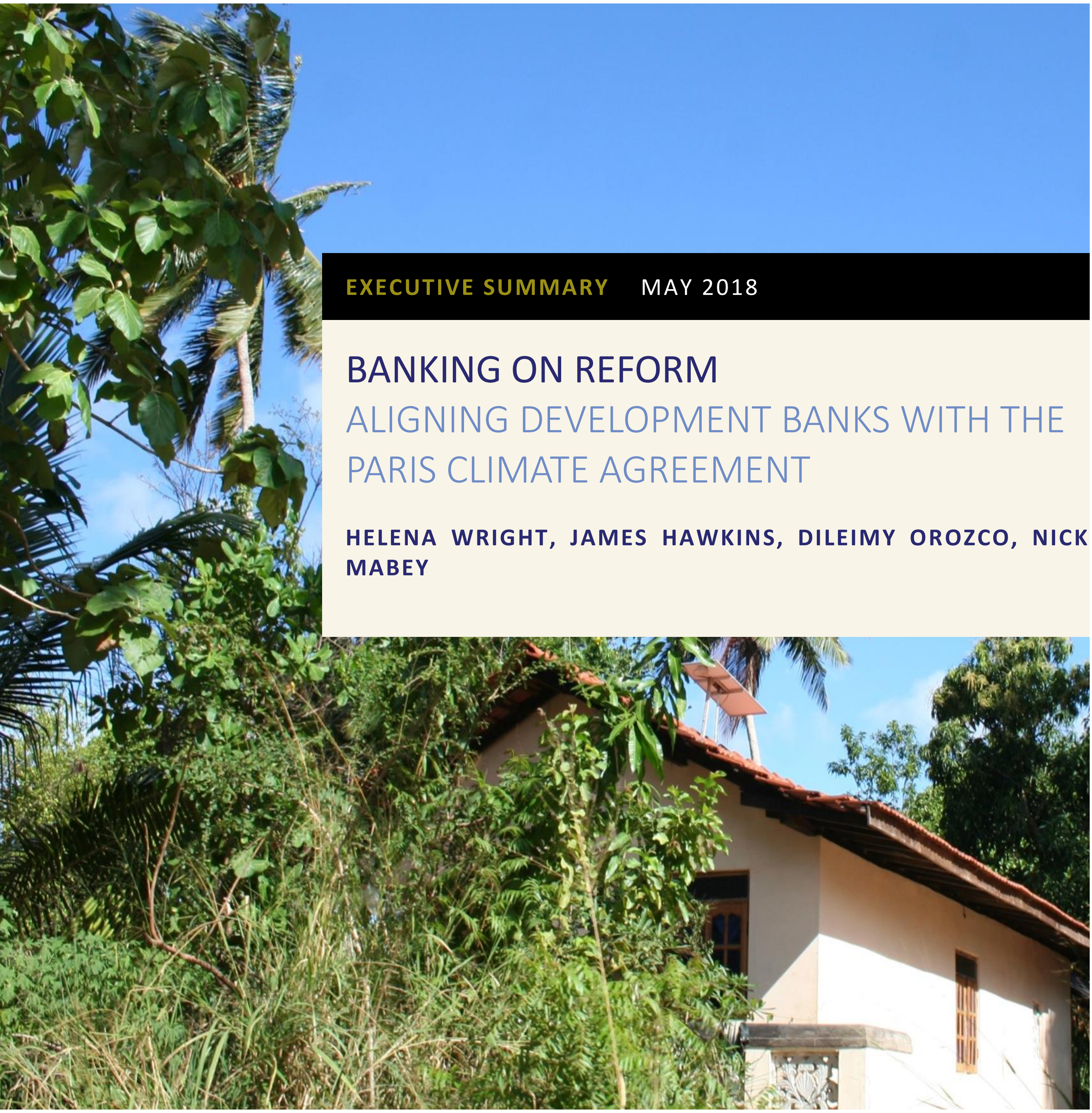

EXECUTIVE SUMMARY MAY 2018

BANKING ON REFORM

ALIGNING DEVELOPMENT BANKS WITH THE PARIS CLIMATE AGREEMENT

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EXECUTIVE SUMMARY

The Multilateral Development Banks (MDBs) have a crucial role in achieving the Paris Agreement and the Sustainable Development Goals (SDGs). The main development banks have committed to align their financial flows with the UN's Paris Agreement on climate change[1]. In this report, we assess their progress in this commitment.

