Adaptation Finance

Lessons and way forward for the International Development Finance Club

IDFC International Development Finance Club

GREEN CLIMATE FUND

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ITACA SOLUTIONS is a technical assistance service provider supporting climate adaptation through technical training, expert consulting and project development. With an extensive and solid network of subject matter experts, partners and associates, ITACA aims to accelerate climate finance by supporting the development of climate ready, transformative and inclusive communities led by motivated and prepared local champions.

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This document was prepared by ITACA who was mandated by the International Development Finance Club (IDFC) to present recommendations for IDFC members on how to deal with adaptation activities and how to do more and better in the future.

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1. Introduction

Public Development Banks (PDBs) have a critical role to play in providing climate finance in alignment with the Paris Agreement. Multilateral, international, regional, national and subnational development banks – known as public development banks given they all are publicly owned financial institutions with specific development or policy mandates – are major providers of climate finance. Given their unique position at the nexus of finance and development, PDBs can support policy integration between sustainable development and climate action, redirect finance flows towards low-carbon and climate resilient investments, and take on early, risk-taking, countercyclical roles to catalyse other private sector and public investment in adaptation and mitigation.

The International Development Finance Club (IDFC), created in 2011, is the leading group of 27 national and regional PDBs from all over the world, a majority active in emerging markets. The IDFC is the largest provider of public development and climate finance globally, with USD $4 trillion in combined assets and annual commitments above USD $600 billion, including over US$ 175 billion per year for climate finance. IDFC members work together to implement the Sustainable Development Goals (SDGs) and the Paris Agreement agendas. Through IDFC, members join forces to promote and leverage sustainable development investment worldwide, translating international priorities into concrete financing opportunities in their own constituencies.

Through the combined assets and commitments of its membership, the IDFC represents the largest provider of climate finance globally with total commitments of over USD $1 trillion in green finance between 2015 and 2020. In 2021, IDFC members committed USD $224 billion to green finance investment around the globe, of which USD $212.7 billion was dedicated to climate finance.[1] Despite the lack of a commonly accepted definition of green finance, for the purpose of this report green finance refers to financial investments flowing into sustainable development projects and initiatives, environmental products, and policies. The IDFC green finance portfolio includes investments across three categories, namely: climate finance, biodiversity finance and finance of other environmental objectives.

The Green Climate Fund (GCF) is the world's largest dedicated climate fund, mandated to foster a paradigm shift towards low emission, climate resilient development pathways in developing countries. To achieve its mandate, the GCF supports developing countries' efforts to create low-emission and climate-resilient markets by fostering long-term climate planning, policy integration between climate action and sustainable development, innovation and de-risking pioneer investments. The GCF has a portfolio of over USD $10.8 billion in projects and programmes with a total value of over USD $40 billion across more than 100 countries. The GCF is an operating entity of the financial mechanism of the United Nations Framework Convention on Climate Change (UNFCCC) and serves the 2015 Paris Agreement, supporting the goal of keeping average global temperature rise well below 2 degrees Celsius.

The IDFC and the GCF have agreed to collaborate and explore avenues to scale up finance towards climate adaptation. The GCF has accredited 35 Public Development Banks (PDBs)[i], 15 of which are IDFC members[ii], making the IDFC the largest group of financial institutions collaborating with the GCF, and making IDFC members key partners in achieving global climate finance goals. To date, IDFC members have 25 approved Funding Proposals with USD $1.75 billion committed from the GCF and

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[i] As of the end of 2021

[ii] Africa Finance Corporation, Agence Française de Développement, Banco Nacional de Desenvolvimento Econômico e Social, Banque Ouest Africaine de Développement, Cassa Depositi e Prestiti S.p.A., CDG Capital S.A., Central American Bank for Economic Integration, Corporación Andina de Fomento, Development Bank of Southern Africa, Japan International Cooperation Agency, Korea Development Bank, Kreditanstalt für Wiederaufbau, Nacional Financiera S.N.C. Banca de Desarrollo, PT Sarana Multi Infrastruktur, and Small Industries Development Bank of India.

a total project value of USD $5.3 billion. This includes a total of 16 approved adaptation Funding Proposals in partnership with 7 different IDFC members, with USD $989 million committed from the GCF and USD $1.05 billion in co-financing, for a total value of USD $2.04 billion.[iii]

The IDFC and the GCF recognize the critical need to increase adaptation finance in order to achieve the targets of the Paris Agreement. Since the Paris Agreement was signed in 2015, IDFC members have committed approximately 20% of their budgets to green investments (including mitigation, adaptation, biodiversity and other environmental investments), averaging approximately USD $175 billion per year in climate finance. In 2021, IDFC members committed USD $21 billion in adaptation finance. However, IDFC members recognize they can do more to scale up adaptation finance in the future. [12]

The IDFC and the GCF also recognize that scaling adaptation finance can contribute significantly to a green and resilient recovery following the COVID-19 crisis. According to IMF estimates, global median GDP dropped by 3.9% from 2019 to 2020, making the COVID crisis the greatest economic downturn since the Great Depression.[3] As countries propel towards economic recovery, it is critical to build a green and resilient recovery.[4] [5] As noted during the first Finance in Common Summit in November 2020, there is an important opportunity in harnessing COVID-19 recovery packages to meet Nationally Determined Contributions (NDCs).[1] In this regard, PDBs have a critical role to play in helping countries navigate unprecedented balance of payments and financing needs and helping governments identify key interventions to meet the dual COVID-19 recovery and climate adaptation goals.

