How to Scale up Responsible Investment and Promote Sustainable Peace in Fragile Environments

Draft report
The International Dialogue on Peacebuilding and Statebuilding commissioned an independent consultant with the production of this report in 2016. The report was developed in conjunction with BNP Paribas Asset Management.

This work is published under the responsibility of the International Dialogue. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the members of the International Dialogue on Peacebuilding and Statebuilding. The report is still in draft version and will be further developed in consultation with members of the International Dialogue in 2018.

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**Acronyms**

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<tr>
<td>AAAA</td>
<td>Addis Ababa Action Agenda</td>
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<tr>
<td>AfDB</td>
<td>African Development Bank</td>
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<td>CDC</td>
<td>Commonwealth Development Corporation (UK)</td>
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<td>CSPPS</td>
<td>Civil Society Platform for Peacebuilding and Statebuilding</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DAC</td>
<td>Development Assistance Committee (OECD)</td>
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<td>DFI</td>
<td>Development Finance Institutions</td>
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<td>EIB</td>
<td>European Investment Bank</td>
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<td>Environmental, Social and Governance standards</td>
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<td>FCS</td>
<td>Fragile and conflict-affected situations</td>
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<td>FDI</td>
<td>Foreign Direct Investments</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>International Dialogue on Peacebuilding and Statebuilding</td>
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<td>International Network on Conflict and Fragility</td>
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<td>MIGA</td>
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<td>ODA</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PSG</td>
<td>Peacebuilding and Statebuilding Goals</td>
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<td>PSW</td>
<td>Private Sector Window</td>
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<td>SDGs</td>
<td>Sustainable Development Goals</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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<td>SSA</td>
<td>Sub-sovereign, Supranational and Agencies</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>UNCTAD</td>
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Executive Summary

This report commissioned by the OECD-hosted International Dialogue on Peacebuilding and Statebuilding, a partnership between the OECD-DAC, the Governments of 20 countries affected by conflict and fragility (g7+), and civil society organisations, explores ways of addressing the real and perceived risk concerns of potential investors that currently impede the scaling up of responsible investment in fragile and conflict-affected situations. It is based on interviews conducted over a year, with experts from the investment and development cooperation fields. Its main audiences are institutional investors concerned with sustainable investment and in leaving an SDG footprint as well as the development community interested in using development aid to leverage private finance for development, to achieve the SDG ambitions.

It argues that the creation of tailored financial instruments, clear investment targeting in line with sustainable development and peace impact criteria, and in-country based information and networking centres that bring investors and investees together, would be key game changers, allowing public and private investors to mutualise their risk concerns in relation to fragile and conflict-affected situation’s (FCS) markets.

Taking forward these recommendations will require multi-stakeholder action by public actors (development aid donors) private actors (institutional investors, financial institutions and private sector in fragile and conflict-affected contexts) and by the governments and civil societies (of countries emerging from conflict and fragile situations).

Two billion people live in countries where development outcomes have been seriously affected by fragility, conflict, and violence. The World Bank (WB) estimates that extreme poverty will increasingly be concentrated in these contexts, rising from 17% of global poverty today to 46% by 2030, partly due to high population growth rates and weak economic development. Yet, fragility is not confined to low-income countries alone. It affects middle-income countries too.

Addressing conflict and fragility is critical for achieving the overall ambition of the Sustainable Development Goals (SDGs) to end extreme poverty by 2030 but also to achieving the SDGs worldwide. Building sustainable peace is key to achieving sustainable development. As such, there can be sustainable development without peace and no peace without sustainable development.

It is now widely accepted that if all countries are to meet the SDGs, “trillions” not “billions” of dollars, will be required in investments, both public and private, in capital and in capacity, at national and global levels. Development aid does not have the financial capacity to meet the majority of the challenges on its own; a joint effort is required. While the contribution of development aid is crucial, as acknowledged by the g7+ twenty countries affected by conflict and fragility, there could be an important role for investors and the private sector to play, for two reasons.

First, investment and a proactive, responsible private sector, operating with sensitivity to conflict-dynamics, can be key to stimulating inclusive economic growth, and job creation that, could help to create the sorts of economic foundations that will enable countries, committed to inclusion and building peace, to transition out of fragility over the long term.

Second, because the scale of financing required, in the context of high strains on public finances, cannot be underestimated. This is particularly true for small and mid-cap investments, which often have a more positive impact on long-term job creation than large scale investments. The g7+ has called for more systematic international support for private sector development that is well adapted to conditions in fragile states, rather than driven by standard models, and which is designed to have impact on a large scale.
Development aid will have to be used in more innovative but equally conflict-sensitive ways, to leverage other sources of finance for development. As acknowledged by the development actors working in FCS who created the ‘New Deal for Engagement in Fragile States’, more finance alone will not necessarily bring about peace. How finance is invested and what it is invested in makes all the difference to whether it helps to consolidate peace or undermine it. This is particularly the case in low income FCS, where sudden surges of capital invested can have a considerable impact on conflict dynamics. How investments are managed, who investees are (in terms of winners or losers on a conflict map) and how they make use of their economic as well as political capital, to promote peace consolidation, all need to be considered.

**Investor reticence and risk in fragile and conflict-affected situations**

Why do responsible institutional investors tend to shy away from investing in FCS? When asked, they cite real and perceived risks as impediments. All too often, ‘red flag reflexes’ on the part of investors, mean that all FCS tend to be tarred with the same brush and avoided by responsible investors, as too high risk. In many FCS, risks are often the result of legacies of violent conflict and the war economies left in their wake. These create long term challenges associated with different types of fragility related to political instability including insecurity, socio-economic factors and weak legal and regulatory frameworks.

Responsible investors are also deterred from investing in geographical areas that are perceived, rightly or wrongly, to suffer from high levels of corruption, human rights or environmental violations. They do not wish to be associated with social or environmental controversies, which can also be the result of business activity in high risk areas. Furthermore, complying with sufficiently robust due diligence standards might require knowledge many investors simply do not have or that is extremely resource-intensive to acquire. Other common disincentives include the general perception that weak business environments, poor regulatory frameworks and weak social and environmental standards, are widespread. These factors dissuade investors from making discerning choices, based on context-specific knowledge. Yet, not all FCS are the same.

Investment in FCS is often either lacking, not matched to demand (due to the small scale, fragmented financing requirements), nor tailored to the specific needs of the context (which often means not being long-term enough) nor patient enough to cope with temporary periods of volatility or the slow pace of reform, or is associated all too often, with contributing to the problem rather than to the solution. Some critical business sectors, including Small and Medium Enterprises (SMEs) and start-ups, which in many FCS and particularly in conflict-affected contexts, are a vital coping mechanism, are often neglected. Yet, SMEs often play a critical role in revitalising local economies, generating jobs and other economic opportunities and often struggle to attract much needed investment.

Yet, it is a paradox that the same FCS are also attracting high levels of investment in multinational enterprises operating mostly in extractives, infrastructure, and increasingly telecommunications. Why is this so and why do the same risk calculations not always apply? The simple explanation is that these sectors are highly lucrative. Although the risks are high, so are the returns. Yet, the challenges associated with these kinds of investments, particularly in relation to conflict, have been well documented. Overcoming the conflict-related challenges associated with large scale multinational investments in FCS, is however not the focus of this report. Instead the report looks at what it would take to stimulate more and better institutional investment outside these traditional sectors in small and medium enterprise development.

This report argues that more and better institutional investment in SMEs in ways that are sensitive to conflict dynamics, could be a game changer, in helping to build the sorts of economic foundations that could contribute to peace.

**Changing the narrative: FCS as opportunities for doing good business and doing good**
A new and more nuanced narrative is called for, that enables investors to differentiate between countries and sectors, based on an understanding of the opportunities and not just the risks associated with doing business in FCS and doing good. It is also argued, that changing the way we refer to these geographies could also be important. The ‘fragile and conflict-affected’ label may be part of the problem. That said, even with the name unchanged, raising investors’ awareness about the potential of FCS as attractive emerging markets for institutional investors, is key. Demographic trends and a growing middle class in many FCS are generating a rising demand for consumer goods, services and agribusiness, which could provide new opportunities for investors.\(^{15}\) This comes at a time when slow growth in many OECD countries has encouraged some investors to look towards emerging markets. As such, there is great potential. In some FCS, growth prospects are promising and over the last few decades, Foreign Direct Investment (FDI) in many FCS economies, at least prior to 2008, grew more quickly than flows to other parts of the world, albeit from a very low starting point, even if it was largely concentrated in the extractive sector and in a few countries. More recently, what had been promising FDI flows, have however shown signs of decline, following the 2016 commodity prices slump.

**Dealing with the risks**

**Risks (financial and political) are real but can be mitigated**, in part by sharing and managing the associated risks and reducing the associated collateral costs. Options include guarantees and blended finance, which can be made available to investors seeking to invest responsibly in FCS, but with clear conflict-sensitivity, and peace consolidation criteria. Here development aid and in particular the Multilateral Development Banks (MDBs) in partnership with private banks, but also civil societies, domestic business sectors and governments of FCS, can play a critical role in defining what conflict-sensitive responsible investment is, and creating and applying stringent conflict-sensitive conditions, for blending and risk mitigation support. This is crucial for ensuring that development actors themselves, in working with the private sector, actually contribute not just to scaling up investment in FCS, but to scaling up responsible investments that do not undermine peace consolidation efforts.

**Risk-pooling and appropriate innovative financial instruments or investment vehicles are becoming options.** Two instruments in particular (there are others), are increasingly believed by a growing number of sustainable investors and actors in the aid community, to have great potential: social bonds and social impact bonds for FCS (‘peace bonds’). These would require adaptation for specific purposes and characteristics, building on the experience of existing social and green bonds and of social impact and development impact bonds.

For the reasons outlined above, financial instruments, even if specifically tailored to FCS markets, would be insufficient on their own. Social bonds and social impact bonds would require accompanying measures to enable would-be investors with the help of development agency partners, to identify ‘credible’ investment targets. An identification scheme or screening process based on a solid methodology combining existing standards and due diligence approaches with relevant criteria,\(^{16}\) could enable the selection of companies or local financial institutions that could lend to them, that are commercially viable and that meet relevant global, country and sector-specific standards for responsible business. The labelling mechanism could also include processes and criteria and/ or metrics for measuring and monitoring investments in companies operating in FCS, so that accountability and social ownership of investments could be guaranteed, by tracking the impact of investments on conflict risk.

**Perceived risks** can be addressed by bridging the information and connection gap that currently exists in the investor community. This can be overcome by making granular\(^{17}\) information available to investors, on where to invest, what to invest in, who to interface with, the actual risk-returns,\(^{18}\) and how to invest responsibly.\(^{19}\) Identifying ‘credible investment targets’ and ‘bridging the information gap’, may help to scale up investments in FCS, but on their own, will be insufficient as strategies to consolidate peace and ‘do no harm’. A more holistic approach is required, that acknowledges the political as well as economic weight of investors and potential investees in FCS.

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Conflict risks can be mitigated by building trust. Civil society organisations, development agencies, including development finance institutions and private sector actors, can play a critical role in ensuring that investors and investees work in ways that create opportunities to rebuild trust (between business and government, business and communities, communities and government and between communities,), which have been undermined in contexts of conflict, and are critical for consolidating peace. “One-stop shops” can potentially serve as vehicles for this. They not only bring investors and potential investees together to identify business opportunities, but can also serve as opportunities to foster public-private dialogue and for monitoring and oversight by community and civil society stakeholders, about how investment decisions are made.

