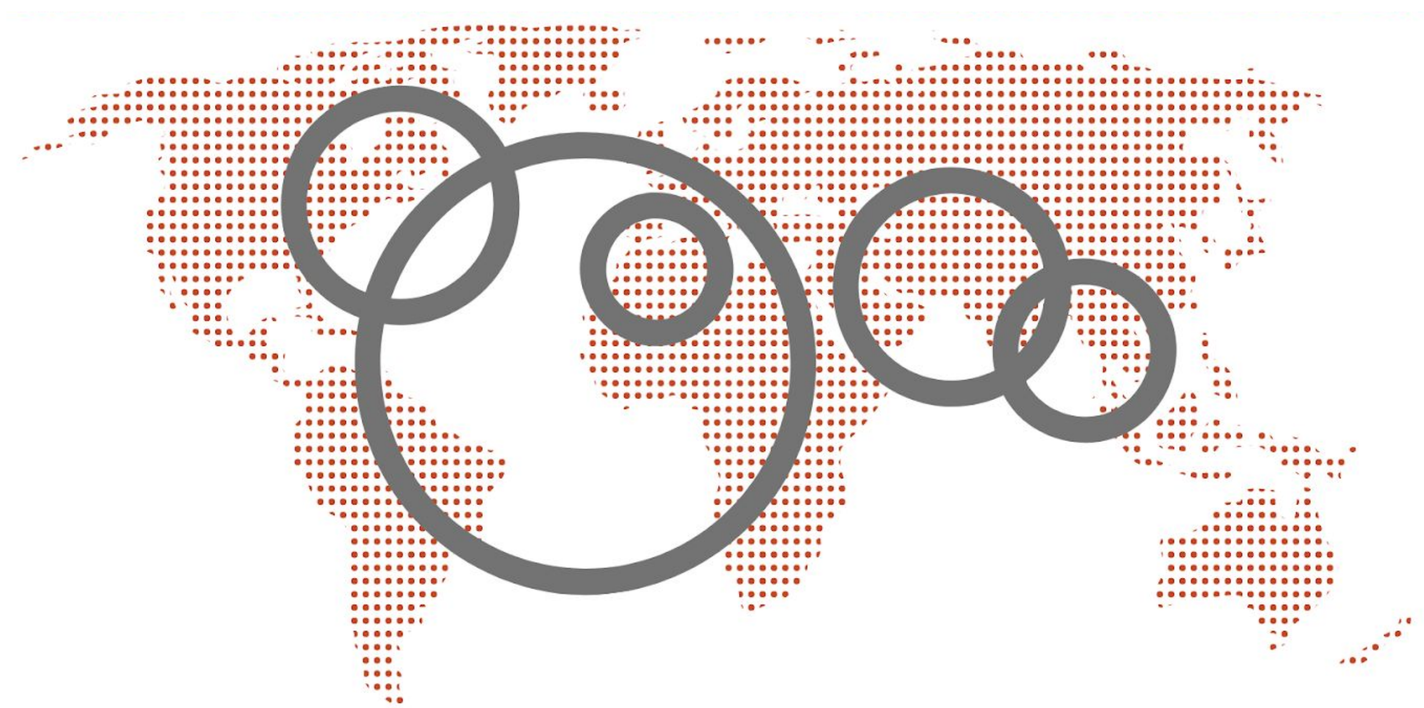
CAFIID Background Paper:
The Nexus of Private Investment and International Development



