

## PRIVATE INVESTMENT MOBILIZATION MODELS (PIMMS) FACT SHEET:

# Domestic Financial Sector Development – Private Sector (PIMM3)

### EXECUTIVE SUMMARY

PIMM3 is designed to improve the domestic financial sector and capital markets through a higher quantity and quality of investment to the sector and individual intermediaries.

Note: PIMM3 is the only proposed PIMM that is specific to a sector; supporting a broad spectrum of good-practice proposals that would develop the domestic financial sector (including capital markets) in one or multiple countries. Proposals for Catalytic and Concessional (C&C) funding in PIMM3 could overlap with the other 11 PIMMs.

### OBJECTIVES

PIMM3 is dedicated to deploying C&C funding to (i) develop the domestic financial sector and capital markets and (ii) mobilize private investment. The private investment mobilized can happen at two levels: either (i) private investment into the financial sector or (ii) financial investment from the financial sector to the real economy.

<p><b>Rationale</b></p>	<p>Clauses 34 a-j of the Zero Draft of the Financing for Development 4 Outcome Document describe the relevant areas of domestic financial sector development. Much of the content of the Zero Draft describe activities aligned to traditional grants (e.g., promoting enabling environments), but PIMM3 is intended for C&amp;C funding to mobilize private investment that develops the domestic financial sector (and capital markets) – both quantity and quality: (i) supporting increased investment to/through existing financial intermediaries and (ii) supporting funding to new intermediaries.</p> <p>Given the importance of deep and broad financial and capital markets for economic development, and Clause 34 of the Zero Draft, it is proposed that PIMM3 be broad enough to capture all reasonable activity to develop the domestic financial sector (i) that would mobilize private investment to SDG and climate investment in developing countries and (ii) requires C&amp;C funding.</p> <p>The risk rating of borrowers in developing countries is driven primarily by high-risk sovereign risk rating (e.g., median B- rating and 76% rated B or lower). Applying sovereign ceiling convention – most projects/borrowers would have implied ratings of B, CCC, and CC impeding many private sector investments into domestic financial markets. PIMM3 is intended to deploy C&amp;C funding to increase private investment mobilization that will develop, deepen, and broaden the domestic financial sector.</p>
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Description	<ul style="list-style-type: none"><li>• <b>C&amp;C funding to develop the domestic financial sector, including capital markets.</b></li><li>• PIMM3 is expected to primarily support banks, microfinance institutions, fintechs, pension companies, insurance companies, and other institutional investors to provide higher quantity and quality of investment (e.g., loans) to real economy entities (e.g., MSMEs, smallholders, mid-caps, and corporates).</li><li>• Most common expected application of PIMM3 is to support investment as (i) common equity into financial intermediaries, (ii) tier 2 capital into banks and microfinance institutions, (iii) debt to financial intermediaries (ideally in local currency), and (iv) developing domestic capital markets.</li><li>• PIMM3 is a complement to PIMM8 (Risk Sharing).</li></ul>																																													
Development rationale	<ul style="list-style-type: none"><li>• <b>Clause 34 of the Zero Draft of the Outcome Document</b> identifies domestic financial sector development as a high priority, agreed upon by developing and developed countries. The clause provides strong guidance for development finance, blended finance, and private investment mobilization.</li><li>• Development literature is rich with evidence on the importance of domestic financial sector development for economic growth and improved standard of living.</li><li>• The financial sector and capital markets in many developing countries need further development to be fit-for-purposes to finance the real economy.</li><li>• The domestic financial sector is often too narrow and shallow – PIMM3 is intended to develop, deepen, and broaden the domestic financial sector and capital markets.</li><li>• Financial intermediaries (e.g., commercial banks) often do not lend to viable borrowers and small projects in low and middle-income countries since they (i) assess the risk to be too high, (ii) the return on capital to be too low due to high administration costs, and/or (iii) the intermediaries do not have sufficient capital to expand their loan portfolio</li><li>• The World Bank has published a great amount of research on this topic:</li></ul> <p>The World Bank and International Monetary Fund often use domestic credit to private sector as a percentage of GDP as a blunt metric to signal financial depth. Per the World Bank Group International Financial Statistics Database, the ratio is 150-160% in high-income and OECD countries, 120-135% in middle-income countries, and 30-33% in least developed countries.