



*The climate finance sector framework ensures consistent AIMM assessments of IFC's climate finance investment projects by articulating the development impact thesis, describing core development outcomes, and specifying relevant AIMM indicators.*

# Climate Finance

## Development Impact Thesis

IFC's climate finance projects seek to address the lack of sufficient financing needed for core development outcomes, while helping to reduce emissions and increase resilience to climate hazards.

The central development thesis for these projects is that, by expanding the provision of climate finance (such as retail loans for individuals to acquire solar panels or climate-smart agricultural loans for farmers) to firms and individuals, IFC can support clients and countries in making a just transition to a low-carbon and resilient pathway. The theory of change establishes how IFC's investment projects directly benefit identified stakeholders and the environment, including how they contribute to the development of climate finance markets.

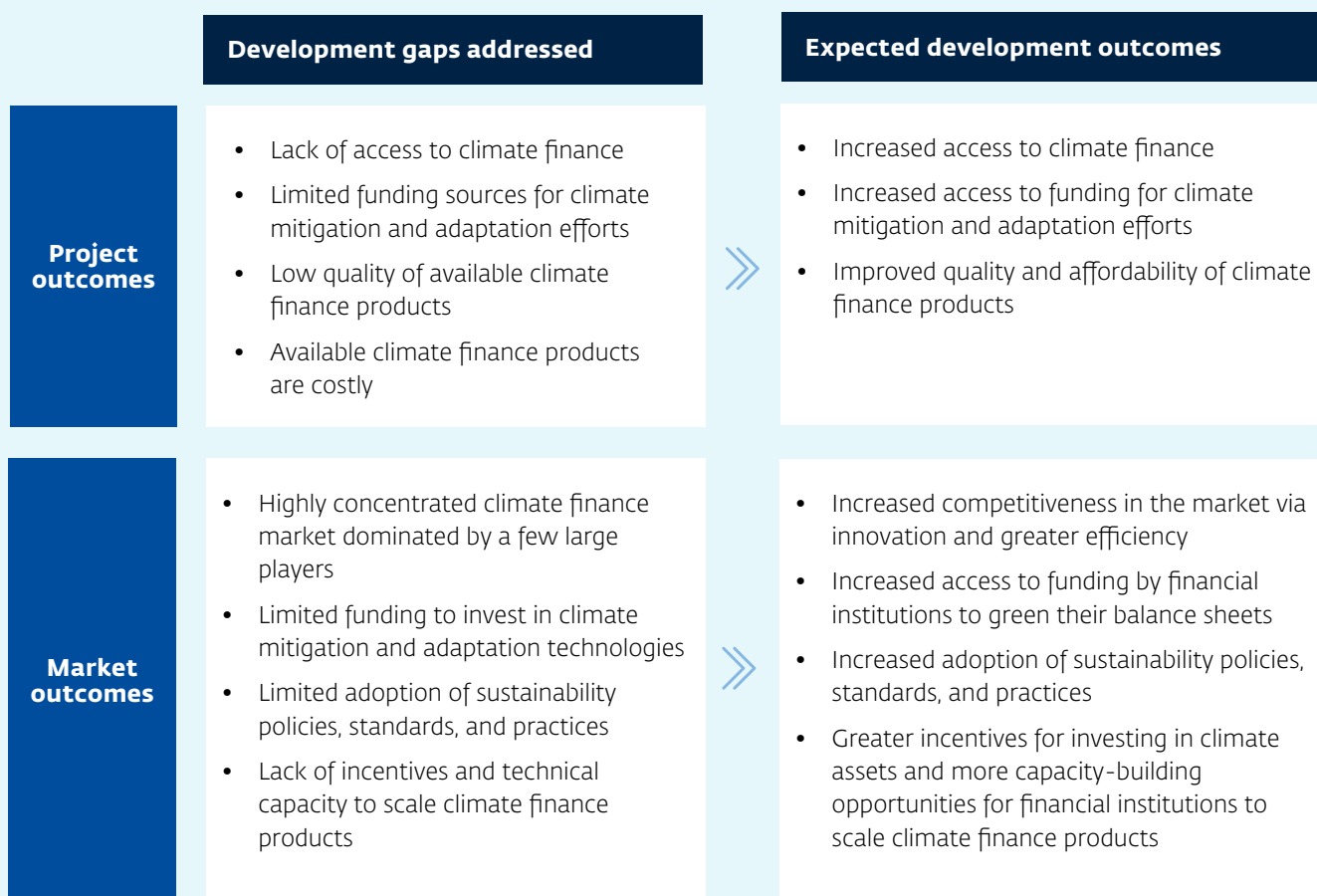
Figure 1 summarizes the types of development challenges that IFC investments in climate finance aim to address, and the types of development outcomes that are expected from successful projects, including both direct project outcomes and their indirect impact on the respective markets. Stakeholders are expected to benefit from increased access to finance and improved quality of access, for example through more

