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Second Workshop on Long-term Finance, Session II: Enhancing enabling conditions: Policies and instruments

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E3G – Third Generation Environmentalism

Contents

- Barriers to mobilising, scaling-up and catalyzing low carbon and climate resilient investment
- Role of public policy and public finance to mobilise, scale-up and catalyse private investment
- Learning from experiences – and role of climate finance
- Potential new instruments and role of the Convention
- Concluding remarks

The 2030 Investment Challenge

- <2C requires $10 trillion in additional energy investment to 2030
- Shifting $26 trillion from high to low carbon energy investment
- $145 trillion in infrastructure investment to 2030 needs to be made low carbon and climate resilient
- Planning investments under uncertainty of the costs of adaptation – integrate climate risks to make all economic sectors and infrastructure resilient
- Investment in major economies mainly low carbon from 2020

Requires transformational changes – align public policy and public finance in all countries and a specific role of climate finance to support developing countries

Barriers to Investment Increase Risks and so Costs of Investment

Policy Barriers

- Policy uncertainty and complexity
- Transaction costs (complying with policy/licensing/reporting etc)
- Land allocation, access and security of ownership
- Enforcement of policy and pricing incentives
- Existing subsidies and policy support for high carbon alternatives

Market and Technology Barriers

- Relatively high upfront cost of technology
- Human and operational risks (lack of trained people)
- Limitations of support infrastructure (e.g. grid infrastructure)
- Immature supply-chain and limited capacity of project developers
- Long term viability of many state utilities under question
- Lack of track record of particular technology/project

Financial Barriers Further Deter Investors

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General financial barriers

- Country risk: possibility of defaults or other factors leading to non-return of invested capital including economic risks such as inflation.

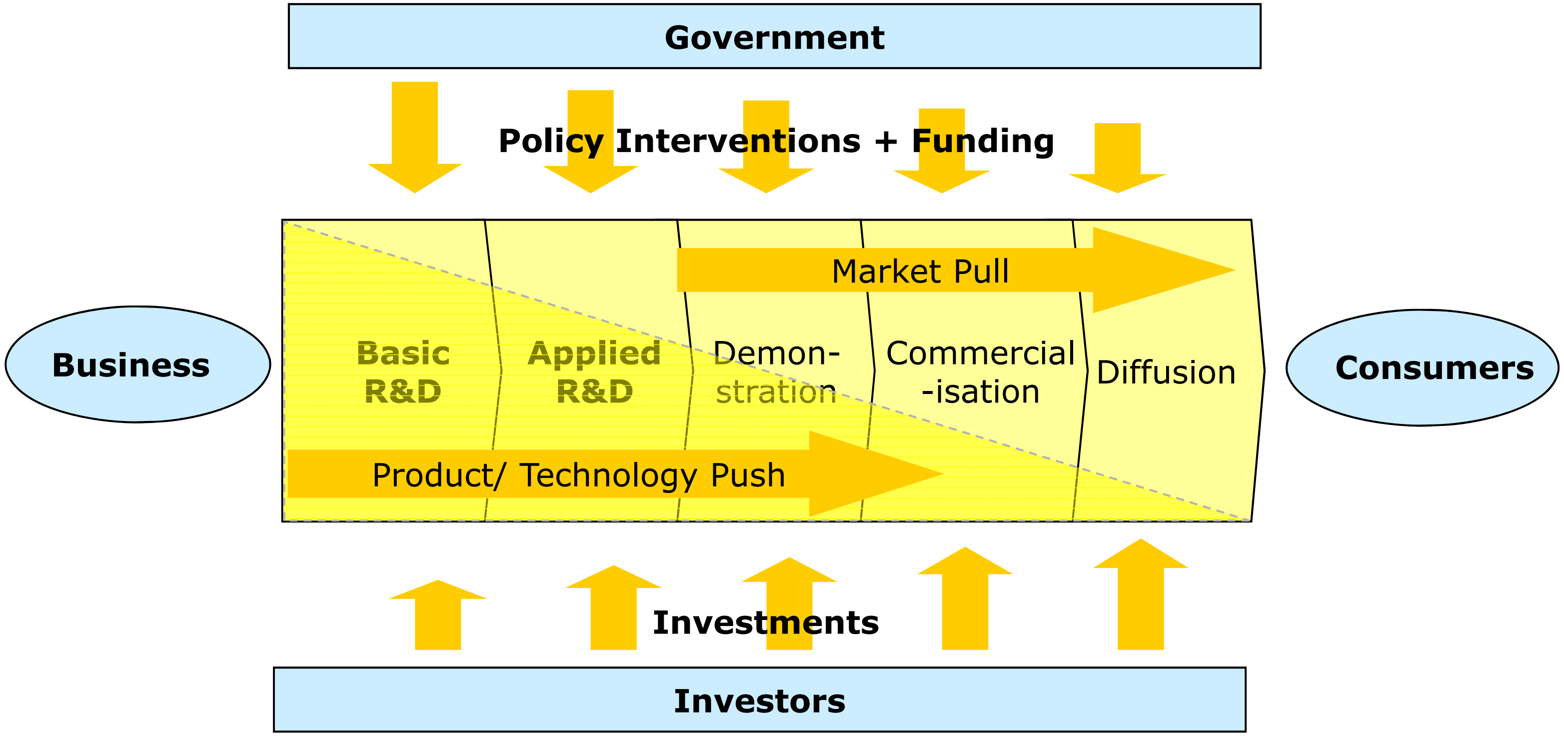
- Currency risk: Exchange rate fluctuations making returns volatile.

