



## The Role of Development Finance Institutions and Development Banks in Scaling Up Green and Climate Investments

A CPI Brief in support of a high-level meeting of senior management  
representatives from Development Finance Institutions and Development Banks  
from developed countries in Frankfurt on 4 September 2013<sup>1</sup>

04 September 2013

### Main Findings

This brief synthesizes findings from a survey among 15<sup>2</sup> Development Finance Institutions (DFIs) with private sector focus and Development Banks (DBs) with focus on the public sector, both from developed countries. It combines qualitative insights on participating DFIs' and DBs' approaches to scale up green financing and mobilize private sector investment, with quantitative information about DFIs and DBs' 2012 green and climate finance commitments. Based on this information, a better understanding of DFIs and DBs' role in scaling up green investments emerges:

- The survey results suggest that DFIs and DBs play a significant role in financing countries' green economic development today. In 2012, the 15 surveyed DFIs and DBs committed approximately USD 18.2 billion to green and climate finance<sup>3</sup>, supporting recipient countries' transition to a green economy (see Figure 1).
- To scale up their support to green economic sectors<sup>4</sup>, 13 DFIs and DBs stated to have participated in activities that specifically included co-financing or syndication deals for projects in green economic sectors. The majority involved Multilateral Development Banks, other DFIs and private financial institutions.
- DFIs' and DBs' catalytic potential in green and climate investments is constrained by a shortage of financially viable, bankable projects, and the uncertain bankability of particular technologies, such as prototype or start-up technologies. The failure of partner countries to prioritize green and climate finance, organizational constraints, and a shortage of human and dedicated financial resources represent other constraints (see Table 1).
- Consistent information is currently not available from the surveyed DFIs and DBs to quantify the respective role as intermediaries in channeling funding to private entities. Data on leveraged third party private investment are uncertain and respective methodologies in their infancy. Neither are methodologies and consistent data available for DFIs and DBs participating in the survey regarding the carbon intensity of their portfolios or the amount of fossil-fuel related funding.

<sup>1</sup> This brief was prepared by Barbara Buchner, together with Claire Painter, Chiara Trabacchi and Jane Wilkinson. It represents the views of the authors and not necessarily the views of participating institutions.

<sup>2</sup> Agence Française de Développement including Proparco, Belgian Investment Company for Developing Countries, Black Sea Trade & Development Bank, CDC Group plc, Compañía Española de Financiación del Desarrollo, Deutsche Investitions und Entwicklungsgesellschaft, Finnish Fund for Industrial Cooperation, Netherlands Development Finance Company, Japan International Cooperation Agency, KfW Development Bank, Norwegian Investment Fund for Developing Countries, The Development Bank of Austria, Overseas Private Investment Corporation, Swiss Investment Fund for Emerging Markets, Società Italiana per le Imprese all'Estero.

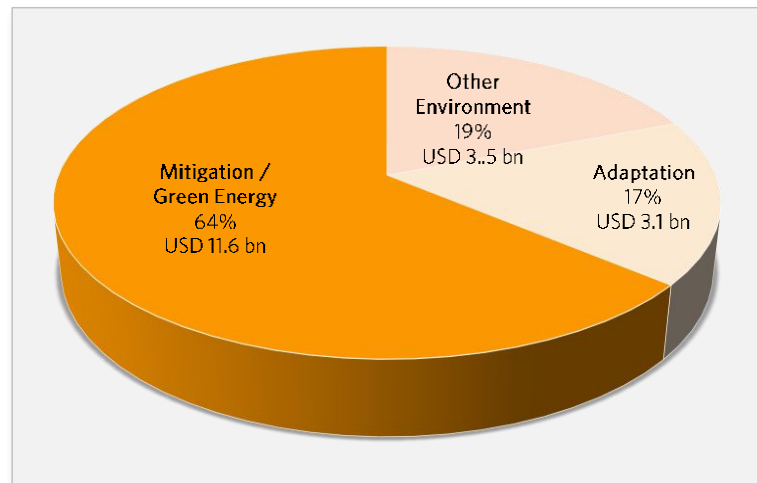
The brief is based on a survey conducted in July 2013 with these institutions and other publically available information. 15 DFIs and DBs completed the survey to various degrees; in total, 14 participated in the qualitative part of the survey, and 14 completed the survey's quantitative part. The accuracy and completeness of survey responses may influence the information presented.

