CDC
Investment works

The UK's development finance institution

Sarah Champion MP
Chair, International Development Select Committee
House of Commons
London
SW1A 0AA

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Dear Sarah Champion,

We are writing further to the oral evidence session on 20 July 2021. The Committee clerk kindly provided the opportunity to provide clarification to the additional points raised in CAFOD's follow-up letter to the Committee (dated 20 August 2021). We hope the following provides clarity on our approach.

We agree with the Committee that climate change is a unique global challenge in terms of scale, urgency, magnitude and complexity of action. From increased flooding and droughts to decreased crop yields, the effects are complex, severe and are happening now. Without decisive action, it will be particularly devastating for those living in Africa and South Asia. The key question for CDC as a development finance institution has been: how do we support economic transformation and poverty reduction in a socially just manner that not only delivers on people's needs for prosperity and improved living standards, but also builds the foundations for net zero emissions by 2050 and increased resilience?

In response, we have adapted our investment practices and published a leading new Climate Change Strategy. The Strategy – launched in July 2020 - it is central to everything we do and ensures that our activities are aligned with the Paris Agreement. This includes assessing investments at a portfolio and transaction level for their 1.5 degree alignment, as well as having a strong focus on adaptation and resilience, and supporting the just transition. In addition, the Strategy increases the amount of climate-focused investment which has already seen CDC invest $1.2 billion across Africa and South Asia since 2017: from helping to build the off-grid home solar market; to pioneering innovative battery storage; and the development of large scale renewable projects.

The letter that the Committee received raised concerns related to the following topics:
- Transparency;
- Fossil Fuel Policy and Gas Tool;
- Energy portfolio;
- Globeleq's investments; and
- Overseas Development Assistance (ODA).

As a taxpayer funded institution, we feel it is important that all stakeholders have clarity on our policies and practices and understand how they are applied. We will now address each of these points in turn, acknowledging that as a learning organisation we are always looking to improve.

Transparency
CDC publishes information on all of our investments on our website (available here)**.** This includes details on both direct and indirect investments. Indirect investments refer to funds. When investing through investment funds, CDC takes an active role as a limited partner to the fund, working with the fund manager to ensure best practices, including in environment, social and governance matters, and investment management oversight. More information on the type of capital we provide is available here.

We were proud to begin reporting under the Taskforce on Climate-related Financial Disclosures (TCFD) in 2019. Our second TCFD-aligned disclosure (available here, p. 22) reflects the work we undertook in 2020 to advance our implementation of the TCFD recommendation. The approach taken preparing this disclosure reflects the fact that good practice on the methodologies and metrics for reporting is still evolving. We recognise it is a multi-year journey and that disclosing consistent and comparable information about the risks and opportunities associated with climate change calls for close collaboration and engagement with peers, investees, borrowers and other stakeholders. To complement our TCFD reporting, last autumn, CDC published our energy portfolio (available here). This is an exercise we plan to repeat this year, as committed to in the answer to this Written Parliamentary Question.

We hope we have demonstrated to the Committee our willingness to engage including with inquiries and in providing briefings on specific thematic areas.

Fossil Fuel Policy

As a DFI, our mandate is poverty reduction and we do this by driving economic development. Climate change undermines this. The development, economic and business cases for climate action is clear and that is why our Climate Change Strategy and Fossil Fuel Policy articulates how we will support clean, inclusive and resilient growth in Africa and Asia.

Transformation of the electricity sector is central to achieving net zero emissions by 2050. An unprecedented increase in the deployment of renewables is required. **Our investment practices have already changed to recognise the challenge** - we have pivoted to renewables with climate finance growing from just 5% in 2016 to a target of 30% today.

Furthermore, our new Fossil Fuel Policy updates our formal exclusions. The Policy – which is aligned with HMG's own policy - ensures:

- coal and oil investments are prohibited;
- the exploration, production, refinement, and distribution of fossil fuels[1] is prohibited;
- no gas investments for the purposes of LNG exports/imports;
- no dual fuel gas/Heavy Fuel Oil (HFO) in any case,
- no gas power investments in a country where the existing grid is sufficient to absorb significant new renewable energy (such as India); and
- no new gas where the assessment has concluded that the investment would not be consistent with a pathway to net zero.

