Finance, Environment and Sustainability

11th and 12th November 2016

The role of institutional investors in climate finance

GREEN WIN

Horizon 2020 Societal challenge 5

Climate action, environment, resource efficiency and raw materials

The GREEN-WIN project

- Develop transformative narratives highlighting opportunities in climate and sustainability action in order to contribute to overcoming cognitive barriers and empowering people

- **Examine climate and sustainability finance policies and governance arrangements to contribute to overcoming financial barriers to mitigation and adaptation**

- Introduce major innovations into the GEM-E3 computable general equilibrium model to discover green growth strategies

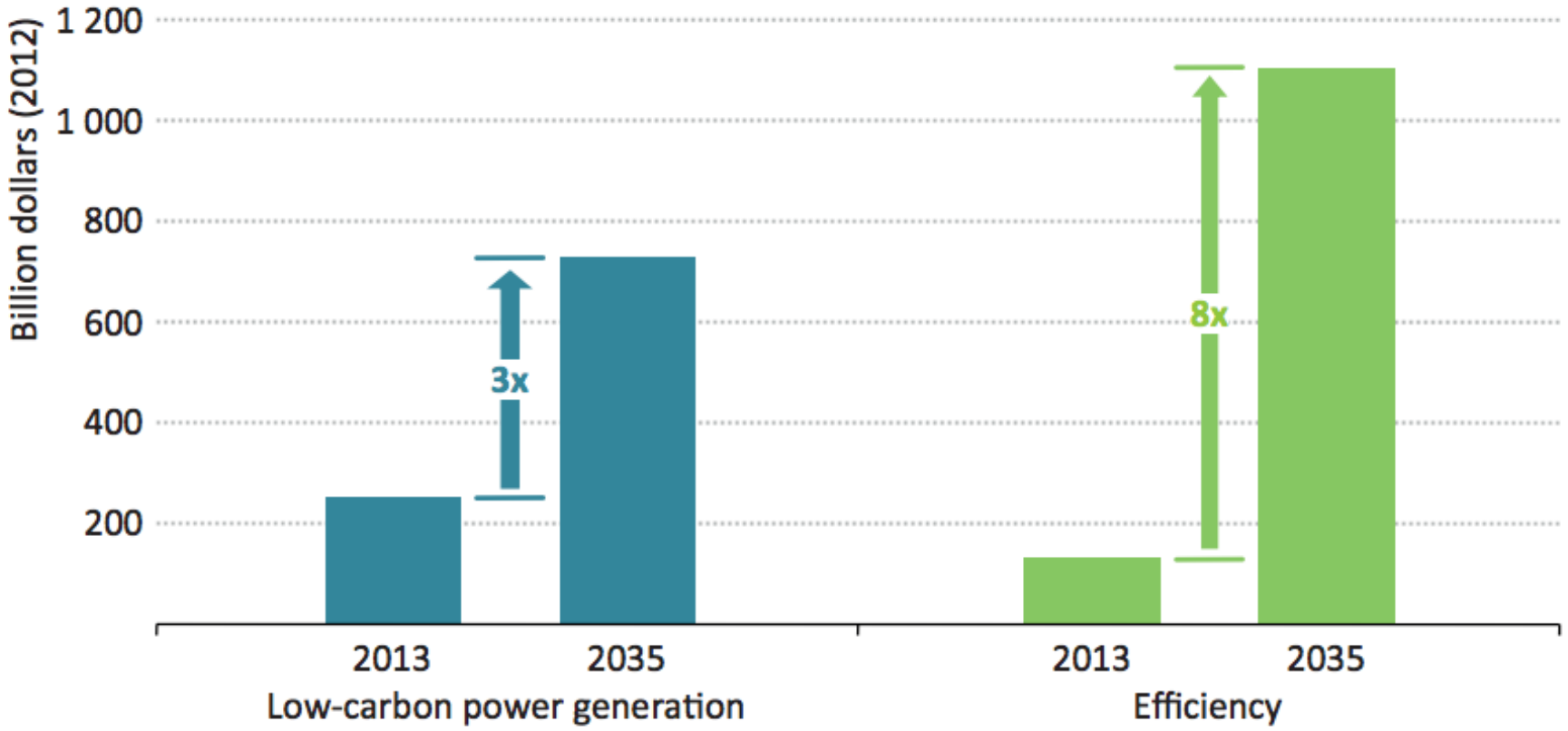
- Identifying sustainable business models in three action fields of coastal zone flood risk management, urban transformations and energy poverty eradication and resilience.

