Re-Imagining Traditional Finance for India's COVID Recovery

Regulatory Enablers for Mainstreaming Innovative Finance


Credits: Deepak Malik/UNDP India


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by
SDG Finance Facility
2030 Water Resources Group, Impact Investors Council & Nishith Desai Associates

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The SDG Finance Facility is a multi-stakeholder platform that supports the incubation and design of innovative financial instruments, aligned with the Sustainable Development Goals (**"SDGs"**), to crowd-in additional capital to address the key development challenges in India. It also works to strengthen the sustainable finance market architecture in India and supports the development of innovative finance through actionable research and strategic partnerships. The SDG Finance Facility is anchored by UNDP with support from the Swiss Agency for Development and Cooperation.

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The Impact Investors Council ("**IIC**") is India's pre-eminent member-based not-for-profit industry body set up to strengthen Impact Investing in the country. IIC's key areas of activity and effort include investor outreach, policy advocacy, research and publications in addition to a strong focus on impact measurement and management. We are supported by 50+ investors and ecosystem partners including Aavishkaar Group, Omidyar Network, Michael and Susan Dell Foundation, Elevar Equity, Caspian Investment Advisors, USAID amongst others.

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The 2030 Water Resources Group ("**2030 WRG**") is a public-private-civil society platform, conceived in the World Economic Forum in 2008, and hosted by the World Bank's Water Global Practice since 2018. 2030 WRG helps countries achieve water security by facilitating collective action between government, the private sector, and civil society, with government firmly in the lead and offers technical support for the design and implementation of policies, programmes, financing instruments, and projects that improve water resilience, transform value chains and promote a circular water economy through innovative approaches. 2030 WRG's mandate is in line with the United Nations' SDG 6, which aims to ensure safe water and sanitation for people, ecosystems, and the economy through SDG 17 on partnerships for the goals by 2030 through SDG 17 for partnerships for the goals. 2030 WRG is active in 11 countries including India where it works in partnership with the state governments of Maharashtra, Karnataka, Uttar Pradesh and Madhya Pradesh, through a Water Multi-Stakeholders platform.

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Nishith Desai Associates ("**NDA**") has the reputation of being one of Asia's most innovative law firms and the go-to specialists for investors and philanthropies around the world, looking to conduct businesses in India. We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bangalore, Singapore, New Delhi, Munich and New York. NDA advises several impact investors and philanthropies, including structuring impact bonds and setting up of impact funds. NDA has been invited to present on Impact Investment and Corporate Social Responsibility ("**CSR**") at an academic conference organized by the University of Lund. Our recent probono project on "India Impact Investing Guide", has been recently nominated for the TrustLaw Impact Award, 2020 which "recognises projects that demonstrate significant impact for a Non-Governmental Organization ("**NGO**") or social enterprise, their community and beyond".

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Disclaimer

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Glossary

ADB	Asian Development Bank
AIF	Alternative Investment Fund
BMZ	Federal Ministry of Economic Cooperation and Development, Germany
COVID-19	Coronavirus Disease
CSR	Corporate Social Responsibility
DDUGKY	Deen Dayal Upadhyay Grameen Kaushal Yojana
DFI	Development Finance Institution
ECB	External Commercial Borrowing
EU	European Union
FCRA	Foreign Contribution Regulation Act, 2010
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act, 1999
FPI	Foreign Portfolio Investment
GAVI	Gavi, The Vaccine Alliance
GDP	Gross Domestic Product
GoI	Government of India
GST	Goods and Services Tax
IFAD	International Fund for Agricultural Development
IFFIm	International Finance Facility for Immunisation
IIC	Impact Investors Council
ILO	International Labour Organization
IMF	International Monetary Fund
INR	Indian Rupees
IP	Intellectual Property
ITA	Income-Tax Act, 1961
KfW	Kreditanstalt Fuer Wiederaufbau (German Development Bank)
LIC	Low-Income Country
LLP	Limited Liability Partnership
MGNREGS	Mahatma Gandhi National Rural Employment Guarantee Scheme
MFI	Microfinance Institution
MHA	Ministry of Home Affairs
MSDE	Ministry of Skill Development and Entrepreneurship
MSME	Micro, Small and Medium Enterprise
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Financial Company
NDA	Nishith Desai Associates
NGO	Non-Governmental Organization
NPA	Non-performing Asset
NSDC	National Skill Development Cooperation
OECD	Organization for Economic Cooperation and Development
PM CARES Fund	Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund
PRI	Programme Related Investment
PSL	Priority Sector Lending
RBI	Reserve Bank of India
RI	Risk Investor
SDG	Sustainable Development Goal
SEBI	Securities and Exchange Board of India
SECO	Switzerland's State Secretariat for Economic Affairs
SPV	Special Purpose Vehicle
SVF	Social Venture Fund
UNCDF	United Nations Capital Development Fund
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
USD	United States Dollar
VC	Venture Capital
WHR	Warehouse Receipts
2030 WRG	2030 Water Resources Group hosted by the World Bank

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Executive Summary

Impact of COVID-19

COVID-19 is an unprecedented health and development crisis, threatening development gains and exacerbating social and economic inequalities around the world. The efforts required to contain its spread by curtailing movement to limit exposure have severely impacted lives and livelihoods and stalled economic activity. As a consequence, informal workers, people who are on the fringes, and those living in poverty are highly vulnerable to falling into poverty or facing deepening poverty.

According to United Nations Economic and Social Commission for Asia and the Pacific ("UNESCAP"), South Asian economies are likely to shrink for the first time in four decades. In India, the financial impact of the pandemic has been significant with GDP declining to a historic 7.7% in 2020-21 and expected to be further impacted due to the second wave of the COVID-19 virus.[1] Stagnation in business activities, increased unemployment levels, losses for small and marginal farmers, disruption in operations of MSMEs and exodus of migrant workers were some of the direct impacts of the pandemic. India's impressive progress in reducing poverty, lifting 271 million people out of multidimensional poverty between 2006 and 2016 threatens to be reversed due to the pandemic.

Current stimulus by Govt of India and need for commercial capital

The Government of India ("GoI") has taken multiple proactive actions to provide care and treatment, support economic relief and ensure delivery of basic services and essential commodities. Eleven empowered committees have been formed under the Leadership of the Prime Minister to oversee India's response to COVID-19. The Atmanirbhar Bharat Abhiyan packages which has committed Government fiscal and monetary resources up to USD 412 billion[2], across areas including agriculture, SMEs and livelihoods is amongst the largest relief packages by a developing country.

In addition to the support packages, the Union and State Governments have since announced further steps to stimulate economic growth and recovery.

In addition to the Government's efforts, corporates, development finance institutions ("DFIs") and other civil society actors have also significantly contributed to COVID relief measures. MSMEs and those in the agriculture sector require financing that is available at a low cost, and allows repayment as economic activity improves. Identifying different measures for supporting immediate employment generation in rural and urban areas is also the need of the hour.

While significant amount of capital has been deployed by the Government, the extent of the impact due to COVID-19 demands tapping into additional sources of finance. Commercial mainstream capital can fill this funding gap, provided opportunities are appropriately structured and the risk return profile is aligned. Grants or charitable funds can be used in innovative ways to de-risk investments by commercial capital and direct it towards specific social and development objectives.

Attracting commercial capital through blended finance

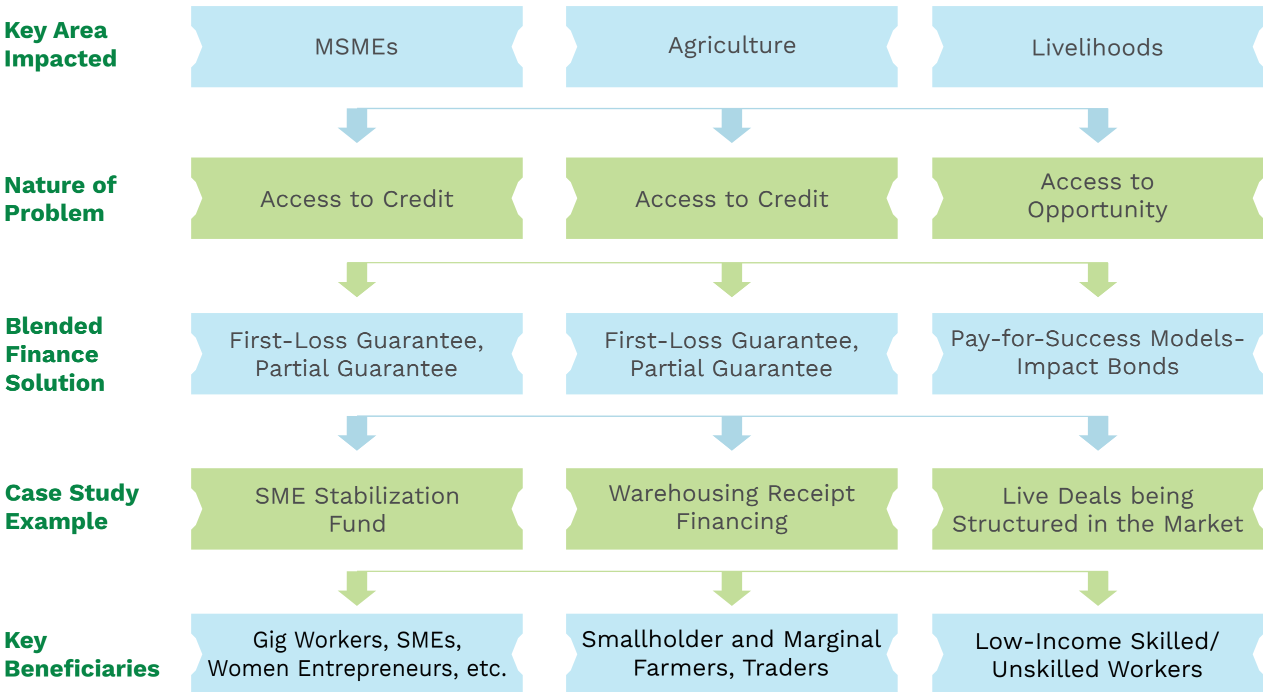
Blended finance involves using philanthropic or concessionary funds to de-risk investments in order to attract commercial capital. This catalytic approach leads to a leveraging effect where every rupee of grant money deployed attracts many multiples of commercial capital. From an impact lens, such capital is often directed towards a social or economic impact objective. Globally, there are several examples of recently successful blended finance transactions that have attracted over USD 1 billion towards development objectives[3]. In aggregate, it is estimated that blended finance has mobilized approximately USD 144 billion in capital towards sustainable development in developing countries to date[4].

Actionable solutions

Bringing together global experiences and opportunities in India, this report looks at adapting blended financing principles in the Indian context and lays out several actionable solutions that leverage philanthropic funds to attract commercial capital. In specific, it highlights two financial structures – guarantee models and pay for success impact bond models that can be used to mobilise capital across a wide range of sectors to address development challenges. The proposed solutions; outcome funding impact bond model and guarantee model to attract low-cost capital have also been discussed in the recommendations for the Social Stock Exchange in India by the Securities and Exchange Board of India ("SEBI")-appointed High Level Committee. This report dwells deeper into these structures and makes recommendations on practical challenges that need to be addressed.

The solutions are based on live projects initiated by SDG Finance Facility, 2030 WRG hosted by the World Bank, IIC and others, which are currently being structured and can be commercially viable. These actionable structures will help mitigate the damage caused by the Pandemic to gig workers, farmers, women entrepreneurs, Small and Medium Enterprises ("SMEs"), low-skilled workers and consumers. While emphasis of the outlined examples is around critical sectors such as MSMEs, livelihoods and agriculture, the underlying financial models can be applied to other areas as well. A non-exhaustive list of actionable solutions tailored to specific needs has been set out below as an illustration.

Figure 1: Financing India's COVID-19 recovery for revival of small businesses, agriculture and livelihoods



Potential to unlock capital from commercial investors and philanthropic donors via blended finance transactions to provide credit to small businesses, farmers and new opportunities to low-income population to earn a liveihood.

