



Report and Recommendation of the President to the Board of Directors

Project Number: 45918
January 2012

Proposed Equity Investment
Climate Public–Private Partnership Fund

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Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
DMC	–	developing member country
ESMS	–	environmental and social management system
FI	–	financial intermediary
IRR	–	internal rate of return
PRC	–	People’s Republic of China
PSOD	–	Private Sector Operations Department
RSDD	–	Regional and Sustainable Development Department

NOTE

In this report, “\$” refers to US dollars.

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PROJECT AT A GLANCE

1. Project Name: Climate Public–Private Partnership Fund		2. Project Number: 45918	
3. Country: Regional		4. Department/Division: PSOD / PSCM	
5. Sector Classification:			
	Sectors	Primary	Subsectors
		Multisector	Energy sector development Energy efficiency and conservation Water supply and sanitation Waste management Urban transport Investment funds Land-based natural resource management
6. Thematic Classification:			
	Themes	Primary	Subthemes
		Environmental sustainability	Global and regional environmental concerns Eco-efficiency Urban environmental improvement
		Economic growth	Widening access to markets and economic opportunities Knowledge, science, and technological capacities
		Private sector development	Private sector investment
		Climate change mitigation and climate change adaptation	
6a. Climate Change Impact:		6b. Gender Mainstreaming:	
Adaptation	x	Gender equity theme	
Mitigation	x	Effective gender mainstreaming	
Not applicable		Some gender benefits	
		No gender elements	x
7. Targeting Classification:		8. Location Impact:	
General Intervention	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium development goals	Income poverty at household level
x			
9. Nonsovereign Operation Risk Rating: N/A			
10. Safeguard Categorization:			
	Environment	FI	
	Involuntary resettlement	FI	
	Indigenous peoples	FI	
11. ADB Financing:			
Sovereign/Nonsovereign	Modality	Source	Amount (\$ million)
Nonsovereign	Equity	OCR	100.0
12. Cofinancing:			
Financier	Category	Amount (\$ million)	
Not applicable			
Total			
13. Counterpart Financing: Not applicable			
14. Aid Effectiveness: Not applicable			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed equity investment of up to \$1,000,000 in a company to be formed to act as the general partner of the Climate Public–Private Partnership Fund; (ii) a proposed equity investment of up to \$1,000,000 in a company to be formed to act as the special limited partner of the fund; and (iii) a proposed equity investment as a limited partner in the fund of up to the balance of \$100,000,000, less the amounts contributed under items (i) and (ii).

II. THE FUND

A. Investment Identification and Description

2. **Description.** The fund is envisaged to invest in environmental finance in Asia. The fund will use a unique platform that combines private sector investment expertise with development finance institutions to provide equity, debt, and grant facilities to climate- and environment-related sectors in the developing member countries (DMCs) of the Asian Development Bank (ADB). ADB will invest up to 25% in the general partner of the fund, provide extensive services under a service agreement to assist the fund manager in day-to-day operations, and invest as a limited partner in the fund.¹

3. **Investment identification.** The fund's concept was initially driven by the interest of a set of large institutional investors, who view climate change challenges in Asia as a compelling investment opportunity. On four occasions during 2007–2009, the Prince of Wales convened some of the world's largest public pension funds, which collectively represent approximately \$3 trillion of assets, with key experts to discuss and develop investment strategies for tackling climate change risks. Inspired by existing and possible models, these investors approached the Department for International Development (DFID) of the United Kingdom and then ADB to collaborate with them to design an innovative, commercially viable vehicle for climate and environmental finance investment in developing Asia.²

4. This paragraph has been redacted due to commercially sensitive information.

B. Business Overview and Strategy

5. This paragraph has been redacted due to commercially sensitive information.

6. **Geography.** The fund will invest in ADB's DMCs. The remainder of this paragraph has been redacted due to commercially sensitive information.

7. This paragraph has been redacted due to commercially sensitive information.

¹ ADB may also take a stake of up to 25% in the special limited partner, a vehicle created for receiving and distributing carried interest earned by the general partner.

