Future of **Institutions**

DIALOGUE SUMMARY

Dialogue topic:
Designing public banks to direct finance for transformative decarbonization

Organizers:
UCL Institute for Innovation and Public Purpose (UCL IIPP)

Key takeaways:
The UCL Institute for Innovation and Public Purpose (IIPP) aims to develop a new framework for creating, nurturing, and evaluating public value, to achieve economic growth that is more innovation-led, inclusive and sustainable. This goal requires that public institutions restructure their policies and practices to align with mission-led, public purpose aims that tackle modern grand challenges.

Public banks' internal capabilities uniquely enable them to accelerate decarbonization. This Dialogue convened 18 public banks and subject experts to brainstorm how public banks can be re-designed and governed to help overcome the challenge of decarbonization. The discussants defined the following challenges regarding institutional design: mandates are needed to accelerate a just transition to net zero; ambitious solutions to climate change require adequate funding; and investment strategies and pipelines must be carefully designed. Low-cost grants to banks can augment green solutions, whereby any investments will undoubtedly yield economic, social and environment impacts.

This Dialogue has ignited a lasting conversation which will propel reform in the public banks. Outstanding tasks include defining effective purpose-oriented mandates; balancing risk and reward; understanding what we mean by 'reward'; innovating effective market-making and co-shaping strategies; investing appropriately; and collaborating around new public-private partnerships.

The challenge(s):
This event was held under the Mission Oriented Innovation Network (MOIN). MOIN brings together public actors (state banks, innovation agencies, city level agencies, etc.) to share challenges and opportunities of using a mission-based approach, and insight on the market shaping (vs. fixing) framing this requires. A key pillar of this work involves re-focusing and designing public organizations around mission-led, public purpose aims, to tackle the grand challenges facing the 21st century.

More than 130 countries currently embrace net zero targets. Decarbonizing the global economy requires large-scale investments across multiple sectors. ~$5 trillion per year for the next 30 years will be required to meet global emissions targets. Who will finance this great transformation?

World public banks are equipped to provide the long-term, patient, strategic finance that the private sector is often unwilling and/or unable to provide. Many existing public banks are exploring how they can most effectively contribute to decarbonization and net zero targets. New public banks, including the National Green Bank in the U.S., have been created to accelerate the green transition.

However, there is no established best practice for how public banks can accelerate decarbonization. How must public banks be designed and governed to effectively accelerate the global transition to net zero? A key pillar of IIPP's research is its understanding of markets as outcomes of the interactions between different actors. In this context, public policy should not be seen as simply fixing market failures, but also as actively shaping and co-creating markets.

Insights for the Future of Institutions:

Mandates. Several participants highlighted the need for public banks to be 'mission and public purpose-oriented', with a focus not on fixing market failures, but catalyzing transformative change and shaping markets. It was recognized that this represents a significant shift for existing banks, who have historically worked within narrower market fixing mandates. Several participants agreed that public banks can play an important role in accelerating decarbonization, although this requires the concurrent building of more just and resilient economies. As one participant stated, "Ensuring that we adapt and build more resilient and just economies is just as important as the transition itself." Multiple participants highlighted the challenges and tensions that decarbonization poses for workers and geographies that have been heavily reliant on fossil fuels. The shift to green energy will mean that different jobs will be created in different locations, potentially creating huge economic dislocation. As one participant stated, "Should banks focus more on the 'just' side of a just transition or the "transition" side?" Some participants suggested the importance of ensuring that mandates do not only focus on accelerating decarbonization – but on promoting wider measures of sustainability, which can involve embedding a "well defined" just transition strategy into each bank's activities. "Let's not use the word 'green' – that's only one dimension. Let's talk about sustainable banks or environmental, social, and corporate governance (ESG) banks," as one participant stated. To this end, numerous participants highlighted how the UN Sustainable Development Goals (SDGs) provide a good basis for aligning mandates around economic, social, and environmental goals.

Risk and reward. In recent years, there has been a trend towards public actors playing a "derisking" role for private finance to accelerate decarbonization. This involves public banks bearing risks through guarantees and other instruments to underwrite private sector returns. However, several participants raised concerns about this trend, on the basis that, if public banks are bearing risks, then they should be able to share the rewards. One participant highlighted how public banks can play a "public venture capitalist" role, structuring investments across a risk-return spectrum so that lower risk investments help to cover higher risk ones. Some participants highlighted the need to create more types of public-private partnerships, where public banks and private actors could work together to "co-create and co-shape" markets and share risks and rewards. Participants also discussed how the "returns" of a public bank should be measured. One participant stressed the need to define and look at "returns" more broadly, not just in financial terms but to capture all benefits. Some participants suggested using the concept of "risk-adjusted returns" to assess the returns banks are making relative to the risks they are taking, while others stressed the importance of using dynamic measures which capture wider benefits to the economy. One participant highlighted that returns should be assessed in relation to the generation of public value, which requires developing new tools to monitor and assess how banks can contribute to public value.

Capacities. Some participants highlighted the importance of developing dynamic capabilities within public banks to enable them to engage effectively with challenges such as decarbonization. Other participants also highlighted the benefits of housing technical expertise to undertake rigorous appraisals of investments using leading ESG criteria. These technical capabilities can help banks align all their activities towards social and environmental goals and enhance the ability of public banks to "crowd-in" private investment by giving private sector actors the confidence they need to invest. Several participants also highlighted the challenges public banks face with retaining staff in a highly competitive market and losing staff to the private sector can often be a challenge.

