GUIDANCE ON SOVEREIGN SDG BONDS FOR COUNTRIES AND INVESTORS

Financing for Sustainable Development

U N D P

GISD Global Investors for Sustainable Development Alliance

Acknowledgements

This guidance is published by the Global Investors for Sustainable Development (GISD) Alliance, under the leadership of the United Nations Department of Economic and Social Affairs (UN DESA) and United Nations Development Programme (UNDP).

Under the general guidance of Marcos Neto, Assistant-Secretary-General and Director Bureau of Policy and Programme Support, UNDP, and Shari Spiegel, Director of the Financing for Sustainable Development Office of UN DESA, Krishnan Sharma, Chief of the Strategic Engagement and Policy Integration Unit, supervised the writing of the guidance with a core team of authors from UN DESA and UNDP. The authors comprised of Rabayl Mirza and Louise Bernander at UN DESA, and Tenke Andrea Zoltani at UNDP. The following contributors to the report are duly acknowledged: Sharjeel Mirza, Evelina Durlind, Marine Blassiau at UN DESA, and Paulo Barbieri Kennedy, Lamin Trawally, and Tim Strawson at UNDP.

Many individuals and organisations have contributed to the development of the guidance, and we are very grateful to all of them for their input and support. We would especially like to express our gratitude to the GISD working group on sovereign SDG bonds chaired by Gavin Power, Chief, Sustainable Development and International Affairs at PIMCO and Karin Svensson, Senior Advisor at the Swedish International Development Cooperation Agency (Sida).

To produce this guidance, the authors conducted in-depth interviews with public and private representatives including PIMCO, Standard Chartered, Bank of America, Citi Group, Grupo Santander, Amundi, Folksam, Enel, Blackrock, Government of Indonesia, Government of Mexico, Government of Benin, Government of Uruguay, and Government of Sweden, as well as with academics including Luis E. Gonzales, Professor of Economics, Institute of Economics at Pontificia Universidad Catolica De Chile, and Dr. Layna Mosley, Professor of Politics and International Affairs at Princeton University. An expert group meeting was held on 9 August 2023 where representatives from the World Bank, OECD, NASDAQ, Luxembourg Stock Exchange, Sustainalytics, Moodys, JP Morgan Development Finance Institute, Climate Bonds Initiative (CBI), Nature Finance provided inputs.

Special thanks to Sida for providing overall support to this work.

Abbreviations

CBI	Climate Bonds Initiative
DFI	Development Finance Institution
DSA	Debt Sustainability Analysis
ESG	Environmental, Social, and Governance
GBP	Green Bond Principles
GRI	Global Reporting Initiative
ICMA	International Capital Market Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
INFF	Integrated National Financing Framework
IPCC	Intergovernmental Panel on Climate Change
KPI	Key Performance Indicator
MDB	Multilateral Development Bank
NDC	Nationally Determined Contributions
NDP	National Development Plan
NSDP	National Sustainable Development Plan
PEFA	Public Expenditure and Financial Assessment
PFM	Public Financial Management
PIMA	Public Investment Management Assessment
SAP	Strategic Action Plan
SBG	Sustainability Bond Guidelines
SBP	Social Bond Principles
SDG	Sustainable Development Goals
SLB	Sustainability-Linked Bond
SLBP	Sustainability-Linked Bond Principles
SPO	Second Party Opinion
SPT	Sustainability Performance Target
SSLB	Sovereign Sustainability-Linked Bond
TCFD	Task Force on Climate-related Financial Disclosures
TNFD	Task Force on Nature-related Financial Disclosures
UNFCCC	United Nations Framework Convention on Climate Change
UoP	Use of Proceeds

Executive Summary

Achieving the Sustainable Development Goals (SDGs) necessitates a substantial scaling up of finance and investment. Sovereign SDG bonds are a subset of thematic bonds that are **anchored in the SDGs** and can help governments finance their sustainable development priorities.

The **Global Investors for Sustainable Development Alliance**, under the leadership of the UN Department of Economic and Social Affairs (UN DESA) and the United Nations Development Programme (UNDP), have developed this **integrated guidance** for the benefit of the global financial community interested in these instruments.

SDG bonds have been issued across all regions by countries looking to advance sustainable development. This guidance focusses on the experiences of the 18 developing countries[1] that, between 2016 and 2023, issued US$70.8 bn worth of sovereign bonds that include reference to alignment with the SDGs in their national financing frameworks.[2] [3]

The guidance provides a summary of these **country experiences** gleaned through interviews with country representatives and the private sector, a survey on investor preferences, in-depth case studies on countries that have issued SDG bonds, and an expert group consultation. Based on this research, the guidance outlines the benefits, challenges and lessons learnt when issuing sovereign SDG bonds.

The analysis finds that issuing sovereign SDG bonds has the potential to offer benefits to countries, including **providing a *greenium,* diversifying the investor base, signalling a commitment to sustainable development, and enhancing the SDG impact of the domestic private sector**. However, the process of developing and issuing a sovereign SDG bond involves many complex and technical steps, which can be challenging for developing countries. These include but are not limited to **multi-stakeholder coordination, mitigating greenwashing in terms of identifying projects and KPIs, monitoring and reporting, and issuance in domestic markets.** In addition, high debt levels, market risk perceptions and borrowing costs can make issuance unfeasible for some countries.

The next section summarizes **best practices** for countries when issuing sovereign SDG bonds. Criteria that governments should evaluate before issuing a sovereign SDG bond include: **1) suitable conditions in the country; 2) 'goodness of fit'; 3) debt sustainability framework; and 4) capacity.** A step-by-step guide for issuing a sovereign SDG bond is then

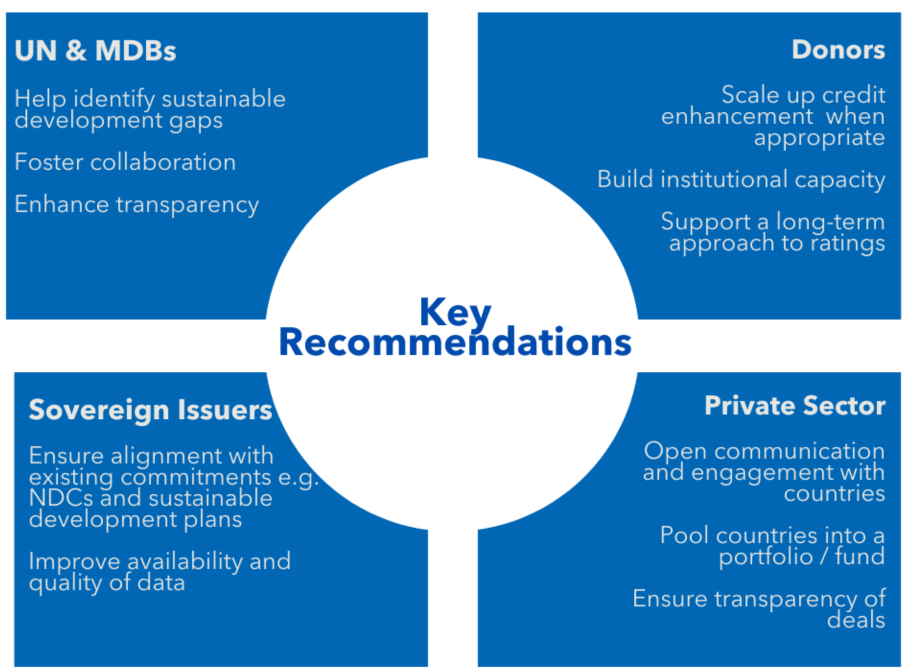
[1] This guidance uses the country classifications in the UN's 2024 World Economic Situation and Prospects report as the definition of developing countries.
[2] Michetti, C, et al., Sustainable Debt Global State of the Market 2022, Climate Bonds Initiative 2023.
[3] Climate Bonds Initiative, Interactive Data Platform, accessed February 2024.

provided, assuming the above evaluations have been completed and conditions are deemed suitable.

The guidance then turns to analysing investor preferences around sovereign SDG bonds, which have been compiled through interviews and further supplemented by a survey. The results shed light on **the decision-making process behind investing in sovereign SDG bonds, pricing risk, preferences between different bond structures, and data and impact.**

A common theme among the best practices derived from these findings is a **more active role on the part of the investors to ensure mutually successful outcomes**. Specific best practices that investors can adopt to enhance their role include: assessing country conditions, engaging with government representatives to understand developmental gaps and national priorities, committing to transparency both in terms of pricing as well as sustainable development outcomes, undertaking independent due diligence to ensure alignment with global standards, signalling to governments the importance of adherence to established international conventions, communicating openly throughout the issuance process, and advancing the overall ecosystem by supporting the development of new technologies and frameworks.

Finally, the guidance suggests **recommendations for advancing the sovereign SDG bond market** that can be brought forth by the UN and multilateral development banks, donors, sovereign issuers, and private sector actors. The main themes underpinning the recommendations are summarized in the chart below:



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1. Introduction

Our shared ambition to achieve sustainable development necessitates that all countries take action to alleviate poverty, reduce inequalities, expand access to health and education, generate economic growth and decent jobs, and confront climate change while conserving nature and biodiversity. This enduring, long-term agenda is enshrined in the United Nations Sustainable Development Goals (SDGs) adopted by all UN member states in 2015. According to recent estimates, the annual shortfall for financing the SDGs is more than US$4 tn for developing countries.[4] Delivering on this agenda will require sizably scaling up finance and investment and ensuring that capital flows toward sectors and geographies with the largest needs.

A growing number of governments are realizing the potential of bond issuances, as a tool for recovering from the COVID-19 pandemic and addressing pressing development and SDG-related challenges alongside Nationally Determined Contribution (NDC) commitments. Thematic bonds are traditional fixed income instruments that allow investors to finance specific investment themes, such as transport, infrastructure, renewable energy, sustainable agriculture, and the expansion of health and education services in support of sustainable development. The total cumulative issuance of Green, Social, Sustainable, and Sustainability-linked bonds – including both sovereign and corporate issuance – surpassed US$3.2 tn according to Dealogic. In 2023, according to Dealogic, there were 27 sovereign issuers of thematic bonds, who priced 46 thematic bond transactions to raise a resulting US$130 bn in proceeds (the highest yearly volume on record).

A global bond market aligned with the SDGs has the potential to meaningfully contribute to advancing the sustainable development agenda. Sovereign SDG bonds analysed for the purpose of this guidance are a subset of thematic (green, blue, social, sustainability) and sustainability-linked bonds issued by a sovereign that are underpinned by a framework that integrates the SDGs.[5] Several countries have also started to include SDG bonds in their Integrated National Financing Frameworks (INFFs), which provide a framework for financing the SDGs and national sustainable development strategies.[6]

For governments, SDG bonds can mobilize additional resources for investment in the SDGs from potentially a wider investor base, signal the government's commitment to sustainable development and climate action, and help develop national capacities to coordinate multiple ministries and engage with external partners. There is evidence that issuers may benefit from a small "greenium," i.e., difference in yield between green bonds and conventional bonds of a similar maturity, of ~12 basis points[7] based on the logic that

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[4] UNCTAD, World Investment Report 2023, 2023.
[5] Note that alignment with the SDGs is a qualitative threshold, rather than a quantitative one.
[6] UNDP, SDG Integration, Integrated National Financing Framework for Sustainable Development, 2020.
[7] IMF, How Large is the Sovereign Greenium?, Working Paper WP/2023/080.

investors are willing to pay extra for a bond with a sustainable development impact.[8] It is notable that the greenium research is evolving, there is a notable divide between developing and developed markets as well as corporates and sovereigns, and it is expected to remain larger in developing than developed markets. An expanding and more liquid market for these issuances could mobilize additional capital for SDG-aligned outcomes in developing countries. Over time as governments return to the market with successful issuances, it can bring more comfort to global investors and reduce perceived risks.

From the perspective of investors, rigorous reporting can help investors track positive and negative impacts of projects to ensure alignment with the SDGs. To improve the transparency and credibility of investments, and prevent the risk of SDG-washing, the Global Investors for Sustainable Development (GISD) Alliance has produced **a harmonized definition of Sustainable Development Investing** which outlines minimum thresholds that investment strategies and products should meet to qualify as aligned with sustainable development.[9] GISD recommends that the sustainable development impact of sovereign SDG bonds must meet the minimum criteria as per the definition of Sustainable Development Investing to avoid allegations of SDG-washing.

The GISD Alliance under the leadership of UN DESA and the UNDP, has developed this integrated guidance for the benefit of sovereign borrowers considering SDG bonds, and investors looking to scale up investments in these instruments. Recommendations are also given for banks, the UN and multilateral development banks and donors who are also often involved in SDG bond structuring and issuance processes.

The objective of the guidance is to enhance the integrity and quality of sovereign SDG bonds through an assessment of this growing market. This includes:

- Consolidated lessons learnt and best practices emerging out of sovereign SDG bonds issued so far.
- Concrete and practical recommendations for enhancing the integrity of future sovereign SDG bond issuances.

This guidance is the first of its kind to pool real world cases of sovereign SDG bonds. This guidance is complementary to globally-accepted standards such as the International Capital Market Association's (ICMA) principles and guidelines,[10] and draws on PIMCO's Best Practice Guidance for Sovereign Sustainable Bond Issuance.[11] It has been informed by analysis by the Organization for Economic Cooperation and Development[12] on how donors can support

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[8] UNDP, Identifying the 'greenium', 2023.
[9] GISD Alliance, Definition of Sustainable Development Investing, 2020.
[10] ICMA, The Principles, Guidelines and Handbooks, 2023.
[11] PIMCO, PIMCO's Best Practice Guidance for Sovereign Sustainable Bond Issuance, 2022.
[12] OECD, Green, Social, Sustainability and Sustainability-Linked Bonds in Developing Countries: How can donors support public sector issuances?, 2022.

governments to scale up the SDG bond market, and the World Bank's[13] survey of debt management offices and investors on the potential of SDG bonds in emerging markets.

To produce this guidance, consultations and in-depth interviews were undertaken with public and private actors, including selected investors, banks and government representatives from ministries and debt management offices, and UNDP Country Offices, with the objective of outlining good practices for SDG bond issuance. UNDP's experience in working directly with governments on SDG bond issuances (over US$14 bn in bond issuances to date), including on-ground technical assistance in developing countries, has served as the foundation of this work. In addition, UN DESA and UNDP have surveyed GISD members on investor preferences.

[13] World Bank, Sovereign Green, Social and Sustainability Bonds: Unlocking the Potential in Emerging Markets, 2022.

1.1 Methodology

The guidance contained in this paper is based on interviews with country representatives and the private sector (including banks and investors), a survey on investor preferences, and in-depth case studies on countries that have issued SDG bonds. In addition, a consultation with experts on sovereign SDG bonds was held to present initial findings and identify key challenges and potential solutions. First-hand accounts are complemented by desk research, including a literature review of recent research, such as publications and studies by the UNDP and the World Bank. In addition, Citi, a member of the GISD Alliance, produced a quantitative analysis of the allocation of SDG bonds, which identified the SDGs that have been targeted to receive these bond proceeds.

In total, 17 interviews were completed, which often involved 45-minute semi-structured conversations. To elicit honest and open feedback, all interviewees were assured that no comment would be attributed to a specific participant or firm.

Eight interviews were conducted with the debt management offices of countries that have either issued an SDG bond or started the process, often together with in-country UNDP colleagues. These interviews covered country experiences with SDG bond issuance, the level of interest from investors, the benefits and challenges of issuing such bonds, and lessons learnt.

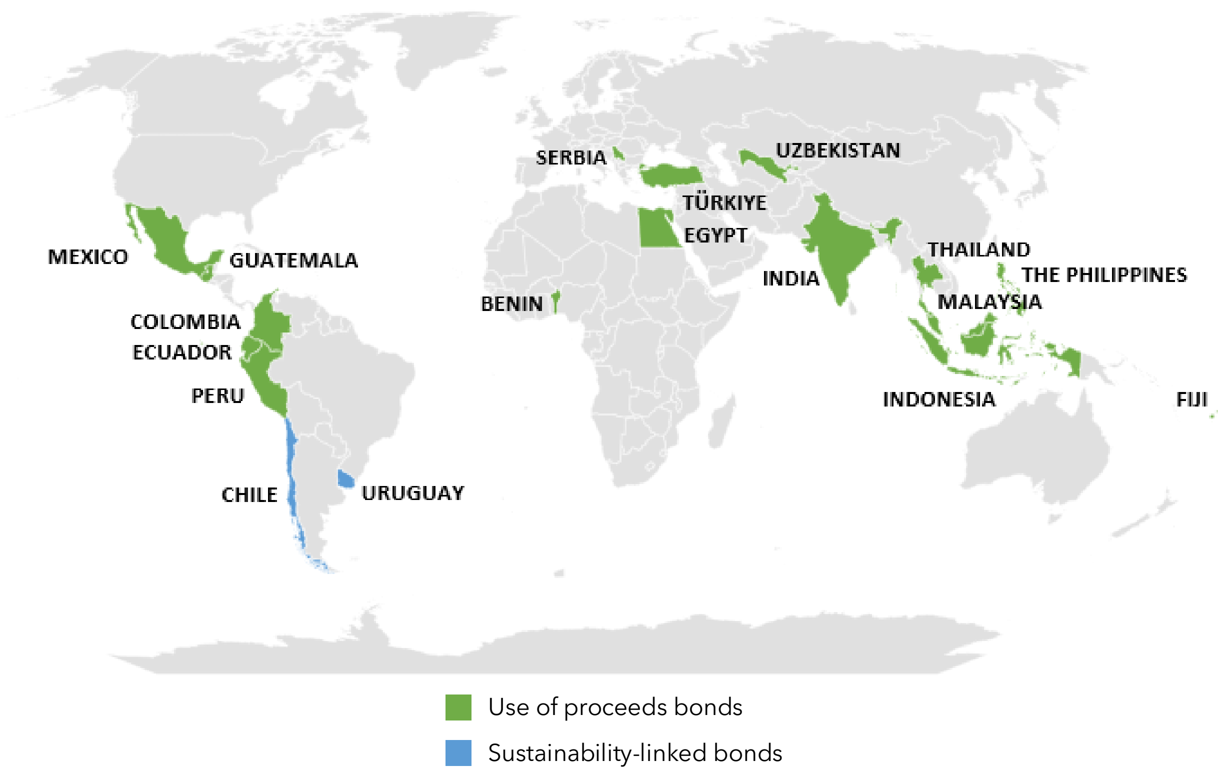
The remaining 9 interviews were conducted with banks and investors that have either structured an SDG bond or invested in one. These interviews covered experiences on structuring/investing in SDG bonds, preferences, views on the credibility, transparency, and integrity of such bonds, and challenges and mitigating solutions. The investor interviews were complemented by a survey that provided further insights on the behaviour and preferences of banks and investors. The survey was completed by eight banks and investors, three of which were also interviewed.

