ADB

# Technical Assistance Consultant's Report

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Knowledge and Support Technical Assistance (KSTA)
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# GREEN BOND GUARANTEE MECHANISM RECOMMENDATIONS IN MONGOLIA

## Final Report



Asian Development Bank

**CURRENCY EQUIVALENTS**

| | | |
|---|---|---|
| Currency Unit | – | togrog (MNT) |
| MNT1.00 | = | $0.0003482 |
| $1.00 | = | MNT3,482 |

# ABBREVIATIONS

| Abbreviation | Meaning |
|---|---|
| **ADB** | Asian Development Bank |
| **AfDB** | African Development Bank |
| **AIF** | ASEAN Infrastructure Fund |
| **AMBIF** | ASEAN +3 Multi-Currency Bond Issuance Framework |
| **ASEAN** | Association of Southeast Asian Nations |
| **ASEAN +3** | Association of Southeast Asian Nations (“ASEAN”) members, China, Japan, Korea |
| **CGC** | Credit Guarantee Corporation Malaysia |
| **CGFM** | Credit Guarantee Fund of Mongolia |
| **CGIF** | Credit Guarantee Investment Facility |
| **CRA** | Total Credit Guarantee |
| **DCA** | USAID’s Development Credit Authority |
| **DFI** | Development Financial Institution |
| **EBRD** | European Bank for Reconstruction and Development |
| **EDGE** | Enterprises for Development, Growth, and Empowerment |
| **EIB** | European Investment Bank |
| **ESMS** | Environmental and Social Management System |
| **EU** | European Union |
| **FCG** | Full Credit Guarantee |
| **FGI** | Flexible Guarantee Instrument |
| **GGC** | Green Guarantee Company |
| **IBRD** | International Bank for Reconstruction and Development. |
| **IDA** | International Development Association |
| **IDB** | International Development Bank |
| **IFC** | International Finance Corporation |
| **IIFCL** | India Infrastructure Finance Company |
| **IIGF** | Indonesia Infrastructure Guarantee Fund |
| **LEAP** | Leading Asia's Private Sector Infrastructure Fund |

| **Abbreviation** | **Meaning** |
|---|---|
| **MDB** | Multilateral Development Banks |
| **MIGA** | Multilateral Investment Guarantee Agency |
| **MOF** | Ministry of Finance |
| **NBFC** | Nonbanking financial companies |
| **NBFI** | Nonbanking financial Institution |
| **NHSFO** | Non Honoring of Sovereign and sub sovereign financial obligation |
| **NSG** | Non Sovereign Guarantee |
| **OTC** | Over The counter |
| **PBCE** | Project Based Credit Enhancement |
| **PCE** | Partial Credit Enhancement |
| **PCG** | Partial Credit Guarantee |
| **PPA** | Power Purchase agreement |
| **PPP** | Public Private Partnership |
| **PRC** | People’s Republic of China |
| **PRG** | Partial Risk Guarantee |
| **RSF** | Risk Sharing Facility |
| **SG** | Sovereign Guarantee |
| **SME** | Small and Medium Enterprises |
| **SOE** | State Owned Enterprise |
| **TCG** | Total Credit Guarantee |
| **TCX** | The Currency Exchange Fund |
| **TLFF** | Tropical Landscapes Finance Facility |
| **USD** | United States Dollars |
| | |

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# 1. INTRODUCTION

## 1.1. Context

The Asian Development Bank (ADB) approved the Knowledge and Support Technical Assistance (KSTA) for the Green Finance Policy Framework in Mongolia in in November 2019. The KSTA aims to support the Government of Mongolia in advancing the green finance policy and regulatory framework and in undertaking capacity development to enhance capability to develop green finance projects and products.

Since 2019, the Mongolian green finance regulatory environment has witnessed some developments. For instance, the Mongolian Government have adopted several legislative changes encouraging introduction or scale-up of green finance products such as green bonds or green insurance (2021). In addition, regulatory and policy documents – most important of which is “National Green Taxonomy” (2019) - have been adopted by various Mongolian authorities. Other recently published documents include “Mongolia Sustainable Finance Roadmap” and “ESG & Sustainability Reporting Guidance for Mongolian Companies” (both adopted in 2022).

Adoption of these legal, regulatory and policy documents has led some of the local stakeholders such as Mongolian Sustainable Finance Association (MSFA) and international partners of the Mongolian Government to step up efforts to achieve objectives and goals set out in these document. One such initiative prioritized by Mongolia is to mobilize green finance in the country through issuance of Green Bonds. However, the issuance of such green bonds have been quite low despite an enabling regulatory framework. This report recommends **<u>options of Green Bond Guarantee Mechanism</u>** as KSTA recommendations which can enhance such issuances in future. .

Green bonds issuance are often perceived as financial instruments with a higher risk compared to commercial bank debt or corporate bonds since they are yet to establish a financial and credit profile (due to low issuances till date) in Mongolia. Also, green projects may have a small investment size compared to conventional bond structures.

To enhance the confidence of local and international investors in green bonds issuance, a guarantee mechanism helps mitigate key risks for subscribers in such bonds. This is especially true and necessary in the case of developing economies, including Mongolia, where the debt markets haven’t matured enough to be able to properly leverage this emerging instrument.

## 1.2. Objective of the Report

This report aims to support the government stakeholders in Mongolia to assess various options for Green Bond Guarantee Mechanisms in the country. A detailed as-is assessment has been completed for existing guarantee options in the country, and recommendation have been made based on an international benchmarking of case study examples of guarantee mechanisms used for green bonds in other Asian countries.

Below mentioned areas are covered as part of this report across various chapters.

| ***Chapter*** | ***Description*** |
|---|---|
| ***Role of Guarantees*** | This section provides a detailed context on the use of guarantee mechanisms in Asia, to catalyze private sector investments for sustainable and green projects. This chapter provides key advantages of such guarantee mechanisms, costs and key categories of guarantee products. |
| ***As-is market assessments*** | This section provides an in-depth review of the existing institutional framework for guarantees in Mongolia, including a review of key players (public and private sector agencies), product offerings, guarantee process, limitations on investment size and progress so far. |
| ***KSTA recommendations*** | This section provides the KSTA recommendations for potential green bond guarantee mechanisms that can be implemented in Mongolia based on the type of green bond issuance.<br>Each recommended option includes an international case-study to enhance the understanding of the recommended guarantee mechanism across other countries in Asia, including the detailed implementation mechanism. |

# 2. ROLE OF GUARANTEES

Guarantee refers to the promise undertaken by a third party for any financial obligation of another company and, therefore, assumes the role of a guarantor for any unpaid financial obligations. Guarantees typically cover political and/or commercial (e.g., credit, regulatory/contractual) risks that investors are unwilling or unable to bear.

Guarantees are often raised by the private sector and other stakeholders for their potential to catalyze more private investment. These instruments protect investors from a borrower's failure to repay and thereby improve a project's risk-return profile.

Guarantees and partial risk guarantees are among the more widely used mechanisms across the financial sector for credit enhancement of conventional bonds and debts. These can be in the form of private collateral or public sector backing. The public sector often provides partial risk guarantees for bond issuances in priority sectors such as infrastructure development.

## 2.1. Guarantees – Key Advantages

Governments in developing countries are often limited in their ability to mobilise market capital or private investment. Debt financing through international capital markets is often a preferred option. Depending on the risk perception of the lender for a specific client (credit rating, market standing, etc.), guarantees can provide risk mitigation in in transactions that involve sovereigns and sub-sovereigns.

The guarantor provides guarantees to mitigate key government-related risks or commercial risks to enable financial viability and bankability.

The benefit of guarantees depends on the nature of the covered obligation and on the speed and conditions required for its payment, when triggered. A benefit that is often mentioned is credit enhancement. Such enhancement is the consequence of effectively mitigating risks, which increases the likelihood of a project being able to serve its debt obligations. The use of a guarantee does not necessarily imply a credit quality improvement in the form of a rating uplift. However, it typically results in lower borrowing costs and longer tenors. This latter benefit is often overlooked.

Although there are indirect benefits to the use of guarantees (e.g., lower infrastructure financing costs turning into lower user tariffs) it is important to distinguish the direct beneficiaries. In this document, the reference to beneficiary denotes the party that receives a payment when the guarantee is called. In some cases, those payments are made directly to the lender, while in other payments are made to the obligors (debt issuers) with the purpose of helping them meet their financial obligations.

Given below are key advantages of guaranteed mechanisms for government and private stakeholders.

### *For Public Sector*

- Catalyzes private financing for key sectors such as infrastructure.
- Provides access to capital markets as well as commercial banks.
- Reduces the cost of private financing to an affordable level.
- Facilitates privatization and public private partnerships (PPP).
- Reduces Government risk exposure by passing commercial risk to the private sector.
- Encourages co-financing.

### *For Private sector:*

- Provides access to international capital markets on more favorable terms.
- Offers longer maturities and lower costs than achievable by the company on its own.
- Mobilizes larger volumes of development capital than the Bank can provide by itself.
- Can help build a track record of credible policy performance for emerging market clients.
- Mitigates risk that the private sector does not control.

Guarantees can be considered in following situations:

- Sector in early-stage reforms
- Larger size/riskier operations
- Operations highly dependent on undertaking/support from Government

Credit enhancement has been crucial for driving green bonds in international markets and there is a range of credit enhancement measures available, largely through guarantees, partial credit enhancements, and subordinated debt or equity.

These mostly rely on a stronger public sector entity or financial institution to support credit enhancement measures.

To make green bonds issuances more attractive for investors and boost this emerging market, credit enhancement measures for improving the credit rating, especially of corporate bonds, are necessary. It essentially means an additional assurance or guarantee to service the bond. The more innovative corporate-backed green projects are likely to have lower credit ratings, in part due to the relatively limited experience with green technologies, such as solar power, and the challenge of establishing a strong revenue stream for green projects, such as forestry or marine conservation projects.

## 2.2. Cost of Guarantees

The cost of a guarantee typically consists of various components, as explained in the figure below.

**Figure 1: Cost of Guarantees - types of charges**

***Front-end Fees***

- The front-end fee is a one-time payment that covers due diligence, processing of the guarantee, and other up-front costs.

***Guarantee Fee***

- The annual guarantee fee covers the guarantor's exposure to the project and is charged on the guaranteed portion of principal outstanding and the guaranteed amount of interest in an applicable interest period.

***Committment Fee***

- The commitment fee applies to the amount of any guaranteed principal that has not yet been disbursed.

***Other costs***

- In addition to the mentioned Guarantee Fee, Borrower shall reimburse all other expenses incurred, including expenses towards independent consultant, Concurrent Auditor/ CA, Legal Counsel, financial Advisor, meetings, travel lodging, boarding, Service Tax etc.

The figure below provides an illustration of various components of guarantee costs based on an analysis of recent transactions in Asia.

