

## Innovative Finance for Climate and The Planet *Delivering on Commitments to Mother Nature*

*"There is no Planet B"*

### Introduction

The human race's consistent disregard for the aforementioned adage has left the planet bruised. Increasing carbon emissions and biodiversity losses have resulted in huge imbalances and pose an existential threat to the future of mankind. The inadequacy of available resources to avert this crisis has dragged down negotiations over the decades. A lack of consensus and other extraneous factors are responsible for the failure to meet targets, even when common goals have been earmarked.

With conventional levers of policy not yielding desired results, there is an urgent need to reorient the global environmental finance architecture, to catalyse increased flows for achieving global climate and biodiversity targets. The interconnectedness of climate change is playing an increasingly important role in the decline of biodiversity.

This Policy Brief sheds light on the prevailing divergence between the availability and requirements of finance to realise global targets on climate and biodiversity. It highlights the disproportionate impact of such crises on the most vulnerable regions/countries and the loss and damage suffered.

The Brief further talks about how Innovative Financial Instruments could be utilised to catalyse much-needed investment to bridge the existing gap in environmental finance. It proposes a set of recommendations for the consideration of the international community along with a global architecture that can facilitate the effective channelisation and utilisation of finance towards the most vulnerable countries.

## Recent Initiatives on Environmental Finance

### **Commitment to Set up a Loss & Damage Fund, Sharm El Sheikh, November 2022**

Notable commitments have been made to spur up the availability of finance for climate and biodiversity globally. Parties to the United Nations Framework Convention on Climate Change (UNFCCC) at the COP 27 Summit agreed to set up a 'Loss and Damage Fund' for countries that have been harmed and are particularly vulnerable to adverse effects of climate change, in Sharm el Sheikh, Egypt in November 2022 (<https://tinyurl.com/zbn.st3v>). It is indeed a welcome sign that the Sharm-el-Sheikh Summit formally recognised that developing countries have incurred significant economic and social costs on account of factors which are linked to climate change.

However, negotiations on the fund's finer details have been rightly criticised on account of a lack of clarity on issues such as the structure of funding, categorisation of beneficiary states, and specific areas where proceeds will be directed while being silent on the question of accountability when commitments are not met. A transitional committee has been set up to make recommendations on operationalising the Loss & Damage Fund. The committee, during its first two meetings, has not been able to identify specific sources and instruments of financing for projects to be implemented under the fund (<https://bit.ly/418CKTT>). Such a sense of palpable ambiguity has been a key marker of climate negotiations and has bogged down progress over the years.

### **Biodiversity Commitment at Montreal, December 2022**

The United Nations Biodiversity Conference (COP15) drew to a close in Montreal, Canada, on December 19, 2022, with a landmark agreement to guide global action on nature through to 2030. The summit resulted in the adoption of the Kunming-Montreal Global Biodiversity Framework (GBF), which is a long-term action plan for realizing global biodiversity targets. (<https://tinyurl.com/56nfm423>).

The GBF aims to address biodiversity loss, restore ecosystems and protect indigenous rights. The plan includes concrete measures to halt and reverse nature loss, including putting 30 per cent of the planet and 30 per cent of degraded ecosystems under protection by 2030. It also contains proposals to increase finance to developing countries – which emerged as a major sticking point during talks.

Amongst other targets, the parties agreed to provide US\$200bn towards biodiversity-related funding, by 2030. However, there is no roadmap for the specific sources of funds and the structure which will fund these commitments. In the absence of such clarity and with the environmental finance gap widening, the need for **'innovative finance solutions'** becomes critical.

### **India's G20 Declaration: Prioritising Climate Action, Adaptation, and Global Cooperation**

In India's G20 Declaration, the extent of the detrimental impact of climate change was acknowledged and adhered to by the participating nations, particularly for the poorest and the most vulnerable nations, including the Least Developed Countries (LDCs) and Small Island Developing States (SIDS). The interconnectedness of healthy ecosystems, climate change, and biodiversity loss was emphasised, underlining their pivotal roles in achieving sustainable development goals.

