The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance

A Landscaping Review

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About the report

This Landscaping Review explores the critical role that credit enhancement and grant-funded technical assistance can play in facilitating the issuance and scaling of performance-linked sovereign debt instruments. To evaluate the credit enhancement landscape and how access to these tools can be facilitated, 24 Development Finance Institutions (DFIs), insurers, reinsurers and insurance brokers were contacted, of which 22 provided feedback. This Landscaping Review provides an overview of the market, the role of credit enhancement and the scope of enhancement tools and technical assistance, concluding with a few case studies that provide proof of concept.

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The views expressed in this paper are those of the authors alone. Any errors are our own.

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The SSDH (the Hub) is an inclusive, cooperative space which brings together the actors from the entire spectrum of the sovereign sustainability-linked debt universe. Founded to support and facilitate the growth of the performance-based sovereign debt market, the Hub supports initiatives that build nature and climate performance into models of sovereign financing.

NatureFinance is the Secretariat and Convenor.

www.ssdh.net

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Executive Summary

Sustainability-linked sovereign debt instruments (also referred to as KPI-linked sovereign debt instruments) are being recognized by a growing number of market participants and other stakeholders as a possible solution to address the triple crisis of debt, nature and climate. The urgency of these inter-connected crises has been intensified given the aftermath of the COVID pandemic, the dramatic erosion of biodiversity, the war in Ukraine and the concomitant pressures on food and energy prices, the potential reduction in available Official Development Assistance (ODA) funds and rising interest rates.

Integrating nature and climate outcomes into sovereign KPI-linked debt instruments provides sovereigns with funds that can strengthen social and macro-economic conditions and sovereign financial viability, and improve access to affordable credit while at the same time addressing nature-related national strategies and policies. This is the Virtuous Circle[1] of KPI-linked debt instruments: connecting nature, climate and debt management can strengthen all three.

The looming sovereign debt crisis amongst lower middle-income countries (LMICs) demands different forms of sovereign financing, not only so these countries can gain access to credit on sustainable financial terms, but so that they have the means to contend with the ways that the erosion and destruction of nature is adversely affecting their climactic, social and economic conditions.

The market, however, is still hesitant. Mainstreaming the market of sustainability-linked sovereign debt, all the more so for the LMICs issuers, still requires providing proof of concept to overcome lingering scepticism. It also requires providing technical assistance on how to structure the instrument to meet the needs and conditions of specific countries and their investors. But most importantly, the market calls for sufficient sources of credit enhancement tools to support the sovereigns under severe debt stress.

To support mainstreaming this emerging market, we provide the following review that maps out three key facets of sustainability-linked sovereign debt instruments:

1. How the Virtuous Circle of Sustainability-linked sovereign debt works: how nature, climate, socio-economic health and sovereign debt can be aligned to be mutually supportive.

2. The Credit Enhancement mechanisms that are often necessary to make issuance of Sustainability-linked sovereign debt possible: this includes public and private capacity, including guarantees, insurance and re-insurance.

3. The range of Market Players and how they can collaborate to scale the issuance of Sustainability-linked sovereign debt.

We conclude this Landscape Review with a few key Case Studies that provide proof of concept.

Our working approach was to have conversations with leading market players: we conducted 24 conversations with Development Financial Institutions (DFIs), reinsurers and insurance brokers.

- 22 provided feedback;
- 7 expressed interest;
- 2 deemed it was not relevant to their business model.

What was quickly highlighted was the interest from both DFIs and (re)insurers to support developing countries in times of distress; they acknowledged that their existing toolbox and capacity are not adequate to address the breadth of the crises of fiscal space shortages, or the quantum of sovereign debt requiring financing—through restructuring, refinancing or other means.

Among the DFIs, most have been involved in some form of sustainable bond issuances (e.g., green or blue bonds). The Inter-American Development Bank (IDB) is perhaps at the most advanced stage with structuring results-based products, including KPI-linked bonds, and is uniquely positioned to play multiple roles including structuring the transaction, providing a guarantee and/or investing, and providing technical assistance to support the climate/nature linked outcomes. Some of the other Multilateral Development Banks (MDBs), while expressing interest, noted challenges to participation, including the prevalence of sub-investment grade countries and/or lack of interest from some member countries on climate commitments where pressing social issues are prioritized.

Bilateral institutions had a mixed response. With the exception of the US International Development Finance Corporation (DFC), a well-known provider of political risk insurance, many bilateral institutions have private sector mandates and more limited involvement with supporting sovereign issuances and debt restructurings. However, several notable opportunities for bilateral involvement are included in this analysis.

From the private sector, international insurance brokerage firms expressed interest, stating that they can quickly identify capacity and provide access to the international insurance markets. Insurers have the appetite and capacity to participate in more public sector deals, especially if a DFI is involved in the transaction as an insurer or investor. This could effectively allow private insurers to provide capacity to higher-risk countries and/or extend the typical tenor or credit line.

There was mixed feedback on demand: some claimed that demand for Partial Credit Guarantees (PCG) and Political Risk Insurance (PRI) has accelerated since the pandemic while others found the opposite. There was also mixed sentiment and risk appetite among investors for investing in the poorest countries or fragile states.

Notwithstanding the hesitancy amongst some, there is a market need, and looming urgency, for the LMICs and investors to have access to a suite of financing tools and services linked to issuing and/or restructuring debt that is tied to concrete nature-based developmental outcomes.

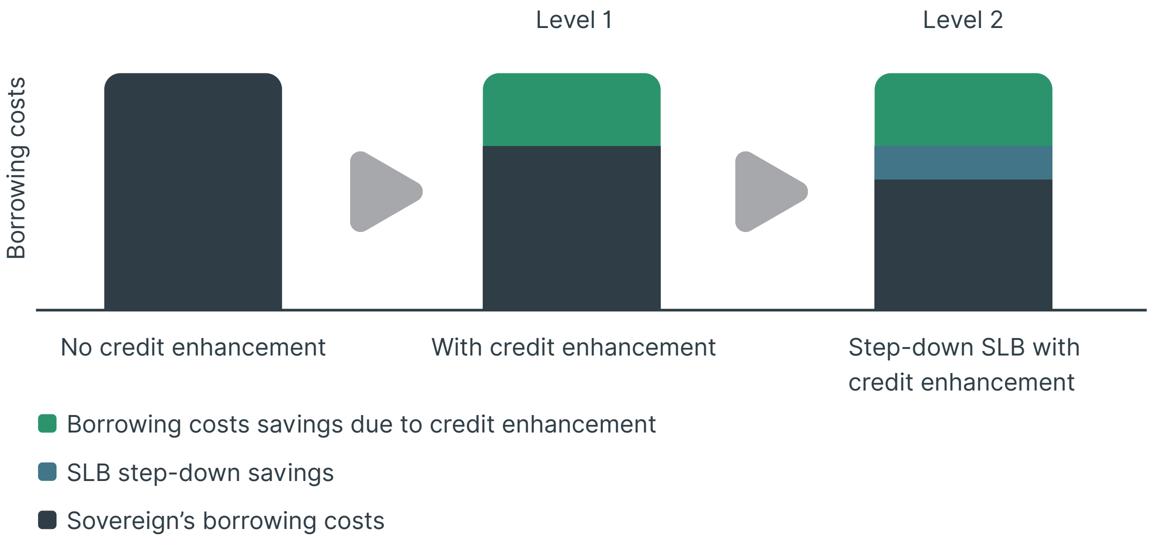
In terms of how KPI-linked sovereign debt can work, there are a few key learnings.

Credit enhancement instruments have a decisive role in scaling the issuance of the sustainability-linked sovereign debt

Credit enhancement instruments reduce the risk and borrowing costs of the debt issuer and crowd in private investors' financing to multiply the impact of public funds. Credit enhancement of sovereign sustainability-linked debt can play a catalytic role not only for a single transaction, but also in the long-term overall debt service cost reduction of a country.

On the first level, sustainability related conditionality to the availability of credit enhancement can directly contribute to an increase in the resilience of the debtor countries in the face of climate and nature-loss risks. Ensuring the materiality and relevance of the KPIs and a sufficient ambition of the sustainability performance targets (SPTs), the issuer can demonstrate its commitment to strengthen its resilience beyond the scope of a specific debt instrument issuance. On the second level, the reduction of sovereign borrowing costs can be further amplified through the integration of step-down clauses in the structure of the sustainability-linked debt instruments and achievement of the specified SPTs.

Chart 1
Illustration of borrowing cost reductions in a step-down SLB with credit enhancement*



*The size of the borrowing costs reduction is not indicative and serves purely for an illustrative purpose

Scaling Sustainability-linked sovereign debt can ignite a revolution in sovereign debt markets

Scaling the issuance of sustainability performance-linked sovereign bonds that reward climate and nature outcomes can catalyse the called-for revolution in sovereign debt markets and create a Virtuous Circle by:

- Directly rewarding positive nature and climate outcomes through reduced costs of capital;
- Incentivizing investments that reduce sovereign risks through improved resilience and economic productivity, thereby lowering the cost of capital across a sovereign's entire debt portfolio;
- Supporting broader sustainable development outcomes, directly through growth and productivity effects and indirectly by creating fiscal space to support increased public spending; and
- Reducing the need for ex-post debt structuring by advancing smarter risk sharing between debtors and creditors.

For the Virtuous Circle to materialize, the applied KPI frameworks must be geared towards increasing the resilience on a country level and address not only mitigation, but also adaptation issues supported by coherent risk management metrics.

Collaboration among public and private stakeholders will be necessary to meet objectives

There is a clear case for the benefits of KPI-linked debt issuance to all concerned parties: LMICs, DFIs, private insurers and investors, although a collaborative approach will be required for successful outcomes. The Sustainability-linked Sovereign Debt Hub (the Hub) can play a valuable role in supporting the transparent collaborations that can mainstream and scale KPI-linked sovereign debt issuance.

