ALIGNING FINANCE WITH THE SUSTAINABLE DEVELOPMENT GOALS

A CONTRIBUTION FROM THE

INTERNATIONAL DEVELOPMENT FINANCE CLUB (IDFC)

Draft version as of October 27, 2020

The present document aims at providing a set of messages from IDFC and its members within the framework of the Finance in Common Summit, which they initiated together with the World Federation of DFI (WFDFI). It is built around previous IDFC position papers[1], on IDFC's mandate as set in 2018 and on the extensive work conducted by IDFC members on aligning finance with the Paris Agreement and the Sustainable Development Goals (see IDFC website and boiler at the end of this paper).

Despite sustained global growth and social improvement, it is well acknowledged that the global economy is not advancing towards the Sustainable Development Goals (SDG). It still remains on an unsustainable trajectory, with persistent mass poverty, predominance of emissive investments, destruction of the ecosystems and growing inequalities.

Climate change and biodiversity loss continue to threaten sustainable development in all regions. The COVID-19 pandemic and its subsequent global socio-economic crisis has further impacted our development pathways. These current challenges reinforce the urgency of adopting national and global approaches to financing sustainable development and achieving sustainable development in way that leaves no one behind.

The adoption of the SDGs in 2015 set a common agenda to be achieved by 2030, providing a systemic framework for sustainable development strategies. The Paris Agreement set out one objective particularly relevant for the financial sector: to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development; the Sendaï Framework defines priority areas to increase safety and resilience, by investing in disaster risk prevention and reduction, for effective response, and to Build Back Better in recovery ; the Addis Ababa Summit highlighted the importance of mobilizing the entire financial system, including domestic and private sector financing for development, but the financial tools to implement it and the frameworks to assess its progress have yet to be defined and the implementation of its action plan scaled-up and accelerated. The 2030 Agenda remains incomplete in terms of financial arrangements.

Public Development Banks (PDBs)[2] have a unique role to play in reorienting economy towards the SDGs, by bridging market failures, by mobilizing government institutions, financial markets, private sectors and civil society, by linking global issues with local solutions. In this unprecedented context, they are more than ever relevant to contribute to the reconciliation of short-term counter-cyclical responses to the crisis with sustainable recovery measures that will have a long-term impact on the

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[1] IDFC Rio+20 Declaration, issued on June 2012 ; a resource paper on green growth in the Post-2015 development agenda, entitled "The Role of International Development Finance towards Sustainable Development" released in March 2013; (iii) "IDFC Messages for the Financing for Development Conference", issued in July 2015 in Addis-Ababa.

[2] There are about 450 Public Development Banks around the world, operating at sub-national, national, regional, international and multilateral levels. The volume of activity of these institutions amounts to about USD 2,3 trillion annually – a staggering 10 percent of the total amount invested in the world every year.

people and planet; and to support multilateralism, because safety, resilience and sustainability suppose enhanced forms of cooperation, embodying SDG 17.

As a leading group of national and regional development banks, committed to work jointly to reach the SDGs and the Paris Agreement, IDFC is presenting its contribution in the framework of the Finance in Common Summit to improve the fundamental drivers of sustainable recovery towards the achievement of the Sustainable Development Goals.

IDFC's contribution to respond to the COVID-19 crisis while serving the SDGs

Facing COVID-19 and its social and economic impacts, IDFC members have been mobilizing their full set of instruments and financial capacity. They were challenged to provide a prompt response to the crisis, **adapting their business model and operations, including governance, funding sources and instruments**. In particular, members have provided a stronger alignment with beneficiaries' needs of maintaining jobs and ensuring survival of companies: they have been supporting sectors more exposed to the crisis, including healthcare equipment and services, and priority SDGs[3] ; they increased their support to existing clients, with rapid disbursement mechanisms, restructuring of repayment plans, extension of grace periods and additional resources on existing exposures (cf. IDFC website and press communiqué).

Members have been able to accelerate their appraisal and decision making process, while carefully monitoring risks, such as with more frequent and lean board decision, which allowed for the rapid implementation of contingency loans and massive reallocation of funding, where it was most needed.

Some members have been using innovative tools (guarantees, fintechs, covid bonds, securitization) to support new lending and ensure better efficiency in operations. They also leveraged non-financial instruments such as research activities, project preparation and capacity building services to define relevant approaches and complement their financial offer in response to the crisis.

