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LIQUIDITY TOOLKIT

A Selection of Tools for USAID's Use in Promoting Liquidity

US-SUPPORT FOR ECONOMIC GROWTH IN ASIA

OCTOBER 2020

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ACKNOWLEDGEMENTS

This report was produced by the US-Support for Economic Growth in Asia (US-SEGA) program, implemented by Nathan Associates. The principal authors of the report are Sean Keogh, Allyson Cross, Caroline Rubin, and Donovan Hambley from Nathan Associates. US-SEGA Chief of Party, Ann Katsiak, and Deputy Chief of Party, Jeremy Schanck, provided technical support and oversight. The authors were guided by USAID/Asia Bureau.

The authors are grateful for the contributions and insights of several individuals and organizations, including: various offices within the U.S. International Development Finance Corporation, representatives from the USAID Vietnam, India, and Indonesia Missions and the USAID Office of Private Capital and Microenterprise, Women's World Banking, a multinational bank, and an emerging market credit fund.

Introduction

As the COVID-19 pandemic continues to affect the financial markets, a critical issue for developing countries—in the Asia-Pacific and elsewhere—is a lack of liquidity.

Investors are shifting capital away from developing countries and into "safer" markets and investments leaving developing markets capital-constrained. Further, many developing countries lack established or sophisticated money markets or fixed income market systems important for supplying short-term liquidity in financial markets. In times of crisis, the implications of a lack of liquidity become even greater, restricting an entire economy—including its government, banks, small and medium-sized enterprises (SMEs), and individuals—and limiting the options for mitigating the crisis. Central banks have introduced a number of measures in response to the COVID-19 pandemic, but many have fallen short of delivering sufficient liquidity to the overall banking and non-banking financial institution (NBFI) system.

Developing country governments sometimes face challenges implementing economic stimulus solutions that address all critically impacted sectors, such as micro- and small- and medium-sized enterprises (MSMEs) operating in the informal sector and microfinance institutions (MFIs) in the NBFI sector because, in many cases, government interventions support bank liquidity, which often only supports the formal sector. This compounds the liquidity risks for vulnerable sectors. Investment capital and technical assistance for banks, NBFIs, and SMEs are also critical to ensuring liquidity flows. Beyond the liquidity issue, ensuring that businesses remain solvent and able to withstand debt loads is crucial.

While some donors, including the International Monetary Fund (IMF) and World Bank, have provided immediate assistance to developing country financial sectors and institutions, including NBFIs and MSMEs, the United States Agency for International Development (USAID) has an opportunity to support the financial markets in these countries by addressing solvency and liquidity issues by using proven tools and leveraging partnerships with the newly created U.S. International Development Finance Corporation (DFC). USAID/Asia Bureau tasked US-SEGA to develop the Toolkit that follows to present options for how USAID Economic Growth Officers and others in Washington and Missions across the Indo-Pacific and throughout USAID can capitalize on the opportunity to support financial markets through the pandemic and in future crises. Though the Toolkit was conceived as a response to the economic problems of the

WHAT IS LIQUIDITY?

Financial liquidity has a broad definition and is not confined to government monetary or fiscal stimulus and market interventions. Liquidity is the ability for financial institutions, businesses, and individuals to access money at any given time. Liquidity can take several forms, including direct cash stimulus, equity or debt financing, or the selling of assets and securities. Refinancing can help companies with much-needed liquidity by freeing up constrained cash. Deeper capital markets provide liquidity by making it easier for investors to sell securities when they need to, and risk mitigation tools help promote liquidity by helping finance flow to constrained sectors. This Toolkit covers the many facets of liquidity.

COVID-19 pandemic, many of these tools can be applied broadly to address liquidity constraints, as well as to leverage and encourage private sector investment.

This Toolkit draws on information from interviews with USAID, the DFC, nongovernmental organizations, impact investors, banks, and the broader private sector conducted from June through August 2020, as well as a desk review of online secondary sources, including reports, government agency and project websites, and analyses from investment banks, donors, and companies involved in mechanisms affecting liquidity and capital markets. This Toolkit builds on the Preliminary Review of Capital Markets in the Asia-Pacific and Potential Opportunities for USAID, diving deeper into the issue of liquidity. For a primer on concepts addressed in this toolkit, such as financial sector literacy and blended finance concepts, please see Appendix A for a selection of resources.

HOW TO USE THIS TOOLKIT

What does the toolkit present?

- **A selection of tools from the DFC and USAID** that USAID can leverage and deploy
- **A description of each tool**, including when to use the tool, the cost, estimated timeline for deploying the tool, and benefits and challenges
- **Examples** to illustrate how the tools have or could be used
- **USAID buy-in mechanisms** that can leverage these tools
- Outcomes that USAID could achieve through the use of liquidity tools, including the development of **investment and enterprise funds or liquidity facilities**
- **Investor feedback** on the current tools
- **Recommendations** for how USAID can use and improve the tools

Who should use these tools?

USAID Economic Growth Officers and Mission staff can use this Toolkit to identify tools that USAID can deploy to address various liquidity scenarios.

When should the tools be deployed?

The toolkit identifies **intervention options to support financial markets** through the pandemic, in liquidity constrained environments generally, and in future crises.

How should the tools be selected?

Appropriate tools may be **identified using various criteria** including timeline required, benefits and challenges, and more.

Where should the tools be used?

While the focus of this Toolkit is for Asia Bureau countries, **Economic Growth Officers globally may find these tools useful** in responding to the economic impacts of the pandemic and supporting liquidity generally.

Why this toolkit?

Beyond helping developing country partners alleviate the immediate economic challenges associated with the COVID-19 pandemic, many of the tools discussed in this Toolkit can also **advance key U.S. priorities under the Indo-Pacific Vision economic pillar**, including promoting open market competition to unlock private enterprise-led growth and pursuing transparent, market-based infrastructure deals.

Tools from the U.S. International Development Finance Corporation

The creation of the DFC expanded the U.S. government's (USG's) existing tools under the Overseas Private Investment Corporation (OPIC) and USAID's Development Credit Authority (DCA), with an emphasis on introducing an equity authority, allowing the agency to compete beyond debt financing and provide alternative investment options for strategic projects globally. Based on USAID's global footprint and relationships in developing and emerging markets, as well as its increased focus on leveraging investment, USAID can be at the forefront of mobilizing the USG's revamped development finance institution through leveraging existing and new tools to promote liquidity and access to transparent and sustainable financing.

The DFC has created a dedicated unit to support USAID objectives as they relate to leveraging DFC tools. This group is called the Mission Transactions Unit (MTU) and sits within the Office of Development Credit. For most engagements with the DFC, USAID works with the MTU and would need to engage with the investment officer covering the country of interest. USAID staff can also reach out to their internally designated "DFC Liaisons," who are located within every MBIO (Mission, Bureau, and Independent Office). If Missions are interested in engaging the DFC, they should do so early on in their project pipeline to ensure suitability and to understand what budget they may need to allocate towards the cost of DFC tools. In addition to the MTU, there is also Structured Finance and Insurance Group, which focuses on transactions over $50 million, and the Funds Group, which focuses on investments into funds, which may include equity investments. At the time this Toolkit was written, an Equity Group was being formed to handle direct equity investments. The Political Risk Insurance Group and Technical Development Group also play critical roles in several of these tools.

