10 Essentials for a 'Truly Green' Green Equity Approach

Reviewing the GEA as a step towards IFC Paris Alignment

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In 2020, the International Finance Corporation (IFC, the World Bank's private sector arm) published its 'Approach to Greening Equity in Financial Institutions' (Green Equity Approach or GEA).[1] The GEA committed the IFC to end equity investments in financial institutions that do not have a plan to phase out coal-related investments by 2030. This initiative to "green" equity investments through the GEA was a step in the right direction in helping IFC's equity financial intermediary (FI) clients to exit coal and boost green investments. This is important because what the IFC does, others follow. And in this context, the IFC plays a crucial role in setting the standard in green equity investments both for the private sector and other development finance institutions (DFIs).

For instance, Federal Bank Limited, which is India's 7th largest commercial bank and previously one of the leading coal backers in the country, turned its back on new coal investments in July 2021 after it signed up to the GEA.[2] This was a watershed moment for the banking industry because commercial banks in developing countries remain some of the biggest fossil fuel financiers at the national level.[3]

But while the GEA represents a welcome, if narrow, opportunity to phase out coal financing by 2030, much is still to be desired for the GEA to align IFC's equity investment portfolio with the Paris Agreement on climate change.

In its 2021 Climate Change Action Plan (CCAP), the World Bank states that it is "committed to leading on the development of methods and metrics needed to close the gap and make Paris alignment a reality."[4] Specific to FIs, the IFC committed in its 2021 annual report to announce a timeline to release its Paris alignment methodology for intermediary financing by October 2021.[5] The IFC also promised to review the GEA in 2021.[6] But neither commitment has been met and the IFC is now overdue in fulfilling these promises.

WHAT IS FINANCIAL INTERMEDIARY LENDING?

Financial intermediary (FI) lending is a form of indirect financing that delegates the responsibility to manage social and environmental impacts of sub-projects to FI clients such as commercial banks or private equity funds. The IFC invests over half its total portfolio in FIs. This hands-off form of lending has been the subject of much scrutiny by Non-Government Organizations (NGOs) and project-affected communities because of the risks inherent to this financing model. NGOs have linked FI investments to cases involving forced evictions and other human rights abuses, forest destruction, environmental pollution disasters and destructive coal mines and power plants.

A 2021 review of the GEA by Recourse and Trend Asia[7] shows loopholes that allow the IFC to continue supporting clients that have exposure to coal, oil and gas via its financial intermediary clients. This clearly demonstrates that the GEA currently does not have what it takes to match the ambition of the Paris Agreement. For example, Hana Indonesia bank, barely a year after it signed up to the GEA, financed one of the most infamous coal plant complexes in the world: Java 9 and 10 in Banten Province, Indonesia. This happened without the IFC even knowing because clients are not obliged under the GEA to reveal when they finance new coal projects.[8] The loan term for Hana Indonesia's support to Java 9 & 10 run until 2035. This raises questions about whether the GEA is fit for purpose for meeting its stated objective "to help client financial institutions increase their climate-related lending while reducing their exposure to coal to zero or near zero by 2030." [9]

In its latest reports, the Intergovernmental Panel on Climate Change (IPCC) confirms "global warming, reaching 1.5°C in the near-term, would cause unavoidable increases in multiple climate hazards and present multiple risks to ecosystems and humans."[10] Similarly, a report by the International Energy Agency demonstrates that current government pledges, even if fully achieved, will fall short of what is required to keep temperature rise below the 1.5°C threshold.[11] In this context, the GEA is an important tool the IFC can use to help its investments avoid contributing to disastrous climate impacts.

DEVELOPMENT FINANCE INSTITUTIONS REVIEWING POLICIES ON FIs

DFIs are reviewing the policies they apply to financial intermediary lending. This creates an opportunity to ensure reforms align investments with the Paris Agreement and make equity truly green. For example, the Multilateral Development Bank (MDB) Paris Alignment Working Group is aiming to align financial flows with the goals of the Paris Agreement, including indirect finance channeled through equity investments. The European Investment Bank has consulted publicly on a new Standard 11 on Intermediated Finance; the British International Investment (formerly Commonwealth Development Corporation) is carrying out a review of its Code of Responsible Investing in early 2022; the Asian Development Bank (ADB) has revised its Energy Policy, and is currently reviewing its social and environmental policies, which address FI investing; the Asian Infrastructure Investment Bank (AIIB) is currently undergoing a review of its Energy Sector Strategy; and the IFC has committed to review the GEA and release its Paris alignment methodology for indirect finance.

When the IFC finally goes ahead with the review it promised to initiate in 2021, it should examine how it can address existing loopholes in the GEA that still allow clients to expand support for fossil fuels. To address these shortfalls and make Paris alignment a reality, the IFC must implement much-needed reforms to the GEA. The reformed GEA should form part of the IFC's Paris alignment methodology, to ensure that it is fit for purpose to achieve global climate objectives.

