Australian Government

CLEAN ENERGY FINANCE CORPORATION

CEFC INVESTMENT POLICIES

Building a clean tech supply chain
BATTERY STORAGE
Low emissions
BUSINESS GROWTH
Innovative Technology
RENEWABLE
On the FARM and in the FACTORY
TOMORROW'S TRANSPORT

PRODUCTIVITY
ACCELERATING
ECONOMIC
Transformation
CATALYSING INVESTMENT
INNOVATION
Diverse solutions for a
DIVERSE ECONOMY
SOLAR ENERGY NATION
HIGH PERFORMANCE

CLEAN
SUSTAINABLE CITIES
High tech
INFRASTRUCTURE
BIOENERGY
EXPORT INDUSTRIES

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This document sets out the CEFC 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 that Section, a copy of these policies is published on the CEFC's website.

The Clean Energy Finance Corporation (CEFC) invests commercially to increase the flow of funds into renewable energy, energy efficiency and low emissions technologies. The CEFC has supported projects across the Australian economy, benefitting a diverse range of businesses, large and small. The CEFC's mission is to accelerate Australia's transformation towards a more competitive economy in a carbon constrained world, by acting as a catalyst to increase investment in emissions reduction. The CEFC does this through direct investments which attract private sector finance, as well as through its strategic co-financing partners. The CEFC was created by the Australian Government and operates under the *Clean Energy Finance Corporation Act 2012*.

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1 Introduction

The Clean Energy Finance Corporation ("CEFC" or "Corporation") was established 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* (Cth) (the "CEFC Act") and the *Clean Energy Finance Corporation Investment Mandate Direction 2015 (No.2)* (the "Investment Mandate 2015 (No. 2)"), as issued by responsible Ministers, the Minister for the Environment and the Minister for Finance.

The CEFC is a corporate Commonwealth entity under the governance regime of the *Public Governance, Performance and Accountability Act 2013* (Cth) (the "PGPA Act"), governed by an independent Board (the Accountable authority under the PGPA Act), chaired by Jillian Broadbent AO and reports to the Australian Parliament through its responsible Ministers. It has access to funding of $10 billion comprising annual appropriations to the CEFC Special Account of $2 billion every 1 July from 2013 to 2017 inclusive. The CEFC commenced funding investments from 1 July 2013.

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's investment objectives are therefore to catalyse and leverage an increased flow of funds for the commercialisation of 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 will supplement existing clean energy initiatives, such as the Renewable Energy Target ("RET"), the Australian Renewable Energy Agency ("ARENA"), as well as the Emissions Reduction Fund ("ERF").

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 ("CEFC Investment Policies") 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, guiding the investment of the CEFC's assets.

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 and risk profile established in the Investment Mandate 2015 (No.2). The CEFC Investment Policies reflect the competing challenges inherent in the Investment Mandate 2015 (No.2). These require a balance to be struck between:

- The commercial imperatives of the CEFC, including investment diversification within a narrowly focused investment market;
- Its requirement to achieve financial self-sustainability and target a Portfolio Benchmark Return;
- A focus on emerging and innovative renewable energy technologies and energy efficiency, as well as cities and the built environment;
- Facilitating change without distorting the market;
- Acting commercially yet taking risks where other financiers are initially reluctant; and
- The core mission of fulfilling its public policy objective and mission.

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 CEFC in relation to the following matters and its requirements, approach and intentions with respect to:

a) The investment strategy of the CEFC;

b) Benchmarks and standards for assessing the performance of the CEFC's investments and of the CEFC itself;

c) Risk management for the CEFC's investments and for the CEFC itself; and

d) A matter specified in the regulations."

These CEFC Investment Policies are formulated under Section 68 of the CEFC Act and this version of the policy document became effective on 18 April 2016 as approved by the Chair (per delegation from the Board).

Under Section 68 (5) of the CEFC Act, these policies 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 CEFC 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 CEFC Investment Policies from time to time as may be required.

3 Investment Mandate

Under Section 64 of the CEFC Act, the Australian Government may issue directions (referred to as the "Investment Mandate") setting out the parameters of the CEFC's investment activities.

The Investment Mandate forms an integral part of the CEFC's investment governance.

The Investment Mandate 2015 (No.2) was registered by the responsible Ministers (the Minister for the Environment the Hon. Greg. Hunt MP and the Minister for Finance Sen. the Hon. Mathias Cormann) on 23 December 2015.

Under Section 68 of the CEFC Act the CEFC must comply with the CEFC Investment Policies (i.e. this document) which, in turn, must be consistent with the directions under the Investment Mandate.

The Investment Mandate 2015 (No.2) is set out in Appendix 1, along with the related Explanatory Statement.

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.

The Board adheres to the view that high quality governance is critical to the success of the investment activities 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's decision-making processes. These objectives are best served through the clear identification and separation of responsibilities of the Board and the Executive Team.

4.2 Roles of the Board and the Executive Team

As set out in the CEFC Act and Investment Mandate 2015 (No.2) 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 79-80 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. 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.

