploying-capital-for-good-the-triple-b-framework>

15. <https://www.resiliencecapitalventures.com/tripleframeworkpositionpaper>

Working group observations

In this section of the report, we have brought together the Working Group's observations on three topics:

- the legal platforms and infrastructure that support blended finance across the world's regions, and sometimes create hurdles and obstacles – the Legal Landscape – this discussion draws on the Jurisdiction Overviews in [Section 3](#) and the reviews of legal critiques and EU regulatory issues in [Section 2](#),
- the different types of Legal Structures and Techniques that are used in blended finance projects – this discussion draws on the Case Studies and instruments and models in [Section 4](#), and
- the further work that needs to be done – the Where To From Here? – problems that need solutions, parts of the legal landscape for blended finance that we have not yet mapped out, and opportunities for reform.

Legal landscape

Jurisdiction overviews

The Jurisdiction Overviews in [Section 3](#) survey the legal landscape for blended finance in a range of jurisdictions selected from APAC (Australia, ASEAN, Hong Kong, Singapore Japan), Europe (France – and see also the discussion on EU issues below), North America (USA), Latin America (Mexico) and the UK.

These are some of the primary capital raising jurisdictions for blended finance. They are not of course the only capital raising jurisdictions, but they are indicative of the legal systems that are relevant when blended finance funds, instruments and other arrangements are put together. They reflect both common law legal systems (Australia, Hong Kong, Singapore, UK and USA) and civil law legal systems (France, Mexico and Japan).

They include jurisdictions which are federations (e.g. Australia, USA and Mexico) as well as unitary states (e.g. UK, France, Japan).

The overviews in [Section 3](#) discuss the legal frameworks for both development and impact finance. As indicated from the Case Studies in [Section 4](#), the jurisdictions surveyed are also locations with significant experience in developing and implementing blended impact finance projects, and some of them are originating jurisdictions for blended development finance projects.

“Instead, blended finance is supported and regulated by the broad spectrum of commercial, public and charitable law in that jurisdiction, as applying generally to the investors, stakeholders and relevant agencies.”

Laws on blended finance

None of the jurisdictions surveyed has a specific law or legal regime dedicated to blended finance. Instead, blended finance is supported and regulated by the broad spectrum of commercial, public and charitable law in that jurisdiction, as applying generally to the investors, stakeholders and relevant agencies.

This is not surprising. Blended finance covers a very wide range of projects and finance, and few jurisdictions have dedicated laws for comparable types of financing.

This is also in many cases an opportunity for legal innovation, as legal structuring can look to the full extent of the legal system to solve issues arising when designing a blended finance project, rather than being confined to a specific statute or legal regime.

Having said that, there is definitely a need for an alignment of principles in blended finance frameworks. As discussed further in [Section 2](#) in the Legal Critiques of Blended Finance), alignment of principles is crucial for a number of reasons including stakeholder cooperation, risk mitigation, efficient capital mobilisation, legal and regulatory compliance, long-term sustainability, mission consistency and transparency. The complex regulatory landscape has been cited as a deterrent to participation in sustainable finance as requirements of compliance are seen to be unclear.

Laws supporting blended finance

While they may not have a specific legal regime for blended finance, a number of jurisdictions have introduced supportive elements into their legal systems.

This includes, for example:

- Corporations that are structured (by statute) for both purpose and profit, such as benefit corporations (USA), community interest companies and community benefit societies (UK), and *Société à Mission* and EESS or ESUS “solidarity” status (France)
- Laws that promote impact investing – for example, requiring insurers and banks to include impact investing products in their savings products (France)
- Impact specific tax relief – for example, the capital gains tax incentives for investments in designated low-income communities (USA), and Social Investment Tax Relief (UK¹⁶).

It is worth including in this context laws establishing impact investing wholesalers like Big Society Capital in the UK (see [Section 4](#) – Blended Impact Finance: Institutional Models). By their nature wholesale impact funders of this kind are catalysts for blended finance projects. They are often also examples of blended finance structures in their own funding.

It is important to note that there is patchy adoption of these kinds of supportive elements across the jurisdictions surveyed. Some jurisdictions have worked on many different supporting elements (e.g. USA, UK, France). Others have few or none.

16. Social Investment Tax Relief lapsed in April 2023. Tax relief under the Community Investment Tax Relief (CITR) scheme has now become available: <https://www.gov.uk/government/publications/community-investment-tax-relief-hs237-self-assessment-helpsheet/hs237-community-investment-tax-relief-2024>

Laws providing the legal infrastructure for blended finance

Even without intentionally supportive elements, the legal systems surveyed generally provide a solid legal infrastructure for blended finance. They all, for example, meet the core legal requirements for investment or for undertaking an enterprise:

- separate legal entities
- enforceable legal rights and obligations
- a range of potential legal vehicles
- a system of corporate governance
- legal recognition and protection of debt, equity, property and priorities
- vehicles for collective investment
- some level of freedom of contract.

Those core elements provide the platform for legal structuring. They allow, for example, some flexibility in:

- choosing a legal vehicle that can pool the blended finance and pursue the project
- building around that vehicle to meet different investor and stakeholder needs, including tandem or hybrid structures using subsidiaries, joint ventures, contractual arrangements or other techniques, and
- designing financial terms and impact undertakings that are specific to the particular venture.
- There are some common themes in these core elements – these legal “building blocks”. For example, across the jurisdictions:
- the types of legal vehicles used in blended finance include commercial companies, charitable entities and investment funds

- many blended finance transactions are structured around loans, bonds and other debt instruments
- government support is often by way of outcomes based contracts (including SIBs) or tax relief.

There are also interesting variations:

- Australia relies primarily on companies and trusts - for profit companies limited by shares, not-for-profit companies limited by guarantee, charitable trusts, and unit trusts (for investment funds)
- the UK's companies and trusts are very similar in legal form, but it also has the option of community interest companies and community benefit societies, and often uses limited partnerships as the preferred investment vehicle
- the U.S. also has a wide range of impact-specific options, including (for purpose and profit) public benefit corporations, (for community ownership) Co-ops, community land trusts and REITs, and (for concessional funding) foundations making program-related investments, and donor-advised funds
- France has a range of different types of foundations, limited profit and non-profit alternatives, including the collective interest cooperative company (SCIC) in which public investors can acquire equity.

Blended development finance

All the jurisdictions surveyed have some participation in development finance.

In most cases this is through a development finance institution (DFI) established in that jurisdiction such as AFD (*Agence Française de Développement*) in France, JICA (*Japan International Cooperation Agency*) in Japan, BII (*British International Investment*) in the UK and DFC (*Development Finance Corporation*) in the U.S.

From a legal perspective this makes the law or other authority on which the DFI has been established, and which determines its governance and mandate, as well as the legal form, relevant to the legal framework. The law influences the expectations and requirements the DFI brings to the structuring of the blended finance fund or contractual arrangements with the commercial banks, pension funds or other private sector participants. Different DFIs have legal forms which significantly impact the legal and regulatory framework that applies (e.g. regulated banks (FMO); state agencies (DFC) and intra-state agencies (IFC)).

The blended finance fund or contractual structuring itself relies, from a legal perspective, on the same legal infrastructure and building blocks as described above and in the Jurisdiction Overviews in [Section 3](#).

Across the regions, the number of countries with their own DFI is relatively small. However, a broader range of countries participate in blended development finance, either as governments indirectly through co-investment and other supporting arrangements or through their banking and institutional sectors.

Australia is an example of a jurisdiction that does not have its own DFI but participates instead through government-supported funds and collaborations. This includes:

- a government sponsored impact investment fund called *Australian Development Investments (ADI)*, established by adapting one of the building blocks noted above – a trust – to incorporate public administration governance requirements, and
- the *Australian Climate Finance Partnership* which is a concessional financing facility managed by the Asian Development Bank.

The legal structures for these collaborations have their own legal features and constraints which can influence how a blended development finance project is put together.

Laws inhibiting blended finance

As outlined above, apart from a few expressly supportive elements, blended finance projects work within and rely on legal systems that are designed for general commercial or charitable purposes and are generally indifferent or agnostic as to whether the financing is blended or not. While this generally provides a solid legal infrastructure for blended finance, there are some aspects of the legal systems that can be problematic for blended finance. Some of the key problems are common across jurisdictions, although the details of how they are resolved can vary.

For profit and non-profit categories

The first common problem is the categorisation of vehicles and enterprises into “for profit” and “not-for-profit”. This has a silo effect that blended finance structures must be specifically designed to overcome. Legally this requires particular attention to fiduciary duties and governance.

Fiduciary duties

The traditional view on fiduciary duties – underpinned by the principles of shareholder capitalism and modern portfolio theory – has been that the duty of directors to act in the best interests of the corporation (in the case of for-profit corporations) means to act in the best financial interests of the shareholders. This limits their ability to consider or pursue impact objectives.

Traditionally a similar duty – or sometimes a stricter statutory duty – has applied to institutional investors and has had a similar effect. A multi-jurisdictional legal analysis of fiduciary duties authored by Freshfields Bruckhaus Deringer¹⁷,

“The traditional view on fiduciary duties – underpinned by the principles of shareholder capitalism and modern portfolio theory – has been that the duty of directors to act in the best interests of the corporation (in the case of for-profit corporations) means to act in the best financial interests of the shareholders. This limits their ability to consider or pursue impact objectives.”

“A Legal Framework for Impact”, has found that notwithstanding differences across jurisdictions and investor groups, where investing for sustainability impact approaches can be effective in achieving an investor’s financial goals, the investor will likely be required to consider using them and act accordingly.

In the case of charitable entities, the duty to act only for the charitable purpose has had the effect of creating a divide between the objects of a grant (limited to the charitable beneficiaries) and the objects of investment of the charity’s assets.

In all of the jurisdictions surveyed, fiduciary duties are still an issue that requires consideration but in most cases, there has been some evolution either in legal practice or through regulatory reform enabling blended finance structures to overcome this barrier, at least to some extent.

17. <https://www.unpri.org/policy/a-legal-framework-for-impact/4519.article>

Working group observations

It is generally more of an issue in the context of blended impact finance than blended development finance as the duties of DFIs are designed specifically for that kind of finance.

It does lead to more complex governance and, particularly in the context of blended impact finance, there are ongoing practical issues that need clearer legal answers.

Tax and accounting

Another common issue is the tax and accounting treatment of blended finance projects.

Tax is a consideration for any legal structure. It is a particular issue for blended finance structures as they commonly combine the tax features of a for profit enterprise with some element of charitable or other non-profit tax relief.

Generally, there is no separate recognition of social impact activities for tax purposes meaning that the blended finance structure must either seek to preserve the for profit/non-profit silos sufficiently to preserve the traditional tax treatment or it must compete for funds with a for profit tax profile and an impact investment risk profile.

Accounting requirements can sometimes differ from or add further complications to the tax analysis; for example, over issues such as when blended finance is an asset and when it is a liability. This is particularly an issue where the structure includes recoverable grants. Certain structures useful for blended finance can also be impacted by accounting rules that bring third party concessional capital on to balance sheets.

Some jurisdictions have introduced some specific tax concessions for social impact (or a close variation), e.g. the US's capital gains tax incentives for investments in designated low-income communities, the UK's (now lapsed) Social Investment Tax Relief and France's incentives for investment in Solidarity Companies. However, these are the exception, not the rule.

Securities

All the jurisdictions surveyed have securities law regulating financial products and financial dealings with varying scope and levels of complexity. They provide a framework for transparency, investor protection and responsible investing. They generally require some level of product registration, adviser licensing, and product disclosure.

They need to be considered when capital raising for a blended finance structure. If they apply, they will usually add costs and time to the raising and require the involvement of specialist managers. Most blended finance projects are not of a size or nature that can accommodate that level of cost.

For this reason, most blended finance structures are wholesale, not retail (as this attracts a higher level of regulation). Even with a wholesale fund, sponsors of a blended finance project may need to weigh up the complexities of a capital raising in one of the more regulated jurisdictions (e.g. Luxembourg) against the benefits of the depth of their capital markets.

Working group observations

EU Regulatory Issues

It is worth making special mention in this context of the EU regulatory framework. For blended finance it is particularly significant in three respects:

- first, it is one of the most comprehensive and detailed regulatory regimes and therefore sharply raises the issue of regulatory implications for to blended finance projects described above
- second, due to the EU's commitment to the SDGs it is an influential regime for other jurisdictions, setting benchmarks that other jurisdictions seek to emulate
- third, it has some regulations that are causing particular concern for blended finance funds, notably AIFMD and the EU Securitisation Regulation – AIFMD is discussed further in Section 2 below and we intend to review the EU Securitisation Regulation in stage 2 of this project.

Laws and complicating factors

Aside from those legal hurdles, the legal framework for blended finance is sometimes made more complex by requiring the structure to meet different legal requirements in multiple jurisdictions. This arises in two contexts. First, several jurisdictions are federations, splitting legal authority and funding between different levels of government. Usually, the outcomes sought from a blended finance project are local, for example creating a positive impact at a local community level. Quite often the public funding, policymaking or implementing agency is national or a State or prefecture.

This can result in more complex legal arrangements because of multiple public stakeholders, and because sometimes the mandates of different levels of government can be poorly aligned.

The second context is where there is more than one country involved in the blended finance project. This is usually the case with blended development finance. It is quite often the case with blended impact finance due to the global nature of the issues that need to be addressed and the opportunities for cross border funding.



Legal structures and techniques

Case studies

The case studies in [Section 4](#) illustrate a range of blended finance structures and instruments. Nine of the case studies classify as blended development finance (**DevBF**) with structures designed for DFI or Development Bank participation. The others (11 structures and 2 instruments) classify as blended impact finance (**ImpBF**).

Using the [Convergence deal typologies](#) (page 17) most of the case studies classify as “Concessional Capital” (including both DevBF and ImpBF) and a few as “Guarantee/Risk Insurance”. In some cases the classification is more complex, for example where the capital is catalytic but not concessional ([Hope Housing](#)) or where the structure combines the “Guarantee/Risk Insurance” and “Technical Assistance Facility” typologies ([REDI Roma](#)).

The different classifications are noted on the [list of case studies](#) on page 122.

Fund structures

About half of the blended finance structures in the case studies are investment funds with the balance being loans, bonds or guarantee structures.

The funds generally adopted a well-known investment fund structure as the basis for their blended finance structure and then modified or developed it as needed for the project.

Luxembourg funds

So, for example, the [Japan ASEAN Women’s Empowerment Fund](#) – a corporate fund for gender lens investing in ASEAN countries where JICA, Japan’s DFI, provided mezzanine finance – was structured as a Luxembourg specialised investment fund.

Similarly the [Mirova Gigaton Fund](#) – a blended development finance fund established to support high impact investments in energy transition infrastructure in emerging economies – was formed as a SICAV under Luxembourg law. So too was the [SDG Loan Fund](#) – an EU based UDS1.1 billion to fund SDG loan to local enterprises in developing and emerging economies.

Notably these are all development finance funds. None of the blended impact finance funds was structured as a Luxembourg fund. The cost and complexities of Luxembourg securities law may have been a factor in this.

Working group observations

Partnerships, Trusts and Corporate Funds

There are quite a wide range of different investment fund vehicles used in the blended impact finance case studies.

All of them are essentially private wholesale investor structures.

Corporate funds

Some use a corporate fund structure like the SPV in the [Resilience and Recovery Loan Fund](#) – an emergency loan fund providing repayable finance to charities and social enterprises experiencing disruption as a result of COVID-19 – as illustrated in the diagram below.

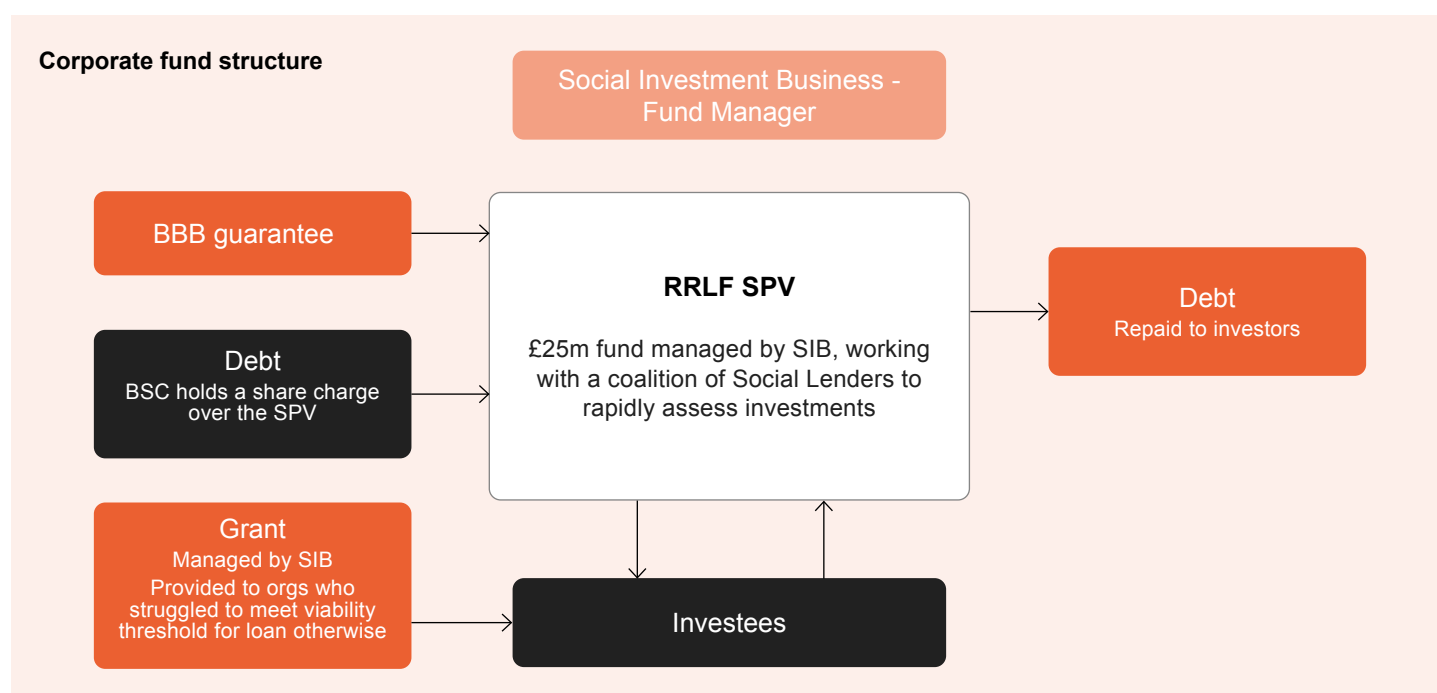
Similarly the [Simplon Co project](#) adopted a tandem blended finance structure combining

a French “Solidarity Company” (ESUS) with a philanthropic foundation and an Association LOI social enterprise, funded by Impact VCs to provide high impact vocational IT training.

Limited partnerships

Some case studies used well established, private limited partnership investment structures.

For example, the [New Forests Tropical Asia Forest Fund 2](#) – a sustainable forestry fund with a concessional class of units to enable more investment in high impact activities – was structured as a Singapore limited partnership. A limited partnership structure was also chosen for one of the development funds – the [Climate Finance Fund](#) established as a private credit fund to provide development and sustainable financing for SMEs engaged in sustainable agriculture,



Working group observations

regeneration and forest protection. This fund involved a number of jurisdictions, including the US, Cayman Islands, Hong Kong and Indonesia.

Trusts

In Australia a number of the structures used unit trusts, primarily because those blended finance projects relate to social and affordable housing and trusts are a preferred legal vehicle for investment funds in the property sector in Australia. The diagram below illustrates how this works in the case of the [Conscious Investment Management Social Housing Fund](#).

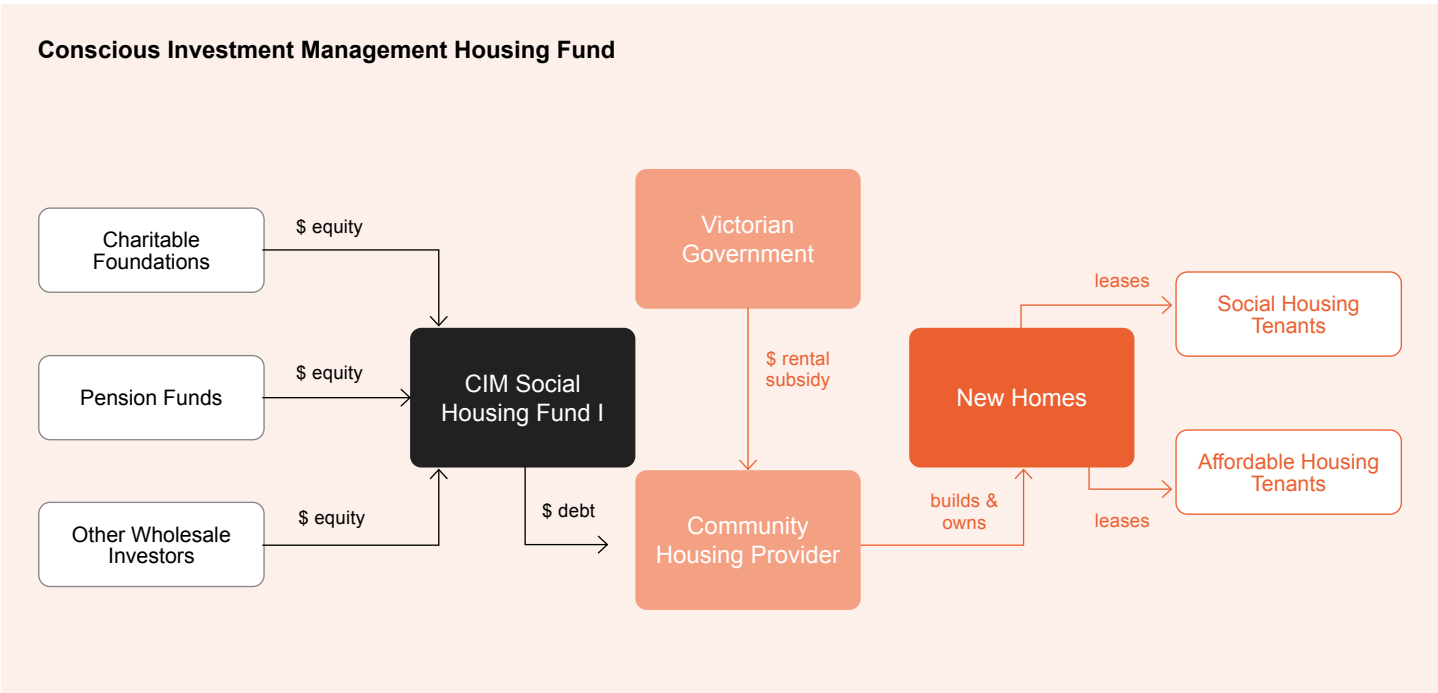
Finance terms

In all cases from a legal perspective the substance of the “blending” of the finance was given effect through the detailed terms of the

fund constitution (e.g. articles, limited partnership agreement, etc) and related contractual arrangements.

Most commonly those terms were set out in different rights of different classes of shares or units, and in the governance and decision-making provisions in the documents.

In most cases they are specific to the particular transaction, i.e. while they may have common themes, they have been drafted and designed for the particular requirements of the relevant project.



Working group observations

Loans, bonds and guarantees

A number of the case studies – for both development and impact blended finance – illustrate structures relying on debt instruments of some kind. Most show quite a level of innovation and tailoring for the project.

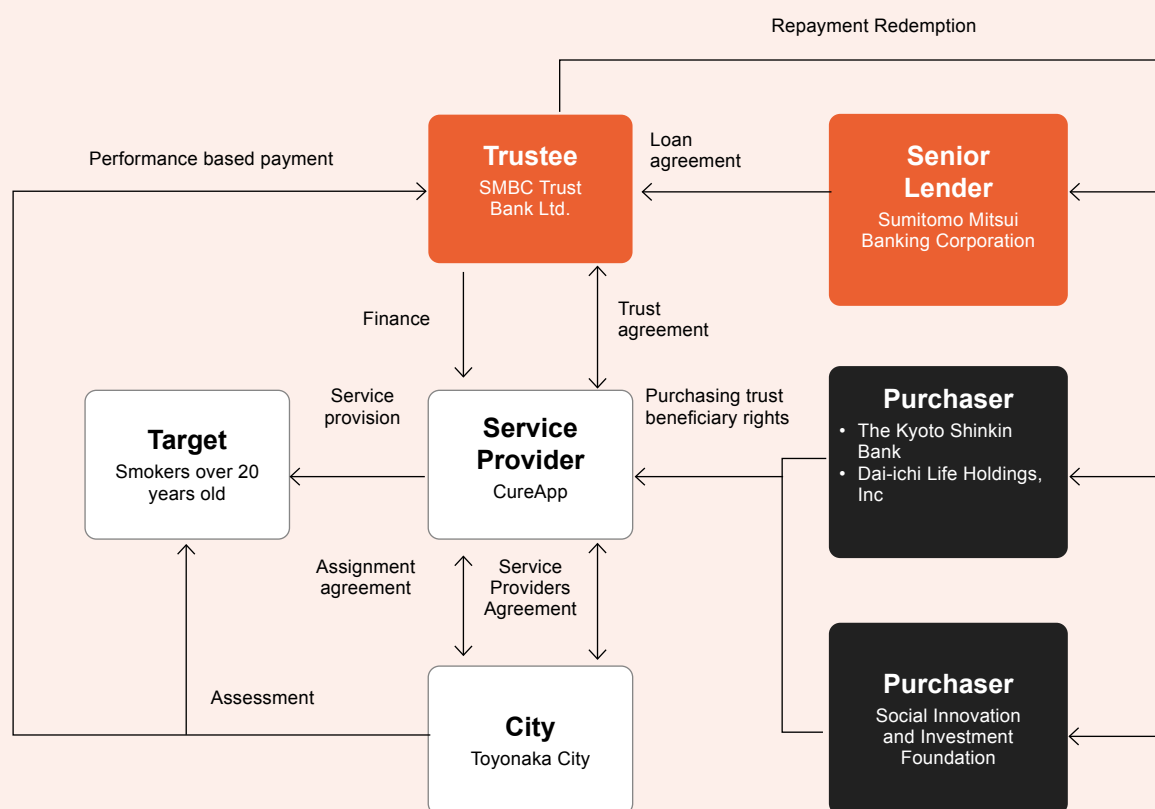
SIBs

Some follow a reasonably well trodden legal path as social impact bonds or development impact bonds but with novel features.

So, for example, the [Near East Foundation Refugee Impact Bond](#) – which delivers a vocational, entrepreneurship and resilience building programme for refugees and members of their host communities in Jordan and Lebanon – includes specially designed risk allocation and evaluation processes to enable capital to be provided at scale.

The [Toyonaka Quit Smoking Social Impact Bond](#) in Japan is interesting in illustrating how the SIB model has been adapted to Japanese legal forms using the purchase of trust beneficiary rights as a method of providing funding to the service provider. This is a variation that reflects Japanese law and practice – see the diagram below.

“A number of the case studies – for both development and impact blended finance – illustrate structures relying on debt instruments of some kind. Most show quite a level of innovation and tailoring for the project.”



Working group observations

Guarantee facilities

Other debt instruments were designed to meet particular challenges. Although they are in that sense bespoke, the techniques and instruments used could well be applied in other situations.

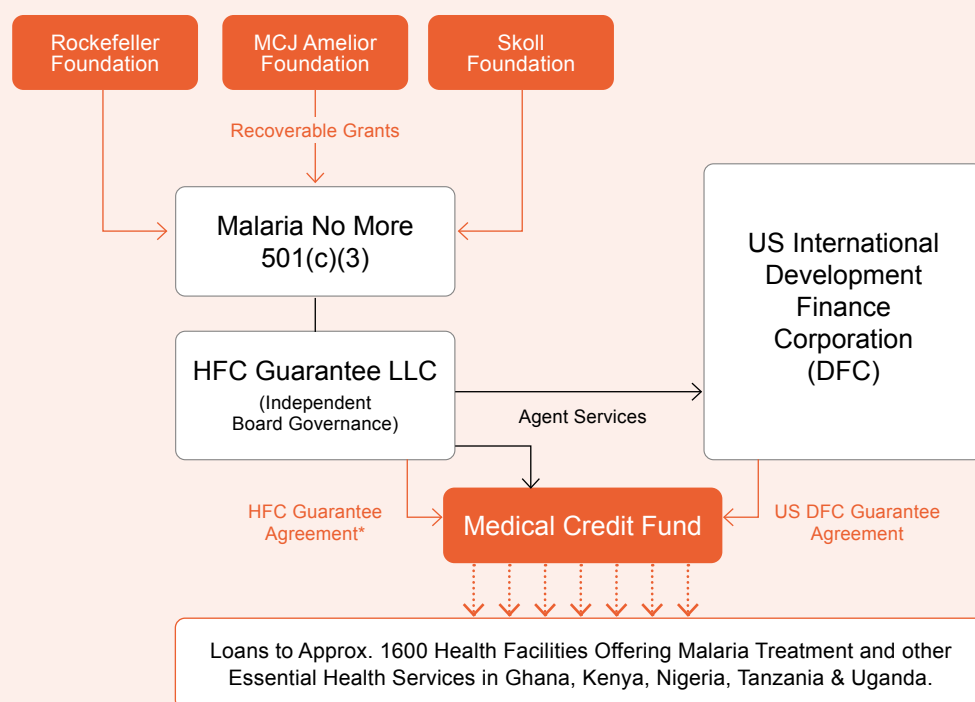
The **Open Doors African Private Healthcare Initiative** illustrates this. It was put together in less than 6 weeks to prevent the collapse of 1600 front line medical clinics providing a sole point of care for 5 million people in Ghana, Kenya, Nigeria, Tanzania and Uganda. There was no time to establish a fund so instead it was structured as a syndicated guarantee facility. This provided a security layer over pre-existing loans in place between the commercial lender, Medical Credit Fund, and the SME medical clinics.

The diagram below illustrates the structure and the case study gives more detail on the legal issues.

Tailored products

It is also worth noting in this context that there are also individual financial instruments being specifically designed for the blended finance market. Section 4 includes brief description of two of these:

- the **AgDevCo mezzanine loan** – this is a long term (8-12 years) subordinated loan at a relatively low interest rate with an equity kicker, usually in the form of a warrant or revenue share – this is suited to companies with growth plans but limited capacity to take on more senior debt and allows the investee company scope to blend their capital with senior secured debt
- the **MCE Recyclable Guarantee** – this is a philanthropic guarantee program that provides credit support to MCE's institutional investors who provide debt financing that MCE lends to financial service providers and small growing businesses in emerging markets. When a loan is repaid the same guarantee can support the re-lending of the loan capital and in that sense is recyclable.



** This agreement also acts as a bridge guaranty until the DFC Guarantee Agreement goes live (which involves a longer lead time than of the philanthropic funders), at which point the HFC and DFC guarantees will fund draws on a pari passu basis.

Where to from here?

So, given the backdrop of the legal landscape and the structures & instruments outlined above, what are the problems that need solutions, what needs more research and what opportunities are there to improve the legal contribution to blended finance?

Alignment of blended finance principles

The issue that stands out most strongly is the need to build a consensus on the legal principles applying to blended finance transactions.

To create an alignment of principles across jurisdictions so that participants – investors, enterprises, public agencies or any other stakeholder – can have common expectations as to the principles defining how a blended finance structure will work, irrespective of the particular laws in a particular jurisdiction.

It is evident from the discussion above about the legal landscape and the legal structures and instruments, that each jurisdiction is dealing with similar legal issues and is coming up with similar legal solutions. But generally, solutions are being developed in isolation to meet a particular need at a particular time. The legal frameworks are patchy and often unclear or untested on key issues. Where consensus is built across jurisdictions it will not only support the growth of a genuinely multi-jurisdictional market, it will also help purely domestic projects by allowing them to draw on a wealth of international experience that is well-tested and well-established.

There are a number of ways of aligning blended finance principles:

- developing a **statement of blended finance legal structuring principles** – this can be a reference tool, developed as a guide for all jurisdictions, similar to a term sheet but less transaction specific, and focused on objectives and benchmark criteria rather than technical legal requirements – it is partly descriptive, and partly about best practice
- increasing the **market awareness** of blended finance legal solutions, particularly the structures and instruments in different jurisdictions that are already fairly well-aligned – one mechanism proposed for this purpose is a blended finance legal primer. This would be an introduction to blended finance legal objectives, structures and instruments designed for lawyers who have not yet worked in this area and for non-lawyers seeking to develop a blended finance project
- **encouraging financial hubs to compete** for blended finance capital raisings – the competition will put into sharper focus what is needed and what works for multiple jurisdictions.

A common statement of principles will be more effective at this stage than seeking standard documents because blended finance covers too broad a range of activities and structures to be realistically reduced to a set of documents (compare, for example, the extent of the International Swaps and Derivatives Association (ISDA)¹⁸ documents for swaps and derivatives which are just two of the financial instruments used in blended finance).

18. <https://www.isda.org/>

It will also be a reference tool that lawyers in particular jurisdictions can then apply to the particular legal vehicles, instruments and regulation in their jurisdiction.

As a tool for building consensus it should lead to reduced risk and more focused negotiations which in turn should reduce the cost and time taken to put the blended finance project together.

As a guide to best legal practice, it should become a reference point for regulators, enabling regulatory convergence to promote greater confidence and comparability for investors in cross-border projects or who are working across multiple jurisdictions.

Research gaps

There are several areas needing further research: some to pursue the alignment of principles suggested above, others as directly noted in the various sections of this Report. Particular items we suggest require further work are:

- **jurisdiction overviews and case studies** – the survey in this Report has covered some major jurisdictions but it needs to be extended to other jurisdictions active in blended finance projects to provide the background information needed for the statement of principles.

“The issue that stands out most strongly is the need to build a consensus on the legal principles applying to blended finance transactions.”

- **EU Securitisation Regulation** – as flagged in section 2 this has particular implications for blended finance that need to be well understood both for projects raising capital in the EU and for its potential influence on jurisdictions outside the EU.
- **Triple B Framework** – as far as we are aware this has not yet been analysed from a legal perspective, but it clearly has significant implications for blended finance legal arrangements and expectations. It needs to be analysed to see what is required legally to support and implement it. In particular, non-financial capital has not yet received significant legal attention as an element in capital structuring and deployment.
- **Insolvency and exit in blended finance transactions** – the concessional nature of blended finance structures means that a different set of expectations and processes for exit, default and remedies needs to be developed.

Directions for practice and reform

There are some principles that have emerged from the Working Group's review that can usefully guide the legal work on a blended finance project and, more broadly, the ways in which the legal aspect of blended finance can itself have a positive impact.

Purpose

First, and most fundamentally, the legal design for a blended finance transaction must focus on the purpose – the impact outcome sought to be achieved. This is a guiding principle at several levels:

- it defines the criteria against which the legal arrangements need to be designed and assessed;
- it guides the substance of the terms of the legal relationships involved in the blended finance; and
- it helps to identify and address unintended consequences that may undermine the impact (e.g. inappropriate exit incentives when a financing terminates).

It is also relevant to the process of developing the project. Areas of tension in the process – like legal due diligence requirements – need to be assessed from that perspective.

This principle may help address some of the criticisms that development finance gives priority to donors and governments, rather than addressing the needs of the targeted population (see discussion in [Section 2](#)). It is a principle that is well aligned with the Triple B Framework.

“First, and most fundamentally, the legal design for a blended finance transaction must focus on the purpose – the impact outcome sought to be achieved.”

Impact Integrity

The legal arrangements should be structured to ensure the impact integrity of the blended finance project. This will ordinarily be a requirement in any case of concessional funders, government stakeholders and tax authorities. It generally is achieved through governance, reporting, project delivery and similar aspects of the project. There is legal knowhow on how to provide that protection while ensuring the project has the flexibility to achieve its impact. This knowhow needs to be more widely spread.

Innovation and Building Blocks

There are a wide range of legal structures and instruments that are used in blended finance and each jurisdiction offers a range of legal “building blocks” for this purpose.

The particular structures vary between jurisdictions but the principle of developing an appropriate legal structure by combining existing legal forms and adjusting them as needed is common across jurisdictions. This is a sensible approach. It makes the structure more readily understandable and acceptable.

It also facilitates legal innovation. Blended finance requires legal innovation. By its nature it is providing new solutions for social and environmental needs where the market fails. It raises governance, risk allocation, reporting and operational requirements that are different from financing that is purely commercial or purely concessional.

Much of the legal innovation involves re-working existing legal infrastructure and instruments to fit the blended finance project. This is a productive approach. It allows solutions to be found and designed more quickly as compared (for example) to newly legislated legal forms. It also reduces the level of legal assurance required as the legal elements are largely familiar to the parties.

Taking a Multi-Jurisdictional Perspective

Some blended finance structures are inherently multi-jurisdictional, for example where the capital is raised in a different jurisdiction to where it is to be employed (as in most development finance), or where the structure is designed to source capital from multiple jurisdictions or to combine capital with credit support or risk management instruments sourced from other markets.

Even where it is not inherent, one of the lessons from our review is that there are common legal themes across jurisdictions, and there are techniques and ideas in other jurisdictions that may be helpfully adopted or varied to solve problems in one's own jurisdiction.

“More broadly, the legal review needs to reflect the learnings being generated from impact accounting (see the International Foundation for Valuing Impacts), Nature-based accounting, and the ongoing work on understanding non-financial capital and social or civic value.”

Beyond the Financing Structure

The legal review should look beyond the financing structure to the underlying operational arrangements.

From a practical perspective, in some structures the key drivers of the risk/return profiles for each layer or category of blended capital are the operational partnerships and the contractual arrangements that support them.

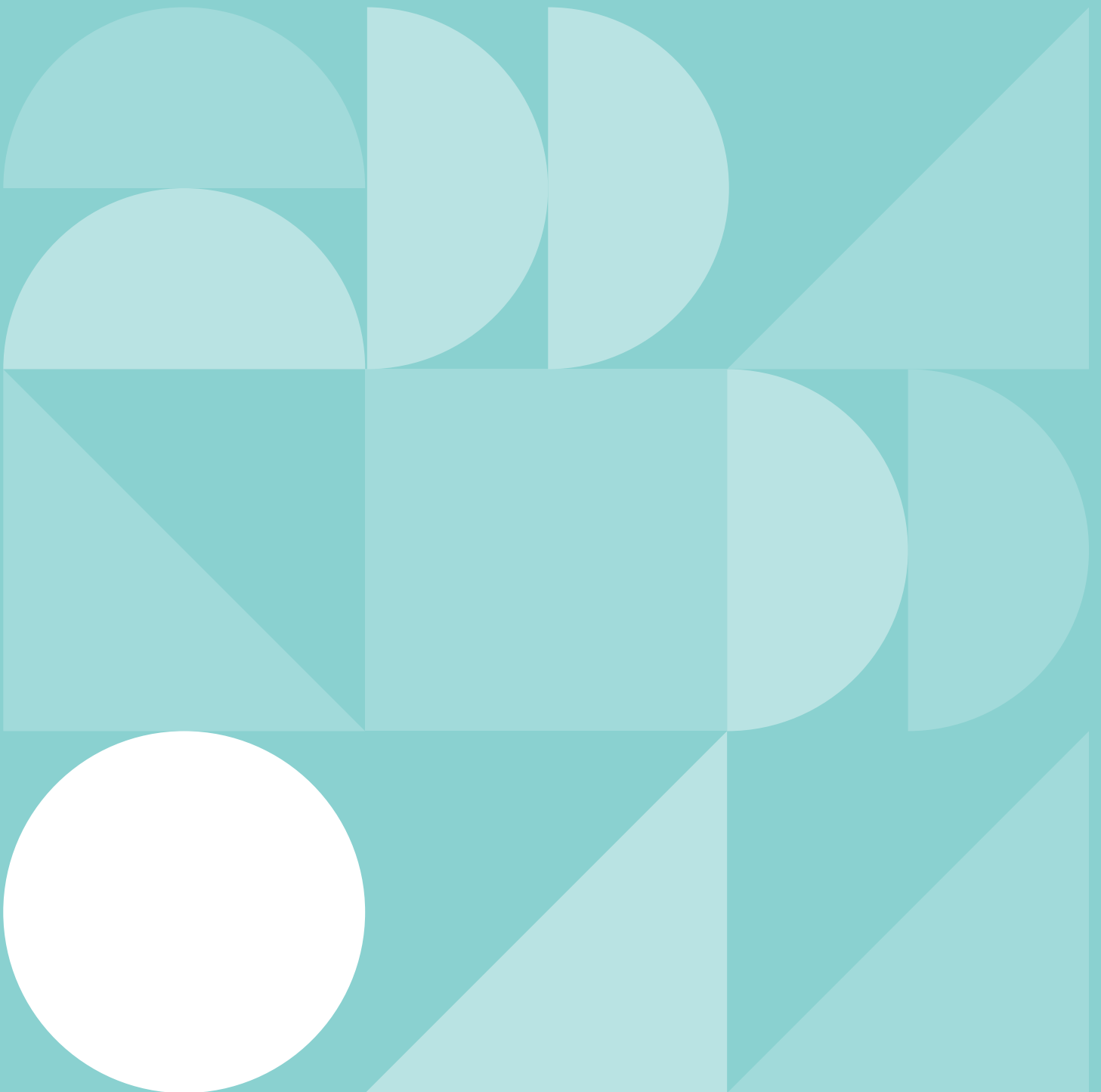
From an impact perspective, it is important to ensure that the way in which the financing is blended does not impose governance, reporting or other requirements that hinder the impact outcomes.

More broadly, the legal review needs to reflect the learnings being generated from Impact accounting (see the International Foundation for Valuing Impacts¹⁹), Nature-based accounting²⁰, and the ongoing work on understanding non-financial capital and social or civic value.

19. <https://ifvi.org/>

20. See, for example, <https://www.accountingformature.org/>

State of Play



Members of the Working Group undertook two specific studies to set out a more detailed background to the legal analysis of blended finance.

Naomi Sander and Selin Bakare of United Green – a privately owned strategic investment group – undertook a literature review of legal critiques and barriers in blended finance to set out the current state of play.

Jaime Begara Breton of FinDev Canada – Canada’s development finance institution – has analysed a major legal and regulatory threshold in the structuring of blended finance debt funds in the EU: AIFMD II. The report on AIFMD II is set out below.

An analysis of the EU Securitisation Regulation will be included in the next GAIL Report on Blended Finance.

Legal critiques and barriers in blended finance

Introduction²¹

Blended finance is, in some senses, a term placed upon investment activity that is already taking place, within existing legal structures (albeit in novel combinations and structures and with innovative impact objectives). For that reason, legal research into blended finance requires, primarily, analysis of black letter law applicable to investment activity in each jurisdiction, as well as consideration of legal theory and concepts, non-legal principles and investment norms and practices.

There is limited legal analysis of blended finance. For the purposes of this Report, therefore, primary sources including domestic laws and in some circumstances multilateral legal systems (such as European Union laws) were the main source of information for legal analysis.

Alongside primary sources, policy documents, academic and non-academic articles, documents, books and, in particular, reports of non-governmental organisations and industry bodies, were reviewed. Together these sources have enabled us to put together a picture of how blended finance is currently operating across multiple jurisdictions.

Legal frameworks in blended finance

Legal structures, instruments, and techniques

At present, there is no single recognised framework for blended finance which has been a key challenge for Development Finance Institutions (DFIs), investors and legal professionals alike (OECD 2017; Bery, 2018). Alignment of principles in blended finance frameworks is crucial for a number of reasons including stakeholder cooperation, risk mitigation, efficient capital mobilisation, legal and regulatory compliance, long-term sustainability, mission consistency and transparency.

The complex regulatory landscape has been cited as a deterrent to participation in sustainable finance as requirements of compliance are seen to be unclear. International law firm, Pinsent Masons (2023), concisely highlights the risks of non-compliance for their clients, often private sector investors, citing the vague and contradictory nature of the disclosure regime under the Sustainable Finance Disclosure Regulation (SFDR) as an example.

In an effort to address this challenge, the OECD Development Assistance Committee (DAC) established principles and guidelines in 1991 which have continued to develop with other international initiatives on blended finance, most notably the 'DFI Enhanced Principles on Blended Finance for Private Sector Projects' (IFC, 2020), creating a framework for impact investors, such as donor countries, to use when providing and managing development assistance capital which are widely recognised in the international financial sector (OECD 2017; Bery, 2018).

21. References: A list of materials referenced in this section is set out in **Section 5** at the end of this Report, together with other material reviewed for this Report

A 2008 review of these principles highlighted a number of criticisms of the principles such as the prioritisation of donors or governments, rather than addressing the needs of the targeted population as success of funding programs are measured against aid intervention goals and not the impact on the needs of the targeted population (Chianca, 2008). The focus on institutional lenders can also be seen in other frameworks such as the Green Climate Fund's Investment Framework. The Green Climate Fund (GCF) was launched in 2010 as a financial mechanism under the United Nations Framework Convention on Climate Change (UNFCCC) to provide financial resources for mitigation and adaptation programs. A recent independent evaluation of GCF's Investment Framework confirmed the discrepancies between the fund's approach towards institutional funders and funders at a local level (UEA, 2024). The evaluation also highlighted the ways in which the GCF investment Framework is not aligned with the fund's other frameworks such as the integrated results management framework (IMRF) and results management framework (RMF) once a financial product has been approved. This draws away from the fund's objective of providing the Investment framework as an overall Governing Instrument, providing clear guidelines for investment decisions.

Jurisdictional analysis

Jurisdiction influences how blended finance is structured, often reflecting the country's attitude to sustainability. For example, tax incentives and government subsidies have been used as the main tool to direct private investment into the energy sector.

“Jurisdiction influences how blended finance is structured, often reflecting the country's attitude to sustainability.”

Globally, senior debt was used the most in blended finance transactions making up 32% between 2015 and 2020 (Convergence, 2021). A joint report by the African Development Bank (AfDB) and DFI supported this finding, stating that senior debt represented 46% of concessional financing commitments. In using traditional business models, MDBs are able to invest their own capital in projects which have a low-medium risk tolerance rather than mobilising private investment which is what concessional finance seeks to achieve (IFC, 2020). The joint report reaffirmed the need to move away from conservative funding structures within blended finance in their Enhanced Blended Concessional Finance Principles for DFI private Sector Operations, specifying that blended concessional finance is to only be used in cases where projects cannot be structured on a fully commercial basis. At COP28, the International Fund for Agricultural Development (IFAD) announced that it had partnered with Green Climate Fund, the Nordic Bank, the governments of Finland and the Africa Climate Finance Mechanism to establish a large-scale public-private climate adaptation platform to de-risk private funding (CISDL Secretariat, 2024). One of the key criticisms highlighted during the panel discussion was the rise in climate mitigation funding as opposed to climate adaptation funding, particularly within some of the highest-risk sectors such as the agriculture sector. Arguably, GCF is

seeking to address this disparity by including a requirement for a 50:50 split between adaptation and mitigation projects in its framework, although according to a 2021 by the fund, this figure stood at 66% being allocated to mitigation projects and 34% to adaptation (Global Climate Fund, 2021).

