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# **CONSIDERATIONS FOR CREATING A UK GREEN INVESTMENT BANK**

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## INTRODUCTION

The BVCA represents the UK private equity and venture capital industry, from small VC firms to large global buyout houses. The BVCA's Energy, Environment and Technology Board (EETB) consists of UK-based fund managers that invest in low carbon, renewable and sustainable technologies, ranging from early-stage venture capital companies to established infrastructure projects deploying proven clean power generation technologies. Collectively EETB members have over £10 billion in funds under management. To date over £700 million of this has been invested in UK companies, saving an estimated 4.2 million tonnes of CO<sub>2</sub> p.a. whilst creating thousands of UK jobs. EETB members have extensive experience of investing in green businesses and projects around the world and, with that experience, unique insight into the needs of the low carbon sector.

The EETB believes that a well-designed Green Investment Bank can facilitate and accelerate private sector investment to meet the UK's 2020 and 2050 low carbon, renewable energy and energy security targets, as well as create UK jobs. Private equity can play a material role in providing the capital needed to achieve these goals, at the same time as providing the prospect of economic returns to both UK and international investors.

The financial crisis adds yet another obstacle to the UK's low carbon aspirations. Capital is in short supply in all sectors, not just infrastructure. Constraints on bank and utility balance sheets and the lack of an effective loan syndication market delay/prevent the funding of many renewable energy projects. Lack of bank financing also affects later stage cleantech companies whilst many early stage technologies are deemed to present too great a risk for many investors. A properly designed and targeted Green Investment Bank (GIB) will provide a vehicle to help identify and address market failures, thus facilitating and enabling the flow of capital required in order for the UK to achieve its low carbon, renewable energy and energy security objectives.

This paper outlines the BVCA EETB's concept of a Green Investment Bank, specifically addressing:

- Objectives and scope
- Operating principles
- Investment products and activities
- Funding, governance and structure

The EETB recommendations are based on its members' collective experience of more than 100 years of investing in the UK and around the world in renewable and clean energy. In addition to the UK investments noted above, EET Board members have invested elsewhere in Europe, North America, Asia and South America. This investment experience covers on and offshore wind, biomass, biogas, solar, offshore wind services, industrial energy projects, biofuels, energy efficiency, low energy manufacturing, sustainable chemicals, battery and storage technology and others. This practical experience across the low carbon sector and around the world means the EET Board is uniquely qualified to comment on the Green Investment Bank design and implementation.

## **EXECUTIVE SUMMARY**

### **GIB objectives and scope**

- Primary objective to help deliver the capital investment necessary to meet the UK's 2020 and 2050 low carbon, renewable energy and energy security targets through:
  - Catalysing and facilitating private sector investment
  - Providing public sector funding and support where private sector capital is not available
  - Underwriting the economic risks of policy change to mitigate investor concerns about politically-induced market instability
- GIB's scope of activities should be focused on delivering the low carbon economy, specifically addressing:
  - Energy efficiency
  - Renewable energy
  - Low carbon energy

### **GIB operating principles**

- To facilitate and not compete with private sector investment
- To provide value to the UK taxpayer by investing on a fully commercial basis (excluding grants/support to critical early stage ventures not otherwise capable of securing private investment)
- To identify and address market failures limiting the flow of capital
- To be independent of policy formation

### **GIB investment products and activities**

- Standardised set of debt and equity products/instruments across the capital structure; available for investment in projects promoted/vetted by private investors where a specific market failure or funding gap exists for as long as that market failure exists
- Grant or zero interest funding to critical early stage ventures currently unable to secure private sector funding but with material low carbon/economic potential for the UK
- Independent research and advice to the Government on delivering the low carbon economy, including:
  - Advice as to the impact of policy decisions on private investment
  - Assistance to policymakers in prioritising spending to maximise carbon savings and UK economic impact and to minimise costs to consumers
  - Use of the GIB's knowledge and interface with private investors to advise on barriers to investment and the effectiveness of policy measures in attracting private investment
- Formal position as a statutory consultee with respect to any changes in policy that could affect private sector investment
- Provision of financial guarantees to private sector investors to mitigate investment losses or reduced returns resulting from adverse policy and regulatory changes
- Potential coordination or consolidation of existing UK agencies and programmes that provide low carbon finance and investment (maximise the impact and provide integrated policy delivery)

