

# Blended Finance for Energy Transition (BFET)

## Key results:

- Significant reduction or avoidance of GHG emissions in high-emitting countries through promotion of renewable energy generation
- Mobilisation of significant amounts of private capital for climate finance (10x – 20x the BFET investment)
- Ensuring a just energy transition with access to affordable and reliable energy after a transition away from coal, and with high-quality employment opportunities
- In addition to the supply-side focus (renewable power generation), BFET may support innovative climate tech solutions e.g. within e-mobility and waste management
- Support for one or two impact-oriented fund managers to raise more capital from private sources, to increase investment volumes and grow their impact.

## Justification for support:

- Alignment with The World We Share strategy and the Government's long-term strategy for global climate action
- Deepened Danish / US collaboration around climate finance, including working with the Special Presidential Envoy for Climate John Kerry
- Evidence of Danish commitment for Just Energy Transition Partnership countries
- Additional Danish mobilized climate finance
- BFET is aligned to the priorities of the reform of IFU ahead by supporting the scale up of green investments and climate finance mobilization envisioned through the reform.

## Major risks and challenges:

- Fundraising risk: even with catalytic capital, the amount of private capital expected for BFET may not be achieved
- Limited additionality: that the investments would have been carried out and the fund raised even without the BFET capital
- Execution risk: even if private funds are raised, the fund manager may not be able to find suitable and sufficiently impactful investment opportunities
- Political and regulatory risks: investments in energy are exposed to risks related to e.g. regulatory changes, permitting and power purchase agreements

## File No.

## Country

51%: India,Indonesia,Vietnam,South Africa

## Responsible Unit

GDK

## Sector

Energy

## Partner

IFU, USAID, USA SPEC, ILO

DKK million

2023 2024 2025 2026 2027 Total

## Commitment

100,0 100,0

## Projected disbursement

100,0 100,0

## Duration

2023-[2031/2043] (TBD)

## Previous grants

## Finance Act code

§06.38.01.11. IFU

## Head of unit

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## Relevant SDGs

 No Poverty	 No Hunger	 Good Health, Wellbeing	 Quality Education	 Gender Equality	 Clean Water, Sanitation
 Affordable Clean Energy	 Decent Jobs, Econ. Growth	 Industry, Innovation, Infrastructure	 Reduced Inequalities	 Sustainable Cities, Communities	 Responsible Consumption & Production
 Climate Action	 Life below Water	 Life on Land	 Peace & Justice, strong Inst.	 Partnerships for Goals	

## Objectives

Mobilising up to USD 1bn from private investors to reduce GHG emissions in high-emitting middle income countries with at least 51% focus on the JETP relevant countries. The mobilized investments will reduce poverty by creating job directly in the energy sector and indirectly from increased growth in the countries while improving the access to affordable clean energy for local populations.

## Environment and climate targeting - Principal objective (100%); Significant objective (50%)

	Climate adaptation	Climate mitigation	Biodiversity	Other green/environment
Indicate 0, 50% or 100%		100%		100%
Total green budget (DKK)		100,0		100,0

## Justification for choice of partner:

IFU being the Danish Development Finance Institution (DFI) is the natural partner of the Danish Government on bilateral blended finance arrangements. At the strategic level, BFET's thematic and geographical focus is well aligned with the Government's climate ambitions and with IFU's investment strategy. BFET is also aligned to the priorities of the reform of IFU ahead by supporting the scale up of green investments and climate finance mobilization envisioned through the reform.

## Summary:

BFET aims to leverage up to USD 50m of catalytic capital to mobilise USD 1bn of private capital into the energy transition in high-emitting emerging markets (focus on JETP relevant countries i.e. India, Indonesia, South Africa and Vietnam. The catalytic capital will provide a first-loss to reduce the risk for private investors, and will be deployed by a fund manager who will integrate it into a fund structure and raise the private capital. A competitive process is underway to identify the fund manager.

