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REPORT JUNE 2026

Empowering Public Development Banks to Deliver

Rebalancing risk in credit ratings and prudential regulation to enable private finance mobilisation

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ACKNOWLEDGEMENTS

The authors would like to thank E3G colleagues Kate Levick, Chiara Falduto and Ronan Palmer for their time, contributions and support. As well as IDFC colleagues Nicolas Picchiotino, Laura Sabogal Reyes, Panayotis Gavras, Alexandre Vas and Florence Marzuk and IDFC members who participated in the valuable consultation workshops coordinated by IDFC.

The authors would also like to thank Liliana Rojas-Suarez (Center for Global Development and 4P EPG), Ricardo Gottschalk (UN), Morgan Després (ECF and CETEx), Agnieszka Smolenska (CETEx), Joe Feyertag (CETEx), Chris Humphrey (ODI) and Sima Kammourieh (FinDevLab) for their valuable contributions, review and guidance in the development of this report.

The authors are also grateful to the EMDE Investor Taskforce, an industry-led initiative convened by HM Treasury and the Foreign, Commonwealth and Development Office, for engagement and feedback during the production of this report. This report has benefited from consultation with the EMDE Investor Taskforce. However, the analysis, conclusions and recommendations contained in it are those of the authors alone and do not represent the views of the EMDE Investor Taskforce, its members or UK Government.

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Executive Summary

Unprecedented geopolitical tensions, economic fragmentation and volatility are significantly impacting the availability of public finance for development while also damaging investment conditions for private finance. These trends reinforce structural vulnerabilities resulting in increased net capital outflows from emerging markets and developing economies (EMDEs) to high-income countries.

Public development banks are explicitly mandated to act to absorb such systemic shocks and mobilise private finance for clean, sustainable development. However, important barriers remain to scaling private finance through multilateral and national development banks for investments in EMDEs. While it is already widely recognised that availability of foreign currency reserves, market liquidity and sovereign debt sustainability can all affect the cost of capital for EMDEs, the role of prudential regulation and credit rating methodologies has been less well explored. There are gaps between the perceived and actual risk of these investments, meaning that evolving these methodologies is a necessary, though not sufficient, condition for scaling private finance to enable EMDEs to deliver national climate and development plans.

2026 is shaping up to be a year of geopolitical turmoil and overlapping shocks, with direct consequences for EMDE fiscal space and the cost of capital. Supply-driven inflation, tighter global financial conditions, and "flight-to-safety" behaviour from investors will raise debt-servicing costs, reinforcing structural vulnerabilities that lead to net capital outflows from EMDEs to high-income countries.[1] In this environment, the ability to finance climate and resilience investment is increasingly constrained – not by ambition alone, but by the price and availability of patient capital from institutional investors.

[1] IMF, 30 March 2026, **How the war in the Middle East is affecting energy, trade, and finance**

The public finance ecosystem of organisations that support emerging markets is broad and deep. Within this, public development banks (PDBs)[2] act as systemic shock absorbers and therefore invest counter-cyclically.[3] For multilateral development banks (MDBs) in particular, distinctive features such as their "callable capital" and "preferred creditor status" enable these institutions to borrow and lend at low rates even under stressed conditions because they are guaranteed by their sovereign shareholders, the majority of which are highly rated. These features permit MDBs to provide a stable flow of investment even in times of restricted availability of private capital availability.

PDB climate finance is growing, reaching approximately $370 billion in 2023,[4] but this is well below the funding required. However, a further issue is the way that risk is translated into capital charges and borrowing costs through prudential frameworks and credit rating methodologies. Through their influence on the cost of capital for EMDE investment, these frameworks and methodologies are an important factor in determining countries' ability to deliver national climate and development plans without destabilising debt dynamics.

Prudential frameworks – including Basel III and, in Europe, Solvency II – play an important role in shaping PDBs' ability to access capital markets and support on-lending between MDBs and national development banks (NDBs). Credit rating agency (CRA) methodologies also influence PDBs' funding costs and lending headroom, with material implications for the cost and availability of capital for borrowers in emerging markets and developing economies. This means that both prudential rules and rating approaches directly affect the ability of development banks to fulfil their public mandates.

Credit rating methodologies. This report finds that CRA methodologies do not yet consistently or fully recognise the operating realities and risk-reducing features of development finance, including preferred creditor treatment, callable capital, NDB mandates and guarantees. Limited instrument-level default and recovery data also constrains more accurate risk assessment.

Prudential frameworks. Basel III and Solvency II can under-credit MDB- and NDB-backed exposures by applying capital treatment that overstates actual risk for guarantees, A/B loans, securitisations, infrastructure and non-OECD exposures. This can raise capital costs, shorten tenors and limit private finance mobilisation.

Barriers to mobilising private finance may therefore arise due to a recurring mismatch between the *regulatory* capital treatment and the *actual* investment risk, which is often reduced by PDB

[2] Finance in Common (FiCS), the global coalition of PDBs, has adopted a broad definition for its members: public financial institutions, established by governments, with a mission to achieve specific policy objectives. This report uses the term "PDBs" to collectively refer to Multilateral, Regional, and National Development Banks, as well as bilateral Development Finance Institutions (specialised international development institutions backed by single governments). Throughout, it will also refer to specific types of PDBs in places where the analysis and recommendations are more narrowly relevant. FiCS, 2025, **Unlocking the Potential of Public Development Banks for Sustainable Development**.

[3] European Commission, February 2023, Discussion Paper 179: **The Role of Public Development Banks & Institutions in the Implementation of the United Nations Agenda 2030: A Survey in Europe**

[4] CPI, **Global Landscape of Climate Finance 2025** (PDF)

involvement. These frameworks, which price the risk of PDB instruments that crowd in the private sector, are currently not aligned with available evidence that demonstrates the extent to which they lower the risk for private sector investors. For example, default rates for MDB- and bilateral development finance institution (DFI)-backed private loans (3.54%) are equivalent to those for non-investment grade firms in advanced economies, while their recovery rates (72.9%) are better than most global benchmarks.[5]

In low-income countries specifically, sovereign risk ratings overstate the default risk of private firms. Private sector firms supported by MDBs and bilateral DFIs show actual average default rates of 7% – over 20 percentage points lower than the default risk implied by sovereign ratings. Evidence suggests many private firms remain creditworthy despite sovereign risk signals, suggesting that the sovereign ceiling constrains access to credit relative to actual corporate performance.[6]

Resolving these discrepancies through targeted, evidence-based clarification could increase the amount of private finance mobilised through PDBs, tighten spreads, and extend tenors. This will support much-needed longer term infrastructure projects and improve the affordability of EMDE transition pathways.

Our recommendations do not seek to reopen frameworks, but rather to support the evolution of regulatory guidance and national transpositions to reflect evolving risk profiles and the role of PDBs in a way that unlocks capital. The exception is the creation of a dedicated NDB asset class, which would require consideration by the Basel Committee. We have therefore scoped this recommendation in a way that reflects the foundational work required as a long-term option for reform once our recommendations on data have been implemented.

Recommendations

We call on finance ministries to work together to deliver a focused agenda through "coalitions of the willing" and, where possible, through existing forums such as the G7, G20, Financial Stability Board (FSB), regional ministerial groups and supervisory colleges.

Evidencing the loss and recovery performance of PDB-supported assets

PDBs should support this agenda by evolving their role as systemic risk-reducing institutions to act as data originators. By providing access to standardised, audited performance histories they can help move EMDE debt from a high-risk to a highly predictable asset class. Enhanced availability and granularity of data is foundational and supports the rest of the

[5] GEMs, 15 October 2024, **New publications by GEMs Consortium offer further insights into emerging market credit risk**

[6] GEMs, March 2026, **Credit Risks and Opportunities for Emerging Market Investments: Insights from MDB/DFI private sector lending** (PDF)

recommendations in this report. Investor comfort – and supervisor acceptance – rises when granular time-series data is standardised and accessible.

1. **A wider set of PDBs should commit to participation in the Global Emerging Markets (GEMs) Risk Database.** Participation currently covers 29 institutions across 40 years of data on sovereigns and 30 years on private market participations. However, coverage is by no means complete and many institutions do not participate, such as those from BRICS nations, or smaller or more specialised institutions. All eligible institutions should pursue membership, supported by existing members. Eligibility currently includes entities within or funded by the public sector and have as their mandate the financing and development of emerging markets, as well as any entity the Steering Committee considers eligible.[7]

2. **PDBs should disclose more granular performance metrics for development finance instruments.** This should include instrument-level default and loss-given-default data for A/B loans, guarantees, insured participations and securitised pools, using GEMs-consistent definitions and building on the aggregated data already available through GEMs reporting. PDBs and investors should collaborate with rating agencies to improve the availability of historical default and recovery data for development finance instruments, as limited data remains a major barrier to more accurate risk modelling. Where possible, institutions should align GEMs reporting with Basel III disclosure requirements. This is particularly relevant for NDBs that are increasingly expected to implement Basel III requirements, including Pillar III disclosures, such as BNDES, KfW and CDB, whereas MDBs are not subject to Basel.

Nevertheless, it is worth bearing in mind that ensuring the ongoing institutional capacity to maintain and evolve important databases, such as GEMs, also requires significant resources, including from donor countries.

Ensuring credit rating methodologies for MDBs and NDBs consistently reflect operating realities

With CRAs continually updating their approaches to rating MDBs and NDBs, there are several opportunities for improved alignment and methodological refinement.

3. **The three major CRAs should continue revising MDB rating methodologies in line with the G20 Capital Adequacy Framework (CAF) Review recommendations.** Substantive differences across CRA methodologies create uncertainty in prudential treatment and capital allocation. S&P has significantly revised its MDB rating methodology to better reflect capital adequacy, shareholder support, and risk exposure, implementing a significant portion of the recommendations made by the G20 CAF Review. However, there remains scope to further refine incorporation of preferred creditor status, callable capital, and concentration risk. Moody's has recently published a new Multilateral Financial Institutions (MFI) methodology,[10] following a consultation process that cited "credit-relevant changes" to the MDBs sector, particularly relating to capital adequacy frameworks and new capital instruments.[11] Fitch

[7] GEMs Membership | MDBs & DFIs, Benefits, and Joining

should endeavour to ensure a similarly comprehensive update is forthcoming, to support consistency while retaining analytical independence.

