Australian Government

CLEAN ENERGY FINANCE CORPORATION

CEFC INVESTMENT POLICIES

(In accordance with section 68, *Clean Energy Finance Corporation Act 2012*).

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1 Introduction

The Clean Energy Finance Corporation ("CEFC" or "Corporation") was established to facilitate increased flows of finance into the commercialisation and deployment of Australian based renewable energy, energy efficiency and low emissions technologies. The CEFC invests in accordance with its governing legislation, the *Clean Energy Finance Corporation Act 2012* (Cth) (the "CEFC Act") and the *Clean Energy Finance Corporation Investment Mandate Direction 2013* (the "Investment Mandate"), as issued by Responsible Ministers, the Treasurer and the Minister for Finance and Deregulation.

The CEFC is a statutory Commonwealth authority operating under the governance regime of the *Commonwealth Authorities and Companies Act 1997* (Cth) (the "CAC Act"). The CEFC is governed by an independent Board of Directors, chaired by Jillian Broadbent AO and reports to Parliament through its Responsible Ministers. In accordance with section 46 of the CEFC Act, it will have access to funding of $10 billion which will be comprised of annual appropriations to the CEFC Special Account of $2 billion every 1 July from 2013 to 2017 inclusive. The CEFC will commence funding investments from 1 July 2013.

The environment and the reliable supply of energy are critical to our standard of living. Public policy in both energy and the environment is challenged by the uncertainty and long lead times which characterise these areas, yet it needs to be maintained across economic and political cycles.

The investment objective of the CEFC is to fulfil our mission to:

> *"Accelerate Australia's transformation towards a more competitive economy in a carbon constrained world, by acting as a catalyst to increase investment in the clean energy sector."*

The Corporation will seek to make commercial investments, to counter market failures and financing impediments and to generate positive public policy outcomes. The CEFC will supplement existing clean energy initiatives, such as the carbon price, the Renewable Energy Target ("RET") and grant funding from the Australian Renewable Energy Agency ("ARENA").

The CEFC will achieve its mission through the prudent application of capital in adherence with the Investment Mandate and these *CEFC Investment Policies* issued by the Board under section 68 of the CEFC Act.

By adopting a commercially rigorous approach to investment activities and risk management practices, it is expected that the CEFC will invest responsibly and manage risk prudently to ensure that its investment portfolio performs above the

Government's cost of funds which is reflected in the Portfolio Benchmark Return in the Investment Mandate.

This document is intended to articulate the framework established by the CEFC Board for the governance and management of CEFC investment activities by providing a statement of investment policies that will be adhered to in investing the CEFC's assets and in managing the Corporation itself. The *CEFC Investment Policies* recognise the competing challenges faced by the CEFC under its Investment Mandate. These challenges, which must be reconciled operationally, include the commercial imperatives of the CEFC, its requirement to achieve financial self-sustainability, its goal of diversification within a narrowly focused investment target market, the public policy objective and its mission.

2 Purpose of this Document

The purpose of this document is to set out the *CEFC Investment Policies* for the purposes of section 68 of the CEFC Act and address the requirements as part of a broader statement about the operations of the Corporation. In accordance with the other provisions of that section, a copy of these policies will be published on the Corporation's website.

In terms of the legislative requirement for this document, section 68 (1) of the CEFC Act, entitled "Investment Policies," states that:

> *"The Board must formulate written policies to be complied with by the Corporation in relation to the following matters and its requirements, approach and intentions with respect to*:
>
> *(a) The investment strategy of the Corporation;*
>
> *(b) Benchmarks and standards for assessing the performance of the Corporation's investments and of the Corporation itself;*
>
> *(c) Risk management for the Corporation's investments and for the Corporation itself; and*
>
> *(d) A matter specified in the regulations."*

The CEFC is required to consider best practice in regards to development of its corporate governance. To better inform the development of this document, the CEFC has surveyed, adopted and adapted applicable elements of the *Statement of Investment Policies* of the Future Fund which has a similar legislative requirement under the *Future Fund Act 2006* (Cth). The Corporation acknowledges the Future Fund's experience and expertise in this regard.

These *CEFC Investment Policies* are issued under section 68 of the CEFC Act and are effective immediately on the date adopted by the Board.

Under section 68(5) of the CEFC Act, these policies are subject to regular periodic review by the Board, and under section 68(7) are subject to review after any change to the Investment Mandate.

The Board also reserves its right to change or amend the *CEFC Investment Policies* from time to time, as required. The Board will therefore cause the *CEFC Investment Policies* to be formally reviewed at least annually, but more often if required.

3 Investment Mandate

The Australian Government may give directions (the "Investment Mandate") to the Corporation about the performance of the Corporation's investment function under section 64 of the Act.

The Investment Mandate is an important part of the Corporation's investment governance.

The Investment Mandate was issued by the responsible Ministers (the Treasurer the Hon. Wayne Swan MP and the Minister for Finance and Deregulation Sen. the Hon. Penny Wong) on 24 April 2013.

The Investment Mandate must not be inconsistent with the CEFC Act (including the object of the Act) or require the Corporation to make, or refrain from making, a particular investment.

The Corporation must comply with the *CEFC Investment Policies* (i.e. this document) and must be consistent with the directions under the Investment Mandate.

The Investment Mandate is set out in ***Appendix 1*** along with the accompanying Explanatory Statement. A summary of the Investment Mandate's requirements are presented in Table 1.

Table 1: Summary of Investment Mandate Requirements

Paragraph Reference	***Requirement***
5	The Corporation will invest at the demonstration, commercialisation and deployment stages of innovation.
5	In line with its policy intent to apply commercial rigour when making its investment decisions the Corporation should have regard to positive externalities and public policy outcomes when making investment decisions and when determining the extent of any concessionality for an investment.
6	The Board is to adopt a benchmark for the return of the portfolio based on a weighted average of the five-year Australian Government bond rate. Performance against this benchmark will be measured net of operating expenses.
6	In targeting the benchmark return and operating with a commercial approach, the Corporation will seek to develop a portfolio across the spectrum of clean energy technologies that in aggregate must have an acceptable but not excessive level of risk relative to the sector.
7	The Corporation must limit the amount of concessionality it provides in any one financial year to $300 million.

Paragraph Reference	*Requirement*
7	Concessionality reflects the mark to market valuation of loans made that financial year and should be measured as the difference between the present value of each loan at market rates and the present value of each loan at the given concessional rate.
8	Guarantees pose a particular risk to the Commonwealth's balance sheet and, as such, restrictions on their use are appropriate and the Corporation should seek to avoid their use where possible.
8	The Corporation must ensure that all guarantees are limited and quantifiable.
8	At no time may the total potential liability under outstanding guarantees exceed the amount of the uncommitted balance of the Clean Energy Finance Corporation Special Account.
8	The Corporation must also ensure the total value of guarantees at any time does not exceed 5% of the total amount that has been credited to the Special Account under section 46 of the Act.
9	Australian Industry Participation (AIP) Plans must apply to projects that the Corporation invests in, in accordance with the Government's AIP Plan policy.
10	In undertaking its investment activities, the Corporation must consider the potential effect on other market participants and the efficient operation of the Australian financial and energy markets.
10	The Corporation must not act in a way that is likely to cause damage to the Australian Government's reputation.
11	In performing its investment function, the Corporation must have regard to Australian best practice in determining its approach to corporate governance principles.
11	The Corporation must develop policies with regard to environmental, social and governance issues.

This document, the *CEFC Investment Policies,* has been formulated in the context of these directions and has been designed to reflect their importance in governing the investment activity of the CEFC.

4 Governance Framework

4.1 Introduction

This part describes how the Board has structured the operations of the CEFC within the framework of the CEFC Act and CAC Act to conduct its investment activities and corporate functions.

The Board adheres to the view that high quality governance is critical to the success of the investment activities of the CEFC. Performing in line with investment objectives and benchmarks requires time, expertise and organisational effectiveness to support the decision-making processes of the Board and the Executive Team. The clear identification and separation of the Board's and the Executive Team's responsibilities is particularly important.

