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Une initiative de la Caisse des Dépôts et de l'Agence Française de Développement

Aligning with the Paris Agreement

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A CPI and I4CE Executive Summary

Foreword

On 12 December 2015, the 196 Parties to the UN Framework Convention on Climate Change (UNFCCC) offered an unprecedented example of reconciliation as they agreed to put a world increasingly fractured by climate change on a pathway towards sustainable, low-carbon, and resilient development trajectories. Five years later, as we must switch gear from summits to solutions, aligning with the Paris Agreement has become a business case for all financial actors, national and regional development banks leading the way. This endeavor involves taking into consideration the upcoming risks and opportunities which underpin climate change.

At a time when climate action is most needed, it is an honor to present this groundbreaking report, produced by independent think tanks CPI and I4CE, which provides a robust framework usable by the members of the International Development Finance Club (IDFC) – a unique group of 24 national and regional development banks – and the financial community at large. This study includes a number of actionable recommendations designed to align any financial institutions' vision with the goals of the Paris Agreement at country, strategic, and operational levels.

National and regional development institutions are best placed to enable strong interconnections between public and private sectors as well as between local governments and global stakeholders. In particular, IDFC members can act as game-changers in the achievement of long-term national climate objectives. Endowed with an important capacity to redirect financing flows towards climate action, these institutions have already demonstrated their power of action.

To consolidate such results and ensure their stability over time, the IDFC needs to act now in fashion that is fully consistent with the Paris Agreement. And this report, of utmost analytical and operational importance, also highlights the fact the growing responsibilities and financial weight of IDFC members, combined with the urgent need to harness their full potential, require giving them a strong mandate to embark on this journey to alignment and support the objectives of the Paris Agreement as well as deploying those of the 2030 Agenda.

Aligning our financial flows with the Paris Agreement is a challenge but our strength lies in our interactions as a Club. Besides, the newly created IDFC Climate Facility will be a place to share our respective experiences on alignment and further concretize it within our respective institutions and in cooperation with all other willing partners.

In short, implementing an ambitious alignment strategy requires strong leadership and inventive ways of doing business, while seizing the opportunities of financing resilient and low-carbon development.



Rémy Rioux

Chief Executive Officer, Agence Française de Développement

Chair, International Development Finance Club

Executive Summary of Joint Research Project

Mandated by the International Development Finance Club (IDFC) and the European Climate Foundation (ECF), Climate Policy Initiative (CPI) and the Institute for Climate Economics (I4CE) have conducted a research project in two parts, resulting in a **Discussion Paper** (Part 1) and a **Final Report** (Part 2) on “**Aligning with the Paris Agreement**”.

Part 1 led by I4CE establishes a theoretical and conceptual basis for alignment, analyzing and describing the emerging interpretations of the definitions, principles, and approaches across the financial community, and building on the experience of the Climate Action in Financial Institutions Initiative¹.

Part 2 led by CPI identifies the changes the Paris Agreement implies for the role of Development Finance Institutions (DFI) – specifically, members of the IDFC – and how they may implement these changes, through a targeted set of activities.

Part 1: I4CE Discussion Paper²

Alignment with the Paris Agreement: Why, What and How for Financial Institutions?

The Paris Agreement: reframing climate action around the long-term transformation of economies and societies

The Paris Agreement has reframed climate action from a focus on the near-term incremental increase of adaptation and mitigation actions to emphasize the long-term transformation of economies and societies. The Agreement highlights the importance of bottom-up country-led low-greenhouse gas (GHG) emissions climate-resilient development pathways to simultaneously achieve both climate and sustainable development objectives. Governments now have the responsibility to put into place the policy and investment frameworks to support the ‘consistency’ or ‘alignment’ of all social and economic activities with the long-term goals of the Paris Agreement.

1 <https://www.mainstreamingclimate.org/>

2 To read the full I4CE Discussion Paper, please see Cochran, Ian and Alice Pauthier (2019) Alignment with the Paris Agreement: Why, What and How for Financial Institutions? I4CE – Institute for Climate Economics. <https://www.i4ce.org/download/framework-alignment-with-paris-agreement-why-what-and-how-for-financial-institutions>

Financial institutions - whether seeking sustainable development impacts or with a commercial focus – are increasingly committing to align their activities with the long-term goals of the Paris Agreement given that:

- Many will be called to directly contribute to the achievement of the long-term climate goals by shareholders and other stakeholders;
- All will need to manage the risks and opportunities associated with the needed transformation of the economy and the financial environment; and
- All will need to take into account and respond to the changing physical climate.