4. **CRA methodologies should enhance their approaches to NDBs.** They should rate NDBs in the context of their national (and often sectoral) focused development mandates, recognising their distinct institutional characteristics; evaluate NDBs in the context of the unique combination of standalone financial strength and state guarantees; and deploy improved long-term default and recovery data (e.g. the GEMs database) to systematically review NDB ratings. Separately, CRAs should consider how international support mechanisms for NDBs (such as the PDB Guarantee Hub[8]) can in some cases further enhance creditworthiness, and how this is accounted for in ratings.

5. **CRA methodologies should ensure that sovereign credit assessments adequately account for investments in adaptation and resilience, as part of a holistic appraisal of climate risk.** This should include several components: integration into fiscal risk assessments, increased economic resilience to natural disasters, access to disaster risk financing and incorporation into accounting for contingent liabilities. These efforts should be complemented by scoping improved mechanisms for ratings adjustments in the event of natural disasters that could allow impacted countries greater flexibility to respond, without compromising ratings integrity and accuracy. This could include a pause in the review of sovereign risk as the country responds to the disaster, including to account for reduction in administrative capacity and recognition of payment pauses as non-default events.

Carefully scoped prudential supervisory clarifications under Basel and Solvency frameworks

The G20 should mandate the FSB to coordinate with relevant International Standard Setting Bodies such as the Basel Committee on Banking Supervision to undertake a review of the treatment of MDBs, NDBs and bilateral DFIs under the Basel III framework. The review should include:

6. **Reviewing the list of eligible MDBs under Basel III** to ensure completeness. Working across jurisdictions to ensure consistent implementation particularly with respect to major economies and key donor countries such as the UK, US, EU, Japan and South Africa[9] which are also key jurisdictions for the implementation of the Basel Accords and where there are existing gaps.

7. **Evaluating the case for better capital treatment for securitisation, blended finance and A/B loan structures.** This would allow for fuller credit substitution across the structure (not only where the MDB participates) and involve reviewing guidance regarding the criteria

[8] NDC Partnership, IDFC, Finance in Common, MIGA, 14 November 2025, **IDFC, MIGA and NDCP launch the Public Development Bank Guarantee Hub (PDB Guarantee Hub) at COP30**

[9] Institute of International Finance, 26 March 2025, **Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance**

for commensurate risk transfer and where firms are required to "look through" to the underlying assets or obligor.

8. **Reviewing the treatment of infrastructure projects.** While long-term projects are riskier at the initial phase, the risk of default decreases after 5 years (the project having proven its viability and with predictable cash flows). There is a strong case, particularly for transition and resilience infrastructure which are linked to lower rates of default, that the strength of these assets could be better reflected through the application of lower risk weights via the design of dynamic risk weights.[10]

9. **Providing clear, technical-level guidance on the impact of certain exclusion clauses**, such as timeliness and nuclear exclusion clauses, on the eligibility of particular development bank instruments as credit risk mitigants, including conditional guarantees and political risk insurance. This should take note of similar progress made with respect to the Solvency II framework.

10. **Improved CRA methodologies (in line with the recommendations above) could support scaling the use of guarantees to mobilise public and private finance for development and climate transition projects.** These clarifications should be consistent with the recommendations of the Green Guarantee Group.[11] In particular, CRAs could work with prudential regulators to develop methodologies for the treatment of complex partial guarantees, including cases where straightforward pro-rata capital relief is inappropriate (such as if a specific risk is being covered).

11. **Exploring the feasibility of the formal creation of a dedicated NDB asset class with preferential regulatory treatment** that identifies common features across NDBs and bilateral DFIs and differentiates between these institutions and public sector entities (PSEs) given their differing shareholder structures and core features. Relevant authorities should work together across jurisdictions to review and harmonise core regulatory guidance defining criteria determining eligibility and identify qualifying NDBs, building on the criteria currently defined by the Basel Committee on Banking Supervision (BCBS)[12] for MDBs. The BCBS could, for example, establish an application and vetting process according to clear criteria in which it receives such applications and assesses the eligibility.

EIOPA should:

12. **Review whether the continued use of proxies for assessing country risk remains appropriate,** including the use of OECD and non-OECD classifications under the Standard

[10] International Chamber of Commerce, June 2025, **Enhancing climate finance in emerging markets and developing economies** (PDF)

[11] Climate Policy Initiative, June 2025, **Scaling Up Green Guarantees: Recommendations by the Green Guarantee Group**

[12] The Basel Framework, January 2023 effective, June 2025 updated, **CRE - Calculation of RWA for credit risk, CRE20 - Standardised approach: individual exposures**

Formula in Solvency II,[13] which can impact private sector participation where the benefits of investing alongside the participating MDB are not recognised.

13. **Review the list of eligible MDBs under Solvency II** to ensure completeness. Basel III and Solvency II operate a unified list of eligible MDBs, therefore both should be reviewed to ensure consistency.

14. **Review the eligibility of MDB-supported green and resilient infrastructure investments under mechanisms such as the matching adjustment under Solvency II**, for example in the UK changes made to expand eligibility to take into account assets with "highly predictable cashflows".

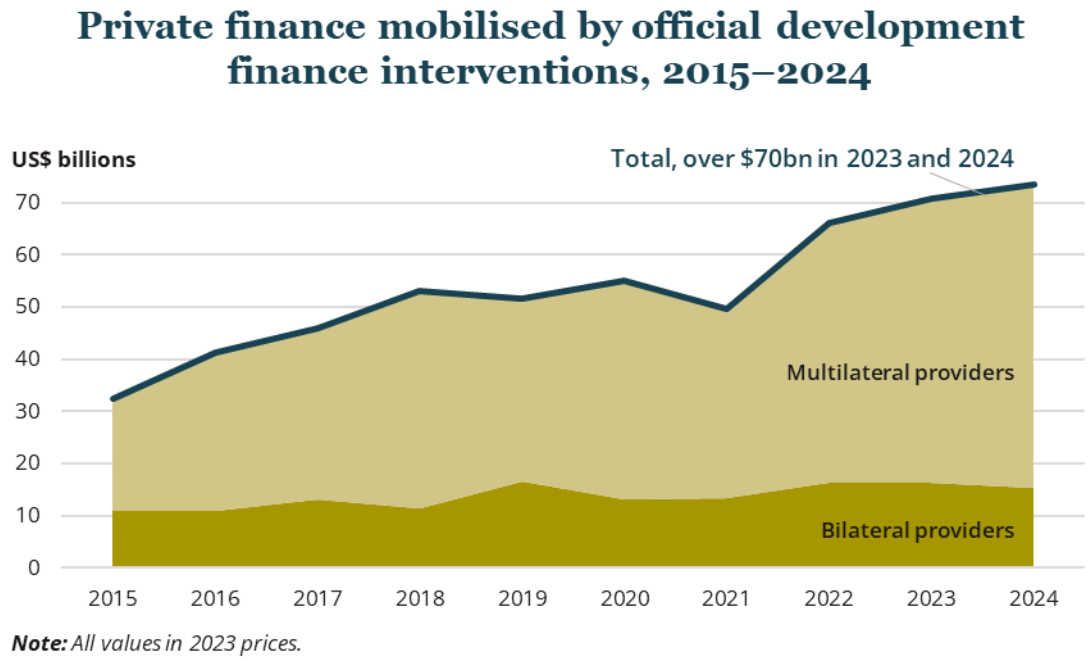
Commitment from the public finance ecosystem on this agenda

15. **Under the G20 International Financial Architecture Working Group, PDBs, financial regulators, and CRAs should convene to discuss collaborating on a framework for reform.** This could take the form of establishing a joint Memorandum of Understanding to align incentives and strengthen coordination across the financial ecosystem. Under this framework, PDBs would commit to improving the availability and quality of data, regulators would assess and adapt supervisory frameworks accordingly, and credit rating agencies would progressively refine their methodologies. This coordinated approach would create a virtuous cycle, reinforcing transparency, risk assessment, and capital mobilisation towards shared objectives.

[13] European Commission, **Solvency II Review**

Background and context: Cost and availability of capital – the key to unlocking transition investment

Private sector financial institutions engage with development banks in a variety of ways, from purchasing bonds to participating in co-financing arrangements. Private finance mobilised through official development finance interventions reached $70 billion in 2023, following a strong rebound from a four-year low in 2021 (Figure 1).[14]



Note: *All values in 2023 prices.*

Source: *OECD Data Explorer, **Mobilised private finance for development***

Figure 1: Private finance mobilised through official development finance interventions has been steadily growing, driven primarily by growth in mobilisation through multilateral providers.

However, private sector participation in development finance remains lower than needed overall. The 2023 Joint Report on MDB Mobilization (published in 2025) suggests that for every $1

[14] OECD, June 2025, **Tracking Private Finance Mobilisation: Latest trends and ways forward**

of multilateral development bank (MDB) capital, only $0.25 to $0.40 of private capital is mobilised in low-income countries.[15] Institutional investors still provide only a modest proportion of capital mobilised through structures supported by public development banks (PDBs), with the largest proportion coming from banks. A persistent perception among private sector investors that these transactions are structurally high-risk leads to conservative pricing, short tenors, and limited balance sheet allocation.

A growing body of practice recognises that the potential for scaling climate finance in EMDEs is constrained not only by the *volume* of available capital, but by the *velocity* at which capital can be absorbed into investable projects aligned with countries' NDCs. Project preparation costs, regulatory uncertainty (e.g., tariff setting and contract enforceability), and gaps in public enabling infrastructure can slow the conversion of national plans into bankable pipelines.

