



# CEFC INVESTMENT POLICIES

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February 2019



## ABOUT THIS DOCUMENT

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](http://www.cefc.com.au)

## ABOUT THE CEFC

The CEFC is responsible for investing \$10 billion in clean energy projects on behalf of the Australian Government. Our goal is to help lower Australia's carbon emissions by investing in renewable energy, energy efficiency and low emissions technologies. We also support innovative start-up companies through the Clean Energy Innovation Fund. Across our portfolio, we deliver a positive return for taxpayers.

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# 1 INTRODUCTION

The Clean Energy Finance Corporation (“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* (Cth) (the “CEFC Act”) and the *Clean Energy Finance Corporation Investment Mandate Direction* (the “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* (Cth) (the “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. It 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’s 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 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.

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. 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; and
- Fulfilling the CEFC’s public policy objective.

## 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; and
- d) A matter specified in the regulations.”

These Investment Policies are formulated under Section 68 of the CEFC Act and this version of the policy document became effective on 15 June 2017 when it was approved by the Board.

Under Section 68 (5) of the CEFC Act, these Investment 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 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 CEFC’s investment function.

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

The current Investment Mandate, along with the related Explanatory Statement, can be found here:

<https://www.legislation.gov.au/Details/F2018L01768>

## 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'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, 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.

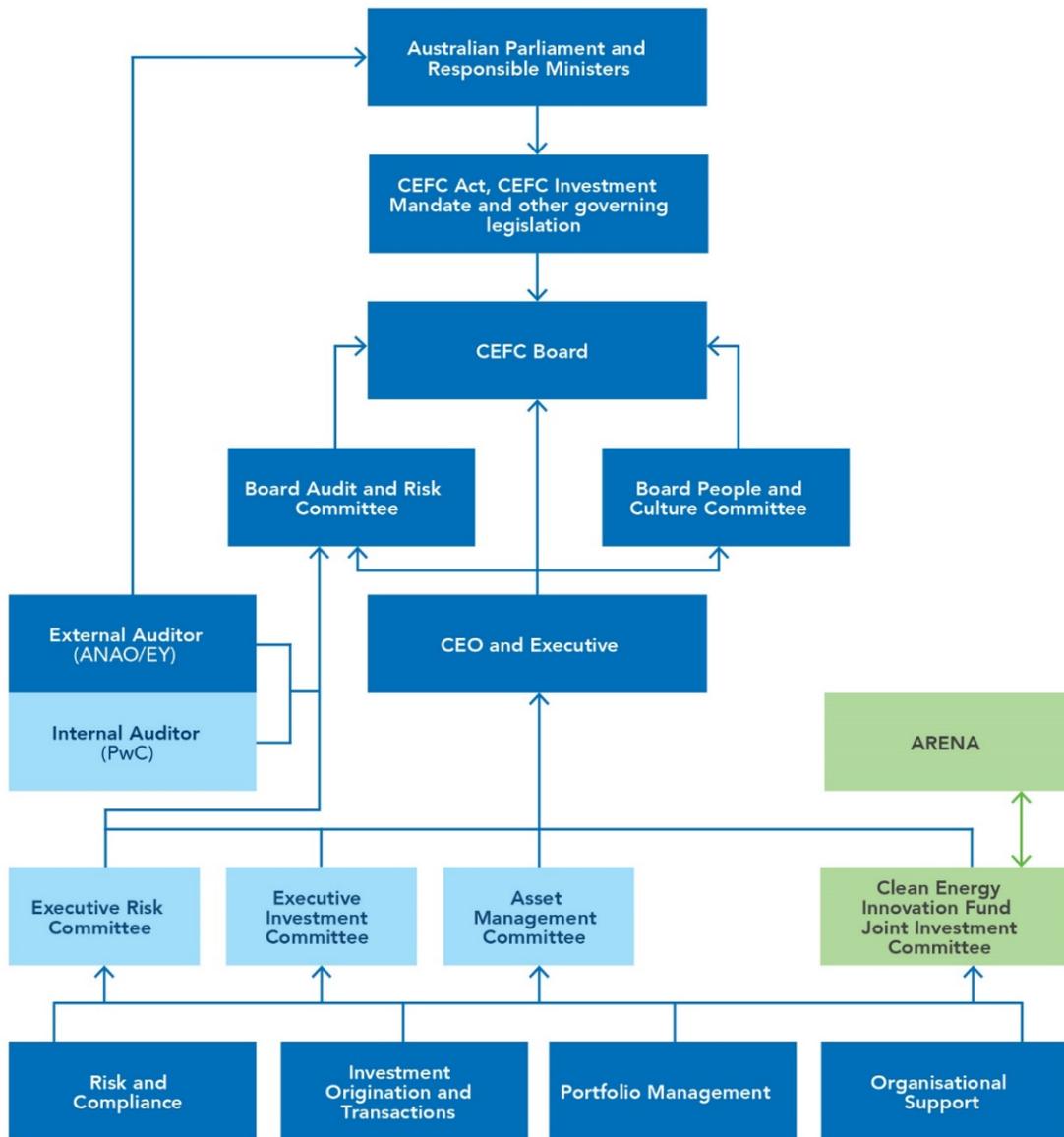
Furthermore, the Board may establish committees to advise or assist in the performance of the Board's or the Corporation's functions. The ultimate responsibility for any exercise of power remains with the Board.