**Table 1: Guarantee Costs – Recent Transactions**

| Particulars | World Bank IDA PRG | ADB Sovereign PRG/PCG | MIGA Breach Of Contract | ADB |
|---|---|---|---|---|
| **Guarantee fee** | 75 bps | 50 bps | Market | Market |
| **Commitment fee** | 0 bps | 15 bps | …. | …. |
| **MOF requirement** | Counter indemnity | Counter indemnity | None | None |
| **Arbitration** | None | None | Yes | Yes |
| **Credit rating of guarantor** | AAA | AAA | Shadow rated | AAA |
| **Ultimate beneficiary** | Sponsors and lenders | Sponsors and lenders | Sponsors and lenders | Lenders |

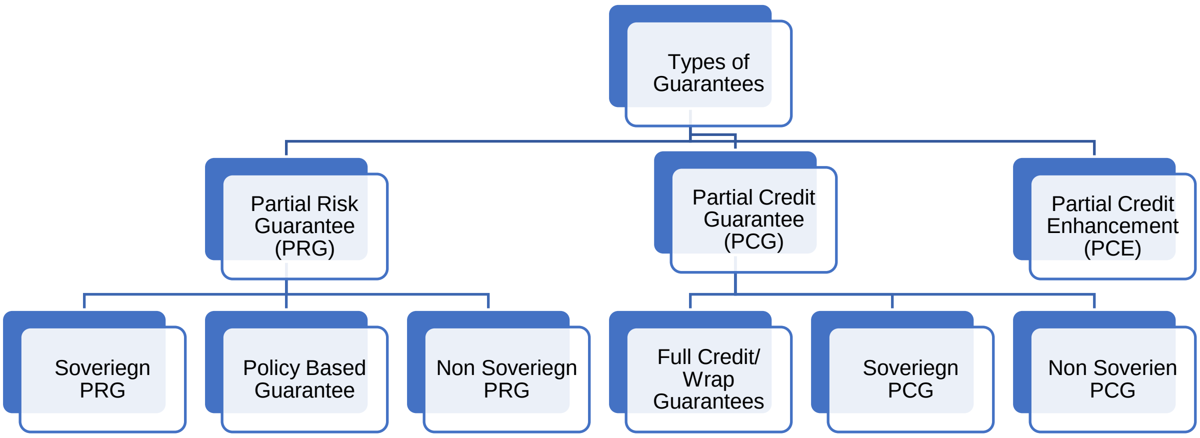
*Source: Publicly available information*

## 2.3. Types of Guarantee Mechanisms

Guarantee mechanisms allows borrowers to obtain cover for their obligations towards a lender in case of non-performance or default in exchange of a fee. They can have a partial or entire coverage of the investment. Guarantees are of three broad types - risk coverage; payment default and credit enhancements.

A risk guarantee covers an obligation triggered by a specific event, generally an act of government (political risk), while a credit guarantee may be called once credit obligations (e.g., interest and principal) have stopped to be paid, regardless of the underlying event that gave cause to the default. The figure below summarizes the types of guarantee mechanisms

**Figure 2: Types of Guarantee Mechanisms**




The subsequent sections provides details of each category of guarantee mechanism as highlighted in figure above.

## 2.4. Partial Risk Guarantees (PRG)

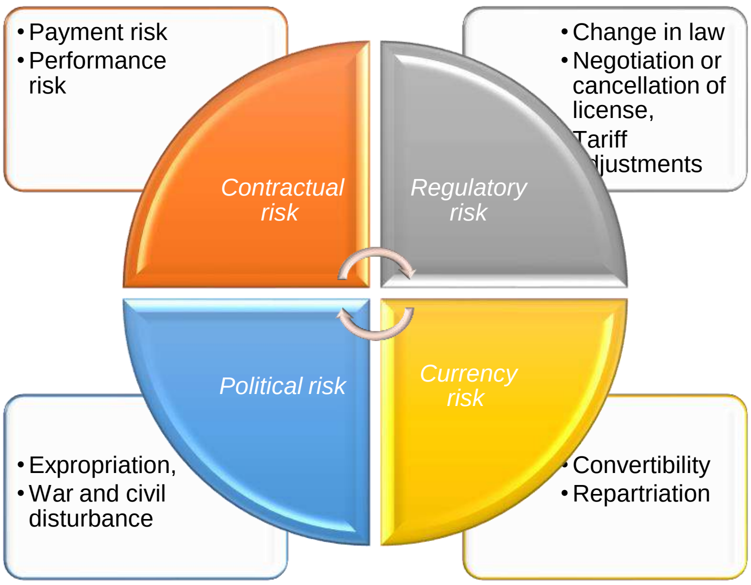
Partial Risk Guarantee covers lenders if the Government does not meet its commitments. Counter guarantee of Sovereign is normally in form of an indemnity agreement. Multilateral development banks (MDB) issues Partial Risk Guarantees (PRGs) as a risk mitigation instrument. PRGs can cover risks that cause performance failures of a government or government-owned entity with respect to contractual obligations for a private project.

Such guarantee mechanism protects against borrower failure to repay because of political events or commercial risks such as governmental expropriation of assets, currency transfer restrictions or inconvertibility, breach of contract, war & other civil disturbances, etc. If such an event occurs and repayments are disrupted, political risk insurance/ guarantees pay out all or a portion of the losses that arise due to the event.

### 2.4.1. Risks Covered under PRG

Partial risk guarantees cover private sector lenders against the risks of a public entity failing to perform its contractual obligations to a private sector project. These obligations are usually non-commercial (political, regulatory, etc.) in nature. PRGs can cover risks that cause performance failures of a government or government-owned entity with respect to contractual obligations for a private project. PRG reinforces obligation to the Government does not add to them. A wide range of risks can be covered as provided in the figure below.

**Figure 3 : Risk covered under Partial Risk Guarantees (PRG)**



## 2.4.2. Advantages of PRG

Partial risk guarantees endow the host country with several benefits for public and private sector, as provided below.

*For Private Sector/ Investors*

- Improvement of the overall credit quality of the investment through the partial use of a "AAA" rated instrument to mitigate key risks.
- Reduction or elimination of key risk drivers beyond the control of private investors
- Mitigation of counterparty risk with governments, political sub-divisions, or government-owned entities
- Strong support to maintain or open new markets despite credit downturns.

*For Public Sector*

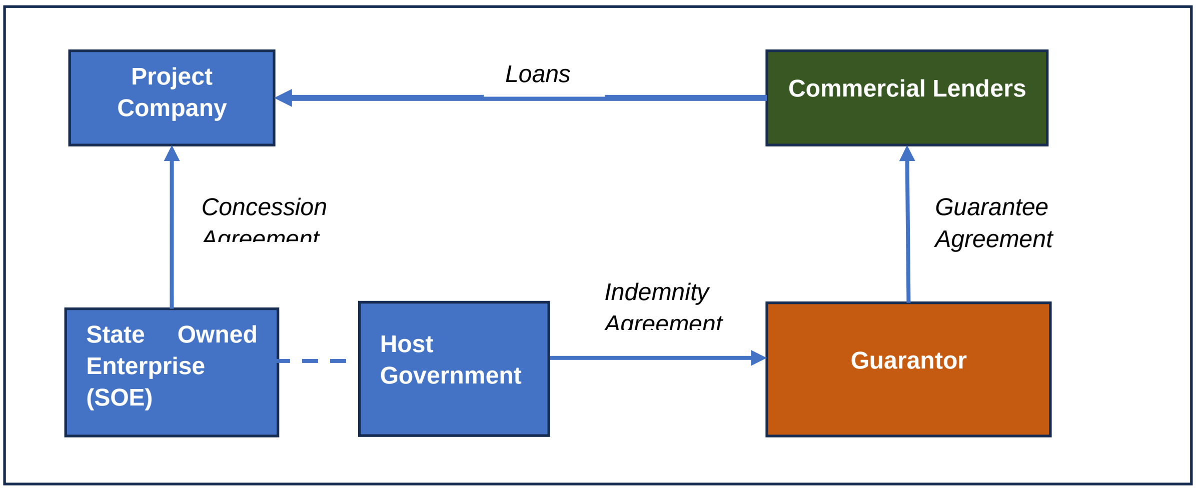
- Facilitate Public Private Partnerships
- Attract investors to strategic sectors that require large and long-term investments.
- Reduction of project costs and bringing cost of commercial financing to affordable levels
- Reduction of government risk exposure through sharing with private sector investors
- Reduction of fiscal burden by reducing the need for direct government guarantees

## 2.4.3. Implementation Mechanism

The PRG for state owned enterprise applies to situations when a financial payment obligation by the sovereign or sub-sovereign to a lender is unconditional and irrevocable, and not subject to defenses other than the nonpayment of the underlying debt, whether because of inability or unwillingness to pay. In effect, the guarantor assumes the credit risk of the sovereign and sub-sovereign.

The figure below provides the implementation mechanism for PRG with sovereign indemnity.

**Figure 4: PRG Guarantee Mechanism with Sovereign Indemnity**



The table below provides an overview of the various stakeholders highlighted in the figure above, and their key roles/ responsibilities in the implementation mechanism for Partial Risk Guarantees.

| Stakeholder | Roles and Responsibilities |
|---|---|
| ***Project Company*** | A company who undertakes a power project and wishes to obtain low-cost finance from commercial banks for the project. |
| ***State Owned Enterprise (SOE)*** | A SOE [State Owned Enterprise] may be defined as a legal entity in which the Government has full ownership and control, or has a controlling interest, that enables the Govt to take part in commercial activities separately from its public administrative functions. It is off taker of the project through **"Concession Agreement"** |
| ***Commercial Lenders*** | A financial institution or an investor providing debt financing/loan to a project company. The project company enters "**Loan agreement"** with commercial lenders provide low-cost finance from the support of guarantee provided by Guarantor under the "**Guarantee agreement".** |
| ***Host Government*** | The host Government is the government of the country in which the project company is located, and the offtake is SOE controlled by the ministry of finance by host Government. The guarantor takes Counter indemnity under **"Indemnity agreement**" for guarantee provided to lenders. |
| ***Guarantor*** | The Guarantor may be development financial institutions (DFI), multilateral agencies, World bank agencies etc. Who provides guarantee for political risk to lenders for Sovereign/sub sovereign financial obligations |

## 2.5. Partial Credit Guarantees (PCG)

Partial credit guarantees (PCGs) cover private lenders against default on a specific portion of debt regardless of the cause of default. Guarantee structure and coverage can be determined flexibly on a case-by-case basis at the level required by a specific debt instrument and the market. For example, PCGs often cover the back end of a loan to extend the tenor beyond what the commercial market would otherwise finance, but other structures are also possible.

