
Debt-for-climate Swaps



Debt-for-climate swaps involve the cancellation, exchange, or refinancing of a portion of a country's debt in return for a commitment to invest the resulting debt-service savings into projects focused on climate change mitigation, adaptation, or environmental conservation.

Instead of making external debt payments in foreign currency, the debtor country could make local currency payments for domestic climate or development projects. The key value lies in freeing fiscal space for priority climate investments without adding to the debt burden.

RISKS ADDRESSED

- **Liquidity risk:** Beyond smoothing debt service, swaps can ease near-term fiscal pressures, allowing ministries of finance (MoFs) to prioritize climate spending without undermining debt sustainability.
- **Market risk:** Swaps can reduce exposure to currency risk, especially when local currency instruments are used, lowering sovereign vulnerability to external shocks.

APPLICATION AND IMPACTS

While debt-for-climate swaps are applicable to a range of sectors, some include:

- **Marine conservation:** In 2023, Ecuador implemented a significant debt conversion by utilizing [The Galápagos Marine Bond](#), replacing over USD 1.6 billion in international bonds with a USD 656 million loan for marine conservation efforts.
- **Nature-based solutions:** A [2023 swap](#) with the US allowed some debts owed by Argentina to be bought back in local currency and reinvested in environmental protection.
- **Energy systems:** For example, in 2021, [Egypt signed a €21 million](#) debt swap with Germany's KfW Development Bank to enhance its renewable and sustainable energy infrastructure

KEY STAKEHOLDERS

A. Bilateral swaps

- Direct arrangements between a debtor country and one or more official creditors that involve the cancellation or restructuring of debt with the agreement that the resulting debt service savings will be directed toward an agreed use to fund climate-related actions or investments.
- DFCs have sometimes been used to achieve additional debt relief alongside a Paris Club agreement when only a portion of the debt service savings are redirected to the climate-related project, or as

additional financing where political or policy circumstances made a swap more easily available than the provision of grant or other concessional financing.

- One example of such exchanges is [AFD's Debt Reduction-Development Contract](#).

B. Tripartite swaps

- Involve the buyback or exchange of debt held by private creditors, often financed by donors through an international non-government organization (NGO).
- NGO provides or facilitates a loan to the debtor country at below-market interest rates, with two key requirements:
 - The debtor country must use the proceeds to repurchase debt held by commercial creditors
 - The debt relief generated must be allocated to finance pre-agreed climate-related projects.

DEBT SUSTAINABILITY

Direct effect:

- Debt-for-climate swaps can ease near-term debt service by canceling part of the debt or extending maturities. This provides fiscal relief, though usually smaller than a full restructuring.

Indirect effect:

- Swaps work best when the main barrier to climate investment is limited fiscal space. Redirecting debt service into climate spending creates budget room without raising new debt, unlike loans or bonds.
- Climate projects financed through swaps can strengthen resilience, reduce future fiscal shocks, and lower sovereign risk. Swaps can improve sovereign credit ratings – thereby reducing the future cost of debt – contingent on the swap successfully reducing the country's liquidity and solvency risks, being perceived positively by financial markets (i.e., not as a distressed exchange meant to avoid default), and demonstrating improved governance. Over time, this can improve a country's credit profile and debt sustainability.

MoFs should evaluate swaps through the [IMF/World Bank Debt Sustainability Framework](#). In situations of outright debt distress, swaps are less effective because they divert savings from immediate relief to climate projects.

INTERNAL CAPACITY REQUIREMENTS

A. Minimum requirements

The MoF and local financial institutions need basic analytical capacity to:

- Track debt portfolios across bilateral and commercial creditors, including maturity, currency, and interest terms.
- Assess fiscal impacts of potential swaps, including near-term cash flow relief vs. long-term obligations.

- Disclose commitments by reporting climate expenditure and monitoring project outcomes (in the absence of an SPV utilized to manage swaps).
- Coordinate stakeholders across line ministries, central banks, and external partners to align fiscal and climate priorities.

At this level, MoFs can engage in simple bilateral swaps with official creditors, typically facilitated by restructuring the debt with a concessional loan. These transactions require contract literacy, familiarity with Paris Club or bilateral negotiations, and the ability to ensure transparent allocation of savings.

B. Requirements for full integration

To structure larger or more complex swaps, particularly with private creditors, MoFs need capacity to:

- Design transactions that combine debt restructuring with climate policy commitments.
- Negotiate across multiple creditor groups with divergent interests (commercial, bilateral, MDBs, NGOs).
- Develop financial structures such as special purpose vehicles, escrow accounts, or trust funds for managing savings.
- Embed climate KPIs and monitoring frameworks to ensure additionality and donor confidence.

This level requires a dedicated team within the MoF or Debt Management Office with skills in financial engineering, legal negotiation, and climate finance integration.

