Closing loopholes

How the IFC can help stop fossil fuel finance

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Introduction

As the climate crisis escalates, public pressure is mounting for action by investors to stop financing fossil fuels. Recent campaigns targeting commercial banks like HSBC or insurers like AIA are exposing how finance is fuelling the crisis and persuading major actors to announce policy shifts.

The call for 'fossil free finance' is also focusing on public development banks, whose mandates are at odds with climate-wrecking oil, gas and coal expansion. The World Bank Group (WBG) is currently developing its new Climate Change Action Plan for 2021-25, providing a vital opportunity to ensure it aligns its policies and operations with the Paris Climate Agreement.

The World Bank's private sector arm, the International Finance Corporation (IFC), has taken significant steps to decrease its exposure to coal as a result of years of campaigning by affected communities and their NGO allies. For example, IFC's Green Equity Approach (GEA), in operation since 2019, aims to help some financial intermediary equity clients reduce their exposure to coal to zero or near zero by 2030, while excluding clients who have no plan to exit coal (see Table 1).

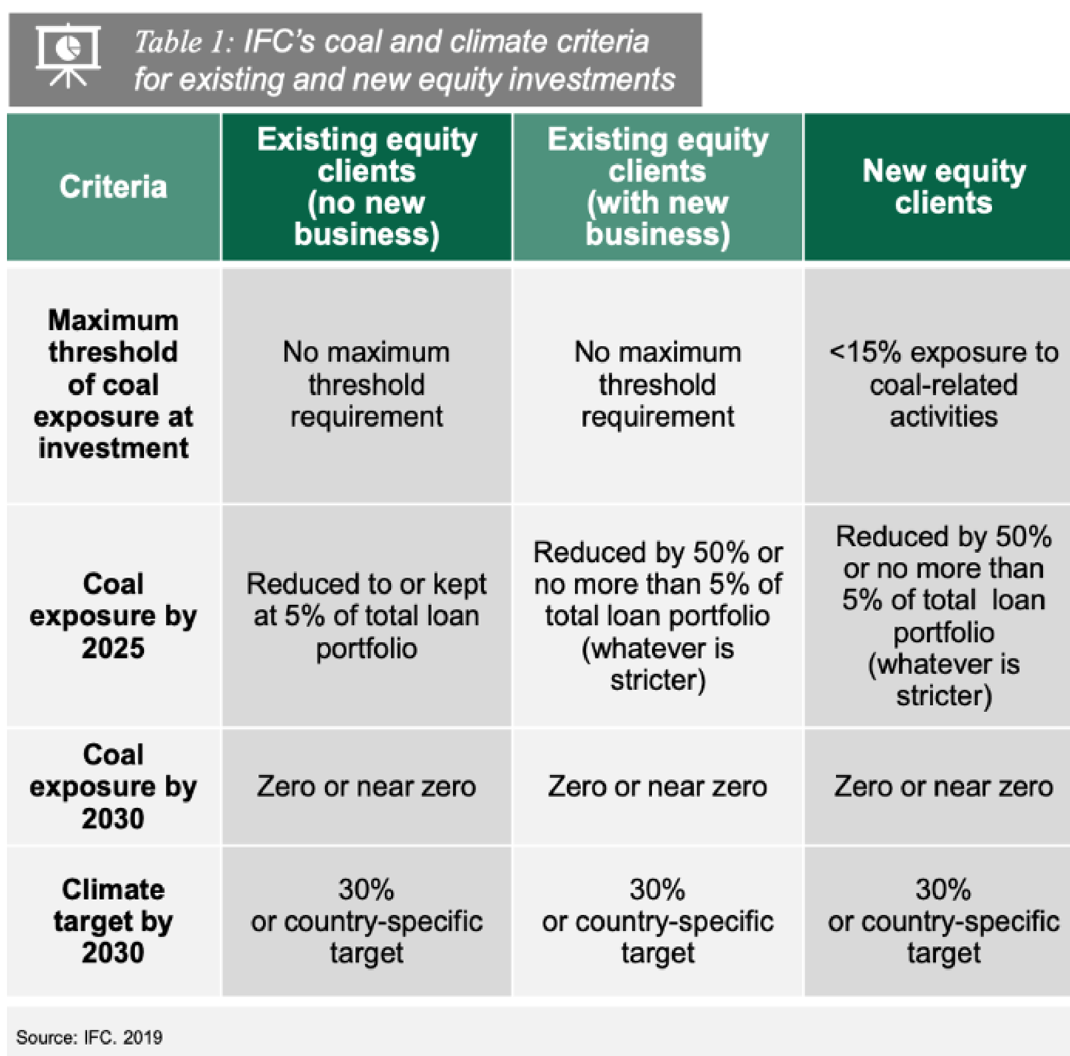


Table 1: IFC's coal and climate criteria for existing and new equity investments

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

