POLICY BRIEF

#1 | NOVEMBER 2026

Unlocking Capital: How Regulatory Reform Can Scale Blended Finance for Sub-Saharan African Infrastructure

BERGERO Jean, CARSON Louis, JESOVER Théo & KIRKE Nile
The Transition Institute 1.5, Mines Paris - PSL, EDHEC Business School

KEY TAKEAWAYS

CONTEXT

Sub-Saharan Africa is warming faster than the global average, **losing an estimated 2 to 5% of GDP per year due to climate-related disasters**, and diverting up to 9% of national budgets to disaster recovery. **Adapting infrastructure to these climate shocks requires significant investment on top of the existing $200bn gap observed in Sub-Saharan Africa** [1][2][3][4][8].

The region also faces some of the **highest borrowing costs in the world, close to four times US sovereign rates**, driven by both risk and perception [5][7][9].

OBSERVATIONS

Blended finance scales capital through risk transfer mechanisms (a public first-loss tranche absorbs initial loss) but **global volumes remain an order of magnitude below estimated annual needs infrastructure investment** [8][11].

Prudential frameworks designed for deep, stationary, data-rich markets treat credit-enhanced exposure as if unprotected: **banks hold full capital against senior loans even when a public first-loss tranche absorbs initial loss** [9][13][14].

Evidence shows **the potential to scale capital through reduced debt burden in blended finance by recognising DFI subordination as credit risk mitigation**, cutting the senior weight capital requirements (Common Equity Tier 1) from 130% to 80%, potentially doubling infrastructure lending per dollar of bank capital [9].

RECOMMENDATIONS

This policy brief proposes a **three-point reform agenda**:

1. **Recognise credit enhancement in banking regulation** to crowd in private capital;
2. **Build a regulatory bridge to pension funds and institutional investors**;
3. **Create a scalable currency-hedging architecture.**

The problem: A Double Squeeze on Infrastructure Investment

Sub-Saharan Africa (hereafter SSA) is confronting rising climate risks and prohibitively high financing costs. Warming faster than the global average at about +0.3°C per decade since 1991, the region loses an estimated 2 to 5% of its GDP (Gross Domestic Productivity) every year due to climate-related shocks, forcing governments to divert as much as 9% of national budgets to disaster response [1]. The IPCC (Intergovernmental Panel on Climate Change), in its last Assessment Report (AR6, Working Group II), identified Africa as the continent most vulnerable to climate change [2]. Yet financing adaptation measures that could mitigate the effects of climate change on SSA economies still falls short [3][4].

Exacerbating the climate-related financial burden, borrowing costs are among the highest in the world in SSA, close to four times those of the United States, and median interest-to-revenue ratios exceed 12%, roughly triple the level of advanced economies [5][6]. Compared to other emerging markets, SSA coupons averaged 1.3% higher between 2014 and 2021, a gap only partly explained by investor rationale [7].

This creates a particularly unfavourable context for infrastructure. The AfDB (African Development Bank) estimates an annual financing gap of $200bn for the power access, water and sanitation and transport infrastructure on which development depends [8]. This estimate is separate from the adaptation financing gap, for which roughly $453bn in additional financing is required in Africa between 2020 and 2030 [3]. Infrastwructure is mainly financed through debt (at an average debt-to-equity ratio of roughly 4 to 1), with no liquid equity market from which cheaper cost of capital could be inferred [9]. The cost of debt is considered the binding constraint on delivery of infrastructure and adaptation to climate change.

These pressures reinforce one another: climate damage worsens fiscal space, weak fiscal space drives up risk premia, and high premia kill the very adaptation projects that would limit the damage. Breaking this loop requires challenging the financial architecture of debt financing itself.

A possible solution: Why blended finance makes sense

Blended finance combines concessional public capital with commercial private investment to improve the risk-return profile of projects. Through instruments such as subordinated debt, first-loss capital, guarantees, and technical assistance facilities, public institutions can absorb specific risks that private investors are unwilling or unable to bear while preserving commercial incentives [10].

Public development finance alone cannot close the continent's gap, while commercial investors view many projects as too risky relative to expected returns. Strategically deployed concessional capital can therefore mobilise far larger volumes of private investment without equivalent increases in public spending. Yet, despite widespread institutional support, blended finance remains deployed at a scale far below infrastructure and adaptation needs.