Combining country and investor interviews with an expert group consultation, alongside desk research and quantitative analyses, provides a nuanced picture of the sovereign SDG bonds landscape, allowing this guidance to provide a comprehensive compendium of recommendations and good practices to advance the sovereign SDG bond market in a responsible and impactful way.

2. Sovereign SDG Bonds: A Description

SDG bonds[14] have been issued across all regions by countries looking to advance sustainable development. Poland was the first to issue a sovereign green bond in 2016. Since then, US$435 bn of sovereign bonds from 50 countries (according to Dealogic) have been issued to fund sustainable development projects, activities, or expenditures. The vast majority of these issuances have been by developed countries in Europe. This guidance focuses on the experiences of the 18 developing countries[15] that, between 2016 and 2023, issued US$70.8 bn worth of sovereign bonds that include reference to alignment with the SDGs in their frameworks[16] [17] (See Figure 1).

Figure 1: Developing countries that have issued SDG bonds[18]



2.1. Types of sovereign SDG bonds

Sovereign SDG bonds can be structured in two different ways. The most common structure for sovereigns is **use of proceeds (UoP) bonds**. **UoP bonds fund projects with dedicated**

[14] SDG bonds are those that include reference to alignment with the SDGs within national financing frameworks. This is a qualitative threshold, rather than a quantitative one.
[15] This guidance uses the country classifications in the UN's 2024 World Economic Situation and Prospects report as the definition of developing countries.
[16] Michetti, C, et al., Sustainable Debt Global State of the Market 2022, Climate Bonds Initiative 2023.
[17] Climate Bonds Initiative, Interactive Data Platform, accessed February 2024.
[18] As of November 2023.

environmental and/or social benefits, such as climate change mitigation/adaptation, water, health, food and education etc.[19] These include green, blue, social, and sustainability bonds. These bonds finance specific projects or activities within the thematic area. For example, eligible project categories for green bonds, which finance projects or activities with positive environmental impacts, include renewable energy, energy efficiency, and clean transportation. Blue bonds are a subset of green bonds that specifically finance projects or activities that are water-related, including sustainable fisheries and sustainable water supplies. Social bonds finance projects or activities with positive social outcomes, including food security, socioeconomic advancement, and affordable housing. Sustainability bonds finance a combination of green, blue, and social projects. Principles, standards, and taxonomies are available for UoP bonds, with specific guidance for green, blue, social, and sustainability bonds.

Sustainability-linked bonds (SLBs) are sovereign general-purpose bonds that tie the cost of borrowing to explicit sustainability targets.[20] The SLB market is still at its nascent stage. Chile and Uruguay issued the first sovereign **sustainability-linked bonds (SSLBs) in 2022**. Sustainability Performance Targets (SPTs) in SLBs are most commonly key performance indicators (KPIs) related to environmental and social goals. Progress, or lack thereof, toward selected SPTs results in a penalty for the issuer, which can be for example a decrease or increase in the instrument's coupon, a premium redemption, requirements to purchase carbon credits and/or make a donation etc.

Table 1 below outlines the characteristics of the different types of bonds covered in this guidance.

Table 1: Characteristics of sovereign SDG bonds

Type of Sovereign SDG Bond	**Use of proceeds bonds**				**Sustainability-linked bond** *(SLB)*
	Green	**Blue**	**Social**	**Sustainability**	
Description	Underlying projects with environmen-tal benefit	Underlying projects that are blue eligible (subset of green)	Underlying projects with social benefit	Combination of both green and social projects	Incentivizes the borrower's sustainability performance objectives by tying the financial characteristics of the bond to the achievement of predetermined SPTs

[19] PIMCO, Understanding green, social and sustainability bonds, 2022.
[20] Ibid.

Examples of eligible project categories / key performance indicators	• Renewable energy • Energy efficiency • Green building • Clean transport-ation • Agriculture • Forestry • Waste	• Management and restoration of water ecosystems (e.g., oceans, rivers, etc) • Sustainable fisheries • Seafood processing / shipping • Sustainable tourism • Sustainable water supply	• Food security • Socio-economic advancement • Affordable housing • Access to essential services	Eligible green and social projects.	Examples of KPIs: • Reduction in GHG emissions • Increase in renewable energy production • Increase in percentage of women in Board Member positions at companies • Completion rate in senior high schools
Principles or guidelines	• ICMA Green Bond Principles • CBI Taxonomy • IFC Climate definitions • EU Green Bond Standard / Taxonomy	• ICMA Green Bond Principles • ICMA Blue Bond Practitioner's Guide • CBI Taxonomy • IFC Blue Finance Taxonomy • UN Global Compact – Practical guidance to issue a blue bond	• ICMA Social Bond Principles	• ICMA Sustainability Bond Guidelines • ICMA Green Bond Principles • ICMA Social Bond Principles • ICMA Blue Bond Practitioner's Guide • CBI Taxonomy • IFC Climate Definitions • IFC Blue Finance Taxonomy • UN Global Compact – Practical guidance to issue a blue bond	• ICMA Sustainability-linked Bond Principles
Year of first sovereign SDG bond issuance	2017	2018	2020	2020	2022

2.2. SDG contribution of sovereign SDG bonds

2.2.1. Use of proceeds bonds

Categories that are eligible to be financed by (use-of-proceeds) SDG bonds are outlined in financing frameworks published by the sovereign issuers. These categories link to budgetary expenditures that provide tangible contributions to one or more SDGs. Which SDGs are covered by a sovereign's financing framework is dependent on the context and priorities of that sovereign as well as the type of bond that is issued; the 17 SDGs therefore do not receive equal financing from SDG bonds.

Table 2: SDG contributions of use of proceeds bonds

Type of Sovereign SDG Bond	**Use of proceeds bonds**			
	Green	**Blue**	**Social**	**Sustainability**
Examples of SDGs that may be advanced by use of proceeds bonds	2: Zero Hunger 6: Clean Water & Sanitation 7: Affordable and Clean Energy 9: Industry, Innovation and Infrastructure 11: Sustainable Cities and Communities 12: Responsible Consumption and Production 13: Climate Action 14: Life Below Water 15: Life on Land	6: Clean Water & Sanitation 11: Sustainable Cities and Communities 12: Responsible Consumption and Production 13: Climate Action 14: Life Below Water	1: No Poverty 2: Zero Hunger 3: Good Health and Well-Being 4: Quality Education 5: Gender Equality 6: Clean Water & Sanitation 8: Decent Work and Economic Growth 9: Industry, Innovation and Infrastructure 10: Reduced Inequalities 11: Sustainable Cities and Communities	A combination of SDGs listed for green, blue and social bonds

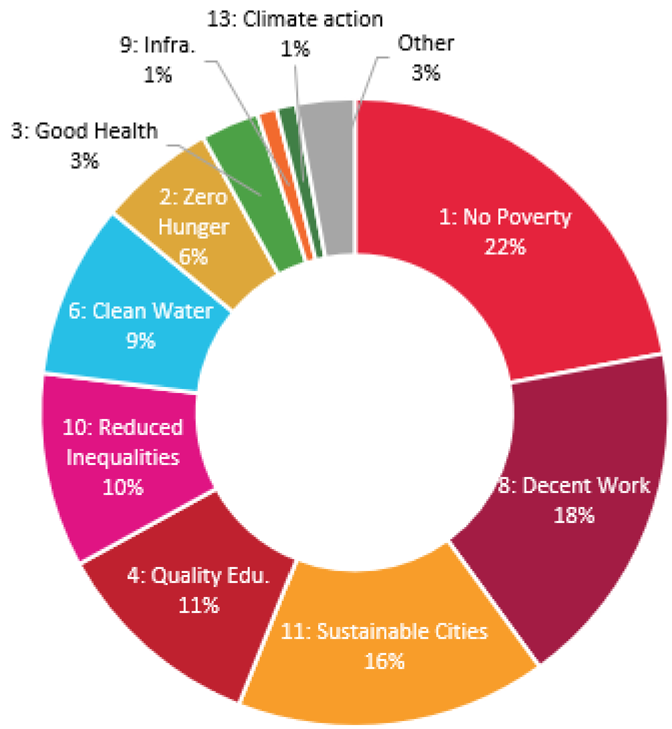
Financing frameworks of those developing countries that have issued SDG bonds (and have published allocation reports) reveal that 15 of the 17 SDGs have been included in these frameworks as eligible to be financed through SDG bonds.[21] Only SDG 16 (Peace, Justice and Strong Institutions) and SDG 17 (Partnerships for the Goals) have thus far not been explicitly targeted by eligible expenditures in the existing financing frameworks.

While a developing country sovereign financing framework is usually broad in terms of the SDGs included, the actual allocations of net proceeds from sustainable financing instruments tend to target specific SDGs (see Figure 2 below). Research by *Citi*[22] based on

[21] Citi, An Analysis of EM Sovereign Sustainable Bond Allocations, October 2023.
[22] Ibid.

12 allocation reports published in 2021-2022 by developing country sovereigns, found that 22% of SDG bond allocations went to projects that primarily targeted SDG 1 (No Poverty), 18% went to SDG 8 (Decent Work and Economic Growth), and 16% went to SDG 11 (Sustainable Cities & Communities).

Figure 2: Aggregated allocations by SDG



Source: Citi, An Analysis of EM Sovereign Sustainable Bond Allocations, October 2023

Projects that target SDGs 4 (Quality Education) and 10 (Reduced Inequalities) received 11% and 10% respectively of SDG bond allocations, while projects targeting SDGs 6 (Clean Water and Sanitation), 2 (Zero Hunger), and 3 (Good Health and Well-Being) received between 3 and 9% each of SDG bond allocations. SDG 9 (Industry, Innovation and Infrastructure) and SDG 13 (Climate Action) saw limited allocations, amounting to 1% each. Allocations to the remaining SDGs, including SDG 7 (Affordable and Clean Energy) and SDG 12 (Responsible Consumption and Production), were less than 1% each. No proceeds from SDG bonds issued by developing countries were allocated to projects that focused primarily on SDG 5 (Gender Equality).

2.2.2 Sustainability-linked bonds

SSLBs have primarily been focused on climate change, with KPIs linked to issuers' mitigation and adaptation efforts. When Chile issued the world's first SSLB in 2022, its framework included KPIs that "encouraged the implementation of necessary actions to fulfil the greenhouse gas (GHG) reduction commitments agreed in Chile's updated NDC and implement an ambitious national clean energy agenda."[23] Uruguay's SLB framework similarly included the reduction of GHG emissions and the maintenance of native forest area as KPIs.[24] These KPIs are aligned with SDG 7: Affordable and Clean Energy, SDG 13: Climate Action, and SDG 15: Life on Land.

Chile recently added the first social KPI to their SLB.[25] In 2023, Chile updated its SLB framework to include a KPI that focusses on increasing the percentage of board members that are women. The objective of this KPI is to enhance gender diversity in management, in both the public and private sectors. This marked the first time a SSLB framework aligned with a social SDG, namely SDG 5: Gender Equality.

[23] Public Debt Office of the Ministry of Finance of Chile, Chile's Sustainability Linked Bond Framework, 2023.
[24] Uruguay, Uruguay's Sovereign Sustainability-Linked Bond (SSLB) Framework, 2022.
[25] Note that while Ghana was the first to publish a framework with social KPIs, they have not yet issued under this framework.

3. Benefits and Challenges for Countries

3.1. Benefits

Issuing SDG Bonds may give countries broader access to international capital to address critical sustainable development needs. In addition, countries may see issuing SDG Bonds in the context of re-financing, potentially allowing them to lower existing debt servicing burdens while simultaneously addressing SDG needs. Countries have found that issuing sovereign SDG bonds has the potential to offer benefits, including **generating a *greenium*, diversifying the investor base, signalling a commitment to sustainable development, and enhancing the SDG impact of the domestic private sector**.

3.1.1. Greenium

Box 1: *Greenium*

Interviews for this research paper found mixed evidence for the existence of a *greenium*:

Significant *greenium*	*Greenium* inconclusive
One country interviewed experienced a significantly larger *greenium* than expected: 20bps lower than the country's secondary yield curve, on the country's inaugural EUR 500 mn 12.5 years (use of proceeds) SDG bond that was priced at 4.95%	On the other hand, another country interviewed stated that there are challenges to measuring a *greenium* and the existence of a quantifiable yield benefit on the country's SDG bond issuance is not yet conclusive.

Sovereign SDG bonds that are use-of-proceeds could potentially offer the possibility of quantifiably tighter yield, commonly referred to as a '*greenium*'. Studies differ in the size and significance of the *greenium* on their issuances. Anecdotally, one country reported a *greenium* of 20 basis points, while another had challenges measuring any significant impact. Similarly, some academic studies have found the *greenium* to be insignificant, while others have pointed to notable gains. The latest research by IMF points to green developing country sovereign bonds achieving a 11 bps *greenium* on average.[26]

Although investors interviewed tended to believe that under the right circumstances there could be a small pricing advantage for issuing green sovereign bonds as compared to conventional sovereign bonds, none believed that it would ever be significantly large because ultimately the bonds share the same credit risk as conventional bonds.

[26] IMF, How Large is the Sovereign *Greenium*? Working Paper WP/2023/080.

Where a *greenium* has been found, UNDP's experience working with countries suggests it could be attributed to several factors including supply and demand, genuine commitment to sustainability among investors, and lower risk perception of SDG bonds.

3.1.2. Diversified investor base

While there may not be consensus on the size of a *greenium*, **there is agreement that SDG bonds help countries attract a larger and/or more diversified investor base.** Some sovereign borrowers have gaining renewed interest from local investors, such as pension funds, and others have drawn investors from new regions.

"[We] achieved a significant greenium when issuing [this country's] first SDG bond, compared to a conventional bond issued earlier in the same year. The SDG bond was oversubscribed and brought interest from new investors, ultimately receiving 3 times the order book."
Country interviewee

The CBI has found that, on average, green bonds achieved a higher book cover and spread compression than conventional equivalents at issuance.[27] In 2020, average oversubscription was 4.2x for green bonds, and 2.9x for conventional equivalents, whilst spread compression averaged 24 bps for green bonds and 21 bps for conventional bonds for green bonds denominated in euros.[28]

A growing investor base with mandates to buy labelled (e.g., green, social, sustainability and sustainability-linked) emerging market sovereign bonds[29] could reduce volatility of the asset class because of these investors' mandate to hold such bonds. In addition, this would result in greater demand for sovereign SDG bonds.

3.1.3. A signal of commitment to sustainable development

Sovereign SDG bonds that are credible and transparent should contribute to advancing sustainable development in the country. Issuance of SDG bonds provides an opportunity for countries to signal their commitment to sustainable development and climate action to the global investor community.

Countries that have partnered with the UN to issue bonds have gained from a boost in reputation and credibility, which can improve the ability of the country to raise funding for additional sustainable development investments. Mexico's collaboration with the UN, for example, has not only led to SDG bond issuances, but has also culminated in an INFF that

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[27] Climate Bonds Initiative (2020), Green Bond Pricing in the Primary Market, https://www.climatebonds.net/resources/reports/green-bond-pricing-primary-market-h2-2020.
[28] Ibid.
[29] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.

enables the country to tap into public and private resources allocated for sustainable development.

Box 2: Uruguay's in-demand SLB

- Uruguay issued a sustainability-linked bond (SLB) in October 2022. The demand greatly exceeded the amount issued of US$1.5 bn, with a joint order book that, at its peak, reached US$3.96 bn.

- Uruguay's Sovereign Sustainability-Linked Bond was an important step to align the country's financing strategy more closely with its environment and climate change targets.

- The SLB was designed to:
    i. Signal and reassert the country's commitments and action plan to deliver on an ambitious climate change and sustainability agenda,
    ii. Provide investors with enhanced transparency and accountability on Uruguay's progress towards its climate change goals and conservation of natural capital,
    iii. Broaden and diversify its bond investor base, particularly of ESG-dedicated funds, and
    iv. Foster innovation in the sovereign bond markets, creating financial incentives for sustainable policymaking in emerging markets.

- As a next step, Uruguay is considering issuing debt instruments in local currency.

3.1.4. Domestic private sector

SDG bond issuances enable governments to introduce sustainable development investing in domestic markets, creating a precedent for local private actors to develop SDG frameworks and issue corporate SDG bonds. Indonesia and Mexico, for example, are prioritising domestic SDG bond issuances in their current financing strategies.

3.2. Challenges

The process of developing and issuing a sovereign SDG bond involves many complex and technical steps, which can be challenging for developing countries. These include but are not limited to **multi-stakeholder coordination, mitigating greenwashing in terms of identifying projects and KPIs, monitoring and reporting, and issuance in domestic markets.** In addition, high debt levels, market risk perceptions and borrowing costs can make issuance unfeasible for some countries.

3.2.1. Multi-stakeholder coordination

At the national level, developing a financing framework for sovereign SDG bond issuance requires complex coordination between multiple ministries and partners. SDG bond issuances requires robust multi-stakeholder governance, leadership, coordination, and close collaboration between various ministries/government agencies. Countries have experienced long lead times when it comes to inter-ministerial coordination, gathering data, and establishing governance frameworks. In addition, countries must engage a range of market participants at the global level, including underwriters, multilateral and national development banks, stock exchanges, data scientists, and Second Party Opinion (SPO) providers to assess alignment of the framework to the relevant principles and/or standards. During the development of the framework, the key is to align national priorities, relevant regulations, and any existing commitments such as the Medium-Term National Development Plan, the National SDGs Roadmap, and the NDC.