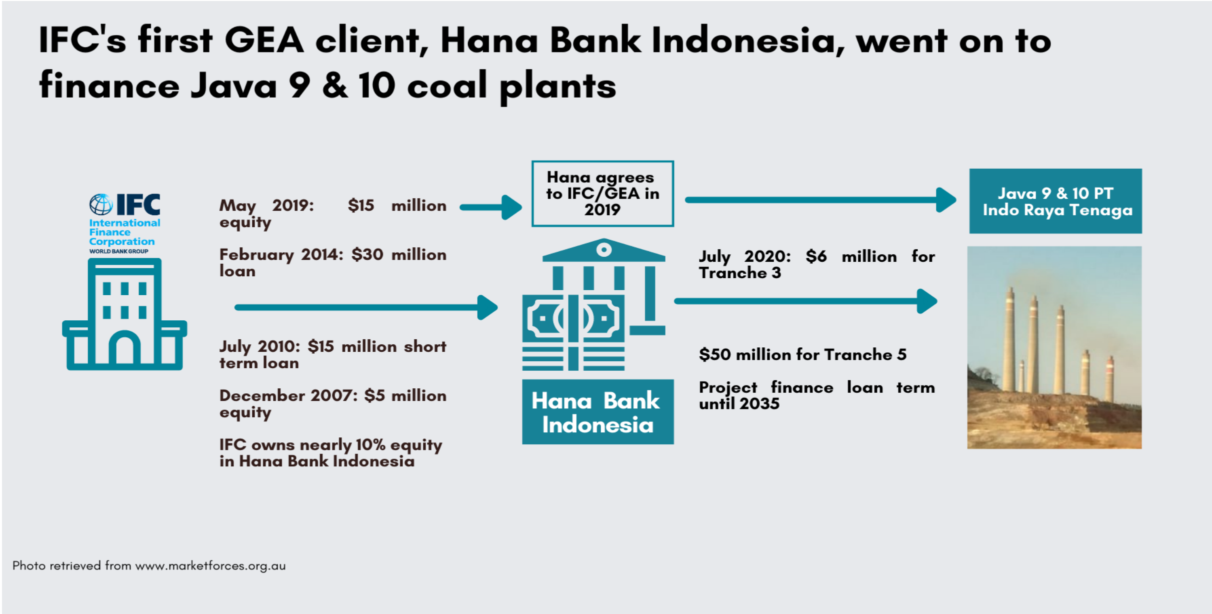
In October 2020, Recourse, Trend Asia and Korea Sustainability Investing Forum released Coming Clean: Can the IFC help end coal finance? which assessed how effective the GEA has been in practice at reducing coal exposure and called for wider reforms to ensure all fossil fuels be phased out.

This briefing is a sequel to the Coming Clean report, focusing on the loopholes that allow IFC support for oil, coal and gas to continue via its financial intermediary clients. It makes recommendations aimed at ensuring IFC plays its part in aligning World Bank Group policies and operations with goals of the Paris Climate Agreement, specifically with Article 2.1c: "making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" and its goal of limiting warming to 1.5°C. **Recourse urges the World Bank Group to ensure these crucial reforms are included in its new Climate Change Action Plan, currently under development.**

1. Undermining the GEA: allowing new coal finance

One of the most shocking discoveries during Recourse's research for Coming Clean was that IFC's first GEA client, Hana Bank Indonesia, provided project finance to new coal plants in July 2020. A year after signing up to the GEA and promising to reduce its coal exposure, Hana gave two tranches of US$6 million and $50 million to PT Indo Raya Tenaga, developer of the massive 2,000MW Java 9 and 10 coal plants in Indonesia (see Box 1).

