



**Everything,
everywhere,
all at once**

**How can private finance be
unlocked for nature and climate
in the international financial
architecture?**



The University of Cambridge Institute for Sustainability Leadership

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Rewiring the Economy

Rewiring the Economy is our ten-year plan to lay the foundations for a sustainable economy. The plan is built on ten interdependent tasks, delivered by business, government, and finance leaders co-operatively over the next decade to create an economy that encourages sustainable business practices and delivers positive outcomes for people and societies.

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Executive summary

In preparation for COP28, there is an urgent need to restructure the international financing architecture to address the escalating demand for climate action.

Climate finance needs are substantial: it is estimated that US\$ 3 to 6 trillion annually will be needed until 2050 to meet the Paris Agreement targets (International Monetary Fund [IMF] 2022). Despite progress towards achieving the US\$ 100 billion financing goal, financing commitments fall short of the substantial funding required. The Bridgetown Initiative indicates an additional US\$ 1 trillion is needed for climate and development resilience (United Nations Framework Convention on Climate Change [UNFCCC] 2023).

As multilateral development banks (MDBs) and bilateral donors strive to meet climate finance goals, engaging the private sector becomes not only beneficial but essential. The Organisation for Economic Cooperation and Development (OECD 2023) reports that MDBs mobilised private finance of US\$ 33.8 billion per year between 2018 and 2020. The International Energy Agency (2023) estimates that US\$ 2 trillion annually by 2030 is needed to achieve global climate goals, with 80 per cent coming from the private sector (IMF 2023).

Research by the World Economic Forum and Price Waterhouse Cooper (PwC) (2022) underscores that US\$ 1.9 trillion is at risk due to biodiversity loss. Addressing this is paramount, yet the current funding levels of US\$ 722 to 967 billion annually only cover 16–19 per cent of the overall amount needed to halt biodiversity loss (Deutz et al. 2020). The disparity between climate and nature financing is evident. While climate finance sees an annual investment of approximately US\$ 579 billion, nature financing, specifically nature-based solutions (NbS), lags behind at around US\$ 133 billion (United Nations Environment Programme [UNEP] 2022). A 2019 report by the Climate Policy Initiative highlighted this gap, revealing that while 56 per cent of the annual climate finance came from the private sector, private investments constituted just 14 per cent of NbS finance (UNEP 2021).

Scaling up private finance for climate and nature requires understanding global and country-level supply and demand factors. Globally, financial regulations, market infrastructure, and official support shape cross-border finance flows, impacting capital availability and costs. On the demand side, in-country conditions, including sector dynamics and project development capacity, dictate investment attractiveness. This journey involves upstream (regulatory quality), midstream (project viability) and downstream (fund transfer) phases. Country-specific platforms endorsed by international entities and governments synchronise these factors, enabling efficient private-finance mobilisation tailored to regional needs. This approach underlines the interplay of regulation, public support and risk perception in fostering an environment for financial scaling (Houérou and Lankes 2023).

Immediate COP28 asks

As discussions at COP28 call for enhanced collaboration, financial reform and actionable climate commitments, the focus needs to be broadened to develop an enabling environment for scaling up private finance for both climate and nature financing at the global and country levels. The policy brief offers a clear framework for pinpointing challenges and proposing recommendations to scale up private finance. Additionally, it outlines key asks for COP28 (refer to Table 1), which presents urgent, short-term recommendations for implementation by stakeholders in the international financial architecture.

Table 1: Immediate COP28 asks

1 Support the Bridgetown Initiative	<p>Desired action</p> <ul style="list-style-type: none"> • Leveraging the International Development Association (IDA) for concessional finance targeting US\$ 279 billion • Establishing a US\$ 500 billion Global Climate Mitigation Trust • Introducing innovative financial and insurance instruments for climate change 	<p>Potential impact</p> <ul style="list-style-type: none"> • Could unlock significant funding for climate mitigation and adaptation, modernise MDB allocation, introduce innovative financial tools and enhance resilience in small island development states (SIDS) propelling global climate action
2 Support diverse financing models	<p>Desired action</p> <ul style="list-style-type: none"> • Promotion of originate-and-share or originate-and-transfer models • Introduction of hybrid capital instruments for MDBs, leveraging models such as the IFFEd's donor portfolio guarantee fund 	<p>Potential impact</p> <ul style="list-style-type: none"> • Promoting advanced financial mechanisms can diversify risks, making climate investments more bankable and attractive, potentially accelerating the pace of climate finance and enhancing its effectiveness in fostering sustainable development
3 Strengthen risk management & guarantees	<p>Desired action</p> <ul style="list-style-type: none"> • Adoption of flexible instruments tailored to contemporary crises • Increased use of MDB and donor guarantees to mitigate risks in emerging markets and developing economies (EMDEs) 	<p>Potential impact</p> <ul style="list-style-type: none"> • Encouraging MDBs to adopt flexible risk management instruments can mitigate investment risks in EMDEs, broadening the investor base and potentially mobilising more private capital for climate and nature projects
4 Enhance data transparency	<p>Desired action</p> <ul style="list-style-type: none"> • Comprehensive data accessibility from platforms such as the GEMs Risk Database • Launch of GEMs 2.0 as a standalone entity by 2024 • Enhanced dialogue between MDBs, CRAs and shareholders on continued transparency in the exchange of information and rating methodologies 	<p>Potential impact</p> <ul style="list-style-type: none"> • Improved data transparency can foster informed risk-sharing and build investor confidence, crucial for attracting more private-sector engagement and facilitating better decision-making in climate finance
5 Incentivise and align criteria with private sector	<p>Desired action</p> <ul style="list-style-type: none"> • Defining clear risk/return criteria in climate and nature financing • Incentivising private financial firms to provide currency-hedging solutions for climate and nature projects 	<p>Potential impact</p> <ul style="list-style-type: none"> • Aligning incentives and risk/return criteria with commercial investor mandates can make investment models more resilient and appealing, potentially leading to an increased flow of private capital into climate and nature projects
6 Promote collaborative platforms	<p>Desired action</p> <ul style="list-style-type: none"> • Establishment of collaborative platforms pooling resources and expertise from public development banks, MDBs, governments and private entities 	<p>Potential impact</p> <ul style="list-style-type: none"> • Establishing collaborative platforms can foster a holistic approach to sustainable investments, scaling efforts, improving access to finance, enhancing affordability, and potentially leading to more integrated and effective global climate action

1 Introduction

A. Need to realign the international financial architecture

In advance of COP28, there is an urgent need to reform the international financing architecture¹ to meet financing demands for climate mitigation and adaptation goals. In particular, a better understanding is required of the role of private finance in partnership with multilateral development banks (MDBs) and other international financing firms in driving financial resources towards building net-zero and nature-positive economies across the world.

Climate finance needs remain vast: it is estimated that between US\$ 3 and US\$ 6 trillion per year will be needed until 2050 to achieve the objectives set by the Paris Agreement (International Monetary Fund [IMF] 2022). While private-sector investments in climate finance have increased in recent years, the existing multilateral financial architecture has struggled to deliver financing at the necessary scale and speed. Furthermore, ensuring an equitable flow to emerging markets and developing economies (EMDEs) and discontinuing flows to high-emitting, low-resilience activities remain critical issues.

Key constraints hindering the mobilisation of private capital for climate- and nature-positive investments include supply and demand factors, macro-financial and microeconomic impediments and hard to develop (perceived or actual) risk–return profiles, and crowding out of private finance by MDBs due to their (current) risk appetite. High upfront costs and (perceived or actual) risks, as well as low liquidity associated with mitigation and adaptation projects in emerging markets and developing economies (EMDEs), have also deterred private-sector involvement. For instance, the United Nations Development Programme (UNDP) (2023) notes that African countries could save up to US\$ 74.5 billion if credit ratings were based on less subjective assessments. Non-objective credit ratings reduce the amount of investment that countries receive as they are perceived to be riskier than they really are.



It is estimated that between

US\$ 3 and US\$ 6 trillion per year

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MDBs already play a critical role in climate finance, providing US\$ 51 billion of climate finance to EMDEs in 2021, supporting both mitigation (65 per cent) and adaptation (35 per cent) projects (Inter-American Development Bank [IADB] 2022). However, these efforts have not been enough to meet the climate financing requirements to limit global warming to well below 2°C and pursue the 1.5°C target.

¹ The international financial architecture refers to the governance arrangements that safeguard the stability and function of the global monetary and financial systems. It includes the governance of public international financial institutions, financial standard-setters that establish norms for the governance of private finance, monetary arrangements, such as regional financial arrangements and the network of bilateral swap lines, Informal country groupings that act as norm-setters (eg, G20), formal but non-universal norm-setting bodies (eg, OECD), creditor groups that address sovereign debt issues and the United Nations (UN) as a norm-setter and implementer (UN, 2023).

Over the past two decades, the global aid and development finance structure has seen remarkable changes. Initiatives such as the G7 Carbis Bay commitments to double bilateral official development assistance (ODA) for climate action to US\$ 60 billion by 2025 (United Nations Framework Convention on Climate Change [UNFCCC] 2023) and the scaling up of MDB financing to exceed their 2025 climate finance goals represent significant strides.

At the 15th Conference of Parties (COP15) of the UNFCCC in Copenhagen in 2009, developed countries committed to a collective goal of mobilising US\$ 100 billion per year by 2020 for climate action in developing countries in the context of meaningful mitigation actions and transparency on implementation. The Organisation for Economic Cooperation and Development (OECD) (2021) noted that this annual target would be achieved by 2023. In 2020, US\$ 83.3 billion was mobilised, of which US\$ 13.1 billion was raised as private finance. Progress has also been achieved under the Resilience and Sustainability Trust (RST) and Poverty Reduction and Growth Trust (PRGT) with pledges for the RST amounting to about US\$ 45.5 billion and for the PRGT to about US\$ 24.2 billion in loan resources and nearly US\$ 1.9 billion in subsidy resources, respectively, through the voluntary channelling of special drawing rights (SDRs) or equivalent contributions (G20 2023).

These sums still fall short of the substantial funding required to address these global challenges effectively. For instance, the Bridgetown Initiative quantifies financing needs for climate and development resilience at an additional US\$ 1 trillion over the current US\$ 100 billion commitment (UNFCCC 2023). Raising this sum will require coordinated action amongst MDBs and development finance institutions (DFIs), governments and private financial firms.

