Pathways for private climate finance

UNFCCC, Bonn, August 2013

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Issuer of report: HSBC Bank plc

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Pathways for private climate finance

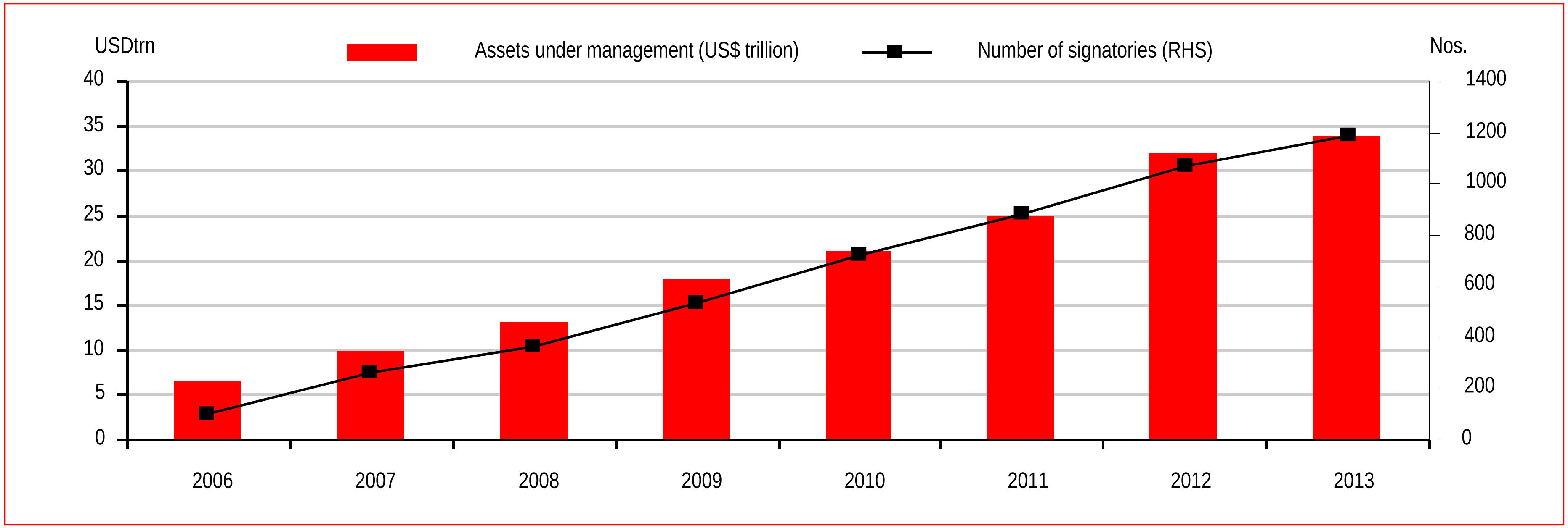
- Growing number of institutions – banks, insurers, investors – are committed to financing climate action
- There is no absolute shortage of capital, but the risk:reward ratio is not yet strategically compelling
- Diagnosis of <u>what is preventing</u> long-term flows of private climate finance increasingly shared
  - Standard barriers to cross-border financial flows
  - The short-term focus of capital markets
  - The credibility of low-carbon *vs* high-carbon policies (eg carbon pricing, fossil fuel subsidies)
  - Relative novelty of financing some low-carbon, climate-resilient options (eg energy efficiency)
  - Unintended consequences of financial regulations and incentives
- Growing convergence in the prognosis of <u>what is needed</u>
  - Implement 'investment grade' climate policies in the real economy (energy, transport, agriculture, infrastructure…)
  - Integrate the climate imperative into frameworks for the financial economy: banking, investment, markets
  - Utilise a menu of public finance mechanisms to shift the risk:reward ratio
  - Mainstream climate into familiar channels for deploying private finance at scale: bonds
  - What gets measured gets mobilised: definitions and disclosure are essential
- Now need to define the <u>pathways to success</u> for scaling up flows of private climate finance

Making private climate finance routine, reliable and rewarding

Growing commitment to low-carbon, responsible finance

UNEP FI represents over 200 banks (66%), insurers (17%) and investors (17%) and is a UN partner of the Principles for Responsible Investment, and host of the Principles for Sustainable Insurance

Principles for Responsible Investment – Assets under management and number of signatories



Source: UNPRI

The new Global Investor Coalition (GIC) represents USD20trn of investment assets specifically committed to climate solutions, bringing together four regional associations

