Round table on "Innovative Finance for Climate and Development"

7th November 2022

Current climate finance flows are insufficient and not increasing in the required speed to deliver on the Paris Agreement goals. Total climate finance flows (including domestic and international investments) have grown by ~5% from 2013-14 to 2017-18, reaching $862bn. However, these flows still need to be increased by ~200% to ~400% from now on to reach $1.6tn to $3.7tn per year, which is the amount necessary to transition to a net-zero-emission and resilient economy by 2050, according to UNFCCC Standing Committee on Finance[1].

As of now, climate finance support for Mitigation and Adaptation action remains particularly insufficient within developing economies. For instance, even though richer nations agreed to channel $40bn annually in adaptation finance to developing countries by 2025, actual projections estimate that the total of adaptation finance likely to be achieved in 2025 should only be around $22bn[2]. There are multiple reasons for adaptation being underserved; including a global misjudgment on short-term adaptation's criticality, low/uncertain returns on capital, institutional capability gaps in receiving countries that hamper the ability to receive funding and a lack of globally accepted vehicles that enable funding flows from developed to developing countries.

Moreover, the mobilization of the $100bn per year by 2020 which was pledged in 2009 has not been met, and might not be delivered before 2023[3]. Indeed, according to OECD, $83bn were channeled to developing countries in 2020[4], among which:

- 82% came from public financing (38% bilateral and 44% multilateral), 16% from private investors and the remaining 2% from export credits;
- Most of these flows took the form of public loans (58% of total flows), enhancing developing countries' debt burdens, whereas only 21% were channeled through grants from bilateral and multilateral development banks;
- These fundings have been primarily used to fund climate projects in the field of energy (32% of total finance flows), transport (14%), agriculture, forestry, & fishing (9%) and water supply & sanitation (8%).

However, according to Oxfam, the level of finance flows reported by developed countries is significantly higher than actual climate-specific net assistance, as Oxfam notably discounts funds declared which are not actually targeting climate action, and focuses on grant equivalence, in order to estimate the actual financial transfer to developing countries once all financial repayments are taken into account (e.g. loan repayments, interest, administration expenses, etc.)[5]

1 UNFCCC SCF (2021) - https://unfccc.int/sites/default/files/resource/54307_1%20-%20UNFCCC%20BA%202020%20-%20Summary%20-%20WEB.pdf
2 IIED (2022) - https://pubs.iied.org/sites/default/files/pdfs/2022-06/20976iied.pdf
3 OECD (2021) - https://www.oecd.org/newsroom/statement-by-the-oecd-secretary-general-on-future-levels-of-climate-finance.htm
4 OECD (2021) - https://www.oecd.org/climate-change/finance-usd-100-billion-goal/
5 Oxfam (2020) - https://oxfamilibrary.openrepository.com/bitstream/handle/10546/621066/bp-climate-finance-shadow-report-2020-201020-en.pdf

As the time window to act is closing, exceptional push on the scale and quality of public as well as private investments is needed to deliver the commitments and reach the Paris Agreements' targets. These funds are destined to serve three primary objectives:

- Close the adaptation gap, build resilience and protect the vulnerable populations from climate change;
- Drive systemic change and innovation for a carbon neutral transformation in the context of just transition;
- Protect and restore natural capital.

Solutions to bridge the climate finance gap have recently been centered around the role of MDBs, some of which have been called out several times ahead of COP26 and the International Cooperation Forum to avail more funds to foster climate action, notably through:

- Updating their exclusion policies for unabated fossil fuel projects;
- Committing to ambitious targets for both Adaptation & Mitigation projects;
- Aligning their financing, policies and portfolios with Paris Agreements objectives

Beyond securing additional funds globally, the use of innovative financial tools and mechanisms (e.g. green bonds, environmental impact bonds, debt-for-climate swaps, blended finance mechanisms) can be an effective vehicle to channel funds to projects and translate NDCs and NAPs into investment action plans. However, several main roadblocks hinder their global expansion, among which:

- The limited availability of at-scale, bankable projects to invest in (i.e. projects with a potential to generate measurable, positive returns in a given period of time);
- The absence of a global standardized policy framework as well as a global marketplace for climate finance deals / activities, which can make funding procedures difficult to access and manage for both debtors and creditors;

As a result, debt remains the main instrument used to fund climate action in developing countries, rather than equity, grants, and concessional financing. For developing geographies, this adds up to their already unsustainable debt burden, hindering investment at scale in the transition to a low carbon economy and in adaptation and resilience projects. Innovative financial tools & mechanisms are therefore crucial in helping overcome these barriers and ultimately foster climate action.

Prior achievements:

Various tools and financing mechanisms have already been set up to improve countries' access to climate finance and catalyze investments into climate action, among which:

- Green bonds: Issuance of total green bonds reached $259bn globally in 2019[6], while green bonds in developing countries more than doubled in 2021 to a record $95bn (from $41bn in 2020)[7].

- Environmental Impact Bonds (EIBs, i.e. bonds for which repayment is indexed to forecasted and/or realized environmental benefits): Use of such bonds is still embryonic, as the first EIB was issued in 2016 by Quantified Ventures with DC Water to fund a $25m green stormwater infrastructure project, and only 4 EIBs has been issued to date[8].

