Australian Government

CEFC Investment Policies

April 2021

The CEFC is a corporate Commonwealth entity established by the Australian Government under the *Clean Energy Finance Corporation Act 2012* (CEFC Act).

Contents

This document sets out the Clean Energy Finance Corporation Investment Policies for the purposes of Section 68 of the CEFC Act, and addresses the requirements as part of a broader statement about the operations of the CEFC. In accordance with the other provisions of Section 68, a copy of these policies is available on the CEFC website: www.cefc.com.au

1. Introduction

The Clean Energy Finance Corporation (the CEFC or Corporation) exists to facilitate increased flows of finance into the clean energy sector.

The CEFC invests in accordance with its governing legislation, the *Clean Energy Finance Corporation Act 2012* (CEFC Act) and the *Clean Energy Finance Corporation Investment Mandate Direction* (Investment Mandate), as issued, amended or replaced by the responsible Ministers from time to time.

The CEFC is a corporate Commonwealth entity under the governance regime of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and governed by an independent Board (the Accountable authority under the PGPA Act). The Board reports to the Australian Parliament through its responsible Ministers. The CEFC has access to funding of $10 billion.

The environment and energy sectors are characterised by long lead times and uncertainty. There is broad agreement, however, that the world is becoming carbon constrained and the Australian economy and industry need to be preparing and positioning to stay competitive in global markets. The CEFC investment objectives are therefore to catalyse and leverage an increased flow of funds for the commercialisation of solely or mainly Australian-based renewable energy, energy efficiency and low emissions technologies.

The CEFC seeks to make targeted commercial investments, to counter market failures and financing impediments and to generate positive public policy outcomes. The CEFC supplements existing clean energy initiatives, such as the Renewable Energy Target (RET), the Australian Renewable Energy Agency (ARENA), and the Climate Solutions Fund (CSF).

The CEFC will achieve its objectives through the prudent application of capital in accordance with the CEFC Act, its Investment Mandate, the investment policies set out in this document, formulated by the Board under Section 68 of the CEFC Act and published on the CEFC website, and other supporting internal policies, procedures and guidelines. These CEFC Investment Policies provide the framework for the governance and management of CEFC investment activities.

Using a commercially rigorous approach to investment activities and risk management practices, the CEFC invests responsibly and manages risk prudently. The CEFC carries out its investment activities while seeking to achieve a target performance in accordance with the Portfolio Benchmark Return (PBR) and risk profile established in the Investment Mandate.

The CEFC Investment Policies reflect the competing challenges inherent in the Investment Mandate. These require a balance to be struck between:

– The commercial imperatives of the CEFC, including investment diversification within a narrowly focused investment market

– The requirement to achieve financial self-sustainability and target a Portfolio Benchmark Return

– Specific areas of focus and direction set out in the Investment Mandate

– Facilitating change while minimising any distortion to the market

– Acting commercially yet taking risks where other financiers are initially reluctant

– Fulfilling the public policy objective of the CEFC.

2. Purpose of this document

Section 68 (1) of the CEFC Act, entitled Investment Policies, states that:

"The Board must formulate written policies to be complied with by the Corporation in relation to the following matters and its requirements:

(a) The investment strategy of the Corporation

(b) Benchmarks and standards for assessing the performance of the Corporation's investments and of the Corporation itself

(c) Risk management for the Corporation's investments and for the Corporation itself

(d) A matter specified in the regulations."

These Investment Policies are formulated under Section 68 of the CEFC Act and are subject to regular periodic review by the Board and, under Section 68 (6), are also subject to review after any change to the Investment Mandate.

The Board has determined that the Investment Policies are to be formally reviewed at least annually, and otherwise as required.

The Board also reserves its right to change or amend the Investment Policies from time to time as may be required.

3. Investment Mandate

Under Section 64 of the CEFC Act, the Australian Government may from time to time issue directions (referred to as the Investment Mandate) about the performance of the CEFC investment function.

Under Section 68 of the CEFC Act, the CEFC must comply with these Investment Policies (that is, this document) which, in turn, must be consistent with the Investment Mandate.

A link to the Investment Mandate, along with the related Explanatory Statement, can be found on the Federal Register of Legislation: www.legislation.gov.au

4. Governance framework

4.1 Introduction

The Board has structured the operations of the CEFC to conduct its investment activities and corporate functions within its legislative framework.

Good governance is critical to the success of the investment function of the CEFC. Producing performance in line with defined investment objectives and benchmarks requires that sufficient time, expertise and organisational effectiveness be applied to support the CEFC decision-making processes. These objectives are best served through the clear identification and separation of responsibilities of the Board and the CEFC Executive Team.

4.2 Roles of the Board and the Executive Team

As set out in the CEFC Act, Investment Mandate, the PGPA Act and as generally accepted in the private sector, the Board has responsibility for overseeing the efficient and effective operation of the CEFC. This includes prudent oversight and governance of investment decisions and risk management.

Under Sections 79 and 80 of the CEFC Act, the Board delegates some of its powers to the CEO and individual Board members, and the CEO further delegates to senior members of staff.

