Paris Alignment Principles:
What International Finance Institutions need to do to align financial intermediary investments with Paris and tackle climate change

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Paris Alignment Principles: What International Finance Institutions need to do to align financial intermediary investments with Paris and tackle climate change

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Introduction

Tackling the climate crisis and keeping the average global temperature rise below 1.5 degrees Celsius requires fundamental shifts in the way financial flows from publicly backed international financial institutions (IFIs) are channeled and managed. In this context, key institutions in the financial sector, including multilateral development banks (MDBs), have committed to aligning their operations with the Paris Agreement. This effort is not nearly ambitious enough, nor is it complete.

MDBs have focused early efforts on aligning their direct finance with the Paris goals. They have set later deadlines for how indirect investments either support or undermine climate goals including through financial intermediary (FI) lending – for example, while most MDBs promise alignment of direct finance by 2023, for indirect investments, this is delayed to 2025.[1]

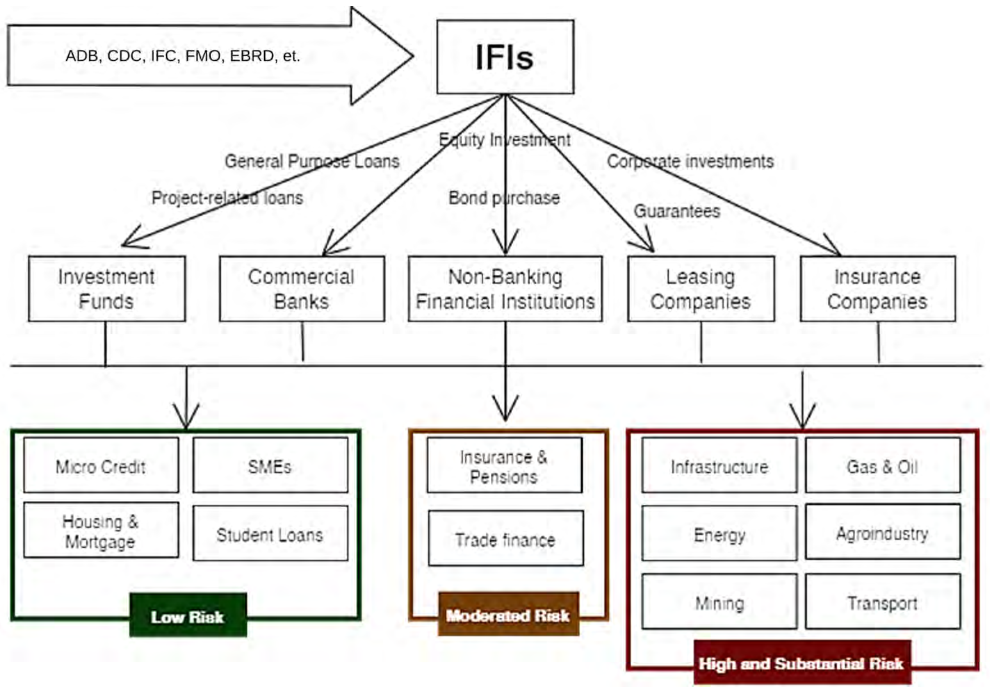
It is vital that MDBs address this type of financing – not only is it a significant portion of many MDBs' portfolios but indirect financing through financial intermediaries can end up providing continued support for fossil fuels. Addressing this will be a critical task if IFIs are to achieve full alignment with Paris goals and to go beyond this, to effectively tackle the climate crisis. The MDB Joint Working Group on Paris Alignment presented a draft framework for aligning financial intermediary investments with Paris at the climate talks in Glasgow in 2021.[2] 2022-2023 will be a crucial period as MDBs adapt this broad framework for their own contexts and publish their own more detailed methodologies. The European Bank for Reconstruction and Development (EBRD) was first out of the block[3], releasing its draft methodology for public consultation in January 2022.[4]

This paper proposes recommendations for principles IFIs should observe in aligning their FI investments with Paris and tackling climate change. It aims to inform ongoing review processes on Paris alignment methodologies for FI lending across the different IFIs such as the Asian Infrastructure Investment Bank (AIIB), the Asian Development Bank (ADB) and the International Finance Corporation (IFC). The recommendations set out in this paper build upon existing work of civil society and the experiences of project-affected communities on investments made through financial intermediaries.[5]

1.1 What is financial intermediary investment? Why is it important?

Financial intermediary investments are a form of indirect financing involving mainly private sector and some public clients that can take the form of equity investments, general purpose loans, project-related loans, bond purchases, corporate investments or guarantees. This type of lending delegates the responsibility to manage social and environmental impacts of sub-projects and sub-investments to FI clients, such as commercial banks, private equity funds, or non-banking financial institutions such as insurance firms or microfinance organisations. FIs then use this financing to fund sub-projects or sub-investments typically implemented at the country or regional levels covered by the financial intermediary's scope of operations. MDBs tend to favour one form of client over another – for example, the IFC overwhelmingly supports commercial banks through its FI portfolio, where the AIIB mainly backs equity funds.

Figure 1. What is a financial intermediary?



