IFC's Approach to Greening Equity Investments in Financial Institutions

IFC Financial Institutions Group
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Summary

IFC is dedicated to helping banks finance climate-related investments and address future climate risks. IFC's approach to greening its equity and equity-like investments in financial institutions was first announced at the World Bank Group - IMF Annual Meetings in 2018. This approach will help client financial institutions increase their climate-related lending while reducing their exposure to coal to zero or near zero by 2030.

IFC already excludes coal-related investments from its loans and risk-sharing facilities with financial institutions by ringfencing any investments for uses that exclude coal. However, for equity and equity-like investments - such as certain forms of subordinated debt - ringfencing is not an option because IFC is exposed to the entirety of a bank's lending business. The green equity approach was developed to close this gap.

Based on a careful assessment of our client's business needs; client countries' national development plans and Nationally Determined Contributions (NDCs); existing World Bank Group and IFC policies related to energy and coal; and the risks and opportunities presented by climate change for financial institutions, IFC believes that the green equity approach is an ambitious and balanced framework to limit risks for our clients, while helping them grow their business and contribute to the world's development goals.

IFC's overall approach to coal exposure through financial institutions

IFC developed the green equity approach to help our clients continue to do business in a changing climate. This more formalized approach and its application to equity, sub-debt, and convertible loans is consistent with the Paris Agreement and in line with the World Bank Group's Energy Sector Directions Paper. The approach does not prevent IFC equity investees from having portfolio exposure to coal, which remains an important part of the energy mix for many of our member countries. The approach will allow IFC to continue engaging with banks that finance coal, but with a transparent framework and declining limits in line with the Paris Agreement and various climate scenarios. At the end of fiscal year 2020, 85 percent of IFC's business with financial institutions was in debt financing (e.g., loans and guarantees), which is ring-fenced. This means that IFC's loans to client financial institutions are targeted to key strategic sectors such as micro, small, and medium enterprises (MSMEs), women-owned businesses, housing finance, and climate-related projects, ensuring that use of proceeds excludes coal. The remaining 15 percent of our financial institution business is in equity. However, only some of those investments could potentially have coal exposure. The rest of the equity investments is in low-risk sectors that do not have exposure to coal-related projects.

Figure 1: IFC's financial institutions portfolio as of June 30, 2020

85%
DEBT

All new loans to Financial Institutions are ringfenced to ensure that IFC financing only supports key targeted sectors such as micro, small and medium enterprises, women-owned businesses, housing finance and climate-related projects. Thus, coal financing is excluded.

15%
EQUITY

Equity investments that might have possible coal exposures:
- Commercial banks
- Insurance companies
- DARP

Equity investments that do NOT have coal exposures:
- Housing finance institutions
- Microfinance institutions
- Small business lenders
- Digital finance

Source: IFC. 2020

IFC's green equity approach

Under IFC's Approach to Greening Equity Investments in Financial Institutions, IFC will work with clients where we have equity or equity-like exposures to increase their climate lending and reduce their exposure to coal-related projects.[1] The first phase of the approach was launched in the fourth quarter of fiscal year 2019 and included all equity and sub-debt investments in commercial banks, non-bank financial institutions with coal exposures, and the Distressed Assets Recovery Program (single asset DARP). The second phase of the approach was launched in fiscal year 2020 to include insurance companies.

IFC no longer makes equity investments in financial institutions that do not have a plan to phase out investments in coal-related activities. However, IFC will continue to provide loans to these financial institutions with defined use of proceeds that can only be used for financing of the key development sectors such as micro, small and medium enterprises (MSMEs), women-owned enterprises, climate-related projects, and housing finance. Equity investees may have portfolio exposure to coal projects until 2030 in line with the respective limits set by this approach.

[1] See Annex A: Defining coal-related projects

Where IFC provides sub-debt in a financial institution, it will seek a formal commitment from clients to make all efforts to direct funding toward targeted sectors and avoid high risk investments. In cases where sub-debt cannot be ringfenced, it will be treated like equity in line with the new approach. In the case of a convertible loan at the time of the conversion, equity requirements will apply. *Table 1* summarizes the specific criteria and targets for existing and new equity investments that will be applicable under the new approach.

