Innovative Financing for Ocean Conservation: What's new in the financing toolbox?

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Session: **6**
Day of presentation: **07 December 2016**

Outline

- Financing the SDGs: The shift towards loan-based mechanisms
- What’s in the financing tool box?
- The cases of debt-for-nature swaps and blue bonds
- Some lessons learned

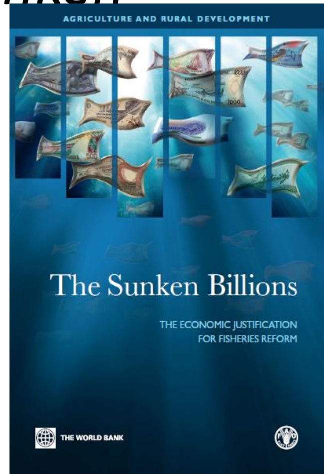
Financing the SDGs:
The shift towards loan-based mechanisms

The narrative of Addis Ababa and SDGs financing in a nutshell

1. The SDGequation requires to « shift from billions to trillions » according to multilateral development banks (MDBs).
2. Grants only cannot make this shift.
3. Increasing role for the private sector, sub-national government, civil society, South-South cooperation and development finance institutions in making this shift.
4. Opportunity of using a broader array of tools: loan-grant blending, de-risking, innovative financing, risk-pooling mechanisms, guarantees, among other.
5. Necessity to experiment and learn, so as to bend the cost curve – in particular transaction costs and hidden costs associated with new instruments/partnerships

Assessing financing needs for the sustainable management of oceans

- There does not exist a comprehensive assessment of investment requirements for the sustainable management of oceans.
- There exists estimates of the economic losses stemming from unsustainable management of global marine fisheries and from the impacts on oceans of climate change and pollution.
- For example, the joint FAO-World Bank (2009) report *Sunken Billions:* economic losses from unsustainable fisheries ranging between US$46 Bn and US$90 Bn annually.

