



Concept Note: Emerging Market Climate Investment Compact

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This is the second edition of a note describing a proposed vehicle for significantly accelerating investment in low-carbon projects in emerging markets and developing economies through the use of guarantees to scale the capacity of large, “mainstream” investors and banks to make such investments. The note has been updated to reflect feedback received from a wide range of interested and expert parties since it was originally circulated in May 2023, but all aspects of the proposal remain open for discussion.

Summary

The Emerging Markets Climate Investment Compact (EMCIC) would be a bold agreement between a group of guarantee providers to use this provenly effective instrument to spur private climate investment in emerging markets and developing economies (EMDEs). Using a facility capable of receiving cash and callable capital from governments, philanthropies, and major corporations, EMCIC would provide—during the decade 2025-35—AA/AAA guarantees to major institutional investors and banks covering \$500 billion equivalent of climate mitigation investments in the Global South.¹

The aims of the Compact would be:

- To help kickstart and scale up mainstream institutional investment and lending for climate mitigation in larger EMDEs in the critical decade between 2025-2035.

- To broaden the sectors, technologies, and infrastructure that can be financed beyond just clean energy, to include sustainable waste, transportation, industrial, water, and agricultural investments.
- To help build human and institutional capacity for green finance within global financial centres and national financial ecosystems.
- To the extent possible, to enable lower interest rate loans and/or lower-return-cost investments to entrepreneurs and developers in markets in the Global South (by reducing the risk of the investments/loans through the guarantees).

The use of the word “Compact” in the title is intended to highlight the fact that the EMCIC facility would be a “two-way street.” While investors would enjoy the benefits of the guarantee cover at effectively subsidized rates, they would also need to demonstrate that EMDE climate

¹ Use of the \$ symbol indicates USD or equivalent

investing is being done in a responsible fashion and that the decade-long window of the facility was being used to develop both practice and presence in EMDE climate investing.

Thus to qualify as a firm eligible to be a recipient of the EMCIC guarantees, investors would in turn agree to (1) a set of standards that must be met for a transaction to be guaranteed, including guidelines for due diligence and underwriting, and (2) a small but measurable set of time-specific key performance indicators (KPIs) as to engagement in EMDE investing. These KPIs would require investors, over the course of the Compact, to develop extensive expertise in evaluating emerging market risks; to create financing techniques for new low-carbon technologies and sectors; and to establish a meaningful presence in local markets (either with “boots on the ground” or via partnerships with local financial market actors delivering the same effect).

EMCIC’s ambition would be to attract a set of “anchor” guarantee clients—perhaps fifteen to twenty major global asset owners or managers and commercial or investment banks—each looking to build guaranteed portfolios of \$25 billion to \$50 billion over the course of the Compact. Such anchors would use the guarantee cover to establish local and regional partnerships and to create green finance products for their underlying clients and smaller investment concerns (for example, private equity players).

The main target countries for these anchor clients would likely be larger, low-to-middle- or middle-income emerging markets with better developed private sectors in terms of both business and finance. There is substantial demand for green finance in these markets, as evidenced, for example, by the UK government’s Climate Finance Accelerator (CFA) capacity building program, active since 2021.² The CFA currently operates in nine of the likely markets for EMCIC-guaranteed origination: South Africa, Nigeria, Egypt, Turkey, Vietnam, Colombia, Mexico, and Peru. Since its inception, it has issued nineteen calls for proposals from projects seeking finance. These have resulted in more than 1,200 potentially bankable project and business responses, seeking \$65 billion equivalent in finance. While the largest single sector has been renewable energy, projects have been proposed across the board in the additional sectors mentioned above.

The issue of lack of “pipeline” is frequently mentioned as a key barrier to investment for mainstream investors, but it would appear from the CFA experience that demand, albeit very often “raw,” does exist in the type of coun-

try that EMCIC clients would target for investment. The structure of the EMCIC facility includes features such as those noted above—especially the development of partnerships with local investors and the potential to reduce finance costs—that should help to uncover new sources of pipeline in these countries. In addition to these features, the design of the Compact specifically seeks to address the issue of “bankability” of this pipeline. It does this via a small levy, additional to the guarantee fee, that would be used to help fund initiatives focused on pipeline development, investment readiness and other capacity building measures within local financial ecosystems—including capacity building of policy makers and green finance providers alongside project developers and entrepreneurs.

EMCIC would also encourage participating governments, as shareholders of multilateral development banks (MDBs) and development finance institutions (DFIs), to take steps to give investors the benefit of the specialist origination experience in these institutions, by way of secondments or similar arrangements.

To achieve the necessary AA/AAA rating for its guarantees, EMCIC will need to have sufficient cash resources to meet expected losses and reliable sources of callable capital to cover unexpected losses, all on a timely basis.

EMCIC’s cash capital could be provided from a range of sources, including governments, philanthropies, and major corporations—for example, providing cash capital to EMCIC would be a highly efficient way for oil and gas companies to fulfil some commitments regarding investment in renewables.

