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FOR RECONSTRUCTION AND DEVELOPMENT**

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**SUSTAINABLE ENERGY INITIATIVE
PHASE 3
2012-14**

Executive Summary

PRESIDENT'S RECOMMENDATION

The EBRD launched the Sustainable Energy Initiative (SEI) in 2006 reflecting the increasing importance of energy efficiency to the region of operations and the call of the G-8 at the 2005 Gleneagles Summit for MDBs to scale up their activity to address climate change.

Through the SEI, the EBRD has become a major source of finance and expertise on climate change mitigation. From 2006 to 2011 SEI financing reached €8.8 billion in 464 operations with a total project value of €46.9 billion. This is expected to deliver an estimate reduction of 46 million tonnes of CO₂ per year.

Phase 3 of the SEI (SEI3) will have to operate in a very complex environment from 2012 to 2014. In particular, the Bank will have to take into consideration the deepening climate change challenge, a difficult economic outlook, increasing energy security concerns and the expansion of operations into the southern and eastern Mediterranean (SEMED) region.

The region of operations of the EBRD continues to be characterised by highly inefficient energy use. SEI experience demonstrates the region provides some of the most cost-effective CO₂ mitigation actions anywhere in the world. Furthermore, several areas of the EBRD region are vulnerable to the impacts of climate change, including in the new region of operations in SEMED.

The development directions of SEI3 combine continuity with innovation. SEI3 will build on the strong record and experience to date while innovating across the range of its activities to capture the sustainable energy potential in the Bank's countries of operations.

The development directions of SEI3 reflect the following factors:

- the strategic directions and competencies of the EBRD set out in the medium-term priorities (BDS09-54 (Rev 1)) and in CRR4
- the strategic context and challenges outlined above and the results and experience acquired during SEI Phases 1 and 2
- the unique transition mandate and comparative advantage of the EBRD in terms of its focus on market creation, institutions and price signals
- the relevance of focusing on productivity, competitiveness and overall resource efficiency given the difficult short- and medium-term economic and financial context ahead.

The operational and financing approach of SEI3 is rooted in and guided by the Bank's transition mandate. The EBRD has developed specific competences in financing energy efficiency and renewable energy. SEI3 will continue to be based on the EBRD business model which is transition driven, private sector focused, and market-oriented with generating commercially motivated projects in the private sector and paving the way for sustainable market-supported financing structures.

The SEI operational model combines the following instruments:

- project financing of specific energy efficiency or renewable energy investments with clear estimates of energy savings and carbon emission reductions
- technical assistance to support project preparation, project implementation and capacity building

- policy dialogue to support the development of an enabling environment for sustainability energy.

Phase 3 of the SEI will build incrementally on the existing structure and content of SEI2. This will involve the following two main development directions:

- further development of SEI *energy efficiency and climate change mitigation* activity reflecting experience and opportunities in the activities area set out in SEI Phase 2
- increased emphasis on *climate change adaptation* reflecting the likelihood of a significant rise in temperature independently of further mitigation action and the relevance of adaptation issues in the SEMED region.

The SEI3 financing approach builds on the following instruments which can be combined in the context of individual projects:

- direct EBRD financing and syndication for private or public sector projects seeking to maximise private sector financing
- where necessary, selective and smart use of subsidies to address specific barriers and market failures in line with the guidelines developed by the Bank
- where possible, the use of carbon finance or other market-based systems which can provide additional revenues to projects.

Based on the above operational and financing approach, SEI3 will aim for the following targets:

- EBRD SEI financing target of €4.5 to €6.5 billion with a target total project value range of €15 to €25 billion
- a target annual carbon emission reduction range of 26 to 32 million tonnes CO₂.

Strong support and commitment by donors is an important determinant of the SEI performance. Thanks to strong donor support, implementation of the SEI2 funding strategy was successful with the mobilisation of €108 million for TC activities and €332 million of investment grants. The Bank will focus on building and consolidating partnerships with donors during SEI3 rather than setting specific TC and grant mobilisation targets.