A Framework for Defining Alignment with the Paris Agreement

I4CE's discussion paper proposes a framework that can be used by financial institutions seeking to align strategies and operations with the Paris Agreement. The framework specifies three dimensions for action:

A Comprehensive Scope of Action: Institutions should seek to directly or indirectly support low-GHG climate-resilient development across all business areas – and take into account impacts on broader systems and value chains. This goes beyond measuring investment in activities supporting mitigation or adaptation outcomes; rather, it implies that all activities are carried out in a manner consistent with the long-term goals of the Paris Agreement.

A Long-Term Time Horizon to Guide Impact: Institutions should prioritize actions that are consistent with both near-term climate objectives and long-term goals and do not lead to lock-in or mal-adaptation. It is essential to recognize that some activities that result in ‘relative’ rather than ‘absolute’ emissions reductions or enhanced resilience may be counterproductive to achieving long-term goals.

An Ambitious Scale of Contribution: Institutions should seek to contribute to the ambitious goals of the Agreement through activities that:

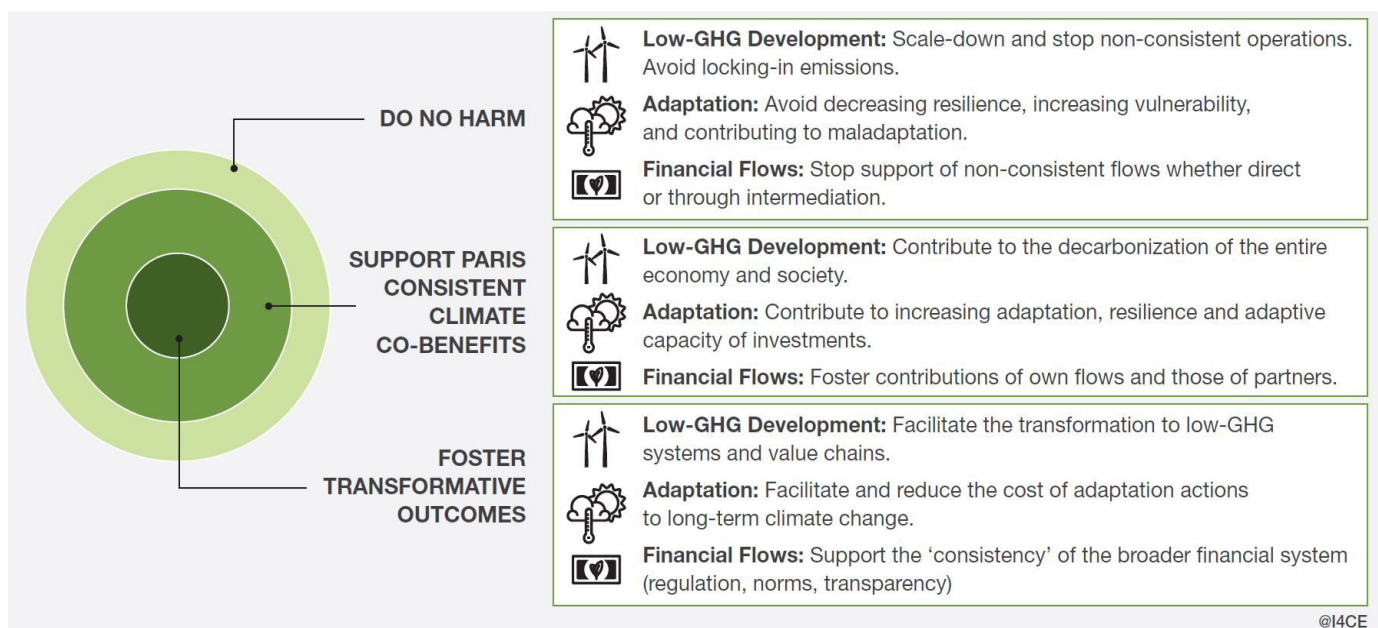
- **Do No Harm:** All activities should neither hinder nor be counterproductive to the achievement of climate objectives and should be consistent with long-term national sustainable and low-GHG, climate-resilient development pathways;

- **Support Paris-Consistent Climate Co-Benefits:** Whenever possible, institutions should prioritize activities with direct or indirect mitigation and adaptation co-benefits that are consistent with the national attainment of the long-term goals of the Paris Agreement;
- **Foster Transformative Outcomes:** Whenever possible, institutions should prioritize activities with ‘transformative outcomes’ that reduce the barriers to and support the large-scale, systemic and structural changes needed for the transition of economic, social and natural systems across and within national economies.