While significant progress has been made in the development of public bank mandates and innovative financing instruments, the prudential and credit risk architecture that shapes how private capital assesses and prices EMDE exposures has not kept pace with market actors' understanding of the actual risk profile of these investments. Although pipeline quality should continue to improve, prudential rules and market conventions could adapt to better reflect risk-reducing features through lower capital charges. For finance ministries, the implication is that supply-side de-risking (power purchase agreements, guarantees, and preparation facilities) and prudential risk alignment are complementary: accelerating one without addressing the other will not allow the full scaling up of development finance.

In this context, the price and availability of patient capital, especially long-tenor capital, becomes a binding constraint on transition investments in EMDEs. PDBs should be able to invest counter-cyclically to help smooth out volatility in local markets, but their ability to do so is partly determined by how rating agencies assess them, and how prudential rules treat their assets and risk-reducing instruments.

The recommendations included in this report are aimed at improving the enabling environment for PDBs to properly perform this function and fulfil their mandates.

[15] MDBs and DFIs, February 2025, **Mobilization of Private Finance** (PDF)

Chapter 1: Credit rating agency methodologies and prudential implications

This section explores how credit rating methodologies interact with prudential frameworks and shape capital requirements for transition finance.

The role of credit rating agencies in the cost of capital in EMDEs

Credit rating agencies (CRAs) play a central role in the architecture of global finance. The ratings that they provide materially impact the cost and availability of capital across supranational, sovereign and corporate borrowers. Emerging evidence suggests that climate vulnerability is already influencing sovereign borrowing costs. Countries highly exposed to climate risks – including small island developing states (SIDS) and climate-vulnerable developing economies – often face higher interest rates when issuing sovereign debt and pay a measurable risk premium in sovereign bond markets.

Several dynamics contribute to this phenomenon:

- **Physical risk exposure**: Frequent natural disasters increase fiscal volatility and raise concerns about long-term economic stability.
- **Insurance and reconstruction costs**: Governments in climate-vulnerable countries face rising expenditures related to disaster response and infrastructure repair.
- **Investor risk perceptions**: Investors may demand higher yields to compensate for perceived climate risks, particularly in countries with limited fiscal buffers.

Modelling suggests that rising global temperatures could lead to widespread sovereign credit rating downgrades by 2030 and beyond, driven by these interrelated factors. If realised, such downgrades could significantly increase debt servicing costs for vulnerable countries, further constraining their ability to finance climate adaptation and resilience investments. This risks becoming a negative feedback loop, as countries' increased climate risk due to their limited ability to build resilience further raises their borrowing costs (Figure 2).

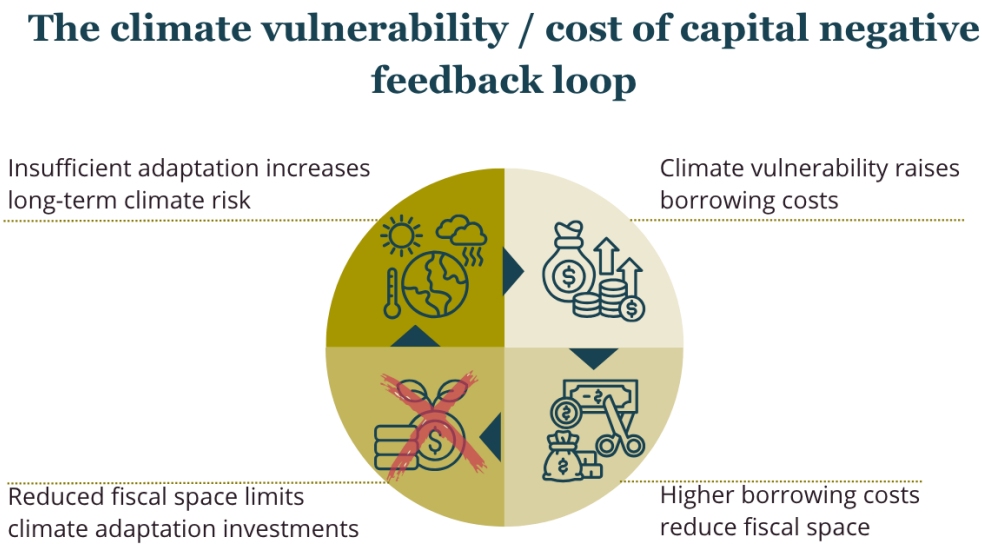


Figure 2: Climate vulnerable countries often face higher borrowing costs. This reduces their ability to invest in climate resilience, exposing them to increased climate vulnerability as the impacts of climate change increase, leading to a reinforcing cycle of growing cost of capital and climate exposure.

Breaking this cycle requires careful consideration of how climate resilience investments are treated within credit assessments. While investments in climate adaptation can significantly reduce the economic impact of climate shocks, they often increase public debt in the short term, potentially weakening fiscal indicators used in credit rating models.

If rating methodologies fail to recognise the long-term benefits of resilience investments, governments will be less incentivised to undertake them. Developing more forward-looking credit assessment frameworks that incorporate resilience benefits could help align fiscal incentives with climate risk management.

For public development banks (PDBs), including multilateral development banks (MDBs), national development banks (NDBs), and bilateral development finance institutions (DFIs), credit ratings influence their ability to access “cheap” funding via capital markets. Risk absorption and concessional financing are typically the core means by which PDBs effectively fulfil their mandates and sustain their business models (while maintaining small margins). They do this by addressing failures in commercial markets, either by investing where the private sector will not, or by making projects viable for private market participation that would otherwise have been considered too risky. Credit ratings in turn determine the rates at which PDBs can issue bonds, which means that credit ratings can have a significant impact on the scale at which PDBs can provide development and climate transition finance.

In recent years, the interaction between credit rating methodologies and prudential regulatory frameworks has become increasingly important for the financing of climate mitigation, adaptation, and resilience. As climate-related risks intensify and capital needs grow, the way these risks are reflected in sovereign and institutional credit assessments will have profound

implications for borrowing costs, capital adequacy frameworks, and the lending capacity of development finance institutions.

The role of ratings in prudential frameworks

Ratings in Basel III

Credit ratings play an important role in prudential banking regulation, particularly within the Basel III framework. Under Basel, firms can either: (i) use the standardised approach, which comprises a set of formulas for calculating regulatory capital requirements mandated by the regulator; or (ii) seek approval from the regulator to use their own internal models instead of those mandated by the regulator.

Banks using the standardised approach for credit risk rely on external credit ratings to determine risk weights for sovereign, bank and corporate exposures. Higher-rated borrowers receive lower risk weights, reducing the capital banks must hold against those exposures. As a result, sovereign rating downgrades can have significant implications for bank balance sheets and lending capacity.

The impact of Basel varies by institution. Large NDBs and commercial banks often have dedicated credit risk teams, internal models and proprietary data, which can reduce their reliance on the standardised approach. Smaller banks, by contrast, are more likely to depend on the standardised approach and are therefore more directly affected by its treatment of external credit ratings.

Even where banks use internal models, external ratings remain important. Regulators often require firms to validate internal methodologies against external credit assessments, meaning CRA ratings continue to shape capital requirements indirectly. This reliance will increase under Basel 3.1, because the output floor limits the extent to which internal models can reduce capital requirements below the standardised approach. As a result, external ratings will become more relevant even for larger institutions with internal models and their own data.

Ratings in Solvency II

For insurance companies, the European Union's Solvency II framework similarly incorporates credit ratings when determining capital requirements for fixed income investments. Higher-rated bonds attract lower capital charges, making them more attractive to institutional investors. As major purchasers of MDB bonds, insurance companies rely on ratings to assess risk and determine regulatory capital requirements.

Implications for development finance

Because prudential frameworks rely heavily on ratings, methodological changes by CRAs can have systemic implications for development finance, for example:

- Changes in risk weight assumptions for MDB exposures could affect investor demand for MDB bonds.
- Sovereign rating downgrades could increase borrowing costs.
- Ratings influence the ability of PDBs to leverage capital market funding.

Ensuring that rating methodologies appropriately reflect institutional features, such as preferred creditor status and government shareholder support, is therefore critical.

Recent changes in MDB rating methodologies and their drivers

CRAs typically evaluate MDBs using specialised methodologies that differ from those applied to sovereigns or commercial financial institutions. MDBs possess unique institutional characteristics, including shareholder backing by sovereign governments, preferred creditor status, and a mandate to pursue development and climate objectives rather than profit maximisation. Historically, these features have supported very high credit ratings – often AAA – for major MDBs.

However, as MDB balance sheets expanded and global fiscal conditions evolved, rating agencies began revisiting their methodologies to better capture the underlying financial and institutional risks associated with MDB operations (Figure 3). MDBs (as opposed to NDBs, which are regulated depending on their relationship with national regulators) are not regulated, but are instead governed by the treaties under which they were instituted. Therefore, the capital adequacy framework (CAF) reforms initiated under the G20 were aimed at achieving cross-MDB consensus and harmonisation, which was seen as a necessary step before other actors, such as CRAs, could adjust their approaches.

