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Operationalization Framework on Aligning with the Paris Agreement

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In order to help its members to strengthen their experience in climate finance and leverage knowledge and resources in the field of climate, the IDFC has created a "Climate Facility (CF)". This facility provides resources and/or services to IDFC members in order to strengthen the integration of climate considerations, scale up climate-change related portfolios and institutionalize and facilitate collaborative work among members on climate change. For more information: IDFC Climate Facility - IDFC.

ABOUT NEWCLIMATE INSTITUTE

NewClimate Institute supports research and implementation of action against climate change around the globe. We generate and share knowledge on international climate negotiations, tracking climate action, climate and development, climate finance, carbon market mechanisms and sustainable energy policy. We connect up-to-date research with the real-world decision-making processes, making it possible to increase ambition in acting against climate change and contribute to finding sustainable and equitable solutions.

ABOUT I4CE

The Institute for Climate Economics - I4CE is a think tank with expertise in economics and finance whose mission is to support action against climate change. Through its applied research, the Institute contributes to the debate on climate-related policies. It also publicizes research to facilitate the analysis of financial institutions, businesses and territories and assists with the practical incorporation of climate issues into their activities.

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DISCLAIMER

This document was prepared by NewClimate Institute and the Institute for Climate Economics (I4CE) who were mandated by the International Development Finance Club (IDFC) to develop an operationalization framework for IDFC members with clear and practical initial guidance on how to align their operations with the requirements of the Paris Agreement. The document has benefited from input and review from Sophie Fuchs and David Ryfisch from Germanwatch.

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Foreword

The concept of alignment with the Paris Agreement has set a renewed context for climate action, in particular within the Public Development Banks' community (PDBs), and fertile ground for research. National and regional development institutions can play a crucial role in efforts to shift global finance toward a sustainable future. They are well placed to enable strong interconnections between public and private sectors and have a significant capacity to redirect financing flows towards activities that are vital to the transition towards low carbon and climate-resilient economies.

Among this community, the members of the International Development Finance Club (IDFC) – a unique network of 26 national and regional development banks worldwide – have already committed to contributing further to the quality and impacts of finance towards climate and Sustainable Development Goals (SDGs). On December 11th 2017, in Paris, together with the multilateral development banks (MDBs), the IDFC members pledged in a joint statement to "align financial flows with the Paris Agreement." At COP24 in Katowice, the IDFC members published a position paper fleshing out the meaning of alignment, in the light of the joint statement, along six core ideas – i.e. climate finance, country led strategies, private sector, adaptation & resilience, energy transition, and internal transformation. In September 2019, on the occasion of the United Nations Climate Action Summit in New York, the IDFC released a study, commissioned with the European Climate Foundation (ECF), to operationalize alignment of the IDFC members with the Paris Agreement.

Building on this momentum, the 450 PDBs operating around the world gathered for the first time ever at the Finance in Common Summit (FiCs) on November 2020 in Paris where they decided to join forces and affirmed *"[their] determination to collectively shift [their] strategies, investment patterns, activities and operating modalities to contribute to the achievement of the SDGs and the objectives of the Paris Agreement, while responding to the Covid-19 crisis".*

Today, it is an honor for us to present this report, elaborated by two independent think tanks: the New Climate Institute (NCI) and the Institute for Climate Economics (I4CE). This report delivers an operationalization framework for IDFC members – and for the financial community at large – with clear and practical guidance on how to reach a better alignment of their strategies, programs, and operations, with the requirements of the Paris Agreement.

While recognizing the importance of climate finance, this report provides a robust framework for action for IDFC members, ensuring that their whole portfolios – not just the climate-finance portion – are supportive of and never undermine the objectives of the Paris Agreement. As each institution is different, this report does not seek to define a unique methodology applicable to all, but instead presents a "menu of options", with number of actionable recommendations, tools and processes designed to align any financial institutions' vision with the goals of the Paris Agreement at country, strategic, and operational levels.

Rémy Rioux,
IDFC Chairperson

Executive summary

In 2017, the International Development Finance Club (IDFC) together with the group of Multilateral Development Banks (MDBs) made a joint commitment to "align financial flows with the Paris Agreement". Since then, IDFC members as well as other financial institutions committed to alignment have recognized that aligning financial flows across all activities and business lines implies transformational changes within financial institutions.

To support this process, NewClimate Institute and I4CE have developed a framework to serve as initial guidance. The operationalization framework is structured around the six principles of the 2018 IDFC position paper that lays out how members aim to achieve their alignment commitment. For each principle, the framework first lays out what the principle implies for development finance institutions at the strategic, operational, and country levels. Second, based on a review of existing tools and best practice examples, it identifies and provides guidance on a first selection of tools and approaches that may be used by an institution to start the alignment process.

The framework is based on the premise that there is no single tool or metric that will allow an institution to align with the Paris Agreement; rather, a tailored combination of tools will be needed for each financial institution, based on its individual mandate, alignment objectives and strategy, its institutional culture as well as areas and sectors of interventions.

The guidance on tools and approaches addresses key questions around four areas:

- Objectives: What concrete outcomes does my institution aim to achieve?
- Key aspects: What are the key aspects of each type of tool, what aspects do I need to pay attention to when using this type of tool? What changes may need to occur within my institution and who needs to be involved? What information do I need to align my activities?
- Existing Approaches and Tools: What approaches and tools are available to make these changes? What are their strengths and weaknesses, how do they address the different dimensions of Paris-alignment?
- Use recommendations for Paris-alignment: What do I need to consider if I want to implement the principle to be fully Paris-aligned?

IDFC Principle 1

Increasingly mobilize finance for climate action

Support for climate mitigation and adaptation actions will be at the core of IDFC members' strategies, representing their contribution to reaching the Paris Goals. To fully align with the Paris Agreement goals, IDFC members will need to:

- Define clear priorities and concrete targets to maximise their contribution to deep decarbonization, adaptation and resilience, in addition to an objective of making all of their finance flows consistent with the Paris Agreement objectives;
- Make sound investment decisions that maximize impact towards transformative change.

Approaches and type of tools to inform the actions above and contribute to Principle 1 include:

- Setting a climate finance target / definition of direct contribution to actions with direct climate-related outcomes;
- Definition of climate finance for mitigation, building on the joint MDBs-IDFC Common Principles for Climate Mitigation Finance Tracking;
- Definition of climate finance for adaptation, building on the joint MDBs-IDFC Common Principles for Climate Adaptation Finance Tracking;
- Reporting on climate finance.

IDFC Principle 2

Support country-led climate-related policies

With their public mandates, IDFC members are uniquely positioned to support both the development and implementation of country-driven strategies to contribute to the objectives of the Paris Agreement. To fully align with the Paris Agreement goals, IDFC members will need to:

- Ensure that strategies and assessment frameworks are adapted and respond to the investment needs of country partners;
- Develop and use all available measures to support countries with the development and implementation of climate goals.

Approaches and type of tools to inform the actions above and contribute to Principle 2 include:

- Country policy analysis including NDCs and LTSs;
- Sectoral analysis of investment opportunities;
- Country policy development and implementation support.

IDFC Principle 3
Catalyze investments and mobilize private capital

IDFC members aim to mobilize private finance to achieve the investments levels required to meet the Paris Agreement and SDGs. To fully operationalize the Paris Agreement goals, IDFC members will need to:

- Build on the key role they can play in understanding and bridging local and international private sector's interests and needs;
- Prioritize and develop instruments and facilities to build capacity and leverage private sector finance to support climate and sustainability goals.

Approaches and type of tools to inform the actions above and contribute to Principle 3 include:

- Development of targeted green financial instruments (Green credit lines with various terms, guarantees, risk sharing mechanism, public-private partnerships, green bonds, etc.);
- Leveraging international resources, including through direct accreditation with relevant climate funds (GCF, GEF, AF);
- Tracking private finance mobilization.

IDFC Principle 4
Recognize the importance of adaptation and resilience, especially in most vulnerable countries

All countries will need to adapt to a changing climate. IDFC members can play an important role in supporting these adaptation efforts in the countries where they operate, especially in the most vulnerable countries. In addition, it is important for IDFC members to foster the resilience of both assets and individual actors to physical impacts of climate change. To fully align with the Paris Agreement goals, IDFC members will need to:

- Take the local, national and regional context into account when developing strategies and assessment frameworks to promote adaptation and resilience;
- Mainstream adaptation and resilience considerations into IDFC members' daily work and across all operations.

Approaches and type of tools to inform the actions above and contribute to Principle 4 include:

- Assessment of physical climate risks at the project level;
- Assessment of physical climate risks exposure on a country level;
- Assessment and management of physical climate risk on a company/portfolio level.

IDFC Principle 5
Support the transition from fossil fuels to renewables financing

IDFC members have committed to support the transition away from a development model dependent on fossil fuels – as well as to prioritize actions that will indirectly support this shift. To fully align with the Paris Agreement goals, IDFC members will need to:

- Take the national context and global level of ambition to achieve long-term climate objectives into account when developing strategies and assessment frameworks to assess and support the decarbonization of energy supply and use across all sectors;
- Mainstream energy transition considerations into daily operations.

Approaches and type of tools to inform the actions above and contribute to Principle 5 include:

- Assessment and management of alignment with the transition (or non-alignment/harm) on a project level;
- Assessment and management of transition risks on a country level;
- Assessment and management of transition risk on a counterparty/portfolio level.

IDFC Principle 6
Internal transformation of the institution

IDFC members need to adapt their institutional governance and processes to align themselves with the Paris Agreement goals. Specifically, IDFC members will need to:

- Review the compatibility of their institution's mandate with Paris alignment objectives. Here, it is important that senior management make institutional commitments in line with those objectives;
- Adjust incentive structures and support system.

Approaches and type of tools to inform the actions above and contribute to Principle 6 include:

- Climate strategy development and implementation;
- Creation of a climate team;
- Management incentives and key performance indicators;
- Internal capacity building across the institution;
- Regular tracking and reporting on the institution's alignment.

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Abbreviations

AF	Adaptation Fund
AFD	Agence française de développement
BNDES	Brazilian Development Bank
BOAD	West African Development Bank
CABEI	Central American Bank for Economic Integration
CAF	Development Bank of Latin America
CliFiT	Climate Finance Readiness Training
CPI	Climate Policy Initiative
DBSA	Development Bank of South Africa
DFI	Development Finance Institution
EIB	European Investment Bank
GCF	Global Climate Fund
GEF	Global Environment Facility
GHG	Greenhouse gas
IDB	Inter-American Development Bank
IDFC	International Development Finance Club
IsDB	Islamic Development Bank
KfW	Kreditanstalt für Wiederaufbau
KPI	Key Performance Indicator
LEDS	Low-Emission Development Strategies
LTS	Long-Term Strategies
MAPS	Mitigation Action Plans and Scenarios (NAPAs), and (NAPs).
MDB	Multilateral Development Bank
NAFIN	Nacional Financiera
NAMA	Nationally Appropriate Mitigation Actions
NAP	National Adaptation Plans
NAPA	National Adaptation Programs of Action
NDB	National Development Bank
NDC	Nationally Determined Contribution
OECD	Organisation for Economic Co-operation and Development
PBD	Public Development Bank
PIA	Project Impact Assessment
PRI	UN-supported Principles of Responsible Investing
SBTi	Science-Based Target initiative
SDGs	Sustainable Development Goals
TBD	Eastern and Southern African Trade and Development Bank
TCFD	Task Force on Climate-related Financial Disclosure
UNEP FI	United Nations Environment Finance Initiative
UNFCCC	United Nations Framework Convention on Climate Change

Introduction

In 2015, Parties from around the world adopted the Paris Agreement that set three global objectives on climate change: limiting global warming to well below 2°C, and pursuing efforts to limit the increase to below 1.5°C; increasing the ability to adapt to climate change and fostering resilience; and importantly - making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development (United Nations 2015).

Rapid and far-reaching transitions in energy, land, and industrial infrastructure systems are needed to limit global warming to 1.5C (Hoegh-Guldberg et al. 2018). Translating this into investment needs, in 2018 the OECD estimated that the achievement of climate objectives and the sustainable development goals will require investments of 6.9 trillion USD a year to 2030 (OECD, The World Bank, and United Nations Environment Programme 2018). Today, the transition is complicated by the economic and social impacts of the current pandemic. The urgent need to support the recovery while simultaneously building back better in a manner consistent with the far-reaching climate and sustainability transition has never been bigger.

The Paris Agreement gives countries a double mandate related to financial resources and financial flows. First, developed countries have strengthened their commitment to scale up the provision of financial support for developing countries in the implementation of mitigation and adaptation measures, with other countries encouraged to do so on a voluntary basis.[1] Second, Article 2.1(c) creates a new mandate for all countries to put into place the policy and investment frameworks to ensure the 'consistency' or 'alignment' of all domestic and international financial flows with the long-term climate objectives (I4CE 2019).

The IDFC's Role in Delivering Climate Finance and the Paris Agreement Goals

The International Development Finance Club (IDFC) is a group of 26 development banks from around the world, representing over USD 4 trillion in assets that works to promote and leverage sustainable development investment worldwide[2].

Since its creation, the mobilization of climate finance has been a priority for the IDFC. IDFC members have demonstrated leadership in contributing to deliver climate finance and the IDFC is now the largest provider of public development and climate finance globally, with US$ 4 trillion in combined assets and over US$ 600 billion of annual commitments, including US$ 150 billion per year of climate finance. At the Climate Action Summit in New York in 2019, the IDFC pledged to deploy more than US$ 1 trillion in climate finance by 2025 (IDFC 2020).

Additionally, IDFC members recognized that they have an essential role to play in delivering the goals of the Paris Agreement and more specifically in "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" (United Nations 2015). In 2017, the IDFC together with the group of Multilateral Development Banks (MDBs) jointly committed to "Align Financial Flows with the Paris Agreement" (IDFC and MDBs 2017). This recognizes that development banks together with other development actors have a key role to play in supporting their clients to scale-up 'consistent and aligned' investment finance flows, scaling-down and redirecting 'inconsistent or misaligned' flows, as well as raising and delivering resources to support national and international climate and development goals (see **Figure 1**).

FIGURE 1: THREE COMPLEMENTARY LEVERS OF DEVELOPMENT CO-OPERATION

Source: OECD 2019

1 Article 9.1 of the Paris Agreement states that "Developed country Parties shall provide financial resources to assist developing country Parties with respect to both mitigation and adaptation in continuation of their existing obligations under the Convention". Article 9.2 of the Paris Agreement also invites "other Parties to provide or continue to provide such support voluntarily."

2 More information: http://idfc.org/

Paris Alignment Implies Transformational Changes within Financial Institutions Themselves

Since COP21, as a growing number of public and private financial institutions commit to "align" themselves with the Paris Agreement, it is increasingly clear that aligning financial flows across all activities and business lines in addition to delivering and increasing climate finance efforts implies transformational changes within financial institutions – including the adaptation of strategies and operations to phase out activities inconsistent with the goals of the Paris Agreement and new measures to contribute whenever possible to national low-GHG climate-resilient development (I4CE 2019).

This alignment process should be understood as a journey. In many instances, financial institutions will implement it step-by-step depending on their respective mandates and capacities; it is key that development banks prioritize their efforts. It is also increasingly recognized that alignment will be an ongoing process to be refined over time: development banks will have to continually review and develop new tools and approaches to respond to the societal, economic, and technological transitions.

Since its commitment to align financial flows, the IDFC has focused its efforts on identifying what alignment means and implies both for financial institutions in general, as well as for development finance institutions in particular. In 2018, IDFC members released a position paper outlining key elements of how they aim to achieve their alignment commitment. In addition, the IDFC commissioned a study to establish a theoretical and conceptual basis for alignment and what internal changes it implies. The study was conducted by the Institute for Climate Economics (I4CE) and the Climate Policy Initiative (CPI) in partnership with the European Climate Foundation (I4CE, CPI 2019).

This operationalization framework is designed to serve as an initial guide to assist IDFC members in the operationalization of their commitment. It is structured around the six principles of the 2018 IDFC position paper that lays out how members aim to achieve their alignment commitment. For each principle, the framework first lays out what alignment implies at the strategic, operational and country levels. Second, it identifies a first selection of tools and approaches that may be used to undertake these practical changes. As Paris alignment is a dynamic process, this operationalization framework will need to be revised, adapted, and further developed over time as IDFC members progress in this alignment journey and as new tools and approaches emerge.

Part 1

How can IDFC members contribute to making flows consistent with the Paris Agreement, and what does it imply for their institutions?

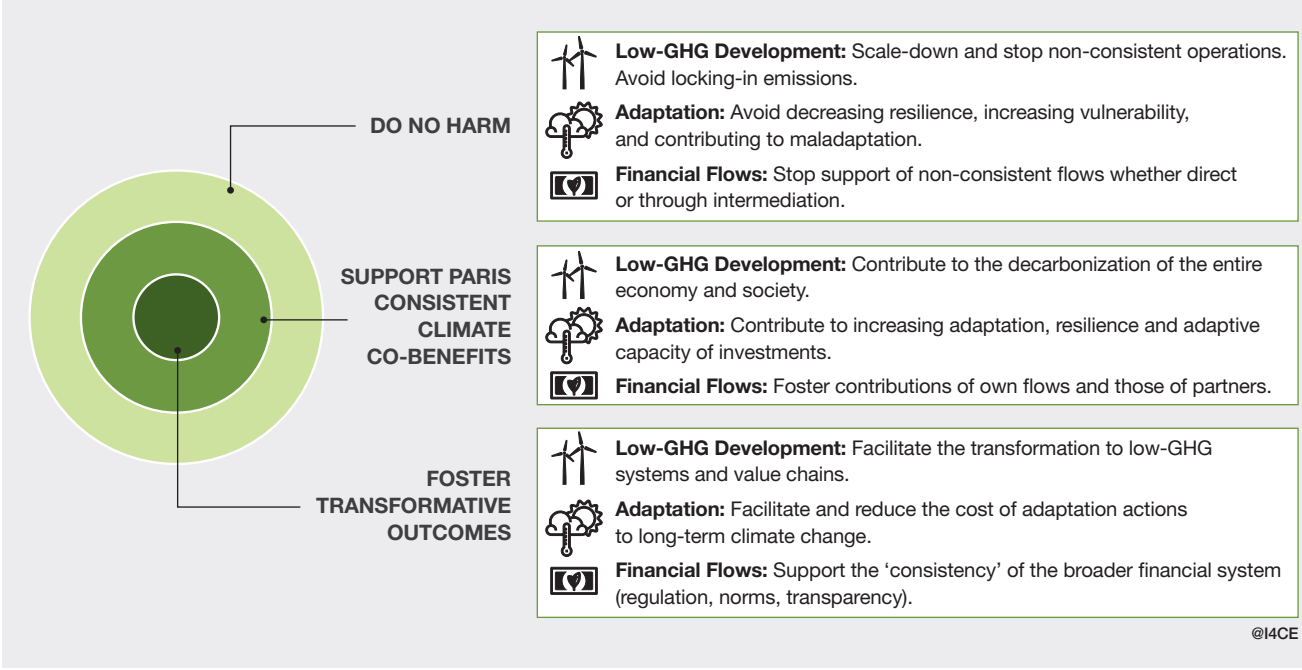
As an introduction to the operationalization framework, this first part of the guide uses the 2019 I4CE and CPI study to identify what Paris alignment implies for IDFC members' strategies and internal processes. The IDFC's 2018 position paper lays out key outcomes that IDFC members aim to achieve in aligning their financial flows with the Paris Agreement: 1) Increasingly mobilize finance for climate action; 2) Support country-led climate related policies; 3) Catalyze investments, and mobilize private capital (local & international); 4) Importance of adaptation and resilience, especially in most vulnerable countries; 5) Support the transition from fossil fuels to renewables financing; and 6) Internal transformation (IDFC 2018). This section presents an overview of the I4CE and CPI work and the changes that may be needed to achieve the six objectives that IDFC members have committed to follow to align their financial flows with the Paris Agreement.

Three Dimensions for making finance flows consistent with the Paris Agreement objectives

I4CE's Paris Alignment conceptual framework defines three dimensions for the alignment of an institution's finance flows: a comprehensive Scope of action, a long-term time horizon to guide impact and an ambitious scale of contribution (I4CE 2019).

1. **A Comprehensive Scope of Action:** Institutions should seek to directly or indirectly support low-GHG climate-resilient development across all business areas – and take into account impacts on broader systems and value chains. This goes beyond measuring investment in activities supporting mitigation or adaptation outcomes; rather, it implies that all activities are carried out in a manner consistent with the long-term goals of the Paris Agreement.
2. **A Long-Term Time Horizon to Guide Impact:** Institutions should prioritize actions that are consistent with both near-term climate objectives and long-term goals and do not lead to lock-in or mal-adaptation. This includes assessing the consistency of actions and measures that may result in near-term climate benefits, but are not sufficiently ambitious to be consistent with medium- and long-term goals and thus risk leading to lock-in.
3. **An Ambitious Scale of Contribution:** Institutions should seek to contribute to the ambitious goals of the Agreement through activities that:
   a. **Do No Harm:** All activities should neither hinder nor be counterproductive to the achievement of climate objectives and should be consistent with long-term national sustainable and low-GHG, climate-resilient development pathways;
   b. **Support Paris-Consistent Climate Co-Benefits:** Whenever possible, institutions should prioritize activities with direct or indirect mitigation and adaptation co-benefits that are consistent with countries achieving the long-term goals of the Paris Agreement;
   c. **Foster Transformative Outcomes:** Whenever possible, institutions should prioritize activities with 'transformative outcomes' that reduce the barriers to and support the large-scale, systemic and structural changes needed for the transition of economic, social and natural systems across and within national economies.