This report outlines the progress made by the IDFC in financing adaptation investments, highlighting the imperatives for adaptation based on the most recent climate science and the current gap in global finance for adaptation. It also highlights the accomplishments of the IDFC in financing adaptation initiatives since 2015, including through the support of the GCF. Acknowledging that global demand for adaptation finance still vastly exceeds supply, the report outlines the strategic role that IDFC members can play in financing adaptation, while showcasing a variety of different adaptation financing solutions that have been deployed by IDFC members using a wide range of financial instruments. The report concludes with a look to the future on how the IDFC can scale-up adaptation finance to help address current gaps in adaptation investments.

2. The Imperative for Adaptation

2.1 The Adaptation Challenge

Despite the understanding of the drivers and implications of global warming and climate change, anthropogenic GHG emissions continue to rise globally and across all major sectors.[6] All modelled pathways limiting warming to 1.5°C and 2°C with no or limited overshoot involve very rapid, sometimes immediate, and significant GHG emission reductions in all sectors.[7] Yet, government ambitions expressed through Nationally Determined Contributions (NDCs) fall short: nations need to redouble their commitments in order to achieve the Paris Agreement goal to limit global temperature rise by 2°C—ideally 1.5°C—by the end of the century.[8]

Adapting coupled socio-ecological systems and making them more climate resilient is therefore crucial to ensuring global prosperity and well-being in a changing climate. Even if carbon emissions ceased tomorrow, significant and sometimes irreversible changes have already been set in motion[9], making it imperative for coupled socio-ecological systems to become more climate resilient and adaptive to change. Investments to support adaptation efforts can be found across all major sectors: including climate-smart agriculture,[10] water management, coastal rehabilitation, and green

[iii] Broken down further, this includes 10 'adaptation' projects (USD $509 million in GCF finance, USD $418 in co-finance) and 6 'cross-cutting' projects (USD $480 million in GCF finance, USD $631 million in co-finance).

infrastructure.[11] [12] Nature-based solutions have a key role to play in helping to address, avert, and minimize risks arising from climate change, complementing or offsetting traditional engineering solutions while providing multi-faceted co-benefits from improved water security to healthier and more attractive environments for living.

The latest science underscores the need for a shift from incremental to systemic mitigation and adaptation responses to meet the scale of the challenge. This implies the need for more systemic, multi-sectoral, inclusive responses to address complex, interacting climate risks. To this end, seven systems transitions have been identified by the IPCC to achieve low-emissions, climate resilient development, covering: (I) energy, (ii) industry, (iii) agriculture, forestry and other land uses, (iv) buildings; (v)transport; and (vi) cross-sectoral; (vii) other Carbon Dioxide Removal (CDR) strategies.[13]

2.2 The Adaptation Finance Gap

Global climate finance flows reached US$ 632 billion in 2019-20,[14] but adaptation finance lags well behind mitigation finance, amounting to less than one-fifth – USD$ 46 billion – of total climate finance.[15] Of these total adaptation finance flows, about two-thirds went to developing countries[16]. The public sector continues to provide almost all adaptation finance, with only about USD $500 million (1.6 %) coming from private sources in that same period.[13] Most bilateral adaptation finance flows in the forms of grants to countries with higher climate risk.[17] Despite adaptation being increasingly prioritized in development finance climate portfolios, it represented just 14% of total public finance as of 2019-20.[13]

There is a clear financial rationale for scaling-up adaptation finance. The Global Commission on Adaptation estimates that investing in adaptation can generate a rate of return of 10:1 or higher.[18] Investing USD $1.8 trillion dollars globally in climate adaptation could yield USD $7.1 trillion in net benefits. In the agriculture sector, for example, climate adaptation not only helps to avoid potential damages caused by climate impacts, but also supports increase in production functions and generates a net increment of income and employment for small-scale farmers.[19]

Despite the evidence on its benefits, adaptation spending is not flowing at scale and falls well short of the volume required to help countries, cities, communities, ecosystems and people adapt to climate risks and impacts. According to UNEP, adaptation costs in developing countries could range between USD $140 and USD $300 billion per year in 2030, and between USD $280 and USD $500 billion per year in 2050.[20] This is significantly below the levels of finance currently being provided, highlighting the shortfall in adaptation finance needed to avoid severe economic, natural and human impacts from climate change, especially in developing countries.[20] UNEP estimated adaptation costs and likely adaptation financing needs in developing countries to be five to ten times higher than current tracked adaptation finance flows.[21] [iv] In addition, an estimated USD $57 to USD $95 trillion worth of infrastructure is expected to be built by 2030, which needs to be climate-smart so that it is resilient to climate impacts.[22]

This lack of financing at scale – referred to as the adaptation finance gap – can be explained by a number of barriers.[23]Gaps remain in the data, information, and metrics needed to guide adaptation finance and investments. This gap in relevant data and metrics particularly hinders private capital investment, which plays a critical role in meeting the scale of global adaptation financing needs in a context of constrained public budgets and increasing costs of climate impacts. Moreover, in contrast to mitigation, investments in adaptation and resilience are also difficult to measure as they can take

[iv] The UNEP Adaptation Gap Report also highlights the limitations of the available evidence and notes that the estimated adaptation costs and likely adaptation financing needs in developing countries are increasing, "potentially leading to a widening of the adaptation finance gap". The report also states that "a more detailed and systemic stock-take of the costs of adaptation and finance needs would be a significant analytical value-add".

many forms and do not often consist of a well-defined set of activities. There is also limited clarity on the government's capital investment needs for financing their adaptation priorities and on how to build project pipelines of transformative adaptation investments. Adaptation investments are also associated with positive externalities which are not well captured by financial metrics, and long-term economic payback profiles and/or delayed benefits. Private actors operate around short or mid-term horizons in a context of imperfect capital markets where there is a shortage of longer-term credit, whereas many adaptation projects are inherently long term, the benefits of which may not be realized for many years into the future, conditional upon uncertain climate outcomes.