Introduction

Lower middle-income countries (LMICs) are facing unprecedented financial stress and have dwindling access to finance, worsened by the impact of COVID-19, the war in Ukraine, the challenging interest rate environment and the emerging market bond fund withdrawals. In addition to experiencing high levels of national debt, many of these countries are also facing a climate crisis that is adversely affecting their economies and communities, posing both immediate and long-term risks to people, sovereigns, biodiversity and investors. This has an outsized potential to negatively affect biodiversity as communities turn to practices that deplete nature in order to support their livelihoods.

As countries have turned to the IMF, World Bank, UN, and others for help, it has become clear that countries below investment grade are not in a position to issue new debt or debt for nature/climate swaps, despite the long-term positive outcomes linked to performance-based issuances. In addition to restrained access to the global financial markets, many LMICs also lack the technical capacity to structure debt issuance deals incorporating climate and nature outcomes. Consequently, these countries will need to rely on sources of concessional finance to lower the cost of capital in order for them to re-gain access to the market, both for restructuring as well as the new issuance of sovereign debt. Only with this type of credit enhancement can these countries access the global market and mobilise institutional capital at the scale required to address the debt, nature and climate crises.

Several pathways exist, among them Sovereign Sustainability-linked Bonds (SLBs)—embedding resilience and sustainability performance KPIs—which could initiate a Virtuous Circle of enhancing the resilience, productivity and investment capacity of a debtor country. Building on the recent growth of sustainability-linked debt, this type of solution is now a realistic possibility.

The Sustainability-linked Sovereign Debt Hub (the Hub) has been founded to facilitate the issuance of these bonds. The Hub exists to support transactions that will reduce the cost of capital to developing countries, support ambitious actions on climate and nature, and make sovereign debt markets responsive to climate change and nature restoration, and to the socio-economic needs of countries facing financing challenges. This analysis explores the necessary role that credit enhancement and the potential of grant-funded technical assistance might play in facilitating these transactions. To evaluate the credit enhancement landscape and how access to these tools can be facilitated, 24 DFIs, insurers, reinsurers and insurance brokers were contacted, of which 22 provided feedback.

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1
A Brief Overview on Sustainability-linked Bonds (SLBs)

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A Brief Overview on Sustainability-linked Bonds (SLBs)

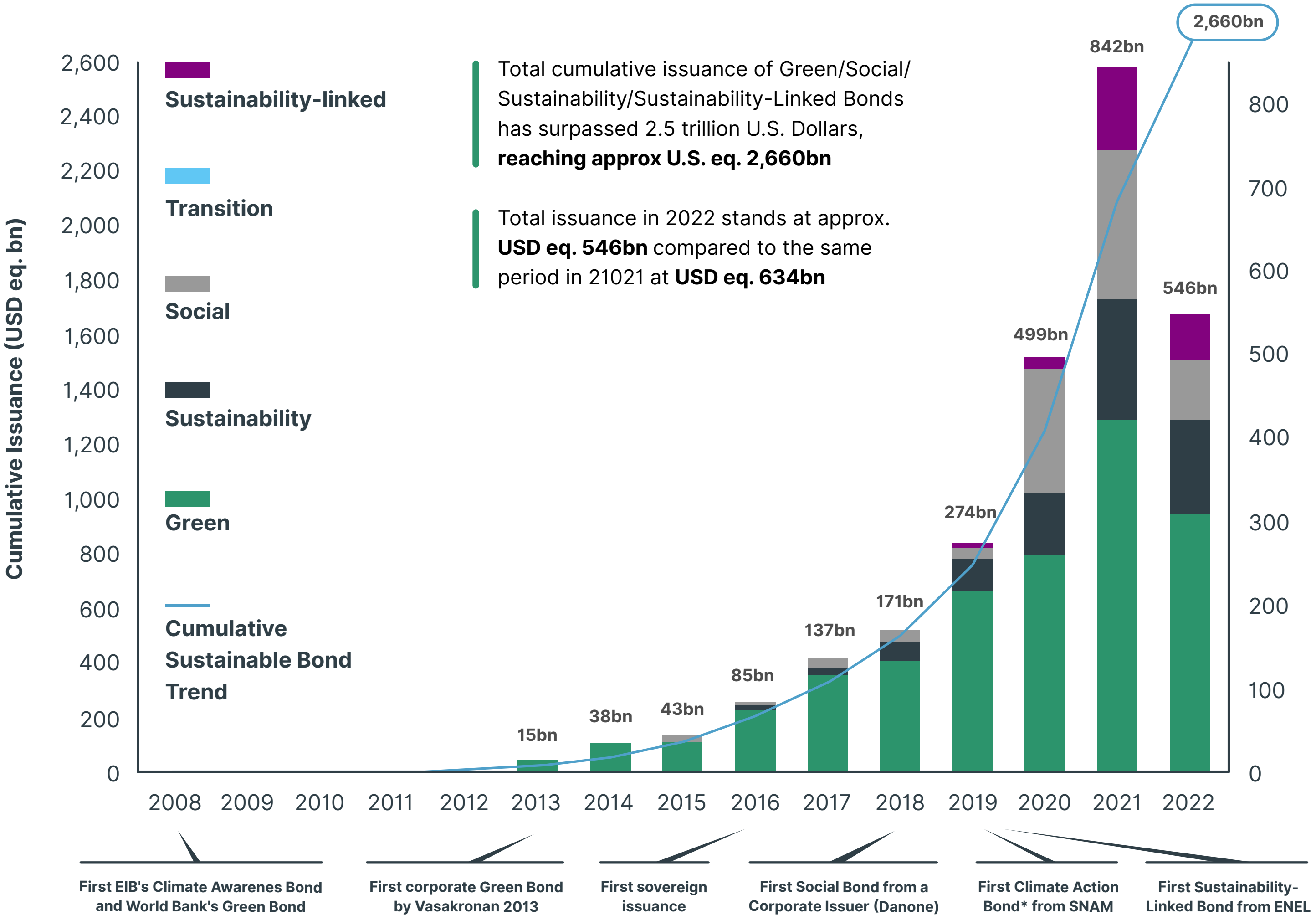
Unlike green bonds, which ring-fence the use of proceeds for a specific purpose, SLBs or KPI-linked bonds have coupon payments that are linked to the sustainability performance of the issuer, allowing the issuer to use the funds for general purposes, as long as sustainability targets are achieved. The non-prescriptive use of proceeds has been one of the criticisms of SLBs, as investors believe that this can lead to less than sustainable results. However, well-structured KPIs can broaden the scope of the sustainability attributes from the KPIs exclusively to the broader use of proceeds, helping countries build resilience through spillover effects into the economy. SLBs hold the potential to put countries on a transition pathway to nature positive outcomes that strengthens macro-economic conditions and earns improved sovereign creditworthiness.

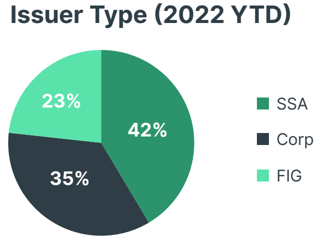
There is an ongoing debate about the concept of “green premium”, or “greenium”; many believe it is elusive and hard to measure, while others suggest that investments in sustainable projects by the issuers can lower their costs of capital. (Discussed in more detail in Section 5).

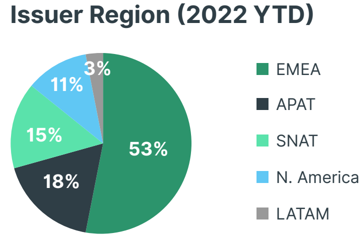
The interest in, and demand for, financial tools that support environmental sustainability has been on a steady growth trajectory over the past decade. Green “use of proceeds” bonds were the early financial tools, first focused on the environment, then social conditions and supporting transition. Since 2020, the issuance of performance-based financial tools has been increasing in popularity because of their flexibility and ability to improve multiple factors. The sustainable bond market at a glance is depicted below[2].

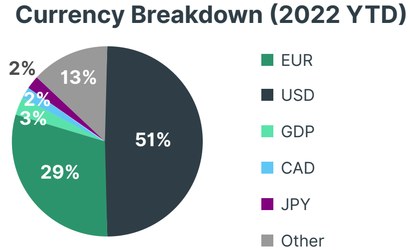
Chart 2
Growth of ESG labelled bonds issuance

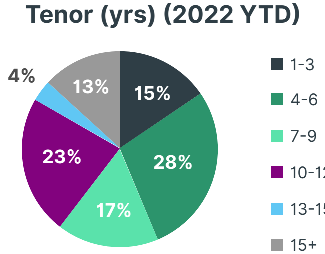
Exponential evolution of Primary Sustainable Issuance that has now crossed the USD 2.5trn mark











Source: BNP Paribas

Recent Examples

As noted in the BNP Paribas chart above, SLBs remain the fastest growing type of environmental bond in the corporate sector despite comprising less than 15% of issuance. Until 2022, all SLBs were corporate, but 2022 marked the first issuance of a sovereign SLB from Chile, with one more issuance in Q4 2022 from Uruguay.

In early March 2022, Chile, which has been affected by a decade-long drought, became the first sovereign to issue an SLB with the issuance of a US$2 billion SLB. This bond stipulates that the country's annual GHG emissions must not exceed 95 MtCO2e by 2030, and a maximum GHG budget of 1,100 MtCO2e between 2020 and 2030, with coupon adjustments to incentivize good performance. The renewable energy Sustainability Performance Targets (SPTs) include achieving 50% electricity generation derived from non-conventional renewable sources by 2028, and 60% by 2032. Demand for the bond was over 4 times the original placed amount.

