

Australian financial institutions' views on climate and clean energy opportunities in South and Southeast Asia

Market Assessment Report



November 2024

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About the Australian Sustainable Finance Institute

The Australian Sustainable Finance Institute is a not-for-profit organisation with a mission to align the Australian financial system with a sustainable, resilient, and inclusive Australia. ASFI was established in July 2021 to coordinate and drive implementation of the Australian Sustainable Finance Roadmap. We work collaboratively across the financial sector, government, regulators, civil society and academia. Our members are Australian banks, asset owners, asset managers, insurers and financial services companies who are committed to ASFI's vision and willing to contribute to sustainable and impactful solutions.

Recognising that Australia's prosperity and sustainability is deeply connected with that of the Asia-Pacific, ASFI's work extends beyond Australia's shores into the region. We are pleased to partner with the Department of Foreign Affairs and Trade to support the Australian Government's blended finance programming in the region as well as implementation of the Government's sustainable finance strategy.

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1 Executive summary

Published in September 2023, Australia's Southeast Asia Economic Strategy to 2040 underscores the opportunity and necessity of increasing Australian investment into Southeast Asia to underpin Australia's long-term security and prosperity. It finds that Australian investment is currently limited and makes recommendations to address a range of barriers to investment.

This report builds on the 2040 Strategy to provide a detailed analysis of the barriers faced by Australian financial institutions ("FIs") seeking to invest in or finance climate and clean energy activities in South and Southeast Asia (the "Target Region"). Findings are based on interviews with 11 large superannuation funds, fund managers, and banks. Six of the FIs interviewed have headquarters in Australia, while the other five are headquartered overseas with a substantial presence in Australia. Interviews were conducted by the Australian Sustainable Finance Institute (ASFI) for the Department of Foreign Affairs and Trade (DFAT).

The report considers the role of key levers for mobilising private sector capital and makes recommendations for what more the Australian Government can do to mobilise finance and investment for climate and clean energy into the Target Region.

1.1 Climate and clean energy is seen as a growth sector in Australia and in the region

All FIs interviewed have a strong interest in climate and clean energy. They expect opportunities in this area to increase both generally, and specifically in the Target Region given strong growth trajectories in those markets. Prospective sectors include large scale renewables, electric mobility and battery supply chains, distributed renewable generation, and cross-border energy transmission. Prospective countries in the Target Region include India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

All FIs interviewed have in place commitments to achieve net zero emissions by 2050, most have internal gender diversity targets, and many have specific targets for sustainable capital allocation. In part, climate and sustainable finance commitments are a response to expectations of key stakeholders such as customers, clients, members, and investors, but also reflect a view that climate-related risks and opportunities are increasingly important for business performance.

1.2 Australian FIs have limited exposure to South and Southeast Asia emerging markets

The level of interest in and exposure to climate and clean energy in the Target Region varies significantly among FIs interviewed. Most Australian-headquartered FIs have low exposure to the Target Region and are not proactively seeking to increase exposure. These FIs express discomfort with the risks associated with emerging markets. They consider that the returns of emerging markets are often not sufficient to justify the additional risk and transaction costs.

FIs interviewed that have headquarters outside of Australia typically have higher exposure to the Target Region and are actively seeking to increase exposure to climate and clean energy in these fast-growing emerging economies. These FIs typically have a strong local presence in the Target Region and are accustomed to navigating local regulatory systems and business approaches.

1.3 Perceptions of risk in the Target Region vary depending on existing exposure

FIs with limited exposure to the Target Region (and low appetite to increase exposure) cite a range of barriers to investing. These include geo-political, sovereign, legal and governance risks; currency risk; and physical climate risks. They also cite a lack of attractive opportunities with appropriate risk-adjusted returns and Australian regulatory barriers. Some suggested that the lack of local presence in these markets, and internal organisational culture, impact perceptions of risks in emerging markets.

FIs with existing exposure to and presence in the Target Region cite some of the same risks but tend to be more confident in their ability to manage emerging market risk. Key risks they identify include rapidly changing policy and regulation, as well as specific laws which prohibit or deter international capital in some jurisdictions.

There is also a limited pipeline of bankable assets and lack of scale (that is, few large or aggregated projects). For renewable energy projects, challenges to pipeline development include inadequate transmission infrastructure, permitting challenges and lack of credit-worthy electricity off-takers.

For FIs that do not have local deposit taking institutions to match their exposure, currency risk and lack of hedging options are barriers. Some FIs interviewed specifically identify the lack of robust climate and sustainable finance policies as a barrier to private capital.

1.4 FIs have mixed views on the role of public finance vehicles

FIs interviewed say that public finance vehicles such as export credit agencies, multi-lateral development banks and development finance institutions can play an important role in providing finance where there is not enough interest from private FIs. Some public vehicles are also helping to de-risk transactions, unlocking private sector capital through use of guarantees and other credit enhancement instruments. However, some FIs interviewed raise concerns that public vehicles sometimes compete with rather than “crowd-in” private sector capital.

1.5 Well-targeted direct Government intervention could help FIs to overcome barriers

Most FIs interviewed see a valuable role for Australian Government support to overcome some or all of the barriers they face investing in the Target Region. This could be through de-risking mechanisms such as blended finance (that is, de-risking through combining public and private capital) as long as this does not “crowd-out” private sector capital.

Some FIs suggest that Government could help overcome a lack of familiarity and on ground presence with the Target Region. For example, through support for due diligence, identification of high-quality local fund managers and investible opportunities, and advice on reputability of local service providers.

Some also suggest that the Australian Government has a role to play in supporting the development of climate and sustainable finance policies in the Target Region. Developing robust, common definitions for transition finance would help unlock capital to decarbonise high emitting sectors. Additionally, reform of certain Australian financial regulation could unlock further Australian participation in the region.



1.6 Recommendations to support institutional finance and investment in the Target Region

While there is interest from some Australian FIs to engage more on climate and clean energy opportunities in the Target Region, converting this interest to capital allocation at scale will require well-targeted and sustained Government intervention. This report makes recommendations for the Government to consider as it looks to build on existing actions under the Southeast Asia Strategy to 2040.