To address COVID-19, the DFC set up a Rapid Response Liquidity Facility that will provide up to $4 billion in additional financing to existing DFC projects. For example, if a current investee has borrowed $50 million from the DFC, they can now borrow up to an additional $50 million in working capital to address liquidity constraints due to the impact of COVID-19. Beyond the response to the pandemic, these tools can be used to enhance and encourage private sector investment, promote sustainable infrastructure financing, and reduce the risk of investing in USAID priority sectors and countries.

Direct Loan (Debt)

DESCRIPTION	Direct loans are debt investments where DFC deploys capital and receives interest and principal payments from its borrowers. These loans have terms including size of the loan, interest percentage, collateral, and maturity (when the loan is fully paid back).
WHEN TO USE THIS TOOL?	Direct loans are used for viable investments where there may be a lack of private sector investors willing to lend or when private capital is too limited, expensive, or constraining. They can also be used when liquidity in a system dries up, such as in the current pandemic environment. They address liquidity through directly injecting more money into the system, particularly for on-lending to MSMEs in target sectors via investment funds, banks and NBFIs, but can also be made directly to companies or projects. Another use of direct loans from the DFC is to signal a demonstration-effect, encouraging additional investment from the private sector. Many times investors find comfort in co-investing in opportunities where they see USG investment alongside it.
COST	Dependent on the size, transaction and country risk, and anticipated return on investment, a subsidy payment is required. When working with DFC's MTU, USAID must pay the subsidy cost of the loan to mobilize this capital. In addition to the interest payment, other fees are charged to the borrower based on the specifics of the transaction. There are collateral expectations for the borrower, which vary based on the type of loan and borrower, as well as the specific objectives the lender is trying to address. USAID can also look at third-parties, like NGOs or the private sector, to offset the subsidy or complement its budget in order to leverage greater amounts of other investment.
TIMELINE	Timing to execute a loan varies and can range from 6 to 18 months. A longer timeline is expected when bankability is difficult to determine, which may require a more extensive due diligence process, greater collateral requirements, and/or additional capital before closing the deal.
BENEFITS AND CHALLENGES	Direct loans can have an immediate impact on liquidity once deployed, although setting up new loans may take time. The Rapid Response Liquidity Facility alleviates time constraints in the pandemic environment, but is only available to existing clients. Though the MTU has less experience with direct loans than other offices that were previously part of OPIC, it is now lending and is considering new clients, though these will require a longer timeline. DFC terms are typically cheaper than the private sector (though these loans are only used when borrowers cannot find sufficient support from the private sector).

How Can USAID Engage?

The USAID Mission should understand what the potential borrower needs, if they desire debt, and how much they are looking to borrow. USAID can be an important partner in pre-screening and screening potential borrowers to help determine if they are considered bankable (have they borrowed before, do they have audited financial statements, a business plan, risk oversight for managing shocks?). This way, the mission can have a better understanding of what the potential borrower really needs and how they may be able to help. Ultimately, the DFC will be able to join the relationship to help navigate the nuances of relevant financing options and terms.

If USAID is working with existing DFC investees, it can help these investees tap into the Rapid Response Liquidity Facility for additional working capital loans. A USAID Mission can reach out to the DFC liaison or investment officer covering that mission and facilitate an increase on the current loan. Additionally, if USAID Missions have identified lenders or SMEs that are struggling to manage their existing debt or access additional debt, USAID can work with the designated DFC Liaison and the MTU to mobilize debt financing to the respective entities.

Guarantees

DESCRIPTION

Guarantees are provided to lenders (not borrowers) and are used to partially offset the credit risk of a loan. Typical guarantees made by the MTU provide 50% coverage on the principal of the loan (not the interest) and are pari passu (evenly shared risk with the lender, so every dollar lost is split between the lender and the DFC up to the guarantee ceiling).

WHEN TO USE THIS TOOL?

Guarantees work best when there is existing capital that could be deployed, but the risk and uncertainty may be too high for the financial institution to lend on its own.

In the medium to long-term, new guarantees are meant to encourage private sector lending where there would otherwise be none (known as "additionality") due to the risk of investment in a specific sector or country, such as a new sector for the lender or a borrower with greater perceived credit risk. With the guarantee, lenders have lowered their risk and are therefore willing to lend.

In the short term, adjustments to existing guarantees can alleviate the liquidity-constrained environment caused by COVID-19 by reducing the risk of lending to current partners in the uncertain environment. Currently, the DFC is seeking to alter the existing guarantee terms of its risk-sharing partners (lenders) to mitigate the increased risk of their loan portfolios. For example, in some cases, the DFC can allow loans already placed under coverage to be restructured, a grace period on guarantee fee payments, or expansion of qualifying borrower categories.

COST

The cost to USAID is in the form of a credit subsidy, which is funding USAID obligates to offset what is roughly equivalent to the expected loss incurred by the DFC by providing the guarantee. This amount depends on the size and risk of the transaction. Typically, the subsidy is a fraction of the overall guarantee size and provides the leverage needed to attract larger pools of private sector investment. Other fees are charged to the lender (user of the guarantee) based on the specifics of the transaction, typically in the form of an origination fee and a utilization fee.

USAID can also look to third-parties to pay for the subsidy or complement its budget in order to leverage greater amounts of guarantees or guarantees focused on higher subsidy working capital. Third-parties, such as NGO's or the private sector, can also offset the subsidy cost in the form of a first-loss. Meaning, if there is an initial loss in the amount of the subsidy, the third party must cover that subsidy amount before the guarantee can be provided to the lender.

TIMELINE

Timing varies and can range from 4 to 12 months.

Guarantees

BENEFITS AND CHALLENGES

In response to COVID-19, the DFC is altering existing guarantee terms (like allowing debt restructuring) through an expedited process. This provides more immediate-term opportunities to mobilize private sector liquidity and could, in some cases, require additional subsidy from USAID to adjust these terms.

A guarantee takes time to identify, diligence, structure, negotiate, and then to close, and does not immediately impact liquidity as it still relies on the financial institution using these guarantees and having sufficient liquidity of its own to lend. A guarantee does not ensure the financial institution will invest in the targeted sector and may sit under-utilized. Additionally, partial credit guarantees may not be able to be classified as suitable collateral for some lenders, as has been the experience of USAID in some countries.

How Can USAID Engage?

In the pandemic context, USAID can also work with existing guarantees and the DFC team to evaluate options for making these guarantees more responsive to the COVID-19 reality.

USAID would engage their DFC Liaison or an existing relationship with the DFC and notify them that the Mission has found a lender in need of a guarantee or a lender that the mission is trying to persuade to invest in a higher risk or new sector. The Mission should ensure it has identified budget (subsidy) or plans to allocate subsidy towards a guarantee. If the Mission is unsure how much subsidy it will need, the DFC will be able to give a fair indication of the cost.

CASE STUDY › Guarantee

USAID/Indonesia is currently structuring a loan portfolio guarantee with DFC as part of its COVID-19 response efforts. While the Government of Indonesia has implemented COVID-19 responses, including support for businesses, systems are not in place to effectively disseminate funds, and thus funds are not reaching all health care providers that need to continue to operate throughout the pandemic. USAID/Indonesia stepped in to mitigate this liquidity crunch with a loan portfolio guarantee for a local fund supporting financial intermediaries that are on lending to non-government and private clinics, pharmacies, and rural health providers. This is one example of how USAID can use credit guarantees to provide liquidity to more critical businesses, including those that are more remote.