## Budget (engagement as defined in FMI):

Engagement 1 – the development project	99.5 DKK million
Engagement 2 - auxiliary activities, such as advisors, M&E and reviews (repeat as relevant)	0.5 DKK million
Total	100.0

# Project document draft on Blended Finance for Energy Transition (BFET)

For Programme Committee meeting 15. August 2023

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## 1. Context, strategic considerations, rationale and justification

### The need for climate finance

In today's global financial and macroeconomic landscape, mobilizing finance for development has become increasingly crucial for countries aiming to achieve sustainable economic growth, alleviate poverty and mitigate and adapt to the climate crisis. The SDG financing gap in developing countries is estimated to approx. 4 trillion dollars annually according to the OECD<sup>1</sup>. An independent high-level expert group on climate finance commissioned by the chairmanships of COP26/27 concluded that the world needs to mobilize 1 trillion annually in external financing by 2025 for emerging markets and developing countries to keep the target of 1.5 degrees within reach<sup>2</sup>. This figure puts the 100 bn. Dollar climate finance target from COP15 into perspective and calls to action on significant upscaling of current efforts by developed as well as developing countries. Developing countries face numerous challenges when it comes to financing their development agendas. These challenges include limited fiscal space, inadequate infrastructure, low levels of private investment, and vulnerability to external shocks. Additionally, the scale and complexity of development projects often require substantial capital injections that cannot be fully met through traditional funding mechanisms alone. Mobilizing finance for development through innovative financing instruments, therefore, becomes imperative to bridge the existing financial gap and ensure sustainable progress.

### The government's priority to mobilize private capital for development

The proposed grant contributes to the implementation of several objectives under Denmark's Development Policy Strategy, The World We Share as well as the Danish government's long term global climate action strategy with a focus in BFET on creating green sustainable investments in developing countries. Further, the grant for BFET delivers on the Government's ambition to use risk willing public funding to mobilize private capital towards climate finance and in support of the international obligations from COP15 and COP26 as stated in the Government's publication on founding ambitions.

### Blended finance as catalyst to scale sustainable investments

The balancing act between limited public external finance being allocated to the objectives of mitigating greenhouse gas emissions vs. building resilience through adaptation of communities, economies and countries most exposed to climate change requires efficient and effective use of funds, not least official development aid. In line with the World Bank's concept of cascade model to maximize the development impact of ODA, market based solutions should be utilized whenever possible to finance development. If market based solutions are not possible, a mix of public and private funds can be considered in combination as *blended finance* solutions, where public funds de-risk private capital deployment thereby mobilizing private investments with a development impact that would not otherwise have taken place. The concept and potential of blended finance have been tested for a number of years and evidence on impact and additionality is available. OECD DAC have developed a series of publications, principles and guiding notes for blended finance<sup>3</sup>, and the chair of OECD-DAC have announced the ambition to set mobilisation of private finance via a.o. blended finance on the agenda for the next OECD-DAC High-Level Meeting (HLM) in November 2023.

### Blended Finance for Energy Transition (BFET)

During COP27 the Nordic Countries and USAID hosted a side-event on 'Delivering at scale on climate Investments in Developing Countries'. At the event the 'Action plan for Climate and SDG Investment

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<sup>1</sup> [Global Outlook on Financing for Sustainable Development 2023: No Sustainability Without Equity | en | OECD](#)

<sup>2</sup> [Finance for climate action: scaling up investment for climate and development - Grantham Research Institute on climate change and the environment \(lse.ac.uk\)](#)

<sup>3</sup> [Blended finance publications - OECD](#)

Mobilization<sup>4</sup> was launched. The report recommends ways to utilize blended finance for unlocking new climate finance at scale e.g. through increased donor coordination on blended finance scaling, and through creating calls for proposals from asset managers to develop blended finance investments trust funds.

The Special Presidential Envoy for Climate John Kerry announced the intention of mobilizing 1 billion dollars in climate finance through a competitive call for proposals to asset managers in April 2023. Based on the fruitful COP27 collaboration Denmark was invited as the first donor to participate in financing 'Blended Finance for Energy Transition (BFET)'. Thereby BFET forms a direct USA/DK collaboration on mobilizing 1 bn. dollars in climate finance in 2023 as part of the annual 100 bn. Dollar goal established at COP15 in Copenhagen.

#### IFU as implementing partner collaborating with USAID, USA SPEC and Chemonics

IFU is the development finance institution (DFI) of the Danish Government. At the strategic level, BFET's thematic and geographical focus is well aligned to the ambitions of the Danish Government and to IFU's investment strategy. As described in section 2 below, BFET aims to create additional green investments in middle income countries primarily to mitigate greenhouse gas emissions through mainly energy supply side investments. Since being untied from Danish commercial interests, IFU has achieved promising results in its transition towards becoming a leading development finance institution that mobilizes significant private capital and invests for development impact purposes. IFU's impact management system is fully integrated into its investment cycle and involves a number of steps from initial project screening to exit. Through IFU's project screening tool all investment opportunities are checked against IFU's investments strategy, including the impact criteria for green transition and for just and inclusive growth. The process with USAID and SPEC Kerry's office and the consultants in connection to the request for proposals process (ref. below) has already benefitted and will continue to benefit from IFU's experience with trust fund management and green energy investments expertise. The funds from MFA to BFET will be given as grant to IFU to be invested into BFET as one or two trust funds under management by one (or several) private asset manager(s) winning the tendering process on BFET.