<sup>3</sup> Green and climate finance refers to financial flows targeting mitigation, adaptation and other environmental activities encouraging sustainable development. Please note that USD 18.1 billion includes USD 390 million of financing to other Development Banks who might be included in the surveyed group.

<sup>4</sup> This refers to, for instance, renewable energy; energy efficiency measures in the building and/or industrial sector; sustainable transport; water management; waste management; land-use management; etc.



**Figure 1:** Allocation of green and climate finance by theme in 2012 (USD billion, %)



Notes: Definitions of mitigation, adaptation and other environmental projects are based on those used by the Organisation for Economic Cooperation Development Assistance Committee (OECD-DAC) Creditor Reporting System (OECD-DAC, 2011) and IDFC (IDFC-Ecofys, 2012). Specifically:

- Mitigation: an activity classifies as climate change mitigation if it (i) contributes to reducing or avoiding greenhouse gas (GHG) emissions, or (ii) increases their sequestration through the enhancement of sinks and reservoirs (e.g. forests), or (iii) promotes the integration of mitigation concerns with the recipient countries' development objectives through institution development, capacity building, strengthening the policy and regulatory framework.*
- Adaptation: an activity classifies as climate change adaptation if it aims to reduce the vulnerability of human or natural systems to the impacts of climate change and climate-related risks, by maintaining or increasing adaptive capacity and resilience. This comprises a range of activities from information and knowledge generation, to capacity building, planning, and the implementation of climate change adaptation actions and investments.*
- Other environment: an activity classifies in the other environment category if it does not directly target climate change mitigation or adaptation, but is related to sustainable development with a positive impact on the environment.*

**Table 1:** Constraints to increasing green and climate investments in 2012

DFIs' and DBs' answers	Frequency of answer*
Projects'/technology bankability	37%
Limited availability of equity/dedicated and appropriate financial resources	19%
Shortage of skilled human resources	15%
Enabling policy framework / sectors strategy in recipient countries	7%
The creditworthiness of state or state-owned counterparties in developing countries	4%
Others (e.g., limitations from donors, weak governance structures, project size, etc)	11%

Note: (\*) The percentages indicate how often a specific constraint was mentioned by participants on the total of answers received through the surveys.

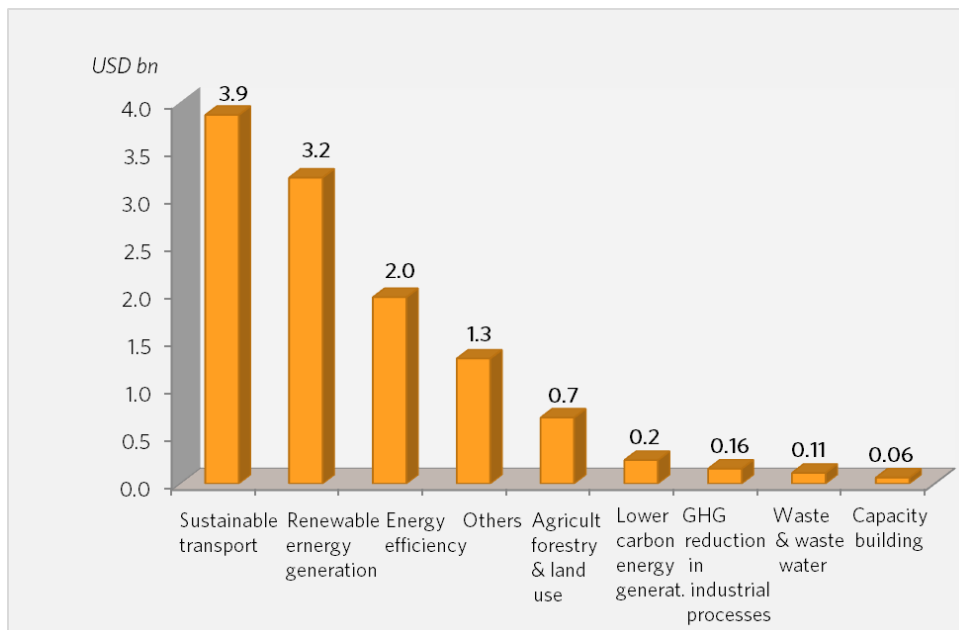


## 1. DFI's and DB's green and climate finance: the state of play

- The 15 surveyed DFIs and DBs committed approximately USD 18.2 billion to green and climate finance, with 64% going to mitigation interventions.
- Loans represented the instrument most frequently used by institutions.
- 69% of DFIs' and DBs' green and climate finance commitments went directly to public sector entities, while 19% to private sector actors. The remainder 12% was channeled indirectly to various organizations, mainly local financial institutions.
- 10 out of 15 surveyed institutions have a strategy or quantitative target(s) for financing green economic sectors.

