SUSTAINABLE FINANCE FACT SHEETS

3

PROTECTED AND CONSERVED AREA DEBT CONVERSION

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Overview and Key Characteristics

There are several debt-related conservation finance mechanisms available to governments. Traditional Debt-for-Nature Swaps originated in the late 1980s and usually involved an official government creditor forgiving a portion of a country's debt in exchange for an equivalent amount of funding being channelled towards a specific conservation outcome, normally through a Conservation Trust Fund (CTF). A large portion of these debt swaps involved the United States government providing bilateral debt forgiveness under the Enterprise for the Americas Act and the Tropical Forest Conservation Act (now the Tropical Forest and Coral Reef Conservation Act–TFCCA). Most of the traditional debt swaps were in the range of US$ 1 million to US$ 25 million. In 2023, a 12-million-euro debt-for-nature swap agreement between Portugal and Cabo Verde and a US$ 20 million TFCCA agreement between the United States and Peru were signed. Over a 25-year period, approximately US$ 380 million was unlocked for conservation under TFCCA across 22 transactions.

Debt Conversions represent a more recent model that focuses on refinancing a country's commercial debt to establish new funding for biodiversity conservation. With these mechanisms, a sub-investment grade sovereign issuer taps international capital markets with a credit-enhanced investment grade issuance and thus achieves an interest rate and/or debt stock reduction compared to its uncovered, "plain vanilla" commercial bonds or loans. International non-governmental organisations (NGOs) and development banks are partnering to provide these credit enhancement mechanisms, such as credit guarantees and political risk insurance. The savings from the transaction (whether they stem from debt stock reduction, interest rate reduction, or otherwise) can then be channelled towards nature and climate projects at no additional burden to budgets or debt levels. Between 2021 and 2023, four large-scale debt conversions were closed, generating an estimated US$ 800 million for conservation (based on total capital raised of US$ 2 billion.)

Sovereign Green Bonds (Green Bonds) and Sustainability Linked Bonds (SLBs) differ from Debt Conversion and Debt-for-Nature Swaps in their focus on incurring new debt rather than refinancing or forgiveness. As such, they are appropriate for countries that have significant headroom to borrow more, typically sovereigns with a high (investment or near-investment grade) credit rating. With Green Bonds and other so-called "use of proceeds" bonds, the proceeds may only be spent on certain types of projects (for example renewable energy projects) in line with the internationally agreed frameworks. The Nature Conservancy (TNC) has led this type of transaction and refers to them as Blue Bonds projects (when directed to marine conservation) and more recently Nature Bonds projects (when directed to conservation beyond marine including terrestrial, freshwater, and climate adaptation).

With SLBs, the proceeds can be spent on general budget needs, but the country agrees on a set of indicators. Failing to achieve such indicators will result in additional interest payments to bondholders. Unlike Debt Conversions, Green Bonds and SLBs do not typically benefit from credit enhancement and thus carry interest rates in line with the sovereign's typical cost of financing.

This factsheet focuses on Debt Conversions.

How to plan for and implement debt conversions

Key enabling conditions include that there is debt to refinance (and a willingness from the Government to do so) and governmental conservation and climate commitments. There are some conditions that need to be in place for this transaction to be financially viable, such as debt amount, type of debt (Eurobonds are the most convenient type of debt for these transactions), interest (coupon) rates and pricing of current debt, among other factors. If the conditions are favourable and a debt conversion can generate resources to direct to the conservation commitments, the country will formally adopt clear commitments that can be incorporated to the transaction. For that, it is key to have a conservation partner identified (such as an experienced NGO), as well as a credit enhancement partner to be engaged (typically a Development Finance Institution).

Besides the Ministry of Finance, the conservation partner and the credit enhancement partner, the Ministry of Environment will be a key player in creating the conservation commitments and including other environmental agencies, such as the protected areas (PA) agency. In many countries, ministries responsible for fisheries, agriculture and climate change will also be key partners. There are also legal and financial advisors to support the government in the negotiations of the Debt Conversion agreements and an investment bank to be the bond issuer.