Timeline of recent evolution of MDB rating methodologies

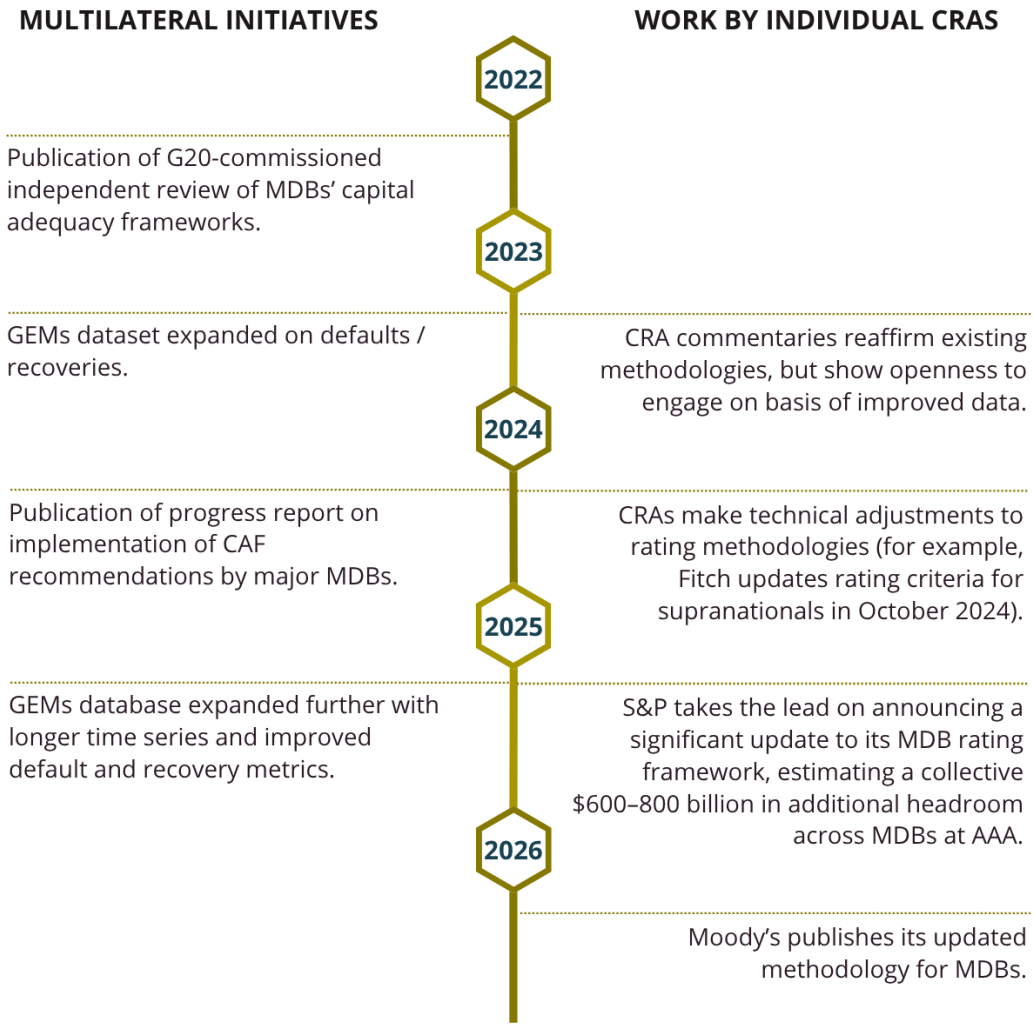


Figure 3: Timeline depicting the evolution of CRAs' MDB rating methodologies over recent years, along with key multilateral initiatives in this area during the same period.

Several factors have driven the evolution of MDB rating methodologies:

- **Calls for MDB capital adequacy reform**: The G20-commissioned independent review of MDB capital adequacy frameworks (CAF) highlighted opportunities to expand MDB

lending capacity without jeopardising financial stability.[16] This review prompted greater scrutiny of how rating methodologies treat MDB capital structures.

- **Access to higher quality data**: The publication of significant parts of the Global Emerging Markets Risk (GEMs) database – one of the key recommendations of the G20 CAF reform report – has enabled the CRAs to conduct more granular, sector-focused risk analysis and a resulting reassessment of risk.
- **Expansion of MDB lending**: The scale of MDB lending has increased significantly in response to global crises, including the global financial crisis, the COVID-19 pandemic, and the growing need for climate finance. Larger balance sheets require more sophisticated risk measurement.
- **Rising global debt risks**: Increased sovereign debt levels in many emerging markets have heightened concerns about concentration risk (when financial exposure heavily depends on a group of correlated assets, as opposed to being diversified) within MDB portfolios.
- **Climate risk considerations**: Climate change introduces new forms of systemic risk that may affect sovereign borrowers, infrastructure assets, and development finance portfolios.

In response to these factors, rating frameworks have begun to evolve, increasingly emphasising, the strength of shareholder support, the quality and diversification of loan portfolios, capital adequacy and risk concentration, liquidity and funding profiles, and institutional governance and policy frameworks.

While these principles have long been present in MDB assessments, recent methodological revisions have refined how these components are measured and weighted.

Spotlight: S&P's Revised MDB Framework

One of the most significant recent developments was S&P's revision of its MDB credit rating methodology in 2025.[17] S&P sought to update how capital adequacy, shareholder support, and risk exposures are incorporated into MDB ratings.

The revised framework retained the core structure of S&P's risk-adjusted capital (RAC) framework, which has been in place since 2012 and measures the relationship between MDB capital resources and their risk-weighted exposures. The 2025 revision introduced targeted changes to specific metrics within that framework, most notably:

[16] Independent review of multilateral development banks' capital adequacy frameworks, 2022, **Boosting MDBs' Investing Capacity** (PDF)

[17] S&P Global, 13 October 2025, **Updated multilateral lending institutions ratings methodology published**

- **Preferred creditor treatment (PCT):** The most significant change in the 2025 revision was an increased benefit given to preferred creditor treatment within the RAC. This followed sustained engagement by MDBs, which worked collectively to present joint evidence to S&P following the CAF review. The result was a substantial increase in RAC ratios and hence lending headroom for MDBs under a given rating level. However, PCT treatment remains inconsistent across CRAs and continues to warrant further refinement.
- **Concentration risk:** MDB portfolios are often concentrated in sovereign exposures from EMDEs, by virtue of their mandates. The revised framework reduced the penalty previously applied to MDB portfolio concentration, which had in some cases resulted in risk weight increases of over 100%. This change was particularly beneficial for regional MDBs with sovereign-focused mandates.
- **Callable capital recognition:** Callable capital – the legally binding commitment by shareholders to provide additional capital if needed – has long been a distinctive feature of MDB financial structures. The revised methodology did not materially alter S&P's existing treatment of callable capital. S&P's framework already recognised callable capital from highly rated shareholders as a meaningful credit support prior to the 2025 revision, and gives the greatest weight to callable capital of the three major CRAs. S&P still assigns zero value to callable capital from shareholders rated below AA, on the assumption that they would be unable to fulfil their obligation in the event of a crisis. This oversimplifies the real-world value of total shareholder capital, since it is highly unlikely that no shareholders below this threshold would be able to meet their obligations in a crisis. A weighted accounting system for the commitments of shareholders below this threshold would contribute to a more complete valuation of total shareholder callable capital.
- **Shareholder support and institutional strength:** MDB ratings continue to benefit significantly from the credit quality of their shareholder governments. The framework evaluates both the willingness and capacity of shareholders to provide support. Institutional governance, policy frameworks, and track records of prudent risk management also play an important role in determining ratings. No meaningful changes were made to these elements in the 2025 revision.

Treatment of country risk and guarantees

Country risk in rating methodologies

Country risk plays a central role in the credit assessment of both sovereign borrowers and PDBs. For MDBs, country risk primarily affects ratings through the creditworthiness of loan portfolios. As MDBs typically lend to sovereigns or sovereign-guaranteed entities in EMDEs, sovereign credit quality directly influences the risk profile of MDB assets.

Rating agencies incorporate country risk through several mechanisms (sovereign risk weights applied to loan exposures, concentration limits for individual country exposures, and macroeconomic and institutional risk indicators). This approach ensures that MDB portfolios reflect the underlying credit conditions of borrowing countries.

NDBs differ significantly from MDBs in their ownership structures, mandates, and operating environments. Many NDBs are wholly owned by national governments and therefore closely linked to sovereign creditworthiness.

CRAs typically assess NDBs through hybrid frameworks that use a combination of stand-alone credit assessments, explicit or implicit sovereign support assumptions, policy mandate considerations, balance sheet strength and capital adequacy, and governance and risk management practices.

Unlike MDBs, most NDBs do not benefit from diversified international shareholder bases or preferred creditor status. As a result, their ratings often move closely with those of their home sovereigns. Nevertheless, strong institutional frameworks and policy mandates can support rating uplift relative to the sovereign rating in some cases.

Guarantees as credit enhancement

PDBs frequently use guarantees to mobilise private capital for development projects. These guarantees can cover political risks, payment default risks, currency convertibility risks, and regulatory or contractual breaches.

From a credit rating perspective, guarantees can significantly enhance the credit quality of the underlying exposure. However, rating methodologies vary in how they recognise the risk-mitigating effect of guarantees.

Key considerations include the legal enforceability of the guarantee, the creditworthiness of the guarantor, and the specific terms and coverage scope of the guarantee.

Greater methodological clarity around guarantees could help ensure that the credit-enhancing role of PDBs is appropriately recognised.[18]

[18] See **BIS guidance on credit risk mitigation**

Recommendations

Recommendations for credit rating agencies

Ensure MDB rating methodologies are aligned with the recommendations of the G20 Capital Adequacy Framework (CAF) Review Recommendations

CRAs should ensure that rating methodologies are consistent in their treatment of unique MDB characteristics, in line with the recommendations of the G20 CAF Review and without compromising analytical independence. Differences across CRA rating methodologies create uncertainty in prudential treatment and capital allocation. Where methodologies of the "Big Three" CRAs diverge, MDBs must in practice calibrate to the most conservative approach, reducing the system-wide benefits of any single agency's improvements.[19] Greater consistency on conceptual approaches to key elements (e.g., preferred creditor treatment, callable capital) would reduce this friction without requiring convergence on specific metrics. International bodies such as IOSCO and the FSB have a role to play in facilitating this dialogue.

S&P has taken meaningful steps in its 2025 methodology revision, particularly through the recalibration of PCT risk weights and the reduction of concentration risk penalties, which have substantially increased MDB lending headroom. However, there remains scope to further refine the incorporation of preferred creditor status and concentration risk, and in the valuation of callable capital. In particular, developing a weighted accounting system (based on assessed creditworthiness) for the callable capital commitments of shareholders below the current AA threshold would support a more accurate and complete reflection of total shareholder strength (and creditworthiness in the event of a crisis).

Moody's 2026 methodology revision will similarly contribute to increased MDB lending headroom.[32] In particular, the introduction of a new MFI adjusted capital ratio (MAC), in conjunction with enhanced valuation of (some) callable capital and a stronger uplift from preferred creditor status, are meaningful changes.[33] That said, the valuation of callable capital remains capped, and updates to the treatment of concentration risk do not benefit smaller, regional MDBs with narrower mandates.

