DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE

DEVELOPMENT FINANCE: TREATMENT OF MARKET-LIKE INSTRUMENTS IN THE
STATISTICAL FRAMEWORK MEASURING AND MONITORING DEVELOPMENT FINANCE
POST-2015

DAC Senior Level Meeting
7-8 October 2014
OECD Conference Centre, Paris

This document is submitted for DISCUSSION under Item 4 of the Draft Annotated SLM Agenda
[DCD/DAC/A(2014)13].

SLM participants are invited to agree with the proposals in paragraph 7.

Contact: Suzanne Steensen - Tel. +33 1 45 24 76 23 - Email: suzanne.steensen@oecd.org
Julia Benn - Tel. +33 1 45 24 90 39 - Email: julia.benn@oecd.org

JT03362373

Complete document available on OLIS in its original format

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.
DEVELOPMENT FINANCE:
TREATMENT OF MARKET-LIKE INSTRUMENTS IN THE STATISTICAL FRAMEWORK
MEASURING AND MONITORING DEVELOPMENT FINANCE POST-2015

1. Market-like instruments (including equity and shares in collective investment vehicles, mezzanine finance instruments and guarantees) have gained more and more attention in development finance in recent years as they help to narrow the profound financing gap to fund sustainable development in two ways. First, they constitute an important form of financing in themselves, with features that cannot easily be mirrored by other instruments (e.g., ownership rights and responsibilities when investing in an equity stake). Second, they have the potential to crowd in additional private funds, both by mitigating the risk for and by demonstrating the financial viability of projects to private investors. Such instruments are employed in particular by development finance institutions (DFIs) mandated to invest in the private sector for development purposes – this explains why they are often referred to as “private sector instruments”. In principle, however, they can be used to finance both public and private sector entities.

2. There is broad agreement that the present ODA reporting does not sufficiently recognise and incentivise these instruments. In accordance with the 2012 DAC High Level Meeting (HLM) mandate, work has therefore been carried out over the last 18 months to map the development finance landscape and better understand the functioning of market-like instruments and their potential to leverage other resources. Statistical categories and methods have been developed for monitoring their use. Major steps forward were taken at the meeting of the Working Party on Development Finance Statistics (WP-STAT) on 16-17 September 2014 where members approved in principle a new taxonomy for financial instruments along with an expansion of the DAC statistical collection to include the mobilisation effect of official development finance. (See Box 1.)

3. There are different ways in which market-like instruments could be better reflected in ODA reporting, and the SLM is invited to give strategic guidance in the lead-up to the HLM. Members have previously stated that recognition of the effort involved in the use of market-like instruments would create further incentives for their use. There seems therefore to be broad agreement that as a minimum, ODA modernisation should remove the disincentives embedded in the current reporting system. (Given that reporting is based on net disbursements, positive sales proceeds from any ODA equity investment score as negative ODA.) Two main approaches to addressing these issues are being explored: an assessment of donor effort instrument by instrument, or including in ODA governments’ contributions to their national DFIs. (See Box 2.)

4. In general, it would seem important to ensure that the overall statistical framework remains coherent. Concrete proposals on the measurement of donor effort involved in the use of market-like instruments should therefore be synchronised with the conclusions of the ongoing discussion on assessing concessionality and the reporting on loans in ODA. A grant equivalent approach in ODA loans reporting could facilitate the development of methodologies for calculating the grant equivalents of equity, mezzanine instruments and guarantees. If ODA reporting remains on a cash-flow basis, it would seem more challenging to include non-flow instruments, at least on an instrument-by-instrument basis. Adoption of a risk-adjusted approach for loans would also logically make it more relevant to valorise risk-taking in the reporting on other non-grant instruments which are designed to mitigate the risks that private investors are not willing to take.

1. See DCD/DAC(2014)48, Table 1.
Box 1. Measuring the mobilisation effect of official development finance

The question on how to use ODA in “smarter” ways to mobilise additional resources for development – and how to measure and valorise these resources – has been at the core of political discussions on development finance for several years. The question is most relevant also for the climate community that has committed to mobilise, by 2020, USD 100 billion for climate change mitigation and adaptation in developing countries. Monitoring climate finance and the fulfilment of this commitment has shown to be complex, due to unclear definitions and lack of internationally accepted methodologies for reporting on mobilisation.

To address these challenges, and in accordance with the HLM mandate, the WP-STAT has explored the scope for expanding the DAC statistical system to collect data on private sector resources mobilised through risk-mitigation and other instruments with a potential leveraging impact. Following a Survey on guarantees for development in 2013, a Survey on the mobilisation effect of official development finance in 2014 and consultations with members and DFI experts, a first proposal for collecting data on amounts mobilised was presented for consideration by the WP-STAT at its meeting on 16-17 September 2014.

