Finance for Peace

Summary Rationale for Peace Bonds and Peace Finance

Assessing the potential of a new category of investment that can lower risk and enhance peace.
Based on Peace Bond feasibility study available at www.financeforpeace.org

V1. 2022

Why Peace Finance ?

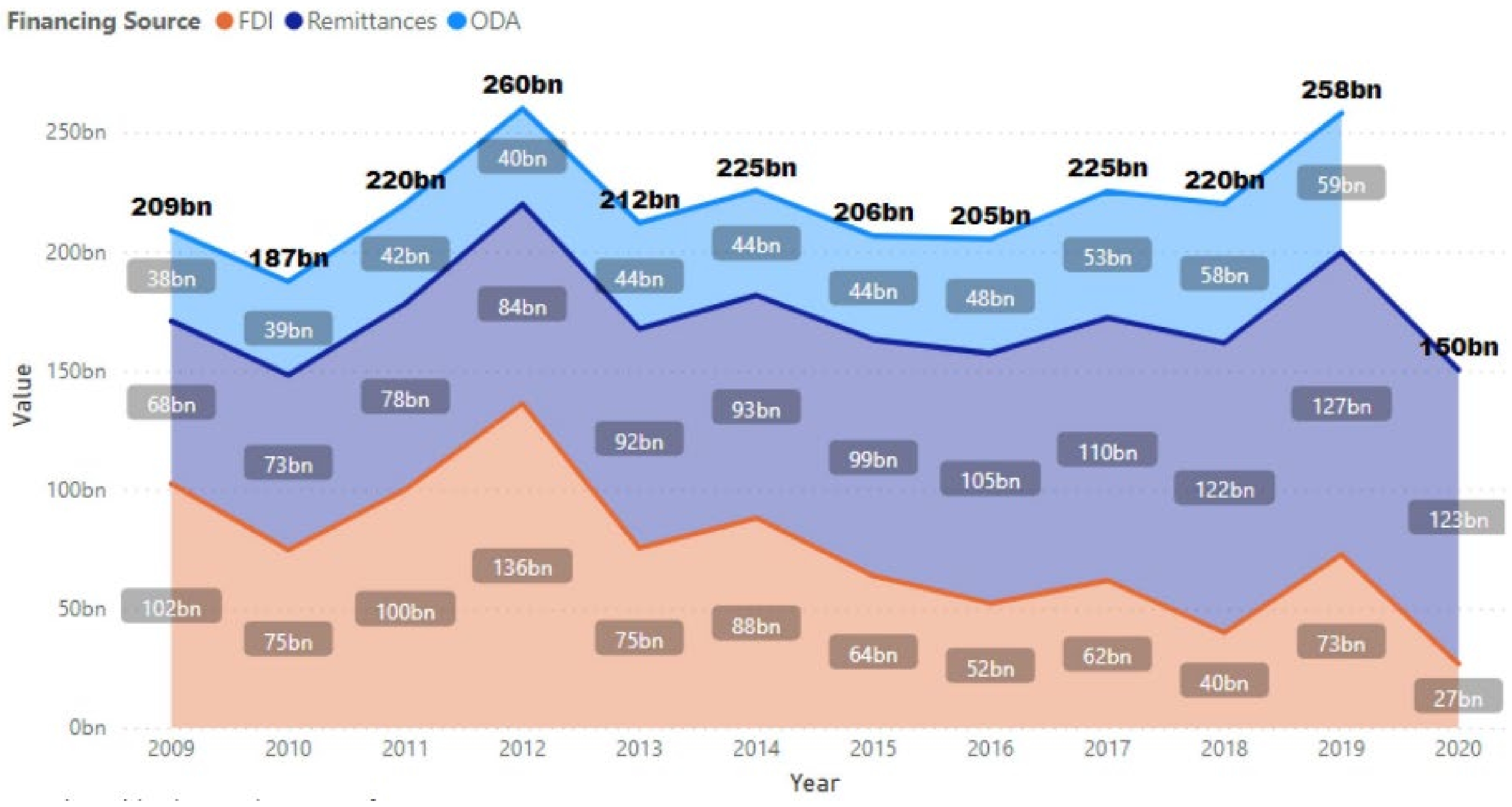
New solutions to finance development in the world's fragile and conflict affected places are urgently needed