These barriers imply that adaptation is or at least is perceived as a lot harder to profit from and less attractive to investors who seek to generate a stream of revenues. Adaptation therefore is too often perceived as an investment of costs without benefits, especially when compared to mitigation, which has much clearer metrics (GHGs), a "product" derived being sold on as a commodity (e.g., sale of renewable electricity), and can be more easily designed in profit-making business models for the private sector.[v] [24]

Addressing these barriers and overcoming the gap in adaptation financing is critical to enabling developing countries to achieve their economic and social objectives as well as international commitments under the Paris Agreement. Adaptation to climate change may be deprioritized in the short term while governments respond to other pressing priorities,[25] in a world struggling to cope with and recover from the COVID-19 pandemic and that is facing global food insecurity and the largest energy shock in decades as a result of Ukraine-Russia conflict. IDFC members, have an important role to play in rising to this challenge, and ensuring that COVID-19 recovery plans and other aid packages are resilient, equitable and inclusive. Section 3 turns to the accomplishments, experience and challenges that IDFC members have faced in delivering on their mandate to finance adaptation around the globe.

2.3 GCF Support for Adaptation Finance

The GCF is committed to a balanced allocation of funding between adaptation and mitigation, and dedicates at least half of adaptation resources to SIDS, LDCs and African States. In total, the GCF has committed USD $4.1 billion of funding towards adaptation in its project and programmes through grants, loans, equity and guarantees.

The GCF has comparative advantages to help address specific financial and non-financial barriers that PDBs and other financial institutions, face in scaling up financing for adaptation. This includes co-financing investments, using risk mitigation instruments to take on early investment risk, project preparation funding for adaptation project pipeline development, and acting as a convening platform to promote partnerships, knowledge-sharing and capacity building that can further integrate PDBs in the global climate finance network.

The GCF also contributes to strengthening the capacity and deal flow of its partners to develop transformative adaptation pipelines, through its dedicated technical assistance programs – the Readiness and Preparatory Support Program (Readiness) and Project Preparation Facility (PPF). While accessing GCF financing is a strong motivation for PDBs, accreditation to the GCF also enables its partners to join, collaborate, co-invest, and share knowledge with the climate finance network in the world.

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[v] A recent evaluation by the GCF Independent Evaluation Unit (IEU) likewise found that the "depth of impact for adaptation interventions cannot be monitored with the current set of indicators".

3. IDFC Finance for adaptation

3.1 IDFC Financial Commitments for Adaptation 2015-2020

IDFC members have cumulatively delivered USD $1 trillion in green finance since the Paris Agreement was signed in 2015 at COP21.[26] In 2021, total annual green finance commitments by IDFC members were valued at USD $224 billion. IDFC members scaled-up their ambition at COP 26 in Glasgow, announcing they could potentially deliver $1.3 trillion in green finance over the period 2019-2025.[27]

Between 2015 and 2020, adaptation finance by IDFC members increased almost fivefold. In 2020, adaptation finance by IDFC members reached USD $27.5 billion compared to USD $6 billion in 2015. Figure 1 shows that adaptation finance has been steadily increasing each year since 2016, highlighting the emphasis the IDFC has put on scaling-up commitments to adaptation finance since the Paris Agreement was signed.

However, in 2021 adaptation finance provided by IDFC members dropped for the first time since 2016 to USD $21 billion. This drop can be, at least in part, explained by higher commitments by members in 2020 for emergency response to the Covid-19 pandemic, which had significant adaptation co-benefits. These commitments have declined in 2021 as a result of decreased pandemic-related expenditure.

Overall, IDFC members still have a significantly higher portfolio of mitigation finance than adaptation finance. In 2021, finance for mitigation was USD $187 billion, while adaptation finance was USD $21 billion - representing less than 10% of total green finance. A total of USD $5.2 billion in IDFC finance was used to invest in projects that had both adaptation and mitigation co-benefits.[vi]

Figure 1: *IDFC green finance commitments in 2015-2021*

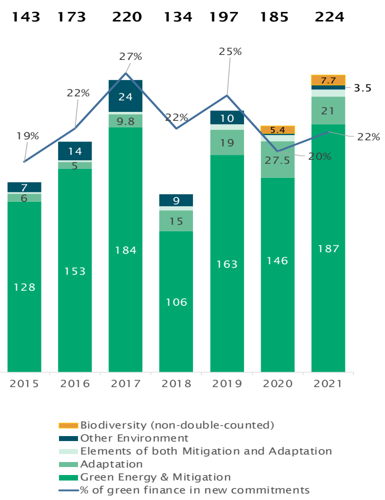
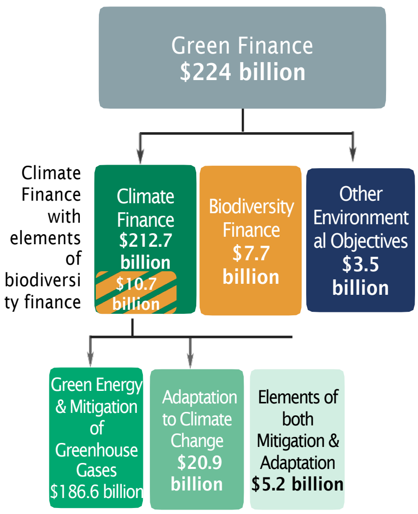