PCGs allow the government and private-sector borrowers to achieve extended maturities, lower their interest rate costs, access higher amounts of commercial debt, and/or access to different markets. In most cases, PCGs (like PRGs) may be offered along with an MDB loan to the same borrower for the same project, or on a stand-alone basis.

A credit guarantee or PCG is created to absorb part or all the debt service default risk of an infrastructure project, irrespective of the cause of default. PCGs can be used for any commercial debt instrument (loans, bonds) from a private lender. The existence or proposed implementation of a PCG is indicative of confidence in the product being floated by the guaranteeing entity and can even assist in bringing new lenders to the table.

### 2.5.1. Advantages of PCG

PCGs credit enhances all or a portion of the funding provided by private financiers, such as the repayment of loans, bonds, or other debt financing instruments (scheduled or bullet). PCGs could support mobilization of private funds for below activities:

- project finance
- financial intermediation
- government borrowing from commercial lenders
- government bond issues to finance public investment projects
- Improving financial terms & conditions, such as a longer maturity, more favorable pricing, or improved market access.
- To cover nonpayment risk under derivatives contracts like cross currency swaps that can be structured to hedge currency risk of eligible borrowers.

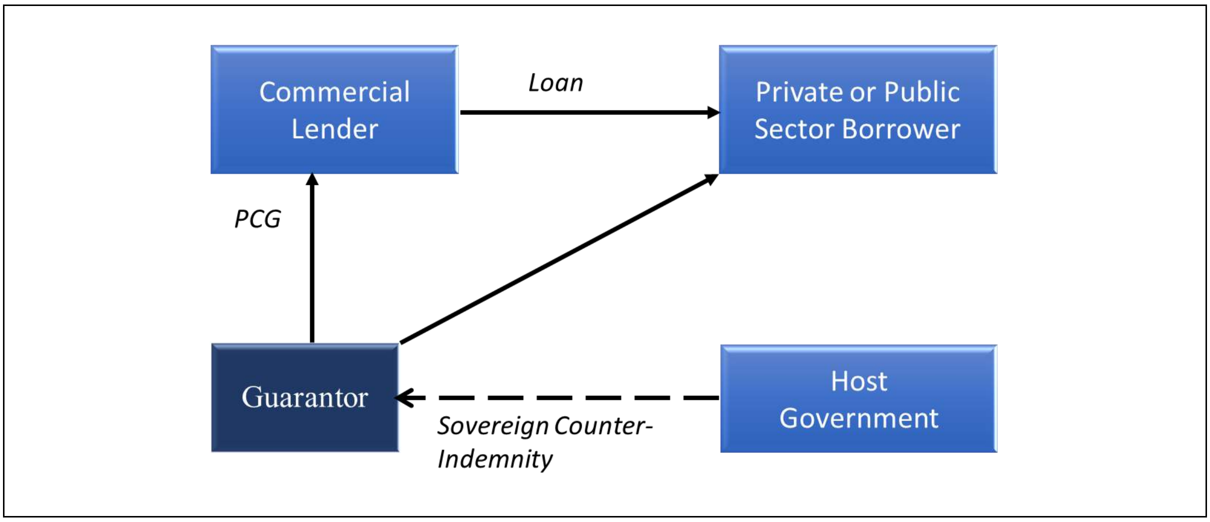
### 2.5.2. Implementation Mechanisms

A typical sovereign PCGs mechanism is implemented using a structure depicted in the figure on the next page. The table below provides an overview of the various stakeholders highlighted in the figure above, and their key roles/ responsibilities in the implementation mechanism for Partial Credit Guarantees.

| Stakeholder | Roles and Responsibilities |
|---|---|
| **Guaranteed Party** | Typically, a private financial institution or an investor provides debt financing to a project that is eligible for financing for PCG. Public institutions may also benefit provided they operate on a commercial basis |
| ***Borrower*** | Principally applied to infrastructure (e.g., power, transportation, water supply and waste treatment, and telecommunications) and/or general sovereign borrowing |

| Stakeholder | Roles and Responsibilities |
|---|---|
| | (See Policy Based Guarantees). This can also be applied to loans or other debt instruments issued by private and public sector projects (limited recourse financings), public–private partnerships, corporates, as well as (sub)sovereign entities |
| ***Host Government*** | The host Government is the government of the country in which the project company is located, and the offtake is SOE controlled by the ministry of finance by host Government. The guarantor takes Counter indemnity for the guarantee provided to lenders. |
| ***Guaranteed Event*** | Non-Honoring of a Sovereign Obligation to pay a scheduled amount of principal and/or interest and/or guarantee fees |

**Figure 5 : PCG Guarantee Implementation Mechanism**




The next chaptr provides as-is market assessment of guarantee mechniasms and institutional framework in Monoglia.

# 3. AS-IS MARKET ASSESSMENT

This section provides an in-dept review of the existing institutional framework for guarantees in Mongolia, including a review of key players (public and private sector agencies), product offerings, guarantee process, limitations on investment size and progress so far.

In Mongolia, there is no dedicated guaranteed mechanism for green loans or green bonds in existence. However, there are certain credit guarantee schemes currently available in Mongolia, which have been explained in this chapter.

## 3.1. Stakeholder discussions

As part of the KSTA, a number of stakeholder discussions were held with different parties who, under Mongolian law, are permitted to offer credit guarantee products, including potential green guarantee products. Below is the list of the various stakeholders that were consulted by the KSTA team.

**Table 2: Stakeholder Discussions - Green Bond Guarantee**

| # | Meeting date | Organization | Attendees | Designation |
|---|---|---|---|---|
| 1. | 19-July-23 | Credit Guarantee Fund of Mongolia | E.Tamir | Head of Project and Business Development Department |
| 2. | 19-July-23 | Khan Bank | B.Suvd | Senior project loan manager (Green finance), Policy and Regulations Department |
| 3. | 28-July-23 | Trade & Development Bank | Nyamsuren Davaatseren | Head of Green Funding Office |
| 4. | 28-July-23 | Trade & Development Bank | Maralmaa | Senior Supervisor, Banking Policy Division, Banking Resolution and Policy Department |
| 5. | 1-Aug-23 | Golomt Bank | Unengerel | Director of Trade and Structured Finance, International Banking Division |
| 6. | 1-Aug-23 | Golomt Bank | Nomuun | Trade and Structured Finance, International Banking Division |
| 7. | 1-Aug-23 | Golomt Bank | Anujin | Director of Sustainable Finance, International Banking Division |
| 8. | 1-Aug-23 | Golomt Bank | Bayarchuluun | Business Development Division |

Based on the stakeholder discussions and information collected, the subsequent sections provides an assessment of the existing market for credit guarantee products/ mechanisms in Mongolia.

# 3.2. Credit Guarantee Fund of Mongolia (CGFM)

The Government of Mongolia has established a government-owned, non-profit Credit Guarantee Fund of Mongolia ("**CGFM**") in February 2012, and the first guarantee was issued in May 2013. The purpose of CGFM is to assist SMEs wishing to access financing of financial institutions, but who lack sufficient collateral by guaranteeing repayment of debt sourced from financial institutions – whether by way of **loans or debt securities**. In particular, CGFM offers four (4) different guarantee products.

CGFM has a governing board. In the past a MOF nominee (usually Director of Financial Markets and Insurance Division of MOF) used to chair this board. As a result, it was MOF who was responsible for overall management and oversight of CGFM. Since recently, the GoM has assigned the Ministry of Food, Agriculture and Light Industry of Mongolia of Mongolia to chair the Board. As a a result, it is this Ministry who exercises the overall management and oversight of CGFM.

## 3.2.1. CGFM Highlights

Given below are the key highlights and features of CGFM

- Until August 2023, **none** of the offerings by CGFM in 1.1-1.4 above specifically backs **green credit**, green bonds or contain any "green element". The guarantee product in 1.4 above includes, as part of the requirements of ADB, the environmental and social safeguards policies and procedures.
- On 9 August 2023, CGFM and a Mongolian commercial bank – Trade & Development Bank (TDB) – have announced partnership whereby green loans by TDB to Mongolian SMEs will be guaranteed by CGFM. This constitutes the first ever time that a credit guarantee specifically dedicated to a green loan will be offered on the Mongolian market. The terms and conditions of a green loan eligible for a guarantee by CGFM are as follows:[1]

| | |
|---|---|
| ***Eligible borrowers*** | SMEs |
| ***Max loan amount*** | <MNT 2b (approx. USD570k) |
| ***Max loan amount guaranteed by CGFM*** | <MNT 1,2b (approx. USD340k) |
| ***Share of CGFM guarantee*** | 60% |
| ***Loan interest rate*** | 10.0% pa |
| ***Loan application fee*** | 0.3% (min MNT50k, approx. USD15) |
| ***Guarantee application fee (paid to CGFM)*** | MNT50k (approx. USD15) |
| ***Guarantee charge (paid to CGFM)*** | 1% (of annual balance of guarantee amount) |
| ***Loan tenor*** | <9 years |
| ***Grace period*** | <12 months |

*1 Source: https://www.tdbm.mn/mn/13387/c?m1775&mc=13871*

| | |
|---|---|
| ***Loan requirements*** | Must qualify under the Sustainable Finance Framework of Trade & Development Bank and not included in the list of prohibited activities of CGFM |

- CGFM guarantee applies to bank loans only and does not extend to green bonds issued by the SMEs.
- Total size of **all** guarantees of CGFM is capped by the regulator (FRC) at **10x** its capital (even though the law permits 20x).
- While the Mongolian legislation permits CGFM to guarantee repayment of **debt securities issued by SMEs on the OTC market** (per the Mongolia's Law on Securities Markets) and acquired by financial institutions, it is understood CGFM is yet to guarantee such bonds.
- All guarantees by CGFM are **indirect** (vs. direct).
- Minimum capital of CGFM is MNT 5,0billion (approx. USD1,4m). As at the end of 2022, the capital of CGFM is MNT **78,5b** (approx. USD 22.4m).
- Guarantee products of CGFM are denominated in MNT (**local currency**) only.
- CGFM is regulated by FRC which has set out other prudential ratios for CGFM.

CGFM **does not have a specific "green finance" product** – i.e., a guarantee product specific designed to underwrite (guarantee) green loans or green bonds. The only aspect of GCFM's activities related to "green" is the **environmental and social management system** (ESMS). PFIs must conduct environmental due diligence as specified in ESMS established by GCFM. Originally, the ESMS was developed to align with the Sustainable Finance Program that the Mongolian Banker's Association initiated for PFIs back in 2014.[2] CGFM monitors PFIs to ensure that SME sub-loans issued by PFIs will finance activities consistent with the ESMS selection criteria (as well as other applicable ADB requirements such as the ADB's 2009 SPS, and other loan qualification criteria, including the extended Prohibited Investment Activities List).

