

EXPLANATORY STATEMENT

Issued by authority of the Minister for the Environment and Energy and the Minister
for Finance

Clean Energy Finance Corporation Act 2012

Clean Energy Finance Corporation Investment Mandate Direction 2016 (No.2)

Under the *Clean Energy Finance Corporation Act 2012* (the “CEFC Act”), the role of the Clean Energy Finance Corporation (the “Corporation”) is to facilitate increased flows of finance into the clean energy sector. The Corporation performs this role by making investments which attract private sector finance, as well as through working with its strategic co-financing partners to catalyse flows of money into the sector.

Under the CEFC Act, the Board of the Corporation (the Board) is responsible for ensuring the proper, efficient and effective performance of the Corporation. This responsibility is subject to any restrictions placed on the Corporation by the CEFC Act. In addition, the responsible Ministers for the purposes of the CEFC Act¹ may issue one or more directions to the Board under sub-section 64(1) of the Act. Directions issued in this manner are known collectively as the Corporation’s “Investment Mandate”.

The Corporation will make individual investment decisions independently of the Government. The purpose of the Investment Mandate is to provide a mechanism for the Government to articulate its broad expectations of how the Corporation invests and is managed by the Board.

The *Clean Energy Finance Corporation Investment Mandate Direction 2016 (No.2)* (the “2016 Mandate No.2”) replaces the *Clean Energy Finance Corporation Investment Mandate 2016*. The primary change is to provide direction in relation to the new Sustainable Cities Investment Program (the “SCIP”) and Reef Funding Program (the “RFP”). It also directs the Corporation to reduce the funding allocation for the Clean Energy Innovation Fund (the “CEIF”). It replaces the Corporation’s previous Investment Mandate.²

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Details of the 2016 Mandate No.2 are outlined in Attachment A.

Pursuant to section 66 of the CEFC Act, the responsible Ministers consulted the Board during the preparation of the 2016 Mandate No.2. The Board’s response, which the Ministers subsequently considered, is tabled and publicly available.

The following additional statutory pre-conditions have been met in relation to the 2016 Mandate No.2:

¹ As prescribed by section 4 of the CEFC Act, as amended by table item 4 of Part 5 of Schedule 1 to the *Acts Interpretation (Substituted References – Section 19BA) Order 2004*.

² The *Clean Energy Finance Corporation Investment Mandate Direction 2016*.

- The responsible Ministers considered the object of the CEFC Act, and any other matters they considered relevant, in preparing the 2016 Mandate No.2.³
- The 2016 Mandate No.2 is consistent with the CEFC Act, and does not directly or indirectly require the Board to make (or not to make) a particular investment.⁴

The Office of Best Practice Regulation (OBPR) agreed that the proposed redirecting of the Corporation had a nil regulatory impact. The OBPR reference number for this matter is 21511.

³ See sub-section 64(2) of the CEFC Act.

⁴ See section 65 of the CEFC Act.

Details of the 2016 Mandate No.2

Part 1 – Preliminary

Section 1 – Name of direction

Section 1 provides that the title of the 2016 Mandate No.2 is the *Clean Energy Finance Corporation Investment Mandate Direction 2016 (No.2)*.

Section 2 – Commencement

Section 2 provides that the 2016 Mandate No.2 commences the day after it is registered. A note to section 2 further clarifies that the 2016 Mandate No.2, as a direction to a government body, is exempt from Parliamentary disallowance and will not automatically expire (or “sunset”) at the completion of a prescribed period of time.

Section 3 – Authority

Section 3 provides that the 2016 Mandate No.2 is made under sub-section 64(1) of the CEFC Act.

Section 4 – Definitions

Section 4 provides definitions for the terms “Act”, “Clean Energy Finance Corporation Special Account”, “Clean Energy Innovation Fund”, “Sustainable Cities Investment Program” and “Reef Funding Program”. It further provides that the terms “ARENA”, “Board”, “clean energy technologies”, “Corporation”, “investment function” and “responsible Ministers” bear the meanings found in the CEFC Act.

Section 5 – Purpose of direction

Section 5 provides that the purpose of the 2016 Mandate No.2 is to give guidance to the Board in relation to the performance of the Corporation’s investment function, as established in section 58 of the CEFC Act and shaped elsewhere in the Act.

Part 2 – Direction

Section 6 – Introduction

The Corporation is to invest in financial assets using financial products and structures to address the barriers currently inhibiting investment to help mobilise investment into the clean energy sector. As this is not a grants organisation, these investments must be made with an expectation of being repaid.

