Mobilizing Private Finance for Sustainable Development at Scale: Exploring Gaps in Financial Regulation

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Context

The GISD Alliance launched a workstream on prudential regulation as part of its engagement in the lead-up to the Fourth International Conference on Financing for Development (FfD4). The Alliance carried out substantive preparatory work to inform policy discussions and organized two key events to present its findings and gather perspectives. The first was a dedicated GISD Alliance meeting held in October 2024, followed by a side event during the 3rd Preparatory Committee for FfD4. These gatherings contributed to growing alignment on key regulatory challenges and opportunities.

The side event at the 3rd Preparatory Committee for the Fourth International Conference on Financing for Development (FfD4) was co-hosted by the GISD Alliance and the Paris Pact for People and the Planet (4P). Moderated by the Director of the Financing for Sustainable Development Office of UN DESA, the discussion featured high-level opening remarks from the National Secretary for Climate Change at Brazil's Ministry of the Environment and Climate Change and the Deputy Assistant Secretary for Multilateral Financial Affairs and Development at the French Treasury. The head of the 4P, as well as a senior fellow at the Center for Global Development delivered scene-setting remarks. This paved the way for a discussion with representatives from Citibank, Standard Chartered, the International Chamber of Commerce, the Bank of France, and the European Bank for Reconstruction and Development. The event also saw active participation from UN Member States.

Key messages

- **Mobilizing private capital is essential to achieving the Sustainable Development Goals (SDGs).** Sustainable finance flows—particularly in emerging markets and developing economies (EMDEs)—continue to face a range of supply- and demand-side challenges. Addressing these effectively requires an *ecosystem of solutions* that considers broader macroeconomic factors, including inflationary pressures, capital market volatility, and other systemic issues. Within this broader landscape, the prudential regulatory framework has emerged as an important area for reflection and possible refinement and was a key focus of this meeting.

- **The meeting highlighted the importance of assessing the potential unintended consequences of**

Basel III and Solvency II on long-term investment flows—especially in infrastructure finance, SME financing, and capital mobilization in EMDEs. Participants discussed in detail how risk-weighting methodologies and the limited use of guarantees as credit risk mitigation tools may create barriers to scaling private investment in these areas.

- **There is growing support for targeted reform from a wide range of stakeholders, including G7 supervisors.** This momentum reflects a shared understanding of the need to ensure that financial frameworks evolve to meet today's global development and climate challenges, while continuing to uphold financial system resilience. The global financial crisis—and the banking turmoil of 2023—demonstrated the importance of strong prudential standards. Looking ahead, the climate crisis poses systemic risks with significant implications for stability. Supervisors must now navigate both legacy risks and emerging challenges, making targeted regulatory adjustments increasingly necessary.

- **Participants explored targeted amendments to address barriers while preserving regulatory integrity**. Addressing financial regulation issues should not entail lowering existing standards, nor compromising the stability of the financial system. The focus should instead be on calibrating risks accurately. Miscalibration risks—particularly in developing countries—can indeed heighten systemic vulnerabilities.

- **Participants agreed that targeted clarifications to the Basel framework should be considered. These could take the form of technical amendments, FAQs, or refinements in supervisory practices (see overview of recommendations below)**. It is important to distinguish between global and jurisdictional levels of implementation. At the global level, such reforms would be led by the Basel Committee or the International Association of Insurance Supervisors (IAIS). At the jurisdictional level, implementation would fall to national or regional authorities responsible for prudential oversight.

Next steps

- **Use the FfD4 Conference, COP30 and the G20** to push forward regulatory and policy reforms.
- **Engage with Member States and regulators** following the publication of the Draft 1 of the FfD4 Outcome Document. Position FfD4 as a catalyst for ongoing dialogue between governments, regulators, and the private sector.
- **GISD Alliance and 4P will continue joint work** to raise awareness on this issue and support its integration in the FfD4, COP30 and G20**.**
- **4P will** launch an **Eminent Persons Group** to provide a comprehensive assessment of unintended consequences from regulatory frameworks and deliver concrete recommendations for targeted reforms. The Eminent Persons Group will be launched at the IMF-WB Spring meetings and initial findings will be discussed in **Sevilla**.

