JUST TRANSITION FINANCE

MOBILISING INSTITUTIONAL CAPITAL TO DELIVER A NET ZERO WORLD WHERE NO-ONE IS LEFT BEHIND

ACTIONS FOR IMPACT INVESTORS

Actions for impact investors

Fulfilling the UN Sustainable Development Goals (SDGs) and transitioning to a world of Net Zero carbon emissions at the pace required – and in a way that's just and inclusive for all – requires trillions in capital every year.

A global transition to Net Zero that is inclusive and socially beneficial – i.e. a Just Transition – can only be achieved with a fundamental shift in financing. This summary highlights key actions that impact investors can take to help achieve a global Just Transition, based on the findings of the Impact Taskforce's report, 'Mobilising institutional capital towards the SDGs and a Just Transition'. The Impact Taskforce's recommendations build on consultations with over 170 finance, policy and thought leaders representing over 110 organisations in 38 countries.

WHAT IS A 'JUST TRANSITION' – AND WHY DOES IT MATTER?

The climate crisis is one of the defining challenges of our time. But there is growing consensus that a single focus on achieving net zero emissions is not enough.

↳ To be successful, climate action also needs to address the socio-economic impacts of moving to Net Zero – from potential job losses to rising household energy prices.

↳ It needs to be recognised that the impacts of climate change tend to disproportionately affect those in poverty and can exacerbate existing inequalities.

↳ To gain support and avoid social tensions or unrest, the transition to Net Zero needs to be fair – and seen to be fair – across regions and across the socio-economic spectrum.

A JUST TRANSITION NEEDS TO CONSIDER:

1 Different climate transition and planet preservation strategies across sectors.

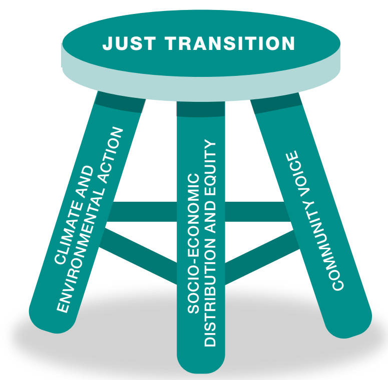
2 Geographic disparities, needs and priorities at international, regional and national levels.

3 Affected, underserved and marginalised communities, households, workers and enterprises.

THE THREE JUST TRANSITION ELEMENTS

Given the considerations above, there are three critical drivers of a Just Transition applicable across geographies, sectors, policies and investments. To be aligned with a Just Transition, actions should:

- Advance Climate and Environmental Action
- *AND* Improve Socio-economic Distribution and Equity
- *AND* Increase Community Voice



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Why impact investors are key to the Just Transition

- Impact investors are individuals, organisations and institutions that purposely seek to invest in opportunities that can deliver a specific, clearly defined and measurable environmental and/or social impact
- They include private individuals and family offices, multilateral development banks (MDBs) and development finance institutions (DFIs), endowments and foundations (especially those with a social or environmental mission)
- To achieve the impact they seek, impact investors may be willing to take additional risk, accept a below-market financial return on their capital (i.e. 'concessionary' capital) and take a long-term view on their investment (i.e. 'patient capital)
- Impact investors can therefore play a key role in supporting Just Transition investment vehicles, and encouraging and enabling participation by those investors that seek a more conventional risk-return profile from their assets

Note: A specific summary of Just Transition actions that can be taken by MDBs and DFIs is available here.

What impact investors can do to advance a Just Transition

ACTION 1: COMMIT TO INVEST IN JUST TRANSITION INVESTMENTS

Impact investors are already familiar with investing for environmental and social impact. Investing for a Just Transition requires them to go a step further and break down the traditional silos that exist between social and environmental action, and invest in ways that integrate both simultaneously.

The Impact Taskforce identified three critical Elements of a Just Transition, applicable across all geographies, sectors, policies and investments. To support a Just Transition, initiatives should include the three Elements of advancing Climate and Environmental Action; improving Socio-economic Distribution and Equity; and increasing Community Voice. The Impact Taskforce's report details the actions that each Just Transition Element involves and the investable opportunities/strategies that investment vehicles might focus on to achieve them.

While there are few investment vehicles that fully satisfy all three of these Just Transition Elements yet, impact investors can help encourage their set-up, and pave the way for mainstream institutional capital to follow, by seeking out, supporting or proactively helping to build and deliver investment vehicles aligned with a Just Transition.

The relative prominence of the individual Just Transition Elements in each financing vehicle will depend on the strategy or funded initiative being pursued. Regardless of the area of priority, all three Elements should be present for the vehicle to qualify as a Just Transition Investment.

The Impact Taskforce's report provides a Just Transition Blueprint. The Blueprint sets out principles to support the launch of Just Transition investment vehicles – from strategy to structure to governance and operations.

ACTION 2: INCREASE EMERGING MARKETS EXPOSURE

Investment in climate and environmental action across all global markets is important. Mobilisation of capital into the world's emerging economies, however, is an especially powerful means of financing the SDGs and delivering a Just Transition. This is because:

- Emerging markets present the biggest gap in funding a Just Transition (an estimated USD2.5 trillion a year, compared to 0.1 trillion in advanced economies[1]) but also some of the biggest opportunities
- These are the markets where the impacts of climate change, such as flooding, drought, heatwaves and crop failure, can be most acute
- Attracting both global and domestic institutional capital to these markets will allow their own financial markets to broaden and mature

Many impact investors are already demonstrating and developing the investability of emerging markets – for example, by providing anchor funding or de-risking support. Wherever possible, this activity should be stepped up to maximise the multiplier effect and encourage more institutional capital to get involved.

