

Development Guarantee Facility

Grant for guarantee subsidies, technical assistance and administration

<p>Key results:</p> <p><i>Outcomes:</i></p> <ol style="list-style-type: none"> 1. Increased mobilized climate finance 2. Increased access to finance for SME's primarily in Africa 3. Increased access to finance for women and youth entrepreneurs <p>Justification for support:</p> <p>Development guarantees is according to OECD DAC the most effective financial instrument to increase private sector investments for development. A long track record at Sida shows significant potential for a Danish guarantee facility to deliver additional development results in parallel to the Danish official development aid budget.</p> <p>Major risks and challenges:</p> <p><i>The reliance of IFU on Sida in originating new guarantees is also a risk in the sense that IFU is only able to enter into new guarantee arrangements jointly with Sida. The internal organisation of Sida, with decision-making for all guarantees being delegated to the various teams and embassies implementing different bilateral/ regional/ global strategies means that IFU will need to keep close relationships to many different stakeholders within Sida to ensure a relevant pipeline for IFU.</i></p>	File No.					
	Country	Global				
	Responsible Unit	GDK				
	Sector	Financial sector				
	Partner	IFU				
		<i>DKK million</i>	2023	2024	2025	Total
	Commitment	45	50	50	145	
	Projected disbursement	45	50	50	145	
	Duration	2023-2025				
	Previous grants	10 mio. Kr.				
	Finance Act code	§06.38.01.16. Udviklingsgarantier				
	Head of unit	Karin Poulsen				
	Desk officer	Jesper Hilsted Andersen				
Reviewed by CFO	YES: Rasmus Ewald					
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		

Strategic objectives

The overall objective of this grant is to allow the Development Guarantee Facility to deploy subsidies and technical assistance to enhance the development impact of guarantees for climate finance and access to finance in support of job creation and climate action, mainly in low-income countries in Africa.

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

	Climate adaptation	Climate mitigation	Biodiversity	Other green/environment
Indicate 0, 50% or 100%		50%		50%
Total green budget (DKK)		72,5		72,5

Justification for choice of partner:

In 2022, IFU was formally chosen to host development guarantees based on its experience with development finance. The present commitment will allow for higher impact of development guarantees. Helping beneficiaries pay for the guarantees based on expected development outcomes is an integral part of the model, and experience shows that targeted technical assistance can further magnify the impact of interventions.

Summary:

A contribution to increase access to finance for SMEs, primarily in Africa applying a youth and gender lens where relevant and promote sustainable economic development with a climate change focus. The aim is to make loan guarantees accessible to broader and underserved groups and make use of technical assistance to address barriers, and empower disadvantaged groups, leading to broad based sustainable economic growth and poverty reduction.

Budget (engagement as defined in FMI):

Engagement 1 – Administration	DKK 25 mil.
Engagement 2 – Subsidies to financial intermediaries premium payments	DKK 90 mil.
Engagement 3 – Technical Assistance	DKK 30 mil.
Total	DKK 145 mil.

DRAFT
Programme Document

Development Guarantee Facility

- **Grant for Guarantee Subsidies, Technical Assistance
& Administration**

July 2023

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List of Abbreviations

AGF	African Guarantee Fund for Small and Medium-Sized Enterprises
DAC	Development Assistance Committee
DFI	Development Finance Institutions
DGF	Development Guarantee Facility
DKK	Danish Kroner
ESG	Environment, Social and Governance
GDK	Green Diplomacy and Climate department of the Ministry of Foreign Affairs
GNI	Gross National Income
IFC	International Finance Corporation
IFU	Investment Fund for Developing Countries
LDC	Least Developed Countries
MFA	Ministry of Foreign Affairs of Denmark
M&E	Monitoring and Evaluation
MSME	Micro, Small and Medium Enterprises
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PPP	Public Private Partnership
RKG	Riksgälden – National Debt Office of Sweden
SDG	Sustainable Development Goals
Sida	Swedish International Development Cooperation Agency
SME	Small and Medium Enterprises
UNFCCC	United Nations Framework Convention on Climate Change
UNGP	United Nations Guiding Principles on Human Rights and Business
USD	United State Dollar
WB	World Bank

1 Introduction

The present programme document outlines the background, rationale and justification, objectives and management arrangements for support to the Development Guarantee Facility (DGF) during a pilot period (2022-2025) as agreed between the parties: The Investment Fund for Developing Countries (IFU) and the Ministry of Foreign Affairs of Denmark (MFA).

Given the additional development potential of development guarantees and the extensive experience available at Sida for a bilateral cooperation with Denmark, the Danish Government's Financial coordination committee approved a Danish pilot phase in 2021 to develop a guarantee facility under IFU in close cooperation with Sida and the Swedish National Debt Office. With the Finance Act for 2022, a frame of DKK 2 billion has been given for issuance of state backed guarantees for climate and development purposes. The Finance Act also includes an account to subsidize the risk premiums paid by intermediaries (banks, investment trust funds etc.) as well as for capacity building and management of the scheme. During 2022 the guarantee agreements between Sida, IFU and MFA was signed and a guarantee team established at IFU.

Moving from the capacity establishing phase at IFU in 2022/2023 to the implementation phase in 2023-2025, DKK 30 million is allocated in 2023 for risk premium subsidies and DKK 10 million for management of the scheme and the first guarantees are expected to be signed. Similar allocations are envisaged for the remainder of the pilot phase (2024 and 2025) with an addition of DKK 10 million for technical assistance for capacity building in parallel to some guarantees. In total DKK 50 million for the instruments management costs at IFU, risk premiums subsidies and technical assistance is allocated at The Finance Bill for 2024 as part of '§6.3. Bistand til udviklingslande'.

