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**DEBT-FOR-NATURE
SWAPS: A NEW
GENERATION**



— THOUGHT LEADERSHIP

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DEBT-FOR-NATURE SWAPS: A NEW GENERATION

Urgency around climate change, and the growing number of countries with high levels of debt vulnerability, in part as a consequence of the COVID-19 pandemic and monetary tightening, are driving renewed interest in debt-for-nature and debt-for-climate swaps. These factors, coupled with the general growth and mainstream acceptance of ESG investments, are reflected in investors' increased appetite for climate and conservation linked debt instruments.

Background and Brief History

Debt-for-nature swaps, debt-for-climate swaps and other debt conversion arrangements, under which external debt owed by a debtor country is reduced in exchange for linked financial commitments (typically payable in local currency) to improve the natural environment in that country, have been in use for many years. Some transactions date back to the 1980s and these early transactions often involved the reduction of official bilateral debt claims (which are broadly debt claims owed by the debtor country to other sovereign states or their agencies).

The Paris Club, which describes itself as an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries, has also contemplated and facilitated debt swaps of this type for many years. It has a section on its [website](#) describing debt swaps (including debt-for-nature and debt-for-development swaps), which notes that a provision may be included in the Agreed Minutes (which will be entered into between the applicable Paris Club members (creditors) and the debtor country in relation to debt treatment for that debtor country), enabling creditors voluntarily to engage in debt swaps. Many such swaps have been undertaken, with the 2017 Seychelles transaction for example, involving the purchase of US\$21.6 million face value of Paris Club debt by the newly created Seychelles conservation trust, being one of the more well known. In addition, the United States as a creditor has conducted many debt-for-nature swaps over the years under the 1990 Enterprise of the Americas Initiative and the 1998 US Tropical Forest Conservation Act.

Two broad factors have contributed to renewed interest in debt-for-nature, or more generally debt-for-climate, swaps. Firstly, increased attention to, and urgency associated with, environmental and climate related issues. Secondly, as a direct consequence of the COVID-19 pandemic, the realisation that many countries are under considerable fiscal strain to the point where they now have high levels of debt vulnerability. These factors are complemented by increased appetite from investors for climate related debt instruments and the general growth (and mainstream acceptance) of ESG investments.

Against that backdrop, the IMF published a [Working Paper](#) entitled "*Debt -for-Climate Swaps: Analysis, Design, and Implementation*" in August 2022, which among other matters sought to compare debt-for-climate swaps with alternative fiscal support instruments. In the Working Paper, the IMF draws out that climate vulnerabilities and fiscal risks for a country are correlated, with the reasons including that climate change can exacerbate debt vulnerabilities (e.g. following a catastrophic event, a country will face reconstruction costs and physical damage to that country's productive capacity and its tax base, as well as increased borrowing costs, particularly external borrowing costs). Further, a country with high levels of debt has less fiscal flexibility to incur expenditure on climate mitigation and adaptation. In broad terms the Working Paper makes the qualified case that, for countries which may experience debt distress and have meaningful climate related investment opportunities, debt-for-climate swaps can be more attractive than the alternatives

(of sovereign debt restructuring and conditional grants for climate related activities) in certain circumstances. It further adds that, "*debt-climate swaps could be useful to expand fiscal space for climate investment when grants or more comprehensive debt relief are just not on the table*".

Several other multilateral international organisations are working on studies and mechanisms which could be drawn upon to scale up debt-for-nature/ debt-for-climate swaps in their areas of operation. Further, following high profile recent transactions such as Ecuador's debt conservation transaction in May 2023 (described in detail below), many developing countries are believed to be contemplating debt-for-nature /debt-for-climate swaps to seek to reap simultaneously the dual benefits of external debt relief and fiscal capacity to enable them to make pressing environmental or climate related investments.