A steadfast commitment to funds was taken into consideration in the Declaration upon reaching a consensus on the inadequacy of the funds to mitigate the climate change and adaption of these countries. The committee encouraged countries worldwide to set comprehensive targets for reducing Greenhouse Gas (GHG) emissions across their economies, aligning with their Nationally Determined Contributions (NDCs).

Within the G20, the member nations made it a priority to address both adaptation and mitigation strategies to meet climate goals, including NDCs, carbon neutrality, and net-zero targets. This approach involves tailoring strategies to the unique circumstances of individual countries. The recommendations put forth by the Sustainable Finance Working Group were deemed crucial in mobilising climate finance, supporting transitional initiatives tailored to each nation's context, and emphasising the importance of blended financial instruments and private sector involvement in combatting climate change.

Furthermore, the Declaration underscored the expanded role of Multilateral Development Banks in mobilising climate finance. Key elements of this involvement encompass maximising the impact of concessional resources from multilateral climate funds to facilitate the implementation of the Paris Agreement in developing countries. This includes advocating for a robust second replenishment of the Green Climate Fund, promoting accessibility to multilateral climate funds, encouraging private capital mobilisation, supporting early-stage technology commercialisation for emissions

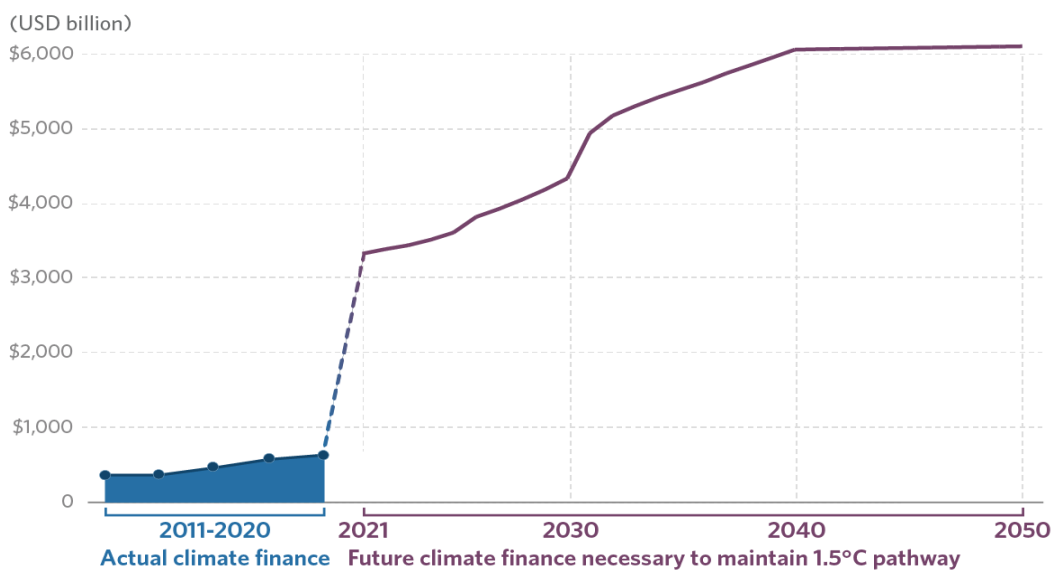
reduction, and stressing the necessity of a comprehensive policy mix, including carbon pricing and incentives, to advance carbon neutrality and net-zero objectives. These actions underscore the G20's collective dedication to effectively addressing the global climate crisis.

## Imperative of Innovative Finance

### Existing State of Climate and Biodiversity Finance

While annual climate finance has grown over the years, the world is on course to miss the target of restricting the temperature rise to 1.5<sup>0</sup>C. It is estimated that an increase of 588 per cent to US\$4.35tn annually by 2030, is required to meet the set global climate targets. (Figure 1) (<https://cutt.ly/u8r6k3b>)

