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## Input Paper

# Mechanisms for mobilisation of timely and adequate resources for climate finance

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वसुधैव कुटुम्बकम्

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## Executive Summary

Climate finance are the financial resources supporting mitigation and adaptation actions to address climate change. These resources can originate from various sources like public funds (such as funds from governments or multilateral financial institutions) and private investments. The need for massive investments into green infrastructure, the general shift of global economies toward net-zero emissions, and enhancing the resilience of vulnerable populations to the negative impacts of climate change is pronounced and urgent. The speed and depth of the transformation can be achieved with enhanced grant and concessional public funding and by catalysing private finance flows.

Several estimates of resource requirements for climate action to meet the Net zero targets set down by countries suggest the need for trillions of dollars per annum in the medium to long term. However, the global climate finance flows have not kept pace with the resource requirements and the flows have continued to be inadequate in both scale and type in addressing the financing challenges of developing countries.

The public sector has a vital role in financing climate mitigation and adaptation. Its role is to not only directly finance climate action but also catalyse private finance through mechanisms that de-risk and unbundle complex projects. The scale of financial resources required to meet global challenges necessitates exploring innovative ways to mobilise private sector financial resources through a mix of concessional and non-concessional loans, equity participation, guarantees, dedicated trust funds as well as other blended financing, and de-risking mechanisms. Therefore, resources for climate action have to be from a mix of public and private capital with various disbursement channels to ensure the sustainability of financing.

There are several instruments that are already in existence at the global and regional/domestic levels, operating through the widely recognised concepts of concessional and blended financing, including de-risking. This paper discusses several of these instruments, such as equity funds, bonds, risk-sharing facility, first-loss capital, outcome-based sustainability-linked loans/bonds, structured funds, etc.

The challenges in attracting private capital entails a discussion on **enhancing grant and concessional financing**, including from philanthropies and pension funds, **enhanced blended financing** through various instruments and **guarantees**, a discussion on innovative mechanisms like **Collective Investment Vehicle structured fund** and **risk mitigation mechanism that can pool risks across projects and geographies** to lower the risk profile, **focusing on sector specificity**. These aspects are discussed in section III of the note and the Presidency hopes to have views of the membership on them in addition to any other aspect that may be mentioned.

For effective climate action, developed countries (where the majority of global capital is located) and developing countries (where the majority of the growth in demand for energy and materials will occur) must act in concert. Given the scale of investments needed, public capital should be used strategically to crowd in private investments for climate action at pace and scale, particularly in developing countries. Given the developmental challenges faced by developing countries and their increasing debt vulnerabilities, developing countries do not have the capacity to de-risk investments at scale. Enhanced role of MDBs and new innovative instruments including de-risking mechanisms with a focus on specific sectors needs to be examined as a means to mobilise resources at scale.

## **I - Introduction**

Climate finance can be understood as financial resources that support mitigation and adaptation actions to address climate change<sup>1</sup>. These resources can originate from various sources like public funds (such as funds from governments or multilateral financial institutions) and private investments.

There are several estimates of resources required for climate action to meet the Net zero targets set down by countries. It is estimated that USD 4 trillion per year needs to be invested in renewable energy up until 2030 to be able to reach the goal of net zero emissions by 2050<sup>2</sup>, and investment of at least USD 4–6 trillion<sup>3</sup> per year will be required for a global transformation to a low-carbon economy. The OECD estimates that USD 6.9 trillion a year is required up to 2030 to meet global climate and development objectives<sup>4</sup>. Further, it is estimated that adaptation could require yearly investments of USD 160–340 billion by 2030 and USD 315–565 billion by 2050<sup>5</sup>.