The preference of debt and equity instruments in blended finance can also be explained through the legislative environment in which they operate. A report by the University of Zurich (Kwon T, et al., 2022) highlighted the fact that some investment instruments are governed by established legislation making them easier to structure and assess their risk and return profile. Therefore, the level of concessionality can be determined by the positioning of the debt or equity capital within the funding structure with more concessional funding taking a subordinate position and thus higher risk. The report also notes that the regulatory landscape can influence the choice of financial instrument. Fewer regulations for being an equity capital provider allows equity to be deployed faster, whereas debt investments are better suited for frontier markets as they are easier to recover due to the requirement of collateral and regular interest payments.

The concept of ‘losses’ within blended finance transactions are only expanded upon when discussing guarantees, for example, first loss capital is often found at the mezzanine level of a debt structure in the form of a first loss guarantee (Moles and Terry, 2003). The Global Impact Investing Networks coined the term “catalytic first loss capital” (CLC) to describe an arrangement in which grant-makers or investors agree to bear the first losses should an investment not perform (GIIN, 2013). Providing such guarantees or taking

“The OECD reported on the role of guarantees for unlocking blended finance for the UN Sustainable Development Goals (SDGs). The report supports the approach of using guarantees to provide certainty, particularly when open-ended or unilateral termination rights which negatively impact the certainty of a contract.”

the most junior equity or debt position acts as a financial catalyst as co-investors who may otherwise not have invested in a particular project are provided with some security. Development guarantees, similar to first loss guarantees, provide security to co-investors by agreeing to “pay part of or the entire value of a loan, equity or any other instrument in the event of non-payment or loss of value” (Johnston 2019; KfW, 2020), therefore absorbing risk. In practice, these guarantees are thought to optimise the use of public funds as they only come into action if an actual loss occurs.

The OECD reported on the role of guarantees for unlocking blended finance for the UN Sustainable Development Goals (SDGs). The report supports the approach of using guarantees to provide certainty, particularly when open-ended or unilateral termination rights which negatively impact the certainty of a contract. A report on Blended Finance Solutions for Clean Energy in Humanitarian and Displacement

Settings by the Norwegian Refugee Council highlights how short termination notice periods can create contractual risk, which in turn creates difficulties in obtaining funding at affordable rates and suggest a guarantee underwriting the termination risk or providing a loan guarantee to improve the creditworthiness of projects, for example in developing a solar home systems in Uganda . The Swedish International Development Cooperation Agency (Sida) also established an internal Green Finance Facility as a mechanism to de-risk contracts between the United Nations High Commissioner for Refugees (UNHCR) and the private sector which includes a termination payment in the event that UNHCR needs to terminate the contract before the payback period (NRC, 2022).

On a national level, we can see the impact that existing regulation can have. As of October 2023, the estimated total of insurance and pension fund assets in the UK is £4.6 trillion and has the potential to unlock £5 billion in private investment for public policy priorities (LSE, 2023). Fiduciary duties imposed on trustees create a barrier to mobilising pension funds as current guidance and interpretations of duties imposed by the Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378) create a potential conflict for trustees. Regulation 4(2)(a) requires trustees of a trust scheme to invest “in the best interest of members and beneficiaries”. Whilst current guidance and interpretations of fiduciary duty create conflict for trustees in allocating funds to investments that deliver a positive economic, environmental and social income alongside a financial return continues to create uncertainty amongst trustees (LSE, 2023), the DWP did provide further guidance on

this subject following COP26 in 2021. Written evidence from the DWP (DWP, 2021) highlights how pension schemes should contribute to helping achieve COP26 targets once agreed. This guidance reaffirms the stance that trustees owe the beneficiaries of a pension scheme a fiduciary duty to act in their best interest. Further on, the guidance states that “[g]iven the nature and likely materiality of the financial risks posed by climate change, trustees’ fiduciary duties require them to take it into account”. Read alongside the Law Commissions 2014 recommendations to amend the Occupational Pension Schemes (Investment) Regulations 2005 and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 to include both financial and non-financial factors “such as improving members’ quality of life or showing disapproval of certain industries” which is defined by a two-part test (Law Commission, 2014).

The Triple B Framework

The Triple B Framework (TBF), developed by Dr Gillian Marcelle, emphasises “the role of structures, processes and cultural rules and norms in behaviour and outcomes” and introduces the idea of “non-financial capital” (NFC) into the equation of blended finance. NFC refers to knowledge, political, social, cultural, network and relationship factors which provide non-capital value to a transaction. Before financial capital is injected into blended finance, non-financial capital should be deployed to identify the best way to deploy financial capital which aligns with the demands of the setting in which it will be used. In doing so, this reduces the barriers which hinder capital mobilisation which Marcelle refers to as ‘bottlenecks’ and identifies ‘blind spots’ in decision making as a result such as

“a resistance to change and gendered, racial and ethnic homogeneity. In taking a systemic, processes based approach, the TBF contrasts the frameworks set by other organisations such as the IFC, OECD, the World Economic Forum (WEF) and Convergence, citing that conventional finance models “work best in advanced capital markets with high degrees of intermediation and specialisation” which emerging markets lack (Marcelle, 2021).

In 2018, the MDB Task Force for Additionality published the Harmonised Framework Additionality in Private Sector Operations, drawing on the concept that DFI interventions, such as blended finance, should provide a contribution beyond what is available in the market (ADB, 2018). IFAD includes NFC into their framework into their private sector engagement strategy for 2019-2024 as a form of “non-financial additionality”, separating these into four categories which include knowledge sharing and building, as well as acting as an “honest broker” by relying on long-standing relationships in the local area (IFAD 2019).

The role of lawyers in blended finance

The [European Bank for Reconstruction and Development](#) (EBRD) plays an influential role within development finance as a Multilateral Development Bank (MDB). Within the EBRD lies the Office of the General Counsel (OGC), comprising of lawyers of 37 nationalities, which plays a key role in promoting “good governance, fostering the development of sound legislation and facilitating access to justice” (EBRD, 2019).

In having a deep understanding of jurisdictional challenges, the OGC has been able to facilitate

“Before financial capital is injected into blended finance, non-financial capital should be deployed to identify the best way to deploy financial capital which aligns with the demands of the setting in which it will be used.”

blended finance arrangements in regions which would normally fall outside of the MDB’s member countries such as the West Bank and Gaza. EBRD membership is limited to members in Europe or non-European members who are member countries of the International Monetary Fund (IMF) as defined in Article 3 of the EBRD’s Articles of Agreement (EBRD, 2013). Following a legal analysis by the OGC in 1999, the Bank was able to provide technical assistance to Kosovo who at the time was not a member of the EBRD or IMF as in “exceptional circumstances, where the proposed activities are “broadly compatible with the purposes and functions of the Bank”, the EBRD can offer technical assistance to economies other than those in which it invests.” (EBRD, 2019). By utilising the “Kosovo Interpretation”, the Bank was able to provide technical assistance to the West Bank and Gaza, as well as loans, equity investment and other forms of financial support. Using a Trust Fund structure, Banks were able to provide an approved net income allocation to the West Bank and Gaza

Trust Fund through further negotiations through bilateral agreements supporting EBRD activities in the region, developing approval and governance arrangements, drafting rules and regulations and consulting on accounting treatment (EBRD, 2019). In the EBRD's most recent 'Law in Transition' Report (2023), the key theme surrounds the role of lawyers in the climate transition. In focusing on the lawyer's role within blended finance, lawyers' ability to advise clients on complying with mandatory disclosure requirements are highlighted in [Section 2](#). Overall, this highlights the need for lawyers to provide legal analysis in order to appropriately expand legal frameworks where needed and implement existing regulatory requirements (EBRD, 2023).

Moreover, risk allocation requires a deep understanding of sectoral issues and the regulatory landscape in which they operate. For example, infrastructure is a key sector within the net-zero transition and makes up an integral part of the EBRD's investment portfolio (EBRD, 2019). To identify the investment risk, an in-detail review of existing and draft lease and pre-lease agreements are required to determine project risk, in the context of real-estate being the agreement term, termination rights and any applicable penalties. In doing so, risk can be allocated by drafting in the agreement itself.

Boutique law firm RPCK Rastegar Panchal, having facilitated over \$1 billion of impact capital in the US since 2010 through its legal guidance to clients, is considered a specialist law firm in the impact investment sector. The firm identifies the unique position blended finance transactions have placed lawyers in. Traditional transactional lawyers have a clearly defined task of placing

“Discussions surrounding blended finance are primarily focused on the facilitation of such transactions using concessional capital, however, there is a lack of discourse surrounding the regulatory and legal frameworks used.”

their client's interests, often economic, first. When blended finance is involved, there is a mutual interest in advancing impact outcomes which becomes particularly important in forwarding the aim of a transaction in instances where there is a breach of covenant (Bourke, 2022).

Research gaps

Whilst conducting this literature review, MDBs and DFIs were the main source of reports on this matter, often supporting each other's findings. To ensure a balanced view on blended finance, further independent reports will be important in analysing the success and failures of different blended finance approaches.

Furthermore, discussions surrounding blended finance are primarily focused on the facilitation of such transactions using concessional capital, however, there is a lack of discourse surrounding the regulatory and legal frameworks used.

VIVA Idea, a thought and action centre with a focus on Latin America, is discussing the role of the legal environment in impact investing. The organisation's Impact Director, Paola Fonesca, states that "[impact investing] is more than a financial profitability tool with social or environmental impact. It is a tool for beneficiaries to develop their own solutions for social inclusion and sustainability, according to their contexts".

As a member of the Global Alliance of Impact Lawyers (GAIL), Fonseca brings recognition to the ways in which the regulatory landscape can impact the deployment of impact investment as well as the ways GAIL is addressing these challenges in the first instance (VIVA IDEA). Finally, there is a distinct lack of discussion on termination rights or insolvency procedures within blended finance. RPCK's commentary on impact investment transactions suggests that this may not necessarily be of importance in blended finance transactions where impact is the key motivation. Therefore, a breach of contract or default on repayment may not result in enforcement action being taken.

A discussion paper published by the Social Science Open Access Repository (Bertzky et al., 2020) conducted a study on 33 blended finance studies and evaluations, including OECD reports, none of which were found to discuss insurance. Regulation and legal challenges were not mentioned at all.

“Finally, there is a distinct lack of discussion on termination rights or insolvency procedures within blended finance.”

Summary

The absence of a standardised framework in blended finance poses challenges for Development Finance Institutions, investors, legal professionals and beneficiaries. Aligning principles in blended finance would facilitate stakeholder collaboration and risk mitigation. We were not able to locate substantive legal analysis on blended finance, however, with further disclosure and transparency from organisations, it may be possible to gain more insight into the specific structuring and legal choices of blended finance agreements and look to developing a methodology that can support the important job of scaling blended finance.

EU Regulatory issues in blended finance funds – AIFMD II

Introduction

A major legal and regulatory obstacle that can be encountered when designing the capital structure of any “blended finance debt fund”²² in the EU are compliance with the Alternative Investment Fund Managers Directive (“AIFMD”).²³ Blended finance funds generally (not only blended finance debt funds) may also face important obstacles to ensure their capital structure is compliant with the EU Securitisation Regulation.²⁴

In this section we focus on AIFMD. We will set out our analysis of how the EU Securitisation Regulation affects blended finance funds in GAIL’s report on Stage 2 of its Blended Finance Project.

Blended finance funds

To discuss how AIFMD affects blended finance funds it is first necessary to outline the features and types of blended finance funds for which AIFMD is relevant.

The capital structures of blended finance debt funds typically feature different layers or “tranches” of capital (both equity and debt capital) to accommodate the different concessional and non-concessional capital investments in the fund. According to Convergence, blended finance is “a structuring approach that allows organisations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both),” and Convergence also notes that “blended finance is not an investment approach, instrument, or end solution.” In turn, impact investing is an “investment approach,” and impact investors often participate in blended finance

“[Under AIFMD II] the capital structure of blended finance debt funds set up in the EU that are considered to be engaging in “loan origination” ... will have to be designed in a way that is compliant with [the new AIFMD II] leverage limits.”

structures. One of the characteristics of blended finance transactions is that there should be public and/or philanthropic parties that are catalytic. Convergence identifies different types of blended finance “archetypes,” depending on the role that public and/or philanthropic investors play in the capital structure of the fund. Thus, the design of the capital structure of a blended finance fund is a key element because this will determine whether a particular fund can be considered a blended finance fund, or not.²⁵

One of the common blended finance structures that Convergence identifies is a structure where public or philanthropic investors provide below-market terms within the capital structure to lower the overall cost of capital or to provide an additional layer of protection to private investors (this is what is referred to as “concessional capital”).²⁶ For the purposes of this analysis, we are assuming that the capital contributions for the concessional and the non-concessional capital come in the form of equity or debt instruments, and we will not be contemplating capital contributions for the concessional capital via guarantee or grants, which actually are present in the capital composition of other archetypes

22. In this section, we will refer to “blended finance debt funds” as blended finance funds whose portfolio is made up of loans (or sub-loans) granted to impact-minded sub-borrowers in emerging economies. The terms “loans” and “sub-loans” are used indistinctively in this section, but they have the same meaning (i.e., the underlying debt investments of the blended finance debt fund which constitute its portfolio).

23. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

24. Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

25. See <https://www.convergence.finance/blended-finance#characteristics>

26. I.d.

of blended finance structures identified by Convergence.²⁷ As further developed below, the reason for this exclusion is twofold; for simplicity, and because we understand that the legal and regulatory issues that we analyse here are most likely to arise in a scenario where the instruments used for the capital structure of the fund are equity or debt instruments, rather than guarantees or grants.

Further, it is important to note that, in a blended finance fund, blending elements can be (i) at the level of the capital structure of the fund, through the creation of different tranches for the concessional and non-concessional capital (the fund takes on concessional capital and blends it with non-concessional capital, which is then used to provide financing to the investee);²⁸ and/or (ii) at the investee level, for example where the fund, for a particular investment, provides capital to the investee by partnering with a commercial investor (the fund provides capital to the investee which is junior to the capital provided by the commercial investor).

The legal and regulatory obstacles that we will analyse in this section operate at the level of the capital structure of the fund. Careful design of the capital structure of any blended finance fund is always needed. As it has indeed been noted in the blended finance literature, big challenges exist in the structuring of blended finance vehicles, which can lead to lengthy negotiations, or to deal failure.²⁹ In this section, we intend to analyse the narrower issue of the legal and regulatory challenges in the structuring of blended finance debt funds in the EU presented by AIFMD.

AIFMD II: loan origination

We should highlight here that AIFMD II³⁰ (which was adopted by the EU Council on 26 February 2024) modifies AIFMD to, most importantly for our purposes, set out new requirements and restrictions on what is called “loan origination” (an activity in which a significant number of blended finance debt funds could engage in, consisting in – in lay terms, not in terms of the AIFMD II definition analysed below – the fund granting, as the original lender, the relevant sub-loans that will comprise the fund’s portfolio). These new rules include most importantly new limits on how leveraged can funds engaging in “loan origination” be, which implies that the capital structure of blended finance debt funds set up in the EU that are considered to be engaging in “loan origination” under AIFMD II, going forward, will have to be designed in a way that is compliant with those leverage limits. The new rules under AIFMD II will be transposed into national legislations of the EU members within the timelines set out below, and there are also certain transitory or grandfathering provisions applicable to existing funds (also analysed below).

27. I.d.

28. See Big Society Capital, What is blended finance?, at <https://bigsocietycapital.com>

29. See, e.g., Global Impact Investing Network’s Blended Finance Working Group, at <https://thegiin.org/>

30. Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds.

EU Securitisation Regulation: Tranching

Although we are not analyzing the EU Securitisation Regulation in this report, it is worth mentioning in passing that while restrictions on loan origination activities carried out by blended finance debt funds is a main issue under AIFMD II, it is tranching that is the issue for blended finance funds from a EU Securitisation Regulation perspective. We will set out our analysis of how the EU Securitisation Regulation affects blended finance funds in GAIL's report on Stage 2 of its Blended Finance Project.

“Tranching” of the capital structure of a vehicle, which as mentioned above is common practice in the capital structures of blended finance funds, could result in that vehicle being considered “a Securitisation” under the EU Securitisation Regulation, which is directly applicable in the EU member states without the need of transposition due to its status as a regulation.

This has important consequences for the feasibility of blended finance funds, because certain types of investors (i.e., insurance companies covered by the so-called Solvency II³¹), which are actually willing to be (or becoming to be) active players in the blended finance industry,³² face significant regulatory impediments when investing in a Securitisation vehicle (namely having to maintain significantly more risk capital for investments in Securitisation vehicles than investments in non-Securitisation vehicles), which makes that investment unattractive to those investors, or even impractical.

What is AIFMD II?

In the EU, alternative investment funds (“AIFs”) and their managers (“AIFMs”) are regulated by the AIFMD. Hedge funds, private equity funds, private debt funds, or real estate funds are examples of AIFs.³³ Both “open-ended” and “closed-ended” vehicles can be AIFs for the purposes of AIFMD (“Open-Ended AIFs” and “Closed-Ended AIFs”, respectively),³⁴ as well as listed and un-listed vehicles.³⁵ Any blended finance private equity or private debt fund set up in the EU will be considered an AIF and will be regulated by the AIFMD.

On 26 February 2024, the Council of the EU adopted the long-awaited amendments to AIFMD through the so-called AIFMD II. AIFMD II amends AIFMD in the following areas: delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by AIFs. AIFMD II will enter into force 20 days after its publication in the Official Journal of the European Union (publication has not yet occurred to date), and EU member states will have two years after the entry into force to transpose the rules into national legislation (but it is important to note that EU member states may not use all of this transposition period and national legislations may be enacted shortly after the entry into force of AIFMD II, and normally EU jurisdictions that are big markets for funds, like Luxembourg or the Netherlands, are fast in implementing new funds-related EU legislation into their national legislations). Market participants have noted that the changes brought by AIFMD II are not too radical in general, except for the important changes in requirements and restrictions

31. Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast)

32. See, e.g., Allianz SE, Oliver Bäte, Daring to Do More Blended Finance, available at <https://www.allianz.com/>

33. The definition of AIF under AIFMD is the following: “any collective investment undertaking, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which does not require authorisation pursuant to the Undertakings for Collective Investment in Transferable Securities Directive of 2009.”

34. According to the Commission Delegated Regulation (EU) No 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers (the “Delegated Regulation”), an Open-Ended AIF is an AIF whose unitholders or shareholders have the right to repurchase or redeem their units or shares out of the assets of the AIF in the following scenarios: (i) at the request of any of its shareholders or unitholders; (ii) prior to the commencement of the AIF's liquidation phase or wind-down; and (iii) according to the procedures and frequency set out in its rules or instruments of incorporation, prospectus or offering documents. In turn, Closed-Ended AIFs are defined in the negative, i.e., they are AIFs not falling within the criteria described above, and the Delegated Regulation further states that any AIF whose shares/units can be repurchased or redeemed after an initial period of at least 5 years during which redemption rights are not exercisable shall also be a Closed-Ended AIF.

35. Recital 6 of AIFMD.

applicable to loan originating funds,³⁶ which actually have very relevant implications for the structuring of blended finance debt funds, as set out below.

What is a loan originating fund?

AIFMD II has created a new regime for the so-called “loan originating funds”, and it has introduced two key definitions: “loan origination” and “loan originating AIFs”, both of which are analysed below.

An AIF will engage in the activity of “loan origination” as defined by AIFMD II through either: (i) the granting of a loan directly by the AIF as the original lender (also called “lender of record”), or (ii) the indirect granting of a loan through a third party or a special purpose vehicle (“**SPV**”) (on the AIF/AIFM’s behalf) where the AIF/AIFM is involved in structuring the loan or pre-agreeing on its characteristics in advance of being exposed to it.³⁷

Under AIFMD II, a loan originating fund is a fund which (i) has an investment strategy which is mainly “loan origination”, or (ii) has originated loans the notional value of which represents at least 50% of its net asset value, and includes loans made via an SPV or another third party (“**Loan Originating Funds**”).³⁸

Loan Originating Funds differ from the so-called “loan participation funds”, which are funds that invest in a portfolio of loans that have already been originated by third parties and granted by those third parties as the lenders of record and that are subsequently purchased by the fund (the fund having no role in the structuring of the

loans prior to the fund being exposed to those loans) (“Loan Participation Funds”), and which fall outside of the scope of AIFMD II.

What is a blended finance loan originating fund?

We refer to “blended finance debt funds” herein as funds whose portfolio is comprised of sub-loans to impact-minded sub-borrowers established in emerging economies. Any given blended finance debt fund can be a Loan Originating Fund or a Loan Participation Fund depending on the characteristics of the particular transaction and the roles that the different participants in the blended finance debt fund play.

Participants in a blended finance debt fund could include the following: (i) an impact-minded AIFM which is one of the sponsors of the fund and acts as the investment manager of the fund, (ii) additional fund sponsors who are also investors in the fund (e.g., a development finance institution or a commercial bank), and (iii) commercial investors that are not sponsors of the fund and have a passive role.³⁹ We will refer to the participants in (i) and (ii) as the “**Blended Finance Fund Sponsors**.”

36. See, e.g., Greenberg Traurig, AIFMD II: New Regulation of Debt Funds and Other Key Changes, at <https://www.gtlaw.com/en/insights>

37. Article 4(1) of AIFMD as amended by AIFMD II.

38. Article 4(1) of AIFMD as amended by AIFMD II.

39. Other participants in a blended finance debt fund could be, for example, a foundation that provides concessional capital through guarantees to de-risk any of the tranches of capital of the fund, or grants to fund technical assistance projects. But, as set out above, the use of guarantees and grants in blended finance debt funds is out of the scope of this analysis.

The special nature (and risk profile) of the sub-loans that make up the portfolios of blended finance debt funds requires special efforts and expertise to originate those loans, and for that reason at least one of the Blended Finance Fund Sponsors will have to bring origination efforts and expertise in order to make the fund happen. Blended Finance Fund Sponsors are compensated for those efforts and expertise from both a financial and an impact point of view, and at least one of the Blended Finance Fund Sponsors will have strong financial and impact incentives to find the right sub-loans that will comprise the portfolio of the blended finance debt fund. In terms of financial incentives, Blended Finance Fund Sponsors may be motivated to earn the relevant fees for the structuring efforts, or simply participate in the returns resulting from the pool of sub-loans through carried interest or management fees in the case of a Blended Finance Fund Sponsor that is the AIFM, or portfolio returns in the case of Blended Finance Fund Sponsors who also sit in the capital structure of the blended finance fund as investors (and are invested in either the concessional or non-concessional capital). From an impact perspective, Blended Finance Fund Sponsors would be motivated to find the right opportunities for the blended finance debt fund in order to maximize the contributions by the fund to sustainable development objectives.

If the AIF/AIFM engage in “loan origination” activities (by either (i) having the AIF originate and be the original lender of the sub-loans, or (ii) if the loans are granted by a third party or an SPV but on behalf of the AIF/AIFM when the AIFM participates in the structuring of the sub-loans before the AIF is exposed to those loans), then the blended finance debt fund may be considered

“If the AIF/AIFM do not engage in “loan origination” activities because those activities are carried out by another one of the Blended Finance Fund Sponsors ..., then the blended finance debt fund may qualify as a Loan Participation Fund and the relevant requirements and restrictions on loan origination under AIFMD II will not be applicable to the fund.”

a Loan Originating Fund, and it will be subject to the relevant requirements and restrictions on loan origination under AIFMD II. In turn, if the AIF/AIFM do not engage in “loan origination” activities because those activities are carried out by another one of the Blended Finance Fund Sponsors (e.g., where a development finance institution or commercial bank that is one of the Blended Finance Fund Sponsors is the original lender of the sub-loans and the AIFM does not participate in the structuring of the sub-loans before the AIF is exposed to those loans), then the blended finance debt fund may qualify as a Loan Participation Fund and the relevant requirements and restrictions on loan origination under AIFMD II will not be applicable to the fund. In this loan participation scenario, instead of the blended finance debt fund seeking and creating opportunities to provide debt capital aligned with the fund’s return and impact expectations, it will invest in participations in sub-loans that already exist and are aligned with those return and impact expectations.

Real-life examples of blended finance funds: loan origination vs loan participation

We will analyse two real-life examples of blended finance debt funds to illustrate how blended finance funds can engage in loan origination and loan participation activities: (i) an existing blended finance debt fund that can be seen as carrying out loan origination activities, and (ii) an existing blended finance debt fund that can be seen as being in the business of loan participation rather than loan origination. It is important to note that the blended finance debt funds included below have been featured considering, solely, the relevant characteristics of those funds that can be extracted from public information (which is many times limited due to the confidential nature of funds' mechanics/economics), and no legal opinion is expressed herein as to whether those funds would indeed be engaging in "loan origination" activities as defined under AIFMD II, or not. The funds below are solely featured for illustrative purposes. We also note that the below analysis is limited to the operations or mechanics of the relevant funds with respect to their loan granting or participation/investing activities, and does not include a description of the capital structure of these funds and why they are considered as blended vehicles.

The IDH Farmfit Fund:⁴⁰ loan origination

This fund is an EUR 100 million blended finance debt fund sponsored by the Dutch government that grants long term financing (from USD 700,000 to USD 5 million, with tenors up to ten years) for production assets (i.e., asset finance, input loans, working capital, capex, and renovation and rehabilitation) to local financial institutions or value chain actors, which will then on-lend to small farmers.

For each of the loans that the fund grants, it partners with other investors to co-finance the relevant sub-borrowers. An example of a transaction that the fund would carry out would be as follows: the fund would partner with a commercial investor, which would provide senior capital to the sub-borrower, with the fund providing junior capital to the sub-borrower.⁴¹ There are two entities in the fund structure that are involved in each particular transaction: (i) IDH Farmfit Fund B.V. (which is the fund, and which would grant to the sub-borrower the relevant loan junior to the loan granted by the commercial investor), and (ii) Farmit Guarantee Facility B.V. (which is an entity set up to receive capital from the commercial investors that co-invest with the fund in any given sub-loan, and which will grant to the sub-borrower the relevant loan senior to the loan granted by the fund).⁴² Farmit Guarantee Facility B.V. benefits from a guarantee from USAID that guarantees 50% of the senior loans. In this fund, the fund itself is the original lender or lender of record for each of the sub-loans, accompanied by Farmit Guarantee Facility B.V., and therefore the fund would be engaging in loan origination.

40. See the fund's website at <https://www.idhsustainabletrade.com/farmfit-fund/>

41. In case the fund partners with an NGO or social lender, it is required to grant loans *pari passu* to the loans granted by that NGO or social lender.

42. IDH Farmfit Fund B.V. (the fund) and Farmit Guarantee Facility B.V. (the SPV set out to receive senior capital from commercial investors) are in common ownership, meaning that they are both owned by the same entity, which is the sponsor of the fund: IDH - The Sustainable Trade Initiative.

The SDG Loan Fund:⁴³ loan participation

This is a USD 1.11 billion blended finance fund sponsored by FMO and Allianz that invests in participations in FMO-originated loans.

The following participants in the blended finance fund play the following roles for each of the investments that the fund pursues: (i) FMO originates loans from its own investment pipeline and is the lender or lender of record for each of those loans, and (ii) FMO Investment Management (which is the independent investment firm of FMO and the fund's portfolio manager) identifies eligible loans for the fund from FMO's investment pipeline and presents all opportunities which meet the fund's investment criteria to the fund for an investment decision. to the fund for an investment decision.⁴⁴ For each investment by the fund in a loan participation, FMO will hold the higher of USD 10 million or 20% of each loan on its own balance sheet. Allianz Global Investors is the Alternative Investment Fund Manager, it maintains a fiduciary responsibility to the investors of the SDG Loan Fund and oversight over FMO Investment Manager and MacArthur Foundation provides a USD 25 million unfunded guarantee to the fund, acting as a "first loss to the first loss".

In the SDG Loan Fund, differently from the IDH Farmfit Fund, the fund is not the lender of record for the loan participations, but a third party (i.e., FMO).⁴⁵ Therefore, assuming that the fund does not participate in the structuring of the FMO-originated loans prior to the fund being exposed to them,⁴⁶ the fund would not be engaging in loan origination activities.

What are the new loan origination rules under AIFMD II and what are the impacts on blended finance loan originating funds?

As noted above, AIFMD II has introduced a new regime for Loan Originating Funds. This new regime includes different sets of rules that apply at the level of the AIFM and at the level of the Loan Originating Fund (including each loan originated by the Loan Originating Fund). The AIFM-level requirements set out under AIFMD II are outside of the scope of this report. We will focus on two restrictions at the level of the Loan Originating Fund, which could be relevant to blended finance debt funds: (i) the new risk retention requirement for Loan Originating Funds; and (ii) the new leverage limits applicable to Loan Originating Funds.

New Risk Retention Requirement

Under AIFMD II, a Loan Originating Fund is required to retain at least five per cent of the notional value of each loan it originates and subsequently sells on the secondary market. The recitals of AIFMD II explain that the rationale of this new rule is to "avert moral hazard and maintain the general credit quality of loans originated by AIFs,"⁴⁷ or in other words to reduce incentives for AIFMS to originate poor quality loans to be immediately sold off on the secondary market.⁴⁸

The applicable retention period is determined in two ways: (A) for loans with a maturity up to eight years, five per cent of the notional value of the loans must be retained until maturity, and (B) for loans with a maturity longer than eight years, five per cent of the notional value of the loans must be

43. See the Convergence case study on the SDG Loan Fund at <https://www.convergence.finance/resource/SDG-Loan-Fund/view>

44. Importantly, the fund has priority access to FMO's investment pipeline.

45. We understand that the relevant sub-loans that comprise the portfolio of the SDG Loan Fund are indeed granted by FMO as the original lender or lender of record because according to public information those sub-loans sit on FMO's balance sheet.

46. The information about whether the SDG Loan Fund participates or not in the structuring of the FMO-originated loans prior to the fund being exposed to them is not available in public sources.

47. Recital 13 of AIFMD II, available at <https://eur-lex.europa.eu/resource.html>

48. See, e.g., Travers Smith, AIFMD II: the next page of EU alternative investment fund regulation, at <https://www.traverssmith.com/knowledge/knowledge-container/aifmd-ii-the-next-phase-of-eu-alternative-investment-fund-regulation/>

retained for a period of at least eight years (the “**Risk Retention Requirement**”).⁴⁹

The Risk Retention Requirement results in debt funds following a pure syndication strategy being practically banned under AIFMD II.⁵⁰ However, there are a number of exceptions to the Risk Retention Requirement that relate mainly to sales of assets of the AIF in the event of liquidation, sales of assets to comply with regulatory requirements, or sales of assets “in the best interests of the AIF’s investors.”⁵¹

Application to blended finance Loan Originating Funds

Even if this Risk Retention Requirement will have a big financial impact going forward on Loan Originating Funds engaging in pure syndication strategies (as noted above), its application to blended finance Loan Originating Funds is quite limited, because a scenario where a blended Finance Loan Originating Fund is set up to originate loans and then sell them on the secondary market would be rare, due to the special nature of the sub-loans that blended finance Loan Originating Funds generally are expected to originate and the special incentives mix present in blended finance Loan Originating Funds, as explained above. In addition, if we assume that the impact investors that act as sponsors and investors of the blended finance debt fund, or otherwise participate in it as passive investors, invest “patient capital,”⁵² such investors would not like to see the fund engaging in those syndication strategies, but they would rather expect the fund to be looking out for the best opportunities in the market to originate and grant loans to impact-minded sub-borrowers, with the fund retaining those investments in its balance

sheet for the relevant time needed for the sub-borrowers to be able to deliver the expected impact.

New Leverage Limits

Under AIFMD II, Loan Originating Funds will be subject to limitations on the use of “leverage” (the “**Leverage Caps**”). This restriction has undergone significant revisions from the original draft of AIFMD II⁵³ and it was polemic during the negotiations of the amended directive, until a compromise was reached, pursuant to which a distinction is made between Open-Ended and Closed-Ended AIFs, with different leverage caps for each: (i) 175% for Open-Ended AIFs (which are perceived to pose a greater risk), and (ii) a cap of 300% for Closed-Ended AIFs.⁵⁴

“Leverage” in this context is measured according to the so-called “commitment method,” meaning that borrowings that are fully covered by commitments from investors of the Loan Originating Fund (for example through the so-called “subscription facilities”⁵⁵) are not considered “leverage” for the purposes of the Leverage Caps. The leverage ratio is then calculated dividing the “leverage” of the fund by its “net asset value.”⁵⁶ According to ILPA (the Institutional Limited Partners Association), “net asset value” or “NAV” of a fund is “the amount by which the value of all of the assets of a fund exceeds all debts and liabilities of the fund, as determined in accordance with GAAP or other accounting or valuation metrics.”⁵⁷ In a fund in the form of a limited partnership which capital structure is composed for example of a USD 300 million debt facility under which investors have provided senior debt to the fund (which would constitute “leverage” for AIFMD II purposes

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49. Article 15 of AIFMD as amended by AIFMD II.

50. See, e.g., Greenberg Traurig, AIFMD II: New Regulation of Debt Funds and Other Key Changes, at <https://www.gtlaw.com/en/insights/2023/12/aifmd-ii-new-regulation-of-debt-funds-and-other-key-changes>

51. Article 15 of AIFMD as amended by AIFMD II.

52. See, e.g., the definition of “patient capital” in the impact investing context given by the Impact Investing Institute: patient capital is an “Investment where the investor is willing to commit for the very long term before realising a financial return in order to support early-stage enterprise and innovation or higher-risk investment – typically in order to solve a social or environmental challenge,” at <https://www.impactinvest.org.uk/glossary/#P>

53. See, e.g., Deveboise & Plimpton, AIFMD II Makes Rapid Headway as Commission Makes Final Compromise Text Available, at <https://www.debevoise.com/insights/publications/2023/11/aifmd-ii-makes-rapid-headway-as-commission-makes>

54. Article 15 of AIFMD as amended by AIFMD II.

55. Deveboise & Plimpton, Considering a Subscription Credit Facility? Here's What You Need to Know, at <https://www.debevoise.com/insights/publications/2014/03/considering-a-subscription-credit-facility-heres>

56. Article 15 of AIFMD as amended by AIFMD II.

57. See https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf

because the debt facility is a borrowing by the fund, as explained below), and of limited partnership units held by investors for an amount of USD 100 million (which does not constitute “leverage” for AIFMD II purposes due to the equity nature of the limited partnership units), the NAV of the fund would be the value of the limited partnership units only, i.e., USD 100 million. And the leverage ratio of this fund would then be USD 300 million (the leverage of the fund) divided by USD 100 million (the NAV of the fund), i.e., 300%.

AIFMD II does not include a particular definition of “leverage” for the purposes of the Leverage Caps, so it has been noted that the definition of “leverage” that should be adopted in this context is the general definition of “leverage” included in the original text of AIFMD: “any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means.” This is not limited to borrowing by the AIF, but it is a broad concept which includes a wide range of “exposures” such as those under derivatives, repos and securities lending agreements.⁵⁸ Note the broad definition of leverage under AIFMD, which has a big impact on blended finance debt funds as set out below.

Pursuant to AIFMD II, the Leverage Caps do not apply to a Loan Originating Fund whose loan origination activity is limited to making shareholder loans, provided that these loans do not exceed 150% of the AIF’s capital.⁵⁹

Application to blended finance Loan Originating Funds

As mentioned above, the capital structures of blended finance funds generally feature different “tranches” of capital in order to accommodate the concessional and non-concessional capital investments in the fund.

Concessional capital in the blended finance fund operates as first-loss capital, meaning that (i) concessional capital absorbs losses of the fund first (prior to non-concessional capital absorbing any loss of the fund), (ii) payouts go first to the non-concessional capital (prior to any payouts to concessional capital) and (iii) non-concessional capital is paid first in the event of an insolvency of the fund. In order to achieve “concessional” (or, in other words, ensure that the concessional capital operates as first-loss capital in the fund) from a legal perspective, the relevant capital contributions in the fund that are labelled as concessional need to be subordinated to the capital contributions that are not labelled as concessional.

As anticipated above, for the purposes of this analysis, we are assuming that capital contributions for the concessional capital come in the form of equity or debt instruments, and not guarantee or grants, so we would focus on the different mechanisms available to subordinate equity interests to debt interests, or different equity or debt interests between each other. The reason for the exclusion of guarantees and grants from this analysis is twofold: (i) for simplicity (analysing the leveraged nature of guarantees or grants is complex as guarantees or grants can take multiple forms and can sit inside or outside of the capital structure of the fund), and (ii) the

⁵⁸ See, Travers Smith, AIFMD II: the next page of EU alternative investment fund regulation, at <https://www.traverssmith.com/knowledge/knowledge-container/aifmd-ii-the-next-phase-of-eu-alternative-investment-fund-regulation/>

⁵⁹ Article 15 of AIFMD as amended by AIFMD II.

issues with the loan origination regime under AIFMD II arise when there is one element in the capital structure of the fund that characterizes as “leverage” under AIFMD II, and we understand that there is a high risk that debt instruments (e.g., a debt facility used by any investor in the fund to provide its capital to the fund) can be characterized as “leverage” for the purposes of AIFMD II (because such debt instruments would constitute “borrowing by the AIF”, as noted above), whereas the characterization of grants or guarantees as “borrowings by the AIF” is less evident and that characterization may vary on a case by case basis depending on the terms of the particular guarantees or grants (for example grants can be structured as repayable or recoverable grants, in which case they could resemble a debt instrument, which could be labeled as “leverage” depending on the circumstances). However, when structuring any Loan Originating blended finance fund, legal advice should be sought to ascertain whether any particular element of the capital structure of the fund, including guarantees and grants, qualifies as “leverage” under AIFMD II (and if the question is affirmative for any of those elements, then the Leverage Caps would apply).

Let’s now take a deeper look into the design of the capital structure of a blended finance fund and how to achieve subordination / concessionality, which will help us understand which of the capital components of the fund can be considered “leverage” for AIFMD II purposes. Subordination of concessional capital to non-concessional capital in a blended finance fund can be achieved in several ways, including through the following mechanisms:

“When structuring any Loan Originating blended finance fund, legal advice should be sought to ascertain whether any particular element of the capital structure of the fund, including guarantees and grants, qualifies as “leverage” under AIFMD II”

- **Traditional subordination of equity to debt, by operation of the law**, which is a common assumption under the corporate laws of any jurisdiction. In this case, the following tranches could be created in the capital structure of the fund: (i) an equity tranche (in the form of limited partnership units, for example), which will accommodate the concessional capital, and (ii) a debt tranche (in the form of a debt facility, for example) which will accommodate the non-concessional capital. This is what we call “subordination by operation of law” of the equity concessional tranche to the debt non-concessional tranche.
- **Contractual subordination of the concessional capital to the non-concessional capital**, through the relevant contractual provisions included in the fund documentation. In this case, the following tranches could be created in the capital structure of the fund: (i) different equity tranches, for example: (A) a junior equity tranche to accommodate the concessional capital (in the form of ordinary limited partnership units), and (B) a senior equity

tranche to accommodate the non-concessional capital (in the form of preferred limited partnership units, with a preferred dividend and priority in payouts to the junior equity); (ii) different debt tranches, for example: (A) a junior debt tranche to accommodate the concessional capital (in the form of a junior or mezzanine debt facility), and (B) a senior debt tranche to accommodate the non-concessional capital (in the form of a senior debt facility); or (iii) a combination of equity and debt tranches, with concessional capital being deployed through junior debt or equity instruments, and non-concessional capital being deployed through senior debt or equity instruments. This is what we call “contractual subordination” of the debt/equity concessional tranche to the debt/equity non-concessional tranche.

Legal advice must be sought at the outset to determine which of the instruments that comprise the capital structure of the fund would qualify as “leverage” under AIFMD II. Debt instruments are the most problematic out of those instruments, because they most likely constitute “borrowings” of the fund and therefore would qualify as “leverage” under AIFMD. In addition to legal advice, Blended Finance Fund Sponsors may also consider undergoing a consultation process with the relevant securities and markets authority of the particular EU member state responsible for the supervision of the fund, in case that would be available and would be desirable in the context of a particular transaction. Because, as already noted, the definition of leverage under AIFMD is so broad (i.e., any instrument that constitutes “a borrowing” by the AIF), we hope to see ESMA (the European Securities and Markets Authority) and/or the national securities market authorities

of EU member states issue guidance as to what instruments that may be used to capitalize an AIF are considered “leverage” for AIFMD II purposes.

The problem: *the capital structure of the blended finance Loan Originating Fund is not compliant with AIFMD II because the leverage ratio of the fund falls outside of the Leverage Caps.*

If counsel (or the securities and markets authority of a EU member state, if applicable) determines that any of the instruments used in the capital structure of the fund qualifies as “leverage” under AIFMD II, then the Leverage Caps under AIFMD II must be respected (subject to the transitional and grandfathering provisions analysed below), which means that the capital contributions in the fund that qualify as leverage need to be sized properly so the Leverage Caps are complied with. This restriction in the size of the capital contributions is key in a blended finance fund, which financial models are normally designed assuming a particular ratio of concessional capital versus non-concessional capital (i.e., those financial models assume that concessional capital must provide a particular buffer at closing of the fund or during the life of the fund).

If the fact that one or more of the instruments used for the capital structure of the fund qualify as “leverage” under AIFMD II makes the leverage ratio of the fund (calculated as leverage divided by NAV) fall outside of the Leverage Caps, then the size of non-leverage instruments must be increased in order to decrease the leverage ratio of the fund. The relevant avenues available to the leverage ratio of a fund are analysed below.

Proposed solution: *decrease the leverage ratio of a blended finance Loan Originating Fund*

Two alternatives to decrease the leverage ratio of a blended finance Loan Originating Fund are analysed below. It is important to note that the alternatives set out below do not constitute legal advice and no legal opinion is expressed herein as to whether proceeding with any of the routes featured below would lead to compliance with AIFMD II, including the Leverage Caps under AIFMD II. Counsel should be consulted at all times when designing the capital structure of a blended Loan Originating Fund. The alternatives analysed herein to decrease the leverage ratio of the fund are the following:

- **Increase the concessional capital contributions in the fund, to bring in additional non-leverage instruments (considering that concessional funds are many times structured via equity-like instruments).** This route has significant complications (which can be “deal breakers” or result in protracted negotiations), namely: (i) lack of availability of additional concessional capital (concessional funds are scarce, remember they constitute risk capital traditionally provided by philanthropic investors), and (ii) changes to the ratio of concessional capital versus non-concessional capital resulting from an increase in concessional capital may not be supported by the underlying financial model of the fund.

- **Change the “leverage” nature of the problematic instruments in the capital structure of the fund to “non-leverage” without altering the commercial/business terms of those instruments.** For example, a pure debt instrument (e.g., a debt facility) used by investors to deploy non-concessional capital into the fund (which, on its face, would qualify as “leverage” under AIFMD), could be replaced by an equity instrument (which, on its face, would not qualify as “leverage” under AIFMD) that assimilates to that debt instrument in its commercial/business terms (e.g., some sort of preferred equity instrument, with recurring payouts – that assimilate to interest payments in a debt facility – and redemption obligations – that assimilate to repayment obligations in a debt facility). Counsel must be consulted at all times when proceeding to re-characterize a “leverage” instrument into a “non-leverage” instrument, and this is an untested area, which warrants the exercise of special care.

As the reader may appreciate, AIFMD II creates special complications in the structuring of blended finance Loan Originating Funds. We hope that the abovementioned guidance by ESMA and/or the national securities and markets authorities of the EU member states would help in clarifying what instruments in the capital structure of a fund would qualify as “leverage” under AIFMD II, thereby reducing the high legal and regulatory risk currently present in the structuring of blended finance Loan Originating Funds.

When will the new rules under AIFMD II begin to apply?

The new regime on loan origination under AIFMD II will generally apply from the end of the transposition period of AIFMD II (as mentioned above, two years from the entry into force of AIFMD II, subject to the possibility that EU member states enact national legislation before that two-year timeline) (the “**Transposition Date**”). If an AIFM becomes the manager of a Loan Originating Fund set up on, or after, the Transposition Date, the AIFM and the AIF will have to comply with all the new requirements and restrictions on loan origination.

For Loan Originating Funds that exist as at the Transposition Date, AIFMD II incorporates certain transitional rules that provide certain reliefs for those funds.⁶⁰ The applicability of these transitional rules will depend on whether the relevant Loan Originating Funds are still in fundraising, or not: (i) for existing Loan Origination Funds that are no longer in fundraising, AIFMs will be exempt from compliance with certain requirements different from the Risk Retention Requirement and the Leverage Caps, which are not analysed in this report (namely, the diversification rules in respect of a single financial borrower and the liquidity risk management requirements for Open-Ended Funds), and (ii) importantly for our purposes, for Loan Originating Funds that are still in fundraising, AIFMs will have a grace period of five years from the Transposition Date with respect to the Leverage Caps as well as the other requirements mentioned in limb (i). However, it is important to note that for the purposes of the Leverage Caps and the diversification rules, if the relevant limits are already exceeded by the fund on the Transposition

Date, the respective Loan Originating Fund is no longer permitted to increase the respective exposure following the Transposition Date. Where such limits are not yet reached on the Transposition Date, AIFMs will be required to exceed the respective limits.

Finally, the rules contain exemptions from certain new requirements applying at the level of each sub-loan (including the Risk Retention Requirement) that will not apply to sub-loans that were granted prior to the Transposition Date, but only with respect to those existing sub-loans.

“If an AIFM becomes the manager of a Loan Originating Fund set up on, or after, the Transposition Date, the AIFM and the AIF will have to comply with all the new requirements and restrictions on loan origination.”

⁶⁰ Article 61 of AIFMD as amended by AIFMD II.