A call to action: A robust multi-stakeholder effort to scale up responsible investment in FCS
More and better investment in FCS is key to promoting inclusive growth, sustainable peace and development and, therefore, to meeting many of the SDGs, not least in their core ambition which is to eradicate extreme poverty by 2030. Feedback from interviews with investors, development actors and the Ministries of Finance of g7+ countries, suggests that innovation in three core areas would be required to enable investors to deal with real and perceived risks, and to de-risk, both from a reputational and financial perspective:

1. Instruments: making the right sorts of financial instruments available;
2. Identification: setting up an appropriate labelling scheme and mechanisms to screen and label ‘investment-worthy’ companies and investment intermediaries (financial institutions) that operate in FCS;
3. Information-Networking-and-Oversight Hubs: ‘One-stop shops’ for facilitating the generation and dissemination of tailored sector and country-specific information, networking between investors and would-be investees at country level, and as vehicles for public-private dialogue to build trust, monitoring and oversight.

Nothing short of a robust multi-stakeholder effort would be required to take these innovations forward.
Chapter 1. Background

This report identifies what it would take for investors to scale up and improve the quality of their investments in businesses, particularly in job-creating firms and domestic enterprises in FCS. Its purpose is to stimulate an action-oriented conversation between investors, the governments of fragile and conflict-affected countries, their development partners, civil society and other key actors, about what they can individually and collectively do, to promote more and better investment in FCS. By ‘better’ investment, the report means ‘responsible and sustainable investments’, that comply with international standards (‘do no harm’) when investing in mainstreamed responsible businesses that operate in countries affected by conflict and fragility, or in the financial institutions that support them, be they local or foreign. The report also explores what investing in ways that go beyond ‘compliance’ to actually ‘do some good’, might require. Going beyond compliance means investing in ways that have a positive social impact, by contributing to sustainable development and, it is hoped, building the foundations for long term peace in FCS. Balancing the need to achieve this medium to long term goal, with the need to change the narrative about investing in FCS in order to make responsible investment in these contexts in ways that ‘do no harm’, a feasible proposition, is indeed challenging.

Yet, three factors linked to the 2008 financial crisis have created favourable conditions which make responsible investment in FCS now more feasible than ever. First, returns for institutional investors in developed countries have experienced a general decline from 2008 onwards, encouraging them to seek other markets. Second, while there is greater reluctance amongst many investors and financial institutions to investing responsibly in developing country contexts where perceived risks are high, and about which knowledge is limited, growing societal pressure has encouraged institutional investors, like those whose assets are managed by BNP Paribas Asset Management, to take a keener interest in venturing into investing in markets where there is a clear social impact. And third, the universally agreed upon 2030 Agenda for Sustainable Development now provides investors with a framework for demonstrating sustainable development and peace impact results, with the potential to have more effective monitoring criteria.

The International Dialogue on Peacebuilding and Statebuilding is a partnership between 20 governments of fragile and conflict-affected countries (g7+), civil society organisations (CSPPS) and OECD-DAC-INCAF providers of official development assistance (ODA) that regularly convene at global and country level in countries affected by conflict and fragility. Its members believe that economic foundations for building and sustaining peace can be built through greater investment in the private sector but, if, and only if, responsibly targeted, sensitive to conflict dynamics and effectively monitored. These principles are outlined in the ‘New Deal for Engagement in Fragile States’ (herein after the New Deal), initially intended to guide the investment decisions of the aid community, but equally applicable to sustainability-conscious investor community, interested in making the right investment choices and for an investor-friendly development community, interested in using public finance to leverage more private finance for fragile and conflict-affected environments and effectively monitor its impact.

1.1 Target audience
This report targets primarily (i) institutional investors with dedicated social funds, who still seek to make a profit, even if lower than average, and who may also wish to contribute, through their investments, to achieving the Sustainable Development Goals (SDGs), (ii) social impact investors, whose main goal is innovative finance to address specific social concerns, and (iii) development agencies interested in using public funds to leverage private sector investment in fragile and conflict-affected environments.
Whilst a broad investor focus is required to attract different sorts of investment and different forms of innovative finance to FCS, the report sees institutional investors in particular and financial institutions in general, as potentially having key roles to play in turning around the fortunes of FCS. First because of the sheer volumes that they can mobilise and their capacity to invest and bring in much needed finance, and secondly because of their potential to make their knowledge on finance and financial products, available to actors operating in these FCS.

The fundamental barriers to responsible investments or to scaling up responsible investments in FCS, in particular outside the traditional extractive sectors, can be summed up in one word: **risk, both real and perceived, financial and reputational**. The report acknowledges that these challenges can be significant, but believes that they are not all insurmountable.

### 1.2 Focus of the report

The report explores how investors can overcome the risks associated with investing in countries affected by conflict and fragility; both real and perceived, financial, and reputational. It draws on evidence of innovation in the conflict-sensitivity and financing for sustainability fields that is potentially applicable to fragile and conflict-affected settings. It also draws on innovations already underway in these settings, spearheaded by multilateral banks, foundations, development finance institutions, and development agencies, as well as by social entrepreneurs and businesses operating. Finally, it proposes further innovation in three interconnected fields:

1. **Instruments**: Investment vehicles such as Social Bonds & Social Impact Bonds for FCS (‘Peace Bonds’) as a vehicle to de-risk and pool investment into countries, sectors, and companies, with the potential to create jobs and consolidate peace.
2. **Identification**: A screening process for identifying and “labelling” responsible investment-worthy opportunities that could contribute to sustainable peace.
3. **Information, Networking and Oversight Hubs**: One-stop shops for facilitating the generation and dissemination of tailored, sector and country-specific information, networking between investors and would-be investees at country level, and as vehicles for public-private dialogue to build trust, monitoring and oversight.

### Box 1 - What this report is not

This report is not exhaustive. It does not provide a comprehensive technical overview of everything that might be required for each of these initiatives to be operationalised, nor does it explore all the accompanying system-wide measures needed to ensure that the initiatives proposed would successfully contribute to the overall goal of peace consolidation in FCS as a whole, or in any given country or sector.

Institutional weaknesses are intrinsic to many post-conflict and fragile environments. The report acknowledges that favorable institutional environments, domestically and internationally and the rationalizing of existing regulations in ways that minimise barriers to market entry faced by investors, could increase the impact of the initiatives proposed.

The report focuses on innovative investment vehicles, and making them responsible, sustainable and sensitive to conflict dynamics, rather than on ‘the enabling environment’ question. Its purpose is to highlight what can be done now to scale up investment, even in the absence of such an ‘enabling environment’, by leveraging financial innovation and by exploring innovative collaborative ways to operate at international and national levels, in ways that take into account conflict-sensitivity and which are grounded in a solid analysis of the political economy. Promoting an enabling institutional environment for investment in FCS, is already the focus of a number of initiatives both within and outside the OECD (Donor Committee for Enterprise Development, Centre for International Private Enterprise, EU, the World Bank Group and others). Promoting an enabling environment in FCS, in ways that are also sensitive to conflict, could enhance the
impact of the innovations proposed, and should also continue to be the focus of attention of providers of development assistance.

The report acknowledges that the proposed initiatives may be applicable in some FCS, but not others, due to the nature of the risk profile and context. Lastly, whilst some of the suggestions in this report are new, others are not. The report is intended to complement and contribute to emerging work and interest in this area among Development Finance Institutions (DFIs), multilateral (EU) and bi-lateral development agencies, international organisations (OECD), multilateral development banks (notably WBG) as well as governments and civil societies inside and outside FCS.
Chapter 2. Introduction

Today peace is recognised as a global public good and is of increasing concern to millions of people throughout the world, including governments and businesses.\(^{37}\) In all FCS, investment and a proactive private sector can be key to stimulating economic growth and job creation.\(^{38}\) The International Dialogue’s New Deal principles, do not presume that more growth necessarily means more peace.\(^ {39}\) The New Deal does, however, presume that inclusive, job-creating economic growth, if managed responsibly (including with the right kind of societal oversight),\(^ {40}\) and if combined simultaneously with a government focus on inclusive politics, security, justice, and the generation of revenues and provision of basic services, backed by international support, can create the conditions, that contribute to consolidating peace over the long term.

The scale of financing required, in a context where the strains on public finances are high, cannot be underestimated, particularly small and mid-cap investments, which can often have a more positive impact on productivity than large scale investments.\(^ {41}\) If all countries are to meet the SDGs, the global community will require “trillions” in investments of all kinds: public and private, national and global, in both capital and capacity. The UN body, UNCTAD, estimates that based on current levels of investment in SDG-related sectors in developing countries, both public and private, there will be an average annual funding shortfall over the 2015-2030 period, of some USD 2.5 trillion.\(^ {42}\) This means that a substantial portion of these resources must be raised by absorbing excess global savings, from the capital markets and offshore. Institutional investors are a large and growing actor in global financial markets, with nearly USD 100 trillion worth of assets under management in OECD countries alone. Attracting and retaining investment in FCS is necessary, and has the potential to be good for business and sustainability.

2.1 The problem

For some FCS, attracting and retaining investment is more difficult than for others, depending on the specific characteristics of fragility\(^ {43}\) and the legacy of conflict or its cyclical nature. These contextual factors often include the debilitating and enduring nature of war economies that investments will necessarily impact. Fragility of this kind tends to compound existing market failures, prevalent in most developing country contexts.

Investors’ primary responsibility is to secure returns on the investments they conduct on behalf of their clients and ultimate beneficiaries. This includes a duty of prudence. Investors also face increasingly stringent international regulations which means that their investment strategies and levels of risk appetite might be constrained.

In FCS, investment is often either lacking, not matched to demand due to small scale fragmented financing requirements, not tailored to the specific needs of the context, which often means being not long term enough nor patient enough to cope with temporary volatilities or the slow pace of reform. Investment tends to be concentrated in just a few sectors (e.g. extractives) and in big, multi-national or occasionally well-established domestic companies.\(^ {44}\) Some critical business sectors, notably Small and Medium Enterprises (SMEs) and start-ups in many FCS, and particularly in conflict-affected contexts, are a vital coping mechanism and play a critical role in revitalising local economies, generating jobs and other economic opportunities. Yet, they often struggle to attract much needed investment.\(^ {45}\)

Common disincentives to investment in FCS are well documented. Together they combine to deter investors (particularly outside extractives and large infrastructural projects) from seeking opportunities to invest in FCS. They include:

- **Weak business environments**: political and security risks; macro-economic and currency risks, and structural risks at the sector level; weak legal and regulatory frameworks; weak institutions and...
governance; difficulty in accessing market data; weak Environmental, Social and Governance standards (ESGs) and other standards (e.g. Equator Principles).

- **Weak supply**: an underdeveloped private sector; few commercially viable proposals, bankable deals or small deals (‘pipelines’) that can be scaled up; proposals often unable to meet key responsible business standards (e.g. IFC’s performance standards); lengthy time-horizons before investments can deliver returns and small underdeveloped markets in some circumstances.

- **Regulatory frameworks** in investor home countries international legal and regulatory standards which are having a much needed positive impact, are making investors more responsible (e.g. the provisions of such regulations as the Dodd-Frank Act and EU Investment policies). Investment in capacity-building support may be required to enable more companies operating in FCS to comply with due diligence standards, which in turn will make them more attractive to responsible investors.

- **Limited, readily available information** amongst investors, **disaggregated by sector and country** about specific investment opportunities in FCS.

- **External disincentives**, notably protectionist trade policies that also constrain domestic investment.

Many of these barriers to investment are real, but not insurmountable. By working in partnership with others (development agencies, including MDBs and DFIs, and governments, financial institutions, private sector of FCS), investors can both reduce their exposure to the associated risks which are real and perceived.

Yet, development actors acknowledge that even if investment were scaled up in FCS, more finance alone would not necessarily bring about peace. How finance is invested and what it is invested in, make all the difference to determine whether it helps to consolidate peace or undermine it. This is particularly true for low income FCS, where sudden surges in investment can have a considerable impact on conflict dynamics. How investments are managed, who investees are (in terms of winners or losers on a conflict map) and how they make use of their economic as well as political capital, to promote peace consolidation, all need to be considered.
Chapter 3. Risks in FCS: What they are and how to deal with them?