All new investments – including to funds - are assessed against this Policy and any deemed to be misaligned would not be approved either because of an automatic exclusion (listed above) or because it does not pass the stringent criteria for gas power (discussed below) . **The claim that a large percentage of existing fossil fuel investments would still be approved is incorrect** - a number of the investments listed in CAFOD's assessment would not even be *considered* by our investment teams now as they would fall into one of the automatically excluded categories. For example, Summit Meghnaghat and Sirajganj 4 are dual fuel gas/oil plants and would automatically be excluded, as would Bangla Offshore LNG because it is gas import infrastructure.

The Fossil Fuel Policy recognises that in certain — but not all — circumstances, gas power can play a transitionary role towards net zero emissions. Our position is supported by the International Energy Agency (IEA). Their Net Zero Scenario sets out that no new oil and gas fields are required beyond those that already have been approved for development. However, the IEA also acknowledges that natural gas fired generation remains an important part of electricity supply to 2050 and strong government support will be needed to ensure that Carbon Capture Utilisation and Storage is deployed soon and on a large scale (p.120 of the IEA's Net Zero Scenario). Therefore, our Policy is fully consistent with this assessment, by excluding oil and gas exploration and production, but permitting, in limited circumstances, gas power generation.

Gas Tool

We have developed a Gas Tool to assess whether a gas project is truly transitionary. It is a clear change from 'business as usual', is consistent with HMG's criteria and sets a high bar for any project**. The Tool considers four areas**: the system-level and asset-level characteristics of a

[1] An exception may be LPG for cooking and heating given the lack of alternatives and strong developmental benefits.

project; its development impact[2]; and the transition (stranded asset) risks associated with it. It is built on the recognition that gas plants can only be considered Paris aligned if they are the only viable option for providing essential energy supply in a context where renewables are also being pursued; and where there is a clear shift away from higher carbon fossil fuels such as coal and HFO.

The system level assessment includes:

- Can the country's demand growth and power need profile be met with renewables alone?
- Would the investment be in line with the country's Nationally Determined Contributions (NDC)[3] and long-term decarbonisation strategy?
- If that is not yet established, has the country's government shown clear commitment to low-carbon pathways?

At an asset level, each potential investment is also evaluated on the extent to which:

- there is no viable renewable alternative;
- the carbon lock-in risk is managed as far as possible;
- the lowest emissions technology is used for the role of the plant;
- the operating regime allows for a more flexible operation over time to support renewables; and
- it is replacing higher carbon alternatives.

The Gas Tool is robust and is designed for practical implementation in our markets. It is important for all countries to develop a long-term decarbonisation strategy (in accordance with Article 4 of the Paris Agreement) and that is why our Gas Tool looks for this assessment in the first instance. However, the reality is that only around 30 countries in the world have submitted these plans to the UNFCCC, of which only two are in countries eligible for CDC investment. In the absence of a decarbonisation strategy (and to incentivise action now behind infrastructure that will lay the foundations for net zero by 2050), the Tool looks for evidence that the country's government has shown a clear commitment to low-carbon pathways.

Our approach recognises the limits of the global remaining carbon budget. In the past, many climate considerations stopped at assessing relative emissions. In other words, whether a specific project represents an incremental improvement in emissions in the short-term: for example, by moving from a higher carbon source to a lower carbon source. While that is an important and necessary factor, the Tool recognises that is not sufficient given the limits of the global remaining carbon budget. Paris alignment as per the Tool is therefore about taking into account 1) the absolute emissions profile of the specific investment and importantly, 2) assessing whether that fits within the country's pathway towards net zero by 2050.

An example of the type of country where CDC might consider gas power is Mozambique where seven out of every ten people do not have access to electricity and 53% of firms report electrical outages. There are no viable renewable alternatives for Mozambique meeting its power needs and avoiding the projected shortfall in electricity production by 2024 and possibility of blackouts.[4] Blackouts affect peoples' homes, their safety at night, and the ability of businesses to grow, as well as vital services such as hospitals, schools and water services. CDC is supporting Mozambique in its transition through investing in renewables and battery technology, as well as a Paris aligned gas project, Temane. The Temane project meets the criteria of HMG's policy, exhibits strong Paris alignment (after a robust asset and system analysis) and represents low transition risk. With a highly flexible design, Temane can provide essential baseload power and over time move towards a peaking role and thus supports intermittent renewables such as solar as they are added to the grid. Furthermore, the project anchors a 563km transmission line enabling greater energy access and enhanced renewable penetration. The evidence of Mozambique's commitment to renewables can be seen in the existing and planned procurement of several solar projects, including Cuamba, one of

[2] For example: how many more people would have electricity and the positive economic impact derived from reliable power resultant from the investment.