In countries (such as Indonesia, Mexico, Uruguay and Uzbekistan) where the UN has provided technical assistance in aligning budgetary expenditures with the SDGs, processes have been significantly expedited with the time saved ranging from several weeks to months for these countries.

3.2.2. Cost of issuing a sovereign SDG bond

For some developing countries, issuing a sovereign SDG bond entails a significant cost. The total costs for development can range widely from US$50,000 - US$100,000 which includes a feasibility study, partner scoping and identification, potential origination costs, framework development, coordination, and obtaining a second party opinion. This figure is based on country experience and varies widely: feasibility and origination costs are very broad, and a procurement process for contractors adds more time and resources. Preparing for an issuance requires many stages and soliciting an SPO alone can be a substantive transaction cost in addition to being a long and difficult process to undertake.

Box 3: Cost of issuing SDG bonds for Indonesia

The total costs for framework development are between

US$50,000 - US$100,000

which includes the feasibility study, framework development, coordination, and Second Party Opinion.

3.2.3. Mitigating greenwashing:

Mitigating the risk of greenwashing is another challenge that countries face both when developing use of proceed frameworks and SLB frameworks. Identifying eligible expenditures (for UoP structures) and relevant and material KPIs and sufficiently ambitious

SPTs (for SLBs) that credibly mitigate the risk of greenwashing has proven difficult for countries.

Investors may also question if the issuance is truly SDG-aligned if the same government is simultaneously pursuing other policies and projects that have negative externalities (such as fossil fuel subsidies) that contradict its stated sustainable development priorities.

Box 4: Mitigating greenwashing through eligible expenditures and material KPIs

MEXICO (use-of-proceeds)	URUGUAY (SLB)
Mexico's bond framework establishes a selection process for Eligible Projects that aims, firstly, to identify the contribution of budgetary programs to the 2030 Agenda and, secondly, to avoid financing programs that may undermine social or environmental development. Therefore, the framework establishes exclusion criteria so that net proceeds from the bonds' issuances are not notionally allocated to budgetary programs related to fossil fuels, deforestation, degradation of biodiversity, conflicted minerals, cattle or beef production, weapons, among others. Broad eligibility criteria compatible with the SDGs and the principles of sustainability, gender equality and inclusion are established. Moreover, the framework provides an additional geospatial criterium for social expenditures to target municipalities and/or states with the highest social gaps.	Uruguay's sustainable strategic priorities are outlined in the country's bond framework. The two KPIs chosen for the SLB are required to be core, relevant, and material to the country's sustainability objectives, namely: (i) reducing the intensity of GHG emissions in the economy and (ii) preserving the area of native forests in the country. The SPTs are based on quantitative goals set for 2025 and are in line with Uruguay's first Nationally Determined Contribution (NDC). The SPTs have been assessed as ambitious by a Second Party Opinion provider.

For UoP bonds, the challenge lies in the rigorous exercise of developing a selection process that identifies projects that have a direct and significant contribution to the SDGs and that do not produce any negative externalities. For SLBs, the challenge is choosing KPIs and targets that are relevant, material, and ambitious and communicating this effectively to investors.

Box 5: Investor education by Uruguay.

Uruguay took time to educate investors as SLBs were at the time - and still are - a debt instrument very rarely used by sovereigns, which required extensive clarifications. The coupon variation based on results (coupon step-up or step-down) is a feature that traditional emerging market sovereign bond investors were not very familiar with. That created a pricing impact for the country and a reputational risk that needed to be mitigated.

Uruguay found that ESG investors were interested in the SLB, and new investors entered the transaction, but not all investors were pleased with the step-up/step-down feature of the SLB and would rather invest in use-of-proceeds SDG bonds. SLB markets for sovereign issuers still require more maturity for the investors to be comfortable with the KPI linked dynamic and facilitate the pricing of the instrument.

3.2.4. Monitoring and reporting

Countries experience an array of challenges when it comes to monitoring and reporting. SDG instruments entail a commitment on the country's part to produce extensive, detailed reporting for many years, in order to build and maintain investor trust. Quantifying the impact of investments on achieving specific SDGs can be difficult. A robust mechanism to measure and report the outcomes of projects funded by the bonds needs to be in place to ensure transparency and accountability. SDG-related projects often have long time horizons for achieving impact. At the same time, sovereign bonds typically have fixed maturities. Aligning the timing of bond issuance, project implementation, and impact realisation can be challenging.

Data issues are especially acute for use-of-proceeds structures. For instance, the underlying datasets are not updated frequently. The median lag (defined as the current year minus the year of data last available) for the social and governance pillars is around three years, and the median lag of environmental data is around five years.[30] For SLBs, there are increased accusations of greenwashing/SDG-washing, because while the KPIs may address sustainability, the rest of the proceeds do not need to, which may erode trust in the instrument over time.

To demonstrate quality and instil confidence, countries should align to the principles and standards set out by ICMA – the standard the market recognises and accepts as a symbol of 'quality'. However, reporting frameworks are not standardized and although templates such

[30] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.

as the one developed by ICMA exists, many issuers do not utilize them to save on time, resources, or because they have not perceived a strong enough signal from the market that it is necessary. Thus, issuance must be complemented with a credible SPO and rigorous and verifiable reporting to instil trust in the market and the instruments. SPOs diminish greenwashing concerns as the framework has been audited by a trusted entity like Sustainalytics or S&P, among others. At the same time, a bigger emphasis on credibility and transparency may crowd out many SDG-advancing projects especially in developing countries, given the difficulty in quantifying and proving a net positive contribution on the SDGs.

3.2.5. Domestic market issuances

The majority of SDG bond issuances to date have been in international markets; underdeveloped domestic markets, currency risks and low awareness of SDGs limit the number of local currency issuances. In the medium term, countries should look to develop domestic markets. Local market issuances allow countries to develop sustainable bond markets and greenify their financial systems. Yet, while local investors understand social gaps better, they often perceive labelled bonds to have added risk when it comes to implementing SDG-tied uses of proceeds, which limits their participation. At the same time, many domestic markets do not have the necessary financial infrastructure to attract international investors, and foreign investors are often wary about taking local currency risk. While the broader issues of developing local capital markets are beyond of the scope of this guidance, the added value for countries to issue SDG bonds over a conventional bond in domestic markets is not adequately reflected in country experiences, with countries having yet to experience a concrete contribution to the yield curve or market liquidity from the issuance of SDG bonds in domestic markets. There is therefore a need to clarify to countries the advantages of developing an SDG framework for domestic bond issuances. This will require a fuller analysis in a subsequent knowledge product.

Box 6: Domestic vs. international issuance

- Mexico has acknowledged the relevance and made significant progress in the development of the domestic debt market. Since May 2022, the government has successfully placed seven issuances under the SDG Bond Framework in local currency (MXN) that amount to almost US$6 bn – in addition to the issuances in dollars, euros and yens placed under the same Framework.

- Indonesia has been successful in issuing SDG bonds in domestic debt markets:
    - In 2019, the Indonesian Government issued its first Green Sukuk in the domestic retail market attracting individual investors, with a minimum investment of IDR 1 mn (US$65).
    - In 2022, the Government issued SDG bonds in the domestic wholesale market (institutional investors).

4. Best Practices for Countries

Country experiences, as identified in interviews conducted with investors and government representatives as well as UNDP experience working with countries, provide several good practices and recommendations in the issuance of SDG bonds. **Criteria that governments should evaluate before issuing a sovereign SDG bond include 1*) evaluating suitable conditions in the country; 2) evaluating 'goodness of fit'; 3) evaluating debt sustainability framework;* and 4*) evaluating capacity*.**

Once a prospective issuer has done evaluations and deemed the conditions suitable to proceed, guidance is needed on the steps to take to issue a sovereign SDG bond. The second part of this section outlines a step-by-step process for issuing, followed by sub-sections on the types of partners to involve, globally accepted standards and frameworks for monitoring and reporting, and a note on costs and fees.

4.1. Before issuing a sovereign SDG bond

4.1.1. Evaluating suitable conditions for issuing a sovereign SDG bond

Broad conditions that determine suitability include:

i. *Clear Alignment with the SDGs:* The projects or initiatives to be funded by the bond proceeds must clearly align with specific Sustainable Development Goals. Governments should identify and prioritize projects that contribute to achieving these goals, such as infrastructure development, clean energy, education, healthcare, poverty reduction, or environmental conservation.
ii. *Robust Project Pipeline:* A sufficient pipeline of eligible and investable projects should be in place to ensure that the funds raised from the bond issuance can be effectively deployed towards sustainable development initiatives. Governments should have well-defined plans and projects ready for implementation.
iii. *Capacity to measure and disclose impact:* Governments should have the capacity to provide regular updates and reports on the progress and impact of the projects funded by the bond proceeds. Reports should be externally verified through third party providers. This ensures that investors and the public can track how their investments are contributing to sustainable development.
iv. *Commitment to Transparency through Monitoring and SPOs:* Transparency and accountability are crucial when issuing SDG bonds. Before the issuance, SPOs provide external verification of the issuer's framework, eligible portfolio, alignment with global standards and principles such as those developed by ICMA, and overall credentials of the thematic programme.
v. *Adequate Institutional Capacity:* Governments must have the institutional capacity to oversee, manage, and execute the projects funded by SDG bonds effectively. This includes having the necessary expertise and regulatory framework in place to ensure that the projects are executed efficiently. This is clearly articulated through a 'goodness of fit' or suitability assessment.

vi. *Investor Demand:* There should be sufficient demand from investors for sovereign SDG bonds. Governments need to assess the market appetite for such bonds and may engage with potential investors, including environmental, social, and governance (ESG)-focused investors, to gauge interest.

vii. *Pricing and Market Conditions:* Governments must consider prevailing market conditions and pricing when issuing bonds, whether they are conventional or thematic in nature. For SDG bonds, the pricing of the bond should be attractive to investors while still allowing the government to raise the necessary capital for its sustainable development projects.

viii. *Legal and Regulatory Framework, as well as alignment to ICMA principles:* Adequate legal and regulatory frameworks should be in place to facilitate the issuance of SDG bonds. This includes ensuring compliance with international and domestic securities regulations.

ix. *Political Will and Commitment:* There must be strong commitment from the government to prioritize sustainable development initiatives and ensure the success of the projects funded by SDG bonds. Political stability and continuity are also important factors.

x. *Engagement with Stakeholders:* Governments should engage with various stakeholders, including civil society organizations, local communities, and international organizations, to ensure that the projects funded by SDG bonds are aligned with the needs and aspirations of the population.

4.1.2. Evaluating 'goodness of fit' for an SDG bond

Any government considering issuing an SDG bond needs to first identify national sustainable development priorities aligned with the SDGs, targets in NDCs, and the existence of INFFs to realise measurable impact tied to predefined country goals. This targeted development outcome is built into a goodness of fit or suitability assessment. The main considerations are the following:

i. Overall commitment to sustainable development and to finance pressing sustainable development priorities: This involves assessing the strength and quality of National Sustainable Development Plans (NSDPs), INFFs, and the legislative/governance frameworks. This part of the assessment is conducted by the national institution and/or ministries responsible for national development planning and financing (working within existing institutions rather than setting up a new institution or sub-body). Sovereign sustainability ratings can be used as a supplementary indicator to determine commitment to sustainability. Key questions to ask include:

   a. Does the country have a robust *National Sustainable Development Plan (NSDP)* of sufficiently long-term horizon (minimum 10 years or longer) which has: i) the buy-in of broad stakeholders; and ii) has been arrived at by a comprehensive consultation and contestation process? The National Development Plan (NDP) should articulate key development/SDG challenges, a policy framework to address them, prioritisation and capacity assessments, time frames, costing and financing assessments. Examining the existence of, and alignment with, INFFs are also appropriate, as the INFF methodology is consistent with much of the process put forward here.

b. <u>Does the country have strong governance and institutional arrangements underpinning the NDP?</u> This entails looking at: i) the availability of a strong legislative oversight of the NDP (an *NDP Act* that legislates the structure, timeliness, consultation and contestation processes as well as other facets of an NDP would be highly desirable and would be considered the 'gold' SDG impact standard); ii) availability of a strong apex institution that provides overall governance and leadership to the NDP ideally headed by the head of state; and iii) availability of a strong secretariat (or similar) under the apex body that provides effective coordination, research/analysis and convening support. If the appropriate institutional structures and capacity are not in place, it will undermine the trust of the market in the issuer's ability to follow through with commitments, and one course of action is to make capacity building part of the ex-ante bond book building process with an entity like the UN or a trusted banking partner.

ii. Medium-term Framework: This largely involves looking at the medium-term framework of the country underpinned by a Strategic Action Plan (SAP) aligned with the NDP and the availability of a budgetary framework that reflects the SAP. Key questions include:

a. <u>Does the country have an SAP?</u> An SAP is a medium-term national plan that is linked to the NDP (which is longer term) but that reflects *current government* policies (and strategies). The link between the SAP and the NDP is important. This gives a sense as to the overarching nature of the NDP and how it is pursued with different governments in office. This is also an important consideration for sustainable investors.

b. <u>Is the budget aligned with the SAP?</u> Does the country have a well-articulated Medium Term Fiscal Framework that reflects the SAP, recognises spending priorities along broad development and SDG goals, and provides overall sector-wise cost/spending envelopes. Of equal importance is the appropriations framework. Three options with increased degree of preference (and sophistication) are:

- *Line items-based*, a simple appropriation strategy that is not strategic.
- *Programme-based,* where allocations are made to broader programmes (e.g., under health, education, environment etc)
- *Performance-based,* which is aligned to the programme-based approach but with a clear focus on results (or performance metrics).

iii. **Specific sector focus of the SDG bond issuance and its links to sectoral/thematic plans and associated budgets.** This is an evaluation of the specific sectoral/thematic focus of the envisaged bond issue (e.g., a green bond addressing climate change). Among other things this will entail looking at: i) the extent to which the thematic/sectoral area of focus for the bond issue is covered under a specific national plan (aligned to the NDP); ii) the extent to which government finances are allocated to this specific thematic/sectoral area; iii) the availability of a suitable bond framework for the envisaged bond issue and the consistency of the bond with the stated bond programme.

4.1.3. Evaluating debt sustainability

While SDG bonds offer access to private finance, it is critical that countries exercise caution when issuing SDG bonds and balance the need to finance long-term sustainable development with responsible debt management. Debt sustainability is particularly critical for Least Developed Countries where more prudent fiscal management is advised. In the context of re-financing, countries could potentially lower existing debt servicing burdens while simultaneously addressing SDG needs. Therefore, it is vital to assess the feasibility of any sovereign debt issuance, as new issuances increase the debt stock and the cost of borrowing for countries. The assessment includes running a debt sustainability assessment and reviewing the current sovereign credit rating and ratings outlook. Specific factors analysed within the Debt Sustainability Framework are described in Box 7. For countries preparing to issue an SDG bond, the evaluation process can result in more transparency on the debt situation of a country.

What is a DSA?

In the context of sovereign debt, DSA stands for Debt Sustainability Analysis. It's a framework used by institutions like the International Monetary Fund (IMF) to assess a country's ability to manage its debt burden over the medium and long term.

What does a DSA do?

Estimates projected debt path: DSAs use economic models and historical data to forecast the trajectory of a country's debt level over a specific period (usually 10-20 years).

Assesses risk of debt distress: It compares the projected debt path to pre-defined benchmarks or thresholds to determine the risk of "debt distress." This means a situation where the country finds it difficult or impossible to service its debt obligations without severe economic and social consequences.

Identifies policy recommendations: Based on the risk assessment, the DSA suggests policy measures that the country can adopt to improve its debt sustainability. These might include fiscal consolidation, economic reforms, or debt restructuring.

How is a DSA used?

IMF surveillance: As part of its regular surveillance activities, the IMF conducts DSAs for member countries to assess their fiscal vulnerabilities and provide early warnings of potential debt crises.

Loan programs: When a country seeks financial assistance from the IMF, a DSA is typically conducted to assess its debt sustainability and inform the design of the loan program's conditionality.

Market access: Some investors use DSAs as part of their risk assessment process when investing in sovereign debt.

A DSA is not a deterministic forecast, but rather a risk assessment based on various assumptions and economic models. Different institutions may use different DSA methodologies, leading to potentially different results.

The outcome of a DSA is primarily for informational purposes and does not have any binding legal force. By providing an objective assessment of a country's debt sustainability, DSAs play a crucial role in promoting fiscal responsibility and preventing sovereign debt crises.

4.1.4. Evaluating (Issuance) Capacity

This is an evaluation of a country's overall capacity to manage an SDG bond programme assessed from two vantage points: *i) overall public finance and investment management capacity and* ii) *capacity of the relevant line ministry or agency assigned to implement the bond programme.*

i. Overall government budgetary process strength: For analysis, two indicators are suggested: i) country public expenditure and financial assessment (PEFA) and ii) country public investment management assessment (PIMA).[31] Under PEFA, scores of mostly As and Bs under broad headings would indicate a strong PFM capacity while a C+ rating is taken as the point of inflection. Below this, ratings of Cs and Ds would reflect a relatively weaker PFM capacity. Under the PIMA, strong capacity would be indicated by ratings of 2-3 under broader categories, medium capacity would be reflected by ratings of 1-2, and ratings below 1 would indicate poor capacity.

ii. Implementing authority capacity and the ability to absorb capacity: Executing an SDG bond requires *strong capacity* at the implementing agency as well as the ability to *absorb capacity* where capacity is currently not at the expected level. This is largely a qualitative assessment that requires deep knowledge of the workings of the specific line ministry or agency in charge of overall implementation. Several of the key facets of this evaluation relate to: i) the availability of adequate staff and the requisite experience at the implementing agency; ii) a clear organisational structure, order of governance and accountability at the implementing agency; and iii) where technical capacity needs to be built, an evaluation of the absorptive capacity, underlined by the availability of required staff (or the ability to hire them), required physical and soft infrastructure and overall competence. In different countries the implementing machinery could differ based on unique governance structures and arrangements.

[31] PEFA is usually spearheaded by the World Bank with inputs from IMF and several other agencies. PIMA is usually conducted by the IMF.