² This model broadly replicates the Regional Challenge Fund Model and the Cornerstone Fund Model structures recommended by the World Economic Forum Low Carbon Economic Prosperity Task Force. Policymakers include the International Investors Group on Climate Change, the UNEP Finance Initiative, the Global Leadership for Climate Action, and the Group of 8 (G8). Reference documents include: 2009. *Mobilizing Private Sector Investments for Clean Energy in Developing Countries*. Paper for the GLCA High-level Roundtable on Enhancing Private Investment in Clean Energy in Developing Countries. New York. 21 September.

C. Ownership, Management, and Governance

1. Ownership and management

8. The fund will be managed by its general partner, a limited liability company to be incorporated in a jurisdiction satisfactory to ADB. ADB will hold up to 25% of the equity shares of the general partner. The general partner will delegate responsibility for day-to-day operations and management of the fund to the fund manager, as is customary.³ The fund manager will enter into a service agreement with ADB, pursuant to which ADB will perform certain services for the fund manager. ADB will share day-to-day fund management work and, in consideration of the services performed for the fund manager, ADB will be paid a service fee.

9. This paragraph has been redacted due to commercially sensitive information.

2. Governance Structure

10. This paragraph has been redacted due to commercially sensitive information.

11. This paragraph has been redacted due to commercially sensitive information.

12. This paragraph has been redacted due to commercially sensitive information.

D. Financial Performance

13. This paragraph has been redacted due to commercially sensitive information.

14. **ADB investment history.** ADB's private equity practice has committed more than \$919 million to 61 private equity fund investments in Asia. As of 30 September 2011, active investments (vintage years 2001–2008) had generated a net return of 9.73% and a multiple of 1.3 times. ADB has been making investments in low-carbon and resource-efficiency sectors since 2003, and had committed over \$144 million to ten funds as of 30 September 2011. ADB fund investments that are consistent with the fund's strategy have generated an aggregate underlying fund net return of 9.0% as of 30 September 2011.

III. THE PROPOSED ADB ASSISTANCE

A. The Assistance

15. ADB will provide (i) a proposed equity investment of up to the lesser of \$1,000,000 and 25% of the shares in a company to act as the general partner of the Climate Public–Private Partnership Fund; (ii) a proposed equity investment of up to the lesser of \$1,000,000 and 25% of the shares in a company to act as the special limited partner of the fund; and (iii) a proposed equity investment as a limited partner in the fund of up to the balance of \$100 million less the amounts contributed under items (i) and (ii). ADB will also contribute human resources to the fund under the terms of a service agreement to be entered into between it and the fund manager. Each of the investee companies (i.e the general partner and the special limited partner entities) will be formed after the date of finalization of fund documentation. The remainder of this paragraph has been redacted due to commercially sensitive information.

³ All of the management and other fees relating to the fund will be paid to the fund manager.

16. This paragraph has been redacted due to commercially sensitive information.

B. Implementation Arrangements

17. In keeping with its stake in the general partner and to help ensure the fund's success, ADB will take an active role in fund management with the involvement of core and extended teams of ADB staff. At the outset, PSOD will dedicate some of its own staff to the fund initiative; additional staff may be deployed over time as the fund's investments expand. ADB expects to employ additional staff with funds generated by the management fee it receives via the service agreement.⁴ The remainder of this paragraph has been redacted due to commercially sensitive information.

C. Value Added by ADB Assistance

18. The fund initiative is designed around the concept of a partnership between a private sector fund manager and a public sector development bank, working in concert to execute the fund's mandate. The remainder of this paragraph has been redacted due to commercially sensitive information.

19. This paragraph has been redacted due to commercially sensitive information.

20. This paragraph has been redacted due to commercially sensitive information.

21. This paragraph has been redacted due to commercially sensitive information.

22. This paragraph has been redacted due to commercially sensitive information.

D. Risks

23. This paragraph has been redacted due to commercially sensitive information.

24. **Pipeline.** A second risk relates to deal flow, and whether the fund can develop a deal pipeline of the scale needed to support the fund's investments. The remainder of this paragraph has been redacted due to commercially sensitive information.

25. **Execution and resource allocation.** Risk is associated with the ability to execute the fund's mandate (i.e., source, make, and exit investments; and generate returns for the fund). The remainder of this paragraph has been redacted due to commercially sensitive information.

