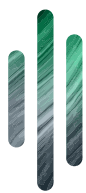

Reshaping Sovereign Debt Markets to Deliver a Sustainability Dividend



SUSTAINABILITY-LINKED
SOVEREIGN DEBT
HUB

Reshaping Sovereign Debt Markets to Deliver a Sustainability Dividend

The Challenge

Today's sovereign debt markets are not fit-for-purpose by failing to take adequate account of climate and nature risks.

Consequently, they neither provide the signals that climate and nature risk, nor do they reward sovereign borrowers that invest in the nature protection and climate resilience critical to their sustainable development.

Moreover, today's sovereign debt markets are ill-suited to a world of increasingly frequent exogenous shocks, resulting in a vicious cycle of debt defaults and debt restructuring, and increased costs of capital, which in turn limits much needed investment and eventually the exclusion of vulnerable nations from accessing the affordable capital they urgently need.

Sovereign debt markets must be sensitised to sustainability risks and so also reward material efforts to mitigate them. Or as Mia Mottley, Barbados's Prime Minister stated more forcefully, "We need a new financial architecture that can better respond to the current reality of massive vulnerability to external shocks".

The Opportunity

Scaling the issuance of sustainability performance-linked sovereign bonds that reward sustainable outcomes can catalyse the called-for revolution in sovereign debt markets.

Some progress has been made, such as disaster clauses that temporarily suspend payments, the earlier generation of nature debt swaps and cancellations, and more recently the sovereign debt issued with the cost of capital directly linked to performance against specific targets. Such efforts point the way to the scaled approach needed for the transformation of the debt markets.

Sustainability-linked sovereign debt can invert the downward spiral, creating a virtuous cycle by:

Directly rewarding positive nature and climate outcomes through reduced costs of capital.

Incentivising investments that reduce sovereign risks through improved resilience and economic productivity, thereby lowering the cost of capital across a sovereign's entire debt portfolio.

Supporting broader sustainable development outcomes, directly through growth and productivity effects and indirectly by creating fiscal space to support increased public spending.

Reducing the need for ex-post debt structuring by advancing smarter risk sharing between debtors and creditors.

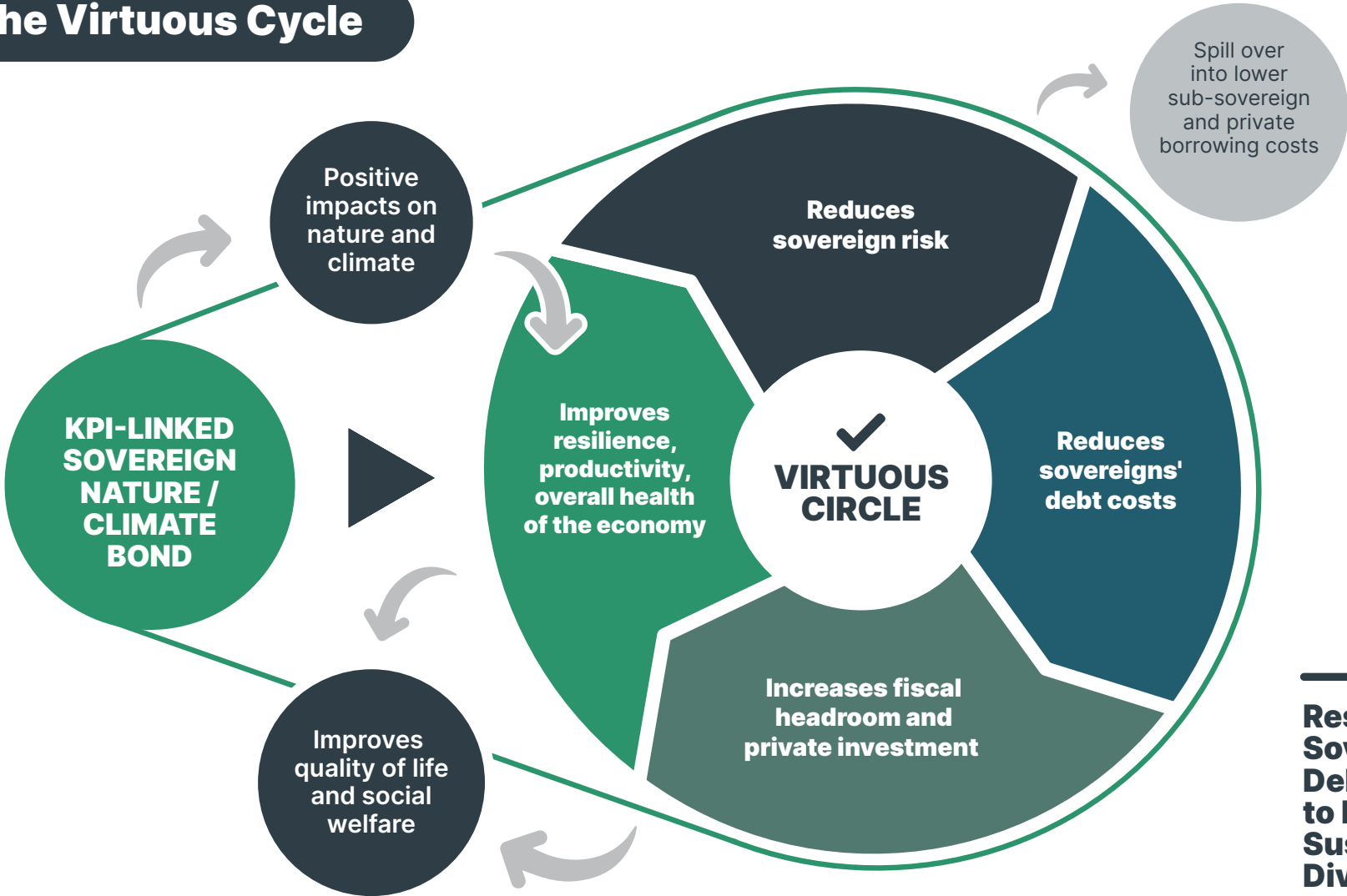
Over time, this virtuous cycle can direct sovereign debt markets to embed sustainability risk into practice, regulation and other rules and so support more viable risk sharing.

