FINANCING THE FUTURE FUND

Triple F

ABSTRACT

A Dutch Climate Fund can provide the much needed instrument to leverage public – private financing in mitigation and adaptation projects and to enhance Dutch business interests in the international environmental market.

Rebel

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Executive summary

Introduction

This report presents the results of a study prepared by Rebel to assess the feasibility of a Dutch public-private sector climate fund (Fund) specializing in investing in climate adaptation and climate mitigation projects in developing countries (Climate Investments). The study is funded by the Ministry of Foreign Affairs (MFA) of the Netherlands.

By pledging long term financing under the Copenhagen Accord, the Dutch government has ushered in a new era of Climate Investments. There are many opportunities to assist the Netherlands in achieving its climate change objectives. As of the time of writing, there are more than 50 international public funds, 45 carbon markets and 6,000 private equity funds. Hence, the Dutch government is faced with a challenge on how to (i) identify which climate instruments are most appropriate, (ii) best coordinate actions, and (iii) to monitor and evaluate the results.

One instrument for the Netherlands to foster Climate Investments is setting up a Fund that could assist the Netherlands in mobilizing climate finance from a variety of sources, to coordinate and blend these sources and to account for them. In this way, the Dutch government is in the driving seat and can make informed choices for directing resources toward activities that deliver results on the ground[1].

The overarching goal – as expressed in the Terms of Reference (ToR)[2]– of the Fund is to mobilize Dutch private financing at scale (EUR 600 million a year) for Climate Investments in developing countries while minimizing public (ODA) financial support. In addition to mobilizing Dutch private financing, the Fund should also:

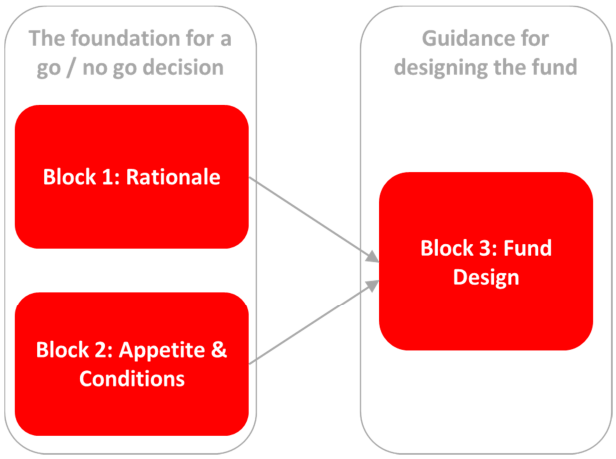
- Maximize development of co-benefits (especially poverty reduction);
- Promote Dutch business interests and;
- Be highly politically visible as a Dutch contribution to mobilizing international climate finance
  in the context of the international climate negotiations.

To address the above overarching goal three interrelated objectives were formulated. Firstly, to identify the rationale of setting up a dedicated Fund as an instrument supporting Dutch government long term commitments under the Copenhagen Accord. Secondly, to identify the private sector appetite and conditions to funding. Thirdly, to identify possible fund designs that optimize leverage at Fund level. Please refer to figure 1 presenting these three building blocks.

[1] Source: United Nations Development Programme: Blending Climate Finance through National Climate Funds. A guidebook for the design and establishment of national funds to achieve climate change priorities

[2] Available at the Ministry of Foreign Affairs. The goals should be interpreted against the background of limitations within the national budget in combination with an increasing long term commitment for climate financing.

Figure 1: Feasibility study building blocks



Rationale

The amount of climate finance required to combat climate change on a global scale is uncertain and dependents on a number of factors such as economic growth and technological improvements. Several international research organizations however have estimated the expected investment need, indicating – at the higher end of the spectrum – amounts to tens of trillions USD in total. According to the CPI, in 2010 and 2011, a total of USD 32.5 billion in climate finance was provided in by the bilateral and multilateral development banks.

Irrespective of the various sources for climate finance, the flow of these funds to actual projects on the ground has been limited over the past years due to various reasons. One overarching factor is the economic downturn and slow economic recovery in major economies, impacting the availability and flow of funds to mitigation and adaptation activities. Some important barriers in the context of this study are: market failure, uncertain regulatory framework, lack of financial returns and financial instruments and weak project development.

Government policies have a significant impact on the funding and implementation of Climate Investments. A mix of various interventions are needed ranging from long term policies, guarantees and insurances and incentives like technical assistance (TA) and capacity building programs. However, not every government will have the financial means and/or regulatory governance structure in place to install these policies. This is especially the case for least developing countries. The developed countries acknowledged this and pledged to mobilize additional funds, increasing towards USD 100 billion a year by 2020, from public and private sources, to address the needs of developing countries (the Copenhagen accord). Part of the commitment is that steps in that direction must be taken now.

A crucial element in the above statement is the acknowledgement that private finance also counts in the USD 100 billion goal if it is mobilized through public intervention. This increases the importance of instruments that foster the flow of private capital at a large scale and over a long term horizon. The Dutch fair share under the Copenhagen Accord may increase from EUR 200 million in 2013 to EUR 1.2 billion in 2020.

The MFA budgetary pathway for climate relevant expenditures – which includes a contemplated EUR 100 million mobilised private finance - does not meet the budgetary needs. There will be an estimated increasing shortfall of approximately EUR 100 million in 2015 increasing to almost EUR 500 million in 2018. Without interventions it will have increased even more in 2020. Options to fill this shortfall include increasing public funding and/or mobilizing more private capital through a mix of public interventions, including existing instruments and the proposed Fund.

The Dutch government has several instruments at its disposal to meet its fair share under the Copenhagen Accord. These instruments should not only meet MFA objectives, but also create a new realm of opportunities for the Dutch private sector that recognizes the economic chances associated with a global transition to a low-carbon economy. Following on from our quick scan of existing instruments we conclude that existing instruments are not able to fully meet MFA's climate objectives, in particular as far as the crucial private leverage is concerned:

- Existing Dutch instruments like grants are not designed to realize and/or maximize private leverage on a structural basis.
- Multilateral funds are unable to turn to good account the full potential of Dutch private sector involvement in climate investments. When Dutch private sector leverage is realized, it does not fully contribute to the Dutch fair share.
- Existing instruments are not designed to limit political involvement. Keeping politics at arm's length is crucial for successful public private cooperation.

The proposed Fund can potentially involve the private sector on a more substantial and structural basis. A Fund is a good instrument to leverage private funds on both fund and project level. Consequently it can boost the Dutch contribution under the Copenhagen Accord.

Appetite

An important finding of this study is that large pension funds showed a willingness to further explore the possibilities of setting up the proposed Fund. It is important to continue the dialogue, as pension funds are at the moment actively pursuing their sustainability policies. Blending their funds with (concessional) MFA funds can help to foster investments in projects and/or countries that would otherwise be marked non-investment grade by the pension funds. Direct involvement of Dutch flagship companies in the design phase can improve the match between the Funds conditions and possible projects.

With their EUR 1 trillion in assets as of the end of December 2012, Dutch pension funds - along with other investors - potentially have an important role to play in climate related to these investments. Institutional and private investors are now investing in climate change related projects via equity (including indices and mutual funds), fixed income (notably green bonds) and alternative investments (such as direct investment via private equity or through green infrastructure funds). Yet, despite the interest in these instruments, private capital allocation to Climate Investments remains low due to barriers including lack of appropriate investment vehicles and knowledge, track record and expertise among pension funds / commercial lenders about these investments and their associated risks. On top of this, LDC's are often "out of area" for many institutional investors. There is also a perceived knowledge gap with institutional investors regarding more complex adaptation projects, the focus is on mitigation.

From private sector consultations it can be concluded that the private sector parties reasonably differ:

- Pension funds are mainly interested in equity and in low risk and return investments (merely returns which cover inflation).

- Commercial banks mainly invest in debt and are looking for higher - but balanced - risks and returns.
- Both pension funds and large commercial banks are interested in a fund which can lower the risk profile of Climate Investments.
- Smaller commercial banks are mostly looking for funding to increase their ticket size. In addition, the Fund should not try to combine all investors but rather start small and be flexible to expand.

The large pension funds have a long term funding timeline, which matches the expected time horizon of the Dutch commitment under the Copenhagen Accord. Funding from commercial banks and other financial institutions on Fund level is not readily expected. A Dutch Fund is strongly positioned to trigger "appetite" of Dutch banks and industry at project level.

The appetite will in the end strongly dependent on the objectives and framework of the proposed Fund. Key is therefore to approach private capital investors with a detailed information memorandum highlighting the scope and nature of the Fund, the Fund Manager, Fund objectives, envisaged capitalization, governance, fiduciary management, implementation agreements and monitoring, reporting and verification plan.

Dutch companies are internationally recognized for their expertise in agriculture, water management, transport and energy efficiency. The Netherlands also enjoys strong financial structuring expertise, among which the structuring and engineering of public private partnerships, a much needed quality for capital intensive Climate Investments. Early stage involvement could enable them to benefit from the Fund once established.

Fund design

The objectives and criteria of public and private parties show that there are several differences of interests, the most fundamental being:

- The private sector investors want a clear single objective, without additional co-benefits like poverty reduction, while the public sector prefers to include these co-benefits in Climate Investments.
- Investment grade criteria for recipient countries limits the number of eligible countries, including several countries with which the Netherlands has aid relationships.
- The private sector demands acceptable risk adjusted financial returns.

These differences of interest show that both parties will have to do concessions in order to come to an agreement on Fund objectives and design. The process of achieving a Fund would therefore be a negotiation where both parties "give and take". Both sides will have to consider whether the concessions are worthwhile to achieve their objectives.

This study includes two potential scenarios for the Fund. The institutional investors were not in a position to commit to a specific amount of funding as the public conditions are still subject to debate. This makes the indicated leverage subject to a high degree of uncertainty.

In both scenarios the Dutch government furnishes EUR 200 million in the Fund. In scenario one 25% of total public funds constitutes a grant, partly used for technical assistance, focussing on local governments (e.g. strengthening institutional capacity, governance and decision-making processes for climate compatible development). In scenario two there is no grant element, with possible

consequences for ODA-eligibility of public funds. In both scenarios Dutch business interests are supported as far as possible.

In both scenario's we included a first loss guarantee. This means that the the provider of the guarantee – the public sector - is liable to bear losses up to a certain specified limit. The government has to be careful with this, because taking on board too much risk can erode incentives at the private side. We would therefore suggest that both returns and losses are divided between the public and private side. To be able to attract institutional investors, it may however be necessary to balance first losses (modestly) towards the public side and to balance first returns (modestly) towards the private side. Following this line of thought, the government is also responsible for (TA) expenses that will not be acceptable for private partners.

Table 2: Overview of the scenario's

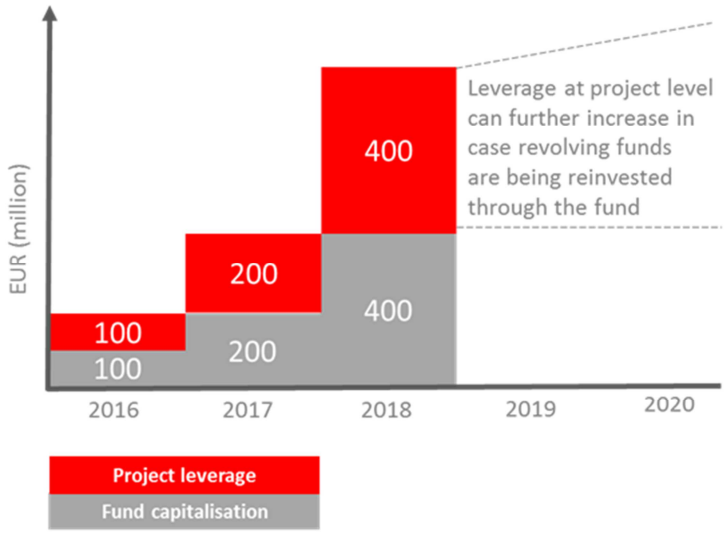
Scenario one	Scenario two
Fund supports primarily mitigation projects in investment and non-investment grade ODA-countries. The Fund acts as a minority investor in projects.	Fund supports mitigation and adaptation projects and allocates a fixed share to least developed non-investment grade countries. The Fund acts as a shared investor in projects and sets additional objectives (such as poverty reduction) for those projects. The government takes a first loss.
Estimates: • Leverage at fund level EUR 160 – 240 million • Leverage at project level at minimum EUR 320-480 million (>50%) • Revolvingness: fully revolving. Private sector takes first profits; public sector funds TA	Estimates: • Leverage at fund level EUR 80 – 120 million • Leverage at project level at minimum EUR 320-480 million (>50%) • Revolvingness: ±90%; public sector takes first losses and funds TA
Public concessions: • Government takes first loss up to limit • No guarantee that least developed countries will be served significantly – it may be expected that most of the investments will take place in investment grade countries that are on the OECD DAC list of ODA recipients	Public concessions: • Government takes first loss up to limit • More difficult to gain leverage and obtain revolvingness on project level in adaptation projects and non-investment grade countries.

The two scenarios above both describe a fund size of EUR 440 million – *in total*. Even if one takes leverage at project level into account, the Dutch government is still short in meeting its commitment under the Copenhagen Accord. Maximization of leverage is the key. There are of course several other fund designs thinkable. Of course, there are nuances applicable to the distinction between adaptation and mitigation. There can be adaptation projects that are financially viable or viable combinations of adaptation and mitigation projects.

In an optimistic scenario, a total of EUR 0.8-1.2 billion can be mobilised by the Fund. At fund level the public contribution (EUR 200 million) can be matched by the private sector. A further 50 percent leverage on this total amount of EUR 400 million can be achieved at project level. The capitalised EUR 800 million can be further increased by attracting additional funds over time or reinvesting revolving funds in case the fund is successful in terms of financial returns. This would mean that every EUR invested by the government could be multiplied by a factor 4 (leverage at fund and project level) to 6 (reinvestment of financial returns). The total leverage on project level over time is illustrated below. It

does not take into accounts reinvestments, due to uncertainties around variables that determine the available budget for reinvestments. Examples are time horizon of projects invested in, grant/TA share and repayment design (e.g. annuity repayments, grace periods etc.).

Figure 2: an estimation of total capitalisation of the Fund and potential project leverage over time



Additional leverage on fund level can be created, over time, by raising additional capital through issuance of new shares. The more successful the fund manager is in raising additional private sector monies, the more leverage that can be created per EUR public money invested in the Fund. Obviously the success of raising additional capital will depend on the financial performance of the Fund.

However, a maximum leverage should not be the objective itself. In the end there is a trade-off between leverage/risks appetite and other objectives such as inclusion of (low/slow return) adaptation projects, project development in some "difficult" countries etc. Moreover maximum private leverage can be reached by MFA taking a maximum risk. A more balanced strategy might be worthwhile to pursue.