It is expected that the Corporation will apply commercial rigour when making its investment decisions. By adopting a commercial approach, it is expected that the Corporation will invest responsibly and manage risk so it is financially self-sufficient and achieves the Portfolio Benchmark Return and the benchmark return for the CEIF. In achieving this aim the Government has the expectation that the Board will take a

medium/long-term outlook (ten years) when setting the investment strategy for the Corporation.

As a Government entity and a responsible investor the Corporation has a duty to consider its potential impact on other market participants when making investment decisions. However, in line with its public policy intent, the Corporation should also consider positive externalities when making investment decisions and determining the extent of any concessionality.

Section 7 – Portfolio benchmark return

The Board is to adopt a Portfolio Benchmark Return for the performance of funds invested by the Corporation (other than under the CEIF⁵) based on the five-year Australian Government bond rate.⁶ In relation to such investments the Board is to target an average return of the five-year bond rate plus 3–4 per cent per annum over the medium to long term.

For each investment in this category, an individual reference rate will first be calculated using the five-year Australian Government bond rate applicable at the time plus 3–4 per cent per annum. The Portfolio Benchmark Return will then be determined by taking the series of individual reference rates for each investment, and weighting them for each individual investment.

Performance against the Portfolio Benchmark Return will be measured before operating expenses, and will be published in the Corporation's annual report. The Corporation will follow the Australian Accounting Standards where applicable in measuring its return and determining any impairment, except in the case of concessional loans, where the measurement should exclude any impairment or mark to market adjustments resulting from any concessional component.

The Portfolio Benchmark Return target is expected to be earned across the portfolio of investments over the medium to long term. Individual investments could be made with expected individual returns above or below the Portfolio Benchmark Return.

Proponents should not expect to be able to access the Corporation's funding at the Portfolio Benchmark Return. The Corporation shall apply commercial rigour in assessing all investments. The actual return the Corporation seeks for any given investment will be a risk-adjusted return reflecting the individual characteristics of specific projects, the need to cover the operating expenses of the Corporation, the requirement to target the Portfolio Benchmark Return on a portfolio basis, and other relevant factors.

The Government is conscious of the risks inherent in investing in a large portfolio of financial assets. It acknowledges that in practice this will involve some short-term volatility in the Corporation's returns, including the possibility of losses in some years.

⁵ The benchmark return for the CEIF is covered under section 14.

⁶ The five-year Australian Government bond rate is the average bond rate as published by the Reserve Bank of Australia for the 15 day period immediately preceding the date a binding investment agreement is executed.

The Government is committed to developing the clean energy sector and it has established the Corporation to invest for the long-term. Therefore the 2016 Mandate No.2 establishes medium-to-long-term portfolio performance measures.

Section 8 – Portfolio risk

In targeting the Portfolio Benchmark Return, the overall level of risk of the Corporation's portfolio (other than for investments under the CEIF) must seek to develop a portfolio across the spectrum of clean energy technologies that has an acceptable but not excessive level of risk, having regard to the terms of the CEFC Act and the focus on particular areas identified in section 13 of the 2016 Mandate No.2.

In particular, the Government has directed the Corporation to include, as part of its investment activities, a focus on emerging and innovative clean energy technologies. This focus may increase the Corporation's exposure to credit risk as these technologies may have a higher risk profile than more mature technologies and therefore the overall level of risk in the Corporation's portfolio may increase.

Within six months of the 2016 Mandate No.2 being made, the Board is required to agree a suitable investment risk evaluation process to assess the level of risk in the portfolio, and provide the agreed evaluation process to the responsible Ministers. In addition, the Board must periodically review its investment risk management practices and must advise the responsible Ministers of specific measures taken in this regard.

Section 9 – Limits on concessionality

To ensure that the Corporation can facilitate the flow of finance, it is expected that it will use a wide range of investment tools. This includes providing commercial and concessional loans where necessary. A concessional loan is a loan provided on more favourable terms than the borrower could obtain in the marketplace. Since concessional loans have a negative impact on the fiscal balance, the Corporation is limited to providing \$300 million of concessionality in any one financial year.

Concessions may be provided in many forms, but will typically take the form of lower than market interest rates, longer loan maturity or additional/longer or more flexible grace periods before the payment of the principal and/or interest is due. Concessionality should be measured as the difference between the present value of a loan provided at the concessional rate and the present value of a loan provided at the appropriate market rate.

The market rate is the prevailing rate of interest the borrowing entity would be subject to in the market for a similar instrument (in terms of currency, term, type of interest rate and other factors) with a similar credit rating. Where the terms are not currently available, an estimation of the likely cost will need to be made. A standard bank lending rate would need to be adjusted to take into consideration the risks associated with the borrower.

As the Corporation will provide loans where there may not be an explicit market rate, this will be a matter of judgement for the Board. The Corporation is expected to

maintain a robust system that is used to determine the appropriate rate, including looking at loans for similar instruments in terms of tenor and risk.