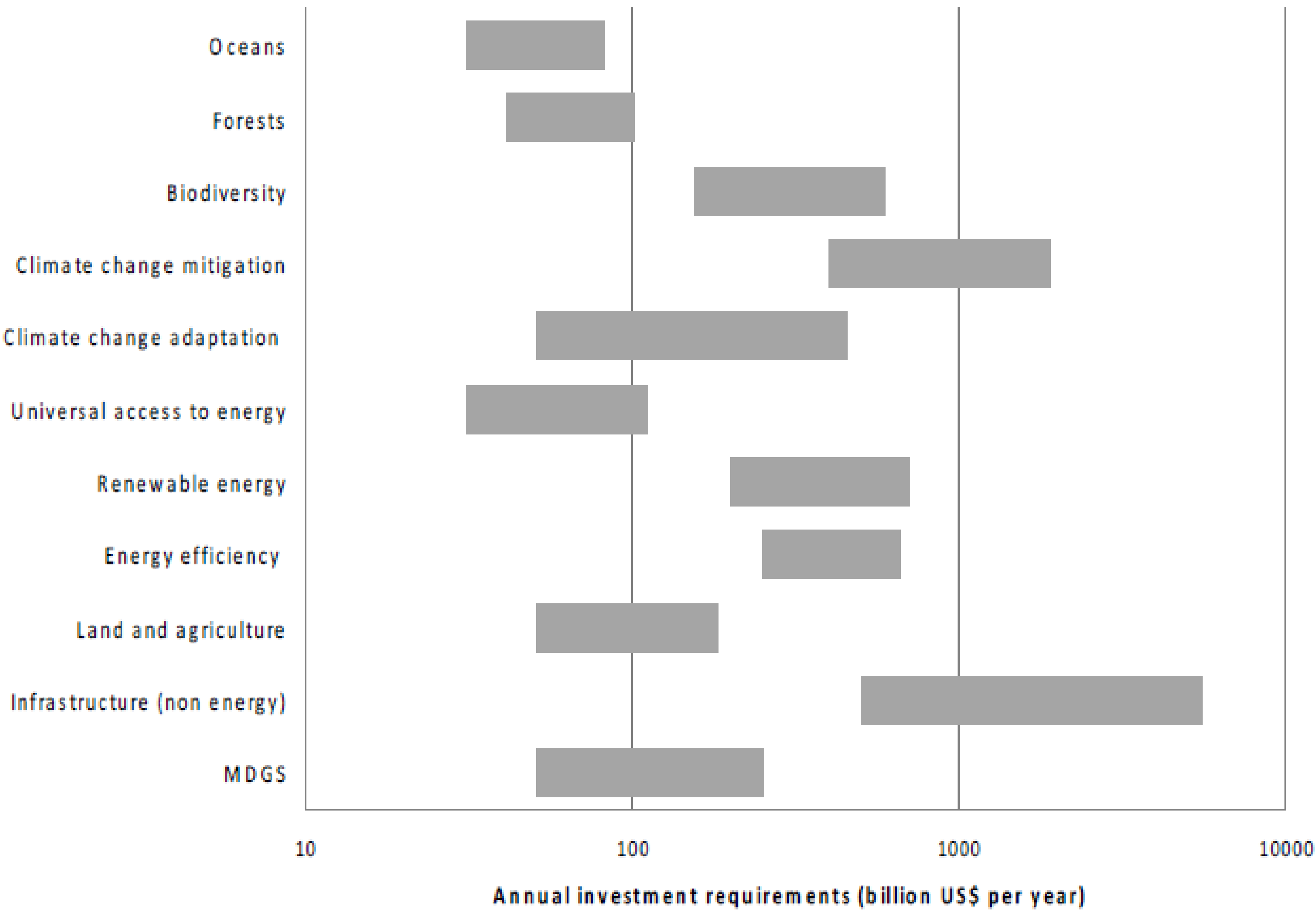


- UNDP-GEF (2012) provided an assessment of resource needed for catalyzing ocean finance to :
  1) reduce nutrient over-enrichment of coastal areas;
  2) improve energy efficient shipping and protect/ restore coastal carbon sinks;
  3) reduce unsustainable fishing practices;
  4) reduce aquatic species transfer via ship hull fouling.

- Initial public investment of US$5 billion over the next 10-20 years could catalyze around **US$35 billion per year**, mostly from private sources.

Summing up the investment needs estimates associated with ocean-related Aichi Targets leads to a total of **US$39 billion per year** for all countries from 2013 to 2020.

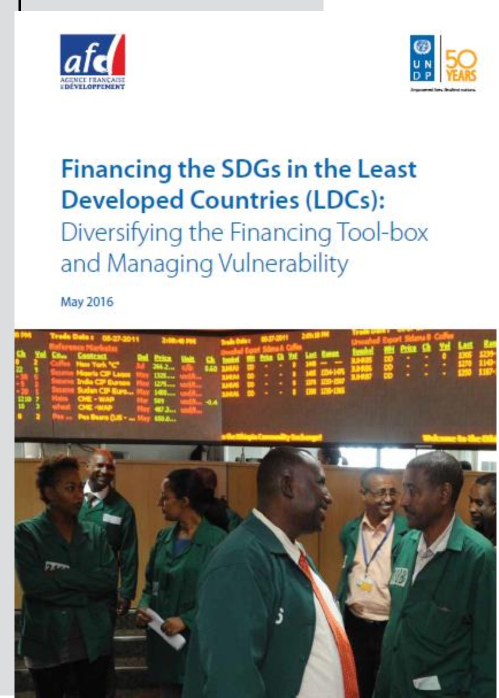
Order of magnitude of investment needs from the literature



Source: International Committee of Experts on Sustainable Development Financing – Background Paper 1 (2013)