Conclusions and implementation

Rebel advises the MFA to opt for a Dutch Fund and take a step by step approach.

1. Following the GO decision, define the public budget for first capitalization, negotiable and non-negotiable objectives and write an information memorandum;

    To successfully achieve alignment of interest, MFA needs to first determine how much capital to commit from their own sources followed by categorising their objectives in negotiable and non-negotiable assets classes. Non-negotiable conditions could for example be the exclusion of partner countries of the Netherlands.

    These conditions can be included in a detailed information memorandum highlighting:

    - *Fund objectives*
    - *Scope and nature*
    - *Fund Manager*
    - *Fund objectives*

- *Envisaged capitalization*
- *Governance*
- *Fiduciary management*
- *Implementation agreements and monitoring*
- *Reporting and verification plan.*

2. With a selected group of financial institutions start the process of aligning interest by defining qualifications of the fund manager and Fund objectives, criteria and instruments. Commercial banks and possible fund managers should be consulted actively in this process.
   - *Establish a common ground by:*
     - *Defining the driving force behind the Fund (a must have)*
     - *Creating a strong vision*
     - *Defining the objective of the Fund*
     - *Setting investment criteria and instruments*
   - *Align and balance public and private interest by:*
     - *Defining social and financial returns*
     - *Defining risk mitigation tool including first loss positions, guarantees and insurances*
   - *Consult Dutch business informally. This may give an indication of a possible pipeline with investments.*

3. Design the Fund build on the outcome of step 2 and prepare procurement of fund management.
   - *Initial fund size (combined public and private funds) for 2016 of EUR 100 million*
   - *Procurement of the fund manager on qualifications and track record in managing a EUR 300-400 million fund.*

4. Raise further capital in small ticket sizes to keep it manageable, growing to EUR 400 million in 2020.
   - *The EUR 400 million Fund should trigger at least EUR 600 million of climate investments, taken into account that the Fund is a financing instrument.*
   - *Further development of the Fund will depend on its success and parties willingness to invest additional funds.*

The planning would be as follows:

Table 3: Indicative planning

Period	Activity	Financially
Q4 2014	Information memorandum + negotiation institutional investors	Commitment 2* 50 million, second pledge and growth till 400 million (together)
Q4-Q1 2015	Preparation tender documentation	
Q2-4 2015	Selection fund manager	
Q1 2016	Fund operational	EUR 100 million total (2*50)
2017	New pledge	EUR 100 million
2018	New pledge	EUR 200 million
2019	Evaluation fund performance	
2020	Possibility for a new pledge (in case of outperformance)	

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One instrument for the Netherlands to foster Climate Investments is setting up a Fund that could assist the Netherlands in mobilizing climate finance from a variety of sources, to coordinate and blend these sources and to account for them. In this way, the Dutch government is in the driving seat and can make informed choices for directing resources toward activities that deliver results on the ground[4].

The overarching goal – as expressed in the Terms of Reference (ToR)– of the Fund is to mobilize Dutch private financing at scale (EUR 600 million a year) for Climate Investments in developing countries while minimizing public (ODA) financial support. In addition to mobilizing Dutch private financing, the Fund should also:

- Maximize development of co-benefits (especially poverty reduction);
- Promote Dutch business interests and;
- Be highly politically visible as a Dutch contribution to mobilizing international climate finance in the context of the international climate negotiations.

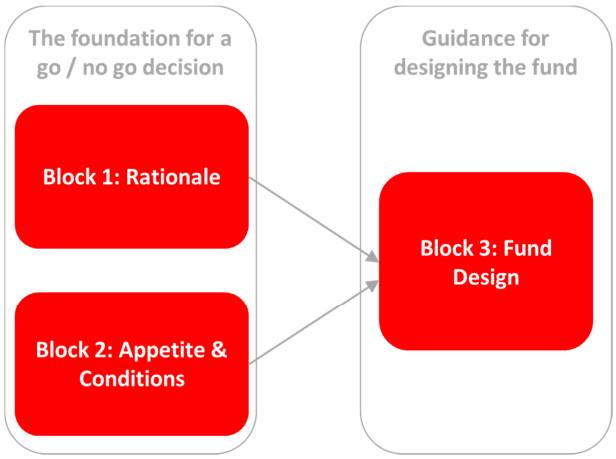
Structure

To address the above overarching goal three inter-related objectives were formulated. Firstly, to identify the rationale of setting up a dedicated Fund as an instrument supporting the Dutch government long term commitments under the Copenhagen Accord. Secondly, to identify the private sector appetite and conditions to funding. Thirdly, to identify possible fund designs that optimize leverage at Fund level. Please refer to figure 1 presenting these three building blocks.

[3] Source: United Nations Development Programme: Blending Climate Finance through National Climate Funds. A guidebook for the design and establishment of national funds to achieve climate change priorities

[4] Source: United Nations Development Programme: Blending Climate Finance through National Climate Funds. A guidebook for the design and establishment of national funds to achieve climate change priorities

Figure 3: Feasibility study building blocks



The output of the study provides the MFA sufficient information to make a balanced and well-informed decision on how best to proceed in relation to the establishment of such a Fund.

This study presents the results of desk research, workshops and interviews undertaken to identify the rationale, appetite to funding and the potential to create leverage. It is structured along the following lines and addresses the following research questions as identified in the ToR:

Table 4: Building blocks and Terms of Reference questions

Building block 1	Chapter 1 – The rationale for a fund – addresses the need for financing Climate Investments and the available sources • Is there a need for climate investments? • What does the climate finance landscape look like, what are the barriers to finance and what is the role of governments? • What are the objectives and available funds of the Dutch government? • What are existing available instruments in this policy area?
Building block 2	Chapter 2 – Private sector appetite and conditions to funding – defines the appetite and conditions to funding of institutional investors and Dutch business community involvement • What are differences between investors, e.g. pension funds and banks/insurance companies? • Which institutional investors are most suitable to be involved in a Fund? • What are the most important criteria of institutional investors? • What are sectors and technologies that could benefit and what kind of projects could be funded? • What are the implications of fund design for the promotion of Dutch business interests?

Building block 3	Chapter 3 – Designed to align public and private interests – combines the results of chapters 1-3. • What are the differences between public and private interests and where can common ground or complementary be found? • What are examples of successful public-private funds? • What are possible first sketches of a fund?
Conclusions	Conclusions and next steps • How could a next phase be entered into? • What should be negotiated?

1 The rationale for a Fund

This chapter addresses the need and sources for Climate Investments, the projected MFA sources to meet the government's commitment under the Copenhagen Accord and to what extend the proposed Fund is in addition to or complements to other instruments in the climate finance landscape.

1.1 Climate change requires global action

Climate change impacts our environment and economy across a number of areas, including water security and supply, agriculture, coastal areas and health. Due to increasing temperatures climate change can for instance cause droughts and thereby increase malnutrition and health problems. At the same time the rising sea level increases the burden on coastal protection and can threaten millions of people living in coastal areas.

According to the World Bank global action is needed to reduce the adverse effects of climate change on human and natural systems by e.g. making cities more climate resilient, agriculture less carbon intensive, energy more efficient and renewable, and by pricing carbon emission and reducing carbon subsidies especially in the least developed countries.[5]

1.2 Combatting climate change requires huge investments

The amount of climate finance required to combat climate change on a global scale is uncertain and dependents on a number of factors such as economic growth and technological improvements. Several international research organisations however have estimated the expected investment need, indicating – at the higher end of the spectrum – amounts to tens of trillions USD in total. The table below is just an illustration.

Table 5: Estimated need for climate investments from various sources

Estimate for	Investment need	Sources[6]
Halving worldwide energy related CO_2 emissions by 2050	In total USD36 trillion (about EUR 27 trillion)[7]	IEA World Energy Outlook (2012)
Investment need for clean energy transformation to restrict global warming by 2 degrees by 2050	USD 65 trillion or USD 1.6 trillion per year	UN World Economic and Social Survey (2011)
Implementing sustainable growth by 2020	USD 0.5-1.5 trillion (EUR 0.4-1.1 trillion) per annum in 2020 rising to USD 3-10 trillion (EUR 2.3-7.6 trillion) per annum in 2050	WBCSD (2010)

[5] Source: http://www.worldbank.org/en/topic/climatechange/overview#2

[6] Sources: International Energy Agency (IEA) (2012), *World Energy Outlook 2012*, World Business Council for Sustainable Development (WBCSD) (2010), *Vision 2050: The New Agenda for Business*, UN World Economic and Social Survey (2011). *The Great Green Technology Transformation*

[7] Source: http://climatepolicyinitiative.org/wp-content/uploads/2012/12/The-Landscape-of-Climate-Finance-2012.pdf#page=11

The examples below illustrate that the capital intensiveness of a single adaptation or mitigation project can be very high.

Table 6: Examples of capital intensive Climate Investments

Examples of capital intensive climate projects	
Adaptation	In Jakarta Dutch and Indonesian partners have joined to develop a plan to make Jakarta flood proof and create perspective for city development. A new dam will protect the city of Jakarta from floods and at the same time provide new land for city development in the crowded city of Jakarta. Components of the master plan are flood protection, land reclamation, port development and specials (pumps, utilities etc.). It was calculated that as a result of especially the land proclamation component, the master plan is commercial viable, despite the initial development costs of more than USD 21 billion.
Mitigation	In March 2014, a financial deal was announced for a 300 MW wind projects in North West Kenya. This project of EUR 623 million, is supported by the Dutch Government, the FMO, Triodos and several multilateral institutes and development banks. The project is meant to provide approximately 20% of Kenya's power capacity and is estimated to avoid 736,000 $tCO2_e$ per year.

1.3 The Climate Finance landscape

A fundamental factor of influence on the design and implementation of Climate Investments is the provision of finance. The Climate Policy Initiative[8] (CPI) describes the financial sources and flows of worldwide public and private climate finance. According to the CPI, in 2010 and 2011, the multilateral development banks provided on average USD 21.2 billion (EUR 16.1 billion) in climate finance, whereas bilateral finance institutions provided USD 11.3 billion (EUR 8.6 billion) in climate finance. Or a total of USD 32.5 billion in climate finance.

The following examples further illustrate the involvement of multilateral development banks in climate finance:

Table 7: Summary of Climate Finance Landscape

Multilateral Development banks and Institutions	Short description of funds under management
The World Bank (WB)	The WB manages 15 carbon funds and supports public projects. In 2013, the WB provided USD 6.5 billion (EUR 4.9 billion) to climate mitigation projects and USD 2.9 billion (EUR 2.2 billion) to adaptation projects. Examples of WB funds: • The Adaptation Fund: finances concrete adaptation projects and programmes in lower developed countries. The fund is financed by pledges from donor governments and proceeds from the Clean Development Mechanism. • Carbon Initiative for Development: finances both capacity building as well as performance based payments to energy access programmes. Fund geographical focus is on least developed countries (especially in

[8] CPI (2012) *The Landscape of Climate Finance 2012.*

Multilateral Development banks and Institutions	Short description of funds under management
	Sub-Saharan region). The WB is also the interim trustee of the Green Climate Fund (GCF), which was agreed to during the Copenhagen accord in 2009 and formally established during the climate summit in Cancun in 2010. A significant portion of the USD 100 billion (EUR 76 billion) joint donor climate finance goal is foreseen to flow via the GCF from developed to developing countries.
The International Finance Corporation (IFC)[9]	The IFC supports private projects and programmes. In 2013 the IFC invested USD 2.3 billion (EUR 1.7 billion) in climate-related projects. Examples are: • IFC Catalyst Fund: Fund of fund investments in emerging private equity and venture capital funds. Focuses on emerging markets. • IFC Blended Finance for Climate: Deploys concessional funds from donor partners alongside IFC's own commercial funds to catalyse climate smart investments that wouldn't otherwise happen and that have a high development impact.
The European Investment Bank (EIB)	In 2013, the EIB invested EUR 19 billion in climate projects. The EIB participates in several funds and climate projects.
Climate Investment Funds (CIFs)	The CIFs support innovative country-led investments in climate projects. Several countries (including the Netherlands) have pledged in total USD 8 billion (EUR 6 billion) to CIF. CIF is leveraged with USD 55 billion (EUR 42 billion) sourced from multilateral development banks and the private sector. The portion of private capital (23.5%) is channelled through these multilateral developments banks. The leverage is achieved by providing risk mitigation and financial instruments to increase the viability of renewable energy systems. The CIFs consist of several funds, including: • Clean Technology Fund: supports USD 5.5 billion (EUR 4.2 billion) to large-scale, country-initiated renewable energy, energy efficiency and transport projects in developing and middle income countries. • Scaling Up Renewable Energy Program: supports USD 551 million (EUR 418) to Low Income Countries to scale up deployment of renewable energy systems and expend renewable markets.

Please refer to annex 5 for more details on (potentially) available climate finance instruments for investing in mitigation projects or projects that build countries' resistance to the adverse impact of changes in climate. It is important to note that this list is not intended to be exhaustive or all-encompassing.

The available sources for climate finance of USD 32.5 billion on average in 2010 and 2011 is in sharp contrast to the need for Climate Investments (e.g. USD 1.6 trillion per annum to restrict global warming by 2 degrees by 2050; see table 1).

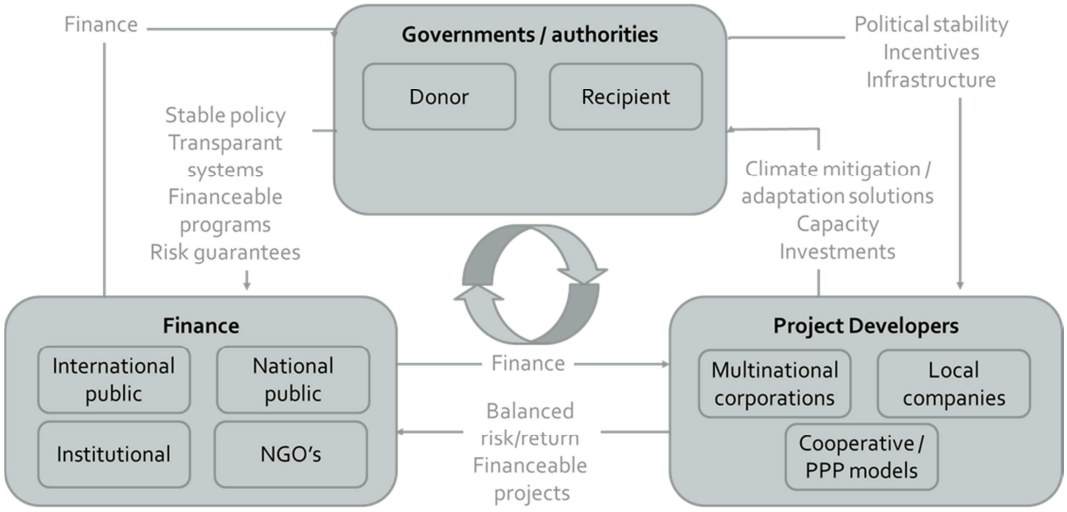
[4] Source: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/CB_Home/Measuring+Reporting/

1.4 Barriers in the climate finance landscape

Irrespective of the various sources for climate finance, the flow of these funds to actual projects on the ground has been limited over the past years due to various reasons. One overarching factor is the economic downturn and slow economic recovery in major economies, impacting the availability and flow of funds to mitigation and adaptation activities. The economic downturn particularly effected mitigation projects that relied on private capital from the sale of carbon assets. Due to the plummeting industrial output and consequently the demand for carbon assets for compliance reasons, the prices dropped dramatically thereby making a number of mitigation projects economically unviable. Higher prices for carbon assets are needed for a transition to a sustainable, low-carbon world. Although the European Union implemented actions to boost the price for carbon assets, the prospect of a coordinated international approach to carbon pricing will remain uncertain for several years[10]. This regulatory uncertainty will hamper the flow of private capital for mitigation projects. A strong price signal for carbon is needed to foster GHG mitigation activities.