The global climate finance flows have not kept pace with the resource requirements. According to the recent Fifth Biennial Assessment report, global climate finance flows were USD 803 billion in 2020. The estimates by the OECD of climate flows to developing, and emerging economies in 2020 were USD 83.3 billion. They find that climate finance flows have continued to be inadequate in both scale and type in addressing the financing challenges of developing countries<sup>6</sup>. Another assessment, following a different approach reports much lower figures.<sup>7</sup>

The public sector, represented by domestic, bilateral and multilateral sources, have vital roles in financing climate mitigation and adaptation. It has a role to not only directly finance climate action but also catalyse private finance through mechanisms that de-risk and unbundle complex projects. The scale of financial resources required to meet global challenges necessitates exploring innovative ways to mobilise private sector financial resources through a mix of concessional and non-concessional loans, equity participation, guarantees, dedicated trust funds as well as other blended financing and de-risking mechanisms. Therefore, resources for climate

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<sup>1</sup> <https://unfccc.int/topics/introduction-to-climate-finance>

<sup>2</sup> World Energy Outlook 2022, International Energy Agency

<sup>3</sup> United Nations Environment Programme. 2022. Emissions Gap Report 2022: The Closing Window – Climate crisis calls for rapid transformation of societies. Nairobi: United Nations Environment Programme

<sup>4</sup> <https://www.oecd.org/environment/cc/climate-futures/policy-highlights-financing-climate-futures.pdf>

<sup>5</sup> Adaptation Gap Report, United Nations Environment Programme, 2022

<sup>6</sup> Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013–2020, OECD 2022

<sup>7</sup> Oxfam report (2022)

action have to be from a mix of public and private capital with various disbursement channels to ensure the sustainability of financing.

This paper outlines a spectrum of “instruments” that could be utilised by the countries to mobilise and access finance for adaptation and mitigation along with examples of such instruments. The objective is to enable a discussion on the subject under the Sustainable Finance Working Group. It ends with identifying issues that need to be deliberated upon on scaling up finance and seeks responses on questions for discussion.

## **II – Instruments for resource mobilisation**

Given the much higher scale of climate finance required vis a vis the actual flows, there is a need to have innovative financial instruments that can address the underlying concerns that investors have in financing new and original technology to address climate action, the scale at which it is required and the longer time horizon of most adaptation and mitigation projects.

At present, there are several instruments at the global and regional/domestic levels operating through the widely recognised concepts of concessional and blended financing<sup>8</sup>, including de-risking. This note encapsulates certain instruments that are in use.

### **Grants**

Grants are generally mobilised through established funds or through bilateral or multilateral agreements and do not place any financial burden on the recipients. They are generally awarded to finance or reimburse activities that meet the recipient government’s priorities and objectives at that time. The Adaptation Fund Board has so far allocated USD 998 million to 139 adaption projects. Further, several developed countries also provide grant support for climate action projects. The recent commitment by the Swedish International Development Cooperation Agency (Sida) and the Food and Agriculture Organization in Iraq (USD 10.2 million for climate resilience of vulnerable agriculture households) is illustrative<sup>9</sup>. Similarly, another is Egypt’s programme on Nexus of Food, Water and Energy (NFWE) in which the European Bank for Reconstruction and Development (EBRD) is Egypt’s lead partner. Apart from its lead role, the EBRD has committed US\$ 1 billion in private renewable finance, US\$ 300 million in sovereign finance and grants of US\$ 3 million from its Shareholder Special Fund<sup>10</sup>.

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<sup>8</sup> A brief on the selected instruments and the mechanism of blending are provided in Annexure I

<sup>9</sup> <https://iraq.un.org/index.php/en/208161-sweden-contributes-usd-102-m-iraqs-agriculture-sector-southern-iraq-mitigate-climate-changes>

<sup>10</sup> <https://www.ebrd.com/news/2022/egypts-nwfe-energy-pillar-gathers-international-support.html>

## Concessional finance

It is finance at below-market-rate provided by developed countries, and institutions, such as development banks and multilateral funds, to developing countries to fast-track development objectives, including climate actions. Concessional finance leverage the limited pools of public sector funding to attract the much larger private sector funds. It includes a range of products such as loans with interest rate below the conventional market rates, grants and, to some extent, equity investments. The Climate Investment Funds (CIF) is a case in point. This is a multilateral fund working with the multilateral development banks that deploys concessional finance for climate action projects. Climate Investment Funds has, so far, mobilized finance for more than 375 projects in 72 countries and has pledged USD 11.1 billion as climate finance<sup>11</sup>. For example, the Mocuba Solar project in Mozambique was supported by a USD 55 million financing package from IFC. By blending CIF financing from two CIF windows – USD 9 million from the Clean Technology Fund and USD 10 million from the Pilot Program for Climate Resilience – with its own commercial funds and mobilized funds from private sector lenders, IFC is helping to diversify and decentralize Mozambique's energy system. Blended concessional finance helped the sponsor offer affordable tariffs to consumers<sup>12</sup>.