Funding. Some participants stressed the importance of public banks being able to access low-cost funding. This lower cost of capital can then be passed onto borrowers, helping to ensure that green solutions become more price-competitive in the marketplace, which will be key if decarbonization is to take place. One participant stressed that the best way to access low-cost capital is at a national government level, seeing as this strategy would present the lowest borrowing costs. Low-cost capital can then be used to "fuel a network of green banks." One participant highlighted the potential for public banks to leverage their lower cost of capital to even design tailored "energy transition mechanisms." This could involve using cheap finance, or "soft money," to buy-out emitting assets such as coal power plants and decommissioning them earlier than planned, therefore helping to reduce greenhouse gas emissions. As stated by one participant, "How else are we going to get coal fired power off the agenda in a hurry?"

Investment activities. Several participants highlighted how being a 'patient' lender is important when financing solutions that accelerate decarbonization. Participants also highlighted the role that public banks can play in creating and shaping new markets. As one participant stated, "Public banks can support the development of new markets, leveraging resources and technical expertise they house." One participant highlighted how this should not involve "picking winners," but "picking the willing" – engaging with organizations across the economy that are willing to tackle decarbonization. Multiple participants also stressed the importance of delivering additionality and "crowding-in" (*i.e.,* catalysing activity that otherwise would not have happened). This can involve working collaboratively with other actors in the financial and innovation ecosystem to crowd-in private investment. One participant explained how they are creating "cutting edge" ESG standards that are integrated throughout the bank's activities to align their activities with the SDGs, which they hope will then become a benchmark ESG standard for the entire market. Finally, several participants highlighted the challenges public banks face once they become successful, citing the fate of the UK Green Investment Bank which was privatized five years after it was established. While it was acknowledged that this problem may reflect specific political and cultural contexts, some participants stressed that public banks could avoid this by continually rebalancing their portfolios to ensure they are focused on delivering additionality and maintaining their "purpose-orientation."

Monitoring and assessment. Multiple participants discussed the importance of undertaking rigorous ex-post technical assessments of the "social, economic, occupational and environmental" impact of a bank's investments. As stated by one participant, "If you can't measure the impact, how can you be sure it has actually happened?" Accurately monitoring impact also allows banks to "course correct" if the desired impact is not being achieved, and/or to increase investment in areas where impact is exceeding expectations. Some participants highlighted the importance of being able to capture the dynamic aspects of market-shaping policies such as spill over effects, uncertainty, innovation, and structural changes to the economy. Other participants highlighted the importance of developing metrics that assess the extent to which the activities of public banks are aligned with the Paris Agreement or SDGs and shared how these metrics were derived.

Political and cultural context. Some participants highlighted that different countries face different challenges associated with climate change and are at different stages in the transition to net zero. Countries in the Global South are particularly vulnerable to the effects of climate change, often also facing significant financing constraints. Countries also operate in different cultural contexts. As a result, while climate change is a common challenge for all public banks, policies must be tailored to accommodate differing socioeconomic circumstances, stages of development, and existing institutional landscapes.

Solutions

There was a broad consensus that public banks are well placed and willing to accelerate decarbonization. However, it was widely acknowledged that the key challenge lies in how they can most effectively do so in practice. Numerous participants highlighted the value of being able to share experiences and challenges around this, to learn from other public banks. As such, a lasting Dialogue was encouraged, to exploring possible areas for collaboration and shared learning. Participants highlighted several areas that would be fruitful for further collaboration:

- Define “mission-orientated mandates.”
- Explore how public banks approach risk and reward.
- Strategize how public banks can become better “market makers” rather than just market fixers, particularly in relation to the creation of new green jobs
- Discuss how public banks can most effectively generate a “flow of investible quality” projects, particularly how they can best identify, structure and finance green investments.
- Engage private sector and governments to build better public-private partnerships which can further accelerate the transition towards a greener economy.
- Avoid “fragmented discussions” by identifying a “common ground” on bank design and governance across different political and cultural contexts.

Given the importance of public banks in releasing the finance needed for both climate and health action, we believe the outcomes of this Dialogue and IIPP’s ongoing work with development banks are critical. We are very keen to continue working with The Rockefeller Foundation on these themes.

Participants:

- Dan Adler, California Infrastructure and Economic Development Bank (IBank)
- Erik Berglof, Asian Infrastructure Investment Bank (AIIB)
- David Burns, London Borough of Camden
- Sarah Davidson, NY Green Bank
- Sonia Dunlop, E3G
- Jill Earthy, InBC
- Warren Evans, Asian Development Bank
- Reed Hundt, Coalition for Green Capital
- Catherine Koffman, Development Bank of South Africa
- Julio Leite, BNDES
- Gene Leon, Caribbean Development Bank
- Stefano Maneri, Cassa Depositi e Prestiti
- Mariana Mazzucato, UCL Institute for Innovation and Public Purpose
- Leah Nguyen, InBC

- Zeph Nhleko, Development Bank of South Africa
- Gareth Phillips, African Development Bank
- Niranjan Rajadhyaksha, IDFC Institute
- Jimmy Williamson, Scottish National Investment Bank