



Financial Systems Strategy 2018-2022

Summary of the midterm review

Financial Systems
May 2022

The Financial Systems Strategy was adopted in 2018. Faced with the challenges and opportunities of a radically changing sector, its purpose is to contribute to building inclusive, sustainable and responsible local financial systems. To this end, the AFD Group Strategy is based on three priority objectives:

- 1 **Promote access to financial systems;**
- 2 **Support the emergence of a new sustainable finance model;**
- 3 **Consolidate the financial systems.**

In 2021, AFD's Financial Systems Division (FSD) and Proparco's Financial Institutions and Inclusion Division (FII) – the two main structures responsible for the strategy within the Group – initiated the midterm review of the Financial Systems strategy in order to evaluate its current relevance; to assess the extent to which its objectives have been achieved; to identify priority actions for the continued implementation of the strategy; and to renew the mobilization of AFD Group actors contributing to its implementation. This report presents the conclusions of this review.

CHAPTER 1 THE COVID PANDEMIC HAS ACCELERATED THE PROFOUND CHANGES UNDERWAY IN THE FINANCIAL SYSTEMS

Even more than before the crisis, **the implementation of the 2030 Agenda for Sustainable Development depends on the effective and systemic mobilisation of financial actors committed to an inclusive and sustainable economic recovery** in financial, environmental and social terms. The COVID-19 pandemic has intensified the obstacles to achieving these commitments. On the one hand, the ability of governments to mobilise the resources needed to finance the required public policies has been affected by the economic slowdown, rising public deficits and a deterioration in the perception of the risks associated with investment in emerging markets. On the other hand, the achievement of some of the SDG indicators is stalling and an increase in poverty and inequality has been observed in many countries where AFD is operating, highlighting the fragility of the economic and social models.

The **paradigm of climate finance** continues to evolve and pushes us to find solutions to mobilise a much larger share of available financial resources to fund low carbon and resilient pathways. As a result, efforts to align the investment strategies of financial actors must include a gradual reduction in support for the most emissions-intensive sectors. By encouraging the direction of available capital towards sustainable investments and by strengthening the integration of climate-related financial risks, governments and financial regulators play a decisive role in supporting the transition. Their action contributes to reconciling short-term (returns), medium-term (financial stability) and long-term (climate change) horizons.

Public Development Banks (PDBs) are now seen as key players in fostering transition. Building on national development mandates, they fill certain market gaps by mobilising long-term financial resources, deploying counter-cyclical initiatives to support the economy, helping to structure new markets and, more broadly, disseminating good practices to the national financial systems. Given the current challenges, the PDBs will remain strategic partners in supporting the transformation of financial systems.

Governments and financial authorities, regulators and supervisors, are **diversifying their activities to contribute to the transformation of financial systems.** They play a crucial role in changing institutional environments and influencing national strategies and regulatory frameworks in favour of sustainable and responsible finance. Central banks in particular have deployed a range of instruments to mitigate the economic and financial consequences of the pandemic, confirming their essential role in ensuring the resilience and stability of financial systems. In a context of economic recovery, this function must progressively integrate issues related to climate change, financial inclusion, responsible finance and digital finance challenges and opportunities.

CHAPTER 2 THE FINANCIAL SYSTEMS STRATEGY PROVED TO BE RELEVANT AND COHERENT OVER TIME

In a context of strong growth in operations, the strategy has effectively guided the Group's "financial systems" activity, providing it with a clear and articulated narrative around the three complementary objectives mentioned above. Between 2018 and 2020, the financial systems activity contributed significantly to the Group annual results (20% of the annual commitments) and maintained its position as the main contributor to the priority on non-sovereign financing. The transactions cover all the regions of intervention of the Group in foreign countries, while maintaining the priority given to the African continent (48% of the activity). In order to respond to the wide range of challenges in financial systems, the activity has also considerably diversified, both in terms of types of beneficiaries (variety of partner financial institutions, regulators), financial tools (subordinated debt, bond underwriting, impact-indexed margin loans) or operational approaches (sovereign FB-PP loans, "transformational" lines). Ownership of these innovations and Group learnings on financial systems beyond SYF and FII is enhanced by an active community of practice and, from 2021, the creation of an annual sectoral training program.

The operational reality reflects the strategic ambitions set for the sector. Following the 2018 private sector reform, AFD Group has renewed its intervention logic in favor of access to financial systems for populations and businesses. AFD – in support of public policies – and Proparco – in direct support to private banks and IMFs – thus demonstrate a strong complementarity. Ambitious initiatives have been built to address gender inequality (2X Challenge) and the needs of rural populations (Agreenfi) and MSMEs (Choose Africa). New approaches will have to be developed to combine these social ambitions with the Group's climate priorities in all regions of intervention.