The high cost of capital in SSA is not merely a regulatory artefact: quantifiable macroeconomic, political, institutional, and climate-related risks justify premia above advanced-economy levels, even if part of the premium reflects sentiment rather than fundamentals [7][9].

Basel III Capital Treatment

Current prudential regulations do not fully recognise the risk mitigation provided by many blended finance structures. Under the Basel III standardised approach, an unrated greenfield project-finance exposure carries a 130% risk weight, and SSA borrowers rarely qualify for the 80% "high-quality" bucket or the EU's Infrastructure Supporting Factor [12][15].

Basel's credit-risk-mitigation rules already contain the required mechanism. Under the substitution approach, the portion of an exposure covered by an eligible guarantee takes the risk weight of the protection provider (0% for listed Multilateral Development Banks), while only the uncovered remainder retains the obligor's risk weight.

A DFI (Development Finance Institution) first-loss tranche, however, is funded structural subordination rather than a guarantee. As a result, it fails the eligibility tests of direct, explicit, irrevocable and unconditional protection, while the securitisation framework is generally punitive for project finance.

Banks' lending alongside MDBs (Multilateral Development Banks) or DFIs must therefore hold substantial CET1 (Common Equity Tier 1) capital against exposures that are economically de-risked, limiting their ability to crowd in private capital [13][14].

Currency Risk

Foreign exchange risk remains one of the most significant barriers to infrastructure investment in SSA. Many projects generate revenues in local currency while debt is denominated in USD (United States Dollars) or euros; depreciation can undermine cash flows and raise default risk even when operational performance is strong.

The Reform Agenda: Maximising the Catalytic Impact of Public Capital

The challenge is fundamentally one of capital mobilisation, not savings. Global capital markets hold more than enough; what is missing is the architecture to connect those resources to investable projects. Blended finance provides the foundation, but its reach is limited by banking regulations that were designed for other economies.

The objective of our reform agenda is not to eliminate risk premia or subsidise unviable projects. Instead, it is to ensure that regulatory capital requirements and investor mandates reflect the residual risk after credible mitigation through first-loss protection, MDB participation or currency-risk facilities.

- Reform 1: recognise credit enhancement in banking regulation to crowd in private capital;
- Reform 2: build a regulatory bridge to pension funds and institutional investors;
- Reform 3: create a scalable currency-hedging architecture.

Reform 1: Recognise Credit Enhancement in Banking Regulation to Crowd in Private Capital

Banks are the gateway through which most infrastructure projects reach financial close, which gives banking regulation significant influence over whether projects go through. As outlined above, current capital treatment does not reflect the risk mitigation embedded in these transactions: credit enhancement from MDBs and DFIs through concessional financing mechanisms is not translated into the capital relief it warrants. We recommend three targeted clarifications, each consistent with active ICC (International Chamber of Commerce) and IIF (Institute of International Finance) policy work [13][14]:

i. recognise MDB/DFI first-loss risk-mitigation tools in line with real contract structures;
ii. apply blended risk weights to partially guaranteed exposures, reflecting only the genuine, uncovered residual;
iii. introduce a scaling factor for high-quality climate-related exposures in emerging and developing economies, analogous to the existing SME and Infrastructure Supporting Factors.

Extending the 80% treatment to the protected residual is justified on the bucket's own terms: "high quality" is defined by the capacity to meet obligations under severe stress, and a senior tranche shielded by a DFI first-loss layer and contracted revenues meets that test in substance. Sovereign ceilings and perception, not project fundamentals, currently exclude SSA borrowers in form.

Box 1: Illustrative example of the rate-compression proposed in the capital requirements reform (Reform 1).