The majority of DFIs' and DBs' commitments towards mitigation-relevant projects were allocated to the sustainable transport (33%), renewable energy (28%) and energy efficiency sectors (17%). Solar energy received 30% (about USD 1 billion) of participants' commitments to renewable sources of energy.

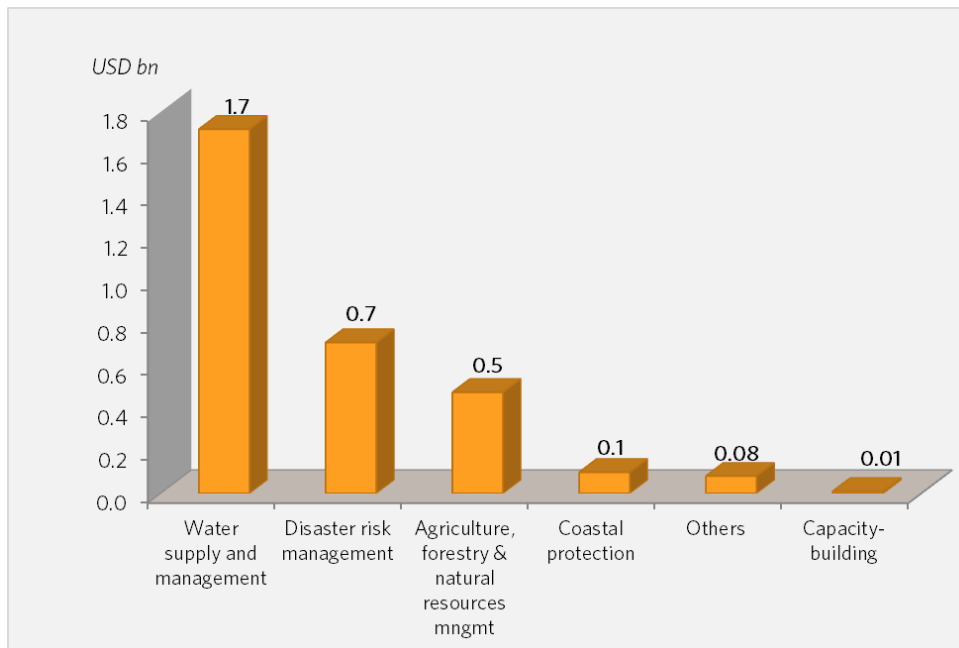
Figure 2: Mitigation – sectoral distribution of green and climate finance in 2012 (USD billion)



Note: The category "others" includes e.g., sectoral or national budget support to climate change mitigation policies, budget support for energy efficiency promotion, support to financial intermediaries' and carbon credits.