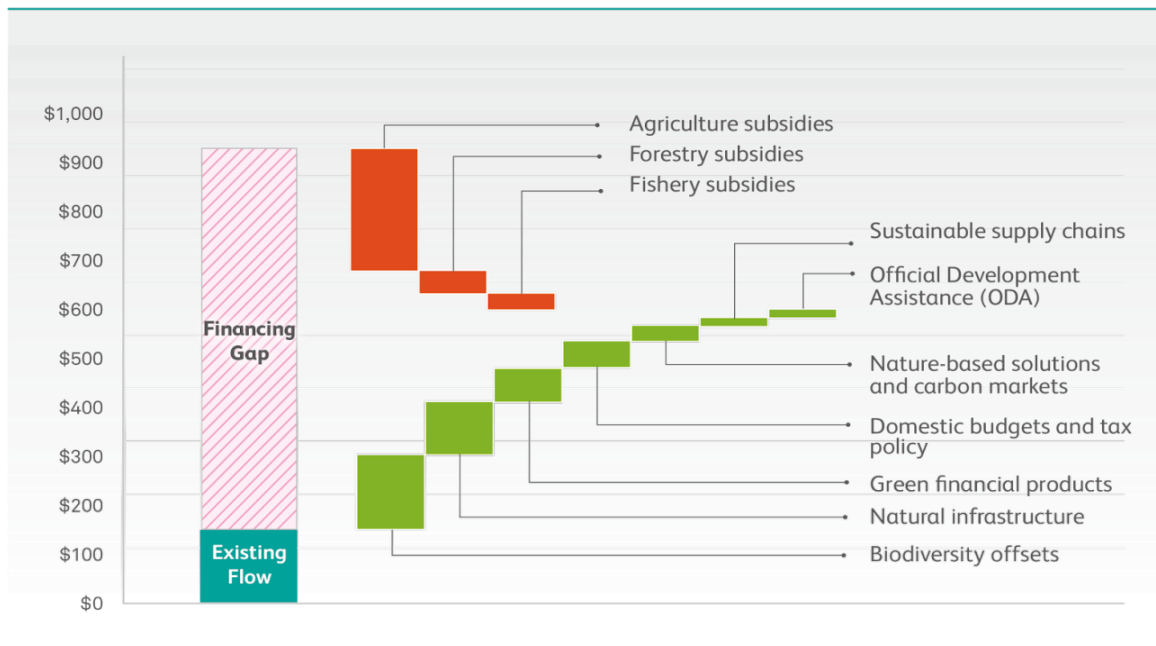
**Figure 1: Climate Finance Gap**



Source: *Global Landscape of Climate Finance - Climate Policy Initiative (2021)*

Similarly, a report on global biodiversity estimates that to halt biodiversity decline by 2030, an extra US\$711bn in annual global finance is needed to prevent this decline (Figure 2). The figure indicates a set of financial and policy mechanisms that, if scaled through appropriate public policies and private sector action, have the potential to collectively make a substantial contribution to closing the global biodiversity financing gap over the next decade (<https://tinyurl.com/385k63s7>).

**Figure 2: Biodiversity Finance Gap**



Source: *Financing Nature: Closing the Global Biodiversity Funding Gap* - The Paulson Institute, The Nature Conservancy (2020)

### Break up of Existing Climate Flows

The aggregate global climate finance flows available in 2019-20 stood at US\$632bn, representing about 15 per cent of the global requirements. A careful analysis of the instruments, and institutions which make up this figure of over US\$600bn, offers an insight into the texture of global climate finance flows (Table 1).

**Table 1: Global Climate Finance Flows**

S. No.	Source of Funds	Amount (in US \$bn)	S. No.	Instruments	Amount (in US \$bn)	S. No.	Uses	Amount (in US \$bn)
1	National Development Finance Institutions	120	1	Project-level market rate debt	232	1	Mitigation	571
2	Bilateral Development Finance Institutions	35	2	Low-cost project debt	47	2	Adaptation	46
3	Multilateral Development Finance Institutions	65	3	Grants	36	3	Dual Uses	15
4	State-owned funds	45	4	Project level Equity	51			
5	Multilateral funds	4	5	Equity (other)	155			
6	State-owned Enterprises (SoEs)	13	6	Debt (other)	105			
7	Commercial Finance Institutions	122						
8	Funds	5						
9	Corporations	124						
10	Households & Individuals	55						
	<b>TOTAL</b>	632		<b>TOTAL</b>	632		<b>TOTAL</b>	632

Source: Global Landscape of Climate Finance - Climate Policy Initiative (2021)

As one can observe in Table 1, much of the climate finance — 61 per cent (US\$384bn) — was raised as debt, of which 12 per cent (US\$47bn) was low-cost or concessional debt. Equity investments, the next largest instrument category after debt, came to 33 per cent of total climate finance, up from 29 per cent during the previous period. Grant finance stood at US\$36bn, representing around 6 per cent of the total flows.