Climate specific financial barriers

- Deal flow problems: insufficient number of commercially attractive deals making diversification in investment portfolios difficult

- Complexity risks: difficulty evaluating multiple, overlapping risks making it easier to invest in business-as-usual investments.

Policy and Financial Interventions Differ Along the Innovation Chain



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The Policy Challenges

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•Policy and regulation is key to an effective investment framework and to reducing risks and so costs of investment

- Main task is to change focus of existing flows of infrastructure investment in energy, cities, water etc
- Policies designed to ensure most effective use of climate finance in order to ensure it:
  - Bridges upfront financing gaps
  - Bridges incremental cost gap
  - Catalyst for transformational change and innovation by removing specific risks and overcoming barriers

The Financial Challenges

- **Front-Loaded Finance**: upfront investment e.g. in efficiency, RES etc to displace long term fossil fuel purchases. Strains capacity of financial system especially in the current post-crisis climate

- **Managing Risk**: low carbon investment has higher political, technology, and policy risks. Investors amplify low carbon risk (downplay high carbon risk)

- **Integration**: regulatory reforms needed to integrate low carbon and climate resilience into on-going infrastructure investment in cities, water systems, industrial clusters, electricity and gas grids

Public policy and regulatory/market reforms – as well as targeted public finance interventions – necessary to reduce risk and mobilise private investors

Investment Grade Policy

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- Early engagement of stakeholders and dialogue – particularly private investors – to increase transparency and buy-in to policy objectives

- A clear, long term and coherent policy and regulatory framework underpinned by rule of law – aim to align investment timescales and policy timescales

- Price signals should incentivise deployment of low carbon/resilient investments:
  - Explicit or implicit (e.g. FiTs) pricing of Carbon to increase cost competitiveness, clear process for review and phasing out
  - Transparency of fossil fuel subsidies and phasing out

- Economic planning with aim of realising benefits of green growth through market creation (e.g. standards, building codes, transport policy etc)

- Institutional arrangements to facilitate effective cross-Ministerial coordination and integrated resource planning

Adaptive Governance to Mobilise Finance

Integrating resilience within national planning processes:

- Increase cooperation and communication between scientific and policy communities
- Integrated approach towards resource planning requires particularly strong coordination and cooperation between Ministries
- Partnering with stakeholders to identify means for increasing resilience of key economic sectors and infrastructure, and strengthening community based responses

Overcome barriers to private sector investment in adaptation through:

- Raising awareness through increasing availability of data, information and user-friendly risk-assessment tools
- Medium and longer-term planning to comprehensively identify and communicate climate risks across different sectors to the private sector
- Create policies and regulation to incentivise resilience measures e.g. building codes