Box 7: Debt Sustainability Framework

A Debt Sustainability Analysis (DSA) is usually carried out for countries by the IMF as part of Article IV consultations or specifically in instances where country authorities have requested IMF support (such as an EFF, PCI or RFI). While the framework is comprehensive and detailed, the important considerations that underly the sustainability of debt are:

i. **Starting stock of debt and composition (D0):** This is an assessment of current debt levels, its composition, and ownership. Countries where current debt is low (below 40% of GDP) should be viewed as more appropriate (notwithstanding the dynamic factors) relative to countries with higher stocks: 40-70% and above 70%. In terms of composition, countries with longer-term debt with long maturity periods would be seen more preferably compared to countries with much of its debt in the shorter- to medium-term. The Macauley duration of the portfolio could be used as an indicator for this purpose. In terms of ownership, high indebtedness to external parties would be considered less preferable than when much of the debt is owned by domestic parties. Currency composition of debt would also be a parallel assessment.

ii. **Economic growth (g):** How fast the economy will grow over the medium- and long-term will have a significant impact on the debt path. Key drivers of this growth are capital, labour, and factor productivity. Also of importance is the determination of the potential rate of growth (that is the maximum growth possible).

iii. **Real interest rates (r):** The current carrying cost of debt, which to a large extent is determined by the debt portfolio and the concessionality of it.

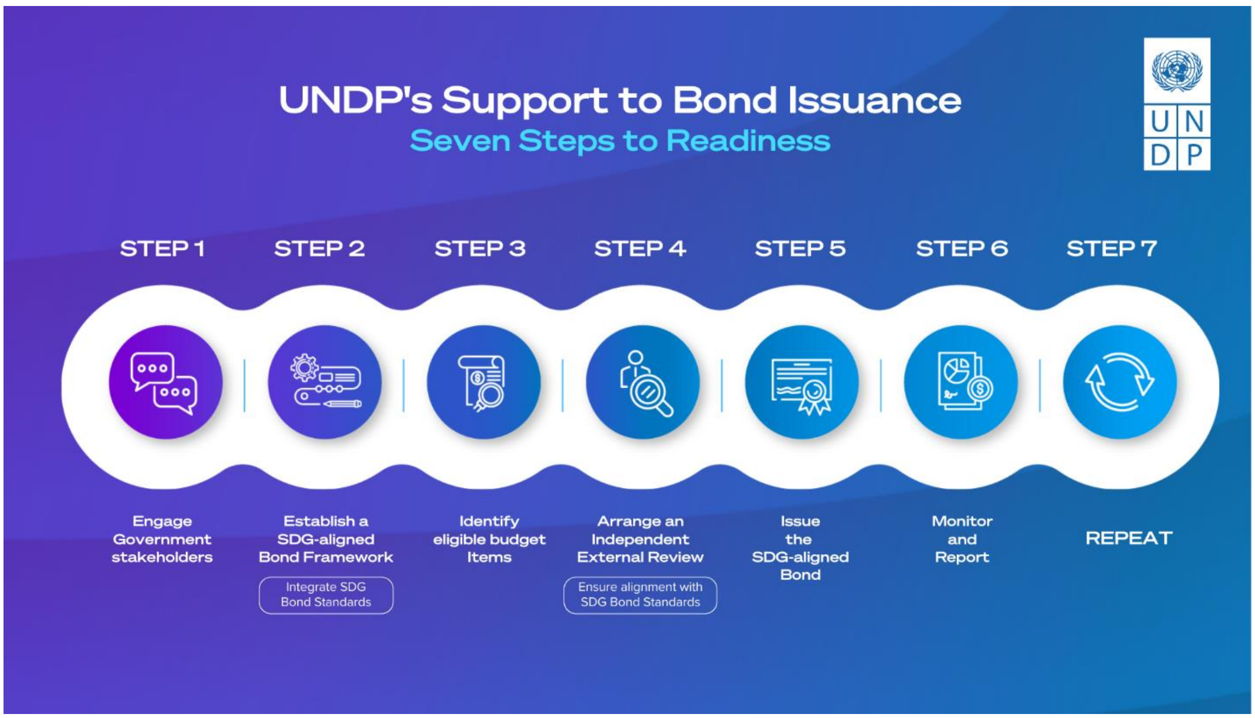
iv. **Primary fiscal Balance (PB):** The Primary fiscal Balance is the key lever to control the debt path that is at the government's disposal. Every country has a debt stabilising level of primary balance, which is the level of primary balance the government should have to not aggravate the debt position. This takes into account projected paths for variables that are not in direct control of the government. The primary balance dynamics are an integral part of the DSA.

v. **Real Exchange Rate®:** The exchange rate is also a key determinant of public debt dynamics. This is particularly for countries with large external debts. Unfortunately, it is difficult to project the dynamics of the R given the complex interactions that determines it.

4.2. Step by step guide to issuing a sovereign SDG bond

Once the evaluations described in section 4.1 have been completed and the government deems the conditions to be suitable, **the following stepwise process can be used as a guide for issuing a sovereign SDG bond.** The steps laid out have been identified by UNDP based on experience, and then reviewed and revised after testing the process across countries.

Figure 3: UNDP's step-by-step guide to issuing a sovereign SDG bond.



4.2.1. <u>Ex-ante Requirements</u>

The first step is to undertake a feasibility assessment, which involves engagement with government stakeholders, project identification, and market analysis. At this stage, it is essential that services are undertaken from a 'buy side' perspective, i.e., advisors should not be pitching debt instruments to governments but should instead support existing demands from governments. This is especially important in the case of low-income countries where institutional capacity for issuing debt and undertaking this process may be lacking. In these situations, pitching debt instruments may not be appropriate for a country's financial stability.

- <u>*Engaging stakeholders:*</u> The issuer (government Treasury) will reach out to relevant internal and external stakeholders that will advise, assist, and facilitate the issuance.

- Project identification and selection: In this step, the issuer will identify and prioritize projects that align with specific SDGs, such as infrastructure development, renewable energy, healthcare, education, or poverty reduction.
    - They will also ensure that these projects have a clear and measurable impact on sustainability (reflected in the post issuance process, see below) and can be funded through the bond proceeds.
    - The identification of projects and KPIs may in some circumstances preclude establishing the bond framework. In some cases, sovereigns already have identified assets that can be shared ahead of structuring the framework, other times, national policies, targets, and priorities are referred to in the framework.
- *Market analysis and feasibility:* The issuer will assess the market conditions and investor appetite for SDG bonds and evaluate the feasibility of issuing the bond, considering factors such as potential demand for SDG bonds, as well as interest rates, maturities, and other factors.
- *Engaging Credit Rating Assessment:* Most countries considering issuing an SDG sovereign international bond will have already issued conventional sovereign bonds, and therefore are likely to have a credit rating. If an issuer does not already have a rating, it can request one from reputable rating agencies to assess the country's creditworthiness. A higher credit rating (investment grade for e.g.) can attract more investors and result in lower borrowing costs.

4.2.2. Issuance Process

The second and third steps include establishing the bond framework and calibrating KPIs. Here the issuer will establish the corresponding SDG set of projects, potential indicators, and requirements for issuance and monitoring. These should be in line with government published plans and targets for development. Budget tagging can be included as well as links to INFFs. This work should, ideally, be undertaken by an independent third party well-versed in the SDGs. KPIs should be in line with national objectives, targets, and NDCs.

The fourth step is to arrange an External Review. This can be done through third party organisations such as Sustainalytics, S&P, Moody’s, Sustainable Fitch or ISS-ESG. External Reviews on sustainability robustness provide market credibility, which is especially important for first-time issuers or countries with lower sustainability scores or credit ratings. This is not a financial review nor does the external reviewer opine on credit ratings.

The fifth step is to engage Bookrunners. The issuer must appoint bookrunners to assist in preparing for the bond execution, as they would do with a conventional bond. The issuer may also appoint financial advisors to avoid in structuring and taking the temperature of the market (potential buyers) to aid in pricing. The bookrunners will work with the government in pricing the bond, which is often done through a book-building process, and setting other essential terms which will be outlined in the bond documentation. The underwriters will allocate the bonds to investors based on their bids and priorities. Once the bond is priced and allocated, they will issue the bonds to investors and ensure the proper settlement and delivery of the bonds to investors' accounts as well as the delivery of funds to the issuer's account.

The bookrunners will often be responsible for coordinating with appointed legal advisors (which is also a task the financial advisor can undertake) to draft the bond documentation (such as the bond indenture and offering circular, which outlines the terms and conditions for investors), including designing the bond structure (its denomination, coupon rate, maturity date, and repayment schedule).

Underwriters should also ensure, in conjunction with appointed legal advisors, that the bond issuance process and documentation follow legal and regulatory frameworks and comply with domestic and international regulations for bond issuance. They should also work with appointed legal advisors and third-party agents (listing agents, paying agents, trustees) to support the process of seeking regulatory approval from relevant authorities, such as the central bank or securities commission, and ensure compliance with securities laws and regulations governing bond issuance.

In addition, the financial advisors, as well as entities like the UN, can support marketing efforts and investor outreach. This includes developing a marketing and pricing strategy to attract investors interested in sustainable investments and promoting the bond issuance through roadshows and investor presentations.

4.2.3. Post-Issuance: Monitoring and Reporting / Repayment

The sixth step involves monitoring and reporting, as well as payment of bond interest and repayment of principal. This stage continues for the entire length or tenor of the bond. The issuer will have established a system for ongoing reporting on the use of bond proceeds and the progress of funded projects in the bond design and execution steps above, the monitoring plan is now executed. The data generated should enable the issuer to provide regular updates to investors and stakeholders on the impact of the projects on sustainable development.

An optional step that the issuer can undertake is impact evaluation. This is performed by a third party to conduct periodic assessments of the projects' impact on sustainability and the progress toward achieving the targeted SDGs. Although it is voluntary, providing third party impact evaluations enhances the credibility and reputation of the issuer and makes future issuances more attractive to investors. Investors are becoming increasingly focused on impact reporting metrics for sustainable bonds, with some anecdotally stating that a lack of impact reporting can cause a sustainable bond to be removed from ESG-focused funds.

As with all loan and bond contracts, the issuer must also manage the payment of bond interest and repayment of bond principal according to the terms specified in the bond documentation.

4.2.4. Repeat

The final step is to assess new or refinancing needs and whether the issuer needs to return to the SDG bond market. Future issuances depend on both the government's sustainable investment funding requirements and the success of the initial bond issuance—here there is no difference from a conventional bond. The country will issue again if there is a need for raising funds, and if gaps persist in SDG delivery that the country expects can be filled with an additional issuance.

4.3. Types of partners and experts to involve

- **The UN system:** The UN system can be a strong partner on a range of needs prior and ex-post issuance by lending credibility on alignment to the SDGs and supporting roadshows and communications. The UN system often has trusted and neutral partners and experts that it can recommend or make introductions to. A country should perform a 'beauty context' allowing various service providers from each category to provide an offer and pricing of their expertise. The UN can facilitate this as well.
- **Development Banks**: Collaborate with multilateral development banks (MDBs) like the World Bank, or regional development banks to leverage their expertise in sustainable development and potentially co-finance projects.
- **Financial Advisors**: Financial advisory firms or individuals with expertise in debt issuance and capital markets can provide guidance on structuring the bond, setting pricing, and managing the overall issuance process.
- **Underwriters**: Underwriting firms or banks help facilitate the sale of the bond by purchasing it from the government and reselling it to investors. They can also provide market-making support.
- **Legal Advisors**: Legal experts specializing in securities law, international finance, and bond issuance can help ensure compliance with regulatory requirements, draft bond documentation, and provide legal guidance throughout the issuance process.
- **Rating Agencies**: Collaborate with credit rating agencies to assess the creditworthiness of the sovereign issuer. A higher credit rating can attract a broader investor base and result in favourable borrowing terms.
- **Investor Relations Professionals**: Engage professionals who specialize in investor relations to effectively communicate with potential investors and provide them with information about the bond offering and the government's commitment to sustainable development.

- **Environmental and Social Consultants**: Experts in environmental and social impact assessments can help evaluate the sustainability of projects and ensure alignment with the SDGs. They can also assist in monitoring and reporting on the projects' impact.
- **Project Managers**: Experienced project managers can oversee the implementation of the projects funded by the bond proceeds, ensuring they stay on schedule and within budget.
- **Regulatory Authorities**: Work closely with regulatory authorities, including central banks and securities commissions, to secure necessary approvals and ensure compliance with legal and regulatory requirements.
- **Economists and Financial Analysts**: Economic experts can help analyse the financial feasibility of projects, conduct cost-benefit analyses, and assess the impact of the bond issuance on the country's fiscal position.
- **Stakeholder Engagement Specialists**: Professionals who specialize in engaging with various stakeholders, including local communities, civil society organizations, and indigenous groups, to ensure that projects respect the rights and interests of all parties.
- **Public Relations (PR) and Communications Experts**: Develop a communications strategy and engage PR professionals to convey to the public and investors the government's commitment to sustainable development, transparency, and accountability.
- **Sustainability and ESG Experts**: Experts in environmental, social, and governance (ESG) criteria can assist in integrating ESG considerations into the bond issuance and reporting processes, attracting ESG-focused investors.
- **Financial Institutions**: Partner with financial institutions, such as commercial banks or investment banks, to provide banking services, facilitate transactions, and manage the distribution of bond proceeds.
- **Technical Experts**: Depending on the nature of the projects, technical experts in areas like renewable energy, healthcare, education, and infrastructure development may be required to ensure project success.
- **Credit Enhancement Providers**: Consider working with organizations that offer credit enhancement or guarantees to improve the bond's credit rating and make it more attractive to investors.
- **Sustainable Finance Advisors**: Experts in sustainable finance can help design and implement a comprehensive sustainability strategy for the bond issuance.
- **Auditors and Accountants**: Ensure that financial reporting and auditing processes are in place to maintain transparency and accountability in the use of bond proceeds. These include SPO providers.
- **Treasury and Finance Officials**: Collaborate with government treasury and finance departments to manage cash flows, ensure timely debt servicing, and monitor fiscal responsibilities.

4.4. Globally accepted reporting standards and frameworks

The foundation of SDG bonds is contribution to the SDGs, including SDG-aligned targets and indicators. Investors view the principles published by ICMA as the most widely accepted set of standards that issuances must be aligned to. Broadly following ICMA principles provides investors with a sense of standardisation and is considered best practice.

The following is an illustrative list of globally accepted standards and frameworks that governments must review before incorporating those relevant into their monitoring and reporting frameworks. Reporting is more standardized for UoP bonds due to regulation and has not yet been standardized for SLBs. In general, guidance is available in the market to differentiate among the principles, and how to apply them. While this list may appear daunting, the UN is available to consult and support countries on which to use, when and how.

- **Sustainable Development Goals (SDGs):** The United Nations' 17 Sustainable Development Goals serve as a global framework for sustainable development. When issuing SDG bonds, issuers align their bond projects with specific SDGs and report on their contributions to these goals.
- **Green Bond Principles (GBP):** The Green Bond Principles, established by ICMA, provide guidelines for issuers of green bonds. While not specific to SDG bonds, they are often used as a framework for environmentally themed bonds. The GBP emphasize transparency and disclosure of the use of proceeds.
- **Social Bond Principles (SBP):** The Social Bond Principles, also developed by ICMA, provide guidance for issuers of social bonds, which can align with SDG-related projects and objectives. SBP focus on transparency, use of proceeds, and the promotion of positive social outcomes.
- **Sustainability Bond Guidelines (SBGs):** ICMA also introduced Sustainability Bond Guidelines, which cover both green and social bonds. These guidelines encourage issuers to provide information on how the bond's proceeds contribute to sustainable development.
- **Sustainability-linked Bond Principles (SLBP)**: ICMA developed the Sustainability-linked Bond Principles in 2020, which recommend structuring features, disclosure and reporting to further develop the key role that debt markets can play in funding and encouraging companies that contribute to sustainability.
- **Climate Bonds Standard:** The Climate Bonds Standard is maintained by the CBI and is designed to guide issuers in creating bonds that finance projects addressing climate change. While not exclusively related to SDGs, climate bonds often contribute to multiple SDGs.
- **Regional and Local Taxonomies:** Taxonomies facilitate investments' alignment with sustainable development by providing standardized definitions of economic activities that can be considered sustainable. For example, the EU taxonomy is viewed as a reference point for environmental and climate activities. As there is more knowledge

and acceptability of taxonomies, reporting aligned with these classification systems fosters more harmonization and trust in the global market.

- **Global Reporting Initiative (GRI):** The GRI provides a comprehensive framework for sustainability reporting. It is not specific to bonds but is often used by issuers to report on the environmental and social impacts of their projects, which can align with SDG bonds.
- **Task Force on Climate-related Financial Disclosures (TCFD):** While primarily focused on climate-related reporting, TCFD recommendations encourage companies to disclose information on how climate-related risks and opportunities are integrated into their financial planning. This can be relevant for issuers of bonds with climate-related objectives.
- **Task Force on Nature-related Financial Disclosures (TNFD):** The TNFD's work can help evaluate nature-related dependencies, and the risks, the impacts, and the opportunities emerging from these dependencies. These would be most relevant to issuers considering projects and KPIs related to nature-related investments.
- **SDG Impact Standards:** The SDG Impact Standards focus on the Bond Issuer's decision-making practices, rather than the bond instrument itself. By focusing more holistically on the Bond Issuer's impact management and decision-making practices, the SDG Impact Standards for Bond Issuers help fill gaps in more transactional current market practices which are undermining progress towards the SDGs. Current approaches focus on the "what". The SDG Impact Standards for Bond Issuers explain the "why" and the "how" to help issuers select and optimize the impact of the right "what". The SDG Impact Standards for Bond Issuers include an Issuer-wide responsible business screen and links the SDG Bond Programme to Issuer impact/sustainability strategy. It focuses on most relevant and material positive and negative outcomes for people and the planet within the scope of the Issuer impact/sustainability strategy and it can be used with existing taxonomy-based UoP bonds or provides a robust outcomes-based framework for SDG/SLBs.

