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Mobilizing private finance for climate action in the global South

Nordic experiences and the way forward

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MOBILIZING PRIVATE FINANCE FOR CLIMATE ACTION IN THE GLOBAL SOUTH

Nordic experiences and the way forward

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Highlights

To implement the Paris Agreement goals, all countries have to increase the mobilization of investments into low-carbon and climate-resilient action, particularly in the Global South and from private sources. Since the Copenhagen Accord in 2009, Nordic countries, as most developed economies, have increased their efforts to support developing economies in the mobilization of private finance. It is now time to take stock of the success stories and lessons learned.

Nordic countries have demonstrated a range of successes, such as the Danish Climate Investment Fund that mobilized Nordic institutional investors for climate action in the Global South, particularly focusing on renewable energy. The co-investment of the Norwegian government along with corporate finance in the &Green Fund enables sustainable land-use and forestry investments in global supply chains. The Energy Savings Insurance shows that Nordic countries can also de-risk and mobilize private finance towards the traditionally more challenging project types, such as energy efficiency.

Nevertheless, a range of barriers have limited the Nordic ability to scale up private climate finance even more. As an example of this, the lack of high-quality climate projects in the pipeline hinder Nordic Development Finance Institutions (DFIs) from investing rapidly. In the past, climate-friendly investments have been focused on renewable energy, while small-scale land use, energy efficiency and adaptation projects have been largely left out due to transaction costs. The project-based carbon markets have shown some major successes, but they have also reached limits for the Nordic countries in mobilizing investments, mainly as a result of policy changes, but also onerous administrative procedures and support of questionable projects, which has led to decreased public support.

This brief presents selected ideas for addressing the barriers and increasing the ambition in mobilizing private finance. First, Nordic countries could build a joint platform that would provide a one-stop access to a range of de-risking solutions for different parties. A pan-Nordic public-private climate fund could assist in increasing the involvement of pension funds beyond the ones that are already involved and use smart aggregation tools for smaller projects. A supply chain facility could enable knowledge exchange amongst Nordic corporate and technical support for innovative projects and ventures in the area of sustainable forestry and agriculture. Finally, Article 6 under the Paris Agreement could be used to scale market-based interventions of Nordic countries to a level where a transformative shift of private investments into low-carbon activities is achieved.

The issue brief was produced as part of the Nordic Public-Private Platform on Mobilization of Climate Finance ahead of COP24 in Katowice, December 2018. It builds on previous studies funded by the Nordic Council of Ministers, such as “Mobilizing climate finance flows – Nordic approaches and opportunities”¹

¹ Nordic Council of Ministers (2017). Mobilizing climate finance flows - Nordic approaches and opportunities. DOI: 10.6027/TN2017-519

Raising ambition for financing climate action

After the Paris Agreement came into force, the science community has concluded that the unconditional pledges made by governments in their nationally determined contributions (NDCs) to date are not sufficient to meet the Paris Agreement's goals, i.e. to limit global warming to well below 2°C. According to recent calculations, the current ambition level of NDCs would barely be enough to limit global warming to 2.6- 3.2°C².

A significant gap also exists between the climate investment needs of more than USD 1 trillion per year for energy-related low-carbon action and the current climate-related investments, which can be estimated at USD 0.6 trillion, when adding around USD 0.2 trillion of energy efficiency investments³ to the USD 0.4 trillion according to the latest 'Landscape of Climate Finance'⁴. Most of the investment needs will have to materialize in developing economies and it is hard to imagine how the investment gap will be closed without substantial increase in private finance.

Related to the need to mobilize more investments in the global South, there is also a clear gap between the 2009 pledge of industrialized countries, including Nordic countries, to mobilize at least USD 100 billion in climate finance per year (from 2020 on) for climate action in developing economies, and the current levels, which have been estimated at USD 62 billion in 2014⁵. Even when the additional pledges made in Paris (approximately 20bn USD) and the projected increase of public climate finance towards USD 69 billion by 2020⁶ will materialize, substantial public and private finance will still have to be mobilized to meet the goals, see Figure 1. Furthermore, in the 2015 Paris Agreement, developed countries including the Nordic countries, committed to increase the ambition in climate finance targets until 2030, clearly calling for even more efforts to mobilize private finance.

