Process of Designing Green Banks/ Financial Institutions

Dileimy Orozco, E3G
19th March, 2019
This work is licensed under the Creative Commons Attribution-NonCommercial ShareAlike 2.0 License.

You are free to:
• Copy, distribute, display, and perform the work.
• Make derivative works.

under the following conditions:

• You must attribute the work in the manner specified by the author or licensor.
• You may not use this work for commercial purposes.
• If you alter, transform, or build upon this work, you may distribute the resulting work only under a license identical to this one.
• For any reuse or distribution, you must make clear to others the license terms of this work.
• Any of these conditions can be waived if you get permission from the copyright holder.
E3G has global experience in National Climate Financing Strategies

Core principles learned from each process
- Functions are relatively similar across countries
- Constitutional and institutional landscape are very different
- Process of building an institution is iterative.

*This is not an exhaustive representation of E3G’s experience.*
The need for a more strategic approach...

• **Developing countries are at critical stage in infrastructure development**, which in turns makes it critical that capital and investments can directed to sustainable areas.

• Public balance sheets alone are not sufficient.

• Private finance sector is rather conservative, and it tends be slow to embrace new technologies.

• In emerging/ developing economies, **the political risk sometimes can be overestimated** by the private sector as there is a lower understanding of the policies in the country.

• Textbook solutions alone will not deliver
  - Boosting private investment by only increasing rewards is a costly way of dealing with risks and market failures.
  - Low carbon responses such as a carbon price are not enough.

Green Banks/Financial Institutions bridge the gap between finance and policy
Our experience shows:

- Creating ambitious institutions doesn't have to be a highly complex process.
- It can be done quickly.
- There are methods and tools that you can use to make this process easier.

We are creating a tool for practitioners to facilitate the process and draw upon other experiences.
The process of designing Green Banks/ Financial Institutions - 5 phases

Case Making | Design | Establishment | Operation | Evolution

KEY DECISIONS AND CHOICES

Decision Making Process | Stakeholder Engagement | Analytical support | Standards and Frameworks
How the process works
Agenda setting can be influenced by different factors: external events, political driver, structural issues, pure advocacy, or a combination of the above.

Engage with key decision makers and establish their role in the process
Market testing: real economy and financiers – input to refine proposals

- What’s the **low carbon strategy**? What is the **total financing requirement to deliver it**?
- What’s the **financial landscape in the economy**? Is there a bond market; is it easy to issue equity; bank debt.
- What is the **current finance gap, and how will it be met**?
- Can the **current financial system deliver the transition**?
- Why is a policy solution better than an institutional one?
- What is the **real vs perceived risk, who owns the risk** and how to reduce the risk?

Precedents from alike institutions
OUTPUT OF CASE MAKING

- Mapping the current financial landscape.
- Low carbon agenda including targets.
- Total infrastructure financing requirement, green requirements by sector.
- Determine the missing markets.
- The objective of the GIB and proposal of the functions based on the finance strategy and market barriers.
- Market testing (finance, government, NGOs, political parties).

The output is the foundation for the key decisions and choices in the next phase.
In response to the 2008 Global Financial Crisis, E3G proposed a UK Sectoral Stimulus Package including a Green Infrastructure Bank.

The scale of financing need was unprecedented ~£40-50 Bn per year over 15 years relative to ~£6-7 Bn actually invested.

Another fund wasn’t the solution: have finite resources aimed at specific purposes, static.

Rising rewards weren’t correcting the risks, inefficient to reward investors for their perception of the political risk.

The solution needed to address at least two challenges: provision of finance and the coherence around policy frameworks.

Transform UK created. A coalition members supportive of Green Infrastructure Bank.

GIB commission was set up to consult on the creation of a GIB.

**Example: UK Green Investment Bank**

**DESIRE OUTCOME**
What do we want to achieve?

**DECISION**
Do we need a new policy or institutional innovation?

**OUTPUT**
Institutional innovation - then the choice is about new or existing institution.
Tools and inputs for the Case Making phase

**Strategy**

UK Sectoral Stimulus GfI role each stage

- Scaling-Up: 2018?
- Mainstreaming: 2025?
- Different issues at each stage

**Policy recommendations**

**Climate Change Capital**

Accelerating Green Infrastructure Financing: Outline proposals for UK green bonds and infrastructure bank

Briefing Note 1 March 2009

**Engagement and mobilization of stakeholder**

- AVIVA
- E3G
- Friends of the Earth
- Climate Bonds
- UKSIF
- ALDERSGATE GROUP
- TUC

**Decision by govt**

The Coalition: our programme for government

**Policy recommendations**

Accelerating the transition to a low carbon economy

The case for a Green Infrastructure Bank

Ingrid Holmes and Nick Mabey

Mar ‘09

2010

May ‘10

Dec’08
OUTCOME
What should or shouldn’t the institution/unit do?

DECISION
What is the most effective structure for the institution/unit?