In October 2022, Uruguay was the second ever sovereign to issue an SLB with KPIs tied to the intensity of greenhouse gas emissions and the protected area of native forests in the country. Despite Uruguay being a country with market access, this transaction includes a suite of technical assistance made possible from entities like the International Development Bank (IDB) and the United Nations Development Programme (UNDP).

Conditionality

There is concern from many investors about use of the term conditionality, which connotes penalizing a sovereign for under-performance, further entrenching sovereign indebtedness, and potentially deterring sovereigns from pursuing SLBs. The current conversation is being shaped by a focus on providing incentives that reward positive performance rather than punishment for poor performance. An outcomes-based conditionality can represent a link to KPIs which can be a de-risking mechanism for future debt and improve creditworthiness, ultimately leading to more nature-informed policies.

IMF Managing Director Kristalina Georgieva seems to agree, saying that debt and climate need to be linked.

> *"You give the country breathing space, and in exchange, you as the creditor can demonstrate that it translates into a commitment in the country that leads to a global public good.[3]"*

The goal is to craft SLBs as carrots not sticks, incentives not penalties. The KPI-linked debt issuances that follow on from Chile and Uruguay will be important cases to observe. Crafting a common narrative around these incentives and documenting evidence from current cases will support the theory and business case for KPI-linked sovereign performance.

It is expected that for countries with less sophisticated financial expertise, structuring these types of bonds can be cost prohibitive unless technical assistance can be accessed and provided ex-ante. The market has also shown that sub-investment grade countries will be unable to access the market without a form of credit enhancement. The rest of this analysis will outline existing credit enhancement mechanisms and discuss how they can be incorporated in sovereign SLBs.

2 Existing Credit Enhancement Mechanisms

2

Existing Credit Enhancement Mechanisms

Credit enhancement tools are external mechanisms typically provided by multilateral development banks (MDBs) and bilateral development financial institutions that improve the creditworthiness of sovereigns. For sub-investment grade countries interested in issuing SLBs, a credit enhancement mechanism will likely be required to attract private investors and insurers.

The most common mechanism utilized for sovereign debt (and the focus of this analysis) is a guarantee: an undertaking by a third party (guarantor) to fulfill the obligations of a borrower (in this case the sovereign) to a lender under an agreement in the event of non-performance or default by the borrower of its obligations under the agreement. The benefits of guarantees for governments include facilitation of public private partnerships, attracting investors to strategic sectors, diversifying financing sources beyond development financing, reduction of project costs and bringing commercial financing to affordable levels, and reduction of government risk exposure.

The two most common type guarantees are Partial Credit Guarantees (PCG) and Partial Risk (also known as Political Risk) Guarantees (PRGs).

Partial Credit Guarantees

OVERVIEW

Partial Credit Guarantees are conditional or unconditional guarantees to mitigate risks associated with a borrower's inability to fulfill debt service obligations. In the sovereign context, specifically for LMICs, these guarantees are typically issued by a multilateral institution such as the African Development Bank (AfDB), the Asian Development Bank (ADB), the Inter-American Development Bank (IDB), the European Bank for Reconstruction and Development (EBRD), or the World Bank (IBRD). The World Bank alone has mobilized more than US$42 billion in commercial capital. These multilateral providers are not solely motivated by financial returns and can thus assume more risk than private providers filling a gap in the market. These guarantees are often catalysts to attracting private-sector investments and commercial financing. Credit guarantees are an important component for supporting the economic growth of sovereigns and their ability to deliver effective social services, improving overall socio-economic performance. The image above depicts how these guarantees function at the ADB[4].

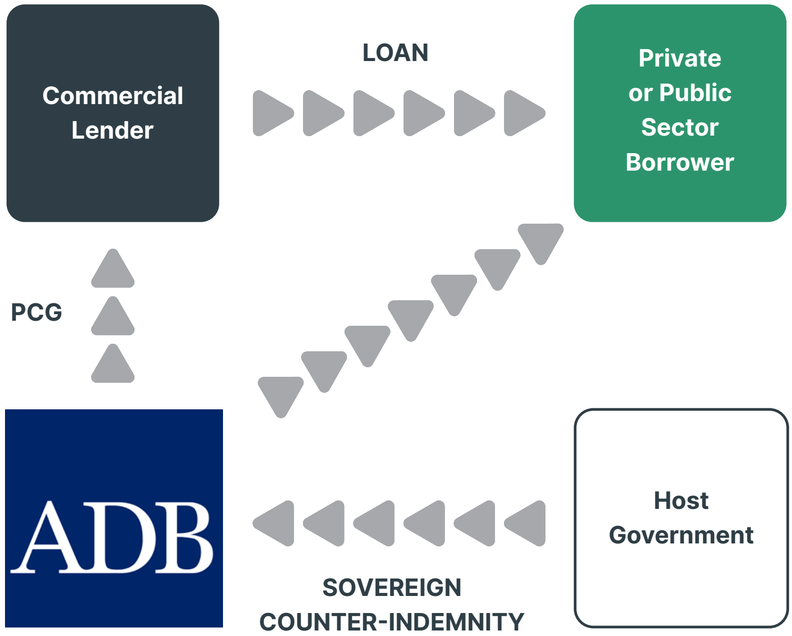
PCGs can serve a variety of functions, including mobilizing private investment for strategic projects or sector support, mitigating key government-related risks to enable financial viability and bankability, enhancing the credit quality of sovereign and sub-sovereign obligors, and reducing costs and improving financing terms for projects and governments. Some of the MDBs delineate their PCGs into categories such as project finance and policy-based finance.

Project Finance: For public sector investment projects, especially in infrastructure, PCGs can encourage the extension of maturity and improve access to capital markets with enhancement of bond issues.

Policy-based finance: PCGs can cover the full risks of portions of sovereign borrowings from private creditors to improve access to markets and raise funds in support of agreed structural, institutional and social policy reforms.

Chart 3
PCG example

Visual representation of how Guarantees function at the ADB



Source: ADB

KEY FEATURES

The key features of PCGs are nuanced depending on the issuing entity, but from a sovereign perspective, PCGs typically provide:

- AAA risk mitigation with respect to obligations due from government or government-owned entities to private investors and to foreign public entities on cross-border projects.
- Risk mitigation to promote balanced risk allocation between government and private investors or between public entities in cross-border projects.
- Concessional pricing with long tenors (typically 20 but as high as 35 years from the IBRD).

ELIGIBILITY AND GUARANTEE PERCENTAGE

Sovereign, sub-sovereign, and private sector institutions can apply for PCGs as all member countries are generally eligible. Underlying projects or policy initiatives that the financing is intended to support need to be consistent with the respective MDB's country strategy. The guaranteed percentage is typically set at the lowest level required to mobilize financing and only goes to 100% in exceptional cases. Additional requirements vary by institution and are publicly outlined online.

TERMS

PCGs from MDBs for sovereign issuances are typically priced with sovereign loan equivalent-based rate plus a front-end fee, and a commitment fee. Loan pricing typically consists of base rate + funding margin + lending spread + maturity premium. Different banks have different maturity premiums for both loan durations and the level of creditworthiness of the country. Some MDBs can also utilize grants – either in lieu of loans for severely distressed countries or to help offset some of the fees. These guarantees typically hold a long tenor ranging from 10 to 20 years and upwards of 35 years from the World Bank. Finally, development banks can typically issue PCGs in any currency in which they can efficiently intermediate, including the currencies of its developing member countries. A notable exception is the IDB which issues guarantees in US Dollars. The IDB is also unique in that it has a Flexible Guarantee Instrument (FGI) for Sovereign Guaranteed Operations. This platform is designed to streamline the guarantee process for both PCGs and PRGs for borrowing member countries that are eligible for concessional financing.

The following table outlines the pricing, tenors, the link to sustainable finance and latest lending spreads amongst the leading MDBs.

Sample Terms for Sovereign Guaranteed Loans

Multilateral	Pricing	Max Tenor	Sustainable Finance Link
AfDB[5]	- Sovereign loan equivalent - Lending spread of 80bps - Front-end fee: 0-25 bps for sovereign guaranteed - Commitment fee of 25bps on undisbursed balance - Some countries are only eligible for grants	Up to 20 years	No separate advisory function; onus would be more on the country to bring the stakeholders together to structure a SLB/KPI-Linked Bond
ADB[6]	- Sovereign loan equivalent (with counter-indemnity) - Lending spread of 50bps - Front end fee of 25bps - Commitment fee of 15bps	15 years +	Guarantee demand has decreased in favour of concessional capital for investment but could be a useful tool for structure SLBs
IDB[7]	- Sovereign loan equivalent - Lending spread of 90bps or 25bps for concessional - Commitment fee of 50bps	Up to 25 years for investment projects and 20 years for policy-based interventions	Takes an active role in advising governments on structuring for SLBs and incorporating PCGs and TA as needed to achieve impact and financial outcomes
IBRD[8] (World Bank)	- Sovereign loan equivalent - Front end fee of 25bps - Guarantee fee of 50-165bps depending on the country - Commitment fee of 25bps	Up to 35 years	Advisory team can help with SLBs, have not seen a lot of interest from countries nor have there been pricing benefits despite oversubscription in a few case studies

PARTIAL CREDIT GUARANTEES IN PRACTICE

Sovereign SLBs are still a nascent instrument with Chile being the first country to issue one in 2022. Since these structures will require multiple stakeholders and private sector partners, it is logical that PCGs could be utilized to great effect in de-risking the transactions for riskier countries. PCGs from multilaterals can also be used in conjunction with other de-risking mechanisms from other DFIs or NGOs. Interviewees confirmed that the application process usually begins with the Ministry of Finance contacting the director of the country office to discuss the feasibility of the project.

The pioneering Seychelles debt for nature swap and blue bond (US$22 million) issued in 2018[9] included two forms of credit enhancement: the Bond is partially guaranteed by a US$5 million guarantee from the World Bank (IBRD) and further supported by a US$5 million concessional loan from the Global Environment Facility (GEF), which will partially cover interest payments for the bond.

