Financing a Global Deal on Climate Change

A Green Paper produced by the
UNEP Finance Initiative
Climate Change Working Group

Executive Summary

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UNEP Finance Initiative
Innovative financing for sustainability

UNEP

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Next steps

The elements outlined in this paper on "Financing a Global Deal on Climate Change" represent a first set of priorities brought forward by the UNEP Finance Initiative as a basis for discussion and further elaboration.

Input from a broad range of financial institutions, government bodies and stakeholders is now essential to develop more thorough and widely accepted suggestions for climate finance elements and mechanisms under a successor deal to the Kyoto Protocol.

You are kindly invited to contribute to this process by providing your input via email to feedback@unepfi.org or by visiting the dedicated section on our website under: www.unepfi.org/feedback. Alternativelly, feel free to get in touch on the phone to Claire Boasson (+33 (0)1 44 37 19 86) or Remco Fischer (+41 22 917 86 85).

The full version of the current report can be downloaded from:
http://www.unepfi.org/fileadmin/documents/FinancingGlobalDeal.pdf

We are looking forward to receiving your input.

Disclaimer

The United Nations Environment Programme Finance Initiative (UNEP FI) is a strategic public-private partnership between the United Nations Environment Programme (UNEP) and approximately 180 financial institutions globally. For the purposes of this paper, the term UNEP FI refers directly to the members of the UNEP FI Climate Change working group (CCwg) plus those UNEP FI member institutions directly involved in the consultation process undertaken during its development.

The content of this paper is based on input gathered from numerous signatory institutions as well as the operational working groups of UNEP FI in an effort coordinated by UNEP FI's CCwg. Unless expressly stated otherwise, the opinions, findings, interpretations, and conclusions expressed in the paper are those of the various contributors. They do not necessarily represent the decision or the stated policy of the United Nations Environment Programme, nor the views of UNEP, the United Nations, or its Member States. Neither do they represent the consensus views of the member institutions of UNEP FI. UNEP and UNEP FI believe that this paper will lead to greater understanding of issues related to the financing of climate change mitigation and adaptation, and thus contribute to agreement among parties to the UNFCCC in Copenhagen.

The designations employed and the presentation of material in this paper do not imply the expression of any opinion whatsoever on the part of the United Nations Environment Programme concerning the legal status of any country, territory, city or area or of its authorities, or concerning delimitation of its frontiers or boundaries.

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Executive summary

The UNEP Finance Initiative[1] is a unique global partnership between the United Nations Environment Programme and over 170 financial institutions from the banking, investment and insurance sectors across the globe. The Initiative aims to promote linkages between the environment, sustainability and financial performance through a comprehensive work programme, including research and training. Over the past 15 years, the Initiative has been working to build an effective financial response to the challenge of climate change across a range of issues including carbon markets, renewable energy, energy efficiency, adaptation and vulnerability as well as reporting and disclosure. This has included active participation in the UNFCCC's Conference of the Parties (COPs) to ensure that the financial sector perspective is integrated into the international framework for climate action.

This Green Paper builds on this experience and focuses on the priorities identified by UNEP FI to mobilise the skills and resources of the banking, investment and insurance sectors behind an effective, efficient and equitable global deal on climate change at COP15 in Copenhagen. The Paper addresses the types of decisions that governments could take in Copenhagen to stimulate financial involvement; it does not cover the equally important issue of how to expand the take-up of best practice measures in the financial sector to manage climate change risks and opportunities.

Our approach is based on three key pillars:

- First, the science demands the agreement of ambitious emission reduction targets over the short, medium and long-term as well as accelerated action to manage the unavoidable impacts of climate change, particularly on the poorest communities;
- Second, the capital expenditure required to decarbonise and adapt the global economy will have to be mobilised jointly by the public and private sectors; the lion's share of the investment is expected to come from the latter which will require a range of public policy measures including carbon markets and taxes, regulations and standards, as well as financial support mechanisms to mobilise private capital; and
- Third, particular attention needs to be focused on how to expand the flow of public and private finance to the developing world for both mitigation and adaptation.

Based on these pillars, this Green Paper seeks to identify the priority actions that financial institutions need in a future agreement to enable them to provide the scale of finance and support required for both mitigation and adaptation. Our proposals focus on six critical areas to enhance finance sector involvement in a post-2012 regime:

I. Reducing the risk of low carbon investments in developing countries: Increasing financial sector interest in investing in low carbon development in developing countries is currently constrained by a range of barriers including a lack of policy predictability as well as an absence of the transparent rules and procedures needed to provide stable conditions for investment into low carbon technologies. A range of public finance mechanisms are available to address these risks, including debt guarantees. In particular, UNEP FI suggests the creation of a mechanism whereby the home government of a foreign investor issues guarantees in order to

1 For the purposes of the current version of this paper the term UNEP FI refers directly to the members of the UNEP FI Climate Change working group (CCwg) plus those UNEP FI member institutions directly involved in the consultation process to date. In coming months and towards CoP15 in Copenhagen we will seek to secure the explicit support for the paper from all UNEP FI member institutions as the consultation proceeds. The paper's aim is to provide detailed input explicitly from a financial services and investment standpoint to assist the processes leading up to CoP 15

facilitate low carbon investments in host countries. Credit risk guarantees and other risk sharing instruments can considerably lower the investment barriers for many investors and keep the risks associated with direct investments at a reasonable level. .