Real and perceived risks which are both financial and reputational need to be well understood and managed in order to reduce the disincentives for investors. This will enable investors to make informed choices which will allow them to invest in FCS in a more confident, secure, and profitable way, whilst contributing to consolidating peace in ways that make sustainable development more likely.

3.1 Real risks

Real risks can often be the result of legacies of violent conflict and the war economies left in their wake, as well as the long run challenges associated with different types of fragility related to political instability, insecurity, socio-economic factors, and weak legal and regulatory frameworks, to name but a few. Many conflicts in fragile settings are at their core conflicts over access to economic opportunities, with restricted access being institutionalised by the state itself, in post-conflict settings. These conditions create particular types of operational challenges for would-be investors. While real, these risks can be mitigated, in part by sharing and managing them and reducing the associated collateral costs. Options include ensuring that mechanisms for underwriting risks of this kind (guarantees/blending) are made available to investors seeking to invest in FCS, and ensuring that appropriate innovative financial instruments or investment vehicles are created and adapted.

Providers of development assistance have a critical role to play. Because they can help investors address their legitimate risk concerns by underwriting their risk (through the use of blended finance modalities), they can also incentivise investors to ‘do no harm’ and potentially do some good, through dialogue establishing clear conditions for support to investors, ensuring investors prioritise conflict-sensitivity informed by analysis of the political economy, transparency in investment decision-making, and trust building, through public-private dialogues between government, the targets of investment and the wider society.

3.2 Perceived risks

Perceived risks result from the negative narrative that clusters FCS together under a ‘red-flag’ group of non-investor friendly or worthy countries. As a result, investors are deterred from investing in geographical areas perceived, rightly or wrongly, to suffer from high levels of corruption, human rights or environmental violations. They do not wish to be associated with social or environmental controversies. Furthermore, complying with sufficiently robust due diligence standards might require knowledge they do not necessarily have and which is, undoubtedly, extremely resource intensive to acquire.

Perceived risks can be addressed by bridging the information and connection gap that currently exists in the investor community. This can be overcome by making available to investors granular information on where to invest, what to invest in, who to interface with, the actual risk-returns, and how to do it right (i.e. responsibly). Country-level mechanisms for disseminating this information and bringing investors and investees together, should also serve as opportunities for fostering inclusive public-private dialogue to build trust, enable societal monitoring and oversight of investors’ decision-making processes.
Chapter 4. The reality is changing: Let’s change the narrative

4.1 Making the case for investing sustainably in fragile and conflict-affected environments

Box 2 - The questions governments of FCS are asking: Highlights from an IFC and g7+ workshop on private sector engagement and job creation in fragile states

- What do investors see as key constraints to creating business and jobs in FCS?
- How can private sector actors create shared value in FCS, while minimising the risks on both sides?
- How can we ensure that investments contribute not just towards economic growth, but also to inclusive peacebuilding and statebuilding, in ways that go beyond CSR to ‘host communities’ and which include the generation of sustainable tax revenues?
- Rather than identifying priority sectors for targeting in advance, how can we benefit from the knowledge generated by actors on the ground (IFC and others) and build on the opportunities as they emerge to make the business environment more conducive to enabling the private sector to grow organically in ways that can have a transformational impact on job creation?
- How can partners strengthen their support to private sector investment in basic infrastructure and provide critical financing for SMEs to create jobs and growth?
- How can international development partners support the country-led efforts by FCS to promote investment and private sector development?

FCS have the potential to be attractive emerging markets for institutional investors. Demographic trends and a growing middle class in many FCS (e.g. Nigeria) are generating rising demand for consumer goods, infrastructure, services, and agribusiness, which could provide new opportunities for investors. In some FCS, growth prospects are promising and over the last few decades, particularly before the 2016 slump in commodity prices, Foreign Direct Investment (FDI) in many FCS economies prior to 2008, grew faster than flows to other parts of the world, albeit from a very low starting point. Yet, the problem was that FDI flows were largely concentrated in the extractives sector and in just a few countries.

Box 3 - The opportunities offered by FCS in numbers

Between 2011 and 2014, external financial flows including FDI, remittances and ODA to fragile contexts, totalled more than USD 829 billion (2014 constant prices). FDI, the third largest part of external financial flows to these contexts, increased by 19% between 2011 and 2014. Over the longer time period of 2002 to 2014, FDI saw an impressive 235% growth even if this growth began to decline after the 2008 financial crisis, and then significantly between 2013 and 2014, and was not equitably shared across all fragile contexts. In global absolute terms, although FDI remains by far the largest type of external financial flow, fragile contexts only attract approximately between 5-6% of the global total despite accounting for 22% of the global population, and even then, it tends to be concentrated in the extractive sectors, where peace consolidation dividends tend to be weak, and conflict risks tend to be high.

The top ten FDI recipients in 2014 received USD 698.63 billion and include the following countries: Lebanon, Iraq, Sudan, Chad, Sierra Leone, Bosnia and Herzegovina, Côte d’Ivoire, Zimbabwe, Madagascar, and Togo. Private flows are concentrated heavily on a few countries from the FCS list. Although Lebanon was affected by spill over effects from the Syrian crisis, it still attracted USD 213.10 billion due to its very attractive investment climate – free economic system, sophisticated banking sector, tax regime, and oil and gas resources.

A decade ago, most countries facing fragile situations were low-income. This situation was reversed over the last decade during which nearly half FCS became classified as middle-income. Today there are 17 out of 36 countries affected by conflict and fragility classified as middle-income countries. Many FCS managed to...
weather the global food, fuel and financial crises. Many low-income fragile states in particular managed to outperform non-fragile states on average per capita GNI growth. Yet, GNI growth rates have not translated into declining levels of fragility or conflict, even if in some cases, fragility is located in isolated pockets. Scaling up investment in FCS, should be about scaling up responsible business in ways that contribute to, rather than undermine peace, by spreading the opportunities for employment-creating growth. Peace consolidation requires investments that are sensitive to conflict dynamics and are regularly monitored, to ensure that they contribute to consolidating peace once achieved, rather than undermining it.

**Box 4 - Growth rates in FCS**

Fast-growing FCS include Ethiopia, whose economy has experienced strong and broad based growth over the past decade, averaging 10.8% per year in 2003/04 – 2014/15 compared to the regional average of 5.4%; Myanmar with a 7% growth rate in 2016, Ivory Coast at 9.9%, Mali at 5.4% despite the on-going instability. Liberia and Sierra Leone had growth rates around 8% before the Ebola crisis and commodity price slump hit in 2014. Timor-Leste’s growth reached over 14% in the last decade now stabilising at around 4%. Strong growth allowed Angola and Nigeria to graduate from low to middle income status, along with the 9 other fragile states that have graduated since 2001. It should be noted however that the commodity price slump in 2016 reversed many initially promising gains in many parts of Africa, where GNI growth had been largely commodity led.

The fastest growing economies in FCS are potentially the site of important business opportunities, which could be further increased, if income inequalities declined. If institutional investors were sufficiently informed of the potential investment opportunities in FCS markets, and of the opportunities for enabling them to more effectively manage their risk concerns, they could be persuaded to allocate a small portion of their investments to social investment and to the SDGs. This is not negligible and could amount up to figures as high as USD 50 million per annum, or 0.01% of USD 1 billion.

**4.2 Innovations underway in FCS**

New investment funds are rising to this challenge. They are increasingly channelling investment into ‘frontier markets’ notably some FCS considered particularly high risk such as the Central African Republic. They are no longer focusing primarily on the extractive industry, but are targeting a range of sectors including agriculture, education, health, infrastructure, including power, SME finance and services. In addition, risk insurance instruments are being expanded to absorb the high risk of investing in FCS.

**Box 5 - Impact investing in FCS: XSML**

XSML is an investment fund manager focused on frontier markets in Central Africa. The Fund focuses on growing small businesses into medium and large scale enterprises with growth capital and know-how, bridging the gap between international investors and the SMEs in FCS. Its Central Africa SME Fund (CASF), invests USD 25 million in the Democratic Republic of the Congo (80%) and the Central African Republic (20%) providing private equity finance and management expertise to SMEs in these two markets where there is little or limited finance available. CASF is expected to provide risk capital to ca. 45 companies with an investment size in the range of USD 100,000 to USD 500,000. In general, the Fund’s investments are made through mezzanine or quasi-equity instruments, including debt with profit sharing or a royalty scheme, preferred shares, convertible debt, or subordinated debt with warrants. The African Rivers Fund (ARF) extends XSML geographical reach to Congo-Brazzaville and Uganda. Between the two funds, total assets under management are at USD 65 million. Investors include both multilateral development banks and bilateral agencies, notably the IFC, the International Development Bank of the Netherlands (FMO), the UK’s Development Finance Institution (CCD), the Dutch Good Growth Fund (DGGF), the private sector financing arm of the Agence Française de Développement (PROPARCO), the Belgian Investment Company for developing countries (BIO), and the Lundin Foundation. Angel investors which traditionally finance start-ups, but mitigate risk by investing where high rates of return can be guaranteed (at least ten or more times their original investment within 5 years), are becoming increasingly active in FCS, some with associated programmes engaged in capacity building for entrepreneurs.
Multilateral development banks and institutions are also leading the way. The IDA 18 Private Sector Window, launched by the World Bank Group on July 1st, 2017 (IDA, IFC, MIGA) and the European Union’s External Investment Plan, in 2016, are two examples. The World Bank Group’s Private Sector Window (PSW) includes a Risk Mitigation Facility, MIGA Guarantee Facility, Local Currency Facility and Blended Finance. These are all new and provide an opportunity for IDA to make strategic use of public resources to catalyse private investment in challenging markets, by leveraging IFC’s and MIGA’s business models and client relationships, and complement IDA’s existing support for policy and business climate reforms. The PSW builds on IFC’s experience with existing blended finance programmes in agribusiness (the private sector arm of the Global Agricultural and Food Security Program (GAFSP), SME finance (Global SME Facility) and climate space, and MIGA’s experience with political risk insurance programmes, such as Conflict-Affected and Fragile Economies Facility (CAFEF).

**Blended finance** for fragile and conflict-affected markets, is an emerging growth area and beginning to attract considerable interest amongst bilateral as well as multilateral donors. In addition to the IFC, IDA 18 Private Sector Window’s and the Blended Finance Facility (BFF), the recently published OECD-DAC Blended Finance Principles for Unlocking Commercial Finance for Sustainable Development Goals, have spawned further widespread interest in the use of Blended Finance in fragile and conflict-affected situations, now the subject of ‘a deep dive’ research project to be completed in late 2018, to inform policy and practice across the thirty bilateral donor members of the OECD-DAC.

**Box 6 - Innovations underway in FCS: Investment made feasible through financial innovation and risk insurance**

**WGB Private Sector Window (PSW) - IDA, IFC, MIGA**

Announced in September 2016, the PSW became operational as of July 1st, 2017 and its successful implementation will be the IFC’s focus over the next couple of years. It is a toolkit of various de-risking instruments (not only risk insurance), as a proposed game changer for IFC’s and MIGA’s operations in challenging markets.

- **Target:** to catalyse private sector investment in IDA-only countries, with a focus on fragile and conflict-affected countries. First to IDA-eligible countries and with a plan for roll out in IDA-only countries.
- **Objectives:** to unlock significant opportunities to attract commercial capital, create jobs, and help move low-income member countries closer to their development goals. This means IFC will support IDA 18 objectives and special themes, scaling up IFC/MIGA engagements in IDA-only FCS, focusing on FCS markets, crowding in private investment and creating markets.
- **Financial envelope:** USD 2.5 billion (USD 2 billion for IFC and USD 500 million for MIGA).
- **Countries of focus:** IDA-FCS, IDA-only countries and conflict-affected regions of IDA blend/gap countries not on the FCS list.
- **Areas of focus:** infrastructure, SMEs, agribusiness, innovation & technology and social inclusion.
- **Access to funds:** IFC/MIGA will be originating the projects. All facilities with an exception of Blended Finance Facility (BFF) are primarily for de-risking. For BFF, it will build on the existing blended finance instruments, and IFC projects will be able to tap into the concessional funds provided by IDA PSW.
- **Expectation of WB teams:** WB will be expected to help prepare conducive legal and regulatory environments and/or help unlock sector-specific bottlenecks, so that IFC/MIGA can build a pipeline of projects.