It can also be observed that adaptation accounts for less than 10 per cent of the total climate finance flows, with most of the funding going towards mitigation. With the share of emissions from developing countries expected to increase in the next two decades, investments in adaptation will have to be scaled up significantly.

While private finance is the dominant driver of climate investments in developed countries, public finance still accounts for a bulk of investments in the developing world. Therefore, public finance will have an instrumental role to play in catalysing adaptation finance. Innovative models like tailor-made blended finance solutions will be required to mitigate investment risks faced by the private sector.

### **Climate Vulnerability Compounded by Debt Distress**

According to the IMF, 60 per cent of low-income countries are now at high risk of or already in debt distress. Moreover, a growing number of middle-income countries are also suffering from high debt service burdens. Many of these countries are more vulnerable to the impacts of climate change. The impact of COVID-19, further, took a toll on public finances. In many countries, including many SIDA, high public debt service is crowding out a critical investment that is needed for climate-proofing economies and enabling a green, resilient, and equitable recovery. As these countries navigate their way out of the twin crisis, it is important to look for instruments that do not exacerbate the debt distress faced by them. (<https://tinyurl.com/4rcp5yur>)

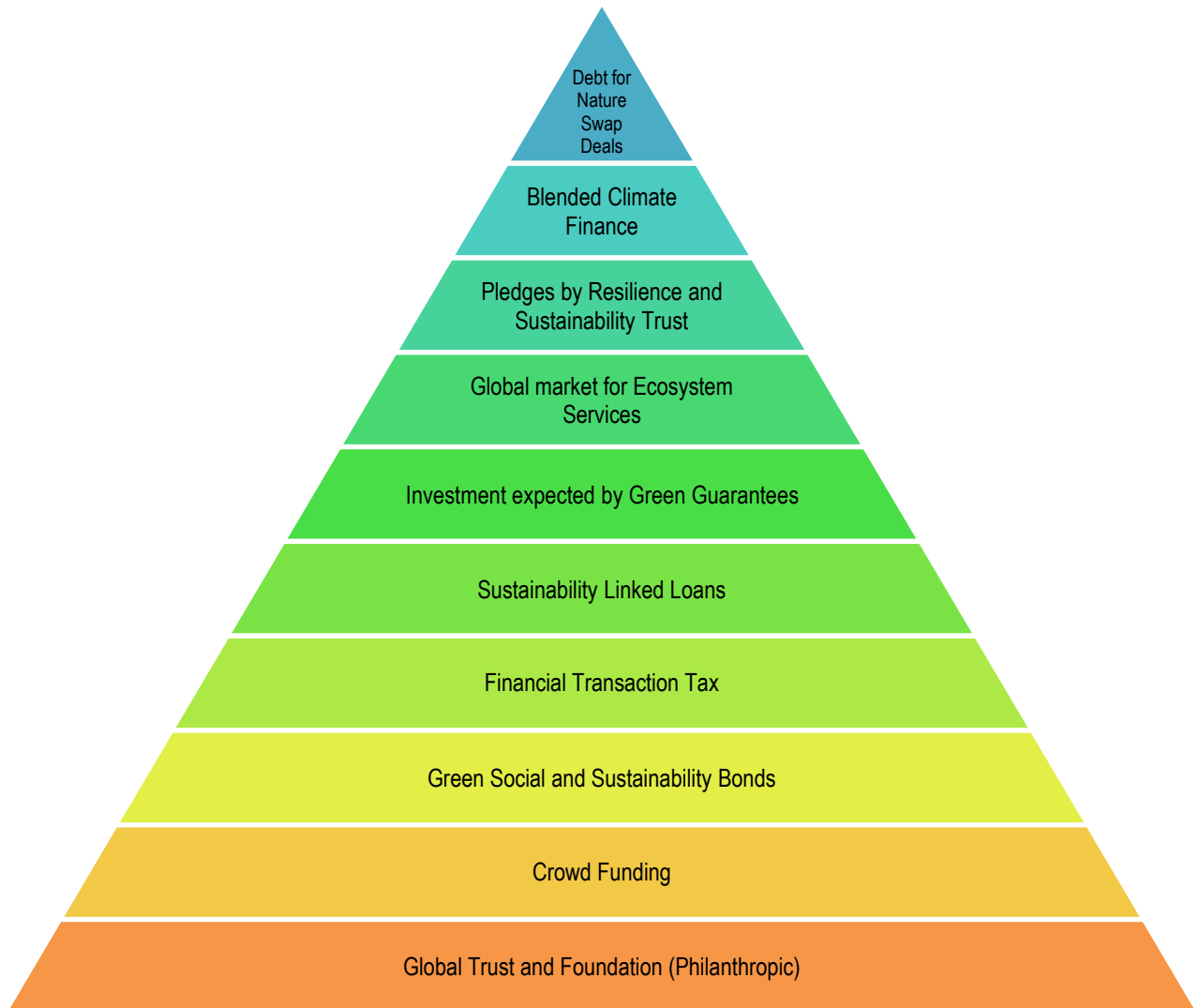
*“People in Africa, South Asia, South and Central America, and the inhabitants of small island states are 15 times more likely to die from climate disasters. These disasters displace three times more people than war. And the situation is getting worse.”*