B. Importance of private financial actors in supporting climate mitigation and adaptation goals

As MDBs and bilateral donors strive to meet and exceed climate finance goals for mitigation and adaptation, engaging the private sector in these efforts is not just a beneficial strategy but a necessary one. Although not explicitly focused on in this paper, loss and damage remain a critical third pillar of climate financing that requires immediate attention. As the topic is so critical to the progress of climate negotiations, it is the focus of a separate CISL publication.

The reform of MDBs' capital adequacy framework, which includes redefining the approach to risk appetite, uplifting from callable capital and strengthening lending headroom, opens new avenues for private-sector involvement. MDBs could be lending US\$ 75 billion more per year with their existing capital and credit rating if they apply the recent recommendations of the G20's Independent Review of MDB Capital Adequacy Frameworks (Persaud and Humphrey 2023). Recently, the Asian Development Bank (ADB) approved capital management reforms that unlock US\$ 100 billion in new funding capacity over the next decade through an update of its capital adequacy framework (CAF). This will expand the bank's annual new commitments capacity to more than US\$ 36 billion – an increase of approximately US\$ 10 billion or about 40 per cent (ADB 2023).

By re-evaluating the accounting for callable capital, implementing preferred creditor treatment and eradicating statutory lending limits whilst safeguarding its credit ratings, each MDB can further elevate its leverage (G20 2023). The mobilisation of hybrid capital, through the recycling of special drawing rights (SDRs) and risk transfers to both private and public entities, emerges as a viable strategy to liberate capital, thus significantly bolstering their financial capacity.

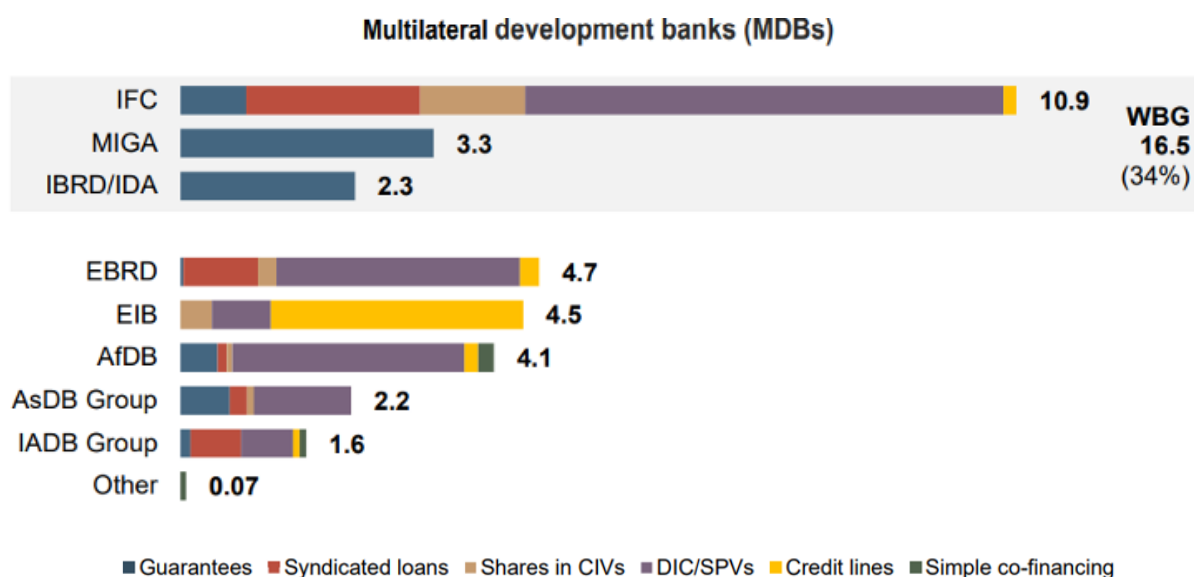
A surge in MDBs' equity is perceived as an unparalleled value proposition for shareholders. Once the recommended leverage and private capital mobilisation strategies are fully actualised, each dollar of fresh equity could feasibly catalyse a minimum of US\$ 15 in supplementary external financing geared towards sustainable investments, split as US\$ 7 in direct MDB lending and US\$ 8 in both direct and indirect external private capital mobilisation (G20 2023). This figure is projected to soar when supplementary investments from national development financial institutions are factored in.

In respect to operating models, a systematic collaboration with the private sector across sovereign and non-sovereign ventures is advocated. This collaboration entails co-generating investment opportunities and setting forth private capital mobilisation targets of at least 1.2:1 for the entire MDB system. Individual institutional contexts may witness variations in these targets, with some positioned above or below the stipulated level in order to adjust to the unique financial landscapes they navigate.

Initiatives such as scaling portfolio risk transfers to the private sector of MDB non-sovereign loans and transforming the GEMS Risk Database Consortium into a standalone entity for private investors demonstrate the potential for private capital to contribute significantly to these goals.

The private sector’s ability to provide substantial funding is evident from the trend of financial flows to developing countries, which have seen a steady increase primarily driven by private-sector finance. Private finance has been growing at a rate of 10 per cent per year, whereas public finance has grown by only 2 per cent (World Bank 2022). Moreover, the high leverage ratios achieved by MDBs due to their specific capitalisation structure further underscore the potential for private finance to fill funding gaps. According to the Organisation for Economic Co-operation and Development (OECD 2023), MDBs mobilised private finance of an average US\$ 33.8 billion per year between 2018 and 2020 (Figure 1).

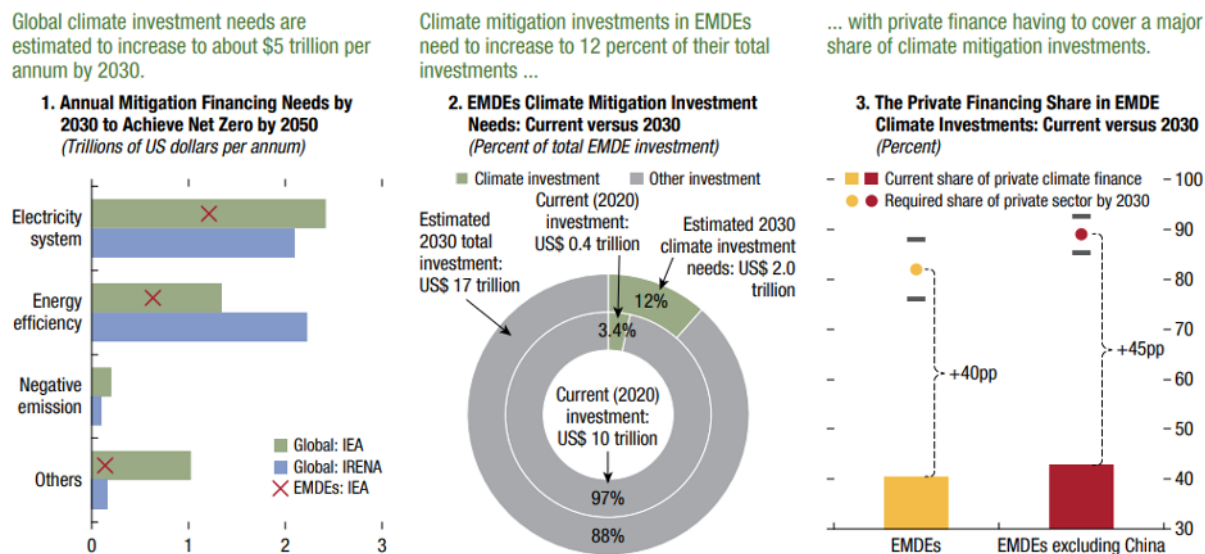
Figure 1: MDBs’ mobilisation of private finance between 2018 and 2020 (US\$ billion)²



The International Energy Authority (2023) estimates that US\$ 2 trillion annually by 2030 is needed to reach the global climate goals, representing a fivefold increase from the current US\$ 400 billion of climate investments planned over the next seven years. The private sector will need to supply about 80 per cent of the required investment, and this share rises to 90 per cent when China is excluded (IMF 2023).

2 CIV: Collective investment vehicle, DIC/SPVs: Direct investment in companies/Special purpose vehicles.

Figure 2. Estimate climate investment needs and the key role of private finance (IMF 2023)



The cost of capital presents a fundamental barrier, with developing countries borrowing at higher rates than countries with international reserve currencies. For instance, the average interest cost for a similar solar farm is 10.6 per cent per annum in leading emerging countries (Brazil, India, Indonesia, Mexico and South Africa) compared to only 4 per cent in the European Union (EU) region (Persaud 2023). This disparity hampers the feasibility of private investments in these regions. It affects the commercial viability of mitigation projects in the developing world and discourages private-sector involvement.

Commercial and investment banks, as well as large institutional investors such as pension funds and insurance companies, are key players in allocating capital through capital markets to climate projects. However, challenges such as low liquidity and small scale often hinder private investments in climate-resilient infrastructure.

A multitude of financial instruments is required to attract private-sector capital to climate mitigation and adaptation investments. Blended finance structures, as demonstrated by initiatives such as the Climate Resilience and Adaptation Finance and Technology-transfer Facility (CRAFT) project, have shown how private equity investment funds with structured capital can effectively deploy climate resilience services and technologies in developed and developing countries (Climate Finance Lab 2017).

MDBs can play a significant role in mobilising private climate finance. For instance, the Climate Investment Funds (CIF), a multi-donor trust fund, has already channelled over US\$ 60 billion from global partners to co-finance green projects (IMF 2022). Moreover, the Green Climate Fund (GCF), established under the UNFCCC framework, has become a US\$ 12.8 billion fund, with US\$ 48.3 billion total of approved projects (GCF 2023). The GCF offers financial products such as concessional loans, lines of credit, equity investments, guarantees and first-loss protection to catalyse private-sector investment in climate projects.

Managing the risks associated with climate finance is crucial for the success of private-sector investments. Macro-financial risks, such as tighter monetary and financial conditions and higher inflation and interest rates, can impact the global financial system and developing countries. For example, capital flows associated with de-risking infrastructure assets could create balance of payments vulnerabilities by increasing current account deficits. Micro-financial risks include investing in high-return projects in EMDEs and low-income countries (LICs). Public-private risk-sharing mechanisms can help reduce risks and increase private-sector confidence.

