Landscape of Guarantees for Climate Finance in EMDEs

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CLIMATE
POLICY
INITIATIVE

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ABOUT CLIMATE POLICY INITIATIVE

CPI is an analysis and advisory organization with deep expertise in finance and policy. Our mission is to help governments, businesses, and financial institutions drive economic growth while addressing climate change. CPI has six offices around the world in Brazil, India, Indonesia, the United Kingdom, and the United States.

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EXECUTIVE SUMMARY

Cross-border guarantees are an important but underutilized tool for mobilizing private capital for climate finance. A recent OECD evaluation found that guarantees leveraged 26% of all mobilized private finance between 2018-2020 and were among the preferred risk mitigation tools of private investors.[1]

Studies suggest that larger and more effective credit guarantee facilities have the potential to mobilize 6-25 times more financing than loans.[2] Their importance is even greater in emerging markets and developing economies (EMDEs), where geopolitical uncertainty and financial instability often hinder investment. Yet, the landscape of guarantee instruments and actors is fragmented.

Climate Policy Initiative (CPI) has conducted a mapping exercise to better understand the landscape of guarantees for EMDEs. This aimed to highlight key gaps in the uptake of guarantees for climate finance and identify areas where further research is needed to increase their scale and effectiveness for climate finance in EMDEs.

METHODOLOGY

CPI undertook a scoping analysis to gain a baseline understanding of the global landscape of guarantees. We identified 52 different cross-border guarantee instruments from 34 key entities (detailed in the appendix). These entities fall into four main types of provider:

1. Multilateral development banks (MDBs),
2. Development finance institutions (DFIs),
3. Export credit agencies (ECAs), and
4. Specialized Institutions.

Specialized Institutions are entities that operate similarly to private sector organizations but are funded by governments and development institutions, generally focusing on guaranteeing specific types of risks in specific situations.

[1] OECD (2022) 'Mobilised private climate finance: trends, insights and opportunities', in Climate Finance Provided and Mobilised by Developed Countries in 2016-2020: Insights from Disaggregated Analysis. Available at: https://www.oecd-ilibrary.org (Accessed: 10 November 2023).
[2] Systemiq Earth (2022) 'Guarantees in climate finance for emerging markets'. Available at: https://www.systemiq.earth/guarantees-climate-emerging-markets (Accessed: 20 November 2023).

For each guarantee instrument, we analyzed several key product criteria, including the type of financial instruments guaranteed, sector and climate focus, geographic coverage, and type of risk covered.

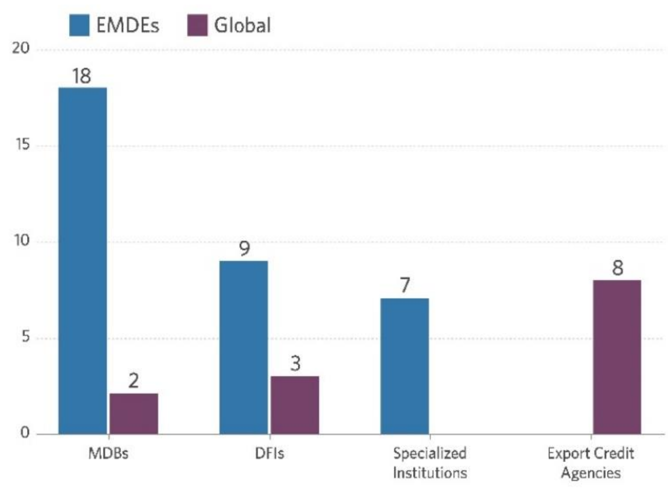
We covered commercial, political, and currency risks for debt investments such as loans, bonds, and any other form of debt. Although less common, we also covered guarantees for equity investments, focusing only on political and currency risks, which are relevant in the context of EMDEs. We categorized guarantees as either ***climate-agnostic***, for those that covered a variety of projects including climate-related ones, or ***climate-exclusive***, solely for climate-related projects.

While representative of the range of major cross-border guarantee facilities available for climate-related investments in EMDEs, our study is not exhaustive and does not delve into the ways in which guarantees are used at the national level to mobilize finance. Nevertheless, this scoping analysis provides valuable insights into the landscape of guarantee instruments and identifies avenues for further research to fill knowledge gaps on the effectiveness and scaling of guarantees.

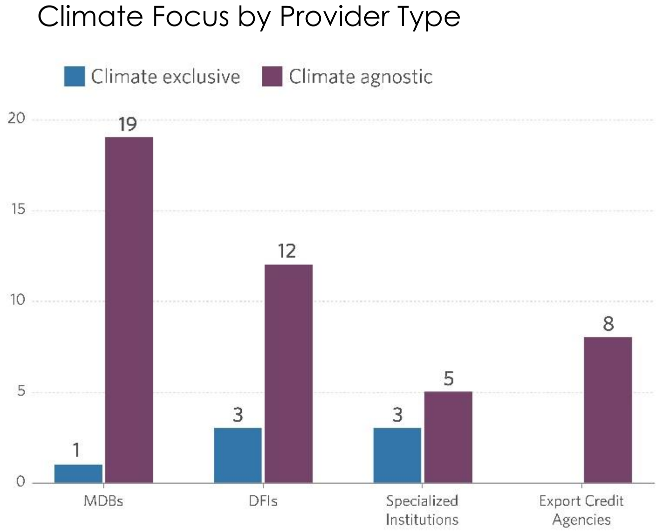
KEY FINDINGS

We categorized and assessed the guarantee instruments against a set of distinguishing criteria, resulting in the following findings.

Geographical Coverage by Provider Type

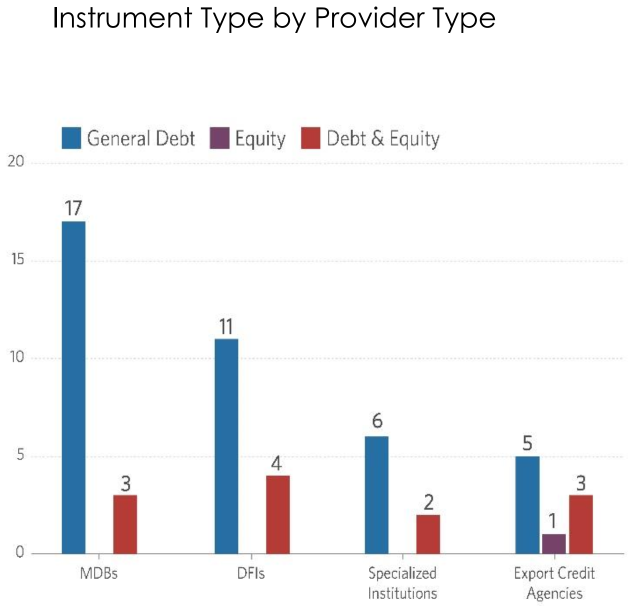


Geographic distribution: More than half of the mapped guarantees are intended for EMDEs, with the largest share going to middle-income countries. MDBs and Specialized Institutions focus primarily on EMDEs, often targeting middle-income countries. While there is a pronounced focus on Africa by these institutions, further research is needed to determine whether this is indicative of a broader trend or reflects a bias in the data sample.



Climate Focus: The majority of guarantees do not focus exclusively on climate issues, with only a handful of Specialized Institutions and DFIs offering climate-specific guarantees.

Examples include the Green Guarantee Company and the U.S. International Development Financing Corporation. There is an opportunity for MDBs to increase the number of climate-exclusive guarantees they offer to better align with global climate goals. Additionally, care needs to be taken to ensure that existing and future climate-exclusive guarantees have a balanced focus on both climate mitigation and adaptation finance.