RECOMMENDATIONS

1. The Government, through the DFAT, should work in partnership with interested Australian FIs and appropriate intermediaries to design and test blended finance products utilising Australian Development Investments, the Private Infrastructure Development Group, and any other available mechanisms.¹
2. The Government, in particular DFAT, should ensure that Australian-supported public finance mechanisms are designed and operated in a way that crowds-in private sector finance and promotes additionality including by:
 - a. Developing and publishing additionality principles and guidance to ensure that finance provided by Australian public finance vehicles is “additional” to private sector finance.
 - b. Commissioning an independent review to assess strengths and weaknesses in Australia’s ability to mobilise Australian private sector capital through its existing public finance mechanisms and identify best practice models for “catalytic” finance vehicles.
3. The Government, in particular DFAT, should play an active role in efforts to improve the ability of MDBs, in particular the International Finance Corporation and the Asia Development Bank’s private sector operations department, to crowd-in private sector finance and to avoid crowding out private capital.
4. The Government through DFAT and relevant Australian public finance vehicles should continue to support Australian FIs to become more familiar with markets, regulatory systems, intermediaries, and blended finance models in the Target Region by:
 - a. Sharing institutional quality due diligence and project information from Australian Government investment vehicles with Australian FIs;
 - b. Connecting interested Australian FIs with local intermediaries such as fund managers and advisors, including through ongoing networking opportunities, roadshows, and other events (building on the Government’s successful Investor Missions);
 - c. Providing information and capacity building on local markets and regulation, as well as on blended finance models and providers, for Australian FIs interested in exploring opportunities in the region.
 - d. Encouraging Australian FIs to establish a local presence in Southeast Asia for example through employee secondments into Australia’s Deal Teams.
5. The Government, led by the Department of Treasury with DFAT, should continue to prioritise and scale up its support for the development of credible, inter-operable sustainable finance policy in the region including for transition finance.
6. The Government, led by the Department of Treasury, should examine Australian regulatory barriers that are inhibiting Australian investment and finance into Southeast Asia emerging markets for climate and clean energy. This could be done in parallel with a consideration of barriers to climate and clean energy finance in Australia.

2 Introduction

2.1 Context

This report was commissioned by Blended Finance and Investor Engagement Unit in the Australian Department of Foreign Affairs and Trade (DFAT) to provide market information on Australian financial institutions' intentions, interests, and capabilities to finance and invest in the net zero transition in Asia-Pacific emerging markets. Australia's [Southeast Asia Economic Strategy to 2040](#) published in September 2023 underscores the opportunity and necessity of increasing Australian investment into Southeast Asia. The rapidly growing economies of Southeast Asia are an important market for Australia's goods, services, skills and capital. Increased Australian economic integration and investment will help underpin Australia's prosperity, support supply chain diversification and management of geo-strategic competition, and contribute to the peace and prosperity of the region as a whole.

The Southeast Asia Economic Strategy found that Australian investment in Southeast Asia is underweight and made recommendations for how to encourage more Australian capital into the region. The Australian Government has already implemented a number of these recommendations, including establishing Deal Teams in the region to identify a pipeline of investment ready projects for Australian investment in the region. In March 2024, the Government announced a new \$2 billion Southeast Asia Investing Finance Facility administered by Export Finance Australia to boost investment and strengthen trade relationships between Australia and the Southeast Asia region.

This report builds on the Strategy to provide a more detailed analysis of the barriers faced by financial institutions in the region, based on a series of interviews with major superannuation funds, fund managers and banks. All interviewees are based in Australia, or have a significant business presence in Australia. It considers the role of key levers such as government-owned special investment vehicles and enabling policy reform in mobilising private sector finance and investment for climate and clean energy in the region. It also makes some recommendations for how the Australian Government can optimise its investment facilitation efforts. This report also builds on DFAT's Development Finance Review 2023 which recommended Australia expand the use of blended finance to catalyse private sector financing, particularly in Southeast Asia.

The geographic focus of this study is South and Southeast Asia, specifically the countries listed below, which are collectively referred to in this report as the "Target Region". This aligns with the Australian International Development Program.

SOUTHEAST ASIA	SOUTH ASIA
Brunei	Bangladesh
Cambodia	Bhutan
Indonesia	India
Laos	Nepal
Malaysia	Pakistan
Myanmar	Sri Lanka
The Philippines	
Thailand	
Vietnam	

2.2 Approach

As part of this study, ASFI conducted structured interviews with 11 financial institutions ('FIs') including banks, superannuation funds, and asset managers. Six of the organisations interviewed have headquarters in Australia, while the other five are headquartered overseas with substantial presence in Australia.

The interviews were conducted with senior executives across a range of positions. Typically, interviewees included the organisation's Head of Sustainable Finance for Australia and/or the Asia-Pacific region. Often multiple interviewees participated in a single interview, including senior representatives from relevant finance and investment teams (such as infrastructure, private equity, and energy and transition finance and advisory).

The interviews sought to ascertain:

- the existing exposure of firms to emerging markets globally, as well as to climate and clean energy in emerging markets in South and Southeast Asia
- perceived opportunities and barriers in these markets
- what sort of interventions or support could overcome the barriers identified
- FIs' experience of transacting alongside government-owned financing vehicles such as multi-lateral development banks, development finance institutions, and Australian agencies such as Export Finance Australia and the Clean Energy Finance Corporation
- to what extent gender equality is considered in capital allocation decisions by these FIs.



3 Key findings

3.1 Current exposure to emerging markets

Exposure to emerging markets among the FIs interviewed for this study varies significantly. Most FIs headquartered in Australia have very little emerging market exposure. Various reasons are cited for this including: general concerns about risk and ability to manage risk in those markets (outlined further below); for some of the banks, there is limited client interest in those markets; for super funds, portfolios being tracked to global indices such as the MSCI benchmark which has very limited emerging market exposure outside of China and Brazil.²

These FIs indicate that allocating capital to emerging markets requires additional resources to understand and manage risks. At present, opportunities in domestic and other OECD markets tend to be more attractive on a risk-adjusted return basis.

In contrast, FIs interviewed for this report that have global businesses and international headquarters tend to have significant emerging market exposure including in the Target Region. Many of these FIs have a physical presence in the Target Region through local branches and offices. They see the Target Region as a key growth market and their local presence and transaction experience is a key factor in providing comfort to manage risks (discussed further below).

KEY FINDING

Overseas-headquartered FIs interviewed for this report typically have significantly greater exposure in emerging markets in the Target Region compared with Australian-headquartered FIs.

3.2 Views regarding climate and clean energy opportunities in the Target Region

All interviewees indicate their organisations have a strong interest in climate and clean energy opportunities generally (that is, in OECD and non-OECD markets). All have set targets to reach net zero greenhouse gas emissions by 2050 and are in the process of translating those into sector specific targets and pathways. Many also have specific targets for sustainable finance or investment. These commitments are a key driver for FIs to seek climate and sustainability related opportunities and to progressively decarbonise their portfolios and lending books.