Conclusion

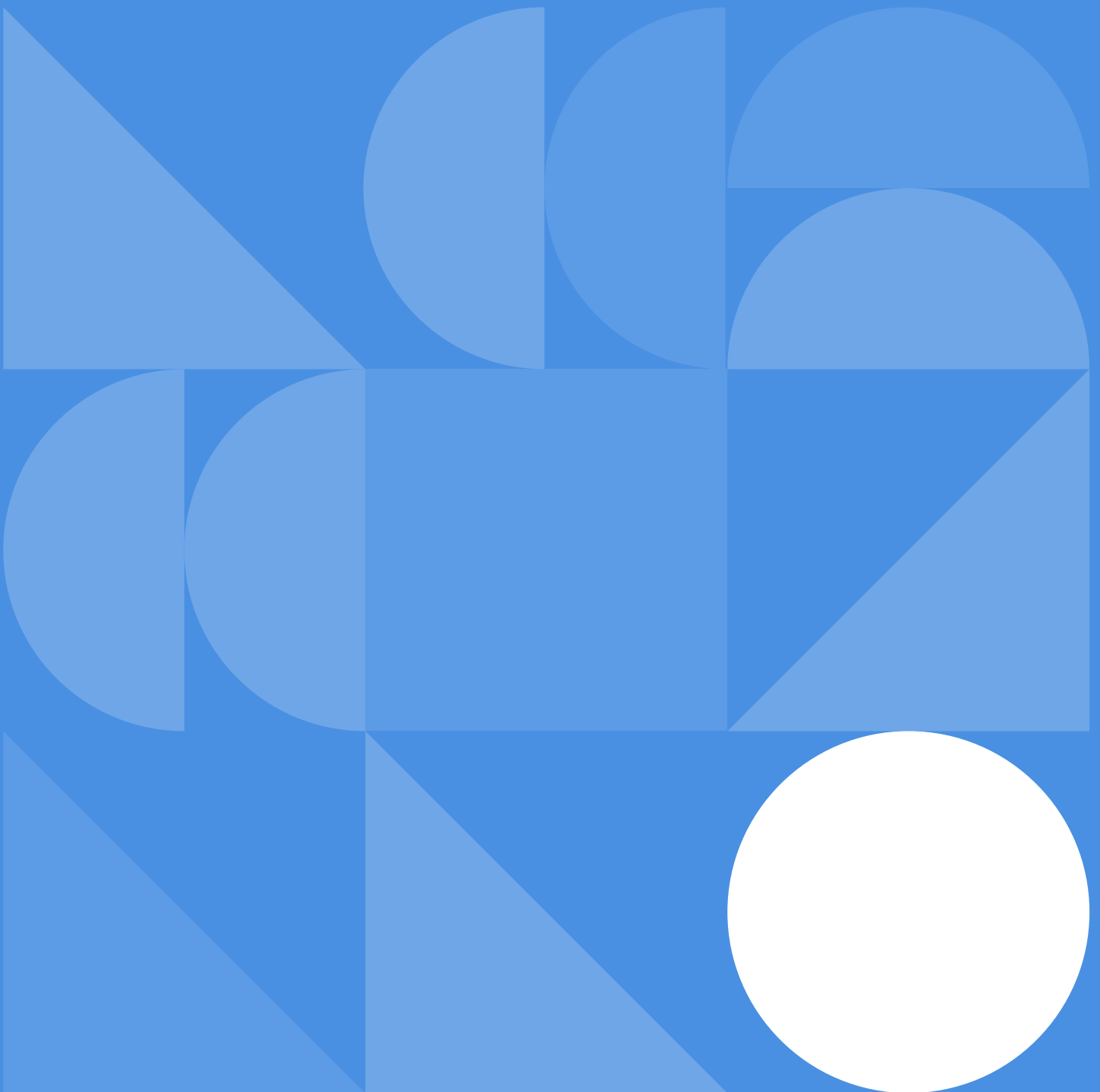
AIFMD II will have a very significant impact on the structuring of blended finance debt funds set up in the EU which engage in loan originating activities as defined in AIFMD II, mainly due to the introduction of caps to how leveraged funds can be. Because the capital structure of blended finance funds is generally complex, with different tranches of capital that are used to accommodate the concessional and non-concessional capital invested in the fund, and blended finance funds are generally designed pursuant to a financial model that assumes a particular ratio of concessional capital versus non-concessional capital, AIFMD II places important restrictions on the use of instruments that would qualify as “leverage” under AIFMD II.

In particular, AIFMD II’s leverage restrictions will require “leverage” tranches be of a particular maximum size as compared to the “non-leverage” tranches. This may eventually result in changes in the structuring of the fund that can compromise fund viability, namely: (i) require additional concessional capital to be deployed into the fund (which may not be feasible for different commercial reasons), or (ii) force changes to the instruments initially envisaged to be used to deploy concessional and non-concessional capital into the fund to replace the “leverage” instruments

“AIFMD II’s leverage restrictions will require “leverage” tranches be of a particular maximum size as compared to the “non-leverage” tranches. This may eventually result in changes in the structuring of the fund that can compromise fund viability.”

by “non-leverage” instruments in order to ensure compliance with the AIFMD II leverage ratios (which may or may not be feasible depending on the circumstances of the particular case and the advice received from counsel). These structuring challenges warrant the engagement of specialized counsel to guide participants in blended finance debt funds through the complex legal and regulatory issues and to ensure that the requirements and restrictions on loan origination under AIFMD II are complied with. We also hope to see ESMA and/or the national securities and markets authorities of the EU member states issue guidance as to what instruments should be considered “leverage” for AIFMD purposes.

Jurisdiction Overviews





Asia

ASEAN, Hong Kong & Singapore

Asia is a highly diverse region in terms of its economies, stages of development and its legal systems. Many jurisdictions within Asia are considered ‘emerging markets’, ‘developing economies’ or ‘the Global South’, however even within these there are significant differences country-to-country, from political systems, population size and demographics, to variations in policy and economic drivers depending on general stages of economic development and geographic localities. This Report seeks to cover blended finance practices and outlook in this context where jurisdictions in Asia require development finance, as well as climate finance for resilience to climate change and net zero transition.



Here, the most populous countries, also the largest economies, China and India, are characterised by strict foreign exchange controls, stringent foreign investment requirements, or a combination of both to varying degrees, as such blended finance transactions are predominantly onshore transactions of sufficient size domestically. Along with strong governmental policies or regulations tending to be protectionist, these features pose unique challenges for international investments or financing into these markets. Other than investments in public markets, the laws in both these countries tend to favour or require the setting up of private enterprises or charities domestically with foreign investments or participation significantly regulated or restricted. In contrast, with smaller economies and strong needs for foreign investments, a number of ASEAN countries have been the target markets of cross-border blended finance transactions, while, as highlighted for selected jurisdictions discussed below, in recent years there are emergence of domestic impact investing actors, ecosystem and social enterprises. As part of a global report, this analysis on Asia has a bias to focus on cross-border investments or finance, to identify opportunities and consider potential barriers for blended finance catered to a global audience, and does not cover wholly domestic blended finance structures or transactions in any jurisdiction.

Having said that, another key trend is the growth of Asian impact actors and funders, which has brought new dynamism to the impact ecosystem in the region, when historically most blended

finance investments into Asia are from non-Asian funders, including the international development finance institutions or multilateral development banks, or the philanthropic foundations of the West. While the developed economies or “the Global North” remain important sources of funding and finance, along with technical assistance and catalytic capital, the dual trends of Asia being the centre of global climate finance and the Asian MDBs becoming or preparing to be more active in blended finance are exciting in adding depth to the market and local contextual understanding. (A separate chapter of this Report covers Japan as a developed economy in Asia and source of blended finance.)

As suggested by the new **Declaration of a Global Climate Finance Framework** established at COP28, with ten agreed principles for making finance available, accessible and affordable for inclusive shared prosperity, there is momentum for international financial architectural reform for sustainability and resilience. The framework is calling for the wider use of climate-resilient debt clauses, debt-for-climate swaps and sustainability linked bonds, as well as the implementation of global mechanisms on debt treatments, debt service suspension and highly concessional funding, wider or innovative sources, to free up fiscal space for climate action and ready support for the poorest and most vulnerable countries. Another emphasis of the said framework is for developing countries to unlock private finance, transfer of knowledge, skills and technology at scale, and for climate transition to be “country-owned”, which underlies the need for each country to adopt achievable transition pathways in line with country circumstances and strategies. This will require strong domestic climate policy frameworks as well as adaptation strategies, as well as country-owned investment platforms as essential starting point for robust investment pipelines co-created with multilateral institutions and private sector finance, to enhance the flows and effectiveness of finance.

It is against this backdrop that some observations in this analysis refer to certain infrastructure and partnerships established in Asia that are laying foundation for mobilising private capital for development finance and impact, which may be further developed with adoption of risk-sharing or catalytic instruments for scale. With respect to climate finance and sustainable finance, quite notably, Asian countries from China to the ASEAN states have developed strong policy frameworks to mobilise finance and domestic capital markets for sustainability and net-zero transition. Among these, Hong Kong and Singapore are two international financial centres in Asia that are quickly positioning as sustainable finance hubs, with significant opportunities and roles to play for the region. Both have adopted policy, regulatory and tax initiatives and incentives that are important to consider with respect to sources and supply of funding, impact actors and funds, which would drive cross-border blended finance from within Asia.

Diverse legal systems in Asia

Unlike the European Union with the benefit of a single market and a model for some level of centrally-driven policy cohesion, Asia presents a distinctive challenging environment for international investors. Political and legal systems are diverse across Asian countries, with very limited similarities or comparability, even though broadly speaking there are the common law jurisdictions on the one hand - India, Pakistan, Bangladesh, Malaysia and, Singapore of the Commonwealth legacy, also Hong Kong (as a Special Administrative Region of the People's Republic of China), and the other countries are of civil law systems of different origins and further complexities under different political systems.

These characteristics present specific challenges for funders and their advisors in navigating legal issues and structures, regulatory and compliance requirements, policy and political risks, country-

“Political and legal systems are diverse across Asian countries, with very limited similarities or comparability, even though broadly speaking there are the common law jurisdictions on the one hand – India, Pakistan, Bangladesh, Malaysia and, Singapore of the Commonwealth legacy, also Hong Kong (as a Special Administrative Region of the People’s Republic of China), and the other countries are of civil law systems of different origins and further complexities under different political systems.”

to-country, especially where impact projects in Asia have a cross-border dimension. There are different nature of legal forms and legal relationships across these systems, such as the different types of companies or legal entities that may be established, or the different understanding of “trusts” premised on different sources of law and jurisprudence. Practitioners should be mindful of the need for parties involved in a cross-border blended finance transaction to establish a correct and aligned understanding of the legal nature and effect of an arrangement or terms across different jurisdictions and legal systems, with potential gaps or risks to misinterpretation or enforceability.

Specifically in the context of impact investing and social enterprises, for example, according to studies conducted by the British Council in collaboration with Social Enterprise UK and the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), the “definitions and understanding of social enterprise vary across the Asian region”. Quite often, a first step

in navigating impact investing is to clarify whether the funders and/or operators involved are on the same page on the ‘non-profit’ or ‘for-profit’ nature of the enterprise, to align structures or objectives, depending on whether the transaction in question involves grant funding and/or any expectation of return of capital and potential financial return.

Regardless of political or legal system, it is dependent on public law and policy which mandates or drives how or the extent social entrepreneurship or public good would be funded by public finance, charity or private finance, and also determines what is considered social entrepreneurship or public good, thereby shaping impact investing. This greatly varies across Asia and is beyond the scope of this Report to cover the position of any country in detail. However, for considering the types or sources of blended finance in Asia, in particular towards mobilising private capital and philanthropic capital, this analysis highlights below selected policy or regulatory trends or updates in Asia.

Another by-product of a lack of a single market in Asia involves addressing issues of interoperability and scalability. The region does not have the benefit of a consistent regulatory push in the EU, from the Taxonomy Regulation (EU Taxonomy) and Sustainable Finance Disclosure Regulation (SFDR), to other laws introduced regionally, including the Corporate Sustainability Reporting Directive (CSRD) and mandatory supply chain due diligence laws. These pose additional challenges to align requirements and standards with local context in Asia in the global impact landscape around climate or ESG issues. Besides the efforts of the International Platform for Sustainable Finance in developing the Common Ground



Taxonomy to map EU Taxonomy with China's, it is particularly noteworthy to consider a number of key initiatives within ASEAN discussed below with respect to development finance.

Turning then to Hong Kong and Singapore specifically as well-established asset management centres and wealth management centres, both jurisdictions have put in place new policies and legislative framework in recent years to develop as funds domicile, and separately new tax incentives to develop as family offices and philanthropic hubs. The Hong Kong open-ended fund company (OFC) and the Hong Kong limited partnership fund (LPF) structure are new legal entity forms created by statutes, and similarly the Singapore variable capital company (VCC) structure. These have expanded potential blended finance structures for establishing wholesale funds or capital aggregation for impact investing, or as sources of impact funding in Asia, along with the philanthropic tax incentives discussed below.

Blended Finance In Asia

Development finance

ASEAN Taxonomy

As noted above, without a single market or standard within Asia, it is more complex to understand local and regional economies. In climate or sustainable finance, the categorisation of what economic activities are “green” or “sustainable” is being mapped with local or regional taxonomies – notably the Common Ground Taxonomy mapping the EU Taxonomy and China’s Green Bond Projects Catalogue, and the ASEAN Taxonomy for sustainable finance, updated version 2 published recently effective from 19 February 2024. The ASEAN Taxonomy encompasses a principles-based Foundation Framework intended to be the common ground for national taxonomies of ASEAN Member States, and is being developed progressively

with periodic reviews “to keep abreast with the global sustainability agenda and technological advancements for continued relevance and effectiveness”.⁶¹ A multi-tiered approach is emphasised to facilitate inclusion, allowing for different levels of adoption depending on the readiness of individual ASEAN countries. While “Green” tier is bench-marked to the 1.5° goal of the Paris Agreement, “Amber” tiers promote inclusivity, where as a global first, the latest version has introduced coal phase-outs technical screening criteria to facilitate transition, stated to be with the intention to promote inclusivity without compromising credibility and interoperability.

The environmental objectives of the ASEAN Taxonomy are: (1) climate change mitigation, (2) climate change adaptation, (3) protection of healthy ecosystems and biodiversity, and (4) resource resilience and the transition to a circular economy. It is remarkable to also note that version 2 of the ASEAN Taxonomy has incorporated the “Essential Criteria” of social aspects along with “do no significant harm” (DNSH) and “remedial measures to transition”.

ASEAN Taxonomy version 2

Social Aspects:

- Respect Human Rights
- Prevention of Forced and Child Labour
- Impact on People Living Close to Investments

61. <https://www.theacmf.org/images/downloads/pdf/ASEAN-Taxonomy-Version-2-Effective-19Feb2024.pdf>

Financing for Sustainable Development Goals

Besides, the United Nations Development Program (UNDP) has analysed the progress to achieving the Sustainable Development Goals (SDGs) in Southeast Asian countries, also the Asia-Pacific SDG Partnership in collaboration with The Economic and Social Commission for Asia and the Pacific (ESCAP) and Asian Development Bank (ADB).

Separately, the ASEAN Capital Markets Forum (ACMF)⁶² has developed the ASEAN Green Bond Standards, the ASEAN Social Bond Standards, the ASEAN Sustainability Bond Standards and the ASEAN Sustainability-linked Bond Standards, based on the Green Bond Principles, Social Bond Principles, Sustainability Bond Principles and Sustainability-linked Bond Principles respectively of the International Capital Markets Association (ICMA). Remarkably, in collaboration with ADB, Sustainable Finance Institute Asia (SFIA) and Climate Bonds Initiative (CBI), the ACMF in 2021 published the ASEAN SDG Bond Toolkit,⁶³ highlighting SDG financing needs in ASEAN and the emerging opportunities for SDG bonds. This is a unique initiative developing and applying the ICMA-based capital markets sustainable bond instruments to development finance. The toolkit is not introducing a new bond label or new standards, but it serves as a primer for potential ASEAN SDG bond issuance. Malaysia in particular has an SDG Sukuk Framework, further to which a sovereign US dollar-denominated Sustainability Sukuk was issued in April 2021.

“The ASEAN SDG Bond Toolkit ... is a unique initiative developing and applying the ICMA-based capital markets sustainable bond instruments to development finance. The toolkit is not introducing a new bond label or new standards, but it serves as a primer for potential ASEAN SDG bond issuance.”

Also published with the ASEAN SDG Bond Toolkit are available country supplements⁶⁴ on the legal and regulatory aspects of the ASEAN countries: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. Although not specifically addressing blended finance, these guides are good resources for structuring of private or public issuance of green, social, sustainable or sustainability-linked bonds, then supplemented with available blended finance instruments or capital stacks, such as guarantees or use of senior and subordinated tranches.

62. <https://www.theacmf.org/>

63. <https://www.theacmf.org/images/downloads/pdf/ASEAN%20SDG%20Bond%20Toolkit.pdf>

64. <https://www.theacmf.org/initiatives/sustainable-finance/asean-sdg-bond-toolkit-supplement-legal-and-regulatory-aspects-for-asean-countries>

ASEAN Catalytic Green Finance Facility

Staying with a focus on development finance, the ASEAN Catalytic Green Finance Facility (ACGF) is an ASEAN Infrastructure Fund that was launched in 2019 by ASEAN governments and ADB to finance and accelerate green infrastructure investments in Southeast Asia, and managed by ADB's Southeast Asia Green Finance Hub⁶⁵

Under the program, ASEAN governments have access to technical assistance and US\$1 billion in loans from co-financing partners, respectively to identify and prepare commercially viable green infrastructure projects and cover upfront capital investment costs. Knowledge services are provided involving training programs to strengthen regulatory environmental and build institutional capacity of ASEAN governments to scale up green infrastructure investments.

ACGF Criteria

- Sovereign or sovereign-guaranteed
- Clear environmental goals and targets
- Financial sustainability plan
- Roadmap for attracting private capital investment

Managed by ADB Southeast Asia Green Finance Hub
Knowledge partners: CBI, Global Green Growth Institute, Infrastructure Asia, OECD

Co-financing partners of ACGF as at end 2022

(Source: ADB website / ACGF webpage)

Partner	Technical assistance	Cofinancing commitment
Agence Française de Développement (AFD)	€1 million	€150 million
Asian Development Bank (ADB)	\$1.5 million	\$300 million
CDP (Italy)	€2 million	€130 million
Economic Development Cooperation Fund (EDCF) (Korea)	\$5 million	\$350 million
European Investment Bank (EIB)		€150 million
European Union (EU)	€4 million	€46 million
Foreign, Commonwealth & Development Office (FCDO) (UK)	£7 million	£100 million
Green Climate Fund (GCF)	\$20 million	\$280 million
KfW		€300 million

65. <https://www.adb.org/what-we-do/funds/asean-catalytic-green-finance-facility/overview>

Blended Impact Finance

Asian Impact Actors

Increasingly Asian impact actors and funders are entering the space, introducing a new dimension to the ecosystem. The Government of Indonesia has established and funded the Indonesia Investment Authority with the specific mandate of investing in the country's sustainable growth. Malaysia sovereign wealth fund, Khazanah Nasional, established Yayasan Hasanah in 2015 as its foundation arm for grant-making, to address community, social and environmental issues in the country, with a goal to “bring together policymakers, civil society organisations, corporations and local communities for collective impact for the people and environment”.

Separately, Dana Impak is a dedicated impact fund of Khazanah Nasional, with an allocation of Ringgit Malaysia six billion (around US\$1.2 billion) for an “Advancing Malaysia” strategy across six key themes of: Digital Society and Technology, Food and Energy Security, Decent Work and Social Mobility, Quality Health and Education for all, Building Climate Resilience and Competing in Global Markets.⁶⁶

Social enterprises?

Distinctively, Malaysia clearly refers to “social enterprises” as for-profit businesses, with an emphasis on financial sustainability, and this boosted visibility and provided support for the social enterprises start-up ecosystem. This is in contrast with other jurisdictions without such clear and concrete policy steps to define “social enterprises”, where the market may consider the term as referring to or including non-profit entities or charities. A previous three-year roadmap to develop Malaysia's social enterprises sector

under Malaysian Global Innovation & Creativity Centre involved an accreditation process to clarify the definition of “social enterprises” and possible business models together with certain accreditation criteria for recognition and certification. In 2022 a new policy for developing social entrepreneurship in Malaysia was launched – the Social Entrepreneurship Action Framework 2030 (SEMy2030). As an example of domestic blended finance within this framework, Malaysia Bank Islam runs an iTEKAD program launched in May 2020, which continues to offer and mobilise social finance instruments and social investment funds by offering structured microfinance, business and financial management training to micro-entrepreneurs and social entrepreneurs.⁶⁷

Policy Drivers & Capacity Building

The Monetary Authority of Singapore (MAS) has emphasised blended finance for net-zero transition, sending strong policy signals to banks and capital market participants in Singapore and the region. MAS and Enterprise Singapore launched Infrastructure Asia to provide technical assistance to enhance project bankability, and in December 2023, MAS entered into a blended finance partnership with ADB and the Global Energy Alliance for People and Planet (GEAPP), to mobilise capital for energy transition projects in Asia. The partnership will seek to mobilise concessional capital from the philanthropic and public sectors, de-risk projects, and crowd-in private capital from around the globe to finance energy transition projects in Asia.

Initiatives such as Temasek Trust and the Centre for Impact Investing and Practices (CIIP) in Singapore are also examples of how Asian funders and impact actors are responding to

66. <https://www.khazanah.com.my/how-we-invest/dana-impak/>

67. <https://www.bankislam.com/wp-content/uploads/MEDIA-RELEASE-BANK-ISLAM-AND-SOSEA-DRIVE-SOCIAL-ENTREPRENEUR-GROWTH-IN-SABAH.pdf>

impact policy drivers and needs. Temasek Trust⁶⁸ has the stated purpose to strive for positive impact by mobilising philanthropic assets, champion new sustainability strategies, innovate and collaborate to amplify collective impact. As part of its impact investing and ecosystem building, Temasek Trust established CIIP to foster impact investing and practices. These initiatives will play a crucial role in shaping the future of impact investing in the region by bridging the gap between existing impact enterprises and emerging social enterprises.

Indicative legal considerations in Asia

Legal vehicles

To cover key legal vehicles for blended finance in Asia, we may broadly consider legal forms or structures on the “supply side” – the impact funders or supply of capital, or on the “demand side” – the enterprises or projects receiving funding.

In the Asia common law jurisdictions, there are some similar legal entity forms, broadly the corporate form with share capital and limited liability (“CLS”) as typically adopted in setting up for-profit enterprises, and the corporate form limited by guarantee (“CLG”) typically adopted for non-profit entities.

To focus on charities and philanthropic foundations as sources of catalytic capital for blended finance in a cross border context in this Asia report, Hong Kong is unique in that:

- its charitable law and practice allows setting up of “charitable institutions or trusts of a public character” which can enjoy tax exemption upon recognition of this status by the Hong Kong Inland Revenue Department (HKIRD);
- be recognised for tax exemption status, Hong Kong applies the four accepted heads of charitable purposes under common law – (a) relief of poverty, (b) advancement of education, (c) advancement of religion, and (d) other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads; and
- while the activities under head (d) will only be regarded as charitable if they are of benefit to the Hong Kong community (funding charitable activities carried out in Hong Kong), the purposes under the first three heads may be for activities carried in any part of the world.

The CLG is the most common structure for setting up charities in Hong Kong, although the alternative is the trust structure. As a corporate form, the CLG is incorporated under and subject to the Hong Kong Companies Ordinance, including requirements on general meetings and directors of the company, and directors of CLG are similarly subject to the statutorily as well as common law duties of directors (as those discussed above for Hong Kong companies limited by shares). Besides complying with requirements of the Companies Ordinance and other requirements that may

68. <https://www.temasektrust.org.sg/>

apply to the general conduct of activities, with the tax exemption status, an approved charity will also be subject to applicable requirements or expectations of the IRD as outlined in the IRD Tax Guide for Charitable Institutions and Trusts of a Public Character. This Guide elaborates on the conditions for tax exemption if an approved charity engages in any trade or business, and among other guidance, also sets out how financial investment or programme related investment may be undertaken within the approved charitable status. These provide scope for Hong Kong charities to engage in grant funding, as well as impact investing in the financial sense, as potential sources of catalytic capital.

IRD recognised charities in Hong Kong enjoy tax exemption on income, and can raise donations issuing tax-deductible receipts to donors. With all of these features described above, Hong Kong tax-exempt charity is an attractive “demand side” and/or “supply side” structure, and the related opportunities should be further developed and leveraged through capacity building of the charitable ecosystem.

Other than IRD recognised charities, there are no other official charitable status under Hong Kong law or charities commission, although quite often corporations as well as ultra-high-net-worth families do establish non-profit entities or structures for charitable purposes, which do not have the said tax benefits and are not subject to the corresponding legal or compliance requirements. While “foundation” is not a legal form available in Hong Kong (also not in Singapore nor Malaysia, for example), these are often referred to as corporate or family foundations, which are increasingly interested in

impact investing and becoming important impact actors and providers of catalytic capital.

For “supply side” legal vehicles, the growth of impact investing in Asia has spurred the set-up of impact funds by Asia investment managers or investors as fund sponsors or promoters, and which may involve the use of fund vehicles in Asia as a pooling vehicle for capital aggregation or a platform for asset management and allocation. Hong Kong and Singapore are both fund management centres and wealth management centres, offering suitable legal vehicles for these purposes. Both are common law jurisdictions where the trust structure has been around and available, and has seen the use of trusts arrangement in private wealth planning as well as corporate or commercial purposes, including unit trusts for funds, whereas in recent years there are specific legislation introduced for new types of legal vehicles for funds.

There are similarities between the Hong Kong OFC and Singapore VCC structures, both largely modelled after the Cayman exempted company and segregated portfolio company structures which have been most popular before these Asia domiciled structures were introduced. The Hong Kong OFC and the Singapore VCC respectively require there to be a Hong Kong licensed manager (regulated by the Hong Kong Securities & Futures Commission) and a Singapore licensed manager (regulated by the Monetary Authority of Singapore) to be appointed and responsible as investment manager. Each of the OFC and the VCC may adopt the structure as a “stand-alone” fund or as an “umbrella fund” structure with multiple sub-funds each sub-fund afforded with segregated assets and liabilities

under the applicable legislation. Generally, both OFC and VCC (as the names suggest) are suitable for “open-ended” funds or funds having “variable capital”, intended for investments in liquid assets or allowing regular subscriptions and redemptions of fund interests. However, they can be (and not uncommon) adopted for “closed-end” funds investing in less liquid assets such as private equity, private credit, or other assets not frequently traded.

Other than the OFC, in recent years Hong Kong has also introduced the LPF structure, modelled after the Cayman exempted limited partnership structure, usually adopted for closed-end funds, including private equity real estate investments or infrastructure funds. A fund sponsor may incorporate a general partner and establish an LPF, with investors committing capital or investing as limited partners (liability of each limited partner typically limited to the amount of capital committed or invested), while the general partner bears general liability and is responsible for the management and operations of the LPF. The general partner of a Hong Kong LPF should appoint an investment manager to manage the investments of the LPF and this is usually a Hong Kong licensed investment manager.

Tax

As noted above, Hong Kong IRD approved charities enjoy tax exemption on income, which may be income from conducting a trade or business, or engaging in financial investment or programme related investment, subject to meeting applicable conditions or requirements. Further, charities approved under the heads of charitable purposes of relief of poverty or advancement of education or religion may fund charitable activities

of these purposes anywhere in the world.

However, Hong Kong tax law or framework does not specifically refer to Hong Kong approved charities as a structure for blended finance and impact investment or offer tax incentives specifically for these purposes. In comparison, in 2023, Singapore has specifically introduced tax incentives to promote blended finance and climate-related investments. Under the tax incentives for single family offices, applying under Section 13O or Section 13U of the Income Tax Act, there are corresponding requirements on minimum asset-under-management (AUM), qualified investment professionals and minimal local business spending, and also a minimum capital deployment requirement (CDR) of at least 10% of AUM or S\$10 million (whichever is lower). Subject to certain threshold conditions, the required local business spending may be met by donations to Singapore registered charities, exempt charities or institutions of public character, or grants to blended finance structures with substantial involvement of financial institutions in Singapore, the latter with an additional benefit of applying a 2x multiplier.

For the CDR, investments may be in blended finance structures or climate-related investments, among other designated investments. While internationally recognised understanding or definition of climate-related investments and blended finance are acceptable, the former referring to investments into activities defined within the green or transition categories under the Singapore-Asia Taxonomy or other internationally recognised definitions of taxonomies, and the latter may be definitions outlined by the OECD Blended Finance Principles Guidance. An

attestation issued by a prescribed professional body, such as a qualified Singapore lawyer is required. Blended finance investments can be accounted with the following multiplier in meeting the CRD, when structured with substantial involvement of financial institutions in Singapore:

- 2x multiplier for deeply concessional capital – where the capital (i) has zero income earned on the investment; or (ii) bears first loss before any other equity and earns lower return than any other equity or debt;⁶⁹
- 1.5x multiplier for concessional capital – where the financier accepts a lower rate of return or higher risk than that which the borrower ordinarily has to offer to financiers seeking commercial risk-adjusted rate of return.

For both section 13O and section 13U incentives, the single family office would establish a fund which must be managed or advised by a fund management company in Singapore which must hold a capital markets service licence or be exempt from the requirement to hold such a licence. It is quite common that the fund adopts a Singapore VCC structure.

Further development

Overall, blended finance is relatively nascent although some foundations have been laid as outlined above in terms of development frameworks, impact actors, supportive regulatory policies or tax incentives. There needs to be first a growing acceptance and broader practice of impact investing, within the realm of development finance but also beyond, to attract more interest and participation of private capital. Otherwise, it

risks remaining in the purview of public finance or philanthropy to deliver social or environmental outcomes, while the private sector might largely remain profit driven. This further underscores the key role of catalytic capital to accelerate impact, which would be instrumental alongside various efforts towards capacity building in an expanded impact ecosystem. The recent global report, “Accelerating Impact: Catalytic Capital in Asia-Pacific, Latin America, Africa and Europe” jointly produced by AVPN, Latimpacto, AVPA and Impact Europe, supported by Catalytic Capital Consortium, defines catalytic capital as debt, equity, guarantees and other investments that accept disproportionate risk and/or concessionary returns relative to a conventional investment to generate positive impact and enable third party investment that otherwise would not be possible. The establishment of the National Advisory Boards (NABs) in Thailand and Malaysia, being the first two ASEAN countries to join the list of jurisdictions with NABs of the Global Steering Group for Impact Investment (GSG) should, as GSG’s core mission, catalyse impact investment and entrepreneurship, serving to galvanise local stakeholders and align impact focus. Such private sector initiatives and private impact actors are important and necessary to fill the gaps of public financing and to supplement or respond to policy initiatives for impact finance or blended finance.

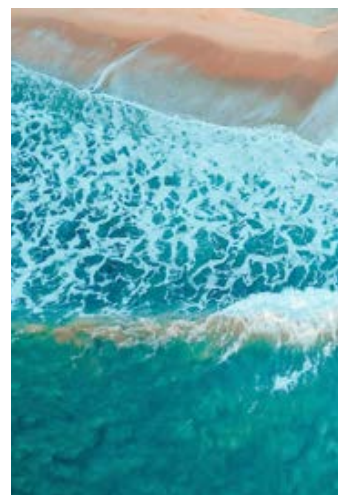
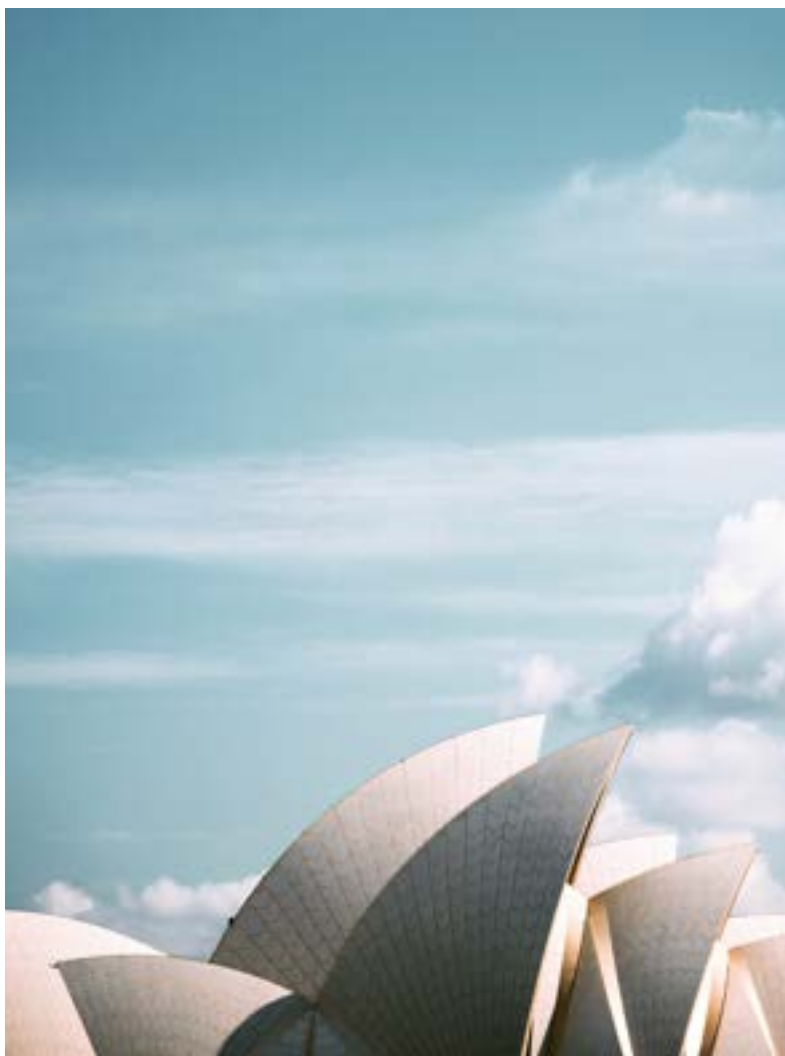
Author:

Vivien Teu

Law Firm:

Dentons Hong Kong

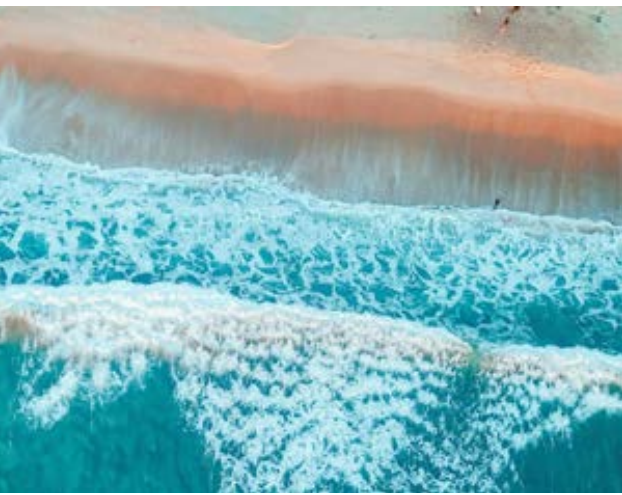
69. Investments in equities listed on MAS-approved exchanges, ETFs with primary mandates to invest in Singapore listed equities on MAS-approved exchanges, non-listed fund distributed in Singapore primarily investing in Singapore-listed equities on MAS-approved exchanges also qualify for 2x multiplier. For further details on section 13O and Section 13U tax incentives, refer to this publication of Dentons Singapore, other than the summary contained in this analysis: <https://dentons.rodryk.com/en/insights/alerts/2023/july/17/updated-conditions-for-single-family-offices-applying-for-the-13o-and-13u-tax-incentives>



Australia

The legal framework for blended finance in Australia

Blended finance in Australia is supported and regulated by the broad spectrum of commercial law that applies generally to finance in Australia. This is then supplemented by public and charitable law, as relevant to the sources of funding. This means that blended finance draws on many areas of Australian law including laws relating to contract, corporations, partnerships, trusts, charities, funds management, financial advice, taxation and public administration.



In broad terms Australia's Commonwealth Parliament has defined heads of power, its legislation overrides State legislation to the extent of any inconsistency, and at both levels legislation overrides case law to the extent of any inconsistency.

The Australian legal framework for blended finance comprises a mix of legislation – particularly for types of legal vehicles, taxation, disclosure and licensing regimes, and public finance – and case law – notably on financing terms, governance and fiduciary principles. Where there is legislation involved it tends to be at the Commonwealth level.

In broad terms the Commonwealth government provides support for blended development finance projects outside Australia and the State governments support domestic blended impact finance projects.

Blended finance raises many of the same legal issues that arise in Australia when establishing an investment fund or structuring a multi-lender or project financing. It adds extra considerations for legal issues relating to charitable investing and charitable grants and to government grants and programs. In many cases it draws on legal techniques that are being developed for impact investing, including impact integrity and governance.

The legal framework is for the most part common to both development finance and impact finance as the Australian government has largely pursued blended development finance through standard commercial vehicles and instruments. However, development finance ultimately depends on laws on public finance and administration that do not apply to impact finance.

Blended development finance

Australia's government contribution to development finance is managed by the Commonwealth Government's Department of Foreign Affairs and Trade (DFAT). Trade and commerce with other countries is a Commonwealth head of power. Australia's Commonwealth Government policy supports using blended development finance.

DFAT is working to scale up Australia's blended finance portfolio to drive greater mobilisation of private finance towards development, climate, and gender equality outcomes in the region.

The Australian legal system

Australia is a common law jurisdiction in the Anglo-American family of jurisprudence. Australia comprises a federation of six States and two Territories. Legally, the national federation is called the Commonwealth of Australia. Law in Australia derives from two main sources:

- Commonwealth and State legislation (ie Acts of Parliament) and the regulations issued under them; and
- case law – judicial decisions on disputes before the courts, including decisions on the interpretation of legislation and regulations.

Australia has not established a development bank or similar DFI with a mandate to provide development finance or to lead or coordinate Australian blended finance projects. Instead it relies on other mechanisms including⁷⁰:

- a A\$250 million government impact investment fund called Australian Development Investments (ADI) – previously known as the Emerging Markets Impact Investment Fund (EMIIF)
- co-ownership and financing of Private Infrastructure Development Group (PIDG) an infrastructure project developer and investor mobilising private investment in sustainable and inclusive infrastructure
- Australian Climate Finance Partnership which is an A\$140 million concessional financing facility managed by Asian Development Bank (ADB)
- a 3 year partnership with Convergence to provide technical support for scaling up Australia's blended finance in the region
- the Business Partnerships Platform (BPP) managed by the Palladium group which supports direct partnerships between the Australian government and inclusive and sustainable businesses.

“DFAT is working to scale up Australia’s blended finance portfolio to drive greater mobilisation of private finance towards development, climate, and gender equality outcomes in the region.”

Development Finance Fund

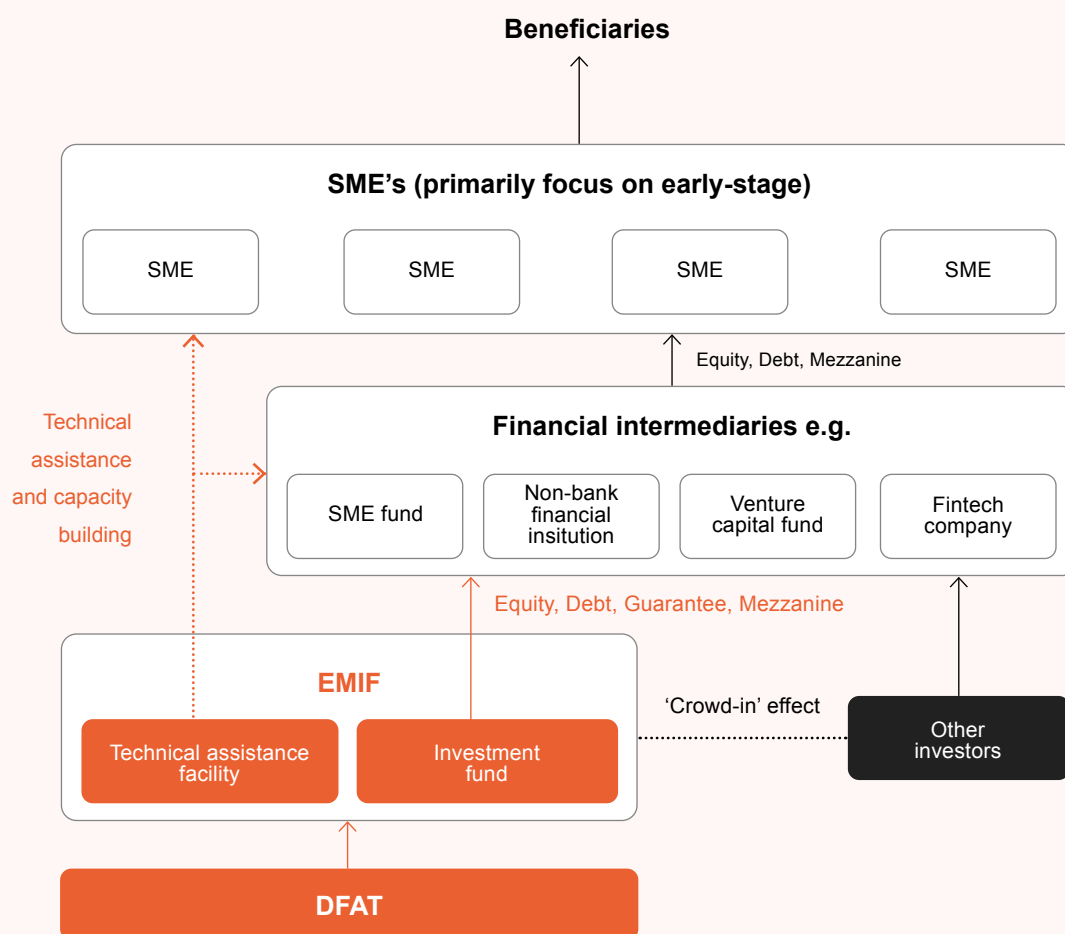
The ADI/EMIIF Fund illustrates how blended finance in Australia can employ a mix of general trust law and public administration governance mechanisms.

The Fund operates as a fund of funds providing investment capital and technical assistance to venture and early-stage capital funds, private debt funds, and non-bank financial institutions (SME funds) that support SMEs to grow in South Asia, Southeast Asia and the Pacific.

⁷⁰. <https://www.dfat.gov.au/development/topics/development-issues/blended-finance>



EMIIF's fund of funds approach



It seeks to catalyse other impact investors, including gender lens investors. The blending occurs primarily by crowding in private investors into supporting the financial intermediaries. There is scope also for blending financial support at the level at which the financial intermediaries support the target SMEs.

The diagram⁷¹ above illustrates its structure.

- Legally, the Fund was established as an un-unitised trust⁷². Trusts are commonly used as commercial investment vehicles in Australia, although usually in unitised form. The Commonwealth of Australia represented by DFAT is the sole beneficiary. The Fund

is domiciled in Australia for Australian tax transparency (i.e. it does not have special tax treatment).

- The Fund was structured to incorporate external professional management within public administration governance requirements. The structure includes an independent trustee to hold the Fund assets and an external specialist investment manager. There are various committees and advisory mechanisms to enable flexible day-to-day management subject to DFAT oversight for alignment with the department's policy and strategic direction.

71. <https://emiif.fund/about/>

72. <https://www.dfat.gov.au/sites/default/files/emiif-draft-design-for-likely-procurement-october-2017.pdf>

Blended impact finance

The legal framework for blended impact finance in Australia reflects two different drivers working in parallel – the finance sector responding to climate change and environmental expectations of investors, and the social enterprise sector looking for new or enhanced sources of funding.

For blended finance this has led to a focus on:

- establishing investment funds to further an impact mandate
- social impact bonds
- parallel or syndicated loan facilities
- structuring hybrid legal vehicles

For legal analysis, each of these areas builds on established commercial law platforms and then adds and adjusts the structuring and terms to facilitate the objectives and requirements of the different philanthropic and government sources of the blended financing.

The primary issue for philanthropic funders is ensuring that the structure and terms comply with their constitutional requirements – particularly to ensure that the proposed investment or grant falls within their charitable purposes – and complies with their charitable registration and tax status. The government contribution largely takes three forms:

- funding from agencies established to support private sector investment in a target area (eg Clean Energy Finance Corporation – Australia’s “Green Bank”⁷³)
- government procurement contracts structured to support blended finance (eg SIBs)

“For legal analysis, each of [the Australian blended finance structures] builds on established commercial law platforms and then adds and adjusts the structuring and terms to facilitate the objectives and requirements of the different philanthropic and government sources of the blended financing ”

- targeted tax relief or other government credit support (eg for housing⁷⁴)

From a legal perspective this involves consideration of areas such as public finance authorities, contract terms, tax criteria and related regulatory requirements.

73. <https://www.cefc.com.au/about-our-finance/>

74. See case study – [CIM Housing](#)

Indicative legal considerations

There are some legal aspects that typically need to be considered in most blended finance projects in Australia.

Fiduciary duties

Australia's business and investment law framework continues to be defined by the divide between for-profit and not-for-profit entities, and underpinned by the principles of shareholder capitalism and modern portfolio theory.

This means that the traditional view has been that the duty of directors to act in the best interests of the corporation (in the case of for-profit corporations) means to act in the best financial interests of the shareholders. This limits their ability to consider or pursue impact objectives. While there has not been any relevant statutory reform of directors' duties, the legal debate has shifted over the last few years. It is now generally accepted that directors should take into account stakeholder interests – including employees, customers, suppliers, creditors, Traditional Owners, the environment and broader community – as part of their consideration of the long-term interests of the corporation, including its interest in avoiding reputational harm⁷⁵.

The fiduciary duty framework for institutional investors has statutory overlays which emphasise financial returns but there is regulatory recognition that investments can be selected for their sustainability impact so long as they offer an appropriate risk adjusted return⁷⁶.

Legal vehicles

The legal vehicles primarily used in blended finance structuring in Australia are:

- **corporations established under the Commonwealth Corporations Act** – which includes both for profit corporations limited by shares and not-for-profit corporations limited by guarantee,
- **unit trusts** – these are commonly used as commercial legal vehicles in Australia for investment funds, and
- **charitable trusts** – charities in Australia are commonly established as incorporated associations, charitable trusts or companies limited by guarantee.

Australia does not have a Benefit Corporation of the kind available in US jurisdictions nor a Community Interest Corporation of the kind available in England. Over the last 10 years there have been several unsuccessful attempts to lobby for the introduction of a vehicle of that kind. This means that for blended finance projects lawyers are involved in tailoring existing legal structures to embed “for purpose” requirements and governance arrangements that support the project's objectives and enable the enterprise to raise suitably aligned capital.

There are other legal vehicles available in Australia, including partnerships and a range of Alternative Ownership Enterprise Models such as cooperatives, mutuals and employee ownership trusts. These are being explored for their potential in blended finance structures.

75. <https://www.aicd.com.au/board-of-directors/duties/liabilities-of-directors/directors-best-interests-duty-in-practice.html>

76. <https://www.apra.gov.au/sites/default/files/prudential-practice-guide-spg-530-investment-governance.pdf>, paras 34-36

Tax

Registered charities enjoy various levels of tax relief from both Commonwealth and State taxes and duties. This relief is subject to compliance with registration and other tax requirements. Blended finance projects commonly need to be structured to ensure that the tax status of charitable investors is not adversely affected. There is no social impact-specific tax relief available in Australia. However, particular projects may attract specific tax or government credit support and need to be structured to satisfy those requirements.

Financial products and dealings

Australia's securities and financial services laws regulate both financial products and dealings. This is particularly relevant for blended investment funds which can attract registration, licensing and disclosure regulation as managed investment schemes.

For this reason, to date most blended investment funds in Australia have been structured as wholesale funds with strictly controlled distribution.

Financial terms

Much of the design of a blended finance project is reflected in the financial and other contractual terms of the vehicle or transaction. Australian contract law is based on the principle of freedom of contract which allows much flexibility in the development of blended finance.