FIGURE 2: THE PARIS ALIGNMENT BULL'S EYE



Three levels for aligning IDFC members with the Paris Agreement objectives

CPI's report elaborates on the implications of Paris Alignment for IDFC members and details implications across three levels within institutions: the country level, the strategic level and the operational level (CPI 2019).

Country-level: IDFC members relationships with governments puts them in a unique position to support public policy measures to help their government partners to achieve the objectives of the Paris Agreement, to which they have all agreed. For IDFC members, alignment should thus start with the special relationship IDFC members have with the governments in their countries of operation.

Strategic level: Paris alignment will require executive leadership to influence how decisions are made and the modalities to execute them. Alignment can be embedded in the strategic level of the organization by adopting institution-wide objectives; a well-structured incentive and support system, and an updated risk management framework.

Operational level: Alignment requires changes in how investments are assessed and how capital is deployed. All investments across the institution's operations will need to be assessed against alignment criteria, and capital should be deployed using modalities that help deliver the transformative change necessitated by the Paris Agreement.

1 IDFC Principle 1: Increasingly mobilize finance for climate action

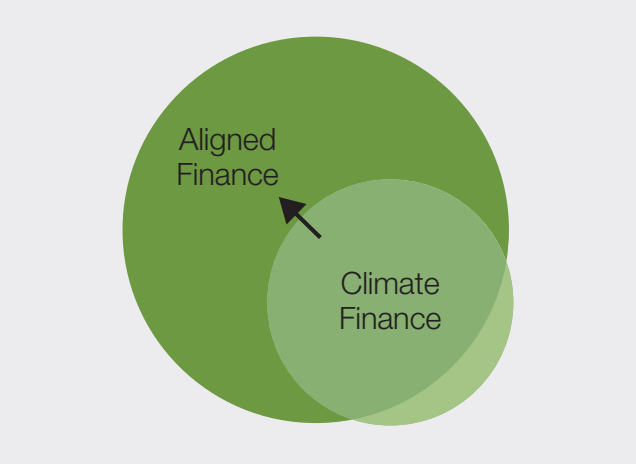
2018 IDFC Position Paper:

By (i) further embedding climate change considerations within their strategies and activities (e.g. via the 5 principles for Mainstreaming Climate Action in Financial Institutions, and the management of climate financial risks); and (ii) redirecting financial flows in support of transitions towards low-carbon and climate resilient sustainable development. Levels and share of climate finance lie at the core of the commitment to align with the Paris Agreement. However, they are more and more viewed as insufficient by themselves, and are to be complemented by information on the "non-climate" part of the portfolio / finance, which needs to be made consistent with the low carbon and resilient pathways.

Through Principle 1, the IDFC highlights that support for climate mitigation and adaptation actions will be at the core of IDFC members' strategies. Building on past experience, IDFC members should aim to maximize their impact on the redirection of financial flows by strengthening their support for mitigation and adaptation action; and by increasing direct and indirect support for climate action through the mobilization and redirection of financial flows from other public and private sources to support the transition.

Climate finance will play an essential role in reaching the Paris goals. However, the 2019 IDFC position paper highlights that climate finance is "insufficient" in and of itself and that even the "non-climate" parts of portfolios and finance need to "be made consistent with the low carbon and resilient pathways". This means taking both the direct and indirect impact of all operations on the low-carbon resilient transformation of all systems and value chains into account**.** As Article 2 of the Paris Agreement places climate action in the broader context of the Sustainable Development agenda, IDFC members should also seek to assess the direct and indirect impact of each activity *vis-a-vis* all aspects of sustainable development (I4CE 2020).

FIGURE 3: PARIS-ALIGNMENT VS. ALIGNED FINANCE



IDFC members' climate action should not only focus on short-term emission reductions and adaptation measures, but more importantly on the long-term impact vis-à-vis long-term goals. It is essential to recognize that some activities that result in 'relative' rather than 'absolute' emissions reductions or enhanced resilience may be counterproductive to achieving long-term goals. This can lead to lock-in that over the lifetime of the project may be counterproductive to climate goals. As seen in **Figure 3**, some activities such as efficiency measures and retrofitting for fossil fuel infrastructure that are traditionally labeled as climate finance may not always be themselves aligned given that the resulting absolute impact is not sufficiently ambitious vis-à-vis the transition pathway of the country. Recognizing this risk of lock-in and the need to assess the impacts of decarbonization and adaptation actions against medium- and long-term climate goals can help IDFC members ensure consistency.

What does it imply within IDFC institutions?

In assessing activities, institutions should consider both current country contexts and national forward-looking decarbonization pathways and resilient development, while ensuring the achievement of long-term goals. Ideally, Paris aligned approaches should use nationally determined near-term plans and long-term strategies to identify how to best contribute to country-specific pathways. However, in their current form, these documents cannot always be used as reference pathways solely and need to be further complemented by scenarios meeting the long-term climate objectives (I4CE 2019).

On a strategic level, IDFC members will need to set clear priorities and concrete targets in order to maximize their contribution to deep decarbonization, adaptation and resilience, while ensuring that the objective of making finance flows consistent with the Paris Agreement objectives is included in all institution-wide strategies. To measure progress towards these goals, IDFC members can build on their experience in climate finance target-setting, tracking and reporting that they have gained since 2015 but they must enhance it towards Paris Alignment.

Operational changes will be needed to make sound investment decisions that maximize impact towards transformative change and avoid doing harm. A combination of tools and approaches will be necessary to identify needs and potential, assess and report the consistency and impact of activities and counterparties and prioritize activities.

2 IDFC Principle 2: Support country led climate related policies

2018 IDFC Position Paper:

This can be translated into several forms, such as financing (i) support for enabling policy and regulatory environments, (ii) development of long term 2050 decarbonization pathways and strategies towards zero net emissions, as well as long term resilience, (iii) shorter term actions towards low carbon and resilient development, (iv) technical capacities and institutions' strengthening to enable the translation of NDCs and longer term climate strategies into policies, investments plans and projects."

With their public mandates, IDFC members are uniquely positioned to support both the development and implementation of country-driven strategies to contribute to the objectives of the Paris Agreement. IDFC members can support countries both in the development and revision of national short-term plans and long-term strategies: bilateral and regional development banks may provide assistance in this process, while national development banks may be directly involved in the process. Finally, IDFC members can play a key role in the implementation of national pathways in addressing financing gaps by mobilizing and tailoring climate finance to local needs.

IDFC members can also help spread long-term thinking at the national level. As important institutions in the countries they operate, it is important that IDFC members consider and promote the consideration of climate risks in the short, medium and long term by all stakeholders, as well as long-term climate objectives to guide impact assessments. IDFC members can support governments in the identification of the sectors' exposure to climate-related risks and opportunities, as well as the definition of a transition pathway and investment needs for each sector of the economy to achieve both the national and international climate objectives.

What does it imply within IDFC institutions?

IDFC members will need to ensure that both their strategies and assessment frameworks are consistent and respond to the investment needs of country partners to achieve national and international climate goals. To this end, IDFC members should first ensure that all activities are consistent with both national pathways and the Paris Agreement's overall global long-term objectives. Second, they should understand the investment needed to achieve the country's national pathway for low-carbon climate-resilient development. Here it is also key for IDFC members to consider the climate risk exposure of national economies, including physical, transition, and liability risks. IDFC members can build on their close relationships with national policy makers, financial regulators and supervisory authorities to ensure the development of such assessments.

IDFC members will need to make the development and implementation of ambitious country-led climate related policies a strategic priority. All countries and sector policies and strategies will have to be adapted accordingly, taking into account the need to both support the development and, in turn, ensure the consistency with ambitious national climate policies.

On an operational level, in order to support countries with the development and implementation of national pathways, IDFC members will need to develop and use all the measures they have available to them. Capacity building and technical assistance will have important roles to play in helping countries 1) create enabling policy and regulatory environments; 2) translate NDCs and longer-term climate strategies into policies and investments plans, and 3) support public and private sector actors in developing and financing the pipelines of needed projects, investments, and services.

3 IDFC Principle 3: Catalyze investments and mobilize private capital

2018 IDFC Position Paper:

They will blend their financing most effectively with other local and international sources to drive climate action, considering the scale of investments needed to achieve the climate and Sustainable Development Goals agendas.

Principle 3 highlights that IDFC members aim to mobilize private finance to achieve the investments levels required to meet the Paris Agreement and SDGs. Using different forms of public financial support, IDFC members can help mobilize and channel private sector investments towards activities that are consistent and have climate co-benefits by: 1) identifying barriers to investments and developing instruments to overcome them; 2) supporting innovation; 3) channeling international finance; 4) building capacity in the private sector and supporting them to align with the Paris Agreement objectives; and 5) supporting the needed evolution in the financial system itself. The mobilization of private capital should aim to accelerate in the fastest possible manner long-term transformation of systems and value-chains. To this end, IDFC members should support the private sector in the areas where their intervention is most needed to support the transition in a given country.

What does it imply within IDFC institutions?

On a country level, IDFC members' alignment strategy and operations will need to reflect and build on the key role they can play in understanding and bridging local and international private sector's interests and needs. Due to IDFC members' positions and knowledge of local markets, they should focus efforts towards mobilizing and channeling the investments suited to specific country contexts and needs.

IDFC members will need to make it a strategic priority to mobilize the private sector to support climate and sustainability goals. To this end, IDFC members will have to develop an engagement strategy at the national level with finance ministers, regulators and supervisors as well as local financial and non-financial institutions. Furthermore, coordination will be needed at the international level with other development actors, climate funds, and international financial institutions.

On an operational level, IDFC members will need to both develop methodologies to assess the alignment and exposure to climate-related risks of counterparties, as well as develop instruments and facilities to build capacity and leverage private sector finance.

4 IDFC Principle 4: Adaptation and resilience

2018 IDFC Position Paper:

The importance of adaptation is not only a matter of international climate politics, as it pertains also to the management of climate risks. Alignment with the Paris agreement implies that adaptation support measures must be strengthened.

Support for adaptation action needs to be strengthened. Alignment with Article 2.1(b) of the Paris Agreement implies that the support for adaptative activities should be a priority on equal footing with mitigation and development objectives. This implies increasing both the volume as well as the impact of adaptation finance and activities with the objective of limiting the risk to an acceptable level (World Bank 2020).

In addition, it will be important to support the resilience of both assets and individual actors to physical impacts of climate change. To this end, adaptation considerations need to be mainstreamed to scale-down support of activities and strategies that: 1) decrease resilience or increase vulnerability of people, assets and economies; or 2) could lock-in economic development which would not be able to cope with ongoing and coming climate changes (such as economic development in flood-prone areas or support growth of water intensive industries in a drought prone area) and increase the resilience of both assets and actors.

In addition, IDFC members should aim to support as much as possible activities that demonstrate new technologies for resilience, support improved national land-use planning, make social protection more reactive to climate shocks, etc. (WBG 2018). IDFC member also should promote ecosystem-based adaptation / nature-based solutions, and develop better analysis of indicators showing tangible improvements of climate risk reductions (UNEP 2021).

What does it imply within IDFC institutions?

Climate change will not affect all countries or regions in the same way, therefore, IDFC strategies and assessment frameworks to promote adaptation and resilience should take the local, national, and regional context into account. It will therefore be important to place national and local stakeholders at the forefront in efforts to promote adaptation and enhance resilience.

Adaptation and resilience require strategic changes at the institutional level to fulfill their potential, including the integration of the support for adaptation as an investment priority and the development of a climate risk management strategy, in line with the institution's adaptation objectives. Furthermore, it will be essential to determine with clients and counterparties the acceptable level of risk that can be tolerated and identify means of limiting risk to these levels (World Bank 2020).

Operational changes may be required to mainstream adaptation and resilience considerations into IDFC members' daily working to identify, assess and manage the physical climate risk exposure of activities and counterparties and prioritize support for short- and long-term adaptation of economies and societies. Assessments should take into account the variety of climate impact scenarios over both the short and long term. Approaches and tools will be needed to support decision making under uncertainty. Metrics measuring adaptation impacts and resiliency will be needed to help avoid maladaptation and help clients and stakeholders maximize opportunities to enable adaptation and boost resilience to climate impacts[3]. Finally, IDFC members will have to report on both their adaptation impacts and physical climate risks and opportunities.

3 In 2019, IDFC and the MDBs released a framework and principles for Climate Resilience Metrics in Financing Operations: https://publications.iadb.org/en/framework-and-principles-climate-resilience-metrics-financing-operations

5 IDFC Principle 5: Support the transition from fossil fuels to renewables financing

2018 IDFC Position Paper:

Based on national and regional circumstances, reduction of greenhouse gas emissions can be achieved through the development and prioritization of alternatives to investments directly or indirectly linked to fossil fuels. Various instruments and measures can support this transition: shadow price of carbon, reporting of GHG emissions, assessments of potential for stranded assets, policies to reduce reliance on fossil fuels and rapidly accelerate financing for renewables. Some target the supply side of fossil fuel; others are better suited to tackle the demand (consumption) side, or both.

Through Principle 5, IDFC members have committed to support the transition away from a development model dependent on fossil fuels – as well as to prioritize actions that will directly or indirectly support this shift. This commitment highlights that actions are needed to decarbonize the energy supply and support renewable energy development. It also recognizes that mitigation efforts in other sectors are critical in shaping energy use and demand that shape the entire energy system of a country.

To be Paris-aligned, it is necessary to consider the energy transition as part of broader efforts to achieve the mitigation goal of the Paris Agreement. IDFC members should thus support the step changes necessary for the decarbonization of entire national economies and societies across all sectors. This includes actions that aim to support the evolution towards the decarbonization of a country's/region's energy production systems as well as the broader energy use in the transportation, buildings stock, and industry sectors and their associated value chains.

What does it imply within IDFC institutions?

Strategies and assessment frameworks to assess and support the decarbonization of energy supply and use across all sectors, should take into account both the national context, objectives and policies as well as the global level of ambition to achieve long-term climate objectives.

Depending on the IDFC member, a strategic shift may be required to phase out support for investments directly or indirectly linked to fossil fuels and help decarbonize entire sectors. The transition towards a fully decarbonized economy may vary widely from one country to another. However, it will be important for each IDFC member to integrate support for mitigation in energy supply and use as an investment priority of the institution. This priority should be reflected in the development of the institution's broader strategy to contribute to mitigation objectives and its climate transition risk management strategy.

Operational changes may be required to mainstream energy transition and broader mitigation considerations into IDFC members' daily operations. This should aim to prioritize support for the short- and long-term decarbonization of economies and societies based on impact assessments and transition risk exposure assessments of activities and counterparties. It will be important to also report on these efforts, as part of mitigation impacts and transition risks and opportunities reporting.

6 IDFC Principle 6: Internal transformation of the institutions

2018 IDFC Position Paper:

Many IDFC members have promoted and endorsed 5 voluntary principles for mainstreaming "Climate Action within Financial Institutions", which were designed in 2015 and adopted during COP21. The principles intend to make climate change considerations a core component of how financial institutions conduct business, parallel to and in addition to the necessary development of appropriate regulatory and enabling environments at the domestic and international levels. They imply a shift from incremental financing of climate activities to ensuring that climate change – as both a risk and an opportunity – is a fundamental consideration around which financial institutions deploy capital.

The 5 principles are the following: (i) Commit to climate strategies, (ii) Manage climate risks, (iii) Promote climate smart objective, (iv) Improve climate performance and (v) Account for your climate action.

The principles of mainstreaming were designed before the Paris Agreement was adopted, but they have proven to be extremely robust and pertinent. They imply that "alignment" does not only pertain to what financial institutions finance, where, in which sectors, but also to the institutions themselves: their governance, their strategies, their processes, their reporting and transparency, etc.

IDFC members also recognize the intrinsic financial risk brought about by climate change. The Task Force on Climate Financial Risk Disclosure (TCFD) identifies three kinds of climate financial risks: (i) physical risks which result from the adverse impacts of climate change, (ii) transition risks which may result in policy changes made necessary to achieve the goals of the Paris Agreement, and (iii) liability risks which would result from legal action undertaken to seek compensation for losses from the physical or transition risks from climate change outlined above. Climate financial risks pertain to both adaptation and mitigation.

Aligning financial flows with the Paris Agreement, will also require IDFC members to adjust their institutional governance and processes – and thus "align themselves" with the Paris Agreement goals. Aligning all activities with the Paris Agreement will take time. It is a long and ongoing process for all economic actors. In some cases, it implies significant shifts in business models, in investments priorities, and with regards to internal expertise and capacity.

Nevertheless, institutions that have committed to align with the Paris Agreement should transparently report on progress and areas for improvement. Committing to an ambitious timeline and roadmap to align all activities can both ensure credibility as well as signal to markets changing priorities and intentions to reallocate capital.

What does it imply within IDFC institutions?

IDFC members will need to integrate the Paris Agreement goals in country programming, clearly identifying and prioritizing their institutions' role in supporting their counterparty's transition.

At the strategic level, IDFC members will need to review the compatibility of their institution's mandate with Paris alignment objectives and have the senior management take institutional commitments in line with those objectives. This commitment should guide the institution's integration of climate consideration as a new 'lens' and be integrated across its business lines and operations. In this process, it is important that the changes in Scope of action, time horizon of impact, and scale of action implicit within the Agreement are taken into consideration. In addition, it will be important for IDFC members to ensure that their climate strategies, including the climate risk management strategies, is in line with their institution's alignment objectives across all three dimensions of alignment.

On an operational level, this means that IDFC members will need to adjust their incentive structures and support system. It will be important to implement operational rules and procedures to build internal capacity and review assessment frameworks to identify and manage climate related risks and assess the climate impact of portfolio activities, as well as minimize climate impact of the bank non-portfolio operations.

Part 2
How to achieve the **6 principles** in practice?

This framework has been developed as an input into IDFC members' alignment processes. Alignment is interpreted here as the process through which IDFC members will ensure that all of their activities – individually and as a whole - actively support the achievement of the three goals of the Paris Agreement by scaling down non-consistent activities and seeking whenever possible to contribute to both the incremental and transformative changes needed at the national and global levels (I4CE 2019).

Based on the identification of internal changes needed, this operationalization framework provides an overview of the different approaches and tools that IDFC members can use. This framework is based on the premise that there is no single tool or metric that will allow an institution to align with the Paris Agreement; rather, a tailored combination of tools will be needed for each financial institution, based on its individual mandate, alignment objectives and strategy, its institutional culture as well as areas and sectors of interventions**.** This guide thus presents a comprehensive, but non-exhaustive, inventory of existing approaches and tools that could be used as part of alignment approaches of IDFC members, as well as other institutions from across the financial community. Based on a review of existing approaches and best practice (see **Annex**), this part focuses on those most pertinent and user-friendly approaches and tools to achieve the IDFC Paris-alignment commitments/principles.

The operationalization framework assesses the strengths and weaknesses of these different approaches and tools when used as part of Paris alignment approaches. A number of the approaches and tools listed in the inventory were developed before COP15, and/or have not been designed specifically with alignment in mind. As such, while they may support institutions in undertaking some of the above-mentioned changes, they may nevertheless not address all dimensions of Paris alignment. In such cases, it is necessary to combine a variety of approaches and tools. The guidance associated with the inventory will aim to help financial institutions identify the set of approaches and tools, which could be used to align their strategies and operations and achieve the outcomes they committed to achieve, providing an in-depth assessment for a number of them.

The Four Principal Questions of an Operationalization Framework for Alignment

The operationalization framework is structured around four key questions that aim to explicitly identify and lay out the specific objectives, steps and needs to align activities and operations at both the strategic and operational levels:

- **Objectives**: What concrete outcomes does my institution aim to achieve?
- **Key aspects**: What are the key aspects of each type of tool, what aspects do I need to pay attention to when using this type of tool? What changes may need to occur within my institution and who needs to be involved? What information do I need to align my activities?
- **Existing Approaches and Tools**: What approaches and tools are available to make these changes? What are their strengths and weaknesses, how do they address the different dimensions of Paris-alignment?
- **Use recommendations for Paris-alignment**: What do I need to consider if I want to implement the principle to be fully Paris-aligned?

1 IDFC Principle 1: Increasingly mobilize finance for climate action

Overview of relevant principles, ideas and tools

Type of tools to inform the actions and contribute to the objective of increasingly mobilizing finance for climate action:

- Climate finance targets
- Definition of climate finance for mitigation
- Definition of climate finance for adaptation
- Transparency: Reporting for climate finance

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

CLIMATE FINANCE TARGETS

What is the principal objective?

Have the senior management make institutional commitments to contribute to climate objectives

SHORT DESCRIPTION

In addition to the aim of ensuring that all of the institution's activities and interventions are aligned with the goals of the Paris Agreement, an institution should set a target in terms of direct contribution to actions with direct climate-related outcomes. Setting clear targets, including for climate finance, helps financial institutions set priorities, provides orientation to employees, and allows for strategies and decisions to be evaluated against such targets. In addition, it helps to mainstream climate within an institution's strategies and operations, which in turn can be a useful lever to then push towards Paris alignment.

A climate finance target can be used by a financial institution to decide and allocate its own and external resources managed by the financial institution to specific activities/projects that have a direct impact on mitigation or adaptation and/or have a climate co-benefit.

Targets should be "SMART": specific, measurable, achievable, relevant, and time based. To set a climate finance target, financial institutions need to decide on the Scope (what should it cover), amount and time horizon of such target.

