GSG
Driving real impact

Financing SDGs in emerging markets

The role of Green, Social, Sustainability and Sustainability-Linked (GSSS) Bonds

August 2023

About the GSG

GSG Driving real impact

The GSG (Global Steering Group for Impact Investment) brings together influential stakeholders from the private and public sectors to collaborate on its mission to shift economies to deliver positive outcomes for all people and the planet. To achieve this objective, the GSG innovates, agitates, advocates, and orchestrates an effective and diverse global impact movement in close partnership with the National Advisory Boards (NABs).

The GSG's NABs currently cover over 36 countries, with more than 20 countries on the way to establishing their own NABs. A NAB is a local platform representing all the stakeholder groups needed to redirect significant capital flows towards positive social and environmental impact. Private-sector led, yet in close partnership with national governments, NABs create awareness and market intelligence, help change policies, and mobilise additional financial resources for public good. The GSG and its community is active in over 50 countries and partners with many organisations at the forefront of the impact sector.

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Summary

$3.8 trillion
is the size of the GSSS bond market

$4 trillion
is the size of the annual SDG financing gap

15%
share of bonds issued in developing countries

Green, Social, Sustainability and Sustainability-Linked (GSSS) Bonds could play a key role in helping developing countries fund progress towards the sustainable development goals (SDGs) and a Just Transition to Net-Zero. The market has grown exponentially since its inception, to reach $3.8 trillion at the end of 2022, and could help fill the growing financing gap. Use-of-proceed bonds ensure that issuers allocate the proceeds towards impact, while newer but fast-growing Sustainability-Linked Bonds go a step further by encouraging issuers to develop holistic sustainability strategies, and increasing transparency. GSSS bonds could help mobilise capital at scale and reduce the cost of capital for SDG-related projects, but issuance in developing markets only make up 15% of the global GSSS bonds market. To harness their full potential, it is essential to build a track record to demonstrate feasibility, de-risk investments to make opportunities in developing markets viable for commercial investors, improve issuer capacity, develop bankable project pipelines, reduce the cost of bond issuance, address impact washing concerns, and harmonise standards.

This paper identifies recommendations on how issuers, private sector investors, policymakers, and development finance institutions (DFIs) can support the growth of GSSS bond markets in developing countries.

Recommendations

ISSUERS

1. Pick instruments carefully
2. Align frameworks with existing standards
3. Adopt good reporting practices
4. Involve third parties

PRIVATE SECTOR INVESTORS

1. Integrate GSSS bonds in developing markets into the investment strategy
2. Assess bond frameworks against recognised standards
3. Actively engage with issuers
4. Design products tailored to developing markets

POLICYMAKERS

1. Issue sovereign bonds to demonstrate feasibility
2. Develop and harmonise standards and taxonomies
3. Reduce transaction costs through tax exemptions and subsidies
4. Stimulate demand and issuance through mandatory requirements

DEVELOPMENT FINANCE INSTITUTIONS

1. Provide anchor funding
2. De-risk investments
3. Build stakeholder capacity
4. Facilitate market connectivity

Table of Contents

Introduction 4

PART I | **Overview of a growing market** 4
1. What are Green, Social, Sustainability and Sustainability-linked Bonds? 4
2. Key trends and drivers in the GSSS bonds market 6
3. Towards better use of proceeds for more impact 10

PART II | **A promising solution to finance SDGs in emerging markets** 11
1. An opportunity for developing countries… 11
2. … still to be harnessed 13

PART III | **Ecosystem recommendations** 15
1. Issuers 15
2. Private sector investors 16
3. Policymakers 17
4. Development Finance Institutions 19

Sources 21

Introduction

$30 trillion of new investment is needed over the next eight years if the SDGs are to be achieved by 2030.

Mobilising capital to fund progress towards the sustainable development goals (SDGs) and finance a Just Transition to Net-Zero is becoming more crucial than ever. More than $30 trillion of new investment is needed over the next eight years if the SDGs are to be achieved by 2030. By increasing financing needs and decreasing availability of resources, the COVID-19 crisis and war in Ukraine have had a magnifying effect on the growing funding gap. Green, Social, Sustainability and Sustainability-linked (GSSS) Bonds have gained traction over the past years and can help bridge the SDG and climate financing gap. However, they remain rare in emerging markets, where they are the most needed.

This paper aims to synthesise the fast-growing body of research on GSSS bonds and identify ways to catalyse and scale their adoption in developing countries. Part one provides an overview of the GSSS bonds market. Part two explores GSSS bonds' potential to mobilise impact finance for developing countries and the barriers to their uptake in emerging markets. Finally, part three provides recommendations for issuers, private sector investors, policymakers, and development finance institutions (DFIs).

PART I Overview of a growing market

1 What are Green, Social, Sustainability and Sustainability-linked Bonds?

Sometimes also referred as ESG bonds, GSSS bonds is a new asset class that comprises two main types of instruments:

- **Use-of-proceed bonds** are fixed-income securities that fund projects with a specific thematic focus and dedicated environmental and/or social benefits. Also referred to as thematic or labelled bonds, they include Green Bonds, which intend to generate a positive environmental impact, Social Bonds, which aim to raise funds for projects with an expected positive social outcome, and Sustainability Bonds, which support a combination of green and social activities. The Green, Social and Sustainability (GSS) bond market started over a decade ago with the issuance of the first labelled green bond by the World Bank in 2008 (World Bank, 2022). They are now a highly diversified asset class financing themes ranging from reforestation to women's empowerment (See Box 1).
- **Sustainability-Linked bonds** (SLB) are a newer addition to the sustainable debt asset class. Kick-started in 2019 by Italian energy group ENEL, SLBs introduced results-based finance principles to the bond market (Lester, 2022). They are pay-for-success instruments: proceeds are not earmarked for specific projects or expenditures, but the issuer commits to meeting predefined key performance indicators within a timeline for defined sustainability policies and actions (ICMA, 2020). Depending on the structure, the issuer

may face a penalty for failing to meet the target, such as a coupon step-up or obligation to purchase offsets, or be rewarded for meeting them, for instance through a coupon step-down (Dembele and Horrocks, 2021). SLBs can be used by individual organisations, but also by governments to finance country-level transition (See Box 2).

