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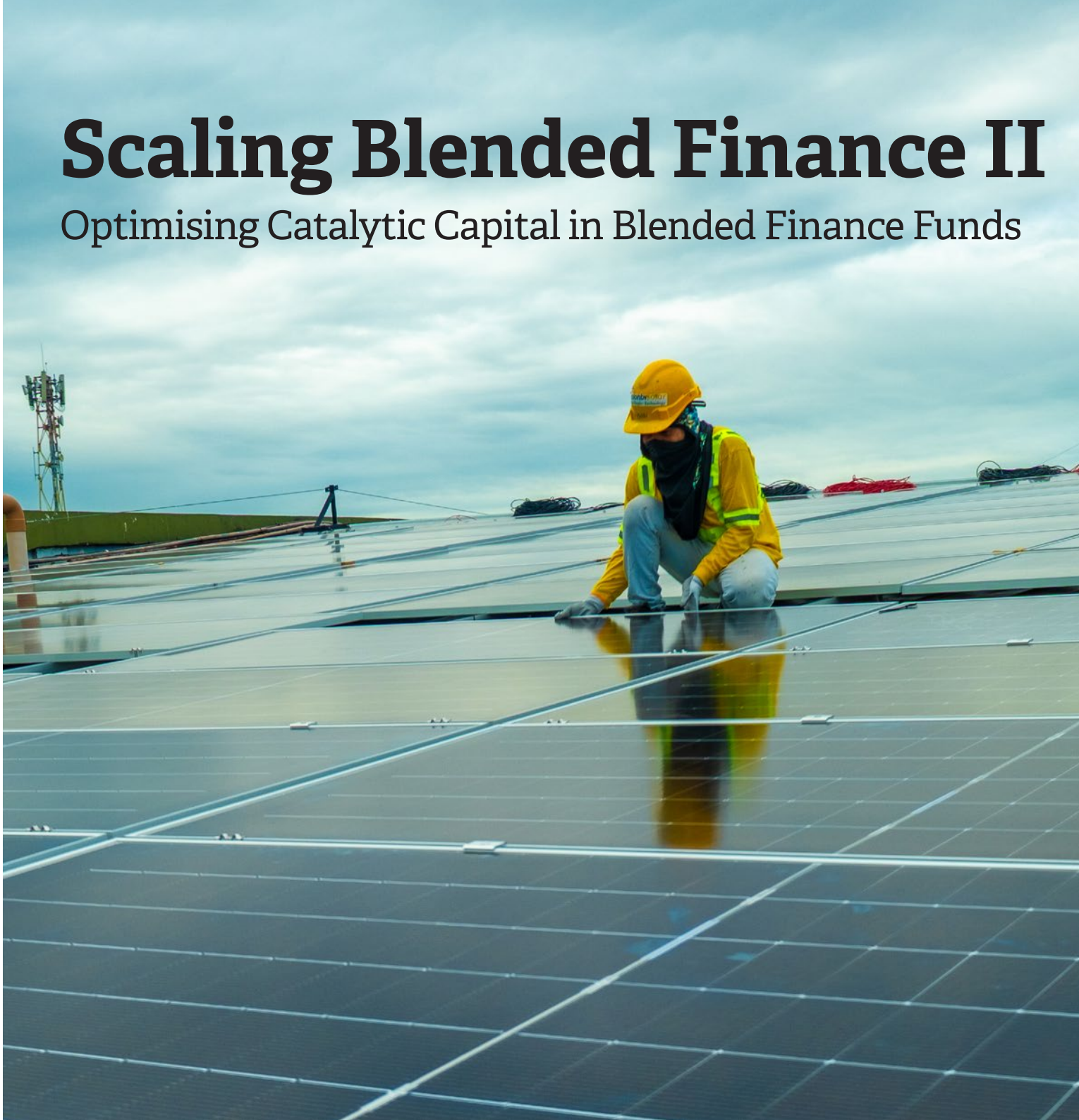
Scaling Blended Finance II

Optimising Catalytic Capital in Blended Finance Funds



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This report presents an analytical framework intended to inform discussion. Any use of this framework is voluntary and at the exclusive discretion of the reader.

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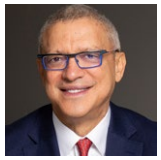
Foreword

Capturing the economic opportunity in clean and resilient energy, infrastructure, and industry across emerging markets and developing economies requires stronger collaboration between development finance institutions and private finance. In recent years, blended finance funds have increasingly shown they can mobilise commercial capital into new markets and sectors, allocating risks more effectively between commercial and catalytic investors.

Yet, despite this progress, structuring blended finance funds remains complex, time-consuming, and costly, constraining the growth of the market. Too often, participants lack a shared understanding of how to structure funds to use scarce concessional capital efficiently, while meeting investors' regulatory and mandate requirements.

This report seeks to help address that challenge. Building on the first Scaling Blended Finance publication and on the direct experience of BII, GFANZ, and BCG, it translates observed, real-world market practice into a robust, practical, voluntary use framework for fund managers, catalytic investors such as development finance institutions, and commercial investors. By providing a common language for why concessional capital is needed, in what form, and in what amount, it aims to help reduce the complexity and cost of structuring these funds, and to support new participants—including fund managers based in emerging markets—in entering this space.

We are grateful to the many practitioners, investors, fund managers, and market experts whose insight and experience have informed this work. They show what can be achieved when funds are well designed and catalytic investors are willing to engage. We hope the framework and case studies presented here contribute to greater transparency, speed, and confidence across the market and, in turn, help mobilise more private capital where it is needed most.



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Purpose and audience for this document

This is the second report in the 'Scaling Blended Finance' series. It provides practical tools for structuring catalytic capital within mobilising-at-scale blended finance funds, building on the structuring typology and scorecard introduced in the first report. It focuses on the three fund archetypes designed to mobilise commercial capital at scale: high-yield mobilisation funds (C), targeted mobilisation funds (D), and diversified mobilisation funds (E). It also addresses three linked questions: what constraints exist for commercial investors that influence their participation, which concessional instruments best resolve those constraints, and how to size those instruments appropriately. This report describes observed market practice; it is not investment advice and does not assess whether a fund's impact thesis justifies the deployment of concessional capital. It is intended to complement existing frameworks, including the DFI Enhanced Principles for Blended Concessional Finance and the OECD DAC Blended Finance Guidance.[1]

This report is intended for practitioners of blended finance with a sound grasp of financial structuring principles, including fund managers, commercial investors, catalytic investors, and policy and regulatory authorities. It assumes familiarity with concepts such as capital stacks, cash flows, waterfalls, and financial structuring mechanics. The analysis draws on stakeholder consultations and publicly available transaction data from more than 40 blended finance funds, and has been developed jointly by BII, GFANZ, and BCG.

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The authors would also like to extend their gratitude to the many practitioners in the blended finance space who kindly shared their views and experience in support of this work.

1 *DFI Working Group on Blended Concessional Finance for Private Sector Project Summary Report* (2017); DAC Blended Finance Guidance (2021).

1. Executive summary

1.1 Why develop another blended finance report?

Blended finance funds combine asset pooling, risk tranching, and concessional capital to incentivise commercial capital participation in vehicles that deliver both financial and development outcomes.[2] Using tools from structured finance, risks and returns are synthetically reallocated across the capital stack to align investors with different mandates. Concessionality is the mechanism that makes this possible: catalytic providers accept below-market terms, bearing risk, sub-market returns, illiquidity, or volatility that commercial investors cannot or will not, enabling private capital to flow into markets and sectors it would not otherwise reach.

A growing number of mobilisation-at-scale blended finance funds are now coming to market with the explicit aim of attracting commercial capital at scale. These funds, corresponding to the 'high yield' (C), 'targeted' (D), and 'diversified' (E) mobilisation archetypes identified in the first Scaling Blended Finance[3] report, represent a promising path for closing the gap between current financial flows and what is needed to meet global development and climate objectives. Realising that promise depends on whether these models can be scaled and replicated in ways that continue to mobilise capital that would not otherwise participate. This in turn requires a broader range of fund managers, commercial investors, and catalytic investors to become familiar with them. It also needs the judicious use of concessional capital, which is crucial and scarce.

Today, that familiarity is lacking. Fund managers designing blended finance vehicles face structuring decisions that go well beyond conventional fund design, and even those with deep experience raising commercial capital encounter unfamiliar territory when concessionality enters the capital stack. The consequence is long structuring timelines, high transaction costs, and significant variability in how effectively catalytic capital mobilises private investment.

Most of the existing guidance on catalytic investing has been written from the perspective of catalytic capital providers, not fund managers. It focuses on principles for deploying catalytic capital from an impact perspective, with less attention to the practical structuring decisions that determine whether a fund's capital stack meets commercial investors' requirements and results in an investable opportunity. Investors and fund managers commonly cite the absence of a consistent, practical framework for fund-level concessional structuring as a key inhibitor. Fund managers understand their underlying assets, and are familiar with certain investor groups, but lack a shared language between catalytic and commercial investors to determine what form of catalytic capital is needed, how it should be structured and priced, and how much is required.

1.2 What this report covers

The first Scaling Blended Finance report set out a framework for assessing the strategic and impact rationale for blended funds. This report takes that assessment as a given and focuses on the mechanics of structuring and sizing concessional capital. Any use of concessional capital will also need a compelling *impact* thesis for catalytic investors,[4] as well as strategic alignment between catalytic and commercial investors. This alignment, along with fund managers' effective selection of assets that optimally match commercial and catalytic investors' appetite, is essential for success, but it lies outside of the scope of this report. In all cases, the expected outcome is that as commercial investors become more familiar with underlying assets and blended finance structures, the level of concessional capital required in blended finance funds will reduce over time. This report exclusively covers debt and equity blended finance funds with concessionality embedded in the capital stack, including any instruments offered at below-market rates or terms. It does not cover standalone blended finance instruments such as guarantees that sit outside of a fund structure, technical assistance grants, blended loans, asset-level blending, or demand-side risk mitigation mechanisms such as offtake agreements.

Finally, concessional structuring is not a substitute for a weak underlying portfolio. The quality of the underlying assets in a fund is the foundation on which everything else rests. Where an investment thesis is not sound, or an asset pipeline is not credible, concessional capital cannot bridge the gap.

2 Some institutions define blended finance more broadly, including structures that mobilise commercial capital using development or public finance that is not necessarily concessional.

3 *Scaling Blended Finance – Practical tools for Blended Finance Fund design*, BII & BCG (2025).

4 Multilateral development banks (MDBs) and development finance institutions (DFIs) may seek to align with the DFI Enhanced Blended Concessional Finance Principles and the OECD Blended Finance Guidance, which call for minimum concessionality, avoiding market distortions, and addressing clear market failures. As the International Finance Corporation (IFC) notes in Recommendation 3 of *The Why and How of Blended Finance* (2020), concessional instruments that are not closely aligned with the underlying distortion they seek to address risk not only undermining effectiveness but also delivering an excessive degree of concessionality.

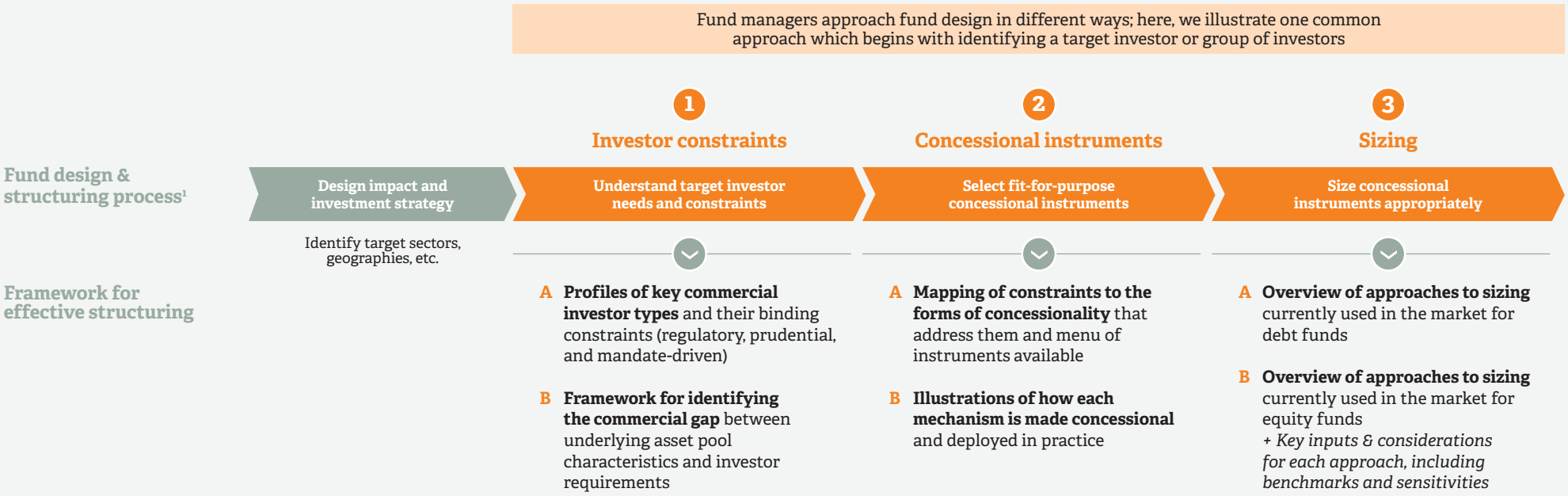
1.3 A framework for structuring concessional capital

Section 2 profiles five groups of commercial investors: insurance companies, pension funds, sovereign wealth funds, banks, and family offices, and organises their constraints across four dimensions: downside, returns, cashflow and liquidity, and volatility. Identifying which constraints apply, and quantifying the gap between investor requirements and asset pool characteristics, provides fund managers with a structured basis for determining the scope of catalytic intervention required before entering into investor negotiations.

Section 3 maps each type of investor constraint to a set of concessional instruments. Downside protection, return enhancement, cashflow and liquidity enhancement, and volatility reduction each resolve a distinct type of constraint, and can be delivered through a variety of funded or unfunded mechanisms. The taxonomy lets fund managers narrow the solution set before detailed structuring conversations and articulate why a given instrument has been selected.

Section 4 details observed market practice for determining the size of the aforementioned concessional instruments required to mobilise commercial participation. For debt funds, approaches range from quantitative risk-profile calibration to precedent benchmarking against comparable structures. For equity funds, where rating anchors are absent and waterfall mechanics do more work, the framework shifts toward scenario analysis and structured heuristics. In both cases, sizing begins with the most binding constraint and moves to the least binding in an iterative fashion where multiple instruments interact.

Figure 1: How fund managers will use this report | Illustrative workflow for an end-user



Note: This is a simplified view of a fund structuring process aligned with the scope of this report. In practice, the process will be highly iterative and depends on external factors such as the form and terms of available concessional capital, investor mandates and approval processes, and legal, regulatory, and tax considerations in the fund's domicile and target markets.

1.4 Who should use this framework and why?

Designing a blended finance fund is an iterative process. Taken together, the three parts of the framework offer a structured approach to help design efficient concessionality within mobilising-at-scale blended finance funds, and a shared language that can benefit all stakeholders. Fund managers gain a starting point for structuring funds suited to specific commercial investor needs, a basis for articulating why specific concessional support is required, reduced time spent on iteration, and shorter negotiation cycles with catalytic providers. Commercial investors gain transparency into how concessional instruments work and why a given structure is designed the way it is, supporting sharper due diligence and faster investment committee decisions where mandates allow.