### **GIB funding, governance and structure**

- Self-funding, other than for grant operations, hence able to draw on capital markets to raise appropriate finance to fund its operations

- Set up to qualify for “off balance sheet” treatment from the UK national accounts, but able to exercise the right, via Treasury, to deploy Government guarantees in support of its objectives
- Independent from policy makers; no government ministers with operational or policy control beyond setting the GIB’s overall strategic remit
- Operates against targets set within overall policy framework for UK objectives laid out by DECC; oversight from Treasury on use of Government guarantees
- Board and senior executive team drawn from suitably experienced banking, equity and finance executives; to include those with direct investment experience in the UK and global renewable energy and low carbon industries
- Required to report regularly and transparently on its investments, activities and performance against key objectives and investment targets (similar to any private bank or investor)

## INTRODUCTION

The global economic crisis and credit crunch has added yet another obstacle to the UK's low carbon aspirations: reducing capital flows to the sector thus increasing the risk that the UK will not meet its 2020 and 2050 low carbon and renewable energy targets. Furthermore, there is a growing recognition of the critical need to invest in UK energy infrastructure to renew ageing conventional power assets and enhance UK energy security.

The UK's low carbon investment need is conservatively estimated at £200 billion to meet the 2020 goals, with more required to reach the suggested 2050 goals. Even before the crisis, capital flows were insufficient to create the requisite trajectory, in large part due to the history of UK policy instability in this area and more attractive investment climates in other countries.

One of the many solutions proposed in recent months to rectify these problems is to create a Green Investment Bank (GIB) to facilitate capital formation for the low carbon economy. The proposals put forward range from merely consolidating the many governmental and quasi-governmental bodies already supporting low carbon investment, to formation of a fully-fledged UK infrastructure bank, including low carbon and renewable energy. The BVCA believes that a GIB can help to deliver private sector investment, but it must be carefully structured if it is to achieve success and realise its objectives.

The overriding principle must be to promote private sector investment over public sector investment. The GIB must therefore not displace or compete with private sector capital, but facilitate private sector investment on a fully commercial basis, thus helping access a greater volume of financing from the private sector than would otherwise be available. If the GIB provides free or low cost capital that directly competes with private investors, private investors will simply deploy their capital in overseas markets.

We support a GIB that complements the private sector, where the latter is ready to invest, and that provides grant or non-commercial investment only in those areas not yet ready for private sector involvement.

This paper outlines the BVCA EETB's concept of a GIB and is organised in to four key sections:

1. Objectives and scope
2. Operating principles
3. Investment products and activities
4. Funding, structure and governance

The EETB recommendations are based on its members' collective experience of more than 100 years of investing in the UK and around the world in renewable and clean energy.

In addition to pure financial constraints, we would also emphasise that there are many non-financial barriers to UK low carbon investment. If these are not addressed then the GIB will not succeed in its mission. These obstacles include:

- The UK's history and reputation for lacking a stable and predictable regulatory regime
- A planning system universally recognised as not fit for purpose
- An approach to new grid and transmission capacity that is not delivering
- The lack of strategic integration or joined up thinking across government departments

- Bureaucratic red tape in accessing grants and other funds that are theoretically available

Removing these and other non-financial barriers is as essential to ultimately delivering the low carbon economy as creating a GIB.

## **OBJECTIVES AND SCOPE**

The GIB should have a single overarching goal:

**To help deliver the capital investment necessary to achieve the UK's low carbon, renewable energy and energy security targets**

The three principal strategies for delivering this single objective should be:

### **1. Catalysing and facilitating private sector investment**

The GIB should invest in a manner that encourages and promotes greater private sector investment, by investing alongside the private sector in a range of debt and equity investments, seeking commercial rates of return.