BOX 1 // EMPOWERING TANZANIAN WOMEN THROUGH A USE-OF-PROCEED BOND

While women make up more than half of Micro-, Small and Medium Enterprises (MSMEs) in Tanzania, they have struggled to obtain access to financing. In 2022, NMB, a large commercial bank, issued the first gender bond in sub-Saharan Africa. Proceeds are exclusively used to finance their 'Jasiri' programme, which aims to provide loans to women-led MSMEs to further gender equality (SDG 5) and reduce inequalities (SDG 10). Issued with technical assistance from FSD Africa, the bond was reviewed by Sustainalytics and listed both domestically and on the Luxembourg Stock Exchange. It was oversubscribed by 197%, allowing the bank to raise $30 million and diversify its sources of financing (UN Women, 2023). Proceeds enabled NMB to issue 3,205 loans to female-owned enterprises (NMB, 2023)

BOX 2 // FINANCING URUGUAY'S ENERGY TRANSITION WITH A SOVEREIGN SUSTAINABILITY-LINKED BOND

In 2022, the Republic of Uruguay issued a $1.5 billion sovereign sustainability-linked bond to finance its green transition. The bond's interest rate depends on the country reaching two Specific Performance Targets (SPTs) linked to quantitative goals set for 2025 in Uruguay's National Determined Contributions to the Paris Agreement.

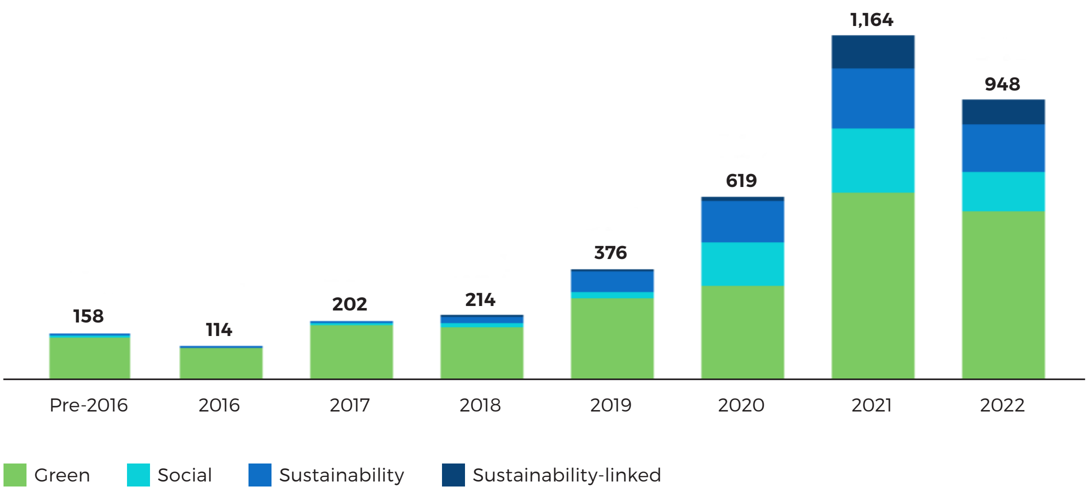
The adjustments will be triggered by performance against two indicators, the reduction in greenhouse gas (GHG) emissions by unit of GDP (in %) and the preservation of native forests (in hectares). Two SPTs are set against each indicator: Uruguay will face a step-up coupon if it fails to meet the minimum target, and be offered a step-down coupon if it manages to achieve an outperformance target. To assess performance, Uruguay will report GHG emissions on an annual basis, and conduct satellite imaging mapping of forests every four years. UNDP will provide an independent external verification (Ministry of Economy and Finance of Uruguay, 2022).

The bond was 2.6 times oversubscribed and attracted 188 investors, of whom 21% were new to Uruguay's bond market, and enabled Uruguayan sovereign debt to achieve an historically high credit rating of BBB+ (IDB, 2022).

2 Key trends and drivers in the GSSS bonds market

Since its inception, the GSSS bond market has grown exponentially, to reach $3.8 trillion at the end of 2022. In only a decade, annual issuance has increased by a factor of more than 140, to reach 1,164 in 2021 (World Bank, 2022, World Bank, 2023). In 2022, issuance decreased for the first time due to challenging market conditions for bonds, but the downsize was less pronounced than in the overall bond market (Moody's, 2022). The pace of issuance is expected to increase again and GSSS bonds to grow their share of the global bond market, which could hit 14-16% of the global bond market (S&P Global, 2023, ICMA, 2020).

FIGURE 1 // **Global GSSS Bond Market, Annual Issuance 2012-2022 (USD Billion)**



Source: World Bank based on data from Bloomberg and Bloomberg NEF

57%

of cumulative bonds to date are Green bonds

Green bonds dominate the market, but sustainability-linked debt instruments are fast-growing. Green bonds make up 57% of cumulative bonds to date (CBI, 2022a), although their share has been decreasing. The COVID-19 crisis had a catalytic effect on Social bonds, which jumped nine-fold from 2019 to 2020 (Lester, 2021). Sustainability bonds, which are especially well suited to supporting a Just Transition by integrating social considerations into green bonds (Impact Investing Institute et al., 2021), have also grown significantly and make up 19.3% of bonds issued to date. Sustainability-Linked Bonds (SLBs) represent 5.5% of GSSS bonds and are almost exclusively issued by corporates. Reflecting the momentum gained by paid-for-success debt instruments (See Box 3), SLBs have been the fastest-growing asset class of the environmental, social and governance debt market (CBI, 2022a, Isjwara, Tanchico and Lozano, 2022), before slowing down in 2022 amidst growing scrutiny from investors and concerns around impact washing.