The Bank will also report on the transition impact of SEI3 projects and will develop a set of specific impact measures which could be used to reflect more comprehensively the co-benefits of SEI activities.

The successful implementation of SEI required a continuous focus on the use of a broad range of financial instruments in support of the private sector. In addition, the Bank employed effective policy dialogue to achieve transformational change in the region and for scaling up sustainable energy investments.

Considering the rising urgency to effectively address the climate change challenge and the growing relevance of energy efficiency within a difficult economic context, I recommend that the Board of Directors approve the proposed Phase 3 of the Sustainable Energy Initiative covering the period 2012 to 2014.

Thomas Mirow

President, European Bank for Reconstruction and Development

EXECUTIVE SUMMARY

SEI as an instrument for climate action, investment and results

Phase 3 of the Sustainable Energy Initiative (SEI) will build on the considerable success achieved in the past few years. SEI was launched at the 2006 Annual Meeting as a component of the third Capital Resource Review (CRR3) (BDS06-21 (Final)). It is the EBRD's specific approach to addressing the climate change challenge with a particular focus on energy efficiency and renewable energy. It helps to fulfil the transition mandate of the EBRD and, beyond energy saving and CO₂ emissions reduction, contributes to improving the competitiveness and productivity of firms and infrastructure services in its region of operations.

From its launch to the end of 2011, EBRD SEI financing reached €8.8 billion in 464 projects, with a total project value of €46.9 billion. SEI Phase 1 (SEI1) and Phase 2 (SEI2) are expected to deliver an estimated reduction of 46 million tonnes of CO₂ per year.

A challenging context

Phase 3 of the SEI (SEI3) will have to operate in a complex environment including a fragmented climate framework, continuing rising CO₂ emissions, a difficult economic outlook, increasing concern for energy security and the expansion of operations into the SEMED. All this underpins the innovation and policy dialogue which will be at the core of SEI3.

The **climate change challenge** is deepening. Despite increased awareness of the severity and urgency of this challenge, global CO₂ emissions have continued to increase. Addressing this issue will require not only political and technical action but also large financial commitments. According to the IEA (2010) an additional US\$ 46 trillion will be needed through to 2050 to achieve global climate change targets. However, the call for additional investments comes at a time when fiscal constraints impact the scope and ambition of government mitigation and adaptation actions. In such a context of fiscal tightening, international financial institution (IFI) and private sector finance will have to play an increasingly important role.

The climate change challenge is increasingly relevant to the EBRD region of operations. The region continues to be characterised by highly inefficient energy use. SEI experience demonstrates the region provides some of the most cost-effective CO₂-mitigation actions anywhere in the world. Furthermore, several areas of the EBRD region are vulnerable to the impacts of climate change – particularly in the new region of operations in the SEMED.

Energy efficiency remains a priority for all countries of operations as it reduces production costs, enhances competitiveness, supports energy security and lowers CO₂ emissions per unit of production. While there has been an overall decoupling of economic growth from emissions in the region of operations, progress after 1995 has been uneven across countries. As a result, energy intensity in the EBRD region remains on average over three times higher than in the European Union (EU).

The economic and financial context and outlook also need to be factored in the formulation of SEI3. In particular, four issues need to be considered. First, the economic slow-down in key regions of the world is expected to affect the EBRD countries of operations and patterns and levels of investment, including from the private sector. Second, instability in financial markets and particularly in the banking

system will affect the portfolio quality, liquidity and financing of the real economy by local banks. This could have an impact on the SEI financing activity through financial intermediaries. Third, austerity programmes and fiscal contraction will place pressure on the availability of public funds – potentially affecting the availability of technical cooperation (TC) and investment grants. Lastly, the urgency and severity of economic and financial issues to be addressed in the short term have caused climate change to recede in priority despite recent negative emissions trends and increased awareness of the issue.

