SLIPPING THROUGH THE NET:
Paris alignment and the missed opportunity for MDBs to stop funding fossil fuels

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Cover photo: The Java 9 and 10 coal power plants in Banten province, Indonesia.
Credit: Melvinas Priananda, Trend Asia.

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EXECUTIVE SUMMARY

After years of talking about 'Paris alignment' – the process of ensuring that public finance investments don't contradict the need to limit global warming to 1.5°C – the multilateral development banks (MDBs) finally published their joint methodology for tackling it in July 2023. While hailed as a momentous occasion, this porous methodology will do little to shore up the streams of public finance still finding their way through to fossil fuel projects.

This should be of little surprise. Firstly, the joint methodology was published with no open public consultation or systematic input from civil society. Secondly, previous initiatives to reduce climate risk and phase out coal exposure from MDB portfolios, such as the International Finance Corporation's (IFC) Green Equity Approach (GEA), have similarly suffered from leaky design and weak implementation.

This paper summarises the intent and impact (so far) of both of these processes, and the loopholes that still must be closed to prevent public finance leaking to coal power, as well as other fossil fuel projects. The paper analyses the impacts of these policies in relation to the IFC's financial intermediary (FI) portfolio. But the recommendations suggested are potentially of relevance to all MDBs, given that many of the issues identified here pertain to the *Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment* (hereafter *Joint MDB Principles*).

In our analysis we find that:

- neither the IFC's GEA nor the *Joint MDB Principles* exclude support for captive coal power, a form of coal set to expand rapidly in support of 'green' industrial processes involved in the energy transition in the coming years;
- loopholes remain that allow FI clients to underwrite bonds for coal developers, a major source of fossil fuel financing, as short-term financial instruments are not covered
- despite stating that its 'no new coal' policy will apply to existing clients, it is currently unclear if and how the IFC will enforce this with those equity clients;
- the IFC's approach to 'ring-fencing' investments for specific purposes does not prevent clients from funding coal in other parts of their portfolio, and may still be supporting captive coal;
- and most importantly, MDBs are still refusing to exclude support for oil and fossil gas projects.

Therefore, while there has been some progress in shifting away from projects and FI clients that represent a high climate risk in recent years, there is still a long way to go. As well as our analysis of how these loopholes persist in the joint MDB Paris alignment approach, we have identified a selection of fossil fuel projects that appear to be still eligible for financing, despite the introduction of the *Joint MDB Principles*.

But this business-as-usual approach does not match the urgency of the climate crisis. The MDBs increasingly fall back on a distorted narrative of climate 'equity', to justify their support for fossil fuels, implying that communities in lower income countries will suffer unless fossil fuels are supported in the short-term.[1] Not only does this perspective fail to take into account the increasing cost-effectiveness of renewables, it also provides no equity or justice for the communities affected by coal investments – communities that are calling for an end to public finance for fossil fuels. Public finance can play an important catalytic role in helping to support the shift from fossil fuels to renewable energy. Public finance institutions therefore have a duty to stop funding the cause of climate catastrophe and to start funding a real alternative. The analysis and recommendations contained in this paper outline some of the ways they can move closer to that goal.

Campaigners call on the World Bank Group to stop funding all fossil fuels at the World Bank Spring Meetings in Washington DC, April 2023. (all in italics)

LOOKING BACK: THE IFC'S APPROACH TO MITIGATING CLIMATE RISK, 2018–23

The IFC plays a significant role in influencing global private financial flows. The IFC is a standard-setter; its environmental and social standards –- the Performance Standards (PS) –- form the basis of the safeguards of over 100 private banks (who group together under the Equator Principles) and influence the policies of export credit agencies and other development finance institutions (DFIs).

As such, the IFC has global influence and, if global warming is to be limited to 1.5ºC, this influence must be used to shift public and private finance away from fossil fuels, reduce the harms done to communities by high-risk projects, and increase investments in genuinely sustainable renewable energy that does no harm to people or planet.