However, SLBs are likely to continue to grow in popularity as market standards and solutions are developed to address these new instruments' challenges (World Bank, 2022, Lester, 2023c). For example, the World Bank is developing a framework to help assess the feasibility and ambition of performance indicators (See Box 4). And regulators in key jurisdictions such as the EU, the US and the UK are actively monitoring the sustainability-linked market to evaluate the need for regulatory change (Stango, Goldberg and Budreika, 2022, EBA, 2023, FCA, 2023).

BOX 3 // **WIDER TRENDS IN RESULTS-BASED FINANCING (RBF)**

SLBs are part of a growing family of financial instruments that tie funding to results. Also referred to as outcome-based or performance-based financing, results-based finance reflects a shift in focus from inputs to outcomes. This change in mindset can not only be observed in public procurement and philanthropy, but also increasingly within the private sector.

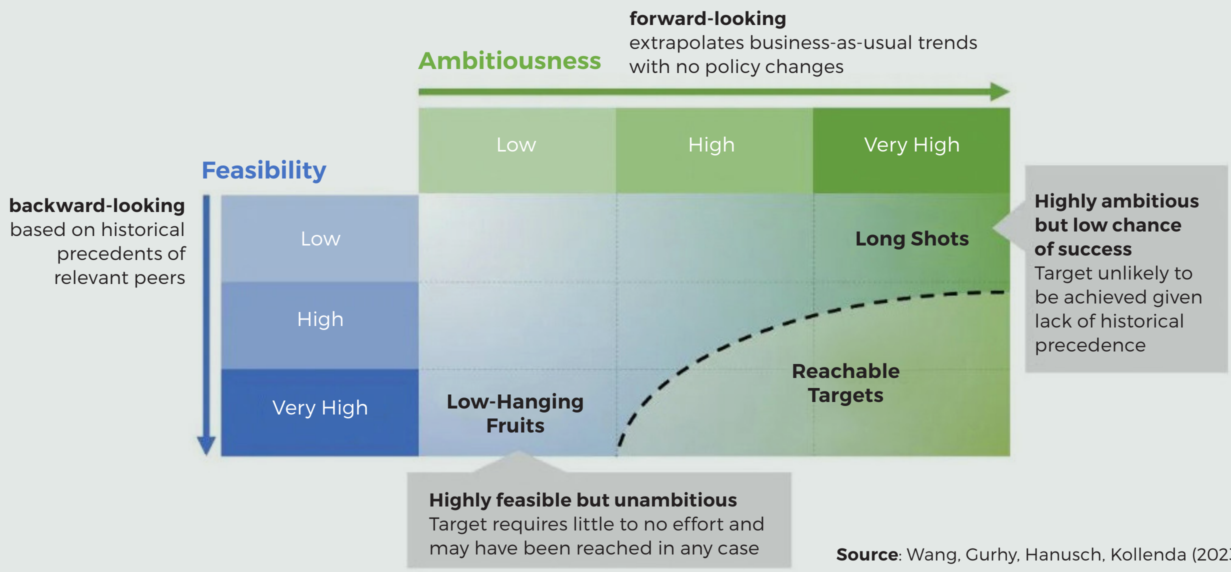
The idea of linking payments to results was first pioneered with the invention of outcome-based contracts such as impact bonds. Not to be confused with GSSS bonds, impact bonds are agreements where a funder such as a government, multilateral donor, or foundation, commits to make payments to investors based on the achievement of pre-determined results. Impact investors provide upfront financing to service providers, shifting the financial risk away from the outcome funder. After delivery, results are assessed by an independent evaluator that checks whether the contract's objectives have been met and determines payments to investors (GSG and Education Outcomes Fund, 2021). Since the first impact bond was piloted by the UK government in 2009, over 250 impact bonds have been launched around the world (GoLab, 2022). Numerous examples of social, environmental, development, and career impact bonds can be found on the GoLab, Brookings Institution, and Social Finance Global Network websites, among others.

Pay-for-success mechanisms were introduced into mainstream financial instruments with the issuance of the first major Sustainability-Linked Loan (SLL) in 2017, a few years before the launch of the first SLB (Thomä, Caldecott and Ralite, 2019). Sustainability-linked loans refer to any type of loan instruments that incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives, by linking financial terms (such as interest rates) to the borrower's sustainability performance (LMA, 2019). In only a few years, the SLL market has grown exponentially, to reach $506 billion in 2021. While issuances decreased in 2022, they are expected to pick up in 2023 (EIU, 2023).

BOX 4 // A FRAMEWORK TO ASSESS THE SUITABILITY OF SLBs' IMPACT TARGETS

One key challenge to the growth of the SLB market has been the difficulty in setting targets that are both achievable and ambitious. To address this issue, the World Bank has developed a matrix that gauges targets along feasibility and ambitiousness dimensions (Figure 2). This can help issuers prevent impact washing accusations by avoiding targets that are feasible but not sufficiently ambitious (low-hanging fruits), or highly ambitious but not realistic (long shots). To assess feasibility, the Bank benchmarks the targets against the performance achieved in the past by issuers with similar profiles and baselines. Ambitiousness is assessed using a statistical model to forecast the likely trajectory of the indicator. The Bank plans to turn the matrix into an open-access tool to enable issuers and investors to identify reachable targets that are both highly feasible and likely to deliver additionality (Wang et al., 2023). Such developments could support the long-term growth of performance-based instruments.

FIGURE 2 // **The World Bank's Feasibility-AmBitiousnes (FAB) matrix**



Source: Wang, Gurhy, Hanusch, Kollenda (2023)

These developments have been driven by a strong increase in demand, with most bonds being significantly oversubscribed. This demand is fuelled by an increasing recognition for the need to invest in climate mitigation and adaptation. With rising demand from customers for ethical, sustainable products and more stringent regulations on the radar, more and more companies are considering social and environmental impact as material, taking steps to integrate them into their operations, and using GSSS bonds to fund this transition.