According to the Asian People's Movement on Debt and Development, the plants will produce around 10 million tonnes of carbon dioxide per year and 250 million tonnes of CO_2 over 25 years, equal to the annual emissions of Spain.



This completely contradicts the GEA's spirit and intention. IFC's website[1] still claims that Hana has reduced its coal exposure from 2.78% to 1.61%, ignoring the new information Recourse provided to IFC about Java 9 & 10. When challenged about this exposure[2], IFC replied, "KEB Hana Bank Indonesia is committed to the Greening Equity Approach (GEA) and they are committed to gradually reduce its [sic] coal exposure as a percentage of the portfolio by 2025 the GEA does not prevent IFC equity investees from having portfolio exposure to coal, which remains an important part of the energy mix for many of the World Bank Group's member countries."[3]

According to the GEA's coal and climate criteria, Hana falls into the category of "Exist-

ing equity client (with new business)". IFC explains that, "Under the GEA, equity investees may be exposed to coal projects. That exposure may fluctuate in the years ahead potentially even rising in some years. This is not a loophole, as described in the Recourse report. For example, equity clients may have coal exposure up to five percent of total loan portfolio in 2025. The end goal is to reach zero or near zero by 2030."[4]

When its project loans to Java 9 and 10 do not mature until 2035, it is difficult to understand how Hana will be able to reduce its coal exposure by 50% by 2025 let alone to zero or near zero by 2030. Moreover, even if Hana divested from Java 9 and 10, the fact remains that IFC has helped to finance these coal plants, profiting from its equity investment, in conflict with its own GEA's commitment and targets. The plants risk becoming stranded assets, and emissions from the coal plants will continue over their lifetime – typically 40 years.[5] IFC will remain responsible for this significant climate footprint, and for any other future coal plants funded by its equity clients. As the NGOs consulted by IFC on its GEA insisted back in 2019,[6] **it is vital that IFC's equity clients commit they will not finance new coal**.

2. It's not just about coal: the problem with oil and gas

Further expansion of oil and gas production and the infrastructure that facilitates this - whether upstream, downstream, or midstream - is not compatible with the Paris Climate Agreement. The Intergovernmental Panel on Climate Change Special Report on Global Warming of 1.5°C (SR15) is clear: in order to have the best chance of limiting warming to 1.5°C, greenhouse gas emissions (GHG) must decline rapidly, falling 45% from 2010 levels by 2030, and reaching net zero by 2050.[7] Recent analyses[8] show that even if coal mining were immediately phased out, the emissions from the oil and gas in already operating fields alone would result in more than 1.5°C of warming.

The oil and gas phase-out imperative

Analysis of latest data from the Global Carbon Project (GCP) shows that despite CO_2 emissions from coal declining, oil and gas emissions are on the rise.[9] Despite the falling costs of renewables in many parts of the world, the majority of increases in energy demand continue to be met by fossil fuels. The GCP suggests that "peak CO_2 emissions could remain decades away" given likely continued growth of emissions from oil and gas.[10]

In every year between 2013 and 2019, gas played a larger role in increasing global emissions than coal. While natural gas is responsible for only around half the CO_2 per unit of energy generated compared to coal, gas use has increased substantially in recent years. Replacement of coal generation with fossil gas will not achieve necessary emissions reductions[11] even if methane leakage is kept to an absolute minimum. As the cost of renewables falls below that of gas[12], coal to gas switching is also poised to replace one uncompetitive energy source with another.