Before addressing more specific barriers, it is useful to place finance within the broader context of the actors and institutions involved in the low carbon economy. Figure 2 below provides setting, showing how finance typically flows between stakeholders.

Figure 4: Actors and flows in promoting adaptation and mitigation action[11]



The figure demonstrates that there are a number of parallel financial and informational flows between various actors. Importantly, it shows that each set of actors requires certain preconditions to be in place and requirements to be met before their individual and collective operation can be optimised. It is precisely these barriers that prevent this efficient flow of finance and that need to be addressed.

[10] Source: European Union, Climate Action: Back-loading of actions in phase 3; proposal for market stability reserve, debate and public consultation on structural measures

[11] Edited from KPMG (2012) context of climate finance in promoting adaptation and mitigation action

Some important barriers in the context of this study are[12]:

- Market failure: most Climate Investments are currently uncompetitive partly due to market failures – with existing "black" technologies mispriced due to pollution externalities not being accounted for. Government intervention is required to create a level playing field between energy sources: removing fossil fuel subsidies and pricing the carbon externality adequately will alleviate pricing distortions that currently work against low carbon technologies. However, this will be a global action and not something the Dutch government can influence on a stand-alone basis.
- Regulatory framework: in most developing countries policies and regulatory frameworks are often underdeveloped and/or unstable, in addition to scarcity or even lack of public funding for adaptation/mitigation activities.
- Lack of financial returns: e.g. adaptation projects typically rely on public funding due to lack of an immediate cash flow generating model. The public nature of these projects and overall public benefit typically require public funding.
- Financial instruments: lack of long term financing instruments, especially for infrastructure projects.
- Project development: project developers are often faced with long lead times associated with the development of projects. For example, designing a wind project can take up to 5 to 7 years to obtain wind data and have the insurances in place. These development risks are inherent to the role of project developer and requires deep pockets to cover the time up to financial close. Particularly the combination of long lead times with other barriers mentioned such as lack of a stable policy framework, hampers project developments.

In annex 4 more barriers to Climate Investments are presented. As shown in figure 2, both recipient and donor governments will have a role to play to address these barriers to foster the flow of funding to Climate Investments and to bridge the gap between the need for Climate Investments and available public and private sources for funding.

1.4.1 Adaptation-mitigation

For clarity purposes, we categorize climate investments in adaption and mitigation investments. Although this categorisation is widely recognized, a remark needs to be made. Mitigation projects are in general revenue based projects, which means that a private partner can collect revenues directly from users. In the contrary, adaptation projects are often availability based, meaning that the government pays a private partner for services on behalf of the users. We identify an increasing amount of hybrid forms, where the two are combined. Examples are land reclamation projects for the purpose of both real estate development and the adaptation to the consequences of climate change. Adaptation and mitigation can be directly combined by wind energy projects on dikes.

1.4.2 The role of governments

Government policies have a significant impact on the funding and implementation of Climate Investments. A mix of various interventions are needed ranging from long term policies, guarantees and insurances and incentives like technical assistance and capacity building programs.

[12] Derived from: KPMG (2012) "A private sector view of enhancing private sector access to climate finance in South Africa, draft. Della Croce, R.C. Kaminker and F. Stewart (2011) "The role of Pension Funds in Financing Green Growth Initiatives" OECD Publishing, Paris

However, not every government will have the financial means and/or regulatory governance structure in place to install these policies. This is especially the case for least developing countries. They are not only expected to be hit hardest by the adverse effects of climate change, they also lack the financial sources and debt raising capacity to implement Climate Investments. In 2009, at the Conference of Parties (COP) in Copenhagen, the developed countries acknowledged this and pledged to mobilize USD 100 billion a year, by 2020, to address the needs of developing countries. More particularly the developed countries agreed to:

Table 8 Quotation from Copenhagen accord confirmed during the Conference of Parties (COP) at Cancun[13]

"the collective commitment by developed countries is to provide new and additional [..] In the context of meaningful mitigation actions and transparency on implementation, ***developed countries commit to a goal of mobilizing jointly USD 100 billion a year, by 2020 to address the needs of developing countries****. This funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance. New multilateral funding for adaptation will be delivered through effective and efficient fund arrangements, with a governance structure providing for equal representation of developed and developing countries. A significant portion of such funding should flow through the Copenhagen Green Climate Fund."*

Jointly mobilizing USD 100 billion a year from 2020 will be a challenge for developed countries, especially since public funds are scarce. The mobilisation already refers to this mobilisation the next years, until 2020. The European Commission has acknowledged this scarcity of public funds and issued a draft common understanding of private climate finance in the context of the USD 100 billion goal.

Table 9 Quotation from common understanding of private climate finance, Brussels, 14 May 2014[14]

Without prejudice to future international agreements, the EU will, in relation to the committed goal by developed countries to mobilise jointly USD 100 billion per year by 2020 from a wide variety of sources in the context of meaningful mitigation action and transparency on implementation, as a starting point, apply an understanding of private climate finance, which specifies that these financial flows are: 1. *mobilised by public finance, or by a public intervention, including in the sphere of policy and regulatory reform, and* 2. *climate relevant in accordance with criteria used by relevant international organisations such as the OECD and Multilateral Development Banks.*

A crucial element in the above statement is the acknowledgement that private finance also counts in the USD 100 billion goal if it is mobilized through public intervention. This increases the importance of using existing or developing new public instruments that foster the flow of private capital at a large scale and over a long term horizon.

Before analyzing possible public instruments including the proposed Fund, an understanding of the Dutch's fair share under the Copenhagen Accord and if the available budget is required. This analysis will provide insight in the tools needed to support the Dutch government in achieving its climate change objectives.

[14] Source: OECD http://www.oecd.org/investment/stats/officialdevelopmentassistancedefinitionandcoverage.htm

1.5 The Dutch fair share under the Copenhagen Accord.

"The restriction decided on by the Dutch Cabinet of Ministers that additional funds should come from the MFA budget means that additional funds can only be ODA-funds"
Quote public sector workshop

The USD 100 billion a year from 2020 is a global commitment; the Dutch fair share under the Copenhagen Accord may increase from EUR 200 million in 2013 to EUR 1.2 billion in 2020. This long term commitment shall be sourced from the MFA budget for international cooperation and from private funds.[15]

1.5.1 The MFA budget for climate relevant expenditures

"In fact, we are trying to solve a budgetary problem here"
Quote public sector workshop

The 2014 MFA budget for Dutch international cooperation is EUR 3.3 billion of which EUR 85 million is directly allocated towards climate[16]. This climate proportion can increase to EUR 235 million through the identification and expansion on synergies between climate projects and traditional development programmes (Synergies). For example, regular water management activities can also be classified as climate investments if through their design they also contribute to making the country more resilient to rising sea levels. The "climate resilience" aspect can be classified as co-benefit or Synergy of the water management project[17]. The percentage can be high (100%), with climate being the main objective, to a mere 5% for annual contributions to a multilateral organisation and funds like the Food and Agriculture Organization and the European Development Fund. While recognising that Synergies increase the effectiveness of both development and climate programmes, there is a limit to the amount of climate finance that the MFA can mobilize in this manner. The estimated cap on Synergies is EUR 150 million.[18]

The 2015 MFA budget for climate relevant expenditures (including EUR 150 million from Synergies) is EUR 340 million. In 2015, MFA strives to mobilize an additional EUR 100 million from private sources through existing national and multilateral private sector instruments[19]. In 2018, the MFA budget for climate relevant expenditures (including EUR 150 million from Synergies) is estimated at EUR 332 million[20].

This MFA budgetary pathway for climate relevant expenditures does not correspond to the trajectory estimated by the Dutch Chamber of Audit. According to the Dutch Chamber of Audit, total expenditures for climate (including EUR 150 million from Synergies) needs to grow to EUR 840 million in 2018 to meet the 2020 commitment under the Copenhagen Accord. Thus far exceeding the current 2018 budget of EUR 332 million.

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[15] Source: Ploumen, E.M.J. (2013). *Hulp, Handel en investeringen*. Brief van de Minister voor Buitenlandse Handel en Ontwikkelingssamenwerking

[16] Source: www.rijksbegroting.nl, 2015 budget

[17] International agreements about Synergies 'Rio-markers' contain criteria to calculate the level of climate relevance of any particular green / brown field project.

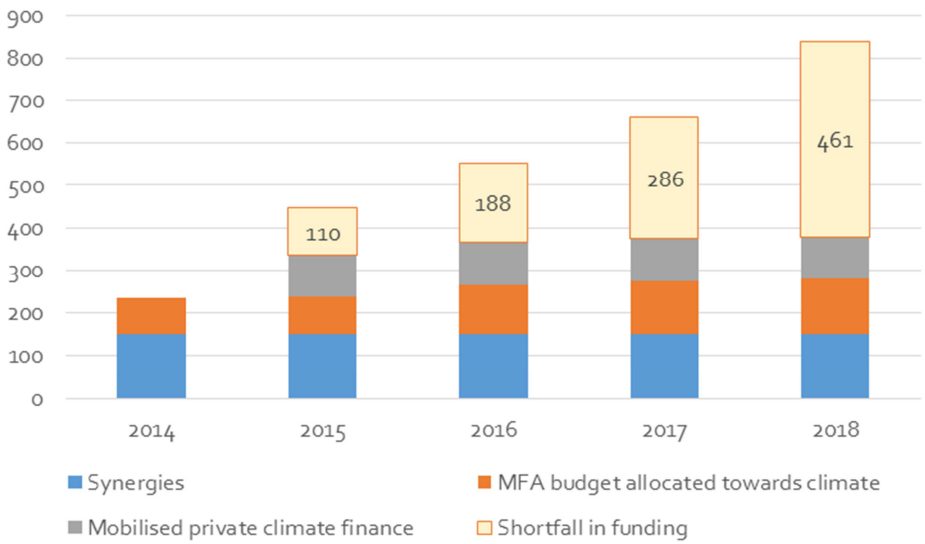
[18] Source: Algemene Rekenkamer: onderzoek budget ontwikkelingssamenwerking en klimaat

[19] Source: www.rijksbegroting.nl, HGIS nota 2015

[20] Source: www.rijksbegroting.nl; 2015 budget

Under the assumption that from 2015 onwards, MFA will (i) continuously succeed in mobilizing an additional EUR 100 million from private sources and (ii) maximize Synergies, the overall shortfall in climate relevant expenditures is predicted as follows:

Figure 5: Trajectory Dutch climate investments 2012-2018[21]



The above diagram shows a shortfall of EUR 110 million in 2015 increasing to EUR 461 million in 2018. Options to fill this shortfall include increasing public funding and/or mobilizing more private capital through a mix of public interventions, including existing and new instruments such as the proposed Fund.

1.5.2 Public objectives for climate finance

The Dutch government can use a broad range of instruments to meet its fair share under the Copenhagen Accord. These instruments, if well designed, should not only meet MFA objectives, but also create a new realm of opportunities for the Dutch private sector that recognizes the economic chances associated with a global transition to a low-carbon economy.

"The Fund itself cannot be the objective. The objective should be what the money aims to do"
Quote public sector workshop

In more detail, we distilled from the public sector workshop, Task Force meetings and interviews, that the instrument should:

- mobilize private sector capital in order to offset scarcity in public funding required to meet the commitment under the Copenhagen Accord;
- support Dutch business interests overseas;
- be transparent and support Dutch visibility in meeting its international obligations;

[21] Sources: The Dutch Court of Auditors, rijksbegroting.nl

- meet ODA criteria including investments in least developing; countries and financial instruments with a grant element of 25 percent;
- balance risks between the public and private sector;
- support adaptation projects with a strong social impact;
- have some form of revolvingness of public funds.

1.5.3 Potential public interventions to mobilize private capital

With the MFA objectives in mind, the question is which instrument would be best suited to support Dutch climate policies. As of the time of writing, there are more than 50 international public funds, 45 carbon markets and 6,000 private equity funds[22], next to policy instruments like regulation, grants and guarantees. The scope of this study did not allow for an extensive study on the impact and effectiveness of all available instruments. Instead a quick scan was carried out to assess the effectiveness of a selection of instruments on MFA objectives. These instruments are selected through discussions and interviews with public sector representatives and climate finance experts and include the proposed Fund. The quick scan will look in particular at the ability of the instrument to enable private sector leverage, as this is a key objective to meet the Dutch fair share of the Copenhagen agreement, but will also touch upon other objectives when applicable to the specific instrument.

Table 10: Potential public interventions

Intervention	Description
Green Climate Fund (GCF)	The GCF was first established during the Copenhagen summit and is a government to government fund. The Dutch government committed in international negotiations to contribute to the GCF. The design of the fund includes a trustee – currently the World Bank – who is accountable to a 24 member board, with equal representation from developed and developing countries, and supported by an independent secretariat. The 24 member board operates on consensus. Considering the GCF governance structure with a large political influence, it is unlikely that the private sector will contribute large amounts of funding to the climate fund. In addition, private sector contribution will not count in full towards the Dutch commitment under the Copenhagen Accord. According to information disclosed so far, a direct contribution from a Dutch institutional investor to the GCF will only partially (pro rate the percentage of Dutch shareholding) count towards the Dutch commitment under the Copenhagen Accord[23].

[22] Source: United Nations Development Programme: Blending Climate Finance through National Climate Funds. A guidebook for the design and establishment of national funds to achieve climate change priorities

[23] To illustrate, under the assumption that the Dutch government owns 3% of the shares of the GCF , in the event a Dutch pension fund deposits EUR 100 million in the GCF, this will only count for EUR 3 million mobilised private capital under the Copenhagen Accord for the Netherlands.

