ASFI Submission on the Australian Government's Net Zero Fund as part of the National Reconstruction Fund

The Australian Sustainable Finance Institute (ASFI) welcomes this opportunity to make a submission on the design of the Net Zero Fund, that will be a sub-fund of the National Reconstruction Fund (NRF).

The Australian Sustainable Finance Institute (ASFI) is a not-for-profit organisation committed to mobilising capital for climate, nature and social impact. ASFI's members are large Australian financial institutions – including major banks, superannuation funds, insurers, asset managers, and financial services firms – that support ASFI's mission. Our members collectively hold over AU$16.5 trillion in assets under management and are committed to allocating capital in ways that create positive social and environmental outcomes. They therefore have an alignment with the objectives to secure future prosperity and sustainable economic growth for Australia, and an interest in ensuring the Net Zero Fund can operate as intended to effectively crowd-in private capital for this purpose.

What are the types of projects or capital expenditure that should be supported to achieve the Net Zero Fund's objectives?

Alignment with Australia's Net Zero objectives

Decarbonisation of Australia's manufacturing and industrial sector is a critical part of implementing Australia's Net Zero Plan. Ensuring the Net Zero Fund invests in activities and projects that are genuinely aligned to and support the transition required in this sector will be a critical part of the design of the fund.

The Australian Sustainable Finance Taxonomy was developed by ASFI from 2023 - 2025, with oversight from Treasury and the Council for Financial Regulators, and significant technical input and expertise from across government and industry. This work included both technical work and broad stakeholder consultation to identify activities and capital investments that are aligned to the net zero transition in the manufacturing and industrial sector.

The technical screening criteria in this part of the taxonomy list technical performance thresholds and decarbonisation measures that are needed to achieve the decarbonisation pathway for this sector, are feasible for industry to adopt, and require capital investment. The taxonomy criteria for manufacturing and industry therefore provide a credible, science-

based and industry informed list of activity and project types for the NRF Net Zero Fund to invest in. Alignment of the Net Zero Fund investment criteria with the Australian taxonomy criteria will be important to ensure investments are only made in those activities that will genuinely decarbonise the sector, in line with net zero 2050 goals and ensure its objectives are met.

TABLE 11
Activity selection and classification - Manufacturing and Industry sector

	Classification	
	Green	Decarbonisation measures
C1. Refining of Copper, Lithium and Nickel	✓	✓
C2. Alumina Production		✓
C3. Aluminium Smelting		✓
C4. Manufacture of Hydrogen	✓	✓
C5. Manufacture of Cement	✓	✓
C6. Manufacture of Iron and Steel		✓
C7. Manufacture of Nitric Acid	✓	✓
C8. Manufacture of Ammonia	✓	✓
C9. Manufacture of Low-Carbon Liquid Fuels	✓	✓
C10. Manufacture of Biogas	✓	✓
C11. Energy Efficiency for Industrial Facilities		✓
C12. Manufacture of Renewable Energy Technologies	✓	
C13. Manufacture of Equipment for the Production of Hydrogen Through Electrolysis	✓	
C14. Manufacture of Low-Carbon Technologies for Transport	✓	
C15. Manufacture of Energy Efficiency Equipment for Buildings	✓	
C16. Manufacture and Recycling of Batteries	✓	
C17. Manufacture of Plastics in Primary Form Through Recycling	✓	

The Australian taxonomy is already being adopted by Australia's largest banks, investors and their clients. For companies seeking to blend investments from the NRF Net Zero Fund with other kinds of private capital, using the taxonomy criteria as the definition of net zero alignment will be valuable to align definitions across funders and reduce complexity for companies.

We would be happy to discuss the taxonomy including the development process and the manufacturing and industrial criteria in particular if this is of interest.

What financing mechanisms are best suited for these investments, based on the mechanisms available to the National Reconstruction Fund?

There is an appetite from Australian financial institutions (FIs) – including ASFI members – to finance and invest in the decarbonisation of the manufacturing and industrial sector, including by supporting emerging industries and technologies. However, these investments can be relatively high risk for a range of reasons including risks associated with unproven technologies, immature supply chains, and uncertain demand. They require FIs to resource deal teams with appropriate expertise which they may not have in house – adding to the

cost of the transaction. Investing in new areas can also take longer because the processes are new and unfamiliar for all parties, again adding to the expense. All of this means the risk-return profile of investment in new industries and technologies can be less attractive than the risk-return profile of opportunities in established sectors, so capital is less likely to flow.

The Net Zero Fund can help address the barriers outlined above by investing in a way that improves the risk-return profile of a given transaction for private capital – meaning its investments should be designed to be 'catalytic' and to (partially) 'de-risk' the investment for private capital. De-risking does not necessarily require a large financial contribution from the public sector: in many cases it is the sharing of risk, and only an incremental improvement in the risk-return profile is required to crowd-in private capital.

