# Common Principles for Climate Change Adaptation Finance Tracking

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## Preamble

The Multilateral Development Banks (MDBs) [1] and the International Development Finance Club (IDFC) [2] are fully committed to promoting and supporting climate-resilient development, as an essential element of the sustainability of their investments, by integrating climate adaptation and resilience into their operations and initiatives. This may encompass support at the national, territorial, local or project level to prepare for, adapt and respond to the impacts of climate change.

Climate adaptation and resilience are intrinsically linked to development. This may make it challenging to accurately estimate adaptation finance in development operations. Recognizing the challenges and the need for comparable approaches, MDBs and IDFC have been working together to improve the harmonisation, comparability and transparency of the climate finance.

## The IDFC-MDB Common Principles for Climate Change Adaptation Finance Tracking

In 2015, the MDBs, who jointly report on Climate Finance, and the IDFC agreed on a set of common principles for climate change adaptation finance tracking (the Common Principles) as an essential and important first step to improve the reporting on adaptation finance (see Annex I the Common Principles as endorsed). These principles defined the context of adaptation finance in development and outlined a common approach for tracking adaptation finance.  They also provided the basis for further joint work that would improve transparency in adaptation finance reporting, and address comparability of the reporting process and relevant process-based concepts and guidelines.

## Updated joint MDB Methodology for Climate Change Adaptation Finance Tracking

Since the adoption of the Common Principles in 2015, the MDBs and the IDFCs have worked together to enhance the understanding of adaptation activities and climate adaptation finance. Following the launch of the updated MDBs' Joint Methodology for Tracking Climate Change Adaptation Finance (the joint MDB Methodology) in November 2022, IDFC and MDBs have further exchanged knowledge and experience on financing adaptation activities on this new methodology, which draws on initial common principles, enhancing their operational application. Following this knowledge exchange, the IDFC adopted the joint MDB Methodology in October 2023. As a result, MDBs and IDFC have issued this update on the Common Principles. Operational Application of the Common Principles

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[1] The African Development Bank (AfDB); the Asian Development Bank (ADB), the Asian Infrastructure Investment Bank (AIIB); the European Bank for Reconstruction and Development (EBRD); the European Investment Bank (EIB); the Inter-American Development Bank (IDB); and the International Finance Corporation (IFC) and World Bank (IDA/IBRD) from the World Bank Group (WBG)

[2] see www.idfc.org

## Operational Application of the Common Principles

The MDBs and IDFC have agreed to adopt the joint MDB Methodology as the operational application of the Common Principles. The MDBs will apply the joint MDB Methodology from the 2023 portfolio according to their respective fiscal years, which will be reported in the joint MDBs climate finance report released in 2024, and by the IDFC in the 2026 portfolio, which will reported in the Green Finance Mapping in 2027. The joint MDB Methodology is enclosed in Annex II.

The MDBs and IDFC invite other institutions to adopt the joint MDB Methodology for Tracking Adaptation Finance, and therewith further increase consistency, transparency and credibility of adaptation finance reporting.

As an inherent and important part of improving climate change adaptation finance tracking, the MDBs and IDFC are committed to continuing to work together, maintaining an open and transparent exchange of information around institutional experience and learning, as well as to jointly discuss potential proposals to improve the Common Principles.

## Moving forward

Building on the joint efforts to date and guided by the Common Principles, the MDBs and members of IDFC shall continue to

- Share and exchange experience on supporting adaptation and applying the Joint Methodology for Tracking Climate Change Adaptation Finance, thereby increasing capacity and knowledge on the topic. This shared knowledge will inform the review and update of and further improve the tracking of climate change adaptation finance;
- Advance understanding on the application of the methodology, taking note of user needs, with the aim of providing increased transparency on areas where differences in tracking approaches continue to exist with a particular focus on further refining definitions for adaptation activities and the process of disaggregation in adaptation finance.
- Develop and collate good practice on topics that will add clarity and substance, for example in guidelines on the key steps for adaptation tracking; good practice in climate vulnerability assessments; avoidance of maladaptation; adaptation decision pathways; and the importance of capacity building.