The Group has also succeeded in adopting a more systemic operational approach to bring about a sustainable and more massive change in financing rules and practices. An operational approach dedicated to the PDB community has been developed based on their potential for transformation, enabling AFD to triple its activity in favour of these actors. Operations to consolidation the financial systems

architecture have increased and matured. By working with institutional investors and on the capital and insurance markets, the Group aims to improve savings mobilization and transform them into long-term resources essential to finance the economy. At the same time, AFD's position on issues related to the development of digital financial services has continued to evolve, by strengthening regulatory frameworks or contributing to the development of responsible digital finance standards. Finally, the structuring of our financial systems consolidation activity has also resulted in support for governments and regulators through budgetary financing of public policies aimed at financial inclusion and the fight against climate change.

The results of the midterm review confirm the strategy's ability to embrace the Group's main strategic guidelines and their evolution. The contribution of the financial systems activity to the Group's climate objectives has significantly increased (25% of the Group's commitments in 2020). Within SYF's commitments, the share including climate co-benefits has increased from half in 2018 to two-thirds in 2020. The success of the integration of climate objectives is now feeding into ongoing considerations on the contribution of the financial systems activity to the Group's biodiversity conservation objectives.

Financial systems commitments are also increasingly integrating gender-related objectives. Between 2018 and 2020, the share of SYF's business volume with a gender DAC marker tripled, from 19% to 56%. These results are the fruit of efforts to capitalize, raise awareness, and train teams, who are now better able to take gender issues into account when identifying new operations.

On a transversal level, the ambitions set by the strategy have also enabled the financial systems activities to contribute to the objectives of the 100% Social Link strategy, although more in-depth work is needed to better understand the link with the reduction of inequalities. In addition, the Group has continued its efforts to implement responsible finance standards and to improve the sensitivity of its financial systems activities to contexts of fragility, crisis and conflicts.

CHAPTER 3 NEW AMBITIONS FOR THE FINANCIAL SYSTEMS STRATEGY

1. Contribute to reducing inequalities

The contribution of financial systems activities to reducing inequality is a growing priority in AFD Group's strategic framework but is not yet very visible. The report makes proposals to strengthen the contribution of financial systems activities to this objective, namely:

- Develop a position paper on the contribution of financial systems to reducing inequality;
- Facilitate the monitoring and evaluation of projects that contribute to the reduction of inequalities;
- Encourage the identification of projects combining social and climate impacts.

2. Promote the transformation potential of financial actors

Capitalising on the driving role financial systems have on their ecosystem, the Financial Systems Strategy sees the transformation of financial actors towards a sustainable finance model as a powerful lever to address economic, social and environmental development challenges. To promote and maximise this transformation potential, the Group will focus on:

- Developing operations with transformative impacts on financial actors;
- Placing the relationship between AFD Group and its clients on a long-term strategic footing;
- Adapting the internal incentive and accountability systems for financial sector projects.

3. Assist in the scaling-up of our public policy support activity

Supporting public policies aimed at adapting the rules, standards, or incentive mechanisms applicable to a country's financial actors is essential to transforming national development trajectories. In order to intensify our activity in this area, the Group will seek to:

- Develop internal capacities to better position AFD as a key partner in supporting public policies on financial regulation and supervision (diagnostic tools, dissemination of the service offer, revision of the monitoring and accountability framework, etc.);
- Deploy a range of diversified tools to offer our partners financial solutions adapted to their needs and place the public policy dialogue on a long-term basis.

Towards a world in common

AFD Group implements France's policy in the areas of development and international solidarity. The Group includes Agence française de développement (AFD), which finances the public sector and NGOs, as well as research and education in sustainable development; its subsidiary Proparco, which is dedicated to private sector financing; and Expertise France, a technical cooperation agency. The Group finances, supports and accelerates transitions towards a fairer, more resilient world.

With our partners, we are building shared solutions with and for the people of the Global South. Our teams are at work on more than 4,000 projects in the field, in the French Overseas Departments and Territories, in 115 countries and in regions in crisis. We strive to protect global public goods – promoting a stable climate, biodiversity and peace, as well as gender equality, education and healthcare. In this way, we contribute to the commitment of France and the French people to achieve the Sustainable Development Goals (SDGs). Towards a world in common.



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