26. **Limit to liability.** The general partner will be a limited liability company, and accordingly, its shareholders will have the general protection provided by law in respect of limited liability companies. ADB will ascertain that in the jurisdiction of establishment of the fund and the general partner (which jurisdiction must be satisfactory to ADB) no special or potentially unlimited liability arises as the result of ADB being an investor in the general partner and, at the same time, a limited partner.

27. This paragraph has been redacted due to commercially sensitive information.

⁴ Implementation Arrangements (accessible from the list of linked documents in Appendix 2) provides further information on the funding arrangements.

IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

A. Development Impact, Outcome, and Outputs

28. **Outputs and outcome.** The key output of ADB's investment will be the establishment of the fund. The outcome will be an increased number of profitable, well-governed, and environmentally responsible investee companies and funds in environmental finance. The remainder of this paragraph has been redacted due to commercially sensitive information.

29. This paragraph has been redacted due to commercially sensitive information.

B. Alignment with ADB Strategy and Operations

30. **Consistency with Strategy 2020.** This sentence has been redacted due to commercially sensitive information. As such, they are aligned with ADB's Strategy 2020, which seeks to reduce poverty and improve living conditions and quality of life by scaling up private sector development and supporting environmentally sustainable models through projects that aim to reduce greenhouse gas emissions and address climate change impacts.⁵

31. **Consistency with ADB's climate change priorities.** ADB recently emphasized the importance of technology transfer and diffusion, one of the identified key "building blocks" under international climate change negotiations, to help address energy security and climate change in Asia and the Pacific. The President's advisory group on climate change and sustainable development has strongly backed these efforts. The advisory group also emphasized ADB's potential catalytic role and urged ADB to help the region to move "from the abstract to the concrete" and from incubation to impact. The remainder of this paragraph has been redacted due to commercially sensitive information.

32. This paragraph has been redacted due to commercially sensitive information.

33. **Consistency with the energy sector strategy.** ADB's 2009 Energy Policy seeks to facilitate a transition to a low-carbon economy and universal access to energy as an important step toward achieving ADB's vision of a region free of poverty. The objective of the policy is to help the DMCs provide reliable, adequate, and affordable energy for inclusive growth in a socially, economically, and environmentally sustainable way. To achieve these goals, policy implementation will be based in part on private sector participation to improve energy efficiency through competition and an increase in investable resources in the DMCs, which is necessary to build and sustain low-carbon infrastructure.

34. **Consistency with previous operations.** ADB recently invested in eight clean energy funds. The remainder of this paragraph has been redacted due to commercially sensitive information.

V. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

35. The investment is classified under category FI for impacts on the environment,

⁵ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

involuntary resettlement, and indigenous peoples.⁶ The investment's potential environmental and social impacts, the risks associated with the fund's likely future portfolio, and the commitment and capacity for environmental and social management, were assessed. The fund will ensure that investments using ADB funds are in compliance with applicable national laws and regulations; apply ADB's Safeguard Policy Statement (2009), including the prohibited investment activities list; and establish and maintain an appropriate environmental and social management system to manage the impacts and risks adequately.⁷ Gender aspects of the investment and the fund's compliance with core labor standards were considered and agreed actions will be monitored during implementation.

B. Anticorruption Policy

36. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

C. Investment Limitations

37. The proposed transaction, once approved and signed, will increase ADB's projected nonsovereign exposure as of 31 December 2012 to \$6.02 billion. Additionally, the proposed transaction will increase nonsovereign exposure to the PRC to \$1.42 billion or 24% of total nonsovereign exposure, increase exposure to India to \$881.7 million or 15% of total nonsovereign exposure, and increase nonsovereign exposure to private equity funds to \$744 million or 12% of total nonsovereign exposure. The proposed transaction is within the medium-term, country, industry, and group exposure limits for nonsovereign investments. However, the proposed aggregate capital contribution exceeds the \$75 million single obligor limit for equity investments. This sentence has been redacted due to commercially sensitive information. In this respect, a waiver of the applicable policy is sought.⁸

D. Assurances

38. Consistent with the Agreement Establishing the Asian Development Bank,⁹ each country where the fund invests will be requested to confirm that it has no objection to ADB's proposed investment in the fund. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

⁶ A proposed project is classified as category FI if it involves the investment of ADB funds to, or through, a financial intermediary. The financial intermediary must apply and maintain an environmental and social management system, unless all of the financial intermediary's business activities have minimal or no environmental impacts or risks.