Two key, simultaneous processes of recent years have shaped how the IFC approaches climate-related risk and fossil fuel investments today; the IFC's shift in investment approach since 2018, and the development of the Joint MDB Principles for Paris alignment.

First, in response to criticism from civil society, the IFC attempted in 2018 to reduce risk and exclude coal finance from its FI portfolio, which represents over half of IFC's total investments. In 2016, Inclusive Development International, BIC Europe (now Recourse) and partners published substantial evidence of the IFC's exposure to coal, covering at least 81 projects in countries including Indonesia, India and the Philippines.[2] In response, the IFC said that it would reduce exposure to high-risk subprojects by:

- investing in fewer high risk FIs;
- reducing the number of equity investments and general-purpose loans it would make to FI clients (investment types that typically exposed the IFC to all of a client's subprojects, including any non-compliant investments);
- 'ring-fencing' its remaining loans (representing 81% of new commitments in 2022) so that clients use them for specific purposes, such as on-lending to micro, small and medium-sized enterprises (MSMEs), women-owned businesses, and climate projects;[3]
- introducing the GEA in 2019 to encourage FI clients to reduce coal exposure over time. In a 2023 update to the GEA, the IFC committed to stop FI clients from funding new coal projects.[4]

> *Over the past few years, civil society groups have been critical of IFC for supporting financial intermediaries that have coal exposures...In response, we have changed our policy in the past two years to vastly reduce our direct and indirect exposure to coal in new financial intermediaries projects.*
>
> **Philippe Le Houérou, CEO of the International Finance Corporation (2016–2020)[5]**

The IFC's Green Equity Approach (GEA)

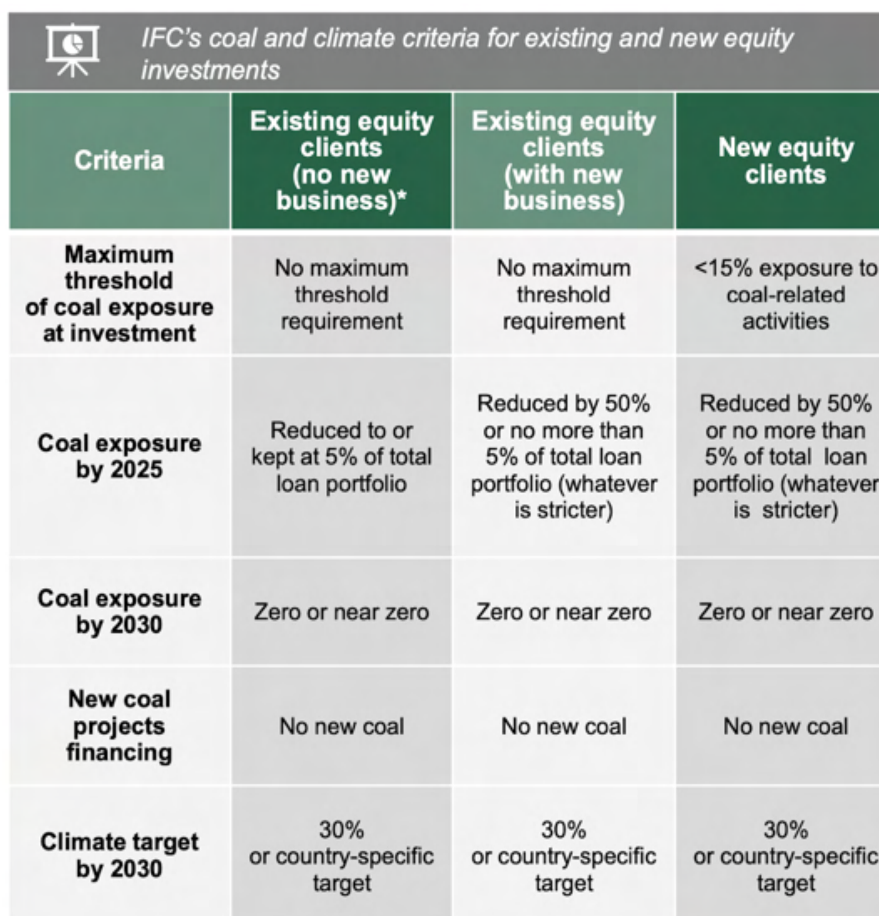
In 2019, the IFC began to pilot its GEA in an attempt to encourage equity clients (not including funds) to reduce their exposure to coal power over time. Under the GEA, new, non-fund equity clients would be required to have less than 15% coal exposure in their portfolios. Furthermore, new and existing equity clients would be required to reduce their coal exposure either by half or to 5% of their portfolio by 2025 (whichever is stricter), and then to 'near zero' by 2030.[6] Importantly, the IFC was also able, through additional negotiations with clients, to encourage some banks (e.g. Federal Bank of India) to agree to stop financing new coal and terminate financing of new coal-related assets on IFC investment.[7]

