International Development Finance Club

IDFC Position Paper

Aligning with the Paris Agreement

December 2018

The Paris Agreement bears significance to development finance institutions. Several articles of the Agreement recall it is to be implemented "in the context of sustainable development", thus recognizing "the intrinsic relationship that climate change actions, responses and impacts have with equitable access to sustainable development and eradication of poverty". Additionally, the Agreement entails strong expectations regarding finance, one of its core objectives being to "*make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*". To date, the Paris Agreement was ratified by 182 Parties to the UNFCCC, out of 197.

In this context, the concept of aligning finance with the Paris Agreement has emerged over the past couple of years as the new frontier for increasing climate action ambition within the financial community. The concept integrates the fact that entire financing and investment portfolios, beyond the shares that are directly beneficial for the climate and traditionally classified as climate finance, need to be made consistent with the Paris Agreement, including its long term goals.

A number of development finance institutions have initiated work in this area, as illustrated among others by the commitment of the International Development Finance Club (IDFC), along with the Multilateral Development Banks (MDBs), to "align financial flows with the Paris Agreement" (see statement released during the One Planet Summit in December 2017 in Annex). The topic of "alignment" has become fertile grounds for research as well, with substantial analytical work being carried out by prominent think tanks and other key stakeholders such as the OECD. It has also become a subject of discussion in the international negotiations of the UNFCCC.

The connection of urgent climate action with the desired longer term objectives is complex and requires not only conceptual and operational innovations, but also collective understanding and work to generate new knowledge and get it right. The present position paper summarizes some of the current thinking within the IDFC about the concept of alignment with the Paris Agreement, and its implications for the Club and its members. Its objective is to foster collaborative thinking amongst IDFC members and with the broader climate finance community on the topic.

1. Significance of the Paris Agreement for IDFC members

➔ IDFC members' mandates resonate with climate change issues

IDFC members are leading national and regional development banks from around the planet. Their development mandate, as given by their respective constituencies, explicitly includes climate action and/or is in all cases impacted by the changing climate, in terms of both risks and opportunities. The Club's raison d'être is to join forces as a platform to promote and leverage sustainable development worldwide, fostering the implementation of the Sustainable Development Goals (SDGs) and the Paris Climate Agreement agendas.

➔ IDFC members can provide useful policy feedback or advice to their constituencies

IDFC members have the unique function of supporting domestic/regional policies while transferring international priorities into their own constituencies. As such, they can have a structural impact on the development pathways of their countries/region with regards to the Paris Agreement, in terms of GHG emissions or vulnerability. IDFC members' close ties to their national governments and/or those of the region within which they operate, allow them to provide direct feedback or advice on policy formulation or implementation, including on their respective countries' NDC, which are to be revised by 2020, and on the longer term (2050) climate strategy also called for by the Agreement.

➔ **As national development banks, IDFC members have in depth knowledge of the social and economic fabric of their country/region**

For example through their networks of local offices, or a wide spanning portfolio of clients, including local government and businesses. Knowledge of the country context, stakeholders and political economy provides key necessary insights to implement the Paris Agreement and to identify risks and opportunities.

➔ **IDFC members can influence finance flows beyond their own operations**

Their mandate and practices are well observed and often interpreted as policy or market signals in their countries.

➔ **IDFC members play a leading role vis-à-vis the community of financial institutions within their respective countries and regions**

They are in a position to partner or otherwise organize initiatives with their local financial markets. The sensitivity of financial actors to regulation is very strong and the adoption of a new system of best practices and incentives can be very fast. IDFC members can be at the forefront of this transformation.

➔ **IDFC members are well poised to catalyze private sector investment**

In their respective countries and regions of operation, IDFC members play a fundamental role in directing international but also local capital towards climate-smart and sustainable investments (e.g. green infrastructure), by demonstrating the opportunities and potential returns, and by reducing the risks associated with them. At the same time, IDFC members can actively contribute to mainstreaming the sustainable development and climate agendas across all sectors, in accordance with their mandates.