As yet there are no standard terms or contracts for blended finance transactions. However, as most blended finance projects are built on well-established corporate and financial structures

and contracts, they can draw on a body of market practice. In addition, in some specific areas (i.e. social impact bonds) a common form of blended finance structure is accepted in the market.

Regulatory factors

Australia has a well-developed body of environmental and business regulation. Each blended finance project needs to be analysed for its regulatory implications which will vary depending on the sector and circumstances of the project.

International regulation and industry codes, like the EU Sustainable Finance Taxonomy and the UK Stewardship Code, are major drivers of the finance sector in Australia and, as a result, define much of the legal framework for implementation of sustainability expectations in Australia.

They are now starting to intersect with Australia's corporate and competition regulation as benchmarks for identifying market issues such as greenwashing. This may amplify their legal effect in Australia⁷⁷.

Further development

Blended finance is at a relatively early stage of development in Australia. There is considerable scope for legal innovation and for law reform to better support blended finance projects.

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77. <https://www.accc.gov.au/media-release/accc-internet-sweeps-target-greenwashing-fake-online-reviews>



France

The legal framework for blended finance in France

France has been one of the pioneers of continental Europe, along with Belgium, in promoting blended finance. Mutual Insurance companies and other innovative legal solutions for promoting blended finance have existed in France for more than 200 years. One could say that blended finance emerged in its earliest forms through “finance solidaire” in the 1980’s and has evolved into more complex and innovative models. The blended finance model now includes so-called “90/10 funds” (where 90% of the fund is invested in liquid assets to protect against illiquidity in the fund, and the remaining 10% is invested in social impactful projects), social and solidarity financing (CCFD- SIDI is one of the oldest worldwide investors in microfinance and fair trade), impact investing and “cigales” (cooperative structures).



In the 2000s, several regulations have reinforced the promotion of the impact investing sector (art. 173 of the law on energy transition in 2015, Loi Pacte in 2019). These regulations oblige insurers and banks to include impact investing products (“fonds d’épargne solidaires”, SRI funds and green funds)

France has promoted the introduction of new labels into the blended finance taxonomy such as “Finansol” a label for solidarity-based finance. The French Ministries have also recently created two new labels: “ISR” for responsible investment, and “Greenfin” for green investment. A more recent update for blended finance has been the introduction of a social impact bond model in 2016 by Martine Pinville, then Secretary of State in charge of social and solidarity economy in France. Since then, other initiatives were implemented by the French Government and grassroots organisations to promote collaboration between public and private entities in order to financially support high social and environmental impact projects. However, traditional legal and

tax regulations remain an important barrier for blended finance to fully take its place as a cost-efficient and innovative solution for financing impact projects.

France legal system

France is a civil law jurisdiction based on the Napoleonic code. The main sources are laws (legislative), whether domestic, European or international are : regulations (executive), case law (jurisprudence), and legal theory and commentaries (doctrine), and the tax administration guidelines. Unlike common law jurisdictions, courts do not have to follow previous case law or decisions made by the court unless the decision comes from the highest court (cour de cassation).

Blended finance in France

1. Development finance

Development financing has existed in France for many years. The main actors are : AFD (Agence Française de Développement), one of its subsidiaries the French Development Finance Institution (Proparco), complemented by the involvement of CDC (Caisse des Dépôts et Consignations– national public bank) on some ad hoc projects particularly in the Mediterranean region. In June 2023, France gathered more than 300 high-level participants, heads of state and government, international organisations, representatives of civil society and the private sector, to lay the groundwork for a renewed financial system suited to fighting inequalities, climate change, and protecting biodiversity. Multiple laws have been passed to support initiatives around climate change (loi climat et résilience), social sector, zero waste, CSR and anti-greenwashing.

2. Blended impact finance

Blended Impact Finance is at the heart of the financing of non-profit organisations as well as limited profit structures (such as cooperative companies, etc.). Main instruments consist of:

- **Social impact bonds (non-profit organisations):** subscribed by private investors – if indicators are met, the government pays the organisation which in turn pays back the investors. If indicators are not met, payment to investors is capped, and if part of the indicators are met, payments are in proportion to specific metrics (see case study).
- **Hybrid ecosystems (combination of non-profit vehicle and commercial company):**

“In France Blended Impact Finance is at the heart of the financing of non-profit organisations as well as limited profit structures (such as cooperative companies, etc.)”

Provided certain conditions are met French law allows non-profit organisations to benefit from uncapped subsidies and the ability to provide donors with tax receipts (allowing them to benefit from a tax reduction of the amount of their grant) (the “**Tax Regime**”).

- Eligible non-profit organisations, in order to increase their resources and not limit their financing to grants and public subsidies, often establish a commercial company entity which is in charge of running the commercial activities (and are externalised from the non-profit in order to secure its eligibility to the Tax Regime. Therefore, many ecosystems combine public financing (uncapped subsidies for the non-profit) and private financing (commercial activities of the company, which often raises funds from private investors (individuals, venture capital, impact funds etc).
- **Hybrid financing:** non-profit organisations with an economic activity (therefore not eligible to the Tax Regime, but able to benefit from capped public subsidies) can issue “**non-profit bonds**”, with a capped interest rate, subscribed by individuals, institutional investors, venture capital impact funds etc

The legal framework for blended finance in France

- Investment in collective interest cooperative company (SCIC): this **specific form of company allows public persons to invest in equity** and acquire shares of the SCIC, as an exception to the prohibition of investment of public persons in commercial companies.
- **Solidarity Financing (finance solidaire):** These interesting financial mechanisms allow for a lower rate of return in order to promote higher impact.
- **Several asset managers:** either global (Mirova, AMundi) or specialised (Investisseurs & Partenaires) are using blended finance funds to finance private equity in Africa (Investisseurs & Partenaires, Ring Capital), clean energy financing (Mirova), energy transition (Amundi), sustainable agriculture (Mirova, Danone Community fund) and ocean protection (Mirova etc)

Blended finance in France covers diverse sectors of activity: A non-exhaustive list includes, social sector (fragile populations, whether mentally and psychologically or economically, with difficulties of integration) promotion of the environment and fight against global warming (reduction of wastes, quality food and short-distance products, sustainable agriculture) and education. Relevant areas of the law: charity law (impact bonds, hybrid ecosystems, hybrid financing), tax law and tax administration guidelines (Tax Regime), corporate law (hybrid ecosystems, SCIC), finance law (impact bonds, non-profit bonds).

Indicative legal considerations in France

3. Fiduciary duties

French Law relating to companies' and directors' duties and liabilities has evolved drastically since the turn of the century:

- **Social responsibility of companies**, defined as the voluntary integration by companies of social and environmental concerns into their commercial activities and their relations with stakeholders, has moved from a voluntary approach into a regulated responsibility. A 2019 statute (loi Pacte) has integrated in the French civil code an obligation for all companies (regardless of size, legal regime, or activity) to take social and environmental factors into account in the management of the company (sect. 1833 of the French Civil code).

This same statute has created the possibility for a company to integrate a purpose (**raison d'être**) within their articles of association. Directors can be held liable if their management of the company results in a violation of the *raison d'être* or a failure to take social and environmental factors into account provided that a fault, a causal link and a damage is found. Even though the application of this law makes it difficult for directors to be sued, this does set the tone for future legislation towards a higher duty of responsibility for directors.

This statute also created the "**Mission Company**" (Société à Mission), a type of company that must pursue a social and environmental mission resulting from its

purpose or *raison d'être*. A higher standard of duty is imposed on directors of mission-driven companies as they are now responsible to execute and pursue the social and environmental objectives set forth in the company's articles of association.

Last but not least, commercial companies can choose to adopt the “**Social and Solidarity Economy Company**” status (**Entreprise de l'économie sociale et solidaire-EESS**), or the accreditation as a “Solidarity Company” (**Entreprise solidaire d'utilité sociale, ESUS**) which requires the pursuit of a social utility, strict governance principles, and financial obligations (for example, 50% of the profits must remain in the company). Failing to fulfil these conditions may be considered as a breach of a director's fiduciary duty if a causal link and damage can be found.

- **Extra-financial reporting obligations** (set up in 2001, strengthened in 2007, 2010 and 2017 (following a European directive): large companies are required to communicate on the social, environmental and societal implications of their activities, as well as on their mode of governance. Directors may be held liable for failure to comply with such obligations.
- **Duty of care (*devoir de vigilance*)**: (set up in 2017); A duty of care is applicable to French companies with 5,000 or more employees and foreign companies with 10,000 or more employees. Companies that fall within these thresholds are required to prevent social, environmental and governance risks relating to their activity. A draft European directive strengthens this duty and extends it (500 employees, €150M revenues). Directors and

companies are liable for violations of this duty of care.

- **Anti-greenwashing statute (*loi Climat et résilience 2021*)**: holds companies (including directors) liable for misleading consumers to believe a product is carbon neutral or has a positive impact on the planet without any legal or regulatory proof.

4. Legal vehicles

The main legal vehicles used in blended finance are:

- The “**Association**” (governed by a 1901 statute, *association loi 1901*): non-profit organisation, concerned by social impact bond, hybrid ecosystems and hybrid financing;
- **Collective interest cooperative company (SCIC)**: preferred commercial company for blended finance, as public investors are authorised to invest in equity. Limited profit company (57,5% of the profit must remain in the company, very limited added value on the shares), with strict governance principles (organisation in colleges, no college being allowed to hold more than 50% of the capital);
- **Commercial companies/hybrid models**: their involvement in blended finance is only through hybrid ecosystems, where they are in charge of the commercial activities (private financing), an association (or other non-profit such as an endowment fund) being in charge of the non-lucrative activities (public and private financing). These commercial companies can transform into mission-driven companies “*société à mission*” or “*bcorp*” or “*entreprise solidaire d'utilité sociale*” (“*ESUS*”)

- **Fonds de dotation / Foundation:** allows investments through non-profit vehicles, and collaboration between funds, foundations, donors and investors. This has become the entity of choice for more innovative, complex legal structuring for blended finance.
- **Shareholder Foundations** (fondations actionnaires) : a law creating « fonds de pérennité » was also created in 2019 to encourage companies to donate their shares to foundations in order to transfer wealth to foundations and to encourage blended finance
- **ESUS / EESS:** label for all legal forms in order to promote limitation of distribution of dividends, stakeholder ownership and purpose-driven activities
- **Alternative investment fund:** the French Asset managers are offering Alternative investments funds either French (FCPR for private equity for instance) or Luxembourg (RAIF for private debts) under the EU passporting regime.

5. Tax

The key tax consideration is the eligibility of non-profit organisations to the Tax Regime which entitles to uncapped subsidies, tax exoneration and ability to provide donors with tax receipts allowing them in turn to benefit from a tax reduction.

Another key consideration, which does not concern tax law per se, is the cap of public subsidies for commercial companies and non-profit organisations not eligible to the Tax Regime: public subsidies are considered State Aids in European law, meaning that one entity cannot only receive a certain amount of subsidies (European law provides for a general regime, as well as exemptions for certain sectors, and rules on accumulation).

Finally, it should be noted that an incentive mechanism exists for investments by individuals in Solidarity Companies (tax reduction).

“France has been one of the pioneers of continental Europe, along with Belgium, in promoting blended finance.”

6. Financial products and dealings

- **French Financial Securities Law:** Monetary and Financial Code (Code monétaire et financier) applicable to issuance and trading of securities, including bonds issued by non-profit organisations (association loi 1901) and shares issued by social enterprises. Issuance to the public over € 8m are subject to specific disclosure obligations, including the preparation of a prospectus approved by the French Financial Markets Authority (Autorité des marchés financiers, AMF).
- **AMF Regulations:** The AMF is the French financial markets regulator. Its general regulations include requirements on licensing, conduct of business rules, and periodic reporting obligations to ensure transparency and protect investors. One recent doctrine published by the AMF in 2020 (“Doctrine AMF DOC-2020-03”) introduces the minimal standards for extra financial communication by asset managers with 3 different levels of communication possible (extended, limited, reduced) aligned with the effective sustainable investment strategy of the fund
- **Prospectus Regulation** (Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market) requires the publication of a prospectus, unless specific exemptions apply. The prospectus must contain detailed information about the issuer and the offered securities to ensure investors are well-informed.
- **AIFMD:** The Alternative Investment Fund Managers Directive (AIFMD) to managers of alternative investment funds based in the EU.
- **MiFID II:** The Markets in Financial Instruments Directive II (MiFID II) and MiFIR applicable to entities providing investment services related to the securities.
- **Corporate Sustainability Reporting Directive (CSRD)** transposed in France in December of 2023, provides for a detailed disclosure of environmental and social impacts, which can influence investment decisions and project implementation.
- **Climate and governance laws** such as the law “Pacte” in 2019, “loi climat” with a full set of rules that encourages the development of responsible investors (for instance the obligation for insurers to offer to their clients at least one solidarity fund, one SRI label fund and one Greenfin fund) and that obliges all French enterprises to integrate sustainable risks into the management of their activities.

7. Financial terms

Standard financial terms and common market practices vary depending on the nature of the project, the types of investors involved, and the goals of the financing.

- **Grants and Subsidies** provided by public or philanthropic institutions funds will require the project to meet specific impact requirements (including employment rates, inclusion and diversity, decarbonation).
- **Equity Participation:** Equity investments in social projects provided by impact investment firms

The legal framework for blended finance in France

- **Quasi-Equity Participation:** include convertible bonds and cooperative participating bonds (issued by cooperatives).
- **Debt Financing:**
 - a. **Blended Finance Funds:** pool different sources of capital to invest in projects or enterprises that align with sustainable development goals. The terms of debt within these funds can vary, including interest rates, maturity, and repayment structures.
 - b. **Green Bonds:** Issuance of bonds dedicated to financing projects with environmental benefits, with the terms reflecting the specific project's risk and return profile. The rates is increased where the issuer meets its impact requirements
 - c. **Social Impact Bonds:** bonds issued by social enterprises or association to private investors that are reimbursed (with premium) by public entities upon social outcomes successfully achieved.
- **Guarantees:** Public entities may offer guarantees to cover certain risks or loans encouraging private investors to participate.



Investors and Public entities will require :

- **Impact Assessment** to ensure the project meets financial viability and impact goals.
- **Reporting:** on financial performance and social/environmental impact aligned with agreed standards, for example aligning with global initiatives like the UN Global Compact.
- **Collaboration among Stakeholders:** in specific committee (involve collaboration between governments, NGOs, and private investors)
- **Adherence to ESG Standards:** Environmental, Social, and Governance (ESG) criteria are increasingly important, with investors seeking to ensure that their investments align with these standards.

Common terms include lower financing rates, governance participation, liquidation preference, anti-dilution provisions, vesting schedules for founders in equity financing, Key Impact Performance Indicators

8. Regulatory factors

Key regulations include;

1. **Corporate Sustainability Reporting Directive (CSRD):** see above
2. **Taxonomy Regulation:** The EU's Taxonomy Regulation provides criteria for environmental sustainability, as a guide to the allocation of investments towards green projects.
3. **Anti-Money Laundering (AML) and Know Your Customer (KYC) Regulations**
4. **EU Sustainable Finance Disclosure Regulation (SFDR)**
5. **The French Energy Transition Law** (includes provisions for mandatory climate reporting for institutional investors and asset managers)
6. **“Loi relative à la lutte contre le gaspillage et à l'économie circulaire”** (Loi AGECC) “Law on the Fight Against Waste and the Circular Economy.” aims to significantly reduce waste and promote a transition towards a circular economy across various sectors of the French economy; and
7. **Extra-territorial Impacts of Overseas Regulations:** certain market participants operate outside of the EU and may require projects in France to comply with U.S. regulations such as the Foreign Account Tax Compliance Act (FATCA) or the UK's Bribery Act.

Further development

France is facing a global reduction of the amount of public subsidies granted to non-profit organisations (as well as companies).

This state of affairs has led a growing number of non-profit organisations to engage into an evolution of their economic model, and the development of more commercial activities. Therefore, in order to secure the eligibility to the Tax Regime of the concerned non-profit organisations, there has been an increase in the setting up of hybrid ecosystems, with the commercial subsidiary compensating the lack of public support.

The main blended finance instrument in France is a social impact bond. Since their introduction in France in 2016, Social Impact Bonds (SIBs) have attracted growing interest as an innovative financing mechanism for social and environmental initiatives. SIBs are praised for bringing together public players, private investors, and social project owners with a common objective of achieving a measurable and significant social impact.

SIBs diverge from the traditional approach to financing social projects by focusing on savings achieved rather than financial performance, thus creating a direct link between the investment and its social impact. It encourages more efficient use of resources and promotes innovation in solving complex social problems.

French projects vary in size and scope, some targeting specific local issues, while others are

The legal framework for blended finance in France

broader in scope, aiming to address national challenges. In 2020 and 2021, the Government launched a call for projects and selected 15 projects for a total of 46.5 million euros. SIBs in France have addressed a variety of social sectors and issues. Notable examples include:

- **Professional integration and employment:** Several SIBs have been designed to facilitate the professional integration of disadvantaged groups, including unemployed young people, migrants and people leaving prison. These projects aim to provide tailored vocational training, personalised coaching and job search support.
- **Health and social well-being:** Initiatives focusing on mental health, recidivism prevention and support for people suffering from chronic illnesses have been set up. These projects aim to provide adapted care and support, thereby improving the quality of life of beneficiaries and reducing costs for public health systems.
- **Education and training:** Some SIBs target the education sector, particularly with regard to reducing school drop-out rates and improving access to education for marginalised populations.
- **Social housing and inclusion:** Projects aimed at providing affordable housing and promoting the social inclusion of people who are homeless or in precarious situations have also been developed.



SIBs attract a diverse range of investors and project owners:

- **Investors:** Investors in French SIBs include banks, impact investment funds, philanthropic foundations and public sector players.
- **Project owners** are organisations from the social economy sector, associations or social enterprises.

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Japan

The legal framework for blended finance in Japan

Blended finance in Japan is supported by the broad spectrum of the Civil Code and Companies Act that apply generally to finance transactions in Japan. Such transactions are then regulated by the Financial Instruments and Exchange Act, or Money Lending Business Act, as relevant to the way of raising funds. Also, if a specific type of partnership is used to raise the fund, the specified legislation to regulate such a partnership applies.



applied to blended finance transactions so that fund raising is conducted in an appropriate way. All these codes and acts are legislated by the government.

Blended finance in Japan

1. Development finance

In the context of development finance, the Japan International Cooperation Agency (“JICA”), a governmental agency, is the leading player in blended finance. JICA is tasked with assisting economic and social growth in developing countries and promoting international cooperation. JICA also invests in funds aiming to aid developing countries in such areas as Asia, South America, and so on. The invested sectors are varied across energy, finance, agriculture, and water, and they conduct gender lens investing as well. The form of investment varies from case to case, such as debt or equity. They also extend technical assistance in some cases. The majority of JICA’s blended finance experience has been through overseas investments and loans, either project finance-type loans or investments in funds. JICA has mainly used overseas investment and loans as a financial assistance tool in cooperation with the private sector. In terms of loans for individual projects, overseas investments and loans can offer more favourable terms and conditions than commercial financial institutions and are considered to have contributed to the mobilisation of commercial funds by improving the profitability of projects and thereby improving their risk-return profile. We will showcase one of the cases that JICA is involved in in the coming Case Study part.

This means that blended finance draws on many areas of Japanese law, including laws relating to contracts, corporations, partnerships, trusts, fund management, and financial advice. However, blended finance generally raises many of the same legal issues that arise in Japan when establishing an investment fund or structuring a multi-lender or project financing.

The legal framework is, for the most part, common to both development finance and impact finance. However, development finance ultimately depends on public organisations, which does not necessarily apply to impact finance.

Japanese legal system

Japan is a civil law jurisdiction, and national legislation is applied uniformly throughout Japan. The source of Japanese law derives solely from national legislation. Cases like judicial decisions on disputes before the courts are used just to interpret a requirement of legislation and regulations.

For financial transactions, the Civil Code is the most general law to underpin the transaction. There are some specific laws, such as the Commercial Code and the Companies Act, that apply to business transactions, including blended finance. Also, some regulatory legislation, such as the Financial Instruments and Exchange Act or the Money Lending Business Act, shall be

2. Blended impact finance

Compared with the cases in development finance, the number of cases using blended finance schemes in areas other than development finance is not large. However, there are some cases of deploying blended finance capital, for example, to invest in companies in foreign countries, foster green energy, and cope with climate change by implementing renewable energy power generation. In that sense, it is difficult to generally clarify the sector or geographical area where the capital raised through blended finance is deployed. However, it is notable that there is a case employing blended finance in the context of social impact bonds, which will be showcased in the case study part.

The players in this area are mostly private actors who try to seek market rates in general. However, the public sector can be a player since there are cases where they grant money as subsidies to that business, and we can evaluate such subsidy-commingled cases as blended finance, as such an asset plays a role as a concessional asset.

“In Japan the players in this area are mostly private actors who try to seek market rates ... However, the public sector can be a player since there are cases where they grant money as subsidies... playing a role as a concessional asset.”

Indicative legal considerations in Japan

3. Fiduciary duties

In general, a director of a company owes the duty of care to the company under the Companies Act, and a general partner of a partnership type fund must follow the duty of care to limited partners under the Financial Instruments and Exchange Act. Therefore, a director or a general partner must form a blended finance project so as not to damage the company or limited partner.

Under the fiduciary duty framework, in the legal debates, it is generally not acceptable to pursue environmental and social factors without regard to investment returns even though it is not known whether those factors have a financial impact. However, where it is reasonably concluded that maintaining or increasing the corporate value of a portfolio company will lead to higher investment returns in the medium to long term, it may be permissible to pursue environmental and social factors, even if this will impede investment returns in the short term.

4. Legal vehicles

The legal vehicles primarily used in blended finance structuring in Japan are:

- **corporations** – which include company limited (Kabushiki Kaisha) and limited liability company (Godo Kaisha)
- **trusts** – these are sometimes used as commercial legal vehicles in Japan for investment funds, and
- **partnership** – investment limited partnerships are the most commonly used vehicle for investment by companies, while basic partnerships (Ninni Kumiai) are less common in that the limited partners of such partnerships also owe unlimited liability

Japan does not have a Benefit Corporation of the kind available in US jurisdictions nor a Community Interest Corporation of the kind available in England, while the Japanese government once considered the introduction of such kinds of corporations.

This means that for blended finance projects, lawyers are involved in tailoring existing legal structures to embed governance arrangements that support the project's objectives and enable the enterprise to raise suitably aligned capital.



5. Tax

There is no social impact-specific tax relief available in Japan.

Taxes will be levied on interests from the principle of lending money, distributions from the shares of corporations, and capital gains from the shares. However, the profit and loss of partners in a partnership are considered pass-through, which means no tax event occurs at the partnership level.

6. Financial products and dealings

If a company issues a bond or share publicly or a general partner solicits an investor to invest in the partnership-type fund that it manages, they must consider the regulations posed by the Financial Instruments and Exchange Act. There are some exemptions to those regulations; however, the requirements to be exempted are complicated. There may be some legal issues when a blended finance project is conducted. For example, asset managers are prohibited from combining investors assets with their own and other managed assets (a separate management obligation). Given that there are some cases where asset managers accept grants as concessional capital, it is

reasonable to consider that such grants shall be classified as investors' assets, not asset managers' own assets, and shall be managed separately even though grantors are not necessarily investors.

Every single blended finance transaction has a potential risk of hitting financial regulation. Thus, it is highly recommendable to ask a lawyer specialising in finance transactions to review the contemplated transaction.

7. Financial terms

Much of the design of a blended finance project is reflected in the financial and other contractual terms of the vehicle or transaction. The Japanese Civil Code is based on the principle of freedom of contract, which allows for much flexibility in the development of blended finance.

Yet, there are no standard terms or contracts for blended finance transactions. However, as most blended finance projects are built on well-established corporate and financial structures and contracts, they can draw on a body of market practice.

Given that the risk orientation differs for each investor or lender, implementing some clauses to adjust the risk allowance and distribute the financial return (distribution or interest) in accordance with the size of their risk is crucial.

8. Regulatory factors

Other than the Financial Instruments and Exchange Act, given that lending schemes are frequently employed in blended finance, it shall be noted that the Money Lending Business Act is applicable to lenders that conduct lending as their business unless a loan is extended by a bank licenced by the Banking Act. Such lenders must register as lending business operators when they extend facilities to borrowers.

There are other regulations in Japan, and what kind of regulation is specifically applicable depends on the types of transactions.

Further development

Blended finance is at a relatively early stage of development in Japan. There is considerable scope for legal innovation and for law and tax reform to better support blended finance projects. Also, to broaden the involved actors, it is important to improve the situation where the concept of blended finance is not necessarily well prevailed among the players and where there are quite few people who can plan and develop a blended finance scheme in Japan.

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Mexico

The legal framework for blended finance in Mexico

The United Mexican States (“Mexico”) does not have a set of federal statutes and regulations that were specifically designed for blended finance, but it does have a broad spectrum of commercial, financing, securities, tax, corporate, administrative and other statutes and regulations that have allowed the design and successful implementation of blended finance initiatives in Mexico.



Environmental, social, and governance policies and procedures and other international trends have contributed to the increase of blended finance products of Mexican issuers, development and finance institutions, and projects. Mexico is a part of the Organisation for Economic Cooperation and Development (OECD) which considers blended finance as the strategic use of development finance for the mobilisation of additional finance towards sustainable development⁷⁸ in developing countries⁷⁹.

In light of the international development of this field, it is likely that governmental regulations in Mexico will evolve to accommodate new structures, as well as ESG regulatory and other developments in the regulatory landscape globally and in other jurisdictions. A significant regulatory development in this direction is the “Sustainable Taxonomy” published by the Mexican Ministry of Finance and Public Credit on March 17, 2023, which includes activities that have both a positive environmental and social impact, based on technical criteria and international standards. In general, the Mexican legal framework and private and public contractual practices and techniques have been able to address the principal legal issues that arise in the structuring and implementation of a variety of blended finance initiatives, as Mexico’s regulatory framework evolves.

Mexican legal system

Mexico is a federal republic composed of 31 states and Mexico City and its legal system is based on the civil law tradition. The statutes and regulations typically applicable to blended finance initiatives are federal statutes, although state and local regulations should also be kept in mind depending on the specific initiatives, for instance, state public debt and real estate mortgage requirements.

At the federal and state levels, the government is organised into three branches: executive, legislative, and judicial. The President of the Republic heads the executive branch, and the federal legislative branch is composed of the Senate and the Chamber of Deputies.

The Mexican financial system consists of various financial institutions, including broker-dealers, commercial banks, development banks, savings institutions, cooperative credit societies, and other financial entities, that are generally regulated by federal laws. Commercial banks are regulated by the Ministry for Finance (Secretaría de Hacienda y Crédito Público) and institutions and agencies such as Banco de México (the central bank), the

78. The United Nations has established sustainable development goals (“SDGs”). Such SDGs consider determined milestones that are directly related to blended finance, such as (i) ensuring inclusive and equitable quality education and promoting lifelong learning opportunities for all, (ii) achieving gender equality and empowering all women and girls, (iii) ensuring availability and sustainable management of water and sanitation for all, (iv) ensuring access to affordable, reliable, sustainable and modern energy for all, (v) promoting sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all, (vi) building resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation, (vii) making cities and human settlements inclusive, safe, resilient and sustainable, (viii) ensuring sustainable consumption and production patterns, (ix) taking urgent action to combat climate change and its impacts, and (x) conserving and sustainably use the oceans, seas and marine resources for sustainable development; among others.

79. Organisation for Economic Cooperation and Development. Blended Finance. Obtained from <https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/>

National Banking and Securities Commission and the Institute for the Protection of Bank Savings. The principal development banks in Mexico that are government-owned are the following: Nacional Financiera, S.N.C. (“NAFIN”); Banco Nacional de Obras y Servicios Públicos, S.N.C. (“BANOBRAS”); Banco Nacional del Comercio Exterior, S.N.C.; Sociedad Hipotecaria Federal, S.N.C.; Banco del Ahorro Nacional y Servicios Financieros, S.N.C.; and Banco Nacional del Ejército, Fuerza Aérea y Armada, S.N.C. Within their respective mandate, such development banks can develop blended finance initiatives through different financing models, such as the granting of green loans, the issuance or guarantee of sustainable bonds and other financial products.

Blended finance in Mexico

1. Development finance

In Mexico, the creation of development banks derived from the need to provide financing for specific economic activities; therefore, originally, development banks were focused on financing the Mexican government and satisfying public sector needs.

However, recently, development banks have suffered thorough regulatory reform to their structure, framework, and mandates, shifting their objectives more towards creating new markets and safeguarding the existing ones.⁸⁰

Considering this new structure and objectives, development banks have reduced their participation in blended finance initiatives although they are still an important participant, for instance, in accordance with the Mexican

“Various blended impact finance structures ... have been launched in Mexico and new projects continue to be developed focusing on areas such as water, energy, mobility, rights of minorities, and social needs.”

Ministry of Finance and Public Credit, from 2015 to 2022, the Mexican financial sector issued 115 bonds related to sustainability, for an estimated aggregate amount of MXN\$552,000,000,000.00, of which 34 bonds for an estimated aggregate amount of MXN\$118,000,000,000.00 were issued by means of the sustainable bond frameworks of NAFIN and BANOBRAS.⁸¹

2. Blended impact finance

There are examples of various blended impact finance structures that have been launched in Mexico and new projects continue to be developed and they focus on areas such as water, energy, mobility, rights of minorities, and social needs, via instruments such as thematic bonds and reference frameworks. Some examples are the following:

- BANOBRAS’ sustainable bond BANOBRAS 22X issued on October 19, 2022, for an estimated amount of MXN\$1,970’000,00.00 destined for high social impact projects that promote the improvement of women’s quality of life, such as mobility projects that guarantee that women can access safe and efficient transportation; educational projects that offer adequate spaces that can allow women to develop their abilities

80. Homero Martínez, Javier Uruñuela. June, 2020. Blended finance in Mexico: an analysis of the instruments for the housing credit market. Obtained from https://www.mastermicrofinance.com/Investigacion/WP_1-2020-H_Martinez-J_Urunuela-Blended_finance_in_Mexico-An_analysis_of_the_instruments_for_the_housing_credit_market_p.pdf

81. Secretaría de Hacienda y Crédito Público. March, 2023, Taxonomía Sostenible de México. Obtained from <https://www.gob.mx/shcp/documentos/taxonomia-sostenible-de-mexico?state=published>

and capacities; projects than provide access to mental health services for woman, among others.⁸²

- NAFIN's sustainable bonds NAFR 21X and NAFF 21X issued on November 18, 2021, for an estimated amount of MXN\$7,800,000,000.00 dedicated to projects that contribute to employment growth, prevent unemployment derived from a socioeconomic crisis, natural disasters, and climate change, and projects that promote energetic efficiency.⁸³
- Grupo Bimbo, S.A.B. de C.V.'s sustainable bonds BIMBO 23L and BIMBO 23-2L issued on June 1, 2023, for an estimated amount of MXN\$15,000,000,000.00 destined to minimise 50% of food wasting and issuances of carbon dioxide, as well as cultivate 200,000 hectares of through a process of regenerative agriculture.⁸⁴

A direct example of blended finance structured as a guaranty trust is the Margarita Loan Guarantee Fund. In operation for more than 12 years, the Margarita Fund was established as an aid mechanism for 900 small-scale dairy farmers in the states of Jalisco, Aguascalientes, and Zacatecas to participate in a sustainable milk supply chain through financing opportunities. Initially, the program granted farmers access to financing opportunities through ROSCA, a funding mechanism that provided farmers with instalment payment facilities for the purchase of assets or working capital necessary to participate in the established supply chain. The fund, through the collaboration of strategic private and public partnerships, began to operate through a guarantee trust that granted

guarantees to farmers to obtain credits with stable interest rates and attractive repayment terms to purchase assets and working capital. In its ten years of operation, the Margarita Fund has facilitated MXN\$150,000,000.00 in loans, 828 loan guarantees, and MXN\$44,000,000.00 in government subsidies.⁸⁵

Indicative legal considerations in Mexico

3. Fiduciary duties

In Mexico, the corporate law framework does contemplate the basic fiduciary duties of directors and does not contemplate a fiduciary duty to stakeholders other than shareholders. The fiduciary duties of directors of Mexican-listed companies are more regulated than those of private companies. Mexico does not yet contemplate in its legal framework B corporations of similar legal models.

4. Legal vehicles

Since, as mentioned above, Mexican law does not yet contemplate legal vehicles such as B corporations and similar models, the required features are usually achieved through other means such as thematic bonds, guarantees, insurance, hedging, subordinated capital, syndicated loans, Securitisation, contractual mechanisms, result-based incentives, and technical assistance.

82. BANOBRAS. October, 2022. BANOBRAS colocó de manera exitosa siete mil quinientos millones de pesos a través de tres bonos en el mercado local de deuda, dos de ellos sustentables con perspectiva de género. Obtained from https://www.gob.mx/cms/uploads/attachment/file/770195/Boleti_n_Informativo_003_banobras_coloco_de_manera_exitosa_siete_mil_quinientos_millones_de_pesos_a_trave_s_de_tres_bonos_en_el_mercado_local_de_deuda_dos_de_ellos_sustentables_con_perspectiva_de_ge_nero.pdf

83. NAFIN. 2022. Informe Bono de Sustentabilidad 2022. Obtained from https://www.nafin.com/portalfn/files/secciones/emisiones-relaciones-internacionales/captacion/documentos/INF_FINAL_NAFIN_ESPAN_771_OL.pdf

84. BBVA. June, 2023. BBVA México y Grupo Bimbo colocan los primeros Bonos Vinculados a la Sostenibilidad por MXN\$ 15,000 millones de pesos - BBVA CIB. Obtained from <https://www.bbvacib.com/es/deals/bbva-mexico-y-grupo-bimbo-colocan-los-primeros-bonos-vinculados-a-la-sostenibilidad-por-mxn-15000-millones-de-pesos/>

85. TechnoServe, Inc. TechnoServe Business Solutions to Poverty. The Margarita Loan Guarantee Fund: Building a blended finance mechanism for small-scale dairy farmers in Mexico. Obtained from <https://www.technoserve.org/resources/the-margarita-loan-guarantee-fund-building-a-blended-finance-mechanism-for-small-scale-dairy-farmers-in-mexico/>

5. Financial products and dealings

Mexico's laws do not regulate either financial products or dealings and, consequently, there are no registration, licensing, or disclosure requirements related to blended finance transactions.

6. Financial terms

In Mexico, there are few standard terms or contracts for blended financing (such as Series "L" Bonds -for those related to sustainability- and Series "V" Bonds -for those related to energetic, water, residual management, and agricultural projects-) since an applicable legal framework has not been established. Considering the contractual freedom under which contractual law (one of the sources under which blended finance projects have been developed) is subject to the flexibility of negotiation of the respective parties, there have not been established standard terms or contracts in this matter. The aforementioned Sustainable Taxonomy seeks to contribute to the standardisation of terminology in this field.

7. Regulatory factors

While there is no specific finance structure or key regulations applicable to blended finance mechanisms, existing financial regulations applicable to the investment market are relevant to the objectives of blended finance. Examples include applicable provisions to securities issuers and securities market participants which require that issuers with security registered for more than one year in the National Securities Registry submit an annual report to maintain their registration, which, among others, shall include information about the use of public resources for bonds linked to sustainability, social and sustainable bonds.

Further development

Blended finance is a recent but relevant subject in Mexico. Although the specific legal framework of such kinds of financing is limited, in light of international trends, it is anticipated that it will continue to evolve in line with international trends.

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United Kingdom

The legal framework for blended finance in the United Kingdom

Blended finance is commonly defined as an approach combining risk-tolerant capital (often referred to as ‘concessional capital’) with capital seeking market-rate returns (‘non-concessional capital’) to address social and environmental issues. In the United Kingdom, the majority of projects using blended finance have involved a greater concessional capital element than projects carried out in other jurisdictions (in particular in the United States). The participation of regulated legal structures, such as charities and community interest companies, is a particular feature of the blended finance market in the United Kingdom.



The United Kingdom does not have a constitution that is contained in a written constitutional instrument. It is to be found in the statutes passed by Parliament and in the common law (known as “precedent”), which have developed over the centuries in the decisions of the courts.

Blended finance in United Kingdom

1. Development finance

Development finance institutions are typically focused on markets in low and middle-income countries and invest with the aim of unlocking and catalysing private sector investment into sustainable technologies and industries (increasingly focused on biodiversity loss, adaptation and nature-based solutions, as well as the Sustainable Development Goals), often with the support of philanthropic, charitable and public institutions.

Building partnerships and investing for development is a prominent part of the UK’s international development offer. British International Investment (BII), the UK’s development finance institution, is a major presence in this field, but there are many other entities in the UK focused on development finance, including many charities, many of whom are supported by funding from the UK’s Foreign, Commonwealth & Development Office.

On this basis, development finance is not deployed into the United Kingdom, though many development finance arrangements (including development impact bonds) are governed by English law and supported by institutions based in the United Kingdom.

Blended finance in the United Kingdom is delivered within a broad framework of law and regulation relating to companies, contracts, corporations, partnerships, trusts, charities, funds, financial regulation, taxation and subsidy control.

United Kingdom legal system

The United Kingdom has three separate legal systems: England and Wales (English law), Scotland (Scots law) and Northern Ireland (Northern Irish law). This reflects its historical origins and the fact that both Scotland and Ireland, and later Northern Ireland, retained their own legal systems and traditions under the Acts of Union 1707 and 1800.

The Supreme Court of the United Kingdom, which has jurisdiction over the entire United Kingdom since it replaced the Judicial Committee of the House of Lords in October 2009.

2. Blended impact finance⁸⁶

Historically, blended finance has been focused predominantly on the social enterprise sector in the United Kingdom. Leading actors have included Big Society Capital and Access the Foundation for Social Investment (**Access**), the latter being the leading supplier of grant subsidy in UK blended funds (approximately £83 million of funds from the UK government's Dormant Asset Scheme have been provided to Access as grant funding to blend with repayable investment with a focus on supporting communities experiencing disadvantage.). Community Development Financial Institutions (**CDFIs**) are locally-rooted social enterprises that provide affordable and responsible capital to people, MSMEs and social enterprises. Other examples of social enterprise lenders using blended finance include Social Investment Business, The Key Fund, Big Issue Invest, and Resonance.

As the Case Study Appendix (set out at the end of this Report) shows, there are also examples of larger scale blended finance initiatives, such as **Bristol City Leap** and the **Mayor of London's Energy Efficiency Fund** which have involved blended finance on a larger scale, not solely focused on voluntary, community and social enterprises (VCSEs).

Blended finance structures in the UK often operate at a “fund” level, where the fund takes on concessional capital and blends it with non-concessional capital which is then used to provide repayable finance to the frontline enterprise. For investors playing a non-concessional role within these funds (i.e. seeking market-rate returns), the use of concessionary capital can help to lower the risk around the deal, by providing protection

against potential defaults and unlocks larger, more diverse pools of capital from other investors. This helps to increase the amount of capital available towards social and environmental impact and creates an investment product that is more flexible for enterprises – for example through being unsecured and offering a more affordable interest rate over a longer term.

For example, Access has helped to design and provide a range of blended funds (each with a differing focus): the **Growth Fund** (which has c.16 funds in operation), **Local Access**, **Covid 19 Related Emergency Support**, **Flexible Finance for the Recovery**, **Enterprise Growth for Communities**, **Cost of Living Social Investment Support Fund** and **Energy Efficiency Social Investment Programme**. (An example of a non-Access would be the **Nesta Arts and Culture Impact Fund**.)

Specific blended finance approaches have included:

- Blending of grant and investment
- Guarantee loan schemes
- Tax reliefs including, Community Investment Tax Relief (CITR), charity tax reliefs and the Enterprise Investment Scheme
- First loss/ subordinated interest
- Return enhancement to incentivise commercial investors
- Technical assistance (free advice and business support)
- Outcomes/ results based mechanisms which financially reward the enterprise for achieving pre-defined impact goals “increased flexibility and autonomy”

86. Resources: Blended Finance: Our Approach - ACCESS (access-socialinvestment.org.uk); <https://www.thinknpc.org/wp-content/uploads/2022/07/Review-of-grant-subsidy-for-blended-finance-to-support-civil-society-executive-summary-new.pdf>

The legal framework for blended finance in the United Kingdom

A key issue for charitable funders (including Access) is ensuring that the structure and terms comply with their constitutional requirements and charity law more broadly – particularly ensuring that the proposed investment or grant falls within their charitable purposes and delivers “public benefit”.

Whilst this jurisdiction report focuses on blended finance projects in England & Wales, there are blended finance projects taking place in both Scotland and Northern Ireland.

Indicative legal considerations in United Kingdom

3. Fiduciary duties

Existing legal considerations and fiduciary duties which derive from the United Kingdom's legal and statutory framework will need to be taken into account for all blended finance opportunities. Under company law, the duties of directors are owed principally to shareholders.

In recent years, there has been an increase in the adoption of bespoke stakeholder governance arrangements for purpose driven organisations focused on operating in a more sustainable and ethical manner (e.g. B Corporation accreditation and Science Based Targets).

There have also been some important recent developments and clarifications in case law:

- Most notably, the case of [Butler-Sloss and others v Charity Commission](#), which clarifies the duties of charity trustees in relation to financial investments positively in relation to investments such that trustees have wide discretion where appropriate to exclude certain investments based on non-financial considerations when making financial investment decisions.
- The Court of Appeal recently refused environmental NGO, ClientEarth permission to appeal the High Court's July 2023 judgment that Client Earth had failed to make out a prima facie case enabling the court to grant permission under the Companies Act 2006 (CA 2006) for it to continue a derivative claim against Shell's directors for alleged breach of their fiduciary duties in connection with the company's climate change risk management strategy. Whilst unsuccessful, the claim did demonstrate that strategic litigation can have benefits in raising the profile of these issues.

There are ongoing initiatives such as the Better Business Act and reforms regarding the fiduciary duties of pension fund trustees (for example, a recent opinion from the [Financial Markets Law Committee](#)) which, if implemented, could incentivise investment into blended finance products.

4. Legal vehicles

The legal vehicles primarily used in blended finance structuring in the United Kingdom are:

- companies limited by shares
- companies limited by guarantee (either charitable or non-charitable)
- community interest companies
- Limited Partnerships and Limited Liability Partnerships
- trusts
- community benefit societies

Often a blended finance arrangement will involve a combination of these different structures, with the concessional finance provided by a regulated legal structure such as a charity or community benefit society, and the non-concessional finance provided by a company or limited partnership.

In addition, it is possible to embed specific requirements and governance arrangements that support the project's objectives and enable the organisation to raise and deploy capital.

5. Tax

Registered English charities receive a range of generous tax reliefs in the United Kingdom, as agreed by HMRC (the UK's tax authority). On that basis, blended finance projects commonly need to be structured to ensure that the tax status of charitable investors is not adversely affected. In addition, the UK government has introduced specific impact related tax reliefs such as Social Investment Tax Relief (SITR) (unfortunately discontinued in April 2023) and Community Investment Tax Relief (CITR).

It would be possible, in principle, for certain projects to receive tax reliefs from the UK government, in particular where the UK government is an investor (please see examples in the Case Study Appendix).

6. Financial products and dealings

The key financial regulations to consider in relation to United Kingdom blended finance (overseen by the Financial Conduct Authority), namely:

- Public participation – financial promotions
- Management and promotion of fund structures – e.g. Collective Investment Scheme and Alternative Investment Fund rules
- Arranging deals in investments, or advising on investments

The ability to engage in blended finance arrangements connected to the UK without the need for oversight from the Financial Conduct Authority will principally depend on the nature of the activities and the status of the investors. For example, there are commonly used exemptions where all the parties involved are deemed to be “high net worth” individuals or institutions.

More generally, it will be important to consider the interaction between a blended finance project and the capital market products (green bonds, sustainability linked loans).

The legal framework for blended finance in the United Kingdom

7. Financial terms

Much of the design of a blended finance project is reflected in the financial and other contractual terms of the vehicle or transaction. Contract law in the United Kingdom is based on the principle of freedom of contract which allows much flexibility and innovation in the development of blended finance projects.

There are no standard terms or contracts for blended finance transactions. However, as most blended finance projects are built on well-established corporate and financial structures and contracts, they can draw on a body of market practice. In addition, in some specific areas, a common form of blended finance structure is accepted in the market.

However blended structures in the UK are frequently quite bespoke and complex relative to investment size (as compared to purely commercial or purely concessional structures).

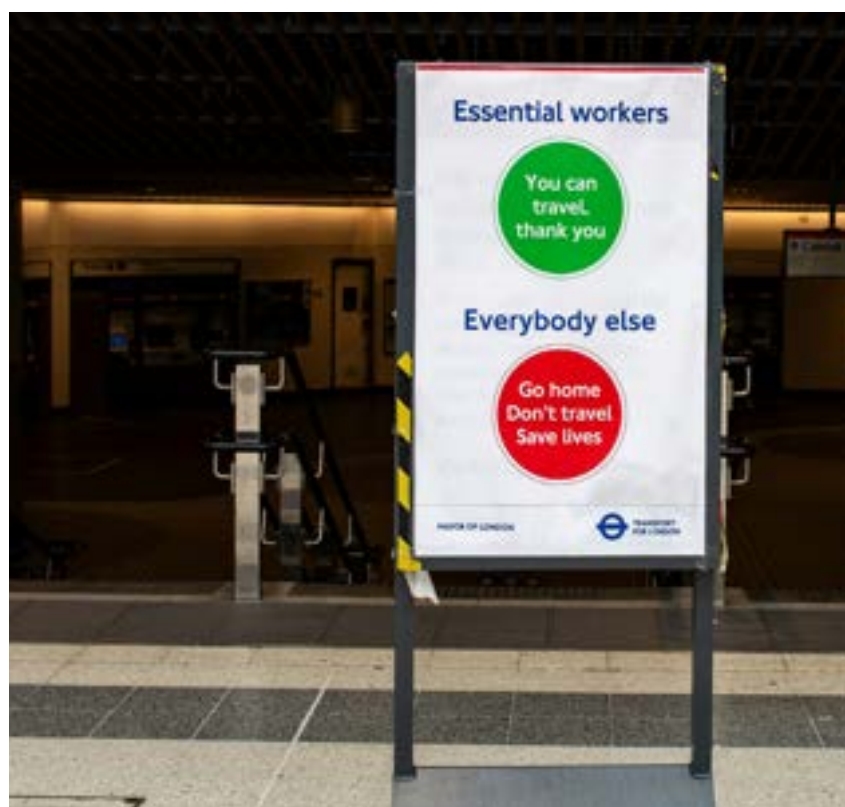
8. Regulatory factors

The principal regulators that affect the existing blended finance market in the United Kingdom are Companies House, the Charity Commission, the CIC Regulator, the Financial Conduct Authority and the Competition and Markets Authority. There are also more specific regulatory frameworks affecting, for example, the provision of subsidies by the UK government and public bodies known as “Subsidy Control”. Beyond these, there may be international standards and codes that apply, in particular deriving from the European Union. The Charity Commission, CIC Regulator (and others) regulate asset and mission locked civil society organisations which provides both

opportunities (favourable tax treatment) and limitations (restrictions on activities and greater regulatory scrutiny).