Across the EBRD region, sustainable energy policy frameworks have generally improved domestically, in contrast to the worsening of the overarching international framework. However, the picture across the Bank's region is mixed: some countries have made considerable progress in implementing sustainable energy frameworks (particularly new EU member states transposing the *acquis communautaire*) while many countries beyond the European Union are lagging behind.

Recent studies by the Bank on the low carbon transition and on the demand for commercially attractive emission reduction measures highlight the importance of SEI policy dialogue activities going forward.

The market-based incentives framework for sustainable energy remains heavily affected by the persistence of fossil fuel subsidies and by the lack of a clear and stable carbon price. The latest International Energy Agency (IEA) study estimates that fossil fuel subsidies remained very high at over US\$ 400 billion for 2010. Also, despite steps forward by the UNFCCC in Cancun (2010) and Durban (2011), major issues remain in agreeing emission targets and how the emissions reduction burden should be shared across countries. This results in further uncertainty relative to the mechanisms to achieve these targets, including public financial flows and carbon markets.

Since Copenhagen (2009), there has also been increased emphasis on the development of large concessional climate funds to support the accelerated development of climate change mitigation and adaptation measures in developing countries (for example, the US\$ 30 billion Fast Start funding for the period 2011 to 2013 and the Green Climate Fund). However, donor-supported and market-driven approaches are not necessarily mutually exclusive. Access to donor funding – used selectively and smartly – can provide additional possibilities for multilateral development banks (MDBs) to develop their climate financing activities particularly in an economic and policy context which may remain adverse. The EBRD is well positioned in this area, having developed internal guidelines on using subsidies in the area of sustainable energy in a way that minimises distortions and prevents crowding out of private finance.

Energy security is an increasing concern for many countries in the Bank's region of operations. Twenty six out of 29 EBRD countries of operations are net energy importers, including large countries such as Poland, Turkey and Ukraine. Energy-importing countries face increasing pressure to reduce their large energy import bills and to decrease their dependence on volatile international energy prices. In contrast, several countries of operations rely on exports of oil and gas to drive their economies. Russia and Kazakhstan in particular are significant energy exporters, with net energy exports equivalent to around 80 per cent and 120 per cent of total domestic primary energy supply.

Transition-related aspects of energy security include reliability and predictability of supply needed to support appropriate long-term commercial decisions, and the effective pricing of energy security and diversity to address the market failure in this area.

The Bank also needs to develop its approach to its new region of operations in the SEMED. The Bank faces high expectations, as part of the collective international response to the "Arab uprising". Initial operational assessment trips to the countries of the SEMED region have shown the importance of energy efficiency and renewable energy. As many countries are dependent on external energy sources, energy efficiency and security are high priority items, particularly taking account of the strong economic and budget impact of energy-related expenditures.

The current economic and financial context is placing a growing emphasis on productivity, efficiency and competitiveness. In parallel there are increasing references to the development of a "green growth" model, reconciling economic growth and environmental sustainability. Resource efficiency is becoming an increasingly important concept in support of this reconciliation. Beyond energy, the efficient use of water resources is of critical importance for SEMED countries which include some of the most water-stressed countries in the world. Reflecting the rising priority of a broader resource efficiency agenda, the Bank is examining how the SEI business model could be effectively used to address water and industrial process efficiency concerns. This work is being developed beyond the scope of this SEI3 strategy.

SEI Phase 2 objectives and results

Building on the results of SEI1, the Bank launched SEI2 in 2009 setting ambitious objectives for the period 2009-11 including:

- EBRD financing of €3 to €5 billion for a total project value of €9 to €15 billion
- CO₂ emission reductions of 25 to 35 million tonnes CO₂/year
- technical cooperation (TC) funding of €100 million and investment grant funding target of €250 million.

During SEI2, the Bank focused its activities in three areas:

- consolidating and expanding Bank operational activity in core SEI Phase 1 activity areas including: large industry energy efficiency; sustainable energy financing facilities; cleaner energy supply; renewable energy; municipal infrastructure energy efficiency and support to carbon market development in the EBRD region of operations
- establishing new operational activities launched as part of Phase 2 including: buildings energy efficiency; biomass energy; gas flaring reduction; transport energy efficiency; and climate change adaptation
- supporting these investment activities with technical assistance, policy dialogue and new product development.