Complex legal framework that prevents blending

While commercially viable, these blended financing solutions have been difficult to implement despite significant interest by stakeholders due to a number of legal, regulatory and tax hurdles. The conservative legal ecosystem in general is geared towards preventing the intermixing of private capital with philanthropic capital. The legal system strictly separates the activities of entities into either for-profit or as not-for-profit. As a result, for-profit and non-profit activities exist within two parallel legal ecosystems and it is difficult for them to interact with ease or combine efforts towards developmental objectives in innovative ways. For instance, unlike the Programme Related Investment ("PRI") laws in the USA, non-profits in India cannot make investments into activities that are considered charitable as the concept of a return is associated with an investment. On the other end, for-profits cannot receive grants without difficulties and tax inefficiencies that make it practically unfeasible for such social enterprises to tap funding which is aligned with their social intent.

While the detailed areas of consideration are in the annexure to this report, a summary of the key points and the change they target are as follows:

SEBI (Alternative Investment Funds ("**AIF**")) Regulations, 2012	SVFs could be allowed to give loans directly to non-profit and for-profit entities that are social enterprises. Regulations could allow for direct payments back to unit holders using funds received by the Social Venture Fund ("SVF") from any source, including grants from outcome funders/charities
CSR Rules, 2014	CSR rules could expressly allow boards to have a multi-year spending plan where CSR can be deployed as a bullet payment at the end of the project up to 3 years in the future. Distinction could be made between an outcome funding grant and an outcome funding service fee, including the accounting and tax treatments
Income-Tax Act, 1961 ("**ITA**")	Level playing field could be created for for-profits and non-profits in the charitable activities space. Designing laws that do not create an arbitrage between for-profits and non-profits when they are engaged in charitable activities could be considered. Conducting charitable work should ideally be equally and easily possible using either form of entity Treatment of various receipts such as grants or service fees could be as entity neutral as possible. Restrictions and lack of clarity with respect to certain provisions that impact the treatment of monies as either grant or service fees should be considered to be resolved Consider allowing charities to be able to invest into commercial instruments of social enterprises and seek return of capital and limited returns, provided all proceeds are further deployed for charitable activities For-profit entities could be allowed to receive grants when undertaking charitable work, and such grants may not be treated as income from other sources. However, such grants may be taxed as regular business income, subject to applicable deductions Charities could be allowed to participate as junior debtors in first-loss guarantee arrangements, as set out in this report, provided charitable money is leveraged and commercial capital is deployed towards charitable activities such as provision of low-cost loans
Goods and Services Tax ("**GST**"), 2017	Services by or to a domestic charity could be zero rated or exempt from GST
Foreign Contribution Regulation Act ("**FCRA**"), 2010	The Ministry of Home Affairs ("MHA") has recently tightened FCRA regulations with a view to prevent any misuse of funds. MHA may consider introducing suitable relaxations with a view to enable blended finance transactions more generally, subject to any additional reporting requirements with respect to spending to ensure it is not misused Addtionally, keeping in mind the concerns around the misuse of funds, projects which involve Government collaboration, MHA may consider approving usage of FCRA funds through a mechanism similar to the prior permission route under FCRA currently. Where another branch of the Government is involved, possibly the risk of misuse is significantly lesser

Evolving with the times and moving forward

The Government of India over the years has taken various steps to promote philanthropy, CSR and enabling availability of low cost capital to the marginalized and vulnerable populations. Promotion of low cost credit through numerous guarantee schemes for farmers and MSMEs has been a commonly used tool by Ministries to ensure availabilty of capital. Beyond these direct schemes, the government has also taken various measures to streghten the CSR sector and encourage philanthropic giving. For instance the recently announced amendments to the CSR law in 2021, have emphasized that corporates should focus on the impact they create and allowed roll over of capital for a three year period which gives more flexibility to create long term sustainable impact. Further, other amendments to the Income Tax Act have also helped charities take loans without the worry of being non-compliant with the legal requirement of charitable spending.

While these are steps in the right direction, to experiment and address a number of challenges that are associated with the structuring of different models in this space, the report suggests the creation of a "regulatory sandbox" for blended finance transactions under the guidance of the Government.

This would allow for a conducive environment to innovate and understand blended finance structures in detail while preventing misuse of funds. Private sector stakeholders would get a chance to explore how they can contribute towards scaling blended finance solutions within a mutually agreeable regulatory framework. It would also instill confidence among regulators on how to put in place the guard-rails that would define the broad scope for a favourable blended finance regulatory landscape.

As demonstrated later in this report, there are ways to re-imagine the use of grant money, make charitable work more impactful and augment Government's developmental efforts. The specific models outlined in Section 2 may over a period of time, help accumulate a pool of funds that can be rapidly deployed towards development initiatives, disaster management and critical challenges like climate change. It could also open a pipeline of capital for COVID-19 impacted sectors. Simplifying and clarifying laws to enable blended finance transactions would enhance responsiveness of private and non-governmental actors, allowing for quick implementation of innovative financing solutions to address evolving crises, thereby building more resilience within the economy.

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Section 1:
Introduction

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Gaganjit Singh/UNDP India

Introduction

1.1 Impact of COVID-19 globally and in India

COVID-19 ("the Pandemic") has not just caused a global health and human development crisis but has also taken a significant social and economic toll around the world. Developing countries are expected to be hit the hardest. According to United Nations Economic and Social Commission for Asia and the Pacific ("UNESCAP"), South Asian economies are likely to shrink for the first time in four decades. Globally, unemployment has risen and people have lost access to education, basic food security and nutrition in many cases. This is coupled with the issue of under-resourced, under-staffed hospitals and inadequate public infrastructure which are increasingly overwhelmed by the impact of the Pandemic. The International Labour Organization ("ILO") estimates that approximately 1.6 billion workers in the informal economy i.e., 76 percent of the global workforce are at the risk of livelihood loss.[5]

In India, the financial impact of the pandemic has been significant with GDP declining to historic 7.7% in 2020-21.[6] Stagnation in business activities, increased unemployment levels, losses for small and marginal farmers, disruption in operations of MSMEs and exodus of migrant workers were some of the direct impacts of the pandemic. India's impressive progress in reducing poverty, lifting 271 million people out of multidimensional poverty between 2006 and 2016 threatens to be reversed due to the pandemic. The informal sector which accounts for more than 85 percent of the workforce, including tens of millions of migrant workers, was badly affected. A protracted crisis will also stall efforts to improve female labour force participation.Micro, Small and Medium Enterprises ("MSMEs") and farmers, a majority of whom are marginal, struggled to get access to traditional sources of finance. The disruption caused by the Pandemic made it harder for them to pay labourers/employees and fixed overheads. Together, MSMEs and the agriculture sector account for 45 percent of India's Gross Domestic Product ("GDP") and provide livelihoods to hundreds of millions, including vulnerable and marginalized groups. Over the course of the Pandemic, millions of urban migrants have returned to their villages, which offered limited employment prospects. This reverse migration is expected to create further hardship for smallholder farmers with remittances drying up and livelihoods of the increasing number of farmers depending on the same farmland.

However, the Government of India has taken several steps to revive economic growth.

The Atmanirbhar Bharat Abhiyan packages which has committed Government fiscal and monetary resources up to USD 412 billion[7] , across areas including agriculture, SMEs and livelihoods is amongst the largest relief packages by a developing country.[8] A number of schemes, fiscal incentives, tax breaks, and policies changes have been made rapidly over the last year to cope with the impact of the pandemic.

This is in line with Governments around the world who have pledged trillions of dollars to keep their economies afloat. Major economies such as China, Japan, UK and USA have unveiled multibillion-dollar rescue packages with unemployment benefits, loans for small businesses and direct payments to citizens.

1.2 Role of private capital in complementing government recovery measures

While the government is making tremendous efforts, the impact of the second wave of COVID-19 has created significant negative impacts, that can be addressed by collective action from the public and private sector along with civil society. There still exists various pockets of marginalized communities who need specific care and attention to tide over the crisis. Agricultural small holder farmers, small and medium businesses, and livelihoods opportunities for migrant workers, women, are amongst some of the areas that require additional support to ensure India achieves its SDG targets as the nation recovers from the pandemic.

Over the last few years, private commercial capital has contributed towards various social welfare projects in the country. Trends such as the flow of institutional capital towards the green bonds market for promoting sustainable eco-friendly investments, boom of the microfinance industry enhancing financial inclusion, and the more recent rise in the impact investment industry in India to support social enterprises delivering goods and services to low-income consumers have shown the large-scale impact commercial capital can have in advancing development goals.

In the wake of the Pandemic, apart from the significant government interventions, DFIs, aid agencies, CSR and other charitable contributions have attempted to mitigate the damage caused. A number of venture capital firms such as Sequoia India, Accel Partners, Lightspeed Ventures Partners, SAIF Partners, Matrix Partners, Nexus Venture Partners, Kalaari Capital and others have raised USD 132 million to leverage technology for scalable initiatives to fight against the Pandemic.[9] The World Bank approved USD 2 billion for 'Accelerating India's COVID-19 Social Protection Response Programme' to support India's efforts for providing social assistance to the poor and vulnerable households, severely impacted by the Pandemic.[10] UN agencies including UNDP have also launched a number of initiatives such as assisting the Ministry of Health on various COVID-19 related healthcare measures, supporting state governments in managing returnee migrants, providing social protection and access to the Government’s COVID relief support and Rural Employment Schemes. India Inc has contributed generously toward COVID relief measures through its CSR budgets (~80%) being directed towards PM CARES Fund, other relief funds, distribution of food, masks, personal protective equipment for healthcare workers, and relief material to the needy.[11]

Credits: UNDP India

1.3 Utilising blended finance principles to attract commercial capital

Building upon the momentum of support from the private sector to bolster government initiatives for the marginalized communities and build resilience to future shocks, it is imperative to create new pathways through which more private capital can be accessed for development projects.

A useful approach that can be utilized for enhancing the flow of commercial capital for development projects is based on the principles of blended finance which promotes the leveraging of concessional funds from donors and/or governments to draw in commercial capital. In blended finance transactions, philanthropic or grant funds are typically used to mitigate specific investment risks and rebalance the risk-reward profiles of pioneering, high-impact investments that would otherwise be deemed too risky to fund. These deals allow government and development agencies to address market failures without the need to entirely utilize public or philanthropic funds. Integral components of blended finance deals include tracking of the 'additionality' that would be created by the presence of subsidized capital and ensuring the amount of concessional capital minimal.

Key principles of blended finance

Blended finance promises substantial additional gains for all parties, especially to the ultimate beneficiaries such as farmers or workers. The key principles issued by OECD include[12]:

Principle 1

All blended finance activities should be tied to a development goal

Principle 2

Blended finance should increase the mobilization of commercial finance

Principle 3

Tailor blended finance to local context

Principle 4

Focus on effective partnering for blended finance

Principle 5

Monitor blended finance for transparency and results

While traditionally grant money has been seen as expenditure towards charitable activities, it has been re-imagined in other countries and deployed in an innovative manner via blended finance transactions to attract commercial capital. For instance, USA enables philanthropic foundations to not only make grants but also invest (in the form of a loan, equity or guarantee) in solutions that address development challenges through Programme Related Investments ("PRIs").[13]

This has been a useful tool for foundations to complement traditional grant making and invest their monies in projects that deliver both financial and social returns. It has enabled large foundations such as the Bill and Melinda Gates Foundation, Rockefeller Foundation and Ford Foundation to bridge the risk appetite gap and subsidize financial risk through grants or forms of low-cost returnable capital to direct commercial capital to development initiatives.[14]