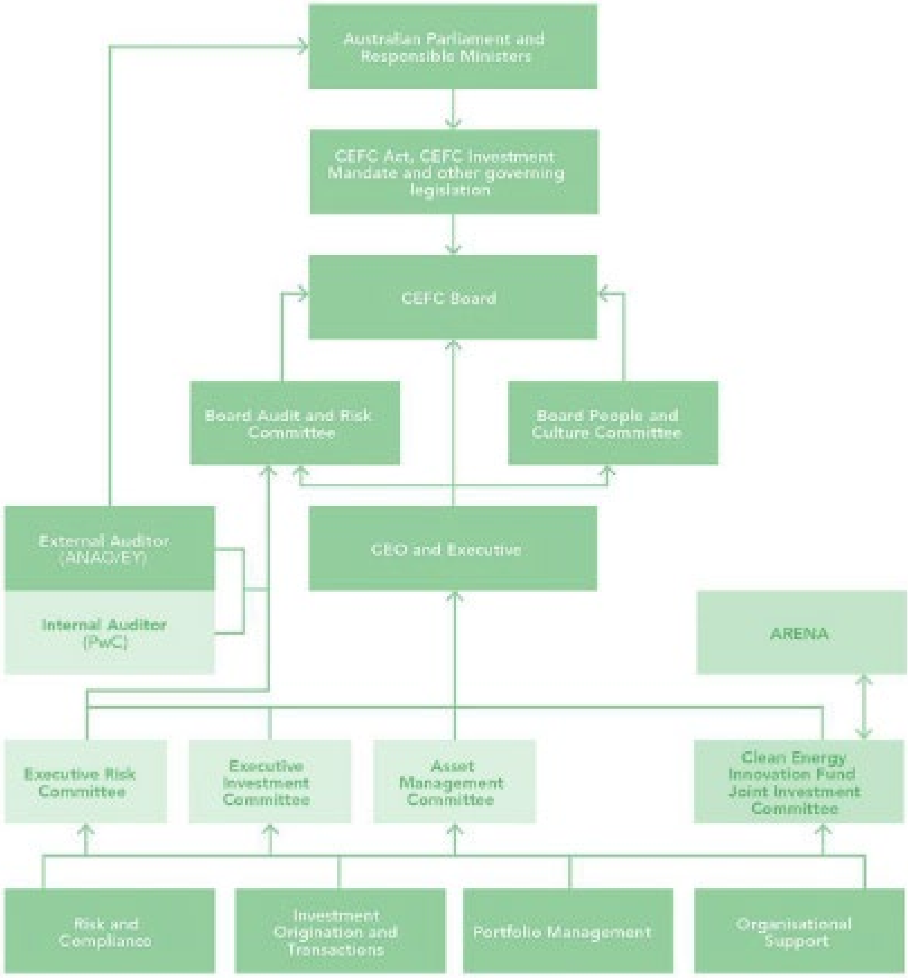
Furthermore, the Board may establish committees to advise or assist in the performance of the Board's or the Corporation's functions. The ultimate responsibility for any exercise of power remains with the Board.

The Board will, as required, delegate authority to individual Board members to work with the Executive Team on investment decision-making or risk management matters.

The Executive Team is responsible for implementing the Board's decisions, conducting portfolio reviews and managing day-to-day investment matters.

The governance framework within which the Board and its committees interact with the Executive Team is illustrated in *Figure 1: The CEFC Corporate Governance Framework*.

Figure 1: The CEFC Corporate Governance Framework



4.3 Board Committees

While the Board retains responsibility for investment decisions and portfolio management, it has established an Audit and Risk Committee to oversee the audit, risk, compliance and assurance functions, to review financial statements and to evaluate the adequacy and effectiveness of the risk management framework.

4.4 Executive Investment Committee

The CEO has established the Executive Investment Committee (EIC) to assess investment proposals. The EIC is responsible for reviewing investment opportunities and making recommendations to the Board or CEO. It oversees progress of transactions until first drawdown, at which point responsibility transfers to the Asset Management Committee (AMC).

4.5 Asset Management Committee

The CEO has established the Asset Management Committee (AMC) to oversee the Portfolio Management function. The AMC has responsibility for the management of all investments post first drawdown, until they are fully repaid or exited. The AMC is responsible for reviewing the performance, including investment risk, of the CEFC portfolio of investments. This involves monitoring the individual investments as well as the performance of the portfolio as a whole against the CEFC Portfolio Diversification Construction Guidelines and Mandatory Portfolio Limits. Both the Chief Asset Management Officer and the Chief Risk Officer are members of the EIC and AMC to ensure continuity of oversight.

4.6 Executive Risk Committee

The CEO has established the Executive Risk Committee (ERC) to provide executive level guidance and ownership of enterprise-wide risk management. The ERC reviews the system of identification, management and monitoring of risks associated with the CEFC itself, in accordance with the CEFC Risk Management Framework (see part 5 of this document). The ERC reports to the Audit and Risk Committee and the Board.