2. "Aligning" with the Paris Agreement

The acceptance of the "alignment" with the Paris Agreement should be first sought in the agreement's three long-term goals, described in its Article 2. The first two goals relate to the limitation of global temperature rise well below 2°C, and 1.5°C if possible, and the strengthening of adaptation capacities. The third goal is "to make all financial flows consistent with a pathway towards low-emissions, climate-resilient development" (Article 2.1.c). As such, it directly concerns development funders who produce, and can influence, financial flows. Article 2.1.c leads to consider "pathways towards low-emissions, climate-resilient development" at country level, and thus countries' long term climate and development strategies. This is consistent with the bottom-up, country driven nature of the Paris Agreement processes such as NDCs.

➔ **As national and regional development finance institutions, IDFC members consider Article 2.1.c of the Paris Agreement to be the guidepost of their alignment**

This approach appears consistent with much of the work being currently undertaken by international organizations like the OECD, as well as prominent think tanks like Germanwatch, WRI, E3G and others. The implementation of Article 2.1.c also is at the core of climate finance discussions in the international negotiations on climate, and the topic will be part of the 2018 edition of the assessment report of the UNFCCC's Standing Committee on Finance.

The underlying implication of Article 2.1.c is that all financial flows would be made compatible with the other two long term goals of the Agreement, or that no financial flow should be found to be inconsistent with them. This has far reaching impacts on the management of operations and of the portfolio of the IDFC members as development finance institutions.

➔ IDFC members' alignment commitment and actions

IDFC members' commitment to align financial flows with the Paris Agreement was highlighted in a joint statement issued during the One Planet Summit in December 2017, together with the Multilateral Development Banks. For the IDFC, such commitment involves the following:

IDFC members committed to increasingly mobilize finance for climate action

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.

IDFC members will support country-led climate related policies

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.

IDFC members seek to catalyze investments, and to mobilize private capital (local & international)

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.

IDFC members recognize the importance of adaptation and resilience, especially in most vulnerable countries

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.

IDFC members support the transition from fossil fuels to renewables financing

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.

Aligning with the Paris agreement is also a process of internal transformation of the institutions, which can build on existing principles and/or practices

Many IDFC members have promoted and endorsed 5 voluntary principles for mainstreaming "Climate Action within Financial Institutions[1]", 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.

[1] https://www.mainstreamingclimate.org/5-principes/

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[2] (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.

➔ **The importance of collective action: IDFC is a platform for cooperation between members and with other climate finance partners to continuously advance on the “alignment” objective**

An illustration of this cooperative spirit between members and with other partners is the collaboration with the Green Climate Fund (GCF). As of today, 10 IDFC members have been accredited to the GCF, while several others are currently in the process of being accredited. IDFC represents the main group of financial institutions entrusted by the GCF to implement its resources, a signal not only of the current evolution of the sustainable development financing architecture, but also of IDFC’s role as platform for advocacy, vision and action to address climate change and foster related action.

As a platform, IDFC also aims at facilitating international cooperation between the different groups of actors working on the alignment of financial institutions with the Paris Agreement, such as the MDBs, other public and private financial institutions, relevant international organizations, think tanks and civil society. Among others, and since 2015, the Club regularly organizes IDFC Climate Finance Forums and related events, as one of the major gatherings of the global climate finance community. IDFC recently decided to set up in 2019 an IDFC Climate Facility, an innovative instrument to further institutionalize and to facilitate collaborative work among Club members on climate change, and to strengthen the capacity of such leading national and regional development banks worldwide to originate and to develop climate mitigation and adaptation projects as well as new and joint business opportunities in this area.