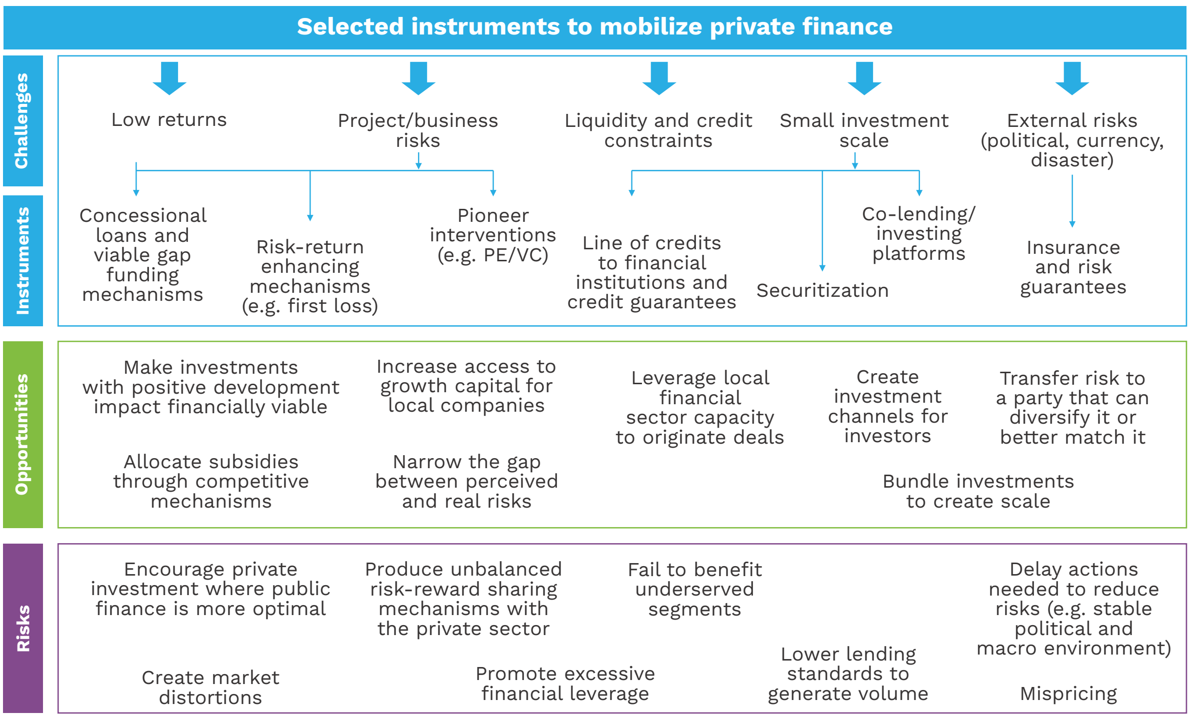
1.4 Types of blended finance instruments

Common examples of blended finance mechanics include guarantee structures, concessional debt and equity, insurance and outcome funding models. Within the philanthropic sector, different sources of funds from foundations, DFIs and CSR allocations can be used for solving market failures that limit the use of private capital. The choice of instrument is influenced by the sector, type of transaction, country circumstances and the fundamental obstruction to private sector investment.[15]

As an example, foundation capital can be used to provide first-loss guarantees on behalf of social enterprises to protect investors against losses, improve the financing costs and enhance the liquidity of local financial institutions. Foundations can also experiment with the setting up of revolving fund facilities that allow philanthropists to recycle funds and support multiple enterprises/organizations with the same base of capital. Other avenues include the provision of concessional capital that targets below market returns in the form of junior equity or debt. This can be directed towards augmenting the credit profile of transactions which aims to help create or reach underserved market segments. DFIs can help investors and banks achieve scale and volume for impact-focused deals while reducing transaction costs through syndicated loan programmes.[16] As a part of the programme, lenders are aggregated to spread the risk and share in the financial opportunity across a diversified investment portfolio. On the CSR front, to make capital more results-oriented, outcome funding contracts can be structured. These are especially useful at a time when grant capital is limited in the market and resources have to be allocated amongst multiple competing and equally important projects. Instruments such as impact bonds based on the principles of outcome funding contracts crowd-in private risk capital to fund programmes upfront and give room to philanthropies to provide grant funding only on achievement of desired outcomes.

Some of these structures such as the guarantee model and pay for success impact bond model has also been elucidated in the report by the High Level Committee appointed by SEBI on the way forward for the Social Stock Exchange in India. A number of transctions based on the guarantee model and a few on the impact bond model have been piloted in the Indian landscape. However, there still exists potential to scale these instruments for application across sectors to ensure social impact is delivered in a cost effective, scalable and sustainable manner.

Figure 2: Schematic overview of instruments to mobilize private finance



Source:
United Nations, 2020. Financing for Sustainable Development Report 2020 [online].
Available at: https://developmentfinance.un.org/sites/developmentfinance.un.org/files/FSDR_2020.pdf

1.5 Advantages of blended finance transactions

With falling income of individuals and declining profits of corporates, the amount of traditional grant capital in the coming years may become limited. Reports indicate funding for traditional CSR activities in India could be reduced by 30–60 percent.[17] Therefore, while traditionally grant money would be in short supply, there is mounting pressure to demonstrate more impact using limited funds/resources. Using grant money to leverage private capital would have a catalytic effect when strategically used, with impacts potentially multiplied by the amount of private capital leveraged by grant money. The additional advantage is that the grant money decides the impact area towards which it is catalyzing capital or subsiding the risk. It ensures that commercial capital is mobilized for funding development measures that create meaningful long-term impact.

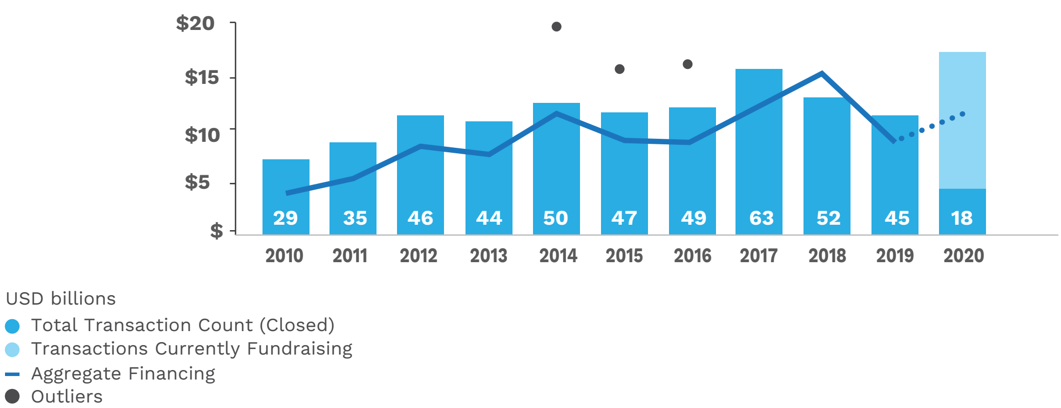
Blended finance transactions can also have a crowding-in effect where once new models are shown to be workable and successful, other commercial players also get involved in the space using similar models. This increases the total capital being deployed in those target areas considerably over a period of time. With the confluence of different types of partners collaborating on particular projects, blended finance transactions create a space for philanthropic donors and commercial investors to bolster opportunities that have shown early signs of success to scale. Traditionally, for any one particular stakeholder to grow a viable idea on its own would take much longer and involve relatively more resources.

1.6 Global success stories of blended finance

Blended finance products are not a new phenomenon and have been deployed in the past with notable success. OECD estimates private finance mobilized for development reached USD 205 billion between 2012 and 2018.[18]

Convergence, which tracks a global database of blended finance transactions has recorded over 3,700 deals which have mobilized an aggregate of USD 144 billion till date towards sustainable development in developing countries.[19]

Figure 3: Overall blended finance market (2010-2020)



Source:
Convergence, The State of Blended Finance 2020, Pg.14 [online].
Available at:https://www.convergence.finance/resource/1qEM02yBQxLftPVs4bWmMX/view!

Close to half of the deals are focused in Sub-Saharan Africa cutting across sectors such as energy, financial services and agriculture. Blended finance transactions have been frequently carried out in India, along with Kenya. The deal size varies from USD 110,000 to USD 8 billion, with the median being USD 64 million for deals between 2010–2018.[20]

Name	Size	Participants	Impact and description
REVIVE[21]	USD 6.85 million	Samhita, UNDP, Omidyar Network, USAID, Michael & Susan Dell Foundation	The platform aims to provide accessible and affordable capital in the form of grants, returnable grants and loans to previously employed or self-employed workers and at-risk nano and micro enterprises to either restart and sustain their work or find alternative business opportunities. REVIVE is working towards supporting 100,000 workers and enterprises with a preference given to youth and women.
Impact Assets COVID Response Fund[22]	USD 1 billion	Aims to make use of its network of over 5,000 partners, ranging from impact driven portfolio companies, fund managers and community banks	The Fund is a hybrid of charitable grants and commercial money and focuses on efforts to protect front-line workers, stop the spread of the virus and increase the supply of much-needed equipment; companies focused on critical areas like climate change and reducing inequality; and small businesses and individuals adversely affected by the downturn. A similar credit facility fund is set out in Section 3 of this report which would work in the Indian context, subject to changes in laws.
SANAD Fund for MSMEs[23]	>USD 300 million	KfW, Calvert Impact Capital, EU, BMZ, Finance in Motion, SECO, Development Bank of Austria	The SANAD fund works across 6 countries in the MENA region through 2 sub-funds, one for debt and the other for equity. In both, a junior tranche of shares are financed by donors taking on a first-loss guarantee and providing a risk cushion for senior investors. It has facilitated over USD 650 million in loans to MSMEs and low-income households across its target regions, and has invested over 15 million through equity.
SDG500[24]	USD 500 million	Bamboo Capital, EU, CARE, Alliance for a Green Revolution in Africa, UNCDF, IFAD, Stop TB Partnership, Smart Africa	A collection of 6 blended capital funds, working across the fields of education, health, agriculture, finance and energy. The fund provides investment scope of USD 360 million to investors and is protected by a cumulative first-loss tranche of USD 140 million.[25]

Name	Size	Participants	Impact and description
Facility for Energy Inclusion[26]	USD 500 million Targeted.[27] First close at USD 160 million in March 2020[28]	African Development Bank, EU Comission, NorFund, Clean Tech Fund, KfW	A debt financing facility for small-scale renewable energy access project. ADB's first blended finance fund for the energy sector.
International Finance Facility for Immunisation ("**IFFIm**")[29]	Bonds have raised over USD 6.1 billion against long-term pledges of USD 6.5 billion	Donors include UK, France, Italy, Australia, Norway, Spain, The Netherlands, Sweden, South Africa, Brazil	IFFIm's fund have helped Gavi, The Vaccine Alliance ("**GAVI**") vaccinate 80 million children between 2011–2019. Issues long-term vaccine bonds against long-term pledges by governments and donors that are used to repay bondholders. The proceeds are used to help fund the Global Vaccine Alliance. The Facility's method has been touted as one way to help reduce the cost of both developing and distributing a COVID vaccine.

Blended finance is therefore an actionable solution that can help bridge the investment gap for the SDGs and build back more sustainable and resilient systems. The next Section explains three ways in which blended finance principles can be adopted to solve issues in India, in critical sectors such as MSMEs and Agriculture along with broader ambit of Skilling and Livelihoods. The examples are based on live deal tranasactions that have seen interest in the market and are in the process and discussion amongst stakeholders. The underlying transaction structures – guarantee models and pay for success models can be used to address development challenges beyond the ones identified in the paper as well. The intent of this paper is to clearly explain the critical bottlenecks that are faced from multiple perspectives while structuring blended finance solutions and urge relevant government departments and ministries to create a favourable ecosystem that would accelerate the flow of capital via these structures for development outcomes. The insights regarding the structures have been gathered from detailed interactions with a range of stakeholders including domestic and foreign foudantions, DFIs, private institutional capital providers who in the past or at present, have faced roadblocks in implementing the financial structures.

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Given the current state of information reporting and sharing, it is not possible for this database to be fully comprehensive, but it is the best repository globally to understand blended finance scale and trends. Convergence continues to build out this database to draw better insights about the market and disseminates this information to the development and finance communities to improve the efficiency and effectiveness of blended finance to achieve the SDGs

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Credits: Gaganjit Singh/UNDP India

Section 2:
Actionable Blended Finance Structures

Actionable Blended Finance Structures

Credits: UNDP India

2.1 MSME and agriculture sector

The MSME and agriculture sectors are among the hardest hit by the Pandemic. Lack of finance and disruption in the value chain have been the key hurdles in addition, to shortage of labour due to reverse migration.The adverse impacts were felt on: (i) Harvesting and marketing of crops, (ii) Farm-gate prices, (iii) Labour supply and (iv) Market linkages, disrupting value chains and significantly eroding capital.