9. Government guarantee schemes

The UK government has provided a number of guarantee schemes via the British Business Bank which have supported blended structures. These have included the Coronavirus Business Interruption Scheme (CBILS) and the Recovery Loan Scheme. These have guaranteed loans by accredited lenders up to a percentage of the loan amount. Each has been utilised to provide a first-loss layer within blended structures which has facilitated the participation of repayable finance.



Further development

The major political parties in the UK have announced plans to mobilise private investment for key policy priorities such as net-zero, housing, transport, education and health. In addition, a report published by the Grantham Research Institute on Climate Change and the Environment has proposed the creation of:

- a UK Growth Fund to attract pension and other large pools of institutional capital and act as an umbrella vehicle for a portfolio of sector-specific funds. This would aim to raise £4.6 billion at launch, rising to at least £46 billion over five to 10 years. ensure buy-in and scale, and it would work within government's existing processes and institutions; and⁸⁷
- a UK Community Growth Fund which would expand on precedents, including the £60 million Community Investment Enterprise Facility, and would target £100 million of commercial bank and social investment at launch, growing in size as additional financial institutions and investors took part.

To lower existing barriers to and incentivise private sector investment into the new funds as well as other public policy priorities, three further 'enablers' are proposed: new guidance on fiduciary duty for institutional investors; reprioritisation of institutional mandates and incentive structures at key government owned UK institutions; and the design of new investment incentives.

“Blended finance structures in the UK often operate at a “fund” level, where the fund takes on concessional capital and blends it with non-concessional capital which is then used to provide repayable finance to the frontline enterprise.”

Tax reliefs (including CITR) could be adjusted to make social investments more appealing to investors as well as easier to obtain. Changes could include the introduction of transferable tax credits which are either transferable over time or between investors, or an improved portfolio-wide relief – rather than on a deal-by-deal basis. Limited uptake of SITR led to its eventual cessation. This was in part due to tight restrictions on what type of project would be eligible.

Another example of using catalytic capital to unlock significant scale of blended finance is the Church of England's announcement of the £100 million of funding commitment to impact investment, research and engagement trying to address some of the past wrongs.

87. Investing-in-our-future-
Practical-solutions-for-the-
UK-government-to-mobilise-
private-investment.pdf;
[https://www.thinknpc.org/
wp-content/uploads/2022/07/
Review-of-grant-subsidy-for-
blended-finance-to-support-
civil-society-executive-
summary-new.pdf](https://www.thinknpc.org/wp-content/uploads/2022/07/Review-of-grant-subsidy-for-blended-finance-to-support-civil-society-executive-summary-new.pdf)

The legal framework for blended finance in the United Kingdom

A report commissioned by the Department for Culture Media and Sport (DCMS) also found an ongoing need for future public policy interventions by the government to support the social investment market through the provision of subsidies into blended finance for voluntary or community organisations and social enterprises. The impact that grant subsidy into blended finance for VCSEs has had is evident in the effect it has had on:

- The social investment market, particularly on the number and strength of social investors offering blended products.
- The social enterprises and charities who have received investment, particularly in their improved resilience and growth and their ability to reach more people (particularly in disadvantaged communities).
- The beneficiaries themselves, through an increase in the impact on beneficiaries and number of beneficiaries reached through VCSE services.

Similarly, a joint report⁸⁸ by the Impact Investing Institute and BSC outlines the role which the three key types of government subsidy (grants, guarantees and tax reliefs) can play in achieving four key policy objectives, namely 1) growing the local and social economy, particularly in deprived areas, 2) increasing investor participation in the social impact investment market, 3) better tailoring capital to the needs of SMEs, charities and social enterprises serving marginalised communities, and 4) facilitating non-financial support for these organisations. The research finds the effectiveness of the subsidy tools to achieve these four objectives depends on the context in which they are deployed.



There are also improvements which can be made to existing subsidies to incentivise private sector investment. For example, organisations including Responsible Finance and BSC have been advocating that the two-year extension of the Growth Guarantee Scheme (formerly the Recovery Loan Scheme) in the 2024 Spring Budget should be made permanent, whilst an amendment is needed to CITR to remove the £2.5 million lending cap between wholesale and retail Community Development Finance Institutions (CDFIs) in the UK which continues to hinder how much capital can be unlocked from investors and mainstream lenders for CDFIs.

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88. <https://www.thinknpc.org/wp-content/uploads/2022/07/Review-of-grant-subsidy-for-blended-finance-to-support-civil-society-executive-summary-new.pdf>



USA

The legal framework for blended finance in Australia

Blended finance in the United States can be found in a wide variety of sectors and is used by a broad array of actors across the market. Historically the province of large-scale development projects – whether in the developing world or at home, these “public private partnerships” (PPP transactions) were employed to finance bridges, toll roads, airports, power facilities and more. In recent years, these approaches have expanded to encompass a broader range of transactions, industries, geographies, and objectives.



But at their core, blended finance transactions are financing arrangements which may involve different sets of actors, objectives, time horizons and return expectations, all coming together around a common financing (and impact) set of objectives.

Thus, the bodies of law that apply to blended finance transactions in the United States include contract law, securities law, tax law, banking & finance law and regulation, secured transactions, bankruptcy law, and dispute resolution.

As a result, a practitioner in the U.S. will draw from common law principles that are state-specific (e.g. contract law), federally enacted statutes enforced by regulatory agencies (e.g. securities and tax law); federal law (e.g. bankruptcy) and principles and issues that fall within either federal or state jurisprudence, depending on the issue and how it may arise.

Add to this efficiency considerations, market practice that is rapidly developing, and a complex set of issues that arise from having a binary tax code that is premised on a general distinction between for-profit (taxable) activity and non-profit (tax-exempt) activity, the blended finance lawyer is engaging in a multidimensional and multidisciplinary practice.

As is the case in other jurisdictions, however, there is no specific set of laws or regulations specific to blended finance. Rather, the laws and regulations that apply generally to financing transactions continue to apply, and the blended

finance practitioner is operating across an array of legal disciplines.

The U.S. legal system

The American legal system is a federal common law system with fifty individual states and a federal government divided into three branches. American jurisprudence is derived from British common law, which is then supported by, among other sources, the U.S. Constitution, judicial opinions (and the principle of stare decisis), statutes, restatements, decrees, and various other judicial, legislative and administrative rules and regulations.

The American legal system is premised upon several key principles, two of which are particularly relevant to practitioners of blended finance: separation of powers and federalism. Separation of powers in the United States is a legal doctrine that divides the federal government into three branches: the legislative, the executive, and the judicial, with each branch having its own functions and powers, as well as the ability to check and balance the other branches⁸⁹. Generally, congress (made up of

⁸⁹. Many commentators posit that administrative agencies (including the SEC, IRS, FTC, etc.) comprise a fourth branch of government in the US.

The legal framework for blended finance in the U.S.

the House of Representatives and the Senate) enacts legislation, and the executive branch (the President and cabinet) carries out and enforces laws, and the judicial branch (at a federal level, comprised of federal district courts, appellate circuit courts and the US Supreme Court) interpret laws, ensure their constitutionality and resolve legal disputes).

Federalism refers to the constitutional division of power between the fifty individual U.S. state governments and the federal government. This arrangement is outlined in the United States Constitution and encompasses the principle that powers not specifically reserved for the federal government are left to the states. The financial products and structures that comprise many of the tools of blended finance are also governed by several regulatory agencies. Thus, blended finance, like many other commercial and financial legal disciplines, is a multidisciplinary legal practice.

Blended development finance

The American blended finance landscape focuses on a broad range pressing issues with multifaceted solutions. Climate change takes centre stage, with investments in decarbonization technologies, renewable energy projects, and resilient infrastructure. The social sector sees blended solutions addressing critical challenges like affordable housing, accessible healthcare, quality education, and financial inclusion for underserved communities. Global health initiatives leverage blended finance to address pandemic preparedness, disease control, and equitable access to life-saving medicines. Finally,

“In the U.S. the blended finance lawyer is engaging in a multidimensional and multidisciplinary practice.”

economic development seeks to create jobs, build essential infrastructure, and expand access to finance for small and medium-sized enterprises, fostering sustainable economic growth.

The United States government plays a key role in supporting blended finance, which aims to mobilise private capital for sustainable development as a key lever in US domestic and foreign policy. Blended development finance involves strategic collaboration between public entities and private institutional investors to achieve common development objectives. Key players in American blended development finance include:

Development Finance Corporation (DFC)

In 2018, the U.S. government established the Development Finance Corporation (DFC) with a commitment of \$60 billion. The DFC focuses on blended finance and began operations in October 2019, consolidating the Overseas Private Investment Corporation (OPIC) and USAID's Development Credit Authority. It aims to attract private sector investment in development projects in energy, healthcare, critical infrastructure, telecommunications and financing for small businesses and women entrepreneurs.

The legal framework for blended finance in the U.S.

USAID INVEST Blended Finance Starter Kit

The U.S. Agency for International Development (USAID) provides resources like the Blended Finance Starter Kit. This kit offers guidance on mobilising private capital for better development results by strategically using development funds from government aid and philanthropic sources.

Blended Finance for the Energy Transition (BFET)

The U.S. Department of State, in partnership with USAID, launched the Blended Finance for the Energy Transition (BFET) program. This initiative seeks private sector-led blended finance structures to accelerate the transition to clean energy. The program issued an initial request for concept proposals to encourage private investment in sustainable energy projects.

Private Sector Engagement

The private sector engagement with blended development finance is comprised mainly of large institutional financial institutions such as banks, pension funds, private funds and corporations. These actors leverage loans, investments and partnerships with development finance institutions, project developers and local businesses to achieve the dual objectives of advancing development goals and generating financial returns.

Blended impact finance

The blended impact finance ecosystem is also very well developed in the US, albeit considering the relative novelty of the approach in general. There are many well established structures and approaches, and many examples of private investors (high net worth / angel investors, family offices, investment funds), charitable investors (public charities, private foundations), and governmental participants (DFIs such as OPIC / US DFC, USAID, and state and local governmental bodies) all participating on the investor side of such transactions. In addition, there are also a growing number of sponsor side participants, ranging from traditional investment fund sponsors to charities to community-based organisations.

By blending different sources of capital and risk, blended finance aims to unlock private sector investment in projects that might otherwise be considered too risky or unprofitable. This approach leverages the relative and differing strengths of the broad range of participants to address complex global challenges more effectively and efficiently. Key private market players active in the blended finance space in the US include the following:

Charities & Foundations

Tax exempt organisations in the United States are a key component of blended impact finance transactions, and examples abound both of tax exempt organisations investing in as well as sponsoring blended finance structures. Foundations can make **Program-Related Investments (PRIs)**, which are below-market-rate loans or equity investments in organisations or

The legal framework for blended finance in the U.S.

projects that advance their charitable purposes, often for the purpose of de-risking an investment opportunity in order to catalyse market rate seeking investors.

Benefit Corporations

Maryland was the first state in the US to enact a benefit corporation statute and since 2010, an additional 36 states have followed suit. A benefit corporation is a for-profit corporation that explicitly states in its approved bylaws that it is committed to improving society, the community, and the environment in addition to turning a profit. Unlike traditional corporations, which primarily focus on maximising shareholder profits, benefit corporations place social and environmental values on an equal footing with financial gains. As such, fiduciary duty concerns that have often been presented in traditional entity architectures (discussed in greater detail below) are relaxed in benefit corporations (and corollary entity types such as benefit LLCs, etc.).

Investment Funds

Investment funds are particularly useful structures for blended finance transactions, particularly where the blending is in service of catalysing an investment thesis that will play out across a portfolio of investments. Most blended finance transactions to date have utilised a private fund structure of some kind, where a diverse set of investors can engage both within the cap table of the fund, as well as invest alongside the fund. These funds are driven by an impact thesis, targeting specific social or environmental challenges and seek to generate positive impact alongside financial returns. By strategically combining capital sources with diverse risk and return profiles, blended finance funds can create

tailored solutions to address uniquely challenging situations. This flexibility allows them to invest in projects with high social or environmental impact potential, even if they might carry higher risks than traditional investments.

Social Impact Bonds / Outcomes Based Contracts

Social impact bonds (SIBs) are also known as a pay-for-success financing, pay-for-success bond (in the U.S.) are a form of outcomes-based contracting comprised of a series of agreements between the public sector authorities, private investors, and suppliers or service providers. The provider is paid based on achieving specific goals or outcomes, allowing private investors to provide up front risk capital for the achievement of large scale social or environmental objectives, and be repaid by the public sector participant upon the achievement and verification of the objectives.

Donor Advised Funds (DAFs)

Donor Advised Funds (DAFs) are charitable accounts established with a public charity. Donors contribute various assets like cash, securities, or even real estate to their DAF, receiving an immediate tax deduction for the full contribution amount. These funds then allow donors to recommend grants to qualified charitable organisations at their discretion. While traditionally used for general charitable giving and tax optimization, DAFs have evolved to accommodate a growing interest in impact investing. This allows donors to align their philanthropic goals with their values and actively participate in supporting positive social and environmental change. Organisations like ImpactAssets offer innovative DAF structures specifically tailored for impact investing. These DAFs go beyond traditional

The legal framework for blended finance in the U.S.

grantmaking by allowing donors to invest their contributions in a portfolio focused on generating financial returns alongside positive social and environmental impact. This self-sustaining and regenerative approach allows DAFs to contribute to positive change while creating a sustainable source for future giving.

In addition to the participants/strategies listed above, blended impact finance involves integration of financial instruments like guarantees, concessional loans, first-loss tranches, and revenue-sharing agreements. Moreover, robust impact measurement and reporting mechanisms are crucial to assess the effectiveness and alignment of the investments with the intended developmental outcomes.

Indicative legal considerations in the united states

Fiduciary duties

Fiduciary duty considerations have long been front and centre in the impact investing conversation and are therefore highly relevant in blended finance transactions.

In the US, as in other legal systems, fiduciary duties exist to ensure that those who manage assets on behalf of others act in the interests of beneficiaries, rather than serving their own interests. Fiduciary duty obligations arise under both federal regulation (as in the case of securities transactions as well as transactions involving tax-exempt organisations such as foundations or charities) as well as the state law governing the transaction.

Using Delaware corporate law as a commonly utilised (and representative) example, Fiduciary duty consists of two main components: the duty of care and the duty of loyalty.

- The **duty of care** requires fiduciaries to make informed, diligent, and rational decisions based on all material information reasonably available. Fiduciaries must exercise their own independent judgement and avoid negligence, recklessness, or wilful misconduct.
- The **duty of loyalty** requires fiduciaries to act in good faith and avoid any conflicts of interest, self-dealing, or unfair advantage. Fiduciaries must not use their position or influence to benefit themselves or harm the principal of which they are the fiduciary (e.g. corporations and stock holders).
- Fiduciaries who breach their fiduciary duty may be held liable for damages or equitable remedies, such as injunctions, rescission, or disgorgement. However, Delaware law also provides certain protections and defences for fiduciaries, such as:
- The business judgment rule, which presumes that fiduciaries act in good faith and with due care, unless there is evidence of fraud, bad faith, or gross negligence.
- The exculpation clause, which allows corporations to limit or eliminate the personal liability of directors for monetary damages for breaches of the duty of care, but not the duty of loyalty or intentional misconduct.
- The indemnification and advancement provisions, which allow corporations to reimburse or advance the legal expenses of fiduciaries who are sued for their actions, if

The legal framework for blended finance in the U.S.

they have acted in good faith and in the best interests of the corporation.

Legal vehicles

Public Benefit Corporations (PBCs)

Answering increased demand for socially responsible enterprises, a number of states have amended their corporate laws to allow entrepreneurs to incorporate a new form of entity known as the public benefit corporation (PBC) and to pursue both for-profit and non-profit purposes. The number of PBCs have grown significantly ever since. Many of these dual-purpose entities have received not only significant investments from private funds but also have successfully gone public. Generally, the board of a PBC is required to manage or direct the affairs of the PBC in “a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.” Stockholders of a PBC may bring a derivative action against a director for a failure to either (i) act in the stockholders’ interests, (ii) pursue a public benefit, or (iii) balance the dual purpose.⁹⁰

Community Ownership Organisations

Community ownership models such as Cooperatives (Co-ops) and Community Land Trusts (CLTs) and Real Estate Investment Trusts (REITs) play a crucial role in fostering economic equity, social impact, and community control in the US. Generally speaking these alternative models democratise decision-making, ownership and the economic benefits of economic activities such as farming, affordable housing investments, retail markets and the like, for the benefit of a broader community of stakeholders. Many impact

investors are motivated to find ways to deploy capital into such entities, resulting in another area of blended finance.

Tax

Impact-Specific Tax Relief and Government Subsidies:

Beyond traditional tax-deductible charitable donations and taxable impact investing, tax incentive programs like Qualified Opportunity Zones (QOZs), New Markets Tax Credits (NMTC), and Renewable Energy Tax Credits offer another avenue for driving capital towards underserved communities.

- **Qualified Opportunity Zones:** The Tax Cuts and Jobs Act of 2017 introduced QOZs, which offer substantial tax incentives for investments in designated low-income communities. Investors can defer and potentially eliminate capital gains taxes on investments made through a Qualified Opportunity Fund, provided certain holding period requirements are met. This incentive has been leveraged in various blended finance initiatives aimed at promoting economic development in underserved areas.
- **New Markets Tax Credit (NMTC):** The NMTC program provides a tax credit incentive for private investment in low-income communities. The program allows individual and corporate investors to claim a tax credit against their federal income tax liability in exchange for investing in designated Community Development Entities (CDEs), which in turn make equity investments or loans to qualified businesses operating in low-income communities.

90. https://www.americanbar.org/groups/business_law/resources/newsletters/delaware-public-benefit-corporations/

The legal framework for blended finance in the U.S.

- **Renewable Energy Tax Credits:** The federal government offers various tax credits to promote the adoption of renewable energy sources, including the Investment Tax Credit (ITC) and the Production Tax Credit (PTC). These credits have been instrumental in attracting private capital to renewable energy projects, often through blended finance arrangements.
- **State and Local Incentives:** In addition to federal programs, many state and local governments offer incentives, such as tax abatements, grants, and subsidies, to encourage private investment in specific impact areas, including affordable housing, community development, and environmental sustainability. These incentives can be leveraged in blended finance structures to enhance the overall return and attractiveness of impact investments.

Tax Rulings

While not having official precedential value, IRS tax rulings carry significant weight in that they indicate how the IRS might act under a set of facts. In an important ruling, PLR 202041009, the IRS denied tax-exempt status to an organisation that proposed to launch and manage an impact investment fund. The ruling has particular importance in blended finance structuring because it puts on record the IRS's view that impact activity is not necessarily charitable activity. Thus, the view among many is that if an impact fund manager can be denied tax-exempt status for being insufficiently "charitable" existing foundations and charities must be particularly cautious about engaging in blended finance structures that are focused on impact objectives, and care must be taken to protect their tax-exempt status.

Financial products and dealings

There are a myriad of US laws and regulations that are likely to apply to blended finance transactions. These securities laws provide a framework for transparency, investor protection, and responsible investing.

Securities Act of 1933:

Often called the "truth in securities" law, it has two main objectives:

- **Disclosure:** Requires that investors receive accurate and significant information about securities offered for public sale.
- **Anti-Fraud:** Prohibits deceit, misrepresentations, and other fraudulent practices in securities sales.

Securities Exchange Act of 1934:

Empowers the SEC (Securities and Exchange Commission) to regulate various aspects of the securities industry. Covers brokerage firms, transfer agents, clearing agencies, and self-regulatory organisations (SROs).

Investment Company Act of 1940:

Regulates investment companies (such as mutual funds) that primarily invest, reinvest, and trade in securities. Imposes disclosure requirements, governance rules, and restrictions on transactions between investment companies and affiliated parties.

Investment Advisers Act of 1940:

Governs investment advisers who provide advice about securities for compensation, including fund managers. Requires, among other things, registration for certain advisors and disclosure of conflicts of interest. Note that the requirement

The legal framework for blended finance in the U.S.

to register as an investment fund manager will depend upon the amount of assets under management, as well as a state-by-state analysis.

Sarbanes-Oxley Act of 2002:

Focuses on corporate governance, financial reporting, and auditor independence and aims to enhance transparency and protect investors.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010:

Introduced significant reforms after the 2008 financial crisis by addressing systemic risk, consumer protection, and transparency in financial markets.

Jumpstart Our Business Startups (JOBS) Act of 2012:

Facilitates capital formation for small businesses by easing certain securities regulations, particularly in respect of small business capital raising via, e.g. crowdfunding.

A fundamental principle in securities law is the prohibition of material misstatements or omissions in disclosures. Blended Finance often involves innovative approaches and new structures that may not be readily comparable to traditional finance structures. This presents a unique challenge. Instead of solely relying on existing disclosure templates, blended finance practitioners must carefully consider the specific information necessary to provide investors with a clear and accurate understanding of the risks, potential rewards, and impact goals associated with the particular investment.

For practitioners, engaging in activities like creating securities or managing investment funds requires adherence to these regulations. The unique and innovative nature of blended finance, however, may not always find direct parallels in existing legal precedent or disclosure practices. This necessitates close cooperation with legal counsel to ensure compliance and mitigate potential legal risks while advancing impactful initiatives.

Financial terms

There is no definitive answer to what typical financial terms for blended finance transactions in the US are, as they may vary depending on the type, size, sector, and location of the project, as well as the objectives, preferences, and risk appetites of the investors involved. However, some possible financial terms that may be encountered in blended finance transactions include:

- **Interest rate:** The percentage of the principal amount that is paid or received as interest over a period. Blended finance transactions may offer concessional or subsidised interest rates to private investors, meaning lower than the market rate, to make the investment more attractive and affordable.
- **Maturity:** The length of time until the principal amount of a loan or bond is due to be repaid. Blended finance transactions may have longer maturities than conventional loans or bonds, to allow more time for the project to generate revenues and repay the debt.
- **Grace periods:** The period when no interest or principal payments are required on a loan or bond. Blended finance transactions may have

The legal framework for blended finance in the U.S.

grace periods to ease the repayment burden on the borrower and reduce the default risk for the lender.

- **Collateral:** The asset or assets that are pledged by the borrower to secure a loan or bond. If the borrower fails to repay the debt, the lender can seize the collateral and sell it to recover the money. Blended finance transactions may have different types of collateral, such as physical assets, guarantees, or insurance, to reduce the credit risk for the lender and increase the confidence of the borrower.
- **Technical Assistance:** Stakeholders often rely on technical assistance from specialised legal, tax, and financial advisory firms with expertise in structuring and executing blended finance transactions, along with financial assistance directed at capacity building.
- **Equity:** The ownership stake or share in a company or project. Equity investors are entitled to a portion of the profits or losses of the company or project, as well as voting rights and influence over its decisions. Blended finance transactions may involve different types of equity, such as common or preferred shares, convertible notes, or warrants, to align the interests and incentives of the investors and the investees.
- **Return:** The amount of money that is gained or lost from an investment over a period of time, expressed as a percentage of the initial investment. Return can be calculated as income (such as interest, dividends, or fees) plus capital gains (or losses) from the change in the value of the investment. Blended finance transactions may offer different types of

returns, such as fixed or variable, nominal or real, or risk-adjusted, to reflect the performance and impact of the investment.

Regulatory factors

Blended finance transactions in the US can be highly regulated. For example, blended finance funds, by virtue of being investment funds offering interests to the investing public and charging management fees on capital invested, are regulated by:

- **Securities Exchange Act** – Blended finance firms that involve the issuance of securities are subject to the Securities Exchange Act of 1934, which governs the trading of securities on secondary markets and establishes ongoing reporting and disclosure requirements for publicly traded companies.
- **Investment Advisers Act** – Entities that provide investment advice or manage investments in blended finance funds may be required to register as investment advisers with the Securities and Exchange Commission under the Investment Advisers Act of 1940, which establishes regulatory oversight and fiduciary obligations for investment advisers.
- **Investment Company Act** – Funds that engage in the issuance and public offering of securities may be subject to regulation under the Investment Company Act of 1940, which establishes comprehensive regulatory requirements for companies that invest, reinvest, and trade in securities.

The legal framework for blended finance in the U.S.

Moreover, if they incorporate tax-advantaged dollars by seeking investment by charities and foundations, they will need to consider IRS rules governing tax exempt organisations. At a high level, for a private foundation to participate in a blended finance structure, it will need to ensure the following principles are respected:

- The transaction must have a primary purpose of accomplishing one or more of the foundation's exempt purposes.
- The transaction must not have a significant purpose of producing income or appreciating property. One way to address this is that the expected financial return of the investment is below "market rate" or commensurate with the level of risk involved.
- The transaction must not be used to influence legislation or participate in political campaigns on behalf of candidates.
- The transaction must be consistent with the foundation's charitable mission and program objectives. From a governance perspective, the foundation must exercise due diligence and have an appropriate degree of oversight over the investment and its impact.
- The transaction must be reported on the foundation's annual information return (Form 990-PF) and must be distinguished from other types of investments. This means that the foundation must keep adequate records and documentation of the investment and its terms, performance, and outcomes.

Further development

Blended finance has gained significant traction in the United States over the past decade, transitioning from a nascent concept to a developing and increasingly mainstream approach for catalysing capital towards sustainable development and impact investing. While still not as highly developed as traditional finance sectors, the blended finance ecosystem in America has seen substantial growth and maturation.

The introduction of initiatives such as the New Markets Tax Credit program, Qualified Opportunity Zones, and various renewable energy tax credits have provided a supportive policy framework for blended finance transactions. Furthermore, the increasing adoption of impact investing principles by institutional investors, foundations, and family offices has contributed to the expansion of blended finance in the country. Major financial institutions, asset managers, and impact-focused intermediaries have established dedicated teams and investment vehicles to facilitate blended finance deals, leveraging a range of financial instruments and structures. However, the market remains relatively fragmented, with a diverse array of players operating at various scales and focusing on different impact areas.

The legal framework for blended finance in the U.S.

While the volume of blended finance transactions has increased, the overall scale remains modest compared to traditional capital markets. Limited awareness, complexity in structuring, and challenges in aligning financial and impact objectives continue to pose barriers to widespread adoption.

Nonetheless, the growing interest in sustainable development, environmental, social, and governance (ESG) factors, and the recognition of the potential for blended finance to mobilise private capital towards addressing global challenges have driven its evolution. As more success stories emerge, and the benefits of blended finance become more evident, it is likely that the market will continue to develop, attracting larger pools of capital and more sophisticated financial engineering.

In summary, blended finance in America can be characterised as a developing and increasingly mainstream approach, with significant room for further growth and maturation as stakeholders navigate the complexities and realise the potential for mobilising capital towards positive social and environmental outcomes.

Author:

Chintan Panchal

Law Firm:

RPCK Rastegar Panchal LLP



“Blended finance in America can be characterised as a developing and increasingly mainstream approach, with significant room for further growth and maturation as stakeholders navigate the complexities and realise the potential for mobilising capital towards positive social and environmental outcomes.”

Case Studies



List of case studies

Case study title	Project description	Primary jurisdiction	Category ⁹¹	Author
Funds and projects				
Climate Finance Fund	Climate finance fund	Indonesia	DevBF GRI	Dentons
Conscious Investment Management Social Housing (2021)	Impact fund for social and affordable housing	UK	ImpBF CC	Centre for Social Finance Law
Debt for Nature Swap	Debt for nature swap	Ecuador	DevBF GRI	Dentons
Evolve Housing AHBA Loan	Loan for social and affordable housing	Australia	ImpBF CC	Prolegis Lawyers
Goodstart Early Learning	Impact funded takeover of listed early childhood childcare business	Australia	ImpBF CC	Centre for Social Finance Law
Hope Housing Investment Fund (2023)	Shared equity essential workers housing investment fund	Australia	ImpBF CC	Centre for Social Finance Law
Japan ASEAN Women's Empowerment Fund	Corporate-type fund for gender-lens investing	Japan	DevBF CC	Nishimura & Asahi
Mirova Gigaton Fund	Debt fund for energy transition infrastructure investment	France	DevBF CC	AMP Avocats, Mirova
Near East Foundation Refugee Impact Bond	Development Impact Bond funding micro-enterprise development for refugees and their hosts	Jordan, Lebanon	DevBF CC	Bates Wells
New Forests TAFF2	Sustainable forestry fund with blended finance to enhance impact	Singapore	ImpBF CC	Centre for Social Finance Law
Open Doors African Private Healthcare Initiative	Emergency loan guarantee providing finance to private SME health providers in 5 high malaria burdened African countries	Ghana, Kenya, Nigeria, Tanzania, Uganda	DevBF GRI	RPCK
Qualitas Build-to-rent Impact Fund	Clean energy sector, sustainable rental stock	Australia	ImpBF CC	Prolegis Lawyers
Resilience and Recovery Loan Fund	An emergency loan fund providing repayable finance to charities and social enterprises experiencing disruption as a result of COVID-19	UK	ImpBF CC/GRI	Big Society Capital, Social Investment Business
Resonance Community Developers Fund	Impact fund providing seed funding through to development finance, and wraparound support, to community groups	UK	ImpBF CC	Big Society Capital, Resonance
Roma Entrepreneurship Development Initiative	Technical assistance to Roma community to support access to microfinance and banks	Europe	DevBF GRI/TA	Bates Wells
SDG Loan Fund	EU based USD1.1 billion fund for SDG loans to local enterprises across Latin America, Asia, Africa and Eastern Europe	Europe	DevBF GRI	Allianz Global Investors, MacArthur Foundation and FMO
Simplon Co.	Tandem structure for vocational training	France	ImpBF CC	AMP Avocats with Simplon.c & Simplon Foundation & Simplon Asso
Student Employment SIB	Social impact bonds issued to support employment of students from disadvantaged neighbourhoods	France	ImpBF CC	Perspectives Avocats
Toyonaka Quit Smoking SIB	Debt funding for local government healthcare campaign	Japan	ImpBF CC	Nishimura & Asahi

⁹¹. See **discussion of categories** on page 29. DevBF = blended development finance. ImpBF = blended impact finance. CC = Concessional Capital. GRI = Guarantee/Risk Insurance. TA = Technical Assistance Facility.

List of Case Studies

Case study title	Project description	Primary jurisdiction	Author
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Tailored products

AgDevCo mezzanine loan	Long term subordinated loan	Sub Saharan Africa	AgDevCo
MCE recyclable guarantee	Credit support for emerging market financiers and enterprises	California	Bates Wells, MCE Social Capital

Blended impact finance – Replication models (short form)

Arts & Culture Impact Fund LLP	Public, private & philanthropic investment fund for cultural and creative sector	UK	Bates Wells – case studies taken from Investing-in-our-future-Practical-solutions-for-the-UK-government-to-mobilise-private-investment.pdf (lse.ac.uk), a report by Sarah Gordon, Visiting Professor in Practice at the Grantham Research Institute on Climate Change and the Environment
Bristol City Leap	Public & private finance collaboration for decarbonisation projects		
Green Investment Bank	Government catalyst finance for low carbon transition		
Growth Impact Fund	Multi-layered social investment fund		
Mayor of London's Energy Efficiency Fund	Public & private investment fund for low carbon projects		
Resonance Homelessness Property Funds	Public & private housing investment fund		

Blended impact finance – Institutional models

BSC & Access	Social investment wholesalers	UK	Big Society Capital, Access – The Foundation for Social Investment
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Climate Finance Fund

Author: Vivien Teu, Dentons

Project description: Development financing for SMEs for sustainable agriculture, regeneration and forest protection

Overview

Project name	Climate Finance Fund
Country & sector	Asia Pacific – Indonesia
Total project finance	Private credit fund to offer SME financing of small deal sizes US\$5 – 20 million
Purpose/potential impact	Development and sustainable financing, for SMEs in target countries to engage in sustainable agriculture, regeneration and forest protection, while also delivering financial returns.
Whether successful	Fund first close in Q4 2023

Finance & capital structure

Financing sources (Development & Commercial)	Commercial capital from limited partners investing in climate finance fund Risk guarantee by US DFC on SME financings, based on sustainable development environmental and social commitments
Capital structure (diagram)	As described above

Legal structuring

Legal structure	<ul style="list-style-type: none">• Climate finance fund structured as limited partnership fund• SME financings• US DFC guarantee
Key structural features	As above
Jurisdictions involved	US, Cayman, Hong Kong, Indonesia
Context – what led to blended finance being proposed	Blended finance element with US DFC risk capital guarantee
Solving for (e.g. legal or regulatory barriers, operational issues)	Align fund objectives with risk capital sustainable development objectives, incentive for commercial capital investment in SME financings to achieve sustainable environmental and social goals
Security/charges	SME financings with deal specific security arrangement, along with US DFC guarantee
Key covenants	Specific environmental and social objectives and criteria under partnership fund, aligned with guarantee criteria, to be achieved under SME financing deals and terms
Key learnings	Aligning objectives within a relatively straight-forward structure that can be replicated
Key legal documents	Partnership fund documents; US DFC guarantee; SME financing facility and security documents

Conscious Investment Management Social Housing

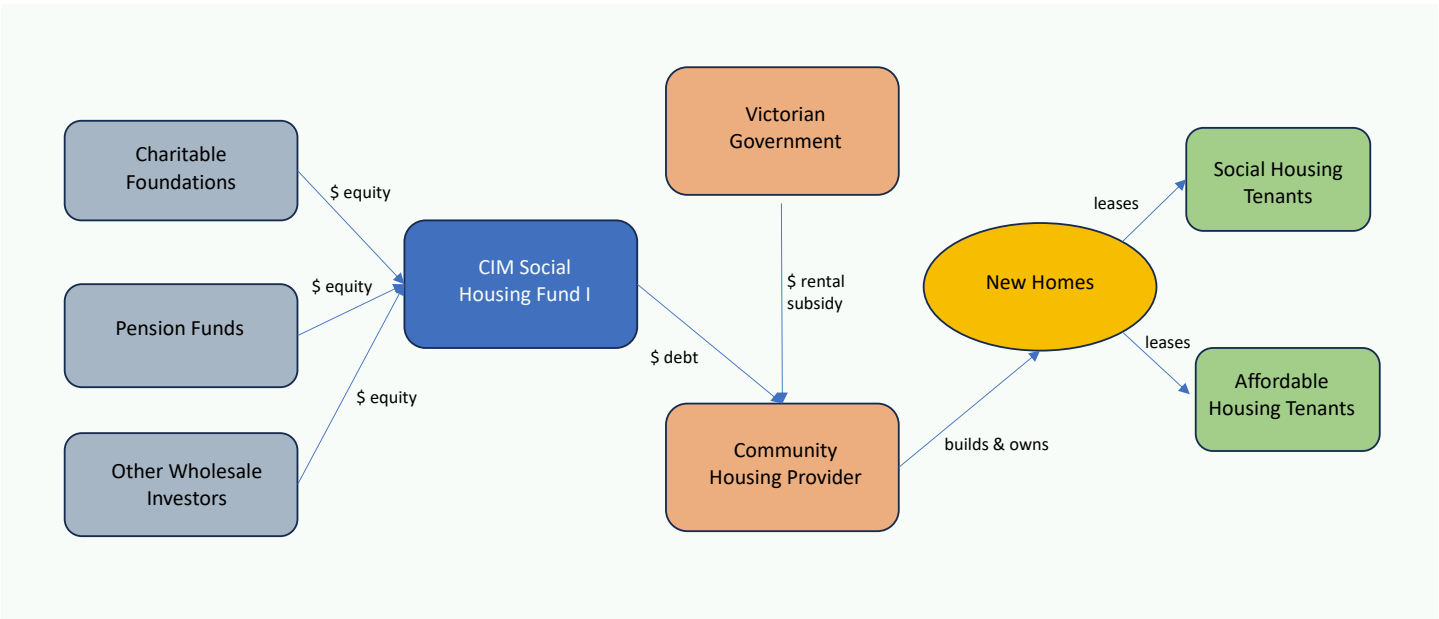
Author: Michael Ryland, Centre for Social Finance Law
Project description: Impact Fund for Social and Affordable Housing (2021)

Overview

Project name	CIM Housing First New Rental Development Program
Country & sector	Australia – Residential Accommodation (State of Victoria)
Total project finance	A\$150 million
Purpose/potential impact	Social and affordable housing for 500 people

Finance & capital structure

Financing sources (Development & Commercial)	Conscious Investment Management Social Housing Fund I supported by “top up” lease payments from Victorian Government under New Rental Development Program
Capital structure (diagram)	CIM Housing First Case Study



Funds and projects

Case study: Conscious Investment Management Social Housing

Legal structuring

Legal structure	A closed ended 10 year wholesale fund providing debt financing to a Community Housing Provider (Housing First) to purchase and manage 307 apartments
Key structural features	<ul style="list-style-type: none">• Wholesale real estate investment fund• Construction and term debt• Community Housing Provider tax and regulatory benefits• Rental returns subsidised by Victorian Government• Fund investors included Paul Ramsay Foundation and Future Super• Operational – CHP tenancy management; Government pipeline of social housing tenants (75%)
Solving for (e.g. legal or regulatory barriers, operational issues)	<ul style="list-style-type: none">• Bridging funding gap between Government/CHP provision of social housing and institutional investment• Confirming power of charitable foundation and pension fund to invest in Impact fund
Security/charges	Real estate mortgages (tbc)
Key covenants	TBA
Key learnings	<ul style="list-style-type: none">• Based on well-established real estate investment fund and financing structures• Charitable purposes/pension fund investment powers based on assessment of market return/risk• Financial viability depends on government subsidy• Outcome viability (and risk assessment) depends on ecosystem – documented by services and partnership arrangements• Indications that it is replicable – eg CIM Bridge Housing NSW A\$65M Social Housing Program (2023)
Key legal documents	<ul style="list-style-type: none">• Fund constitution• CHP debt financing agreement• CHP services agreement• Government program partnership agreement (rental subsidy)

Debt For Nature Swap

Author: Vivien Teu, Dentons

Project description: Debt for nature swap for marine conservation in Ecuador

Overview

Project name	Debt for nature swap
Country & sector	Caribbean – Ecuador – marine conservation
Total project finance	Approximately US\$656 million
Purpose/potential impact	Marine conservation and preservation in the Galapagos
Whether successful	Deal executed in May 2023 – Dentons team in Latin American, Europe and US acted for Ecuador on the transaction

Finance & capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none"> Fixed-rate term facility with GPS Blue Financing Designated Activity Company Partial credit guarantee granted by Inter-American Development Bank Political risk insurance policy by US IDFC
Capital structure (diagram)	<ul style="list-style-type: none"> Exchange of earlier issued sovereign debt for new term facility granted to Ecuador, with payment obligations covered by US IDFC risk insurance policy and partial guarantee up to US\$85 million by Inter-American Development Bank. Payments by Ecuador under term facility to be reference for payments under Galapagos Marine Conservation Linked Bonds associated with marine conservation and preservation in the Galapagos, and debt exchange tied to additional contributions to Galapagos Life Fund.

Legal structuring

Legal structure	As described above
Key structural features	Debt-for-nature swap, linked to Ecuador's sustainability commitments on the management and conservation of marine reserves in Galapagos and growth of nature capital of Galapagos Islands and their marine ecosystem.
Jurisdictions involved	Ecuador / Latin America/Caribbean, US
Context – what led to blended finance being proposed	Repurchase of sovereign debt at discount, with deal resulting in significant savings on debt repayment by Ecuador, carried with the benefit of credit enhancement along incentives for conservation funding
Key covenants	Specific environmental criteria and commitments as basis for blended finance, debt-for-nature swap
Key learnings	This transaction is the largest-ever debt-for-nature swap in the world, (other swaps associated to marine or ocean protection and conservation: Seychelles (2017), Belize (2021), Barbados (2022) and Gabon (2023)) and have sparked tremendous interest within development finance institutions and the broader impact ecosystem, on the scale and potential of such transaction, the scope for innovation towards financing sustainability or impact outcomes, with multiple stakeholders

Evolve Housing AHBA Loan

Author: Stephanie Judd, Prolegis Lawyers
Project description: Social and affordable housing loan in Australia

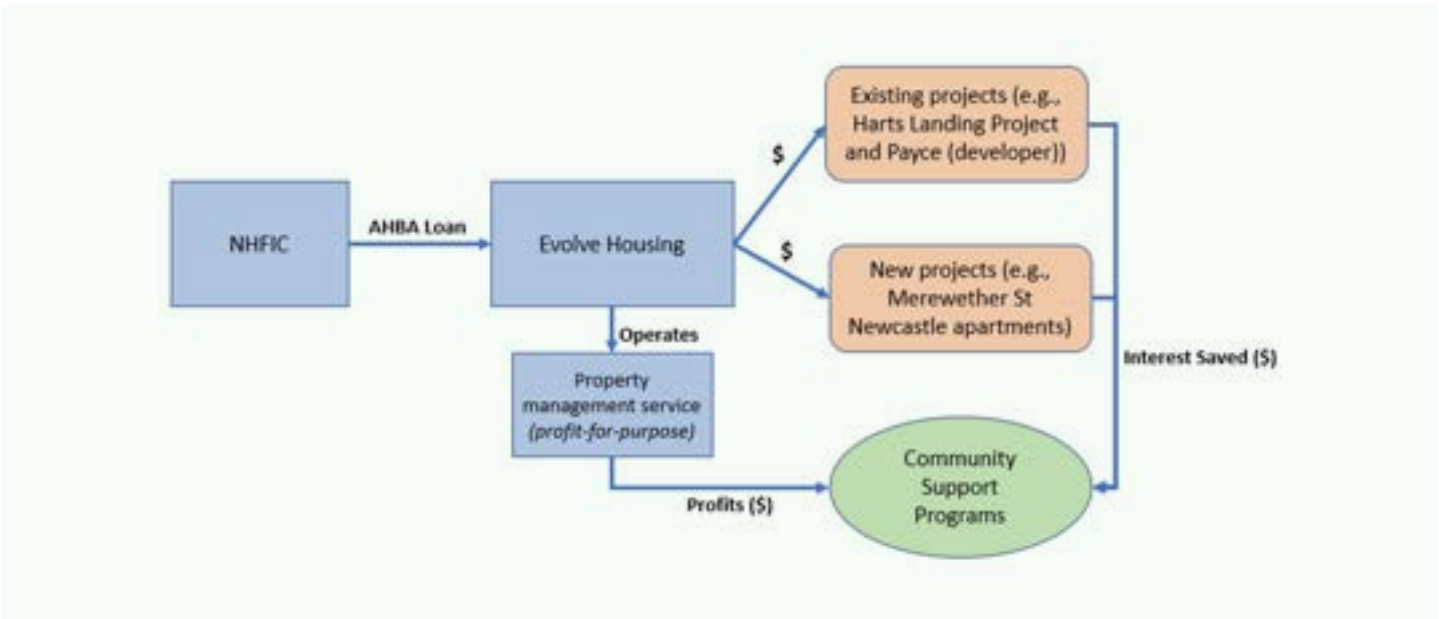
Overview

Project name	Evolve Housing
Country & sector	Australia – Social and affordable housing in VIC and NSW
Total project finance	A\$72 million*
Purpose/potential impact	<p>Relieve housing stress by increasing quality and availability of housing portfolio to enable more people to live in quality homes in thriving and inclusive communities by:</p> <ul style="list-style-type: none">• Refinancing over 670 social and affordable dwellings (with a socially inclusive tenant cohort including key workers, couples over 65, single women over 55, and persons with a disability)• Enabling construction of 34 new dwellings in Newcastle• Anticipated interest savings of around \$9 million over the term of the loan, which will be injected into community programs (and flexibility to acquire further developed sites)

Finance & capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none">• 10-year Affordable Housing Bond Aggregator (AHBA) loan of ~\$70 million from Housing Australia (formerly National Housing Finance and Investment Corporation) to Evolve Housing• This AHBA loan was used to refinance completed assets in a joint venture with a private developer, comprised of commercial tenancy and a mixture of private, social (10 dwellings) and affordable (124 dwellings) housing apartments.• Evolve Housing also operates a profit-for-purpose property management service, which reinvests profits back into social support programs.
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Capital structure (diagram) Evolve Housing AHBA loan structure



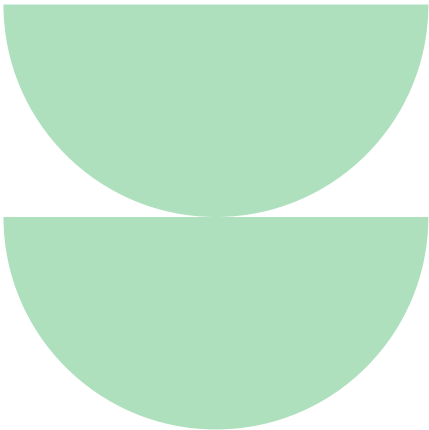
* Evolve Housing Annual Report FY 21-22 states that the NHFIC debt facility is \$100 million, \$72 million of which is available for community housing leasing opportunities, with \$28 million to fund affordable housing acquisitions.

