Shaping the Future of Energy, Materials and Infrastructure

WORLD ECONOMIC FORUM

# Net-Zero Equity: Mobilizing Capital to Fight Climate Change

BRIEFING PAPER

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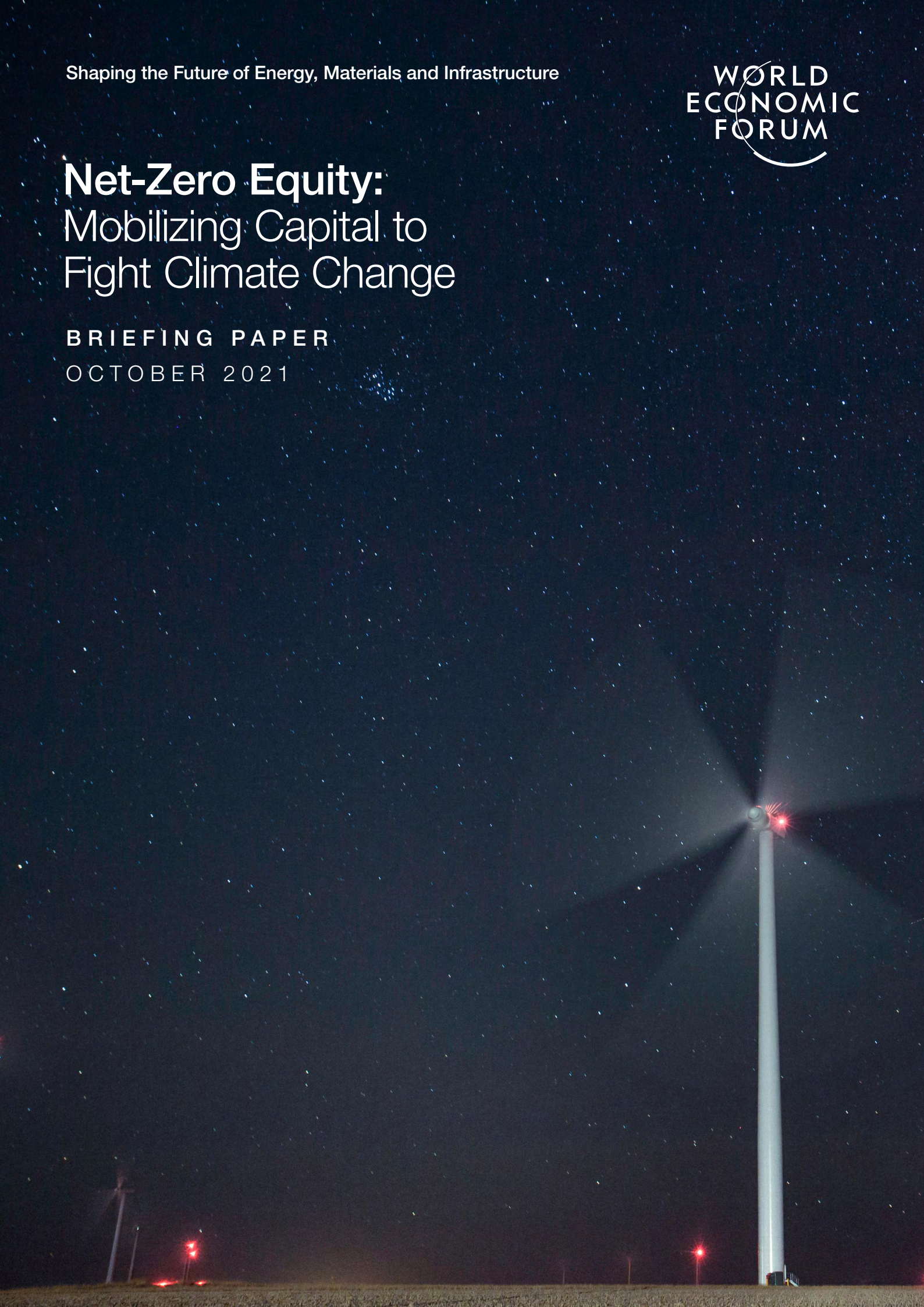


**Cover:** Zach Woolf, Unsplash – **Inside:** Getty Images

**Net-zero equity** is a new investment concept designed to mobilize capital that is prepared to accept highly uncertain financial returns to fund the most challenging elements of the climate agenda. It will allow investors, particularly global citizens and corporations, to demonstrate action and play an active part in the fight against climate change.