SPOTLIGHT › The Export-Import (Ex-Im) Bank

The Ex-Im Bank provides direct loans, guarantees, and export credit insurance to support U.S. exports to countries around the world. In December 2019, Ex-Im Bank received a seven-year reauthorization to set the Bank's exposure cap at $135 billion through FY2027. It is the longest reauthorization to date, indicating an increasing importance on the supporting U.S. exports. However, the Ex-Im Bank's programs – particularly the guarantees on commercial loans – can also support the countries in which USAID works. The Ex-Im Bank supports other economies by providing loan guarantees to foreign companies so that they have the liquidity needed to purchase goods from the U.S. These commercial loan guarantees provide companies in developing countries with liquidity and the ability to support and grow their businesses, and in turn, support a thriving economy.

Equity

DESCRIPTION	The DFC's authority to invest in equity is a new capability for the U.S. government writ-large. As of June 2020, DFC has approved its first seven equity deals. DFC can invest equity into both funds and individual businesses. As equity is a new tool, the DFC has made more investments into funds due to its familiarity with the funds structure and limited concentration risk. The DFC is in the process of establishing an Equity Group that will handle all equity investments in the future. Equity investment is a riskier form of investment and it takes an ownership stake in the target project or fund.
WHEN TO USE THIS TOOL?	Equity can directly address a lack of liquidity through injecting money into a fund or business. It is best used for longer-term engagements, and while equity can be an impactful tool for addressing pandemic-related liquidity constraints, the timeframe for deployment may be long. In some cases, projects and funds need equity investment instead of debt. Reasons could be that the investee cannot afford traditional debt repayments in the near-term or that the investee needs committed equity in order to attract greater pools of debt-based investment. Equity can have a powerful influence on the project or fund and sometimes has a greater impact on the ability to leverage additional private capital, particularly debt.
COST	Equity funding has a separate funding cap from the rest of the DFC, which was $150 million per the USG FY2020 budget. Also, how equity is structured is still being adjusted with the Office of Management and Budget. Current positions are conservative, requiring a 1:1 investment to cost ratio (i.e. if the DFC makes a $1 million investment, $1 million must be allocated to internal cost). The DFC is working to reduce the ratio of this provision as it is currently cost-prohibitive. At the time of writing, it is still being determined whether USAID can transfer funds to DFC for equity investments.

Equity

TIMELINE	This is the newest product the DFC offers, so unfamiliarity with the investment could cause significant time constraints and will likely be on the longer end of the investment spectrum for the DFC MTU. Additionally, all equity investments must be approved by the DFC board of directors, which meets quarterly and brings higher political scrutiny. Until investment officers become more familiar with the process, USAID can anticipate that equity investment will take one year or more. The Funds Group has experience investing directly in investment funds.
BENEFITS AND CHALLENGES	DFC just began making equity investments this year, and the MTU has limited equity experience. Further, requirements for board approval may make the process more challenging while it is still new. For now, it is likely that most equity investments will be made to investment funds and invested out of the Funds Group. Equity investment is subordinate to senior debt, and while it provides the opportunity for greater returns, it has inherently greater risk and is therefore more expensive. Due to the slower process for equity, it is not necessarily the best tool to use in addressing immediate liquidity constraints, such as the liquidity issues associated with the COVID-19 response.

How Can USAID Engage?

USAID can work with existing funds looking to raise additional equity capital, especially those investing in USAID priority sectors in a given country or with an environment, social, and governance (ESG)-oriented investment strategy.

If a USAID Mission is engaged with an investment fund, it may find that the fund is looking to raise capital in order to provide liquidity into sectors like SMEs. The Mission will want to understand the amount of capital the fund is seeking and what the fund's experience is making similar investments or what its history and track-record are. The Mission can then engage the DFC to examine the viability of an equity investment into the fund in order to catalyze investment and potentially leverage additional private sector investors into the fund. At this stage, the MTU would likely connect the Mission to the Funds Group (or the future Equity Group) to further vet the opportunity. As indicated above in the cost section, it is still under discussion whether USAID can transfer funds to DFC for equity investment. Missions interested in DFC equity support should reach out to DFC to discuss options. Should it be determined that USAID can transfer funds for equity investment, the Mission should be prepared to allocate a sufficient amount of budget in order to support an equity investment from the DFC.

Technical Development

DESCRIPTION

Technical development consists of feasibility studies and technical assistance (TA) and is specifically for targeted DFC projects that have received or may receive DFC financing or insurance. USAID engagement with DFC technical development is envisaged to take place with the MTU; however, the mechanisms through which this may occur are still being considered.

This tool should not be confused with traditional USAID TA, as DFC technical development is typically one-off support for a specific investment, such as a sponsor requiring a feasibility study or providing TA to banking and financial institutions that may be unfamiliar with priority sectors, such as SMEs or women-owned businesses.

WHEN TO USE THIS TOOL?

Technical development will not directly inject liquidity, but can be used to make sure investments are viable, to better operationalize investments, or to assist in focusing investments toward a specific mandate like gender-lens investing, which can indirectly support liquidity.

To support existing DFC projects or potential investments, technical development can provide the assistance or study needed to ensure successful project implementation or investment. Under the current structure, USAID would consider using DFC TA only when a MBIO's annual program does not include language that would allow for TA to a DFC product.

COST

Directly correlated with the amount of technical assistance or feasibility study required and all costs associated with that work. USAID still must pay for the TA that DFC would implement until the MTU establishes a TA mechanism with an internal budget.

TIMELINE

The DFC has supported a small number of targeted projects and is still evaluating its pipeline. In many cases, timing depends on the project and its sponsor's selection of technical support. Further, timelines can be delayed as all DFC TA currently must be approved by the DFC board of directors, which meets quarterly. If timed opportunistically, approval could take as little as two months. The MTU is still working to establish a TA mechanism and is currently relying on existing USAID mechanisms to fund TA.

BENEFITS AND CHALLENGES

TA must be for existing deals or potential deals, to be determined by the demand (see scenarios below). USAID must fund the TA that the DFC provides and may have to do so through an interagency agreement. This promotes inefficiencies and may be better delivered through USAID buy-in mechanisms, such as US-SEGA. In general, it is best practice to have TA support for USAID-owned DFC transactions, but it is more efficient for that TA to come from the USAID MBIO and be integrated into USAID's existing TA programming. As there may be times when that is not possible, at the time of writing, DFC is still exploring how it will partner with USAID to provide TA.

Other parts of DFC ("non-MTU") have their own technical development budgets and may be less likely to partner with USAID to provide TA for existing projects.

How Can USAID Engage?

In addition to working with the MTU (as referenced above), USAID can expand engagement to non-MTU technical development partnerships through the DFC's own mechanism (and budget), such as supporting feasibility studies for DFC's existing investments in key infrastructure projects. As mentioned above, while USAID could provide funding for DFC MTU TA, the MTU would provide the scope of work for the TA and it would be implemented through a buy-in mechanism (such as US-SEGA). Thus, this tool is best used when annual program language does not accommodate technical assistance to a fund, project, or initiative in which a Mission may be interested.

When USAID is working on new guarantees and investments with the DFC, TA should be incorporated proactively from the onset of a project, rather than being added later when trying to fix problems after they occur (such as under-utilization).