To equip client financial institutions with the tools needed to help them better identify coal exposures in their portfolios, IFC has partnered with an NGO[2] to jointly develop and maintain a Global Coal Exit List (GCEL).[3] Clients will have the opportunity to screen their exposures against the GCEL to identify coal-related projects.

To monitor the performance of its equity clients in reducing exposure to coal-related projects, IFC will require financial institution clients to publicly disclose on an annual basis on their website or in their annual report their aggregated exposures to coal-related projects. IFC's disclosure portal will link to these client disclosures.

IFC began applying the green equity approach to all new equity and equity-like investments starting in the fourth quarter of fiscal year 2019. As of July 1, 2020, two projects are applying the approach.

Table 1: IFC's coal and climate criteria for existing and new equity investments

Criteria	Existing equity clients (no new business)	Existing equity clients (with new business)	New equity clients
Maximum threshold of coal exposure at investment	No maximum threshold requirement	No maximum threshold requirement	<15% exposure to coal-related activities
Coal exposure by 2025	Reduced to or kept at 5% of total loan portfolio	Reduced by 50% or no more than 5% of total loan portfolio (whatever is stricter)	Reduced by 50% or no more than 5% of total loan portfolio (whatever is stricter)
Coal exposure by 2030	Zero or near zero	Zero or near zero	Zero or near zero
Climate target by 2030	30% or country-specific target	30% or country-specific target	30% or country-specific target