Other sources are readily available from leading banking and public sector partners within the GISD Alliance. For example, PIMCO has an industry-recognised sovereign sustainable bond guidance available for investors.[32] The IMF has published a guidance note on Sovereign ESG Bond issuance focused on emerging and developing economies.[33]

[32] PIMCO, PIMCO's Best Practice Guidance for Sovereign Sustainable Bond Issuance, 2022.
[33] IMF, Sovereign ESG Bond Issuance: A Guidance Note for Sovereign Debt Managers, 2023.

Box 8: Best practices on monitoring and reporting

- **Align with and consistently apply standardised frameworks** that are already developed and well-accepted by market participants, such as the Green Bond Principles (GBP) and the Sustainability-Linked Bond Principles (SLBP).
- **Provide timely data and reporting** as these are the most important factors to improving the credibility, transparency, and accountability of issuers and these instruments. Increased SDG mapping as part of the budgetary process would also be helpful, for example as seen in Mexico.
- **Engage with stakeholders**, including investors, issuers, regulators, and civil society organisations, to gather diverse perspectives and insights on SDG bond reporting and verification. This collaborative approach helps ensure that the reporting frameworks and verification processes are relevant, credible, and responsive to the needs of stakeholders.
- **Encourage the use of independent third-party verification** to enhance credibility and trust in the reporting of SDG bonds. Independent verifiers can assess the alignment of bond issuance and use of proceeds with SDGs, evaluate impact metrics and targets, and provide assurance on the accuracy and completeness of reporting.
- **Conduct thorough materiality assessments** to identify the most significant sustainability issues and impacts related to the SDG bonds. This assessment should consider the specific context and characteristics of the projects or activities financed by the bonds. It helps focus reporting and measurement efforts on the most relevant factors.
- **Foster transparent reporting** by disclosing relevant information related to the SDG bonds. This includes details on the use of proceeds, project-specific impacts, methodologies used for impact measurement, and progress towards SDG targets. The reporting should be accessible to investors, regulators, and the general public.
- **Leverage artificial intelligence** to collect and organize data.

4.5. A note on pricing and costs

In general, fees for bond issuance are 1% - 2.5% of the total issuance amount (principal value). Fees and costs related to SDG bonds can be higher given the additional structuring work undertaken to set up the framework and the general need to obtain a SPO as well as part of the 'quality assurance' not associated with conventional bonds, i.e., impact monitoring and reporting performed. As mentioned above, the SPO can be a substantive transaction cost. Often, the smaller the issuance the higher the fee proportion. Fees can be difficult to navigate for first-time issuers and especially for issuers with limited capacity and financial resources. The findings of this study are that the benefits outweigh the fees, but they still need to be considered. Countries can possibly receive financial support from public investors, Development Finance Institutions (DFIs), or the UN, and receive discounts on the SPOs. To consider as well is the potential for a small *greenium* to partially offset the costs. Once a bond programme is established, it will cover several issuances, so economies of scope and scale can be reaped.

The fee types and costs are noted below.

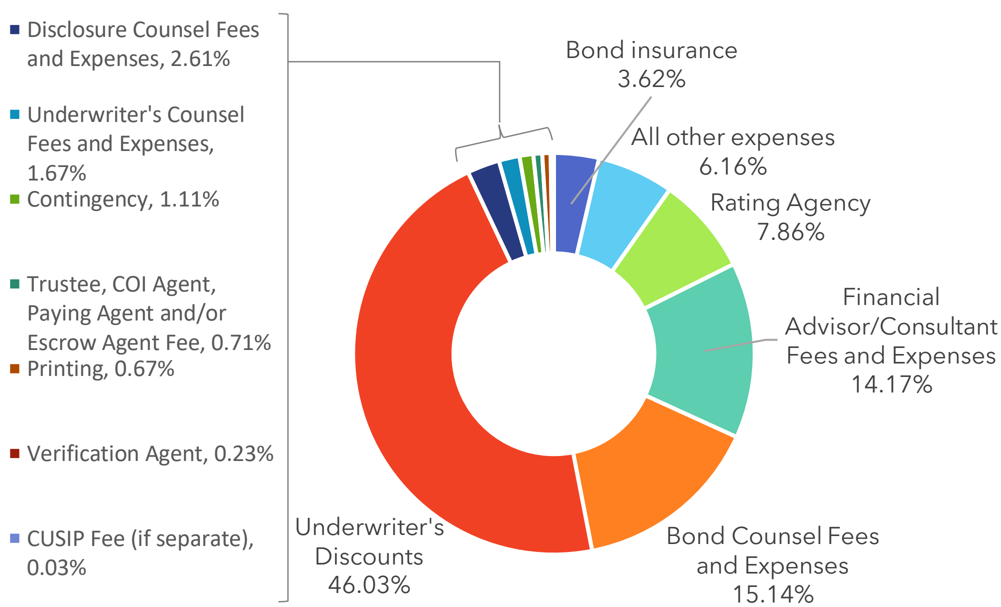
- *Underwriters' Fees:* Issuers usually hire investment bank(s) to sell their bonds. The investment bank, or underwriter, retains a portion of the sales proceeds as a commission for its services. In the U.S., underwriting fees, in recent years, have averaged about 0.7 percentage points on investment-grade corporate bonds, meaning that for a US$1 bn bond issue, companies would pay about US$7 mn to banks arranging the sale. For U.S. high-yield, or "junk," bonds, the fee averages 1.2 percentage points, according to data from Thomson Reuters—this is more in line with what we would expect for emerging markets as well. Fees in Asia are generally lower and can vary widely, bankers find.
- *Underwriter's and Issuer's Counsel Fees and Expenses:* usually both the underwriter(s) and issuer hire law firms to represent them during the bond preparation and issuance process, to prepare and certify bond documentation. Although underwriter's counsel is directly accountable to the underwriter, the underwriter may pass along its fees to the issuer. Legal costs for the issuer's counsel often comes to ~US$100k, while underwriter's counsel costs tend to be slightly lower.
- *Structurer, Financial or Sovereign Advisor (or Consultant) Fees and Expenses:* a professional consultant retained (customarily by the issuer) to advise and assist the issuer in formulating and/or executing a debt financing plan to accomplish the public purposes chosen by the issuer. A financial advisor may be a consulting firm, an investment banking firm, or a commercial bank. The structuring fee is a pre-agreed number of basis points normally.
- *Rating Agency Fees:* are paid to an internationally recognised statistical rating organization (or credit rating agency) such as Moody's, S&P or Fitch. These agencies assign letter grades to the issuer and/or the bonds indicating their level of credit risk. Bonds with higher ratings are expected to pay lower interest rates than those with lower ratings or those that are unrated.
- *Bond Insurance Premiums:* Some issuers insure their bonds. The insurance company agrees to pay interest and principal in the event that the issuer defaults. When an issuer purchases bond insurance, its bonds receive a higher rating and the expectation of lower interest costs.
- *Verification Agent Fees (like SPO):* A verification agent is a consultant that checks various calculations in bond documents or alignment to the Climate Bond Standards. Verifiers also include SPO providers. The SPO provides an expert assessment of a Green, Social, or Sustainability Bond framework against the ICMA principles. For example, when a local government issues a refunding bond to pay off a previous bond issue, a verification agent determines whether sufficient proceeds from the new bond issuance are being escrowed to fully pay the interest and principal on the original bonds. Discounts are available and can be negotiated. For example, UNDP has trusted relationships with SPOs and can offer this at a cheaper rate as a result. The fee depends on bond size but usually is US$20-US$25k. Verification costs can range widely, as the 'big 4' are often expensive compared to the smaller entities. The

proposed set rate for the certification fee for the green label of the CBI is a flat 0.1 basis points of the issue value. A minimum fee of US$2,000 for issuers in developed countries and US$1,000 for issuers in developing countries will be charged by the CBI upon awarding the certification label as per CBI.

- *Trustee, Cost of Issuance Agent, Paying Agent and/or Escrow Agent Fee:* These are various names assigned to a bank or other financial institution that handles payments on behalf of the bond issuer. For example, a trustee ensures that bondholders receive their interest and principal payments on time and in full.
- *Contingency:* This is a reserve for any unanticipated expenses. Can be about 1 percent of total issuance costs.
- Gatekeepers/brokers: Usually success fee to make introductions or facilitate payments.

According to Credit Suisse, a selling fee is client-driven for green bonds. For high-quality investment grade green bonds, this is 30-50 bps, high yield can be 100-150 bps. Legal costs are an additional US$100k at least (paid by the client) and often two sets of lawyers are needed, for client counsel and bank counsel (underwriter) if the deal is sufficiently large (i.e., US$150 mn or more).

Figure 4: Issuance costs by category[34]



[34] Joffe, Marc. "Doubly Bound: The Cost of Issuing Bonds." Berkeley, CA: Haas Institute for a Fair and Inclusive Society, University of California, Berkeley, 2015. To note, this diagram assumes there are no extra fees for the setting up the sustainability reporting process.

5. Investor Preferences

This section is derived from the primary research conducted with members of the GISD Alliance, including investors as well as banks that provide underwriting services. **The results shed light on the decision-making process behind investing in sovereign SDG bonds, pricing risk, preferences between different bond structures, and data and impact.**

5.1. Decision-making process behind investing in sovereign SDG bonds

Most fixed income investors (including pension funds) expressed interest in sovereign SDG bonds. The main drivers of investing in SDG-aligned instruments are compliance with the organization's investment thesis and sustainable financing strategy. For example, some investors have large bond portfolios by regulation. The second main driver is internal or national regulation to diversify into labelled assets (such as green, social, sustainable, or SLBs). Green and social labels can contribute to increasing demand but are not sufficient to offset credit weakness.

In general, projects that address climate adaptation and mitigation (including biodiversity) are most attractive for investors interested in sovereign SDG bonds, followed by projects related to a just energy transition. While sovereign SDG bonds often have a 10-year average tenor, most investors would be willing to consider SDG bond offers with longer tenors.

The starting point for investors is determining what can be done in the allotted timeframe and what use of proceeds can be identified, rather than alignment with the SDGs. Investors were less concerned about the level of rigor in the measurement of SDG impact, as well as whether the country has an INFF in place.

Large and sophisticated investors have developed in-house bespoke frameworks for evaluating labelled issuances which assess factors ranging such as creditworthiness, alignment with global principles, and impact on developmental outcomes. Less sophisticated investors expressed confusion when facing the different acronyms and labels used to differentiate types of bonds.

5.2. Pricing risk

The most critical factor in pricing risk for investors are creditworthiness, including political stability and the macroeconomic environment of the country. While there is strong interest in contributing to sustainable development in emerging markets, it is not a primary driver of investment allocation. Repeatedly returning to the market increases the credibility of the issuer, for example in the case of Indonesia, the Philippines, and Thailand.

In general, investors prefer to let the market determine prices based on risk and return. Most investors surveyed said that they are not willing or able to take a discount (pay a premium) for sustainable development outcomes. Yet, while investors did not say they would accept a direct premium or discount for SDG bonds, including the extra costs associated with an SDG bond (for example impact verification, payment for an SPO) indicates an implied willingness to pay a premium.

Some investors and clients also emphasise transparency and minimum SDG criteria in their investment decisions, while others are driven only by risk and return and diversification of risk.

5.3. Preferences between different structures

There is a preference for UoP bonds over SLBs mainly because SLBs are relatively new compared to the now established green bond market. Green bonds are a more familiar instrument (with a direct line between proceeds and projects) and are easier to trust and resell. Even with UoP bonds, investors nevertheless point to challenges in assessing impact of the projects on the SDGs.

In terms of SLBs, some investors have concerns over the materiality and rigor of the chosen KPIs. This has more to do with the country's strategy on setting credible targets and not a weakness of the instrument itself. Therefore, it is crucial that the data and information shared by the country is transparent and credible. Investors also raise the additional question of how potential changes in governments might impact progress against the targets.

With regards to SLBs, investors have a strong preference for the coupon step-up structure, which gives investors a compensatory step-up in coupon if the issuer fails to hit a sustainability target. SLBs can include coupon 'step-ups' and/or 'step-downs,' where progress, or lack thereof, toward the SDGs or selected KPIs results in a decrease or increase in the instrument's coupon. This incentivises the borrower's sustainability performance objectives by tying the financial characteristics of the bond to the achievement of predetermined SPTs. Uruguay is so far the only sovereign to issue an SDG bond with a step-down structure, which is when an issuer exceeds its SPTs leading to a coupon step-down. Investors remain hesitant about including step-down structures based on arguments that the SPTs set to date have generally been viewed as easy to meet. However, if material KPIs and targets are selected, then these serve as an incentive for the issuer to exceed its targets and by including both step-ups and step-downs, risk is shared by both the issuer and investors.

5.4. Data and impact

Issuances that align with ICMA-approved guidelines are considered credible by investors. Existing standardised frameworks, such as GBP and SLBP are well-accepted by market participants and provide guidelines on transparency, disclosure and on promoting integrity. Investors positively favour UoP bonds that are aligned with the targets underpinning the SDGs, resulting in impact reporting that references specific targets and/or indicators.

Disclosures across different issuances and projects, however, are not standardised and there is limited comparability. Meeting the SDG Impact Standards for Bond Issuers developed by UNDP further offers a boost to the reputation of the instrument.

Adding further complexity to reporting, countries have their own taxonomies which lead to an additional layer of analysis for investors. As different taxonomies can yield different conclusions for the same product, a global convergence on minimum standards would improve decision-making by investors.

While it is vital that issuers are transparent with what they do with the funds, it is inherently difficult to calculate contribution to each SDG and provide evidence for net positive impact. For instance, measuring the impact of green bonds is arguably easier than social bonds, as the underlying data of social aims (including to reduce unemployment, improve gender equality, and expand access to healthcare) is harder to accurately monitor and report. Therefore, a green label for issuances in emerging markets often receives greater demand from investors, especially since the strict frameworks that green bonds must comply with reduce the risk of allegations of greenwashing.

Investors do not yet have consensus on the consequences for sovereign SDG bond issuers that do not meet their commitments as laid out in the framework. This could mean that either the projects were not completed (or completed in a manner that was not SDG-aligned) or the government pursued activities that undermined its sustainable development strategy. This risk can be mitigated by continuing to engage with the issuer or reduce exposure, but this may not be effective unless these actions are pursued collectively by sizeable group of bondholders.[35]

[35] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.

6. Best Practices for Investors

Through extensive interviews with investors and government representatives, several best practices from the investor community can be distilled. A common theme among them is a more active role on the part of the investors to ensure mutually successful outcomes. Our analysis finds that best practices that investors can adopt include: **assessing country conditions, engaging with government representatives to understand developmental gaps and national priorities, committing to transparency both in terms of pricing as well as sustainable development outcomes, undertaking independent due diligence to ensure alignment with global standards, signalling to governments the importance of adherence to established international conventions, communicating openly throughout the issuance process, and advancing the overall ecosystem by supporting the development of new technologies and frameworks.**

6.1. Assess country conditions

Countries vary considerably in their capacity to take on debt. As part of the 'goodness of fit' assessment, country conditions including macroeconomic indicators and debt sustainability must be examined by investors *(refer to Section 4.2 for more details)*.

For sovereign SDG bonds in particular, in addition to the overall assessment of country conditions, investors should also look for strong government cohesion and political consensus on a national SDG roadmap. This can generate confidence that countries will continue to focus on these objectives even after a change in government.

6.2. Engage with governments to understand development gaps and national priorities

Investors should be aligned with the country's needs for financing and fully understand the country's specific debt situation. Whenever applicable, the connection to a country's INFF, national plans (only sustainable projects) and NDCs should be applied. This ensures that bonds have use of proceeds in areas that address national sustainable development needs, whether environmental or social areas like gender and education. One suggestion is to include a materiality analysis of the country's largest investment needs related to realising the SDGs to help guide investment decisions.

6.3. Commit to transparency

Investors must themselves display transparency by disclosing pricing and rates, standards and principles applied, methods for assessing issuer frameworks and projects, and third-party assurances and verification utilised. This information is helpful for both new and repeating issuers who can learn from past experiences to structure more attractive instruments. Developing a clear framework for measuring the impact of investments on the targeted SDGs is an essential part of the process. Investors should look for sovereign issuers that provide transparent reporting on their SDG progress and demand greater clarity on use of proceeds before agreeing to buy new issues.

6.4. Ensure alignment with global standards and undertake due diligence

Investors should refer to existing standards and ensure alignment with globally accepted standards starting with the SDGs, relevant ICMA principles and other applicable frameworks. External reports and opinions published by third parties are useful guides, but they must be supplemented with additional due diligence undertaken by the investor. In addition, **investors should make it clear to issuers that strong alignment with the SDGs and the relevant targets and indicators must be spelled out in the bond framework.**

6.5. Signal to countries on importance of adherence to international conventions

Investors can emphasise the importance of international treaties and conventions with special attention to human rights, youth, gender, education, health, peace and security, climate, biodiversity, building strong institutions. Key among these include the UN Guiding Principles, ILO Conventions, UN's Convention on Biological Diversity , UN Global Compact, and the International Finance Corporation (IFC) Performance Standards. Focus should also be put on promoting trade and private sector engagement.

6.6. Engage in open communication with governments throughout the process

Clear and open communication between investors and governments both pre- and post-issuance, for example through roadshows, is the most important success factor for any issuance. This enables investors to understand government priorities and needs and provide critical feedback on how the instrument and the underlying projects or targets should be structured to have maximum impact. Aligning incentives helps both issuers and investors build trust and deliver shared objectives.

Through UN backed initiatives such as the GISD Alliance, investors can maintain an active dialogue with sovereign issuers regarding their SDG projects. They can encourage transparency and accountability in the issuer's pursuit of SDG targets while also observing how the country advances.

6.7. Support advancement of the overall ecosystem

Investors can help advance the market by promoting technology-driven data management through blockchain, open-source platforms, and other technologies. Large language models and data scraping using artificial intelligence (AI) are recent developments that can address some of the data challenges. Over time this can reduce transaction costs and make monitoring and reporting more resource efficient.

In addition, **investors should encourage credit rating agencies to develop more refined and longer-term ratings** that account for the unique risks and attributes associated with SDG-oriented investments. This refinement can provide more accurate insights for investors and help guide their decision-making.