Intervention	Description
	Conclusion: The GCF imbeds the risk of limited transparency and accountability, limited control on direction of funds, and thereby limited ability to trigger private sector leverage on fund level[24].
Funds managed by multilateral agencies	The multilateral agencies World Bank and IFC manage several climate funds in which the Dutch government can allocate public funding. It is unlikely that the private sector will leverage this budget with large sums of money. Dutch institutional investors have up to now been hesitant to invest in funds managed by the IFC or the World bank due to underperformance and high management fees[25]. Advantages of funds managed by multilateral agencies is that these generate immediate access to projects in portfolio and sourcing capacity on the ground. Financing under the umbrella of the World Bank and IFC also mitigates country risk. Although the multilateral agencies provide a portal for financing, Dutch businesses expressed difficulties in dealing with funding from multilateral agencies due to (i) its complex and long processes and (ii) strict eligibility criteria. From a "global good citizenship" perspective, the Dutch government will need to continue its financial support to multilateral agencies, especially given the broader agenda of these agencies and the important role they play in the international financial market. *Conclusion:* There is no reason to terminate current funding to funds managed by multilateral agencies. However, allocating more than is currently budgeted (see figure 4) is not perceived as the best value for money as it does not optimize private sector gearing.
International initatives (e.g. NAMAs)	The Dutch government could invest in existing climate initiatives such as the Nationally Appropriate Mitigation Actions (NAMAs)[26]. NAMAs refer to any action that reduces emissions in developing countries and is prepared under the umbrella of a national governmental initiative. NAMAs are supported and enabled by technology, financing, and capacity-building and are aimed at achieving a reduction in emissions relative to 'business as usual' emissions in 2020[27]. In general, the selection of projects / programs and allocation of funds are usually the responsibility of financial institutions and local ministries / agencies in developing countries. It requires strong host country commitment, strong price for carbon and flexibility to align investor requirements with the requirements of the developing country. NAMAs generally gauge the interest of multi- and bilateral agencies such as the FMO given the strong development

[24] Source: Designing the Green Climate Fund: How to spend USD100 billion sensibly.

[25] Source: Interviews with pension funds

[26] Concluded at COP 18 in Doha

[27] Source UNFCCC: Focus: Mitigation – NAMA's National Appropriate Mitigation Actions

Intervention	Description
	impact and the fact that these agencies are more accustomed to dealing with local governments. Co-investment from other Dutch capital providers is not foreseen on the short term due to this political setting and regulatory risk in connection with carbon credits. *Conclusion:* NAMAs have the potential to create interesting business opportunities for the FMO and Dutch businesses. Leverage from other capital providers will be limited.
Insurances and guarantees (managed by the Ministry of Finance)	Guarantees and insurances (such as the export credit insurance) can support business interest overseas, including developing countries. They are effective in channelling private sector capital towards Climate Investments on a project level as they reduce investment risks. This private sector capitalization is however not committed upfront and on an incidental basis. Guarantees are a useful instrument in countries with perceived high political risk, dysfunctional markets and lack of policy incentives of investments (estimated leverage is 6-10 times)[28]. Policy insurance are instrumental to cover country risk including risk of expropriation, transfer risk and FX risk (estimated leverage 10 time or more)[29]. The risks for public finance associated with guarantees is high. The Ministry of Finance therefore applies a "no" position if it comes to issuing new state guarantees[30]. *Conclusion:* Guarantees and insurances are effective tools but comes with public risks in case of defaults under guarantees outstanding. In addition, obtaining upfront commitment from the private sector on the basis of guarantees and insurances will be difficult; leverage usually takes place at project level.
Regulation (in particular pricing carbon)	The latest report from the United Nations Intergovernmental Panel on Climate Change highlights the importance of putting a price on carbon to curb GHG emissions[31]. A price on carbon, set high enough, will channel private sector financing towards mitigation projects. The proceeds from the sale of carbon credits can further enhance the financial viability of said projects. Various instruments can be used to price carbon, such as (domestic) emissions trading systems, carbon taxes, use of a social cost of carbon and/or payments for emission reductions[32]. Carbon prizing (if not applied on a global scale) has consequences for the competiveness of the economy and/or income positions of households. It is not within the scope of this report to fully explore the options to extend pricing carbon policies.

[28] Source: Della Croce, R.C. Kaminker and F. Stewart (2011). "The role of Pension Funds in Financing Green Growth Initiatives, OECD Publishing, Paris

[29] Source: Della Croce, R.C. Kaminker and F. Stewart (2011). "The role of Pension Funds in Financing Green Growth Initiatives, OECD Publishing, Paris

[30] Source: Commissie Risicoreglingen (2013). *Risicoregelingen in beeld.*

[31] Source: Common understanding of private climate finance, Brussels, 14 May 2014

Intervention	Description
	Conclusion: A reasonable carbon price has the potential to channel significant private finance towards climate mitigation projects. The extent to which a reasonable price on carbon can be achieved will depend on international negotiations, the outcome of which is uncertain at this point of time.
Direct grants	The MFA can allocate a certain portion of its budget to direct grants to support Climate Investments in developing countries. Grants can be used to support private sector co-funding at project level and to support Dutch business interests. The MFA will have control on the use of grants to Climate Investments on the ground. The money will deplete over time. Grants can also be used for technical assistance. *Conclusion*: Grants have the potential to achieve private sector leverage on projects on the ground. Grants will however deplete over time and do not achieve upfront commitment to private sector leverage.
Memorandum of Understanding (MoU)	An MoU can be the result of a negotiation between the MFA and Dutch private sector to create commitment to financing climate projects. An MoU is an intention and is not legally binding. If the Dutch government is able to persuade the private sector to invest in climate relevant projects, the intervention of the Dutch government would make the private capital mobilization count in the Dutch fair share. Dutch businesses could benefit from an MoU, especially those projects that fall within the low risk / high return category and are thus attractive for private investors. An MoU could be a costless option for the Dutch government. However, it does not seem likely that institutional investors are willing to give up part of their autonomy without a quid pro quo from the public sector, as there is no clear benefit yet for the private sector to participate. In addition, as an MoU is not legally binding, the Dutch government is not able to legally enforce the counterparty to take action. *Conclusion:* An MoU is a costless option for commitment of the private sector to invest in climate relevant projects. The viability of an MoU is however uncertain as there is no real benefit yet for private parties to participate.
Proposed Fund	A new Fund can be a tool to mobilise private sector funding. With a Fund, leverage can be created at two levels; at Fund and project level. This feature increases the total impact per public euro invested. As the initial Fund objectives and criteria are still to be determined, the MFA has control on the directions the Fund should aim to achieve. One of these objectives can be to directly support Dutch business interest. Concessions on public objectives might however be needed in order to gain private sector leverage. *Conclusion:* The Fund has the potential to create private sector leverage. Other objectives can be included in the design of the Fund, but concessions might be

Intervention	Description
	necessary to align public – private interests.

From this quick scan it can be concluded that although several possible instruments exist, not all instruments are able to fully meet MFA's climate objectives, in particular leverage. The existing Dutch instruments are not designed to create and maximize leverage, while international instruments do not always allow for earmarking private investments as a Dutch contribution. The proposed Fund has the potential of meeting these targets.

This does not mean that the Fund should exclude other instruments for future climate finance. Providing funding for the Green Climate Fund or other multilateral funds can for instance be required from an international political perspective. At the same time, grants and insurances can play a role as part of, or complementing to a Fund. Furthermore, there is no reason for the Dutch government not to plead for better carbon market conditions as a reasonable carbon price can enhance many Climate Investments and can increase the impact of the proposed Fund.

However for additional funding with the objectives presented at the beginning of this paragraph, a new Fund can provide best value for money. A Fund is a good instrument to realize private sector involvement both upfront and in projects on the ground and can thereby help the Dutch contribution to grow towards the Copenhagen commitment.

2 Private sector appetite

This chapter addresses the private sector appetite. What is the appetite of the financial sector to contribute to the fund, what are their conditions and to what extend does the proposed Fund support Dutch business development?

2.1 Involving the private sector

As illustrated, the need for Climate Investments is high and public sources are scarce. With their EUR 1 trillion in assets as of end of December 2012, Dutch pension funds - along with other investors - potentially have an important role to play in financing these investments. Institutional and private investors are now investing in climate change related projects via equity (including indices and mutual funds), fixed income (notably green bonds) and alternative investments (such as direct investment via private equity or through green infrastructure funds)[33]. Yet, despite the interest in these instruments, private capital allocation to Climate Investments remains low due to barriers including lack of appropriate investment vehicles and knowledge, track record and expertise among pension funds/commercial lenders about these investments and their associated risks. On top of this, LDC's are often "out of area" for many institutional investors. There is also a perceived knowledge gap with institutional investors regarding more complex adaptation projects, the focus is on mitigation.

To gain access to this source of capital and to create leverage at the Fund level, the Dutch government needs to ensure that private capital providers are well-informed of the opportunities to invest in the Fund, the underlying conditions to funding and associated risks. An open dialogue with the private capital providers to align interests will therefore be a prerequisite. Cultural differences will need to be addressed.

This also applies to possible involvement of the Dutch industry. In general, the Dutch industry expressed an interest in a funding vehicle designed to support their international business development. However, in the end, actual demand for funding will depend on funding conditions and viability of business opportunities in developing countries.

2.2 Defining the financial sector

The appetite and conditions to funding as presented in this study are obtained by combining two research techniques; a literature review and interviews including a workshop with financial sector representatives. The literature review provides a synthesis of a growing body of academic and 'grey' literature on the spectrum of climate finance instruments and their application in the market under various conditions. Details of the stakeholders consulted are listed in annex 3.

The main stakeholders interviewed include representatives from: commercial banks, development banks, institutional investors and insurance agencies. See below.

[33] Source: (www.climatebonds.net/.../OECD_Role_of_PFs_in_Financing_GreenGrowth- WP10.pdf)

Table 11 Private sector stakeholders

Type of institution	Name
Commercial Banks	ABN Amro ING Triodos ASN
Bilateral Development Bank	FMO
Institutional Investors/ asset managers	APG PGGM Robeco
Insurance company	Atradius DSB
Multilateral Development Banks	IFC World Bank

2.2.1 General interest in climate financing

The private sector was asked to express their interest to participate in the Fund without any public sector specifics regarding fund objectives, scope and available sources. The advantage of this process is that it allows for an open dialogue between the two parties and to learn were common ground can be found. The disadvantage is that without Fund specifics, the financial sector is not in a position to make any commitments about funding. The expressed interest should therefore be considered as a first indication of possible involvement of the financial sector in the Fund.

In addition to creating leverage at Fund level, leverage can also occur on project level through co-financing techniques. At this early stage, it is hard to expect any up-front commitment from the private sector as this will depend on co-financing arrangements and project characteristics. As such, conditions to funding is limited to Fund level only.

2.2.2 Interest Pension funds

The Dutch pension funds expressed an initial interest to continue discussions regarding the Fund with FMA. They are also the ideal candidates for capitalizing the Fund at Fund level.

- These parties have a long term funding timeline, which matches the expected timeline of Climate Investments of the Fund.
- The pension funds initially expressed ticket sizes in the order of EUR 50 million. These ticket sizes however strongly depend on the amount of public funding, public/ private risk sharing, the objectives and (project-)criteria of the Fund.
- They are used to their role of frontrunners.

The commercial banks expressed an initial interest to continue discussions at project level. Capitalization at Fund level from commercial banks and other financial institutions is not readily expected.

- Commercial banks and other financial institutions face solvency restrictions under the international regulatory framework for banks (Basel III). And for this reason, not interested to furnish capital in the Fund. In addition, commercial banks indicated that they are in general not eager to outsource investments as this is their core business, which they rather retain in-house.

- Leverage or co-financing from commercial banks can be expected at project level or in restructuring the Fund's debt financing portfolio through the issuance of green bonds.

The ultimate interest will strongly depend on the objectives and framework of the proposed Fund. Key is therefore to approach pension funds with a detailed information memorandum highlighting the scope and nature of the Fund, the Fund Manager, Fund objectives, envisaged capitalization, governance, fiduciary management, implementation agreements and monitoring, reporting and verification plan.

The following initial conditions to funding were expressed during interviews and the workshop.

2.2.3 The objectives of the Fund should be well defined

"The Fund should have a clear and focussed objective"
Quote private sector roundtable

The Fund should have clear strategic goals on climate change that are measurable and realistic. It should not include a range of other co-benefits that are now imbedded in ODA criteria's.

The Fund should be designed as an "open end" fund as this allows for issuance of shares at any time to re-capitalize the Fund.

To maximize its impact, the Fund should accommodate linkage with other bi- and multilateral agencies, including international climate funds as well as with domestic financial institutions and institutional investors. Some countries in the developing world have pension funds that can be tapped into while investing in green growth projects.

2.2.4 The objectives of the Fund should be realistic

"The proposed Fund should not have the ambition to solve all barriers; nor strive to meet a broad range of objectives in Least Developing Countries including poverty reduction, gender, biodiversity, water…… "
Quote private sector roundtable

The Fund should only invest in countries that seek to develop and have implemented green growth development strategies and, moreover, have the institutional capacity, government and policies in place to engage with private sector developers and the Fund. The countries should also be classified as "investment grade" (BBB+).

The latter condition from the private sector implies that not all countries currently served under DAC can be supported by the Fund. In fact, it would mean that most countries in Africa would not be eligible for funding.

2.2.5 Returns should balance risks

"The public and private sector speak different languages. Public parties talk of public goods, private parties talk of returns"
Quote private sector roundtable

The key to increasing private sector capital allocation and thereby to maximise leverage is to make sure that the underlying Climate Investments generate competitive risk adjusted returns. Private

investors will not make an investment in the proposed Fund just because it is green – it also has to deliver financially. Our experience in other projects points out that the required return of pension funds can be below 10%. For investments in developing countries – without risk mitigating instruments – institutional investors will require an estimated 15% minimum return. In the existing Danish climate fund, investors agreed on 12%, with a risk mitigating mechanism. Institutional investors will receive their financial return on a preferred basis.

It should be noted that the private sector is not looking for a risk-free environment, but rather one in which risks can be understood, anticipated and managed. Hence, to encourage the involvement of private sector capital in the proposed Fund, the Funds' financial instruments needs to be combined with other public sector instruments including government guarantees and insurances – to mitigate political risk, currency risk, regulatory and policy risk. Note that the risk and return level can defer between the different investors. As pension funds are merely looking for investments to cover inflation, they look for low return, low risk investments. Commercial Banks might be able to deal with higher risk and returns.

Risks will also differ by country and by project. Country risk refers to the risk of investing in a country, depending on changes in the business environment that may adversely affect operating profits or the value of assets in a specific country. For example, financial factors such as currency controls, devaluation or regulatory changes, or stability factors such as mass riots, civil war and other potential events contribute to companies' operational risks. This term is also sometimes referred to as political risk; however, country risk is a more general term that generally refers only to risks affecting all companies operating within a particular country. To effectively channel private sector capital, the Fund should allocate its monies to Climate Investments in investment grade countries (S&P BB+, Moody's Ba1, Fitch BB+).