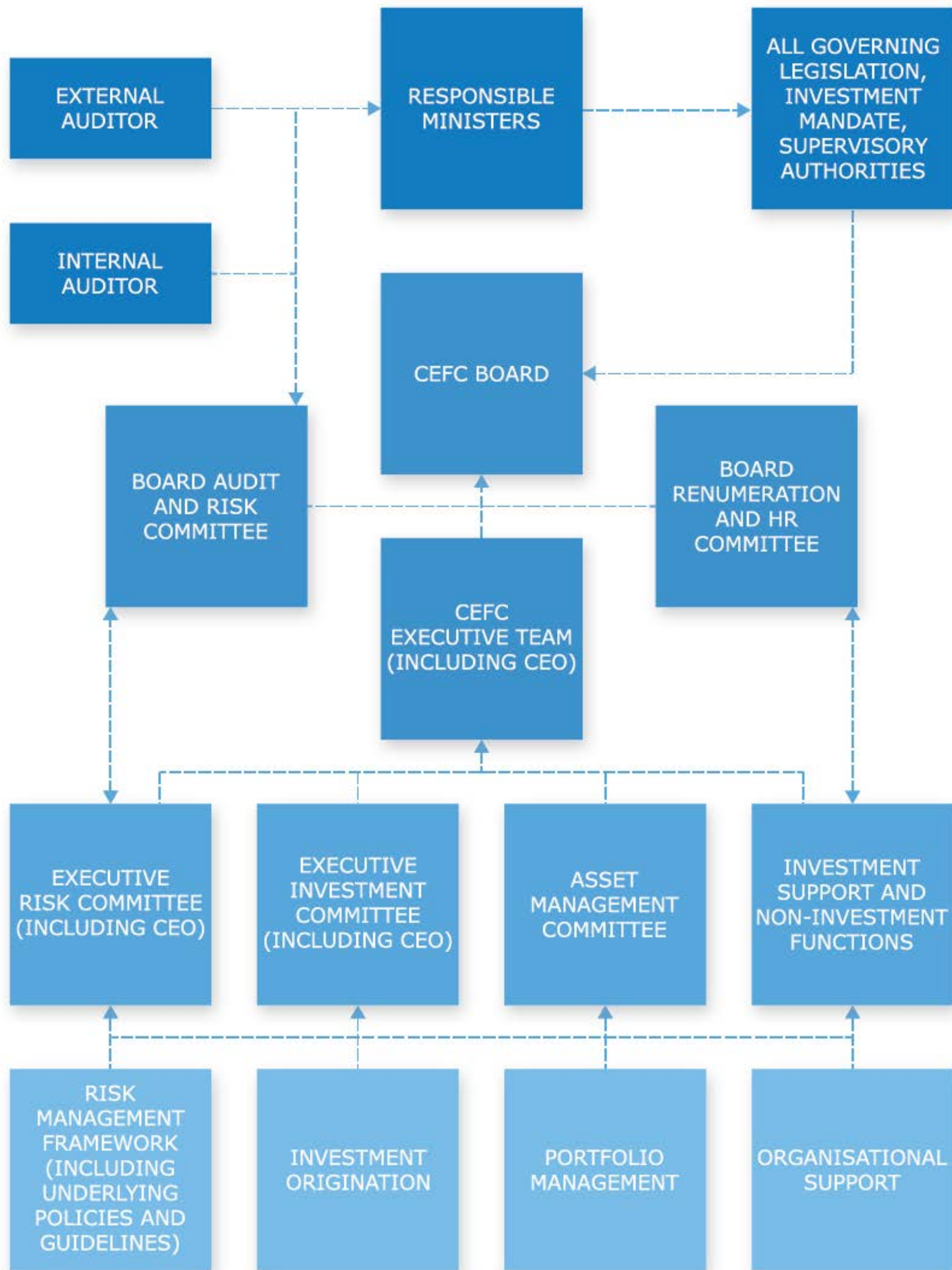
The Executive Team is responsible for implementing the Board's decisions, conducting portfolio reviews and managing day-to-day investment matters.

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

4.3 Board Committees

While the Board retains responsibility for investment decisions and portfolio management (unless specifically delegated to the CEO and Executive), 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.

Figure 1: CEFC Corporate Governance 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, making recommendations to the Board, and making investment decisions under Board-delegated authority. It oversees progress of transactions until first drawdown, at which point responsibility transfers to the Asset Management Committee.

4.5 Asset Management Committee

The CEO has established an Asset Management Committee (AMC) to oversee the Portfolio Management function. The AMC has responsibility for management of all investments post first drawdown. The AMC is responsible for reviewing the performance, including investment risk, of the CEFC's portfolio of investments. This involves monitoring the individual investments as well as the performance of the portfolio as a whole against its Portfolio Diversification Construction Guidelines and Mandatory Portfolio Limits.

4.6 Executive Risk Committee

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

4.7 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 the CEFC's tax obligations are met and advising on the tax implications of particular investment structures; and
- Audit, including advice on ensuring that the management controls around the CEFC's 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; and
- 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 that the Board formulate written policies with respect to risk management for the CEFC's 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 CEFC operates under a sound enterprise risk management framework ("Risk Management Framework") designed to identify and effectively manage risk.