To revive growth of these sectors in India, there is a need to provide low-cost debt that can help business owners tide over these uncertainties. Complementary to various government schemes that have provided guarantees to farmers and farmer collectives to borrow money, a blended finance fund that provides low-cost debt can be a potential avenue to kick-start lending and spur growth of businesses

Loans against warehouse receipts

Loans against warehouse receipts ("WHR") received major impetus in India post the establishment of the Warehouse Development and Regulatory Authority in 2010, which introduced a negotiable warehouse receipt system. Lending against warehouse receipts is an asset backed loan under which a bank extends a loan (up to 70 percent of the value of the collateral) to the owner of commodities viz. farmers, traders, processing companies stored in a warehouse.

Warehouse Receipt Financing acts as working capital for the farmer, thereby increasing holding capacity and therefore better price realisation. As the prices are at their lowest during the harvesting period, WHR lending helps the farmers in avoiding sales of their produce at rock bottom prices. This assists farmers in increasing income, ensuring working capital availability for the next crop, funding for household expenses, reduced price volatility and easy participation in forward markets.

However, lending against WHR is currently concentrated to urban/semi-urban centres and accredited warehouses, and has associated costs related to collateral management agency, insurance and transportation. Models are scaling up WHR as one of the possible solutions for the agriculture sector as discussed below.

Models to address challenges for these sectors

To address the challenges for the MSME and agriculture sectors, the following proposed models can be deployed. While the first loan guarantee model is a commonly understood structure, it is suitable for a relatively small-scale transaction. The second model that leverages an SVF holds the potential to scale and attract large flows of money by introducing cost efficiencies in the structure. The SVF model can lead to crowding-in effect, thereby making way for even more philanthropic and private capital to flow into a sector.

Beneficiaries

MSME transaction: MSMEs, their employees, gig workers, women entrepreneurs, marginalized communities who receive low-cost loans and any risk on their defaults is borne by the charity that acts as first-loss provider, thereby de-risking it for the commercial investor. This brings down the cost of capital for the beneficiaries.

Warehouse receipt financing: Farmers who receive low-cost loans against warehousing receipts. This should allow for easier access to credit and prevent prices for agricultural products from crashing.

Case Study

MSME transaction: IIC along with several impact investors and philanthropies have capital lined up and products ready to be rolled into the market, subject to clarity on legal aspects.

Warehouse receipt financing: 2030 WRG, World Bank, of which the SDG Finance Facility platform is a contributor, has ideated this solution along with several blended finance products to solve for this issue and is in the process of bringing stakeholders together, subject to clarity on legal aspects. Discussions by the 2030 WRG Maharashtra Multi Stakeholder Platform's Taskforce on Alternative Financing till date have not been around the SVF structure but instead around the first-loss guarantee model (explained below). However, should this be legally viable, it would be a worthy option for consideration and deployment of funds in a scaled manner with large impact potential.

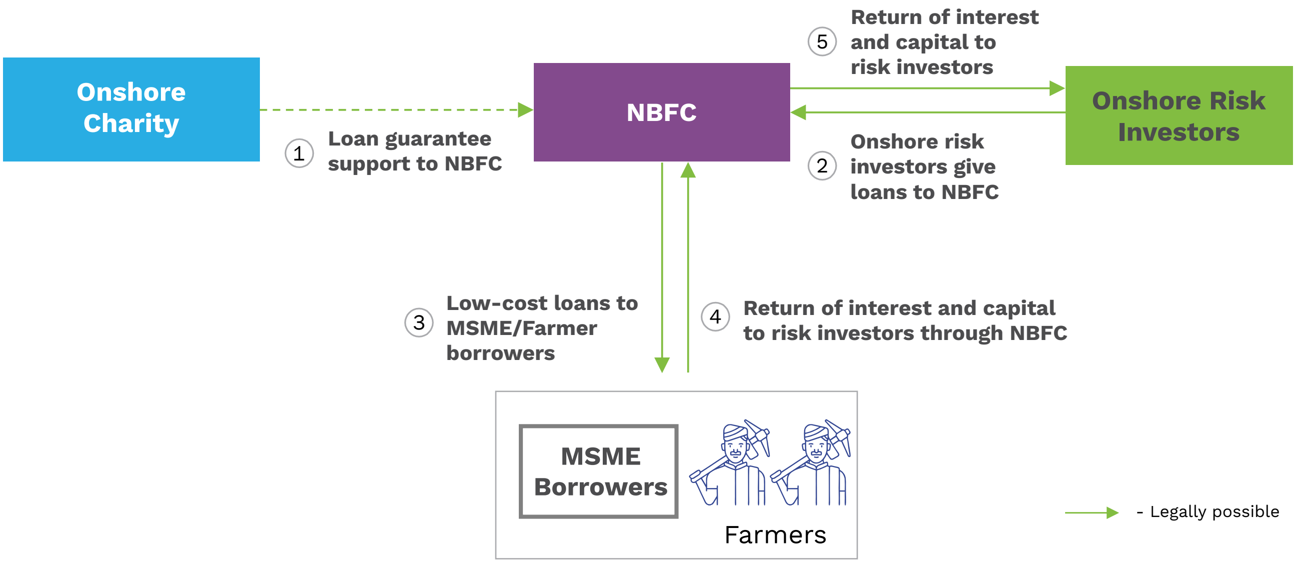
2.1.1 Model I. A: Mobilizing low-cost borrowing for micro, small and medium enterprises, and farmers

MSMEs and farmers need capital for their immediate needs, at a low cost and from a source that accepts repayment over a longer period of time. The loan guarantee model, set out below, helps to mobilize additional capital from commercial investors. The commercial investors are called "Risk Investors" ("RI") as they typically bear the risk of non-payment of capital or returns.

Under this model, an onshore charitable organization leverages its grant money and agrees to pay the NBFC partially or fully in case of default by the borrower. On the basis of this promise, the NBFC uses money raised from Risk Investors and provides loans at a lower interest rate since the cost of capital is reduced by way of grant money de-risking the transaction. This helps in leveraging grant capital and thereby, increases the availability of funds to the MSMEs or farmers and consequently creates exponential impact. The guarantee is only invoked in the case of non-payment by the beneficiary.

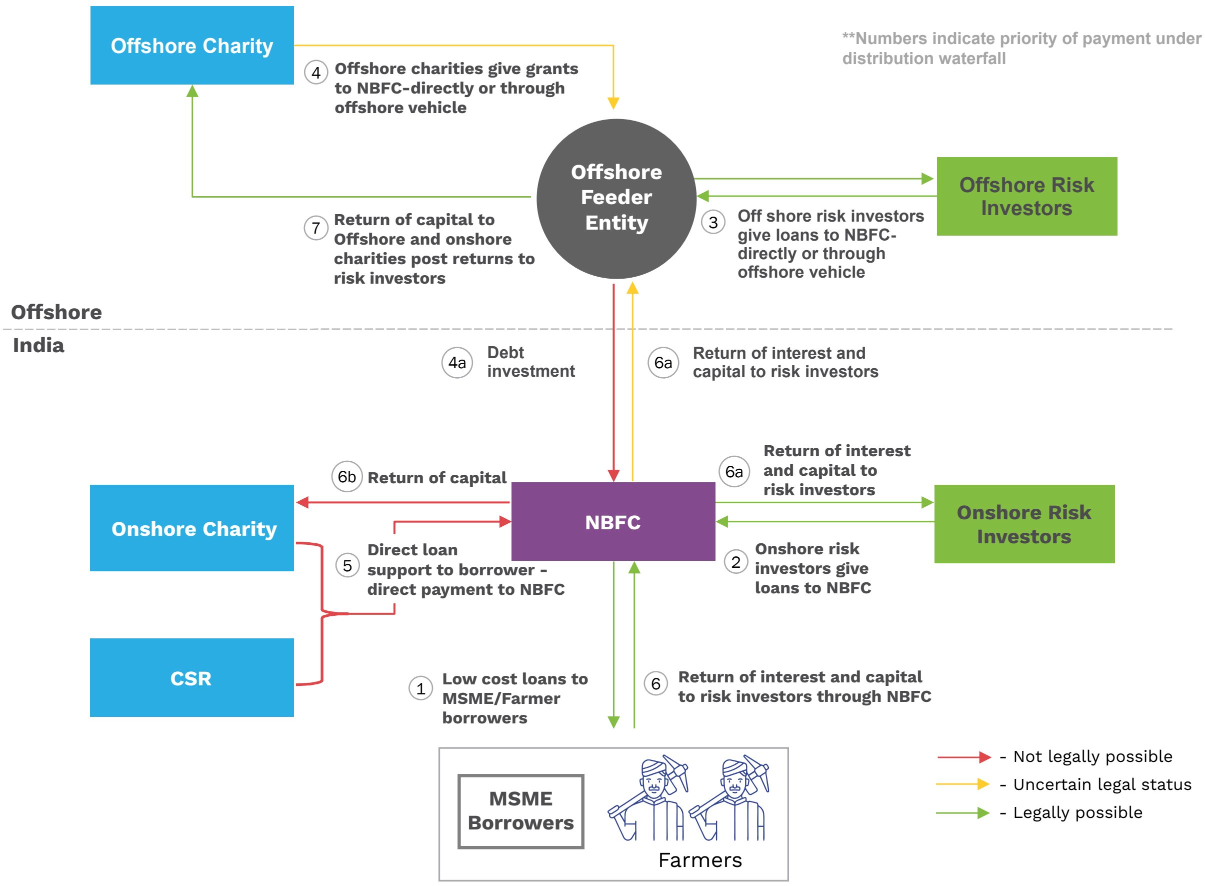
For instance, if a foundation has INR 100 to spend towards charitable purposes, it can either expense it out as a one time grant (creating impact worth INR 100) or use the capital as a first-loss guarantee to attract additional commercial capital (eg., creating impact worth INR 900, assuming there is 9x leverage to mobilize additional INR 900 from investors). In the latter model, the same base of INR 100 can leverage more funds to create a much larger impact relative to a traditional grant model.
Approximately one-third of blended finance transactions (35 percent) have used a development guarantee, and these transactions represent a total capital flow of USD 77 billion.[30]

Figure 4: First-loss guarantee/loan support model



Further, in an alternate model, the charity may also provide its grant capital to the NBFC to be deployed as low-cost loans. In such a case, it is also possible that if all the loans are repaid, the Charity receives its money back and such money can be used for charitable activities in the future. This structure depicted below illustrates the potential to scale the transaction through involvement of offshore participants and CSR funds.

Figure 5: First-loss guarantee/loan support model - Expanded



Key steps

1 The NBFC provides low-cost loans to MSMEs/ farmers.

2 Onshore risk investors deploy capital as loans to the NBFC.

3 Capital from offshore risk investors is pooled by an offshore feeder entity or directly given as loans to the NBFC.

4 Offshore charity deploys funds to the NBFC either through the offshore pooling vehicle or directly.

5 The onshore charitable organization/CSR entities deploy a small amount of capital to the NBFC and enter into a first-loss arrangement with the NBFC, which in turn provides loan support to the MSME borrowers.

6 On receipt of loan payments from MSMEs/farmers, the NBFC makes distributions to risk investors. The distribution waterfall is such that the risk investors are entitled to receive return on their capital first.

7 After distributions to the risk investors, the NBFC returns the capital to onshore charitable organizations directly or through the offshore feeder entity to the offshore charities, as applicable.

Illustrative key step-wise challenges

The transactions that are allowed under current law and are commercially viable have been marked as green. Transactions where it is not clear as to whether the law permits it or there are commercial challenges requiring a change in law are marked in yellow. Those transactions that are prohibited are marked in red. While we have set out some of the key challenges here for the sake of brevity, the more detailed set of issues are provided in Annexure. The challenges below are illustrative of the difficulty in achieving this structure.

