Institutional Investors and the Low-Carbon, Sustainable Transition

10th Annual OECD High-Level Breakfast Event

Co-hosted by the OECD and IIGCC

10 December 2019, Madrid, Spain

Summary record

On 10 December 2019, the OECD and the Institutional Investors Group on Climate Change (IIGCC) co-hosted the 10th Annual High-Level Breakfast Event on Institutional Investors and the Low-Carbon, Sustainable Transition on the margins of UN Climate Change Conference COP25 in Madrid. The event gathered over 60 senior representatives from institutional investors, other financial stakeholders, policy makers and civil society. Topics discussed under the Chatham House rule included: (i) investment mobilisation initiatives to maximise impact on greenhouse gas emissions in the next 10 years; (ii) selected investment vehicles established to address specific market gaps and scale-up low-carbon, sustainable infrastructure investment; and (iii) a stocktake of progress and outstanding barriers, including to mobilise institutional investment beyond clean energy, in other sustainable assets. Key takeaways from the discussion included the following:

1. The scale and pace of investment is far behind what is needed to deliver the Paris Agreement and achieve the SDGs. While policy signals are critical, we cannot wait for them to emerge. Transformative actions and initiatives are needed to massively scale-up investment.
2. Limited public money can be more strategically used to provide risk mitigation for land use and natural capital projects, among others.
3. Mainstreaming infrastructure investments requires standards, data, scale and a secondary market to provide liquidity, in addition to multi-stakeholder co-operation.

As the climate conversation moves into the "decade of delivery", current investment practices must evolve to accelerate institutional investment in low-carbon infrastructure, and broader sustainable investments at pace and scale. Multilateral Development Banks (MDBs) and other Public Financial Institutions (PFIs) are providing an increasing number of investment vehicles with risk mitigation to facilitate institutional investment in environmentally sustainable projects in emerging economies. During the discussion, three PFIs presented their investment vehicles and highlighted the types of investment barriers the vehicles were designed to overcome. In addition to speeding the uptake and replication of such vehicles, there is a massive need for larger pipelines of bankable projects in emerging economies, and for transformative actions and initiatives to create markets and massively scale up investment.

Market actors and policymakers need to give much more thought to the means by which institutional investment portfolios can become much less emissions-intensive year by year, as countries' climate objectives become more ambitious. In particular:

- Several participants expressed concerns about the compatibility of passive investing with climate objectives. Large passive asset managers need to think more closely about climate change and take a much more active role in capital redeployment. Governments need to discourage passive investing, since index funds and other passive funds rely too heavily on indices made up of high-emitting companies. Best-in-class strategies without exclusion in benchmarks and indices have limited impacts in terms of emissions reductions.

- Participants also debated the use of divestment versus engagement strategies. On the one hand, divestment can raise the cost of capital for carbon-intensive sectors and reduce it for low-carbon assets, thereby increasing the attractiveness of green assets compared to fossil-fuel assets. On the other hand, divestment means selling fossil-fuel assets to companies that may care less about environmental impacts, and will benefit from the highest dividend ratio (e.g. in natural gas). From that perspective, it may be preferable to retain carbon-intensive assets in portfolios and engage with companies to change their business models and behaviours.

More broadly, we need markets to work more effectively to deliver on the transition to a low-carbon, sustainable economy, not just at project-level. Participants agreed that transitioning to sustainable economic model requires a better assessment and management of the linkages between climate change and biodiversity, especially for sustainable land-use. Going forward, governments should consider integrating into investment decision-making the "do no significant (environmental) harm" principle, following such efforts in the European Commission's proposed taxonomy for sustainable activities.

While institutional investment in low-carbon assets (especially solar and wind energy) has increased in recent years, de-risking by the public sector is still needed in most non-OECD markets. Investment vehicles, blended finance and other public sector interventions are particularly needed to enable institutional investment in sustainable assets beyond clean energy, such as sustainable land-use. Several participants agreed that a balanced approach to the public sector's risk mitigation interventions is needed to address barriers such as inadequate risk-adjusted returns on infrastructure assets, low credit rating and country risk while not crowding out pure-play private equity market participants. The nature of public intervention further needs to be calibrated to sectoral realities and risks. Onshore wind and solar projects are now cost-competitive in much of the world, even without subsidies. Limited public money can be used more strategically to provide risk mitigation for biodiversity and natural capital assets, along with less commercial clean energy technologies and low-carbon transport. In addition, as the frontiers of sustainable investing evolve, public interventions need to become more creative. For example, efforts to scale-up sustainable investment could focus more on innovative equity investments that can make infrastructure assets attractive from the very beginning.

Mainstreaming infrastructure investments requires standards, data, scale and a secondary market to provide liquidity. This requires multi-stakeholder cooperation and initiatives that include actors, like commodity exchanges, that have hitherto been in the background. One such initiative focusing on energy storage, transport and buildings was presented at the event – VERT-Infra ("Vision for an Environmentally Responsible Transition-Infrastructure"). VERT-Infra aims to provide a common, integrated framework through which stakeholders can scale up sustainable infrastructure investments through originating bankable projects, providing low-cost financing to National Development Banks and local financial institutions, purchasing loans on their books, and providing government capacity-building upstream.

The scale and pace of investment is far behind what is needed to achieve the Paris Agreement and broader Sustainable Development Goals (SDGs). Governments need to raise ambition and ensure policy stringency and consistency across different sectors while investors must step up and reallocate capital to low-carbon, sustainable assets. There is a palpable sense of urgency. As one of the participants put it: "we need to do things faster and better; we aren't winning."

For more information on the work of the OECD Centre on Green Finance and Investment, please visit: www.oecd.org/cgfi/

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IIGCC The Institutional Investors Group on Climate Change