Possible Role for the CDM in Green Bond Principles and Impact Investing

CDM for the Future Workshop – Bonn, 15 September 2014

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Investment Decisions

Weighted Average Cost of Capital =

$$E/T * (C_e) + D/T * (C_d) * (1 - R)$$

Where:

E = Equity

D = Debt

T = Total project cost

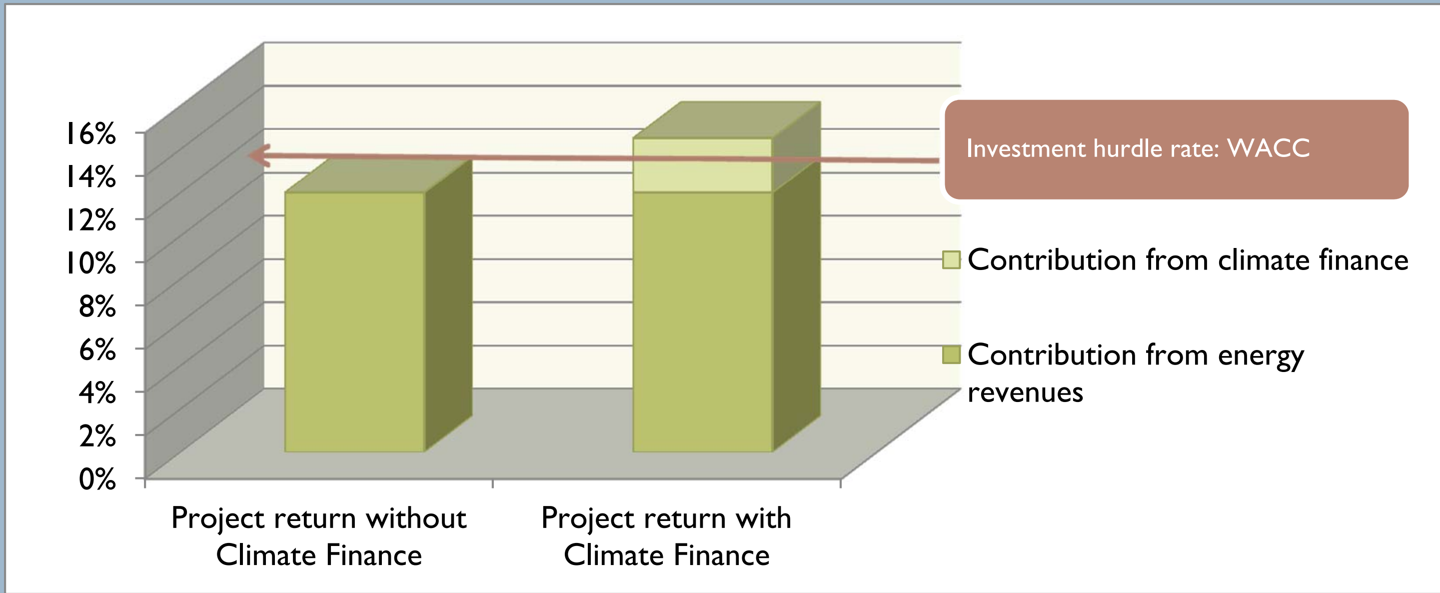
C_e = Average cost of equity

C_d = Average cost of debt

R = Project marginal tax rate

Additionality and Climate Finance

The specific aim of climate finance is to use various instruments – namely interest rate subsidies, carbon finance, grants, guarantees and tariff support - to influence project design and investment decisions



Note: the above is for illustrative purposes only

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Green Bonds

Potentially similar in its effect to climate finance initiated from public finance sources are green or climate themed bonds. Such bonds initially began as a funding source for multilateral development banks' lending to renewable energy and other environmentally beneficial infrastructure projects, but are increasingly being considered by corporates as a means of raising asset finance – either for new projects or to refinance existing assets.

First green bond in 2007. There are now over US$21 billion in green bonds globally, of which $10 billion was issued in 2013. Forecasts by Bloomberg New Energy Finance suggest that up to $40 billion will be issued in 2014, most of which will be "self labelled".