As countries turn away from coal, gas expansion poses one of the greatest threats to our planet and communities. IFC's role in promoting the expansion of long-lived gas and oil infrastructure undermines global action on climate and the World Bank's own climate goals. The GEA does not currently cover oil and gas. Although the former World Bank President, Jim Yong Kim committed to rule out support for upstream oil and gas investments from 2019,[13] IFC has argued that such an exclusion does not apply to financial intermediary investing.[14] Nevertheless, Recourse research showed that IFC has begun to exclude oil and gas in its FI investments, with 21% of both debt and equity projects excluding oil and gas in the year July 2019 - June2020.[15]

A review of IFC's active equity clients shows significant exposure to oil and gas, which IFC must acknowledge and address if it is to play its part in helping the WBG tackle the climate crisis. Despite the lack of transparency in the vast majority of IFC's equity portfolio – until 2020, IFC only disclosed private equity sub-projects, while commercial banks' investments remain a black hole – Recourse was still able to identify 17 significant oil and gas investments. These range from gas plants in Ghana, Nigeria[16] and Russia[17], to oilfield services[18] and offshore drilling equipment.[19] It is vital that IFC takes steps to address this oil and gas exposure in its financial intermediary portfolio: **both through exclusions in private equity investing, and through extending the GEA to oil and gas.**

Case study: Active IFC equity in Helios Investors II

In 2010, IFC took a $60 million equity stake in private equity/venture capital fund Helios Investors II.[20] Helios II subsequently bought in 2015 a 12.4% stake in Africa Oil Corp[21][22], a Canadian oil and gas company operating in Sub-Saharan Africa as well as Guyana, active in development, operation and exploration.[23] One of Africa Oil's major investments is the South Lokichar[24] project, which entails ongoing oil extraction in Kenya's Turkana county, in partnership with Total and Tullow Oil. The project is reported to have gone ahead in the absence of a community land law to regulate the negotiations with the local community for compensation mechanisms. Approximately 700 square kilometres of communal land has been carved off so far with catastrophic consequences for the county's pastoralist community, according to Pastoralist Development Network.[25] The project also led to a series of grave environmental problems, such as an oil leak which took place in February 2015, causing "significant air pollution and environmental damage", according to media reports.[26] Just a few months later, five years after IFC invested in Helios II, it took a direct equity stake in Africa Oil.[27]

Helios II also invested in Petrobras, a Brazilian oil and gas company notorious for its poor environmental record that includes a long list of oil spills. The Helios investment is in Petrobras' African operations, with two offshore oil fields in Nigeria.[28] Despite its claims to being a sustainability champion, Petrobras has not taken any steps to diversify into renewables in the face of the emerging climate crisis, but in fact has scaled up its investment in fossil fuels, "with plans for an almost 30 per cent increase in daily oil production by 2024," according to the *Financial Times*.[29]

3. Engaging with existing equity clients

As can be seen in Table 1 the GEA commits IFC not only to engage with new equity clients, but also existing clients, aiming to support them in phasing out coal in their portfolios. To assess the size and scope of IFC's current active equity exposures, Recourse searched all equity investments marked as 'active' status on IFC's information portal.[30] Our research identified 437 active equity investments; however, on checking this with IFC, staff informed us that 37 of these projects had already been closed.[31] This lack of accuracy matters, since the IFC portal is the only public source of information relating to IFC's financial intermediary portfolio, which comprised 52% of total IFC investments in 2020.[32]

As of March 2021, IFC has 400 active equity investments, in which IFC holds a total of over $14.6 billion equity. Of these, the vast majority are private equity funds, which the GEA does not cover, since IFC has the ability to exclude coal up front. Nearly a fifth of the active equity investments are covered by the GEA.

Among these active equity clients covered by the GEA, how many are exposed to coal? Unfortunately, after almost two years of im-

plementing the GEA it is impossible for the public to know, even though the GEA states that "IFC will require financial institution clients [existing and new] 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." In early 2020, IFC also committed to disclose its high-risk commercial bank subprojects. However, we are still waiting for this disclosure. Without adequate disclosure, it will be impossible to track whether the IFC lives up to any climate commitments it makes, including the promises of the GEA.

In response to a question about how much coal exposure is in its active equity investments, IFC told Recourse "6% of the existing equity clients that have coal exposures have an average exposure of 0.71%." As stated above, there is no way of verifying this figure.