⁷ Summary Poverty Reduction and Social Strategy; Safeguards and Social Dimensions Summary; Financial Intermediary: Environmental and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2)

⁸ ADB. 2010. Exposure and Investment Limitations on Nonsovereign Operations. *Operations Manual*. OM D13/BP. Manila. The maximum limit for investments in a private equity fund is the lesser of \$75 million or an amount equal to 25% of committed amounts.

⁹ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

VI. RECOMMENDATION

39. I am satisfied that the proposed equity investment would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve

- (i) a proposed equity investment of up to \$1,000,000 in a company to act as the general partner of the Climate Public-Private Partnership Fund; (b) a proposed equity investment of up to \$1,000,000 in a company to act as the special limited partner of the Climate Public-Private Partnership Fund; and (c) a proposed equity investment as a limited partner in the Climate Public-Private Partnership Fund of up to the balance of \$100,000,000 less the amounts contributed under subparagraphs (a) and (b), from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board; and
- (ii) the waiver of the limit for nonsovereign operations exposure to a single obligor, as described more fully in paragraph 37 of this report.

Bindu N. Lohani
Vice-President

24 January 2012

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Increase of capital and expertise in environmental finance in Asia and the Pacific</p> <p>Demonstrated viability of environmental finance in Asia and the Pacific</p> <p>Reduction in or avoidance of greenhouse gas emissions</p>	Redacted due to commercially sensitive information	ADB portfolio statistics	<p>Assumptions Climate change mitigation and adaptation, and enhancement of energy security continue to be a key driver of DMCs' national development policies^a</p> <p>A pipeline of commercially attractive projects exists</p>
<p>Outcome Increased number of profitable, well-governed, and environmentally responsible investee companies and funds in environmental finance</p>	Redacted due to commercially sensitive information	Fund reports	<p>Assumptions Targeted DMC governments maintain legal and regulatory frameworks that facilitate environmental finance investments</p> <p>Third-party debt and other financing schemes are available to provide leverage for the fund's investments</p> <p>Risks Asset managers and investors might, due to uncertainties in the global economy, reduce their allocation to private equity investments</p>
<p>Outputs Fund established and</p>	Redacted due to commercially sensitive information	Fund reports	<p>Assumptions The market is interested in investing in</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
funded as planned			environmental finance projects and companies in the targeted DMCs Risks Fund might raise less funding than anticipated ADB does not have experience in working as a co-general partner or working with a fund manager in this capacity
Activities with Milestones Operational arrangements. This paragraph has been redacted due to commercially sensitive information. Financing arrangements. This paragraph has been redacted due to commercially sensitive information.			Inputs ADB: \$99 million ^b invested in the fund

ADB = Asian Development Bank, DMC = developing member country.

^a ADB outsourced an analysis of the environmental finance investment climate and regulatory framework in target countries. ADB. 2011. *Investment Environment and Government Policy for Climate Change Adaptation and Mitigation Technology Focused Venture Capital Funds*. Interim Report. Manila.

^b This is the likely quantum of investment into the fund; the exact amount will be \$100 million less the balance of amounts invested in the general partner and special limited partner.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

1. Sector Overview
2. Ownership, Management, and Governance
3. Details of Implementation Arrangements
4. Contribution to the ADB Results Framework
5. Financial Analysis
6. Country Economic Indicators
7. Summary Poverty Reduction and Social Strategy
8. Safeguards and Social Dimensions Summary
9. Financial Intermediary: Environmental and Social Management System Arrangement

Supplementary Documents

10. Climate Public–Private Partnership Fund: Legal Structure
11. Climate Public–Private Partnership Fund: Links to Existing ADB Initiatives
12. Climate Public–Private Partnership Fund: Differentiating Factors
13. Climate Public–Private Partnership Fund: Value Addition to ADB
14. Climate Public–Private Partnership Fund: Fundraising
15. Climate Public–Private Partnership Fund: Pipeline Development and Capital Deployment