Callable capital would need to be provided by highly rated entities, whether governments or otherwise. There are twenty-two sovereigns with ratings of AA/AAA, as well as a number of philanthropic endowments and corporations. Callable capital could also be created in the form of bonds that would allow an even wider set of donors to contribute to EMCIC’s balance sheet. Because the portfolio of guarantees would ramp up relatively slowly over the first couple of years, the program has a type of “built-in” pilot feature, with the cash commitments required from individual contributors being in the low tens of millions of dollars per year at the outset.

The Compact would cover new investments and loans made during its ten-year window, with guarantees of up to 100 percent of the noncurrency risks of investments (though these risks could also be covered in certain cir-

² UK Department for Energy Security and Net Zero, “Notice: Climate Finance Accelerator,” GOV.UK, May 31, 2023, <https://www.gov.uk/government/publications/climate-finance-accelerator/climate-finance-accelerator>.

cumstances, as discussed below). While most guarantees would probably cover debt, equity investments could also be considered for cover. Investments could be made in both hard and local currencies and guarantees could cover both direct and fund investments (for example, funds specializing in certain geographies or certain sectors or technologies).

EMCIC guarantees will only be available for private sector projects and businesses; government projects would not be included since these are already covered by arrangements with MDBs and DFIs. As to the private sector activities of DFIs and MDBs, the likely focus of EMCIC guarantee clients on larger or more developed emerging markets would free up the capital of these public institutions to be used more in smaller and less advanced EMDEs where the kind of returns needed for commercial investment are more difficult to achieve, for example small island states. In this respect, EMCIC fits with the kind of agenda being pursued under the Bridgetown Initiative and clearly delineates the complementary roles of public and private capital for finance climate mitigation.

The mechanics of EMCIC will be as straightforward as possible for investors to use. Having signed up to the due diligence and origination standards required to qualify to use the facility, investors would be able to self-assign guarantees within a set of investment criteria periodically agreed with EMCIC. These criteria, which EMCIC would require to manage the risk of its portfolio at a global level, would address concentrations by type of investment (debt vs equity), country/region, sector, project maturity, etc. As a protection against poor origination, EMCIC would perform *ex post facto* checks on origination standards on a selection of investments. In dealing with any issues arising as a result of these checks, EMCIC would rely principally on a strong in-house dispute resolution capability and would expect to resolve most situations by negotiation. In cases where such resolution was not possible, the facility would, however, have a set of sanctions available to it to deal with cases of breach of contract or abuse including, as is normal in any contractual arrangement, the right to withdraw a guarantee from a particular investment in case of incurable gross negligence or deliberate abuse.

By authorizing guarantees for investments in a portfolio managed globally across diverse geographic regions and technologies, the risk level of the entire EMCIC guarantee pool should be effectively reduced.

EMCIC has been designed from the outset to meet a range of conditions required to mobilize private capital for EMDE climate investment at scale and pace. EMCIC's features will include:

- Ease of access, in keeping with the way private capital owners and managers work.
- Usability for a wide range of investments and in as wide of a spectrum of countries as possible.
- Incentives for private capital through its size and the potential for good returns.
- Incentives for the development of partnerships between local and international capital sources, in particular to help unearth and evaluate local investment opportunities.
- Reduced cost of capital for EMDE businesses and project developers, thus increasing the number of viable projects.
- Capacity building in green finance among investors, investees, and policymakers in local and international markets.
- High leverage potential—experience suggests between 12x and 30x—facilitating extremely efficient use of public funds (and philanthropic or corporate funds).