Fitch should ensure an update to its rating methodology is forthcoming and equally comprehensive in its revisions (in line with the G20 CAF recommendations)[34] to ensure system-wide consistency on core principles.

[19] ODI Global, 21 October 2025, **The $600 billion question: how far can multilateral development banks go?**

Develop dedicated NDB-adjusted rating frameworks to refine NDBs' ratings treatment beyond existing hybrid frameworks

The penalisation of geographic and sector concentration by existing hybrid CRA methodologies, while potentially appropriate for commercial financial institutions, does not apply in the same way to PDBs given their mandate-driven risk profiles. This is particularly consequential for NDBs, given that these characteristics are typically inherent to their mandates. This, along with the strong linkage to home sovereign ratings, can limit the flexibility of NDBs to innovate financially, such as through risk-sharing. While they do not benefit from the preferred creditor status or diversified, multi-state shareholding of MDBs, NDBs are designed to play a counter-cyclical, national development role, and benefit from a combination of standalone strength and state guarantees.

Consequently, CRA methodologies should:

- Rate NDBs in the context of their national (and oftentimes sectoral) focused development mandates – recognising their distinct institutional characteristics and avoiding ratings formulas intended for commercial financial institutions whose risk profiles do not account for the privileges, state guarantees and counter-cyclical mandates that make NDBs structurally different from commercial peers. CRAs should also consider allowing NDBs whose financial metrics justify it to be rated above the sovereign ceiling, rather than treating sovereign linkage as a binding constraint.
- Evaluate NDBs in the context of their unique combination of standalone financial strength and state guarantees, as well considering the associated 'halo' effect.
- Consider how international mechanisms for NDBs (such as the PDB Guarantee Hub[20]) can in some cases further enhance creditworthiness.
- Deploy improved long-term default and recovery data (e.g. the GEMs database) to systematically review NDB ratings.

Adapt rating horizons to systematically embed climate risks and mitigating actions in sovereign credit assessments

CRA methodologies should ensure that sovereign (and institutional) credit assessments adequately account for investments in adaptation and resilience, as part of a holistic appraisal of climate (both physical and transition) risk. This integration should consider:

- Data enhancements that assess countries' natural capital base (such as ecosystem services) and forward-looking data that assesses climate vulnerability;

[20] NDC Partnership, IDFC, Finance in Common, MIGA, 14 November 2025, **IDFC, MIGA and NDCP launch the Public Development Bank Guarantee Hub (PDB Guarantee Hub) at COP30** (PDF)

- The value of fiscal reforms aimed at increasing economic resilience to climate shocks – in view of the long-term economic impacts of climate change, this should include rewarding investment in resilient infrastructure that often disrupts the country's short-term fiscal position; and
- Allowing grace periods that reflect a country's ability to access adequate levels of disaster risk financing.

These efforts should be complemented by scoping improved mechanisms for ratings adjustments in the event of natural disasters that could allow impacted countries greater flexibility to respond, without compromising ratings integrity and accuracy.

Recommendations for lenders

Improve instrument-level default and recovery data

A major constraint on improved risk modelling is the limited availability of historical data on default and recovery rates for development finance instruments. Developing time-series data for instruments such as A/B loans, guarantees and political risk insurance would allow rating agencies to refine risk assumptions and improve analytical precision. Collaboration between PDBs, investors, and rating agencies could support this effort in the following ways:

- A wider set of PDBs should commit to participation in GEMs, using their evolved role as systemic risk-reducing institutions to act as data originators. By providing standardised, audited performance histories they can help move PDB-supported EMDE debt from a high-risk to a highly predictable asset class. While participation currently covers 29 institutions (major MDBs and DFIs), many smaller or more specialised institutions do not participate. All eligible institutions should pursue membership, with the support of existing members. Eligibility currently includes entities within or funded by the public sector and have as their mandate the financing and development of emerging markets, as well as any entity the Steering Committee considers eligible.
- Specifically in the case of guarantees, the GEMs Consortium should expand the GEMs database to include a guarantee performance database, in line with the recommendations of the Green Guarantee Group. The database should incorporate guarantee-specific information on default rates, recovery rates and pricing benchmarks across sectors and countries, alongside relevant macro-financial indicators such as sovereign default events and real exchange rate movements. It should also be structured to support the analytical approaches used by credit rating agencies and draw on both public- and private-sector data sources. Expanding the evidence base in this way would address one of the principal constraints to improving risk modelling, enabling more accurate guarantee pricing, strengthening credit assessments and ultimately contributing to a lower cost of capital.

- To facilitate data collection and reduce reporting burdens, institutions should, where possible, seek to align GEMs reporting with existing Basel III disclosure requirements. This is particularly relevant as an increasing number of NDBs are expected to comply with Basel III – including Pillar III disclosure requirements – while MDBs are generally not subject to the Basel framework. Greater alignment would improve data comparability, strengthen the evidence base for risk assessment and enable more consistent analysis across development finance institutions.

Chapter 2: Prudential regulation and the treatment of public development bank exposures

Prudential regulations similarly have an influence over the mobilisation and allocation of private capital, as well as the ability for PDBs to access capital markets alongside other well-recognised demand and supply-side constraints already discussed earlier in this report. This section of the report therefore focuses on the prudential treatment of MDB-, NDB- and broader PDB-supported exposures in jurisdictions where Basel III and Solvency II-style frameworks (primarily focused on the EU and the UK) materially shape private capital allocation, particularly in advanced-economy banking and insurance markets.

There is space within current prudential frameworks to make targeted, risk-based adjustments to reflect the counter-cyclical and systemic risk reducing role of PDB-supported investments. Such adjustments would be aimed at better supporting development finance in EMDEs, while reflecting the core objective of prudential regulation to promote financial stability. In addition, there are opportunities to tailor national transpositions under both Basel III and Solvency II.

These opportunities include providing updated guidance and best practice addressing:

- The treatment of PDB exposures under Basel III, including guarantees, risk-sharing instruments and securitised assets.
- Solvency II treatment of PDBs and their instruments for insurers.
- Areas where current market best practices are inadequately covered, approaches are outdated or overly conservative due to data gaps or simplified risk assumptions, such as the use of OECD vs non-OECD as a proxy for country risk, or a lack of availability of instrument-level data.
- How climate transition characteristics (longer time horizons, policy-backed revenue streams, and the growing commercial attractiveness of renewables investments) interact with prudential requirements.

The macro-financial imperative for recalibrating prudential treatment

Prudential frameworks (Basel III for banks and Solvency II for EU insurers) play an important role in shaping how PDBs are able to mobilise private finance, both by (a) providing important signalling to financial institutions on where and how to allocate capital; and (b) influencing the commercial viability of co-financing with MDBs and PDBs. Tentative steps have been taken by the UK Prudential Regulation Authority (PRA), ECB, EBA and EIOPA to improve guidance to firms, adjust how certain aspects of prudential frameworks assess the risk of these investments, and improve supervisory practice. However, there are concerns that changes made still treat developing countries as a homogenous block rather than reflecting a more nuanced understanding of the risks of different development finance exposures and developing countries.

The foundations of the international prudential regulation framework were fundamentally overhauled after the 2008 crisis – before the Paris Agreement and before Mark Carney's "Tragedy of the Horizon" speech[21]. At the same time, the creditor base has expanded exponentially since Basel III was agreed. Reforms related to the climate transition, long-horizon green infrastructure, or blended finance vehicles in EMDEs were not a priority. As a result, many bank and insurance balance sheets face structural disincentives to investing in the core development and climate transactions that MDBs and PDBs are explicitly mandated to scale. Such disincentives include:

- Limited recognition of MDB/NDB guarantees or risk-transfer arrangements.
- Conservative or inconsistent treatment of securitised or tranched products associated with MDB/NDB portfolios.
- Gaps in loss history and default data that prevent regulators from calibrating rules to existing empirical risk.

This does not necessarily mean changes to prudential regulation are sufficient in and of themselves. Nevertheless, targeted risk-consistent adjustments to prudential requirements, alongside other demand and supply-side reforms and within existing Basel and Solvency frameworks, can help to expand private co-financing with PDBs/MDBs without undermining financial stability. Such adjustments do not require reopening core Basel III or Solvency II negotiations. Rather they involve clarifying supervisory guidance, updating interpretations, and incorporating existing and emerging empirical evidence.

[21] Speech by Mark Carney given at Lloyd's of London, September 2015, **Breaking the tragedy of the horizon - climate change and financial stability**

MDBs and NDBs as system-level risk-reducing institutions

MDBs are a linchpin in the international financial landscape, moving beyond bilateral lending to become providers of system-level risk mitigation. NDBs play a similar role within their jurisdictions and, in the case of bilateral DFIs, beyond their own borders. When assessed on portfolio performance, liquidity buffers and capital adequacy, MDBs – and many NDBs and bilateral DFIs – often behave more like quasi-sovereign stabilisers than conventional public-sector entities. The evidence already available shows that across sovereign, corporate, and structured transactions MDB portfolios consistently outperform private lenders during crises,[22] while NDBs and bilateral DFIs with strong mandates and governance structures perform better than typical "public-sector entities".[23] Development bank involvement, whether through origination discipline, policy links, or preferred creditor practices, reduces both the probability of default and loss given default. This is sometimes referred to as the "halo effect" of investing alongside these institutions.

They do this through:

- Strong capital and liquidity policies (including sizeable liquidity buffers and the backstop of callable capital), enabling counter-cyclical lending in periods of stress.
- Preferred creditor dynamics in respect of sovereign exposures and institutional seniority practices that support unusually strong repayment performance in sovereign stress episodes (where applicable).[24]
- Origination discipline and monitoring capacity (technical due diligence, safeguards, ongoing supervision) that improves borrower behaviour and reduces loss severity.
- Portfolio approaches – guarantees, risk transfers, securitisation vehicles, and data initiatives – that diversify and redistribute risk in ways that can crowd in private investors.