GREEN WIN

Horizon 2020 Societal challenge 5

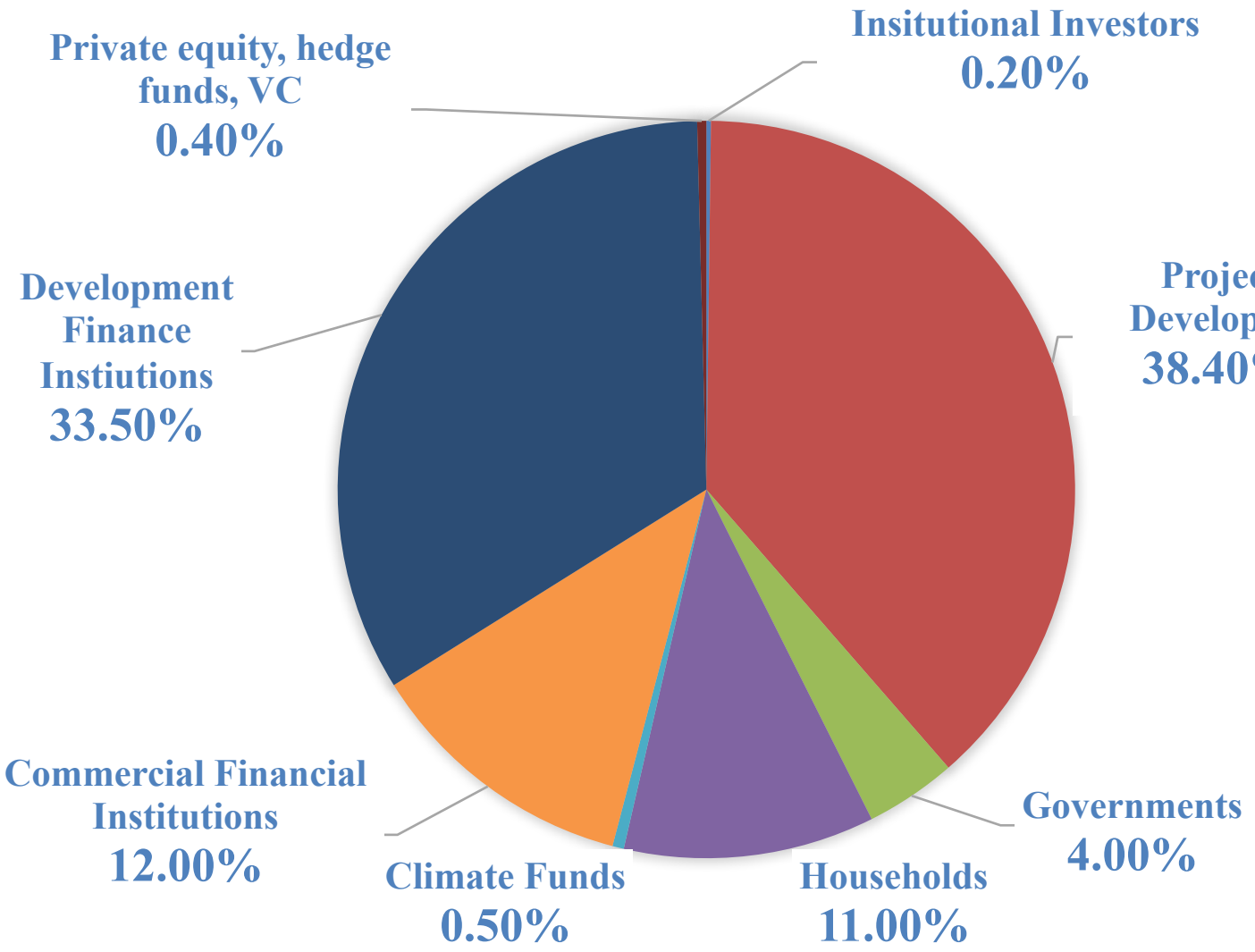
Climate action, environment, resource efficiency and raw materials