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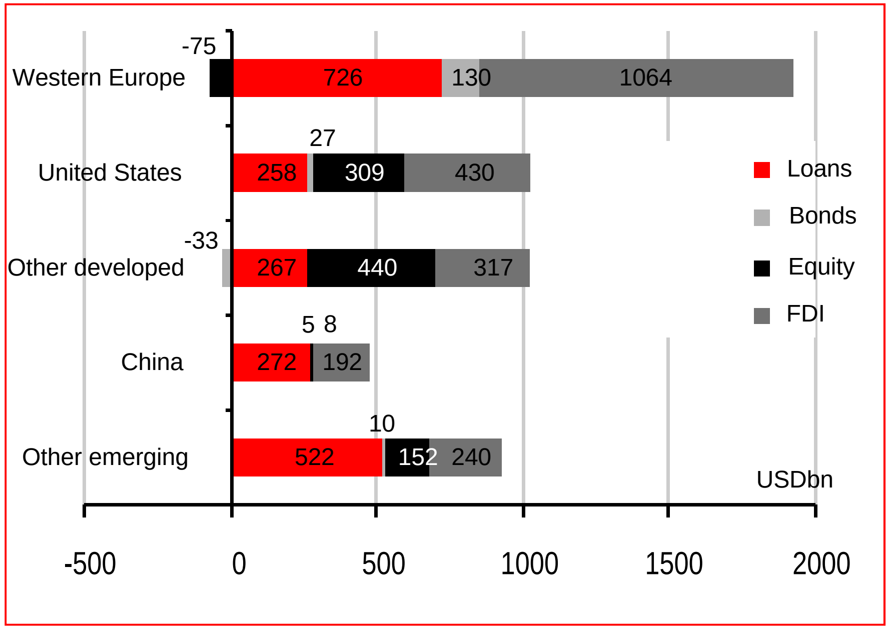
Aligning global capital stocks and flows with climate action

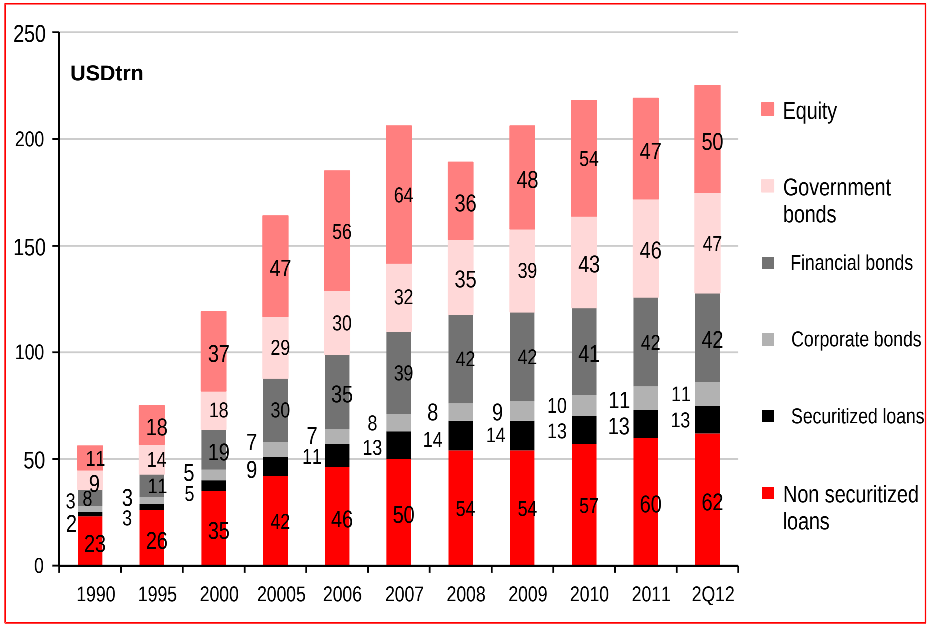
- Bonds make up USD100trn of the global capital stock, but foreign direct investment dominates flows
- Foreign Direct Investment, Equity, Bonds have longest maturity and lowest volatility

Flows: capital into emerging markets in 2011 (USD1.4trn)



Note: Loans include primary loans, currency and deposits, as well as a small share of trade credit,
Source: McKinsey Global Institute, Financial globalization: Retreat or reset?, 2013

Stocks: Value of global capital markets 2000-2Q2012



Note: values at constant 2011 exchange,
Source: McKinsey Global Institute, Financial globalization: Retreat or reset?, 2013

How to shape climate finance to build on current practice and expand areas of potential?