These system-level features support better key credit risk metrics such as probability of default, loss given default and monitoring of non-performing loans, but they will not translate into lower borrowing costs at scale unless they are consistently recognised in prudential treatment and investor capital models.

The emerging empirical evidence clearly supports this where these loans are backed by participation from MDBs and NDBs:

[22] Fitch Ratings, 18 February 2025, **New Sovereign Default Data Highlight MDBs' Preferred Creditor Status**

[23] AFD, October 2020, **Funding sources of national development banks** (PDF); ODI, December 2022, **An exploration of bilateral development finance institutions business models** (PDF)

[24] Fitch Ratings, February 2025, **New Sovereign Default Data Highlight MDBs' Preferred Creditor Status**

- Annual average default rates for MDB and DFI-backed private loans (3.54%) are comparable to advanced economies, with high recovery rates (72.9%). While for sovereign loans this drops to 0.2%, with recovery rates over 95%.[25]
- MDB sovereign portfolios have exceptionally low non-performing loans (NPLs) – as low as 0.2–0.3% for several AAA institutions and consistently below commercial comparators.[26]
- Even sub-AAA MDBs show NPL rates far below the 2.6% average estimated by S&P for non-MDB sovereign lenders.[27]
- For NDBs NPL rates are roughly comparable with some institutions operating at 0-3%.[28] However, there are some institutions that run slightly higher at between 5 and 7%.[29]
- Loss given default (LGD) for MDB sovereign portfolios tends to be 2–10%, significantly lower than the 45–52% LGD assumed in standard Basel guidance for commercial lenders.[30]

A central rationale for recalibrating the prudential treatment of MDB/NDB exposures rests on the accumulated evidence that these institutions reduce credit risk at both project and portfolio level.

MDB loan risk is now a recognised and growing (re-)insurance asset: EBRD's unfunded risk participation (URP) volumes, ADB's multi-insurer panels, and MCPP structures show insurers are progressively allocating capital, where the prudential framework allows, at scale. Nevertheless, while the GEMs 2025 reports provide aggregated statistics, the underlying granular data remains confidential to the participating MDBs and DFIs. Without a product that shares disaggregated data, commercial insurers and pension funds cannot use this data to justify lower capital buffers to their respective national regulators.

[25] **GEMs default and recovery statistics**

[26] **GEMs default and recovery statistics**

[27] ODI Global, February 2026, **Preferred Creditor Treatment and Multilateral Development Banks' Mobilisation Agenda – Working paper** (PDF)

[28] SOAS Development Leadership Dialogue Case Study, March 2025, **Banking on Transformation: China Development Bank's Role in China's Development** (PDF); Scope Ratings, June 2025, **Scope affirms KfW at AAA with Stable Outlook**

[29] Fitch Ratings, September 2025, **AFD** (Highlights that the majority of non-performing loans sit within their private sector lending portfolio as opposed to their sovereign exposures.)

[30] ODI, March 2024, **How Likely are Multilateral Development Banks to Need Callable Capital? – Working paper** (PDF)

MDBs as empirically low-risk counterparties: implications for Basel calibration

Basel III's standardised approach (SA) remains the dominant regulatory model in most EMDE banking systems and continues to govern the treatment of MDB/NDB/bilateral DFI exposures in many advanced jurisdictions. While the Basel Committee on Banking Supervision (BCBS) recognises a subset of MDBs for a 0% risk weight, the framework has not kept pace with the expansion of the MDB system nor with the diversification of their instruments.

At the same time, the allocation of lower risk weights to NDBs/bilateral DFIs is left to the discretion of national supervisors, while jurisdictions also differ significantly with respect to the treatment of NDBs themselves under Basel. There is no standard global exemption from the Basel Committee, therefore some NDBs which are deposit taking institutions are regulated to a degree by their national supervisors, but most will be subject to exemptions. This means that, in practice, these institutions are often treated similarly to public sector entities – a practice that does not reflect the strength of their mandates and sovereign guarantees or that of their own internal financial risk management practices.

Together, these issues mean that transactions which should appear attractive under risk-sensitive prudential standards instead trigger disproportionately high capital requirements – reducing the supply of private co-financing.

The consequences of the treatment of these exposures result in gaps that reduce the capacity of Basel-regulated financial institutions to participate in MDB/NDB/bilateral DFI-co-financed transactions, even when those transactions demonstrably carry lower credit risk than their regulatory treatment implies.

Table 1: MDB instruments – their capital treatment and Basel III and Solvency II, and the primary regulatory hurdles to better treatment

Instrument	Description	Basel capital treatment	Solvency capital treatment	Primary regulatory hurdle
Overall MDB treatment		0% risk weight	0% spread risk factor	
Synthetic securitisation	Bank retains assets but buys credit protection (via guarantees or derivatives) from an MDB/NDB for specific tranches (usually mezzanine or junior risk).	Significant Risk Weighted Assets reduction if significant risk transfer is proven through substitution of the higher risk weight that would have applied with that of the MDB.	Spread risk is often a high capital "cost" for these types of deal structure.	Strict "commensurate risk transfer" tests.

A/B loans	**A loan:** funded and held by the MDB, benefits from a 0% or low risk weight. **B loan:** funded by commercial participants but participated through the MDB.	Partial RWA reduction (mainly for "A" portion). B portion not automatically granted the risk weight associated with the A portion.	The B portion is usually treated as a corporate or sovereign risk.	Preferred Creditor Status not always recognised for "B" portion.
Partial guarantees	Benefit from substitution for the guaranteed portion of the loan.	For partial credit guarantees, only the covered portion receives capital relief. The uncovered portion only retains the original risk weight of the borrower.		Pricing & "moral hazard" concerns.
Blended (first-loss)	Uses "catalytic" MDB/NDB capital to de-risk private investment. MDBs take a "first-loss" or junior position. This effectively creates a synthetic "thickening" of the senior tranche for private lenders.	Structural credit enhancement. Private lenders can treat the senior tranche as having a lower probability of default due to the MDB's first-loss buffer, though direct risk-weight relief usually requires a formal guarantee or securitisation structure.		Complexity in "look-through" calculations.

Basel risk weights for MDBs – completeness and national transposition

A first step could involve expanding the BCBS-recognised list of MDBs under the Basel framework and establishing transparent eligibility criteria (e.g. governance quality, capital adequacy, lending performance, sovereign backing). Institutions that are not currently included are, for example, Corporacion Andina de Fomento (CAF), New Development Bank and other smaller, regional development banks such as the Black Sea Trade Bank, West Africa Development Bank (BOAD), Central American Bank for Economic Integration, and the Trade and Development Bank.

Currently, the BIS guidance on criteria for including MDBs in the list of those benefiting from 0% risk weighting focuses on those that hold AAA ratings, sovereign shareholders and level paid in capital, as well as a strict application of lending requirements. Expansion of these criteria could include:

- Recognising MDBs that are identified by all or one of the following: (i) the EU under prudential requirements for credit institutions and investment firms; (ii) the OECD under

its Multilateral and Regional Institutions Risk Classifications; and/or (iii) international agreements registered with the Secretariat of the UN.

- Establishing an application and due diligence process for inclusion in the list, including the option for peer references.
- Including specific reference to external bodies such as CRAs, leveraging the updates made to rating methodologies.
- A demonstrated track record of good governance and implementation of stated lending requirements and investment policies.

MDB securitisations or synthetic risk transfers

MDBs, bilateral DFIs and NDBs increasingly deploy structured instruments to mobilise capital, e.g. A/B loans, synthetic securitisations, risk-transfer vehicles, hybrid guarantees and mezzanine tranches. Yet when Basel capital requirements are applied to these types of structured instruments and securitisations in an emerging market context, they often assume the credit risk or default to the credit rating of the borrower, overlooking MDBs' role as anchor investors and servicers.

MDB securitisations or synthetic risk transfers – such as AfDB's Room2Run,[31] IFC's Collateralised Loan Obligation[32] and IDB Invest[33] structures – have several distinguishing features:

- Pools typically consist of high-quality, MDB-originated assets.
- Historical repayment behaviour is significantly superior to corporate Emerging Markets securitisations.
- MDBs remain lender-of-record or servicer, maintaining strong due diligence and ongoing monitoring discipline.

Yet under Basel III, the senior tranches still receive capital charges similar to private emerging market collateralised loan obligations, suppressing investor demand. The case for tailored supervisory guidance is strong.

This is similarly the case with A/B loans – where the private investor participating in the B portion of the loan benefits from the MDB "umbrella", which effectively removes transfer and convertibility risks. National regulators do not currently recognise this risk adjustment and therefore treat the counterparty risk as the same as that of an EMDE sovereign or corporate exposure, and will not allow the investor to "look through" to the MDB's immunity.

[31] AfDB, 14 October 2018, **African Development Bank and partners' innovative Room2Run securitization will be a model for global lenders**

[32] World Bank Group, 19 September 2025, **World Bank Group successfully closes inaugural securitization transaction, marking pivotal step in private sector mobilization effort**

[33] IDB Invest, **Our Solutions**

In A/B loan structures:

- The MDB originates and retains the A-loan.
- The B-lender benefits from MDB seniority in recoveries, MDB oversight and often quasi-preferred creditor status borrower behaviour.

Yet B-loans receive no differentiated risk weight under Basel, but are treated like any other EMDE corporate exposure. The BCBS could mandate quantitative analysis, using GEMs data, to evaluate whether lower risk weights are warranted.

Together, these issues create structural capital charges that make even de-risked EMDE instruments unattractive from a prudential perspective – regardless of their underlying creditworthiness.

Examples of where reforms are already in progress

- The FSB is currently monitoring the implementation of reforms to the treatment of securitisation, but the BCBS has not yet specifically granted an "MDB-specific" lower floor for securitised MDB portfolios.[34]
- A/B loan participations – assessment of these is rating-based. Some EU/UK banks now benefit from credit risk mitigant recognition, but this is not universal.
- In 2026, in its PS1/26, the UK PRA retired the "infrastructure supporting factor" (ISF) to align with Basel 3.1 but introduced a UK infrastructure lending adjustment under Pillar 2A.
- In addition, the matching adjustment has been widened to include assets with "highly predictable" cash flows and matched tenors.