Political Risk Insurance

DESCRIPTION	Political risk insurance (PRI) provides coverage against losses caused by currency inconvertibility, government interference, and political violence. However, PRI does not cover foreign exchange risk, which is currently a gap in available tools to promote liquidity. DFC also has a reinsurance product to help increase underwriting capacity. Political risk insurance can both be a standalone product or combined with other DFC products in a cohesive investment package.
WHEN TO USE THIS TOOL?	PRI is a dynamic tool used to address particular risks within an investment structure, especially where political risk can have a significant impact on the success of a project, but is not a tool for injecting short and intermediate-term liquidity. USAID can use political risk insurance to cover risks that discourage foreign direct investment or infrastructure development in particular countries. While this may not be an immediate-term liquidity tool, it is crucial in some places to ensure a transaction's risk is properly mitigated. This tool indirectly leverages significant private sector investment that would otherwise not flow without this type of insurance.
COST	PRI must also set aside subsidy for its transactions based on size, country, and risk. As with other subsidy costs, this budget amount is based on expected loss. The DFC MTU must work with the Structured Finance and Insurance Group if it wants to support a PRI transaction. As a result, the subsidy expense would be paid by the DFC budget if deemed a viable transaction.
TIMELINE	Due to its complexity, PRI takes as much time as direct loans, with the precise timing varying from deal to deal, ranging from 6 to 18 months. USAID's main DFC counterpart, the MTU, has yet to use political risk insurance. So under the current arrangement, a partnership involving PRI would require another step because USAID must work directly with the DFC's Structured Finance and Insurance Group.
BENEFITS AND CHALLENGES	There are several benefits if the risk is identified. While it does not cover currency depreciation or fluctuation, it does cover inconvertibility, which is key for international investors. USAID may find it difficult to navigate this tool as it is typically for more complex projects that must mitigate several risks in addition to political risk.

How Can USAID Engage?

In order to support infrastructure projects trying to attract private sector investment, USAID can engage the DFC to mitigate risks specifically related to national government risk that can impact the overall success of the project, such as when the government decides to nationalize a company/project that directly impacts the investment. The DFC has not used political risk insurance in the Asia-Pacific as much as other regions, and there have been no new agreements in the region since 2018. However, given the focus on infrastructure investment in the region, PRI could be useful for USAID to consider both in tandem with other investment promotion or as a standalone product, as it seeks to promote sustainable infrastructure investment.

For example, if a USAID Mission is in a country where the political regime is either unstable or considered volatile, the country may be perceived as too risky for international investors. In order to mitigate this risk, the Mission may want to consider discussing the options for PRI to attract foreign investment with the DFC. Typically, a Mission would be in discussions with a project sponsor in country or a foreign investor, either of which find it difficult to operate in country due to the significant possibility of adverse actions by the government that could derail investment or lock up a country's financial system. At that point, to facilitate business and investment flows, the Mission would contact the DFC to explore PRI options for those specific investment opportunities.

CASE STUDY › Leveraging DFC Tools with First-Loss Mechanisms

In some cases, there may be a project that USAID is interested in but has a much higher risk profile due to is more developmental purpose, and the DFC may not have sufficient risk appetite for such an investment on its own. In these cases, USAID could offer first-loss coverage (see below) for the investment in the project as part of a blended finance approach to lower risk and make DFC and private sector financing more viable. However, at the time of writing, first-loss was being reviewed by the Office of Management and Budget, which may present additional hurdles. USAID could also bring in philanthropic or private sector partners that could provide first-loss funding.

Tools from USAID

USAID has several tools and mechanisms at its disposal that can mitigate liquidity issues in partner countries. The tools described below can also be used to promote social outcomes by partnering with funds and investors with a stated focus, such as investing in primarily woman-run businesses, which have been adversely impacted at a higher rate throughout the pandemic.

First-loss Grants

DESCRIPTION

First-loss, also referred to as concessionary capital, is a form of credit or equity enhancement in which USAID agrees to cover a certain amount of loss for an investor or pool of investment (through the form of a grant). USAID, as the first-loss provider, is the first to lose its money (or last to be repaid), which makes it more likely that the private sector investors will see a return on their capital. USAID can also leverage the DFC guarantee as second-loss pari-passu, meaning another party has taken on the first-loss position, while DFC would provide a second layer of risk mitigation with a credit guarantee for private investment.

WHEN TO USE THIS TOOL?

First-loss can help inject liquidity by providing financing directly and mitigating the risk for other investors, thereby promoting the financial attractiveness of an investment and incentivizing private sector/commercial investment.

In most cases, this tool is deployed as a medium to longer-term liquidity strategy, especially for helping to capitalize funds investing in USAID priority geographies and sectors. First-loss could also be combined with a standard guarantee as part of a package with the DFC (see example above).

COST

The amount committed by USAID varies for each investment. In the past, the value of USAID first-loss grants has ranged from $500,000 to $1 million. This has mobilized varying amounts of private sector investment, including a 10:1 ratio in one of the examples presented below.

The cost of first-loss may also be spread across third party private sector and/or philanthropic partners. For example, USAID could bring in a foundation that wants to invest, and is willing to provide the capital on a subordinated basis, thereby increasing the pool of concessionary capital (which could attract more private funding) or taking on the first-loss position entirely.

Timing is an additional cost that is difficult to quantify. The feedback from those at USAID that have successfully deployed grants in the form of first-loss is that they are typically a brand new concept to contracting officers and face a substantial amount of resistance from concept to execution.

TIMELINE

Deploying first-loss grants can take 6–12 months or more, depending on the parties involved. The investment period typically ranges from one to ten years and a fund's term limit typically ranges from five to ten years. As indicated above, the contracting efforts can add a significant amount of time to the process.

First-loss Grants

BENEFITS AND CHALLENGES

First-loss grants decrease risk and thereby encourage private sector investment that otherwise would not take place. This can have a positive impact on liquidity since capital tends to flow faster when there is coverage on initial losses to investment. One challenge is that first-loss covers a limited amount of capital and does not mitigate overall risk, so investors must conduct proper due diligence. Additionally, contracting officers are not uniformly comfortable with this tool and are not always familiar with how these mechanisms have been set up previously, so the process can vary considerably depending on the personnel involved.

CASE STUDIES › First-Loss

USAID provided first-loss capital to the Medical Credit Fund (MCF), a debt fund established by the PharmAccess Group to finance health SMEs in sub-Saharan Africa. USAID's $1 million grant sought to mitigate risks around foreign exchange and helped draw in an initial $10.6 million in debt from OPIC, Calvert Impact Capital, three foundations, and Dutch private investors. As of January 2020, MCF is a $50 million fund; much of the later funding rounds came from impact-oriented private sector investors. A success story in sustainability, the fund runs independently without USAID grant support and aims to be independent of all donor financing by 2021.

USAID Office of Private Capital and Microenterprise (PCM) with support from Power Africa assisted the Cross-Boundary Energy Investment Structure mobilizing $1.3 million in grant funding as subordinated capital. Power Africa funding attracted $7.5 million in private equity and $10 million loans.

USAID has also used second-loss structures, such as with the IDH Farmfit Fund. This fund is the world's biggest-ever impact fund for smallholder farmers. The fund's model de-risks investment in smallholder farming, making private financing more attractive. In the structure, IDH Farmfit has a 10% first loss, while USAID provides a second loss guarantee of 40% up to $250 million, providing significant reassurances for investors. Other investors include major value chain companies, banks, and development agencies.