Source: Oxfam International with modifications by author[6]

FI investments comprise a significant and growing share of overall IFI commitments. For instance, in 2020, around 60% of the overall portfolio of the IFC was made up of FI investments.[7] The European Investment Bank (EIB) has doubled its use of this lending model over the last 15 years, so that it accounted for approximately 37% of lending in 2020.[8]

1.2 Why is financial intermediary lending problematic?

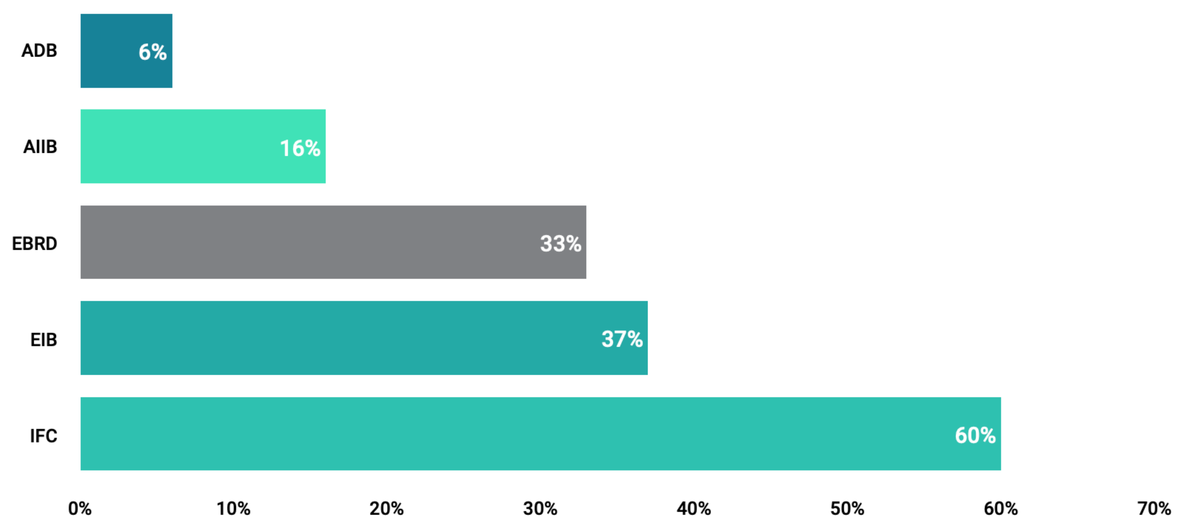
Unlike in direct financing, IFIs rarely disclose information about what sub-projects are financed by their FIs, with some exceptions. Generally speaking, once an FI investment is approved, IFIs largely delegate the responsibility to assess and approve sub-projects to FIs. In some cases, IFIs may require FI clients to submit sub-projects for approval, for example, the EBRD and the AIIB require high risk sub-projects to be referred back to the bank for scrutiny.

But in many cases, FI lending transactions allow IFIs to 'outsource' the responsibility of ensuring sub-project compliance with environmental and social safeguards to FI clients. They do this often without providing clear commitments to disclose sub-project level information or exacting clear lines of accountability for corrective actions needed to address possible harms caused by sub-project operations on communities and the environment.[9] This becomes problematic especially when the FI investment is channeled to high-risk sub-projects such as infrastructure, fossil fuel or other extractive projects. The opacity of FI lending operations makes it more difficult to track if and to what extent IFI finance is going to fossil fuel development. This in turn prevents communities and civil society organisations from holding IFIs accountable for their investment decisions that have detrimental consequences for people and planet.

There is growing evidence of FI investments in higher-risk sub-projects that harm people and the environment. For example, in 2018, communities filed a complaint against the IFC's investments in two intermediaries, VietinBank and ABBank, which supported the construction of the Lower Sesan 2 dam. This hydropower project in Cambodia resulted in the forced

displacement of local communities from their ancestral territories as well as the loss of their sources of livelihoods and property.[10]

Figure 2. IFI investments through FIs as a share of total investments



NOTE: *Caution should be taken when comparing figures across IFIs due to differences in definition, reporting standards and disclosure dates on FI investments. For the IFC, data is based on the Early Warning System database released December 2021. Data for the AIIB is based on AIIB's online project database, approved projects E&S category FI. ADB, EBRD, and EIB data is based on the GermanWatch paper Aligning Financial Intermediary Investments with the Paris Agreement released June 2021.*

Sources: AIIB's project database, June 2022; Oxfam and Early Warning Database, December 2021; GermanWatch, June 2021.

Further, the longer investment chains characteristic of FI investments make it difficult to ensure IFIs' environmental and social standards are upheld in IFI-backed projects. Investigations conducted by the IFC's accountability mechanism, the Compliance Advisor Ombudsman (CAO) has repeatedly uncovered cases where these standards have not been applied in sub-projects financed by FI clients. A case in point is IFC's exposure to multiple coal power plants through its $223 million investments in Philippine-based Rizal Commercial Banking Corporation (RCBC). A recent investigation[11] by the CAO confirmed the IFC's failure to ensure that RCBC applied its environmental and social Performance Standards to the financing of 10 coal-fired power plants in the Philippines. This in turn caused serious impacts to the livelihoods, health and well-being of affected communities due to air and water pollution, and physical and economic displacement among other harms.[12]

To bring their investments into alignment with the Paris agreement, it is imperative that MDBs address indirect financing to FI clients with high exposure to fossil fuels. A case in point is the IFC's $75 million investment in Southeast Asia Commercial Joint Stock Bank (SeABank) in Vietnam, approved 31 May 2022. SeABank's track record demonstrates links to PetroVietnam Gas (PV GAS) which is a major fossil fuel player in the country and a member of the Vietnam National Oil and Gas Group (PVN).[13]

Another example is the AIIB's $200 million investment in Infrastructure Development Company Limited (IDCOL)[14] approved in March 2022. Project documents identify potential support for two gas power plants in Bangladesh – a 600 MW Liquified Natural Gas (LNG) plant by Unique Power in Megnaghat and another 600 MW LNG power plant in Chattagram developed by