4.2 Roles of The Board & The Executive Team

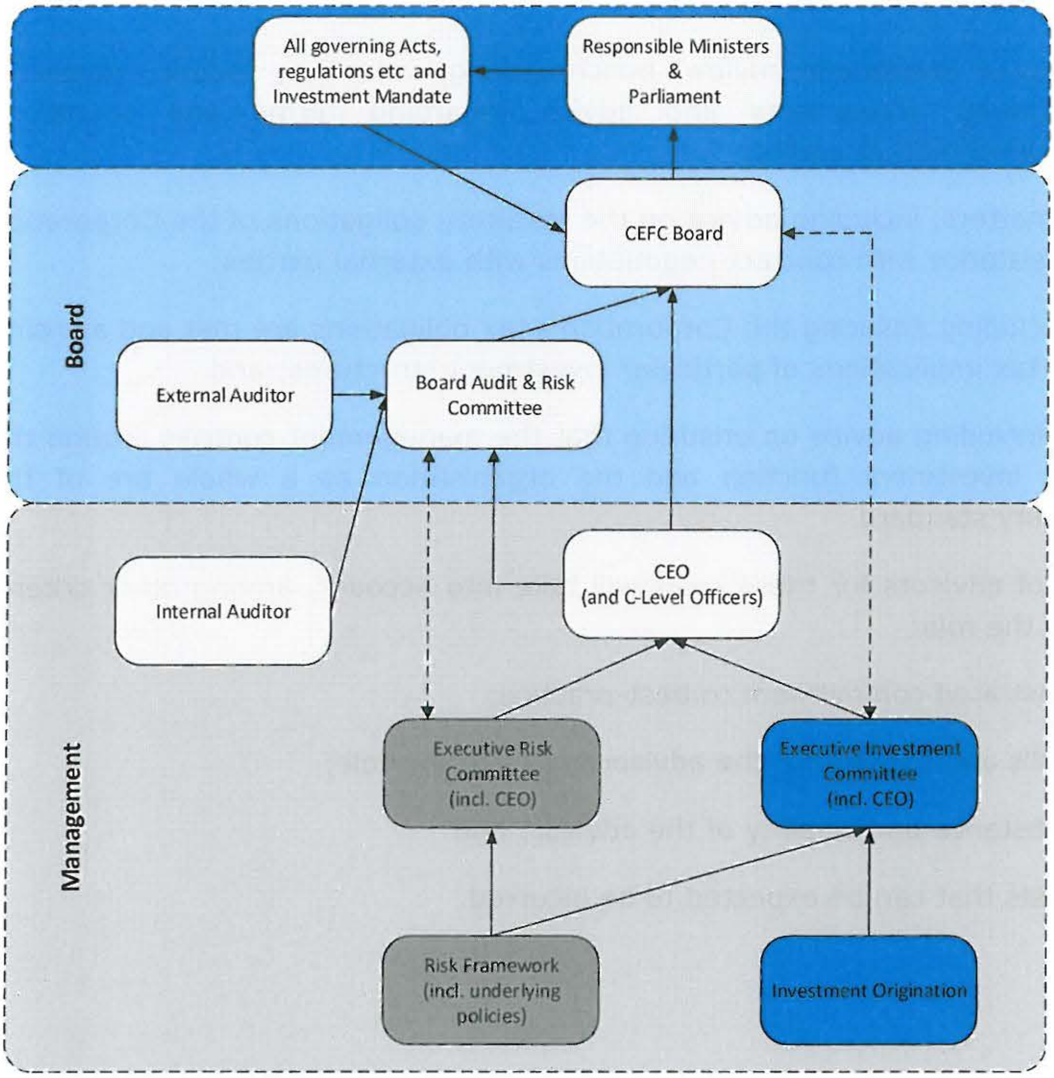
The Board is responsible for setting the strategic and prudential direction of the investment activities of the CEFC, consistent with the CEFC Act and the Investment Mandate. The Board retains ultimate responsibility for all investment decisions.

The Board has adopted a governance framework which defines how it will interact with the Executive Team. Figure 1 below provides an overview of these arrangements and sets out the responsibilities of each party.

The Board sees value in ensuring an adequate timeframe, diversity of viewpoints and specialist advice are applied to its deliberations in relation to investment decisions.

The Board is supported and advised by the Executive Team who is responsible for making investment recommendations after consideration by the Executive Investment Committee. The Executive Team is responsible for implementing the Board's decisions, conducting portfolio reviews and managing day-to-day investment matters.

Figure 1: CEFC Governance Framework



4.3 Board Committees

The Board has appointed an Audit & Risk Committee to oversee the audit, risk compliance and assurance functions, to review key financial statements and to evaluate the adequacy and effectiveness of the risk management framework.

4.4 Executive Investment Committee

The Executive Investment Committee is responsible for reviewing investment opportunities and making recommendations to the Board.

4.5 External Advisors

The Board and Executive Team may appoint advisors in a number of areas including:

- Investment policy advice or technology, industry or construction risk due diligence or market research;
- Portfolio or investment review, benchmarking, valuation, security research, investigating accountants and advice regarding terms and conditions constituting market norms;
- Legal matters, including advice on the statutory obligations of the Corporation and assistance with contract negotiations with external parties;
- Tax, including ensuring the Corporation's tax obligations are met and advising on the tax implications of particular investment structures; and
- Audit, including advice on ensuring that the management controls around the CEFC's investment function and the organisation as a whole are of the necessary standard.

Selection of advisors for these roles will take into account, among other criteria specific to the role:

- Demonstrated commitment to best-practice;
- The skills and experience the advisor brings to the role;
- The substance and viability of the advisor; and
- The costs that can be expected to be incurred.

5 Investment Strategy

5.1 Introduction

The Board is charged with overall governance responsibilities for the investment activities of the CEFC. This includes development of an investment strategy and approach which is consistent with the Corporation's obligations under the CEFC Act, Investment Mandate and normal investment risk management practices.

The universe of potential investments for the CEFC is limited by a number of constraints established by various legislative documents and selection criteria developed by the Board and Executive Team.

A common characteristic of successful investment organisations is that they are able to clearly define their investment objectives and articulate principles that they will follow in seeking to achieve those objectives.

The Act provides that a minimum of 50% of the CEFC portfolio must be invested in renewable energy technologies by 1 July 2018, or within five years of the first receipt of the Corporation's funding into the Special Account. The balance of funds will be directed to investments in energy efficiency and low emissions technologies.

These basic portfolio construction requirements have been extended into a broader set of objectives which underpin a 2018 portfolio vision which serves as a guide to determining the investment strategy for the CEFC. The 2018 portfolio vision will serve as a benchmark against which to evaluate the future success of investment activities and, by extension, the CEFC itself in seeking to build a self-sustaining, commercially focused investment operation.

5.2 2018 Portfolio Vision Statement

The Board has sought to define a series of portfolio construction parameters and transactional outcomes that would constitute success in light of the mission of the CEFC and the nature of its addressable market.

The 2018 portfolio vision is set out in Figure 2 and will be reviewed periodically.

The CEFC will adapt rationing mechanisms and proactive programs to achieve this portfolio vision.

Figure 2: 2018 Portfolio Vision - Investment Streams and Outcomes 2018 Target Portfolio

The Board has determined its 2018 Target Portfolio and outcomes as follows:

50% Renewable Energy diversified across:

- On grid, off grid and behind the meter
- Diversified across Australia and by borrower
- Direct and indirect financial participation
- Creative and innovative structures to reduce the cost of capital
- Enabling transactions in energy storage and transmission
- "Market first" joint transactions with ARENA

50% Low Emissions & Energy Efficiency diversified across:

- Diversified across Australia and by borrower
- Balanced between low emissions and energy efficiency transactions
- Direct and indirect financial participation
- Creative and innovative structures to reduce the cost of capital

OUTCOMES

- Diversification of renewable energy generation sources in Australia
- Significant awareness & adoption of energy efficiency across industries
- Significantly lower emissions in Australia
- Matched private sector funds from co-financiers of 3:1
- Demonstrable improvement of the flow of funds into the clean energy sector from:
  - Institutions
  - Individuals
  - Commercial banks
- Financial self-sufficiency by 2016
- Steady flow of dividends to ARENA by 2017

5.3 Investment Approach and Guidelines

With its 2018 portfolio vision in mind, the Corporation will seek to make commercial investments that counter market failures, address financing impediments and generate positive externalities.