Seed Funding

DESCRIPTION	USAID uses seed funding via grants to provide initial investment in an equity or debt fund, managed by an implementing partner or financial institution, which then invests in enterprises. Seed funding into investment funds can be partially recoverable, is often combined with technical assistance, and can also be combined with first-loss financing, among other tools.
WHEN TO USE THIS TOOL?	Seed funding promotes liquidity through a direct injection of funds for operational expenses, on-lending, or investment. Seed funding is typically a medium to longer-term tool, and should be used when USAID wants to catalyze and attract other private investment into funds, as well as to act as anchor funding to help show viability. This is typically used when USAID wants to promote new investment into a specific sector where there is currently a void of investor presence in that country or sector.
COST	Cost varies depending on the size of the investment fund. Examples referenced in this Toolkit range from $500,000 to $24 million.
TIMELINE	Similar to first-loss, timing will vary depending upon the stakeholders involved and could be a year or longer. Again, another significant challenge will be the engagement process with OAA and the contracting mechanism used, whether from straight grant, a GDA (see below) where you can have matching funds, or other type of contract.
BENEFITS AND CHALLENGES	Benefits of seed funding include acting as a catalyst to attract private capital and the option to combine seed funding with other blended finance and technical assistance tools to maximize impact. Because USAID cannot hold equity and typically does not deploy debt, funding must go through an implementing partner, which could create challenges around structuring.

Match Funding (Global Development Alliance)

DESCRIPTION	USAID match funding through the Global Development Alliance (GDA) is used to leverage private funding and resources from a private sector partner or consortium of partners to increase impact. Through a process of co-creation, USAID and GDA partners apply their respective knowledge and expertise, resources, and assets to solve development problems in a sustainable way. Such partnerships could be used to create investment funds or other liquidity-supporting facilities.
WHEN TO USE THIS TOOL?	GDAs aim to harness aligned interests and objectives with the private sector in order to leverage more private funds. GDAs are also a medium to longer-term tool, and should be used in pursuit of a specific objective that MBIOs are trying to finance through establishing external partnerships or promoting private sector buy-in.
COST	Cost requirements for GDAs are a minimum 1:1 leveraging of private sector resources, meaning to mobilize at minimum $1 million in private sector investment, USAID invests $1 million. Private sector resources may be contributed at a greater ratio. If leveraging funding for equity or loan investments, and the private sector resources are only going towards the investment pool, then the level of funding intended for equity investment must be five times the level of the USG contribution in order to count toward meeting the private sector resource leveraging requirement.
TIMELINE	Timeline from the submission of concept paper to implementation can vary depending on the private sector partners, Missions, and Bureaus involved. Concept papers must be submitted before the closing date specified in the GDA Annual Program Statement (APS).
BENEFITS AND CHALLENGES	GDAs engage the private sector and leverage resources and expertise using market-based, sustainable approaches and solutions. They allow flexibility and innovative design through the co-creation process, and can be complemented by DFC guarantee or lending activities. GDAs may not provide the greatest amount of leverage relative to other tools, and results are not always readily apparent. Furthermore, they may require either intensive searching to identify a partner or time and luck for the right partner to submit a concept paper. The funding cycle is not flexible, and GDAs must adhere to the annual GDA APS deadline. Moreover, the co-creation process involved in developing a GDA could be time-intensive, and may be better suited for a long-term initiative.

CASE STUDY › Match Funding Through the Global Development Alliance (GDA)

USAID partnered with the DCA, GDA, Root Capital, Keurig Green Mountain Coffee, and Starbucks in 2014 to create the Coffee Farmer Resilience Fund, which provides loans to farmer cooperatives that provide short-term credit for working capital to their members in Latin America. Keurig provided a $400,000 first-loss investment and USAID provided a 50% guarantee of $15 million as well as $2 million in grant funding to deliver technical assistance such as financial literacy training. Technical assistance and additional resources serve to increase the likelihood that the DCA guarantee will be repaid.

SPOTLIGHT › Blended Finance

Many of the tools discussed in this Toolkit are vital components of blended finance. Blended finance is the strategic use of concessionary capital to mobilize private capital for developmental outcomes, such as improving infrastructure, education, agriculture, and healthcare; encouraging investment in critical sectors, like SMEs and women owned businesses; and more. Blended finance strategies are designed to encourage investors from the private sector to invest in activities that are profitable and have positive social and environmental outcomes. The tools discussed can be combined in innovative ways to reduce risk for the private sector and encourage investment into critical or new markets, sectors, and projects. Partial grants can be used for first-loss and seed funding, among other applications, and combined with technical assistance, can encourage investment through increasing an investor's potential return and mitigating risk factors.

For example, the USAID **Partnering to Accelerate Entrepreneurship (PACE) Initiative** worked with Open Capital Advisors (OCA) to develop the Investment Readiness Program (IRP), which worked with five impact investors to support early-stage, high-growth-potential enterprises in East Africa. PACE IRP encouraged investors to support pre-investment-stage enterprises through using grant capital to subsidize capacity building costs, pipeline development and screening, and the cost of assistance to selected enterprises. These costs were shared with partner investors and the beneficiary enterprises. Investors shared the cost of pre-investment support in exchange for a right of first refusal to invest in enterprises upon completion of capacity building. Additionally, OCA deferred a portion of its fees to the successful completion of a capital raise, sharing risk with the selected businesses. By PACE IRP's close, the program provided pre-investment support to 15 enterprises and mobilized $2.3 million in early stage investments into six of the enterprises.

For more resources on blended finance, see Appendix A.

USAID Buy-in Mechanisms

Buy-in mechanisms are typically flexible, demand-driven mechanisms housed within USAID projects that offer an avenue for Missions to implement various activities, including the tools detailed above. These activities can promote liquidity by providing technical assistance to central banks, banks, and NBFIs that are trying to adjust to the economic conditions and policy changes associated with the pandemic, or by developing new mechanisms of directly injecting liquidity. The following buy-in mechanisms for both Asia and beyond offer a vehicle for implementing some of the aforementioned tools.

US-Support for Economic Growth in Asia (US-SEGA): Components 2 and 3

DESCRIPTION	US-SEGA helps USAID Missions and other USG partners implement flexible, demand-driven economic growth programming throughout the Indo-Pacific.
PURPOSE	This mechanism is used for Missions that want to undertake studies or pilot activities, particularly initiatives that could be scaled. Missions have used this mechanism to undertake activities such as assessments, pilot and bridge activities, and surge support. US-SEGA also has a COVID-19-specific component, which Missions can buy into to undertake COVID-specific activities and research.
HOW IT WORKS	Missions work with the USAID/Asia Bureau Economic Growth team and US-SEGA team to draft a scope of work. US-SEGA provides a cost-estimate for the activities. Funding for this mechanism can come from the USAID/Asia Bureau, as buy-in funding from the Mission, or a combination thereof, sometimes with funds from additional sources. US-SEGA also has core funding that can be deployed quickly for smaller, discrete activities. There is no minimum for buy-ins.
TIMELINE	Since US-SEGA is a precomputed mechanism, activities are deployed rapidly without a request for proposals (RFP). Smaller activities can be mobilized in days, while larger activities can be mobilized in several weeks.
HOW IT ADVANCES GENDER EQUITY	The *Preliminary Review of Capital Markets in the Asia-Pacific and Potential Opportunities for USAID* report presented opportunities for how capital markets can advance ESG and gender equality goals, with global and regional examples. These included gender diversity requirements for listed companies and stock exchange signatories to the UN Women's Empowerment Principles. US-SEGA could also be used to advance gender equality through the tools presented in this Toolkit, such as helping to target liquidity for women-owned businesses.