From Theory to Practice, Financial Institutions Can Build on Existing Approaches to Overcome Barriers

Whether institutions are principally focused on sustainable development impacts or commercially-oriented, a commitment to ‘Paris Alignment’ is a commitment to adopt the high level of ambition that is embodied in the Paris Agreement. The scale of contribution of financial institutions will vary as institutions may be involved in different types of business lines that have impact-oriented objectives or more commercial objectives. Nevertheless, for all financial institutions aligning with the Paris Agreement goals must scale-down and halt activities inconsistent

Figure 1: The Paris Alignment ‘Bulls Eye’: actively support national and international transformations across all activities



Source: I4CE

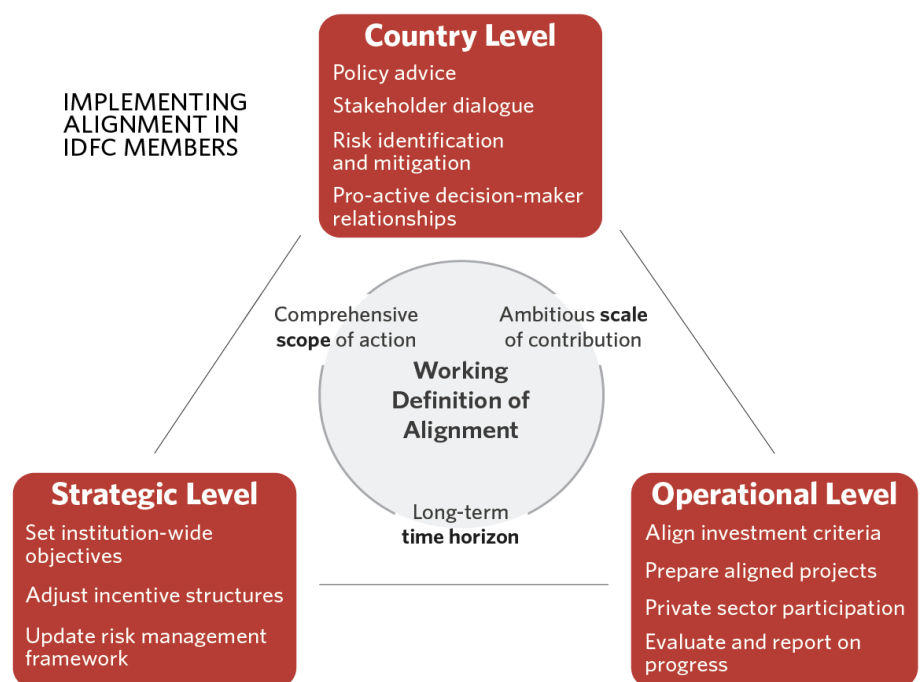
Furthermore, Paris alignment should take into account national contexts and support shared pathways or ‘visions’ of how long-term climate goals could be met nationally and internationally. Assessment of activities should consider both current country contexts and national forward-looking pathways for decarbonized and resilient development. When insufficient or not available, institutions may need to fall back on global projections and scenarios to achieve the long-term goals of the Agreement.

with these goals and contribute whenever possible to national attainment of low-GHG climate-resilient development.

Doing this in practice requires financial institutions to integrate considerations of the Paris Agreement goals into their overarching strategies and operational frameworks and procedures for decision making and investment. Ensuring that all of an institution’s activities are consistent with long-term goals is important. However, it is also important for institutions to determine and act on how they can best leverage their potential to support low-GHG climate-resilient transformations in their countries and sectors of operations.

The financial sector is not starting from zero and institutions can build on existing and emerging climate mainstreaming and climate risk management approaches. However, while addressing many similar issues, these approaches in their current form alone may not lead to institutions rapidly scaling down all 'harmful' activities and reorienting capital to scale up transformative contributions supporting long-term low-GHG and climate-resilient development. As a result, existing approaches may need to be adapted to take into account the changes around scope of action, time horizon of impact, and scale of contribution introduced by the Paris Agreement.

