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PREFACE

By many accounts, Asia has done very well in the past three decades: its major economies have achieved unprecedented economic growth that has underwritten progress in poverty alleviation, job creation, and trade. And the story may be just beginning. Asia accounts for close to 50 per cent of recent global growth, and by 2050 may comprise well over 50 per cent of global GDP.

These trends are both driven by, and fuelling, the rise of Asia’s middle class as a key force in global consumption. By mid-century, Asia will house over 60 per cent of the global middle class.

Asia’s increasing wealth and prosperity have not come without costs. Socially, significant poverty still exists, with over 800 million people living below the poverty line of US$1.25 per day, over 360 million still lack access to safe water, and almost a billion lack access to electricity. As the world writes the next chapter of the Millennium Development Goals (which expire in 2015), Asia will, for sure, be both a driver of change as well as a centre of need.

Environmentally, Asia’s faster growth is fuelling an unsustainable consumption of natural resources, while increasing its carbon emissions. Parts of Asia are already suffering from water stress. The region is already responsible for 45 per cent of the world’s emissions, and without decisive action, these emissions will triple by 2050, triggering dangerous climate change risks.

Clearly, Asia needs to figure out how to balance prosperity and a growing middle class, with environmental and climate responsibility. The “responsibility” refers both to Asia’s responsibility as a member of the global community, but also the responsibility of Asia’s governments and business leaders towards their fellow citizens.

Simultaneously tackling poverty and climate change, which will likely impose greater costs on the poor, will be a huge challenge. But moving to a greener and more equal economy is an imperative that requires resources, innovation and determination. We know that there are many actions that we can take already to push the region towards a safer climate pathway. Low-carbon energy is an obvious first step, but this must be complemented by the right infrastructure, buildings, urban design and planning and changes in consumers buying habits and daily lives.

All of this will not come without a cost – estimated at 2 to 3 per cent of global GDP per year – from now until 2030. The majority of that amount will likely come from the private sector rather than the public purse. Few doubt whether the financing exists: the world already devotes many times that amount to derivative financing and trading. The challenge is how – using policy and regulation, public incentives, and enlightened leadership – to channel private capital to more productive uses.

With that in mind, the Climate Policy Initiative, CLP Holdings, and the Fung Global Institute convened a roundtable to highlight the issues and possible solutions to Asia’s climate finance challenge. Why us? The Climate Policy Initiative brings significant global experience and expertise; CLP, currently one of Asia’s largest investors in clean and renewable energy, contributes an understanding of project and operational finance, with a focus on Asia; and the Fung Global Institute is committed to Asian sustainability and adds an understanding of the Asian financial industry which will be needed as a key channel.

We are pleased to present herein a few thoughts generated from the discussions, in the hope that it might help inspire new thinking and options for change. And we look forward to continuing our work to both finance and act on Asia’s climate challenge.

Climate Policy Initiative • CLP Holdings • Fung Global Institute
1. The United Nations Framework Convention on Climate Change was adopted in 1992 and signed by 166 Parties, but contained no binding emission reduction targets or system for financial transfers. Its protocol, the Kyoto Protocol, was agreed in 1997 and established mandatory emission reductions for developed countries. 195 state Parties are now signatories to the UNFCCC.
At the same time, the coalescence of high demand for energy infrastructure and growing investment flows means there is a real opportunity for Asia to lead the green investment revolution. More renewable energy infrastructure has been installed on the Asian continent than on any other. In spite of these emerging new players and financing practices, investors still favour brown or carbon intensive sources over renewables. And, if this pattern of growth continues, the climate problem will be difficult to resolve without deeply destructive interventions.

In order to understand the potential to shift investment patterns and to draw in new actors at scale, policymakers, project developers and financiers need to think specifically about how the finance landscape operates in Asia. How do Asia’s patterns and practices fit into the global landscape of climate finance? And what are the mechanisms that are proving successful in unlocking green investment?

Knowing how much and what type of financial support is available to advance low carbon infrastructure, between which countries and in what direction money is flowing (eg, south to south, north to south, etc.), whether it flows from public or private sources, and whether it covers incremental costs or is investment capital, will be useful in understanding the patterns that are likely to emerge in Asia, and the further steps needed to build a strong foundation for transformative green investment.

