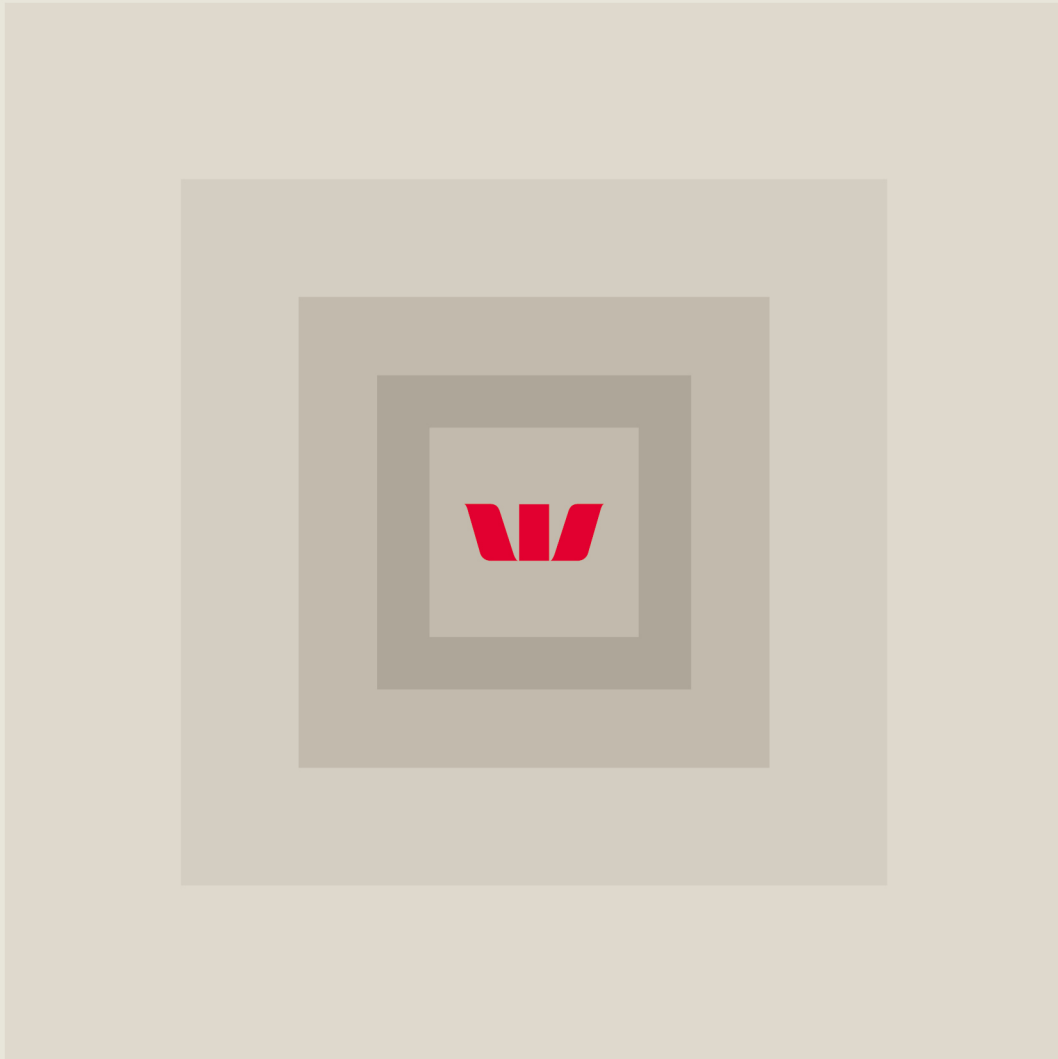


# Clean Energy Finance Corporation **Expert Review**

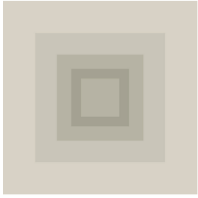


**Westpac submission**



12 December 2011  
Emma Herd  
T: 61 2 8254 8967  
[eherd@westpac.com.au](mailto:eherd@westpac.com.au)

A division of Westpac Banking Corporation ABN 33 007 457 141



# Summary

Westpac is an active participant in ongoing public policy dialogue on an appropriate national response to climate change. We welcome the opportunity to provide a submission to the Clean Energy Finance Corporation (CEFC) Expert Review.