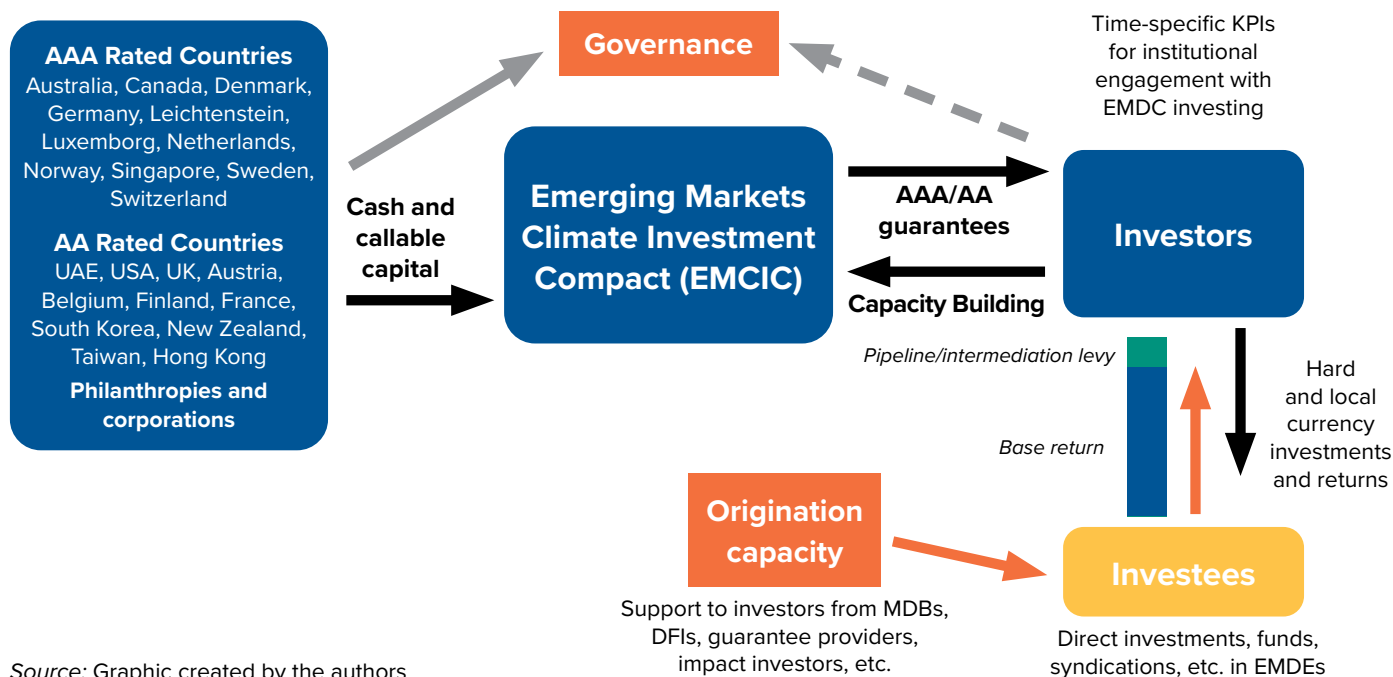
An outline graphic of the EMCIC structure and participating parties is shown on page 4. Where reference is made to “investments,” these include, unless otherwise specified, both equity and debt. A more detailed discussion of the rationale for EMCIC and its key features follows.

Rationale and Need

Major institutional investors in developed country financial centers have little experience in investing in most emerging markets. Only about 5 percent of the \$130 trillion assets under management (AUM) of Glasgow Financial Alliance for Net Zero (GFANZ) signatories, for example, is believed to be invested in these markets (and little of that, probably, in green assets). What familiarity there is with green technologies and green finance techniques, both in developed and emerging market financial centers, tends to be limited to financing renewable power generation. Other low-carbon technologies and infrastructure, and the techniques for financing them, are largely unfamiliar, and there is therefore little or no finance supporting their advancement.

At the same time, strict prudential regulation of institutional investors and conservative mandates from their trustees severely limits their ability to make significant investments that are not rated at least investment grade

EMCIC Structure and Participating Parties



(and often high investment grade). Investments tend to be made out of “wallets” specifically allocated to EMDEs and/or new technologies that are relatively very small compared to the overall AUM of the institutions creating them. Similar constraints apply to institutional investors in the EMDEs themselves. Another constraint on pipeline is the need, because of transaction costs, to focus almost exclusively on large-ticket opportunities.

Finally, mainstream institutional investors have shown very little appetite for getting involved in blended finance arrangements, or for the complexity and long time frames typically encountered in transactions involving MDBs and DFIs. A recent report by the Blended Finance Taskforce, using Organisation for Economic Co-operation and Development data, noted that between 2016 and 2020 some \$26 billion of finance for climate from MDBs and DFIs attracted just \$7 billion of private finance, achieving leverage of just 0.25:1.³ While proposed reforms to these public financial institutions, if successful, may bring about changes in practice and culture, this is likely to be slow and there is no certainty that such changes will in any case attract greater interest from institutional investors.

Because (a) the Compact is aimed entirely at private-sector investments, while the main clients for the MDBs/DFIs are governments and the public sector, and (b) in light of the presently low (and expected to remain so) level of interaction between mainstream investors and the MDBs/DFIs in terms of private sector investment, the EMCIC product would be complementary and additional to the work of the public financial institutions and not competitive with it.

Turning to needs in the EMDEs themselves, because of the perceived risks of investments in renewable and other low-carbon projects in these markets, interest rates/return requirements on investments are very high. As a result, many projects either cannot be financed at all or can only deliver energy or other products at a very high price compared to prices in developed markets where finance costs are lower. This difference in finance costs creates significant equity issues between markets and could prevent developing markets from benefitting from the transition to clean energy. The guarantees provided by the EMCIC—by enabling financing in EMDEs at much more competitive and reasonable interest rates—could help reduce this risk significantly.

³ Carolien van Marwijk Kooij, Jesse Hoffman, and Jeroen Huisman, “Better Guarantees, Better Finance,” Blended Finance Task Force, [Unpublished manuscript].