II. Improving the operation of flexible mechanisms: UNEP FI welcomes the current efforts of the international climate community to focus attention on areas where the Convention's flexible mechanisms such as the CDM and JI are not attracting sufficient private capital, either in terms of sector (e.g. energy efficiency; reforestation and afforestation), region (e.g. Africa and Central Asia) or scale (e.g. smaller project sizes, programmatic activities). UNEP FI fully supports, therefore, the expansion of small-scale CDM as well as programmatic CDM (Programmes of Activities – PoAs). Achieving this will require the formulation of clear standards, the reduction of procedural complexity and intensive capacity building on local and regional levels. UNEP FI suggest that increased funding of PoAs could be promoted via the use of credit guarantees issued by governments, development banks or agencies located in the country of origin of the participating financial institution. A guarantee addressing the perceived counterparty and/or country risk will, for instance, enable commercial financial institutions to become more proactive in financing PoAs.

III. Establish funding for low carbon technology development and deployment in developing countries: Public finance could be usefully deployed at the margin to (1) stimulate equity investments in technology through venture capital (VC) and (2) mobilise private finance and investment (in the form of project/corporate finance and private equity) for low-carbon technology deployment in developing countries. UNEP FI proposes that this could be structured either as two single international funds for low carbon technologies (a Technology Development Fund and a Technology Deployment Fund) – building on existing national and international experience on how best to leverage private capital – or as a suite of regional and/or sector-focused funds. The fund(s) would support entrepreneurs across developing countries, and the contribution of capital from private investors would enrich the fund's perspective by providing technology insights and expertise to investment decisions. In essence, such funds would create the confidence needed for early stage technology development and deployment financing and enable a public-private partnership structure allowing sufficient flexibility and shared perspectives for all parties involved.[2] The Technology Deployment Fund would accelerate technology transfer, e.g. towards low carbon infrastructure, by reducing the financing cost of low-carbon (best available) technologies in developing countries, relative to that of conventional technologies. The public component of the fund could be used to reduce the cost of capital invested and borrowed; the private component would provide the actual bulk of investment. The spread between the interest rates collected from borrowers and the competitive returns paid back to investors could be financed from public sources. This would represent a very small fraction relative to the overall financing ultimately mobilised.

IV. Creating an international carbon insurance vehicle: UNEP FI recognises the importance of readily available commercial insurance to provide a sound environment for new low-carbon technologies and carbon projects across host countries and market environments. UNEP FI therefore proposes the creation of a Carbon Insurance Vehicle equipped with public funds but open for private insurer participation. The insurance vehicle should be used to insure the carbon credit generation and delivery risks of projects under a future Convention. Such an insurance vehicle would help to scale-up project activities and be of specific help in developing countries, especially LDCs, which so far have not seen, as a result of perceived risks, much carbon finance activity. This vehicle could either be designed as a stand-alone mechanism under the Convention. It could be more effective and efficient, however, if it consisted of a system of national Carbon Insurance Vehicles managed by national Export Credit Institutions. These could

2 Such funding mechanisms at the international level should go hand in hand with policy reforms on the national level including, for instance, fiscal incentives for low-carbon business models and technologies. Such incentives on the national level will be complementary to mechanisms under the Convention and equally necessary for the transition to low-carbon economies, especially in developing countries

indeed be the same vehicles issuing credit guarantees for climate change mitigation projects as described under Proposal 2 above.

V. Enabling enhanced investment in low carbon buildings: The UNFCCC has yet to fully exploit the potential for low and no cost investments in low carbon buildings. UNEP FI proposes a focused effort under the Convention to boost incentives and standards for accelerated low carbon investment in the property sector. Over and above crucial policy actions with global relevance such as improving and standardising information metrics on building emissions, making standards and building codes materially more demanding and extensive, and ensuring cities develop in compact form, UNEP FI believes there is room to establish an interconnected suite of regionally based property funds to support entrepreneurs gain experience in reducing the environmental impacts of existing and new stock. The on-going process to reform the CDM should also aim to promote more investment in CO_2 abatement in the building sector.

VI. Expanding the application of insurance mechanisms for adaptation: UNEP FI supports the development of an International Adaptation Fund whereby commercial finance institutions could add expertise and leverage publicly available funds through commercial contributions. UNEP FI also proposes to expand the application of risk pooling and risk transfer mechanisms such as natural catastrophe bonds, weather derivatives and climate proofed micro-products to increase the adaptability of clients in exposed locations. UNEP FI supports the proposal set out by the Munich Climate Insurance Initiative on the role of insurance adaptation which foresees the creation of two insurance pillars under a multilateral adaptation fund, one for prevention and risk assessment in vulnerable regions, the other offering insurance cover for extreme weather events and support for new disaster insurance systems.

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ABOUT THE UNEP FINANCE INITIATIVE

The United Nations Environment Programme Finance Initiative (UNEP FI) is a strategic public-private partnership between UNEP and the global financial sector. UNEP FI works with over 170 financial institutions that are Signatories to the UNEP FI Statements, and a range of partner organisations, to develop and promote linkages between the environment, sustainability and financial performance. Through a comprehensive work programme, regional activities, training and research, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.