However, the GEA also had numerous drawbacks in terms of reducing the potential harm caused to communities by fossil fuel investments.

- Initially, there was no requirement on FI clients to stop financing new coal. This was a major loophole that allowed FIs such as Hana Bank Indonesia and PVI Holdings to expand their support for coal power after IFC investment. This loophole has now been closed as of a 2023 update to the GEA.[8]
- The GEA only applies to the IFC's non-fund equity investments, which only represented 5.6% of new commitments in 2019.[9] Debt clients would therefore not be encouraged to reduce coal exposures in the same way.
- The GEA only applies to coal and not to oil and gas support. For an approach to 'greening' financial institutions, this is a major oversight.
- The GEA does not apply to the underwriting of bonds and equities by FI clients. Underwriting accounted for an estimated 36% of all global fossil fuel financing in 2022.[10]
- The GEA's definition of coal-related projects "excludes captive coal-fired power plants used for industrial applications such as mining, smelters, cement or chemical industries". As is elaborated on below, this is a key loophole in need of rectifying as the IFC's FI clients are already exposed to captive coal power, and this is likely to increase as demand for metals involved in the electric vehicle (EV) supply chain increases in the coming years.

Further details on the GEA and its flaws can be found in Recourse's research paper published earlier this year.[11]

Figure 1: The IFC's updated Green Equity Approach (as of 2023) [12]



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
New coal projects financing	No new coal	No new coal	No new coal
Climate target by 2030	30% or country-specific target	30% or country-specific target	30% or country-specific target

*Applicable on Commercially Reasonable Effort (CRE) basis

Second, also since 2018, several MDBs (including the World Bank Group (WBG)) have collaboratively developed a joint framework for aligning their portfolios with the goals of the Paris Agreement on Climate Change, specifically the goal of "holding the increase in global average temperature to well below 2°C above pre-industrial levels and pursuing efforts towards limiting it to 1.5°C".[13] This process ultimately led to the creation of the *Joint MDB Principles,* published in June 2023, which will be the primary means of assessing the Paris-compatibility of future IFC investments (the IFC has, so far, not published its own separate methodology, which the European Bank for Reconstruction and Development has done). The key points and weaknesses of these principles are discussed in more detail below.

The IFC's argument appears to be that the application of the *Joint MDB Principles* for Paris alignment completes its approach to mitigating climate risk. Following these principles, the IFC will exclude support for coal power and mining from most investments, prioritise ring-fenced loans for target sectors (MSMEs, climate, women-owned businesses), and encourage clients (through the 'counterparty' approach outlined in the Paris alignment methodology) to reduce exposure to high greenhouse gas (GHG)-emitting sectors over time.[14]

However, our analysis of the IFC's FI investments in the period 2018–23, when many of the IFC reforms outlined above were already in place, tells another story. There remain key loopholes in the way that the IFC applies its coal exclusions (which do not cover captive coal power, or general bond underwriting for coal developers). The IFC's ring-fencing approach, while

arguably reducing the IFC's exposure to coal projects, is in some cases not preventing coal expansion but simply removing it from IFC's responsibility. And perhaps most importantly, no element of the IFC's approach to aligning with the 1.5ºC goal of the Paris agreement recognises the urgent need to stop funding all fossil fuel projects with public finance.