How current Basel requirements could improve private sector mobilisation

The interaction between MDB/NDB risk-mitigating features and existing prudential frameworks generates a series of distortions.

[34] FSB, January 2025, **Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation - Final Report** (PDF)

Under-crediting MDB/NDB guarantees

The Basel III framework includes a substitution approach for credit-risk mitigation (CRM) which is intended to ensure that capital requirements are lowered when credit risk is genuinely transferred to a higher-quality counterparty. However, the eligibility tests are defined narrowly and, in practice, can prevent MDB guarantees from delivering the expected capital relief.

Under the Basel standardised approach, banks generally obtain capital relief by applying the guarantor's risk weight to the protected portion of an exposure, while the uncovered portion continues to be treated as unguaranteed. In principle, this should allow MDB guarantees to lower capital requirements where they genuinely transfer credit risk. In practice, however, relief is available only when the guarantee meets a narrow set of operational and legal conditions: it must be legally enforceable, direct, explicit, irrevocable and unconditional, with clear requirements governing how and when a claim can be triggered and paid.

This creates a tension with the way many MDB instruments are deliberately designed. To preserve borrower incentives, stretch scarce balance-sheet capacity and keep projects performing, MDB guarantees are often partial, layered or contingent. They may also include standard exclusions, longstop provisions or dispute-resolution mechanisms, including arbitration, that are intended to avoid a hard default rather than accelerate one. These design features can therefore sit uneasily with prudential assumptions that protection will pay out on a simple, tightly specified default event. Basel's current rules consequently recognise only a subset of MDB instruments, and only where they satisfy strict criteria around:

- Timeliness of payment, which may be difficult to demonstrate where arbitration or other resolution mechanisms are used to keep a project solvent and avoid default.
- Absence of exclusion clauses, even where those clauses are immaterial in a given EMDE context, such as nuclear-related carve-outs in countries with no nuclear sector.
- Coverage scope, since Basel relief is easiest to obtain for guarantees that provide clear and comprehensive protection, whereas MDB guarantees are often partial or structured in layers.

A similar dynamic arises for insurers under Solvency II, where the standard formula does not always capture the full risk-reducing effect of contingent or partially covering guarantees in capital charges, particularly when the regulatory look-through is anchored in the underlying obligor/country risk rather than the guarantor's credit quality.

The result is a persistent gap between economic risk (materially reduced by MDB or DFI involvement, including through preferred creditor dynamics) and regulatory capital consumption. Higher capital charges raise required spreads, shorten tenors, and reduce balance-sheet capacity, thereby constraining the scalability of guarantee-based mobilisation

even where the underlying transactions are demonstrably lower risk than their prudential treatment implies.[35]

Towards a coherent NDB prudential asset class

The BIS, financial markets and CRAs already recognise MDBs as a distinct category (albeit incompletely in the case of BIS) based on distinct criteria and the risk features that these institutions hold distinct from those of commercial banks. However, NDBs and bilateral DFIs do not currently benefit from similar recognition. While the highest rated MDBs benefit from 0% risk weightings, NDBs are treated as either sovereign or institutional exposures, which of these is applied depends on their state guarantee. For example, KfW has a full, explicit government guarantee and therefore the sovereign's risk weight is applied. NDBs without a full guarantee are treated as public sector entities and therefore a higher 20% risk weight is applied even in high-rated jurisdictions. CDB, for example, ends up being rated a step below the sovereign where this approach is applied.

Similarly, under Solvency II, treatment of NDBs depends on the Prudent Person Principle and the strength of the link to the sovereign. If the NDB is assessed as an extension of government, it will receive the same spread risk factor of 0% as for sovereign bonds. If not, then it will be treated the same as a financial or corporate exposure with a spread risk charge determined based on duration and credit rating.

This is, to some extent, in recognition of the different default history of NDBs compared to MDBs. While there are no instances of an MDB defaulting for credit reasons, there are cases where NDBs default as a result of financial distress of the sovereign, governance issues or misallocated resources. Nevertheless, NDBs differ significantly from other public sector entities, such as public utilities, as their business models, governance structures and financial risk profiles are in many respects more comparable to those of MDBs.

The creation of a distinct NDB asset class, differentiating NDBs from other PSEs, would enable qualifying NDBs to benefit from risk weights that more accurately reflect their financial strength and government backing. It could also provide access to other forms of preferential prudential treatment, including the recognition of NDB guarantees, which are not available under the current regulatory framework.

[35] Bank for International Settlements (BIS), Basel Committee on Banking Supervision, **Basel Framework CRE22 – Standardised approach: credit risk mitigation**; European Union, **Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)**; European Union, **Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC (Solvency II)**; European Insurance and Occupational Pensions Authority (EIOPA), July 2021, **Opinion on the use of risk mitigation techniques by insurance undertakings** (PDF)

Table 2: Core features of MDBs vs NDBs and regulatory treatment

Feature	MDBs	NDBs
Source of support	Callable capital from multiple nations.	Support or ownership from a single sovereign.
Preferred creditor status	Explicitly recognised by many regulators; protects against FX restrictions and sovereign restructuring.	Neither global nor de facto, dependent upon domestic and bilateral legal provisions; risk is therefore tied to a single country's solvency.
Capital charge	0%, but only for listed "major" MDBs.	0% only if explicitly guaranteed by a 0% rated sovereign, otherwise treated as a PSE or as a standard corporate exposure.
Regulatory listing	Must be on the BIS/BCBS list for global 0% treatment.	Preferential treatment depends on discretion of national regulator. Treated locally under public sector entity (PSE) rules or as a standard corporate exposure.

A discreet NDB, including bilateral DFIs, asset class, that would support dedicated treatment of NDBs, could:

- Treat NDBs more like sovereigns for risk weight purposes, with 0–20% risk weights for highly rated institutions.
- Harmonise treatment across jurisdictions.
- Reduce transaction costs arising from piecemeal recognition of NDBs.

However, given that this would require consideration by the Basel Committee, this is a long-term option for reform that would require our recommendations on data to be implemented first. A first step would therefore be to review the treatment of NDBs with a view to enabling the BCBS and banks to treat eligible, qualifying NDBs similarly to exposures to sovereigns. Criteria for inclusion of NDBs would focus on governance, operating structure and risk profile, including:

- A clear development mandate and focus
- Statutory independence

- Strong shareholder support demonstrated in capital contributions or explicit state guarantees
- Reserve and liquidity adequacy
- Strict statutory lending requirements and investment policies.

Solvency II: Unlocking insurance balance sheets for MDB/NDB-backed mobilisation

Why insurers matter for EMDE mobilisation

Global insurers are natural holders of long-dated, predictable cash-flow assets and have shown growing appetite for structured participation in MDB/NDB portfolios – through unfunded risk participations (URP), credit insurance, and significant risk transfer (SRT) securitisations. In recent years, leading MDBs have scaled partnerships with insurance groups precisely because insurers can absorb multi-year risks at attractive pricing, learn quickly from new evidence, and operate under capital regimes distinct from banks. This has already translated into multi-billion transactions – for example, ADB's US$1bn (2022) and $2.75bn (2025) credit-insurance programmes with global insurers; and EBRD's growing URP book – demonstrating real mobilisation capacity under current market conditions.

Yet, despite this momentum, Solvency II's calibrations still apply a capital charge to MDB/NDB-supported EMDE exposures that is greater than the actual risk. In particular, the generic treatment of structured transactions raises capital charges for assets that, in practice, have lower expected loss due to MDB/NDB origination, monitoring and credit support. Addressing these frictions will be central to crowding in European insurers at scale.

Where Solvency II under-rewards MDB/NDB risk mitigation

MDB/NDB guarantees and unfunded risk participations: limited substitution effects

Solvency II does not consistently "substitute" counterparty quality where MDBs provide partial credit guarantees, political risk cover, or unfunded participations. In practice, the presence of a highly rated MDB as guarantor or risk-taker materially reduces expected loss, yet capital relief for the insurer is often limited or uncertain, especially for partial or contingent structures. The result is under-investment in instruments whose realised losses are historically far below generic emerging market debt.

Structured MDB assets treated like generic emerging market securitisations

Senior tranches of MDB securitisations (synthetic risk transfers or collateralised loan obligations) are typically assessed under standard securitisation rules, even though underlying pools consist of MDB-originated assets which have superior payment performance with the MDB is often retained as servicer/lender-of-record. This wrongly lumps MDB structures in with opaque or

purely private EM securitisations, over-charging capital relative to empirical risk and dampening insurer demand.

OECD vs non-OECD: use of country-risk proxies

Under Solvency II, insurers face higher capital charges for equities and infrastructure exposures in non-OECD countries than in the OECD, irrespective of granular sovereign fundamentals or the presence of MDB/NDB guarantees. For example, the standard equity shock is 49% outside OECD vs 39% inside OECD; infrastructure calibrations also differentiate by geography rather than by the actual risk characteristics of the asset or the quality of public credit enhancement. This binary geography screen penalises projects in stronger EMDE sovereigns and fails to recognise NDB involvement that demonstrably reduces default probability and loss severity. These country risk proxies also apply to NDBs where PCS is not recognised by the national regulator.

Recommendations

These recommendations are provided for consideration by prudential regulators at jurisdictional level and coalitions of finance ministers and central banks. The objective is not to reopen Solvency II or Basel III, but to introduce targeted, evidence-based adjustments through Level 2/3 guidance, supervisory statements, and standard-setting dialogues.

