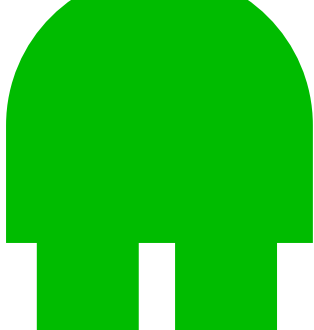


HOW TO FINANCE THE EMERGING CLIMATE OPPOR TUNITY.

Enhancing climate finance in emerging markets and developing economies through prudential regulatory clarification and reform.



Policy brief

- **Private climate finance to emerging markets and developing economies (EMDEs) is falling**, despite these countries representing 25% of global GDP and requiring an additional US\$450–US\$550 billion annually in external climate investment by 2030.
- **Basel III rules, as currently interpreted, unintentionally discourage EMDE lending**, including by unnecessarily limiting recognition of robust credit enhancement tools.
- **Project finance is treated highly conservatively under Basel capital calculation approaches**, despite strong data showing lower-than-expected default rates and high recovery rates over time.
- **Country risk ceilings often overstate risk for EMDE exposures**, limiting bank participation even in high-quality, co-financed projects – thus driving up the cost of capital.
- **Targeted clarifications and reforms to the Basel Framework could unlock significant volumes of private investment** – increasing, we estimate, the bank capital available for high-impact, climate-aligned EMDE projects in emerging markets by 3-4x, without compromising financial stability.

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Introduction

Emerging markets and developing economies (EMDEs) have a critical role to play in achieving global climate goals under the Paris Agreement. Yet, these countries face a persistent shortfall in climate finance, with private capital flows declining over recent years.

In line with the ambition of the 2024 United Nations Climate Change Conference (COP29) and the New Collective Quantified Goal (NCQG), external finance from all sources – including international public, private, and other channels – must contribute approximately US\$1 trillion annually by 2030, rising to around US\$1.3 trillion by 2035, to meet total climate investment needs in EMDEs.¹

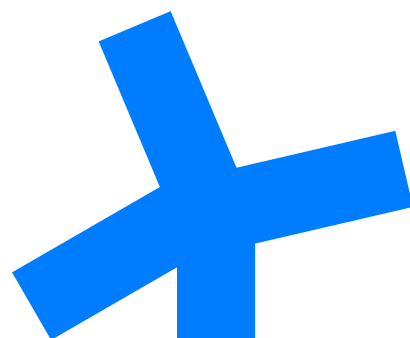
Despite accounting for roughly a quarter of global GDP, EMDEs (other than China) attract just 14% of global climate finance flows. According to the Independent High-Level Expert Group on Climate Finance, these economies currently receive only around US\$30 billion of external private finance and will require an additional US\$450–US\$550 billion per year in external finance by 2030 to remain on a net-zero trajectory – an increase of 15 to 18 times². Mobilising this scale of investment is essential to global climate outcomes and financial stability alike.

In this context, policymakers have repeatedly emphasised the importance of mobilising much higher levels of private investment in EMDEs – most recently as part of the Baku to Belem Roadmap at COP29. Moreover, multilateral development banks (MDBs) and development finance institutions (DFIs) have introduced a range of enhanced tools to address prevailing market gaps.

However, this collective effort is hindered by aspects of the Basel III prudential framework that unintentionally deter bank lending to EMDEs. Banks within the network of the International Chamber of Commerce (ICC), the world's largest business organisation, report severe difficulties in meeting capital efficiency thresholds for projects in EMDEs – while some have exited or actively avoid emerging markets entirely. Others report passing on additional risk costs to EMDE borrowers – in effect negating the intended pricing impact of concessional finance.

We welcome increasing international efforts to highlight these barriers, including by the Glasgow Financial Alliance for Net Zero (GFANZ) and the Institute of International Finance (IIF). It is now time to translate this growing momentum into action and practical solutions.

This note summarises key barriers within the prudential framework and outlines recommended actions to align capital regulation with climate and development goals while maintaining financial stability.



