GLOSSARY OF FINANCING INSTRUMENTS

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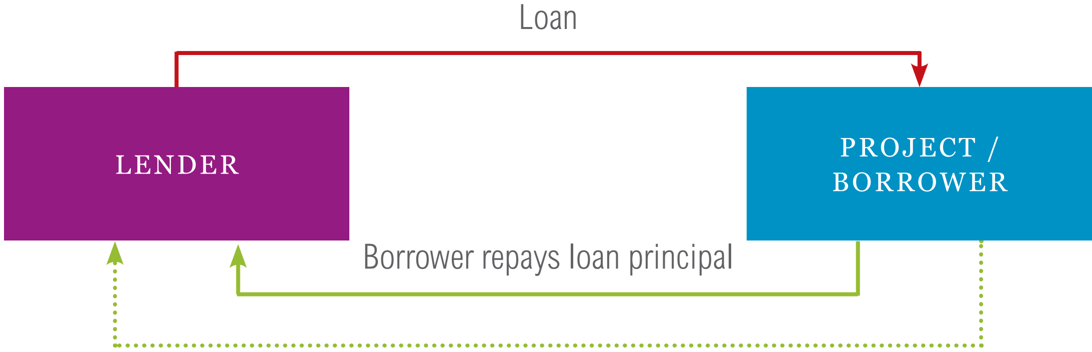
This document provides a glossary of financing instruments and the mechanism of these instruments as described in WRI's working paper "Moving the Fulcrum: A Primer on Public Climate Financing Instruments Used to Leverage Private Capital." These definitions may serve as a useful reference for public sector decision-makers evaluating the broad toolkit of options available to support private sector climate change mitigation projects in developing countries.

For full text of the working paper go to: http://www.wri.org/publication/moving-the-fulcrum.

FINANCING INSTRUMENT	DEFINITION
Lending (Debt)	**Lending or debt instruments provide borrowers with upfront funding in exchange for repayment of this funding (known as "principal") along with interest, based on pre-determined timeframes and interest rate terms.**
Concessional / Flexible Loans	Concessional and flexible loans include special features like no or low interest rates, extended repayment schedules, and interest rate modifications during the life of the loan.
Concessional / Flexible Loans through Financial Intermediaries	Loans provided to projects through financial intermediaries, like commercial banks, under concessional / flexible terms. The public sector typically uses this financing approach to increase the comfort and awareness of financial intermediaries in lending to new or less established markets.
Debt Funds	See "Funds and Structured Products" category.

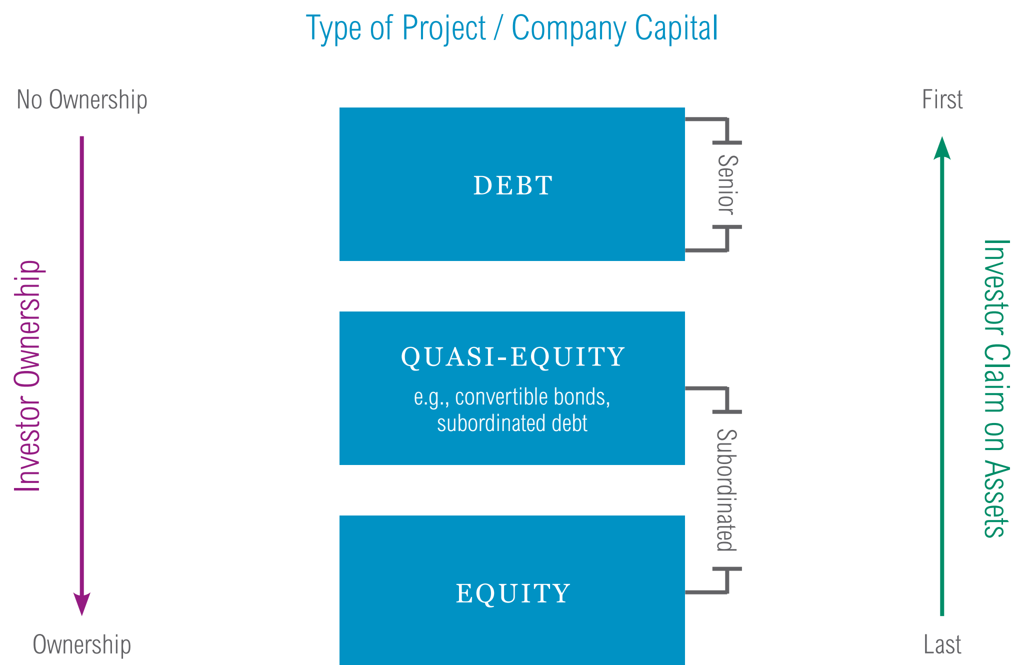
Lending (Concessional / Flexible Loans)