In 2011 and 2012, Climate Policy Initiative’s successive Landscape of Climate Finance studies began to map climate finance flows around the world, from sources to intermediaries responsible for distributing money, to the instruments used, and eventually, the final uses. Clear trends are emerging which have specific implications for the strategies adopted to meet rising energy demand in ways that are consistent with the global emissions constraint and profitable for investors.

2. The methodologies used in the landscape studies to calculate global finance flows were not intended to imply which (or which proportion) of these contributions to climate finance should count toward the goal to mobilise US$100 billion per year by 2020 to assist developing countries’ climate responses, or which (or which proportions) should not. Neither study infers that the goal (of mobilising US$100 billion per year by 2020 to assist developing countries’ climate responses) has already been achieved.
The role of intermediaries – public and private – is growing in importance. Increased international focus on the role of national and sub-regional development banks made it possible for The Landscape 2012 to gather more detailed information about climate finance flows and the role of intermediaries in managing and disbursing funds. Together with bilateral finance institutions, national and sub-regional development banks distributed the majority of intermediated climate finance. Moreover, 89 per cent of total climate finance from national and sub-regional development banks was invested in the country in which these institutions were located. Of critical importance when considering the future of Asia’s financial landscape, national development banks in emerging economies, such as China Development Bank (and in the Latin American region, the Brazilian Development Bank), channelled the largest share of intermediated funds in developing countries. They play an increasingly privileged position in local markets where their knowledge of national circumstances and ability to link international and national financing sources are unlocking capital at different stages of the green infrastructure lifecycle. More analysis is needed to understand how governments contribute to development finance institutions such as national development banks. The Landscape 2012 highlighted that government backing of development institutions in developing countries had underpinned their ability to raise funds, including in capital markets, and to provide a range of tailored instruments to unlock and deliver low-emission climate resilient investments.

Research shows that approximately 74 per cent of annual global climate finance comes from private sources, though this is still concentrated in developed countries.

WHO ARE THE MOST IMPORTANT ACTORS?

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HOW MUCH CLIMATE FINANCE IS THERE AND WHAT IS THE SPLIT BETWEEN PRIVATE AND PUBLIC SOURCES?

The Landscape of Climate Finance 2012 estimates that in 2011, annual global climate finance flows reached approximately US$343–385 billion, on average US$364 billion. Importantly, almost 74 per cent of this derived from private sources, including private sector intermediaries. Close to two thirds of overall private finance came from developed countries (US$143 billion). The sources of private finance were predominantly domestic in both developed and developing countries: domestic actors were the major contributors to asset finance in developed countries (around 84 per cent of the total) while in developing economies, domestic actors contributed 83 per cent (US$85 billion) of private finance. While households have emerged as significant investors in developed countries, the same trend is not yet evident in emerging economies.
WHAT ARE THE MOST IMPORTANT FINANCIAL INSTRUMENTS?

The Landscape 2012 revealed that most climate finance was paying for ownership interests with market rate loans and equity (US$293 billion - of which around US$262 billion was provided by the private sector), which were emerging as the dominant instruments. In developing countries, concessional loans provided by public intermediaries enabled investments and filled viability gaps that had prevented private investors from engaging in capital-intensive, riskier and in the short term, less profitable ventures.

Beyond grants, loans, equity and debt finance, a variety of risk management instruments are available to mitigate risks that private actors are not willing to bear, such as regulatory, credit, foreign exchange, or perceived technology risks. Improving the risk-return profile of low carbon projects for private investors in all economies is the key to unlocking private finance, and in all economies, public support instruments are playing a growing role.

WHAT ARE THE USES, AND WHO ARE THE RECIPIENTS OF CLIMATE FINANCE?

There is a continuing imbalance of climate finance between adaptation and mitigation. Importantly, this suggests that a significant proportion of mitigation efforts are part of the “business as usual” economic activities, particularly in emerging economies including Asia where rapid, government-backed industrialisation is well advanced, and the demand for new energy infrastructure strong. Of the global mitigation finance captured, renewable energy generation and energy efficiency projects accounted for 85 per cent and 4 per cent of the total respectively, reflecting the governments’ low carbon growth ambitions as well as growing commercial viability for a broad range of proven technologies.
WHAT DOES THIS MEAN FOR ASIA?

