

Climate Finance



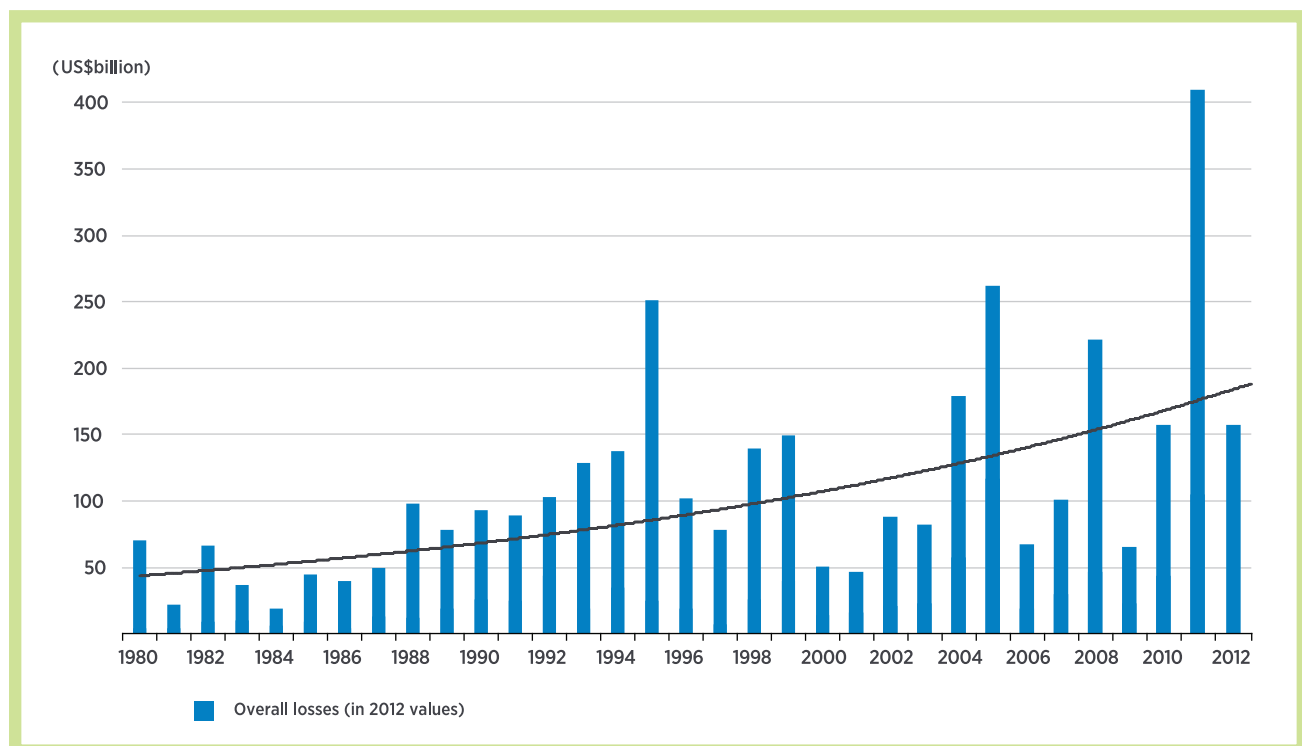
➤ At a Glance

- Climate finance is flowing. It is providing new opportunities for investment that create stronger, resilient communities, job opportunities, and healthier citizens. Leaders are showing how to seize these opportunities and challenging others to follow.
- But the current investment level is not enough. Global climate finance flows today are less than half of the US\$700 billion to US\$1 trillion per year that the World Economic Forum and others estimate to be needed.
- Developed countries have made a commitment to provide US\$100 billion a year by 2020 for climate change activities in developing countries, including through the Green Climate Fund. It's important but not sufficient alone.
- Governments, investors, and businesses can work together to provide the supportive policies that will turn the climate challenge into a global investment opportunity.

THE CHALLENGE

Climate change presents a serious risk to lives, communities, and financial systems. A number of recent studies show the economic impact that climate change is already having. From 1980-2012, disaster-related losses amounted to US\$3.8 trillion globally; extreme weather was responsible for 87 percent of these reported disasters and 74 percent of the damage, estimated at \$2.8 trillion.

Figure A: Global disaster losses from 1980-2012



The bars indicate annual disaster losses. The line indicates the trend.

Source: © 2013 Münchener Rückversicherungs-Gesellschaft, Geo Risks Research, NatCatSERVICE (as of January 2013)

Addressing climate change is an economic imperative—and an opportunity. “Climate-smart” investments such as efficient, clean infrastructure, clean energy, and resilient agriculture and water resources offer stable, attractive returns for investors when the conditions are right. In 2013, investors put nearly US\$270 billion into renewable energy, five times more than in 2004. Bloomberg New Energy Finance estimates that global clean energy investment has grown from US\$54 billion in 2004 to US\$254 billion in 2013.

