

## IV. IFC'S APPROACH TO CLIMATE CHANGE

### INTRODUCTION

4.1 IFC has reviewed its approach to climate change as a part of a broader World Bank Group process that is underway<sup>1</sup>. The review has been prompted by growing demand from clients and countries and growing climate change related market opportunities. At the same time, the growing recognition of the inevitability of climate change<sup>2</sup>, the contribution of human activities to it, and the risks that climate change poses for development, have highlighted the need for action to address the issues. Following the recent Bali discussions, there is the prospect of a new international consensus in this respect in the next 18 months or so.

4.2 IFC proposes a balanced and demand-driven approach aligned with its mandate of supporting economic development while helping mitigate the risks of climate change and adapt to its impacts. While climate change presents a considerable challenge for developing countries, it also provides IFC with the opportunity to expand its activities and development impact while supporting private sector led responses to climate change in developing countries. As a part of this, IFC will increase its investment support and aim for a catalytic role in helping facilitate the transfer of appropriate new technologies and approaches to the private sector in developing countries. IFC's approach in this respect will be developed in the context of the wider World Bank Group approach and will build on and support World Bank efforts to address broader policy and regulatory issues. In addition, IFC will partner with the World Bank, MIGA and other institutions to enhance effectiveness where possible.

4.3 This note reviews IFC's climate change related activities to date and summarizes IFC's proposed approach going forward, both in the near term, and in areas for further review. Continuing work could form the basis of refinements to our approach, which would be discussed with the Board in the future. We will continue to work closely with the rest of the World Bank Group (WBG) in the development of a WBG Climate Change Strategy.

### REVIEW OF IFC CLIMATE CHANGE RELATED ACTIVITIES TO DATE

4.4 To date, IFC's approach to climate change has been mainly focused in three areas in which it has had a number of achievements and accumulated useful experience to inform it going forward:

4.5 *Investment support* for investment in renewable energy (RE) and energy efficiency (EE) that reduce greenhouse gas emissions (GHGs). For example:

- During the three years of FY05-07, IFC investment supported projects which included \$4.6 billion worth of EE and RE equipment and services. IFC's investment support for these EE/RE project components totaled \$1.1 billion for its own account.
- As part of its activities in this respect, IFC has been active in working with local financial institutions to increase their awareness of the opportunities and their capacity to provide such financing to their clients.

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<sup>1</sup> An overall WBG strategy framework for climate change is being developed for consideration by the Board at end CY2008.

<sup>2</sup> E.g. as described in the Fourth Assessment Report of the Intergovernmental Panel on Climate Change.

**Box IV-1: EE/RE Highlights**

- In FY07, IFC leveraged over \$2 billion in sustainable energy investment in 27 projects.
- Over the last three years, IFC investment activity includes 45 MW in wind projects, 12 run-of-river hydro projects, over 600 MW of biomass-fired power generation, and privatization financing for the largest geothermal company in Asia.
- IFC/GEF programs supporting local financial institutions are now operational in 8 countries with commitments of more than \$400 million in IFC funds.
- IFC, combining donor resources and its own capital, is the largest financier of off-grid solar in the developing world.
- IFC/GEF has now also implemented the largest grid-connected photovoltaic installation in the developing world, a 1MW facility in the Philippines.

4.6 *Initiatives* to promote greater energy use efficiency/access such as:

- The development of in-house expertise in energy efficiency and cleaner production, to help clients identify opportunities for profitable investments that also reduce energy use.
- Specific initiatives such as “Lighting Africa”, a partnership with the World Bank and the Global Environment Facility (GEF).

**Box IV-2: Lighting Africa Highlights**

- A World Bank Group initiative launched in 2007, aiming to provide up to 250 million people in Sub-Saharan Africa with access to non-fossil fuel-based, low cost, reliable lighting products and services by 2030.
- The sponsor consortium reaches over 1000 participants, representing over 500 organizations from over 40 countries involved in all parts of the supply chain.
- 400 proposals were received for 2008 Development Marketplace in Ghana, and the final 54 chosen. Ten to twenty winners will be selected and receive grants up to \$200,000.
- The web portal has become a vibrant online platform for B2B networking, with more than 21,000 people reviewing over 130 new business opportunities online in the last months.