In terms of its addressable investment universe, the CEFC may invest in businesses and projects that develop, commercialise or use renewable energy, low emissions or energy efficiency technologies. In addition, it may also invest in businesses that are related to renewable energy or energy efficiency technologies, such as the supply of goods or services which are an input to, or in some manner, support the deployment of such clean energy technologies. The Board and Executive Team are cognizant of the fact that, relative to its private sector counterparts, the investment mandate of the CEFC is a narrowly defined and mission critical target market. The limitations of such a tightly defined investable market constrain the capacity for risk reduction by portfolio diversification.

The investment activities of the CEFC are governed by a variety of legislative requirements including The *Clean Energy Finance Corporation Act 2012* (Cth), and any requirement specified by regulations made under the Act, The Investment Mandate and The governance regime of th *Commonwealth Authorities and Companies Act 1997* (Cth).

The *CEFC Investment Policies* set out herein have been devised with the legal requirements of these legislative documents in mind. In determining its investment approach, the Board has sought to supplement these basic constructs with a commercial investment risk management approach that, within the constraints of the CEFC's sector focus, are as robust as any in operation at a typical private sector financial institution, funds management operation or commercial bank. The result is that a wide number of factors must be considered prior to making investment decisions.

When the CEFC evaluates an opportunity for investment, three broad threshold factors are considered:

- ***Eligibility Constraints:*** The CEFC's ability to invest is limited by legislation (namely the CEFC and CAC Acts) which, along with the Investment Mandate issued by the Responsible Ministers, set out certain criteria that must be met for the opportunity to be eligible for investment (for more detail, see *Eligibility Constraints,* section 5.4). In addition to eligibility requirements, the CEFC will also consider whether an investment proposal would generate any positive externalities, overcome any market failures or alleviate any financing impediments;

- ***Investment Selection Criteria:*** The CEFC recognises that the demand for its funds is likely to exceed its available appropriations. Simply establishing technical eligibility will not, in itself, justify a positive investment decision. Once eligibility has been established, the CEFC will evaluate the commercial merits and relative investment attractiveness of each prospective investment. The ranking of particular investments will be influenced by the risk management approach of the CEFC and the implications of each potential investment decision for the 2018 portfolio vision. (for more detail, see *Investment Selection Criteria,* section 5.5); and

- ***Portfolio Diversification Strategy:*** The tightly defined nature of CEFC's Investment Mandate heightens the risk of concentrated positions within CEFC's portfolio. This risk is managed by setting a requirement to achieve a certain level of diversification in the portfolio and, thereby, reduce the systemic risk posed by large concentrated exposures in any single investment, technology, industry, counterparty or geography. Accordingly, consideration will be given to the impact that an individual investment will have upon portfolio concentration in addition to the implications for the 2018 portfolio vision (for more detail, see *Portfolio Diversification Strategy,* section 5.6).

Establishing eligibility in accordance with Eligibility Constraints can be an involved process and the Board has provided detailed guidance to assist sponsors and proponents in self-determining their eligibility for investment. However, to reiterate, while a technology type or opportunity may be technically eligible, it still may not qualify for investment based upon a commercial assessment of its relative merits.

The Board notes guidance within its Investment Mandate which stipulates CEFC investment activities will "*have an acceptable but not excessive level of risk.*"

The Board reserves the right to invest selectively, using its discretion and in accordance with its appetite for risk. For the first several years of the operation of the CEFC, the Board has a preference for investing in the debt securities and bank loans of later stage opportunities. Consequently, during this period, the Board may decline to invest in early stage technologies which may be technically eligible for investment but are assessed as having an unacceptably high risk of potential capital loss relative to CEFC's risk appetite.

Investment activities will be reviewed in the Annual Report and Quarterly Investment Reports published on the CEFC website.

5.4 Eligibility Constraints

The legal framework for the CEFC creates a number of constraints with regard to investment activities. Specifically, the CEFC may only invest in:

- "Clean energy technologies;"
- Businesses which support or service the clean energy technology sector;
- Clean energy technologies which are not a "prohibited technology;"
- Opportunities which are "solely or mainly Australian based;"
- Guarantees up to a defined a limit;
- Derivatives in limited circumstances; and
- Projects with Australian Industry Participation Plans.

"Complying investments" is a term used in section 59 of the CEFC Act to describe the first three of these constraints.

Constraint 1 - Clean Energy Technologies

Firstly, a complying investment must be a "clean energy technology" and satisfy the requirements of section 60 which in turn specifies three categories of clean energy technologies, namely:

- ***Renewable energy technologies*** - Includes (a) hybrid technologies that integrate renewable energy technologies; and (b) technologies (including enabling technologies) that are related to renewable energy technologies.

- ***Energy efficiency technologies*** - Includes technologies (including enabling technologies) that are related to energy conservation technologies or demand management technologies.

- ***Low emissions technologies* -** The Board has established guidelines setting out the matters to which it will have regard in satisfying itself that a technology is a low-emission technology.

Within these broad definitions, the Board has produced formal guidelines as required by the Act for "Low Emissions Technologies" – this is the *CEFC Low Emissions Technologies Guidelines for Purposes of Section 60(5) Clean Energy Finance Corporation Act 2012 ('the CEFC Act')* published on the CEFC website.

As part of the *CEFC Investment Policies*, the Board has also produced guidance on definitions for "renewable energy technologies" and "energy efficiency technologies."

See Appendix 2 for more detailed definitions of these terms and a reproduction of the formal guidelines issued by the Board in relation to the "Low Emissions Technologies."

Constraint 2 - Prohibited Technologies

Irrespective of whether a particular technology technically qualifies as a clean energy technology, if it falls into one of the categories prohibited under section 62 of the CEFC Act, then it will not be a complying investment and, therefore, is ineligible for CEFC investment.

Section 62 defines nuclear technology, nuclear power or carbon capture and storage to be prohibited technologies. Accordingly the CEFC cannot consider investments in these technology classes.

Constraint 3 – Solely or mainly Australian based

Section 61 of the CEFC Act specifies that the Board must issue written guidelines setting out circumstances, conditions or other matters to which the Board will have regard in satisfying itself that an investment is solely or mainly Australian based.

The Board has issued such Guidelines as required by the Act for the term *"solely or mainly Australian based"* – this is the *"Solely or Mainly Australian based" Guidelines for Purposes of Section 61 Clean Energy Finance Corporation Act 2012 ('the CEFC Act')* published on the CEFC website.

See Appendix 3 for a summary of guidelines which determine whether an investment is solely or mainly Australian based.

Constraint 4 - Eligible Financial Assets

The CEFC will invest only in Financial Assets which, although more broadly defined, will typically fall into the category of debt or equity securities.

The CEFC cannot directly acquire physical assets, such as property nor any type of fixed asset. Within the context of Financial Assets, the CEFC is also not permitted to hold a control position in any operating entity through the purchase of Financial Assets. The CEFC does not have mandate to operate businesses or assets, and as a statutory authority, special rules apply that restrict the acquisition of subsidiaries under the CEFC and CAC Acts.

The term "Financial Assets" is defined under the CEFC Act in sections 4 & 63(2) and is drawn from the *Australian System of Government Finance Statistics: Concepts, Sources and Methods*. Figure 3 sets out a summary of relevant elements.

Figure 3: Financial Assets

Assets are defined in the *Australian System of Government Finance Statistics: Concepts, Sources and Methods* as instruments or entities over which ownership rights are enforced by institutional units and from which economic benefits may be derived by holding them, or using them, over a period of time.

Financial assets are assets that are in the form of financial claims on other economic units (e.g. cash and deposits; investments, loans and placements; accounts receivable; advances outstanding; equity).

All other assets are described as **nonfinancial assets** and include fixed assets (i.e. real estate and buildings), inventories, valuables (e.g. works of art) and non-produced assets (e.g. natural forests, mineral reserves).

Note also that section 4 of the CEFC Act defines an ***asset*** as real or personal property, a legal or equitable right in the same, or other legal or equitable right.

Please refer to *Australian System of Government Finance Statistics: Concepts, Sources and Methods for more information.*

Constraint 5 - Guarantees

Guarantees are defined by reference to section 69.

The Investment Mandate specifies that, where possible, guarantees should be avoided by the Corporation, but where any guarantee is made, the Corporation must ensure that all guarantees are limited and quantifiable. There is a statutory limitation on the issuance of guarantees.

Constraint 6 – Derivatives

The CEFC will not acquire derivatives for speculation nor leverage, per the requirements of CEFC Act, section 70. However, the Corporation may acquire or write derivative positions to (i) protect the value or returns of an investment; (ii) achieve indirect exposure to financial assets; or (iii) for transactional efficiency.