The CEFC Risk Management Framework focuses on six pillars of risk management activity, to ensure an 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 Identification, Profiling and Reviews
4. Compliance
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 ISO31000:2009. In combination, these activities, (along with underlying supporting policies and procedures documentation), form the CEFC's Risk Management Framework.

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

An investment strategy that is too risk-averse would not allow the CEFC to fulfill its mandate, 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 activities of the CEFC. This includes development of an investment strategy and approach which is consistent with the CEFC's obligations under the CEFC Act, the Investment Mandate 2015 (No.2) and normal 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 principles that they will follow in seeking to achieve those objectives.

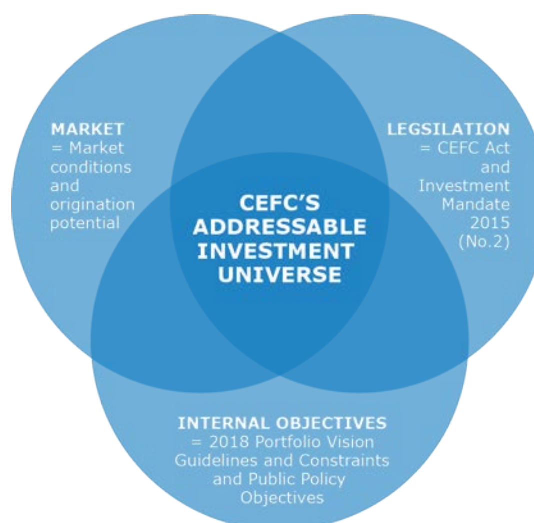
Successfully aligning these objectives and principles so that they maximize the CEFC's universe of potential investments (see Figure 2: *CEFC's Addressable Investment Universe*) allows the CEFC the greatest flexibility in achieving its mission.

The CEFC mission is on the CEFC website: www.cleanenergyfinancecorp.com.au/about/mission.aspx

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 will be directed to investments in energy efficiency and low emissions technologies. The Investment Mandate 2015 (No.2) also directs the CEFC to include a focus on emerging and innovative renewable technologies and energy efficiency, as well as cities and the built environment.

These basic portfolio construction requirements have been extended into a broader set of objectives as set out in the 2018 Portfolio Vision which serves as a guide to determining the investment strategy for the CEFC.

Figure 2: CEFC's Addressable Investment Universe



6.2 2018 Portfolio Vision Statement

The CEFC 2018 Portfolio Vision is set out in Figure 3: *2018 Portfolio Vision – Investment Components and Outcomes*. This vision defines what would constitute success in light of the mission of the CEFC and the nature of its Addressable Investment Universe. The Portfolio Vision is reviewed periodically.

Figure 3: 2018 Portfolio Vision – Investment Components and Outcomes

6.3 Investment Approach and Portfolio Guidelines

With its 2018 Portfolio Vision, 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 to a focus on emerging and innovative renewable technologies and energy efficiency, it may also invest in businesses that are related to renewable energy or energy efficiency technologies, such as the supply of goods or services which are an input to, or in some manner support, the deployment of such clean energy 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.

The CEFC Investment Policies have been devised with the statutory requirements of the CEFC's governing legislation in mind. 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's 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. Eligibility Constraints

The CEFC's ability to invest is limited by its governing legislation which, along with the Investment Mandate 2015 (No.2) issued by the responsible Ministers, sets out certain criteria that must be met for the opportunity to be eligible for investment (for more detail, see Eligibility Constraints, part 6.4). In addition to eligibility requirements, and a focus on emerging and innovative renewable technologies and energy efficiency, as well as cities and the built environment, the CEFC will also consider whether an investment proposal would generate any public policy outcomes, such as overcoming market failures or alleviating any 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 management approach of the CEFC and the implications of each potential investment decision for the 2018 Portfolio Vision (for more detail, see *Investment Screening and Selection*, part 6.6).

3. Portfolio Diversification Strategy

The tightly defined nature of CEFC's Addressable Investment Universe heightens the risk of concentrated positions within the CEFC's 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 6.9).

The Board reserves the right to invest selectively, within its discretion, and in accordance with its appetite for risk. Its decisions and approach are guided by the Investment Mandate 2015 (No.2) which stipulates CEFC investment activities will in aggregate "have an acceptable but not excessive level of risk relative to the sector", having regard to the terms of the CEFC Act and the focus areas outlined in the Investment Mandate 2015 (No.2).

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 renewable energy technologies which typically have a higher risk of potential capital loss.

Investment activities are reviewed in the CEFC Annual Report and in its Quarterly Investment Reports, which are published on the CEFC website.

6.4 Eligibility Constraints

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

- In "clean energy technologies", including businesses which support or service the clean energy technology sector; and
- Not a "prohibited technology"; and
- Are "solely or mainly Australian based"; and
- Take the form of a "financial asset" (which may include in limited circumstances, guarantees or derivatives); and
- 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. These guidelines are published on the CEFC website at:

   www.cleanenergyfinancecorp.com.au/submit-proposal/definitional-guidelines.aspx

The Board has also produced guidance on definitions for "Renewable Energy Technologies" and "Energy Efficiency Technologies". These guidelines are also available on the CEFC website using the link above.

