THE PROJECT FINANCE LAW REVIEW

Editor
David F Asmus

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CONTENTS

PREFACE v
David F Asmus

Chapter 1 WHAT IS PROJECT FINANCE? 1
David F Asmus

Chapter 2 PROJECT FINANCE ARRANGEMENTS IN GENERAL 7
Rajiv K Luthra and Pallavi Bedi

Chapter 3 BOND MARKETS AND DEBT PLACEMENTS 16
David Armstrong and Robert Warfield

Chapter 4 MULTILATERAL LENDERS AND REGIONAL DEVELOPMENT BANKS 29
Ana Carolina Barretto and Amanda Leal Brasil

Chapter 5 EXPORT CREDIT AGENCIES AND INSURERS 38
Barry N Machlin

Chapter 6 CORE PROJECT AGREEMENTS 46
Richard M Filosa

Chapter 7 COUNTERPARTY RISK 54
Ben Farnsworth

Chapter 8 LENDER RELATIONSHIP WITH PROJECT COUNTERPARTIES 64
David Armstrong and Gregory Howling

Chapter 9 PROJECT CASH, TYPICAL ACCOUNT STRUCTURES AND PROJECT CASH WATERFALLS 74
Brian A Bradshaw

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Chapter 10 TYPICAL SECURITY ARRANGEMENTS FOR A SINGLE SOURCE PROJECT FINANCING 80
Borja Contreras and Ignacio Álvarez

Chapter 11 COMMON COLLATERAL FOR MULTI-SOURCE FINANCING 90
David F Asmus and Adam Cowan

Chapter 12 PUBLIC-PRIVATE PARTNERSHIP AND THE PRIVATE FINANCE INITIATIVE 96
Ania Gorna

Chapter 13 TAX-EQUITY FINANCING 101
Scott Cockerham, Brian Greene, Kelann Stirling and Mateo Todd Aceves

Chapter 14 ISLAMIC FINANCE 113
Munib Hussain

Chapter 15 GOVERNMENT PROCUREMENT 122
Alexandra Felekis, Mzukisi Kota, Nonkululeko Nojoko, Tina Terblanche and Ntokozo Qwabe

Appendix 1 ABOUT THE AUTHORS 131
Appendix 2 CONTRIBUTORS' CONTACT DETAILS 139

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PREFACE

Many of the classic project finance texts are becoming increasingly dated as the years go by, while project finance itself continues to evolve with the markets it serves. The purpose of this volume is to provide a living guide to project finance that will be updated on a regular basis, while still tackling the core project finance concepts that every practitioner needs to understand.

As the inaugural addition, this volume seeks to cover the most salient topics while leaving scope for expansion into other key areas (such as mezzanine financing, government funding, and social and environmental issues) in the second edition. As discussed briefly at the end of chapter 1, all three of these areas have been in great flux, with newer funding sources (e.g., private equity), changes in the bond insurance market and more substantial environmental restrictions in effect at key lending institutions (particularly with respect to climate change concerns) all combining to change the complexion of the project finance market. The next several years should bring more clarity to all of these subjects, including particularly the future of project finance in the large oil and gas industry.

I would like to express my thanks to all of the authors of this inaugural edition. It is never easy to be a pioneer, which in this case entailed late nights drafting chapters from scratch for a new publication. Our authors have executed this task with distinction and aplomb. It is the hope of all of the authors that this volume not only will be of use to all of its readers today, but will also continue to grow in scope and utility in the years ahead.

David F Asmus
Sidley Austin LLP
Houston
April 2019

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Chapter 4

MULTILATERAL LENDERS AND REGIONAL DEVELOPMENT BANKS

Ana Carolina Barretto and Amanda Leal Brasil[1]

I GENERAL ROLE IN PROJECT FINANCE

Multilateral development banks and regional development banks (MDBs) are international financial institutions created by a group of countries with the primary function of mobilising finance, knowledge and expertise to address the biggest challenges faced by developing countries, including poverty and environmental problems. MDBs are creations of multiple nations and the main features for distinguishing among them is the composition and number of member countries,[2] and the region for which financial assistance and the promotion of economic and social development is made available.

The most well-known multilateral development banks are: the World Bank, the European Investment Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Development Bank of Latin America, the Inter-American Development Bank Group (IDB), the African Development Bank and the Asian Infrastructure Investment Bank. Among the most recognised regional development banks are the Eurasian Development Bank and the East African Development Bank. Each of these institutions has its own role in helping to design and coordinate approaches relating to global and regional development issues.

