BIC EUROPE

AIIB's Climate Loopholes

DECEMBER 2019

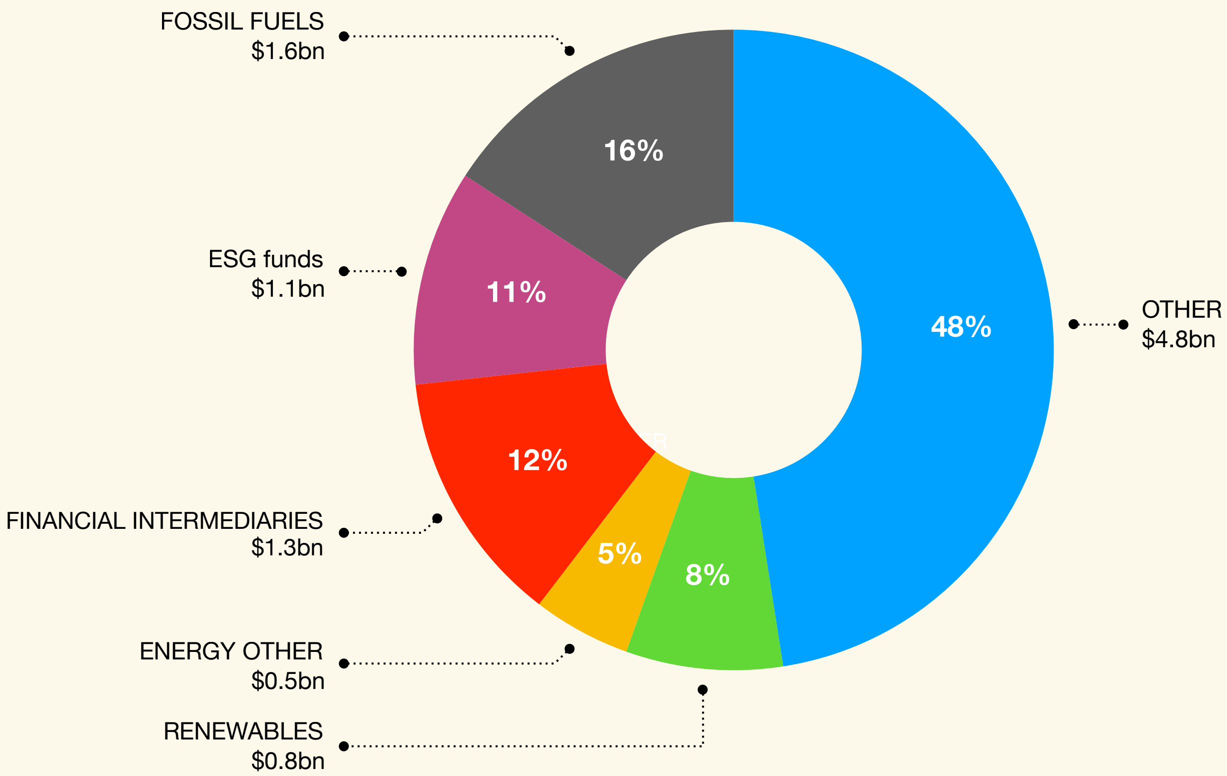
The need to tackle climate change is urgent. According to the Intergovernmental Panel on Climate Change (IPCC), global warming has already reached 1°C above pre-industrial levels, “resulting in profound consequences for ecosystems and people.”

The Asian Infrastructure Investment Bank (AIIB), was launched in 2016, hot on the heels of the Paris Agreement on climate change. From the start it set out to be “lean clean and green”, but its early portfolio was dominated by fossil fuel investments. Since then the AIIB has made some progress. The share of fossil fuels of the AIIB’s overall portfolio has shrunk from a quarter a year ago, to a sixth today. This is promising, but can partly be explained by the fact that the share of energy sector project approvals has gone down from almost half of the AIIB portfolio in 2017 to less than a fifth in 2019. The share of renewable energy has increased but fossil fuels still dominate the energy portfolio. For every $1 the AIIB has invested in renewables, it has almost twice that invested in fossils.

For the AIIB to be truly green, it must stop funding fossil fuels entirely, as its peer, the European Investment Bank, has just announced that it will do. This means closing the loopholes for unsustainable projects, supported through both direct and indirect finance. Funding through financial intermediaries (FI) is a growing part of the AIIB’s overall portfolio - but some FI clients are investing in fossil fuels. Other risky investments that can support fossil fuels include energy transmission and distribution projects.