This programme document defines the objectives and management arrangements for a grant to IFU for

- (i) management of the Development Guarantee Facility, a pilot program (2022-2025) introducing development guarantees in Danish development cooperation;
- (ii) subsidies to risk premium payments by financial intermediaries of development guarantees;
- (iii) technical assistance to support new lenders' and borrowers' full realisation of the benefits of guaranteed finance.

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 strategy for climate action and the Government's ambition to use risk willing public funding to mobilize private capital towards climate finance.

2 Programme context

In today's global financial and macroeconomic landscape, mobilizing finance for development has become increasingly crucial for countries aiming to achieve sustainable economic growth and alleviate poverty. The SDG financing gap in developing countries is estimated to approx. 4 trillion dollars annually according to the OECD. 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 2030 for emerging markets and developing countries to keep the target of 1.5 degrees within reach. This figure puts the 100 bn. Dollar climate finance target from COP15 into perspective as a call 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.

Guarantees can act as powerful tools for mobilizing finance and attracting both domestic and international investors. According to OECD, guarantees for development is one of the most effective tools for mobilizing private capital for development with a minimal use of ODA.

It is often relevant to support the implementing parties (the banks and/or their borrowers or other relevant partners) with technical assistance on, for example, the development of business plans and credit assessment of investments into the environment and climate financing space. In this context, the guarantee facility at IFU can advantageously provide a contribution that enables the provision of technical assistance to support the developmental purpose of the guarantees.

2.1 Background and thematic context

One key advantage of guarantees is their ability to unlock existing liquidity from the private sector into new investments. By assuming a portion of the risk, guarantees encourage commercial banks and private investors to provide financing that they might otherwise perceive as too risky. This expanded access to funding promotes investment in sectors and regions that are typically underserved or deemed high-risk. Consequently, guarantees act as catalysts, stimulating private sector involvement in development projects and leveraging additional financial resources. Guarantees facilitate access to finance from the private sector by sharing the risk burden and reducing perceived investment risks.

Development guarantees can address a range of thematic issues across sectors, country credit risk categories and income levels. Aligning with the Danish Government's development policy priorities a central focus in the implementation of the guarantee instrument will be given to addressing climate change and financing just energy transitions eg. in middle income developing countries, as well as increasing access to finance in the poorest and fragile countries no least in Africa, while also focussing on access to finance for women and youth.

Mobilizing climate finance

Climate change poses a significant challenge especially for developing countries not least countries in Africa south of Sahara, as large parts of the continent is highly vulnerable to the impacts of global warming. Rising temperatures and changing weather patterns are affecting agriculture, water resources, and by implication economic opportunities and prospects for many citizens. In addition, extreme weather events such as floods and droughts are becoming more frequent and severe, causing displacement and insecurity. African countries have large populations with high degrees of poverty, making it difficult for countries to adapt to the effects of climate change.

Guarantees can leverage resources and mobilize additional investment for eg. renewable energy, sustainable agriculture, and water management. This can help build resilience to climate change, reduce greenhouse gas emissions, and promote sustainable economic growth. Guarantees can also support the development of financial markets and business models that can help address the financing gap for climate action in Africa. The ambition is to promote sustainable development in Africa addressing the challenges of climate change.

Access to finance

Creating better access to finance is a critical tool for addressing development challenges, including the

consequences of climate change, inequality, and poverty reduction. Not least in Africa. Lack of access to financial services especially for small and medium enterprises (SME's) is a major barrier to economic growth and job creation. With little access to formal sector finance, entrepreneurs and small businesses struggle to invest in productive assets, and cope with unexpected shocks. This perpetuates a cycle of poverty and limits opportunities for upward mobility and economic expansion. A central focus of the guarantees will be to promote lending to small African businesses and entrepreneurs who would otherwise not be able to obtain loans for new investments. Development guarantees can increase access to financial markets and banks for otherwise underserved groups. When SMEs save, invest, and grow, they create jobs and opportunities for more equitable and sustainable societies.

Focus on Africa

Several countries and situations in Africa are characterized by fragility and conflict. Development guarantees will be relevant in these situations to support investments that are fundamental for building resilience and putting these economies on a sustainable development path. In these geographies transaction costs and risks are relatively high, and capacity to pay for risk premiums is low. The need for subsidies and technical assistance is primarily needed in these contexts.

Including a focus on women and youth

Another significant challenge facing many developing countries is the gender gap in access to finance. Women are often excluded from the formal financial system, making it difficult for them to save, invest, and build assets. This limits their ability to contribute to economic growth and perpetuates gender inequality. Expanding access to finance for women can promote gender equality and enhance women's participation in economic activities, leading to sustainable development. Young people constitute another group that can be helped to overcome barriers accessing formal financial services to build more sustainable and prosperous lives.

IFU as implementing partner

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 impact. 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. Development guarantees can benefit from the same systems with a few pertinent additions where necessary.

At a strategic level, preliminary experience shows that deployment of regular IFU blended finance funds through equity and loans must take into account the high return requirements and short time horizons of institutional investors. This means that the mobilized funds under IFU management, such as the SDG Fund prioritise investments with a lower risk profile in relatively mature developing markets. Development guarantees do not have a return requirement, but seek to strike a long-term balance between income and losses, which maximizes the development impact per DKK supported by ODA. Thereby adding guarantees to IFUs toolbox provide a new lever for IFU to engage in lower income countries and fragile states to a larger extent than previously.

2.2 Lessons learned

The Danish development guarantee facility is modelled on the set-up in Sweden and guarantees are issued in collaboration with Sweden during the pilot period. Sweden's development guarantee program was formally launched in 2009 with a guarantee frame of SEK 5 billion with security in the state's balance sheet. The guarantee frame has been continuously increased and today amounts to SEK 20 billion.