# 1 Introduction

In the lead-up to the 26th Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change (UNFCCC) in November 2021, it is important to recognize that climate change is a problem for all of society and all parts of society need to be part of the solution.

This paper highlights the role that society can play, particularly individuals and corporations, to help mobilize capital to address two key topics of concern in the fight against climate change – the pace of transition in the developing world and the climate innovation agenda. Both areas are perceived to be very high risk and are not receiving anything close to the amount of capital funding required from either the public or private sector.

Consequently, a new and innovative financial concept has been developed to enable individuals and society at large to address this issue. KPMG originally created the **net-zero equity (NZE)** concept, and then shared it with the World Economic Forum to socialize the idea with global stakeholders and test its feasibility.

# 2 What is net-zero equity?

**War bonds** are debt instruments issued by governments to finance military operations in wartime. War bonds tend to appeal to the sense of patriotism in individuals, who even see their purchase as a civic duty rather than a financial investment yielding returns.

**Net-zero equity** is designed to identify providers of capital who are prepared to accept highly uncertain financial returns that would in no way be commensurate with the underlying risk, but that would have positive impact on the climate agenda and on society generally. The social, environmental and development impact of the investment should be seen as more than compensating for the inherent financial risks. The NZE concept is modelled on the historical use of "war bonds" that were prevalent during both world wars.

The hypothesis is that there are significant numbers of people around the world who would be willing to act on the climate change agenda but for whom there are no readily available means to do so. However, in a post-pandemic world where the threat of climate change now looms larger than ever, there is a new sense of purpose, awareness and global solidarity emerging around the world. The proposal is to use the **NZE** idea to harness these sentiments and values in the fight against climate change.

**NZE** has a number of key features:

- It is a unique financial mechanism aimed at creating tangible benefits on the climate agenda. Investors' capital will generate social, environmental and development impacts.
- It is created to match "latent investors", meaning investors with available capital who are willing to invest into high-risk projects but who do not have access to the very high risk projects that need this type of capital (see section 3) in emerging markets and developing economies (EMDEs).
- For individuals, it will be issued in denominations as low as $50-$300 per investor – the ultimate aim being to raise capital through the sheer volume of investors. For other investor groups, investment amounts will be larger.
- Investors would contribute patient capital that may generate a return if the project is ultimately successful. Short- to medium-term financial returns are not the primary intent for investors.

It is intended that the **NZE** product would target particular groups of investors, including the following:

- Individuals
- Large global corporations – particularly those making net-zero commitments
- National governments
- Climate change foundations