Public–private partnerships are essential in leveraging public financial resources to attract private-sector investments. The CIF and GCF are prime examples of such partnerships, providing platforms for pooling and leveraging financial resources from partners to de-risk investments and attract private capital.

C. Expanding the scope of financing to achieve nature-positive outcomes

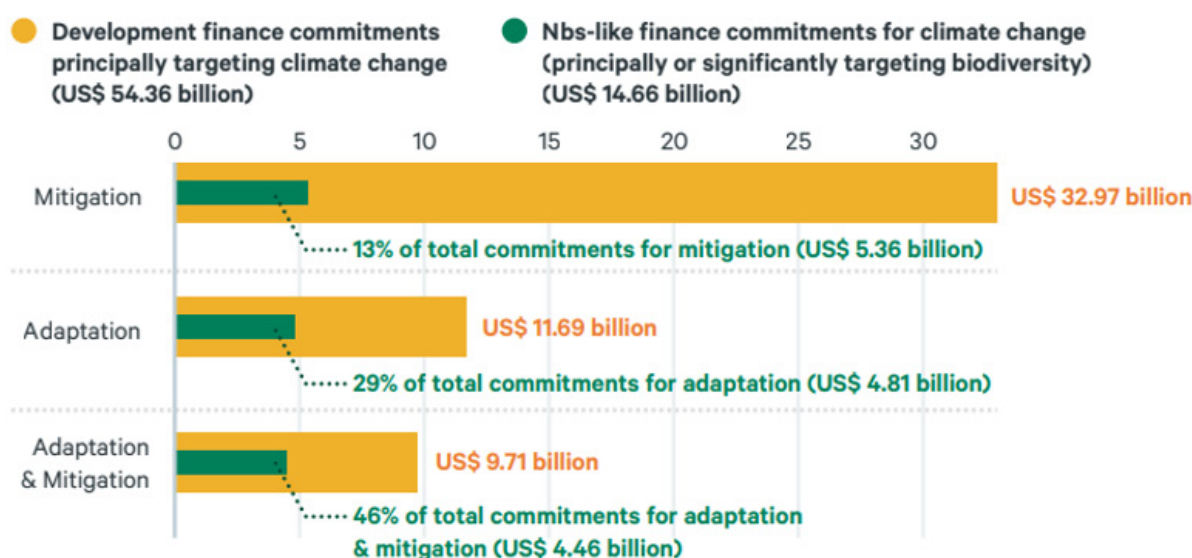
Research by the World Economic Forum and Price Waterhouse Cooper (PwC) (2022) underscores that US\$ 1.9 trillion is at risk due to biodiversity loss. Addressing this shortfall in funding is paramount, yet current funding levels amount to US\$ 722 to 967 billion annually and thus only cover 16–19 per cent of the overall need to halt biodiversity loss (Deutz et al. 2020).

Nature financing often presents a cost-effective solution to climate challenges. Investing in nature not only ensures environmental sustainability but also makes financial sense. By directing funds towards nature-based solutions, we can achieve significant climate benefits at a fraction of the cost of other interventions, offering a higher return on investment and ensuring a sustainable and resilient future. These benefits include: climate mitigation (carbon sequestration), climate adaptation (disaster risk reduction), biodiversity enhancement and local economic well-being improvement.

The disparity between climate and nature financing is evident. While climate finance sees an annual investment of approximately US\$ 579 billion, nature financing, specifically NbS, lags behind at around US\$ 133 billion (United Nations Environment Programme [UNEP] 2022). The private sector contributes about US\$ 18 billion focusing on biodiversity offsets, sustainable supply chains and impact investments. Public Overseas Development Assistance adds roughly US\$ 2 billion annually.

A 2019 report by the Climate Policy Initiative highlighted this gap, revealing that while 56 per cent of the annual climate finance came from the private sector, private investments constituted just 14 per cent of NbS finance (UNEP 2021). Over the past five years, an estimated total of US\$ 14.66 billion has been committed to NbS activities to combat climate change in developing nations, averaging US\$ 2.93 billion annually (Stockholm Environment Institute [SEI] 2022).

Figure 3: Total climate finance commitments and total NbS-like finance commitments, 2016–2020 (SEI 2022)



MDBs, with their global influence and financial clout, are uniquely positioned to lead the charge in nature financing. They can collaborate with ministries of finance and financial regulators to integrate climate and nature considerations into economic policies. By promoting green and sustainability bonds (e.g., sovereign sustainability-linked bonds), MDBs can align funding with NbS. At COP26, 10 MDBs committed to mainstreaming nature into their policies.

According to various data dated 2015–2017, the private sector’s biodiversity expenditure is estimated at US\$ 6.6–13.6 billion annually (OECD 2020). There is a need to leverage international public finance to mobilise private resources for an ambitious Global Biodiversity Framework (GBF), encouraging investments in biodiversity through blended financing mechanisms. Investments have already been made by the LEAF coalition (~US\$ 1.5 billion), the Global Fund for Coral Reefs (~US\$ 2–3 billion), Legacy Landscapes Fund (~US\$ 1 billion) and the Great Green Wall Accelerator (~US\$ 19 billion).

The Finance Sector Deforestation Action (FSDA) initiative, launched at COP26, exemplifies the efforts of financial institutions to eliminate deforestation risks from their investment and lending portfolios. It brings together 37 financial institutions with over US\$ 8.5 trillion in assets under management working towards deforestation-free investments and lending by 2025. Several more firms joined in November 2022. In 2022, a total of US\$ 6.1 trillion was directed towards the 350 companies most at risk of driving tropical deforestation.



To meet global climate and land degradation targets, it is imperative to bridge the US\$ 4.1 trillion financing gap for nature by 2050

To meet global climate and land degradation targets, it is imperative to bridge the US\$ 4.1 trillion financing gap for nature by 2050 (UNEP 2022). NbS could provide 30 per cent of the required climate solutions by 2030 and have the potential to uplift many from poverty, generate jobs and boost the global economy (International Union for Conservation of Nature [IUCN] 2022).

Expanding the scope of climate financing to intentionally co-design instruments to achieve nature-positive outcomes is not only an investment worth making for the future of our planet but also offers significant economic and social co-benefits. By mobilising public- and private-sector resources and deploying innovative financial instruments, we can bridge the financing gap for nature and create a sustainable and resilient future for all. MDBs, along with other international financial institutions, have a pivotal role to play in leading this transformative effort.



2 Overview of the challenges and potential solutions

The conceptual approach to scaling up private finance for climate and nature is rooted in understanding both supply and demand side factors at both global and country levels (Houérou and Lankes 2023). On the supply side, at the global level, factors such as financial regulations, the adequacy of financial market infrastructure and the extent of official support play pivotal roles in shaping the flow of cross-border finance. Inadequacies in these domains can curtail the availability of capital and increase its cost.

On the demand side, in-country conditions largely influence the attractiveness of investments. These conditions encompass sector-level market dynamics in critical areas such as energy and ICT, the capacity for project development (with a notable emphasis on infrastructure) and the effectiveness of mechanisms that connect investment opportunities to both domestic and foreign financing sources. Within this, the journey from idea to investment is segmented into upstream, midstream and downstream phases (World Bank 2021). The upstream focuses on regulatory quality and broader institutional capacities; the midstream emphasises the preparation and viability of projects; and the downstream deals with the actual channels that facilitate the transfer of funds (London School of Economics [LSE] 2021).

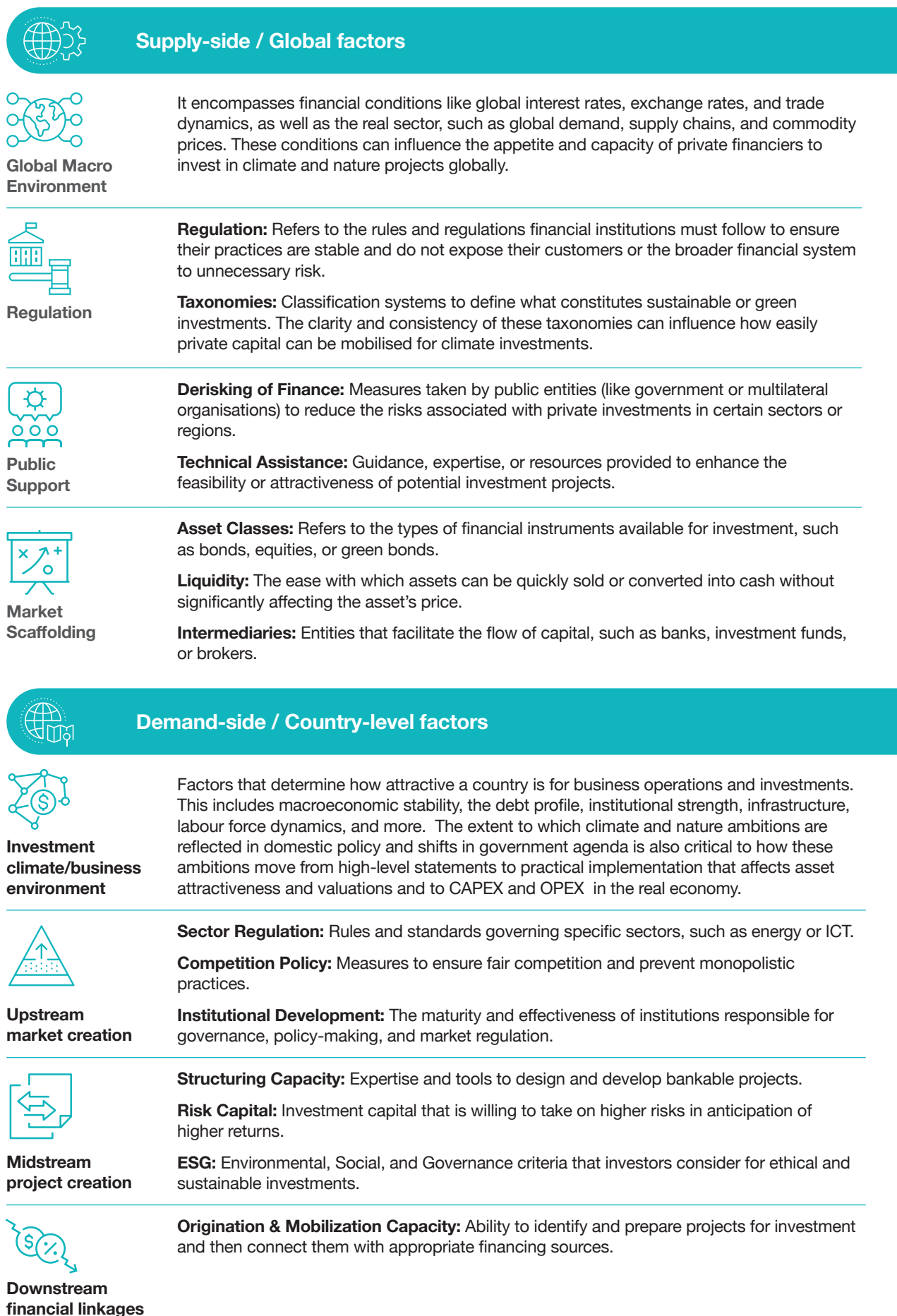
Country- or sector-specific platforms, backed by leading international bodies and governments, play a significant role in harmonising these multifaceted factors to ensure a coordinated and efficient mobilisation of private finance tailored to the unique needs and constraints of different regions and sectors (T20 Brief 2023).