When issuing a guarantee under the development guarantee programme, the Swedish Riksgälden (the Swedish state's internal bank) determines the government's credit risks for the guarantee. The risk can be financed by charging risk premiums from the guarantors, possibly is subsidized by Swedish development aid. Income from risk premiums and subsidies is accumulated on a guarantee reserve, which is used to cover future losses on Sida's guarantee portfolio.

At the end of 2020, Sweden had an active development guarantee portfolio of SEK 8.8 billion. The portfolio contains 40 guarantees across 23 countries and regions. The portfolio contains six large guarantees to multinational development banks totalling SEK 4.6 billion. In total, the guarantees underwritten by Sweden have mobilized SEK 24.3 billion in private capital. The majority (84 percent) of the Swedish guarantees are provided in the areas of renewable energy, sustainable infrastructure, and market development.

Of Sida's total guarantee portfolio, 70 percent are loan portfolio guarantees, which cover a proportion of banks' lending to selected recipient groups. The purpose of these guarantees is typically to promote local banks' lending to SMEs, mainly in Africa. Guarantees are designed to secure the financing of investments in renewable energy and cover the entire range from small household solar installations to large wind farms.

At the end of 2020, the loss rate (the amounts disbursed from guarantees that have been triggered) stood at 1.12 percent of the total guarantee amount to beneficiaries. The loss rate of 1.12 percent is significantly lower than the expected loss on Sida's portfolio, which was estimated to be 10.27 percent. However, many guarantees have not yet expired, which is why more future losses can and should be expected. In the long term, the loss rate should be expected to be equal to the calculated expected losses.

2.3 Justification of programme design

In terms of explaining and justifying the design of the proposed grant it is important to consider key aspects such as relevance, efficiency, effectiveness, impact, sustainability and additionality.

Relevance: Development guarantees are relevant in situations and investment environments where there is a high degree of risk or uncertainty. For example, banks may be reluctant or hesitant to invest in renewable energy projects because of concerns about the sector and / or the sponsors or borrowers, who often may lack the required collateral and financial “track record”. In such situations, credit guarantees can provide assurance that the investment will be protected, and that the bank will be repaid. In essence guarantees can be useful in situations where there is a lack of trust or understanding between different stakeholders, such as banks and potential investors. In many contexts it may be useful to supplement these guarantees with technical assistance.

Efficiency: Development guarantees is an efficient way to mobilize private investment for climate and development projects. By making projects bankable or investable, development guarantees can help attract private investors, who may otherwise be hesitant to invest in projects with high perceived levels of risk. Using *un-funded guarantees* is a particularly efficient version of development guarantees as less capital is provisioned for losses than funded guarantees, where sometimes half the guaranteed amount is provisioned for expected losses. While being efficient in the use of ODA and provisioning the development of a guarantee portfolio can be a resource demanding and less efficient process. As a rule of thumb one in three potential guarantee negotiations succeed in reaching a signature on financial close. A series of causes can lead to negotiations not succeeding in a signed guarantee, while it is most often not possible to predict in advance as information unfolds during negotiations.

Effectiveness: The OECD-DAC report on development guarantees underlines development guarantees have proven to be the most effective instrument towards mobilizing private finance for development. Quote from the executive summary: *Guarantees are also uniquely suited to mitigate commercial, credit and political risks, and they can bring financial additionality by changing the risk-return profile of investments and alleviating credit restrictions for underserved borrowers.*¹

The effectiveness of the individual guarantees depends on a variety of factors, including the design of the guarantee, the quality of the underlying project, and the ability of the guarantee beneficiary to utilize the guarantee for the intended purpose. The partnership with Sweden gives access to many years' worth of experience with guarantee design – also in complex and fragile situations. This is one of the main reasons for including technical assistance under the facility. Appropriately designed and executed guarantees increase effectiveness, and ultimately the likelihood of success. To be effective, guarantees must be structured in a way that provides sufficient incentives for private investors and or banks to invest in projects.

Impact: The impact of development guarantees can be significant, particularly in situations where private investment is needed to achieve development outcomes. By providing assurance to investors, development guarantees can help to mobilize private investment that might not otherwise be available. This investment can then be used to finance projects that have the potential to create jobs, improve infrastructure, and enhance the overall quality of life for local communities. In negotiating the guarantee support for investment funds, development impact targets are set as a requirement for the fund manager (eg. The MDB or private asset manager) to deliver as part of the investment targets. Eg. Local job creation for decent jobs, gender balancing, green house gas emission reduction targets, new grid connections etc.

Sustainability: The underlying projects and investments may contribute to sustainable outcomes eg. in terms of environmental impact and climate change (adaptation and mitigation) if appropriate screening and eligibility criteria and safeguards are applied. Here the guarantee facility relies on the strong and demonstrated expertise of Sida and the impact investment capacity of IFU. The financial sustainability of the development guarantee facility hinges on professional underwriting, careful design of guarantees, and not least data analysis and proper risk assessment. Guarantees will only contribute to more sustainable outcomes if it is financially sustainable. If a development guarantee is issued for a project that is not sustainable over the long term, the guarantee will not be effective in achieving the desired development outcomes. Experience shows that targeted technical assistance can make a difference to that end and should be combined with guarantees in relevant contexts to achieve better sustainability.

Additionality: The additionality of development guarantees refers to the extent to which the guarantee mobilizes investment that would not otherwise be available. Analysis to ascertain with confidence that development guarantees are likely to be additional and not crowd out commercial alternatives is fundamental. This is important for claiming development impact of the supported projects and interventions and for respecting rules on use of state aid in a way that does not distort markets.

Development guarantees can be a useful tool for mobilizing private investment and achieving development outcomes. However, the effectiveness of these guarantees depends on a variety of factors, including the design of the guarantee, and the characteristics and quality of the underlying project or engagement. Additionally, the sustainability and additionality of development guarantees must be carefully considered to ensure that they are effective in achieving the desired development outcomes.

