CLIMATE POLICY INITIATIVE

Implementing Alignment with the Paris Agreement:

Recommendations for the Members of the International Development Finance Club

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Descriptors

Region	Global
Keywords	Paris alignment, Paris Agreement, climate finance, development finance
Related CPI Reports	Global Climate Finance: An Updated View 2018 Blended finance in Clean Energy: Experience and Opportunities IDFC Green Finance Mapping Supporting the Momentum of Paris: A Systems Approach to Accelerating Climate Finance.
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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, Kenya, India, Indonesia, the United Kingdom, and the United States.

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.

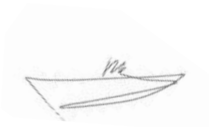
At a time when climate action is most needed, it is an honor to present this groundbreaking report, produced by independent think tanks CPI and I4CE, which provides a robust framework usable by the members of the International Development Finance Club (IDFC) – a unique group of 24 national and regional 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 Initiative[1].

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.

This Executive Summary discusses both parts, with the remainder of the paper constituting Part 2.

Part 1: I4CE Discussion Paper[2]

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.

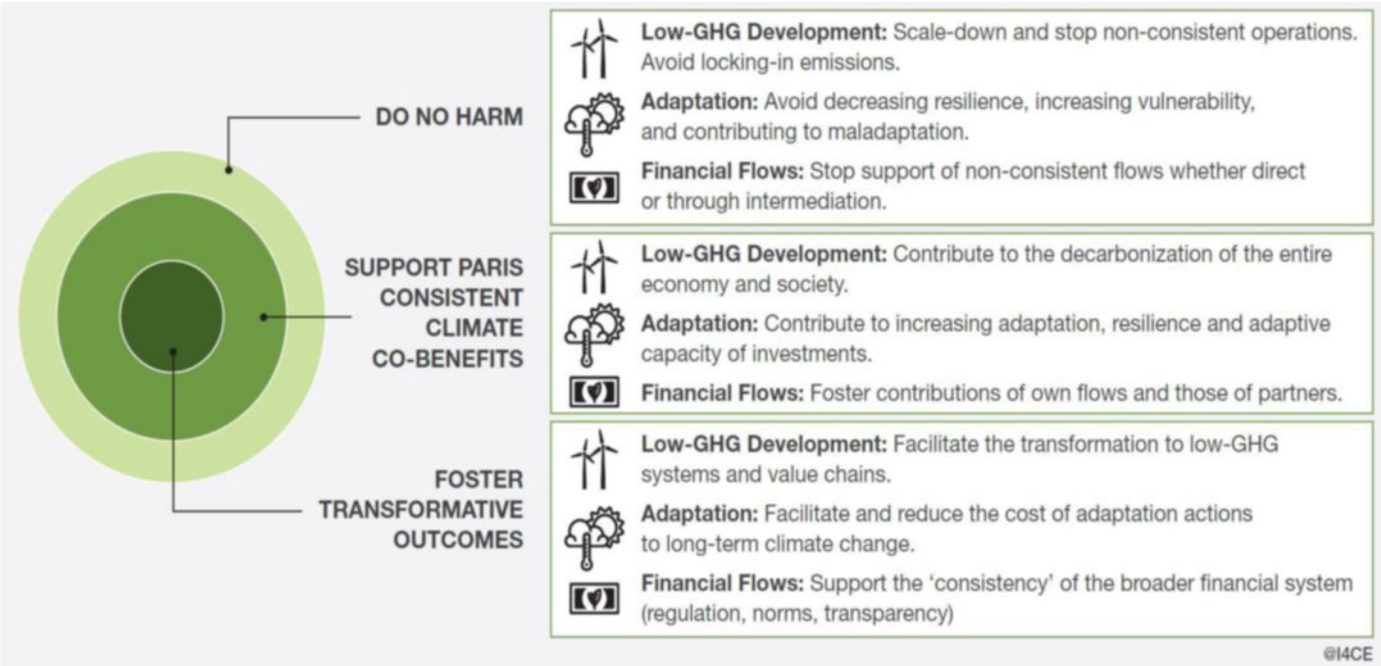
Furthermore, Paris alignment should take into account national contexts and support shared pathways or 'visions' of how long-term climate goals could be met nationally and internationally. Assessment of activities should consider both current country contexts and national forward-looking pathways for 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.

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 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

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



Source: Cochran & Pauthier (2019)

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 are insufficient for institutions to rapidly scale down all 'harmful' activities and reorient capital to scale up transformative contributions supporting long-term low-GHG and climate-resilient development. As a result, existing approaches 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.

Part 2: CPI Final Report

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.

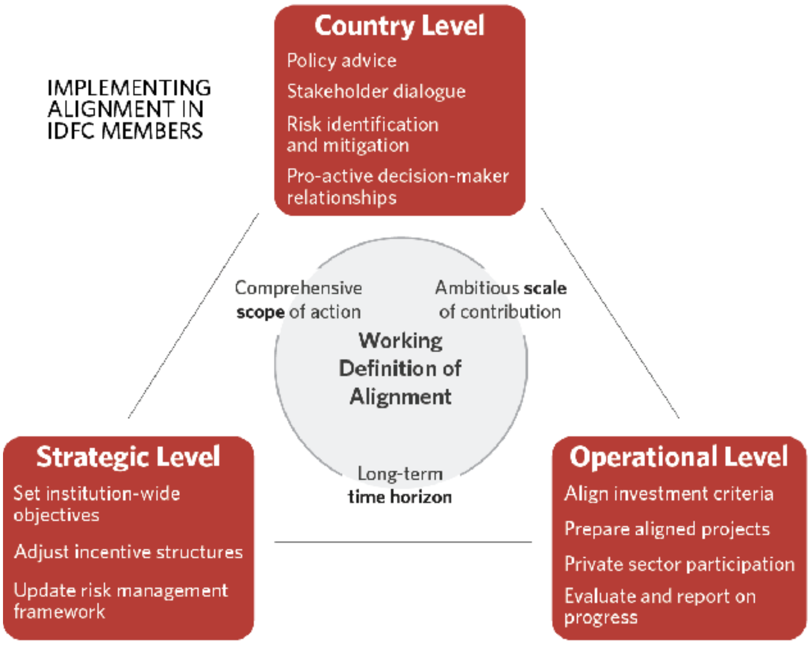
In 2018, the IDFC released a Position Paper on Alignment[3], which all members committed to. The Position Paper spells out the members' specific understanding of alignment, establishes their role in implementing the requirements of the Paris Agreement, and lists a set of commitments to which members agreed.

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

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.

Figure 2: Recommendations for implementing alignment



Source: CPI in collaboration with I4CE

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).

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 and help 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. 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.

Table of Contents

Introduction

Achieving the Paris Agreement's long-term objectives as described in Article 2.1[4] will require rapid and far-reaching transformation of financial sector practices, a process and goal known as Paris alignment. Article 2.1 sets objectives to limit temperature increase to well below 2°C, foster climate resilience and low greenhouse gas (GHG) emissions development, and make all finance flows consistent with these two outcomes, respectively.

Public financial institutions have played a central role in the global landscape of climate finance[5] for some time, contributing significantly to aggregate annual climate finance flows globally. Development finance institutions (DFIs), including multilateral, bilateral, regional, and national development banks, jointly accounted for USD 194 billion in climate finance on average over 2015-16, over 40% of the total tracked (Oliver et al. 2018). The International Development Finance Club (IDFC) played a key role in achieving these figures, contributing USD 147 billion annually over the same period (IDFC and CPI 2016). Established in 2011, the IDFC represents 24 DFIs across the globe with over USD 4 trillion in assets.[6]

However, sole emphasis on increasing climate finance flows falls far short of the economic transformation sought by the Paris Agreement and that can be supported by DFIs. Climate finance, as defined today, is not necessarily consistent with the long-term Paris Agreement objectives, and notably does not account for the vast quantities of non-aligned, or 'brown' financial flows entering the system, including with DFI support (IPCC 2018; Friends of the Earth et al 2019). While recent climate mainstreaming efforts have sought to expand the scope of climate finance to address all flows, they are still not enough to meet the Paris Agreement goals.

IDFC members hold a uniquely influential role in shaping the Paris-aligned future of finance. Member institutions are well-positioned to support transformative change in their countries of operation by assisting governments to improve policy environments, building programmatic and knowledge sharing partnerships with a wide variety of commercial and other DFIs, and sending long-term market signals that climate action is an investment priority. In addition to the sheer size of their direct loan portfolios, IDFC members manage a wide range of financial instruments which are essential to encourage the reorientation of private financial flows to address climate goals. Supporting these actions will require implementation at the strategic and operational levels of IDFC member institutions, as well as closer collaboration with the governments in members' countries of operations.

Meeting the high level of ambition embodied in the Paris Agreement goals will not be an easy process for many IDFC members. Many of the institutional changes required to achieve alignment will pose significant challenges for IDFC members, as well as for other financial institutions. However, IDFC members – and more broadly DFIs in general – can and should scale up and build on their existing practices to meet the sustained, focused effort needed across a number of priority areas to be 'Paris aligned.' The level of political support from shareholding governments can be a key factor in determining the success of alignment. Using the guiding principles and concrete commitments set out in the 2018 IDFC Position Paper On Alignment (IDFC Position Paper)[7] as a basis, as well as theconceptual framework for alignment developed

4 Article 2.1a: "Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change"; Article 2.1b: "Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production"; Article 2.1c: "Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" (United Nations 2015 and further discussed in Cochran and Pauthier 2019, forthcoming)

5 Climate finance is defined differently by different organizations in different contexts. The Global Landscape of Climate Finance, published by CPI (climatefinancelandscape.org) captures any public or private investment or support that reduces emissions or builds resilience to a changing climate for which reliable data is available.

6 www.idfc.org; By contrast, multilateral development banks have US$ 1.5 trillion in assets (Morris 2018)

7 In December 2018, IDFC members made 6 alignment commitments in the "IDFC Position Paper, Alignment with the Paris Agreement": 1) IDFC members committed to increasingly mobilize finance for climate action; 2) IDFC members will support country-led climate related policies; 3) IDFC members seek to catalyze investments, and to mobilize private capital (local & international); 4) IDFC members recognize the importance of adaptation and resilience, especially in most vulnerable countries; 5) IDFC members support the transition from fossil fuels to renewables financing; and 6) Aligning with the Paris agreement is also a process of internal transformation of the institutions, which can build on existing principles and/or practices. For more information, see https://www.idfc.org/wp-content/uploads/2019/04/idfc_alignment-with-paris-agreement_position-paper_12_2018.pdf (reproduced in Annex 3 of this paper)

by the Institute for Climate Economics (I4CE)[8] as part of this joint study, **this report identifies and prioritizes specific implementation steps that members of the IDFC, and other DFIs, can take to align their own activities and to catalyze the Paris alignment of the economies in which they operate**.

The report proceeds as follows:

- **Section 1** introduces the context of Paris alignment by presenting a definition of alignment, explaining why IDFC members play an important role in driving alignment, and setting out a conceptual framework of alignment as developed by I4CE.
- **Section 2** then presents a set of recommendations for IDFC members on implementing alignment, first by presenting a comprehensive roadmap, followed by recommendations divided into three levels:

  Country-level: actions that support governments in developing and implementing long term low-GHG and climate-resilient development pathways.

  Strategic-level: actions that can be implemented at the strategic or leadership level of an IDFC member institution.

  Operational level: the actions that can be implemented by staff with management support.

To develop these recommendations, the authors conducted an extensive literature review and surveyed eight IDFC members, six of which serve on the IDFC's Steering Group, representing bilateral, national, and regional development banks and 20% of the IDFC's total assets under management. In-depth follow-up interviews were conducted with six institutions. Examples of activities being undertaken by members are included throughout the report.[9]

8 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

9 See Annex 1, Methodology, for more information

1. Understanding Alignment for IDFC Members

1.1 Defining Paris alignment

Paris alignment is the process of ensuring that an institution's strategies and activities are consistent with the goals of the Paris Agreement as described in Article 2.1a, b, and c, which set objectives to limit temperature increase to well below 2°C, increase adaptive capacity, and make all finance flows consistent with low-GHG emissions and climate-resilient development pathways. While no one definition or framework for alignment has been proposed to date, emerging work in this area has focused on assessing existing assets and portfolios (Thomä et al. 2017; Nicol et al. 2017; 2° investing initiative 2017), understanding the implication for governments (OECD et al. 2018; Kessler et al. 2018; Whitley et al. 2018), and how development finance institutions may support alignment (Larsen et al. 2018; Wright et al. 2018; Friends of the Earth et al. 2019).

It is increasingly and widely acknowledged that achieving the Paris Agreement goals will require a rapid and far-reaching transformation of the economy, far beyond what current climate action is able to achieve. Therefore, being aligned requires financial institutions to support the achievement of the three goals by scaling-down non-consistent activities and seeking whenever possible to contribute to both the incremental and transformative changes needed at the national and global levels (Cochran and Pauthier 2019).

1.2 The pivotal role of IDFC members in driving Paris alignment

As intermediaries between governments and the private sector, as well as national and international financial systems, IDFC members play a central role in driving both sustainable development and economic transformation. IDFC members are uniquely positioned and equipped to play a central role in supporting Paris alignment for several reasons:

- **Close relationships with governments**: IDFC members' close relationships at the national and subnational levels, with both their own sponsor governments and the governments of other countries in which they operate, allow them to shape policy design and advocate for specific types of projects (Crishna Morgado et al. 2019).
- **Diversity of clients and operating contexts**: IDFC members have a wide range of public- and private-sector clients operating in diverse market structures, political environments, and geographies, providing contact across investment value chains and allowing members to magnify their impact through market signals. Notably, IDFC members primarily finance private entities and subnational governments, as compared to other DFIs, such as multilateral development banks, that primary finance national governments (Morris 2018).
- **Potential for large-scale impact**: IDFC members have assets under management totaling over USD 4 trillion and issued over USD 604 billion in new financing in 2018, of which USD 125 billion was green finance (see Figure 3). Their sponsor countries account for 69% of global emissions and suffered 53% of global economic losses (in PPP) from extreme weather events in the last 20 years (see Figure 4). In addition, 16 of the 25 countries most vulnerable to climate change are represented in IDFC member institutions.[10]
- **Strong foundation for further action**: Since at least 2012, IDFC has led several climate-oriented projects and initiatives, including a biannual green finance mapping report, a joint statement on alignment with the MDBs, and the 2018 IDFC Position Paper.

The IDFC counts several distinct types of DFIs within its membership: Bilateral DFIs engaged in financing projects in developing countries; national development banks with a single shareholder government; and regional development banks with multiple shareholding governments. Their sizes vary greatly—over 90% of total IDFC members' assets are represented by four members: CDB (China), KfW (Germany), BNDES (Brazil), and KDB (Korea)(Morris 2018; De Luna-Martinez et al. 2018). The political will of the shareholding governments plays a decisive role in determining how quickly and thoroughly alignment will be implemented.