Members welcomed progress in work on the mobilisation effect of official development finance and saw the proposal as an initial concrete step towards a system for recording, at the activity level, the private funds raised for development by all official actions that have mobilisation as an explicit objective. It focused on financial mechanisms for which the Surveys demonstrated that it was feasible to measure amounts mobilised in the short-term, namely:

- **Syndicated loans.** A syndicated loan is one provided by a group of lenders (called a syndicate) who work together to provide funds for a single borrower. The main objective is to spread the risk of a borrower default across multiple lenders, and thus encourage private investment.

- **Guarantees for development.** Guarantees facilitate the mobilisation of finance by transferring or mitigating risks that private investors would not be able or willing to take.

- **Shares in collective investment vehicles.** Highly rated investors (e.g., development finance institutions) increase the creditworthiness of the collective investment vehicle, and thus provide a positive signal to the market and attract private finance that may not have invested otherwise.

WP-STAT members approved the proposal in principle and the work plan to revise the Directives accordingly. Members encouraged the Secretariat to carry out further work to expand the coverage of the measurement to other financial instruments such as direct equity and mezzanine finance instruments.

5. Pending agreement on the treatment of loans, and given that members have specifically requested that ODA modernisation resolves the issue of disincentives, members are invited to consider a two-phased approach where, as a first step, the “institutional approach” be adopted for reporting on market-like finance to the private sector. It is technically relatively easy to implement, although it would require clarifying which institutions are considered as DFIs and whether only capital contributions, or capital contributions and reinvested earnings, would be reportable as ODA. As a second step, “instrument-specific solutions” would be developed further in alignment with the treatment of ODA loans, expected to be decided upon at the HLM in December 2014. Further discussions would be required on the question of whether some flexibility could be built in the reporting system as suggested by some members.

6. In any case, within the current framework, there would be scope to address the issue of disincentives by aligning the treatment of ODA equity investment with that of ODA loans, i.e. limiting the measurement of net cash flows to the initial investment value.² The question that arises, however, is

---

² This would imply reporting the amount of the initial investment as a positive entry and the amount received from divestment as a negative entry but limited to a maximum of the initial investment value.
whether data on profits from sales of equity should be collected for transparency purposes; some members have also suggested that a good practice would be to ensure these profits are reinvested for development.

Box 2. Recent approaches to accounting for the donor effort of market-like finance

Recent discussions in the DAC, its Expert Reference Group and the WP-STAT have all stressed the need to account for market-like instruments in a consistent, instrument-neutral and easily justifiable manner in modernised DAC statistics. While members have made significant progress in their thinking on how to capture the totality of official flows and private flows mobilised by official efforts in the new measurement system complementing ODA, views are still divided on how best to estimate the donor effort involved, i.e. the ODA-eligible portion, in the deployment of such instruments.

Recent discussions for valuing and thus reflecting such instruments in ODA have focussed on direct private sector financing. As most – albeit not all – bilateral private sector financing is channelled through Development Finance Institutions (DFIs), some members suggest an institutional approach. Instead of trying to calculate the degree of concessionality for each activity, they propose changing the point of measurement from outflows to inflows for DFI operations, i.e. counting in ODA official capital contributions to DFIs and potentially also reinvested earnings. Members supporting this approach point to the relative simplicity and hence feasibility of reporting which would not require any instrument-specific concessionality test or calculation considered as too complex or arbitrary. They furthermore argue in favour of conceptually aligning the treatment of bilateral DFIs with the treatment of International Finance Institutions (IFIs) which operate under a comparable mandate and for which capital contributions are already counted in ODA under the current system. When following this proposal, complementary solutions would still have to be developed for accounting for market-like instruments that are provided by those other than DFIs.

Several other members favour an instrument-specific approach in which market-like instruments are reported on in the same manner as grants and sovereign loans, i.e. defining in which circumstances the instruments are ODA-eligible and counting either the relevant flows in a flow-based system or the estimated ODA grant equivalents in a grant equivalent system. Such an approach would be independent of the institutional set-up within donor countries and could incorporate market-like instruments extended to official and private sector entities alike. Members supporting this approach point to the possible application and adaptation of existing financial accounting practices to calculate the associated costs or grant equivalents, while acknowledging that some simplifying assumptions are required to keep reporting simple and feasible.

Some members also suggested an optional choice between the institutional and instrument-specific approach. This would however pose the question on how to ensure statistical comparability and consistency across the membership.

7. The SLM is invited to agree that:

- as a minimum, Reporting Directives be revised to remove the disincentive for the provision of ODA equity investment by capping the reflows to the amount of the initial investment;

- in going forward, a two-phased approach be adopted for the treatment of market-like instruments in the DAC statistical framework, as suggested in paragraph 5, where:
  - an institutional approach is further detailed with a view to implementing it as soon as possible, and
  - technical options for instrument-specific treatment of market-like finance in ODA and TOSD are developed further, synchronised with the agreement on concessionality.