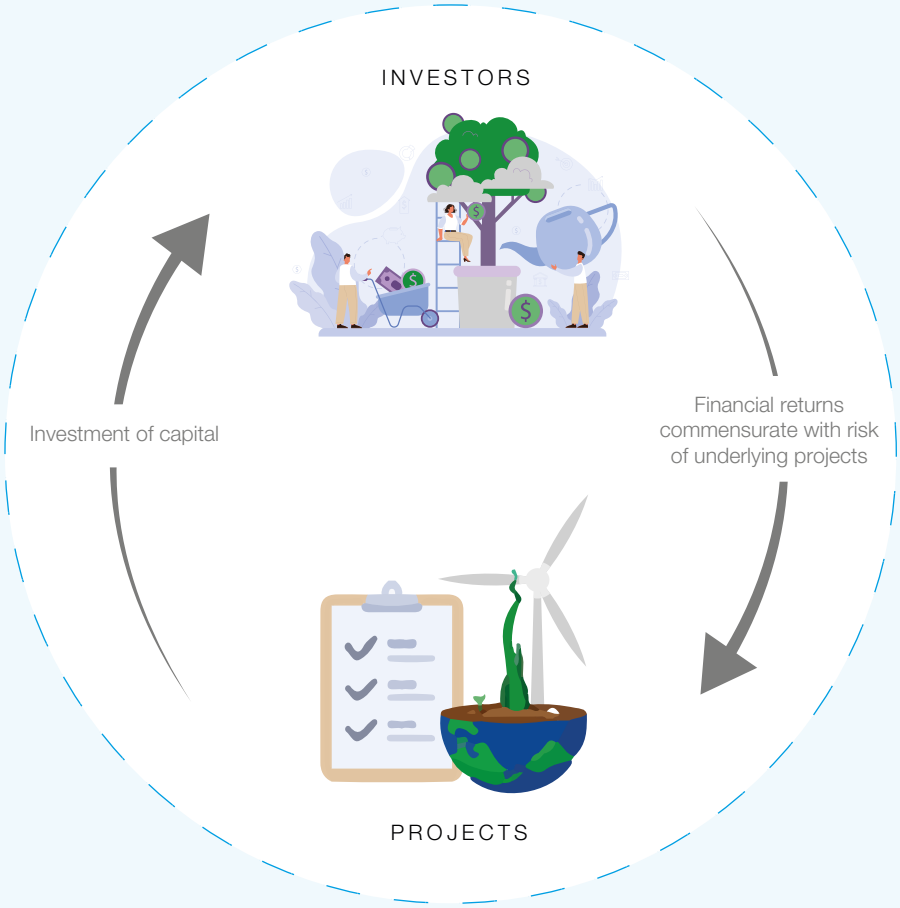
This paper focuses on the first two of these groups.

TABLE 1 **What net-zero equity is and is not**

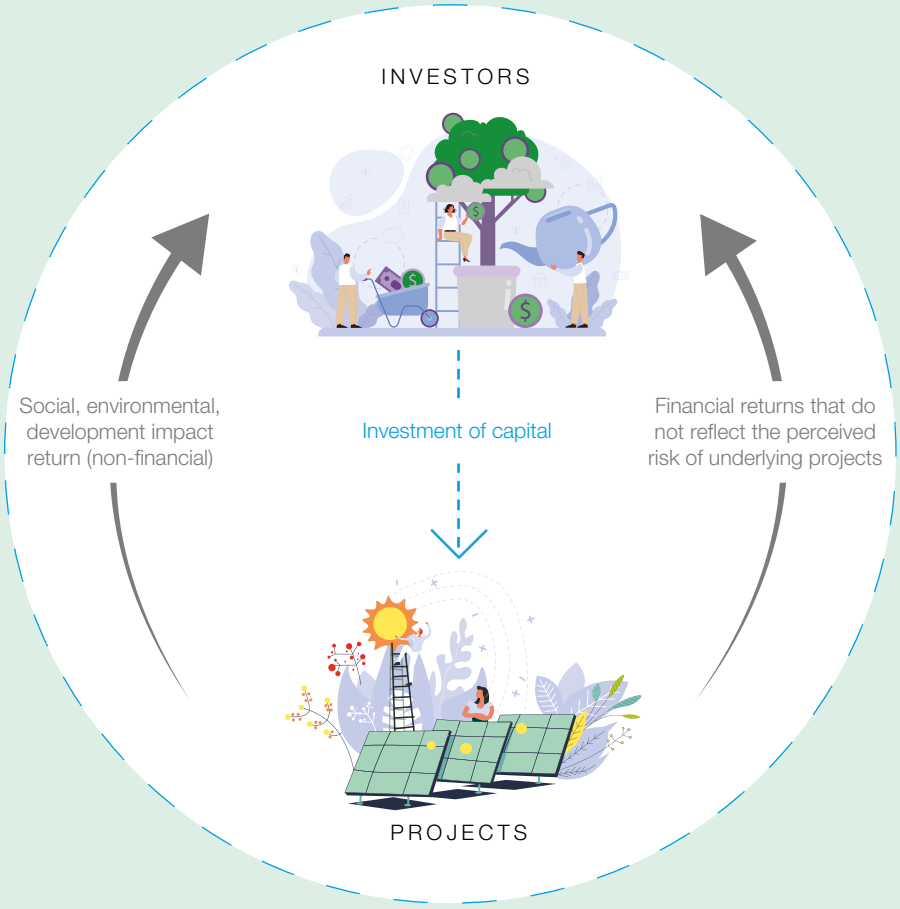
| What net-zero equity is not | What net-zero equity is |
|---|---|
| It is not a charitable donation or a grant. | It is a high-risk financial product designed for investors who are more focused on climate impact than on financial returns. |
| It is not concessional or blended finance. | It is taking equity risk in high-risk projects to help attract more conventional forms of financing. |
| It is not intended that a financial return would be guaranteed. | It is intended for investors to have full transparency so that they will have visibility on how and where their money is used. |
| It is not specifically an impact investment product in the way that idea is normally understood. | It is an innovative solution to enable individuals to take effective climate action by making a small investment in the product. |
| It is similar to crowdfunding in some respects but different in others. | It is a way for citizens to actively engage on climate issues. |