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: *CEFC Corporate Governance Framework*.

Figure 1: CEFC Governance Approach



### 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, 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 the Asset Management Committee (AMC) to oversee the Portfolio Management function. The AMC has responsibility for 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'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 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 and ARENA. The purpose of the JIC is to provide objective oversight of the Innovation Fund's investment evaluation, selection, execution and portfolio management processes and, in so doing, providing 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 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 the Board to 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 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's 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 the CEFC's 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 principles that they will follow in seeking to achieve those objectives.

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

The CEFC mission is available on the CEFC website: [www.cefc.com.au](http://www.cefc.com.au)

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 investments in other complying investments. The Investment Mandate may also direct the CEFC to include a focus on specific theme(s) for example sectors, technologies or stage of commercial development.

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 Addressable Investment Universe

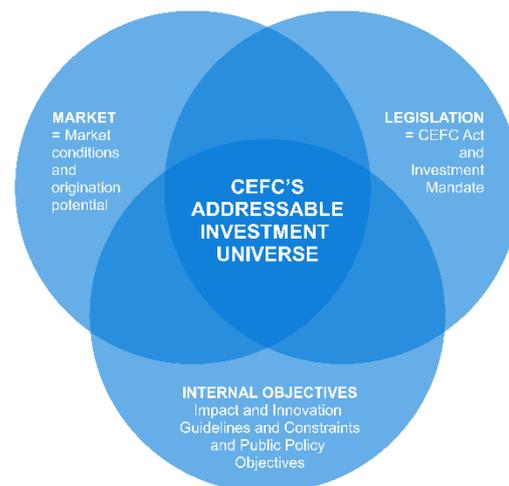
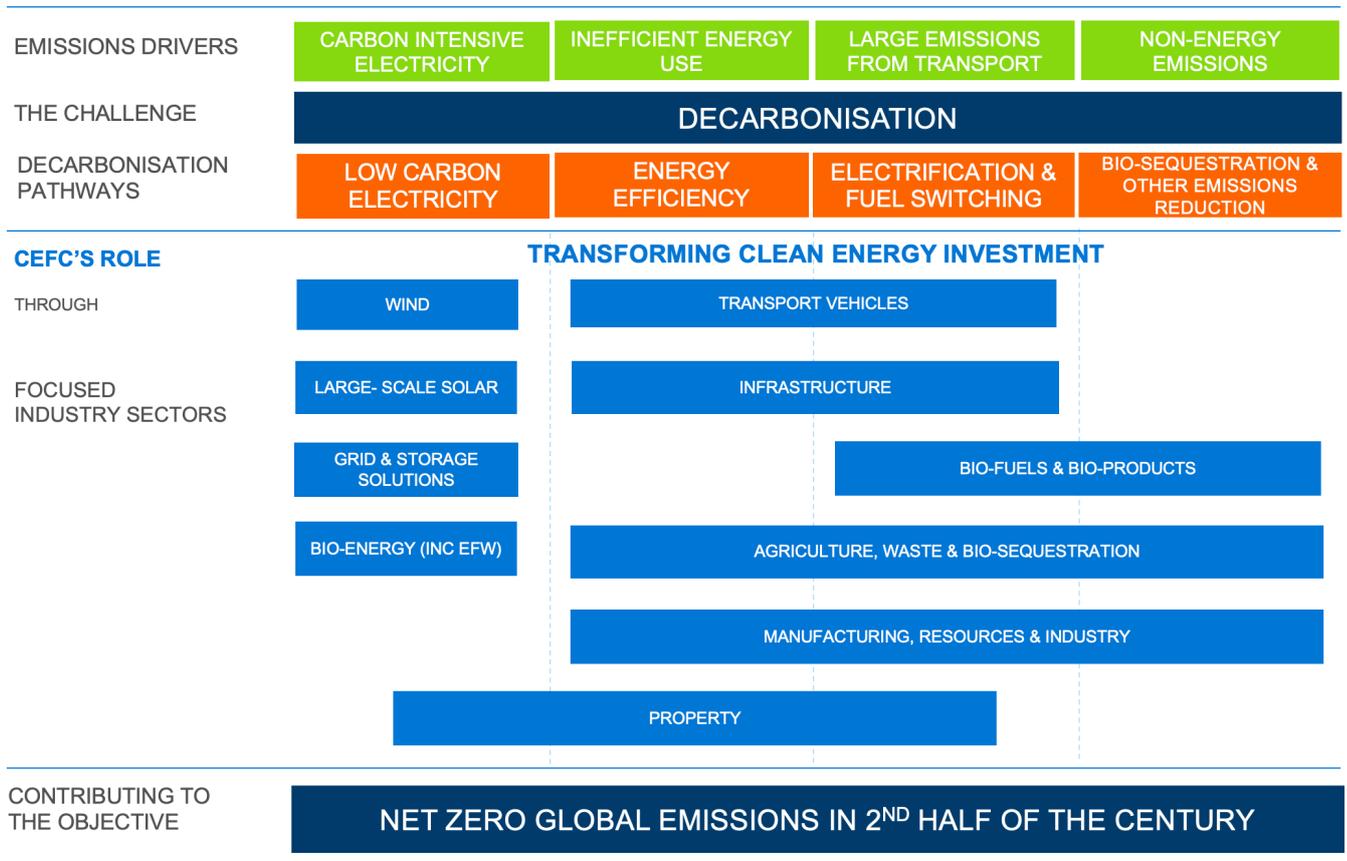


Figure 3: Investment Origination Framework



## 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 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. COMPLYING INVESTMENT CRITERIA

The CEFC's 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 this 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 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 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 6.8).

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 reviewed in the CEFC Annual Report and Quarterly Investment Reports, which are published on the CEFC website: [www.cefc.com.au](http://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; 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.

The Board has also produced guidance on the terms for “Renewable Energy Technologies” and “Energy Efficiency Technologies”. These guidelines are on the CEFC website: [www.cefc.com.au](http://www.cefc.com.au)

### 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 61 of the CEFC Act specifies that the Board must make 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: [www.cefc.com.au](http://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 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.

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 restrict the acquisition of subsidiaries under the CEFC and PGPA Acts.

### CONSTRAINT 5 – GUARANTEES

Section 69 of the CEFC Act limits the CEFC’s use of guarantees as part of its investment activity. 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.

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.

### 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:

- (i) To protect the value or returns of an investment;
- (ii) To achieve indirect exposure to financial assets for a purpose in connection with CEFC’s investment function; or
- (iii) For transactional efficiency for a purpose in connection with CEFC’s investment function.

The CEFC exists for the purpose of addressing capital shortfalls by funding investments. 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; 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.