4.7 Innovation Fund Joint Investment Committee

The Board and CEO have established the Innovation Fund Joint Investment Committee (JIC) to establish and operate the Clean Energy Innovation Fund, drawing on the expertise and experience of the CEFC, ARENA and independent industry specialists. The purpose of the JIC is to provide objective oversight of the Innovation Fund's investment evaluation, selection, execution and portfolio management processes. In so doing, the JIC provides support to the investment review processes of the CEFC Board.

4.8 External advisors

The Board and Executive Team may appoint advisors to support the investment activities of the CEFC from time to time. These may include assignments pertaining to:

- Investment policy advice
- Due diligence support in respect of technology, environmental, industry, market or construction risk
- Market research
- Portfolio or investment review, benchmarking, valuation, security research, investigating accountants and advice regarding terms and conditions constituting market norms
- Legal matters, including assistance with contract negotiations with external parties and advice on the statutory obligations of the CEFC
- Tax, including ensuring CEFC tax obligations are met and advising on the tax implications of particular investment structures
- Audit, including advice on ensuring that the management controls around the CEFC investment function and the organisation as a whole are of the necessary standard.

The selection of advisors for these roles takes into account, among other criteria specific to the role:

- Demonstrated commitment to best practice
- The skills and experience the advisor brings to the task
- The substance and viability of the advisor
- The value for money incurred.

5. Risk management

As noted in part 2 of this document, Section 68 (1) (c) of the CEFC Act requires the Board to formulate written policies with respect to risk management for the CEFC investments and the CEFC itself.

The CEFC Investment Policies embody the investment strategy, benchmarks and standards for assessing performance and investment risk management for the CEFC.

The Board has formulated the CEFC appetite for risk in the Board Risk Appetite Statement, which addresses investment, regulatory, operational and reputational risks.

The CEFC operates under a sound enterprise Risk Management Framework designed to identify and effectively manage risk.

The Risk Management Framework focuses on six pillars of risk management activity, to ensure a holistic approach to risk management on an enterprise basis and across all business disciplines. The six pillars of risk management activity applicable to the CEFC business are:

1. Governance
2. Strategy
3. Risk Analysis
4. Culture and Conduct
5. Controls
6. Assurance.

These functional pillars work progressively and collectively to identify and manage risks and thereby reduce the effects of uncertainty on objectives, in accordance with the International Standard on Risk Management, known as ISO31000:2018. In combination, these activities, (along with underlying supporting policies and procedures documentation), form the CEFC Risk Management Framework.

As a responsible investor, the CEFC is conscious that return does not come without risk and, furthermore, the level of investment returns should be commensurate with the risk assumed.

An investment strategy that is too risk-averse would not allow the CEFC to fulfil its statutory objective and public policy purpose. On the other hand, an approach which is too tolerant of investment risk could lead to higher than acceptable capital losses.

6. Investment strategy

6.1 Introduction

The Board is charged with overall governance responsibilities for the investment function of the CEFC. This includes development of an investment strategy and approach which is consistent with CEFC obligations under the CEFC Act, the Investment Mandate and typical commercial investment risk management practices.

The universe of potential investments for the CEFC is limited by a number of constraints established by legislation and regulatory requirements, market demands and the overall selection criteria developed by the Board and Executive Team.

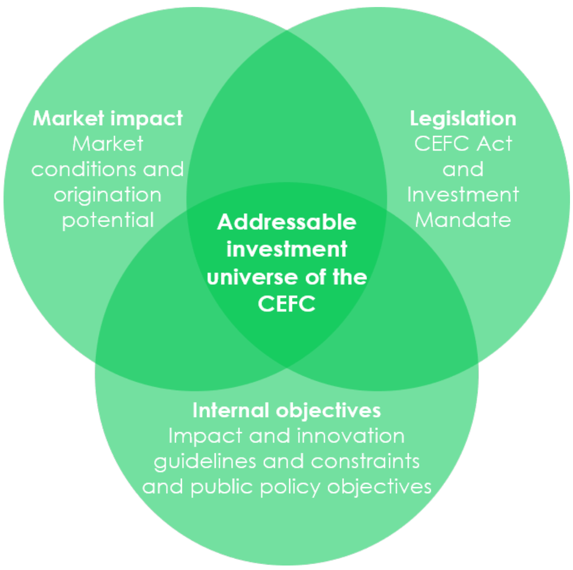
A common characteristic of successful investment organisations is that they are able to clearly define their investment objectives and articulate the principles they will follow in seeking to achieve those objectives.

Successfully aligning these objectives and principles so that they maximise the CEFC universe of potential investments allows the CEFC the greatest flexibility in achieving its mission. Refer *Figure 2: CEFC Addressable Investment Universe*.

The CEFC Act provides that in performing its investment function the CEFC must ensure that, at any time on or after 1 July 2018, at least half of the funds invested at that time for the purposes of its investment function are invested in renewable energy technologies. The balance of funds invested will be directed to other complying investments. The Investment Mandate may also direct the CEFC to include a focus on specific theme(s), for example sectors, technologies or stages of commercial development.

These basic portfolio construction requirements have been extended into a broader set of portfolio guidelines, as set out in this document.