Against that backdrop we begin with a description of the practical workings of debt-for-nature swaps or debt-for-climate swaps and for the remainder of this briefing we effectively use those two terms interchangeably, as well as the term "debt conversion".

How debt-for-nature swaps/debt conversions work

It is clear that there is currently broad interest in the use of debt conversions from market participants, international organisations, governments and non-governmental organisations.

In a December 2022 [blog post](#), the IMF noted that 34 of the 59 developing economies most vulnerable to climate change are also at high risk of fiscal crises, while The Nature Conservancy ("**TNC**"), a non-governmental organisation ("**NGO**") involved in a number of debt conversion transactions, has [noted](#) that at least a third of the roughly \$2.2tr of commercial debt owed by the developing world is in some form of debt distress. Recent high profile debt conversion transactions have involved exchanges of debt securities, and so transactions of this type may be an option available to several of those countries which have a significant stock of such debt. Recent sovereign debt conversions involved the buyback of debt securities at significant discounts (for example, Belize bought back its debt at 55 cents on the dollar and Ecuador at between 38 and 52 cents on the dollar). However, the Barbados transaction and the more recent Gabon debt conversion transaction, in which the debt was bought back at 92.5 and between 85 and 96.75 cents on the dollar respectively, show that a deep discount is not an essential precondition for these transactions (although clearly a deeper discount on the price of the relevant debt will generate greater fiscal savings for the sovereign, allowing

more funds to be redirected to conservation objectives).

Other countries which do not have significant commercial debt (whether in the form of debt securities or otherwise) may consider conversions of official bilateral debt. As described above, there are multiple examples of Paris Club creditors agreeing debt conversion transactions with debtor countries (with a case study on the Seychelles debt for nature swap relating to Paris Club debt set out below). However, China, which is now the largest official bilateral creditor (and is an observer rather than a member country of the Paris Club), is not known to have executed a debt conversion transaction with a debtor country. Whilst not ruling out the possibility, the Export Import Bank of China (China EXIM) has [suggested](#) there is a need for an "internationally-agreed mechanism and support systems" to be in place first.

This is not however to say that debt conversions will be appropriate for all countries with a high debt burden. The terms of each deal will be specific to the country in question, including the composition of its debt stock, the sustainability thereof and the relevant conservation (or other) objectives.

Given the recent attention on debt conversion transactions in respect of publicly traded bonds, the remainder of this briefing focuses on that segment of the market.

Seychelles Case Study

In 2016, the Government of Seychelles closed a landmark debt for nature swap linked to marine conservation. Under the transaction, Seychelles bought back USD21.4m of its Paris Club debt at a discounted price, financed by a low interest loan from TNC as well as USD5m of private grants. A portion of the Seychelles repayments on the loan were directed to the Seychelles Conservation and Climate Adaptation Trust ("**SeyCCAT**"), a specially created local organisation established to use funds received to fund marine conservation and climate adaptation work in Seychelles. The transaction allowed Seychelles to smooth out the repayment profile on its official bilateral debt (as well reducing its indebtedness), convert certain ongoing payment obligations into local currency and also to redirect certain payments for conservation purposes within the country.

SeyCCAT uses its funds to finance (through grants and loans) work in Seychelles that advances marine and coastal conservation, including strategies for ecosystem-based climate adaptation and disaster risk reduction. This has included funding projects related to the management of coasts, coral reefs, mangroves and sustainable fisheries, as well as expanding marine protected areas to safeguard 30% of the Seychelles Exclusive Economic Zone (which was achieved in 2020). Additional funds have been used by SeyCATT to capitalise an endowment to ensure that it can continue to fund climate and conservation initiatives beyond the maturity of the transaction.

In 2018, additional funding was raised by Seychelles for conservation activities by SeyCATT through the issuance of a USD15m blue bond. The blue bond benefitted from a partial credit guarantee from the World Bank, with Standard Chartered Bank acting as placement agent. Clifford Chance acted as legal counsel on both the debt for nature swap and the blue bond.