## 6.5 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 CEFC's public policy purpose, mission and objectives.

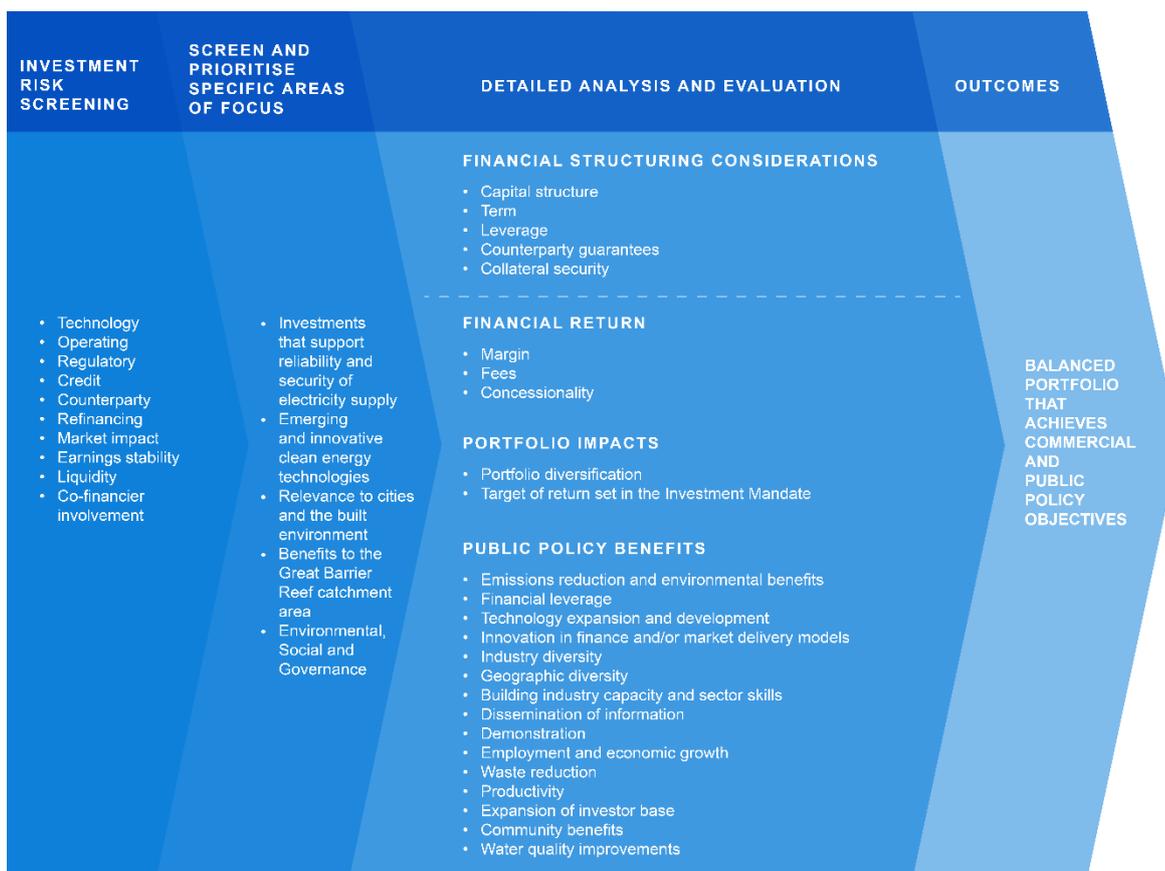
Screening of investments is focused on identifying a series of characteristics which are likely to be highly predictive of the stable, cash flow generative investments that would match the conservative risk profile of the CEFC. For example, in the electricity generation sector, assets with a long term 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 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 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 versus solar) and across individual investment proposals (e.g. 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 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. 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 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 (eg, 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 intended prospective 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:

- Where appropriate, **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 may also direct the CEFC to include a focus on specific theme(s) for example sectors, technologies or stage of commercial development (for more detail, see *Other Requirements*, part 6.9).