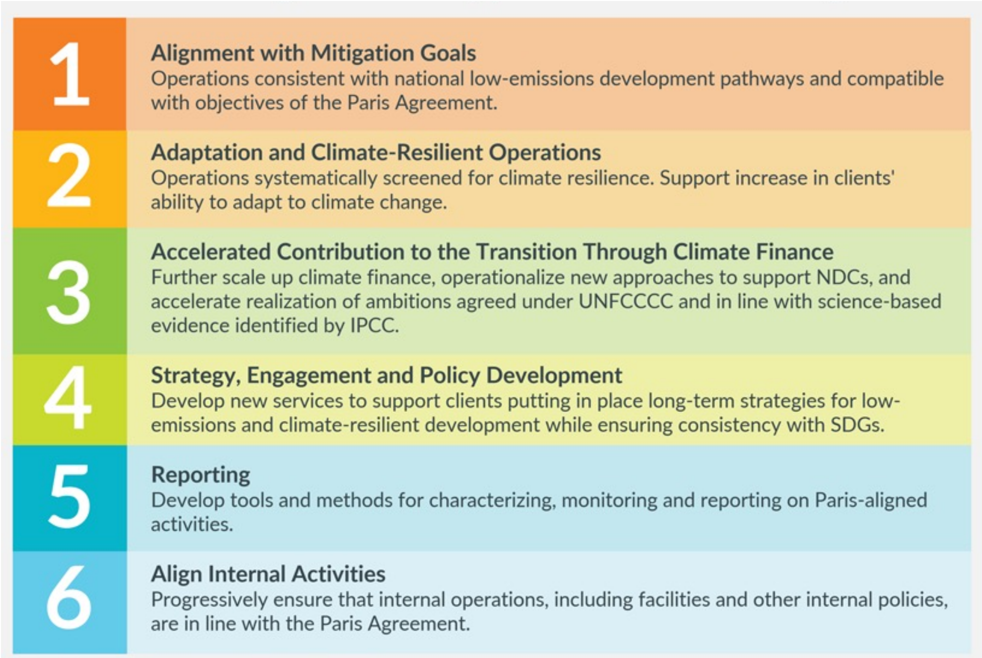
Fenipower. IDCOL has previously supported heavy-fuel oil and gas projects in the country.[15] Despite warnings from civil society, the AIIB has not been sufficiently explicit to ensure its support to IDCOL ends up supporting small-scale renewables instead. The AIIB has included specific restrictions in project documents for other energy-related investments in the past ensuring its funding goes to renewables for example and not fossil fuels, demonstrating that such explicit restrictions are possible.

1.3 What is Paris alignment? Why is it important, but not sufficient to tackle climate change?

In 2015, signatories of the Paris Agreement committed in Article 2.1(c) to make "finance flows consistent with a pathway towards low greenhouse gas emissions and climate resilient development".[16] This commitment provides the mandate for IFIs to align their investments with Paris, which entails the alignment of financial flows to both public and private sectors with the objectives of the Paris Agreement on climate change.[17] For IFIs, this process entails developing a methodology or a framework which can be used to verify if their investments are consistent with development trajectories compatible with the Paris Agreement's temperature and climate resilience targets.

In 2016, several MDBs[18] announced a joint framework for aligning activities with Paris. The framework includes six building blocks (see Figure 3) aiming "to limit the increase in global temperatures to well below 2°C, pursuing efforts for 1.5°C."[19] In 2021, these MDBs also announced target dates for their Paris alignment commitments. Based on these deadlines, MDBs will not fully implement their Paris alignment approaches until 2023 or 2024 (2025 for the IFC) – several years since they first pledged to do so. In addition to the fact that these target dates do not reflect the urgency of the climate crisis, the frameworks developed by MDBs will apply first to new direct investment operations and only later to FIs and indirect finance. The frameworks will not cover the IFIs' existing portfolios[20] and the IFIs will only begin 'road-testing' the methodology for intermediated finance in 2022 – a commitment that has not yet been met as of writing.[21]

Figure 3. MDBs' Building Blocks Approach to Paris Alignment



Source: Joint MDB Working Group on Paris Alignment

Box 1. What are NDCs and why is it problematic to rely on them for Paris Alignment?

Since the signing of the Paris Agreement, countries have pledged to contribute their fair share to combat climate change through their Nationally Determined Contributions (NDCs). NDCs set out country mitigation and adaptation targets every five years to keep global warming in check.

However, the 2021 United Nations Environment Programme's (UNEP) Emissions Gap Report shows that under current government pledges, NDCs are largely insufficient to tackle global warming. Instead, current NDC-based plans will lead to at least a 2.7°C warming by the end of the century. This presents a huge challenge to IFIs who have existing instruments meant to 'align' with Paris while at the same time relying on NDC targets as the basis of their investment projections.

Sources: UNEP Emissions Gap Report 2021; IISD, Are Countries Walking the Talk on Cutting Carbon? 2021

Further, the commitment of IFIs to align finance flows with the Paris Agreement does not necessarily guarantee their finance will align with a 1.5C trajectory considering IFIs base their emissions projections on Nationally Determined Commitments (NDCs) which have been shown to be 'collectively inconsistent' with the Paris Agreement.[22] For example, in a response letter to CSOs, the IFC stated that its Paris Alignment framework for financial institutions "will need to take into account country-specific NDCs."[23]