Targets can either be relative or absolute. For relative targets, financial institutions could decide on a specific percentage of investments in their portfolio, which could relate to their overall portfolio but could also be sector specific. Allocating a specific sum to climate finance would constitute an absolute target. Depending on the specific mandate of the institution and its strengths, both mitigation and adaptation should be important considerations for climate finance target setting. It may be useful to set separate targets for different climate finance (sub)areas, *e.g.*, separate targets for climate mitigation and climate adaptation finance, and separate targets for private capital mobilization for climate finance for example.

Overarching climate finance targets should take into account sector or country strategies. This might require to also define climate finance sub-targets for specific sectors and/or countries. In addition, for Paris alignment, it is also important to define the part of the climate finance target which aims to achieve transformational outcomes, *i.e.* targets for activities that do not only contribute to direct climate-related outcomes but which support the large-scale, systemic and structural changes needed for the transition of economic, social and natural systems across and within national economies.

In accordance with the IDFC principle to increasingly mobilize finance for climate action, the climate finance target and transformative climate finance target should become more ambitious over time. To effectively incentivize implementation of climate finance targets, financial institutions should also provide internal incentives to reach climate finance targets.

It is important for financial institutions to keep in mind the link between the target itself as well as the impacts and outcomes that contribute to achieving climate goals. It is therefore important to ensure that attention is paid both to the volume of finance (if applicable) as well as a qualification of the direct or indirect impact on long-term emissions reductions and enhanced resilience. The climate finance target should thus be complemented by impact assessments.

Lastly, targets should be based on an assessment of specific climate investment needs of their countries of operations (*e.g.*, at country, sector or (sub)sector level) as well as opportunities for investments that can lead to transformative climate outcomes, for example due to technological advances.

EXAMPLES

1. CAF pledged to set a green finance goal of 30% of annual commitments by 2020, with the goal of incrementally increasing this percentage to 50% by 2050.
2. CABEI aims for 40% of its financing to have climate co-benefits.
3. In 2018, the AFD Group set the objective of achieving EUR 5bn of annual climate finance by 2020 in its countries of operation, excluding the French Overseas Territories. 50% of all its commitments must have climate co-benefits. In addition, the group committed to align all of its financing activities with the Paris Agreement goals.
4. The World Bank Group has set a target for 35% of its financing to have climate co-benefits, on average, over the next five years. In addition, the group also aims for 50% of its climate financing to support adaptation and resilience.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

Financial institutions first need a definition of what qualifies as climate finance. IDFC members may refer to the IDFC-MDBs Climate Finance Common Principles which provide a common set of definitions for climate mitigation and adaptation finance. For transformative climate finance specifically, IDFC members may draw on recent World Bank guidance. Further tools and assessments might also be needed, depending on the focus and Scope of the target.

Institutions will also need to know how much climate finance their institution is currently mobilizing, what are the climate investment needs in their countries of operations as well as the technology pathway scenarios and (depending on the scope) also (sub)sector specific technological options to come up with realistic feasibility projections.

STRENGTHS

Setting a climate finance targets provides a clear incentive for management and operational teams for the mobilization of climate finance. It is an opportunity to identify and prioritize areas and interventions for direct impact.

Finally, setting a climate finance target allows to track progress over time, and readjust strategies and interventions as needed.

WEAKNESSES

Having a climate finance target in place, may be insufficient to target development banks' investments where they are the most needed as it measures volume of finance and not the impact of activities on the decarbonization and adaptation of economies and societies. Current targets do not provide an indication of whether investments achieve transformative impact.

In addition, it does not prevent an institution's activities from doing harm via activities not covered by the target and current climate finance targets.

USE RECOMMENDATIONS TO SUPPORTPARIS-ALIGNMENT

To be Paris-aligned, climate finance targets should be set at a level of ambition that is consistent with the level of ambition of the Paris Agreement. Climate finance targets should foster DFIs investments where they are the most needed for the transition – in support of countries NDCs and long-term strategies. A climate finance target should thus be disaggregated at the country and sector level and combined with other targets to ensure that the institution is doing no harm (lock-in and maladaptation).

When setting a climate finance target, it is important to rely on a robust definition of climate finance, which is compatible with the Paris Agreement. If the eligibility criteria, *i.e.* the definition of what counts as climate finance, are not sufficiently robust, there may be a risk that part of what might be defined as climate finance may not be Paris aligned or do significant harm to the achievement of the Paris Agreement objectives (also see Definition of climate finance for mitigation and Definition of climate finance for adaptation further below).

Lastly, in accordance with the Common Principles, the climate finance target should be regularly updated, and become increasingly ambitious. Similarly, IDFC members should also report on and track progress on the achievement of their climate finance target as well as impact for mitigation and adaptation.

MORE INFORMATION

Reports

- I4CE (2017). Building Block of Mainstreaming: A framework for integrating climate change across financial institutions
- Germanwatch, World Resources Institute and NewClimate Institute (2020). Raising the Game on Paris Alignment. Memo 3 - Climate Finance: Accelerating the Transition to Carbon Neutrality and Climate Resilience
- NewClimate Institute and Germanwatch (2018). Aligning investments with the Paris Agreement temperature goal. Challenges and opportunities for multilateral development banks
- World Bank (2020). Transformative Climate Finance. A new approach to achieve low-carbon resilient development in developing countries
- MDB-IDFC Common Principles for Climate Change Adaptation Finance Tracking
- MDBs – IDFC Common Principles for Climate Change Mitigation Finance Tracking

Case studies

- Lending targets lead to performance tracking at Inter-American Development Bank (IADB)
- IsDB: Development of the Climate Change Policy Implementation Framework and Action Plan
- JICA's Internal Strategy for Climate Change and 2020 financial target
- CABEI'S 2020-2024 Institutional Strategy

Name of principle, idea, type of tool:

DEFINITION OF CLIMATE FINANCE FOR MITIGATION

What is the principal objective?

Define eligibility criteria and screening tools for individual operations contributing to climate objectives

SHORT DESCRIPTION

Having a clear and concise definition of what counts as Paris-aligned climate finance for mitigation helps financial institutions channel investments into projects that meet identified priorities, supports the implementation of climate mitigation finance targets and facilitates the tracking of progress.

IDFC members can refer to the joint MDBs-IDFC Common Principles for Climate Mitigation Finance Tracking which define what constitutes climate finance for mitigation. An activity is considered as contributing to climate change mitigation if it promotes "efforts to reduce or limit greenhouse gas (GHG) emissions or enhance GHG sequestration". The Common Principles for climate mitigation finance are based on a positive list of eligible activities in sectors and sub-sectors – according to each financial institution's operational practice – that reduce GHG emissions and are compatible with low-emission development pathways. As a consequence, not all activities that reduce GHGs in the short term are automatically considered mitigation finance.

The Common Principles represent a minimum standard which could be supplemented by additional criteria and tools to ensure that climate mitigation finance is also Paris-aligned. Specifically, it is important that activities do not only reduce emissions, but also accelerate the transition of national economies to net-zero emissions by 2050 and maximize impact. In addition, it is important that activities do not cause significant harm and lead to maladaptation and lock-in of emissions.

To do so, financial institutions can use both positive and negative lists as well as performance-based criteria.

Lists / descriptive approaches include:

- (Expanded) positive lists: Based on ex-ante established criteria of what Paris-aligned climate finance technologies, projects and activities are, financial institutions can use positive lists to screen potential investments for eligibility to "climate mitigation finance". Projects and activities not included on the positive list are automatically not eligible. An expanded positive list for IDFC members could include only those activities that lead to transformative climate outcomes. Positive lists should be regularly updated to reflect evolving technology options and ensure that the Paris Agreement goals can be met.
- Exclusion lists: In contrast to a positive list, exclusion lists identify those projects and activities which are non-aligned and clearly do not qualify as climate finance for mitigation. Examples include fossil fuel investments or investments that lead to deforestation. Thought with a climate focus, many development banks already work with exclusion lists.[4]

Performance-based approaches include:

- Key Performance Indicators (KPIs): KPIs consider the (potential) outcomes of climate mitigation finance, for example tons of avoided emissions, kWhs of renewable energy produced or capacity installed, etc. Project/activities that contribute to those pre-defined KPIs are classified as climate finance for mitigation.
- Performance thresholds: Emissions and energy performance thresholds, including emissions intensity thresholds can be set for a variety of (sub)sectors. Projects and/or activities below such thresholds would be eligible for climate mitigation finance.
- Standards to be used to address mass sectors like domestic appliance industry, car industries, housing etc.

In addition, institutions may choose to develop their own criteria or to use shared sets of definitions and standards set out in a taxonomy. Taxonomies often take the form of positive lists and may include performance-based metrics as well as exclusion lists. Formalized taxonomies provide a classification system to identify eligible projects and activities that is at times produced by a single country, a regional governing body or by some form of co-constructed market process. In addition to the IDFC-MDBs Common Principles, national and regional taxonomies could be used by IDFC members to ensure that investments are consistent with the specific country's definition of climate finance.

EXAMPLES OF COMPLEMENTARY APPROACHES TO THE COMMON PRINCIPLES

1. EU Taxonomy

The EU Taxonomy represents a government-established and legally binding classification system that allows for the screening of economic activities that can make a substantial contribution to climate change mitigation or adaptation, while avoiding harm to four other environmental objectives: sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. In addition, for economic activities to qualify, they need to comply with minimum social and governance safeguards. The EU Taxonomy is based on the EU's sustainability objectives.

4 The IFC Exclusion list can be found here: http://www.ifc.org/exclusionlist; the EDFI Exclusion List can be found here: https://www.edfi.eu/wp/wp-content/uploads/2017/09/EDFI-Exclusion-List_-September-2011.pdf

The EU taxonomy thus goes beyond the Common Principles by capturing a broader set of sustainability aspects, and aiming to ensure that activities do no cause significant harm to the other objectives.

For climate change mitigation objectives, activities are considered sustainable if:

- They are low carbon;
- They enable emission reductions in other activities, *e.g.* manufacturing of components needed for the energy transition;
- They are not yet low carbon but can transition to become green in the future, *e.g.* by employing best available technologies.

The EU taxonomy covers most sectors in detail. However, some activities, not currently covered by the Taxonomy, for example reduction of material losses, could still be counted as aligned climate mitigation finance. In addition, activities are mapped against the EU's sustainability goals (and related policies and standards) but most of which are internationally applicable even outside the EU.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

For the implementation of the Common Principles, project-specific information is needed to identify suitable climate mitigation activities. For the use of other tools, more specific data may be needed (*e.g.* sector-specific indicators, emissions thresholds etc.).

STRENGTHS

The Common Principles provide a clear and concise positive list of what constitutes climate finance for mitigation. Together with other methodologies, they help operational teams identify projects and activities contributing to the mitigation objective of the Paris Agreement, and management / strategy teams to prioritize and shift investment flows to such projects and activities, set a climate mitigation finance target and track progress towards such target.

WEAKNESSES

The Common Principles do not take into consideration the specific investment needs of national economies associated to their specific decarbonization and adaptation pathways. They are insufficient to help an institution assess the relevance of a specific project for the transition of national economies or judge a project's or an activity's transformational impact potential. For example, the Common Principles definition of climate mitigation finance would allow for energy efficiency improvements of coal power plants as this will reduce emissions. At the same time, such investments would not be aligned with the long-term temperature goal of the Paris Agreement and are likely to lead to stranded asset risks.

In addition, they do not ensure that other (potentially non-aligned) projects and activities of the organization do not cause any harm.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

In addition to the Common Principles for climate mitigation finance tracking, it is highly recommended to complement them with other tools to ensure that climate mitigation finance is Paris-aligned, ambitious enough and does not cause harm. For example, energy efficiency improvements of a coal fire plant that prolongs the life of that asset. It is therefore critical that the entire assessment approach of climate mitigation finance reflects the ambition of the Paris Agreement. To this end, an international reference scenario is needed that identifies what is needed both globally and at sector level to meet the Paris Agreement objectives. This should be complemented by technology pathways scenarios and an assessment of technological options for readily decarbonizable sectors.

Finally, as part of Paris-alignment approaches, these assessment tools and methodologies should be complemented by methodologies to assess the impact, and more specifically transformative impact as well as incentives to prioritize such investments.

MORE INFORMATION

Reports

- MDBs – IDFC Common Principles for Climate Change Mitigation Finance Tracking
- I4CE (2017). Building Block of Mainstreaming: A framework for integrating climate change across financial institutions
- Germanwatch, World Resources Institute and NewClimate Institute (2020). Climate Finance: Accelerating the Transition to Carbon Neutrality and Climate Resilience
- World Bank (2020). Transformative Climate Finance. A new approach to achieve low-carbon resilient development in developing countries

Case studies

MDBs and IDFC establish common principles for climate finance tracking

Name of principle, idea, type of tool:

DEFINITION OF CLIMATE FINANCE FOR ADAPTATION

What is the principal objective?

Define eligibility criteria and screening tools for individual operations contributing to climate objectives

SHORT DESCRIPTION

Having a clear and concise definition of what counts as Paris-aligned climate finance for climate change adaptation helps financial institutions channel investments into projects that meet investment priorities, supports the implementation of climate adaptation finance targets and the tracking of progress and impact.

Adaptation and resiliency needs and impacts are highly context and location specific, varied, and require a more qualitative definition than finance for mitigation.

IDFC members can refer to the joint MDBs-IDFC Common Principles for Climate Adaptation Finance Tracking. According to the Principles, an activity is considered to count as climate change adaptation if it "addresses current and expected effects of climate change, where such effects are material for the context of those activities".

To identify eligible activities, the MDBs and IDFC members use a context- and location-specific approach (process-based approach) which captures the invested amount associated with activities directly linked to vulnerability to climate change. It thereby focuses on the incremental cost of adaptation activities. In particular, they propose a three-step (process-based) approach:

- First, set out the context of risks, vulnerabilities, and impact related to climate variability and climate change;
- Second, state the intent to address the identified risks, vulnerabilities and impacts in project documentation;
- Third, demonstrate a direct link between the identified risks, vulnerabilities and impacts, and the financed activities.

The Common Principles represent a minimum standard which can be supplemented by additional eligibility criteria developed by individual (or group of) financial institutions.

Complementary approaches include

- Key Performance Indicators (KPIs): KPIs consider the (potential) outcomes/impact of climate adaptation finance, for example the contributions towards building resilience of project beneficiaries etc.
- Climate resilience metrics/indicators: Similar to KPIs, climate resilience metrics can be used to complement the Common Principles, by enabling the evaluation of multiple aspects of project quality and (expected) project results across varying temporal and spatial scales.

In addition, institutions may choose to develop their own criteria or use shared sets of definitions and standards set out in a taxonomy. Formalized taxonomies provide a classification system to identify eligible projects and activities that is at times produced by a single country, a regional governing body or by some form of co-constructed market process. In all instances, they should also be regularly updated.

EXAMPLE OF COMPLEMENTARY APPROACHES TO THE COMMON PRINCIPLES

1. EU Taxonomy

The EU Taxonomy represents a classification system and inventory of economic activities that can make a substantial contribution to climate change mitigation or adaptation, while avoiding harm to other environmental objectives, including sustainable use and protection of water and marine resources and a transition to a circular economy. The EU Taxonomy is based on the EU's sustainability objectives.

For climate change adaptation, activities are considered sustainable if:

- They reduce climate related risks to the extent possible and on a best effort basis;
- They enable risk reduction in other activities;
- Those measures should also not increase the risk of an adverse impact on other people, nature and assets in terms of hindering adaptation efforts by others for example by shifting impacts faced by others.

The EU taxonomy thus goes beyond the Common Principles by capturing a broader set of sustainability considerations, including that activities do not cause significant harm to the other objectives.

The EU taxonomy covers most sectors in detail. However, some activities, not currently covered by the Taxonomy, could still be counted as aligned climate adaptation finance. In addition, activities are mapped against the EU's sustainability goals (and related policies and standards), but most of which are internationally applicable even outside the EU.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To implement the Common Principles, context and project specific information is needed to identify the most appropriate adaptation finance activity. Useful sources of information include: USAID's Regional & Country Risk Profiles and GHG Emissions Fact Sheets, WRI's Aqueduct Water Risk Atlas, GERICS country climate factsheets, climate knowledge portal of the World Bank Group. Further data may be needed to evaluate the impact of climate adaptation finance.

STRENGTHS

The Common Principles provide a clear and concise definition of what constitutes climate finance for adaptation that helps to identify eligible projects and activities, set priorities, shift investment flows to such projects and activities, set a climate adaptation finance target, and track progress towards that target.

WEAKNESSES

The Common Principles do not take into consideration the specific investment needs of national economies associated to their specific decarbonization and adaptation pathways. They are insufficient to help an institution assess the relevance of a specific project for the transition of national economies or judge a project's or an activity's transformational impact potential.

A definition of what constitutes climate finance for adaptation alone does not ensure that other (potentially non-aligned) projects and activities of the organization do not cause any harm, and in particular maladaptation. For example, investments in concentrated solar power plants might lead to increased water usage needed for cooling which in turn might decrease the adaptive capacities of the local population which depends on water.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

It is highly recommended to adopt the definition of climate adaptation finance of the joint MDB-IDFC Common Principles for tracking adaptation finance. At the same time, institutions should ensure that everything that they classify as climate finance for adaptation is also Paris-aligned.

In addition, it will be important to also consider the impact of adaptation finance. As part of Paris-alignment approaches, these assessment tools and methodologies should be complemented by methodologies to assess the impact, and more specifically transformative impact as well as incentives to prioritize such investments.

MORE INFORMATION

Reports

- MDB-IDFC Common Principles for Climate Change Adaptation Finance Tracking
- I4CE (2017). Building Block of Mainstreaming: A framework for integrating climate change across financial institutions
- Germanwatch, World Resources Institute and NewClimate Institute (2020). Climate Finance: Accelerating the Transition to Carbon Neutrality and Climate Resilience
- Lessons learned from three years of implementing the MDB-IDFC common principles for climate change adaptation finance tracking
- A Framework and Principles for Climate Resilience Metrics in Financing Operations
- World Bank (2020). Transformative Climate Finance. A new approach to achieve low-carbon resilient development in developing countries

Case studies

- MDBs and IDFC establish common principles for climate finance tracking

Name of principle, idea, type of tool:

TRANSPARENCY: REPORTING FOR CLIMATE FINANCE

What is the principal objective?

Report and disclose publicly on the institution's investments in climate-relevant projects

SHORT DESCRIPTION

Transparency is a substantial requirement of the Paris Agreement. As public banks, it is important for IDFC members to disclose all activities to facilitate overall transparency, including reporting to shareholders and the public. To be Paris-aligned financial institutions should report on their contribution for and impact on the low-carbon and climate-resilient transition of national economies (both positive and negative). As part of these efforts, IDFC members should therefore report regularly on the volume (either total or relative) of their investments in climate mitigation and adaptation, as well as on the methodologies used for tracking climate finance. They should also aim to demonstrate additional impact, aiming to foster transformative outcomes. Reporting can be done either at the institution's level and/or a group/IDFC level.

IDFC members should base their climate finance reporting on the joint MDB-IDFC Common Principles for climate change adaptation and mitigation finance tracking. In addition, group level reporting is encouraged through the IDFC Green Finance Mapping, which is aligned with the Common Principles.

The IDFC Green Finance Mapping is based on a survey sent out to IDFC members to encourage project-level reporting, including data on co-financing and adaptation. The Green Finance Mapping includes climate finance but is not limited to climate finance as it also includes reporting on other environmental objectives that are not directly related to climate mitigation and adaptation (*e.g.* finance for biodiversity).

Specifically, it includes:

- Volume-based climate mitigation, adaptation and other environment commitments, including at financial institution level and over time;
- Green finance ratio at IDFC level;
- The source and destination of financing;
- Commitments by instrument type and category (mitigation, adaptation, other environment objectives);
- Commitments by subcategory (subsector);
- Private finance mobilized, by source and category.

In addition to the Common Principles and IDFC group level reporting, institutions should ideally also report on the outcomes of their climate mitigation and adaptation finance, as well as more generally on aligned and non-aligned finance flows.

EXAMPLE OF TOOLS

1. AFD climate activity reports

AFD's climate activity reports 2019 assesses progress towards the Group's four main commitments to achieve Paris-alignment, which includes an increase in climate finance. The report details climate finance flows by region, sector and instrument, among others, and separately for mitigation and adaptation finance.

2. BNDES reporting on alignment with the SDGs

BNDES monitors and discloses its contribution to the SDGs. Results are publicly available. The contribution to climate action (SDG 13) is mapped against the Brazilian NDC.

IMPLEMENTATION PRINCIPLES

The joint Common principles lay down a set of key principles that IDFC members should take into consideration when reporting their climate finance volumes:

- Additionality: Reporting focuses on the type of activity to be executed, not its purpose, the origin of financial resources nor its results;
- Timeline: Climate finance flows should be reported ex-ante project implementation;
- Conservativeness: If data is unavailable, it is better to under than to overreport climate finance flows;
- Scope: Only the portion of the investment that contributes to mitigation or adaptation should be counted as climate finance;
- Mitigation results: Reporting does not imply evidence of climate change impacts. Any inclusion of climate change impacts is not a substitute for project-specific theoretical and/or quantitative evidence of GHG emission mitigation;
  - Avoidance of double counting: Where the same project, sub-project or project element contributes to mitigation and adaptation, an institution's individual processes will determine what proportion is counted as mitigation or as adaptation, so that the actual financing will not be recorded more than once;
- Exclusions (for mitigation finance): Care should be taken to identify projects that are included on the positive list but do not mitigate emissions due to their specific circumstances.