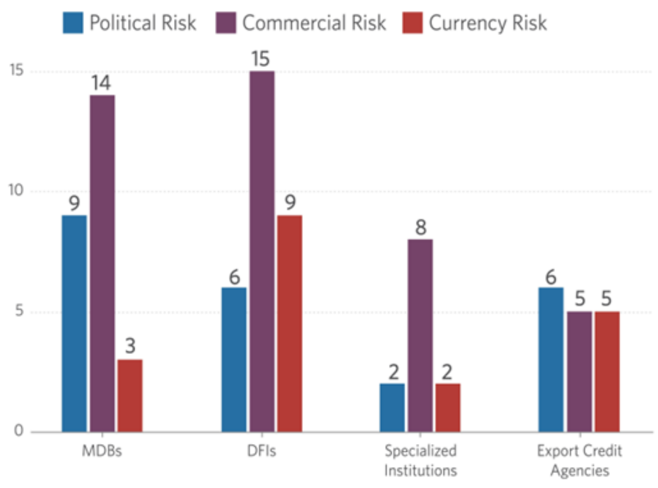


Instrument type: The mapping exercise found a predominance of debt guarantees, with a low presence of equity investment opportunities. This is consistent with the distribution of financial instruments tracked in CPI's Global Landscape of Climate Finance.[3] While equity investments are meant to take risks, further research is needed to determine whether the relatively limited availability of equity financing for climate projects in EMDEs is a binding constraint on climate finance flows due to political and currency risks. If so, the research could

[3] Climate Policy Initiative. (2023). Global Landscape of Climate Finance 2023. Available at: https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/ (Accessed: 20 November 2023).

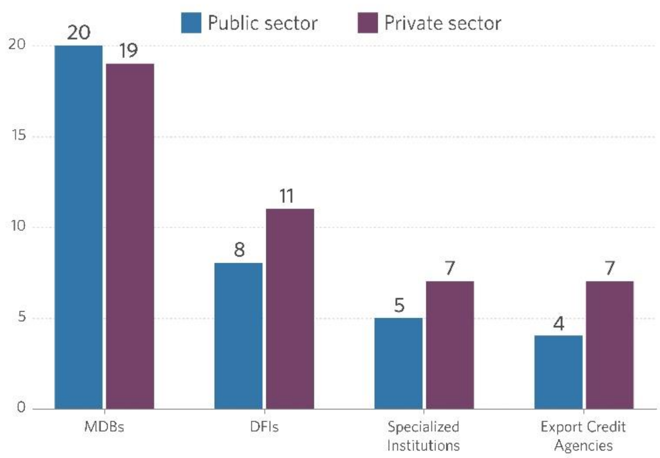
explore the potential role that guarantees for political and currency risks in equity investments could play in easing that constraint.

Risk Coverage by Provider Type



Risk management: Guarantees predominantly cover commercial risks, with less emphasis on political and currency risks. Political and currency risk products are often limited in scope, expensive, and complex. Potential solutions to expand, simplify, and potentially discount the availability of political and currency risk coverage in EMDEs for climate finance have gained traction in the last year, which could lead to greater availability of guarantees for climate projects.

Sectoral Coverage by Provider Type



Sectoral coverage: We analyze how guarantees cover investments in both private[4] and public sector projects[5], including sovereign debt, state-owned enterprises, and public-private partnerships, as both play a critical role in the energy transition in EMDEs.

The distribution of guarantees is relatively even across the private and public sectors, with a slight preference for the private sector among providers, suggesting a balanced market for guarantee coverage.

[4] Private sector projects and entities, which include businesses, industries, and projects that are funded, owned, and managed by private organizations or individuals.
[5] The public sector encompasses economic activities that are owned and operated by the government or public authorities.

RECOMMENDATIONS FOR FUTURE RESEARCH

To improve the effectiveness of guarantees in catalyzing private sector finance, particularly for green transitions in EMDEs, further research is needed. Guarantees in climate finance are difficult to track due to low default rates, so the additionality of guarantees on climate finance is not fully understood. Future research areas include:

- **Cost of obtaining guarantees,** including this affects the accessibility of guarantees to different entities.
- **Delivery mechanisms** and the impact of different approaches, such as direct insurance, intermediaries, or pooled guarantees instruments.
- **Scale and limits of guarantees** to help reach the estimated USD 2.4 trillion per year[6] needed for a green transition in EMDEs (excluding China).
- **Utilization rates** to determine what proportion of available guarantees is used.
- **Duration of guarantees** and their impact on projects, particularly for green initiatives, which often have longer development and payback periods.
- **Comparative analysis with other instruments** to provide insights into the relative effectiveness of guarantees in mobilizing private finance for green transitions compared to other traditional financial instruments.
- **Climate-related research** focused on how to tailor guarantees specifically adapted to different climate-related projects and sectors, assess their effectiveness, and align them with the unique needs of each project.
- **Role of national development banks in providing guarantees** through credit guarantees, which are essential for catalyzing domestic private investment.
- **Leadership opportunities** for MDBs to catalyze a much larger universe of guarantee providers at a regional and national level through qualifying financial institutions such as DFIs and local financial institutions.
- **Nature and scope of guarantee coverage**, examining how commercial risks are divided between partial and full coverage and whether pari passu or first loss risk sharing is more prevalent.
- **Sizes of guarantees and financial instruments** to establish the threshold at which cross-border guarantees become unattractive or nonviable.
- **Impact of local regulatory challenges on guarantees,** including how these instruments fit with domestic financial regulations and the role of local financial institutions in enabling effective guarantee implementation.

[6] Songwe, V., Stern, N., & Bhattacharya, A. (2022) 'Financing for Sustainable Development in the Era of COVID-19 and Beyond', IMF. Available at: https://www.imf.org/-/media/Files/Publications/GFSR/2023/October/English/ch3onlineannex.ashx (Accessed: 10 November 2023).

TABLE OF CONTENTS

1. GUARANTEE OVERVIEW

To mobilize the volumes of private climate finance needed and reduce the cost of capital, consensus is emerging that guarantees have a key role to play. In fact, an OECD evaluation found that guarantees leveraged 26% of all mobilized private finance between 2018-2020 and were a preferred blended finance tool of private investors[7]. Studies suggest that increased and purposeful credit guarantee facilities, with standardized contracts and agreed criteria, have the potential to mobilize 6-25 times more financing than loans.[8] Yet, the landscape of guarantee instruments and involved actors is fragmented.

Before undertaking a comprehensive review of guarantees to understand the gaps, the effectiveness of existing guarantees, and how they could be made more effective, there is a need to map and analyze the current guarantees landscape. This is the objective of this report.

1.1 WHY ARE GUARANTEES CRUCIAL TO PRIVATE SECTOR FINANCING?

Guarantees play a crucial role in mobilizing financial resources, especially in the private sector. Their importance is even greater in emerging markets and developing economies (EMDEs), where geo-political uncertainty and financial instability often hamper investment flows. Understanding the various reasons for the need for guarantees is key to using them effectively for economic development, investment promotion, and long-term sustainability.

Addressing the challenge of high-risk perception and its effect on limited investment: For example, of the 54 African countries only three are investment grade[9]. This significantly limits international private sector investment. Guarantees address both commercial and political risks to address this challenge.