Catalytic investors gain a basis for assessing proposed structures from a commercial investor's perspective, helping them judge whether a given structure uses their capital efficiently to mobilise commercial participation.

By increasing market participants' familiarity with concessional capital structures and providing a framework for their use, this work can help to reduce structuring and closing timelines, improve the efficiency of concessional capital, and ultimately mobilise greater volumes of private capital into the markets that need it most.

2. Investor constraints – Identifying barriers to investor participation in funds

2.1 Investor constraints

Commercial investors face four major types of constraints when participating in a blended finance fund, each corresponding to a distinct feature of the return distribution they require: limited exposure to losses (downside); an expected return above a minimum threshold (returns); a cashflow profile that matches their liability structure or mandate (cashflow and liquidity); and predictability in returns over time (volatility). These constraints arise from regulatory frameworks, fiduciary obligations, and internal mandates, and structure the analysis that follows in this section and across the rest of the report.

- **Downside** – Investors require that the risk profile of an investment satisfies a credit ratings threshold or internal risk assessment. This is the primary constraint for most debt fund investors, but is rarely binding in isolation for equity fund investors.
- **Returns** – Investors require a minimum risk-adjusted return based on market benchmarking, internal mandates, or actuarial requirements.
- **Cashflow and liquidity** – Investors require a cashflow profile, tenor, and degree of liquidity compatible with their liability structure, portfolio mandate, or member redemption obligations.
- **Volatility** – Investors require a degree of return predictability consistent with their tolerance for variability from sources such as foreign exchange (FX) movements, interest rate shifts, or asset performance.

A broader set of considerations also influence commercial investors' participation in blended finance funds, including minimum ticket size, timing and sequencing of investor engagement, governance processes, strategic asset allocation, and data availability. These factors are important in practice and can shape investment but are typically less directly addressable through structuring and therefore fall outside the scope of this analysis. Investors may also find it easier to assess simpler over more complex structures. This section profiles five groups of commercial investors against the four dimensions: insurance companies, pension funds, sovereign wealth funds, commercial banks, and family offices.[5] Each group represents a significant potential source of commercial capital for blended finance funds and exhibits identifiable patterns of constraint. Figure 2 summarises the key constraints by investor type at a high level (detailed profiles are provided in the Annex). In practice, constraint strictness will vary significantly across individual institutions and jurisdictions, and any specific investor will have nuances not captured by the group profile.

Other sources of private wealth

This report does not cover private wealth held outside of the family office channel, such as high-net-worth individuals reached through private banks and wealth management platforms. These investors face different constraints, centred on wealth platform suitability, liquidity needs incompatible with closed-end fund structures, ticket-size and operational mismatches in fund onboarding, and fee-layering across the distribution chain. Closing these gaps requires a distinct set of solutions outside of the capital stack, which can include evergreen and semi-liquid fund wrappers, wealth platform distribution infrastructure, and advisor education, which are beyond the scope of this report.

5 These groups were selected based on the size of their assets under management, their historical participation in blended finance funds at scale, and identifiable patterns of investment needs and motivations within each group that feed into common constraints. For example, asset managers were excluded because they reflect the highly varied interests of underlying asset owners, making it difficult to identify consistent motivations or priorities. This section focuses on the participation of these groups as investors in blended finance funds. Several, notably banks, also play other roles—as originators, arrangers, and distributors—but those functions are outside the scope of this analysis.

2.2 What this means for fund managers designing a capital stack

The four dimensions of commercial investor constraints (set out in 2.1) directly impact capital stack design. Where targeted investors share a constraint profile, fund managers can build simpler, more efficient structures. A fund targeting European insurers and defined-benefit pension schemes, for instance, faces investors with a need for investment-grade credit protection, predictable, long-dated cashflows, and modest return enhancement. In this example, a capital stack with a rated senior tranche, a subordinate first-loss position, and predictable distributions might serve both groups without requiring multiple additional bespoke accommodations.

Targeting investors with divergent constraints introduces structural complexity that concessionality alone may not resolve. A fund seeking capital from both insurers and banks must reconcile insurers' need for long-duration, rated, fixed-rate exposure with banks' need for short-tenor, capital-efficient, liquid positions. This reconciliation may require multiple tranches with different tenor and seniority profiles, each adding negotiation cost, legal complexity, and time to fund closure. The decision to target a diverse investor base should be taken deliberately, with a clear view of the structural cost.

A practical starting point, therefore, is to identify the primary target investor type, understand its binding constraint profile, and design the structure to satisfy it. Secondary investor types can then be assessed against the same structure. Where their constraints can be accommodated at low marginal cost, the fund benefits from a wider capital base. Where they cannot, the fund manager must weigh the value of broader participation against the cost of structural complexity.

Figure 2: Investor constraints (I/II) | Constraints are often driven by regulatory frameworks and mandates, and not equally binding across investor types

Relative optimisation priorities by investor segment:

	Insurance Companies	Pension Funds	Sovereign Wealth Funds	Banks	Family Offices
Downside	Risk-based regulatory capital charges	Fiduciary duty and SAA[2] limit	Political, legal, and reputational sensitivity	Risk-based regulatory capital charges (Basel RWA[4] & output floors)	Flexible risk appetite
Returns	Moderate return uplift over benchmarks required for EM & illiquid assets	Benchmark-anchored return discipline	Preference for return varies by mandate	Risk-adjusted spread requirements (ROE-driven)	Opportunistic; heterogenous preferences
Cashflow and liquidity	ALM[1] duration requirement Stable cashflow (life)	Scheme-level cashflow requirement (DB)[3]	Horizon varies by mandate	Prudential frameworks increase funding costs for long-term, illiquid, or structured exposures	Shorter-duration profiles preferred
Volatility	ALM[1] currency exposure requirement	Not level of variability, but alignment with asset class and benchmarks	Preference for volatility varies by mandate	Not regulated but may affect regulatory capital or reported earnings	Greater variability in outcomes, especially with impact mandate

Binding constraint | Less binding constraint | Focus varies by investors

Note: Detailed investor profiles can be found in the Annex.
1. Asset–liability matching
2. Strategic asset allocation
3. Defined benefit
4. Risk-weighted asset

Source: Insurance Development Forum; Convergence; *Trillions or billions? Reassessing the potential for European institutional investment in emerging markets and developing economies*, ODI (2024); *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders*, OECD (2015); BCG, BII, and GFANZ analysis, informed by practitioner interviews (2026).

Figure 3: Investor constraints (II/II) | Fund structures can be tailored to align with investor-specific constraints

	Insurance Companies	Pension Funds	Sovereign Wealth Funds	Banks	Family Offices
Core implication for fund design	**Senior, ratings-anchored structures** with amortising cashflows and calibrated tenors to optimise capital treatment and liability alignment ***E.g., SDG Loan Fund (Allianz GI)***	**Liability-aligned, income-oriented structures** anchored by catalytic investors and calibrated to SAA[1] buckets ***E.g., Amundi Planet – Emerging Green One Fund***	**Large-ticket, mandate-aligned vehicles** structured for flexible co-investment including hybrid equity–credit formats ***E.g., Leapfrog Emerging Consumer Fund IV***	**Senior, RWA-efficient structures** with recognised credit enhancement and shorter tenors to manage liquidity and balance sheet impact ***E.g., Philippines Water Revolving Fund***	**Flexible, transparent formats** to accommodate diverse preferences and decrease burden on smaller investment teams ***E.g., Gigaton Fund***
Sub-type nuances	**Life insurers** Longer tenors (10–20 yrs), fixed or predictable coupons	**Defined benefit (DB)** Long-duration private debt / infrastructure-style exposure	**Stabilisation funds** Liquidity buffers and lower-risk allocations; may have lower appetite for BFFs	**EU / UK banks** Greater reliance on IRB; structures may not benefit from full risk mitigation due to RWA[2] floors	N/A
	Non-life insurers Shorter duration, senior positioning, lower capital intensity	**Defined contribution (DC)** Evergreen or semi-liquid; benchmark-classifiable strategies; may have lower appetite for BFFs	**Strategic dev. funds** Commercial returns combined with strategic sector exposure	**US banks** Greater reliance on standardised risk weight framework	

1. Strategic asset allocation
2. Risk-weighted assets

Source: Insurance Development Forum; Convergence; *Trillions or billions? Reassessing the potential for European institutional investment in emerging markets and developing economies*, ODI (2024); *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders*, OECD (2015); BCG, BII, and GFANZ analysis, informed by practitioner interviews (2026).

2.3 Defining the commercial gap

The gap between investors' constraints and a fund's underlying asset profile establishes the commercial rationale for concessionality. Where underlying asset pool characteristics meet or exceed investor requirements, no concessionality should be required.

Where gaps exist, fund managers typically first consider whether they can be closed through non-concessional means, including portfolio diversification, portfolio optimisation, structural features such as securitisation, or adjustments to fund terms. Concessional capital can then be introduced to close gaps that remain after these options have been exhausted.

Identifying the commercial gap is, in principle, a two-step exercise. First, each constraint is assessed in turn—starting with the one most likely to be binding for the target investor, such as downside risk for insurers and banks, or returns for pension funds and sovereign wealth funds—to establish which apply. Second, for each binding constraint, the asset pool's characteristics are compared to the investor's requirements. The difference establishes the commercial case for concessionality and the scope of what the structure must address. Figure 4 illustrates this comparison. In practice the process is iterative. Fund managers solve simultaneously for three moving parts: the underlying asset pool, the target investor, and the fund structure. The target investor profile may itself shift if the binding constraint can be addressed at lower cost by another investor type.

Both sides of this comparison involve uncertainty. Investor requirements are rarely clean thresholds—a pension fund's strategic asset allocation (SAA) bucket may carry some flexibility; an insurer's rating floor may allow some internal discretion—and they shift over the protracted time-to-market typical of blended funds. Asset-pool characteristics are equally uncertain, resting on assumptions about default correlation, recovery, and data quality that are not precisely known at design. The commercial gap is therefore best understood as an approximate range, not a precise number, though even an approximate diagnosis gives managers a structured basis for instrument selection and a shared reference point for negotiation with catalytic providers.

Figure 4: Commercial gap | Gap between asset characteristics and investor appetite establishes the commercial case for concessionality

Steps to identify gap

1. **Assess each dimension independently**
   - Starting with the constraint most likely to be binding for the target investor
   - A gap may exist in only one dimension or across multiple; to be determined iteratively
2. **Quantify the gap** between what the assets offer and what the investor requires

For each constraint, identify the gap to determine the concessionality required:

	Underlying asset pool characteristics	−	Appetite of commercial investors	=	
Downside	What is the asset's risk profile? (e.g., credit rating, risk etc.)		What does the investor require? (e.g., minimum rating)		**Commercial gap**
Returns	What net return do the assets support?		What is the investor's hurdle rate or benchmark?		
Cashflow & liquidity	What is the asset's tenor and expected distribution profile?		What does the investor's ALM, mandate, or reporting require?		
Volatility	What volatility are returns subject to? (e.g., FX, interest rate, credit)		What is the investor's tolerance for variability?		

Where asset characteristics meet or exceed investor requirements, no concessionality is needed; certain gaps may be solvable by non-concessional means (e.g., duration mismatch)

Note: This figure presents a simplified view. Both underlying asset characteristics and the appetite of commercial investors are dynamic and may only be estimated imprecisely.

3. Concessional instruments

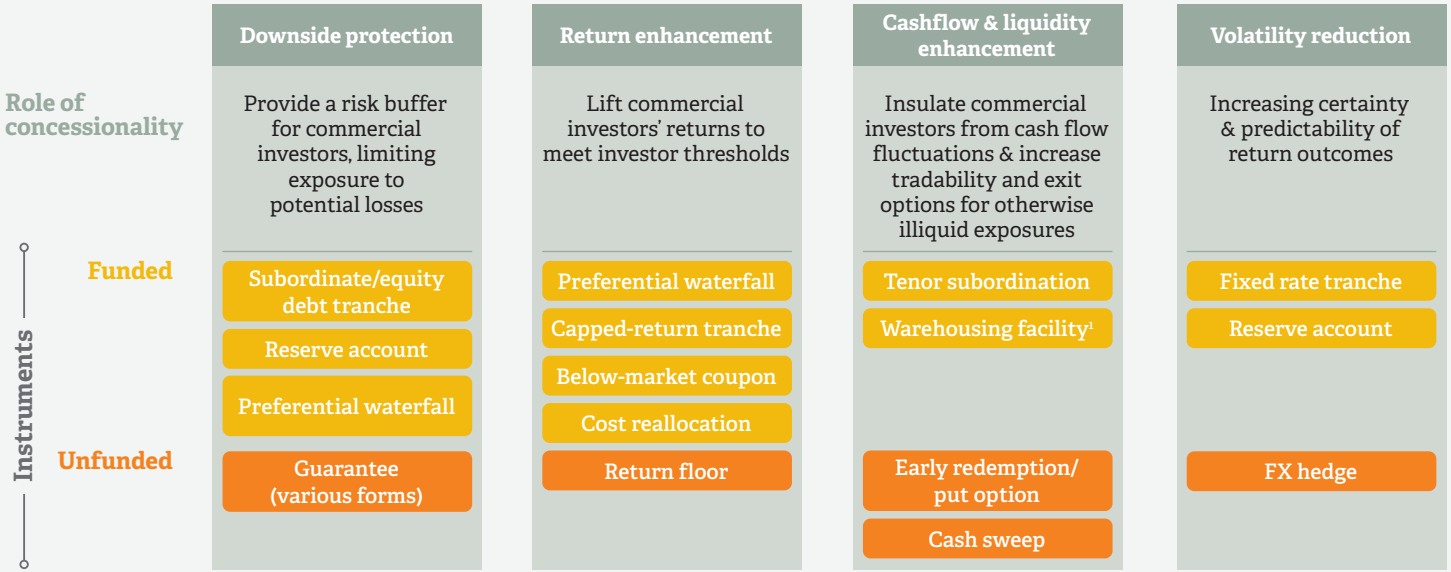
This section presents a taxonomy of the concessional instruments most commonly used to address investor constraints in blended finance funds, illustrated with real-world examples. The instruments are organised into four forms of concessionality, corresponding to the four constraints outlined in Section 2:

- Downside protection absorbs left-tail risk before it reaches commercial investors.
- Return enhancement reallocates economic upside in the capital structure to lift commercial returns.
- Cashflow and liquidity enhancement takes on longer-duration or less predictable cashflows on behalf of commercial investors.
- Volatility reduction transfers return variability to balance sheets better positioned to absorb it.[6]

Each form can be delivered through a variety of funded and unfunded mechanisms, often in combination.

Funded mechanisms require the concessional capital provider to deploy capital upfront, while unfunded mechanisms involve a contractual commitment that is only drawn upon if a defined trigger event occurs. The distinction has implications for the availability of concessional capital, balance sheet treatment of the concessional provider, and for how the instrument is recognised by commercial investors and their regulators. Funded and unfunded mechanisms are often used in combination.

Figure 5: 3-4 concessional instruments shortlisted as most relevant for solving each type of investor constraint



Note: This report focuses on instruments deployed on concessional terms. Many can also be deployed on fully commercial terms, but are made concessional through pricing and structuring relative to market conditions.