IDFC members also have different development priorities: Private sector oriented IDFC members like the Islamic Corporation for the Development of the Private Sector (ICD) and Industrial Development Bank of Turkey (TSKB), or those with majority-owned private

10 As ranked by the ND-GAIN vulnerability and readiness index. Fourteen of these most vulnerable countries are in sub-Saharan Africa, and all sixteen are participants in either the Eastern and Southern African Trade and Development Bank (TBD), the West African Development Bank (WADB), or the Islamic Corporation for the Development of the Private Sector (ICD). See https://gain.nd.edu/our-work/country-index/rankings/

sector arms, like Proparco (AFD) and CDG Capital Private Equity (CDG), aim to create new markets, spur growth, and engage commercial investors.

At the domestic level, national development banks (NDBs) primarily serve to promote the domestic economy through their knowledge of and connections with local financial actors (OECD et al. 2018). In developing countries, NDBs play an especially important role in supporting their countries' development priorities particularly for areas where private capital is lacking (Lorenzo and Netto 2013; Studart and Gallagher 2016).

Despite the different development priorities, each IDFC member is well-positioned to support its shareholding government(s) in increasing climate ambition.

Figure 3: 2018 investment volumes of IDFC members, all investments (USD m)(Source: authors)

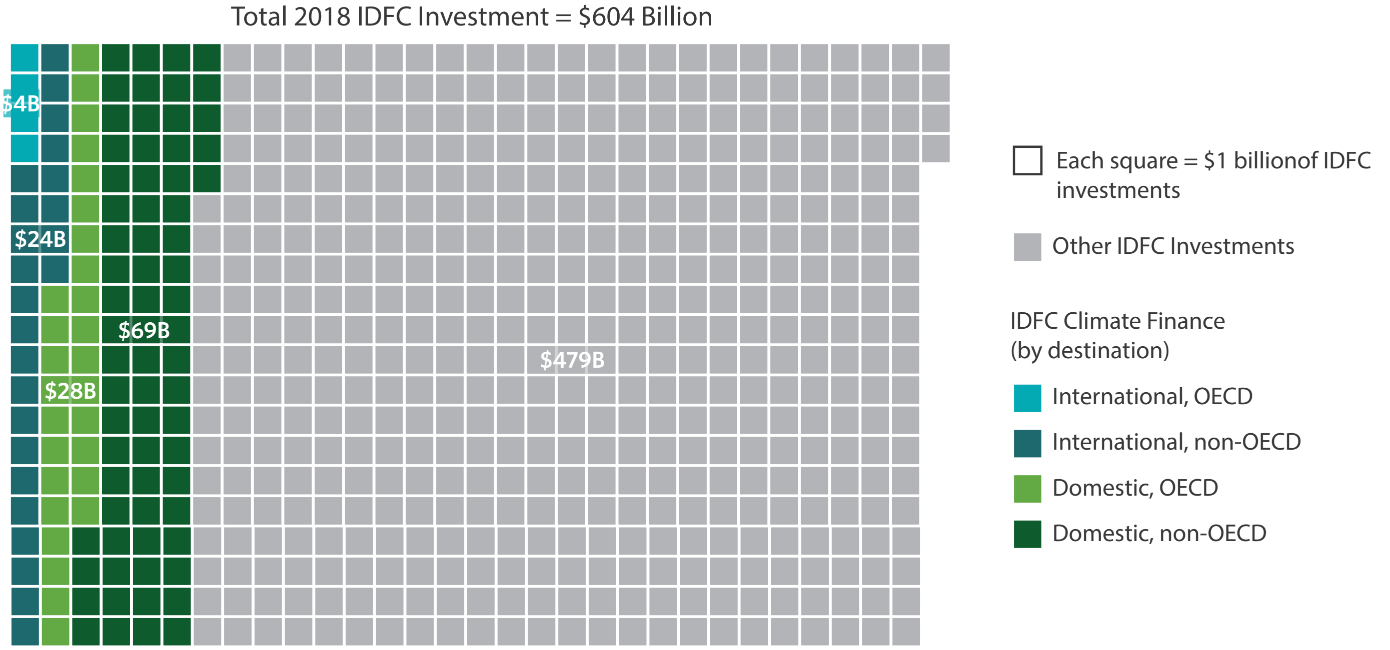
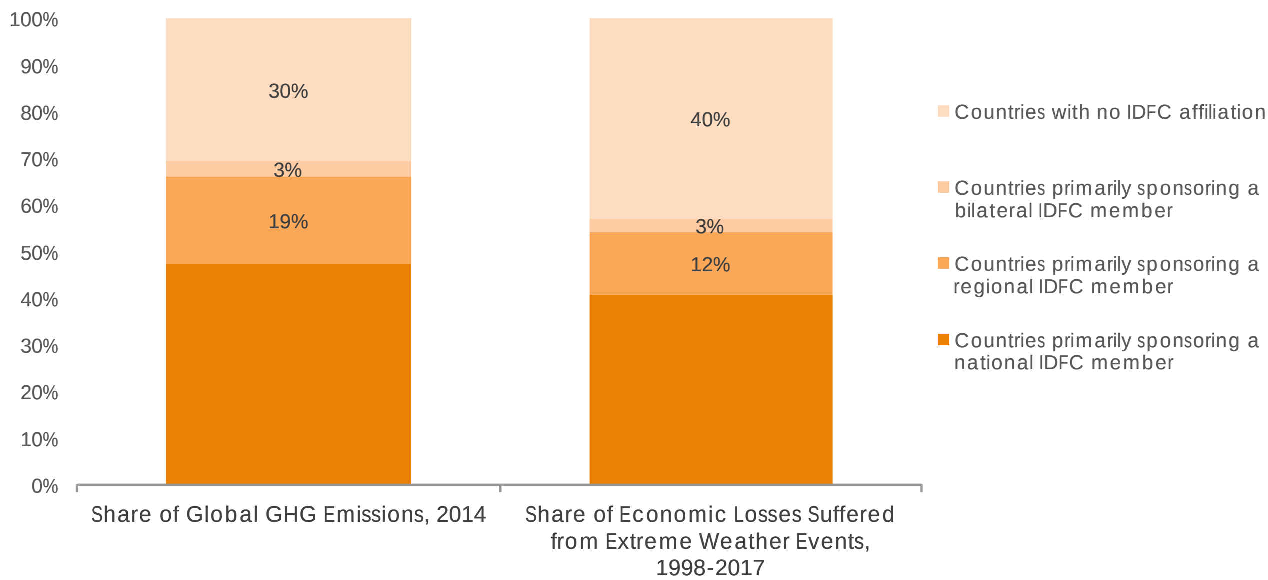
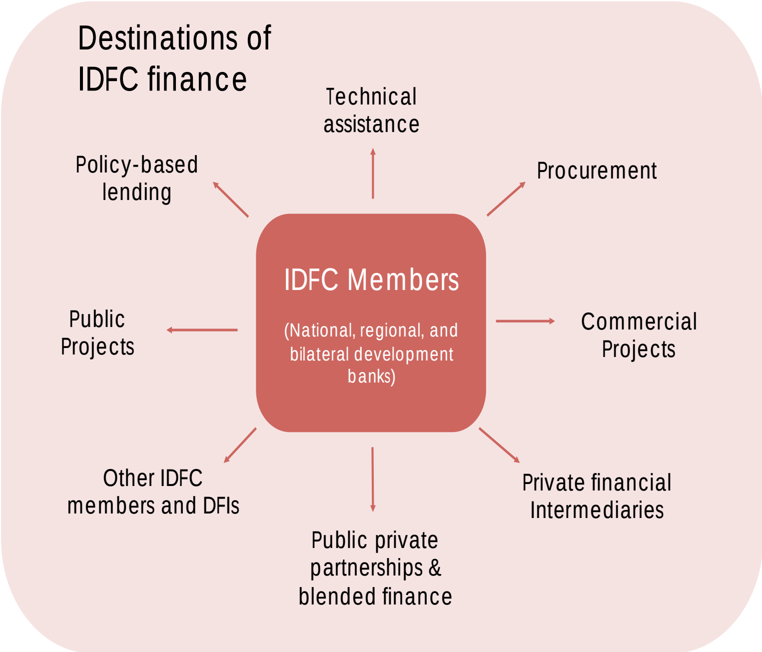


Figure 4: IDFC member countries have high potential for global impact on emissions and resilience



Original economic losses data provided in USD PPP terms.
Economic losses data from Germanwatch Global Climate Risk Index 2019.
GHG emissions data from ClimateWatch Data Explorer.

Figure 5: IDFC member countries have high potential for global impact on emissions and resilience



Furthermore, IDFC members collaborate closely with each other and with other DFIs to support an ecosystem of financing for development. Figure 5 describes the many levers of influence IDFC members have through their activities.

Cognizant of its unique role, the IDFC, along with other DFIs and commercial financial institutions, has worked actively to understand and implement climate considerations into strategy and operations since at least 2012 (see Figure 6).

This report builds from the following efforts:

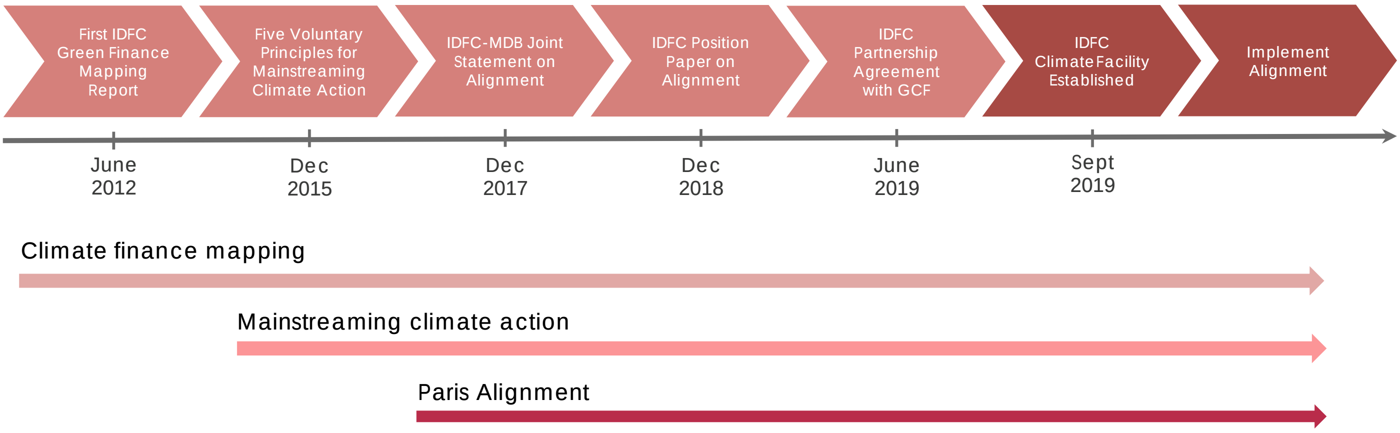
- **The first IDFC Green Finance Mapping report (2012)**: IDFC members have been working together to report publicly on their annual aggregate green finance flows since 2012 (with data on 2011).
- **Five Voluntary Principles for Mainstreaming Climate Action (2015)**[11]: On the sidelines of the 21st Conference of Parties (COP21) in December 2015, just before the Paris Agreement was established, a number of IDFC members, MDBs, and commercial financial institutions endorsed the five voluntary Principles for Mainstreaming Climate Action within Financial Institutions.
- **IDFC-MDB Joint Statement on Alignment (2017)**[12]: IDFC and MDBs introduced 'alignment' terminology to signify compatibility with the Paris Agreement.
- **IDFC Position Paper: Aligning with the Paris Agreement (2018)**[13]: IDFC published a position paper spelling out a specific understanding of alignment, establishing the role of IDFC members in implementing the requirements of the Paris Agreement, and listing a set of key associated commitments for members to agree on. The Paper notes that IDFC members' unique insights position them well to offer policy feedback to their principals and constituencies, and to influence financial flows beyond their balance

11 1) Commit to climate strategies, 2) Manage climate risks, 3) Promote climate smart objectives, 4) Improve climate performance, 5) Account for your climate action See https://www.mainstreamingclimate.org/5-principes/

12 https://www.eib.org/attachments/general/events/20171212-joint-idfc-mdbstatement.pdf

13 https://www.idfc.org/wp-content/uploads/2019/04/idfc_alignment-withparis-agreement_position-paper_12_2018.pdf (reproduced in Annex 3 of this paper)

Figure 6: Timeline of IDFC members' commitments to alignment since 2015 (Source: authors)



sheets, including by catalyzing private sector investment and acting as a first mover in the financial sector.

- **IDFC and Green Climate Fund Partnership Statement (2019)**[14]: In June 2019, the IDFC and GCF agreed on a strategic partnership establishing a framework for collaboration in line with many of the points raised in this report.
- **IDFC Climate Facility (2019)**: In 2019, IDFC set up a USD 10 million instrument to further institutionalize and facilitate collaborative work among members on climate change, and also to strengthen the capacity of leading national and regional development banks worldwide to originate and to develop climate mitigation and adaptation projects (IDFC, direct communication).

These efforts represent increasing ambition on the part of IDFC members to address climate change. Moving to implementation of alignment will require continued ambitious efforts on the part of all members.

1.3 A foundation for implementing Paris alignment

The IDFC Position Paper (2018) committed the IDFC members to align their institutions with the Paris Agreement, but did not describe a detailed plan for doing so. This study, comprising two parts, sets out to provide such guidance. The first part, a conceptual framework of alignment developed by I4CE, is summarized in this section and in Figure 7 (Cochran and Pauthier 2019).

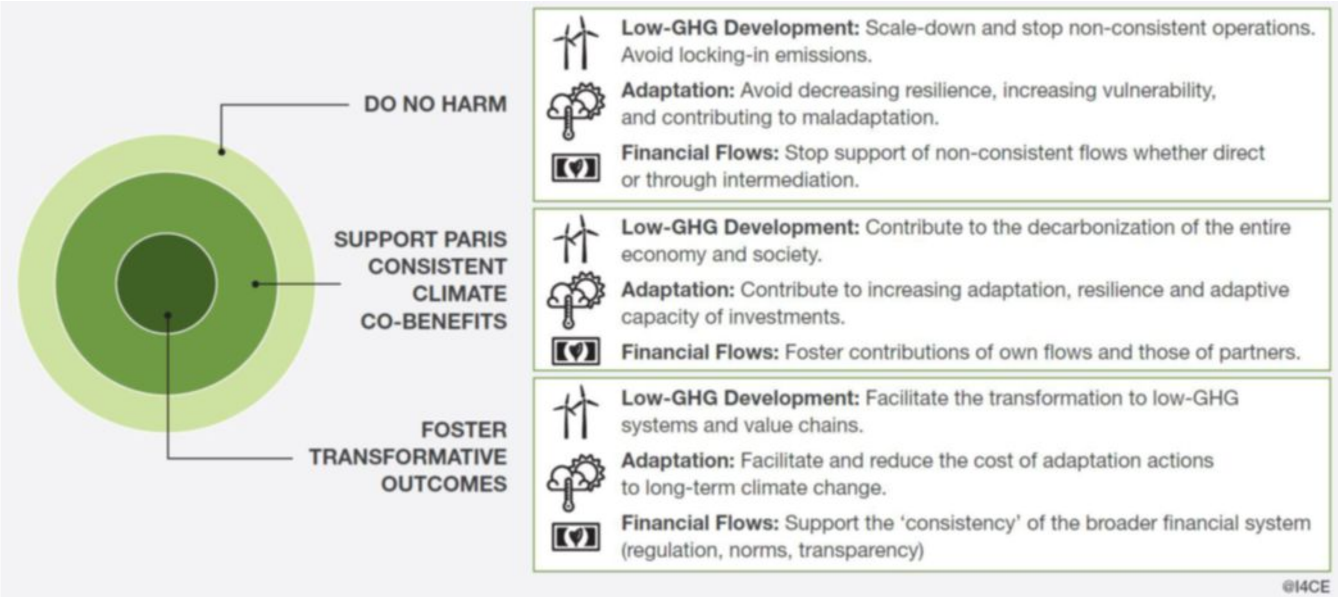
The I4CE report proposes a framework that can be used by a given economic actor or financial institution as it seeks to align strategies and operations with the Paris Agreement. It is structured around three dimensions (Cochran and Pauthier 2019, direct quotation):

- "*A Comprehensive Scope of Action:* actors 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:* actors 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.[15] It is essential to recognize that activities that result in 'relative' rather than 'absolute' emissions reductions or enhanced resilience may be counterproductive to achieving long-term goals.