1. **Conflict and violence is rising**
2. **Conflict is the main cause of acute hunger**
3. **Because of conflict the SDGs are not being achieved**
4. **Private financial flows (FDI) to fragile and conflict affected places has seriously declined**
5. **Existing Blended Finance approaches are not filling the gap or adequately reducing risks related to conflict**
6. **Yet, there is significant bankable opportunity in growing new categories of sustainable finance.**

We need new solutions that better align peace actions with investments and reduce risks not just for investors but for communities as well.

Private Financial Flows to Fragile States

FDI into fragile settings has been falling for ten years, even before Covid-19 – currently at a third the average level since 2009-2020

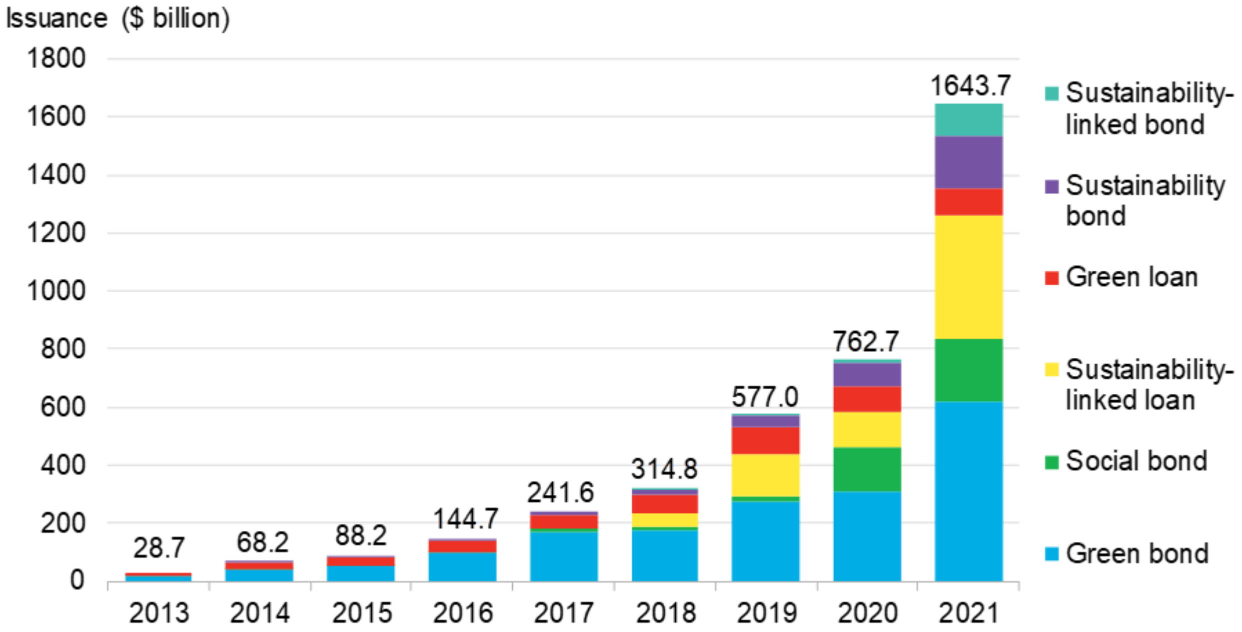


Source: UN PBSO (2021) background paper on financing

The Current Opportunity to Leverage New Sources of Finance

If only 1% of 2021's global issuance in sustainable investment categories was aligned with peace finance standards and impact frameworks, that would represent more than $16 Billion of peace enhancing finance

Figure 1: Annual sustainable debt issuance, 2013-2021



Source: BloombergNEF, Bloomberg L.P.