To achieve this, the IFC should ensure the revised GEA:

1 | Stops clients supporting new coal.

Coal is the most carbon-intensive fossil fuel in terms of carbon dioxide (CO2) emissions.

Coal investments remain a central driver of rising global temperatures. Despite commitments to end support for coal through the GEA by 2030 and no longer make equity investments in financial institutions that do not have a plan to phase out coal-related investments, the GEA still allows equity clients to support new coal investments, as long as they phase out by 2030. The IFC must close this loophole that allows GEA clients to invest in new coal fired power stations and associated infrastructure.

2 | Supports clients to cease finance for all new oil and gas projects.

In May 2021, the International Energy Agency concluded that "there is no need for investments in new fossil fuel supply in our net zero pathway" including not just coal, but also oil and fossil gas.[12] To align with the Paris goal of keeping global warming below 1.5 degrees, the IFC must extend the GEA to cover not only coal but also oil and gas. Further expansion of oil and gas production and the infrastructure that supports these – whether in the upstream, downstream or midstream segments – is not compatible with the Paris Agreement.

3 | Supports clients to scale up investments in sustainable renewables.

Solving the energy crisis and attaining universal access to energy is closely linked to ending the world's dependence on fossil fuels. It is widely recognised that a clean energy transition is of paramount importance in achieving the Paris Agreement and some important shifts have started to occur. However, energy financing remains wedded to an outdated business-as-usual scenario. IFC could play a key role in ensuring a swift and radical transformation of energy systems by helping to shift financial flows.

Rapidly scaling up publicly supported investments in renewables must therefore complement efforts to rapidly phase out all fossil fuel energy sources. For instance, while the GEA commits the IFC to support its FI clients in increasing support for climate-related investments to 30% for mitigation and adaptation, it must ensure renewable energy investments form a majority of this effort. At the same time, measures must be put in place to enable a Just Transition in recipient countries and ensure no one is left behind in the shift to clean sustainable energy pathways. Efforts to implement measures towards Just Transition must be based on the principles of social justice, meaningful work, self-determination, reducing consumption and promoting ecological resilience in addressing the climate emergency.

4 | Ensures more clients adopt the GEA.

In the three years since the GEA was put into practice, the IFC has only signed up a few clients. Out of the nearly 70 commercial banks in which the IFC has active equity investments, so far just three have signed the GEA, in addition to two insurance companies. The IFC explains that "the limited application of the GEA to date reflects IFC's recent history of equity transactions in financial institutions, which are subject to market conditions and other factors, and IFC's selectivity in its equity investments."[13] As the IFC reviews the GEA, it must address why only a handful of its clients have adopted the agreement, address barriers, and commit to targets to increase uptake.

In addition, the IFC must set a Paris-aligned timescale for existing equity clients to either sign up to the GEA or face IFC divestment.

Communities in the Philippines harmed by 10 coal-fired power stations financed by the IFC through intermediary client Rizal Commercial Banking Corporation (RCBC) raise their voices loud. Photo: PMCJ

Dozens of environmentalists and residents of Banten staged a rally in front of the South Korean Embassy in Jakarta to protest Korean state-owned utility company Korea Electric Power Corporation's (KEPCO) plan to invest in two new coal-fired power plants (Java 9 & 10) in Cilegon, Banten. KEPCO in turn is financed by Hana Bank, a financial intermediary client of the IFC under the GEA. Photo: TrendAsia

5 | Closes the coal underwriting loophole.

The IFC must close the current loopholes in the GEA that allow for continued support for coal through underwriting. The IFC defines 'exposure' to coal projects as "coal-related projects [that] refer to long term (more than 36 months) project finance and/or corporate finance for the development of new coal-related projects".[14] This definition leaves out financial services, such as underwriting of bonds or share issues, which are a vital source of funding for coal power plants. This results in several IFC equity clients, such as Chinese banks which are heavily exposed to coal via underwriting, not being covered by the GEA. This matters because in 2020 alone, a massive 65% of bank financing for fossil fuels was through the underwriting of bond and equity issuances rather than through project or corporate lending.[15]

6 | Puts gender equality front and centre.

Gender equality must be a key priority in the IFC's review of the GEA, given the disproportionate impacts of climate change on women and girls, and marginalized communities. In its current iteration, the GEA only mentions women a total of three times and then strictly confined to ring-fencing investments for women-owned businesses. This is grossly insufficient. The IFC must ensure that the investments it supports are gender-responsive. This not only implies addressing the gendered impacts of investments, but also underlying inequality and power imbalances. To do this, gender assessments and gender action plans must be mandatory under the GEA and provided with adequate human and financial resources. In addition, the GEA review as well as the IFC's Paris alignment methodology must include accessible and independent gender-responsive grievance mechanisms.

7 | Addresses past harms caused by IFC-backed fossil fuel projects.