Green investments are happening on the margins, and Asia has many prime examples of best practices. However, to finance and accelerate the transition to cleaner, more sustainable forms of growth in Asia we need systemic shifts to create an infrastructure that satisfies growth demands whilst also being consistent with avoidance of damages on the economy. This would involve wholesale changes to policy, industrial strategy and technology. It requires us to push forward our thinking on how lessons from past and emerging financing practices can help get green finance to scale.

Provided the right policy frameworks are in place, emerging economies in Asia are comparatively well positioned to overcome the cost and risk barriers that continue to inhibit the scaling-up of green infrastructure investments. A case in point: in 2011, China, Brazil, and India were the largest recipients of global mitigation-directed climate finance flows, with US$121 billion, close to 33 per cent of the total. Given these countries’ significant and growing contributions to global greenhouse gas emission levels, these investments seem to have been made where they are needed most and where mitigation potential is the greatest. However, if growing investment in developing countries and emerging economies, and in Asia in particular, is to fill the gap between current climate finance flows and actual climate financing needs, barriers associated with clean investment, and particularly cost barriers, must not be understood by these countries as constraints on development.

The ability of national development banks (and similar development finance institutions) to build the low-carbon economy is striking. They can directly provide a full range of financial services and tools that enable them to direct public resources smartly to bridge critical funding gaps, perform in areas underserved by the private sector, and implement national strategies set by their governments, often in partnership with other international public intermediaries. A particular input of future work of the San Giorgio Group is to consider furthering the role of national and other development finance institutions in providing debt to help drive Asia’s green investment revolution.

The ability to increase resource productivity as a source of both growth and reduced energy and carbon intensity – to effectively decouple economic growth from emissions growth – will be a key objective for effective policy for climate finance. The knowledge and guidance produced by our continuing work will help to ensure that the financing of green and low-emission development becomes more than just a marginal phenomenon.
China is currently the world’s largest carbon emitter, and is a key battleground for the global effort against climate change.

China has set impressive targets for de-carbonisation, yet success in the long term is far from guaranteed as the country is still early in its development process.

A combination of institutional reform, effective use of market mechanisms, the rule of law, and a broad vision linking China’s economic, environmental, and social priorities, will allow China to meet its long-term carbon objectives as well as that of the world’s.
“A beautiful China must be realised with market mechanisms.”

Liu Mingkang, Distinguished Fellow, Fung Global Institute and Former Chairman, China Banking Regulatory Commission

“For a long time China has been a planned economy, and we’re learning, but find it very hard, to get the optimal balance, in terms of the role of the public sector leveraging the market. I don’t think we’ve solved that yet.”

Wu Changhua, Greater China Director, The Climate Group

“I think the overall challenge for China is whether or not you can balance this rapid and massive economic development with environmental protection, including climate protection. Economic development is needed for addressing many of the economic and social issues. As you know there are still millions, tens of millions of people who live under the poverty line and you have to grow the economy to meet the need for poverty alleviation and eradication. On the other hand, this economic development model, relying heavily on high input, high emissions, low efficiency and low innovation in technological terms – this kind of a model has been going on for a few decades and we have already seen the problems of this.”

Qi Ye, Director, Climate Policy Initiative Beijing and Cheung Kong Professor of Environmental Policy, School of Public Policy and Management, Tsinghua University
CHALLENGES:

CHINA’S CARBON EMISSIONS WILL CONTINUE TO RISE

China is currently the world’s largest source of carbon emissions, and thus must be a key part of any global effort to fight climate change. However, putting a fast-growing country of 1.3 billion people onto a low-emissions growth path is a task that would challenge even a very committed and resourceful government with the full backing of industry and society. In China’s case, the government has recognised the scale of the challenge and committed the nation to addressing change through its national strategy and successive five-year plans. Success in implementation, however, is far from guaranteed.