The structure of a commercial debt conversion transaction

The basic structure of a commercial debt conversion transaction involves a debtor country buying back its existing debt at its market price through a tender offer or similar operation, funding such buyback out of a new financing that benefits from a guarantee (or similar credit enhancement) from a highly rated entity. The new financing will often be provided by a special purpose vehicle ("**SPV**") established for the transaction in a suitable jurisdiction (giving consideration to the regulatory and tax frameworks in place, which is particularly important where insurance is an element of the transaction), with the SPV funding itself via a back-to-back arrangement in the form of either a bond issue or a loan from a financial institution. The investors in the new debt of the SPV may be the same as those tendering the sovereign's existing debt in the tender offer. But the investors will often be different, given the different risk profile of the new SPV debt compared to the debtor country's bonds (i.e. the new investors will primarily be taking credit risk on the highly rated entity providing the credit enhancement, subject to a complexity premium, compared to taking credit risk on the sovereign itself).

The savings generated from debt conversion operations for a sovereign will be two-fold. Firstly, the sovereign will be buying back its existing debt at a price below par, funded out of new debt, meaning that not only will the sovereign not be incurring new external indebtedness (on a net basis) but it will ultimately be reducing its overall external indebtedness. Secondly, the sovereign will be replacing more expensive commercial debt with cheaper guaranteed debt, delivering a debt service cost reduction for the sovereign (both due to the expected lower coupon and the lower principal amount on the new debt, although noting some costs will be incurred in respect of any premium payable in connection with the relevant credit enhancement).

The key to the structure will therefore be the credit enhancement provided by the highly rated entity, which allows the new debt to be raised with an interest rate priced by reference to such highly rated entity's credit rating rather than by reference to the credit rating of the sovereign in question (which will necessarily be lower). In recent

transactions this has been provided by The United States Development Finance Corporation ("**DFC**"), TNC and/or the Inter-American Development Bank ("**IADB**") (with the IADB's role in a number of recent transactions reflecting the fact that most of the recent deals have involved Central and South American sovereigns but, we expect that other Multilateral Development Banks ("**MDBs**") will follow IADB's lead as the geographical reach of the transactions expands). The credit enhancement can take the form of either a direct guarantee (as was provided in the Barbados deal by TNC and IADB) or political risk insurance, (which is the product preferred by DFC to date in transactions in which it is involved). Guarantees or partial credit guarantees provided by MDBs or similar entities are well understood products in blended finance transactions and should be familiar to investors in this space. With DFC political risk insurance, which may be less familiar to some investors and market observers, following a default by the sovereign, the SPV must obtain an arbitral award against the sovereign (or prove a denial of recourse) before DFC will pay out under the policy. This adds a layer of complexity and generally requires a liquidity facility to cover debt service on the SPV's funding instrument whilst any arbitral process plays out (so as to maintain the high credit rating, directly or indirectly, of such funding instrument). The liquidity facility may either be in the form of a funded reserve account or an unfunded liquidity guarantee (which was provided by the IADB for example in the Ecuador transaction, see "*Ecuador Case Study*" below for further information). As DFC's political risk insurance is backed by the full faith and credit of the United States, a number of statutory and policy requirements must be met by the other transaction parties, including environmental and social performance standards, anti-money laundering and anti-bribery and corruption undertakings, with appropriate remedies in place in case of a breach. For the SPV, this may require it to have policies and procedures beyond those which a typical transaction-specific SPV might have (although it should not be difficult for a newly established entity with a single purpose to agree to such representations and undertakings).

The primary policy reason why such entities are willing to provide credit enhancement for transactions of this type

is the furtherance of conservation or development goals, so this is where the conservation element will come into play. In exchange for benefitting from the credit enhancement, the sovereign will need to agree to utilise a certain percentage of the fiscal savings in furtherance of agreed conservation objectives, with robust contractual protections to ensure that these are adhered to. This usually involves providing funding to the NGO (or similar) that is sponsoring the transaction, so as to fund its conservation work in the country. The legal documentation for the transaction will also require robust monitoring and reporting regarding the achievement of the agreed conservation objectives, with a separate verification agent often appointed to provide additional comfort to the credit enhancement provider(s) and the investors.