</p> <p>Domestic credit to private sector (% of GDP)</p> <table><tr><th>Country Name</th><th>2020</th><th>2021</th><th>2022</th><th>2023</th></tr><tr><td>High income</td><td>161.8</td><td>159.2</td><td>147.6</td><td>153.0</td></tr><tr><td>Least developed countries</td><td>30.2</td><td>31.4</td><td>31.4</td><td>33.0</td></tr><tr><td>Low income</td><td></td><td></td><td></td><td></td></tr><tr><td>Lower middle income</td><td>47.8</td><td>46.5</td><td></td><td></td></tr><tr><td>Low &amp; middle income</td><td>121.7</td><td>119.9</td><td>128.6</td><td>134.6</td></tr><tr><td>Middle income</td><td>122.8</td><td>120.8</td><td>129.7</td><td>135.6</td></tr><tr><td>OECD members</td><td>161.9</td><td>159.6</td><td>144.5</td><td>148.1</td></tr><tr><td>World</td><td>147.6</td><td>144.8</td><td>140.9</td><td>146.5</td></tr></table> <p>Source: <i>World Bank, International Financial Statistics Database</i></p> <p>The domestic financial sector in developing countries is generally dominated by commercial banks (in most countries accounting for 75%+ of financial sector assets). Illustrative examples of mobilizing private investment to develop the domestic financial sector could include:</p> <ul style="list-style-type: none"><li>• Commercial banks as investment recipients: Increasing common equity, tier 2 capital, local currency loans, bonds, guarantees, etc. (Note that risk-sharing on their loan portfolios is covered separately by PIMM8)</li><li>• Non-bank investment recipients: Similar types of investment above, but to microfinance institutions, fintechs, insurance companies, pension companies, fund managers, etc.</li></ul>	Country Name	2020	2021	2022	2023	High income	161.8	159.2	147.6	153.0	Least developed countries	30.2	31.4	31.4	33.0	Low income					Lower middle income	47.8	46.5			Low & middle income	121.7	119.9	128.6	134.6	Middle income	122.8	120.8	129.7	135.6	OECD members	161.9	159.6	144.5	148.1	World	147.6	144.8	140.9	146.5
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<b>Existing comparable precedents of C&amp;C funding</b>	<p>There are hundreds of precedents of deploying C&amp;C funding to develop the domestic financial sector and mobilize private investment. There are two types of blended finance / mobilization solutions to develop the domestic financial sector: (i) cases/proposals aligned with one of the other 11 PIMMs or (ii) cases that fall outside the remit of the 11 PIMMs. Examples:</p> <ol style="list-style-type: none"> <li>1. Aligned to other 11 PIMMs: (1) A blended finance debt fund to invest in local currency loans and bonds to microfinance institutions, (2) a blended finance equity fund to invest in common equity and tier 2 capital for banks, (3) a blended finance equity fund to invest in fund managers.</li> <li>2. Not aligned to the other 11 PIMMs: (1) Grants to establish an African Guarantee Fund for Asia, (2) incentive payments to banks to lend to smallholders, (3) grants to support crowdfunding to microfinance institutions, (4) grants to set up a bank green bond issuance program in Africa.</li> </ol>
<b>Indicative activities for Network of C&amp;C Funders</b>	<p>The Network of C&amp;C Funders could establish a sub-group of organizations interested to award C&amp;C funding to develop the domestic financial sector. It is likely most productive for the sub-group to have a broad, open call for proposals signalling the sub-group is prepared to accept proposals to award C&amp;C funding to the best proposals that will develop the domestic sector and mobilize private investment at one of the two levels described above.</p> <p>In addition, individual country governments (e.g., Government of Nigeria) could issue comparable call(s) for proposals where it would lead C&amp;C funders to stimulate domestic financial market development in Nigeria.</p> <p>In competitive global calls for proposals, it is expected the Network could receive hundreds of proposals annually facilitating the award of C&amp;C funding on a quasi-auction basis.</p>
<b>Expected C&amp;C funding instrument</b>	<p><b>Majority of C&amp;C funding expected in form of loans, equity investments, and guarantees for fair/equitable outcomes.</b> Some funding expected in the form of grants.</p>
<b>Expected financial profile of C&amp;C funding (including risk profile)</b>	<p>C&amp;C funding deployed in PIMM3 is expected to take on risk profiles beyond the willingness or ability of multilateral development banks (MDBs) and development finance institutions (DFIs). There are likely three possible financial expectations of C&amp;C funding in PIMM3:</p> <ul style="list-style-type: none"> <li>• Break-even or better expectations: It is likely a portion potentially a majority of C&amp;C funding could be deployed at break-even (or better) financial outcomes.</li> <li>• Partial loss expectations: It is likely a portion (potentially a minority) of C&amp;C funding would result in a partial loss.</li> <li>• Full loss: It is likely some proposals will require grants.</li> </ul>

<b>Expected sources of private investment mobilized</b>	Varied.
<b>Expected leverage</b>	Reasonable leverage expectations in this PIMM range from 10-20 times.
<b>Single-country or multi-country application</b>	Both.
<b>Recommended standardization for this PIMM</b>	Convergence does not recommend any standardization for PIMM3. Over time, the Network might identify benefits of standardization of PIMM3.



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