Credits: Ishan Tankha/UNDP India

S. No.	Step	Issue(s)
01	**Step 3** Direct loans by offshore risk investors to NBFCs	» Direct loans by offshore risk investors are subject to conditionalities under the FPI and External Commercial Borrowings ("**ECBs**") frameworks: i) The minimum maturity period under the ECB regime ranges from 3 to 10 years depending on the end use; ii) FPI route require prior registrations » Obtaining an FPI registration and complying with a 3-year minimum maturity period, when the goal is to provide immediate liquidity during the period of the crisis, is not feasible » Therefore, in step 3, an offshore pooling vehicle may become necessary to pool offshore money, to provide flexibility to offshore investors to manage investment timelines. However, this increases transaction costs and partly addresses the challenge that mandates a minimum 3-year holding period
02	**Step 4** Offshore charities provide funding to NBFCs	» Grants from offshore charities are subject to FCRA restrictions where only entities that have an FCRA registration can receive offshore grants. FCRA registrations are not granted as a matter of practice to for-profit entities (in this case, an NBFC). That said, offshore charities cannot provide grants to NBFCs in India » It would not be therefore possible for NBFCs to take offshore grants and deploy it for further purposes
03	**Step 5** First-loss arrangement between onshore charitable organization/ CSR entities and NBFCs	» First-loss arrangements by charities have an unclear status under the ITA. There are concerns whether such an arrangement directly for a for-profit entity such as NBFC will qualify for the requirement of a charitable spend. If it is not a charitable spend, the charity risks losing its tax-exempt status » CSR can not be used in the current legal regime to provide first loss. In spirit, CSR was meant to be used for actual charitable expenses. This means that if the CSR paid the money as a grant to a farmer or MSME and then the farmer or MSME paid back the loan to the NBFC, that is acceptable under current laws. However, today, in a complex world, it is impossible to achieve this on a large scale due to the number of transactions, documents and compliances required. It would be easier to achieve the same result by enabling a direct first-loss payment by the CSR to the NBFC. As long as the same end result is achieved, it should not be viewed as a violation of the spirit of CSR
04	**Step 6** Return of capital to charitable organizations by NBFCs	» Repayment of grants to charities by NBFC, in situations where grant money is given by the charity to the NBFC for deployment as loans, would raise issues from a tax, accounting and Foreign Exchange Management Act, 1999 ("**FEMA**") perspective as the receipt of such grants may be seen as returns to the charity or as some form of investment that is prohibited under law today. Further, it is unusual for an NBFC today, to make grants to anyone and may raise accounting concerns for the NBFC. The lack of clarity and legal restrictions prevents it from being possible. This applies equally to both domestic (except for FEMA issues) and foreign charities

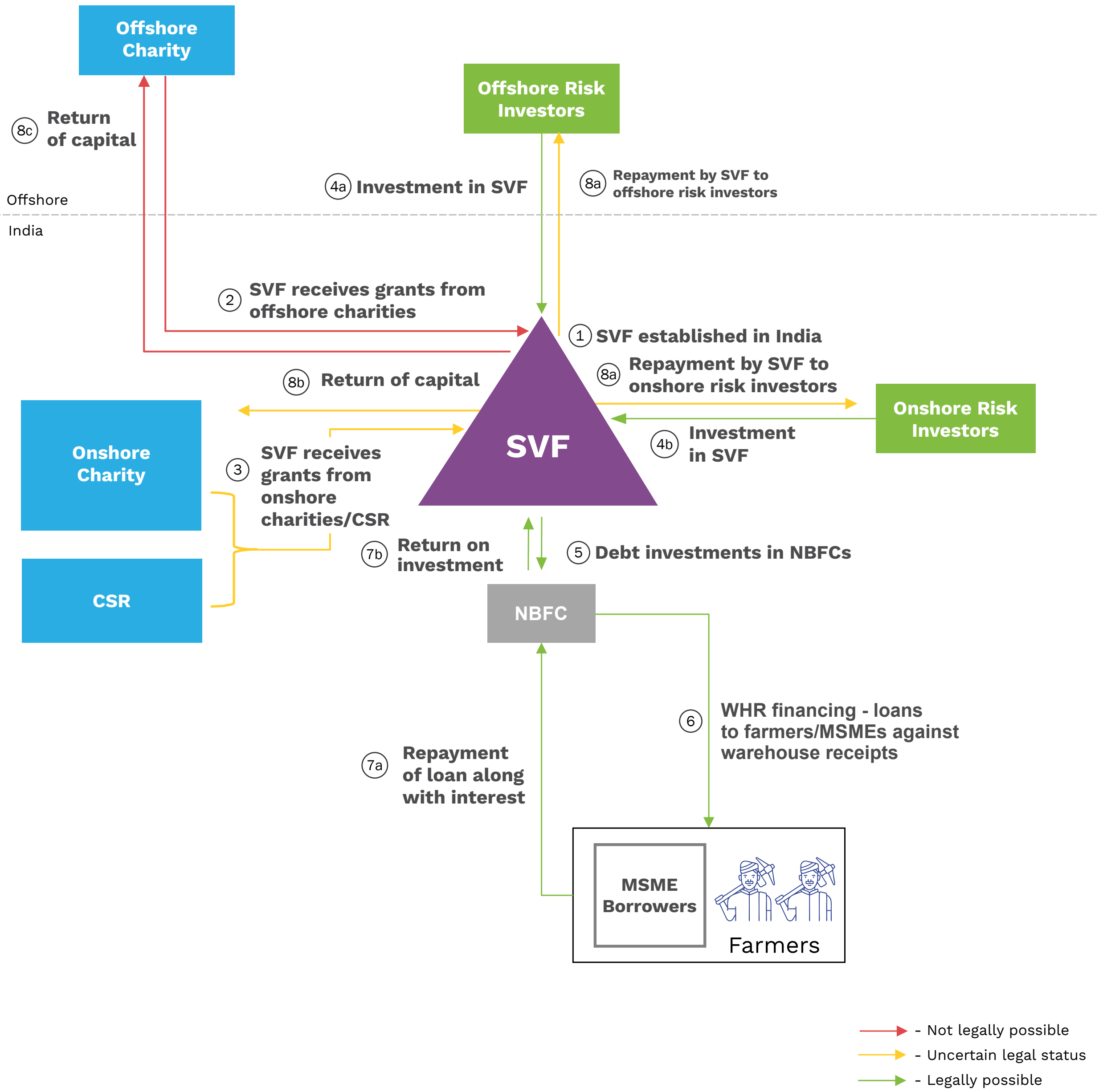
There are limitations to the scale of impact that can be achieved by the First-Loss Guarantee/Loan Support structure above. The nature of the structure is that involving several risk investors or charities in addition to beneficiaries increase the number of contracts that may need to be entered into, thereby creating practical operational challenges.

2.1.2 Model I. B: Social Venture Fund

While there are several ways to structure blended finance products to address this issue, the scale of impact and the size of capital attracted from funders can be improved dramatically if an SVF structure is adopted. The report therefore, discusses the potential of the SVF structure using MSME loans/WHR as a possible example or use case.

Using an SVF structure should not only unlock additional capital for the agriculture and MSME sectors but may also result in a crowding-in effect, thereby making way for even more philanthropic and private capital to be directed towards these sectors.

Figure 6: Social Venture Fund



Key steps

1. A SVF is established in India which pools money from onshore and offshore risk investors. The SVF also receives investments into its units from onshore and offshore risk investors. The risk investors are issued units and are eligible for normal return along with any returns.

2. SVF receives grants from offshore charities.

3. SVF receives grants from onshore charities/ CSR entities.

4. The SVF uses the pooled money to make debt investment in one or more NBFCs.

5. The NBFCs, in turn, provide loans to MSMEs/Farmer Producer Organization borrowers against warehouse receipts.

6. Returns from loans issued to MSMEs/farmers are paid to the NBFC, which in turn pays back the risk investors. If there are any losses, then the grant money paid by charities is used to compensate risk investors upto a certain limit.

7. If all money is recovered, the grants may be repaid to charities by the SVF.

Credits: Deepak Malik/UNDP India

Illustrative key step-wise challenges

The challenges below are illustrative of the difficulty in achieving this structure:

S. No.	Step	Issue(s)
01	**Step 2** SVF receives grants from offshore entities	» Grants from offshore charities are subject to FCRA restrictions where only entities that have an FCRA registration can receive offshore grants. FCRA registrations are not granted as a matter of practice to for-profit entities (in this case an AIF 1: SVF) » It would not be therefore possible to take offshore grants and provide them as low-cost loans or use it to repay losses to commercial risk investors in the event of non-payment
02	**Step 3** SVF receives grants from onshore entities/CSR entities	» Grants by charities to for-profits entities could be taxed as income from other sources, although there are some tribunal judgments that state similar receipts could be treated as non-taxable capital receipts. Charities are concerned that grants to private entities such as an SVF may not be considered as a charitable spend. If it is not a charitable spend, the charity risks losing its tax-exempt status
03	**Step 4** SVF invests into debt instruments of an NBFC	» SVFs under current law are not allowed to invest into debt instruments of entities
04	**Step 6** Repayment to offshore and onshore risk investor	» SVF regulations required 100 percent of the grants received to be invested into downstream entities. It may not be possible to use the grants received from charities to directly compensate the risk investors for their losses
05	**Step 7** Repayment of grants to charities by the SVF	» Repayment by SVF to the onshore charity may be problematic because this repaid money would be seen as a return on capital for the charity. This would imply that the charity has engaged in for-profit work which is not currently allowed by law » Repayment by SVF to the offshore charity may also prove difficult as the payment would have to be made from returns from the debt investment into the NBFC. As such, the returns from downstream investments are to be distributed to unit holders. However, the funds cannot be used to pay grants to offshore charities. Only funds received as grants can be further deployed as grants by the SVF under current laws

2.2 Model I. A: Mobilizing low-cost borrowing Skilling and Livelihood

While the Government has launched several programmes and initiatives, the Pandemic has created a unique challenge for the Government to not only accelerate economic growth but also ensure availability of sustainable livelihood options. To provide livelihood opportunities to workers who have lost their income due to the Pandemic, a number of up-skilling initiatives can be carried out in sectors such as healthcare where there is incremental need for manpower. Pay-for-success models wherein philanthropic funding is provided only on achievement of pre-agreed outcomes can be utilized to deliver successful skilling programmes.

Pay-for-success model and Impact Bond model

Under this model, private, philanthropic, government and CSR capital can be collectively utilized to achieve targeted outcomes. Impact bonds are a pay-for-performance contract wherein a risk investor provides up-front capital to a service provider (either a not-for-profit or for-profit entity) to achieve pre-defined social and development outcomes. In case the outcomes are met, the outcome funder, typically a philanthropic entity, provides the risk investor the principal amount along with a nominal return for underwriting the risk of performance of the service provider. In case outcomes are not met, the outcome funder does not provide any capital and the risk investor has to incur corresponding losses.

Outcome funders (governments/donors/philanthropists/CSR) are guaranteed that their funding is used judiciously. It emphasizes the accountability of every penny spent and eliminates wasteful expenditure. The service providers benefit from full flexibility and autonomy to use the proceeds in a manner most conducive to achieving pre-defined outcomes. In light of COVID-19, stretched fiscal budgets and strain on the Government's ability to immediately pump in additional capital for new relief measures, outcome funding models become all the more viable as they shift responsibility of deployment of initial up-front capital from the Government (as an outcome funder) to a risk investor. Private capital can deploy the up-front working capital to service providers for starting the interventions.

Globally, over 181 social impact bonds have been deployed by governments across countries such as UK, USA and others to address employment and social welfare related issues[31]. The Indian market has also seen activity in the last few years as development impact bonds (wherein the outcome funder is a non-government philanthropic entity) have been designed for primarily education and healthcare related interventions[32].