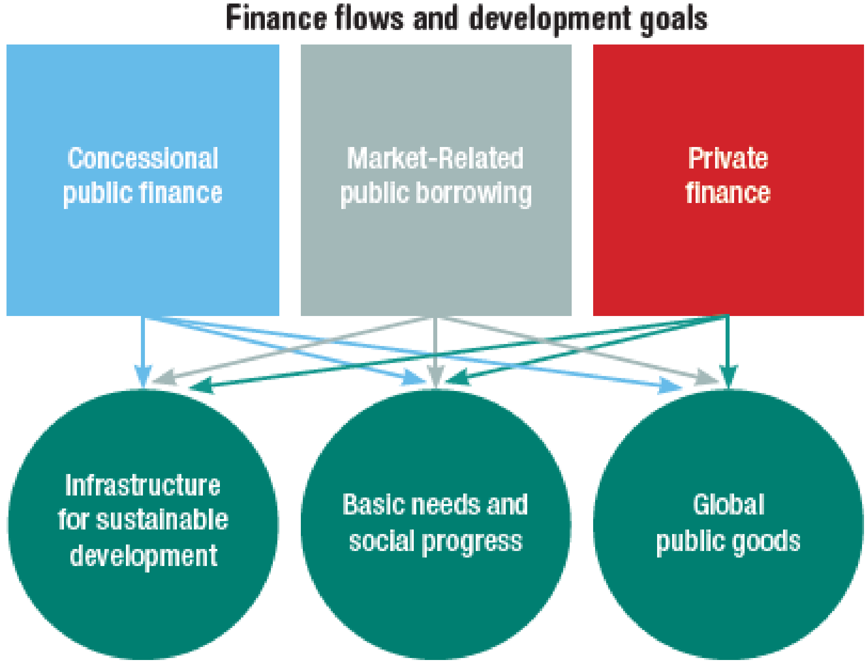
What's in the financing toolbox?

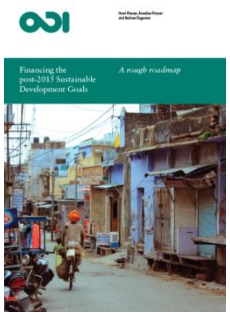
Bonds	Loans and guarantees	Public revenue	Insurance	Funds	Grants
Sovereign bonds issued on international and domestic markets Diaspora bonds GDP-linked bonds Green/blue bonds Social impact bonds Development impact bonds	Loans *Including:* • Multilateral and bilateral development banks (MDBs) • Other Official Flows (OOFs) • Counter-cyclical loans • Contingent credit facilities • Development policy loan deferred drawdown options • Catastrophe risk deferred drawdown options • Debt buy-backs • Debt-swaps • Blended finance • Public-private partnerships Guarantees	Taxes and levies *Including:* • Income taxes • Value added/ consumption tax • Property taxes • Tariffs • Green taxes • Domestic financial transaction tax • Airline ticket tax	Weather index-based insurance Catastrophe Risk Insurance Facility	Vertical Funds *Including:* • GAVI Alliance • Global Fund (and UNITAID) • Adaptation Fund • Global Environmental Facility (GEF) Green Climate Fund Securities and structured funds Microfinance investment funds	Official Development Assistance (ODA) Philanthropic and other private donations



How and what to choose in the box?