Figure 2: CEFC Addressable Investment Universe



6.2 Investment approach and portfolio guidelines

The CEFC seeks to make commercial investments that counter market failures, address financing impediments and help achieve its broader public policy objectives.

In terms of its Addressable Investment Universe, the CEFC may invest in businesses and projects that develop, commercialise or use renewable energy, low emissions or energy efficiency technologies. In addition, the CEFC may also invest in businesses that supply goods or services needed to develop or commercialise, or needed for use in, renewable energy, low emissions or energy efficient technologies.

The Board and Executive Team are cognisant of the fact that, relative to its private sector counterparts, the investment function of the CEFC is focused upon a narrowly defined and mission critical target market. The limitations of such a tightly defined Addressable Investment Universe constrain the capacity for risk reduction by portfolio diversification. This heightens the requirement for prudent risk management.

These CEFC Investment Policies have been devised reflecting the statutory and legislative requirements of the CEFC. In determining its investment approach, the Board has supplemented these basic constructs with a commercial investment risk management approach that, within the constraints of the CEFC investment focus, have the robustness of a private sector financial institution, funds management operation or commercial bank. The result is that a wide number of factors must be considered prior to making investment decisions.

When the CEFC evaluates an opportunity for investment, three broad threshold factors are considered:

1. Complying investment criteria

The CEFC ability to invest is limited by its governing legislation, which sets out certain criteria that must be met for the opportunity to be a complying investment (for more detail, see Complying Investment and Other Constraints, part 6.4). In addition to these criteria, and the requirement to comply with the Investment Mandate, the CEFC will also consider whether an investment proposal would generate positive public policy outcomes, such as overcoming market failures or alleviating financing impediments.

2. Investment selection criteria

Once eligibility has been established, the CEFC undertakes a thorough evaluation of the commercial merits and relative investment attractiveness of prospective investments. The selection of particular investments is influenced by the risk profile of the investment and the implications of each potential investment decision for the portfolio.

3. Portfolio diversification strategy

The tightly defined nature of the CEFC Addressable Investment Universe heightens the risk of concentrated positions within the CEFC portfolio. This risk is managed by defining a series of diversification parameters for the portfolio which are designed to reduce the potential systemic risks posed by concentrated exposures in any single investment, technology, industry, counterparty or geography. Accordingly, consideration is given to the impact that an individual investment will have upon these portfolio concentration parameters (for more detail, see Portfolio Diversification and Risk Management Strategy, part 6.7).

The Board reserves the right to invest selectively, within its discretion, and in accordance with its appetite for risk. The Board has a preference for a balanced portfolio with heavier weighting towards senior debt securities and loans to later stage opportunities, balanced against a focus on emerging and innovative clean energy technologies which typically have a higher risk of potential capital loss. Investment activities are reported in the CEFC Annual Report and Quarterly Investment Reports, which are published on the CEFC website: www.cefc.com.au

6.3 Complying investment and other constraints

The legal framework for the CEFC creates a number of constraints with regard to the exercise of its investment function. Specifically, the CEFC may only make investments that:

– Are in "clean energy technologies", including businesses that supply goods or services needed to develop or commercialise, or are needed for use in, clean energy technologies

– Are not a "prohibited technology"

– Are "solely or mainly Australian-based"

– Take the form of a "financial asset" (which may include in limited circumstances, guarantees or derivatives)

– Have developed Australian Industry Participation Plans (where applicable).

Constraint 1 – Clean energy technologies

Section 59 of the CEFC Act defines "complying investments". As well as satisfying other criteria, a complying investment must be a "clean energy technology" and satisfy the requirements of Section 60 of the CEFC Act, which in turn specifies three categories of clean energy technologies, namely:

1. Renewable energy technologies: Includes (a) hybrid technologies that integrate renewable energy technologies and (b) technologies (including enabling technologies) that are related to renewable energy technologies

2. Energy efficiency technologies: Includes technologies (including enabling technologies) that are related to energy conservation technologies or demand management technologies

3. Low emissions technologies: The Board has established formal guidelines as required by the CEFC Act setting out the matters to which it will have regard in satisfying itself that a technology is a low emissions technology.

Constraint 2 – Prohibited technologies

Irrespective of whether a particular technology is a clean energy technology, as defined in the CEFC Act, if it falls into one of the categories prohibited under Section 62 of the CEFC Act it is ineligible for CEFC investment.

Constraint 3 – Solely or mainly Australian-based

Investments made by the CEFC must be solely or mainly Australian-based. Section 61of the CEFC Act specifies that the Board must make guidelines setting out the circumstances, conditions or other matters to which the Board will have regard in satisfying itself that an investment is solely or mainly Australian based. The Board has issued guidelines as required by the CEFC Act to assist in determining if an investment is "solely or mainly Australian-based". These guidelines are published on the CEFC website: www.cefc.com.au

Constraint 4 – Financial assets

Where the CEFC invests directly, that investment can only be in Financial Assets. The term "Financial Assets" is defined under Sections 4 and 63 (2) in the CEFC Act) and is drawn from the Australian System of Government Finance Statistics: Concepts, Sources and Methods.