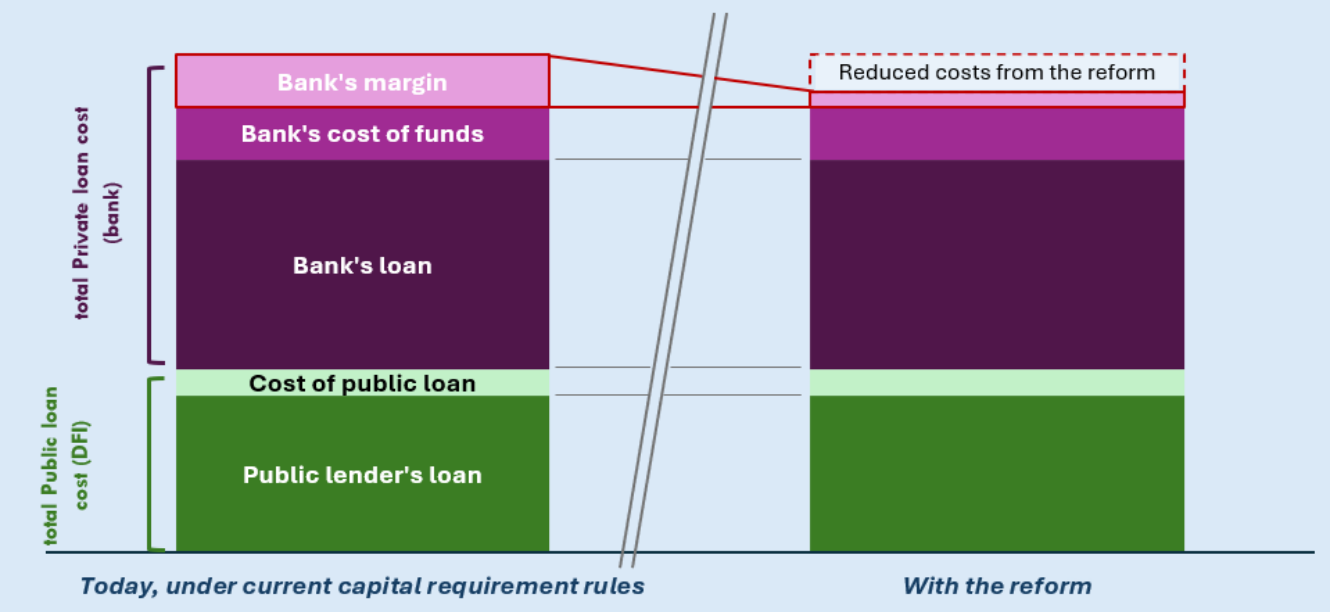


Figure 1: Illustration of the anticipated effect of Reform 1 on debt repayment volumes. The bar charts show what the project SPVs (Special Purpose Vehicles) repay to debtors only (meaning excluding equity from shareholders). Public and private loan costs correspond to the sum of the principal (loan amount) and interest repayments.

The rate-compression mechanism is explained below. The margin is determined as follows:

Margin = Target return x **Risk weight** x Capital ratio[1]

The reform changes only the risk weight (highlighted in bold in the formula). Today the entire senior loan is weighted at 130%, as if the DFI first-loss tranche did not exist. With recognition, the portion covered by the junior tranche is weighted at 0% and the uncovered remainder qualifies for the 80% bucket, giving a blended weight of (1 - w) x 0% + w x 80% (w being the private share of total debt). Target return and capital ratio do not move, so the margin falls in the same proportion: 1 - (80% x w) / 130%.

The central impetus of this reform is the effect of reducing the risk weight on the ability of banks to lend at higher volumes for the same amount of CET1 capital. Bergero et al. (2026) illustrate this with a case study on a $40 million Tanzanian off-grid solar and storage project that closed at an all-in rate of 8.59%. Full recognition of its 30% DFI first-loss tranche would have cut the senior risk weight from 130% to 56% (w = 0.70 so 0.70 x 80%), supporting 2.3 times more lending per dollar of bank CET1 capital and a blended cost of debt of about 3.15%, a compression of roughly 540 basis points. One project cannot be generalised mechanically, but the mechanism is structural: it applies wherever tranched DFI protection exists [9].

The reform's deeper effect is allocative: deployed as subordination and guarantees rather than senior loans, the same concessional volume mobilises more total capital, because it acts on the multiplier rather than substituting for the private dollar. The priority is to redeploy concessional capital, not simply to ask for more of it. Nor is this a dilution of standards: default histories pooled in the MDBs' GEMs (Global Emerging Markets) risk database indicate that infrastructure lending in these economies performs substantially better than its current capital treatment assumes.