As set out in a paper jointly prepared by several MDBs and endorsed by the World Bank and the International Monetary Fund for the Development Committee[3] meeting of April 2015, the world needs to move 'from billions to trillions' of dollars in order to meet the international community's need to maximise finance for development and meet the 2030 Sustainable Development Agenda[4] and the relevant sustainable development goals (SDGs), such as promoting social inclusion, sustainable growth, reducing poverty and inequality, and protecting the planet.

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1 Ana Carolina Barretto is a partner and Amanda Leal Brasil is an associate, at Veirano Advogados.

2 The United States is a member, and donor, to five major MDBs: the World Bank and four regional development banks, including the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank.

3 The Development Committee is a ministerial-level forum of the World Bank Group and the International Monetary Fund for intergovernmental consensus-building on development issues. The Committee advises on critical development issues and on the financial resources required to promote economic development in developing countries. Over the years, the Committee has interpreted this mandate to include trade and global environmental issues in addition to traditional development matters.

4 On 1 January 2016, 17 SDGs came into force aiming to end poverty, fight inequalities and tackle climate change. Available at https://www.un.org/sustainabledevelopment/development-agenda/.

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In this context, the MDBs coordinate with each other through many working groups to address practical issues across the development landscape, supporting and engaging in partnerships and platforms for a broader cooperation across multilateral, regional, national and bilateral development institutions and NGOs.[5]

The worldwide landscape requires agility, innovation, new players in the development space, new technologies and financing models to accelerate the rate of global change. This scenario results in greater convergence of the business and development worlds, in line with growing corporate and investor interest that aims to achieve social value combined with financial returns. As stated by the IDB, 'companies are realizing that staying competitive and growing now and in the future means looking beyond short-term gains and toward addressing salient economic, social, and environmental challenges that affect both their business and society.'[6]

In the light of those shifting parameters, MDBs are committed to strengthening those working relationships, particularly through providing financial and non-financial support at the regional, national and subnational level, and have joined forces to harmonise methodologies to catalyse other financing (private sector and domestic revenues), always aiming to maximise resources such that the SDGs become a reality.

The value proposition for MDBs consists in their ability to be trusted partners who can provide the best services at the lowest cost, using a strong presence in the countries in which they act, which allows them to tailor solutions to their clients' (usually national shareholders) needs on a case-by-case basis.[7] MDBs' project finance operations consist of a leverage structure on which the investor can deliver profit and generate measurable, positive, social or environmental impact, combined with a financial return. MDBs' financial structure and financing capabilities enable them to leverage their capital to provide finance in many forms ('blended' finance, loans, guarantees, equity investment) and purposes.

MDBs use the money contributed or 'subscribed' by the relevant member countries to support the assistance programmes. They fund their operating costs from money earned on non-concessional loans to borrower countries. To offer non-concessional loans, MDBs borrow money from international capital markets (in many cases backed by the guarantees of their member governments, which are callable capital) and then re-lend the money to developing countries. This backing is provided through share ownership to which countries subscribe because of their membership in each bank. Only a small portion (typically less than 5–10 per cent) of the value of these capital shares is actually paid to the MDBs.[8] By leveraging these amounts, the MDBs' banking model attracts substantial resources from capital markets at interest rates reflecting their strong financial structure and high ratings.[9]

5 The African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank (2015). From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance. Development Committee Discussion Note 2015-0002.

6 lnter-American Development Bank – 2018 Development Effectiveness Overview (DEO).

7 Bhattacharya A, Kharas H, Plant M, Prizzon A (2018) The New Global Agenda and the Future of the Multilateral Development Bank System. *International Organisations Research Journal*, vol. 13, no 2, pp. 101–12.

8 Multilateral Development Banks: Overview and Issues for Congress, Rebecca M Nelson, dated 6 July 2018.

9 From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance. Development Committee Discussion Note 2015-0002.

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With regard to engagement with their clients, MDBs help to design and implement demand-based, country-driven, cross-sectoral technical and financial development solutions, and provide policy advice and technical assistance on tax matters related to the financed projects. In addition, MDBs support investment in systems, institutions and marketing. With respect to climate change matters, for instance, MDBs can assist through collective work with its global clients on actions aiming to generate multiple local health, agricultural, employment and resilience benefits.