1. Warehousing facilities are commonly used in commercial structures, which potential for deployment in blended finance.
Source: *A Framework for Structuring a Blended Finance Fund*, Amundi (2025); *Blended Finance 2.0: Giving Voice to the Private Sector*, BlueOrchard (2018); *The Why and How of Blended Finance*, IFC (2020); *Blended Finance: When to use which approach – Decision-making tool and framework*, Initiative for Blended Finance at the University of Zurich (2022); BCG, BII, and GFANZ analysis, informed by practitioner interviews (2026).

While the taxonomy applies to both debt and equity funds, equity funds differ in three important respects. First, the primary sizing question centres on returns rather than downside protection. Second, equity waterfalls offer more degrees of freedom and less established convention than debt waterfalls. A single waterfall mechanism in an equity fund, such as preferred return, hurdle rate, catch-up, carry-split, return cap, or residual allocation rule, will typically serve multiple purposes simultaneously, whereas in debt funds the equivalent functions are delivered through more separable instruments. Third, volatility in equity funds is managed primarily through portfolio construction rather than through concessional instruments.

The instruments presented are not exhaustive, and each is presented in its concessional form, such as when it is offered at below-market prices or terms relative to what a commercial investor would require. Many of the same instruments are also deployed on fully commercial terms; the concessional character comes from the pricing and terms, not the instrument itself. The fund examples illustrate specific structuring solutions and are not a representative sample of the market.

6 Not all enhancements are recognised equally. A structural feature can reduce economic risk without delivering rating or regulatory benefit. Whether an enhancement is rating-creditable depends on enforceability of the support, counterparty strength, hard payment triggers, and replenishment mechanics.

3.1 Taxonomy of concessional instruments

Many blended finance funds use more than one concessional instrument. A single instrument does not always close the commercial gap across all binding constraints. Managers typically combine instruments across forms, for example by pairing a subordinate tranche with a return cap or a guarantee with a tenor subordination, to address a target investor's full constraint profile. In practice, instrument selection is also shaped by the availability of concessional capital. The instrument that best fits a given constraint may not be on offer in the volume or the terms required, and fund managers frequently work between what is analytically indicated and what can be assembled.

3.1.1 Downside protection

Concessional downside protection mechanisms reduce the risk of loss to commercial investors. Catalytic investors absorb losses ahead of commercial tranches and receive below-market compensation for doing so. Downside protection is the most commonly deployed form of concessionality in blended finance funds and is often directly linked to the regulatory and internal approval criteria that govern commercial investor participation.[7]

Funded mechanisms:

- Subordinate tranches – A junior tranche, structured as first-loss equity, first-loss debt, or mezzanine, absorbs principal losses up to a defined threshold before senior tranches are affected. Catalytic investors occupying these tranches accept higher risk on below-market terms.
- Reserve account – Catalytic investors fund a cash reserve at zero or below-market return. These reserves absorb losses before any investor tranche is impacted, with the catalytic provider bearing the cost in the form of foregone returns. The same mechanism can serve a volatility reduction function (detailed in 3.1.4).

Example: the Amundi Planet Emerging Green One Fund, a $1.4 billion emerging market green bond fund, uses two **subordinate tranches** to achieve investment-grade treatment for its senior tranche, from a starting fund rating of BB+. A first-loss junior tranche (6.25 per cent of total fund size) and a second-loss mezzanine tranche (3.75 per cent) were anchored by the IFC along with the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), and Proparco[8]. Together, the two subordinated tranches provided sufficient credit enhancement for the target commercial investors, Swedish and Norwegian pension funds and a Finnish insurance company, which required investment-grade credit ratings to satisfy regulatory requirements and mandate-driven risk profile constraints.[9]

7 Convergence market data

8 The French development finance institution

9 World Bank Group (2023); IJ Global (2021); Convergence (2026).

Unfunded mechanisms:

- Guarantees – A catalytic investor commits to cover losses on a defined pool of exposures if they occur, in exchange for a fee that is set below the commercial market rate (or waived entirely). Variations include first-loss guarantees, which cover an initial layer of losses up to a defined percentage, and wrap guarantees, which cover principal and interest payments in full.[10]

Example: Allianz GI's SDG Loan Fund, a $1.1 billion private debt fund combines funded and unfunded downside protection. A subordinated first-loss equity layer, financed by the Dutch Entrepreneurial Development Bank (FMO)[11], sits beneath $1 billion in senior equity from Allianz SE, Skandia (a Swedish insurer and financial services provider), and other private investors.[12] A separate $25 million **credit guarantee** from the MacArthur Foundation, provided on grant terms, supports the first-loss equity layer. The credit guarantee was a familiar tool for both the market and target investors, helping to accelerate approval and fund closure when deployed in conjunction with the funded first-loss equity.

Equity waterfall mechanisms:

In equity funds, downside protection operates primarily through the fund waterfall rather than through distinct instruments. A single mechanism frequently serves multiple purposes simultaneously and multiple mechanisms are often combined.

- Preferential waterfall and priority distributions. The distribution waterfall sequences returns such that commercial investors receive distributions in priority, typically through return of capital and preferred return thresholds that must be met before catalytic investors participate. Catalytic investors typically sit at the bottom of this sequence, receiving distributions only after all commercial tranches have met their respective thresholds, thereby absorbing losses first where fund-level realised value is insufficient. The same mechanism can serve as a return enhancement function (detailed in 3.1.2).

10 *The Role of Guarantees in Blended Finance*, OECD (2021).

11 The Dutch development finance institution.

12 The Class A and Class B shares are share classes of a SICAV-SIF rather than securitisation tranches. They function as senior and subordinated positions in the capital stack.

3.1.2 Return enhancement

Concessional return enhancement mechanisms reallocate economic upside in the capital structure to bridge the gap between a fund's underlying return profile and commercial investors' target returns. Catalytic investors accept reduced, capped, or delayed returns, freeing upside for reallocation to commercial tranches. These mechanisms are widely deployed where portfolio economics or structural features prevent the fund from meeting institutional return hurdles, which are often directly linked to the regulatory and internal approval criteria that govern commercial investor participation.

Funded mechanisms:

- Capped-return tranche – Catalytic investors fund a tranche that receives returns only up to a defined threshold. Returns above the threshold are reallocated to other tranches.
- Tiered hurdle rate – Commercial tranches receive priority on returns, with catalytic tranches accepting lower priority or below market returns. For example, commercial investors in senior tranches may be prioritised to receive risk-adjusted market-rate returns in full first, before junior catalytic investors.
- Below-market coupon – A catalytic lender accepts below-market interest payments, with forgone interest effectively reallocated to commercial co-lenders or, in some cases, to the underlying borrowers.
- Cost reallocation – Catalytic investors can bear a disproportionate share of fund-level costs—such as upfront credit rating fees—that would otherwise reduce commercial investors' net returns. This can be particularly relevant for activities that contribute to market building.

Example: The Brookfield Catalytic Transition Fund (CTF) is a targeted $5 billion fund focused on climate transition investments in emerging and developing markets. ALTÉRRA, the UAE's $30 billion climate investment vehicle, committed $1 billion in concessional capital on **capped-return** terms, earning modest risk-adjusted returns up to a defined single-digit hurdle rate, with returns above the cap allocated to commercial investors. The structure lifts commercial returns where the underlying asset pool alone would not clear commercial hurdle rates, enabling participation from pension funds, insurance companies, and sovereign investment vehicles including La Caisse, Prudential, GIC, and Temasek.[13]

Unfunded mechanisms:

- Return floor – A catalytic investor promises to make up the difference if commercial investors' returns fall below a designated threshold. The floor is provided free of charge or at discounted rates relative to what a commercial insurer would require.

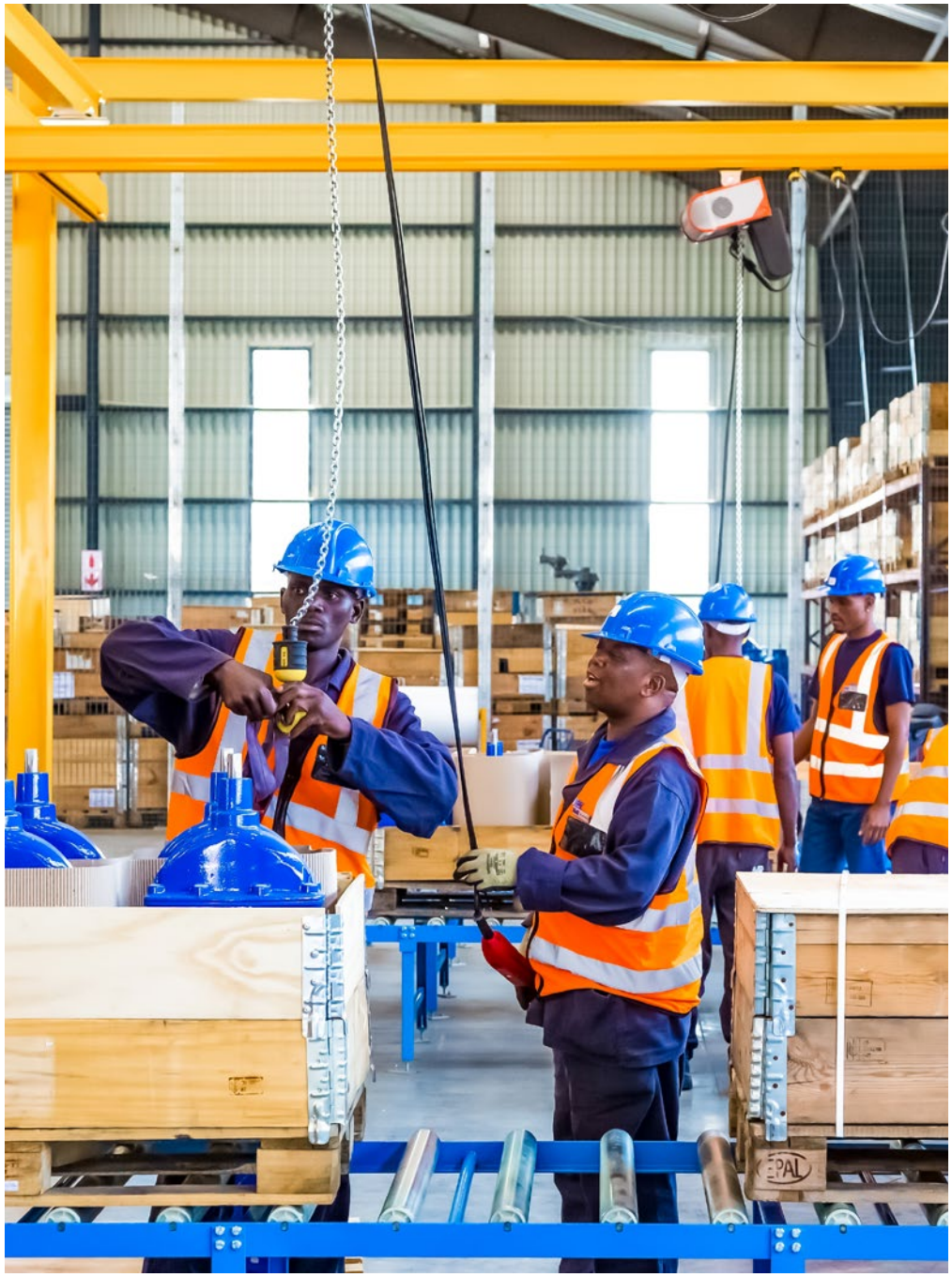
Equity waterfall mechanisms:

In equity funds, return enhancement operates primarily through the fund waterfall rather than through distinct instruments. A single mechanism frequently serves multiple purposes simultaneously and multiple mechanisms are often combined.

- Capped returns with upside reallocation. The catalytic investor's return is capped at a specified level, with returns above the cap flowing to commercial investors. A common variation allows the catalytic investors to resume participation in returns once the commercial investors have reached a defined hurdle, sharing in upside above that level. This is the equity analogue to the capped-return tranche in debt funds but is implemented through waterfall allocation rules rather than tranche structure.
- Preferential waterfall and priority distributions. The distribution waterfall sequences returns such that commercial investors receive distributions in priority, typically through return of capital and preferred return thresholds that must be met before catalytic investors participate. Catalytic investors typically sit at the bottom of this sequence, receiving distributions only after all commercial tranches have achieved their target returns, increasing the commercial investors' overall share of fund returns. The same mechanism can serve a downside protection function (detailed in 3.1.1).
- First-in drawdown. Concessional capital is drawn first, with commercial capital drawn only after concessional commitments are substantially deployed. This mechanically improves commercial investor internal rate of return (IRR) by shortening their effective investment period and simultaneously compressing their J-curve.[14]
- Fee and carry concessions. The general partner (GP) foregoes fees or carried interest on the catalytic tranche, transferring economic value to commercial investors through reduced fund-level costs.
- Co-investment rights on concessional terms. Commercial investors are offered co-investment rights alongside the fund on a no-fee, no-carry basis. This improves the net return on the commercial investor's total exposure by reducing the blended fee drag across their fund commitment and co-investments.

13 *Blended Finance Best Practice*, The Investor Leadership Network & The Sustainable Markets Initiative (2024).

14 J-curve refers to the typical return pattern in private funds where returns are negative in early years due to upfront costs and are followed by gains as investments mature increase in value.



Cashflow and liquidity enhancement

Concessional cashflow and liquidity enhancement mechanisms align the timing and predictability of fund cashflows with commercial investors' liability profiles, deployment expectations, or exit horizons. Catalytic investors take on longer-duration liabilities, absorb illiquidity during a fund's ramp-up phase, or guarantee exit options, at below-market cost.

Funded mechanisms:

- Tenor subordination – The catalytic tranche carries a longer effective life than the commercial tranche, absorbing the tail risk of later exits. Commercial investors are repaid or exited first, with concessional capital remaining to wind down the residual portfolio. This is well-evidenced in debt fund structures, but harder to implement in equity funds.
- Back-ended catalytic waterfall – Catalytic investors are positioned last in a debt fund's distribution waterfall for both principal and residual returns, giving commercial investors effective priority on exits. Unlike tenor subordination, this can shorten commercial investors' effective exposure even within a common fund term by directing early realisations to them first.
- Warehousing facility – A catalytic investor provides a short-term line of credit at a below-market rate to finance the acquisition or origination of assets ahead of long-term capital. It allows assets to be accumulated during a fund's ramp-up phase, before investor capital is called. The catalytic investor absorbs early-stage risk to enable asset aggregation that supports fund formation and reduces the risk of negative carry. The facility is repaid once assets are transferred into the fund or refinanced through permanent financing.

Example: The Africa Agriculture and Trade Investment Fund (AATIF) uses tenor subordination to match investment maturities to the varying liquidity needs of different investor groups. The fund issued Class A shares with 4–10-year maturities and Class B shares with 5–15-year maturities, targeting different groups of private investors.[15] A concessional Class C tranche with no fixed maturity absorbs residual liquidity risk and enables the shorter-maturity commercial tranches to be offered on terms compatible with investors' cashflow and duration requirements.[16]

15 Private investors' names and types were not disclosed.

16 *Case study: Africa Agriculture and Trade Investment Fund (AATIF)*, Convergence (2015).