¹ <https://unfccc.int/topics/climate-finance/workstreams/baku-to-belem-roadmap-to-13t>

² Independent High Level Expert Group on Climate Finance (2023) "A Climate Finance Framework" <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2023/11/A-Climate-Finance-Framework-IHLEG-Report-2-SUMMARY.pdf>

Barriers to EMDE climate finance

■ Insufficient recognition of public risk mitigation tools

Multilateral development banks and development finance institutions play a vital role in reducing the risk profile of EMDE investments through credit guarantees and co-lending structures. While the Basel Framework, a globally agreed set of standards for the prudential regulation of banks, permits the use of MDB/DFI guarantees for capital relief, strict operational requirements limit their applicability:

- **Unconditionality requirements:** Guarantees must be unconditional, yet widely used MDB products, such as non-honouring guarantees of the Multilateral Investment Guarantee Agency (MIGA), include standard (but rarely used) exclusions that render them ineligible for capital relief purposes.
- **Timeliness requirements:** Key instruments like political risk insurance (PRI) or breach of contract protections must pay out promptly after a default to qualify for capital relief, but most instruments used in EMDEs involve processes (e.g. arbitration) that render them ineligible – even if they effectively reduce credit risk.
- **Treatment of partial risk insurance:** Basel III grants capital relief only for the guaranteed portion of a loan, creating a cliff edge where even a 49% guarantee offers no more benefit than a much smaller one. This severely limits the usefulness of partial guarantees commonly used in EMDEs to share risk and support lending.
- **Incomplete recognition of MDBs:** The Basel Framework list of MDBs eligible for favourable risk weights is static and excludes newer institutions with strong credit ratings and mandates aligned with climate finance.³
- **Treatment of blended finance structures:** Current rules do not recognise the risk-reducing benefits of blended finance structures, preventing banks from receiving capital relief even when public or concessional partners absorb first-loss risk.

Moreover, although the Basel Framework permits credit mitigation from private insurers, in practice most private political risk insurance does not qualify for capital relief because of structural and legal conditions in standard commercial contracts. As a result, banks cannot obtain capital relief for exposures backed by established private political risk insurance providers, even when it significantly reduces credit risk.



³ Examples include: UK-backed GuarantCo (rated AA by Fitch) and the Central American Bank for Economic Integration (rated AA by S&P).



Conservative treatment of project finance

Project finance is central to climate and infrastructure investment in EMDEs, yet the Basel Framework assigns conservative risk weights to this form of financing:

- **Standardised approach:** Risk weights for project finance are set at 130% in pre-operational phases and 100% during operation – compared to 100% for unrated corporates. Even high-quality projects (with cash flows, reserves and credit protections) face stringent criteria for an 80% risk weight. This is despite data from Moody's⁴ and the GEMs Consortium⁵ demonstrating that project finance in EMDEs outperforms corporate loans, with higher recovery rates and default rates comparable to investment-grade corporates after five years. Moreover, S&P Global – in a spring 2025 Request for Comment – proposed raising recovery rate assumptions for project finance in collateralised debt obligation to 70% under a 'BBB' stress scenario in many EMDEs, reflecting also how better data is enabling rating agencies to update key methodological assumptions.⁶
- **Internal ratings-based (IRB) approach:** The internal ratings-based (IRB) maturity adjustment assumes linear risk growth over time. In practice, the experience of banks is that project finance exhibits decreasing risk as projects stabilise and generate revenue.
- **Embedded protections:** Basel does not currently recognise borrower-level mitigants in project finance transactions (e.g. FX hedging, purchase agreements).

Impact of country risk calculations

While the Basel Framework does not explicitly assign capital charges based on country risk per se, it does so indirectly through **country risk ceilings** (the maximum credit rating that any entity within a country can receive) and **risk-weight floors** (a minimum percentage risk weight that regulators require banks to apply) to corporates or projects in lower-rated jurisdictions.

For example, exposures to a corporate in a country with a sovereign rating of B or below may receive a 100% or higher risk weight, even if the underlying project or borrower is highly secure.

Illustrative example:

A commercial bank considers lending to a solar energy project in a Sub-Saharan African country rated B-. Despite having:

- A long-term power purchase agreement with a multilateral-backed utility,
- Multilateral Investment Guarantee Agency political risk insurance against currency inconvertibility and breach of contract, and
- Co-financing from a multilateral development bank (A-loan),

...the exposure still attracts a 100%+ capital charge due to the country's sovereign rating. This undermines the effect of risk mitigants and disincentivises the bank's participation.

4 Moody's (2017) "Default and Recovery Rates for Project Finance Bank Loans, 1983-2015": Research covering 30 years of global infrastructure finance showed EMDE project loans have default risks comparable to BBB- corporates by year five (0.55%) and A- corporates by year nine (0.12%). Since these ratings attract 75% and 50% risk weights respectively, operational-phase projects – especially with credit enhancements – could warrant significantly lower capital charges.