Westpac has had a consistent position on climate change for over a decade and under three consecutive governments. Westpac recognizes climate change as an environmental, economic and business risk and is committed to developing practical solutions to assist Australian business and the community to respond and position for the low-carbon economy of the future.

In making recommendations for the CEFC, the following considerations have informed our position. The CEFC must support:

- Investment certainty
- Market confidence
- Environmental outcomes
- Innovation and economic transformation at scale
- Affordable and efficient greenhouse gas abatement across the economy; and
- A clear understanding of ongoing liabilities.

Transforming the way Australia produces and uses energy is a critical component of our national climate change response and Australia must explore complementary policies to accelerate the commercial uptake of breakthrough low emission technologies. The rate of technology improvement and subsequent adoption must be faster than the usual commercial timeframes if these technologies are to be available at scale, performance and at an acceptable cost when required to meet challenging emission trajectories.

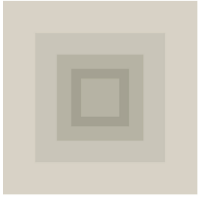
Westpac believes that the CEFC will have an important role to play in bringing forward new clean energy technologies to a point where private capital will be attracted. Policy enablers will be important in:

- Bringing forward the entry point for private capital
- Lowering investment risk to enable private sector investment
- Bridging the funding gap for pre-commercial clean energy projects; and
- Enabling the deployment of supportive infrastructure for new clean energy technologies.

It will be critical that the CEFC does not unintentionally crowd out private sector investment which would normally have taken place, particularly in market conditions where the Renewable Energy Target (RET) is operating normally, where the carbon price is coming into effect, and in circumstances where the cost of clean energy technology becomes competitive within wider market dynamics.

This submission draws upon the bank's considerable experience in factoring environmental considerations into business policies, systems and procedures, our investment and lending experience, as well as our practical participation in carbon and environmental markets across jurisdictions where we operate. Further information on Westpac's climate change credentials are detailed in Appendix B.

Westpac would be happy to meet again with the Review Panel to discuss these matters further.



# Submission

## 1. Westpac response

### 1.1 Scope of the CEFC

Westpac would support a clearly delineated framework for investment, including a structured timetable, key milestones and a clear investment mandate.

While this would clearly need to maintain flexibility to support unforeseen technological or market developments, it is critical that certainty, transparency and deliverability are the key criteria for determining the scope and approach of the CEFC.

In addition, Westpac would argue that it is vital that the CEFC play a complementary role to private sector investment in clean energy, ensuring that the approach and activities of the CEFC support the 'crowding in' of private sector investment and not unintentionally effect the 'crowding out' of private capital.

#### 1. How do you expect the CEFC to facilitate investment?

Westpac has long supported a comprehensive framework of climate change policy to promote the transition to a less emissions intensive Australian economy. This includes the introduction of a carbon price signal, the operation of the Renewable Energy Target, support for research and development in new and emerging technologies and clear and consistent long term policy signals around Australia's emissions reduction trajectory. Westpac believes that the CEFC has an important complementary role to play within this framework.

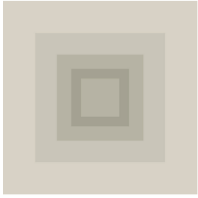
From both a clean energy and a low emission technology perspective, Westpac believes that the CEFC should work alongside existing policy and funding initiatives to support the development of a pipeline of new and emerging clean energy projects and technology investments by addressing the key capital risk, technology risk and policy risk factors currently inhibiting investment within Australia.

To date, most investment activity in the clean energy market has been driven by the RET scheme, and has focused predominantly on wind projects. Even here there have been capital shortfalls because of policy uncertainty. This would indicate that even more mature clean energy technologies can experience a liquidity gap and that the CEFC will have a role to play in leveraging greater private sector investment into the market.

Given that the CEFC is working to a deadline of 2020, Westpac would recommend that the CEFC focus on objectives which are deliverable and achievable within that relatively tight timeframe, and build on the experience of existing programs such as Low Carbon Australia to accelerate the deployment of capital.

#### 2. Are there principles beyond financial viability that could be used to prioritise investments, such as emissions impact or demonstrated affect?