FIGURE 1 | **Net-zero equity – A new investment thesis**

**NORMAL INVESTMENT MODEL**




**NET-ZERO EQUITY – THE NEW INVESTMENT THESIS**




The net-zero equity idea relies on the fact that for some investors, purpose is as important as profit.

**Source:** KPMG, Net-Zero Equity Product, 2021.

# 3 Why is it necessary?

The vision is to use proceeds from issuing **net-zero equity** to help mobilize capital for critical parts of the climate agenda where such capital is not easily available from any source, thereby limiting important climate action.

- **Developing world:** Currently, investment capital is not being sufficiently mobilized to fund many high-risk sustainable energy and climate projects in developing countries because of the level of inherent risk. This includes political risk, land ownership risk, lack of infrastructure, currency risks, and many others. Most providers of multilateral funding (such as development finance institutions [DFIs], etc.) have indicated that they are still obliged to operate according to normalized commercial returns. This means that there are projects that they cannot fund because the level of risk is too high for the returns that would be generated. A key focus area for **NZE** will be the issue of sustainable energy for all, with an emphasis on transmission and distribution solutions, such as microgrids in EMDEs that will help deliver wind and solar projects. It will also be used to build renewable energy projects that would not be built otherwise because of the inherent risks.
- **Innovation:** The world will not reach net-zero emissions by 2050 without an unprecedented level of new technology and business innovation. Thankfully, this innovation is taking place and a global system of climate innovators has emerged in recent years to respond to the global need. However, a common challenge facing many of these innovators is the lack of funding to support both early stage innovation and scaling up the opportunities identified.[1] This systemic issue remains one of the critical barriers to successful action on the climate change agenda.

**Both of these scenarios highlight a single message – a critical need for a new form of capital that is prepared to invest into these high-risk areas.**

In the innovation space, it is envisaged that **NZE** proceeds will be used for a number of key technology solutions, including:

- Carbon removal and reduction technologies
- Next generation biofuels
- New storage solutions
- Completely new innovations, such as generating clean electricity and clean water from ambient air moisture.
- Consideration will be given to partnering with national governments to provide innovation funding on a matched basis.

[1] World Economic Forum (prepared in collaboration with KPMG), Accelerating Sustainable Energy Innovation, 2018.