Source: IFC. 2019

2 For more information, see Urgewald (https://urgewald.org/english)

3 For more information, see: GCEL at www.coalexit.org/database

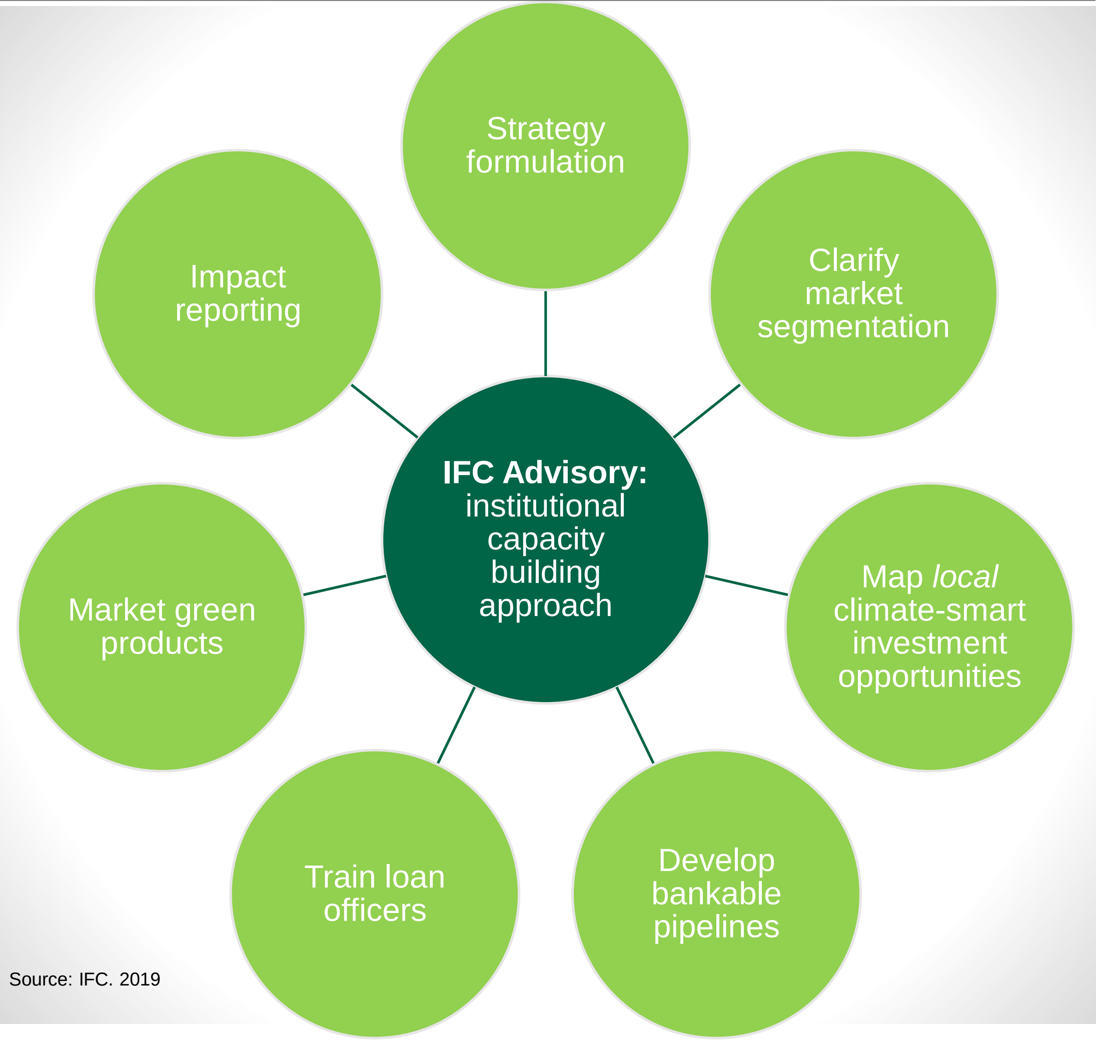
IFC Advisory services

In addition to the green equity approach, IFC offers advisory services that help financial institutions become green.

As of 2020, IFC's Financial Institutions Group has worked with more than 75 banks and non-bank financial institutions around the world to promote energy efficiency and renewable energy financing, green building finance, climate-smart agriculture, climate-smart trade, and green bond issuances. **IFC's advisory clients in the financial sector have provided approximately $26.2 billion of financing for climate-eligible projects in emerging markets, contributing to accumulative GHG reduction of over 84 million tons per year.**

Furthermore, IFC supports market-level interventions such as working alongside regulators and industry associations to develop green finance and green bond policies in various countries or facilitating industry partnerships to connect financial institutions with other market players, technology suppliers, and academic and training institutions.

Figure 1: IFC Advisory services



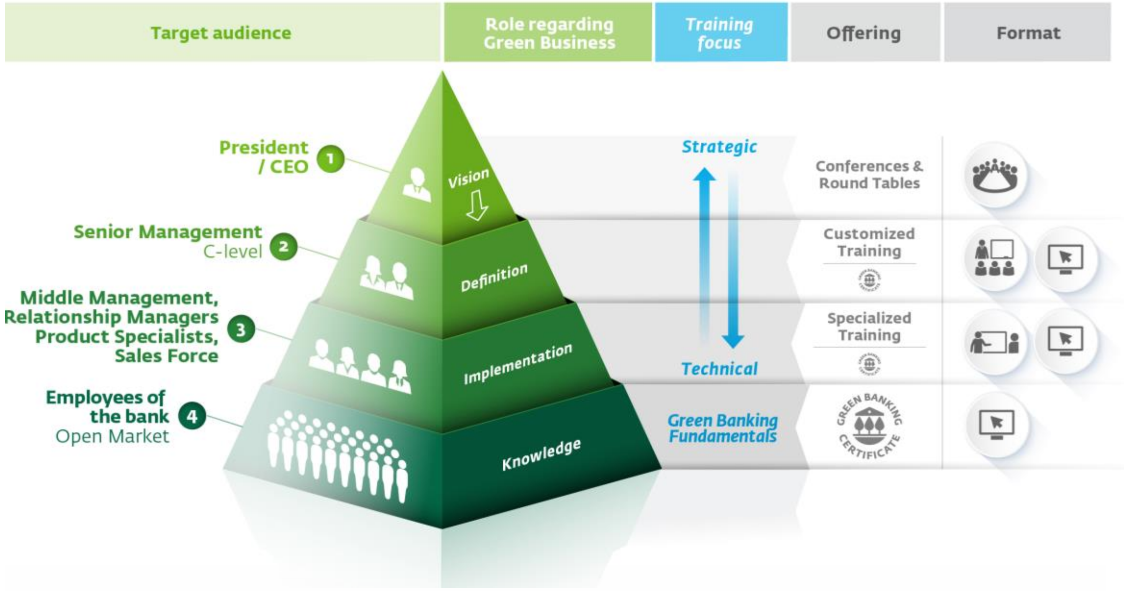
Source: IFC. 2019

IFC Green Banking Academy (IFC-GBAC)

IFC's Green Banking Academy (IFC-GBAC) supports green transformation of the banking sector in Latin America and the Caribbean's in adopting greener business models to mitigate the negative effects of climate change and promote green business opportunities. The platform provides educational programs to train banks in the economic and financial aspects of renewable energy and energy efficiency projects.