- → Total issuance of sustainable debt issuance recently exceeded USD 1.6 trillion = **More than 9x Global Official Development Assistance (ODA)**
- → **1% of this issuance is equal to 2x all conflict prevention, security and peacebuilding ODA** to fragile and conflict affected countries in 2020

What are Peace Bonds

Peace Bonds are a proposed new type of bond instrument where the proceeds are exclusively applied to finance new or existing projects that realise verifiable peace impacts, oriented by a robust set of new principles and standards.

Peace Bonds impact peace in two ways:

(1) Proposed Peace Bond Principles and Standards provide certification to show that Peace Bond aligned investment is verifiably deploying capital in ways that are peace responsive.

(2) Peace Enhancing Mechanisms (PEMs) embedded and financed by the proceeds of a Peace Bond directly impact peace and address key project risks which (a) leads to lower discount rates on Peace Bonds and (b) improves project cash flows which can further lower discount rates on Peace Bonds.

Two types of Peace Bond Structure

There are least two main typologies of peace bond which differ in terms of their issuance and the extent of government support they require to be viable.

(1) **Outcome peace bonds** are blended financial structures that can be issued by a variety of actors and feature some element of guarantees and/or risk sharing from donors. Their proceeds can be allocated directly to peacebuilding actions

(2) **Commercial peace bonds** would largely be issued by corporates requiring no blending. Their proceeds would largely achieve indirect peace impacts.

An example – Peace and Energy

Peace is key to unlocking today's Energy Investment trap

- **The world's large and growing energy needs are largely unfinanced:** 57% of Africa does not have access to electricity, public climate finance to fragile states averaged just $8.8 per person compared to $161.7 per person for non-fragile states (UNDP, 2022). Yet the AfDB estimates yearly investment of 44Bn required to meet needs.

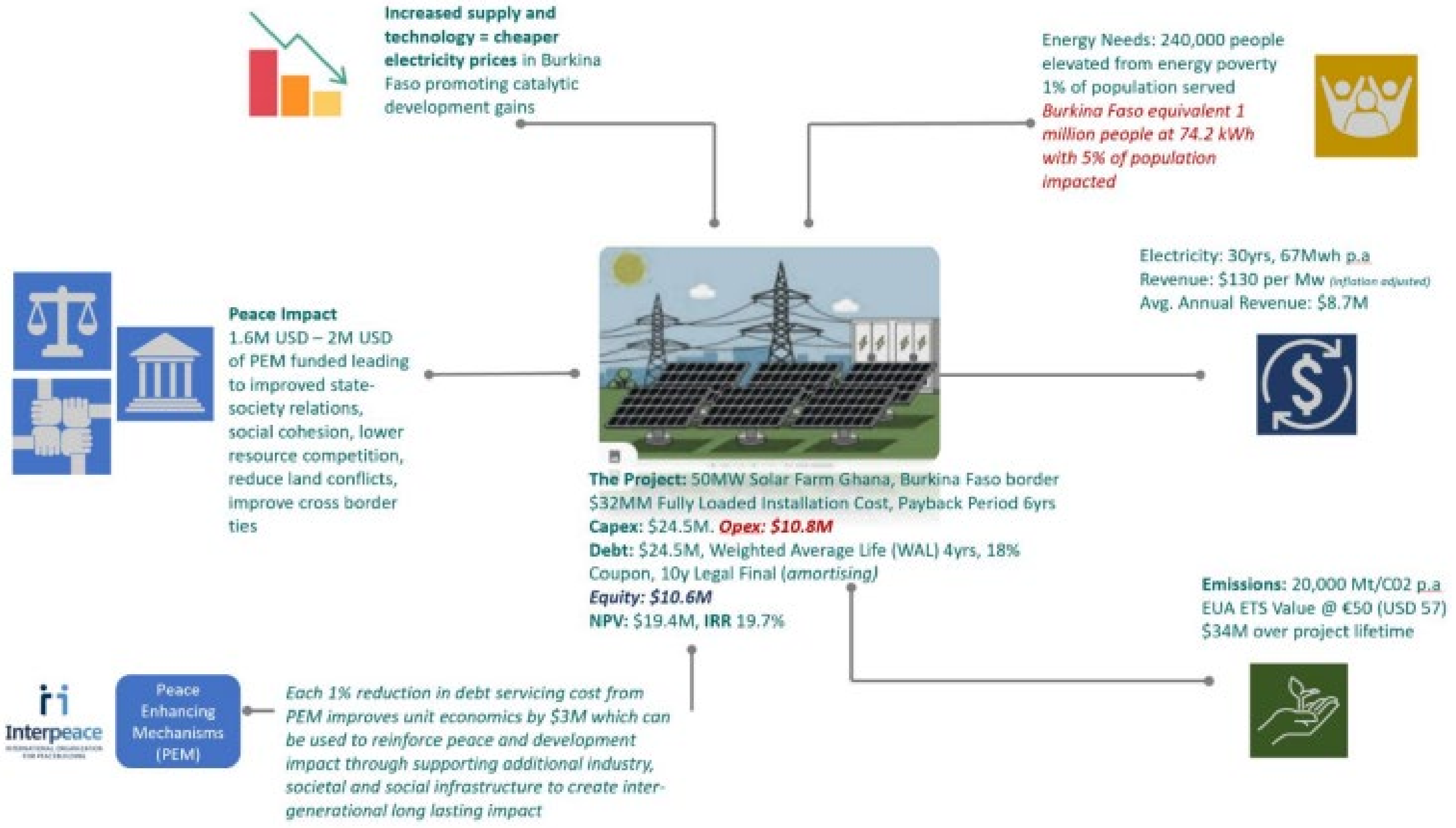
- **Many large energy projects are not conflict sensitive**. Community engagement and buy-in is key to successful project execution, lack of conflict sensitive engagement increases risks and costs for investors i.e. Lake Turkana wind farm

