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Next MFF :

Incentives and safeguards for climate friendly investments

BACKGROUND DOCUMENT

Climate policy is a cross-cutting objective in the 2014-2020 EU Multi-annual Financial Framework (MFF). The European Parliament and Member States agree that the MFF should be aligned to the priorities of the Europe 2020 Strategy and that at least 20% of the expenditure should target climate-related activities. But it is clear that substantial private finance should be mobilised in order to match the amount of investment required for the transition towards a low-carbon and climate resilient economy. The EU plans to expand the use of financial instruments (FIs) in order to leverage private capital for low carbon and climate resilient actions.

Two recently commissioned studies by DG Climate Action have explored the potential for mainstreaming climate change in investment decisions for financial institutions and EU financial instruments for the 2014-2020 Multi-Annual Financial Framework (MFF).

Objective of the workshop

The main objective of this workshop is to discuss the opportunities and challenges for implementing the recommendations of the studies.

Overview of the two studies

A brief summary of the two studies is provided overleaf.

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Mainstreaming climate change infrastructure in investment decisions

Objective of the study

The study is exploring how Multilateral Financial Institutions (MFIs) and Bilateral Financial Institutions (BFIs), are incorporating climate considerations into infrastructure investment decisions, including (but not limited to) those activities that might be considered climate finance under the UNFCCC, or be tagged using the Rio Markers. The findings will be included alongside a more general overview of MFIs and BFIs climate policies and practices. The lessons learned were used to develop a best practice framework for mainstreaming climate change in investment decisions. The study also seeks to provide policy recommendations for the European Commission, and identify in which areas they should cooperate with the MFIs and BFIs in order to maximise the climate compatibility of EU funding (both within and outside the EU).

Study method

This study reviewed literature on eight European and international financial institutions¹ from wide variety of sources, ranging from academic, policy, NGO and private sector perspectives. These findings were complemented by focussed interview with all eight financial institutions to generate evidence to support the development of the investment framework and policy recommendations. The specific recommendations were supported by the two case studies - Connecting Europe Facility (CEF) and Neighbourhood Investment Facility (NIF) to demonstrate the practicality of the investment framework developed.

Study outcomes

The review of MFIs/BFIs for mainstreaming climate change showed that climate financing is now a priority activity in all the MFIs/BFIs. It is increasingly integrated and mainstreamed into the MFIs/BFIs development and operational strategies though not in a consistent and transparent manner. The review looked at: the link between investment plans and climate policies and sector strategies; environmental and climate change-related commitments and targets; definition and tracking of climate finance; project impact and screening criteria; and appraisal tools for climate related finance.

The study also found that analytic and option evaluation approaches such as cost-benefit analysis can be an effective and robust tool to support decision-making in relation to climate change and related infrastructural investments.

The team developed an investment decision framework based on the scope for incorporating climate change in various stages of the project or programme cycle. This provided a strong template to evaluate current practices and recommend best practices. Finally, the investment framework was applied to two EU financing facilities (TEN-T and TEN-E Programmes under CEF and NIF blending facility) to provide a summary of climate change considerations in various stages of programme of the cycle.

Study recommendations

The study findings and workshops with various stakeholders contributed to recommendations across four key areas relevant to EU policy making and cooperation with European and international financial institutions. These are summarised below:

Main areas	Recommendations
For Financial mechanism supported through EU budget (e.g. EU Major projects under structural funds, TEN-T/E, NIF and other EU blending facilities)	<ul style="list-style-type: none">• Incorporate best practice into policy design and legislative framework• Apply best practice in operational and technical implementation of EU major infrastructure projects and EU blending facilities investment guidelines• Reinforce links between climate policy and strategies and investment plans.
For Financial institution policy, procedures and tools:	<ul style="list-style-type: none">• Influence financial institutions to adopt and share best practice tools.• Integrate climate considerations and safeguards in sector strategies.• Develop common indicators and tools.• Share challenges faced in new geographies or sector/activity
For EU legislation government project development:	<ul style="list-style-type: none">• Influence legislation by incorporating best practice (e.g. in new EIA Directive).• Improving guidelines in SEA/EIA, DG REGIO CBA, etc.
Capacity building	<ul style="list-style-type: none">• Training for EC and MS staff working on major projects by providing training courses and workshops.

¹ European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), Kreditanstalt für Wiederaufbau (KfW) and Agence Française de Développement (AFD), World Bank, Asia Development Bank (ADB), International Finance Corporation (IFC) and Inter-American Development Bank (IDB). The contribution of the Africa Development Bank to the MDBs development of a tracking methodology for adaptation and mitigation has been also reviewed

Optimal Use of EU Grant and Financial Instruments in the Next MFF to Address the Climate Objective

Aim and background

A sustained increase in public and private investment is needed for the EU to meet its 2020 climate and energy objectives and to take forward its 2050 decarbonisation and climate resilience agenda. Key investment needs have been identified in various areas including energy infrastructure, buildings, research and development, sustainable transport systems, agriculture and forestry.

In the context of on-going negotiations on the EU's 2014-2020 MFF, this study is intended to explore how to improve the 'mainstreaming' of climate change by leveraging more financing for climate action in the future. The main objective of this study is to provide an overview of which grant schemes and financial instruments (FIs) in the 2014-2020 MFF are best suited to achieve the EU's climate change policy objectives.

