Reducing the risk of investing in climate finance

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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

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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

- CO_2 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 <u>that must succeed in leveraging, not crowding out, private sector investment flows</u>

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…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

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