Unfunded mechanisms:

- Early redemption / put option support – A catalytic investor underwrites a put option or liquidity facility that lets commercial investors exit before the natural end of the fund's life, typically at a pre-agreed valuation. This mechanism is often paired with a liquidity backstop or guarantee so that redemptions can be honoured even when underlying assets are illiquid.
- Cash sweep – Excess cash from the portfolio is used to prepay senior tranches, accelerating the return of capital to commercial investors. Catalytic investors accept lower priority in cashflow allocation, taking longer or more uncertain repayment schedules in exchange. This addresses the mismatches between irregular portfolio payments and regular coupon requirements of commercial investors.

Example: Octobre Liquidity Guarantee Facility (OLGF) is an independent facility that provides a **liquidity guarantee** to investors seeking to exit holdings in closed-end emerging market and developing economy (EMDE) credit and equity funds. When liquidity in the secondary market is constrained, the OLGF guarantees execution of redemption requests within ten business days, making an initial payment based on the latest available net asset value (NAV) supplemented by adjustments within the next 12 months based on the market value of the position after secondary sale.[17] Investors pay a set, transparent fee for the exit option. The OLGF represents a relatively novel solution: few comparable liquidity tools have been deployed systematically within blended finance funds. Note: the OLGF is an independent facility rather than an instrument embedded within a fund structure; fund managers may need to adapt the approach for in-fund deployment.

Equity waterfall mechanisms:

In equity funds, cashflow and liquidity enhancement operates through waterfall design and structural features rather than through distinct instruments.

- First-in drawdown – As described under return enhancement, first-in drawdown simultaneously compresses the J-curve for commercial investors by delaying their capital deployment until catalytic commitments are substantially utilised.
- Put options and liquidity facilities – A catalytic investor underwrites a put option or liquidity facility that allows commercial investors to exit before the natural end of the fund's life, typically at a pre-agreed valuation methodology. This operates similarly to the early redemption/put option mechanism described under unfunded instruments above, but is implemented through waterfall provisions rather than as a separate instrument.

17 *Secondary Market Vehicles in EMDEs: Lessons and Implications for Development Actors*, ThirdWay Partners (2026).

3.1.4 Volatility reduction

Concessional volatility reduction mechanisms reallocate return variability across the capital structure, transferring exposure away from commercial investors and toward catalytic investors. For certain investors, such as insurers operating under Solvency II, return variability carries direct regulatory consequences, generating capital charges that make participation in volatile asset classes structurally impractical, regardless of the underlying return profile. The rationale of volatility reduction mechanisms is not that volatility risk disappears, but that it can be held more efficiently by catalytic investors whose mandates, funding structures, or policy objectives enable them to bear it at lower cost than commercial investors.

Many of the instruments used to address downside protection also reduce volatility, and the two constraints overlap in practice. Volatility reduction instruments are most distinctly relevant where the binding constraint is the shape of the return distribution, rather than the level of expected loss, particularly where investors require return certainty to match the predictability of their own liabilities.

Funded mechanisms:

- Fixed-rate tranche – Commercial investors receive a fixed-rate return. Catalytic investors in junior tranches absorb variation in underlying returns to stabilise the senior tranche's distributions, accepting no or below-market premiums for the additional volatility exposure.
- Reserve account – A concessional capital provider funds a cash reserve that buffers shortfalls in debt service or distributions that would otherwise flow through to senior commercial tranches. The same mechanism can serve a downside protection function (detailed in 3.1.1); when used for volatility reduction, the focus is on smoothing periodic distributions rather than absorbing terminal losses.

Example: Green Investments Partnership (Pentagreen Capital)
provides above base rate fixed margins to senior investors in its sustainable infrastructure financing platform in Asia. The fixed-margin structure is supported by a concessional partial equity guarantee from the European Fund for Sustainable Development Plus (EFSD+) and by concessional rates for junior equity holders, who absorb the variability senior investors would otherwise face. The guaranteed fixed margin directly addresses investors' concerns about return predictability in single-B-rated emerging market credit exposures with limited track records, enabling banks and a sovereign wealth fund to participate in the senior tranche.[18]

Unfunded mechanisms:

- Political risk insurance (PRI) – A catalytic investor offers cover against expropriation, currency inconvertibility and transfer restrictions, breach of contract by sovereign counterparties, and political violence at below-market premiums, making coverage available in jurisdictions where commercial PRI capacity is thin or unavailable.
- FX hedge – A catalytic investor offers currency swaps or forward contracts at below-market rates, making FX risk management affordable in markets where commercial hedging is prohibitively expensive or unavailable.[19]

These mechanisms are most relevant to debt fund structures; volatility reduction in equity funds is addressed primarily through portfolio construction, including geographic diversification, sector mix, and vintage spreading, rather than through concessional instruments. Unfunded mechanisms for volatility reduction remain rarely used compared to funded mechanisms, but show potential for greater uptake.

18 *Blended Finance Best Practice*, The Investor Leadership Network & The Sustainable Markets Initiative (2024).

19 FX hedging is increasingly used at the fund level, particularly for structures with significant local-currency asset exposure. PRI is more commonly applied at the underlying asset level.

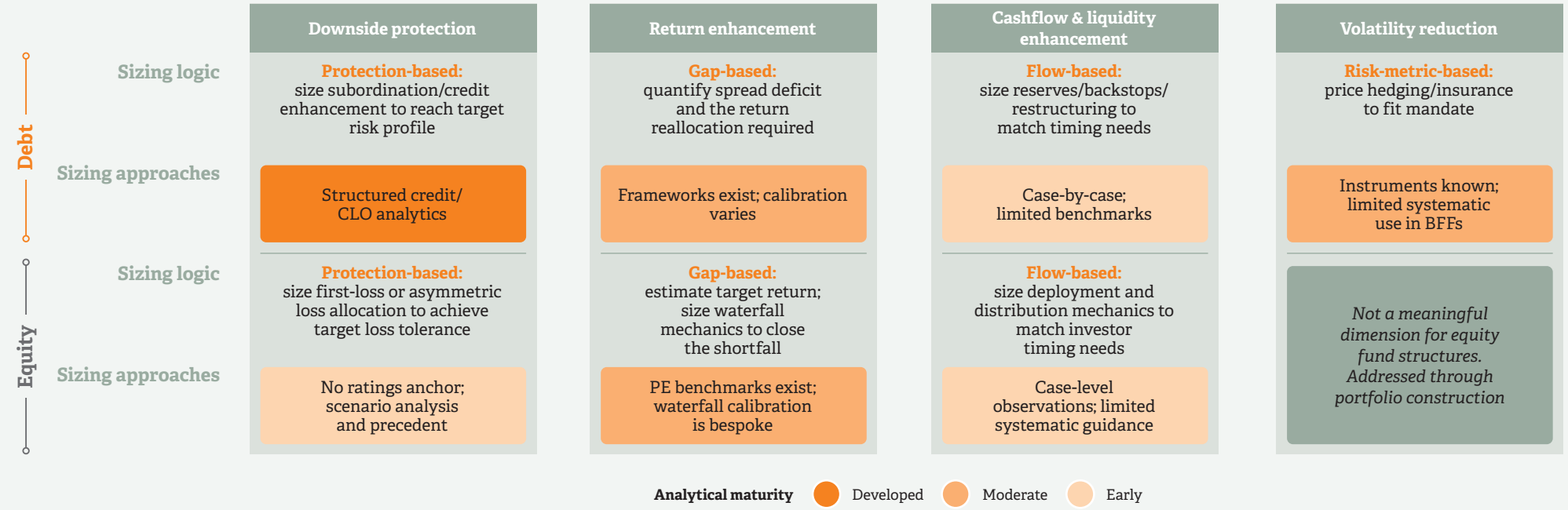
4. Sizing – Sizing concessional instruments & mechanisms appropriately

This section addresses how market participants have determined the appropriate size of concessional capital to bridge the commercial gap for investors. The sizing approaches in this section are organised around the four forms of concessionality established in Section 3: downside protection, return enhancement, cashflow and liquidity enhancement, and volatility reduction.

For each, we describe the tools and observed market practice that fund managers can, and do, use to arrive at a defensible sizing estimate. Often these forms of concessionality interact with one another - addressing one reduces the need for another. Sizing is also shaped by the availability of concessional capital. The quantum and terms of concessional capital on offer may not match what the commercial case calls for, and fund managers typically negotiate between what is analytically required and what can realistically be raised from available sources.

This section covers sizing for debt funds first, then equity funds. Debt fund sizing can draw on more established analytical tools such as credit risk models, default probability databases, and structured credit analytics developed for collateralised loan obligation (CLO) and securitisation markets. Equity fund sizing operates in a less mature analytical environment.

Figure 6: Sizing | Framework links investor constraints to the minimum concessional package required for commercial participation



Source: BCG, BII, and GFANZ analysis, informed by expert interviews (2026).

4.1 Sizing for debt funds

4.1.1 Downside protection

The goal of sizing downside protection is to calibrate the subordination or credit enhancement such that the risk profile of the commercial tranche aligns with a target, often expressed as a risk rating or an investment-grade-equivalent requirement. Fund managers typically use three broad approaches to determine the quantum of concessionality needed for this objective. The approaches vary in analytical rigour, and the chosen approach depends upon the institution's modelling infrastructure.

Approach 1: Risk-profile calibration (when modelling tools or credit rating agency engagement are available). This is the most analytically rigorous approach and is typically used to apply a target rating to a commercial tranche. Fund managers draw on four commonly used tools, selectively and sometimes in parallel.

- **Engagement with a credit rating agency**, where available, provides the most market-credible validation of the structure. Fund managers can pursue either a public rating, which is published and subject to ongoing monitoring, or a private rating opinion, which provides the agency's view on the achievable rating without those obligations. Both involve paid, iterative engagement. The structure must be sufficiently defined before the agency can deliver a rating, and the achievable rating depends on the structure being assessed. Therefore, several rounds of adjustment to the catalytic tranche's thickness, subordination, or asset pool assumptions are typical before settling on a design. The Annex includes an overview of the role of credit rating agencies in enabling insurer participation in blended finance funds, including methodology constraints and the case for iterative co-design.
- **Implied ratings using credit modelling tools**, such as Moody's CDOROM, Fitch PCM, PolyPaths, and similar platforms, which model the portfolio loss distribution and solve for the catalytic tranche thickness that achieves a target implied rating for the commercial tranche. The critical sensitivity is default correlation (ρ): For example, for a BB+ portfolio targeting an AAA senior tranche, the optimal junior tranche is small when defaults are assumed to be independent, but rises steeply as default correlation increases.[20]
- **Expected loss benchmarking** builds from the bottom up, estimating the likelihood and severity of default for each underlying asset. It does this by using agency probability-of-default tables, the Global Emerging Markets Risk Database (GEMs)[21], asset manager track record, and realised loss experience in comparable segments or internal models, then aggregating to the portfolio-level. The catalytic tranche is sized to absorb expected loss plus a buffer for unexpected loss, with the size of the buffer informed by the fund manager's view of how realised losses could deviate from the mean, particularly under default correlation, concentration, and stress. As a reference, the GEMs database reports default rates of ~3-4 per cent for MDB/DFI private lending with a 75 per cent average recovery.[22] Moody's publicly rated credit infrastructure assets in EMDEs report an average 10-year accumulated default rate of ~14-21 per cent with ~60 per cent mean recovery.[23]
- **Stress testing, scenario analysis, and value-at risk analysis** size the junior tranche to withstand adverse conditions (correlation stress, recovery rates, concentration stress, rating migration). A fixed structure such as a 10 per cent first-loss tranche under a 90 per cent senior tranche becomes non-viable when default correlation of underlying assets is high (ρ ≥ 50 per cent). Correlated losses cluster, and a 10 per cent buffer can be exhausted by a single adverse scenario. This underscores the importance of stress-testing beyond the base case.

20 Within investment grade, sizing implications scale non-linearly with target rating. Required subordination grows faster than rating-notch distance would suggest, because cumulative default rates expand non-linearly across the rating scale and the gap widens with portfolio default correlation. The insurer capital efficiency benefit of a higher rating is also non-linear: Solvency II spread-risk capital charges step up disproportionately across credit quality steps. Also note that some rating models allow for testing sensitivities on portfolio correlations and concentrations.

21 GEMs is a joint MDB/DFI initiative that pools credit risk data on lending in emerging markets, providing publicly available statistics on default and recovery performance.

22 *Global Emerging Markets Risk Database (GEMs) Consortium, World Bank* (2025); *Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance*, Institute of International Finance (IIF) (2025).

23 *Infrastructure defaults and recovery rates*, 1983-2023, Moodys Ratings (2024).

Approach 2: Simplified analytical approach (when credit data is available but full modelling is not). This approach uses the expected loss estimate as its starting point but instead of modelling how losses could deviate from the mean, it anchors the size of the catalytic tranche to loss thresholds published by rating agencies. These thresholds set out how much cumulative loss a tranche can absorb while maintaining a given rating, drawn from the agencies' analysis of historical loss outcomes across rated structures. The fund manager relies on the agencies empirical work rather than building their own loss distribution view. The core logic has four steps:

1. Estimate the portfolio's expected loss using available proxies (rating agency default tables, DFI internal scores, sovereign-adjusted sector benchmarks, and historical loss databases).
2. Determine the maximum loss the commercial tranche can bear by mapping the target rating to published cumulative loss thresholds.
3. Size the catalytic tranche to absorb the difference, adding a buffer above expected loss to account for loss volatility, default correlation, and model uncertainty.
4. Cross-reference the result against the precedent benchmarks in Approach 3.

This approach tends to produce more conservative sizing than a full quantitative model, because the published thresholds and the buffer above them cannot capture the diversification benefits and tail-risk precision that distribution modelling provides. That conservatism may be appropriate given the greater uncertainty, but it can result in more concessionality than a fully worked modelled structure would require. Where the result diverges materially from the precedent in either direction, that divergence warrants investigation.

Approach 3: Precedent benchmarking (when tools or data are limited). Where analytical tools are unavailable or data is limited, calibration against precedent structures provides a practical starting point. Material divergences from these benchmarks may reflect genuine risk differences or assumptions that need revisiting. The table below provides illustrative examples of junior tranche sizes and the resulting senior tranche credit profile.

Fund	Junior tranche	Senior credit profile	Supplementary credit enhancement
Asia Climate Strategy (responsAbility)	18%[24]	Indicative investment-grade	–
GAIA (MUFG)	~21%	BBB+ minimum	$300m guarantee, 5% reserve, FX facility
Emerging Africa and Asia Infra Fund (Ninety One / PIDG)	40% first-loss equity[25]	A	Retained earnings recycling ($160m over fund life)

24 Convergence Market Data (2026).

25 *Case Study: The Emerging Africa Infrastructure Fund*, Convergence (2018). In 2024, the fund expanded its mandate to invest in Asia and was renamed the Emerging Africa and Asia Infrastructure Fund.

4.1.2 Return enhancement

Even with sufficient downside protection, senior investors may still face a yield shortfall against their mandate or hurdle rate. The goal of sizing the return enhancement is to quantify the spread deficit and size the minimum support required to clear the target return.

The target return for a commercial investor in a blended debt fund senior tranche is a function of the risk-free rate and a premium for a combination of duration, risk profile (geography, sector, borrower, and instrument characteristics), illiquidity, complexity and investor-specific factors (mandate constraints, existing asset allocation framework, benchmarks, regulatory capital charges, etc.). The spread deficit is the gap between this target return and the yield the structure naturally delivers to the commercial tranche after the downside protection structure has been established.