To start with, China is barely half way through its industrialisation and development process, and while it has achieved much progress thus far, the transition from traditional to service industries is just beginning. This transition will be accompanied by a demographic shift: the size of the Chinese middle class – now between 200 to 300 million – is poised to double over the next decade. These new consumers will support a rebalancing towards service industries and an economy driven by domestic demand, but they will also increase China’s consumption of energy, food, and natural resources significantly. For these reasons, it is optimistic to think that China’s emissions will peak around 2015 – some say that the peak will appear even later without more decisive actions.

AGGRESSIVE TARGETS NEED TO BE DELIVERED

The 12th five-year plan and the 18th Party Congress documents have set out clear goals and targets of carbon footprint reductions. The latest document also imposes an energy consumption cap of 4 billion tonnes of coal equivalent (tce) by 2015, a mere increase of 10 per cent from 2012 levels. What China needs now is effective implementation to realise those ambitions. At present, most targets are aggressive and require almost immediate decoupling of emissions and economic growth. But administrative measures alone may be insufficient to achieve sustained impact over the long term. Instead, China should work towards building the mechanisms, the rule of law, and the mentality to fulfil its carbon objectives.

THE PRIVATE SECTOR IS CROWDED OUT

Making use of the markets is an obvious solution. A lot of capital has already gone into renewable energy projects in China, even if the term “climate finance” is not actively seen in local markets. It is to China’s credit that many large scale projects have been funded from the public sector. But over the long term, a large public sector role may be self-defeating because it crowds out private capital and stymies private-sector dynamism, efficiency, and innovation which support growth over the long term.

It is estimated that in China, the public sector accounts for up to 20 per cent of the total financing for climate change, compared to 4.5 per cent in the UK and 3.3 per cent in Germany. Moreover, in China it is often difficult to distinguish between state and private money, meaning that the role of the public sector may be underestimated in many cases. Introducing and defining the concept of climate finance, and increasing transparency in project finance, will help incentivise and unlock more private capital flow in China.
A BROAD VISION TO LINK AN EFFECTIVE MARKET TO OTHER COMPONENTS IN THE SYSTEM

A well-functioning market relies heavily on the rule of law backed by a coherent and broadly accepted policy framework, and herein lies another challenge for climate finance in China. While China does have aggressive reduction targets, these are often individually expressed and are not articulated within a broader vision of the economic, social, environmental and behavioural reforms that must accompany the change. Without such a broader vision, leaders will be handicapped when they design the institutional architecture which will coordinate these changes across society.

The lack of a broader vision can undermine China’s real carbon objectives, as illustrated in an example from Inner Mongolia where disjointed urban, environmental and economic policies led to undesirable results. Even with a price on carbon that is set at a right level, players will not be responsive to the price signals if everyone operates in silos, and either lacks, or is unresponsive to, the various feedback mechanisms between market and institutions.

INSTITUTIONAL REFORM TO SUPPORT CLIMATE FINANCE

To remedy this, China will need institutional reform to lay foundations for a steady and consistent policy environment, eliminating policy risks – a primary deterrent of climate finance worldwide. It can start with strong and well-articulated legislation, a unified rule of law, and effective enforcement across the nation. Coupled with a market mechanism, China could then put itself on the fast track to reaching its daunting targets.
Due to increasing wealth and rising demand, Asia has the opportunity to lead the world in low-carbon investment flows. However, low-carbon investment remains in the margins in Asia, as it involves risks that private actors are not yet willing to bear. Policy instruments for improving the risk-return profiles of low-carbon projects will prove essential. In particular, intermediaries and national development banks will play a key role.
“Every country is different and unique. Macro-economic structure has to be adapted to that. We need to be careful about applying one example to the next.”

David Nelson, Senior Director, Climate Policy Initiative San Francisco

“Each country which has come out with renewable energy policies, for different reasons, has had to backtrack from those policies, or from the feed-in tariff levels. These are risks which tend to be 1) uncertain; and 2) difficult to quantify upfront, and therefore act as a natural aversion for financiers to come into these sectors.”

Anita George, Regional Industry Director, Asia Infrastructure and Natural Resources, International Finance Corporation

“Sometimes the difficulties are that, in order to demonstrate effectiveness in new areas, you have to invest across a whole portfolio of options. It’s not that you can just pick in advance which technologies, which types of reforms are going to be successful. So anytime you’re managing an investment portfolio – especially when you’re managing a public investment portfolio – you have to understand that the success of any of these technologies is not just a matter of the hardware. It’s a matter of the organisational strategies and firms. It’s a matter of the policies and the institutions that are there.