As the Debt Conversion relies on the success of a bond issuance in the capital markets, the details of the transaction are typically kept confidential until financial closing. This has generated some concerns suggesting that the approach is not as participatory as other financial solutions. Such concerns do not apply to Debt Conversions structured to high standards where the conservation commitments are generally developed in close consultation with the Ministry of Environment and relevant government agencies, are based on existing country targets (in their National Biodiversity Strategies and Action Plans or Nationally Determined Contributions), and carefully consider the processes and enabling conditions required to achieve them. The final conservation commitments include clauses related to following global standards and science-based, inclusive and participatory processes in line with international best practices and the legal framework of each country. As such, these projects often *increase* participation in planning processes and conform to standard policy making processes, where the government's targets are subject to consultation and further development with key stakeholders.

The main risk of a Debt Conversion for the country is the possibility of a default, which can be related to the repayment of the new debt or to the achievement of the conservation commitments. As with any other debt service default, a payment default in the context of a Debt Conversion can affect the country's credit rating. However, it should be noted that the new issuances for Debt Conversions are extended at favourable terms (competitive interest rate, long repayment period), and thus they can improve the debt sustainability of the sovereign and reduce the probability of default.

The risk of not achieving the conservation commitments is minimised by using an independent CTF, which can ensure resources will only be directed for the purpose established. In addition, the presence of a credible conservation advisor improves the probability of a successful conservation program. Nonetheless, the capacity of the government to use the resources, establish the required policies and report to the CTF is a risk factor that should be considered and managed for the implementation.

Required Elements

Countries considering Debt Conversions make decisions based on many factors, including the current and expected economic conditions, debt and budget sustainability, political stability, and the ability to manage the conservation and financial commitments. While circumstances are different and unique for each country, some key considerations for successful Debt Conversions include:

- **Strong political will and commitment.** A Debt Conversion is a government-led debt liability management exercise. It is a decision of the country government to adopt the credit enhancement tools provided by partners and enter legally binding conservation and/or climate commitments. The government must have a strong commitment to environmental conservation and sustainable development, and a willingness to prioritize Debt Conversion as a viable financing mechanism. It involves a cross-cutting effort among governmental bodies to agree on financial and social environmental terms. The Debt Conversion is especially interesting for developing countries, which often face biodiversity, climate, and debt crises as well as harsh lending conditions, effectively preventing their access to capital markets (particularly in the current environment of rising interest rates).
- **Availability and affordability of guarantors and credit enhancement**. To achieve significant savings to be directed to conservation, credit enhancement tools are needed in the context of Debt Conversions to lower the interest rates and/or extend tenors. For that, political risk insurance and credit guarantees have been successfully provided by bilateral and multilateral development finance institutions.
- **Availability of debt to refinance**. It is essential that the existing debt can be refinanced with better conditions to generate savings. While Debt Conversions work well with sovereign debt trading at a discount in the capital markets, they are not exclusively for countries threatened by high debt distress. High-coupon bonds and/or syndicated loans traded at little to no discount can still be refinanced with lower coupons and longer tenors to create funding for conservation and climate.

Success Factors and Risks

In addition to the key conditions detailed above, success factors include:

- **Conservation partnerships for technical assistance.** A pillar of Debt Conversions is the conservation commitments created and assumed by the government. These are aligned with the country's international commitments, and can include the development and implementation of spatial plans, new and improved PAs, new or reformed legislation and structures, etc. International NGOs have played a key role in partnering with the countries to provide technical assistance during the design of these commitments and monitoring them after the debt transaction closes.
- **Conservation Trust Fund in place.** All debt conversion resources are channelled through a CTF. A new sub-account to receive funding can be created if a CTF already exists. If a CTF does not exist, a new CTF can be created. The CTF's essential role is to receive, invest and disburse the resources to local project implementers and to ensure compliance with social and environmental standards, monitor and report on the funded initiatives. Debt Conversion partners should adopt international **best practices** to select the CTFs, which ensures the funding is going to be used for the purpose agreed until the end of the debt period, which has ranged from 15 to 25 years.
- **Complementarity with other programs**. The Debt Conversion mobilizes significant amounts of funding but will not fulfil the whole financial gap of a country's conservation goals. It is key that it is used by the country in addition to current public budgets, and in coordination with other initiatives, such as a Project Finance for Permanence (PFP), so that the debt-generated funding is contributing to public budgets and other public and private resources. A CTF facilitates coordination between different programs.
- **Communications and transparency for national buy-in**. A complicating factor of the Debt Conversion is that they must often be kept confidential until the transaction's closing, so that negotiations do not influence the conditions achieved in the capital markets. This requires that involved entities sign non-disclosure agreements and stakeholder consultation for the conservation commitments are restricted to government and closer partners. Nevertheless, the planning process to agree on conservation commitments promotes increased coordination among government agencies and a thorough review of best available science and data. Developing the Debt Conversion in parallel with other initiatives allows the broader stakeholder consultation to be carried out through the other program and inform the debt agreements. In the case of a stand-alone Debt Conversion, detailed communications around the transaction are needed as soon as it closes, to clarify the arrangements and implementation plan, including sharing documents on the governance and management of the CTF.