- Financing instruments do not differ by the goal they can reach



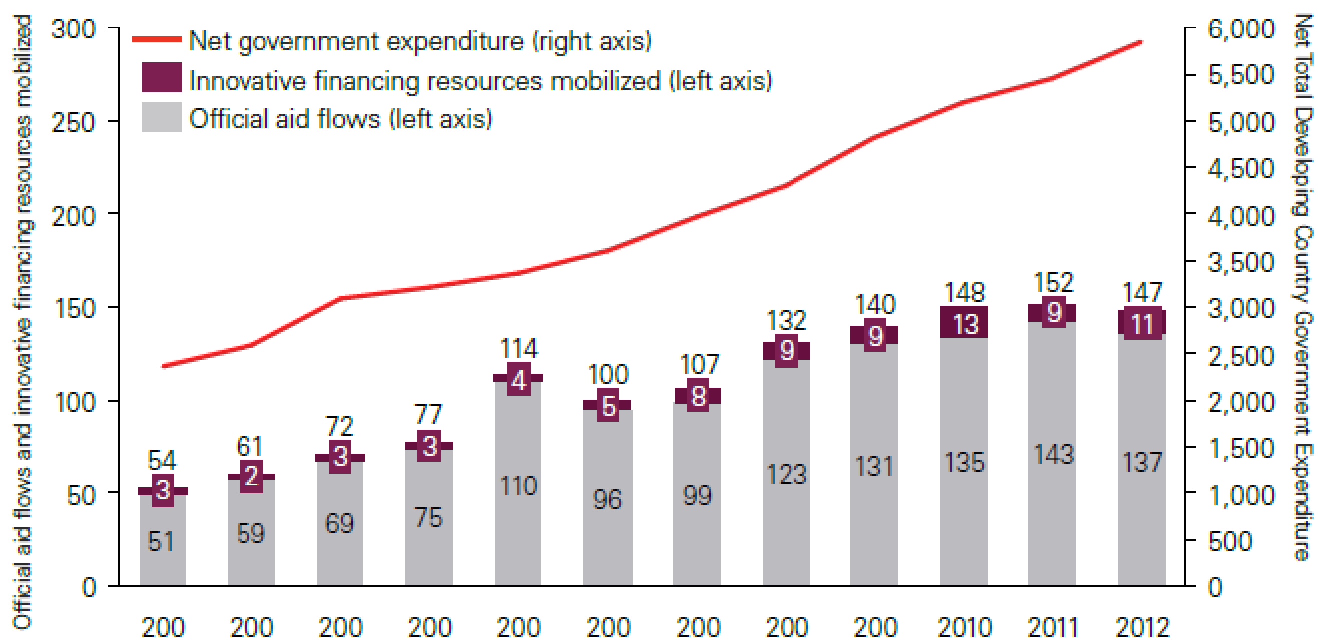


- They differ by the implementation conditions, various costs (upfront, transaction, insurance, opportunity) and benefits they entail