Reform 2: Build a Regulatory Bridge to Pension Funds and Institutional Investors

Commercial banks alone cannot finance Africa's infrastructure needs: their balance sheets are constrained and their funding structures too short-term for the scale required. The natural long-term holders are pension funds and insurers, whose long-duration liabilities match infrastructure cash flows, and the crowding-in channel is documented: Broccolini et al. (2021) find that MDB participation in syndicated lending generates a sizeable multiplier of private co-financing in subsequent years [17]. Institutional absorption of credit-enhanced assets is not untested either: IFC's (International Finance Corporation) Managed Co-Lending Portfolio Program places institutional investors behind an IFC first-loss layer, the AfDB's Room2Run securitisation transferred mezzanine risk on a roughly $1bn loan portfolio to institutional investors, and the ILX Fund[2] channels Dutch pension capital into DFI-syndicated loans [18]. These remain pilots relative to the need. The task is to certify and scale them, with Reform 1 supplying the sequence: bank mobilisation builds a pipeline of seasoned, credit-enhanced assets that can later be refinanced for institutional absorption. We note this extension reaches beyond the underlying study's evidence, which concerns bank lending at financial close.

[1] Margin: what the bank adds on top of its own funding costs; Target return: the return the bank requires on the capital that it locks away behind the loan set by the bank; Risk weight: the multiple that defines how much capital has to be set aside, set according to regulatory requirements and risk profile; Capital ratio: share of the weighted amount that must be the bank's own capital, set by regulation.

[2] ILX Fund II: Climate-focused emerging market private debt fund launched in 2024 (succeeding Fund I founded in 2017), managed by ILX Management B.V. with commitments from Danish pension providers Sampension and Akademiker. The Fund provides institutional investors access to investment opportunities of the Development Finance asset class through loans arranged by MDBs and DFIs.

Reform 3: Create a Scalable Currency-Hedging Architecture

Reducing credit risk alone will not be sufficient if foreign exchange risk remains unaddressed. A dedicated currency-risk architecture should become standard in blended-finance transactions, and could include:

- MDB-backed foreign-exchange facilities;
- expanded support for specialised providers such as TCX[3];
- regional currency-guarantee platforms;
- local-currency lending windows;
- publicly supported foreign-exchange liquidity facilities;
- and risk-sharing mechanisms designed specifically for climate infrastructure.

Reducing currency risk would improve bankability and investor confidence, lowering premia across the capital structure.

Policy Implications and Implementation

Prudential recognition comes first, because it unlocks the commercial banks that originate transactions. Concessional resources are then redeployed toward catalytic positions rather than simply expanded. The institutional-investor bridge is built as the resulting pipeline matures.

The capital-treatment changes (Reform 1) are set by the BCBS (Basel Committee on Banking Supervision) and then transposed regionally, through the EU's CRR (Capital Requirements Regulation) and the EBA (European Banking Authority), the UK's PRA (Prudential Regulation Authority), and the US federal banking agencies. Because a full reopening of the Basel standard is slow, the near-term route is twofold: supervisory clarification of how existing credit-risk-mitigation rules apply to MDB and DFI guarantees, achievable through guidance rather than legislation and the scheduled CRR review as a concrete vehicle to extend the Infrastructure Supporting Factor to credit-enhanced exposures in emerging and developing economies. The technical proposals already exist in the work of the ICC and IIF [13][14], so the implementation task is to place them on the Basel Committee's and the EBA's agendas, with the G20's MDB reform and Capital Adequacy Framework workstreams and the multilateral banks themselves as natural sponsors. Reforms under the Capital Adequacy Framework have already added more than $250 billion of projected MDB lending headroom since mid-2024, demonstrating that the machinery for capital-efficiency reform exists and moves [16].

The reform agenda sits largely within institutions' own mandates and requires board decisions rather than treaties. The MDBs and DFIs can shift a defined share of concessional resources from senior lending into first loss and guarantee positions and capitalise a dedicated blended-finance window by building on instruments already operating: the African Development Fund, the hybrid-capital and SDR-rechanneling structures the AfDB began using in 2024, donor guarantee platforms on the model of the EU's Global Gateway, and IDA's (International Development Association) Private Sector Window. The institutional-investor bridge (reform 2) is built through the insurance and pension frameworks, by adapting the reduced "qualifying infrastructure" charges that already exist under Solvency II (via EIOPA) and the global Insurance Capital Standard to a defined, certified category of credit-enhanced blended exposures. The currency architecture

[3]The Currency Exchange Fund founded in 2007 by a group of DFIs, MIVs (Microfinance Investment Vehicles) and donors to propose financial instruments (such as swaps and forward contracts) to manage currency risk in developing and frontier markets by shifting the risk to TCX, protecting investors and clients.