The journey from idea to investment is segmented into upstream, midstream and downstream phases

The conceptual approach adapted from the works of Houérou and Lankes (2023) is presented in Figure 4. Based on the Houérou and Lankes (2023) classification, we have provided definitions for categories, combined certain categories and expanded others. For example, we combined the regulation and public support categories recognising the intertwined nature of the recommendations in them. We also expanded the downstream financial linkages at the country level to include the risk perception aspect. These factors were then used to arrange the challenges and recommendations listed in the brief to showcase both the supply and demand sides of scaling up private finance for climate and nature financing.

Figure 4. Conceptual approach to scaling up private finance for climate and nature financing



3 Challenges for scaling up international private finance for climate and nature

Attracting and amplifying private-sector investment in climate and nature finance present a multifaceted conundrum that is deeply rooted in both global and national dynamics. The landscape is further complicated by supply–demand imbalances, macro-financial hurdles, microeconomic barriers and data-related challenges that exist at both the origin and destination of sustainable finance flows, especially to EMDEs. These challenges not only deter investor interest but also elevate capital costs and limit the potential project pipeline. Given the diverse nature of these issues across countries, sectors and investors, a universal solution remains elusive. As we delve deeper into this section, we will unpack these challenges to understand their intricacies at both global and national levels.

Global factors



Global macro-environment

Attracting and scaling up private-sector climate and nature finance presents a multifaceted challenge, entwined with market failures and geopolitical factors. Geopolitics significantly mould the climate finance landscape. Interpretations of climate impacts across different geopolitical realms influence the structuring of financing and motivation or appetite for climate action. This divergence compounds the challenge of attracting private-sector finance.

Furthermore, the uncertainties surrounding the integration of climate ambitions into mainstream policies amplify the complexity. The difficulty lies less in generating future standalone climate policies than in ensuring that climate ambitions are part of all conventional policy frameworks, thereby reshaping the financial landscape.

Additionally, the economic intricacies of emerging climate-friendly technologies and the broader economic repercussions of climate impacts cloud the financing panorama. The prevailing high-interest-rate environment further complicates diverting investments towards projects in EMDE as financing costs soar, rendering these investments less attractive than those in developed markets.

In terms of broader macro-financial risks, debt sustainability is a paramount issue due to its direct impact on fiscal health, yet other significant risks, such as market, liquidity risks and the intricacies of balance of payments, alongside potential social disruptions are notable concerns. The dynamics of these risks may vary across economies, necessitating a nuanced understanding to provide a clearer risk landscape picture.

The emergence of new asset classes related to climate financing introduces another layer of complexity to the macro-financial risk matrix. These novel asset classes, crucial for channelling funds towards climate mitigation and adaptation projects, could exhibit volatility due to their nascent nature and the evolving regulatory framework. Valuation and risk assessment models for these emerging asset classes are still under development, potentially contributing to the perceived or actual volatility.

For EMDEs, these challenges are magnified. Existing debt vulnerabilities are significant, and any additional borrowing, especially when funnelled into highly risky equity-like structures, could exacerbate these vulnerabilities. For instance, the average interest cost on external borrowing for developing countries is three times higher than that of developed countries. Least developed countries (LDCs) dedicate an average of 14 per cent of their domestic revenue to interest payments,

contrasting sharply with the mere 3.5 per cent allocated by developed countries despite their much larger debt stocks (United Nations Department of Economic and Social Affairs [UN DESA] 2022). This situation highlights the financial strain on EMDEs, underscoring the need for meticulous financial strategies to navigate the complex macro-financial risk landscape.



Regulation and public support

Engaging in nature-climate financing necessitates navigating complex regulatory and legal frameworks. Mechanisms such as SDRs, rechannelling and green bonds, among others, demand clear guidelines and supportive policies from governments and international institutions. A substantial barrier is the absence of an established taxonomy for sustainable finance. This barrier is further exacerbated by a lack of trust in government policies, especially when existing incentives are often tied to high-emitting, low-resilience activities and infrastructure that run counter to promoting sustainability.

Furthermore, massive fragmentation and inconsistency within the existing taxonomic frameworks impede the growth of sustainable investments. The situation is worsened by limited data availability, which is crucial for the usability of taxonomies. It is imperative that taxonomies are designed to seamlessly integrate pathways to environmental objectives and a comprehensive systems approach is adopted when specifying eligible economic activities.

Moreover, there is a notable policy deficit in the nationally determined contributions (NDCs) that significantly affects investments and portfolios. The misalignment of most investments/portfolios with NDC goals hampers more robust action towards climate financing. A broader spectrum of activities is happening than most investors are aware of, a situation which underscores the need for better communication and transparency.

The emerging climate insurance industry, though receiving some impetus from philanthropic actions, requires further development to close the prevailing risk gap. Additionally, the absence of industry benchmarks, which could be utilised to motivate the urgency for action at 5-year increments, further stalls the momentum needed for substantial action in nature-climate financing. Addressing these gaps and fostering a more conducive environment for sustainable finance necessitates a multi-faceted approach encompassing policy reforms, enhanced government incentives aligned with sustainability and a unified, comprehensive taxonomy alongside improving data availability and establishing clear industry benchmarks.

Many projects in EMDEs do not move forward because either the risk – real or perceived – is too high or the return is too low. This situation has led to the development of de-risking approaches that include the use of guarantees and blended finance. In addition to reassuring private investors through solid macroeconomic management, blending and guarantees offer a complementary approach by helping match risk and return profiles to investor requirements. The complexity of blended finance, which combines concessional funding with private investment, holds potential. However, implementing blended finance approaches poses challenges. One significant challenge is its scale limitation; with most blended finance initiatives operating on a project-by-project basis, the breadth and impact of such efforts remain constrained. Furthermore, the frequent reliance on single donor governments for funding limits the size and scope of potential deals. In the 2022 State of Blended Finance report, Convergence (2023) found an overall downward trend in blended climate aggregate financing from 2016–2018 to 2019–2020, from US\$ 36.5 billion to US\$ 14 billion, respectively. Between these periods, the average size of climate-focused blended finance deals also decreased.

In designing effective blended finance strategies, there is a crucial need to take into account context-specific drivers, including additionality, concessionality, mobilisation and commercial sustainability. Yet, even with such designs, the persisting high risk remains a pervasive issue. Despite the intent of blended finance to use public funds to lower risks for private investors, the perceived risks in developing countries continue to deter private investment.



Market scaffolding

The expansive scope of global fixed income and Asset-Backed Security (ABS) markets, coupled with a broad spectrum of investor types and risk profiles, presents certain complexities. These complexities are accentuated by varying investment time horizons and the diverse climate strategies prevalent across the asset management sector.

A crucial aspect to consider is the absence of market signals for investments in nature, which contrasts starkly with the clearer market indicators available for climate and carbon investments. There is a notable opportunity to extrapolate concepts from established carbon markets to cultivate and develop nascent natural capital markets. This initiative could provide clearer investment pathways for nature-related finance, paralleling the more established frameworks within climate finance.

Institutional investors, acting as intermediaries that facilitate capital flow, are often caught in a predicament. With their attention limited to only about 12 to 15 investment-grade EMDEs boasting sizeable and liquid bond markets, a large portion of EMDEs is left bereft of the much-needed private-sector climate funding. This limitation not only hinders the creation of diversified bond portfolios but also amplifies the lack of investable projects. A consequence is that development institutions, especially those channelling subsidised public resources into private-sector projects, grapple with absorption capacity issues and face development finance saturation. This situation is particularly noticeable in LICs and smaller states, including small island developing states (SIDS).

The integration and active participation of insurance market participants, including re-insurance players, is imperative in fostering a more resilient financial landscape, especially concerning climate and nature risks. They play a critical role in providing credit insurance, credit enhancement and credit guarantees, which are essential for elevating the investability of debt packages from low-rated countries, thereby attracting more private-sector players. However, a significant concern is the willingness of the private-sector insurance market to assume this role, especially considering the traditional framework of short-term contracts, typically encapsulating a one-year risk rollover.

The short-term nature of insurance contracts presents a notable challenge when it is necessary to navigate the complexities of climate and nature risks, which often have long-term implications. Transitioning towards multi-year insurance solutions could provide a more robust mechanism to mitigate these risks. It is crucial to explore avenues to better signal to the insurance markets the importance and benefits of extending their scope to multi-year solutions in addressing climate and nature risks. This transition would not only align the insurance sector more closely with the long-term nature of climate and environmental risks but also contribute to a broader systemic response in mitigating these challenges and promoting sustainable finance.

Another key constraint is the current inability to effectively price carbon. While proper pricing systems for carbon emissions can help reflect the societal impact of these emissions in private investment choices, implementing such pricing systems is often more complex in EMDEs. Many EMDEs opt not to introduce carbon prices, instead adhering to carbon subsidies, primarily due to socioeconomic factors. A notable concern is that a large portion of the population in these regions already struggles to afford fuel; introducing carbon pricing could exacerbate this burden and trigger social tension.

