EXPERT ANALYSIS

ECA Finance: A promising financing mechanism to scale the delivery of the SDGs

By Hussein Sefian, Founding Partner, Acre Impact Capital

The Sustainable Development Goals represent the 'blueprint to achieve a better and more sustainable future for all'[1] yet they remain significantly underfunded, with a financing gap of $2.5 trillion a year in emerging markets. Numerous actors, including development banks, private investors, impact investors, charities and philanthropists are looking for solutions to address this challenge but often do so independently of each other. As per SDG17, a more ambitious partnership approach is required to tackle the challenge. In this article, we argue that combining the savoir-faire and expertise of export credit agencies in emerging markets with impact investor's capital and focus on achieving social and environmental benefits could be an innovative new type of partnership to help address the gap.

What is impact investing?

The Global Impact Investment Network (GIIN) defines impact investments as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return"[2]. In order to be considered an impact investment, three key features must be present:

(i) Intentionality. The investor must have the intention to create a positive social or environmental impact through its investment.

(ii) Financial returns. A misconception amongst some investors is that impact investing delivers sub-commercial returns. In fact, the majority of impact investors target

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market risk-adjusted returns and most meet or exceed investor expectation in terms of financial returns[3]. The pursuit of financial returns differentiates impact investing from philanthropy and charities which pursue other priorities.

(iii) Measurement. Impact investors are committed to measure and report on the social and environmental performance of their investments.

The impact investment industry is still at an early stage of development. The term 'impact investing' was initially coined by the Rockefeller Foundation in 2007[4]. In a short ten years, the industry has grown to $502bn Assets under Management (AuM) by the end of 2018[5], an impressive 122% increase over 2017. The industry has expanded into different asset classes such as real assets and infrastructure, while devising new innovative products such as pay-for-performance social impact bonds.

Why does it matter?

The Sustainable Development Goals (SDGs) are at the core of the 2030 Development Agenda aimed at addressing global developmental challenges such as poverty eradication, climate change, inequality, health and education and infrastructure. Achieving the SDGs will require significant

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increases in investments from current levels. For developing countries, the UN estimates an annual financing shortfall of $2.5 trillion for the period 2015-2030[6]. It is widely recognised that existing development sources of funding (government spending and development institutions) will not be sufficient. Mobilising new sources of both public and private sector capital is needed. Impact investors are well placed to mobilise additional sources of capital and pave the way for new innovative financing mechanisms that could bring us closer to achieving the SDGs.

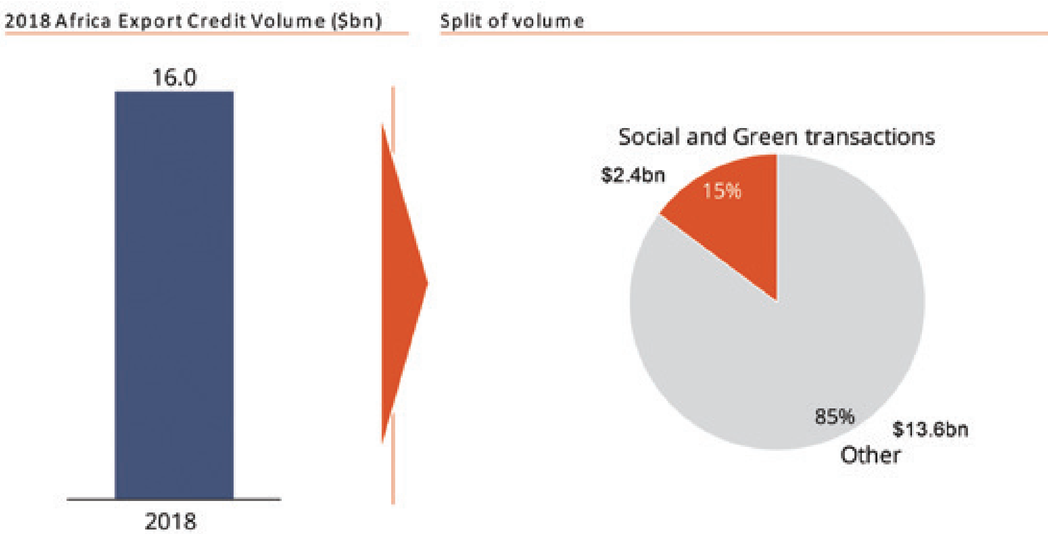
Sustainable financing in the Export Credit market