It is also worth noting the commitment of the relevant participant countries in implementing the 2030 Sustainable Development Agenda and other global priorities. As per the request by the Group of Seven (G-7) countries dated 3 May 2017, there was a call for MDBs to collaborate in more concrete joint efforts and actions aiming at the development of a common framework based on maximum economic efficiency and effectiveness of the investments, together with the private sector.[10] Given the ambitious targets set out by the SDGs and the considerable financial resources needed to meet such commitments, MDBs have a role to play in engaging in relevant projects to mitigate risks and support the required financing through public or private partners (or both).

II LOAN PROGRAMMES

i Instruments, guarantees and eligibility requirements

The implementation of project financing solutions by MDBs is established in each contractual instrument involving the relevant players, which may require certain types of guarantees, risk insurance, blended finance and other risk-mitigation measures to be structured and customised on a case-by-case basis to solve specific issues.

Beyond the traditional undertakings provided in the project finance instruments commonly used in the private sector (such as loans, equity investment and guarantees), the 2015 'Billions to Trillions' Discussion Note outlined the following categories of financing solutions used by MDBs, each one comprising specific approaches and tools for customisation purposes to achieve a project goal:

> *(1) adding, pooling and enabling instruments to generate new flows, or more results for the same money; (2) debt-based/right-timing instruments that match flows to when cash is needed; (3) risk management instruments to manage or reduce risk for investors (i.e., correcting market failures, reducing regulatory risk) or consumers (e.g., weather insurance for farmers, local currency matching for micro, small and medium-sized enterprises (MSMEs)); and (4) results-based financing where payments are made specifically for desired results.*'[11]

Public-private partnerships (PPP) are supported by several MDBs by means of assistance to the member countries to build capacity and knowledge to structure and implement quality PPPs, including complex emerging-market infrastructure projects. For this purpose, the World Bank has a 'PPP Certification Program' to enhance performance, build capacity and ensure global good practice. The Inter-American Development Bank in turn provided

10 G-7 call for more concrete actions to develop a common approach for value for money. Available at www.g8.utoronto.ca/finance/170513-communique.html.

11 From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development Finance. Development Committee Discussion Note 2015-0002.

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advisory support to Argentina to assist in the structuring of contracts and bidding documents for the first PPP road project under Argentina's new PPP law. The advisory support was successfully provided and as a result the Argentine government requested additional support from the bank to structure transmission line projects. The bank also provides similar technical assistance for other member countries, such as Bahamas, Bolivia, Brazil, Dominican Republic and Guatemala, in response to each one's regional demands.[12]

With respect to eligibility criteria, most of the regional and sub-regional MDBs require existing membership of a specific organisation or region for countries to join as members or borrowers. Although all MDBs have a common mandate to support private development finance to implement the proposed SDGs, each one has its own internal operations and strategic goals in serving their relevant region and improving its own internal operations. In the context of project finance, MDBs consider that an assessment of the potential impact of changes in each regional context is fundamental for the success of efforts to develop a relevant project. Depending on the result of that assessment, the legal and financing structure of a project will be adapted accordingly, to accommodate the relevant region's particularities and development stage.

The World Bank group was founded in 1944 and it is currently the world's largest source of funding and knowledge for developing countries. It is composed of five institutions: the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency, and the International Centre for the Settlement of Investment Disputes. In 2018, the commitments of the World Bank Group amounted to around US$67 billion and the disbursements around US$46 billion.[13]

The World Bank was created initially to focus on providing financing for large infrastructure projects. Over time, the bank has broadened its scope to include social projects and policy-based loans. Certain criteria are applied to determine if a relevant project or policy is eligible for support. The project must implement the bank's policies, and be capable of meeting the bank's environmental, social and anti-corruption guidelines in the member country. There must be a clear and defined development impact and the necessity to mobilise private investment or mitigate government payment risk.

The World Bank requires the execution of contractual agreements typically used in project finance transactions reflecting the direct relationship between the bank and the relevant member country. The parties to those agreements are the World Bank (as guarantor), the relevant government (as obligor) and the private investors (as beneficiaries).[14] The World Bank also provides a 'guarantee program' to enhance the credit quality of sovereign and sub-sovereign obligors to reduce costs and improve financing terms for projects and governments, and ensure the long-term sustainability of projects.[15]

Similarly, the Asian Development Bank was also initially established in the early 1960s with the purpose of providing financing for large infrastructure projects rather than social projects or direct poverty mitigation. Nowadays, the main infrastructure projects developed by the bank are related to transport, water, energy, urban development, and information and communications technology. Its mandate consists of promoting economic growth and

12 lnter-American Development Bank – 2018 Development Effectiveness Overview (DEO) Report.