## Annex I IDFC-MDB Common Principles on Adaptation Finance Tracking

- Adaptation finance tracking relates to tracking the finance for activities that address current and expected effects of climate change, where such effects are material for the context of those activities.[3]
- Adaptation finance tracking may relate to activities consisting of stand-alone projects, multiple projects under larger programs, or project components, sub-components or elements, including those financed through financial intermediaries.
- Adaptation finance tracking process consists of the following key steps:
  - Setting out the context of risks, vulnerabilities and impacts related to climate variability and climate change;
  - Stating the intent to address the identified risks, vulnerabilities and impacts in project documentation;
  - Demonstrating a direct link between the identified risks, vulnerabilities and impacts, and the financed activities.
- Adaptation finance tracking requires adaptation activities to be disaggregated from non-adaptation activities as far as reasonably possible. If disaggregation is not possible using project specific data, a more qualitative or experience-based assessment can be used to identify the proportion of the project that covers climate change adaptation activities. In consistence with the principle of conservativeness, climate finance is underreported rather than over-reported in this case.

## Annex II – Updated MDB Joint Methodology for Climate Change Adaptation Finance Tracking

### I. BACKGROUND AND GUIDING PRINCIPLES

1. Climate resilience and adaptation are intrinsically linked to development. This makes it challenging to accurately estimate adaptation finance in development operations. In response to this challenge, the joint MDB Working Group on Climate Finance Tracking developed a common adaptation finance tracking methodology in 2012[4].This common methodology has been applied to assessing and reporting multilateral development bank (MDB) finance directed to specific adaptation

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[3] The purpose of this Principle is to frame the space of activities that can be classified as adaptation finance tracking in the context of MDB and IDFC developmental work. As such, it recognizes the existence of differing scientific and institutional definitions of adaptation to climate change and does not attempt to define adaptation to climate change in a wider global context e.g. whether to include adaptation to current climate variability or not. However, as a next step the joint MDB and IDFC group will work on further refinement of definitions for adaptation activities in the context of adaptation finance tracking.

[4] See Section 2.3 of the Joint MDB report on climate finance 2013 and subsequent joint MDB reports for details of the common MDB methodology.

activities[5] that are carried out in response to experienced and anticipated climate change impacts.

2. The methodology takes a context-specific, granular and conservative approach to reduce the scope for over-reporting of adaptation finance. The MDB adaptation finance tracking methodology requires project activities that contribute to adaptation to be disaggregated from activities that do not.

3. The joint MDB methodology seeks to identify the links between adaptation activities and the project's explicit intent to reduce vulnerability to climate change. Only activities that directly address climate change vulnerability are considered when estimating the adaptation finance. This means that the volume of MDB-reported adaptation finance is an estimate of the finance associated with specific project activities that contribute to adapting to climate change.

4. Multilateral development banks and members of the International Development Finance Club (IDFC) have been working together to improve the harmonisation, comparability and transparency of the climate finance they report. As a result of these joint efforts, the multilateral development banks and members of the IDFC agreed on the Common Principles for Climate Change Adaptation Finance Tracking in July 2015. The principles establish the parameters with which to identify and estimate the volume of adaptation finance in MDB and IDFC operations. They also form the basis for further joint work to increase the comparability of reported figures on climate adaptation finance and to harmonise key concepts related to reporting guidelines and processes.

5. Between 2021 and 2022, the MDBs carried out a review of the joint MDB methodology for tracking adaptation finance, while continuing to apply both the methodology and the joint MDB-IDFC principles. The review built on collective experiences of applying the methodology over the preceding decade.[6] It aimed to better characterise adaptation activities for the purpose of tracking adaptation finance, and to provide guidance on the application of the joint methodology in a broader range of financing instruments.

6. The outcome was an update to the methodology that reflected the evolving understanding of adaptation and climate resilience and advances made in the fields of adaptation finance. These developments include the following:

   a. Adaptation is no longer viewed purely as an add-on to development investments, but rather as an imperative for putting development on the path to resilience. As a result, adaptation support has expanded from traditional infrastructure sectors to a wider range of sectors, such as education, health, social protection, financial services, and research and innovation for adaptation solutions.

[5] Under this methodology, "activities" should be understood as projects, project components, or elements or proportions of projects.

[6] Lessons learned from the implementation of the common principles are available at a joint MDB-IDFC report.

b. Financing modalities supporting adaptation have broadened from the typical investment loans and programmes to other financial instruments, including policy-based loans, working capital and credit lines

c. Relevant advances concerning green and sustainable finance have emerged in recent years, notably the EU taxonomy for sustainable finance and impact reporting for green bonds, introducing new concepts and approaches for better defining, reporting and monitoring adaptation activities, including private investment in adaptation.

