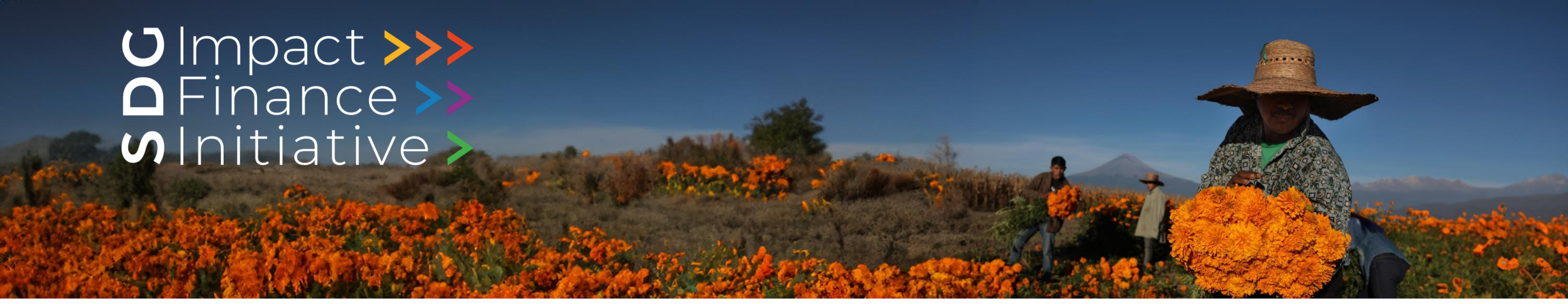

May 2024

Event Summary:

Scaling Up Impact Investing in Developing Markets:

addressing the misperception of risk and lack of liquidity

The inaugural event of the SDG Impact Finance Initiative (SIFI) in London, held on the 25th April 2024, brought together distinguished experts to tackle pressing issues in impact investing within developing markets, specifically focusing on the prevalent misperceptions of risk and the significant challenges related to liquidity. This interactive panel discussion offered an in-depth analysis and fostered collaboration among key stakeholders to improve methodologies and financial structures supporting impact investments. SIFI was excited to welcome Liliana de Sá (Head of Private Market Development, SECO), Bernard de Longevialle (Global Head of Sustainable Finance, S&P Global Ratings), Adrian Rimmer (Director Sustainable Finance, London Stock Exchange), Zbigniew Kominek (MD Finance, EBRD) and Sylvain Goupille (Founder and MD, Octobre) to the panel, moderated by Lena-Katharina Gerdes (Program Manager, SIFI) and Catherine Bukhal (Partnership Lead, SIFI). Selected participants included major asset managers, foundations, government representatives and think tanks.

Key Insights

Misperception of Risk:

Our panel of financial experts discussed how the perceived risk in developing markets often overshadows the actual risk. Highlighting compelling data, speakers noted that the actual default rate for DFI transactions graded as CCC+ is less than 5% due to the skillful structuring. The dialogue underscored the urgent need for a shift in investor mindset and raising awareness to recalibrate perceptions.

Despite improvements in transparency, the challenge of effectively aggregating diverse datasets remains a significant hurdle, especially for sector and country-level recovery rates. The conversation gravitated towards a critical consensus on the need for revised rating methodologies that better reflect the unique dynamics of impact investments with blended finance component. While the diverse nature of these transactions cannot rely on one-size-fits-all approach, developing adequate methodologies can be still possible based on the existing datasets of blended finance transactions.

Criticism was raised about how sovereign default rates disproportionately influence the ratings of funds dedicated to impact investing, often overshadowing other relevant factors. This suggests a systemic issue that may undervalue the true stability and potential of impact investments.

To wrap up this segment, the importance of collaborative efforts was emphasized, highlighting the need for financial institutions, rating agencies, and other stakeholders to join forces in developing unified strategies to tackle these unique market challenges.

To summarize, the significant misperception of risk in the impact investing sphere in developing markets calls for:

- Strengthening Investor Awareness: Realignment of investor perceptions with real risk levels.
- Improved Transparency & Data Granularity: Although transparency is improving, more granular country and sector level recovery data is needed for accurate risk assessments.
- Revised Rating Methodologies: New methodologies should incorporate the diverse nature and risk profiles of these investments.
- Collaborative Efforts: Strengthening collaboration among financial institutions, rating agencies, and other stakeholders is crucial for developing unified strategies to tackle these unique market challenges.

Targeting Illiquidity:

During the insightful panel discussion on the challenges of scaling up impact investing in developing markets, a significant focus was placed on the persistent issue of illiquidity. This barrier, critical yet often overlooked, hampers the flow of sustainable investments into regions that need them the most.

The experts emphasized that for impact investing to thrive, not only does capital need to flow in, but it must also stay committed over extended periods. Innovative solutions such as liquidity facilities, can offer exit options to investors while ensuring long-term capital commitments to impact projects. This stability is crucial for the success of projects aimed at generating both financial returns and positive social or environmental impacts.

A pivotal point of discussion was the role of stock exchanges and governments in facilitating these investments. The panelists highlighted innovative financial products and regulatory enhancements that could revolutionize market structures, making them more attractive and functional for investors. Such innovations are essential for the creation of robust secondary markets, which provide the liquidity necessary for investors to enter and exit their positions effectively.

By collaboratively developing and supporting innovative solutions, and by enhancing the structural foundations of financial markets, there's a greater chance for impact investing to achieve its transformative potential in developing economies. In order to further scale up the impact investing market, initiatives should focus on:

- Increasing Capital Commitment: There is an imminent need for innovative financial products that attract long-term investments, facilitating sustained funding for impactful projects.
- Innovative Roles of Exchanges and Governments: The development of new financial products by stock exchanges, in collaboration with governments, is crucial for improving market structures and investment flows.
- Addressing Information Asymmetry: Improving transparency in the investment process is crucial to building trust, enabling more informed decision-making, and ultimately attracting more investors.
- Developing Secondary Markets: The lack of robust secondary markets in emerging economies presents a major challenge. There is a critical need for targeted efforts to develop these markets, as they are essential for providing liquidity and enabling effective investor exits.

At the heart of the SDG Impact Finance Initiative (SIFI) is our commitment to advocate for essential action points highlighted during our recent panel discussion on scaling up impact investing in developing markets. SIFI is dedicated to not only pioneering the innovation of new financial vehicles and scaling up impact funds but also to assembling a solution driven coalition of institutions and market participants.

Our goal is to establish the necessary framework conditions that foster a thriving ecosystem around impact investing. By aligning our efforts, we aim to propel investments towards the Sustainable Development Goals (SDGs) in developing markets at the required scale, ensuring meaningful and sustainable impact. To learn more about our activities and how we are driving change in impact investing, follow us on LinkedIn.