Remarks of Mahesh K. Kotecha, CFA, President of Structured Credit International Corp. on the Scaling Up of Emerging Markets ESG Debt Financings at Sept. 19, 2023 CFANY Conference on "Filling the Global ESG Gap Before It's Too Late!" on Sidelines of UNGA.

The Global Emerging Markets (GEMS) Risk Database was established by group of MDBs and Development Finance Institutions (DFIs).[1] A granular disclosure of its delinquency and loss data is critical in climate finance. Similar borrower loan performance data was critical in asset and mortgage backed securities markets (ABS, MBS) which grew into the trillions. A greater disclosure of repayment record catalyses lending.

To realize this potential, we must encourage faster professionalization, disclosure and use of the GEMs database especially by the rating agencies and investors. We must encourage a faster implementation of the African Union's proposed Model Law in its Member States to enhance the rule of law, improve the business environment and increase private institutional investor asset allocation to 5% from the current 1.5%, in support of climate adaptation and mitigation, in addition to the achievement of SDG goals in Africa.

The AU has also proposed that its Member States grant a Preferred Investor Status to attract additional institutional investments into climate finance as MDBs have for long been granted their own Preferred Creditor Status (PCS). For MDBs, the PCS limits their losses and underpins their triple-A ratings. Similar private investor preferences could help increase funding, if implemented while preserving the triple-A ratings of MDBs

Credit Rating Agencies (CRA): The credit rating agencies use default and loss data to develop credit enhancement levels for structured transactions and asset classes. Rating agencies need such data to assess the impact of defaults and delinquencies by one or more borrower(s). They run stress tests (often using the

[1] GEMS is a credit risk database for Emerging Markets and Developing Countries (EMDCs) built up over the past 15 years. Its consortium and data providers comprises 24 institutions, led by the European Investment Bank (EIB) and the World Bank's International Finance Corporation (IFC). The participating DFIs have contributed their respective data on over 17,000 financing contracts (e.g., loans) to more than 10,000 counterparties in over 170 countries over 33 years. The GEMs database is owned by a consortium of MDBs. Its governance structure is informal to support MDBs in their credit modelling. It requires all members, data and non-data providers, to approve any material decisions and has no firm commitment from participants to supply data in the future. The GEMs secretariat is based at and staffed by EIB employees and is required to follow EIB policies and procedures. GEMS Secretariat and the responsible GEMS MDB representatives are predominantly Chief Risk Officers (CROs) with demanding responsibilities limiting their ability to effectively implement GEMS 2.0.

highest historical default and recovery rates and the volatility of such rates) to set standards on credit enhancement for targeted investment grade and other ratings. Credit ratings help attract global institutional investors in size and help investment bankers and investor price rated securities. Developing rating agency credit enhancement standards for investment grade and lower rated securities requires reams and reams of data -- on defaults and losses on public and private sector loans in a broadening set of countries covering different sectors and over an increasingly long history.

African Development Bank's Room2Run transaction in 2019 relied only on its internal loan loss data to pool and securitize 50 loans totalling one billion dollars to 25 African countries.[2] The credit enhancements totalled 27.25%. So it used about one dollar in risk mitigation for four dollars of loans. If GEMS data were to show lower default and loss rates, then the leverage consistent with investment grade ratings could be higher -- for example not 4x but 5x.[3]

GEMs: The Global Emerging Markets Risk Database is arguably the best sovereign and related emerging markets default and loss rate database but it is not made available publicly for rating agencies or investors.[4] The result is higher credit enhancement levels, lower lending volumes and higher funding costs. If GEMs were fully disclosed and professionalized, it would help unlock more private capital, bring it on stream faster and allow appropriate de-risking. This would help close the Climate Finance and Investment Gap estimated at $3 trn for Africa and 23 trn worldwide.

The GEMs database has serious limitations: its data collection, aggregation and distribution processes are bureaucratic and its definition of default appears both unclear and non-uniform. But its most serious limitation is that its data is not public. This must change so the data can meet market scrutiny, is improved and used to generate a rapid rise in climate investments by private investors. If the

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[2] See a description of this pioneering Room2Run and other similar risk sharing transactions in Mahesh Kotecha, CFA, "MDB Loans: A New Asset Class for CLOs', The Journal of Structured Finance, Volume 28 (4) 28-39 at https://www.pm-research.com/content/iijstrfin/28/4/28.

[3] see https://www.brettonwoods.org/article/mdbs-should-be-credit-enhancer-rather-than-lenders

[4] Limited disclosure of aggregate probabilities of default to 2020 is available at www.gemsriskdatabase.org.

GEMs database is thus professionalized and disclosed, a substantial volume of blended financings could be rapidly structured and sold at attractive costs.

Another challenge in climate finance is that of better project development to generate bankable projects. But this can probably be done: a trillion dollar Green Bond market has already grown in just a dozen years. We have also seen Blue Bonds from Seychelles, Barbados, Belize, Ecuador and most recently Gabon. These too can be scaled up with greater standardization and institutionalization, with a growing ecosystem of green and blue bond standards, verifiers, bankers and investors. For example, The Nature Conservancy oversees the Gabon and Ecuador nature projects for their Blue Bonds. IADB has provided credit enhancement and US DFC political risk insurance.

Credit Enhancement

MDBs like IADB and DFIs like US DFC can act initially as guarantors and others like the Green Guarantee Company (https://greenguarantee.co) are likely to join them. Over time, credit enhancement can be provided also by cash collateral, senior subordinated structures and other options.

In the ABS and MBS markets, the initial stages in scaling up required third party guarantees from the private sector (monoline insurers, highly rated banks and triple-A rated US secondary mortgage market agencies). Over time, the markets outgrew such guarantees using cash collateral or investor segmentation instead. Junior investors familiar with the risks protected senior investors. In senior-sub structures, the senior investors get safety and the junior investors get yield. So both can stay in their respective habitats.

Next Step – GEMs 3.0: GEMs 2.0 commits to some limited disclosure but the urgent need to address rising climate risks requires more to be done.

- This is in the interests of the borrowing countries and MDBs themselves.
- With GEMs data, rating agencies and bankers can build market confidence.
- With GEMs data, investors will likely increase asset allocations to Emerging Markets and climate finance.
- An Investor Preference Status could accelerate funding, if done without loss of MDB's triple-A ratings.

GEMs 3.0 seeks to increase the utility of GEMs for the global institutional investor community, working with current GEMs management, key MDBs, private sector mobilization experts and the rating agencies to broaden the investor base.

Specifically, GEMs 3.0 needs to:

- Complement, expand and broaden the development of relevant data to mobilize private resources,
- Work with rating agencies to develop criteria for climate finance transactions,
- Develop analyses to elicit interest from global institutional investors, and
- Enhance asset allocations by demonstrating the high credit quality of climate & SDG financings.

Conclusion: During the World Bank and International Monetary Fund's (IMF's) October 2022 meetings in Washington, DC, Larry Fink—the founder of Blackrock, which has over $10 trillion under management at the end of 2021—predicted that private capital will be attracted in droves if developing countries provide the first-loss cover and MDBs provide the second-loss cover. If so, this would mimic the monoline guarantee phases of the ABS markets and the Fannie Mae, Freddie Mac and Ginnie Mae phase of the MBS markets. With GEMs reforms, the Model Law, and a possible Investor Preference Status on climate finance, investor segmentation and cash collateral could broaden the choice of credit enhancement options in a growing climate finance market.