The growth of the market has also been fostered by the development of GSSS bond principles and standards. The International Capital Market Association (ICMA) has issued guidelines for the issuance of Green Bonds, Social Bonds, Sustainability Bonds, and SLBs, and UNDP on how bond issuers can apply the SDG Impact Standards (ICMA, 2023b, UNDP, 2021). The Emerging Market Investors Alliance developed Enhanced Labelled Bond Standards to guide the structuring of GSSS bonds in emerging markets (EMIA, 2023). Many countries have started developing national guidelines. For instance, Colombia issued a good practice guide for green bonds, and Thailand released its sustainable financing framework with guidelines on eligible green project categories. (Dembele and Horrocks, 2021). Standards are also being developed at the regional level. For example, the ASEAN Capital Market Forum issued Green Bond Standards based on ICMA's, and the EU Parliament and Council reached a provisional agreement on the EU Green Bond Standards (ACMF, 2017, Holroyd, 2023, European Commission, 2023). All these guidelines contribute to improving transparency and disclosure by clarifying the approach for issuing GSSS bonds.

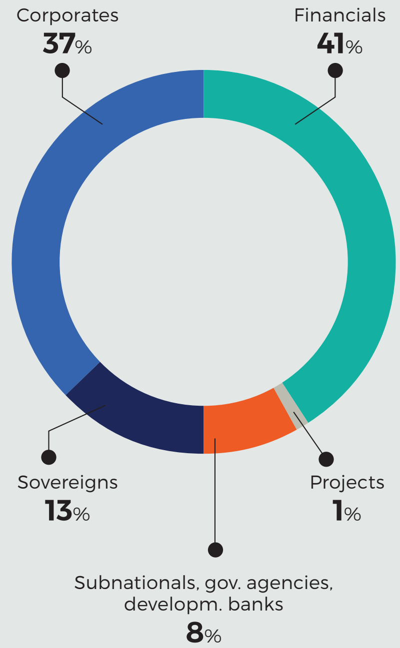
Finally, access to market intelligence has made the market easier to navigate. For example, the Inter-American Development Bank (IDB) set up the digital Green Bond Transparency Platform, which allows users to learn about the proceeds, impact and methodology used for each bond issued in Latin America (Dembele and Horrocks, 2021). The Luxembourg Green Exchange established the LGX DataHub, a centralised hub for sustainability data on green, social and sustainability bonds (UNFCCC, 2020). In 2022, the Climate Bond Initiative added data on Social and Sustainable bonds to its interactive data platform, in keeping with the diversifying labelled bond market (CBI, 2022b). And Bloomberg launched Global Aggregate Green, Social, Sustainability Bond Indices (Bloomberg, 2022). Greater availability of data on the nascent GSSS bond market has enabled issuers and investors to better understand trends and dynamics and make informed decisions.

BOX 5 // GSSS BONDS IN DEVELOPING COUNTRIES

Emerging markets represent a small fraction (15 percent) of the total amount issued, but interest is growing. In 2021, emerging market issuers issued $182 billion in GSSS bonds, more than triple the amount issued in 2020 (World Bank, 2022).

In developing countries, the majority of bonds come from the private sector. The main issuers of GSSS bonds are financial institutions, followed by corporates. Sovereign bonds only make up 13 percent of the total amount issued, while subnational governments (regional and local), government agencies, and development banks account for eight percent (World Bank, 2022).

FIGURE 3 // **Emerging market GSSS bond issuance, according to issuer type**



Source: World Bank, based on data from Bloomberg 2022.

The Asia Pacific region is leading issuances across emerging markets. By June 2022, cumulative issuance of green, social and sustainable bonds amounted to $447 billion (CBI, 2022b). With $115 billion in outstanding bonds, China has the third largest volume of green bonds globally after the United States and France. Indonesia pioneered the world's first Islamic green bond (sukuk) (Dembele and Horrocks, 2021).

The GSSS bond market in Latin America and the Caribbean is also fast-growing. Thematic bond issuance doubled between 2020 and 2021, and cumulative issuance surpassed $76 billion by June 2022. With over $31 billion across both green, social and sustainable bonds, Chile is the largest issuer in the region, followed by Brazil and Mexico (Souza and Tukiainen 2021, CBI, 2022b). Chile launched the world's first sovereign Sustainability-Linked Bond, and Mexico the first SDG bonds (Sy, 2022, Dembele and Horrocks, 2021).

Sub-Saharan Africa is lagging behind, with cumulative issuances amounting to only $6.7 billion, or 1% of issuances in emerging countries (CBI, 2022b). South Africa is the market leader in the region, with issuance of GSSS bonds by financial institutions and corporates. The Seychelles issued the world's First Sovereign Blue Bond in 2018 (See Box 11).

3 Towards better use of proceeds for more impact

While financing for the energy transition and SDG-aligned activities can also be raised through traditional instruments, using GSSS bonds could result in more impact:

- **GSS bonds ensure that issuers allocate the proceeds towards impact**. Use-of-proceed bonds are better suited than traditional instruments to fund projects aiming to generate social and environmental impact. In contrast with conventional bonds, funds cannot be reallocated to projects or activities that do not aim to deliver the intended impact in case of change of governments or company strategy. To align with ICMA Bond Principles, GSS bonds issuers need to clearly communicate to investors the sustainable activities or assets which the bond proceeds will be allocated to, justify the methodology used to assess whether the projects are expected to deliver impact, earmark the funds for the intended use, and report annually on the use of proceeds (ICMA 2021a, ICMA, 2023b, ICMA 2021b).
- **Sustainability-Linked Bonds go a step further by encouraging issuers to develop holistic sustainability strategies, and increasing transparency**. SLBs have the potential to prevent impact washing since they reflect not only standalone projects whose benefit could be offset by the negative impact resulting from other operations, but consider the issuers' overall sustainability and impact. This means that to make proper use of these instruments, governments or companies interested in issuing SLBs should fully integrate impact into their strategy, an approach more likely to lead to systemic change. In addition, ICMA Sustainability-Linked Bond principles require issuers to set specific impact targets, measure progress towards them, and seek independent verification (ICMA, 2023b). This brings more transparency on the extent to which the issuer intends to benefit people and the planet, and makes it easier for investors to compare investment opportunities. Often, it also makes issuers' commitment more binding, since failure to meet the target is generally linked to a penalty.