## Equity funds

Investment in the equity securities (i.e. shares) of firms/companies expected to benefit from the transition to a low-carbon environment or driving the reduction of greenhouse gases and/or adaptation to climate change, or which are in the process of making their business models more resilient to the long-term climate risks - provides direct capital to such firms. Equity funds created by the MDBs signal the due diligence on projects done by the MDBs, thereby reducing information asymmetries for private investors and creating an enabling environment for the latter.

**Example:** Asian Infrastructure Investment Bank (AIIB) has established a private equity fund called the SUSI Asia Energy Transition Fund (SAETF) to engage institutional investors in funding projects related to the energy transition in developing Asia and fund projects related to energy storage, renewable energy, microgrid projects, and energy efficiency. The total target value of the Fund is USD 250 million. Global private investors contributed around USD 81 million while AIIB, Dutch Development bank FMO, Nordic DFIs Norfund, and Swedfund provided balance funding.

**Another example is** a USD 300 million equivalent affordable housing fund set up to provide equity to develop affordable housing projects, primarily in South Africa and Sub-Saharan Africa. IFC participated in the project through an equity investment of USD 25 million and a USD 10 million

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<sup>11</sup> <https://www.cif.org/country/latin-america-caribbean>

<sup>12</sup> Inputs provided by IFC, World Bank Group

concessional investment from the Global Environment Facility that will support the Fund to make investments in green housing projects in South Africa<sup>13</sup>.

**Yet another type of example is** the new Norwegian Climate Investment Fund, managed by Norfund, which is investing about 500 crore INR in equity in an Indian solar and Agri waste-to-energy company in 2023. The investment will contribute to avoiding more than 2.8 million tons of CO2 emissions and improving air quality by reducing stubble burning<sup>14</sup>.

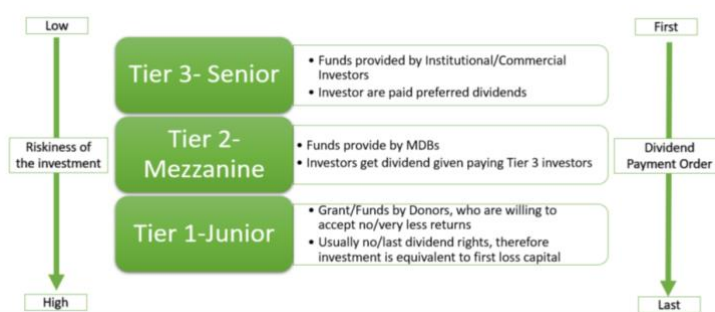
In addition to these instruments, few novel instruments (but not exhaustive) that are evolving under various financial circumstances are elaborated below with country experiences.

### Collective Investment Vehicle Structured Funds

Structured funds are multi-tiered equity funds with a waterfall equity structure. Structured funds consist of three-tier equity investments.

MDBs can provide specialised structured funds to support Emerging markets and developing countries to meet the target specified in the respective country's NDCs and Long Term Strategies (LTS). These funds allow MDBs to multiply the investment amount by attracting private investors for projects and policy implementations towards NDCs and LTS by a country, duly establishing performance evaluation from time to time either under UNFCCC stocktakes or any other convenient method.

#### *Utilizing Structured Fund for climate finance*



**Example:** Climate Investor Two (CI2) facility has instituted a Construction equity fund, a 3- tier collective investment vehicle. Tier 1 equity capital (junior tranche) amounting to USD 250 million

<sup>13</sup> <https://disclosures.ifc.org/project-detail/SII/31851/ihssa-project>

<sup>14</sup> <https://www.norway.no/en/india/norway-india/news-and-events/newsnde/norways-climate-investment-fund-to-invest-in-sael-to-develop-3000-mw-clean-energy/>



has been provided by donors such as the European Commission and Nordic Development Fund. Tier 2 equity capital (mezzanine tranche) amounting to USD 375 million has been provided by Commercial investors and development finance institutions. The institutional investors have provided tier-3 equity capital (senior tranche) amounting to USD 375 million. The Climate Investor Two (CI2) facility aims to provide funds for the project's life cycle. Funds in the form of development loans and technical assistance will support the development phase. Construction equity funds support the construction phase and refinancing. Fund in the form of senior debt funds operation phase<sup>15</sup>.

