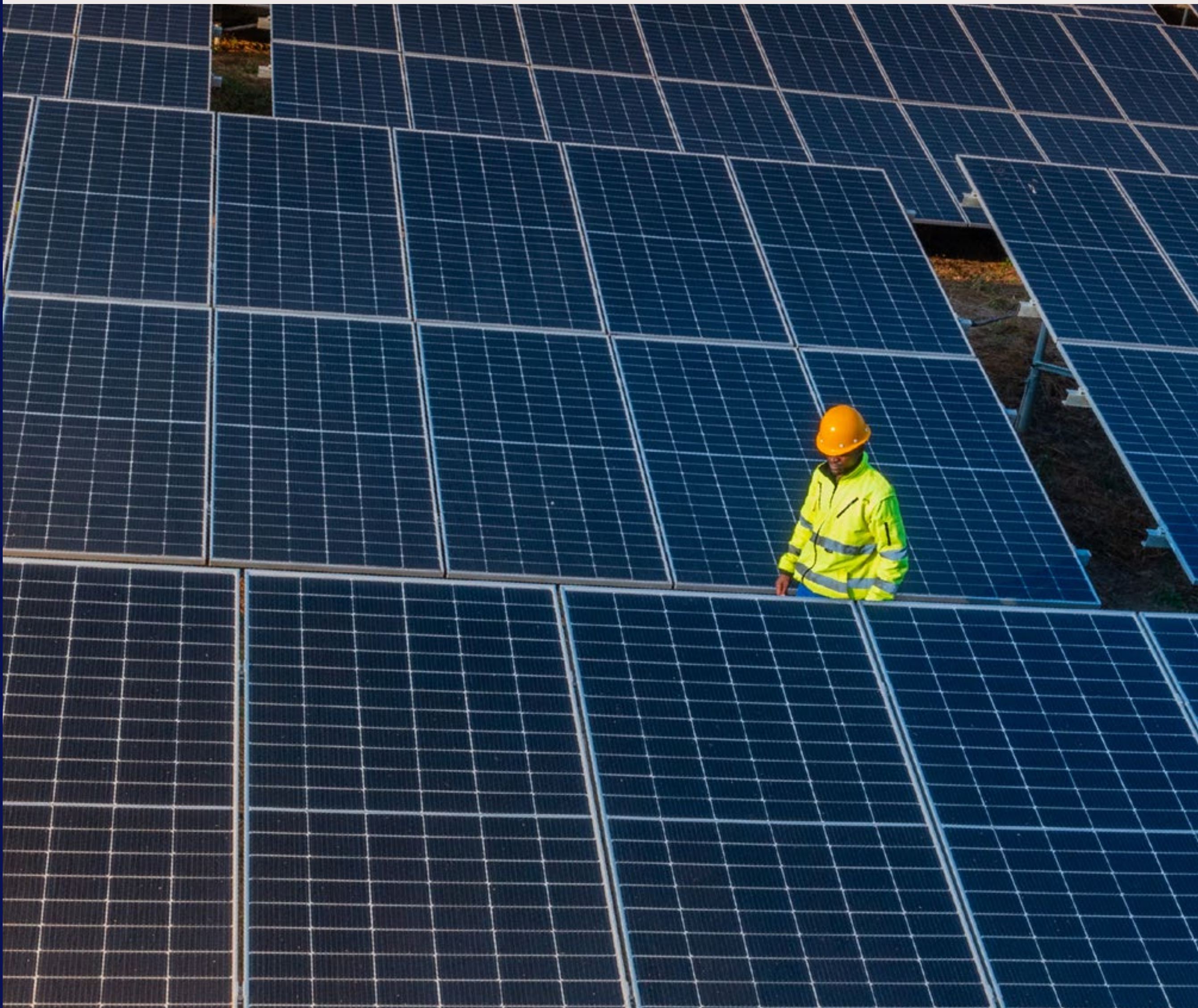
Department for Evaluation

NORFUND'S COMMENTS

Evaluation of Norfund's investments in renewable energy



Norfund

Norfund's comments on "Evaluation of Norfund's investments in renewable energy"

Norfund welcomes the external evaluation of Norfund's Renewable Energy Investments.

We are pleased to note that ***the evaluation finds that Norfund's investments in renewable energy have a significant development and climate impact, and that Norfund's strong focus on sustainability and operational efficiency contributes to these results***.

The evaluation provides useful recommendations ***to increase ambitions for CIM[1], further strengthen corporate governance and documentation of additionality*** (see comments to recommendation 5, 7, 11, 12, 13).