PART II

A promising solution to finance SDGs in emerging markets

1 An opportunity for developing countries...

Funding needs in developing countries are expanding. Multiple global crises have worsened socioeconomic challenges, and investment levels have fallen short ever since the launch of the sustainable development goals (SDGs). According to the latest estimates, the funding gap increased by at least 60% to 70% as compared to 2014, to about $4 trillion. More than half of that amount corresponds to developing countries' energy investment needs, estimated at $2.2 trillion per year. Large gaps exist also in the water and transport infrastructure sectors (UNCTAD, 2023). Beyond the energy transition, developing countries are highly vulnerable to the increasing effect of climate change and will require funding to cope with its long term consequences: annual adaptation costs are expected to reach $140-300 billion by 2030 (UNEP, 2021). And the needs are highest in the Least Developed Countries (LDCs), who saw foreign direct investment (FDI) drop by 16% in 2022. Investment in the SDGs in developing countries remains concentrated in a few larger, more advanced economies: only 5% of SDG-relevant investment projects in developing countries were in LDCs. (UNCTAD, 2023).

FIGURE 4 // **Key SDG Sectors: estimated annual investment gap in developing countries, capital expenditure, 2023-2030** (Trillions of dollars)

Source: UNCTAD (forthcoming). Note: Investment refers to capital expenditure. The range for the health and education sectors reflects uncertainty about the size of the capital expenditure component in the total investment gap for the two sectors, for which the operational expenditure component is expected to be substantial.

Bonds constitute a large, diversified asset class that could help mobilise capital at scale. Moving from a niche market to the mainstream is essential in order to match the scale of the funding needs, and this requires instruments that appeal to diverse sources of capital and are suited to the needs of large investors (ITF, 2021). A long-term, lower-risk asset class with an $6.7 trillion annual issuance, bonds cut across a broad set of stakeholders, including corporates, governments, municipalities and development banks (Dembele and Horrocks, 2021). In particular, they have the potential to bring institutional investors such as insurance companies and pension funds into impact investing (OECD, 2022). By signalling their commitment to social and environmental impact, GSSS bonds can enable issuers to tap into the growing number of institutional investors looking for impact investment opportunities. Their transparent governance structure can also enhance investor confidence, and attract investors looking to diversify their portfolio with long term debt.

GSSS bonds could reduce the cost of capital for SDG-related projects. Developing countries are generally seen as risky, which makes borrowing money expensive. Cost of capital constitutes a key barrier to investments in the SDGs, and the energy sector in particular (UNCTAD, 2023). There is some evidence that GSSS bonds have enabled issuers to raise capital at a lower cost as compared to the regular bond market. In some cases, the mismatch between the limited offer and booming demand has resulted in lower yields as compared to regular bonds, a phenomenon referred to as “greenium” or “socialum”, as it lowers the costs for issuers. For instance, in 2021, the Government of Germany used a “twin bond structure”: a conventional bond with similar financial characteristics was issued alongside a green bond. The labelled bond priced 2 basis points below the conventional one, maintained a lower yield in the secondary market, and exhibited lower volatility (Dembele and Horrocks, 2021). While this premium could fade as issuance grows, higher regulatory standards could slow down supply. Alongside fast-growing demand, this could make it hard for issuers to match demand in the medium term (Duguid, 2022).

BOX 6 // **CHILE’S NATIONAL GSSS BONDS STRATEGY**

The Government of Chile has successfully embraced GSSS bonds as a strategy to finance the country’s sustainable development. Since its debut in 2019, it has raised more than $38 billion through a combination of green, social, sustainability and sustainability-linked bonds. In 2023, the Ministry of Finance plans to raise at least two thirds of its $15 billion planned bond issuance from GSSS bonds, including $7 billion from SLBs (Lester, 2023b). This strategy allowed Chile to tap into an increasingly diversified investor base, and achieve the lowest yield for a sovereign bond in Latin America (Ministry of Finance of Chile, 2021).

2 ... but an opportunity still to be harnessed

Despite their high potential to raise impact finance, issuances in developing markets only make up 15% of the global GSSS market (World Bank, 2022). Their growth is constrained by a number of factors, and key barriers need to be addressed for developing countries to fully harness the potential of these financial instruments.

Building a track record is essential to demonstrate feasibility: There is still a lack of awareness around GSSS bonds and the cost/benefits of their issuance among potential issuers in developing countries (OECD, 2023). In addition, most GSSS bonds to date have been issued in developed countries, and much less data is available on their performance in developing economies. In Africa in particular, the overwhelming majority of countries have not issued a single GSSS bond to date (CBI, 2022b). Successful examples are needed to strengthen the business case for GSSS bonds in developing countries and build the knowledge base on how best to use these instruments in various contexts.

De-risking investments is necessary to make investment opportunities in emerging markets viable: The underlying credit aspects are an overarching consideration for investors. For many developing economies, macroeconomic conditions make investment riskier and may prevent transactions (World Bank, 2022). Debt sustainability concerns are rising, and economic growth has been negatively impacted by the pandemic. Domestic capital markets often lack liquidity and struggle to meet the credit rating requirements to tap into international markets (OECD, 2023). There is thus a need to de-risk GSSS bonds, for instance through the use of blended-finance (See Box 10).