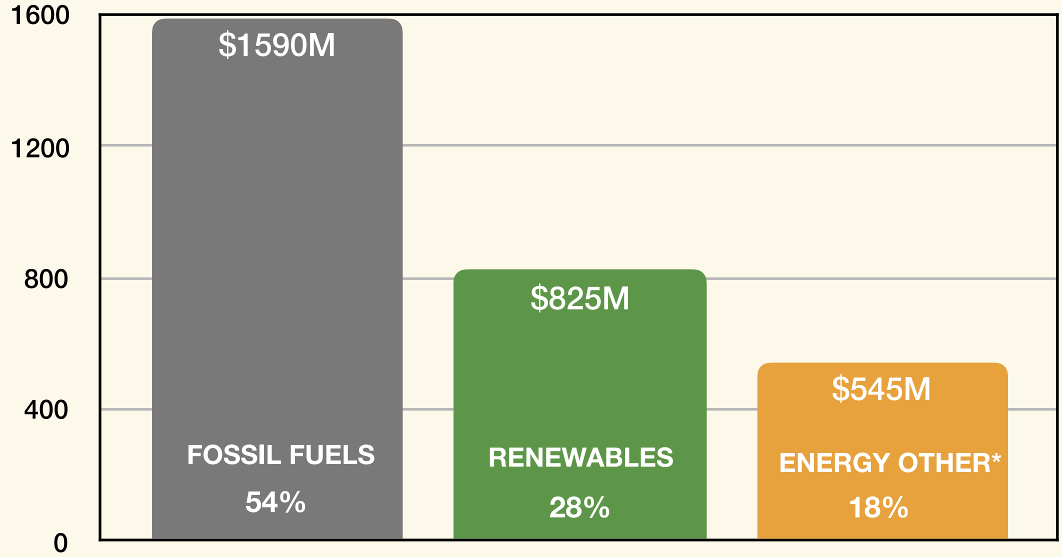
There are other loopholes, too, where climate goals can be undermined by socially and environmentally unsustainable projects. For example, not all renewable energy options are entirely carbon free and can also have negative impacts on local communities.

AIIB TOTAL PORTFOLIO $10 BILLION



** Energy other includes projects, such as transmission and distribution, where the fuel source is not defined*

AIIB ENERGY SECTOR PORTFOLIO $2.9 BILLION



** 'Energy other' includes projects, such as transmission and distribution, where the fuel source is not defined*

Financial Intermediaries

Funding through financial intermediaries (FIs) – such as infrastructure and private equity funds – represents over 12% of the value of the AIIB's portfolio. Unlike direct investments in a company or project, an FI investment essentially 'outsources' funding decisions to a third party, which in turn invests the capital in sub-projects or sub-clients. This poses significant risks as there is little oversight or information about what happens to the funds once they have been disbursed to the FI. To date the AIIB's FI investments have backed fossil fuels, including gas and heavy fuel oil, and even coal.

T&D

Just over half of the AIIB's energy sector projects focus on energy transmission and distribution (T&D), either as the main aim or as part of the overall project. The power sources linked to T&D are not always obvious. A T&D investment that funds electricity transmission from a generation source powered by fossil fuels cannot be considered to be in alignment with the Paris Agreement. Controversial AIIB T&D investments to date include the Trans Anatolian Natural Gas Pipeline (TANAP), a high risk natural gas pipeline from Azerbaijan to Turkey, to supply gas to Europe.

COAL

The AIIB has no explicit ban on coal but it has repeatedly committed not to fund any coal power projects. To date it has kept its word, but does not apply this exclusion to coal used for industrial processes, such as cement production. According to the IPCC, industrial processes account for over a fifth of direct global GHG emissions and this contribution keeps growing, particularly in Asia. The AIIB also does not exclude funding for coal mines, despite associated methane emissions, responsible for around 1,200 million tonnes CO_2 equivalent per year globally. The AIIB's 2017 investment in the IFC Emerging Asia Fund is linked to coal for industrial use and the expansion of a coal mine in Myanmar.

MDB Paris Alignment

Countries around the world signed the Paris Agreement in December 2015, uniting them in common cause to fight climate change and help developing countries adapt to its effects. The agreement aims to keep the global temperature rise to well below 2°C above pre-industrial levels, while pursuing efforts to limit warming to 1.5°C.

In December 2018, nine multilateral development banks (MDBs), including the AIIB, announced their intention to develop a joint framework for aligning with the Paris Agreement. This followed a 2017 commitment to align their financial flows with the objectives of the Paris Agreement, and in September 2019, the MDBs committed to jointly increase climate finance to $175 billion by 2025. To date there is little information on how the AIIB will contribute to these commitments. Unlike its MDB peers, the AIIB does not have a climate change action plan, which spells out how a bank seeks to address the climate challenge systematically through its internal and external processes and operations.