The CEFC cannot directly acquire physical assets, such as property or any type of fixed asset. Within the context of financial assets, the CEFC generally seeks to avoid acquiring a controlling interest in an operating entity. As a corporate Commonwealth entity, special rules apply that regulate the formation of subsidiaries under the CEFC and PGPA Acts. *Figure 3: Financial Assets, sets out a summary of relevant elements.*

Figure 3: Financial assets

Assets are defined in the Australian System of Government Finance Statistics: Concepts, Sources and Methods as instruments or entities over which ownership rights are enforced by institutional units and from which economic benefits may be derived by holding them, or using them, over a period of time.

Financial Assets are assets that are in the form of financial claims on other economic units (for example, cash and deposits; investments, loans and placements; accounts receivable; advances outstanding and equity).

All other assets are described as non-financial assets and include fixed assets (that is, real estate and buildings), inventories, valuables (for example, works of art) and non-produced assets (for example, natural forests, mineral reserves).

Note also that Section 4 of the CEFC Act defines an asset as real or personal property, a legal or equitable right in the same, or other legal or equitable right.

Constraint 5 – Guarantees

Section 69 of the CEFC Act limits the use of guarantees as part of CEFC investment activities. The CEFC may only provide a guarantee for repayment of a loan where that loan would be a complying investment under the CEFC Act and that guarantee is consistent with these Investment Policies.

Constraint 6 – Derivatives

The CEFC is not permitted to acquire derivatives for speculation or leverage, per the limits set out in Section 70 of the CEFC Act. However, the CEFC may acquire a derivative:

- To protect the value or returns of an investment
- To achieve indirect exposure to financial assets for a purpose in connection with the CEFC investment function
- For transactional efficiency for a purpose in connection with the CEFC investment function.

The CEFC exists for the purpose of addressing capital shortfalls through its investment activities. It has not been established for the purpose of speculating on tradable financial market instruments or commodities, nor to absorb such risks on behalf of counterparties.

6.4 Investment instruments

The CEFC may invest across the capital structure in publicly traded or privately held instruments, including without limitation:

- Senior debt
- Subordinated debt
- Preferred equity/convertible debt
- Common equity
- Interests in Pooled Investment Schemes, Trusts and Partnerships
- Net profits interests, royalty interests, and entitlements to volumetric production payments.

This capacity is limited as follows:

- For concessional loans, by a portfolio limit of $300 million in net present value terms per annum
- For guarantees, by a portfolio limit of 5 per cent of the total amount credited to the Special Account under Section 46 of the CEFC Act.

6.5 Investment screening and selection

Upon establishing complying investment status, the CEFC applies a commercially rigorous set of investment selection criteria in the evaluation of a prospective investment. A conservative investment approach is adopted, while also recognising the public policy purpose, mission and objectives of the CEFC.

Screening of investments is focused on identifying a series of characteristics which are likely to be highly predictive of the stable, cash flow generative investments that would match the conservative risk profile of the CEFC. For example, in the electricity generation sector, assets with a long term power purchase agreement are preferred to those without such agreements. However, it is also recognised that often long term contracted assets are more readily financeable by the private sector and hence the need for CEFC debt finance can be more limited.

Individual investment prospects are initially screened against a number of risk parameters and financial structuring mitigants. The overall process and some key decision factors are set out in *Figure 4: Investment Screening Process.*

While the CEFC employs structured risk screening techniques in the early stages of assessment, there are usually a core set of risks that are universally applicable to every investment and need to be considered at a threshold level. Strength of management or sponsorship, financial flexibility, operating margins and industry competitiveness are likely to represent relevant key factors for the consideration of any investment. There is also frequently a more detailed set of risk factors which will vary across individual sectors (for example, renewable energy versus energy efficiency) as well as within sectors (for example, wind versus solar) and across individual investment proposals (for example, conservative versus leveraged capital structures).

In seeking to advance an individual investment proposal through its various stages of assessment, the focus of the CEFC is, firstly, upon identifying unique and generic critical risk factors and, secondly, upon ensuring they can be adequately addressed through due diligence or investment structuring. If the key risks cannot be addressed to the satisfaction of the CEFC, the CEFC investment will not proceed.

Figure 4: Investment screening process

Investment risk screening	Screen and prioritise specific areas of focus	Detailed analysis evaluation	Outcomes
– Technology – Operational – Regulatory – Credit – Counterparty – Refinancing – Market impact – Earnings stability – Liquidity – Co-financier involvement	– Investments that support reliability and security of electricity supply – Emerging and innovative technologies – Relevance to cities and the built environment – Benefits to the Great Barrier Reef catchment area – Investments in recycling and recycled content – Investments to support the growth of the Australian hydrogen industry – Environmental, social and governance matters	**Public policy benefits** – Emissions reduction, environmental benefits (incl waste reduction) – Private sector leverage and investor base expansion – Technology expansion and development – Innovation in finance and/or market delivery models **Financial return** – Margin – Fees – Concessionality **Financial structuring considerations** – Capital structure – Term – Leverage – Counterparty guarantees – Collateral security **Portfolio impacts and benchmark return** – Portfolio diversification – Target of return set in the investment Mandate	**Balanced portfolio that achieves commercial and public policy objectives**

Investment risk screening

The CEFC is exposed to counterparty risk associated when extending finance to other parties. There is the macro risk that any business may fail or default on its payment obligations. At the portfolio level, diversification and concentration guidelines are applied to single asset, entity and industry level exposures.