**Four Facilities**

1. Risk Mitigation Facility (RMF) – USD 1 billion
2. Local Currency Facility (LCF) – USD 400 million
3. Blended Finance Facility (BFF) – USD 600 million
4. MIGA Guarantee Facility (MGF) – USD 500 million

**Three-Level Governance Structure**
1. A facility-specific process to enable decision-making at the transaction level
2. An oversight committee consisting of 3 VPs (IDA, IFC and MIGA) to provide strategic direction and monitoring and resolve transaction-specific disagreements
3. The respective Boards of the three institutions

The IFC Blended Finance Facility (BFF)⁶⁸

The BFF, which is part of the IDA 18 Private Sector Window, aims to mitigate various financial risks associated with investments in SMEs and agribusiness as well as pioneering investments across sectors to unlock private sector opportunities that promote productivity improvements and innovation with strong development impact. The BFF builds on and expands IFC’s existing blended finance platforms, including the Blended Climate Finance programmes, the private sector window of the Global Agriculture and Food Security Program (GAFSP), and the SME Finance facilities, and extends support into new high-impact sectors. The BFF will enable IFC to expand its engagements in markets and sectors covered by its current blended finance platforms and enter into new ones critical to enabling high-impact transactions in PSW-eligible markets. In sectors currently covered by IFC’s blended finance program—SME, agribusiness, and climate change, the BFF will build on the current facilities, leverage existing experience and practices, and bring in additional scale and scope of engagement.

Transaction financial mechanics
Existing IFC financial products will be eligible for clients under the facility, including senior loans, subordinated loans, equity (direct and through funds), preferred equity and guarantees (e.g., first-loss in risk sharing facilities). The BFF will enable IFC to undertake additional projects by providing: i) blended financing to enable IFC to support projects which are not yet able to meet fully commercial financing terms, but which promise to be sustainable and have strong development impact; and/or ii) risk mitigation, through subordination, deferrals, provision of first loss, and structuring flexibility (e.g. longer tenors) to enable IFC to support higher risk projects. Long tenors are particularly important for green-field projects, which typically have higher risk than expansion projects, but which are more common in PSW-eligible markets. The facility could incur losses only up to the designated allocation of PSW’s resources.

EU External Investment Plan⁶⁹
The new European Fund for Sustainable Development (EFSD) lies at the core of the External Investment Plan, launched in September 2016.

Envelope: EU funds totalling EUR 3.35 billion (EU budget and the European Development Fund) until 2020. EFSD is expected to mobilise up to EUR 44 billion additional public and private investment. The EU Commission calls on the Member States and other partners to match these EU contributions by providing second-loss guarantees. If they match the contribution to the guarantee, the total amount of additional investment could be EUR 62 billion. If Member States also match the contribution to the blending, this amount could reach EUR 88 billion.

- Objectives:
  - Mobilise investment and leverage funds: to help reach those countries where investments are currently difficult and facilitate investments by (private) actors that would otherwise invest less or not at all in these areas.
  - Target socio-economic sectors and in particular infrastructure, including energy, water, transport, information and communications technology, environment, social infrastructure, human capital, and provide finance in favour of micro-, small- and medium-sized enterprises with a particular focus on job creation.
  - Assist in developing economically and financially viable projects to attract investment.
  - Help to improve the business environment in partner countries by supporting reforms and economic governance.

4.3 FCS as opportunities for achieving the SDGs

Investing in FCS would allow investors to address rising consumer demand for more sustainable investments.
Today, investors are increasingly being expected to contribute to sustainability, understood as part and parcel of their fiduciary responsibility to their shareholders, just as much as their compliance with other relevant industry regulations, including investing judiciously in ways that guarantee returns. Investors are increasingly scrutinised to ensure that their investments are sustainable, and do not damage the environment or society. The Principles for Responsible Investment (PRI) hold that it is investors’ fiduciary duty to integrate environmental, social and governance issues into their investment decision-making processes. Increasingly, investors are not only expected to manage the environmental and social externalities of their investments, but to play a positive role in the transition to a sustainable development and equitable economic model.

The SDG framework has also spelled out what sustainability should look like in 15 years, and narrowed it down to 17 SDGs to be realised across the globe, in all countries. The SDGs as a whole recognise peace as a cross cutting ambition, and in particular SDG 16 which focuses on building peaceful and inclusive societies and institutions, serves as a useful guide for considering what contribution of investment to consolidating peace could look like.

Several potentially useful initiatives are underway to identify criteria for assessing the conflict/peace-sensitivity of private investors (notably multinational companies). The aim is to guide investors by identifying investment opportunities that will not only generate a profit but also contribute to peace and development such as the UN Global Compact – PRI “Guidance on Responsible Business in Conflict-Affected and High-risk Areas: A resource for Companies and Investors”.

A range of innovative financing solutions, including impact investing in companies, organisations and funds (see chapter 5 below on Social Bonds and Social Impact Bonds) aimed deliberately at having a social or environmental impact as well as financial return, are proliferating and are increasingly being tried out in FCS, with inbuilt mechanisms for managing risk. MDGs and agencies are increasingly active in this area. The targets of investor finance could benefit from the expertise and support of development actors and other stakeholders operating in FCS, in order to minimise the risk of doing harm and increase the chances of doing good.

If investment is to contribute to sustainability, in terms of peacebuilding criteria, providers of development assistance have a role to play in encouraging investors to consider their part in the ‘bigger peacebuilding picture’. This means enabling them to consider how to leverage their investments to foster inclusive public-private dialogue on issues related to business per se (i.e. transparency in investment decisions and accountability) but also on issues specifically related to building peace, by bringing an ever wider group of actors to the negotiating table (‘inclusive political dialogue’).

A multi-stakeholder effort involving both private and public actors, notably investors and the governments of FCS, their development partners, Development Finance Institutions (DFIs) including MDGs, and civil society actors, is key to developing and implementing the kinds of solutions that address both types of risk concerns, in all their dimensions.
Chapter 5. Proposal for a multi-stakeholder effort to reduce the risk of investing in fragile and conflict-affected environments

A plethora of tools and approaches are required to mitigate the multiple real and perceived risks associated with investing in FCS. Innovation in three areas in particular is likely to have the most positive and catalytic impact on addressing real and perceived risks: Instruments, Identification and Information-Networking and Oversight.\textsuperscript{72}
5.1. **Instruments: The right type of investment vehicles for FCS**

Innovative finance and appropriate investment vehicles tailored to FCS are necessary to meet the different investment needs, capacities, and risks in FCS. These include the need for smaller-scale investment; investment in particular in sectors that are most relevant from a sustainable peace and development perspective; investment that can be scaled up as new opportunities arise; and investment that increases access to finance in the massive non-formal sectors in FCS. Typically, FCS tend to be heavily cash-based economies with significant liquidity (as a response to political and economic policy uncertainty and disruptions in the banking system). Investing directly in local financial actors in these contexts is vital. This could in turn increase access to financial services for SMEs. Social bonds and social impact bonds, targeted at institutional investors or impact investors such as high net worth individuals and foundations are two financial instruments that have great potential to attract institutional investment and to reduce the risks of their investment.74

**Social bonds and social impact bonds for FCS**, can ultimately be targeted towards business initiatives and financial institutions that have peace promoting potential. The choice of social bonds for FCS, builds on the experience of existing social and green bonds and of social impact and development impact bonds.

**Social Bonds and Social Impact Bonds**

Given that FCS markets find it difficult to attract institutional investors’ financial potential, equities and bonds seem to be vehicles of choice. At the moment, weak or non-existent capital markets mean that the equities market is limited in FCS. Yet, some recent developments are worth noting.

Bonds can be issued by states as well as by Sub-sovereign, Supranational and Agencies (SSA); they may be public (i.e. listed on a stock exchange) or private (non-listed). For this reason they can potentially be adapted to FCS markets. Moreover, the so-called “use of proceeds bonds” tends to be geared towards investment in specific projects or types of projects that the issuer selects beforehand.

The characteristics and structure of the product, and whether a social impact bond or a social bond is most suited to the context, will depend on the specific FCS market for which the instrument is developed, taking into account issues such as the size of potential businesses to invest in. While prevailing wisdom is that, on the whole, the size of the bonds that could currently be issued in FCS would be too small to make bonds a worthwhile investment vehicle option for potential investors in FCS, particularly given the associated high risks.

This report challenges prevailing wisdom and proposes an initiative focused on designing appropriate ‘instruments’. This initiative would set in motion a process that would enable investors, development agencies, and governments of FCS, to come up with bond-based best practice solutions as a means of addressing the issue of scale through aggregation, i.e. grouping together potential investment opportunities, as more attractive targets for large scale investments. This process would allow responsible business principles, SDGs impact, and other key criteria for workability to be developed and promoted.

**Applying the Green and Social Bond experience to fragile and conflict-affected situations**

Green and social bonds present could provide an interesting model for mobilising investment in FCS. The growth of the green bond market, which saw the issuance of only USD 3 billion in 2012 but around USD 85 billion in 2016 (exceeding the USD 150 billion threshold) suggests this model is being picked up by a growing group of actors. This creates opportunities for exploring the creation of similar instruments for use in countries facing fragile and conflict-affected situations. Could social bonds for FCS (‘A Peace Bond’) do for financing peace and development outcomes, what green bonds did for climate change adaptation financing? The recently issued Humanitarian Impact Bond, by the International Committee of the Red Cross (September 2017), raised CHF 26 million, specifically tailored to support services for people with disabilities in FCS, is one example of emerging innovation trends in this field.76
The rationale behind bonds for FCS is that significant investment will be required to support peace and development in FCS by re-investing in the growth of their economies in a sustainable way. These needs cannot be covered by current levels and types of public or private investment. In the same way, the risks and opportunities created by conflict and fragility are beginning to converge with national, regional and global interest in building sustainable peace as a global public good. If such social bonds were to be created to leverage more investment into FCS for building sustainable peace (‘Peace Bonds’), they would also need ‘standards and criteria’ for selecting projects, funds and assets, which would spell out, through a labelling scheme, what conflict sensitivity (i.e. ‘do no harm’) means, and what peace and development benefits would look like. Such a labelling scheme could significantly reduce the risk of investors’ reticence about investing in FCS and the concerns of development actors about underwriting the financial risk of investors, in ways that might ‘do harm’.

**Box 7 - Social Impact Bonds or Social Bonds**

**Social Impact Investment**
There is currently no universally agreed upon definition of what Social Impact is, so there is still much debate about what Social Impact Investment (SII) is. Generally speaking, impact investments are investments made in companies, organisations, and funds with the intention of generating social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns, from below market to market rate, depending on investors’ strategic goals. The growing impact investment market provides capital to address the world’s most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.

Social Impact Investment includes social impact bonds, development impact bonds and other types of social impact investment instruments, including social impact investment funds. SII has become increasingly relevant, as social challenges of globalisation and inclusive growth have mounted while public funds in many countries are under pressure. New approaches are needed for addressing social and economic challenges, including new models of public and private partnership, which can fund, deliver and scale innovative solutions from the ground up.

**Social Impact Bond**
For the purposes of this report, we understand a social impact bond or “pay for success” contract as a public-private partnership financial instrument in which investors pay for a set of interventions to improve a social outcome that is of social and/or financial interest to the commissioner, usually or traditionally a government.