2. What are IFIs doing to align with Paris?

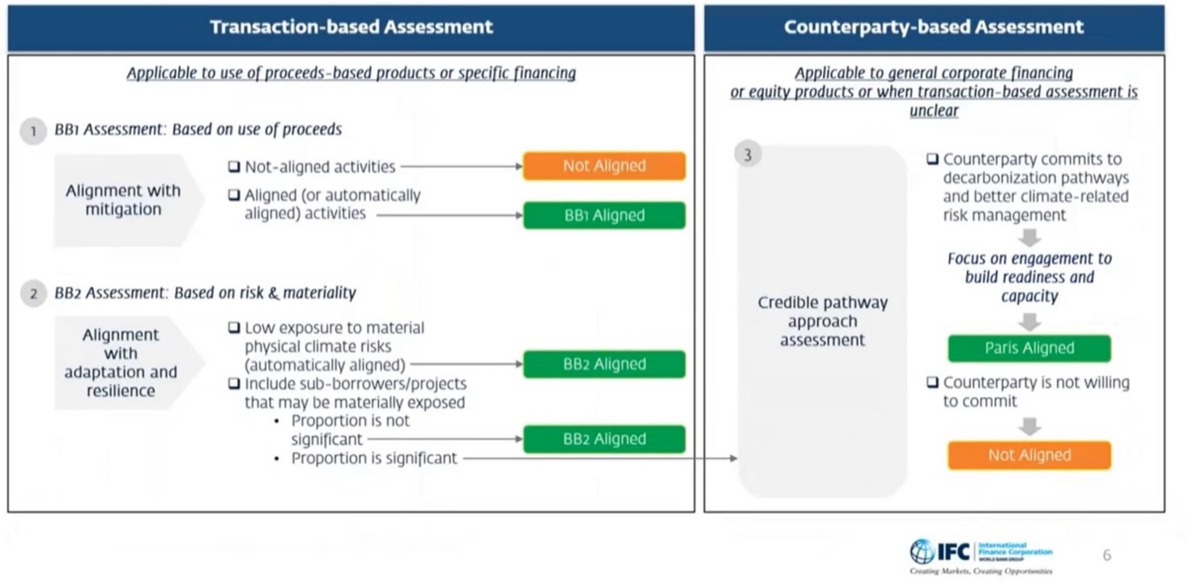
2.1 International Finance Corporation

As the World Bank's private sector arm, the IFC's commitment to Paris alignment is based on the World Bank Group's Climate Change Action Plan 2021-2025 which states that "For IFC and MIGA, 85 percent of Board-approved real sector operations will be aligned starting July 1, 2023 and 100 percent two years later starting July 1, 2025. Once a methodology for financial institutions and funds is finalized among multilateral development banks (MDBs), a similar approach will be taken for this business as well."[24] IFC officials have also stated that Paris Alignment means "being aligned with the objectives of the Paris Agreement, and consistent with client countries' nationally determined contributions (NDCs), long-term strategies and other national climate commitments."[25]

In 2020, around 60% or $6.7 billion of the IFC's entire investment portfolio was channeled to FIs.[26] At the time of writing, the IFC had not released its Paris Alignment methodology for review despite its commitment to "announce its own public consultations this year" including with civil society.[27] For the IFC, as for other MDBs, the Joint MDB Working Group on Paris Alignment's intermediated financing assessment framework will form the basis of this methodology. The framework will be applicable across the MDBs with each institution developing its own approach based on their specific contexts and operations.

The framework assesses FI transactions in two ways: first, if an FI investment is ring-fenced for specific financing, it will go through an alignment verification process based on whether it aligns with building blocks 1 (mitigation) and 2 (adaptation and resilience). Second, investments classified as general corporate financing or equity products will be subject to "counterparty-based assessment". If the FI (the counterparty) is not willing to commit to a 'decarbonisation pathway', the FI investment is deemed not aligned with Paris.

Figure 4. Intermediated Financing Assessment Framework



Source: IFC, 2022

While the framework presents a promising opportunity for fundamental shifts in the way the IFC and other IFIs can ensure Paris alignment of their FI lending operations, it lacks critical details that would be significant in determining whether FI transactions are genuinely consistent with the Paris Agreement. For example, assessing Building Block 2 (BB2) alignment for proceeds-based products (i.e., ring-fenced investments) lacks specificity on how much risk exposure is acceptable for it to be considered Paris aligned. This can potentially pave the way for continued support for FIs that still have exposure to oil and fossil gas for example which is inconsistent with Paris agreement goals. Moreover, the assessment approach for equity investments does not explicitly prohibit an MDB from investing in non-Paris aligned projects. An FI committing to a decarbonization pathway is promising but at present is too weak and lacks detail: how robust will targets and metrics be and who will monitor and enforce these? Crucially, the framework in no way addresses civil society concerns surrounding the lack of transparency in FI transactions which make it difficult to track whether IFIs or their clients are meeting their commitments in reality and ensure IFI accountability for possible harms to people and planet.

2.2 Asian Development Bank

In July 2021, the ADB officially announced its commitment to align its operations with the goals of the Paris Agreement, stating the "ADB will achieve full alignment of its sovereign operations by 1 July 2023. Alignment of its non-sovereign operations will reach 85% by 1 July 2023 and 100% by 1 July 2025."[28] In November 2021, the ADB reported that it is developing a Paris Alignment Guidance Note "to guide project officers in assessing the alignment of its operations…and will not only cover guidance for the assessment of operations but will also cover monitoring and reporting on Paris Alignment."[29] Despite these pronouncements, however, the ADB has not committed to carry out a public review of its methodology.

Like many other public development banks, since the financial crisis of 2008, the ADB has stepped up its support to the financial sector. In the decade after the financial crisis, the ADB increased its lending to FIs tenfold.[30] Since 2009's adoption of the Safeguard Policy Statement (SPS),[31] ADB's active FI portfolio in 2020 stood at over $6 billion, supporting 86 clients. Loans

comprise the majority of the ADB's FI exposure at just over $3.5bn while equity investments total just over $2bn.