Thomas C. Heller, Executive Director, Climate Policy Initiative
Persuading policymakers that climate change is a real and present danger is one of the toughest challenges facing advocates of more financing in the fight for climate change. A sense of urgency about renewable energy must be created among decision makers. The world is facing a potentially catastrophic five degree Celsius rise (from pre-industrial levels) in temperature by the end of this century. This reality is often too far removed from national and day-to-day concerns pressing on government officials, especially those who hold short-term power. Fostering and driving political will is of paramount importance – once that is achieved the finance is more likely to follow.

When the 2008 financial crisis hit, for example, governments became increasingly cautious about climate financing: the Indian government’s discussion on removing help for solar projects is one example of this reticence. Another issue is the stay on financing when it comes to the environmental impact. The Fukushima disaster demonstrated how a meltdown could have an effect on policy worldwide. Many national moratoriums on nuclear energy imposed in its wake remain in place today.

On a yearly basis, more than a quarter trillion dollars is being invested in clean energy; so to some extent, financing is reaching worthy projects. The issue is one of scale – that financing fails to reach the levels necessary to stabilise global temperatures – and impetus, in that most of the financing is currently reactive rather than proactive. Financiers and their institutions need to believe that climate financing is a safe investment with real returns. In other words, advocates should sell it not as an obligation or social measure, but as a viable investment.

Among the issues for some financiers are a lack of liquidity and the time frame for the rate of returns. Some funds cannot support long-term, illiquid investments. They need to be able to cash out whenever a need arises, not wait until a project starts operating (there is usually a two-year gap between investment and the start of operations). From another perspective, a fund would have to be worth at least US$30 million to afford the type of low liquidity currently built into climate financing and the market capitalisation of a company that could absorb that as a potential loss would have to be in the region of US$50 billion.

Another point made is the high cost of capital in some Asian countries, such as India. Looking across to Brazil, as a case in point, the government there has offered concessional debt to lower the price of debt as a solution, instead of focusing on the feed-in tariff.

There is much being done to make this sector credible for financiers. They could turn to the example provided by the International Finance Corporation. The IFC’s portfolio has shifted dramatically from 75 per cent fossil-based fuels to 75 per cent renewable energies in only the last five years. But while this is a huge step in the right direction there is plenty more that can be done.
CHALLENGES:

THE TECHNOLOGY AND ECONOMIES OF SCALE

A major challenge is the technology itself, which remains in development, while continuing to decrease in cost. Take wind power, which still has room for technological leaps: Further technological advancement could be achieved in blade repowering, gearboxes and reductions in the drag effect. This will bring the cost of wind power down. For example, the price of installed solar power in India has fallen from US$4 million to US$1.7 million per megawatt in three years. This is leading to increasing parity with national grids in that country. Much work has already been done to make the industry attractive as a saleable package to investors, but there is certainly space for improvement.

More positively, a recent report by the International Energy Agency showed that more and more governments worldwide are opting for renewables as a source of power. Today, 75 per cent of countries are investing in renewable energy, with emerging markets like China, India and Brazil driving this trend.

A NEW GROWTH MODEL

Advocates of climate financing are careful to point out that it should not be seen as a short-term trend – and therefore one that will soon lose its appeal. World GDP is US$65 trillion; banking assets stand at US$10 trillion, pensions circulate at US$20 trillion, and private wealth is estimated at US$45 trillion. In other words, the money is available; it is just a question of channelling the funds so that they support the global transition to a brighter energy future.

