Konrad Adenauer Stiftung

CLIMATE REPORT 2017

PRIVATE SECTOR AND CLIMATE FINANCE IN THE G20 COUNTRIES

ABOUT THE REPORT

The G20 countries comprise two thirds of the global population as well as more than three quarters of the world's economic output, trade and CO_2 emissions. Climate change is on the G20 agenda as a central future issue, also as an economic and fiscal challenge because corresponding investments from the private sector are a prerequisite for the fulfilment of the Paris climate protection goals. Our latest Climate Report, which continues the series from 2007, 2011 and 2014, provides answers to the question of how far the private sector plays a role in climate financing in the G20 countries.

GERMANY

Players in the private sector understand that the transition to a low carbon economy is on the agenda. So far, private sector activities have been focused on energy production and efficiency, while the public debate on private climate finance in general terms tends to be more low profile. The financial sector is only beginning to embrace low carbon finance systematically. However, several recently launched initiatives could bring about a change to this situation.

In the federal state of Brandenburg, wind power was rapidly expanded owing to annual grants of several million euros.
Source: © senorcampesino, iStockPhoto

PRIVATE SECTOR CLIMATE FINANCE IN THE GERMAN DEBATE

Private Climate Finance in Germany is understood as the non-public sector share in finance mitigation and adaptation measures. While this term is predominantly used in political and public debates by government and NGOs, it is less frequently invoked within the private sector, including the real economy and the financial sector.

The public debate on private climate finance in general terms tends to be low profile because investment volumes are difficult to track. In contrast, the debate is much more prominent in relation to concrete domestic issues. For example, the debate concerning investment in renewable energy instead of fossil fuel production, e-mobility solutions, energy efficient and low carbon housing is fairly prominent. It is also becoming increasingly more prominent in relation to climate-aligned financial products and portfolio management.

Germany has introduced well defined climate goals, in particular for reducing CO_2 emissions by 40 percent (though the 2020 goal is likely to be missed), and 80 to 95 percent (2050) relative to the levels that were being measured in 1990. Since November 2016, these goals have been included in the 2050 climate protection plan.

The withdrawal of the USA from the Paris Agreement has already triggered strong reaffirmation of the German government's political commitment to the Agreement itself and the wider issue of tackling climate change. The Paris Agreement has been instrumental in providing further confidence and guidance, and players in the private sector understand that the transition to a low carbon economy is on the agenda. The question is then not a matter of *if* but rather a matter of *how*. The USA's move opens up an opportunity for industry to further strengthen its relatively strong position in offering green solutions.

PRIVATE SECTOR ACTIVITIES

Private sector activities are focused on energy production and efficiency. Investments in mobility and agriculture are much less pronounced. The financial sector is only beginning to embrace low carbon finance systematically, with the exception of a few institutions (e.g. Allianz and MunichRe) and niche markets (e.g. green bonds).

In the energy sector, power production from renewable sources (share in 2016 was 31.7 percent) is continuing to be one of the most important areas for private climate finance, based on the German feed-in tariff model. Although the share of renewable energy investment is still low in insurers' and pension funds' portfolios (i.e. usually below one percent), the asset class is becoming increasingly familiar (mainstream) for many institutional investors due to the reliability of the cash flows and the diversification benefits.

The move from a support policy based on feed-in tariffs to competitive auctioning caused some uncertainties in the renewable energy sector. There is a downward trend for new capacities being added to energy production with solar photovoltaics.

Energy efficiency is a growing market in Germany. Measures tend to be self-financed by industry and real estate companies. The involvement of private financial investors is low due to a fragmented market and relatively low investment volumes per implemented measure. Investment activities tend to be driven by cost savings, which in many cases (like LED lighting) offer quick returns, and by public regulation. Domestically, KfW's energy efficiency programmes continue to play an important role in triggering private finance.

Low-carbon mobility is still at very low levels, in particular in comparison with more ambitious markets like China and Norway. However, it is expected to rise. As this occurs, private investment is expected to flow consequentially.

The Paris Agreement has certainly had an influence on the German financial sector. As financier of the economy, it is playing a steadily increasing role as a catalyser of the low carbon transition. It promises to do so by anticipating and measuring the risks of an unabated climate change and a difficult transition. Compared to other countries, like the UK and particularly France, the Netherlands, and the Scandinavian countries, German financial institutions on average are lagging considerably behind in embracing climate change action and making it a central part of their long-term strategy. Various options exist for supporting climate finance:

1. Positive impact investments, e.g. renewable energy
2. Making the overall (mainstream) portfolio more sustainable
3. Understanding and managing portfolio carbon risks (transition, physical, litigation risks)
4. Providing climate related insurance solutions
5. Transparency

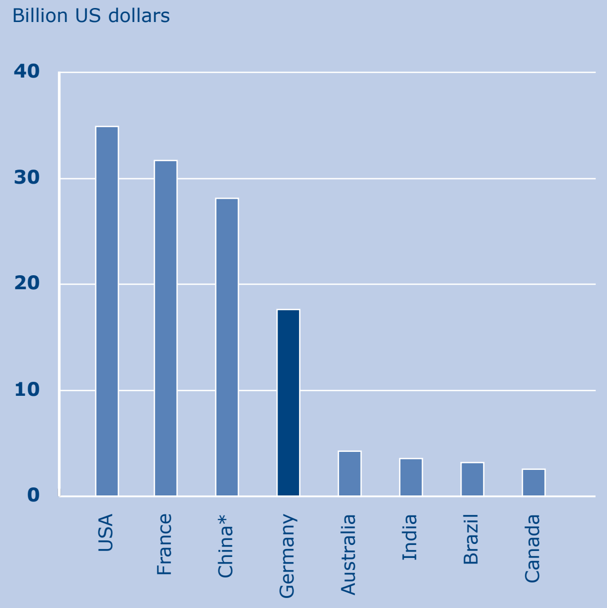
Financial institutions have also limited financing certain fossil fuel business models, notably the mining and burning of coal for power production (Allianz). The impact on the insurance industry of AXA's, the French insurer's, decision to withdraw from offering insurance to companies that generate more than 50 percent of their revenues from coal-based business models, remains to be seen.

