Australian Government

CEFC Approach to Risk Management

November 2021

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

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1. CEFC approach to risk management

The CEFC monitors and manages strategic, investment, financial, operational, and regulatory risks, consistent with section 68 of the CEFC Act. We have appropriate tolerance for the risks necessary to deliver on our statutory and strategic objectives. We do not accept risks that compromise the integrity of the organisation.

The CEFC Board has oversight of risk management, supported by the Audit and Risk Committee and the Executive Committees. Central to effective risk management is recognition that the CEFC does not accept risks that may compromise the integrity of the organisation.

The CEFC Code of Conduct and Ethics shapes the CEFC risk culture, setting the required standards of behaviour for the Executive and staff consistent with the highest professional and ethical standards. This includes requiring CEFC personnel to consistently consider "should we" act as distinct from "can we" act.

2. Risk culture

We promote a risk aware culture where:

- our people are required to conduct themselves in a manner consistent with the highest professional and ethical standards;
- we consistently consider "should we" do things and not just "can we" do things;
- our incentive and reward systems are structured to encourage behaviour consistent with our risk appetite and do not reward excessive risk taking;
- we empower our people to the full extent of their abilities and hold them accountable for their actions;
- we seek to apply leading practices in identifying, assessing, managing, and pricing risk; and
- we invest in our risk management capabilities, including implementing cost effective controls.

3. Risk management framework

Consistent with section 68 of the CEFC Act, the CEFC Board has established an integrated approach to risk management, founded on a Risk Management Framework (RMF), to monitor and manage strategic, investment and financial, reputational, operational and regulatory risks. This framework uses a "three lines of defence" model, with responsibility across all staff, the independent CEFC credit risk function and internal audit process.

The RMF recognises the fundamental linkage between strategic objectives and the impact that uncertainty (or risk) may have on the achievement of those objectives and more importantly, the performance of the CEFC. The RMF promotes a holistic approach to managing risk, starting with strong governance structures that promote transparent decision-making, guided by a well-developed and well-executed strategy that remains cognisant and informed about the risks embedded in that strategy.

4. Risk appetite statement

The Risk Appetite Statement (RAS) is the key operational document that facilitates the RMF. The RAS goes to the heart of how the CEFC pursues its strategic objectives and the types of investments it considers. The RAS also sets out the risk limits (or tolerances) that are applied to both financial and non-financial consequences of accepting the risks outlined in the RAS.

The CEFC, as with any prudent investor or financier, must take risks to achieve returns. For the CEFC, a heightened level of risk, beyond what is deemed acceptable by a commercial financier, may be appropriate in specific circumstances in pursuit of broader public policy objectives. In contrast to some other investors, the CEFC has limited opportunities to diversify its portfolio by sector, particularly given the requirement to have at least 50 per cent of the portfolio invested in renewable energy technologies from 1 July 2018, thereby concentrating exposure in the clean energy sector.

5. Role of the CEFC investment committees

Due diligence is a key feature of CEFC's risk assessment with respect to investment decisions considered by the CEFC investment committees:

1. Transaction teams are required to review, screen and develop structures to mitigate potential financial and reputational risks that may be associated with proposed investments

2. The Chief Risk Officer/Credit team independently review and challenge this risk assessment and ensure that the proposed investment is consistent with the RAS, Investment Policies and risk limits and guidelines

3. Investment Committees then make a case-by-case assessment of the merits of proposed investments, their assessed risk, and their returns.

6. Markets trends and risk

The CEFC works closely with other investors, businesses, and project developers to achieve emissions reduction. In investing to accelerate the decarbonisation of the Australian economy, we seek to address market gaps and financing impediments. As a specialist investor, we operate in a rapidly changing market environment, with policy, technology and changing capital markets offering challenges and opportunities. These factors are among the key matters considered as part of our risk management processes.

6.1 Investor trends

The marked shifts in energy policy, technology and market dynamics are driving an unparalleled shift in the investor approach to clean energy investments. Increased capital availability is occurring alongside increased regulatory scrutiny with climate reporting and disclosure of increasing importance to investors and regulators, both globally and in Australia.

6.2 Finance market dynamics

With debt finance accounting for some 75 per cent of the CEFC investment portfolio, we closely monitor finance market dynamics which may impact the ability of borrowers to repay principal and interest. Credit risk is influenced by a number of external factors, including general economic conditions and developments specific to particular industries.

6.3 Energy market dynamics

Despite the welcome trends in emissions and renewable energy, delivery of the generation, energy storage and transmission needed to accommodate the exit of ageing coal-fired generation poses a very substantial and sustained investment task. Delivery of upgraded grid transmission infrastructure is becoming more necessary to transport increasing flows of new low-cost renewables generation and storage to businesses and communities. In addition, the accelerated adoption of rooftop solar is driving an enhanced focus on demand management solutions, including virtual power plants and distribution network solutions.

6.4 Technology advances

The market has seen profound advances in low emissions technology solutions, across multiple sectors of the economy. Established technologies, such as large-scale renewables, are benefiting from the introduction of more large-scale, efficient and higher performing models, while rapid improvements in battery technologies are seeing large-scale storage become an increasingly important and competitive part of the energy system. A global shift to low carbon transport is gathering pace, from freight infrastructure to the increased uptake of electric vehicles, creating diverse investment opportunities in rail, hydrogen production and charging infrastructure. The growing focus on embodied carbon and Scope 3 emissions is driving the adoption of low carbon construction materials, while advances in on-farm management are accelerating innovation in soil carbon and bio-sequestration.

6.5 Global influences

As a mature industrialised economy, global investment flows play a critical role in Australia's emissions transition, reflecting both the strength of the national economy and the scale of the national emissions challenge. Increasingly, CEFC capital is working alongside that of global institutional investors and experienced large-scale project developers. This includes bringing established technologies to Australia as well as capitalising on emerging areas such as hydrogen and cleantech innovation, including soil carbon, measures to address embodied carbon and innovative demand management solutions. Increasingly, global investor sentiment is being influenced by evolving international regulatory and disclosure regimes with respect to both climate risk and ESG investment exposures.

About the CEFC

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