The world is expected to invest approximately US$90 trillion in infrastructure over the next 15 years. The investment choices over the next few years will start to lock-in a climate-smart and inclusive growth pathway or a high-carbon and unsustainable pathway for decades to come[2].

The multilateral development banks occupy a unique catalytic position in achieving the Paris goals - complementing governments limited resources and leveraging multiple times their investments from private capital. Moreover, MDBs assist client governments in planning and project preparation, and can play a role in providing economic advice on development pathways that last for decades. As publicly funded institutions, they have a duty to ensure their investments are in the wider public interest and that they are not financing harmful or risky activities.

This report assesses the progress of the six main MDBs: the African Development Bank (AfDB), Asian Development Bank (AsDB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank (IADB) and World Bank Group (WBG) in aligning their financial flows with the UN's Paris Agreement on climate change. The assessment scores and ranks their progress across sixteen criteria within four different thematic areas: Governance, Strategy, Risk and Operational Management, and Transformational Initiatives[3]. MDB performance is rated on a scale ranging from 'rogue' to 'transformational'. Analysis involved a combination of desk research, project-level data analysis, and stakeholder consultations.

[1] IDFC-MDB Statement (2017) **Together Major Development Finance Institutions Align Financial Flows with Paris Agreement**

[2] New Climate Economy (2016) **The Sustainable Infrastructure Imperative**

[3] These sub-categories of indicators were informed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures. See: **www.fsb-tcfd.org**

Key Findings and Recommendations

The multilateral development banks have the potential to lead the world towards a sustainable transition. The final ranking shows that **the Inter-American Development Bank is leading the way among the group in supporting the transition to a low-carbon and resilient economy**. The European Investment Bank and World Bank Group also perform reasonably well.

Nevertheless, none of these institutions has been shown to be transformational across the four different areas, demonstrating that **these banks must do more to integrate climate change across their operations to help achieve the Paris Agreement goals.**

According to the MDBs own estimates, they committed more than US$27 billion in climate finance in 2016[4]. However, some of the banks are still investing in fossil fuels. **The revision of sectoral strategies over the next two years offers a key opportunity to align with the Paris Agreement.**

For all the MDBs, there were gaps in data availability and transparency[5]. MDBs should do more to share learning with one another on best practices and pool data to inform collective progress. Limited data was available on the green/brown energy finance ratio. It is therefore recommended the **MDBs begin tracking and self-reporting on their alignment with the Paris Agreement.**

MDBs are also working in a range of ways to translate Paris pledges – known as nationally determined contributions (NDCs) - into investment plans. The research identified IADB's NDC Invest[6] initiative as a good example. Since country pledges under the Paris Agreements are insufficient to limit global temperature rise to 2°C, we recommend that **MDBs should go beyond offering support on NDCs and offer technical assistance on long-term pathways that align with the goal of achieving net zero greenhouse gas emissions.**