Innovative financing remains a small component of public assistance

Evolution of funding for public goods in developing countries, 2001-2012

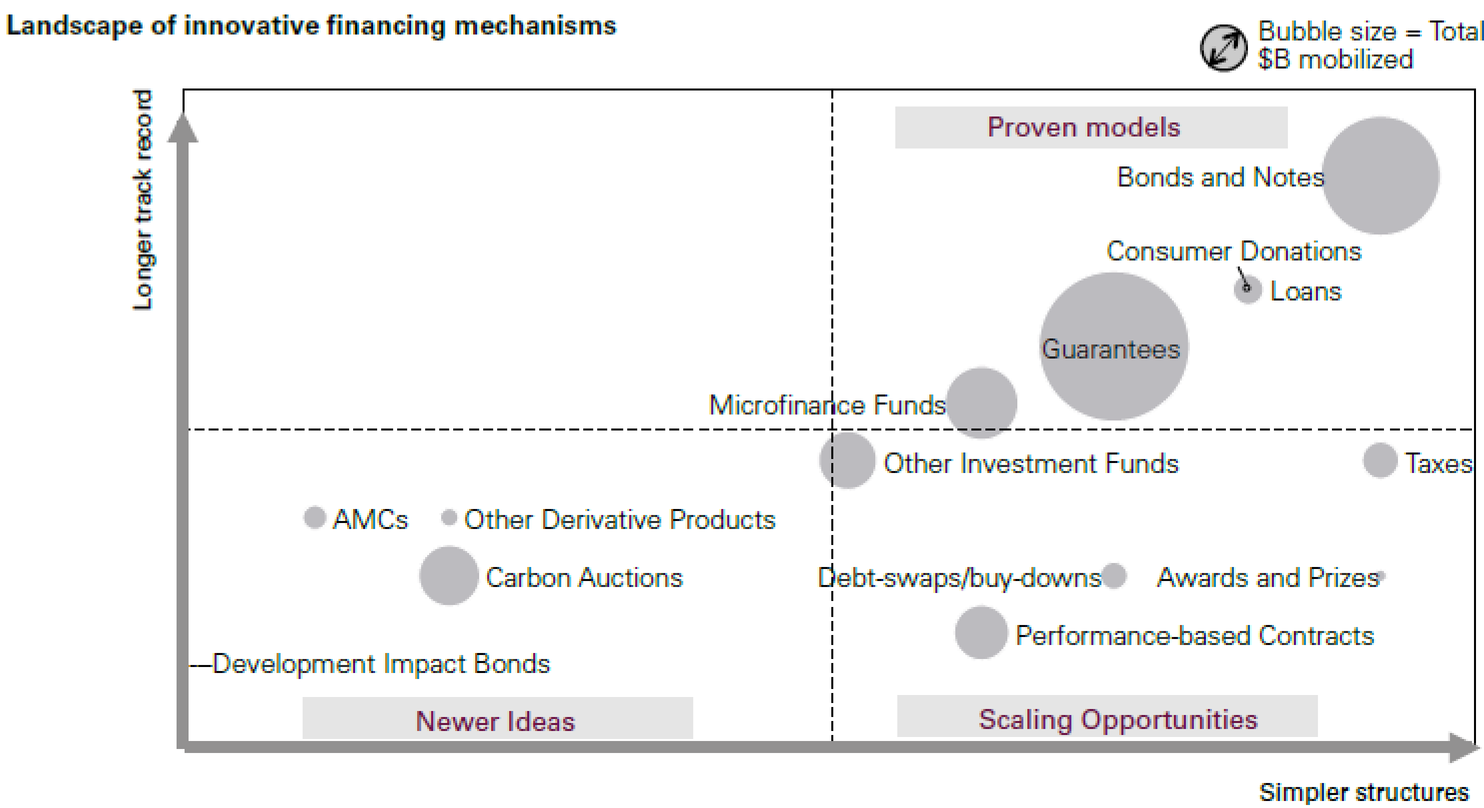
$ billions



Notes: Net Government expenditure does not include general budget support and loan disbursement to public sector; Official aid flows include Official Development Assistance and Others Official Flows; Innovative finance data is based on 278 innovative finance initiatives where volume data broken down by year was available. It assumes that innovative financing is additional to official aid.

Source: Development initiatives, "Investments to End Poverty," 2013; OECD DAC Table 1; Innovative Financing Initiative Database; Dalberg analysis.

« Keep it simple »: established instruments rely on standards and mobilize more resources



Note: No known Development Impact Bonds have been successfully issued to date although many are under development.

Source: Innovative Financing Initiative Database; Dalberg analysis.

The cases of debt-for-nature (DFN) swaps and blue bonds

Debt-for-nature (DFN) swaps

- **DFN swap** is a financial instrument that enables indebted countries to restructure part of their external debt in exchange for implementing measures to protect the environment, usually via setting up a trust fund.
- A hard currency debt is restructured into a local currency one, with specific conservation objectives
- Heralded as a win-win solution, as DFN swaps benefit both the debtor and creditor while unlocking finance for biodiversity conservation in biodiversity-rich areas.

The rationale

- External debt of developing countries steadily increasing
- Servicing hard currency debt is in most cases damaging for biodiversity (large-scale extractive economic activities)
- Lead to CBD objective 3.8 to “promote biological diversity in debt relief and conversion initiatives, including debt for-nature swaps"
- Expected benefits

  -> Redirection of external debt service to investment in country

  -> Improved fiscal space (extended maturity)

How do DFN-swaps work?