From its launch in 2009 to the end of 2011, EBRD SEI2 financing reached **€6.1 billion** for 298 operations for a total project value of **€32.9 billion**, exceeding the upper end of the SEI2 range. At double the level achieved by SEI1, SEI2 results reflect a marked increase in activity in line with the original financial scaling-up objective of SEI. Accordingly, SEI has grown to become a key area of transition and business activity of the EBRD with about two-thirds of SEI2 investments in the

private sector. On an annual basis, SEI2 investments doubled from €1.3 billion in 2009 to €2.6 billion in 2011. SEI2 investments are anticipated to deliver a reduction of **25.6 million tonnes of CO₂** per year – equivalent to the combined annual emissions of Croatia and Georgia in 2009.

Within the current economic context, the leverage achieved by EBRD finance and donor funds is increasingly important and challenging. Over the 2009-11 period, on average, every euro of grants committed to SEI leveraged €19 of EBRD finance.¹

Through SEI the Bank seeks to deliver significant CO₂ and energy savings as a result of its investments. Over a project lifetime of 10 years, each tonne of CO₂ reduction required, on average, an SEI investment of €24 and each tonne of oil equivalent saved required, on average, an investment of €53.

The main operational results achieved during SEI2 for core activity areas include:

- **Industrial energy efficiency** investment grew by 22 per cent per year from €17 million in 2009 to €78 million in 2011. Cumulative SEI2 investments in industrial energy efficiency reached €1.34 billion. The potential energy savings are 2 million toe/year and a reduction of 4.6 million tonnes CO₂/year.
- **Sustainable energy financing** facilities (SEFF) activity trebled from €35 million in 2009 to €18 million in 2011. Cumulative SEFF investments during SEI2 totalled €1.1 billion. In total, the SEFFs have financed over 30,000 projects which are estimated to deliver avoided CO₂ emissions of 2.3 million tonnes of CO₂ per year.
- **Cleaner energy production** remains the largest activity area in terms of cumulative investment volume. By the end of 2011, cumulative SEI2 investment in cleaner energy production reached €1.6 billion. Cumulatively, over SEI2, investments in cleaner energy production are estimated to deliver a reduction of 11.7 million tonnes CO₂ per year.
- **Renewable energy investments** sharply increased from €125 million in 2009 to €59 million in 2011. By the end of 2011, cumulative SEI investments in renewable energy reached €1.4 billion delivering an estimated 5.6 million tonnes of CO₂/year. Investments in hydropower and wind generation dominated the renewable energy portfolio of SEI2.
- **Municipal and environmental infrastructure** investments continued to grow over the SEI2 period. By the end of SEI2, cumulative municipal infrastructure related sustainable energy investments grew to €645 million in 15 countries compared with €38 million in SEI1. SEI2 municipal **infrastructure** investments offer significant climate change mitigation with CO₂ emission reductions estimated at around 1.8 million tonnes/year.
- **Carbon market development** the Bank has made progress in three areas: (i) through its two *carbon funds*, the Bank has signed 30 carbon credit transactions for a combined total of nearly 16 million carbon credits for delivery within the Kyoto Protocol commitment period; (ii) the Bank is currently supporting a further 5 *carbon asset developments* for about 4 million carbon credits; and (iii) the Bank is in *policy dialogue* with its countries of operations to support the design, establishment and operations of carbon markets.

¹ Note that grant leverage includes all TC committed to overall SEI activities and Non-TC grants. mobilised for SEI activities during the period

- SEI investments in **buildings energy efficiency** increased from around €30 million in 2009 to around €267 million in 2011 for a total of 48 projects.² Together, these investments are estimated to deliver 2.6 TWh/year of primary energy savings and to reduce emissions by around 0.6 million tonnes CO₂/year.
- SEI investments in **transport sector energy efficiency**: reached €72³ million. Together, these projects are estimated to reduce CO₂ emissions by around 1.1 million tonnes per year. These investments included more efficient rolling stock in rail transport and air and sea port facility modernisation.
- The Bank has developed a portfolio of 16 **climate change adaptation** pilot projects during SEI2 with a total EBRD investment volume of €382 million.

