

Financing the Global Low Carbon Transition

Over the next 15 years, approximately \$93 trillion will be needed for investment in low carbon infrastructure across the world¹. The finance sector has already taken big steps forward to bridge the gap between this aspiration and the current reality, but to mainstream and build on this progress governments need to set out a clear vision of their infrastructure needs and provide the right national, regional and international policy frameworks. Success would mean mobilising more private capital behind public goals, delivering economic growth and putting us on the path to a net-zero emissions global economy. This paper makes a series of recommendations to achieve this goal.

This paper was written by the Green Growth Platform's Finance Advisory Council (ACIII). The Council draws on leaders from the European finance sector to advise on mobilising capital behind the low carbon transition. The recommendations herewith have been developed in consultation with ACIII members, which include senior representatives from Deutsche Bank, E3G, the European Investment Bank, HSBC, Natixis, and the Institutional Investors Group on Climate Change (IIGCC).

The Green Growth Platform² brings together European Ministers from BE, DE, DK, EE, FIN, FR, IRL, IT, LUX, NL, NO, PT, SE, SI, SP, UK with businesses and parliamentarians to catalyse and champion a European policy and economic framework that supports the delivery of an orderly low carbon transition. The Green Growth Platform and its four Advisory Councils were established and are managed by the Cambridge Institute for Sustainability Leadership³ and its Corporate Leaders Group⁴.

A global framework that provides certainty & catalyses low carbon investment

The Global Investor Statement⁵ demonstrates the overwhelming support from the finance sector for an ambitious Global agreement in Paris at the end of this year. We echo this support and underline the importance of the Intended Determined National Contributions (INDCs), which will eventually establish national ambition to reduce emissions. These plans will set the long-term direction for each country's economy and will therefore bear great influence on investors. Furthermore, the Sustainable Development Goals (SDGs) will also be a vital component of the international policy landscape and meeting them depends heavily on the finance sector. ***The synergies between the SDGs and delivering the low carbon transition should be recognised and global efforts behind them aligned.***

The Green Climate Fund (GCF) was set up by the UNFCCC to direct funding from developed countries to mitigation and adaption in the developing world. It has the potential to become a major force in scaling up private capital for decarbonisation in the developing world, driving economic growth and the low carbon transition. We welcome the innovative approach of the GCF in allowing private sector accreditation to the Fund and the value of accrediting a diverse range of private sector entities. However, the accreditation process should be streamlined where possible to accelerate the participation of private sector entities.

Essentials of a global investment strategy for low carbon energy

The global outlook for low carbon energy looks better than ever: there was a resurgence in global clean energy investments in 2014, and renewable energy costs are continuing to fall rapidly. Yet Governments need to be proactive and continue to develop and improve the policy environment if this growth is to be sustained⁶. In Europe, for example, banks have scaled back their lending to meet regulatory capital requirements imposed after the financial crisis. Similarly, utility balance sheets across the world are either shrinking or simply not big enough to take on the large upfront investment needed to support clean energy investment. Accessing new sources of scaled finance to support clean energy investment and bridge the financing gap is therefore a clear imperative.

The focus should therefore be on how to ensure access to adequate and timely cost-effective finance for energy supply, infrastructure and efficiency investment globally. This will require drawing on under-used pools of institutional investor assets. ***For these initiatives to succeed, however, they need to be carefully designed to leverage public and private finance around the highest value investment for national objectives – particularly around energy efficiency, electricity networks and renewable heat and power.*** Over-investment in fossil fuel infrastructure and in coal-fired generation would displace higher-value investment and work counter to a low carbon investment agenda as a whole.

A ten-point action plan to mobilise private capital

The importance of private capital in financing the transition to a low carbon economy is widely acknowledged, and considerable progress has been made by leaders in the finance sector. Some pension funds, for example, are proactively increasing their allocation to low carbon assets, and investors are increasingly financing renewable energy projects⁷. Yet most private capital remains invested in the conventional economy. The following ten-point action plan aims to increase the supply of capital for low carbon infrastructure as well as demand; both approaches are essential.

1 Aim to mobilise the funds managed by institutional investors

Approximately \$71 trillion of assets are managed by institutional investors in OECD countries⁸. This is invested across a wide range of asset classes, and could, with the appropriate policy framework and incentives in place, be mobilised much more effectively behind low carbon energy and economic goals.