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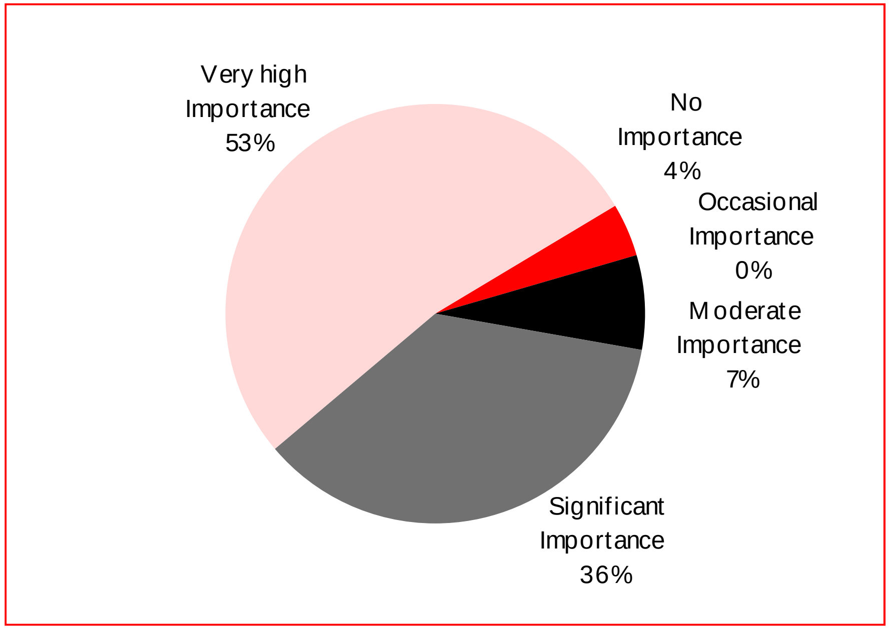
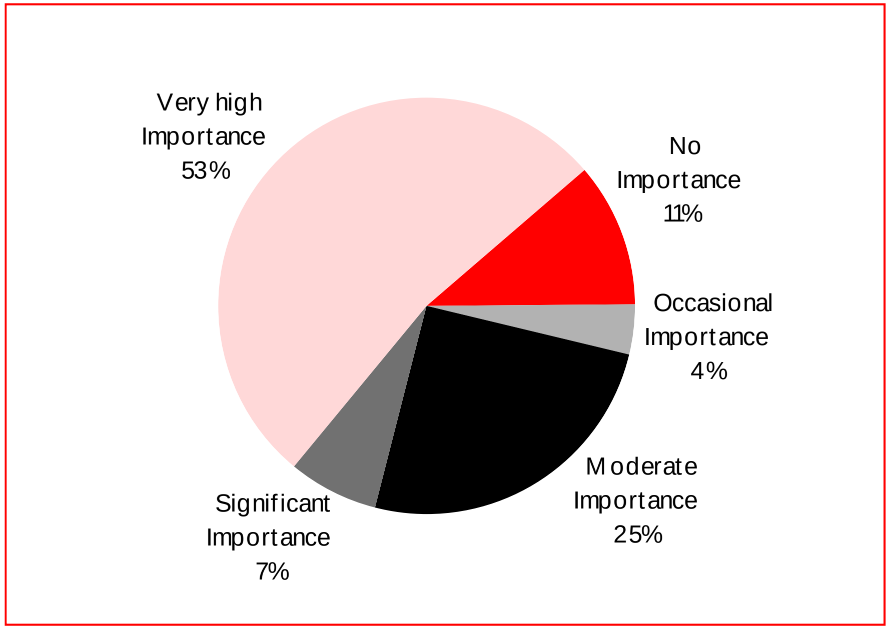
What is preventing climate finance? Views of finance practitioners: 1

Importance of key factors as barriers to renewable energy deployment in developing countries