### **2. Providing public sector funding and support where private sector capital is not available**

Certain critical technologies (such as carbon capture and storage, offshore wind, wave and tidal power) present development/deployment risks and time frames to commercial viability beyond the scope of typical private investment. Similarly, small companies such as housing insulation contractors will generally not offer the scalability or returns required by the private equity sector whilst their access to bank financing will have declined with the credit crisis. The GIB should be able to provide the grant, seed equity and business loans and other financial instruments to support such businesses and projects.

### **3. Underwriting the economic risks of policy change**

Private investors are wary of regulatory risk in general, and are specifically wary in the UK, with its history of regulatory change and instability. Given policy decisions sit with the Government, as a Government-affiliated body the GIB should be able to offer financial instruments and guarantees that take the economic risk of policy change away from investment, especially in the larger infrastructure investments that will be required.

We believe that to ensure maximum chance of success, the GIB's scope of activities should be focused on delivery of the low carbon economy. In particular it should be targeted at the areas of energy efficiency, renewable energy and low carbon energy. Activities and investments that may reduce carbon but are not clearly in these three core sectors (such as high speed rail and greater internet penetration) would likely be better addressed by institutions other than the GIB. We therefore see the GIB operating in the following three areas:

#### **1. Energy efficiency**

It is well known that energy efficiency presents substantial opportunities to reduce carbon emissions and energy consumption and reduce costs to consumers. The GIB should operate in this area, which should be broadly defined. Clearly energy efficiency should include home

insulation, more efficient buildings and the like; the definition should also extend to investments in smart grid companies and technical suppliers, new devices (such as computer data storage that uses less energy) and new more efficient manufacturing processes.

## **2. Renewable energy**

This would cover large scale and small scale energy generation in both onshore and offshore wind, solar, biomass, marine renewables, geothermal and biofuels (bioethanol, biodiesel, biogas), as well as related areas such as the grid, pipelines, storage (both large and small scale) and supply chain infrastructure (such as offshore wind port facilities and installation and service vessels).

## **3. Low carbon energy**

This would include the likes of carbon capture and storage, nuclear power, district heating systems and potentially even efficient combined heat and power units, and of course related grid, pipeline and storage infrastructure.

The EETB believes that the GIB should be separate from a broader infrastructure bank mandate for the following reasons:

- Energy and low carbon requires specific expertise distinct from other infrastructure such as rail, roads and transport, and social infrastructure like schools and hospitals
- Providing greater focus to the GIB will ensure it can be staffed for a clear purpose, is not competing with other claims on funding and is consequently more likely to achieve success in its core target areas
- The markets in which the GIB might raise capital for its operations may be more favourably disposed towards “traditional” low carbon investment than general infrastructure, making it easier to raise funds

This is not to say that these other infrastructure requirements are not of high importance but simply that a GIB more focused on a few core areas would likely have a better chance of achieving measurable success. Over time, as these positive results are achieved, the GIB’s core mandate and scope can be further expanded if it is found to be an effective delivery body.

## **OPERATING PRINCIPLES**

Private capital not public capital; the market and not Government. These should be the overriding principles behind the GIB.

The BVCA EETB believes that the GIB should clearly be a facilitator and catalyst of private capital. It should not be a substitute or a competitor to private capital. If private investors believe that they are competing against subsidised/artificially low-cost capital, or if the GIB is not seeking a commercial rate of return in areas that can command this, then private capital will not flow and the Government’s objectives will not be met. Similarly, if the GIB backs technologies and projects for non-market reasons (such as purely for jobs or hopes of an export market), is required to back only politically favoured technologies/companies or seeks to “pick winners” over the market, it again runs the risk of failure and pushing out the private sector.