*– Antonio Guterres, Secretary General of the United Nations – at COP 27*

## Innovative Finance Instruments

Innovative financial instruments refer to a set of unique mechanisms and approaches that can be utilised to generate financial resources toward fulfilling environmental targets. These instruments are designed to unlock access to financial resources from financial institutions, private investors, institutional investors, impact investors, foundations, and other philanthropists, and may be blended with traditional sources of financing. Innovative instruments are characterised by their ability to demonstrate scalable and effective pathways of existing financial flows towards realising the concerned objectives.

**Figure 3: Innovative Sources of Finance – Some Examples**





**Table 2: Innovative Instruments for Environmental Finance**

S. No.	Instrument/Mechanism	Estimated Market Capitalisation/Aggregate Value - 2022
1	Green Social and Sustainability Bonds <sup>1</sup>	US\$3.8tn
2	Sustainability Linked Loans <sup>2</sup>	US\$600bn
3	Global Market for Ecosystem Services <sup>3</sup>	US\$36-\$42bn
4	Investment Expected by 'Green' Guarantees <sup>4</sup>	US\$50bn
5	Pledges by Resilience and Sustainability Trust <sup>5</sup>	US\$40bn
6	Blended Climate Finance - Annual Aggregate Deal Value <sup>6</sup>	US\$7bn
7	Debt for Nature Swap Deals (combined value of all deals to date) <sup>7</sup>	US\$3.7bn
8	Financial Transaction Tax	US\$546bn
9	Crowd Funding <sup>8</sup>	US\$1.67bn
10	Global Trust and Foundation (Philanthropic) <sup>9</sup>	US\$153.96bn
	<b>Total</b>	US\$5243.97bn