The overall agreed conservation objectives are often achieved in two ways. The first will be a number of conservation commitments given by the sovereign (for example, where a conservation reserve is involved, the sovereign will need to commit to maintaining or expanding the reserve's status). For the sovereign, this will likely involve a significant degree of intragovernmental coordination, as the commitments will often be within the jurisdiction of a ministry or agency outside of the Ministry of Finance (or equivalent) and such ministries or agencies may be unfamiliar with finance transactions usually handled solely by the Ministry of Finance (although where a sovereign has established a sovereign sustainable bond framework, there may be some existing coordination to build upon). The second element will be the application of the new funding for conservation purposes (and, critically, ensuring that such funding is ring-fenced for the conservation objectives for the life of the transaction). Depending on the transaction, the full amount of the conservation funding could be provided upfront on day one, or it could be provided over the life of the transaction (noting that the reduction in the principal amount of the sovereign's external debt will be realised fully on day one, whilst the debt service savings will be realised over time). The conservation funds could be provided directly to the NGO where the NGO has sufficiently robust governance and procedures. The absorption capacity of the NGO in relation to the proposed conservation activities

will also need to be taken into account. However, as the funding is given for a specific purpose (which must be ring-fenced) and the sovereign will likely want to have a degree of control over how the money is used, it will often make sense to establish a new trust fund (a "**Conservation Trust Fund**" or "**CTF**") for the specific objectives of the transaction, either within the existing structure of the NGO or on a standalone basis. The benefit of this approach is that the CTF's governing documents can be tailored precisely to the conservation objectives in question and its board of directors established with members from the sponsoring NGO and the sovereign (or its nominees) as well as experts and local community participants. The CTF can be established solely to receive the funding from the structure and to determine how such funding is utilised in furtherance of the conservation objectives (in accordance with policies and guidelines agreed upon its establishment), or the CTF could be permitted to raise additional funds for the same objective where that is desirable (most likely only on a grant basis). The sovereign will need to decide which approach to follow up front. Funding may be utilised fully for operating the CTF and furthering its objectives, or some funds may be directed towards an endowment to build up capital in order to increase the CTF's longevity. Where an endowment is established (or indeed where all of the funding is provided upfront), the CTF will need investment guidelines and likely an investment manager in order to manage efficiently the endowment funds until they are needed for the conservation goals. As the recipient of the funds, the CTF will also need to adhere to the policy requirements of the credit enhancement provider(s).

Recent transactions have focused on marine conservation, which is a particular focus of **TNC** as well as the **Oceans Finance Company** ("**OFC**", a key player in the Ecuador transaction). But there is no reason why the debt conversion structure cannot be replicated for other objectives (see "*Looking Forward*" below).

Other possible elements of a debt conversion transaction

There are a number of other features which may or may not be included in a given debt conversion. For example, climate and pandemic resilient debt clauses were included in the Barbados structure, which allow Barbados

Barbados Case Study

Barbados executed its debt-for-nature swap in September 2022. At the time it was the first such transaction involving commercial debt exchanged outside of a broader debt restructuring. The transaction was arranged by Credit Suisse and CIBC FirstCaribbean (with Clifford Chance acting as legal counsel to Credit Suisse and CIBC FirstCaribbean). Barbados bought back more than \$77 million of its international bonds and called almost \$73 million of local bonds using funds provided by CIBC FirstCaribbean and an SPV via a dual currency blue loan which benefited from guarantees from both the IADB and TNC. The SPV in turn funded itself via an issue of blue bonds also arranged by Credit Suisse.