14 Framework for collaboration includes" Sharing knowledge for climate finance and action; Integration of climate considerations within financial institutions; Facilitation of access to GCF resources with co-financing from IDFC members and support to capacity building activities; and Outreach and awareness raising". See https://www.greenclimate.fund/news/green-climate-fund-and-the-international-development-finance-club-signs-a-statement-of-partnership-to-join-forces-in-fighting-climate-change

15 Lock-in refers to the tendency of fossil-fuel based systems to persist over time due to the co-evolution of interdependent technologies and policies that continue to support and benefit from existing systems. The IPCC defines maladaptation as "actions, or inaction that may lead to increased risk of adverse climate-related outcomes, increased vulnerability to climate change, or diminished welfare, now or in the future" (Intergovernmental Panel on Climate Change 2014).

Figure 7: Conceptual framework of alignment



- *An Ambitious Scale of Contribution:* actors should seek to increase the ambition of contribution to the goals of the Agreement, ensuring that all activities:

  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, actors should prioritize activities with direct or indirect mitigation and adaptation co-benefits that are consistent with the national attainment of long-term goals of the Paris Agreement;

  Foster Transformative Outcomes: whenever possible, actors 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.

- **Being Paris aligned does not require 100% of activities of an entity to contribute to specific mitigation and adaptation activities**, but rather to ensure all its activities are consistent with and best contribute to low-GHG, climate-resilient development pathways."

Based on its analysis of the Agreement, I4CE emphasizes that Paris alignment should, whenever possible, account for national contexts and support shared 'pathways' or 'visions' of how long-term climate goals could be met nationally and internationally (Cochran and Pauthier 2019, direct quotation): "While successfully addressing climate change requires global action, the Paris Agreement recognizes the importance of supporting low-GHG, climate resilient development at the country level. [...] Long-term strategies and forward-looking scenarios can provide important insights on the paths a country may follow and the transformations that will be necessary to achieve the three goals of the Agreement. In addition, national government plans and NDCs can provide roadmaps of near-term national priorities and actions to achieve the long-term visions. Assessments of investments and activities should therefore consider both current country contexts and forward-looking pathways for low GHG and resilient development. When these assessments are insufficient or unavailable, countries may need to fall back on global projections and scenarios to achieve the long-term goals of the Agreement."

In brief, an activity would be considered 'Paris aligned' if it does not counteract the long-term prospects of meeting the Paris Agreement goals in the context of national pathways, and ideally pro-actively leads to climate co-benefits consistent with the Paris Agreement and transformative outcomes (Cochran and Pauthier 2019). A development finance institution could be considered Paris aligned if it has adopted the practices as outlined in the remainder of this report that lead to alignment of all activities and "best leverage their potential to support low-GHG climate-resilient transformations in their countries and sectors of operations" (Cochran and Pauthier 2019).

1.4 Building on existing approaches

The I4CE Discussion Paper explores how financial institutions can build on existing climate mainstreaming and emerging climate risk management approaches. **However, existing approaches are insufficient for institutions to rapidly scale down harmful activities and scale up activities with transformative long-term contributions to low-GHG, climate-resilient development that are central to Paris Alignment** (Cochran and Pauthier 2019). The Climate Action in Financial Institutions Initiative[16] has already provided a strong basis for undertaking alignment work, obtaining endorsement of the 5 Voluntary Principles for Climate Mainstreaming from many financial institutions. These principles serve as a starting point, indicating financial institutions' intent to go beyond incremental financing of climate change projects toward practices that make climate change a core consideration and "lens" through which capital is deployed.

The three dimensions previously discussed inform the overarching mindset in which alignment should be implemented. The alignment framework asks institutions to go a step further and proactively prioritize efforts across their full range of operations that foster transformative change, identify and phase out activities that counteract climate objectives, and ensure that all activities contribute to the long-term prospect of achieving climate goals. While no common definition or framework of "transformative change" or "transformative outcomes" exist, existing approaches led by the Climate Investment Funds, World Bank, NAMA Facility, and GCF offer some potential criteria for identifying activities that can lead to transformative change (Table 7). Furthermore, not all eligibility lists currently employed by institutions for identifying climate-related projects are based on assessment of emissions in line with the long-term mitigation goal, nor identify adaptation actions based on their link to SDGs. This calls for updating existing criteria as well as the development of new criteria to shift business models towards alignment (Section 2.5.1).

I4CE notes that "the importance of identifying and managing climate-driven changes in economic and regulatory environments is increasingly seen as part of core risk management practice for financial institutions. The recommendations of the Task Force on Climate Related Financial Disclosures (TCFD) are being used as a starting point for the integration of climate change, particularly by commercial financial institutions, and represent an important part of climate mainstreaming approaches. The recommendations and guidance of the Task Force provide a useful framework for financial institutions – especially commercial financial institutions - to identify, disclose and develop management strategies to address climate-related physical and transition risk" (Cochran and Pauthier 2019). However, the improved management of these risks does not necessarily imply that development financial institutions will be Paris aligned, as managing climate risks to the institution may lead to a decrease in the institution's activities exposed to physical climate risks or to future stranded assets, without an accompanying impact on the asset's emissions or resilience itself.[17]

These tasks imply fundamental changes in the way IDFC members make investment decisions and manage the overall portfolio and risks. The remainder of this work focuses on implementing these changes.

16 https://www.mainstreamingclimate.org/initiative/

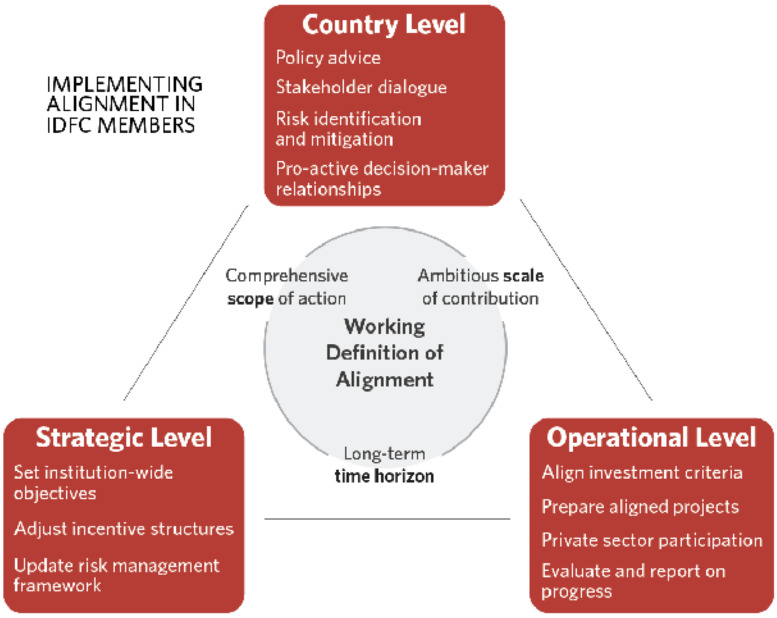
17 For example, a risk management strategy that prioritizes divestment from fossil fuel assets – rather than early modification or retirement of assets – may have little impact on actual emissions with a limited contribution to achieving climate-related goals.

2. Implementing Paris Alignment

2.1 A comprehensive roadmap to Paris alignment

In implementing Paris alignment as previously defined, IDFC members will need to go beyond their current climate finance and mainstreaming efforts.[18] However, due to the range of circumstances and challenges in which IDFC members operate, as well as the significant variation in their capacities and available resources, no two institutions will implement alignment in the same way. **Therefore, this section presents a comprehensive roadmap (Figure 8) that IDFC members may use to structure their implementation approach, without prescribing the specific order in which each step should be taken.** The remainder of Section 2 describes each step in detail, organized by country, strategic, and operational levels of implementation.

Figure 8: Comprehensive roadmap for implementing alignment



Source: CPI in collaboration with I4CE

2.1.1 WORKING DEFINITION OF PARIS ALIGNMENT

It is important for each IDFC member's implementation approach to be guided by an internal working definition of alignment which references its three dimensions. In addition to serving as a common basis for implementation throughout the organization, the definition would clearly demonstrate the institution's commitment to alignment over the short- and long-term, sending a clear message to internal staff and external market participants that climate action underpins the institution's development objectives.

2.1.2 COUNTRY, STRATEGIC, AND OPERATIONAL LEVELS OF ALIGNMENT

Along with the working definition, IDFC members may undertake specific implementation steps across the country, strategic, and operational levels of alignment. Progress on each of the levels are mutually reinforcing. For instance, developing and enforcing alignment criteria across all investment decision making processes would not occur unless supported by the institution's mandate and leadership. Meanwhile, setting ambitious targets for alignment at the strategic level may require proofs of concept at the project level to demonstrate the feasibility of alignment criteria, or starting with alignment in pilot facilities. Finally, overall ease of implementation will depend on support at the country level.

Implementing Paris alignment at the country level

Country level priorities are reflected not only in the ambition of Nationally Determined Contributions but also in their sectoral development strategies, national and subnational policies, and project pipelines, which in turn affect the investment environment of IDFC members.

However, this relationship goes both ways as IDFC members are uniquely positioned to support governments in identifying ways to contribute to the objectives of the Paris Agreement. Therefore, Paris alignment may be greatly facilitated through the special relationship IDFC members have with sub-national and national governments.

18 For a detailed analysis of mainstreaming, see Cochran & Deheza 2017, Building Blocks of Mainstreaming, https://www.mainstreamingclimate.org/publication/building-blocks-of-mainstreaming-a-framework-for-integrating-climate-change-across-financial-institutions/

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 governance relationships**: Working pro-actively with government stakeholders who have oversight over member institutions (Board, Assembly, etc) to understand and prioritize alignment alongside development priorities.

Implementing Paris alignment at the strategic level

To implement alignment, institutions will need to make decisions and drive action at the level of leadership – both the Board and executive management team. A high-level commitment to Paris alignment must be demonstrated across all institutional strategies and objectives.

IDFC members may support alignment at the strategic level 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 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 manage climate risks. The risk management framework should take advantage of existing unused risk capacity to seek transformative investment opportunities. In addition, the DFIs' focus on development benefits means that proposed 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.

Implementing Paris alignment at the operational level

The operational level is where investments are developed and implemented in support of the three dimensions of alignment.

IDFC members may support alignment at the operational level by undertaking the following actions:

- **Update investment processes and 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 consistent with the Paris Agreement, and contribute to transformative change, as well as those that are not-aligned at all. They should also establish 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 the development of aligned projects and programs from the earliest stages. Later stage projects that seek development finance are often more difficult to make modifications 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 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.

2.1.3 GETTING STARTED

Depending on the political environment and readiness of the leadership, institutions will have different starting points. For instance, IDFC members benefiting from centralized leadership may start from the top—by reviewing compatibility of the institution's mandate and establishing a working definition with ambitious targets. On the other hand, IDFC members facing more challenging political circumstances may start from the bottom—by demonstrating how climate and development objectives can be mutually achieved through alignment, and then developing a working definition feasible for the institution. IDFC members may also benefit from the process of collaborating with international climate resources such as the Green Climate Fund and Global Environment Facility, as well as learn from each other through the newly established IDFC Climate Facility. As IDFC members vary greatly in their size, composition, main business function, internal capacity, geographic scope, and the maturity of the markets in which they operate, a range of context-specific political, financial, and technical challenges may limit members' capacity to follow the roadmap as described above in the short term. Nonetheless, as development finance institutions, all IDFC members 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.

Table 1: Implementing alignment: Recommendations summary

RECCOMENDATION SUMMARY	
Country Level	1. Supporting governments in building capacity to develop forward-looking policy analyses based on multiple scenarios and undertake reform as necessary 2. Facilitating multi-stakeholder dialogue among Ministries, private sector, and civil society 3. Supporting countries to identify and manage climate risks 4. Working pro-actively with decision-makers to support the institution in moving towards alignment
Strategic Level	1. Adopting institution-wide alignment objectives that incentivize increasing ambition 2. Developing supportive incentive structures and performance management systems 3. Updating the organization's risk management framework to both catalyze investments in aligned activities as well as to manage climate risks
Operational Level	1. Developing and integrating alignment investment assessment processes and decision-making criteria, including for direct lending, intermediary lending, procurement, policy-based lending and technical assistance 2. Supporting clients with the development of aligned projects from the earliest stages 3. Promoting private sector participation and market development 4. Evaluating and reporting on progress

2.2 Working definition of alignment

Regardless of the different starting points for each institution, all IDFC members can work towards establishing a working definition of Paris alignment adapted to their and their countries' context, with a plan to regularly review and update the definition depending on progress. While the specific details of the working definition may vary, each should cover the three dimensions of alignment, examples of which are detailed in Table 2. These definitions should reference specific targets wherever possible (See Section 2.3.3)

At least one IDFC member is developing a working definition of alignment based on an article-by-article analysis of the Paris Agreement, and one member has referenced 100% Paris compatibility in its working definition.