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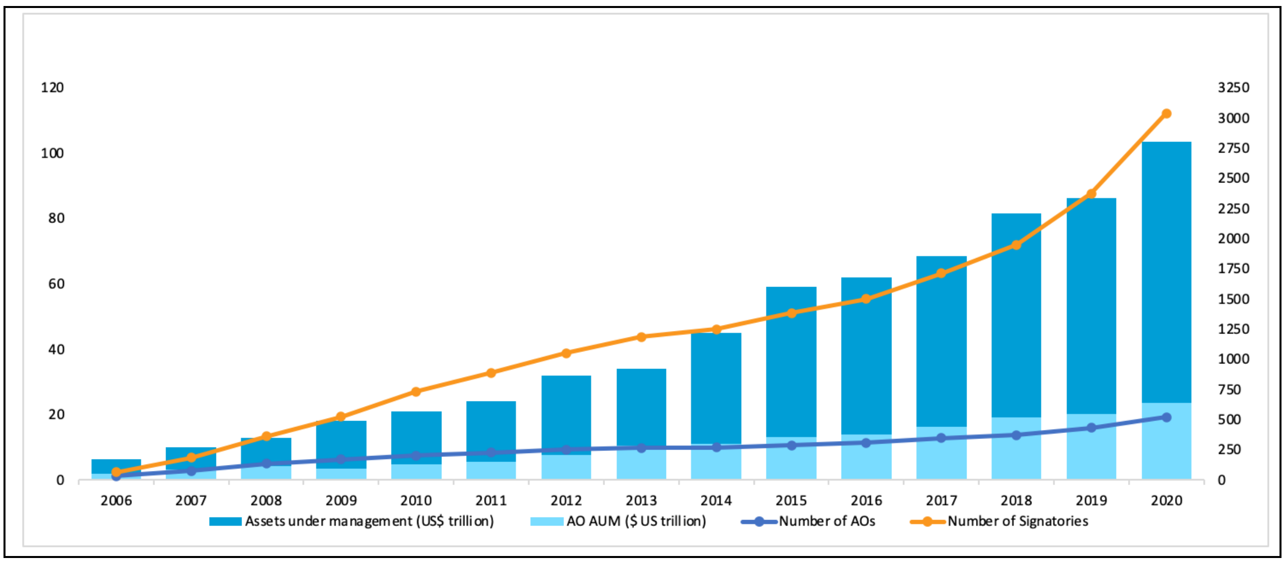
Private Investment to achieve financial objectives and “purpose” investment strategies

Around 3,400 organizations with USD 103 trillion of Assets Under Management globally have signed up to the United Nations Principles for Responsible Investment. This signatories now represents around 30% of global financial assets. Amongst the 170 Canada-based signatories, 103 are investment managers and 54 are asset owners (See attached excel sheet for list of Canadian organizations). In its 2019 Annual Report, the Responsible Investment Association (RIA) of Canada reported its 399 members have CAD 24.8 trillion of assets under management.

Global signatories to UN Principle for Responsible Investment



Across most sectors of private investment, there is an increasing appetite for investment assets aligned to responsible investment, ESG investment, sustainable finance, impact investment and green finance. A 2019 survey by the International Finance Corporation estimated global demand for impact investment assets at least USD 32 trillion and a subsequent 2020 IFC report indicates the current market at least USD 2.1 trillion.

The large majority, estimated at 90%+, of these investments are made in the 49 High Income Countries. The United Nations estimates the annual investment needs to achieve the Sustainable Development Goals in the 145 Low and Middle-Income countries at USD 3.9 trillion, but actual investment levels are only $1.4 trillion – funded by domestic investment and cross-border flows, the latter including Foreign Direct Investment (around USD 559 billion annually), Portfolio Investment (USD 110 billion) and Debt (USD 259 billion). There are several challenges to investment in these countries, including high country risk (around 10% of the counties are Investment Grade and 90% are Non-Investment Grade).

The international development community, including Global Affairs Canada, is increasingly interested to mobilise private sector investment and expertise to Low and Middle-Income Countries. But GAC and its peers understand the country risk is often too high, and with most private sector companies, financial institutions and projects subject to the sovereign rating ceiling, the country risk impedes investors from investing in good-quality, bankable/investible investment assets and projects. For example, in 2018, GAC established its CAD 1.5 billion International Assistance Innovation Program to alter the risk of investment in Low and Middle-Income Counties to create investible/bankable investment assets for private sector investors. The primary financial structuring approach combines (i) create a portfolio of investments that diversifies risk across multiple counties and companies/projects, and then (ii) credit enhancing the portfolio by guarantees and subornation. These approaches are typically called blended finance or innovative finance, and now mobilise around USD 20 billion of private investment globally. And now in 2020, Canada is developing a first-ever Private Sector Engagement for Sustainable Development Strategy.

All the investment assets that result from the IAIP, blended finance and the new strategy will be aligned to at least one of responsible investment, ESG investment, sustainable finance, climate finance and impact investment. That is, the IAIP and new strategy will create investible/bankable assets for asset owner and asset managers pursing one or more of these investment strategies.