The ADB's FI portfolio remains marginal compared to other banks that have their own private sector arm such as the World Bank through the IFC. As of 2020, the ADB's total active FI investments comprise six percent of its total portfolio. Nonetheless, the ADB's FI investments are not without risk. For instance, its Operations Manual states that "[the] ADB may provide loans to financial intermediaries to finance specific development projects whose individual financing requirements are not large enough to warrant the direct supervision of the ADB."[32] This implies the ADB's de facto policy of disengaging from any form of supervision at the sub-project level in smaller deals. A recent internal evaluation by the ADB points to problems with implementation of environmental and social safeguards in FI investing: "projects implemented through FIs have remained the weakest performers on safeguards. Further, FI projects and finance sector projects have performed less well, despite the low-risk portfolio. Similar risks also apply to increasingly important private sector operations in private equity funds and general corporate finance."[33]

The ADB's FI investments also lack transparency, in common with other IFIs. For instance, the SPS does not currently provide clear language on sub-project disclosure requirements to ensure transparency to project-affected communities.

Recourse examined all 86 FI investments approved by the ADB from 2010 to 2020 and nearly every single one had vital social and environmental information withheld. This is unacceptable and lagging behind current good practice[34]; and also makes it impossible for civil society to be able to track and monitor the implementation of any climate commitments the ADB may make.

This transparency is key, since there are several FI investments in the ADB's portfolio that raise red flags, possibly indicating exposure to fossil fuels. Three examples of the ADB FI investments – in commercial banks, a private equity fund and an infrastructure fund – illustrate this problem.

The ADB has invested $400 million in Axis bank and Yes bank in India[35], both of which are heavily exposed to coal. Though ADB's loans target small farms and women, they are not sufficiently ring-fenced. Axis is invested in fossil fuel companies such as Adani, Coal India, Power Finance Corp and Tata Power, among others, with over $5.2bn exposure to fossil fuels[36]; while Yes bank has over $2bn in exposures to companies such as Power Finance Corp and Calcutta Electric Supply Corporation (CESC).[37]

Another risky ADB FI investment is its $95m equity holding in private equity fund Clifford Capital.[38] Clifford has investments in gold and copper mining, oil drilling, oil shuttle tankers, gas power plants, LNG and oil-power plants.[39] In 2015, the ADB entered into its first co-financing deal with Clifford Capital Pte. Ltd. (CCPL) with support to Myanmar's Myingyan Gas Power Project.[40]

The ADB has also invested $100m in India's National Infrastructure Investment Fund (NIIF).[41] Indian NGOs have expressed deep concerns about the NIIF, not least about its partnership with the National Thermal Power Corporation (NTPC).[42] In its MoU with NTPC, NIIF announced its intention "to collaborate to further help India's vision of building sustainable and robust energy infrastructure in the country." With a total installed capacity of 62,100 MW, NTPC

Group has 70 Power stations including 24 Coal, and 7 combined cycle Gas/Liquid Fuel power plants.[43]

2.3 Asian Infrastructure Investment Bank

In October 2021, the AIIB joined the ranks of its IFI peers when it announced its commitment to align its operations with the Paris Agreement by 1 July 2023.[44] This includes the development of a Paris alignment methodology that will cover intermediated finance.

> ***Box 2. Why fossil gas is not Paris-aligned***
>
> Gas is a fossil fuel that generates significant and highly underestimated life-cycle emissions that make a gas power plant only marginally less polluting than a coal plant or equally polluting depending on the location. Gas emits methane, a greenhouse gas that is 87 times as potent as carbon dioxide over a 20-year timeframe. Methane emissions make both conventional and shale gas worse for the climate than coal. The climate impacts of gas are even worse when it is turned into liquified natural gas (LNG) because of the cooling required for the liquefication process, shipping and re-gasification. In 2021, the International Energy Agency concluded that no new coal, oil or gas can be developed if the world is to stay within (already dangerous) global warming targets. Gas infrastructure takes two to five years to build and in order to be financially viable is generally built to operate for 30 to 40 years – which can hardly be considered 'transitional.'
>
> Further investment in gas infrastructure through FIs therefore risks locking countries into decades worth of GHG emissions, pollution and high fuel costs. It diverts critical resources away from renewable energy investments.
>
> Sources: Swanson, C., Levin, A. & Mall, A. (8 December 2020). Sailing to Nowhere: Liquefied Natural Gas is not an Effective Climate Strategy; IEA, May 2021

FI investments are an important and growing portion of the AIIB's overall portfolio at approximately 16 percent of the value of its investments. The AIIB also uses FIs as a vehicle to support the energy sector in various ways including grid infrastructure financing as well as bundling of small-scale renewable energy investments. Its draft Energy Sector Strategy (ESS), currently under revision, however, fails to specify whether it applies to both direct and indirect financing. Ensuring the ESS applies to indirect finance can avoid unintended loopholes that allow projects to be financed indirectly that the AIIB would not usually support directly. An example is the Shwe Taung Cement project in Myanmar, supported by the AIIB through its FI client, the IFC Emerging Asia Fund, which increased extraction from a coal mine, tripling its output.[45]

While the draft ESS excludes support for coal power and inlcudes language on scaling up investments in renewable energies, it strongly features fossil gas as a 'transition fuel' for countries transitioning to low-carbon energy sources. For example, the AIIB recently approved a $200 million loan to IDCOL in Bangladesh, a public aggregator with a significant track record in supporting small-scale renewable energy projects such as rooftop solar. But IDCOL has also supported fossil fuel projects before and this particular investment by the AIIB risks backing two gas power plants (Unique Meghnaghat and Fenipower) in IDCOL's pipeline, which could lock in emissions for up to 30 years.