Figure 2: IDFC green finance in 2021 by theme

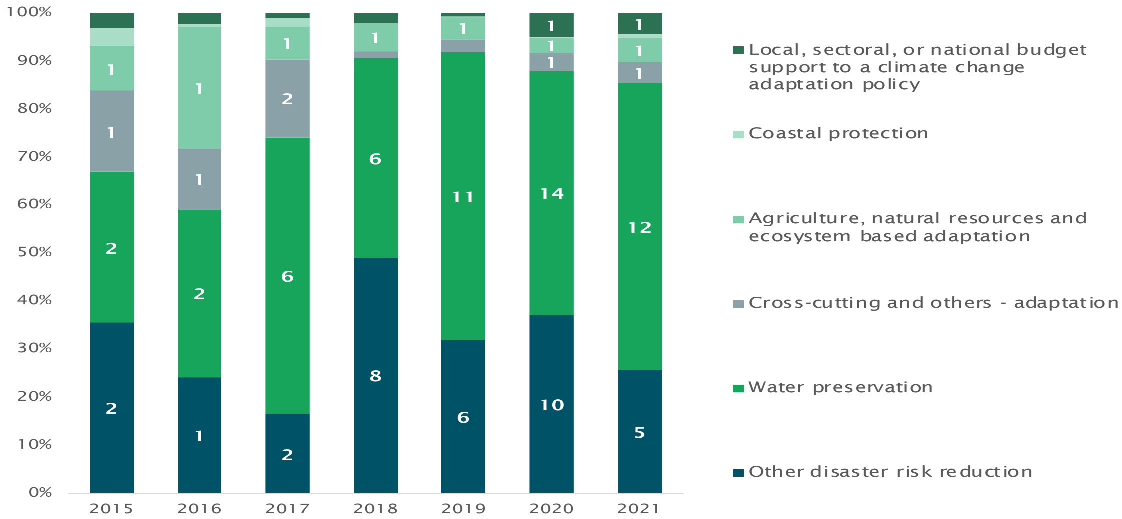


The main sectors that IDFC members have provided adaptation finance for are water preservation and disaster risk reduction. Finance for water preservation in 2021 was USD $12 billion, while finance for DRR by IDFC members was USD $5 billion. An additional USD $1billion was committed in 2020 for

[vi] Comparing total volumes of mitigation finance and adaptation finance is difficult, since the Common Principle methodologies that are used for adaptation and mitigation are very different. The approach for tracking mitigation finance is to account for the whole amount of activities that contribute to reducing GHG emissions, which is often the whole project value. Adaptation finance, particularly when it comes to climate-proofing non-climate related investments, only counts the incremental finance provided for adaptation measures. While adaptation finance is indeed lower than mitigation finance, the appropriate comparison to assess the gaps in adaptation finance is comparing adaptation finance needs versus supply of finance.

each of the three categories: agriculture, natural resources and ecosystem-based adaptation; for adaptation policy implementation; and for miscellaneous adaptation investments.

Figure 3: IDFC member commitments to adaptation by sector, 2015-2021 (USD $ billion)



Loans were the primary financial instrument used by IDFC members to deliver adaptation finance. In total, USD $18 billion or 90% of finance was delivered as loans - USD $11 billion (54%) in non-concessional loans and USD $7 billion (36%) in concessional loans. Grants accounted for USD $2 billion in commitments by members (10%). Other instruments, such as guarantees and equity, account for only a small percentage of total IDFC climate finance commitments.

The East Asia and Pacific region received the majority of commitments by IDFC members going to adaptation. East Asia and Pacific received a total of USD $11.4 billion, or 55% of total adaptation finance. Europe received USD $5.7 billion, or 28% of total adaptation finance. Latin America and the Caribbean received 5% of adaptation finance, South Asia and Africa both received 4% of adaptation finance and the Middle East and North Africa received 3% of adaptation finance. These trends largely reflect the relative scales of IDFC members within their region of operation, and their overall climate mandates.

IDFC members and the GCF have combined to deliver $2.04 billion in adaptation finance. A total of 15 IDFC members are accredited to the GCF. Collectively, IDFC members have accessed USD $989 million in finance from the GCF and co-financed USD $1.05 billion for investments in adaptation. 66% of this adaptation finance has been delivered to investments in Africa, 25% in Latin America and 9% in Asia. Overall, 57% of GCF adaptation finance has been provided as grants, 34% as senior loans, 6% as subordinate loans and 3% as guarantees.

3.2 IDFC Initiatives to Improve Adaptation Financing

Despite the progress highlighted above, IDFC members currently face a number of challenges in improving the quality and quantity of adaptation financing. These challenges include aligning their financing activities with national climate priorities, building adaptation project pipelines, mobilizing private sector finance for adaptation investments, screening projects for adaptation benefits (e.g. using standard metrics to qualify whether a project is considered adaptation), climate-proofing investments that are not climate-related (e.g. large-scale infrastructure projects), and tagging and tracking adaptation finance across their portfolios. Different IDFC members have differing levels of capacity in these areas, and many require additional capacity support to scale-up adaptation finance. To address these challenges, the IDFC has worked with its members to improve the quality and quantity of adaptation financing, through new partnerships with other key climate finance actors, participation at international platforms on climate finance, targeted capacity building activities and the promotion of new tools and methodologies for climate screening and tracking.