The same applies to the underlying projects. The Fund should invest in investment-grade deals, with complementary instrument providing for risk mitigation.

2.2.6 A stable and long term horizon

"The private sector is risk averse for policy risk"
Quote private sector roundtable

Another key driver to unleash private capital, either at Fund or project level, is the need for transparent, long-term and certain regulations governing carbon emissions, renewable energy and energy efficiency. To quote the World Economic Forum's report "Green Investing 2010" (WEF 2010),

"While the world's investors may be ready to invest in clean energy companies and projects, they still have questions over the policy environment in which they operate."

Most Climate Investments are currently uncompetitive partly due to market failures – with existing, "black" technologies mispriced due to pollution externalities not being accounted for and fossil fuels still being heavily subsidized (see barrier analysis). Government intervention is required to create a level playing field between energy sources: removing fossil fuel subsidies and pricing the carbon externality adequately will alleviate pricing distortions that currently work against low carbon technologies. However, this will be a global action and not something the Dutch government can influence on a stand-alone basis.

2.2.7 Complementary to existing instruments

"The market has the know-how to invest. The government can set targets and contribute funding."
Quote private sector roundtable

The purpose of the proposed Fund is to provide new and additional financing to complement existing financing mechanisms for the support of mitigation and adaptation actions. One of these existing instruments, as mentioned earlier, are green bonds and investment vehicles such as private equity and infrastructure funds as well as risk mitigation tools such as guarantees and insurances provided by the Dutch government.

Another tool to create synergy is in the Funds investment criteria. For example by defining that the Fund provides risk capital to Dutch businesses looking to set up operations or invest in climate relevant projects in developing countries and emerging market. Or by involving the commercial banks in the issuance of green bonds as a refinancing mechanism (more on this in Chapter 3). Basically launching the Fund as a form of partnership with all Dutch enterprises. A successful example of the above is the Danish Climate Investment Fund.

Some larger pension funds with considerable in-house resources also invest directly in green projects or allocate monies to bilateral or multilateral agencies.

The key to attract private sector allocation is to make the Fund and its underlying Climate Investments are an attractive investment alternative.

2.2.8 An independent fund manager

"Handing over a fund to a fund manager means you hand over your core business to another party"
Quote private sector roundtable

Other important element to foster private capital includes independence of the fund manager in making funding decisions using competitive procedures with clear criteria for project selection, sectors and geographical boundaries. The fund manager should be able to assess the local risk and returns in the projects' country and have sufficient sector knowledge. Furthermore, the Fund Manager should enjoy solid proven track records indicating its capability to effectively and efficiently operate and manage a Fund. The Fund Manager should also be able to operate independently from politics. This all seems to indicate that one need to look for a "sheep with five legs". Better is to keep it manageable by limiting sectors and markets.

The management fee of a fund manager should be in conformity with market standards, typically 2-3% of the committed investment amount – depending on the size of the Fund.

2.2.9 Differences within the private sector

The interviews and workshop also highlighted differences within the private sector, such as:

- Pension funds are mainly interested in equity and in low risk and return investments (merely returns which cover inflation).
- Commercial banks (not including insurance) mainly invest in debt and are looking for higher - but balanced - risks and returns.

- Both pension funds and large commercial banks are interested in a fund which can lower the risk profile of Climate Investments.
- Smaller commercial banks are mostly looking for funding to increase their ticket size.

Due to these differences, the private sector participants to the workshop recommended to start discussions with a select group of parties and to keep the initial size of the Fund small and manageable. The Fund would become too complex if it needs to accommodate all investors' interests. After a successful starting phase, other parties might join, resulting in a new round of capital raising.

2.3 Dutch business community involvement

2.3.1 The role of Dutch technology

Dutch companies are recognizing the economic opportunities to invest in projects that are sustainable and contribute to – instead of further deplete - the world's natural resources. This interest to work on environmental friendly projects clearly facilitates a match between the political agenda of MFA and Dutch businesses.

However the Dutch business community often copes with projects in which the customer or recipient country is unable to pay large investments up front. In addition, some companies in adjacent countries have governmental instruments available to support investments, for example in Denmark, Germany and the United Kingdom. A dedicated Dutch Fund could also create a more equal level playing field.

Dutch companies are internationally recognized for their expertise in agriculture, water management, transport and energy efficiency. The Netherlands also enjoys strong financial structuring expertise, among which the structuring and engineering of public private partnerships, a much needed quality for capital intensive Climate Investments. Private sector stakeholder consultations revealed that Dutch project developers would strongly support a Fund contributing to "BV The Netherlands". Especially for Climate Investments in those countries that show structural willingness to adapt to climate change or reduce/avoid GHG emissions; have the (potential) ability to pay for long-term commitments, and have the necessary legal and institutional framework to conduct sound business transactions.

During the interviews with the Dutch businesses including project developers, possible projects for inclusion under the Fund were addressed. Some projects mentioned include (i) changing large scale farming practices in Africa, from intensive farming to sustainable farming practices, with the sale of carbon credits from sequestration and avoidance as a possible income stream and (ii) energy efficiency activities in buildings. Climate adaptation projects deliver a competitive advantage and new opportunities for a wide spectrum of Dutch companies that can be considered as front runners in this area. Signals from private investors suggest that further capital could be raised specifically for adaptation activities. Provided the right investment products are available. Life cycle optimalisation allows for example that incomes from dredging or real estate are used for upfront investments in adaptation.

2.3.2 Opportunities for Dutch technology

Four areas of opportunities were mentioned by interviewees:

- *A fund to stimulate large and highly visible adaptation projects in the water sector:* The international business environment of the water sector is changing. Companies specializing in water management are requested under international tenders to not only bring their technical expertise but also financing to the project. This poses a challenge to the Dutch water sector as they do not have the financial capacity to provide financing. Hence they need to rely on commercial loans, and depending on the country, backed by government guarantees and insurances. This financial package is often considered more expensive than packages proposed by overseas competitors. A Fund designed to support the Dutch water sector in international tenders by increasing their competitive advantage is an explicit wish of the sector.
- *A fund to enhance Dutch innovation in developing countries:* there is a need for early stage capital to accommodate more innovative and integrated solutions that are so evidently of importance if it come to climate change. This provision of early stage capital is often seen as one of the most important gaps in the current financial landscape and critical to encourage innovative climate solutions in developing countries. This demand for early stage capital was nearly expressed by all private sector stakeholders.
- *A fund which aggregates small scale projects*: another gap mentioned was the support of small innovative projects. Banks are often unable to support small local projects (such as efficient lighting). A fund can help to aggregate a number of small projects. From the public sector, the agricultural department of the Ministry of Economic Affairs expressed an opportunity for this type of funding to support aggregation of small scale land management projects.
- *Technical assistance and capacity building:* another element that comes to play is the trend to not only design and implement the project but also to operate and manage the project on a long term basis. Recipient countries do not always have a clear view on the risks involved during the entire lifetime of a new technology. It is important to enhance local expertise to allow countries to manage and operate their own systems by means of a capacity building component in the Fund. This can of course be combined with other fund objectives.

2.3.3 Early stage involvement

It will be important to involve Dutch businesses in an early stage as the success of the Fund will be determined by the flow and quality of Climate Investments. These discussions could provide clarity on:

- Identification of focus sectors: in an open dialogue sectors with Climate Investment opportunities can be identified.
- Construction of technical assistance facility: Dutch business will probably have a view on the technical assistance facility that is needed in the Fund (e.g. the Danish fund lacks a TA-facility and would, with hindsight, have included this).
- Project pipeline: the Dutch business community can indicate which projects are in an early stage and could eventually be eligible for the Fund.
- Innovation: the government can obtain an impression of product development in the climate business.

These elements will have an impact on the Fund design and related Technical Assistance.

3 Align public and private interests

This chapter builds on the appetite and interest from pension funds and commercial banks to further explore the Fund design and conditions. What are the common grounds and what are the trade-offs?

At this moment pension funds are actively pursuing their sustainability policies. Blending their funds with (concessional) MFA funds can help to foster investments in projects and/or countries that would otherwise be marked non-investment grade by the pension funds. To tap into this opportunity, the focus of this chapter is on pension funds. Private sector means "pension funds" and in some cases other potential investors.

3.1 Alignment of public and private interests

3.1.1 Differences in criteria and objectives

Chapter 1 described the public rationale for the Fund. From this rationale several public objectives and criteria could be derived. We summarized these objectives in the table below and plotted them against the private sector criteria as described in chapter 2.

Table 12 Overview of public and private criteria and objectives

	Public sector	Private sector[34]
Fund objectives	• Investment in climate relevant projects: mitigation and adaptation • Contribute to political solution for the Copenhagen pledge • Maximize development co-benefits (especially poverty reduction) • Promote Dutch business development • Mobilize private sector capital with appropriate risk allocation	• Single objective that is concise, realistic and manageable • Investment in balanced risk – returns projects (depending on type of investor)
Countries	• ODA countries, with focus on least developing countries (LDCs), or partner countries • ±50 in total or 15 partner countries	• Investment grade developing countries • less than 20 in total
Sectors	• Broad focus ranging from: infrastructure, water management, agriculture, energy and transport	• Dedicated focus, one asset class.
Projects	• Climate adaptation and mitigation within sectors	• Project that generate financial returns within dedicated sectors • To ensure a sufficient amount of bankable projects, a TA component (from public budget) is preferred

[34] Most likely candidates for funding are the pension funds. Other private investors (banks, insurance companies) would have similar criteria and objectives. This is equally important as in specific projects (leverage at project level) these parties are supposed to step in as well.

	Public sector	Private sector[34]
Returns	• Climate impact • Compliance with Copenhagen accord (rather an increase of the volume of transactions)	• Financial returns reflecting risk profile investment • Balanced risk-returns
Instruments	• Partly revolving • Grants (25%), debt, equity, mezzanine	• Fully revolving • Debt and/or equity, guarantees and insurances
Fund Manager	• Internal or External	• External and independent from government • Strong conditions in relation to performance track record within sectors
Fund size	A gradual growth in capitalization to: • EUR 600 million p/a from private sources from 2020	A gradual growth in capitalization, • starting with small ticket sizes (i.e. EUR 25 million)

The objectives and criteria show that there are several differences of interests, the most fundamental being:

- The private sector investors want a clear single objective, without additional co-benefits like poverty reduction, while the public sector prefers to include these co-benefits in Climate Investments.
- Investment grade criteria for recipient countries limit the country scope, including several countries with which the Netherlands has aid relationships.
- The private sector demands double digit returns from the Fund, making certain type of projects not eligible for funding, e.g. adaptation projects due to lack of cash generating capacity.

These differences of interest show that both parties will have to do concessions on criteria in order to come to an agreement on Fund objectives and design. The willingness to "give and take" will depend on each parties' objectives and climate agenda.

3.1.2 Examples of successful leverage

The process to align interest can be tedious, time consuming and cumbersome. Some agencies and countries have already successfully gone through this process, for example the IFC and the Danish government:

IFC Catalyst Fund (total fund size USD 418 million or EUR 323 million).

- Fund to fund financing, meaning that instead of direct funding to projects, the fund supports private equity funds which provide finance to climate projects or companies.
- The IFC and governments contributed USD 280 million to the IFC Catalyst Fund.
- Two private pension funds from Australia and Germany invested USD 138 collectively[35] (33% private finance).
- Additional leverage at the funded private equity funds.

[35] Source: http://www.asiaasset.com/news/IFC_Catalyst_Fund_completes_418_million_in_fundraising1407.aspx

- The fund mainly invest in emerging markets.

Danish Climate Fund (total DKK 1.3 billion or EUR 175 million):

- Is funded by the government (40%) and Danish pension funds (60%).
- It aims for a 12 percent return in which the institutional investors take a first return[36].
- The fund acts as a minority investor in a project and offers risk capital to increase additional finance on a project level.
- The fund is not revolving, meaning that the returns do not directly flow back into the fund. Funding is open to most of the developing countries, but all projects have to be financial viable.
- The fund will run for 4 years.

In case of the Dutch government, there is momentum to move to the next step and start the discussions with pension funds. Pension funds are making a shift in their assets under management from conventional asset classes towards climate/sustainable investments.

3.1.3 Scenarios where alignment of interest is found

The differences of interests predict a tedious process in which both the public and the private sector need to be willing to "give and take". The differences of interest in paragraph 3.1.1 show that choices for public fund objectives can strongly impact the appetite of the private sector. The other way around, making design choices in order to enhance private sector capitalization hampers public objectives. In deciding whether or not to continue the process of designing a Fund, MFA should consider if the concessions on public objectives are acceptable.

This paragraph will provide a rough sketch of the possible consequences of design choices. The possible fund design is not limited to two scenario's, there are many other possible scenario's. Please note however that these outcomes are based on existing fund designs, were possible adjusted to the Dutch context. As mentioned before, the institutional investors were unable to commit to a specific amount of funding as long as the public fund framework has been made explicit. This makes the indicated leverage subject to a high degree of uncertainty.

We included technical assistance (TA) in both scenario's. The service area's for technical assistance should be (focussing on area's that can support project realisation):

- Strengthening institutional capacity to smoothen the process of decision making for climate projects.
- Piloting and scaling up innovative climate projects and address barriers for private sector involvement.
- Supporting stakeholder participation processes for the realisation of climate projects.
- Aimed at investment readiness for those projects where Dutch business can organise immediate follow up.

The country selection for TA could be more stringent than the selection for investments. TA could be focussed on LICs or Dutch partner countries (15 countries with which the Netherlands has a special relationship that revolved around development cooperation). In emerging market there might be less need for technical assistance.

[36] This condition is similar to the "First loss" principle. When there is for example a 6% return on the funds' investments instead of 12%, the institutional investors receive this return (6% on the total investment roughly equals to 12% on share of institutional investors). Everything above the 6% flows to the public sector.

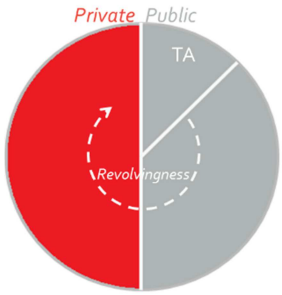
TA budget can technically be separated from the fund. As a consequence, it will not eat in on the Funds' financial return. For this moment we have included TA because at this moment no separate funds are available and a strong link between TA and the actual investment process brings more focus to the TA itself.

In both scenario's we included a first loss guarantee. This means that the provider of the guarantee (the public sector) is liable to bear losses up to a certain specified limit. The government has to be careful with this, because taking on board too much risk can erode incentives at the private side. We would therefore suggest that both returns and losses are divided between the public and private side. To be able to attract institutional investors, it may however be necessary to balance first losses (modestly) towards the public side and to balance first returns (modestly) towards the private side. Following this line of thought, the government is also responsible for (TA) expenses, that will not be acceptable for private partners.

