Risk Instruments for Green Investments

IRENA-CPI Side Event, WFES
“Risk Coverage for Renewable Energy Investments”
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Perceived Risks for Green Investments

**POLITICAL, POLICY, SOCIAL RISKS**

**Sources:**
- Actions of governments and citizens

**Enhanced by:**
- Reliance on public financial and institutional support
- Investment horizon longer than policy cycle
- Environmental impact of some technologies creating social resistance

**TECHNICAL, PHYSICAL RISKS**

**Sources:**
- Technology characteristics
- Environment/sites impacts

**Enhanced by:**
- Not yet proven green technologies
- Lack of accurate technology performance data
- Uncertainty over measurements of the natural resources availability

**MARKET, COMMERCIAL RISKS**

**Sources:**
- Valuation of input and output
- Cost and availability of financial resources

**Enhanced by:**
- High upfront costs
- Long investment horizon and payback periods
- Financiers’ unfamiliarity with green investments
- Complexity of infrastructure investments

**OUTCOME RISKS**

**Sources:**
- Commitment of limited public resources
- Uncertainty of delivering public interest goals/objectives

**Enhanced by:**
- Amount of public support required
- Current budget constraints

Most risks are common to all infrastructure investments, but unique features of green investments enhance the perception of relatively common-place risks.
Demand and supply of risk coverage: identifying the gaps – Developed countries

**KEY:**
- **High Demand intensity**
- **Low Demand intensity**

**Types of risk mitigation instruments:**
1. Contracts
2. Credit Enhancement
3. Insurance
4. Revenue Support Policy
5. Direct Investment
6. Political/Institutional Support

...and numbers represent which type of risk mitigation instrument is used to cover that particular risk at that particular stage of a project’s life cycle.
In developed markets:
- Demand for coverage of **policy risk** is not yet met;
- Gaps in coverage of **physical risks** occur in prospective technologies;
- Project-by-project interventions have done little to mitigate investment **liquidity risks**.
Demand and supply of risk coverage: identifying the gaps – Developing countries

**Diagram Description**

- **Project Life Cycle**: Development → Construction → Financing → Operation → Decommissioning → Outcome

- **Political Policy and Social Risk**
  - Political: 1.6, 1.6, 6
  - Policy Change: 1.6, 1.6
  - Private Governance: 1.6
  - Reputation & Social: 1.6

- **Technical, Physical Risk**
  - Construction & O&M: 1.3, 3
  - Environment: 6
  - Reliability of Output: 1
  - Decaying: 6

- **Commercial, Market Risks**
  - Currency: 5
  - Output Price: 1.4, 1.4, 2.5
  - Envi Markets: 1.4
  - Access to Capital: 2
  - Liquidity: 2
  - Counterparty: 2

- **Outcome Risks**
  - Emission Reduction: 6, 6, 5
  - Co-impacts: 6, 6, 5
  - Public Budget Impact: 6, 6, 5

**Key**

- **Gaps in Risk Coverage**: High
- **Demand Intensity**: Low
- **Color Coding**: We use color to show the relative demand intensity from project stakeholders for risk coverage in different categories and at a particular stage in a project’s life cycle.

**Types of Risk Mitigation Instruments**

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...and numbers represent which type of risk mitigation instrument is used to cover that particular risk at that particular stage of a project’s life cycle.
In developing markets:
- **Political and policy risks** are critical; only the former is covered;
- **Financing risks** enhanced by weakness of domestic financial markets;
- **Concessional resources** highly active but have had little impact on the involvement of private resources or **liquidity** of investments.
**World Bank Group risks instruments**

- Most WBG instruments *explicitly* cover *counterparty/credit risk* and *political risk*.
- Other risks are *implicitly* covered mostly through *partial credit guarantees*.
- The WBG helps *indirect mitigation* of additional risks.

*NOTE:* Coverage offered is a different concept than effectiveness of risk mitigation.

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<th>RISKS</th>
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**Table Legend:**
- **Green**: Risk covered.
- **Yellow**: Risk not covered.

**World Bank Group Coverage:**
- **Direct**: Counterparty/credit risk and political risk.
- **Indirect**: Other risks through partial credit guarantees.

**Coverage offered is different than effectiveness of risk mitigation.**
World Bank Group risks instruments

- Most WBG instruments explicitly cover counterparty/credit risk and political risk.
- Other risks are implicitly covered mostly through partial credit guarantees.
- The WBG helps indirect mitigation of additional risks.

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| MIGA |                      |                     |                     |         |
| IFC  |                      |                     |                     |         |
| IDA  |                      |                     |                     |         |
| IBRD |                      |                     |                     |         |

**Legend:**
- WBG coverage: none | indirect | implicit | explicit

**CLIMATE POLICY INITIATIVE**

Risks in Renewable Energy Investments
The risk gap

Risk, whether real or perceived, is the single most important factor impeding investment in renewable energy projects.

- Gaps in risk coverage in developing and developed markets, particularly for policy risk and financing risks.
- A wide range of instruments (e.g., WBG) exist that theoretically cover most risk categories, but only a few types appear to have been used at a significant scale for climate related projects.
- New or improved risk mitigation instruments are needed to address financing and policy risks.

Development financing institutions and the public sector have significant opportunities to fill these gaps.
...helping nations spend their money wisely
Further Reading

- **The Landscape of Climate Finance 2013**

- **Studies on Risk Gaps and Risk Mitigation instruments**


- **Case studies on Climate Finance effectiveness**

- **Information about the San Giorgio Group**