CGFM may invest up to **40%** of its capital in (i) shares listed on main board of the Mongolian Stock Exchange or (ii) government securities. No mention of "green" bonds Acquisition of bonds >1 year is capped at 20% of the total bonds held by CGFM.

CGFM is a state-owned entity. There is currently no private credit guarantee system. The Government of Mongolia is contemplating amendments to the Law of Mongolia on the CGFM to support an enabling environment for a private credit guarantee system.[3] However, this undertaking is yet to be realized – the Government of Mongolia appears to lack capacity to devise, and implement, such scheme. ADB expressed its readiness to assist should the Government of Mongolia submit a formal request for assistance with devising and implementing a private credit guarantee scheme.

The next section provides details of CGFM guarantee products for various types of lenders.

*2FYI - Sustainable Finance Program (SFP) was initiated by the Mongolian Banker's Association in 2014 with input from the IFC whereby the Association, together with its member FIs, developed generic financial institution-wide ESM framework which the individual FIs apply according to their own organizational structures and imperatives.*
*3 https://www.adb.org/sites/default/files/project-documents/48015/48015-002-pam-en.pdf. (Paragraph 50, page 29)*

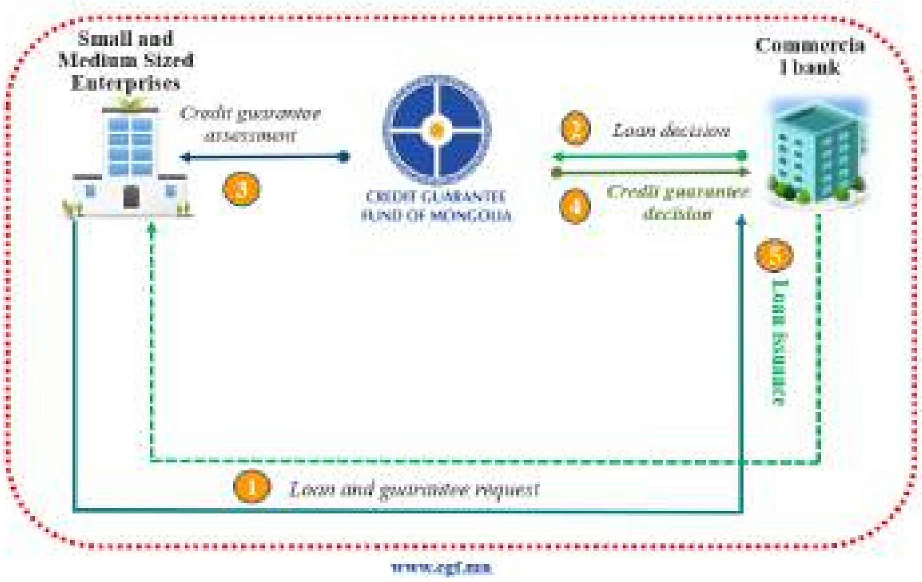
### 3.2.2. CGFM – Guarantee of loans by commercial banks

CGFM provides guarantee of loans by commercial banks on below mentioned terms:

| | |
|---|---|
| ***Eligible borrower*** | SMEs lacking sufficient collateral |
| ***Type of loan*** | Investment capital, working capital |
| ***Maximum loan size*** | As determined by the lending bank |
| ***Loan tenor*** | As determined by the lending bank |
| ***Loan interest rate*** | As determined by the lending bank |
| ***Guarantee size*** | Up to 60% of the total loan amount |
| ***Maximum guarantee size*** | Up to MNT500m (approx. USD140,000) |
| ***Guarantee application fee*** | MNT10,000 (approx.USD3)(paid once) |
| ***Guarantee fee*** | 1% of declining loan balance (guarantee up to 1 year); 2% (guarantee up to 2 years); 3% (guarantee up to 3 years) |

The below figure provides an overview of the loan guarantee process to commercial banks by CGFM.

**Figure 6: CGFM Guarantee to Commercial Banks**




As of the end of 2022, CGFM has a memorandum of understanding for cooperation with eleven (11) banks in Mongolia. But has thus far actually issued guarantees for loans of seven (7) of them. These seven (7) banks make up over 90% of the Mongolia's total bank assets. Considering there are total 12 licenced banks in Mongolia, CGFM needs not only to expand its cooperation to the other banks in Mongolia, but also leverage the impact of its products by ramping up the number of guarantees it issues.

### 3.2.3. CGFM – Guarantee of loans by NBFIs

CGFM provides guarantee of loans by NBFIs on below mentioned terms:

| | |
|---|---|
| ***Eligible borrower*** | SMEs lacking sufficient collateral |
| ***Type of loan*** | Investment capital, working capital |
| ***Maximum loan size*** | Up to MNT80m (approx.USD25,000) |
| ***Loan tenor*** | Up to 48 months |
| ***Loan interest rate*** | As determined by the lending NBFI |
| ***Guarantee size*** | Up to 60% of the total loan amount |
| ***Maximum guarantee size*** | Up to MNT48m (approx. USD15,000) |
| ***Guarantee application fee*** | MNT50,000 (approx.USD15)(paid once) |
| ***Guarantee fee*** | 1% of declining loan balance (guarantee up to 1 year); 2% (guarantee up to 2 years); 3% (guarantee up to 3 years) |

As of the end of 2022, CGFM has a memorandum of understanding for cooperation with five (5) NBFIs in Mongolia. But has thus far actually issued guarantees for loans of only one (1) NBFI. Considering there are total 536 licenced NBFIs in Mongolia, CGFM appears to be far away from being able to contribute to the target of 5% green loans within the total NBFIs loans in Mongolia.

### 3.2.4. Guarantee of home mortgages in remote areas

Since 2021, CGFM's scope has been expanded to **home mortgages** and individuals purchasing such mortgages.

Under this product, CGFM guarantees repayment of up to 60% of the down payment of households/individuals (with insufficient collateral) applying for a mortgage loan from financial institutions to purchase housing in **provincial** towns of Mongolia. The loan features annual interest rate of 6% and is understood to be subsidized by the Government of Mongolia. The product is designed to support the Government of Mongolia's policy to **reduce centralization** in the capital city Ulaanbaatar and promote decentralization and balanced development of rural areas.

CGFM provides guarantee of home mortgages in remote areas on below mentioned terms:

| | |
|---|---|
| ***Eligible borrower*** | Households in provincial towns lacking sufficient collateral |
| ***Type of loan*** | Down payment for 6% mortgage loan |
| ***Geographic coverage*** | 21 provincial centers, plus two remote districts of Ulaanbaatar |
| ***Maximum loan size*** | Provincial centers: up to MNT100m (approx. USD 30,000) |
| | Districts of Ulaanbaatar: up to MNT150m (approx. USD 45,000) |
| ***Loan interest rate*** | 6% per annum |

| | |
|---|---|
| ***Guarantee size*** | Up to 60% of the down payment |
| ***Guarantee application fee*** | MNT10,000 (approx.USD3)(paid once) |
| ***Guarantee fee*** | 1% of the guarantee balance per annum |

### 3.2.5. Guarantee of loans by PFIs under ADB MON-3338 “Supporting the Credit Guarantee System for Economic Diversification and Employment Project”

This product was launched by CGFM in 2016 as part of “Mongolia: Supporting the Credit Guarantee System for Economic Diversification and Employment Project”. The product benefits from a loan from ADB to the Government of Mongolia of up to USD60m (ordinary capital resources) and consists of the following main features:

The Government of Mongolia (represented by Ministry of Food, Agriculture and Light Industry of Mongolia of Mongolia) re-lends the ADB loan funds to CGFM. CGFM will place time deposits in qualifying participating financial institutions (**PFIs**) - Capitron Bank, Golomt Bank, Khan Bank, State Bank, Trade and Development Bank and XacBank.

In addition to USD60m from ADB, the Government of Mongolia contributes USD8.1m and the private sector of Mongolia – USD 21.9m, bringing the total of the project to USD 90m. Each PFI will use the time deposits and guarantees received to issue new market-based, floating or fixed-rate local currency-denominated sub-loans, leases and other forms of finance to eligible SMEs for eligible sub-loans. Project executing agency is Ministry of Food, Agriculture and Light Industry of Mongolia of Mongolia.

| | |
|---|---|
| ***Maximum loan size*** | Up to MNT2,0b (approx. USD 570,000) |
| ***Loan tenor*** | Up to 10 years |
| ***Loan interest rate*** | 8.8%-15.0% per annum (depending on the PFIs) |
| ***Grace period*** | Up to 24 months |
| ***Guarantee size*** | (i) 30%-60% of the loan size or (ii) MNT1,2b (approx.USD340,000) |
| ***Guarantee application fee*** | MNT50,000 (approx.USD15)(paid once) |
| ***Guarantee fee*** | 1% of the guarantee balance per annum |

## 3.3. Government of Mongolia

In addition to CGFM, Government of Mongoli can guarantee payment obligations under loans **and debt securities**.

It should be noted the definition of a government guarantee provided in the Law of Mongolia on Debt Management (adopted in 2012, as amended from time to time) suggests that it is **limited to payment defaults** only, not other kinds of obligations or commitments of the obligor. Also, the Mongolian legislation on sovereign guarantees **lack provisions or incentives with respect to guaranteeing green bonds or green loans.**[4]

### 3.3.1. Fiscal and regulatory requirements

Under Mongolian legislation, a sovereign (government) guarantee is subject to certain regulatory and fiscal requirements, as provided below:

- Total size of sovereign debt, of which a sovereign guarantee is part, is subject a **ceiling of 60% of GDP** in present value terms
- No special provisions exist with regard to “green” loans/bonds or “green” projects
- A sovereign guarantee must be coherent with the **National Security Concept** of Mongolia as well as the long, medium, and short-term development policies of Mongolia (as adopted by the Parliament of Mongolia)
- Maximum annual size of sovereign debt, including sovereign guarantees, must be **approved each year** by the Parliament of Mongolia (together with the annual budget law)
- A sovereign guarantee must be **reflected in the state budget**
- The regulations do not prescribe any size of the government guarantee – thus, the guarantee can be 100% or partial
- A proposed sovereign guarantee must be first **reviewed, pre-approved, and submitted by MoF** to the Cabinet of Mongolia,
- Any sovereign guarantee must be finally **approved by the Parliament** of Mongolia
- Sovereign guarantee can cover debt (loans and bonds alike) denominated in local as well as foreign currencies.
- **MoF acts as sovereign guarantor** (i.e., enters into a sovereign guarantee contract on behalf of the Government of Mongolia) and monitors the project/activity for which the sovereign guarantee has been issued.
- A municipal government **cannot** issue a guarantee, only the state (central government) can.

*4 In this report, the words “Government guarantee” and “sovereign guarantee” have the same meaning and are used interchangeably*.

### 3.3.2. Eligibility Criteria

The following parties are eligible for sovereign guarantee and may apply to MOF for a sovereign guarantee:

- Development Bank of Mongolia
- A state-owned or municipal-owned entity
- A private domestic entity incorporated in Mongolia.