² Carbon Action Tracker: www.carbontracker.org

³ IEA (2017). Energy Efficiency 2017. <https://www.iea.org/efficiency/>

⁴ CPI (2017). Landscape of Climate Finance 2017. <https://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2017/>

⁵ IEA/OECD (2015). Climate Finance in 2013-14 and the USD 100 billion goal. www.oecd.org/environment/oecd-cpi-climate-finance-report.htm

⁶ DFAT (2016). Climate finance roadmap to USD 100 billion. <https://dfat.gov.au/international-relations/themes/climate-change/Documents/climate-finance-roadmap-to-us100-billion.pdf>

Figure 1. Mobilized climate finance against the USD 100 billion goal

The Mobilization of private finance will mainly have to occur at the national level through domestic climate-related policies, general enabling conditions (e.g. rule of law) as well as specific public finance interventions, see Table 1.

International and domestic public instruments	Domestic climate-related public policies	Enabling conditions
Grants	Joining/ratification of the Paris Agreement	GDP level and growth
Loans (including credit lines)	Nationally/Determined Contributions	Structural demand
Mezzanine finance	Formalized and quantified objectives	Technology costs
Direct and fund-level equity investments	Incentive programmes	Absorptive capacity
Guarantees	Subsidies	Investment environment
Insurances	Carbon Pricing	Legal framework
	Quotas	Political stability

Table 1: Factors affecting mobilization of climate finance from the private sector

Source: OECD⁷

⁷ OECD (2016). 2020 projections of Climate Finance towards the USD 100 billion goal. <http://www.oecd.org/environment/cc/Projecting%20Climate%20Change%202020%20WEB.pdf>

Apart from national interventions, international interventions can support the mobilization of climate finance. In this way, Nordic countries can play a significant role beyond their borders. As consequence of the 2009 pledge, a range of innovative initiatives like the UK CP3 Fund or the German-driven Global Climate Partnership Fund have been set up to mobilize private capital in the Global South. The Nordic countries have been part of some of these international initiatives and additionally, have set up their own initiatives.

Almost 10 years after the Copenhagen pledge, it is time to look back on past achievements, lessons learned and the way forward in Nordic efforts to mobilize even more private finance for climate action in the Global South.

In the following sections a range of Nordic success stories are presented that focus on innovative approaches and functional concepts. The brief furthermore summarizes the lessons learned and offers ideas for future climate contributions in the wake of increased pressure to raise ambition for climate action.

Nordic success stories in mobilizing private capital

The Nordics have demonstrated the below success stories in the mobilization of private finance for climate action in the Global South.

Engaging Nordic institutional investors in financing green infrastructure in the global South

The most renowned international success case on engaging institutional investors in North-South climate finance is the Danish Climate Investment Fund (KIF), a cooperation with Danish pension funds and DFI, and the Investment Fund for Developing Countries (IFU).

KIF managed by IFU, was founded in 2014 with a capital of DKK 1.3 billion (EUR 180 million), of which two thirds is funded by pension funds and one third by the Danish Government through IFU. It uses a blended financing model through a pure equity fund. The fund has a target return of 12% per year and supports mainly renewable energy (RE) and energy efficiency projects, see figure 2.

Figure 2: Danish Climate Investment Fund (KIF), overview

Adapted from: Africa-EU Renewable Energy Cooperation Programme (2018)⁸

⁸ Africa-EU Renewable Energy Cooperation Programme (2018). www.africa-eu-renewables.org/funds/danish-climate-investment-fund-kif/

Another impressive example of Nordic institutional investors' investments in climate action in emerging economies, is the one of the Danish Industriens pension fund that invested approximately USD 99 million on solar and wind assets in emerging Asian markets and Japan between 2012-2015, even without any public sector co-investment or de-risking. The pension fund has since then sold out its investments and yielded a 100% return.⁹

Financing agribusinesses

Apart from the Danish Climate Investment Fund, IFU also set up the Danish Agribusiness Fund (DAF). DAF offers risk capital and advice for agribusiness projects in developing countries and emerging markets and has invested a total of DKK 4.2 billion in agribusiness projects in developing countries.¹⁰

The Norwegian government backed &Green Fund and supports clean agricultural supply chain investments, mainly via loans and guarantees, and plans to catalyze over USD 2 billion and benefit half a million households. In addition to the USD 100 million from Norway's International Climate and Forest Initiative (NICFI), &Green Fund has mobilized USD 25 million in private investments from Unilever.¹¹

Engaging corporate for Energy Efficiency finance

The Energy Savings Insurance was first introduced by Denmark in cooperation with the Inter-American Development Bank (IDB). The financial instrument addresses technology performance risks and mobilizes corporate finance for energy efficiency investments through standardized performance contracts, performance verification and a back-up energy savings insurance, as illustrated in the Figure 3. The mechanism has been introduced in several markets, first in Mexico with Danish support, then in other Latin American countries, partly funded by the Green Climate Fund.