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About the IDFC

IDFC, created in 2011, is the leading group of 24 national and regional development banks from all over the world, a majority active in emerging markets. IDFC is the largest provider of public development and climate finance globally, with USD 4 trillion in combined assets and annual commitments above USD 850 billion, including USD 200 billion of climate finance. IDFC members have the unique function of supporting domestic policies while transferring international priorities into their own constituencies. IDFC members are aligned with and work together to implement the Sustainable Development Goals (SDGs) and the Paris Climate Agreement agendas. Through IDFC, and in close partnership with other development bank networks, members join forces as a platform to promote and leverage sustainable development investment worldwide.

[2] The Financial Stability Board established the TCFD in 2016 to develop recommendations for voluntary climate-related financial disclosures. In June 2017 the TCFD released key documents to describe its recommendations: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf

Our members

24 Members from developed and developing countries

EUROPE

Black Sea Region (Location: Greece)
Black Sea Trade and Development Bank (BSTDB)

Croatia
Croatian Bank for Reconstruction and Development (HBOR)

France
Agence Française de Développement (AFD)

Germany
KfW Bankengruppe

Italia
Cassa depositi e prestiti (CDP)

Russia
Vnesheconombank (VEB)

Turkey
Industrial Development Bank of Turkey (TSKB)

AFRICA

Morocco
Caisse de Dépôt et de Gestion (CDG)

Eastern & Southern Africa Region
(Location: Burundi & Mauritius)
The Eastern & Southern African Trade & Development Bank (TDB)

South Africa
Development Bank of Southern Africa (DBSA)

Western Africa Region (Location: Togo)
Banque Ouest Africaine de Développement (BOAD)

ASIA AND MENA

China
China Development Bank (CDB)

India
Small Industries Development Bank of India (SIDBI)

Japan
Japan International Cooperation Agency (JICA)

South Korea
The Korea Development Bank (KDB)

CENTRAL AND SOUTH AMERICA

Brazil
Banco Nacional de Desenvolvimento Econômico e Social (BNDES)

Central and Latin America Region (Location: Venezuela)
Development Bank of Latin America (CAF)

Central America Region (Location: Honduras)
Central American Bank for Economic Integration (BCIE/CABEI)

Chile
Banco Estado (BE)

Colombia
Bancoldex S.A.

Mexico
Nacional Financiera (NAFIN)

Perú
Corporación Financiera de Desarrollo S.A. (COFIDE)

INTER-REGIONAL INSTITUTIONS

Islamic Corporation for the Development of the Private Sector (ICD)
(Location: Saudi Arabia)

The International Investment Bank (IIB)
(Location: Russia)

www.IDFC.org   @IDFC_Network   International Development Finance Club (IDFC)

Annex

Joint IDFC-MDB Statement

Together Major Development Finance Institutions Align Financial Flows with the Paris Agreement

The global development agenda is being transformed in fundamental ways. The Sustainable Development Goals (SDGs), agreed upon by the international community, constitute a universal compass, highlighting the need for systemic and collective action for sustainable, equitable and inclusive development for everyone on this planet. The imperative for mobilizing and shifting financial flows, public and private, towards sustainable development was highlighted by the 2015 Addis-Ababa Financing for Development Conference. The Paris Agreement reached at COP21 recognized that all countries and stakeholders must act to combat climate change. Since the Agreement's entry into force in 2016, the momentum for climate action has become irreversible.

Development Finance Institutions (DFIs) play a pivotal role in scaling up and directing climate finance, and in helping shape the policies and regulations needed to transition to low-carbon, climate resilient development, including achieving net zero emissions in the second half of this century. Development banks – national, regional, international and multilateral - represent some of the largest providers of public finance for sustainable development. Together, they can facilitate and accelerate the implementation of the Paris Agreement, continuously raising their ambitions.