The parties above must meet the following requirements:

- Proven profitability over the most recent three (3) years
- No overdue debt
- The lender is an unrelated party with the obligor
- The project/activity whose financing is sovereign guaranteed (whether partially or wholly) must meet the requirements below:
    - must be compliant with the medium-term budget framework statement
    - must be included in the Mongolia's development policy planning documents
    - must have drawing, budget, technical and economic feasibility study (as applicable)
    - must have social and environmental analysis (as applicable).
- Supporting information must be truthful and prepared in accordance with the law
- Bankability (ability to repay the loan/debt securities).

Size of sovereign guarantee can be up to 85% of the total loan/debt securities; and up to 100% of the total loan obtained by the Development Bank of Mongolia. Also, a sovereign guarantee can be issued to a project financed by a loan/debt security from the Development Bank of Mongolia if the social benefits component of the project whose cost does not exceed 15% of the total budget cost (and which cannot be repaid)

### 3.3.3. Outstanding sovereign guarantees

As at the end of 2021, the Government of Mongolia has outstanding guarantees in the amount of MNT 876.5b (approx. USD 250m). Compared to 2020, it is less by MNT 183.8b (approx. USD52m). The following table shows some of the largest sovereign guarantees of the Government of Mongolia outstanding as at the end of 2021:

**Table 3: Government of Mongolia - Outstanding Guarantees**

| No | Beneficiary/obligor/ designation | Lender | Currency | 2021 | | Maturity |
|---|---|---|---|---|---|---|
| | | | | Loan currency | MNT in Bn | |
| **1** | MIAT Mongolian Airlines – acquisition of aircraft | Private Export Funding Corporation (USA) | USD | 10,1m | 29.0 | 2023 |
| **2** | Development Bank of Mongolia | Buyers of DBM's Samurai bonds (Japan) | Yen | 30b | 744.05 | 2023 |
| **3** | Development Bank of Mongolia – construction of highway, infrastructure, energy projects | China Development Bank (China) | USD | 27,5m | 76.9 | 2022[6] |
| **4** | Erdenes Mongol SOE | Asian Development Bank | USD | 9.3 | 26.5 | 2031 |
| **Total** | | | | | **876.5** | |

- As can be seen above, almost 80% of the outstanding sovereign guarantees cover the "Samurai" bonds of Development Bank of Mongolia which mature in December 2023.
- Since 2021, in Nov 2022, the Government of Mongolia has issued, upon the Parliament's approval, a guarantee for the following two debt facilities:[7]
- Short-term debt(s) incurred in order to accumulate reserves and prevent the increase in the price of petroleum products time of fuel shortage on the condition that such debt will be repaid within 2023, and
- Re-financing(s) by Development Bank of Mongolia to pay on its international bonds maturing in 2023.

In the fiscal year 2023, the maximum guarantee that the Government of Mongolia can issue is MNT 3,730,335 million (approx. USD 1,084 million).[8]

5 Co-guaranteed by JBIC.
6 We understand this loan has been paid off in full in 2022.
7 Parliament of Mongolia, Resolution No.68 (2022).
8 Art.14, the Budget Law of Mongolia, (source: https://legalinfo.mn/mn/detail?lawId=16532001935011)

### 3.3.4. Government strategy toward sovereign guarantees

According to the 2023-2025 Debt Management Strategy of Mongolia published by the Parliament in May 2022, the Government has not issued any new sovereign guarantee since 2016.9 Moreover, it has been following a policy of not issuing any new sovereign debt guarantees going forward, instead focusing on monitoring of performance of guaranteed loans.

Furthermore, the 2023-2025 Debt Management Strategy of Mongolia suggests that going forward the Government of Mongolia may consider issuing guarantees to private sector or PPP projects. For instance:

- given budgetary constraints, some of the high-impact projects set forth in the New Recovery Policy of Mongolia (adopted in 2021) may be guaranteed by the Government of Mongolia,.
- based in improved debt management, risk assessment, financial control and reporting, Government guarantee can extend to PPP projects

In any case, any government guarantee – whether for state-owned entity or private company – will be subject to the debt ceiling set in the Mongolian regulations above.

***Case study: Financing of acquisition of the Boeing aircraft by "MIAT Mongolian Airlines" state-owned company:***

In 2013, the Government of Mongolia issued a debt guarantee for a total loan of USD 121.4m for the purchase of Boeing 767-300 ER aircraft by MIAT[10].

The total guaranteed loan consisted of the following three sub-loans:

- 10-year loan from to the US EXIM Bank (USD 77.4m, fixed annual interest rate of 2.52%);
- 7-year loan from ING Capital Bank (USD 23.9m, variable interest 5.3% + 3-month Libor);
- 5-year loan from ING Bank (USD 20.0m, variable rate debenture 9.38%+USD 3-month Libor).

MIAT has been repaying the loans on schedule. The balance of the government's outstanding guarantee is USD 10.1m as at the end of 2021.

*9 Chapter 3, "2023-2025 Government Debt Management Strategy" adopted by Parliament Resolution No. 26 dated 27 May 2022 (source: https://legalinfo.mn/mn/detail?lawId=16530615498831&showType=1)*
*10 Government of Mongolia, Resolution No. 319 (2013).*

## 3.4. Development Bank of Mongolia (DBM)

DBM finances projects and activities in the sectors of Mongolia that grow and sustain the national economy, and expand production and services that are alternatives to imports or that increase export revenues.

### 3.4.1. Regulatory requirements for guarantees by DBM

DBM can issue guarantees, subject to below mentioned regulatory requirements:

- At least 60% of the total funding financed or guaranteed by DBM must be used for projects and activities that support exports.
- Also, the aggregate of loans and guarantees by DBM must not exceed 30x its capital.
- Otherwise, the regulations with respect to DBM do not prescribe any size of its guarantee,
- Guarantees of DBM are subject to ratios set by the BoM (upon consultation with MOF)[11]

As per the existing regulatory framework, DBM has no obligation to guarantee green credit, green bonds or support any "green element", including in its lending. DBM guarantee can cover debt (loans and bonds alike) denominated in local as well as foreign currencies.

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[11] We understand these ratios are under discussion and are yet to be adopted.

## 3.5. Other Institutions (local banks, DFIs)

### 3.5.1. Local Commercial Banks

Under Mongolian regulations, local commercial banks are permitted to offer guarantees to their clients as part of their banking services. However, few, if any, banks actually offer their clients products guaranteeing loan obligations.

Given below is an example of fees for different guarantee products offered by Trade and Development Bank in Mongolia

**Table 4: Example of Local Commercial Bank Guarantee**

| | |
|---|---|
| LG issued abroad/overseas | |
| To issue a LG | 0.2%<br>/min. USD 150.0, max. USD 350.0/ |
| Additional services (fees deducted based on the customer's request) | |
| To increase the amount /from the increased amounts/ | 0.2%<br>/min. USD 50.0, max. USD 150.0/ |
| To amend LG's terms and conditions | USD 50.0 |
| To cancel a LG | USD 50.0 |
| LG issued domestically | |
| To issue a LG | MNT 30,000.0 |
| To change LG's conditions | MNT 10,000.0 |
| To cancel a LG | MNT 5,000.0 |
| The risk commission will be charged additionally for issuance of uncovered LG. | According to contract: (min. USD 150.0) |
| | According to contract: (Foreign currency - min. USD 150.0) |
| | According to contract: (Domestic currency – min. MNT 50,000.0) |
| A particular customer is responsible for paying postal fees /via DHL/ to dispatch LG documents. | |
| **Fees related to receiving overseas originated LG** | |
| To advise receipt of a LG | USD 30.0 |
| To receive an invoice and other related documents and send for payment upon verification | 0.15%<br>/min. USD 75.0, max. USD 350.0/ |
| Additional services (fees deducted based on the customer's request) | |
| To advise amendments of a LG | USD 10.0 |
| To advise cancellation of a LG | USD 25.0 |
| A particular customer is responsible for paying postal fees /via DHL/ to dispatch LG documents. | |
| Note: Any other banking fees and commissions related to a LG shall be borne by a customer. | |

*Source: https://www.tdbm.mn/en/32/c*

### 3.5.2. DFIs

In addition, DFIs/IFIs offer guarantees to their private sector clients in Mongolia, usually in the form of risk sharing programs in partnership with some local banks.

***Case Study: EBRD Risk Sharing Framework***

The EBRD has created the "Risk Sharing Framework" (RSF) in several countries of its operations, including Mongolia, to share risk on loans of its Partner Financial Institutions (PFIs) to local companies.

In Mongolia in 2015, EBRD extended a total of USD 70 million in loans to Khan Bank. This financing featured a risk-sharing facility helping Khan Bank clients access longer-term financing, and an increase in the trade finance facility, which helps companies perform export and import operations.

In 2021, EBRD partnered with XacBank, a Mongolian commercial bank, providing an MNT loan equivalent to USD 4.8 million to “Suu” (“Milk”) JSC, a large Mongolian dairy producer. Specifically, EBRD assumed 65% of the risk on the loan under its risk-sharing facility signed with XacBank.

According to EBRD, loans under the RSF can contribute to the *Green* Economy Transition by supporting the adoption of green technologies and improving climate disclosures at the corporate level. This can be achieved by financing green investments specifically, but also by working with clients to improve environmental standards and reporting related to climate risks and environmental performance

# 4. KSTA RECOMMENDATIONS

This chapter provides the KSTA recommendations for potential green bond guarantee mechanisms that can be implemented in Mongolia based on the type of green bond issuance.
Each recommended option includes an international case-study to enhance the understanding of the recommended guarantee mechanism across other countries in Asia, including the detailed implementation mechanism.

**Table 5: KSTA recommendations – Green Bond Guarantee Mechanisms**

| # | Type Of Guarantee | Description | Case Study |
|---|---|---|---|
| 1. | ***Full Credit/Wrap Guarantees*** | When credit guarantee covers 100% of loan/bond amount it is wrap/ full credit guarantee. | Sindicatum Renewables, Singapore,2018 |
| 2. | ***Partial Credit Enhancement*** | Guarantee provided to enhance credit rating and get more favorable debt financing terms. | Renew Power, India,2015 |
| 3. | ***Non-Sovereign Partial Credit Guarantee (PCG)*** | PCG which does not involve sovereign or SOE or any government body. | Tiwi-MakBan geothermal power, Philippines ,2018 |
| 4. | ***Sovereign Partial Credit Guarantee (PCG)*** | Under this structure the beneficiary of the payment guarantee requests payment from the Guarantor directly in case of a payment default under a contract and when such payment default has been caused by the government or government-controlled entity in the underlying project. | Southern Gas Corridor CJSC, Azerbaijan,2020 |
| 5. | ***Non-Sovereign Partial Risk Guarantee (PRG)*** | Non-sovereign backed financing means any financing extended by the Bank that is not a sovereign-backed financing. | Elazig Integrated Hospital Campus, Turkey, 2016 |
| 6. | ***Sovereign Partial Risk Guarantee (PRG)*** | PRG backed by sovereign or host Government counter indemnity. | Lake Turkana Windfarm, Kenya, 2014 |
| 7. | ***Policy Based Guarantee*** | Risk mitigation to commercial lenders for payment defaults by a government, when the proceeds of the financing are applied to budgetary support in the context of development policy operations. | Ghana's Ministry of finance,2015 |

## 4.1. Full Credit Guarantees or Wrap Guarantees

Wrap Guarantees cover the entire amount of the debt service in the event of a default. They are often used by bond issuers to achieve a higher credit rating to meet the investment requirements of institutional investors.