Investment guidelines set by the CEFC will need to balance a number of concerns. A number of policy frameworks have already been put in place which are guiding investments in the energy sector, including both the RET scheme and the forthcoming carbon price framework. It will be important to ensure that the



CEFC does not unintentionally distort market behavior by establishing investment priorities which drive perverse outcomes or undermine existing market signals. In addition, if the CEFC chooses to prioritise projects solely on the basis of environmental outcomes achieved, then it is possible that these investments may not achieve maximum value for money and fail to achieve viable commercial returns.

Westpac would recommend that the CEFC explicitly establish a clear and transparent framework for proving 'additionality' for investments or projects seeking CEFC participation. There are a number of examples of this already operating which financial institutions and market participants are familiar with. For example, Low Carbon Australia currently operates with an 'additionality' provision as part of its investment mandate for energy efficiency projects. In addition, the international Clean Development Mechanism (CDM) under the Kyoto Protocol carbon market framework incorporates a test of 'Additionality' into project verification and certification by the CDM Executive Board.

Both of these provisions require, essentially, that the project or investment would not proceed without meeting a fixed and predetermined set of criteria incorporating both environmental outcomes and the proviso that the project would not proceed without the involvement of additional funding support. This would serve both to ensure that the CEFC delivers on its mandate for greater investment in clean energy and does not inhibit or undermine private sector investment.

### 3. What are the opportunities for the CEFC to partner with other organizations to deliver its objectives?

Private sector participation will be critical.

Westpac would strongly recommend that the CEFC partner with financial institutions, super funds, third party equity providers and debt and equity investors across the full range of financial service providers and investors in pursuing its objectives.

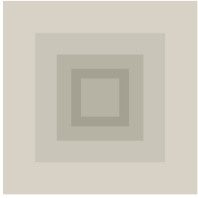
This would deliver a number of benefits including greater leverage of private sector capital into clean energy investments, utilization of private sector experience and expertise in structuring commercially successful projects and the establishment of cooperative relationships which would facilitate the smooth transition from CEFC funded projects to investment structures operating under standard commercial terms and market conditions.

Westpac also believes there are opportunities for the CEFC to work with other financial services providers in taking a portfolio approach to financing projects in a particular area, such as energy efficiency or distributed solar generation for example, where the deal sizes are relatively small. There are potential opportunities for the CEFC to partner with private capital providers in a pooled fund under third party management, subject to a specific investment mandate.

Westpac notes that partnering with private sector financial services providers will also serve to ensure that appropriate due diligence, documentation, financial structuring and contractual arrangements are comprehensively addressed. This will also assist in ensuring that CEFC deals mirror typical private capital structures, facilitating the smooth transition to standard investing conditions as the CEFC withdraws over time.

## **1.2 The market gap and overcoming it**

There is no doubt that there is strong industry recognition and appetite for clean energy investments in Australia, however the risk/return balance across the majority of investment opportunities is not strong enough to support the major deployment of private sector capital under standard commercial terms and



conditions. This is a product of external market conditions (including international conditions impacting the cost of capital and investment tenors) as well as domestic policy uncertainty, technology risks and capital constraints more broadly.

#### 4. How could the CEFC catalyze the flow of funds from financial institutions?

Westpac believes that the CEFC will have an important role to play in bringing forward new clean energy technologies to a point where private capital will be attracted. Policy enablers will be important in:

- Bringing forward the entry point for private capital
- Lowering investment risk to enable private sector investment
- Bridging the funding gap for pre-commercial and first of a kind clean energy projects; and
- Enabling the deployment of supportive infrastructure for new clean energy technologies.

It will be critical that the CEFC does not unintentionally crowd out private sector investment which would normally have taken place, particularly in market conditions where the RET is operating normally, where the carbon price is coming into effect, and in circumstances where the cost of clean energy technology becomes competitive within wider market dynamics.

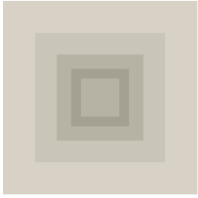
Westpac has provided a more detailed overview of potential structures or mechanisms in Appendix A.

#### 5. What experiences have firms in the clean energy sector had with trying to obtain finance; have term, cost or availability of funds been the inhibitor?

Westpac would agree that, to date, scale issues, tenor, cost and availability of funds have all been factors in inhibiting substantial investment in the clean energy sector. These issues have played out differently across technologies and project types.