The CEFC has been established for the purpose of addressing capital structuring solutions by providing debt and, in limited circumstances, equity investments. It has not been established for the purpose of speculating on tradable financial market instruments or commodities, nor to absorb such risks on behalf of counterparties.

Constraint 7 – Australian Industry Participation Plans

The CEFC's Investment Mandate specifies that the CEFC may only invest in projects with an Australian Industry Participation (AIP) Plan.

AIP Plans are aimed at increasing opportunities for capable and competitive Australian and New Zealand small and medium sized enterprises (SMEs) to participate in major projects.

Only investment recipients of over $20m will be required to have AIP Plans.

5.5 Investment Selection Criteria

The CEFC will act commercially in the selection of its investments and, therefore, upon establishing eligibility, apply a commercially rigorous set of investment selection criteria in the evaluation of a prospective investment. A conservative investment approach will be adopted which, at the same time, will reflect the CEFC's public policy mission and objectives.

Screening of investments will focus on identifying a series of characteristics which are likely to be highly predictive of the stable, cash flow generative investments that would match the conservative risk profile of the CEFC. In seeking out these characteristics, individual investment prospects will be initially screened against a number of risk parameters which include, but are not limited to the factors set out in Table 2.

Table 2: Risk Screening Parameters

Investment Risks	*Financial Structuring Considerations*	*Other Considerations*
• Technology • Operating • Regulatory • Legal • Capital Structure • Counterparty • Credit • Refinancing • Price • Interest Rate • Market • Earnings stability	• Margin • Term • Leverage • Concessionality • Counterparties • Credit • Collateral • Liquidity • Market risk • Subordination • Re-packaging opportunity	• Emissions Intensity • Energy Productivity Improvement per $ of capex • Technology • Geography • Australian Industry Participation and other Government policy outcomes • Scalability • Replicability • Demonstration Value • Cost Impact • Enabling of other transactions

While the CEFC will employ structured risk screening techniques in the early stages of assessment, there are usually a core set of risks that are universally applicable to every investment and need to be managed for the success. Strength of management, operating margins and industry position are likely to represent universally relevant factors across all investments. There are also frequently a more detailed set risk factors which will vary across sectors (renewable energy versus energy efficiency) as well as within sectors (wind versus solar) and across individual investment proposals (strong versus weak transaction sponsors).

In seeking to advance an individual investment proposal through its various stages of assessment, the focus of the CEFC will be, firstly, upon identifying both sets of unique and generic critical risk factors and, secondly, upon ensuring they are adequately addressed through due diligence or investment structuring.

If the key risks cannot be addressed to the satisfaction of the CEFC Board and Executive Investment Committee, it is unlikely the investment will proceed to financial close.

5.6 Portfolio Diversification Strategy

The CEFC has established target portfolio exposure guidelines in an attempt to construct a portfolio that is diversified across individual assets, technologies, industries and geography.

The purpose of these guidelines are:

- Firstly, to achieve the objective of facilitating broad and diversified financial flows throughout Australia to support the growth of renewable energy, lower emissions and energy efficiency technologies; and
- Secondly, as part of a risk management strategy of attempting to minimize the impact on portfolio returns of any potential losses on individual assets due to overweight concentrations or systemic sector risks.

With these objectives in mind, the Board has set concentration guidelines across a number of exposure categories including:

- Individual transaction exposures;
- Counterparty risk;
- Technology type;
- Industry concentration;
- State geographies; and
- Type of investment security.

Portfolio Limits and Guidelines

It should be noted that the portfolio strategy of the CEFC also incorporates certain mandatory requirements set out in the Investment Mandate and the CEFC Act.

These statutory portfolio requirements are set out in Table 3.

Table 3: Mandatory Portfolio Limits

Measure	*Limit*
Renewable Energy Requirement	From 1 July 2018, no less than 50%
Guarantees	5% Maximum Limit
Concessional Loans	$300 million annual NPV Limit each year
Equity Investments	Must be a minority, non-controlling stake
Derivatives	Only to: (i) protect the value of investments, (ii) achieve indirect exposure to financial assets; or (iii)for transactional efficiency

In addition, the Board has established a diversification and portfolio construction strategy consistent with its investment approach. This is outlined in Table 4.

Table 4: Board Portfolio Diversification Guidelines

Measure	*Guideline*
Preferred Minimum CEFC Investment Size – Renewable Energy	$20m*
Maximum Individual Transaction Size	$200m or 10% of the amount credited to the CEFC Special Account
Concentration of Technology, Industry or Geography	No more than 30%
Technology Maturity	Later stage development that is cash generative and able to service debt
Security Type	Debt Target 80%
***The Preferred Minimum CEFC Investment Size of $20 million** is considered appropriate for renewable energy technology investments. In order to address smaller transactions and the SME market, the CEFC preference is to establish pooled financing and partnership strategies which leverage the larger market reach of financial intermediaries such as fund managers and commercial banks.	

5.7 Other Mandate Requirements – Ancillary Factors

The Investment Mandate requires the CEFC to conduct a comprehensive evaluation of investment proposals in arriving at its investment decisions and consider a wide array of factors that a private sector financier would be unlikely to consider. These include:

- The potential effect upon the efficient operation of the Australian financial and energy markets and on other market participants;

- A duty of care to not act in a way that is likely to cause damage to the Australian Government's reputation; and

- Supporting best practice principles in environmental, social and corporate governance matters in the context the CEFC and its investment activities.

In addition to these factors, CEFC investments will generate positive externalities. These positive externalities are necessary if the CEFC's mission is to be achieved. Over time, they will have a cumulative impact across the sector, on carbon emissions and contribute to the task of accelerating Australia's transformation towards a more competitive economy in a carbon constrained world. Positive externalities result from technologies moving faster along the innovation chain, down the cost curve and through greater acceptance in financing markets. They can also flow from improvements in technology design, supply chain depth, construction practices, operating skills, financing structures and market risk appetite. Such positive externalities include:

- ***Technology Expansion and Development*** – Increasing future energy optionality by expanding available technologies. Improving acceptance of a new concept or approach in financing markets by supporting the completion of "first wave" projects employing a new or emerging technology and lowering the cost for subsequent projects;

- ***Dispersion and Takeup*** – Assisting in broadening the acceptance and timely take-up of a clean energy technology or energy efficiency measure across all sectors of the economy;

- ***Demonstration*** – Investment in transactions which establish successful precedents and pave the way for the rollout of similar facilities;

- ***Financial Leverage*** - Leveraging and catalyzing private sector funds into clean energy investment;

- ***Expansion of Investor Base -*** Extending participation in clean energy investment across all investor classes;

- ***Market Capacity and Sector Skills*** – Building and maintaining local market capacity in terms of technological know-how, engineering, manufacturing capability or localised supply chains; and

- ***Emissions Reduction*** – Progressing Australia's reduction in emissions.

The obligation of the CEFC is only to take these matters into account in evaluating investment opportunities.

These factors do not constitute further qualifying or eligibility preconditions for investment. The degree to which they influence decisions is a matter of business judgment and will be assessed on a case-by-case basis.

5.8 Permitted Investment Instruments

The CEFC has the capability to invest directly or indirectly and across the capital structure in publicly traded or privately held instruments such as:

- Senior Debt;
- Subordinated Debt;
- Preferred Equity / Convertible Debt;
- Common Equity;
- Interests in Pooled Investment Schemes, Trusts and Partnerships; and
- Net Profits Interests, Royalty Interests, Entitlements to Volumetric Production Payments.

This capacity is limited as follows:

- For concessional loans, by a portfolio limit of $300 million in net present value terms per annum; and
- For guarantees, by a portfolio limit of 5% of the total amount credited to the Special Account under section 46 of the CEFC Act.

5.9 Investment Approach - Board of Directors

The following investment approach guides the Board's strategic and prudential oversight of the investment activities and portfolio risk management activities of the CEFC:

- Recognition of the inherent uncertainty in investment markets and the encouragement of an approach of continual sceptical enquiry;
- The objective of generating portfolio returns above the Government's cost of funds as reflected in the five-year Australian Government bond rate;
- The CEFC Act with its dedicated appropriation and Investment Mandate allows an investment strategy different from that of private sector commercial banks or investment funds;

- While quantitative assessment of risk factors is important, so is an evaluation of qualitative factors; and

- It is important to understand the prevailing macro-environment and its potential impact on the portfolio or individual investments.