Mechanics of the Compact

Vehicle

EMCIC would be a vehicle rated at AAA/AA and capable of receiving cash and callable capital from a range of providers. The vehicle could be set up either as an independent entity or housed within an existing multilateral entity. While the latter route is probably the preferable choice, because of the efficiencies it could create in terms of modalities for capital receipts and disbursements, HR arrangements and so forth, the EMCIC facility would need to be remote from the finances of the host entity and have specific governance arrangements separate from those of the host. Stakeholders in governance would mainly be guarantee providers, but there would need to be representation for guarantee users and for civil society, in respect of just-transition issues.

Capitalization and External Ratings

EMCIC would target a high investment grade rating for its guarantees, AA or AAA. To achieve this, it would need to have access to capital enabling it to settle claims on a timely basis both for expected and unexpected losses. It is proposed, therefore, that EMCIC would be capitalised with a mix of cash capital (to cover expected losses over a given period) and callable capital (covering losses beyond those expected).

There is a wide range of potential providers of cash capital. These could include governments (whatever their sovereign rating), philanthropic foundations, and major corporations. The latter might include those looking to advance the expansion of clean industrial processes and supply chains in EMDEs from which they source, alongside, for example, fossil fuel companies that may find EMCIC an efficient way of meeting commitments to help advance renewables and other low-carbon infrastructure.

In terms of callable capital from sovereign funds, there are presently twenty-two entities (plus the EU as a whole) rated AA/AAA by S&P. These are listed below and show a good global spread:

- AAA rated: Australia, Canada, Germany, Sweden, Denmark, Norway, Switzerland, Singapore, Netherlands, Liechtenstein, and Luxembourg.
- AA rated: United Arab Emirates, United States, United Kingdom, France, Belgium, South Korea,

Austria, New Zealand, Taiwan, Finland, and Hong Kong.

Many philanthropic foundations and global corporations also have high investment grade ratings.

Bond issuances, aggregating a number of parties wishing to help capitalize EMCIC, including smaller players, could also be used to provide callable capital. The principal of the bond issuance would be made available as callable capital and would earn a return from (a) its investment in highly liquid AAA assets and (b) a share of the fees from guarantees issued as a result of this source of capital being available. Needless to say, such a bond would be a high-risk investment and investors, knowing there could be a high probability of some of their principal being eroded, would be seeking a return via the global goods EMCIC would be delivering in terms of scaled climate investments in EMDEs. One possibility could be for investors with a higher risk appetite (for example philanthropies and sovereigns) to invest in junior tranches of a structured issuance, with private investors taking more senior positions.

EMCIC's cash capital would also be invested in liquid AAA assets, earning a small return too. The facility's ability to receive cash and callable capital pledges from a wide range of providers (sovereigns, philanthropies, corporations, and bond issuers) will help to guard against short-term rating or budget issues in any one provider, especially sovereigns. Conversely, it may be that additional sovereign callable capital guarantors could be added if the ratings of other wealthy countries beyond the present set of twenty-two improve over time.

With regard to philanthropic capital contributions, the ten largest endowments in the world have over \$350 billion of wealth, and many are already engaged with climate and just-transition issues.⁴ There have already also been instances of endowments using their high credit ratings for financial innovations, for example a debt conversion facility for the Seychelles to finance protection of its marine environment, supported by the balance sheets of The Nature Conservancy and other philanthropies.⁵

Major/multinational corporations could also contribute to the cash or callable capital of EMCIC. Such investors would have an interest in climate solutions being implemented in EMDEs where they have operations or supply chains. Contributions by fossil fuel companies from re-

⁴ <https://www.swfinstitute.org/fund-rankings/foundation>

⁵ The Nature Conservancy. "Seychelles Protects 158,000 Square Miles of Ocean." The Nature Conservancy, March 16, 2018. <https://www.nature.org/en-us/about-us/where-we-work/africa/stories-in-africa/seychelles-conservation-commitment-comes-to-life>.

cent windfall profits would give them a way of meeting commitments on investment in renewables.

Since the institution-level portfolios created by the EMCIC guarantees would be a new asset class, it is unclear at this point what approach rating agencies would take to assessing them, for example, with regard to the effects of including or not including currency volatility risk in the guarantees provided. This would need to be worked through in the feasibility stage of the development of the EMCIC concept, as would the approach taken by the internal ratings models of banks and investors, and by regulators.

If currency risks needed to be covered in certain instances to avoid significant “haircuts” to the EMCIC guarantee, then such guarantees could be made available but probably at a higher cost, for example through a partnership with EMDE currency hedge provider TCX. TCX, which now has a proven business model and already provides cover for one hundred currencies, is looking to significantly scale its operations.