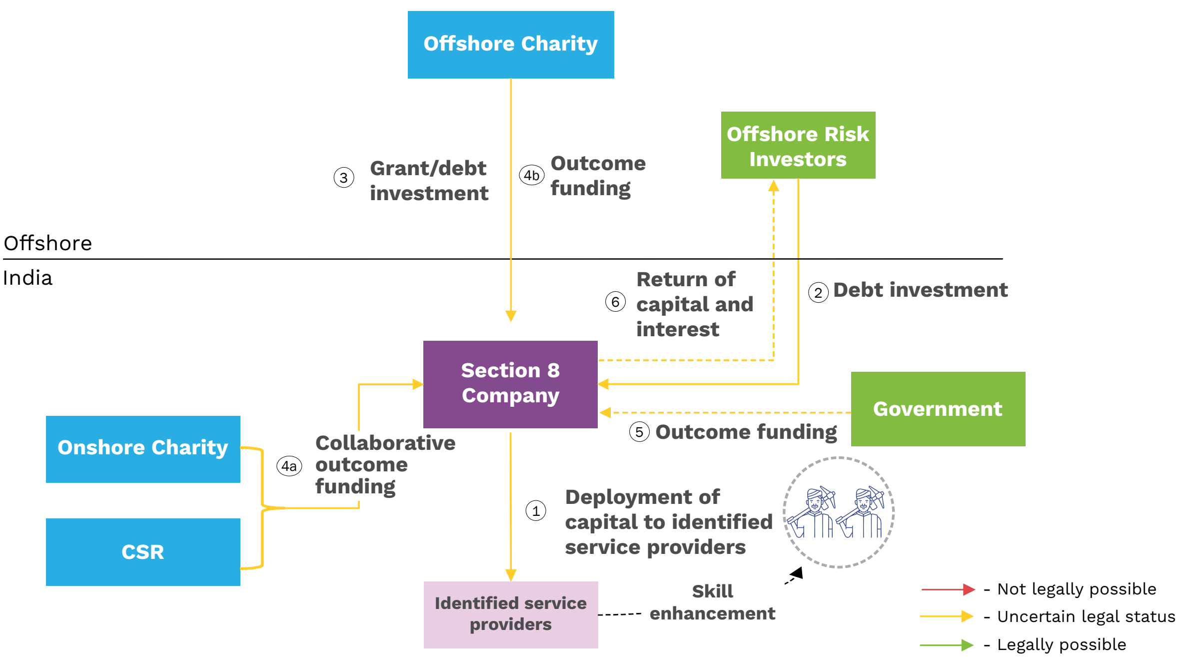
Beneficiaries

Gig workers, unemployed and low skilled or unskilled workers. They get skilling support that helps them become part of the workforce at the earliest and reclaim their livelihoods.

Case study

Over the past five years, the 'Skills for Jobs' programme has worked with various partners delivering technical assistance to build capacities, conceptualize new schemes, develop and strengthen operational systems and processes, working with central and state-level partners such as Ministry of Skill Development and Entrepreneurship ("**MSDE**"); National Skill Development Corporation ("**NSDC**"); Deen Dayal Upadhyay Grameen Kaushal Yojana ("**DDUGKY**"), Ministry of Rural Development; Handicrafts and Foods Sector Skills Councils; Jharkhand and Madhya Pradesh State Skill Development Missions; and with the private sector and other autonomous institutions both from UK and India. New projects are likely to be looking at innovative financing methods that make these structures easier and scalable.

Figure 7: Pay-for-success model



Key steps

1. A Section 8 company acts effectively like a special purpose vehicle ("**SPV**") through which all the funds and contracts are routed. This makes operations easier as well. The Section 8 company deploys the capital to identified service providers who provide training or skill enhancement courses to gig/migrant workers in order to open additional sources of livelihood for them.

2. Offshore risk investors make debt investment in Section 8 company in India.

3. Offshore charity makes risk investment into the Section 8 company either in the form of returnable grants or debt.

4. The outcome is usually pre-agreed between the service providers (could be for-profit or not-for-profit), risk investors and outcome funding providers. Upon achievement of the outcome by the service provider, the Section 8 receives outcome funding from offshore and onshore charitable organizations and CSR entities.

5. Upon achievement of the outcome by the service provider, the Section 8 receives outcome funding from the Government (in case where government is an outcome funder).

6. Section 8 company uses the outcome funding to discharge its obligation towards the offshore risk investors in form of interest payouts or returns the grant.

7. If outcomes are not met, then the outcome funder does not have to pay the capital or the interest to the risk investor and the loss is borne by the risk investor.

Illustrative key step-wise challenges

The challenges below are illustrative of the difficulty in achieving this structure under current laws:

S. No.	Step	Issue(s)
01	**Step 1** The Section 8 company deploys capital to identified service providers who provide training or skill enhancement courses to gig/migrant workers in order to open additional sources of livelihood for them. A Section 8 company acts effectively like an SPV through which all the funds and contracts are routed	» The extent to which Section 8 can engage third-party service providers, for providing skilling or training in this case, is unclear. If the Section 8 is an SPV for this structure, tax authorities may challenge its activities as being non-charitable if all the money is paid by it to third-party for-profit service providers
02	**Step 2** Offshore risk investors make debt investment in Section 8 company in India	» Due to tax and accounting challenges, Section 8 companies, while allowed under corporate laws, may not issue debt instruments. » This has been mitigated to some extent by recent changes introduced through the Finance Act, 2021 where the tax treatement of interest and loan repayments has been clarified. An express circular setting out the treatment of such payments in the larger context of outcome payment structures would provided much more comfort and confidence for stakeholders.
03	**Step 3** Offshore charity makes risk investment into the Section 8 company either in the form of returnable grants or debt	» Inward granting to section 8 by offshore charities is governed by FCRA restrictions where only entities that have an FCRA registration can receive offshore grants. FCRA registrations are not granted as a matter of practice to for-profit entities. It would not be therefore possible to take offshore grants and use them to pay for services of for-profit entities in the skilling space
04	**Step 4** The outcome is usually pre-agreed between the Section 8 company and the outcome funding providers. Upon achievement of the outcome by the service provider, the Section 8 receives outcome funding from offshore and onshore charitable organizations and CSR entities	» Challenge on account of onshore outcome funding: Clarification on whether this outcome funding contract will be a service contract or a conditional grant. The fact that there are severe conditions (e.g., achievement of the predefined outcome) attached to this transaction may not lend the transaction to be classified as a grant. Secondly, if the activity conducted under the contract is being viewed as 'private benefit', it may not be treated as a grant. On the other end, if the contract is treated as a service contract, the challenge is that there will be a GST implication and an income tax liability which will make the transaction commercially unviable. It should be kept in mind that ultimately, all these

S. No.	Step	Issue(s)
		are for the benefit of the beneficiaries and that such payments are tied to the achievement of beneficial outcomes. » Section 8 companies that receive CSR money may not be able to use them to pay back the interest and loan capital back to offshore risk investors as CSR money is typically expected to be deployed only for expenses of actuals in India. The focus should be on the substance of the transaction which is the impactful work being carried out on the ground in India. Any such payment to a foreign risk investor should be acceptable as such payment is possible under this construct only when impact is achieved within India. Therefore, it is a more efficient use of limited CSR funds » Further, CSR boards may have hesitation in entering outcome funding contracts as the contract requires a majority of the payment at the end of the contract tenure versus payment every year. Additionally, CSRs are not used to planning for a 'contingent event' (in this case, the event of an outcome being not met would lead to a case of no payment of outcomes). CSRs do roll over unspent capital but this is only in the case when any capital is leftover, this is not planned in advance
05	**Step 5** Upon achievement of the outcome by the service provider, the Section 8 receives outcome funding from the government	» Outcome funding by government in a specific structure such as this may be subject to tender process and government procurement rules when it comes to contracting with entities. Section 8 companies may not qualify for bidding criteria
06	**Step 6** Section 8 company uses the outcome funding to discharge its obligation towards the offshore risk investors in form of interest payouts or returns the grant	» Return of grant money or return of capital and loans may be in violation of income tax requirements with respect to spending requirements under law that state that the outcome funding money must be used for charitable activities within India. Further, there would be apprehensions as to whether such an act would qualify as a charitable spending by the Section 8
07	**Step 7** If outcomes are not met, then the outcome funder does not have to pay the capital or the interest to the risk investor and the loss is borne by the risk investor	» Clarification on whether a charity can carry forward the capital to the next year for a 'contingent' event (in this case the achievement of outcomes is not certain until the end). Charities by law today are allowed to carry forward money for planned activities. However, there is no past precedence of carrying forward for contingent activities » In case of outcomes not being met, the treatment of the unspent money left in the hands of the charity can be viewed as a violation of its commitment to spend 85 percent of annual receipts towards charitable activities

Sources:

[30]Convergence finance. 2020. The Use Of Guarantees In Blended Finance - Blog - Convergence News | Convergence. [online] Available at: <https://www.convergence.finance/news-and-events/news/5sx7ivKz7eNwZBlLNRfN87/view>

[31]Brookings Institution. 2020. Brookings Impact Bonds Snapshot – March 1, 2020. [online] Available at: https://www.brookings.edu/wp-content/uploads/2019/01/Global-Impact-Bonds-Snapshot-March-2020.pdf

[32]Impact bonds in India include : Education sector: Educate girls DIB, Quality Education India, the billion dollar India Education Outcome Fund, Healthcare: Utkrisht DIB, Agriculture: Lakhpati Kisan DIB

Credits: UNDP India

Credits: UNDP India

Section 3:

Creation of an Enabling Environment for Scaling the Proposed Blended Finance Solutions

Creation of an Enabling Environment for Scaling the Proposed Blended Finance Solutions

Credits: UNDP India

Blended finance can play an important role in the collective response from government, corporates and investors, primarily by accelerating the ability to enable economic reconstruction, thereby mitigating the adverse impacts of the Pandemic. The Pandemic has already resulted in deeper collaboration between various stakeholders.

Even if the specific models, set out in Section 3, are challenging to achieve in the immediate term, efforts to create an enabling and collaborative environment for the future are worthwhile, given the promise of blended finance transactions. Re-imagining grants and charity to help mobilize commercial capital would augment Government efforts significantly. It could act as a pool of money that can be rapidly deployed not only towards development initiatives but also for disaster management and other external shocks such as climate change, thereby building more resilience within the economy. As unprecedented shocks to the economy increase, preparedness and enabling mechanisms for quick recovery becomes increasingly important. De-regulation would enable rapid implementation of innovative financing solutions to address the evolving crises and enhance the speed of responsiveness of the private and non-governmental actors.

Despite the several advantages, blended finance transactions have typically not scaled or proliferated because of:

High cost of structuring:

Bespoke transactions that have to be constantly tailored and are expensive due to complex legal, regulatory, tax regime and key legal challenges as set out in Section 3 (in yellow and red within the diagrams).

Lack of templatized models:

Templatized models have not been created due to the inherent complexity in the laws while structuring fund flows between different sources of capital.

Lack of ease in merging different types of commercial and philanthropic capital:

Laws in principle seek to prevent mixing of various sources of capital which limits the ability to design blended finance structures.

While the detailed points for consideration are in the annexure to this report, a summary of the key legal considerations and the change they target are as follows:

Law	Key points for consideration
SEBI (Alternative Investment Funds ("**AIF**")) Regulations, 2012	» SVFs could be allowed to give loans directly to non-profit and for-profit entities that are social enterprises. Regulations could allow for direct payments back to unit holders using funds received by the Social Venture Fund ("SVF") from any source, including grants from outcome funders/charities
CSR Rules, 2014	» CSR rules could expressly allow boards to have a multi-year spending plan where CSR can be deployed as a bullet payment at the end of the project up to 3 years in the future. Distinction could be made between an outcome funding grant and an outcome funding service fee, including the accounting and tax treatments
Income-Tax Act, 1961 ("**ITA**")	» Level playing field could be created for for-profits and non-profits in the charitable activities space. Designing laws that do not create an arbitrage between for-profits and non-profits when they are engaged in charitable activities could be considered. Conducting charitable work should ideally be equally and easily possible using either form of entity » Treatment of various receipts such as grants or service fees could be as entity neutral as possible. Restrictions and lack of clarity with respect to certain provisions that impact the treatment of monies as either grant or service fees should be considered to be resolved » Consider allowing charities to be able to invest into commercial instruments of social enterprises and seek return of capital and limited returns, provided all proceeds are further deployed for charitable activities » For-profit entities could be allowed to receive grants when undertaking charitable work, and such grants may not be treated as income from other sources. However, such grants may be taxed as regular business income, subject to applicable deductions » Charities could be allowed to participate as junior debtors in first-loss guarantee arrangements, as set out in this report, provided charitable money is leveraged and commercial capital is deployed towards charitable activities such as provision of low-cost loans
Goods and Services Tax ("**GST**"), 2017	» Services by or to a domestic charity could be zero rated or exempt from GST
Foreign Contribution Regulation Act ("**FCRA**"), 2010	» The Ministry of Home Affairs ("**MHA**") has recently tightened FCRA regulations with a view to prevent any misuse of funds. MHA may consider introducing suitable relaxations with a view to enable blended finance transactions more generally, subject to any additional reporting requirements with respect to spending to ensure it is not misused » Addtionally, keeping in mind the concerns around the misuse of funds, projects which involve Government involvement or collaboration, MHA may consider approving usage of FCRA funds through a mechanism similar to the prior permission route under FCRA currently. Where another branch of the Government is involved, possibly the risk of misuse is significantly lesser

It is important to note that the suggestions in this report are meant to be understood with respect to their cumulative effect as they are meant to be put in a more enabling ecosystem. A single area of consideration read in isolation may in some circumstances appear radical, when in fact it is balanced out by another suggestion. At present, the considerations are made with primary objective of first enabling the transactions set out in Section 3 of this report. Further, several of the examples used in the report and the changes required under law are also based on feedback from discussions with members of the industry. To that extent the report seeks to identify the critical issues and attempts to collate possible solutions.