### First loss capital

MDBs can provide initial first-loss capital in the form of junior debt/grant/equity by creating a waterfall structure. In this instrument, funds supplied by private investors will be accorded the status of the senior-most debt – they are paid first in the event of default. First loss capital primarily acts as a catalyst to crowd-in private investment by improving the project risk profile and reducing technological and political risks. The presence of MDBs reduces information asymmetry for private investors based on the expected due diligence by the MDBs providing first-loss capital. This mechanism is particularly useful in facilitating funding for new technologies.

**Example:** The Managed Co-Lending Portfolio Program (MCP) is IFC's syndication platform for institutional investors. Since its launch in 2013, it has raised \$10 billion from 11 partners to unlock institutional capital to invest alongside IFC on commercial terms in globally diversified loan portfolios that mimic IFC's own portfolio – similar to an index fund. In this programme, IFC provides the first loss tranche to de-risk the portfolio and achieve an investment-grade risk profile, which may be in partnership with any international development cooperation agencies.<sup>16</sup>

### Outcome-based Sustainability linked loans/bonds.

These are loans where interest rates are linked to achieving pre-decided measurable intermediate targets or outcomes. Initially, loans are offered at higher rates. However, on achievement of the pre-decided outcomes, rebates on interest rates are offered, thereby reducing the cost of financing. MDBs can provide outcome-based sustainability-linked loans to incentivise investment in green and sustainable projects. These instruments are still nascent in emerging markets, representing only 5 per cent of total issuance (more than USD 809 billion) until December 2021<sup>17</sup>.

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<sup>15</sup> <https://www.wri.org/insights/de-risking-low-carbon-investments>

<sup>16</sup> Inputs provided by IFC, World Bank Group

<sup>17</sup> <https://openknowledge.worldbank.org/bitstream/handle/10986/36872/Sustainability-Linked-Finance-Mobilizing-Capital-for-Sustainability-in-Emerging-Markets.pdf?sequence=5>

**Example:** Tata Power recently raised USD 320 million in India through sustainability-linked loans from foreign lenders, saving 25 bps borrowing costs<sup>18</sup>. Also, suppose Tata Power does not invest in fossil fuel-based power generation and increases renewable power generation by 1.5-2 GW. In that case, Tata Power will get an additional reduction of 8 bps in the borrowing costs.

Adani Electricity Mumbai Limited (electricity distribution company) has raised USD 300 million through sustainability-linked bonds as part of its USD 2 billion global medium-term notes program in July 2021.

### Syndicated loans (Co-financing)

Syndicated loans allow for spreading the risk over multiple lenders. Co-financing will enable borrowers to access more considerable capital for a longer tenor. Usually, one of the lenders acts as a lead banker in the group of lenders and negotiates the contract terms with the borrower. There can be multiple modes of syndicate formation. Multiple MDBs can provide a syndicated facility or with the private investor(s) and other development finance institutions (DFI), or Multiple MDBs can form a syndicate with the private investor(s). Governments can also act as a co-financer in such loans, thereby adding to the confidence of private investors.

**Example:** ADB provided a USD 220 million syndicated loan to fund the Riau Natural Gas Power Project in Indonesia with a tenor of 20 years. LEAP fund of ADB provided USD 20 million, and IFC provided USD 50 million. ADB also provided a partial risk guarantee to the commercial lenders who contributed<sup>19</sup>. ADB has also approved a USD 50.65 million package to help the Kyrgyz Republic procure battery-electric buses and enhance transport infrastructure. The package comprises a USD 25 million loan, a USD 25 million grant, and USD 650,000 in co-financing from the High-Level Technology Fund.