Some important lessons learned have emerged from SEI2, and are reflected in the formulation of SEI3. These include:

- The model of establishing and building a team to be a technical centre of expertise which partners with other banking teams has been effective in mainstreaming and scaling up SEI investment and developing new products and themes that cut across the matrix in the Bank.
- The provision of comprehensive energy audits is a useful tool in developing projects and the underlying capital investment appraisal is key to linking technical efficiency to financial performance and investment decisions.
- Sector-wide analysis is a very useful precursor to the development of investment operations. This is important in major energy intensive sectors (for example, gas flaring and refining) where there are no specific counterparties with vested interest in pursuing low-carbon investment.
- Carbon markets and their development can provide financing for renewables and energy efficiency projects but are very resource-intensive.
- Close integration of technical assistance and policy dialogue can significantly enhance the impact of an operation, but requires both a focus on institutional diagnostics and detailed legislative follow-up.
- Enhanced impact monitoring would allow better measurement of results and improve project preparation and donor relationship management.
- Technical assistance in policy work in non-traditional SEI areas like budget reforms and housing legislation can improve the investment climate for energy efficiency and is best conducted in conjunction with other IFIs when possible.

SEI Phase 3 development directions and targets

The **development directions** for Phase 3 of the SEI (SEI3) put the emphasis on innovation, while not losing continuity. Accordingly, SEI3 will build on the strong record and experience to date to capture the sustainable energy potential in the Bank's countries of operations.

The development directions of SEI3 reflect the following factors:

- the strategic directions and competencies of the EBRD set out in the medium-term priorities (BDS09-54 (Rev 1)) and in CRR4

² Across the agribusiness, transport, property and tourism, manufacturing and services sectors and including built-environment related investments from SEFFs.

³ Note that this excludes investments led by the transport team relating to buildings (such as railway station upgrades) as they are accounted for in the buildings energy efficiency section (€85 million). Public transport projects led by MEI are included (€385 million).

- the strategic context and challenges outlined above and the results and experience acquired during SEI Phases 1 and 2
- the operational and policy dialogue established in a large number of countries of operations including Sustainable Energy Action Plans (SEAPs), sector studies, country sustainable energy market assessments and an integrated set of operational, technical assistance and policy activities
- the unique transition mandate and comparative advantage of the EBRD in terms of its focus on market creation, institutions and price signals
- the relevance of focusing on productivity, competitiveness and overall resource efficiency given the difficult short- and medium-term economic and financial context ahead.

Taking account of the above, SEI3 will further develop its climate change mitigation and adaptation activities reflecting experience and opportunities within each SEI activity area (see section 6).

SEI3 will continue to pursue challenging **targets**. Considering the context within which SEI3 will operate, the business volume and CO₂ mitigation metrics used in SEI2 will be maintained for SEI3 for the following reasons:

- as reflected in the recently concluded COP17 at Durban, the scaling up of climate financing remains a key global objective
- the CRR4 document mentions that: “investments in sustainable energy and sustainable energy projects will be a core priority accounting over time for a quarter of new business”
- given the global emissions trajectory mentioned in section 1, the measurement of CO₂ emissions reduction remains a key climate change mitigation parameter and an important outcome to measure.

Accordingly, SEI3 will aim for the following targets:

- EBRD SEI financing target of **€4.5 billion to €6.5 billion** with a target total project value range of **€15 to 25 billion**
- a target CO₂ emission reduction range of **26 to 32 million tonnes CO₂/year**.