13 The World Bank Annual Report 2018.

14 www.worldbank.org/en/programs/guarantees-program#4.

15 www.worldbank.org/en/programs/guarantees-program#2.

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cooperation in Asia and the Far East, and contributing to the acceleration of the process of economic development of the developing member countries. The bank's support is made through loans and grants, as well as by means of technical assistance to its member countries, to the private sector, and through PPP structures. As a demonstration of the bank's focus on infrastructure, its projected transactions will have increased by 50 per cent, from US$14 billion in 2014 to more than US$20 billion in 2020, of which 70 per cent is addressed to infrastructure projects.[16]

The IDB was created in 1959 to support Latin American and Caribbean economic development, social development and regional integration. It is the largest source of development financing for the region.[17]

In addition to the IDB, the Development Bank of Latin America (CAF) also plays an important role in Latin America and the Caribbean. The main difference among these MDBs is that CAF has a strong focus on infrastructure and projects that promote connectivity and integration within the region (such as transport and energy), with almost 70 per cent of its financing portfolio directed to those types of projects. Geographically, the bank's operations are mainly focused on Venezuela, Ecuador, Argentina, Peru and Colombia. Most of the IDB's loans, on the other hand, aim to accelerate the process of economic and social development in member countries: Brazil and Mexico are the two largest beneficiaries of such loans.[18]

The European Bank for Reconstruction and Development was founded in 1991, at a time of transition to a free market economy in the former communist countries of central and eastern Europe and the former Soviet Union. The bank differs from other MDBs given its historical provenance and its political mandate to focus on supporting democracy-building assistance targeting the private sector.[19]

The Asian Infrastructure Investment Bank started its operations recently in 2016, targeting social and economic development in Asia through investments in sustainable infrastructure, such as energy generation, water supply, sanitation and environmental matters. Its membership includes several advanced European and Asian economies, consisting of regional members (e.g., Australia, Cambodia, Fiji, India and Malaysia) and non-regional, prospective members (e.g., Argentina, Brazil, Canada, Spain and the United Kingdom). It is worth noting that the United States and Japan are not members of the bank.

The Eurasian Development Bank was created in 2006, by the Presidents of the Russian Federation and the Republic of Kazakhstan. The bank is primarily focused on projects related to energy, transport and infrastructure in the six member states (Russia, Kazakhstan, Armenia, Tajikistan, Belarus and Kyrgyzstan). According the bank's website, as at January 2019, the bank's investment portfolio comprises US$3.442 billion, involving 85 projects.[20]

The African Development Group was founded in 1964 and its current shareholders are 54 African regional countries and 26 non-regional member countries. Its operational priorities relate to infrastructure development, regional economic integration, support for private

16 Asian Development Bank's website. Available at: https://www.adb.org/about/infrastructure.

17 https://www.iadb.org/en/about-us/overview.

18 Overseas Development Institute (ODI) – A Guide to Multilateral Development Banks 2018 edition. Available at: https://www.odi.org/sites/odi.org.uk/files/resource-documents/12274.pdf.

19 Multilateral Development Banks: Overview and Issues for Congress. CRS report prepared for the Members and Committees of Congress. Rebecca M Nelson 6 July 2018.

20 Eurasian Development Bank website. Available at: https://eabr.org/en/projects/eabr/.

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economic development, governance and institutional accountability, and improvement of skills and technology. As at 2017, the bank's approved transactions amounted to US$6.2 billion.[21]

As a final note on the various MDBs, it is worth mentioning the New Development Bank (NDB). The NDB was formed in 2015 by the BRICS countries (Brazil, Russia, India, China and South Africa), which represent 26 per cent of the planet's land mass and is home to 46 per cent of the world's population.[22] In the period 2016 to 2017, NDB's board of directors approved loans involving financial assistance of over US$3.4 billion for projects in the areas of green and renewable energy, transportation, sanitation, irrigation and other areas.[23] The bank is committed to continuing to mobilise development resources in BRICS projects, complementing the efforts of other MDBs to supplement and promote global development by attracting resources for the infrastructure sector.

ii Projects covered by MDBs

According to the working paper 'Mobilization of private finance by multilateral development banks and development finance institutions 2017', produced by the MDBs[24] led by the IFC,[25] in 2017 more than US$160 billion in private investment was mobilised by MDBs and development finance institutions. It was also assessed that in 2017: total private investment stimulated by MDBs in low- and middle-income countries amounted to US$59 billion, of which US$19 billion was private, direct mobilisation; US$26.7 billion, or 45 per cent of the total private investment mobilised in low and middle-income countries was directed into infrastructure projects; and the IFC accounted for more than 30 per cent of all private investment mobilisation in low and middle-income countries. One-fourth of that was private direct mobilisation.