Canada's international development assistance

In 2015, the international development community established the 2030 Agenda for Sustainable Development – an ambitious 15-year global framework centred on 17 Sustainable Development Goals (SDGs) that cover social, economic and environmental dimensions of sustainable development. In the same year, the international community agreed to the Addis Ababa Action Agenda, which highlights the importance of engaging the private sector as a source of development finance in supporting SDG achievement. The United Nations estimates annual investment needs in 145 developing countries to achieve the SDGs at USD 3.9 trillion, with actual investment levels around USD 1.7 trillion in 2017 (itemized in the table below) leaving an annual SDG Investment Gap of USD 2.5 trillion. The full impact of COVID-19 and the anticipated reduction in FDI to developing countries will create an even larger financing gap – especially if we see a parallel reduction in ODA.

Private Sector Flows (82% of flows) 2017		**Public Sector Flows (18% of flows) 2017**	
Foreign Direct Investment	USD 559 billion	Bilateral aid and loans	USD 210 billion
Remittances	USD 417 billion	Multilateral aid and loans	USD 101 billion
Debt	USD 259 billion		
Portfolio Investment	USD 111 billion		

The three main sources of public sector, cross-border flows to these countries are as follows:

1. 37 high-income and upper-middle income countries, including Canada, are members of the OECD Development Assistance Committee, and commit around USD 150 billion annually to improve the lives of people living in developing countries. Almost all of this funding is in the form of grants (i.e. aid) and sovereign loans to governments[1];
2. International Financial Institutions and Multilateral Development Banks, like the World Bank and African Development Bank, allocate grants and loans to governments; and
3. Development Finance Institutions, like FinDev Canada and the World Bank's International Finance Corporation, commit around $40 billion annually in the form of debt and equity investments in the private sector.

Over the years, the international development community has come to recognize the private sector as a key development partner capable of mobilizing additional development finance, implementing initiatives and delivering the technical expertise required to achieve the SDGs. OECD guidance on private sector engagement recognizes the importance of (i) evidence and experience, (ii) tracking how development finance mobilizes private investment, and (iii) bringing together public and private sector actors.

Canada committed around $6.1 billion in international assistance in 2018-19, mostly through Global Affairs Canada and Finance Canada. Details of Canada's international assistance spending can be found in the 2018-2019 Report to Parliament. Canada's international assistance is delivered through partnerships with multilateral organizations (e.g., United Nations, World Bank and African Development Bank), partner country governments, civil society organizations and the private sector.

To support transformative change, Canada is pursuing a comprehensive approach, laid out in the Feminist International Assistance Policy, across six action areas through programming, policy, and advocacy efforts. The action area policies help shape the broad parameters for Canada's international assistance, while enabling flexibility for country and institutional contexts.

In 2018-2019, Canada invested the following (all figures CAD $) by action area:

1. Gender equality and the empowerment of women and girls	$90 million
2. Human dignity (health and nutrition, education, humanitarian action)	$2,670 million
3. Growth that works for everyone (infrastructure, transport, communications, and energy)	$982 million
4. Environment and climate action	$630 million
5. Inclusive governance	$442 million
6. Peace and security	$314 million

[1] While emerging economies and other non-members of the OECD-DAC such as China, Brazil, Saudi Arabia, India and South Africa are playing an increasingly prominent role in financing development co-operation, the OECD estimates the spending to be less than 10% of the total spent by DAC members.

Canada's recent $1.5 billion International Assistance Innovation Program (IAIP) and Sovereign Loans Program, and establishment of FinDev Canada are examples of how Canada is extending its global policy leadership around innovative development finance to include new funding and programming channels. Effective private sector engagement is essential to the deployment of IAIP funds and, more broadly, achieving the objectives of GAC's international assistance mandate.

Background on Blended Finance to create investment assets

Blended finance is aligned with the objectives of the 30 global institutional investor members of the Global Investors for Sustainable Development Alliance.

Blended finance is a financial structuring stucuting approach that allows funders/investors to achieve targeted financial objectives and non-financial objectives (e.g., sustainable finance and impact investment). Two good resources are:

- Blended Finance 101
- The State of Blended Finance 2019 Report

An excellent case study is the IFC-Sida MCFF Infrastructure Program with an implied rating of "BBB+" that attracted $1.5 billion of investment from Allianz Global Investors, Axa and Prudential.

Additional case studies can be found here.

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