It is therefore our recommendation that the GIB should operate under the following fundamental operating principles:

- 1. To facilitate and not compete with private sector investment**
- 2. To provide value to the UK taxpayer by investing on a fully commercial basis (excluding grants/support to critical early stage ventures not capable of securing private investment)**

Principles 1 and 2 are addressed together. The GIB should only invest where required to deliver low carbon investment. Wherever possible, it should do so only alongside private sector investors who originate, diligence, price and promote the investments on a commercial basis. In this way the market and not the Government remains the arbiter of the winning technologies, projects and management teams, as well as ensuring the appropriate pricing and returns relative to the risks involved.

Consequently, other than in the provision of grants/support to non-commercial activities (as described elsewhere) the GIB:

- Should not take the lead in originating, sponsoring or structuring investments
- Should only co-invest alongside private investors in opportunities brought to it by the private sector
- Should only look to invest for commercial rates of return, commensurate with the private sector

This approach should not only ensure the private sector is not displaced, but should also serve to minimise political pressure to back specific investments or technologies. In addition, it will reduce the staffing level and thus the operating costs of the GIB, given much of the origination, diligence and screening will be done by the private sector. With the exception of grants and support for nascent clean technology ventures, the requirement of ensuring a commercial return will avoid the GIB becoming perceived as a competitive threat to the private sector.

- 3. To identify and address market failures**

The GIB should operate in areas where there are identifiable and addressable market failures. For example, the current lack of an effective banking syndication market, which is proving to be a key limiting factor in projects getting funded. Although the syndication market is likely to come back over time, the need for banks to hold large quantities of long-dated debt on their balance sheets is constraining overall lending levels to green projects. The GIB should look to intervene to rectify this and other market failures, as long as they exist, and withdraw as soon as they are corrected.

- 4. To be independent of policy formation**

We see the GIB as an implementation vehicle, not a policy formulation vehicle. By setting the GIB apart from any regulatory or policymaking role it will further ensure that it operates on an independent commercial basis and remains fully aligned with its core mission of stimulating private sector investment. However, this does not mean that it should not have a key role as a source of independent technical and economic research and analysis for policymakers in this area, as indeed we suggest below.

## INVESTMENT PRODUCTS AND ACTIVITIES

We suggest six potential activities or roles for the GIB. We have identified market or funding failures relevant to each of these areas and recommend investment products and measures that we believe could help alleviate these failures, attract private capital and rapidly accelerate low carbon oriented investment in the UK. The proposed investment products and activities for the GIB are:

1. Standardised set of debt and equity products/instruments across the capital structure; available for investment in projects promoted by private investors where a specific market failure or funding gap exists
2. Grant or zero interest funding to critical early stage ventures currently unable to secure private sector funding but with material low carbon/economic potential for the UK
3. Independent research and advice to the Government on delivering the low carbon economy, through information and analysis to assist policymakers in prioritising spending to maximise carbon savings and job creation and minimise costs to consumers
4. Formal position as a statutory consultee with respect to any changes in policy that could affect private sector investment, including analysing the costs and risks of such changes and impacts on investment levels
5. Provision of financial guarantees to private sector investors to mitigate investment losses or reduced returns resulting from adverse policy and regulatory changes
6. Potential coordination or consolidation of existing UK agencies and programmes that provide low carbon finance and investment, with a view to maximising the impact and providing integrated policy delivery

Each of these six areas is expanded on in more detail below.

### **1. Standardised set of debt and equity products/instruments across the capital structure; available for investment in projects promoted/vetted by private investors**

For projects that can secure meaningful but not 100% private sector investment, or where there are market failures that have stalled or constrained private sector investment, we envisage the GIB having the ability to provide a range of debt and equity instruments capable of mobilising private capital and filling funding gaps.

Although the GIB should have the flexibility to invest across the capital structure, we strongly recommend that it develop a standardised, limited number of products in each area. This will ensure investments can be categorised in a straightforward fashion (an important point for the reporting requirements we suggest below) and will also give clear guidance to private investors as to types of support available. The GIB should avoid too wide a range of products, or highly bespoke products for individual investments. We would anticipate that the GIB would typically provide such support instruments/co-investment to projects where a minimum of 60-80% of the capital required has already been secured.