affordable terms for development solutions that support the transition to a low-carbon and resilient pathway. While not directly assessed under the Anticipated Impact Measuring and Monitoring (AIMM) framework, IFC's Advisory Services may complement investment projects by providing technical support to financial institutions, financial authorities,

industry associations, academia, public entities, and so on. Climate finance investment projects also contribute to market outcomes through greater market-wide awareness and increased technical capacity in financing sustainable solutions, stronger regulatory systems, and institutional support that help deepen the climate finance market.<sup>1</sup>

Figure 1

### Development Gaps Addressed and Expected Outcomes



<sup>1</sup> The data for these indicators is obtained from secondary sources of data or market intelligence.

## Core Development Outcomes

The AIMM scoring methodology assesses project and market outcomes. Stakeholders and environmental effects are the key components of project outcomes for climate finance projects. The stakeholder claims may be related to increased access to, and improved quality and affordability of, climate finance. In addition, projects may assert environmental claims related to the reduction of greenhouse gas (GHG) emissions where credible data is available. Most projects in the financial sector focus on stakeholder-related outcomes—primarily increased access to climate finance through lending to financial institutions, which, in turn, on-lend to borrowers targeted by the project. Consequently, financial institutions may not always have detailed and specific information about the assets that they will finance.

The AIMM framework uses three market attributes to assess market outcomes for climate finance projects: competitiveness, resilience, and sustainability. Climate finance projects can assert a competitiveness claim if they have a specific focus on innovation in business models, diversification of financial products and services, entry into new markets, and diversification of funding instruments to catalyze capital mobilization for climate-related investments. Climate finance projects may contribute to the resilience of financial systems as they strengthen the capacity of financial institutions to manage risks stemming from climate hazards.

The most common market impact of climate finance operations is sustainability, which typically arises from projects designed to establish climate finance ecosystems and deepen the climate finance market. Such projects often work on the implementation of technical capacity in the financial sector, ensuring that financial institutions can channel more capital to these uses and that the increased flows are measured and monitored using good international practices and principles.

## Key Inputs and Building Blocks of AIMM Assessments

### Project Outcomes

When assessing potential project outcomes, AIMM begins by analyzing the development challenge that a project seeks to address in the sector or segment of interest—the development gap. The sector or segment-specific development gap is benchmarked against all emerging markets and developing economies using specific core development gap indicators and data collected by IFC from various public sources. The benchmarking methodology groups countries based on their gap levels per indicator: Small, Medium, Large, or Very Large. The project is placed in the appropriate band based on the data available for the country.

The next step is the assessment of the extent to which the project is expected to contribute to addressing the gap—the project intensity. The assessment of the project intensity is based on specific standard indicators, shown in Table 1, designed to collectively estimate the extent to which the project is effective in assessing the abovementioned gaps. It is assessed along a four-bucket continuum: Below Average, Average, Above Average, or Significantly Above Average.

The core project outcomes of IFC's climate finance projects may be in the form of stakeholder, economy-wide, and environmental effects.

**Stakeholder effects:** IFC's investment projects can pursue different development objectives to directly affect target stakeholders. As mentioned earlier, the key beneficiaries of climate finance projects include firms and households that financial institutions on-lend to, increasing access to, quality of, climate finance. As shown in Table 1 below, the core development gap indicators used for climate finance projects are (i) a composite indicator based on CO<sub>2</sub> emissions (kilograms per purchasing power parity US\$ of GDP and CO<sub>2</sub> emissions (kilotonnes)) for mitigation

finance, and (ii) the Notre Dame Global Adaptation (GAIN) index for adaptation finance. The core indicators may be supplemented by additional indicators such as supply of climate finance in a country.

**Economy-wide effects:** Climate finance projects typically do not aim to achieve economy-wide effects.

**Environmental effects:** When financial institutions have detailed information on specific climate-related assets

they expect to finance, the project-level outcome may relate to the expected reduction in GHG emissions. The gap and intensity assessments for these cases are based on the relevant real sector frameworks, such as power, transportation, and so on.