INVEST

DESCRIPTION	INVEST is a five-year program (2017–2022) managed by the USAID Office of Private Capital and Microenterprise (PCM). INVEST provides USAID with access to a pool of partners, including but not limited to investors and technical advisors. MBIOs must approach the INVEST procurement team with a need or idea to use the mechanism.
PURPOSE	INVEST aims to make it easier for private enterprises to work with USAID. It provides investment opportunity assessments, structures funds and financial instruments, delivers transaction advisory services, and produces knowledge and learning products across a range of development topics with a focus in Africa. Most recently, INVEST is beginning work around liquidity assistance to businesses during COVID-19.
HOW IT WORKS	INVEST's model is mainly blended finance, including first-loss investment and catalytic capital. Each MBIO contributes funding to the activity. Awards to implementing partners range from $200,000 to $2 million.
TIMELINE	INVEST works with USAID to finalize an RFP and Statement of Objectives (SOO), then releases them to the pool of INVEST partners. Turnaround time for each proposal ranges from six weeks to several months. The total time from when the RFP is issued to when USAID MBIOs work with a firm (subcontractor of DAI) and begin implementation is two to three months at minimum.
HOW IT ADVANCES GENDER EQUITY	Through a buy-in from USAID/GenDev, INVEST produced a mapping of gender lens investing. USAID also provided first-loss capital to Women's World Banking Capital Partners Fund II (WWBCP II), further described below.

Catalyze

DESCRIPTION	CATALYZE is an eight-year, $250 million innovative finance mechanism managed by USAID PCM. The project intends to mobilize $2 billion to frontier markets and social sectors, using blended finance as a tool to incentivize and de-risk transactions and generate yields.
PURPOSE	CATALYZE aims to ensure greater access to capital by catalyzing greater private sector investment to new sectors and markets, primarily through the use of blended finance to de-risk opportunities for investors.
HOW IT WORKS	CATALYZE's model uses blended finance, typically by providing a form of catalytic capital, with about 20% of the mechanism value intended for grant-funding. This has included a new approach of "pay for disbursement" which offers a fund or bank a certain payment upon proof of disbursement of targeted loans. MBIOs contribute funding to the activity and work with CATALYZE to develop a statement of objectives.
TIMELINE	The process can take three to four months from the time an MBIO contacts CATALYZE to the launch of a project. CATALYZE is designed to be highly iterative and adaptive, involving an initial and continual co-creation process to determine a statement of objectives and develop a performance work statement and work plan.
HOW IT ADVANCES GENDER EQUITY	CATALYZE can advance gender equality through targeting investment towards gender-focused funds or for gender-focused lending. Currently, CATALYZE is working with the Women's Economic Growth Initiative through a buy-in focused on gender finance.

USAID Investment and Enterprise Funds

Using the tools at its disposal, USAID can achieve broader development impact and increase liquidity by setting up facilities similar to enterprise and investment funds and emergency liquidity facilities. These mechanisms enable USAID to leverage private sector funding and expertise to address issues surrounding liquidity. The following examples illustrate how USAID can use its tools to structure long-term liquidity-injecting solutions, which can serve as models for how to approach current and future liquidity constraints.

Enterprise Funds

DESCRIPTION

The enterprise fund model sought to transfer U.S. experience and knowledge of equity finance by bringing U.S. financial experts to the leadership of U.S.-funded investment funds that would train local experts and demonstrate by example this market mechanism. Current enterprise funds include a mix of U.S., international, and national leadership on their boards of directors.

Enterprise funds have had mixed success, but in many cases have achieved sustainable economic development impacts. They have leveraged additional investment resources, and have often generated sufficient returns to endow long-term host country legacy foundations that continue work of the enterprise funds without budgetary support. Several have returned a significant portion of their original grant funds to the U.S. Treasury.

Current enterprise funds are overseen by USAID, but new enterprise funds will be under the purview of the DFC. However, enterprise funds can be difficult to structure, as they must be approved by Congress and the roles and responsibilities of various agencies and stakeholders involved are not always clear.

PURPOSE

The purpose of enterprise funds is to (i) encourage equity investment in markets where the investment landscape is limited, and (ii) help develop more robust financial systems. The funds should catalyze private sector investment and demonstrate viability of equity investment. In some cases, funding disbursed by enterprise funds has also helped to seed nascent banking industries.

CASE STUDIES

The **Tunisian American Enterprise Fund** currently has $100 million in financing. It has a 10-year fund term, expecting to invest through 2027. The **Egyptian American Enterprise Fund** currently has $300 million for investment.

Previously, the **Eastern European Enterprise Funds** had $1.2 billion of USG funding (overseen by USAID), which was invested in enterprise development in 19 countries; $6.9 billion of private capital was raised, based on the convincing value proposition of the Funds.

Investment Funds

DESCRIPTION

Because USAID cannot invest equity and generally does not deploy debt, a USAID grant contribution to seed an investment fund can catalyze private sector investment, which could take the form of equity or debt. USAID can also provide first-loss financing to a fund, and it can combine these forms of catalytic capital for a blended finance approach to supporting investment funds. USAID also supports investment funds through technical assistance and other risk mitigation tools.

PURPOSE

Through support and contributions, USAID can act as a convening party and demonstrate viability to other investors. Often, for USAID funding to be deployed, USAID's contributions must be matched or exceeded by private investors in the fund, thereby catalyzing capitalization. Investment funds can therefore spur private investment in a country or sector of interest, with the goal of investment funds eventually becoming self-sustaining.

CASE STUDIES

Women's World Banking Capital Partners Fund II:

USAID's Office of Gender Equality and Women's Empowerment provided financing to support a blended-finance vehicle through the INVEST mechanism (see above). USAID provided $500,000 in first-loss funding and $100,000 in technical assistance to help capitalize what eventually become a $100 million blended finance fund. Innovatively, USAID's contribution was provided as a deliverable for the successful capitalization of the fund. USAID's support of and contribution to this fund helped attract other investors by both demonstrating USAID's stamp of approval as well as reducing risk.

The MENA Investment Initiative (MENA II):

USAID provided funding to a regional investment initiative that created an investment management company that co-funds, partially insures, and provides other technical assistance to incubators, angel funds, venture capital funds, and other early-stage investors throughout the region. This has included the launch of a $15 million fund in Lebanon, managed by IM Capital, which will match 50% of outside private sector investment, provides partial equity guarantees, and technical assistance to investors and entrepreneurs.

In Morocco, MENA II partnered with Small Enterprise Assistance Funds to establish an independent investment management company, Wise Venture Capital, intended to work with early stage investors to co-fund and raise capital for early stage businesses, as well as provide technical assistance to entrepreneurs. USAID's $3 million contribution was leveraged to raise an additional $15 million in capital.

Liquidity Facility

DESCRIPTION

A liquidity facility is a fund that can be seeded with grant money (or other forms of financing) intended to tackle liquidity constraints from multiple avenues. This includes providing stabilizing liquidity in a financial crisis, and financing can also be combined with innovative other forms of technical assistance such as:

- Training banks and NBFIs to prepare for emergencies
- Helping financial institutions to develop new products for clients that can help address liquidity constraints in times of crisis
- Working with insurance providers to develop disaster-based insurance products
- Supporting banks and NBFIs to construct membership-based pooling mechanisms, while resolving regulatory and structural obstacles to building formal and broader liquidity funds
- Working with reinsurance providers to design portfolio-level insurance products, enabling insurance providers to protect their portfolios

PURPOSE

The purpose of the liquidity facility is to increase resiliency to financial shocks. This is achieved by dispersing funding, creating new financial products, and engaging in preparatory activities with host-country firms and institutions.