The absence of effective carbon pricing makes investments in low-carbon technologies less attractive than those in high-carbon technologies. Low-carbon investments often necessitate higher initial capital and take longer to yield returns, rendering them more susceptible to uncertainties. These uncertainties, further amplified by the lack of clear policy and technology pathways regarding the transition to low-carbon solutions, can significantly deter private-sector investments. This scenario underscores the nuanced challenges faced by EMDEs in transitioning towards a low-carbon economy while catering to the immediate economic and social needs of their populations.

Global financial institutions predominantly dictate the capital supply to EMDEs through their capital allocation decisions. Alarming, allocations to EMDEs often fall short of their actual contributions to the global GDP or their evident growth potential. It is apparent that many global institutions prefer ‘top-down’ allocation models, grounded in historical data, and some sidestep EMDE investments altogether. This hesitance stems from several apprehensions, such as the perceived misalignment between the risk–return profiles of EMDE investments and the risk tolerance of institutional investors.

Country-level factors



Investment climate/business environment

A major constraint to attracting private investment is the lack of an investment-grade sovereign credit rating for many EMDEs, exacerbated by the short-termism of credit-rating methodologies. Only about 60 per cent of emerging markets and a mere 8 per cent of developing economies have an investment-grade rating. The sovereign rating also serves as a benchmark for the credit rating of private entities (the ‘rating ceiling’). The distinction between instruments rated ‘investment grade’ and those rated ‘below investment grade’ is of the utmost significance in international capital markets and effectively determines the potential investor base. Furthermore, potential bias is shown by CRAs in their ratings, especially from a developing and emerging economies perspective (United Nations Department of Economic and Social Affairs [UN DESA] 2021). This bias can lead to inaccurate ratings, which can impact the cost of borrowing for countries and reduce the potential investor base.

There is limited market pressure on CRAs to change their practices as the three largest CRAs (Moody’s, Standard and Poor’s and Fitch) hold over 90 percent of market share. Yet, fast-evolving changes in technology, the growing nature of systemic risks, the impact of the pandemic on access to finance, and the increasingly complex linkages in the financial system have underscored the need to re-evaluate the informational ecosystem supporting sovereign borrowing in EMDEs.



Upstream market creation

Many of the impediments to the functioning of markets are found ‘upstream’ of investment decisions. The International Finance Corporation (IFC)/World Bank Group have made laudable efforts to build upstream advisory capacity, but these efforts should be scaled up massively across the development finance system. Organisational challenges also persist, especially for PDBs, which face hurdles in integrating climate and nature considerations into their investments. Biodiversity is poorly integrated into the strategies of most financial institutions.

In the energy sector, countries struggle to strengthen investment signals through transparent and reliable regulatory frameworks. For instance, in half of the emerging markets surveyed by Bloomberg NEF (2022), standardised PPAs, which would help lower transaction costs for offtake contracts, were absent. Just half of the emerging markets tracked allow power generators to charge cost-reflective energy tariffs, and only 16 per cent allow power generators to supply electricity directly at cost compared with 52 per cent of OECD markets. In sectors with sizable investment potential but unfinished or imperfect markets, obstacles upstream of investment should be identified and systematically tackled as part of public–private strategies. Apart from energy, these areas might include digitalisation, commercial transport or Water and Sanitation Hygiene (WASH) infrastructure, agribusiness supply chains or certain segments of the education and health sectors.



Midstream project creation

In many countries, the lack of ‘bankable projects’ is a key concern. It is a capacity issue deriving from lack of skills or execution capacity. For instance, if a medium-sized bank decided to allocate 1 per cent of its assets to primary market impact investments, this could translate to a substantial amount, say US\$ 5 billion. A chief investment officer (CIO) at this bank, now entrusted with the responsibility of judiciously investing this significant sum, could encounter substantial challenges. Identifying ‘bankable’ projects that resonate with the bank’s impact investment objectives could be a huge task given the existing hurdles. The complexity of this scenario is magnified when envisioned on a broader scale. Should a cohort of banks or, more ambitiously, banks on a global scale commence dedicating 1 per cent of their assets to impact investments, the demand for ‘bankable projects’ would escalate considerably. This scenario amplifies the urgency for a robust, scalable mechanism to enhance the project pipeline to meet this burgeoning demand.

Challenges in matching financiers with projects also persist. Private financiers often struggle to identify projects that align with their objectives. One hurdle is the financial aspect of project preparation, which typically accounts for 5 per cent to 10 per cent of the entire investment cost. Many private financiers also have a minimum ticket size that they are willing to invest, which can be a challenge for smaller projects that require less capital.

A significant oversight exists in the methodologies adopted by several CRAs still factoring in vital ESG components in their evaluations as these methodologies notably fail to take into account the proactive climate policies implemented by middle- and lower-income nations.



Downstream financial linkages

In the context of capital mobilisation, the primary challenge lies in achieving scale by transitioning from tailored and ad hoc finance to portfolio- and market-based solutions. The emphasis should be on tapping into institutional investors, both international and domestic, as they represent a vast reservoir of untapped funds for projects in EMDEs. However, to harness these funds effectively, there might be a need to alter the mandates governing institutional investors, which do not currently favour such allocations. This shift could be driven by regulatory changes, demand from the actual asset owners, or a nudge towards managing systemic risk by investing in EMDE mitigation, adaptation and nature positivity. The bottleneck is not the availability of funds but the mechanism to connect these funds to viable investments.

A significant impediment to capital mobilisation in EMDEs is the perception of risk. Many projects in these regions stall because the perceived risk is deemed too high or the expected return too low. This risk perception is exacerbated by high interest rates, uncertainties surrounding future climate policies and transition plans, the costs of emerging technologies, and the broader economic implications of climate impacts. Investments in EMDEs come with inherent risks that are often absent from or mitigated in more established markets. Another colossal barrier is the lack of mandates from beneficiaries, customers and shareholders to allocate funds to climate finance in EMDEs. These actors often prefer to seek what are perceived to be ‘safer’ returns in developed markets, hoping that public money or other sources will address the climate issues in emerging markets. When similar projects, assets or opportunities in developed countries present a much lower cost of capital, it becomes particularly challenging for an asset manager or bank, acting on behalf of others, to justify these allocations without a direct mandate from the beneficiaries, shareholders or asset owners. An economic rationale exists for de-risking innovative finance, especially when the broader economic benefits, as seen by pioneers in the field, are substantial.

Currency rate fluctuations further complicate the landscape. During some project phases in particular, borrowers view exchange rate risks as a significant concern. This concern is accentuated by the fact that a large chunk of foreign currency debt is either in USD or Euros. Recent research underscores that about 60 per cent of the foreign currency debt assumed by firms is in USD with an additional 23 per cent in Euros (BIS 2022).

The high cost of capital is another formidable challenge. These costs, especially in developing countries, are influenced by a myriad of factors, from prevailing market perceptions and established regulations to foreign exchange fluctuations and overarching policies. It is noteworthy that LDCs often borrow at rates averaging around 14 per cent, a figure considerably higher than countries with international reserve currencies (UN DESA 2022). This situation not only highlights the financial challenges these nations face but also casts a shadow on the commercial viability of mitigation projects within their borders.

The risk perception is further intensified by inadequate data and risk-screening mechanisms. The lack of comprehensive information on nature risks and conservation projects hampers the ability of financial institutions to effectively screen and evaluate investments. Without a consolidated and universally accepted nature information framework, the financial sector finds it challenging to pinpoint investable nature-positive projects, thereby restricting the flow of capital to these initiatives.

To address these challenges, a multi-pronged approach is essential. This involves mobilising additional funds, enhancing the integration of climate and nature considerations, understanding blended finance mechanisms better, and fostering collaboration between public and private financiers. Governments and financial institutions must collaboratively create a supportive nature information framework and set clear international commitments. By addressing these challenges collectively, we can unlock the investments needed to protect nature, mitigate climate change and achieve the SDGs.



4 Recommendations

Advancing nature–climate financing requires a holistic approach that represents the needs not just of finance but of all sectors and civil society – and, ultimately, the global citizens whose money and interests the financial system ought to serve. This new paradigm shift will require both mindset and purpose shifts, harnessing the expertise and innovation embedded within the private sector and utilising it in a new spirit of global coordination and cooperation, acting in the collective interest and the interests of future generations. Coordination and collaboration between the macro and micro levels can improve the trajectory of learning curves and delivery schedules, creating a positive ‘ambition loop’ or even a reinforcing ‘triple helix’ of action (Aviva Investors 2022).

To provide a structured roadmap, the following recommendations are organised based on their relevance to the challenges identified for scaling up private finance at the global and national levels.

Global factors



Global macro-environment

1. Supporting the Bridgetown Initiative

The key demands of the Bridgetown Initiative include expanding MDBs’ lending for climate and SDGs by US\$ 1 trillion, raising the access limits to concessional finance, and assessing funding eligibility in light of a country’s vulnerability and providing low-cost, 50-year loans to help it invest in areas including climate resilience, water security, pandemic preparedness and access to renewable energy.

To support the Bridgetown Initiative, MDBs, private financial firms and governments can:

- increase the leveraging of the World Bank’s International Development Association (IDA), which provides concessional finance, fully fund its emergency support facility to US\$ 6 billion by end 2023, and scale up its funding to US\$ 279 billion;
- create a US\$ 500 billion Global Climate Mitigation Trust through unused SDRs issued by the IMF;
- expand the role and funding base of MDBs so countries can borrow at rates below the market price;
- modernise how MDB support is allocated;
- develop new financial instruments through guarantees and equity funds and develop insurance instruments for climate change effects;
- increase risk appetite in SIDS and developing countries’ financing; and
- work with governments to strengthen supply chains to make them more resilient.

Recommendation

Support the Bridgetown Initiative by leveraging the IDA for concessional finance, targeting US\$ 279 billion in funding, establishing a US\$ 500 billion Global Climate Mitigation Trust, modernising MDB allocation, introducing innovative financial and insurance instruments for climate change, enhancing risk appetite in SIDS and bolstering supply chain resilience.

2. Harnessing the power of SDRs for biodiversity finance

The flexibility and potential of SDRs present a golden opportunity to mobilise private capital for climate-centric initiatives. By fostering collaborations with Eurosystem national central banks (NCBs), SDRs can be channelled towards green bonds, interest rate buy-downs and carbon credits. Moreover, there is a growing chorus advocating for a fresh allocation of SDRs dedicated to biodiversity, reinforcing the integration of biodiversity into the IMF's operational framework.