C. Pathways

Ministries and local financial actors can:

- Leverage MDB and IMF programs (e.g., Debt Sustainability Framework, climate-macroeconomic assessments) to align swaps with debt strategies.
- Adopt climate budget tagging and expenditure tracking systems to demonstrate effective use of swap savings.
- Partner with DFIs and NGOs to co-structure special-purpose vehicles or conservation trust funds, gaining technical and operational experience.
- Invest in training for debt management units on negotiation, structuring, and monitoring of climate-linked transactions.
- Pilot small-scale swaps (e.g., bilateral or sectoral) to build institutional learning before scaling to complex, multi-creditor arrangements.

REGULATORY CAPACITY REQUIREMENTS

A. Minimum

MoFs need basic legal authority to:

- Authorize debt restructuring (buybacks, exchanges, or refinancing of sovereign debt).
- Create SPVs or escrow funds to manage swap proceeds.
- Reallocate budgetary savings explicitly to climate or environmental purposes.
- Enable public scrutiny by ensuring transparency provisions for monitoring commitments and project outcomes.

At this level, MoFs can conduct simple bilateral swaps with official creditors, provided domestic laws allow debt operations and transparent allocation of proceeds.

B. Requirements for full integration

MoFs need frameworks to:

- Permit pooled or regional transactions involving multiple creditors or countries.
- Enable outcome-based instruments, such as performance-linked bonds tied to climate KPIs.
- Align with international standards, including International Financial Reporting Standards and sustainable finance reporting norms.
- Recognize new asset classes, such as carbon credits, as eligible for debt service or collateral.

Such reforms allow MoFs to negotiate more flexible terms, attract concessional co-finance, and integrate swaps into broader sovereign financing strategies.

C. Pathways

Ministries can:

- Amend debt management legislation to explicitly authorize climate-linked restructuring.
- Establish legal mandates for climate or biodiversity targets to strengthen credibility.
- Adopt sustainable finance taxonomies to align with investor expectations.
- Standardize Key Performance Indicators frameworks for climate outcomes, reducing monitoring costs and improving accountability.
- Leverage MDB/DFI advisory to review legal frameworks and ensure compliance with international norms.

FINANCIAL MARKET READINESS

A. Shallow financial markets

- **Characteristics:** Limited or no secondary market activity; most debt held by official creditors.
- **Constraints:** Few instruments to restructure; limited investor appetite; high transaction costs.
- **Applicable solutions:** Focus on bilateral swaps with official creditors, supported by grant-based technical assistance.
- **Readiness pathways:** Strengthen sovereign debt transparency; participate in IMF/World Bank Debt Sustainability Framework to create a credible basis for swaps.

B. Emerging financial markets

- **Characteristics:** Some activity in sovereign bond markets; debt held by mix of bilateral and commercial creditors.
- **Constraints:** Complex creditor coordination; legal hurdles in restructuring commercial bonds.
- **Applicable solutions:** Tri-partite swaps using NGOs/DFIs as intermediaries; donor guarantees and political-risk insurance to make deals bankable.
- **Readiness pathways:** Build creditor engagement platforms; hire advisory firms to manage negotiations and structure SPVs; develop domestic legislation for debt buybacks.

C. Mature financial markets

- **Characteristics:** Active sovereign issuers with established capital markets and diversified creditor base.
- **Constraints:** Creditors may prefer conventional liability management (buybacks, exchanges) over concessional swaps.
- **Applicable solutions:** Structure large-scale swaps linked to sustainability bonds; combine donor guarantees with private participation; use NGOs/DFIs as intermediaries if necessary to facilitate structuring.
- **Readiness pathways:** Blend concessional finance with market-based instruments; align swaps with green bond frameworks and climate KPIs to appeal to ESG investors.

PRICING CONSIDERATIONS

A. Drivers of cost

- **Secondary market value of debt:** Swaps are most cost-effective when sovereign bonds trade at a significant discount. The larger the discount, the greater the fiscal space generated.

- **Creditor type:** Bilateral creditors may offer concessional terms if swaps align with policy or climate priorities, while commercial creditors typically require near-market compensation.
- **Transaction costs:** Legal, structuring, and monitoring costs can be substantial, particularly for tripartite deals with private creditors.

B. Role of concessional support

- **Concessional donor support** (grants or highly subsidized loans) can bridge gaps when debt is not trading at a steep discount.
- **Credit enhancements** such as guarantees ([IDB in Ecuador](#).) and political risk insurance (USDFC in [Ecuador](#)) improve bond ratings, reduce risk premiums, and lower borrowing costs
- **Blended finance structures** can combine concessional resources with private capital to make swaps attractive at scale.

AVERAGE TIMEFRAME TO DEPLOY

- **Preparation period:** Debt-for-climate swaps typically require **2-4 years** from initial discussions to execution.
- **Key steps:** Ministries must identify eligible projects, coordinate across multiple domestic stakeholders, and negotiate terms with bilateral or commercial creditors.
- **Transaction complexity:** Timelines are longer for commercial swaps, which involve structuring SPVs, securing guarantees or insurance, and aligning legal frameworks.
- **Examples:** [Belize's Blue Bond](#) conversion took about **two years** (2019–2021). [Ecuador's 2023 Galápagos Marine Bond](#) required extensive negotiations with creditors and development partners.