Origination Standards and Engagement KPIs

The ambitions of guarantee providers for the EMCIC facility will be twofold:

- To use demonstrably the best risk mitigation instrument yet seen—guarantees—to speed and scale up climate investments in EMDEs, but to do this in a way that ensures value for money in the use of public funds and guards against moral hazard (i.e., the risk that guarantees will be used carelessly by investors).
- To ensure that investors are using the ten-year “window” created by the facility to significantly improve their understanding of, and engagement with, both EMDE investment and investment in technologies beyond renewables, so that the need for guarantees decreases over time as experience grows.

To qualify for participation in the EMCIC guarantee facility—and thus the opportunity to make investments that are likely to be significantly profitable over the course of the Compact—investors would therefore need to commit to two undertakings:

- A set of standards for originating investments, to guard against moral hazard.
- A set of time-specific but quite broadly defined KPIs demonstrating that they were taking steps to increase their engagement with EMDE investment and new products.

The standards for originating investments would essentially require investors to originate with the same care and attention as they would if not covered by guarantee, and would in any event reflect the standards adopted by any responsible investor. They would include quality of due diligence and underwriting, quality of counterparties, and the use of normal commercial insurance and hedging products where available. Such commitments are routinely required of arrangers of, for example, “blind pool” investment vehicles such as revolving securitizations. Mainstream investors less familiar with EMDEs could be assisted in meeting these standards by the transfer of knowledge from MDBs and DFIs, as discussed below.

Once qualified for the EMCIC facility, and subject to the agreed investment criteria described below, investors would be able to assign guarantees to investments on a notice-only basis to EMCIC, that is, without EMCIC itself conducting due diligence on the proposed transaction. This feature of the facility would be designed to avoid the very lengthy and costly process of risk-mitigation providers being involved in due diligence on a deal-by-deal basis, as typically happens in transactions using blended finance from MDBs and DFIs.

Instead, to protect against carelessness or even abuse of its origination standards, EMCIC would conduct *ex post facto* spot checks on adherence to investment criteria and origination standards, and would have a set of sanctions it could apply to correct failings. These might include, for example, the right to charge higher fees for its guarantee on the relevant transaction, or even, in cases of recklessness or egregious abuse, the right to withdraw its guarantee from an investment reasonably found to have been improperly originated. The rest of an investor’s EMCIC-guaranteed portfolio would not be affected by such withdrawal.

The “engagement KPIs” to be agreed by investors would be designed to create the best possible chance that, by the end of the Compact period, they will have the confidence, ability, and relationships necessary to invest in EMDEs without continuing support, or with much less support.

There would be milestones for progress in the decade during which the Compact is active, for example after two, five, and eight years. KPIs would be limited in number and as easy as possible to measure and might include, for example:

- Staff numbers engaged in EMDE investing, including in-country staff.
- AUM invested/loans made/bonds issued.

- Development of partnerships with local investors and banks (e.g., coinvestment vehicles with local investors, “club deal” loans, regional funds, etc).
- Use of blended finance.
- Sectors and technology types invested in.
- New financing techniques/products generated.

Investors that materially fail to meet progress targets, even after a correction period, could be removed from the Compact and required to exit investments in a responsible way. In such cases guarantees would remain in place until this was done and then transferred to the new owner, if EMCIC-qualified.

Investors would also be expected to respect high market standards in the origination and administration of assets in terms of environmental and governance protocols, gender, equality and social inclusion principles, treatment of indigenous peoples, etc. EMCIC will use standards that will be determined during the feasibility stage of the program.

As noted above, EMCIC would be aimed principally at large, developed market institutional investors and banks as its “anchor” clients, each looking to have portfolios of \$25 billion to \$50 billion covered by the Compact over time and acting as “hubs” to attract partnerships with local actors and smaller investors. The good names of these anchors would be important in maintaining the investment standards described above, since the reputational risk to them of being seen to have a guarantee questioned or even sanctioned would be significant.

Investment Criteria

EMCIC will determine a set of criteria for eligible investments, revised from time to time (with respect to new guarantees) to adapt to portfolio outcomes, technological advances, and geopolitical developments, etc. Criteria would include characteristics of investments such as the type of instrument (debt, equity, blended), sector/technology, jurisdiction, structure (direct/fund), and life stage of company/project. Portfolio management would be conducted via standard techniques to achieve diversification, such as concentration limits.

Investment criteria at the EMCIC global portfolio level will be translated down to a regional and anchor user level and agreed with such anchor users in respect of the composition of their own portfolios on a periodic (e.g., yearly) basis. Guarantee users will be responsible for respecting the agreed criteria, which, as noted above, will be spot-checked by EMCIC.

An important factor in developing investment criteria will be reference to theationally determined contributions (NDCs) and other low-carbon transition strategies of the EMDEs where investments are mainly taking place. A part of the governance structure of EMCIC will be an advisory board comprised of representatives of these countries. However, to keep the Compact attractive to anchor clients who value speed and flexibility, and recognizing that EMCIC would only be one component of overall country-level climate investment efforts, target geographies will be mainly investor led. This in turn would likely mean that the initial targets for EMCIC clients would be larger emerging markets with better developed private sectors (both business and financial) where they have the best chances to find (a) experience local financiers as partners, (b) co-investment capital, and (c) pipeline that could reasonably quickly be brought to investable status.