Constraint 2 – Prohibited Technologies

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

Section 62 specifies prohibited technologies to be nuclear technology, nuclear power or carbon capture and storage. Accordingly, the CEFC cannot consider investments in these technology classes.

Constraint 3 – Solely or mainly Australian-based

Investments made by the CEFC must be solely or mainly Australian-based. Section 61 of the CEFC Act specifies that the Board must issue written guidelines setting out 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.at: www.cleanenergyfinancecorp.com.au/submit-proposal/definitional-guidelines.aspx

Constraint 4 – Eligible Financial Assets

The CEFC will invest only in Financial Assets which, although more broadly defined, will typically fall into the category of debt or equity securities.

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 any operating entity. The CEFC does not have mandate to operate businesses or assets, and as a corporate Commonwealth entity, special rules apply that restrict the acquisition of subsidiaries under the CEFC and PGPA Acts.

The term "Financial Assets" is defined under the CEFC Act in Sections 4 and 63 (2) and is drawn from the Australian System of Government Finance Statistics: Concepts, Sources and Methods. Figure 4: *Financial Assets*, sets out a summary of relevant elements.

Constraint 5 – Guarantees

Section 69 of the CEFC Act limits the CEFC's use of guarantees as part of its investment activity. In addition, the Investment Mandate 2015 (No.2) specifies that, where possible, the CEFC should seek to avoid the use of guarantees, but where any guarantee is made, the CEFC must ensure that all guarantees are limited and quantifiable. There is a statutory limitation on the issuance of guarantees.

Figure 4: 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 (e.g. cash and deposits; investments, loans and placements; accounts receivable; advances outstanding; equity).

All other assets are described as **non-financial assets** and include fixed assets (i.e. real estate and buildings), inventories, valuables (e.g. works of art) and non-produced assets (e.g. 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.

Please refer to Australian System of Government Finance Statistics: Concepts, Sources and Methods for more information.

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 or write derivative positions:

(i) To protect the value or returns of an investment;

(ii) To achieve indirect exposure to financial assets; or

(iii) For transactional efficiency.

The CEFC has been established for the purpose of addressing capital structuring solutions by investing in debt and equity instruments. 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.

Constraint 7 – Australian Industry Participation Plans

The Investment Mandate 2015 (No.2) specifies that the CEFC may only invest in projects with an Australian Industry Participation (AIP) Plan where such plans are required under the Australian Government's AIP Plan policy. AIP Plans are aimed at increasing opportunities for capable and competitive Australian and New Zealand small and medium sized enterprises (SMEs) to participate in major projects. Only investments of more than $20m involving material procurement or construction programs are required to have AIP Plans.

6.5 Permitted Investment Instruments

The CEFC may invest directly or indirectly and across the capital structure in publicly traded or privately held instruments such as:

- Senior Debt;
- Subordinated Debt;
- Preferred Equity / Convertible Debt;
- Common Equity;
- Interests in Pooled Investment Schemes, Trusts and Partnerships; and
- 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; and
- For guarantees, by a portfolio limit of 5% of the total amount credited to the Special Account under Section 46 of the CEFC Act.

6.6 Investment Screening and Selection

Upon establishing eligibility, the CEFC applies a commercially rigorous set of investment selection criteria in the evaluation of a prospective investment. A conservative investment approach is adopted which, while recognising CEFC's focus on emerging and innovative renewable technologies and energy efficiency reflects its public policy, mission and objectives.

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 agreements 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 the CEFC is more limited.