- Debt-for-climate swaps: In 2021, Belize signed a debt-for-climate swap with 'The Nature Conservancy' (TNC), by committing to spend ~4m annually on marine conservation until 2041 in exchange of a commercial debt's purchase by TNC of ~$550m.

- Blended finance: In November 2021, Allianz Group and International Finance Corporation signed a blended finance partnership aiming to create a global platform dedicated to climate-related investments, providing up to $3bn to private companies in developing economies.[9]

- The role of IMF: Following the ~$650bn Special Drawing Rights' (SDRs) allocation round completed in 2021, establishment in 2022 of the Resilience and Sustainability Trust, a global framework which aims at providing long term financing & low interest loans to vulnerable countries[10] by re-channeling SDRs from countries with strong external positions.

- Voluntary carbon markets: Even though their use remains limited, voluntary carbon markets, on which stakeholders sell their carbon credits on a voluntary basis, are gaining in traction, as their global size quadrupled within one year, reaching $2bn in 2021[11]. A few private initiatives have recently been launched to provide a code of conduct and guidance on the use of carbon credits (e.g. the Voluntary Carbon Market Integrity Initiative).

- Private philanthropy: Philanthropic giving represents a potential source of financing for climate positive projects, but its use remains insufficient, as granting for climate change mitigation globally reached $6-10bn in 2020 (+14% vs 2019)[12], corresponding to ~2% of total global philanthropic giving.

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6 UNFCCC SCF (2021) - https://unfccc.int/sites/default/files/resource/54307_1%20-%20UNFCCC%20BA%202020%20-%20Summary%20-%20WEB.pdf
7 IFC (2022) - https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=27022
8 Brookings (2022) - https://www.brookings.edu/research/social-and-development-impact-bonds-by-the-numbers/
9 Allianz (2021) - https://www.allianz.com/en/press/news/commitment/environment/211103_Allianz-IFC-and-Allianz-Group-enter-partnership-for-1-5-degrees-celcius-aligned-investments-in-emerging-markets.html
10 United Nations (2022) - https://press.un.org/en/2022/sgsm21239.doc.htm
11 Ecosystem Marketplace (2021) - https://www.ecosystemmarketplace.com/publications/state-of-the-voluntary-carbon-markets-2021/
12 ClimateWorks (2021) - https://www.climateworks.org/wp-content/ uploads/ 2021/10/ CWF_Funding_Trends_2021.pdf

Goal:

Solutions identified shall ultimately assist developing countries in accessing qualitative climate finance while alleviating their sovereign debt burden, and should be focusing on scaling the use of innovative climate finance tools and mechanisms (e.g. debt-for-climate swaps, blended finance mechanisms, etc.):

- **Create an international framework on innovative climate finance:** A guidebook, based on the concepts of inclusion, equity and justice, including clear guidelines for every stakeholder (e.g. when and how to use innovative climate finance tools such as debt-for-climate swaps/green or environmental impact bonds/blended finance, how to effectively manage funding processes, etc.), enabling potential investors to go from pledges to action in terms of climate finance

- **Assist developing countries with identifying and developing a comprehensive offer of bundled, bankable climate projects:** The objective is to foster climate investments, notably through capacity building or through creating dedicated guidebooks**,** to help countries unlock more qualitative climate finance

- **Develop a global hub/marketplace for climate finance to encourage the creation of climate finance platforms**: As developing countries face hardships in managing funding procedures quickly and finding the right set of partners to access to climate finance, creating a global hub/marketplace, would enable to facilitate the meeting of supply (e.g. public and private actors from developed countries, MDBs, philanthropies) and demand (e.g. developing countries) of climate finance and enable to accelerate and scale the creation of climate finance platforms

Guiding questions for the roundtable

This roundtable will gather representatives from contributing countries (developed world) and from recipient countries (developing countries), together with International Financial Institutions, MDBs and actors from the private sector. Developed countries may elaborate on the barriers hindering the acceleration of investment into climate action (e.g.: the need for more investment-ready projects presented by recipient countries). Developing countries may want to discuss various challenges related to obtaining financing for climate projects (e.g.: the difficulty to identify bankable projects without knowing whether financing will be accessible, complex granting procedures…), and showcase some success stories on reducing the cost of green financing.

Participants will seek to get to a common understanding of the challenges and identify concrete solutions, including innovative finance solutions which could help address these challenges and unlock additional climate finance flows.
Suggested guiding questions:

- Questions for developing countries:
  1. What challenges do you face in securing and accessing funding for mitigation, adaptation and just transition projects and plans?

  2. What coordinated global response (e.g. creation of a Global Hub for Climate Finance, the use of de-risking tools) can be developed to facilitate, accelerate and scale countries' access to innovative climate finance?

- Questions for developed countries:
  1. What are the current barriers to the acceleration of financing flows into climate projects from the Global North to the Global South?

  2. What innovative finance tools could be leveraged to accelerate and scale financial flows towards climate projects in developing countries while reducing the cost of climate finance?

- Questions for and about financial institutions:
  1. What are the most promising and innovative financial tools and mechanisms to improve quality and access to climate finance for developing countries and how to accelerate their adoption?

  2. What reforms or innovative approaches could be envisaged on financial institutions to bring forward substantial appropriate finance (i.e. scaled up, facilitated access and concessional instruments).

- Questions for the private sector:
  1. How to maximize the involvement of the private sector in financing climate action, both in developing and developed countries? What challenges and what opportunities do you see to scale investment in climate action.