STRENGTHS

Reporting on climate finance enables the institution to take stock of progress (and bottlenecks) on the institution's investments for adaptation and mitigation and therefore to actively manage its climate finance target, if the institution has one. It also shows transparency with external stakeholders.

WEAKNESSES

Reporting and disclosure does not provide information of whether the finance provided is commensurate with the climate finance needs of particular countries or in particular sectors.

Finally, reporting and disclosure does not provide a complete indication of whether the IDFC member itself is Paris-aligned as it neither presents if all activities are aligned nor what financing may be supporting non-aligned activities.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

It is highly recommended to use the Common Principles to report on the institution's climate finance investments and progress against any specific climate finance targets. In addition, ideally, this is combined with additional reporting on the institution's contribution to meet the Paris Agreement more generally, including activities (or share of activities) that are not aligned, do no significant harm but do not contribute to climate goals, as well as activities with transformative outcomes. Maximizing climate finance impact is necessary to meet the Paris Agreement objectives. It will therefore be important to develop meaningful indicators to that effect and progressively report on impact as well. Reporting should also cover all non-portfolio activities.

Moreover, it is important to integrate resulting information into broader portfolio management to maximize impact. For example, climate finance reporting can help improve understanding about how the financial institution supports the transformation of the recipient country's economy or supports specific sector transformations.

MORE INFORMATION

Reports

- MDB-IDFC Common Principles for Climate Change Adaptation Finance Tracking
- MDBs – IDFC Common Principles for Climate Change Mitigation Finance Tracking
- IDFC Green Finance Mapping Report 2020
- Germanwatch, World Resources Institute and NewClimate Institute (2020). Climate Finance: Accelerating the Transition to Carbon Neutrality and Climate Resilience
- I4CE (2017) Building Block of Mainstreaming: A framework for integrating climate change across financial institutions
- MDB 2019 Joint Report on climate finance
- OECD (2018). Measuring Mobilization: Briefing on efforts to harmonize OECD and MDB measurement methodologies

Case studies

- The IDFC publicly reports green and climate finance data
- BNDES's contribution to the SDGs

2 IDFC Principle 2: Support country-led climate related policies

Overview of relevant principles, measures and tools

Type of tools to inform the actions and contribute to supporting country-led climate related policies:

- Country policy analysis including Nationally Determined Contributions (NDCs) and Long-Term Strategies (LTS)
- Sectoral analysis of investment opportunities
- Country policy development and implementation support

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

COUNTRY POLICY ANALYSIS INCLUDING NDCS AND LTS

What is the principal objective?

Develop a nuanced understanding of country priorities, challenges, and opportunities to invest in projects in a country's specific geographic, economic, political, and social context with respect to climate resilient long term decarbonization.

SHORT DESCRIPTION

Conducting analysis of a partner country's policies, including its Nationally Determined Contribution (NDC) and Long-term Strategy (LTS) can help IDFC members identify and better understand a partner country's priorities, approach to climate policy making, and the most important challenges and opportunities in working with a country as part of a Paris aligned investment agenda.

An analysis of a country's NDC can provide a general overall summary of climate policy planning in a country both in terms of mitigation and adaptation action as part of the global effort. Other relevant documents can help provide further details and nuances as well as a historical understanding of the current situation – these include: Mitigation Action Plans and Scenarios (MAPS), Low-Emission Development Strategies (LEDS), and Nationally Appropriate Mitigation Actions (NAMAs), National Adaptation Programs of Action (NAPAs), and National Adaptation Plans (NAPs). Under the Paris Agreement, countries agreed to update their NDCs on a regular basis at least every five years. By January 2021, 34 countries had submitted updated NDCs. A 2016 IFC report found that implementing NDCs presented 23 trillion USD in climate-smart investment opportunities in emerging markets between 2016 and 2030[5].

In addition to NDCs, "long-term low greenhouse gas emission development strategies" – often referred to as Long Term Strategies or LTS can also provide a longer term understanding of a country's climate policy planning. Though the Paris Agreement does not specifically spell out the relation between a country's LTS and its NDC, an LTS can help countries plan and set short- and medium-term targets on their way to the deep decarbonization necessary to limit global warming to well under 2 degrees. By January 2021, 28 countries had submitted LTS to the UNFCCC. A growing number of countries have announced carbon neutrality targets.

Insights gained from such an analysis, can help a DFI to identify how a country can best benefit from DFI support, start planning where bankable projects could be developed, understand how to best overcome market barriers, and develop an approach to support implementation of national planning.

NDCs and LTS can further serve as a point of departure when engaging with national policy makers on finance priorities and planning. Country policy analysis should provide insight into future medium (NDC) and long-term (LTS) climate policy planning. Given their often relatively short length and level of detail however, further analysis is likely to be needed, including with further review of national communications, GHG inventories, and sectoral planning, budgeting, expenditure projections, and other specific policies. Third party analysis of country planning can also provide input, with a multitude of further stakeholders including development cooperation agencies, academia and research institutes as well as NGOs analyzing and publishing further research, analysis and making further proposals.

5 See the „more information" section for publication

EXAMPLES

1. The CAF Development Bank of Latin America is a member of the NDC Partnership, which seeks to help member countries leverage resources and expertise to provide countries they need to implement their NDCs and combat climate change. CAF's country strategies also now integrate considerations with regard to the partner country NDC and GCF country programs.
2. The International Finance Corporation, part of the World Bank Group published an analysis of "Climate Investment Opportunities in Emerging Markets" in 2016.
3. The analysis built on the Paris Agreement, countries' NDCs, and the business opportunities presented by dramatic price reductions in clean technologies in key emerging markets in key economic sectors. Although on a high level, it provides insights for development finance institutions with regard to business opportunities in the low carbon transition.
4. Landscape of climate finance in Morocco. The Caisse de Dépôt et de Gestion du Maroc (CDG) worked with I4CE to conduct a study tracking climate investments made in Morocco, how they were financed, and developing projections of financing needs in the short and medium term. This builds on previous I4CE developing and refining climate finance landscapes in France as part of the "Panorama des financements climat" research program.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To conduct country policy analysis to help guide investment decision making, NDC and LTS are a good place to start. However, depending on their level of detail, other sources of information will help in translating them into insights for investment strategies. These include:

- Other relevant policies in various sectors to implement the NDC;
- The current emission profile of the country (GHG emissions inventories);
- Analysis of current investment flows and green budget analysis;
- Understanding of global sectoral mitigation options, best practice, and best available technology;
- Vulnerability mapping with regard to areas and infrastructure particularly at risk with regard to the physical impact of climate change under different scenarios;
- Understanding of transition risk exposure of the different sectors of the economy.

STRENGTHS

Country analysis including NDC and LTS can help IDFC members gain a nuanced understanding of the geographic, economic, political, and sociological context of a country in order to help better prepare and tailor engagement with stakeholders, develop strategies and set priorities.

WEAKNESSES

While analysis of NDCs and LTS are helpful, according to the UNEP Gap Report 2020, current NDCs are (cumulatively) insufficient to limit global warming to well below 2 degrees by approximately 12 gigatons of CO_2e. They are therefore not a sufficient indication of Paris alignment in and of themselves. Further, of concern is that according to the report, many countries are not currently on track to reach their already insufficient NDC targets.

Another weakness is that although this may improve in the future, there are no standardized formats or templates for NDCs and LTS, one NDC or LTS is therefore not always comparable to another in terms of ambition, scope, coverage, or detail.

Most countries have not yet submitted an updated NDC, and in many cases NDCs submitted in 2014 or 2015 are now out of date, especially considering falling costs of renewable energy, election cycles and government changes. Many countries have yet to submit an LTS, in some cases submitted LTS are already out of date and would benefit from an update although the Paris Agreement does not specifically provide for this.

Similarly, reflecting different countries' capacities not all have moved to implement or further detail policies and strategies on a sectoral, sub-sectoral level, or sub-national level.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Country policy analysis should be conducted in conjunction with a solid understanding of decarbonization technologies and options on a global sectoral level with special attention paid to best practice or best available technologies which can also indicate where there may be increased potential to ratchet ambition.

A country policy analysis has limitations as a resource to understand current needs, dynamics, and views of stakeholders. Any country policy analysis should be followed up with extensive engagement, and understanding of global decarbonization pathways. Further, it is important to ensure that a country analysis cover all sectors of the economy

(regardless of the coverage of the NDC or LTS), and that a DFI develop a nuanced understanding of possible pathways to helping a country achieve long term decarbonization and resilience goals integrating different scenarios including of climate change impacts over the short, medium, and long term.

MORE INFORMATION

- Climate Action Tracker: (analysis of 27 countries plus the EU)
- World Resources Institute, NewClimate Institute and Germanwatch (2020). Raising the Game on Paris Alignment. Memo 4 – Engagement and Policy Development Support
- International Finance Corporation (2016). Climate Investment Opportunities in Emerging Markets
- I4CE international support for landscapes of domestic climate finance

Name of principle, idea, type of tool:

SECTORAL STRATEGIES AND ANALYSIS OF INVESTMENT OPPORTUNITIES

What is the principal objective?

Sectoral analysis of investment opportunities allows for a nuanced understanding of the current capital stock and emissions profile of a sector in a certain country in conjunction with what available options there may be to help shift a sector towards decarbonization and climate resilience.

SHORT DESCRIPTION

As a complement to NDC and LTS analysis, the process of developing sectoral strategies can help a DFI understand the current status of sectors, identify where the DFI has a comparative advantage or a strategic role to play (considering their mandates), and see where it is best placed to concentrate its efforts to mobilize investment in order to support country efforts to decarbonize the economy and enhance resilience.

Various sectors have different emissions profiles and different decarbonization options, different levels of exposure to physical climate risks and adaptive capacity as well as associated costs. On some level, technology is global, although opportunities and barriers to its implementation will vary according to the specific country context. At the same time, different countries start from different places in terms of the age of their capital stock, associated emissions intensity/efficiency, risk exposure to stranded assets or fossil fuel lock in, and climate vulnerability. Different countries also have a variety of strengths – and face a variety of challenges – with regard to their ability to mobilize domestic public and private finance to make investments in any given sector.

Taking the time to mapping out a robust understanding of investment needs, barriers (notably risks), and opportunities vis-à-vis a DFI's is a key step to developing sector strategies and applying them to different country contexts.

Important elements of sectoral strategies can include an examination of what financial instruments are best suited to address the particular risks, investment barriers, and opportunities in a certain sector in a certain country, as well as capital raising plans. Such analysis can also provide an understanding of quick wins or low hanging fruit as well as sketch out what will need to be done to mobilize investments for decarbonization in the medium to longer term. Developing a sectoral strategy should not be a one-off exercise but should rather be conducted regularly to respond to dynamic sector developments including new technology and price developments.

Such analyses can be internal or carried out by a DFI or NDB itself, but for many sectors in many countries, DFIs and NDBs can draw on third parties such as academia, other research institutes, consultancies, and investment managers existing research.

EXAMPLES

1. Global Efficiency Intelligence conducted a study entitled "Deep decarbonization roadmap for the cement and concrete industries in California" (2019) to examine emission patterns and reduction opportunities for cement and concrete in California, breaking down opportunities with mitigation options and providing estimated costs and financing options to support the industry and regulators.
2. The International Transport Forum has conducted an analysis of opportunities and challenges to decarbonizing the transport in Morocco as part of a larger Decarbonising Transport in Emerging Economies (2020) program.
3. NewClimate's analysis of the electricity sector in Argentina presents opportunities and insights for what falling cost of renewable energy technologies means for the country's climate targets and energy sector planning in the country.
4. Islamic Development Bank has written a sector guidance note on the climate change adaptation sector Guidance Note as part of an effort to support the integration of climate change considerations into its operations.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

Sectoral analysis of investment opportunities can draw on:

- Global technology roadmaps, developments in best available technologies;
- Sectoral emissions profiles, for example from national inventories;
- Economic analysis of existing capital stock and current investment flows;
- National sector policies (see previous tool).

STRENGTHS

Sectoral analysis of investment opportunities can help identify key areas for engagement with national policy makers. Understanding of global pathways and best available technologies or practices can also help to serve to engage with national policy makers to identify areas to ratchet ambition. In addition, sectoral analysis is an important measure to deepen understanding of investment opportunities and needs on a sectoral basis.

WEAKNESSES

Conducting and updating sectoral analysis may be resource intensive, but is an important exercise to keep up to date with dynamic trends in technology, economic projections, and sociological and behavioral shifts.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Because of the resource demands of thorough sectoral analysis, while it is important to cover all sectors, a prioritization could be made first concentrating on high emitting and most vulnerable sectors then expanding analysis to other sectors.

Short term sectoral analysis should integrate not only current situations and trends but also long-term goals so as to avoid contributing to stranded assets, emissions intensive lock-in, or maladaptation.

MORE INFORMATION

Report

- Ayoub (2019). The development of a carbon roadmap investment strategy for carbon intensive food and retail industries. Energy Procedia. Volume 161, March 2019, pages 222.243
- World Future Council (2017). 100% Renewable Energy for Tanzania

Case studies

- IsDB: Climate Change Adaptation Sector Guidance Note

Name of principle, idea, type of tool:

COUNTRY POLICY DEVELOPMENT AND IMPLEMENTATION SUPPORT

What is the principal objective?

Support programs to help policy makers develop and implement new policies to reach overall goals

SHORT DESCRIPTION

DFIs and NDBs can support countries in the development and implementation of policies to reach overall decarbonization and resilience goals. Such support may include providing technical advisory services, for example in updating NDCs, LTS, or sectoral policies or concentrate on mobilizing finance for the implementation of particular parts of these plans – depending on the mandate of the institution. Depending on the institution, DFI's including national development banks can play an important consultative role in policy development providing insight and input into financing strategies for policy implementation.

Such support can take a number of different forms:

- NDC updates, LTS development and updates in particular ways to ratchet ambition towards resilient deep decarbonization;
- General national planning processes;
- Fiscal policy reforms including "green budgeting", carbon pricing which may help understand the climate impacts of certain public revenue raising measures as well as spending. Such technical advisory can also help national policy makers to develop strategies to use public spending to catalyze private finance to "help fill the gaps" in national investment planning;
- Sectoral policy reforms relevant for mitigation (for example electricity market reforms, building codes for energy efficiency with minimum performance standards); adaptation (for example, urban planning and flood risk management); or just transition (worker retraining programs);
- Social policy reforms including unemployment and retraining opportunities key to a just transition.

FIGURE 4: OVERVIEW OF RELEVANT POLICY AREAS FOR DIFFERENT TYPES OF POLICY SUPPORT (NON-EXHAUSTIVE)

Policiy areas relevant for climate change migration	Policiy areas relevant for climate change adaptation	Policiy areas relevant for just transition
• General national plarming process • Fiscal policies including "green budgeting", carbon pricing, subsidies, taxes • Energy policy • Transport urban and land use policies • Building codes • Agricultural and forest policies • Industrial policies • Waste policies • Water and sewage policies • Environmental and conservation policies	• General national plarming process • Transport urban and land use policies • Building codes • Agricultural and forest policies • Industrial policies • Water and sewage policies • Environmental and conservation policies • Disaster risk and managment • Health policies	• General national plarming process • Employment policies • Educational policies including vacational (re)training • Social insurance policies

EXAMPLES

1. AFD 2050 Facility: The Agence française de développement established the "AFD 2050 facility" to provide support for some 30 of the highest emitting countries in their transition to a low-carbon and resilient development model in particular to strengthen climate policy dialog through the financing of studies and capacity-building activities.
2. The Central American Bank for Economic Integration (CABEI) worked jointly with the World Bank to prepare financing for Development Policy Operations (DPO) in Costa Rica to reinforce fiscal sustainability and continue to improve environmental sustainability enabling to set the foundations for inclusive and sustainable economic growth linked with the country's decarbonization plan.
3. AFD and IDB Policy Based Loan for Costa Rican National Decarbonization Plan: AFD and IDB have provided Costa Rica with a policy-based loan to support reforms as part of the implementation of the National Decarbonization Plan with a strengthening the management and monitoring of climate action in the planning, investment, and public budget process.
4. KfW NAMA Support Project for Urban Mobility in Peru: The KfW developed a NAMA support for project together with the GIZ to support policy reform in the urban mobility sector in Peru, an example of providing both concessional finance and technical assistance.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

Technical assistance for policy development and implementation support can draw on:

- Analysis of existing policies, including NDCs, LTS, and sectoral policies;
- Technical expertise for sectors and understanding of international best practice and best available technologies;
- Political economy of country including important stakeholders;
- Public budget, if possible at a project level granularity to identify climate / consistent uses;
- Private financial and investment flows that are co-financed by public funds (similar to aspects in Principle 3- tracking privately mobilized funds).

STRENGTHS

Technical assistance in policy development and reform can unlock new opportunities to ratchet country ambition towards resilient deep decarbonization and foster an investment climate conducive towards private investment and transformation.

In addition, direct investments in on the ground projects and green budget and climate-related investment and financial flow assessments can provide valuable information for both governments as well as DFIs as it can identify trends, sufficiency of deployment as well as gaps.

WEAKNESSES

IDFC members may face a number of challenges:

- Historical data is important to understand the current situation, but may not be up to date or may be lacking in many countries;
- Country policy development and implementation support are data intensive / availability of data can limit the feasibility of conducting this type of assessment;
- Relatedly, capacity may be lacking to engage on this level.

One additional potential challenge that DFIs might encounter are political economy barriers from vested interests that stand to lose out from a transition.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Policy support should be careful to ensure and maximize country ownership and involve all relevant stakeholders. Moreover, it can help policy makers in more improved and effective policy development and implementation.

Specifically, with respect to fiscal policies, public spending and mobilizing private finance, policy support public and private investors (government and non-government) it can help identify the appropriateness of the current use of funds within a country.

MORE INFORMATION

- AFD (2019). Policy based loans: Boosting the potential of a booming instrument
- KfW (2018). What is “policy-based lending”?
- World Bank – Development Policy Financing

3 IDFC Principle 3: Catalyze investments, and mobilize private capital

Overview of relevant principles, ideas and tools

Type of tools to inform the actions and contribute to the objective of catalyzing investments and mobilizing private capital:

- Targeted green financial instrument development
- Leveraging of international resources (GCF, GEF, AF), GCF accreditation
- Tracking of private finance mobilization

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

TARGETED FINANCIAL INSTRUMENT DEVELOPMENT

What is the principal objective?

Have a wide array of suitable instruments to further catalyze investments and mobilize private capital

SHORT DESCRIPTION

Targeted financial instruments can help finance or refinance Paris-aligned projects and activities and if possible, have co-benefits for adaptation and/or mitigation. They can play an important and effective role in (re)directing non-aligned investments towards Paris-aligned projects, and in mobilizing private capital for activities that have climate co-benefits. Since public funds alone will not be sufficient to meet the financing needs of decarbonization, it is important that public funds are used to create the long-term conditions to leverage and mobilize private capital to effectively shift markets. Developing suitable finance instruments is therefore a prerequisite to meeting the Paris Agreement goals.

Targeted (green) products can help address a range of investment barriers (*e.g.*, market or political) which can lead to (perceived) investment risks and therefore lack of investment towards a Paris-aligned economy. Because of their mandate, DFIs are well positioned to help address those barriers and to also act as first movers to support nascent technologies that can help meet the Paris Agreement goals.

DFIs have a wide variety of financial instruments that they can deploy, depending on the maturity of markets and technologies (also see below). In addition to seeking to ensure all activities and transactions are consistent with climate goals, DFIs can help proactively re-direct financial flows through the development (and tailoring) of finance instruments to the specific barrier and context in question.

It should be noted that not all instruments will be equally effective to solve a particular problem, and the impact on the re-direction of funds may vary depending on the context and specific challenge. Furthermore, instruments are typically designed to both mobilize private capital in the near-term, but also lead to shifts in market dynamics in the longer term to have a transformative impact on how the broader private finance community addresses climate-related issues. Finally, instruments may also be used in combination.

The mechanism through which the instruments work varies, and each instrument will work in different market contexts and different project phases. For example:

For nascent markets/technologies:

- **Grants for feasibility studies**: Grants which can contribute to lower the risks and costs for the preparation of investment projects, mostly aimed at supporting small and medium-sized companies.
- **Mezzanine finance** - Hybrid capital investments, from development banks seeking to support private investment in the senior debt or from investors with a higher risk appetite. Mezzanine finance can be used to fund projects where commercial lenders are typically dissuaded by the maturity of a sector and/or country and political risk.
- **Guarantees**: By mitigating the political and commercial risks of private and publicly owned investments, guarantees can facilitate access to capital for aligned/climate finance activities. This can enhance the mobilization of resources for a specific project or in support of specific government policies.
- **Concessional lending**: Dedicated preferential lending to Paris-aligned/climate finance projects. Can also be blended with the DFI's own funds.
- **Technical assistance**: to provide the stakeholders with the means to size the opportunities of Paris Aligned/climate finance activities opportunities. While financial tools aim to strengthen offer, TA aims to facilitate the origination of projects by pushing demand.

- In addition, **green bonds** may be used to raise an institution's funds whose conditions make it possible to support more risky activities. Bonds whose use of proceeds are earmarked for climate-related projects. Especially interesting for DFIs which are rated by at least one international credit rating agency and, thus, have access to capital markets.