Despite warnings from civil society, the AIIB has not specified that its investment in

IDCOL must be directed to bundling small-scale renewables for energy access. In previous investments, the AIIB has been explicit in project documents to exclude sectors it does not want to finance, including in the energy sector. For example, the AIIB's 2021 $150 million investment in Global Infrastructure Partners (GIP) Emerging Markets Fund 1 specifies that "Coal mining, coal transportation and coal-fired power plants, as well as infrastructure exclusively dedicated to support any of these activities will be excluded from eligibility for financing under the Project." The same investment also rules out "portfolio companies' Category A or high-risk Category B subprojects."[46] In the same year, the AIIB invested $100 million equity in Keppel Pierfront, stipulating that its private credit fund must "avoid high risk projects which may have, (i) significant adverse impacts to community health and safety as a result of construction/operation of the assets, (ii) significant number of serious injuries and/or fatal accidents during construction and/or operation of the assets, (iii) involuntary resettlement of people and (iv) impacts on critical habitat, indigenous Peoples and cultural resources. These sensitive activities are either to be avoided or managed in accordance with the AIIB's ESP, including applicable ESSs. The Fund shall not invest in coal-related activities."[47] The AIIB's $100 million support to TCB Bank in Georgia in 2021 goes yet further, excluding not only "all Category A sub-projects and Category B sub-projects[48] including inducing higher environmental and social risks" and coal projects, but also stipulating that "large dams will also be excluded."[49] The newly approved Everbright Infrastructure Investment Fund stipulates that, as well as coal, "gas-related subprojects will also be excluded."[50]

Since greenfield gas projects are regarded by the AIIB as either Category A (Sirdarya, 1,500 MW CGGT power plant in Uzbekistan, for example) or Category B (Bhola IPP in Bangladesh), exclusions of Cat A and higher risk Cat B projects in several recent FI investments have de facto ensured that the AIIB does not finance fossil fuels through intermediaries. This ad hoc approach however is still not codified in any of the AIIB's strategies and policies. Nevertheless, the restrictions demonstrate that it is possible to be explicit about fossil fuel exclusions as part of a Paris alignment methodology for FIs to ensure a uniform approach across FI investments.

The AIIB can go further in its framework for Paris alignment of FIs by promoting the potential of FI investments in shifting private finance out of fossil fuels and towards clean energy. One example is the AIIB's investment in the IFC's Emerging Asia Fund, which in 2021 took a stake in India's seventh largest commercial bank - Federal Bank. Building on the IFC's Green Equity Approach (see below), this equity investment resulted in Federal Bank – till now, one of the most important financiers of coal in India – committing to exclude all future coal projects.[51] This catalytic potential to effect transformative shifts in FI clients should be encouraged in the AIIB's Paris alignment methodology especially given such leverage will be key to ensuring the AIIB succeeds in aligning both its direct and indirect investments with the goals of the Paris Agreement. In both the AIIB's Paris alignment methodology and its revised ESS, it is vital that exclusions and targets be stipulated in contracts between AIIB's FI clients and sub-project developers or financiers, to ensure they implement the AIIB's commitments at project level.

3. Why IFIs need stronger guidance to align their portfolios with Paris goals

In examining how IFIs might develop robust Paris alignment methodologies, it is instructive to look at existing methodologies for greening FI finance. One such is the IFC's Approach to Greening Equity (GEA), published in 2020, which commits the IFC to end equity investments in financial institutions that do not have a plan to phase out coal-related investments by 2030. The GEA only covers coal, however, and does not extend to oil and gas. A review of the GEA by Recourse and Trend Asia shows loopholes that allow the IFC to continue financing clients that support new coal projects. For example, Hana Bank Indonesia, barely a year after it signed up to the GEA, financed one of the largest coal plant complexes in the world: Java 9 and 10 in Banten Province, Indonesia (see box). The loan term for Hana Bank Indonesia's support to Java 9 and 10 runs until 2035, in contravention to the GEA's own target to help the IFC's equity clients reduce "exposure to coal to zero or net zero by 2030."[52]

In 2019, the EBRD started implementing its new Performance Requirements (PR), including stricter categorisation and supervision for higher-risk sub-projects supported by FIs. It requires clients to refer such projects back to EBRD for due diligence before proceeding with the investment. The EBRD's PR standards also require FIs to disclose such investments and clearly identifies which of the bank's PR should be met by such projects.[53] This level of scrutiny will allow the EBRD to track fossil fuel exposure among its high risk FI investments. Earlier this year, the EBRD also held a series of public consultations on its Paris alignment methodology for indirectly financed investments – the first of the MDBs to do so.[54]

Overall, civil society welcomed EBRD's efforts to tackle the difficult task of aligning indirect investments with Paris but urged EBRD to set clearer targets and more urgent deadlines, to rule out fossil fuel finance explicitly, and to be more open about where its indirect investments end up.[55] EBRD's alignment methodology will only apply to new clients – not adequately addressing the impacts of its existing 8 billion euro FI portfolio. EBRD proposes, in its Pillar 3, to evaluate its FI client's climate action against "leading market and regulatory practice". This is the wrong metric and will not ensure the urgent action required to avert runaway climate change. The EBRD should rather ensure FIs' climate action is measured against what averting the climate crisis requires. EBRD's Pillar 1 defines its client's commitment "to move towards

Box 3. The case of Java 9 & 10 coal complexes

The IFC was instrumental in founding Hana Bank Indonesia (HBI) as a subsidiary of South Korea's Hana Bank, providing $65 million in equity and loans since 2007. In May 2019, the IFC took an equity stake in HBI, signing the bank up to its Green Equity Approach. However, in July the following year, HBI provided project loans to PT Indo Raya Tenaga to develop the Java 9 and 10 coal plants in Banten Province, Indonesia, with a combined capacity of 2,000MW.