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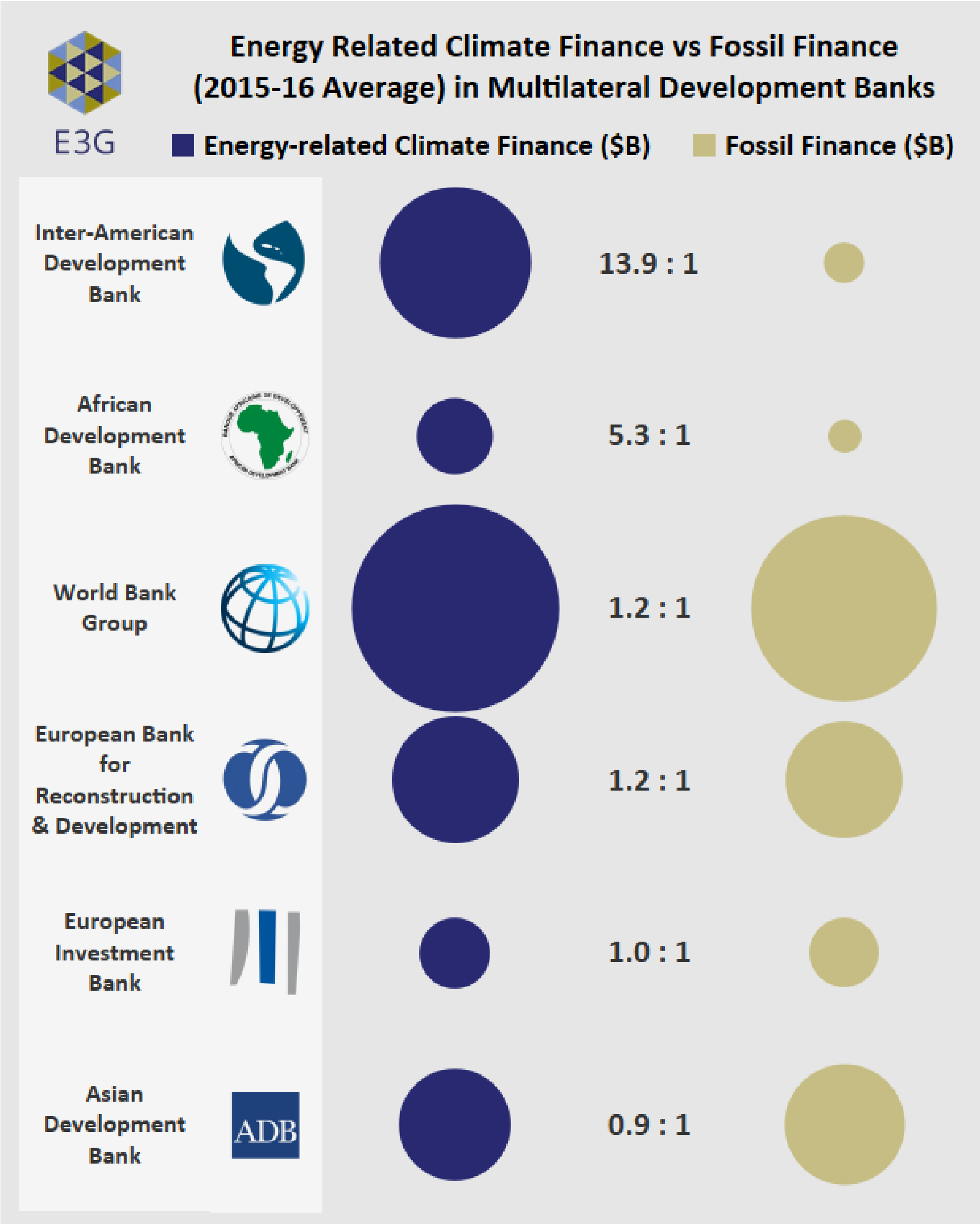
[4] IADB (2017) **MDB 2016 Joint Report on Climate Finance**

[5] The analysis of OECD-DAC climate finance data was also limited by the completeness of reporting by MDBs.