In 2019 the IDFC and the GCF signed a Statement of Partnership to strengthen their collaboration and formally structure their partnership to achieve the Paris Agreement and promote the key role of PDBs in climate financing. The IDFC-GCF partnership has centred on the following aspects: (i) sharing knowledge for climate finance and action; (ii) mainstreaming climate considerations into financial institutions; (iii) facilitating access to GCF resources with co-financing from IDFC members; (iv) and supporting capacity building and awareness raising on the potential for scaling-up climate finance in various international forums.[28]

In 2020 the IDFC and the GCF participated in the launch of the first ever Finance in Common Summit. This summit brought together over 500 PDBs from around the world to discuss their role in financing countercyclical actions related to pressing global challenges such as the COVID-19 recovery, climate change and the cost-of-living crisis. The Summit has turned into an annual event which gives PDBs the platform to establish new partnerships, discuss their roles and ambitions in reorienting and leveraging finance for investments that deliver the Paris Agreement and SDGs, and form new partnerships for delivery of initiatives at national and international levels.[29] The Finance in Common Summit provides a platform for IDFC members to discuss their ambitions and develop new forms of cooperation for pressing global challenges.

The IDFC has also deployed the IDFC Climate Facility to build capacity amongst its membership in scaling-up climate finance. The Climate Facility (with financial support from the GCF) aims to support members to align their portfolios with the Paris Agreement and to improve both the quality and quantity of climate finance, by enhancing knowledge exchange between members and building their capacity on climate-related topics. The Climate Facility will run for four years and will focus on four key areas: knowledge sharing; capacity building; support for project preparation; and facilitating access to the GCF.[30]

The IDFC is working to scale-up the use of tools and frameworks that support members to screen and track adaptation investments across their portfolios. Many IDFC members lack the capacity and tools to screen projects for adaptation benefits, to conduct climate risk assessments to estimate the impact of climate shocks on their investments, and to tag and track investments across their project portfolios. This capacity gap has led to collaboration amongst members to share solutions and develop tools for project assessment, risk screening and tracking. For example, AFD has developed a climate risk screening tool which it uses to screen projects for investment decision-making. This has helped influence CAF to develop its own tool. However further efforts can be made to scale-out these tools across IDFC members through the IDFC Climate Facility as part of its ongoing capacity development workplan.

4. The Strategic Role of IDFC Members in Financing Adaptation

IDFC's membership is made up of Public Development Banks, who are a key group of actors with substantial potential to finance adaptation investments in alignment with the Paris Agreement. There are over 500 multilateral, international, regional, national, and subnational development banks. Each year, finance from these PDBs represents 12 per cent of global investments, amounting to over USD $2.3 trillion annually. Collectively, PDBs have the capacity to provide more than USD $400 billion in climate finance per year.[31]

IDFC members are uniquely positioned to scale-up adaptation finance in the countries in which they operate. Working at the interface between finance and development, PDBs are the principal interface between the public and the private sectors and have the unique ability to promote economic and social development by shaping government policies and financing activities with climate benefits. Given that they are mandated to support development – as opposed to just generating financial returns for their investments – PDBs can provide longer-term, patient investment that is focused on social and/or environmental outcomes, as well respond rapidly to short term shocks and crises. They are also large providers of capital in the countries – uniquely positioning IDFC members as investors in adaptation at scale. With a wide range of financial instruments at their disposal, PDBs can help overcome the main barriers to adaptation finance. They are also uniquely positioned to set market signals for innovative and transformative adaptation and ensure all investments – not just adaptation – are made compatible with adaptation objectives. Each of these key functions of PDBs are outlined in the subsections below.

4.1. Strategic Position at the Nexus of Policy and Financing

Many IDFC members play an important role in engaging with government to develop national climate policy strategies, serving as knowledge brokers on how to translate international and national agendas into tangible financing strategies. PDBs are unique partners in delivering adaptation and mitigation actions since they are situated at the nexus of policy and financing. They can engage with government to both develop and finance NDCs, National Adaptation Plans (NAPs) and Long-term Strategies (LTS) in line with the Paris Agreement goals. They often serve as knowledge hubs that bring in non-financial expertise on critical policy areas – such as climate change adaptation – to help build capacity and raise awareness of new policy agendas. This includes support to mainstream adaptation into national policies and development plans under established national coordination mechanisms.