As noted above, the use of EMCIC capital to guarantee investments made in more “approachable” emerging markets would free up the capital of public financial institutions to focus on more difficult markets (because of size of state of development) where their origination expertise would be best used and where blended finance could be employed alongside specialist private sector investors (impact funds, etc.) to overcome issues of lack of fully commercial returns. Such an outcome would be in line with proposed MDB/DFI reforms (including greater risk appetite) and the agendas of initiatives such as Bridgetown.

Level and Application of Guarantees

EMCIC’s objective will be to overcome sovereign ceiling and similar current barriers to EMDE investment. Broadly speaking, therefore, its principle in providing guarantees will be to do so at whatever level allows investments to be rated at investment grade (i.e., from BBB to AAA) either by investors’ internal risk models/committees or external agencies. Guarantees might thus be up to 100 percent cover of both principal and interest and, in the case of equity investments, potentially returns as well (see below), with the nature of risks covered also being as extensive as required to achieve investment grade. Costs would differ depending on the level of guarantee provided, and the risks covered, but in order to reduce complexity and avoid deal-by-deal pricing, the range of risks would probably need to be relatively standardized. Such modalities will be explored at the feasibility stage.

Over time, as the experience of investors in EMDEs and with new technologies grows, it would be likely that the levels of guarantee needed would decrease, incentivised by lower pricing alongside greater confidence about true risks.

Qualifying investors making eligible investments will need to be able to label these risks and include them in a specific EMCIC portfolio. A critical feature of EMCIC is that it will aim to include equity investments. Where these are made, and in order to protect guarantee providers, including donors of public funds, from excess returns being enjoyed, a mechanism would be developed to look at claims on guarantees at a portfolio level. This mechanism might, for example, use an agreed “hurdle rate” on returns at a portfolio level to allow excess gains on one investment to be set against losses on another.

Claims on guarantees would be made on the basis of project losses and to the standards of immediacy required by EMCIC’s high rating. Before making any guarantee claims, investors would need to be able to demonstrate that all available remedial measures to avoid or reduce losses had been taken. EMCIC would have a strong internal dispute resolution capability, giving it the capacity to negotiate effectively with investors. It would also, however, rely appropriately on existing dispute resolution mechanisms where available.

Where appropriate, because of the nature of the project, investors would also be expected to withdraw investments from the guarantee scheme as soon as possible, in order to free up headroom for new guarantees. For example, infrastructure assets with long operating lives should be able, once construction and early operation risks are passed, to be refinanced into green bond markets with no or far lower levels of guarantee being needed.

Ramp-Up Period

EMCIC’s portfolio-building would likely start at around \$10 billion to \$20 billion in the first two years and then accelerate to \$50 billion to \$75 billion annually during the middle and later years of its ten-year window. One effect of this ramp-up pattern will be to limit the amount of cash required from donors supporting the Compact in the early years, especially with cash capital to meet expected losses.

For illustration, if guarantee issuance in years one to three was \$10 billion, \$20 billion and \$35 billion respectively, and there were ten, then fifteen, then twenty shareholders of various kinds (sovereigns, philanthropies, corporations), cash required per shareholder to cover expected losses at 7 percent (or 5 percent net after guarantee fees) would be \$50 million, \$67 million, and \$87.5 million in those years.

This ramp-up period would create what would effectively be a pilot phase for EMCIC, with the ability to assess early demand and to review adherence to origination

standards and other features of the program and make corrections as needed.

Pipeline and Capacity Building

The returns from investments (especially those in local currencies) are expected to be considerably higher than the cost of the guarantees on them, which creates an arbitrage opportunity for investors. A very small part of this arbitrage could be used, through a levy or similar mechanism, to meet two important needs for the market for EMDE investments as a whole:

- Developing new pipelines of investments, via accelerators, project readiness funds and other technical assistance to developers and entrepreneurs.
- Building green finance capacity in both financial institutions and governments/regulators in both developed and emerging markets, including intermediation capacity.

The proposed levy would be charged only on first issuance of a guarantee. Because of the size of the overall EMCIC portfolio, the levy would be very small in percentage terms and could decrease over time. For example, a levy of just five basis points on a year one issuance of \$10 billion of guarantees would create a capacity building fund of \$50 million. If issuance in year three were \$35 billion, then a levy of just three basis points would create a fund of \$105 million. This fund could be deployed through the many technical assistance and capacity building programs that already exist but are often underfunded, and would represent a private sector contribution to what is a critical activity for developing investable project pipelines. Official Development Assistance (ODA) budgets saved could be redeployed instead, for example, to grant funds for start-up companies, which are scarce to nonexistent in many EMDEs.