¹ OECD-DAC report: “The Role of Guarantees in blended finance”, May 2021, page 11. Link: [The role of guarantees in blended finance \(oecd-ilibrary.org\)](https://oecd-ilibrary.org/blended-finance)

3 Programme presentation

3.1 Objectives and outcomes

The overall development objectives of this grant are (i) to mobilize additional private capital for investments in sustainable development, in line with the Danish Strategy for Development Cooperation, with a special focus on mobilization of climate finance and access to credit markets for underserved groups and sectors; (ii) to promote sustainable economic development, (iii) to limit climate change and help address its consequences, and ultimately (iv) to contribute to more sustainable societies to reduce poverty.

The immediate objective is to increase access to finance for small and medium-sized enterprises (SMEs), including those owned by youth and women, and to promote sustainable economic development with a particular focus on engagements related to climate change (adaptation and mitigation). By increasing access to finance and support services, SMEs will be able to grow their businesses, create jobs, and contribute to the economic development of their communities. This will lead to increased income and livelihood opportunities for individuals and families, as well as the development of local economies and the reduction of poverty.

Annex 1 presents an explainer on how guarantees work depicting the flows from MFA, through IFU to intermediaries and to the end beneficiaries. Subsidies for intermediate financial entities (banks, funds etc.) and technical assistance to enhance the development impact of guarantees for access to finance will support job creation and climate action, mainly in low-income countries in Africa. This will support the programme ambition of developing a balanced guarantee portfolio that supports the climate and development priorities of the Danish Government with strong capital mobilization effect, providing access to finance for underserved groups and sectors - grounded in solid risk assessments.

3.2 Eligible countries

In principle, all countries on the OECD DAC list are eligible for use of development guarantees. Given the objectives of the proposed grant, the primary focus will be on Africa. Guarantees and interventions in other geographies may also merit support if the objectives of addressing climate change (adaptation and mitigation) or other development aspects justify use of subsidies and technical assistance.

Specifically, it is expected that guarantees can be usefully deployed to support the overall development objectives of partnerships that Denmark has with a number of countries.

3.3 Other strategic considerations

IFU is a signatory to the IFC Operating Principles for Impact Management, which is a framework for investors for the design and implementation of their impact management systems, ensuring that impact considerations are integrated throughout the investment lifecycle. The Impact Principles instil a discipline around impact investing, fostering greater mobilization of capital for impact and a high standard for the social and environmental impact that it can achieve. Development guarantees are underwritten in accordance with IFU's mandate to invest for impact.

The capital mobilized for climate investments can be reported to the UNFCCC (UN Convention on Climate Change) as part of Denmark's global climate contribution. For example, a development guarantee of DKK 100 million, which mobilizes DKK 200 million from private investors for climate action, the full mobilization of DKK 200 million is included. Thereby the development guarantee facility will support the government's ambition to contribute at least 1.0 percent of the developed countries' goal of mobilizing USD 100 billion annually in global climate finance for developing countries.

Gender inequality is a pervasive challenge in Africa that undermines human development, economic growth, and social stability. Women and girls in Africa face significant barriers to accessing education, healthcare, and economic opportunities, which limits their potential and contributes to poverty and social exclusion. Women also face gender-based violence and discrimination, which not only violates their human rights but also limits their ability to participate fully in social and economic life. Addressing gender inequality is essential for promoting inclusive and sustainable development in Africa.

4 Theory of change and key assumptions

Goal: To increase private capital mobilization for Danish development priorities including climate change mitigation and adaptation, as well as increasing access to finance eg. To SME's with a particular focus towards SME's owned by youth and women.

Development guarantees mobilize investments by addressing failures in financial markets in developing countries. These market failures occur when banks and other financial institutions refrain from lending to certain groups of recipients, such as (micro) small and medium sized enterprises (MSMEs), investments in energy efficiency, renewable energy, and marginalised groups. Commercial banks often have limited knowledge of these client groups and technologies, and thus assess the risk of lending higher than it actually is. This results in otherwise sound projects and business ideas not being financed. Neglecting these groups and segments may entail a significant loss to the economy and hold back growth, development and job creation.

By increasing access to finance and support services, large scale green infrastructure projects, new business ventures and existing SMEs will be able to grow their businesses, create jobs, and contribute to the economic development of their communities and regions. This will lead to increased income and livelihood opportunities for individuals and families, as well as the development of local economies and the reduction of poverty.

In addition, providing technical support to eg. Banks and asset managers will help to address some tangible aspects of the discrimination and prejudice that holds back loans to the targeted sectors. Helping these groups access finance will contribute to their empowerment and provide the resources and skills necessary for their projects to succeed. They will be better equipped to overcome barriers and achieve economic and social empowerment. This will contribute to the broader goal of promoting gender and youth equality, as well as the United Nations Sustainable Development Goals related to better jobs and climate change and of reducing poverty and promoting economic growth and development of more sustainable societies.

By addressing some of the root causes of insufficient investments in climate and productive employment opportunities, guarantees have the potential to create sustainable change and contribute to a more equitable and prosperous future – also in difficult and fragile contexts.

Assumptions:

- Barriers for accessing capital for adapting and building more climate change resilient operations is holding back investment in many developing countries and emerging markets
- SMEs face challenges in accessing finance due to lack of collateral, credit history, and financial management skills.
- Providing credit guarantees and technical assistance can mitigate the risks associated with lending to SMEs, making it more attractive for lenders to provide financing.
- By increasing access to finance, SMEs will be able to grow their businesses, create jobs, and contribute to the economic development of their communities.

