New Environmental and Climate Trends and Opportunities

Globally, funding for sustainable activities has increased greatly in the last decade, but only 4.7% of this is allocated to LAC, despite the high incidence of natural disasters and climate change in the region.

The disparity in funding raises the question: why does LAC receive such a small fraction of global funding for sustainable activities, despite its vulnerability? There is a clear need for greater attention and to carry out more actions in the region to ensure that financial resources for sustainability are more equitably and effectively distributed.

Even more so, considering that, among the ten main global risks identified, half of them are directly related to environmental and climate change issues, and of these, four are considered critical. In the financial area, the importance of addressing these risks is recognized. The commitment of the financial sector is to find solutions and strategies to mitigate the risks associated with climate change and other environmental problems. It is understood that where there is risk, there can also be business opportunity if approached appropriately. This perspective highlights the importance of understanding and managing risks as a means of identifying new opportunities in a changing and challenging context.

Twelve years ago, only 25% of banks understood what a sustainability-related product or service was. Today, it is rare to find a development bank without some initiative on gender inclusion or sustainability issues. In addition, there has been significant progress in integrating climate change risks into development banks' analysis systems in recent years. This change indicates a more positive mindset and practices in the financial sector, with greater consideration of environmental and social risks in its operations. With respect to the evolution of sustainable products and services, there has been a notable increase in awareness and implementation, reflecting a growing demand and recognition of the importance of sustainability in the financial sector. The proliferation of green sustainability protocols in LAC, with the active participation of financial institutions and governments, signals a regional commitment to climate action and the implementation of measures to address these challenges.

Although it is commonly believed that climate funds come mainly from multilateral and international sources, the reality is that national development banks play a crucial role, contributing more than 25% of international mobilization in climate finance and more than 50% of the resources from the public sector perspective. At the Green Climate Fund, the world's largest climate change fund, more than 40% of the institutions in LAC that can access this fund are development banks. The LAC region recognizes the importance of this dialogue between governments and development banks to attract and mobilize international resources.

A key strategy to increase the impact of development banks is the issuance of green, social and sustainable bonds. Although these issuances previously represented a smaller part of the market due to their lesser development, in the last five years there has been a significant increase in the participation of development banks in this market. However, there is a trend towards innovation in financial products in the region, although there is less interest on the part of private banks in adaptation and resilience in the face of climate change and natural disasters. Although these projects do not always generate immediate financial benefits, governments are increasingly interested in mitigating these risks and dealing with more frequent natural disasters to prevent future

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infrastructure damage. Thus, they can avoid a significant fiscal impact to a state or country; save lives that would otherwise be lost in a disaster; and protect entrepreneurs whose businesses could be damaged by possible climate events.

It is observed that many governments are beginning to incorporate the concept of adaptation and resilience into their taxonomies and medium- and long-term development programs. For development banks, structured lending helps reduce the perception of high risk, facilitates long-term financial flows and reduces the costs of loans in developing countries. However, there is a need for these financial institutions to play an agent role on behalf of the government, by helping to de-risk long-term development projects, creating flexible structures and increasing the appetite of foreign investors.

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Development banks have a crucial role to play in promoting adaptation and resilience where private banking does not address the gaps. This path may face many challenges with financing from both the government and development banks. It is essential for development banking to understand the regional context, from the government to the most vulnerable communities. Indicators such as KPIs, which are being incorporated by financial institutions through environmental and social risk systems, are also important. These indicators are crucial for developing opportunities, such as thematic bonds and access to other sources of financing. In addition, the issue of adaptation and access to international funds, such as the recent fund created under the framework of the United Nations Framework Convention on Climate Change on Loss and Damage, represents another opportunity for development banks. The latter have demonstrated their ability to meet high standards and bring meaningful projects to the most affected and vulnerable communities.

Below are some cases of efforts of development banks to raise funds. Nacional Financiera (Nafin), of Mexico, is an example. Nafin has identified three main sources of resources for sustainable financing: 1) Thematic bonds: 60% of its issuances are social or environmental bonds, attracting some US$3 billion with lower interest rates than traditional issuances due to high investor demand; 2) International financial institutions, which provide loans or lines of credit with environmental and social safeguards, including access to the Green Climate Fund (GCF); and 3) the Nafin Sustainable Fund, a public trust that leverages non-reimbursable resources from international financial institutions. Nafin has been actively involved in environmental and social projects, offering direct financing to companies related to foreign trade in Mexico. These projects cover areas such as clean transportation, energy efficiency, renewable energy, solid waste management and water treatment.

We can also refer to Financiera de Desarrollo Nacional (FDN) of Colombia, which in addition to providing financing, plays a crucial role in structuring projects. In this regard, it provides support in conducting the necessary studies and obtaining resources to carry them out. FDN has also adopted a sustainability policy and is committed to following international environmental standards. In addition, it is exploring blended finance strategies to support the energy transition and sustainable transportation in the country. FDN has developed a variety of specific financial products to support infrastructure projects at different stages of their life cycle. These include senior debt, which serves as the basis for any structured financing, as well as long-term subordinated debt, designed especially for wind energy projects. In addition, it offers liquidity lines for the road sector and bank guarantees to secure reserve account resources, which help to reduce the capital cost of projects. FDN also offers co-financing and an aggregation model to facilitate the financing of solar projects, which allows for the efficient approval of a project and sets conditions that other projects of the same sponsor can meet to access financing more efficiently.