2 Enable investors to discriminate between high carbon and low carbon assets

Investors need to understand their exposure to carbon risks and full life-cycle carbon impacts. Government requirements to disclose this information would help investors understand these risks and respond accordingly.

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Financial regulators should recognise and respond to the risks to financial stability posed by the economy's structural bias towards high carbon infrastructure

This can be achieved by adapting established stress-testing regimes used by regulators (e.g. within Basel III and Solvency II) to develop better understanding of such exposures. This would ultimately enhance regulators' ability to define regulatory capital requirements.

4

Require state-owned finance institutions to demonstrate their investment strategies are consistent with national INDC and climate pledges

Equally, government-enabled mechanisms to attract alternative flows of private finance into infrastructure investment, such as the European Long Term Investment Funds (ELTIF), should be required to support the transition to a low carbon economy and prioritise low carbon assets.

5

Provide savers with choice and incentives to invest in a low carbon future

Current incentives, such as tax breaks, are not linked to low carbon policy objectives. Specifically, governments could:

- Require financial intermediaries to provide green alternatives to mainstream retail finance products.
- Incentivise their uptake through improved return characteristics or other incentives that recognise the public utility of these products.
- Facilitate the smooth implementation of regulations that affect investment products and ensure that clean energy investment funds are able to expand and grow.

6

Provide clarity on the forward infrastructure investment pipeline and a long-term and stable policy framework that makes investment in low carbon infrastructure attractive

Capital will be deployed by investors when it is economically justified, and in the case of clean energy this is heavily influenced by the policy environment. Much private capital continues to be invested in damaging, high carbon industries rather than serving the public good. Policy should therefore concentrate on making low carbon industries and projects relatively more attractive to investors than the high carbon alternatives. To unlock capital, governments need to agree long term, stable, policy conditions that do not compromise the economics of the projects during their lifetime. This entails a series of structural reforms:

- Phasing out fossil fuel subsidies and all subsidies for price competitive mature technologies to provide a level playing field and ensure a well-functioning energy market with robust supply and demand side management.
- If a level playing field does not exist between conventional and non-conventional energy sources, put in place properly designed subsidy schemes, such as Feed In Tariffs, and prevent retroactive changes to such incentives.
- A carbon price sufficient to tilt investment towards low carbon industries and projects.

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Work with the finance industry to improve and, where required, help standardise new mechanisms to facilitate low carbon investment

- Financial institutions should encourage and support the aggregation of infrastructure assets. This will help to attract more potential investors and diversify risk across projects with different risk profiles, and is particularly important for the renewable energy sector, where projects are often numerous but small.
- The green bond market is growing rapidly. Working with the market to help develop transparent standards could facilitate this growth.

8

Introduce mechanisms to share risk between the public and private sector

Simple to access mechanisms, such as public guarantees and 'first loss' finance in areas subject to policy risk, are important transition measures that will speed up capital flows.

9

Use procurement and planning policies to support investment in low carbon infrastructure and innovation

The public sector is the largest buyer in the economy and can be used to drive low carbon deployment and innovation. Beyond the public estate itself, the public sector can drive demand-side innovations such as large-scale retrofit of buildings, where aggregation is key and planning challenges can bring progress to a halt. Such interventions would have a strong supporting effect on employment and SME growth.

10

Reassure the private sector that governments intend to work systematically to build a green economy

Current policy signals are not necessarily aligned with this goal, including the presence of perverse incentives for carbon intensive activity and financial regulation that does not encourage or, in the worst case, inhibits, long-term, low carbon investment.

Sources:

¹ Global Commission on the Economy and Climate (2014)

² Green Growth Platform - <http://www.cisl.cam.ac.uk/business-action/low-carbon-transformation/green-growth-platform>

³ Cambridge Institute for Sustainability Leadership - <http://www.cisl.cam.ac.uk>

⁴ Corporate Leaders Group - <http://www.cisl.cam.ac.uk/business-action/low-carbon-transformation/clg>

⁵ Global Investor Statement - <http://bit.ly/1FuDFIP>

⁶ <http://about.bnef.com/blog/liebreich-10-predictions-clean-energy-2015/>

⁷ IIGCC (2014) Financial institutions taking action on climate change

⁸ Climate Policy Initiative (2013) The Challenge of Institutional Investment in Renewable Energy

Disclaimer:

The consultation process undertaken by the Green Growth Platform Advisory Council on Finance does not constitute full endorsement of this paper from the organisations represented and only reflects the views of those representatives consulted.