- Youth and women-owned businesses face additional barriers in accessing finance due to systemic discrimination and lack of social capital.
- Providing targeted support to youth and women-owned businesses will help to address these barriers and promote inclusive economic growth.
- These types of engagements will require subsidies to pay the risk premium of the guarantees.

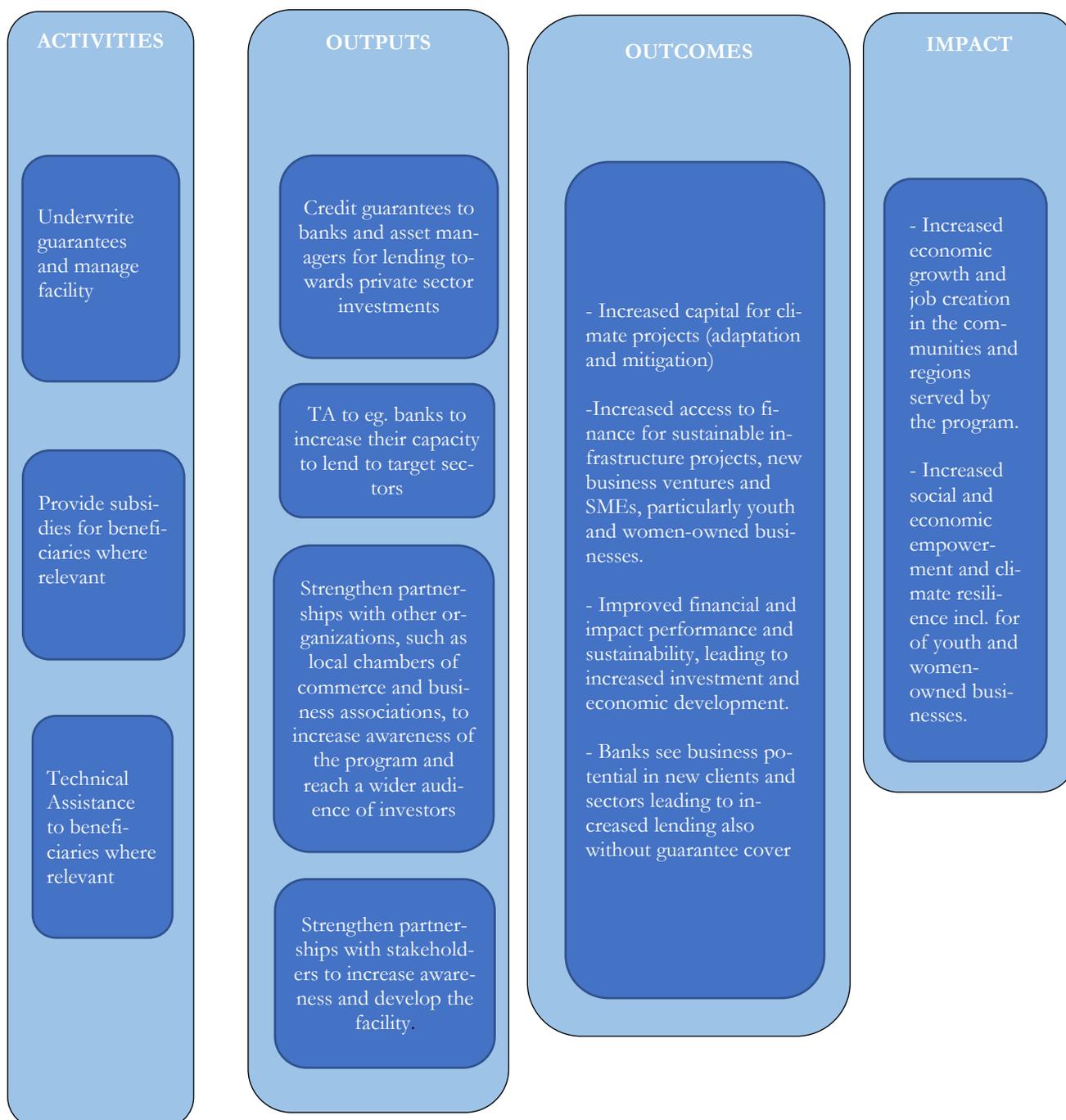
Activities and outputs:

- Provide credit guarantees to enhance lending to eg. SMEs, where relevant including youth and women-owned businesses, to encourage lending and reduce the risks associated with lending to these businesses.
- Provide technical assistance to eg. Banks and asset managers, with a focus on assessing clients and projects related to climate and energy efficiency to help them build capacity and increase their loan books in these areas.
- Work with financial institutions to increase their capacity to lend to eg. SMEs and provide targeted support to youth and women-owned businesses.
- Develop partnerships with other organizations, such as chambers of commerce and business associations, to increase awareness of the program and reach a wider audience of financial institutions and asset managers.
- Monitor and evaluate the program to measure its impact and the wider community, and make adjustments as necessary to ensure its effectiveness.

Outcomes:

- Increased loans to climate relevant projects (adaptation and mitigation)
- Increased access to finance for infrastructure projects, new business ventures and SMEs, particularly youth and women-owned businesses.
- Increased economic growth and job creation in the communities and regions where investments are spurred.
- Increased social and economic empowerment of youth and women-owned businesses especially in African countries.
- Improved financial performance and sustainability of SMEs, leading to increased investment and economic development.
- Banks and asset managers see business potential in new clients and sectors leading to increased lending also beyond a guarantee cover

Programme level Theory of Change diagram



5 Summary of the results framework

To monitor the delivery of impact, IFU has defined impact targets at portfolio level. To date, portfolio targets have been set for climate finance and gender lens investing. Monitoring of financial performance, application of environmental, social and governance (ESG) safeguards, as well as business integrity screening and impact monitoring of the engagements feeds into annual reporting. In the case of guarantees this will include reporting from guarantee beneficiaries. IFU is continuously developing the monitoring and evaluation system for documenting development effects of engagements based on

standard indicators such as: Number of direct and indirect jobs (total, female, youth); Installed capacity of renewable energy; Avoided CO2 emissions and number of female clients in financial institutions.

