Green bonds for Latin America
The BMZ mobilises the private sector for climate-friendly investments

BACKGROUND
In the 2015 Paris Agreement, 195 countries committed themselves to the goal of limiting global warming to well below 2 °C, and to 1.5 °C if possible. To that end, the mobilisation of private capital is essential. Public budgets are too small to reduce CO₂ emissions sufficiently to achieve this goal. The bond market plays a central role in private climate financing. In that market, debt instruments are issued, bought and traded in a standardised and regulated way.

The Nationally Determined Contributions (NDCs) are at the heart of the Paris Agreement. They contain mitigation and adaptation targets for industrialised and developing countries up to 2030. However, there is a financing gap for the NDCs which is unlikely to close without the help of bond markets.

In order to issue bonds, a country needs, above all, a well-functioning local bond market, a base of issuers and investors, an appropriate macroeconomic framework and appropriate regulatory and legal standards. However, in many parts of the world, the bond markets are poorly developed, including in Latin America.

This situation presents a significant obstacle to growth for economies there, since savings and pension assets do not flow back sufficiently into the real economy in the form of local currency loans. This means that project financing often relies on foreign sources in US dollars. Domestic capital for local businesses, banks, institutions etc., is not sufficiently available. Strengthening bond markets is, therefore, considered an important factor for generating economic growth – and green bonds are at the same time an opportunity to do something to protect the climate.

Green bonds are bonds for which issuers make a commitment vis-à-vis investors to use the funds exclusively to finance environmental and climate protection measures. The issuance of green bonds requires much greater transparency and effort than that of a normal bond, where proceeds are typically earmarked for general corporate purposes. For green bonds, the issuer must establish internal reporting and monitoring mechanisms that enable it to report transparently on the use of proceeds and the process of project selection and evaluation. An independent consultant must verify the whole process and issue a second-party opinion, which is made publicly available to all interested investors.

Green bonds enable large investments, e.g. in renewable energies and energy efficiency measures, thus making a significant contribution to reducing CO₂ emissions and mobilising additional capital for the implementation of NDCs. However, they also come with a higher workload.
KEY MEASURES AND INITIATIVES

In order to strengthen the regional green bond market in Latin America, the BMZ is addressing different levels:

→ It has commissioned KfW with establishing an anchor investment fund, the Latin American Green Bond Fund (LAGREEN), by the end of 2019. The fund combines public and private funds in a public-private partnership (PPP) approach and invests in selected green bonds in order to finance climate-friendly projects in Latin America. Together with the EU Commission, the BMZ is assuming responsibility for the first-loss tranches. This reduces risks for private actors, increasing their readiness to invest in green bonds. LAGREEN will officially be launched in 2020, together with further public and private partners.

→ Supporting local businesses in issuing green bonds. The BMZ provides grant funding to strengthen the institutional capacity of issuers and to cover the additional costs of issuing green bonds. In addition, knowledge about the advantages of issuing green bonds and, thus, the pool of potential issuers and investors are to be expanded. In that way, high standards for green bonds are established in local capital markets, which increases investor confidence. Participating companies must comply with the Green Bond Principles (GBP), which include guidelines on transparency, disclosure and reporting. The application of the GBP is intended to ensure that the bonds really support sustainable business practices.

→ Coordination and harmonisation with other international actors. The BMZ seeks to establish a strategic green bond partnership for Latin America, in order to provide, for the various activities under way such as those of the Inter-American Development Bank (IDB) and the EU Commission, a policy framework for jointly developing green capital markets in Latin America.

IMPACTS

These key measures will mobilise additional private capital for climate-friendly investment. In that way, they contribute to the goals of the global NDC Partnership in Latin America and to the achievement of SDGs 7 (Clean energy), 9 (Innovation and infrastructure) and 13 (Climate action).

Through LAGREEN, banks and companies in Latin America are able to refinance the issuing of green bonds in a tailor-made manner. LAGREEN also has a signal effect that mobilises more local private funds for green bonds, thereby generating more financing for climate-friendly and environmentally sound projects. This helps countries to close financing gaps and to achieve their NDC targets.

At the same time, green bonds are becoming established on the local bond markets, thus expanding the range of financial products on offer. This has positive effects in social, environmental and economic terms, because investment returns and confidence-building measures encourage institutional investors to make their private capital available to the real economy. This improves the refinancing situation for local banks and companies and provides an overall boost to the economy.