Aids to Origination

Whilst there will always be political and other unpredictable risks associated with EMDE investing, the level of call upon guarantees will likely depend most heavily on the quality of the origination of investment assets. Although institutional investors in developed markets are typically not well versed in EMDE risks and opportunities, there are a wide range of parties that are familiar with these risks and have learned how to approach and mitigate them over many decades. These include local private equity and venture capital investors in certain markets, impact investors, DFIs, MDBs, and other multilateral initiatives such as the World Bank’s Multilateral Investment Guarantee Agency (MIGA). There are also multilateral

guarantee providers that have operated specifically in the infrastructure sector for many years, for example the Private Infrastructure Development Group (PIDG) and its subsidiary InfraCo Africa.

The engagement KPIs that EMCIC clients will sign up to will encourage partnerships with experts in EMDE investing. In addition, since the shareholders of DFIs, MDBs, and guarantee providers will, however, also likely be among the main guarantee providers for EMCIC, it would be in their interest to harness the very considerable EMDE investing experience housed in these entities to ensure the best possible quality of assets generated for guarantee by EMCIC.

The experience within public institutions could be made available to EMCIC-guaranteed investors via, for example, secondments of staff or the provision of “origination-as-a-service” by these institutions. Under the latter arrangement, DFIs and MDBs would originate assets on behalf of private sector investors rather than putting them on their own balance sheets—itself a far more leveraging approach than the public entities originating and then holding the assets.

An entity like PIDG or MIGA, for example, with their broad and deep understanding of providing EMDE guarantees, could also be brought in to provide an ongoing assessment of the risk levels in the overall EMCIC portfolio, and to help determine adjustments to permitted investment criteria and guarantee pricing as required to keep expected losses (and therefore guarantee calls) at an agreed level.

Currency

One risk that could probably not be easily covered by the EMCIC guarantees is currency volatility. In some emerging markets, hedging products may be available, although these are likely to be quite short term and expensive in many cases.

To promote the use of local rather than hard currencies for investments (especially those relying on revenue streams in local currency to service debts or pay returns), EMCIC could look at partnering with a provider of more “exotic” currency hedging products such as TCX.

Founded by a number of DFIs in 2007, TCX currently provides hedges in one hundred currencies. A partnership with a facility such as EMCIC would provide TCX with a ready market for its products among guarantee users, and TCX has expressed its potential interest in such arrangements.

Governance

EMCIC would be governed by its cash and callable capital providers as shareholders or some equivalent designation depending on the entity’s legal form.

Investors entering the Compact would be able to provide input on the development of EMCIC’s strategy, investment criteria, and operational management via an advisory committee or similar arrangement, as could the EMDEs principally being invested in at any given time. It may also be useful for representatives of EMDE transaction support providers (e.g., rating agencies and export credit facilitators) to be engaged at an advisory level. Representation of civil society should also be provided for, especially with regard to just-transition issues that will arise in determining EMCIC’s strategy and policies from time to time.

EMCIC’s Roles and Staffing

As noted above, EMCIC would not oversee or approve guarantees at a project level, but rather an institutional portfolio level. In line with this, it would have the following key roles and capacity requirements:

- Setting origination standards, engagement KPIs and investment criteria, and revising these periodically.
- Portfolio management and monitoring at the EMCIC level.
- The ability to check, on a spot basis, adherence by investors to investment criteria, portfolio management, and origination standards.
- Checks on progress made by investors toward their engagement KPIs, and dealing with any shortfalls in performance in this respect.
- Dispute resolution with investors.
- Appropriate treasury and financial/guarantee management capabilities, including, for example, investment of cash assets and the disbursement of capacity building levy monies.

Tasks such as administration of guarantees could be sub-contracted to existing providers.

For indicative purposes, a set of roles such as the above might involve a staff of one hundred and (given the mainly high levels of skill and experience required) annual costs of \$250,000 per staff member (including premises etc.). This would require a total budget of \$25 million per

year, which would be provided from the guarantee fee. It should be noted that, assuming an average guarantee fee of 2 percent, such a budget would be largely covered by the first \$1 billion of guarantees issued in any given year.

Costs to Guarantors and Leverage Achieved

The cost to those providing cash capital backed by callable capital to the EMCIC vehicle will be the losses incurred on the portfolio less the price paid for the guarantees (plus the operating costs of EMCIC, which as just mentioned are *de minimis* in relative terms). Thus, if losses were 5 percent and the average price of guarantees 2 percent, the net loss would be 3 percent. On \$500 billion such a loss rate would equate to \$15 billion over the ten-year program period, providing a 33x leverage of public funds. At 10 percent (or 8 percent net) losses, the losses would be \$40 billion, providing leverage of 12.5x.

Given that the leverage typically achieved via DFI/MDB climate finance is, as noted with reference to the Blended Finance Taskforce report cited above, only 0.25:1, these loss rates would equate to orders of magnitude greater than the leverage usually seen via blended finance.