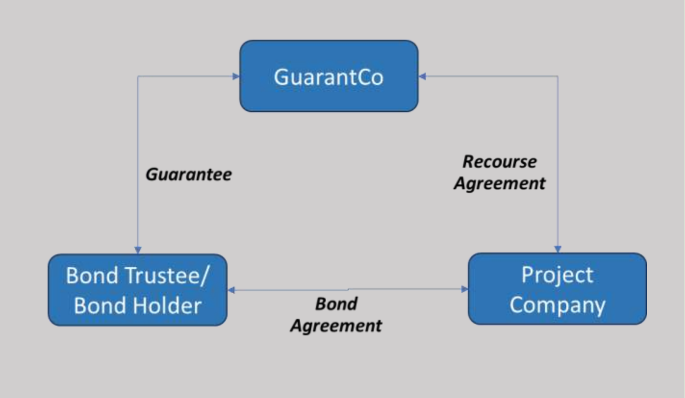
DFIs (like ADB and IFC) offer full credit guarantees (FCGs) as a credit enhancement mechanism for debt instruments (bonds and loans) issued mainly by its private sector clients. Both products provide an irrevocable promise by IFC and ADB to pay all shortfalls of principal and/or interest up to a pre-determined amount.

In some institutions, although the credit and risk guarantees are called "partial", they may be tailored to cover up to 100 percent of total project costs irrespective of the events that gave cause to the default. This is the case with IDB's PCG. Other institutions, including the ADB, the AfDB and the IBRD/IDA, have explicit restrictions on providing 100 percent coverage. In the case of AfDB, policy revisions may take place soon to provide 100 percent guarantee coverage under certain circumstances.

**Case Study 1 : Sindicatum Renewables, Singapore, 2018**

| | |
|---|---|
| *Name of Company* | **Sindicatum Renewables** |
| *Country* | **Singapore** |
| *Amount* | **$60 Mn** |
| *Year* | **2018** |
| *Name of Guarantor* | **Guarant Co. (PGDIP)** |
| *Type of Guarantee* | **100% credit Guarantee** |

***Implementation mechanism:***




***Description and Key Learnings:***

***<u>Problem:</u>***

Sindicatum Renewable Energy Company Pte Ltd (Sindicatum Renewables), an award-winning developer and operator of clean energy projects in Asia, has listed its three guaranteed Indian Rupee (INR) and Philippine Peso (PHP) Green Bonds on London Stock Exchange's International Securities Market (ISM).

***Solution:***

The Green Bonds, all guaranteed by GuarantCo, were issued in three tranches: INR 951,100,000 due in 2023; INR 1,585,300,000 due in 2025; and PHP 1,060,200,000 due in 2028. The proceeds of the bonds, totalling an approximate USD 60 million equivalent as at the respective issue dates and each payable in USD, have been used, or are in the process of being used, to finance renewable energy projects in India and the Philippines as well as refinance certain existing indebtedness.

The Green Bonds were issued in accordance with the International Capital Market Association (ICMA)'s Green Bond Principles 2017 and the ASEAN Green Bond Standards (GBS). The INR denominated Green Bonds, which were the first ever issued in accordance with these standards to be admitted to the ISM Green Bond segment. Sindicatum Renewables is the first ever offshore private sector corporate entity to issue a 7-year INR Bond. The PHP- denominated Green Bond is the first to list on London Stock Exchange.

***Impact:***

It achieved rating of A1 by Moody's and for INR denominated bonds rated at AA- by Fitch. By utilising an innovative and first of its kind structure developed for this project, GuarantCo was able to reduce currency risk for the developer and attract funding from international institutional investors. The transaction will also have significant demonstration effect in attracting institutional investors to invest in future bond issues supporting infrastructure in Asia.

The three brownfield renewable energy projects financed with the bond proceeds generate a total capacity of 50MW which will improve quality of service for an estimated total of 106,100 people. The three projects also employ 105 people.

## 4.2. Partial Credit Enhancement (PCE)

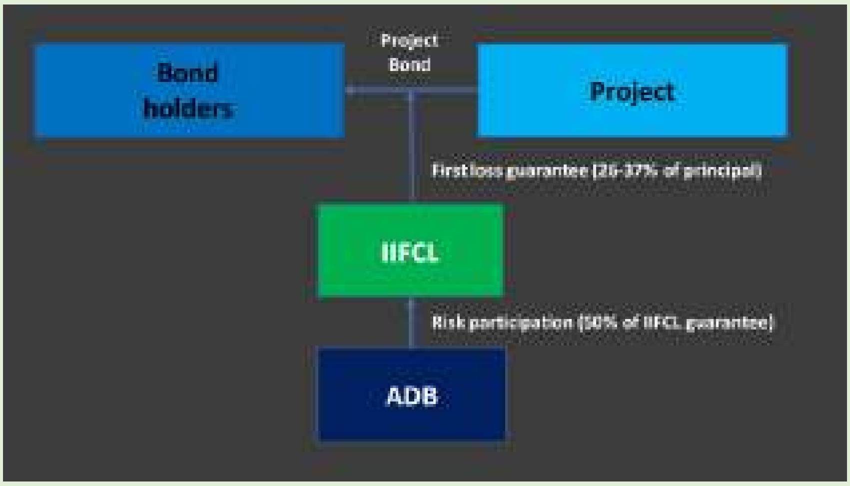
Credit enhancement has been crucial for driving green bonds in international markets and there is a range of credit enhancement measures available, largely through guarantees, partial credit enhancements, and subordinated debt or equity. These mostly rely on a stronger public sector entity or financial institution to support credit enhancement measures.

To make green bonds issuances more attractive for investors and boost this emerging market, credit enhancement measures for improving the credit rating, especially of corporate bonds, are necessary. It essentially means an additional assurance or guarantee to service the bond. To mitigate the higher perceived risk, large investors looking to invest in green bonds are predominantly looking at certified and investment-grade bonds, which in the current scenario, are mostly backed by the state. The more innovative corporate-backed green projects are likely to have lower credit ratings, in part due to the relatively limited experience with green technologies, such as solar power, and the challenge of establishing a strong revenue stream for green projects, such as forestry or marine conservation projects.

**Case Study 2 : Renew Power, India,2015**

| | |
|---|---|
| *Name of Company* | **Renew Power** |
| *Country* | **India** |
| *Amount* | **$87 Mn** |
| *Year* | **2015** |
| *Name of Guarantor* | **Asian Development Bank** |
| *Type of Guarantee* | **Partial Credit Guarantee** |

***Implementation mechanism:***



***Description and Key Learnings:***

***<u>Problem:</u>***

- There was a need to substitute bank funding with capital market funding because of the difficulty of banks whose liabilities were predominantly short term, to fund long-term projects.
- High infrastructure financing demands surpassed bank financing, but project bond markets were underdeveloped.
- The projects were typically rated BBB, but bond investors required AA-.

***<u>Solution:</u>***

Project Bond Credit Enhancement via India Infrastructure Finance Company (IIFCL), a state-owned enterprise issued first-loss guarantees (26-37% of principal). The Asian Development Bank structured the first loss guarantees and participated in 50% of the risk of the IIFCL guarantee.

- It was designed as a program to support individual projects.
- The first-loss guarantees were set-up to bring bond ratings to AA-

***<u>Impact:</u>***

- The rating uplift was from BBB+/A- to AA-.
- The total amount mobilized was the Indian Rupee equivalent of USD 87 million.

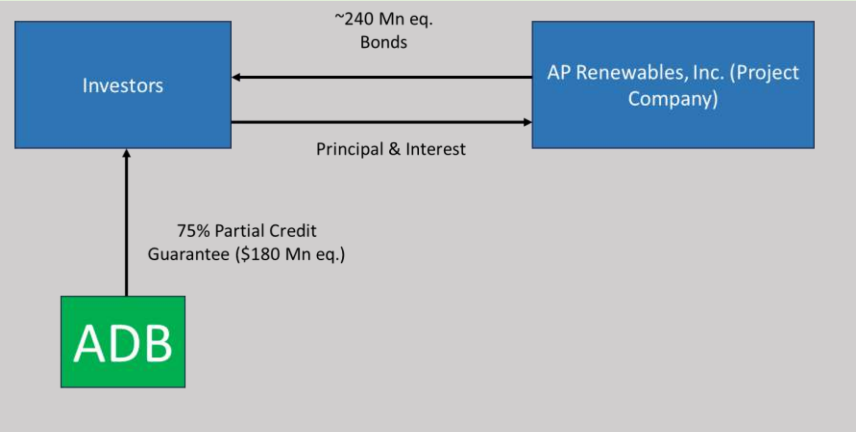
## 4.3. Non-Sovereign Partial Credit Guarantee (PCG)

Non sovereign PCG financing means any financing extended by the Bank that is not a sovereign-backed financing; it includes any financing to or for the benefit of a private enterprise or a sub sovereign entity (such as a political or administrative subdivision of a member or a public sector entity) that is not backed by a guarantee or counter-guarantee.

**Case Study 3 : Tiwi-MakBan geothermal power, Philippines,2018**

| | |
|---|---|
| *Name of Company* | **Tiwi-MakBan geothermal power** |
| *Country* | **Philippines** |
| *Amount* | **$226 Mn** |
| *Year* | **2018** |
| *Name of Guarantor* | **Asian Development Bank (ADB)** |
| *Type of Guarantee* | **Partial Credit Guarantee** |

***Implementation mechanism:***




***Description and Key Learnings:***

***<u>Problem:</u>***

MakBan is the 4th largest geothermal plant in the world. Tiwi and Makban, together, are about 15% of the grid of Luzon, the biggest island market in the Philippines. The Philippines is a geothermal hotspot. 9% of the country's installed power capacity is geothermal. By 2030, the government wants to boost this capacity by 70%. Developing this natural resource would reduce fuel imports and help meet surging energy demand without creating harmful greenhouse gases. Participation of the private sector is critical to making this happen.