In this context, it is worth highlighting the following project finance transactions in the infrastructure sector that demonstrate the challenges related to catalysing private sector investment combined with public resources and its effective development impacts.

The IDB has invested in a renewable energy project named Santa Vitoria do Palmar, located in the south of Brazil, which is considered a priority for the Brazilian government regarding electricity supply and the diversification of Brazil's energy matrix. The project includes the construction of 12 wind farms and ancillary facilities that would produce 207 megawatts (MW) of electricity. The estimated total cost of the project is 1.3 billion reais (around US$325 million). To support financing the project, 105 million reais of debentures were issued in the local market and IDB Invest issued a total credit guarantee of 125 million reais (approximately US$33 million) with a 12-year tenor for the debentures to improve their risk profile and pricing. The financing plan was completed with the participation of two local development institutions (Banco Nacional do Desenvolvimento and Banco Regional

21 African Development Group website. Available at: https://www.afdb.org/en/about-us/corporate-information/.

22 brics.itamaraty.gov.br/about-brics/economic-data.

23 https://www.ndb.int/about-us/essence/history/.

24 African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, The Inter-American Development Bank and World Bank.

25 Mobilization of Private Finance by Multilateral Development Banks and Development Finance Institutions, dated June 2018. Available at https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/2018_mdb-mobilization-report.

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de Desenvolvimento do Extremo Sul, which provided a 680 million reais (around US$180 million) long-term loan, as well as equity contributions. The project had a security package in line with what is customary for project finance transactions.[26] According to IDB Invest, this is the first time that a full-wrap product of this type was structured in the Brazilian market and it is also IDB Invest's first guarantee issued in reais for a renewable energy project and its first guarantee of an infrastructure debenture in the local capital markets. By providing an international AAA guarantee, IDB Invest seeks to foster growth in Brazilian capital markets to attract new sources of liquidity, such as domestic multi-family offices. The bond settlement took place on 31 July 2018 and raised up to five times more than the amount required, demonstrating the success of this strategy to mobilise private capital.[27]

Another example of a project supported by a blended finance structure is the development, construction and operation of a 1,070MW Hydropower Project named Nam Theun 2 (NT2), located on the Nam Theun River in Laos, one of Asia's poorest countries. The project cost US$1.3 billion and its main objective is to support the government of Laos' poverty alleviation efforts by generating income of about US$2 billion over 20 years. NT2 is expected to provide 1,000MW of power for export to Thailand and an additional 75MW for domestic consumption. The Asian Development Bank, European Investment Bank and World Bank are among the MDBs involved in financing the project, together with other bilateral funding agencies and commercial banks.[28]

As a final example, a project finance arrangement was structured in 2010 to enhance access to electricity in northern Tanzania, achieve better power distribution across regions, improve the reliability of power supply and improve integration in regional power pools. The project included equity, loans and guarantees from 26 financial institutions, including MDBs (the World Bank Group, the Asian Development Bank, the European Investment Bank and the Nordic Investment Bank), bilateral funding agencies and several commercial banks. The project involved the construction of a 667km transmission line between Iringa and Shinyanga, operated at 220 kilovolts, with a total cost of up to approximately US$468 million. According to the World Bank's project report, the expected closing date of the project was 31 December 2016. However, the project experienced a delay of more than 30 months, because of a lack of appropriate mechanisms for coordinating procurement decisions by donors and the limited procurement capacity of the promoter or financial intermediary, Tanzania Electric Supply Company, at the time. According to the World Bank's assessment, the outcomes of the project were satisfactory, the risk to development outcome was low, the bank performance was moderately satisfactory, and the borrower performance was also moderately satisfactory. The lesson learned is that, for future multi-donor projects, additional legal arrangements could be introduced, suggesting conditions for joint procurement, advanced procurement and capacity-building activities addressing the inherent complexities of harmonising different processing requirements of development partners.[29]

26 https://www.idbinvest.org/en/projects/atlantic-santa-vitoria-do-palmar.

