Climate Public Private Partnership

The Climate Public Private Partnership (CP3) incorporates two funds supported by the UK Government. It will invest £110 million (US$170 m) in two commercially run private equity funds, alongside the IFC and Asian Development Bank, as well as up to £11 million (US$17 m) in technical assistance. The stated aim is "to mobilise new sources of finance, such as pension funds, in to low carbon, climate-friendly projects."

Background

In 2010, the UK Department for International Development (DfID) held meetings with the P8 group, which includes nine of the world's largest state-owned pension funds from the US, UK, Sweden, South Korea and The Netherlands, as well as the Norwegian Sovereign Wealth Fund. They successfully lobbied for the creation of the CP3 as a pair of "private equity" funds, i.e. funds that take a share in the ownership of companies, rather than offering grant or loan financing. The Business Case for the CP3 was also informed by a study by consultancy firm Castalia, jointly commissioned by DfID, the IFC and the Global Environment Facility, which argued that public institutions should invest in private equity and venture capital funds as a means of capturing climate-friendly investment opportunities that are "risky, innovative and relatively small". The money is drawn from the UK's £3.87 billion (US$6.35 bn) International Climate Fund, which also includes a number of debt-financing facilities.

Funding structure

The UK Government is putting its £110 million into two funds, the Climate Catalyst Fund managed by the International Finance Corporation (IFC), and another run by the investment bank Credite Suisse in conjunction with the Asian Development Bank (ADB). The money is provided in the form of "returnable capital with potentially material financial returns beyond return of the initial capital invested." In other words, money is provided as a grant to the multilateral institutions responsible for the projects on the understanding that if the project breaks even or makes a profit this will be returned to the UK government.

The expectation is that the equity investment made by the CP3 funds will be matched by equity and debt from private sources. The CP3 is officially aiming for a "leverage ratio" of 30:1, which means that it aims to mobilize £30 of private money for every £1 of public money put into it (no actual figures are yet available).

The start-up phase is almost entirely funded by public institutions, however, as set out in the tables below.

Tables. Initial funding of CP3

Funder	IFC Climate Catalyst Fund (US$)
UK (DfID)	80
IFC	75
Canada	76
Azerbaijan (SOFAZ)	50
German pension fund	65
Total	**346**

Funder	ADB CP3 Fund (US$)
UK (DfID)	90
ADB	100
CFIG*	50
Total	**240**

* The Customised Fund Investment Group was sold by investment bank Credite Suisse to hedge fund Grosvenor Capital Management in August 2013. It is not clear whether the new owners will continue with their investment and management.

The UK government has made clear that "[t]he funds will be run on a strict commercial basis by professional fund managers." This means that it "will not have a role in choosing the investments" and "[does] not know exactly what spread of investments will result."

The Climate Catalyst Fund is intended to be a "funds of funds" that is global in scope. It is managed by the IFC Asset Management Company, a subsidiary of the bank that specializes in private equity. It will then invest in managed thematic sub-funds, focused on specific sectors such as energy and energy efficiency. The fund managers of these private funds will then determine what companies are invested in.

The ADB's CP3 fund will take a more active role, directly investing a majority of its money in companies. The fund management is arranged by a special company newly set up for this purpose in the Cayman Islands, which is jointly owned by the ADB and the Customised Fund Investment Group (CFIG), a wholly owned subsidiary of a hedge fund called Grosvenor Capital Management. CFIG (formerly owned by investment bank Credite Suisse) has a majority stake and provides the fund managers.

The funds will not own more than a 25 per cent equity stake in any one company, in accordance with ADB and IFC investment rules. All investments and funds are required to adhere to the IFC or ADB environmental and social governance standards, although these need not be independently verified at project level.

First funding

The IFC-housed Catalyst Fund is now operational and had made investments worth US$35 (£22 million) as of August 2013. The ADB fund is expected to make its initial investments in 2014.

The UK government claims that the IFC has to date invested in 3 sub-funds, although only Armstrong Asset Management is named. This is a private equity fund registered in Singapore, which has set up a fund to invest in renewable energy and resource efficiency projects in South East Asia. The IFC Catalyst Fund is reported to have invested $20 million (£13m) in Armstrong's South East Asia Clean Energy Fund. The IFC has separately invested a further $20 million of its own, out of a total of $164 million. Other investors include development finance institutions GEEREF (European Union, $13 million), DEG (Germany), FMO (Netherlands), PROPARCO (France), private asset managers Obviam and Unigestion, an Asian-based corporation (not disclosed), and the individuals involved in Armstrong's management team.