Funds and projects

Case study: Evolve Housing Ahba Loan

Legal structuring

Legal structure	<ul style="list-style-type: none">• Evolve Housing Limited (ACN 127 713 731) is a public company limited by guarantee incorporated in NSW, Australia on 1 October 2007.• It is registered as a charity with the Australian Charities and Not-for-profits Commission, with the public benevolent institution subtype and accordingly endorsed as a deductible gift recipient.• It is a Tier 1 registered community housing provider (CHP) (R4530140623) within the meaning of the Community Housing Providers National Law (NSW), and must comply with the National Regulatory System for Community Housing Standard Conditions of Registration.
Key structural features	<ul style="list-style-type: none">• Evolve Housing is endorsed to access a number of tax concessions.• Evolve Housing's eligibility to receive the AHBA loan is based on its status as a CHP.• NHFIC funds AHBA loans by issuing its own bonds into the wholesale capital market. The Australian Government has provided a \$1 billion line of credit facility through which NHFIC may advance initial loans to community housing providers prior to issuing bonds. AHBA provides greater funding certainty and lower finance costs to CHPs. This assists them to expand their operations and the supply of social and affordable housing.
Solving for (e.g. legal or regulatory barriers, operational issues)	Achieving sustainable growth; Enhancing business practice and capacity; Provide quality homes and services; Improve social outcomes for our clients
Key learnings	<ul style="list-style-type: none">• Based on well-established reinvestment strategies• Developing more detailed operational plans
Key legal documents	Loan Agreement



Goodstart Early Learning

Author: Michael Ryland, Centre for Social Finance Law

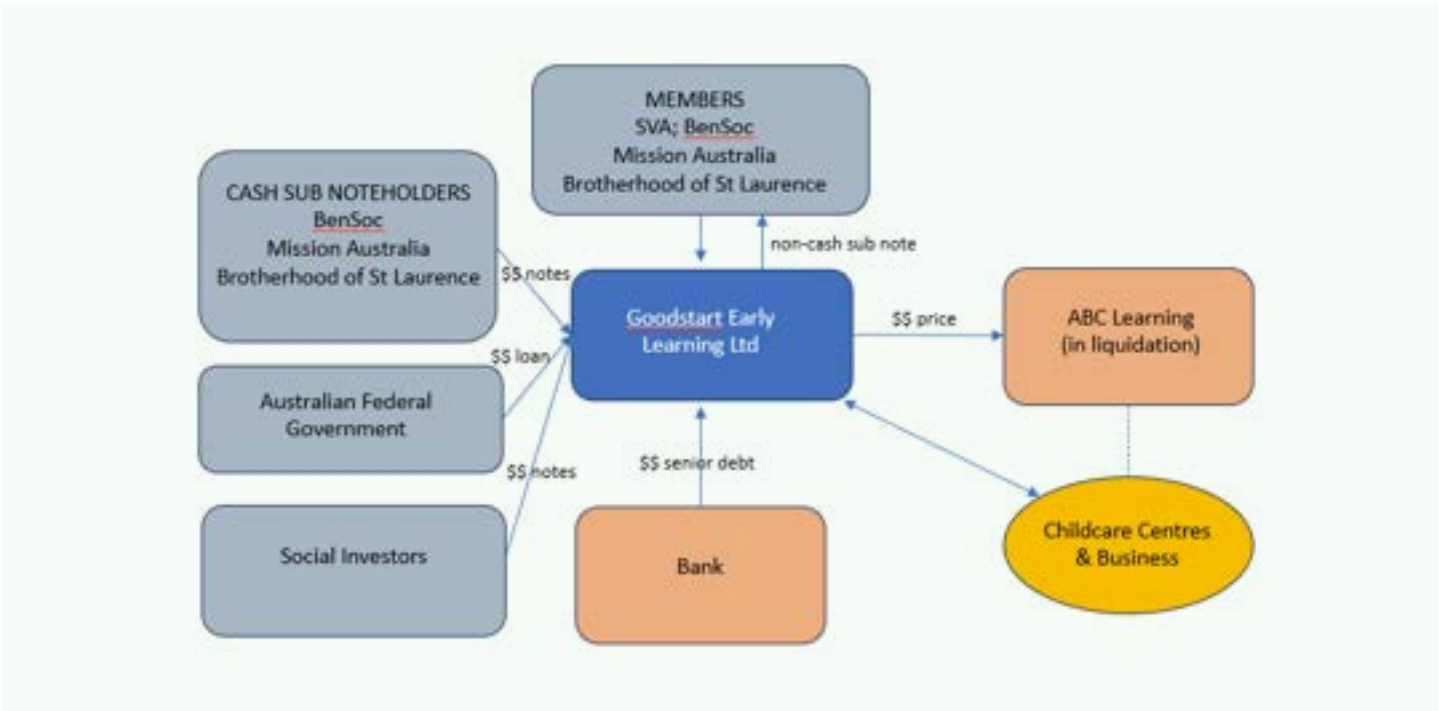
Overview

Project name	Goodstart Early Learning
Country & sector	Australia – Childcare
Total project finance	A\$165 million
Purpose/potential impact	Purchase of 678 childhood centres out of listed company insolvency (otherwise facing closure)

Finance & capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none">A\$95M purchase price + A\$70M operational costs <p>Funded out of</p> <ul style="list-style-type: none">A\$7.5M subordinated notes (15% interest) – 3 charity sponsorsA\$22.5M social capital notes (12% interest) – wholesale social investorsA\$120M senior debtA\$15M Federal Government medium term loanBid advisory costs A\$5M, with A\$750K upfront funded by 3 charity sponsors and balance on successA\$2.5M non-cash members deeply subordinated note (@15% interest) to allow members (2 charity sponsors + impact adviser) to earn income for bid and deal completion
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Capital structure (diagram) Goodstart Early Learning case study



Funds and projects

Case study: Goodstart Early Learning

Legal structuring

Legal structure	<ul style="list-style-type: none">• Charitable consortium formed non-profit corporation as bidding vehicle.• All debt financed because non-profit bidding vehicle could not issue equity.• Layered debt finance as outlined above.• Asset purchase.
Key structural features	<ul style="list-style-type: none">• Non-profit bidder• Non-profit payroll tax benefits preserved• Impact debt layers• Regulated industry• Regulated sale process• Federal government support on commercial terms• Complex acquisition• Time constrained• Non-profit structure allows reinvestment of surplus into impact objectives• Early Learning subcommittee
Solving for (e.g. legal or regulatory barriers, operational issues)	<ul style="list-style-type: none">• Managing a commercial bidding consortium out of non-profit entities• Managing all debt funding of high-risk M&A transaction• Managing primacy of impact objectives in highly leveraged transaction• Maintaining no-profit tax concessions in commercial bid and operational business
Key learnings	<ul style="list-style-type: none">• Iconic but old transaction – 2009. Established impact investing in a listed insolvency context. Query why not replicated?• Transaction was built on strong individual and corporate relationships across relevant sectors.• Successful outcome meeting initial and ongoing impact objectives
Key legal documents	<ul style="list-style-type: none">• Consortium agreement• Note issuance documents• Bank debt documents• Federal government medium term loan agreement• Asset acquisition documents

Hope Housing Investment Fund

Author: Michael Ryland, Centre for Social Finance Law
Project description: Shared Equity Essential Workers Housing Investment Fund (2023)

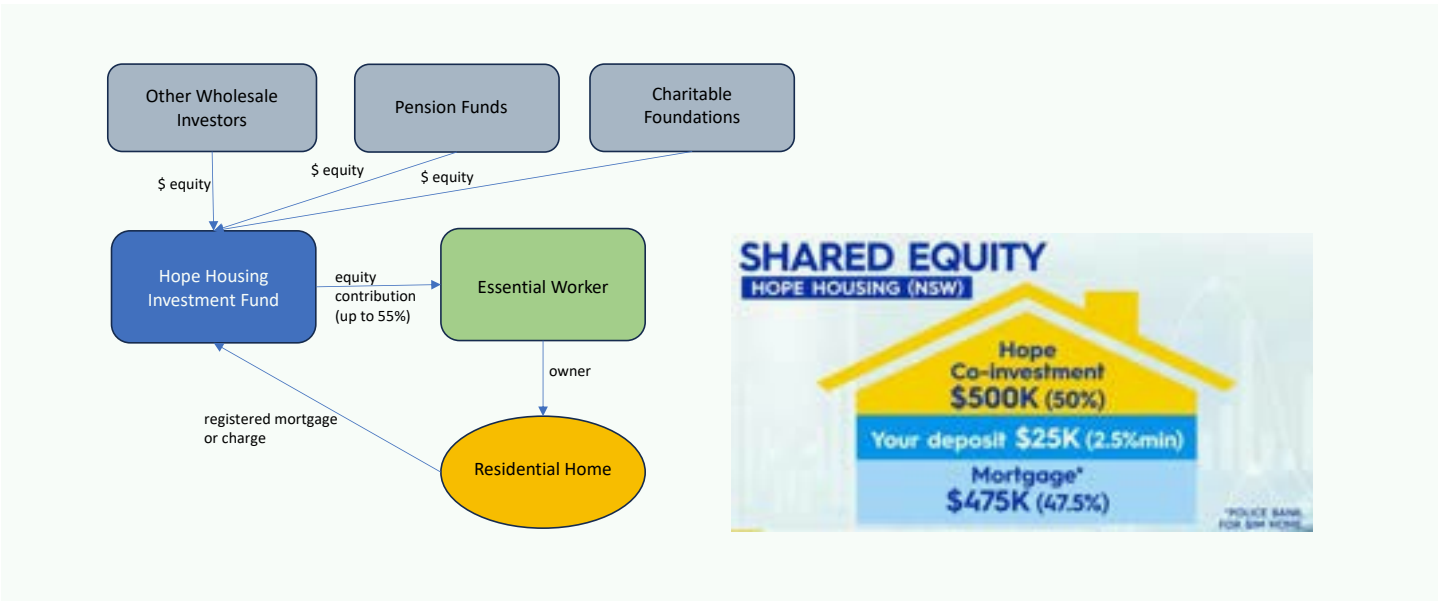
Overview

Project name	Hope Housing Investment Fund
Country & sector	Australia – Residential Accommodation
Total project finance	Target: A\$400 million.
Purpose/potential impact	Helping essential workers buy homes closer to their workplace – reducing burnout, improved health and financial stability
Whether successful	Initial portfolio of 8 homes (A\$6 million) has delivered investment returns better than market and a social dividend of 67cents for each dollar invested

Finance & capital structure

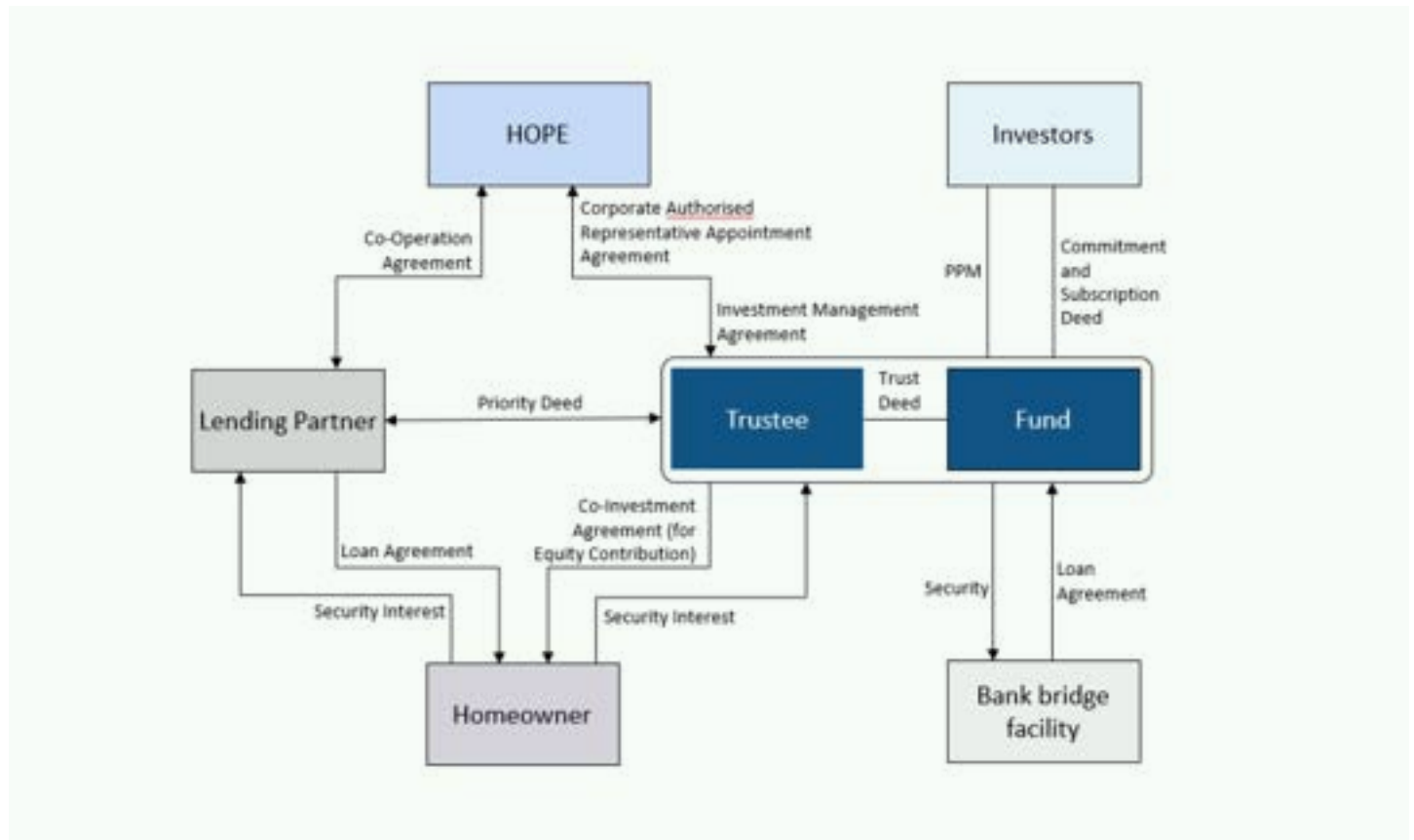
Financing sources (Development & Commercial)	<ul style="list-style-type: none">• Hope Housing Investment Fund is a wholesale investment fund issuing equity interests to foundations, institutional investors and high net worth investors.• It has secured some investment from a private ancillary fund (“PAF” – a type of Australian foundation) which seems to have been catalytic in that it has enabled the Fund to be established and to acquire its initial assets. However, the PAF has invested on the basis that it will derive market returns from the investment (ie it is not a program related investment).• The Fund purchases up to 55% of the residential asset with the balance being provided by the essential worker as owner.
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Capital structure (diagram) Hope Housing case study



Funds and projects

Case study: Hope Housing Investment Fund



Legal structuring

Legal structure

- The Fund is a closed-end, 10 year unlisted wholesale unit trust called "Hope Housing Investment Trust".
- The Trust is operated by a professional trustee (SILC Group) and managed by Hope Housing Fund Management Limited, which is a not-for-profit company focused on raising funds for shared equity investments in essential worker homes.
- As a wholesale fund it is not required to be registered with the Australian Securities and Investments Commission (ASIC). The trustee holds a relevant Australian financial services license (AFSL) and has appointed the manager its corporate authorised representative for AFSL purposes.
- The Fund is intended to qualify as an AMIT for tax purposes (which carries certain tax benefits including for offshore investors).
- Fund reporting includes a regular social impact report benchmarked against impact metrics in the Fund's theory of change.

Key structural features

- Wholesale real estate investment fund
- Existing residential assets only (not off the plan)
- Tax and stamp duty efficient
- Blended finance in two respects:
 - catalytic Foundation investment in Fund on a market return basis
 - Fund co-investment with Essential Worker to achieve social impact

Funds and projects

Case study: Hope Housing Investment Fund

Jurisdictions involved	Australia
Context – what led to blended finance being proposed	<ul style="list-style-type: none">• Housing market in Australia is not affordable for essential workers• Lack of access to market has social cost (health, inequality etc) as well as adverse productivity and retention consequences
Solving for (e.g. legal or regulatory barriers, operational issues)	<ul style="list-style-type: none">• Lack of viable funding structures for essential workers• Tax and stamp duty barriers for institutional investment in relevant asset class
Security/charges	Real estate mortgage or charge over the residential asset
Key learnings	<ul style="list-style-type: none">• Based on well-established real estate investment fund and financing structures• Charitable investment needed even though full market returns due to novelty of structure• Social investment attracted through robust social impact reporting and strong governance arrangements (including personnel)
Key legal documents	<ul style="list-style-type: none">• PPM• Trust Deed• Investment Management Agreement• Co-investment Agreement with Essential Worker• Priority Deed with Essential Worker's lender



Japan ASEAN Women’s Empowerment Fund

Author: Sotaro Hotta, University of Oxford, Nishimura & Asahi
Project description: Corporate-type fund for gender-lens investing

Overview

Project name	Japan ASEAN Women Empowerment Fund (2016)
Country & sector	Country: Association of Southeast Asian Nations (ASEAN) Countries (Cambodia, Myanmar, Philippines, Vietnam, Laos, Malaysia, and Indonesia) and India, Pakistan, and Sri Lanka Sector: Microfinance Institutions
Total project finance	\$241.0 million (final close: 2019)
Purpose/potential impact	<ul style="list-style-type: none">To empower women through increasing their access to financial services, by investing in microfinance institutions (MFIs) that serve female entrepreneurs in primarily ASEAN countries.Target borrowers are MFIs whose borrowers are majority female (60% of clients or more) and/or MFIs that have a product for women or clear intention to develop one.
Whether successful	Impact-to-date (As of Q4 of 2019) <ul style="list-style-type: none">250,000 microentrepreneurs reached.78% of end borrowers are rural clients.91% of end borrowers are female. Investment Period: September 2016 ~ March 2023 Term Closing: September 2024

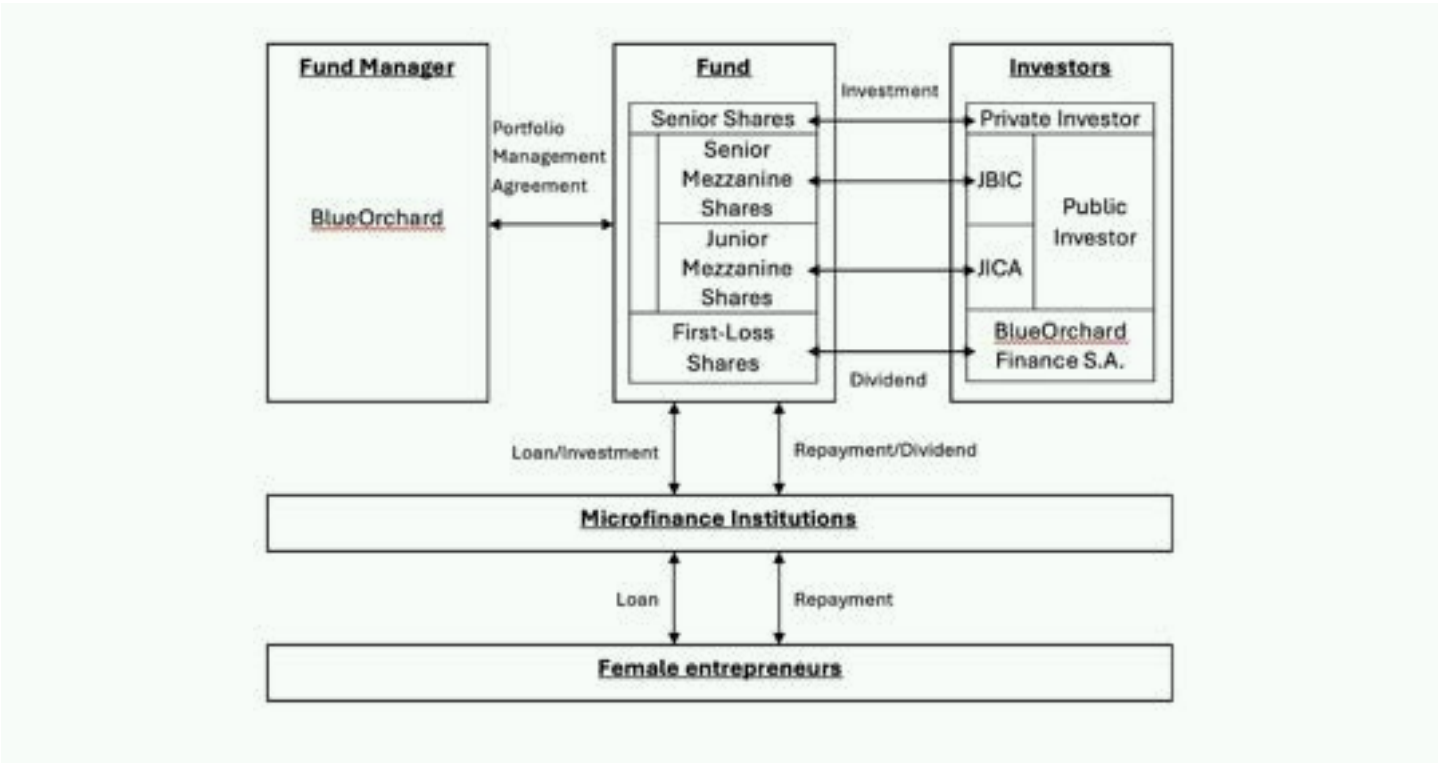
Finance and capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none">Class A Shares: Private Investors (Sumitomo Life, The Sasakawa Peace Foundation)Mezzanine Shares: Public Investors (Japan Bank for International Cooperation, Japan International Cooperation Agency)Junior (first-loss) shares: BlueOrchard, Summit Financial
Capital structure	<ul style="list-style-type: none">Class A Shares: ~ \$120 millionMezzanine Shares: ~ \$120 millionJunior (first-loss) shares: ~\$1 million (to cover foreign exchange (FX) and credit risks on underlying investments)

Funds and projects

Case study: Japan ASEAN Women's Empowerment Fund

Capital structure (diagram) Japan ASEAN Women's Empowerment fund structure



Funds and projects

Case study: Japan Asean Women's Empowerment Fund

Legal structuring

Legal structure	Luxembourg specialised investment fund, formed as a company.
Key structural features	Three-tiered shares.
Jurisdictions involved	Luxembourg
Context – what led to blended finance being proposed	<p>JBIC and JICA were attracted to JAWEF given the Fund's focus on women's empowerment, and the opportunity to mobilise Japanese private sector to commit first-time investments with an impact mandate. Specifically, JICA's investment aligned with JAWEF's strategic objective to support women's empowerment. Meanwhile, through JAWEF, JBIC identified an opportunity to fulfil its own mandate to support the interests of the Japanese private sector.</p> <p>To provide adequate risk coverage for the Fund's target senior shareholders – Japanese institutional investors – JAWEF was structured with a moderate concessional first-loss tranche and a larger concessional mezzanine tranche.</p>
Solving for (e.g. legal or regulatory barriers, operational issues)	It is governed by a Board of Directors and an Advisory Committee. The Board of Directors is comprised of three members. The Fund's Advisory Committee is appointed by the Board of Directors and is comprised of mezzanine and senior investors, including representatives of JBIC and JICA, and senior staff from BlueOrchard.
Key covenants	These tranches rank junior in repayment and receive lower returns than the senior tranche. JBIC and JICA are also eligible for a share of residual and retained earnings at the end of the fund term (i.e. carry).
Key learnings	<ul style="list-style-type: none">• Concessional capital providers do not need to take a first-loss position but rather a mezzanine position to attract the private sector.• Blended finance can be an effective tool for mobilising institutional capital towards gender-lens investing.• Commercially-oriented blended finance vehicles can mobilise institutional investors, particularly when positioned for a specific target market
Key legal documents	<ul style="list-style-type: none">• (Subscription Agreement)• (Shareholders Agreement)



Mirova Gigaton Fund

Author: Alissa Pelatan, AMP Avocat and Sebastien Duquet, Mirova

Mirova is an asset manager dedicated to sustainable finance and impact at scale. With a multi-decade and multi-asset classes experience, it aims at mobilising public and private capital for the ecological and energy transition. In this frame, Mirova acquired SunFunder in 2022, a specialist in emerging markets energy transition infrastructure investment based in Nairobi, the result being the launch of the Mirova Gigaton Fund⁹² (the “Fund”).

Its deep experience in financing and investment structuring combined with a will to mobilise investors seeking to maximise impact enables Mirova to offer a blended finance fund and hence play a catalytic role in energy transition infrastructure investment. The Fund is structured as a debt fund with 3-tranches, its junior investors offering a partial de-risking mechanism to senior and super-senior investors, as they will carry the first potential loss, subordinated to private institutional capital.

The Fund also has a portfolio-level \$50 million guarantee provided under Sida’s regional strategies for Africa and Asia with key cooperation with Norad, as a further de-risking mechanism.

The Fund is designed to bring a commercially scalable blended finance fund into the market that can deploy significant capital into distributed energy. To help achieve this goal, the Fund aims to bring in significant private capital, which would be impossible if it offered below-market pricing to its borrowers. These private capital investors, while clearly keen to make impact investments, are much more strongly motivated by risk-adjusted returns than the

Development Finance Institutions (the “DFIs”) and donor communities, and as such demand market terms from investments.

92. MIROVA GIGATON FUND is structured in the form of a SICAV RAIF (Société d’Investissement à Capital Variable, Reserved Alternative Investment Fund) under Luxembourg law, open to subscription to eligible investors as defined in the regulatory documents. Mirova is the management company and Mirova SunFunder East Africa acts as Investment Advisor to Mirova. The supervisory authority approval is not required for this fund. The Fund is exposed to capital loss risks, legal and regulatory risk, liquidity risk, rate risk, credit risk, emerging markets risk, currency risk, sustainability risk.

Funds and projects

Case study: Mirova Gigaton Fund

Overview

Fund Manager	Mirova S.A.
Fund Vintage	2023 (4th vintage in this strategy)
Investors (commitment as of end 2023) in USD	<ul style="list-style-type: none">• Catalytic Junior Shares: 50 million• Senior Notes: 210 million• Super Senior Notes: 22 million
Mandate	The Mirova Gigaton Fund aims to mobilise institutional investor support for high-impact investments in climate change mitigation and adaptation, social development, economic infrastructure and gender equality in emerging economies, and particularly in Africa, Asia, the Middle East and Latin America, capitalising on its experience with 3 previous vintages and on projects already invested.
Country & Sector	Emerging markets (Africa, Asia, the Middle East and Latin America) – Energy Transition Infrastructure
Target Fund Size	\$400M to \$500M

Legal structuring

Legal/Fund	Luxembourg domiciled Société d'Investissement à Capitale Variable, Reserved Alternative Investment Fund (SICAV-RAIF)
What is this structure solving for?	<p>Today, more than 775m people lack energy access in the world⁹³ - mostly in Africa (600m) and developing Asia (130m) – and the energy crisis makes solving energy precarity even more challenging, as 70m people who recently gained energy access may not be able to afford it⁹⁴.</p> <p>Our goal is to reduce energy poverty and create an equitable, low-carbon world powered by clean energy by becoming a key fund manager for climate investments in emerging markets and underserved communities.</p> <p>The Mirova Gigaton Fund seeks to contribute to climate mitigation, social development, economic infrastructure and gender equality in emerging countries.</p> <p>This blended finance debt fund aims to accelerate the clean energy transition in emerging countries in Africa (particularly Sub Saharan region) and Asia Pacific predominantly, as well as Latin America and the Middle East, by deploying private debt primarily to SMEs (Small-Medium-Enterprises), in solar home systems, agri-solar, commercial & industrial, telco solarization, mini-grid and other promising sectors such as e-mobility, storage, climate-smart food systems, energy efficiency and carbon credit pre-financing. The fund seeks also to have a strong catalytic effect to attract private investors.</p>
Investment Instruments	Debt investments (term and syndicated loans, senior ranking with a cap on subordinated debt instruments)
Fund term	15 years following the Fund's first close

93. IEA, World Energy Outlook 2023.

94. IEA, World Energy Outlook 2022.

Structural risk mitigation mechanism	<p>First loss capital (FLC) is needed to protect commercial private investors in the Super Senior Notes and the DFI investment in the mezzanine tranche</p> <p>Private donors are a top source of FLC, but they can be unreliable and unscalable relationships. As a result, we are moving DFIs down the capital stack compared to our previous funds where they invested in the most senior tranches. DFIs will be subordinate to private institutional capital, but protected by the catalyst junior shares (as DFIs do not want to take the first risks)</p> <p>To provide additional comfort to both DFIs in the mezzanine tranche and to the private institutional investors in the super senior tranche, a SIDA portfolio guarantee of 50 million USD has been successfully established. This guarantee that covers almost all transactions (except the deal in the MENA region), is positioned at a pari passu level with the catalyst junior shares to cover potential losses that the fund may encounter.</p>
Key covenants	<ul style="list-style-type: none"> • Minimum Subordinated capital ratio of 15 % • Juniors + senior above 50 % of the NAV • Problem assets loans below 15% of the NAV
Capital Structure	<ul style="list-style-type: none"> • One tranche of shares: Catalyst Junior Shares • 2 tranches of Notes: Senior Notes and Super Senior Notes
Features to highlight	<p>4 impact key metrics (based on internal and 3rd party assessments as of end January 2024):</p> <ul style="list-style-type: none"> • Climate mitigation targeted level of 13.4 million tons of CO2 emission avoided • Access to energy: 10 million of persons will benefit from a new clean electricity access • Gender lens investing funds: 2X certification • Economic development: 1000 SMEs will benefit from an affordable clean energy access, direct and indirect support of 3.4 million jobs
Key legal elements	<ul style="list-style-type: none"> • SICAV governed by its board of directors, with Mirova S.A. as AIFM and Mirova SunFunder East Africa as investment advisor • SFDR 9 fund • Advisory committee where investors can vote on key strategic decisions • A specific and unusual profit sharing was put in place in the waterfall structure with a specific part for the fund manager should impact objectives have been achieved.
Key legal documents	<ul style="list-style-type: none"> • Articles of Association • Offering Memorandum • Advisory committee policy • AIFM agreement • Investor advisor agreement • Investor Side Letters
Governance structure	<ul style="list-style-type: none"> • Investment decisions are made by the board of directors of the Fund on the recommendation of AIFM (Mirova S.A.) • Investors have some key decision-making power on key matters such as (1) amendments to its Articles of Association and Offering Memorandum, (2) changes to the investment strategy, (3) changes on the impact performance framework

Funds and projects

Case study: Mirova Gigaton Fund

Conflicts between blended sources	<ul style="list-style-type: none">• No conflicts of interest between the different share classes of the Fund• The AIFM and Investment Advisor have conflicts of interest policies in place
Regulatory issues	Some specific elements have been integrated into the fund structure and fund documentation in line of the EU Securitisation regulation
Exit and insolvency	<ul style="list-style-type: none">• Catalyst junior shares (representing 15% of the Fund) will be reimbursed at the liquidation of the Fund (after 15 years)• Senior and Super Senior Notes are reimbursed at maturity (10 years for Super Senior, 15 years for Senior)
Key legal learnings	<ul style="list-style-type: none">• Inclusion of the portfolio guarantee into the Fund key ratios• Long negotiations on the Fund documentation which was exacerbated by dealing with multiple DFI investors on separate streams. Recommend to combine all DFIs demands and negotiate with a single consortium of investors.





Near East Foundation Refugee Impact Bond

Author: Oliver Hunt, Bates Wells

The first Development Impact Bond (DIB) for refugees launched in 2021, 11 years after the start of the Syrian crisis. The Refugee Impact Bond funds the Near East Foundation to deliver a vocational, entrepreneurship, and resilience-building programme for refugees and members of their host communities in Jordan and Lebanon.

The first tranche, in Jordan, is supported by two European private foundations, the Norwegian Agency for Development Cooperation, the U.S. International Development Finance Corporation and a Norwegian investment company.

The DIB addresses three key issues affecting livelihood programmes in humanitarian settings. It offers a multi-year funding commitment, which frees the programme from annual grant cycles. It enables the Delivery Partner to innovate and adapt delivery to a changing context when needed.

Finally, donor risk is reduced by tying payments to the results of a rigorous and independent evaluation of outcomes.

Funds and projects

Case study: Near East Foundation Refugee Impact Bond

Overview

Project name	Refugee Impact Bond
Country & sector	Jordan (phase 1) and Lebanon (phase 2) – Micro-enterprise development
Total project finance	\$9,825,000 for phase 1
Purpose/potential impact	<p>The programme is financed through a development impact bond – a financial model where social investors provide capital to roll out a development programme. Outcome funders pay back the investors if—and only if—the programme achieves measurable social outcomes. Micro-enterprise development is one of the most effective ways to create new businesses, jobs, wealth, and economic independence for disadvantaged communities, while contributing to more dynamic and stable economies.</p> <p>Potential impact:</p> <ul style="list-style-type: none">• 4,380 refugees and Jordanian aspiring entrepreneurs supported through business development and resilience-building training.• 3,400 entrepreneurs to receive start up grants and coaching sessions to support the launch of their micro enterprise.• 1,750 entrepreneurs further supported with additional market-linked technical training and one-to-one mentorship.• +17% expected increase in household consumption.• 75% women supported and 30% youth, both groups that are disproportionately impacted by the crisis.
Whether successful	It is governed by a Board of Directors and an Advisory Committee. The Board of Directors is comprised of three members. The Fund's Advisory Committee is appointed by the Board of Directors and is comprised of mezzanine and senior investors, including representatives of JBIC and JICA, and senior staff from BlueOrchard.

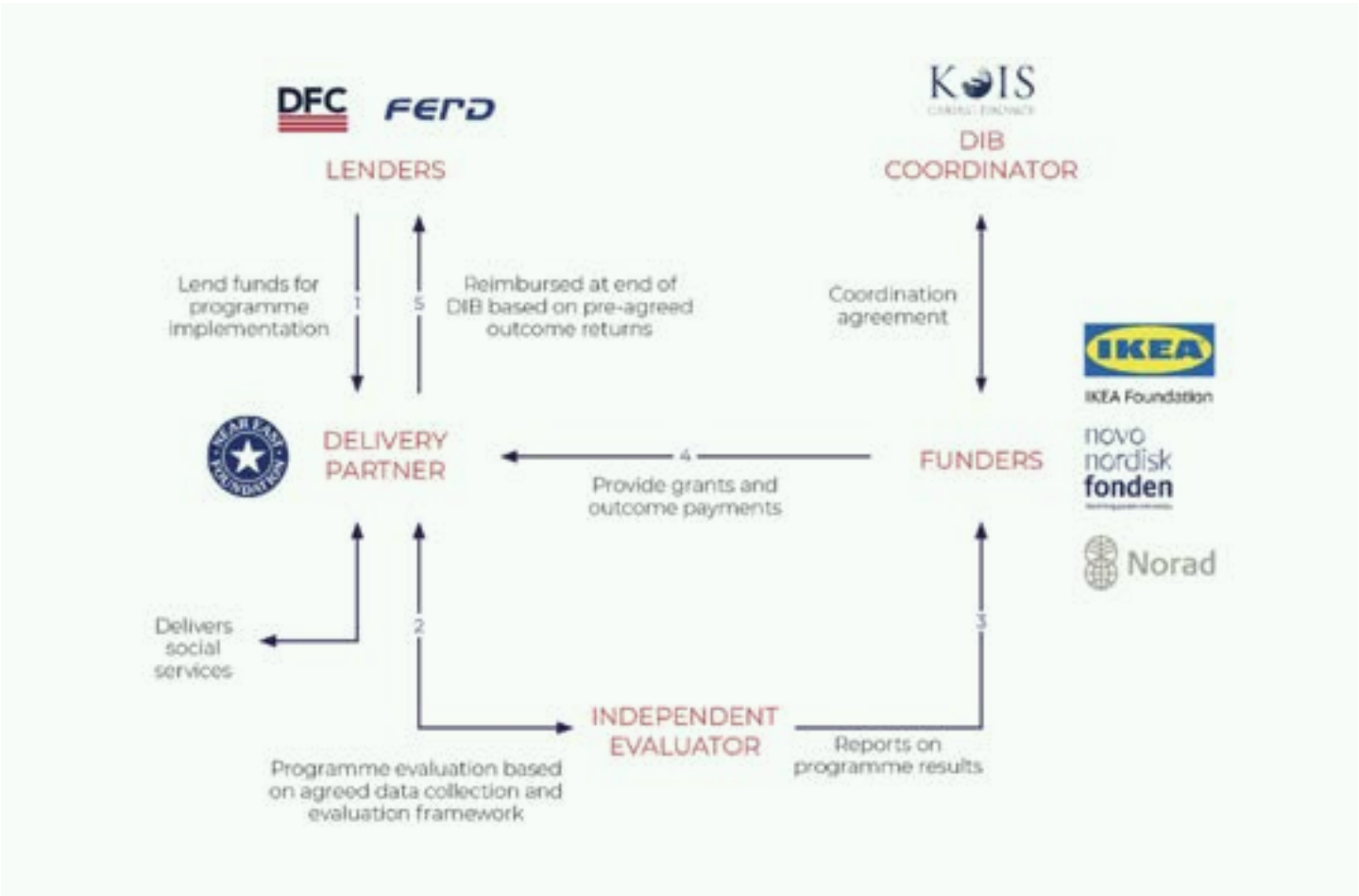
Finance & capital structure

Financing sources (Development & Commercial)	<p>The first phase, in Jordan, is supported by:</p> <ul style="list-style-type: none">• Ikea Foundation, Novo Nordisk Foundation, Norad (outcome funders)• Development Finance Corporation ("DFC"), FERD (lenders funding programme implementation) <p>The Independent Evaluator (Mathematica) and DIB Coordinator (Kois) are contractors to the scheme. KOIS has been retained by the Outcome Funders to monitor the programme's progress, facilitate relationships between the parties and support the relationship with the evaluator with respect to the DIB during its lifetime.</p>
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Funds and projects

Case study: Near East Foundation Refugee Impact Bond

Capital structure (diagram) Near East Foundation Refugee Impact Bond



Funds and projects

Case study: Near East Foundation Refugee Impact Bond

Legal structuring

Legal structure	<p>Near East Foundation UK (“NEF UK”), a UK charity, is the recipient of the lending and outcome funding. NEF UK is part of the Near East Foundation group of charities, headquartered in the USA. NEF UK delivers the micro-enterprise development programme in Jordan alongside other NEF entities, which are also non-profits.</p> <p>A series of finance agreements, outcome funding/grant agreements, framework agreements and evaluation agreements between the parties in the diagram above regulate the relationships, drawing on previous impact bond structures.</p>
Key structural features	<p>DFC and Ferd, the project’s lenders, have committed \$9.8m to prefinance programme implementation. Their commitments are purely outcome-based and unconditional on the programme’s intermediary results.</p> <p>Repayment will be made in one bullet payment, 4 years after inception. The maximum 22% total return (5.1% annualised) will depend on the programme’s success in achieving two payment metrics: business survival after ten months, and improvement in household spending on basic needs after 24 months.</p> <p>The targets for these metrics have been set higher than past results of the programme and of similar benchmark programmes. The programme design has been strengthened to increase the likelihood of achieving these targets.</p>
Jurisdictions involved	UK, US, Jordan, Lebanon
Context – what led to blended finance being proposed	<p>Lebanon and Jordan host more than two million refugees between them, most of whom come from Syria. This puts huge pressure on their economies and creates social tensions. There’s also a lack of long-term funding for programmes to help refugees improve their livelihoods.</p> <p>This method of funding allows refugees and communities affected by conflict to reduce their reliance on humanitarian aid and become self-reliant once again.</p>
Solving for (e.g. legal or regulatory barriers, operational issues)	<p>Providing capital at scale whilst sharing risk amongst different types of capital provider. The lenders risk up to 20% of their capital if the programme fails to meet its impact targets.</p>
Key learnings	<p>All the DIB parties have agreed to share the final evaluation report and learnings to serve the wider community of humanitarian, livelihood, and Blended Finance funders and practitioners. Mathematica will assess business survival rates in relation to past success rates of the programme. The level of success of the household consumption metric will be measured through a quasi-experimental control group method. At the same time, it will assess the impact of other outcome goals which are essential to the programme’s theory of change, along with key modules of the programme results chain. This will support learning and adaptation for NEF.</p> <p>The high-level evaluation framework and payment metrics were designed during the structuring phase of the DIB.</p>

New Forests TAFF2

Author: Michael Ryland, Centre for Social Finance Law

Project description: Sustainable forestry fund with blended finance to enhance impact

Overview

Project name	The Tropical Asia Forest Fund 2 (TAFF2)
Country & sector	Singapore, Sustainable Forestry
Total project finance	USD120M raised; USD300M goal
Purpose/potential impact	<ul style="list-style-type: none"> To invest in certified plantation forestry integrated with landscape management, nature restoration, biodiversity conservation and community benefits. Create value through improved forest management, governance, and timber marketing and processing. The blended finance structure enables the fund to have a “beyond business as usual” impact, investing in 18 high-impact environmental and social activities – including climate action, biodiversity conservation and community engagement and livelihoods at scale (UN SDGs 8, 13 and 15) – alongside commercial outcomes. The fund invests in a diversified portfolio of sustainable forest plantation assets in Malaysia, Indonesia, Vietnam, Thailand, Laos and Cambodia for end markets such as timber, rubber and carbon.
Whether successful	<ul style="list-style-type: none"> Successful first close at USD120M; continuing to raise capital. Awarded the Financial Investigator Impact Investing Award 2021 in the ‘Private Funds’ category. No reports publicly available on impact achieved.

Finance & capital structure

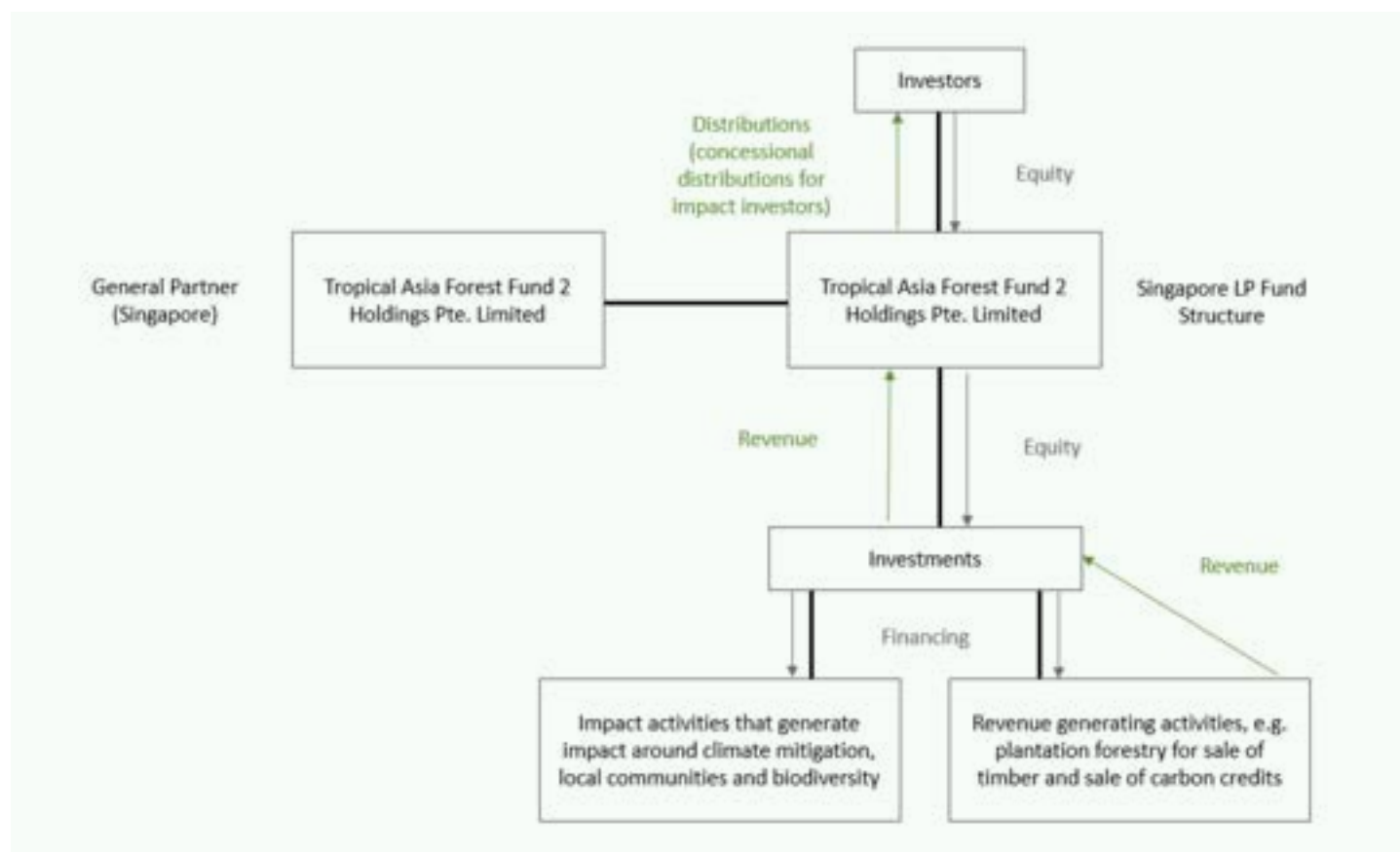
Financing sources (Development & Commercial)	<ul style="list-style-type: none"> Investors in the first close included Asian Development Bank (ADB), the Australian Government’s Climate Finance Partnership, David and Lucile Packard Foundation, Sumitomo Mitsui Trust Bank (SuMi TRUST), Gen Zero (a Temasek-owned entity) and Total Energies. There are 2 classes of units, Class A (Commercial) and Class B (Impact). There is no difference between the Class A and Class B units other than the returns they generate. The majority of cash distributions will go to Class A investors. Their target rate of return is 12%+. Class B investors’ target rate of return is 4%+. The lower Class B return enables more investment in high impact activities. But everyone is investing pro rata in both the fund’s commercial and impact activities. The Class B units are not a first loss facility. Approximately USD50M was invested in Class B units – the impact tranche – at first close.
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Funds and projects

Case study: New Forests TAFF2

Capital structure (diagram)

New Forests TAFF2 structure diagram



Legal structuring

Legal structure

Singapore limited partnership.