Members of the International Development Finance Club (IDFC)[1] and the Multilateral Development Banks (MDBs) play a fundamental role in directing capital towards sustainable investments by demonstrating the opportunities and potential returns, and by reducing the risks associated with them. At the same time, IDFC members and MDBs can actively contribute to mainstreaming the sustainable development and climate agendas across all sectors, in accordance with their mandates. Their total annual climate finance commitments have increased over the last few years, and continue on an upward trend.[2]

Members of the IDFC and MDBs are increasing their climate financing in mitigation and adaptation. They also continue to: mobilize external investments for climate actions; jointly lead on the transparent tracking and reporting of climate finance flows and impacts; support the implementation of the Nationally Determined Contributions (NDCs); and facilitate activities that transition development to low-carbon and climate-resilient pathways.

Today, at the 2017 One Planet Summit organized in Paris, building on their proven capacity and combining the power of DFIs worldwide and at all levels, IDFC and MDBs commit to deepen their collaboration, with each other and with other interested entities, in order to:

- Further embed climate change considerations within their strategies and activities, and promote the mainstreaming of climate action throughout the financial community, inspired by the five voluntary Principles for Mainstreaming Climate Action within Financial Institutions. Specific attention will be devoted to managing climate risk and to the integration of climate resilience and adaptation.

[1] See www.idfc.org.

[2] The MDBs annually publish the Joint Report on MDBs' Climate Finance. The 2016 report is available at: http://www.ebrd.com/2016-joint-report-on-mdbs-climate-finance.pdf

The IDFC reports Green and Climate Finance Data through the Green Finance Mapping reports (www.idfc.org/Our-Program/green-finance-mapping.aspx).

- Redirect financial flows in support of transitions towards low-carbon and climate resilient sustainable development. Building on what is already being done, this will increase the overall amount or share of finance that goes towards climate action.
- Catalyze investments to address new economic, social and environmental challenges and opportunities related to climate change, in particular by using their capital to mobilize additional private capital and to blend their financing most effectively with other sources to drive climate action and results.
- Pursue the development of processes, tools, methodologies and institutional arrangements that make it possible to design and implement climate action at the required scale. This includes reinforcing the collaborative effort between DFIs to improve the quality, robustness and consistency of climate finance tracking and reporting through the sharing of best practices and knowledge and by increasing the transparency and accessibility of their climate finance data. It also involves the development of a common framework for tracking progress towards achieving resilience, to be shared by COP24.
- Collaborate with national and sub-national governments in promoting the reduction of greenhouse gas emissions, including through developing sustainable alternatives to fossil fuel investments, based on national circumstances and contexts, and prioritizing the financing of these alternatives. This should involve the implementation of instruments or measures to shift investments to sustainable asset classes, such as: the use of a shadow price of carbon; reporting of greenhouse gas emissions; assessments to avoid the potential for stranded assets; employing measures to avoid deforestation and encourage improved land use; or putting in place more explicit policies to significantly reduce reliance on fossil fuels and rapidly accelerate financing for renewables.
- Support the development of enabling policy and regulatory environments, at both national and sub-national levels, in conjunction with the private sector and civil society, while remaining focused on the most vulnerable populations. IDFC members and MDBs will continue to deepen this work and increase country-level coordination between institutions. As per their respective mandates, IDFC members and MDBs will continue to contribute to policy dialogues, develop technical capacities of clients, and strengthen institutions to enable the translation of NDCs into policies, investment plans and financeable programs and projects, as well as into incentives for the business community.
- Further support countries and partners to accelerate climate action and ambition by 2020, including the development of long-term 2050 decarbonization pathways and strategies to reach zero net emissions and promote shorter-term actions that provide the building blocks for achieving these longer-term development pathways.

Poverty eradication and sustainable development goals cannot be met unless there is a collective push to address climate change at the same time. To accelerate impact, it is particularly important for all development partners to come together, move forward on their enhanced commitments, and raise the internal and external ambition on climate.

As public actors with long-term mandates, DFIs have a responsibility to contribute to the collective governance and action needed to fight climate change. Turning the Paris Agreement into concrete action requires new cooperative approaches. In this spirit of collaboration, the IDFC members and MDBs are teaming up, two years on from the historic moment at COP21, to reaffirm their joint commitment to align their financial flows with the Paris Agreement.