Barbados agreed to direct the fiscal savings resulting from the debt conversion, realized through lower debt service payments on the blue loan compared to the bonds subject to the buyback and redemption, to the Barbados Environmental Sustainability Fund ("**BESF**"). The BESF, which is expected to receive approximately **\$50 million** over the next 15 years, funds marine conservation and other environmental and sustainable development projects in Barbados. Alongside the funding, Barbados agreed to a number of conservation commitments, including to protect and sustainably manage up to 30% of its Exclusive Economic Zone and Territorial Sea – an area of more than 55,000 square kilometres.

The transaction also built on Barbados's pioneering of climate resilient debt clauses by including a mechanism pursuant to which Barbados may elect to defer scheduled amortisations on the blue loan for two years following the occurrence of an earthquake, tropical cyclone or pandemic event provided that certain criteria are met. For earthquakes and tropical cyclones, the trigger is linked to Barbados's parametric insurance policy from the Caribbean Catastrophic Risk Insurance Facility ("**CCRIF**") and subject to a minimum pay-out threshold. For pandemic events, the trigger is linked to the declaration of a pandemic by the World Health Organisation and subject to either a minimum real GDP contraction or a minimum increase in spending by Barbados linked to such pandemic. The blue bonds issued by the SPV in turn include mirroring deferral provisions which are triggered simultaneously.

temporarily to suspend debt service upon the occurrence of certain severe weather events or the onset of a pandemic, provided that certain criteria are met. We would encourage sovereigns (particularly those which are G20 Common Framework eligible countries, Small Island Developing States, members of the Climate Vulnerable Forum or other IMF high climate vulnerability countries which are not advanced economies) considering a debt conversion (and debt finance more generally) also to consider the inclusion of such clauses, tailored to that country's risk profile, which are complementary to the goals of the wider transaction (see "*Barbados Case Study*"). Such transactions may also include a parametric insurance element linked to the sovereign's climate and/or natural disaster risks.

Timing a commercial debt conversion transaction

When considering a debt conversion transaction, the conservation objectives should be a key consideration and a primary goal of the transaction and not simply a means of achieving debt relief. For sovereigns which are facing high levels of debt distress, debt conversions should not be considered as an alternative to traditional debt restructuring processes, although they may be a component of such. Debt conversions are fairly complex transactions, involving many different stakeholders and taking several months to execute, so they cannot easily fit into the sequencing of a standard sovereign debt restructuring timeline for a sovereign already in arrears. In such situations, a debt conversion may be more appropriate to complement any broader restructuring contemplated.

For a sovereign considering a pre-default reprofiling, it may be more easily feasible to include a debt conversion as one component and this may be attractive to investors asked voluntarily to reschedule their holdings of the sovereign's external debt.

Challenges and solutions

As fairly complex financing transactions involving a number of parties (and therefore a number of law firms) and a significant amount of documentation, debt conversion deals are not without challenges. Establishing the SPV and CTF, as well as agreeing a number of

contracts with a number of key stakeholders (likely including more than one government ministry), can be a time consuming process. Additionally, given that the transactions involve the buy-back of public debt securities and are sensitive to the market value of the sovereign's bonds, timing the transaction launch appropriately can be a significant factor in its success.

As the transactions transcend what a given sovereign will be used to when raising funding (whether by way of conventional sovereign bonds, ESG use of proceeds bonds or sustainability-linked instruments), they may go beyond the legal framework and authorisation processes previously used, meaning that the input of local counsel from an early stage will be crucial in order to navigate a path through to smooth execution. Strong leadership from finance and environment ministries will also be key to facilitate intra-government inputs.