In addition to these developments, multilateral development banks are committed to making their operations consistent with a pathway towards low-carbon and climate-resilient development, in line with the goals of the Paris Agreement.[7] Assessing the alignment to the Paris Agreement and tracking adaptation finance are clearly linked, while serving different purposes. Multilateral development banks have developed a joint methodology to assess the alignment of their operation to the Paris Agreement.

This assessment is applied at the project level and provides an effective filter to ensure that MDB financing causes no significant harm to the abilities of communities, economic activities and the environment to cope with physical climate risks. The adaptation finance tracking methodology provides guidance for estimating the finance associated with the filtered projects supporting communities, economic activities and the environment to adapt to a changing climate.

7. The multilateral development banks will continue to work together to enhance approaches to tracking adaptation finance and support advances in this area. They will also continue to work on the development of metrics that can adequately capture the effectiveness of the adaptation activities financed through their operations, building on experience and jointly developed initial frameworks.[8]

8. This annex describes the updated MDB methodology for tracking adaptation finance, clarifying the types of activities that can contribute to adaptation. As before, the methodology is based on a three-step process required to identify adaptation activities (see Annex I).

## II. ACTIVITIES CONSIDERED FOR ADAPTATION FINANCE

9. The multilateral development banks have a wide variety of operations across different geographical regions, economies and financing instruments. As a result, adaptation finance tracking may take place across a range of activities categorised as follows (see Table 1):

   a. Type 1/Activities that are adapted: Activities that integrate measures to manage physical climate risks and ensure that the project's intended objectives

[7] As specified in Article 2.1(c) of the Paris Agreement.
[8] A Framework and Principles for Climate Resilience Metrics in Financing Operations.

are realised despite these risks. These activities include adjustments or improvements required to ensure that the project performs well against experienced and anticipated impacts of climate change. Adaptation is not the primary objective of the activity.

b. Type 2/Activities that have shared objectives of adaptation and development: Activities that directly reduce physical climate risk and build the adaptive capacity of the system within which the activity takes place.[9]These activities are typically identified based on a robust understanding of physical climate risks faced by the system within which the project takes place. These activities are themselves adjusted to cope with experienced and anticipated impacts of climate change. Adaptation is one of the objectives of the activity.

c. Type 3/Activities that enable adaptation: Activities that contribute to reducing the underlying causes of vulnerability to climate change at the systemic level and/or removing knowledge, capacity, technological and other barriers to adaptation. This type of activity supports adaptation beyond its immediate scope by creating enabling conditions for policy and regulatory environment developments, physical or natural asset enhancements, capacity strengthening, technology developments or knowledge enhancements. These activities are themselves adjusted to cope with the experienced and anticipated impacts of climate change. Adaptation is the primary objective of the activity.

**Table 1. A summary of the three types of adaptation activities**

| | ADAPTATION ACTIVITIES | | |
|---|---|---|---|
| | **Type 1** | **Type 2** | **Type 3** |
| Description | Activities that integrate measures to manage physical climate risks and ensure that the project's intended objectives are realised despite these risks | Activities that directly reduce physical climate risk and build the adaptive capacity of the system within which the activity takes place | Activities that contribute to reducing the underlying causes of vulnerability to climate change at the systemic level and/or removing knowledge, capacity, technological and other barriers to adaptation |
| Objective | Activities that integrate measures to | Activities that directly reduce physical climate | Activities that contribute to reducing the |

[9] The system within which the activity takes place can include the project or programme it is part of, surrounding geographic areas and landscape, and/ or the socioeconomic entities and groups benefiting from the project.

| | | | |
|---|---|---|---|
| | manage physical climate risks and ensure that the project's intended objectives are realised despite these risks | risk and build the adaptive capacity of the system within which the activity takes place | underlying causes of vulnerability to climate change at the systemic level and/or removing knowledge, capacity, technological and other barriers to adaptation |
| Adaptation finance | Less than 100% of MDB finance on the activity | Less than 100% of MDB finance on the activity | 100% of MDB finance on the activity |

10. The MDB adaptation finance tracking methodology centres on the understanding that adaptation is context- and location-specific. Adapting to climate change requires the use of a process-based approach to assess climate change vulnerabilities and identify the activities required to reduce such vulnerabilities. The following sections describe how this process-based approach is applied to different financial instruments to identify adaptation activities and estimate adaptation finance.