The IFC's portfolio 2018 – June 2023

Before assessing how Paris alignment will influence the IFC's investment approach, it is important to first analyse how effective the IFC's decision of recent years to shift away from riskier investments, and from general corporate financing to ring-fenced investments, has been.

How the IFC categorises investments

The IFC assigns an environmental and social risk category to each of its investment projects, designed to reflect the "magnitude of risks and impacts" associated with a prospective client's portfolio. It is based on a client's *whole* portfolio – not just on specific subprojects.

For FI projects, the categories are:

- "FI–1: when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
- FI–2: when an FI's existing or proposed portfolio is comprised of…business activities that have potential limited adverse environmental or social risks or impacts that are few in number…or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts…
- FI–3: when an FI's existing or proposed portfolio includes financial exposure to business activities that predominantly have minimal or no adverse environmental or social impacts."[15]

As we can see from the chart below, it is true that the IFC has reduced the number and proportion of high-risk (classified as FI–1) investments that it makes, with FI–1 investments falling from 5.18% to 2.30% of total investment volume between 2017 and 2022. However, the absolute number of FI–1 investments made by the IFC has increased from only one per year, in 2019 and 2020, to 3 and 4 (respectively) for 2021 and 2022. From this, it is clear that the IFC has not entirely stopped investing in high-risk clients.

Over the same 2017–22 period, the number of medium-risk (FI–2) projects has slightly decreased. However, the investment volume represented by FI–2 clients increased significantly during 2019 and 2020, the years when FI–1 investments were at their lowest, suggesting that FI–1 investments are simply being replaced, or potentially even being miscategorised (as discussed below), as FI–2 investments. Furthermore, the volume of investment that the IFC is committing to high- and medium-risk clients has only fallen since 2017 from 41.13% to 37.54%, and actually peaked at 45.59% in 2019. In other words, there is still a significant, and fairly consistent, level of risk that the IFC is taking when selecting clients.

Figure 2: Number of FI-1 and FI-2 projects, 2017-22. Source: IFC Annual Reports.[16]