[7] OECD (2022) 'Mobilised private climate finance: trends, insights and opportunities', in Climate Finance Provided and Mobilised by Developed Countries in 2016-2020: Insights from Disaggregated Analysis. Available at: https://www.oecd-ilibrary.org/ (Accessed: 10 November 2023).
[8] Systemiq Earth (2022) 'Guarantees in climate finance for emerging markets'. Available at: https://www.systemiq.earth/guarantees-climate-emerging-markets/ (Accessed: 20 November 2023).
[9] United Nations Economic Commission for Africa (2024) 'Africa Sovereign Credit Rating Review: 2023 Year-End Outlook. Available at: https://www.uneca.org/africa-sovereign-credit-rating-review-2023-year-end-outlook (Accessed: 10 November 2023).

Overcoming project finance shortfalls: Local banks often do not have deep expertise in project finance, and instead focus on short-term working capital or corporate finance. This limits both the quantum of loans and affordable financing solutions to provide long-term project funding for climate impact related infrastructure. Guarantees, provided through national financial institutions, address this challenge.

Tackling high local currency borrowing rates: The cost of finance in many EMDEs exceeds 10% and can be as high as 25% for longer-term funding. The use of guarantees from MDBs and DFIs adjusts the risk profile for local financial institutions on a blended interest rate margin basis and reduces the local borrowing costs.

Mitigating foreign exchange risk, including convertibility and availability risk: Long-term currency management is either limited or absent in many developing markets. Guarantees, mitigate this risk given currencies in most developing economies depreciate over the long term against hard currencies. Guarantees enable hard currency loans by private sector funders and investors in these economies.

Strengthening local debt capital markets: Developing economies have local pension funds, asset managers, and life insurance companies which have largely avoided investing in local infrastructure. Guarantees can increase the use of local domestic capital markets by providing support for loan tenor extension and sub-ordinated funding.

Providing political risk cover: To the extent investment and funding can be provided by national financial institutions with guarantees from DFIs abroad, there is no requirement for political risk insurance cover and the associated costs.

The use of local financial institutions: The introduction and management of guarantee products and instruments can be effectively achieved through national financial institutions which are regulated by local central banks and international conventions. They provide governance and importantly represent the best source of project infrastructure pipeline, which they co-fund with the support of the appropriate guarantees. It is also important to recognize the role of offshore guarantees in mobilizing foreign capital by providing access to larger pools of capital, international expertise, and risk diversification.

2. DATA COLLECTION METHODOLOGY

The purpose of this report is to map the landscape of cross-border guarantees available to international debt and equity investors in climate projects, with a focus on investments in emerging markets and developing economies (EMDEs). We categorize these guarantees as either *climate-agnostic*, covering a range of projects including both climate-related and non-climate-related initiatives, or *climate-exclusive*, focusing exclusively on climate-related projects. Guarantees in this study cover commercial, political, and currency risks for debt investments, and less commonly, they also cover equity investments, but only for political and currency risks.

The mapping and initial analysis contained in this report are intended to identify major gaps in the availability of guarantees and form the basis for productive future research on ways to improve the existing system of guarantee mechanisms for climate-related projects. The methodology underpinning this analysis is based on a comprehensive approach to data collection, designed to capture a wide range of guarantee providers.

Our methodology for this landscape involved identifying a representative sample of the most significant providers of cross-border guarantees for climate-related projects in EMDEs. Therefore, domestic guarantees were not part of our sample, but are mentioned to indicate an area for further research. These providers were categorized into the following key guarantor institution types:

- Multilateral Development Banks (MDBs)
- Specialized Institutions: Entities that operate similarly to private sector organizations but are funded by governments and development institutions, generally focusing on guaranteeing specific types of risks in specific situations.
- Development Finance Institutions (DFIs) other than MDBs
- Export Credit Agencies (ECAs)
- Private Sector Entities

While recognizing that the landscape is extensive, this report focuses on a targeted list of over thirty providers. These institutions were selected based on their significant role within the guarantee landscape and their potential to represent the broader market. The list of identified providers and the detailed categorization have been included in an appendix. We did not individually analyze private-sector guarantors (such as political risk insurers and dealers of exchange rate hedges) due to the large number of individual providers and the high price of the guarantee products in

EMDEs, but we have incorporated private guarantors into our analysis throughout this report.

For each guarantee within our sample, we analyzed several key product criteria, including:

- The type of financial instrument(s) guaranteed
- The sectors they aim to support (public vs. private)
- The degree of focus on climate-related investments.
- Geographic reach and targeted income levels of recipient countries
- The types of risks covered including political, commercial, and currency risks.

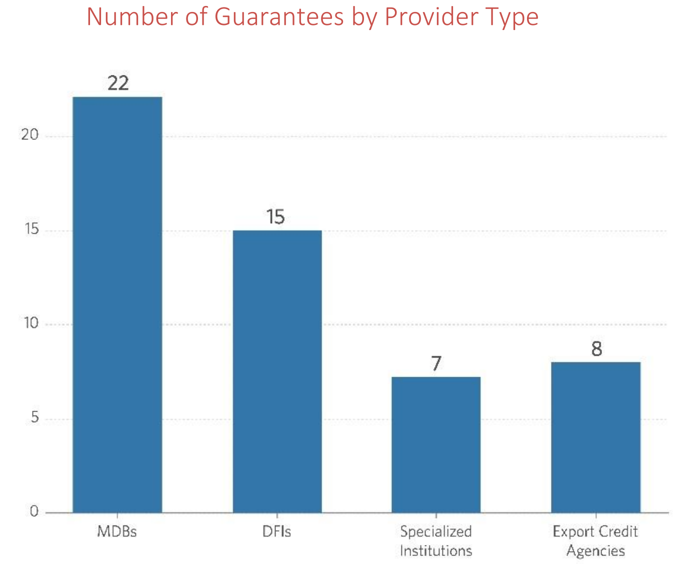
The primary sources of information were the public websites of the identified guarantee providers. It is worth noting that while certain guarantee products are technically listed as available on these websites, there may be limited evidence that these guarantees have been used in actual transactions.

Note: In our data collection process, we were careful to avoid double-counting programs offered by different providers. However, given the complexity and overlap in some program areas, it is possible that some instances of duplication may have occurred. We are committed to continually refining our data to ensure accuracy and reliability. For the purposes of this analysis, we consider institutions that run guarantee programs funded by the same donors as unique if they address different risks and geographies.

3. COMPARATIVE ANALYSIS

This mapping exercise identified 34 distinct institutions that are key actors in developing and offering guarantee products. Across these institutions, a total of 52 distinct guarantee products were uncovered based on the following metrics: provider type, climate coverage, geographies covered, type of instrument, sectoral focus, and risks covered.

3.1 GUARANTEE PROVIDER TYPE



Identifying the types of providers that are currently offering guarantees is critical to better understanding how to expand the guarantee market. This analysis found four types of institutions that are active in providing and managing guarantee products and funds. Multilateral development banks (MDBs) comprise the largest actor type, with 11 MDBs offering 22 distinct types of guarantees.

The 13 development finance institutions (DFIs) offer 15 distinct guarantees, with the vast majority being provided on a bilateral basis like Agence Française de Développement (AFD), and many funded in part by the European Union. While we strive to ensure the robustness of our analysis, there are rare instances where overlap occurs between funding and managing agencies. One example is the Development Guarantee Facility, which is managed by the Investment Fund for Developing Countries, and funded by DKK (the Danish bilateral aid agency) and SIDA (the Swedish bilateral aid agency).

ECAs, such as UK Export Finance, offer eight distinct guarantee products across four ECAs. The limitation of ECAs is that they are tied to host country and regions providing equipment and services to the beneficiary country and finance needs to be advanced by an accredited commercial bank, which are limited. The OECD arrangement on officially supported export credits, an agreement between 11 economic markets, aims to provide an orderly use of official export credits by fostering a level playing field and encouraging competition.[10] The eight Specialized Institutions, defined here as entities with a specific purpose set up by donors or governments but operating in a similar way to the private sector, each offer a distinct guarantee product; these products have the most specificity across the other metrics and the most unique products.