- **Energy access or lack thereof is a feature of many conflict dynamics**. Urban/Rural divides and digital divides, biomass, wood burning etc. a source of resource competition

- **Decentralized solutions now more economic and needed without large grid infrastructures.** Solar energy dramatically down in cost/land use but these solutions require significant local engagement and political navigation

= Country risk premiums underpin the high cost of finance – these are fundamentally related to conflict and fragility. Aligning peace actions at the level of the asset is key for de-risking

A Real Case Study Example – Renewable energy in Burkina Faso



Proposed PEM actions

- Participatory peace and conflict analysis and resilience mapping
- Establish a locally designed multi-track platform to embed peace responsive commitments into the PPA.
- Allocate energy for under-served rural communities in Burkina Faso, or for specified agricultural purposes that can reduce resource competition.
- Allocate a proportion or percentage of profits from the energy venture to intentional peacebuilding actions led by local civil society and peacebuilding actors.
- Establish a local peace infrastructure, including multistakeholder dialogue and a benefit sharing platform, run by key community members and stakeholders in the project area in northern Ghana
- Establish a community land acquisition dialogue mechanism
- Establish a dedicated representation, research and monitoring and evaluation function funded by the proceeds of the project.

Key potential outcomes

1

Through peacebuilding actions, (Peace Enhancing Mechanisms) financed by the project, local populations and authorities would be engaged, potentially co-developing benefits sharing mechanisms and increasingly trust and understanding. Through proposed local dialogue platforms and multitrack engagement this could lower the potential risk of the investment.

2

Lower risks. The feasibility study shows that a feasible set of PEMs could directly address key conflict and peace risks as well as key project risks to credibly bring the risk premium on the debt financing down by 200 basis points from 19% to 17%.

3

This would enable the energy plant to be financed. The proposed project is a 50MW solar plant that has the potential to impact 1 million people in Burkina Faso based on current per capita energy consumption. This is equivalent to 5% of the population and 14% of the country's energy import needs.