Concessional | e.g., lower, or no, interest rates
Flexible | e.g., modified repayment period

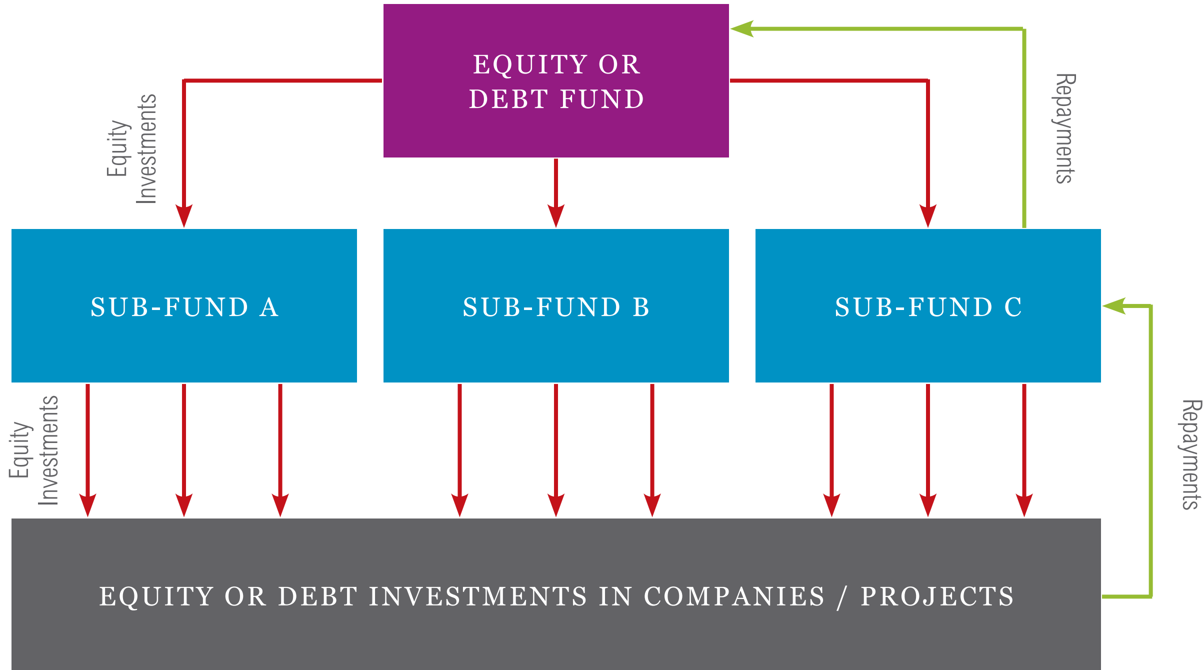
FINANCING INSTRUMENT	DEFINITION
Equity and Quasi-Equity Investments	**Equity investments provide a critical capital base for a company or project to grow its operations, access other sources of finance, and reduce investment risks faced by other project/company investors, especially debt investors who are repaid before equity investors.**
Direct Equity Investment	Direct capital contribution to a project without the guarantee of repayment; the return on a direct equity investment will depend on the performance of a project/company over the investment period.
Equity Funds	See "Funds and Structured Products" category.
Quasi-Equity	Quasi-equity investments exhibit a mix of debt and equity characteristics in terms of ownership and claim to assets in the case of default. These investments' risk-return profile typically fall between debt and equity in a company's capital structure. Some types of quasi-equity may be converted from possessing debt to equity characteristics, and vice versa.
■ Convertible Bonds	A type of bond that can be converted into shares of common stock in the issuing company, or into cash of an equivalent value. A convertible bond is essentially a bond with a stock option; because interest is paid before any stock dividends, this is a safer instrument for the lender relative to an equity investment.
■ Subordinated Debt	Riskier than traditional debt, subordinated debt has a lower claim on assets; that is, if a project/company falls into bankruptcy, subordinated debt will be repaid only after other, more "senior" debt is repaid. While subordinated debt is a riskier investment, investors can potentially achieve higher returns from subordinated debt investments relative to traditional debt.