Box 1: Government guarantees to domestic financial intermediaries

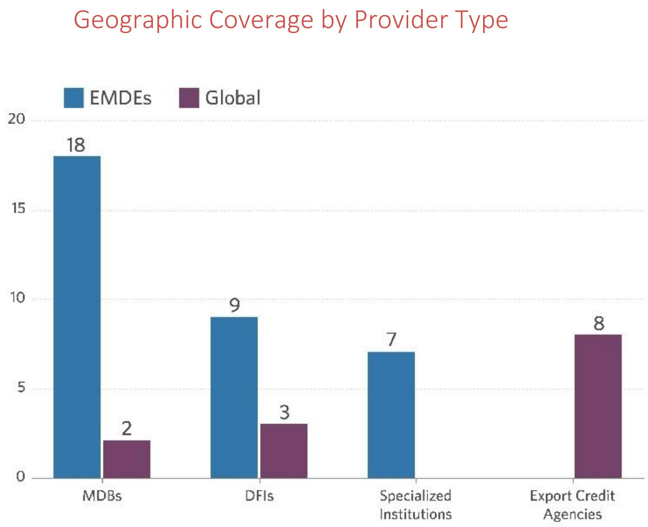
While not the primary purpose of this study[11], guarantees for domestic financing merit further research as a tool used by governments to stimulate domestic lending. Government guarantees are often provided to domestic banks. In India[12], for example, the government pioneers unique guarantee programs with an innovative approach. The Credit Guarantee Scheme for Startups (CGSS), administered by the Department of Promotion of Industry and Internal Trade (DPIIT), provides credit guarantees to startups that lack credit history or collateral. These guarantees are extended to financial institutions, including commercial banks, Non-Banking Financial Companies (NBFCs)[13], and investment funds, which in turn lend to startups[14].

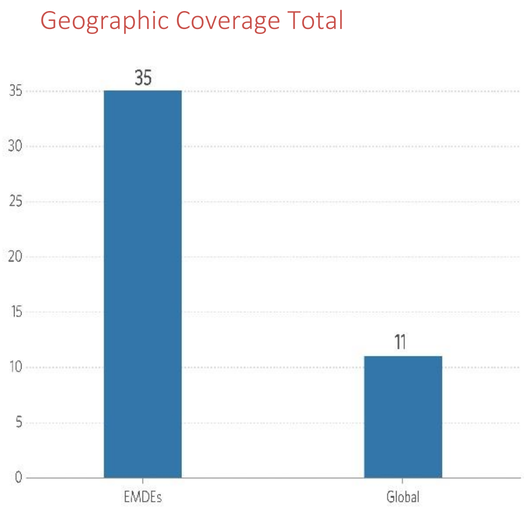
The other example is the Credit Guarantee Scheme for MFIs (CGSMFI), where the government guarantees loans made by member lending institutions (MLIs) to non-banking financial companies. These MLIs, which include banks and other financial institutions, then lend to small, eligible borrowers[15].

[10] OECD. Arrangement and Sector Understandings. Available at: https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/ (Accessed 21 February 2024).
[11] This analysis focuses on cross-border financing, excluding domestic guarantees from our sample to focus on cross-border cases. We refer to domestic guarantees only for future research.
[12] The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and the National Credit Guarantee Trustee Company (NCGTC) are two other prominent examples in India that provide credit guarantees with a focus on micro, small and medium enterprises that might otherwise struggle to secure financing due to lack of collateral or the perceived riskiness of their operations.
[13] Financial institutions that provide various banking services but do not hold a banking license, meaning they cannot accept traditional demand deposits (like savings accounts). NBFCs are an essential part of the financial ecosystem, particularly in expanding access to financial services (loans and credit facilities, retirement planning, money market) in areas and sectors underserved by traditional banks.
[14] Startup India. Credit Guarantee Scheme for Startups. Available at: https://www.startupindia.gov.in/content/sih/en/credit-guarantee-scheme-for-startups.html (Accessed: 20 November 2023).
[15] Standard Chartered Bank India. (2021). Credit Guarantee Scheme for MFI – NCGTC. Available at: https://www.sc.com/in/important-information/credit-guarantee-scheme-for-mfi-ncgtc/ (Accessed: 20 November 2023).

Further research into the effectiveness of government guarantees in promoting sustainable investment would be valuable to better understand the volume of capital mobilized. Such research can demonstrate how these guarantees enable DFIs, ECAs, and other domestic financial intermediaries to channel resources into climate-related projects, offering a scalable and replicable model for blended finance.

3.2 GEOGRAPHIC COVERAGE





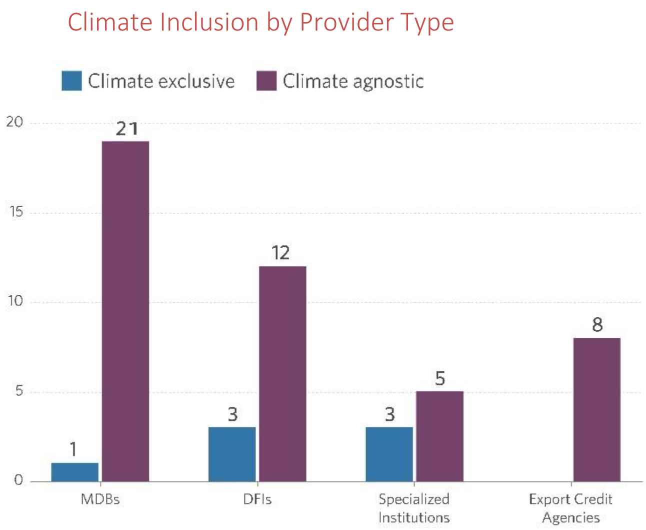
Guarantees are a critical tool to increase financial flows into EMDEs by mitigating the more significant risks of investment. Of the 52 guarantees identified, 35 are targeted towards recipients in emerging markets and developing economies (EMDEs). An additional 11 have no geographic specificity and can be applied globally. The remainder are limited to specific countries or regions in developed economies; the UK Export Finance Agency (UKEF), for example, has a guarantee product tailored for UK small and medium enterprises (SMEs) that are looking to increase their exports.

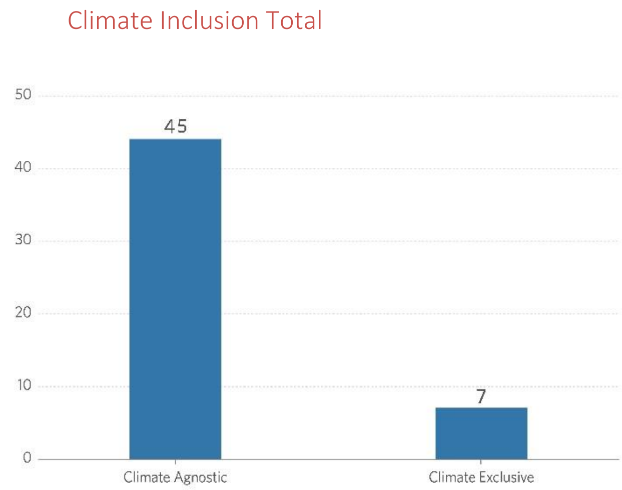
All of the guarantee products offered by MDBs and Specialized Institutions are intended for use in EMDEs, given the mandates of MDBs and the specific development purposes of the Specialized Institutions. The majority of DFIs' products are for EMDE financing, with three exceptions for global applicability. By contrast, while Export Credit Agencies (ECAs) provide guarantees that are globally applicable, their role is to fill the gaps in coverage where the commercial market falls short. ECAs are designed to help domestic companies export abroad —

through risk management, market demand, and strategic trade relationships — not only in high-income countries but in a wide range of economies, especially where traditional financial institutions may consider the risk too high.