In order to present realistic scenarios, the following design elements were used. The scenarios include percentage of leverage, revolvingness and concessions on public objectives.

A. The total MFA budget is EUR 200 million. To meet ODA criteria, 25% of public funding will come in the form of a grant for TA.
B. All scenario's include a TA budget financed by public funds. Although the study focusses on the mobilisation of additional funds, substantial effort will be required to guarantee a flow of quality projects. Possible TA structures are:
    - TA projects are fully funded in the form of a 50% loan/50% grant or;
    - TA projects are partly funded with at least a 50% own contribution to create skin in the game from the project developer.
C. Funding is limited either to Dutch partner countries (scenario 2) or investment grade countries that are on the DAC-list of ODA eligible countries (scenario 1). A narrow country scope is advised given the small size of the initial Fund.
D. The scenarios include a preferred role of Dutch technology in the projects.
E. Fund management is fully outsourced. MFA role is that of shareholder.

Table 13: Impact of design choices scenario 1

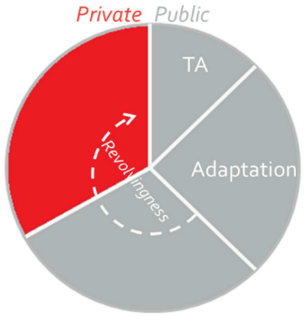
Design Choices	Consequences
• Dutch government funds EUR 200 million • Objective: primarily mitigation in investment and non-investment grade countries • Fund is minority investor in a project (max 50%) • Instruments: Debt & Equity in the revolving part • Private sector obtains first benefit	• Leverage at fund level EUR 160 – 240 million • Leverage at project level at minimum EUR 320-480 million (>50%) • Revolvingness: fully revolving. Public sector funds TA  • Public concessions: o Government takes first loss up to specified limit o No guarantee that least developed countries will be served significantly o No additional objectives like poverty and gender equality o No support for adaptation projects

Scenario one reflects in broad lines the Danish fund in a Dutch context and is meant to maximize private sector leverage[37]. The design choices are clear and limited. On a Fund level, leverage can be expected in the range of 0.8-1.2 times the public contribution. Additional leverage can be expected on a project level through co-financing arrangements (at least 50% co-financing). All projects will be financed on market conditions and, if deemed necessary, can be covered under export credit insurance schemes.

Adaptation projects and projects in the least developed countries are not eligible. Additional objectives such as poverty reduction and gender equality are possible, but only to a limited extend and provided they do not negatively impact the financial returns.

[37] Technical assistance and capacity building were not part of the Danish model. However as indicated by in chapter 2, this component will help in achieving a pipeline of bankable projects.

Table 14: Impact of design choices scenario 2

Design Choices	Consequences
• Dutch government capitalizes EUR 200 million of which 35% grant element • Grant element for Technical Assistance (TA) and adaptation projects • Objective: adaptation (at least 25%) and mitigation in both investment and non-investment grade countries; fixed share of investments in non-investment grade countries • Additional objectives, like poverty reduction • Fund is shared investor in a project[38] (max 60%) • Instruments: Debt & Equity in the revolving part • Government takes first loss	• Leverage at fund level: EUR 80-120 million • Leverage project level: at minimum EUR 50-70 million • Revolvingness: ±65%  • Public concessions: o Government takes first loss up to specified limit o No maximisation of private capital leverage o More difficult to gain leverage on project level in adaptation projects and non-investment grade countries.

In scenario two 25% of the budget shall be invested in adaptation projects.[39] Objectives for funding include additional co-benefits like poverty reduction and the country scope includes all countries with which the Netherlands has an aid or transitional relation (see annex 7). These choices are expected to reduce the private sector interest to funding. Adaptation projects have limited financial returns, and consequently reduce the revolvingness of the fund[40]. In addition, investments will also take place in non-investment grade countries. All these element combined negatively affect private sector leverage.

The two scenarios above both describe a fund size of EUR 440 million – *in total*. Even if one takes leverage at project level into account, the Dutch government is still short in meeting its commitment under the Copenhagen Accord. Maximization of leverage is key.

This can be created, over time, by raising additional capital at Fund level through issuance of new shares. The more successful the fund manager is in raising additional private sector monies, the more leverage that can be created per EUR public money invested in the Fund. Obviously the success of raising additional capital will depend on the financial performance of the Fund.

[38] In adaptation projects leverage at fund level is expected to be more difficult. Therefore this leverage is set lower than in scenario 1.

[39] Earlier we noted that the distinction between mitigation and adaptation, where the latter category is more difficult in terms of private financing, should be approached with some more nuance. As stated before, there can be adaptation projects that are financially viable or viable combinations of adaptation and mitigation projects.

[40] Returns can be possible on small scale within integrated adaptation projects (see for instance the Jakarta case in chapter 1). The possible returns of adaptation projects are subject to further reserach. However as this design merely provides broad outlines only, those returns are disregarded in the scenarios.

In an optimistic scenario, a total of EUR 0.8-1.2 billion can be mobilised by the Fund. At fund level the public contribution (EUR 200 million) can be matched by the private sector. A further 50 percent leverage on this total amount of EUR 400 million can be achieved at project level. The capitalised EUR 800 million can be further increased by attracting additional funds over time or reinvesting revolving funds in case the fund is successful in terms of financial returns. This would mean that every EUR invested by the government could be multiplied by a factor 4 (leverage at fund and project level) to 6 (reinvestment of financial returns). Please see table below.

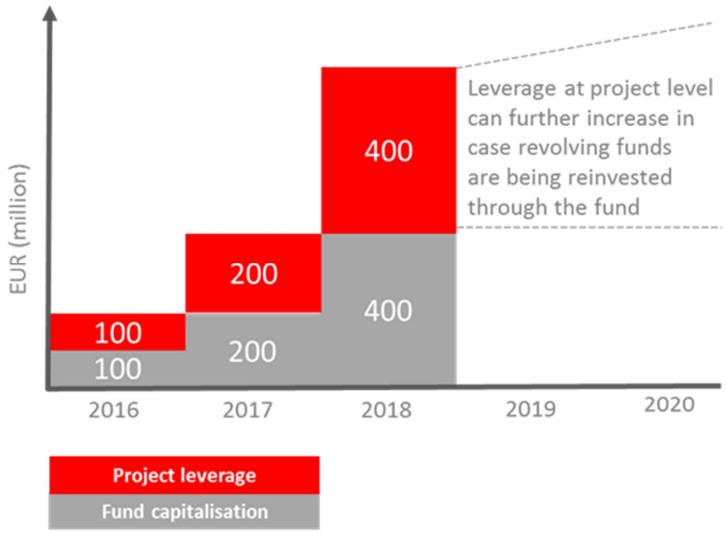
Table 15: Total leverage of EUR 200 million from the public budget

Value (EUR million)	Multiplier	Comment
200	*1	Public budget (note that pledges can be made gradually)
400	*2	Pension fund pledge (similar speed as pubic budget
800	*2	Banks and private business invest in projects, minimum 50%
150	*1,5	Refinancing/ re investment of fund resources
A rough estimate of a total multiplier	*±6	Depending on funding conditions, risk appetite, inclusion of specific additional objectives, investment grade of countries etc.

More precise estimations can be made once Fund criteria are agreed upon and even more when a fund manager has been selected. Particularly the final multiplier (refinancing) is hard to predict at this stage. On the one hand it can be higher as the Fund will expect a return on its investments, on the other hand it can be lower due to defaulting loans. Under both scenario's the government will take a first loss position.

With a multiplier of 6, a total investment volume of EUR 1.2 billion could be created, but this is depending on many aspects of fund design that still need to be decided upon. More importantly at this stage is that the EUR 200 million commitment of public funds represents an important first step to start mobilizing private capital. The Fund could be one of the instruments to meet the climate agenda of MFA, alongside other instruments.

Figure 6: Estimate of total capitalisation of the Fund and potential project leverage over time



However, a maximum leverage should not be the stand-alone objective. In the end there is a trade-off between leverage/risks appetite and other objectives such as inclusion of (low/slow return) adaptation projects, project development in some "difficult" countries etc. Moreover maximum private leverage can be reached by MFA taking a maximum risk. A more balanced strategy might be worthwhile to pursue.

3.2 Long term funding

3.2.1 Issuance of shares and green bonds

Developed countries committed to a goal of mobilizing jointly USD 100 billion a year. An annual contribution is however not typical for funding structures. Private parties are not likely to commit to a yearly fixed pledge, especially as the MFA indicated to only make a one-time contribution to the Fund. It is however possible that private parties will invest more over time. The actual private commitment and willingness to commit additional funding over time will depend strongly on the mandate, type of projects in portfolio and overall financial performance of the Fund.

The following may apply:

- The Fund starts to generate returns as soon as the projects pay out dividends (in case of an equity investment) or start with repayment of debt service obligations (amortization and interest). These returns can subsequently be re-invested in new projects (revolving).
- When choosing for a Fund design with higher risks, out of pocket money for TA and projects that will deliver returns only after several years, the Fund's capital may deplete over time. In this case, the fund manager can raise new capital by issuing new shares to existing investors in the Fund. Or alternatively, if permitted, the Fund manager can approach external investors.
- When the Fund manager approached the government for new capital, the government can either invest more funds or not. If not, and assuming the private sector will be interested to allocate more funds to the Fund, the shareholding of the government will dilute but the

potential to create leverage will increase. The initial EUR 200 million of public funding is now leveraged with more private funds.

- Climate relevant investments will undergo different phases, i.e. from development to construction to becoming operational with each phase having a different risk profile and different financing methods (equity, then debt). Once the projects become operational, additional funds can be raised through the issuance of green bonds. Issuance of green bonds will be another strategy to continuously source private sector capital and increase the much needed leverage.

3.2.2 Procurement of carbon credits

As mentioned before, most Climate Investments are currently uncompetitive partly due the fact that existing technologies do not pay for externalities. Government intervention to create a level playing field is a highly political process.

On a smaller and more manageable scale, the Dutch government is positioned to correct market failures through the procurement of carbon credits at above market rates, similar to what the Norwegian and Swedish government are doing.

The Norwegian Ministry of Finance has signed an agreement with the Nordic Environment Finance Corporation (NEFCO) to purchase carbon credits from stranded UN-approved projects facing a risk of discontinuation due to the low prices on Certified Emission Reductions (CER). The Norwegian Carbon Procurement will invest in registered projects under the Clean Development Mechanism (CDM) facing risk of discontinuation due to the prevailing low carbon prices. This includes projects which are otherwise at a standstill or "stranded". The fund's target is to procure up to 30 million Certified Emission Reduction Units from these project types.

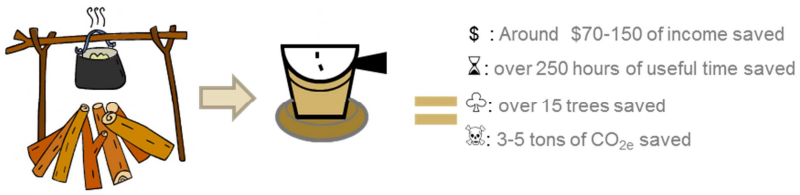
By following a similar strategy, the Dutch government could channel private sector capital in mitigation projects that are now stranded. The procurement of carbon credits above market rate will generate a long term stable cash flow to projects triggering the release of private capital to cover the project costs. This would allow FFF to gain a return on mitigation projects. The revolving character of the fund would be strengthened.

Please see example below[41]

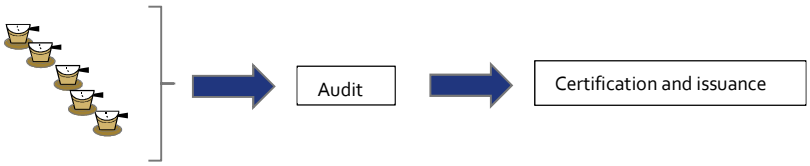
Table 16: Example of a stranded project

Cook stove project: replacing 2 million inefficient three-stone fires with highly improved cooking stoves. It creates a dire4ct impact on lives of over 10 million people in Africa and reduces African deforestation resulting in mitigating over 18 million tons of CO_2 emissions. *Step 1*: Replacement of archaic open fire methods through the free distribution of efficient cook stoves.

[41] Source: C-Quest Capital cook stove programme in Zambia, Senegal, Nigeria, Malawi and Mozambique



Step 2: Annual monitoring of the cook stove population as stipulated in the UN Clean Development Mechanism methodology AMS. The data is verified by an independent auditor resulting in the issuance by the UN of CERs.



Step 3: sale of carbon credits Dutch Climate Fund over a 10 year period at above market prices. Commercial banks can use this contract as a collateral to provide funding to cover implementation costs. Alternatively, the Dutch government can release a portion of the contract value up front.

3.3 Horizontal issues

3.3.1 Prevention of market distortions

Stakeholder consultations are still in an early stage, making it difficult to determine the expected capitalization rate of the Fund and whether the Fund will distort the market. This analysis becomes even more difficult in the context of the sectors the Fund could operate in. For example, the market for fossil fuels is heavily distorted by subsidies and by some this is seen as an argument to counter-subsidize renewable energy.

The Fund has to seek efficient solutions that minimize market distortions and moral hazard in the use of the Fund's resources. Two items have to be considered:

- In case the Fund's focus is on financial return (for instance scenario 1 in paragraph 4.1.3), the Fund could operate closely or at financial capital market conditions. Because it hard to determine whether a project would have been viable without involvement of the Fund, it is advisable to strongly limit the grant element. The instrument – when designed this way – should mainly be seen as a way to mobilize private capital.
- In case the Fund's supports adaptation projects (like in scenario 2) that generate positive social impact but a negative financial return, financing in the form of grants will be prerequisite as the financial capital market will not be in a position to provide commercial loans. In this model, the grant element of the Fund will need to be substantial. However, this comes at a risk. The Fund should not become a conduit for subsidizing international companies and become a source of windfall profits for the private sector. One way to prevent this, is to use competitive processes, like tenders.

The above examples se are two extreme scenarios. When the objectives of the Fund are more detailed, appropriate solutions might have to be sought to minimize market distortions. In the end one should realise that the fund will be there for at least 7-10 years. At this point it is rather hard to

predict the precise market conditions within the next 3-5 years, let alone beyond 2020. The fund itself should have an internal incentive to minimize market distortions. A balance has to be created as on the other hand the FFF should have the objective to speed up project development and finances.

3.3.2 Legal issues

Two legal issues apply to the proposed Fund, being:

- State aid. State aid rules apply in case individual companies enjoy specific benefits that have an impact on competitive positions within the European Union. The most likely design of the Fund is that eligible parties can apply for funding covering a proportion of the total investment costs. If the lending policies of the Fund reflect "market conformity", it does not distort the financial market. As the latter will be the case, state aid rules will not apply to the Fund design.
- Public procurement rules. The government will need to issue a tender for the role of the Fund manager.