Equity and Quasi-Equity



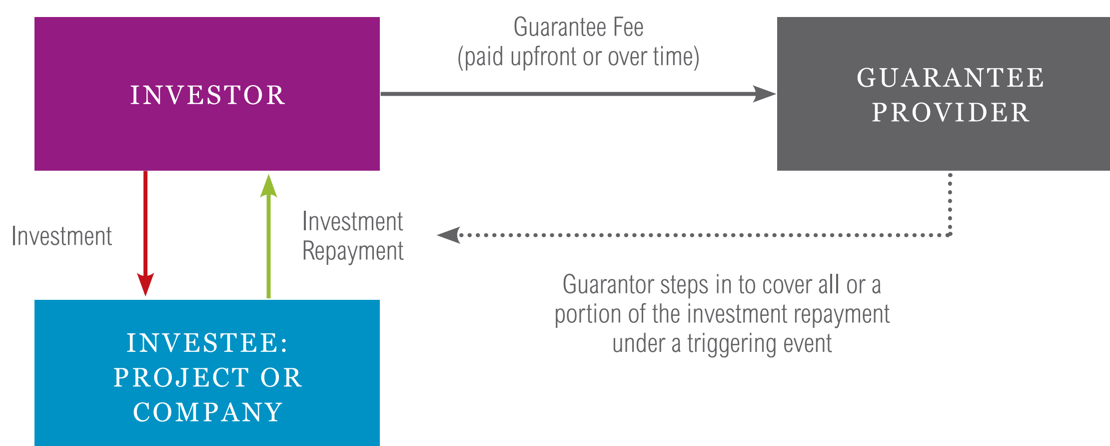
FINANCING INSTRUMENT	DEFINITION
Funds and Structured Products	**Funds and structured products allow investors to diversify their investments (thus improving their aggregate risk-reward profile) and reduce investment transaction costs, and improve borrower's access to finance especially for smaller projects.**
Debt and Equity Funds	Pooled investments in debt or equity of several projects and/or companies. The objective of debt funds is to preserve capital and generate income. The objective of equity funds is investment growth through capital gains or dividends. Both debt and equity funds may invest in sub-funds to further leverage their investment.
Structured/Securitized Products	A broad class of highly customized investments where pools of assets, such as mortgages, are aggregated to create a new security, which is then divided up and sold to investors with different risk-return tolerances. These securities' repayment value depends on the performance of the underlying assets.
Pledge Funds	A targeted private equity fund working towards a specific investment goal. Members make defined contributions to the investment pool over a period of time. Such an approach allows individual investors to consider investment opportunities on a case-by-case basis and is often used as a format for venture capital investing.

