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Building a Genuine Derisking Policy

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- This paper analyses derisking in development finance and shows that the failure of the slogan "from billions to trillions" does not condemn the approach, but rather reveals a poorly conceived quantitative ambition.
- The use of public funds is legitimate only if the investment yields a social return greater than its private return, if the private sector would not have invested on its own, and if no other use of public funds is more effective.
- Implementing derisking requires genuine public-private engineering: detailed risk analysis, specialist expertise, robust project pipelines and the removal of regulatory barriers that hinder risk-sharing instruments.
- An effective derisking policy must prioritise additionality, risk assessment and risk management, address criticisms regarding its political legitimacy and the risk of subordinating the collective interest to private interests, promote guarantees in particular, and remain complementary to other development finance instruments.

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Derisking has become a buzzword, with the slogan 'from billions to trillions' intended to mobilise the private sector on a massive scale to increase the volume of funding for sustainable development. This quantitative ambition has largely failed. However, one should not conclude from this that the concept is ineffective: it was the ambition that was misguided. It failed to recognise that increasing financial flows would require a reallocation from existing investment stocks, even though viable alternatives in developing countries were not readily identifiable. It also underestimated the absorption constraints that a massive influx of capital might encounter in many developing countries. Finally, it overlooked the fact that the practical implementation of derisking entailed significant transaction costs and a need for relatively scarce specialist expertise. It was thus based more on communication than on an analysis of operational feasibility. It equated sustainable development financing to the desired volume of financial resources, overlooking the fact that this reduced the issue of financing to a financial metric, whereas financing volumes – particularly private financing – are inextricably linked to the real economy and risk/return profiles.

Nevertheless, derisking remains a promising concept, not only for mobilising private finance, but also for establishing a new form of joint public-private action – a new form of 'public-private partnership'. In this note, as in the working paper from which it is drawn, derisking is conceived as a form of intermediation involving public funds to facilitate private investments that deliver social and environmental impacts[1]. Its scope and relevance have been discussed, in particular, in relation to the strategies of multilateral development banks (Lee 2025) and bilateral development finance institutions. However, this makes it a concept that goes beyond the sole issue of development finance; it also appears crucial for financing the various energy and environmental transitions, as well as the social objectives that must be organised and prioritised within a particularly strained budgetary context. It has the potential to modernise the practice of public policy beyond the realm of development policy.

1. In the rest of the text, the adjective 'social' (in 'social impacts' or 'social return') encompasses both social and environmental dimensions.

Practising derisking is not simply a matter of freeing up budgets to facilitate private investment. Care must indeed be taken to avoid windfall effects for private companies and investors, which would rightly be deemed unacceptable and would render derisking illegitimate . Attention must therefore be paid to the social impact of the selected investments, and it must be verified that this impact could not be achieved by market forces alone. This involves being able to break down a project's risk — to identify what legitimately falls within the remit of the private sector and what must be borne by the public sector. This expertise in assessment, financial analysis and risk management is already present within development banks. It must be expanded and developed. Beyond the financial aspect, practising derisking also requires an enabling legal and regulatory environment conducive to the analysis and allocation of risks, as well as to the use of financial instruments suited to this purpose.

A Quantitative Failure

Derisking has not lived up to the hopes placed in it at the macro-financial level. The results in terms of the volumes mobilised remain well below the stated ambitions. For example, multilateral development banks mobilise less than 30 cents of private capital for every public dollar invested in climate action; private development finance institutions fare only slightly better, rarely exceeding one dollar mobilised for every dollar invested. Far from increasing, foreign direct investment flows to developing countries have declined since the 2010s, remaining concentrated in a handful of emerging economies and leaving low-income countries and sub-Saharan Africa largely sidelined.

The concept of derisking is not new. During the Bretton Woods negotiations and the discussions on the creation of the World Bank, Keynes considered it absurd that the Bank should use its capital to make loans rather than provide guarantees – which is a form of derisking – and he argued, with remarkable foresight, that loans amounted to making international investment dependent on the borrowing countries. Eight decades later, it is loans in particular that have flourished. These instruments differ not only in the use of capital associated with them, but also in the nature of the risk-sharing they entail: a loan involves counterparty risk, but shifts the burden of project risk primarily onto the borrower (at least, prior to any debt rescheduling or debt relief); a guarantee represents a targeted assumption of risk on the part of the lender granting it. Development banks only really began to make use of guarantees from the 1980s onwards, and this instrument continues to play only a marginal role in their practices (it accounts for 5 per cent of operations by multilateral development banks). Yet it is recognised as the most effective instrument in terms of resource mobilisation, as it accounts for 45 per cent of their total mobilisation of private resources.