3.4 Implementation

Stakeholder consultations revealed that establishing a common ground can be a tedious and lengthy process, often exceeding 12 months. Best is to start these discussions with those parties that have expressed an interest to continue the dialogue with MFA and have a vested interest.

In addition to these discussions, we also recommend to start discussions with Dutch flagship companies to gain better insight in the need for funding and possible projects in pipeline. The implementation process will be further elaborated on in chapter 4, recommendation.

4 Conclusions and recommendations

4.1 Conclusions

There is rationale for a new Dutch Fund

- The need for financing mitigation and adaptation projects far exceeds available financial sources.
- The flow of private capital to GHG mitigation and adaptation projects is limited due to barriers.
- Being strong in the water, energy, food nexus, the Dutch business community can benefit from additional climate investments.

Under the Copenhagen Accord developed countries acknowledged the need for financing climate relevant projects in developing countries

- Developed countries pledged to commit USD 100 billion per year from 2020 onwards for climate relevant investments.
- The Dutch fair share under the Copenhagen Accord may increase from EUR 200 million in 2013 to EUR 1.2 billion in 2020 .
- Establishment of a Dutch fund co financed at a fund level, would be a first crucial step forward to comply with the global commitment.

Existing Dutch instruments for climate relevant investments will not meet this long term commitment

- The Dutch long term commitment under the Copenhagen Accord needs to be mobilized from ODA budget complemented with private funds.
- Projected shortfall in funding taking into account existing MFA budget for climate relevant investments, synergies and anticipated private sector contribution grows rapidly.
- Leverage or mobilization of private sector capital is key to close the Dutch public funding gap.

In an optimistic scenario, a total of in the order of EUR 0.8-1.2 billion can be mobilised by the Fund. At fund level the public contribution (EUR 200 million) can be matched by the private sector.

- 50 % Leverage can be achieved both at fund level and project level, resulting in EUR 800 million.
- The capitalised EUR 800 million can be further increased by attracting additional funds over time or reinvesting revolving funds in case the fund is successful in terms of financial returns.
- This would mean that every EUR invested by the government could be multiplied by a factor 4 (leverage at fund and project level) to 6 (reinvestment of financial returns).

A quick scan shows that alternative instruments, like multilateral funds and agencies, regulation on carbon pricing etc. do not have a similar leverage potential as a fund to bridge the funding gap:

- National instruments are not designed to create and maximize leverage.
- Multilateral funds are not able to mobilize involvement of Dutch institutional investors or do not always allow for earmarking private investments as a Dutch contribution.
- Other instruments such as carbon pricing are highly dependent on international decision making, largely beyond control of MFA and with no convincing indication that things move in the right direction.

Developing a Dutch Climate Fund: more impact per EUR invested and added value to the business community

- Leverage at both Fund and project level
- Monitoring and evaluation of protocols allows for steering during shareholding meetings.
- A Dutch fund creates direct business opportunities for Dutch companies, specifically in the areas of water, agriculture and energy.

A public-private Dutch Climate Fund is a feasible option, under certain conditions. Agreement will be necessary on:

- Fund objectives
- Scope and nature (coverage adaptation-mitigation)
- Fund Manager and funding conditions
- Countries covered
- Envisaged capitalization
- Governance
- Fiduciary management
- Implementation agreements and monitoring
- Reporting and verification plan

This results in a detailed information memorandum

Institutional investors showed interest

- Institutional investors are diverse in character, knowledge areas, governance and capability to assess risks in specific markets.
- Large Dutch pension funds showed a clear interest to continue the discussion regarding the Fund on a more detailed level.
- A dedicated Fund has the potential to create leverage at fund level of around 50%.
- An additional and similar leverage can be expected at project level.

4.2 Recommendation

Rebel advises the MFA to opt for the further development of a Dutch Fund and take a step by step approach.

1. Following the GO decision, define the public budget for first capitalization and negotiable and non-negotiable objectives and write an information memorandum;

   To successfully achieve alignment of interest, MFA needs to first determine how much capital to commit from their own sources followed by categorising their objectives in negotiable and non-negotiable assets classes. Non-negotiable conditions could for example be the exclusion of partner countries of the Netherlands

   These conditions can be included in the detailed information memorandum
2. With a selected group of financial institutions start the process of aligning interest by defining qualifications of the fund manager and Fund objectives, criteria and instruments. Commercial banks and possible fund managers should be consulted actively in this process.
   - *Establish a common ground by:*
     - *Defining the driving force behind the Fund (a must have)*
     - *Creating a strong vision*
     - *Defining the objective of the Fund*
     - *Setting investment criteria and instruments*
   - *Align and balance public and private interest by*

- *Defining social and financial returns.*
- *Defining risk mitigation tool including first loss positions, guarantees and insurances.*

3. Design the Fund build on the outcome of step 2 and prepare procurement of fund management.
    - *Initial fund size (combined public and private funds) for 2016 of EUR 100 million.*
    - *Procurement of the fund manager on qualifications and track record in managing a EUR 300-400 million fund.*
4. Raise further capital in steps – to keep it manageable - growing to EUR 400 million in 2018.
    - *The EUR 400 million fund should trigger at least EUR 800 million of climate investments, taken into account that the Fund is a financing instrument.*
    - *Further development of the Fund will depend on its success and parties willingness to invest further.*

The go decision consists of:

- A mandate to develop an information memorandum on public conditions for the establishment of a Fund and starting of negotiations with institutional investors.
- An intention to select a fund manager via procurement, the final tender documentation will be subject to separate approval from both MFA as well as the institutional investors.
- A commitment to make a first pledge of EUR 50 million after selection of a fund manager; a second pledge of EUR 50 million as soon as required by the development of the fund portfolio and strong commitment to increase government funding up to EUR 200 million.

The planning would be as follows:

Table 17: Indicative planning

Period	Activity	Financially
Q4 2014	Information memorandum + negotiation institutional investors	Commitment 2* 50 million, second pledge and growth till 400 million (together)
Q4-Q1 2015	Preparation tender documentation	
Q2-4 2015	Selection fund manager	
Q1 2016	Fund operational	EUR 100 million total (2*50)
2017	New pledge	EUR 100 million
2018	New pledge	EUR 200 million
2019	Evaluation fund performance	
2020	New pledge	

Annex 1: List of acronyms

Acronym	Full Form
COP	Conference of Parties
BDB	Bilateral Development Bank
CER	Certified Emission Reduction
CIF	Climate Investment Funds
CPI	Climate Policy Initiative
DAC	Development Assisance Committee
DGGF	Dutch Good Growth Fund
DOF	Daey Ouwens Fund
EAIF	Emerging Africa Infrastructure Fund
ECI	Export Credit Insurance
EIB	European Investment Bank
FFF	Finance the Future Fund
FMO	Financierings Maatschappij voor Ontwikkeling (Dutch Development Bank)
GHG	Green House Gas
IEA	International Energy Agency
IFC	International Finance Corporation
KIF	Danish Climate Investment Fund
MDB	Multilateral Development Bank
MFA	Ministery of Foreign Affairs
MIGA	Multilateral Investment Guarantee Agency
NEFCO	Nordic Environment Finance Corporation
NGO	Non-Governmental Organisation
NorCaP	Norwegian Carbon Procurement Facility
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OPIC	Overseas Private Investment Corporation
SREP	Scaling Up Renewable Energy in Lower Income Countries Program
UNEP	United Nations Environmental Programme
UNFCCC	United Nations Framework Convention on Climate Change
WB	World Bank
WBCSD	World Business Council for Sustainable Development
WEF	World Economic Forum
COP	Conference of Parties

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Annex 3: List of consulted stakeholders

Dutch public sector
Ministry of Foreign Affairs
Ministry of Finance
Ministry of Economic Affairs
Procurement Agency

Dutch asset management
Commercial Banks
Bilateral Development Bank
Institutional Investors/ asset managers
Insurance company
Multilateral Development Banks

Consulted Dutch private business
Van Oord
Boskalis
IHC Merwede
Philips
FrieslandCampina
NaBu (Netherlands Association of International Contractors)
ClimateFocus

Consulted International Businesses
Climate Change Capital
C-Quest Capital
Global Green Growth Institute

Annex 4: Categorization of barriers to Climate Finance

Category	Barriers[42]
Policy & market related	1. Misalignment between green economy vision, industrial policy and structure of the financial system 2. Unstable policies and regulatory framework 3. No adequate availability of market and/or risk mitigation tools 4. No internalization of external costs, leading to higher costs for sustainable projects compared to high carbon projects[43] 5. No adequate insurance market (specific impact on adaptation; no possibility of internalising these costs/fair comparison with adaptation investments) 6. Existing policies and subsidies favouring historical carbon intensive technologies
Structural	7. Barriers in financing early stage, high risk projects and for moving projects from early development to commercialization (high opportunity costs) 8. Barriers in funding for mid-sized projects 9. Sub-optimal coordination between various finance institutions and access to funding is not transparent 10. Long lead times to funding and complex processes to funding (high costs of meeting due diligence requirements) 11. The financial return of the projects has a horizon that does not match with private sector demands for return on investment 12. Risks and returns are not appropriately balanced 13. Poor governance/enforcement (e.g. regarding deforestation, CHG emissions, sustainable land use); the fact that production methods that are not sustainable can flourish, makes the competitive position of sustainable investments far worse
Skill & capacity	14. Capacity constraints of implementation partners 15. Project development and contract management skills shortages within project developers 16. Project sourcing and evaluation skills shortages within financial institutions
Fund design	17. High transaction costs 18. Costs and administrative burden of monitoring, evaluation and reporting requirements 19. Lack of long term financing instruments, especially for infrastructure projects 20. Lack of knowledge on the side of investors for opportunities that fall outside their investment mandate; hence lack the capability to assess risks associates with these investments, especially if located in least developed countries.

[42] Source: KPMG (2012) "A private sector view of enhancing private sector access to climate finance in South Africa, draft. Della Croce, R.C. Kaminker and F. Stewart (2011) "The role of Pension Funds in Financing Green Growth Initiatives" OECD Publishing, Paris

[43] Source: A study by US National Academy of science estimated that internalizing non-carbon environmental impacts of fossil power generation in the US would add about 1-3cents/kwh to its cost.

Annex 5: Climate Finance Landscape

Multilateral Development banks and Institutions	Short description of funds under management
The World Bank (WB)	The WB manages 15 carbon funds and supports public projects. In 2013, the WB provided USD6.5 billion (EUR4.9 billion) to climate mitigation projects and USD2.9 billion (EUR 2.2 billion) to adaptation projects. Examples of WB funds: • The Adaptation Fund: finances concrete adaptation projects and programmes in lower developed countries. The fund is financed by pledges from donor governments and proceeds from the Clean Development Mechanism. • Carbon Initiative for Development: finances both capacity building as well as performance based payments to energy access programmes. Fund geographical focus is on least developed countries (especially in Sub-Saharan region). The WB is also the interim trustee of the Green Climate Fund (GCF), which was agreed to during the Copenhagen accord in 2009 and formally established during the climate summit in Cancun in 2010. A significant portion of the USD100 billion (EUR 76 billion) joint donor climate finance goal is foreseen to flow via the GCF from developed to developing countries.
The International Finance Corporation (IFC)[44]	The IFC supports private projects and programmes. In 2013 the IFC invested USD2,3 billion (EUR1.7 billion) in climate-related projects. An example of an IFC fund: • IFC Catalyst Fund: Fund of fund investments in emerging private equity and venture capital funds. Focuses on emerging markets. • IFC Blended Finance for Climate: Deploys concessional funds from donor partners alongside IFC's own commercial funds to catalyse climate smart investments that wouldn't otherwise happen and that have a high development impact.
The European Investment Bank (EIB)	In 2013, the EIB invested EUR 19 billion in climate projects. The EIB participates in several funds and climate projects.
Climate Investment Funds (CIFs)	The CIFs support innovative country-led investments in climate projects. Several countries (including the Netherlands) have pledged USD 8 billion (EUR 6 billion) to CIF. CIF is leveraged with USD 55 billion (EUR 42 billion) sourced from multilateral development banks and the private sector. The portion of private capital (23.5%) is channelled through these multilateral developments banks. The leverage is achieved by providing risk mitigation and financial instruments to increase the viability of renewable energy systems. The CIFs consist of several funds, including: • Clean Technology Fund: supports USD 5.5 billion (EUR 4.2 billion) to large-scale, country-initiated renewable energy, energy efficiency and transport projects in developing and middle income countries. • Scaling Up Renewable Energy Program: supports USD 551 million (EUR 418) to Low Income Countries to scale up deployment of renewable energy systems and expend renewable markets.

[4] Source: http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/CB_Home/Measuring+Reporting/

Annex 6: Alternative Instruments

GCF - the GCF is a government to government fund that is accountable to and operates under the "guidance" (rather than the direct "authority") of the COP. The GCF fund design includes a trustee – currently the World Bank – who is accountable to a 24 member board, with equal representation from developed and developing countries, and supported by an independent secretariat. The 24 member board operates on consensus. The GCF is constructed in an international political arena and imbeds the risk of[45]:

- potential conflicts in objectives;
- limited transparency and accountability;
- un-collaborative relationships and flaws in organizational structures;
- Political agenda's influencing approval processes;
- Expensive administrative mechanisms with not enough flexible, fastness, and transparency;
- Limited ability to get a grip on selection of those investments with the highest impact; and
- Limited ability to trigger private sector investments.

Nevertheless, the GCF will have a key political role to play in international climate negotiations. The initial capitalisation process is expected to be completed this year, culminating in an official pledging session in November 2014. Germany has taken the lead by pledging EUR 750 million for the initial capitalization of the GCF[46]. The Netherlands will follow in pursuit.
Leverage: Any Dutch contribution to the GCF will come from the MFA sources – either existing or new- and count in full towards the Dutch commitment under the Copenhagen Accord. This is in contrast to private sector contributions. According to information disclosed so far, a direct contribution from a Dutch institutional investor to the GCF will only partially count towards the Dutch commitment under the Copenhagen Accord. To illustrate, under the assumption that the Dutch government owns 3 percent of the shares of GCF any contribution from the private sector to the GCF will be discounted pro rate the percentage of Dutch shareholding. Meaning that in the event a Dutch pension fund deposits EUR 100 million in the GCF, this will only count for EUR 3 million mobilised private capital under the Copenhagen Accord for the Netherlands. Co-financing arrangements at project level between GCF and private investors do count and are expected once the GCF is operational.

Trade for aid: Unclear is the appetite for funding from the Dutch private sector in these GCF Climate Investments and whether these projects will support Dutch business development overseas in Climate Investments. Time will tell.
Effectiveness: What is clear is that the GCF is not an instrument that optimizes gearing.