There has been a bit of collective aversion to guarantees, but with a big push to mobilise more private capital we might see them gaining popularity.

Few guarantee programs target biodiversity or nature specifically. Among the respondents, this was not a focus nor an exclusion; the guarantee provision is sector-agnostic and evaluated according to financial factors. One of the program's respondents identified is the Central American Bank of Economic Integration (CABEI). In its 2010–14 strategy, CABEI listed environmental sustainability as a major goal and it is currently working to achieve this goal through its two green partial credit guarantee programs: the first for renewable energy through the Accelerating Renewable Energy Investments in Central America and Panama project (ARECA); and the second for the promotion of biodiversity through its Central American Markets for Biodiversity project (CAMBIO). In the case of CABEI-CAMBIO, the scheme's managers noticed early in the implementation phase that the coverage ratio was not attracting enough FIs. They increased it to 60% and got a much better response without jeopardizing the sustainability of the scheme. The number of defaults on the guaranteed portfolio is still very low[10].

KEY INTERVIEW INSIGHTS

PCGs are accounted for similar to loans, and thus are best used when there is a goal to mobilize significant amounts of private sector capital.

Although this mechanism has been around since the 1980s, the volume of guarantees is modest, typically representing less than 5% of total exposure to sovereign borrowers.

One important aspect that deserves further study is determining the right amount of coverage to encourage the issuance of nature-targeting debt while managing investors' residual risk exposure at a reasonable level.

The IDB is currently designing an advisory and credit enhancement program for the issuance of bioeconomy use-of-proceed bonds in Brazil, Colombia and Ecuador. Eligible investments include bioeconomy supply chains, such as sustainable agroforestry, non-timber forest products, native species aquaculture, forestry plantations of native species, and nature led community tourism.[11]

Outside of the group of institutions surveyed, the GEF is perhaps the best-known guarantee-providing entity working in the realm of nature-focused outcomes[12]. The GEF provides full and partial credit guarantees. Depending on the chosen instrument, the GEF either guarantees the entire amount of a commercial loan or a pre-defined portion of it by covering general credit risk during a particular phase of the project. In the case of a partial credit guarantee, the rest of the risk of potential losses is shared with the lender and other investors. GEF has most recently received accolades in its support of the pioneering Wildlife Conservation Bond (the Rhino Bond colloquially known), where it played a role as an outcomes payer in a nature performance impact-bond.
For its guarantees, there is a funding cap for a typical project set at US$ 15 million and tenor of coverage for a private sector beneficiary: maximum maturity of 20 years and public sector beneficiary: maximum maturity of 40 or 20 years.

Political (Partial) Risk Guarantees

OVERVIEW

Political (Partial) Risk Guarantees (PRG) or Political Risk Insurance (PRI) protect the borrowers from default caused by the failure of a government to meet specific obligations due to government (i.e., non-commercial) risks that include, but are not limited to: contractual performance of public counterparties, change of laws and regulations, expropriation, non-convertibility of currency, war and civil disturbance. An example of a PRG (Chart 4) is one that supports the obligations of an off taker to an Independent Power Project (IPP) under a Power Purchase Agreement (PPA)[13].

PRGs are typically utilized for public projects with either private sector participation or involving cross-border financing. These guarantees can catalyze private sector funding by giving assurance to the private partners that government will meet its obligations towards the partnership. Additional benefits to private investors include improvement of the overall credit quality of the investment through partial use of a "AAA" rated instrument, reduction of risk drivers beyond the control of private investors, and strong support to maintain or open new markets despite credit downturns. PRGs are commonly used when commercial lenders are prepared to accept the commercial (or credit) risks of a project, but not the political risks. Unlike PCGs that cover non-payment, political risk insurance pays out following a breach of contract that leads to an arbitration by a host government. The Multilateral Investment Guarantee Agency (MIGA) has a specific product called the non-honouring of sovereign financial obligations that does not require the investor to obtain an arbitral award.

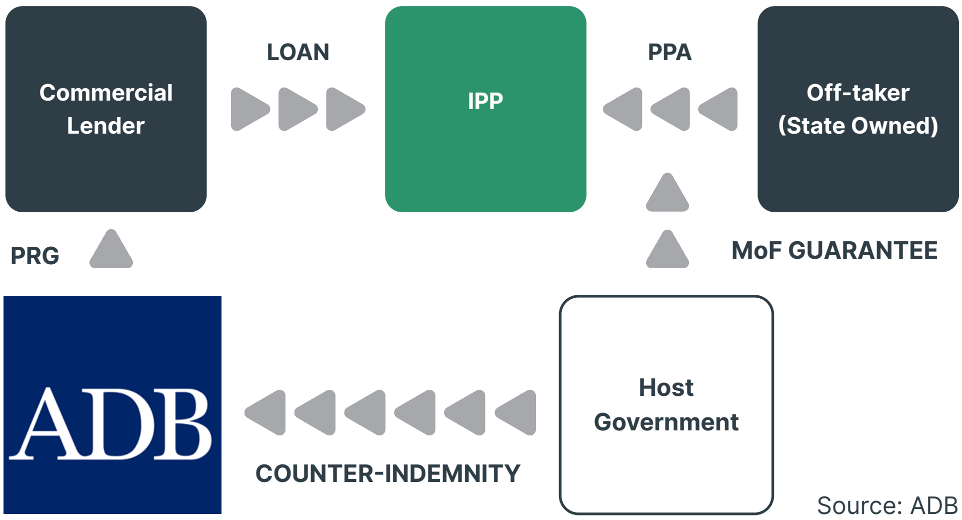
ELIGIBILITY & GUARANTEE PERCENTAGE

Eligible entities for PRGs typically include the private implementing entity in public private participation (PPP) projects or a cross-border government owned company operating on a commercial basis. Like PCGs, the guaranteed percentage is typically set at the lowest level required to mobilize financing and only goes to 100% in exceptional cases. Guarantee limits for this type of insurance can be quite high, with the US DFC marketing coverage of up to US$1B and the other MDBs saying that there is no firm upper limit.

TERMS

Pricing for PRGs can be market-based, or for guarantees that benefit from a sovereign, counter-indemnity sovereign loan equivalent pricing can apply. The African Development Bank (AfDB) and the Asian Development Bank (ADB), for example, can structure contracts in any currencies in which they can efficiently intermediate although they are often in euros or US dollars. The US DFC contracts and IDB contracts will always be in US dollars.

Chart 4
PRG example



Source: ADB

The following table outline PRG pricing, tenors and sustainability finance link for the leading MDBs

Multilateral/DFI	Pricing	Max Tenor	Sustainable Finance Link
AfDB[5]	- Not commonly used but pricing likely on par with Partial Credit Guarantees	Up to 40 years	Not seeing a strong demand for PRGs, nor a strong demand for SLBs from member countries
ADB[6]	- Sovereign loan equivalent (with counter-indemnity) - Lending spread of 50bps - Front end fee of 25bps - Commitment fee of 15bps	15 years + provided tenor is in-line with risk policies	Fewer PRGs done than PCGs
IDB[7]	- Typically blended based on level of concession. - Ordinary Capital lending spread of 90bps, Concessional rate is 25bps.	Up to 25 years for investment projects and 20 years for policy-based interventions	Strong interest in SLBs with a platform to support with PRGs and other enhancement mechanisms
MIGA[14]	- Commitment fee of 25bps - Application fee - Processing & Syndication fee if applicable - Average of 100bps of insured amount per year but can vary significantly	Typically, 15 years, up to 20 years	Has insured sustainable loans
US DFC	- 60bps-180bps* - No front-end fee	Up to 20 years	Interest in SLBs but need an anchor to structure transaction

* Sourced from interviews

POLITICAL RISK GUARANTEES IN PRACTICE

The Insurance Information Institute in New York said that political risk insurers issued US$19 billion of new coverage in 2021. Despite the new entrance of both public and private players, the market in PRGs continues to be dominated by a small group that constitute the vast majority of issuances. In the public sector, the US DFC and Multilateral Investment Guarantee Agency (MIGA) are perhaps the best-known providers of political risk insurance and both organizations have an online application process. The US DFC (formerly Overseas Private Investment Corporations, OPIC, which started issuing political risk insurance in the 1970s) can provide coverage of up to US$ 1billion against losses due to currency inconvertibility, government interference, and political violence including terrorism. MIGA began issuing political risk insurance in 1988 and as of 2018 MIGA had issued over US$33 billion coverage in over 100 countries. Both the US DFC and MIGA also offer reinsurance to increase underwriting capacity. Indeed, many private insurers will seek the involvement of the US DFC, MIGA, or another MDB when entering a deal (discussed more in the Section 4).

In 2022, the US DFC participated in the seminal Belize blue bond transaction, in collaboration with The Nature Conservancy (TNC), the Government of Belize, and Credit Suisse. Together they structured US$610 million in political risk insurance (covering loan principal and interest) in a US$364 million blue bond to provide sovereign debt relief and simultaneously fund projects in support of Belize's commitment to protect 30% of its ocean. DFC's insurance enables Belize to repurchase US$553 million sovereign debt at a discount. Given that preserving marine ecosystems is key to Belize's environment and economy, the deal demonstrates the opportunity to align financial, economic and environmental goals. It was noted in interviews that the deal would not have happened without the de-risking providing by the US DFC. After the transaction, Standard & Poor's upgraded Belize's unsecured foreign currency credit rating from Selective Default to B-. (Please see Annex 1 for more details.)

KEY INTERVIEW INSIGHTS

- There is a greater demand for PRGs from institutions in North American markets, where demand has been increasing.
- With the issuance of the Belize Blue Bond, the US DFC demonstrated that its insurance could effectively facilitate that transaction by de-risking the transaction for other private investors.
- The market view is that political risk can be a key lynchpin for unlocking KPI-linked transactions.