Figure 2: Recommendations for implementing alignment



Source: CPI in collaboration with I4CE

Part 2: CPI Final Report³

Implementing Alignment: Recommendations for the International Development Finance Club (IDFC)

Members of the IDFC, 24 national, bilateral, and regional development finance institutions with more than USD4 trillion in assets under management, can play a critical role in supporting the economic transformation of their countries of operation towards Paris alignment. IDFC members' close relationships with national and sub-national governments allow members to provide direct input and feedback on policy design and influence project pipelines (Crishna Morgado et al. 2019), and their diversity of clients in the public and private sectors allows them extraordinary reach across investment value chains and their enabling environments.

In 2018, the IDFC released a Position Paper on Alignment,⁴ which all members committed to. The Position Paper spells out the members' specific understanding of alignment, establishes their role

in implementing the requirements of the Paris Agreement, and lists a set of commitments to which members agreed.

This Part of the report describes how IDFC members can implement alignment in their institutions, using Part 1's framework of scope, scale, and time horizon as a guide to develop recommendations and taking into consideration IDFC specificities. While IDFC members vary greatly and no two IDFC members may approach alignment in the same way, all play a key role in advancing the alignment agenda through their practices and their ability to support their countries of operation in meeting the goals of the Paris Agreement.

All IDFC members will need to make changes to the way they do business to support the long-term transformational change required. The report proposes that alignment implementation can be facilitated by focusing on the following areas (see Figure 2).

3 To read the full CPI Final Report, see <https://climatepolicyinitiative.org/publication/implementing-alignment-recommendations-for-the-international-development-finance-club>

4 https://www.idfc.org/wp-content/uploads/2019/04/idfc_alignment-with-paris-agreement_position-paper_12_2018.pdf

Institutions can take a first step towards alignment by developing an internal working definition.

An internal working definition of alignment can serve as a common basis for implementation throughout the organization by clearly articulating how the institution will contribute to the Paris Agreement objectives and by sending a clear signal to staff, external market participants, and other stakeholders that climate action underpins the institution's development objectives. The working definition can describe how the scope, scale, and time horizon dimensions of alignment apply to the institution.

Alignment of IDFC members is dependent on their relationships with government, and often vice versa

For publicly mandated development finance institutions, the ability to implement alignment will be greatly facilitated – or constrained – by their countries of operation, both through enabling environments as well as the influence of governments on IDFC members through their Boards. However, IDFC members are also uniquely positioned and trusted to support governments to contribute most effectively to the objectives of the Paris Agreement to which they have all agreed. Therefore, we propose in this study that alignment starts with the special relationship IDFC members have with the governments in their countries of operation.

Specifically, members can support countries in implementing commitments to the Paris Agreement through multiple levers:

- **Policy advice:** Supporting governments to build capacity on and develop forward-looking policy analysis and reform to devise low-GHG, climate-resilient development pathways.
- **Coordination:** Facilitating multi-stakeholder dialogue to include ministries beyond environment including among others finance, development, planning, and sectoral ministries such as agriculture and energy, as well as the private sector and civil society.
- **Risk mitigation:** Building in-country capacity to identify and mitigate climate risks, including physical, liability, and transition risks.
- **Pro-active decision-maker relationships:** Working pro-actively with government stakeholders who have oversight over member institutions (Board, Assembly, etc.) to understand and prioritize alignment alongside development priorities.

Action on alignment is greatly facilitated by executive leadership and institution-wide strategies

Paris alignment will require executive leadership to influence how decisions are made and the modalities to execute them. Alignment can be embedded in the strategic level of the organization by adopting:

- **Institution-wide objectives:** Adopting institution-wide objectives based on the working definition, encapsulating both a long term vision as well as near term milestones, and accompanied by appropriate metrics, can measure progress and incentivize increasing ambition. These objectives should drive the phase-out of non-aligned projects on the one hand, and encourage projects that meet criteria for transformative change on the other.
- **Well-structured incentive and support system:** Adjusting the incentive structures and support system of the institution to build capacity and generate buy-in among staff to support implementation across all operations.
- **An updated risk management framework:** Updating the organization's risk management framework can both encourage investments in aligned activities as well as to manage climate risks. The risk management framework should take advantage of existing unused risk capacity to seek transformative investment opportunities. On the other hand, the DFIs' focus on development benefits means that projects with heightened climate risks might still warrant further preparation and investment – either with accompanying risk mitigation measures or by exploring alternatives that achieve similar levels of development benefits.