Table 2: Working definition examples

SCOPE	SCALE OF CONTRIBUTION	TIME HORIZON
Covers all operations of an institution, including: - Direct lending and investment - Intermediary lending - Policy-based lending - Procurement - Technical Assistance and Advisory Services **Describes how both new investments and existing portfolio** will be managed **The definition recognizes climate change as an underlying factor** for achieving broader development objectives and the institution's potential to influence broader systems and value chains	**References how the institution will support Paris-consistent climate co-benefits** and foster transformative change within national contexts References how the institution will **phase out non-aligned activities**[19]	**References short-term and long-term emission reduction and adaptation goals** References how short-term milestones contribute to long-term objectives References how targets will be regularly reviewed and adjusted upwards based on progress
Examples: "100% of the institution's activities are compatible with the Paris Agreement goals" "All of the institution's activities, including intermediary lending, procurement, and technical assistance, will be considered for alignment" "Paris alignment criteria will first apply to new investments and eventually the existing portfolio"	Examples: "Activities leading to transformative change will be prioritized" "Non-aligned activities to be stopped by (target year)"	Examples: "Activities contributing to long-term prospects for achieving the Paris Agreement goals will be prioritized" "Activities must contribute to the long-term target of achieving net zero emissions by 2050, and ensure that all assets are resilient to climate risks" "Targets will be reviewed and adjusted every five years"

19 A non-aligned activity counteracts the long-term net zero emissions goal and/or increases vulnerability to climate risk (See Section 2.3.1)

Creating a functional and consistent working definition of alignment is a considerable challenge which requires the commitment of senior leadership. The process of defining Paris alignment should be led by the Board and senior staff, providing incentives and resources for relevant staff to participate, and ensuring that all staff are engaged through internal workshops and presentations. This socialization could be done, for example, via a special taskforce within the institution, or led by an existing climate unit, as long as staff from all operational units are engaged. The development process can also include dialogue with key external stakeholders, including from government, civil society, and private sector clients, to help build trust and cooperative working relationships across different types of organizations driving progress toward Paris alignment.

2.3 Paris alignment at the country level

In supporting country alignment, IDFC members can assist local, regional, and national governments to implement their existing commitments as defined in their Nationally Determined Contributions, and over time strengthen their ambition and increase their scope within the economy.

IDFC members have committed to supporting country-led climate related policies. The IDFC Position Paper (2018) notes that the actions in support of this can include "financing:

Support for enabling policy and regulatory environments.

- Development of long term 2050 decarbonization pathways and strategies towards zero net emissions, as well as long-term resilience.
- Shorter-term actions towards low carbon and resilient development.
- Technical capacities and institutions' strengthening to enable the translation of NDCs and longer-term climate strategies into policies, investments plans, and projects."

At the same time, IDFC members' own abilities to align their institutions are greatly influenced by government through governance arrangements including Board membership, assemblies of government stakeholders, and legislative oversight. IDFC members can play a pro-active role in helping governments via their oversight role to understand and prioritize Paris alignment within the member institutions.

These actions in practice can include the following:

2.3.1 SUPPORTING GOVERNMENTS ON POLICY ANALYSIS AND REFORM

Policy analysis support can help governments develop scenarios and low-GHG, climate-resilient development pathways which assess long-term expectations of climate change impacts, economic development, and technology, their dynamic interactions with each other (for example how climate change could affect economic development, how climate change could affect sovereign credit ratings,[20] how technology could affect climate impacts), and how policy can impact them both positively and negatively. This type of long-term scenario modeling at both the economy and sectoral levels is foundational for helping a country develop long-term decarbonization strategies, address climate risks, and set progressively more ambitious NDCs.

However, many countries lack access to the necessary data inputs and/or technical capacity to understand fully and apply these analytical models and other tools. **IDFC members can therefore play a key role as information providers and facilitators to countries for building the technical capacity, data systems, and models, as well as the learning and feedback processes, required to provide sufficient information on which to base and improve national policy and strategy decisions.**

Alignment with respect to policy reform requires that all an institution's policy advice and technical assistance operations are consistent with the goals of the Paris Agreement.

20 For example, emerging market sovereign issuers are potentially vulnerable to ratings downgrades due to climate impacts (S&P Global Ratings 2017).

Table 3: Summary table of recommendations for how IDFC members can support Paris alignment in their countries of operation

ALIGNMENT AT THE COUNTRY LEVEL	HOW THE DIMENSIONS ARE ADDRESSED		
	SCOPE	SCALE OF CONTRIBUTION	TIME HORIZON
1. Supporting governments in developing forward-looking policies and analyses that incorporate scenarios on climate change, the economy, and technology, market barriers, and potential policy impacts at the economy-wide and sectoral levels	Analyze all sectors of the economy and support development of sector pathways meeting the Paris Agreement goals	Support development of policy that enables transformative action and reduces non-aligned investment in all sectors	Support capacity-building and policy development addressing short-term needs but based on long-term emission reduction goals and forward-looking climate scenarioss
2. Facilitating multi-stakeholder dialogue to include ministries beyond environment including finance, development, and sectoral ministries such as agriculture and energy, as well as the private sector and civil society	Engage a wide range of public and private actors (beyond traditional climate stakeholders)	Identify and demonstrate how each type of actor can contribute to transformative impact and identify barriers to action	Support each actor in developing a long-term plan for undertaking transformative impact projects
3. Identifying and mitigating climate risks for the economy, including physical, transition, and liability risks	Consider the impact of physical, transition and liability climate risks for the whole economy	Identify transformative paths for addressing the risks, including for just transitions and linked to the SDGs	Support risk assessment and mitigation based on both short-term and long-term trajectories
4. Pro-active decision-maker relationships to support the IDFC member's ability to align its institution and activities	Mandate, mission statement, and strategies allow institution to consider all of its operations in the context of the Paris Agreement	Mandate, mission statement, and strategies prioritize climate action as fundamental to achieving long term climate goals and SDGs	Mandate, mission statement, and strategies support the institution's contribution to long-term objectives of the Paris Agreement

The Adapt'Action Facility aims to translate NDCs into long-term sectoral public policies focused on the most climate-vulnerable sectors and to speed up adaptation investments in the most vulnerable countries. The Facility also aims to better take into account gender-related climate vulnerabilities and support nature-based solutions.

2.3.2 FACILITATING MULTI-STAKEHOLDER DIALOGUE

Acting as conveners by bringing together stakeholders from all relevant government ministries, as well as national industries and civil society, IDFC members can help to inform policy decisions, ensure buy-in, and reduce policy uncertainty over time, ultimately helping governments and other institutional actors to achieve the scale of ambition of the Paris Agreement. IDFC members can work to involve all relevant government entities in climate-related policy efforts, including finance, economic development, and planning ministries as well as sectoral ministries such as agriculture, energy, forestry, and water. For example, they can work with government ministries to develop alignment criteria for use in their own decision-making processes, and they can bring together the public and private sectors to understand investment barriers.[21]

2.3.3 IDENTIFYING AND MITIGATING CLIMATE RISKS

Governments need support for identifying and managing the physical risks of climate change in investment planning, infrastructure design, and policy reform. Physical risk can affect vulnerable populations, economic growth, and/or government finances, including by affecting sovereign credit risk. IDFC members' support can include technical assistance and financing for integrating climate risk assessment and risk mitigation measures into public project design processes and procurement.

In supporting countries' transition from fossil fuels to renewables financing and other Paris-aligned investments, members can also help countries and ministries assess transition risks from increasingly ambitious climate policy, such as stranded assets and social equity concerns, and devise strategies to mitigate these risks. (see example in Box 1)

DBSA and Government Dialogue

DBSA has been working to reduce coal investments by working with the Department of Energy, implementing the Renewable Energy Independent Power Producer Programme (REIPPP), and engaging in discussions about whether DBSA should continue participating in coal IPPs. DBSA is also preparing to update its energy financing strategy by undertaking an expert study that will inform a least cost approach,how to manage transition risk, and how to support a just transition.

IDFC members have several modalities for this support, including:

- The use of policy-based lending, a tool that DFIs (typically bilateral development banks) have used to support development and implementation of sectoral policy reforms, such as for the energy sector.[22]
- Dedicated technical cooperation facilities that can be sector- or issue-specific (such as for adaptation) and/or available to multiple countries within the member's remit, such as the Adapt'Action Facility
- Leveraging external bilateral and multilateral funding and technical assistance (such as from the Green Climate Fund).
- Technical assistance and advisory services (particularly relevant for National Development Banks that do not typically lend directly to national governments, as well as regional banks for whom direct lending to governments accompanied by advisory services is a significant proportion of their portfolio.

21 For an example, see UNDP's Derisking Renewable Energy Investment (DREI) Framework, at https://www.undp.org/content/undp/en/home/librarypage/environment-energy/low_emission_climateresilientdevelopment/derisking-renewable-energy-investment.html

22 See, e.g., https://www.kfw-entwicklungsbank.de/PDF/Download-Center/Materialien/2018_Nr.2_Policy-Based-Landing_EN.pdf

Transition Risk Case Study: DBSA

In March 2019, on behalf of DBSA and AFD, CPI's Energy Finance team published a detailed report examining risks to South Africa's economy, government, cities, companies, and financial institutions from a global transition to a low-carbon economy (Huxham et al 2019).

The report analyzed six transition risks, three each in domestic policy and international trends, estimating the cumulative transition risk impact of a global carbon transition from 2013 to 2035 at a net present cost of over USD 120bn.

Two major risk areas identified in the report are the domestic power sector and exports of fossil fuels, such as oil and coal. In the power sector, current and planned new fossil-fuel fired generation assets are at risk of becoming stranded assets, retiring early in order to meet emissions cuts necessary to keep planetary temperature increase at or below 2°C. Meanwhile, other countries' climate policies under a 2°C scenario would reduce demand for South African coal exports, resulting in lower volumes sold and prices received.

Although the South African government would directly bear an estimated 16% of downside transition risk, knock-on effects on government spending, tax revenue, and the capital bases of state-owned financial institutions would almost triple this figure, with the national government effectively bearing over half of total national climate transition risk. To aid DBSA and the South African government in planning to develop the fiscal, financial, and policy tools necessary to mitigate these risks, CPI's report provided seven key recommendations on addressing transition risk, ranging from explicitly allocating and communicating responsibility for climate risk, to collaborating with other IDFC members, to managing the interplay between climate commitments and vulnerable economic sectors.

2.3.4 PRO-ACTIVE DECISION-MAKER RELATIONSHIPS

In the case of publicly mandated finance institutions, donors and shareholding governments can enable the implementation of Paris alignment by formally including long-term climate goals as key components of a Member's objectives, including in their mandates, mission statements and strategies. [23] Notably, climate should become a fundamental aspect of all investment decisions, and not one priority among many other development objectives. These types of changes require pro-active discussions with the institution's governance bodies which are primarily represented by government.

The Board, typically comprising shareholder government(s), may consider adjusting the institution's mandate and/or mission statements as appropriate and necessary to implement full Paris alignment. Specifically, adjusting mandates may involve making a reference to contributing to low-GHG and climate-resilient development pathways and the Paris Agreement itself. Often, Board action is preceded by pro-active proposals from the executive leadership of the institution (e.g., CEO and Senior Management). Other important governance bodies include member assemblies and national legislatures.

Several Boards of IDFC member institutions have established targets for 100% of bank investments to be 'Paris compatible,' adjusted sustainability mission statements to make an explicit reference to the Paris Agreement, and/or updated project assessment mechanisms to include climate criteria. In a few cases, the Board made decisions to adopt new climate strategies or support member countries in achieving their climate goals.

23 For a full list of IDFC member mission statements, see Morris (2018) Appendix 1.

A starting point for exploring adjustments could be to commission an independent review of the institution's mandate and mission statements to assess compatibility with achieving full Paris alignment and to suggest what, if any, changes are required. The Board and executive team can then propose and approve the needed changes. A balance needs to be struck between flexibility in interpretation for implementation, and too much flexibility such that the mandate and mission statements may be easily ignored in favor of non-aligned investments.

In April 2019, the CABEI Governors' Assembly issued a Carbon-Zero statement, refining the 2016 commitment by targeting specific sectors (sustainable food production, clean energy generation, energy efficiency) and the pursuit of the low-carbon and resilient economy articulated in the Paris Agreement. Alongside this came a declaration to increase transparency on the projects and programs funded by the bank to drive accountability for financing socially beneficial projects. [24]

Even if the mandate does not require adjustment, IDFC executive leadership can clearly communicate how they interpret their mandate in the context of the Paris Agreement – both internally and externally – to help catalyze the action of staff in their institution and in the broader economy.

In July 2018, KfW's Executive Board set up a Group-wide internal initiative, 'KfW Roadmap Sustainable Finance,' tasked with identifying a holistic approach for integrating sustainability into its operations by mid-2020. As a first step, the Board approved the adjustment of KfW's sustainability mission statement to include references to the Paris Agreement and Sustainable Development Goals as well as to emphasize support for a just transition.

24 https://thecostaricanews.com/59th-bcie-governors-assembly-ended-with-new-commitments-of-zero-carbon-and-access-to-information/ , http://www.bcie.org/en/news/latest-news/article/the-lix-cabei-board-of-governors-meeting-ends-with-new-commitments-to-zero-carbon-emissions-and-ac/

2.4 Paris alignment at the strategic level

In an aligned institution, Board members and executive staff understand that climate change affects the Bank's ability to fulfill its long-term development mandate and take concrete steps to lead the institution towards alignment (Table 4).

SETTING INSTITUTION-WIDE PARIS ALIGNMENT OBJECTIVES

Institution-wide objectives drive action internally within institutions and provide signals to market participants about an institution's near- and long-term path.

Targets serve as milestones towards full alignment that help communicate institutions' alignment ambitions both internally and externally, and can be revised upwards as progress is made.