Table 2: Summary of the results framework

Programme	Development Guarantee Facility - Beneficiary Subsidies, Technical Assistance and Administration
Programme Objective	<p>The objective of the programme is to develop a balanced guarantee portfolio that supports the development priorities of the Danish Government with strong capital mobilization effect, providing additional mobilized private climate finance and access to finance for underserved groups and sectors - grounded in solid risk assessments.</p> <p>Development Objective: To mobilize additional private capital for investments in sustainable development, in line with the Danish Strategy for Development Cooperation, with a special focus on mobilization of climate finance and access to credit markets for underserved groups and sectors.</p>
Impact Indicator	The impact of development guarantees will be ascertained on the basis of the individual guarantees, which will be issued to cover credit risks across countries and thematic areas/sectors. Impact assessments will be based on the indicators that are retained at the time of underwriting the guarantees, reflecting the specific climate and / or development objectives. These indicators will also be used in relation to evaluations and other ex-post studies of selected guarantees.
Outcomes and outcome indicators	<p>Major outcomes and outcome indicators most likely to be relevant for the initiative include eg.:</p> <ul style="list-style-type: none"> • Increase in installed capacity of renewable energy • Avoided CO2 emission • Mobilized private capital for development with a share towards climate finance • Access to finance created for a number of SMEs, measured by continent • Number of jobs supported and measured by gender, age and continent • Increased climate resilience by number of farmers reached with access to adaptation finance measured by continent • Female financial inclusion beneficiaries

6 Budget

An initial grant of DKK 5 mil. Was committed in 2022 towards the establishment of the administrative capacity at IFU towards the guarantee instrument. An additional grant of DKK 5 mil. At departmental level covers the first half of 2023. The present grant contributes towards the period from second half of 2023 to end-2025. As noted, the present contribution would supplement any administration fees that may be collected from guarantee beneficiaries. No guarantees were issued in 2022, in consequence no administration fees were collected from beneficiaries. In general, administration fees are not likely to be sufficient to cover management and implementation of the facility.

Table 3: Programme budget (million DKK)

Pilot phase implementation period 2023-2025, DKK millions				
	2023 (2. Half)	2024	2025	Total
<i>Administration Income</i>				
Administration fees collected from beneficiaries*	2	3	4	9
Administration (grant from MFA)	5	10	10	25
Total income IFU for admin/mgmt.	7	13	14	34
<i>Administration costs</i>				
Salary costs	3	4,5	4,5	12
Estimated overhead, 150% of salaries	4,5	6,8	6,8	18
Travel	0,3	0,5	0,5	1,3
Risk assessment	0,2	0,3	0,4	0,9
Due diligence	0,6	0,6	0,6	1,8
Total administrative costs	9	10,3	11,4	34
Subsidies for guarantees (grant from MFA)	30	30	30	90
Technical Assistance (grant from MFA)	10	10	10	30
Other costs (up to 10%)**	0	0	0	0
Total grant	45	50	50	145

* Best estimate, but subject to variation depending on actual portfolio of guarantees. Fees collected from beneficiaries will be used to lower the necessary management grant from MFA.

**IFU can reallocate up to 10% of the budget eg. To other costs within the objectives of the grant. A higher reallocation of budget lines beyond 10% requires approval by the MFA.

7 Management arrangements

The MFA and IFU have agreed to the following management arrangement to ensure adequate dialogue and timely decisions with regard to this program.

Within the MFA, the team responsible for IFU will be responsible for coordination on behalf of the ministry with IFU and the guarantee team established at IFU. The coordination will focus on strategic alignment between the development policy priorities and the portfolio pipeline of guarantees in development.

IFU has established a Guarantee Committee to discuss risk and impact of individual proposals, with participation of senior management, investment professionals, legal experts as well as impact and safeguards specialists from IFU. The MFA is represented to also at this level ensure strategic alignment with Denmark's strategy for development cooperation and priorities for climate policy. During the pilot phase, the Guarantee Committee will unanimously submit guarantee proposals to the board of IFU for decision. The Guarantee Committee will also review semi-annual assessments of outstanding commitments.

8 Financial management, monitoring and learning

Financial reporting on the Development Guarantee Facility and use of grants will be integrated into IFU's overall financial reporting as part of the audited annual report.

IFU's impact management system is fully integrated into its investment cycle and involves a number of steps from initial project screening to exit. Development guarantees benefit from the same system with a few pertinent additions where necessary.

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.

Development guarantees will be part of the overall IFU portfolio and reported in the annual report, which will include financial performance data as well as a narrative description of the guarantees. IFU's annual report will also include progress and performance of selected guarantees including the rationale, the additionality as well as the expected climate and development outcomes.

Monitoring of financial performance, application of environmental, social and governance (ESG) safeguards, as well as business integrity screening and impact monitoring of the engagements feeds into annual reporting. In the case of guarantees this will include reporting from guarantee beneficiaries. IFU is continuously developing the monitoring and evaluation system for documenting development effects of engagements based on standard indicators such as: Number of direct and indirect jobs (total, female, youth); Installed capacity of renewable energy; Avoided CO2 emissions and Number of female clients in financial institutions.

A status report have been developed by IFU on the establishing phase from mid 2022 to mid 2023 on capacity building at IFU and initiation of pipeline building. The report will be discussed at IFUs board and will feed into the full version of this project document before presentation for the Council for Development Policy.

An additional joint IFU/MFA review of the development guarantee facility will be conducted before the end of the pilot period. This review will assess progress against targets, the mandate, the quality of procedures and risk assessments, how the approved guarantees support climate and development priorities to assess the merits of continuing support to use development guarantees as part of Denmark's engagement and climate priorities.