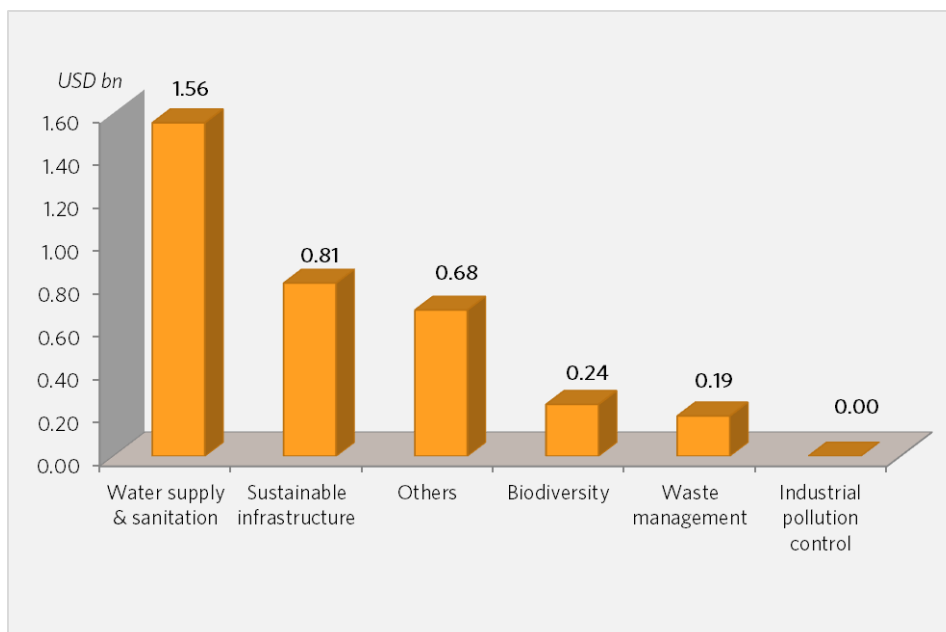


Figure 3: Adaptation – sectoral distribution of green and climate finance in 2012 (USD billion)



Note: The category "others" includes activities such as eco-tourism, prevention of groundwater salinity through improved waste water infrastructure and waste management or health-related products.

Figure 4: Other environment – sectoral distribution of green and climate finance in 2012 (USD billion).



Note: The category "others" includes activities such as disaster management and capacity building that could not be classified as adaptation or mitigation, or projects with high environmental risks where an environmental management system or an environmental and social action plan has been agreed and is under implementation. The category "industrial pollution control" received USD 0.3 million from one participant.

In 2012 DFIs and DBs provided USD 15.1 billion in loan instruments to support green and climate finance, 83% of which went to mitigation interventions. Grants represented a minor proportion, making up 10% of the total.



**Table 2:** Breakdown by instrument type in 2012 (USD million, %).

Green and climate finance by instrument	Mitigation (USD million)	Adaptation (USD million)	Other environment <sup>^</sup> (USD million)	% on Total
Grants	485	656	620	10%
Loans	10,560	2,369	2,192	83%
- of which at concessional terms	7,152	2,200	1,691	
- of which at market rate	3,408	169	501	
Equity	522 <sup>*</sup>	-	91	3%
- of which direct equity into companies	3	-		
- of which direct equity into projects	176	-	78	
- of which equity into Funds	177	-	13	
Guarantees	27		5	0.2%
Others	21	69	567	4%
<b>TOTAL</b>	<b>11,614</b>	<b>3,094</b>	<b>3,475</b>	<b>100%</b>

Notes: The category "others" includes e.g., mandates, political risk insurance coverage, mezzanine financing, etc.

(\*) The detailed breakdown between the various categories of equity financing does not add up to the total because some participants did not provide information at such a level of detail.

(^) As not available, the breakdown by instruments of financing directed to the other environment category for 2 participants has been estimated based on the allocation of mitigation & adaptation finance.

In 2012 DFIs and DBs directed the majority of green and climate finance flows directly to the public sector (69%). 19% went directly to private businesses, covering businesses and project special purpose companies. They distributed the remainder indirectly to other Development Banks, private equity /venture capital / infrastructure funds, and local financial institutions.

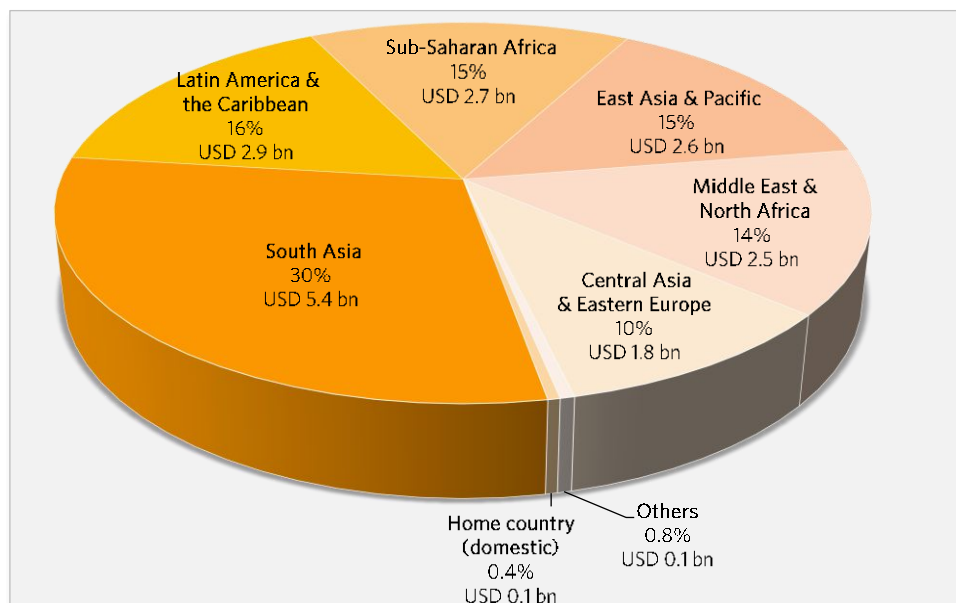
**Table 3.** Green and climate finance breakdown by recipient typology in 2012 (USD billion, %)