The Department of Finance's *Resource Management Guide No. 115: Accounting for concessional loans*⁷ provides further information on calculating the amount of concessionality as well as worked examples.

Section 10 – Limits on guarantees

Guarantees are arrangements to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due. Under the Australian Government reporting framework, guarantees are to be accounted for in accordance with the Australian Accounting Standards.

Guarantees pose a particular risk to the Commonwealth's balance sheet and can have unexpected consequences when called. As such, the Corporation should avoid their use wherever possible.

Where guarantees are to be used, the 2016 Mandate No.2 requires them to be limited in nature and quantifiable. At no time may the value of the Corporation's outstanding guarantees exceed the uncommitted balance of the Corporation's special account;⁸ neither may this value exceed 5 per cent of the total amount credited to the account at any point in time under section 46 of the CEFC Act. Further restrictions on guarantees are imposed by section 69 of the CEFC Act.

Section 11 – Application of Australian Industry Participation Plans

The Corporation will provide significant support to projects in Australia. The application of Australian Industry Participation (AIP) Plans to investments made by the Corporation is aimed at increasing opportunities for capable and competitive Australian and New Zealand small- and medium-sized enterprises to participate in major projects.

An AIP Plan details how a project proponent will provide full, fair and reasonable opportunity to Australian industry to participate in a project. This applies to any subcontracting or purchasing opportunities that may be available. AIP Plans do not mandate the use of Australian industry, but rather aim to provide Australian industry with the opportunity to demonstrate their capabilities and capacity.

Further details on AIP Plans are available at <http://www.industry.gov.au/industry/IndustryInitiatives/AustralianIndustryParticipation/Pages/default.aspx>.

Section 12 – Corporation must consider impacts from its investment strategy

In establishing the Corporation it is the expectation of the Government that the investments of the Corporation should not disrupt the areas where the market is

⁷ Available at

<http://www.finance.gov.au/sites/default/files/RMG%20115%20Accounting%20for%20concessional%20loans.pdf>.

⁸ As established by section 45 of the CEFC Act.

functioning well. That said, the Corporation has the potential to impact on other market participants and the operation of the Australian financial and energy markets. The Corporation should always consider this potential impact when making investment decisions.

Given that at least half of the Corporation's investments must be in the renewable energy sector by 1 July 2018,⁹ there is a particular risk of impact on the market for Large-Scale Generation Certificates under the Renewable Energy Target. The Corporation should ensure it is cognisant of these risks when investing in projects eligible for these certificates.

As a statutory authority operated by the Commonwealth, the Corporation has a responsibility to act in a way that is not likely to cause damage to the Australian Government's reputation.

Section 13 – Focus areas for the Corporation's activities

The Government has directed the Corporation to include amongst its investment activities a focus on supporting emerging and innovative renewable energy technologies and energy efficiency technologies (for example, large-scale solar, storage associated with large- and small-scale solar, offshore wind technologies, and energy efficiency technologies for the built environment). This recognises that, in many circumstances, the financing requirements for mature and established clean energy technologies such as onshore wind technologies may be met from commercial financing sources.

These focus areas do not mean the Corporation must divest from any of its current investments. The Corporation will consider this direction in relation to new investments only.

Section 14 – Other directions

The Government has prescribed the following additional focus areas for the Corporation's activities:

- (1) A Clean Energy Innovation Fund: To make available up to \$200 million for investments in projects and businesses that have technologies that have passed beyond the research and development stages but are not yet established or of sufficient maturity, size or otherwise commercially ready to attract CEFC support under existing arrangements, and are unable to secure enough private sector capital. Investments will have the primary purpose of earning income or a profitable return and may be in the form of debt products or equity investments or a combination of both. The Corporation will work with ARENA in delivering the CEIF; in particular, ARENA will provide advice on the technical and commercial feasibility of prospective projects and technologies and the competitive environment of businesses seeking to deploy the relevant technology. The Corporation will take this advice and ARENA's overall recommendation on whether to fund a proposal into account when making investment decisions under

⁹ See sub-section 58(3) of the CEFC Act.

the CEIF. Examples may include technologies that support large-scale solar with storage, offshore energy, biofuels and smart grids.