The fact that guarantees specifically tailored for use in EMDEs account for the majority of the guarantees covered in this study suggests that they are being effectively used as a tool to mitigate the various real and perceived risks associated with investing in developing regions.

3.3 CLIMATE COVERAGE





Climate-focused guarantees are critical for mobilizing climate finance, especially from the private sector, because they reduce the financial risks and lower the cost of capital for investors, similar to other guarantees. Their distinct advantage is that they are tailored to the specific risks and financial structure often faced in climate-related projects. The last several years have seen a marked increase in financial instruments designed specifically to support climate finance.

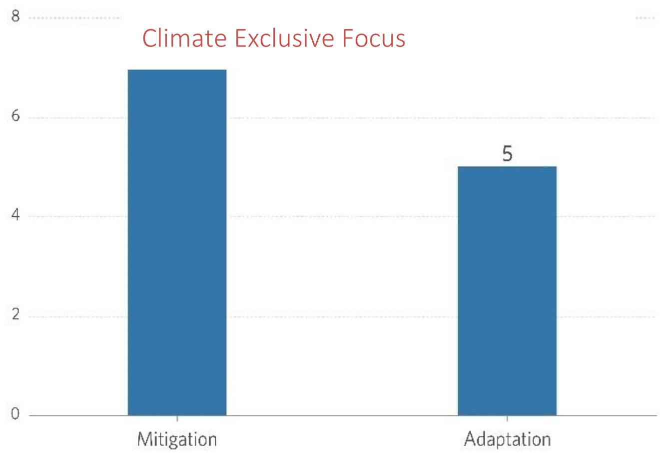
To determine which of the mapped guarantees are supporting larger volumes of climate finance, they were categorized as the following:

- Climate-agnostic: it covers climate and non-climate related projects.
- Climate-exclusive: It covers climate-specific products designed to directly address climate related challenges.

Climate-agnostic guarantees represented the majority of the guarantees analyzed, accounting for 87% of the total. This predominant trend indicates that most guarantee products are designed for universal relevance and highlights a current gap in offerings and an opportunity to create more tailored guarantee products as climate finance expands.

The institutions examined in our study have implemented guarantee programs for climate-related purposes in different ways:

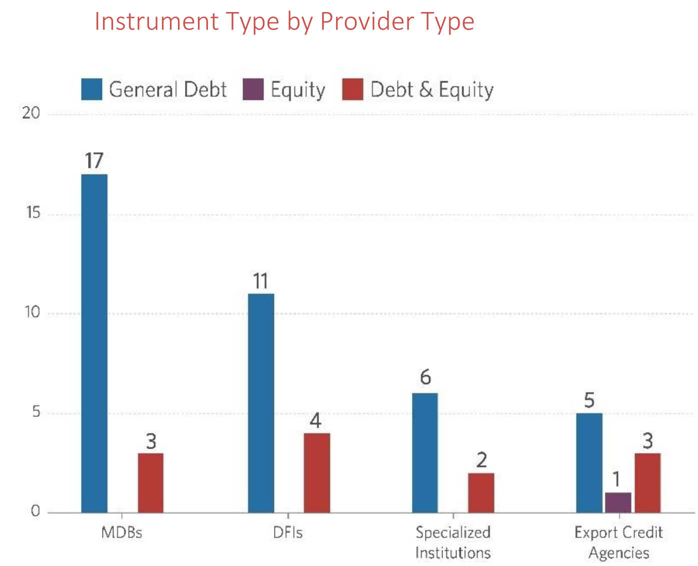
- MDBs dedicate only one guarantee instrument exclusively to climate initiatives, with the remaining being climate-agnostic. This suggests a potential gap in addressing climate change more aggressively, considering the significant role MDBs play in global financing.
- DFIs allocate about 80% of their guarantees to climate-agnostic projects. This indicates that a significant portion of their portfolio is designed to be universally relevant, rather than exclusively focused on climate-specific objectives.
- Specialized Institutions – entities with a specific purpose set up by donors or governments but operating in a similar way to the private sector – are more likely to be climate-specific. About 63% of their offerings are dedicated to exclusive climate products, reflecting a more focused approach to climate issues than the other institutions mentioned.
- Finally, ECAs allocate all of their guarantees to climate-agnostic projects as their funding is tailored to support exports from the ECA's home country. The Climate Change Sector Understanding annex to the OECD Arrangement on Officially Supported Export Credits, updated in July 2023, allows extra flexibility in providing climate finance, including longer loan terms.[16]

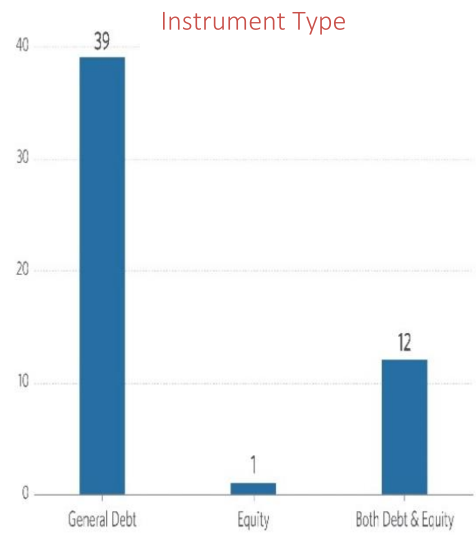


Within climate-exclusive products, CPI assessed whether the guarantee was focused on mitigation, adaptation, or both. We found a fairly balanced distribution in focus between mitigation and adaptation, with mitigation (58%) having a slightly higher number of guarantee products offered.

[16] OECD. Arrangement and Sector Understandings. Available at: https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/ (Accessed 21 February 2024).

3.4 INSTRUMENTS GUARANTEED





Guarantees and insurance products can be designed to protect lenders, debt providers, and equity investors or they may provide coverage for both types of investors. In the context of EMDEs, guarantees covering equity investments are designed to protect against risks such as political instability, expropriation, or currency inconvertibility, rather than the investment itself, to avoid creating moral hazard.

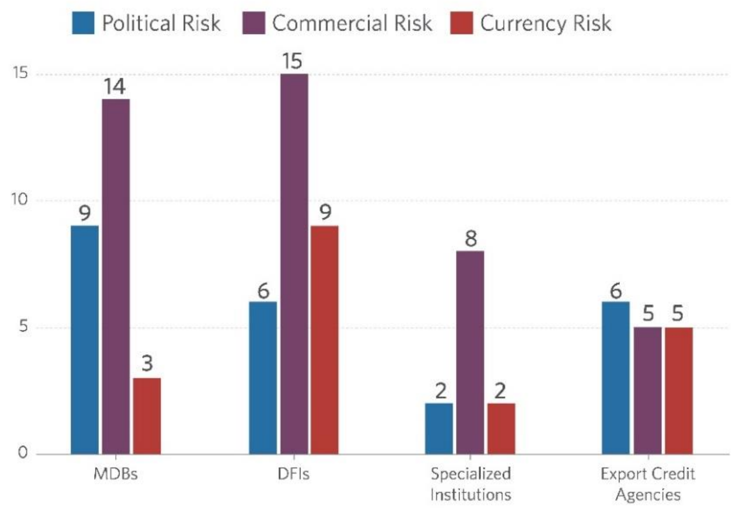
The guarantee products sampled for this analysis were considerably more debt-focused than equity-focused: 39 only covered debt investments, while 12 covered both debt and equity; none focused exclusively on equity investments. All of the types of guarantor institutions offered more debt-focused products than equity-focused ones; MDBs, in particular, offered only three products that guaranteed equity investments, compared to 17 that covered debt investments.