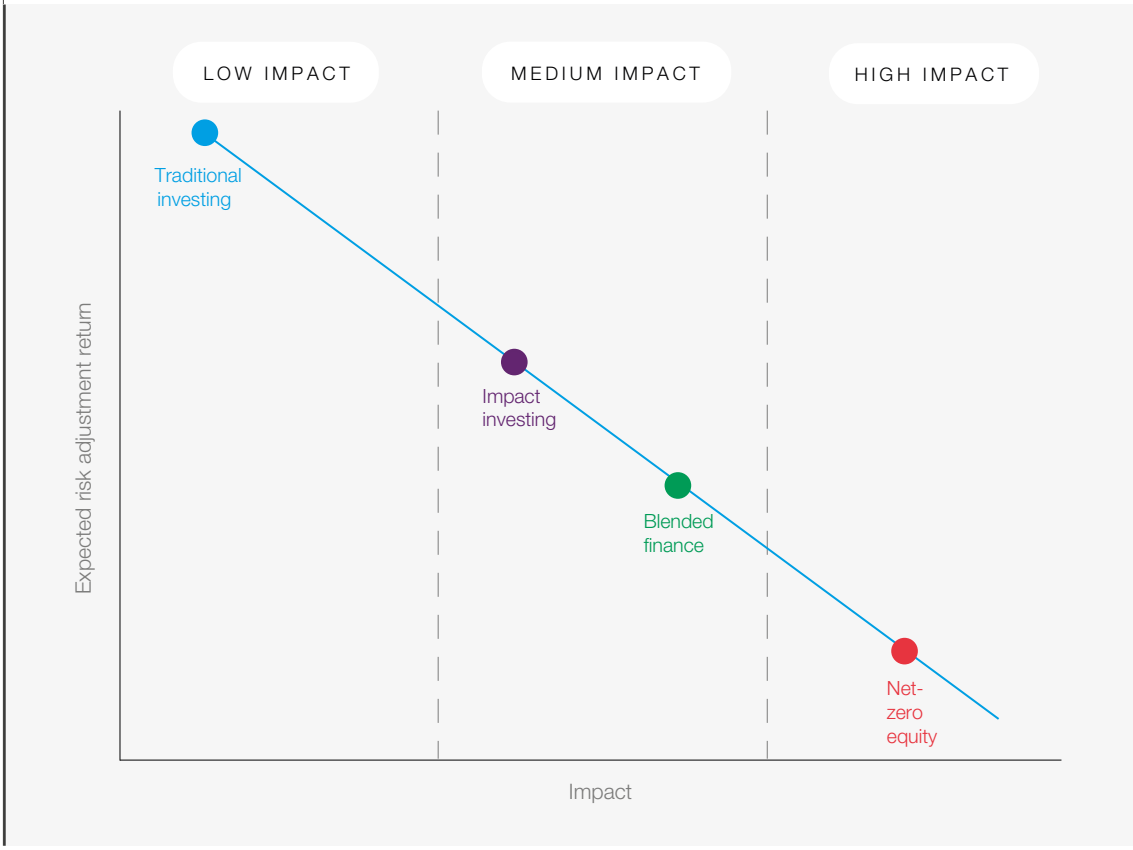
# 4 How does net-zero equity differ from existing mechanisms?

Net-zero equity is a completely new concept and it is ultimately different from existing mechanisms such as blended finance or concessional finance. NZE is unlike blended and concessional finance because there is no specific expectation that the projects that NZE invests in should deliver a financial return. On the other hand, blended and concessional finance demand a return commensurate with risk. Also, it is not intended for NZE plans to make grant funding available as, notwithstanding the high risk, it is still intended to act as a commercial proposition.

NZE is also different from traditional impact investing and crowdfunding. The goal of traditional impact investing is to generate financial returns alongside making a positive social or environmental impact. However, the positive impact is the primary goal of NZE and the financial returns that may be generated are secondary to this. NZE is similar to crowdfunding as it is dependent on a large number of individuals investing a small amount of money; yet it is different because of the financial return expectations.

The critical differences between NZE and existing mechanisms are summarized in the graph below. Traditional climate investing generates an appropriate level of return but has low to medium impact, while NZE may generate a low level of return (if any) but will have a huge impact on the climate agenda.