- (2) A Sustainable Cities Investment Program: To make available up to \$1 billion of investment finance over 10 years for clean energy projects and businesses that improve the productivity, accessibility and liveability of cities. Example investments could include loans to cities to finance innovative upgrades to street lighting and commercial buildings; equity or loans in privately funded co-generation installations in commercial buildings and manufacturing; and long-term loans to support community housing providers to build or retrofit energy efficient, affordable homes.
- (3) A Reef Funding Program: To make available up to \$1 billion of investment finance over 10 years for clean energy projects and businesses that support delivery of the Government's Reef 2050 plan. Example investments could include projects or businesses that have a positive co-benefit for the health of the Reef (either directly by improving water quality, or indirectly by reducing emissions). The RFP will focus primarily on projects located in (and businesses that provide services or products to) the water catchment areas that flow into the Great Barrier Reef World Heritage area.

Together with the focus areas outlined in section 13, these additional focus areas will support the Government's jobs and innovation agenda, improve the productivity, accessibility and liveability of cities and the built environment, and help protect the long-term health of the Great Barrier Reef. They do not mean the Corporation must divest from any of its current investments. The Corporation will consider this direction in relation to new investments only.

In relation to investments made for the purposes of the CEIF, the Board is to adopt a benchmark return based on the five-year Australian Government bond rate. In relation to such investments the Board is to target an average return of at least the five-year bond rate plus 1 per cent per annum.

For each investment in this category, an individual reference rate will first be calculated using the five-year Australian Government bond rate applicable at the time plus 1 per cent per annum. The benchmark return for the CEIF will then be determined by taking the series of individual reference rates for each investment, and weighting them for each individual investment.

Performance against the benchmark return for the CEIF will be measured before operating expenses, and will be published in the Corporation's annual report. The Corporation will follow the Australian Accounting Standards where applicable in measuring its return and determining any impairment, except in the case of concessional loans, where the measurement should exclude any impairment or mark to market adjustments resulting from any concessional component.

The benchmark return for the CEIF is a target expected to be earned across the portfolio of investments over the medium to long term. Individual investments could be made with expected individual returns above or below the benchmark return for the CEIF.

Proponents should not expect to be able to access the Corporation's funding at the benchmark return for the CEIF. The Corporation shall apply commercial rigour in assessing all investments. The actual return the Corporation seeks for any given investment will be a risk-adjusted return reflecting the individual characteristics of specific projects, the need to cover the operating expenses of the Corporation, the requirement to target the benchmark return for the CEIF, and other relevant factors.

In targeting the benchmark return for the CEIF, the Corporation must seek to develop a portfolio that has an acceptable but not excessive level of risk, having regard to the terms of the Act and the focus on projects and businesses that are not yet established or of sufficient maturity, size or otherwise commercially ready to attract CEFC support under existing arrangements. This focus area prescribed for the CEIF may increase the Corporation's overall exposure to credit risk as these technologies may have a higher risk profile than more mature technologies.

Within six months of the 2016 Mandate No.2 being made, the Board, in consultation with ARENA, is required to agree a suitable investment risk evaluation process to assess the level of risk in the CEIF portfolio, and provide the agreed evaluation process to the responsible Ministers. In addition, the Board, in consultation with ARENA, must periodically review its CEIF investment risk management practices and must advise the responsible Ministers of specific measures taken in this regard.

It is expected that a memorandum of understanding will be developed between ARENA and the CEFC in relation to ARENA's role and responsibilities under the CEIF. ARENA will use its agency resources to discharge this role, and will not charge the CEFC for its input.

Section 15 – Reporting outcomes

The Corporation is required to report annually on the non-financial outcomes of all its investments, including those under the CEIF, the SCIF and the RFP. This would go beyond standard financial and investment return reporting to include measuring and reporting on clean energy outcomes achieved, as well as measuring and reporting of co-benefits achieved and the development of emerging businesses and technologies.

Within six months of the 2016 Mandate No.2 being made, the Board, in consultation with the Department of the Environment and Energy, is required to agree a suitable range of performance indicators against which to report these non-financial outcomes. An example performance indicator would be the amount of greenhouse gas emissions reductions expected to be realised through the Corporation's investments. Once agreed, the Board is required to advise the responsible Ministers of the indicators chosen.

Section 16 – Corporate governance

In undertaking its investment function, the Corporation must act consistently with, and establish policies in relation to, Australian best practice corporate governance. In particular, the Government expects the Board's policies to include details of the Corporation's approach to environmental, social and governance issues.

Section 17 – Repeal of previous direction

Section 17 provides that the 2016 Mandate No.2 replaces the Corporation’s previous Investment Mandate.¹⁰ The power to repeal a previous Investment Mandate is implied in the power of the responsible Ministers under sub-section 64(1) of the CEFC Act to issue new Investment Mandates to the Corporation.¹¹

¹⁰ The *Clean Energy Finance Corporation Investment Mandate Direction 2016*.

¹¹ Under sub-section 33(3) of the *Acts Interpretation Act 1901*, where an Act confers a power to make, grant or issue any instrument of a legislative or administrative character (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.