More generally, our global consumption-based model to drive GDP is taxing the planet’s resources and jeopardising the ability of future populations to meet basic needs. The world needs a new growth model. A major drawback in current perception is that the return on investment for such models is falsely understood to be lower than the rate of return on current models in play. For sure, there are positive social and environmental returns alongside these new models, but these are not being felt by investors. In short, we must look beyond GDP, and current accounting models, in order for climate financing to really capture the minds of policymakers and reach the levels in time to avert dangerous climate change.
SOLUTIONS:

RE-CHANNELLING THE FINANCE

Twenty managers representing sovereign wealth funds worldwide control an estimated US$5 trillion. These are individuals who operate at the uppermost level of global wealth management. Some are autonomous, but a handful of them do engage with policymakers – and it is this potent relationship which could be harnessed to channel funds into climate financing. One solution would be to turn to them with credible project offerings and request financing on this basis. Substantial investment in renewables by sovereign wealth funds will send a serious and effective signal to markets about the soundness of backing both climate financing and climate policy.

PUBLIC-PRIVATE PARTNERSHIP

Developing public-private partnerships is key to the success of scaling up renewables. An example is the Financial Institution Partnership Program (FIPP) in the US. Government should drive these types of initiatives, because the private sector has its own stakeholders to worry about in the form of shareholders, customers and suppliers. High government commitments to loan guarantees – in FIPP’s case, up to 80 per cent of the loan capital – could serve as an incentive for the private sector to think in a 20 to 25 year frame.
“In telling the story of what we have to do, I think we can be more and more positive, as we now have a deeper understanding of what is possible. I see this as fundamental in creating political will – absolutely fundamental – that this is not a horserace between growth and poverty reduction on the one hand, and climate responsibility on the other. If it turns into that horserace, climate responsibility will lose. It’s a basic mistake – analytical, political, logical mistake, to let that happen.”

Nicholas Stern, Chairman, Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science and Member of the Academic Council, Fung Global Institute

“I’m absolutely convinced that this is not an issue about financing – the world has financed massive investments in infrastructure over the last century – it’s one of having the right policies in place, which I think is a massive challenge because we are talking about burdening economies today with a real cost in order to avoid potential problems in the future. That’s the difficult one for the world to get its mind around.”

Andrew Brandler, Chief Executive Officer, CLP Holdings

“There is no shortage of money, the question is do we have the political will to change policy. What we really need to worry about is changing the mindset, then the policy will come.”

Andrew Sheng, President, Fung Global Institute
Climate Policy Initiative (CPI) is a policy effectiveness analysis and advisory organisation whose mission is to assess, diagnose, and support the efforts of key governments around the world to achieve low-carbon growth.

CPI is headquartered in San Francisco and has offices around the world, which are affiliated with distinguished research institutions. Offices include: CPI at Tsinghua, affiliated with the School of Public Policy and Management at Tsinghua University; CPI Berlin, affiliated with the Department for Energy, Transportation, and the Environment at DIW Berlin; CPI Rio, affiliated with Pontifical Catholic University of Rio (PUC-Rio); and CPI Venice, affiliated with Fondazione Eni Enrico Mattei (FEEM). CPI is an independent, not-for-profit organisation that receives long-term funding from George Soros.

The Fung Global Institute is an independent think-tank and learning institute that generates and disseminates new thinking from Asian perspectives on issues that are transforming the global economy. Its business-relevant research is combined with practical experience and learning that can be applied by senior global business executives as well as policymakers and civil society leaders. The Institute is a non-profit organisation based in Hong Kong.

CLP Holdings
CLP Holdings Limited, a company listed on the Hong Kong Stock Exchange, is one of the largest investor-owned power businesses in Asia Pacific. Through CLP Power Hong Kong, it operates a vertically-integrated electricity supply business providing a highly reliable supply of electricity to 80 per cent of Hong Kong’s population.

Outside Hong Kong, CLP holds investment in the energy sector in Australia, Mainland China, India and Southeast Asia. Its diversified portfolio of generating assets uses a range of fuels including coal, gas, nuclear and renewable sources. The company is the largest external investor in the mainland’s renewable energy sector and the largest investor, foreign or domestic, in India’s wind sector. In Australia, its wholly-owned subsidiary EnergyAustralia is one of the largest integrated energy companies, providing gas and electricity over 2.7 million customers.

CLP is listed in the Global Dow – a 150-stock index of the world’s leading blue-chips, the Dow Jones Sustainability Asia Pacific Index, the Dow Jones Sustainability Asia Pacific 40 Index and Hang Seng Corporate Sustainability Index.
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