7. Recommendations to Advance the Market

While it is critical for countries that suitable conditions are in place before issuing a sovereign SDG bond, some countries will need the support of MDBs, donors, the UN, and other partners to do so. The following recommendations present solutions that can be brought forward by stakeholders to responsibly increase access of developing countries to global capital markets through sovereign SDG bonds.

7.1. Recommendations for the UN and MDBs

Help identify sustainable development gaps

- Perform materiality analyses of countries' needs for the SDGs and direct flows toward maximum impact. In countries where UNDP provided technical assistance (e.g., in aligning budgetary expenditures with SDGs), the development and issuance processes have been significantly expedited.
- Support policy coherence including integrating the SDGs into national development plans, fiscal policies, and budgetary processes.

Foster collaboration

- Foster collaboration among stakeholders, to share best practices, experiences, and challenges in SDG alignment. This collaboration helps create collective understanding and drives continuous improvement in SDG-related investing practices.
- Provide a platform for governments and investors to interact bilaterally to better understand investor preferences.
- Facilitate international cooperation to share best practices, provide financial assistance, and promote investment in SDG-aligned projects.

Enhance transparency

- Form quality assurance committees in collaboration with donor countries to share best practices in data, monitoring and reporting, and set minimum standards for transparency.
- Build capacity to enhance statistical capabilities to ensure proper provision of data and information required by investors.
- Simplify reporting by improving access to available data and information.
- Harmonise SDG reporting by creating a standardised reporting template across the SDGs (identifying indicators and a taxonomy) that aligns with investor preferences, to enhance clarity and to accelerate the process.

7.2. Recommendations for donors

Scale up credit enhancement when appropriate

- When appropriate,[36] provide credit enhancement such as first loss guarantee. Such guarantees make instruments more appealing to investors by lowering their risks. Donors can combine efforts with MDBs. Guarantees can also be 'pari passu' in another connected portfolio.
- Typically, insurance and credit enhancements have largely been in favour of the investor with the donor taking on the market risks while the investors keep the return (i.e., overcompensating the investor). For some investments, support can be structured as equity-like instruments so that donors can participate in the upside.
- In the case of SLBs with grants or guarantees, allocate part of the proceeds from the step-up structure to reimburse the guarantor.
- Consider including risk mitigation insurance, for example the costs of insurance or currency conversion could be part of the UoP (like the TCX fund, for example). Capacity building and technical assistance would be required.

Build institutional capacity

- Donors should contribute to building strong institutional capacity and a good investment climate.
- Support in the form of technical assistance and marketing can also benefit countries on activities such as developing an SDG framework, identifying relevant projects, and outreach to external service providers, consultants and SPO providers. Countries can then deploy those savings to increase investments in sustainable development.

Support a long-term approach to ratings

- Encourage credit rating agencies to develop more nuanced and longer-term ratings that reflect risk, as well as SDG investment.

7.3. Recommendations for sovereign issuers

Ensure alignment with existing commitments, e.g., NDCs and sustainable development plans

- Enhance national capacities and create an enabling environment for SDG bond issuances, which can be supported with technical assistance and peer to peer learning from other countries that have issued SDG bonds.

[36] Credit enhancement must be applied selectively and should be a function of country conditions and needs. Importantly, guarantees and incentives should serve the purpose of eliminating bottlenecks in the market and not contribute to negative market disturbance.

- Ensure there is alignment between NDCs, NSDPs and existing policies and government resources deployed in other activities are not contradictory (for example subsidising the fossil fuel industry).

Improve availability and quality of data

- Debt instruments have historically served as vehicles for prudent financial management for governments. Some countries such as Mexico have in addition to issuing SDG bonds also implemented SDG budgeting tagged to specific expenditures to better plan and manage projects. Treating them as such enables innovative solutions for data sharing, coordination, and governance issues surrounding these instruments.
- A robust mechanism to measure and report the outcomes of projects funded by the bonds needs to be in place to ensure transparency and accountability. Access to reliable and standardised data is crucial for investors to assess the impact and alignment of sovereign SDG bonds.
- Build the capabilities of national statistical agencies to improve data availability and the quality of data related to sustainable development indicators and performance as well as on economic and financial conditions.

7.4. Recommendations for investors and banks

Open communication and engagement

- Maintain open communication and continuously engage developing countries to understand national plans for sustainable development, SDG aligned projects, targets and KPIs.
- Maintain open communication between investors and banks, to ensure sharing of knowledge of the challenges faced on both the issuer (who the banks will be advising) and the investors themselves. This will ensure banks are keeping investor preferences and standards in mind when advising issuers, while investors account for sustainability agenda trends of different types of issuers.
- Banks play a big advisory role in ensuring compliance with international guidelines and standards. Enhancing the knowledge of banks through trainings on SDG-related standards, principles, and structures can result in better advisory and underwriting services for governments issuing SDG bonds.

Pool countries into a portfolio / fund

- Pool several smaller and more risky countries into a portfolio / fund to distribute risk.

Ensure transparency of deals

- Enhance transparency on deals, for example through a digital platform announcing all deals.
- Support the development of secondary markets, trading platforms, and other infrastructure to improve liquidity and facilitate bond transactions.

ANNEX I: Case studies

i. Overview of case studies

	Financing framework				**Examples of issuances**						
	Type of bonds	**SDG alignment**	**Technical assistance**	**INFF?**	**Year of issuance**	**Type of bond**	**Size of issuance**	**Tenor (years)**	**Coupon**	**Issued on global / domestic market?**	**Over-subscribed?**
Indonesia	Use of proceeds	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15	UNDP	Yes	2018 2019 2021 2022 2023	Green sukuk Green sukuk SDG bond Green sukuk Blue bond	US$1.25bn IDR 1.4 trn EUR 500 mn IDR 5.66 trn JPY 20.7 bn	5 2 12 7 7 & 10	3.75% 6.75% 1.30% 6.625% 1.2% & 1.43%	Global Domestic (retail) Global Domestic (wholesale) Global	✓ *n/a* ✓ ✓ ✗
Uruguay	SLB	13, 15	UNDP and IDB	Yes	2022	SLB	US$1.5 bn	12	5.935%	Global	✓
Mexico	Use of proceeds	2, 3, 4, 6, 7, 8, 9, 11, 13, 14, 15	UNDP	Yes	2020 2021 2022 2022 2022 2023 2023 2024	SDG bond SDG bond SDG bond SDG bond SDG bond SDG bond SDG bond SDG bond	EUR 750 mn EUR 1.25 bn MXN 45,000 mn USD 2,203 mn JPY 75,600 mn USD 2,941 mn MXN 53,000 mn EUR 2,000 mn	7 15 1-6 10 3-20 30 1.7-5 8	1.35% 2.25% 4.49%	Global Global Domestic Global Global Global Domestic Global	✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓
Chile	SLB	5, 7, 13	IDB, CBI, and UNDP	No	2022	SLB	US$2 bn	20	4.34%	Global	✓
Benin	Use of proceeds	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15	UNDP	Yes	2021	SDG bond	EUR 500 mn	12.5	4.95%	Global	✓

ii. Indonesia

Overview of the country's financing strategy for the SDGs

Commitment to sustainable development: Indonesia is committed to successfully implementing the SDGs. A legal basis has been created, as well as an inclusive coordination team to promote the achievement of the SDGs. Through regulation, Indonesia sets national targets in the medium-term NDP, which aligns with the SDGs. These national targets are used by Ministries/Institutions and Local Governments in the preparation, implementation, monitoring, and evaluation of the SDGs and have become reference for other stakeholders in developing a programme for the SDGs. The government has regularly released Voluntary National Reviews and annual SDG achievement reports to update on progress.

Indonesia has completed a Development Finance Assessment and an INFF Roadmap. The document has identified thematic debt issuances (green sukuk and SDG bonds) as an alternative financing source to finance the SDGs and climate action. One of the financing strategies identified relevant to SDG debt instruments is to strengthen the domestic capital market.

Enabling environment in the country

Political support: Strong political commitment and support from the Ministry of Finance, the Ministry of National Development Planning (BAPPENAS), and other critical players backed the SDG bond issuance in Indonesia. In addition to strong political commitment, a robust technical framework and roadmap was needed to achieve the SDGs. The government prepared national action plans (2017-2019) and the most recent (2020-2024), which consist of targets for each indicator of SDGs, policy directions, and programmes and activities of the government and non-state actors to achieve the five-year targets.

Experience with global markets: Indonesia has been a regular issuer of sovereign SDG bonds in the international capital markets in different currencies. The government issued the first global sovereign green sukuk in 2018 amounting to US$1.25 bn, followed by more issuances in the global and domestic markets. In 2021, Indonesia issued an SDG bond in global markets with a total amount of EUR 500 mn, followed by the issuance of a Samurai Blue Bond of JPY 20.7 bn. At the end of the second quarter of 2023, Indonesia's total thematic bond issuance was more than US$8.5 bn.

Local institutions and bodies: Indonesia also actively issues thematic bonds in the local domestic debt markets. In 2019, the government issued its first Green Sukuk in the domestic retail market attracting individual investors, with minimum investment of IDR 1 mn (US$65). In 2022, the government issued an SDG Bond in the domestic wholesale market (Institutional Investors).

SDG framework

Overview of framework development: The SDG framework established in 2021, adopts the ICMA GBP and SBP 4 Core pillars with a detailed description of each of the pillars: use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. The framework expanded on the earlier green bond and green sukuk framework, established in 2018. It incorporates additional aspects of SDGs including advancement of the blue economy (blue focus) and positive social outcomes (social focus). The framework will enable the government to issue different thematic bonds (blue, gender) in the future.

The SDG framework received an external SPO by CICERO and International Institute for Sustainable Development (IISD) to ensure its adherence to globally recognised principles and standards. The SDG framework was awarded "Medium Green" for the green aspects and "Good" for the framework's overall governance structure.

SDGs covered: The SDG government securities framework covered eligible SDG expenditures that aligned with 15 out of 17 SDG Goals (Goal 1 to Goal 15).

Technical assistance received.: The framework was developed by the Ministry of Finance in collaboration with BAPPENAS and the Coordinating Ministry of Maritime and Investment Affairs, with technical support from HSBC, CACIB, and UNDP as joint advisors.

External partners involved:

- UNDP has been involved throughout the bond issuance process, including developing a feasibility study, framework, and the SPO process. UNDP also support the development of climate budget tagging.
- Advising Banks (HSBC & CACIB)
- SPO (CICERO & IISD)

Eligible Expenditures

The net proceeds will be used to finance and/or refinance, in whole or in part, new or existing eligible SDGs expenditures with green, blue and social focuses.

Under the green and blue focus, the following expenditure categories were listed in the framework: Renewable Energy, Energy Efficiency, Sustainable Transport, Waste to Energy and Waste Management, sustainable management of natural resources on Land and Ocean, Green Tourism, Green Buildings, and Sustainable water and wastewater management.

Under social focus, the categories of expenditures listed are socioeconomic advancement and employment, employment generation, food security, sustainable food systems, access to essential services, and affordable basic infrastructure.

Project Evaluation and Selection: This process ensures that the proceeds are used for eligible expenditures only.

There are two tagging processes (collectively called the "budget-tagging process") that are used to select projects. The budget tagging process is designed to identify expenditures on projects that Indonesia's climate change mitigation and adaptation objectives as well as the Roadmap of SDGs, involving at least 22 Line Ministries.

For eligible SDGs expenditures with green and blue focus, Indonesia leveraged its existing climate budget Tagging ("CBT") mechanism. For social projects, Indonesia selected expenditures tagged as SDGs-related by line ministries. BAPPENAS oversees the list of expenses that are eligible to be tagged. Indonesia, represented by BAPPENAS and the Ministry of Finance, reviews and approves project budget allocation/subsidies to be included in the state budget.

Costs: The total costs for framework development are between US$50,000 – 100,000, which include feasibility study, framework development, coordination, and SPO.

Monitoring and Reporting

Indonesia, represented by the Ministry of Finance, will prepare reports annually for each Green and SDG security issued, initially on the date falling no more than one year after the issuance. The information will include both allocation and impact reporting.

For monitoring and reporting, Indonesia adheres to ICMA's impact reporting metrics. It provides specific indicators both for green and social projects in alignment with the GBP and SBP. For alignment with the SDGs, indicators are cross-referenced with Indonesia's national document (established by BAPPENAS), called SDGs Metadata Indicator which is derived from the Mid Term NDP. The document consists of the detailed elaboration and breakdown of selected SDG targets and their indicators (within Indonesia's context), as well as the measurement methodologies.

Challenges

Unlike conventional bonds, SDG bonds require extra effort and resources in preparing a framework and getting second-party opinions, as well as project selection and impact reporting.

Measurement and Reporting: Quantifying the impact of investments funded by SDG bonds on achieving specific SDGs can be difficult. Indonesia put in place a robust mechanism to measure and report the outcomes of projects funded by the bonds to ensure transparency and accountability. SDG-related projects often have long time horizons for impact realisation.

Moreover, sovereign bonds typically have fixed maturities. The government found aligning the timing of bond issuance, project implementation, and impact realisation tricky.

Coordination and Collaboration: The successful implementation and reporting of SDG bond funded projects required collaboration among various government agencies in Indonesia. Ensuring effective coordination was challenging.

<u>Lessons Learned:</u>

- Overall, the issuance of SDG bonds requires strong coordination and close collaboration between various ministries/government agencies – this is especially necessary throughout the framework development, underlying project selection, and during the annual impact reporting to ensure the alignment with the national strategic needs and priorities as well as streamlining the data flow.
- During Framework development, the key is to be mindful of the national priorities/strategies and to ensure alignment of every aspect within the framework with the national commitment/relevant regulations, such as the Medium-Term NDP and National SDGs Roadmap, and Climate Ambition (NDC).
    - Having all the critical players understand the objective is crucial so that all efforts, policies, and resources are deployed for the common goal.
    - The involvement of the right stakeholders and providing leadership and commitment from the beginning to the end is critical for SDG bonds.
- A solid project evaluation and selection process needs to be in place. For Indonesia, an assessment was conducted with reference to the existing national SDGs roadmap. The document presented the policy direction for every indicator of the goal and SDG interlinkages and the financing needs of the SDGs. Based on the analysis of this document, the key issues to be prioritised within the SDGs are health, education, social protection, foods security and sustainable agriculture, and infrastructure, including the basic infrastructure such as water and sanitation, telecommunication, and green energy.
- Ensuring credibility in an SDG bond issuance is critical: developing a framework, getting a SPO on the framework, and verifying the allocation and impact reports externally.
- The market and currency of issuance is also another critical factor identified when issuing sovereign SDG bonds.
- With high demand from domestic retail investors, the issuance of SDG bonds in the domestic market has proven successful in Indonesia and encouraged where possible.

<u>Future Plans</u>

Indonesia has continued to expand its thematic bond portfolio over the years – this is also reflected in its inaugural Blue Bond issuance in 2023. The government is likely to continue maintaining its thematic bond portfolio – however, looking at the current state budget condition (which is in low deficit level) and the global market volatility, the issuances of debt instruments will be limited. As a response, the government has been and will continue to issue SDG bonds domestically for now – this also includes a plan to launch its very first SDG bond in the domestic retail market in the near future.

iii. Uruguay

Overview of the country's financing strategy for the SDGs

In October 2022, Uruguay issued a global dollar-denominated SSLB, due in 2034. Concurrently, it launched a switch and cash tender offer for dollar-denominated bonds of shorter maturity. Total nominal amount issued was approximately US$1.5 bn, of which US$1 bn was new money, and the remaining funded the tendering of eligible bonds.

The demand exceeded the amount issued, with an orderbook that, at its peak, reached US$3.96 bn. The annual yield to maturity at issuance was 5.935% (with a 5.75% annual coupon) corresponding to a spread of 170 basis points with respect to the reference U.S. Treasury. In November 2023, Uruguay issued a second tranche of the SLB for an additional US$700 mn.

Uruguay's SSLB was a crucial step to align the country's financing strategy more closely with its environment and climate change targets. The SLB has a step-down mechanism that is activated if it reaches certain environmental targets. The innovative aspect is the strong alignment of the country's sovereign debt policy with its climate goals by issuing a bond that links the coupon to compliance with the climate and environmental goals that the country set in its first NDC to the Paris Agreement.

Enabling environment in the country

The design of the SLB and its corresponding framework was a result of the joint effort of five ministries: Economy and Finance; Environment; Livestock, Agriculture and Fisheries; Industry, Energy and Mining; and Foreign Relations. The project received technical and financial assistance from the Inter-American Development Bank (IDB) and UNDP.

Uruguay's SLB was designed to: (i) signal and reassert the country's commitments and action plan to deliver on an ambitious climate change and sustainability agenda, (ii) provide investors with enhanced transparency and accountability on Uruguay's progress towards its climate change goals and conservation of natural capital, (iii) broaden and diversify its bond investor base, particularly of ESG-dedicated funds, and (iv) foster innovation in the sovereign bond markets, creating financial incentives for sustainable policy-making in emerging markets.

SDG Bond Framework

This Framework describes the sustainable strategic priorities of the country and establishes goals regarding performance indicators, one linked to the evolution of the intensity of GHG emissions, and the other to the protection of native forests.

In particular, the SLB embeds two KPIs namely (i) reducing the intensity of GHG emissions in the economy and (ii) preserving the area of native forests in the country. Together, they address two complementary environmental global public goods: mitigating global warming and preserving a key carbon sink. The SPTs are based on quantitative goals set for 2025 and are in line with Uruguay's first NDC. The selected KPIs are core, relevant, and material to the country's sustainability objectives, and the SPTs are ambitious, according to the SPO assessment.

Uruguay has set the following SPTs for its KPIs:

- SPT 1.1: Achieve at least a 50% reduction in GHG emissions per unit of real GDP by 2025, from a 1990 reference year.
- SPT 1.2: Achieve more than a 52% reduction in GHG emissions per unit of real GDP by 2025, from a 1990 reference year.
- SPT 2.1: Maintain at least 100% of the Native Forest area estimated for 2012 by 2025.
- SPT 2.2: Achieve an increase higher than 3% in the Native Forest area by 2025 compared to reference year 2012.