In Asia, ADB's political risk product[15] has recently been highlighted in a multipartner consortium launched in August 2022 alongside the insurer Tokio Marine HCC (TMHCC), Tokio Marine & Nichido Fire Insurance Co., Ltd. (TMNF) plus four other global insurance companies. This consortium launched a new framework credit insurance program, covering loans to financial institutions and increasing lending capacity by US$1B to the Asia-Pacific region. ADB's program utilizes credit insurance, which covers losses in the event of non-payments by borrowers under loan agreements, and covers its loans to financial institutions, meeting certain criteria over the next three years. The program enables ADB to mitigate its credit risk exposure and provide additional funding to organizations throughout the Asia-Pacific region. Separately, but also supporting the demand for impact-aligned products, in September 2021, the ADB issued its first-ever dual-tranche blue bonds, a US$151 million, 15-year instrument denominated in Australian dollars and a 10-year issue of the same size denominated in New Zealand dollars, that will finance ocean-related projects in Asia and the Pacific[16].

The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance

A Landscaping Review

3 Reinsurance and Syndication

SUSTAINABILITY-LINKED SOVEREIGN DEBT HUB

3

Reinsurance and Syndication

DFIs issuing political risk insurance (or PRGs) can also use reinsurance to leverage their capacity, manage the risk profile of the overall portfolio, and foster the growth of the private political risk insurance market. Whenever a project exceeds capacity, due to challenging operating environments, below investment grade sovereign debt or other reasons, the DFIs can syndicate with private and public sector (re)insurance companies in order to meet clients' needs. Indeed, most examples of large instruments with insurance provision are likely to be syndicated. Lloyds of London plays an important role in private PRI underwriting; and many underwriters manage "syndicates for Lloyds". Reinsurers are an essential part of this sovereign debt process as they enable insurers to adjust the risk-return profile of their portfolios especially as risks in this market are cross-correlated.

MIGA, for example, will have preliminary discussions with a number of potential (re)insurers and inform the client on available capacity and premium rates. The client will then authorize MIGA to seek capacity and pay applicable syndication fees. MIGA will invite potential reinsurers and select partners. As noted above, guarantees are also typically structured to mobilize additional capacity through partnership arrangements. In the last 20 years, the increased participation of the private sector has been driving market growth and providing additional capacity for risk sharing.

The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance

A Landscaping Review

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The Private Insurance Market

SUSTAINABILITY-LINKED SOVEREIGN DEBT HUB

4
The Private Insurance Market

The private insurance sector plays a key role, on commercial market terms, in the risk sharing of sovereign-supported financing transactions. Participating in transactions with LMICs typically requires one or multiple forms of credit enhancement from a DFI that has a preferred creditor status. Like the DFIs, private insurers have different products to mitigate the risks arising out of financing, trading, and investing in developing markets. The 2022 Market Capacity Report issued by Gallagher shows private insurance capacity increasing across product lines with a total private market capacity of US$3.5 billion for political risk, US$3.2 billion for contract frustration, US$2.5 billion for credit and US$1.9 billion for non-trade. Capacity for tenors greater than 15 years is significantly lower, with companies interviewed saying they would probably need to see a credit enhancement mechanism in place for longer tenors.

The following table outlines capacity for credit and political risk, by company. Tenors noted are typically the max as opposed to the norm, and some interviewees noted different layers of approval needed for max tenor transactions. Despite the large capacity limits for these organizations, most companies stated that their "sweet spot" tended to be participation in a syndicate with a lower amount (e.g., US$15-US$75 million).

January 2022	Political Risk		Contract Frustration		Credit		Non-trade	
Company*	Line (mUSD)	Tenor (Years)	Line (mUSD)	Tenor (Years)	Line (mUSD)	Tenor (Years)	Line (mUSD)	Tenor (Years)
AIG	150	15	150	15	100	10	150	10
AXA	150	20	150	20	150	20	150	20
Liberty Mutual	100	15	100	15	100	15	100	10
Munich Re	35	15	35	7	35	7	35	7
Swiss Re	75	20	75	20	200	5	0	0

*Note all companies were interviewed except AIG, which was included due to their high maximum lines in credit and political risk.

Source: Gallagher Specialty Structured Credit & Political Risk Insurance Market Update February 2022

TERMS

All pricing is done at market, or commercial terms, which at the time of writing (December 2022) was quoted to be approximately 70% of margin with some flexibility on a case-by-case basis. Arbitration award default coverage is typically less expensive than credit non-payment coverage because of the requirement that there be a final award before a claim is paid. Like the MDBs, these private insurers also have country capacity limits, single obligor limits, and other limits linked to credit rating of the obligor. Several groups noted that demand for coverage in emerging markets is continuing to grow, but capacity can become constrained in more challenging countries (e.g., Russia, Ukraine and some Sub-Saharan Africa countries – at the time of writing.)

PROCESS AND POTENTIAL PARTNERS

Private insurers often maintain direct relationships with the MDBs and DFIs, but typically work through brokers when it comes to negotiating deal terms. As such, large brokers, like Alliant, Marsh, Willis Towers Watson and Aon are critical to the process of structuring SLBs and providing access to the global private (re)insurance market. Large transactions (e.g., US$500 million+) might require the participation of twenty of more private insurers. Most insurers agreed there would be clear benefits to increased standardization to scale these transactions, including common terms, common financing structures, and common metrics for impact measurement and monitoring. However, there was also general acknowledgement that a large degree of customization is inevitable.

Although no private insurers interviewed have specific nature or climate mandates, there was a strong appetite to participate in such transactions on commercial terms, which can be achieved even in sub-investment grade countries by utilizing a credit enhancement mechanism.

“The key to making this all happen is often multilateral involvement. When we’re standing behind a multilateral or DFI, we’ll benefit from their preferred credit status, monitoring and due diligence.”

Private Insurer

The insurers interviewed also commented that Environmental, Social, Governance (ESG) standards are increasingly being incorporated into the broader mission of their organizations and they predict an increase in demand to support these transactions at market rates.

5

Sustainability-linked Bonds and Lowering the Cost of Capital

SUSTAINABILITY-LINKED SOVEREIGN DEBT HUB

5 Sustainability-linked Bonds and Lowering the Cost of Capital

When examining the linkages between KPIs, lower cost of borrowing and long-term creditworthiness, there are several factors to consider. First, sustainability-linked finance allows borrowers to highlight nature-based commitments to their existing investor bases while attracting a wider pool of investors interested in impact and sustainable investing. By doing so, the issuer, in this case sovereigns, may achieve a lower cost of capital, as well as an expanded and diversified investor base.

In addition, sustainability interventions tied to nature improvements enhances shareholder value, both in the short and long term, by increasing community resilience, tourism, lowering climate risks, increasing productivity, and other socio-economic factors.[17] According to the International Finance Corporation (IFC), financial institutions are beginning to incorporate ESG performance into their credit rating systems, reflecting the positive impact that ESG can have on portfolio quality.[18]

Green bonds, for example, have presented lower yields than conventional bonds in the secondary market. An example of this green premium occurred with Germany's unique twin bond structure whereby each green security was issued together with a conventional bond with the same financial characteristics. The result was that the German green Bund priced with a "greenium" maintained a lower yield in secondary market, and exhibited lower volatility compared to its vanilla twin. This provides clear evidence that investors can attach a premium to the green label, thereby offering less expensive financing[19]. Across developing countries, Egypt, Thailand, Indonesia and Chile also experienced a "greenium" according to the Confederation of British Industry (CBI). Importantly, the OECD notes, the issuance for these sustainability bonds, and certainly KPI-linked bonds (like nature performance bonds) are scarce, and the supply-demand mismatch can trigger a greenium[20].

According to a joint paper by MIT and Uni Zurich[21], which examined the yield differential between SLBs and non-sustainable bonds by matching bonds from the same issuer, in most cases investors pay for the improvement in sustainability, while issuers benefit from a sustainability premium. The analysis suggests that the sustainability premium is larger for bonds with a higher coupon step-up and for callable bonds. They also identified a so-called 'free lunch' for some SLB issuers, as their financial savings are higher than the potential penalty, and they have a call option to reduce this penalty. These findings suggest that most SLBs incentivise sustainability improvements by offering a lower cost of capital.