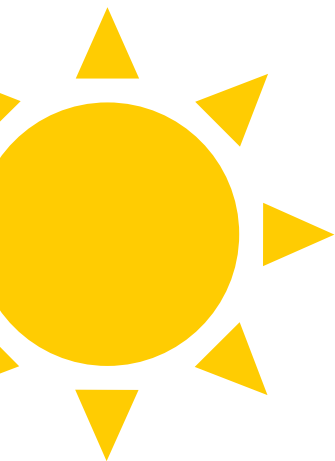
5 IFC (2024) "Global Emerging Markets Risk Database (GEMs) Consortium"

6 S&P Global (2025) "Request For Comment: CDOs Of Project Finance Debt: Global Methodology And Assumptions"

Recommendations

Climate change presents a systemic risk to financial stability, especially in EMDEs. As countries and financial institutions mobilise to support net-zero transitions, prudential regulation must evolve to avoid unintended obstacles to climate-aligned investment.

Given the urgency of the financing challenge faced by many EMDEs we encourage policymakers to consider a two-step approach to macroprudential reform – starting with low-hanging fruits that could yield an immediate boost to climate finance flows, before considering broader structural reforms.

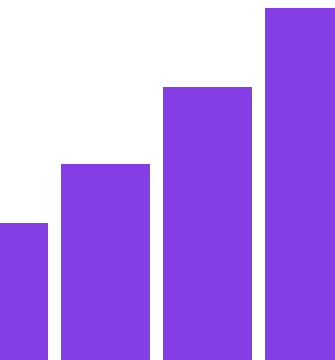


Step 1: Technical adjustments and clarifications

Small, targeted adjustments to the Basel Framework could unlock substantial additional investment – either by way of new guidance from the Basel Committee on Banking Supervision or, failing that, coordinated action from national regulators.

Such steps could include:

- i. **Updating credit risk mitigation guidance** to accommodate the real-world mechanics of MDB/DFI and private credit enhancement tools, including political risk insurance. At a minimum, such guidance should allow guarantees or insurance to qualify if exclusions are: standard market practice (e.g. nuclear or war clauses); and statistically remote or immaterial to the exposure in question.
- ii. **Clarifying time limits for credit risk mitigants** by recognising that contracts with defined arbitration periods (e.g. under 180 days) or subject to the established claims procedures of MDBs/DFIs can provide functionally timely payouts and should qualify for capital relief.
- iii. **Allowing the application of blended risk weights to exposures covered by partial guarantees** to reflect the real risk reduction offered by these tools.
- iv. **Allowing for automatic recognition of credit enhancements provided by all MDBs/DFIs** with credit ratings at or above AA-.
- v. **Providing clear guidance on the treatment of borrower-level risk mitigants** in project finance transactions (both during pre-operation and operational phases) – including interest rate or currency hedging, purchase agreements, reserve accounts and performance bonds.



Step 2: Structural reforms

Building on these initial measures, we recommend that Basel Committee is mandated to establish new work programmes to:

- i. **Refine the treatment of project finance** to reflect its proven performance based on available market data; introduce dynamic risk weights that adjust over a project's lifecycle (particularly between pre-operation and operational phases); and consider recognising project finance as a distinct asset class within the prudential framework.
- ii. **Review Basel's approach to country risk to better differentiate between sovereign and project-level risk.** This should permit risk weight adjustments where exposures are highly secure or mitigated by credible guarantees/involve MDB participation.
- iii. **Consider the potential introduction of a scaling factor for high-quality, climate-related investments in EMDEs** – similar to the existing Supporting Factor for Small and Medium-Sized Enterprises under Basel III or the Infrastructure Supporting Factor within the European Union's Capital Requirements Regulation.
- iv. **Review potential modalities to recognise well-structured blended finance arrangements** – notably those with public or concessional first-loss tranches – as eligible credit risk mitigation where they provide transparent and reliable risk absorption.

ICC, the institutional representative of more than 45 million businesses in over 170 countries, calls on governments and financial standard-setters to **initiate a structured dialogue** – under the Baku to Belem Roadmap at COP30 – with the engagement of the Basel Committee on Banking Supervision, to explore targeted prudential adjustments that can be implemented in the near term. These 'quick fixes' can help unlock urgently needed capital flows to EMDEs to meet global climate goals – while ensuring the continued soundness of the global financial system.

The European Union's Infrastructure Supporting Factor under CRR Article 501a offers a pragmatic precedent: by reducing risk weights for qualifying infrastructure projects, it has materially improved the economics of long-tenor investments in Europe. Replicating similar jurisdiction-level approaches globally can serve as a bridge to eventual harmonised reform, while catalysing real private capital flows in the near term. We also recognise the ongoing efforts of MDBs and DFIs to ensure their instruments and solutions are as closely aligned as possible with existing regulations.

We further encourage the establishment of a **clear pathway for longer-term regulatory reform** that aligns capital rules with global climate and development goals. ICC stands ready to support this effort and contribute technical input and private sector expertise to accelerate progress in this important area.

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