Figure 3: Energy Savings Insurance concept

Adapted from: Micale et al. 2015¹²

⁹ Top 100 Funds (2018). www.top100ofunds.com/2018/05/industriens-seeks-more-in-renewables/

¹⁰ IFU (2018). www.ifu.dk

¹¹ &Green (2018). www.andgreen.fund/

¹² Global Innovation Lab for Climate Finance (2015). Energy Savings Insurance: Pilot Progress, Lessons Learned, and Replication Plan. <https://www.climatefinancelab.org/wp-content/uploads/2014/08/Energy-Savings-Insurance-Lab-Phase-3-Analysis-Summary-1.pdf>

De-risking renewable energy investments: From mainstream to off-grid

The Finnish Fund for Industrial Cooperation Ltd. (Finnfund) has successfully undertaken equity and debt investments in renewable energy (RE) in the Global South. By the end of 2017, Finnfund investment portfolio and undisbursed investment decisions reached approximately EUR 719 million. The funds were directed to 171 projects in 39 countries.¹³ In earlier years, Finnfund rather targeted on-grid large scale investments with equity investments but has since then also moved to off-grid investments and using less risky financial instruments, such as debt, for off-grid plants, as the RE markets matured. At the end of 2017, approximately 25% of Finnfund's investment were in the energy sector. In addition, Finnfund has a strong focus on sustainable forestry (20% of portfolio).

Mobilizing European corporate finance

The Development Finance Institution of the Swedish State (Swedfund) has several success cases related to climate finance directed to emerging economies, some of which involved European corporate finance. In cooperation with Shell and Engie, Swedfund provided a USD 20 million equity investment for Husk Power systems, which operates mini-grid systems in rural Asia and Africa.¹⁴ Husk Power Systems estimates a rapid growth through installing 300 mini-grids in India and Tanzania, 15 MW of renewable power plant assets eliminating a total of 150,000 tons of CO₂ per year and serving over 100,000 customers throughout its operations.

"Access to clean and reliable energy is a prerequisite for poverty reduction. This is why Swedfund has chosen energy & climate as one of our key focus sectors."

Maria Håkansson, the CEO of Swedfund

Swedfund also teamed up with the Nordic Development Fund (NDF) and the INGKA foundation, as well as the Dutch and UK government to create the world-leading public-private investment fund Climate Investor One (CIO), which uses blended finance to fund RE infrastructure projects in emerging markets.¹⁵ The fund will invest USD 2 billion in RE projects with additional capacity of 1,100MW and provide 3,200GWh of electricity per year to approximately 7 million people living in emerging markets.

The previously mentioned &Green Fund, is a prime example of how Nordic countries, such as Norway, can mobilize European corporate finance for climate action in the Global South.

Making climate-friendly projects and funds ready for commercial investments

NDF is a challenge fund with a co-financing requirement. Some examples of initiatives include the establishment of a Green Guarantee Facility under the African Guarantee Fund, preparatory financing for the first global investment fund on climate change resilience and adaptation, preparatory funding and investment in the off-grid Energy Access Fund in Africa, a blended finance package provided for an investment

¹³ Finnfund (2018). www.finnfund.fi

¹⁴ Husk Power Systems (2018). www.huskpowersystems.com

¹⁵ Climate Investor One (2018). www.climateinvestorone.com

fund platform providing projects access to support over a long time horizon as the financing needs of the projects evolve. NDF is specialized in preparing projects to be able to enter the investment cycle.

The Nordic Climate Facility (NCF) is a challenge fund set up by NDF in 2009 to finance early stage innovative climate change projects. Financing from NCF is allocated on a competitive basis with thematic calls for proposals arranged annually. All project proposals are thoroughly evaluated, and the highest scoring ones can receive financing between EUR 250,000 and EUR 500,000.

The Energy and Environment Partnership (EEP) is a grant offering program to support early stage projects that promote the use of RE, energy efficiency and clean technologies, financed by the Ministry for Foreign Affairs of Finland and NDF. Its objective is to combat climate change while providing sustainable energy services to those who lack them.¹⁶

Engaging global commercial banks in financing wind energy

The Danish Export Credit Agency (EKF) de-risks the senior debt on wind farms in the emerging market economy Taiwan. The wind farm totals DKK 4 billion in investments and is the first major offshore project finance in Taiwan. EKF covers 62% of the senior debt and thereby unlocks the private capital flows from the banks.