FIGURE 2 **Impact**




**Source:** KPMG, Net-Zero Equity Product, 2021.

# 5 Key building blocks to make net-zero equity a reality

### Governance and management

It is envisaged that, in all cases, an independent investment manager will operate and manage the subscription proceeds on behalf of net-zero equity investors. The key roles that the investment manager will undertake include:

- Project identification and undertaking due diligence followed by commercial negotiations with developers and other finance providers
- Managing the proceeds of NZE raised from investors and investing into appropriate projects
- Providing ongoing corporate governance and oversight in relation to the various investments made
- Ongoing reporting responsibilities to NZE investors
- Determining the optimal exit strategy.

### Structure

NZE can be structured both as a single project financing solution and as a fund including multiple projects. The idea is that the NZE will accept the "first loss" position, which means that all other investors will be paid first, including any blended or concessional finance. The developer and the NZE provider then share any remaining or residual returns.

The critical point is that for the other providers of finance, their overall risks are mitigated on the basis that the funding provided by the NZE investors will absorb significant losses, thereby helping de-risk the project for other investors.

In order to spread the risk from the investor perspective, NZE could be invested through a fund structure to enable the diversification of risk between different projects. This should help make the idea even more attractive to NZE investors.

The NZE would be listed on the stock exchange in order to help meet investor demand to trade the instrument.

### Transparency

The issue of trusted and verifiable data is of fundamental importance in ensuring transparency with investors. The proposal is that blockchain and machine learning solutions would be implemented to enable each investor to obtain ongoing verifiable information as to the destination of their investment subscription to avoid any concerns about greenwashing. Such data would be readily available to investors using mobile applications.

### Fundraising

This briefing paper does not go into detail about the various capital raising techniques that will be used to attract NZE investors. Through appropriate media campaigns, using high-profile champions and influencers and various other solutions, sufficient numbers of investors can be identified.