As pictured in Figure 9, institutions can set targets for both aligned and non-aligned activities. The targets can include:

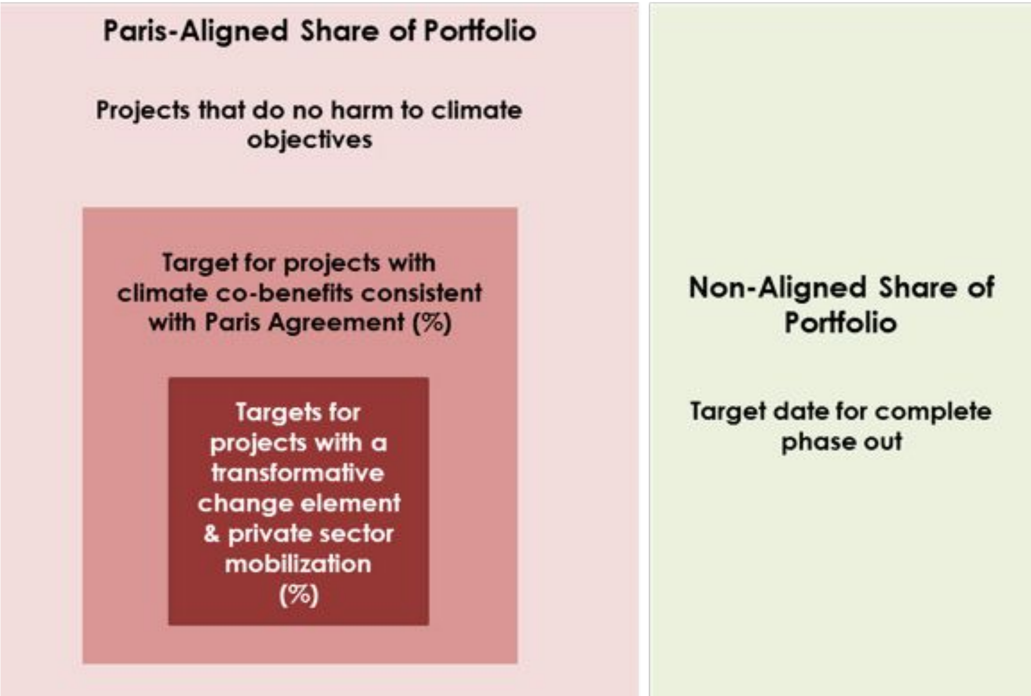
- A target for share of activities that contribute climate co-benefits consistent with the Paris Agreement.[25]
- A target to increase the share of transformative change projects (See Table 7 in Section 2.5.1 for suggestions of possible criteria).
- A target for private finance mobilization that helps drive the adoption of investment modalities that are particularly effective in crowding in the private sector.
- A target date for stopping non-aligned or harmful activities (those that undermine long-term prospects for achieving Paris Agreement goals, by contributing to emissions lock-in and/or mal-adaptation)

25 These may be different from current climate finance targets which may not be consistent with long term goals based on current definitions

Table 4: Summary table of recommendations for how IDFC members can can implement alignment at the strategic level of the institution

ALIGNMENT AT THE STRATEGIC LEVEL	HOW THE DIMENSIONS ARE ADDRESSED		
	SCOPE	SCALE OF CONTRIBUTION	TIME HORIZON
Adopting institution wide alignment objectives that assess progress and incentivize increasing ambition	Targets cover all operations, in addition to 'climate business'	Targets exist for climate co-benefits, private sector mobilization, and transformative projects, as well as target for stopping non-aligned projects	Targets increase in ambition over time, and metrics favor long-term low GHG and climate-resilient development objectives over near term reductions and resilience
Adjusting incentive structures and support system	Both incentives and capacity building cover all staff in all operations	• Incentivize transformative outcomes • Ensure incentive structure does not counteract alignment	Support staff in identifying opportunities to meet long term low-GHG resilient development pathways
Updating the organization's risk management framework to both catalyze investments in aligned activities as well as to manage climate risks	Framework includes climate risk management and encourages appropriate risk taking in all sectors and operations in line with public role to foster impact	Risk capacity and management should be optimized towards transformative change in both mitigation and adaptation	Risk management should consider long term risks from climate change, and risk capacity should be considered from the perspective of long-term systems change

Figure 9: Setting targets for alignment



In addition to specific quantitative targets for new investment, IDFC members can set a qualitative objective to assess the existing investment portfolio, particularly long-term investments such as infrastructure, for climate risk (both physical and transition) and identify opportunities to reduce these risks.

KPI for Mobilization: In 2016, DBSA introduced a target for mobilization, making it one of very few banks in the world where catalyzing finance is featured in their corporate scorecard. One of DBSA's KPIs in the 2018 annual report was to "be a catalyst for infrastructure by crowding-in third parties for between ZAR 28 billion and 116 billion over the next three years." To measure progress on this target, DBSA has established a working group to develop an internal methodology for mobilization (DBSA 2018; Crishna Morgado et al. 2019).

IDFC members can establish methods and processes for regular assessment and to raise ambition. The IDFC Common Principles for climate finance tracking are a good starting point, but will likely need to be reviewed to ensure eligible projects are Paris consistent, and extended to track finance for non-aligned projects as well as projects supporting transformative change. The ambition of all targets should be informed by forward-looking global and national climate change risk and policy scenarios, and the targets can be adjusted based on changes in scenarios stemming from improved forward-looking scientific and policy knowledge.

In setting targets, members can consider their contribution to achieving long-term goals at the country or system level. To meet the definition of 'Paris-aligned investment,' setting goals to meet short-term emission reductions or adaptive capacity measures is not sufficient and may even be counterproductive. For example, investment in a lower emissions solution today could result in lock-in of emissions in the long run, or investing in incremental abatement or resilience today will make the large reductions and transformation necessary in the long term more expensive (as referenced in Cochran & Pauthier 2019). An aligned approach to targets should balance these short-term gains with an assessment of potential contributions to achieving sustainable long-term emissions reductions and resilience respectively.

2.4.1 WELL-STRUCTURED INCENTIVE AND SUPPORT SYSTEM

For targets to make an impact on decision-making and institutional performance, **their progress needs to be reported to and assessed at the highest levels of the organization**: The Board and the executive leadership team. It is important that there are sufficient resources and capacity to help meet these objectives, and that staff performance management metrics are consistent with the objectives. A well-structured incentive and support system is important for building capacity and generating internal buy-in among staff, which in turn can support implementation across all operations. This support should not be limited to those with specified ‘climate’ responsibilities, but cover all staff in all levels and departments. While much of the organizational resource needs are covered in discussions of mainstreaming (see Cochran and Deheza 2017), it is worth highlighting the importance of providing proper support to staff to achieve targets. Briefly, supporting staff can entail:

- Assigning climate alignment responsibilities within the organization, both to management (G20 Eminent Persons Group 2018; TCFD 2017) and designating institutional units or functions responsible for alignment to sustain and implement the agenda (Cochran and Deheza 2017).

  Both separate ‘alignment’ units or decentralized expertise are utilized within IDFC member institutions. If a climate business unit is to be used to drive alignment, its remit will likely need to be expanded to include measurement of non-aligned investment. If using a decentralized model, a coordinating unit or person can be designated to ensure that climate targets and appropriate metrics are consistently applied and there is a hub of knowledge in the organization.

  Decentralization with regular and intensive coordination works well in building staff ownership of the implementation of climate strategies, while for institutions backed by activist leadership and strong stakeholder buy-in, a centralized model that regularly solicits feedback and engagement from other teams can be productive.

  It is critically important that feedback and analysis supplied by a Paris alignment unit be formally considered at an early stage in the project assessment cycle, and be closely integrated with the country-level planning processes that determine project selection and development priorities.

- **Increasing internal expertise on climate and sustainability by implementing several enhancements to hiring and training**, including:
  - » Regular assessments of capacity needs for implementing alignment within the organization.
  - » Using sustainability and climate expertise as selection criteria for Board directors, executive management, and investment teams (G20 Eminent Persons Group 2018).
  - » Incorporating sustainability and climate as a requirement for continuous learning for all directors, management, and investment team (High-Level Expert Group on Sustainable Finance 2017).
- **Involving external experts** when specialized knowledge is required to support decision of directors, management and investment team (G20 Eminent Persons Group 2018).
- **Aligning staff performance incentives**:
  - » The performance incentive system can be a key lever for institutions to ensure progress on Paris alignment by holding staff and management accountable for outcomes (G20 Eminent Persons Group 2018) through linking qualitative and quantitative alignment targets (Cochran and Deheza 2017; WEF 2019).

AFD’s Climate Division is responsible for the overall supervision of the AFD’s Climate Strategy, including its commitment for 100% Paris Agreement compatibility. The Division provides support to internal operational staff to identify climate co-benefits throughout project preparation, as well as building and managing partnerships with external counterparts (climate negotiations, IDFC, Green Climate Fund, MDBs, etc.). There are climate focal persons in other AFD divisions responsible for dissemination and retrieval of information, tools, and climate commitments. The Division also carries out climate trainings for all AFD staff, at headquarters and in country offices, and provides support across the AFD Group.

Several IDFC members headquartered in developing countries cited the process of applying for GCF accreditation as important to shedding light on skills and capacity gaps, and serving as a starting point for knowledge exchange and designing, refining and implementing financing for climate-related projects. In response, members are beginning to enhance their capacity to manage environmental and social risks linked to climate change, and integrate them into traditional risk management functions. For instance, DBSA cited GCF and GEF accreditation as a reason for improving their environmental and social safeguard policies as early as 2012 (Crishna Morgado et al. forthcoming).

2.4.2 ORGANIZATIONAL RISK MANAGEMENT FRAMEWORK

IDFC members play a critical role in supporting transformative investments in their countries of operation – through systematically assessing barriers to implementation of climate-aligned projects, and implementing investments that not only mitigate these barriers but actively prioritize their removal (World Bank Group 2018).[26] These types of investments go beyond traditional project-based lending to take a systemic and dynamic view. Often taking such a view requires updating the organization's risk management framework. **Updates to the risk management framework can thus reduce institutional constraints to Paris alignment**.

Before seeking external concessional finance, **institutions can use their full risk capacity to catalyze investments that would not otherwise occur**, particularly those that can lead to transformative outcomes. Many DFIs are highly conservative in their decision-making despite unused risk capacity (Oliver et al 2018). For example, they can:

- Increase their use of risk mitigation instruments, such as guarantees which are responsible for a disproportionate share of private sector mobilization among DFIs (G20 Eminent Persons Group 2018; Blended Finance Taskforce 2018). However, to do this, an institution would likely need to update its methodologies for calculating guarantees' balance sheet impacts in line with the expected risk of guarantees, to more accurately demonstrate their benefits over traditional lending.[27]
- Update their risk frameworks to reduce minimum thresholds for allowed equity-to-debt ratios and increase the maximum amount of non-performing loans allowed in the portfolio[28] (G20 Eminent Persons Group 2018).

IDFC members can also require the **evaluation of investments across their operations for climate risk**. Climate risks pertain to IDFC member investments, operations, and strategy (TCFD 2017), as well as to those of IDFC member counterparties and can include:

- **Transition risks**, such as the risk of policy tightening over time leading to the stranding of fossil fuel-based infrastructure and assets, or social unrest from changing industries.
- **Physical risks** from both chronic and acute climate events, for example, heatwaves, changing precipitation patterns and increased frequency and intensity of storms, that may affect projects' expected returns, especially for long-term physical infrastructure projects.
- **Liability risks** such as civil society lawsuits arising from the institution's failure to meet the increasing expectations and responsibility to address climate change.

26 http://documents.worldbank.org/curated/en/879251537779825585/pdf/130066-REPLACEMENT-PUBLIC-WBG-Strategic-Use-of-Climate-Finance-Sept2018.pdf

27 Guarantees are typically calculated as though they would be utilized at 100%, leaving them on equal footing with direct lending despite performance that indicates a better than 1:1 ratio. (Blended Finance Taskforce 2018).

28 This applies most pertinently to AAA-rated institutions.

Rather than using this information to reduce exposure to risky assets, through, for example, divestment or declining to invest in the first place, a key implication of alignment for DFIs is that, in cooperation with investment counterparties, notably the government, they can utilize this information to develop and implement risk reduction measures or alternatives so that the development benefits of the project can still be achieved.

Members can first identify appropriate metrics to enable integration of climate risk-related concerns into investment decision-making processes, securing the expertise necessary to develop such metrics, either internally or externally through consultants. For example, producing an assessment of vulnerability to physical climate risk requires an understanding of the relevant climate hazards (such as drought and flood) and the exposure of a project to those hazards. At least one IDFC member is working on devising and enhancing sector-level metrics for measuring vulnerability to climate change in order to identify and prioritize adaptation needs.

IDFC members can overcome the challenges posed by technical and organizational resource constraints by sharing best practices and developing standard climate risk frameworks collaboratively. The recently launched IDFC Climate Facility can be a useful platform for this type of exchange.

Improved risk assessment frameworks can incorporate the following practices:

- Support the assessment of transition risk and physical risk on new investments, pipeline and/or an existing portfolio[29] (High-Level Expert Group on Sustainable Finance 2017; Pauthier et al. 2017), including:
  - » Standard assumptions for scenario analysis, common input and output metrics for risk assessment modeling, and protocols for adapting these modeling procedures to measure climate impacts of individual project financing decisions.
  - » At least one member uses IEA-based scenario analyses for assessing transition risks to its fossil fuel portfolio.
  - » Macro-economic modeling that integrates climate impacts on the economy with transition risks.
  - » A description of the specific climate-related risks and opportunities for the relevant short-, medium-, and long-term time horizons, taking into consideration the useful life of the organization's assets or infrastructure (TCFD 2017; WEF 2019).
  - » A description of the specific climate-related risks and opportunities for the organization's businesses, strategy, and financial planning (TCFD 2017; WEF 2019).
  - » A description of processes for identifying and managing climate risks (TCFD 2017; WEF 2019).
  - » Self-assessments of exposure to broad or disruptive changes in market and policy conditions, including initial transition assessments in the context of TCFD implementation (Data from Surveys).
- Encourage counterparties to provide forward looking information on their climate-risk exposure (Cochran and Deheza 2017).

29 This could include for example impacts on physical assets, investments where the impairment of physical assets would have a significant financial and/or developmental impact, and potential impacts from climate related extreme weather events on financial or economic health, or development objectives. Providing technical support to strengthen climate risk management shifts towards structural and non-structural interventions that investment projects could integrate to address physical climate risks (Cochran and Deheza 2017)

- Assess and manage liability risk of existing portfolio investment through dialogue with civil society, conducting internal liability risk reviews, engagement programming focused on environmental and climate justice, and best practice sharing.

AFD AND PHYSICAL RISK EXPOSURE

In 2018, AFD launched an assessment of its physical risk exposure. Each existing client in AFD's loan portfolio was scored against five major climate hazards: cyclones, extreme rainfall events, water stress, heat stress or rising sea levels. "Attention flags" were allocated to counterparties with scores greater than or equal to the 90th percentile of the portfolio in at least one of the five hazards. This enabled AFD to (1) identify its existing clients facing enhanced physical risks and (2) to build on this experience to integrate climate risk more systematically in its risk management process.

Therefore, in the context of new loan originations, AFD developed a physical risk assessment process involving a scoring method based on a sector-country matrix covering the five major climate hazards previously identified. Counterparties operating in geographies and industries exposed to enhanced risks for a specific climate hazard receive attention flags that trigger enhanced due diligence. The goal is to assess in more detail the level of risk, including potential mitigation solutions already in place, and to identify or define with the counterparties relevant mitigation strategies. AFD does not use these assessments to avoid the risk, but rather to support the most exposed borrowers by offering them appropriate financing solutions, related to adaptation and resilience in particular.

2.5 Paris alignment at the operational level

Table 5: Summary table of recommendations for how IDFC members can implement alignment at the operational level of an institution

ALIGNMENT AT THE OPERATIONAL LEVEL	HOW THE DIMENSIONS ARE ADDRESSED		
	SCOPE	SCALE OF CONTRIBUTION	TIME HORIZON
1. Developing and integrating alignment assessment processes and decision-making criteria into all investment decisions	• Direct lending/ investment • Policy-based lending, technical assistance, and advisory services • Intermediary lending and procurement	• Develop qualitative and quantitative criteria and methodologies to assess non-alignment, climate co-benefits, and transformative change • Paris alignment is prioritized in investment decisions	• Long-term alignment prioritized over near-term considerations
2. Supporting clients with development of aligned projects from the earliest stages	• Applies to all operations • Identifies synergies and trade-offs with other SDGs • Considers impact on systems and value chains	• Planning support offered for low carbon development and adaptation/ resilience, transformative projects • Planning support offered for the identification and management of activities "doing harm"	• Planning support to ensure projects are consistent with long-term pathways, including avoiding emissions lock-in and supporting long term technology deployment
3. Promoting private sector participation and market development	• All finance instruments available for consideration, notably risk mitigation instruments • Staff performance measurement aligned with private sector mobilization	• Instruments that promote transformative change prioritized, including risk mitigation instruments and innovative products as well as policy lending and advisory and technical assistance	• Focus on supporting projects with higher potential for long term impact, including with innovative risk finance, with pathway to financial sustainability over time defined
4. Evaluating and reporting on progress	• All operations, including intermediary lending, procurement, and technical assistance	• Both direct impacts and systemic effects	• Evaluate progress against short-term and long-term objectives • Publish performance data to enable market development over time

This section focuses on implementing alignment at the operational level – the specific alignment criteria, processes, and modalities the institution can adopt to support alignment in its investment portfolio as summarized in Table 5.