## III. ESTIMATING ADAPTATION FINANCE IN INVESTMENT AND PROGRAMME LOANS AND GRANTS WITH KNOWN USE OF PROCEEDS

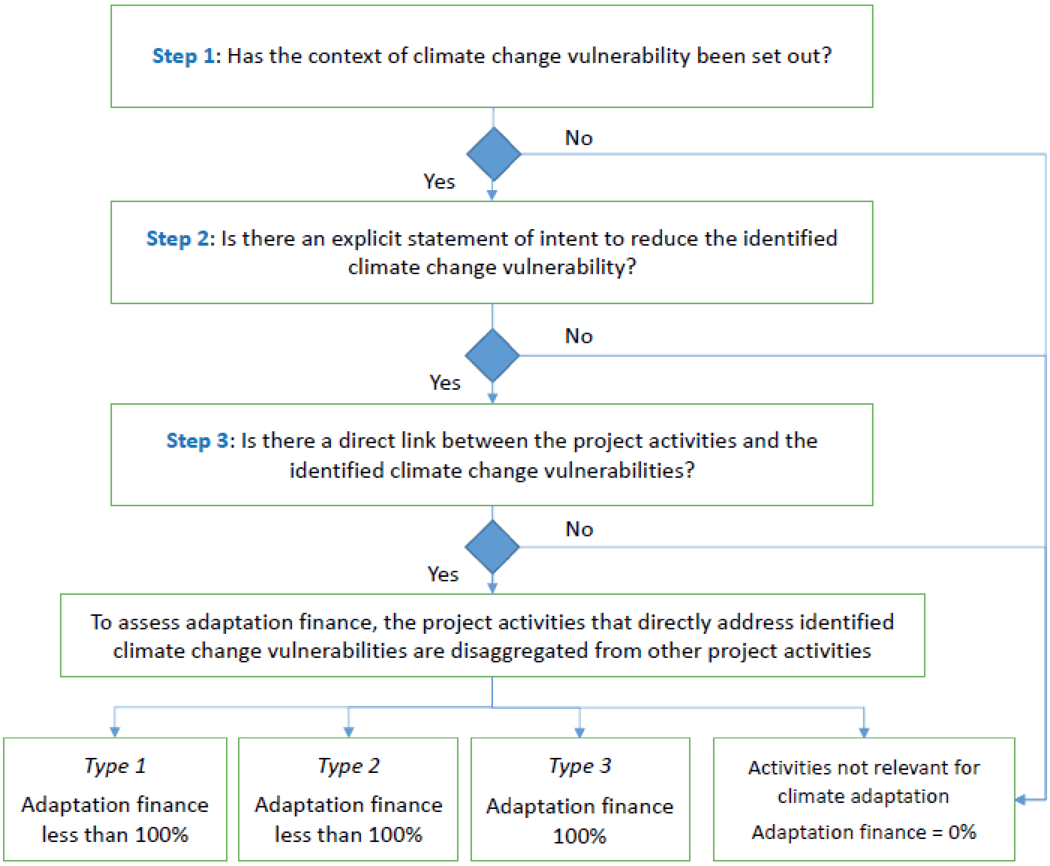
11. Investment loans and grants with known use of proceeds are financial instruments where the project's sectoral and geographical scope is typically known in advance.

12. In such financial instruments, the MDB methodology on adaptation finance tracking requires the following three key steps to identify adaptation activities:

    1. Setting out the project's context of vulnerability to climate change.
    2. Making an explicit statement of intent of the project to reduce the climate change vulnerabilities identified.
    3. Articulating a clear and direct link between specific project activities and the climate change vulnerability identified in Step 1.

13. Once adaptation activities are identified in a project, adaptation finance can be estimated using either an incremental or proportional approach. Figure 1 illustrates the process for applying the updated MDB adaptation finance tracking methodology to investment and programme loans and grants. The process is discussed in further detail below.