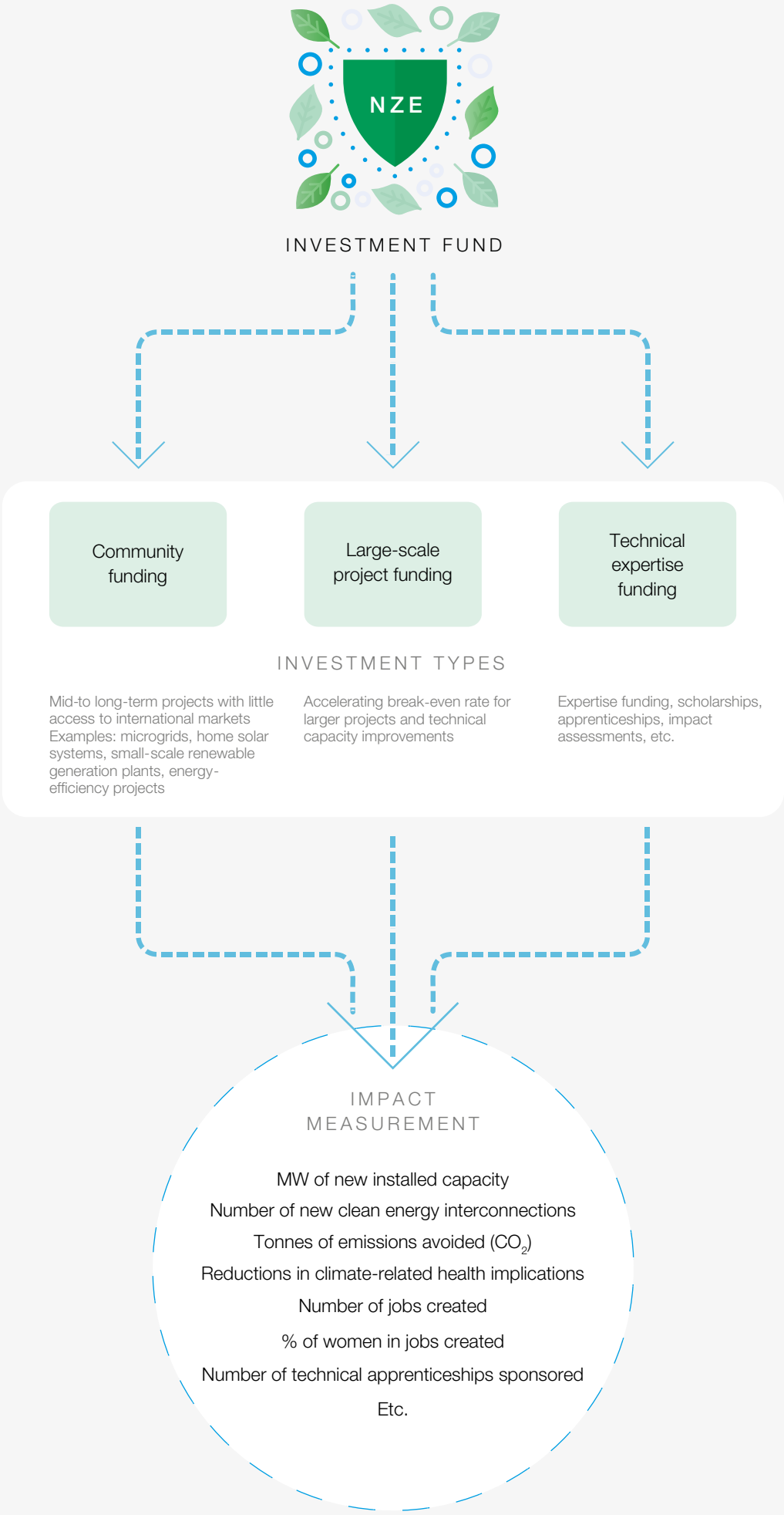
One effective solution would be for global corporations, particularly those that have made net-zero commitments, to engage their employees, customers and supply chains to become first movers in implementing the concept on a pilot basis. Loyalty programmes operated by these companies could also be used as a technique to access many more potential investors. Leading by example, it is anticipated that many other global corporations would follow this example, which would help catalyse the idea globally.

In due course, consideration will be given to providing some form of tax incentive for investors.

### Impact measurement

Measuring the impact of investments in a tangible and verifiable manner will be critical to the success of NZE. It is suggested that impact would be measured on the basis of the investment contribution to the Sustainable Development Goals (SDGs). Figure 3 outlines a number of impact indicators.

FIGURE 3 | **NZE investment types and impact measurement**




**Source:** Marsh, 2021.

# 6 Key benefits of net-zero equity

Net-zero equity would:

- Help deliver meaningful change by mobilizing capital for clean energy and climate investment in high-risk emerging markets and on the climate innovation agenda. Furthermore, it would have a catalytic effect in that the use of NZE would draw in many other forms of conventional debt and equity financing.
- Provide much needed impetus to the sustainable energy and climate innovation agenda.
- Help engage global citizens in the climate agenda in such a way that they become part of the solution rather than waiting for others to take action. In effect, the message is that the world cannot just rely on governments to solve the climate crisis.

# Call to action

The World Economic Forum's Net-Zero Equity working group calls on global corporations and other key stakeholders to reflect on the potential game changing nature of net-zero equity and to volunteer, with employees and customers, to participate in a pilot project to demonstrate the power of the idea.

This is an opportunity for global corporations to show a willingness to do something beyond their own core business and help implement a completely new solution in the fight against climate change.


# Contributors

**Michael Hayes**
Global Head, Renewable Energy, KMPG
Co-Lead, Climate Change and Decarbonization, KPMG Impact

**Funke Adeosun**
Vice-President, Energy Risk Engineer, Marsh

**Justine Roche**
Growth Markets Programme Specialist, World Economic Forum

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World Economic Forum
91–93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland

Tel.: +41 (0) 22 869 1212
Fax: +41 (0) 22 786 2744
contact@weforum.org
www.weforum.org