Calibration through triangulation. Confidence increases when the target return is benchmarked from multiple starting points. For example:

(i) Starting from **public market emerging market corporate debt indices at BBB**, such as the JP Morgan Corporate Emerging Markets Bond Index (CEMBI), and estimating premia for duration, illiquidity, and complexity to arrive at the target return for a comparable private blended structure.

(ii) Starting from **infrastructure private debt transactions at comparable risk level and weighted average life**, then estimating adjustments for risk profile (which may decrease due to portfolio diversification) and for structural complexity.

Return enhancement sizing is less analytically codified than downside protection. The tools are benchmarks and structured judgment rather than loss distribution models, but the triangulation approach above provides a disciplined basis for negotiation.

4.1.3 Cashflow & liquidity enhancement

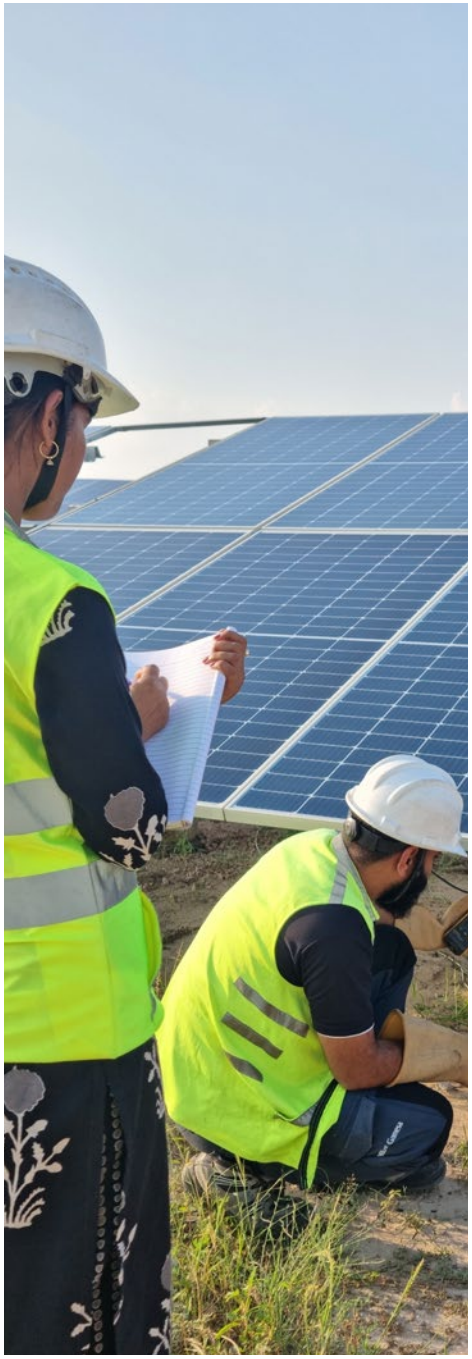
The goal of sizing cashflow and liquidity enhancement is to align the fund's cashflow profile with the investor requirements for tenor, payment certainty, deployment pace, and exit flexibility. The target liquidity profile is a function of regulatory requirements and investor appetite. These can take different forms: a maximum investment tenor, fixed or more highly predictable interest or dividend payment, a defined principal repayment schedule; the ability to deploy capital in full at fund inception (versus ramp-up with negative carry), and periodic exit opportunities.

The size of concessionality needed is determined by quantifying the mismatch between the cashflow profile the fund naturally delivers and the profile the commercial investor requires. Hence the size of the support is set to close the gap. The choice between funded and unfunded support is itself a sizing decision: it determines whether the concessional cost is certain or contingent. For this reason, contingent or unfunded instruments (backstops, credit lines) can be preferred over funded buffers, because the subsidy cost of an unfunded commitment is typically much smaller than the cost of funding the equivalent position upfront, with most of the catalytic investor's exposure crystallising only if the facility is triggered.

Three mismatch types are most commonly observed, each calling for a different sizing logic:

- **Tenor mismatch:** The gap is between asset maturity and commercial investor horizon, the size of the catalytic position is a function of expected asset realisation timing versus the desired exit timeline for commercial investors, and how much portfolio value needs to remain in the structure to absorb the tail period. Instruments include tenor subordination, where the catalytic tranche is sized to fully absorb the tail period, and back-ended catalytic waterfalls, where the catalytic position is sized to allow early realisations to flow to commercial investors first. For example, the Managed Growth Fund locked super senior investors at ten years within a 15-year fund; mezzanine amortises only after year 13. This is a structural solution where the concessionality is embedded in the tranche design, not a separate funded instrument.
- **Deployment mismatch:** The gap is between fund close and full deployment. The catalytic position is sized to the value of the asset pipeline that needs to be financed during the ramp-up period. This is typically the expected volume of asset origination between fund close and full deployment. A warehousing facility is sized to this pipeline value.
- **Cashflow mismatch:** The gap is between irregular portfolio cashflows and predictable payments required by commercial investors. The size of the catalytic position is calibrated against the worst-case exposure the catalytic investor must be prepared to meet. A liquidity reserve covers periodic shortfalls supporting senior payments during cashflow gaps. For example, MUFG's GAIA Climate Loan Fund (GAIA) targets a reserve capped at 5 per cent of fund size. The sizing question is the reserve's maximum expected draw — whether the reserve is funded upfront or structured as a contingent facility, its size reflects the worst-case timing gap between portfolio receipts and senior coupon obligations. A put option or early redemption facility is sized against the maximum reasonable redemption volume the catalytic investor could be called upon to underwrite.

These three types are not exhaustive, but they account for the majority of cashflow-related concessionality observed in blended debt funds. Systematic benchmarks for liquidity sizing do not yet exist—in part because cashflow mismatches are highly fund-specific, varying with asset class, geography, and investor composition. These approaches represent starting points for validation.



4.1.4 Volatility reduction

The goal of sizing volatility reduction is to determine how much protection commercial investors require to keep the range of possible return outcomes within their threshold, whether driven by regulatory requirements or mandate.

The volatility instruments described in Section 3—FX hedges, fixed-rate tranches, reserve accounts, and political risk insurance—are well-established in commercial markets and have observable commercial prices. The concessional element is not the instrument itself but the pricing: catalytic investors offer these protections at below-market rates or absorb costs that would otherwise make them prohibitively expensive, particularly in frontier currency markets or for long-dated exposures.

Sizing is therefore primarily a pricing exercise. For each source of volatility, the size of the required concessionality is the gap between what the relevant protection costs on commercial terms and the price the catalytic investor charges. The commercial price is observable for liquid instruments such as FX swaps in major currencies, but harder to determine in frontier currencies or for unusual exposures, where the absence of commercial supply is the constraint and that concessional cost must be approximated from analogues.

Systematic benchmarks for volatility sizing do not yet exist, in large part because concessionally priced hedges and insurance remain uncommon in blended fund structures. As more funds deploy these instruments and report on their costs, more precise calibration will become possible.

See the Annex for case studies from blended finance funds in the market, which demonstrate how these considerations come together.

Substitution effect

Volatility instruments and downside protection are particularly prone to substitution because both reshape features of the loss distribution. A thinner junior tranche combined with strong hedging may deliver a risk profile equivalent to a thicker tranche without hedging. The sizing of these two forms is therefore most useful when done together, with the level of downside protection and the volatility hedging strategy calibrated as a pair rather than in isolation.

4.2 Sizing for equity funds

The sizing framework established for debt funds applies to equity, but the mechanics of equity investing require a different approach. Blended equity funds targeting institutional capital at scale are a newer phenomenon than blended debt funds, and observed practice is more limited. Three differences shape the exercise:

- First, equity funds lack the ratings anchor that disciplines debt funds. The target risk profile for an equity investor is expressed as a return expectation, such as a target net IRR or total value to paid-in (TVPI) multiple, and a loss tolerance. As a result, sizing in equity funds anchors to target returns and scenario outcomes.
- Second, equity waterfalls have more degrees of freedom and less market convention than debt structures. Multiple combinations of tranche size, waterfall mechanics, and concessionality can deliver the same outcome to commercial investors. Conversely, two funds with the same tranche split can have very different concessionality profiles depending on waterfall design.
- Third, volatility reduction in equity funds is primarily delivered through portfolio construction (geographic diversification, sector mix, vintage spread), rather than through concessional instruments. There is no equivalent of the volatility sizing exercise described in section 4.1.4.

In equity blended finance funds, the waterfall is the primary instrument. In debt funds, the sizing section walks through each form of concessionality in turn because the instruments are relatively separable: a subordinate tranche provides downside protection, a capped return enhances returns, tenor subordination addresses cashflow. In equity funds, the waterfall does all of this simultaneously. A preferential return structure that directs distributions first to commercial investors is both downside protection (commercial capital is returned before concessional capital bears losses) and return enhancement (commercial investors receive priority returns before catalytic investors participate). First-in drawdown is both return enhancement (higher IRR resulting from delayed capital calls) and cashflow enhancement (reflected as a compressed J-curve for commercial investors).

The sizing exercise for equity funds is therefore a joint calibration of the waterfall—the quantum of concessional capital, the terms on which it participates, and the distribution mechanics—rather than a sequential sizing of separate instruments. In practice, this calibration starts from the most binding commercial constraint and works outward, checking secondary effects as the structure takes shape.

4.2.1 Sizing for the returns gap

For most equity blended finance funds, returns are the binding commercial constraint. The fund's expected gross IRR, after standard portfolio costs and pari passu allocation, falls short of what commercial investors require for participation. Return enhancement is therefore the primary or sole form of concessionality in most equity structures, and sizing it means determining how much catalytic return must be reallocated to lift the commercial tranche from its natural return to its target.

Identifying the gap. The target commercial return is built from a benchmark that matches the strategy, typically a comparable private equity or infrastructure equity reference, adjusted upward for the premia that apply to a blended fund: emerging market or frontier risk, illiquidity and the 10–12-year fund life, structural complexity and novelty, and investor-specific factors such as strategic asset allocation discipline and peer benchmarking. The expected fund-level return is estimated from the underlying asset pool, the GP's track record in comparable strategies, sector and geography exposure, and any portfolio-level effects on gross IRR. Under pari passu treatment, the commercial tranche's natural return equals the fund-level return, so the gap between target and natural, the spread deficit, is the required uplift.

Closing the gap. Five mechanisms can deliver uplift to commercial investors, all described in Section 3: capped returns on the catalytic tranche, preferential waterfall and priority distributions, first-in drawdown, fee and carry concessions, and co-investment rights. Capped returns are the most common because the relationship between the structural variables and the resulting uplift is direct and observable. The catalytic tranche accepts a return ceiling; returns above the ceiling reallocate to commercial investors. Two variables determine the magnitude of the uplift, the catalytic share of the fund and the depth of the cap relative to the expected fund-level return. They trade off against each other, as a larger catalytic share with a higher cap delivers the same uplift as a smaller share with a deeper cap, so multiple combinations are typically feasible. The choice between feasible combinations is shaped by what concessional capital is available, what cap level catalytic investors will accept, and how the remaining waterfall mechanics interact with the cap. In practice, given the degrees of freedom involved, the sizing process is likely iterative. Fund managers often model the structure at different combinations of share and cap and refine through direct engagement with anchor investors, to converge on a configuration that is both investable and efficient in its use of concessional capital.

The Global South Initiative (GSI) illustrates the approach in practice: ALTÉRRA's catalytic commitment with capped returns lifts commercial investors' return towards the hurdle required from an emerging-market private equity strategy.

Calibration through triangulation. As with debt, confidence in the sizing increases when the target return is triangulated from multiple reference points. For equity, useful references include emerging market private equity benchmarks (Cambridge Associates, Preqin Emerging Market Private Equity indices), infrastructure equity benchmarks for infrastructure-focused funds, and comparable blended equity structures where structuring details are available. Triangulation is more constrained in equity than in debt because public-market reference points map less directly onto private equity exposures and because private-market comparables are less observable. Where benchmarks diverge, the wider range typically reflects real uncertainty in the underlying market rather than imprecision in the sizing — a reason to engage anchor investors directly on the return they require, rather than over-anchoring to any single benchmark.

4.2.2 Checking for downside protection

Once the waterfall is sized to close the return gap, the next question is whether the resulting structure also provides sufficient downside protection or whether additional concessionality is needed on that dimension. In some funds it does: for example, the GSI has no separate downside protection; losses are borne pari passu, and the waterfall mechanics alone were sufficient to secure commercial participation. In others, a distinct first-loss allocation is required.

Where downside protection is needed beyond what the waterfall provides, two sizing approaches are observed:

Approach 1: Scenario-based calibration. Define two to three portfolio return scenarios (e.g. base, stress, severe stress) reflecting the range of plausible outcomes for the underlying equity portfolio. Size the first-loss tranche so that the commercial investor achieves at least a defined threshold, typically capital preservation, or a minimum acceptable return in the stress case. This requires:

- A view on portfolio-level returns under each scenario (informed by GP track record in comparable strategies, sector and geography risk assessment, and comparable fund performance data).

- A defined threshold for the commercial investor in the downside (for example, at least 1x capital back in a stress case, or no more than 20 per cent capital loss in a severe stress).
- Modelling or structured estimation to solve for the junior tranche size that delivers the return thresholds across the scenario set.

This is the equity equivalent of risk-profile calibration in debt, but with less precision as equity return distributions are harder to model than credit loss distributions and because equity investors typically think in terms of scenario outcomes rather than loss probabilities mapped to a rating scale.

Approach 2: Investor-led calibration. Start from what the target investor requires (identified in Section 2) and work backwards. For example, the design of the Emerging Market Climate Action Fund (EMCAF) recognised that the scarcity of data on blended finance equity funds was a significant constraint, and that the sophisticated investors targeted were bound by their mandate and operated under stringent regulatory oversight. The catalytic tranche size was calibrated through direct engagement with anchor investors (Allianz, Folksam) to determine what level of first-loss protection was required to secure participation. This approach is inherently bespoke but reflects how equity deals are structured in practice.

With debt funds, precedent benchmarking is presented as a standalone approach – a fallback when more rigorous methods are not available. With equity funds, precedent benchmarking does not stand alone: scenario calibration draws on comparable fund performance data and investor-led calibration is informed by what comparable structures have delivered.

4.2.3 Checking for cashflow and liquidity effects

The waterfall mechanics sized for return enhancement often also address cashflow constraints, particularly through first-in drawdown (which compresses the J-curve) and priority distribution structures (which accelerate the return of capital to commercial investors). The sizing question is whether these secondary effects are sufficient, or whether additional cashflow concessionality is needed.

Common timing constraints for equity investors include fund life limits, J-curve tolerance, deployment pace certainty, and exit uncertainty. Where the waterfall design does not sufficiently address these, three additional mechanisms can be considered, each with a distinct sizing question. For tenor subordination: what is the difference between the commercial investor's maximum acceptable investment horizon and the expected portfolio exit timeline? For put options and liquidity facilities: what is the expected value of the option? For back-ended catalytic waterfalls: what share of early distributions must be directed to commercial investors to achieve their target effective tenor?

See the Annex for case studies from blended finance funds in the market, which demonstrate how these considerations come together.

5. Looking ahead

Structuring concessional capital to mobilise commercial investors is complex, and blended finance funds are bespoke by nature. This report offers a framework to help market participants assess when, what, and how much concessional capital may be needed to mobilise commercial investors. The objective is not to establish new standards, but rather to build familiarity with emerging market practices and help make structuring decisions more deliberate, evidence-based, and rigorous, thus supporting more commercial and catalytic investors, and fund managers to participate confidently in this space.