Key structural features

- Private wholesale closed end fund
- Based on standard Singapore LP structure
- GP is a special purpose vehicle owned by New Forests Pty Limited. Manager is New Forests Asia (Singapore) Pte Limited which is also owned by New Forests Pty Limited.
- Manager holds a Singapore Capital Markets Services Licence.
- 2 classes of units in limited partnership, Class A (Commercial) and Class B (Impact) to enable blended finance

Jurisdictions involved

- Singapore fund
- Singapore manager
- Fund expects to invest in Malaysia, Indonesia, Vietnam, Thailand, Laos and Cambodia

Funds and projects

Case study: New Forests TAFF2

Context – what led to blended finance being proposed	<p>Asia has the world's fastest growing demand for wood products and Southeast Asia's forestry sector typically produces higher risk-adjusted returns than mature forestry markets.</p> <p>At the same time, overexploitation of Southeast Asia's natural forests has led to declining natural forest supply and production volumes.</p> <p>A lot of new investment is required in sustainable plantation forestry to meet rising regional demand over the long term and create positive climate, community and biodiversity impacts.</p> <p>Despite the potential financial, environmental and sustainable development benefits of sustainable forestry investment in Southeast Asia, institutional investment has lagged in the region due to limited track record and perceived risks.</p>
Solving for (e.g. legal or regulatory barriers, operational issues)	<p>Mobilising more high-impact social and environmental investment from both institutional and impact investors in the context of an investment opportunity that is generating normal commercial rates of return:</p> <ul style="list-style-type: none">• Impact investors are basically getting impact at scale by leveraging the capital commitments of the commercial investors; and• Commercial investors have the opportunity to invest in impact at a greater scale than they could with a conventional fund, but are compensated for doing so with impact-oriented investors' equity <p>Objective is to demonstrate that asset management that integrates commercial forestry investments with activities like ecosystem restoration, reforestation and community forestry will lead to better returns, alongside long-term sustainability outcomes.</p>
Security/charges	n/a
Key covenants	<ul style="list-style-type: none">• 50% of the Class B capital commitments will be spent on impact activities during the life of the fund, with climate mitigation being a particularly big focus.• A rigorous ESG approach, asset management certified to international standards, and regular reporting to investors on the plan for impact activities and progress.
Key learnings	<ul style="list-style-type: none">• Singapore was chosen for the structure because it was an acceptable location for the institutional investors and it was the location of the Manager.• The structure was based on an established form of investment fund. The blended finance elements were able to be designed and incorporated in that fund structure without giving rise to any special legal problems or hurdles.• The structure adopted fairly standard terms for governance and decision making, and for default• In principle the structure should be replicable for any similar project where there is sufficient blended finance investor interest.
Key legal documents	<ul style="list-style-type: none">• Limited Partnership Agreement• Management Agreement• Private Placement Memorandum• Side Letters for individual investors

Open Doors African Private Healthcare Initiative

Author: Chintan Panchal, RPCK Rastegar Panchal LLP

Project description: Emergency loan guarantee providing finance to private SME health providers in 5 high malaria burdened African countries

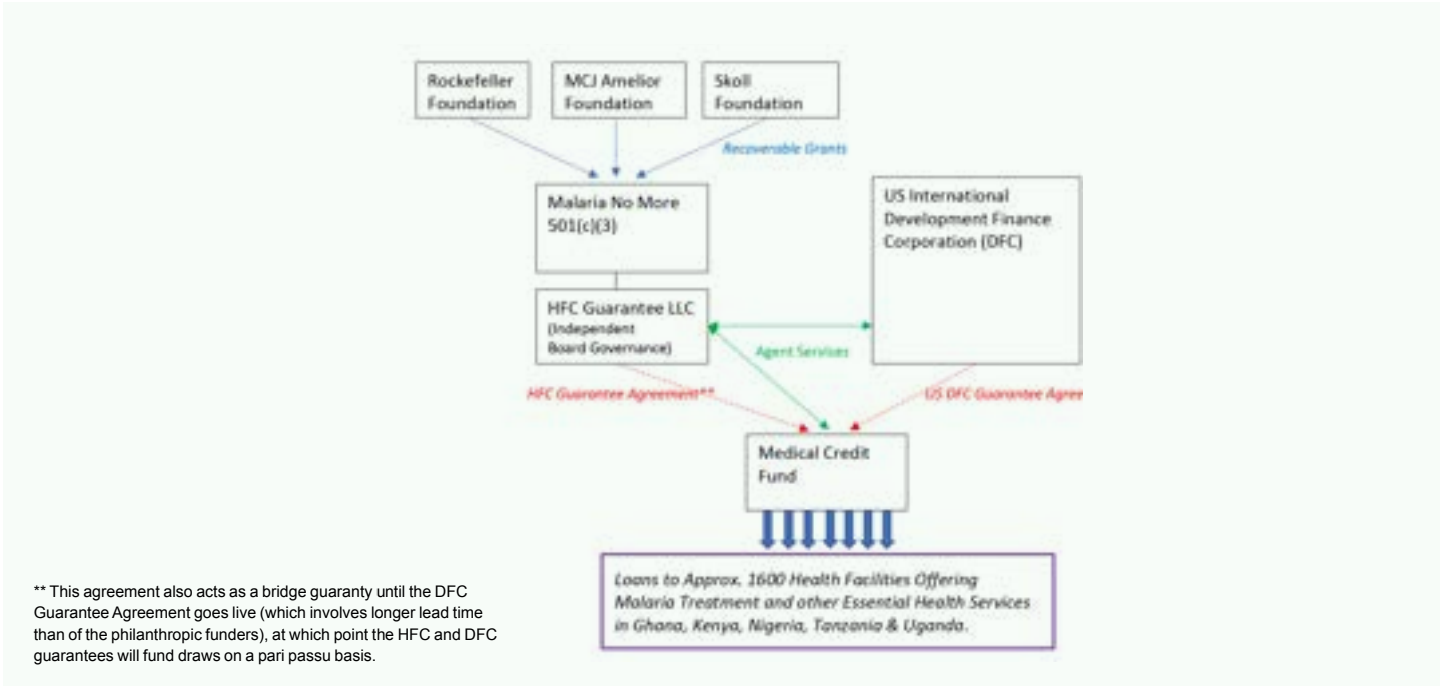
Overview

Project name	Open Doors African Private Healthcare Initiative (ODAPHI)
Country & sector	Ghana, Kenya, Nigeria, Tanzania, Uganda; Healthcare
Total project finance	USD \$19.2 million guarantee, which unlocked \$30 million in emergency loans
Purpose/potential impact	Preventing collapse of 1600 front line medical clinics providing sole point of care for 5 million people (3 million low income; 2.4 million women; 1.4 million children)
Whether successful	Yes

Finance & capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none">Govt: (US President’s Malaria Initiative; US DFC); Philanthropic: (Rockefeller Foundation, Skoll Foundation, MCJ Amelior Foundation);Technical Assistance: USAID;Commercial: Medical Credit Fund (lender)
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Capital structure (diagram)	Medical Credit Fund Guaranty Structure
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Funds and projects

Case study: Open Doors African Private Healthcare Initiative

Legal structuring

Key structural features	<p>A \$700k investment by the President's Malaria Initiative unlocked a \$17.7m guarantee by DFC, which needed private foundation guarantees to be integrated into the structure, both de-risking the DFC commitment and acting as an immediate bridge guarantee while the DFC guarantee went through internal approvals.</p> <p>A SPV was set up as an independent pass-through entity (DE LLC) to originate and administer the dual-guarantee facility. The SPV serves as facility agent for the guarantors and coordinates and administers the guarantees provided by each guarantor.</p> <p>The private guarantors (i.e. foundations) enter into a Master Guarantee Agreement (MGA) with the SPV, as facility agent, and MCF, as guaranteed party. This facilitates direct accountability between the private guarantors and MCF. Key components of the MGA will include the rights and responsibilities of the guarantor parties, the guaranteed party, and the role of the SPV to manage the relationships among the various private guarantors, and between MCF and those guarantors.</p> <p>DFC enters into its guaranty agreement (DFC Guarantee) with MCF, as guaranteed party, and the SPV, as syndication agent, which facilitates direct accountability between DFC and MCF, while allowing the SPV to coordinate guarantee coverage and draws across the MGA and the DFC Guarantee. In addition, the SPV streamlines processes, reporting obligations, and other responsibilities vis-à-vis the two agreements for MCF, thus reducing its administrative burden.</p>
Jurisdictions involved	US (Delaware), Netherlands, Ghana, Kenya, Nigeria, Tanzania, Uganda
Context – what led to blended finance being proposed	Severely decreased revenues due to COVID-19 threatened to shutter 1600 healthcare SMEs in sub-Saharan Africa. The pre-existing lender's (MCF) covenants restricted it from lending to any companies at a high risk of default. Thus, the stakeholders needed to move quickly to amass a significant amount of capital needed to keep the SME medical clinics operational. A syndicated guarantee structure was devised to blend private foundation capital together with US Govt. development capital, in order to unlock MCF's ability to resume commercial lending to the SME medical providers.
Solving for (e.g. legal or regulatory barriers, operational issues)	Speed, risk sharing
Security/charges	The objective of this project was to create a security layer over pre-existing loans in place between MCF and the SME medical clinics. The specific security feature utilised in this project was a guarantee.
Key covenants	Even though this structure is at its core a guarantee, the overall relationship is more of a lender-borrower dynamic as between the guarantor and guaranteed party. Thus, a number of standard DFI lender-style covenants were included.
Key learnings	When solving for speed, we sought to utilise as much existing commercial and relationship infrastructure as we could. Even still, regulated entities and complex structures take time to implement, even when there is significant political will. Thus, we needed to repeatedly return to first principles and re-imagine elements of the structure that could meet the impact goals while working within the overall framework (e.g. utilising the foundation guarantee as a bridge and then evolving it into a pari passu guarantee).
Key legal documents	Guarantee Facility Agreement

Qualitas Build-To-Rent Impact Fund

Author: Stephanie Judd, Prolegis Lawyers

Project description: Australia's first environmental and sustainable focussed real estate debt fund in the build-to-rent sector.

Overview

Project name	Qualitas Build-to-Rent Impact Fund
Country & sector	Australia wide – Clean energy sector, sustainable rental stock
Total project finance	<ul style="list-style-type: none"> • A\$1 billion Build-to-rent (BTR) impact debt fund • Combined with up to \$125 million cornerstone commitment from Clean Energy Finance Corporation (CEFC)
Purpose/potential impact	<ul style="list-style-type: none"> • Providing a cost-effective capital solution to develop and own BTR accommodation and to lead the way through capital allocation to promote and reward sustainable construction methodologies. • Australia's first property debt fund to elevate minimum sustainability criteria through investment. • Accelerates Australia's transition to a low carbon economy and helps reduce emissions generated by residential housing. • The fund will finance housing that meets strong sustainability standards and reduces greenhouse gas emissions by at least 35 percent compared with the current building code, boosting the availability of sustainable rental stock and extending clean energy benefits to renters in Australia. • Best practice energy performance initiatives give property owners and managers the opportunity to unlock substantial energy savings, reduce emissions and potentially improve liveability for tenants.
Whether successful	<p>First transaction in 2021 is a development named Cordelia in Brisbane, Queensland.</p> <p>It is a collaboration between Qualitas, CEFC, Arklife (a specialist BTR developer and operator) and ADCO (a construction company). Unsure of investment returns at this stage.</p>

Finance & capital structure

Financing Sources (Development & Commercial)	<ul style="list-style-type: none"> • Qualitas Build-to-Rent Impact Fund is Australia's first environmental and sustainable focused real estate debt fund in the BTR/multifamily sector. • The fund is backed by cornerstone investment commitment of A\$125 million from CEFC. • Secured debt arrangement. Fund provides up to 7-year loans, loan to value ratios (LVRs) of up to 70%, and competitive pricing.
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Funds and projects

Case study: Qualitas Build-To-Rent Impact Fund

Legal Structuring

Legal Structure	The Fund is an unlisted secured debt real estate investment fund managed by Qualitas Limited, an ASX-listed Australian alternative real estate investment manager with A\$8 billion of committed funds under management.
Key Structural Features	<p>First dedicated sustainable investment fund in the BTR market</p> <p>First debt fund to elevate sustainability into its investment criteria. To qualify for QBIF finance, projects must demonstrate minimum sustainability standards, including:</p> <ul style="list-style-type: none">• Average NatHERS rating of seven stars• 5 Star NABERS for Apartments Energy rating• Criteria for energy efficient appliances• Capacity includes rooftop solar. <p>Targets a 6% return on investment</p> <p>BTR provides significant benefits within real estate and credit portfolios, including low volatility, low correlation to other asset classes, and a diversified credit risk due to a large tenant base.</p>
Solving for (eg. Regulatory barriers, operational issues)	<ul style="list-style-type: none">• BTR based on environmental, social and governance principles• Improving quality of rental housing stock to reduce emissions generated by residential housing
Security/Charges	Yes – but unclear nature of the security
Key Learnings	<ul style="list-style-type: none">• Attractive to BTR developers, evidenced by Qualitas' identification of a pipeline of 5 significant projects totalling over \$700 million in loans.• Tailor-made for emerging BTR sector, with loans covering both the construction and the operational phases (rather than merely pre-sales debt coverage like in the build-to-sell model)



Resilience And Recovery Loan Fund

Authors: John White and Guilia Todres, Big Society Capital

In 2020 there was a global pandemic of COVID-19. The UK government (like most others) responded with a series of lockdowns which severely restricted economic activity. Many charities and social sector organisations found their income streams drying up while many still needed to operate to deliver their missions. The Resilience and Recovery Loan Fund was put in place at pace (within 6 weeks of the UK's first lockdown) to deliver repayable capital to a section of the social sector that required liquidity in order to survive (many organisations struggling at the time would not have benefited from repayable finance).

The fund benefited from The British Business Bank's Coronavirus Business Interruption Loan Scheme (CBILS) which provided a loss-sharing guarantee to accredited lenders of 80% of any loan capital losses on each loan with no portfolio cap. Arrangement fees for the loans and the interest payments for the first 12 months were paid by the British Business Bank on behalf of the customer. The fund was intended to allow the social sector to benefit from access to funding where risk appetite was increased due to the guarantee of this scheme.

A grant from Access was dispersed to the frontline organisations alongside repayable capital, but only in instances where the grant would make the total funding package affordable to the customer.

The fund was managed by Social Investment Business (SIB) and delivered via a 'hub-and-spoke' model alongside seven other social lenders (Big Issue Invest, Social Investment Scotland, Wales Council for Voluntary Action, CAF Venturesome, Charity Bank, Social and Sustainable Capital, Resonance).

The social lender partners would introduce customers to the fund, and also undertake due diligence, credit assessments and funding recommendation to a central fund investment committee. This was very much a fund that fostered a collaborative social lender response across Wales, England and Scotland to provide liquidity to the social sector through the pandemic

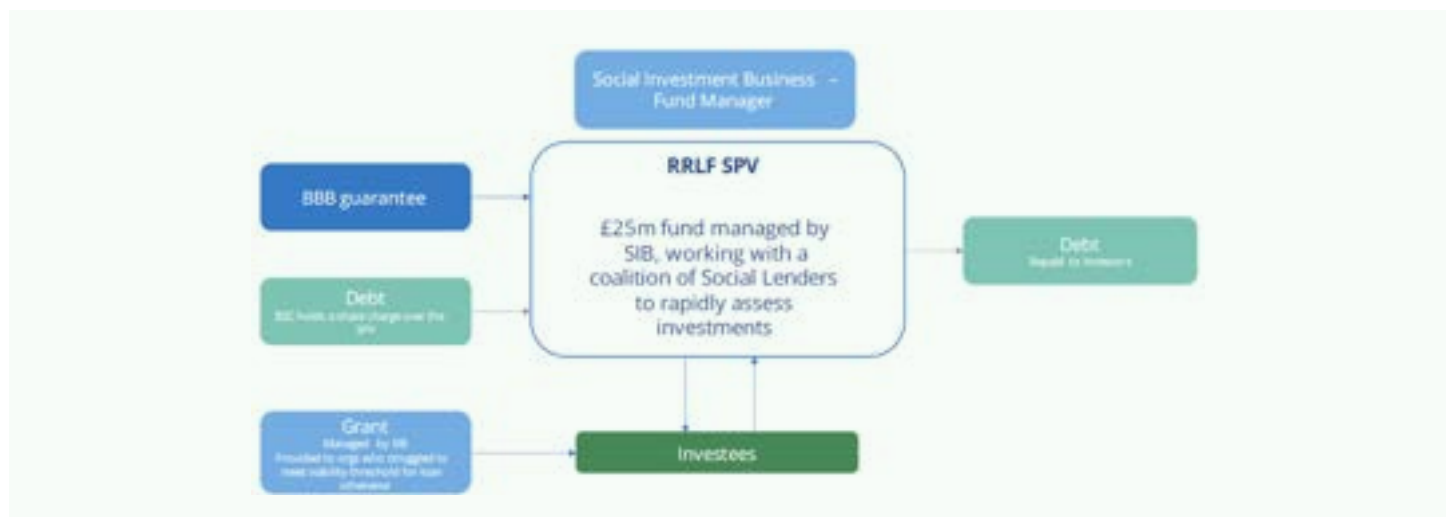
Funds and projects

Case study: Resilience And Recovery Loan Fund

Overview

Fund Manager	Social Investment Business Foundation (SIBF), working with coalition of Social Lenders to assess investments
Fund Vintage	2020
Investors	<ul style="list-style-type: none"> • Debt £25m: Big Society Capital (BSC) • Guarantee: The British Business Bank's Coronavirus Business Interruption Loan Scheme (CBILS) • Grant £4m: Access – The Foundation for Social Investment (added later) (Access)
Mandate	An emergency loan fund (RRLF) which sought to provide repayable finance to charities and social enterprises experiencing disruption as a result of COVID-19 but who otherwise have a viable business model, by making the Government guarantee scheme more easily accessible to these entities.
Country & sector	UK Social Lending
Target Fund Size	£25m
Legal/Fund Structure	Special Purpose Vehicle – private company limited by shares with social objects
What is this structure solving for?	Social sector organisations struggled to access repayable finance from mainstream lenders offering government-backed Coronavirus Business Interruption Loan Scheme (CBILS) so the RRLF sought to provide emergency finance, with a successor Recovery Loan Fund later providing financing to stabilise and grow in the recovery phase after the COVID-19 pandemic.
Investment Instruments	Limited-recourse debt with equity characteristics (no fixed interest rate; cash sweep return from SPV to BSC)
Fund term	6 years (later extended to 7 years)
Structural risk mitigation mechanism	Guarantee: Debt, Concessional Capital + Guarantee
Key covenants	<p>All loans must comply with and be made under the CBILS</p> <p>Loans could only be made to Eligible Social Sector Organisations – see below</p>

Capital Structure



Funds and projects

Case study: Resilience And Recovery Loan Fund

Features to highlight	<ul style="list-style-type: none">• It is structured in a way that allows for the participation of a coalition of different fund managers, maximising reach and speed of delivery, particularly in a crisis. To underline the point this fund was designed, funding secured and launched to applications within 6 weeks of the UK government announcing the first COVID-19 lockdown.• COVID-19 interruption to organisations' business models meant that some would struggle to meet a viability threshold for a loan even with CBILS guarantee – a grant from Access was added later on to help de-risk the most fragile borrowers
Key legal elements	<ul style="list-style-type: none">• The debt was paid into Social Investment Business FM Limited (SPV). The grant flowed through SIB's separate trading entity. The SPV is structured as a private company limited by shares as this is a flexible and well understood vehicle.• The Fund's mission is protected by: (1) protective provisions embedded in the SPV's articles of association and the facility agreement; (2) external investment management with contractual obligations in the service level agreement to pursue the Fund's mission; (3) charge over the shares in the SPV; (4) the production by the manager of an "Impact Canvas" setting out how the Fund intends to create and measure impact against which the Fund reports to investors.• The grant contract was restricted to being deployed alongside a loan, only where it made an unviable/unaffordable funding package viable/affordable.• Fees to Social Investment Business for running the fund are payable as a % on outstanding loans to frontline organisations less write offs. Other fees funded by an arrangement fee which is paid by CBILS.• CBILS provided a guarantee to accredited lenders of up to 80% per loan.• Investments must be made into "Eligible Social Sector Organisations" (ESSOs) defined as 1) eligible for securing financial support under CBILS, 2) based in and operating in the UK, 3) has social objects and is asset locked, and 4) is either a registered charitable organisation or adopts social and mission lock wording in its articles• Grants could only be awarded alongside a loan to organisations in England as the Funder (Access) money is restricted to use in England only.
Key legal documents	<ul style="list-style-type: none">• Memorandum of Understanding – signed within 6 weeks of the first UK lockdown as important signalling to the sector<ul style="list-style-type: none">- SIBF- BSC- SIBF as parent- BSC as lender- BSC as agent- BSC as security trustee• Grant agreement, between:<ul style="list-style-type: none">- Access- SPV• Service level agreement (incorporating the Investment Manual), between:<ul style="list-style-type: none">- Social Investment Business Limited (SIBL)- SPV

Funds and projects

Case study: Resilience And Recovery Loan Fund

Key legal documents continued	<ul style="list-style-type: none">• Social lender service level agreement (incorporating the Investment Manual), between:<ul style="list-style-type: none">- SIBL- Other social lenders acting as introducers• Share pledge, between:<ul style="list-style-type: none">- BSC- SIBF• Bank account charge<ul style="list-style-type: none">- BSC- SPV• Security trust deed, between:<ul style="list-style-type: none">- SPV as borrower- SIBF as parent- BSC as lender- BSC as agent- BSC as security trustee• Ancillary documents included:<ul style="list-style-type: none">- Standard Assessment Templates- Application form- ESSO loan agreements- ESSO grant agreements- ESSO security agreements
Governance structure	<ul style="list-style-type: none">• Investment decisions are made by the Investment Committee which is constituted by the SPV. BSC has a voting and observer seat on the IC.• SIBL conducts the business of the SPV and co-ordinates IC papers and recommendations prepared by SIB and other social lenders.• Investment committees were held weekly or over a year to make rapid funding decisions given the urgency and volumes.• Investors have veto power over the customary matters which would be expected in a facility agreement including amendments to the service level agreement, any social lender services level agreement and the investment manual
Enforceability	<ul style="list-style-type: none">• All obligations are drafted with the intention to be legally enforceable (investment and grant into the SPV and onward investments).• Grant funding is subject to a claw back on the occurrence of certain events including use of the grant outside of the agreed purposes.
Conflicts between blended sources	<ul style="list-style-type: none">• There is no specific dispute resolution mechanism.• The Investors and grantors are parties to different agreements.• The grants and loans flowed through separate companies in the SIB Group and out to customers.• There were separate terms of reference for the grants and loan committees with separate minutes of decisions. However, the members of the grant and loan committees were the same and the awarding of a loan and grant would be presented and discussed together for each individual case.• Part of the blend was a government scheme which the parties to this fund developed the fund specifically to access.

Funds and projects

Case study: Resilience And Recovery Loan Fund

Regulatory issues

- Both Access and BSC were subject to EU state aid rules with regard to the use of public money.
- Access is subject to regulation by the Charity Commission and must provide grant in line with its charitable objects
- The fund was reliant on the government backed CBILS scheme to be viable.
- RRLF was structured with only bilateral funding from BSC meaning that the structure was not a “collective investment scheme”(CIS) or an “Alternative Investment Fund”(AIF) – which have enhanced regulatory requirements. If additional investors had come into the structure it could have become a CIS or an AIF.
- The successor fund was structured as a club debt facility with multiple lenders which is not captured by the rules on CISs or AIFs.

Exit and insolvency

- Investors exit by repayment of their loan via a cash sweep with outstanding amounts repaid at the end of the term.
- CBILS provided a guarantee to accredited lenders of up to 80% per loan.

Key legal learnings

- A key challenge was moving at pace to provide needed support to the sector swiftly.
 - The fund contributed many lessons for the set-up of the Recovery Loan Fund which was backed by the government’s Recovery Loan Scheme. There were structural similarities but key improvements:
 - Multiple lenders investing as a club debt facility
 - Upside/downside risk held by SPV (not lenders) avoiding enhanced regulatory requirements which would be triggered by CIS or AIF status
 - Instructed third party agent and security trustee
 - SIB contributed an equity layer to the SPV
 - The RLF did maintain some RRLF features such as:
 - Hub and spoke model with multiple partners continues
 - Use of government guarantee remains (the sector had to push to for the reinstatement of charity exemption to trading income percentage (one of the CBILS eligibility factors)
 - Additional grant alongside loans for targeted support e.g. Flexible finance for BAME-led and Cost of living grants for organisations tackling cost of living
 - The crisis response nature of the RRLF required a distinct approach from all parties:
 - BSC, SIB and partners working at risk and on trust, without all legal documentation in place in the usual order
 - Pooling of capacity and resources across BSC and SIB and partners to get what was needed done i.e. informal secondment of time/work by BSC to SIB
 - Adapting and gaining funder sign off to changes to investment manual to adjust for rapidly changing external environment
 - IC members willing to read papers with 24 hours pre-circulation and attend weekly meetings
 - Funders agreed flexible terms in terms of risk/return and default assumptions in light of low forward looking visibility
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Resonance Community Developers Fund

Author: John White, Giulia Todres (Big Society Capital) & Resonance

There is a lack of resources within communities and from local authorities in the UK to tackle local housing shortages and finance non-essential assets and services such as sports and leisure facilities. Local community groups often lack the operational and financial expertise to develop assets, and to attract and manage funding, for local community-led solutions to these problems.

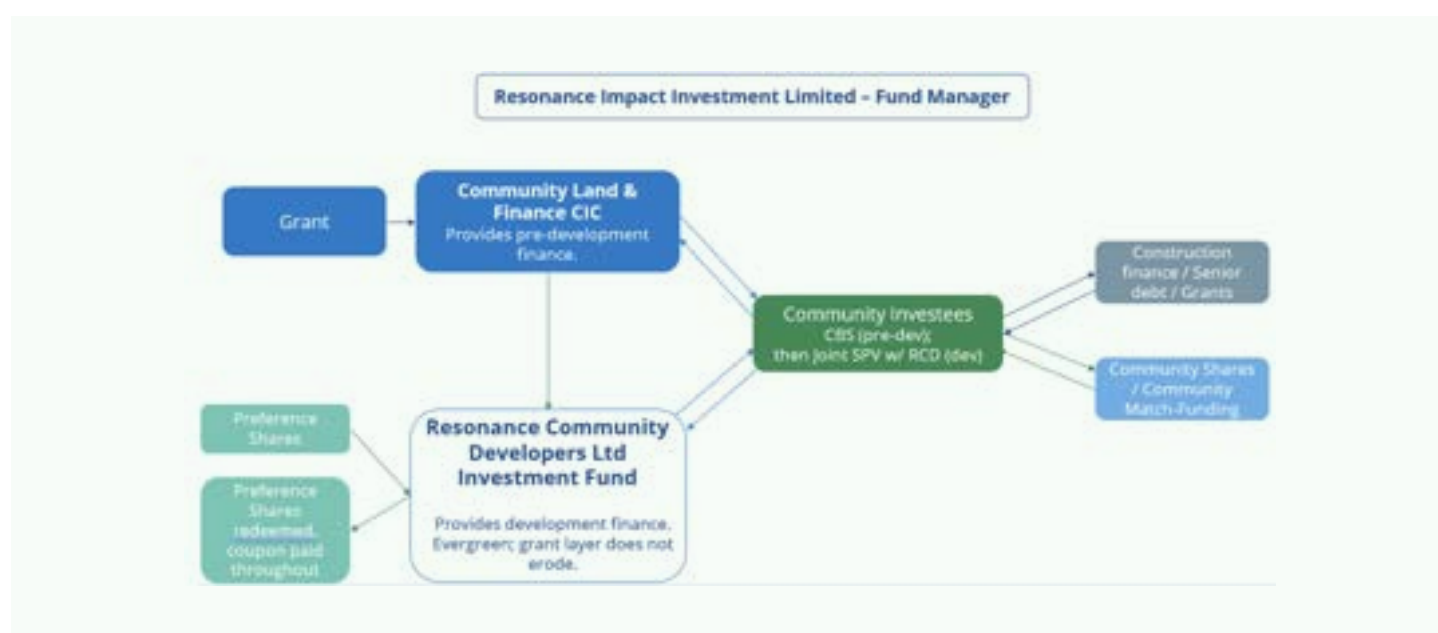
In 2021, Resonance Community Developers Fund was set up as a blended structure that combines grant funding from funders such as Access – The Foundation for Social Investment and repayable finance from investors such as Big Society Capital. This fund provides end-to-end financing and wraparound expert assistance, including support for pre-development, through to planning, land acquisition and construction for community groups who want to create and own income-generating assets such as affordable homes, sports facilities, and renewable energy generation.

This structure has two vehicles managed by Resonance: 1) Resonance Community Developers (RCD) Ltd, an evergreen investment fund and 2) Community Land and Finance Community Interest Company (CLF CIC), a grant funded asset-locked vehicle. CLF CIC receives the grant funding, some of which is used to invest into community groups set up as Community Benefit Societies (CBS), to finance the pre-development work (planning, viability, feasibility, etc.) and purchasing of land; the remaining grant funding is invested into RCD Ltd, to be used as leverage to attract further capital, such as the social investment from BSC. The fund is managed by Resonance Impact Investment Limited.

Funds and projects

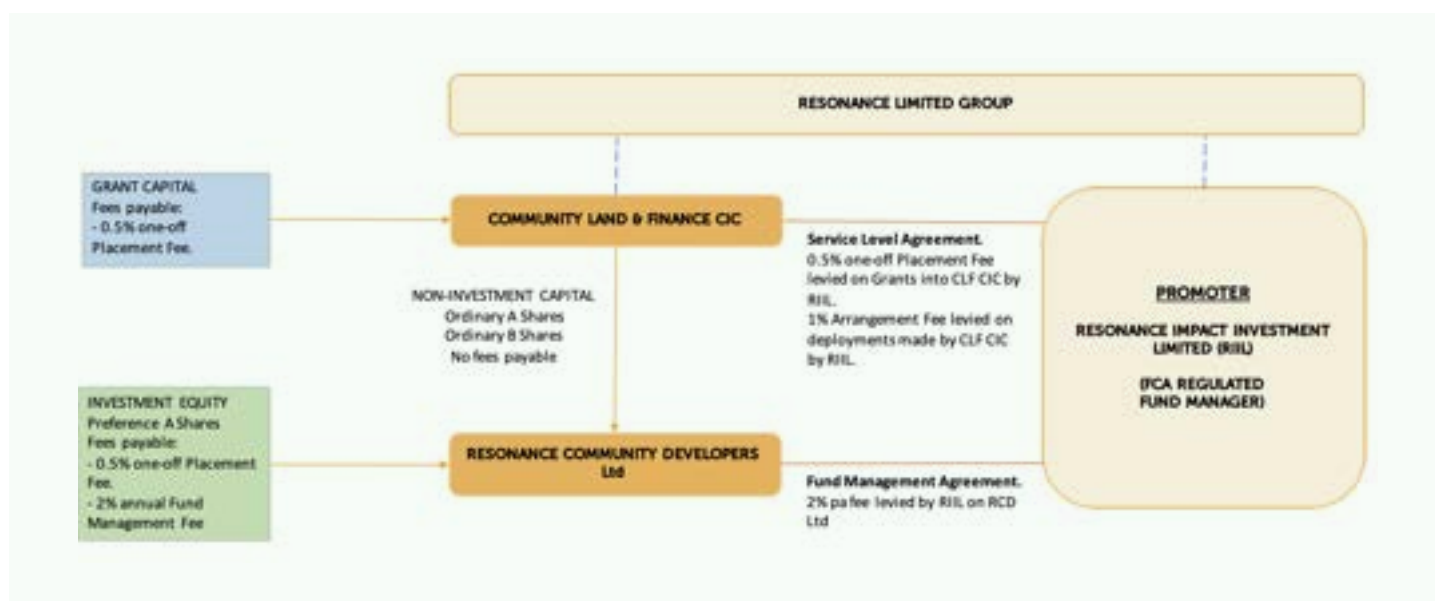
Case study: Resonance Community Developers Fund

Fund Manager	Resonance Impact Investment Limited (RIIL)
Fund Vintage	2021
Investors	<ul style="list-style-type: none"> Equity: Big Society Capital Limited (BSC) Catalytic/Grant: Access – The Foundation for Social Investment (Access), DLUHC, Power to Change, Esmée Fairbairn and Sport England
Mandate	To provide community groups seeking to develop income generating assets, such as affordable housing and sports facilities, with an end-to-end financial package from seed funding to development finance, as well as wraparound support.
Country & sector	UK – Housing and Community Infrastructure
Target Fund Size	£40m
Legal/Fund Structure	<ul style="list-style-type: none"> Investment capital paid into private company limited by shares (CLS) Grant capital paid into a community interest company (CIC) CLS and CIC each managed under separate agreements with Fund Manager
What is this structure solving for?	Community-led solutions lack seed and development funding with adequate levels of risk and wraparound support to allow them to scale sustainably. The Resonance Community Developers Fund aims to address this by providing communities with patient and flexible (equity-like) finance that is more risk absorbing.
Investment Instruments	Ordinary equity, preference shares and debt
Fund term	Evergreen
Structural risk mitigation mechanism	First Loss Tranche - must be a non-investment capital layer within the CLS of least 33% or £20m (comprising ordinary shares)
Key covenants	Ratio of Equity in investment structure (risk cover)
Capital Structure	



Funds and projects

Case study: Resonance Community Developers Fund



Features to highlight

- Twin structure - grant vehicle separate to investment vehicle, aiming to: 1) provide funding to investees with very different risk profiles, matched with funders with similar appetite, 2) efficiently combine capital from concessional capital funders with different impact requirements, and 3) reduce fee drag and transaction costs.
- Provides end-to-end finance and support to investees.
- Structure allows for surplus returns to increase the grant layer, with the potential to be recycled in perpetuity thus reducing future concessional capital needs to remain in operation.

Key legal elements

- The grant vehicle is Community Land & Finance CIC (CLF CIC)
- The investment vehicle is Resonance Community Developers Limited (RCD Ltd). This was set up as a private company limited by shares so that (1) it can raise equity capital by the issue of preference shares, and (2) is a familiar and well understood vehicle.
- The Fund's mission is protected by (1) protective provisions embedded in the articles of association, investment policy and shareholders agreement of the investment vehicle and the grant agreement to the grant vehicle; (2) external investment management with contractual obligations in the service level agreement and fund management agreement to pursue the Fund's mission; (3) restrictions on sale and other dealings in shares in the investment vehicle; (4) the production by the manager of an "Impact Canvas" setting out how the Fund intends to create and measure impact against which the Fund reports to investors.
- The first loss ratio was determined to deliver risk adjusted returns to investors, meet fund costs and fees and invest at appropriate rates for social enterprises. Once a stable distribution of dividends is reached, the percentage of ordinary shares may reduce, to no less than 33%.
- Investments must be made into "Eligible Social Sector Organisations" defined as 1) based in and operating in England, and either 2) has social objects and is asset locked, or 3) is a registered charitable organisation or adopts social and mission lock wording in its articles.
- Investments must be made into "Community Asset Projects" that meet local need, contribute to local place-making and generate net additional floorspace for target asset types.

Funds and projects

Case study: Resonance Community Developers Fund

Key legal documents	<ul style="list-style-type: none">• Private Placement Memorandum• RCD Ltd Shareholders agreement, between:<ul style="list-style-type: none">- RCD Ltd- CLF CIC- BSC• RCD Ltd Investor Agreement, between:<ul style="list-style-type: none">- RCD Ltd- CLF CIC- BSC (and further/future investors)• Grant Agreement, between:<ul style="list-style-type: none">- Access & DLUHC (and further/future concessional capital providers)- CLF CIC• Services Agreement, between:<ul style="list-style-type: none">- CLF CIC- RIIL• Fund Management Agreement, between:<ul style="list-style-type: none">- RCD Ltd- RIIL• RCD Articles of Association
Governance structure	<ul style="list-style-type: none">• The Resonance investment team prepares IC papers and makes detailed investment proposals and recommendations to the Investment Committee• The Investment Committee (comprising Resonance senior management and independent appointees) has a remit to recommend decisions on investment opportunities to the Fund Manager, based on their fit with the risk and return criteria of the Fund, and suitability for its desired social impact• RIIL makes the final investment decision based on this recommendation• Advisory Committee, comprising representatives of CLF, investors and specialist impact investors reviews performance and conflicts of interest• Investors have veto power over RCD 1) creating new classes of share, 2) amending the investment policy or articles, 3) amending the Fund Management Agreement, 4) increasing the fund management fee, 5) issuing ordinary shares to persons outside CLF Group, or 6) RCD Ltd and RIIL ceasing to be in the same VAT group.• CLF has veto power over RCD Ltd 1) amending the investment policy, 2) amending the Fund Management Agreement, or 3) increasing the fund management fee.
Enforceability	<ul style="list-style-type: none">• All obligations are drafted with the intention to be legally enforceable (investment into the investment vehicle, grant into the grant vehicle and onward investments).• Grant funding is subject to a claw back on the occurrence of certain events including use of the grant outside of the agreed purposes.
Conflicts between blended sources	<ul style="list-style-type: none">• There is no specific dispute resolution mechanism.• The Investors and grantors are party to different agreements

Funds and projects

Case study: Resonance Community Developers Fund

Regulatory issues	<ul style="list-style-type: none">• Both Access and BSC were subject to state aid rules with regard to the use of public money.• Access is subject to regulation by the Charity Commission and must provide grant in line with its charitable objects• RCD is an alternative investment fund and is managed by a regulated fund manager (RIIL)
Exit and insolvency	<ul style="list-style-type: none">• Exit is via redemption of preference shares using proceeds from the repayment of projects• Exit by redemption is the principal means by which an investor can leave the fund. Redemption is subject to sufficient distributable profits being available.• BSC can terminate the Investor agreement if RCD Ltd or CLF CIC are in breach of the Investor Agreement or Shareholders Agreement.
Key legal learnings	<ul style="list-style-type: none">• Given the fund's twin structures, it is able to provide pre-development support through grant funding, without affecting the investment vehicle. In the investment vehicle, grant funding should be able to be recycled.• The twin vehicles safeguard grant funders who may have concerns around 'subsidising private gain'• The structure is easily replicable and scalable. The documents used could form the basis for standard documents for future products.



Roma Entrepreneurship Development Initiative

Author: Oliver Scutt, Bates Wells

Project description: Supporting the development of Roma-owned businesses and enterprises across Europe.

Overview

Project name	Roma Entrepreneurship Development Initiative (REDI)
Background	<p>REDI was established as a pilot in 2016 by Open Societies Foundation (OSF) – OSF is the umbrella organisation of the Soros Economic Development Fund (SEDF).</p> <p>REDI supports development of Roma-owned businesses and enterprises across Europe. For clarity, Roma was a community which migrated from India c. 1,000 years ago. They moved for about 300 years and were then enslaved when they reached Romania for c.500 years. Financial literacy in the community is a problem and lack of trust between financial institutions and the community is rife. Certain Roma businesses are considered as more risky. Only two out of five Roma individuals in Romania between the ages of 20 and 64 (41%) are employed or engaged in paid work, compared to the national average of 71% and every second young Roma person between the ages of 16 and 24 (59%) is either unemployed or not in education or training.</p> <p>This was the first attempt to provide catalytic investment vehicle for c.10 to 12 million Roma - only 4 in every 1,000 have access to loans/ bank finance.</p> <p>SEDF and Council of Europe Development Bank (CEB) capitalised REDI with c. €4 million on concessional terms.</p> <p>Two-step process:</p> <ol style="list-style-type: none"> REDI provides (1) technical assistance, (2) long-term debt/ risk-sharing mechanisms to microfinance institutions of between US\$205,000 and US\$1m; and Microfinance institutions/ lenders: loans of c.US\$25,000 at competitive/ below-market rates to Roma businesses and entrepreneurs – flexible repayment terms. <p>The transaction was governed by English law.</p>

Finance & capital structure

Financing sources (Development & Commercial)	<ul style="list-style-type: none"> CEB: €3m in loans SEDF: \$1.2m loan funding Microcredit Foundation Horizonti: In North Macedonia, €1 million loan scheme aims to ease access to finance for c. 600 low-income persons and vulnerable persons, including Roma.
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Funds and projects

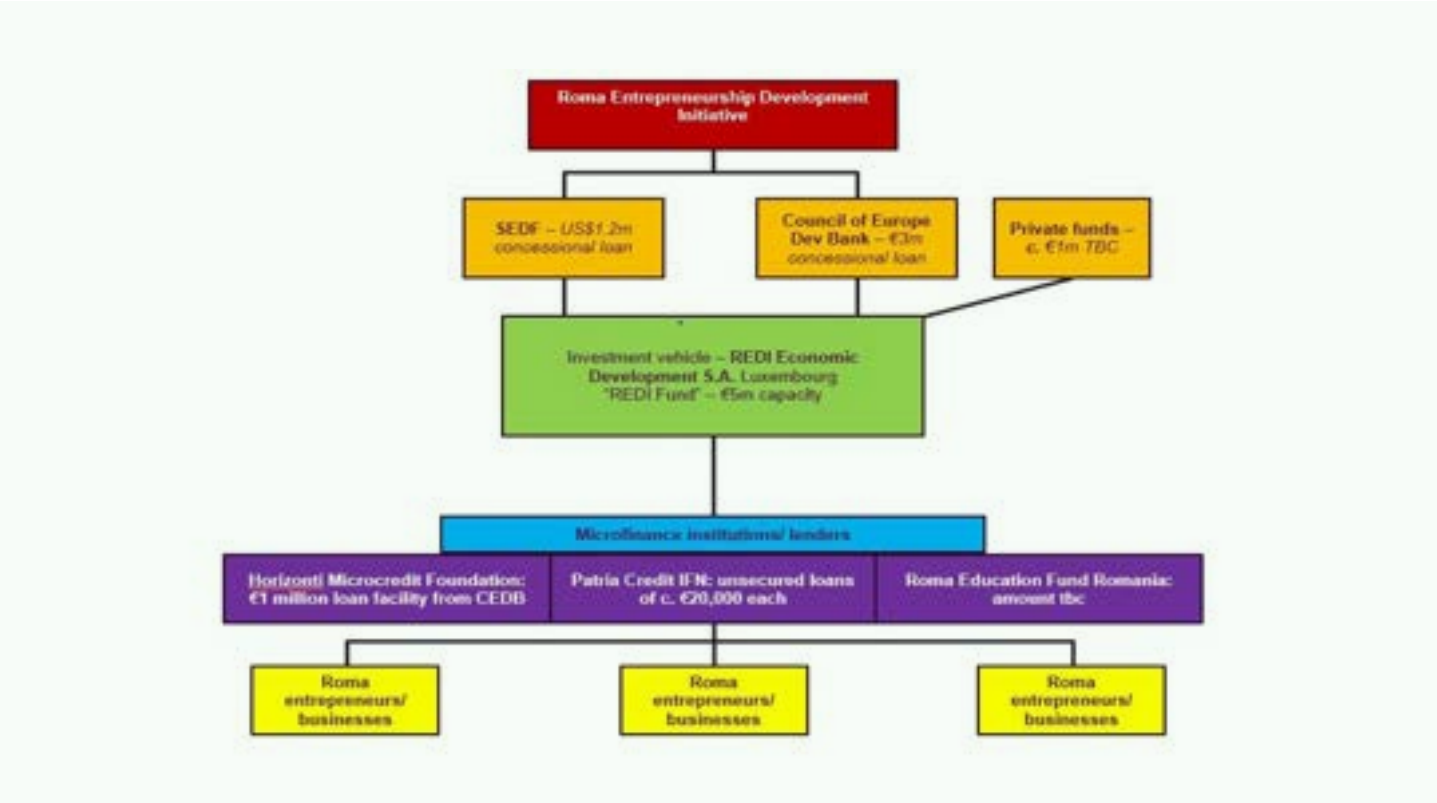
Case study: Roma Entrepreneurship Development Initiative

Financing sources
(Development & Commercial)
continued

- Patria Credit IFN: unique local partnership for the financing and inclusion of Roma entrepreneurs, particularly those involved in agriculture, from small rural communities in the country. Through this partnership, businesses managed by Roma individuals and local businesses employing Roma workers will be financed. Loans can be accessed by agricultural producers and small Roma entrepreneurs through the Patria Credit program. Unsecured and granted for a period of up to 5 years, have a flexible repayment with possibility of using the money for investments, financing current activity and mixed-use projects.

Capital structure (diagram)

REDI Structure



Funds and projects

Case study: Roma Entrepreneurship Development Initiative

Aims, outcomes and next steps

SEDF aims	<p>Four principal aims:</p> <ol style="list-style-type: none">1. Catalyse additional funding to benefit Roma community2. Create jobs in Roma communities across sectors3. Enable access to finance and increased financial health for Roma entrepreneurs4. Collect evidence on impact and commercial viability of financing to Roma entrepreneurs <p>The data collected was analysed to see if funding can be utilised to reach other communities.</p>
SEDF outcomes to date	<ul style="list-style-type: none">• Circa 200 loans supporting close to 450 jobs, including car wash business in Romania, fashion retail in North Macedonia and restaurant in Serbia. Interactive sessions taking place between entrepreneurs for knowledge, challenges and success stories to be shared.• Non-performing loans c.5% with those to Roma businesses at c.2%.• Creation of REDI Business Club – this supports Roma businesses by providing networking opportunities and business development services.• Open Society have now committed further funding to the Roma Community as announced in September 2023 (€100 million to Roma Foundation based in Brussels who will work with Roma in Western Balkans, Eastern Europe, Spain, Italy and Germany). This foundation will develop the REDI and three other Roma-led initiatives.
Next steps	<p>OSF – September 2023: announced €100m fund for Roma Foundation based in Brussels who will work with Roma in Western Balkans, Eastern Europe, Spain, Italy and Germany. Roma Foundation will develop REDI and three other Roma-led initiatives.</p>



SDG Loan Fund

Authors: Allianz Global Investors, FMO Investment Management, John D. and Catherine T. MacArthur Foundation, GAIL Editorial Team
Project description: USD1.1 billion blended finance debt fund to advance the United Nations Sustainable Development Goals (“SDGs”) in emerging and frontier markets.⁹⁵

Overview

Project name	SDG Loan Fund (the “Fund”)
Country & sector	<ul style="list-style-type: none">Target countries: Emerging and Frontier MarketsTarget sectors: Renewable Energy, Financial Institutions, and Agribusiness
Total project finance	USD1.1 billion (fund size)
Purpose/potential impact	Providing capital for high-impact, SDG-aligned loans to local companies and projects across Latin America, Asia, Africa, and Eastern Europe
Whether successful	<ul style="list-style-type: none">Successful capital raising of USD1.1 billion (target size), of which USD 1 billion is private sector capital. The Fund reached its target size and is closed to new investors.Robust pipeline of eligible loans sourced by FMO.Approximately USD100 million deployed to date, the majority of which were assets warehoused by FMO in the lead up to the investment period.

Finance & capital structure

Financing sources (Development & Commercial)	<div>Commercial capital<ul style="list-style-type: none">Institutional investors (including Allianz and others): 90% of the Fund’s capital (USD 1 billion) (“Institutional Capital”).FMO, the Dutch entrepreneurial development bank: 10% of the Fund’s capital (USD 111 million). FMO provided first loss capital (“FMO First Loss Capital”) to the Fund. This is not concessional capital (i.e., it has an expected return commensurate with the risk profile of its investment).</div> <div>Philanthropic capital<ul style="list-style-type: none">The John D. and Catherine T. MacArthur Foundation (“MacArthur Foundation”) committed a USD 25 million guarantee to the Fund, structured as a program-related investment (“PRI”).⁹⁶ The guarantee acts as a first loss to the FMO First Loss Capital which provides further de-risking.</div>
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95. The SDG Loan Fund is closed and is not looking for new investors. The information contained herein is solely for educational purposes and should not be relied upon as a forecast, research or investment advice and is not a recommendation to adopt any investment strategy. It is for information only and is not to be construed as a solicitation or an invitation to make an offer to conclude a contract, or to buy or sell securities. This case study does not constitute legal, financial or other professional advice.