Recipient typology	USD billion	%
<b>Direct</b>		
Public sector	12.5	69%
Private sector	3.5	19%
<b>Indirect</b>	<b>2.2</b>	<b>12%</b>
<b>TOTAL</b>	<b>18.2</b>	<b>100%</b>

Regarding the geographical distribution of DFIs' and DBs' green and climate finance in 2012, South Asian countries were the largest recipient, about 30% of the total (USD 5.4 billion).



Figure 5: Geographical distribution of green and climate finance, 2012 (USD billion, %)



Note: The category "others" includes Western, Northern and Southern Europe and Trans-regional.

Even while capturing only a subset of DFIs and DBs, the survey results highlight that **DFIs and DBs play a significant role in financing countries' green economic development today**. Given that Multilateral Development Banks' contributed USD 21.2 billion toward climate finance in 2011<sup>5</sup>, the surveyed groups' USD 18.2 billion contribution to green and climate finance in 2012 is a noteworthy amount.

In addition, **10 of surveyed DFIs and DBs indicated they have a strategy or quantitative target for financing green economic sectors**. Quantitative targets to finance green economic sectors range from a 30% to 50% share of all new commitments. Of the DFIs and DBs that have a strategy in place but did not provide a quantitative target, they highlighted that financing green economic sectors was a key priority.

## 2. DFIs and DBs and fossil fuel projects: the state of play

- 9 DFIs and DBs have either a strategy to limit, or selection criteria to guide investments in financing fossil fuel extraction, processing and use.
- 12 surveyed respondents reported total new commitments to fossil fuel projects over the last 5 years, ranging between less than 1% and 10%.

DFIs and DBs continue to provide financing to fossil fuel projects (e.g., coal, oil and natural gas).

- In the survey, 12 DFIs and DBs reported the percentage of their total new commitments to fossil fuel projects over the last 5 years—which ranged between less than 1% and 10% (with the majority being in the low range) of their total annual new commitments.
- 4 DFIs and DBs indicated they had an explicit reduction target for financing fossil fuel projects, which was implemented through selection strategies including the assessment of

<sup>5</sup> For further information see CPI's Landscape of Climate Finance 2012 report, available at <http://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2012/>



impacts associated with projects in terms of greenhouse gas emissions, institution-internal prioritization or the institutions own commitment to specific GHG reduction targets.

- **9 out of the DFIs and DBs have a strategy or criteria to guide and limit financing to fossil fuel extraction, processing and use.** Where financing is provided to support these activities, projects must fulfill stringent environmental and social compatibility requirements, and outcomes must significantly improve the overall environmental impact of the power generated.
- Approximately **60% of DFIs and DBs release publically available details** about their strategies or criteria for financing projects involving financing fossil fuel extraction, processing or use.

### 3. The importance of risk, and DFIs and DBs' potential to address it

- Development Finance Institutions and Development Banks are typically well placed to address country risks, operational and project-related risks (e.g., execution), and technology risks.
- Some of the survey institutions aim to avoid risks related to currency, start-up businesses and prototype technologies.

Whether real or perceived, risk is the single most important factor keeping promising climate- or environment-related projects from finding investors. CPI recently categorized the risks most associated with green infrastructure projects, matched them with available risk mitigation instruments, and identified gaps in risk coverage in both developing and developed markets, particularly for policy or regulatory risks and financing risks (including access to capital and investment exit/liquidity risks)<sup>6</sup>. CPI also found that the surveyed institutions are already major providers of risk coverage.

The participating institutions typically take risks such as **country risks, operational and project-related risks** (e.g., execution), and **technology risks**. Some DFIs and DBs aim to limit their exposure to certain risks, related to **currency, start-up businesses, and prototype technologies**.

