Reducing the risk of investing in climate finance

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CPI, Venice, October 2010
A financier perspective on low-carbon finance

• The fundamental challenge for low-carbon finance is one of capital reallocation from highly-carbon intensive assets to low/no carbon-intensive assets at scale and speed

• The private sector will need to deliver the majority of finance to be deployed
  – Venture capital, private equity, public markets, and asset financing (including carbon markets) all have roles.
  – Each of these investors have different risk/reward expectations

• Policy and investment frameworks need to leverage smart and targeted public sector interventions to lower the risk of low-carbon investments and to lower the cost-of-capital of finance

• Existing market mechanisms such as CDM have succeeded in leveraging private capital, sometimes up to 10:1, but are now running into barriers:
  – Insufficient demand for emission reductions
  – New climate change policy for post-2012 is stalling
  – CDM reform is required to allow future scale-up
Carbon markets are an excellent option for reducing risks...

- The emergence of a carbon spot, futures, and options market has allowed participants to hedge their carbon exposure and to allow financial intermediaries to offer risk management services
  - Case Study: EUA collateral lending, Repo transactions

- CO2 pricing enables financial institutions to ensure that investors price carbon risks into other assets classes
  - Case Study: Rainforest Bonds that offer investors/communities floor price plus upside sharing

- Carbon markets have encouraged an “MRV culture” to flourish via the supporting infrastructure and human capital of legal contracts, exchanges, verification expertise

- The strains on sovereign public debt highlight more than ever the importance in designing public policy instruments that must succeed in leveraging, not crowding out, private sector investment flows
...but, in absence of political will, cannot deliver the required scale up

- Creation of demand for emissions reductions, through policies or other incentives, is the strongest tool to spur private investment
  - (Removal of government subsidies for high-carbon is also very useful)

- Third-parties offering a “carbon price put option” would serve a positive de-risking role
  - Buyer of last resort could be multilateral or national government
  - Case Study: Eliasch proposal for REDD+

- This could also be done in the form of a government issued index-linked bond
  - Case Study: Z/yen proposal

- Government-funded Green Investment Banks could play a key role
  - Seed funding provided by emission auction revenues, sales of green bonds, Red Cross model in US