In other words, the government pays private investors a return for funding successful social projects that meet measurable outcomes. Social providers (it could be development agencies or non-governmental organisations) make a proposal to financial institutions; if the project is agreed, the state provides oversight of the contract and independent experts evaluate the outcome. If the project meets its targets, the government pays back the principal and the agreed return on capital. While promising, social impact bonds can also be complex and time-consuming to structure and implement. According to a UBS study, rates of return vary between 2 to 15%. Proposed returns would define the type of investors interested; the lower the return, the closer one is to requiring philanthropic capital. While most are commissioned by governments, other commissioners can be municipalities, development agencies or DFIs.

**Development Impact Bonds**
Building on the social impact bond / pay-for-success contract model, development impact bonds are focused on producing results in developing countries. They seek to improve the effectiveness of development co-operation by shifting the focus from the quantity of the investment onto the quality of implementation and the delivery of successful results. Yet unlike social impact bonds in developed countries, the typical commissioner of a development impact bond is not a local government, but rather an international organisation or development agency. A social bond of this type would be an opportunity to fund the Sustainable Development Goals. BNP Paribas has just launched an SDG-Social impact Bond. There are more than 60 social impact bonds launched to date.

**Social Bonds and Green Bonds**
**Green Bonds are a type of social bond that** raises funds to finance or re-finance projects with environmentally sustainable or social benefits. They differ from regular bonds because they include an explicit commitment by the issuer to use the funds raised to finance or re-finance projects, assets or business activities with social or environmental benefits, such as renewable energy, low carbon transport, or projects that support employment for marginalised communities. They may be issued by public, supranational and private entities. This “labelled” social bond market is dominated by the “use-of-proceeds” bond-type, but in fact, is no different to normal, senior bonds issued by the same entity. The credit risk for the investor is the same; they are remunerated through a coupon with a fixed or variable rate of return. Social bonds may also be structured as asset-backed securities, in which cash flows to repay the investor are derived from a pool of identified social assets (i.e. green), or as social project bonds, in which the investor has direct exposure to the risk of the project without recourse to the issuer.

The rationale behind green bonds was the need to raise an estimated USD 6-7 trillion in annual investment over the 15 years to meet the demand for green investment that would facilitate the global transition to an environmentally sustainable and low-carbon economy. This could not be funded by existing financial vehicles alone. Green bonds have come of age in the past few years, as the environmental risks and opportunities facing capital markets have converged with policy imperatives.

**What makes a Green Bond Green?**

There is, as of yet, no universal consensus on what constitutes a green/social bond; the market operates on the basis of a self-labelling system. Yet, the Green Bond Principles (GBP), a set of voluntary guidelines formulated by key market participants, under the coordination of ICMA (International Capital Market Association), are widely accepted as defining the process for issuing a green/social bond. The GBP, updated most recently in June 2016, have achieved broad market acceptance as well as growing recognition by policy makers and regulators. By June 2016, over 117 Green Bond issuers, underwriters and investors had become members of the GBP and over 73 organisations had become observers. The GBP are voluntary guidelines for issuing green bonds, focusing on disclosure and transparency. They also provide guidance on eligible green project types, through key areas of concern and high level project categories.

For green bonds governed by the Green Bond Principles (GBP) proceeds must be used purely for assets or activities with environmental benefits. A number of initiatives have been introduced to assist with defining what is green, thereby providing the basis for developing a credible green bond market by avoiding “green washing”. One such initiative is the Climate Bonds Standard, developed by academic experts under the stewardship of the Climate Bonds Initiative (CBI), an NGO whose role is to promote the development of the green bond market. The CBI has produced a taxonomy of green investments, and includes sector specific criteria for identifying appropriate projects for green bonds. Some investors, like BNP Paribas Asset Management, have gone further and developed a thorough in-house methodology to properly assess all sustainable / green bonds.

At present, apart from the Green Bond, there is no comparably well-established initiative on other types of social bond. This was included as an annex to the GBP in June 2016 where it is acknowledged that for social issues such as health and education, where there are a much wider range of outcomes, there is far less clarity on how to measure them.

The growth of momentum around the continued issuance of green bonds, has led to demand for greater consensus on what constitutes a green bond and increased regulatory scrutiny by governments and international organisations like the G20 and the OECD. This is expected to increase the impetus around standards and impact measurement.

### 5.2 Challenges and gaps

Challenges and gaps to be worked on relate to two key risks barriers to the creation of social bonds in FCS: size (i.e. aggregation) and financial risk. Only a limited number of investors are willing to take on the financial risk in FCS (particularly for investment outside extractives and infrastructure), even if the use of the financial instruments (bonds) were linked to an effective labelling system to screen potential investment targets. A potential solution would be to create an entity or agency (formed by DFIs and donor countries) able to guarantee securitisations of FCS. Cash flows for securitisation could come from the loans made to the corporate investor and to governments in FCS. In case of a default, the newly created entity would guarantee the loans and repay them, instead of the FCS entity. Of course, the process would be organised according to the entity or agency criteria on both risk and ESG principles. Therefore, the entity or agency would fully control the risk. The investor base would be very wide given a global agency (if possible AAA or AA rated) would
guarantee the bonds. The size of the bonds would be much greater, since it would aggregate many small loans to FCS entities.

**Box 8 - Examples of Social Bonds with potential transferability to the FCS**

**Instituto de Crédito Oficial (ICO) – Spain**

**Issuer:** ICO is a state-owned bank attached to the Ministry of Economic Affairs and Competitiveness. ICO’s primary mission is to promote economic development in Spain.

**Social Bond:** ICO’s social bond aims to foster employment in Spanish regions most affected by unemployment. The bond raises funds to provide loans to financial institutions that will, in turn, finance micro enterprises and SMEs. A mechanism known as a second floor facility involving saving and retail banks, acts as an intermediary.

ICO’s second floor facilities must be made available to enterprises that meet the following three criteria:

1. **Being a micro-enterprise or SME.** ICO adheres to the European Union’s definition and categorisation of Small and Medium Enterprises. SMEs employ fewer than 250 people and have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. A micro-enterprise employs fewer than 10 people and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

2. **Being located in an economically underperforming region of Spain.** ICO defines economically underperforming regions of Spain as regions with GDP per capita in 2013 lower than the Spain’s national GDP per capita, as per Spanish Regional Accounts. These economically underperforming regions are also characterized by an unemployment rate of 19% or greater.

3. **Not being engaged in any business activity under the Exclusionary Criteria.** ICO will not allocate the proceeds from the social bond to SMEs in a number of industries that are considered to have potentially negative social or environmental impacts. Businesses or enterprises that meet any of the following criteria are not eligible for ICO’s social bond proceeds: 1. The business falls under the NACE codes, which cover a range of businesses such as: alcohol, tobacco, gambling, coal mining, energy production, amongst others. 2. The business has a record of engaging in illegal business practices.

ICO’s bond was launched on February 4th, 2015 for EUR 1 billion followed by a second emission in 2016 of EUR 0.5 billion.

**Social Bonds & Microfinance: FMO – Netherlands**

**Issuer:** FMO is the Dutch development bank. FMO operates in over 60 countries and focuses on supporting sustainable development in key areas such as: microfinance, private sector development, agriculture, food and water.

**A Social Bond & Microfinance:** The FMO bond supports projects covering environmental and social issues. On the social side, FMO commits to expanding access to affordable financial products for vulnerable and poor communities.

Projects are classified as microfinance if they meet the following criteria:

- **The end-client should meet two of three criteria to be eligible for the Sustainability Bond:** 1) number of employees < 10; 2) turnover < USD 100,000; 3) a. total assets < USD 100,000; or b) If data mentioned in point ‘a’ is not available, then the loan size should be < USD 10,000.

- **Inclusive finance projects selection respect a set of exclusion criteria:** 1. Forced labour or child labour; 2. Activities or materials deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans; 3.Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations; 4. Destruction of High Conservation Value areas; 5. Radioactive materials and unbounded asbestos fibres; 6. Pornography and/or prostitution; 7. Racist and/or anti-democratic. The bond was firstly launched in November 2013 to raise USD 672.7 million; a second one was launched in 2015 for USD 537 million and a third one in 2016 for USD 76 million.

**BNP Paribas “SDGs Everyone” initiative**

BNP Paribas helped the World Bank to issue bonds that link returns to the performance of companies included in the
Solactive Sustainable Development Goals World Index. The bonds were arranged by BNP Paribas as part of the “SDGs Everyone” initiative which aims to find innovative new financial models to support the SDGs. The bonds raised EUR 163 million worth of funding to support the financing of World Bank projects related to the advancement of the 2030 Agenda from institutional investors in France and Italy.\(^{82}\) Further, the index included 50 companies with a sound ESG footprint or at least one fifth of their activities dedicated to sustainable products.

**Examples of Innovative finance with a social purpose: Investing in women\(^{82}\)**

- The IFC Banking on Women bonds (2013) raised over USD 160 million for investments that support access to finance for women-owned or women-controlled enterprises.\(^{83}\)
- **Impact Investment Exchange Asia (IIX)** launched in 2015 a USD 16 million bond for women’s impact enterprises and microfinance institutions to grow their businesses and scale social impact.\(^{84}\)
- **Calvert Foundation and Bank of America.** Bank of America USD 10 million investment in Calvert Foundation will enable loans to be made to connect women-led, small to medium enterprises in developing countries with financing and provide access to services and products.\(^{85}\)
- **CITI and the Overseas Private Investment Corporation (OPIC)** have been partnering with national banks, providing them loans to support SMEs in a number of countries.\(^{86}\)
- **Goldman Sachs and IFC 10,000 women initiative.** In 2014, Goldman Sachs and IFC created the first-ever loan facility for women-owned SMEs to enable 100,000 women in emerging markets to access capital.\(^{87}\)

There has been a growth in the range of actors operating in the social impact bond and social bond market, a veritable ecosystem made up of social ventures, intermediaries and investors committed to addressing social needs. There is also an emerging consensus among the public sector, the private sector and civil society actors that challenges in fragile contexts cannot be addressed unilaterally and need to be tackled collectively. Governments can play a key role in the ecosystem, by helping to create an enabling environment for it (or by hindering it), and through their potential indirect or direct engagement with the market.\(^{88}\) Governments and the DFIs could play a catalytic role in developing a social impact market for FCS, by helping to create conducive regulatory environments, stepping in to fill financing gaps, providing more accessible and simplified risk capital and guarantees that respond to both big and medium/small investment needs. They could also take concrete steps such as launching social or social impact bonds specifically targeting FCS.\(^{89}\) Non-governmental organisations can also potentially play an important role within the bond market ecosystem as service providers, if the government agrees, working to deliver social outputs, especially in FCS where government capacity might be weak.\(^{90}\) More broadly, civil society organisations have an important role to play in monitoring who and what (i.e. companies, institutions, organisations, projects) benefit from social bonds, and what their impact on conflict and peace dynamics is.

### 5.3 Identification: Screening and labelling sustainable investment targets in FCS

A labelling scheme could mitigate risks by identifying and screening companies and financial intermediaries in FCS, as conflict sensitive or peace promoting and guiding the governance of issuing social bonds.

A screening process or “labelling scheme” to identify and single out, in a systematic way, ‘investment-worthy’ companies and investor intermediaries (financial institutions) that operate in FCS, could be a way of enabling investors to de-risk,\(^{91}\) both from a reputational and financial perspective. Such a screening process, based on a solid methodology that would combine existing standards and due diligence approaches with criteria that are relevant from a sustainable peace perspective, would enable investors to go beyond compliance with existing standards.\(^{92}\) It could help investors and their financial intermediaries select companies that are not only commercially viable, but also meet relevant global, country and sector-specific standards for responsible business, and thereby enable their investments to contribute to sustainable peace and progress towards the SDGs, notably through creating the jobs, services and other opportunities that will help generate inclusive growth.