Interviewees expect opportunities in clean energy and other climate-related sectors to continue to grow in coming years. Some of their organisations are positioning to be leaders in this sector – actively building client capabilities and supporting market development, for example through public policy advocacy and engagement with governments in the region. Others are more passively assessing and acting on climate and clean energy opportunities as they arise.

Interviewees are also optimistic about climate and clean energy specifically in the Target Region. They cite the scale offered by the larger countries such as Indonesia, Vietnam and the Philippines in the Target Region as key to the region's potential. National level commitments (such as Nationally Determined Contributions (NDCs)) or sector targets (for example in battery manufacturing) are seen as key indicators of the potential for growth. Interviewees noted that governments vary in the ambition and sophistication of their country targets and policies to achieve those targets.

The countries commonly cited as the most prospective for climate and clean energy finance and investment

in the Target Region are India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam. Prospective sub-sectors in climate and clean energy include:

- utility-scale renewables in particular onshore wind and solar, although competition from capital providers for these projects is driving down margins, and the pipeline in countries such as Indonesia and Vietnam is seen as constrained (see discussion on barriers below)
- commercial and industrial renewables projects, often involving multiple facilities such as electricity generation and industrial manufacturing
- decentralised solutions such as rooftop solar and mini-grids that can be financed through a portfolio of aggregated assets
- electric vehicles and their supply chains
- cross-border energy transmission infrastructure.

According to interviewees, opportunities vary depending on the unique characteristics, capabilities, and ambitions of each country. For example: Indonesia is positioning to become a significant player in battery manufacturing and to expand from nickel extraction into downstream industries; and the Philippines has sent a positive signal by lifting limits on foreign ownership to incentivise investment in renewables. In Vietnam, renewables financing is currently serviced substantially through its well-established local banking sector (protected by local regulation limiting international finance), but development of offshore wind will require international finance due to the scale of those projects exceeding local lending capacity. One bank interviewed sees cross-border energy transactions as a growing area – for example, renewable energy exports from Laos to Thailand, China, Vietnam and Singapore.

Bank interviewees that have a regional presence indicate very strong demand for finance across all types of lending including project finance and corporate finance. They say decarbonisation and transition are a focus for their clients and there is an opportunity for banks to demonstrate value by providing know-how and product development to support that transition. For some, this means using their strong technical expertise and experience with emerging technologies in other markets to support clients to understand the opportunities and risks across the full value chain. For others, the focus is on supporting clients to access green and ESG capital markets through corporate finance products such as green bonds and sustainability-linked corporate loans.³

The investor organisations interviewed are less actively involved in the Target Region, despite seeing it as a growth market. One asset manager interviewed has significant exposure to the Target Region but invests only in publicly listed assets where the opportunity set is limited for climate and clean energy. Such opportunities can be highly sought after, putting pressure on returns. The other investors interviewed have very limited exposure in the Target Region, but nonetheless speak optimistically with respect to climate and clean energy in those markets.

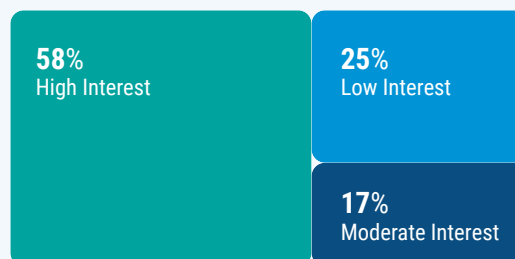
KEY FINDING

FIs see a highly varied range of finance and investment opportunities in climate and clean energy across the Target Region, with an optimistic view of potential future growth.

3.3 Level of interest in increasing exposure to climate and clean energy opportunities in the Target Region

Bullish views on climate and clean energy opportunities in the Target Region do not always correlate with high exposure to the Target Region or an active strategy to allocate more capital to these opportunities. Interviewees were asked to rate their organisation's level of interest in climate and clean energy opportunities in the Target Region on a scale of 1 to 5, where 1 indicated "no interest" and 5 indicated "strong interest, actively seeking to increase exposure", as shown in Figure 1.

Figure 1 – Respondent interest in climate and clean energy opportunities in Target Region



Respondents who give a low score typically emphasise that the score reflects a lack of comfort with the Target Region, rather than a lack of interest in climate and clean energy opportunities. Scores also reflect the existing business strategy and operational presence of each FI. Six out of the seven interviewees who indicate "high interest" are multi-national financial institutions with headquarters outside of Australia. These FIs already have significant exposure to or operations in the Target Region, are comfortable with the risks, and are seeing significant opportunities which they are already pursuing. Typically, these FIs are actively positioning to be the lender or asset

manager of choice for the net zero transition and see the Target Region as key to this. One Australian-based FI has minimal current exposure to the Target Region but is actively exploring opportunities to increase exposure. The other five Australian headquartered FIs register low or moderate interest in increasing their exposure to climate and clean energy opportunities in the Target Region.

KEY FINDING

FIs have a varied level of interest in taking up opportunities in the Target Region. Familiarity and comfort with emerging markets, in particular in the region, is the principal difference between FIs actively interested in increasing exposure in the region, and those with little or no interest.

3.4 Barriers to investing in climate and clean energy in the Target Region

Interviewees have varied perceptions of barriers to investing in climate and clean energy opportunities in the Target Region. All recognised greater or additional risks and barriers in the Target Region relative to OECD markets. Those with an existing presence in the Target Region and a high interest in increasing their exposure are more confident in their ability to manage high level risks, and tend to be more specific in their identification of risks and barriers.

FIs with limited existing exposure to the Target Region

This group identifies a range of risks associated with the local environment including: geo-political or sovereign risk; rule of law and legal risks such as uncertainty regarding the ability to enforce security or withdraw funds; ESG and bad actor risk; labour risks and potential modern slavery exposure.

Some also mention a lack of credibility in the transition plans of companies – in part due to “weaker” national sustainable finance policies. Currency risk and lack of hedging options are also commonly mentioned. One interviewee cites physical climate risk and lack of resilience planning as a barrier, but notes that this risk is also present in investments in OECD markets through supply chain exposure.

These interviewees also see a lack of attractive opportunities with appropriate risk-adjusted returns. Investors say they do not tend to have relationships with experienced fund managers in these markets, resulting in a lack of awareness of opportunities and potential for investment. Lack of familiarity and local presence also increases transaction costs, including due to uncertainty regarding local law and local approaches to documentation, and unfamiliar counterparties.