By way of example, some of the specific market failures that we perceive, together with certain illustrations as to the instruments/products that the GIB could offer, include:

- Failure of the bank syndication market. The banking crisis has resulted in virtual elimination of loan syndication markets for large investment projects. Without such a market, and in light of constrained bank balance sheets, it is nearly impossible to raise the large amounts of capital needed for green infrastructure like offshore wind. Rating agency requirements for investment grade bonds are difficult to meet, thus the bond markets are not available. If the GIB could either purchase and securitise project finance loans or offer credit enhancement to publicly traded bonds, it would free up capital that is not flowing to the sector. Such an intervention by the GIB should, however, be temporary, recognising that the syndication markets for long-dated, relatively low risk green infrastructure debt should return.

Another idea would be for the GIB to support a debt fund (as the Government is providing support for a venture capital fund of funds, through the Innovation Investment Fund) that would make debt investments alongside private sector lenders. It could do so by providing a level of seed funding to be matched by other lenders such as pension funds. The fund would then purchase participations in loans originated by private sector banks.

- Lack of loan or investment guarantees. In many cases private sector confidence to invest could be enhanced through the provision of some level of loan or investment guarantees. These could be used by the GIB in lieu of direct cash investments, thus extending the GIB's reach, which could otherwise be limited through funding constraints. Whilst the use of guarantees would require the GIB to take some risk, it would not need to fund any cash commitments unless the guarantees were called upon. It could also be possible to contemplate some charge for providing such guarantees, ensuring a return for the GIB.
- Funding gap for venture capital co-investment. Venture capital (VC) backed companies, whether start-ups or later stage, are typically funded by syndicates of VC investors rather than by a single VC investor. With the recent decline in VC fundraising arising from the credit crisis, assembling such syndicates is taking longer and is at times failing. A facility that simply offered to match, say, 10-20% of the capital invested in such companies by qualified, experienced, investors would have multiple benefits, including:
  - Increasing the amount of venture capital available in the market (along the lines of what is currently being done through the Innovation Investment Fund). This could stimulate VC funding of early stage clean or green technology ventures through a multiplier effect, very much as the German and Irish governments have been doing successfully for many years through the High-Tech Grunderfonds and Enterprise Ireland
  - Giving comfort to VC investors that policy changes are unlikely as the GIB is an investor for a commercial rate of return on tax-payers' money
  - Reducing the time it takes to assemble a venture capital syndicate and making such funding consortia more likely

When acting as a VC investor, we would suggest the GIB should have the ability to "follow" its investments through subsequent investment rounds. In VC it is not uncommon for new companies to have several "rounds" of fundraising, with each round hopefully (but not always) at a higher valuation than the previous round. To maximise the GIB's prospects of earning a return on its early stage investments, it should be able to invest in subsequent rounds alongside other investors. Clearly, at some point in a VC investment the actual requirements for GIB support may fall away. Nevertheless, we would suggest the GIB be given broad flexibility in determining when not to provide follow-on investments. From an

operational standpoint, this means that the GIB may need to reserve capital for such follow-on investments.

- *Lack of intermediate capital for projects and companies.* Certain companies and newer technologies, which may be proven but lack the extensive track record of onshore and offshore wind, may be able to secure workable levels of project finance debt but not at gearing levels sufficient to provide equity investors with the necessary rate of return. In many such cases the gap may be filled with “intermediate or mezzanine” debt or quasi-equity capital, subordinated to the principal senior bank or bond debt but ranking higher than equity. It earns a higher return than senior debt but lower than equity because it has a lower risk profile. Given its return is usually limited, if the project or company performs as expected then actual equity returns will be higher. This additional leverage can make the difference between acceptable and unacceptable returns to private sector capital.