5.10 Investment Approach - Executive Investment Committee

The following principles guide the Executive Investment Committee's approach to developing investment recommendations to put to the Board:

- A flexible and diversified approach to asset allocation and investment selection is appropriate within the constraints of the Act and Investment Mandate;

- A more stable expected risk-adjusted return and a consistent achievement of objectives will be obtained from a broadly diversified allocation across individual assets and sectors;

- The CEFC is formed to facilitate investment flows into the clean technology sector, not to displace or substitute for existing investment flows;

- The CEFC will, as a matter of policy, generally not be the sole funder of a proposed clean technology investment;

- Further, to avoid unintended market impacts or distortions in the efficient operation of the capital markets and other government policies and programs, offers of concessional finance will be limited;

- In relation to concessional finance, the general investment approach of the CEFC will be to seek to invest its funds on terms that are as close to market as possible and that are necessary for a given investment proposal to proceed; and

- The CEFC will have regard to positive externalities in making investment decisions and determining the extent of concessionality for an investment.

The Executive Investment Committee has structured the investment selection and approval process so that it involves three phases of assessment of opportunities where eligibility tests have been met.

This process is set out in Figure 8.

Figure 8: Investment Selection and Approval Process Stages

A given opportunity must pass each stage before it can advance to the next. Feedback from the Executive Investment Committee is provided to investment teams at each phase as a reiterative input into the assessment, analysis and structuring of each investment.

The Board will be informed of investment opportunities as they are being progressed through Phases 1 and 2, and then at Phase 3, involved in assessments related to final capital approvals being sought.

Phase 1 of the assessment process will involve a high level screening of investment opportunities by the Executive Investment Committee and will focus upon a few simple considerations:

- How does the opportunity fit within CEFC's Investment Mandate?
- Why is the involvement of CEFC required?
- What financial market impediments is the transaction facing?
- How attractive an economic proposition is the transaction?
- Who is the primary sponsor or proponent and what is their track record?
- Does a co-financier support the opportunity?
- What additional key elements to completion remain even with CEFC involvement?
- Will the investment create positive externalities?

Phase 2 requires a more detailed screening of the opportunity to be undertaken by the investment team. Detailed screening papers will be reviewed by the Executive Investment Committee and, where deemed necessary, by the Board. Within this phase, the investment team will consider a broader set of factors as part of scoping out critical risks to success and develop detailed investment terms and conditions in the form of a term sheet. This process, in turn, will define key risk areas to be focused upon in financial modeling analysis and external due diligence report scopes covering technical, legal, financial and other risks.

Phase 3 will involve a review of all external due diligence and investment structuring arrangements pursuant to a final capital approval recommendation to the Board. This stage of the investment process will focus on covering off key risks identified in the first two screening phases either through appropriate supplementary due diligence or further investment structuring.

It should be noted that screening techniques constitute only a general framework for assessment. The key risks specific to and the merit of each individual investment will be determined on a case by case basis.

Investment decisions will also be considered in the context of portfolio limits, diversification targets, concentration guidelines and the 2018 portfolio vision.

5.11 Portfolio Performance Benchmark

The benchmark for the performance of the CEFC is specified in the Investment Mandate.

As appropriations are financed through Government borrowings, the Investment Mandate sets a return benchmark for the return of the portfolio based on a weighted average calculation of the five-year Australian Government bond rate. This measure was chosen to ensure the Government's cost of borrowings is covered. Portfolio performance against this benchmark will be measured net of operating expenses.

The Investment Mandate supports a long term investment strategy and it is the objective of the CEFC to exceed the return benchmark over this horizon. There may be fluctuations in investment performance over an individual year.

6 Risk Management

6.1 Introduction

The CEFC operates under a sound risk management framework designed to identify and effectively manage critical risks.

The Investment Mandate directs that the key performance criteria for the CEFC is to:

- Generate a return above the Portfolio Benchmark Return;
- Deliver its mission; and
- Achieve these objectives by assuming appropriate but not excessive levels of risk.

In accepting the Investment Mandate, it is clear the CEFC must also inevitably accept a certain risk profile to achieve its dual objectives of achieving both its commercial return and public policy outcomes. These risks arise, in part, as a consequence of the narrow nature of the addressable market of the CEFC and this heightens portfolio concentration risks. In addition, the sector focus and public policy mission of the CEFC compels it to accept and to be prepared to manage a higher risk profile than its private sector peers.

There is a clear requirement to have a well-defined enterprise and investment risk management approach.

The Board sets the tone from the top and works with the Executive Team to establish a heightened culture of risk management - both in the context of investment activities and enterprise risk management through the establishment of:

- An intensive and iterative investment assessment and approval process;
- Deep engagement with the Executive Team on risk management issues through the Executive Risk Committee and the Executive Investment Committee; and
- The Board Audit and Risk Committee which oversees risk management activities.

The CEFC's risk management processes are based on the *AS/NZS ISO 31000:2009 Risk management—Principles and guidelines* standard which is consistent with the international standard. In addition, the following documents were used to inform the development of the CEFC risk management framework:

- Comcover Better Practice Guide, *Risk Management*, Department of Finance and Deregulation, Canberra, June 2008;

- Australian National Audit Office Better Practice Guide, *Public Sector Governance*, Volume 1, Framework, Processes and Practices, ANAO, Canberra, July 2003;

- Australian National Audit Office Better Practice Guide 2005, *Public Sector Audit Committees*, ANAO, Canberra, February 2005; and

- Australian National Audit Office Better Practice Guide, *Innovation in the Public Sector*, ANAO, Canberra, December 2009.

6.2 Investment Risk

Mitigating investment and portfolio risk management is integral to the Corporation's overall enterprise-wide risk management framework. It can be described as the risk of a loss of capital or income attributable to poor investment decisions or inadequate post-financial close investment management and surveillance.

For effective and prudent investment risk management, the CEFC believes the following governance arrangements are required:

1. A highly developed investment portfolio strategy, including diversification requirements, clear definitions around key target markets and supporting procedures;

2. An intensive, reiterative and multi-phase assessment and approval process for individual investments, based on standardized templates and risk assessment processes;

3. A dedicated portfolio management team charged with the task of monitoring individual investments, determining performance against portfolio objectives and providing regular periodic reporting to the Executive Investment Committee and the Board;

4. An effective escalation and remedial process for underperforming investments; and

5. Highly experienced, engaged staff involved in multiple levels.

Above all, effective investment risk management starts with making the right individual investment decisions.

In achieving its mission and mandated public policy outcomes, the CEFC may need to consider risk positions that are, at times, leading and novel in order to remove or reduce financing impediments in the clean energy sector or generate positive externalities. The CEFC will adopt a careful, case-by-case assessment of the returns and inherent risks of individual investments.

Investment proposals that meet the requirements of the CEFC Act and the Investment Mandate will be considered with commercial rigour by evaluating them against a set of investment selection criteria and assessing them against a set of universal investment risks.

6.3 Enterprise Risk

Enterprise risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Enterprise risk can include investment risk.

The Board acknowledges that the quality of its enterprise risk management procedures must be of best-practice standard. It is committed to achieving this and will seek to continually improve and enhance its policies over time.

Enterprise risk is managed by a focus on the six pillars of risk management activities, to ensure a holistic approach to risk management across all business disciplines, for all investment decisions and throughout the entire investment and operating cycle.

The six pillars of risk management activity applicable to the CEFC business are:

1. Investment Portfolio Strategy;
2. Risk Profiling and Reviews;
3. Governance;
4. Compliance;
5. Controls; and
6. Assurance.

The interlocking responsibilities of risk management and investment activities will be pursued at an operational level across the business via the six functional pillars, which work progressively and collectively to identify and manage risk.

A summarised representation of enterprise wide risk management activities is described in Table 5.