One large asset manager observes that presence on the ground is a huge part of being able to invest more in a region, and says it is therefore increasing its presence in some markets in the Target Region. This FI also notes that the lack of demand from asset owners to invest in the Target Region may be in part due to lack of familiarity, and that perceptions of risk may be higher than actual risk. Asset managers may therefore need to lead the way in introducing opportunities and providing comfort about the ability to manage risks in these markets.

Super funds interviewed mention Australian regulatory barriers to investing in the region. Existing obligations on super funds create a limited lens through which to define benefits to members.⁴ The legislated Your Future Your Super performance test penalises under-performance but does not reward higher performance. This is consistent with feedback that ASFI has received frequently from super funds on the Australian regulatory environment acting as a barrier to investing in emerging markets, and in climate and clean energy more broadly.⁵

In general, there is a sense from Australian-headquartered FIs that the additional transaction costs and risk associated with investing in the Target Region make opportunities in these markets less attractive than opportunities in Australian and other OECD markets. Corporate culture and policies are also a factor: portfolio managers in these firms have a long track record of success in familiar markets and little incentive to try something different. The super funds interviewed indicate that this might change as the super industry continues to grow and competition for deals in OECD countries forces asset owners to look elsewhere.

FIs with existing exposure to the Target Region

Interviewees with existing exposure and presence in the Target Region cite some of the same risks as outlined above – including geo-political and regulatory risks – but express a greater degree of comfort about managing these types of risks in emerging markets. Two specific risks identified in this category are:

- continual or rapid changes in policy and regulation which create uncertainty about financial returns and inhibit investor confidence
- the presence of specific laws which deter international finance – such as prohibitions on local lenders re-financing to international banks.

A more significant barrier cited is the lack of bankable asset pipeline. Plenty of capital is seeking large scale renewable energy projects (onshore solar and wind), but project development is often hampered by a range of issues including:

- inadequate transmission infrastructure. Transmission upgrades, in turn, are difficult to finance because they typically require corporate finance to a local, state-owned monopoly – many of which are considered uncreditworthy by international finance standards
- permitting, which constrains both renewable generation projects and the build-out of transmission infrastructure
- in project finance, the quality of power-purchase agreements and the absence of a credit-worthy off-taker in particular.⁶

The insufficient scale of opportunities is also seen as a challenge, particularly in smaller markets in the Target Region. It is noted by one respondent that investors seeking clean energy and climate opportunities in listed equities have limited options in these markets. Listed ‘pure play’ opportunities – that is, companies that specialise largely or exclusively in clean energy or climate technology – are rare. Where pure play opportunities do exist, there is a large amount of capital competing for the opportunity.

Another aspect of scale relates to distributed solutions such as rooftop solar. These small projects are in some cases being aggregated to attract institutional investment, but remain challenging for international FIs for a range of reasons. For example, the revenues are in local currency, the smaller off-takers don’t meet credit standards, or there is uncertainty regarding feed in tariffs and grid connection.

Interviewees for whom climate transition in the Target Region is core to their business strategies identify new technologies as an opportunity rather than a barrier. For these FIs, their global experience and expertise with new climate technologies could be applied in new markets to add value for clients. Support could be sought from export credit agencies in those cases where it is necessary to manage residual technology risk – for example, in hydrogen projects.

Several interviewees cite a lack of consistent, inter-operable sustainable finance policy and regulation as a barrier to private capital. In particular, a lack of common taxonomy (i.e. agreed definitions) for ‘transition’ finance is inhibiting much-needed capital to decarbonise high emitting sectors.⁷ One interviewee notes that the lack of sustainable finance policy architecture makes it difficult to assess and validate the credibility of corporate transition plans, which is an important consideration for corporate lending. The lack of climate-related disclosure requirements makes it challenging to access baseline historical data needed to demonstrate additionality for green bond issuances. Further, inconsistency between taxonomies is creating ‘friction’ (i.e. unnecessary transaction costs and complexity).

Currency risk and lack of hedging options are also seen as barriers where FIs do not have local deposit taking institutions to match their exposure. Banks with a strong presence in the Target Region are typically able to manage currency risk for several countries but not all.

KEY FINDING

FIs identify a range of significant risks and barriers to increasing investment in the Target Region. FIs with exposure and presence in the Target Region express greater confidence about their ability to manage these risks. Local presence and/or familiarity is a key factor in increasing comfort of FIs in managing risks and taking up opportunities.

3.5 Experience with public finance vehicles and blended finance

Interviewees have varying degrees of experience engaging with government-backed finance vehicles both in Australia and abroad. Internationally, many have worked alongside export credit agencies (“ECAs”) including Australia’s Export Finance Agency (“EFA”) and ECAs from Germany (Euler Hermes Aktiengesellschaft), France (BPI France), UK (EXEFC), Canada (EDC), Japan (JBIC, NEXI) and Denmark (EIFO).

These FIs comment that ECAs are often present in transactions where commercial banks are unwilling to take on certain risk. In such instances, they can perform a useful role to complete the debt stack (i.e. provide a missing piece of debt finance that takes more risk than what commercial banks can accept). Many also offer ‘credit wraps’, which involve the ECA guaranteeing specific payment obligations under the loan agreements in the event of default, which is seen as particularly helpful.

Some FIs interviewed note that in some instances, some ECAs participate in transactions where they are not needed, which has the effect of crowding out commercial finance. These FIs would like to see more cooperation between ECAs and commercial capital providers, with more sharing of risk and opportunity through approaches such as equity investment, mezzanine finance, and credit wraps.

Interviewees have also participated in transactions alongside various bilateral development finance institutions and multi-lateral development banks (MDBs), including the Asia Development Bank (ADB), International Finance Corporation (IFC), European Bank for Reconstruction and Development (EBRD), DEG (the international development arm of Germany’s development bank, KfW), and FMO (a Dutch development bank). One bank has completed multiple transactions with GuarantCo in Africa and was in discussions with the Private Infrastructure Development Group’s InfraCo in Vietnam and Indonesia.⁸

FIs express mixed views on the role and value of these agencies. Many see blended finance (i.e. the combining of public sector capital like MDBs and DFIs with private sector capital) as critical to catalyse capital into newer markets or non-standard projects. In some cases, the MDBs/DFIs are doing this successfully including for new bond issuances and for projects in less developed markets. For example, in Vietnam, Bangladesh and Sri Lanka, the ADB adds value and commercial lending would not happen without them in many instances. The ADB’s financing of transmission/grid infrastructure in the Target Region is also enabling and appreciated by the market. Programs such as ADB’s “Innovative Finance Facility for Climate in Asia and the Pacific program”,⁹ and Pentagreen Capital¹⁰ in Singapore have catalytic mandates and are playing an important role.