A final statement of accounts (covering the entire project period) shall be submitted no later than three months after completion of the pilot period.

9 Risk management

The development guarantees during the pilot phase will be implemented in partnership with Swedish Sida that has more than 10 years of experience with originating and implementing development guarantees. The underlying model for the IFU guarantees is basically the same as for Sida. Sida has an established organisational structure for origination as well as for monitoring guarantees, and a close partnership with the Swedish National Debt Office for risk assessments of the guarantees.

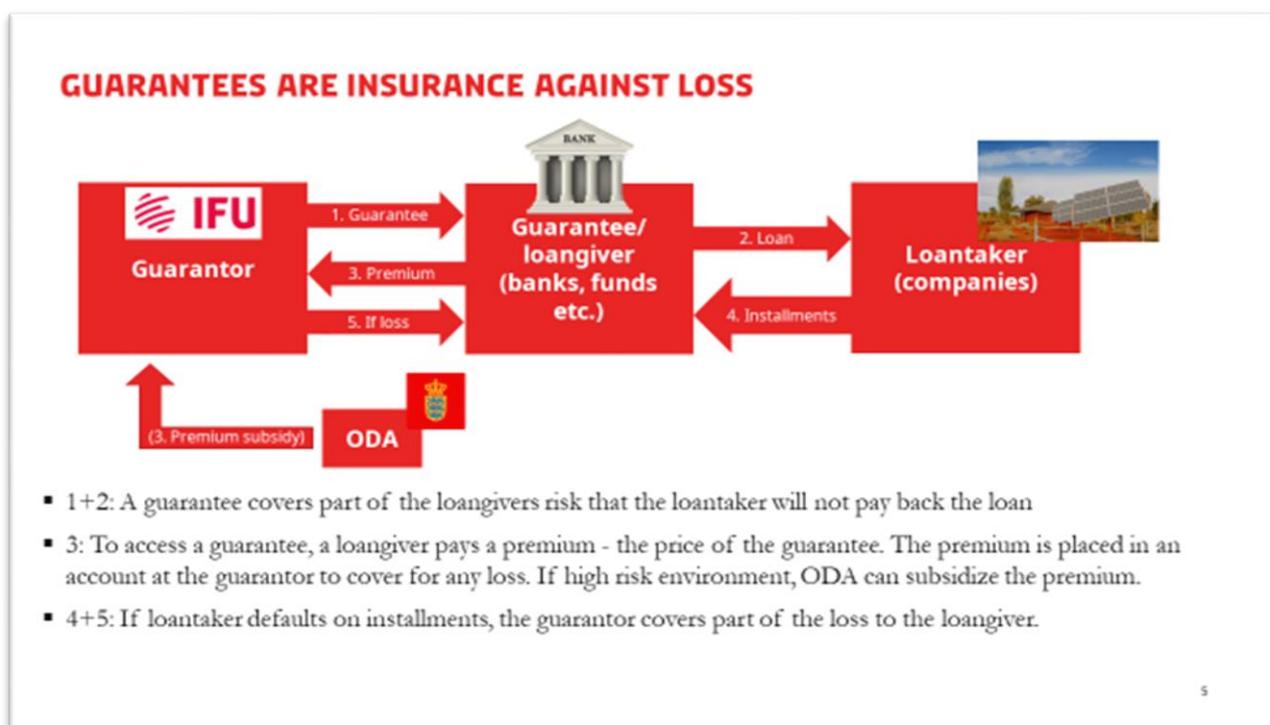
The Debt Office has strong capacity for risk assessment, and it is also the coordination agency for all sovereign guarantees in Sweden. This provides comfort for structuring as well as pricing of Sida's guarantees. During the pilot period, this arrangement will also benefit the guarantees underwritten by Denmark.

The reliance of IFU on Sida in originating new guarantees is also a risk in the sense that IFU is only able to enter into new guarantee arrangements jointly with Sida. The internal organisation of Sida, with decision-making for all guarantees being delegated to the various teams and embassies implementing different bilateral/regional/global strategies means that IFU will need to keep close relationships to many different stakeholders within Sida to ensure a relevant pipeline for IFU. Through existing strong relationships with Sida, this risk is deemed as manageable.

As the guarantee facility presents new areas of risks compared to regular development aid grants, a preliminary risk matrix is included in annex 3.

Annex 1 Explainer on how guarantees work

The development guarantee model is based on the principles used in private insurance companies. An economic risk, or expected loss, is calculated and financed when the guarantee is issued. The expected loss is financed by a premium levied on the guaranteed party, e.g. a bank in Africa. The scheme is in theory cost neutral for the state, which is ultimately liable for the guarantee obligations. Income from risk premiums (and subsidies) are accumulated on a state guarantee reserve that is used to cover future losses on the guarantee portfolio. Official development aid will not cover any losses related to the guarantees (above subsidies provided to cover part of the premium fee from the guaranteed party). Figure 1 below explains the structure of a credit risk.



The guarantees are expected to be provided to partnering local banks, private and NGO fund managers and financial institutions such as the multilateral development banks (MDB's) as intermediates to support the impact beneficiaries through the mobilized investments for development. International investors and MDB's banks have capacity to pay the full risk premium with no needs for subsidies. Also, these partnering organizations will not require technical assistance to the same extent, and will have other ways of accessing it. Accordingly, the focus of the present proposal is on the activities related to access and mobilization with and through local banks, NGO's and institutions – primarily in Africa.