Understanding the Reasons for the Quantitative Failure

The failure is therefore partly institutional and practical. Structuring a bespoke financial arrangement takes time: it took four years to set up the *Room2Run* synthetic securitisation between the African Development Bank and private investors, and five years to launch the *ILX* fund – two projects which, amongst others, can be considered innovative successes. These delays reflect transaction costs and a need for expertise that development banks struggle to mobilise on the required scale: structuring expertise remains concentrated in a few departments, and less than 1 per cent (around $2.5 billion) of official development assistance was allocated to blended finance in 2022. The shareholders and executives of these institutions, torn between the conservatism required to maintain their credit ratings — AAA for the World Bank — and the requirement for additionality, which, by contrast, involves taking risks that the private sector would not accept on its own, have not always opted for innovation.

There are also accounting and regulatory obstacles. Guarantees, although the most effective derisking instruments, are still provisioned by multilateral development banks as if they were loans, even though the claims they trigger are 7 to 20 times less frequent than loan defaults (Cull et al. 2024) — which unnecessarily ties up capital and discourages their use. International prudential regulations (Basel III, Solvency II) exacerbate this bias by imposing capital requirements that do not take into account the actual reduction in risk achieved through government guarantees.

Finally, the failure also stems from the difficulty of designing viable projects with a social impact that could justify the implementation of derisking-based financing. The weakness of project pipelines explains the low volumes of international private funds mobilised. Before focusing on overall volumes, considerable effort must be devoted to the design and feasibility of such projects. This involves, in particular, understanding the risk premium that affects the cost of capital in low-income countries – as documented by the work of Aswath Damodaran at New York University – whether or not it results from a biased perception. And this is particularly important, because it is at this level that derisking makes sense in theoretical terms, and it is this work that will enable scaling up.

A Brief Theory of Derisking

When is it justified to use public funds to support private investment? This is a fundamental question for ensuring the legitimacy of derisking. Three conditions (Pegon 2023) must be met simultaneously. Firstly, the expected social return on the investment — the totality of its effects on the community, including financial, social and environmental impacts — must be positive and greater than its private return: the subsidy must be matched by a clearly defined social impact. This is the condition that distinguishes a legitimate subsidy from a mere windfall effect. Secondly, the private return on the investment in question, in the absence of public support, must fall below the risk-adjusted rate of return required by private investors — typically in the region of 12 to 15 per cent: this is the condition of additionality, which guarantees that the private sector would not have acted on its own. Thirdly, no other use of public funds must yield a higher net social return. This third condition, which concerns the opportunity cost of public expenditure, implies a quest to optimise the use of public funds. Compliance with it requires an exploration of alternative uses and will ultimately rest on an analytical and informed judgement: yet the question must still be asked.

These three conditions are demanding, and meeting them for any project requires analytical skills and a culture of impact that cannot be improvised. One must be able to estimate social returns, compare the private sector's required rate of return with the project's risk profile, and weigh up alternative uses of public resources. And the analysis cannot be left solely to the private sector, whose interest lies in inflating the expected social return and minimising the private return in order to secure a grant or a guarantee. What needs to be developed is a culture of financial analysis and impact assessment of public expenditure.

Derisking Instruments

A derisking intervention involves modifying the risk/return profile faced by the private investor, so that the latter can expect risk-adjusted returns sufficient to incentivise them to take on the investment risk. The range of possible instruments for achieving this is broad and diverse. From a financial perspective, it includes direct risk protection instruments, such as guarantees (partial or full) and insurance, including insurance against political risk, of which MIGA is a leading example. It also includes structured finance approaches, which involve breaking down risks and selecting financial instruments suited to allocating the various risk components to the party best placed to bear them.

However, the range of tools contributing to derisking is not solely financial. Regulation plays an important role, either by hindering or, conversely, by encouraging innovative instruments for risk-sharing or risk reallocation. Standardisation and securitisation make it possible to streamline information on different assets and transmit it at lower cost, standardising clearly identified asset classes and thereby defining different risk classes. All these financial and non-financial approaches can be combined, potentially leading to a myriad of innovations and instruments depending on the risks to be covered.