The IFC must be held to account for past harms caused by fossil fuel investments it has supported over the years. Urgent and thoroughgoing reform is needed especially in light of the devastating findings of the Compliance Advisor Ombudsman in the case of Philippine-based Rizal Commercial Banking Corporation (RCBC). The CAO report found that the IFC breached its own standards in allowing RCBC to finance 10 coal plants in the Philippines without application of the Performance Standards, resulting in egregious harms to local communities and the environment. .[16] Local communities have expressed similar fears about air and water pollution and associated respiratory and skin diseases as a consequence of Java 9 and 10 coal plants in Indonesia financed by Hana Bank, the IFC's first client who signed up to the GEA.[17]

> **"the IFC breached its own standards in allowing RCBC to finance 10 coal plants in the Philippines without application of the Performance Standards, resulting in egregious harms on local communities and the environment."**

To address past harms, the IFC should commit to work with its clients in ensuring remedy is provided and future harms are prevented in consultation with local communities. As a first step, the IFC should commission third party assessments of harms, in consultation with local communities, and where they breach IFC Performance Standards, produce recommendations about how these breaches can be rectified. The IFC's forthcoming Framework for Remedial Action represents an opportunity for the IFC to examine how best to address harms caused in consultation with civil society and those affected adversely by its investments.

8 | Ensures transparency and full public disclosure.

The GEA includes commitments to enhanced transparency including for FIs "to publicly disclose, on an annual basis, their aggregated exposures to coal related projects on the financial institution's website/annual report and/or on IFC's project disclosure portal."[18] Such aggregate data, however does not include project-specific information. Its use is primarily as a means to track whether IFC's GEA client is indeed reducing exposure to coal per the requirements of the GEA (to 5% by 2025 and to zero or near zero by 2030.) Separately from the GEA, the IFC has also committed to disclose information about Category A and some Category B subprojects funded through intermediaries.

Though the World Bank President made this commitment in March 2020, the IFC has not yet implemented disclosure. In addition to disclosing aggregated data on coal exposure of its FI clients, IFC must ensure it fulfils its commitment to disclose higher risk subprojects. In the context of the GEA, this should entail disclosing the name and location of all oil, and coal-related investments of its FI clients. Public disclosure is critical to ensure civil society can monitor, track and verify commitments in the GEA.[19] Unless there is a complete disclosure of these higher risk sub-investments, IFC's commitments – whether to increase climate finance or avoid fossil fuel investments - cannot effectively be verified.

9 | Allows for an evidence-based, public review of the GEA.

The IFC must hold an evidence-based, public review of the GEA to examine barriers to its efficacy and wider engagement of equity clients. The review must identify concrete steps the IFC should take to align with the Paris Agreement, including ending support for coal, oil and gas in its FI equity portfolio. A public review of the GEA presents an important opportunity to ensure existing and future investments made by the IFC are truly green: that they do no harm, prevent human rights abuses and negative social and environmental impacts, and promote gender equity.

This public review should form part of a wider consultation on the IFC's methodology for Paris alignment of its indirect investments. Like the European Bank for Reconstruction and Development,[20] the IFC should hold public consultations - including meetings, allowing for written submissions, and roundtable discussions with experts and project affected communities - on its methodology.

10 | Ensures a rights-based approach and meaningful participation.

To be truly 'green' the GEA must prioritise the protection and promotion of human rights, including ensuring the rights of marginalised communities, such as people of colour, LGBTQ people, Indigenous Peoples, women, and people with disabilities.[21] The IFC must uphold and implement its Performance Standard requirements in its GEA investments, including ensuring meaningful consultations with civil society and affected communities throughout the planning, implementation and monitoring of investments.

> **"The planet can no longer accept excuses that these actions are too difficult or that the market is not yet ready for such steps. The IPCC report confirms that we are at the cliff edge of disastrous and irreversible climate consequences if global temperature rise is not kept well below 2°C and ideally to a 1.5°C threshold."**

In order for the GEA to be truly impactful and for the IFC to lead in helping shift finance out of fossil fuels, it needs to demonstrate faster and bolder action. The IFC should deliver on its commitments to review the GEA and engage through a public consultation with stakeholders to develop its Paris alignment methodology for indirect lending. It must recognise that these instruments will never be truly 'green' if its investments continue to support fossil fuels.

The recommendations outlined above are designed to ensure IFC plays its part in steering financial flows in the right direction. The planet can no longer accept excuses that these actions are too difficult or that the market is not yet ready for such steps. The IPCC report confirms that we are at the cliff edge of disastrous and irreversible climate consequences if global temperature rise is not kept to well below 2°C and ideally to a 1.5°C threshold.

Apart from the IFC being a major lender in its own right, its standards are widely used as a reference point by other major development banks and the private sector. The IFC therefore has a vital role to play in ensuring public money is used to shift private financial flows out of destructive and dirty development towards a safer and more just future for us and the planet. It's time for the IFC to step up and use its equity influence effectively and positively.

Endnotes

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