ESG funds

In just a year, the AIIB's investments into Environmental and Social Governance (ESG) funds, i.e. portfolios of equities and/or bonds which are guided by specific ESG criteria, has grown to over a tenth of the value of its overall portfolio. ESG funds are exempt from the AIIB's Environmental and Social Framework, meaning that the investments lack essential checks and balances. The AIIB has instead opted to use the funds' own ESG frameworks or one developed by the AIIB itself, but it is unclear how these ESG frameworks will be assessed. A key concern is whether the urge to leverage private capital will encourage weaker ESG criteria, meaning that ESG funds could potentially invest in unsustainable projects, including those causing harm to the climate. There is also no clear framework of accountability - people affected by ESG investments do not have access to the AIIB's accountability mechanism, the Project-Affected Peoples Mechanism, if they suffer harm.

Renewables

The AIIB has taken steps forward and the share of renewables in its portfolio and pipeline has grown. Yet renewables remain a small part of the AIIB's total investments – representing no more than 8% of the value of the overall portfolio and just over a quarter of the energy portfolio. Most of this goes towards large-scale projects, including hydropower – known to cause significant negative environmental and social impacts - while very little goes to support energy access for poor communities. Renewables also include geothermal energy, a technology that isn't strictly CO_2 free. For example, the AIIB's investment in a geothermal power expansion project in Turkey is expected to release 420,000 tonnes CO_2 equivalent per year.

GAS

All of the AIIB's direct investments in fossil fuels support natural gas projects, including two greenfield power plants in Myanmar and Bangladesh. There are a number of reasons why gas is not viable for the transition to a 1.5°C world. Natural gas emits methane as well as carbon dioxide, both potent greenhouse gases. In recent years the IPCC has revised its estimates of the global warming potential of methane upwards, assessing it is 86 times worse than CO_2 in the short term. The process of creating Liquified Natural Gas (LNG) is particularly energy intensive and is driving growth in emissions. Prioritising gas capacity can also displace investment in new wind and solar projects, which goes against the urgent need to decarbonise the power sector. For example, an AIIB funded greenfield gas power plant in Bangladesh has a power purchasing agreement with the government lasting 22 years – well beyond 2030 targets to reduce emissions under the Paris Agreement.

Opportunities to turn the tide on climate change

In 2020, the AIIB has a chance to start turning the tide on fossil fuels and false solutions to the climate crisis. The AIIB will start its review of the ESF early in 2020. The AIIB released the first iteration of the ESF as it began operations and the review presents an opportunity to expand the policies and address its many flaws – one of which is the weak safeguard on climate change. The AIIB will also develop its first Corporate Strategy in 2020. This represents an opportunity to ensure it addresses the climate challenge in a meaningful and impactful way, both internally and externally. Finally, as the AIIB ramps up its collaboration with other MDBs to align with the Paris Agreement, it is time for the bank to set out a clear pathway for how it will tackle the climate crisis, by developing a climate change action plan.

The time is now for the AIIB to tackle the climate crisis by:

- **Developing an AIIB Climate Change Action Plan, with clear and ambitious targets for how the AIIB will align its policies and operations with goals of the Paris Climate Agreement and efforts to limit the global temperature increase to 1.5°C above pre-industrial levels.**

- **Providing a road map for the AIIB to shift direct and indirect investments from fossil fuels to renewable energy by end of 2020, including ruling out all financing for coal and any investment that would result in increased coal use, and matching the World Bank's commitment to end financing for upstream oil and gas.**

- **Ensure all energy projects funded by the AIIB help lift more people out of energy poverty in a sustainable way, especially by scaling up support for decentralised renewable electricity and clean cooking solutions. This should exclude large hydro dams which can cause extensive social and environmental harms.**

- **Include ambitious and comprehensive climate considerations in the revised Environmental and Social Framework and the new Corporate Strategy, and ensure it covers all types of AIIB investments.**

SELECTED RESOURCES

AIIB and Climate Change by BIC Europe and The Big Shift Global
AIIB and Fossil Fuels by BIC Europe and The Big Shift Global
Dangerous Distractions: Why the AIIB must help Bangladesh turn the tide on fossil fuels by BIC Europe, CLEAN and NGO Forum on ADB
Risky venture: The AIIB's hands off approach to funding infrastructure in India by BIC Europe and Centre for Financial Accountability India
Debunked: The G20 clean gas myth by Oil Change International
Financing development in Myanmar: The case of Shwe Taung Cement by BIC Europe, SOMO and Inclusive Development International
Securitization for Sustainability: Does it help achieve the Sustainable Development Goals by Heinrich Boell Stiftung
Asset Owner Guide to Oil & Gas Producers by WWF

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