The AIMM system combines the development gap and intensity assessment to arrive at the project outcomes rating (Marginal, Moderate, Strong, or Very Strong).

Table 1

### Gap and Intensity Indicators for Core Project Outcomes in Climate Finance Projects

	Gap indicators	Intensity indicators
<b>Stakeholder effects</b>	<p><b>Access</b></p> <ul style="list-style-type: none"> <li>• Composite indicator based on CO<sub>2</sub> emissions (kilograms per purchasing power parity US\$ of GDP and CO<sub>2</sub> emissions (kilotonnes)) [for mitigation finance] Source: World Bank data</li> <li>• The GAIN index [for adaptation finance] Source: University of Notre Dame: <a href="https://gain.nd.edu/our-work/country-index/">https://gain.nd.edu/our-work/country-index/</a></li> </ul> <p><b>Quality</b></p> <ul style="list-style-type: none"> <li>• Current loan terms, such as pricing, value, tenor, etc. [qualitative assessment] Source: Market research</li> </ul>	<p><b>Access</b></p> <ul style="list-style-type: none"> <li>• Change in climate finance loan portfolio per IFC contribution in US\$ millions Source: IFC client</li> <li>• Change in the share of climate finance loan portfolio over total loans Source: IFC client</li> <li>• Climate finance loan portfolio annual growth Source: IFC client</li> </ul> <p><b>Quality</b></p> <ul style="list-style-type: none"> <li>• Better loan terms, such as pricing, value, and tenor, compared to counterfactual [qualitative assessment] Source: IFC client</li> </ul>
<b>Environmental effects</b>	<ul style="list-style-type: none"> <li>• See relevant real sector framework</li> </ul>	<ul style="list-style-type: none"> <li>• See relevant real sector framework</li> </ul>

## Market Outcomes

To measure the project's contribution to market catalytic effects, AIMM assesses the stage of the market's development and the type of market effects expected from the project.

The characterization of the stage of market development is based on elements specific to the sector. Table 2 shows some of the elements of a financial system that are considered to characterize the market's stage of development for the assessment of sustainability.

Table 2

### Characterization of Market Development Stage in the Climate Finance Framework for Sustainability

Highly underdeveloped markets	Underdeveloped markets	Moderately developed markets	Highly developed markets
<p><b>Financial institutions' practices in climate finance</b></p> <ul style="list-style-type: none"> <li>No or only ad-hoc climate finance lending activities in the market.</li> <li>No adoption of climate finance principles and standards outside of development finance institution interventions.</li> </ul>	<p><b>Financial institutions' practices in climate finance</b></p> <ul style="list-style-type: none"> <li>Less than half of the top-tier financial institutions are starting to undertake climate finance on commercial terms.</li> <li>Top-tier financial institutions may be starting to track and report their sustainable finance portfolios on an ad-hoc basis.</li> </ul>	<p><b>Financial institutions' practices in climate finance</b></p> <ul style="list-style-type: none"> <li>More than half of top-tier financial institutions and a growing number of other institutions understand the business case for climate finance</li> <li>More than half of top-tier financial institutions and a growing number of other institutions follow or apply internationally accepted principles and standards, eligibility criteria, and increasing subscription and adherence.</li> </ul>	<p><b>Financial institutions' practices in climate finance</b></p> <ul style="list-style-type: none"> <li>All tiers of financial institutions undertake climate finance on commercial terms and a broad range of climate finance products are available in the market.</li> <li>All financial institutions follow or apply internationally accepted climate finance principles and standards, as well as eligibility criteria for climate finance.</li> </ul>
<p><b>Policy and regulatory environment</b></p> <ul style="list-style-type: none"> <li>No voluntary or non-voluntary standards or regulatory requirements exist for climate finance.</li> </ul>	<p><b>Policy and regulatory environment</b></p> <ul style="list-style-type: none"> <li>Voluntary policies and regulatory frameworks are emerging, yet still limited, untested, uncoordinated, and without incentives.</li> </ul>	<p><b>Policy and regulatory environment</b></p> <ul style="list-style-type: none"> <li>Voluntary industry frameworks and ESG standards partially aligned with international standards exist. More than half of top-tier financial institutions are adopting them.</li> </ul>	<p><b>Policy and regulatory environment</b></p> <ul style="list-style-type: none"> <li>Voluntary industry frameworks for sustainable finance and ESG standards are in place, and in full alignment with international standards.</li> </ul>
<p><b>Broad-based capacity building and ecosystem</b></p> <ul style="list-style-type: none"> <li>No local providers of climate finance and environmental, social, and governance (ESG) related services to financial institutions, nor is there demand for those services.</li> <li>No supporting tools, such as geospatial tools and Climate Assessment for Financial Institutions (CAFI), and data available for the market.</li> </ul>	<p><b>Broad-based capacity building and ecosystem</b></p> <ul style="list-style-type: none"> <li>Industry champions are establishing networks of climate finance and ESG ecosystem to further market uptake of climate finance and ESG.</li> <li>Limited availability of supporting tools and data collected on the climate finance market.</li> </ul>	<p><b>Broad-based capacity building and ecosystem</b></p> <ul style="list-style-type: none"> <li>Sustainable finance and ESG ecosystem are maturing and growing their influence across the market, jointly tackling challenges.</li> <li>Some availability and use of supporting tools and data collected on the sustainable finance market.</li> </ul>	<p><b>Broad-based capacity building and ecosystem</b></p> <ul style="list-style-type: none"> <li>Sustainable finance and ESG ecosystem across industry are well-integrated, and challenges are jointly tackled.</li> <li>Supporting tools and data are available to support the sustainable finance market.</li> </ul>