Case Studies

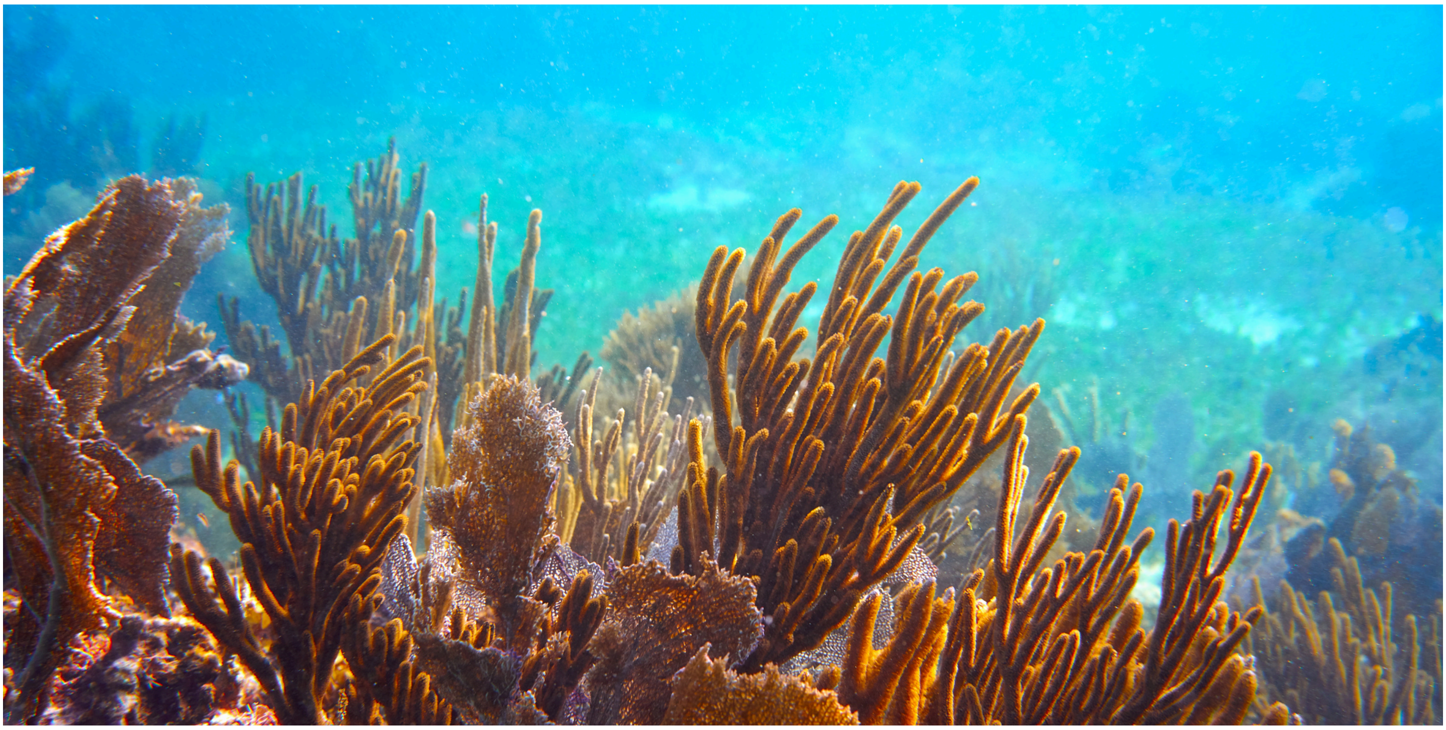
Belize Blue Bonds Project

In November 2021, TNC and the Government of Belize (Belize) announced the completion of a US$ 364 million Debt Conversion for marine conservation that reduced Belize's debt by 12% of GDP, unlocked an expected US$ 180 million in long-term sustainable financing for conservation, and established a commitment to protect 30% of Belize's ocean, in addition to a range of other conservation measures.