On the one hand, this preponderance of debt-focused guarantee products mirrors the debt-heavy capital structure usually observed in businesses and projects deploying mature technologies and products. Indeed, CPI's most recent Global Landscape of Climate Finance (2023) tracked USD 766 billion in debt-based climate finance flows annually in 2021-22, compared to USD 422 billion in equity flows[17]. Nevertheless, it is possible that the high perceived risk of equity investment in climate projects in EMDEs is the constraining factor, and that higher equity investment would unlock even larger debt flows (when accompanied by the subsequent debt financing). More research would be needed to determine if this is the case. If so, it would suggest that increasing the scale and flexibility of equity guarantees and insurance that specifically address political and currency risks for climate projects in EMDEs should be a priority.

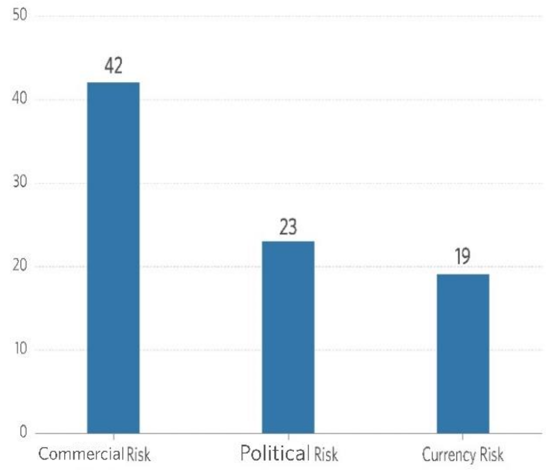
[17] Climate Policy Initiative. (2023). Global Landscape of Climate Finance 2023. Available at https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/ (Accessed: 20 November 2023).

3.5 RISKS COVERED

Risk Coverage by Provider Type



Risk Coverage Total



Although different guarantors and insurers[18] often offer somewhat different terms on their products, the types of risks covered usually fall into three major categories: commercial risks, political risks, and currency risks. All three types of risk contribute to the cost of capital for climate projects in developing economies.

- Commercial risks generally arise from unexpected circumstances or outcomes that are specific to the business entity or project that is insured or guaranteed, such as insolvency, bankruptcy, or protracted default.
- Political risks refer to losses due to interactions with the government or other political events, such as currency inconvertibility or transfer restrictions, expropriation or nationalization, and political violence; political risks are often excluded from standard commercial insurance contracts.
- Currency risk refers more narrowly to the possibility that local currency depreciation makes debt denominated in foreign currency more difficult to service when revenues are denominated in local currency, and equity investments by foreign investors lose value due to currency depreciation or the availability or convertibility of foreign currency risks.

The guarantee products sampled for this study suggest that commercial risk cover is more widely available than political and currency risk cover: 42 products we surveyed covered commercial risks, compared to 23 for political risk and 19 for currency risk. However, these results were limited by the inability to analyze ECAs, DFIs, and commercial insurers and guarantors by way of publicly available data.

[18] Traditional insurance policies typically do not cover commercial, political, and currency risks. An exception is parametric insurance, a less conventional form of insurance, which provides payouts based on specific predefined events, such as natural disasters, regardless of actual losses incurred.

Many developed economies have ECAs and DFIs that offer political and currency risk cover, but only for transactions that involve their domestic exporters or investors. Likewise, many commercial insurers offer political risk cover, and many financial institutions offer currency hedges, but these products are often prohibitively expensive or unavailable in lower-income countries.

Our survey therefore suggests that the problem for climate projects in developing economies is not that political and currency risk products are few. Rather, these products are limited in their geographical scope and affordability. The complexity of the application process and the difficulty of coordinating multiple providers with different nationality-based restrictions also pose barriers.

Box 2: Guarantee facilities for climate projects - risk coverage in EMDEs

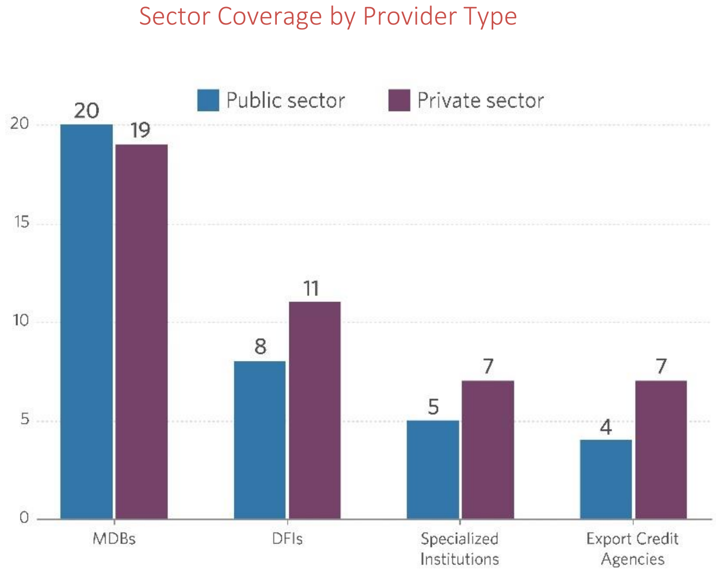
Research has demonstrated the effectiveness of guarantees in covering a range of risks - political, commercial, and currency — to support climate-related projects in EMDEs. Climate Policy Initiative's Global Credit Guarantee Facility (GCGF) aims to show how facilities can de-risk and reduce the cost of global capital financing from developed countries to EMDEs across a variety of risk factors.

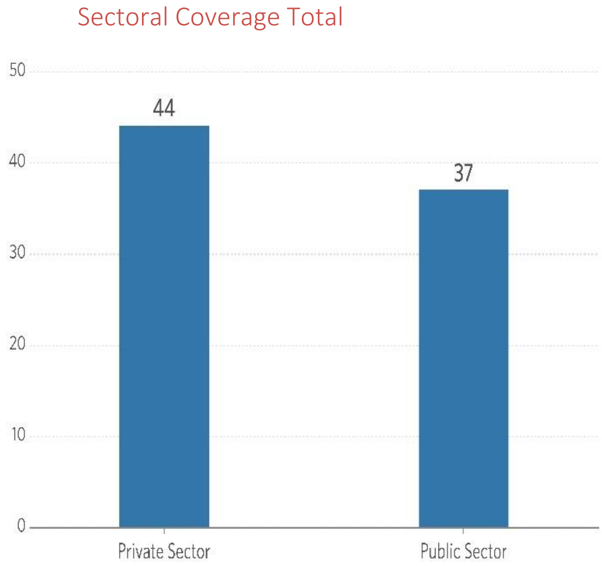
The facility proposes to partially cover (sub-)sovereign and project credit risks. The GCGF would work as a bilateral loss-sharing agreement between the credit guarantee trust and member institutional investors/international financial institutions. Credit risk — sovereign and off-taker — would be managed by providing a partial guarantee. In case of delay/default in debt servicing, GCGF would reimburse a portion of any losses incurred by borrowers. This proposed GCGF initiative strategically focuses only on credit risk, leaving political and currency risks to be covered by institutions such as MIGA and TCX, respectively. The primary goal is to ensure a robust mechanism for financial protection against default that helps reduce the cost of financing for climate projects in EMDEs by using a hybrid, partially capitalized approach to cover expected losses[19].

Further research is needed to assess the operational effectiveness of such facilities and their potential for broader application.