Some recommendations, however, build on misinterpretations of Norfund's mandates, noting that the stated objective of the evaluation is to assess effects and extract lessons learned, *within* Norfund's mandates, as adopted by the Norwegian Parliament and Norfund's Annual General Assembly (see comments to recommendations 1, 3, 4, 8, 9, 10).

The report also makes some ***recommendations and conclusions that are not well substantiated in the analysis of the evaluation*** (see comments to recommendations 1, 2, 6).

Norfund responses to the recommendations of the report

Recommendation 1: *Under the "supply" objective, more focus should be given to enabling technologies and other bottlenecks besides capacity (such as grids, transmission, evacuation of power), which in many countries can be important factors in addition to generation capacity.*

It is true that investments in enabling technology and addressing bottlenecks are necessary in certain DIM[2] core countries, and Norfund is already making such investments under the current strategy. However, a major expansion of investments in this area would

[1] Climate Investment Mandate (CIM), also known as the Climate Investment Fund.
[2] Development Impact Mandate (DIM), Norfund's original mandate

likely be inconsistent with the DIM guidance of investing at least 60% of allocated capital in *renewable energy*.

The report also does not adequately address the limited opportunities for investments in grid and transmission. Many DIM focus countries do not permit private investments in these sectors or do not face transmission or balancing constraints, but rather face electricity deficits where investment in new generation capacity is indeed needed.

The report does not discuss the trade-off involved in reallocating funds from generation to enabling technologies, grid, and transmission for these countries.

Recommendation 2: *Norfund should change the DIM focus countries to more challenging countries with higher needs, where investments are more likely to be additional. Current focus countries such as Colombia, South Africa and Vietnam are considered more crowded markets with less needs for DFI investments.*

Both OECD DAC and this evaluation have found that Norfund's investments are additional, and that Norfund is able to identify investments that are additional both in low-income countries, as well as in developing countries with higher income levels.

As of Q3 2024, DIM has approximately 33% of its renewable energy portfolio invested in LDCs, 66% in Sub-Saharan Africa, and 84% of the capital is invested as equity (which is the riskiest capital class). These rates are among the highest among the DFIs, indicating that Norfund's country choice, comparatively, is oriented towards more challenging countries.

The recommendation to shift to countries with "higher needs" also fails to account for other relevant considerations, such as investable opportunities and the benefits of maintaining a diversified portfolio.

Recommendation 3 *(for owner): MFA should clarify the mandate for CIM in light of the trade-offs between targeting countries with high coal-intensity and targeting "investments that would not otherwise have been made". In the current iteration, the strategy built on the mandate is designed more around the former than the latter, potentially leading to less additional investments.*

This recommendation does not recognize that the CIM mandate is "*to contribute to reduction or avoidance of GHG emissions by investing in renewable energy in* ***developing countries with large emissions*** *from coal or other fossil power generation*". The mandate thereby implies that countries with small economies (and hence small emissions), such as many LDCs, are out of scope.

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Additionality is not a mandate, but a pre-condition for all Norfund investments. OECD's ODA eligibility assessments of Norfund have confirmed that all new investments are additional, including the latest assessment, which was conducted for 2023 disbursements (CIM and DIM). Furthermore, the report has not found any evidence that CIM investments are not additional.

The evaluation appears to conclude that investments in countries with significant inflows of capital are unlikely to be additional. However, the relevant question is not the size of the capital inflows, but the difference between the inflows and the underlying investment needs. India is a case in point where it is true that significant investments are going into renewable energy, but equally true that the need for such investments far outstrips the supply. This gap clearly shows that there is a need for the type of capital that CIM provides and that Norfund can be additional in these investments.

Recommendation 4: *Norfund should consider balancing CIM investments in IPPs in the large MICs with enabling technologies or more challenging contexts*

The CIM mandate is to contribute to reducing or avoiding emissions of greenhouse gas emissions by ***investing in renewable energy*** in developing countries with large emissions from coal and other fossil fuel production (see also comment on recommendation 3).

Norfund's interpretation is that the CIM mandate allows for some investments beyond purely renewable energy, such as investments in transmission that connect renewable IPPs to the national grid, and investments in hybrid IPPs that combine batteries with wind or solar energy production, and Norfund is allocating a portion of CIM capital to these areas. An increased allocation to grid, transmission and evacuation of power is however likely to be inconsistent with the mandate, as provided in the instructions.

Implementing this recommendation may reduce the potential for climate impact, which is not discussed in the report.

Recommendation 5: *Norfund should reassess the targets for the current CIM period, considering the progress made so far, just two years into the mandate, and while investing approximately 38 percent of total funds available for the period.*

The report importantly notes that the ambitions on avoided emissions have been overachieved for the CIM so far. It is thus prudent to revisit the ambitions considering the very positive results of the first two years of the fund.