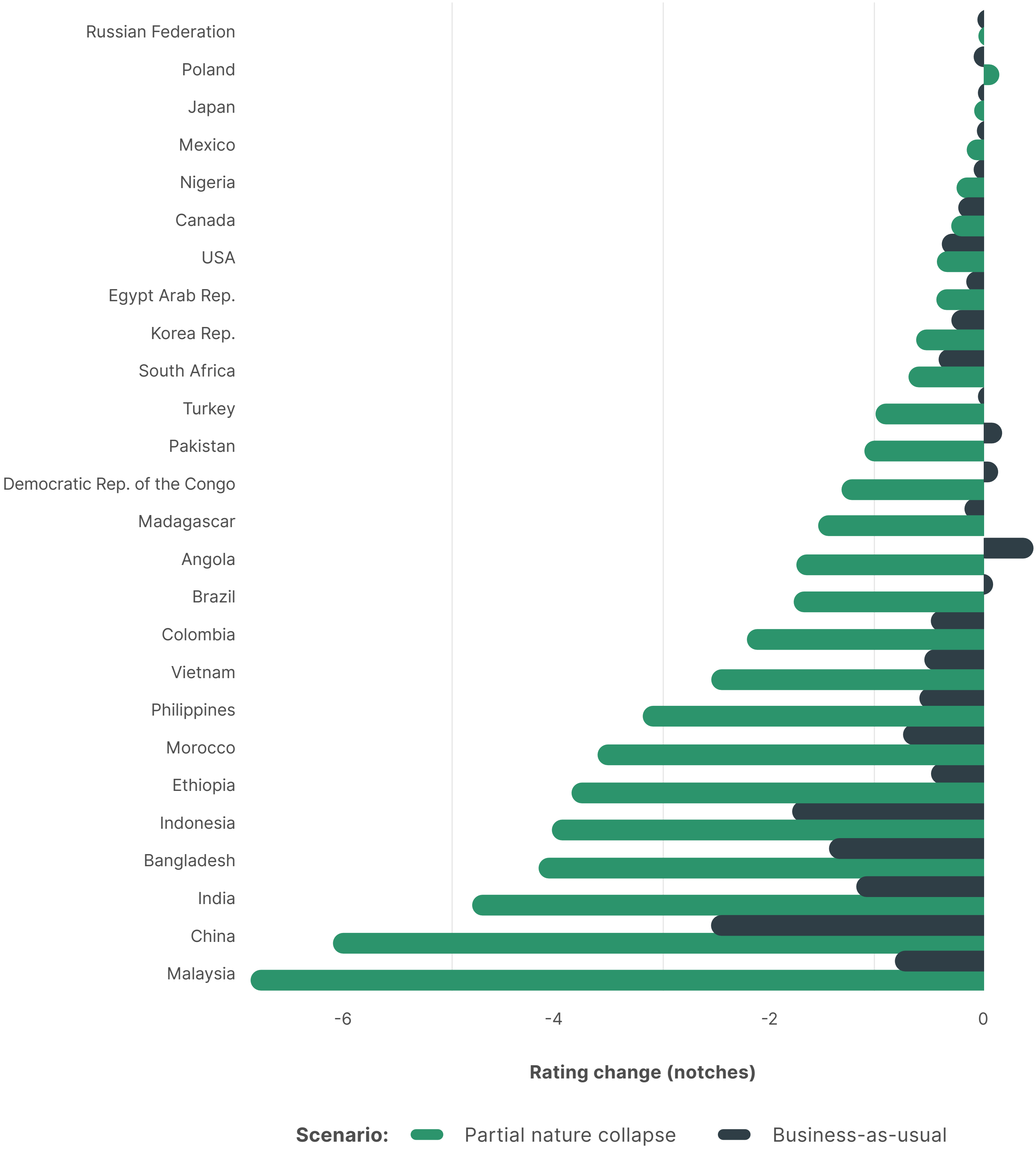
KPI-LINKED BONDS AND CREDITWORTHINESS

In 2021 the volume for SLBs rose to US$103 billion, 803% above 2020 figures; this was driven, in part, by the European Central Bank's (ECB) decision to accept SLBs as collateral for Euro system credit operations and monetary policy purchases, starting in 2021.[22] This reinforces the creditworthiness and potential positive economic impacts to the issuer.

Institutional investors are typically looking for investment-grade instruments and are often mandated to do so in line with their fiduciary duty; this means that high-risk countries are not of interest to them, even when their private capital is much needed. The solutions identified in this landscaping review are essential: without the assistance provided by credit-enhancement mechanisms, issuances of KPI-linked bonds from LMICs remain unfeasible and unable to reach critical size from private financiers. An increasingly proven solution is to use guarantees and political risk insurance to improve the credit quality of sovereigns. The companies interviewed cited the halo effect: demonstrating to other investors that the country/issuance is viable and sustainable financially.

A prominent example is the Seychelles sovereign blue bond (discussed in section 2), which was partially guaranteed by a US$5 million guarantee from the World Bank (IBRD) and further supported by a US$5 million concessional loan from the Global Environment Facility (GEF) which partially covered interest payments for the bond. On the corporate side, GuarantCo, a Private Infrastructure Development Group (PIDG) company, has guaranteed the first International Corporate Indian Rupee Green Bond in Asia by providing an unconditional and irrevocable guarantee, which covers 100% of the principal and interest of the green bond. The strength of GuarantCo's guarantee was responsible for the strong rating (Moody's rated the Green Bond A1 and Fitch AA) which also made it feasible for institutional investors to subscribe to the Green Bond.[23]

Chart 5
Rating changes due to partial nature collapse



Source: Nature Loss and Sovereign Credit Ratings report[24]

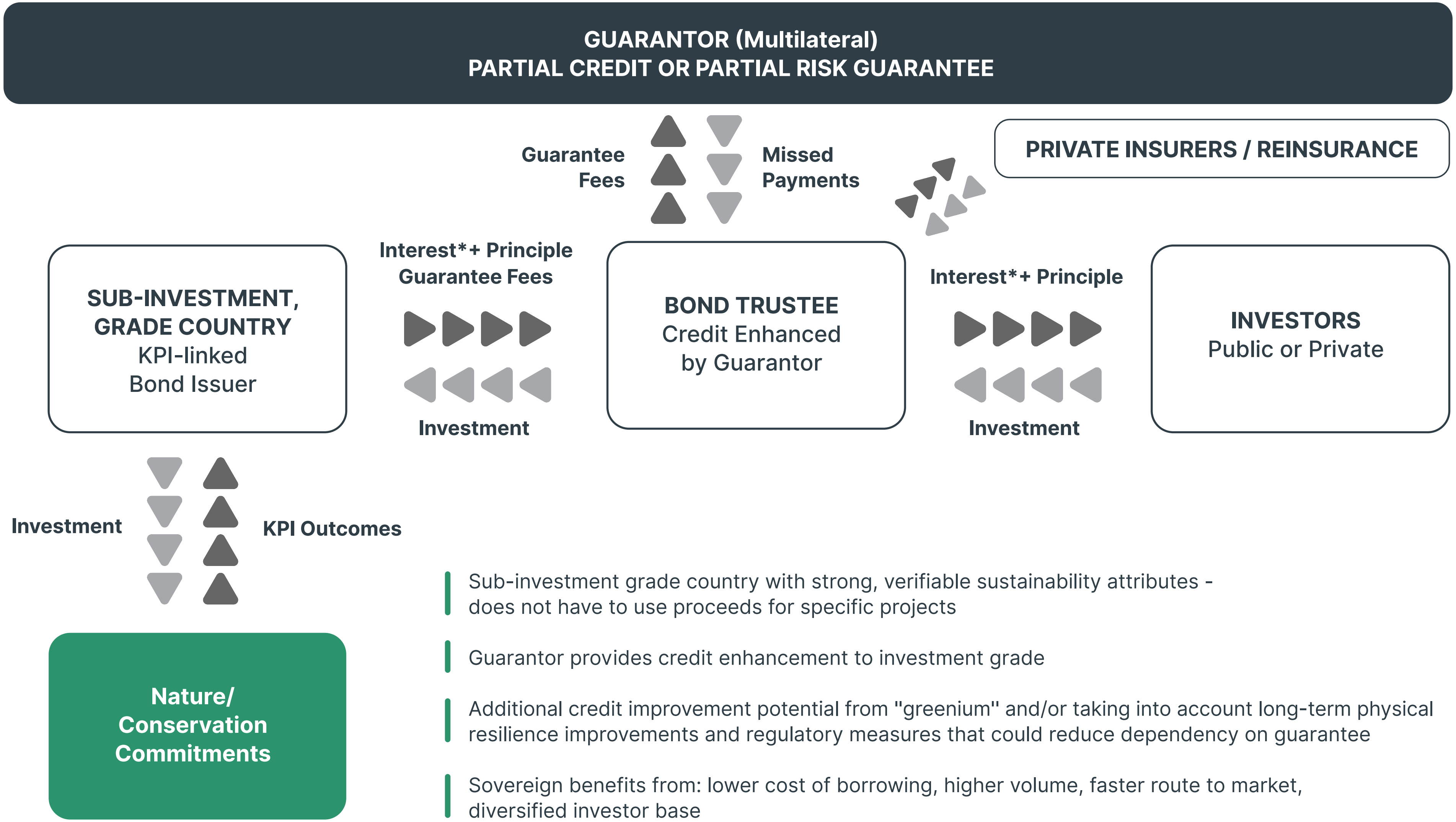
6 Incorporating Nature into the Structure

6 Incorporating Nature into the Structure

NatureFinance previously demonstrated that biodiversity loss and environmental degradation can have material impact on sovereign creditworthiness.[24] Current methodologies published and applied by leading credit rating agencies do not explicitly incorporate biodiversity and nature-related risks, but omitting them may result in overlooking serious risks. Biodiversity loss was modelled by the World Bank[25] and found to affect sovereign debt markets negatively in 26 nations. Across the 26 countries these downgrades would increase the annual interest payment on debt by up to US$53 billion a year[26], leaving many LMICs at significant risk of sovereign debt default – in effect, bankruptcy, the researchers say. A continued depletion of nature and biodiversity would increase the risk of partial nature collapse, with potentially significant downside risks in terms of output losses, credit ratings downgrades, and a higher cost of capital. The report points out that the opposite can also be true: economies with high dependence on ecosystem services can invest in nature to generate long-term returns for people, business, and nature which can ultimately improve credit ratings.

Currently, Fitch Ratings[27] considers GHG emissions and air quality, energy management, water resources and management, biodiversity and natural resources management, natural disasters and climate change to be potentially applicable to indicators in rating models. However, their ESG relevance scores[28], which determine whether these factors have a material impact on a country's credit, remain generally quite low, being pegged either as minimally relevant or irrelevant to a sovereign's rating. Fitch Ratings strengthens this argument, but also states that data are missing and the correlations are multifactorial. The reports conclude that there is not a linear relationship from biodiversity improvements to higher credit scores.[29] But measures that can be embedded in a KPI bond for nature, such as transitioning to a greener economy, reducing physical (climate) risks, and improving regulation while reducing the likelihood of litigation (especially for corporates), can all have long term implications on improved credit ratings. For now, credit enhancement measures can partially fill this gap.