The BFET process operates at capital market speed with a tendering process of 4 months, approximate two months for fund capitalization and followed by capital deployment within a few years. The strategic alignment with IFU's investment priorities and capacities combined with the plug-in to IFU's impact management systems allows IFU to step into the BFET process on a short notice and bring the necessary capacity and qualified inputs. As the development finance institution of the Danish Government, IFU is an appropriate partner for a bilateral blended finance such as BFET. The allocation of the proposed grant through IFU is coherent with the objective of reforming and strengthening IFU to fully assume the role of development and climate finance tool of the MFA.

#### International Labour Organization

When investing in private sector infrastructure projects in developing countries a poverty reduction focus must be central to the impact targets of the investment fund. Investing in infrastructure can impact poverty mainly through ensuring local quality job creation as integral to the investment projects financed by the fund(s). To strengthen the quality of job creation of BFET Denmark is working to bring ILO in as partner to the process in setting up the trust fund(s). A first meeting between USAID, USA SPEC, Chemonics, MFA and IFU with the ILO identified concrete areas of collaboration on BFET eg. On how to strengthen the target setting and monitoring of the quality of jobs to be created. ILO have since offered their support to BFET through several initiatives. (1) Sharing the Just Transition Finance Tool<sup>5</sup> on concrete governance and impact management tools to implement by investment managers. (2) Individual direct support to the winning trust fund manager(s). (3) Explore further possibilities of collaboration eg. As a knowledge partner in the ILO Just Transition Finance Hub about to be

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<sup>4</sup> [The Action Plan for Climate and SDG Investment Mobilization - Convergence Resources | Convergence](#)

<sup>5</sup> [Just Transition Finance Tool for banking and investing activities \(ilo.org\)](#)

established. IFU and MFA will work to incorporate the knowledge and corporation with ILO as much as possible into BFET and the contracts with the winning trust fund manager(s).

## 2. Project objective

The BFET process is managed by the consultancy company Chemonics chosen by USAID under the Climate Finance For Development Accelerator facility<sup>6</sup> (CFDA) funded by USAID. Initiating the BFET process Chemonics produced a market sounding report on the emerging market blended finance landscape trends and barriers to deployment of private capital to energy transition in developing countries with a focus on emerging markets. This generated inputs from investment actors such as asset managers, developers, institutional investors and knowledge actors.

### Geographical focus

The market sounding report supported a strategical focus on high emission middle income developing countries with at least 51% focus on Indonesia, Vietnam, South Africa and India. The geographic scope is thereby aligned to the Just Energy Transition Partnerships (JETPs) with all except India having announced JETP plans with international bilateral partner countries. Denmark have joined the JETP agreements for Vietnam, Indonesia and South Africa, which is seen as a leading political level initiative driven by G7+ countries to accelerate the green energy transition in high-emitting developing countries. The additional mobilized private capital for energy transition through BFET will supplement the official JETP financing packages with the thematic alignment to JETP's.

### Thematic focus

The BFET trust fund(s) will focus on renewable energy generation, energy storage, enabling infrastructure and transmission, smart grid technology, and clean hydrogen technology and infrastructure. BFET is aiming to create (mobilise) 1 bn. dollars in private sector investments within the scope defined above. The market research report estimated a possible leverage factor within the geographic and thematic focus of x20, whereby 50 mil. dollars in public grants composing 5% of the trust fund(s) should be able to mobilize 20 times the amount in private capital e.g. from institutional investors, pensions funds etc.

Clean energy investments in developing countries generate direct jobs through construction and operation of renewable projects, involving skilled and unskilled workers. Indirectly, improved energy access stimulates economic growth, creating jobs in various sectors like manufacturing, commercial services, and local businesses, benefiting the broader community. Transitioning to a low-carbon economy needs to go hand in hand with equitably addressing socio-economic risks and opportunities is outlined in the ILO Guidelines for a Just Transition.