OUTPUT
Proposal for the optimal design and capitalization

- What does the process look like?
- Which government departments need to be consulted about the GIB?
- Why wouldn’t the finance gap be met by existing financiers?
- What is the form of the institution? and why?
- How should it most effectively be set up: governance, shareholders?
- What is the scale of the capitalization?
- How is the capitalization going to be financed?
- What should it use its financial resources to support?
- How is the institution going to evolve?
Example: UK Green Investment Bank

OUTCOME
UK GIB should mobilise other private sector capital into the UK’s green economy

DECISION
A new dedicated institution
£3bn amount of capitalization
Independence established by law

OUTPUT
- Independent institution
- Focused and dedicated
- Mobilise private capital

- Coalition government included GIB in their agreement, but differed on scale, focus and structure
- Treasury didn’t see the value, prefer a wait-and-see approach
- Unprecedented scale, urgency and nature of the challenge

- Pros and cons of establishing a new or using an existing financial institution were explored.
- The capitalization depends on priority sectors and the ability and willingness of the private sector to invest. Alternative sources could have been bonds, existing quangos, Green ISAs.
- Govt initially announced £3bn for capitalization
- 6 operating principles including working towards a ‘double bottom line’, green impact and + returns
- GIB needs to have sufficient flexibility to adjust to changing market needs
Tools and inputs for the establishment phase

**Policy recommendations**

*Unlocking investment to deliver Britain's low carbon future*
*Report by the Green Investment Bank Commission*

- Jun ’10
- Sept ’10
- Oct ’10
- Nov ’10
- May ’11

**Groups mobilized**

- TransformUK
- ALDERSGATE GROUP

**Options analysis on capitalization**

*Capitalising the Green Investment Bank: Key issues and next steps*
*October 2010*

- Ernst & Young LLP

**Decision by Government**

*Update on the design of the Green Investment Bank*

*Green Investment Bank Position Statement – September 2010*

The UK is facing a time of considerable economic stress. Restoring growth and re-balancing the economy are urgent priorities. Focusing our recovery effort on low carbon growth can re-power the economy, increase our energy security and help tackle climate change.

*TransformUK*

*Investment for a clean energy future*

*The case for legislation*
OUTCOME
Reflect the optimal design of the institution as determined above

DECISION
How to ensure the institution is delivered as intended?

OUTPUT
Proposal for its optimal design and capitalization

- Who could advise on the details of establishing the GIB?
- What is the governance model?
- What about securing funds for initial establishment?
- What is the strategy?
- How does this type of institution fit within the current financial landscape?
- What are the borrowing powers of the institution?
- What is the accounting treatment required?
- What are the screening criteria to be eligible for GIB support?
- What is the risk management e.g. guidelines, geographical, sectoral?
Example: UK Green Investment Bank

**OUTCOME**
Reflect the optimal design of the institution as determined above

**DECISION**
Establish a Shadow Institution to start operations; and independent Advisory Group to advice on establishment

**OUTPUT**
A shadow bank was set up to start making deals – £775mn was allocated

The proposed governance model had 5 components

- UK Govt main shareholder
- GIB Policy Group (advice on policies to Ministers)
- GIB Corporate Board
- Committees and the Executive Management

-Funds were allocated for GIB to start operating via **Shadow Bank**

- **Legislative process** started where the GIB was going to be given a clear green mandate, key financial powers, operational independence and permanence.

- **Chairman, CEO and Board were appointed**, including six Non-Executive Directors (backgrounds in academia, business, investment funds, equity finance and the low carbon sector)

- **Ensure maximum ‘additionality’ and minimum market distortion**
ToRs for Advisory Groups

BIS Department for Business Innovation & Skills

The Green Investment Bank
The Advisory Group Terms of Reference

1. The Advisory Group is a temporary group that will operate during the incubation phase of the GIB (from the summer of 2011, for around an 18 month period). The first full meeting of the Group will be September 2011. The Advisory Group will be disbanded at the end of the incubation phase, around the time that State Aid Approval is granted by the Commission for the GIB Institution. On creation of the GIB Institution, a GIB Board will replace the Advisory Group.

Options analysis
The economics of the Green Investment Bank: costs and benefits, rationale and value for money

Legal analysis
Towards the Green Investment Bank Act
Legislation to secure the mandate and governance of the UK’s Green Investment Bank

Stakeholder engagement

Decision by Government
Oral statement to Parliament
The Queen’s Speech 2012

HM The Queen addressed Parliament about the legislative programme for government, with an introduction from David Cameron and Nick Clegg.

My government will introduce legislation to establish a Green Investment Bank.

Impact Assessment before legislation

<table>
<thead>
<tr>
<th>Title:</th>
<th>UK Green Investment Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>IA No:</td>
<td>98666342</td>
</tr>
<tr>
<td>Lead department or agency:</td>
<td>BIS</td>
</tr>
<tr>
<td>Other departments or agencies:</td>
<td>DECC, DEFRA, HM Treasury</td>
</tr>
</tbody>
</table>

Contact for enquiries: Emily Croke (emily.croke@bis.gsi.gov.uk)

Summary: Intervention and Options
RPC Opinion: RPC Opinion Status
Key takeaways

• Everything is different but everything is the same

• The process is the same across countries, and breaking it down into bitesize chunks makes it easier to deliver and explain.

• The core functions of this type of institutions are highly similar between countries.

• There are some critical decisions that are going to take you along different pathways which are bespoke to the country context.
Next steps

• Create a general framework for designing Green Banks/Financial Institutions as a tool for decision makers.

• Illustrate the process with different designs and tools that are going to be available for use in your own process

• Planning to incorporate more case studies:
  - South African Green Fund
  - Colombia Sostenible – land-related fund

WE WOULD LIKE TO HEAR FROM YOU
Thank you

You can read more at:

https://www.e3g.org/showcase/green-investment-bank
https://www.e3g.org/showcase/mexico-in-focus/
https://www.e3g.org/showcase/international-climate-finance/
https://www.e3g.org/showcase/international-financial-institutions

Contact me at: dileimy.orozco@e3g.org
About E3G

E3G is an independent climate change think tank operating to accelerate the global transition to a low carbon economy. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere. In 2018 E3G was ranked the fifth most globally influential environmental think tank for the third year running.

More information is available at www.e3g.org