The Armstrong fund's initial investments include up to US$30m to a company called Annex Power, which intends to develop solar PV and biogas power projects in Thailand, Indonesia and the Philippines; and a 60 per cent stake in Symbior Elements, which will develop solar photovoltaic (PV) power projects in Thailand. The Fund aims to make 10 to 15 such investments, and hopes "to provide investors with a gross return in excess of 20% per annum."

Further funding

Overall, the UK government estimates that 70 per cent of CP3 investments should go to mitigation, of which it hopes to have invested in 70 energy generation projects (including CCS and biofuels), and 50 energy efficiency projects for manufacturers and supply chains by 2017. The remaining 30 per cent of investments would be in adaptation and forestry.

In the case of the ADB fund, the estimate is that the largest expenditures will be in China and India, with most going into "asset development" (building infrastructure to grow the business) on a large scale,

rather than venture capital for small start-up companies.

Concerns and drawbacks

○ **Who's in the driver's seat?** The UK government lays great stress on the role of the CP3 in "mobilizing" other funding, although investment decisions are exclusively in the hands of private fund managers. The picture being drawn is of public money steering the flow private money into cleaner projects, but the funding structure suggests that public money is actually being controlled, with limited accountability, by the private sector. With the fund aiming for a very high ratio of private to public money, it is also not clear how such a small proportion of public financing could be used to exert significant influence.

○ **What counts as "mobilized" finance?** The CP3 aims to use the UK government's initial £110 million investment to "(m)obilise the flow of at least £15bn into the developing country climate sector of which £11bn should be private sector funds." The record of other public-private collaborations suggest these figures are extremely inflated.

There is also considerable scope for double, or multiple, counting as the initial investments in Armstrong Asset Management fund make clear. In reality, it is not clear which investments are driving the others, although it is likely that the IFC and the development finance institutions involved in co-funding projects will all independently claim to be the main "mobilizer."

○ **Geographical distribution.** Private equity financing in "emerging markets" is concentrated in a handful of middle-income countries such as China, Chile and Malaysia, as well as a handful of wealthy non-Annex I countries (to use the UN climate convention terminology) such as Singapore, South Korea, Taiwan and Israel. It is likely that the CP3 would follow a similar distribution, although focusing climate finance on these countries could further disadvantage some of the poorest countries in greatest need of financial support.

○ **Mitigation Bias.** Private equity financing seeks a considerable return on investments, which requires projects to have a clearly identifiable and reliable revenue stream. While this may be achievable in the case of renewable energy, for example, there are far fewer adaptation projects that are capable of such returns. The CP3 could worsen the existing mitigation bias in climate financing unless measures are taken to counter-balance this with grant-based adaptation financing.

○ **Transparency and accountability.** The IFC Catalyst Fund's "fund of funds" structure does not lend itself to transparency, as several layers of investment are involved, clouding the overall picture about where investment is flowing. More broadly, the reliance on private fund managers, with their expectations of commercial confidentiality, undermines transparency in terms of both what companies are invested in, and what particular projects are being backed as a result of the financing. This is exacerbated by the routing of funds through companies hosted in secrecy jurisdictions (tax havens), such as the ADB's CP3 fund and, in all likelihood, many of the IFC Catalyst Fund's sub-funds.

○ **Accountability of fund managers.** Although funds are required to meet formal environmental and social safeguards, the application of these (especially at project level) is largely left to self-reporting. Fund managers are not trained to fulfill these tasks adequately, and the IFC's record on financing via financial intermediaries suggests due diligence and safeguard reporting has been poor.

○ **Returns on investments.** The UK Government's £110 million comes in the form of "returnable capital," while the expectation of private equity fund managers (including Armstrong Asset Management, the first sub-fund receiving finance from the CP3) is that returns of 20 per cent or more per annum will be achieved. These returns represent a significant outflow of finance from countries hosting projects.

A referenced text is available at
www.climatemarkets.org