[6] NDC Invest is a comprehensive package of assistance which includes advising on enabling policies to unlock investments at scale. See **www.ndcinvest.org**

Figure 1: Ratio of Energy-related Climate Finance to Fossil Finance Directed to Developing Countries (2015-16 Average), from High to Low



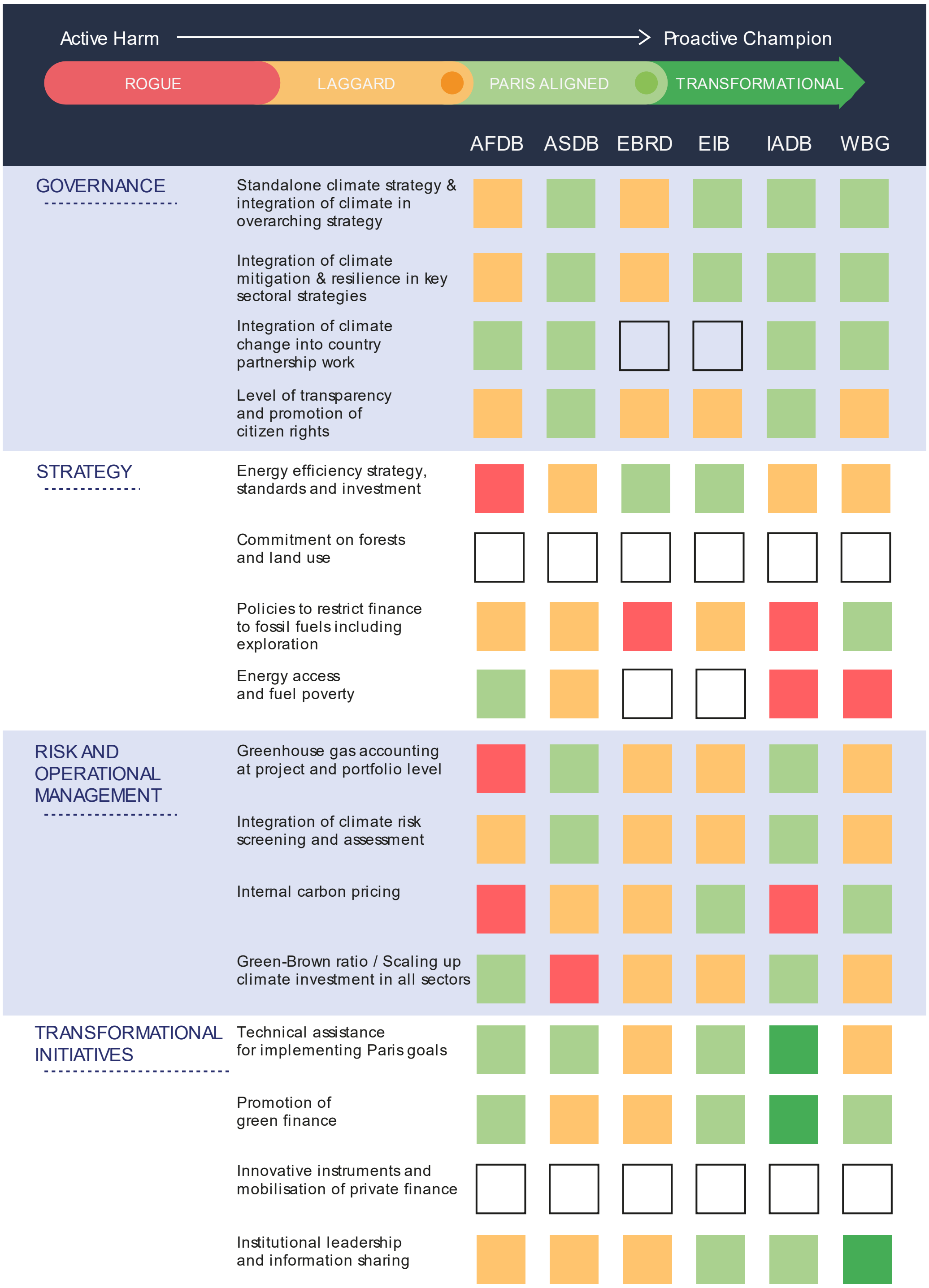
Source: *E3G analysis of OECD-DAC climate finance data*[7] *and fossil finance data from Oil Change International*[8]*. Ratio covers investment in developing countries only. IFC only includes data for 2015*[9]*.*

[7] OECD (2018) **OECD DAC External Development Finance Statistics**

[8] OCI (2017) **Shift the Subsidies**

[9] The International Finance Corporation (IFC) did not report the sectoral breakdown of its climate finance in 2016. MIGA is not included because it does not currently report climate finance data.