**Figure 1: The multilateral development banks' adaptation finance tracking process**




**Step 1. Context of vulnerability to climate change**

14. For an activity to be considered an adaptation activity, the context of climate change vulnerability to experienced and anticipated impacts of climate change must first be set out clearly using a robust evidence base. Project documents may refer to existing analyses and reports or to original, bespoke assessments of climate change vulnerability.

15. Good practice in conducting original, bespoke analysis entails the use of information from trusted sources, which document the vulnerability of communities, physical assets and/or ecosystems to climate change, as well as the use of recent climate trends including any departures from historic means. These may be combined with climate change projections drawn from a range of climate model simulations, with high and low greenhouse gas emission scenarios, to explore the full range of projected impacts and uncertainties. Climate projection uncertainties should be presented and interpreted transparently. The timescale of projected climate change impacts should match the intended lifespan of the activities being financed through the project. For activities without clear lifespans (for example certain types of nature-based solutions or investments in operational expenses), an appropriate timescale of projected climate change impacts should be considered.

**Step 2. Statement of intent**

16. Once a project's context of vulnerability to climate change has been established, the project documents should set out the explicit intention to address the identified climate change vulnerabilities. This is an important step to ensuring experienced and anticipated impacts of climate change are considered in a project.

17. The methodology is flexible about the way in which this intent is demonstrated, as long as the project does not exacerbate vulnerabilities beyond the project boundary or is not inconsistent with relevant adaptation strategies and plans such as national adaptation plans, nationally determined contributions and long-term strategies or other relevant policy documents. For example, the statement of intent could be reported in final technical documents, documents for MDB board approval, internal memos or other associated project documents.

**Step 3. Clear and direct link between climate change vulnerability and project activities**

18. In line with the principles of the overall MDB climate finance tracking, adaptation finance estimations consider only the finance allocated to specific project activities that are clearly linked to the context of climate change vulnerability identified in Step 1. Therefore, where possible, projects are disaggregated into discrete activities. Adaptation finance is attributed only to the activities that clearly respond to the context of climate change vulnerability. Each project activity can then be assessed as an adaptation activity or not relevant for adaptation. When it is not possible to break a project down into activities, the project should instead be treated as a whole.

19. Adaptation finance can be estimated using one of the following two approaches:

    a. The incremental approach estimates the additional costs associated with the activities required to adapt the project to climate change against a hypothetical baseline where the project would aim to deliver expected results without addressing physical climate risks.

    b. The proportional approach refers to adaptation finance estimated as a proportion of the MDB finance that corresponds to the adaptation activities included in a project. This may be informed by a range of credible sources including assessments of the cost of adaptation in similar operations or expert knowledge on the relevant sectoral practice, together with information on the assumptions and calculations used. The multilateral development banks will continue to share and exchange knowledge on the criteria that may be used to inform the use of the proportional approach.

20. For type 1 and type 2 activities, adaptation finance is less than 100% of the activity cost. Adaptation finance is estimated using an incremental approach or a proportional approach.

21. For type 3 activities, adaptation finance is 100% of the activity cost because such activities are motivated by the need to address experienced and anticipated impacts of climate change.

## IV. ESTIMATING ADAPTATION FINANCE IN OTHER FINANCIAL INSTRUMENTS

22. Since 2012, the multilateral development banks have diversified and grown their offering of financial products in order to serve the needs of their clients and as a result of advances in the field of sustainable finance. In addition to financial instruments such as investment and programme loans and grants, multilateral development banks have also increasingly provided adaptation finance through other financing instruments such as lines of credit, guarantees, equity, policy-based financing and results-based financing

23. This section provides an initial framework to track adaptation finance in policy-based financing, working capital and intermediated financing. Adaptation finance attribution for these instruments is still based on the three-step approach, which has been further clarified to reflect the nature of these financial instruments.

24. The multilateral development banks will continue to work together and with other financial institutions to further develop approaches for tracking adaptation finance in other financial instruments, such as guarantees, equity and results-based financing.

**Policy-based financing**

25. Policy-based financing supports national and subnational programmes of policy reforms and institutional actions that promote growth, poverty reduction and sustainable development. Financing is made available as non-earmarked general budget financing upon satisfactory implementation of the overall policy and institutional reform programme, which includes a set of critical policy actions.

26. The policy actions supported through policy-based financing are defined and agreed upon between the MDB and the recipient government in advance and are outlined in the project documents. Policy actions may be fully dedicated to addressing climate change vulnerabilities and contributing to climate change adaptation or may be designed to simultaneously support other development objectives.

