TRANSITIONAL COMMITTEE
FOR THE DESIGN OF THE GREEN CLIMATE FUND

SURVEY OF THE PRIVATE SECTOR

Response from the Institutional Investors Group on Climate Change (IIGCC)

1. *Opportunities*

(a) What opportunities do you see today for scaling up your organization's financing in mitigation[1] and adaptation[2]?

Private sector capital will be critical to solve the climate challenge. Leading institutional investors, including pension funds and asset managers, are already acting to address climate change and opportunities. They are integrating climate issues into their investment practices, addressing climate strategies in dialogues with companies and considering investment opportunities in areas such as renewable energy generation and infrastructure and energy efficiency.

Pension funds are bound by fiduciary duty to provide the best possible risk adjusted returns across their portfolios. In order for them to allocate a greater proportion of their investments to climate solutions, these investments must provide similar risk adjusted returns to other types of investments. This means that financing the move to a low carbon growth path requires policy that provides investors with clear, credible and sustained incentives.

This is why the Institutional Investors Group on Climate Change (IIGCC) and similar investor groups around the world have called on domestic governments and international institutions to provide the climate change and energy policy frameworks needed to support low carbon growth. Investors are looking for policies that put an effective price on carbon and provide a level playing field for investment in energy efficiency and low carbon assets.

The importance of credible regulatory frameworks and low-carbon domestic policies for attracting private sector investment in size applies to both developed and developing countries. In some emerging economies investors may face additional risks, for example more limited transparency, third party dependency, transaction costs and higher financial as well as political uncertainties. This means that private sector investment in climate solutions in these countries will only be accelerated if risk levels are brought down through a combination of capacity and policy development, well structured risk mitigation and the formation of financing models to attract private capital.

[1] Reducing greenhouse gases and/or implementing strategies to capture and store carbon.
[2] Measures to reduce the vulnerability of natural and human systems to climate change.

(b) What are the possible avenues for bringing private sector finance into the GCF, for instance through climate bonds raised on the capital markets?

There will be a number of structures which may be suitable for bringing private sector finance into the GCF. For example:

Public private partnerships - One structure could be for institutional investors to invest alongside the GCF directly in low-carbon assets. A GCF product which meets long-term investors' needs for assets which deliver long term bond-like returns at a low fee base with a basic level of stewardship could be attractive for long-term institutional investors, including pension funds, who are seeking low-risk, long-term, inflation-linked investments with stable cash flow characteristics.

The transitional committee could consider how the low-carbon investment framework could drive new forms of public-private partnerships.

Green bonds – Another way that might also help to raise additional finance from the private sector would be the use of green bonds, which may form a small part of an investors' asset allocation. However, to date the appetite for green bonds has been limited as institutional investors have struggled to source green bonds which have the required level of returns and liquidity to meet requirements.

While the multilateral development banks and institutions have ventured into green bond issuance, investors have been unable to purchase them in scale due to the lower yield profile of early attempts compared to existing bonds, along with the reduced liquidity and short tenor (please see the attached paper for more background on our position on green bonds).

(c) What are the opportunities for the GCF to support and leverage private sector investment in climate change mitigation and adaptation?

We strongly support the setting up of the GCF to help drive the scale of funding required to move a low carbon economy. We recommend designing the GCF and any products with a view to unlocking long-term private sector investment, including from pension funds, from the outset. It is critical that the GCF has a clearly defined role which does not crowd out private sector investment.

The GCF could have an important role in providing concessional loans or risk reduction mechanisms, such as credit enhancements, for developing countries. Another idea that is being explored by some of our members is for the GCF to have the flexibility to implement mechanisms that will provide a subsidy for action that is measured, reported and verified using CO2 equivalent metrics.

2. Barriers

(a) Risks: In relation to investing in climate change mitigation and adaptation, which commercial, technological and political risks do you see as most difficult to deal with? What risks are associated with the overall investment environment? Which risks are better managed by the public sector and which by the private sector?

According to a major pension scheme funded study, investors' biggest climate portfolio risk stems from policy uncertainty[3]. Political risk (policy and regulatory risk) is out of the control of investors - hence it is the most difficult risk to deal with. While domestic legislation is the critical determinant of the level of capital flows into areas such as renewable energy and energy efficiency, a rules based international climate change regime is also critically important and would significantly support the case for investment in climate change solutions.

At the national level, the lack of established regulations that provide clarity on how particular policies will be implemented and evolve over time adds to the political risk. In this regard, GCF policy guarantees could be particularly helpful where no grandfathering is in place. Uncertainty and long delays in obtaining permits from government bodies are also detrimental to low carbon investment.

Technological risk will be specific to the technological application, sector or region. The maturity or deployment of a given technology is a significant factor in the overall risk perception for that technology and will only be addressed through the relatively wide deployment of the technology.

Commercial risks are also difficult to generalize as they are dependent and specific to management teams and counterparties. However, they can partially be mitigated and managed through appropriate assessments and structuring of the investment.

(b) Access: Is there a lack of long-term or other necessary financing for climate change projects in the markets where you operate? What are the reasons for this lack of access to finance?

(c) Economics: Do many climate sectors/projects you deal with lack financial viability? How are adaptation and mitigation projects different from the financial perspective?

(d) Other: What other barriers prevent you from financing climate projects?

Barriers for institutional investors have included the dispersed nature and small scale of projects.

[3] Climate Change Scenarios –Implications for Strategic Asset Allocation, Mercer, 2011

3. Responses

(a) Risks: In what ways could the GCF most effectively help the private sector overcome risks to climate investments? What risk sharing instruments could the GCF support (e.g., partial credit guarantees, local currency hedging, subordinated financing structures and other public-private instruments)? What design elements should be considered for the GCF to ensure the most effective implementation of such instruments?

Risk sharing instruments such as partial credit guarantees, local currency hedging, subordinated financing structures and other public-private instruments are all very useful tools to help mitigate investment risks. The GCF should have the flexibility to use this type of structures to help private sector overcome risks.

(b) Access: What options could the GCF consider to improve access to finance for climate actions, particularly for those most vulnerable to the adverse impacts of climate change, including the least-developed countries and small island states?

The GCF could consider how best to aggregate or bundle smaller projects in order to enhance the long-term risk adjusted returns of these projects to make them investable.

(c) Economics: What are the options for the GCF to improve project economics and which do you feel would be the most cost-effective? What are the options for lowering the cost of capital for projects and what impact could they have on project economics? How could the GCF enhance or otherwise improve revenue streams?

(d) Other: What other actions could be undertaken by governments or supported by the GCF to improve the conditions for climate investment (e.g., project development support, institutional strengthening)?

4. Engagement

(a) How could the GCF engage effectively with the private sector in developing and implementing instruments to support private sector climate investments?

The GCF should have the mandate to consult directly with the private financial sector including institutional investors. The engagement should be transparent, objective and permanent.

(b) Would a dedicated GCF window for the private sector be useful?[4] If so, how would this window operate differently from the rest of the fund?

We encourage a dialogue with the private sector on all windows of the GCF.

(c) Of the current multilateral fund models (Climate Investment Funds, the Global

[4] A private sector window could include a dedicated governance structure and special approval, contracting and reporting procedures.

Environment Facility, etc), which ones are working well for the private sector? What concrete improvements could be implemented to increase private sector engagement in climate change action through the GCF?

The survey responses will be synthesized into a report for members of the Transitional Committee for consideration at their next meeting in Geneva from September 11–13, 2011. All responses can, or will be, made publicly available. Please submit responses electronically to tjacinto@unfccc.int by August 12th, 2011.