JUST TRANSITION FINANCE

MOBILISING INSTITUTIONAL CAPITAL TO DELIVER A NET ZERO WORLD WHERE NO-ONE IS LEFT BEHIND

ACTIONS FOR INSTITUTIONAL ASSET OWNERS

Actions for institutional asset owners

Fulfilling the UN Sustainable Development Goals (SDGs) and transitioning to a world of Net Zero carbon emissions at the pace required – and in a way that's just and inclusive for all – requires trillions in capital every year.

A global transition to Net Zero that is inclusive and socially beneficial – i.e. a Just Transition – can only be achieved with a fundamental shift in financing. This summary highlights key actions that institutional asset owners can take to help achieve a global Just Transition, based on the findings of the Impact Taskforce's report, 'Mobilising institutional capital towards the SDGs and a Just Transition'. The Impact Taskforce's recommendations build on consultations with over 170 finance, policy and thought leaders representing over 110 organisations in 38 countries.

WHAT IS A 'JUST TRANSITION' – AND WHY DOES IT MATTER?

The climate crisis is one of the defining challenges of our time. But there is growing consensus that a single focus on achieving net zero emissions is not enough.

↳ To be successful, climate action also needs to address the socio-economic impacts of moving to Net Zero – from potential job losses to rising household energy prices.

↳ It needs to be recognised that the impacts of climate change tend to disproportionately affect those in poverty and can exacerbate existing inequalities.

↳ To gain support and avoid social tensions or unrest, the transition to Net Zero needs to be fair – and seen to be fair – across regions and across the socio-economic spectrum.

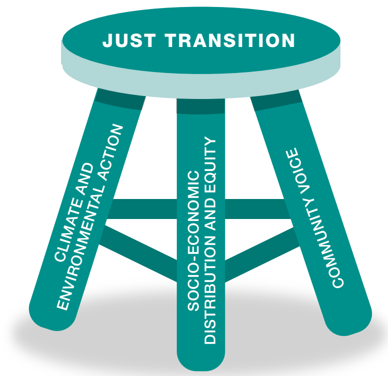
A JUST TRANSITION NEEDS TO CONSIDER:

1. **Different climate transition and planet preservation strategies across sectors.**
2. **Geographic disparities, needs and priorities at international, regional and national levels.**
3. **Affected, underserved and marginalised communities, households, workers and enterprises.**

THE THREE JUST TRANSITION ELEMENTS

Given the considerations above, there are three critical drivers of a Just Transition applicable across geographies, sectors, policies and investments. To be aligned with a Just Transition, actions should:

- Advance Climate and Environmental Action
- *AND* Improve Socio-economic Distribution and Equity
- *AND* Increase Community Voice



Why institutional asset owners are key to the Just Transition

- Institutional asset owners such as pension funds, life insurers, sovereign wealth funds, and endowments and foundations manage assets collectively worth an estimated $154 trillion as of end-2020- the biggest segment of investable private capital in the world.[1]
- By allocating substantially more capital to finance solutions that can meet the SDGs and deliver a Just Transition, institutional investors have the opportunity to contribute to addressing the world's greatest environmental and societal challenges, as is increasingly expected by their members and clients.
- Deploying capital in this way can deliver substantial value, for example through job creation or operational cost savings, which can feed through to the returns institutions are generating for their own members and clients.

What institutional asset owners can do to advance a Just Transition

ACTION 1: COMMIT TO INVEST IN THE SDGs AND A JUST TRANSITION

Institutional asset owners are deploying record levels of capital into 'responsible', 'sustainable' and 'impact' investment funds. But that activity needs to be stepped up to achieve the SDGs and a Just Transition at the pace required to avert a much deeper climate crisis.

Alongside stated ambitions to reduce portfolio carbon footprints by 2030, asset owners across the spectrum of capital are invited to increase the amount of capital flowing to investments that seek solutions aligned with the SDGs and a Just Transition. Specifically, asset owners should:

- Double capital flows from a 2021 baseline by 2025
- Double capital flows from a 2025 baseline by 2030

By taking clear, bold and public steps to show they are ready, willing and able to deploy capital to meet the challenges confronting society today, institutional asset owners have the power to deliver transformative environmental and social impact – and inspire other asset owners to follow suit.