IDFC members have been working together to explore and implement joint initiatives regionally in order to create synergies in the response to COVID-19 by leveraging resources to better support their beneficiary countries.

Also benefiting from regulatory relief or specific mandate and additional resources from their respective Governments (through grants, sovereign guarantees, interest rate subsidies), IDFC members have played a countercyclical role to respond to the COVID-19 crisis with a significant increase of their lending volumes, more than 50% in average and even a doubling of commitments for some member institutions, according to their mandate and sectors of operation.

Still, the Covid-19 crisis **has not affected the strategic objectives of IDFC members in terms of climate and SDG finance**. IDFC members support their country's SDGs action plan and long-term strategy under the Paris Agreement and tend to define ambitious goals according to country needs. IDFC is committed to capitalizing on its member's respective experiences to structure the most adequate collective answer in supporting sustainable and inclusive economic recovery.

IDFC has been actively engaged in the UN Financing For Development process[4] through the Discussion Group "Recovering Better for Sustainability" and contributed to the policy options to recover from the current crisis in the short term, to mobilize the financial resources to contribute to the 2030 agenda and the SDGs in the medium term and to build the resilience and sustainability of countries and the

[3] SDGs 8 (Decent Work and Economic Growth)/ 3 (Health and well-being)/ 1 (No poverty)/ 9 (Industry, Innovation and Infrastructure)/ 17 (Partnership for the Goals)/ 2 (Zero Hunger)

[4] Whose objective to review the Addis Ababa Action Agenda and other financing for development outcomes and the means of implementation of the SDGs.

global financial architecture in the long term. The Finance in Common Summit and its aftermath will be an important milestone in the follow-up of this process, and a place of implementation and action.

IDFC is aiming at aligning its investments with the SDGs and the Paris Agreement

As public actors with long-term mandates, IDFC members have a critical economic and financial role in the area they operate. USD 600 billion is the annual amount of investment IDFC's members have financed, at least, over the last years, and IDFC has the potential to mobilize significantly higher amounts. **IDFC is willing to align its investment with the SDGs and the Paris Agreement.** At the UN Climate Action Summit in September 2019, IDFC strengthened its quantitative and qualitative contributions to low carbon and climate resilient development, stating its potential to mobilize more than USD 1 trillion of climate finance by 2025 (cf. IDFC Climate Action Communiqué).

IDFC shares the collective recognition that shifts in development models are necessary to advance towards sustainability. Members are willing to increasingly include climate and SDGs considerations into their strategies, governance, risk management and business model. However, there are still a few barriers, common to other PDBs, which must be overcome to optimize a full uptake of these principles.

Depending on country contexts, this may include **the explicit mention of climate and sustainable development considerations in the mandates of development banks**. SDG-related incentivizing mechanisms for PDBs should be promoted with their respective Governments: PDBs should increase their contribution to national policy making, requesting from their Government increased support, enabling financing schemes and collaboration to commonly achieve the 2030 agenda.

In particular, there is insufficient capacity in terms of methodologies, for translating SDGs and Climate principles into action and for integrating them across the organization at all levels. Besides, the mismatch between donor's ad client's appetites should be noticed. PDBs could face difficulties in incorporating ambitious climate and SDG standards into bankable projects while at the same time fulfil requests and needs of client sometimes disconnected from the sustainability agenda. Grant resources for project preparation and capacity building to align borrowers' strategies and operations with climate and SDGs are of particular importance in that regard.

Besides, the current regulatory frameworks influence business decisions of IDFC members in sustainable finance - mostly impacting SDGs 13 (Climate Change), 7 (Clean Energy), 9 (Industry, Innovation, Infrastructure) and 11 (Sustainable Cities and Communities) – and their ability to expand development activities. **Regulatory framework should facilitate PDB's unique role in the promotion of SDGs**. While capital remains the optimal way in which to increase PDBs' capacity to fulfill their mission, alternate measures to enhance liquidity, reduce risk weights, free up capital, and improve risk pooling need to be developed (including setting-up of a green supporting factor, swap facilities and access to Central Banks' liquidity facilities).

Heterogeneous regulatory regimes mirrors the diversity of PDBs. The regulatory frameworks of national institutions should be more closely oriented to multinationals' ones, in order to allow them to fulfill their mandate in an equally and effective manner and to foster cooperation between them.