In 2008, Aboitiz Group acquired the Tiwi and Makiling-Banahaw (MakBan) assets from the government. The first concern of the organization was how to bring it up to, acceptable standard that worked towards building the facilities safely and soundly and that –everybody benefits from this enterprise. Sponsor funded its acquisition/rehabilitation investments entirely with equity and now needs to free up capital for new projects, including renewables.

Refinancing via banks is a challenge: local banks are now approaching "single borrower limits" on Aboitiz Power

***Solution:***

The Asian Development Bank (ADB) provided a Partial Credit Guarantee covering up to 75% of scheduled principal repayments and interest payments. ADB lent Aboitiz Powers Renewables, Inc. $37.7 million to help finance the plant's operations, maintenance, and expansion. The ADB also provided a limited recourse direct senior secured loan of PHP1.8bn.

***Impact:***

- Credibility to a renewable energy generation company.
- It also gives a template for other generators to follow,
- Working with ADB helps the company get A-games to play because ADB has a high set of standards in working with the community, working with regulators, working with the banks.
- Philippine bond market developing, interest building from institutional investors.
- Credit-enhanced project bonds can offer an attractive alternative to bank financing and expand private sector interest in long-term investments.

## 4.4. Sovereign Partial Credit Guarantee (PCG)

An SG guarantee (including PCG, PRG, or others) is typically initiated by the national government to provide credit support for an infrastructure project or transaction with private sector financing. In general, it reduces risks for the private financiers or sponsors of a government's contractual or performance obligations. The private sector therefore benefits from the overall mitigation of risks, particularly those related to government actions known as political risk, by providing a credit enhancement provided by the MDB's rating thereby allowing commercial banks to reduce the amount of risk capital they provision, thus lowering financing costs.

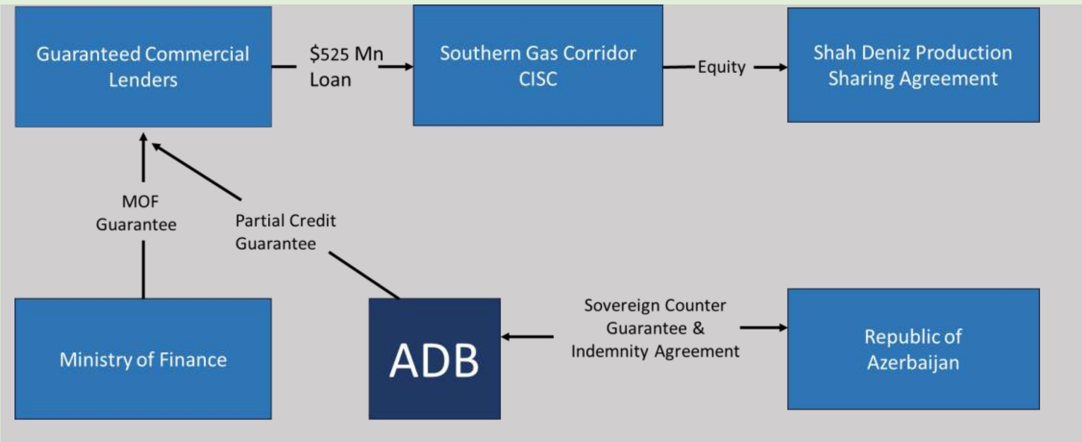
Policies vary by institution, however in many cases the national government is also responsible for the guaranteed fee in an SG guarantee operation. Once issued, the guarantee may be first demand, unconditional, and irrevocable; even in the case the government falls behind in its payment obligations, calls on the guarantee will be filled by the MDB.

SG guarantees are well suited to cover risks that are better managed by the government, or that are endogenous to government actions that are broadly defined as political risks. This may encompass contractual and regulatory changes that negatively impact availability payments, revenues from user tariffs or demand, and administrative decisions that delay construction or affect a project's performance.

**Case Study 4 : Southern Gas Corridor CJSC, Azerbaijan, 2020**

| | |
|---|---|
| *Name of Company* | **Southern Gas Corridor CJSC** |
| *Country* | **Republic of Azerbaijan (ROA)** |
| *Amount* | **$525 Mn** |
| *Year* | **2020** |
| *Name of Guarantor* | **ADB** |
| *Type of Guarantee* | **Sovereign PCG** |

***Implementation mechanism:***




***Description and Key Learnings:***

***<u>Problem:</u>***

Globally depressed oil prices and the halving of the value of the Azerbaijan manat against the United States dollar in 2015 have placed pressure on Azerbaijan's economic growth and balance of payments. As a result, government revenues and the country's foreign exchange reserves have decreased significantly. The downgrading of Azerbaijan's credit rating in early 2016 increased Azerbaijan's financing costs and adversely affected access to commercial funds. SOFAZ was responsible for 50.8% of the national budget in 2014 and 46.5% in 2015. 19 Low oil and gas prices, however, have decreased SOFAZ's net holdings.

***Solution:***

ADB's PRG supported a $525 million loan facility to Southern Gas Corridor CJSC backed by a counter-guarantee and indemnity agreement between the Republic of Azerbaijan (ROA) and ADB. The loan facility supported an increase in the Shah Deniz gas field's annual production capacity.

ADB's PCG covered the risk that the Ministry of Finance, acting on behalf of ROA, would not honor its sovereign obligation to repay the lenders in case of a missed payment of principal, interest or guarantee fees.

Low hydrocarbon prices and consequential unfavorable financial market conditions resulted in the government requesting multilateral financing institutions to help finance the Shah Deniz-II and the pipeline projects, totaling $51 billion in aggregate investments by 2020. ADB has been requested to consider financing SGC's cash calls for Shah Deniz-II. To help overcome adverse market conditions, it is proposed for ADB to (i) issue a PCG covering up to $500 million in principal payments plus interest and guarantee fees against the non-honoring of a Ministry of Finance (MOF) guarantee to commercial banks for SGC's borrowing, and (ii) provide a non-sovereign loan of up to $500 million.

***Impact:***

The use of the PCG is essential for SGC to continue meeting its financial obligations toward the Shah Deniz gas field expansion and pipeline projects through private sector participation, despite the current unfavorable market conditions. Without ADB's credit enhancement, SGC's ability to meet its participation obligations with funding from commercial lenders is likely to be prohibitively expensive. Although ADB's PCG will help lower SGC's cost of financing, it reflects commercially feasible risk-based pricing for an export revenue-generating project, while sharing underlying project and commercial risks with commercial lenders for the uncovered portion. In contrast to making a direct loan, the proposed PCG instrument allows ADB to leverage the use of its own capital resources.

## 4.5. Non-Sovereign Partial Risk Guarantee (PRG)

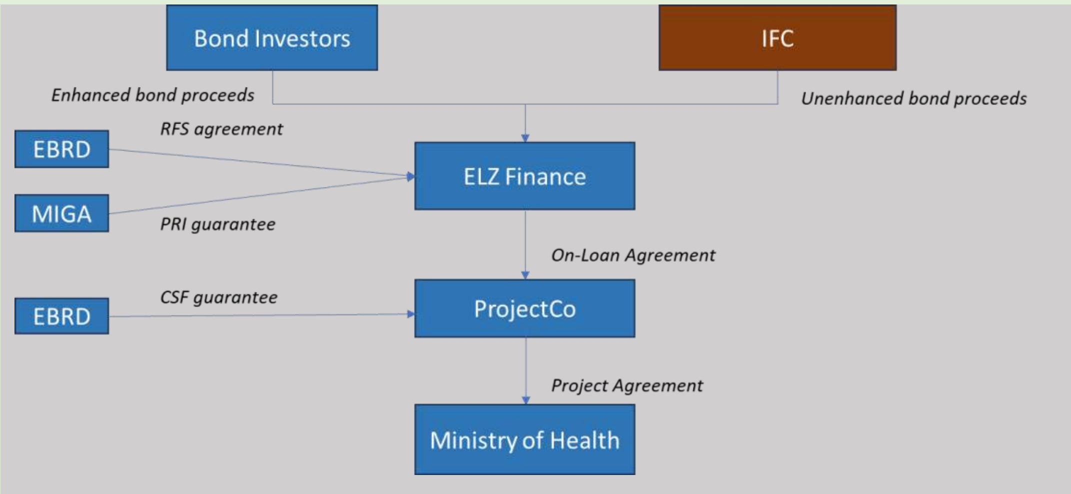
MDBs also offer guarantees through their NSG windows. The difference in relation to an SG guarantee is that it does not require a sovereign counter-guarantee, however NSG guarantees may require either a no-objection or an approval from the host government before being issued. In most cases an NSG guarantee is provided directly to the private sector (borrower or lender) who is responsible for paying the corresponding fees, which are set on a commercial basis. NSG guarantees may also be provided to governmental entities such as state-owned enterprises and subnational governments if they are eligible as a borrower under the MDBs' private sector window.

Non sovereign PRG financing means any financing extended by the Bank that is not a sovereign-backed financing; it includes any financing to or for the benefit of a private enterprise or a sub sovereign entity (such as a political or administrative subdivision of a member or a public sector entity) that is not backed by a guarantee or counter-guarantee and indemnity provided by the Member to the Bank.

**Case Study 5 : Elazig Integrated Hospital Campus, Turkey, 2016**

| | |
|---|---|
| *Name of Company* | **Elazig Integrated Hospital Campus** |
| *Country* | **Turkey** |
| *Amount* | **€ 288 Mn** |
| *Year* | **2016** |
| *Name of Guarantor* | European Bank for Reconstruction and Development and MIGA |
| *Type of Guarantee* | **Partial Risk Guarantee (Non-Sovereign)** |

***Implementation mechanism:***




***Description and Key Learnings:***

***Problem:***

Construction of greenfield PPP hospital with the following needs:

- Diversification of investor base (bond holders)
- Longer tenors o Lower cost of financing

Bondholders required a minimum investment grade but…

- Turkey (at the time) rated at the lowest investment grade.
- Construction risk was present.
- Political risk was a concern (breach of contract)

***<u>Solution:</u>***

Project bond enhancement via a tailored solution utilizing 2 institutions, MIGA and EBRD

- EBRD guarantees were sequenced: 1) for construction period, 2) for revenue support during operations (availability payments or termination proceeds).
- MIGA guarantee (entire project life). MIGA covered: breach of contract, expropriation risk and transfer and convertibility risk –summarized as Political Risk.
- EBRD to complement MIGA by servicing debt payments until an arbitration process is completed after which MIGA honors its payment obligations.
- For construction, it covers 15% of Engineering, Procurement and Construction Contract (EUR36.5m), for operation 25% (EUR52.5m) of nominal bonds.
- Although the regulatory and technology risks were not directly covered by the facilities, both were implicitly mitigated through the combination of (i) a comprehensive termination regime for any event of default built in the project agreement; and (ii) EBRD and MIGA bridging grantor's termination obligations in case of its failure to pay the compensation proceeds.