By financing the imports and investment needs of developing countries, the Export Credit market is already active in financing exports and projects that address the SDGs. In order to size the 'sustainable' export finance market, ICMA's (International Capital Markets Association) Green Bonds Principles (GBP) and Social Bonds Principles (SBP) were used as a basis for defining which transactions could be considered as 'sustainable'. These principles – underpinning $456bn[7] of Green and Social bonds outstanding as of 2018 – provide helpful definitions and categorization of types of projects and financings that could be considered as either Green or Social[8].

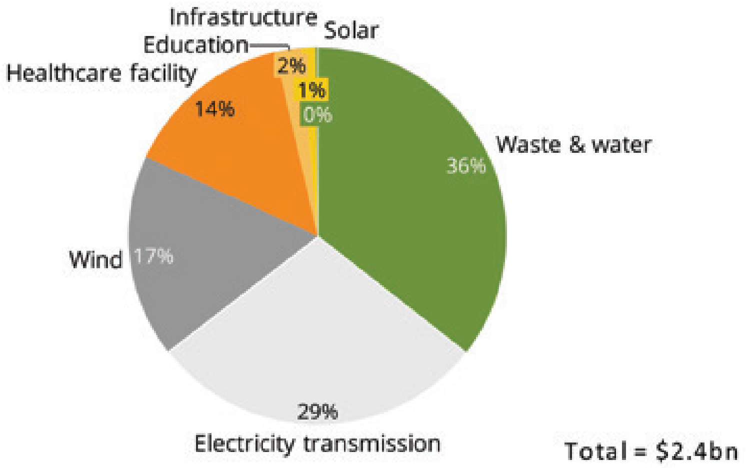
In addition, many of the arranging banks active in the Export Credit market have issued Green bonds and, in some cases, Social or Sustainable bonds. This implies that they have put in place (i) a Green / Social / Sustainable bond framework which outlines their adherence to the principles (ii) a governance mechanism to select the relevant projects for inclusion in the bond (iii) a mechanism to track the use of proceeds of the bond (iv) a mechanism to report on the performance of the selected projects. It may very well be that these banks have selected Export Credit loans for inclusion in their Green Bonds.

Working closely with TXF to exploit the TagMyDeals data with an initial focus on Africa in 2018, each transaction[9] was classified as either Green or Social for the purposes of sizing the market.

In 2018, only 15% of all Export Credit



Africa 2018 Social / Green transaction volume split by industry



volume in Africa could be classified as either Green or Social, representing $2.4bn of financing. Within this, the majority of the financing was in Waste & Water (36%), followed by Electricity Transmission (29%), Wind Power Generation (17%) and Healthcare (14%).

A proportion of sustainable financing of 15% is a relatively low starting point for the industry. It is not difficult to imagine that the share of sustainable export credit financing will grow gradually over time as companies embrace the principles of sustainable and green growth and as governments are held to account on the progress of their COP 21 NDC (Nationally Determined Contributions) commitments.

However, more can be done by arranging banks and ECAs both at the policy level and on individual transactions. The efforts of the ICC Global Export Finance Committee to engage into an industry-wide conversation on this topic are a welcome and worthwhile step in this direction. In addition, the EBF in its November 30th 2018 position paper highlights the significant potential for export finance to support sustainable growth.