The CEFC is also indirectly exposed to market risk and, most commonly, energy market risk associated with a general fall in prices of energy and in particular, a fall in realised (as compared to expected) prices for electricity. Such price changes may adversely impact the returns of the asset and ultimately a borrower's ability to make repayments in accordance with a loan facility. The CEFC includes regulatory risk that impacts on received prices within this set.

The CEFC is, in addition, exposed to technology risk. Technology risk is defined as the risk of losses arising as a result of a technology not operating as effectively as predicted which may arise from design, engineering and/or implementation issues. Renewable energy, energy efficiency and low emissions technologies all present varying degrees of technological risk depending on the nature of the technology under consideration, the nature of the technology's application in the subject investments, the technology's stage of development along the innovation chain, and the nature and pace of innovation in competing technologies.

Each individual project will carry its own risks for implementation underperformance (for example, delays in construction or installation). Technology risk can also be impacted by regulatory risk associated with the use of the particular technology. Assessment, analysis and mitigation for technology risk is a key component of the CEFC investment risk analysis process.

Key risks are assessed by conducting thorough technical due diligence and integrating those findings and outcomes with financial modelling analysis. Critical considerations for CEFC technical due diligence include the historical data on the reliability of the technology, the assessed suitability of the technology for the purpose and location, the degree of customisation required, levels of testing undertaken, and the confidence levels expressed regarding the expected performance of the technology.

Rigorous due diligence and financial modelling analysis of the business case, along with assessments of other key investment risks, including credit risk, are used to determine appropriate investment structures, financial covenants, and the required legal undertakings for intended prospective investment. This is designed to enhance and protect the CEFC position.

Specific focus areas under the Investment Mandate

The Investment Mandate directs the CEFC to include a focus on specific themes, technologies and sectors (for more detail, see Other Requirements, part 6.8).

Detailed analysis, including financial structuring

The CEFC has established sector-specific financial structuring and underwriting guidelines to promote a structured and uniform investment approach. These guidelines set out certain boundaries for an investment. Examples include:

Where appropriate, capital structure rebalancing measures in the form of underperformance “triggers” that result in accelerated repayments of capital based on certain financial key performance indicators (KPIs)

– For projects where revenues are not contracted or supported by Counterparty Guarantees, requiring clear evidence the investment will be serviced by revenue even under downside scenarios

– For the power generation industry, aggregate exposure to non-contracted generators or those with exposure to market risk is capped on a portfolio basis

– For sub-investment grade debt investments, setting a guideline that the CEFC would typically expect appropriate security to mitigate risk.

Public policy outcomes

CEFC investments are intended to generate positive public policy outcomes which are at the core of the CEFC purpose.

Core public policy outcomes, in particular leveraging and mobilising private sector capital will, over time, have a cumulative impact across the economy on reducing Australia’s emissions.

Positive public policy outcomes result from technologies moving faster along the innovation chain and down the cost curve and from a greater degree of familiarity and acceptance in conventional financing markets. They also flow from improvements in technology design, supply chain depth, construction practices, operating skills, financing structures and market risk appetite.

Public policy benefits that are considered and taken into account in evaluating investment opportunities are set out in *Table 1: Investment Screening – Public Policy Benefits.*

Table 1: Investment screening – Public policy benefits

Emissions reduction and environmental benefits	What emissions reductions can be achieved, directly or indirectly? In addition to reduced emissions, does the project have other environmental benefits? (for example, reduced air pollution)
Financial leverage / catalyst	Direct – Does this transaction leverage additional capital from sources other than the CEFC? Indirect – Is this transaction likely to be easily replicated elsewhere or have demonstration value (for example, climate bonds where a number of institutions are considering similar issuances)?
Technology expansion and development	Does this transaction help to prove up a new and emerging technology, such as hydrogen, or fund a commercially-viable pilot program?
Dispersion and take-up	Does this transaction help accelerate or widen market take-up of a proven technology or concept which is not widely deployed or assist in deploying a technology that will lower the cost for subsequent projects?
Innovation in finance and/or market delivery models	Will this transaction involve a new finance structure, product or program delivery model in the Australian market, or facilitate the flow of finance to the sector?
Industry diversity	Is this transaction in an industry sector where the CEFC hasn't already committed finance?
Geographic diversity	Is this transaction in a less populated state/territory, rural or regional area of Australia?
Building industry capacity and sector skills	Will this transaction involve and help develop the Australian market (for example, for engineering, manufacturing, services, sector or other supply chain inputs)?
Dissemination of information	Will the transaction help de-risk/reduce the cost for similar transactions in the future?
Demonstration	Will this transaction provide a demonstration that others in the sector can follow?
Employment / economic growth	Will this transaction create future employment in construction installation or ongoing operation?
Waste reduction	Does this transaction reduce, reuse or recycle waste (for example, municipal, industrial)?
Productivity	Does this transaction deliver wider productivity gains for business in addition to energy cost savings?
Expansion of investor base	Does this transaction expand the clean energy investor base?
Community benefits	Does this transaction have a community engagement program or the capacity to generate broader public benefits?
Water quality improvements	Does the transaction have a positive co-benefit for the health of a water catchment area?