Carefully scoped prudential supervisory clarifications under Basel and Solvency frameworks

These recommendations are focused on national transposition of the Basel Framework and ensuring consistency:

- **Reviewing the list of eligible MDBs under both Basel III** and Solvency II to ensure completeness. Working across jurisdictions to ensure consistent implementation particularly with respect to major economies and key donor countries such as the UK, US, EU, Japan and South Africa[36] which are also key jurisdictions for the implementation of the Basel Accords and where there are existing gaps.
- **Evaluating the case for better capital treatment for securitisation, blended finance and A/B loan structures.** This would allow for fuller credit substitution across the structure, not only where the MDB participates. Regulators should therefore review guidance regarding the criteria for commensurate risk transfer and where firms are required to "look through" to the underlying assets or obligor.
- **Reviewing the treatment of infrastructure projects.** While long-term projects are riskier at the initial phase, the risk of default decreases after 5 years (the project having proven its viability and with predictable cash flows). There is a strong case,

[36] IIF, 26 March 2025, **Policy Paper: Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance**

particularly for transition and resilience infrastructure which are linked to lower rates of default, that the strength of these assets could be better reflected through the application of lower risk weights through the design of dynamic risk weights.[37]

- **Providing clear technical-level guidance on the impact of certain exclusion clauses**, such as timeliness and nuclear exclusion clauses, on the eligibility of certain development bank instruments as credit risk mitigants, including conditional guarantees and political risk insurance. This should take note of similar progress made with respect to the Solvency II framework.

- **Ensuring that improved CRA methodologies (in line with the recommendations above) could support scaling the use of guarantees** to mobilise public and private finance for development and climate transition projects. These clarifications should be consistent with the recommendations of the Green Guarantee Group.[38] In particular, CRAs could work with prudential regulators to develop methodologies for the treatment of complex partial guarantees including cases where straightforward pro-rata capital relief is not appropriate, such as if a specific risk is being covered).

The following recommendation should be considered by national regulators in terms of assessment of feasibility. However, for implementation would require a review by the BCBS of the relevant standards:

- **Exploring the feasibility of the formal creation of a dedicated NDB asset class with preferential regulatory treatment** that identifies common features across NDBs and bilateral DFIs and differentiates between NDBs and PSEs given their differing shareholder structures and core features. Relevant authorities should define criteria determining eligibility and identify qualifying NDBs and bilateral DFIs, building on the criteria currently defined by the BCBS[39] for MDBs, which are inconsistently implemented across key jurisdictions such as the UK, US, EU, Japan and South Africa.[40]

EIOPA should:

- **Review whether the continued use of proxies for assessing country risk remains appropriate,** including the use of OECD and non-OECD classifications under the Standard Formula in Solvency II,[41] which can impact private sector participation where the benefits of investing alongside the participating MDB are not recognised.

[37] International Chamber of Commerce (ICC), June 2025, **How to Finance the Emerging Climate Opportunity**

[38] Green Guarantee Group, June 2025

[39] See BIS note CRE22 **BIS Calculation of RWA for credit risk**

[40] Institute of International Finance, March 2025, **Lifting Prudential Barriers to Mobilizing Private Capital for Development Finance** (PDF)

[41] European Commission, **Solvency II Review**

- **Review the list of eligible MDBs under Solvency II** to ensure completeness. Basel III and Solvency II operate a unified list of eligible MDBs, therefore both should be reviewed to ensure consistency.
- **Review the eligibility of MDB-supported green and resilient infrastructure investments** under mechanisms such as the matching adjustment under Solvency II, for example in the UK changes made to expand eligibility to take into account assets with "highly predictable cashflows".

Commitment from the public finance ecosystem on this agenda

- **Public development banks, financial regulators, and credit rating agencies should establish a joint Memorandum of Understanding to align incentives and strengthen coordination across the financial ecosystem.** Under this framework, PDBs would commit to improving the availability and quality of data, regulators would assess and adapt supervisory frameworks accordingly, and credit rating agencies would progressively refine their methodologies. This coordinated approach would create a virtuous cycle, reinforcing transparency, risk assessment, and capital mobilisation toward shared objectives.

Conclusion: Reform is both necessary and possible

As the global economy confronts multiple, overlapping shocks as a result of geopolitical tensions alongside the twin challenges of climate change and sustainable development, the interaction between credit rating methodologies and prudential frameworks has become increasingly important. At the same time, evidence suggests that climate vulnerability may already be influencing sovereign borrowing costs, with potentially significant fiscal consequences for climate-vulnerable countries. Addressing these challenges will require improved data, methodological transparency, and dialogue between CRAs, regulators, MDBs, NDBs, bilateral DFIs and investors. By recognising MDBs and NDBs as contributors to financial stability – rather than exceptions to prudential rules – this report presents an evidence-based case for regulatory and methodological reforms that can help inform future engagement with central banks, supervisors and other standard-setting bodies.

CRAs occupy an important position in the global financial system. Their methodologies influence sovereign borrowing costs, institutional funding capacity, and the allocation of capital across markets, both as key inputs into prudential regulations and through their credit assessments of MDBs. Recent methodological revisions, such as S&P's updated MDB framework, reflect ongoing efforts to refine risk assessment tools in a changing financial environment. However, important questions remain regarding the treatment of climate risks, guarantees, preferred creditor status, and other development finance instruments.

Prudential regulations similarly have an important influence over the mobilisation and allocation of private capital, as well as MDB and NDB/DFI ability to access capital markets. The way these frameworks are currently designed influences whether banks and insurers can hold PDB-supported assets efficiently, how long they can lend for, and at what price. They do so in a way that implies a potential gap between regulatory capital treatment and actual investment risk. While regulators and international standard setting bodies have indicated steps forward in addressing this, more work is needed to resolve these discrepancies through targeted, evidence-based clarification and supporting regulatory convergence around common market interpretations and practice.

These reforms can be implemented without reopening Basel III or Solvency II, while supporting much-needed longer term infrastructure projects and improving affordability of EMDE transition pathways. At a time when governments face increasingly constrained fiscal space and limited capacity to expand concessional financing, regulatory and methodological reforms offer a timely opportunity to unlock additional private capital. If implemented, they could constitute a significant expansion of institutional capacity for the mobilisation of climate finance to developing countries.

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Annex: Definitions and key concepts

Basel III list of MDBs recognised for 0% risk weight under CRE20, footnote 8:

- World Bank Group, including International Bank for Reconstruction and Development, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the International Development Association;
- Asian Development Bank;
- African Development Bank;
- European Bank for Reconstruction and Development;
- Inter-American Development Bank;
- European Investment Bank;
- European Investment Fund;
- Nordic Investment Bank;
- Caribbean Development Bank;
- Islamic Development Bank;
- Council of Europe Development Bank;
- International Finance Facility for Immunization;
- Asian Infrastructure Investment Bank.

Basel III's substitution approach for credit-risk mitigation (CRM): A method by which banks are permitted to calculate lower capital requirements when a loan is secured by a third-party guarantee or collateral. It works by replacing or substituting the high-risk weight of the original borrower with the lower-risk weight of the guarantor.

Credit risk mitigant: Under Basel III, exposures to MDBs and certain NDBs can be treated as a credit risk mitigant where their capital structure, shareholder support and preferred creditor status materially reduce expected loss, allowing lower risk weights than comparable sovereign or corporate exposures.

Matching adjustment: A regulatory mechanism under Solvency II (which has now become Solvency UK) that allows life insurers to recognise a portion of their projected investment returns

upfront as capital. Therefore, increasing the discount rate used to value long-term insurance liabilities (such as annuities) reducing the amount of capital (called "technical provisions") an insurer must hold. The PRA has expanded eligibility from strictly fixed cash flows to include those that are "Highly Predictable", important for infrastructure and project finance. Those must:

- be time and amount bound
- have bond-like characteristics (such as specific construction-phase infrastructure loans)
- be capable of being credit quality assessed either by an external credit rating or an internal credit assessment of comparable standard.

These assets can make up a maximum of 10% of the matching adjustment portfolio. A fundamental spread must be added to account for residual risk of cash flow variability.

The PRA has also removed the cap on Sub-Investment Grade opening up MA portfolios to investments in riskier tranches of blended finance or securitisation pools where MDBs may provide on partial de-risking.

Pillar 2A: Pillar 2A captures idiosyncratic risks not fully reflected in Pillar 1, enabling supervisors to require additional capital where a bank's exposure to MDBs or NDBs raises concentration, governance, or correlated sovereign risk concerns beyond standardised risk weights.

Political risk insurance definitions and practice: See Multilateral Investment Guarantee Agency (MIGA), **Political Risk Insurance**; OECD, **Export credits and guarantees** (context).

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Standard formula (Basel III and Solvency II): A set of risk measurement calculations prescribed by regulators to determine the minimum level of capital a bank or insurer must hold. It is a more conservative and uniform way of calculating minimum capital in comparison to internal models, which are developed by insurers and banks themselves and require the completion of a lengthy regulatory approval process.

Supporting factor: A supporting factor applies a regulatory capital adjustment to encourage lending to policy-priority sectors, and in the context of MDBs or NDBs would recognise their counter-cyclical and development roles by reducing capital requirements where exposures demonstrably support financial stability or long-term economic growth.

Abbreviations

ADB	Asian Development Bank
BCBS	Basel Committee on Banking Supervision
CAF	capital adequacy framework
COP29	the 29th United Nations Climate Change Conference (Conference of the Parties), held in Baku, Azerbaijan in November 2024
COP30	the 30th United Nations Climate Change Conference (Conference of the Parties), held in Belém, Brazil in November 2025
CRA	credit rating agency
CRM	credit-risk mitigation
DFI	development finance institution
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
EMDEs	emerging markets and developing economies
FSB	Financial Stability Board
G7	Group of Seven: the seven largest advanced economies and liberal democracies
G20	Group of Twenty: the world's largest 19 economies and the EU
GEMs	Global Emerging Markets Risk Database Consortium
IAIS	International Association of Insurance Supervisors
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IsDB	Islamic Development Bank
JETP	Just Energy Transition Partnership
LGD	loss-given-default
MDB	multilateral development bank
NCQG	New Collective Quantified Goal
NDB	national development bank
NDC	nationally determined contribution: climate action plan committed to by parties to the Paris Agreement
NGFS	Network for Greening the Financial System

NPL	non-performing loan
PDB	public development bank
PRA	prudential regulation authority
PSE	public sector entity
S&P	Standard and Poor's
SA	standardised approach (under Basel III)
SRT	significant risk transfer
URP	unfunded risk participation