Overview of Recommendations

Infrastructure	SMEs	EMDEs	Guarantees	Other issues
Short Term: **Jurisdictional level**: Consider **capital haircuts for qualifying infrastructure exposures** (recommendation 1) Medium Term: **Global level**: **Enhance data availability**, including through initiatives like the GEMs database publication, to help better assess actual risks (recommendation 2) Long Term: **Global level**: **Reclassify infrastructure as an asset class**. To this end, land on a shared, internationally accepted taxonomy for infrastructure finance, and standardized contracts (recommendation 3)	Short Term: **Jurisdictional level**: Consider **capital haircuts for SMEs** (recommendation 4) Medium to Long Term: **Global & Jurisdictional level**: **Strengthen support for the use of credit bureau data**—already permitted under existing rules—to enable more accurate SME credit assessments at the national level. **Eventually, refine SME risk weightings using credit local data** (recommendation 5)	Short to Medium Term: **Global level: Move away from non-risk-based geographical criteria**, such as the OECD vs. non-OECD distinction in Solvency II (recommendation 6)	Short to Medium Term: **Global level: Clarify treatment of exclusion clauses in MDB guarantees**, ensuring they do not automatically disqualify partial or conditional guarantees issued by MDBs from being recognized as credit risk mitigation (recommendation 7) Global/local level: **Harmonize the list of development finance institutions (DFIs) eligible for a 0% risk weight** across jurisdictions, and **expand the list globally to reflect all MDBs** (recommendation 9) **Global level: Introduce guidance on timeframes** for triggering a guarantee that depends on an arbitrage process (recommendation 8)	Short to Medium Term: **Global level: Assess the relevance of lower risk weights** for 1. **blended finance** 2. **A/B loans** (recommendation 10) Long-term **Global level:** Leverage alternative data to **reduce the dependence on credit ratings in regulatory frameworks** (recommendation 11)

Detailed Summary

Treatment of infrastructure finance in regulation

***Challenge*:** While Basel III has strengthened global financial stability, some of its provisions may have unintended consequences for infrastructure finance, particularly in developing countries where investment has slowed.

- The framework assigns disproportionately **high capital charges to infrastructure finance, despite empirical evidence showing that infrastructure projects have lower default rates and higher recovery rates than corporate lending**.[1]
- Different areas merit careful consideration:

  Net Stable Funding Ratio (NSFR): The NSFR, introduced to limit reliance on short-term wholesale funding, requires that long-term assets like infrastructure loans be matched with stable, long-term liabilities. However, in contexts where long-term funding is limited and costly, NSFR compliance can be challenging, potentially discouraging long-term lending.

  Output floor, under the Standardized Approach: aiming at curbing underestimation of risk through banks' bespoke internal models, it mandates that risk-weighted assets (RWAs) cannot fall below 72.5% of those calculated under the standardized approach. However, the standardized approach assigns high risk weights to project finance—130% during construction and 100% during operation—unless the project is externally rated, which is uncommon in EMDEs.

    - The 130% risk weight in the pre-operational phase is even higher than that for unrated corporates (100%), despite project and export finance generally exhibiting lower credit risk. Moreover, a flat risk weight across the life of a project does not reflect the actual risk profile of project finance, where risk typically peaks around year five and then declines.
    - Participants also highlighted ambiguity regarding the transition from pre-operational to operational phases. Current rules require declining long-term debt for a project to be considered operational—but many projects repay at maturity, meaning the higher 130% risk weight could apply for the project's entire lifespan, even after the riskiest phase has passed.
    - While the standardized approach allows for an 80% risk weight for "high-quality" projects, the criteria for qualifying as such remain unclear, limiting its practical application.

  Internal Ratings-Based (IRB) Approach: The IRB approach also has issues at it includes a full maturity adjustment that increases linearly with the life of the transaction, capped at five years. However, this does not align with the non-linear risk profile of project finance. Risk typically peaks around year five and then declines rapidly—yet the five-year cap does not capture this dynamic, potentially overstating risk during the most stable periods of the loan.

Recommendation 1: **Capital haircuts for infrastructure projects**: Consider easing capital requirements, without compromising prudential standards, through targeted measures such as jurisdiction-level capital discounts for infrastructure project. For instance, the EU applies a 25% capital discount to qualifying infrastructure investments, which could serve as a model for similar regulatory calibrations in other jurisdictions.

Recommendation 2: **Enhance data availability**: Expanding access to project-level data would help better assess actual risks, reducing reliance on overly conservative risk weights. Data-sharing still faces challenges, including data localization laws and internal banking restrictions that limit cross-border or

[1] CGDEV, Aligning International Banking Regulation with the SDGs, Liliana Rojas-Suarez (2025).

cross-market aggregation.

- Multilateral development banks (MDBs) hold extensive data on defaults and recoveries, yet much of it is not publicly accessible. Releasing this information, including through initiatives like the GEMs database, would significantly enhance risk evaluation.
- Institutions like the Global Infrastructure Hub collect valuable infrastructure data, but gaps remain—especially in EMDEs.
- Technology, such as AI-driven models, could help create anonymized, aggregated datasets that comply with privacy and regulatory constraints, easing data sharing.