### Delivering objectives through calls for proposals

A call for proposals (CfP) was announced by USAID og SPEC Kerry's office in April.<sup>7</sup> Danish MFA and Swedish Sida were invited to provide initial comments to the first round of CfP, which was done in collaboration with IFU investment directors giving guidance on IFU investment criteria and exclusion lists. The first round of CfP produced 30 concept papers from asset managers from around the world. An initial screening reduced the concept papers to 9 continuing to round two where full proposals for trust fund vehicles was requested. The initial screening was conducted on criteria such as need for concessional finance, climate/energy and social benefits, private capital mobilization, innovation, development stage of target investments etc.

Four of the proposals were for debt funds and five for equity funds. The fund sizes were in the range from USD 500m to USD 1bn, with two exceptions (one fund targeting USD 350m and one fund targeting USD 3-4bn). Four funds had a global investment focus, while the remaining five focussed on either Asia or

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<sup>6</sup> [USAID Climate Finance for Development Accelerator \(CFDA\) | Global Climate Change \(climatelinks.org\)](#)

<sup>7</sup> [Blended Finance for the Energy Transition \(BFET\) | Global Climate Change \(climatelinks.org\)](#)

Africa. In line with the criteria, all funds had a primary focus on supply-side solutions. Most of the funds also included a smaller allocation to demand-side solutions, and three funds covered other climate or sustainability-related sectors as well.

The subsequent round 2 have further reduced the 9 proposals to 5 finalists for oral presentations. A political pledge from the MFA has been given to participate in BFET (subject to the Danish grant approval process). Based on this, IFU was invited to participate in the technical evaluation committee for round 2.

Selection criteria for the second round included alignment with BFET geographic and thematic priorities, impact, ability to implement in timely manner and Strategy & management. The MFA and IFU provided inputs to strengthen the impact and additionality e.g. by requesting that job creation was part of the evaluation criteria in round two and by linking the consultancy team up with ILO specialists to strengthen the quality aspects of jobs created, reflecting the “just” element in “just energy transition”.

The final evaluation of the winning proposal(s) will be completed by mid-August after which negotiations with the winner(s) on the final capital structure and targets will take place. BFET is set to be launched at COP28 at a high-level side event hosted at the American pavilion with participation by the Danish Government.

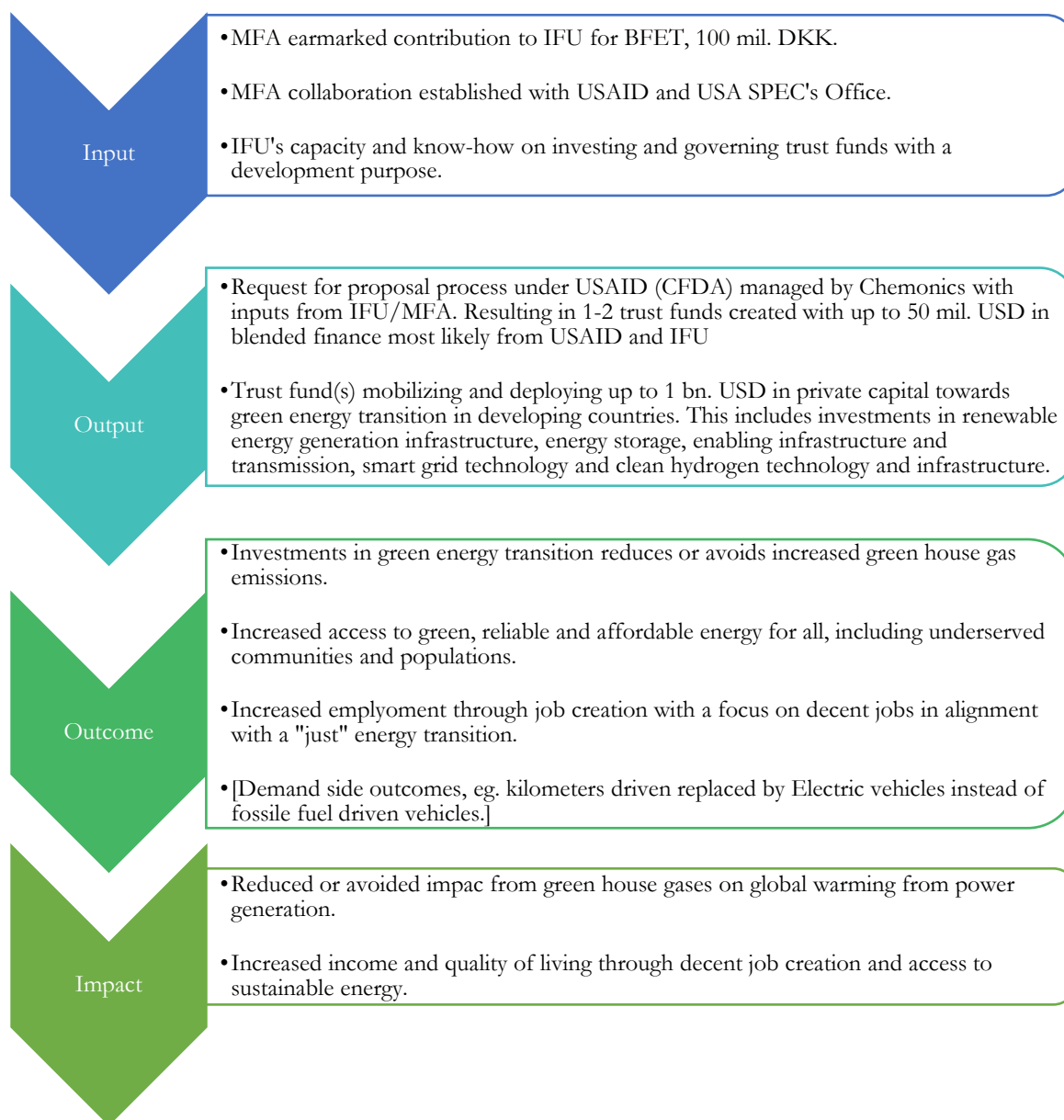
The proposed Danish grant of 14.7 mil. dollars as part of the 50 mil. dollars in grant financing for BFET is envisioned to generate up to x20 in mobilized climate finance. Proportionally, this implies up towards 2 bn. DKK in climate finance mobilized by Denmark in 2023 in addition to the approx. 7 bn. DKK mobilized through direct climate aid, IFU and other sources. All else being equal, BFET thereby lifts the ‘fair share’ of Danish climate finance from approx. 1% to approx. 1.3% in 2023.