Overall, EKF has backed approximately 1000 companies with guarantees totalling over DKK 100 billion since 2002, mainly supporting wind energy projects globally.¹⁷ Swedish, Finnish and Norwegian export credit finance has also been successful in private climate finance mobilization.

Mobilizing investments through carbon markets

Based on the Nordic Council of Ministers' study on the Nordic carbon market experience¹⁸, two decades of Finnish experience in the carbon markets show significant achievements of international carbon markets instruments. To date, the Clean Development Mechanism, as a first-of-its-kind carbon market under the UN in developing countries, managed to mobilize over USD 300 billions of mostly developing country private finance for more than 8000 projects in 111 developing countries, and developed over 200 international methodologies for measuring emission reductions. This is a significant achievement to which Nordic countries have contributed substantially from before 2000 to this very day. When CDM was first conceived, no-one expected such results. The expectations began to rise later, leading to much disappointment after the market collapsed

¹⁶ NDF (2018). www.ndf.fi

¹⁷ EKF (2018). www.ekf.dk

¹⁸ Nordic Council of Ministers (2011). Nordic perspectives of carbon market mechanisms. <http://norden.diva-portal.org/smash/get/diva2:700266/FULLTEXT01.pdf>

Lessons learned and remaining challenges

After almost 10 years of Nordic experience in mobilizing private finance for climate action in the Global South, a range of lessons have been learned;

- Nordic private sector participation in North-South climate finance has been limited (with the notable exception of Danish pension funds), with **most private finance mobilized being domestic**. The domestic private finance focus in Nordic programs is not surprising, as more than 90% of private investments into low-carbon development tends to come from a domestic source ¹⁹. Still, the success of Norwegian and Swedish public entities in mobilizing corporate finance in other European countries shows that it may be worth the effort to try and engage also Nordic corporates to become more active.
- Danish pension funds are the only amongst Nordic investors that have shown notable levels of investments into clean energy infrastructure in emerging economies²⁰, both on a pure commercial basis but also in partnership with the government. This raises the question of why other Nordic pension funds and investors have not been active? The Danish case suggests that **well-funded pension schemes, government leadership and industry frontrunners are all key to engage the pension industry**.
- To date, most private finance was mobilized for investments into RE, while **little private finance flew into energy efficiency in buildings, transport and industry, as well as sustainable and climate-resilient land use and water, all sectors where additional funding would be urgently needed**.

"In order to achieve this, the Nordic community needs new instruments such as small-scale de-risking for energy efficiency (EE) and solutions for meeting high transaction costs of guarantee instruments for funding land use projects. In these cases, pooling can offer an interesting option to target small-scale energy efficiency, off-grid and land use private investments."

Helena Teppana, Finnfund

- There is still little cooperation between the Nordic countries on climate finance initiatives.
- The lack of investable, high quality projects (the so called 'deal flow' problem) is still a major barrier for mobilizing private investments.

"Innovative financing vehicles suffer from a lack of bankable project in the pipeline."

Torben Huss, IFU

¹⁹ CPI (2016). <https://climatepolicyinitiative.org/wp-content/uploads/2016/10/Global-Climate-Finance-An-Updated-View-on-2013-and-2014-Flows.pdf>

²⁰ The Norwegian Statoil company is another example, with investments in hydro power in several emerging economies

- **An important aspect of the Nordic cooperation is to ensure information-sharing on existing climate-finance options and opportunities for partnering across public and private sectors.** This information sharing is for instant suboptimal, in case of corporate supply chain actions. There are existing funds that invest in projects in supply chains such as the &Green fund, which could be further capitalized through activating the Nordic private sector into identifying a broader spectrum and volume of suitable projects.
- The key lesson from the Clean Development Mechanism (CDM) is that carbon markets are politically created markets that are wholly dependent on the ambition of the targets that drive its demand and political decisions on its use, as well as on trust in the quality of the mechanism. **Policy-related risks can undermine the ability of carbon market to mobilize private finance and political decisions can lead to the market's collapse overnight, and therefore have to be well managed.** Furthermore, project-based mechanisms have shown some limits in reaching scale and achieving transformational impact due to onerous administrative procedures, but also approvals of some questionable projects, which has led to decrease in public support. As such, it would be important to fully utilize the lessons learned and build upon the already concluded work to improve the implementation of these market based mechanisms.

Ideas for the future

To reflect the lessons from the past years, Nordic countries can become active with some of the below ideas for future actions.