These investment opportunities were created through a combination of supportive government policies, technology cost reductions, and innovative finance and business models. Each public and private sector actor has opportunities to go further:

Public finance providers can play a more catalytic role in engaging private finance providers to accelerate their investment in low-carbon and climate-resilient growth options. Multilateral development banks, national development finance agencies, and bilateral aid providers have delivered a number of successful climate finance solutions. They can expand their offerings to include greater equity investment in early-stage project development, a wider range of political and policy risk mitigation tools, and greater use of first-loss provisions to improve project bankability. The new Green Climate Fund will provide a key mechanism for scaling up.

Financial regulators can be more systematically engaged to identify the barriers that financial regulation can present for climate finance. More work is needed to engage central banks, financial regulators, and private standards agencies to advance regulations focused on sustainability. The UNEP Financial Inquiry is one important effort.

Government policymakers can focus on drawing in private investment through “smart” investment and climate change policies. Private investment will not flow unless countries, states, and cities put in place policies to price carbon, remove fossil fuel subsidies, and set investment frameworks for cleaner options. While some governments are taking a comprehensive approach, the global picture is mixed—with the result being a continued flow of finance into high-carbon, risky assets.

Private finance providers are only just beginning to realize that their returns will be undermined by economic and social disruption resulting from climate change, and that the wellbeing of their pensioners’ savings are best protected by addressing climate change. A few enlightened investors are showing the way to a better future by creating climate-indexed funds, screening the carbon footprints of investments, and setting “green” investment targets, but there remains a lack of suitable financial vehicles to attract institutional capital.

Moving Forward

More leadership is needed to address these challenges and unlock investment opportunities. The public and private sectors must work together in more proactive ways if we are to scale up climate finance solutions in time.

- Governments can send the right economic signals through smart policies that put a price on carbon, remove fossil fuel subsidies, implement energy efficiency performance standards, and create strong investment frameworks for clean energy.
- Investors can systematically reduce their climate risk while scaling up profitable “green” asset holdings that outperform the market. Financial regulators can require investors to assess the carbon footprint of their portfolios, and investors can explore the creation of new funds with a carbon reduction goal that shifts their portfolios into lower-carbon options.
- Banks, corporations, and public finance agencies can grow the green bonds market. The green bonds market has rapidly diversified to include banks, corporations, and governments as issuers. With the growth in issuer type and structure, the investor base for green bonds has expanded to include more pension funds, insurance companies, asset managers, and retail investors. As the market expands and draws more institutional investors, there is a need to increase transparency and reporting on the environmental impact of supported projects. The creation of the Green Bonds Principles is a step in the right direction.
- Governments, communities, insurers and the private sector must increase climate adaptation and resilience investments, and address climate risks in the most vulnerable countries. Mainstreaming disaster risk management in development planning can reverse the current trend of rising disaster impact. Given that many developing countries lack the tools, expertise, and instruments to factor the potential impacts of adverse natural events in their investment decisions, more support is needed.
- Public finance agencies need to recognize that public finance alone is not enough and increase their efforts to mobilize private investment through policy risk tools, support for project preparation, and other solutions.

> Examples of Leadership

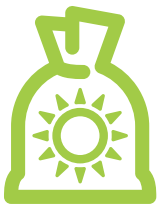
Smart policies: Morocco's government has adopted aggressive national renewable energy and energy efficiency targets, reduced fossil fuel subsidies, and created an attractive legal framework. As a result, the country saw its renewable energy investment grow from US\$297 million in 2012 to US\$1.8 billion in 2013. The International Finance Corporation estimates that Morocco has over US\$13 billion in renewable energy investment potential.

Smart investors: After a portfolio-wide carbon footprint exercise, Swedish Pension Fund AP4 developed a climate indexed fund that has outperformed the market. Other investors – such as France's ERAPF – have begun to systematically screen potential investments for their carbon footprint.

Green bonds: Since the first green bond in 2007, the World Bank Group, European Investment Bank and German Development Bank KfW have played key roles in expanding the market for this type of climate-friendly investment. Major financial institutions including Bank of America, Citi, Credit Agricole and JPMorgan Chase showed leadership in creating the Green Bonds Principles, and new leadership is being seen from cities like Johannesburg and a range of corporations.

Investment in adaptation and resilience: Mexico's FONDEN fund is a critical component of the country's climate- and disaster-risk preparedness. FONDEN was originally established to build back infrastructure after natural events. In 2006, the government recognized the need to promote stronger preventive disaster risk management and allocated additional funding, combining prevention with rehabilitation in a pioneering way.

Public finance: Germany's recent US\$1 billion pledge to the Green Climate Fund demonstrates leadership. Multilateral Development Banks and DFIs are also advancing new solutions. For example, the U.S. Overseas Private Investment Corporation offers regulatory risk coverage specific to renewable energy projects in some regions as a means to reduce policy risk. The European Investment Bank's Project Bond initiative is attracting institutional investors to infrastructure projects by providing subordinated debt via project bond credit enhancement.



References and suggested reading

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