Choice of instruments

The NRF should be able to use the full range of investment and financial instruments through this Fund so it can structure transactions in a way that can crowd-in private capital. Examples of ways in which the NRF could de-risk investments to mobilise private capital include:

- Providing **equity** in a transaction so that FIs can co-invest using debt or mezzanine finance. Equity is a particularly flexible and useful tool for crowding in private capital including from commercial banks. It would also give the NRF a 'seat at the table' and the ability to influence aspects of the investee project or company consistent with Government priorities – for example, it could require certain minimum standards are met regarding the environment, climate, and social risk management of investee projects and companies in addition to achieving the primary objectives of the NRF.
- Providing **guarantees** which offer a range of different ways to de-risk and can be targeted to take on specific risks such as some commercial risks like credit risk or offtake risk. In many cases a guarantee may not be called on but provides the confidence for private investors to step in.
- Offering or encouraging the use of **insurance/re-insurance** products to provide confidence to investors – for example to free up funds allocated for weather and event related losses, add capacity to guarantees, or at the design stage to assure delivery and returns.
- Helping to provide the **scale** (i.e. ensure transactions are large enough in dollar terms) that institutional investors seek by aggregating smaller projects or companies in funds or other structures and bearing the costs of establishing these structures.
- **Creating deal pipeline** by investing in or financing companies or projects at an early stage. Private sector finance can step in once a company is more mature or a project is operational, freeing up public funds to be re-invested elsewhere.
- Government finance vehicles can provide significant **in-kind and technical support** including through technical due diligence and expertise. This assistance reduces

transaction costs for private capital, improving the attractiveness of an opportunity. They can also support ecosystem development by making available model transaction documents (such as term-sheets and contracts), technology assessments, and other resources to support subsequent transactions in that sector. It would also be valuable to resource the Net Zero Fund in a way that enables effective information sharing with Government regarding policy and regulatory barriers that may be inhibiting investment in emerging green industry and technology.

Risk and return profile

The risk and return profile of the Net Zero Fund should reflect its objectives to stimulate investment in new and emerging industry and technology. Its catalytic function means it will need to have a higher risk tolerance than commercial investors and be able to accept lower returns than commercial returns. This should be reflected in the targeted rate of return for this Fund. The Fund should make investments based on sound commercial and technical due diligence to help ensure capital preservation and avoid supporting unsuccessful prospects. It should also apply a principle of additionality – only intervening and 'de-risking' to the extent required to bring in private capital. This is necessarily a subjective assessment but there are examples that can be followed and learned from including the experience of the CEFC, OECD DAC guidance,[1] and the approach of international development finance mechanisms including those managed by the Department of Foreign Affairs and Trade.[2]

ASFI recommends that the Government consider earmarking the Net Zero Fund as higher risk capital with lower return expectations. This will allow the NRF to take on earlier stage and more experimental opportunities that could have strong dividends in terms of both financial returns and transformational economic impact. This higher risk capital is important to help fill a persistent gap in the innovation landscape. Earmarking a subset (eg 25%) of the Fund in this way would limit the exposure of the NRF and the Net Zero Fund as a whole, and help ensure it can be financially self-sustaining through its broader investment portfolio.

Some ways to help inculcate an approach to risk that can ensure the Net Zero Fund is able to successfully mobilise private capital, particularly in the scale up of renewable or low carbon technologies include:

• Setting a lower return target for the Fund;

• Explicit instructions from government that set expectations regarding the market-building mandate and approach to risk;

• Ensuring the Net Zero Fund has the right mix of commercial skills and impact/climate technology skills

[1] Blended finance guidance & principles - OECD
[2] See ASFI's submission to the Government's Development Finance Review: https://www.asfi.org.au/publications/development-finance-review-submission?rq=development

• Ensuring that remuneration incentives for NRF employees are calibrated to encourage appropriate levels of risk (i.e. ensure bonuses are not linked purely to maximising financial returns of projects but are connected to achieving policy outcomes).

An example of where this earmarking has been applied (albeit at a smaller scale) is the CEFC's Innovation Fund which successfully supported the emergence of the Australian climate-tech investment ecosystem. We recommend the NRF be able to invest its 'higher risk' capital in a range of areas which could include early stage companies, emerging fund managers, or projects. The ability for the Net Zero Fund to take on 'first loss' positions would be particularly valuable for this tranche of the NRF as a tool to crowd-in private capital.

Resourcing, leadership and expertise (human capital)

The Net Zero Fund should be resourced appropriately to allow it to carry out its mandate, with a culture and workforce that combines commercial finance and investment skills, technical research and analytical skills, and industrial decarbonisation skills.

This technological and technical expertise in each of the priority areas will be crucial to its ability to crowd-in private capital by reducing technology-risk and lowering transaction costs for private participants. It should be set up to work collaboratively with private capital providers – this has been an important part of the CEFC's role and activities in the clean energy market.

Best ways to leverage existing capabilities of the Clean Energy Finance Corporation to help rapid, effective implementation of the Net Zero Fund

Given the commercial, climate and technology expertise that exists within the CEFC, and the strong market relationships already in place, the Net Zero Fund should work very closely to utilise this expertise and ensure appropriate coordination and where possible, alignment of investment processes, due diligence requirements etc.

Given the scope of the Net Zero Fund is also to support the scale up of manufacturing renewable and low emissions technologies, there is also the opportunity for close coordination with ARENA, which provides early-stage support to the development and commercialisation of these technologies. With the appropriate risk tolerance, flexible structuring and return mandate, the Net Zero Fund could usefully fill the funding gap between grant funding provided by ARENA and more commercial funding provided by CEFC, rather than directly overlapping with the CEFC mandate.