These targets reflect the uncertain environment within which SEI3 is expected to operate during 2012 to 2014, the overall planned level of activity of EBRD and the experience of SEI2 particularly in terms of CO₂ emissions reduction. Considering the broad set of SEI targets and parameters, the Bank will seek to optimise its SEI financing and carbon emissions reduction results taking account of transition, sector and geographic distribution, and other co-benefit metrics. Accordingly both SEI financing and carbon emissions reduction results need to be interpreted in light of the results achieved by SEI along other dimensions of strategic relevance to the Bank such as transition, other strategic initiatives such as the ETC and Western Balkans initiatives, broader systemic economic impacts and other dimensions of SEI impact mentioned later in this section.

Given the Bank’s track record of optimising its leverage of donor contributions, the Bank will focus on building and consolidating partnerships with donors during SEI3 rather than establishing TC and grant mobilisation targets. In addition the Bank will report on the transition impact of SEI3 projects.

Innovation will be a defining feature of SEI3 including, for example:

- technological development within each SEI activity area
- the development of adaptation project financing including the new region of operations
- the enhanced use of carbon market instruments in the region
- the expansion of the range of SEI financial instruments
- the definition of efficient policies to scale sustainable energy investment through policy dialogue.

Beyond SEI3, innovation will also be pursued by considering the possible extension of the SEI business model to water and process efficiency.

Notwithstanding the continuing validity of the above metrics, these do not capture the full range of impacts from SEI activities (for example, the above metrics do not report on the financial returns and contribution to firm-level competitiveness or the CO₂ mitigation effectiveness of SEI investments). The development of additional “co-benefit” metrics is complex and has resource implications for the Bank and its clients to collect, analyse and report. Accordingly, as part of SEI3, the Bank will build on existing methods and develop a set of specific impact measures which could be used to reflect more comprehensively and appropriately the impact of SEI activities. This work will be developed within the first year of SEI3 and could be presented to directors and SEI donors in an upcoming SEI forum.

SEI Phase 3 operational and financing approach

The operational and financing approach of SEI3 is rooted in and guided by the Bank's transition mandate. The EBRD occupies a niche reflecting its **specific competences** among other international and bilateral public financial institutions that provide finance to energy efficiency and renewable energy. This niche is based on a "bottom-up" project-driven business model that prioritises the private sector and is able to deploy considerable resources to target specific problems. Therefore SEI builds on its alignment with the unique EBRD business model, that is, transition-driven, private sector focused, market-oriented, commercially motivated projects crowding-in the private sector and paving the way for sustainable market-supported financing structures.

The SEI operational model combines the following instruments:

- **project financing** of specific energy efficiency or renewable energy investments with clear estimates of energy savings and CO₂ emission reductions
- **technical assistance** to support project preparation, project implementation and capacity building
- **policy dialogue** to support the development of an enabling environment for sustainable energy.

The SEI3 financing approach builds on the following instruments which can be combined in the context of individual projects:

- direct EBRD financing and syndication for private or public sector projects seeking to maximise private sector financing
- where necessary, selective and smart use of subsidies to address specific barriers and market failures in line with the guidelines developed by the Bank

- where possible, the use of carbon finance or other market-based systems which can provide additional revenues to projects.

SEI Phase 3 activity areas and financial instruments

Phase 3 of the SEI will build incrementally on the existing structure and content of SEI2. This will involve the following two main development directions:

- further development of SEI **energy efficiency and climate change mitigation** activity reflecting experience and opportunities
- increased emphasis on **climate change adaptation** reflecting the likelihood of a significant rise in temperature independently of further mitigation action and the relevance of adaptation issues in the southern and eastern Mediterranean region.