Monitoring and Reporting

To ensure timely and transparent disclosure, the reporting process underpinning the SSLB goes beyond Uruguay's requirements under the United Nations Framework Convention on Climate Change (UNFCCC) and its Paris Agreement. For one, GHG emissions reporting has moved from biennial to annual frequency, in line with the standards of most developed economies. Additionally, Uruguay has used geospatial data and satellite-imaging mapping to estimate the native forest area, in line with international best practices.

The first SLB Annual Report updates the performance of the KPIs through the year 2021. It provides detailed quantitative and qualitative information to allow investors and other stakeholders to track progress towards the SPTs, monitor their level of ambition, and track Uruguay's direct contribution to global climate efforts. The methodologies and data used to calculate the performance of the two KPIs are the same as those employed by Uruguay to report NDC progress data to the UNFCCC.

The UNDP has provided an external, independent, and qualified review on both KPIs. The External Verification Report, published in June 2023, concludes that the reported values for KPI-1 and KPI-2 adhere to the methodology and good practices established in the 2006 Intergovernmental Panel on Climate Change (IPCC) Guidelines and the relevant provisions and guiding principles of the Methods and Guidance of the Global Forest Observations Initiative. It also states that the data and information used in this report comply with the quality principles in terms of Transparency, Accuracy, Consistency, Comparability and Completeness established by the IPCC.

The preparation of the SLB Annual Report followed ICMA's voluntary guidelines on post-issuance disclosure, reporting, and verification for SLBs. Beyond those requirements, the Ministry of Economy and Finance engaged with key stakeholders to factor in market expectations on the report's content. This involved an active dialogue with underwriting banks, UNDP, the IDB, the Emerging Markets Investors Alliance, and the Assessing Sovereign Climate-related Opportunities and Risks project group (led by asset owners, asset managers, and wider investor networks).

Uruguay and UNDP have innovated together, setting up an accelerated four-month external review process for both KPIs. Despite the complexities of collecting and externally validating the country's annual emissions, Uruguay's publication of annual, externally verified GHG data, with a lag of approximately one year and five months from the end of the observation year (2021), enhances the current reporting and peer-reviewed verification process applicable to the country as established under the requirements of the UNFCCC.

Challenges

One of the main challenges was the inter-ministerial coordination required throughout the issuance process. The large coalition of ministries involved, and the innovative aspects of the transaction affected the timeline of the issuance, which took almost 2 years.

Educating investors was another important challenge to overcome. SSLBs are not very common still and thus required extensive clarifications during the roadshow. The coupon variation based on results (coupon step-up or step-down) is a feature that traditional emerging market sovereign bond investors are not familiar with. This created a pricing impact for the country and a reputational risk that needed to be mitigated.

Lastly, on the instrument itself, adapting a framework most often used for corporate issuances was a challenge, for which non-financial actors such as UNDP and the IDB provided support. KPI and SPT calibration was one of the most challenging parts of setting up the SLB. KPIs needed to be innovative and ambitious while balancing the potential risks associated in case high quality data is not produced or the SPT is not met.

Lessons Learned

One of the main lessons learned is related to institutional coordination within the country. Clear roles and responsibilities can enhance and speed up the issuance process for cases that require regulatory adaptation (developing the framework) and SPT/KPI calibration.

The second key takeaway is related to investor reactions. ESG investors were interested in the SLB, and many new investors entered the transaction with a robust order book with strong interest from real-money ESG focused accounts. Close to 40 new accounts invested in a Uruguay global sovereign bond for the first time. SLB markets for sovereign issuers still require more maturity for investors to be comfortable with the KPI linked dynamic and to facilitate the pricing of the instrument.

Future Plans

As a next step, Uruguay will continue to work to integrate sustainable finance within loan instruments with multilateral institutions that will include positive financial incentives.

iv. Mexico

Overview of the country's financing strategy for the SDGs

Mexico's issuance of a sovereign SDG bond was a decisive step forward in the country's commitment to the achievement of the SDGs and a major advancement for sustainable development finance. It was a crucial step forward in the development of a market for SDG financing on a large scale and an innovative mechanism to tap into the private capital market to finance SDG-related programmes. The bond issuances have allowed the country to expand its investor base by accessing international and domestic funds committed to sustainable development. Proceeds have been allocated to social and green expenditures, contributing to addressing sustainable development challenges in a more integrated manner.

The Ministry of Finance and Public Credit has implemented appropriate measures to institutionalize the SDG bonds' dynamics, related to the selection, tracking, and reporting of eligible expenditures. The SDG bond is part of a series of integrated efforts to advance development finance, namely the formulation of the Mexican Sustainable Taxonomy, the Sustainable Finance Mobilization Strategy, and the Development Finance Assessment.

Enabling environment in the country

Mexico has shown a strong commitment to sustainable development and the achievement of the 2030 Agenda by creating an appropriate institutional architecture and by integrating this action framework into different stages of the planning and budgeting processes. The institutionalization of the 2030 Agenda has taken the form of a National Council for the 2030 Agenda (an Executive's high-level multi-stakeholder collegial body) responsible for the coordination of actions aimed at contributing to the advancement of sustainable development), a Specialized Technical Committee for the Sustainable Development Goals responsible for the monitoring framework, and a National Strategy for the Implementation of the 2030 Agenda.

With regards to planning, Mexico incorporated the 2030 Agenda vision into the Planning Law by adopting amendments aimed at acknowledging the three dimensions of sustainable development in national planning instruments, allowing for a medium-term vision in strategic plans, and mainstreaming the approach and principles of sustainable development into the design of the NDP and sectorial programmes. Thus, the NDP for the period 2019-2024 is compatible with the 2030 Agenda as it is structured under three axes: (1) justice, rule of law and human rights; (2) social policies to achieve wellbeing; (3) sustainable and equitable economic development. Moreover, programs derived from the NDP were explicitly formulated to close development gaps and to leave no one behind.

In terms of budgeting, the Mexican Government, with the support of UNDP, established an SDG budget tagging methodology that allows for the identification of budgetary programmes' contributions to SDG targets. This methodology is implemented on a yearly basis by the programmes' implementing institutions and validated by the SHCP. The SDG budget tagging has proved to be useful in tracking 2030 Agenda progress through budget allocations, in bridging sustainable development long-term planning and short-term execution, and in the provision of relevant inputs for the resource allocating process and for the estimation of SDG finance gaps.

Furthermore, the SDG budget tagging methodology comprises a cornerstone for the country's SDG bonds, as the selection process of eligible expenditures screens programmes based on their reported direct contribution to at least one of the priority SDGs established in the Bond's Framework and selected each year by SHCP. Therefore, the tagging process is considered to be a key enabler of the SDG bonds in Mexico.

Finally, the presence of a Performance Evaluation System – comprised in part by process and performance indicators attached to budgetary programmes – enhances the SDG bonds' impact reporting by providing granular information to display the eligible expenditures' effect on sustainable development.

SDG Bond Framework

The SDG Bond Framework is a flexible and innovative instrument aligned to the 2030 Agenda and the Addis Ababa Action Agenda, as it aims to finance sustainable development policies, programmes, actions, and projects that reduce social gaps and tackle climate change. The SDG Bond Framework was designed based on the ICMA Sustainable Bond Guidelines.

The Framework puts forward the commitments that Mexico, as the bonds' issuer, will meet in terms of the use of proceeds, the selection of eligible expenditures, the management of proceeds and the allocation and impact reporting. It also establishes governance features to benefit from the multistakeholder bodies that are already in place for the implementation and monitoring of the SDGs, namely the National Council for the 2030 Agenda and the CTEODS. Moreover, it counts on SPOs, the reports' review by the Federal Superior Audit Office, and the involvement of UNDP as an observer of the budgetary selection process and in the provision of technical assistance in the reporting processes. The adoption of these quality assurance mechanisms signals the commitment of Mexico to quality reporting.

UNDP provided an opinion on the Framework in the form of an alignment letter where it welcomes the unique features of this instrument, including the use of the SDGs as an entry point, and the application of a geospatial eligibility criterion to notionally allocate the bonds' proceeds to social expenditures addressing the most deprived locations. As part of UNDP's involvement, the SDG Bond Framework considers the formulation of a non-binding opinion on the annual reports. For the 2021, 2022 and 2023 allocation and impact reports, UNDP has recognized the positive institutional dynamics that the issuance of the SDG bonds has produced in terms of information exchange, the review of indicators associated to the SDGs, the production of more granular and updated data, and the generation of a sense of appropriation of the Bonds' results within line ministries.

Eligible Expenditures

The SDG Bond Framework establishes a set of criteria to conduct the selection process of Eligible Expenditures that aims at maximizing impact on sustainable development and at preventing SDG-washing. In this sense, Eligible Expenditures must be budgetary programmes included in the annual federal budget, that comply with national debt regulation, and that contribute directly to at least one of the SDGs from the main eligible categories established in the Framework (SDGs 2, 3, 4, 6, 7, 8, 9, 11, 13, 14, 15). Afterwards, SHCP may refine the SDG eligible categories based on the government's priorities. For instance, in 2021 and 2022 five of the eleven eligible SDGs were selected; while in 2023 the selection broadened to consider nine of the eleven eligible SDG categories, including, for the first time, green SDGs.

Afterwards, Eligible Expenditures that contribute to the selected SDGs are screened to remove budgetary programs with potential negative spillovers, based on the exclusion criteria established in the Bond's Framework. The remaining Eligible Expenditures are then subject to Pareto Principal, to filter programs based on their relevance, continuity perspectives and the expected social and environmental outcomes. Finally, social Eligible Expenditures are subject to the geospatial criterion, to pinpoint locations with the biggest social gaps.

Compliance with the selection process has been consistently documented, contributing to transparency and accountability. Furthermore, the management of the bonds' proceeds ensures that an equal amount was used to finance Eligible Expenditures.

It is worth noting that the selection process relies on governance practices led by SHCP with the participation of institutions with a seat in the CTEODS. The Mexican Government has advanced in consolidating deliberative and collaborative processes leading to the elaboration of the Report, including the validation of Eligible Expenditures, consolidation of more granular information, together with the selection and identification of better indicators.

Monitoring and Reporting

Under Mexico's SDG Sovereign Bond Framework, Mexico has committed to providing investors with annual allocation and impact reports. The 2021, 2022 and 2023 reports have proved to comply with the commitments established in the Framework and to embody the four foundational elements of the SDG Impact Standards for Bond Issuers.

The allocation reports have successfully described the process to notionally allocate net proceeds to different eligible programs from the federal budget and to different territories – when applicable – based on the geospatial criterion previously described. For social eligible expenditures, therefore, a weighing factor is applied so that the notional allocation reflects the proportion that goes to marginalized territories. Valuable efforts have been made to improve the accuracy of such estimations to enhance transparency.

The impact reports are successful in reflecting an underlying theory of change behind budgetary program allocation through its concatenation to figures of estimated end beneficiaries, output, and State of Affairs indicators. The maps and graphs provided in these reports contribute to having a reference of where Bonds' resources are channelled, especially after applying the geospatial criterion for social Eligible Expenditures. Impact reports also provide a summary table in which the breakdown of outputs and beneficiaries is displayed for each of the selected SDG eligible categories. Reporting trends in SDGs target indicators contributes to enhance the results chain framework.

Establishing direct causality between resource allocation and impact results is complex for sovereign bonds, however a clear commitment to continuous improvement is showcased. Impact reports have shown clear improvements year after year thanks to a consolidated delivery of data by line ministries responsible for each of the selected Eligible Expenditures. It is worth noting that the reporting processes have led to positive dynamics within and between ministries, as well as to the strengthening of the results-oriented approach in budget allocation and execution. The SDG budget tagging methodology and the SDG Bonds' impact reports are reinforcing each other.

UNDP and Mexico's Federal Superior Audit have highlighted the compliance of the reports with the Framework's provisions. In addition, SHCP has shown strong commitment to transparency by sharing databases with UNDP to replicate procedures and figures, which is highly acknowledged.

Challenges

As mentioned above, establishing direct causality between resource allocation and impact results is complex for sovereign bonds. Nonetheless, Mexico's government has enhanced its reporting methods. For future reports, and whenever there is available data, it is expected that results are further disaggregated by gender, age, employment situation and other relevant categories, as established in the SDG Bond Framework.

Institutional changes, especially during election periods, pose additional challenges. Until now, the SDG Bond Framework has proved resilient and flexible in the face of institutional changes. Furthermore, SHCP has initiated the implementation of actions aiming at the institutionalization of processes internally, through the development of guidelines and handbooks to standardize the reporting methodologies. The SHCP has also advanced in the formalization of an area entirely dedicated to the selection, tracking, and reporting of Eligible Expenditures. It is crucial that these efforts are consolidated.

Lessons Learned

Mexico issued its first SDG bond in 2020 during the pandemic, which affected its rationale on the small volume (EUR 750 mn). It chose to issue in the European market, as it considered Europe to have a mature and developed market on thematic issuances. The government issued a second SDG bond in 2021, also in the European market. Mexico's initial ambition was to build an SDG bond curve for different markets and create greater investor attraction with strong credit quality, and in different currencies, across differing maturities. Based on lessons learned from the initial issuances to the European market, Mexico developed a market strategy on SDG bonds for the US and the Japanese market. Until January 2024, Mexico has issued 6 SDG bonds to international markets for a total of US$10 bn and has successfully issued 5 SDG bonds to the domestic market, for a total of around US$4 bn.

Future Plans

Mexico's plans are focused on expanding the investor base and diversifying risk in the external markets, while educating investors and reassuring them on potential risks in the internal one. Mexico also plans to expand the framework to include new eligible categories and potential links to taxonomies.

In terms of type of instrument, Mexican law requires that financing is directly linked with their federal budget, which restricts the use of SLBs in favour of use-of-proceeds SDG bonds.

v. Chile

Overview of the country's financing strategy for the SDGs

Chile can be considered a leader in sovereign SDG bonds and has issued over 20 bonds across bond types, including social bonds, green bonds, sustainability bonds, and SLB totalling US$19.27 bn, EUR 7.14 bn, and CLP 4,161 bn between 2019 and April 2022.[37]

Chile's SLB in 2022 was the first time a government linked a bond to its official NDC commitment on climate change.[38] Chile is one of only 11 countries to make unconditional commitments to the United Nations to reduce emissions over the next decade and beyond.[39]

The Ministry of Finance has a key role in channelling public and private capital flows to support and comply with environmental commitments, as can be seen in diverse initiatives that have constituted important milestones over time. The incorporation of social criteria in the issuance of its sovereign bonds, along with its green bond issuances, are concrete steps in Chile's shift towards a sustainable financing strategy that facilitates inclusive development and promotes economic growth. Chile is not yet, however, part of the UN's INFF programme.

Enabling environment in the country

The decision to issue green bonds was closely aligned with the government's strategy and policy objectives, as well as the country's stage of sovereign debt market development. Since 2008, public debt has been increasing progressively. With the global financial crisis, Chile's fiscal situation deteriorated as public spending rose to address the consequences of the global slowdown.[40] Sovereign bonds have been the main channel of government borrowing.

Following the Paris Agreements, Chile had already begun amassing green projects and investing in the solar energy sector, meaning that by 2019 there were already many projects available to be included in the upcoming sovereign SDG oriented bonds.[41]

The timing of Chile's pivot toward issuing ESG-labelled instruments was critical to the success of Chile's issuances because the government took advantage of the high foreign demand for

[37] World Bank, Unlocking the Potential for Emerging Markets and Developing Economies, 2022.
[38] Environmental Finance, Sustainability-linked bond of the year: Republic of Chile, 2023.
[39] BNP Paribas, Chile sets a trend with first sovereign sustainability-linked bond, 2022.
[40] IMF, IMF Country Report No. 22/283: Chile, 2022.
[41] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.

green bonds from investors in the United States and Europe in both foreign and domestic currencies.[42]

SDG Bond Framework

Chile's Green Bond Framework was first prepared in 2019 by the Ministry of Finance in coordination with other sectoral ministries and with the support of the IDB. Chile, by collaborating with the IDB and CBI, supported the issuance of the first sovereign green bond in the Americas.[43]

Chile looked to the experiences of Belgium, France, and Ireland and developed a framework by collecting best practices and the highest standards of the GBPs published by ICMA in 2018.[44]

In November 2020, Chile updated and broadened its sovereign green bond framework to support future social, green, and sustainability bond issuances. In November 2020, Chile issued its first sovereign social bond, in local currency, to an amount of US$2.1 bn.[45] The green bond framework that regulated government debt issues did not require congressional approval and, therefore, the framework was quickly developed and implemented.[46]

In 2022, Chile launched a framework for issuing SSLBs that included environmentally related KPIs.[47] In June 2023, this framework was updated to include a social KPI focussing on gender equality (percentage of Women Board Members). The SLB framework builds on Chile's prior green, social, and sustainable bond issuances.

Monitoring and Reporting

The government's goal was to develop a framework that ensured transparency and accountability throughout the issuance process. SPO provided by Sustainalytics found the Banco de Chile Sustainability Financing Framework to be credible and impactful and aligned with the Sustainability Bond Guidelines 2021, Green Bond Principles 2021, Social Bond Principles 2021, Green Loan Principles 2021, and Social Loan Principles 2021. Banco de Chile

[42] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.
[43] Ibid.
[44] Ibid.
[45] World Bank, Egypt: The First Sovereign Green Bond in the Middle East and North Africa, 2022.
[46] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.
[47] Public Debt Office of the Ministry of Finance of Chile, Chile's Sustainability Linked Bond Framework, 2023.

will report on the allocation and impact of proceeds on an annual basis until the maturity of the sovereign instruments.[48]

For Chile's 2022 SLB, the issuance is linked to two KPIs: a target on GHG emissions and percentage of electric power generation from Non-Conventional Renewable Energy sources. The 2023 updated SLB framework includes a third KPI on social inclusion, namely the percentage of women in Board Member positions. The reporting for Chile's SLB is managed by the private sector, which is deemed effective and reliable.