Impact investing and Export Credit

A number of features of the Export Credit market are potentially very attractive to impact investors:

Additionality. The involvement of an Export Credit Agency often implies that pure commercial financing on market terms is not available or only available at terms that would be too prohibitive for the transaction to close. By supporting impactful transactions in this market, impact investors provide a true incremental contribution to environmental and social outcomes. ECAs also have a key role to play in providing support for innovative companies committed to the export of technology and services that further the SDGs and deliver a sustainable energy transition. Some of these companies may be smaller organisations today, but

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could very well be the leading industry champions of the future.

Strong environmental / social practices. OECD ECAs adhere to the "OECD Common Approaches" on Environmental, Social and Human Rights due diligence. For riskier projects, an Environmental and Social Impact Assessment (ESIA) must be conducted in line with the World Bank Safeguard Policies and the IFC Performance Standards. While these assessments do not guarantee positive social or environmental outcomes, they do ensure that any negative impacts that could be foreseen are identified and mitigated. In addition, transactions are monitored for any new risks that may arise, at least during the construction period and often during the life of the ECA cover. As such, they allow impact investors to avoid unintended consequences and "do no harm".

Control of the use of proceeds. Arranging banks and ECAs play a critical role around the compliance functions of KYC and AML and anti-bribery and corruption, providing key safeguards to impact investors. In addition, the disbursement of funds directly to the contractor helps ensure capital is used for the stated purpose of the project.

The financing gap in emerging markets to achieve the SDGs stands at $2.5 trillion a year until 2030. In order to close this vast gap, a concerted effort is required across public funding, private sector solutions, development finance institutions, impact investors and philanthropists.

Debt sustainability. In public sector transactions, where the buyer is a government or a municipality, most OECD ECAs will perform debt sustainability assessments before supporting a transaction. This could include assessing the priority of the project for the social and economic development of the country, ensuring alignment with the debt sustainability analysis of the World Bank / IMF, and applying value for money tests.

Impact investors can be crucial partners to the industry. Indeed, they can play an active role in providing funding in ECA-covered transactions and/or in down-payment financing. Beyond financing, impact investors contribution to sustainable development in Export Finance can be catalytic in two unique ways. First, by providing a readily available source of financing, they can help crowd-in contractors, banks and ECAs, enabling the completion of highly impactful, yet marginal transactions. Secondly, by applying an impact lens on transactions in which they participate, they can help achieve improved social and environmental outcomes by ensuring that these considerations are embedded in the project from the onset.

Conclusion

The financing gap in emerging markets to achieve the SDGs stands at $2.5 trillion a year until 2030. In order to close this vast gap, a concerted effort is required across public funding, private sector solutions, development finance institutions, impact investors and philanthropists. ECAs also have a key role to play. They already operate in emerging markets, where they have the skills, experience and risk capacity to support the sustainable development of these economies. Governments around the world are espousing the principles of sustainable development and are looking to deliver on their NDCs under the Paris Climate Accord. It is only a question of time until this agenda filters through their national ECAs.

About Acre Impact Capital

Acre Impact Capital aims to deliver environmental and social impact through targeted investments in social infrastructure in Africa and the Middle East. Acre is launching an impact credit fund focused on down-payment financing for impactful transactions in the Export Credit market.

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Notes:

1. https://www.un.org/sustainabledevelopment/sustainable-development-goals/
2. https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing
3. GIIN Annual Impact Investor Survey 2018
4. Rockefeller Foundation Innovative Finance (https://www.rockefellerfoundation.org/our-work/initiatives/innovative-finance/)
5. GIIN Sizing the Impact Investing Market
6. UNCTAD World Investment Report 2014
7. Bloomberg, ThomsonReuters
8. For example, the GBPs provide examples of green projects that fit within the following categories: renewable energy, energy efficiency, pollution & prevention control, environmentally sustainable management of living natural resources and land use, terrestrial and aquatic biodiversity conservation, clean transportation, sustainable water and wastewater management, climate change adaptation, circular economy adapted products and green buildings.
9. Note: The classification was largely done on the basis of the sub-industry classification in TagMyDeals. More information will need to be input by market participants in order to improve the accuracy of the analysis.