This report reflects the current state of financial market practice and available track records, but concessionality assessment is not a solved problem. As more transactions close using these tools, and more performance data becomes available, the framework should sharpen. We encourage practitioners to stress-test its logic, share what works and what doesn't, and contribute to the evidence base that will make blended finance an ever more rigorous and nuanced field in the impact finance profession.

The framework is designed to be used either as an end-to-end approach or as standalone parts. The sections are modular, and practitioners can draw on individual components as required by their transaction or existing knowledge or apply the full end-to-end framework. For sizing, the tiered analytical approaches accommodate institutions with different levels of modelling infrastructure and maturity in designing blended finance funds.

The prize is substantial: faster fund closes, more disciplined use of scarce public capital, and greater confidence from commercial investors that concessional terms are calibrated rather than negotiated in the dark. Getting concessionality right is the prerequisite to mobilising private capital at the scale into impactful projects.

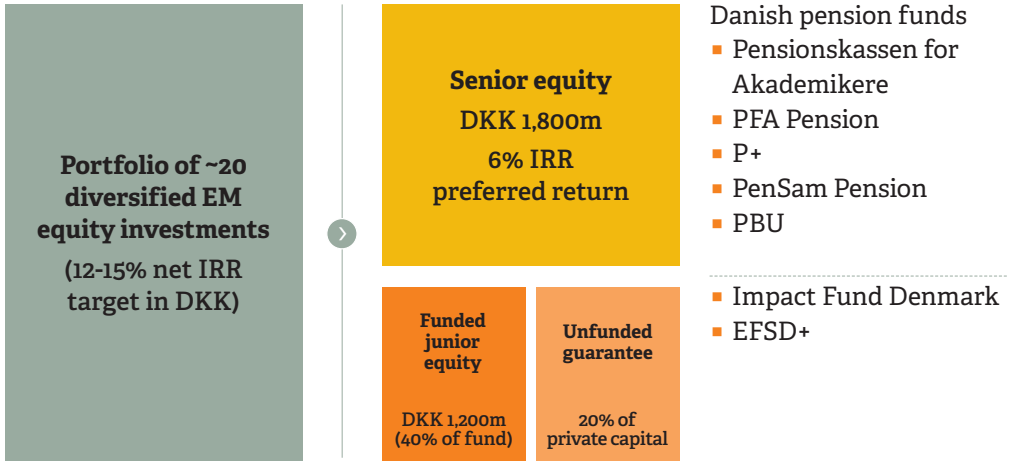
Annex | Case studies

The following case studies are real-world examples of structuring blended finance funds. They describe how investor constraints were understood and resolved, which concessional tools were deployed, and the iterative conversations and decision processes that determined the final design. We focus on funds that targeted pension funds and insurance companies as their primary investors, as these two groups represent the largest pools of commercial capital active in blended finance funds.

Growth Markets Impact Fund (SDG Fund II)

Characteristic	Description
Target size	DKK 5bn (~$770m)
Mobilisation to date[26]	DKK 3bn (~$470m) ▪ DKK 1.8bn from five Danish pension funds (400m each from PKA, PFA, P+, and Pensam and 200m from PBU)[27] ▪ DKK 1.2bn from Impact Fund Denmark (IFDK)
Target commercial investors	▪ Danish pension funds (primary) ▪ Other Nordic and European institutional investors to be targeted in future closes (Sweden, Netherlands, Norway, UK, Switzerland, Finland)
Asset profile	Private equity (direct minority investments) in emerging markets
Geographic mix	13 focus countries in Africa, Asia and Latin America
Sectors	Infrastructure focus (~50%), with health, sustainable food systems, financial services
Instrument	Direct minority equity
Impact targets	Gender equality, decent jobs, socioeconomic equality and climate action

Fund structure



Impact Fund Denmark's Growth Markets Impact Fund builds on its earlier SDG fund I, a Danish public-private partnership model that has demonstrated successful mobilisation of pension fund capital into emerging markets equity at scale. The Growth Markets Impact Fund combines a preferential return waterfall with an external first-loss guarantee to align the risk-return profile with pension fund requirements.

Danish pension funds operate under regulatory pressure to deliver market-rate, risk-adjusted returns, and an emerging markets private equity fund can raise investment committee concerns regarding both risk and return. To resolve this constraint, IFDK's 40 per cent equity stake is subordinated in the distribution waterfall, with commercial investors receiving a 6 per cent IRR preferred return before IFDK receives any returns. The preferred return primarily functions as a downside protection mechanism, with IFDK bearing initial underperformance through delayed participation in the waterfall, thereby supporting commercial investors in achieving their required return in downside scenarios. This is complemented by a first-loss guarantee provided under the European Fund for Sustainable Development Plus programme (EFSD+) of up to DKK 535 million (covering around 20 per cent of the fund's private capital). In the event of losses, private investors can draw on the guarantee immediately, rather than at the end of the fund's life. For Latin America and North Africa, which fall outside the scope of the EFSD+ fund-level guarantee, deal-level guarantees are negotiated individually using sector-specific EU instruments, which required specialist knowledge of EU guarantee programmes. The combined effect of these mechanisms is significant, where modelling has demonstrated that even if the fund's overall IRR were as low as 1.7 per cent, commercial investors would still receive a 6 per cent return.

The fund structure was inherited from SDG Fund I and refined iteratively through conversations with target investors and EFSD+. The preferential returns waterfall mirrors SDG Fund 1, where a 6 per cent preferred return was sufficient to mobilise participation from Danish pension funds. The guarantee was sized through negotiations with EFSD+ within the constraints of the programme. The resulting structure was then tested across a range of simulated portfolio outcomes, demonstrating that the combined mechanisms were sufficient to deliver an acceptable risk-return profile for commercial investors.

26 As of 6 May 2026.

27 BCG, BII, and GFANZ interview with IFDK (2026).

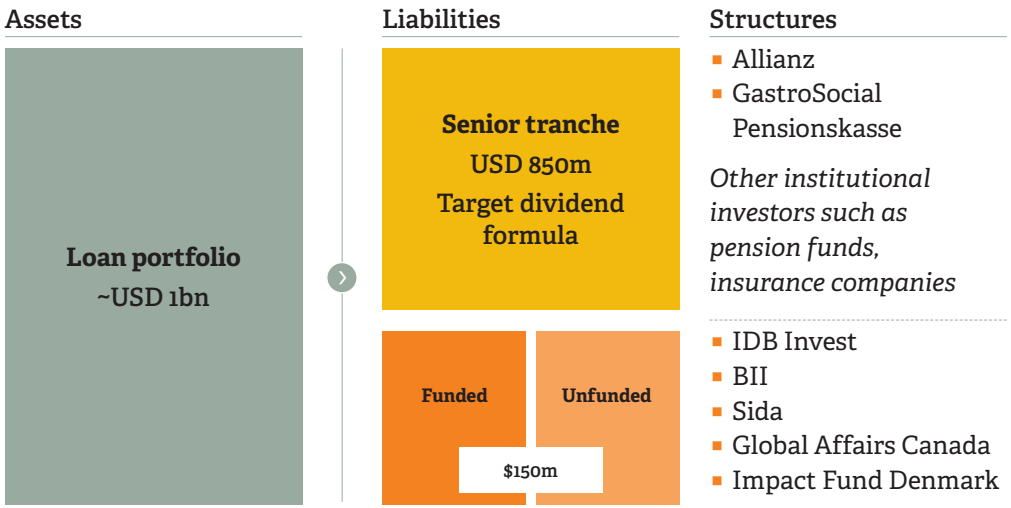
	Identifying barriers to target investor participation	Selecting fit-for-purpose concessional instruments	Sizing concessional instruments appropriately	Outcome
Downside	**Target risk-adjusted returns** – Pension funds are required by regulation to deliver market-rate returns to members. They often prefer familiar structures and assets with well-established performance and market-rate risk-adjusted returns. Commercial gap: High perceived risk due of underlying assets exceeds investor risk appetite, despite potential for attractive returns.	**Preferred return waterfall** – Commercial investors receive priority returns up to a cap, before IFDK receives any return. Familiar structure (used in SDG Fund I) with high comfort among institutional investors. **First-loss guarantee** protects senior commercial capital. The guarantee was provided by the EU EFSD+ programme and is new to the Growth Markets Impact Fund.	**Portfolio simulation** – Simulations across return scenarios demonstrated that combined mechanisms delivered target returns to commercial LPs under multiple downside scenarios. **Availability** – Guarantee provided based on EU EFSD+ programme availability.	**6% preferred return** for commercial LPs (60% of total fund size). **20% first loss guarantee** from EU EFSD+ programme, subsidised by IFDK (which paid the guarantee fee), plus deal-level guarantees for countries outside of the programme scope (Latin America and North Africa).
Returns	**Target return threshold** – Pension funds are required by regulation to deliver market-rate, risk-adjusted returns to members. Commercial gap: Uncertainty that the minimum required return (6%) would be achieved in downside scenarios, despite higher expected returns (12–15% net IRR).	**Preferred return waterfall** – Commercial investors receive priority distributions up to a fixed return threshold before IFDK participates, improving commercial investor outcomes relative to fund-level performance in downside scenarios.	**Benchmarking** – 6% preferred return for commercial investors was deemed sufficient to meet commercial investor requirements based on SDG I. **Portfolio simulation** – Simulations across return scenarios demonstrated that combined mechanisms delivered target returns to commercial limited partners (LPs) under multiple downside scenarios.	Priority distributions support achievement of minimum return thresholds, improving outcomes in downside scenarios.
Cashflow and liquidity	**Cash lock-up on losses** – Pension funds require predictable return outcomes. Commercial gap: Potentially unrecoverable cash lock-up from realised losses undermines return certainty over the fund life cycle.	**Immediate guarantee payout mechanism** – The EU guarantee was structured so that realised losses triggered immediate reimbursement to private investors instead of deferred payment to fund liquidation, removing cash lock-up risk.	N/A – Immediate payout mechanism applied to full guarantee amount.	Immediate reimbursement of realised losses via guarantee. Guarantee repaid to EU if fund reaches 6% net IRR.
Volatility	Return volatility not a primary constraint. Commercial gap: None.	N/A	N/A	N/A

Allianz Credit Emerging Markets (ACE) Vehicle

Characteristic	Description
Target size	$1bn
Mobilisation to date	$690m ▪ $540m from Allianz SE and GastroSocial Pensionskasse (Swiss pension fund) ▪ $150m from BII, IDB Invest, GAC, Sida, and Impact Fund Denmark
Target senior investors	Insurance companies* and pension funds
Asset profile	Diversified pool of MDB/DFI-originated loans
Geographic mix	Africa, Latin America, APAC, and other ODA-eligible markets
Sectors	Infrastructure, financial institutions, manufacturing, agriculture, and services
Instrument	Senior loan participation in mostly MDB/DFI-originated transactions, with some commercially-originated transactions
Concentration limits	Caps on single-borrower, single-country, lower rated borrowers, amongst others
Impact targets	Paris-aligned, climate finance, and gender finance

**Note: We focus on insurance companies as the target investor group for the purpose of this example*

Fund structure



The Allianz Credit Emerging Markets Vehicle (ACE) is managed by Allianz Global Investors (AllianzGI), building on its experience of launching five large-scale blended finance vehicles over the past decade.[28] ACE announced its first close at $690 million in January 2026, anchored by Allianz SE and Swiss pension fund GastroSocial Pensionskasse (combined commitment of $540 million) in the senior equity investment.[29] The primary target investors are **insurance companies** and **pension funds** in continental Europe and beyond, participation from which is heavily shaped by the regulatory requirements and capital charges imposed by Solvency II and similar prudential frameworks.

The most important constraint to solve was the need for credit enhancement to avoid heavy capital charges for sub-investment-grade exposure, which was addressed through subordinated equity in the form of a first-loss layer. A significant portion of the first-loss was funded based on availability of catalytic capital from three institutions anchoring the junior layer, while the rest was comprised of unfunded commitments.

Benchmarking indicated that no return enhancement beyond the portfolio's expected yield was needed by commercial investors, with downside protection preventing erosion of expected returns. A simple **tenor subordination** mechanism closed the gap between the underlying assets' tenor and commercial investors' requirements for a year weighted average life of approximately ten years. Finally, the fund manager's view was that limited return volatility would be important for fundraising. This was achieved by setting a **target return formula** anchored to a base spread for the senior equity investment and implementing a cashflow shortfall mechanism to reduce return volatility in a potential downside scenario.

28 *Allianz Global Investors accelerates its drive in blended finance*, AllianzGI, (2022).
29 *AllianzGI Launches $1 Billion Emerging Markets Climate Finance Fund*, ESG Today (2026).

	Identifying barriers to target investor participation	Selecting fit-for-purpose concessional instruments	Sizing concessional instruments appropriately	Outcome
Downside	**Credit risk requirement –** Investment-grade (IG) risk profile required due to highly punitive capital charges for sub-IG under Solvency II for European insurers, with cushion to avoid ratings cliff-edge. Commercial gap: Ratings gap between average credit risk profile of portfolio assets (below investment-grade) and investors' target.	**Subordination** is widely used both in blended and commercial structures (e.g., CLOs), with high comfort and familiarity for both catalytic and commercial investors.	**Risk profile calibration** – Ran shadow ratings exercise using Moody's CDOROM to meet investment-grade rating requirement (plus buffer). GEMs database used for loss data on DFI-originated loans.	15% first-loss junior equity investment (achieves target, investment-grade risk profile for senior equity investment). Funded/unfunded split based on availability of catalytic capital.
Returns	**Target return threshold** – Insurers require returns in line with benchmark for the credit-enhanced risk profile. Commercial gap: None; expected portfolio returns are on par with market benchmarks.	No additional return enhancement required.	**Calibrated through triangulation** – Baseline sizing through relative value analysis against JP Morgan CEMBI[30]/ Bloomberg EM BBB Index[31]. Pickup sized on requirement for illiquidity/complexity premium.	N/A
Cashflow and liquidity	**Tenor requirement** – Insurers require weighted average life of ~10 years, based on appetite. Commercial gap: Fund assets have longer tenor than investor appetite (avg 7-12 years, up to 20 years).	**Tenor subordination** shortens term for senior equity investment vs asset tenor, closing gap to insurers' target term.	**Sized to match investor requirements** – Solvency frameworks require insurers to align asset duration and currency with long-dated liabilities.	Tenor subordination whereby junior investors are in the fund for a longer period of time and receive principal payments after senior investors repaid.
Volatility	**Return certainty preference** favoured by investors to reduce downside volatility. Commercial gap: Investors required greater return certainty than underlying assets provide without modification.	**Target return formula** and cashflow shortfall mechanism reduce the potential return volatility to support fundraising.	**Based on investor discussions** – Target return structure and shortfall mechanism to reduce returns variability.	Senior investors expect to receive a target dividend, (benchmark-aligned) with residual returns allocated to certain junior investors.

30 J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI), a benchmark tracking USD-denominated emerging market corporate bonds.