The identification or labelling mechanism could also include processes and criteria or metrics for measuring and monitoring investments in companies operating in FCS, so that accountability and social ownership of investments could be guaranteed, by tracking the impact of investments on conflict risk. The types of risk...
analysis that typically underpin current risk management strategies are too narrow and do not recognise the role investors can play as actors in FCS. They tend to overlook the link between the social and environmental impacts of investments themselves and heightened or reduced levels of political risk.

**Box 9 - Doing Good While Doing Good Business: Incorporating non-financial criteria in investment decision-making helps deliver better outcomes**

There is growing recognition among mainstream investors of the need for new ways of thinking and of incorporating non-financial considerations, for example Environmental, Social and Governance (ESG) metrics in investment decisions. This is accompanied by an emerging belief that such metrics may drive long-term risk mitigation and value addition. The context and risk analyses underpinning current risk management strategies are unduly narrow and do not recognise the overall role of investors as actors in context of ‘high risk’. Investors often overlook the fact that it is the nature of the linkages between social and environmental impacts and political risks that determine whether a particular investment is likely to create or exacerbate conflict or help prevent and resolve it.

The empirical evidence around how ESG criteria affect financial returns is still preliminary but suggests that there is a business case to be made for the integration of non-financial considerations (ESG and responsible business standards).

A recent study that looks at how institutional investors are incorporating ESG into their investment strategies and what is driving them to do so, showed that 80% of a cohort of investors, representing USD 7.6 trillion assets under management, and which provide capital to companies to finance growth, are already considering ESG issues in their investment decisions. Nearly three-quarters of them cite risk mitigation as the primary reason. This is based on the assumption that upfront consideration of issues like climate change and resource scarcity will reduce risk in the long term. Approximately 50% of respondents consider these issues in order to enhance investment returns and to avoid investing in firms with unethical conduct.

Academic literature surveyed by Deutsche Bank in 2012, on the relationship between ESG factors and investment returns, showed that firms with high ratings for CSR and ESG factors had a lower cost of capital in terms of debt and equity. In addition, almost 90% of studies examined showed that firms with high ratings for ESG exhibit market-based outperformance and accounting-based outperformance (89% and 85% respectively).93 Efforts are currently underway to help investors consider if investments within the ESG spectrum help to position themselves competitively. Emerging research by PeaceNexus shows that companies that perform well against Peacebuilding Business Criteria (see box 10) also outperform on other standard performance criteria.

Making the business case for responsible investment in fragile states means leveraging this evidence, and current thinking in investors’ circles about the importance of integrating non-financial considerations into investors’ decision-making, as a medium to long-term risk mitigation strategy.

Drawing on the compliance architecture developed around green bonds, a labelling scheme would offer investors and companies a service that would help standardise and simplify the process of matching investments with opportunities, that otherwise they would not be able or willing to provide themselves as it would be too costly or cumbersome.

Civil society organisations would be critical partners in this process as they could provide, amongst other things, specific contextual ‘local’ knowledge, understanding of conflict dynamics and the political economy as well as of societal expectations. They could help investors and investor intermediaries to identify businesses with a higher potential to contribute to sustainable peace.

In practice such a scheme would:

1. Provide investors interested in investing in FCS with a list of companies screened against a set of agreed standards and criteria, including criteria relevant for sustainable peace and development;
2. Reassure investors that their clients apply enhanced risk-based due diligence, where risks include not only ESG issues, but also the positive and negative impact of their work on the conflict context and vice-versa;
3. Provide a means to monitor the positive (and negative) impacts of the investment on sustainable peace showcase investor contributions to the SDGs.

4. Provide a platform for multi-stakeholder learning which would help investors understand how to manage and mitigate the risks they face.

This would be similar to ‘Fairtrade’ Certification, which certifies products that are traded fairly, or the Climate Bond Standard and Certification that provides a stamp of approval that an asset or project meets the requirements of the Climate Bond Initiative’s environmental standards. Norm compliance therefore, can become a strategic advantage for companies in competitive markets, and contribute to a “race to the top”.

Such a scheme would complement and enhance the existing fiduciary duties of investors and companies to conduct due diligence, in line with international and industry standards for responsible business conduct. The scheme would also contribute to assessing companies’ compliance with Responsible Business Conduct (RBC) and ESG standards.

The box below briefly outlines some principles, criteria and approaches which such a scheme could draw on. A range of public and private entities could contribute institutional experience to develop such a scheme, including institutional investors themselves and DFIs. Engagement with civil society actors around the screening and monitoring process could also add value as a means of determining impact on the ground and preventing potential reputational damage.

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**Box 10 - Principles, criteria and approaches that could help guide more and better investment in FCS**

**OECD Guidelines for Multinational Enterprises and Due Diligence Guidance are foundational.** According to the OECD frameworks, due diligence is understood as processes through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems. Due diligence is a key aspect of responsible business conduct as it enables businesses to demonstrate their efforts to behave responsibly. Under the OECD Due Diligence Guidance, investors are expected to 1) avoid causing or contributing to adverse impacts through their own activities and address those impacts where they do occur 2) seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship. The severity and likelihood of the adverse impact are the most important factors in determining the scale and complexity of the due diligence processes the investor needs to have in place in order to know and show that it is acting responsibly. Additionally, due diligence efforts should be reasonable, i.e. comprise reasonable steps that an investor should undertake, in the light of its circumstances (including sector, operating context, size and similar factors). Some sectors, like the extractive industries and those with very complex value chains, will require more attention to due diligence than others.

**Investment with country ownership:** The New Deal for engagement in Fragile States advocates an approach which goes beyond compliance with ‘do no harm’ due diligence standards, but calls for investment to be directed towards actually building the economic foundations needed for peace, in line with national governments’ own inclusive national development plans, i.e. developed in consultation with their populations, to make their countries more resilient and achieve sustainable peace and development. The New Deal acknowledges that building trust through structured and regular dialogue and partnership between state and society, but also public and private actors, can be challenging, but is vital, particularly in contexts emerging from conflict.

**Screening companies for peacebuilding:** The Peacebuilding Business Criteria (PBBC) developed by PeaceNexus aims to simplify and harmonise thinking about what is required of a business in order to be classified as “engaging in peacebuilding”. The PBBC serves as the foundation of a Peacebuilding Company Index (PBCI) and as a targeted investment mechanism to enhance the peacebuilding impact of the PeaceNexus endowment fund.

**Conflict-sensitive investment lens:** The European Investment Bank (EIB) “conflict sensitive investment lens” is used to implement investment projects in conflict-prone and conflict-affected countries. The aim is to reduce the risk of
conflict derailing the project; to mitigate and manage the risk of conflict being unintentionally exacerbated by the project; and/or whenever possible, depending on context, to maximise the project’s potential contribution to conflict prevention, structural stability and peacebuilding. In 2014 EIB had operations in 39 countries out of the 51 included in the OECD’s list of fragile states.\textsuperscript{39}

**International Financial Corporation (IFC)’s Conflict Affected States in Africa (CASA)** Program developed a “conflict and fragility lens” by using a macro/country and micro/project level analytical approach to ensure an understanding of the context and of the potential interaction of IFC operations within it. IFC has applied its fragility lens to Advisory Projects and in the following countries to date: Burundi, Côte d’Ivoire, DRC, Guinea, Mali, Somalia, South Sudan and Zimbabwe.\textsuperscript{100}

Questions outstanding include: What standards should be considered for the screening? How would such a scheme be implemented? Who would be responsible for issuing labelling and for overseeing monitoring compliance? And how would labelling standards be used, and by whom? The overall ambition of the scheme would be to enable investors to make discerning choices about where and what to invest in FCS and to enable them to consider FCS in more than just exclusionary terms.

This report acknowledges “labelling” (e.g. what can be labelled, where, and what is a realistic methodology), is complex, notably because information on companies is often difficult to obtain, or of insufficient quality in FCS. The setting up of a ‘labelling’ scheme could be costly, could take time to put in place, and ultimately only companies of a certain size could be eligible. Whilst attractive, labelling alone is not a silver bullet.\textsuperscript{101} Labelling would require political champions and significant political buy-in from a range of stakeholders, in particular from investors and companies themselves. A multi-stakeholder platform at global level, linked directly to public-private and community dialogue processes at country level, would be critical to securing the type of buy-in required, and would be beneficial to companies in mitigating and managing the risks they may face.

### 5.4 Information-Networking and Oversight Hubs: Investor Information Hub for sharing knowledge, networking, fostering dialogue and oversight

What kind of information is required, how and from where it can be sourced (particularly when in most instances, it is scarce, even at the country level) and can it be made easily available to investors? These are just some of the questions that creating country-level Information-Networking and Oversight Hubs, would aim to solve. Yet, it is acknowledged that business information, by its very nature, will not always be easily shared. The role of the Information-networking and oversight hubs, would be to create greater awareness amongst investors and investor intermediaries about potential investment opportunities. To be useful, information must be granular, country-specific, sector-specific and company-specific. It must provide investors with a more comprehensive picture of the market, including: how to invest in sectors in ways that are conflict-sensitive from a sustainable peace and development perspective; which companies (including SMEs) and local financial institutions are doing good business and could potentially do good from a sustainable peace perspective; how the country context is changing (e.g. positive impact of key reforms); what the real and perceived risks are and what challenges businesses and governments face at country level area. Accessing such information is essential for changing the narrative with respect to the opportunities and challenges of investing in FCS. At the same time, investors can bring knowledge that can benefit a variety of other actors at the country level.

Secondly, developing or strengthening existing country level platforms (e.g. investment facilities, country level one-stop shop mechanisms) could create the necessary vehicles for fostering public-private dialogue to build trust, opportunities for societal monitoring and oversight of investment decision-making processes. This Investor Information Hub or one-stop shop (e.g. national investment authority with private sector and civil society representation or a public-private investment mechanism for dialogue), idea could build and improve on existing models and processes.\textsuperscript{102}
Box 11 - The New Deal ‘Fragility Assessment’\textsuperscript{103}: An opportunity to collect country and sector specific information about sustainable investment opportunities

The International Dialogue’s New Deal Framework includes the need to conduct government-led nationally consultative Fragility Assessments on a regular basis. These should inform national planning and could include an assessment of existing one-stop shop initiatives to identify why they have worked, why they have not worked, and what the obstacles are to building the kind of economic foundations needed to consolidate peace. New Deal Fragility Assessments could also be informed by the kinds of reporting used by private consulting firms. Traditional New Deal Fragility Assessment exercises and emerging ‘Country Dialogue’ processes (as currently being tried out in Sierra Leone) could provide an important opportunity for an inclusive national conversation about how to ensure that private investment has a positive impact on peace, or at the very least ‘does no harm’.

Information-Networking and Oversight Hubs could assist investors and companies beyond the traditional “investment services” by:

- Generating country and sector-specific research on investment opportunities using different analytical tools including standard economic and financial data and risk profiling, as well as conflict-sensitive political economy analysis. Such joint research with the active participation of companies, investors, governments, development partners and civil society would for instance provide information on the sectors in which investment would be most relevant from a sustainable peace and development perspective, and examples of how companies are doing good business even in challenging situations;

- Producing “investor country notes” out of this research and using it to attract “more and better” investment at the global (e.g. at investment fora) and country level, with the specific aim of attracting investment in sectors and companies that can have an impact on sustainable peace and development. These country notes would be different from existing open source and proprietary publications, which do not specifically address the peacebuilding potential associated with investment targets;

- Bringing investors, governments and development partners together for problem-solving multi-stakeholder consultations and partnerships, whilst research and country notes are being produced, to avoid time-lag between results and action. Consultations could help identify specific collective or individual measures required to maximise the opportunities and manage the risks associated with investment in specific sectors and types of businesses, and in alignment with the recovery and peacebuilding trajectory of the country (e.g. identify and agree on critical reforms, specific due diligence processes, identify the right type of guarantees; develop mitigation plans);

- Matching investors’ interests with concrete opportunities (i.e. deal making), always with the sustainable investment for peace and conflict-sensitivity lens in mind, through these consultations.
Chapter 6. Main Conclusions

Based on extensive consultations with investors, development agencies and the governments and business in countries facing conflict and fragility, about how to scale up responsible and sustainable investment in FCS, this report focuses on how investors, in collaboration with the development community, can overcome risks; both real and perceived, financial and reputational. Addressing the real and perceived risk concerns of potential investors in FCS is vital if there is to be more and better investment in FCS. Scaled up investment, if well harnessed and well targeted, could be key to promoting inclusive growth, sustainable development and peace. In singling out the importance of addressing the real and perceived risks for institutional investors in ways that are sensitive to conflict dynamics in FCS, this report fills an important gap in the on-going discussions about how to address the multiple challenges associated in FCS, which if left unaddressed and threatens to undermine the prospects of achieving the SDGs worldwide.