Political, economic and legal stability



Reliability of low-carbon policy & support



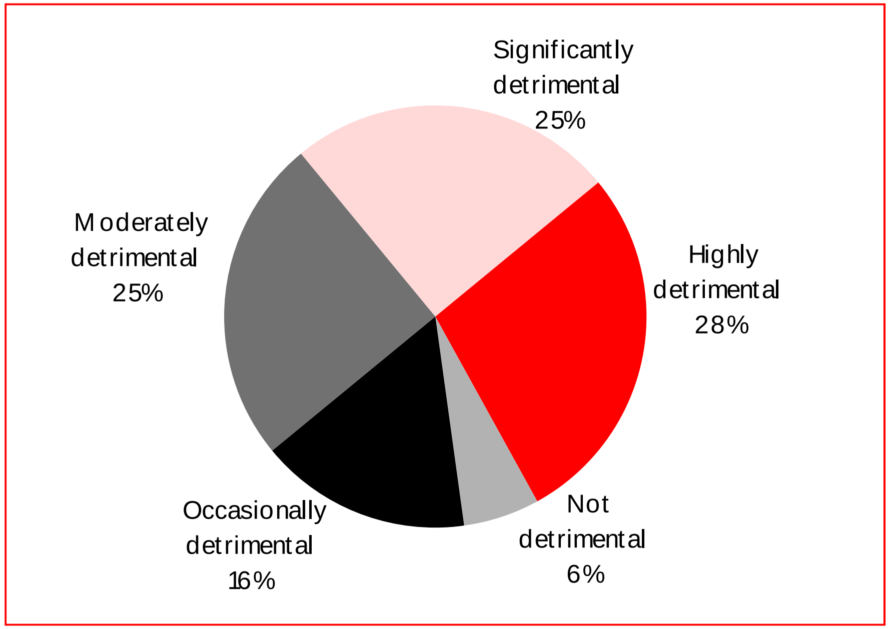
Source: Financing renewable energy in developing countries, UNEP 2012

Both conventional <u>and</u> climate specific factors are crucial

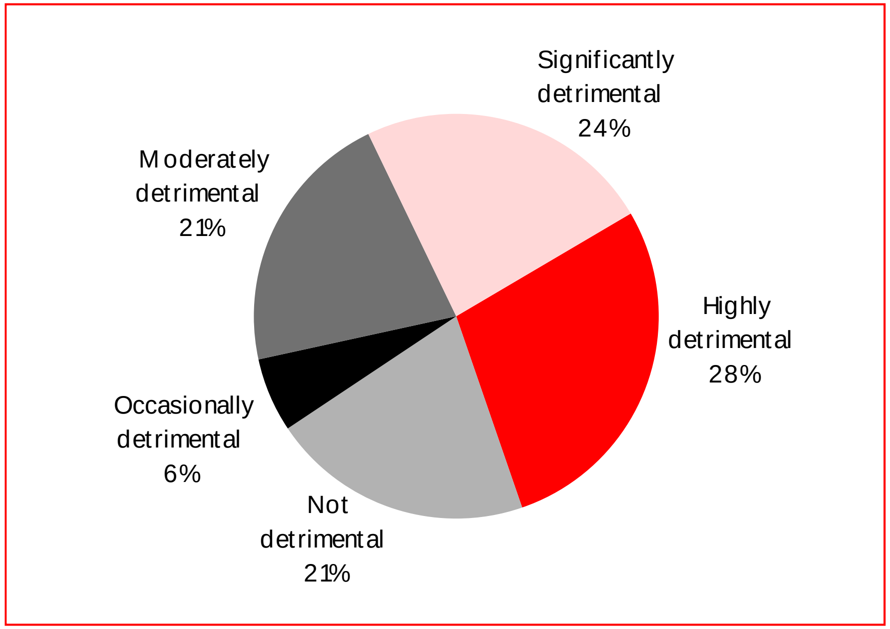
What is preventing climate finance? Views of practitioners: 2

Importance of key factors as barriers to renewable energy deployment in developing countries