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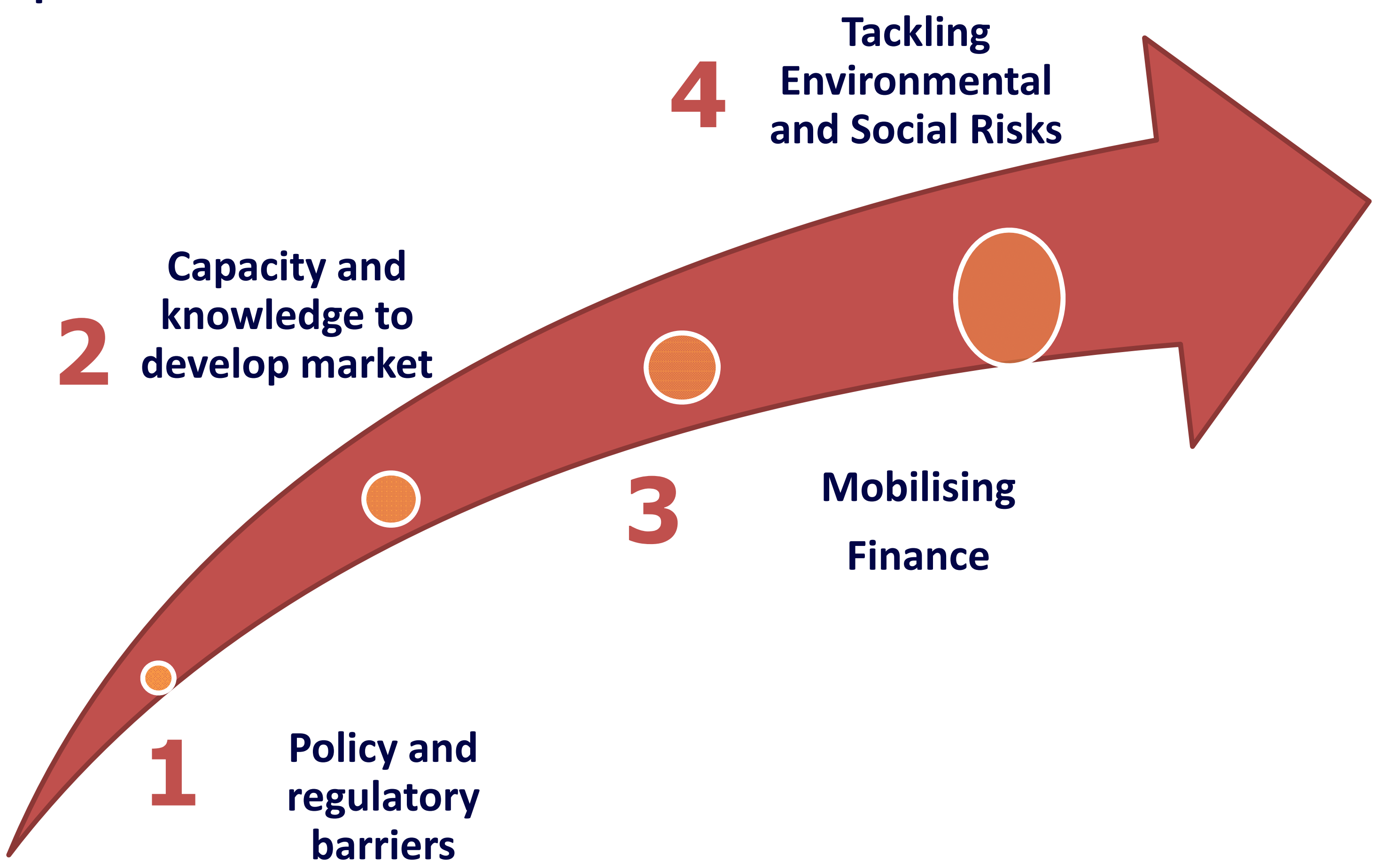
Case study: Mexico-IDB-IFC Renewable Energy CTF Program

The Renewable Energy Program – to address key barriers for renewable energy development in the Mexican market



Developing a Robust Policy and Regulatory Framework

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Program Components:

- Bank support for the Government of Mexico's national climate change strategy – policy based loans to develop the **institutional framework**

- Grants for **studies to strengthen policy and regulatory agencies and to develop methodologies to define pricing incentives**

- Grant to undertake a comprehensive assessment of opportunities for attracting **carbon finance** for renewable energy and energy efficiency

Develop policy, regulations and price incentives to support scaled up investment

Strengthening Capacity and Knowledge

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Program Components:

- **Developing the market:** wind energy projects in Oaxaca provide opportunity to strengthen capacity and build relevant expertise:
  - Market knowledge regarding wind energy financing – role of private developers and investors
  - Technical aspects of specific renewable technologies, such as wind turbines – including $5m GEF grant for technology development
  - Study on property rights, leasing and land access for local and indigenous communities
  - Studies on economic benefits of developing a local wind industry

- **Robust knowledge management** for capturing and disseminating relevant knowledge – nationally, regionally and internationally

Building technical, institutional capacity for scaled-up investments over time

Mobilising Private Finance and Catalysing Domestic Public Financial Institutions

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Program Components:

- **Mobilising direct private sector finance:**
  - CTF funds used to address risk and cost barriers for early market entrants
  - Goal: to achieve a track record of successful projects through a limited number of initial investments
  - Up to $80 million of CTF used to catalyze up to $160 million of MDB financing and $850 million other financing (sponsors, private investors and other bilateral banks)

- **Catalyzing financing through national public banks:**
  - $70 million of CTF resources used to leverage minimum of $70m domestic public finance from NAFIN and further $70m IDB loan
  - Provide direct loans and contingent credit lines to cover cash flow shortages (e.g. debt repayments)
  - grant finance to strengthen NAFIN's institutional capacity

Mobilising resources from public and private sector into a new sector

Managing Environmental and Social Risk

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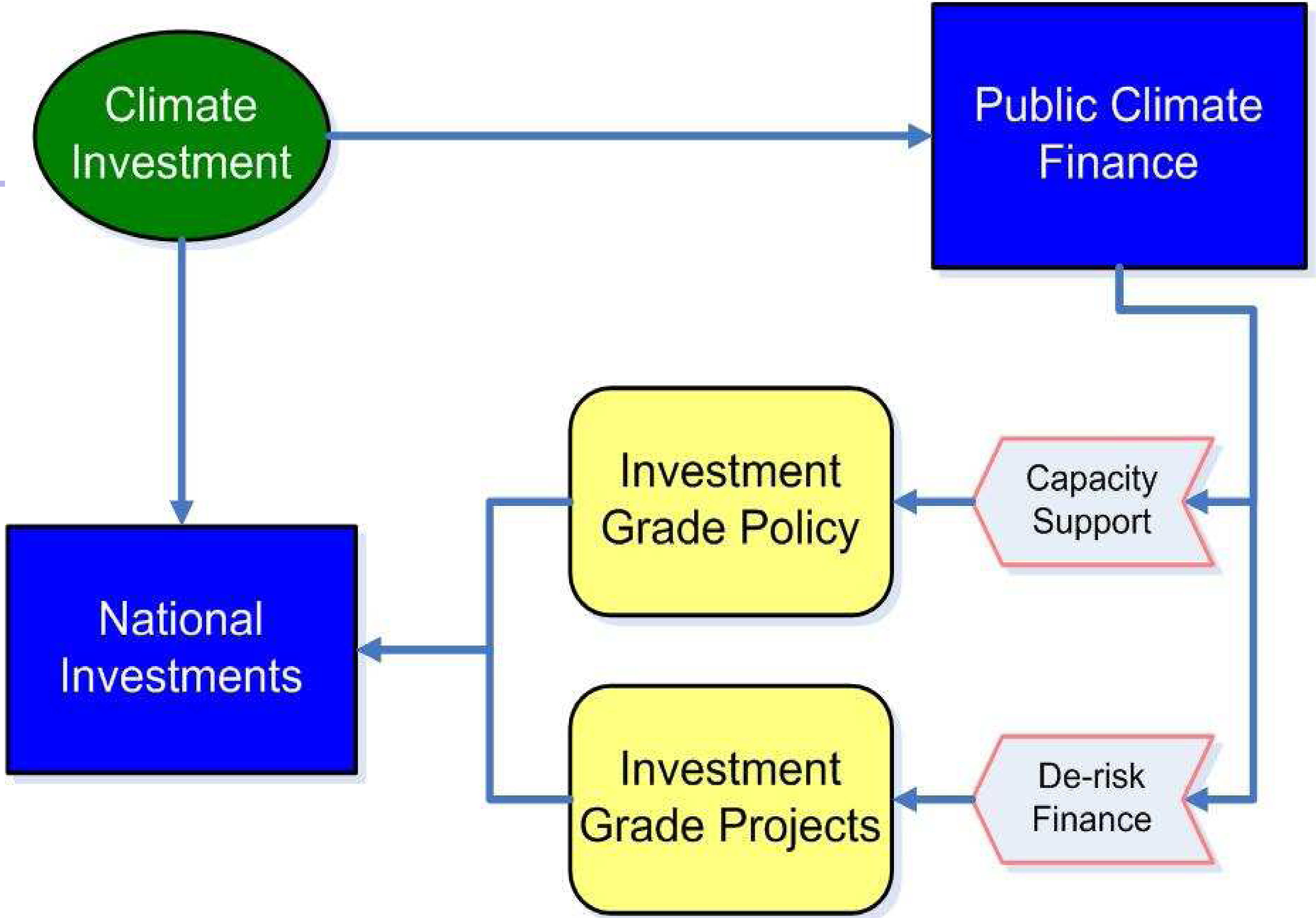
Program Components :