For mature markets/technologies

- **Green credit lines:** Mostly credit lines to support investments in renewable energy and energy efficiency by financial institutions, to finance projects of different sizes and with different market or project development capacity. Green credit lines may include special financial conditions (*e.g.*, reduced interest rates), longer tenors, increased grace periods or incentive payments, among others. They can also include capacity building components to help shift overall mainstreaming of climate in beneficiary financial institutions.
- **Public-private partnerships:** Partnership often used to finance large energy projects.
- **Non-concessional lending:** Non-preferential lending to Paris-aligned/climate finance projects. Can also be blended with the DFI's own funds.

In addition to the development of tailored green instruments, it is important for IDFC members to also develop a communication and marketing strategy to promote demand of these products. Information about those products can also be included in discussions and trainings with clients and counterparties.

EXAMPLES

1. TBD & AFD green credit line

In 2020, Eastern and Southern African Trade and Development Bank (TBD) & Agence Française de Developpement (AFD) signed a USD150 Million Credit Line to Finance Green Infrastructure in Africa. The credit line aims to help finance renewable energy projects which might not have been received funding otherwise. It thereby aims to contribute to a paradigm shift and reinforce the use of renewable energy and climate change investments in TBD countries and strengthen TBD's role as a leading regional bank for climate finance in the region.

2. CAF green bonds

CAF has issued its first public green bond on the European market (Switzerland) in 2020. A bond of EUR 750 million and with a 0.625% coupon was issued to fund environmental projects that foster energy efficiency, renewable energy, sustainable transport, waste, water and natural resource management and land use.

3. Nacional Financiera (NAFIN) green bonds

To strengthen the sustainable finance market in Mexico, NAFIN issued Mexico's first green bond issued in Mexican Pesos in 2016 with a coupon of 6.05%. This issuance was the first listed in the Mexican Stock Exchange segment dedicated to green bonds. In addition, it also issued another USD denominated green bond in 2015 and certified by the Climate Bond Initiative to finance wind energy generation projects in Mexico, which received a number of awards from internationally renowned organizations.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

For the development and tailored use of specific finance instruments, country/sector context is needed, including information about market maturity of sectors/technologies as well as a country's Paris Agreement investment and support needs. In addition, information about country and/or sector-specific investment barriers is also required. Moreover, more detailed information may also be required for due diligence procedures.

STRENGTHS

Targeted finance instruments can help address investment barriers and provide support to nascent technologies and markets. This in turn helps to fund and re-direct funding from non-aligned projects and activities to aligned projects and activities, in particular those with direct or indirect contributions for mitigation and/or adaptation. In some instances, and when properly structured, the developing of dedicated tools and piloting of targeted instruments can have a transformative impact in reducing the barriers to the development and deployment of similar tools by other financial actors, and thus contribute to shifting markets.

WEAKNESSES

The development and usage of financial instruments to re-direct and fund Paris-aligned activities do not ensure that other (potentially non-aligned) activities of the institutions do not cause harm. In addition, attention should be paid to the design of the instruments (*e.g.* green bonds) to make sure that they effectively support Paris-alignment and foster investments where they are the most needed for the transition and adaptation of national economies and societies.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

The development and increased usage of tailored instruments to proactively fund and (re)direct financial flows is highly recommended. Instruments should be developed and used with the aim to maximize impact, and achieve the required decarbonization and adaptation of economies and societies. Therefore, careful consideration of all dimensions of Paris-alignment for design and implementation needs to be ensured, *e.g.*, by putting in place internal structures. In addition, impact assessments should be carried out regularly and the development and use of instruments adapted accordingly. Finally, financial institutions should fully disclose their usage and impact of different finance instruments towards the re-direction of financially flows towards the Paris Agreement goals.

MORE INFORMATION

Reports

- I4CE (2017). Green Bonds: what contribution to the Paris Agreement and how to maximize it?
- I4CE (2018). Using credit lines to foster green lending: opportunities and challenges
- Climate Bonds Initiative (2019). ASEAN Green Financial Instruments Guide
- Green Belt and Road Initiative Center (2019). A growing toolbox of sustainable finance instruments
- Coffey (2014). Financial Instruments for Private Sector Development
- IDB and IIC (2017). Comparative Study of Equity Investing in Development Finance Institutions (DFIs)
- World Bank (2015). From billions to trillions: transforming development finance post-2015 financing for development: multilateral development finance
- World Bank (2018). Strategic Use of Climate Finance to Maximize Climate Action
- World Bank (2020). Transformative Climate Finance. A new approach to achieve low-carbon resilient development in developing countries

Case studies

- AFD's program to make the financial systems converge with the climate agenda
- TSKB's Turkey & CEEMEA regional Green/Sustainable Bond
- DBSA's innovative blending financing mechanism to catalyze small scale renewable energy market in South Africa
- The Development Bank of Latin-America (CAF) "Cities with a Future" initiative
- Japan International Cooperation Agency (JICA) promotes climate change-related projects through program loans

Name of principle, idea, type of tool:

LEVERAGING OF INTERNATIONAL RESOURCES (GCF, GEF, AF), GCF ACCREDITATION

What is the principal objective?

Mobilize additional resources to finance projects and programs with transformative outcomes, report on leveraged sources and their size

SHORT DESCRIPTION

Leveraging international resources can help DFIs amplify their (climate) finance and provide an opportunity to develop and finance transformational projects and programs. Multilateral climate financing bodies can provide additional access to concessional finance which in turn enables DFIs to take on early investment risk and help DFIs to develop their investment portfolios to foster mitigation and adaptation (*e.g.*, by building an investment pipeline). This can also help deepen and improve access to local markets which is important to reach the scale required to finance transformative climate action.

To access international resources, DFIs can either gain "direct access" by becoming an accredited entity to the different finance bodies or submit funding proposals through another accredited entity. While accreditation can be cumbersome and resource intensive, it reduces transaction costs and enables DFIs to gain more independence – it can also help an institution access resources to support improved climate and broader ESG safeguard systems.

The main international bodies are:

- The Green Climate Fund (GCF): Established in 2010, GCF is the world's largest dedicated fund helping developing countries meet its mitigation and adaptation goals, and the main financing mechanism under the UNFCCC. It aims to particularly fund transformative projects. To date, the GCF has approved 15 projects submitted by IDFC members, totalling USD 985 million;
  - A strategic partnership with the IDFC was signed in June 2019 to support public development banks (PDBs) to re-direct financial flows in line with the Paris Agreement. So far, the GCF has accredited 30 PDBs, 13 of which are IDFC members, making the IDFC the main group of financial institutions collaborating with the GCF. The partnership also aims to facilitate knowledge sharing on climate finance and action, access to GCF resources with co-financing from IDFC members, and support capacity-building activities. GCF also contributed to the IDFC Climate Facility which aims to support members to further integrate climate change into their mandates, develop innovative financial products, mainstream climate finance into operations, and promote knowledge-sharing;
- The Global Environment Facility (GEF): Established in 1992, the GEF provides grants and mobilizes co-financing which can support a financial institution's client countries invest in new technologies, overcome investment barriers, and meet renewable energy goals. The GEF recently adopted a new strategic direction, which includes, inter alia, a focus to catalyze transformational change in key systems that are driving major environmental loss, in particular energy, cities and food;
  - Among IDFC members, the Development Bank of South Africa (DBSA) and the West African Development Bank (BOAD) have direct access;
- The Adaptation Fund (AF): The Adaptation Fund was established under the Kyoto Protocol of the UN Framework Convention on Climate Change, and since 2010 has committed USD 720 million to climate adaptation and resilience activities. The Adaptation Fund finances projects and programs that help vulnerable communities in developing countries adapt to climate change. Initiatives are based on country needs, views and priorities.

EXAMPLES

1. KfW, BLUE ACTION FUND (BAF): GCF ecosystem-based adaptation program in the western Indian ocean

Submitted to the GCF for funding by the KfW in 2019, the objective of the Blue Action Fund (BAF) is to reduce or avoid climate change impacts through ecosystem-based adaptation for vulnerable coastal populations. This project is funded by 30 million EUR from the GCF, 25 million EUR from German Federal Ministry for Economic Cooperation and Development via KfW.

2. DBSA's direct access to the GEF

In 2014, the Development Bank of South Africa (DBSA) became the first (and only) accredited IDFC member to the GEF. This has helped the bank leverage additional resources to support SMEs access funding in the renewable energy sector, support various biodiversity projects and support for high-efficiency LED lightning and distribution transformers.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To leverage international resources, specific information about how to access the funds, either through project financing or direct access (and becoming an accredited entity) is required.

To become an accredited entity, institutions need to undergo an extensive accreditation process and demonstrate, among other, that they have the ability to financially manage the projects, to safe-guard funded projects and programs against environmental or social harm and comply with the fund's standards and various policies.

STRENGTHS

Leveraging resources from international multilateral financing bodies can help IDFC members secure additional concessional funding for Paris-aligned projects and activities, in particular for those with transformative outcomes for the decarbonization and adaptation of national economies and societies. A direct access to those bodies, by becoming an accredited entity, can build and get access to an attractive investment pipeline, and thereby reducing transactions costs.

WEAKNESSES

The accreditation and accessing the funds is time and resource intensive. In addition, the leveraging of international resources may require additional assessments to ensure that the projects financed are aligned with both national and international long-term objectives, and allocate resources where they are the most needed.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Consider leveraging international resources whenever possible, in particular to fund transformative projects and programs which might be difficult to finance otherwise. In addition to becoming accredited entities and thus being able to directly access funds, it could be useful for IDFC members to secure co-financing from international climate funds which can serve to complement IDFC baseline funding and thus help strengthen climate-alignment of investments.

MORE INFORMATION

Reports

- GCF (2020). The Green Climate Fund and the International Development Finance Club: A strategic alliance to realize the full potential of public development banks in financing the green and climate-resilient transition
- ODI (2020). How to get climate finance to flow through national development banks
- Global Environment Facility
- Green Climate Fund
- GCF entity accreditation
- Adaptation Fund

Case studies

- AFD's program to make the financial systems converge with the climate agenda
- CDG Capital sets up a Sustainable Development unit

Name of principle, idea, type of tool:

TRACKING OF PRIVATE FINANCE MOBILIZATION (INCLUDING METHODOLOGY OF HOW TO DO SO)

What is the principal objective?

Track and publicly disclose on the institution's mobilization of private finance

SHORT DESCRIPTION

Public sources are not sufficient to meet international climate goals; therefore, the mobilization of private finance (co-financing) for mitigation and adaptation is key.

Development banks are in a unique position to leverage private funds and contribute to meeting countries' climate pledges. To ensure that public funds are used effectively, and to assess the institution's contribution towards meeting investment needs of partner countries, DFIs should track and disclose private finance mobilization. This can also help to determine collective and country specific progress towards meeting its investment needs. In addition, tracking and disclosing private finance mobilization can help to ensure continued and additional private sector mobilization in the future.

Tracking of private finance mobilized aims to estimate the volume of financial resources invested by public and private external parties alongside the own institution for climate mitigation and adaptation activities.

There are two main challenges with regards to the effective tracking of private finance: Methodologies for tracking vary, including because of different definitions and attributional considerations, and data is often difficult to obtain (or estimate).

Methodological considerations include:

- What counts as private finance: DFIs need to decide whether only finance mobilized by DFIs from private entities for a specific activity will count as private finance mobilized, or whether it is broader and includes also activities by the DFI that will help countries to attract private investments but without direct or active involvement of the DFI (often defined as private investment "catalyzed" or private indirect mobilization). While it is easier to measure direct private finance mobilized (linked to a specific activity), tracking private finance catalyzed is more difficult;
- What should be tracked: Ideally, tracking should be done at project-level, and differentiated by source (and possibly destination / including sector) as well as by category / instrument. In addition, private finance mobilized should be tracked separately for mitigation and adaptation;
- Timeline of measurement: Tracking should ideally be done at commitment stage and reported annually.

Data remains another significant challenge and the data collection can be resource intensive. Therefore, especially for private finance catalyzed, tracking could be both quantitative (wherever possible) and qualitative, describing how activities by the DFI have helped countries attract private investments and what has been achieved.

In addition to the tracking of private finance mobilized, it is critical to disclose the amount of finance flows mobilized (possibly also disaggregated by instrument, geography etc.) as well as the methodology used for tracking. It is encouraged that IDFC members disclose their private finance mobilized through the annual IDFC Green Finance Mapping, possibly in addition to their own, institution-specific reporting. This can be combined with the annual disclosure of climate finance flows.

The IDFC collects data on private sector mobilization of its members through a survey, the results of which are then published in the Green Finance Mapping annual report. Private sector mobilization is qualified as such if the asset financed is in private ownership (>50%) and/or the financial contribution comes from a private sector actor. Eligible co-finance includes loan by private sector actors mobilized by IDFC member loans / equity / grants or guarantees, equity from private sector actors mobilized by IDFC member loans / equity positions or grants, loans to the private sector generated by the revolving use of credit lines or green funds, and loans and equity mobilized from the private sector in other ways under public-private-partnerships. To track mobilization where several public sector actors are involved, the mobilized investment is allocated on a pro-rata basis to different public financiers independent of the specific instruments applied.

EXAMPLES

1. MDBs joint climate co-finance (CCF) approach

In 2015, MDBs started to track private finance mobilized for mitigation and adaptation using a harmonized approach. A separate reference guide from 2017 further details how they calculate and jointly report private investment mobilization.

The methodology differentiates between direct and indirect private finance mobilized. To count as direct private finance mobilization, it must be demonstrated that the MDB plays an active and direct role for the private financial commitment to be made. Data is tracked at project-level.

Specific tracking criteria are developed for each instrument (equity, guarantees, on-lending, trade finance etc.).

Other tracking principles include:

- Timing of measurement for private direct mobilization is the date of commitment;
- Timing of measurement for private indirect mobilization is also date of commitment (if available), otherwise based on the MDB's commitment date;
- If no commitment date is available, the approval date of the MDB commitment will be used;
- Where the MDB's financing contribution is made in several tranches over more than one calendar year, and a commitment date is not available, private co-financing is to be measured on a pro rata basis using the share of the MDB's financing commitments in each year to the total amount approved by the MDB for the activity;
- Data is tracked (and reported) annually.

2. OECD approach

The OECD-hosted Research Collaborative on tracking private climate finance developed tracking criteria in close collaboration with the OECD's development assistance committee (DAC). The methodology attributes private finance mobilization to all official development finance interventions in a project (additionality assumption). It thereby does not differentiative between direct and indirect mobilization. It covers a subset of a financial institution's instruments: guarantees, syndicated loans, shared in collective investment vehicles, credit lines and direct investments in companies). In May 2020, the OECD published also a new draft methodology which covers a wider array of instruments, including project finance schemes.

Where multiple public finance institutions are involved in one transaction, amounts of private co financing are attributed at the activity-level using volume-based pro rating across public finance instruments and actors.

Among the IDFC members, the AFD Group is currently using the OECD approach to track private finance mobilization.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

Tracking the mobilization of private finance requires a reliable and recognized methodology, which integrates Paris alignment considerations.

The criteria used in the tracking of private finance are typically the same criteria used in relation to the institution's tracking of climate finance. For example, they should be differentiated by category/instrument and supplemented by information on its financing sources (both public and private), among others. Data should ideally be collected at commitment time.

While work is under progress to further develop and harmonize current methodologies, quantitative methodologies can be supplemented by qualitative information, in particular with regards the catalyzation of private finance.

STRENGTHS

The tracking of private finance mobilization allows the IDFC member to understand their effectiveness in leveraging private funds, and to actively manage its private finance mobilization strategy (if they have such strategy). It also helps assess collective and country specific progress towards meeting its investment needs, both for adaptation and mitigation. In addition, if combined with appropriate target setting, it creates incentives for increasing use of private finance and boost efforts to scale up engagement by private sector.

WEAKNESSES

Current methodologies for the tracking of private finance do not yet integrate Paris-alignment considerations, nor do they provide any information whether other (potentially non-aligned) projects and activities of the organization do not cause any harm.

Tracking the mobilization of private finance does not provide an indication of whether the IDFC member itself is Paris-aligned – nor if private counterparts are aligned.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

It is highly recommended to track and disclose private finance/co-mobilization, both at disaggregated and aggregated levels to be able to measure the effectiveness of public finance in leveraging private funds and meeting the Paris Agreement goals. This should be combined with the yearly tracking and reporting of climate finance.

In addition, it is important to integrate resulting information into broader portfolio management and institutional strategy to maximize impact. For example, private finance tracking can help improve understanding about the leverage of public funds and how the financial institution supports the transformation of the recipient country's economy or supports sector specific transformations.

MORE INFORMATION

- OECD (2020). DAC methodologies for measuring the amounts mobilised from the private sector by official development finance interventions – DRAFT May 2020
- World Bank (2018). Joint MDB reporting on private investment mobilization: methodology reference guide
- IFC (2019). Mobilization of private finance by multilateral development banks and development finance institutions - 2019
- IDFC (2020). IDFC Green Finance Mapping Report 2020
- 2019 Joint Report on MDB's climate finance International Finance Corporation's. Access to Information Policy.

4 IDFC Principle 4: Adaptation and resilience

Overview of relevant principles, ideas and tools

Type of tools to inform the actions and contribute to the objective of catalyzing investments and mobilizing private capital:

- Assessment of physical climate risk at the project level
- Assessment of physical climate risks exposure of national economies
- Assessment and management of physical climate risk on a company/portfolio level

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

ASSESSMENT OF PHYSICAL CLIMATE RISK AT THE PROJECT LEVEL

What is the principal objective?

Ensure the resilience of development projects

SHORT DESCRIPTION

To align with the Paris Agreement adaptation goal, IDFC members should work to ensure that all of their activities – not only adaptation finance, but also mitigation finance and all other activities - are resilient to physical impacts of climate change. This will require that they identify and measure the physical risk exposure of their projects and, when necessary, engage with local counterparties to identify the most appropriate adaptation options.

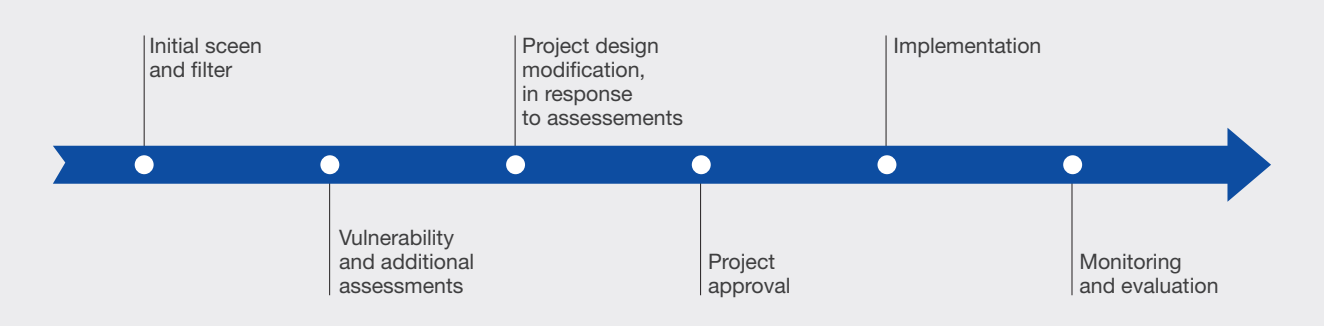
Several development banks have important experience in the assessment of exposure and vulnerability of new projects. Over the past decades, a number of DFIs have developed and progressively improved risk screening processes relying either on in-house screening methodologies, on existing tools developed by service providers, or a combination or both. These processes aim to identify, assess, measure and manage the physical risk exposure of new investments.

To achieve this across all new projects, these screening processes are to be embedded in the project cycle. However, as in-depth climate risk assessments can be resource intensive, project screening processes are often developed in a minimum of two phases: a first analysis is conducted on all new investments to identify projects that are the most exposed to climate-related risks. In turn, only this selection of projects is screened a second time as part of an in-depth analysis including a vulnerability assessment as well as the identification of relevant adaptation measures.

For example, across the MDBs a relatively standard process is emerging, consisting of six main steps: initial screening, additional assessments, project design modification, project approval, implementation, and monitoring (see **Figure 5**):

These processes require that resources are made available to operational teams to assist them in the screening process and the identification of adaptation measures, when necessary.

FIGURE 5: STAGES OF CLIMATE RISK IDENTIFICATION AND MANAGEMENT



Source: WRI, NewClimate Institute, Germanwatch (2018)

EXAMPLES

1. In-house Disaster and Climate Change Risk Assessment Methodology developed by the Inter-American (IDB) Development Bank

The IDB has developed and publicly released its in-house methodology integrated in the project cycle of all IDB projects in the identification, preparation, and implementation phases. The process is organized around five steps—hazard exposure, criticality and vulnerability, simplified qualitative analysis, complete qualitative analysis, and quantitative analysis— which are grouped into three phases—screening and classification, qualitative assessment, and quantitative assessment.

2. Online tools to mainstream an initial physical risk assessment screening in the project cycle of all investments:

As a first step in the assessment process, a number of development banks, including some IDFC members, such as are using online tools developed by service providers such as the Aware screening tool to identify in their pipeline of projects the ones that are the most exposed to physical climate risks, based on their location, and a series of broad questions related to water resources, energy security, the company's dependency on other supplies and services or transport routes. These tools produce a climate risk screening report highlighting major issues to look at. This initial screening is then complemented by more in-depth assessments. The IsDB for example developed a follow-up Project Impact Assessment (PIA) based on climate change adaptation sector guidance notes.