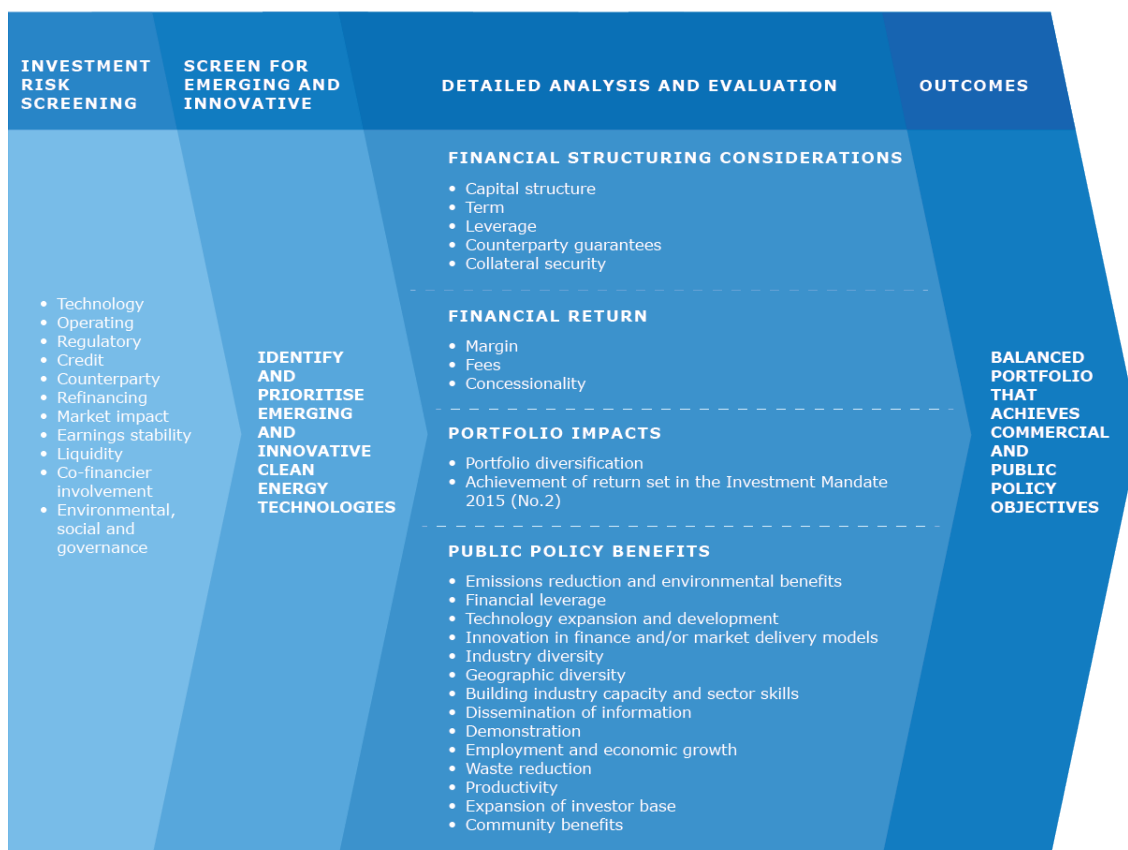
When evaluating investment opportunities, the CEFC must balance a conservative risk profile against the guidance provided by the Explanatory Statement to the Investment Mandate 2015 (No.2) that: "The Corporation shall support policies such as the Renewable Energy Target, to mobilise and leverage the flow of funds for commercialisation and deployment of renewable energy, low emissions and energy efficiency technologies necessary for Australia's transition to a lower carbon economy."

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 5: *Investment Screening Process.*

While the CEFC will employ 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 (e.g. renewable energy versus energy efficiency) as well as within sectors (e.g. wind v solar) and across individual investment proposals (e.g. conservative v 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 CEFC's satisfaction, the investment will not proceed.

Figure 5: Investment Screening Process



Investment Risk Screening

The CEFC is exposed to **counterparty risk** associated when extending finance to other parties. This 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** associated with a general fall in prices of energy and in particular, a fall in realised (as compared to expected) prices for both "green" and "black" 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 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 includes regulatory risk associated with the use of the particular technology. Assessment, analysis and mitigation for technology risk is a key component of the CEFC's 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 the CEFC's 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 an intended investment – all of which are designed to enhance and protect the CEFC's position.

Financial Structuring Guidelines

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:

The Underwriting Guidelines may propose applying **Capital Structure** rebalancing measures in the form of underperformance "triggers" that result in accelerated repayments of capital based on certain financial KPIs (key performance indicators).

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 to hold **Collateral Security.**

Focus on Emerging and Innovative Renewable Technologies and Energy Efficiency

The Investment Mandate 2015 (No.2) directs CEFC to have a focus on emerging and innovative renewable technologies and energy efficiency, with particular reference to large-scale solar, storage associated with large and small-scale solar, offshore wind, and energy efficiency technologies for cities and the built environment.

The CEFC therefore looks to identify and promote projects that involve these emerging and innovative technologies and/or energy efficiency, whilst also recognising the level of risk typically associated with these types of projects and their impact on the CEFC's overall *"reasonable level of portfolio risk"* as specified in the Investment Mandate 2015 (No.2)

Public Policy Outcomes

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

Core public policy outcomes, over time, will have a cumulative impact across the sector, on carbon emissions and contribute to the task of accelerating Australia's transformation towards a more competitive economy in a carbon constrained world. 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 are achieved? In addition to reduced emissions, does the project have other environmental benefits? *(e.g. reduced air pollution)*
Financial leverage / catalyst	Direct – Does this transaction leverage additional capital from sources other than CEFC? Indirect – Is this transaction likely to be easily replicated elsewhere or have demonstration value? (e.g. green bonds where a number of banks are considering similar issuances)
Technology expansion and development (first wave)	Does this transaction help to prove up a new and emerging technology or fund a commercially-viable pilot program (e.g. funding for wave power generation technology)?
Dispersion and take-up (second wave)	Does this transaction help to 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? (e.g. large-scale solar projects which grow the installation ecosystem and improve the experience curve; residential storage battery products which are proven commercially but not yet widely used in households)
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 funds 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 rural or regional area of Australia?
Building industry capacity and sector skills	Will this transaction involve and help develop the Australian market? (e.g. for engineering, manufacturing, services, sector or other supply chain inputs)
Dissemination of information	Will the project help de-risk/reduce the cost for similar transactions in the future?
Demonstration	Will this project provide a demonstration that others in the sector can follow? (e.g. after first anaerobic digester installation in agriculture, a number of businesses in similar industries saw how this worked and followed suit)
Employment / economic growth	Will this project create future employment in construction installation or ongoing operation?
Waste reduction	Does this transaction reduce or reuse waste? (e.g. municipal, industrial)
Productivity	Does this project deliver wider productivity gains for business in addition to energy cost savings? (e.g. if energy efficient equipment also reduces time to produce output)
Expansion of investor base	Does this transaction expand the clean energy investor base? (e.g. co-financier has never invested in Australian clean energy market or has only invested in wind and will now invest in waste-to-energy; or an co-financier who has provided only finance debt in the clean energy market and will now provide equity finance).
Community benefits	Does this project have a community engagement program or generate some public good for the community?