Institutional asset owners can publicly demonstrate their commitment to action by amending their investment mandates, policies and incentive structures to require asset managers or consultants to provide strategies, or pursue transactions, that align with the SDGs and a Just Transition.

1 Thinking Ahead Institute (2021): "Global Pensions Asset Study - 2021"; including in their analysis pension funds, insurance companies, sovereign wealth funds, endowments and foundations and mutual funds

ACTION 2: DEMAND (AND ALLOCATE TO) VEHICLES THAT ADVANCE A JUST TRANSITION

Investing towards a Just Transition and the SDGs requires suitable investment vehicles in which to deploy capital. In line with the supply and demand dynamics of any market, the onus is partly on asset owners to demand such vehicles from asset managers and then commit to using them.

Specifically, asset owners and their chosen asset managers are encouraged to focus on creating investment vehicles that incorporate the three Just Transition Elements identified by the Impact Taskforce: Advancing Climate & Environmental Action, Improving Socio-economic Distribution & Equity, and Increasing Community Voice.

The Impact Taskforce's report details the actions that each Just Transition Element involves and the investable opportunities that investment vehicles might focus on to achieve them. The relative prominence of each of the Elements will depend on the strategy or funded initiative being pursued. But regardless of the primary area of priority, all three Elements should be present to qualify as a Just Transition investment.

Asset owners and investment managers are invited to move beyond a siloed focus on climate/ environmental or social considerations and integrate them, alongside community inclusion, within portfolios across all asset classes.

While there are few vehicles that satisfy all three of the Just Transition Elements yet, the Elements are structured so they can be applied to existing investment products as well as the design of new ones. The Elements are applicable across asset classes and a number of financing strategies further detailed in the Impact Taskforce's report.

ACTION 3: COMMIT TO INCREASE EMERGING MARKET EXPOSURE

Large-scale mobilisation of capital into the world's emerging economies by institutional asset owners is an especially powerful means of financing the SDGs and delivering a Just Transition. This is because:

- Emerging markets present the biggest gap in funding a Just Transition (an estimated USD2.5 trillion a year, compared to USD0.1 trillion in advanced economies[2]) but also some of the biggest investing opportunities
- These are also the markets where the impacts of climate change, such as flooding, drought and crop failure, will be most acute – and therefore are critical to a Just Transition
- Attracting substantially more global and domestic institutional capital will allow local financial markets in emerging economies to broaden and mature, providing further investing opportunities in the future

Institutional asset owners are invited to move beyond their comfort zones, using the tools and instruments that will allow them to deploy increasing amounts of capital into SDG investments in emerging markets. This may require:

Alignment	Insight	Partnership	Cost analysis
Disaggregating risk-reward requirements to identify the parts of a portfolio where SDG-aligned emerging market investments can fit, including quantifying long-term liability exposures that can match less liquid opportunities.	Engaging with investors, development finance institutions and asset managers to get an informed view on appropriate vehicles – and building internal expertise to make informed investment decisions in emerging markets.	Being willing to explore blended structures that incorporate instruments to help achieve an acceptable risk profile (see Action 5).	Assess the fees required by asset managers operating in emerging markets to execute appropriate strategies.

Alongside increasing their exposure to emerging markets, institutional asset owners are encouraged to focus on private assets as the availability of listed assets may be limited in these markets. Private equity, debt, real estate and infrastructure offer a powerful means to achieve social and environmental objectives, given the greater influence and control they involve for investors.