(Reform 3) is built by the MDBs and donors themselves, expanding TCX-type capacity, adding regional guarantee platforms, and opening local-currency windows within existing DFI mandates.

REFERENCES

[1] World Meteorological Organization (2024). Africa faces a disproportionate burden from climate change and adaptation costs. WMO, 2 September 2024.
[2] IPCC (2023). Climate Change 2022: Impacts, Adaptation and Vulnerability. Working Group II Contribution to the Sixth Assessment Report. Cambridge University Press. https://doi.org/10.1017/9781009325844
[3] United Nations Environment Programme. (2025). Adaptation Gap Report 2025: Running on Empty - The World is Gearing up for Climate Resilience — without the Money to get there. UNEP. ISBN: 978-92-807-4237-4, Job number: CLI/2719/NA, DOI: https://doi.org/10.59117/20.500.11822/48798.
[4] International Monetary Fund (2025). Regional Economic Outlook — Sub-Saharan Africa: Recovery Interrupted. IMF, April 2025.
[5] United Nations Conference on Trade and Development (2025). A World of Debt 2025: It is time for reform. UNCTAD.
[6] Laws, A., Lemaire, T., Pafadnam, R., Spatafora, N., & Khandelwal, K. (2025). Breaking the Trend: Debt Stabilization in Sub-Saharan Africa. IMF Notes 2025/001. https://doi.org/10.5089/9798229008679.068
[7] Gbohoui, W. (2023). Sub-Saharan Africa's Risk Perception Premium: In the Search of Missing Factors. IMF Working Paper 2023/130. https://doi.org/10.5089/9798400242144.001
[8] African Development Bank Group (2024). Scaling up financing is key to accelerating Africa's structural transformation. AfDB, August 2024.
[9] Bergero, J., Carson, L., Jesover, T., & Kirke, N. (2026). Climate Exposed, Debt Decomposed, Reforms Proposed: Climate Disasters and Financing Solutions for Infrastructure in Sub-Saharan Africa. The Transition Institute 1.5, Working Paper. DOI: 10.23646/qjp5-3h48.
[10] OECD (2025). OECD DAC Blended Finance Guidance 2025. Best Practices in Development Co-operation. OECD Publishing. https://doi.org/10.1787/e4a13d2c-en
[11] Convergence (2025). State of Blended Finance 2025. Convergence Blended Finance.
[12] Basel Committee on Banking Supervision (2017). Basel III: Finalising post-crisis reforms. Bank for International Settlements.
[13] International Chamber of Commerce (2025). Enhancing climate finance in emerging markets and developing economies through prudential regulatory clarification and reform. ICC Policy Brief, June 2025.
[14] Institute of International Finance (2025). Lifting Prudential Barriers to Mobilizing Private Capital for Development. IIF Policy Paper, March 2025.
[15] European Banking Authority (2022). Report on the application of the Infrastructure Supporting Factor. EBA.
[16] Goko, C. (2025). African development banks set to expand lending as capital buffers rise, S&P says. CNBC Africa.
[17] Broccolini, C., Lotti, G., Maffioli, A., Presbitero, A. F., & Stucchi, R. (2021). Mobilization Effects of Multilateral Development Banks. The World Bank Economic Review, 35(2).
[18] African Development Bank (2018). Room2Run: landmark $1 billion impact securitisation with Mariner Investment Group. AfDB, September 2018.

MINES PARIS
UNIVERSITÉ PARIS SCIENCES & LETTRES
TTI.5° The Transition Institute

The Transition Institute 1.5
Mines Paris - PSL
60 boulevard Saint Michel
75272 Paris cedex 06
FRANCE
the-transition-institute.minesparis.psl.eu
tti.5@minesparis.psl.eu