Java 9 & 10 coal power plants are predicted to produce an average of 10 million tonnes of CO2 per year and 250 million tonnes of CO2 over 25 years, which is equivalent to the annual emissions of Thailand or Spain. The plants are predicted to have extreme adverse effects on local communities' public health: Greenpeace estimates that the pollutant emissions will "cause between 80 and 244 additional annual premature deaths in the Indonesian population, accumulating to 2,400 to 7,300 additional premature deaths over a typical 30-year lifetime of coal-fired power plants."

Sources: Trend Asia, 2020; Recourse, 2020; Greenpeace, 2020; APMDD, 2020

business practices that are consistent with the goals of the Paris Agreement and to work with the EBRD, partner MDBs, a development institution or an impact investor to implement that commitment." A vague intention to 'move towards' undefined business practices 'consistent' with Paris goals is again too vague: this fundamental commitment should be much clearer and timebound, giving targets and dates.

More recently, the Dutch Development Bank (FMO) consulted publicly on its Position Statement on Impact and ESG for Financial Intermediaries. The position statement

fails adequately to address climate risks in FMO's FI portfolio, delegating responsibility to its FI clients and failing to ensure transparency about where money ends up. Dutch NGOs expressed frustration that the policy did not address fossil fuel exposure in FMO's FI portfolio, especially given the fact that FMO's earlier policy on fossil fuels did not cover FI investments.[56] This ommission was highly disappointing given nearly 40 percent of FMO's portfolio – corresponding to 3.7 billion out of the 9.7 billion committed portfolio in 2021 – is channeled through FIs.[57]

In developing realistic and effective ways forward for IFIs to align their FI portfolios with Paris, it is vital to look at where those IFIs are currently at in addressing fossil fuel exposure – what is working, what is not, and where loopholes result in unintended consequences such as that seen in the Java 9 & 10 cases.

4. Recommendations

Box 4. Working Paper on Aligning Intermediary Investments with the Paris Agreement

A coalition bringing together World Resources Institute, Germanwatch, and New Climate Institute, has published a technical guide for how IFIs could align their FI investments with Paris. Such guides can provide helpful technical support, tailored to the many different kinds of FI client and types of FI investments. The guide helpfully includes decision trees for investments, and bases decision-making on four pillars: mitigation, adaptation and resilience, governance and transparency. Usefully, under the mitigation and adaptation pillars, the guide applies to the sub-project level – tracking what the FI client actually does – with governance and transparency at the institutional level.

Source: World Resources Institute, Germanwatch, New Climate Institute, June 2021

Below, Recourse and our partners are putting forward a series of recommendations regarding IFIs' methodologies to align their FI finance with the Paris Agreement, and to tackle climate change. These recommendations are principle-based – putting forward fundamental guiding principles, such as observance of human rights – that must underpin any approach to meeting the climate challenge.

Any Paris alignment methodology for financial intermediaries should be based on the following principles:

Stop financing new coal, oil, and gas projects

Based on the lessons learned from the IFC's Green Equity Approach[58], coal phaseout restrictions are not sufficient to fully align financial intermediary operations with the Paris Agreement. The GEA only prevents the IFC from investing in FI clients that do not have a coal phaseout plan, but it still essentially allows financing for new coal investments, as in the case of Java 9 & 10 coal plants in Indonesia. The prominence of fossil gas touted as a 'transition fuel' in the World Bank's Climate Change Action Plan, the ADB's new Energy Policy and the AIIB's draft Energy Sector Strategy also risks perpetuating fossil fuel lock-in, rather than a shift to renewables. The International Energy Agency concluded that "there is no need for investments in new fossil fuel supply in our net zero pathway" including not just coal, but also oil and fossil gas. To align with the Paris Agreement and keep global warming below already dangerous levels, IFIs must stop supporting new coal, oil and gas projects. Further expansion of oil and gas production and the infrastructure that supports these – whether in the upstream, downstream or midstream segments – is not compatible with the Paris Agreement.

Ramp up support for sustainable renewables

Rapidly scaling up public finance for renewables must complement efforts to rapidly phase out fossil fuel energy sources. Sustainable renewables are energy sources that can meet current levels of energy demand without compromising the ability of future generations to meet their own needs. These include energy sources such as wind, solar photovoltaic, and geothermal energy. Aligning with Paris does not simply entail a phaseout of fossil energy sources, but a transformational increase in the share of renewable sources to the world's energy mix. For instance, while the GEA commits the IFC to support its FI clients in increasing support to climate-related investments to 30 percent for mitigation and adaptation projects, it also must ensure renewable energy investments form a majority of this effort.[59] At the same time, IFIs must exclude fossil fuel projects or sub-projects utilising unproven, risky and expensive technologies, such as carbon capture and storage, which can divert public finance away from a just transition to renewable energy or large dams, which have unacceptable social and environmental impacts. Paris alignment methodologies for FIs must also recognise and prioritise the potential of FIs to act as aggregators in channeling funds to support decentralised renewable energy facilities and related grid and infrastructure development.