Table 5: The Six Pillars of Enterprise-Wide Risk Management

1. **Investment Portfolio Strategy** initially relies on assessment of the opportunity against the eligibility constraints defined by the constituent legislation of the CEFC. Once eligibility is established, the next stage of assessment involves identifying the financing impediments preventing the financing requirement from being addressed in normal commercial investment markets, the commercial robustness of the investment case, whether the transaction is associated with any other positive externalities and the extent to which its completion would serve public policy outcomes. These deliberations will be driven by the consideration of the investment selection criteria and decision making processes outlined in the CEFC Act, the Investment Mandate and portfolio diversification objectives. As described in above, the strategy is underpinned by a multi-tiered approval process and regular monitoring and performance reporting.
2. **Risk Identification Profiling and Reviews** ensure that all risks associated with an investment opportunity or business activity are identified and assessed in terms of likelihood, consequence, mitigation measures and effectiveness of controls. Risk registers will be prepared and owned by the relevant risk owners.
3. **Governance** includes the direction of people, business processes and committees to ensure collective responsibility for risk management, successful strategy execution, sound investment recommendations and effective operations.
4. **Compliance** ensures adherence to applicable laws, regulations, the Investment Mandate, as well as internal policies and procedures. Compliance will also include periodic assessments of the enterprise wide risk framework, risk, appetite, culture and governance activities.
5. **Controls** ensure that there are appropriate systems, processes and behaviours in place to ensure that objectives are achieved with effective risk management, including regular monitoring and reporting of all operating and investment risks.
6. **Assurance is undertaken using both internal and external resources.** It involves reviews, audits, due diligence and other checks and scrutiny. Such processes provide confidence and affirmation that objectives are being met within an acceptable degree of risk in accordance the **Governance, Compliance and Controls** in place across the business.

All of these risk management activities are supported by underlying internal policies, procedures and charters which form an integral part of the CEFC's risk management framework.

6.4 Investment Structuring

In implementing its investment strategy, the Board invests in different legal structures, types of investment securities and investment vehicles for a variety of commercial, legal and tax reasons. Properly structuring investments can be essential to maintaining the legal rights and entitlements of the CEFC.

The CEFC only invests through arrangements and structures that are commonplace and well-tested by other financial institutions, funds management operations and commercial banks in terms of compliance with applicable laws, regulations and commercial risk management practices.

Central to the focus on investment risk management is the operational, legal, financial, technical, market and taxation due diligence which is undertaken both as part of the investment decision process and through the ongoing monitoring of investments and the overall portfolio.

7 Environmental, Social & Governance Risk Management

7.1 Introduction

The Board believes that effective management of financial and reputational risks, including matters related to environmental, social and governance (ESG) issues will, over the long term, support its objectives and mission. The Board has incorporated this perspective into investment decision processes and criteria.

In particular, the Board believes that there is a positive relationship between good governance and good investment returns.

Accordingly, the Board will act as any prudent investor would in seeking to encourage the adoption of good governance practices within the CEFC itself as well as in the businesses and projects in which it invests.

7.2 Implementation Considerations

In accordance with the Investment Mandate, the Board will develop policies with regard to environmental, social and governance issues.

While the CEFC is not expected to invest heavily in traditional investment assets such as public equities where it would have the potential to exert the most influence, the Board believes that it can play a role nonetheless in advancing good practices for institutional investment, contributing to system integrity, protecting investor rights and building new markets.

The Board believes that improving the stability, transparency and efficiency of the markets in which it operates goes hand-in-hand with the CEFC's commercial and public policy objectives, namely to address financing impediments and market failures, as well as its reputation as a responsible and respected long-term investor.

The Board will regularly review its policies in relation ESG risk management and will refine and develop the implementation of these policies over time as its investment activities evolve.

7.3 Environmental Policies

As the CEFC's mission is focused upon facilitating financial flows to the clean energy sector, the development of robust environmental policies are essential in guiding investment selection. To this end the Board has not only developed a robust eligibility screening process but has gone beyond the statutory minima, in further defining the terms "renewable energy technologies" and "energy efficiency technologies" and publishing these policies on its website.

In addition the Board will develop a methodology for assessing energy efficiency and low emissions technologies to provide a standardised, systematic approach to the assessment of carbon saving and emissions reductions claims within the context of potential investments, which, in turn, can assist the Board to prioritise opportunities.

7.4 Social Policies

In serving the Australian public through the prism of investing in Australian-based businesses, the CEFC is committed to excellence and professionalism as part of its commercial approach.

The CEFC exists to serve the social good of preparing and positioning the Australian economy and industry for a carbon constrained world. In selecting investments, the CEFC has extensive regard to social outcomes through a focus upon positive externalities. This assessment is embedded within the investment process.

Within the business, the CEFC supports the principles of equal opportunity and diversity and has a zero tolerance approach to unlawful discrimination.

7.5 Governance Policies

The CEFC has invested significant time and effort at both the Board and Executive Team level in developing an ethical governance framework, its risk management approach and these *CEFC Investment Policies*. Underpinning this approach is a shared governance ethos of doing the right things at the right times for the right reasons.

As a Commonwealth statutory authority, the CEFC is mindful of its statutory requirements and has moved beyond these edicts by developing codes of conduct and ethics that inform and infuse its operational and investment management approach.

In the context of the operations of the CEFC, governance is addressed through the appointment of a Chief Governance and Strategy Officer, the development of detailed prudential policies and various levels of oversight by the Board and its Audit & Risk subcommittees, the Executive Team and its Investment and Risk committees.

In the context of CEFC's investments, any proponent, corporation or project receiving funds will be held to a similar standard not only for ethical reasons but also due to the view that, as previously stated, sound corporate governance is the foundation for good management practices. The CEFC believes good management practices are a key factor which differentiates good and bad investments.

The Investment Mandate states that the CEFC must not act in a way that is likely to cause damage to the Australian Government's reputation. Consistent with that guiding directive, the CEFC aims to build a market reputation founded upon prudent investment and operational management and a culture wherein staff are well aware of the high level of governance and ethical behavior that is required of the CEFC and its employees.

7.6 Investment Governance

The CEFC will seek to invest in businesses with sound governance policies that support:

- Proper treatment of shareholders and investors;

- Where appropriate, the appointment and retention of the highest quality auditors, advisers or their equivalents; and

- High standards of behavior in regard to, governance, transparency and accountability, management of environmental and social risks, business ethics, compliance with relevant legislation and regulation, effective management of relationships with employees and regulators, and a holistic approach to the risks and opportunities that will be encountered by the entity.

As part of its investment selection process, the CEFC will seek assurance, where possible, that the financial risks and opportunities that may arise from enterprise-wide ESG issues are being managed by the entities or projects which it considers for investment.

In the context of investment structures, the Board and Executive Investment Committee will review the corporate governance arrangements of an investment or project in detail before committing capital. The terms of any investment will be structured to ensure the interests of the CEFC are effectively protected through certain rights or actions permitted under legal documentation or representation on appropriate governance bodies or the boards of companies which are the subject of investment. Regular investment reporting will be required.

Through its investment structures, the Board will also generally set a requirement for the companies and projects in which it invests to maintain compliance with all applicable laws in connection with their activities.

While the CEFC may hold voting rights through equity, preferred equity or other interests, the Board may form the view it is more efficient and effective to communicate a perspective or concern directly to relevant stakeholders rather than seeking to exercise influence solely through its voting rights and in the absence of any consultation.

However, the CEFC will avail itself of any legal voting rights or enforce investment terms as it deems appropriate in seeking to protect its position consistent with the actions that any prudent investor would be expected to take.

APPENDIX 1 – Investment Mandate & Explanatory Statement

Clean Energy Finance Corporation Investment Mandate Direction 2013

We, WAYNE MAXWELL SWAN, Treasurer, and PENELOPE YING YEN WONG, Minister for Finance and Deregulation, give this direction under subsection 64 (1) of the *Clean Energy Finance Corporation Act 2012*.

Dated 16 April 2013

WAYNE MAXWELL SWAN	PENELOPE YING YEN WONG
Treasurer	Minister for Finance and Deregulation

Part 1 Preliminary

1. Name of Direction

This direction is the *Clean Energy Finance Corporation Investment Mandate Direction 2013.*

2. Commencement

This direction commences on the day after it is registered (on the Federal Register of Legislative Instruments).

3. Definitions

In this direction:

Act means the *Clean Energy Finance Corporation Act 2012.*

Note: ***Board, Corporation*** and ***responsible Ministers*** are defined in the Act.

4. Purpose of this direction

The purpose of this direction is to give guidance to the Board in relation to the performance of the Corporation's investment function. The Corporation is required under section 58 of the Act to invest in clean energy technologies subject to its other obligations under the Act and any directions given by the responsible Ministers under subsection 64 (1) of the Act.