Improving issuer capacity is key to increasing successful issuances: Potential issuers often lack familiarity with GSSS bonds, standards and reporting requirements. Investors have expressed a need for stronger bond frameworks, aligned with international standards, and identified quality of impact reporting as a key driver in their investment decisions (World Bank, 2022, Environmental Finance, 2021). In addition, issuers in developing countries often have limited capacity to identify and develop pipelines of sustainable projects, and are poorly connected to international investors with a preference for GSSS bonds (OECD, 2022). Technical assistance is needed to build issuers' capacity, in particular with regards to the highly sophisticated SLBs.

Attracting investors requires strong investable project pipelines: A key hurdle to the growth of the thematic bond market in developing countries is the lack of bankable projects with the potential to deliver social and environmental benefits. While the investability of some large-scale projects can be improved through better structuring, project sizes are often not large enough for GSSS bond financing. This can be addressed by aggregating projects, or using SLBs (OECD, 2022, OECD, 2023).

Cost of GSSS bonds issuance needs to fall to facilitate adoption at scale: GSSS bonds have additional transaction costs as compared to regular bonds, that many potential issuers in developing countries do not have the resources to cover (OECD, 2022). In particular, the cost and time required for impact data collection is a key obstacle, not only for issuers but also for investors who have to gather data from issuers (Cooper, 2020). Subsidising or offsetting this cost could make GSSS bonds more attractive and facilitate their adoption by issuers who do not have the means to cover these additional costs.

Impact washing concerns must be addressed to ensure GSSS bonds' credibility: Risk of impact washing remains a key concern. While the key advantage of GSSS bonds resides in their transparent structure, adherence to international standards remains limited, with less than half of emerging market debt issuance adhering to the ICMA Principles (Goel, Gutan and Natalucci, 2022). For use-of-proceed bonds, this often translates into a lack of clarity on eligibility criteria and selection process for projects. Another area of concern for labelled bonds is that the consequences of non-compliance with allocation of the use-of-proceeds are unclear, since enforcement regulation is currently lacking. Meanwhile, for SLBs, there have been growing worries that setting targets and penalties that are not ambitious enough could equally result in impact washing (OECD, 2023). Finally, although the availability of quality independent evaluation is growing, a strong regulatory environment is paramount to facilitate and ensure compliance with standards and proper use of debt raised through GSSS bonds.

Harmonisation of standards is needed to reduce market confusion and increase transparency: Due to the proliferation of standards and principles with different expectations regarding the content and format of reporting, fund managers are finding it increasingly difficult to aggregate and compare impact data, since reports differ widely in format and frequency (Environmental Finance, 2023). This makes it difficult to compare different GSSS bonds and make investment decisions. The lack of harmonisation between taxonomies can also be a barrier to entry since it requires investors interested in investing across geographies to familiarise themselves with different approaches (OECD, 2023). Ensuring that standards are interoperable and identifying common metrics and KPIs for impact measurement can thus increase transparency and make the GSSS bonds in developing countries more accessible to investors.

PART III | Ecosystem recommendations

Adopting an ecosystem approach is essential to scale up GSSS bonds in developing countries. Issuers, private sector investors, policymakers, as well as development finance institutions and other market builders all have a part to play in supporting the growth of the market. This section offers non-exhaustive considerations for each category of stakeholders.

1 Issuers

Adoption of GSSS bonds by issuers in developing countries has the potential to attract the investments necessary to significantly contribute to closing the funding gaps. This includes financial institutions and corporates, but also non-conventional issuers such as nonprofits and cooperatives. Sovereigns in particular have a key role to play in catalysing the market. To do so successfully they should adopt good practices such as:

- **Picking instruments carefully**: GSSS bonds are not one-size-fits-all instruments and they present trade-offs. It is important for issuers to thoroughly assess which type of bond is best suited to their situation. For instance, SLBs can open the GSSS bond market to smaller issuers, and could be less costly since they do not require use-of-proceed tracking (OECD, 2023). However, managing potential penalties can be challenging for issuers who lack experience, and coupon step-ups can sometimes be incompatible with public budgeting laws followed by sovereign issuers (OECD, 2022, World Bank, 2022).
- **Aligning frameworks with existing standards**: Developing bond frameworks in accordance with international standards is essential to ensure quality and attract investments. The most commonly adopted are ICMA standards, which come with templates for issuers (Environmental Finance, 2023). When relevant, issuers should also align bond frameworks with local and regional taxonomies.
- **Adopting good reporting practices**: While ex-post reporting is the priority, other good reporting practices to adopt include communicating reporting commitment at issuance; reporting both at project and portfolio levels when possible, including a list of deals; clearly defining methodology and metrics; and reporting on potential adverse impacts (Almeida and Lonikar, 2021, Dembele and Horrocks, 2021). The ICMA has started tackling the harmonisation of reporting standards by publishing the Harmonised Framework for Impact Reporting Handbook, which provides detailed recommendations on reporting (ICMA, 2022c). The guide also includes templates for reporting to facilitate data collection.
- **Involving third parties**: Issuers can seek independent experts to provide Second Party Opinions (SPOs) on their bond framework pre-issuance. External reviewers have shown to affect pricing positively for the issuer (Simeth, 2021). External audits on resource allocation and impact verification boost credibility and are increasingly requested by investors (Environmental Finance, 2023). Finally, issuers can get certifications from labels such as that of the Climate Bond Initiative (See Box 7), or GSSS scoring from rating agencies (ICMA, 2022b, FSD Africa, 2020).

BOX 7 // KENYA'S FIRST CERTIFIED GREEN BOND

Acorn Holdings, a Kenyan real estate company, raised KSh 4.3 billion ($40 million) through a use-of-proceed bond to finance green and environmentally-friendly accommodation for 500 university students in Nairobi. The bond was certified under the Climate Bond Initiative's Climate Bond Standard and Certification Scheme, which ensures that bonds are aligned with a 1.5C warming limit from the Paris Agreement (CBI, 2019).