4

Win-Win for community, investors and local authorities. The value from lowering risks results in an upfront improvement of the NPV of the project by USD 6 million. The surplus value from the PEMs and the Peace Bond alignment is thus calculated at USD 4.4M. Thus, the peace impact is achieved through PEMs embedded and financed by the structure.

Conversely, what can go wrong: Kinangop Wind Park

- **Investment Size:** 150M project for Wind park in Kenya.
- **Peace related risk:** lack of community engagement, trust and buy-in, protests to government.
- **Outcome:** Complete cessation of the project and significant losses of USD66Million by equity holders

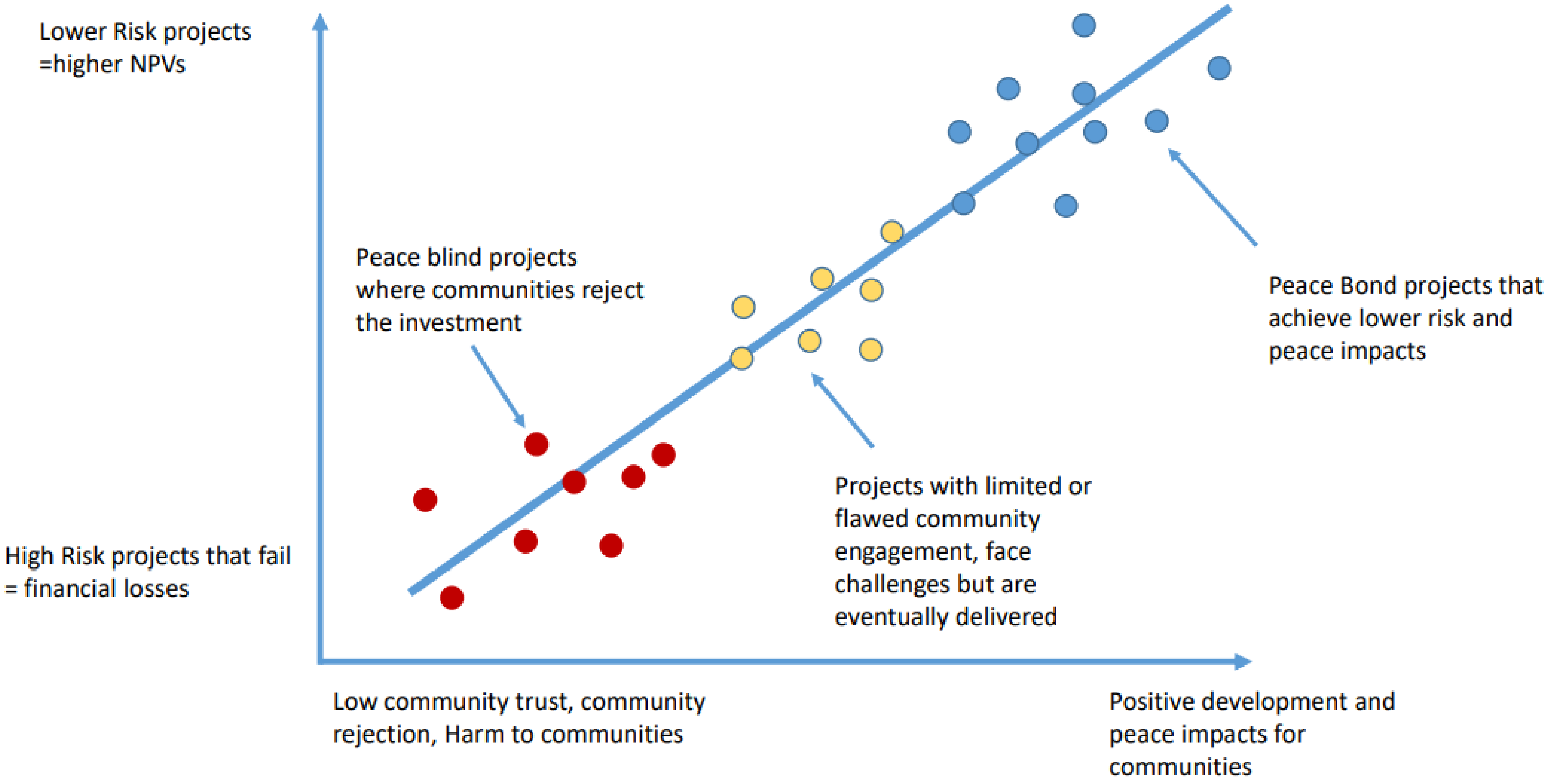
- 60.8 Megawatt wind turbine farm to be located in Kinangop, Kenya at a cost of US $154 Million, part of Government's Vision 2030 initiative and sought to increase the generation capacity from 1.5GW to 5.6GW by the year 2022. **Was halted by local communities in 2015 and held up by the Kenyan high court in 2016.**