2.5.1 INVESTMENT DECISION PROCESSES

Investment decision-making is not only about managing climate risks, but also about ensuring that the members are meeting their potential to catalyze Paris-aligned markets in the broader economies in which they operate. For both cases it is important for members to apply consistent Paris-aligned processes, metrics, and criteria to investment decisions. To meet the scope, scale, and time horizon dimensions of alignment, and to fulfill IDFC members' commitment to internal transformation, investment evaluation and decision-making processes should evolve.

Specifically, institutions can develop and apply project-level alignment criteria across all operations (including direct lending / investments, intermediary lending, procurement, and technical assistance), with a particular focus on transformative change, stopping non-aligned investment, and long-term contribution to Paris Agreement objectives. In addition, appraisal processes would ideally undertake climate risk assessment with a view to identifying opportunities to increase the adaptive capacity of communities and resilience of investments in the long run.

A key issue specific to alignment is decision-making in the face of uncertainty, related to the timing and severity of climate impacts, the ambition and timing of enabling policy developments, and the commercialization of technology alternatives. It is a key role of development finance institutions to not only be responding to uncertainty, but also driving a reduction in this uncertainty, and investment decision-making should reflect this.

Specifically, **IDFC members can undertake a number of actions to improve their investment decision-making processes and embrace their catalytic role**, building on mainstreaming efforts already implemented (Table 6).

Several IDFC members report that they have declined project investments due to non-alignment with the Paris Agreement, including several highly emissive and/or high lock-in effect projects.

Table 6: Updating investment decision-making processes and criteria

CATEGORY	SCOPE OF ACTION	SCALE OF CONTRIBUTION	LONG TERM HORIZON
UNDERSTAND COUNTRY CONTEXT	**NDCs**: Assess the alignment of projects with country pathways, including NDCs, which is not always a sufficient requirement for alignment over the long-term **Development and climate connections**: Assess project contributions to sustainable development goals and development projects' contributions to Paris alignment as a way to increase adaptation investment in particular (Germanwatch and NCI 2018)	**Barriers analysis:** Assess barriers to Paris-aligned investments and identify measures to remove those barriers, including with policy reform For example, if off-taker risk is a key barrier to renewable energy, how can the institution work to improve the utility's creditworthiness while also supporting directly the infrastructure investment (Tonkonogy et al. 2018). **Developing country status:** Consider potential for avoiding lock-in and addressing high levels of vulnerability in developing countries.	**Optionality:** Assess possibilities for introducing options into investment decisions to manage future uncertainty around technology deployment and climate impacts. For example, an infrastructure investment could include electric vehicle charging stations even if electric vehicles have low market penetration today, in preparation for future deployment.
IMPROVE MODELING CAPACITY	**Sector-based and country-specific**: Incorporate sector-specific and country-specific techno-economic modeling where possible to understand how projects may contribute to sectoral emissions pathways and adaptation needs as well as identify opportunities for technological development and systems transformation (e.g. Germanwatch and NCI 2018, World Bank Group 2018)	**Externalities:** Employ economic models that better reflect the price of externalities in investment decision making (High-Level Expert Group on Sustainable Finance 2017; Germanwatch and NCI 2018), e.g. by building carbon pricing / social cost of carbon into economic analysis of investments **Leverage:** Compare investments on the basis of how much external funds and private capital they expect to leverage (Cochran and Deheza 2017)	**Impact modeling:** Develop impact assessment tools that go beyond marginal abatement cost curves to prioritize long-term greenhouse gas emissions reductions and adaptation strategies over short-term, low-cost incremental improvements, even if this implies higher upfront costs (Brown and Granoff 2018; World Bank Group 2018) **Climate risks:** Undertake climate risk assessments (physical, transition, and liability) based on forward looking scenarios to identify the potential range of impacts and accompanying measures that can be implemented to reduce these risks while achieving the intended development benefits.
DEVELOP NEW CRITERIA	**Systems Criteria:** Develop criteria that consider systemic effects – e.g. benchmarking life cycle costs of renewable energy at the national level and how an activity would contribute to their reduction	**Criteria for transformative change:** Develop criteria to identify and scale-up investments with the potential for transformative change (Table 7). For example, the construction of electricity transmission lines should not be evaluated only in terms of its direct emissions, but also in terms of its contribution to facilitating the shift from fossil-fuel based energy systems to renewable energy (Cochran and Pauthier 2019).	**Criteria for long-term contribution:** Develop qualitative criteria for ensuring that investments are in line with long-term pathways. For example, assessing the entire mitigation-related portfolio to ensure that near-term projects are not consistently prioritized over projects contributing to longer-term decarbonization; assessing the adaptation-related portfolio to ensure that not just project-level adaptation, but that key vulnerability factors at the community-level are being addressed—thus encouraging a link to SDGs
UPDATE EXISTING CRITERIA	**Expand existing criteria:** Existing criteria should expand application to all operations, not just for 'climate finance' investments. Climate finance criteria can also be updated to reflect consistency with the Paris Agreement.	**Eligibility criteria:** Not all eligibility lists currently employed by institutions deploying climate finance use rigorous emissions standards, nor identify adaptation actions based on their link to SDGs. Based on assessment against long-term low emissions and resilient development pathways, emissions standards must tighten over time, and a wider range of appropriate adaptation actions identified.	**Exclusion criteria:** Develop criteria for excluding investments that undermine long term pathways - e.g. sector-based emission thresholds, and qualitative criteria for identifying potential lock-in or maladaptation, and apply progressively strict standards over time. For example, emission-intensive investments must be accompanied by context on how it fits into a long-term strategy to shift into renewables. Investments in vulnerable regions must be accompanied by robust climate risk assessments.

Table 7: Potential criteria for assessing whether an activity contributes to transformative change[30]

Removal of Barriers[31]	Does the activity.... - Remove existing policy barriers for undertaking climate projects? - Address financial barriers to aligned investment in a new or improved way? - Remove technical barriers to aligned investment in a new or improved way?
Replicability and Scalability[32]	Is the activity potentially replicable in other regions/countries? Is there a plan in place to scale up the project once successful or otherwise achieve long term financial sustainability?
Encourages uptake by other economic actors[33]	Does the activity... - Include mechanisms to ensure the sustainability of impacts, including local ownership? - Involve the private sector or contain a concrete roadmap for phasing out public sector support? - Allow for systematic learning processes?
Innovative Approach[34]	Does the activity... - involve the use of innovative technologies and approaches that have not yet been applied in the target market(s)? - employ an innovative method of mobilizing private capital?
For Adaptation	Does the activity... - increase the client's adaptive capacity so that they can anticipate and be better equipped to address future climate impacts?

Beyond direct investments, IDFC members can drive transformative change by applying alignment criteria to transactions beyond direct lending and assistance, requiring implementation partners to meet the same standards applied to internal investment evaluation.

There is significant potential to increase intermediary lending as a tool for mobilizing Paris-aligned finance. Even for institutions with relatively limited such engagement, the volume of funds leveraged through intermediary lending can be significantly greater than the size of the DFI's own commitment. The majority of intermediary lending occurs under special development programs intended to target sectors, technologies or populations[35]; climate considerations can be added into these lending criteria. To note, in discussions several IDFC members also cited the importance of

30 The Climate Investment Fund describes transformational change as "strategic changes in targeted markets and other systems, with large-scale, sustainable impacts that shift and/or accelerate the trajectory toward low-carbon and climate-resilient development."https://www.climateinvestmentfunds.org/sites/cif_enc/files/knowledge-documents/evaluation_of_transformational_change_in_the_cif_final_w_mresp_jan_2019.pdf

31 World Bank Group 2018

32 See, e.g., NAMA Facility 2018 https://www.nama-facility.org/fileadmin/user_upload/publications/factsheets/2014-08_factsheet_nama-facility_potential-for-transformational-change.pdf, Green Climate Fund https://www.greenclimate.fund/documents/20182/239759/Investment_Framework.pdf/eb3c6adc-0f24-4586-8e0d-70aa6fb8c3c8, Global Innovation Lab for Climate Finance criteria available at https://www.climatefinancelab.org/wp-content/uploads/2018/03/The-Lab-Guidelines_Cycle-4_final.pdf

33 NAMA Facility 2018

34 N.b. not all actions contributing to transformative change necessarily must be "innovative." This criteria is to broadly encourage the exploration of new approaches, bearing in mind that there are many existing channels for affecting transformative change.

35 As indicated in surveys and interviews

credit linesextended to other development finance institutions (e.g., from a bilateral development bank to a national development bank) as another key leverage point for promoting alignment.

Yet intermediaries such as local commercial banks and smaller-scale public financial institutions often have limited internal capacity to assess climate impacts and lack incentives to bear assessment costs.

By extending their own investment assessment and risk framework procedures to encompass intermediary lending, IDFC members can help overcome these challenges, implementing appropriate safeguards to withhold funding to ineligible projects and supporting intermediaries in developing the required capacities to build a pipeline of bankable aligned projects.

In addition, to promote the alignment of the intermediary as a whole beyond specific, dedicated programs, IDFC members can engage directly with intermediaries to develop a Paris-aligned investment strategy, making use of existing tools (e.g. exclusion lists and internationally recognized safeguard frameworks). IDFC members' experiences with setting up and implementing climate units, and developing technical expertise on measuring the extent and financial materiality of climate risks and impacts, can help intermediaries to develop in-demand financial products that can support an aligned business strategy.

In addition to direct credit lines, IDFC members can support alignment of intermediary lending through:

- Technical support programs, such as for providing energy audits and technical advice on energy efficiency (High-Level Expert Group on Sustainable Finance 2017);
- Providing advisory services to help clients gain a greater understanding of opportunities involving mitigation and resilience/adaptation strategies and programs (Cochran and Deheza 2017), and helping them set up and strengthen climate risk management systems (Germanwatch and NCI 2018).

Procurement also presents a significant lever for IDFC members to influence service and product provision in the economies in which they operate. This includes direct provision of products and services to IDFC members to support their operations, as well as IDFC member influence over procurement processes for public sector projects. However, existing procurement frameworks typically require the contracting entity to pursue the option with the lowest upfront cost, which can penalize clean or renewable technologies with higher upfront costs, but lower operating costs and fewer negative social and environmental externalities (Baron 2016).

Adjustments in the procurement process to penalize non Paris-aligned elements (such as significant carbon emissions or deforestation impacts) and reward aligned elements (such as low-carbon technologies or resilient infrastructure standards) could be a major lever for change in directing public resources towards Paris-aligned projects, with concurrent impacts on contractors' own supply chains and procurement processes.

36 The Climate Investment Fund describes transformational change as "strategic changes in targeted markets and other systems, with large-scale, sustainable impacts that shift and/or accelerate the trajectory toward low-carbon and climate-resilient development https://www.climateinvestmentfunds.org/sites/cif_enc/files/knowledge-documents/evaluation_of_transformational_change_in_the_cif_final_w_mresp_jan_2019.pdf

Approaches to Investment Criteria for Non-Aligned Activities

At the time of publication, **KfW** has in place an exclusion list across all subsidiaries prohibiting financing of all coal power plants and associated infrastructure, as well as non-conventional oil exploration and extraction (KfW Group 2019). The KfW Development Bank does not finance desalination or energy efficiency projects based on fossil fuels. Until now, exclusion lists have been favored over shadow carbon pricing partly due to the low application of shadow carbon pricing across KfW's portfolio and products. In addition, tests have shown that implementing a carbon price at a moderately high level would not have affected clients' decisions.

Experiences with Intermediary Lending: Credit Lines and Technical Assistance

AFD's Sustainable Use of Natural Resources and Energy Finance (SUNREF) initiative supports local financial institutions financing energy and environmental projects. Through a combination of financial and technical support, AFD provides two main instruments:

- **Credit facilities** to local financial institutions to promote climate change mitigation and adaptation investments with financial incentives (lower interest rate, longer tenors, investment grants).
- **Technical assistance to build banks' capacities** to sustainably finance its activities, including assistance in the implementation of an environmental and social management system and a gender policy, and support companies to structure green investments.

To date, 50 SUNREF projects have been successfully implemented in partnership with 70 local banks in more than 30 countries, for a total commitment of over EUR 2.6bn of loans allocated by AFD, including EUR 1.9bn already disbursed. This successful experience led AFD to develop a large scale program with the Green Climate Fund for a total amount of USD 750 million (USD 280m GCF and USD470m AFD). Like SUNREF, the program's ambition is to support the transformation of local financial partners' practices to promote a sustainable finance model, and leverage private sector for adaptation and mitigation investments. As it pivots toward a Paris-aligned strategy, AFD is leveraging this with climate-linked intermediary lending to address barriers and finance more mitigation and adaptation projects.

Implementing these adjustments is a significant challenge, as suppliers themselves are currently responsible for much of the required reporting and due diligence activities. **IDFC members can address this issue by adding specific climate alignment considerations into their own procurement processes** – both in technical and financial appraisals – that exclude non-aligned proposals and rank proposals against alignment. Further, IDFC members can engage with national and subnational entities during the project planning stage to incorporate alignment in their own procurement processes, in some cases facilitating concessional finance to overcome higher upfront costs conditional on implementing these changes. Procurement processes and scoring can also be published transparently to allow bidders to adjust their strategies accordingly. Members can require awardees to report against these metrics on an ongoing basis.

2.5.2 PROJECT DEVELOPMENT

One of the key constraints to rapid scale-up is a lack of bankable projects that meet climate criteria. To support transformative change, signal the importance of alignment to market participants, avoid emissions lock-in, and ensure a pipeline of projects that meet investment decision-making criteria, **IDFC members underlined the importance of working with clients to develop projects from the earliest stages**.

With governments, this support can often take the form of technical cooperation facilities that help them develop sector strategies and investment plans and pipelines. Importantly, given that multiple development finance institutions work in most countries, these efforts should also include coordination among these institutions that complement individual institutional country intervention strategies (World Bank Group 2018). This technical support should focus not only on projects designated part of "climate business," but all operations, to identify areas where climate co-benefits can be incorporated.

For direct lending orinvestment activities, compared to other types of financial institutions IDFC members can typically participate in earlier stages of project preparation. While a riskier project stage, members can have a much larger multiplier effect and contribute to development of markets and technologies that might not otherwise get considered due to a variety of barriers (UNEP 2011; World Bank Group 2018). Technical assistance can be tailored to the size and complexity of the project, and can be provided at all project preparation stages, such as pre-feasibility and feasibility studies for developing a project idea, technical-financial assessment, and environmental and social risk assessment.

IDFC members can support Paris-aligned project preparation, including as follows.