Utilising this range of instruments requires time, as well as in-depth financial and risk analysis expertise: mobilising the private sector is neither a matter of issuing orders nor of mere rhetoric. The latter may be useful and even necessary to encourage and channel initiatives, but the technical and operational dynamics are essential. The role of public policy is not limited to allocating a budget (which remains, of course, essential), but to understanding the drivers of this dynamic in order to encourage it. This different approach to public policy is essential for increasing the social effectiveness of highly constrained public budgets.

Conclusions and Public Policy Recommendations

Derisking, conceived as a form of financial intermediation designed to bring together public actors and private investors, is a promising approach for increasing the social return on public and private funds, for development finance and beyond. The legitimacy and effectiveness of using public funds for derisking purposes rest on the identification, measurement, feasibility, monitoring and evaluation of the expected social impacts; and, as we have emphasised above, on verifying that private investors would not achieve these impacts on their own, on the one hand, and that no more effective alternative allocation of public funds has been identified, on the other. This approach is particularly important in the context of development finance, notably to reduce the very high cost of capital faced by private investors in low-income countries. But it also applies, more broadly, to climate finance and to all matters concerning the social and environmental aspects of well-being. The recommendations set out below follow naturally from this.

The first is to recognise derisking as a specific component and an essential practice of international development finance, complementing existing instruments. Development aid is in crisis in 2026 for political, conceptual, empirical and budgetary reasons. Derisking forms part of the legitimate future of development finance, alongside the imperative of solidarity, which remains indispensable and enjoys public support. Establishing an effective derisking policy involves setting aside a budget allocation and mobilising the necessary expertise to implement it. The aim is to generate clearly identifiable social and environmental impacts in cooperation with the private sector. The provision of any public subsidy must meet stringent criteria, whether it takes the form of derisking support, a grant, or an interest-rate subsidy on a loan; and, as we have seen, doing so to mobilise the private sector requires particular attention to the nature of the project, its social impacts, and the rationale for the involvement of private investors. The evaluation process forms part of the public policy on derisking: ex ante evaluation to identify social impacts and assess the suitability of proposed projects for achieving them; ongoing evaluation during implementation to monitor implementation and its alignment with the objectives pursued; and ex post evaluation to learn from the experience and communicate the findings. Without these requirements, derisking risks being diverted from its intended purpose and lending credence to the approach's critics. (Gabor 2023) thus draws attention to the risk of defining a relationship between the state and capital in which the interests of capital dominate (including in the definition of social goods), as the conditions set by the state will ultimately be watered down. (Bayliss et al. 2020) sees in derisking a danger that public funds will essentially serve the interests of private shareholders. Emma Mawdsley also sees in this the risk of the financialisation of development at the expense of a deeper understanding of what development actually is (Mawdsley 2018). Whilst these warnings may certainly fuel certain ideologies, they are based on sound arguments.

The second recommendation concerns the non-financial aspects of derisking. On the one hand, efforts to standardise the various assets – in order to reduce the cost of obtaining information about them and to facilitate the analysis and assessment of risks – should be encouraged. Standardisation efforts must also extend to the measurement of social impact, and must require the use of scientific criteria in the methods employed, transparency in the implementation of these methods, and a systematic debate on the results. On the other hand, a particular effort must be made to promote the instrument recognised by the literature and experience as the most effective derisking tool when it comes to mobilising the private sector, namely guarantees. Accounting and financial regulations, particularly at the international level, must better recognise the difference in risk between a loan and a guarantee, in order to encourage their use: Given the historical risk profile, guarantees tie up less capital. The World Bank's shareholders must clearly urge the Bank's teams to make greater use of guarantees, notably by aligning the incentives offered to staff, simplifying procedures, strengthening MIGA and setting ambitious targets for the development of this instrument. However, the same criteria apply to this recommendation: it must include quantitative targets, but their implementation requires sufficient risk analysis capacity.

The third recommendation concerns an important principle of implementation: derisking should not be viewed as a subsidy for the private sector, but as public participation in a joint public-private effort to promote specific social objectives[2]. Derisking cannot be conceived outside this partnership-based approach. It requires organising public-private interaction prior to the design of specific projects. This cooperation is also essential for strengthening project pipelines in the various countries.

2. Mariana Mazzucato thus proposes mission-oriented innovation policies (Mazzucato 2017)

Finally, for national or multilateral public donors, derisking also involves knowing how to take risks. In each case, these are promising but risky ventures. The risks are financial, economic and social, and relate to reputational concerns stemming from suspicions of subsidising private profits. These risks can only be managed through the gradual establishment of a genuine culture of risk analysis, which involves the education system and continuing professional development, as well as public communication.

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