The assessment of the catalytic effects that a project is expected to generate in this market context is anchored on the degree of innovation and scalability. It is ranked on a four-point scale (Modest, Sustaining, Deepening, or Transformational).

Innovation refers to the implementation of new or significantly improved products, practices, processes, and organizational methods compared to existing norms in the market. Scalability encompasses the visibility of the innovator in the market, and the ability for innovation to be scaled given the market conditions in which the project operates (such as policy environment, demand conditions, competitive dynamics, and the capacity of other market players). The degree of innovation may be assessed as Low, Medium, or High, and that of scalability as either Low or High. The type of market catalytic effect is determined by

the combination of the degrees of innovation and scalability (Table 3).

Depending on the development impact claim, indicators that are often used include:

- Number of firms adopting or competing with the innovation introduced by the project (novel products, business models, practices, or technologies)
- Volume of climate finance in the market
- Share of climate finance as a percentage of total credit in the market.<sup>1</sup>

The AIMM system combines the market stage and the type of catalytic effects to arrive at the market outcomes rating of the project (Marginal, Moderate, Strong, or Very Strong).

Table 3

### Assessment of Market Catalytic Effects

		Degree of innovation		
		Low	Medium	High
Degree of scalability	Low	Modest	Sustaining	Deepening
	High	Sustaining	Deepening	Transforming

<sup>1</sup> The data for these indicators is obtained from secondary sources of data or market intelligence.

## Risk Assessment

AIMM incorporates risk assessments to account for uncertainties that may hinder a project's ability to realize its expected project and market outcomes. Projects facing material risks to achieving expected development outcomes receive a Qualified rating, while those with moderate risks—or where material risks have been adequately mitigated—receive an Unqualified rating. Table 4 presents examples of risk factors for IFC's climate operations.

Table 4

### Examples of Relevant Risk Factors for Climate Finance Projects

Risk factor	Example
<b>Operational factors</b>	<ul style="list-style-type: none"><li>Operational capacity of client.</li><li>Strategic priority for the expansion of climate finance.</li><li>The financial institution's capacity in climate finance development, risk mitigation strategy, and the support of IFC Advisory Services as needed.</li></ul>
<b>Sector factors</b>	<ul style="list-style-type: none"><li>Industry associations' commitment, expertise, and influence.</li><li>Capacity of the real sector for the development of climate mitigation and adaptation projects.</li></ul>
<b>Macroeconomic factors</b>	<ul style="list-style-type: none"><li>Overall economic growth projections.</li><li>Impact of the macroeconomy on the real sector climate-related activities expected to be financed by financial institutions.</li><li>Impact of the macroeconomy on the financial sector and the financial institution's operations and/or appetite for climate finance.</li></ul>
<b>Policy factors</b>	<ul style="list-style-type: none"><li>Enabling environment such as laws and incentives underpinned by government's commitment to the Nationally Determined Contributions.</li><li>Specific regulatory risks.</li><li>Financial authority's capacity.</li></ul>

## Scoring Adjustment

AIMM uses a scoring adjustment mechanism to explicitly recognize climate finance projects that make a material contribution to addressing negative climate and environmental effects through mitigation or adaptation efforts. Projects that meet the eligibility criteria for the climate scoring adjustment (linked to the level of ambition embedded in their expected results) are awarded additional points to their overall AIMM score.