Westpac believes that these issues can be represented with three types of projects:

- *Projects that are small and complicated which fall between the gap in investment channels within financial institutions:* Within the solar sector, for example, the majority of solar projects are small by comparison, usually around 5MW in size requiring between \$10-15m in funding. At this point, the size of the project means that funding requests fall in the commercial banking divisions of most financial institutions. However, the complexity of the project and the technology risks involved, means that an institutional banking level of due diligence is required for credit approval. Therefore, projects of this nature tend to fall between the cracks, as they are too small for the institutional bank and too complicated for the commercial bank.
- *Projects that have appropriate scale but contain significant technology risks and therefore face a funding gap:* Where pre-commercial technology is being developed on a first time basis, or being significantly scaled up for the first time, there are significant technology risks involved. This can inhibit the appetite of financial institutions to provide significant levels of at risk capital, leaving a funding gap.
- *Projects that cannot compete against mainstream energy sources in straight commercial conditions with the current relative low cost of energy:* The price of energy in Australia is comparatively low. Even when the RET price and the carbon price are factored in, energy pricing is expected to remain modest for the time being. This limits the ability of many clean energy projects to be commercially competitive with mainstream infrastructure investments where the risks are known and understood,



confidence levels around the rate of return are high and essentially the risk/return balance is more compelling.

Westpac believes that the CEFC could play a valuable role in addressing these issues by reducing the upfront funding costs, by providing capital support in an amount and structure which secures substantial co-investment from the private sector and by creating an appropriate risk/return outcome for each investment opportunity identified.

#### 6. What non-financial factors inhibit clean energy projects?

The major non-financial factors which have inhibited investment in clean energy projects can broadly be categorized as policy uncertainty/regulatory risk and technology risk.

Delivering clear and unambiguous regulatory and policy frameworks and signals around carbon management is now fundamental to supporting investment in long life assets. Frequent policy adjustments and interventions, stop/start funding programs and a rapidly evolving regulatory environment at the Federal level have all combined to generate significant regulatory risks for the clean energy sector.

To really drive the level of investment required to deliver carbon reductions across the energy sector without system dislocation, investors will need to be able to reasonably look to carbon and clean energy policy signals over the longer term. This requires scheme and regulatory stability, long term national emission reduction signals and stronger policy consensus to deliver greater investment certainty out into the future.

Technology risks can impact investment in two ways. First, emerging or pre-commercial technology with no proven track record of performance may fall outside the credit appetite or investment mandate of mainstream financial institutions. Second, existing technologies without a proven track record of operation or performance within Australia attract higher risk premiums, which may result in marginal investments.

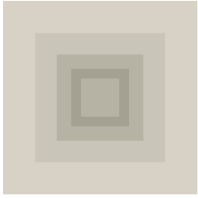
Lastly, investment in supporting or enabling transmission infrastructure will also be critical to delivering cost effective or commercially competitive clean energy projects.

#### 7. Are there special factors that inhibit energy efficiency projects?

Given the work undertaken to date by Low Carbon Australia on identifying investment barriers for energy efficiency, investment constraints around these project types are relatively well understood. These include:

- High up front capital costs vs longer tenors for return on investment
- Lack of available capital
- Lack of scale in project size
- Split incentives between property owners and tenants
- Lack of prioritization around energy efficiency projects to date because of the relatively low cost of energy; and
- The requirement for a strategic shift in management thinking from a primary focus on capital expenditure to ongoing operating expenditure.

Westpac believes that the increasing focus on energy consumption as a major input cost for medium size enterprise in particular, as well as reporting and disclosure requirements through both the National Greenhouse and Energy Reporting (NGER) framework and the Energy Efficiency Opportunities (EEO) Act, mean that more businesses are identifying energy efficiency as a means of reducing ongoing operating costs.



Many of these projects are funded through general finance facilities in place with financial institutions, or via bespoke funding vehicles established in conjunction with energy efficiency delivery companies or specialist services. It will be important to ensure that the CEFC play a complementary role to activity already underway in this space, with an investment strategy targeted specifically at overcoming investment barriers operating across the market preventing lending and investment under standard commercial terms.

### **1.3 Other issues**

There is now a range of Government funding and investment bodies operating across the low carbon and clean energy spectrum. It will be critical that all of these vehicles target different issues and operate at different stages of the technology deployment spectrum – and do not replace or undermine private sector lending and investment activities.