SEI3 will continue to target sustainable energy investments across all core areas of activity with a continued focus on the key aims of climate change mitigation and energy efficiency. This will involve:

- **industrial energy efficiency**: delivery of energy audit services as the main instrument to exploit the energy efficiency potential of industrial projects; promoting clean-energy technology; expanding energy management capacity building and knowledge sharing among clients; expanding activity in sectors such as chemicals/petrochemicals and pulp and paper
- **Sustainable Energy Finance Facilities (SEFFs)**: extending the scope of sectoral coverage, in particular to the residential, municipal and agricultural sectors; expanding the financial product range; streamline SEFF administrative processes; and improve communication of results
- **cleaner energy production**: ensuring investments aim for the highest efficiency in energy production, transmission and distribution; reduction of gas flaring; support efficiency in oil refining and gas production; capture cost-effective low-carbon solutions; expand investments in smart meters
- **renewable energy**: developing the EBRD's direct loan finance instrument; expanding coverage of renewable energy sources; pursue policy dialogue efforts
- **municipal infrastructure energy efficiency**: capturing growing demand for public transport investments; continuing to enhance energy efficiency of district heating projects; exploring projects that exploit the water-energy nexus and waste to energy; pursuing developments of public buildings energy efficiency business
- **carbon markets**: mainstreaming carbon asset development; investing in carbon assets; providing capacity building and policy dialogue support
- **buildings energy efficiency**: continuing to promote energy efficiency investments in commercial buildings complemented by growing operations in the residential multi-family building retrofit market and in public buildings; developing appropriate financial instruments targeted at sustainable urban development and building integrated renewable energy; continuing policy dialogue effort to resolve regulatory barriers to residential building capital repairs and the potential use of ESCOs in public buildings
- **transport energy efficiency**: focusing on transport-related sustainable energy components of major infrastructure; investigating potential new areas such as sustainable energy in shipping; developing policy instruments to support sustainable transport planning and practices.

SEI3 will also place increased emphasis on **climate change adaptation** reflecting that a significant rise in temperature is by now likely independently of further mitigation action and that adaptation issues are expected to become more severe. This has potentially serious implications for a range of sectors and industries in which the Bank invests, and which are critically important for the economic development of the region of operations. While the Bank has demonstrated during SEI2 its ability to develop adaptation-related investments, the challenge for SEI3 will be to scale up these investments. One important element of scaling up will be to systematise the Bank's project screening for climate sensitivity and adaptation potential.

The successful implementation of SEI requires a continuous focus on the effective application of **financial instruments**. SEI3 will continue to make use of different financial instruments – some already deployed for SEI activities and others offering potential for expanding the range of financing instruments used for sustainable energy.

SEI Phase 3 policy dialogue

The Bank's experience and analysis shows that effective **policy dialogue** is critical to achieving transformational change in the region and for scaling up sustainable energy investments. In line with CRR4 objectives, the Bank has systematically pursued opportunities for policy dialogue with a close link to banking operations.

The EBRD policy dialogue activities deliver benefits across three inter-related areas: (i) enabling investments through policy/legislative/regulatory changes; (ii) enabling EBRD finance; and (iii) creating knowledge. Through SEI, the EBRD has been instrumental in sustainable energy policy changes across many of the Bank's countries of operations. Examples of successful policy dialogue activities include:

- in Kazakhstan, EBRD policy dialogue activities led to successfully supporting the government to implement secondary legislation for renewable energy and supported the likely introduction of feed-in tariffs
- activities directly leading to the improvement of energy efficiency in buildings (such as the adoption of EU-level, high-performance building regulations in the Kyrgyz Republic and the likely adoption of similar regulations in Moldova and Ukraine).

In a number of countries, policy dialogue has been developed in the context of Sustainable Energy Action Plans which can provide a useful framework for coordinated action.

Policy dialogue activities link closely to the Bank's financial products. A number of finance facilities are directly a result of multilateral policy dialogue engagement. In particular, work supported by the Clean Technology Fund (CTF) has led to the implementation of four energy efficiency and renewable energy financing facilities in Kazakhstan, Turkey and Ukraine. In addition, several financing facilities are being developed linking directly policy dialogue to residential energy efficiency in Kazakhstan, the Kyrgyz Republic, Moldova and Russia.