- 1 The World Bank, Green Social and Sustainability Bonds – Market Update, 2023 - <https://thedocs.worldbank.org/en/doc/98c3baab0ea4fc3da4de0e528a5c0bed-0340012023/original/GSS-Quarterly-Newsletter-Issue-No-2.pdf>
- 2 LSTA, Sustainable Lending Continues to Surge, February 22, 2023 - <https://www.lsta.org/news-resources/sustainable-lending-continues-to-surge/>
- 3 The global status and trends of Payments for Ecosystem Services, Nature Sustainability, March 12, 2018 [https://www.nature.com/articles/s41893-018-0033-0?WT.mc\\_id=COM\\_NSustain\\_1803\\_Salzman](https://www.nature.com/articles/s41893-018-0033-0?WT.mc_id=COM_NSustain_1803_Salzman)
- 4 Impact Investor, 'Green guarantees to fill the financing gap for climate projects in developing countries, February 06, 2023 <https://impact-investor.com/green-guarantees-to-fill-financing-gap-for-climate-projects-in-developing-countries/>
- 5 Resilience and Sustainability Trust FAQs – International Monetary Fund (IMF) [https://www.imf.org/en/About/FAQ/Resilience-and-Sustainability-Trust#:~:text=As%20of%20October%2012%2C%202022,\(about%20US%2437%20billion\).](https://www.imf.org/en/About/FAQ/Resilience-and-Sustainability-Trust#:~:text=As%20of%20October%2012%2C%202022,(about%20US%2437%20billion).)
- 6 Convergence Blended Finance 2022 - The State of Blended Finance 2022: Climate Edition - <https://rb.gy/1jt4g>
- 7 Insight: Bankers bet billions on new wave of debt for nature deals, November 28, 2022 <https://www.reuters.com/business/cop/bankers-bet-billions-new-wave-debt-for-nature-deals-2022-11-17/>
- 8 Skyquestt. (April 2023). Global Crowdfunding Market Size, Share, Growth Analysis, By Product Type (Reward-Based Crowdfunding, Equity Crowdfunding), By Sales Model (Reward, P@P Lending), By End User (Cultural Sector, Technology), By Deployment (On Premise, Cloud) – Industry Forecast 2023-2030. Retrieved from <https://tinyurl.com/bde3hyze>
- 9 Trust And Foundations Global Market Report 2023: Increases in Philanthropy and Charity Activities Worldwide Bolsters Sector. Available at: <https://finance.yahoo.com/news/trust-foundations-global-market-report-111300105.html>

As indicated in Table 2, a variety of innovative instruments operate in the world today, with valuations running into billions of dollars, even trillions for some. However, scaling of many of these instruments/mechanisms continues to remain a challenge. It must also be noted that the estimated market potential/deal value may not correspond to existing finance flows under these instruments. However, implementing these solutions at a greater scale could help narrow the gap instead of existing finance flows.

An increasing number of firms are adapting their strategies and business models to reduce their exposure to environmental risks, setting net-zero targets to cut their emissions and investing in new products and services to grow in this new economic reality. However, the cumulative impact of their commitments represents a fraction of the required financial flows.

## Recommendations

- 1. Fast-tracking investments with demonstrable sustainability of returns:** The global environmental architecture must develop an overarching framework which facilitates the fast-tracking of investments in sectors which have made gains by integrating sustainability in their operations. Industries with a greater reliance on natural ecosystem services must be nudged to raise their commitments with well-designed instruments of policy support corresponding to specific stages of business operations. A global coalition of such business entities must be created to increase cross-border environmental flows.
- 2. De-risking the investment climate in the least developed countries (LDCs):** It is estimated that losses to nature could cost 2.3 per cent of the global GDP by 2030, while this drop could be over 10 per cent for some of the LDCs. Since most LDCs lack critical financing to support climate-resilient initiatives, global development finance institutions must offer development finance below the prevailing market rates, under a global framework. National governments will have an important role to play in helping identify the optimal risk thresholds to discover appropriate rates.
- 3. Optimising institutional framework for global portfolios to achieve global targets:** The UN-convened Net Zero Asset Owner Alliance (NZAOA) is a member-led initiative of institutional investors committed to transitioning their investment portfolios to net-zero GHG emissions by 2050 – consistent with a maximum temperature rise of 1.5°C. The alliance members have set

intermediate targets, to be fulfilled by 2025 and 2030, including an obligation to align portfolios to reduce carbon emissions by 22-32 per cent by 2025 and by 40-60 per cent, by 2030. (<https://www.unepfi.org/net-zero-alliance/>) Though the alliance members have made notable commitments, including reporting on progress, their efforts must be streamlined with other plans to achieve global targets.

4. **Adopting a programmatic approach, complemented by external assistance:** Future packages of solutions must be based on a programmatic approach to be determined by each country based on its internal assessment. Apart from being more expansive in scope than a project-based approach, a programmatic approach for environmental action allows a long-term pursuit *vis-a-vis* the overall developmental priorities.

Solutions driven by this approach will lead to more impactful policy outcomes in line with a country's aggregate contributions to global environmental action. Global institutions could draw up a long-term roadmap for external financial assistance, linked with the aggregate progress towards meeting global environmental goals.