Recommendation 6: *Norfund should investigate how to measure development effects more accurately, in particular in terms of attributing development effects to Norfund's actions.*

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Measuring attributed effects could indeed offer insight, but there are methodological challenges and no commonly agreed methodology on how to do this. Among the challenges, is that pro rata attribution would obscure the differences between investors' contributions (additionality). The evaluation report does not give any guidance to this point.

Beyond attribution, the recommendation does not explain further what "more accurately" would entail. It is worth noting that the annual data collection exercise where Norfund collects and analyses data from more than 1,200 companies in the portfolio is already a large undertaking.

Recommendation 7: *Norfund should develop and implement a specific corporate governance framework which adapts the framework developed by the Corporate Governance Development Framework but tailored to Norfund's unique position and objectives. This framework should include specific criteria and expectations for board composition, oversight, risk management, and internal controls.*

The report does not identify any inadequacies in how Norfund exercises corporate governance in individual investments. However, the report notes that Norfund should formalize a framework and processes, a valuable recommendation to be further explored.

Recommendation 8: *Norfund should consider including geographical targets for the CIM similar to those employed for the DIM, in order to provide further safeguards to ensure investments are made with financial additionality.*

CIM is already guided by portfolio wide KPIs to safeguard additionality (i.e. *greenfield* and *equity*) and drive the fund towards projects with a need for Norfund's capital. The recommendation lacks an assessment of how a geographical KPI would influence overall impact and efficiency of CIM. The CIM instructions specify what types of countries should be targeted ("(...) ***developing countries with large emissions*** *from coal or other fossil power generation.")*. Further, the evaluation has not found that any investments are not financially additional.

The report incorrectly describes additionality and impact as two seemingly conflicting "mandates" for Norfund's investments. Meanwhile, the Terms of Reference for this evaluation describes Norfund's dual mandates as DIM and CIM: "*Norfund's investments with the purpose of generating development outcomes, and those that seek to contribute to reduce or avoid greenhouse gas emissions*". We refer to comments under *Recommendation 3* which explain that additionality is a pre-condition for all investments, not a mandate.

Recommendation 9: *Norfund should consider moving beyond the minimum standards set by OECD and not consider non-financial additionality to be a substitute for financial additionality. Financial and non-financial additionality should be treated as two separate scores, with a separate threshold for financial additionality*

Norwegian development aid is based on the principles set out by the OECD. Based on the OECD definition of additionality, Norfund has developed a framework to guide investment decisions. In this, Norfund does not consider non-financial additionality as a substitute for financial additionality, but addresses the various dimensions of additionality in each investment. In the evaluation period there are no projects that have been approved without demonstrating financial additionality. The report correctly points out that there is a theoretical possibility for Norfund to approve a project based solely on its non-financial additionality, but in practice this opportunity is not used.

The report incorrectly asserts that there is a discrepancy between the requirements of additionality outlined in Norfund's mandates and the OECD's definitions of additionality. The report appears to discredit the role the OECD plays as a standard setter for official development assistance.

Recommendation 10: *Similarly, mobilization should be detached and separated from additionality, and be treated as a separate objective. Mobilization is neither necessary nor sufficient for additionality. Mobilization might be a worthy objective in itself, as a means to amplify developmental outcomes, but it should not be conflated with additionality.*

The OECD defines mobilization as one of four types of financial additionality, and not a separate objective. Norfund's approach is in line with this (see also comments to recommendation 9).

Further, the report does not refer to any external sources to support detaching mobilization from additionality. As such, the recommendation is not substantiated.

Recommendation 11: *Qualitative justifications for additionality should be strengthened in investment documents to strengthen accountability and make explicit the decision-making behind investment approval.*

Additionality is an essential requirement in all Norfund's investments, but challenging to measure. Qualitative assessments are valuable to strengthen the understanding of additionality. Ensuring that such assessments are made consistently and with quality is a helpful recommendation.

Recommendation 12: *Internal ex-post assessments of additionality for investments should be conducted in order to provide feedback that can be used to improve the system.*

Reviewing the results and impact of an investment ex post is already an established practice in Norfund (in line with the Operating Principles for Impact Management). This can be strengthened to give an improved understanding of the additionality of the investment.

Recommendation 13: *Norfund should enhance integration and utilization of the Country Risk Assessment Tool in the initial screening and due diligence phases of every investment process. Norfund should ensure that all investment teams are trained and familiar with the tool's functionalities and methodologies.*

The country risk tool is intended for portfolio-wide assessment and reporting of risk. It does not cover granular sub sector or within-country regional data, which is often required when conducting due diligence. However, the tool is already available for all Norfund staff and Norfund will consider if it can be used more integrated in the investment process.

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