[3] NDCs are national climate plans including climate related targets, policies and measures governments aim to implement in response to climate change and as a contribution to global climate action.

[4] Timescales for the hydropower alternatives in country are significantly too long for when the power is needed in Mozambique. Renewables plus storage alternatives would cost the national power utility and end users multiples more per unit of energy, require a battery installation significantly larger than the largest battery installed anywhere in the world today, and would require more solar and wind generation than is grid connected in sub-Saharan Africa today (excluding South Africa)/ Even then renewables plus storage would still be unable to provide the certainty of 24-7 supply (offered by Temane) in certain climatic scenarios (e.g. a cloudy, winter).

the first solar PV and energy storage projects in sub-Saharan Africa, developed alongside Temane by Globeleq. All of this underlines the role Temane can play to a support rather than hinder the introduction of more renewables over time.

Energy portfolio

Due to investment decisions made since 2017, **our portfolio has already been transitioning away from fossil fuels.** The proportion of renewables is continuing to increase and this process will accelerate as we implement the targets set out in our Climate Change Strategy**.** Evidence of this can be seen in our portfolio: last year, the value of our renewable portfolio reached $954m, surpassing that of fossil fuel investments. An additional $135m in Climate Finance assets other than renewable energy at year-end means our overall climate finance portfolio is now 20 per cent larger than our fossil fuel portfolio.

Divestment sounds like an easy solution, but it can create damaging unintended consequences. Responsible exits are a key part of CDC's mandate. A quick sale of assets now would simply offload the emissions problem onto other investors. While that might improve our portfolio statistics, ultimately it will not benefit the host country or the planet as the emissions will still exist and potentially be overseen by less responsible investors. Instead, we will actively support companies to adapt and transform to reduce their carbon footprint.

We're developing a carbon budget which will set out the clear trajectory for achieving net-zero by 2050 and meeting the ambitions of the Paris Agreement. We expect to publish later this year and alongside our Climate Change Strategy and related policies, the budget will guide future investment decisions.

Globeleq

CDC is proud of the role we have played in influencing Globeleq – sub-Saharan Africa's largest independent power producer – to pivot towards renewables. Globeleq has 11 renewable projects either in construction or operational in four countries in Africa, totalling over 500MW generation capacity. This is an increase from three projects in one country when CDC and Norfund (Norway's DFI) took majority ownership of the company.[5] Globeleq's projects include Cuamba, the solar and battery storage project referred to earlier, as well as Malindi in Kenya, the first full utility scale (>40MW) solar plant to get to financial close in East Africa. The significant increase in renewables at Globeleq demonstrates the direction of travel for the company. Globeleq has adopted the Gas Tool developed by CDC and the Temane gas project has been subject to careful assessment in line with the commitment to support the transition to net zero by 2050. **All future Globeleq investments will be in line with CDC's own climate policies.**

For completeness, references were made to a company owned by Globeleq and operating in Nigeria called GPSN (formerly CPGNL). This company has been working with business to replace higher emitting diesel auto-generation with gas generation and in seeking to introduce hybrid solutions with solar in order to provide reliable power to one of sub-Saharan Africa's most challenged countries from a grid electricity provision perspective.

Overseas Development Assistance

Governments globally recognise the need for different financing tools to meet the SDGs, from grants through to fully commercial investment. CDC is a complementary part of the UK Government's overall aid effort in providing development finance, which helps to bridge the gap between grant aid and full commercial investment. The growth in CDC's size over the past decade brings us in in line with French, German and Dutch DFIs. The majority of our investment commitments over the last ten years have been funded from returns from successful investments and CDC's operating expenses are covered by long-term returns, not the aid budget – noting that, along with the rest of the sector, CDC has not been immune to the impact of recent changes. We work closely with the FCDO on our funding requirements and decisions on future funding for 2022 will be made in due course. Funding allocations are recorded on Dev Tracker.

Thank you for providing us with this opportunity to respond.

[5] Please note: Globeleq is an independently run company, owned by CDC and Norfund and with a diversely constituted board, rather than an entity which is a subsidiary of CDC.

Yours sincerely,

Amal-Lee Amin
Climate Change Director