- Project preparation facilities or internal units can help attract and manage external funds, and also draw the attention of the institution's investment officers to climate projects. Many members take advantage of external funds, notably from international sources, such as the Green Climate Fund (GCF) and Global Environment Facility, to develop projects.
- One member has a dedicated funding line available to developing bankable adaptation projects through vulnerability and feasibility studies.
- Another member has established an innovation unit to design innovative financial instruments to improve project bankability.
- Another member runs a technical cooperation support line focused on project pipeline development that contributes to NDCs.
- One member has helped identify and fund climate projects related to NDCs through designated authorities of the GCF. Specifically, it has signed MoUs to develop and fund project pipelines, help other countries implement country readiness support programs, and assists institutions in their GCF accreditation process.
- Another IDFC member cooperates with national programs and municipalities to manage their project development efficiently.
- Other members also engage in policy dialogues with national governments to improve bankability of public sector projects.
- Members can also develop their own policy tools to provide market signals to increase aligned project development. For example, one member created an efficient construction consumer label that has influenced the development of efficient housing in its geography.

Similar efforts can be undertaken for supporting intermediaries' project pipeline development. For example, one member uses internal resources to support local and regional financial institutions to identify and improve bankable climate-related projects.

2.5.3 PRIVATE SECTOR PARTICIPATION AND MARKET DEVELOPMENT

With the focus of Paris alignment on systems change and transformative action, IDFC members can play a stronger role in market development through utilizing a full suite of investment instruments to promote private sector participation in climate alignment.

Catalyzing much higher levels of private finance in climate-aligned projects will multiply the impacts that IDFC members would otherwise get from acting alone.

This can include the mobilization of private finance either directly in portfolio projects and programs including use of risk mitigation instruments, indirectly through intermediary lending, procurement, and technical assistance, or through green bond issuance at the corporate level. Transformative projects will also seek to systematically dismantle barriers to private investment.

IDFC members can, in many cases, deploy a greater variety of instruments targeted to catalyzing private capital participation in markets. These can include:

- **Aggregation platforms** that allow for scale and diversification needed to draw in institutional investors[37]
- **Loan syndication**: Borrowers obtain much larger volumes of resources than otherwise possible, external financers can rely on DFI knowledge in an area where they would like exposure but cannot adequately assess and hedge risk, and the DFI increases its development impact while using less capital (G-24 and GGGI 2015);
- **Equity financing**:[38] Equity finance in developing countries is often lacking particularly for early stage projects and companies (Tonkonogy et al 2018);
- **Risk mitigation**: Risk mitigation instruments that address barriers to investment can be effective in leveraging private capital (Tonkonogy et al 2018; Blended Finance Taskforce 2018), yet 99.85% of IDFC member commitments are loans (Morris 2018). Potential risk mitigation instruments can include:
  - » Develop political risk insurance and expand use of private reinsurance markets (G20 Eminent Persons Group 2018).
  - » Develop risk-sharing structures through layered funds (High-Level Expert Group on Sustainable Finance 2017).
  - » Develop risk-sharing facilities or guarantees (High-Level Expert Group on Sustainable Finance 2017; G-24 and GGGI 2015).
- **Proofs of concept** for new structures in sustainable finance investment as cornerstone investors: Develop internal innovation capacity or participate in external incubators, such as the Global Innovation Lab for Climate Finance[39] (High-Level Expert Group on Sustainable Finance 2017; Cochran and Deheza 2017)(Box 7)
- **Credit enhancement initiatives or credit insurance** to improve the risk-return profile of climate-friendly assets (High-Level Expert Group on Sustainable Finance 2017). Sixty four percent of IDFC members already offer preferential rates to certain sectors (Morris 2018), so the challenge is to align this credit enhancement with the Paris Agreement objectives.

Increasing leverage of private investment can require cultural shifts in an institution, both in terms of the speed with which the institution makes decisions as well as how staff are incentivized to work with the private sector.

Senior leadership can examine which, if any, performance indicators and incentives might contribute negatively to the alignment agenda. For example, staff incented to maximize loan volumes may not focus on mobilizing private investment (Blended Finance Taskforce 2018).

At the same time that institutions focus on crowding in private capital, they should also take care to **avoid crowding out private capital** through market distortion. Aligned institutions can put policies in place to guide practitioners in making investment decisions that do not distort markets (see World Bank Group 2018 for some example methodologies).

2.5.4 EVALUATING AND REPORTING ON PROGRESS

An effective reporting system that evaluates alignment-related indicators alongside other existing financial and development indicators is critical to drive institutional change. In particular, reporting on alignment-related

37 The development of a standardized, large-scale asset class, that diversifies risk across the development finance system, will help mobilize this large pool of investments (G20 Eminent Persons Group, 2018). Supporting aggregation platforms (with and without public funds) that can either match interested investors with assets or hold greenfield assets so that they can be placed with institutional investors once assets are operational and have a track record. (High-Level Expert Group on Sustainable Finance, 2017)

38 Given the significant increase in debt ratios in many countries, much greater emphasis will have to be given to equity financing. (G20 Eminent Persons Group 2018).

39 The Lab identifies, supports, and launches innovative financial instruments and has to date supported instruments in mobilizing USD1.9 billion in investment. CPI acts as Secretariat. www.climatefinancelab.org

ADOPTING A RANGE OF INSTRUMENTS

The **DBSA** Climate Finance Facility draws inspiration from the 'green investment bank' model, and is the first of its kind on the African continent. The facility aims to improve the risk-return profile of climate projects in local currency that would otherwise not be able to take off in the market. It provides opportunities for DBSA to introduce and test innovative financial instruments, and use the results to showcase their application, without requiring DBSA itself to take on additional risk.

Brazil has a legal framework for securitization in place known as a 'Fundo de Investimentos em Diretos Creditoris' (FIDC). FIDC structures are conducive to the development of sustainable finance vehicles, including the **BNDES**-run USD 144m Sustainable Energy Fund, which counts public pension funds, insurers and institutional investors among its subscribers. Investors in FIDC funds gain access to a pool of pre-approved projects, reducing assessment and monitoring costs, and reducing risk through diversification. In addition, FIDC financing vehicles are income-tax exempt, inflation-indexed, have credit ratings of A and above, and provide a robust infrastructure project pipeline directly supporting future resilient infrastructure investment needs (Adapted from Crishna Morgado et al, forthcoming).[39]

CABEI became accredited to the Adaptation Fund in September 2015, and to the Green Climate Fund in December 2016, having thereby access to resources and financial instruments deployed by these Funds in the implementation of climate projects. loans, equity, grants and partial guarantees, while also strengthening CABEI's support to member countries in achieving the commitments and goals they agreed upon in various climate change conventions and in the implementation of NDCs.[40] CABEI's own Intervention Framework for Climate Change establishes its ability to complement GCF funding with pre-investment technical support, direct co-financing, public-private partnership agreements, trusts and financial intermediation structures for high-impact projects.[41]

39. See also https://www.climatefinancelab.org/project/green-receivables-fund-green-fidc/ to learn about a FIDC under development with the Brasil Innovation Lab for Climate Finance
40. https://www.bcie.org/en/enlaces-rapidos/investor-relations/green-bank/accreditations-to-green-funds-and-strategic-partnerships/
41. https://www.bcie.org/en/about-us/institutional-strategy/

KPIs can be effective in ensuring accountability for meeting alignment targets. In addition to internal reporting mechanisms, external progress reporting via annual reports can serve as a basis for further collaboration among IDFC members and the broader DFI community on alignment. This collaborative review process can be useful for identifying common challenges and best practices, and in revising alignment strategies based on the findings.

The existing MDB-IDFC Common Principles for Climate Finance Tracking indicate that there is momentum for standardized approaches to measuring climate finance. IDFC members report aggregate climate finance numbers as part of the IDFC's annual Green Mapping exercise. Updating and further harmonizing criteria, and extending reporting to all projects in a way that builds upon current standards and processes will enable enhanced collaboration within the IDFC and with other financial actors pursuing Paris alignment.

A first step is to review progress on increasing the share of aligned activities and decreasing the share of non-aligned activities. Members should note that the purpose of this exercise is not to penalize institutions for having a high share of currently non-aligned activities, but to assess subsequent efforts to reduce the non-aligned portion as the institutions implement their alignment strategies. IDFC members may also disclose information on carbon assets at potential risk due to policy reform or market changes as part of their assessment of mis-aligned activities.[41]

41 E.g. Disclose metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process, and measure performance against targets (TCFD 2017; Cochran and Deheza 2017).

In one IDFC member institution, the Board convened and mandated a 'strategy team' to take stock of all current initiatives on climate change and compare them to the public commitments made by the Bank, identifying areas of conflict and opportunity.

The scope of assessment is broader than the member's own investment portfolio to include intermediary lending and procurement practices. The level of detail available from final beneficiaries will vary depending on the intermediaries' capacity to enforce investment criteria and report on alignment metrics. In this case, the IDFC member's assessment could describe the share of its intermediary lending and procurement that has not been adequately assessed for alignment.

In addition to reporting progress toward financing commitments, IDFC members can evaluate the contribution of activities towards sustainable development objectives and systems change.

Alignment also implies that IDFC members should assess each activity based on its scale of contribution. While systematic ex-ante data collection for 'climate projects' is generally already in place, equivalent systems for non-aligned 'brown' projects and other projects are lacking. For transformative impact projects that leverage or mobilize private finance, IDFC members with capacity may also assess the 'additionality' of these initiatives (Escalante et al. 2018). Qualitative evaluations can also cover systemic effects of investments beyond the direct project impact.

Furthermore, IDFC members may qualitatively assess activities with respect to their link to the time-horizon dimension of Paris alignment - more specifically, whether or not their short-term actions contribute – or are in conflict with – long term climate objectives. In terms of mitigation, this could involve a qualitative evaluation of mitigation activities undertaken, to ensure that activities contributing to long-term decarbonization plans have been prioritized over near-term options that may be "cheaper" but introduce lock-in effects (Vogt-Schilb et al 2018).

For adaptation, the analysis should assess the potential for mal-adaptation. Depending on the institution's short-term and long-term climate action plans, as well as the country in which the institution is operating, relevant metrics and benchmarks for determining how an activity is aligned with long-term strategies may vary.

Conclusion

The development finance community is faced with a complex challenge in aligning its institutions 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 converge towards activities reflecting the full scope and scale the Paris Agreement requires, at an appropriate time horizon for 2050 net zero emissions to be realized. 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 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.
- Finally, members can leverage collaboration within the IDFC to learn from each others' 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 governments and other financial institutions, both public and private, will be needed to develop and streamline methodologies, metrics, and programming; reduce duplication; and accelerate the development and deployment of appropriate policy and financial instruments.

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Annexes

Annex 1: Methodology

The methodology for identifying and prioritizing actions for operationalizing the Paris Agreement was developed in three stages.

Stage 1: Concepts

The first, **conceptual** stage, undertaken in collaboration with I4CE, analyzed the text of the Paris Agreement itself in detail, drawing on interviews with key individuals involved in the design, drafting and negotiation of the text to understand its genesis and development. This information was then used to identify the three overarching dimensions of a Paris-aligned strategy.

The authors also conducted an extensive literature review of existing and ongoing studies on the alignment of financial institutions to the Paris Agreement; and of literature on decision-making process and structures of DFIs. complemented and enriched by survey and interview data gathered from IDFC members participating in the study.

Key alignment literature reviewed included the UNFCCC 2018 Biennial Assessment (UNFCCC Standing Committee on Finance, 2018); unpublished CPI work on alignment with Article 2.1c of the Paris Agreement (Brown et al., 2017); a joint study on operationalizing Article 2.1c conducted by the Overseas Development Institute, World Resources Institute, Rocky Mountain Institute and E3G (Whitley et al., 2018); an E3G study on alignment in the banking sector (Wright et al. 2018); ongoing OECD work on aligning development cooperation with the Paris Agreement (Sedemund et al. 2019, forthcoming) and a joint study by the New Climate Institute, World Resources Institute and GermanWatch on the alignment of MDBs with the Paris Agreement (Larsen et al., 2018).

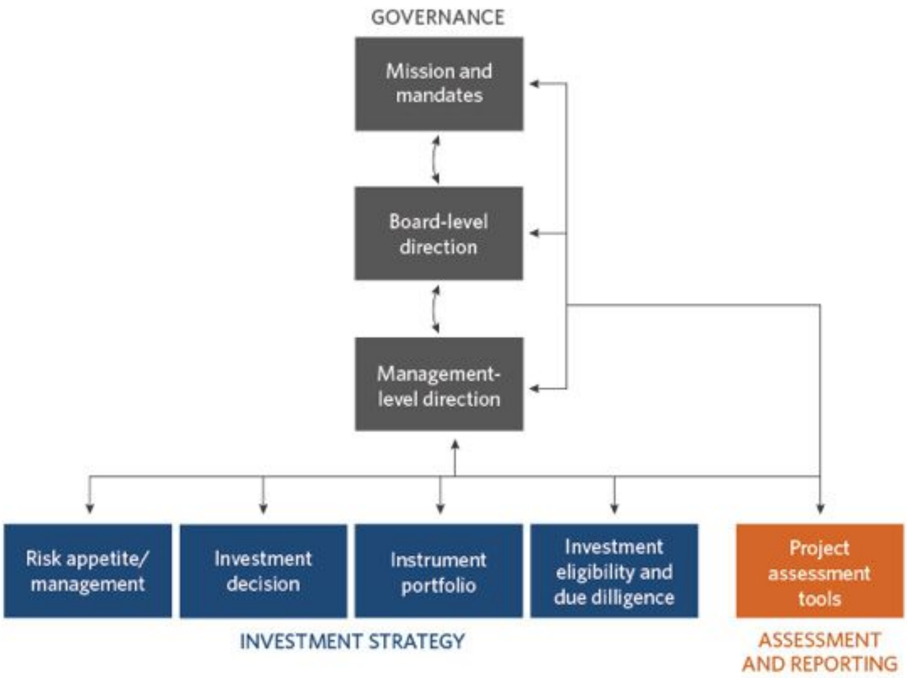
Stage 2: Data Collection and Analysis

The second, **analytical** stage identified the core drivers of climate action within IDFC members and these drivers' relationships to each other (see Figure 8), breaking down decision-making structures in order to capture key intervention points and interdependencies critical to the implementation of an alignment strategy. IN addition to ongoing input on a conceptual framework for Paris alignment from study partners I4CE, the authors drew on literature (including Humphrey 2015; G20 Eminent Persons Group on Global Financial Governance 2018; High-Level Expert Group on Sustainable Finance 2018; Pauthier et al. 2017; Abramskiehn et al. 2017) and interviews with representatives of research institutions, MDBs, IDFC members and UN agencies. The results of this process informed the design of an institutional matrix

Table 8 - Summary Characteristics of Institutions Surveyed

	IDFC MEMBER	LOCATION OF HEADQUARTERS	DEVELOPED OR DEVELOPING COUNTRY-LED	ESTIMATED TOTAL ASSETS (USDBN,2018)	TOTAL ASSETS AS % OF IDFC TOTAL
Bilateral	AFD	France	Developed	51	1,1%
	JICA	Japan	Developed	112	2,9%
Bilateral/National	KfW	Germany	Developed	574	14%
National	CDG	Morocco	Developing	14	0,2%
	PT SMI	Indonesia	Developing	4	0,1%
Regional	CAF	Venezuela	Developing	38	0,9%
	DBSA	South Africa	Developing	7	0,2%
	CABEI	Honduras	Developing	11	0,3%
	TOTAL			811	19,4%

Figure 10: Schematic of Operational Structure of DFIs



Source: CPI in collaboration with I4CE

for collating, comparing and analyzing qualitative information on each IDFC member participating in the study.