Recommendation

Advocate for collaborations with Eurosystem NCBs to channel SDRs towards green bonds, interest rate buy-downs and carbon credits and support a dedicated SDR allocation for biodiversity within the IMF's operational framework.

3. Capital augmentation – strengthening the financial backbone of MDBs

Capital is the lifeblood of any financial institution, and MDBs are no exception. There is a need to issue innovative 'hybrid capital' instruments to amplify the available capital, making it attractive for both shareholders and large-scale institutional investors.

Initiatives such as the donor portfolio guarantee fund, modelled on the International Financing Facility for Education (IFFEd), and partnerships with insurance giants such as the Multilateral Investment Guarantee Agency (MIGA) can diversify risks and expand the lending horizon. MDBs could boost annual lending by another US\$ 25 billion if shareholders extended guarantees to de-risk a portfolio of climate-related MDB loans (Persuad and Humphrey 2023). Regular capital adequacy benchmarking across MDBs and recognising the intrinsic value of callable capital can further solidify the financial foundation of MDBs.

Recommendation

Issue hybrid capital instruments for MDBs, leveraging models such as the IFFEd's donor portfolio guarantee fund and partnerships with entities such as MIGA, while routinely benchmarking capital adequacy to enhance financial stability and expand lending capabilities.



Regulation and public support

1. Aligning with global agreements

MDBs, beyond their financial roles, stand as global leaders with the onus of setting and achieving ambitious targets. As stewards of global finance, they can advocate for and subscribe to principles that align with paramount global agreements, such as the Paris Agreement and the GBF. In their capacity, MDBs can champion innovative financial instruments such as DNS swaps. Such instruments have the transformative potential to redirect governmental funding towards crucial areas such as nature conservation. By doing so, they not only support global environmental goals but also provide tangible financial solutions to governments.

MDBs can take a proactive role in ensuring that a substantial portion of climate and nature finance is channelled towards supporting indigenous people and local communities. Recognising the indispensable socio-environmental contributions of these communities, MDBs can advocate for their rights, support their initiatives and integrate their perspectives into broader financial strategies and decisions.

Recommendation

Advocate for collaborations with Eurosystem NCBs to channel SDRs towards green bonds, interest rate Recommend MDBs to align their portfolios with global agreements, championing DNS swaps and allocating at least 25 per cent of nature finance to support indigenous people and local communities by 2025.

2. Applying the cascade principle

The Cascade principle refers to a principle of subsidiarity where the public sector portion of the MDBs should abstain from funding endeavours that could and should be financed by the private sector and private finance, thereby averting the accumulation of further public debt. This straightforward concept, however, has encountered opposition during its execution. Sovereign project lending is propelled by the interactions between MDB loan officers and line-ministry clients, a scenario in which neither party is keen on exploring whether private-sector solutions might be more suitable. The G20 (2023) notes that the principle has resurfaced within the World Bank's 'Evolution Roadmap' framework as a strategy for redirecting limited sovereign loan resources towards domains where MDBs hold a comparative advantage. Nonetheless, most management and staff incentives continue to be tied to distinct transactions encompassing sovereign loans. In the absence of impact metrics that emphasise comparative advantage, fostering a culture that prioritises evaluating private-sector involvement will initially pose a challenge.

Recommendation

Implement impact metrics that emphasise MDBs' comparative advantages, promoting a culture that prioritises evaluating private-sector solutions first to ensure optimal utilisation of public-sector resources in line with the Cascade principle.

3. Revitalising the RST with biodiversity at its core

The RST stands at a pivotal juncture. Although the RST is small (about US\$ 40 billion in total) relative to global climate investment needs, the reforms it supports can help create an enabling environment to attract private finance. Member countries may choose to use part of the fiscal space created by the RSF to provide risk-sharing and credit-enhancement mechanisms to private investors, considering fiscal and debt sustainability considerations. In combination with traditional IMF programmes, the RSF can help address macroeconomic challenges in member countries, which can mobilise domestic financial resources. By integrating biodiversity-sensitive criteria as a core challenge, we can breathe new life into the RST. Whether it is tapping into the reservoir of undrawn resources within the RST or initiating a fresh round of SDR pledges, the focus remains clear: addressing biodiversity loss and fortifying ecosystem functionality.

Recommendation

By 2025, revitalise the RST by integrating biodiversity-sensitive criteria, leverage the RSF to attract private finance, and explore undrawn resources and new SDR pledges with an emphasis on addressing biodiversity loss and enhancing ecosystem functionality.

4. Integrate biodiversity criteria in financial sector decision-making

Governments can support the integration of biodiversity criteria in financial sector decision-making by adopting NCA practices and providing relevant data as a public good. Governments can also mobilise private investment for biodiversity by including a role for the private sector in their national biodiversity strategies and action plans (NBSAPs).

Recommendation

In line with the commitment to the GBF, governments should adopt NCA practices, offer biodiversity data as a public good, and incorporate private-sector roles in their NBSAPs to enhance biodiversity criteria in financial sector decisions.



5. Developing a global net-zero transition plan

A whitepaper by Aviva Investors (2022) presents a climate emergency roadmap for the global finance architecture, ascertaining need to develop a global net-zero transition plan for finance with the private sector at the core of the ambition loop. Private financial firms should collaborate with policymakers and advocate for supportive regulations to create an enabling environment for climate and nature investments. The roadmap can include a reporting and synthesis function to highlight where progress is (or is not) being made.

Recommendation

Formulate a global net-zero transition plan for finance, emphasising private-sector involvement and urging private financial firms to collaborate with policymakers to streamline regulations, fostering climate and nature investments.

6. Examining the Global Investment Recovery Act (GIRA) features

Green industrial strategies from China, the EU and the US aim to merge job creation and competitive advantage with net-zero emission goals. It is crucial to assess how these strategies influence investment in EMDEs. Specifically, we need to understand the challenges they present in terms of capital and market access and the potential to refine or enhance these strategies to boost private capital inflow into EMDEs. The JET-P collaboration with various countries might be a foundational step, given its capacity to set investment criteria and oversee support. Yet, a more inclusive approach for all EMDEs is vital to ensure that new measures like the US Inflation Reduction Act (IRA) incentives are universally accessible (T20 Brief 2023).

Recommendation

Undertake a comprehensive analysis of green industrial strategies, especially from China, the EU and the US, for their effects on EMDE investments, addressing challenges related to capital and market access. Advocate for refining these strategies with the JET-Ps and other incentive frameworks and collaborative platforms for financing and incentivising similarly to how the US IRA structures a just transition from highly intensive, fossil fuel energy systems to stable renewables-based grids.

7. Debt relief

Mechanisms such as DNS and DCS swaps can be woven in, building on successful models from nations such as the Seychelles and Belize. Collaborations with financial institutions might unlock a vast potential of swaps dedicated to achieving the SDGs. Oxfam (2023) proposes an annual allocation of US\$ 500 billion by the IMF and World Bank towards refinancing the high-cost debt burdening many developing nations.

Recommendation

Initiate a new phase of debt relief by integrating mechanisms such as DNS and DCS swaps through collaboration within financial institutions.

Urge the IMF and World Bank to allocate US\$ 500 billion annually towards the refinancing of high-cost debts for developing countries.

8. Role of central banks in greening the financial system

Central banks hold a unique position and are perfectly placed to extend and broaden the existing frameworks of collaboration and action, especially under the NGFS. It is not just possible but necessary to integrate nature and biodiversity loss considerations into existing policy frameworks from micro-prudential to disclosure requirements and even macroprudential assessments and scenario analyses.

Recommendation

Encourage central banks to leverage their role in the NGFS by incorporating nature and biodiversity loss considerations into policy frameworks, spanning micro-prudential to macroprudential assessments, aligning with climate risk considerations.

9. Development Assistance Committee of the OECD

This committee is actively engaging with members to reach a consensus on the official development assistance eligibility of members' private-sector instruments, treatment of loans to the private sector and treatment of credit guarantees. This commitment follows OECD's decision in 2016 to pursue an enhanced enabling environment for partnerships with the private sector.

Recommendation

Advise the Development Assistance Committee of the OECD to intensify engagement with members, aiming for agreement on the eligibility of private-sector instruments in ODA, the handling of loans to the private sector and the approach to credit guarantees, building on the 2016 resolution to foster a conducive setting for private-sector partnerships.

10. Replicating crisis response models

MDBs can use flexible instruments that adapt to the dynamic nature of crises. This approach emphasises the importance of MDBs being nimble and proactive, especially during crises. The use of flexible instruments and a higher risk tolerance allow MDBs to adapt swiftly to changing circumstances and address challenges head-on. The World Bank's current funding model is not adequately designed to handle recurrent crises. This shortcoming points to a need for a more robust and adaptable funding structure that can withstand repeated shocks and challenges.

Recommendation

Encourage MDBs to adopt flexible instruments tailored to respond to dynamic crises, urging a shift from the World Bank's current funding model to a more resilient and adaptable structure capable of managing recurrent challenges.



Market scaffolding

1. Diverse market instruments

The financial landscape is continuously evolving, and a diverse set of instruments is emerging as a crucial tool to address pressing global challenges. Introducing taxes on financial transactions and fossil fuels, along with levies on sectors such as shipping and aviation, is among the innovative approaches being considered. The potential yield from these measures is staggering, estimated to be between US\$ 1.5 trillion and US\$ 2 trillion annually. Additionally, a notable development is the consideration of a global methane tax, spurred by initiatives such as the US IRA provision giving the Environmental Protection Agency (EPA) authority to levy US\$ 900 per tonne penalties on methane leaks. This provides a semblance of a framework that could be extrapolated globally to incentivise rapid curbs on methane emissions. While political plausibility might be a challenge, especially with nations such as China, there is a discernible momentum towards negotiating targets, such as the 30 per cent reduction by 2030. If a global methane tax were agreed upon at a rate similar to the US\$ 900 per tonne, it could be used to capitalise the loss and damage fund.

Recommendation

Advocate for the introduction of new financial mechanisms, including taxes on financial transactions and fossil fuels, as well as levies on shipping and aviation sectors and a global methane tax with the potential to generate an annual revenue of US\$ 1.5 trillion to US\$ 2 trillion.