Overall assessment:



The MDBs were scored on their progress against these 16 criteria in a simple scoring system[10], with the final ranking being:

- Inter-American Development Bank (1st) – Overall Score: 23 points
- European Investment Bank 2nd) – Overall Score: 22 points
- World Bank Group (3rd) – Overall Score: 21 points
- Asian Development Bank – Overall Score: 20 points
- African Development Bank – Overall Score: 17 points
- European Bank for Reconstruction & Development - Overall Score: 15 points

The analysis and information gathered in this report was used to develop a series of targeted priority recommendations for each MDB, outlined below.

Policy Recommendations

African Development Bank (AfDB)

- **AfDB should update sectoral strategies to incorporate climate change, in key sectors.** The transport strategy is set to be revised soon which provides an opportunity for alignment with the Paris Agreement - it is recommended this be updated to include the 'avoid-shift-improve' approach.
- **AfDB should adopt standards for energy efficiency of power generation and building projects which it supports**, including learning from the IFC's EDGE program. AfDB requires 20% energy savings from energy efficiency projects - a positive signal which could be adopted more widely. AfDB should seek to ensure key infrastructure investments are efficient in terms of energy use.
- **AfDB should consider becoming the first MDB to make a commitment on reducing deforestation or increasing afforestation with its finance.** This would be particularly significant given the importance of forests for the African region.
- **AfDB should disclose the absolute greenhouse gas emissions from projects in high-emitting sectors, as well as reporting on emissions across the portfolio,** and considering setting a reduction commitment, as well as considering the usage of shadow carbon pricing for project assessment.
- **AfDB should make additional effort to support countries with climate-resilient policies,** particularly given the vulnerability of the region it operates in.
- **AfDB should explore which member countries would benefit the most from energy subsidy reform**, as other MDBs have done.
- **AfDB should continue to support countries with green banking and green bond issuance**, building on existing work. AfDB could assess what proportion of its credit lines go to green activities and consider providing technical assistance to local financial institutions interested in financing green investment.

[10] MDBs were scored with a simple points system with a score of '3' for transformational, '2' for Paris-aligned, '1' for laggard and '0' for rogue. EIB and EBRD's average scores for categories they were ranked on were extrapolated to the total number of criteria so as not to disadvantage them for categories which were not applicable.

Asian Development Bank (AsDB)

- **AsDB should continue to integrate climate into its country work** following the Paris Agreement, and support countries with deep decarbonization, as IADB is doing.
- **AsDB should require energy efficiency standards for power generation or buildings** in AsDB-supported projects, in line with best practice in other MDBs.
- **AsDB should consider committing to net zero deforestation** or making an equivalent commitment on forests. AsDB's climate framework notes that AsDB has a very limited portfolio of investments on preventing deforestation and degradation and AsDB should look at filling this gap given the importance of forests for the Paris Agreement goals. Fisheries and oceans may well also be a crucial gap given the importance of fisheries in the Asian region – an area which requires further research.
- **AsDB should put restrictions in place to limit oil and gas lending**, which would improve the Bank's green to brown energy lending ratio.
- **AsDB should ensure its commitment to reduce portfolio emissions takes into account best practices** in terms of disclosing absolute emissions and on project inclusion thresholds.
- **AsDB should update its internal carbon price** with the recommendations from the High-Level Commission on Carbon Pricing, as the World Bank has recently done.
- **AsDB should support regulators on greening the financial system and green fiscal reforms**, building on existing work.