Equity or Debt Fund



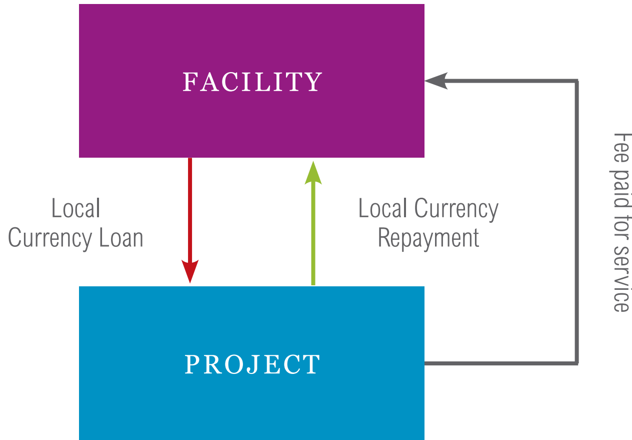
FINANCING INSTRUMENT	DEFINITION
De-Risking Instruments	**De-risking instruments help investors reduce or manage investment risks, typically in exchange for a fee, and thus, improve the perceived risk-reward profile of an investment.**
Insurance and Guarantees	Insurance and guarantee products protect investors from a borrower's failure to repay as a result of pre-specified events. A guarantee can be a minimum guarantee that protects a portion of the investment through its lifetime, or a back-end guarantee that covers the entire investment after a pre-specified timeframe.
■ Political Risk	An insurance/guarantee that protects against borrower failure to repay as a result of political events 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.
■ Partial Risk	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.
■ Partial Credit	Partial credit guarantees—which are used primarily in poorer countries—support commercial borrowing for public investment projects by partially covering private sector lenders against the risk of debt service default by the public sector.

Guarantee / Insurance Product



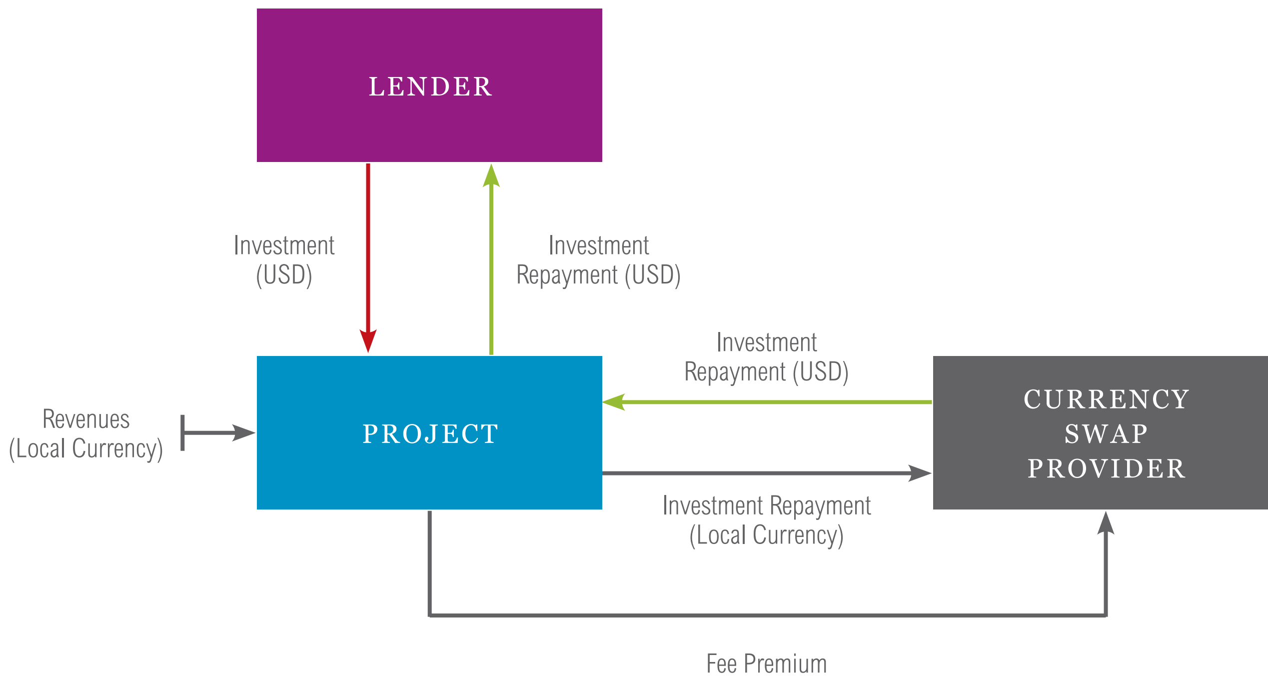
FINANCING INSTRUMENT	DEFINITION
De-Risking Instruments	**De-risking instruments help investors reduce or manage investment risks, typically in exchange for a fee, and thus, improve the perceived risk-reward profile of an investment.**
Local Currency Loans and Facilities	Cross-border loans that are disbursed in local currency and thus, protect the borrower from foreign exchange risks that could otherwise result from the mismatch of earning revenues in local currency while repaying debt in foreign currency; a fee may be charged for these services.
Liquidity Facilities	A financial arrangement, such as a line of credit, used to provide critial short-term cash flow to a project or company. A foreign exchange liquidity facility is a type of liquidity facility that allows borrowers to draw upon the facility to help manage fluctuations in foreign exchange rates.