- The protests specifically centered on the lack of proper community engagement and sensitization, compensation of the people around the set back areas, relocation and the manner in which the land was leased. The project had earmarked development funds for the community and benefit sharing but the community engagement was poor.

- See for more detail: https://www.youtube.com/watch?v=BToTRyUCisE&ab_channel=KBCChannel1

Financial logic of Peace Bonds
Peace Impacts and Risks are closely correlated

Project Risks and Peace Impacts are highly correlated in most cases - Peace Enhancing Mechanisms (PEMs) are designed to positively move projects on the risk/peace impact curve



Risk reducing PEMs

Investment projects in emerging and developing markets either fail or are not as successful as they could have been for a number of common reasons across countries and sectors – most risks are at the planning or inception phase

- Lack of community engagement at the design and construction phase of projects
- Poorly managed land acquisition process that displaces or confuses communities
- Failure to systematically engage all political actors, from the local, county to national levels in all phases from design, commencement to implementation
- Unfair compensation schemes or unmet promises that raise expectations about the benefits that are subsequently not delivered

Cessation. Outright community rejection leading to full cessation, loss of operating rights and significant loss of capital

Delays and damage to assets. Community concerns that result in significant delays or damage to assets resulting in loss of revenue

Cost-overrun. Community and political pressure leading to the company needing to pay significant ameliorative costs beyond what was planned

Negative Revenue Impact. Ongoing project risks that threaten revenues, like refusal to pay

Reduced bankability

Harm to communities

Reputational Risk

Typical Project Risks

Financial Consequences of Risk

Bankable, Peace Enhancing Sustainable Development

Peace Enhancing Mechanisms (PEMs)