European Bank for Reconstruction and Development (EBRD)

- **On fossil fuel finance, the upcoming revision of EBRD's Energy Sector Strategy this year is an opportunity to align with the Paris Agreement.** EBRD should immediately rule out oil finance as well as putting in place a timeline for ruling out gas investments by 2020.
- **EBRD should consider setting a target for emission reductions to be achieved across its portfolio.** IADB and AsDB have already made commitments in this regard. EBRD has a portfolio-wide greenhouse gas accounting system in place, providing a suitable basis for setting a reduction target.
- **EBRD should consider additional efforts to support clients with climate resilience**, as well as scaling up adaptation finance**.**
- **EBRD should introduce a carbon price across all sectors and update its carbon price** in line with levels recommended by the High-Level Commission on Carbon Pricing. EBRD is currently looking into this area and deciding on the application and scope of shadow pricing[11].
- **EBRD should improve on the quality of reporting of its climate finance data to OECD-DAC.** Many climate finance projects were missing the project description and/or short description.

[11] Information received from EBRD.

- **EBRD should provide technical support on long-term pathway planning for deep decarbonization**, as well as in supporting countries and private sector actors to understand stranded asset risks.
- **EBRD should provide green finance support for regulators and a broader set of national financial institutions**, building on existing work on green bonds and work with local financial institutions.
- **EBRD should work with other MDBs to share its learning on financing energy efficiency.** The research identified EBRD's work on energy efficiency as an example of leadership among the MDBs.

European Investment Bank (EIB)

- **On fossil fuel finance, EIB's upcoming revision of its energy strategy is an opportunity to align its energy lending with the Paris Agreement**. As for EBRD, EIB should immediately rule out oil finance, strengthen its emission performance standard, as well as putting in place a timeline for ruling out gas investments by 2020. This would improve EIB's green to brown energy finance ratio.
- **EIB should consider setting a greenhouse gas emission reduction target across its portfolio,** as well as measuring the greenhouse gas impacts of its equity investments.
- **EIB should make additional efforts to scale up adaptation finance,** as well as support climate resilience as part of its technical support.
- **As part of the European Investment Advisory Hub (EIAH), EIB should provide advisory support on 2050 pathway planning and support on fossil fuel subsidy reform.** Our analysis found that all of the MDBs had provided some form of technical support on fossil fuel subsidy reform, apart from the EIB.
- **EIB should work to support regulators and local or national financial institutions on green finance**, including continuing to support green bond markets, building on existing work.
- **EIB should continue to work on alignment with the Paris Agreement, including sharing the learning and findings with other MDBs.** There are signs of progress given that EIB plans to assess the level of alignment with the Paris Agreement as part of its mid-term review of its Climate Strategy 5-year implementation plan.

Inter-American Development Bank (IADB)

- **IADB should set standards for energy efficiency for investments in relevant sectors** e.g. learning from IFC or EIB. IADB currently does not require the use of a specific energy efficiency standard in buildings financed through its operations (hospitals, schools, offices, housing, etc).
- **IADB should be the first MDB to pledge to net zero deforestation or make an equivalent commitment on reducing deforestation.** To address deforestation, IADB could be the first among the MDBs to **provide technical advice to support sustainable food consumption**, in line with the goal of keeping global temperature rise below 2 degrees.
- **IADB should go further than the WBG and rule out oil and gas investment**. This commitment would reflect existing progress in greening IADB's investments whilst setting an example for others.

- **IADB should assess whether it should increase its portfolio emission reduction targets.** IADB has a target for reducing emissions across its portfolio and should assess whether this target is ambitious enough to support the Paris Agreement goals. IADB should consider pioneering a commitment for **alignment of its portfolio with 1.5 degrees.** This may require conducting an assessment of its alignment.
- **IADB should consider using internal carbon pricing** and to align this shadow price with the High-Level Commission recommendations. The IADB is currently reviewing this issue.