- Most of the past transactions have involved a third party – typically an international conservation NGO such as WWF, Conservation International, and The Nature Conservancy.
- Debt is typically purchased ("debt price") at a significant **discount rate** (e.g., 50% of face value).
- In exchange, the debtor government reallocates local currency funds from the budget ("debt redemption price") towards domestic conservation activities, with payment usually in cash installments or in local bond notes.
- The proceeds (i.e., funds) from a DFN are typically channeled into a "counterpart fund" (e.g., national conservation trust fund) that disburses the money for specific projects.
- DFNs typically achieve a high "**leverage ratio**," (e.g., 2 to 1) making them an attractive conservation investment for donors. The debt price < local currency redemption price

Example of a DFN-swap

Philippines Commercial Debt Swap with Third Party Assistance

CREDITOR: Commercial Bank holds $19 million of Philippine debt

Step 1

AID pays WWF-US $13 million

Step 2

WWF-US purchases debt from bank for $13 million

Step 3

Philippines and WWF-US agree to DFN transaction

Step 4

Philippines Government agrees to channel proceeds into Foundation for the Philippine Environment and contribute US $17 million in local currency to FPE

Specifics of transaction

Face value of debt:	US $19 million
Debt price:	68% of face value (US $13 million)
Redemption price:	90% of face value= US $17 million
Leverage ratio:	1.3 to 1

DFN-swaps still « severely under-utilised »

- DFN-swaps remain marginal : < $2 Bn of investment in conservation Trust funds
- CBD (2016) : opportunities for debt-for-nature swaps have been ‘severely under-utilised’
- Among the 36 Heavily Poor Indebted Countries (HIPC) eligible for priority debt restructuring, only 7 have so far taken part in debt-for-nature swaps.
- Why?

Some lessons learned

Specific enabling factors for DFN-swaps

Sine qua non factors	Additional enablers
Long-lasting and high-level political commitment to biodiversity – Biodiversity is a priority in both the debtor and creditor countries – Head of state & Ministry of Finance of the debtor exhibit high support for biodiversity – Biodiversity is an institutionalised priority in the debtor nation	Favorable global context – Biodiversity is on the agenda of priorities of the international community, directly or indirectly (e.g. via climate action)
Capacity to carry forward with the deal – There is a vibrant domestic NGO scene with financial sector experience – OR an experienced international NGO is involved as a broker	Broad based consensus to support conservation – Support of private economic actors

Key lessons learned

- Patience
- Pedagogy and consultations to build up consensus among stakeholders
- Much of the success of negotiating DFN-swap depends on the entrepreneurial nature of the government and policy-makers in the debtor country, and their ability to work across different ministries and agencies to achieve a shared goal.
- Advanced commitment to biodiversity protection as pre-requisite to build trust

Blue bonds

- A novel financing initiative which taps into capital markets for funds.
- Pioneered by the Seychelles Government
- The proceeds from the bond are specifically designated for financing the blue economy (e.g. the implementation the Mahe Plateau fishery management plan).
- Bond proceeds are transferred to a dedicated body (e.g. the Seychelles Fishery Authority).
- Repayment of the bond is the obligation of the Government
- MDBs (World Bank, African Development Banks) are involved in the issuance of the bonds, to help reduce costs and ensure an affordable interest rate thanks to their AAA.

Blue Bonds

- High quality « bankable projects » are needed that maximize social, environmental and financial returns.

- Need of blue investment project pipeline to reduce the risk perceived by the market.

- The risk of poorly designed or implemented projects sanctioned by unbearable interest rates.

- Many low income countries will need to ‘test-drive’ these initiatives in partnership with experienced multilateral or national development banks in the initial phases.

Conclusion

- Innovative financing instruments are part of a large spectrum of financing instruments brokered by IFIs and NGOs for sustainable development objectives, including ocean conservation.
- They are not panacea but do help, provided specific conditions are met
- Conditions more stringent than for grants:
  - Specific costs (design, debt service)
  - Institutionalised and political commitment
  - Pipeline of bankable/sustainable projects
  - Shared vision among stakeholders

Conclusion

- Benefits go beyond leverage – hallmark of a country
- Bending further the learning curve is needed, through:
  - learning platforms
  - capacity development
  - advanced commitments to biodiversity
- Loan-based financing comes *after* policies have made it possible