The countercyclical role of PDBs should be supported by regulatory regimes and emergency governance mechanisms that allow for flexibility when warranted and a rapid and effective response to crises. In particular, contingency measures to face the pandemic crisis should be evaluated to decide if they could be effectively embodied into institutions' standard governance in relation other emergency responses, such as natural disaster responses.

Building on their key role during COVID-19 crisis, members should set up **new investment strategies with relevant and innovative tools to build back better.** Among others, increased financing in energy transition (SDG 7), climate (SDG 13) and ecosystems conservation (SDG 14 & 15), realization of human security (SDG 16) - by protecting everyone's health (SDG 3) and dignity and building resilient societies, support to local economies and industries (SDG 9) - including local integration and decarbonisation of value chains, and private sector mobilisation through blended finance mechanisms and increased cooperation (SDG 17) came out for IDFC members as key elements of the integrated approach needed toward a lasting recovery.

A deeper analysis of members' operations shows their capacity to implement a wide scope of instruments and to develop innovative business models to broaden their impacts and tackle SDGs while taking into account the needs and characteristics of the contexts where they are operating. While the use of the credit line and technical assistance stands out as the most used combination in innovative business models of IDFC members and has proven its effectiveness in tackling SDGs, credit enhancement products and de-risking mechanisms (eg. guarantee for thematic bonds, first-loss mechanism), equity investments and concessional resources in local currency aligned with local needs and capacities are in great demand. Non-financial products, including technical assistance for project preparation and monitoring, have become key to generate deeper impacts and ensure their sustainability on the ground.

IDFC's efforts to characterize climate and SDG compatible investments towards the definition of alignment methodologies

Public development banks need not only renewed and explicit mandates, adapted business models, and incentive frameworks, but also **practical and standardized tools to characterize which investments are aligned with SDGs and Paris Agreement** and which are not, in order to achieve reorientation and alignment of investment portfolios.

In the area of climate as a first step, IDFC members, along with the MDBs, agreed in 2015 on Common Principles for climate finance tracking (mitigation and adaptation) and have been reporting together on this basis. IDFC provides in average USD 150 billon of green finance annually with a further increase in 2019 (USD 197 bn), confirming its leading role as the largest provider of public climate finance worldwide. Thirteen of IDFC members are accredited to the Green Climate Fund, the majority of which are national and regional development banks of emerging and developing countries. For the first time, such institutions are gaining access to international concessional resources. IDFC members, together with the MDBs, subsequently committed in 2017 to align finance with the Paris Agreement, and have since developed corresponding methodologies structured around 6 core ideas: (i) increasing climate finance, (ii) supporting country led strategies, (iii) mobilizing the private sector, (iv) promoting adaptation & resilience, (v) backing the energy transition, and (vi) recognizing the need for internal transformation of financial institutions. In 2020, IDFC decided to continue working on Paris alignment by developing an operationalization framework and toolbox for its members.

Beyond climate, IDFC conducted a survey in 2019 to review members' existing approaches to characterize compatibility of their activities vis-à-vis the whole SDGs. This work has been pursued in 2020 with the view to analyze in more details the SDG frameworks and taxonomy methodologies put in place by IDFC members[5]. Although there is a lack of homogeneity among members' approaches, a couple of recommendations emerge.

[5] For further information, please refer to IDFC SDG Framework report.

Many members have been exploring SDG target through SDG mapping, via their own methodology or via OECD SDG tracker tool. Mapping is not alignment and does not identify any potential or actual negative impact, but is relatively easy to carry and is quite useful. As a first, quite intuitive, step to discover what SDGs represent in an organization, i.e. as a mobilization tool. Then, as an analytic tool, regarding the portfolio of a development bank, e.g. to identify the strengths, as well as orphan sectors.

Mapping tools have shown that there is no "perfect" coverage of all SDGs, and that there is a great diversity of approaches of the SDGs across institutions. In their regular activities, half of IDFC members focus on "economic" objectives (SDG 9 and 8), reflecting the mandate to target economic or industrial development. Many members are committed on environmental goals (SDG 13, 12, 7), reflecting the integration of Paris-aligned criteria. Partnerships and governance matter very concretely (SDG 16 and 17), reflecting the importance of collaboration governments, authorities and with all stakeholders, and the attention to corporate governance when investing. Lastly, some goals remain less mentioned in members' annual reports and public documentation such as social SDG, and in particular SDG1, as well as SDG related to biodiversity (SDG 14 and 15) – stressing that while biodiversity conservation is gaining momentum, it is not yet fully integrated into investment strategies.