To maximize their ability to increase the level of risk they can assume, some of the surveyed DFIs and DBs indicated they have developed **specific solutions**. These include using structured instruments that use special vehicles, grant elements to back 'first losses' or technical assistance support, loan guarantees from partner governments, partial loan guarantees by their home governments, and commercial country risk guarantees.

### 4. DFIs and DBs' experiences with scaling up green investments

- **13 DFIs and DBs have participated in activities that specifically included co-financing or syndication deals for projects in green economic sectors, and partnered with a number of public and private organizations.**

The participating institutions primarily apply **financial instruments** such as commercial loans as well as soft/concessional loans, grants, equity capital and guarantees, and use them to invest directly or indirectly through fund-of-funds investment structures (e.g., private equity or infrastructure funds) or local financial institutions (see Table 2 and 3). Beyond these tools, Table 4

<sup>6</sup> All the reports of CPI's Risk Gaps series are available on <http://climatepolicyinitiative.org/publication/risk-gaps/>.



provides an overview of other instruments that surveyed DFIs and DBs indicated they have at their disposal.

**Table 4.** DFIs' and DBs' instruments to catalyze investment in green economic sectors

Type of instrument	Example
Sectoral budget support	Energy Renovation Infrastructure Assistance Program for the promotion of energy efficiency
Structured funds	<ul style="list-style-type: none"> <li>Funds in the form of a public-private partnership, such as the Global Climate Partnership Fund (GCPF) or European Fund for Southeast Europe (EFSE)</li> <li>Investment funds, such as Interact Climate Change Facility (ICCF) and Department for International Development (DFID)'s Impact Fund</li> </ul>
Financing lines	<ul style="list-style-type: none"> <li>Financing Line for Investments Generating CO<sub>2</sub> Emission Credits (FINCARBONO); and</li> <li>Investment Financing Line for the Service Sector (FINSER)</li> </ul>
Public-Private Partnerships	• Base of Pyramid (BOP) business support
Performance based payments	• GET FIT
Risk financing arrangements	<ul style="list-style-type: none"> <li>Political and regulatory risk insurance mechanisms</li> <li>Guarantee funds</li> </ul>
Technical Assistance and Advisory Programs	

Surveyed DFIs and DBs also find ways to pool their resources more effectively and efficiently. Examples include co-financing and syndication:

- 13 of the surveyed group indicated that their institution had participated in activities that specifically included **co-financing or syndication deals for projects in green economic sectors**.
- The majority of respondents indicated that other participants in these deals involved **Multilateral Development Banks, other DFIs and DBs and private financial institutions**.
- Four of the respondents identified previous co-financing or syndication of deals for projects in green economic sectors with **philanthropic organizations**.
- To co-finance green deals, some of the institutions use **dedicated facilities**, such as the EDFI Interact Climate Change Facility (ICCF) and the Renewable Energy Asia Fund (REAF).

## 5. Options to address other green investment constraints - the demand and supply-side of DFI and DB financing

- A shortage of financially viable and bankable projects represents a significant constraint for scaling up the green investment portfolios of the surveyed institutions.
- The bankability of certain technologies, such as prototype or start-up technologies, represents other significant investment barriers.
- A number of conditions could tackle supply side issues and stimulate demand for green financial resources.





DFIs and DBs highlighted important constraints restrict their ability to invest in green economic sectors. The majority are associated with a **shortage of financially viable and bankable projects** in target regions. Among other barriers, DFIs and DBs indicated that a deficit of experienced, high quality project sponsors and equity providers, and unclear or changing investment criteria by sponsors, have impeded the creation of a comprehensive project pipeline.

10 DFIs and DBs surveyed rated the **bankability of certain technologies as a vital concern** during the project review and appraisal process, with implications in form of funding limitations in green economic sectors. They raised specific concerns about the bankability of **prototype or start-up technologies** and **technologies with a high dependence on subsidization**. While the project design, business model and capacity of the implementation partner represent important enabling factors, a number of DFIs and DBs indicated that they **generally prioritize projects that utilize technologies that have been proven in the marketplace**.

A major factor constraining DFIs and DBs potential to scale up green and climate investment is that **recipient countries themselves often fail to prioritize green and climate finance**. This often manifests as poorly aligned or inadequate public policies, issues relating to labor capacity limitations, sector strategy and planning, fiscal capacity and governance structures and may affect the creditworthiness of state or state-owned counterparties.