The World Bank has developed Climate and Disaster Risk Screening Tools, including at the project level "Rapid Screening Assessments" and "In-Depth Screening Assessments", requiring respectively 30 minutes and two hours to complete. These tools are available for different sectors and are intended to help users determine the appropriate level of effort for further studies, consultation, or dialogue in the course of project design. The tools provide access to data on climate change (historic, projected) and help users connect this information to project components and allow users to account for non-physical components such as institutional capacity and the larger development context.

These tools are relatively simple and easy to use for operational teams, however they do not provide a detailed risk analysis, nor do they suggest specific options for increasing the project's resilience.

3. Resilience Rating System piloted by the World Bank

The World Bank Group is currently piloting a rating system, which represents a major step forward in the development of project assessment processes: it assesses both the resilience of the project design as well as how people are being made more resilient through the project itself. The objective of the World Bank would be that this rating system progressively become a standard for financial institutions - both public and private financial institutions.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

First, information on hazards is needed. To this end, IDFC members can use database of hazards per sectors and countries / regions built or purchased from a service provider, which is then applied to the characteristics of individual projects (geolocation, sector, suppliers, etc.).

Second, for exposed projects, information about options on adaptation measures is also needed. Engagement with the project developers and local counterparties is then recommended.

STRENGTHS

These methodologies and tools can be useful to mainstream the integration of physical climate risk in the development of projects and promote their resilience. Moreover, they have been used for some time by DFIs. There is therefore a significant amount of lessons learned to rely on.

WEAKNESSES

Conducting these assessments may be resource intensive, but a number of DFIs have developed processes to limit this as much as possible and simplify the process for operational teams. Experience shows that screening processes need to be tailored to institutions' business models to ease smooth adoption of these new additional processes.

These tools and assessment methodologies were developed to ensure the resilience of projects and programs and promote adaptation measures when necessary. However, when these assessments are conducted late in the project cycle, DFIs may not have a large room for maneuver in the development of adaptation measures, while the data needed to screen risks are usually readily available at the start of project appraisal.

In addition, DFIs should consider promoting the resilience *of* projects (project scale) together with the building of resilience *through* projects (system scale) to promote and maximize adaptation efforts where the support of DFIs may be the most needed in each country. Additional analyses and engagement may be necessary to achieve this.

Finally, Paris Alignment is increasingly seen as a process that must occur at the counterparty level, not only at a project-by-project level. These assessments should thus be complemented by other analyses at the counterparty level.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

As the physical impact of climate change will intensify over time, physical risk assessments and adaptation measures need to take into consideration both short- and long-term physical impacts of climate change on projects. Similarly, adaptation measures should take into consideration both short- and long-term physical impacts of climate change to make sure that they do not contribute to maladaptation.

In addition, while promoting the resilience of projects themselves (resilience of projects), physical climate risk management measures should aim to contribute to the adaptation of economies and societies more broadly (resilience through projects). To this end, it is important to embed climate risk considerations as early as possible in the project design process to identify the most appropriate adaptation measures and engage with all counterparties on what is the acceptable level of risk a financial institution, counterparty or client is willing to accept vis-à-vis climate impacts – and thus the level of resilience to in turn target. The acceptable level of risk – and the acceptable/feasible level of increased cost for resilience measures - should rather be a point of discussion as early as possible in the planning and project cycle between DFIs and their clients.

To be Paris aligned, adaptation measures should not only address relevant physical risks but also take into account mitigation considerations (*i.e.* avoid lock-in in GHG emissions themselves) and be in line with national short - and long-term sustainable development trajectories. Involving local stakeholders in the design of adaptation measures and linking projects assessments with country assessments may be key in this process.

Finally, it would be important to disclose the level of resilience of projects and programs for transparency purposes vis-a-vis all counterparties.

MORE INFORMATION

Reports, publications & tools

- IDB (2019). Disaster and Climate Change Risk Assessment Methodology for IDB Projects: A Technical Reference Document for IDB Project Teams
- World Bank (2021). What You Need to Know About the Climate Change Resilience Rating System
- World Bank. Climate Screening Tools
- World Resources Institute, Germanwatch and NewClimate Institute (2020). Enhancing Adaptation and Climate-Resilient Operations within the Multilateral Development Banks
- Towards an alternative approach in finance to climate risks: Taking uncertainties fully into account.

Case studies

- ADB scales up the integration of physical climate risk management into its operations
- IsDB: Climate Change Adaptation Sector Guidance Note
- World Bank's Climate and Disaster Risk Screening Tool Helps Identify Short- and Long-Term Climate and Disaster Risks for Better Risk Management in Development

Name of principle, idea, type of tool:

ASSESSMENT OF PHYSICAL CLIMATE RISKS EXPOSURE OF NATIONAL ECONOMIES

What is the principal objective?

Within a specific country, identify exposure to physical climate-related risks – including the areas and sectors the most exposed to physical climate-related risks. This information can be used to support adaptation directly or indirectly through both direct interventions as well as to inform national strategies to mobilize climate finance for adaptation.

SHORT DESCRIPTION

Climate change will not affect all countries or regions in the same way, it is therefore important to conduct an analysis of potential climate-related impacts at the country level. These assessments should identify: 1) the physical impacts of climate change (both acute and chronic) that the country may be faced with and its socio-economic consequences, and 2) the specific adaptation and resilience capacity needs in the country across regions and sectors.

The result of the assessments can be used by IDFC members to measure how these risks may impact country risk but also adapt strategies, assessment frameworks and instruments and interventions to best promote adaptation and resilience. Bilateral and regional development banks may use this information as part of country program and dialogue processes.

This assessment process by DFIs should be differentiated from the assessment of Sovereign Climate Risk by investors and credit institutions to assess the exposure of sovereign issuers to climate risks. While these methods may identify risk exposure at the issuer level, they do not identify the actions necessary to increase resilience and foster adaptation.

Identifying the options available to increase resilience and reduce the identified risks is essential for public financial institutions as it can help them identify where their intervention is the most needed and increase access to both public and private sources of capital in that countries/regions/sectors where higher levels of exposure may reduce financial sector participation.

This process should be integrated into the planning cycle of the financial institution to inform both strategic and operational decisions.

EXAMPLES

1. A number of Multilateral Development Banks have developed disaster risk assessments at the country level

These include for example:

- National Disaster Risk Profiles (Asian Development Bank);
- Country profiles (Inter-American Development Bank).

In addition, the World Bank developed country risk assessments on its Climate Change Knowledge Portal, which provide comprehensive overviews of trends and projected changes in key climate parameters, as well as sector-specific implications, relevant policies and programs, adaptation priorities and opportunities for further actions.

These country risk assessments may be used as such by IDFC members for the identification of countries' needs, or complemented by further in-house analyses at the sector level, updated based on dialogue and engagement with national stakeholders including the private sector.

2. Integration of physical climate risk in country risk assessment by the AFD

AFD has integrated physical climate risk in its country risk assessment through a four-step process:

1. Identification of the country's exposure to climate hazards (with the support of a data provider),
2. Analysis of vulnerability per sector,
3. Impact on components of country risk assessment (economic growth, public finance, external position, banking and financial sector)
4. Analysis of public policies and strategies.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

First, information is needed about the partner country's exposure to climate hazards and climate change impacts. Second, financial institutions also need some information on country policies and programs on adaptation – as well as the implied investment implications.

STRENGTHS

These assessments may be very useful to promote dialogue with countries on the development and implementation of national adaptation plans, and where DFIs support may be the most needed.

Similarly, these assessments may be useful as part of the dialogue with private counterparties at a local scale to foster the adoption of physical risk assessments practices.

WEAKNESSES

Country risk assessment may be too general and not directly usable by operational teams. As many countries have not yet developed a National Adaptation Plan and integrated it into national planning, the level of detail of country profiles on countries strategies and priorities may also vary from one country to another.

Methodologies for assessing Sovereign Climate Risk are not standardized and may not produce a level of information that would allow for the identification of actions to take to increase adaptation and resilience. Outcomes should be used only as indicative of potential overall levels of risk of a country.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

These assessments should be used as part of the dialogue with the country for the development and implementation of national adaptation plan consistent with long-term global goals to identify where the DFIs support would be the most needed.

As the physical impact of climate change will intensify over time, physical risk assessments need to take into consideration both short- and long-term physical impacts at the country level. Different scenarios should be considered.

The dialogue with countries should also take into considerations the trade-offs and synergies with mitigation objectives and the broader sustainable development path of the country.

MORE INFORMATION

Reports, publications & tools

- ADB (2017). Disaster risk management and country partnership strategies: A Practical Guide
- I4CE (2018) Getting started on Physical climate risk analysis in finance
- Risk monitor tool

Name of principle, idea, type of tool:

ASSESSMENT AND MANAGEMENT OF PHYSICAL CLIMATE RISK ON A COMPANY / PORTFOLIO LEVEL

What is the principal objective?

Identify the financial risk exposure of counterparties to the physical impacts of climate change. Engage with counterparties and explore how to foster increased resilience.

SHORT DESCRIPTION

To support the resilience of both assets and individual actors to physical impacts of climate change, development banks need to identify and assess the physical climate risk exposure of all of their counterparties. As in the case of traditional risk assessment approaches, it is increasingly recognized that the financial risk of the physical impacts of climate change should be assessed at the counterparty level. This creates an opportunity for DFIs to work with counterparties and clients in addressing risks holistically, rather than project by project. In turn, the counterparty level analysis can support financial institutions assessing portfolio-level implications of climate related risks and better integrate climate risk assessment in existing risk assessment procedures. These assessments should however not lead to reduced IDFC members' risk appetite towards their most vulnerable clients that they can support in improving their resilience to climate change.

A number of service providers and financial institutions recently started to develop and implement physical risk assessment methodologies for companies and counterparties. Most of these methodologies are built to identify, assess and measure the exposure and vulnerability of counterparties individually and aggregate outcomes at the portfolio level. In some instances, service providers produce financial estimates on the physical climate risk to the counterparty.

EXAMPLE

1. AFD's Initiative on Assessing and Managing Physical Climate Risks

AFD started assessing its portfolio in 2018 with the help of an external consulting firm and developed an in-house scoring system for each physical risk in line with its core development mandate. To help assessing those scores, AFD went on to develop two new sets of tools:

- a sector-country matrix that produces preliminary scores and warning flags for each client, based solely on 2 simple inputs: the country and the sector the client is operating in;
- ready-made questionnaires intended to be used during the due diligence process for new projects in order to have more complete information on whether the client is aware of the identified risks and has elaborated potential adaptation strategies.

2. UNEP FI TCFD pilots

After the Task Force on Climate-related Financial Disclosures (TCFD) released its guidance on climate risk disclosures in 2017, the United Nations Environment Programme Finance Initiative (UNEP FI) convened a consortium of banks to pilot these new recommendations. The consortium collaborated with Acclimatise to develop a physical risk assessment methodology. A similar effort was conducted to develop an approach for evaluating corporate lending portfolio exposure to transition risk under different climate scenarios. Several case studies were released, including an assessment of physical risk in the agriculture sector by Itau Unibanco, an assessment of physical risk for electric utility companies by UBS and an assessment of physical risk for commercial real estate in China by Standard Chartered.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

- Data on climate hazards (both acute and chronic, historical and future);
- Data on geolocation of the counterparty's main assets;
- Data on the decomposition of the borrower's income according to strategic assets;
- Data on the value chain's exposure to physical risks (upstream and downstream);
- Data on a counterparty's aggregate risk exposure and vulnerability.

STRENGTHS

These assessment methodologies can be a good basis for engaging with clients on physical climate risk to promote the adoption of resilience strategies that go beyond an individual project or transaction. This has the potential of a higher impact in overall 'real world' increases in resilience than a project-by-project approach.

A counterparty level analysis also allows an institution to produce climate-related financial risk assessments that may be more pertinent for the risk teams of an institution.

WEAKNESSES

Methodologies on this aspect are quite new and require further developments as a growing number of financial institutions are only starting to use them:

- Approaches available today make tradeoffs between specificity, exhaustiveness and detailed information. This results in heterogeneous scopes and granularity of the risk information, with mostly qualitative results;
- Uncertainty is embedded at different stages of the assessment process;
- The limited availability of counterparty-specific data on the location of its assets is a major challenge;
- Adaptive capacity is little integrated in existing approaches. Engagement with counterparties is required;
- Outputs of the analysis cannot be included in the credit rating due to time horizon issues.

However, these methodologies are also evolving rapidly, especially as a number of initiatives such as the TCFD pilot of UNEP FI are focusing on addressing these gaps and regulators are starting to implement reporting requirements for companies and financial institutions.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

These assessment approaches should be conducted with the objective of identifying the most vulnerable counterparties and supporting them improving their resilience. Risk management strategies should be developed in coherence with the development mandate of DFIs as well as with countries needs and adaptation strategies. These assessments should be paired with project and country level physical risk assessments as well as with transition-related risk assessments at the counterparty level.

MORE INFORMATION

Reports

- I4CE (2018). Getting started on Physical climate risk analysis in finance
- Acclimatise (2018). Navigating a new climate
- UNEP FI (2020). Charting a New Climate
- NGFS (2020). Case Studies of Environmental Risk Analysis Methodologies

Case studies

- AFD's Initiative on Assessing and Managing Physical Climate Risks
- Assessment of HSBC France's exposure to physical and transition risks related to climate change

5 IDFC Principle 5: Support the transition from fossil fuels to renewables financing

Overview of relevant principles, ideas and tools

Type of tools to inform the actions and contribute to the objective of supporting the transition from fossil fuels to renewables financing:

- Assessment and management of alignment with the transition (or non-alignment/harm) on a project level (e.g., MDBs decision trees)
- Assessment and management of transition risk on a country level
- Assessment and management of transition risk on a counterparty/portfolio level

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

ASSESSMENT AND MANAGEMENT OF ALIGNMENT WITH THE TRANSITION (OR NON-ALIGNMENT/HARM) ON A PROJECT LEVEL

What is the principal objective?

Determine whether a specific project is aligned with or detrimental to achieving national and international climate goals.

SHORT DESCRIPTION

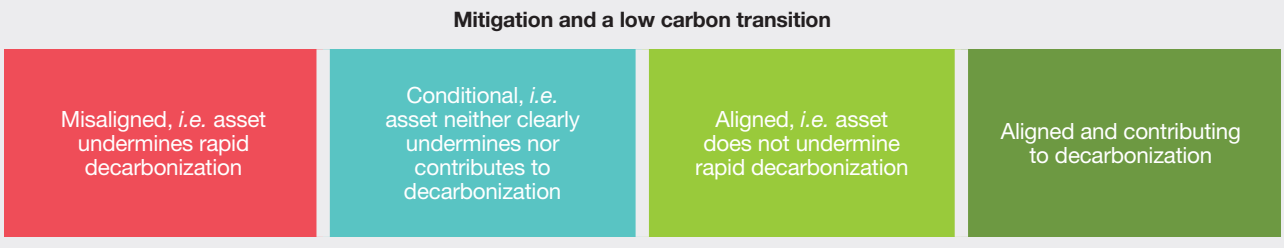
Development finance institutions have a responsibility to proactively screen all projects for their alignment - or non-alignment/harm vis-à-vis international climate goals, and national strategies and objectives.

Paris-alignment goes beyond assessing the potential transition risks of a project to screen for their compatibility and, in some instances, contribution to decarbonization goals. To be aligned, an institution must screen projects to identify those that may be non-aligned with climate goals, leading to outcomes that "harm" or undermine the transition to a Paris-aligned economy. This is essential as aligned financial institutions must seek on one hand to scale-up positive contributions, while on the other scaling down negative impacts.

Criteria to assess the mitigation consistency of projects need to indicate whether the project corresponds to the sector's transition trajectory from fossil fuels to renewables as well as with other Paris Agreement goals (such as adaptation and resilience). Furthermore, the overall impact of actions should be aligned with the ambition level of the Paris Agreement, *i.e.*, peaking global greenhouse gas emissions as soon as possible, rapid deep decarbonization, and reaching net-zero CO_2 emissions by mid-century.

In some instances, contextualized criteria related to national decarbonization pathways may be necessary to determine whether "conditional" projects – projects that neither clearly contribute nor undermine the transition to a Paris-aligned economy -cause harm or are 'aligned', but with negligible climate-related impact. For example, depending on the ambition of energy efficiency investments and the potential of resulting locking-in of emissions, these investments may in some country contexts contribute to climate goals, but in other do 'harm' over the lifetime of the project. As a result, an assessment of these investments requires more specific criteria (*e.g.*, which sector are they targeting) to understand whether they might lock in the client into an emissions intensive pathway.

FIGURE 6: OVERVIEW OF DIFFERENT LEVELS OF ALIGNMENT



Specifically, a project's assessment process can include:

- An analysis of a project's Paris-alignment (misaligned, aligned, aligned and providing a substantial contribution, conditional[6]) using tools such as decision trees that combine a number of criteria and/or negative and positive lists for example (see also example section below);
- For "conditional" projects which are neither clearly misaligned nor aligned, sector and country specific criteria may be required. To inform this analysis, transition pathways for specific sectors and/or countries can help to break down global long-term goals and, lastly, inform decision making. This can also include an assessment of different (technical) options and their Paris-alignment contribution.

Finally, this information should be fed in early into the (financial) appraisal process.

EXAMPLES

1. AFD Sustainable Development Analysis

The AFD's Sustainable Development Analysis decision making approach includes an analysis of both the consistency and possible contribution of projects in a broader matrix analysis that not only considers the "fight against climate change and its impacts" (including how a project fits with a transition to a low carbon pathway and climate change resilience) but also five other dimensions of sustainable development including sustainable growth and resilient economy; gender equality; sustainability of project impacts and governance framework; conservation of biodiversity and management of environments and natural resources; and social well-being and the reduction of social imbalances.

Specifically, it consists of three main steps. First, a project opportunity is evaluated by a screening committee to agree on (i) the ambitions it can contribute to, for each of the 6 above mentioned sustainable development dimensions, and (ii) the specific conditions required to reach them (technical cooperation…); second, as part of the appraisal of the project, the project team evaluates the project's expected impacts on each of the 6 sustainable development dimensions. Eventually, a formal opinion is given by an independent body of AFD's Operations Division on the sustainable development contribution of the project, to assist AFD's credit committees in their decision process. A detailed methodology has been developed to facilitate these discussions and process.

2. MDB multi-criteria assessment framework, including decision trees

MDBs are in the process of developing an overall approach for assessing the alignment of new, direct investments with mitigation and adaptation goals. They use a binary (aligned, non-aligned) approach. Many projects are expected to be assessed against check lists of project and activity types (positive/negative lists) and will not need to go through detailed assessments. Specific criteria are developed for projects that do not fall under the negative lists (first screening), nor positive lists (second screening) and thus correspond to the conditional category of projects. The specific criteria take into account a country's Nationally Determined Contribution (NDC), longer term national or regional low-GHG strategies over the projects lifetime, science-based sector decarbonization pathways criteria, and others.

3. Natixis green weighting factor

In anticipation of a possible future regulatory change, Natixis developed a Green Weighting Factor to promote financing deals that have a positive climate impact and support the transition to a low-carbon economy, while providing for a negative adjustment for financing deals with environmental risks. This mechanism has applied to Natixis' new financing deals across all business sectors since 2019. Specifically, based on a 7-level color coding scale, the Green Weighting Factor applies a negative or positive adjustment of weighted assets to loans depending on the scale of the color ranging from dark brown (transactions with negative impact) to dark green (transactions with a positive impact).

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

First, 1.5°C/<2°C compatible emission pathways and/or transition scenarios are needed, possibly at the sector and/or country level. Criteria would be needed to assess specific project characteristics against these scenarios or pathways – such as GHG emissions, performance metrics or intensity measures. Project level (or ideally also asset level) data would also be required. This needs to be supplemented by information on available technological options, including best practice and best available technology.

To improve project design and impact, and/or more generally to increase buy-in for the development and/or use of the above-mentioned approaches, it is important that operational teams have the capacity and the necessary tools in this process.

6 Conditional: An investment which is neither clearly aligned, nor misaligned and therefore requires additional criteria and context to determine its Paris-alignment

STRENGTHS

Assessing individual projects consistency with the Paris goals is a critical step in the Paris-alignment process. This type of assessment allows DFIs to identify the projects and activities with potentially detrimental impacts vis-à-vis climate goals across their entire portfolio. This can also allow institutions to improve overall climate performance and impact – as well as weigh different technological options. The use of scenarios and established criteria can help improve the transparency and the replicability of the analysis across projects, sectors and operations.

WEAKNESSES

National and sector pathways are not systematically available for all countries. Available sector pathways may not include sufficient detail to assess specific project characteristics, such as technology choices, etc.

IDFC members should not only focus on the alignment of project financing but on the alignment of all of their operations.

Finally, Paris Alignment is increasingly seen as a process that must occur at the counterparty level, not only at a project-by-project level. These assessments should thus be complemented by other analyses at the counterparty level.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

The assessment of projects' consistency with the mitigation objective of the Paris Agreement is a critical step in the Paris-alignment process of a financial institution. However, it needs to be supplemented by a broader analysis of Paris-alignment, including assessments on adaptation and integration with Sustainable Development Goals, and also take into account country-specific pathways. It should be applied with priority to new investments and transactions, but should also be used to assess and identify options for addressing positive or negative impacts of existing investments. This should include both the establishment of exclusion lists for projects that are likely to cause harm and an assessment for positive contributions to the required transition.

Assessments can be challenging due to data and scenario limitations, among others. If in doubt, misalignment should be assumed. A conservative approach should be taken to activities where no clear judgement on alignment is possible and methods should be refined and updated over time.