Chart 6
How a KPI-linked bond issued by a sub-investment grade country could benefit from credit enhancement



- Sub-investment grade country with strong, verifiable sustainability attributes - does not have to use proceeds for specific projects
- Guarantor provides credit enhancement to investment grade
- Additional credit improvement potential from "greenium" and/or taking into account long-term physical resilience improvements and regulatory measures that could reduce dependency on guarantee
- Sovereign benefits from: lower cost of borrowing, higher volume, faster route to market, diversified investor base

* Component of interest payment linked to nature outcomes

The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance

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7
The Role of Bilaterals and other Governmental Organizations

SUSTAINABILITY-LINKED SOVEREIGN DEBT HUB

7
The Role of Bilaterals and other Governmental Organizations

All conversations with bilaterals conducted for this Landscaping review, (excluding the US DFC) revealed that these organizations typically work with the private sector and are unable to provide direct credit enhancement to sovereigns. Moreover, bilaterals tend to have smaller ticket sizes and more specific development objectives. Several bilaterals indicated that there could be potential to be involved either in the establishment of the facility or in individual transactions depending on the structure.

The Swedish International Development Cooperation Agency (SIDA), for example, is a market leader in guarantees and interested in exploring partnerships with sovereigns. SIDA has previously applied a guarantee to a MDB, and they frequently guarantee private funds involved in public/private partnerships. Like the MDBs, SIDA's guarantees are priced with a front-end (origination) fee, a utilization fee, and a non-utilization fee. SIDA is interested in exploring participation in SLBs and has a track record of issuing co-guarantees. Like other bilateral agencies, SIDA at this point would still need a private sector enterprise, but the end beneficiary could be sovereign.

Proparco has also been recognised for pioneering and risk taking in the bond space, investing in Morocco's first green bond and then committing EUR 100 million to the Amundi Planet fund to invest in green bonds globally. Through the interview, Proparco pledged interest in supporting SLBs where there is a strong nature-lens; indeed, Proparco claims that they are the strictest among the DFIs when it comes to biodiversity protection and promotion, and they would be a counterpart in an NPB type issuance but, like SIDA, would need private sector local involvement.

The European Investment Bank (EIB) has also indirectly provided credit enhancement to sovereign debt in public-private partnerships. EIB, for example, has been involved in multiple transactions involving guarantees, but does so through pooled mechanisms and not on a standalone basis. For example, in 2018 they formed a multistakeholder consortium to unlock US$1.4 billion of new clean energy investment across Africa with insurance alongside Munich Re and the African Trade Insurance Agency (ATI).[30] The new facility, the Africa Energy Guarantee Facility (AEGF) provides the first dedicated reinsurance for sustainable energy projects across Africa. EIB's role is both as convener and as a provider of de-risking capital (US$50 million of a total cost of US$1.4 billion). Products offered under the AEGF include insurance against sovereign or sub-sovereign non-payment under a Power Purchase Agreement, expropriation and breach of contract, currency inconvertibility, war, civil unrest and arbitration award default. Notably, ATI was repeatedly cited as a partner or anchor of choice for both DFIs and insurers but they were not reached in this analysis.

The Swiss State Secretariat for Economic Affairs (SECO) has been a thought-leader in impact-linked finance. To date, they have not provided any credit enhancement to sovereigns, but they frequently use grants as instruments to develop strategies for economic development that include impact-linked finance and SLBs. They provide advisory work and have several projects working with governments on how to issue green bonds. SECO notably works with middle-income countries with grants ranging in size from US$ 1 to 5 million which is a meaningful amount to support strategy around the structuring SLBs and supporting the standardization of defining impact metrics and monitoring procedures.

Organizations like the UN are also well positioned to provide grant support and technical assistance for structuring, impact measurement and monitoring. This has been the case for launching the world's first Nature Performance Bond in Pakistan, which was temporarily halted, but nonetheless has laid the groundwork for future opportunities[31].

The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance

A Landscaping Review

8 The Role of the SSDH

SUSTAINABILITY-LINKED SOVEREIGN DEBT HUB

8
The Role of the SSDH

There is a need for LMICs and investors to have access to a suite of financing tools and services linked to issuing debt that is tied to concrete nature-based developmental outcomes. A key starting point is a strong commitment to environmental conservation from the host government, and investor appetite for sustainability-linked products. KPI-linked sovereign debt issuances show promise and growth, and early examples provide measurable impacts to investors and investees.

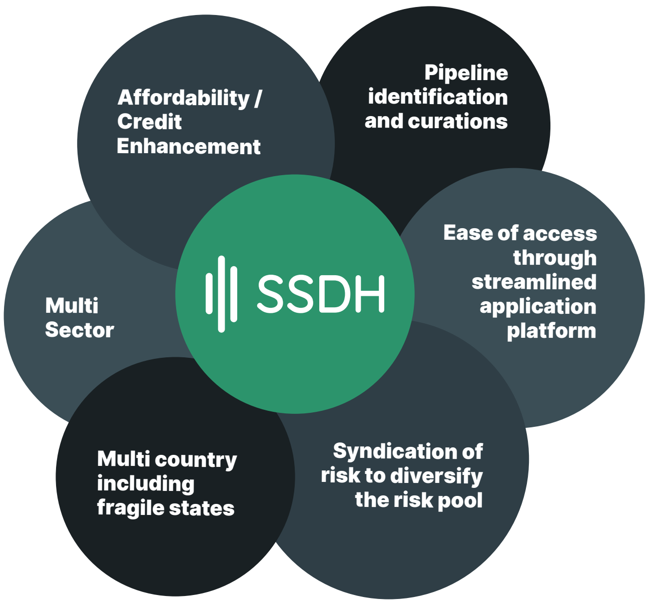
All parties interviewed agreed that SLBs are complex multi-stakeholder transactions and that closing deals that will have a meaningful impact on both the country's debt profile and the environment will require pooled capacity from public and private institutions. Although there have only been two sovereign issuances to date (Chile and Uruguay), the respondents agree the positive implications of the KPIs can have knock-on effects towards improving the investability of the country and as such expect to see an acceleration of these instruments.

The current market for grants, advisory and technical support is quite fragmented with parties willing to support SLBs but unsure how to take the first step. Scale will ultimately depend on numerous factors: increased standardization (especially on impact metrics and management); a streamlined process for collaboration (typically led by a project anchor); and, in the case of sub-investment grade countries, credit enhancement to facilitate the transaction.

SSDH intends to be instrumental in addressing these market gaps. As a collaborative body of key players, SSDH could support the establishment of a framework for standardization, streamline the application process for advisory, grants and technical support, provide a platform for collaboration and serve as a knowledge hub to educate stakeholders on SLBs and the credit enhancement tools needed to facilitate some of these transactions.

The SSDH can also provide a crucial link to the private sector, bringing international insurance brokers, insurers and investors to the platform to pool capacity and facilitate larger, meaningful transactions. One large insurance broker stated that they "would be interested in knowing how the platform is being set up and what countries are being targeted. [They could] give them access to the global insurance market as well as open some doors with the DFIs." Similarly, a large insurer said that "if [SSDH] could create a platform that would bring together credit enhancement providers with the private insurers earlier on [they] could agree on parameters up front and ensure more transactions meet our criteria."

The SSDH intends to play a central role in catalyzing the development and mainstreaming of the market in KPI-linked sovereign debt instruments that, as the Virtuous Circle and recent data supports, improves nature, communities and sovereign fiscal viability.



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Annexes

9
Annexes

Annex 1
Credit Enhancement Case Studies

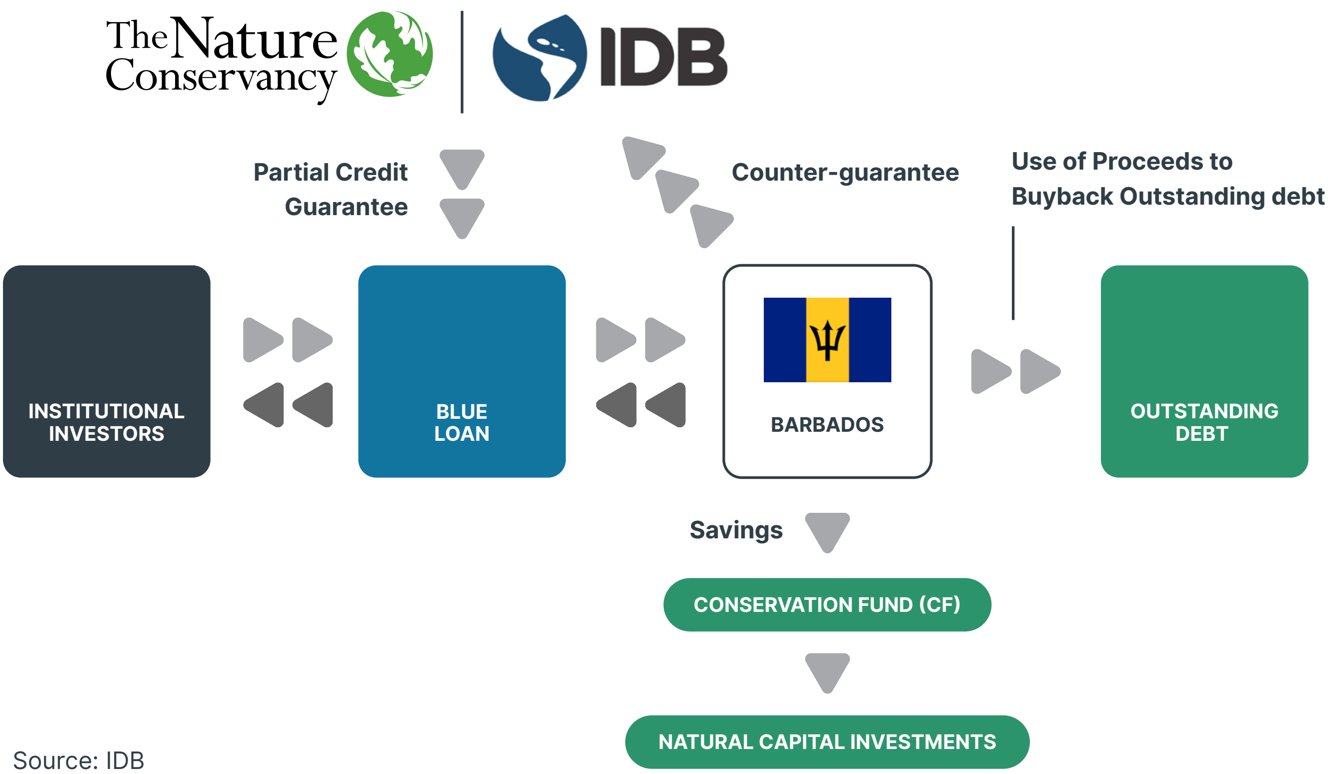
1.
CREDIT ENHANCEMENT IN BARBADOS BLUE LOAN