2. Development of Multi-Year Underwriting Policies

Insurance and re-insurance players traditionally provide a safety net against unforeseen adversities, thus promoting financial stability and investor confidence. However, a notable limitation within this sector is the prevalent 12-month underwriting policy, which often falls short in addressing the long-term nature of climate and environmental risks. The mismatch between the short-term underwriting policies and the long-term repercussions of climate risks underscores a significant gap in the current insurance framework.

Historically, underwriting practices have evolved to adapt to emerging risks and market demands, with significant shifts occurring as early as the 20th century. Despite this, the adoption of multi-year underwriting policies, mainly aimed at climate and environmental risks, appears to have lagged, possibly due to the extended liability and uncertainty they entail compared to annual policies.

The 12-month underwriting policy is structured to assess and cover risks within one year, which aligns well with common market fluctuations and individual claims but starkly contrasts with the multi-year, often multi-decade, timeline of climate risks. This short-term focus inhibits the development of insurance products that can provide coverage over the longer term, thus potentially deterring investments in climate resilience and adaptation projects which require a longer-term risk mitigation framework.

Recommendation

Encourage developing and adopting multi-year underwriting policies that align with the long-term nature of climate and environmental risks. This could include providing incentives for insurance companies that adopt such policies, thus promoting a gradual shift towards longer-term underwriting.

Country-level factors



Investment climate/business environment

1. IMF Green Public Financial Management framework

This framework provides a holistic view of entry points and opportunities for integrating climate priorities into public financial management. The IMF Climate–Public Investment Management Assessment can help governments identify improvements in public investment institutions and processes to build low-carbon and climate-resilient infrastructure. It can also include a further focus on nature-related projects. The IMF can also provide capacity development, especially in LICs, to advance climate policies, including the collection of high-quality, reliable and comparable climate-related data.

Recommendation



Call upon the IMF to implement its Green Public Financial Management framework for immediate climate priority integration and embed nature finance considerations in it.



Upstream market creation

1. Market creation and infrastructure development

Market creation and infrastructure development are essential for instilling confidence and drawing private finance. Developing asset classes and enhancing market infrastructure can establish a robust environment that is further bolstered by having clear policy pathways, strengthening local banking sectors and capital markets, and employing strategies such as blending and refinancing, all of which cumulatively create a favourable atmosphere for private investment.

In contrast, private markets often suffer from a lack of transparency regarding performance, cost and underlying investments. To address these deficiencies, an open architecture model is proposed in which distinct entities oversee trading, settlement/clearing and transfer/registry, mirroring the infrastructure found in public markets. An exemplar of this approach is the Nasdaq Private Market, which offers a platform for private companies and their shareholders to list shares. This platform becomes an avenue for institutional investors and family offices to engage in transactions.

Furthermore, targeted public investments hold significant potential to align and complement private-sector investments, especially in areas such as industry, infrastructure and workforce development. Such investments not only coordinate with private endeavours but also fortify the foundation for thriving domestic industries, such as the semiconductor and clean energy sectors. These industries are pivotal in achieving both national security and climate goals, and they encompass facets such as novel infrastructure development. The World Bank's 'Creating Markets' strategy is a testament to the importance of such efforts. It augments support to nations where private capital is insufficient to bridge major development discrepancies, including challenges tied to the SDGs.

Recommendation



Governments and financial institutions should collaborate to develop an open architecture model for private markets in which separate parties provide trading, settlement/clearing and transfer/registry for private assets, similar to the public market infrastructure, while concurrently bolstering local banking sectors and capital markets.

2. Collaboration across system players

Harnessing the potential of the entire public development bank system, including bilateral DFIs and local development banks, is crucial. Collaboration among MDBs, governments and private-sector stakeholders is crucial in mobilising private finance. Sharing knowledge, best practices and expertise can create an enabling environment for private investment. Policymakers should facilitate strategic partnerships between private financial firms and MDBs to support sustainable investments. These partnerships can leverage the expertise and local knowledge of MDBs with the financial resources and innovation of private firms. With enhanced support and concessional finance from donor countries, MDBs can confidently take on more risks, effectively reduce project risks and bear the initial costs that make investments more bankable.

Joint projects should be designed to address critical gaps in capital markets with a focus on promoting sustainable economic growth, social equity and climate resilience. For example, the World Bank has set up a Private Sector Investment Lab focused on addressing barriers preventing private-sector investment in emerging markets, primarily emphasising renewable energy.

Recommendation

Establish a collaborative platform where PDBs, MDBs, governments and private firms share expertise and resources, focusing on sustainable investments and addressing market gaps, inspired by models like the World Bank's Private Sector Investment Lab.



Midstream project creation

1. Improving environmental and social risk management

Addressing environmental and social risks is paramount. MDBs can lead the way by identifying the impacts of nature's decline on borrowing country economies and integrating these insights into country risk analyses. Tools and methodologies are available to mitigate specific environmental risks, especially when it comes to infrastructure projects. These tools need to also focus on systemic risks faced by MDBs, central banks and supervisors and in disclosures by private financial firms.

Recommendation

Build capacity to implement advanced environmental risk management tools in MDBs and integrate nature-impact insights into country risk analysis.

Downstream project creation

1. Originating and sharing business models

Transitioning from traditional balance-sheet-based approaches to originate-and-share or originate-and-transfer models can facilitate private capital mobilisation, broadening the range of investors that can mobilise capital and scaling up multi-asset mobilisation. This approach allows for greater diversification of risks and enhances the financial sustainability of climate projects. For instance, pooled debt vehicles can include the securitisation of a portfolio of conservation properties, for example, by the Conservation Fund and the Iroquois Valley Farms Real Estate Investment Trust (REIT). Issuance of private debt for green infrastructure and sustainable agriculture is highly scalable and replicable because these opportunities present credible collaterals and sources of cashflow. These pooled vehicles are critical to expanding the investor universe for conservation finance (World Bank 2020).

Recommendation

Promote the transition to originate-and-share or originate-and-transfer models to diversify risks, ensure the financial sustainability of climate projects, and leverage scalable pooled debt vehicles.

2. Addressing currency risk for climate and nature infrastructure

In many low- and middle-income countries, accessing local currency finance for climate and nature infrastructure projects is unattractive due to high interest rates and short maturities. As a result, these countries rely on hard-currency, long-term concessional lending, exposing them to currency risk and increasing debt service costs over time. Private financial firms can step in to address this challenge by providing currency-hedging solutions for climate and nature projects.

By subsidising currency hedging, private financial firms can make hard-currency loans more sustainable and appealing to developing countries. For example, TCX has de-risked nearly US\$ 8.4 billion of external lending in emerging and frontier countries across 70 currencies and has contributed to market development by selling US\$ 1.5 billion of currency risk to international investors (CPI 2023). Private financial firms can also provide political risk hedges to help mitigate political risks associated with investing in developing countries. DFIs should increase support for risk mitigation programmes that help projects in developing countries meet the risk/return criteria of private financiers.

Recommendation

Encourage private financial firms to offer currency- and political risk-hedging solutions for climate and nature projects in low- and middle-income countries, making hard-currency loans more sustainable, as demonstrated by TCX's de-risking efforts in emerging economies.

3. Private sector push for transition plans

Private financial firms can ask their clients, governments and regulators to provide transition plans that outline how they plan to transition to a low-carbon economy. This will help identify investment opportunities in climate and nature projects. Private financial firms can push for sector-wise net-zero transition road maps that can provide benchmarks for client transition planning and reporting.

Recommendation

Encourage private financial firms to create transition plans and help their clients develop and submit their own plans, highlighting paths to a low-carbon economy, to uncover potential climate and nature investment opportunities.

4. Expanded use of guarantees by MDBs and donors

Guarantees of this kind could be an effective instrument to reduce real and perceived risks in EMDEs, thereby broadening the potential private investor base. MDBs' ongoing discussions with the G20 and international community aim to enhance their financial capacity and operating models, based on recommendations made in the Capital Adequacy Framework Review of the G20 (Group of Twenty 2023; Group of Twenty Independent Expert Group 2023). Policymakers should also consider whether there are regulatory barriers disincentivising the use of MDB and donor guarantees by financial institutions such as banks and insurance companies.

Recommendation

Promote the extended use of MDB and donor guarantees to mitigate risks in EMDEs, attracting more private investors, while policymakers assess and address potential regulatory barriers hindering financial institutions from leveraging these guarantees.




5. Data transparency and risk sharing

Policymakers and MDB shareholders need to advocate for increased data transparency on risk to incentivise risk sharing. By broadening the scope of the GEMS Risk Database to encompass detailed historical data on losses and recoveries from MDBs, private investors can be better equipped to make knowledgeable decisions, subsequently reducing capital expenses. Currently, 24 MDBs feed into the GEMs database, which boasts over 30 years of data on default likelihoods and anticipated loan losses, both to sovereign entities and the private sector (Verney 2022). Although it is one of the most extensive credit performance databases globally, only contributing institutions can access it.

Offering broader access to these data can influence the risk evaluations assigned to MDB portfolios by rating agencies, particularly concerning private-sector loans. This transparency would empower private investors to more accurately gauge the risks associated with collaborating with MDBs and lending aligned with SDGs. The G20 (2023) called for the use of a transparent, consultative process to create a publicly available, interactive (anonymised) database with annual data that permit granular analysis of MDB credit performance by country and detailed sector and to do so by 2024.

Recommendation



Advocate for expanded data transparency in the GEMs Risk Database to foster informed risk-sharing. Granting wider access to its comprehensive credit performance data can better inform risk assessments, enabling private investors to confidently partner with MDBs and support SDG-aligned initiatives.

Furthermore, Table 2 showcases the anticipated timeframe for implementation: short (1–2 years), medium (3–5 years) or long (5+ years) terms. It also highlights the key target actors and whether the focus of each recommendation is predominantly on climate finance, nature finance or both, offering a clear and actionable blueprint for stakeholders.