However, these interviewees say it is also common for MDBs/ DFIs to compete with commercial finance in markets and transactions where development banks are not required. For example, in Indonesia the ADB is competing with commercial banks in renewables projects. There is a view that public finance vehicles need to be more ‘catalytic’ and should not be simply providing ‘cheap’ money. They receive concessional capital and should be able to pass this on. One respondent notes the World Bank and ADB credit-enhancement programs can be complex and difficult to navigate.

One bank also sees the need to ensure blended finance transactions are not overly complex and structures adopted are familiar to commercial capital providers. This is consistent with a general preference by FIs for standardised transactions that can be replicated with ease, rather than bespoke or complex arrangements that take more time and therefore erode profit margins.

In the Australian domestic context, a number of interviewees have experience with the Clean Energy Finance Corporation (CEFC). The CEFC is seen as a useful provider of patient capital, with deep expertise

in climate and clean energy which enable it to conduct reliable, thorough due diligence particularly on newer technologies. CEFC generally has a good understanding of its mandate as a government green bank and how to ensure its funding is “additional” to private sector finance, and an ability to de-risk transactions to crowd-in private capital.¹¹ This means it is generally not competing with private sector capital. While some consider CEFC's processes can take longer than commercial investors, it is able to give a good ‘read’ early on in transactions. This provides a signal to FIs regarding the quality of an investment opportunity and gives confidence to invest.

Some interviewees say their organisations have participated in transactions alongside CEFC. Others see CEFC's role as being part of the first round of investment in a particular sector or project where risk adjusted returns are not sufficient, allowing commercial capital to come in on subsequent rounds or projects. This creates a ‘demonstration effect’ similar to the US Government's multi-billion dollar Loan Programs Office debt facility.¹²

KEY FINDING

Blended finance approaches, including from export credit agencies and international development banks, are seen by FIs as being critical to de-risk investment opportunities to allow commercial finance involvement. However, FIs note it is important for these institutions to play a complementary, rather than competitive, role to commercial finance, and that public blended finance vehicles vary in the value they bring.

3.6 Approach to gender

Many of the FIs interviewed have gender targets. These targets typically relate to gender diversity within their own organisations rather than their investments or lending. When asked about their approach to gender in allocating capital, most interviewees say it is a consideration in ESG screening which typically includes consideration of gender diversity in the investee or client's corporate board or executive team.

Some FIs also consider the diversity and inclusion policies of investees as part of this process. For FIs with social impact or sustainable finance targets, there is a focus on supporting women-led businesses and on incorporating gender diversity into key performance indicators for sustainability-linked loans.

One international bank says gender is increasingly a factor in assessing company level and supply chain risk. They are also pursuing gender lens investing through their social impact solutions team, recognising the benefits that gender analysis and management bring to businesses and projects. They note that reporting and quantifying impact is a challenge.

KEY FINDING

Consideration of gender in investments takes place principally through ESG screening, with some FIs also incorporating gender considerations directly into their finance activities.

4 Key challenges

Interviews with FIs for this report reveal several significant challenges to increasing Australian investment in climate and clean energy in the Target Region.

Australian FIs are uncomfortable with the risks associated with the Target Region

Opportunities in the Target Region tend not to present a sufficient level of risk-adjusted return to attract finance and investment from Australian FIs, when considered against opportunities in OECD markets. Lack of familiarity with markets in the Target Region and lack of on-ground presence is a key factor. This suggests more is needed to facilitate greater levels of FI comfort and catalyse additional finance activity in the Region.

Current blended finance approaches are not always effective at crowding in private sector capital

While the role of blended finance in increasing investor comfort in providing finance in the Target Region is critical, current blended finance approaches are not always effective at crowding in private finance into the Region. Blended finance approaches that are fit for the specific purpose of increasing climate and clean energy investment in the Region are needed to make the opportunities available within the Region more attractive for Australian FIs.

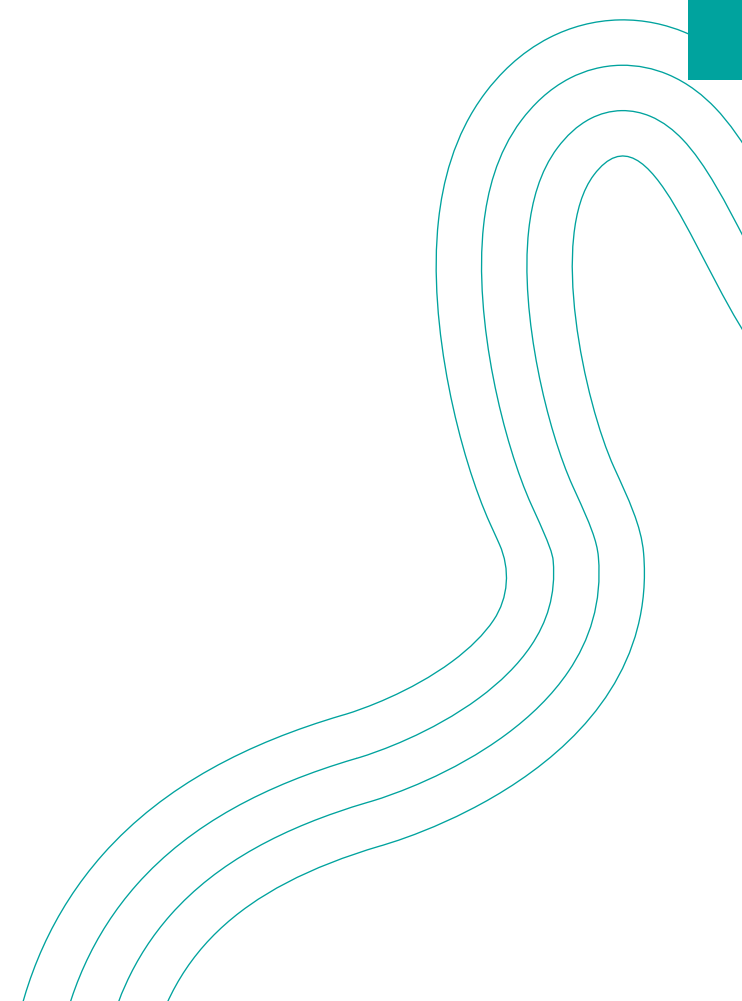
Investable opportunities are often unsuitable

Investment opportunities in the Target Region often lack sufficient scale or quality to be sufficiently attractive for Australian FIs to deploy capital. More work is needed to develop the pipeline of investable opportunities, and in some cases to aggregate smaller opportunities to achieve scale.