Recommendation 3: **Reclassify infrastructure as an asset class:** Recognizing infrastructure as a distinct asset class could allow for more accurate risk assessment and capital treatment within the project finance segment. Infrastructure investments typically exhibit lower default rates and higher recovery rates than general corporate lending, especially over the long term.

- **To this end, a shared, internationally accepted taxonomy** for infrastructure would be a critical first step, ensuring consistent definitions and classification for infrastructure finance across markets and institutions.
- **Moreover, standardized contracts on infrastructure would improve project comparability and support securitization**, making it easier for investors to assess and participate in infrastructure deals. FfD4 could serve as a platform to facilitate agreements (e.g. MOUs) on contract standardization. This would not require changes to Basel III.

- To address issues linked to the NSFR, participants also mentioned that rather than broadly discouraging wholesale funding, regulators could adopt a more nuanced approach by aligning asset treatment with liability structures. Banks that rely on wholesale funding would be expected to hold asset portfolios that appropriately match those liabilities, rather than facing blanket penalties. This would uphold financial stability objectives while offering greater flexibility for long-term infrastructure financing—particularly important in EMDEs.

Treatment of SMEs

***Challenge*:** Under Basel III's standardized approach, SME loans typically carry a risk weight of 85%, or 75% if classified as retail. To qualify for lower risk weights, SMEs must have an external credit rating of A- or higher, which is a significant hurdle in many developing countries where such ratings are rare. This rigid framework can fail to account for the actual creditworthiness of SMEs that lack formal ratings but may still be financially sound.

Recommendation 4: **Targeted capital haircuts for SMEs**: Consider easing capital requirements, without compromising prudential standards, through targeted measures such as jurisdiction-level capital discounts for SMEs. The EU's SME supporting factor—effectively a 23.81% reduction in the capital requirement for qualifying SME exposures—is a useful example that could be adapted by other jurisdictions to better support small business lending. Any such adjustment should be grounded in a robust, data-driven assessment of SME credit risk. In developing countries, data from public credit registries and private credit bureaus - which often capture comprehensive loan-level information across the financial system – could be leveraged.

Recommendation 5: **Refine SME risk weightings using credit bureau data:** Basel III already permits the use of local credit data. The Basel Committee could go further by explicitly encouraging its use, giving jurisdictions greater confidence to leverage local data for more accurate risk-weight calibration. These sources offer granular insights into SME creditworthiness, helping reduce overreliance on external credit ratings. Importantly, this does not imply universally lower risk weights for SMEs—some may justifiably remain high—but it promotes more nuanced, data-driven risk assessments.

Treatment of EMDEs

Challenge: Current regulatory frameworks apply higher capital charges to infrastructure projects and equity investments in non-OECD countries compared to OECD countries. Under the standard model, equities listed in non-OECD markets face a 10-percentage point higher capital charge compared to OECD listed equities (i.e., 49% vs. 39%). This criterion is seen as a country risk proxy and a distinction based on political grouping rather than actual risk. The OECD is a diverse set of (38) countries with different performances across economic and financial indicators, which are not always less risky than those of non-OECD members. In fact, the loss for a given default is lower in an EMDE than in an AE.[2]

Recommendation 6: **Move away from non-risk-based geographical criteria, such as the OECD vs. non-OECD distinction in prudential frameworks.** As the risk profile of OECD and non-OECD jurisdictions evolves, a review of this methodology could be performed, for example to improve the treatment of EMDEs that have a solid sovereign rating.

Treatment of guarantees

Challenge: Multilateral Development Bank (MDB) guarantees are recognized under prudential frameworks as eligible forms of credit risk mitigation (CRM), with the potential to reduce capital charges for financial institutions. In practice, however, banks often face challenges in applying these guarantees for CRM purposes due to specific regulatory requirements—particularly: 1. the requirement that guarantees be unconditional; and 2. the timeliness of payout, which may be affected by procedural steps such as arbitration.

- **The requirement that guarantees be unconditional**: To qualify as credit risk mitigation (CRM) under prudential frameworks, guarantees must be deemed “unconditional.” However, many MDB guarantees—such as those issued by MIGA—include language that introduces elements of conditionality. For instance, the World Bank’s sovereign risk insurance includes exclusion clauses, such as for losses related to nuclear activities. MDBs often reinsure their guarantees through commercial markets, where reinsurance contracts typically include boilerplate provisions like the Radioactive Contamination Exclusion (RACE) clauses, excluding coverage for losses stemming from nuclear events, radiation, or hazardous waste. The presence of such exclusions on their guarantees introduces conditionality for banks, rendering the guarantees ineligible under prudential regulations.

- **The timeliness requirement**: Basel requires guarantees to be promptly available “in a timely manner” in order to be recognized as credit risk mitigation (CRM). However, the World Bank guarantees for political risks are only triggered after an arbitration process has been performed to try to allow the project to continue. This once again often renders the guarantees ineligible for CRM.