At the same time, there is clearly a role for Government support in overcoming investment hurdles and in leveraging greater volumes of private sector investment into clean energy and low emissions technology. Given the terms of reference for the CEFC, and the timeframe within which it is operating, simplicity will be key. While flexibility and adaptability will be important, Westpac would recommend identifying a limited pool of technologies, finance structures and preferred investment models and targeting investment into deploying a higher number of specific transactions over the prescribed period. Essentially, getting more deals done then developing complicated deal types.

#### 8. How do you see the CEFC fitting in with other government initiatives on clean energy?

In 2007, Westpac participated in the Australian Business and Climate Group releasing the report *Stepping Up: Accelerating the deployment of low emission technology in Australia*<sup>1</sup>. This report noted that 'the key to the effective development, deployment and commercialization of new step-change low emission technologies is traversing the transitional period between basic R&D to fully commercial'. This requires both technology push mechanisms and market pull factors as the cost per unit decreases and the technology moves through the stages of basic and applied R&D to demonstration, pre-commercial, supported commercial and fully commercial operations.

Westpac believes that each of the various government initiatives on clean energy now established have a role to play at different stages of the technology innovation chain.

The Australian Renewable Energy Agency (ARENA) will have an important role to play in supporting early stage R&D and technology demonstration via competitive grants and funding support.

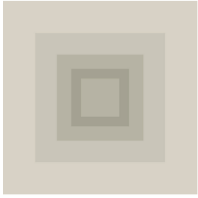
The CEFC will be important in joining private sector investment or overcoming funding gaps in the later stages for pre-commercial or marginal investments.

The Renewable Energy Target (RET) is an important energy market signal for a transitional period while the Carbon Price Mechanism comes into force. These will both provide market pull factors in getting private sector investment across the line.

Lastly, there are significant opportunities for the CEFC to assimilate the learning and experience of Low Carbon Australia in delivering finance to energy efficiency projects over the last 12 to 18 months. With a pipeline of potential deals already in place, the incorporation of Low Carbon Australia as an operating arm of

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<sup>1</sup> Australian Business & Climate Group, *Stepping Up: Accelerating the deployment of low emission technology in Australia*, August 2007. Available [online](#). Participating companies included Westpac, BP Australia, Deloitte, Mirvac, Rio Tinto, Santos, Swiss Re and VicSuper.



the CEFC could potentially help deliver the swift commencement of tangible investment and lending activities as the CEFC is being established.

All of these programs will need to work cooperatively to ensure maximum value for money for taxpayer dollars invested, and specifically to ensure that government initiatives do not crowd out legitimate private sector investment.

## **2. Concluding comments**

The transformation of the energy sector over the coming decades will present a range of risks and opportunities. Westpac supports practical solutions which deliver emission reductions without supply dislocation across the energy system.

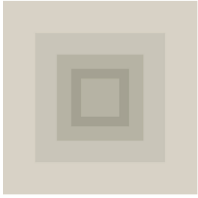
We seek to facilitate the transition of business to a low emission economy via a strategy of proactive customer engagement to promote outcomes which are financially and environmentally sustainable. In addition we factor carbon risk into our decision making processes and in consultation with impacted customers may require them to demonstrate risk reduction programs.

Our position has been to support flexible market-based mechanisms as part of a wider policy response to climate change. We acknowledge that the transition into a carbon constrained operating environment may be challenging for some of our customers. We are actively working with those customers as we would during any other period of regulatory uncertainty and change.

Westpac is also actively seeking to develop products and solutions to support clean energy, energy efficiency and low emission technologies and is eager to explore further investment partnering opportunities with the Clean Energy Finance Corporation.

Westpac will continue to work with Government, with market participants and with our customers as investment frameworks and opportunities continue to emerge.