### Guarantees

Governments and MDBs can also play the role of a guarantor by agreeing to bear the partial or total loss in the event of default, loss of value, or any other occasion. Guarantees will reduce the default risk for private investors, allowing them to charge a lower interest rate. MDBs need to disburse funds only in the event of default by the borrowing entity. By carefully building a basket of projects using a robust actuarial analysis, MDBs can guarantee projects worth significantly more than the provision kept for guarantee. Guarantees can take forms such as partial credit

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<sup>18</sup> <https://economictimes.indiatimes.com/industry/energy/power/tata-power-raising-320m-in-sustainability-linked-loans/articleshow/93759709.cms>

<sup>19</sup> <https://www.adb.org/sites/default/files/project-documents/50182/50182-001-dpta-en.pdf>

guarantees, partial risk guarantees, political risk guarantees, private equity fund guarantees and project-based guarantees.

**Example:** Multilateral Investment Guarantee Agency (MIGA) has issued guarantees of USD24 million to JCM Golomoti UK Limited for equity and shareholder loan investments into Golomoti JCM Solar Corporation Limited for the development, construction, and operation of a new 20-megawatt solar photovoltaic plant in Malawi. The guarantees will extend over 20 years and protect JCM against the risks of transfer restriction and breach of contract<sup>20</sup>.

### Securitisation

MDBs can use securitisation for financing climate action in two ways. First, MDBs can facilitate the creation of a special vehicle to purchase green loans, create tranches and issue asset-based securities in the capital market. Second, MDBs can sell their portfolio of green loans to third-party SPV and redeploy the capital to fund new projects. MDBs should play the role of facilitators in identifying worthy assets for securitisation by leveraging their expertise and experience in project funding, which is difficult for private investors. Securitisation reduces costs and risks for the initial originator of green loans, allowing them to provide low-cost climate financing.

**Example -** Securitization has become a prominent funding source for rooftop-solar companies in the US, including Vivint Solar Inc and Tesla Inc. More than USD 1.3 billion in solar asset-backed securities was raised in 2017, demonstrating that the residential solar industry in the US has become large enough for installers to monetise long-term consumer contracts by refinancing them in the capital markets<sup>21</sup>.

### Low carbon Investment Trusts (LCITs)

The risk profile of green infrastructure projects differs during the construction and operation phases. Projects are generally riskier during the construction phase compared to the operation phase when revenue streams are stable and visible. Initial investment should come from less risk-averse investors. These Investment Trusts offer an exit mechanism to initial investors and an entry mechanism to investors willing to take lesser risks during the operation phase, significantly reducing risks faced by initial investors. Therefore, the opportunity to exit later will allow initial investors to charge less interest due to lower risks associated with long-tenor debt and refinancing risk.

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20 <https://www.miga.org/press-release/miga-supports-construction-solar-photovoltaic-plant-malawi>

21 <https://www.renewableenergyworld.com/wind-power/could-sustainable-clean-energy-securitization-save-the-planet/#gref>

MDBs can sponsor LCITs by deploying their initial capital and taking over operational green assets. LCITs can raise equity capital from other investors by selling units in an IPO for purchasing assets and leverage equity capital to raise debt from investors such as insurance funds, pension funds, debt mutual funds etc. Like shares, units are traded on stock exchanges, and unit holders get regular dividends, allowing even MDBs to recover their capital from investing in new projects. MDBs can later exit the trust by selling their stakes to private investors.

## Bonds

**Green bonds** are financial instruments that fund projects aligned with environmental and climate objectives while providing investors with regular or fixed-income payments. The proceeds are exclusively applied to green projects, assets, and expenditures, aligned with the four core components of the Green Bond Principles (use of proceeds; process for project evaluation and selection; management of proceeds; and reporting). Green bonds can help attract investors who primarily look to invest in low-carbon and sustainable infrastructure projects, thereby taking advantage of possible 'greenium'. MDBs can raise funds from the market through Green Bonds using their top-notch credit ratings.

**Puttable bonds** - In climate financing, puttable bonds can be designed so bondholders can exercise the option if borrowers do not invest in green projects. These bonds will address the risk of green washing. At the same time, borrowers who invest in green projects will not have to worry as the put option will not be exercised, and they can access the finances at a lower rate.