[The final version of the project document will base the project objective description as well as the Theory of change and results framework on the final structure and impact of the BFET trust fund(s).]

### 3. Theory of change and key assumptions

The intervention logic of Blended Finance for Energy Transition (BFET) is presented in figure 1 below.

**Figure 1.**



The Theory of change for Blended Finance for Energy Transition (BFET) is:

**If...**

- The MFA provides capital to IFU to invest in BFET;
- The MFA connects IFU to USAID and USA SPEC collaboration partners;
- IFU utilizes it's capacity and know-how on investing in trust funds with a development purpose to participate and influence a Request for Proposal process on energy transition investments



## **Then...**

- Additional private capital can be mobilized and deployed through a private asset manager governed trust fund.
- Investments in greenhouse gas reduction and avoidance in developing countries will take place with 51% of investments in India, Vietnam, South Africa and Indonesia.
- Jobs will be created in the local energy sector in alignment with a “just” energy transition with a focus to generate decent jobs which will reduce poverty and spur economic growth.
- Access to green and reliable energy increases for underserved communities and populations.

## **Because... (assumptions)**

- Private asset Owners eg. Pensions funds have an increased interest in ESG aligned investments and are willing to invest in emerging markets and developing economies given the right risk/return profile and governance structure.
- 50 mil. dollars to mobilize 1 bn. dollars (5%) in blended finance from public concessional sources provides sufficient catalytic force to create the right risk/return profile for asset managers to offer asset owners given the sector(s) and geographical focus of BFET.
- The winning asset manager(s) can develop and deploy their bankable portfolio of investment opportunities into the energy sector and connecting sectors in the countries.
- The asset manager(s) have the capacity to deploy investments in a timely manner within the sectorial enabling environment in the countries of choice.

## **Ultimately...**

- Generate reduced or avoided emissions of greenhouse gases contribution to global warming and the climate crisis.
- Increased income and quality of living from jobs created with a focus on decent working conditions and wages etc. as well as from increased access to sustainable energy.

## **4. Draft results framework**

The mandate of the BFET is to support the green energy transition in high-emitting emerging markets. As such, the main outcome of the programme is the reduced or avoided carbon emissions resulting from the investments. This will be achieved through mobilising private capital, through leveraging the BFET catalytic capital. The other key outcome will therefore be the amount of impact mobilised private capital aligned with Paris-agreement and SDG's that would not otherwise have been allocated towards emerging markets or energy transition investments. With the focus on supply-side of the climate transition, another outcome will be the amount of additional renewable energy that is generated from the investments.