Recommendation 7: **Clarify Treatment of Conditionality linked to Exclusion Clauses in MDB Guarantees:** Targeted updates to Basel standards—whether through technical amendments or interpretive FAQs—could clarify that certain exclusion clauses do not automatically disqualify partial or conditional guarantees issued by MDBs from being recognized as credit risk mitigation (CRM). For instance, the World Bank’s standard exclusion of losses related to nuclear activities could be interpreted as having no practical impact

[2] 4P Paris People and Planet (2024).

for banks that already maintain nuclear exclusions in their own policies, and therefore should not affect the guarantee's eligibility under prudential rules.

Recommendation 8: **Introduce guidance on timeframes for triggering a guarantee that depends on an arbitration process:** The Basel Committee could consider issuing guidance that defines what constitutes a "reasonable time frame" for the activation of guarantees involving arbitration. Such guidance could clarify that these guarantees may still qualify as credit risk mitigation, provided the arbitration process is completed within a specified duration (e.g., six months) and the institution has appropriate measures in place to manage any related liquidity risks.

Treatment of MDBs

Challenge: Participants emphasized that how Basel III is implemented varies widely across jurisdictions. Banks operating in multiple jurisdictions must navigate different risk-weighting requirements. Moreover, globally, the list of MDBs eligible for a 0% risk weighting does not include all MDBs.

- Basel III provides a list of 16 multilateral development banks (MDBs) that qualify for a 0% risk weight under the standardized approach. This list has changed little over the years, failing to keep pace with newer institutions in some regions. The list also comprises MDBs and not other DFIs.
- Further, this list of 16 has been faithfully transposed in the EU. [3] However, interpretations of this provision vary by jurisdiction. In the U.S., for instance, only a limited group of supranational entities and MDBs are recognized as eligible for the 0% risk weight under its implementation of Basel III, for example the Asian Infrastructure Investment Bank is missing. While U.S. guidance includes a discretionary clause allowing institutions with comparable credit risk to qualify, this determination must be made by the Federal Reserve Board and is seldom applied in practice.

Recommendation 9: **Expand the list of Basel-endorsed list of multilateral development banks (MDBs) eligible for a 0% risk weight and promote consistency across jurisdictions by standardizing the implementation.**

Other comments

Treatment of Blended finance and A/B loans in the regulation:

Challenge:

- **Blended finance** is inherently lower-risk, given that it brings together both public and private creditors under a single credit structure. However, reflection in the regulation remains challenging. Blended finance transactions vary widely, making it difficult to quantify risk reduction statistically.
- **A/B loan structures**, typically arranged by MDBs, are loans in two tranches where the MDB retains the "A" tranche and syndicates the "B" tranche to commercial banks. These structures benefit from the MDB's preferred creditor status, which aims at reducing default risk. The current Basel III framework does not fully recognize the implicit credit enhancement—or "halo effect"—in such arrangements.

Recommendation 10: **Assess the relevance of lower risk weights for 1. blended finance 2. A/B loans**

- In the short-term, the Basel Committee could explore the feasibility of lowering RWAs to blended finance exposures, on the basis of sufficient data. Current proposals—such as those in draft 1 of the FfD4 outcome document (paragraph 27g)— on standardizing blended finance structures, and developing blended finance taxonomies, could help build a stronger case for prudential

[3] Article 117(2) CRR.

adjustments over the medium term. To evaluate their regulatory treatment, it would be important to establish clear benchmarks, such as for example such as the number and creditworthiness of participating entities. The end goal could be to develop a “blended finance” new category of investments.

- The Basel Committee may consider undertaking an in-depth analysis of A/B loan structures to assess their actual risk profile. Emerging insights from the GEMS database indicate that these instruments, which incorporate risk-sharing features, tend to exhibit stronger performance than standard risk models predict. This suggests that A/B loans could merit distinct regulatory treatment, potentially as a separate asset class.

Reliance on credit ratings in the regulation

Challenge: Basel III embeds a heavy reliance on external credit ratings, which can create sharp “cliff effects” in capital requirements—where small changes in ratings lead to significant shifts in capital charges. This reliance is difficult to move away from unless alternative data sources are available. However, in today’s digitalized world, an increasing amount of data is accessible. This opens the door to rethinking how risk is assessed and whether regulatory frameworks can evolve to reflect modern data capabilities while maintaining prudential soundness.

Recommendation 11: **Leverage alternative data to reduce the dependence on credit ratings in regulatory frameworks:** Regulators could consider incorporating alternative data sources into prudential frameworks to reduce over-reliance on private credit rating agencies, allowing for more gradual and risk-sensitive adjustments.