4.7 *Carbon financing* centered on helping investors in developing countries take advantage of the opportunities presented by the Clean Development Mechanism (CDM). For example:

- IFC has had an active presence in the carbon finance market for more than five years, including its engagement with the management of \$185m of funds provided by the Dutch government.
- IFC has recently developed a carbon delivery guarantee (CDG) to facilitate access to carbon finance markets.

**Box IV-3: CDG Highlights**

- Four CDG deals have been approved by the Board since December 2006.
- In December 2007, IFC committed its first CDG with Rain Calcining Ltd. (India) for Certified Emission Reductions (CERs)<sup>3</sup> from a 49 MW waste heat recovery plant.
- The structure: IFC buys CERs forward from an emerging market client, then sells them forward to buyers through independent back-to-back contracts.
- Given IFC’s reputation and AAA-rating, the CDG provides the seller with improved access to the carbon markets, a higher net CER price, and timely payment; and the buyer with certainty of CER delivery and mitigation of project, credit and country risk (and lower costs for compliance buyers).

4.8 In all these activities, donor countries and other parts of the WBG, including GEF, proved to be vital partners.

**LOOKING FORWARD – PROPOSALS FOR THE NEAR TERM**

4.9 Looking forward, in order to respond to the demands it now faces from clients and markets, IFC proposes to substantially strengthen its approach to climate change to help the private sector

<sup>3</sup> CERs are carbon credits generated by projects in developing countries that qualify under the Kyoto Protocol’s CDM.

address the challenges that climate change poses for them, and to realize new investment opportunities that are likely to become available. Key areas of focus for the near term are:

**4.9.1. Enhanced support for RE/EE investment and other mitigation opportunities.**

- Increased concern about climate change has coincided with high oil and other energy prices, continuing technology refinements which are bringing down the costs of alternative energies, and concerns about energy security. These factors have all added up to increase the economic incentive to use renewable energies and to increase energy efficiency.
- IFC proposes to substantially increase its support of RE/EE investment through developing its own capacity and skills and having its sector and regional investment departments strategically pursue RE/EE investment opportunities embedded in their core investment operations, directly and through financial intermediaries. Over the period FY09-11, IFC aims to double to triple (depending on resource allocation and strong advisory services support) its total RE/EE investments from the \$1.1 billion invested in RE/EE in FY05-07.
- IFC would also pursue mitigation opportunities across a broader range of industrial and economic sectors, including, for example, the supply of cleaner fuels, gas flaring reduction in partnership with the World Bank's Gas Flaring Reduction Partnership, and through sustainable forestry (e.g. in the Amazon) and agriculture that can have positive climate change impacts.
- Through its investment in innovation and partnership with donors, direct investments and investments in targeted funds, IFC will aim to facilitate the transfer and adoption of appropriate new technologies by the private sector in developing countries. In addition, donor facilities (see next paragraph) will at times be able to play a catalytic role through their support for demonstration plants and pilots.

**4.9.2. Partnerships to address climate change mitigation and adaptation.**

- Industrialized economies are keen to accelerate the spread of more climate friendly technology and processes, both for mitigation and adaptation, to developing countries, and some are now preparing to make substantial funds available to help facilitate this. The World Bank Group can be an effective partner in such initiatives in helping ensure that these resources are employed as effectively as possible to benefit developing countries and also help address climate change concerns. A priority for IFC in this respect is to work with the World Bank to ensure that such initiatives create effective mechanisms to help leverage responses from the private sector.

**4.9.3. Extending IFC's carbon financing activities.**

- Carbon financing remains a potentially powerful tool for allowing developing countries to access financing to buy down the higher cost of less GHG intensive investments, giving these countries access to better technology. Depending on the state of the carbon finance markets and the specifics of investment proposals, investors and countries may also benefit financially.
- The carbon market has been growing rapidly, and is potentially on the verge of a new growth phase, especially for the period beyond 2012. Along with its new carbon delivery guarantee that is now meeting a market gap for investors in developing countries, IFC, in cooperation with the rest of the WBG, is developing a range of approaches that can address market gaps and meet investors' needs.