Structure

The structure of the matrix was divided into seven sections under three primary headings corresponding to establishing Paris alignment as a key component of strategy (focusing on governance, particularly the roles of the Board and management), Operationalizing national visions of Paris alignment (focusing on investment strategy, risk management, investment modalities and instruments, and eligibility criteria) and Assessment and reporting (focusing on assessment tools and approaches, and their effect on investment decisions).

On the basis of this matrix, the authors then developed a detailed survey of participating IDFC members, supplemented by desk research on each Member to address remaining gaps, in tandem with in-depth follow-up interviews. The survey was designed to capture the key decision making structures and processes to be considered in operationalizing alignment.

Participating IDFC Members

The institutions participating in the study were:

- Agence Française de Développement (AFD)
- Kreditanstalt für Wiederaufbau (KfW)
- Development Bank of Southern Africa (DBSA)
- Caisse de dépot et de gestion (CDG)
- Central American Bank for Economic Integration (CABEI)
- Corporación Andina de Fomento (CAF)
- Japan International Cooperation Agency (JICA)
- PT Sarana Multi Infrastruktur (PT SMI)

The institutions surveyed jointly represent USD 780 billion in assets (Table 8). This is slightly less than 20% of the estimated total assets of the IDFC, but the eight institutions also represent a diverse set of institutional configurations and circumstances. One institution not featured in this study, the China Development Bank (CDB), alone represents 61% of the total assets of the IDFC, with a balance sheet of USD 2.4 trillion in 2018[42], with the Brazilian (BNDES) and Korean (KDB) development banks representing another 6% each,.[43],[44].

Stage 3: Operationalization

The final, **operationalization** stage combined the results of surveys, interviews, desk research, and available literature, to develop recommendations on priority actions for IDFC members to take in implementing alignment. For each of the discrete topics identified in the results, we developed, in sequence:

A 'full alignment scenario' describing what a fully aligned DFI would look like, and what this would require, across the three dimensions of Paris alignment identified in Step 1.

Discussion of the impact potential of progress in this area to drive full alignment, and the challenges faced in doing so

Recommendations for action based on these findings, organized into a series of steps accompanied by guidance and caveats where applicable.

Graphics and visualizations

The data used in 3 were sourced from CPI's IDFC Green Mapping Survey, a major component of the forthcoming 2019 IDFC Green Mapping Report.

Figure 4 used data from two sources. The economic damage from extreme weather dataset was obtained from the Germanwatch Global Climate Risk Index 2019, while the global GHG emissions dataset was obtained from the ClimateWatch Data Explorer. Both datasets provided figures at the individual country level. Countries were sorted into the four categories that appear Figure 4 based on the following criteria:

- **Countries primarily sponsoring a national IDFC member**: If a country's national DFI was an IDFC member, it was included in this category, even if the country was also affiliated with an IDFC member regional DFI. For example, Brazil is a member of IDFC member CAF, a regional DFI, but is categorized as a country primarily sponsoring a national DFI because Brazil's own BNDES is also an IDFC member.
- **Countries primarily sponsoring a regional IDFC member**: If a country was a member/shareholder of an IDFC member regional DFI but not of an IDFC member national DFI, it was categorized as a country primarily sponsoring a regional DFI.
- **Countries primarily sponsoring a bilateral IDFC member**: If a country had an affiliation with a bilateral IDFC member, but was not directly affiliated with either national or regional IDFC members, it was categorized as a country primarily sponsoring a bilateral DFI.
- **Countries with no IDFC affiliation**: If a country had no affiliation with any IDFC members, it was categorized as such.

Note that the Germanwatch Global Climate Risk Index 2019 provided data on economic damage from extreme weather events in USD PPP terms rather than in real USD. These data have been converted to percentage terms in the version of the bar chart that appears in the report.

Annex 2: IDFC Position Paper

IDFC Position Paper (text)

Aligning with the Paris Agreement

December 2018

The Paris Agreement bears significance to development finance institutions. Several articles of the Agreement recall it is to be implemented "in the context of sustainable development", thus recognizing "the intrinsic relationship that climate change actions, responses and impacts have with equitable access to sustainable development and eradication of poverty". Additionally, the Agreement entails strong expectations regarding finance, one of its core objectives being to "make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development". To date, the Paris Agreement was ratified by 182 Parties to the UNFCCC, out of 197.

In this context, the concept of aligning finance with the Paris Agreement has emerged over the past couple of years as the new frontier for increasing climate action ambition within the financial community. The concept integrates the fact that entire financing and investment portfolios, beyond the shares that are directly beneficial for the climate and traditionally classified as climate finance, need to be made consistent with the Paris Agreement, including its long term goals.

42 http://www.cdb.com.cn/English/gykh_512/ndbg_jx/2018_jx/
43 https://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_en/Galerias/Download/Informe_Contxbil_1T19_Inglxs-BNDES.pdf
44 https://www.kdb.co.kr/wcmscontents/cmsFileDown.jsp?path=/wcmscontents/hmp/ch/gl/ir/rc&fileName=KDB_2018AR_Design_TCG0426.pdf

A number of development finance institutions have initiated work in this area, as illustrated among others by the commitment of the International Development Finance Club (IDFC), along with the Multilateral Development Banks (MDBs), to "align financial flows with the Paris Agreement" (see statement released during the One Planet Summit in December 2017 in Annex). The topic of "alignment" has become fertile grounds for research as well, with substantial analytical work being carried out by prominent think tanks and other key stakeholders such as the OECD. It has also become a subject of discussion in the international negotiations of the UNFCCC.

The connection of urgent climate action with the desired longer term objectives is complex and requires not only conceptual and operational innovations, but also collective understanding and work to generate new knowledge and get it right. The present position paper summarizes some of the current thinking within the IDFC about the concept of alignment with the Paris Agreement, and its implications for the Club and its members. Its objective is to foster collaborative thinking amongst IDFC members and with the broader climate finance community on the topic.

1. Significance of the Paris Agreement for IDFC members

IDFC members' mandates resonate with climate change issues

IDFC members are leading national and regional development banks from around the planet. Their development mandate, as given by their respective constituencies, explicitly includes climate action and/or is in all cases impacted by the changing climate, in terms of both risks and opportunities. The Club's raison d'être is to join forces as a platform to promote and leverage sustainable development worldwide, fostering the implementation of the Sustainable Development Goals (SDGs) and the Paris Climate Agreement agendas.

IDFC members can provide useful policy feedback or advice to their constituencies

IDFC members have the unique function of supporting domestic/regional policies while transferring international priorities into their own constituencies. As such, they can have a structural impact on the development pathways of their countries/region with regards to the Paris Agreement, in terms of GHG emissions or vulnerability. IDFC members' close ties to their national governments and/or those of the region within which they operate, allow them to provide direct feedback or advice on policy formulation or 2 implementation, including on their respective countries' NDC, which are to be revised by 2020, and on the longer term (2050) climate strategy also called for by the Agreement.

As national development banks, IDFC members have in depth knowledge of the social and economic fabric of their country/region

For example through their networks of local offices, or a wide spanning portfolio of clients, including local government and businesses. Knowledge of the country context, stakeholders and political economy provides key necessary insights to implement the Paris Agreement and to identify risks and opportunities.

IDFC members can influence finance flows beyond their own operations

Their mandate and practices are well observed and often interpreted as policy or market signals in their countries.

IDFC members play a leading role vis-à-vis the community of financial institutions within their respective countries and regions

They are in a position to partner or otherwise organize initiatives with their local financial markets. The sensitivity of financial actors to regulation is very strong and the adoption of a new system of best practices and incentives can be very fast. IDFC members can be at the forefront of this transformation.

IDFC members are well poised to catalyze private sector investment

In their respective countries and regions of operation, IDFC members play a fundamental role in directing international but also local capital towards climate-smart and sustainable investments (e.g. green infrastructure), by demonstrating the opportunities and potential returns, and by reducing the risks associated with them. At the same time, IDFC members can actively contribute to mainstreaming the sustainable development and climate agendas across all sectors, in accordance with their mandates.

2. "Aligning" with the Paris Agreement

The acceptance of the "alignment" with the Paris Agreement should be first sought in the agreement's three long-term goals, described in its Article 2. The first two goals relate to the limitation of global temperature rise well below 2°C, and 1.5°C if possible, and the strengthening of adaptation capacities. The third goal is "to make all financial flows consistent with a pathway towards low-emissions, climate-resilient development" (Article 2.1.c). As such, it directly concerns development funders who produce, and can influence, financial flows. Article 2.1.c leads to consider "pathways towards low-emissions, climate-resilient development" at country level, and thus countries' long term climate and development strategies. This is consistent with the bottom-up, country driven nature of the Paris Agreement processes such as NDCs.

As national and regional development finance institutions, IDFC members consider Article 2.1.c of the Paris Agreement to be the guidepost of their alignment

This approach appears consistent with much of the work being currently undertaken by international organizations like the OECD, as well as prominent think tanks like Germanwatch, WRI, E3G and others. The implementation of Article 2.1.c also is at the core of climate finance discussions in the international negotiations on climate, and the topic will be part of the 2018 edition of the assessment report of the UNFCCC's Standing Committee on Finance. The underlying implication of Article 2.1.c is that all financial flows would be made compatible with the other two long term goals of the Agreement, or that no financial flow should be found to be inconsistent with them. This has far reaching impacts on the management of operations and of the portfolio of the IDFC members as development finance institutions.

IDFC members' alignment commitment and actions

IDFC members' commitment to align financial flows with the Paris Agreement was highlighted in a joint statement issued during the One Planet Summit in December 2017, together with the Multilateral Development Banks (IDFC and MDBs 2017). For the IDFC, such commitment involves the following:

<u>IDFC members committed to increasingly mobilize finance for climate action</u>

By (i) further embedding climate change considerations within their strategies and activities (e.g. via the 5 principles for Mainstreaming Climate Action in Financial Institutions, and the management of climate financial risks); and (ii) redirecting financial flows in support of transitions towards low-carbon and climate-resilient sustainable development. Levels and share of climate finance lie at the core of the commitment to align with the Paris Agreement. However, they are more and more viewed as insufficient by themselves, and are to be complemented by information on the "non-climate" part of the portfolio/finance, which needs to be made consistent with the low carbon and resilient pathways.

<u>IDFC members will support country-led climate related policies</u>

This can be translated into several forms, such as financing (i) support for enabling policy and regulatory environments, (ii) development of long term 2050 decarbonization pathways and strategies towards zero net emissions, as well as long term resilience, (iii) shorter term actions towards low carbon and resilient development, (iv) technical capacities and institutions' strengthening to enable the translation of NDCs and longer term climate strategies into policies, investments plans and projects.

<u>IDFC members seek to catalyze investments, and to mobilize private capital (local & international)</u>

They will blend their financing most effectively with other local and international sources to drive climate action, considering the scale of investments needed to achieve the climate and Sustainable Development Goals agendas.

<u>IDFC members recognize the importance of adaptation and resilience, especially in most vulnerable countries</u>

The importance of adaptation is not only a matter of international climate politics, as it pertains also to the management of climate risks. Alignment with the Paris agreement implies that adaptation support measures must be strengthened.

<u>IDFC members support the transition from fossil fuels to renewables financing</u>

Based on national and regional circumstances, reduction of greenhouse gas emissions can be achieved through the development and prioritization of alternatives to investments directly or indirectly linked to fossil fuels. Various instruments and measures can support this transition: shadow price of carbon, reporting of GHG emissions, assessments of potential for stranded assets, policies to reduce reliance on fossil fuels and rapidly accelerate financing for renewables. Some target the supply side of fossil fuel; others are better suited to tackle the demand (consumption) side, or both.

Aligning with the Paris agreement is also a process of internal transformation of the institutions, which can build on existing principles and/or practices

Many IDFC members have promoted and endorsed 5 voluntary principles for mainstreaming "Climate Action within Financial Institutions", which were designed in 2015 and adopted during COP21. The principles intend to make climate change considerations a core component of how financial institutions conduct business, parallel to and in addition to the necessary development of appropriate regulatory and enabling environments at the domestic and international levels. They imply a shift from incremental financing of climate activities to ensuring that climate change – as both a risk and an opportunity – is a fundamental consideration around which financial institutions deploy capital.

The 5 principles are the following:

(a) Commit to climate strategies,

(b) Manage climate risks,

(c) Promote climate smart objectives,

(d) Improve climate performance and

(e) Account for your climate action.

The principles of mainstreaming were designed before the Paris Agreement was adopted, but they have proven to be extremely robust and pertinent. They imply that "alignment" does not only pertain to what financial institutions finance, where, in which sectors, but also to the institutions themselves: their governance, their strategies, their processes, their reporting and transparency, etc.

IDFC members also recognize the intrinsic financial risk brought about by climate change. The Task Force on Climate Financial Risk Disclosure2 (TCFD) identifies three kinds of climate financial risks: (i) physical risks which result from the adverse impacts of climate change, (ii) transition risks which may result in policy changes made necessary to achieve the goals of the Paris Agreement, and (iii) liability risks which would result from legal action undertaken to seek compensation for losses from the physical or transition risks from climate change outlined above. Climate financial risks pertain to both adaptation and mitigation.

The importance of collective action: IDFC is a platform for cooperation between members and with other climate finance partners to continuously advance on the "alignment" objective

An illustration of this cooperative spirit between members and with other partners is the collaboration with the Green Climate Fund (GCF). As of today, 10 IDFC members have been accredited to the GCF, while several others are currently in the process of being accredited. IDFC represents the main group of financial institutions entrusted by the GCF to implement its resources, a signal not only of the current evolution of the sustainable development financing architecture, but also of IDFC's role as platform for advocacy, vision and action to address climate change and foster related action.

As a platform, IDFC also aims at facilitating international cooperation between the different groups of actors working on the alignment of financial institutions with the Paris Agreement, such as the MDBs, other public and private financial institutions, relevant international organizations, think tanks and civil society. Among others, and since 2015, the Club regularly organizes IDFC Climate Finance Forums and related events, as one of the major gatherings of the global climate finance community. IDFC recently decided to set up in 2019 an IDFC Climate Facility, an innovative instrument to further institutionalize and to facilitate collaborative work among Club members on climate change, and to strengthen the capacity of such leading national and regional development banks worldwide to originate and to develop climate mitigation and adaptation projects as well as new and joint business opportunities in this area.

1 A non-aligned activity counteracts the long-term net zero emissions goal and/or increases vulnerability to climate risk (See Section 2.3.1)

2 World Bank Group 2018

3 See, e.g., NAMA Facility 2018 https://www.nama-facility.org/fileadmin/