As the programme will support the energy transition in Just Energy Transition Partnership (JETP) countries, the success of the programme is also linked to ensuring that the investments support the “just” component of the transition. IFU will work to incorporate the Just Transition Finance Tool<sup>8</sup> created by the International Labour Organization. Success on this dimension will be tracked by the net change in job opportunities due to the energy transition investments as well as the quality of the jobs created.

In addition to the primary focus on supply-side sectors, most of the fund managers applying for the BFET funding are also planning to dedicate a smaller share of the investment allocation to demand-side solutions. These include e-mobility, waste and recycling and water solutions. The outcomes that can be expected from investing in demand-side sectors will be dependent on the fund manager chosen and the strategy of the specific fund.

A less quantitative outcome of BFET is related to the chosen fund manager. The programme has potential to support first-time fund managers to successfully raise capital or fund managers that have not previously been able to attract significant amounts of private capital. The catalytic capital (and the loss protection it

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<sup>8</sup> [Just Transition Finance Tool](#)



offers to private investors) may also create incentives for fund managers to invest in less mature markets, less mature sectors or less mature companies, thereby contributing to bridging the large financing gaps in emerging markets.

#### Draft results framework matrix

Programme Title		Blended Finance Energy Transition (BFET)
Objective		Using catalytic funding (provided by Denmark, USAID, the US Special Presidential Envoy for Climate and potentially others) to mobilise up to USD 1 billion of private capital to support the green energy transition in high-emitting emerging markets.
Impact indicators		GHG emissions avoided, capital mobilised for impact investments
Baseline and targets		Baseline is assumed to be zero (impact from BFET assumed additional)
Target	Year	End of fund life (depending on fund manager chosen, likely 10 year fund)
Outcome indicator 1		GHG emissions avoided or reduced
Baseline		0
Target	[2034]	TBD
Outcome indicator 2		Amount of private capital mobilised towards sustainable, Paris-aligned and SDG aligned investments
Baseline		0
Target	[2034]	TBD
Outcome indicator 3		Affordable and reliable green energy generated in investments, supporting access to electricity for underserved communities (measured as MW)
Baseline		0
Target	[2034]	TBD
Outcome indicator 4		Net change in employment from transition investments
Baseline		0
Target	[2034]	TBD
Outcome indicator 5		Share of jobs created that meet ILO's criteria for Decent Work
Baseline		0
Target	[2034]	TBD
Outcome indicator 6		[Relevant demand-side indicator – e.g. kilometres driven replaced by EVs instead of fossil fuel powered vehicles]
Baseline		0
Target	[2034]	TBD

## 5. Inputs/budget

The MFA is planning to contribute 100.0 mio. DKK (approx. USD 14.7m) to the catalytic capital for BFET, invested through and managed by IFU. In addition, a mid-term review is expected to be conducted to assess the success of the programme.

Use	Amount (DKKm)
Capital contribution to BFET <sup>9</sup>	99.5
MFA review	0.5
<b>Total contribution</b>	<b>100.0</b>

IFU's expected return on the capital invested will be calculated as part of the final negotiations with the winning trust fund manager(s). IFU is expected to commit the full amount in 2023. Once the capital are successfully invested from the BFET trust fund(s) into projects the MFA will close this appropriation<sup>9</sup>. Financial reporting on BFET will thereafter follow IFU's general reporting systems to MFA. Reflow of funds and returns from the investments to IFU will be an integrated part of IFU's capital and business activities, in line with IFU's investment mandate.

The grant period is expected to be between [2-4] years until full deployment of funds. The investment period is expected to be between [8-20] years – until [2031-2043]. Both timelines depends on the winning proposal(s).

## 6. Institutional and Management arrangement

IFU will invest the allocated capital into the chosen fund structure applying the scrutiny, diligence and monitoring of the investment cycle and process. IFU applies EDFI's Environmental and Social Standards for Fund Investments for all IFU investments in funds. IFU's requirements also include issues related to corporate governance and business ethics as well as green and/or just and inclusive impacts.<sup>10</sup>

The progress and performance of the fund will during the course of the investment be monitored by IFU, with one of IFU's investment professionals allocated as a Portfolio Manager for the investment. Regular reporting will be done by IFU to the MFA on the performance of the fund, and reporting materials from the fund manager will also be shared with the MFA. Reporting materials are expected to contain status on capital deployment in the investment portfolio, job creation, GHG reduction/avoidance etc. in accordance with the results matrix.