MORE INFORMATION

- AFD Sustainable development analysis
- NewClimate Institute, Germanwatch and World Resources Institute (2020). Aligning Multilateral Development Banks' Operations with the Paris Agreements Mitigation Objectives
- I4CE (2017). Building Block of Mainstreaming: A framework for integrating climate change across financial institutions
- NewClimate Institute and Germanwatch (2018). Aligning investments with the Paris Agreement goal. Challenges and opportunities for multilateral development banks
- UNEP FI (2019). Changing Course. A comprehensive investor guide to scenario-based methods for climate risk assessment, in response to the TCFD
- I4CE (2020) Integrating Climate-related risks into Banks' Capital Requirements.
- AFD. Energy Transition – 2019 – 2022 Strategy

Name of principle, idea, type of tool:

ASSESSMENT AND MANAGEMENT OF TRANSITION RISK ON A COUNTRY LEVEL

What is the principal objective?

Within a specific country, identify exposure to transition climate-related risks – including the areas and sectors that are most exposed to climate-related transition risks.

SHORT DESCRIPTION

"Transition risk" is the financial risk that may affect financial institutions and economic actors as the result of their exposure to different potential low-carbon transition trajectories. Transition risks will vary from one country to another depending on the current specificities of the national economy, as well as how and at what pace it will transition. Such financial risks can materialize either as a loss to the borrower or even as a loss to the creditor (in case of default of the borrower).

As national economies will transition towards net zero, financial risks are very likely to materialize for a number of economic actors, and, as part of Paris-alignment efforts, it is the role of governments and public actors to accompany local economic actors in this transition and reduce their exposure to transition risk. It is thus important for DFIs to assess these transition risks at the country level to identify and measure potential of sovereign credit risk, but also as part of the dialogue with the national government on the implementation of climate policies and other actions to help manage these potential financial risks for national economies in a just manner.

These assessments should consider a range of different transition scenarios adapted to the country context. Scenarios can be used to explore a series of plausible future states if certain trends continue or if certain conditions are met. To assess transition risk at the country level, those scenarios should ideally be country (or region) specific. Possible scenarios include:

- IEA's World Energy Outlook / Sustainable Development Scenarios;
- One Earth Climate Model;
- Integrated Assessment Models;
- NGFS climate scenarios;
- PRI's Inevitable policy response.

Further analyses that take into consideration national policies as well as long-term decarbonization strategies to complete the assessment and to identify which (sub)sectors are most at risk, potential risk transmission channels within the national economy – as well as those sectors which might benefit from the transition.

This information can then be a useful input into national policy making as well as part of the policy dialogue with the country partner when discussing future projects and programs. Decisions on specific investments however need to take into account individual projects or the counterparty's (company) exposure. These assessments can however be used to identify how proposed projects might be adapted in a way reducing transition risks, for example by adapting the technology choice, and/or, ideally, contributing to transformative climate outcomes and supporting the country's long-term climate objectives.

Finally, development finance institutions could also proactively raise awareness and offer technical assistance to countries on this topic.

EXAMPLE

1. CPI's climate transition risk assessment for South Africa

CPI, with support from AFD and the Development Bank of South Africa among others, quantified transition risks and opportunities to the economy of South Africa. They identify different sources of transition risk as well as their distribution and impact on different actors, among others. In addition, they look at potential policies that may be implemented in the near future to mitigate the transition risk.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To assess transition risks, different transition scenarios at country and/or sector level are needed, in addition to national strategies and policies.

STRENGTHS

The assessment and management of transition risks at the country level helps to identify those countries (sectors and stakeholders) which are likely to be most at risk, and also provide ideas and/or an assessment of possible solutions to ensure a just transition.

WEAKNESSES

Transition scenarios that underly transition risks assessments are not always available at a country-level and may not have the national government buy-in as they might differ from the government's own analysis of transition risks (if available).

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Assessments of transition risk can provide valuable insights into how different types of risk may materialize over the course of the low-carbon resilient transition. They can help DFIs and countries identify the potential impacts of the transition on different parts of the economy and different parts of the population, allowing for the design of policies and actions to mitigate negative impacts when needed in the pursuit of a just transition and to achieve the Paris Agreement goals. Therefore, transition risk management strategies should go beyond current risk mitigation policies and targets to support Paris-aligned pathways.

They should also be incorporated into strategic decision-making beyond risk management at the country level.

MORE INFORMATION

- NewClimate Institute, Germanwatch and World Resources Institute (2020). Aligning Multilateral Development Banks' Operations with the Paris Agreements Mitigation Objectives
- I4CE (2017). Building Block of Mainstreaming: A framework for integrating climate change across financial institutions

Name of principle, idea, type of tool:

ASSESSMENT AND MANAGEMENT OF TRANSITION RISK ON A COUNTERPARTY / PORTFOLIO LEVEL

What is the principal objective?

Identify the financial risk exposure of counterparties to climate-related transition risk. Engage with counterparties and explore how to foster their transition.

SHORT DESCRIPTION

In addition to assessing the alignment of projects with the transition to low carbon economies, DFIs have the responsibility to assist counterparties transition over time, reducing their exposure to transition risk and increasing their positive impact on the transition. As part of these efforts, counterparties transition risk assessment represents one important tool to identify the most exposed counterparties, which may need to receive the support of DFIs. Transition risk will depend on a number of factors, including the sector in which the counterparty operates, its specific business stream (which in turn includes considerations such as its value chain, dependence on exports etc.) and the policy environment in which it operates.

A number of service providers and financial institutions recently started to develop and implement transition risk assessment methodologies for companies and counterparties using climate hazards and forward-looking carbon policy and technology variables as inputs in order to calculate the financial risk exposure of their clients.

The foundation of forward-looking climate risk assessment is the design of a scenario or set of scenarios that best shapes assumptions around the climate, society and the economy.

Similar to the assessment of transition risk at the country level, assessments of transition risk on a counterparty / portfolio level should take into account a range of different transition scenarios. Possible scenarios include:

- IEA scenarios;
- PRI's Inevitable policy response forecast tool (portfolio level).

In addition, the NGFS released a set of reference scenarios, which set a standard for climate scenarios for the finance sector (NGFS, 2020b). These include three principal scenarios:

- Orderly (1.5-2°C by 2100);
- Disorderly (1.5-2°C by 2100, though with greater transition risks than for an orderly transition);
- Hothouse world (3°C+ based on current policies, which do not meet even current Nationally Determined Contributions).

The final choice of tool(s) and scenarios will depend on the specific circumstances / context the DFI operates in as well as how the DFI wishes to use outcomes of the assessment.

While it is important to manage transition risks at the portfolio level, DFIs should avoid simply moving out of emissive sectors such as industry as other financial institutions are likely to pick up the divested assets or support projects. Instead, it will be important that financial institutions engage with sectoral players and individual counterparties to help them to transition their activities over time in an ambitious and robust manner and increase their contribution to the Paris Agreement objectives.

Counterparties risk assessments should thus be complemented by broader alignment / contribution assessments and outcomes of these different assessments should lead to strategic portfolio reallocation and engagement strategies aiming to maximize impact on the transition.

EXAMPLES

1. UNEP FI TCFD pilots

After the Task Force on Climate-related Financial Disclosures (TCFD) released its guidance on climate risk disclosures in 2017, the United Nations Environment Programme Finance Initiative (UNEP FI) convened a consortium of banks to pilot these new recommendations. The consortium collaborated with Oliver Wyman to develop an approach for evaluating corporate lending portfolio exposure to transition risk under different climate scenarios. A similar effort was conducted to develop a physical risk assessment methodology in collaboration with Acclimatise, a climate-focused consultancy. Several case studies were released, including one presenting how CaixaBank has applied the transition risk methodology provided to assess the change in Expected Loss in the Oil & Gas and Power Utilities sectors. The exercise has been carried out by calibrating the tool with a sample of different companies from CaixaBank's Energy portfolio for different regions according to portfolio segmentation (World, Europe, Latin America, Middle East and United States).

2. PRI's Inevitable policy response

The inevitable policy response is a forecast tool which lays out the policies that are likely to be implemented in the 2020's and quantifies the impact of this response on the real economy and financial markets. It can be used to assess transition risk at the portfolio level. It helps to assess which asset classes will be most impacts and which sectors are most at risk. All regions and key countries are covered.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To assess transition risks, climate change and climate policy scenarios at country and/or sector level are needed. In addition, company / counterparty specific data will be needed, including transition strategies, emission reduction targets, capital expenditure plans etc. – depending on the tool chosen.

STRENGTHS

These types of methodologies can be a good basis for engaging with companies and other counterparties on transition risk to promote the adoption of decarbonization strategies. Engaging with counterparties can lead to more 'real world' impact than a project-by-project approach.

A counterparty level analysis also allows an institution to produce climate-related financial risk assessments that may be more pertinent for the risk teams of an institution.

WEAKNESSES

Current methodologies and tools are still nascent, and approaches (*e.g.* choice of metric and scope) vary widely. Therefore, they differ with regards their inclusion of transition risk drivers and impact propagation channels.

In addition, transition risk assessments face many challenges:

- Uncertainty is embedded at different stages of the assessment process;
- The limited availability of counterparty-specific data is a major challenge.

However, these methodologies are also evolving rapidly, especially as a number of initiatives such as the TCFD pilot of UNEP FI are focusing on addressing these gaps and regulators are starting to implement reporting requirements for companies and financial institutions.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Tools should ideally take account of various risk sources and their interactions, and also integrate companies' own transition risk strategies.

Assessments methodologies should:

- Take into consideration different transition scenarios;
- Be forward-looking and provide information on appropriate range of time horizons (both short- and long-term);
- Have a broad perimeter in terms of transition risk drivers and impact propagation channels.

These assessment approaches should not lead to reduced IDFC members' risk appetite towards their most vulnerable clients that they can support in accelerating their transition. Risk management strategies should be developed in coherence with the development mandate of DFIs as well as with countries needs and decarbonization strategies.

These assessments should be paired with project and country level transition risk assessments as well as with physical climate risk assessments at the counterparty level.

MORE INFORMATION

- UNEP FI (2020). Beyond the horizon
- ETH Zurich and The Council on Economic Policies (2020). Climate Risk Analysis Requires Common Standards
- ETH Zurich (2020). Taming the Green Swan. How to improve climate-related financial risk assessments
- UNEP FI (2019). Changing Course. A comprehensive investor guide to scenario-based methods for climate risk assessment, in response to the TCFD
- UNEP FI (2021). The Climate Risk Landscape

6 IDFC Principle 6: Internal transformation of the institutions involving all functions of the institution

Overview of relevant principles, ideas and tools

Type of tools to inform the actions and contribute to the objective of internal transformation of the institutions involving all functions of the institution:

- Climate strategy development and implementation
- Creation of a climate team
- Management incentives and key performance indicators
- Internal capacity building across the institution
- Regular tracking and reporting on the institution's alignment (including non-portfolio operations)

Analysis of specific principles, ideas and tools

Name of principle, idea, type of tool:

CLIMATE STRATEGY DEVELOPMENT AND IMPLEMENTATION (INCLUDING REGULAR REVIEWS)

What is the principal objective?

All institutional strategic and operational decisions are informed and guided by a Paris-aligned climate strategy

SHORT DESCRIPTION

Paris-alignment requires financial institutions to support the achievement of the three goals of the Paris Agreement by scaling-down non-consistent activities and seeking whenever possible to contribute to both the incremental and transformative changes needed at the national and global levels. These considerations thus need to be mainstreamed within the broader framework of their investment strategies.

As part of these efforts, developing a climate strategy for the financial institution can be an important tool to guide all strategic and operational decisions. A climate strategy can help to define the institution's vision and contribution to the Paris Agreement objectives to fulfil its mandate. It can thus serve to firmly put the topic on the institution's agenda and provide a roadmap for its implementation. At the same time, it can also be an opportunity to identify priority investment areas (geographies, sectors, technologies etc) where the involvement of the institution can achieve maximum impact. Similarly, it can be an occasion to discuss and decide how to integrate climate into sectoral and country lending priorities, how to establish goals and deadlines for implementation.

It is important to clearly define the Scope of the climate strategy. Climate strategies are often cross cutting in nature, covering all aspects of the institution, and can take the form of an institution-wide strategy. To align with the Paris Agreement, climate action cannot be addressed in silo and considered as a specific activity or business line, even if some parts of the institution seem more impacted than others or are better placed to take the lead. Climate considerations should be mainstreamed. This can also send an important signal to the wider financial market.

The strategy can take the form of an institution-wide strategy, but also a climate action plan, climate roadmap or similar. While the form will vary from one institution to another depending on its internal strategic arrangements, it is crucial the strategy or action plan reflects the ambition level of the Paris Agreement and is broad in scope.

For the development of such a strategy/action plan, leadership at the highest level is key, and it is useful to involve different teams of the institution, including the highest level of management, to achieve necessary buy-in, and both be anchored at the management and operational levels. This can be achieved for example through board level approval and close cooperation with the Climate/Sustainability/ESG team and other operation teams of the institution.

To implement such a strategy, financial institutions could:

- Establish institutional priority areas and guiding principles including for how climate should be integrated into sectoral and lending priorities;
- Specify (both short-term and long-term) targets for key performance indicators;
- Provide incentives to management and operational team;
- Build internal capacity and facilitate knowledge sharing;
- Assign detailed roles and responsibilities.

In addition, the strategy should be regularly revised, and progress towards achieving targets should be regularly assessed. Therefore, the strategy should also detail the process and a timeline of revision.

EXAMPLES

1. EIB Group Climate Bank Roadmap 2021-2025

The Roadmap lays out how the EIB Group intends to move from "an EU bank supporting climate" into "the EU climate bank". More specifically, the EIB commits to increase on the one hand to increase its climate finance to above 50% of its overall lending by 2025, and on the other hand, to ensure that "all financing activities are aligned to the goals and principles of the Paris Agreement by the end of 2020". The Roadmap also specifies the approach on the Group intends to meet those commitments.

2. AFD's climate strategy 2017 - 2022

AFD's climate and development strategy lays out the institution's strategic objectives with regards its role and place in climate action and proposes four main targets (commitments), including the commitment to ensure a 100% Paris Agreement-compatible activity. In addition, the AFD has conducted a mid-term assessment of their climate strategy to assess whether it is on track to meet its targets/commitments.

3. IDB Group Climate Change Action Plan 2021-2025

The IDB Group Climate Change Action Plan 2021–2025 lays out an approach to further incorporate climate change and sustainability in the IDB Group's work so it can have a lasting impact as the region attempts to build back more sustainably. The plan centers on maintaining ambitious climate action by presenting key priorities at the IDB Group and regional level. It specifically focuses also on Paris-alignment.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

First, an analysis of the DFI's current mandate and portfolio should be conducted to assess how far the institution already takes into account Paris-alignment considerations. Relevant information (if available) includes volume and share of climate finance, climate finance mobilized, aligned and non-aligned finance, as well as country's of operations climate and development policies. In addition to the information needed to assess the status quo, it will be useful to consider forward-looking pathways towards low-carbon and climate resilient economies and societies, assess counterparty's investment needs which will help with the development of the climate strategy. In addition, information is needed about the institution's internal activities, including sources of emissions, carbon footprint, governance aspects.

STRENGTHS

The development of an institution-wide climate strategy contributes to establishing an institutional mandate. It also provides clear guidance to management and operational teams and, if well implemented, incentivizes action and can help foster transformative outcomes. Furthermore, a climate action plan can help keep this issue on the agenda and give a roadmap for implementation.

WEAKNESSES

A climate strategy is not sufficient in and of itself to integrate Paris-aligned considerations at the strategic level. Once objectives and investments priorities are defined, these should be further integrated into all sectoral/countries strategies.

As the Paris Agreement integrates climate considerations as part of the broader sustainability agenda, climate objectives should be integrated into a broader sustainability strategy and coherent with other objectives.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

An institutional climate strategy is an important requisite for Paris-alignment and is also the first of the five voluntary principles of mainstreaming climate action within financial institutions. It should be applied to all activities and projects – and cover both mitigation and adaptation.

The level of ambition of the climate strategy should be consistent with the level of ambition of the Paris Agreement objectives. It should ensure that the institution "does no harm" and contributes as much as possible to the decarbonization and adaptation of national economies and societies, taking into consideration the mandate of the institution.

It should be reviewed regularly to ensure it takes account of the most up to date technology, market and political developments.

MORE INFORMATION

Reports

- NewClimate Institute (2020). Raising the Game on Paris. Memo 6. Aligning Multilateral Development Banks' Internal Operations with the Paris Agreement
- I4CE (2017). Building Blocks for Mainstreaming. A framework for integrating climate change across financial institutions
- AFD (2020). Mid-term assessment of AFD climate and development strategy

Case studies

- JICA's Internal Strategy for Climate Change and 2020 financial target
- IsDB: Development of the Climate Change Policy Implementation Framework and Action Plan

Name of principle, idea, type of tool:

CREATION OF A CLIMATE TEAM

What is the principal objective?

Creation of one dedicated team responsible to oversee and support the Paris-alignment process of the institution

SHORT DESCRIPTION

The creation of a dedicated climate team within a financial institution can help put climate and Paris-alignment firmly on the agenda as well as to have a central, go to unit for all kinds of questions and advice regarding Paris alignment. According to an IDFC needs assessment, 6 out of 18 IDFC members already have a climate team. A climate team's objective is to help implement the overarching climate strategy, ensure coherency and consistency with regard to the institution's approach to Paris-alignment, and serve as support for operational teams to mainstream climate considerations. To ensure this objective can be pursued, the climate team needs to be equipped with a tailored and formal mandate and be given the necessary resources (human, financial) to perform its role - including the ability to draw on internal and external expertise. Moreover, it will need high-level support and endorsement by the management.

In addition, it is important that the climate team:

- Have clearly defined tasks and responsibilities including identifying, assessing, measuring, monitoring, and reporting on climate risks and Paris alignment;
- Sets specific KPIs linked to the achievement of the institution's climate or Paris-alignment strategy;
- Proactively identify climate risks and opportunities;
- Supports operational teams to develop capacity and knowledge;
- Works in close contact and collaboration with country and sector-focused teams;
- Regularly reports to management on progress and challenges.

The final form and where it sits in the organization will very much depend on the organizational set up and preferences. It can be staffed both with climate change experts and/or draw from other existing teams and functions of the organization. To further raise awareness for Paris-alignment, it may also be useful for the climate team to meet regularly with operational teams and offer training. Ultimate responsibility for Paris-alignment should reside with the financial institution's management.

EXAMPLES

1. AFD's climate team

The AFD has a climate-focused team (CLI) which is a cross cutting multidisciplinary support unit housed within the Operations directorate. To further raise awareness for Paris-alignment within the institution, the AFD has also set up focal points in operational teams and an independent team part of the Strategy Department is in charge of providing the Sustainable Development analysis that includes the consideration of the alignment of the operation with the Paris Agreement.

2. CDG Capital's Sustainable Development unit

CDG Capital sustainable development unit was set up following the Bank's experience over a number of years of experience with climate-related activities and involving different partners and stakeholders. Strong management support was key to successful implementation. In addition, joining networks and clubs to learn and share best practices was seen as an important part of the process leading to the establishment of the Sustainable Development Unit.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To set up a climate team, information is needed about the institution's specific needs, what function the team should play, with whom it should interact and when. In addition, the available budget to set up and run the team will need to be clarified, as well as how it should be staffed.

STRENGTHS

A dedicated climate team helps to put Paris-alignment on the agenda of the institution. It can also help to coordinate the development and implementation of new assessment processes around Paris-alignment and climate-risk management across all sectors and business units. In addition, it can support operational teams in the development of tailored instruments to leverage private climate finance and reduce market barriers. It can also lead or support the exchange with networks and initiatives on the topic and/or manage the relationship with international funds, such as the Green Climate Fund.

WEAKNESSES

Setting up a dedicated climate team will not in and of itself be enough to ensure Paris-alignment, especially if the mandate of the team is weak and/or its work is not sufficiently integrated across the institution's activities and strategies.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Setting up a dedicated climate team can be helpful in supporting Paris-alignment. To be successful, it needs to be equipped with enough resources and a suitable mandate. Incentives might help to fulfill the mandate. The climate team can also have a transversal function within the institution, or a wider Scope over time. It should also regularly report to the management and on challenges encountered. In addition, wider capacity-building across the organization is needed.

MORE INFORMATION

Reports

- I4CE (2017). Building Blocks for Mainstreaming. A framework for integrating climate change across financial institutions
- Network for greening the financial system
- Kumar (2020). Managing climate change risks. Key actions for financial institutions

Case studies

- CDG Capital sets up a Sustainable Development unit
- The Islamic Development Bank. Development of their Climate Change Policy Implementation Framework and Action Plan

Name of principle, idea, type of tool:

MANAGEMENT INCENTIVES AND KEY PERFORMANCE INDICATORS

What is the principal objective?

Measurement and alignment of board, management, and staff performance and linking them to incentive structures to support alignment efforts

SHORT DESCRIPTION

Institutions have put into place tracking and reporting mechanisms to follow progress to meeting institution's objectives. This information is principally used to assess and incentivize internal performance, but also communicate externally voluntarily or not on the institution's contribution to climate objectives.