Policy does not effectively support finance flows

Policy uncertainty or lack of enabling policy in the Target Region is a substantial barrier to investor confidence in engaging in the Target Region. This includes national climate targets and policies. In particular, the lack of internationally harmonised sustainable finance policies – such as mandatory climate-related disclosures and taxonomies – is a barrier to sustainable finance flows. There are also regulatory barriers in Australia that create challenges for super funds and banks seeking to increase their exposure to the Target Region.

While these challenges are significant, they are potentially solvable through well-designed government interventions. The next section canvasses potential solutions to these challenges.



5 Overcoming the barriers

FI views and ASFI recommendations

Interviewees identify a range of options that could help overcome many of the barriers identified above. These can be broadly grouped as: blended finance; transaction support and pipeline identification; support for policy development in the Target Region; and Australian regulatory reform. These are set out below, together with recommendations from ASFI for the Australian Government to consider as it looks to build existing actions under the Southeast Asia Strategy to 2040.

5.1 Blended finance

Many FIs suggest that transactions could be de-risked through 'blended finance' approaches where the Australian Government (through an appropriate investment vehicle) participates directly in transactions. Examples of the types of blended finance approaches identified include:

- **Guarantees, insurance or other instruments to reduce political, legal, regulatory, credit and other risk.** These instruments involve the issuer (for example, the Australian Government) promising to make good on payment obligations under financing or investment contracts. One area FIs identify where this could be particularly valuable is in renewable energy generation projects (solar or wind) where offtake entities lack investment grade credit ratings. A guarantee, or 'credit enhancement' facility by the Australian Government would substantially improve the bankability of the project. This type of intervention is especially needed in countries with higher sovereign risk.

- **Local currency or hedging facilities.** These help FIs manage the risk of lending or investing in markets with volatile currency and/or where affordable hedging and other financial market solutions are not available.
- **Providing scale by aggregating investments.** This could involve creating a fund structure or investment platform that invests in a number of smaller underlying assets, or a bond issuance where the Australian Government invests bond proceeds into climate and clean energy projects.
- **Liquidity facilities for banks.** These could involve the Australian Government taking advantage of its access to lower-cost finance to lend to banks at cheaper rates than what banks would otherwise pay. Banks can pass on the discount to the clean energy project, lowering the project's cost of capital and thereby increasing its profitability, helping it to secure additional finance and investment.
- **Transition finance instruments/funds.** This could be any structure where the underlying investments are in sectors or projects that support existing high-emitting companies or facilities to decarbonise. As identified by a number of interviewees, the challenge with transition finance is the lack of common definition for what activities should be eligible (see further below). Australian government participation could apply a credible approach to determining eligibility, drawing from the Australian taxonomy methodology.

Some FIs also identify grants, compensation, and tax incentives as potential tools to support finance and investment by improving the profitability of a project or business. On the other hand, a number of FIs caution against providing 'cheap' money through blended finance and competing with the private sector in attractive deals or markets that are well developed.

Recommendations on blended finance

In 2023, following DFAT's Development Finance Review, the Australian Government committed to scaling up its existing international blended finance mechanisms including the Australian Development Investments ("ADI") and funding for the Private Infrastructure Development Group ("PIDG") – see box 1. These programs are intentionally designed to support market development and mobilise private finance in their parts of the market (early-stage impact funds, and early stage infrastructure development respectively) in Southeast Asia.

While ADI and PIDG investments are often too early stage and too small scale to attract institutional co-investment, over time it is expected that they will build a pipeline of investment for institutional capital. In the near term, the Australian Government could work in partnership with interested FIs and appropriate intermediaries to design and test products that utilise the investment capabilities of these mechanisms to attract Australian institutional capital into Southeast Asia.¹³

For example, this could involve aggregating well performing ADI and/or PIDG assets through a fund or platform structure for "follow on" investment by commercial FIs, or issuance of a bond that aggregates smaller transactions in a structure that institutions FIs are familiar with. Ideally, structures should be replicable and require incrementally less public finance – creating a pathway to pure (non-blended) commercial investment over time.¹⁴

ASFI'S RECOMMENDATION

1. The Government, through the DFAT, should work in partnership with interested Australian FIs and appropriate intermediaries to design and test blended finance products utilising ADI, PIDG and any other available mechanisms.¹⁵

BOX 1: AUSTRALIAN GOVERNMENT INTERNATIONAL BLENDED FINANCE VEHICLES

The Australian Government's Australian Development Investments (ADI) (formerly the Emerging Markets Impact Investment Fund) was established by DFAT in 2020 to provide access to finance for small and medium-sized enterprises (SMEs) in the Asia-Pacific. It is a fund of fund model that supports promising new fund managers to attract private capital and make strong returns, building the intermediary ecosystem for SME finance primarily in South and Southeast Asia. It does this by deploying early and concessional finance to help de-risk funds and crowd in private capital. As ADI expands it will continue its focus on gender lens investment and have an increased focus on (i) supporting climate and clean energy outcomes, and (ii) connecting Australian investors to the region.

The Private Infrastructure Development Group (PIDG) is an innovative infrastructure development and finance organisation funded by six governments (Australia, Germany, the Netherlands, Sweden, Switzerland and the United Kingdom) and the IFC. PIDG is intended to overcome market and institutional failures constraining private sector participation in infrastructure development in developing countries. The companies and facilities in the group mobilise private sector investment for infrastructure. PIDG has two channels through which private sector investment is mobilised: the facility channel—commercial and development financial institutions provide financing to PIDG vehicles alongside equity from PIDG members (through a trust); and the project channel—private sector investment alongside the investment of PIDG vehicles.

In addition, the Government could commission an independent review of Australia's public finance vehicles to examine strengths and weaknesses and identify best practice models for "catalytic" finance vehicles. To provide the greatest value, the review should:

- be independent from Government;
- be led by individuals with strong expertise in blended or development finance;
- focus on private sector transactions – not on sovereign lending which involves a different set of considerations;
- consider domestic and international examples of and experiences in public finance;
- take into account Australian Government's policy objectives including as set out in the Southeast Asia Strategy, Australia's international climate commitments, and clean energy superpower agenda.

Supporting Australia to crowd-in private capital

The reflections in section 3.5 above indicate that public finance mechanisms such as ECAs, MDBs, and DFIs should be carefully designed and calibrated to crowd in, and avoid crowding out, private sector finance. Australia should ensure that its own activities in Southeast Asia support mobilisation of private finance and investment and do not compete with private capital.