- **Environmental risk assessments** that benefit all sector players and reduce information barriers (e.g. impact on endemic and migratory bird and bat populations of existing and future wind farms)

- **Creation of a "foundation" for local communities** affected by wind farms (could be replicated for other technologies)
  - Contributions from all local wind farms, Government, MDBs and philanthropic organizations
  - Promotes community and social development
  - Method of sharing benefits
  - Reduces risk of local opposition to the development of the sector

Creating opportunity for scale-up over the medium and longer-term


Climate Investment
Public Climate Finance
Capacity Support
De-risk Finance
Investment Grade Policy
Investment Grade Projects
National Investments

Brazil's Amazon Fund: innovative governance features

- Decades of experience in creating incentives for reducing deforestation, sustainable forestry and sustainable forest management
- Governance involves wide stakeholder base, including local government, national ministries and civil society (IPs, traditional communities, NGOs, industry and scientists)
- Funded projects in line with national policy priorities and guidelines of the Sustainable Amazon Plan and the Action Plan for Prevention and Control of the Legal Amazon Deforestation
- States participating in the Amazon Fund Governance or applying for funds must develop a full strategy to fight deforestation
- NGOs and other public and private institutions can also apply for funding
- Delivery of pledged finance contingent on demonstrating credible emission reductions based on accepted baselines and subject to robust monitoring and certification

Strengthening Institutional Capacity for Engaging and Mobilising Private Sector

- Zambia: Inter-ministerial Secretariat on Climate Change:
  - Led by Ministry of Finance and engaging line ministries focus on mitigation and adaptation
  - Partnership between public and private sector for low carbon investment, open to adaptation measures in the future
- India's National Solar Mission combines:
  - Regulatory measures through FiTs based on reverse auctions
  - Innovative public-private finance instruments such as Partial Credit Guarantee Facility, FOREX hedging facility and Solar Park Financing Vehicle
- GEF, LDCF, SCCF and PPCR have all focused on reducing identifying vulnerabilities and strengthening adaptive capacity
  - Few emerging examples of how climate finance can share risks with the private sector for adaptation e.g. Caribbean Risk Insurance Facility and Piloting Index-based Agriculture Insurance Niger

Delivering Scaled-up Investment: case of offshore wind in the UK

- **Scaling up investment in offshore wind:** current 2 GW to be increased to 18 – 30GW by 2020
- Historically \$4 – 5bn/year utilities balance-sheet financing and project finance → to 2020 requires at least a fourfold increase to \$15 – 25 bn/year
- Exceeds balance-sheets when post financial crisis utilities are deleveraging and commercial banks required to maintain capital reserves
- Relative scarcity of capital compared to scale - need to accelerate participation of low cost capital from institutional investors
- Role for the UK's new Green Investment Bank – to facilitate refinancing of offshore wind assets post the construction and early operation phases
- Sharing risks – construction and early operational risks require expertise of utilities and commercial banks then flip into debt/bond markets to allow recycling of capital

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International Policy and Instruments

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- Plethora of international and regional funds, mechanisms and facilities – providing public (climate) finance for mitigation and adaptation
- UNFCCC GEF, special funds and the Adaptation Fund
- Climate Investment Funds – concessional finance
- Multilateral and bilateral development banks ordinary capital
- Growing number regional/sector public-private climate finance vehicles
- Green Climate Fund under design, considering private sector facility and calling for “readiness” for receiving climate finance