The operational risk associated with banks in less developed financial markets with a weak regulatory environment is high. This means that the risk-based premium will also be high. In many cases it will be too expensive for the local bank and its clients (the target group and beneficiaries of the guarantee). To overcome this challenge and open opportunities also for those who are unable to pay the full risk premium, it is possible to subsidize the premium, i.e. bring down the cost to beneficiaries with official development aid. These subsidies are the only direct expenses that are itemized as development aid. Indirect expenses include support to administration of the guarantee facility at IFU, and as presented in this programme document, a grant to finance targeted technical assistance to banks, funds etc.

While subsidies to bring down the risk premium the intermediaries are charged for a guarantee count as ODA according to OECD-DAC the actual guarantee cover is not considered ODA. However, the capital mobilized for climate investments can be reported to the UNFCCC (UN Convention on Climate Change) as part of Denmark's global climate contribution. For example, a state guarantee of DKK 100 million with a subsidy (ODA) of DKK 10 million, which mobilizes DKK 200 million DKK from private investors for climate action, the full mobilization of DKK 200 million will be counted as DK climate contribution. This contributes to Denmark delivering at least 1.0 'fair share' percent of the developed countries' goal of mobilizing USD 100 billion annually in global climate finance for developing countries.

Annex 2 Partner Assessment

IFU was established by the Government in 1967. The legal basis for IFU is §9 in the Law for International Development Cooperation. The Ministry of Foreign Affairs (or Development Cooperation) manages the ownership of IFU on behalf of the State. The Minister for Development Cooperation and Global Climate Policy nominates the Board of Directors and its Chairperson. An ownership document lays out the rationale and principles for the state ownership of IFU. As the owner (and de facto sole shareholder), the Minister for Development Cooperation and Global Climate Policy meets annually with the Board's Chairperson, Deputy Chairperson, the CEO and the Deputy CEO to take stock of performance as presented in the annual report. The MFA is represented by an observer to the Board of Directors and participates in all board meetings. Senior management of MFA meets quarterly with senior management of IFU to discuss issues of common strategic interest.

Over the years, IFU has invested in more than 1,300 companies in more than 100 countries in Africa, Asia, Latin America and Eastern Europe.

According to IFU policies, all engagements must support the green transition and contribute to poverty alleviation and reduced inequality. IFU has a strong focus on safeguards and ESG requirements.

IFU offers risk capital and advice to companies that want to invest in commercial investment activities in developing countries. IFU has built up a strong experience with investments in developing countries including low-income countries, and IFU has the required capacity and networks to develop and implement the new instrument.

Annex 3: Preliminary Risk Management Matrix

Contextual risks					
Risk Factor	Likelihood	Impact	Risk response if applicable	Residual risk	Background to assessment
Possible global financial instability and economic slow-down	Possible	Medium	Careful and rigorous risk assessments can mitigate the impact through appropriate pricing of risk	Minor	Financial turbulence and economic slow-down triggered by global political or financial crises.
Political and/or financial instability in some of the targeted countries	Possible	Major	Guarantees that are eligible for subsidies will primarily be issued against credit risks in different African countries, which may help mitigate concentration risks	Medium	During recent years political and financial turbulence have taken place in many developing countries, particularly in the least developed countries and fragile states, including Africa.
Programmatic Risks					
Risk Factor	Likelihood	Impact	Risk response	Residual risks	Background to assessment
Inadequate interest at standard rates of cover and price	Possible	Medium	A broad geographical and thematic approach will limit the risk	Minor	Many commercial banks require risk cover in excess of what the facility should provide given alignment of incentives
Commercial failure of individual clients of guarantee intermediaries	Medium	Major	A rigorous and evidence-based risk management system is needed. Some losses are to be expected, given the risk of investing in the least developed countries and fragile states and guarantees will be priced to reflect this	Minor	Experience from engagements with credit lines and financial guarantees in the targeted countries indicate that careful preparation, design and pricing are crucial
Shortage of bankable projects and guarantee opportunities	Medium	Major	The guarantee facility is aware of the importance of maintaining a solid pipeline of guarantee opportunities, and efforts are devoted to developing and maintaining a satisfactory pipeline.	Minor	Overall there is a shortage of bankable investment projects in developing countries, and that is in particular an issue in the least developed countries and fragile states in Africa where the risk-return balance is relatively challenging.
Institutional Risks					
Risk Factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Reputational risks due to violation of human rights,	Medium	Major	The Development Guarantee Facility benefits	Minor	Various studies indicate that international and not least local companies often

OSH, environmental standards etc.			from IFU's well-established policies and procedures which ensure that safeguards are in place and sustainability issues are professionally addressed during guarantee preparation and execution		violate human rights, OSH, environmental standards etc.
Misuse, corruption and fraud by participating international and local partners	High	Medium	These risks can never be eliminated, but IFU has developed a number of monitoring and control procedures to mitigate the frequency and impact of these risks.	Minor	According to international business environment indexes, including the Transparency International Index, corruption, fraud and misuse of funds is widespread in the concerned countries.

Annex 4: Process Action Plan for Implementation

PROCESS ACTION PLAN		
Activity	Timing/deadline [month or quarter]	Responsible
Finalisation of project/programme document following PC meeting		
Appraisal		
Follow up on appraisal recommendations		
Presentation for the Council for Development Policy (UPR)		
Finalisation of project/programme documentation		
Approval by the Minister		
Parliamentary Finance Committee, if applicable		
Expected timing of commitment		
<i>[Other points as relevant]</i>		
PROCESS ACTION PLAN		
Activity	Timing/deadline [month or quarter]	Responsible
Finalisation of project/programme document following PC meeting	16. August to 25. August	GDK
Appraisal	25. August to 1. October	ELK
Follow up on appraisal recommendations	1. October to 8. October	GDK
Presentation for the Council for Development Policy (UPR)	26. October	GDK
Finalisation of project/programme documentation	November	GDK
Approval by the Minister	November	GDK
Expected timing of commitment	November	GDK