International experience shows that establishing and maintaining an appropriate level of risk tolerance in public finance vehicles is not easy and requires carefully designed institutional and governance settings. Box 2 outlines the example of the significant reforms undertaken by the UK Government to encourage greater risk-taking by the UK's DFI (formerly CDC) to be catalytic,

public finance vehicles require a culture, mind-set and incentive structure that promote appropriate risk-taking, as well as specific expertise and experience.¹⁶

To support an effective approach to crowding in private capital, the Australian Government could develop a set of clear 'additionality' principles and guidance for Australian public financing. This guidance should consider both financial and development additionality.¹⁷ It could draw on the OECD's definitions as well as work undertaken by DFAT to inform the design of ADI.¹⁸ The guidance may also be relevant for public financing undertaken by Australian Government vehicles in Australia, depending on their mandate.

ASFI'S RECOMMENDATIONS

2. The Government, in particular DFAT, should ensure that Australian-supported public finance mechanisms are designed and operated in a way that crowds-in private sector finance and promotes additionality:
 - a. Develop and publish additionality principles and guidance to ensure that finance provided by Australian public finance vehicles is "additional" to private sector finance.
 - b. Commissioning an independent review to assess strengths and weaknesses in Australia's ability to mobilise Australian private sector capital through its existing public finance mechanisms and identify best practice models for "catalytic" finance vehicles.

MDB reform

There are ongoing efforts from several developed country governments to reform the MDBs, including to increase the additionality, risk tolerance and ability to crowd-in private finance of their private sector operations.¹⁹ The Government should use its own influence in the MDBs – particularly the ADB’s Private Sector Operations Division, and the World Bank’s International Finance Corporation – to actively support these efforts.

ASFI’S RECOMMENDATION

3. The Government, in particular DFAT, should play an active role in global efforts to improve the ability of MDBs, in particular the International Finance Corporation and the Asia Development Bank’s private sector operations department, to crowd-in private sector finance and to avoid crowding out private capital.

5.2 Transaction support and pipeline identification

A number of interviewees suggest that the Australian Government could play a role in overcoming barriers associated with a lack of familiarity with the Target Region and lack of on the ground presence. This could include conducting and sharing high-quality due diligence – particularly with regard to political and ‘bad actor’ risks of state-owned entities or family-owned assets or borrowers.

Australian Development Investments already routinely shares its due diligence reports with Australian and other private sector investors. This has been an effective strategy for providing confidence, and ADI has successfully crowded in investment from both Australian family offices and international institutional investors (but not yet Australian institutional investors).

Some interviewees suggest that DFAT, through its overseas missions, could provide advice on reputability of local firms that provide transaction-related services, such as law firms or construction firms. Government may also have a role in education and building awareness for Australian financial institutions regarding the availability of high-quality local fund managers and other investment opportunities in the Target Region.

Some interviewees observe that there is limited awareness among Australian FIs of transactions in Southeast Asia that have been successful and that the Australian Government could create a ‘deal book’ of these transactions to promote the opportunities in the region.

BOX 2: IMPROVING ADDITIONALITY

In 2010, in response to mounting criticism of the UK Government’s Development Finance Institution, CDC (now BII), the House of Commons International Development Committee inquiry found that although CDC had increased its net assets by GBP1.5 billion since 2004 and had contributed to employment and the tax base of developing countries, its development impact has been insufficient for a Government-owned company whose net investments count as Official Development Assistance. The inquiry also found that CDC’s activities were not additional to private sector activity:

“We are concerned that some of the investments CDC has made are ones the private sector would have made anyway.”²⁰

In response, the UK Government oversaw a significant reconfiguration of CDC to increase development focus and expertise, and address systemic cultural attitudes and incentive structures within CDC that entrenched a low risk tolerance and prioritised profitability over impact.²¹ This included significant changes to CDC’s investment strategy, a new remuneration framework, more transparent reporting, and closer engagement with the UK’s Department for International Development.

Recommendations on transaction support and pipeline identification:

ASFI'S RECOMMENDATIONS

4. The Government through DFAT and relevant Australian public finance vehicles, should continue to support Australian FIs to become more familiar with markets, regulatory systems, intermediaries, and blended finance models in the Target Region by:

- a. Sharing institutional quality due diligence and project information from Australian Government investment vehicles with Australian FIs.

Australian Development Investments should continue to make due diligence reports available to Australian and other private sector investors. The Government should encourage other Australian blended finance and special investment vehicles – such as PIDG and EFA – to do likewise where this might help bring in private sector capital. It would also be valuable to share and promote details of successful transactions in Southeast Asia to support better awareness of opportunities in the Australian market. The new investment Deal Teams could provide a coordinating function for such information sharing and connecting interested investors to the appropriate resources.

- b. Connecting interested Australian FIs with local intermediaries such as fund managers and advisors, including through ongoing networking opportunities, roadshows, and other events (building on the Government's successful Investor Missions).

Where possible, the Australian Government should connect interested FIs with high quality local financial advisory and service firms, as well as local fund managers. This could be facilitated through the Government's investment Deal Teams provided they have appropriate expertise and networks.

DFAT, through its overseas posts, should build on the successful Investor Missions to Indonesia, Vietnam and Singapore by holding events such as roadshows and investor forums in Southeast Asia – including Singapore – that encourage networking and build awareness of local investment opportunities.

- c. Providing information and capacity building on local markets and regulation, as well as on blended finance models and providers, for Australian FIs interested in exploring opportunities in the region.

Lack of familiarity with local markets and regulation is a key barrier raised by Australian FIs to investing in the region. The Government should consider opportunities to provide high quality, targeted information and training for Australian FIs. Many private sector investors and lenders are also not familiar with blended finance models or providers of concessional or blended capital. The Australian Government could make available capacity building and other resources on blended finance, and help connect private capital providers with expert intermediaries as well as the wide range of special investment vehicles managed by Australia, other governments, multi-lateral development banks, and philanthropic organisations.

- d. Encouraging Australian FIs to establish a local presence in Southeast Asia, for example through employee secondments into Australia's Deal Teams

This would help interested Australian FIs to build local knowledge and networks and promote two-way learning between the Australian finance sector and the Australian Government.

5.3 Policy development in the target region

Interviewees' comments regarding the lack of credible, harmonised sustainable finance policy in parts of the Target Region imply a strong role for the Australian Government in supporting partner countries to develop and implement policies such as national economic transition plans, taxonomies, and climate-related disclosures.

ASFI'S RECOMMENDATION

5. The Government, led by the Department of Treasury with DFAT, should continue to prioritise and scale up its support for the development of credible, inter-operable sustainable finance policy in the region including for transition finance.