Top-down measures provide support for countries to create conducive enabling environments and capital for sharing risks to mobilise the private sector

National Policy and Instruments

- Governments leadership in creating conducive enabling environments, LEDS and NAPs:
  - active approach towards understanding how different sources of finance can best meet national and/or sectoral objectives
  - identify and prioritise capacity needs – both institutional and for market development e.g. make data available or for aggregators of small projects for EE
  - design and implement policy instruments that share risks with private sector e.g. FiTs
  - provide seed capital or concessional finance to provide targeted financial interventions, directly or through national/state development banks or dedicated green funds
  - market enabling activities to increase project deal flow e.g. data and tools for project developers, fund managers, access to feasibility studies etc.
  - maximise use of existing international financial mechanisms which support private sector e.g. foreign exchange hedging or political risk guarantees

Create effective supply and demand for climate finance: top-down incentives and effective use of climate finance

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International

e.g. GCF, C Market, CIF, GEF – with programming guidelines, investment criteria, operational procedures to catalyse transformation

???

National

Countries define transformation and develop LEDS, NAPS, REDD+ based on national/sectoral priorities, stakeholder objectives, local circumstances and needs

Potential New Policy and Instruments – inside or outside of the Convention?

- **National Financing Strategies or Platforms:** engage public and private stakeholders on financing options for implementation of LEDS and NAPS (including integration within the national budget and sector plans)

- **Capacity Development Facility:** dedicated to strengthening institutional capacity, including for national public banks, Green Funds or Green Investment Bank vehicles (readiness?)

- **Innovative Finance Fund:** reward innovative public-private financing approaches to low carbon and resilient

- **Project Pipeline Development Facilities**: bankable mitigation and adaptation projects that can have a transformational impact

Bridging top-down supply with effective demand for climate finance

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International

- **National Financing Strategies and Platforms that identify opportunities for use of climate finance to effectively mobilise public and private sources of finance**

- **Build capacity of National Financial Institutions – State/Development Banks and hosts of Green Funds – that blend, direct and track domestic and international sources of finance**