Another challenge which is quite unique to these transactions is ensuring the buy-in of local stakeholders and communities. As the conservation objective will likely focus on a specific project or location or activity, it is important that the community is supportive of the venture and how it is being executed. Lack of engagement with local groups prior to execution could lead to a subsequent lack of support. For example, directing funds from the government to an NGO or CTF could be perceived as a surrender of sovereignty over the area in question when in fact the government retains ownership over the area and has significant control over the decision-making process (both prior to execution of the relevant deal and throughout its life). Moreover, the conservation or development funding will be subject to checks and balances which should give reassurance to local communities and investors that funding will be available over the life of the transaction and beyond. Involving an NGO (where an NGO is not a sponsor of the deal, which is often the case) or an additional NGO to a sponsoring NGO with history and experience in the local area, as well as credibility in the particular area of conservation, is one way to meet this challenge.

Ecuador Case Study

Ecuador executed its debt-for-nature swap transaction in May 2023. The transaction was arranged by Credit Suisse and was structured and executed in partnership with DFC, OFC, the IADB and the Pew Bertarelli Ocean Legacy ("**Pew**") (with Clifford Chance acting as legal counsel to Credit Suisse on all elements of the transaction). It is the largest transaction of its kind to date, with Ecuador buying back \$1.628 billion of its outstanding bonds from the market via a third-party tender offer led by Credit Suisse. The buyback was financed by a \$656 million loan to Ecuador from an SPV, which in turn funded itself via an issue of marine conservation linked bonds also arranged by Credit Suisse. The transaction was made possible by a \$656 million political risk insurance policy from DFC and an \$85 million liquidity guarantee from the IADB, which allowed Ecuador to swap \$1.628 billion of commercial debt securities (paying commercial rates of interest) for \$656 million of debt effectively guaranteed by DFC (and paying a lower rate of interest).

DFC's \$656 million political risk insurance policy can be called upon by the funding SPV (on behalf of the bondholders) following a failure by Ecuador to discharge an arbitral award obtained by the SPV following a payment default by Ecuador on the loan. The IADB's liquidity guarantee is intended to cover debt service on the SPV's bonds during the course of the arbitration. The DFC policy can also be triggered in the event that Ecuador frustrates or otherwise denies the SPV's efforts to obtain an arbitral award.

Successful execution of the transaction required close collaboration between the transaction parties and their respective legal counsel and coordination across various Ecuadorian government stakeholders including the Ministry of Economy and Finance, the Ministry of Environment, Water, and Ecological Transition, the Ministry of Production, Foreign Trade, Investments, and Fisheries, the Ministry of Foreign Affairs and the Galápagos National Park.

The transaction will generate an estimated \$323 million for marine conservation in the Galápagos Islands during the life of the deal, split between operational funding and funding for an endowment, with the goal of supporting marine conservation projects beyond the term of the transaction. Combined, the debt conversion and endowment will generate more than **\$450 million** for marine conservation in the Galápagos Islands. The conservation funding is paid over time to a newly established Delaware non-profit organisation, the Galápagos Life Fund (the "**GLF**") (the CTF in this transaction), which is tasked with directing the funding in furtherance of the agreed conservation objectives.

The GLF's founding and governance documents include agreed parameters for the use of the conservation funds in furtherance of the conservation objectives and the GLF (as well as OFC and the funding SPV) agreed to DFC's environmental and social standards as well as certain other policy standards.

The GLF is governed by an 11-member board of directors that includes five Ecuadorian government ministers and six non-government representatives. It will finance conservation activities over the life of the deal in both the Galápagos Marine Reserve and the *Reserva Marina Hermandad*, a new marine conservation area created in 2022. The *Reserva Marina Hermandad* comprises 60,000 square kilometres of ocean between the Galápagos Marine Reserve and the Costa Rican maritime border northwest of the Galápagos Islands. It includes a 30,000-square-kilometer (11,583-square-mile) fully protected area to help safeguard a migratory corridor used by sharks, whales, sea turtles, manta rays, and many other species between the Galápagos Islands and the Cocos Island of Costa Rica. This biological corridor has been recognized as a conservation priority by the signatories (which included Ecuador and Costa Rica) to the Declaration for the Conservation of the Marine Corridor of the Eastern Tropical Pacific signed in November 2022. The IADB **noted** that the transaction "*will help create a corridor of trans-national protected areas in a vitally important habitat for threatened shark species. The Galápagos Marine Reserve comprises 13 large islands in an area of 40 nautical miles. It has more than 3,500 species, 25% of which are endemic marine organisms, and 24 species of mammals, two of which are endemic. In addition to their intrinsic value, these two reserves' natural capital is crucial for important economic sectors in Ecuador, such as tourism and artisanal fishing*".