The fundraising for the fund as well as investment activities will be the responsibility of the chosen fund manager(s). IFU will participate in the governance of the fund in an investor role, and the exact governance structures will be determined together with the fund manager(s) in the contract negotiations. IFU and the MFA will in the negotiations with the fund manager(s) strive to ensure that the compensation to the fund manager(s) is, at least partially, linked to the impact outcomes expected for the programme.

When funds are fully deployed by the fund manager(s) into investments a review will be conducted by MFA to evaluate the expected impact at that point in time and to harness lessons learned for future blended finance cooperation.

## 7. Risk Management

The main risk with the BFET funding is related to the fundraising of private capital. There is a risk that with the catalytic, first-loss, capital from BFET, the fund manager(s) is not able to mobilise the expected amount of private capital. This risk can be mitigated by working together with fund manager(s) that already has well-established relationships with private investors, a track record of attracting private capital and potentially already a pipeline of interested investors. However, this can be at the expense of additionality, as the capital still need to be considered necessary to unlock the private capital for the fund.

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<sup>9</sup> Building on guidance in "Vejledning for håndtering af kapitalindskud fra Udenrigsministeriet til IFU".

<sup>10</sup> IFU Sustainability Policy (2022) [www.ifu.dk/wp-content/uploads/2022/07/Sustainability-policy-final-20220623-signed.pdf](http://www.ifu.dk/wp-content/uploads/2022/07/Sustainability-policy-final-20220623-signed.pdf)

Related to the above argument, there is a risk that the BFET capital is not additional to the extent hoped and intended. If the capital is awarded to a fund structure that would have been able to raise impact aligned private capital without it, it would not be sufficient catalytic. This is a key screening condition when choosing the fund manager(s) to work with.

Execution risk is also relevant to consider. There is a risk that even if the fund manager is able to raise sufficient capital, it is unable to deploy the capital into relevant investments. This could be due to a lack of deals that meet the likely stricter risk/return expectations of commercial private investors (even with catalytic capital), due to stiff competition for relevant deals or due to adverse changes in market conditions.

There is also a risk that the investments are not able to achieve the impact that they were expected to create. This is more relevant for debt funds, which as debt providers will have fewer tools at their disposal to influence the operations of their investees. It is however also a risk to consider in relation to equity funds that take minority roles in their investments, especially when there are other strong investors or shareholders. This risk is best mitigated by ensuring that complete due diligence is carried out and that alignment on impact priorities is clear before the investment.

A risk that is however more relevant for equity funds is the risk of not being able to exit the investments. If relevant buyers for the investments cannot be identified towards the end of the holding period, there is a risk that the intended return cannot be realised for the private investors. This is an inherent risk with equity investments which is difficult to fully eliminate, but it can be mitigated through e.g. the deal structure (ideally by including a sell option on another shareholder) or through exits rights (such as being able to tag-along with or drag-along other shareholders in an exit process).

A common risk in fund investment is misalignment in incentives between investors and the fund manager. If the fund underperforms to the extent where the fund manager will not receive any performance above the fixed management fee, there can be an incentive for the fund manager to deprioritise working with the investees and exiting the investments and instead extend the time during which they receive the fixed fee. This risk depends to a great extent on the compensation structure agreed with the fund manager, and can best be mitigated by ensuring that there are strong investor / LP rights and a well-functioning governance structure and strong incentives to perform and not to expand the timeline of receiving fees.

Finally, the BFET structure and the chosen fund(s) will be exposed to all the “standard” risks of investing in developing markets: negative macroeconomic developments incl. currency depreciation, regulatory issues including with permitting, adverse political interventions or even wars and conflicts. This is partly mitigated by the targeted countries being slightly lower risk and more stable than many other developing economies. The fund is further expected to have an adequate diversification both geographically and sector-wise to spread its risks.

## Annex 2: Partner Assessment (draft)

IFU was established in 1967. IFU equity stood at DKK 4.6bn by the end of 2022 with total capital under management of DKK 15.6bn. IFU provides financing on a commercial basis through equity, loans and guarantees and advice to climate and SDG impactful project companies in emerging markets and developing economies. IFU can invest in all OECD DAC countries. The aim is to undertake investments with a significant positive climate and development impact, which would not otherwise be undertaken on standard market terms due to high (perceived) risk. IFU undertakes direct investments into companies, investments into other funds managed by IFU and into funds/financial intermediaries managed by third party capital managers.