6.7 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 benchmark set out in the Investment Mandate 2015 (No.2);
- The CEFC Act with its dedicated special appropriation and the Investment Mandate 2015 (No.2) 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's 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 2015 (No.2), 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 CEFC's purpose is to facilitate investment flows into the clean energy sector. It is not to displace or substitute existing investment flows;
- 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 sector;
- The CEFC's 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, or 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 the 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 6: *Investment Selection and Approval Process*. It involves three phases of assessment of opportunities, including eligibility tests. A given opportunity typically passes each stage before it advances to the next.

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

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

- How does the opportunity fit within the CEFC's investment objectives and on what basis was eligibility determined?
- Does the investment contribute to the CEFC's focus on emerging and innovative renewable technologies or energy efficiency?
- Why is the involvement of the CEFC required?
- 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 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.

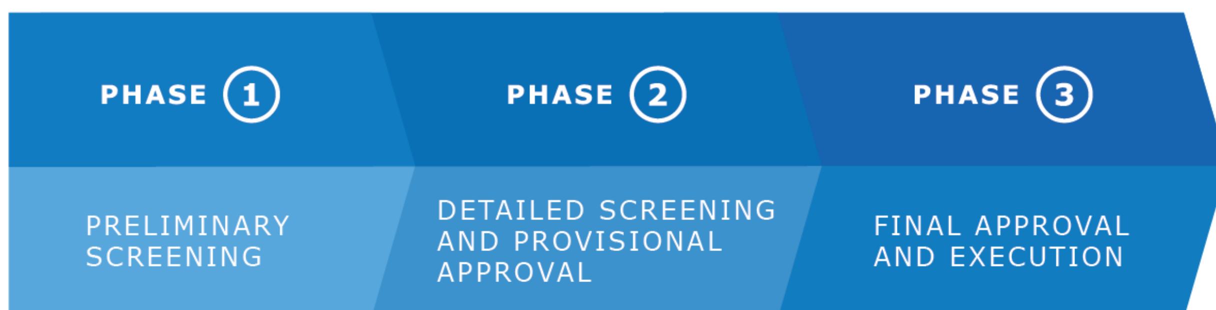
This process involves the identification of key risk areas, financial modeling and further external due diligence analysis of technical, legal and financial risks. Within this phase, detailed investment terms and conditions designed to mitigate the key risks are developed in conjunction with project 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, the Investment Mandate 2015 (No.2) and the 2018 Portfolio Vision.

Figure 6: Investment Selection and Approval Process



6.8 Portfolio Benchmark Return and Risk Profile

The Investment Mandate 2015 (No.2) sets a benchmark rate of return for the portfolio based on a weighted average calculation of the five-year Australian Government bond rate plus 4-5%, calculated before CEFC operating costs.

The CEFC is required to target this benchmark return over the medium term while not increasing the level of portfolio credit risk above a reasonable level having regard to the terms of the CEFC Act and the focus areas specified in the Investment Mandate 2015 (No.2).

6.9 Portfolio Diversification and Risk Management Strategy

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 specifies certain Mandatory Portfolio Limits. These are set out in Table 2: *Mandatory Portfolio Limit.*

The CEFC 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 are:

1. 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 the focus areas specified in the Investment Mandate 2015 (No 2); and
2. To 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.

Portfolio Limits and Guidelines

The portfolio strategy of the CEFC incorporates the following mandatory requirements of the Investment Mandate 2015 (No.2) and the CEFC Act in Table 2: *Mandatory Portfolio Limit.*

Table 2: Mandatory Portfolio Limit

Measure	Limit
Renewable energy requirement	From 1 July 2018, no less than 50%
Guarantees	5% maximum limit
Concessional loans	$300m annual NPV Limit each year
Derivatives	Only to: (i) protect the value of investments (ii) achieve indirect exposure to financial assets (iii) for transactional efficiency
Exposure to credit risk	A reasonable level having regard to the terms of the Act and the focus on emerging and innovative renewable energy technologies reflected in the Investment Mandate 2015 (No.2)

In addition, the Board has established a set of portfolio diversification and construction guidelines which also guide its investment approach as the CEFC portfolio evolves and grow. This is outlined in Table 3: *Board Portfolio Diversification and Construction Guidelines.*

Table 3: Board Portfolio Diversification and Construction Guidelines

Measure	Guideline
Preferred minimum CEFC investment size	$20m*
Maximum individual transaction size	$200m, or 10% of the amount credited to the CEFC Special Account
Concentration of technology, industry or state geography	No more than 30%
Security type	Appropriate mix of debt and equity instruments reflective of the CEFC's overall target portfolio risk

*The preferred minimum CEFC investment size of $20m is considered appropriate for renewable energy technology investments. In order to address smaller transactions and the SME market, the CEFC preference is to establish pooled financing and partnership strategies which leverage the larger market reach of financial intermediaries such as fund managers and commercial banks.