27. The MDB methodology on tracking adaptation finance in policy-based financing identifies adaptation activities using the following three steps:

    a. Context of vulnerability: The operation clearly sets out the context of climate change vulnerability using a robust evidence base, and adaptation activities that are required to strengthen the recipient's policy and institutional framework.

    b. Intent: The operation supports the recipient to identify policy actions that can contribute to adaptation and sets out the explicit intention to develop such policy actions consistent with the context of vulnerability and in line with relevant adaptation strategies and plans.

    c. Clear and direct link between climate change vulnerability context and policy actions: The policy actions included in the MDB operation directly contribute to addressing the identified climate change vulnerabilities and/or enabling adaptation.

28. If these three criteria are met, climate adaptation finance is estimated at the policy action level and using a proportional approach. Adaptation finance is allocated to each policy action that articulates a clear and direct link between the climate change vulnerability context and the specific policy action.

**Working capital**

29. Working capital is finance provided by a multilateral development bankto an entity for operational expenditures. Working capital is considered to contribute to adaptation if it leads to, enables or supports the implementation and operation of adaptation activities.

30. The MDB methodology on tracking adaptation finance in working capital identifies adaptation activities using the following three steps:

    a. Context of vulnerability: The context of climate change vulnerability has been clearly set out for the recipient's business model or stakeholders of influence.

    b. Statement of intent: The recipient conducts adaptation activities, has sustainability certifications that require practices associated with reducing climate change vulnerability, and/or produces products or provides services that enable adaptation.

    c. Capacity of the recipient: The recipient has the institutional capacity to report on related adaptation activities, sustainability certifications that include adaptation practices, and/or information related to products or services that enable adaptation, or otherwise commits to strengthen that capacity.

31. If these three criteria are met, then the adaptation finance is estimated as the finance associated with the adaptation activities included in the business model of the recipient using a proportional approach or incremental approach. The estimate is based on the operational expenditures associated with the adaptation activities.

**Intermediated financing**

32. Intermediated financing is financing that multilateral development banks provide through banks, non-banking financial institutions, funds or other financial intermediaries.

33. For intermediated operations, there is often high level of uncertainty on the use of proceeds in advance. In this case, estimating adaptation finance relies on a robust understanding of the activities that can contribute to adaptation within the geographical and sectoral scope of the MDB transaction, and the capacity of the recipient to utilise this information to scope, implement and monitor these activities.

34. When the use of proceeds is defined, the MDB methodology on tracking adaptation finance in intermediated financing identifies adaptation activities using the following three criteria:

a. Context of vulnerability: The recipient has an understanding of climate change vulnerabilities and adaptation activities within the geographical and sectoral scope of the MDB transaction, based on existing national/regional/local adaptation plans, other relevant information sources or an assessment developed by the multilateral development bank.

b. Statement of intent: The recipient has a preliminary project pipeline or an initial list of activities covering the scope of the MDB transaction. In the event such a pipeline does not exist, the intermediary undertakes to develop and deliver such a pipeline. In both cases, such a pipeline contributes to reducing climate change vulnerabilities and does not undermine relevant adaptation strategies and plans. This commitment is reflected in the financing agreement and is realised by the time the MDB finance is fully utilised.

c. Capacity of the recipient: The recipient has the institutional capacity to identify and report on adaptation activities, or otherwise commits to strengthen that capacity. Evidence of this capacity could include dedicated responsibility for climate change adaptation, a climate risk management system, the disclosure of physical climate risk, or other evidence of processes that can support the identification of physical climate risk and adaptation activities.

35. If these three criteria are met, the multilateral development bank may determine the adaptation finance as follows:

   a. When the use of proceeds is known, adaptation finance is estimated as the percentage of finance associated with adaptation activities included in the initial project pipeline.

   b. When the use of proceeds is undefined — for example if a project pipeline is still being developed at the time of project approval or in the case of a general credit line — the multilateral development bank may estimate adaptation finance using a projected allocation to activities that contribute to adaptation, as committed in the financing agreement. The projected allocation can be based on the percentage of the recipient's existing investment portfolio financing adaptation activities at the moment of the MDB's transaction, a client survey or a market assessment. The multilateral development bank will periodically verify actual disbursements to inform future similar operations.

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