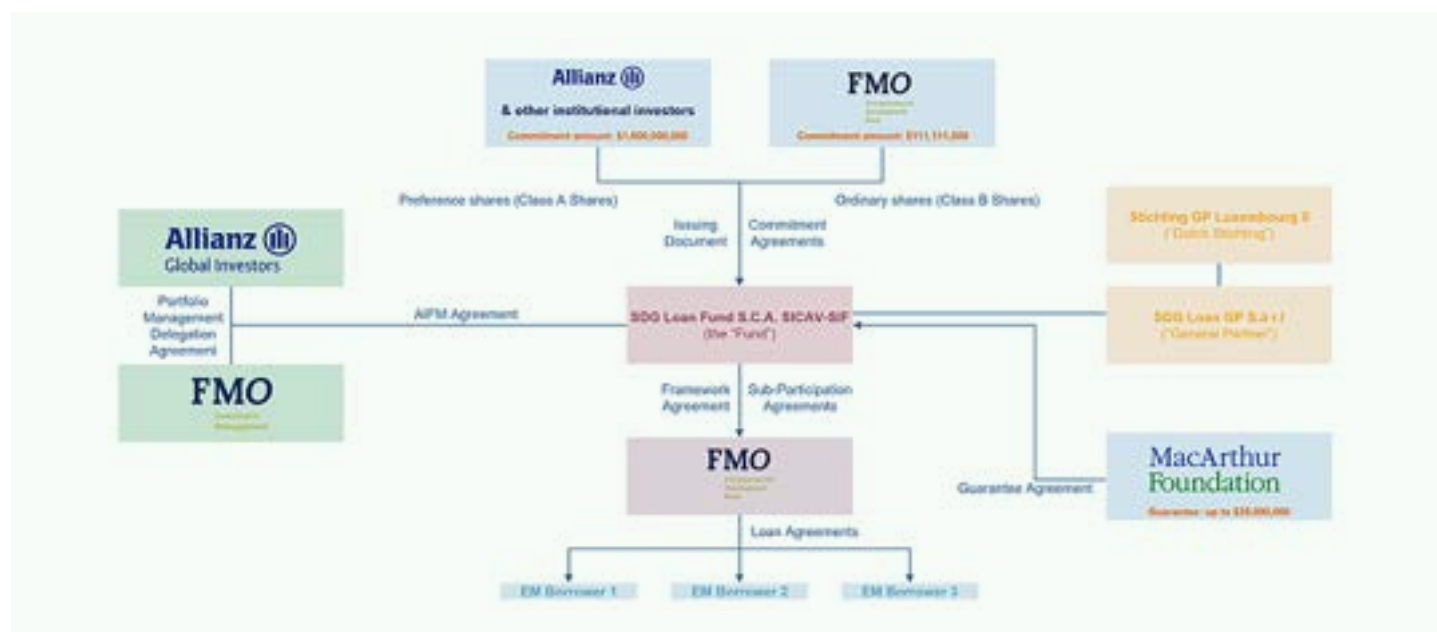
96. Program related investments (“PRIs”) are statutorily defined investments under the United States Internal Revenue Code (section 4944) made by U.S. based private charitable foundations primarily to advance a charitable purpose, with below market financial returns or value appreciation.

Funds and projects

Case study: SDG Loan Fund

Capital structure (diagram)

SDG Loan Fund Structure Chart



Legal structuring

Legal structure

The SDG Loan Fund is structured as a Luxembourg S.C.A. SICAV-SIF. As such it is a corporate partnership limited by shares in the form of an investment company with variable capital and is subject to Luxembourg's Specialised Investment Law of 2007 ("SIF Law").

Key structural features

Key Parties

- Allianz Global Investors (acting through its Luxembourg branch) is the Alternative Investment Fund Manager ("AIFM").
- The General Partner of the Fund is owned by a Dutch Stichting (a type of foundation).
- FMO Investment Management is the Fund's delegated Portfolio Manager – this gives the Fund priority access to FMO transactions which meet the Fund's investment criteria.
- MacArthur Foundation provide an unfunded guarantee to the Fund.

Investment Format

- The investment format is shares and the Fund has two classes of shares: (i) the Institutional Capital was issued in the form of preference shares (the "Class A Shares"); and (ii) the FMO First Loss Capital was issued in the form of ordinary shares (the "Class B Shares").
- The Fund's underlying investments are structured as sub-participations in loans originated by FMO, of which FMO retains a percentage of for its own portfolio.
- The Fund is in substance a co-investor alongside FMO in its loan portfolio. The Fund's investment criteria is applied and eligible loans may enter into the Fund's portfolio.

Key structural features continued

Legal & Regulatory Form

As a Luxembourg S.C.A. SICAV-SIF:

- The Fund is not tax transparent, but tax exempt except for an annual subscription tax of 0.01% of its NAV.
- It is subject to supervision by Luxembourg's financial regulator, Commission de Surveillance du Secteur Financier ("CSSF"). The Fund therefore had to be approved by the CSSF.
- The Fund and its General Partner must comply with SIF Law and the EU's Alternative Investment Fund Managers Directive ("AIFMD") as applicable.
- It is a wholesale vehicle; i.e., it is only able to be offered to professional investors.
- It is subject to diversification requirements; i.e., in general no more than 30% of the Fund's assets in one investment, and a minimum of 4 to 5 investments. CSSF approval was required for the Fund due to its single counterparty exposure to FMO, which was appropriately mitigated.

SFDR Classification

- The Fund has been classified as an Article 8 fund under the EU's Sustainable Finance Disclosure Regulation ("SFDR")⁹⁷; i.e., it is a "Light Green" fund – it promotes social and/or environmental characteristics and may invest in sustainable investments but it does not have sustainable investing as a core objective, and has corresponding level 2 disclosure requirements.

Jurisdictions involved

- Fund jurisdiction: Luxembourg
- Alternative Investment Fund Manager: Luxembourg (Allianz Global Investors, acting through its Luxembourg branch)
- Portfolio Manager: The Netherlands (FMO Investment Management)
- Guarantor: U.S. (MacArthur Foundation)

Context – what led to blended finance being proposed

The SDG Loan Fund was designed to address the urgent need for capital to reach the SDGs in developing countries. Totalling USD 3.9 trillion per annum in 2020, the annual funding gap increased by 56 percent after the outbreak of COVID-19.⁹⁸ Public sector capital and donor funding is insufficient to close this gap, and the need for private capital mobilisation is clear. Private capital however is not flowing at the rate at which is it required in these markets, which is partly due to investment barriers private capital investors face: (i) high perceived risk and actual risk as most emerging and frontier market borrowers are below investment grade; and (ii) access to investment opportunities which directly contribute to the SDGs.

97. Information accurate at time of publishing.

98. Source: OECD, <https://www.oecd.org/finance/global-outlook-on-financing-for-sustainable-development-2023-fcbe6ce9-en.htm>.

Context – what led to blended finance being proposed continued

Blended finance is an effective tool for addressing these challenges through the creation of structures which allow for private capital investment at scale. The first loss investment from FMO, coupled with the MacArthur Foundation's guarantee unlocked USD 1 billion of institutional capital, providing essential credit enhancement for the Institutional Capital in the Fund. The structure mobilised capital from investors who would not customarily be able to finance high-impact loans in emerging and frontier markets. The Fund will provide access to investment opportunities which target:

- decent work and economic growth (Sustainable Development Goal 8),
- reduced inequalities (Sustainable Development Goal 10), and
- climate action (Sustainable Development Goal 13).
- Once fully invested in approximately 100 high-impact loan participations, the Fund aims that its investments support close to 60,000 jobs and to avoid approximately 450,000 tCO₂ eq of greenhouse gasses per annum according to FMO's historical experience and analysis.⁹⁹

The USD 1.1 billion SDG Loan Fund builds on a growing range of efforts to mobilise capital from private sector investors for investments in emerging and frontier markets towards the SDGs and is one of the largest blended finance funds launched in the market to date. The MacArthur Foundation guarantee had a high level of catalytic impact in terms of the capital it mobilised (achieving a ratio of 1:44) as well as the first loss capital provided by FMO (achieving a ratio of 1:9), which provided critical de-risking for institutional investors.

Security/charges

- Up to 100% of loans in Financial Institutions may be unsecured (unsecured loans are the market standard for this sector).
- Up to 5% of loans in Renewable Energy and Agribusiness may be unsecured. Suitable security packages will be considered on a deal-by-deal basis for all sectors.

Key covenants

- Both secured and unsecured loans usually have a strict set of financial covenants (based on FMO's Investment Criteria) to govern and monitor the borrower's performance and restrict the amount of leverage it has.
- Typical covenants include profitability, liquidity, leverage, asset quality and specific ESG considerations which are tested on a regular basis.

Key learnings

Some of the key pillars to success include: (i) shared institutional goals, (ii) commitment from leadership, (iii) trust, (iv) teamwork, and (v) support and patience from the Fund's investors. The Fund can serve as an example to the market which may be replicated, modified, or further developed. It is important to note that every institution has unique requirements and limitations which they are solving for. As a result, the documentation of successful blended finance vehicles may be used as a helpful starting point, though modifications and structural amendments are expected in most cases and would depend on who the vehicle is being created for and the applicable laws and regulations for the vehicle, its fund manager, investors and other partners.

⁹⁹ Source: FMO, 2023. For more information on this please visit <https://annualreport.fmo.nl/2022/>

Funds and projects

Case study: SDG Loan Fund

Key legal documents

- Constitution and incorporation documents for the Luxembourg S.C.A. SICAV-SIF, Dutch Stichting and General Partner
 - Issuing Document
 - AIFM Agreement
 - Delegation Agreement
 - Framework Agreement
 - Guarantee Agreement
-

Additional information (where available)

Governance structure

- Investment decisions are made by the Fund's Investment Committee who has discretion to invest the Fund's capital according to the Fund's investment objective and policy and in accordance with the Fund's legal documentation.
 - The Investment Committee is made up of voting members of FMO Investment Management and a non-voting member from Allianz Global Investors who can exercise a certain number of veto rights.
-

Enforceability

- Yes, all funding, including the FMO First Loss Capital, is enforceable as investors have subscribed for shares in the Fund up to their commitment amount, and the MacArthur guarantee is enforceable as a contract.
-

Exit and insolvency

- Shares are redeemed from principal repayments received on the underlying loan portfolio at defined intervals (where available).
 - Both share redemptions and dividends are subject to the Fund's performance and the cash flows of the underlying loan portfolio.
 - Shares may be transferred to eligible investors subject to certain criteria and consent by the AIFM in the case of the FMO First Loss Investment.
 - Impairments and write-offs are allocated first to the FMO First Loss Investment, and should impairments and write-offs exceed the value of the first loss, then to Institutional Capital.
 - The first USD 25 million of write-offs on a fully invested portfolio of USD 1.1 billion will be borne by the MacArthur Foundation.
-

Disclaimer

This information contained herein is solely for educational purposes and should not be relied upon as a forecast, research or investment advice and is not a recommendation to adopt any investment strategy. This is for information only and not to be construed as a solicitation or an invitation to make an offer, to conclude a contract, or to buy or sell any securities. This document does not constitute legal, financial or other professional advice.

Private Market investments are highly illiquid and designed for professional investors pursuing a long-term investment strategy only. Please refer to Fund legal documentation for a full description of General and Specific Risk Factors.

Investing involves risks. The value of an investment and the income associated with it can go down as well as up. Investors may not get back the full amount invested. Past performance does not predict future returns. If the currency in which the past performance is displayed differs from the currency of the country in which the investor is resident, the investor should be aware that the performance shown may be higher or lower due to exchange rate fluctuations when it enters the local currency of the investor is converted. The views and opinions expressed herein, which are subject to change without notice, are the views and opinions of the issuer and/or affiliates at the time of publication. The data used come from various sources and are believed to be correct and reliable. This document does not contain any statements about the suitability of the investments described here for the individual circumstances of a recipient. 04/2024 – Admaster 3491059

Simplon Co

Author: Alissa Pelatan, AMP AVOCATS (France); with the assistance of Frédéric Bardeau, President Simplon Co & Simplon Foundation & Simplon Asso

Project description: Hybrid legal, fiscal and economic model for social impact

Overview

Project name	Simplon Co
Country & sector	Vocational Trainings
Total project finance	SAS ESUS (€22m raised, €33m income 2022) + FONDS DE DOTATION (€3m raised per year) + ASSOCIATION LOI 1901 (less than €1m€ per year) + 4 foreign for-profit subsidiaries that operate as regional hubs (Maghreb and sub saharan Africa)
Purpose/potential impact	Since 2013: 30000 people trained on IT entry level jobs - 70% in job after 6 months (85 after 12 months), 7000 people per year, 40% women, 12% disabled, 5% refugees, 45% low/no diploma, 48% coming from underserved areas
Whether successful	Yes

Finance & capital structure

Financing Sources (Development & Commercial)	<ul style="list-style-type: none"> • Equity - Debt • Income (Public And Private, Prestations, Franchising Model For Europe, Middle East & Africa) • Public Subsidies • Private Philanthropy
Capital structure	IMPACT VC FUNDS (80% - Caisse des Dépôts, Amundi, France Active, Phitrust, INCO, Abeille Invest, Crédit Coopératif, Mirova) - MANAGEMENT (20%)

Legal structuring

Financing Sources (Development & Commercial)	SAS ESUS (2013) + FONDS DE DOTATION (2019) + ASSOCIATION LOI 1901 (2020)
Key structural features	<ul style="list-style-type: none"> • SAS ESUS operate training programmes (fiscally considered as “lucrative” whereas they are completely free for the beneficiaries) • FONDS DE DOTATION fundraise through private philanthropy (Foundations, Corporate Foundations, Private donors) general interest programmes complementary to training programmes, give grants and leverage “audience specific” programmes (disable, refugees, women, drop-outs) • ASSOCIATION is operating general interest programmes funded by FONDS DE DOTATION and fundraise public subsidies (FONDS DE DOTATION is NOT eligible to public subsidies)

Funds and projects

Case study: Simplon Co

Key structural features continued	<ul style="list-style-type: none">• SIMPLON AFRICA and SIMPLON MAGHREB operates in Morocco, Sénégal, Ivory Coast and Burkina Faso• SIMPLON FRANCHISEES (independent organisations) pay flat fees to operate Simplon programmes
Jurisdictions involved	France, Morocco, Senegal+Ivory Coast+Burkina Faso
Context – what led to blended finance being proposed	Maintaining and financing the high positive impact project which provides a one-stop shop for beneficiaries who would not have access to IT training and jobs : starts with sourcing, then selection, then training, all the way up to finding an internship, and placement in job value train.
Solving for (e.g. legal or regulatory barriers, operational issues)	<ul style="list-style-type: none">• No end-to-end financing solution to generate full impact for project (sourcing > selection > pre-qualification > training > apprenticeship/internship > placement in job value chain: training is the only part that has a real and permanent funding in countries)• Syndicate multi-funding (public, private, philanthropic) programmes and projects• Legal and tax barriers
Security/charges	Convertible bonds, bank notes, loans, debt.
Key covenants	<ul style="list-style-type: none">• Each legal entity has its own key covenants and its own regulations.• In terms of governance: cooperation agreement between the legal entities which sets forth the covenants and commitments for each specific entity.• Sharing in costs and making sure the non-profit activity and the for-profit activity are separate and secure.
Key learnings	<ul style="list-style-type: none">• The objectives and goals are slightly different depending on who your client is (investor, entrepreneur, government, foundation). When the client is a social entrepreneur, the legal innovation and hybrid model will probably be more focused on the type of legal entities created (hybrid models) rather than one unique blended finance structure to invest in target company/non-profit.• The lawyer and investor need to be innovative in proposing multiple options to fund a project which can be managed using multiple legal vehicles (for-profit and non-profit). The entrepreneur as a client will want to ensure that the high positive impact is a priority and that the initial values and ideas will be protected and upheld regardless of the funding received.• In this type of structure, setting up a global governance for the legal entities is the key to success. Transparency and communication with the different actors involved is important.• The take away is: “know why we need to blend, what we are blending and how to blend.”
Key legal documents	ESUS authorization (for investor-driven tax advantages), shareholder agreement, loan agreements, legal documents for entities, governance agreement, charity status (equivalent)

Student Employment SIB

Author: Julien Steinberg, Perspectives Avocats / Impact Lawyers

Project description: SIB for the prevention of discrimination and integration of students from disadvantaged neighbourhoods.

Overview

Project name	Social Impact Bonds (SIB)
Country & sector	France – Prevention of discrimination in the professional integration of students from disadvantaged neighbourhoods
Total project finance	3,405,322 euros
Purpose/potential impact	<ul style="list-style-type: none"> Indicator 1 Number of students reached – goal of 3000 Indicator 2 Number of students with grants and/or from disadvantaged neighbourhoods reached – goal of 800 Indicator 3 Percentage of students on grants and/or from disadvantaged neighbourhoods put in contact with a company – goal of 65% Indicator 4 Employment rate 6 months after completion of studies – goal of 66% (71% to trigger the investors' premium) Indicator 5 Percentage of positive school leavers in sustainable employment – goal of 71% (81% to trigger the investors' premium)
Whether successful	Currently active

Finance & capital structure

Financing Sources (Development & Commercial)	<ul style="list-style-type: none"> Social Impact Bonds by an association Loi 1901 Public Subsidies
Capital structure (diagram)	<ul style="list-style-type: none"> No capital – social impact bonds paid by Investors (private Impact VC investors) If indicators are met by the end of the program, the government pays the association which in turn pays the investors. If no indicators are met, payment to investors is limited to a cap If part of the indicators are met, payments to investors are in proportion to specific metrics

Legal structuring

Legal structures	ASSOCIATION LOI 1901
Key structural features	<p>Estimate and finance avoided costs of an intervention compared with the status quo</p> <p>Master Agreement: Central document governing the relationships among all stakeholders of the SIB. It details:</p> <ul style="list-style-type: none"> The governance of the SIB, including the rights and obligations of the parties. The operator's intervention procedures and the definition of the target population. Indicators triggering payment and methods for determining the amount of the subsidy. Management of the various cases of default.

Key structural features continued	<p>Financing Agreements: Bond issuance agreement and its terms and conditions governing the relationships between the issuer and the private investors. They include:</p> <ul style="list-style-type: none"> • The obligations of the operator and the investors. • The conditions under which financial flows occur, such as the repayment of financial obligations solely from the public grant, except in cases of non-compliance with the obligations by the social operator. • A financial flow schedule, often staggered in tranches to match the needs of the action program. <p>Collateral Agreement: Established to secure the financial payments among the parties</p> <p>Grant Agreement: Between the operator and the third-party payer (the government), that specifies the amounts to be paid by the third-party payer at each evaluation, as well as the conditions of these payments.</p>
Jurisdictions involved	France
Context – what led to blended finance being proposed	<p>Aim at encouraging the raising of private funds to finance social programmes with a view to social experimentation.</p> <p>Part of three grants proposals:</p> <ul style="list-style-type: none"> • “Circular Economy” SIB, aimed at developing innovative solutions for the circular economy (reuse, waste reduction, wastage): 8 projects have been selected for a total of €27.3 million. • “Equal economic opportunities” impact contracts, aimed at developing innovations to meet the challenges of equal economic opportunities (non-discrimination, priority areas, combating exclusion): 4 projects have been selected for a total of €12.3 million. • “Innovating for access to employment” impact contracts, focusing on innovation in access to employment (integration of young people, mobility, keeping people with health problems in work): 4 projects were selected in March 2022, then 5 new projects were selected for a total of €13 million
Solving for (e.g. legal or regulatory barriers, operational issues)	<ul style="list-style-type: none"> • It encourages the private sector to invest in social programs, shifting some of the financial risks associated with these interventions from the public to the private sector. • SIBs are particularly focused on areas where governments anticipate cost savings as a result of successful outcomes
Security/charges	Bonds issued by charitable organisations
Key covenants	<ul style="list-style-type: none"> • Collaboration among stakeholders: requires a collaborative approach among government agencies, private investors, and operators. Control of the governance by most investors. • Outcome evaluation: the SIB emphasises the importance of defining meaningful and measurable outcomes with a clear understanding of what achieving the outcome is worth to the government and society, not just the cost to the external organisation delivering the services. • Risk management: Involves structuring of payments to be based on outcomes at different intervals during the performance of the SIB, which also poses a challenge in ensuring that these outcomes are both ambitious and achievable. • Data Sharing: Effective implementation requires data sharing including sensitive and personal data. Guidelines, protocols, and security for handling these data are necessary to avoid data loss and confusion on impact outcome key metrics.

Key learnings	<p>Despite certain challenges and the lengthy process of structuring, SIBs have made notable progress. These innovative projects have shown their ability to generate measurable social impact, leading to a positive shift in the attitudes of investors and philanthropists.</p> <p>It shows potential to achieve measurable social impact while offering potential financial returns. This shift is supported by a growing awareness of the importance of responsible investment and social impact in the financial world. Foundations and philanthropists have also shown increasing interest in SIBs, viewing them as an effective way to maximise the impact of their contributions by targeting social projects with measurable and sustainable outcomes.</p> <p>However, SIBs face significant challenges, including the complexity of their structuring and implementation (close to 2 years), difficulties in measuring impact and financial return, and a lack of engagement from both public and private actors to pursue efforts after the end of the first SIB. These challenges underscore the need for a supportive regulatory and incentive framework to foster the development of SIBs, as well as efforts to standardise documentation and streamline the complex process of launching a SIB.</p>
Key legal documents	See above



Toyonaka Quit Smoking SIB

Case study author: Sotaro Hotta, University of Oxford, Nishimura & Asahi

Project description: Social impact bond in Japan

Overview

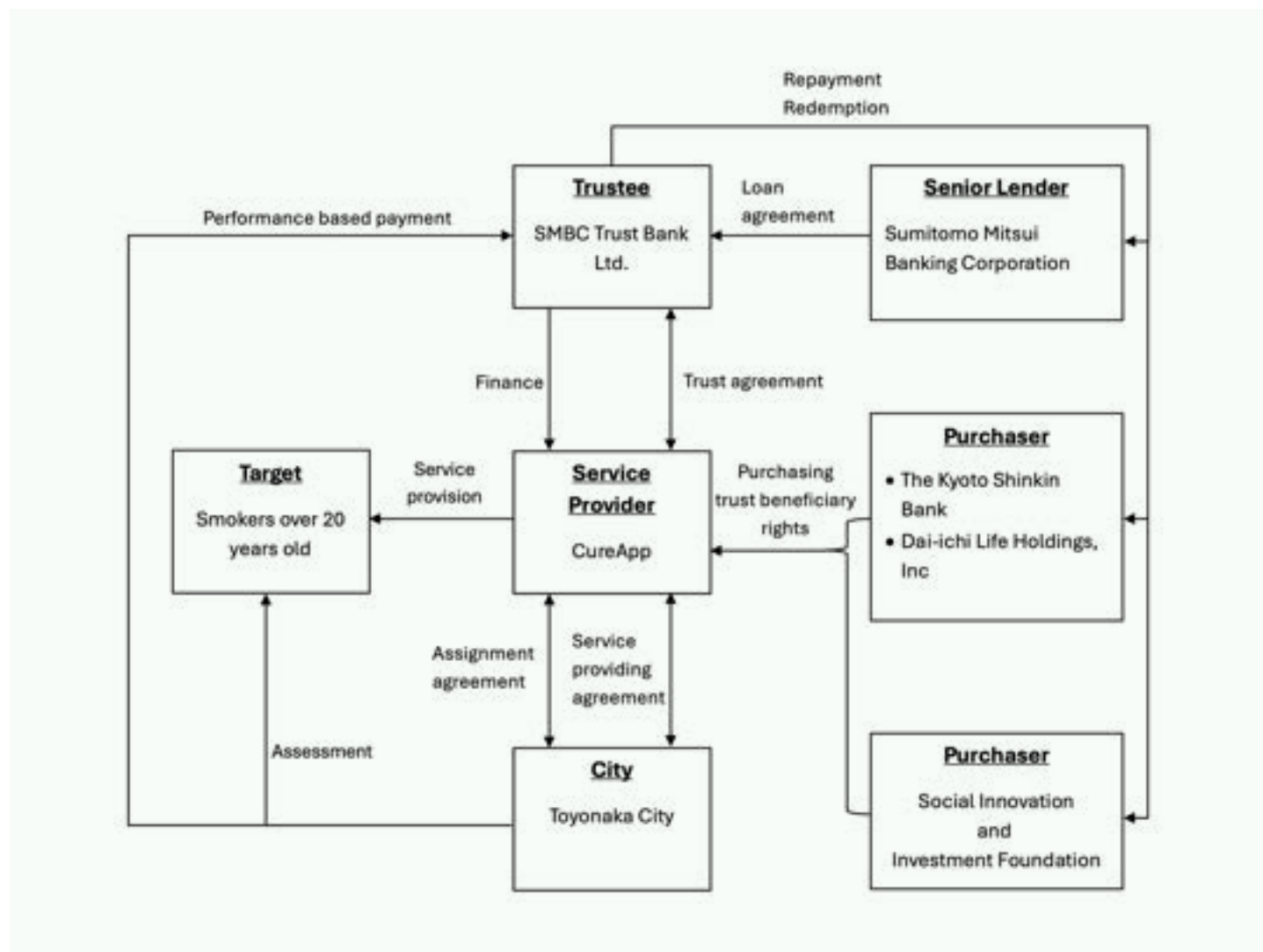
Project name	Smoking cessation support project for smokers living and working in Toyonaka City (2019)
Country & sector	Country: Toyonaka City, Osaka Prefecture, Japan Sector: Healthcare
Total project finance	Unknown
Purpose/potential impact	In contrast to the nationwide trend to promote smoking cessation, Toyonaka City's anti-smoking efforts are limited to the introduction of smoking cessation outpatient clinics, making it a challenge to implement more diverse anti-smoking measures for the citizens. The aim is to prevent the deterioration of health caused by smoking and passive smoking through smoking cessation, and to optimise medical and nursing care benefit costs.
Whether successful	<ul style="list-style-type: none"> Number of participants in smoking cessation programmes: (Target) 900 people (Achievement) 792 people Number of people who have remained smoke-free one year after the initial interview: (Target) 450 people (Achievement) 337 people

Finance & capital structure

Financing Sources (Development & Commercial)	<ul style="list-style-type: none"> Senior lender: Private Investors (Sumitomo Mitsui Banking Corporation) Purchaser of trust beneficiary right: Private Investors (The Kyoto Shinkin Bank, Dai-ichi Life Holdings, Inc., Social Innovation and Investment Foundation)
Capital structure (diagram)	<ul style="list-style-type: none"> Senior lender: The amount of debt is not disclosed. Purchaser of trust beneficiary right: The Kyoto Shinkin Bank: JPY 3M Dai-ichi Life Holdings, Inc.: JPY 12M Social Innovation and Investment Foundation: The paid amount is not disclosed. <p>Diagram on following page</p>

Funds and projects

Case study: Toyonaka Quit Smoking SIB



Legal structuring

Legal structure	Debt and trust beneficiary rights in Japan.
Key structural features	Funding was raised by trusting the future monetary claims acquired by the service provider addressed to Toyonaka City to a trustee company (SMBC Trust Bank Ltd.) and selling the trust beneficiary rights received in return to the purchaser. Senior lender extended its facility to the trustee.
Jurisdictions involved	Japan
Context – what led to blended finance being proposed	In commercialising SIBs, Toyonaka City considered it important to involve private financial institutions in order to expand the SIB market and build momentum, and made the use of private funding a condition of the public call for service providers.

Funds and projects

Case study: Toyonaka Quit Smoking SIB

Key covenants

The senior lender pursued the market rate. Therefore, they were repaid from the performance-based payment by Toyonaka City regarding the number of participants in smoking cessation programmes, since this index is easier than the other index.

Among the purchaser, The Kyoto Shinkin Bank and Dai-ichi Life Holdings, Inc. were redeemed proportionally to their amount of payment from the performance-based payment by Toyonaka City regarding the number of people who have remained smoke-free one year after the initial interview, since they agree to accept any possible loss due to the incompleteness of the goal.

Another purchaser, Social Innovation and Investment Foundation, was placed in the first-loss position since they were redeemed when all the other players (senior lender and other purchaser) were repaid and redeemed.

Key learnings

- Social Impact Bond cases can employ the private money by forming a blended finance scheme.
- Trust beneficiary rights composed of entrusted future monetary claims can be the asset to raise money from private investors in the context of blended finance.
- Tranche between different financial instruments works in the context of blended finance.

Key legal documents

- Trust agreement
 - Trust beneficiary rights purchase agreement
 - Loan agreement
 - Service provider agreement
 - Assignment agreement
-





AgDevCo Mezzanine Loan

Author: Melissa Manzo, AgDevCo

AgDevCo is an impact investor operating in the agriculture sector in Sub-Saharan Africa with a mission to reduce poverty and improve food security. AgDevCo makes direct debt and equity investments in socially-responsible businesses, operating across the supply chain, which have the potential to make a major positive social impact in their communities, and provides on-the-ground technical support and specialist agricultural advice to management teams.

AgDevCo's investment strategy has evolved over the years to adapt to the demands and priorities of AgDevCo's clients in the context of the jurisdictions in which AgDevCo invests (Sub-Saharan Africa). AgDevCo's preferred instrument is now a mezzanine product, usually involving a long term (8 – 12 years) subordinated loan at a relatively low interest rate with an equity kicker (usually in the form of a warrant or revenue share) ("AgDevCo Mezzanine Loans").

For the investee company, AgDevCo Mezzanine Loans offer many of the benefits of equity financing at a lower cost of capital, with less dilution and fewer control rights. They are potentially well-suited to companies which have growth plans but limited capacity to take on more senior debt, or where companies are seeking to restructure their balance sheets to reduce debt service without raising new equity.

They also allow the investee company to 'blend' their capital by allowing some room for secured senior debt, such as working capital facilities, or overdraft facilities. Some AgDevCo Mezzanine Loans are secured, but where unsecured, they will contain contractual restrictions on debt and security above specified levels.

Tailored products

Case study: Agdevco Mezzanine Loan

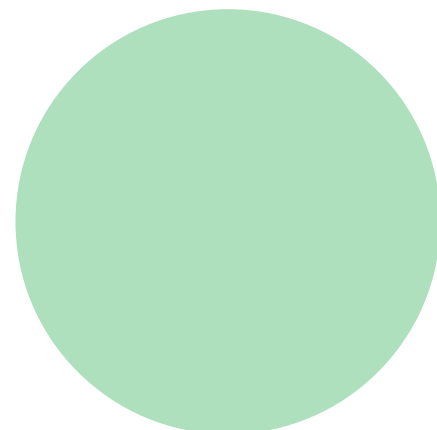
For AgDevCo as investor, AgDevCo Mezzanine Loans provide a running income yield and access to equity upside. They benefit from some downside protection given they rank ahead of ordinary and preferred equity and shareholder loans. Downside protection is enhanced if AgDevCo Mezzanine Loans are secured behind the senior debt.

In terms of legal execution, AgDevCo Mezzanine loans also benefit from the following advantages:

- They can be easier to negotiate than equity, whether ordinary or preference shares, given there are often differences of views on valuation;
- In many jurisdictions, gazetted fees and stamp duties associated with taking security can be prohibitively expensive, and can take several weeks to register (thus delaying or complicating disbursement). Where the AgDevCo Mezzanine Loan is unsecured, these challenges fall away;

- Equity investments in a number of jurisdictions may require local antitrust/competition approval if the equity investment confers 'control' on the investor ('control' being widely defined, with transaction thresholds set relatively low). Debt instruments are therefore easier to execute and agree.

AgDevCo recognises that in some jurisdictions there may be less appetite for warrant instruments, particularly in countries where there are few precedents of similar structures. In such cases, loans with a revenue or profit share may be preferable (and easier to explain to investees/advisers/regulators).





MCE Recyclable Guarantee

Author: Ginny Reyes Llamzon, MCE Social Capital

MCE Social Capital (MCE) is a California nonprofit impact investing firm that provides flexible capital to enterprises generating sustainable livelihoods in emerging markets—with a focus on women and the environment—to allow these enterprises to scale and better serve their customers, their employees, and their communities. Since 2006, MCE has disbursed over US\$304 million in debt capital to 155 institutions in 65 countries throughout the developing world.

Since its inception, MCE has been using a blended finance model that allows MCE to leverage the excellent credit of high-net-worth individuals and foundations – our Guarantors under our Philanthropic Guarantee Program. Currently, our Guarantor community collectively provides over \$150M in guarantees to MCE and consists of more than 200 individuals and foundations. On the strength of these Guarantees, MCE secures financing from U.S. and European financial institutions and accredited investors, mostly in the form of senior loans. The proceeds of these loans are then on-lent to two types of organisations in emerging markets: Financial Service Providers (FSP) and Small and Growing Businesses (SGB). In the event of a default on the beneficiary level, MCE's Guarantors divide the loss and provide MCE with the funds corresponding to such loss, which allows MCE to pay its own lenders. The Guarantor payments to MCE are made in the form of a tax deductible donation. For the Guarantor, the guarantee commitment does not require any movement or segregation of assets - it only requires the Guarantor to make a charitable contribution to MCE in the event of a portfolio loss, and all of the portfolio losses are shared pro-rata across all of the responsible Guarantors.

As an example of how our Guarantor model operates: A Guarantor who signs up to support MCE's Financial Service Provider (FSP) portfolio enables MCE to borrow and disburse \$500,000 to a financial institution that helps people living in rural areas gain access to credit and other critical services. That capital is recycled and on-lent as another loan to an FSP as soon as that loan is paid back. An FSP portfolio Guarantor who signed up in 2006 has personally enabled more than \$3.1M in loans to FSPs across the developing world. Compared to their total \$60,013 in charitable gifts to MCE since 2006, the multiplier effect on that Guarantor's capital is over 52x!

Blended impact finance – Replicable models

Case studies: UK examples (short form)¹⁰⁰



Arts & Culture Impact Fund LLP

Arts & Culture Finance, a division of innovation foundation Nesta, launched the Arts & Culture Impact Fund in March 2020 to provide arts, culture and heritage organisations with affordable (3–8.5% interest rates, with a base-rate floor), flexible (£150,000 – 1 million) and unsecured loans, repayable by May 2030.

The fund's investors include public, private and philanthropic funders such as Arts Council England, the National Lottery Heritage Fund, Big Society Capital, Bank of America, the Esmée Fairbairn Foundation, Freelands Foundation and Nesta. At launch, it was believed to be the world's biggest impact investment fund for the cultural and creative sector.

To encourage investors to support unsecured lending to this largely untested sector, the £20 million fund has a three-tranche structure to tailor levels of reward and risk: a concessional, first-loss tranche of £5 million in repayable grants; a mezzanine layer of £13 million provided by social 4. Musicians' Union (2023) investors, which pays a return to reflect its risk profile; and a senior debt layer of £2 million, which is marketed to private investors – its lower rate of return reflects its low credit risk, making it attractive to risk-sensitive debt investors.

¹⁰⁰. The Case Studies in this section are taken from [Investing-in-our-future-Practical-solutions-for-the-UK-government-to-mobilise-private-investment.pdf](http://www.lse.ac.uk) (<http://www.lse.ac.uk>), a report by Sarah Gordon, Visiting Professor in Practice at the Grantham Research Institute on Climate Change and the Environment



Bristol City Leap

A public and private finance collaboration for net zero in Bristol involving a 20-year partnership between the city council, a US cleantech business and a Swedish energy company – bringing together government, business and private investors at scale.

Bristol City Leap aims to decarbonise England's seventh-largest city by giving business and investors the policy certainty needed to commit for the long term. With an initial focus on the council's own assets, a partnership has been developed with Ameresco and Vattenfall that will direct about £630 million of public and private investment over five years into solar, wind, heat networks, heat pumps and other energy efficiency measures to help Bristol meet its target to be "carbon neutral and climate resilient" by 2030.

More than 180 companies expressed interest in being involved. The partnership aims to deliver improved air quality, and higher housing standards and to create more than 1,000 local jobs.



Green Investment Bank

The Government created the GIB in 2012 to bridge the gap between the then-current levels of investment and the amount of investment needed to transition the UK to a low-carbon economy.

From 2012 to 2017, the bank provided £3.4 billion in direct funding for projects in energy efficiency, waste and bioenergy, offshore wind and onshore renewables (Matikainen, 2017).

As well as direct investment, the GIB mobilised private sector investment at a ratio of 1:3 – for every £1 the GIB invested, it mobilised another £3 in private capital. The GIB is widely credited with having created a functioning commercial market for offshore wind energy in the UK (Green Investment Group, 2017), and for successful investments in other environmentally significant sectors.

Between 2012 and 2017, GIB helped to finance more than £12bn of UK green infrastructure projects.¹⁰¹

¹⁰¹ <https://www.greeninvestmentgroup.com/en/who-we-are/our-mission.html>



Growth Impact Fund

The Growth Impact Fund is a blended capital fund, launched in 2022 by social investment specialists Big Issue Invest (BII), UnLtd and Shift, to tackle inequality in the UK. It has a target size of £25 million, and an initial five-year investment period, providing patient and flexible capital to social purpose organisations (SPOs) that combine sustainable business models, job creation and a focus on social justice.

At least 50% of the fund's investments are to be made to SPOs with leaders from diverse backgrounds, with other investors supported to improve their equity, diversity and inclusion. The fund is accompanied by a bespoke £3 million technical assistance facility (TAF) to provide technical support to investee SPOs. Seventy per cent of the fund's capital will be deployed into equity or quasi-equity investment products, and the other 30% will provide patient and affordable debt products.

The fund is made possible by offering competitive returns and significant impact to investors, through a three tiered structure: a grant layer, a social/ impact investment tranche, and a social and commercial investor layer. Both investment layers have a target 7% net return, but the social investment tranche has a longer lock-up period. These returns are supported by the £3.5 million grant layer, which subsidises upside returns and provides downside protection for investors.

Grant funding is provided by Access, the foundation for social investment, and Bank of America Foundation. Philanthropic funders can also participate through grants in the catalytic capital layer and in the TAF.



Mayor of London's Energy Efficiency Fund

The Mayor of London's Energy Efficiency Fund (MEEF) is a £500 million-plus investment fund, established in 2018 by the Greater London Authority (GLA) with funding from the European Commission.

MEEF seeks to address market failures in London's low carbon sector by providing flexible and competitive finance to enable, accelerate or enhance viable low carbon projects across the capital. To cater to the different risk appetites of investors, MEEF comprises both senior (low-risk) and junior (high-risk) debt tranches.

The public money provided by the GLA/European Regional Development Fund (ERDF) principally funds junior tranches, accepting the potential capital risk of market failure, enabling private investors, including commercial banks, and other fund investors to allocate to the lower risk senior debt. The GLA has committed £101.4 million, which in turn has enabled Amber Infrastructure Limited to secure £456 million from private investors – close to five times the public funding.

MEEF has invested in small and medium-sized enterprises (SMEs), and NHS and Local Authority projects across London.



Resonance Homelessness Property Funds

National Homelessness Property Fund 1 (NHPF1) was launched in 2015 and raised £43.6 million from socially motivated investors to buy a portfolio of 229 homes across Bristol, Oxford and Milton Keynes.

The second fund (NHPF2) was launched in December 2020, with a six-fold target fund size of £300 million to purchase 1,500 homes across UK regions.

Both funds blend private capital with public funding from local government programmes and national government. Investors include institutional and certified sophisticated investors, See Resonance National Homelessness Property Fund and Resonance National Homelessness Property Fund 2 local authorities and pension funds, in particular local government pension schemes like the Greater Manchester Pension Fund. NHPF2 has a target net Internal Rate of Return of 6%.

Blended impact finance – Institutional models



Big Society Capital & Access

Big Society Capital (BSC) and Access – The Foundation for Social Investment (Access) are sister organisations which work together to build the UK blended finance ecosystem. BSC was established in 2012 and capitalised pursuant to the Dormant Bank and Building Societies Accounts Act 2008. BSC received further equity capitalisation from four high street banks (Barclays, Lloyds, Royal Bank of Scotland and HSBC).

Access was established with funds from the Department of Culture, Media and Sport (DCMS) and started to receive Dormant Accounts funds in 2018.

The Dormant Accounts Act provides for financial institutions to transfer money in dormant accounts to the Reclaim Fund which disperses the funds via The National Lottery Community Fund for investment in certain social activities in the UK. One eligible use for the funds is funding social investment wholesalers – which are bodies that exist to assist or enable other bodies to give financial or other support to charities and social enterprises.

Both BSC and Access are social investment wholesalers. BSC and Access are part of the Dormant Assets Group alongside Fair4All Finance and Youth Futures Foundation. All are private limited companies and Access is also a registered charity. The four organisations are subsidiaries of The Oversight Trust – Assets for the Common Good whose mandate is to ensure that each organisation delivers on its mission.

BSC was launched with a mandate to make social investments and to become financially self-sustaining. Nevertheless it became clear that the type of finance being offered to much of the social sector was not most suited to its needs. In order to seek to address this gap, in 2015, Access was launched with the backing of the DCMS, The National Lottery Community Fund and BSC. Access had the twin mandate of stimulating demand for social investment through capacity building and to increase supply of social investment in still underserved areas through grant-making alongside repayable finance.

Blended impact finance – Institutional models

Case study: Big Society Capital & Access

A challenging aspect of the establishment of Access was the negotiation with the Charity Commission. The Charity Commission must approve the registration of any new charities and to do so must be comfortable that the organisational purpose is charitable. The support of social investment is a relatively novel and unfamiliar charitable purpose but the Charity Commission were convinced that such a purpose was charitable. Access was therefore able to register as a charity.

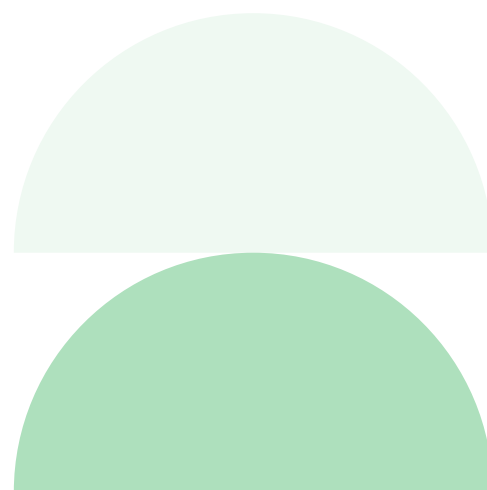
BSC and Access have collaborated on a number of programmes.

The Growth Fund – Access launched in 2015 with The Growth Fund. This programme combined £22.5m of grant from The National Lottery Community Fund and £22.5m of loan from BSC, managed by Access. This facilitated small unsecured loans of up to £150k to charities and social enterprises many of whom would not have taken on social investment before. The Growth Fund was delivered through a number of smaller funds managed by a range of first time and more established social investors.

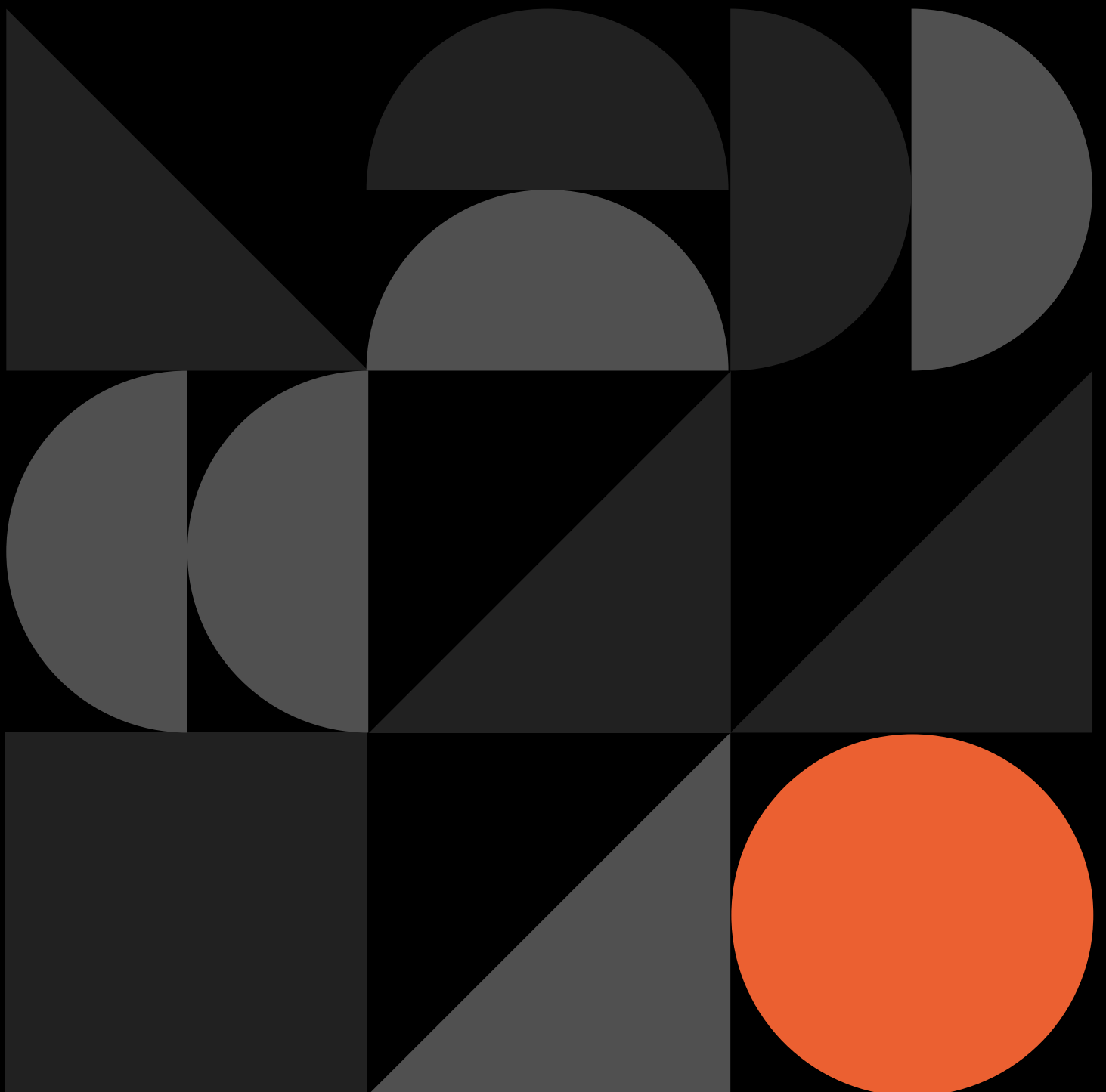
Capacity building – BSC and Access collaborate in capacity building in the social investment and blended finance space. In 2016 BSC, Access and DCMS launched Good Finance. Good Finance is a project which intends to demystify social investment – through digital content, programmes and projects. It seeks to improve knowledge of social investment, to enable organisations to make informed decisions based on their needs and to help organisations connect to the right investors. More recently BSC, Access, Save the Children, EBRD and others launched the Blended Finance Community of Practice which seeks to share lessons and disseminate best practice in the blended finance space.

Blended Investments – BSC and Access frequently invest alongside each other – BSC providing loan capital and Access providing grant. Frequently Access's grant acts as a first loss layer which serves to de-risk the repayable finance layer. Investments to-date have included the Local Access programme – which seeks to develop stronger, more resilient and sustainable social economies in disadvantaged places. This programme places decision-making in local hands which allows support to be tailored to the needs of the local community.

Access had been set up in 2015 with funding set to last about 10 years. With the confirmation that further dormant assets will be made available over the longer term and the widespread view in the social investment sector that Access's role was still needed - it was confirmed in 2023 that Access would not work towards closure.



Appendices



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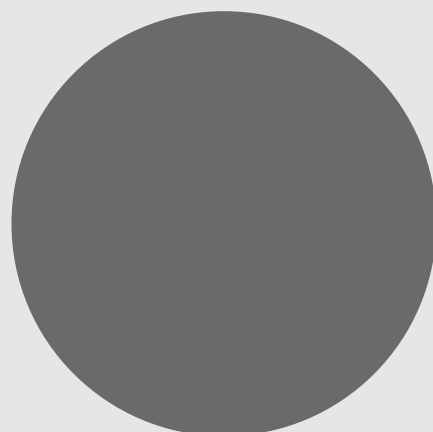
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