To obtain the certification, an approved verifier must conduct a pre-issuance review to confirm that the framework conforms with the standard. To maintain their certification, issuers must publish a post-issuance report confirming that the proceeds have been applied and the processes respected. The report must be reviewed and approved by the verifier (FSD Africa, 2020).

UNDP is in the process of designing a similar scheme to certify alignment with its SDG Impact Standards (UNDP, 2023b).

2 Private sector investors

Private sector investors, including institutional investors in both international and domestic markets, can contribute to funding the SDGs and energy transition by investing in GSSS bonds in developing countries. They should consider:

- **Integrating GSSS bonds in developing markets into the investment strategy**: Investors can set themselves impact objectives and allocate capital specifically for investing in GSSS bonds issued by developing countries. For example, mainstream investors such as Blackrock and Amundi have set up specific Emerging Markets GSSS Bond funds (Environmental Finance, 2023). By actively investing in these bonds, investors signal market demand and contribute to the growth of the GSSS bond market in those countries. Investing in GSSS bonds in developing economies requires that investors have a good technical understanding of these instruments, keep up to date with the fast-evolving regulatory environment, and be familiar with the markets in which they invest. Alternatively, investors can hire advisors or invest in specialised funds (Dunbar, Shigiya and Whistler, 2022).
- **Assessing bond frameworks against recognised standards**: As part of the due diligence process, investors should ensure that bond frameworks are aligned with international and local standards.
- **Actively engaging with issuers**: Pre-issuance, investors can leverage their position to challenge issuers, ask for ambitious targets, and request robust governance and transparent reporting. They can continue to engage post-issuance to ensure the sustained impact of their investment by actively monitoring project progress for use-of-proceed bonds, and progress against targets for SLBs, and work with issuers to address any challenges or areas for improvement (Dunbar, Shigiya and Whistler, 2022, UNPRI, 2017).
- **Designing products tailored to developing markets**: Investors can also support the mainstreaming of GSSS bonds from emerging economies by developing products that address market challenges. Loans to small-scale projects can be aggregated and then securitised to reach a size adequate for bond markets (CBI, 2017). For example, Symbiotics developed a special purpose vehicle to make thematic bonds accessible to small firms (see Box 8).

BOX 8 // **SYMBIOTICS' MSME BOND PLATFORM**

Symbiotics is an impact investing firm specialised in emerging and frontier economies. To enable MSMEs in developing countries to tap into the labelled bond markets, Symbiotics set up a special purpose vehicle, based in Luxembourg. The platform issues small GSSS bonds ($5-20 million) that are used to raise funds for microfinance institutions, small and medium-sized banks, and other companies in emerging markets, both in USD and local currency. Each bond is used to disburse a loan to one institution, which pays interest and principal to the platform. These payments are then passed to investors, net of a fee (Dembele and Horrocks, 2021). Since its inception in 2020, the platform has issued more than 300 bonds (Proparco, 2022).

3 Policymakers

Supportive policies and regulations are essential to enable GSSS bond markets to flourish. Some strategies that can be adopted by governments and regulatory agencies in developing countries include:

- **Issuing sovereign bonds to demonstrate feasibility**: Sovereign bonds have a key role to play in catalysing GSSS bond markets. They have the power to scale up the market through large issuances, and typically have a spillover effect on the local bond markets by providing a benchmark for other issuers (Dembele and Horrocks, 2021, OECD, 2022, World Bank, 2022). Using a twin bond structure can be particularly effective to demonstrate the potential for premium and generate appetite. In particular, governments can promote domestic capital markets by setting a precedent for issuance in local currency (OECD, 2022). Policymakers can encourage the issuance of sovereign bonds by integrating them in national strategies, such as National Development Plans or Integrated National Financing Frameworks (UNDP, 2023a).
- **Developing and harmonising standards and taxonomies**: Adapting standards to local context can provide clarity to the market and ensure that developing country issuers are not overburdened with expectations that do not reflect their reality and facilitate GSSS bond adoption. For instance, the development of local taxonomies can make it easier for issuers to issue labelled bonds (Jain, 2022). But they need to be comparable, interoperable and harmonised with regional and global approaches to create familiarity for investors and enable comparability of investment opportunities (OECD, 2023). For example, India is reviewing its guidelines to align with ICMA principles, and require independent evaluation pre- and post issuance (Holroyd, 2023). In the longer term, requiring compliance with standards can significantly reduce the risk of impact washing. China, for instance, made its Green Bond Principles mandatory for issuers (See Box 9).

- **Reducing transaction costs through tax exemptions and subsidies**: Tax incentives and subsidies can reduce the cost of issuing GSSS bonds. For example, the government of Malaysia supported the bond market by covering the majority of external review costs for bonds issued in accordance with their Green Sukuk Framework, and offered tax deductions on issuance costs (Dembele and Horrocks, 2021, Burge, 2023). In Argentina, the government encouraged the entry of local service providers, which were able to provide SPOs at a significantly lower cost as compared to international companies (See Box 10).
- **Stimulate demand and issuance through mandatory requirements**: To maintain the GSSS bond premium, governments can also stimulate demand through mandatory requirements to invest in sustainable debt. For example, France established solidarity-based retail funds, which are required to invest between 5-10% of their funds into accredited social enterprises, and made it mandatory for companies of more than 50 employees to include them in their pension fund offering (Fourrier, 2019). This strongly incentivised the mobilisation of capital from institutional investors towards impact, with the number of assets under management in these funds growing sevenfold over the past decade. Requiring investors and corporates to publish transition plans can also prompt action and encourage GSSS bond issuance (Borge, 2023).