Structure of the Deal
Barbados completed a Debt for Nature Conversion backed by a US$150 million guarantee from the Inter-American Development Bank (IDB) and The Nature Conservancy (TNC), allowing the country to reduce borrowing costs and use savings to finance a long-term marine conservation program. This operation included a US$100 million guarantee from the IDB and another US$50 million guarantee from TNC that enhanced a loan provided to Barbados (Blue Loan) to buyback existing debt.

Credit Suisse acted as Global Lead Arranger and CIBC FirstCaribbean acted as Domestic Lead Arranger of the Blue Loan. Credit Suisse and CIBC Capital Markets acted as joint deal managers for Barbados buyback of its USD 2029 bonds.

Outcomes of the Deal
The savings generated by this debt conversion, estimated at US$50 million over the next 15 years, will be used to fund the Barbados Environmental Sustainability Fund (BESF), which will fund marine conservation and other environmental and sustainable development projects in the country. Barbados has made a number of conservation commitments, including the protection and sustainably managing up to an aspirational target of 30% of its Exclusive Economic Zone and Territorial Sea.

Unique Feature of the Deal
This transaction features the first-ever financial instrument to be guaranteed by both a multilateral institution and a non-governmental organization and provides the first ever sustainability linked debt framework focused on nature conservation developed by the IDB and Barbados as part of this operation.



Source: IDB

2.
CREDIT ENHANCEMENT IN THE BELIZE BLUE BOND

Structure of the Deal
Belize could not borrow the funds in the market to repay its existing bondholders because the interest rate would have been too high to create savings. TNC arranged a US$364 million blue loan between the Belize Blue Investment Company (BBIC), a TNC subsidiary, and the Belize government, which allowed the country to repurchase its superbond.

Because the transaction directly funded marine conservation, BBIC secured a credit enhancement for the blue loan from the United States International Development Finance Corporation (DFC), which in turn, allowed BBIC to fully finance the loan through blue bonds issued by Credit Suisse. Credit Suisse issued the blue bonds, which obtained a Moody's credit rating of Aa2 through a repackaging vehicle that the bank subsequently syndicated to institutional investors globally.

"With the credit enhancement, the blue bonds were very highly rated and very low risk. That took us from a very small investor base of high-risk emerging market investors into the gigantic world of pension funds and insurance companies that buy double-A paper. Within that universe, we could target the investors that are really focused on ESG to help us drive down the spread."

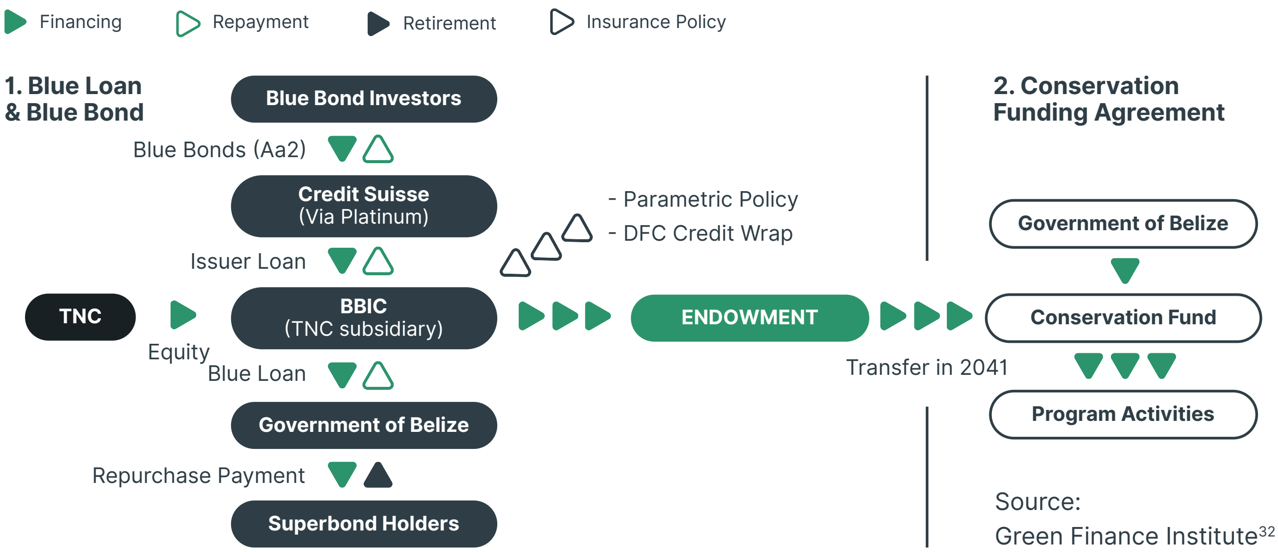
TNC's Kevin Bender, who led the transaction

The blue bond syndication received high interest from investors, was oversubscribed and BBIC was able to pass on this cheaper cost of funding to Belize. The blue loan to the Belize government comes with original issue discount and a coupon that steps up on a semi-annual basis, starting at 3% in April 2022 and going up to 6.04% from April 2026 onward. This structure reduces the country's near-term debt payments and makes its debt much more sustainable. The 19-year loan also has a grace period on principal payments for 10 years.

Outcomes of the Deal
This innovative debt conversion created both immediate and longer-term fiscal savings for Belize. It cut US$189 million, in principle, from its outstanding debt and reduced its debt service costs by $200 million over 20 years. It also avoided a US$58.4 million principal reinstatement, part of the agreement from a previous restructuring of its superbond that would add back this amount to the country's debt if it defaulted. After the transaction, Standard & Poor's upgraded Belize's unsecured foreign currency credit rating from Selective Default to B-.

Unique Feature of the Deal
Hurricanes and large storms are a risk to the Belize economy and to government revenues, so the blue loan structure also incorporates the world's first commercial sovereign debt catastrophe insurance cover. The parametric insurance policy, designed by Willis Towers & Watson and underwritten by a Munich Re subsidiary, provides coverage for blue loan coupon and principal payments following an eligible hurricane event in Belize.

Belize Blue Loan / Blue Bond & Conservation Funding Agreement Structure



Source:
Green Finance Institute[32]

3.
CREDIT ENHANCEMENTS IN BOND FUNDS

Structure of the Deal
Risk cushion in the form of subordinated tranches could be provided to investors without previous experience in emerging market debt, thereby allowing them to commit a senior tranche. This was the case of the Amundi Planet Emerging Green One (EGO) fund, a green bond fund focused on emerging markets. The fund is the first of its kind to take a holistic approach, investing in emerging market green bonds while also supporting the creation of a robust green bond market through tailored capacity building activities.

Participation from IFC and other DFIs as anchor investors, investing in the junior tranche of the fund, allowed crowding in capital from private investors such as leading pension funds and insurance companies. The first credit loss protection allows the project, by design, to credit enhance the credit rating of BB+ average on the fund's bond portfolio, to BBB+ equivalent to senior tranche investors in the fund. As the rating becomes investment grade, it is then possible to attract a broader range of investors compared to a portfolio which is non-investment grade. The rating approach to structure the EGO fund with junior, medium and senior tranches, is an important feature to make the fund more catalytic with investors.

Outcomes of the Deal
Other important features include:
1. The initial size of the fund at US$1.42 billion and a US$2 billion investment strategy over 7 years, was meant to attract many institutional investors who typically want to buy minimum US$ 100 million tickets and own less than 5% of such debt funds.

2. The listing of all the fund's shares on the Luxembourg Stock Exchange eases secondary market shares trading and contributes to making fund's shares marketable securities in line with market-based accepted regulation/supervision. (Source: OECD)[33]

Unique Feature of the Deal
Private investor, pension fund and insurance company participation will increase the scale and pace of climate finance.

Annex 2
Example of Digital Technical Assistance Tool - The Green Bond Transparency Platform[34]

The Green Bond Transparency Platform (GBTP) is a digital tool launched by the Inter-American Development Bank (IDB) to help bring more transparency to the green and sustainable bond market in Latin America and the Caribbean. The platform is a public taxonomy-neutral instrument that reports the use of proceeds and environmental impacts of the bonds issued in the region.

Its open and accessible system design provides Sustainability Performance Target traceability, and this facilitates replicability in other types of bonds facilitating the monitoring of sustainability-linked (SLB) instruments. The GBTP includes over 200 KPIs with over 60 nature based and biodiversity metrics used in more than forty projects related to climate change adaptation, climate observation, early warning systems, environmental management, natural landscapes, and reforestation.

With more than 80% of the regional market volume reported, it is a knowledge hub to inform stakeholders on SLBs reporting practices and provide the data granularity required for investment decision-making.

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