The best estimates for expected default and loss rates would be provided by the rates observed by MDBs and DFIs on their private sector investments. These are not publicly available but could presumably be accessed by shareholders. To give some indication for potential loss scenarios from public sources, a 2022 paper from the Center for Global Development estimated that the United States could achieve leverage ratio of 11:1 in bond issuances on a subsidy outlay of \$2 billion on a country portfolio very similar to the likely EMCIC portfolio, suggesting a theoretical loss rate of 9 percent.⁶ However, the paper also noted that there had never been a claim against a US sovereign bond guarantee in a long-running program including countries of the same credit quality as contemplated for EMCIC. MDB/DFI private-sector losses are believed to be much lower than this rate.

A range of mitigants embedded in the EMCIC approach should also actively contribute to minimizing losses. These include:

- The wide range of investments covered, going far beyond just infrastructure projects. These would include, for example, loans to mature corporates

in EMDCs to green their production processes or product lines.

- Ability to adjust investment criteria for new guarantees periodically.
- Active portfolio management at the EMCIC level, in particular via concentration limits, assisted by massive geographic and sectoral diversification.
- Guarantees provided at an institutional portfolio level, so that certain gains in each portfolio offset losses when making claims.
- Imposition and monitoring of origination standards.
- Requirement to use commercially available insurance/hedging at a project level where reasonably available.
- Transfer of DFI/MDB origination skills.
- Creation of better quality pipelines via accelerator and other capacity-building initiatives funded by the investor “levy.”
- Currency hedging available to investors via a potential partnership with TCX.

It should be noted that the intention would be to have many shareholders in EMCIC, meaning that no one investor should have more than, for example, a 5 percent to 10 percent liability. At 5 percent losses this would equate to \$1 billion and \$2 billion over ten years.

Even at very conservatively high loss assumptions, EMCIC guarantees would provide an enormously effective use of public, philanthropic, and corporate-social-responsibility funds compared to traditional blended finance approaches. Indeed, the highly leveraging effect of the private capital flowing through the EMCIC vehicle may also serve to save sovereign outlays by reducing the need to increase the publicly funded balance sheets of DFIs and MDBs themselves.

Finally, the leveraging effect of EMCIC would be seen not just in terms of high levels of private finance mobilized, but also in terms of a massive increase in emerging market investment skillsets within mainstream investing, significant development of global/local investor partnerships, and strong improvements in pipeline building and

⁶ Scott Morris, Alan Cameron, and Rowan Rockafellow, “Greening the US Sovereign Bond Guarantee Program: A Proposal to Boost Climate-Directed Sovereign Finance in Developing Countries,” Center for Global Development. Center for Global Development, February 2022, <https://www.cgdev.org/sites/default/files/greening-us-sovereign-bond-guarantee-program-proposal-boost-climate-directed-sovereign-paper.pdf>.

capacity in local markets via the “sidecar” initiatives mentioned above.

Next Steps

The EMCIC concept was first circulated in May 2023 and has since been the subject of initial discussions with a wide range of potential providers of capital and end users of guarantees. Their extensive and valuable feedback has been incorporated into the structure and features of EMCIC set out in a second edition of the long-form note. The authors believe that (as evidenced also by a recent Atlantic Council briefing on the topic of guarantees) EMCIC is the largest and most-developed portfolio-level guarantee proposal presently under discussion in relevant circles, and that it has significant support among the stakeholders thus far engaged.

The next stage in the development of EMCIC will be a detailed feasibility stage, which would need to address key features of the proposal such as:

- Overall size and duration, ramp-up period, etc.
- Likely loss rates and consequent guarantee fee levels.
- Potential providers of cash and callable capital and modalities for receiving capital and meeting claims.
- Suitable initial target countries and sectors.
- High-level investment criteria and origination standards.
- High-level KPIs for EMDE engagement.
- Legal form and “housing” of EMCIC, and law to be applied, etc.

- Operational costs.
- Governance.

Resources to model the facility have been secured, so the main requirement for the feasibility stage would be to build a small team of experts to address the issues mentioned above. Such experts could ideally be seconded *pro bono* with part-time work (perhaps two days per month) done remotely from interested parties—and such parties are therefore requested to come forward with potential offers for team members.

If the feasibility stage could be completed by the end of 2023, then the aim would be for EMCIC to be incorporated and staffed during 2024, with a view to its relatively small initial funding being in place ready for the start of operations in 2025.

About the Author

Ian Callaghan is a project and investment banker by background, with project finance experience including the £20 billion Eurotunnel facility. He was one of the pioneers of developing country impact investing, which he has been involved with since 2005. He has specialized in EMDE climate finance since 2015 and is engaged both as an intermediary in transactions and as the co-founder of the Climate Finance Accelerator. This is a UK government capacity building program, presently operating in nine larger emerging markets in Asia, Africa, and Latin America, to which he acts as adviser.

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