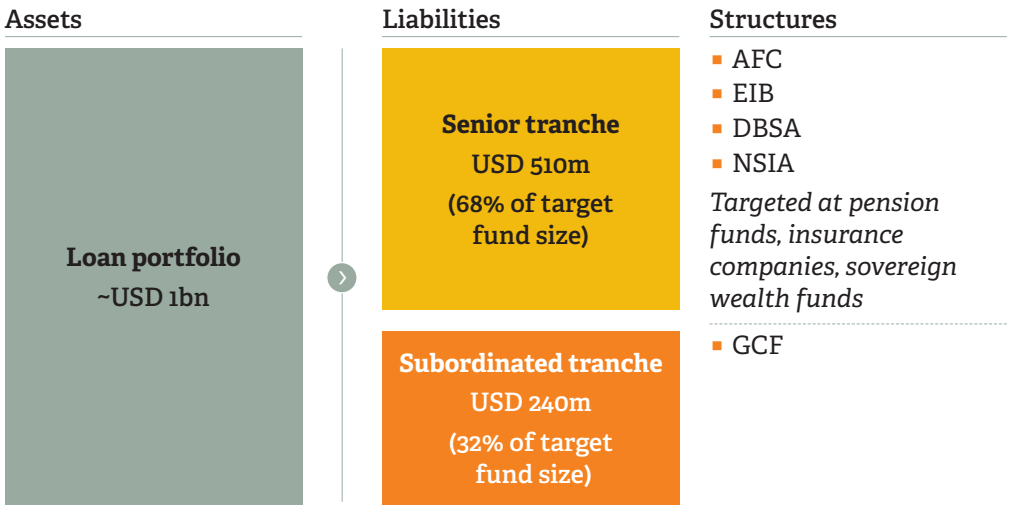
31 Bloomberg sub-index tracking BBB-rated emerge market bonds.

The Infrastructure Climate Resilient Fund (ICRF)

Characteristic	Description
Target size	$750m
Mobilisation to date	Over $500m raised to date; still actively fundraising ▪ Commercial Investors: Nigeria Sovereign Investment Authority (NSIA) and other African pension funds committed (amounts not disclosed) ▪ MDBs and DFIs: ▫ $240m from the Green Climate Fund (GCF), the junior/first-loss provider ▫ $60m from AFC (sponsor) ▫ $52m from EIB ▫ $50m in discussion with South African DFIs ▫ $35m board approval from Italian DFI
Target commercial investors	African pension funds
Asset profile	Long-term infrastructure projects targeting 15%+ returns
Geographic mix	Pan-Africa
Sectors	Climate-resilient, low-carbon infrastructure (ports, bridges, and industrial zones; power systems; transport infrastructure; ICT / fibre optic systems). 25% green energy target
Instrument	Direct equity, quasi equity, and high-yield subordinated debt
Impact targets	Embedding physical climate risk (sea-level rise, precipitation change, drought, wind) into infrastructure design and funding Capacity-building for climate-resilient policy and planning across ~30 country ministries

The Infrastructure Climate Resilient Fund (ICRF) is one of the first infrastructure adaptation equity funds focused on Africa, targeting $750 million in total commitments to integrate physical climate risk into the design, construction, and operation of infrastructure assets across the continent. ICRF is managed by AFC Capital Partners, the asset management subsidiary of the Africa Finance Corporation (AFC), a pan-African multilateral with 20 years' experience of developing and financing greenfield, expansion and growth infrastructure across African markets. Its investment thesis was informed by foundational research conducted in collaboration with the Green Climate Fund (GCF) and Oxford University for understanding physical climate risks to infrastructure across the continent, with implementation supported by a separate GCF capacity building grant. ICRF has raised approximately $500M to date from DFIs and **African pension funds** and is still actively fundraising.

Fund structure



Senior commercial investor participation was secured through first-loss protection and return enhancement. GCF was the sole provider of the junior first-loss tranche of $240m, representing 32 per cent of the fund, as it was the only catalytic investor whose terms met pension fund requirements. The junior equity is fully subordinated: senior investors receive full return of principal plus a 10 per cent preferred return before the junior investor receives any payment at its 3 per cent hurdle, with remaining profits shared pro-rata afterwards.

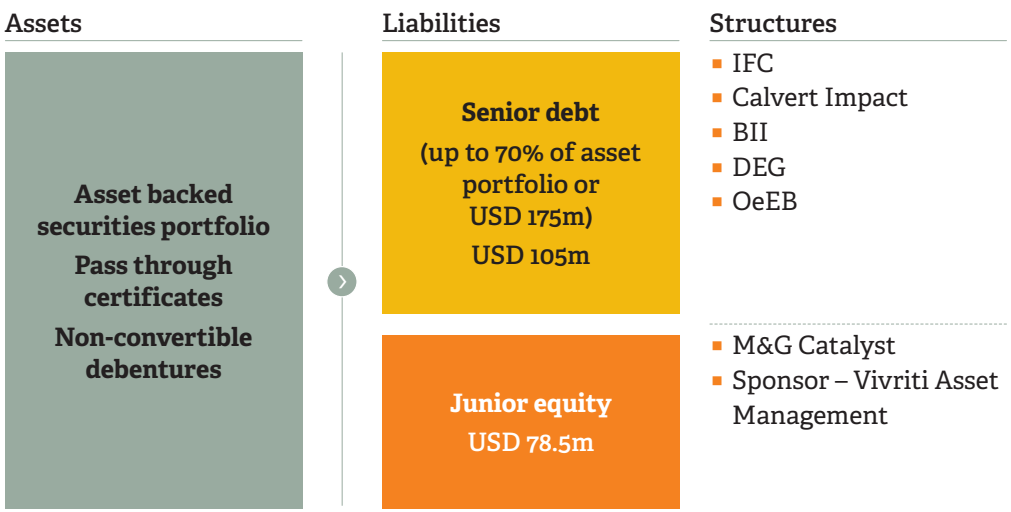
The first-loss tranche was sized through interviews with more than 70 project owners and governments. Of the total 32 per cent first-loss tranche, 20–22 per cent represents the average additional upfront capital cost of building climate resilience into infrastructure design and construction, a cost that project sponsors, developers, and governments were unwilling or unable to absorb without support, despite the long-term cost savings. An additional 10 per cent provides protection to senior investors and supports the return enhancement needed to clear the pension fund participation threshold. ICRF deliberately set a higher **senior hurdle** than comparable infrastructure funds in the market to reach the approximately 15 per cent total return required by its target pension fund investors.

	Identifying barriers to target investor participation	Selecting fit-for-purpose concessional instruments	Sizing concessional instruments appropriately	Outcome
Downside	**First-loss requirement** – Investors made participation explicitly conditional on the presence of a first-loss facility. Commercial gap: Asset profile would not yield pension funds return requirements.	**First-loss tranche** – Inclusion of a funded first-loss tranche to provide sufficient downside protection and cover higher-than-usual upfront costs (due to additional costs of built-in climate resilience).	**Investor-led calibration & availability** – Size of first-loss tranche determined based on investor demand and availability of capital from GCF as the sole catalytic investor.	▪ 32% ($240m) first-loss junior tranche, wholly funded by the GCF. ▪ Senior investors receive principal and 10% preferred return before GCF receives a payout.
Returns	**Return threshold** – African pension funds required a return of around 15% to participate. Commercial gap: Approx. 20-25% higher upfront costs in asset profile due to built-in climate resilience.	**Above-market hurdle rate** – Senior tranche receives principal and preferred return before junior receives any payout, enabled by junior tranche taking a subordinate position in the waterfall.	**Investor-led calibration** – Investors required 'usual' infrastructure assets benchmark returns in Africa of 14-15%.	▪ Senior investors receive 10% preferred return before junior receives payout (principal or return). ▪ Junior tranche hurdle set at 3%, with pro rata disbursements after. ▪ **Note:** First-loss subordination here works as a return enhancement.
Cashflow and liquidity	**Tenor requirement** – Fund tenor aligned to asset tenor.	N/A	N/A	N/A
Volatility	Return volatility not a primary constraint. Commercial gap: None	N/A	N/A	N/A

Vivriti India Retail Assets Fund (VIRAF)

Characteristic	Description
Target size	$250m
Mobilisation to date	$75m from M&G Catalyst
Target commercial investors	▪ International banks ▪ International institutional investors
Asset profile	Granular retail loans to low-income borrowers and MSMEs
Geographic mix	India
Sectors	MSME lenders, microfinance, and rural mobility
Instrument	▪ Mostly asset backed securities (ABS) issued by non-bank financial companies (NBFCs) – *80% of portfolio* ▪ Some direct lending to NBFCs through senior, secured, non-convertible debentures – *up to 20% of portfolio*
Impact targets	Access to financial services for individuals and MSMEs

Fund structure



Vivriti India Retail Assets Fund (VIRAF) is a target $250 million innovative blended finance vehicle designed to mobilise institutional capital into Indian retail and MSME credit markets through securitised, asset-backed instruments. The fund is managed by Vivriti Asset Management (VAM), part of the wider Vivriti Group, one of India's leading private credit platforms focused on addressing the debt needs of mid-sized corporates, which currently manages over $500 million across its asset management platform, alongside a large on-balance-sheet NBFC lending business.

To increase investor confidence and address risk concerns associated with MSME and microfinance lending, the fund incorporates multiple, layered downside protection mechanisms for senior investors. First, VIRAF's innovative pooling and securitisation of loans creates a diversified, rated instrument with a materially lower risk profile compared to lending directly to the underlying originators. Second, the fund offers significant structural subordination through a large junior equity tranche to absorb first-losses. Third, diversification is enforced at multiple levels, including strict caps on single originator exposure, and sector concentration limits. As a result of these protections, senior debt investors benefit from a risk-return profile more consistent with investment-grade structured credit than with direct lending to Indian NBFCs, thus driving access to credit for these originators from global institutional investors in a market segment that is otherwise difficult to access directly.

The fund's innovative structure drives the potential for a demonstration effect at the market level. VIRAF remains one of the few examples of blended finance funds where commercial capital is invested in the junior tranche, concessional capital taking a more senior position in the capital structure. This is enabled by senior investors accepting a marginally concessional return to compensate commercial investors with an appropriate risk premium for investing in a novel, unproven structure, thus demonstrating the viability of the structure to commercial investors. Since the senior debt tenor is only four years, catalytic investors can be replaced by private lenders once a track record has been established for the nascent asset class, especially with an AA+ local rating.

	Identifying barriers to target investor participation	Selecting fit-for-purpose concessional instruments	Sizing concessional instruments appropriately	Outcome
Downside	**Credit enhancement –** Structure provided sufficient credit enhancement through diversification and liquidity reserves requirement to meet commercial investors' risk requirements. Commercial gap: None	N/A	N/A	No additional credit enhancement provided by catalytic investors; in fact, junior equity cushion provided enhancement for catalytic investors.
Returns	**Target return threshold** – Commercial investors require risk-adjusted, market-rate returns. Commercial gap: Expected returns slightly below market for commercial investors in the junior tranche without concessionality.	**Residual returns allocated to commercial investors** – Generated by catalytic investors accepting a lower, fixed rate of return.	Pricing for senior debt determined through benchmarking against the observed pricing on dollar-denominated instruments of AA+ locally rated originators; for junior equity, returns are determined by benchmarking to internal hurdle rates for investments of similar risk profile.	Senior debt receives a fixed spread over base rate and residual income is allocated to junior investors.
Cashflow and liquidity	**Tenor requirement** – Underlying assets of 18–24-month tenor, where commercial investors had appetite for up to 10 years. Commercial gap: None	N/A	N/A	N/A
Volatility	**Return certainty preference** favoured by investors to reduce downside volatility. Commercial gap: None	N/A	N/A	N/A

Annex | Investor profiles – deep dives on constraints and implications

The following profiles detail the constraints and structuring implications for each of the five investor types summarised above. Each profile is organised around the four types of investor constraints. Fund managers can use these profiles as reference material when assessing whether a given fund structure aligns with the requirements of their target investor base.

Insurance companies

Insurance companies invest premiums from policyholders to cover future claims. They typically prioritise investment-grade, long-duration assets that are capital-efficient under relevant regulatory frameworks.

Nuances: Regional regulatory regimes (including Solvency II, Solvency UK, US Risk-Based Capital (RBC), and Asia-Pacific (APAC) frameworks) differ in their treatment of credit risk and duration. Life and non-life insurers diverge primarily in cashflow and duration requirements. Constraints may be less binding where insurers have dedicated impact mandates, specialised internal teams, or leadership-driven sustainability priorities. EU and UK regulation requires insurers to conduct Own Risk and Solvency Assessments (ORSA), and non-standard structures can increase modelling effort, lengthen approval timelines, and raise compliance costs. Simpler fund designs can help reduce this friction.

Key constraints and implications for fund design:

	Key constraint	Implications for concessionality needed
Downside	Investment decisions rely heavily on ratings, internal models, and regulatory capital frameworks. Under Solvency II (EU) and RBC (US), moving from investment-grade to sub-investment-grade exposure can increase regulatory capital charges from roughly 10% to 20–30%[32] or more, materially reducing capital efficiency. Non-standard structures and less-established asset pools face increased scrutiny both internally and from regulators.	Insurer participation is typically associated with an investment-grade or equivalent rating for the relevant tranche to support capital-efficient regulatory treatment. In practice, downside protection mechanisms, such as subordination or guarantees, are only effective where they are recognised by credit rating agencies and reflected in the rating outcome. Structures that reduce economic risk but do not translate into an investment-grade rating may not address this constraint.
Returns	Assets under management (AUM) of insurers are managed to deliver stable, benchmark-relative returns, typically referenced to public market equivalents (for example, investment-grade credit) with an additional premium to compensate for illiquidity and complexity. Investment decisions are closely linked to rating and capital treatment, with a focus on achieving returns consistent with expectations for the asset class rather than pursuing higher but less predictable upside.	In practice, insurer participation is typically associated with structures that deliver returns aligned with internal benchmarking approaches, that is, comparable to public market assets of similar rating, with an additional premium to reflect illiquidity and EM exposure.
Cashflow and liquidity	Solvency frameworks require insurers to broadly match the timing and currency of their assets with expected liabilities to manage volatility and capital requirements.[33] In practice, life insurers, such as annuity providers with DB pension exposures, tend to have long-dated and predictable liabilities, while non-life insurers face shorter-term and less predictable claims linked to underwriting cycles. This results in differing preferences around duration and liquidity.[34]	Life insurer participation is typically associated with structures that provide long-dated, predictable, and income-oriented cashflows aligned with liability profiles—for example, exposures with durations of ~10–20 years and regular fixed or floating-rate distributions. In contrast, non-life insurer participation is more often associated with shorter-duration exposures and structures that offer some degree of liquidity or exit flexibility, reflecting more variable liability profiles.
Volatility	Solvency II and Solvency UK frameworks impose capital charges linked to return variability. FX risk, interest rate exposure, and mark-to-market volatility have direct regulatory costs.	Participation is typically associated with structures that reduce variability in returns, for example, FX hedging, which can improve capital efficiency alongside downside protection.
Other	Under EU and UK regulation (Solvency II and Solvency UK), blended funds with multiple tranches may be classified as securitisations and incur punitive capital charges as a result. (No equivalent constraint applies to North American insurers.)	Funds are structured with fewer tranches to avoid securitisation classification. Guarantees or other mechanisms outside the capital stack may be used to provide additional downside protection or other enhancement if constraints are not fully addressed through structuring within the stack. Creating separate asset pools with different risk profiles is another innovative way to avoid triggering securitisation regulations, such as the Infrastructure Resilience Development Fund which was jointly developed by *Insurance Development Forum* members (AXA, Convex, Generali, SCOR, Swiss Re, and Zurich) and BlackRock.[35]

32 Solvency II Regulation amending DR 2015/35.

33 *The UK as a Climate Finance Hub*, IIGCC (2025).