At the operations level, alignment requires changes in how investments are assessed and how capital is deployed.

All investments across the institution's operations will need to be assessed against alignment criteria, and capital should be deployed using modalities that help deliver the transformative change necessitated by the Paris Agreement. An aligned IDFC members will undertake the following actions:

- **Update investment criteria:** Develop and integrate alignment assessment processes and decision-making criteria into its investment decisions across all operations, including direct lending, intermediary lending, procurement,

and technical assistance. These assessment processes and criteria should define and distinguish between investments that do no harm, have climate co-benefits, and contribute to transformative change, as well as those that are not-aligned at all. They should also establish a priority for emissions reductions and resilience in the long term, and will therefore need to guide the institution in decision-making under uncertainty.

- **Support early stage project preparation:** Support clients with development of aligned projects and programs from the earliest stages. Later stage projects that seek development finance are often more difficult to make modifications to due to the extensive planning that has already occurred.
- **Promote private sector participation and market development:** Increase use of modalities, such as risk mitigation instruments, that are effective at mobilizing private capital yet are often under-utilized in development finance institutions, including as a result of internal accounting methodologies and individual performance metrics.
- **Evaluate and report on progress:** Measurement and knowledge sharing will allow IDFC members to improve over time.

No IDFC member is currently fully aligned – this is a journey for all members, and they will each approach this differently

The development finance community is faced with a complex challenge in aligning itself with the goals of the Paris Agreement. IDFC members are critically important actors in both laying out and implementing a clear vision for what alignment means. In collaboration with governments, Members can be an effective bridge between the supply and demand for aligned finance.

While IDFC members share a common goal, the differences between them in terms of internal capacity, mandate, national circumstances, and resources imply a range of possible short-term paths. However, these must nonetheless converge with urgency towards activities reflecting the full scope, scale, and time horizon of the Paris Agreement objectives. Multiple options exist to progress towards the Paris goals:

- IDFC members benefiting from centralized leadership can start from the top – with a review of the mandate and development of working definition and targets that then disseminate throughout the organization.
- IDFC members with more challenging political environments can start from the bottom – by proving that climate and development are compatible, and by demonstrating new ways of doing business. An innovation unit can be helpful in this regard to generate internal buy-in.
- Accessing international climate resources – such as from the Green Climate Fund and Global Environment Facility, as well as from other DFIs – can also help drive internal change by building capacity and increasing focus on climate issues.
- Finally, members can leverage collaboration within the IDFC to learn from each other’s experiences and harmonize approaches when possible.

The transition to alignment for the IDFC, individually and collectively, will not be easy, and it will take time – and therefore it should start now. With the roadmap to alignment presented here as a guide, members can scale up and build upon successful examples of existing practices with the sustained, focused effort required across all activities for the Paris Agreement’s goals to be met.

While meeting this challenge will require unwavering commitment and engagement from members themselves, partnerships with others outside the IDFC will be vital. Collaboration with other financial institutions, both public and private, will be needed to streamline methodologies, metrics, and programming; reduce duplication; and accelerate the development of appropriate policy and financial instruments. Most crucially, IDFC members will need support – both political and financial – from the international community and shareholder governments to reach their potential to drive investment towards a Paris-aligned future.

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About CPI

With deep expertise in finance and policy, CPI is an analysis and advisory organization that works to improve the most important energy and land use practices around the world. Our mission is to help governments, businesses, and financial institutions drive economic growth while addressing climate change. CPI has six offices around the world in Brazil, India, Indonesia, Kenya, the United Kingdom, and the United States.

About I4CE

I4CE – Institute for Climate Economics is a think tank that provides public and private decision-makers with expertise on economic and financial issues related to the energy and ecological transition. We strive to implement the Paris Agreement, and make global financial flows compatible with low-carbon development that is resilient to climate change. I4CE is an initiative of Caisse des Dépôts and Agence Française de Développement and is also supported by the ADEME and Morocco's Caisse de Dépôts et Gestion.

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