Project questions

The study aims to answer the following questions:

- What are the most relevant sectors to address climate change mitigation and adaptation within Europe? What are the main investment needs and market demands in these sectors?
- Which FIs are most suitable to finance climate mitigation and adaptation type of projects?
- What lessons can be learnt from the use of FIs for promoting climate change in the 2007-2013 EU MFF?
- What is the potential of the proposed grants and FIs in the 2014-2020 MFF for financing climate change activities? What are potential gaps and how can these gaps be closed, either through funding action at the EU level or other action?
- Which grants and FIs proposed in the 2014-2020 MFF can be best used to leverage financing for mitigating and adapting to climate change within Europe?

Study outcomes

The study shows that the required investment needs to be considerable in order to tackle climate change in the energy transport, buildings, agriculture and water sectors. Climate mitigation and adaptation projects in these sectors face a number of barriers to attract private investors including the perception of high policy and technology risks, low capacity of some projects to generate revenue/profit, high transaction costs especially in relation to smaller scale projects, information problems or lack of expertise. Some of these barriers can be addressed by the use of FI, for example debt (loans and loan guarantees), equity and quasi equity, other risk sharing arrangements and/or technical assistance.

The EU has an increasing experience of using FIs and technical assistance in the 2007-2013 MFF. For the first time, the new EU Financial Regulation provides a coherent governance framework for FIs, which should simplify and streamline their use. The Commission's proposals on the different 2014-2020 EU funding programmes/instruments set out fairly generic provisions for FIs; however they do not provide detailed requirements on the scale and scope of the FIs that can be used for climate action. The only straightforward case regards FIs under the future LIFE programme which will be used exclusively for climate change activities.

The objective of LIFE is to test new solutions, however only a fairly small share of the total budget (in the range of €120-200 million) could be used for testing financial instruments. Given the scale of the required investment, more substantive support for climate action should be sourced from elsewhere; this is in line with the rationale of the climate mainstreaming approach in the next MFF. In terms of scale, the biggest opportunities exist under Cohesion Policy, Rural Development Policy, Horizon 2020 and the CEF. While opportunities do exist, it is important that additional actions are undertaken to better target the proposed FIs in relation to climate policy objectives and the priority areas with greatest investment requirements.

Study recommendations

On the basis of a sound assessment of the needs, gaps and barriers as well as the Commission proposals on the 2014-2020 EU funding instruments, this study finds that additional action to complement or modify the proposals for FIs is warranted to help better address the challenges of adequate low-carbon finance.

Main areas of action include:

1. Better mainstreaming of climate objectives in centrally managed FIs, including introducing a climate 'window' in the Debt Facility under Horizons 2020 to address financing gaps in the financing of demonstration, deployment and market take up of emerging renewable energy technologies in relation to the EU Strategic Energy Plan implementation and expanding the scope of the Project Bonds Initiative to include renewable energy generation together with its connection to the grid;
2. Better mainstreaming of climate objectives in FIs under shared management, including the provision of technical assistance, loan guarantee facilities and other risk sharing instruments for energy efficiency and/or project bonds for integrated mitigation and adaptation projects at city level;
3. Allocate funds for technical assistance dedicated to adaptation to climate change under LIFE.

All the options address relevant needs in a complementary manner. Instruments under central management offer better opportunity structures than instruments under shared management where there is a need to coordinate with a much larger number of actors. Additional actions could be considered for a longer term perspective, such as micro-credit instruments, bonds for projects at city level or an EU Natural Capital Fund to pilot financing models for eco-system based adaptation projects.

In addition it appears relevant to strengthen procedural requirements and efforts to build the information base need to be considered as well. These can be implemented

alongside the use of FIs and grant financing including project selection criteria, ex-ante conditionality for mainstreaming climate change concerns into expenditure and investment programming, better ex-ante assessment and good monitoring systems. Creating of dedicated expert groups can add value, if these expert groups are focusing on specific instruments or specific sub-sectors.

Key questions to explore during the two sessions

MORNING SESSION -

MAINSTREAMING CLIMATE CHANGE INFRASTRUCTURE INVESTMENT DECISIONS

- Are certain elements of the framework presented and IFIs tools and methods more important or effective than others? Are some tools more replicable and scalable than others?
- How to better leverage climate policy and sector strategies with investment plans?
- Cost Benefit Analysis allows to calculate in an objective way trade-off between climate impact, and other non-climate benefits of the project and to justify public financing. How to improve the use of `climate proofed` CBA in and outside the EU?
- There are only few methodologies or guidelines to incorporate climate resilience in EU projects and financial facilities; what are the most important steps to address this issue?

AFTERNOON SESSION -

INNOVATIVE SOLUTIONS TO MAINSTREAM CLIMATE CHANGE IN FINANCIAL INSTRUMENTS

- Why is it relevant to think about additional action for innovative solutions compared to existing proposals (E.g. to remove market imperfections and market failures)?
- Is it more feasible to scale up existing instruments or create a new financial instrument?
- What would be the most efficient type of instrument to take forward - debt, equity, or technical assistance - and should this be targeted at European or Member State level?
- How can climate performance be measured and added value maximised?

For further questions please contact:

MAINSTREAMING CLIMATE CHANGE IN
INFRASTRUCTURE INVESTMENT DECISIONS

Adarsh Varma

ADARSH.VARMA@RICARDO-AEA.COM

For further questions please contact:

OPTIMAL USE OF EU GRANT AND FINANCIAL
INSTRUMENTS IN THE NEXT MFF TO ADDRESS THE
CLIMATE OBJECTIVE

Axel Volkery

AVOLKERY@IEEP.EU