CASE STUDIES

Indonesia Liquidity Facility after Disasters (ILFAD)

USAID/OFDA (Office of Foreign Disaster Assistance), partnering with Mercy Corps, created a proof-of-concept initiative to increase the resiliency of Indonesian firms to natural disasters. In addition to providing emergency liquidity through cash injections into MFIs, ILFAD provides technical assistance to Indonesian MFIs on disaster preparedness and supports the development of tools and financial services specifically designed for disasters, such as disaster recovery loans to help affected people repair homes and businesses or replace tools and inventories.

Investor Feedback and Insights

To identify key gaps in ensuring liquidity reaches those who need it throughout the global health pandemic, consultations were held with international banks, emerging market funds, impact investors, the DFC, USAID projects and Missions within the Asia Bureau. The discussion below presents key themes that emerged from these consultations around liquidity during the pandemic and identifies commonly cited funding gaps that could be addressed by USAID.

Government and Donor Interventions	Both governments and donor organizations have made efforts to inject liquidity into financial systems by providing additional liquidity to banks and NBFIs as well as providing support directly to individuals. However, some of these interventions only reach institutions and companies operating within the formal economy or those receiving financing through formal banks rather than NBFIs such as MFIs. Overlooking liquidity for the informal economy tends to have a greater negative impact on poorer and more vulnerable populations, including women, who have lower access to formal banking.
Recapitalizing Financial Institutions	Based on conversations with private equity investors, including Women's World Banking, many companies—including ones in existing portfolios—need recapitalization. While this could typically be in the form of equity, it is difficult to put appropriate valuations on companies in this environment, in particular given the risk of demand destruction in certain sectors. For private equity investors to become more comfortable with providing additional capital, they may wish for debt investment to step in to ensure appropriate financing is in place. This is where guarantees can be effective if banks have sufficient liquidity to lend.
Microfinance Institutions at Risk	Investors are noticing many MFIs are struggling to obtain liquidity. First, governments sometimes overlook the non-bank sector when providing emergency support. Second, while banks can take deposits, MFIs depend heavily on external sources of finance (typically in foreign currency). Third, the very investors that have been financing MFIs are retrenching and requiring MFIs to continue paying their loans. On the other hand, governments are requiring lenders to provide moratoriums and interest rate caps to their borrowers. This leaves non-bank financial institutions particularly vulnerable and poses a tremendous risk to the MFI industry.
Guarantees	Guarantees are helpful when there is capital available, but less useful when banks and other financial intermediaries themselves face limited liquidity. When funding is available, greater deployment of guarantees will help buy down the risk of investing, particularly when financing last mile financial institutions (such as MFIs). When institutional lenders themselves face a liquidity crunch, providing financing through more direct liquidity injecting mechanisms, such as refundable grants or other liquidity facilities, would have more impact.

Foreign Exchange Hedges	While DFC Political Risk Insurance covers currency inconvertibility, government interference, and political violence, it does not cover any risks around extreme currency fluctuation, which may be seen during crises. This could stymie the flow of private sector funds into an economy. While third parties offer currency hedging, often at cost-prohibitive prices, there is no tool from DFC or USAID that currently provides a direct form of currency hedging.
New Requirements from Governments	As governments seek to manage the financial impacts of the pandemic and inject liquidity into their systems, they often place new requirements on existing financial institutions, such as interest rate caps, grace periods/moratoriums on loan portfolios, or mandates to lend to certain sectors or segments of the economy. Furthermore, these lenders have no information on the current status of their borrowers, since they cannot collect debt payments and have no indication of whether these companies have cash flow or are insolvent. These requirements impact a financial institution's ability to manage its portfolio, disburse new loans, quantify risk, or analyze new sectors. Ultimately, these challenges can reduce a lender's ability to meet its own financial obligations and pay debt, thus creating a lock up in liquidity up and down the system. This could be mitigated through technical assistance to financial institutions for strategies to navigate new requirements, or direct loans from the DFC and other combinations of liquidity tools.
Support Needed at the Bottom	Investors and the DFC point out that when the financial institutions get strangled, the ultimate beneficiaries seeking access to finance are devastated. Investees need support in order to repay obligations, though they may also need debt from third parties to cover capital constraints in the near-term. New loan requirements will likely be more stringent from lenders that are not under the same government mandates that require leniency and will likely require additional restrictions like loan-loss reserves and not allowing additional indebtedness.
Pooled Guarantee Facility for SMEs	One investor noted that a successful platform was recently established in the United States that pools funding from various institutions to collectively provide a guarantee facility to small business owners.[1] While a traditional guarantee is provided by a guarantor to the lender, this type of guarantee is provided to the borrower and used to attract investors directly. USAID could play a much-needed role in aggregating larger pools of funding to establish an external guarantee facility for SMEs to access directly.
Women Adversely Impacted in Economic Crisis	Typically, women's programs are the first to be cut. Women business owners struggle with childcare during pandemic-related lockdowns and often their businesses suffer as a result. While the digital economy provides relief to some business owners, a digital gender divide remains; women are less likely to own mobile phones, and thus are less likely to access digital relief efforts.
Returning Migrants	With migrants returning home due to pandemic-related lock-downs, there is additional strain on households and economies. The lack of remittances from abroad and the added cost at home has caused a huge gap in financial flows in developing countries and is adding to the liquidity crisis at the ground level.

1 For more information, see, The Kresge Foundation, "U.S. Sees Launch of First Guarantee Pool Community Development Investments," Jan. 28, 2020 (https://kresge.org/news/us-sees-launch-first-guarantee-pool-community-development-investments).

Recommendations

USAID has a number of existing tools it can use to mitigate liquidity constraints in the current COVID-19 financial environment, as well as to help improve sustainability and transparency of investment in key sectors. Through opportunities to partner with the DFC, USAID can leverage DFC's tools to inject liquidity into the financial system and achieve greater impact. Considering the tools discussed in this Toolkit, as well as the gaps and needs highlighted by investors and other stakeholders, the recommendations below outline actions USAID can take to support liquidity in the current environment—in the short and medium-term—as well as new tools USAID can develop to help combat the longer-term liquidity implications of the post-COVID-19 economic environment and plan for future liquidity issues, pandemic-induced or otherwise.

USE OF EXISTING TOOLS AND MECHANISMS TO INJECT LIQUIDITY

- **Use technical assistance to help mobilize domestic government-provided emergency relief funding.** While governments have announced and allocated budgets toward emergency relief funds in response to COVID-19 for crisis-impacted banks and businesses, many NBFIs and MSMEs have not been able to access these funds. USAID can provide technical assistance to governments and/or NBFIs and MSMEs to access these designated funds quickly. USAID may even establish a liquidity facility that can receive these emergency funds and distribute them more effectively and efficiently to the informal sector, providing a much-needed service to the national government and its economy.
- **Provide technical assistance to financial institutions** that must adjust to new mandates and regulations, such as interest rate caps, required moratoriums on loan repayment, tenor extensions, or requirements to lend to vulnerable segments of the market, particularly when financial institutions do not have a risk assessment process in place for specific segments of the market. Financial institutions do not have the technical, operational, or administrative capacity to manage these new mandates.
- **Provide technical assistance to businesses** facing insolvency issues through existing programs or through a buy-in mechanism. Technical assistance to companies could also complement the DFC work in partner countries by providing broader technical assistance to specific sectors and markets where guarantees or loans are in place. US-SEGA is currently developing a study identifying the key issues APEC economies face in implementing an effective insolvency regime; that study will propose concrete interventions to promote efficient and predictable insolvency frameworks.
- **Explore ways USAID can work with PRI early in infrastructure lifecycle**, when political risk is viable, in order to fully capitalize on risk mitigation for project financing support. While this has been a long-standing product offered by OPIC, it introduces a new set of tools for USAID to leverage with the DFC.
- **Advance gender equality through DFC or USAID tools.** Through the US-SEGA project and in line with the DFC's 2X initiative, USAID could target women-owned businesses by injecting liquidity through the use of these tools. Women-owned businesses that lack access to the formal banking system and are in the informal economy should be targeted.
- **Create solidified processes for DFC liaison engagement and steps for working with DFC investment officers.** Among the feedback from Missions was confusion around how exactly and when exactly to engage the DFC. Though the DFC is new and evolving, USAID should work to put these

standard operating procedures in place to streamline communication and processes between the two agencies. There is little known about how to engage the DFC Liaisons and the Liaisons have varying degrees of technical understanding of the DFC. Training on both sides as well procedural manual would help this process.