Table 2: Key recommendations in scaling up private finance


Factor	Recommendations	Timeframe	Key players	Focus
 <p>Global Macro Environment</p>	<ul style="list-style-type: none"> Support the Bridgetown Initiative by leveraging the IDA for concessional finance, targeting US\$ 279 billion in funding, establishing a US\$ 500 billion Global Climate Mitigation Trust, modernising MDB allocation, introducing innovative financial and insurance instruments for climate change, enhancing risk appetite in SIDS, and bolstering supply chain resilience. 	Short/medium	All financial institutions, governments	Climate
	<ul style="list-style-type: none"> Implement impact metrics that emphasise MDBs' comparative advantages, promoting a culture that prioritises evaluating private sector solutions first, to ensure optimal utilisation of public-sector resources in line with the cascade principle. 	Short	MDBs	Climate, nature
	<ul style="list-style-type: none"> Advocate for collaborations with Eurosystem NCBs to channel SDRs towards green bonds, interest rate buy-downs and carbon credits; support a dedicated SDR allocation for biodiversity within the IMF's operational framework. 	Short	Eurosystem, NCBs, IMF	Climate, nature
	<ul style="list-style-type: none"> Recommend issuing hybrid capital instruments for MDBs, leveraging models such as the IFFEd's donor portfolio guarantee fund and partnerships with entities such as MIGA while routinely benchmarking capital adequacy to enhance financial stability and expand lending capabilities. 	Medium	MDBs, MIGA	

Table 2: Key recommendations in scaling up private finance


Factor	Recommendations	Timeframe	Key players	Focus
 <p>Regulation & Public Support</p>	<ul style="list-style-type: none"> By 2025, revitalise the RST by integrating biodiversity-sensitive criteria, leveraging the RSF to attract private finance, and exploring undrawn resources and new SDR pledges with an emphasis on addressing biodiversity loss and enhancing ecosystem functionality. 	Short	IMF, DFIs, member countries	Nature
	<ul style="list-style-type: none"> In line with the commitment to GBF, governments should adopt NCA practices, offer biodiversity data as a public good, and incorporate private-sector roles in their NBSAPs to enhance biodiversity criteria in financial sector decisions. 	Short	Regulatory bodies, governments	Climate, nature
	<ul style="list-style-type: none"> Formulate a global net-zero transition plan for finance, emphasising private-sector involvement and urging private financial firms to collaborate with policymakers to streamline regulations, fostering climate and nature investments. 	Short	Private financial firms, policymakers	Climate
	<ul style="list-style-type: none"> Initiate a new phase of debt relief by integrating mechanisms such as DNS and DCS swaps through collaboration within financial institutions. 	Long	Governments, DFIs, private financial firms	Climate, nature
	<ul style="list-style-type: none"> Encourage central banks to leverage their role in the NGFS by incorporating nature and biodiversity loss considerations into policy frameworks spanning from micro-prudential to macroprudential assessments. 	Short	Central banks, NGFS	Climate, nature
	<ul style="list-style-type: none"> Advise the Development Assistance Committee of the OECD to intensify engagement with members, aiming for agreement on the eligibility of private sector instruments in ODA, the handling of loans to the private sector, and the approach to credit guarantees, building on the 2016 resolution to foster a conducive setting for private sector partnerships. 	Short	OECD, DAC, private financial firms	Climate, nature
	<ul style="list-style-type: none"> Encourage MDBs to adopt flexible instruments tailored to respond to dynamic crises, urging a shift from the World Bank's current funding model to a more resilient and adaptable structure capable of managing recurrent challenges. 	Medium	MDBs	Climate, nature

Table 2: Key recommendations in scaling up private finance






Factor	Recommendations	Timeframe	Key players	Focus
 <p>Market Scaffolding</p>	<ul style="list-style-type: none"> Advocate for the introduction of new financial mechanisms, including taxes on financial transactions and fossil fuels, as well as levies on shipping and aviation sectors with the potential to generate an annual revenue of US\$ 1.5 trillion to US\$ 2 trillion. 	Medium	Private financial firms, DFIs	Climate
	<ul style="list-style-type: none"> Urge the IMF and World Bank to allocate US\$ 500 billion annually towards the refinancing of high-cost debts for developing countries. 	Short	MDBs, DFIs, governments	Climate
	<ul style="list-style-type: none"> Encourage MDBs to adopt flexible instruments tailored to respond to dynamic crises, urging a shift from the World Bank’s current funding model to a more resilient and adaptable structure capable of managing recurrent challenges. 	Medium	MDBs	Climate, nature
	<ul style="list-style-type: none"> Encourage the development and adoption of multi-year underwriting policies that align with the long-term nature of climate and environmental risks. This could include the provision of incentives for insurance companies that adopt such policies, thus promoting a gradual shift towards longer-term underwriting. 	Short/medium	Regulatory bodies, insurance firms	Climate, nature
 <p>Investment Climate/Business Environment</p>	<ul style="list-style-type: none"> Call upon the IMF to implement its Green Public Financial Management framework for immediate climate priority integration and embed nature finance considerations in it. 	Short	IMF	Climate, nature
 <p>Upstream Market Creation</p>	<ul style="list-style-type: none"> Governments and financial institutions should collaborate to develop an open architecture model for private markets, akin to the public market infrastructure, while concurrently bolstering local banking sectors and capital markets. 	Short	Financial institutions, governments	Climate, nature
	<ul style="list-style-type: none"> Establish a collaborative platform where PDBs, MDBs, governments and private firms share expertise and resources, focusing on sustainable investments and addressing market gaps, inspired by models such as the World Bank’s Private Sector Investment Lab. 	Short	MDBs, governments, private financial firms	Climate, nature

Table 2: Key recommendations in scaling up private finance

Factor	Recommendations	Timeframe	Key players	Focus
 <p>Midstream Project Creation</p>	<ul style="list-style-type: none"> Implement advanced environmental risk management tools in MDBs and integrate nature-impact insights into country risk analyses. 	Short	MDBs, governments	Nature
 <p>Downstream Financial Linkages</p>	<ul style="list-style-type: none"> Promote the transition to originate-and-share or originate-and-transfer models to diversify risks, ensuring financial sustainability of climate projects, and leverage scalable pooled debt vehicles. 	Medium	Private financial firms, governments	Climate, nature
	<ul style="list-style-type: none"> Encourage private financial firms to offer currency and political risk hedging solutions for climate and nature projects in low- and middle-income countries, making hard currency loans more sustainable, as demonstrated by TCX’s de-risking efforts in emerging economies. 	Short	DFIs, private financial firms	Climate, nature
	<ul style="list-style-type: none"> Define clear risk/return criteria in nature-climate financing to align with commercial investors’ mandates, ensuring successful private-sector engagement and project funding. 	Short	MDBs, donor governments	Climate, nature
	<ul style="list-style-type: none"> Encourage private financial firms to create their own, and help their clients develop and submit, transition plans. 	Short	MDBs, G20, OECD	Climate, nature
	<ul style="list-style-type: none"> Promote the extended use of MDB and donor guarantees to mitigate risks in EMDEs, attracting more private investors, while policymakers assess and address potential regulatory barriers hindering financial institutions from leveraging these guarantees. 	Medium	MDBs, policymakers	Climate, nature
	<ul style="list-style-type: none"> Advocate for expanded data transparency in the GEMs Risk Database to foster informed risk-sharing. Granting wider access to its comprehensive credit performance data can better inform risk assessments, enabling private investors to confidently partner with MDBs and support SDG-aligned initiatives. 	Medium	MDBs, private investors	Climate, nature

5 Conclusion and COP28 asks

Recognising the pivotal role of private capital as a game-changer in climate finance, there is an immediate need to streamline and optimise multilateral funding processes to swiftly and effectively boost private climate investment in EMDEs. With an ambitious aim of unlocking the US\$ 5 trillion required to achieve pressing climate targets, the emphasis on trade as an avenue for sustainable and equitable growth brings to the forefront the themes of supply chain decarbonisation and transition resilience.

As these dialogues and themes unfold, discussions at COP28 can call for enhanced collaboration, financial reform and actionable climate commitments. The focus needs to be broadened to develop an enabling environment for scaling up private finance for both climate and nature financing at the global and country levels.



Table 3: Immediate COP28 asks

1 Support the Bridgetown Initiative

Desired action

- Leveraging the IDA for concessional finance targeting US\$ 279 billion.
- Establishing a US\$ 500 billion Global Climate Mitigation Trust.
- Introducing innovative financial and insurance instruments for climate change.

Potential impact

- Could unlock significant funding for climate mitigation and adaptation, modernise MDB allocation, introduce innovative financial tools, and enhance resilience in SIDS propelling global climate action forward.

2 Support diverse financing models

Desired action

- Promotion of originate-and-share or originate-and-transfer models.
- Introduction of hybrid capital instruments for MDBs, leveraging models such as the IFFEd's donor portfolio guarantee fund.

Potential impact

- Promoting advanced financial mechanisms can diversify risks, making climate investments more bankable and attractive, potentially accelerating the pace of climate finance and enhancing its effectiveness in fostering sustainable development.

3 Strengthen risk management & guarantees

Desired action

- Adoption of flexible instruments tailored to contemporary crises.
- Increased use of MDB and donor guarantees to mitigate risks in EMDEs.

Potential impact

- Encouraging MDBs to adopt flexible risk management instruments can mitigate investment risks in EMDEs, broadening the investor base, and potentially mobilising more private capital for climate and nature projects.

4 Enhance data transparency

Desired action

- Comprehensive data accessibility from platforms such as the GEMs Risk Database.
- Launch of GEMs 2.0 as a standalone entity by 2024.
- Enhanced dialogue between the MDBs, CRAs and shareholders on continued transparency in the exchange of information and rating methodologies.

Potential impact

- Improved data transparency can foster informed risk-sharing and build investor confidence, which are crucial for attracting more private-sector engagement and facilitating better decision-making in climate finance.

5 Incentivise and align criteria with private sector

Desired action

- Defining clear risk/return criteria in climate and nature financing.
- Incentivising private financial firms to provide currency-hedging solutions for climate and nature projects.

Potential impact

- Aligning incentives and risk/return criteria with commercial investor mandates can make investment models more resilient and appealing, potentially leading to an increased flow of private capital into climate and nature projects.

6 Promote collaborative platforms

Desired action

- Establishment of collaborative platforms pooling resources and expertise from public development banks, MDBs, governments and private entities.

Potential impact

- Establishing collaborative platforms can foster a holistic approach to sustainable investments, scaling efforts, improving access to finance, enhancing affordability, and potentially leading to a more integrated and effective global climate action.

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