Growth in investment needs in low-carbon power generation and energy efficiency



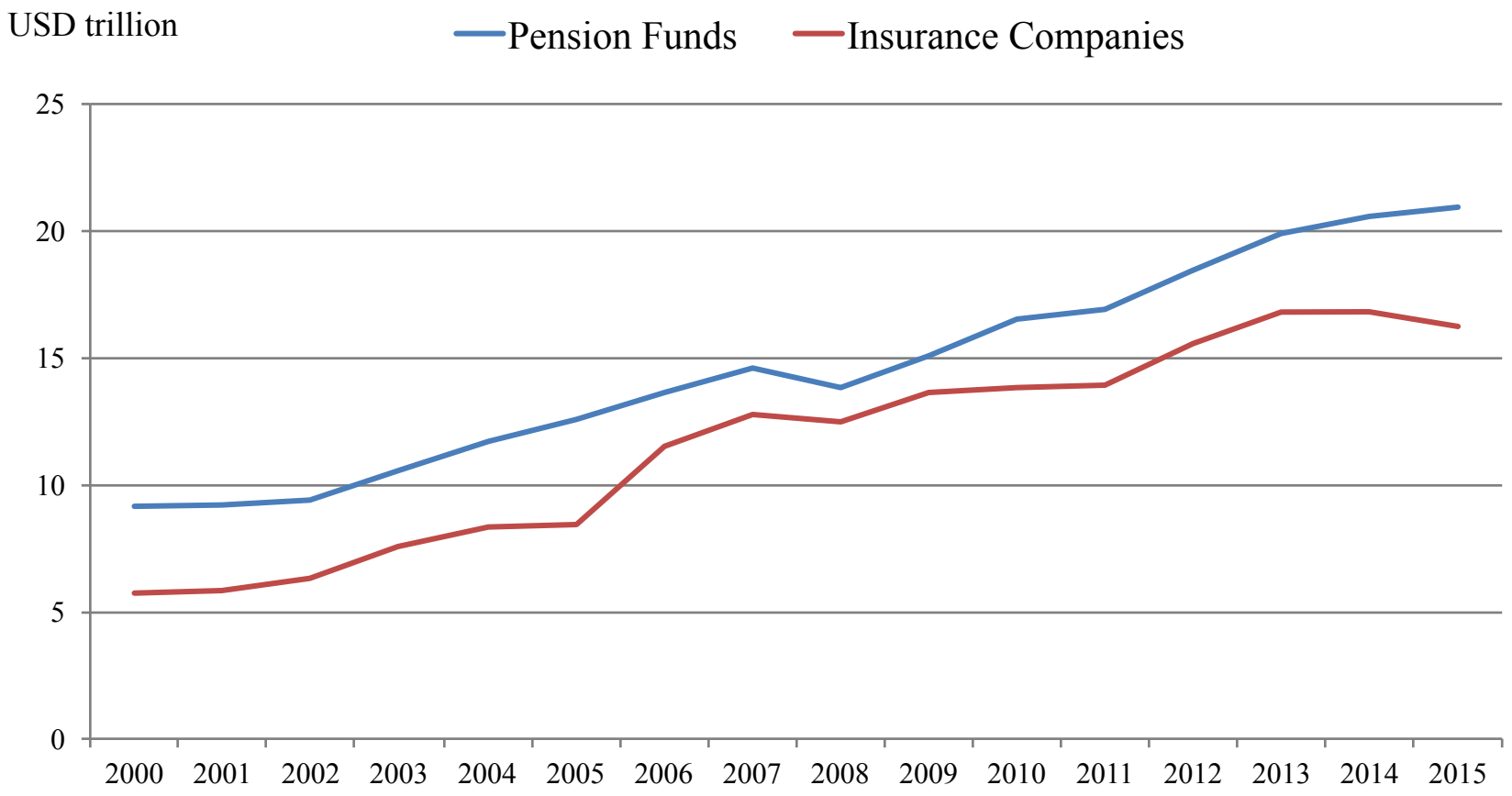
Source: IEA, World Energy Investment Outlook 2014