5. **Creating ecosystems for scaling innovative finance:** Though a variety of innovative instruments have come up over the years, their implementation is yet to be scaled up in lieu of the prevailing finance gaps. Existing platforms/networks to support such instruments need to look at creating more expansive options.

The Global Innovation Lab for Climate Finance network is a public-private partnership, which came into existence in 2014. The network accelerates well-designed financial instruments which can help unlock billions of dollars for climate finance activities. Since 2014, the lab has helped launch 55 innovative instruments, which have unlocked more than US\$2.5bn in climate-related investments. Though the value of investments unlocked so far is relatively small, the network could give a push to a larger bouquet of investments, to be implemented over some time.

6. **Technological transfer for climate mitigation:** It is a process that involves the dissemination of innovative technologies and practices that reduce greenhouse gas emissions and address climate impacts. This process, often occurring from developed to developing nations, is essential in accelerating the adoption of climate-friendly solutions.

7. **Efficient Implementation and Monitoring of the Mission LiFE initiative:** The LiFE initiative was announced at the COP26 in 2021 by India's Prime Minister Shri Narendra Modi, emphasizing individual behavior change for eco-friendly living, aligning with reduction in environmental burden. Sustainable technologies in renewable energy, energy efficiency, waste reduction, and sustainable agriculture are pivotal for eco-conscious lifestyles.

Furthermore, the creation of a 'Pro-Planet People' (P3) network can be strengthened through technology transfer, allowing the sharing of knowledge and solutions to reduce carbon footprints. By integrating technology transfer, Mission LiFE can further empower individuals to mitigate climate change and lead environmentally responsible lives.

### Proposed Framework for Utilisation

As the threat of environmental damage looms large, the world today needs an overarching supporting framework which is transparent and verifiable. A possible solution for monitoring this could be the creation of a **reporting and monitoring framework** under the aegis of the United Nations, based on the recommendations by the transitional committee, constituted to establish a Loss and Damage Fund. A group of experts must be drawn in to administer this framework, from platforms like the Independent High-Level Expert Group on Climate Finance.

- The framework must include a set of criteria to determine the quantum of assistance to be earmarked for countries identified as particularly vulnerable to climate change as well as a roadmap to integrate innovative finance instruments with the domestic policy architecture.
- The overarching framework should cover standards to be followed *vis-à-vis* assessment, channelisation, utilisation, reporting, and monitoring of inflows for each country.
- Each beneficiary country should submit a comprehensive action plan before the UNFCCC, which covers the proposed pathways for climate and biodiversity action, alignment with global commitments, exposure to environmental risks, and requirement of external assistance.
- Global environmental efforts must accord primacy to the prevention of climate-induced losses, instead of compensating these, later. Therefore, investments in

climate-resilient infrastructure must be accorded priority, while determining the level of inflows.

- Specific programmes must be incentivised to strengthen community capacities and disaster resilience, driven by an ecosystem-based approach. Investments in nature represent vital contributions to both resilience-building and emissions reductions. A comprehensive programme-based approach must support the utilisation framework of the proposed flows.
- The **United Nations Environment Programme (UNEP)** is already involved in over 50 ecosystem-based adaptation projects, all over the world. Hence, UNEP's capacities could be utilised to explore similar projects in regions/countries, which face a disproportionate threat on account of climate change.

**The same action points, as mentioned above, could be the template for designing funding solutions for fulfilling biodiversity finance gaps.**

## Conclusion

As the world anxiously stares at the crisis which awaits us, the urgency of action cannot be overemphasised. The huge gaps which separate the availability and requirements of environmental finance must be bridged by scaling innovative finance solutions in the world and deploying the same in the most vulnerable regions of the world. Therefore, a bouquet of such solutions needs to be integrated with the global environmental finance architecture, with an eye on the 'scale' and 'urgency' of realising climate and biodiversity targets. In our collective quest to leave a cleaner and greener world for future generations, the 'pace' of action will prove to be the most critical determinant.

**Therefore, an urgent global response must not only be adequate but also timely**

This Briefing paper is prepared by Jayesh Mathur, Senior Research Associate, and Sankalan Dey, Research Associate, CUTS International.

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