- **Promote an understanding of how to use first-loss and other innovative grants amongst USAID Office of Acquisition and Assistance (OAA) staff.** Providing training and/or innovative grant manuals to demonstrate to Contracting Officers how these innovative grants have been used successfully in the past and the process required to implement them. Making these tools more approachable from a procurement standpoint could increase the use of them and the speed with which they are implemented.
- **Support targeted investment funds, including equity funds, by leveraging the DFC's new equity investment authority.** Investment funds previously had few options from the USG due to restrictions on equity investments or guarantees linked to equity. Many either sought outside support or had to materially change their fund approach in order to access credit guarantees or direct loans into the fund. This made it very difficult for investment funds to leverage additional capital due to the restrictive nature of senior debt. Equity investments better align with most fund structures.

Additional TA recommendations from the DFC MTU for USAID:

- **Origination strategy and loan product calibration:** Designing a strategy to continue client acquisition and loan disbursements, including market analysis in light of COVID-19, recalibration of risk limits, and redesign or modifications to existing loan products.
- **Loan portfolio quality management and recovery:** Analysis of the effects of the crisis on loan portfolio quality, creating a strategy for managing deteriorating portfolio quality, developing restructuring guidelines, and adapting loan monitoring and collection processes.
- **Analysis of revenue streams and funding costs:** Development of recommendations for optimizing and maintaining revenue streams, and review of existing debt funding commitments, potential to renegotiate with lenders, and possible new sources of liquidity.
- **Balance sheet resilience:** Analysis of the potential effect of the pandemic on capital adequacy levels and liquidity management, including scenario planning and stress testing.
- **Business continuity planning:** Scenario planning on effects of crisis on day-to-day business continuity, and assistance in redesigning and modifying business processes to account for remote work.
- **Information technology (IT) and digital tools:** Support to adjust IT system capacity to enable remote operations, including maintenance and expansion of digital tools.
- **Operational and business support to borrowers:** Provision of expertise to existing clients in adjusting and diversifying business operations, altering business plans, and identifying new supply chain linkages and markets.

DEVELOPMENT OF NEW TOOLS TO SUPPORT LIQUIDITY

- **Use first-loss mechanisms through establishing a separate platform/entity** to provide first-loss grants to investment funds supporting liquidity injection, particularly those focused on last mile financing. A flexible mechanism that can provide several, targeted first-loss guarantees at a country or regional level would provide more impact and achieve greater scale if managed and disbursed appropriately and that aligns with a specific USAID objective. This would leverage a significant amount of private capital and complement tools and investment from the DFC. This may be viewed by the DFC as greatly advantageous for emergency liquidity and could be coordinated to focus on the Indo-Pacific region. The first-loss grants could also be used to offset subsidy costs for the DFC and free up USAID budgets in the long run.

- **Establish a pandemic emergency liquidity facility to provide support for existing borrowers and struggling lenders.** USAID can provide emergency liquidity to help borrowers and financial institutions to manage existing loans that cannot be repaid due to a lack of revenue generation associated with the financial impact of the pandemic, particularly when there is no moratorium or restructuring available. The liquidity facility will disburse funding based on a set of specific criteria and can be in the form of concessionary capital. This liquidity facility can provide technical assistance alongside liquidity infusions. A regional facility focused in Asia could provide additional scale if managed appropriately.

- **Establish a stand-by letter of credit facility to support trade finance.** This will address significant breakdowns in trade and also support importers and exporters struggling to mitigate risk. While the DFC provides political risk insurance, it does not directly provide letters of credit that cover trade finance. USAID could provide catalytic capital to establish a letter of credit facility to mitigate barriers to trade, provide much-needed liquidity to manufacturers and exporters and even leverage the ability to distribute necessary vaccines in underserved countries. This could also benefit woman-run businesses, who are less likely than their male counterparts to receive the trade financing they need.

- **Expand USAID's understanding of securitizations to better understand their effectiveness in scaling liquidity.** Securitizations, where an entity such as an MFI, packages a pool of debt obligations to sell in the form of an investment security, helps that MFI raise additional capital at scale to on-lend into the very sectors that it intends to help. These structures provide much-needed liquidity both to the NBFIs and the SMEs that borrow from them. The more USAID can get comfortable with these concepts, the more impact it can have in the financial system.

- **Support revolving credit guarantees** by allocating sufficient subsidy and fee support on behalf of financial institutions to accommodate the restrictive nature of DFC's traditional guarantee tool, which inhibits efficient pricing for revolving debt facilities. Many borrowers depend on lines of credit for working capital needs during various business cycles throughout their operations. Revolving credit is necessary for liquidity, yet guarantees for this structure require substantially higher subsidy due to its compounding effect on risk calculations.

Appendix A: Additional Resources for Financial Concepts Primers

- **Mobilizing Private Finance for Development: A Comprehensive Introduction (2019):** This primer provides an overview of how to mobilize private sources of financing. It includes an overview of finance generally, as well financial instruments, markets, and actors. It also discusses constraints, intervention and procurement strategies, and financial accounting concepts.
- **Finance Vignette Handbook: A Financing Growth Training (2018):** This vignette showcases 50 examples of how USAID has mobilized private capital, including use of seed-funding, guarantees, technical assistance, and partial grants, among others.
- **Blended Finance Landscape Review (2020):** This review looks at definitions of blended finance, how USAID implements blended finance in its program cycle, and blended finance knowledge gaps within USAID.
- **USAID Pay For Results In Development - A Primer For Practitioners:** This is a USAID training on how to integrate pay for results into programming. This is an internal USAID resource, and must be accessed on appropriate servers.
- **USAID INVEST Blended Finance Starter Kit:** 10 Questions About Mobilizing Private Capital For Better Development Results (2020): This primer provides an overview of blended finance and how it can be strategically deployed to leverage development funds and mobilize private capital.
- **Global Impact Investing Network:** What You Need to Know About Impact Investing: This primer provides a 101 on understanding impact investing, and how it can unleash the power of capital for good. It covers core characteristics, key actors, and the results these investments can achieve.
- **Financial Sector Knowledge Sharing Project:** This resource provides a set of additional resources to promote knowledge sharing in the financial sector and presents best practices and lessons learned from the the Project, which tested innovative approaches to financial sector development.
- **USAID Strategy for Financing Self-Reliance (2020):** This strategy outlines USAID's vision to reorient its programming and investments to better support governments, civil society, and the private sector to mobilize, manage, and invest domestic resourcse while reducing dependence on donor funding.

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