This direction is given under subsection 64 (1) of the Act.

Part 2 Direction

5. Introduction

The Corporation is a mechanism to help mobilise investment in renewable energy, low-emissions and energy efficiency projects and technologies in Australia, as well as manufacturing businesses and services that produce the required inputs. The Corporation will invest at the demonstration, commercialisation and deployment stages of innovation. The Corporation has been established to finance Australia's clean energy sector using financial products and structures to address the barriers inhibiting investment.

The intention of the Corporation is to apply commercial rigour when making its investment decisions. The Corporation will have regard to its potential effect on other market participants when considering investment proposals. In line with its policy intent, the Corporation should have regard to positive externalities and public policy outcomes when making investment decisions and when determining the extent of any concessionality for an investment.

6. Portfolio Benchmark Return

The Board is to adopt a benchmark for the return of the portfolio based on a weighted average of the five-year Australian Government bond rate. Performance against this benchmark will be measured net of operating expenses.

In targeting the benchmark return and operating with a commercial approach, the Corporation will seek to develop a portfolio across the spectrum of clean energy technologies that in aggregate must have an acceptable but not excessive level of risk relative to the sector.

7. Limits on Concessionality

The Corporation must limit the amount of concessionality it provides in any one financial year to $300 million.

Concessionality reflects the mark to market valuation of loans made that financial year and should be measured as the difference between the present value of each loan at market rates and the present value of each loan at the given concessional rate.

8. Limits on Guarantees

Guarantees pose a particular risk to the Commonwealth's balance sheet and, as such, restrictions on their use are appropriate and the Corporation should seek to avoid their use where possible. The Corporation must ensure that all guarantees are limited and quantifiable.

At no time may the total potential liability under outstanding guarantees exceed the amount of the uncommitted balance of the Clean Energy Finance Corporation Special Account. The Corporation must also ensure the total value of guarantees at any time does not exceed 5% of the total amount that has been credited to the Special Account under section 46 of the Act.

9. Application of Australian Industry Participation Plans

Australian Industry Participation (AIP) Plans must apply to projects that the Corporation invests in in accordance with the Government's AIP Plan policy.

10. Corporation must consider impacts from its investment strategy

In undertaking its investment activities, the Corporation must consider the potential effect on other market participants and the efficient operation of the Australian financial and energy markets.

The Corporation must not act in a way that is likely to cause damage to the Australian Government's reputation.

11. Corporate Governance

In performing its investment function, the Corporation must have regard to Australian best practice in determining its approach to corporate governance principles.

The Corporation must develop policies with regard to environmental, social and governance issues.

EXPLANATORY STATEMENT – Clean Energy Finance Corporation Investment Mandate Direction 2013

Purpose of the Direction

Under the *Clean Energy Finance Corporation Act 2012* (the Act), the Government has established the Clean Energy Finance Corporation (the Corporation) to facilitate increased flows of finance into the clean energy sector.

The Corporation will make individual investment decisions independently of the Government. The purpose of the Investment Mandate is to provide a mechanism for the Government to articulate its broad expectations of how the Corporation invests and is managed by the Board.

Under the Act the Board is responsible for ensuring the proper, efficient and effective performance of the Corporation. This responsibility is subject to any restrictions placed on the Corporation by the Act and to any directions given by the responsible Ministers under subsection 64(1). Directions issued under subsection 64(1) of the Act are known collectively as the Investment Mandate.

Direction

Introduction

The Corporation will supplement existing initiatives, such as the Renewable Energy Target and the carbon price, to catalyse and leverage the flow of funds for

commercialisation and deployment of renewable energy, low-emissions and energy efficiency technologies necessary for Australia's transition to a lower carbon economy.

The Government's aim is for the Corporation to invest in financial assets using financial products and structures to address the barriers currently inhibiting investment to help mobilise investment into the clean energy sector. As this is not a grants organisation, these investments must be made with an expectation of being repaid.

It is expected that the Corporation will apply commercial rigour when making its investment decisions, focusing on projects and technologies at the later stages of development. By adopting a commercial approach, it is expected that the Corporation will invest responsibly and manage risk so it is financially self-sufficient and achieves a benchmark rate of return. In achieving this aim the Government has the expectation that the Board will take a long-term outlook when setting the investment strategy for the Corporation.

As a Government entity and a responsible investor the Corporation has a duty to consider its potential impact on other market participants when making investment decisions. However, in line with its public policy intent, the Corporation should also consider positive externalities when making investment decisions and determining the extent of any concessionality.

Portfolio Benchmark Return

For the purpose of this Investment Mandate, the Government has directed the Board to adopt a Portfolio Benchmark Return for the performance of funds invested by the Corporation based on a weighted average of the five-year Australian Government bond rate.

For each investment, an individual reference rate will first be calculated using the average of the five-year Australian Government bond rate as published by the Reserve Bank of Australia for the 15 day period immediately preceding the date a binding investment agreement is executed.

The Portfolio Benchmark Return will then be determined by taking the series of individual reference rates and weighting them for each investment.

The Portfolio Benchmark Return is a long-term target and expected to be earned across the portfolio and over a period of time. Individual investments could be made with expected individual returns above or below the Portfolio Benchmark Return.

Proponents should not expect to be able to access the Corporation's funding at the Portfolio Benchmark Return. The Corporation shall apply commercial rigour in assessing all investments. The actual return the Corporation seeks for any given investment will be a risk-adjusted return reflecting the individual characteristics of specific projects, the need to cover the operating expenses of the Corporation, the requirement to meet the Portfolio Benchmark Return on a portfolio basis and other factors.

Performance against this Portfolio Benchmark Return will be measured net of operating expenses with reports published annually. The Corporation will follow Australian Accounting Standards where applicable in measuring its return and determining any impairment, except in the case of concessional loans, where the measurement should exclude any impairment or mark to market adjustments resulting from any concessional component.

The Government is conscious of the risks inherent in investing in a large portfolio of financial assets. It acknowledges that in practice this will involve some short-term volatility in the Corporation's returns, including the possibility of losses in some years.

The Government is committed to developing the clean energy sector and it has established the Corporation to invest for the long term. Therefore the Investment Mandate establishes long-term portfolio performance measures.

Limits on concessionality

To ensure that the Corporation can facilitate the flow of finance it is expected that it will use a wide range of investment tools. This includes providing commercial and concessional loans where necessary. Concessional loans have a negative impact on the fiscal balance. The Corporation is therefore limited to providing $300 million of concessionality in any one financial year.

A concessional loan is a loan provided on more favourable terms than the borrower could obtain in the market place. The concession provided may be in many forms but typically will be in the form of lower than market interest rates, longer loan maturity or additional/longer or more flexible grace periods before the payment of the principal and/or interest is repayable. Concessionality should be measured as the difference between the present value of a loan provided at the concessional rate and the present value of a loan provided at the appropriate market rate.

The market rate is the prevailing rate of interest the borrowing entity would be subject to in the market for a similar instrument (in terms of currency, term, type of interest rate and other factors) with a similar credit rating. Where the terms are not currently available, an estimation would need to be made of the likely cost. A standard bank lending rate would need to be adjusted to take into consideration the risks associated with the borrower.

As the Corporation will provide loans where there may not be an explicit market rate, this will be a matter of judgement for the Board. The Corporation is expected to develop a robust system to determine the appropriate rate based on looking at loans for similar instruments in terms of tenor and risk.

The Department of Finance and Deregulation Accounting Guidance Note No. 2010/2 provides further information on calculating the amount of concessionality as well as worked examples.

Limits on guarantees

Guarantees are arrangements to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due.

Under the Australian Government reporting framework, guarantees are to be accounted for in accordance with the Australian Accounting Standards.

Guarantees pose a particular risk to the Commonwealth's balance sheet and can have unexpected consequences when called. As such, the Act and the Investment Mandate impose restrictions on their use. To limit any risk the Corporation must ensure that all guarantees are limited in nature and quantifiable.

The Act requires the Corporation to maintain sufficient uncommitted balance in the Clean Energy Finance Corporation Special Account to meet any potential liabilities in issuing a guarantee. In addition the Investment Mandate limits the amount of guarantees the Corporation can issue to 5 per cent of the total amount that has been credited to the Special Account under Section 46 of the Act.