To date there is no industry wide standard that defines a green bond, though in January 2014 a collection on banks published the Green Bond Principles (GBP) to help provide guidance to issuers.

Sources: Bloomberg New Energy Finance (BNEF) and the International Capital Market Association (ICMA)

Key Requirements - Eligibility

The GBP recognize several broad categories of potential eligible Green Projects for Use of Proceeds including but not limited to:

- ☐ Renewable energy
- ☐ Energy efficiency (including efficient buildings)
- ☐ Sustainable waste management
- ☐ Sustainable land use (including sustainable forestry & agriculture)
- ☐ Biodiversity conservation
- ☐ Clean transportation
- ☐ Clean water and/or drinking water

Sources: International Capital Market Association (ICMA)

Key Requirements – M&V

Quoting directly from the Principles on Measurement and Verification:

The GBP recommend the use of quantitative and/or qualitative performance indicators which measure, where feasible, the impact of the specific investments (e.g. reductions in greenhouse gas emissions, number of people provided with access to clean power or clean water, or avoided vehicle miles travelled, etc.). While there is variability in impact measurement systems, much progress towards standardization has been made in the past several years.

Issuers are recommended to familiarize themselves with impact reporting standards and, where feasible, to report on the positive environmental impact of the investments funded by Green Bond proceeds.

Sources: International Capital Market Association (ICMA)

Key Requirements – M&V

Second party consultation

- Issuer ("first party") can hire an expert consultant ("second party") with climate expertise to help in the establishment of a Green Bond's eligible Green Project categories. The issuer may choose to keep the recommendations of the consultant private.

Public reviews and audits

- If an expert consultant or auditor and an issuer so choose, a consultant's recommendations or an auditor's evaluation may be put in the public domain by the issuer

Third party verification

- At least one or more standards intended for use by accredited third parties to certify Green Bonds are in development. The GBP are supportive of certification of Green Bonds against fully developed and vetted standards. It is also the intention of the GBP to allow for third party evaluation/audit of conformance with the guidelines recommended herein

Impact Investing

Impact investors are a nascent class of investors who generally deploy private sector capital into projects with environmental and social outcomes extending beyond business as usual. They are getting a lot of political traction, with British Prime Minister David Cameron last year raising the concept at the G8 as a way of helping to finance the environmental and social agenda of that group.

Under impact investing, expected returns somewhere around the midpoint of the commercial market and philanthropy - meaning they are a potential source of lower priced debt or equity for projects. In exchange they usually ask for a level of measurement and verification of social and environmental outcomes associated with their investments.

Sources: Global Impact Investment Network, J.P. Morgan

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Next Steps

Awareness and Consultation

- The first and perhaps most fundamental step is to engage with the industry (issuers, investors and underwriters) to increase awareness and identify cooperation opportunities

Legal Frameworks

- If in the likely event CDM becomes attractive to the industry, modifications may be needed to the legal framework constituting the CDM to make it accessible

Modification of Modalities

- Modalities themselves may need to be adapted to be fit for purpose. There will likely be costs associated with this, however it is almost certainly going to be more efficient for industry than developing its own new approach

Benefits to CDM from Green Bond Market

New Market Opportunity

- Increases demand in short to medium term for service providers within the CDM while depressed CER market conditions prevail

Alignment of Efforts

- Presents an opportunity to align efforts across the CDM, climate finance and private sector initiatives with similar objectives

Private Sector Engagement

- Development of frameworks to increase the amount of private sector capital being invested into climate finance initiatives, providing maximum leverage to public money being allocated to the area

Benefits of CDM to Green Bond Market

Legal Risk

- Issuers and underwriters face significant legal risks associated with misrepresenting the features of products in which they deal to investors

Reputation Risk

- Issuers, underwriters and investors all face the reputation risk of concentrated future efforts of NGOs and others to criticise environmental integrity of the industry

Market Growth

- Issuers, underwriters and investors all have a vested interest in establishing the conditions on which the market can grow

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