It should be noted that, where the GIB makes an equity co-investment, it should have all the same economic rights and upside potential as the private equity investors. However, we strongly recommend the GIB takes a passive role opposite the underlying projects/companies and would discourage any attempt to manage its investments actively. The latter should be left to the private sector investors who have the requisite experience and expertise and who are already answerable to their funds’ investors on a quarterly or semi-annual basis for optimal investment performance.

## **2. Grant or zero interest funding to critical early stage ventures unable to secure private sector funding but with material low carbon/economic potential for the UK**

In addition to the seed capital and early stage VC co-investment described above, there are emerging and unproven technologies that cannot be advanced or deployed without significant Government support. These would include early stage energy storage, marine, wave and tidal technologies, and carbon capture and storage demonstration projects. Other innovative businesses may not be able to attract funding until they are more mature. The GIB should clearly operate in the sphere, either directly or potentially coordinating existing programmes.

## **3. Independent research and advice to the Government on delivering the low carbon economy, through information and analysis to assist policymakers in prioritising spending to maximise carbon savings and job creation and minimise costs to consumers**

The GIB should serve as an independent research and financial advisory unit to Government, and potentially to the private sector, on economic and financial matters impacting on low carbon investment. This is not intended to put the GIB in the position of directly formulating policy, which we believe should remain with DECC or another appropriate agency. Rather, the GIB would have a role in providing experience-based financial and economic advisory input and acting as a source of expert information.

The research and advice should assist policymakers in prioritising spending and shaping legislation to maximise carbon savings and job creation and minimise the costs to consumers. As such it should include:

- Cost/benefit analysis of various renewable and low carbon technologies
- Review of investments offering the greatest low carbon impact per £1 invested

- Advice on financial structuring of large scale projects
- Analysis of investment risks and returns, to provide non-specialist private sector investors with better information about low carbon investment prospects
- Experienced-based suggestions for improving policy effectiveness

We envisage that this could be set up as an independent research and analysis function, similar to that in a private banking environment. The GIB will also be well placed to potentially police any market abuse of new policies, such as Feed in Tariffs.

The GIB will be uniquely positioned to advise the Government on which policies are working and which are not working in attracting private capital, and thus to suggest changes from time to time to improve capital flows. For the avoidance of doubt, we see this as advice on delivery of the low carbon targets based on practical experience and not a primary policy making role, which properly belongs with Government.

However, clearly there must be an interaction between research and policy and, as the goal of the GIB is implementation, it must have regular interface with policy makers. At present it appears to be broadly accepted that there are too many policymaking bodies with overlapping and sometimes conflicting remits and objectives. Even though the GIB should not make policy, for it to be successful, an effective policy making function is required. To this end, we believe that placing low carbon policy in one place would greatly contribute to the effectiveness of the GIB.

#### **4. Formal position as a statutory consultee with respect to any changes in policy that could affect private sector investment, including analysing the costs and risks of such changes**

With its interface with market, the GIB should have an important role in advising on the economic impact of any low carbon policy changes. As noted above, the policy instability of the UK is one of the main reasons as to why it lags much of the rest of Europe in low carbon investment. The GIB should be consulted as a matter of statute on policy changes, specifically addressing the economic costs of any change and the impact on private sector investor confidence and appetite.

#### **5. Provision of financial guarantees to private sector investors to mitigate investment losses or reduced returns resulting from adverse policy and regulatory changes**

The UK low carbon and renewable energy sector has been plagued by regulatory uncertainty. Examples include the continual changes to and consultations on the Renewables Obligation, changing targets on the Renewable Transport Fuels Obligation and Ofgem's Project Discovery suggesting reversals of established energy policies. This instability harms investor confidence and drives private capital to other markets that do not present such uncertainty.