-> Founding a Nordic de-risking platform

After looking at the several individual success cases on de-risking private finance, and also reflecting on the gaps, it becomes evident that there is a strong benefit of centralized coordination of projects and funds amongst Nordic countries through a joint platform. It would ensure information sharing on viable projects and give access to Nordic de-risking instruments such as export guarantees, equity, loans and project development grants, all in one place. Project developers could approach a centralized entity and be linked with different Nordic de-risking institutions (ECAs, DFIs) for different kinds of specific needs. The specific deals would still remain independent, but a centralized entity would ensure coordination of efforts and resources and enhance cooperation between the Nordic countries.

Nordic cooperation through pooled funding and spreading risks across different stakeholders would be a great option, comments Dan Cleff from EKF.

-> Founding a Nordic Public-Private Smart Climate Fund

A pan-Nordic public-private climate fund could help to fill gaps in the Nordic climate finance landscape, e.g. by using smart aggregation tools for bundling smaller projects on energy efficiency and land use. The bundling of resources in a larger fund also enables the spreading of risks across projects and funders. By involving public high-risk capital (equity, mezzanine or guarantees), a larger number of private institutional investors could be involved. With public and private anchor investors like DFIs or Danish pension funds, the fund could also attract the interest of other Nordic pension funds.

-> Connecting actors for climate-friendly investments in corporate supply chains

We propose that the Nordic Council of Ministers starts to facilitate the interaction between existing sustainable supply chain actors, such as the &Green Fund, Nordic DFIs and the corporate sectors in the Nordics. Such interactions could improve knowledge and cooperation, also potentially helping to raise funding for existing funds and platforms, such as the &Green Fund.

The Nordic corporate and financial sectors, potentially supported by some public funding, could establish a supply chain climate action facility that would focus on facilitating low-carbon investments in supply chains. The facility could offer technical support and connect private and public-sector actors for financing projects with a focus

on climate-smart agriculture and forestry, water efficiency and watershed management,

zero deforestation, forest conservation and rehabilitation, and livelihood improvement. To avoid overlaps and find synergies with the &Green Fund, such new facility would not provide investment finance but support the development of projects and corporates that could then become investment cases for the &Green Fund.

Corporate climate action in North-South supply chains will always be closely linked to public policy initiatives and incentives from the government, public sector and consumers. Aligning the procurement policies of Nordic cities and national governments with the climate agenda would further support the design and production of low-carbon products across sectors driving significant climate investments in the supply chain. Similarly, Nordic governments, cities and public institutions could further raise awareness across consumers on the value of selecting low carbon products and services.

Financial institutions in the Nordic countries could also find ways to incentivize such corporate practices and performance by further recognizing and rewarding corporates sustainability and climate performance in North-South supply chains. This can be done through better commercial terms in relation to trade finance, credit loans and others.

-> Using Article 6 (market-based mechanisms) to mobilize private finance

Drawing on the extensive experience of Nordic countries with the Kyoto Protocol's market-based mechanisms, the Nordic countries can contribute to the development and testing of cooperative approaches under Article 6 of the Paris Agreement. Such approaches can have a significant role in mobilizing private sector finance for climate action.

Article 6.2 enables Nordic countries to team up directly with individual emerging countries to set up and implement collaborative market instruments that will lead to internationally transferred mitigation outcomes (ITMOs), which can be used to count towards the achievement of the countries' NDCs. Article 6.2 instruments provide a flexible and decentralized solution for implementing international cooperation and are subject to international safeguards under the United Nations Framework Convention on Climate Change (UNFCCC) in relation to environmental integrity, sustainable development and transparency. For those Nordic countries who still purchase carbon credits this would mean closer cooperation with host countries and potential support for domestic policy instruments (e.g. feed-in tariffs) that mobilize private finance. Article 6.4 creates a centralized, international crediting instrument under the UNFCCC, with assured quality and acceptance of emission reductions that may be used by all countries to help achieve their NDCs and support their sustainable development efforts. While the implementation of Article 6.2. And 6.4 is still subject to further UNFCCC negotiations, Nordic countries can already move ahead with bilateral test instruments that can later on be integrated under Article 6.2.

Nordic Council of Ministers is the official body for intergovernmental cooperation in the Nordic region. It seeks solutions with visible positive effects for everybody who lives in the Nordic countries.

Implementing partners of the Nordic Public-Private Collaborative Platform for Mobilization of Climate Finance:

South Pole offers a full spectrum of sustainability solutions to both public and private clients. We are proud to support notable organizations in taking meaningful steps to improve their performance and to reduce their negative impact on the environment, affected communities and the climate.

Gaia is a consultancy for sustainable business. We help our clients become more competitive with responsible business that respects the environment. Sustainable business means efficiency, reduced risks and more opportunities. It's all about producing more from less.

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