IFC partnered with the Renewables Academy AG (RENAC), a leading international provider of training and capacity building in renewable energy and energy efficiency based in Berlin, Germany to integrate its "Green Banking - Capacity Building for Green Energy and Climate Finance Program" into IFC-GBAC's knowledge offering. With this partnership, RENAC and IFC are taking further steps toward increasing the availability and use of financing instruments for renewable energy and energy efficiency projects. Together, RENAC and IFC are encouraging regional financial institutions to finance such projects and increase their national contribution to reducing the negative effects of climate change.

Figure 2: The value proposition of the IFC Green Banking Academy to financial institution equity clients



Source: IFC. 2018

30 by 30 zero: 30 percent share of climate loans in bank portfolios by 2030 and zero climate risks

IFC's 30 by 30 zero Program helps the banking sector increase climate-related lending to 30 percent with zero or near zero coal exposure by 2030. To reach this goal, IFC harnesses the financial sector to scale up private sector financing for climate mitigation and adaptation projects in line with NDC targets, working with regional and local financial institutions to strengthen their role as aggregators of climate financing for domestic economies by growing the climate share in their lending portfolios.

The partnership helps regulators and policy makers strengthen their management and oversight of climate risks and opportunities. The 30 by 30 zero Program is a collaboration between IFC, the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, the World Bank (WB), and the Renewables Academy AG (RENAC). This multi-stakeholder partnership will follow a holistic three-pronged approach, intervening at policy, market, and financial institution levels, as illustrated in *Figure 3*.

Figure 3: IFC's 30 by 30 zero Program

Policy level (WB and IFC)
Development and adaptation of conducive framework conditions for national financial sectors to finance NDCs

Market level (GIZ)
Technical assistance for capital and green bond market stakeholders on climate finance and green bonds

Financial institution level (IFC)
Technical assistance and financing for banks on climate finance and the development of corresponding NDC-related business models, leveraging science-based targets

- *Align financial sector strategies to support NDC implementation.*
- *Increase the climate share to 30% of credits portfolios of participating banks.*
- *Manage and reduce climate and carbon-related risks in participating banks' overall portfolios.*
- *Develop domestic green bond markets to foster cross-border investments.*

Source: IFC. 2019.

Annexes

Annex A: Defining coal-related projects

Coal-related projects refer to long-term (more than 36 months) project finance and/or corporate finance for the development of new coal-related projects including coal mining, coal transportation, as well as infrastructure services exclusively dedicated to support any of these activities, and coal-fired power plants. It excludes captive coal-fired power plants used for industrial applications such as mining, smelters, cement or chemical industries, etc.

Annex B: Electric utility companies and other companies with exposure to coal

Long-term corporate finance provided by financial institutions to electric utility companies and other companies that may have exposure to coal mining, coal transportation, coal-related infrastructure and coal-fired power generation shall be counted as follows towards the coal exposure limits:

1. General purpose corporate finance to companies that: a) generate more than 20 percent of energy or revenues from coal*****, or b) have an annual coal production of 10 million tons or more, or c) have an installed coal-fired capacity of 5,000 MW or more, or d) are involved in any coal mining or coal power expansion plans, or are exclusively dedicated to new coal transportation, new coal power transmission or infrastructure will be considered as supporting coal-related projects;

2. Project and/or general purpose corporate finance to such companies regardless of the energy mix, if the financing provided is meant and used for the development of coal-fired power plants, coal mining or exclusively for coal transportation, coal power transmission or coal-related infrastructure, will be considered as supporting coal-related projects; and

3. Project and/or corporate finance to such companies as listed in Point 1 above with a specified use of proceeds that is not coal-related (e.g. for the expansion of electricity generation from renewables, upgrades to the electricity grid to accommodate renewables, investments in storage capacity, expansion of mining for minerals such as copper, iron ore and other non-coal minerals, corporate refinancing that does not involve refinancing of coal-related projects, and manufacturing) will not count towards the coal exposure of the client financial institution.

*****_Including coal power production, thermal coal trading for electricity generation (this excludes trade in coal for the purpose of various chemical/manufacturing processes where coal is an integral component (e.g. industrial fuel, reductant) of such processes), thermal coal logistics, thermal coal engineering and construction services, coal exploration, and underground coal gasification._