## AREAS FOR FURTHER REVIEW

4.10 In a number of areas, IFC proposes further work to both position itself to respond more effectively in the future to the challenge of climate change, and to contribute to thought leadership on key issues relevant to the private sector in developing countries.

### 4.10.1. IFC's role in adaptation to climate change.

- The risk of climate change poses two challenges for IFC: (i) to understand the vulnerability of its own portfolio from a risk management perspective; and (ii) to help the private sector in developing countries adapt to these impacts. At this stage, an understanding of the impact of climate change on businesses and of the approaches needed to address this is still evolving.
- To enhance its understanding and help contribute to broader knowledge in the development community, IFC has embarked on an initial review by working with three clients (in China, South Asia and Sub Saharan Africa) to examine in-depth the possible impacts of climate change on their operations and to explore strategies to cope with these. The outcome of this initial review will inform further work by IFC in the area.
- IFC will continue working with the World Bank and other partners on broader issues of adaptation to climate change and to explore risk mitigation instruments for adaptation, e.g. structured finance products in the insurance sector. IFC is also looking at issues in the water sector, which has a strong linkage to adaptation.

### 4.10.2. Measuring GHGs in IFC's portfolio.

- IFC already reports on its own GHG emissions. To better understand its portfolio from a climate change perspective and to help provide insights into the issue of managing GHGs in its investments (see below), IFC proposes to measure the GHGs emissions of its investment portfolio in a phased manner and to learn from doing. It will follow the widely-used carbon accounting methodology for private business which is the GHG protocol established by the World Business Council for Sustainable Development and the World Resources Institute. IFC will, in addition, liaise with the World Bank team working on emissions monitoring and refine and adapt its approach to reflect developments and lessons learnt from that work as appropriate.
- Initially, IFC will confine its measurement to "Scope 1" emissions (GHGs emitted by the enterprise through the burning of fossil fuels, or through chemical processes) and "Scope 2" emissions (those attributed to purchased electricity, heat or steam). "Scope 3" emissions (indirect emissions from a company's upstream and downstream activities) will not be measured at this stage at the level of IFC's client companies.
- IFC proposes to measure the emissions of new real sector investments from the start of FY09. Once measured, these investments will be tracked each year. Given the turnover of its portfolio, this method will enable full coverage after around five years. A retrospective review of its existing portfolio is not intended on the grounds of practicality and cost. Measurement of corporate lending activities and financial sector investments poses particular difficulties and we propose to learn from our real sector measurement experience to devise appropriate methodologies for doing this. We expect to systematize the measurement of these activities starting in FY10.

#### 4.10.3. **Managing GHGs - Pilot use of shadow costs.**

- Governments and investors in developing countries will continue to ask IFC to finance GHG intensive investments such as fossil fuel extraction, fossil fuel power and industrial sector investments such as cement and iron and steel.
- Pending new international agreements about how to address climate change issues after 2012, IFC will not constrain its support for projects based on GHG emissions and will continue to support projects that will generate economic benefits from a country perspective. IFC's continued engagement in high impact sectors remains the most effective way to influence best practices and in particular to help investors move to higher levels of energy use efficiency/less GHG intensive processes.
- To better understand the implications of possible new approaches, however, IFC intends to pilot on an information basis the use of shadow costs in its real sector project economic appraisals to reflect the economic costs of carbon emissions. IFC believes that, should it move to manage GHG emissions in its investments, then the use of shadow costs is the most efficient way to do this – as opposed to alternatives such as, for example, quantitative targets for emission reduction or prescriptive sector efficiency standards that do not reflect local realities or economics.
- There remains uncertainty about some aspects of the use of shadow costs for project evaluation including what is the most appropriate range of values of shadow costs to use. By embarking on a pilot now, however, IFC can help develop knowledge and experience of how such an approach could work in practice, and better understand the sensitivity of outcomes to assumptions and approaches used. The outcome of the pilot will also help inform future internal policy discussions, including helping to identify the extent to which any new policy by IFC to manage its portfolio GHGs should be nuanced to account for development priorities including the interests of the poorest countries. The application of shadow GHG costs (even in a pilot) may also help identify opportunities for “win-win” investments in less GHG intensive alternatives (that may be supported by carbon finance or donor financing).