Transaction costs



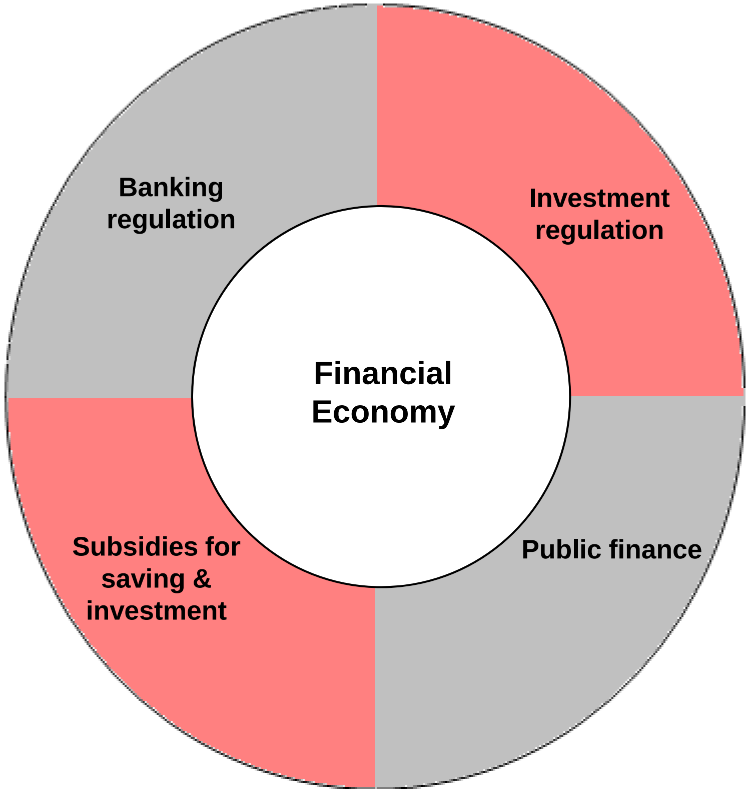
Fossil fuel subsidies

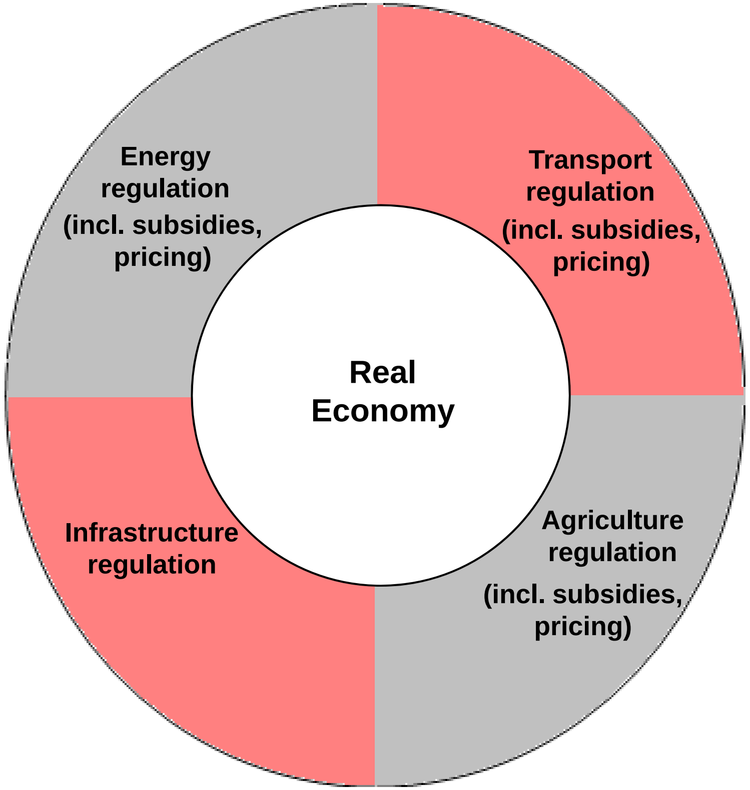


Source: Financing renewable energy in developing countries, UNEP 2012

Both conventional <u>and</u> climate specific factors are crucial

Integrating the climate imperative into financial and sector policies





Source: HSBC

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EU: Low-carbon investment and financial regulation

Need to integrate climate factors into financial policy to avoid unintended consequences