World Bank Group (WBG)

- **WBG should support client countries with long-term economic planning for 2050 pathways** and integrate this into their work as well as supporting client countries on understanding stranded asset risks**.** WBG should seek to provide more publicly available information about its NDC Support Facility to enhance transparency.
- **On energy access, WBG should consider setting a target** to improve overall progress on sustainable energy access, as well as supporting Climate Vulnerable Forum countries to meet their goal of 100% renewable energy by 2050.
- **WBG should ensure its commitment to greenhouse gas reporting integrates best practices from across the MDBs.** This should include disclosure of absolute project emissions, for all projects with emissions above 25kt of emissions. Based on available evidence, WBG should set **a reduction target for gross portfolio-wide greenhouse gas emissions.**
- **WBG should further strengthen its climate finance target,** in line with the ambition in other MDBs.
- **Among the WBG institutions, the International Finance Corporation (IFC) should adopt climate risk screening processes**, as are already used within the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA).
- **IBRD and IDA projects should adopt energy efficiency standards for investments in the power sector and buildings.** i.e. IFC standards requiring power plants to be in the top quartile of efficiency, and for buildings to reduce absolute energy use by at least 20% compared to the baseline.

Conclusions and implications for future research

The MDBs have committed to aligning with the Paris Agreement. To ensure this commitment is robustly implemented, the MDBs must commit to use tools which assess their level of alignment across the portfolio. The European Investment Bank shows emerging signs of leadership in this area, as EIB plans to assess the level of alignment as part of its mid-term review of its Climate Strategy 5-year implementation plan. For all MDBs there was limited transparency of project-level data with which to estimate the MDBs green to brown energy finance ratio, meaning that fossil fuel spending was drawn from secondary data. To improve transparency on climate-related disclosures it would be helpful if the MDBs Annual Reports and/or Joint Reports would self-report on such information, including to inform country members on progress. In line with the Task Force on Climate-Related Financial Disclosures (TCFD)[12], MDBs should assess their exposure to high-carbon assets. MDBs should also disclose disaggregated data on the instruments used and private finance mobilised. Various transformational case studies were identified in the report from across the MDBs, including the Carbon Pricing Leadership Coalition[13], ProAdapt[14], and IFC's EDGE tool[15]. MDBs should do more to share learning with one another on best practices and pool data to inform collective progress.

Research challenges included the difficulty of tracking down missing data, and new initiatives and updates being announced on a regular basis. As such, we have included all data possible where it was robust and conclusive, but we also understand that this would benefit from further research or annual updates. In addition, while this research focused primarily on key infrastructure sectors, there are other important climate-relevant sectors such as forests, agriculture, oceans, and waste on which further research is needed. Among all MDBs, it was found that additional research was needed to identify what proportion of climate finance goes to forests. Additional research would be needed explore how transport investments can better align with the Paris Agreement. In addition, scoring against several criteria was based on guidelines and policies which were introduced recently, and future research will be required to review the implementation of those guidelines and policies in practice as information becomes available. As such, further updates to the methodology may be required.

Overall, the MDBs should seek to learn from best practices within other MDBs. On green finance, all MDBs should seek to provide relevant technical assistance on green finance for regulators including finance ministries, central banks and local and national financial institutions. This should include putting in place robust policies and incentives to build capacity of other institutions to carry out environmental screening and 'green' their investments. In addition, MDBs should seek to create investment vehicles and financial structures that maximize private sector leverage, as well as working with local financial institutions. These rankings are likely to change in future, and climate change should be incorporated as sectoral strategies are updated.

The findings have implications for other national and international financial institutions, given that multiple institutions have committed to aligning their financial flows with the Paris Agreement. For example, new multilateral institutions such as the Asian Infrastructure Investment Bank (AIIB) should look to implement best practices from the MDBs on areas such as portfolio greenhouse gas accounting, climate risk screening and energy efficiency.

[12] See: **www.fsb-tcfd.org**

[13] Convenes leaders to put in place effective carbon pricing policies. See: **https://www.carbonpricingleadership.org/**

[14] Aims to increase the climate resilience of micro, small, and medium enterprises and works with microfinance institutions (MFIs) to help them incorporate climate risk. See: **https://www.proadapt.org/**

[15] EDGE provides a no cost assessment tool to help broaden uptake of green buildings. See: **https://www.edgebuildings.com/**