Debt for climate swaps: Are they feasible in the Pacific?
And what do debtors need to know?

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Presentation

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Message 1: Debt for climate swaps are NOT the Same as debt forgiveness

Debt for climate swaps are a mutually beneficial agreement between the debtor and the creditor.
Message 2: Debt for climate swaps are an innovative financing mechanism

- Debt restructuring’s goals → enhance fiscal space, release pressures on the exchange rate
- Debt for climate swaps can contribute to both goals
- However, ...
  - The fiscal space created is earmarked for projects in climate change mitigation and adaptation
  - The scale of the debt swaps is likely to be small compared to the overall debt restructuring needs of the debtor
Basic mechanism

BILATERAL OR DIRECT SWAP

1. Cancellation of debt
   - Creditor Government
   - Debtor Government

2. Local currency payment

   - Counts as ODA / climate finance

   - National fund, environmental project(s)
A common debt for climate swap scheme

THIRD-PARTY SWAP

1. Debt title (face value) to Intermediary / NGO
   - Purchase at a discount or at the secondary market price
   - Commitment to fund an environmental project

2. Cancellation of debt to Debtor Government
   - Commitment to fund an environmental project

3. Local currency payment to National fund, environmental project(s)
An intermediary can play a useful role

It can

• Facilitate the negotiation process
• Mobilize additional finance, including grants
• Provide financial advice on how to structure the deal
• Provide technical support on the projects to be financed by the swap
• Examples of intermediaries include Conservation International, the Nature Conservancy, and WWF
Seychelles (2015) example

- Seychelles paid back a debt owed to Belgium, France and UK for $21.6m
- Received a discount of 6.5% so that it paid $20.2m
- The $20.2m came from a loan from NatureVest for $15.2m plus grants from philanthropies for $5m with support from The Nature Conservancy
- With the savings in debt service payments to Belgium, France and UK, Seychelles committed to fund for 20 years $280,000/year in conservation activities and to contribute $150,000/year to a trust fund for future conservation activities
- The Government’s payments are in local currency
The Nature Conservancy helped the Government of Belize to raise $364m through the issuance of a 20-year blue bond with Credit Suisse as placement agent.

The $364m were lent to the Belize Government to (a) retire a Eurobond with face value of $553m at 55c to the dollar for a value of $301m, (b) set aside $28m in reserves, (c) pre-fund a conservation endowment for $24m, and (d) pay $10m in closing costs.

The Government committed to provide $4m/year to conserve 30% of its ocean.

The deal was backed by political risk insurance by the U.S. International Development Finance Corporation (DFC) for $610m.
Some lessons learned so far

- The funding from a debt for climate swap does not come only from the creditor(s)
- Additional financing can be raised at more convenient terms to pay for the debt retirement, including through grants
- In raising financing, reputable international financial institutions and guarantees schemes can be very helpful
- A well-structure deal can help raise the debtor credit rating
  - Belize S&P rating increased from CC in Feb 2021 to B- in Nov 2021, after the deal was announced
What if a country’s main creditor is an MDB?

Scenario 1: Debt is cancelled immediately via a lumpsum payment
Scenario 2: Debt is gradually written off over 10+ years
Message 3: Give the highest priority to the use of the funds from the swap

Debt for climate swaps require

- A suitable pipeline of projects or a well-thought-out program
- Transparent and effective financial management of the funds provided through the swap
- Accurate and timely monitoring, reporting, and verification of the projects implemented
- Financial contributors to the swap (creditors and/or donors) need to be reassured that the funds are managed and utilized with the highest level of professionalism and according to international best practices
How could debt for climate swaps be implemented in the Pacific SIDS?

Positive factors

- The PSIDS have supportive development partners that could be amenable to consider supporting debt for climate swaps, including through grants
- The PSIDS have acute needs in climate adaptation investments, which could be an excellent use of debt for climate swaps
- The PSIDS are small economies and their total investment needs are not as high compared to larger economies
Negative factors

• The small investment needs of individual PSIDS can make the management of debt for climate swaps too expensive

• Specialized technical and financial experts to manage a debt for climate swap deal may be in short supply in PSIDS with small population
How could debt for climate swaps be implemented in the Pacific SIDS? (Cont’d)

Possible solution

• Economies of scale can be gained through a regional institution that can manage the funds and ensure effective project implementation

• The Pacific Resilience Facility (PRF) could play a role for this purpose
Takeaways

• Debt for climate swaps are an innovative financing mechanism that can also help lower external debts
• They are a flexible instrument that can be structure in many ways
• Development partners of the PSIDS could play an important role in providing financing
• The funds should be used to address major challenges in the area of climate adaptation
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