27 https://www.idbinvest.org/en/news-media/idb-invest-provides-r125-million-total-credit-guarantee-santa-vitoria-do-palmar-wind-farm.

28 https://www.worldbank.org/en/news/press-release/2018/01/30/statement-on-the-closure-of-the-world-bank-funded-nam-theun-2-social-and-environment-project.

29 Tanzania Backbone Transmission Investment Project – Projects & Operations Overview. Available at http://projects.worldbank.org/P111598/tanzania-backbone-transmission-investment-project?lang=en&tab=overview.

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III CONCLUSION

The ambitious vision of achieving 'billions to trillions' and the achievement of the SDGs by 2030 will require global coordination and initiatives aimed at increasing the private and public resources devoted to national policies and programmes that focus on the world's biggest problems in their highly varied national contexts. Despite the fundamental role of MDBs in this process, eight of the major MDBs (excluding the European Investment Bank) invested only US$35 to 40 billion a year in infrastructure, and public expenditure on infrastructure has also significantly decreased.[30] In addition, according to the European Investment Bank report 2018/2019, the number of investments through PPPs[31] fell to €9 billion in 2017 from €30 billion in 2005, a trend that can be explained by a very cautious attitude to PPPs replacing a previous enthusiasm, rather than changes in regulation or the cost of funding.[32]

This can be understood as reflecting the concerns of governments regarding the risks and uncertainties of business success in these projects, with success defined as generating a measurable, positive, social and environmental impact with an effective financial return. In this sense, reassessing the pros and cons of the existing financial structures, and their relevant instruments and alternatives, to increase credit exposure is a way to ensure the effectiveness of the MDBs. For this purpose, governments can take a stronger role in infrastructure finance arrangements that aim to attract more proceeds from other sources by improving the legal instruments and protections for private investors. In this sense, the greater and more strategic use of MDBs will be fundamental to mobilise much more private finance, including through blended finance.

Although the investment circumstances vary from country to country considering the relevant context, development stage and specific country needs, it is important to have an attractive environment to investment, which includes transparency, a predictable legal, regulatory and investment framework, as well as structures that support innovation.

Innovations in finance include, for instance, increasing the issuance of 'green bonds', which are conventional bonds, issued by corporations, commercial banks, MDBs and other participants, the proceeds of which are earmarked for projects with climate or other environmental benefits. The use of green bonds has been encouraged by the MDBs with the purpose of attracting additional resources. In 2018 and 2019, eight more National Development Banks in Argentina, Brazil, Colombia, Ecuador, Mexico and Uruguay will receive support to issue green and sustainable bonds. This strategy will also mobilise additional resources by combining IDB technical support with anchor investments from bilateral banks and other MDBs, including the European Investment Bank.[33] Green bond issuances amounted to US$167.3 billion in 2018 and the demand for green bonds continues to grow exponentially.[34]

30 Business and Sustainable Development Commission 2017. Better Business Better World: The Report of the Business & Sustainable Development Commission. London. Available at report.businesscommission.org/report.

31 Public-Private Partnerships are an important example of where an effective and supportive business enabling environment is fundamental to success. World Bank Group Support to Public-Private Partnerships: Lessons from Experience in Client Countries, WBG Independent Evaluation Group, 2014.

32 Investment Report 2018/2019: Retooling Europe's economy. Available at www.eib.org/investment-report.

33 lnter-American Development Bank – 2018 Development Effectiveness Overview (DEO).

34 https://www.climatebonds.net/resources/reports/2018-green-bond-market-highlights.

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In addition, the use of blockchain technology or similar systems is creating new standards of keeping transaction records securely and across multiple locations, given that all users 'hold' the ledger in a distributed fashion, transforming the role of 'trusted' third parties. Blockchain technology is being used for applications as diverse as land ownership registries, individual identity records and custody of assets.

Lastly, the MDB's support for the harmonisation of the standards, involving the MDBs' agreement on a shared definition of private capital mobilisation, was an important milestone to facilitate additional long-term financing that can support countries in reaching the SDGs. At the request of the G20, the IFC has launched globally an MDB Toolbox to support private sector initiatives.[35]

All these efforts help not only promote SDGs but have the added benefit of improving local market conditions, thereby enabling project finance structures to be more widely adopted worldwide. In that way, they help improve investor confidence and the market fundamentals required to make project finance structures viable in developing countries.

35 See Global Toolbox to Advance Private Sector Investment. Available at https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications/MDBs-Global-Toolbox.

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Appendix 1

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