**Convertible bonds** - Convertible bonds allow bondholders to convert debt into common equity at an exchange price defined in the bond covenant. This option will enable borrowers to issue bonds at a lower coupon rate than option-free bonds. The intention to finance green projects with convertible bonds would signal the firms' growth potential and help improve the project's risk profile. Convertible bonds are especially useful in supporting projects based on nascent and unproven technology in emerging and developing countries, thereby managing project risk and technology risk. MDBs can create specialised debt funds by pooling funds from other MDBs and private investors to invest in green/sustainable convertible bonds.

### Example:

- a) To support more private-sector led green investments, IFC is investing \$100 million in Egypt's first private sector green bond to help unlock finance for climate-smart projects, reduce greenhouse gas emissions, and support the country's transition to a greener economy. The bond, issued by Egypt's Commercial International Bank (CIB), the country's largest private bank, will help CIB increase lending to businesses that want to invest in eco-friendly initiatives, including green buildings, renewable energy and energy efficiency, markets that are still nascent in Egypt. The

project will leverage \$1.4 million in funding from the UK-IFC Market Accelerator for Green Construction, which provides incentives to developers who construct certified green buildings, in the form of a performance-based incentive (PBI). The PBI is designed to benefit CIB's end-borrowers, with payment of the incentive contingent upon their ability to meet specific green building eligibility criteria and completion of a green building certification process<sup>22</sup>.

- b) In 2018, B. Grimm Power Public Company Limited in Thailand issued green bonds worth five billion Thai baht (USD155 million) to finance and refinance various solar generation assets. These bonds were fully subscribed by ADB<sup>23</sup>.
- c) The Hong Kong-based real estate investment trust, Link Real Estate Investment Trust (REIT), raised HK\$4 billion (\$509.57 million) by issuing green convertible bonds in March 2019 to fund future and existing green projects<sup>24</sup>.

### Green Loan

A green loan enables borrowers to use the proceeds to fund climate action projects including from governments or through multilateral institutions as per the green loan principles. Considering the higher transaction costs of bond issuance, the requirement of a minimum bond size to be tradable, and the fact that only bonds above a specific size are tracked by various indices, potential issuers in emerging markets with small green portfolios may consider receiving a green loan instead of issuing a green bond.

**Example:** USD 541 million 15-year green loan facility structured by IFC in 2019 to support Infraestructura Energetica Nova (IEnova) in Mexico to finance five solar plant projects in Mexico with a total installed capacity of 526 MW. Following IEnova's adoption of the Green Loan Principles, this investment became the first certified IFC Green Loan in Mexico<sup>25</sup>.

### Risk Sharing Facility

In this facility, MDBs do not directly invest in green projects but support local financial institutions in de-risking their investments to fund local projects by providing irrevocable and unconditional obligations to bear or share the loss. Support from MDBs can be in the form of co-financing or guarantee, as per the requirements of the local financial institutions. MDBs can provide additional paid-in capital to local financial institutions to increase their borrowing capacity, with the mandate to leverage and utilise additional capital to fund green projects. This allows local financial institutions to manage liquidity and capital constraints. Risk sharing facilities can also more broadly target non-project specific risks (such as currency, political and off-taker risks). This

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<sup>22</sup> Inputs provided by IFC, World Bank Group

<sup>23</sup> <https://asianbondsonline.adb.org/green-bonds/pdf/How%20to%20Issue%20Guide%20English%20FINAL%20PRINT.pdf>

<sup>24</sup> <https://www.reuters.com/article/link-reit-convertible-bonds-idUSL5N20V0CK>

<sup>25</sup> <https://www.worldbank.org/en/news/feature/2021/10/04/what-you-need-to-know-about-green-loans>

facility can provide long-term finance to small and medium enterprises (SMEs) for undertaking green projects.

Besides underwriting risk for local financial institutions in specific countries, another method of de-risking involves the pooling together of risks across both projects and countries. Such an approach offers the benefits of scale and diversification and thereby helps lower the cost of de-risking<sup>26</sup>.

**Example:** The EBRD has created a risk-sharing facility by providing EUR 220 million to support local financial institutions<sup>27</sup>. In any loan denominated in local or foreign currency, risk participation of EBRD will be up to EUR 25 million, and the maximum tenor loan will be 15 years for project finance and ten years for corporate loans.