6.6 Investment approach

The following considerations guide the investment and portfolio risk management approach of the CEFC:

- Recognition of the inherent uncertainty in investment markets and the encouragement of an approach of continual sceptical enquiry
- The objective of generating appropriately risk-adjusted investment returns while targeting the portfolio benchmarks set out in the Investment Mandate
- The CEFC Act, with its dedicated special appropriation and Investment Mandate, allows an investment strategy different from that of private sector commercial banks or investment funds, noting such a strategy must be pursued with a high degree of prudence and analytical rigour
- While quantitative assessment of risk factors is important, so is an evaluation of qualitative factors
- There must be an appropriate understanding of the prevailing macro-environment and its potential impact on the portfolio or individual investments.

The following principles guide the CEFC approach to developing opportunities for investment:

- A flexible and diversified approach to asset allocation and investment selection as appropriate within the constraints of the CEFC Act and the Investment Mandate, including the focus areas specified in that Direction
- A broadly diversified allocation across individual assets and sectors in order to produce a more stable expected risk-adjusted return and a consistent achievement of objectives
- The role of the CEFC in facilitating investment flows into the clean energy sector
- As a matter of policy, the CEFC may be the sole funder of a proposed clean technology investment if this is important in the context of playing a pioneering role to support the emergence of a new financing technique or clean energy technology or sector
- The CEFC commercial approach means it assesses investments on a case-by-case basis, with a view to providing funds on as close to market terms as possible so a project can proceed in a timely manner
- The CEFC considers public policy benefits in making investment decisions and in determining when it is justifiable to offer any form of concessionality
- Offers of concessional finance will generally be limited to avoid unintended market impacts, distortions in the efficient operation of the capital markets, or other government policies and programs.

Investment selection and approval process

The investment selection and approval process is endorsed by the CEFC Executive Investment Committee and Board.

It entails a well developed process for gating and screening investments to ensure that there are multiple "checkpoints" for risk before a given investment proposal is approved. The progression of the investment may be paused while additional due diligence or market specific research is undertaken.

The typical investment selection and approval process is set out in *Figure 5: Investment selection and approval process.*

It involves three phases of assessment of opportunities, including complying investment analysis. A given opportunity typically passes each stage before it advances to the next.

The Board is kept informed of investment opportunities as they progress through all phases, and in particular Phase 2, when conditional or delegated approval from the Board may be sought.

Figure 5: Investment selection and approval process

Phase 1 of the assessment process involves a high-level screening of investment opportunities and focuses on a number of key considerations:

– How does the opportunity fit within CEFC investment objectives and on what basis was complying investment status determined?

– Does the investment contribute to any focus areas in the Investment Mandate?

– Why is the involvement of the CEFC requested?

– What financial market impediments is the transaction addressing?

– How attractive an economic proposition is the transaction?

– Who is the primary sponsor or proponent and what is their track record of success?

– Does a co-financier support the opportunity?

– What additional key elements to completion remain, even with CEFC involvement?

– Will the investment include public policy benefits?

Phase 2 requires a more detailed screening of the opportunity and, for debt investments, the development of a shadow credit rating.

Within this phase a broader set of factors are considered as part of identifying and evaluating critical risks to success. These include understanding the execution capability of key transaction counterparties, assessing critical technical and engineering factors, evaluating the appropriateness of the proposed capital structure and considering the contribution of the investment towards meeting the public policy purpose objectives of the CEFC.

This process involves the identification of key risk areas, financial modelling and further external due diligence analysis of technical, legal and financial risks. Within this phase, detailed investment terms and conditions designed to mitigate the key risks are developed in conjunction with project sponsors.

Phase 3 involves a thorough review of all external due diligence prepared and investment contractual arrangements pursuant to final approval.

This stage of the investment process focuses on covering off key risks identified in the first two screening phases either through review of appropriate due diligence as scoped out in Phase 2, or further refinement of investment structuring.

The approach to screening described here provides only a general framework for assessment. The key risks specific to and the merit of each individual investment are determined on a case-by-case basis.

Investment decisions are considered in the context of portfolio limits, diversification targets, concentration guidelines, the public policy objectives of the CEFC Act and the Investment Mandate.

6.7 Portfolio diversification and risk management

The CEFC faces significant geographical and industry concentration risks. The sector-specific purpose of the CEFC limits the scope for diversification as a risk mitigant. At the portfolio level, diversification and concentration guidelines are applied to technology types, along with geographic, regulatory, single asset and industry level exposures.