Application of Australian Industry Participation Plans

The Corporation will provide significant support to projects in Australia. The application of Australian Industry Participation (AIP) Plans to investments made by the Corporation is aimed at increasing opportunities for capable and competitive Australian and New Zealand small and medium sized enterprises (SMEs) to participate in major projects.

An AIP Plan details how a project proponent will provide full, fair and reasonable opportunity to Australian industry to participate in a project. This applies to any subcontracting or purchasing opportunities that may be available. AIP Plans do not mandate the use of Australian industry, but rather aim to provide Australian industry with the opportunity to demonstrate their capabilities and capacity.

Corporation must consider impacts from its investment strategy

In establishing the Corporation it is the expectation of the Government that the investments of the Corporation should not disrupt the areas where the market is functioning well. That said, the Corporation has the potential to impact on other market participants and the operation of the Australian financial and energy markets. The Corporation should always consider this potential impact when making investment decisions.

Given half of the Corporation's investments will be in the renewable energy sector, there is a particular risk of impact on the market for Large-Scale Generation Certificates under the Renewable Energy Target. The Corporation should ensure it is cognisant of these risks when investing in projects eligible for these certificates.

As a statutory authority owned by the Commonwealth, the Corporation has a responsibility to act in a way that is not likely to cause damage to the Australian Government's reputation.

Corporate governance

In undertaking its investment function, the Corporation must act consistent with, and establish policies in relation to, Australian best practice corporate governance. In particular, the Government expects the Board's policies to include its approach to environmental, social and governance issues.

APPENDIX 2 – Clean Energy Technologies Guidelines

Clean Energy Technologies fall within the following categories:

- Low Emissions
- Renewable Energy
- Energy Efficiency

The CEFC Board of Directors has provided guidance on the definitions of each of these terms.

Definition of Low Emissions Technologies

CEFC Low Emissions Technologies: Definitional Guidance
The CEFC provides the following guideline for the term "low emissions technologies."

Low emission technologies may be applied to a number of activities including but not limited to:

- energy production;
- electricity generation including the use of non-renewable, fossil fuels;
- fuels for and modes of transportation; and
- using, reducing, or eliminating existing fugitive greenhouse gas emissions.

In addition to meeting the above criteria, the Board requires that at the time of CEFC investment, the low emissions technology must result in emissions of CO_2e being substantially lower than the current average of the most relevant baseline for the activity being undertaken. To satisfy this test a proponent must demonstrate:

- that if the technology is solely for electricity generation, it achieves an emissions intensity of less than 50 per cent of the existing generation system as connected to the transmission network/grid, or where not connected to a grid, less than 50 per cent of the emissions intensity of the baseline activity;
- that, if otherwise, the technology achieves useful-life emissions at 50 per cent less than the relevant current average baseline of the activity being undertaken.

The Board will consider on a case-by-case basis the level of reduced emissions in ranking low emissions technology investments against other investments the CEFC may make.

As a matter of investment policy, the CEFC will consider as eligible for investment, supply chains (manufacturing operations or service providers) that support the deployment or implementation of low emission technologies.

Low emission technologies exclude "prohibited technology" as described in the CEFC Act, section 62, namely:

- a technology for carbon capture and storage (within the meaning of the *National Greenhouse and Energy Reporting Act 2007*);

- nuclear technology; or
- nuclear power.

Definition of Renewable Energy Technologies

Renewable Energy Technologies: Definitional Guidance

The CEFC provides the following guidance on "renewable energy technologies" including "renewable energy" and "technologies."

Under the CEFC Act, the definition of "renewable energy technologies" includes:

(a) hybrid technologies that integrate renewable energy technologies; and
(b) technologies (including enabling technologies) that are related to renewable energy technologies.

"Renewable energy" is energy derived from resources that are naturally replenished. Renewable energies include but are not limited to electricity, thermal energy and fuel for transport generated or derived from:

- Bioenergy;
- Geothermal energy;
- Hydro energy;
- Ocean (tidal and wave) energy;
- Solar energy; or
- Wind energy.

"Technologies" has its ordinary meaning, namely the application of:

- scientific knowledge for practical purposes, or
- machinery and equipment developed from such scientific knowledge.

The CEFC defines a "hybrid" as a combination of technologies that integrate a renewable energy generation technology with other technologies into a combined system (i.e. a "hybridised" generation system).

The Board has adopted the principle that to qualify for investment:

- hybrid technologies and/or systems should have a majority renewable energy technology component; and
- an eligible project involving hybrid technologies and/or systems would produce an outcome which results in energy production from the hybrid system having an emissions intensity of less than 50 per cent of the existing generation system as connected to the transmission network/grid or (where not connected to a grid), less than 50 per cent of the emissions intensity of the baseline activity.

The CEFC will also consider as eligible for investment enabling technologies associated with the storage, prediction of supply, or assistance in transmission of renewable energy or a hybrid technology.

Renewable energy technologies exclude "prohibited technology" as described in the CEFC Act, section 62, namely:

- a technology for carbon capture and storage (within the meaning of the *National Greenhouse and Energy Reporting Act 2007*);
- nuclear technology; or
- nuclear power.

Definition of Energy Efficiency Technologies

Energy Efficiency Technologies: Definitional Guidance
The CEFC provides the following guidance for the term "energy efficiency technologies" which includes "energy efficiency," "energy conservation" and "demand management."

"Energy efficiency" is an increased output per unit of energy input, where:

- output and energy input are measured in physical units; and
- this results in a decrease in CO_2e emissions intensity relative to the baseline activity.

"Energy conservation" is the reduction of energy consumption.

"Demand management" includes demand response, demand side management, demand side response. A demand management technology might be considered eligible for CEFC investment where it can be clearly demonstrated that the technology results in a reduction in emissions intensity.

Energy efficiency technologies exclude "prohibited technology" as described in the CEFC Act, section 62, namely:

- a technology for carbon capture and storage (within the meaning of the *National Greenhouse and Energy Reporting Act 2007*);
- nuclear technology; or
- nuclear power.

APPENDIX 3 – Definition of "Australian Based"

"Solely or Mainly Australian Based": Definitional Guidance
The CEFC provides the following guideline for the term "solely or mainly Australian based."

The CEFC Board will consider an investment to be "solely or mainly Australian based" if the Investment Recipient is:

a) an entity registered with the ATO with an Australian ABN; AND
b) the proposed investment relates to one of the matters in Table 1.

Table: Subject of Investment

If the Clean Energy Finance Investment relates to...	...then satisfaction of the following conditions will make the Investment 'solely or mainly Australian based'...	...and the Corporation will use this metric as appropriate evidence of same:
1. Building, fixtures or specific projects (including construction and bridging finance).	The project is located: • in Australia; or • in Australian waters; or • in international waters but only where it is used solely or mainly for the economic benefit of Australia.	GPS coordinate of project site.
2. Equipment /chattel (including ships and aircraft) or otherwise undefined activity (whether of a commercial, governmental or other nature).	a. the equipment is located and primarily used: • in Australia; or • in Australian waters;, or • in international waters but only where it is used solely or mainly for the economic benefit of Australia. b. the activity is located: • in Australia; or • in Australian waters; or • in international waters but only where it is solely or mainly for the economic benefit of Australia.	Presence of conditions precedent and binding covenants in contracts prior to investment being made to same effect.
3. Indirect finance of either or both of one of the above	The activities being financed fit into one of the above categories.	Presence of conditions precedent and binding covenants in contracts/mandates

categories (e.g. Fund of Funds)		prior to investment being made to same effect.

Note on Definitions of "Australia" and "Australian"

For the purposes of this guideline a reference to "Australia" and "Australian" includes the external territories (CEFC Act, section 6). The external territories of Australia are at present:

- the Australian Antarctic Territory;
- the Coral Sea Islands Territory;
- the Territory of Ashmore and Cartier Islands;
- the Territory of Christmas Island;
- the Territory of Cocos (Keeling) Islands;
- the Territory of Heard Island and McDonald Islands; and
- the Territory of Norfolk Island.

Note on Definition of "Australian waters"

For the purposes of this guideline a reference to "Australian waters" includes:

- the "exclusive economic zone" as defined in the Seas and Submerged Lands Act 1973 including the external territories; and
- the waters above the "continental shelf", that is, any part of the area in, on or over the "continental shelf" as that term is defined in the *Seas and Submerged Lands Act 1973* including the external territories.