IDFC Flagship initiatives
AFD is implementing the AdaptAction programme which supports countries in translating NDCs and national climate priorities into bankable investments. AdaptAction helps countries produce vulnerability and feasibility studies, guidance in drafting national policy and action plans, as well as other capacity-building actions. It targets SIDS, LDCs and African countries, and focuses on four areas: strengthening climate governance to ensure a successful implementation of the NDCs, translating the NDCs into public policies; concrete action plans in the key sectors for adaptation, as well as designing structural adaptation programs and projects. For example, in Senegal AdaptAction supported the Ministry of Environment and Sustainable Development to undertake a feasibility study to develop a climate change adaptation project to protect water resources in the area of Pout. The feasibility study included a vulnerability assessment of the area and the incorporation of climate and human factors to better understand pressures on water resource availability. The results of the study were used to create awareness and sensitize the general public to the existing challenges and impacts on the availability of water as a critical resource for the area. As a result, a project was designed to better define the shared use of the water resource (for consumption and for irrigation), to construct an artificial aquifer recharge system, and to define sustainable agricultural practices that allow a more efficient use of the water resource and the use of nature-based solutions to address soil erosion challenges. To date, more than 70 studies were conducted under AdaptAction, by more than 500 experts, covering various sectoral topics including climate governance, agriculture, land use, water resources, climate services, local planning, biodiversity, infrastructures, education, social protection, health, coastal zones management, and disaster risk reduction.

4.2. Mandate to Support Development Objectives

With their mandate to support regional, national and sub-national development, IDFC members provide finance to many actors that would otherwise struggle to access finance. PDBs provide medium and long-term support to sub-national governments, Micro, Small, and Medium Enterprises (MSMEs), Non-government Organizations (NGOs) and Community-based Organizations (CBOs). Their comparative advantages rely in long-standing relationships with public and private sectors, and their capacity to on-lend to other local financial intermediaries.[32] This provides them with more agile access to sectors, project developers, and local expertise, and empowers them to work across a wide range of political and economic actors and leverage their relationship at sub-national level.

In line with their development mandate, IDFC members also play an important role in responding to short term crises and shocks. PDBs have played a leading role in responding to the COVID-19 pandemic. They have also played a leading role in providing flexible credit lines, support contingency planning, disaster risk response, investment in early-warning systems and emergency finance when climate and other types of shocks occur. Their investments in basic health infrastructure and equipment, energy access, emergency stimulus and budgetary support, and available credit lines for businesses has been essential in the continued response to the COVID-19 crisis.

IDFC flagship initiative
CABEI and the GCF have partnered to implement a programme that provides concessional credit lines to encourage MSMEs to invest in adaptation: The Central American Bank for Economic Integration (CABEI) has established the productive investment initiative for adaptation to climate change (CAMBio II) with a view to reduce barriers for MSMEs in accessing credit and to support the best available adaptation measures in seven Central American countries (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama). This initiative provides concessional loans alongside technical assistance to encourage MSMEs to invest in adaptation and is also designed to adapt agricultural production systems to changing climate. A grant component of this programme also provides financial rewards to MSMEs and intermediary financial institutions for their successful implementation of adaptation activities.

4.3. Ability to Deploy a Range of Financial Instruments for Investments

IDFC members are unique in that they have a wide range of financial instruments at their disposal for investments. PDBs can use loans (concessional and market-rate), grants, guarantees, equity and debt, amongst others instruments to invest in climate action. While loans are the most widely used instrument by PDBs, guarantees can be useful when uncertainty is high, such as when introducing new technologies. Similarly, debt financing is often used in combination with equity at later stages of development providing investors' confidence in diversifying risk, scaling-up solutions, and bringing innovation with multi-thematic projects. For high-risk projects with potentially high development and profitability potential, equity investments can be a better match so that PDBs can capitalize on the upside potential, and more importantly, for companies to be able to deal with their high borrowing needs. Grant funding has proven to be essential and attractive to pilot initiatives, overcome policy and regulatory barriers, strengthen institutional capacity, and demonstrate innovative approaches to conservation, environmental protection, and replication.

IDFC flagship initiative
JICA is providing Official Development Assistance (ODA) loans for disaster risk management in Indonesia: Indonesia is prone to climate related disasters; a situation that threatens to worsen in the face of climate change. In June 2019, the Government of Indonesia launched the Disaster Resilience Enhancement and Management (DREAM) Program, in collaboration with JICA to support the implementation of disaster-related policies and strategies. JICA signed in 2020-2021 two ODA loans with the Government of Indonesia, amounting to a total of USD $750 million in support of the DREAM Program. In 2021, AFD also joined JICA in supporting the DREAM Program, through a loan of USD 115 million. The Program focuses on four areas of activities: strengthening the Indonesian government's capacity to manage disaster risks; improving the understanding of disaster risks; improving the early warning system and increasing investment to reduce

natural disaster risks; and promoting post-disaster recovery. DREAM also supports the government of Indonesia to integrate disaster risk management in key government planning and strategic frameworks including the National Medium Term Development Plan 2020-2024.

4.4. Ability to Catalyze Finance at Scale and Unlock Private Capital

In addition to their direct role in financing and policy support, IDFC members play a critical role in catalyzing finance from both public and private sources. PDBs can access finance from international sources and commit their own resources to blend finance and reduce the cost of financial borrowing. As secondary creditors with greater knowledge on local market conditions, PDBs can blend their concessional funding from international sources to make the investment terms more attractive to co-financiers.[33] This is especially important for governments with limited fiscal space for public investment, high levels of debt and more critically during recession times when liquidity/capital shortages are likely and risk profiles deteriorate potentially leading to credit under provision.[34] In developing economies especially, the largest volumes of development financing are still originated domestically from public funding and or borrowing, and therefore governments can leverage PDBs financing to reduce the cost of borrowing without compromising debt sustainability. Under the current market conditions, it could be expected that growth will continue to slow down, investment and public spending will lower, and debt will increase. Therefore, PDBs are uniquely positioned to inject efficiency into financing structuring and help avoid countries falling into inequitable development trajectories.