34 *Playbook on the insurance sector's role in blended finance at the climate-health nexus*, Convergence (2025).

35 *Insurance Development Forum announces first close of Infrastructure Resilience Development Fund for resilient infrastructure projects in emerging and developing economies*, Insurance Development Forum (2025); BCG, BII, and GFANZ interviews with practitioners (2026).

The role of credit agencies in enabling insurer participation in blended finance funds

For insurers, achieving an investment-grade rating from a recognised agency is a regulatory necessity placing credit ratings agencies (CRAs) in a pivotal position to enable large investors' participation in blended finance funds at greater scale. Current methodologies were not designed with blended structures or emerging market asset pools in mind, and practitioners report a persistent disconnect between actual portfolio performance and achievable ratings.[36] Part of the constraint is evidential: EMDE credit risk data is limited and regulators do not have adequate information on default and recovery rates in developing markets.[37]

Active engagement between CRAs and market participants offers a practical path forward. An effective model, as described by practitioners interviewed for this report, is one in which fund managers and rating agencies co-design structures iteratively, with the CRA providing explicit guidance on how incremental changes to first-loss sizing or subordination levels would affect the achievable rating throughout the design process rather than fund managers submitting completed structures for assessment, reducing costly late-stage redesigning. Practitioners note that CRA engagement on blended finance has improved in recent years, with agencies developing clearer understandings of how tranching and credit enhancement interact in blended structures.

36 BCG, BII, and GFANZ interviews with practitioners (2026).

37 *State of Blended Finance*, Convergence (2024).

Pension funds

Pension funds manage retirement savings for employees (corporate schemes) or citizens (public schemes), either as defined-benefit (DB) or defined-contribution (DC) structures. They may include allocations to higher-risk asset classes within their portfolios, but these allocations remain governed by mandates and strategic asset allocation (SAA) limits, requiring investments to deliver benchmark-anchored returns while supporting liability matching and portfolio diversification.

Nuances: Regional variation influences constraints — some APAC DC systems require periodic liquidity, certain African public schemes operate under statutory liquidity limits, and some jurisdictions favour high sovereign bond allocations over private assets. Regulatory fee caps, for example, approximately 0.75 per cent[38] for UK DC schemes, can effectively limit participation in higher-cost emerging market or blended finance vehicles. Constraints may be less binding where pension funds have dedicated impact mandates, specialised internal teams, or leadership-driven sustainability priorities.

Key constraints and implications for fund design:

	Key constraint	Implications for concessionality needed
Downside	For pension funds, downside constraints are shaped primarily by trustee governance, mandate, and predefined SAA frameworks. These structures create a stronger preference for familiar, easily benchmarked investments, with decisions often guided by internal investment policies, asset allocation limit, and peer precedent. This can limit appetite for first-of-kind or unconventional strategies, especially stronger in public/national DB schemes.[39] In some cases, regulatory and accounting frameworks reinforce this dynamic. For example, IAS 19 links liability discount rates to AA-rated corporate bond yields, which can anchor allocations towards investment-grade fixed income and benchmark-relative performance.	Pension fund participation is typically associated with structures that are familiar, transparent, and readily benchmarked within existing portfolio frameworks. In practice, simpler structures are generally preferred, as complexity can make it difficult to position investments within existing asset allocation buckets or obtain investment committee approval. Where structures are less familiar or more complex, additional downside protection or clearer risk framing may help improve alignment with governance expectations.
Returns	AUM by pension funds is managed in line with benchmark performance targets. Accordingly, there is typically less appetite for investment strategies that lack credible or comparable benchmarks. A "novelty premium" is often required for first-of-its-kind or less-proven asset pools, including some emerging markets.[40]*	Pension fund participation is typically associated with structures that demonstrate returns comparable to public or private market benchmarks, for example public equity plus spread, or private credit IRR targets, to pass pension funds' actuarial review.
Cashflow and liquidity	DB schemes require long-duration assets that track their obligations over time; misaligned cashflow profiles can undermine the ability to honour liabilities. DC schemes require frequent valuation and flexible liquidity, as plan holders retain individual investment risk and may need access to capital. Predefined strategic asset allocation buckets may limit exposure to illiquid or complex vehicles across both scheme types.	Pension fund participation is typically associated with structures where cashflow profiles and duration can be aligned with liability profiles, particularly for DB schemes, which favour predictable, income-oriented distributions and limited exposure to back-ended returns. In contrast, DC schemes are more often associated with structures that offer some degree of liquidity or flexibility, for example, periodic dealing or semi-liquid formats, to accommodate member-driven inflows and outflows.
Volatility	Pension funds are not primarily constrained by the absolute level of return variability. Instead, return variability is assessed in the context of how an investment fits within existing portfolio allocations and benchmarks. In practice, variability arising from sources such as FX, interest rates, or credit performance is more acceptable where it is consistent with the characteristics of the asset class and can be clearly explained within internal frameworks. Variability that is less familiar or difficult to benchmark may create additional scrutiny in governance and approval processes.	Pension fund participation is typically associated with structures where sources of return variability are transparent, attributable, and comparable to existing asset classes or benchmarks.

**This constraint may be less binding where investors have dedicated impact mandates, such as SDG targets, specialised internal teams, or leadership-driven sustainability priorities.*

38 *The Occupational Pension Schemes (Charges and Governance) Regulations 2015*, UK Department for Work and Pensions (2015).

39 *The UK as a Climate Finance Hub*, IIGC (2025).

40 *Trillions or billions? Reassessing the potential for European institutional investment in emerging markets and developing economies*, ODI (2024).

Sovereign wealth funds

Sovereign wealth funds are state-owned funds that manage and invest national reserves for long-term growth and economic stability. In blended finance, participation is shaped by political, legal, and reputational considerations, alongside requirements for commercial returns and appropriate liquidity.

Nuances: These constraints vary by mandate, particularly between stabilisation funds and strategic development funds. In particular, stabilisation funds may be unlikely participants in blended finance vehicles given their very targeted liquidity and capital preservation mandates, which often drive a preference for listed assets and liquid or semi-liquid instruments.

Key constraints and implications for fund design:

	Key constraint	Implications for concessionality needed
Downside	Political, legal, and reputational sensitivity is typically pronounced, particularly for stabilisation funds. This leads to a preference for de-risked or multilateral-supported exposures and caution toward first-of-a-kind frontier markets. Strategic development funds may demonstrate greater flexibility where investments are aligned with national priorities.	Participation is often associated with structures incorporating robust legal frameworks, political risk mitigation, and multilateral or DFI involvement, particularly for stabilisation-oriented capital.
Returns	Sovereign wealth funds generally require benchmark-aligned, market-rate returns. For stabilisation funds, this is closely linked to capital preservation and low volatility. Strategic development funds pursue commercial returns alongside strategic objectives.	Participation is often associated with structures that are more aligned where a clear commercial investment case is maintained, with impact or development objectives complementing rather than substituting for financial performance.
Cashflow and liquidity	Stabilisation funds favour liquid or short-duration exposures with limited tolerance for long lock-ups or J-curve profiles. Strategic development funds are generally more able to accommodate longer investment horizons and less liquid structures where the investments are aligned with strategic objectives.	Structures with shorter tenors, predictable cashflows, and exit flexibility are more aligned with stabilisation fund preferences. Longer-dated structures may be compatible with strategic development funds where there is clear long-term value creation.
Volatility	Stabilisation funds have low tolerance for volatility, reflecting their role in supporting fiscal stability. Strategic development funds may accommodate greater variability where there is alignment with long-term objectives, while remaining mindful of downside risk.	Structures with more stable return profiles, through diversification, seniority, or downside protection, are more aligned with stabilisation-oriented capital. A wider range of risk-return profiles may be acceptable for strategic development funds.

Banks

Banks invest deposits and market funding to earn net interest income while meeting capital and liquidity requirements. Commercial banks are not frequent investors in blended finance funds and are unlikely to become so due to regulatory restrictions. Banks that *have* invested in blended funds have done so primarily for strategic reasons, for example, to gain experience in new markets or asset classes, or to fulfil sustainability objectives, rather than as a straightforward balance sheet optimisation exercise. In addition to strategic objectives, investment decisions are influenced by the capital required for an exposure, the returns generated relative to that capital, liquidity considerations, and internal credit approval processes.

Nuances: Regional differences influence risk-weight treatment — the EU's 72.5 per cent output floor, US standardised capital rules (which typically assign 100 per cent risk weights to corporate exposures), and varying APAC approaches. Non-standard or structured exposures, including subordinated tranches or guarantees, require additional credit, risk, and compliance review, increasing approval timelines and internal scrutiny; simpler structures reduce this burden. Constraints may be less binding where banks have dedicated impact mandates, specialised internal teams, or leadership-driven sustainability priorities.

Key constraints and implications for fund design:

	Key constraint	Implications for concessionality needed
Downside	Exposures are assessed through risk-weighted assets, internal ratings models, and concentration limits. Sub-investment-grade exposures attract materially higher risk weights (often 100%+ under standardised approaches), increasing capital consumption.[41] Project ratings are often constrained by sovereign ceilings, limiting eligibility of otherwise sound assets in lower-rated markets.* Under Basel IV, the 72.5% output floor may limit the extent of risk-weight reduction from credit enhancement. Not all structures or counterparties qualify for regulatory capital relief.	Participation is typically associated with structures that are capital-efficient: senior positioning, higher credit quality, and the use of eligible downside protection. Simplicity, diversification, and alignment with internal rating frameworks support more favourable capital treatment and facilitate internal approval. Guarantees are preferred where regulator-compliant and provided by acceptable counterparties.[42]
Returns	Returns are assessed on a risk-adjusted basis, with return on equity influenced by capital intensity. Higher risk weights reduce the attractiveness of a given spread, particularly for complex or illiquid exposures.	Participation is typically associated with structures that combine sufficient yield with lower effective capital intensity. For example, through tranche structuring or downside protection that improves risk-adjusted returns are more attractive.
Cashflow and liquidity	Banks operate under capital and liquidity regulations, such as the liquidity coverage ratio, favouring shorter-duration, liquid, and standardised exposures. Longer-dated or illiquid investments risk introducing funding mismatches and increased liquidity costs.	Structures with shorter effective tenors, such as 3–5 years, predictable cashflows, and some degree of tradability or distribution are more aligned with these constraints.
Volatility	Return variability is not a primary or directly regulated constraint for banks. However, it can affect regulatory capital and reported earnings, particularly through mark-to-market, FX, or credit movements.	Structures with predictable, stable return profiles and limited mark-to-market exposure reduce friction with internal treasury and risk functions.
Other	PPrudential standards (Basel II) do not fully recognise the risk-reducing benefits of A/B loan structures (including effective transfer of preferred creditor status) or the credit risk mitigation effect of some common MDB and DFI products and guarantees. The list of MDBs eligible for 0% risk weight excludes newer institutions, meaning that banks might not be able to obtain the capital relief that the economic risk profile of a transaction would justify.[43]	N/A

**This constraint may be less binding where investors have dedicated impact mandates, such as SDG targets, specialised internal teams, or leadership-driven sustainability priorities.*

41 *Blended Finance: A Primer for Commercial Investors*, World Economic Forum (2020).

42 *State of Blended Finance 2023*, Convergence (2023).

43 See IIF's *Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance* for further discussion.

Further reading

The International Institute of Finance (IIF) analysis *Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance* (2025) identifies four specific aspects of the Basel Framework that inadvertently increase the cost to commercial banks of participating in MDB and DFI-facilitated transactions in emerging and development markets, including blended funds. The paper proposes near- and medium-term recommendations to regulatory authorities, including the Basel Committee on Banking Supervision, to better align capital treatment with the actual risk profile of these instruments. It also provides useful context for fund managers and catalytic providers on the regulatory constraints facing bank investors and structural features relevant to banks' participation in blended funds.

Family offices

Family offices manage the wealth and often the philanthropic activities of ultra-high-net-worth families. They are generally not subject to prudential regulation, which gives them flexibility to participate in blended finance funds in multiple roles: as commercial investors in senior or mezzanine tranches, as providers of concessional capital through philanthropic vehicles, or both.[44] Interest from family offices in blended finance has grown significantly in recent years: survey data suggest that over half of HNWIs and family offices plan to increase their allocations to impact-first investing.[45]

However, practitioners report a gap between demand and available products: family offices are actively looking but not finding scalable, low-friction vehicles on the market. A central challenge is heterogeneity: family offices are diverse and idiosyncratic in their governance, impact objectives, and investment preferences. Engaging numerous smaller actors with bespoke requirements is costly for fund managers and makes achieving scale more difficult.[46] Despite this, their adaptability can unlock additional pools of capital across tranches in the capital stack.

Key constraints and implications for fund design:

	Key constraint	Implications for concessionality needed
Downside	Family offices have more flexible risk appetites relative to regulated institutional investors but remain selective. They may prefer situations with strong underwriting visibility and defined downside protection. Some are willing to take higher risk, including sub-investment-grade or equity-like exposures, particularly where these align with specific impact theses. However, many family offices lack the internal analytical capacity to evaluate complex or unfamiliar risk structures, which can create a preference for simplicity and transparency over structural sophistication.	Flexible structuring, including co-investment or bespoke options, with clear underwriting visibility and defined downside protection. Unlike regulated investors, family offices may not require investment-grade ratings, but clear and simple risk framing may support engagement, particularly where offices lack dedicated investment teams.
Returns	Return expectations are heterogeneous and often unconstrained by external benchmarks. They may range from capital preservation to opportunistic strategies. Family offices deploying capital through philanthropic vehicles may accept below-market or concessional returns in exchange for impact and mobilisation leverage.	Modular options, such as tranche selection and co-investment, to accommodate differing return preferences across diverse investment and impact mandates
Cashflow and liquidity	Family offices generally prefer investments with visible cashflows or shorter durations over long back-end-heavy return structures. Wealth clients more broadly favour liquidity, evergreen or semi-liquid structures, and products simple enough for relationship managers to communicate. However, family offices have more flexibility than regulated investors and can accept illiquidity where the impact thesis is compelling. May prefer investments with visible cashflows or shorter-duration profiles over long back-ended return structures but have more flexibility than private banks.	N/A
Volatility	Family offices may accommodate greater variability in outcomes than institutional investors if aligned with specific investment theses, while maintaining focus on downside risk.[47]	Variability arising from FX, interest rates, or credit performance might be more acceptable where it is consistent with the investment or impact strategy and can be clearly communicated. Volatility reduction instruments may be less critical for family offices than for regulated institutional investors, although FX hedging or other stabilisation mechanisms may still support engagement.

Note: there is significant heterogeneity across family offices, which vary significantly in size, sophistication, and mandate. The table above should be understood as a very broad characterisation of this group of investors.

44 BCG, BII, and GFANZ interviews with practitioners (2026); *Blended Finance 2.0*; BlueOrchard (2018); *State of Blended Finance 2024*, Convergence (2024).
45 BCG analysis.
46 BCG, BII, and GFANZ interviews with practitioners (2026).
47 *Global Family Office Report*, Campden Wealth (2023).

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