BOX 9 // **THE GOVERNMENT OF CHINAS HANDS-ON DEVELOPMENT OF THE GSSS BOND MARKET**

China is by far the largest GSSS bond issuer among emerging countries, and the world's second issuer of Green Bonds. The market's growth was facilitated by the Chinese government's active role in facilitating its development. In 2016, they issued the Guidelines for Establishing the Green Financial System, which recognised green bonds as an important vehicle for green finance (Lin and Hong, 2021). Issuance significantly increased in 2021, following Xi Jiping's commitment to the twin goal of carbon peaking before 2030 and carbon neutrality by 2060, and a series of developments by Chinese regulatory authorities of transition finance frameworks, standards and products (Deng, Xie and Shang, 2021).

However, the Chinese market's lack of alignment with international standards led to severe worries about the risk of greenwashing. For instance, the regulator only required issuers to invest 70% of proceeds in green projects. To address these concerns, the government issued new Green Bond Principles in 2022, which mostly align with ICMA Principles (ICMA, 2022a). Unlike their international counterparts, which are voluntary, these standards are compulsory for companies seeking to issue green bonds in China, and mandate alignment with specific taxonomies (Holroyd, 2023, Moody's, 2022).

To increase comparability and attract international investments, China also worked on harmonising its standards with the European Union, and published the Common Ground Taxonomy, which maps out the commonalities and differences between the Chinese and EU taxonomies (Deng, Xie and Shang, 2021). This allowed China to identify at least 193 green bonds issued in alignment with the EU taxonomy (Lester, 2023a).

BOX 10 // LINKING ARGENTINA'S INFORMAL ECONOMY TO THE LABELLED BOND MARKET

MSMEs and informal businesses make up a large part of Argentina's economy. They have the highest potential for job creation, but often struggle to access financing (Isasa and Piñeyro, 2023). Recognising the potential of labelled bonds to raise funds for disadvantaged segments of its economy, the regulator (CNV) enacted a series of reforms to facilitate their issuance by SMEs and other organisations with strong links to the informal sector.

After developing a simplified regulatory regime to enable more SMEs to access capital markets, it issued national GSS bond guidelines, based on ICMA standards (CNV, 2017, CNV, 2019). In addition, it lowered transaction costs by reducing the barriers to entry for local providers of SPOs. These offer rates that can be ten times cheaper than that of international firms, making them more affordable for SMEs (Tinelli, 2023).

Finally, the regulator extended the existing simplified regulatory regime available to SMEs to other issuers of labelled bonds. This means that larger organisations and non-conventional issuers such as microfinance institutions and nonprofits can issue bonds and apply simplified reporting measures, provided that they follow the national GSS guidelines, guarantee 100% of the issuance, and do not exceed the maximum amount allowed for SMEs (CNV, 2022). CNV also extended existing tax incentives for organisations investing in SMEs to other labelled bonds issued under the simplified regime (Tinelli, 2023).

These reforms have facilitated the issuance of labelled bonds by SMEs, but also by non-conventional issuers that serve the informal economy, such as microfinance institutions. For instance, nonprofit Pro Mujer issued Argentina's first Gender Bond that will enable loans for 1429 female-owned MSMEs (CNV, 2023).

4 Development Finance Institutions

Support from market builders such as institutional donors, philanthropic organisations and intermediaries is essential to facilitate the market. In particular, Development Finance Institutions, including both Multilateral Development Banks (MDBs) and Public Development Banks (PDBs), can be instrumental. Key areas in which they can support the market include:

- **Providing anchor funding**: This helps the issuing company build investor confidence and contributes to catalysing investments from a wider pool of private actors. By advertising their investment, DFIs can also help new issuers get their names out to investors (Dembele and Horrocks, 2021). For instance, IFC's anchor investment of $256 million in Amundi Planet Emerging Green One fund, the world's largest green bond investment vehicle focussed on emerging markets, helped mobilise about $1 billion from private institutional investors (OECD, 2022).

- **De-risking investments**: DFIs can enhance the risk/return profile of GSSS bonds through a range of mechanisms. For example, they can issue credit guarantees and binding agreements where the guarantor agrees to pay some or all of the amount due in case of non-payment (Garbacz, Vilalta and Moller, 2021). They can also purchase first-loss or more subordinated tranches, exposing themselves first to the risk of financial loss and giving reassurance to more senior debt holders, or offer insurance to protect investors against risks such as currency inconvertibility, political force majeure, or regulatory risks (OECD, 2022).
- **Building stakeholder capacity**: DFIs can provide technical assistance on the preparation of issuances, for instance by helping issuers develop bond frameworks, structure project pipelines or develop credible transition plans, advertise their bonds, and improve on their impact reporting. They can also work with fund managers to package these assets into investible, risk-diversified portfolios for institutional investors (Gregory, 2023), build the capacity of third parties, and support policymakers and regulators with the development of localised standards and guidelines (OECD, 2023).
- **Facilitating market connectivity**: DFIs can leverage their networks to link issuers to potential investors. They can also use their convening power to launch or support multi-stakeholder and international initiatives to facilitate knowledge sharing and cooperation. For example, the Sustainable Banking and Finance Network (SBFN) hosted by IFC, brings together financial sector regulators and industry associations on sustainable finance topics, including GSSS bonds issuances. (OECD, 2023).

BOX 11 // THE WORLD BANK'S SUPPORT TO THE GOVERNMENT OF SEYCHELLES

In 2018, the World Bank supported the Seychelles in issuing the world's first Sovereign Blue Bond. The bond aimed to support the country transition its fisheries sector to sustainable practices, governance, and management. The Bank supported the structuring of the bond, provided a partial credit guarantee of $5 million, and helped arrange a $5 million concessional loan from the Global Environment Facility. The DFI also secured a donation from Rockefeller Foundation to cover most of the transaction costs, engaged with investment banks to find a top tier placement agent and trustee, and connected Seychelles to investors. The de-risking mechanisms lowered borrowing costs by 5%, and the bond allowed the Seychelles to mobilise $15 million of private sector investment (World Bank, 2018).

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