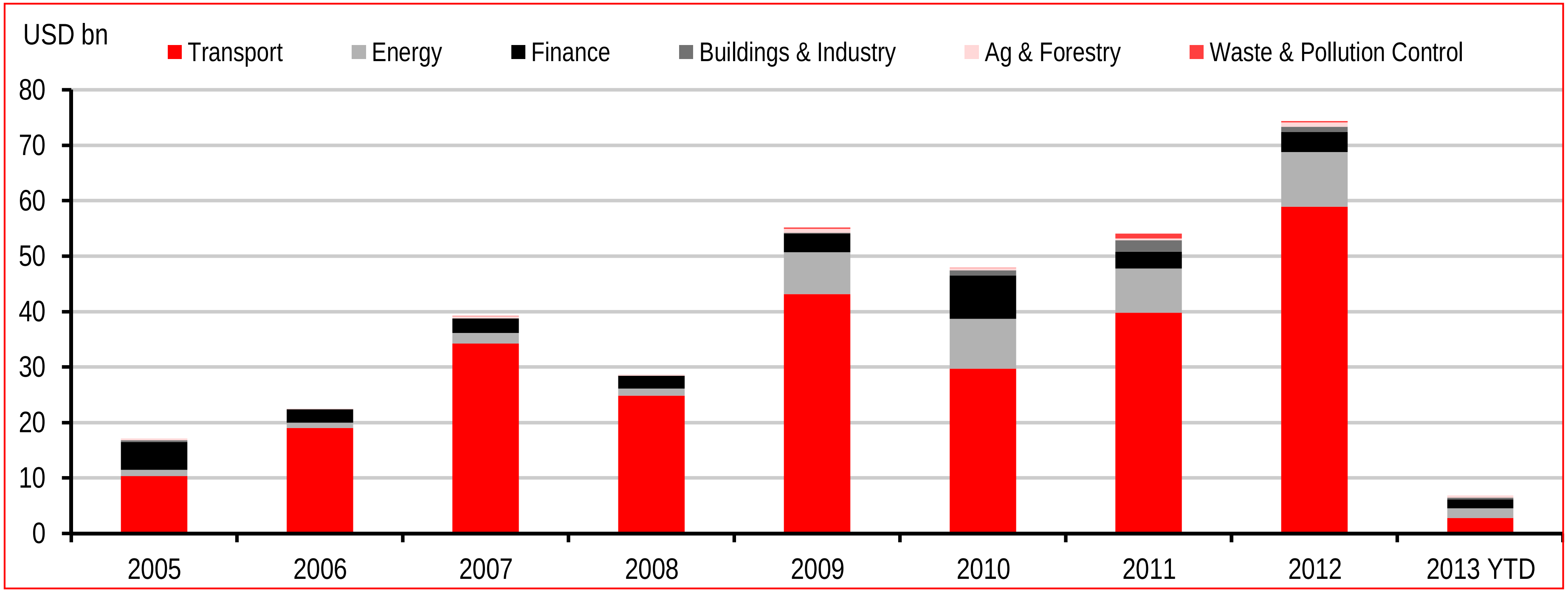
- Post-crisis financial regulation will cut the capacity of banks to provide long-term credit (Basel III): this is important as low-carbon investments tend to be more capital intensive
- Solvency II regulations for insurers ‘incoherent’ with policy objectives of mobilising investors for long-term, low-carbon capital
- Potential countervailing measures:
  – Create a low-carbon guarantee scheme to reduce refinancing risk for developers
  – Create a secondary bond market for low-carbon assets to accelerate recycling of long-term credit
  – Support direct equity investments by institutional investors (including addressing the Solvency II issue)

Source: IDDRI, EU Low-carbon investment and new financial sector regulation: what impacts, what policy response, April 2013

Bonds and climate: a USD346bn market; issuance growing at 25%

New issuance of climate-themed bonds amounted to USD74bn in 2012; transport remains dominant

