

EXPLANATORY STATEMENT

Issued by authority of the Minister for Energy and the Minister for Finance and the
Public Service

Clean Energy Finance Corporation Act 2012

Clean Energy Finance Corporation Investment Mandate Direction 2018

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 2018* (the “2018 Mandate”) replaces the *Clean Energy Finance Corporation Investment Mandate 2016 (No. 2)*. The primary change is to provide direction in relation to supporting the development of a market for firming intermittent sources of renewable energy generation. It replaces the Corporation’s previous Investment Mandate.²

Details of the 2018 Mandate are outlined in [Attachment A](#).

Pursuant to section 66 of the CEFC Act, the responsible Ministers consulted the Board during the preparation of the 2018 Mandate. 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 2018 Mandate:

- The responsible Ministers considered the object of the CEFC Act, and any other matters they considered relevant, in preparing the 2018 Mandate.³

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 (No. 2)*.

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

- The 2018 Mandate 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

⁴ See section 65 of the CEFC Act.

Details of the 2018 Mandate

Part 1 – Preliminary

Section 1 – Name of direction

Section 1 provides that the title of the 2018 Mandate is the *Clean Energy Finance Corporation Investment Mandate Direction 2018*.

Section 2 – Commencement

Section 2 provides that the 2018 Mandate commences the day after it is registered. A note to section 2 further clarifies that the 2018 Mandate, 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 2018 Mandate 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 2018 Mandate 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 2018 Mandate 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 2018 Mandate.

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.

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 2018 Mandate 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 <https://www.industry.gov.au/regulation-and-standards/australian-industry-participation>

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 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.

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.

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 in its investment activities a focus on technologies and financial products as part of the development of a market for firming intermittent sources of renewable energy generation, as well as a focus on supporting emerging and innovative clean energy technologies. The Corporation is strongly encouraged to prioritise investments that support reliability and security of electricity supply.

The Corporation has also been directed to take into consideration the potential effect on reliability and security of electricity supply when evaluating renewable energy generation investment proposals, and if commercially feasible, consider investment in proposals that support reliability or security of electricity supply.

These directions recognise that in recent years there has been considerable investment in intermittent sources of generation with the amount of electricity generated from intermittent sources in the National Electricity Market forecast to increase by more than 250 per cent between 2017-18 and 2020-21.

In order to ensure reliability and security of electricity supply, intermittent sources of generation must be integrated with technologies that support the reliability, safety and security of the national electricity system, complimented by investments in dispatchable generation and storage.

The Corporation's support for the development of a market for firming intermittent sources of generation will complement the Government's ongoing commitment to implement a retailer reliability obligation in the National Electricity Market. The retailer reliability obligation will provide a clear signal to businesses and market participants to invest in the reliability, safety and security of the national electricity system.

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 made after the commencement of this direction.

Section 14 – Other directions

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

The Government has retained the following additional focus areas for the Corporation's activities consistent with the *Clean Energy Finance Corporation Investment Mandate Direction 2016 (No.2)*:

- (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 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.

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.

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.

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 2018 Mandate 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 (No.2)*.

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.