The Debt Conversion enabled Belize to repurchase US$ 553 million, a quarter of the country's total public debt, from bondholders at a 45% discount through a "Blue Loan'' arranged by TNC. The Debt Conversion resulted in a US$ 189 million reduction in principal outstanding. The savings achieved in the refinancing will enable Belize to create an estimated US$ 180 million in conservation funding over 20 years, composed of annual cash flows from the government and an endowment capitalized through the Blue Loan.

As part of the transaction, Belize committed to ocean conservation, including placing up to 30% of its ocean, including parts of the , under protection by 2026, subject to the outcomes of a transparent, participatory Marine Spatial Planning process, and establishing an independent CTF to allocate the conservation funding to in-country partners.

The Debt Conversion was arranged by TNC, and Credit Suisse arranged and financed the Blue Bond. The structure was credit enhanced by the United States International Development Finance Corporation (DFC) and incorporated a commercial parametric insurance policy by Willis Towers Watson (WTW) to mitigate the financial impact of natural disasters.



The Mesoamerican Great Mayan Reef

Galapagos Life Fund

In May 2023, Ecuador, with technical and financial support from the Pew Bertarelli Ocean Legacy Project and other partners, converted US$ 1.6 billion in existing commercial debt into a US$ 656 million loan financed through a bond structured and issued by Credit Suisse. DFC provided political risk insurance against default on the note. The deal provides significant and dedicated financial resources for conservation in the Galapagos in perpetuity through a long-term funding commitment by Ecuador, which includes a CTF endowment to support conservation activities, estimated at US$ 12-13 million annually.

By leveraging a loan guarantee from the Inter-American Development Bank (IDB) to support the reserve requirements for DFC's political risk insurance, the new arrangement will also save Ecuador more than US$ 1 billion in total borrowing costs—resulting from forgiven debt and reduced interest. Over the next 20 years, the deal will generate conservation resources totalling more than US$ 450 million (including payments and assets) for the globally significant Galápagos Islands marine reserves, including a newly created Hermandad Marine Reserve.

The Galápagos Life Fund (GLF), a Delaware-based U.S. 501(c)(3) non-profit operating in Ecuador, was established to oversee allocation of the conservation funding. The GLF has an 11-member board of directors composed of five government and six non-government representatives of the artisanal fishing, local tourism, conservation, and academic communities.

Galapagos Marine Iguana (*Amblyrhynchus cristatus*)

Trends and Future Directions

Trends and potential future directions include:

Scale: Given the debt crisis facing many countries and the success of Debt Conversions, more Debt Conversions are expected in the coming years. Already, there is growing demand from governments to explore debt conversion options, and more actors are becoming interested and available to provide support to governments on the different building blocks of Debt Conversions (technical assistance on the conservation commitments, credit enhancement products, and different types of debt to refinance). It is imperative that future projects be structured and carried out at high standards and for the right reasons (ambitious biodiversity and climate targets vs. primarily for liability management).

Expansion beyond oceans: Initially, the Debt Conversions were focused on marine conservation, with the Blue Bonds in Seychelles inaugurating this modality and the transactions in Belize, Barbados, Gabon, and Ecuador following the focus on the sea. Discussions are already underway with different countries to use the Debt Conversion as an instrument to finance terrestrial and freshwater conservation objectives, in addition to marine conservation, as well as climate and community development.

Additional Resources and References

Resources	
	Green Bond principles set out by the International Capital Market Association (ICMA)
	The Belieze debt conversion case study
	The Barbados debt conversion case study
	Ecuador completes world's largest debt-nature conversion
	Seychelles debt conversion

Suggested Citation

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