Local Currency Loan / Facility



FINANCING INSTRUMENT	DEFINITION
De-Risking Instruments	**De-risking instruments help investors reduce or manage investment risks, typically in exchange for a fee, and thus, improve the perceived risk-reward profile of an investment.**
Swaps/Derivatives	Financial agreements that typically supplement other financing instruments to help manage different types of risks faced by an investor or borrower. These agreements are customized to protect against a specified set of risks in exchange for an upfront fee or ongoing premium. These agreements typically involve an exchange of cash flows with a third party entity or financing mechanism.
■ Weather-Indexed	These agreements reduce the borrower's risks associated with adverse weather conditions. For example, farmers can use weather-indexed swaps/derivatives to hedge against poor harvests due to low levels of rainfall.
■ Interest Rate	These agreements protect the borrower against changes in interest rates; for example, an agreement may convert an adjustable interest rate that frequently resets or "floats," to a fixed interest rate, or vice versa.
■ Currency	These agreements protect the borrower against changes in currency exchange rates; for example, an agreement may convert one type of currency to another at a pre-determined rate regardless of prevailing market exchange rates over the agreement period.
■ Commodity	These agreements protect the borrower against changes in commodity prices and are highly relevant to markets that depend on certain commodities (for example, agriculture-based or oil-dependent markets); for example, an agreement may fix the price of a commodity over the agreement period regardless of the underlying commodity's prevailing market price.

Swap Example: Currency Swap



WRI'S CLIMATE FINANCE SERIES

WRI's Climate Finance series tackles a broad range of issues relevant to public donors, intermediaries, and recipients of climate finance. A subset of this series, including this primer, examines how public climate finance providers—whether governments, development finance institutions, or international finance mechanisms like the proposed Green Climate Fund—can meet the significant investment needs of developing countries by mobilizing private sector investment. It focuses on how the public sector can finance and mobilize investment into private sector projects, but also acknowledges the importance of overarching support for complementary low-carbon policies. Low-carbon sectors specifically considered include renewable energy, energy efficiency, and related infrastructure and services, though lessons may equally apply to other climate change-relevant sectors like sustainable agriculture, transportation, and water infrastructure.

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People & Ecosystems: Reverse rapid degradation of ecosystems and assure their capacity to provide humans with needed goods and services.

Governance: Empower people and strengthen institutions to foster environmentally sound and socially equitable decision-making.

Climate Protection: Protect the global climate system from further harm due to emissions of greenhouse gases and help humanity and the natural world adapt to unavoidable climate change.

Markets & Enterprise: Harness markets and enterprise to expand economic opportunity and protect the environment.

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