Such integration, for example into ratings, and into debt sustainability assessment frameworks, may over time reduce the need for stand-alone performance-linked sovereign debt instruments as the process would have become mainstreamed.

Please find the Virtuous Cycle on the next page ▶

The Opportunity

The Virtuous Cycle



Reshaping Sovereign Debt Markets to Deliver a Sustainability Dividend

The HUB

A Sustainability-linked Sovereign Debt Hub is being established to assist the development and scaling of performance-linked sovereign debt.

The Hub is intended to provide the three-fold public good of: (a) enhancing sovereign debt markets' sensitivity to emerging risks; (b) delivering a lower cost of capital to sovereign debtors that invest in ways that deliver sustainable development outcomes, particular nature and climate-linked adaptation and resilience, and; (c) advancing innovations that make sovereign debt markets more suited to a world of external shocks.

The Hub will create an inclusive cooperative space which brings together the actors from the entire spectrum of the sovereign sustainability-linked bonds universe. It will support new debt issuance over the longer-term, whilst offering a vehicle for short-term action in new debt issuance linked to debt refinancing.

Technical support provided by the Sustainability-linked Sovereign Debt Hub would:

Enable **engagement of sovereign debtors and creditors** to raise the awareness and use of sustainability-linked sovereign debt.

Support the **design and use of performance-linked sovereign debt** offerings.

Develop and support the use of **data rich KPI platforms** for individual debt offering and for use across a broader population of sustainability linked sovereign debt offerings.

Work with providers of **concessionary financing** to optimise its use in support of nature and climate performance-linked sovereign debt.

Ensure effective **verification of KPI-related commitments and deliverables** and associated debt cost agreements.

Increase **awareness and experience** in using sustainability-linked sovereign debt instruments through convenings, research and capability development.

Support the development of **enabling standards and other tools** that facilitate the integration of nature and climate into sovereign debt instrument design and markets.

The Sustainability-linked Sovereign Debt Hub will be established as a partnership-governed, independent unit, ensuring success in achieving a delicate balance between minimizing bureaucratic complexity and guaranteeing transparency and accountability.

It will be assisted by an **Advisory Board** with representatives of key stakeholders, including international and development finance institutions, financial sector associations, and advocacy and expert groups.

A small **core team** will ensure efficient and effective execution, coordinating key technical partners and a wider ad hoc network of service providers.

NatureFinance (formerly known as Finance for Biodiversity), a non-profit entity established in Geneva, Switzerland will provide the roles of fiduciary host and secretariat.

The Sustainability-linked Sovereign Debt Hub will be established in the first instance for a limited, four-year period, with regular performance reviews, ensuring that its continued operation is marked by distinct needs and outcomes.

The Expected Outcomes

The Sustainability-linked Sovereign Debt Hub's success in addressing its core mandate will be judged against its:

Contribution to increasing the volume, quality, and impact of sustainability-linked sovereign debt issuance.

Wider contribution to market building such as the development of relevant innovations, standards, and norms.

The Hub will provide a platform for relevant research, convening and communication on all matters related to sustainability-linked sovereign debt. Given its varied contributory roles to such efforts, specific targets have not been set. It would be hoped, however, that over the planned period there would be at least US\$7.5 billion of sustainability-linked sovereign debt new issuance and refinancing spread globally across a variety of country profiles. It is expected that this volume of transactions would require a pipeline of concessionary financing and credit enhancement that might amount of upwards of US\$500 million.

Advisory Board Members



(Nigel Topping)



*Observer status



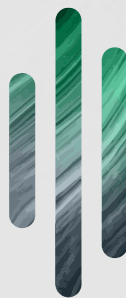
*Convener

Partners



An Invitation

The Hub is a collective effort, involving private and public actors with diverse, complementary strengths and interests. In this context, interest in and comments on the Hub are welcome, as are suggestions for collaboration. For more information, contact ssdh@naturefinance.net.



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