Challenges

Chile faced challenges both for UoP bonds as well as the SLB. In the short term, for the UoP issuances, there were challenges in transmission lines and startup investment for solar and wind projects. However, this was overcome due to public-private partnerships with the private sector leading the implementation and monitoring for the green projects that had been established since 2019.

For the SLB, there were challenges in terms of meeting the targets set for the KPIs and in the measurement of these KPIs. For monitoring and reporting on the social objectives, the Chilean government had to incentivise private sector companies to improve the participation of women in executive leadership. One method was for the government to lead by example by being the first to hire more women in leadership. However, there is general concern that this is insufficient. There is currently no legal enforcement for projects to meet the KPIs of the SLB which proves long term challenges for the legitimacy of the SDG bonds.[49]

Furthermore, even a small increase or decrease in the coupon of the SSLB could turn out to be significant for Chile under certain market conditions.

Lessons Learned

There was an advantage of the timing of the SLB in that there was macroeconomic stability allowing them to attract international investment. Chile also took advantage of the existing institutional frameworks for debt management to help facilitate the implementation process of new labelled bond issuances, including the Green Bonds Initiatives.[50]

[48] Sustainalytics, Project: Government of Chile Sustainability-Linked Bond Framework Second Party Opinion (2022), 2022.
[49] World Bank, Paving the Path: Lessons from Chile's Experiences as a Sovereign Issuer for Sustainable Finance Action, 2021.
[50] Ibid.

Another lesson learnt was that there is a discrepancy between Chile's NDC, long-term climate strategies and the existing policies. These should be aligned to further improve the process of issuing effective and successful sovereign SDG bonds.[51]

For example, the Chilean government was subsidising approximately 1% of GDP for fossil fuels to address the energy crisis, whilst simultaneously asking for money from the market to finance renewable energy.[52] This highlights the restrictions placed due to political pressures and opposing interests. Academics highlight this as an inconsistency that needs to be addressed to further advance the goals of the green projects.

Future Plans

Going forward, Chile has a focus on adaptation and resilience projects to be financed by SDG bonds. Adaptation refers to adjustments in ecological, social, or economic systems in response to actual or expected climatic stimuli and their effects. Until now, much of their SDG bonds have focused on themes of mitigation. This is improving efforts to become carbon neutral, however this will not be seen as efficient in "moving the needle" towards progress. This is the most important for developing countries.

[51] Ibid.
[52] UNFCCC, Introduction: Adaptation and resilience, 2023.

vi. Benin

Overview of the country's financing strategy for the SDGs

Benin is fully committed to successfully implementing the SDGs. To achieve the 2030 Agenda, Benin has adopted several ambitious measures and initiatives to incorporate the 17 SDGs into its national planning, budgetary, and fiscal policies. This includes a critical concept of anchoring public action to the SDGs. Notably, Benin carried out an extensive and ambitious "costing" exercise in partnership with UNDP and IMF to evaluate the cost of achieving the SDGs. This is incorporated into all its planning and strategy documents linked to the 2030 Agenda.

Benin has made the 2030 Agenda a long-term focus for the entire country in the context of planning. It has formulated several strategies and plans to achieve the SDGs, such as the Government's Action Programme (GAP), NDP, Growth and Sustainable Development Program, sectoral strategic plans of the different ministries, and municipal development plans.

In 2018, Benin initiated a landmark SDG financing campaign, "leaving no one behind," which is tied to 20 projects related to the SDGs.

In December 2016, the government of Benin created an institutional structure to implement the 2030 Agenda. The National Committee of Resource Mobilization (CMR) was established to carry out the GAP for achieving the key SDGs outlined in the SDG target priority report. In 2020, when implementing the Ten-Year (2021-2030) Action Framework for Accelerating the Implementation of the SDGs, the CMR was redefined to strengthen policy dialogue with development partners. In addition to the framework, Benin has committed to incorporating the 2030 Agenda into its national legislation by drafting a law on the planning of development projects. The General Directorate for Development Policies has been leading this effort since September 2020.

Enabling environment in the country

- **Political support**

The successful issuance of the SDGs required significant support from the Office of the President, the Ministry of Economy and Finance, the General Directorate for Sustainable Development Goal Coordination and Monitoring of the Ministry of Planning and Development, and other crucial stakeholders. Along with strong political commitment, a well-established technical framework, comprehensive plans, and roadmaps were necessary to accomplish the SDGs. To attain the SDGs, the GAP 2016-2021 and the most recent 2021-2026 were adopted by the Council of Ministers, which incorporated various priorities.

- **Experience with global markets**

Benin has actively issued sovereign bonds in the international capital markets since 2019. In the first quarter of 2021, Benin issued 1 billion Eurobonds. This included EUR 700 mn with a final maturity of 11 years, at a coupon of 4.875%, and EUR 300 mn with a final maturity of 31 years, with a coupon of 6.875%. The 31-year tenor is the longest ever reached by the country, and it joins a limited number of emerging market issuers to have a Eurobond in euros with a maturity greater than 30 years. The bond was highly sought after and oversubscribed, with the operation's orderbook reaching a peak of almost EUR 3 bn, which is equivalent to a subscription of 300%. Out of the EUR 3 bn, 1.9 bn were for the 11-year tenor and 1.2 bn for the 31-year tenor bond.

- **Local institutions and bodies**

The government has previously issued bonds in both local and regional debt markets. The majority of public debt within the country is made up of government securities issued in the regional bond market. Between 2014 and 2017, the government of Benin relied heavily on the domestic and regional bond market to raise funds. At the end of 2019, approximately 82% of domestic liabilities were made up of government securities issued within the regional financial market.

<u>SDG Bond Framework</u>

- **Overview of framework development**

Benin's SDG Bond Framework, issued in July 2021, adopts the ICMA's Green Bond and SBPs. The framework is based on existing arrangements developed by Benin to implement the 2030 Agenda (notably prioritizing the SDG targets to be achieved and an SDG costing exercise). The Ministry of the Economy and Finance manages the Republic of Benin's SDG issuances in accordance with the principles described in this framework. Citi, Natixis and SocGen acted as structuring banks.

The SDG bonds issued with reference to this framework will be used to finance the national budget. The repayment of principal and interest under the SDG bonds is not conditioned upon the selection or realization of the eligible expenditures described below. As a result, purchasers of Benin's SDG bonds will not bear any risk tied to projects. This issuance framework is aligned with the most recent SBGs published by ICMA.

The framework and the SPO are available online on the official site of the Ministry of the Economy and Finance in a clearly identified and easily accessible area.

Benin appointed Vigeo Eiris (VE) as the SPO provider. V.E concluded that "*the Republic of Benin's SDG Bond Framework is coherent with the Republic of Benin's Government's strategic sustainability priorities, and that it contributes to the achievement of its sustainability commitments and targets*." It deemed that the SDG Bond Framework is "*aligned with the four core components of the GBP & SBP and best practices identified by V.E*." The contribution to sustainability has been assessed as advanced by VE (i.e., the highest score possible). Expected impacts are considered "advanced," and ESG risk management as "robust."

Monitoring and Reporting

Investors in Benin will be provided with an allocation report and an Impact report, both of which will be published annually throughout the duration of the issue. These reports will be available on the official website of the Ministry of the Economy and Finances, in a clearly identified and easily accessible area. They will be posted on the anniversary date of the relevant issuance or within three months of such anniversary at the latest. In case of any environmental or social controversies related to eligible projects, the Republic's responses and remediation actions will be communicated to investors.

As part of the partnership framework signed in July 2021, the Sustainable Development Solutions Network (SDSN) will provide an in-depth analysis of Benin's progress in achieving the SDGs. This analysis will be purely consultative and will help provide information for the annual reports. The allocation report will reflect the prioritization and selection of eligible expenditures made in the previous year, based on the latest observations and recommendations made by the SDSN. The impact report will illustrate Benin's progress on the priority SDG targets and the primary areas of improvement identified by the SDSN.

Challenges

Developing a sustainable financing framework and securing a SPO requires additional resources. Monitoring and reporting impact is particularly challenging and requires considerable technical assistance.

Lessons Learned

- SDG bond issuances requires robust multi-stakeholder governance, leadership, coordination, and close collaboration between various ministries/government agencies.
- Establishing a robust, sustainable financing framework is fundamental.
- Reporting on ESG norms must be transparent to ensure success.
- The country achieved a significant greenium in its inaugural 12.5-year EUR 500 mn SDG bond, priced at 4.95%, which was 20bps lower than the Benin secondary yield curve. Having well-trained personnel involved in the process and support from reliable partners is important.

Future Plans

Benin is committed to financing projects that greatly impact achieving the SDGs. It will continue to raise funds to finance projects critical to attaining the NDP aligned with the SDGs, including SDG bonds and loans.

vii. Barbados, Belize, Seychelles: The Role of Credit Enhancement[53]

Credit Enhancement in the Barbados Blue Loan[54]

Barbados completed a Debt for Nature Conversion backed by a US$100 mn guarantee from the IDB and a US$50 mn guarantee from The Nature Conservancy (TNC). The country received a Blue Loan to buy back its outstanding debt. Credit Suisse acted as Global Lead Arranger of the loan while CIBC First Caribbean acted as its Domestic Lead Arranger. Credit Suisse and CIBC Capital Markets acted as joint deal managers for Barbados' buyback of its USD 2029 bonds.

This transaction was unique in that it features the first financial instrument to be guaranteed by both a multilateral institution and an NGO. It also provides the first sustainability-linked debt framework focused on nature conservation developed by the IDB and Barbados.

The guarantees reduced the country's cost of borrowing and allowed it to use savings to finance a long-term marine conservation programme. They enhanced the Blue Loan provided to Barbados to buyback existing debt. The savings generated by this debt conversion were an estimated US$50 mn over 15 years, and they will be used to fund the Barbados Environmental Sustainability Fund, which will fund environmental and sustainable development projects in the country.

Credit Enhancement in the Belize Blue Bond[55]

Belize's debt restructuring meant that it would have to pay high interest rates to its bondholders. This led to TNC arranging a US$364 mn blue loan between TNC's Belize Blue Investment Company (BBIC) subsidiary and the Belize government, enabling the country to repurchase its superbond i.e., the government's entire stock of external commercial debt, equivalent to 30 percent of GDP. The loan came with an original issue discount and a coupon that steps up on a semi-annual basis, starting at 3% in April 2022 and rising to 6.04% from April 2026 onward. This structure reduced near-term debt payments, making the country's debt more sustainable, and the 19-year loan also has a ten-year grace period on principal payments.

Since the transaction directly funded marine conservation, BBIC was able to secure a credit enhancement for the loan from the United States International Development Finance

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[53] Note that while the role of credit enhancement in the Barbados and Belize transactions and the channeling of coupon savings to blue projects are important, there are some concerns that labelling these bonds/transactions as blue or sustainable is misleading. The actual proceeds of the loans/bonds go towards debt management rather than the blue projects.
[54] Sustainability-Linked Sovereign Debt Hub, The Role of Credit Enhancement in Sovereign Sustainability-linked Debt Issuance , 2023.
[55] Ibid.

Corporation, allowing them to fully finance the loan through blue bonds issued by Credit Suisse. The bonds obtained a Moody's credit rating of Aa2 through a repackaging vehicle that the bank then syndicated to institutional investors globally. The syndication received high interest from investors; it was oversubscribed, enabling BBIC to pass on this cheaper cost of funding to Belize.

The debt conversion created immediate and longer-term fiscal savings for Belize. Not only did it reduce its outstanding debt and debt servicing costs, but the transaction also played a role in boosting the country's unsecured foreign currency credit rating from Selective Default to B-. TNC deemed the blue bonds "very highly rated" and "very low risk" with credit enhancement, adding that it "took [them] from a very small investor base … to the gigantic world of pension funds and insurance companies."

The deal was unique in that the blue loan structure incorporated the first commercial sovereign debt catastrophe insurance cover, which provides coverage for blue loan coupon and principal payments following eligible hurricane events in Belize, which are a real risk for the country.

Credit Enhancement in the Seychelles Sovereign Blue Bond[56]

The World Bank supports Seychelles' efforts in building a diversified blue economy with the Third South-West Indian Ocean Fisheries Governance and Shared Growth Project (SWIOFish3), which supports countries in the region as they transition their fisheries sectors to be more sustainable. To this end, the World Bank Treasury (WBT) has put together an innovative financing package that mobilized the US$15 mn of private sector investment needed to support the SWIOFish3 Project, which saved the Seychelles' government over US$8 mn in interest charges over ten years.

The WBT integrated their financial package with a partial credit guarantee of US$5 mn into the Blue Bond and helped arrange another US$5 mn in concessional financing from the Global Environment Facility, which reduced Seychelles' net borrowing cost by at least five percent per year. Most transaction costs were covered by a donation from the Rockefeller Foundation, and the WBT engaged with investment banks to find an ideal placement agent and trustee for the issuance. Standard Charter Bank and Bank of New York Mellon were involved to help manage the process and payments, and Seychelles was connected with the investors who purchased the blue.

[56] World Bank. Seychelles: Introducing the World's First Sovereign Blue Bond, 2018.

ANNEX II: Integrated National Financing Frameworks

About Integrated National Finance Frameworks

In 2015, world leaders adopted the Addis Ababa Action Agenda at the United Nations Third International Conference on Financing for Development. The Addis Agenda created a holistic and coherent framework for financing the SDGs through seven action areas covering all aspects of public and private finance. At the national level, member states envisaged implementing the SDGs through cohesive national sustainable development strategies supported by INFFs.

INFFs help countries finance their national sustainable development objectives and the SDGs. INFFs are voluntary and country-led. Through INFFs, countries develop a strategy to mobilise and align financing with all dimensions of sustainability, broaden participation in the design, delivery and monitoring of financing policies, and manage risk. INFFs are embedded within national plans and financing structures, enabling gradual improvements and driving innovation in policies, tools and instruments across domestic and international sources of public and private finance.

To date more than 85 countries have used and are using the INFF approach to strengthen financing for sustainable development at the country level. A growing number of countries have established and are implementing country-led, impact-oriented financing strategies encompassing public and private finance – a transformation from just five years ago when most national sustainable development plans had no financing strategy. Of the 85+ countries using the INFF approach, 13 have a financing strategy under implementation, including one at the provincial level. Another 20 countries are in the process of negotiating their financing strategy, with more than 50 countries implementing reforms shaped through their INFF process. Countries have prioritised more than 250 reforms to mobilise and align public and private financing with all dimensions of sustainability, including gender equality, climate and social sector priorities. Over 50% of these (143 reforms) are in the process of being implemented or have been already delivered.

Countries are already observing emerging impacts of the INFF implementation – initial data based on a selection of emerging reforms in 18 countries show more than US$16 bn in resources leveraged for SDG investment and enhanced SDG-alignment and scope for alignment of more than US$27 bn in existing resources.

For more information about INFFs, visit www.inff.org.

About the INFF Facility

The INFF Facility is a joint flagship initiative of the UNDP, the UN DESA, United Nations Children's Fund (UNICEF), the Organisation for Economic Co-operation and Development (OECD), the European Union and the Governments of Italy, Sweden and Spain. It supports countries developing INFFs. The Facility brokers technical assistance, facilitates knowledge exchange and provides access to technical guidance.

About INFFs and sovereign SDG bonds

Forty countries that are developing an INFF have either issued or are planning to issue sovereign SDG bond (e.g., developing thematic/SDG bond framework). Countries are developing comprehensive financing strategies to ensure the long-term sustainability of sovereign debt by enhancing domestic revenue mobilization, the effectiveness and efficiency of expenditure and its alignment with sustainable development priorities.

Debt sustainability is a growing concern, as 52 low- and middle-income developing countries are either already in debt distress or at high risk of debt distress.[57]. Therefore, integrated approach to financing ensures consideration of the trade-offs and spillovers between different financing policy choices and is particularly important in the context of debt management, to avoid debt distress, to enhance the SDG impact of the proceeds and to deliver reforms that would enable better financing terms in the future.

Experiences of countries issuing sovereign SDG bonds showcase opportunities for integrating SDG impact broadly into the public financial management systems, leading to reforms and innovations related to the overall alignment of public finance with the SDGs, including aligning or tagging budgets, investment, and government programmes based on the impact framework already developed for the SDG bond issuance.

Therefore, an INFF is a critical framework for countries to finance their needs sustainably over the long term and enhance the SDG impact of each dollar borrowed and spent.

INFF implementation leading to SDG bond issuance: Uzbekistan country example

Uzbekistan started developing an INFF in 2020 to finance the Government's Development Strategy for 2022-2026 and to accelerate the attainment of the SDGs in Uzbekistan through a more efficient, transparent, and results-oriented use of public financial resources, as well as a better coordinated and integrated use of public and private resources in social sectors, with a specific focus on the inclusion of women and vulnerable groups.

Uzbekistan developed and issued sovereign SDG bonds as part of its resource mobilization efforts within its integrated national financing framework, becoming the first country in the region and second in the world to issue a sovereign SDG bond. The issue size was UZS 2.5 tn to finance public projects in seven priority SDGs, including education, health, water supply and transport (~US$235 mn). This was a major achievement. Uzbekistan increased the issue size of UZS-denominated bonds by 25 per cent and, at the same time, lowered the coupon rate, representing strong progress compared to its previous inaugural UZS issuance in

[57] UNDP, Building blocks out of the crisis: The UN's SDG Stimulus Plan, 2023.

November 2020. The government of Uzbekistan further issued its inaugural green sovereign bonds worth UZS 4.25 tn (~US$336 mn equivalent) in 2023.

Aside from raising new sources of financing, the SDG bond issuance helped to set up a system and build the institutional capacity dedicated to informing investors and the public on allocation, use and impact of the bond proceeds. This lays the ground for the effective use and increased transparency and accountability of not only the public borrowings but also broadly public sources of financing. For example, budget tagging reforms saw a US$4 bn increase in government spending aligned with SDGs, reaching a total of US$14 bn. In addition to mainstreaming SDGs in budgeting, other planned measures such as strategic planning of tax and revenue mobilization, decentralization of public finance and public funds, mainstreaming sustainability in the financial sector (e.g., through the adoption of the sustainable finance taxonomy), private sector development, and capital markets development are expected to create an integrated, sustainable financing architecture in the country.