- **Create deal flow: facilities to develop pipeline of financeable projects**

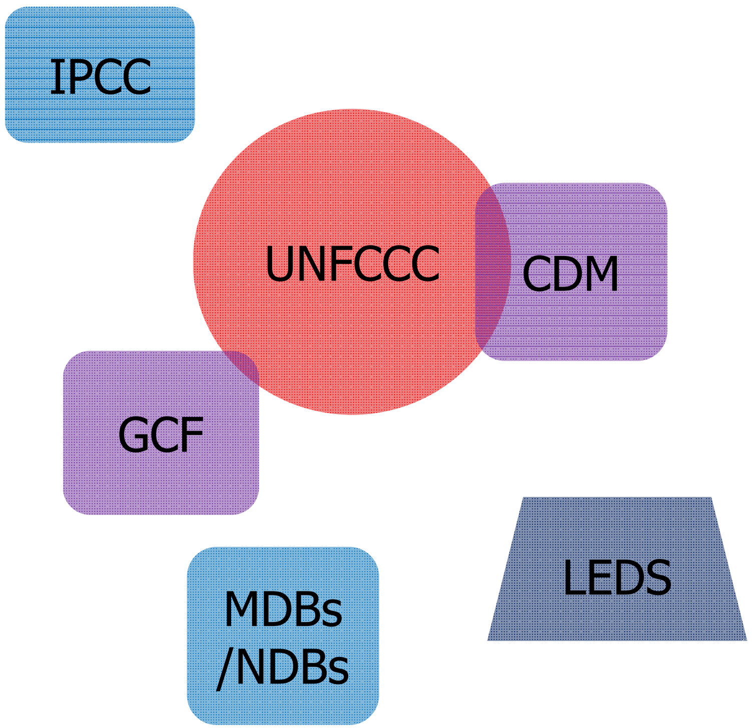
National

Role of Convention in Providing an Effective International Framework

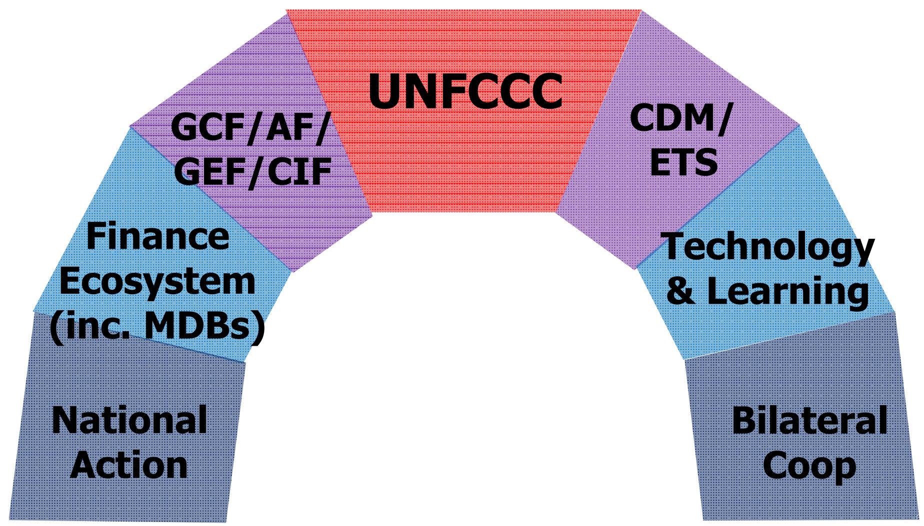
- Green Climate Fund and its private sector facility
- Adaptation Fund
- Existing or new KP mechanisms for Carbon Finance
- Global Environment Facility
- Adaptation Committee
- Technology Executive Committee and Climate Technology Centers
- NAMA Registry
- Standing Committee
- Forum for Capacity-building
- Measurement, Reporting and Verification

The Climate Regime must evolve

Current Regime



Future Regime?



Past regime shaped by theory and negotiation.
Future regime must be built on practical experience

Role of the Convention

- **Incentivise and reward national leadership:** "climate financing compact" recognising primary role of national policies to align climate financed activities with national priorities
- **Grant resources for capacity-building**: important that national policies and measures can access and attract climate finance
- **Concessional finance for targeted risk-sharing instruments:** allocate risks (and rewards) to those best placed for those
- **Measuring, reporting and verification:** transparency and accountability of finance and actions
- **Learning**: how to strengthen institutional learning on policy, regulatory and financial models

Policies and Instruments Outside the Convention

- Accelerate investment by pension fund, insurers, sovereign funds:
  - Grow international green bond market (now only $150bn)
  - Reform financial regulation (Solvency II; Basel III) discriminating against infrastructure investment (now 1%)
  - Tax incentives for pension funds to stimulate climate related investments
  - Transparency and accountability of long-term investments by institutional investors
  - Standards and data based on common definitions
  - Regulation to manage systemic financial risks of high carbon investment and disclose company/fund carbon liabilities

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Learning Lessons from Experience

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- Need to learn much more from existing use of climate finance
- Climate finance not same as development finance – involves new and complex issues, linked to major policy and market reform
- Country leadership in designing strategies and plans that actively identify financing options – grounded through strong involvement of local stakeholders
- Understand what policies and instruments work best in different contexts, identify where there may be particular challenges with implementation
- Realising benefits of green growth will require Government efforts to grow local markets and support for technology and innovation
- Integrated approach towards mitigation and adaptation - institutional constraints?
- Understanding the role of the private sector in adaptation?
- Simplistic M&E systems (e.g. tons of carbon) will incentivise wrong project portfolio and culture in delivery organisations

Summary

- Ultimately it will be necessary to redirect all public flows of finance to lever all forms of private capital into low carbon and resilient investment options
- Keep focus on policy and regulation as key to an effective investment framework
- Sharing risks through combining public policy with targeted use of public finance – designed to reduce overall costs of investment, emerging cases of role of climate finance within this
- Support required Governments to strengthen institutional capacity – coordination and integration of differing policy objectives with existing and potential sources of finance
- Catalytic role of the Green Climate Fund – must focus on both institutional strengthening i.e. non-reimbursable grants and investments i.e. concessional finance
- Multilateral, bilateral and national development banks can be important source of policy expertise as well as channels for blending public, private and climate finance
- MRV system to increase transparency of actions as well as financial flows

Thank You

Detailed materials of E3G finance work can be found at www.e3g.org

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