As shown in the diagram, Germany has become the fourth largest green bonds market with 17.7 billion US dollars outstanding. Public issuers paved the way (NRW.Bank, KfW), followed by only a few private issuers (e.g. Nordex, Senvion, MEP Werke).

Asset ownership and retail demand for low carbon financial solutions is still low in the absence of incentives and a myopic time horizon that is, on average, significantly shorter than the time before impacts of climate change will become apparent.

Compared to international collaboration on climate finance (e.g. UNEP Finance Initiative, Principles for Responsible Investment and Sustainable Insurance, ClimateWise, and the Global Investor Coalition on Climate Change), national activities dedicated to climate finance have remained below their actual potential. This may change with climate (and sustainable) finance becoming

COUNTRY COMPARISON: THE BIGGEST ISSUERS OF GREEN BONDS (MAY 2017)



* Only includes bonds in line with CBI taxonomy are shown. Total figure outstanding from Chinese issuers if bonds financing coal, large scale hydro etc. are included sum up to 41.5 billion US dollars.

Source: Climate Bonds Initiative 2017, data: ibid., Bloomberg LLP., Thomson Reuters more prominent with the recent sustainable finance initiative of the Deutsche Börse, the Green Finance Hub of the German Council for Sustainable Development, and the Hessian initiative to establish Frankfurt as a Green Finance Cluster in collaboration with the industry.

PUBLIC SECTOR SUPPORT AND ACTIVITIES

According to the German Ministry of Economic Cooperation and Development (BMZ), in 2015 the German government mobilised approx. 8.3 billion euros in climate finance, 900 million for supporting the private sector through revolving credit lines to local (development-) banks, participations in structured funds and public-private-partnerships.

Public-private collaboration with domestic institutions in climate finance is a field that can be further developed.

- Deutsche Bank successfully applied for Green Climate Fund support for its sustainable energy for Africa project.
- Allianz joined forces with the International Finance Corporation of the World Bank.
- The Global Climate Partnership Fund initiated by the German Ministry for the Environment and KfW attracted private sector investors in its senior notes (pension fund ÄrzteVersorgung Westfalen-Lippe and ASN Bank of the Netherlands).

With its national and international climate initiatives, the German Ministry for the Environment supports private sector initiatives. Likewise, Germany's support of the Global Innovation Lab for Climate Finance strengthened the collaboration between the public and the private sector with the aim of scaling up innovative financing ideas.

In September 2016, the German Finance Ministry received a report on how climate change could affect Germany's financial sector. At nearly the same time, the German Environment Agency (UBA) commissioned a study to analyse and assess the risk of a carbon bubble in the German financial system.

CHALLENGES AND BARRIERS

In the absence of relevant internalisation of the external climate effect (i.e. a low CO_2 price), markets are driven by investment opportunities that are already commercially viable or get sufficient support outside of the emissions trading scheme.

Increasing demand for green (finance) solutions would entice solution providers to design adequate products. Transparency on climate risks and alignment with climate goals will enable clients to make informed decisions. The public sector is in a perfect position to align all its investments (e.g. from public pension schemes) with overall climate goals as is the case in some neighbouring countries.

On the supply side, sovereign and sub-sovereign issuers could issue green bonds for demonstration purposes, thus signalling its viability to the financial sector and other (corporate) issuers.

The development of methodologies and models would enable financial institutions to achieve climate-smart decision-making and give them the tools to assess whether they are on course to reaching the long-term goal (science-based targets).

Financial regulation, due to its one-year risk horizon, is inherently short-term oriented. It fails to set incentives to look at the longer-term risks, what Mark Carney called the "tragedy of the horizon".

Support in risk mitigation by the public sector is key for private climate finance flow to emerging and developing countries.

G20 SUPPORT

G20 has provided, through its Green Finance Study Group, useful analysis of the design of a sustainable financial system. Though not binding, the recognition of the importance of scaling up green finance by the G20 played an increasingly important role, including promoting international collaboration to facilitate cross-border investment in green bonds and facilitating knowledge sharing on environmental and financial risks.

The recommendations by the Financial Stability Board's Taskforce on Climate-related Financial Disclosure (TCFD) are crucial for the German financial sector. Investors will have much firmer ground to base their decisions on, particularly in terms of forward looking climate risks and opportunities. Only the standards and methodologies still need to be developed. Experiences from Article 173 of the French energy transition law might inform the debate about implementing the TCFD recommendations.

Germany plays a crucial role in continuously putting mainstreaming green and climate finance high on the G20's priority list.

CONCLUSION

Germany has potential to increase its ambition in setting the right incentives for the financial sector to play its role in the transition to a low carbon economy. A credible and coherent strategy is key.

Creating public demand for green solutions is a relatively straightforward first step, as activities by German states show. Additionally, systematic crowding-in of large institutional investors should become a priority for the public sector. Complemented by increasing transparency and climate risk management requirements, investors, on the whole, would be incentivised to take their role more seriously.

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