2 UNEP Finance Initiative (2018): Rethinking impact to finance the SDGs

ACTION 4: BE WILLING TO OVERCOME BARRIERS TO INVESTMENT

Several external and internal barriers currently limit the flow of potentially transformational capital – especially into emerging markets. These include real and perceived risk, lack of liquidity and sub investment-grade credit ratings. These barriers should not be an excuse for inaction. Institutional asset owners can find solutions so progress can happen at scale, for instance by exploring 'blended finance' solutions, which integrate tools that can address specific investment barriers such as:

- **Subordinated capital** to provide an important de-risking mechanism as senior-ranking tranches benefit from loss protection by junior tranches, typically held by impact investors including multilateral development banks, which absorb losses first
- **Insurance** to cover specific risks – such as political, trade credit or non-payment – so that institutional asset owners can participate in an investment vehicle that would otherwise not fit within their risk budgets
- **Securitisation** to allow loans to be packaged up into securities paying cashflows with varying risk-return profiles – enabling institutional asset owners to align income streams to their risk requirements

By combining institutional capital from other investors willing to accept different terms, blended finance can direct capital to Just Transition opportunities that would otherwise remain on the sidelines.

ACTION 5: BE READY TO CO-CREATE VEHICLES WITH MANAGERS

As a tangible starting point for developing suitable investment vehicles, the Impact Taskforce's Just Transition Blueprint details how Just Transition considerations can be integrated into every stage of vehicle creation and management.

Based on this Blueprint, investors can help foster vehicles to attract and accommodate large-scale institutional participation, by consulting with managers on vehicle design, including:

- **Risk/return profile** – allowing for satisfactory returns and considering structural enhancements to satisfy risk requirements
- **Size** – enabling institutional asset owners to deploy large capital amounts
- **Pipeline** – ensuring potential investments are sizable, viable and meet the investment level criteria of a Just Transition vehicle
- **Target markets** – including an analysis of respective macro and market risks
- **Diversification** – showcasing the risk and performance contributions of diversification within the strategy
- **Investment story** – ensuring the vehicle communicates the Just Transition angle clearly and concisely, backed up by data

In addition to international sources of capital, the growing pools of domestic institutional capital in emerging markets have a significant role to play in building domestic capital markets, and their participation in Just Transition investments should therefore be encouraged. Participation by domestic investors can include serving as a vital source of local currency funding to help local projects reduce currency risk.

Examples of Just Transition investments

There are multiple examples of investments aligned with a Just Transition already on the market. Detailed case studies of select investment propositions, as well as further examples of investments on the market, are available here.

Asset class hierarchy			Vehicle	Case study	Examples
Alternatives	**Private equity**	**Private equity** (Note: Forestry included herein, however, often included in real assets depending on investor allocation buckets)	**Private equity fund** (direct)	**LeapFrog**: Emerging Consumer Fund III	• **DPI**: African Development Partners III • **New Forests**: Tropical Asia Forest Fund • **TPG**: Rise Fund II
			Fund of funds	N/A	• **AllianzGI**: AfricaGrow Fund • **Credit Suisse**: Climate Innovation Fund
	Private debt	**Private debt**	**Private debt fund**	**Ninety One**: Africa Credit Opportunities Fund 2 **responsAbility**: Access to Clean Power Fund	• **FMO/NNIP**: Emerging Markets Loans Fund • **BlueOrchard**: InsuResilience Investment Fund • **Triodos IM**: Triodos Microfinance Fund
	Real assets			**Actis**: Energy Fund 4	• **Ninety One**: Emerging Africa Infrastructure Fund • **Africa Finance Corporation**: Infrastructure Climate Resilient Fund
		Real estate	**Real estate fund**	**IHS**: IHS Fund II SA	• **Divercity**: Urban Property Fund • **Schroders**: Schroder Capital UK Real Estate Impact Fund
Fixed income		**Bonds**	**Bond fund**	**BlueOrchard**: Schroder International Selection Fund BlueOrchard Emerging Markets Climate Bond fund (CBF)	• **Amundi/IFC**: Amundi Planet Emerging Green One • **IFC**: Masala bond programme (Note: Alternative structure)

Regardless of different starting positions, every institutional asset owner can – and must – do more to meet the magnitude of the challenges confronting people and the planet. This requires concerted and coordinated action with all financial market actors to use existing pathways or create new ones to help institutional capital to flow where it can have the most impact.

For other Just Transition Finance Action Summaries in this series and case studies of financing vehicles that can help deliver a Just Transition, visit www.impactinvest.org/just-transition-finance/