Multilateral Agencies - This include donations to existing climate programs and instruments under management of the World Banks and IFC.

Leverage: Any funding through these agencies will count towards the Dutch Commitment under the Copenhagen Accord.
Trade for Aid: Any funding through multilaterals will give generate immediate access to projects in portfolio and sourcing capacity on the ground. Financing under the umbrella of the World Bank and

[45] Designing the Green Climate Fund: How to spend USD100 billion sensibly.

[46] Source: http://www.rtcc.org/2014/07/14/merkel-returns-to-climate-politics-with-call-for-eu-leadership/#sthash.ZDxsM2Pp.dpuf

IFC also mitigates country risk. Although the multilateral agencies provide a portal for financing, Dutch businesses expressed the following barriers in requesting funding from bilateral and multilateral agencies:

1. Perceived overall lack of transparency of financing instruments available;
2. Too strict eligibility criteria and funding requirements;
3. Long and cumbersome due diligence process resulting in high opportunity costs;
4. Initial investment thresholds are too high; and
5. Complex process to funding.

In addition, institutional investors are hesitant to invest in funds managed by the IFC or the World bank due to underperformance and high management fees[47].
Effectiveness: From a "global good citizenship" perspective, the Dutch government will need to continue its financial support to multilateral agencies, especially given the broader agenda of these agencies and the important role they play in the international financial market. However, allocating more than is currently budgeted (see figure 4) is not perceived as the best value for money as it does not optimize gearing and Dutch companies are cautious in raising financing from these agencies.

Bilateral agencies agency – This includes donation to the FMO. The FMO initially received funding from the Dutch government which came to came to an end once the FMO successfully generated profits and was clearly capable to operate independently without MFA support. FMO is backed by the state with a state guarantee. As a consequence, FMO is able to borrow against low interest rates on the capital market.

Leverage: Any contribution to the FMO will count towards the Dutch commitment under the Copenhagen Accord especially if earmarked for Climate Investments.
Trade for Aid: FMO's lending portfolio does benefit from government guarantees and is subsequently well positioned to provide lending to developing countries. Commercial banks typically underwrite FMO's debt facility to indirectly benefit from this government guarantee. The global financial crisis shifted the investment mandate from commercial banks from developing countries to developed countries, leaving a void for Dutch businesses with a strong presence in developing countries. The FMO has stepped into this gap and is gradually positioning itself as a financing outlet accommodating Dutch businesses in developing countries.
Effectiveness: The Dutch government could provide additional funding to the FMO with a clear directive to allocate this money for Climate Investments. This option does seem to trigger all the right boxes as it will count towards the Dutch commitment under the Copenhagen Accord, creates leverage at project level and supports Dutch business interests overseas. However, the potential to create leverage could be further enhanced buy positioning the FMO as fund manager as further described below.

Climate initiatives - the Dutch government could in invest in existing climate initiatives such as the Nationally Appropriate Mitigation Actions (NAMAs), concluded at COP 18 in Doha. NAMAs refer to any action that reduces emissions in developing countries and is prepared under the umbrella of a national governmental initiative. They can be policies directed at transformational change within an economic sector, or actions across sectors for a broader national focus. NAMAs are supported and enabled by technology, financing, and capacity-building and are aimed at achieving a reduction in emissions relative to 'business as usual' emissions in 2020[48].

[47] Source: Interviews with pension funds

[48] Source UNFCCC: Focus: Mitigation – NAMA's National Appropriate Mitigation Actions

KfW has developed a framework for financial support of NAMAs and belongs to the pioneers in the financing of NAMAs[49]. The Ecocase NAMA program in Mexico, for example, contributes to the Mexican government's effort to reduce GHG emissions from the residential sector by providing financial incentives for energy efficiency investments and low carbon houses. Starting in 2011, its supports of up to 27,000 low carbon houses and up to 800 passive houses. This program is not only funded with funds from KfW but also e.g. IDB (total: EUR 168 million).

Leverage: Any contribution to international climate initiatives will count towards the Dutch commitment under the Copenhagen Accord.
Trade for aid: In general, the selection of projects / programs and allocation of funds are usually the responsibility of financial institutions and local ministries / agencies in developing countries (such as the ministry of finance, planning). It requires strong host country commitment, strong price for carbon and flexibility to align investor requirements with the requirements of the developing country. Importantly, it requires the establishment of "business as usual' to estimate the GHG mitigation aspect and strong monitoring requirements. NAMAs generally gauge the interest of multi- and bilateral agencies such as the FMO given the strong development impact and the fact that these agencies are more accustomed to dealing with local governments. Co-investment form other Dutch capital providers is not foreseen on the short term due to this political setting and regulatory risk in connection with carbon credits.
Effectiveness: NAMAs create interesting business opportunities for FMO and Dutch businesses. Gearing potential is currently limited due to lack of strong price for carbon.

Insurances and guarantees - Besides these instruments, the MFA can also use government guarantees and insurances to channel private sector capital towards Climate Investments. Both instruments – carefully managed by the Ministry of Finance - are effective financial leveraging tools. Loan guarantees are a useful instrument in countries with perceived high political risk, dysfunctional markets and lack of policy incentives of investments (estimated leverage is 6-10 times)[50]. Policy insurance are instrumental to cover country risk including risk of expropriation, transfer risk and Foreign-Exchange risk (estimated leverage 10 time or more)[51]. By increasing of the Dutch government under these instruments, leveraging can be further enhanced and if applied for Climate Investments, it will support the Dutch commitment under the Copenhagen Accord.

However, it is not foreseen that simply by revising / enhancing these instruments, long term mobilization of private capital to Climate Investments will be guaranteed. The Ministry of Finance prefers to manage and control the already high exposure of the State and will act cautiously to any requests for extensions, see table 8.

[49] Source: Key issues and Challenges of financing NAMAs

[50] Source: Della Croce, R.C. Kaminker and F. Stewart (2011). "The role of Pension Funds in Financing Green Growth Initiatives, OECD Publishing, Paris

[51] Source: Della Croce, R.C. Kaminker and F. Stewart (2011). "The role of Pension Funds in Financing Green Growth Initiatives, OECD Publishing, Paris

Dutch central government loans, guarantees and subordinate guarantees (2013)[52]	EUR billion
Total guarantees	214.2
Total loans	8.8
Total indirect guarantees	259.1

Finally, guarantees and insurances are tools designed to support (climate) finance; not tools to support the demand for (climate) finance per se. To increase the demand for climate finance, the Dutch business interests and opportunities to invest come to play.

[52] Source: Annual report 2013 (www.rijksbegroting.nl)

Annex 7: List of partner countries and investment grade

In the field of foreign trade and development cooperation the Netherlands has a special relationship with certain countries. These are known as 'focus countries' when the relationship revolves around trade and 'partner countries' when it revolves around development cooperation. The Netherlands maintains 3 types of relationships with partner countries and focus countries. [53]

1. **Aid relationships**. The Netherlands helps countries that are unable to solve their poverty problems alone: 'fragile states' affected by war, weak governance, and major ethnic and political tensions. They lack the capacity to reduce poverty effectively without outside aid. The Netherlands has an aid relationship with Afghanistan, Burundi, Mali, the Palestinian Territories, Rwanda, South Sudan and Yemen.
2. **Transitional relationships**. The Netherlands helps low- and middle-income countries reduce poverty and boost economic growth. It also helps them to increase their market access and improve their business climate. The Netherlands runs programmes aimed at reducing poverty and promoting the four priority themes of Dutch development cooperation policy. The Netherlands has a transitional relationship with Bangladesh, Benin, Ethiopia, Ghana, Indonesia, Kenya, Mozambique and Uganda.
3. **Trade relationships**. Most of the Netherlands' trade relationships are with OECD countries. Here, the emphasis is on activities that chiefly benefit the Dutch economy and employment. The category also includes countries with which the Netherlands used to have an aid relationship, which has now become a trade relationship that benefits both parties. The Netherlands has a trade relationship with Colombia, South Africa and Vietnam, among others.

In the table below, the partner countries and some of the developing trade partners and their investment grade are summarized. Not all grades could be found. For S&P, a bond is considered investment grade if its credit rating is BBB- or higher. Bonds rated BB+ and below are considered to be speculative grade, sometimes also referred to as "junk" bonds. For the Fund, lowering the bar negatively affects the appetite of institutional investors. As we can see, holding on to BBB- or higher, would exclude all the partner countries of the Netherlands.

Credit ratings[54]	S&P rating	Moody's rating	Fitch Rating
Aid relationships			
Afghanistan			
Burundi			
Mali			
The Palestinian Territories			
Rwanda	B		B+
South Sudan			
Yemen			
Transitional relationships			
Bangladesh	BB-	Ba3	

[53] http://www.government.nl/issues/development-cooperation/partners-in-development

[54] http://www.tradingeconomics.com/country-list/rating

Credit ratings[54]	S&P rating	Moody's rating	Fitch Rating
Benin			
Ethiopia	B	B1	B
Ghana	B	B2	B
Indonesia	BB+	Baa3	BBB-
Kenya	B+	B1	B+
Mozambique	B	B1	B+
Uganda	B	B1	B
Trade relationships			
Colombia	BBB	Baa2	BBB
South Africa	BBB-	Baa1	BBB
Vietnam	BB-	B1	B+

Annex 8: Lessons learned from existing climate funds[55]

[55] Source: United Nations Development Programme: Blending Climate Finance through National Climate Funds. A guidebook for the design and establishment of national funds to achieve climate change priorities

Annex 9: Initial Terms of Reference Fund Manager

The leverage at fund level can only be arranged if the fund management is organised at arm's length. An independent strong fund manager can be a trustworthy partner both for public and private financers.

Typically the fund manager should meet requirements that satisfy all stakeholders involved. For example they should have: experience in climate finance; the ability to create both public and private values; and have the ability to bring promising initiatives from development to financial close and implementation.

In the process to select the Fund manager, the following steps are proposed starting from October 2014 onwards:

1. Development of terms of reference for fund management in concept (Q4 2014)
2. Organization of a market consultation process (Q1 2015)
3. Preparation of final documentation for public procurement of fund management (Q2 2015)
4. Selection of fund management through public procurement (Q3 2015- Q1 2016)

Main issues to be included in the terms of reference for Fund management

- Minimum requirements experience (experience, good repute)
- Fund objectives and country coverage
- Public interest targets (CHG emissions, portfolio development least develop countries, minimum % investment in adaptation)
- Private interest targets (financial interest, involvement Dutch enterprises)
- Fund strategy (rules for investment, project selection, financial tools, co-financing requirements)
- Management contract (fees, obligations, division of risks evaluation of fund management)

Further detailing will depend on choices made regarding fund criteria and design. The market consultation will allow potential Fund managers to present preferences regarding the Fund criteria and design. These will assist in:

- Possible appetite from potential Fund managers or eagerness;
- Public comfort that the Fund design allows the government to manage public interests at stake;
- Private comfort that the Fund design will be lean, independent and efficient

Institutional investors are supposed to co-finance the Fund and to smooth this process, the above steps have to be taken in close co-operation and consultation with all parties involved, including the financial institutions who showed keen interest to continue and the relevant ministries selected to continue the process of defining Fund criteria and design.

Key for a successful selection of a Fund manager are clear rules of the conditions that should be applied by the fund manager to finance projects. In the end this will determine the abilities of the Fund manager to realise public and private values. A clear set of funding rules, as part of the terms of reference, allows the potential fund manager to judge whether he can fulfil the tasks required. Although still at an early stage, the core competences should include:

- Management of a gradually increasing sum of public sector funds (doubled by institutional investors)
    - 2016: EUR 50 million (EUR 100 million)

    - 2017: EUR 50 million (EUR 100 million)
    - 2018: EUR 100 million (EUR 200 million)
- Actual availability of funds depending on development of a pipeline of projects (funds will be transferred only once projects have been selected for funding), efficient alignment with other instruments
- The strict requirement to organize a multiplier at fund level of at least 50% in combination with a modest financial return on public resources (allowing pension funds to step in with a minimum financial return requirement)
- A single investment regulation that reflects the public and private demands of the financing entities (government, pension funds) for climate investments
- The freedom to develop sub-funds as long as the overall multiplier is not jeopardized; however some pubic requirements
- Annual evaluation of the performance of the fund management and preceding any next step to increase the size of the Fund. Evaluation criteria: Number of Climate Investment in pipeline and financial close, involvement of Dutch companies, financial performance instruments

The management fee uses should allow for professional high level management of the fund that takes into account the challenges involved in organising climate investment in developing countries. Management fee should be in conformity with the market.

Since the fund will be active in numerous countries and cooperate and seek for synergies with stakeholders and other financial instruments the Fund manager should possess the ability to work along with many different stakeholders. A maximum percentage (e.g. 5%) of the fund should be earmarked for TA.

Fund management is a partnership for the long term, 12-15 years. Partners involved should be cautious not to fix financial conditions, selection methods etc. in detail reflecting the situation of 2015. The Fund should have the ability to evolve, anticipate and improve over time. Therefore a "modest" start (50 million public + 50 million private) should be preferred over a "hasty" introduction of a Fund that fills the entire EUR 1,2 billion commitment. The Fund should be able to prove itself, towards all stakeholders (projects, state, pension funds, companies, recipient countries) and create a natural setting for each next step.

Annex 10: ODA definition

Official Development Assistance (ODA) is defined as those flows to countries and territories on the Development Assistance Committee (DAC) List of ODA Recipients and to multilateral development institutions which are: i. provided by official agencies, including state and local governments, or by their executive agencies;
and ii. each transaction of which:

a. is administered with the promotion of the economic development and welfare of developing countries as its main objective; and
b. is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent).

- This calculation helps determine whether a loan is concessional. If the loan satisfies the ODA criteria, then the whole amount is reported as ODA. The grant element itself is not reportable as a flow. Reporting is on a cash (nominal) basis, except for Paris Club debt service reduction.
- In case ODA is allocated towards the Fund, it is predominantly the 'concessional character' and the 'grant element' that will have consequences on the Fund instruments. To determine upfront whether these instruments are ODA eligible, the loan agreement between the Fund and the borrower will need to include clauses regarding re-structuring or even cancellation of the debt facility[56].
- Where concessional and non-concessional financing are combined in so-called "associated financing packages", the official and concessional elements may be reported as ODA, provided they have a grant element of at least 25 per cent. Such contributions must also meet the special "concessionality" criteria for associated financing, which are based on market interest rates and set out in the Arrangement on Guidelines for Officially Supported Export Credits (OECD, 2008 Revision).
- At the moment, revolving funds, guarantees and insurances are not ODA-eligible, provided not in default, despite current efforts of the Dutch government to adjust the ODA-definition.

[56] Source: 'is it ODA?' from the OECD