***<u>Impact:</u>***

- EUR288 million euro-denominated long-term project bond with two tranches: a EUR208 million enhanced and rated tranche supported by the EBRD and MIGA and an EUR80 million unenhanced and unrated tranche subscribed by International Finance Corporation.
- Rating uplift from Ba level to Baa2 two notches above sovereign credit rating (SCR) at the time of issuance (currently 4 notches above Turkey's SCR).
- Turkey's first greenfield project bond and first PPP financing with a 20-year maturity.

## 4.6. Sovereign Partial Risk Guarantee (PRG)

A guarantee issued for a sovereign borrower will be treated as a sovereign-backed guarantee. The treatment of a sovereign-backed guarantee would be consistent with that of an equivalent sovereign loan.

Most MDBs offer guarantees with a sovereign counter-guarantee (also called a sovereign counter indemnity) through their public-sector lending windows. A sovereign counter-guarantee is an agreement between the MDB providing the guarantee and the sovereign that, in the event there is a call on the guarantee, the sovereign will be obligated to repay the amount disbursed to fill the call to the MDBs. This means that no matter what gives cause to a guaranteed payment, the sovereign is ultimately responsible for covering its financial costs. In case the sovereign does not honor its obligation under the sovereign counterindemnity, the MDB can call cross default to the sovereign loan portfolio.

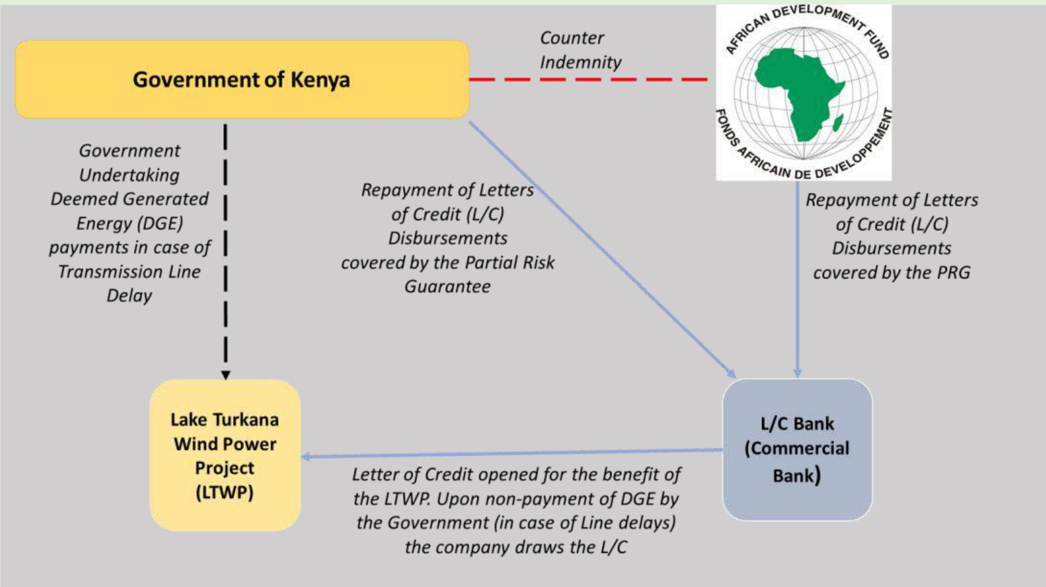
Sovereign partial risk guarantees have two main advantages over traditional insurance.

1. Pricing – The sovereign counter indemnity and guarantee agreement ensures that projects can be priced at a similar interest rate to sovereign loans offered by MDBs
2. Timing – In traditional political risk insurance, the sponsor needs to have an arbitral award to receive payment.

**Case Study 6: Lake Turkana Windfarm, Kenya, 2014**

| | |
|---|---|
| *Name of Company* | **Lake Turkana Windfarm** |
| *Country* | **Kenya** |
| *Amount* | **$ 625 Mn** |
| *Year* | **2014** |
| *Name of Guarantor* | **African Development Bank** |
| *Type of Guarantee* | **Partial Risk Guarantee with a letter of credit** |

***Implementation mechanism:***



***Description and Key Learnings:***

***<u>Problem:</u>***

The Lake Turkana Wind Power Project involved the construction and operation of a 310 Mega Watt wind farm, located in northern Kenya, near Lake Turkana.

- The project cost was estimated to be around EUR625.1 million, including EUR149.6 million equity and preference shares. The African Development Bank acted as Mandated Lead Arranger to syndicate EUR435.5 million senior debt and EUR40 million subordinated debt.
- The Government of Kenya had several obligations vis-à-vis the Turkana project articulated in a letter of support, including the delivery of a 428 km transmission line to be connected to the national grid.
- A delay in the line would imply that required revenues for debt servicing would not be available, despite the generation of power by the Turkana project.

***<u>Solution:</u>***

To mitigate risks associated with potential delays in the construction of the publicly owned and managed transmission line and to facilitate the participation of investors and lenders, the African Development Bank approved in 2013 a Partial Risk Guarantee in support of the Turkana project.

The Partial Risk Guarantee had a government counterindemnity and was signed in December 2014. It was backed by a standby letter of credit opened by a commercial bank at the request of the Government for the benefit of LTWP. The Partial Risk Guarantee was provided in case there was a delay in the construction of the T-Line and the Government did not honor the delay payments. Turkana can draw on letters of credit to cover its debts and other operational costs. If the letter of credit is drawn, the Government has one year to reimburse the letter of credit and if the Government fails to do so, the letter of credit can Bank call the African Development Bank Partial Risk Guarantee.

The Partial Risk Guarantee covers up to EUR20 million, the equivalent of four months' worth of payment obligations for up to five years maturity.

***<u>Impact:</u>***

The main impact of the guarantee was to crowd-in investors and lenders in the largest greenfield wind power public-private partnership (PPP) project in Africa for an investment of EUR625.1 million.

The guarantee facilitated the syndication of a long tenor (15 years) of senior and subordinated debt for the project. It also allowed the Government to get a 5-year commitment period and an interest rate that considers the guarantee from the African Development Bank.

## 4.7. Policy Based Guarantee

Policy-based guarantees provide risk mitigation to commercial lenders with respect to debt service payment defaults by a government when the proceeds of the financing are applied to budgetary support in the context of development policy operations.

While a standard guarantee supports the funding of a specific project, a policy-based guarantee supports the general government budget. Like a policy-based loan, a policy-based guarantee is anchored with policy conditions but provides a guarantee over government borrowing from private financiers in lieu of a direct loan.

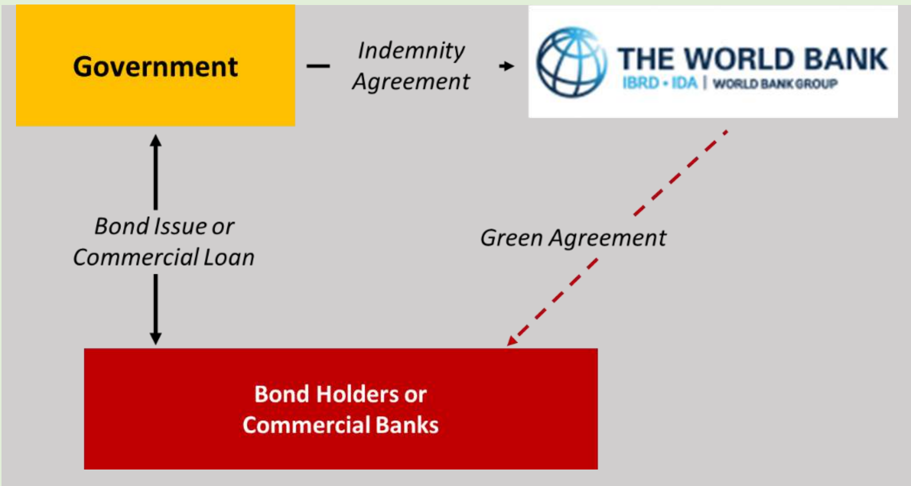
Policy based guarantee helps give the government access to commercial borrowing and improves the terms of such borrowing. The policy-based guarantee is provided with a sovereign counterindemnity and the guaranteed fee is equal to the sovereign loan spread.

This type of Guarantee can only be used by governments to access budgetary support in the context of a specific program of policy and institutional actions.

**Case Study 7 : Ghana's Ministry of Finance, 2015**

| | |
|---|---|
| *Name of Company* | **Ghana's Ministry of finance** |
| *Country* | **Ghana** |
| *Amount* | **$400 Mn** |
| *Year* | **2015** |
| *Name of Guarantor* | **World Bank** |
| *Type of Guarantee* | **Policy Based Guarantee** |

***Implementation mechanism:***




***Description and Key Learnings:***

***<u>Problem:</u>***

In 2015, Ghana was facing difficult market conditions. It had large financing needs, high debt levels that were maturing soon, and no access to international financial markets.

Refinancing deadlines, extending debt maturities to reduce fiscal pressure, and smoothing out its debt service profile were priorities for Ghana in 2015. Ghana’s Ministry of Finance sought help from the World Bank to meet these goals and requested a policy-based guarantee in combination with a credit from the International Development Association (IDA – The World Bank’s fund for the poorest countries), to be able to mobilize the volume of financing needed to settle upcoming debt repayments.

***Solution:***

A policy-based guarantee is an instrument that allows a country to raise money by mitigating the risk for bond investors or commercial lenders in case of potential debt service payment defaults. In this case, Ghana issued a $1 billion Eurobond series due in 2030. The 2030 Eurobond was backed by IDA's guarantee covering up to $400 million in both principal and interest. Since then, Ghana has bought back and cancelled $70 million of the 2030 Eurobond, reducing the amount of the guarantee to $372 million.

***Impact:***

Ghana applied the proceeds of the 2030 Eurobond issuance to refinance existing debt that had an interest rate of 25% to a lower rate of 10.75%. In addition, the maturity of the existing debt – which was between 90 days and two years – was increased to 15 years on average.

# 5. CONCLUDING REMARKS

As part of the Knowledge and Support Technical Assistance (KSTA) by The Asian Development Bank, this report aims to contribute towards enhancement of the Green Finance deployment in Mongolia and support implementation of the Mongolia Sustainable Finance Roadmap in the country. This TA aims to support the Government of Mongolia in advancing the green finance policy and regulatory framework and in undertaking capacity development to enhance capability to develop green finance projects and products.

As per the objectives of the Report, a set of seven (7) recommendations have been provided for consideration by Ministry of Finance and other relevant stakeholders to provide guarantee mechanisms for future green bond issuances in the country; which will support Mongolia to achieve its NDC targets.

These recommendations are based on international best practices, and the Report provides an explanation regarding the implementation mechanism and case studies from across the globe to enhance the understanding of these implementation mechanisms.