Year of issuance of climate-themed bonds outstanding in 2013

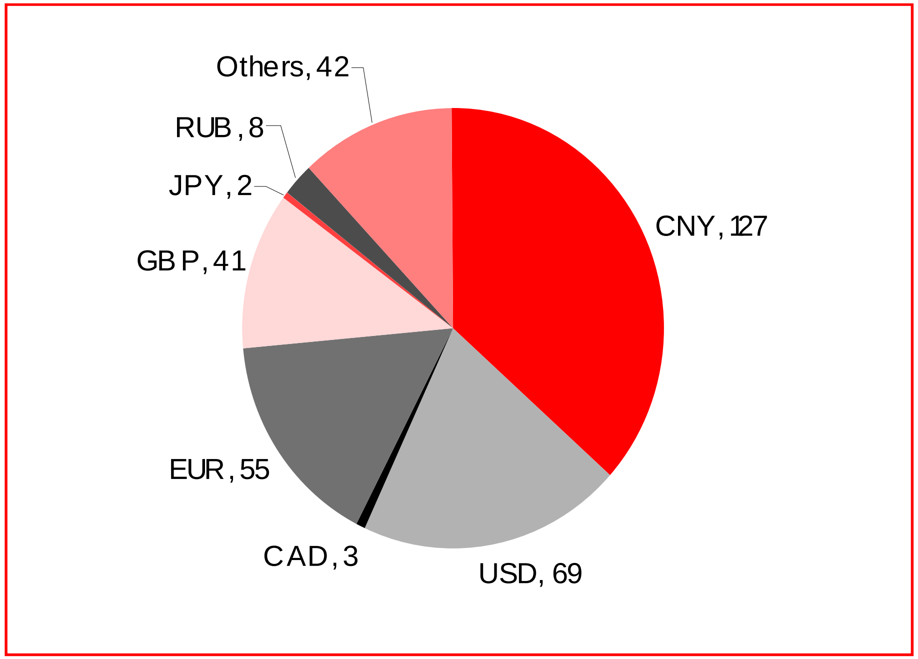


Source: Bloomberg, Climate Bonds Initiative, HSBC

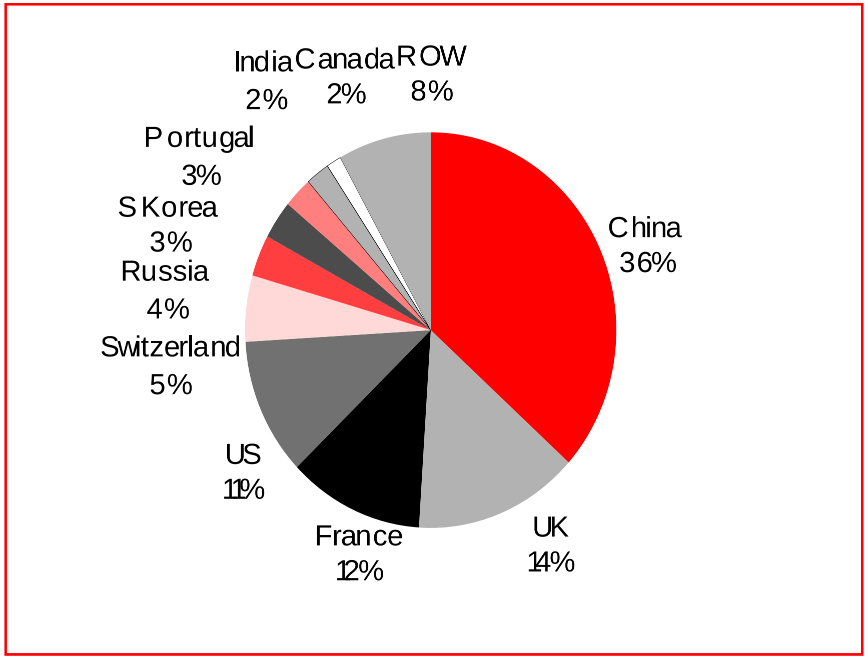
Bonds and climate change: not just the developed world

China has the largest stock of climate-themed bonds, linked to its rail network

Climate-themed bonds by currency in USDbn



Top 10 countries for climate-themed bonds



Source: Bloomberg, Climate Bonds Initiative, HSBC

Keys to future success? Standards, aggregation & public finance pump-priming

What gets measured gets mobilized: definitions and disclosure

- Lack of common definitions of climate finance is hampering financing decisions and flows
- "Climate"
  - Good data on clean energy does not exist for all themes: buildings, industry, transport; adaptation
  - Market standards underpin volume expansion: climate-themed bonds and equity
- "Finance"
  - A multiplicity of institutions in each transaction (eg bond/equities: borrower, issuer , owner & deployer)
  - Investors provide mostly indirect capital flows into listed equity for corporations and bonds – both key for Foreign Direct Investment. But modest direct capital flows to date
  - Banks provide direct credit, facilitate capital raising - & owned by investors…
  - Need to be able to aggregate at country and institution level
- To date, financial market disclosure has focused on climate risk
- Time to focus on climate finance - building on existing and emerging disclosure initiatives?
  - Carbon Disclosure Project
  - Asset Owners Disclosure Project
  - UNEPFI/GHG Protocol Standard for Financed Carbon

Making private climate finance routine, reliable and rewarding

- Shift the risk:reward ratio in core sector policies
- Integrate climate into financial policy frameworks
- Use a menu of public finance mechanisms to reduce risk/enhance returns
- Mainstream climate into practical and familiar funding channels: bonds
- What gets measured gets mobilised: definitions and disclosure are essential

Disclosure appendix

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