Finally, DFIs and DBs indicated that issues stemming from **organizational constraints** such as the **geographical location** or the **individual size of the project**, and a **shortage of human and financial dedicated resources** (including internal administrative capacity), pose major challenges. Other challenges related to shortages of finance comprising both limited resources for equity investments and for finance at concessional terms. Limitations on the use of funding imposed by the national or international programs may further worsen the situation.

The survey sought to gauge what conditions or strategies, if adopted, might assist DFIs and DBs to scale up their provision of green and climate finance, even beyond existing targets. Respondents highlighted the following preconditions:

- an **attractive and solid policy environment** (e.g., the existence of policy regimes that drive demand for green projects, such as feed-in-tariffs);
- **business environments backed by a strong rule of law, sufficient investor protections, and predictable, transparent regulatory processes;**
- **access for DFIs and DBs to soft financial resources or concessional terms finance with a below-market rate of interest** (coming from national and international funds or foundations) **to allow them to blend those resources with own resources** in order to provide a wide range of instruments and incentives adequate for green investments;
- a **strong pipeline of projects** that meet DFIs and DBs' eligibility criteria and provide tangible developmental benefits to the host countries;
- **sufficient operating budget** and good partner countries' capacities, including financial and human resources;
- **enhanced coordination among DFIs and DBs** in preparing harmonized procedures and methodologies for co-financing;
- **good stakeholders' support**, in line with country priorities.

There are a **variety of ways to stimulate demand for green investments in partner countries**. The surveyed DFIs and DBs made numerous suggestions which are summarized in Table 5 below.



Table 5: Suggestions to stimulate demand for green finance from developing countries partners.

DFIs and DBs' suggestions	No. of responses*
Improving local institutional and regulatory frameworks and relevant national policy	7
Increasing concessional financing and incentives to boost participation in green growth activities	5
Discontinuing subsidies / concessional financing for fossil fuels	3
Establishing agreed, simple and clear methodologies, procedures, and investment criteria, as well as monitoring and evaluation and reporting frameworks	3
Supporting transparent public tender processes	2
Encouraging appropriate risk-sharing between the public and the private sectors	1
Facilitating grid access and/or transmission lines	1
Promoting and marketing DFIs' and DBs' capabilities	1
Developing local financial sectors	1

Note: (\*) Some respondents provided more than one suggestion.

## 6. Enhancing transparency: the first step toward strengthening DFIs' and DBs' role in green and climate finance

- 12 of the surveyed DFIs and DBs publicly disclose information on financing for green economic sectors
- 11 agree that an annual public reporting schedule for this information is potentially acceptable.

A system to measure, report and verify (MRV) the relevant financial flows across activities, recipients, and instruments, down to final uses, increases transparency about DFIs and DBs' collective financial commitment to the green economy.

- 12 of surveyed DFIs and DBs indicated they publicly disclose information on financing for green economic sectors. Information is primarily published online within Annual Reports, or in the form of ad hoc reporting, press releases and evaluation documentation. The disclosed data includes information on total financial commitments and project approvals, sectoral distribution, instrument types, recipient typology and the geographical distribution of projects. **Robust estimates of traditional "brown", or business-as-usual, finance<sup>7</sup> are currently not available from most participating institutions but would be a useful benchmark to assess progress towards a low-carbon, climate-resilient future to put green and climate finance figures into perspective.**
- 5 of the surveyed DFIs and DBs stated to have a methodology in place to account for green and climate finance, mainly based on the OECD Development Assistance Committee Rio Markers<sup>8</sup> and coupled with internal classification systems assessing, for instance, the environment and climate impacts of the financing allocated to projects.
- **Consistent information is currently not available from the surveyed DFIs and DBs to quantify the respective role of intermediaries in channeling funding to private entities.** Data on leveraged third party private investment is uncertain and methodologies to estimate the leverage effect are still in their infancy.

<sup>7</sup> "Brown" investments relate to investments in traditional fossil fuel projects, and continuing these investments would imply extending the business-as-usual, or the normal course of institutions' activities, into the future without major shifts.

<sup>8</sup> The OECD Development Assistance Directorate (DAC) monitors aid targeting the objectives of the Rio Conventions through its "Creditor Reporting System" using the so called "Rio markers". Since 1998, the OECD has monitored climate change mitigation-specific aid using this policy marker system. In 2009 the DAC approved and introduced a new marker to track contributions aimed at adaptation interventions, which have been applied from 2010 onwards.