As part of the transaction, Ecuador agreed to achieve or maintain certain sustainability commitments necessary to address overfishing, illegal fishing, climate change, and pollution. For example, Ecuador committed to maintaining the *Reserva Marina Hermandad* as a marine conservation area, fully implementing Vessel Monitoring Systems on all tuna purse-seine vessels in Ecuador's industrial fleet and limiting the number of drifting Fish Aggregation Devices per purse-seine vessel (which Pew **notes** "*generally results in significant bycatch—because they attract nontargeted and juvenile species—and produces marine debris because the devices are often abandoned at sea after use*"). Pew also noted that "*in developing the conservation commitments and funding priorities, the Ecuadorian government sought consensus by working inclusively with the artisanal and industrial fishing sectors and local communities through a process that included numerous formal and informal consultations.*"

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Looking forward

The recent excitement surrounding debt conversion transactions is in our view justified. Whilst the recent transactions are highly bespoke and quite complex, as more transactions are executed the structures will hopefully become more standardised and more easily accessible to the pool of countries which can consider and execute such transactions.

We also see no reason why debt conversions must be limited to debt-for-nature or debt-for-climate transactions. The structure is versatile and can be applied to almost any objective, provided that an MDB or other highly-rated entity is willing to provide credit enhancement in furtherance of such objective, and an NGO or international organisation with sufficient experience in the relevant field is willing and able to sponsor such a transaction. This might include furtherance of any of the United Nations Sustainable Development Goals, Paris Agreement objectives, food security objectives or healthcare objectives. At a time when huge amounts of funding will be needed by the developing world to achieve such objectives, this is a key advantage of these structures.

Some criticisms of these transactions have been made, primarily that they are expensive and do not provide sufficient funding to the relevant conservation objectives (with some observers opining that some transactions amount to "greenwashing"). No transaction is without its drawbacks and these must be balanced against the benefits to the country considering pursuing the debt conversion. As noted above, such structures will be not best suited to all sovereigns in all situations, and sovereigns should consider a wide array of options before opting for one structure or another.

We do not however consider that properly structured debt-for-nature swaps amount to greenwashing. Whilst it is true that the full amount of the fiscal savings generated by a debt conversion transaction will not go towards the conservation objectives, the funds that are so designated have to be used for that purpose in accordance with very specific parameters and milestones (in contrast to the more standard use of proceeds safeguards in ESG thematic bonds). The consequences of breaching any conservation funding obligations (where they are ongoing) are clearly defined and should be strong enough to deter such action by the sovereign (with reasonable flexibility to allow for unexpected situations). The amount of funding which is designated for the conservation objectives should also be clearly defined at the outset and communicated to investors at that time, so that there is no suggestion that investors are being misled. The extensive and tailored impact reporting and verification in these transactions should also provide investors with a level of confidence.

Overall, debt conversions related to commercial debt are in our view a highly positive innovation, with recent transactions providing a foundation for future transactions to develop in accordance with a given sovereign's goals. The viability of these transactions should not deter sovereigns from also pursuing debt-for-nature swaps in respect of official sector claims (see "*Seychelles Case Study*" above). Whilst not a one-size-fits-all solution to every sovereign's debt and climate challenges, debt conversions provide another string in a sovereign's bow at a time when many are facing debt distress and unprecedented levels of funding for environmental and development challenges are badly needed.



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