Mobilizing ERC Finance

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Section Overview

This section aims to assist governments, project developers, and financiers in understanding key transaction-enabling conditions and financial structures to mobilize finance for ERC generation. ERC markets are growing rapidly, but at the current level of market maturity there is not sufficient investment to support scaling up the market to meet the expected exponential growth in ERC demand.

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Watch this space. ***Unlocking Global Emission Reduction Credit*** *is intended to be a living document and will be reviewed at regular intervals. Check the page below, or visit* ***Strategic Guidance for Country System Assessments****,* ***Guidance for Countries in Assessing ERC Projects****, or* ***Mobilizing ERC Finance****. Let us know what you think by taking a* ***Quick Survey****.*

A significant amount of effort has gone into quantifying the supply and demand for ERCs globally. There has been less focus on understanding the scale of investment into ERC-generating activities or analyzing the financing structures that are best suited to accelerate capital flow to ERC activities. This report aims to assist governments, project developers, and financiers in understanding key transaction-enabling conditions and financial structures to mobilize finance for ERC generation.

ERC markets are growing rapidly, but at the current level of market maturity there is not sufficient investment to support scaling up the market to meet the expected exponential growth in ERC demand. By any measure—issuance, trade value, trade volume, and retirement—the ERC market expanded significantly in recent years, correlated with a rise in net-zero commitments and urgency for climate action. Investment in ERC activities and developers is also increasing, but not in line with the pace of investment needed to meet ERC demand and enable a market that otherwise has the potential to grow significantly by 2030.

Establishing policies and market infrastructure is critical to grow ERC markets, but meeting the expected near-term demand for ERCs also requires financial solutions and risk mitigation to unlock greater pools of capital to invest in ERC-generating activities now. ERC markets are largely policy-driven and remain highly fragmented, creating a high degree of uncertainty from an investor perspective and thus hindering the growth of the market. To unlock the level of financing for ERC activities required to meet the growing demand, the fundamentals of the enabling environment will need to improve. However, the market cannot wait until the fundamentals are in place; ERC activities take time to plan, develop, and start issuing ERCs. Investment must happen now to meet greater future demand and accelerate progress on global climate goals, and this will require tailored financing solutions and targeted risk mitigation for ERC transactions to reduce risks for investors in the short term and create a more enduring ERC market in the long term.

Examples of novel ERC finance have demonstrated the application of standard blended finance approaches and a range of financial structuring options to allocate risk and mobilize private sector finance, but the use of any of these elements remains limited. Standard blended finance instruments—including credit guarantees, first-loss/concessional capital, and technical assistance—can be particularly helpful to mitigate credit and ERC activity-level risk. But, of the $7.4 billion of blended finance transactions for climate mitigation tracked

by Convergence in 2019-2021, only one deal worth about 1.5% of the total issued ERCs.[1] Experimentation with different ERC linkages and combinations of different types of investors have generated a menu of options for structuring ERC finance to attract investors with different preferences for ERC returns and market risk. Political risk remains the most challenging area, where engagement, and in some cases political risk insurance, will be critical to scale up finance while ERC policies and regulations are being developed. As the enabling conditions for ERC markets are put in place, the need for blended finance and other public support for ERC activities will decrease. In the meantime, such support should continue to focus on harder-to-reach markets where it is needed most.

Drawing on the available finance elements and pilot experience with novel ERC finance, three non-mutually exclusive options to scale up private sector capital for ERC activities appear particularly promising at this stage of market maturity and given current investor appetite:

- Support ERC-backed debt issuance with targeted support from development financiers. Debt instruments partially linked to or paid back in ERCs have been successfully piloted on a small scale; this approach could be scaled and replicated by large, non-multilateral issuers supported by the tailored use of concessional risk mitigation.
- Aggregate supply and mobilize capital to a broader set of ERC activities. An aggregation facility with sufficient DFI (including MDB) support, both financial and technical, could accomplish two objectives: (i) support small-scale ERC activities to overcome capacity and scale barriers to entering the market, and (ii) enable these ERC activities to collectively raise finance and so help mobilize capital toward ERC activities from smaller and hard-to-reach market segments.
- Establish an ERC club to pool demand and promote standardized approaches. Buyer's clubs can send a strong market signal and more practically reduce market risk and improve the expected cash flows of ERC activities, which helps to unlock debt capital, especially when other market participants are invited into the club. A club may prove particularly beneficial to small-scale ERC activities needing a route to market and to small or mid-sized buyers for which extensive ERC due diligence may be prohibitively costly. The benefits of an ERC club can potentially be heightened through an Article 6.2 club that provides a government-sanctioned path to market.

Please click here to view Acknowledgements.

Footnote 1: Convergence, *State of Blended Finance 2022: Climate Edition*, 2022.

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Financing ERC Generation

Key Enablers of ERC Finance, Photo energy saving light bulb and tree growing on stacks of coins

Key Enablers of ERC Finance

Scaling Finance for ERC Generation, money stack with small tree growing step by step

Scaling Finance for ERC Generation



Emission Reduction Credits



Unlocking Global Emission Reduction Credit

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This section is intended to be a living document and will be reviewed at regular intervals. The Guidelines have not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the Guidelines be reviewed and adapted for specific transactions. Unless expressly stated otherwise, the findings, interpretations, and conclusions expressed in

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