IDFC Flagship initiatives

The CDG group played a major role in structuring and financing the Agadir desalination plant, a € 365 million public private partnership (PPP) project. As a national development bank committed to serving the Moroccan economy, CDG developed the first PPP in the desalination sector in Morocco. With this initiative, CDG aims to improve the resilience of the Souss Massa region to the effects of climate change by ensuring a fair access to water to both farmers (for irrigation) and local population of the region (for consumption) while maintaining/creating opportunities of employment in the agriculture sector. The project is expected to benefit about 1.2 million water users and about 3,000 farmers. CDG Group provided equity through InfraMaroc, an infrastructure fund sponsored by CDG, as well as advisory services for structuring the transaction through CDG Capital Infrastructures, the management company of the fund. In addition, CDG Capital, the corporate and investment bank of CDG group, financed the project with debt along with a consortium of local banks.

One of the main ways in which IDFC members 'crowd-in' private investment is by providing first-lost capital to de-risk investments given their focus on development. Important financial instruments and mechanisms like credit enhancements, credit guarantees, and grants serve to absorb some of the risk to attract and encourage private sector investors to join, increase the flow of capital, provide incentives and address demand-side barriers[35]. Less risk encourages more investors and catalyses resources for non-traditional investments that are socially and environmentally driven.

IDFC members can also further mobilize private capital by deepening capital markets through the introduction of new green financing instruments. PDBs can borrow in both domestic and international capital markets, and these loans can then be used to finance their own lending. PDBs can help develop domestic capital markets, especially for more sustainable friendly instruments, such as green bonds which are important instruments for mobilizing capital from institutional investors.

IDFC Flagship initiatives

DBSA and the GCF are delivering a first Green Bank model in Africa: Private sector interest in climate finance is surging at a time when the African private sector is entering new stages of development, innovation and growth. Development Bank of Southern Africa (DBSA) in partnership with the GCF launched the first private sector Climate Finance Facility in Africa, using a pioneering green bank model. It aims to de-risk and increase the bankability of climate projects to crowd in private sector investment. The Climate Finance Facility is a lending facility intended to increase climate-related investment in Southern Africa by addressing market constraints and playing a catalytic role with a blended finance approach. The facility uses its capital to fill market gaps and crowd in private investment, targeting projects that are potentially able to attract market-rate capital at scale without "credit enhancement," but that are currently unable to do so. This landmark facility offers significant proof-of-concept value to middle- and low-income countries seeking to scale up the private investment required to meet commitments laid out under the Paris Agreement. Its successful implementation will prove that similar financial models can be replicated in other developing countries.

4.5. Ability to make Innovative and Transformative Investments

IDFC members are also key financers in forward-looking innovation and transformative investments that set market signals for adaptation investments and technologies. PDBs play a vital role in financing new technologies and sectoral actions, scaling-up finance for emerging interventions before they are market-ready and tackling emerging policy agendas from the global and national levels. In the past, PDBs have taken a lead role in introducing and scaling new climate technologies for adaptation and mitigation, such as renewable energy, energy efficiency, electromobility and low-carbon agriculture.

IDFC Flagship initiative

KfW on behalf of the German Government/ BMZ and the GCF are financing a specific funding window small grants fund in the Western Indian Ocean focused on ecosystem-based adaptation in marine protected areas: The Western Indian Ocean region is undergoing rapid climate change. Mozambique was hit by two major cyclones in 2019, while the other countries in the region are facing similarly increasing threats of cyclones and tropical storms, exacerbated by climate change. The Blue Action Fund (BAF) set up by KfW aims to reduce or avoid climate change impacts through ecosystem-based adaptation for vulnerable coastal populations. The GCF-backed funding window of the BAF fund provides individual grants to selected conservation projects in marine protected areas and their buffer zones to support climate adaptation of coastal communities in the Western Indian Ocean, especially in Mozambique, Tanzania, Madagascar and South Africa region. The BAF serves as a financial partner for national and international nongovernmental organizations that are already working successfully in this field.

4.6. Climate-Proofing Investment Portfolios

As large-scale providers of finance – even for investments that are not climate-related – IDFC members can have further impact by climate-proofing a wide range of investments so that they are resilient to current and future climate impacts. PDBs are increasingly screening their investment portfolios to de-risk their investments, so they are insulated from the impacts of climate change. PDBs can ensure they fully incorporate externalities linked to climate change in project evaluation (consistent with public policies), de-risk adaptation projects through the appropriate use of the wide range of financial instruments at their disposal and technical assistance. PDBs can incorporate national development goals (such as NDCs) into all financing decisions and project cycles. Lastly, the provision of technical assistance by PDBs to accompanying funding, is especially crucial in the case of financing investment in adaptation.

IDFC Flagship initiatives
CAF and AFD have provided technical assistance and capacity-building to cities to climate proof their investments: Against the backdrop of rapid urbanization, cities in Latin America have seen remarkable progress in improving people's lives and livelihoods over the past two decades. The impacts of a changing climate including intensifying disaster risk, however, now threaten to reverse those gains. In the past two decades alone, nearly 152 million people across Latin America and the Caribbean were affected by one or more natural disasters. Recognizing these realities, Latin American cities are determined to build a climate-resilient future for their economies and citizens, an effort that will require major investments in scaling up resilient infrastructure. With the support of the Latin American Investment Facility (LAIF) funded by the European Union, CAF and AFD put in place between 2019 and 2020 a technical team to assess options for adaptation investments focusing on nine cities in four countries in Latin America: La Paz and Tarija (Bolivia), Recife and Fortaleza (Brazil), Loja, Portoviejo and Santa Cruz de Galapagos (Ecuador), Trujillo and Piura (Peru). A key first step of this analytical work has been to assess climate risks and hazards for specific locations. As a result, today those municipalities have a better understanding about their risks and vulnerabilities, from a changing climate, so that they can incorporate this information into their planning and investment cycle.