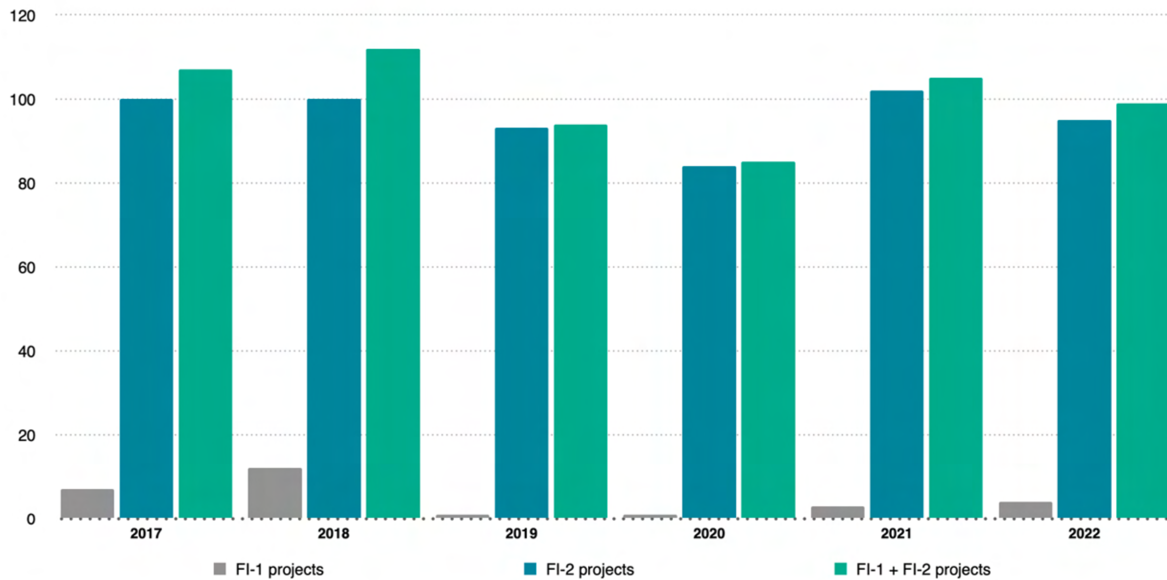
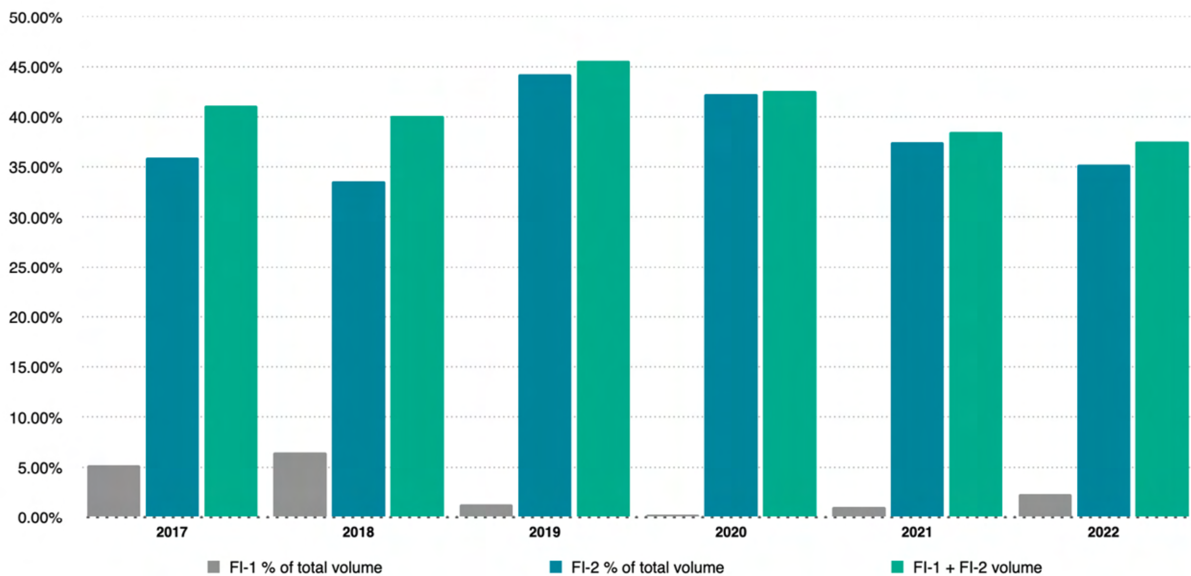


Figure 3: FI-1 and FI-2 investment volume as % of new commitments, 2017-22. Source: IFC Annual Reports.[17]



Effectively managing risk

While the data above suggests the IFC has shifted a little away from high-risk clients, it does not necessarily follow that severe environmental and social risks, and harms, have been eliminated from the IFC's portfolio. One FI client alone can entail huge risks for affected communities. For example, the IFC's multiple equity and debt investments in Rizal Banking Corporation (RCBC) – which were later subject to a complaint to the IFC ombudsman submitted on behalf of affected communities by the Philippine Movement for Climate Justice, Recourse and Inclusive Development International – exposed the IFC to 11 new coal power plants in the Philippines. RCBC more than "tripled its financial exposure to coal projects and companies" between the IFC's first investment in 2011 and 2018.[18] Another of IFC's FI–1 clients, PVI Holdings (see case study: Insuring coal expansion in Vietnam), provided insurance to the Vung Ang 2 coal power project in Vietnam less than six months after the IFC invested.