Beyond mapping, IDFC members are willing to build compatible SDG frameworks and taxonomy. Members should strengthen their collaboration in measuring development impacts along the project cycle (from appraisal to monitoring and evaluation), defining ex-ante planned impacts assessment tools, monitoring indicators and ex-post impact measurement methodologies.

To be fully SDG-compatible, SDG frameworks should cover the entire financing and investment portfolios; consistent, in their methodology, with the multi-dimensional impacts of the SDGs; providing quantified synthesis reflecting the positive or negative balance of a project or an investment, and therefore facilitating and influencing the final Board decision. All members should be able to guarantee that their decision committees are informed of the SDG-characteristics of all projects (including both negative and positive impacts). This requires an ex-ante assessment tool, beyond environmental and social safeguards. On the other way around, ex-post assessment tools are also extremely useful, to assess actual impacts, to fine-tune parameters used in ex-ante assessments.

This aims to allow members to end up with a certain level of standardization while also having some flexibility according to their mandate, specific strategies, and activities and taking into account local contexts. IDFC is ready to work with the finance community towards the elaboration of basic principles characterizing the alignment of finance with the SDGs, to improve global knowledge and accountability.

IDFC is committed to join forces to reach new levels of cooperation, bridging all public development banks and private actors, towards the alignment of all financial flows with climate and SDGs

IDFC members recognize that cooperation and partnership are key to addressing SDGs sand maximizing the impact of PDBs. There is a strong background of bilateral cooperation between IDFC members, through various ways such as knowledge sharing (for instance around the accreditation process to the GCF), capacity building (through staff exchange), co-financing and common operational tools, such as the IDFC Climate Facility, to strengthen the capacity of IDFC members to originate and develop climate mitigation and adaptation projects and to institutionalize and facilitate collaborative work among members on climate change.

Over the longer horizon, there is a risk that the pandemic leaves lasting scars through lower investment in particular in countries more affected by the economic impacts of COVID. In this context, alliances between IDFC members, with other national and multilateral development banks and with private sector are critical. Collaboration could be a solution when a single organisation cannot meet the required needs and could have concrete benefits such as resources pooling, risk sharing and better execution with roles and responsibilities clearly defined.

<u>Members are leveraging on diversified partnerships for financing investments in favor of SDGs</u>: with multilateral banks, which can bring value added on sectoral approaches linked to the SDGs such as social sectors (human capital, education, health) or sustainable infrastructure, lead sectorial transition and address both global and regional challenges on the ground ; with bilateral agencies, which stimulate local demand through dialogue with authorities and development of fine-tuned thematic instruments to support SDG-compatible projects ; with other national or sub-national development banks, benefiting from a privileged dialogue with governments and municipalities and a deep knowledge of the local context, they can rapidly implement public policies. They can also engage in more innovative dynamics, for SDG-related programmes according to local challenges (perhaps by privileging certain SDGs); with international funds, which represent a stimulus to keep updating PDBs' SDGs and climate-related standards and policies to the highest and best international practices, even though their access remain often a challenge for a majority of PDBs and should be facilitated to deploy increased investment towards low-carbon, resilient and sustainable development.

Beyond traditional development actors, <u>blended finance and innovative approaches in mobilizing private actors appear to be a strategic lever to align and scale their impacts on SDGs</u>. IDFC members are willing to build on successful experiences of private sector mobilization through different instruments (in particular project preparation fund and de-risking mechanisms) with the view to reinforce or develop new lines of cooperation between banks to improve effectiveness, maximize impacts on the ground and align the whole finance chain with climate and SDGs.

Making the best use of the role and capacities of all PDBs and their stakeholders as enablers of SDG-promoting finance is a crucial elements of the needed transformation of the development financing and more generally of the financial system, as called for by the Paris Agreement and the SDGs agenda. Echoing SDG 17, enhanced forms of cooperation, as promoted by the Finance in Common Summit, are essential to strengthen the means of implementation and <u>**to revitalize the global partnership for sustainable development. IDFC stands ready to pursue the dynamic building on the momentum of the FIC Summit.**</u>

<u>*About IDFC*</u>

The International Development Finance Club (IDFC), created in 2011, is the leading group of 26 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 US$ 4 trillion in combined assets and annual commitments above US$ 600 billion, including US$ 150 billion per year 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.

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