### Insurance and Re-insurance mechanism

To cover and diversify various climate change risks, MDBs can design insurance products in consultation with local insurance agencies. With the local insurance agency providing insurance to investors and lenders of particular green and climate-resilient projects, MDBs can facilitate the re-insurance of insurance offered by local insurance by giving a second-loss guarantee to the global re-insurance agencies, who are capable of further diversifying the risk. This would increase the capacity of the local insurance agencies, providing funds at a low cost for a longer tenure. Further, given that different countries are characterised by varying levels of vulnerability to climate shocks, mechanisms that pool together and mitigate climate risks across countries could help lower risk curves for each country. This mechanism can be helpful to countries where risk perception due to political instability and project execution capability is higher.

**Example:** In Africa, Africa Energy Guarantee Facility (AEGF) has been created in collaboration with the European Investment Bank (EIB), German Development Bank KfW, Munich Re, and the African Trade Insurance Agency (ATI). African Trade Insurance Agency acts as the primary insurance agency to protect investors against political risk, sub-sovereign risk, project risk etc. EIB will issue a second loss guarantee to Munich Re, which, in turn, insures selected projects of ATI. By this mechanism, AGEF plans to ensure projects worth USD 1.4 billion.

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<sup>26</sup> Ghosh, Arunabha, and Nandini Harihar. 2021. Coordinating Global Risk Mitigation for Exponential Climate Finance. A GCF-CEEW Report. Stockholm: Global Challenges Foundation.  
<https://www.ceew.in/publications/mitigating-climate-change-and-clean-energy-finance-risks-for-developing-nations>

<sup>27</sup> <https://www.ebrd.com/work-with-us/projects/psd/risk-sharing-facility-direct.html>

## Credit Default Swaps

There are other examples of instruments which can mobilise resources with de-risking components. One such example is Credit Default Swaps which have not been specifically used for climate action but can be utilised for the purpose. In this mechanism, private investors provide debt funding to green projects through loans or bonds. However, to reduce default and political risks, MDBs can purchase Credit Default Swaps (CDS)<sup>28</sup> on behalf of private investors from international CDS sellers by deploying funds provisioned for grants. Thus, private investors are incentivised to provide debt-based climate financing at a lower rate. Buying CDS for private investors secures them from default risk, thereby incentivising private finance flows into the projects.

## III – Way forward – deliberation on mechanisms/instruments to scale up climate finance

In the foregoing section, the discussion was on various instruments including the innovative ones that are already in existence. The fact remains that the scale of financing through these is not commensurate to the goals set down by countries. Not only do the public sector – governments and the MDBs - need to substantially enhance the scale of their interventions, but there is also a need to design and adopt new innovative mechanisms and instruments that are able to mobilize financial resources at scale and at a reasonable cost. The following are the possible measures and mechanism that need to be discussed to enhance scaling up of climate finance:

- a) **Enhancing grant and concessional financing including from philanthropies and pension funds to support upstream policy and robust project pipeline.** MDBs can effectively mobilize and manage grants and Trust funds deployed for climate action, as well as tap into new sources, such as philanthropic capital, which has historically underinvested in climate. These funds could be used for project preparation and diagnostics to identify and prioritize the most impactful climate action as well as the policies and enabling environment required to unlock climate action and investment. Given their strong credibility and convening power, MDBs can try to channel grant and concessional resources from philanthropies and pension funds for project preparation, blending, and de-risking just as the World Bank currently does from Trust Funds and the IBRD Global Public Foods Fund.