ACTION 3: ENGAGE IN BLENDED FINANCE TRANSACTIONS TO MOBILISE INSTITUTIONAL CAPITAL

Blended finance refers to transactions where investors with different risk-reward expectations come together to provide funding. Investors that are able to take more risk facilitate participation by other parties by helping to 'de-risk' their exposure.

Structures to help mobilise more risk-averse institutional capital include:

Subordinated capital – This can be structured so a junior tranche (e.g. held by a risk-tolerant impact investor) absorbs any financial losses first, giving the senior tranche (held by more risk-averse institutional investors) loss protection. This is the most widely-used blended finance tool for impact investing vehicles.

Guarantees – These can be provided on loans or other debt structures in return for a fee, so the guarantor (e.g. an impact investor such as an MDB or DFI) agrees to pay the investor or lender in the event that the investee or borrower cannot. Among other benefits, this can enable a proposition to attain the investment-grade rating required by institutional investors.

Securitisation – An MDB or DFI packages part of its loan portfolio then sells the loan cashflows as securities to investors (or synthetically transfers risk using credit derivatives). By offering different tranches of risk (with other impact investors typically taking the higher-risk tranches) securitisations can be tailored to the risk profile of different institutional investors.

1 UNEP Finance Initiative (2018): Rethinking impact to finance the SDGs

ACTION 4: PROVIDE FIRST COMMITMENTS TO JUST TRANSITION FINANCING VEHICLES

Catalytic capital will be required to support the market activity around the creation of Just Transition financing vehicles, including to support asset managers in creating such vehicles and to encourage institutional investors to invest in them. This may include anchoring funds that are of a sufficient scale to attract institutional investors.

Impact investors are therefore key to enabling Just Transition vehicles to progress from concept to reality by being at the front of the queue to invest in them.

Co-creation partnerships can enable impact investors to work with asset managers to design and sponsor the creation of Just Transition investment vehicles in order to catalyse institutional capital towards them.

ACTION 5: HELP BUILD A STRONGER JUST TRANSITION INVESTMENT ECOSYSTEM

To attract sustained, large-scale flows of capital, Just Transition investing needs high-functioning markets with multiple participants, strong liquidity, deep and reliable information flows, and a broad range of investment vehicles and opportunities.

Impact investors that already have substantial experience in the areas that Just Transition investing entails can help build this necessary ecosystem by:

- Providing transparent information and data on their own investment performance to allow others, including private investors and rating agencies, to assess the risks of relevant investments, especially in emerging markets
- Using their own performance experience to challenge the perception of an inverse relationship between social/environmental impact and positive financial return
- Selling strong-performing assets onto other investors to help create deeper, more liquid secondary markets
- Backing commercial impact investing products at scale to accelerate the growth, maturity and overall impact of the industry

Examples of Just Transition investments

There are multiple examples of investments aligned with a Just Transition already on the market. Detailed case studies of select investment propositions, as well as further examples of investments on the market, are available here.

Asset class hierarchy			Vehicle	Case study	Examples
Alternatives	Private equity	**Private equity** (Note: Forestry included herein, however, often included in real assets depending on investor allocation buckets)	**Private equity fund** (direct)	**LeapFrog**: Emerging Consumer Fund III	• **DPI**: African Development Partners III • **New Forests**: Tropical Asia Forest Fund • **TPG**: Rise Fund II
			Fund of funds	N/A	• **AllianzGI**: AfricaGrow Fund • **Credit Suisse**: Climate Innovation Fund
	Private debt	**Private debt**	**Private debt fund**	**Ninety One**: Africa Credit Opportunities Fund 2 **responsAbility**: Access to Clean Power Fund	• **FMO/NNIP**: Emerging Markets Loans Fund • **BlueOrchard**: InsuResilience Investment Fund • **Triodos IM**: Triodos Microfinance Fund
	Real assets			**Actis**: Energy Fund 4	• **Ninety One**: Emerging Africa Infrastructure Fund • **Africa Finance Corporation**: Infrastructure Climate Resilient Fund
		Real estate	**Real estate fund**	**IHS**: IHS Fund II SA	• **Divercity**: Urban Property Fund • **Schroders**: Schroder Capital UK Real Estate Impact Fund
Fixed income		**Bonds**	**Bond fund**	**BlueOrchard**: Schroder International Selection Fund BlueOrchard Emerging Markets Climate Bond fund (CBF)	• **Amundi/IFC**: Amundi Planet Emerging Green One • **IFC**: Masala bond programme (Note: Alternative structure)

Impact investors can pioneer new investment markets, themes or approaches. They are therefore critical to driving the systemic change and product innovation urgently required to make Just Transition financing part of mainstream investment. By taking the actions listed here, impact investors can help to break down the barriers preventing the world's largest institutions from deploying capital towards a Just Transition.

For other Just Transition Finance Action Summaries in this series and case studies of financing vehicles that can help deliver a Just Transition, visit www.impactinvest.org/just-transition-finance/

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