6.10 Other Mandate Requirements

The Investment Mandate 2015 (No.2) also requires 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; and
- Have regard to, and adopt policies in respect of, best practice principles in environmental, social and corporate governance.

7 Environmental, Social and Governance Risk Management

The Explanatory Statement for the Investment Mandate 2015 (No.2) states that:

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

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

In particular, the Board believes that there is a positive relationship between good governance and good investment returns.

The Board believes that improving the stability, transparency and efficiency of the markets in which it operates goes hand-in-hand with the CEFC's commercial and public policy objectives, namely to address financing impediments and market failures, as well as maintaining its reputation as a responsible and respected long-term investor.

Accordingly, the Board will act as any prudent investor would in seeking to encourage the adoption of good governance practices within the CEFC itself as well as in the businesses and projects in which it invests.

While the CEFC is not expected to invest heavily in traditional investment assets such as public equities where it would have the potential to exert the most influence, the Board believes that it can play a role nonetheless in advancing good practices for institutional investment, contributing to system integrity, protecting investor rights and building new markets.

Appendix 1 –Investment Mandate Direction 2015 (No.2) and Explanatory Statement

Clean Energy Finance Corporation Investment Mandate Direction 2015 (No.2)

We, GREG HUNT, Minister for the Environment, and MATHIAS HUBERT PAUL CORMANN, Minister for Finance, give this direction under subsection 64(1) of the *Clean Energy Finance Corporation Act 2012*.

Dated 3 December 2015

GREG HUNT	MATHIAS HUBERT PAUL CORMANN
Minister for the Environment	Minister for Finance

Part 1 Preliminary

1. Name of Direction

This direction is the *Clean Energy Finance Corporation Investment Mandate Direction 2015 (No.2)*.

2. Commencement

This direction commences on the day after it is registered (on the Federal Register of Legislative Instruments).

Note: Section 42 of the *Legislative Instruments Act 2003* (which deals with the disallowance of legislative instruments) does not apply to this instrument: see section 44 of that Act. Part 6 of that Act (which deals with the sunsetting of legislative instruments) does not apply to this instrument: see section 54 of that Act.

3. Revocation of Previous Direction

The *Clean Energy Finance Corporation Investment Mandate Direction 2015* issued on 17 February 2015 is revoked in full.

4. Definitions

In this direction:

Act means the *Clean Energy Finance Corporation Act 2012*.

Board, Corporation and ***responsible Ministers*** have the same meaning as in the Act.

5. Purpose of this direction

The purpose of this direction is to give guidance to the Board in relation to the performance of the Corporation's investment function. The Corporation is required under section 58 of the Act to invest in clean energy technologies subject to its other obligations under the Act and any directions given by the responsible Ministers under subsection 64(1) of the Act.

This direction is given under subsection 64(1) of the Act.

Part 2 Direction

6. Introduction

The Corporation is a mechanism to help mobilise investment in renewable energy, low-emissions and energy efficiency projects and technologies in Australia, as well as manufacturing businesses and services that produce the required inputs. The Corporation will invest at the demonstration, commercialisation and deployment stages of innovation. The Corporation has been established to finance Australia's clean energy sector using financial products and structures to address the barriers inhibiting investment.

The intention of the Corporation is to apply commercial rigour when making its investment decisions. The Corporation will have regard to its potential effect on other market participants when considering investment proposals. In line with its policy intent, the Corporation should have regard to positive externalities and public policy outcomes when making investment decisions and when determining the extent of any concessionality for an investment.

7. Portfolio Benchmark Return

The Board is to adopt an average return of at least the five–year Australian Government bond rate + 4 to + 5 per cent per annum as the benchmark return of the portfolio. Performance against this benchmark will be measured before operating expenses.

In targeting the benchmark return and operating with a commercial approach, the Corporation will seek to develop a portfolio, subject to clauses 13 and 14, across the spectrum of clean energy technologies that in aggregate must have an acceptable but not excessive level of risk relative to the sector.

8. Portfolio Risk

In targeting the Portfolio Benchmark Return, the Board must not increase the level of exposure to credit risk above a reasonable level having regard to the terms of the Act and the focus on emerging and innovative clean energy technologies reflected in this direction. Within six months of the date of this direction the Board should agree a suitable investment risk evaluation process to assess the risk and advise the responsible Ministers of the process chosen.

The Board is to periodically review its investment practices for the purposes of managing the risk of the portfolio over time and must advise the responsible Ministers of specific measures taken in this regard.

9. Limits on Concessionality

The Corporation must limit the amount of concessionality it provides in any one financial year to $300 million.

Concessionality reflects the mark-to-market valuation of loans made that financial year and should be measured as the difference between the present value of each loan at market rates and the present value of each loan at the given concessional rate.

10. Limits on Guarantees

Guarantees pose a particular risk to the Commonwealth's balance sheet and, as such, restrictions on their use are appropriate and the Corporation should seek to avoid their use where possible. The Corporation must ensure that all guarantees are limited and quantifiable.