[19] Climate Policy Initiative. (2023). *Proposal for a Global Credit Guarantee Facility*. Available at: https://www.climatepolicyinitiative.org/publication/proposal-for-a-global-credit-guarantee-facility/ (Accessed: 20 November 2023).

3.6 SECTOR FOCUS





We considered whether the guarantee products in our sample covered investments in private sector projects and entities or investments in public sector projects (including sovereign debt, state-owned enterprises, and public-private partnerships). Guarantees for both of these sectors are necessary because both have a critical role to play in the energy transition and both face high capital costs in EMDEs.

Our sample of guarantee products showed roughly equal coverage of these sectors: 37 products covered public sector investments and 44 covered private sector investments. Most of the guarantor types we analyzed exhibited this roughly even balance across sectors, with only ECAs showing substantially more products with private-sector coverage. These results suggest that there is not a meaningful gap in guarantee coverage across the public and private sectors.

4. EXAMPLES OF GUARANTEE PRODUCTS BY PROVIDER TYPE

Provider	Description
MDB: IFC's Risk Sharing Facility (RSF)	**Description:** RSF involves bilateral loss-sharing agreements between IFC and an originator (which can be either a bank or a corporation). This facility is particularly beneficial for originators who need protection against credit risk but do not require additional funding. Under the RSF, the IFC agrees to reimburse the originator for a predetermined portion of any incurred losses that exceed a specified threshold, known as the "first loss," on a portfolio of eligible assets. The primary objective of the RSF is to enhance the originator's ability to generate new assets within a particular asset category. **Climate focus:** The guarantee is climate agnostic. **Geography:** The guarantees are limited to EMDEs, focusing on both low- and middle-income countries. **Risk covered:** The guarantee covers commercial risks.
Specialized Institution: The Green Guarantee Company	**Description:** GGC is a specialized guarantor for climate change adaptation and mitigation projects, particularly in EMDEs. Its focus is on de-risking green bonds and loans, coupled with transparent impact measurement. GGC provides credible borrowers with a comprehensive hard currency guarantee, aligned with the international Climate Bond Standard, to support bonds and loans with tenors of up to 20 years. The company underwrites a significant volume of loans and bonds, providing guarantees of up to $200 million per transaction. GGC's target capital is approximately $600 million. **Climate focus:** The guarantee is climate exclusive. **Geography:** The guarantees are focused on EMDEs, including low- and middle-income countries. **Risk covered:** The guarantee covers commercial risks.
DFI: FMO's Nasira program	**Description:** Nasira is a risk-sharing facility by the Dutch entrepreneurial development bank FMO, which provides a second loss guarantee of up to 95% of the losses on the underlying portfolio, promoting lending to demographics considered high-risk, such as agricultural MSMEs, young, female, and migrant entrepreneurs. Funded by the European Commission and the Dutch government fund MASSIF, Nasira aims to support MSMEs in Africa and the EU Neighborhood with a goal to leverage €500 million of loans by August 2024. The program is set to expand globally, supporting sectors like rural/agricultural MSMEs to stimulate local production, food security, and clean energy solutions, with an additional €264 million guarantee provided by the European Commission to help leverage €1.3 billion of loans to MSMEs worldwide. **Climate** focus: The guarantees are climate agnostic. **Geography:** The program guarantees are focused on EMDEs, covering regions in Africa, the EU Neighborhood, Asia, Latin America and the Caribbean, and Turkey. It includes low- and middle-income countries. **Risk covered:** The guarantees cover commercial risks.
ECA: Export-Import Bank of the United States	**Description:** The Export-Import Bank of the United States (EXIM) offers medium- and long-term guarantees, as well as short-term export credit insurance, to support U.S. exports. These guarantees are non-concessional, meaning they are offered on commercial terms rather than being subsidized. Coverage may be extended to countries and terms not typically available in the private

	market. For climate-related projects, both mitigation and adaptation, repayment tenors of up to 22 years are available. **Climate focus:** The guarantees are climate agnostic. **Geography:** they are globally applicable and tied to U.S. exports, with up to 50% coverage available for local costs in the importing country. **Risk covered:** The guarantee covers political, currency, and commercial risks.

Box 3: Scaling up climate investments with guarantees: the GCF-DBSA strategic partnership in southern Africa

The Green Climate Fund (GCF) and the Development Bank of Southern Africa (DBSA) have entered into a strategic partnership to scale up climate investments across Southern Africa. The collaboration will address the significant market barriers to private sector investment that are critical to helping four Southern African countries meet their Nationally Determined Contributions (NDCs) to mitigate and adapt to climate change.

As a first of its kind in Africa, the DBSA program, supported by the GCF, establishes a private sector climate finance facility (CFF) modeled on a green bank. The CFF will play a key role in overcoming market barriers through a blended finance strategy. It will focus on projects that are commercially viable but lack private sector bankability without additional financial or development support, such as credit enhancements. This approach will complement traditional banking roles by incorporating elements such as first loss coverage, subordinated tranches, and guarantees[20].

Research on the impact of this joint venture will be meaningful. It will serve as a case study to evaluate the effectiveness of blended finance structures that utilize various financing and risk mitigation tools. This analysis will help understand how such collaborations can mobilize capital for socially or environmentally impactful projects and assess their potential for scalability.

[20] Green Climate Fund (n.d.) DBSA Climate Finance Facility. Available at: https://www.greenclimate.fund/document/dbsa-climate-finance-facility (Accessed: 20 November 2023).

5. GAPS IN THE GUARANTEE LANDSCAPE

5.1 GEOGRAPHY

Current status:

- While over half the guarantees mapped are targeted for use in EMDEs, a significant share of guarantees is directed to middle-and high-income countries. This distribution indicates a potential mismatch between the areas of greatest need (i.e., low-income countries) and the focus of current guarantee products.
- There is a notable regional gap, particularly in Asia and Latin America (LA). The current guarantee landscape as mapped shows a predominant focus on Africa, especially among Specialized Institutions. This could indicate either a gap in the mapping or a genuine lack of guarantees focused on the Asian and Latin American regions.

Recommendations:

- Increase the number of guarantees targeting low-income countries. These regions face higher risks and have significant barriers to investment, particularly in climate-related projects. Such recovery can be done on a regional rather than a country-by-country basis to allow for the pooling of resources and broader risk sharing, potentially overcoming challenges related to scale, targeting, and capital.
- Prioritize high-emitting EMDEs to help countries with significant climate impact potential transition to sustainable practices.
- Conducting additional mapping to identify and address the potential gaps in guarantee allocation in Asia and Latin America. If needed, develop and implement more guarantees for these regions to ensure equitable distribution.

Box 4: National banks and MDBs: Guarantees to promote private investment

National banks in EMDEs are establishing guarantee platforms with support from concessional funds. These platforms aim to reduce risk and mobilize private investment, especially in green and sustainable projects. Additionally, national banks can receive guarantees from MDBs and developed country DFIs to cover potential losses in on-lending. This approach reduces risks for banks and private investors, attracting capital to traditionally considered risky sectors. Comprehensive research can evaluate such partnerships between MDBs and DFIs and national banks to understand their effectiveness in promoting green sectoral transformation.

5.2 CLIMATE COVERAGE

Current status: Most guarantees are climate-agnostic, with a small proportion being climate-exclusive. MDBs have a minimal focus on climate-exclusive initiatives, while Specialized Institutions are leading in this area.

Recommendation: There is a need for more climate-exclusive guarantee products, especially from MDBs. These institutions should increase their share of climate-specific guarantees to better align with global climate goals. There is also a need for a balanced focus on mitigation and adaptation in climate-exclusive guarantees.