It proposes a new way of addressing real and perceived risks facing investment in FCS, by proposing simultaneously innovations in three concrete areas:

1. **Investment instruments** aided by leveraging mechanism including blended finance;
2. **Identification** of investment worthy businesses and financial institutions; and
3. **Information-networking and oversight hubs**, to enable investors to identify bankable opportunities for responsible investment in ways that ‘do no harm’, and which potentially can promote peace. Innovation in each of these areas could help to address some of the major constraints faced by institutional investors and other actors in FCS, to scaling up their investments.

This report has provided an outline of some concrete ways of attracting the finance, innovation and investment needed to make a qualitative difference to the lives of millions of people in conflict-affected and fragile situations, in ways that promote rather than undermine peace. Whilst preliminary, the ideas contained in this report, attest to the kind of much needed blue sky thinking required if sustained peace and sustainable development are to stand a chance of becoming a reality. Progress in these complex markets is critical, not only for the millions living there, but for the global community who stand to benefit if the SDG ambition of ending poverty and achieving sustainable development for all by 2030, is achieved.

**Nothing short of a robust multi-stakeholder effort is required, at national and international levels, which would bring the investor community, the development finance community and the governments and civil societies of countries facing fragility together, to address these challenges and take these initiatives forward.**
**Annex A - Methodology**

The OECD-hosted International Dialogue on Peacebuilding and Statebuilding is a multi-stakeholder partnership between governments and civil society organisations from OECD and g7+ countries, which actively promotes responsible international engagement in fragile and conflict-affected countries, in ways that contribute to sustainable peace.105

The idea for the report grew out of the ambition of the International Dialogue to make the principles of the ‘New Deal for Engagement in Fragile States’, initially intended to guide the investment decisions of the aid community, relevant for the private sector. Many of the New Deal principles are today incorporated into the SDGs, in particular into SDG 16 (Inclusive, Effective and Peaceful Institutions) and related goals and indicators.

In 2014, the IDPS Steering Group charged the IDPS Secretariat with the responsibility for defining concretely what a ‘New Deal for the private sector’ would look like. A virtual network of ‘champions’ was created to guide the International Dialogue’s efforts at effective engagement with the private sector and included the Netherlands, private banks, multilateral development banks (including the World Bank FCV group), g7+ countries (Liberia, Sierra Leone and Afghanistan), academics, think tanks and multi-stakeholder initiatives (UN Global Compact).

Discussions in late December 2015 with BNP Paribas Asset Management (Sustainability Research), one member of the virtual network of champions, highlighted gaps within the plethora of guidance that now exists on responsible business in fragile and conflict-affected situations, this includes the brochure106 on key international standards for responsible business conduct and how they apply to fragile states in 2015, developed by the International Dialogue earlier in 2015. Whilst useful in helping corporations and investors appropriate ESG standards and due diligence practice, much of this guidance is less useful in helping investors make the leap and venture into markets (beyond extractives) where the risk and the return ratio are unclear. It became clear from these conversations that more than guidance, what was required was actual tools to help investors make more informed choices and partnerships with others, to enable them to address some basic risks concerns –real, perceived, financial and reputational.

The International Dialogue Secretariat, with the generous support of the European Union and BNP Paribas Asset Management, commissioned a consultant, based on terms of reference jointly developed by the OECD hosted Secretariat of the International Dialogue on Peacebuilding and Statebuilding and BNP Paribas Asset Management, to conduct research, to explore ‘what it would take’ to enable investors to scale up responsible investments in fragile and conflict affected environments, in ways that potentially contribute to peace.

The interviews (conducted over a year) and consultation with experts in the worlds of investment and development co-operation alike, led to an analysis of preliminary findings compiled in the form of a report, used to solicit expert feedback.107 This resulted in the compilation of a report, which led to the development of this report. The drafting process involved a constant back and forth between researcher/consultant, and the OECD-IDPS Secretariat (responsible for managing and overseeing the intellectual content), BNP Paribas Asset Management, the investor community and International Dialogue members.

The work was based on a desk review and extensive consultations with the investor community multilateral development banks (WBG and AfDB), development agencies (from OECD-DAC INCAF), fragile and conflict-affected state governments (Ministries of Finance and Trade), academics, and policy experts working in this field at the OECD (Investment Division of Directorate of Finance and Trade Development, Development Co-operation Directorate, Development Centre). The narrative outlined in this report was developed in a series of three stages.
The first stage consisted of a desk review, and discussions involving a small expert group including (BNP Paribas Asset Management, World Bank/IFC, International Dialogue and OECD experts). The second stage involved the ‘ground truthing’ of the main pitch outlined in the desk review with a wider audience – notably investment funds, social impact investors, and multilateral development banks with specialist expertise. This led to the further development of a narrative pitch, further consultative reviews (small IDPS, BNP Paribas, WBG teams), further consultations with a wider group (OECD-wide, WBG wide, BNP Paribas Asset Management-wide) and wider IDPS virtual reference group, initially set up to guide the private sector workstream of the International Dialogue. A third pre-final draft was presented in January 2017 at the OECD Development Co-operation Directorate’s Private Sector Meeting and with the coordinating Secretariats of the International Dialogue’s three main constituencies (g7+, OECD-DAC International Network on Conflict and Fragility and Civil Society Platform for Peacebuilding and Statebuilding) and International Dialogue’s Steering Group, in April 2017. Comments received were integrated into the body of the final draft. Final editing, proof reading, and layout was overseen by the International Dialogue Secretariat (OECD).

A list of all those who have contributed to intellectual content of this work, are listed in the acknowledgements section at the beginning of the report.

The report’s findings and recommendations outlining that joint action by investors working in partnership with development actors to address the multiple risks faced by investors which impede the scaling up of responsible investment in fragile and conflict-affected situations, are based on the desk review, interviews and consultations with investors, expert and stakeholders.
Annex B - Glossary

“More and better” investment
For the purpose of this report, “more” investment means “greater number” and “greater volumes” of investment in businesses and financial institutions in FCS. “Better” investment means investment that not only complies with international standards for responsible business conduct and avoids “doing harm”, but that takes a pro-active approach to contributing to the SDGs, and to sustainable peace, by helping to create the economic foundations that are necessary for a country’s stability, for inclusive growth, and to generate opportunities, including jobs.

Investors
For the purpose of this report, references to investors, means institutional investors, as explained in the first section of the report. Institutional investors are entities or organisations that have (own/manage) large quantities of cash reserves that need to be invested. They include “asset owners” that own the funds, such as pension funds/endowments, insurance companies, high net-worth/family offices, and foundations, and asset managers, that manage the investments on behalf of asset owners; they act as agents on behalf of clients. They also include financial service providers, such as banks, liquid investment funds (mutual funds, hedge funds) and illiquid investment funds (private equity, venture capital). This report does not focus on FDI, although it recognises that increasing FDI to FCS is also important.

Fragile and conflict-affected situations (FCS)
FCS represent a diverse group of countries and situations. Whilst conflict-affected situations are inherently fragile, not all fragile situations are the same and not all fragile situations are conflict-affected.

A definition of fragility - The OECD States of Fragility report 2016 characterises fragility as the accumulation and combination of risks combined with insufficient capacity by the state system, and/or communities to manage it, absorb it, or mitigate its consequences. This situation of exposure to risk can lead to negative outcomes, including violence, protracted political crisis, and chronic underdevelopment. According to the OECD States of Fragility Framework (see table below), five dimensions of fragility are significant: economic, environmental, political, security, and societal, and in 2016, 56 countries were identified as experiencing ‘fragile’ situations. These situations also differ, depending on the type of conflict (internal, regional), level of violence, the type of fragility experienced, the phase/stage of (post)-conflict, and the range of political and socio-economic dimensions (e.g. low or middle income countries, the presence of natural resources, demographics, etc.) faced.

Table 1: Five dimensions of fragility

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Description</th>
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<tbody>
<tr>
<td>Economic</td>
<td>Vulnerability to risks stemming from weaknesses in economic foundations and human capital including macroeconomic.</td>
</tr>
<tr>
<td>Environmental</td>
<td>Vulnerability to environmental, climate and health risks that affect citizens’ lives and livelihoods. These include exposure to natural hazards, pollution and disease epidemics.</td>
</tr>
<tr>
<td>Political</td>
<td>Vulnerability to risks inherent in political processes, events or decisions; lack of political inclusiveness (including of elites); transparency, corruption, and society’s ability to accommodate change and avoid oppression.</td>
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<tr>
<td>Security</td>
<td>Vulnerability of overall security to violence and crime, including both political and social violence.</td>
</tr>
<tr>
<td>Societal</td>
<td>Vulnerability to risks affecting societal cohesion that stem from both vertical and horizontal inequalities, including inequality among culturally defined or constructed groups and social cleavages.</td>
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These definitions and the table are taken from the States of Fragility Report 2016: Understanding Violence, OECD, 2016

Risks
For the purpose of this report real and perceived risks for institutional investors are: a) financial risks or risks of financial loss (e.g. due to sudden political or policy changes or high levels of insecurity, etc.); b) reputational risks (e.g. association with companies involved with human rights abuses or with corrupt governments, etc.). Both financial and reputational risks are caused by other risks linked to the country, regional or global context. For example, a political risk in a country or region translates into financial risks to the investor. A security risk may translate into a physical risk for a company the investor has invested in, but ultimately it is a reputational risk for the investor (which could have financial implications). Likewise, the risk of “doing harm” (i.e. of having a direct negative impact on the context) for an investor would fall under the two main risk areas of financial and reputational risks. Different organisations and communities use different risk categorisations. Risk assessment and management are specific disciplines with dedicated entities. In addition to the dimensions of fragility highlighted above, each of which includes a range of risks, the World Economic Forum World Risk Report 2016, for example, identifies six categories of risk: economic, environmental, geopolitical, societal, and technological. The type and severity of risks to an investor in a FCS will depend on the context and the characteristics of fragility, as outlined above. These will have to be assessed and understood using appropriate and adapted risk assessment methodologies. These are not the object of this report.

Conflict sensitivity
Conflict sensitivity means acting with the understanding that any initiative conducted, particularly in a conflict-affected environment, will potentially interact with that environment, in ways that have positive or negative effects with respect to conflict dynamics. It is a deliberate and systematic approach to ensuring we understand and minimise negative effects (risks) and maximise positive effects of our actions (opportunities). “Do no harm” i.e. avoid a negative impact of your action on the environment (for example avoid human right abuses) is the first basic step of conflict sensitivity. There are different models to help companies, and potential investors, be conflict-sensitive and understand their potential contribution to peace. These include work by the Centre for Research on Multinational Corporations (SOMO, https://www.somo.nl), and by CDA Collaborative Learning Project (http://cdacollaborative.org/what-we-do/conflict-sensitivity/).
1 The term ‘fragile’ or ‘high risk’ is used to denote a range of contexts, where violence, protracted political crisis and weak state capacity to manage exposure to risk, are features. OECD (2016), States of Fragility 2016: Understanding Violence, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264267213-en. This report explores however how to enable private investors to sustainably invest in these markets, whilst diminishing their exposure to different types of risk.