KEY CHALLENGES TO UPTAKE

- **Limited structuring capacity:** Many MoFs lack the technical expertise to negotiate multi-creditor swaps or design special purpose vehicles and escrow arrangements.
- **Low creditor appetite:** Although commercial creditors may be attracted by the earlier and more certain repayment of swaps, some may prefer conventional restructuring tools, making swaps more difficult to arrange when government debt is not trading at a discount.
- **High transaction costs:** Legal, advisory, and monitoring costs can be substantial, reducing the net fiscal benefit of the transaction.
- **Complex coordination:** Multiple parties (official creditors, commercial lenders, development banks, and civil society organizations) must agree on terms, which slows down negotiations.
- **Additionality concerns:** Donors and creditors require assurance that swaps finance *new* climate investments rather than replacing existing budget commitments.
- **Limited government control:** When proceeds are ring-fenced through external funds or special purpose vehicles, ministries may have little discretion over allocation, weakening political ownership.

HOW TO ADDRESS KEY CHALLENGES

A. For ministries of finance:

- Embed swaps into national debt management strategies to ensure alignment with fiscal priorities.
- Standardize contracts and reporting frameworks to reduce transaction complexity.
- Strengthen laws to authorize debt restructuring and transparent allocation of savings to climate budgets.
- Establish monitoring systems with clear climate performance indicators to prove additionality.

A. For For donors/DFIs:

- Provide guarantees and political risk insurance to improve credit ratings and lower borrowing costs.
- Offer concessional financing or grants to close pricing gaps when debt is not trading at a discount.
- Deliver legal, technical, and structuring support to ministries during negotiations.
- Facilitate regional platforms to pool expertise, share templates, and coordinate creditor engagement.

EXAMPLES OF ENABLING REFORMS AND PILOT INITIATIVES

- [Seychelles \(2015\)](#): Creation of the Seychelles Conservation and Climate Adaptation Trust as a dedicated vehicle to manage proceeds and build monitoring capacity.
- [Belize \(2021\)](#): Political risk insurance from the United States Development Finance Corporation enabled the buyback of USD 553 million in debt at a 45% discount.
- [Ecuador \(2023\)](#): A Combination of an Inter-American Development Bank guarantee and political risk insurance scaled the world's largest swap, showing how blended credit enhancements can attract investors.
- [AFD's Debt Reduction-Development Contracts](#): Example of bilateral swaps linked to agreed use of proceeds for development and climate projects.

RELEVANT LINKS

- [World Bank \(2024\). Debt for Development Swaps](#)
- [CPI \(2021\). Debt for Climate Swaps](#)
- [IMF \(2022\). Debt-for-Climate Swaps: Analysis, Design, and Implementation](#)
- [IMF \(2022\). Debt for Development Swaps: An Approach Framework](#)
- [WEF \(2024\). Climate finance: What are debt-for-nature swaps and how can they help countries?](#)
- [Perspectives Climate Research \(2024\). Debt-for-Climate Swaps: a controversial tool to unlock climate change mitigation and adaptation in countries with high debt burden](#)

KEY TERMS

Debt swap	A general category of transactions where debt is cancelled, exchanged, or refinanced in return for policy commitments or earmarked spending
Debt-for-nature swap	A type of debt swap focused narrowly on biodiversity or conservation outcomes; historically, these were the first swaps used in the 1980s-1990s
Debt-for-climate swap	A broader form of debt swap that links debt relief to investments in climate mitigation or adaptation; debt-for-nature swaps are a subset of these
Fiscal space	Budgetary room created when debt service payments are reduced or restructured, allowing governments to allocate funds to climate investments
Additionality	Ensuring that climate investments funded by swaps are new and incremental, not simply replacing existing budgeted expenditures
Special Purpose Vehicle (SPV)	A legally separate entity created to manage swap proceeds or issue new instruments, providing transparency and ring-fencing funds for climate use
Escrow fund	A dedicated account where debt service savings are deposited and from which climate-related expenditures are made, ensuring oversight and accountability
Climate performance indicators (KPIs)	Measurable targets such as hectares of forest conserved or marine areas protected, used to demonstrate that swaps achieve real climate outcomes
Credit enhancement	Financial tools such as guarantees or political risk insurance provided by development banks or donors to lower borrowing costs and make swaps viable
Blended finance	The strategic use of concessional donor resources together with private capital to improve the scale and affordability of swaps
Paris Club	An informal group of official bilateral creditors that negotiates debt restructurings; bilateral swaps may be used alongside Paris Club agreements
Transaction costs	Legal, advisory, and monitoring expenses associated with designing and implementing swaps, often significant in complex multi-creditor deals
Debt transparency	Clear and public disclosure of debt terms and climate commitments, a precondition for swaps to gain credibility with creditors and donors
Pooled or regional platform	A facility that brings together multiple countries or creditors to standardize contracts, reduce negotiation costs, and expand access to swaps