The Southeast Asia Economic Strategy to 2040 recommended that Australia's Treasury lead expanded work with Southeast Asian partners on high-quality and interoperable sustainable finance classifications and climate-related disclosure rules. Likewise, the Government's Sustainable Finance Roadmap identifies international engagement on sustainable finance as a key priority including through ASEAN engagement, bilateral engagement, and multilateral and plurilateral engagement as focus areas.²² The Government has already begun to implement these commitments including through capacity building and technical exchanges with Southeast Asian officials and regulators.

With its own sustainable finance agenda now well underway, the Australian Government is well-positioned to continue to promote credible, inter-operable sustainable finance policy in the region. The structural similarities between Australia's economy and many countries in the Target Region – in particular our strong mining industry, and our historical dependence on fossil fuels for electricity generation and exports – means the Australian sustainable finance taxonomy will be highly relevant for many partner countries as an alternative to the EU taxonomy model (the most prevalently used globally). Australia is also leading the world in developing a credible, workable approach to defining 'transition finance' for our taxonomy – a key concern identified by FIs during this study. Inter-operability, as identified in the Government's Sustainable Finance Roadmap, continues to be a challenge and should be a key focus.

5.4 Australian regulatory reform

Some interviewees also note the potential for changes to Australian financial regulation. Specifically, as noted above, changes to the Your Future Your Super framework and the 'best financial interests' duty could help remove barriers to super fund investment into the region. Interviewees also suggest that lowering the capital requirements for green loans would strongly incentivise green lending. We note that 'green capital weightings' are being considered in other jurisdictions to reflect that green assets have lower climate-related risk, and to incentivise investment in those assets.²³

ASFI'S RECOMMENDATION

6. The Government, led by the Department of Treasury, should examine Australian regulatory barriers that are inhibiting Australian investment and finance into Southeast Asia emerging markets for climate and clean energy. This could be done in parallel with a consideration of barriers to climate and clean energy finance in Australia.

- 1 The Indo-Pacific Net Zero Transition Bond announced in 2023 by Prime Minister Albanese and President Biden is one example already being developed by DFAT together with US Development Finance Corporation and US AID.
- 2 MSCI is a widely used set of indices to benchmark investments against. See <https://www.msci.com/our-solutions/indexes>
- 3 Sustainability-linked loans oblige or incentivise the borrower to meet pre-determined targets for emissions or other sustainability goals by linking interest or other conditions to the achievement of those targets.
- 4 These include a superannuation trustee's fiduciary duty to make investment decisions in the 'best financial interests' of members, and to ensure the fund is maintained for the sole purpose of providing benefits to members upon their retirement or attainment of a certain age, under the Superannuation Industry (Supervision) Act 1993. In practice, the best financial interests of members requirement means that superannuation funds prefer to invest in industries or regions where members are employed or live, or in impact themes that will directly improve the retirement of their members, while also seeking strong risk-adjusted returns. Because members are Australian, the best financial interest duty is easier to meet for domestic investments unless there are outsized returns for the level of risk taken from international portfolios. The other implication of this duty and publication of regular management fee information by APRA is that super funds have a strong focus on the cost of managing their portfolios. Additional transactions costs incurred in investigating or undertaking due diligence in unfamiliar or riskier markets.
- 5 See, for example, in relation to the Your Future Your Super performance test: Connexus Institute and LSEG, "Constraint on ESG, Sustainability and Carbon Transition Activities" Report, November 2022, <https://www.asfi.org.au/publications/your-future-your-super-yfys-performance-test>
- 6 To secure finance, renewable energy projects need a long-term power purchase agreement to be in place between the project company and a large, credit-worthy, purchaser of electricity. In emerging markets, this purchaser is often a state-owned utility that may be inefficient and have a credit rating that is below investment grade, making the project difficult to finance.
- 7 "Transition finance" means funding to support high-emitting activities, such as steel, cement, chemical manufacturing, agriculture, aviation or construction, to adopt low or zero-emissions technology on a pathway to full decarbonisation.
- 8 The Private Infrastructure Development Group is funded by a group of developed country governments, including Australia, to support clean infrastructure development in Africa and Asia emerging markets.
- 9 <https://www.adb.org/what-we-do/funds/ifcap>
- 10 <https://www.pentagreen.com/about-us.html>
- 11 The concept of additionality is discussed further in section 5.
- 12 See <https://www.energy.gov/lpo/loan-programs-office>
- 13 This collaboration occurs already in other contexts, for example, the development of the Housing Affordability Future Fund, see <https://www.ifminvestors.com/en-au/news-and-insights/media-centre/super-collaboration-set-to-inject-funds-into-affordable-housing-delivering-returns-for-members/>
- 14 The Bayfront Infrastructure Capital debt securitisation series is an example of this, see <https://www.bayfront.sg>
- 15 The Indo-Pacific Net Zero Transition Bond announced in 2023 by Prime Minister Albanese and President Biden is one example already being developed by DFAT together with US Development Finance Corporation and US AID.
- 16 Catalytic vehicles such as the Australian Development Investments see their role as proactively shaping transactions to crowd-in private sector capital. This can occur for example through providing early advice to a fund manager on how to structure a blended finance transaction, engaging proactively with other investors, sharing due diligence, etc. See, eg, Alinea International, "Emerging Markets Impact Investment Fund: Impact Study 2021-2022", and Geddes et al, "The multiple roles of state investment banks in low-carbon energy finance: An analysis of Australia, the UK and Germany", *Energy Policy* 115 (2018) 158-170.
- 17 The OECD defines "financial additionality" as situations where additional finance is mobilised and an investment is made that would not have otherwise occurred, and "development additionality" as development impacts that arise because of investment that otherwise would not have occurred, see OECD, "Evaluating financial and development additionality in blended finance operations", OECD 2021.
- 18 This was part of DFAT's design process for the Emerging Markets Impact Fund, the pilot program that preceded ADI.
- 19 "Strengthening multilateral development banks: The triple agenda," Report of the Independent Experts Group commissioned by the Indian G20 Presidency, 30 June 2023.
- 20 "The Future of CDC," report by House of Commons International Development Committee, published on 3 March 2011.
- 21 "Investment for development: The UK's strategy towards Development Finance Institutions," House of Commons International Development Committee, report published on 15 September 2023.
- 22 Australian Government – Treasury, Sustainable Finance Roadmap, published on 19 June 2024.
- 23 The role of environmental risks in the prudential framework, Discussion Paper, EBA/DP/2022/02 2 May 2022.