Implementing these legal changes may require amendments to various legislations, rules, regulations, or notifications. Such changes may also need consequential changes in other related laws where applicable. In any event, any concerns regarding abuse or misuse of any provision may need to be addressed when the changes are made in the laws. Putting in checks and balances may require inputs from respective regulators and further deliberation through a collaborative approach with industry stakeholders.

Nevertheless, the need of the hour is to deregulate and create a favourable investing environment for blended finance solutions to create maximum impact.

In this regard, support for such deregulatory measures can be derived from past precedents for similar relaxations on legal issues that have yielded commendable and impactful results. For example, the Government itself has demonstrated that de-regulation works well through its successes with NSDC and the Prime Minister's Citizen Assistance and Relief Emergency Situations Fund ("**PM CARES Fund**"). They may even be considered to be successful pilot projects for blended finance structures, where intermixing of various types of capital has led to mobilizing capital at scale for impactful development work.

NSDC which is a 51 percent privately owned non-profit Section 8 company, presumably has special dispensations to conduct a lending business[33] where it provides low-cost loans for skilling purposes, despite being a plain-vanilla Section 8 company. Further, special amendments in the ITA allow it to conduct a charitable lending business without having to worry about losing its tax exempt status under Section 12AA of the ITA. These relaxations have clearly worked well as evidenced by the scale of commercial and lending activities undertaken by it since its inception and the impact it has had on skilling in India, thereby saving livelihoods.

Further, in addition to the above measures, the Government has established the PM CARES Fund[34] under the chairmanship of the Prime Minister with the aim to supplement the fight against the Pandemic. Recognizing the urgency of the situation and the need to draw capital from various sources, several legal dispensations have been made towards creation of the PM CARES Fund. Specifically, donations to PM CARES Fund will qualify for 80G benefits for 100 percent exemption under the ITA[35] and will also qualify as a valid CSR expense under the Companies Act, 2013[36]. Additionally, donations into the fund by foreign charities are not subjected to restrictions under FCRA, 2010. These relaxations have gone a long way in ensuring that COVID-19 relief work is undertaken with the required urgency and has unlocked significnat capital towards that end.

As these special dispensations or relations from restrictions under current law appear to be working well, this report makes the case for considering similar benefits to others carrying out charitable activities (as set out in Annexure). To experiement and address a number of the challenges and bottlenecks that are associated with the structuring of different models, a regulatory sandbox for blended finance transactions under the guidance of the Government could be created. This would allow for a conducive environment to innovate and understand blended finance structures in detail while ensuring prevention of misuse of funds. Private sector stakeholders would get a chance to explore how they can contribute towards scaling blended finance solutions within a mutally agreeable regulatory framework. It would also instill confidence amongst regulators on how to put in place the guard-rails that would define the broad scope for favourable blended finance regulatory landscape.

Sources:

[33]nsdcindia.org. (n.d.). Funding | National Skill Development Corporation (NSDC). [online] Available at: https://nsdcindia.org/funding.

[34]Pmcares.gov.in. 2020. PM CARES Fund - PM's Citizen Assistance & Relief In Emergency Situations Fund. [online] Available at: <https://www.pmcares.gov.in/en/>

[35]Ministry of Law and Justice. The Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020. Available at: http://egazette.nic.in/WriteReadData/2020/218979.pdf

[36]Ministry of Corporate Affairs. Office Memorandum: Clarification on contribution to PM CARES Fund as eligible CSR activity under item no. (viii) of the Schedule VII of Companies Act, 2013. Available at: http://www.mca.gov.in/Ministry/pdf/Circular_29032020.pdf

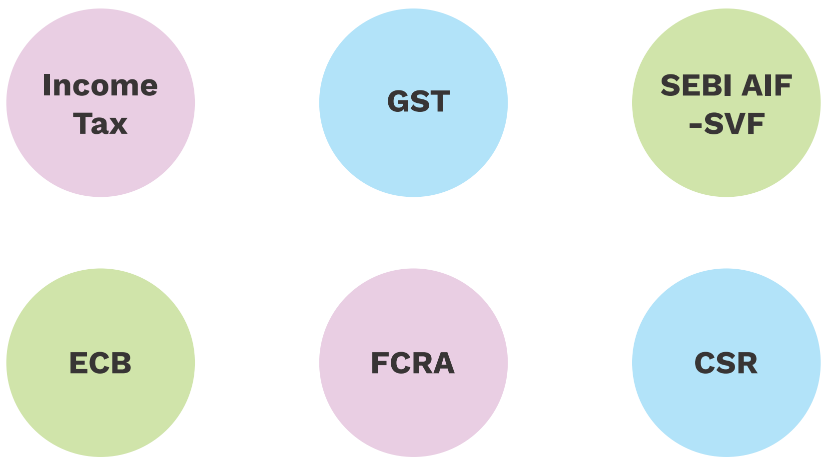
Credits: Deepak Malik/UNDP India

Annexure on Legal Issues and Detailed Points for Considerations

The legal ecosystem in India in general is geared to prevent intermixing of commercial capital with philanthropic money. The underlying presumption of all the laws is that for-profit entities generate income and set aside a portion of it towards charity. It was never envisaged that these two pools of capital could combine in more effective and powerful ways. The pools of capital once separated were meant to remain that way and any linking of the two has been viewed with suspicion by the law. For instance, payments by CSRs to for-profit service providers as service fees is perceived as a circumvention of the spirit of the law and investments by charities are not allowed by law.

Further, even entities and forms of incorporation supported this separation as even today, it is possible to set up an entity purely as a non-profit or a for-profit entity. For instance, the Limited Liability Partnership ("**LLP**") Act requires an LLP to be set up with the intention of making a profit and does not permit the setting up of an entity that intends to be run on no-profit, no-loss basis. Ironically, an LLP can be loss making so long as the intent was to make a profit, but it cannot be set up for conducting charitable activities.

Similarly, other laws also strictly segregate charitable from profitable activities, partly to ensure that charitable money is not being used from profitable activities. However, there are ways to re-imagine the use of grant money and make charitable work more impactful, compared to traditional forms of charity, as set out in Section 3. Keeping that in mind, while a whole ecosystem change is required, the major legal hurdles and critical bottlenecks can be narrowed down to issues relating to the following laws:



Implementing the solutions with respect to the above laws should significantly ease many of the difficulties faced by stakeholders in structuring blended finance transactions. Further, it is important to note that the considerations below are meant to be understood with respect to their cumulative effect as they aim to put in a more enabling ecosystem. Considering the ecosystem change that is being sought, any single consideration read in isolation may, in some circumstances, appear radical, when in fact it is balanced out by another aspect. Readers should bear in mind that on a holistic reading, the intention of the report is advocate for an enabling blended finance ecosystem with some of the illustrative transactions being set out. In any event, any concerns regarding abuse or misuse of any recommended provision may need to be addressed when the changes are made in the laws. At present, the areas of considerations are presented with the primary objective of enabling the transactions, set out in Section 3 of this report along with some wider ecosystem changes that would also accommodate variations of transactions set out in this report.

Further, while we understand it is important to keep the concerns of the regulators in mind and prevent abuse of any provisions of law, it is also important to make the system easier to operate for those who are keen on doing impactful work via blended finance transactions.

The legal considerations on the major issues are set out in the table below.

1. Income Tax

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	A charity cannot give a grant to any for-profit entity (has to enter service contract) because it may be perceived to be a non-charitable transaction. As an extension, charity grants to an SVF or an NBFC may be questioned by tax officers The charity can be at risk of: • Losing tax exempt status • Paying tax on grant amount • Paying additional 30% of the total market value of their assets as a tax On the for-profits: a received grant will be treated as income. • The for-profit entity may have to pay 30% income tax	Technically allowed by law but there is audit risk	Guarantee models	Not-for-profit-donor - domestic	Charities could be able to provide grants directly to SVFs or NBFCs or other for-profits, for furthering charitable purposes, without losing tax exempt status. Express amendments could be considered in the ITA to allow for tax exempt grants to be made to private entities for furthering charitable objectives.
02	Charity cannot make any investment i.e., cannot invest in debentures or shares of any entity as set out in Section 3 structures Due to tax and accounting challenges, Section 8 companies, while allowed under corporate laws, may not issue debt instruments Charities are allowed to only make: • Grants • Service fee to engage for-profit entity (pay service tax 18% GST) In the event, a charity makes a debt investment and such investment is allowed, repayment of a low-cost loan by an SVF or an NBFC to a charity can be viewed with suspicion by authorities, as receipt of interest income could be seen as a non-charitable activity	Not allowed by law	Variations of guarantee model could include investments into debt instruments of NBFCs	Not-for-profit-donor - domestic	Charities could be permitted to make investments through debt or equity or any other type of security or instrument or engage in low-cost lending without the threat of losing their tax exemption certificate, so as long as the returns are muted or to the extent only, capital is recovered and further used for charitable activities. Charities engaging in recoverable grants products or investing into commercial instruments for muted returns is an accepted worldwide practice (including under the 'project

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
					related investments' scheme in USA) and clarifications could be issued in relation to usage of the same as being in compliance with charitable spending requirements under income tax laws.
03	If an entity does not have a 12AA, it means that the money it gives out can be taxed[37] Foreign charities do not have 12AA because they are not registered in India. Therefore, when a foreign charity gives grant to any entity, it can be taxed However, not-for profits have a special exempt status wherein the money they receive is exempted from tax But any for-profit receiving this money, will not get an exemption. Hence, a for-profit that receives a grant from an entity that does not have 12AA, it can be taxed 30% For e.g., foreign charities do not have 12AA. Thus, when the foreign entity tries to give a grant to an SVF (for-profit), the money given to the SVF can be taxed	Technically allowed by law but there is audit risk	Guarantee model and outcome funding model	For-profit-implementing agency - domestic	SVFs, NBFCs or other for-profit entities could be allowed to receive grants without having to pay tax on it as income from other sources, provided they receive it for the purpose of carrying out charitable activities. Tax exemptions given to receipts from domestically registered charities could be extended to receipts from foreign charities as well, so long as the recipient entity is conducting activities in furtherance of charitable objectives. The intention is to reduce regulatory and tax arbitrage so that investors and social ventures can focus on the on ground work that leads to impact.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
04	Many charities do not have an 80G certificate. This means that the entities that give money to the charity will not be able to deduct this from their income	Lacuna in the law	General ecosystem	Not-for-profit-donor - domestic	This arbitrage could be removed. 80G exemptions could be extended to charitable activities carried out by entities using blended finance transactions. This could be irrespective of which entity is carrying out the charitable activity. This will incentivize and equalize the playing field where grants will flow more easily into such structures.
05	There is no concept of returnable grant under law. This is useful in structures where charities are keen to ensure provision of low-cost loans to low-income beneficiaries. For instance, a charity may give a low-income beneficiary a low-cost loan, however if the beneficiary is not able to repay, it should be treated as a grant to the beneficiary rather than a write-off Ideally charity should be able to: • Provide the capital as a loan first • If it cannot be recovered, then be able to treat it as a grant Charity can give a loan by law but the basic nature of this transaction may not be seen as charitable as there is a return expectation on the loan which can be construed against the spirit of a charitable activities On the recipient end, If the loan is shown as a write-off in case the recipient entity is not able to recover	Loan by charity not allowed by law	General ecosystem	Not-for-profit – investor-domestic	Convertible grants are a common instrument in the US. Tax and accounting rules could allow for recognizing a receipt of money as a loan initially and allow it to be categorized into a grant in a subsequent financial year based on whether outcomes are achieved. This may even require allowing filing revised returns for this purpose in subsequent financial year. Amendments should be made to allow for this change in accounting without any additional tax implications. The conversion of the loan should not be treated as a write-off of a loan in the