Sources of climate finance (about USD 360 billion)



Source: CPI 2015

Institutional investors have great potential to fill the finance gap



Source: OECD Institutional Investor's Assets Database (2015)

Research questions

- Which **asset classes and investment channels** do institutional investors **perceive as most promising** for increasing their low-carbon investments?

- What are the **factors influencing** institutional investors' **investment decision** in low-carbon?

- What **policy instruments or measures** would allow institutional investors to increase their low-carbon investments?

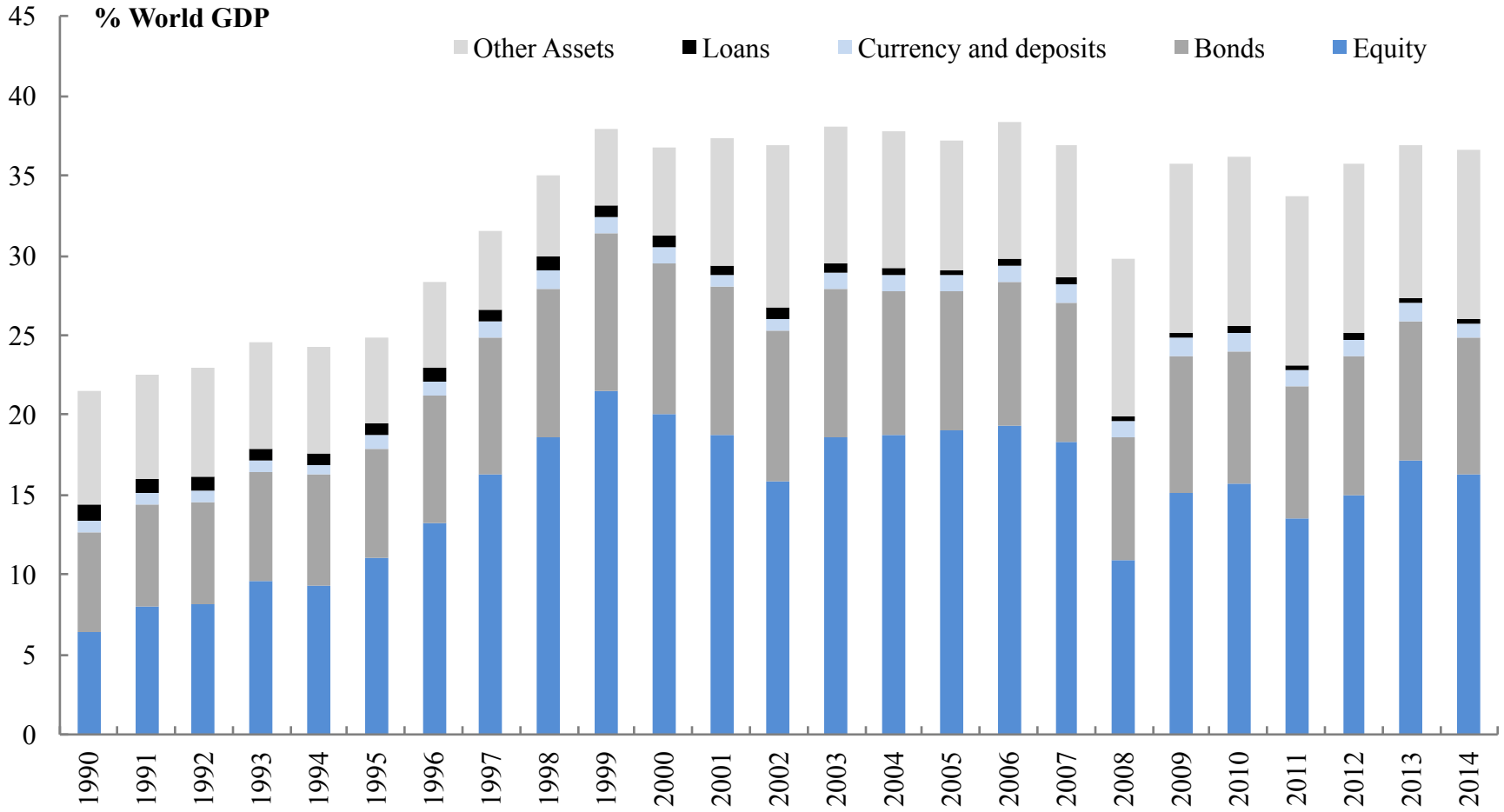
Methodology

- Finance workshop (London, July 2016)

- Direct interviews (July to October 2016)
  - EU and US
  - 30 interviews
  - sample: pension funds (8), insurers (10), academics (2), asset managers (5), advisors/DFIs (5)

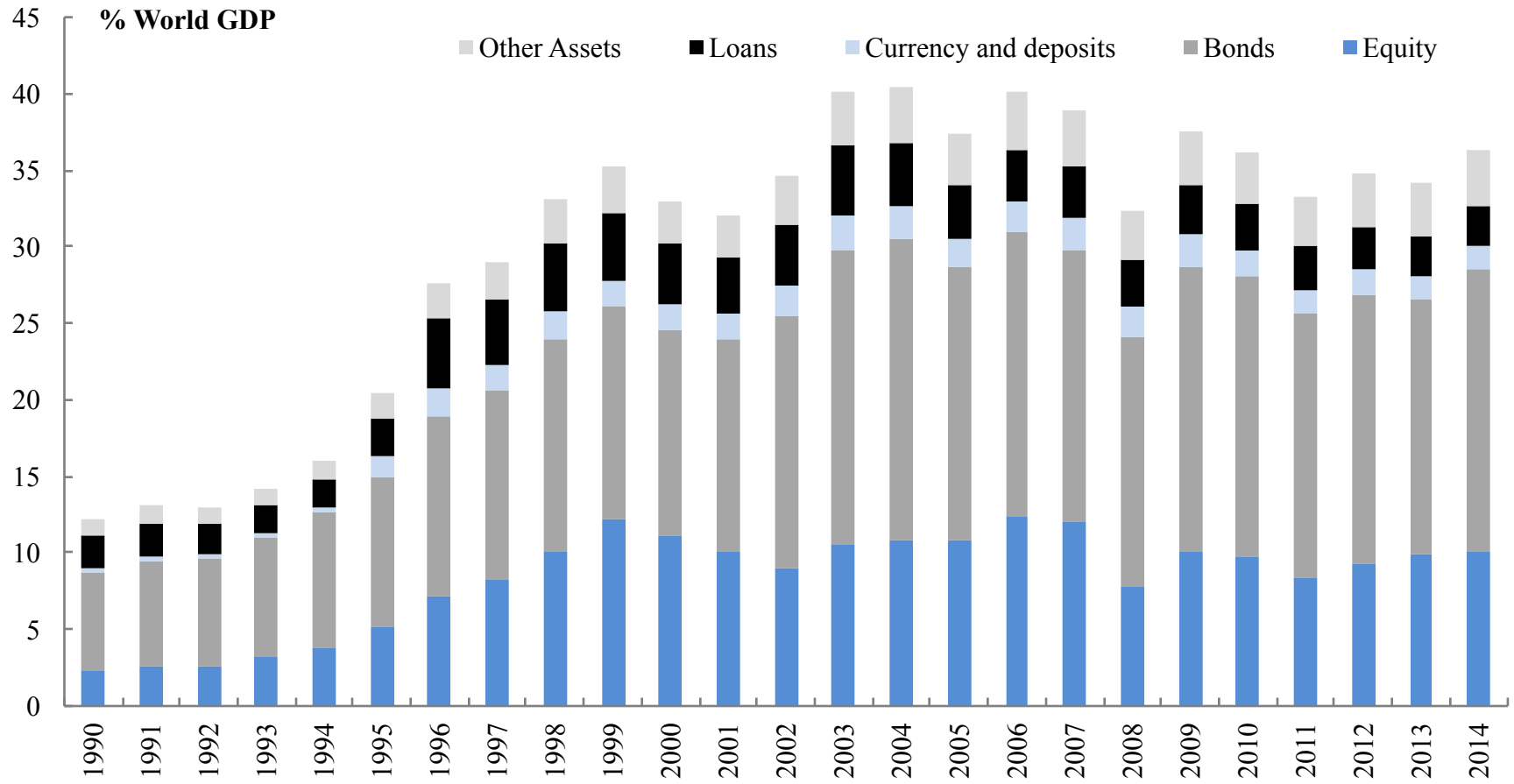
  (USD 4 trillion asset owners + USD 5.5 trillion asset managers)