5. Lessons and recommendations

The IDFC has made significant strides in delivering adaptation finance since the Paris Agreement was signed in 2015. As key actors in delivering global public climate finance, IDFC members must renew their commitment to financing adaptation investments. This section presents some recommendations from ITACA for how the IDFC can scale-up its adaptation commitments by 2030.

IDFC members should increase the annual volume of climate finance for adaptation in the years ahead. Given recent evidence that annual adaptation finance has decreased in line with reductions in COVID-19 recovery spending, there is an urgent need to scale-up their adaptation commitments. This amplifies the existing gap in IDFC member commitments between mitigation and adaptation – with adaptation only representing 20% of green finance commitments in recent years. As climate impacts around the world become more frequent and severe, this finance can play a vital role in building resilient livelihoods, economies, infrastructure and societies. Financing strategies to achieve this can highlight important adaptation actions that can be undertaken in the short term, which that are aligned with national development plans and COVID-19 recovery plans.[36] Adaptation finance flows should be directed, where possible, towards systemic investments, drawing on a deep understanding of the adaptation problem and a well-developed theory of change.[37] They should as well tackle all aspects relating to disaster risk reduction: early warning systems, adaptation measures, contingencies, insurance, and potential loss and damage.

As part of its commitments to adaptation finance, the IDFC would therefore benefit from setting a target for adaptation finance. The IDFC currently has a high-level target for the total amount of green finance delivered by members. This could be supplemented by an annual or an overall target for adaptation finance, which could spur further financing and serve as a rallying point to build further capacity for project pipeline development for adaptation financing within member banks. This target could be broken down by region, noting regional differences on adaptation financings needs. The IDFC Secretariat can set this process in motion by convening a collaborative dialogue amongst members to develop a shared understanding on an appropriate adaptation finance target.

The IDFC Secretariat – through the IDFC Climate Facility – should improve the uptake and availability of adaptation tools and methodologies among IDFC members. There is disparity in capacity of different members to identify appropriate adaptation projects, screen projects for climate risks, track adaptation finance across investment portfolios, and evaluate the effectiveness of finance in achieving resilience outcomes. A key area for improvement is to develop clearer guidelines or a more robust typology on what investments qualify as adaptation finance (since the 'Common Principles on Adaptation' are quite vague), so that IDFC members can screen projects for investment decision-making and tag them for measurement. Another key area of action is that the IDFC Climate Facility should continue to build capacity for IDFC members to screen projects for climate risks in order to improve the resilience of their portfolios.

IDFC members should support the formulation and establishment of national visions, strategies and investment pipelines for climate adaptation. In many countries, there is a need for strategic adaptation plans and bankable pipelines of adaptation investments at national and sub-national. These need to be demand-driven and owned by national and local stakeholders. IDFC members can raise awareness and work in partnership with governments, communities, the private sector and civil society to develop project pipelines, respond to emerging policy agendas and experiment with novel financing instruments to help address this gap.

IDFC members should ensure they are well equipped and prepared to finance actions that tackle the full spectrum of adaptation needs. IDFC members need to improve their preparedness to deal with a range of approaches in their constituencies as the impacts of climate change continue to accelerate and intensify. This includes the need to combine adaptation with disaster preparedness, disaster response, building back better, and loss and damage. It is of critical importance that IDFC members are up to date in terms of knowledge, latest trends, innovative approaches, to respond in these multiple ways depending on the context and needs. IDFC members should also ensure they have the necessary funds and financial instruments to allow them to fit into national emergency schemes and provide effective and quick support, while also providing long term support to building back better.

IDFC members should explore opportunities to use new financial instruments in their adaptation portfolios to both scale-up and scale-out adaptation finance. Different members have differing levels of capacity and experience with using novel financing instruments. Some of the instruments that can be explored are insurance, contingency credit lines (e.g. catastrophe deferred drawdown (CAT DDO) financing lines)[38]green bonds and blue bonds,[39] [40] insurance, and debt for nature swaps, amongst others.

The IDFC can explore opportunities to finance action in new themes that support adaptation, development and other co-benefits. One of the main new areas that the IDFC has committed to action is on biodiversity. The IDFC will harness synergies between the fight against climate change and the loss of biodiversity, to protect ecosystems and support the restoration and sustainable management of natural areas, with and for the benefit of local populations, for example through the development of nature-based solutions. The IDFC has already begun to track biodiversity finance in member portfolios and will aim to increase biodiversity finance in the future.

IDFC members are in a unique position to maximize the use of partnerships to leverage adaptation funding and inter-agency collaboration. There is untapped potential to create strategic alliances between IDFC members (or with members outside the club) to create joint adaptation projects – for example between National Development Banks and PDBs with an international reach. One way of actioning this recommendation could be through the establishment of pilot cooperation agreements between two IDFC members, allowing for the systematic screening of opportunities in a set of pilot countries benefitting from multiple sources of funding and the development of more systemic financing strategies for adaptation.

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