The CEFC Act and the Investment Mandate specifies certain Mandatory Portfolio Limits. These are set out in *Table 2: Mandatory Portfolio Limits.*

The Board has established target portfolio exposure guidelines directed at constructing a portfolio that is diversified across individual assets, technologies, industries and geography. The Board Portfolio Diversification and Construction Guidelines are set out in Table 3: Board Portfolio Diversification and Construction Guidelines.

The purpose of these guidelines is to:

- achieve the objective of facilitating broad and diversified financial flows throughout Australia to support the growth of renewable energy, low emissions and energy efficiency technologies (including any focus areas specified in the Investment Mandate)
- operate as part of a risk management strategy directed at minimising the impact on the overall portfolio returns of any potential losses on individual assets due to overweight concentrations or systemic sector risks.

With these objectives in mind, the Board has set concentration guidelines across a number of exposure categories including individual transaction exposures, technology type, industry concentration, state geographies and type of investment security.

Table 2: Mandatory portfolio limits

Measure	Limit
Renewable energy technologies	From 1 July 2018, at least half of the funds invested for the purpose of the investment function are to be invested in renewable energy technologies.
Guarantees	Five per cent of the amount credited to the Clean Energy Finance Corporation Special Account under section 46 of the CEFC Act
Concessional loans	The amount of concessionality provided in any one financial year is limited to $300 million
Exposure to portfolio risk	Acceptable but not excessive level of risk across the aggregate portfolio

Table 3: Board Portfolio diversification and construction guidelines

Measure	Limit
Preferred minimum CEFC investment	$20 million*
Preferred maximum individual transaction size	$250 million
Concentration of technology	No more than 40 per cent of the portfolio invested in any single technology
Security type	Appropriate mix of debt and equity instruments reflective of overall CEFC portfolio risk target

**In adopting a commercial approach, the preferred minimum CEFC investment size is $20 million for direct investments in order to maintain transactional efficiencies. However, lower values may be considered where the transaction falls within a focus area under the Investment Mandate and does not apply to investments undertaken by the Clean Energy Innovation Fund. In order to address smaller transactions and the small and medium enterprise (SME) market in an efficient manner, the CEFC preference is to establish pooled financing programs and strategies which leverage the larger market reach of financial intermediaries such as external fund managers and commercial banks.*

6.8 Other requirements

The CEFC Act and Investment Mandate also require the CEFC to:

- Consider the potential effect of its investments on the efficient operation of the Australian financial and energy markets and on other market participants
- Not act in a way that is likely to cause damage to the Australian Government's reputation
- Have regard to, and adopt policies in respect of, best practice principles in environmental, social and corporate governance
- Only invest in projects with an Australian Industry Participation (AIP) Plan where such plans are required under the Australian Government's AIP Plan policy
- Include 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 supporting emerging and innovative renewable energy technologies
- Prioritise investments that support reliability and security of electricity supply and take into consideration the potential effect on reliability and security of supply when evaluating renewable energy generation investment proposals and if commercially feasible, consider investment in proposals that support reliability or security of supply
- Through the Clean Energy Innovation Fund, make available up to $200 million for debt and equity investment in emerging clean energy technology projects and businesses that involve 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 sufficient private sector investment
- Make available up to $1 billion of investment finance over 10 years for a Sustainable Cities Investment Program, to invest in clean energy projects and businesses that provide productivity, accessibility and liveability benefits for cities
- Make available up to $1 billion of investment finance over 10 years for clean energy projects and businesses through the Reef Funding Program to support delivery of the Australian Government's Reef 2050 plan
- Make available up to $100 million for an Australian Recycling Investment Fund to support recycling or recycled content projects utilising clean energy technologies, with a particular focus on waste plastics, paper, glass and tyres
- Through the Advancing Hydrogen Fund, make available up to $300 million in concessional finance to support the growth of a clean, innovative, safe and competitive Australian hydrogen industry.

7. Environmental, social and governance matters

Effective management of financial and reputational risks, including matters related to environmental, social and governance (ESG) issues will, over the long term, support the CEFC objectives and mission. The Board has incorporated this perspective into investment decision processes and criteria.

In particular, over the longer term, good governance is expected to contribute to good investment returns.

Improving the stability, transparency and efficiency of the markets in which the CEFC operates goes hand-in-hand with the commercial and public policy objectives of the CEFC, namely to address financing impediments and market failures, as well as maintain the reputation of the CEFC as a responsible and respected long-term investor.

Accordingly, the CEFC has established an Environmental, Social and Governance Policy that is available on the CEFC website: www.cefc.com.au

About the CEFC

The CEFC has a unique mission to accelerate investment in Australia's transition to net zero emissions. We invest to lead the market, operating with commercial rigour to address some of Australia's toughest emissions challenges. We're working with our co-investors across renewable energy generation and energy storage, as well as agriculture, infrastructure, property, transport and waste. Through the Advancing Hydrogen Fund, we're supporting the growth of a clean, innovative, safe and competitive hydrogen industry. And as Australia's largest dedicated cleantech investor, we continue to back cleantech entrepreneurs through the Clean Energy Innovation Fund. With $10 billion to invest on behalf of the Australian Government, we work to deliver a positive return for taxpayers across our portfolio.