## 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

<b>Emissions reduction and environmental benefits</b>	What emissions reductions are achieved? In addition to reduced emissions, does the project have other environmental benefits? (e.g. reduced air pollution)
<b>Financial leverage / catalyst</b>	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. climate bonds where a number of institutions are considering similar issuances)?
<b>Technology expansion and development</b>	Does this transaction help to prove up a new and emerging technology or fund a commercially-viable pilot program?
<b>Dispersion and take-up</b>	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?
<b>Innovation in finance and/or market delivery models</b>	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?
<b>Industry diversity</b>	Is this transaction in an industry sector where the CEFC hasn't already committed finance?
<b>Geographic diversity</b>	Is this transaction in a less populated state/territory, rural or regional area of Australia?
<b>Building industry capacity and sector skills</b>	Will this transaction involve and help develop the Australian market (e.g. for engineering, manufacturing, services, sector or other supply chain inputs)?
<b>Dissemination of information</b>	Will the project help de-risk/reduce the cost for similar transactions in the future?
<b>Demonstration</b>	Will this project provide a demonstration that others in the sector can follow?
<b>Employment / economic growth</b>	Will this project create future employment in construction installation or ongoing operation?
<b>Waste reduction</b>	Does this transaction reduce or reuse waste (e.g. municipal, industrial)?
<b>Productivity</b>	Does this transaction deliver wider productivity gains for business in addition to energy cost savings?
<b>Expansion of investor base</b>	Does this transaction expand the clean energy investor base?
<b>Community benefits</b>	Does this project have a community engagement program or generate broader public benefits?
<b>Water quality improvements</b>	Does the project or business 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 benchmark 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'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, 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 mission is to facilitate 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'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, 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 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.

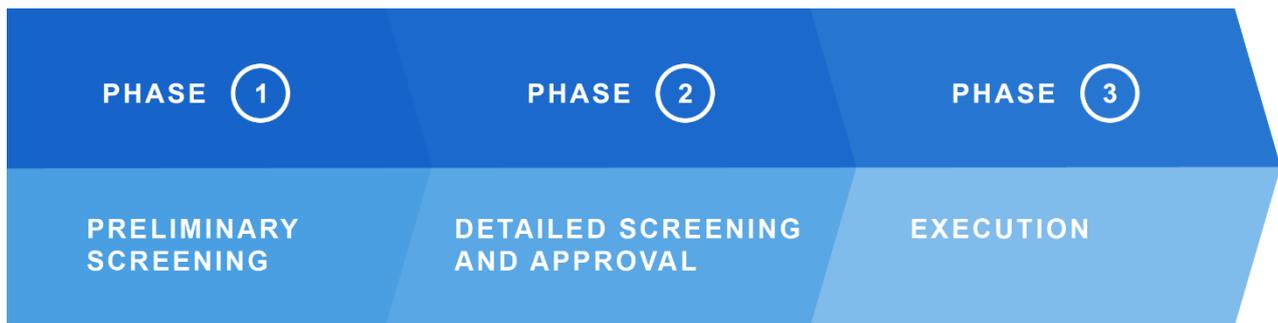


Figure 6: Investment Selection and Approval Process

**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 the CEFC’s 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 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, the Investment Mandate and the 2018 Portfolio Vision.

## 6.7 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 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 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 any focus areas specified in the Investment Mandate); 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.

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 grows. This is outlined in Table 3: *Board Portfolio Diversification and Construction Guidelines*.

Table 2: Mandatory Portfolio Limits

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
Exposure to portfolio risk	Acceptable but not excessive level of risk across the aggregate portfolio

Table 3: Board Portfolio Diversification and Construction Guidelines

MEASURE	GUIDELINE
<b>Preferred minimum CEFC investment</b> <b>– Renewable Energy</b>	<b>\$20m*</b>
<b>Maximum individual transaction size</b>	<b>\$200m, or 10% of the amount credited to the CEFC Special Account</b>
<b>Concentration of technology, industry or state geography</b>	<b>No more than 30%</b>
<b>Security type</b>	<b>Appropriate mix of debt and equity instruments reflective of the CEFC’s overall target portfolio risk</b>

*\*The preferred minimum CEFC investment size of \$20m is considered appropriate for renewable energy technology investments, but not including the Clean Energy Innovation Fund. In order to address smaller transactions and the SME market, the CEFC preference is to establish pooled financing and programs strategies which leverage the larger market reach of financial intermediaries such as 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 livability 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.

## 7 ENVIRONMENTAL, SOCIAL AND GOVERNANCE RISK MANAGEMENT

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's 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 CEFC's commercial and public policy objectives, namely to address financing impediments and market failures, as well as maintain its reputation as a responsible and respected long-term investor.

Accordingly, the CEFC 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.

The CEFC can play a role in advancing good practices for institutional investment, contributing to system integrity, protecting investor rights and building new markets.

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