Funding coal mining and coal power in Turkey:

In 2012, IFC provided a $30 million loan to Turkish bank, Fibabanka,[33] for on-lending to women-owned SMEs in Turkey, followed by a $40 million subordinated loan in July 2013, and a trade finance line[34]. In 2015, IFC followed took a 10% equity stake in Fibabanka, worth $50 million, as well as providing another $50 million loan, "to implement its growth strategy." The investment is classified as FI2 – or medium risk.[35]

According to Fibabanka's 2018 Annual Report,[36] it invested in Fina Enerji Holding A.Ş – an energy company which focuses largely on renewable energy but has recently invested in the highly controversial Kınık power station (also known as Eynez power station).[37] Kınık is a proposed new 2-unit 700-megawatt (MW) (2x350MW) coal-fired power plant in İzmir province, Turkey[38] which has faced strong local opposition.[39]

Fibabanka's parent company, Fiba Holding Board Member Murat Özyeğin said of the coal exposure, "with Fina Enerji Holding A.Ş. and Polat Mining Ltd., we aim to make investments in underground coal mining and thermal power plants that will contribute to significantly reducing the current account deficit for energy imports in our country."[40]

What is perhaps surprising is that in two years, IFC has still only signed up two clients to the GEA – Hana Bank Indonesia, which as we have seen is funding new coal, and CBC bank in Sri Lanka, in which IFC invested $15 million equity and $50 million debt in September 2020.[41] Since, according to the project documents, "IFC funds will not be used to support any coal-related activities", it is unclear how much coal exposure CBC has and how significant its commitment to phase out of coal finance will be.

IFC explains the slow take-up of the GEA as follows: "the limited application of the GEA to date reflects IFC's recent history of equity transactions in financial institutions, which are subject to market conditions and other factors, and IFC's selectivity in its equity investments. In the last 12 months, IFC in fact has dropped a number of potential equity transactions or lost transactions to other investors as a result of our new coal and sub-project coal requirements."[42] It is important that when the GEA is reviewed, the question of why only two equity clients have adopted it – with debatable success – out of nearly 70 banks and financial institutions, when it has been in operation for two years, must be addressed.

4. The need for public review of the GEA

The GEA was greeted warmly by civil society who saw it as a genuine effort by IFC to help shift finance out of coal, and in that spirit, many groups engaged with IFC to ensure its success.[43] For the GEA to have had so little

apparent impact in its first two years is a disappointment.

When IFC goes ahead with the review it promised in 2021, it could and should include an examination of the following:

- How to engage a higher proportion of equity clients with the GEA;
- How effective GEA has been in supporting clients to exit coal;
- What loopholes in the GEA allow for continued expansion of fossil fuel exposure, and how to close them to help the World Bank Group align with the Paris Climate Agreement.

This review alone will not be sufficient to ensure IFC is helping to end fossil fuel finance. It is vital that the World Bank's Climate Change Action Plan identifies steps IFC will take to end support for coal, oil and gas in its financial intermediary lending.

Recommendations

It is clear that the GEA is not meeting its stated objectives "to allow IFC to influence a greater number of financial institutions who may otherwise be much slower or never reduce their coal exposure."[44] Yet the approach does have potential and could contribute to the World Bank's efforts to support countries in tackling the climate crisis. For this to happen, the following steps are necessary:

- Hold an evidence-based, public review of the GEA in 2021, to examine barriers to its efficacy and opportunities for wider engagement;
- Close loopholes that allow GEA clients to invest in new coal plants;
- Expand the GEA to cover all fossil fuels, given the threats posed by oil and gas expansion to global temperature rises;
- Exclude oil and gas up front in private equity fund investments, as IFC has with coal.
- Bring pressure to bear on Hana Bank Indonesia to stop financing Java 9 & 10 and ensure these devastating coal plants do not go ahead.

Endnotes

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33 Fibabanka is 98.6% owned by Fiba Holding. Fiba Holding is part of Fiba Group, which is 100% owned by Mr. Husnu Ozyegin and his immediate family members. Fiba Holding captures all banking and financial services of the Group. See: https://disclosures.ifc.org/project-detail/SII/36167/fibabanka-equity

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