2 The research for the report was conducted in close collaboration with BNP Paribas Asset Management (Sustainability Research Department). The conclusions and ideas are at a preliminary stage of development and represent a first attempt to ambitiously think outside the box. They are intended as ‘food for thought’ for members of the International Dialogue on Peacebuilding and Statebuilding and its network of collaborators, including BNP Paribas Asset Management, working to promote responsible business in FCS.


5 Measured as people living on less than USD 1.25 per day one of the ‘facts and figures’ underpinning SDG 1, www.un.org/sustainabledevelopment/poverty/ (accessed 30 April 2018)


8 g7+ Briefing Note 3, The Private Sector in Conflict-affected Situations, ‘The private sector has the potential to accelerate progress towards resilience and development in fragile or conflict-affected countries (FCAS)’, http://g7plus.org/test-site/sites/default/files/basic-page-downloads/FFD_side_event_BRIEF_3-private_sector.pdf.


14 Ibid. Ganson, B 2017


17 Context, sector and company-specific.

18 Information about risks-return is often misconstrued due to the lack of transparency or functioning financial market. The gathering of this data, as part of an effort to bridge the information gap would allow for a better understanding of risk-return by investors.

19 Information about risks-return is often misconstrued due to lack of transparency or functioning financial market. The gathering of this data, as part of an effort to bridge the information gap would allow for a better risk – return calculations by investors.

20 A glossary of terms such as “more and better”, FCS, institutional investors, risks, etc., is provided at the end of this paper.


23 Responsible investment can contribute to building peace. While it is acknowledged that the motivations of investors and industry more generally will differ from traditional ‘peacebuilders’ from the development community. See Cechvala, S (30 May 2017), ‘Failing the Duck Test: Labeling companies as peace actors’, CDA Perspectives Blog, http://cdacollaborative.org/blog/failing-duck-test-labeling-companies-peace-actors/.

24 The Sustainable Development Agenda for the next 13 years was set up in December 2015 by the United Nations and adopted by 193 member countries. It has been referred to as the 2030 Agenda and consists of 17 Sustainable Development Goals and 169 targets. For more information, please refer to https://sustainabledevelopment.un.org/post2015/transformingourworld


26 The report acknowledges that investors comprise a broad range of public and private actors that collaboration among them is critical to address the financial needs in FCS, and that Foreign Direct Investment (FDI) flows are necessary for FCS. It also recognises that in many FCS the financial system is weak, which presents challenges to attracting institutional investors. See Annex B for a definition of investors.

27 The Development Assistance Committee (DAC) brings together the world’s biggest donors, playing a key role in defining and monitoring Official Development Assistance (ODA), developing policy guidelines on development assistance, and providing a forum for dialogue and sharing of experiences among its Members. The International Network on Conflict and Fragility (INCAF) is a subsidiary body of the DAC which provides a platform for members and key multilateral agencies working in fragile and conflict-affected contexts to share lesson, promote good practice, and achieve policy commitments and behaviour change among international actors at headquarters and field levels.

28 OECD (2015), Social Impact Investment: Building the Evidence Base, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264233430-en. In addition, many institutional investors might have a dedicated “social impact investing” unit as it is the case for BNPP IP.

29 Even if only a small portion of the trillions of USD currently under management by institutional investors is directed to investments in FCS, it has the potential to fill very significant funding gaps in FCS.

30 The paper acknowledges that there are many impediments to attracting and retaining investment in FCS. These are not elaborated on in and addressed by this paper. See Annex B for a definition of risks.


33 See Centre for International Private Enterprise, http://www.cipe.org/

34 Determining which FCS are more likely targets for these initiatives, would require a granular, country and sector specific analysis that is not within the scope of this paper. The paper also acknowledges that risks vary depending on the context and the specific characteristics of fragility, and that whilst some risks can be managed, others go beyond investors’ control. The initiatives proposed in this report aim to provide instruments and approaches to facilitate investment by addressing some of the common impediments related to investing in FCS. Their specific use and applicability will depend on the context and will have to be considered on a case-by-case basis. The report also acknowledges that risk assessment methodologies exist and must be used to assess the specific risk context. These, and risk management approaches are not treated in this paper.

35 For example Commonwealth Development Corporation (CDC), the UK Development Finance Institution. See CDC Strategic Framework 2017-2021, ‘Investing to Transform Lives’


37 Building the economic foundations for peace has been recognised in the New Deal for Engagement in Fragile States as a key Peacebuilding and Statebuilding Goal by more than 40 countries and organisations, and by the UN Sustainable Development Goals (SDGs) which seek to eradicate poverty everywhere by 2030, and for which sustainable peace is a cross-cutting objective, and building peace and building economic foundations, the explicit focus of at least 3 Goals: Goal 8 (To Promote Inclusive and Sustainable Growth, Economic Growth, Employment and Decent Work for All), Goal 9 (To Build Resilient Infrastructure, promote sustainable industrialisation, and foster innovation) and Goal 16 (To Promote Justice, Peace and Inclusive Societies). http://www.un.org/sustainabledevelopment/sustainable-development-goals/ (accessed 30 April 2018)

38 These are the 5 Peacebuilding and Statebuilding Goals (PSGs) of the New Deal for Engagement in Fragile States (2011), recently reaffirmed by over 50 countries and organization in the ‘Stockholm Declaration’. IDPS (2011), A New Deal for engagement in fragile states, www.pbsbdialogue.org/media/filer_public/107/69/0769270d-3557-9a4e-918e-1a4d00e9473/the_new_deal.pdf. See also the IDPS (2016), Stockholm Declaration, Addressing Fragility and Building Peace in a Changing World http://www.pbsbdialogue.org/media/filer_public/1e/23/1e237c73-5318-4a03-9a87-b1aa6d914d20/stockholm_declaration.pdf


40 Under the OECD Guidelines “responsible business conduct” means that business should a) make a positive contribution to economic, environmental and social progress with a view to achieving sustainable development and b) should avoid and address adverse impacts through their own activities and seek to prevent or mitigate adverse impacts directly linked to their operations, products or services by a business relationship, OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, OECD Publishing, Paris.

41 Vietnam’s experience appears to challenge prevailing wisdom that large scale investments and specialization, brings greater productivity gains in FCS. See Van Arkadie, B and R. Mallon (2004), Viet Nam — a Transition Tiger? ANU Press, ANU E Press, Canberra


43 See Annex B Glossary of Terms for a definition and dimensions of fragility.

44 Many domestic companies find it difficult to access international financial markets.

45 Financial services provision for SME development is a growth area. See for example the LANDT Group – 6 aligned companies providing credit guarantees for financial institutions to promote SME development in fragile settings. http://www.landt-group.com

Both in terms of protecting the investments from high risks, and to ensure investors themselves do no harm.


The negative narrative prevents investors from even considering accessing the available risk guarantee mechanisms where they might exist and which could facilitate their access to these markets.

Providers of development assistance can also leverage their support to investors by encouraging investors to use their influence to promote the inclusion of stakeholders critical for establishing a political settlement and re-building peace. See Ganson, B. and Wennmann, A. (2016), Business and Conflict in Fragile States: The Case for Pragmatic Solution, Routledge, London. See also Austin, Luke J. and Wennmann A. (2017) “The Private Sector and Violence Prevention in Kenya, 2007-2013”.

Context, sector and company-specific.

Information about risks-return is often misconstrued due to the lack of transparency or functioning financial market. The gathering of this data, as part of an effort to bridge the information gap would allow for a better understanding of risk-return by investors.


For the detailed description of the PSW, see the PSW website - [https://ida.worldbank.org/financing/idah18-ifc-miga-private-sector-window](https://ida.worldbank.org/financing/idah18-ifc-miga-private-sector-window)


65 World Bank (2016), op.cit.

66 Final eligibility will be defined based on the FY18 IDA and FCS lists. Eligibility of the conflict-affected regions of Cameroon, Nigeria and Pakistan for the Private Sector Window, is currently under discussion.

67 The full preliminary list of eligible countries can be accessed here: https://spark.worldbank.org/docs/DOC-153182

68 For more information on IFC Blended Finance Facility see: https://ida.worldbank.org/financing/blended-finance-facility-bff

69 European Commission (2016) op.cit

70 For more information on Principles for Responsible Investment (PRI) see www.unpri.org


72 The paper recognises that well-functioning financial institutions, both as conduits and regulators for investment, are needed and would increase the efficiency of the initiatives proposed.

73 As explored in Afghanistan by LANDT, http://www.landt-group.com

74 The paper acknowledges that any discussion and work on new financial instruments needs to include a discussion on risks insurance and guarantee mechanisms. This is not within the scope paper, but could be part of this work if taken forward, as explained at the end of this section (“how to take this forward”).

75 Equities, i.e. investing directly in companies that are large and sophisticated enough to be listed in one or more stock markets.


80 NACE is the “statistical classification of economic activities in the European Community” and is the subject of legislation at the European Union level which imposes the use of the classification uniformly within all the Member States. NACE is derived from the French title "Nomenclature générale des Activités économiques dans les Communautés Européennes" (Statistical classification of economic activities in the European Communities), NACE Rev II, Statistical classification of economic activities in the European Community, Eurostat Methodologies and Working Papers (2008).


89 The World Bank Group’s recent IDA 18 replenishment, and announcement of the creation of a Private Sector Window, which includes a Social Impact Bond.

90 This is in compliance with International Dialogue’s ‘New Deal for Engagement in Fragile states’ principles, which insist on the need for external investments both public and private to consolidate peace, by reinforcing state capacity to deliver services / oversee service delivery, as a means of becoming more resilient and legitimate in the long run.

91 De-risking for FATT issues should be different from de-risking when it comes to conflict-affected situations. In some cases, business will have to work with the existing political economy. See Skrobiszewski, F (2012), ‘Market Making: How Enterprise Funds can jump start stagnant economies’, Innovations, Vol 7/2 Cambridge MA, USA, pp 33-60. Francis Skrobiszewski led an initiative in post-Berlin Wall Poland that used the existing institutional structures to leverage financial intermediation and investment.


94 https://www.climatebonds.net/about

95 This mechanism would enhance for example to work of the National Contact Point mechanism which serves to assess and remedy specific instances of non-compliance of the OECD’s MNE Guidelines (2011).


100 Contribution by the IFC Africa Programme.
The report also acknowledges that metrics for ex-post evaluations and investment tracking may be quicker to develop than a labelling scheme. The SDG indicators framework suggests the possible scope of such evaluations.


The Fragility Assessment is a perception based analytical tool used to foster a periodic assessment by a country of its own state of fragility, based on a wide stakeholder consultation process. It is intended to serve as the basis for national planning and the development of a compact, locking in providers of development assistance to a nationally agreed plan. See International Dialogue on Peacebuilding and Statebuilding (2014), Guidance Note on Fragility Assessment, https://www.pbsbdialogue.org/en/new-deal/new-deal-principles/ and https://www.pbsbdialogue.org/media/filer_public/d8/ae/d8ae82f3-1370-48d2-9e6e-ccd0337ad4a84/new_deal_fragility_assessment_guidance_2014.pdf

The paper acknowledges that there are many impediments to attracting and retaining investment in FCS. These are not elaborated on in and addressed by this paper. See Annex B for a definition of risks.

This paper is part of an International Dialogue project to promote ‘More and Better Private Sector Development and Investment in Fragile and Conflict Affected States’, as part of its ambition to create a ‘New Deal’ for the Private Sector, i.e. to share its core principles for support to peacebuilding and statebuilding in FCS with the private sector.

For information on responsible business in fragile environments, see https://www.pbsbdialogue.org/media/filer_public/6f/96/6f96d1ad45bb-48ae-8614-8d84d6f7b2e9/id-rbc.pdf

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