Asset allocation of pension funds



Source: OECD Institutional Investor's Assets Database (2015)

Asset allocation of insurance companies



Source: OECD Institutional Investor's Assets Database (2015)

Asset allocation in low-carbon

Asset Liability Management (ALM) as the basis for selecting the core portfolio and the optimal asset allocation

- Preferred assets are fixed-income and alternatives
- Investors are relatively exposed to low-carbon assets in public equity, while they are reluctant to invest in private equity
- Differences emerge – CalPERS case (the largest public pension fund in the US, with $300 billion in assets)

Targets for low-carbon investment at portfolio level

None has set specific targets, however:

- Zurich has a target to allocate USD 2 billion to green bonds (about 1% of their total assets)
- Allianz excludes companies involved in the mining of coal and in coal-fired power generation
- CalPERS, Candriam, and Cometa have signed the Montréal Pledge, which commits them to measuring and publicly disclosing the carbon footprint of their investment portfolios on an annual basis

Investment channels

- Direct (in-house expertise) – very little
- Indirect (through funds/external mangers)
  - 2% fee on top (e.g. $100m assets -> $2m fee)
  - 10-15% performance fee
- Hybrid forms (co-investment)

Factors influencing investment decision

Key criteria for investment decision is the
risk-adjusted return

1. Government support for low-carbon investments
2. Investment & market conditions
3. Institutional investor characteristics & capability

Government support for low-carbon investments

- Stable **supporting schemes**

(e.g. Spain – retroactive change, Italy – FiT instability)

- Stable **political commitment**

(e.g. French's Energy Transition Law, California Insurance Commissioner calls for divestment from coal)

- **Other regulations**

(e.g. Solvency II)

Investment & market conditions

- Availability of investments

- Availability of **suitable investment channels**

(e.g. tradable instruments such as green bonds, energy efficiency aggregators, fee structure)

- **Lack of transparency/shortage of data**

(e.g. data disclosure, green indices)

- **Technology risk** (not really perceived)

Institutional investor characteristics & capability

- **Management experience and track record**
- **Mandate** (e.g. fiduciary duty)
- **Scale of projects/transaction costs**
- Difficult to **apply an internal carbon price**

Role of the policy and actions required

- Clear **policy signals and commitment** (eg. carbon prices)
  "policy frameworks need to be 'Three L's' - Long, Loud and Legal"
- Stable **policy framework** and supporting schemes (eg. FiT)
- **Data disclosure and transparency** (eg. standards, green indices)
- **Projects aggregation**
- Greater **DFIs involvement** (eg. taking risks, PPPs)