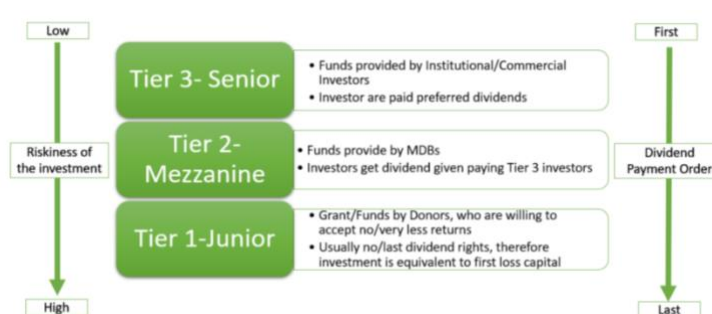
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<sup>28</sup> A credit default swap (CDS) is a contract between two parties in which one party purchases protection from another party against losses from the default of a borrower for a defined period of time.  
<https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/credit-default-swaps#>



- b) **Enhancing blended financing through various instruments, including those discussed in section II such as IFC's Managed Co-lending Portfolio Program (MCP).**
- c) **Collective Investment Vehicle - structured fund** is an innovative mechanism which needs focus and use at scale. These are multi-tiered equity funds with a waterfall equity structures. They allow MDBs to multiply the investment amount by attracting private investors for projects. Performance evaluation from time to time of this mechanism could enable further improvement. The diagrammatic representation of a structured fund is given below.

*Structured Fund for climate finance*



- d) A **Global Clean Investment Risk Mitigation Mechanism** that can pool risks across projects and geographies to lower the risk profile further as risk pooling would reduce the non-project risks like policy uncertainties, currency fluctuations. This mechanism could be funded through international public money, leveraging it to attract private capital for clean infrastructure.
- e) **Focus on sector specificity in mechanisms and instruments** enable addressing the distinct needs and peculiarities of a sector may be necessary and crowd in more private capital.
- f) **Expanding and customizing guarantee instruments to mitigate risks and leverage market finance.** MDBs through the risk insurance and credit enhancement guarantees, de-risk and mobilize cross-border private capital to invest into developing countries for climate mitigation and adaptation finance. MDBs should explore cheaper guarantees for purely climate risks.

## IV- Conclusion

As climate change is now one of the biggest challenges facing the world, the case for investing in climate mitigation and adaptation has never been stronger. The need for massive investments into green infrastructure, the general shift of global economies toward net-zero emissions and enhancing the resilience of vulnerable populations to negative impacts of climate change is pronounced and urgent. The speed and depth of the transformation can be achieved with public funding catalysing private finance flows.



One of the biggest challenges is to reduce the risk associated with climate-related projects, often due to adoption risks associated with new-technology, unproven commercial viability, and longer time horizon.

For effective climate action, developed countries (where the majority of global capital is located) and developing countries (where the majority of the growth in demand for energy and materials will occur) must act in concert. Given the scale of investments needed, public capital should be used strategically to crowd in private investments for climate action at pace and scale, particularly in developing countries.

The mechanisms for mobilising timely and adequate climate finance need to be further analysed addressing future requirements, leveraging effects of government interventions and MDBs, effectiveness, and accessibility, especially by capacity building of accessing entities and adoption of early climate technologies.

The note discusses various instruments including the innovative ones that are already in existence. The fact remains that the scale of financing through these is not commensurate to the goals set down by countries. Not only do the public sector – governments and the MDBs - need to substantially enhance their interventions, but there is also a need to design and adopt new innovative mechanisms and instruments that are able to mobilize financial resources at scale and at a reasonable cost. Focus on sector specificity in financing mechanisms and instruments enable addressing the distinct needs and peculiarities of a sector and crowding in more private capital. Financing of the renewable energy sector, hard-to-abate industries, research and development, climate resilient infrastructures, and climate-smart agriculture need diversity in the blend of capital.

De-risking aids in reallocating, distributing, or decreasing the present or potential risks associated with climate investment. Given the developmental challenges faced by developing countries and their increasing debt vulnerabilities, developing countries do not have the capacity to de-risk investments at scale. It is, however, critical to ensure efficient management and allocation of risk to investors through programmatic or sectoral de-risking. Focussed interventions are required if the net zero goal has to be achieved.

Enhanced role of MDBs and new innovative instruments with a focus on specific sectors is vital and needs to be examined as a means to mobilize resources at scale and at a reasonable cost.

### Question for Discussion

- What are the views of the members on the mechanisms/instruments through which timely and adequate climate finance can be mobilized?
- What are the roles and responsibilities of Advanced Economies in facilitating the flow of required funds and that of EMDEs who are most likely to be recipients of funds, whether they are concessional or non-concessional loans, grants or guarantees, or other forms of funding?