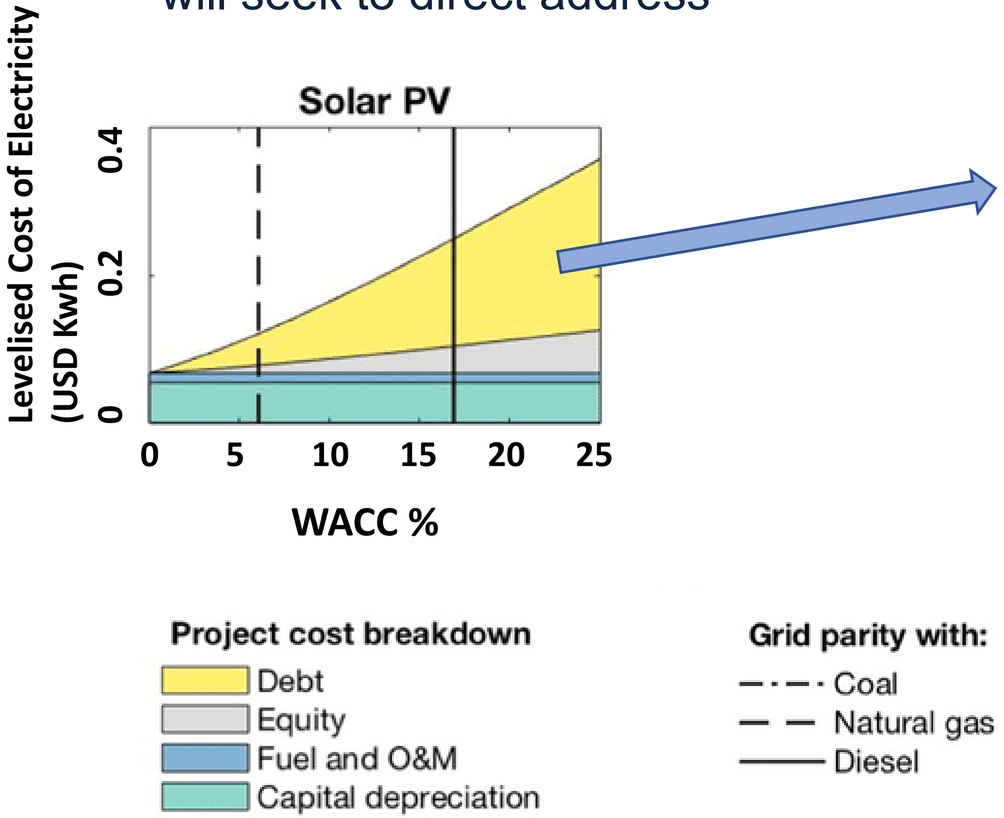
Risk mitigation & Peace Positive Impacts

Investor Premium

Why PEMs are Financially Impactful – an example

PEMs are Cost Positive as they directly address the major portion of the cost of capital for investment projects in emerging markets

For renewable investments – the cost of debt is the major portion of the costs, as seen in the figure below. Critically, the key determinant of the WACC is country-specific risks. It is these risks that PEMs will seek to direct address



By lowering the debt portion of costs, PEMs achieve significant improvements in NPVs

→ this is why de-risking is the critical hurdle for developing countries to overcome if they are to crowd in funding for large projects – PEMs directly address this

Source: Sweerts, B., Dalla Longa, F., Zwaan B. (2019)

The Potential Peace Bond Premium

Peace Bond issuance designed PEMs will seek to generate a market premium over time in three key areas (1) Improved NPVs (2) Market Premiums (3) Additionality

1

Improved NPVs

NPVs are improved because PEMs materially lower risks

Lower risks translate to lower borrowing costs, a major part of the cost of investment in fragile and conflict affected places

2

Market Premiums

Peace Bonds would be aligned with various ESG and SDG frameworks and could potentially command a similar market premium to green bonds if a reliable stream of issuance can be established

3

Additionality

The key benefit of peace bonds is additionality, in many cases this will be created in two ways (1) by lowering cost of borrowing efficiently projects will become bankable that otherwise were not. (2) many investments require forms of multistakeholder and political engagement individual investors are often not well placed to structure or achieve.

Compared to standard issuance, there is a potential peace bond premium that could underpin the growth of a significant new category of investment

Bond	Conventional	Green Bond	Peace Bond
Improved NPV (ex ante)	0	0	+
Market Premium	0	+	+
Additionality	0	0	+

What is Needed to Scale these Examples?

Standards and frameworks are urgently needed to both regulate and incentivise private investment in fragile and developing settings. Current ESG and blended finance guidance are not strong on peace. There is an inadequate focus on how communities are engaged. Standards and frameworks can reduce the risk of 'peacewashing' but also help investors leverage the opportunity to align peace actions to mitigate risks.

The market for peace finance needs to be created. The investor demand is there, but currently there is a lack of investments, guidance and standards to support a trusted pipeline. At first, support will be needed from Development Finance Institutions (DFIs) and governments but over time peace finance can become a new category of sustainable finance.

The ultimate aim to create a system of incentives for private sector actors to positively impact peace. To realise the pipeline of peace finance projects, we need new partnerships, engagement with investors, communities and peacebuilders to showcase the potential market premium of peace finance structures, whether in the form of peace bonds or peace equity.

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