5.3 INSTRUMENTS GUARANTEED

Current status: Guarantees are predominantly debt-oriented, with limited offers for equity investments. This distribution is consistent with the broader trend seen in CPI's Global Landscape of Climate Finance, which shows a similar preference for debt financing for climate-related projects.

Recommendations:
- Conduct further research on equity constraints to determine whether the scarcity of equity-focused guarantees is indeed a limiting factor for climate finance. Focus should be on understanding the specific needs for equity investment in different types and stages of climate projects and the potential role of guarantees in meeting those needs.
- If research indicates that equity is a limiting factor, develop more equity-focused guarantees concentrating on political and currency risks. This would fill a gap in the market and could unlock additional capital for climate initiatives, including more private and debt capital.

5.4 RISKS COVERED

Current status: Guarantees mainly cover commercial risks, with less emphasis on political and currency risks. Political and currency risk products are often limited in scope, expensive, and complex.

Recommendation: Expand and simplify the availability of currency risk coverage, particularly in EMDEs. This could include creating more standardized products, reducing costs, and improving accessibility. With respect to political risk guarantees, efforts should be directed at accelerating payment processes and providing liquidity facilities during arbitration, especially for high-emitting EMDEs. In addition, efforts should be made to coordinate different providers to offer comprehensive risk, particularly for high-emitting EMDEs.

6. AREAS FOR FUTURE RESEARCH

To improve the effectiveness of guarantees in catalyzing private sector finance, particularly for green transitions in EMDEs, further research is needed, particularly on these key areas:

Cost of obtaining guarantees: Research should examine how these costs affect the accessibility of guarantees to different entities. This includes examining fee structures, application processes, and any additional costs that may prevent smaller or less financially robust organizations from accessing these instruments. In addition, the research should examine how the capitalization of guarantees influences the cost of provision. Understanding the capital requirements and financial underpinnings of guarantees can shed light on their overall affordability and availability.

Delivery mechanisms: The effectiveness of guarantees can vary significantly depending on how they are delivered. It is important to assess the impact of different approaches such as direct insurance, intermediaries, or pooled guarantees instruments. Each method has its own set of advantages and challenges, and any study should aim to identify which delivery mechanisms are most effective in different contexts, considering factors such as ease of access, administrative efficiency, and risk distribution.

Scale and limits of guarantees: With EMDEs needing an estimated USD 2.4 trillion per year for the green transition, it is critical to assess whether the current scale and limits of guarantees are sufficient. This involves analyzing the proportion of total financing needs that guarantees can currently cover and identifying potential gaps where increased or additional guarantees could be beneficial.

Utilization rates: It is essential to examine the percentage of available guarantees that are used. This research should identify factors contributing to under-utilization and explore strategies to increase the uptake of these financial instruments to ensure that they are fully utilized for maximum impact – or to consider consolidating under-utilized instruments or releasing committed capital to redeploy in other new instruments.

Duration of guarantees: The length of guarantees can have a significant impact on project success, particularly in the context of green initiatives, which often have longer development and payback periods. Research should focus on determining optimal guarantee durations that match the life cycle and risk profile of different types of projects.

Comparative analysis with other instruments: A comparative study should be conducted between guarantees and other financial instruments such as loans and credit lines. This analysis would provide insights into the relative effectiveness of guarantees in mobilizing private finance for green transitions compared to other traditional financial instruments.

Climate-related research questions: Given the urgency of climate action, there is a need for specific research focused on how guarantees can support climate-related projects, with a focus on key sectors such as renewable energy, sustainable agriculture, or green infrastructure. This research could include assessing the effectiveness of guarantees – e.g., in mitigating financial risks and leveraging private capital for various types of projects.

Findings from a comprehensive analysis would be instrumental in shaping policies and strategies to maximize the impact of guarantees as a financial instrument for sustainable development.

Role of national development banks in providing guarantees: The role of national development banks (NDBs) in the provision of guarantees has been largely underrepresented in research on the guarantee landscape. These institutions play a critical role in supporting high-risk sectors through credit guarantees, which are essential for catalyzing private investment in development sectors. Further research will be useful in understanding the role of NDBs in development finance. Research should assess the scope and scale of guarantees provided by NDBs compared to regions without such institutions. It should also assess how these guarantees affect private investment in key sectors and their overall contribution to climate projects.

Leadership opportunities: The leading MDBs can both lead and catalyze a much larger universe of guarantee providers at a regional and national level through qualifying financial institutions such as DFIs and local financial institutions. Proposals can be made on how this is best achieved using existing initiatives such as the European Fund for Sustainable Development Plus.

The nature and extent of guarantees: Further research could examine how guarantees cover commercial risks, in particular by distinguishing between partial and full risk coverage options in the markets. In addition, this research could assess which risk-sharing arrangements, such as pari passu or first loss sharing, are more common in current guarantee structures. Understanding these issues will help identify how guarantees can be structured more effectively to encourage investment in high-risk sectors and regions.

The viability of cross-border guarantees based on threshold analysis: Research could examine the median and minimum sizes of cross-border guarantees, particularly as they relate to climate-related projects and related financial instruments. This study could aim to establish a practical threshold for the effectiveness of these guarantees in the context of climate finance. By identifying the size at which the provision of guarantees becomes more costly than beneficial, the research can inform climate finance policies and strategies.

Regulatory Challenges: Research could explore the impact of local regulatory constraints, which can be a significant impediment to capital flows. This includes understanding how guarantees must comply with domestic financial sector regulations and assessing the role of local financial institutions as partners in complying with these regulations and facilitating effective guarantee implementation.

7. APPENDIX

List of providers by category in this study

Multilateral Development Banks (MDBs):

1. Asian Infrastructure Investment Bank (AIIB)
2. African Development Bank (AfDB)
3. Asian Development Bank (ADB)
4. Development Bank of Latin America and the Caribbean (CAF)
5. European Bank for Reconstruction and Development (EBRD)
6. European Investment Bank (EIB)
7. Inter-American Development Bank (IDB)
8. International Finance Corporation (IFC)
9. Islamic Development Bank through the Islamic Corporation for the Insurance of Investment Export Credit (ICIEC)
10. Multilateral Investment Guarantee Agency (MIGA)
11. World Bank (IBRD & IDA)

Specialized Institutions

1. Afreximbank, the African Export-Import Bank
2. African Guarantee Fund for Small and Medium Enterprises
3. African Trade Insurance Agency (ATI)
4. GuarantCo
5. The Africa Energy Guarantee Facility (AEGF)
6. The Green Finance Institute
7. The Green Guarantee Company

Development Finance Institutions (DFIs)

1. Agence Française de Développement (AFD)
2. British International Investment (BII)
3. The Development Guarantee Facility of the Danish Government (Danido) (counted as the funder of IFU)
4. Dutch Entrepreneurial Development Bank (FMO)
5. EU - European Fund for Sustainable Development Plus (EFSD+)
6. EU European Guarantee Fund (EGF)
7. Governments-led Public Credit Guarantee Schemes (PCGSs)

8. Japan Bank for International Cooperation (JBIC)
9. Japan International Cooperation Agency (JICA) (no guarantees found)
10. Kreditanstalt für Wiederaufbau (KfW)
11. Swedish International Development Cooperation Agency (Sida)
12. Swiss Economic Cooperation and Development (SECO)
13. United States Development Finance Corporation (USDFC)

Export Credit Agencies

1. Export-Import Bank of the United States (EXIM)
2. China Export & Credit Insurance Corporation (Sinosure)
3. UK Export Finance (UKEF)
4. The Swedish Export Credit Agency

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