	from a beneficiary, then the problem is that this shows poor financial performance of the recipient entity, and the credit rating is affected further So, to ensure this financial burden is not there on the recipient, the treatment of a write-off as a grant is important Currently, the charity giving the loan cannot treat the write-off as a grant				hands of the recipient entity. To prevent any abuse or misuse, this could be strictly restricted to entities or arrangements that are involved in charitable activities.
06	There is a question on if a charity can take a loan: • Once a loan is taken by a charity and it tries to repay it, the money used for repayment may not be counted as charitable spending	Lack of clarity around loan repayments qualifying as a charitable spend	Outcome funding model	Not-for-profit-donor - domestic	This has been mitigated to some extent by recent changes introduced through the Finance Act, 2021 where the tax treatement of interest and loan repayments has been clarified. An express circular setting out the treatment of such payments in the larger context of outcome payment structures would provided much more comfort and confidence for stakeholders.
07	Concern on concept of outcome funding, specifically: • Payment of money at the end of the project • Payment only if outcome achieved **Concerns:** • Concern as to whether charity can carry forward money for a contingent event (pay only if outcomes met) • If outcome is not met, then there is no payment. This unspent money can be treated as a violation in yearly 85% spending requirement • Question regarding the treatment of an outcome funding contract as a service contract or as a grant Treatment of outcome funding contract either as a service contract or a conditional grant is also not clear	Carry forward is allowed by law for planned expenses If unspent money is more than 85%, then it is violation of law If unspent is less than 15%, it can be carried forward with an explanatio n for non-contingent event	Outcome funding model	Not-for-profit-donor - domestic	It could be clarified that outcome funding contracts as described here in this paper should be acceptable by tax authorities as valid means of spending charitable money. In fact, for charities, this is more beneficial since they do not pay for services but only for actual outcomes and that too only where they are achieved. Charities could also be allowed to carry forward unspent amount after explaining reasons for such carry forward and should set out the outcomes that were not achieved which necessitated the carry forward.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
	There are two core factors that define a grant: • Treatment of the use of money for public or private purpose. Grant monies should be for public purposes • Grants do not have strings attached, these are typically very basic contracts and not detailed to specific payment terms linked to outcomes Tax authorities may not treat the outcome funding contract as a grant because: • An outcome funding contract has severe condition attached • Additionally, there can be a question on whether the outcome being achieved is for private benefit or public benefit. If it is seen for private benefit, then it is not treated as a grant However, if in contrast, the contract is treated as a service contract, there will be a need to pay GST and income tax, making the contract more expensive	However, the possibility of allowing more than 15% to be carried forward should exist if one is giving a proper contingent explanation			Outer time limits may also be prescribed for such carry forwards to prevent accumulation of too much money in the hands of charities. Focus should be on the fact that the payments are made only on the proof that ultimate beneficiaries have benefitted from such arrangments.
08	Charity is not allowed to receive more than 20% of total receipts from business activities (i.e., service fees)	Majortiy of the service providers are non-profits and are unable to receive outcome funding as service fees due to the limitation of being able to receive only 20% of total receipts from	General ecosystem change	Not-for-profit – implementing agency – domestic	As a charity, all their income is in any case is required to be spent towards charitable activities alone. If they are allowed to earn service fees without limits, it enables them to function as vehicle for social businesses where the focus is not on the level of profits they make but rather on the charitable activities being conducted by them.

		business activities (i.e., service fees) despite carrying out charitable activities			Without having to introduce new laws or forms of incorporation, removing this requirement will offer a lot more flexibility and attract social enterprises to be set up as a charity instead. Such charities could be run as sustainable social businesses as they would be fully subject to the requirements of tax laws that all their spending should be towards charitable activities alone. Hence, the concerns around abuse or misuse should be limited.
09	Concept of first-loss provision and guarantee by charity is not clear **Case 1:** Guarantee model: Charity gives a guarantee on behalf of a beneficiary who has failed to repay to an NBFC (for-profit lender). The money flows from the charity to the NBFC only when a loss is incurred • Charity is repaying the loan on behalf of a beneficiary to the NBFC. But this payment by the charity to the NBFC directly on behalf of a beneficiary may not be seen as charitable • If the beneficiary cannot repay, then the guarantee that is coming in from the charity should be seen as a repayment for the loan, not as a write-off on the books of the NBFC **Case 2:** First loss, in the form of a low-cost loan: Charity is giving a subordinate loan and willing to be repaid last in the	Grant to a not-for-profit entity is audit risk	Guarantee model	**Case 1:** Not-for-profit - donor-domestic **Case 2:** Not-for-profit-investor-domestic	It could be clarified that such arrangements are allowed and that it could qualify as a charitable spend under current laws.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
	waterfall. The charity agrees to provide a first-loss cover if losses are incurred upto a certain limit • Charity providing a loan to a for-profit entity such as an NBFC can be questioned on whether it is charitable in nature • If the money has to come back to the charity if all goes well, then the treatment of this money is questioned as to whether this is considered as service fee or grant				
10	When charities are used as an SPV for a specific project, it is possible as set out in the outcome funding model that monies flow through it and the SPV acts as an intermediary The extent to which a Section 8 can engage third-party service providers, for providing skilling or training for instance, is unclear, since effectively nothing will be retained by the SPV. Concern is that tax authorities may challenge its activities as being non-charitable if all the money is paid by it to third-party for-profit service providers	Percept-ional risk	Outcome funding model	Domestic non-profit	Keeping in mind the total picture of the structure and the role played by the SPV, tax authorities could clarify that such transactions shall not be viewed with suspicion. To obtain comfort, adequate disclosure or reporting mechanisms could be put in place to ensure that tax authorities have the background to the transaction.

2. GST

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	Foreign charities do not need to pay GST on service contracts. But Indian charities need to pay GST on service contract	Not allowed by law	Outcome funding model	Not-for-profit-donor-domestic	Charities and all supplies of goods or services, by and to charities could be exempt from GST.

3. SEBI AIF – SVF

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	SVF 'may' accept muted returns	Market perception issue	Guarantee model	For-profit investor-domestic and foreign	Being a perceptional issue, clarification of government intent in this regard would unlock a significant amount of capital.
02	Challenge in giving outcome funding which has been raised on behalf of successful performance of a service provider (either for-profit or not-for-profit) to be given directly to the risk investor when outcomes are met • Any money coming into SVF have to be invested downstream. This means that as per regulations, outcome funding raised to be paid to the risk investor has to be 'invested' into a downstream entity • Once invested downstream, to bring the money upstream to pay the risk investor is not straightforward. There are several restrictions around the withdrawal of capital–reduction rules for companies that permit only a 24% capital reduction in a year, subject to conditions	Not allowed by law	Guarantee model	Outcome funding - not-for-profit-donor-domestic and foreign Risk investor - for-profit investor-domestic and foreign	SVFs could be allowed to directly pay outcome payments to the investor using grant money given to them for that purpose without having to mandatorily make investments into downstream entities.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
03	SVF can invest in not-for-profits but the instruments allowed for an SVF are limited to partnership interest and equity shares. These instruments are not acceptable for a not-for-profit Further, a SVF cannot invest into debt instruments	Not allowed by law	Guarantee model	Risk investor - for-profit Investor-domestic and foreign	Thus, if the ambit of instruments that can be used by SVF expands to loans, then this can be potentially used by a not-for-profit to receive funding. It could be better to allow for SVFs to invest into debt instruments or provide loans to entities involved in outcome funding or blended finance transactions. This could enable other non-profits to also access such funding directly from SVFs.

4. ECB

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	Minimum maturity period for a debt investment by foreign charity/investor is 3-10 years depending on end use	Not allowed by law	Guarantee model	For-profit – foreign investor	For providing funds to an entity that is involved in charitable work, the minimum maturity period may be reduced to 1 year across the board.
02	Not clear if non-profit entities that are not MFIs can receive funding (debt) under ECB E.g., investment into shares (equity) of non-profit Section 8 by offshore entity is treated as FCRA, not Foreign Direct Investment ("**FDI**")		Outcome funding model	Not-for-profit-impleme nting agency-domestic	Any entity that is involved in charitable work could be considered eligible for receiving loans under the ECB route.

5. FCRA

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	MHA does not grant permissions to receive foreign contribution (in the form of grants, equity, debt) by any for-profit entity. In effect, only not-for-profits get FCRA to get grants • SVF cannot get foreign contributions (grants) • Other for-profit entities are unable to receive grants despite operating as social enterprises	Allowed by law but matter of practice	Guarantee model Outcome funding model	Not-for-profit-donor-foreign	MHA has recently tightened FCRA regulations with a view to prevent any misuse of funds. MHA may consider introducing suitable relaxations with a view to enable blended finance transactions more generally, subject to any additional reporting requirements with respect to spending to ensure it is not misused. Typically, the goal of blended finance transactions is to achieve both developmental and commercial objectives such as providing low-cost funds to SMEs and farmers. Addtionally, keeping in mind the concerns around the misuse of funds, projects which involve Government involvement or collaboration, MHA may consider approving usage of FCRA funds through a mechanism similar to the prior permission route under FCRA currently. Where another branch of the Government is involved, possibly the risk of misuse is significantly lesser.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
02	Foreign contribution can only go to FCRA compliant entity so no for-profit entities can get money If outcomes are met, then once an SVF gets outcome funding money, it further needs to repay the RI. However the RI is a for-profit. Thus, it is not FCRA compliant. Hence paying an RI with foreign outcome funding is a challenge	Not allowed by law	Outcome funding model	For-profit-implementing-domestic	Same as above
03	Sub-granting by Section 8 company of grants received by it from foreign foundations is prohibited under law currently Further, there are doubts regarding whether using FCRA money through service contracts to for-profits and non-profits would be seen as a violation of the sub-granting restriction	Not allowed by law	Outcome funding model	For-profit-implementing-domestic	Same as above

6. CSR

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
01	Using CSR money to pay interest to risk investor	Market perception and lack of clarity by law	Outcome funding contract	Not-for-profit-donor-foreign	Outcome funding payments that are made in a grant form may not be questioned on such grounds as ultimately they are being spent for specified purposes under Schedule VII. Commercial understanding notwithstanding, the payment is that of a grant.

Sl. No.	Issue	Legal/ Market perception issue	Which model needs this?	Stakeholder impacted	Considerations
02	Using CSR to pay for outcome funding • Approval by board to carry forward money (it is not clear if boards will allow policies wherein there is no substantial payment for first 2 years and majority is in final year) Here, the difference is that in an outcome funding contract, the intention may be to spend close to zero in the first few years versus the situation where the CSR is carrying forward unspent money	Market perception	Outcome funding contract		Considering that amounts can be carried forward and spent, it makes sense to allow for Boards to expressly be able to plan their expenditures over a longer period if required. They can have an annual CSR policy, which will carry over any approved expenditures from previous years as well. It is suggested that all types of non-profits and for-profits which are involved in schedule VII activities be allowed to receive CSR funding.
03	Using CSR capital to provide a first-loss guarantee. The use of CSR capital to provide a low-cost loan is not allowed by law	Not allowed by law	Guarantee model	For-profit-implementing agency - domestic	The CSR law envisages the payment only through grants. However, CSR can be more effectively deployed via a first-loss or a low-cost loan for the purposes of Schedule VII objectives. Thus the scope should be broadened beyond grants and should allow for these structures as well.
04	CSR capital is not allowed to give a grant to an SVF which can be ideally used to provide low-cost loans to social enterprises	Not allowed by law	Guarantee model	Non-Profit – domestic CSR	SVFs being a for-profit entity eligible to receive grants under AIF regulations could be allowed to receive CSR money directly as grants. Further, grants received by SVFs from CSR sources could be allowed to be deployed into social enterprises carrying out charitable work either as loans or grants.

Additionally, outcome funding by government in a specific structure such as the one suggested in Section 3 may be subject to tender process and government procurement rules when it comes to contracting with entities. Section 8 companies may not qualify for bidding criteria for lack of track record. Further, tender processes and procurement rules require a bidding process which does not always work for niche and sophisticated projects such as this. Therefore, for development impact bonds to thrive, requisite changes to ease norms and regulations on such transactions are necessary.

Sources:

[37]If an entity has 12AA, then the money given by this entity to any other should be tax exempt under income from other sources.

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