To attract capital, therefore, the GIB could consider providing financial guarantees against policy change that harms private investment. This is relatively unexplored territory, but possible tools the GIB could consider include the following:

- Providing insurance against adverse policy change, for example through a compensation mechanism that can be triggered to address the resulting economic delta

- Application of a guarantee for the original investment made, such that investors do not lose the money invested in good faith, in the event of a change in Government policy
- Forfeiture or subordination of any GIB investment described above in the event of a policy change that materially changes the prospects for the business and hence the returns expected by the private sector

#### **6. Potential coordination or consolidation of existing UK agencies and programmes that provide low carbon finance and investment (maximise impact and provide integrated policy delivery)**

By one estimate, there are more than 50 different governmental and quasi non-governmental agencies that have overlapping remits in seeking to encourage low carbon investments, provide grants/other funding available to the low carbon sector or advise the Government on low carbon strategies and deployment. Many of these programmes have yielded success, yet there has been overlap and lack of joined up thinking, reducing the overall effectiveness and the impact of Government expenditure. It is worth reviewing whether the GIB could coordinate or consolidate some of these agencies and programmes, in order to enhance efficiency, maximise return on investment and provide more integrated policy delivery.

### **FUNDING, STRUCTURE AND GOVERNANCE**

#### **Funding**

We envisage that the Government will make an initial investment to found the GIB and secure its equity capital (although this could potentially be done in partnership with private investment). Apart from that the GIB should draw its capital from two sources: (i) for its general operations the GIB should be self-funding, raising funds directly from the capital markets; and (ii) for its grant/non-commercial support operations the GIB should be allocated funds direct from Government.

We would expect that the GIB would issue Green Bonds in the capital markets and that these Green Bonds would have the explicit or implicit guarantee of the Treasury. The characteristics of these bonds will determine their attractiveness to institutional and individual investors. We believe that making the income on such Green Bonds tax-exempt and inflation linked would be a powerful tool to attract both pension funds (worried about inflation from the recent Government stimulus) and individual investors (attracted by the tax exemption). The implications from a regulatory standpoint of attracting different investor types would, however, need careful consideration. Given much of the investment required to deliver a low carbon economy will be in long term infrastructure, we suggest longer term bonds may make sense.

Another source of funding that might not require a Treasury guarantee would be to raise a charge on electricity and gas consumption. In effect each KWh electricity and BTU of gas consumed would have a charge of, say, 1p per KWh attached to all consumer bills. This revenue stream would be made available to the GIB against which it would issue bonds, which should be AAA because they are implicitly guaranteed by the entire consumer base. The proceeds from the bonds would be used to finance GIB investments. If the returns on the investments exceeded the returns on the bonds, the profit could either be returned to consumers as a reduction in bills, or used for reinvestment.\*

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\* The EET Board acknowledges that the genesis of this concept came from Rothschild and continues to be explored.

Finally, a further logical source of funding for the GIB could be revenues derived from the auction of carbon credits under the EU ETS. These are anticipated to ramp up significantly as the percentage of EUAs auctioned, rather than given away for free, increases over time.

### **Structure and governance**

We recognise that the governance structure and staffing of the GIB covers a broad array of policy issues and concerns, ranging from which Government department or departments would set its strategic direction to the compensation of its staff. We offer the following broad suggestions:

- The GIB should be independent and operate on a commercial basis, much like the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD). We would, however, stop short of the strict additionality requirements imposed on the European Bank of Reconstruction and Development in favour of a different standard: whether or not the GIB's activities are fostering the Government's low carbon policies and objectives
- We believe that the GIB should operate under the clear strategic direction of just one Government department or agency. We recommend that this should likely be DECC, given DECC is the Government department charged with delivering the low carbon economy. The GIB will be a key delivery tool to that end, so having it placed under DECC's aegis would appear to be logical and efficient
- For the GIB to be viable and deliver its mission, while at the same time providing value for money to the UK taxpayer, the GIB will need to attract experienced private sector lenders and equity investors and will have to pay them competitively versus the private sector. This is consistent with both the EIB and EBRD, who have managed to attract top flight private professionals through competitive remuneration
- We think that the board of the GIB should be staffed with senior, experienced bankers and investors from the City, with direct experience of investing in these types of companies. We do not think it should be populated with academics who do not have the relevant practical investment expertise. We also believe that thought be given to whether the Government representatives should be from Treasury or a finance function in an enlarged DECC, but not necessarily from a policy function. This is because the GIB's role should be clearly focused on delivering the capital to implement government policy and should not be a policy making body in and of itself