Enable a just transition

Paris alignment methodologies for indirect finance should also prioritise supporting and enabling a just transition in recipient countries, to ensure no one is left behind in the shift to clean and sustainable energy pathways. IFIs must base efforts towards a just transition on the principles of social justice, human rights, meaningful work, self-determination, reducing consumption and promoting ecological resilience in addressing the climate emergency.

Review fossil fuel exposure definitions and close loopholes

In their Paris alignment methodologies, IFIs must be careful to ensure they capture all forms of fossil fuel exposure, otherwise loopholes can threaten to undermine effective action. IFIs must close current loopholes in definitions of fossil fuel exposure and in their policies that allow for continued support for coal and other fossil fuels. A current example is the IFC's GEA which defines 'exposure' to coal projects as 'coal-related projects (that) refer to long term (more than 36 months) project finance and/or corporate finance for the development of new coal-related projects.' This definition leaves out financial services, such as underwriting of bonds or share issues, which are a vital source of funding for coal power plants. This results in several of IFC's equity clients, such as Chinese banks which are heavily exposed to coal via underwriting, not being counted and therefore not covered by coal phase-out commitments. This matters because in 2020 alone, a massive 65% of commercial bank financing for fossil fuels was through the underwriting of bond and equity issuances rather than through project or corporate lending.[60]

Address ring-fencing leakage

Ring-fencing is one way for IFIs to channel investments to intended purposes and must be addressed by any Paris alignment methodology. There are concerns that ring-fencing, as currently operated, is insufficiently robust to fully prevent support leaking to fossil fuels. One example is the IFC's 2017 loan to Federal Bank which was ring-fenced for on-lending to SME borrowers. Federal Bank on its part provided a loan to JSW Energy for refinance purposes, which in turn was further sub-loaned to a Special Purpose Vehicle (SPV) that was meant to finance a coal plant.[61] WRI et al address this issue, pointing out that "even earmarked investments can free up capital to invest in misaligned projects by decreasing an FI's overall weighted average cost of capital." It recommends instead that IFIs use totally separate Special Purpose Vehicles to enable clear separation from the FI's balance sheet and core lending.[62] Any targeting of funds to specific purposes must be fully transparent and accountable: able to be traced from source to project.

Ensure timely disclosure in line with the highest standards of transparency and accountability

Transparency is one of the key issues that remains largely unaddressed in FI investments. To be even considered Paris-aligned, IFIs must disclose sub-project information – including at minimum the name, sector and location of high-risk sub-projects, including through second and third-level sub-investments. At the same time, IFIs must require FI clients to disclose disaggregated sub-project information in a timely manner. An example is the IFC's 2021 $84.05 million investment in Equity Group Holdings PLC (EGH),[63] an FI which has significant exposure to the oil and gas sectors. The IFC only disclosed this investment publicly on 11 May 2022 despite its being approved by the board 141 days earlier in December 2021. Another example is the IFC's $75 million investment to Southeast Asia Commercial Joint Stock Bank (SeABank)[64] in Vietnam which has links to domestic oil and gas expansion operations. The IFC disclosed this investment on 1 July 2022 but it had already been approved by the board on 31 May 2022. While the IFC reserves the right to delay disclosure consistent with Section 14 of its Access to Information Policy[65], in cases of exposure to fossil fuels, such exceptions to disclosure – which exist at most MDBs – should be disallowed in Paris alignment methodologies.

Conduct a public review of Paris alignment methodologies for indirect finance and regular reviews.

Each IFI must open up their Paris alignment methodologies – for both direct and indirect finance – for public review to allow stakeholders, including civil society and project-affected communities, to provide input. Like the EBRD, other IFIs should hold public consultations – including meetings, allowing for written submissions, and roundtable discussions with experts and project affected communities – on their methodologies. The EBRD's draft methodology also allows for annual reviews, which are essential to enable the methodologies to be adjusted given new imperatives.

Accountability for harmful fossil fuel FI sub-projects funded to date

Though Paris alignment methodologies should by their nature be forward looking, IFIs must still bear responsibility for the harms that have occurred to date through their indirect financing of fossil fuel projects, such as the RCBC-funded coal plants in the Philippines and Java 9 & 10 coal plants. IFIs should commit to specific actions plans that outline corrective measures for harms caused by FI sub-projects, including who is responsible for taking these actions and within a clear timeframe, and ensure that consultation with local communities is at the heart of these plans.

Ensure a rights-based approach and meaningful stakeholder participation.

Aligning with the goals of the Paris Agreement and tackling climate change do not simply mean being consistent with the goal of 1.5C warming. Being Paris-aligned is not solely a question of supporting climate-compatible investments, such as reducing emissions, but about equity at a deeper level: benefitting people and ensuring a livable planet, being transparent and inclusive, promoting gender equality, doing no harm[66] and respecting human rights. This is the true meaning of Paris alignment. The preamble[67] to the Paris Agreement includes an acknowledgement "that climate change is a common concern of humankind" and that "Parties should, when taking action to address climate change, respect, promote and consider their respective obligations on human rights." The Paris Agreement also adopted measures to promote gender equality and participation, sustainable development, and poverty eradication. In other words, as UN special rapporteur on human rights and the environment John Knox has said, "Governments do not check their human rights obligations at the door when they respond to climate change."[68]

IFIs' Paris alignment methodologies must prioritise the protection and promotion of human rights, including the rights of marginalised communities, such as people of colour, LGBT, Indigenous Peoples, women, youth, children and people with disabilities. In order to do so, IFIs must prioritise addressing energy poverty such as through decentralised renewable energy provision; and renewable energy infrastructure and operation should never come at the expense of human rights.

Paris Alignment Principles

Endnotes

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Paris Alignment Principles

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