IFU manages several funds such as the SDG Equity Fund where 60% of the funding are from private investors. In addition, IFU manages part of the Green Future Fund and facilities with contribution from the Ministry of Foreign Affairs such as the India Climate Finance Initiative, the Ukraine Facility, the Project Development Programme, the High Risk, High Impact Facility, and Danish Sustainable Infrastructure Finance. IFU also manages a guarantee with a frame of DKK 2bn.

In 2017, IFU was untied from Danish commercial interests. The untying has provided IFU with more opportunities for impact investments enabling IFU to grow its impact significantly. IFU's purpose, stated in the law for international development cooperation (§9) is to promote investments that support sustainable development and contribute to the realisation of the SDGs in these countries. The overall strategic framework for IFU is set out in a hierarchy of documents as follows:

- Law for International Development Cooperation (lov om internationalt udviklingssamarbejde)
- Danish development policy strategy (The World We Share and related political agreements)
- The Ownership document, based on Statens Ejerskabspolitik (the Danish State's policy for ownership of companies) and formulated within the frame of the law and strategy mentioned above (new Ownership document underway (attached as appendix 1))
- IFU's statutes (approved by the board)
- IFU's strategies and policies approved by the IFU board

IFU is a self-governed institution. The Minister responsible for development cooperation has the oversight responsibility. The Minister appoints the board members (3-year term), the board chair, vice chair, and IFU's CEO. The MFA is represented in the board by an observer. The Minister meets annually with the Board's Chair, Deputy Chair, the CEO and the Deputy CEO to take stock of performance, approve the annual report as well as discuss the overall strategic issues related to the ownership document etc. The MFA leadership (State Secretary for Development Policy) meets twice a year with the IFU board chair and vice chair for strategic follow-up. Senior management of Ministry of Foreign Affairs meets quarterly with senior management of IFU for mostly operational follow-up.

The responsible Minister's supervision of IFU further consists in ensuring that the Danish state's applicable regulations in the area are complied with by IFU, and that good practice for legal-critical review as well as financial and management audit is observed, including standards for public audit (offentlig revision). Based on recommendation from the board, the Minister appoints an audit company with international experience, which undertakes audit of the annual account in accordance with Danish and international audit standards.

The IFU board is responsible for assuring that the strategic management of IFU are aligned to and within the parameters of the ownership document (and hence the law and development policy etc.). The board

is hence responsible for IFU's strategies and policies and for ensuring that IFU complies with these. The CEO is responsible to the board for implementing strategies and policies set by the board.

The primary rationale for the state ownership of IFU is to mobilise private capital to promote sustainable and responsible investments in developing countries, where it would otherwise be difficult or impossible to implement investment projects because of too high risks perceived by the private sector. IFU's participation in such investments can mitigate the risk and thereby mobilise finance and technology to developing countries in line with the countries' development plans. This mobilisation can be in a concrete investment that IFU take part in or over time as IFU help develop a company to become attractive to more private investors and eventually exit the investment, ideally to a private investor and redeploys the capital.

As responsible "owner" of IFU, the Ministry of Foreign Affairs has embarked on a reform process with the aim to strengthen IFU over the coming years (2024-2030) to significantly increase IFU's capabilities to increase its investments and impact in climate and in lower income countries and countries affected by fragility or conflict with a strong focus on Africa.

The intention is to strengthen IFU in the coming years so that IFU can better support Denmark's global climate commitments and the development policy priorities as an innovative, trend-setting development financing institution.

It will be the responsibility of IFU to ensure that its investments are additional, including financially and developmentally additional, and at the same time ensure high standards regarding environment, social, governance and human rights. IFU will be obliged to document additionality appropriately in all investments in line with relevant OECD standards.

## Annex 8: Process Action Plan

PROCESS ACTION PLAN		
Activity	Timing/deadline <i>[month or quarter]</i>	Responsible
Finalisation of project/programme document following PC meeting	30. aug. – 6. Sep.	GDK
Appraisal	6. sep. – 20. Sep.	ELK/GDK
Follow up on appraisal recommendations	20. sep. – 9. Oct.	GDK
Presentation for the Council for Development Policy (UPR)	26 Oct.	GDK
Finalisation of project/programme documentation	26. oct. – 30. Oct.	GDK
Approval by the Minister	30. oct.	GDK
Expected timing of commitment	30. oct.	GDK