### **Reporting**

Too often existing Government investment schemes fail to report activities, performance and results in a timely and coherent manner. As the GIB's mission is to catalyse private sector investment the GIB should adopt the same reporting and information standards as its private sector banking and equity investor counterparts. The GIB should report regularly and transparently on its investments and activities, as well as on performance against its key objectives and investment targets. Such reporting should include:

- Annual and semi-annual financial statements, delivered within the same timeframes as a London Stock Exchange listed company

- Quarterly reports on investments made and investment performance, including valuing investments at least semi-annually using fair value accounting
- Clear status reports on how the GIB is delivering private sector investment and hence contributing to the UK's transition to a low carbon economy

These measures will help ensure that that appropriate transparency and accountability is in place around the GIB's operations.

## **CONCLUSION**

A well designed and implemented GIB, operating under the principles and in the areas outlined in this paper, could prove an extremely powerful tool to spur private sector investment and help the UK meet its low carbon, renewable energy and energy security objectives. However, if this is going to happen then action is needed quickly and decisively, as the UK is already falling behind its existing targets. To that end there should be a clear development roadmap and a strong sense of urgency in putting the GIB in place, once the decision to proceed has been made.

## **BVCA AND UK PRIVATE EQUITY**

The BVCA represents the UK private equity and venture capital industry, from small VC firms to large global buyout houses. The BVCA's Energy, Environment and Technology Board (EETB) consists of UK-based fund managers that invest in low carbon, renewable and sustainable technologies, ranging from early -stage venture capital companies to established infrastructure projects deploying proven clean power generation technologies. Collectively EETB members have over £10 billion in funds under management. To date over £700 million of this has been invested in UK companies, saving an estimated 4.2 million tonnes of CO<sub>2</sub> p.a. whilst creating thousands of jobs. EETB members have extensive experience of investing in green businesses and projects around the world and, with that experience, unique insight into the needs of the low carbon sector.

The EETB supports the proposals for a Green Investment Bank to facilitate and accelerate private sector investment in support of the UK's 2020 and 2050 low carbon, renewable energy and energy security targets, as well as in creating jobs for the UK economy. Private equity can play a material role in providing the capital needed to achieve these goals, at the same time as providing the prospect of economic returns to both UK and international investors

UK Private Equity has demonstrated over the last 10 years that it:

- Excels at backing innovative companies
- Creates UK jobs
- Provides superior returns to UK investors
- Spurs capital formation

The UK is home to the world's second largest private equity (PE) industry. In 2008 UK PE investors invested £20 billion in over 1,600 companies. Many private equity and venture capital firms have been investing in clean technologies and renewable energy projects for over a decade. In particular:

- PE-backed companies currently employ 1.1 million people in the UK, almost 6% of the total private sector workforce
- PE excels at backing innovation (both finding new technologies and reinvigorating old ones) and backing ideas, such as information management; skills which will be much needed for low carbon innovation

PE funds, through their long-term investments, are successfully generating superior returns to UK and international institutional investors and pensioners. The debt crisis has affected most asset classes and investment strategies, including private equity, but long-term private equity returns remain superior to other investment classes. Over ten years, annual private equity returns have been, on average more than ten times higher than the FTSE All-Share index (15.4% compared with 1.2%). This is in part because long-term fund manager compensation is linked to long term superior performance – the alignment of interest that has been missing in much of the financial sector. We believe the UK Private Equity and Venture Capital industry has a lot to offer in helping drive the UK's transition towards a low carbon economy.

Together with determined government support, we would then be in a position to build the UK into a world leading centre of excellence for clean technologies and renewable energy infrastructure, with all the attendant social and environmental benefits entailed.

**KEY CONTRIBUTORS TO THIS PAPER  
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