At no time may the total potential liability under outstanding guarantees exceed the amount of the uncommitted balance of the Clean Energy Finance Corporation Special Account. The Corporation must also ensure the total value of guarantees at any time does not exceed 5% of the total amount that has been credited to the Special Account under section 46 of the Act.

11. Application of Australian Industry Participation Plans

Australian Industry Participation (AIP) Plans must apply to projects that the Corporation invests in, in accordance with the Government's AIP Plan policy.

12. Corporation must consider impacts from its investment strategy

In undertaking its investment activities, the Corporation must consider the potential effect on other market participants and the efficient operation of the Australian financial and energy markets.

The Corporation must not act in a way that is likely to cause damage to the Australian Government's reputation.

13. Corporation's activities to focus on emerging and innovative clean energy technologies, energy efficiency, and the built environment

As part of its investment activities in clean energy technologies, the Corporation must include a focus on supporting emerging and innovative renewable technologies and energy efficiency, such as large scale solar, storage associated with large and small-scale solar, offshore wind technologies, and energy efficiency technologies for cities and the built environment. This will in turn increase the uptake of emerging technologies such as large scale solar and energy efficiency.

This direction does not require the Corporation to divest investments that were in place prior to the date of this direction.

14. Corporate Governance

In performing its investment function, the Corporation must have regard to Australian best practice in determining its approach to corporate governance principles.

The Corporation must develop policies with regard to environmental, social and governance issues.

EXPLANATORY STATEMENT – CLEAN ENERGY FINANCE CORPORATION INVESTMENT MANDATE DIRECTION 2015 (No 2)

Purpose of the Direction

Under the *Clean Energy Finance Corporation Act 2012* (the 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 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 of the Corporation (Board).

Under the Act 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 Act and to any directions given by the responsible Ministers under subsection 64(1). Directions issued under subsection 64(1) of the Act are known collectively as the Investment Mandate.

Direction

Introduction

The Corporation will support policies such as the Renewable Energy Target, to mobilise and leverage the flow of funds for commercialisation and deployment of renewable energy, low-emissions and energy efficiency technologies necessary for Australia's transition to a lower carbon economy.

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. In achieving this aim the Government has the expectation that the Board will take a medium-term outlook 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.

Portfolio Benchmark Return

For the purpose of this Investment Mandate, the Government has directed the Board to adopt a Portfolio Benchmark Return for the performance of funds invested by the Corporation based on the five-year Australian Government bond rate.

For each investment, an individual reference rate will first be calculated using the five-year Australian Government bond rate plus 4 to 5 per cent.

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 Portfolio Benchmark Return will then be determined by taking the series of individual reference rates and weighting them for each investment.

The Portfolio Benchmark Return is a medium-term target and expected to be earned across the portfolio and over a period of time. 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 factors.

Performance against this 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 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.

The Government is committed to developing the clean energy sector and it has established the Corporation to invest for the long term. Therefore the Investment Mandate establishes long-term portfolio performance measures.

Portfolio Risk

In targeting the Portfolio Benchmark Return, the overall level of risk of the Corporation's portfolio must not increase above a reasonable level having regard to the terms of the Act and the focus on emerging and innovative clean energy technologies reflected in the direction.

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.

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 within six months of the Investment Mandate being given.

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. Concessional loans have a negative impact on the fiscal balance. The Corporation is therefore limited to providing $300 million of concessionality in any one financial year.

A concessional loan is a loan provided on more favourable terms than the borrower could obtain in the marketplace. The concession provided may be in many forms but typically will be in 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 Resource Management Guide No 115 Accounting for concessional loans provides further information on calculating the amount of concessionality as well as worked examples.

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 Act and the Investment Mandate impose restrictions on their use. To limit any risk the Corporation must ensure that all guarantees are limited in nature and quantifiable.

The Act requires the Corporation to maintain sufficient uncommitted balance in the Clean Energy Finance Corporation Special Account to meet any potential liabilities in issuing a guarantee. In addition the Investment Mandate limits the amount of guarantees the Corporation can issue to 5 per cent of the total amount that has been credited to the Special Account under Section 46 of the Act.

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.

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.

Given at least half of the Corporation's investments must be in the renewable energy sector by 1 July 2018, 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 owned 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.

Corporation's activities to include focus on emerging and innovative clean energy technologies, energy efficiency, and the built environment

The Government has directed the Corporation to include, as part of its investment activities in clean energy technologies, a focus on supporting emerging and innovative renewable technologies, energy efficiency, storage associated with solar, and energy efficiency technologies for cities and the built environment. These projects will support the Government's innovation agenda and improve the liveability of our cities and the built environment.

The Government has also directed the Corporation to include, as part of its investment activities in clean energy technologies, a focus on offshore wind technologies.

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 requirements are intended to increase the uptake of emerging technologies such as large scale solar and energy efficiency.

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.

Corporate governance

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

Commencement

This direction commences on the day after it is registered.

Consultation

The Board was consulted on the investment mandate in accordance with section 66 of the Act.

The Office of Best Practice Regulation assessed that the impact of the changes made by the investment mandate are minor and do not require a Regulation Impact Statement
(OBPR ID: 20102).

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