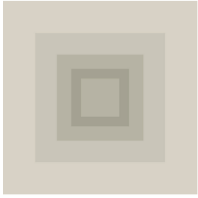




# Appendix A

## Overview of sample finance products or structures for the CEFC to explore

| Mechanism                                    | Description/comments  |
|--|---|
| Direct loan                                  | <ul style="list-style-type: none"> <li>• Direct loan from the CEFC, alongside private sector debt, typically at a lower rate than market debt and/or on a subordinated basis.</li> <li>• Could also apply for a longer tenor than commercial finance to minimize re-financing risk or alternately include a 'refinancing guarantee' post construction.</li> <li>• Opportunity to provide a tranche of debt and sit alongside private sector capital.</li> <li>• This could address short term liquidity issues and the risk of capital shortfalls, and lower the overall cost of capital.</li> </ul>    |
| Mezzanine debt                               | <ul style="list-style-type: none"> <li>• CEFC provides direct mezzanine debt to bridge gap between debt and equity.</li> <li>• This could address short term liquidity issues and the risk of capital shortfalls, and lower the overall cost of capital.</li> </ul>   |
| Loan guarantee                               | <ul style="list-style-type: none"> <li>• Plays a significant role in de-risking private sector investment, thereby reducing the cost of funds and increasing the commercial competitiveness of the project.</li> <li>• Alternately the CEFC could provide a 'covered loan', and partially insure a tranche of the loan.</li> <li>• Potentially applicable for relatively mature technologies but with no proven track record in Australia. The CEFC could support the first few projects applying a technology for the first time then step back and let standard market conditions operate.</li> </ul> |
| Offtake agreement or contract for difference | <ul style="list-style-type: none"> <li>• Support an offtake agreement or provide payment for the gap from the floating off take price to a fixed benchmark. This would need to be set in advance and layered across RET, carbon and baseline electricity prices over time.</li> <li>• This would potentially address short term policy risk and transitional issues while delivering a medium term price signal to support investment.</li> </ul>   |
| Pooled clean energy investment fund          | <ul style="list-style-type: none"> <li>• Create or support a portfolio approach to small scale clean energy or clean technology projects.</li> <li>• Create or support a portfolio approach to investment in grid or enabling infrastructure investment shortfalls.</li> <li>• Leverages private sector investment and addresses scale issues.</li> </ul>   |
| CEFC equity investment                       | <ul style="list-style-type: none"> <li>• Aimed at bridging the funding gap with debt investment.</li> <li>• Could address lack of third party equity investment in the current marketplace.</li> </ul>  |



# Appendix B

## About Westpac

Westpac Banking Corporation (“Westpac”) was founded in 1817 as the Bank of New South Wales, and has a long and proud history as Australia’s first bank. With a market capitalisation of \$69bn billion and total assets of A\$618 billion as at 30 September 2010, Westpac is one of Australia’s top five listed companies. Our financial strength and risk management practices have been recognised by investors and rating agencies globally.

Today Westpac provides a broad range of retail, commercial and wholesale banking services to around ten million personal, business, corporate and institutional clients.

Westpac Institutional Bank, a division of Westpac Banking Corporation, manages the financial needs of corporate, institutional and government clients that are based, or have interests in, Australia and New Zealand. We are a leading provider of wholesale banking services in the region and are consistently recognised as a leading bank for Australian and New Zealand dollar-denominated financial products and risk management. We are located in Australia, New Zealand, London, New York, Singapore, Hong Kong and Shanghai, with representative offices in Beijing, Mumbai and Jakarta.

## Westpac’s climate change credentials

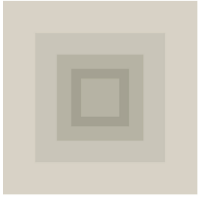
Westpac has maintained a consistent position on climate change risks for business and the need for an effective market based policy response for over a decade and under three consecutive Governments.

Westpac’s commitment to working with clients to transition into a low carbon operating environment is built upon our broader commitment to sustainability as a key differentiator of our business.

Westpac is determined to play a constructive and positive role in promoting effective and practical solutions for our customers and across our business. As a facilitator of the growth of the Australian economy for the last 200 years, we will work with all of our customers to make this transition happen.

Recent significant achievements include:

- Westpac was the only Australian Bank to be recognised as one of the Global 100 Most Sustainable Corporations at the 2011 Davos World Economic Forum in Switzerland.
- In 2011, Westpac was ranked number one out of 190 banks globally as a leader in sustainability by the Dow Jones Sustainability Index, and included for the 10th year running.
- The Westpac Group was ranked sixth in the world in the Carbon Disclosure Project (CDP) 2011 Global 500 report and was rated the top Australian company. Westpac has been included in the global Carbon Disclosure Project Climate Leadership Index since 2003.
- Westpac was the only Australian bank, and one of only three banks globally, to be named as one of the 2010 World’s Most Ethical Companies by the Ethisphere Institute.
- In 2010, Westpac Institutional Bank was voted ‘Best Trading Company in Australasia’ and ‘Runner-up in the Best Finance House - Renewable Energy Finance Asia-Pacific’ in the global Environmental Finance awards.
- Westpac received the 2010 Money Magazine inaugural ‘Climate Leadership’ award in Australia.
- In 2003, Westpac was the first Australian bank, and one of only ten founding signatories globally to sign the Equator Principles, a voluntary global set of guidelines developed for managing social and



## Submission Westpac Institutional Bank

environmental issues related to the financing of projects. Today there are over 50 signatories worldwide.