Donor contributions have been critical for delivering the Bank's policy dialogue work. During SEI2, policy dialogue activities benefited from around €10 million to cover 36 policy dialogue assignments. In addition, policy dialogue activities are also supported by several grants from the Global Environment Facility (GEF) for Romania, Russia and Ukraine.

SEI3 will continue to systematically pursue opportunities for policy dialogue to transform sustainable energy markets in the region. Specifically, the Bank will continue to offer a full range of tools including supporting market-based instruments, addressing persistent market failures and institution development and capacity building:

- *market-based instruments*. The EBRD will increasingly deploy market-based instruments to support renewable energy and energy efficiency. This will particularly be the case in more advanced transition countries
- *addressing persistent market failures*. The EBRD will scale up its policy dialogue activities in five areas: renewable energy policy and legislative development; development of policy and legislation for energy efficiency in buildings; building institutional and regulatory capacity for sustainable energy; energy efficiency policy for industry and equipment; and removing barriers to effective Energy Service Companies (ESCOs) operations.

Partnerships, funding approach and implementation

The Bank's **partnerships** are a critical element in ensuring the successful delivery of SEI3. Such a partnership-based approach is consistent with the Bank's strategic mode of operation (see BDS09-054 (Rev 1) and CRR4). Accordingly, during SEI3, the Bank will continue to build up partnerships with the private sector (for example with local banks for sustainable energy credit lines), governments (for example through SEAPs) and donors (see section 10) as a critical element of its delivery of SEI investments. A broad consultation process involving over 150 participants representing 111 organisations was carried out as part of the preparation of SEI3.

The EBRD also recognises the importance of engaging with civil society organisations (CSOs). Going beyond the requirements for consultations outlined in the Public Information Policy,⁴ the EBRD organised a series of meetings with civil society stakeholders to obtain their perspectives on proposed SEI3 development themes.

There are increasing opportunities for **collaboration** with a range of public institutions. In particular, during SEI3, the Bank will continue to cooperate with a range of public institutions from IFIs to the EU and the IEA to achieve SEI objectives. Such cooperation will be cognisant that the partner institutions have complementary attributes and capabilities.

Implementation of the SEI2 **funding strategy** was successful with €108 million of TC mobilised compared with a target of €100 million and €32 million of non-TC funding mobilised compared with a €250 million target. Reflecting the strategy close to three-quarters of non-TC mobilisation was achieved through multilateral sources, namely the Climate Investment Funds (CIF), with the EU accounting for 20 per cent of total non-TC mobilisation. In terms of TC funds mobilisation, bilateral sources accounted for 30 per cent of amounts mobilised including SEI dedicated and SEI commitments from general TC funds whereas multilateral sources accounted for 70 per cent including the EU and the EBRD Shareholder Special Fund (SSF).

Internally, the EBRD will refine its approach to prioritising grant use in line with the existing policies and the results of the currently ongoing strategic review of grant

⁴ www.ebrd.com/pages/about/policies/pip.shtml

utilisation. The aim will be to ensure that grants continue to be used in the most efficient and effective manner.

Taking account of the current funding context, the SEI3 funding strategy includes the following components:

- pursuing active implementation and use of mobilised but uncommitted clean Technology Fund and develop activity under other CIF windows
- working closely with the European Union to participate in the implementation of activities under the EU climate windows
- maintaining strong relationships with historic SEI donors and build up relationships with new donors, including from Asian countries
- pursuing development and implementation of Eastern Europe Energy Efficiency and Environmental Partnership (E5P) fund
- continuing to develop technical financial and policy packages attractive to donors
- contributing to the development work on the Green Climate Fund and other potential global climate funding mechanisms with particular focus on private sector mobilisation
- maintaining the important role of SSF to address specific priority funding gaps not covered by the above funding sources.

A strength of the SEI business model is that it is implemented as a Bank-wide strategy. This approach allows it to draw on strengths and skills from across the Bank into the sustainable energy area. Building on the strong results achieved by this model during SEI2, the Bank will continue to develop the “**mainstreaming**” of sustainable energy activities and investments during SEI3.