Potential key performance indicators could include, depending on the responsibilities of managers:

- Amount of Paris aligned private finance mobilized;
- Climate finance approved/disbursed;
- Carbon emission footprint of assets;
- Emission intensity of lending portfolios or new projects;
- Portfolio exposure to climate related risks;
- Portfolio alignment with a decarbonization scenario;
- Sector specific indicators for example: MW of renewable energy capacity financed; MW of flexible electric storage capacity financed; Number of net zero energy buildings financed; Average energy label of mortgage portfolios;
- (From bank facilities) total energy consumption per full time employee including car fleets and business travel;
- (From bank facilities) share of renewables in bank facility consumption;
- Negative indicators could also be considered reflecting for example fossil fuel investments;
- Green financial product development.

The choice of the KPI should aim to support and be consistent with the achievement of the institution's objectives towards Paris alignment and thus be in line with the Paris Agreement objectives.

Aligning remuneration or other incentive structures to some of these KPI is a key measure to foster the implementation of the institution's objectives. "Incentivization" is a guiding principle of the World Economic Forum's guidance on "How to set up effective climate governance on corporate boards" and is an important measure to align interests of management with the medium to long term success and climate resilience of the bank. A variety of financial institutions, notably asset managers, have already started to establish such incentive structures in the private sector, and according to Institutional Shareholder Services (ISS), a growing number of companies are integrating climate change indicators into executive pay considerations. Most of these incentives come in the form of short-term incentives such as annual bonuses, though more companies are also exploring longer term incentive structures.

Provisions and outlining of such incentive structures should be established in the bank's overall strategy, reflected in the climate strategy and then cascaded down to individual business lines and portfolios.

EXAMPLES

1. The Interamerican Development Bank's Corporate Results Framework includes a number of climate related key performance indicators including emissions avoided (tons of CO_2e), beneficiaries of enhanced disaster and climate change resilience (number of people), habitat that is sustainable managed using eco-system-based approaches (hectares), installed power generation capacity from renewable sources (MW), and value of investments in resilience and /or low carbon infrastructure (USD).
2. Allianz Insurance Company's renumeration system includes non-financial targets such as a reduction of the carbon footprint of the company, GHG reduction, and the implementation of a step-by-step plan to achieve net-zero asset allocation by 2050 at the latest.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE/IDEA

KPIs and incentives structures should be developed on the basis of the institution's objectives and taking into consideration any potential perverse effect.

STRENGTHS

Can motivate and support management and staff to take the initiative and find innovative solutions to shift towards alignment.

WEAKNESSES

Incentive structures by themselves will not bring about alignment and must be carefully structured to overcome potential existing institutional structures such as investment targets that generate a bias towards large transactions that while smaller transactions may be needed for the decarbonization and adaptation of economies and societies.

In addition, some KPI may produce perverse incentives or lead to outcomes such as prioritizing quantity over quality and should therefore be carefully selected.

Finally, establishing KPI and establishing incentive structures require careful tracking, follow-up and accountability, including flexibility to reform and adjust to reflect to what extent management and staff behavior respond.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Incentive structures related to climate performance of bank management and staff should be based on measurable and quantifiable key performance indicators (KPIs) wherever possible minimizing room for interpretation. Incentive structures should be tested to ensure that they fulfil their objective to positively influence behaviour not only reward what may have happened anyway. Management should ensure that such incentive structures are consistent with the overall institution's mandate, integrated in business and climate strategies, and are reflective of overall long term Paris alignment objectives.

Implementation of new incentive structures to help achieve alignment goals is likely to require reviewing and changing existing policies for remuneration and career development. Such changes should be implemented in close consultation with human resources departments and staff representatives, which may themselves require capacity building about climate change and Paris alignment strategies in order to understand and more effectively implement required changes. Expectations for change should take into account the ability and agency of management and employees to respond to new incentives and alter their lending activity accordingly.

MORE INFORMATION

- I4CE (2017). Building Blocks for Mainstreaming. A framework for integrating climate change across financial institutions
- World Economic Forum (2019). How to Set Up Effective Climate Governance on Corporate Boards: Guiding principles and questions
- European Central Bank – Banking Supervision (2020). Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure
- NewClimate Institute (2020). Raising the Game on Paris. Memo 6. Aligning Multilateral Development Banks' Internal Operations with the Paris Agreement.
- Whelan (2021). Boards Are Obstructing ESG – at Their Own Peril

Name of principle, idea, type of tool:

INTERNAL CAPACITY BUILDING ACROSS THE INSTITUTION

What is the principal outcome?

Build sufficient capacity to achieve Paris-alignment

SHORT DESCRIPTION

Climate change is a complex and multifaceted issue affecting most if not all parts of a bank's business, making internal capacity building about climate change and Paris alignment essential.

Capacity building and training exercises are a key way to ensure that all bank teams and functions have the necessary background, knowledge, expertise, and resources to perform the functions demanded of them to ensure Paris alignment. Some training and awareness can be built with internal capacities and expertise, however in many cases, it is likely that banks will need further support from external experts.

Potential elements of a capacity building curriculum could include:

- The basic science of climate change;
- Monitoring reporting and verification aspects and emissions accounting (for example of the GHG Protocol);
- Background on renewable energy technologies, low-carbon transport and other climate investments across sectors (including both financing and sustainability considerations);
- International climate finance institutional structures;
- ESG and impact investing;
- NDCs and national climate policy making;
- Transition risk;
- Climate and disaster risk screening and options to enhance resilience;
- Identifying opportunities from the transition;
- Project and counter party evaluation and assessment.

Capacity building of board members and senior management is essential in order to have a strong mandate and to implement measures to move to Paris alignment. Recent research by Harvard Business School and the NYU Stern School of Business found that corporate boards often do not have the relevant expertise to recognize and respond to sustainability issues including climate. The situation is often similar in public banks. Once developed, awareness, expertise, and understanding on the board level can then help drive awareness and improved practice among management and staff.

Capacity building of operational teams is also necessary to develop the staff ability to recognize and develop appropriate responses to climate transition risk, physical climate risk, and opportunities associated with climate resilient deep decarbonization; understand climate scenarios, sectoral decarbonization options, and their related financial barriers to develop project pipelines; and ability to communicate and engage on Paris alignment with clients and other stakeholders.

Finally, the entire institution should be aware of the institution's objectives related to climate change, and why and how the institution's aim to achieve them.

EXAMPLES

1. The IDFC has launched a Climate Facility including efforts to conduct a needs assessment and capacity building program for IDFC members.
2. The TCFD knowledge hub offers online courses and case studies to learn about climate risks and opportunities.
3. A collaboration of adelphi and the GIZ have developed the Climate Finance Readiness Training (CliFiT) program to build capacity about basic climate finance considerations (for climate finance, not necessarily for Paris alignment).
4. The Renewables Academy AG has developed a Green Banking – capacity building covering energy efficiency and renewable finance (not comprehensive Paris alignment).
5. The World Bank Group's Open Learning Campus includes a number of online courses including on climate change related issues.
6. The International Finance Corporation has developed a Green Banking Academy (IFC-GBAC) to help Latin American and Caribbean banks with specialized advice and training to accelerate their green transformation.
7. The Frankfurt School of Finance and the United Nations Environment Programme (UNEP) have formed the UNEP Collaborating Center for Climate and Sustainable Energy Finance which offers a number of training options on sustainable finance.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

Capacity building could start with a survey to find out the current knowledge level of staff and management with regard to climate considerations and Paris alignment. Such a survey could serve as the basis for a gap analysis / needs assessment in terms of what knowledge is necessary to help the institution make a transition towards Paris alignment. Further, an understanding of internal staff resources including existing opportunities available to staff and management, and what other options third parties or external institutions may offer. Depending on current capacity and understanding, significant resources may be needed to build needed capacity and cost estimations including in terms of staff time and expense of external support should be considered and made a priority.

WHAT TEAMS NEED TO BE INVOLVED

Because climate change and Paris alignment are relevant for all parts of an organization, capacity will likely need to be built in on all levels and in all departments. Still, it is important to start with key functions of banks including the board, senior management, and critically human resources as well as with operational teams directly involved in the identification and assessment of projects and activities in terms of climate performance criteria.

STRENGTHS

Internal capacity building can represent a key measure to build awareness and understanding of the importance of Paris alignment, foster the development of approaches to achieve it, and encourage buy-in.

WEAKNESSES

Internal capacity building may be resource intensive depending on the current knowledge level of bank management and staff.

There is currently no “off the shelf” or “one size fits all” capacity building program tailor made for Paris alignment. Needs vary depending on the institution’s staff current expertise and capacity and the climate objectives, tools and criteria chosen to achieve them.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Before starting a capacity building program, it is important to assess existing capacity and capacity needs considering the internal transformation needed. Based on such an assessment, a determination can be made to what extent internal trainings and measures can be carried out and to what extent external expertise and training may be needed for board, management, and staff.

Internal capacity building for Paris alignment should not be seen as a one-off exercise, but rather as a dynamic ongoing process responding to the fast-moving climate change issue area. Establishing internal communications processes to share new studies and news can help bank management and staff keep up to date on latest research and developments.

MORE INFORMATION

- I4CE (2017). Building Blocks for Mainstreaming. A framework for integrating climate change across financial institutions
- NewClimate Institute (2020). Raising the Game on Paris. Memo 6. Aligning Multilateral Development Banks’ Internal Operations with the Paris Agreement
- ECBI (2018). Pocket guide to capacity building for climate change (more general, not specific for the financial sector or for Paris alignment)

Name of principle, idea, type of tool:

REGULAR TRACKING AND REPORTING ON THE INSTITUTION'S ALIGNMENT (INCLUDING NON-PORTFOLIO OPERATIONS)

What is the principal objective?

Report and disclose regularly on the institution's Paris-alignment

SHORT DESCRIPTION

DFIs increasingly track and report upon the financial resources available to them. They also face a wide range of voluntary, recommended and obligatory reporting requests. These requests relate to risk assessments, impact measurements or financial commitments and are associated with a range of reporting tools and methodologies (see **Principle 1 for climate finance reporting**). For DFIs to become fully Paris-aligned, it is important to track and report on the institution's contribution to climate objectives. Moreover, it is critical to ensure that reporting incentivizes Paris-aligned and transformative investments that contribute to the transition to low-carbon and climate resilient economies. Reporting can be done following the TCFD reporting guidelines (also example section below).

As public banks, it is important for IDFC members to disclose the financial materiality of climate-related risks as well as the environmental materiality of all of their activities in order to facilitate overall transparency, including reporting to their shareholders and the public. For mitigation, this may include the institution's alignment across all emission sources:

- Scope 1 emissions: Emissions caused directly by the institution, *e.g.*, from its own car fleet;
- Scope 2 emissions: Indirect emissions from the use of heating and/or cooling;
- Scope 3 emissions: Financed emissions, but also emissions caused by employee commuting, (air) travel (other indirect emissions not covered by Scope 2).

To be Paris-aligned, emissions across all those categories need to be reduced to a minimum. While internal operations likely have a small impact on overall emissions, especially development finance institutions have a role model function. Therefore, in a first step, it is important to measure the institution's current carbon footprint across all its activities. This could be done by appointing specific staff for this task. Interdepartmental exchange is likely needed to perform the work.

In a second step, (technological, financial) options for reducing emissions to a minimum should be discussed. For staff buy-in, it is beneficial to involve a number of different staff/teams in this discussion. For example, it could be discussed whether and how air travel could be avoided as much as possible, by using other modes of transport (*e.g.* train) or by organizing meetings virtually. The climate team could steer and/or facilitate this process. Final responsibility should remain with management.

Reporting should be carried out once a year, and can be combined with the institution's annual reporting on climate finance or other relevant annual reports. Reporting should cover both portfolio and non-portfolio operations. In addition, institutions should also disclose their methodology for tracking Paris-alignment.

EXAMPLES

1. TCFD reporting framework

The Task Force on Climate-related Financial Disclosures (TCFD) has developed a framework to help companies, including banks and other organizations to guide their more effectively disclose climate-related risks and opportunities disclosures. The framework includes four main dimensions for which specific guidance is provided: governance, strategy, risk management, and metrics and targets. In addition, based on the recommendations, UNEP FI has developed an action-oriented UNEP FI TCFD Banking Pilot Project which provides specific advice to banks on how to operationalize the TCFD guidelines While these recommendations were developed mainly for institutions with commercial purposes, some developments finance institutions such as the EBRD, the EIB or KfW are adapting them to their development mandate.

2. AFD climate activity report

The AFD publishes an annual activity report which provides details on the group's activities with regards its climate change commitments, including a breakdown to regions, sectors and by instruments.

3. EIB carbon footprint tracking

The EIB has tracked its internal carbon footprint for ten years and published a de-tailed emissions inventory in April 2019.

WHAT INFORMATION IS NEEDED TO USE THE TOOL, IMPLEMENT THE PRINCIPLE / IDEA

To track and disclose the institution's alignment with the Paris Agreement goals, the institution needs to know the amount of investments allocated to non-aligned and aligned activities, as well as the amount of climate finance and mobilized climate finance. When available, information on the impact of operations would be necessary as well.

To report following the TCFD recommendations, information in the financial risk exposure related to climate risks would be needed.

In addition, for non-portfolio operations, it needs to know its current Scope 1-3 emissions, thus covering both internal and external activities. To reduce its carbon footprint, the financial institution needs information about technological options for the reduction of the institution's emissions, and potentially resources needed to implement them (also see the information on climate strategy above).

STRENGTHS

Tracking and reporting on the institution's alignment helps to identify gaps and where increased efforts are needed to fully align with Paris. It can thus enable the management to make informed decisions in adjusting the climate strategy and climate-related targets.

In addition, disclosing this information conveys accountability and transparency. This can have positive effects also on other financial institutions.

Tracking the institution's carbon footprint and its own Paris-alignment helps to understand the institution's impact on emissions and status quo re Paris-alignment.

WEAKNESSES

Tracking and disclosing information about the institution's Paris-alignment, does not by itself ensure Paris-alignment. For example, recent evidence suggests that many financial institutions that use the TCFD guidance to report on climate-related risks and opportunities, report to a large extent only non-material climate risk information. The criteria used to measure, and track Paris-alignment of the institution are key. However, as alignment strategies vary from one institution to another no one single criteria will be enough.

USE RECOMMENDATIONS TO SUPPORT PARIS-ALIGNMENT

Measuring and reporting on the institution's alignment with the Paris Agreement goals is highly recommended. As part of Paris alignment efforts, DFIs should clearly present their strategy to be Paris aligned, the sub-targets they have set for themselves, how they aim to achieve these targets and how they monitor this. It is important the methodology used for monitoring and tracking is pertinent with regards to the specific objectives of the institution and scientifically robust and aligned with the goals of the Paris Agreement. Tracking should include all internal and external activities of the institution and focuses on the impact of the institution on the real economy. Finally, reporting should be done regularly.

MORE INFORMATION

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- NewClimate Institute (2020). Raising the Game on Paris. Memo 6. Aligning Multilateral Development Banks' Internal Operations with the Paris Agreement.
- World Resources Institute, Germanwatch and NewClimate Institute (2019). Towards Paris Alignment. How the Multilateral Development Banks can better support the Paris Agreement (only financed emissions)
- EIB Group Carbon Footprint Report 2018 (internal emissions)
- EIB Group Annual Sustainability Report (financed emissions)
- Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures
- UNEP FI. TCFD Banking pilot projects

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Annex

TABLE 1: INVENTORY OF TOOLS AND OVERARCHING ACTIONS WHICH CAN SUPPORT PARIS-ALIGNMENT

Actions and tools highlighted in bold have been short-listed and analyzed in more detail in the framework

IDFC commitment / principle	Level	Overarching Actions	Example of approaches and tools
1	STRATEGY	**Have the senior management take institutional commitments to contribute to climate objectives**	**Climate finance targets (different forms of climate finance targets)**
			Qualitative / Impact objectives
	OPERATIONAL	**Develop an institutional definition for what constitutes a contribution to adaptation and resilience**	**Definition of climate finance for mitigation (Positive lists / taxonomy, KPIs, exclusion lists, emissions thresholds / GHG accounting)**
		Develop an institutional definition for what constitutes a contribution to mitigation / transition risk / what it means to foster a transition from fossil fuels to renewables	**Definition of climate finance for adaptation (Process-based approaches / taxonomy, KPIs / metrics)**
		Report and disclose publicly on contribution / hindrance of the institution (all operations) to climate objectives	**Reporting for climate finance**
			Disclosure on sustainable activities
2	STRATEGY	Include support to country-led climate related policies as a strategic investment priority	Country support for climate-related policies objective
		Define objectives of policy-based lending for climate relevant sectors	Sector objectives
	OPERATIONAL	**Analyze countries' strategies**	**Country policy analysis including Nationally Determined Contributions (NDCs) and Long-Term Strategies (LTS)**
			Sectoral analysis of investment opportunities
		Assess climate investment needs to achieve the country's national pathway for low-carbon climate-resilient development	Domestic climate investment landscape presenting current investments in relation to national objectives
		Engage with countries to identify and agree on priorities for support	Integration of climate considerations early in the process of country programming
		Develop instruments to support enabling policy and regulatory environments, technical capacities and institutions' strengthening to enable the translation of NDCs and longer-term climate strategies into policies, investments plans and projects	**Country policy development and implementation support**

3	STRATEGY	Define private sector mobilization as an investment priority	Private finance mobilization target
		Define an engagement policy with non-aligned counterparties	Engagement policy including the support to clients – not only countries – in establishing a climate strategy (low-carbon and or adaptation)
	OPERATIONAL	Identify barriers to and opportunities for private sector mobilization	Barrier analysis and sector surveys
		Use and develop finance instruments and support mechanisms to foster private sector mobilization	**Targeted green financial instruments (Green credit lines with various terms, guarantees, risk sharing mechanism, public-private partnerships, green bonds, etc.)**
		Leverage additional sources of financing (international and domestic)	**Leveraging of international climate funds (GCF, GEF, AF), GCF accreditation**
			Leveraging of international financing through local banking network (Green credit lines)
		Track and report on private finance mobilized	**Methodology for tracking private finance mobilization**
		Build capacity in the private sector	Information campaigns, helpdesks, workshops, specific technical assistance
		Support innovation	Direct financing of research and development, demonstration, and scaling of projects
			Project development facilities
4	STRATEGY	Develop/update a climate-related management risk policy, integrated in the broader risk management policy of the institution	Climate risk management policy for physical risk
	OPERATIONAL	Assess and manage adaptation consistency/harm of counterparties based on sector specific criteria	N.A.
		Assess and manage adaptation consistency/harm of individual operations based on sector specific criteria	Assessment and management of alignment with the adaptation goal (or non-alignment/harm) on a project level (*e.g.*, MDBs decision trees)
		Assess climate risks exposure of national economies	**Assessment of physical climate risks exposure of national economies**
		Assess and manage physical risk at the project level	**Assessment of physical climate risk at the project level**
		Assess and manage physical risk at the counterparty and portfolio level in line with Paris aligned strategic priorities	**Assessment and management of physical climate risk on a company/portfolio level**
		Evaluate, track, and report on climate impact for adaptation increased resilience	Assessment of impact for adaptation at the project and portfolio level

5	STRATEGY	Develop/update a climate-related management risk policy, integrated in the broader risk management policy of the institution	Climate risk management policy for transition risk
	OPERATIONAL	**Assess and manage mitigation consistency/harm of individual operations based on sector specific criteria**	**Assessment and management of alignment with the transition (or non-alignment/harm) on a project level (*e.g.*, MDBs decision trees)**
		Assess and manage mitigation consistency/harm of counterparties based on sector specific criteria	Assessment and management of mitigation consistency/harm of counterparties though set of criteria (*e.g.* IIGCC) and target setting (*e.g.* Pacta module, NZAOA Protocol)
		Assess transition risks exposure of national economies	**Assessment and management of transition risk on a country level**
		Assess and manage transition risk at the project level	Assessment and management of transition risk on a counterparty/portfolio level (*e.g.* Shadow carbon price)
		Assess and manage transition risk at the counterparty and portfolio level	**Assessment and management of transition risk on a counterparty/portfolio level**
		Evaluate, track, and report on impact for mitigation at the project and portfolio level	Assessment of impact for mitigation at the project and portfolio level (*e.g.* GHG accounting methods)
6	STRATEGY	Review compatibility of the institution's mandate with Paris alignment objectives	Adjustment of the institution's sustainability mission statement
		Define strategic investment priorities consistent with the institution's desired contribution to the Paris Agreement objectives and develop new & update existing policies and action plans for areas of intervention and/or markets (overarching, sector, geographies, asset classes)	**Climate strategy**
			Sustainability strategy integrating climate considerations
			Paris alignment considerations mainstreamed into sectoral and country policies
		Develop an institutional architecture to support reaching alignment targets	Climate change operational framework
			Creation of a climate team
			Creation of transversal working group for the assessment and management of climate-related risk
			Appointment of focal points supporting operational teams in the assessment of climate performance and risk exposure
		Develop a strategy to reduce the institution's internal operations impact on climate change	Emission reduction target at the company level
			Targets for mobility, buildings, energy efficiency, energy use and other areas
	OPERATIONAL	Adjust incentive structures and support system	Ensure that current incentives are in line with alignment objectives
			Operational team incentives
			Management incentives and key performance indicators
		Build internal capacity	**Internal capacity building across the institution (operations, risk management, funding and treasury, middle-office and support, management of bank owned assets, purchase, etc.)**
		Implement operational rules and procedures to minimize climate impact of bank operations	Rules and procedures for procurement
			Investment policies for treasury
			Business travel guidelines
			Energy use guidelines
			Employee commuting support
		Track and report on the institution's alignment (including portfolio and non-portfolio activities)	**Regular tracking and reporting on the institution's alignment (including non-portfolio operations**

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