- In 1991 Westpac was one of six founding members of the United Nations Environment Programme Finance Initiative (UNEP FI). Today there are over 250 signatory institutions, in more than 45 countries.

Westpac first launched an Environment Policy in 1991 and began measuring and reporting on operational greenhouse gas emissions and broader environmental impacts in 1996. Westpac reduced our emissions by over 40% between 1996 and 2008, and is targeting a further 30% reduction by 2013.

The Westpac Climate Change Position Statement was published in 2008 and is endorsed by the Westpac Group Executive and the full Westpac Board. Progress is reported to the Board on a quarterly basis and performance against Key Performance Indicators is built into the remuneration scorecard of the full Group Executive.

Westpac's climate change strategy focuses on managing carbon risk in credit systems and processes, developing lending and investment products and services, engaging employees, advocacy and community engagement and reducing operational greenhouse gas emissions.

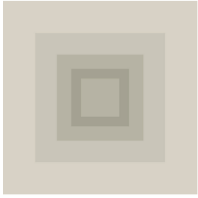
Westpac is working with clients across our Corporate and Institutional Banking division along with agribusiness and Commercial Banking clients, to understand where customers are seeing emerging risks and opportunities, and implementing practical products and solutions to assist.

Westpac's Renewable Energy Strategy was revitalized in 2008 to increase our involvement in clean energy and large scale renewable financing. Today, now more than 50% of our global infrastructure and utilities financing is directed towards hydro and renewables. Westpac's involvement in the renewable energy market includes:

- Financial relationships with energy retailers with significant liabilities under mandatory renewable energy supply frameworks (eg the Renewable Energy Target in Australia)
- Financial relationships with energy intensive trade exposed entities
- Financing for large scale renewable energy projects
- Support for small businesses involved in the distribution and installation of small and mid-size solar generation and solar hot water units; and
- Portfolio trading in electricity, Renewable Energy Certificates, carbon and other commodities and energy markets.

WIB has also established a dedicated team of carbon specialists to hothouse carbon and carbon related solutions. This team brings together expertise from across the business to focus on delivering integrated carbon solutions for our customers. This includes debt and equity funding for emerging business opportunities in the domestic offset sector (forestry and agriculture), clean energy opportunities, energy efficiency, internal abatement financing requirements and carbon credit off-take, price risk management or origination activities. This team has a global mandate across Westpac.

In late 2007, Westpac Institutional Bank brought together financial markets teams trading commodities markets and the National Energy Market (NEM) in Australia, along with Group Sustainability and emerging carbon market expertise to form an integrated trading team Commodities, Carbon and Energy (CCE). This approach recognizes overlapping market dynamics and resource conditions influencing pricing as well as how our clients look to manage their own price risk exposure.



**Submission  
Westpac  
Institutional  
Bank**

CCE continues to build a strong track record of market firsts:

- Westpac's Energy Team has been trading in the National Electricity Market (NEM) in Australia since 1999 and has consistently been the single largest financial intermediary in the derivative wholesale swaps market. Carbon and carbon cost pass through is an increasingly significant influence in forward pricing.
- Westpac was the first bank to commence trading of Renewable Energy Certificates (RECs) in Australia in 2002.
- Westpac has been trading the EU ETS since 2006.
- Westpac undertook the very first trade of Australian compliance credits in May 2008.
- Westpac was the first and remains the only financial institution making a market in the New Zealand Emissions Trading Scheme (NZ ETS), which has been operating since January 2010.
- More recently, in 2011 Westpac and Perenia partnered to develop a joint 'primary CER' (pCER) deal, where Westpac agreed to offtake pCERs for sale into New Zealand and Australian compliance markets.

Westpac believes that managing the risks and opportunities posed by climate change will be a defining factor in achieving long term profitability for our clients and for business. Westpac is committed to developing practical and effective solutions for our customers at every level of the economy.