These are just two of many examples of how a single FI client can cause tangible harms and why extreme caution is needed. In some cases, the IFC reduced the potential for environmental harms by negotiating an exclusion for coal-related activities with its clients, such as its agreement with Federal Bank of India which went beyond the requirements of the GEA (at the time) by including a commitment to stop financing new coal and terminate financing of new coal-related assets on IFC investment.[19] In 2023, the IFC updated the GEA in an attempt to commit all of its non-fund equity clients to stop funding new coal power (although it is unclear if and how this will be enforced with existing clients), signalling further important progress.[20]

However, no such exclusions exist for oil, gas or mining, even in cases (e.g. the IFC's investments in SeABank, Equity Group Holdings, or JSCB Uzpromstroybank) where the IFC notes that such activities are part of a client's portfolio.[21] In short, there is still significant environmental and social risk being taken by the IFC by continuing to invest in FI–1 clients such as these. This is not to say that the IFC should never invest in any risky clients, but instead that the IFC should not be investing in clients where it cannot show that it is effectively managing those risks.

FI categories may not accurately reflect risks

Another reason why reducing FI–1 investments alone is not a cast-iron method of preventing harms is that FI–2 investments still involve a significant level of risk, although the IFC's change of approach in 2018 had little to say about these investments. One such FI–2 investment was the IFC's participation in a rights issue (a sale of shares to existing shareholders) by Hana Bank Indonesia in 2020; less than six months later, Hana Bank Indonesia financed the construction of the two huge Java 9&10 coal power units in Banten, Indonesia.[22] Our analysis of the IFC's debt portfolio, shared in more detail below, also highlights how many FI–2 investments are still being made with incredibly risky clients (such as BDO Unibank, China Banking Corporation or Union Bank, all of which are still contributing to coal expansion in the Philippines), yet the IFC categorises these investments as medium-risk because it believes its 'ring-fencing' approach will prevent funds being used to finance harmful activities.

On both points, it seems clear that while the IFC has slightly reduced the overall risk attributed to its investments, this has not led to an end to harms. Where the IFC has made headway has been in progressively excluding coal from its portfolio – although as discussed in detail below, it has not been completely successful in doing this, and opportunities have also been missed to extend these exclusions to oil and gas in the IFC's Paris alignment methodology. Finally, as we discuss in the next section, while the IFC's approach to ring-fencing investments does reduce the likelihood of the IFC being exposed to fossil fuel projects, it does not necessarily avoid the potential for harms to be caused to communities and the environment.

The Java 9 and 10 coal-fired power plants in Banten province, Indonesia.
Photo credit: Melvinas Priananda, Trend Asia.

Ring-fencing: reducing risk or evading responsibility?

The impression given by the IFC's website is that its ring-fencing of investments to support climate projects, women's empowerment and SME on-lending is a near-watertight way of reducing the risk associated with FI investments.[23] It appears as if, by instructing FI clients to only use IFC funds for sustainable, low risk investments, the IFC can guarantee that it does not support high risk projects and that it is promoting a greener, less carbon intensive and more gender-friendly form of development. However, as set out below, even if such terms are consistently written into legal agreements with FI clients (which it is impossible to externally verify) there are still several issues with this approach.

Fungibility and the ring-fencing of responsibility

Firstly, the funds that the IFC invests in FI clients are, ultimately, fungible (that is to say, interchangeable). In practice this means that, if a client has a portfolio of low and high-risk activities that it needs to fund, the IFC's ring-fenced investment could still free up funds that could be easily redeployed to support other, higher risk activities, such as coal power expansion. Because of this, it makes little sense to pick and choose activities that the IFC's investment supports, as the net effect is that IFC's investment in a commercial bank enables that client to expand its entire portfolio. This is why, for certain investments designated for climate projects or SME on-lending, the IFC is considered to be exposed to the entire climate or SME portfolio of the client, rather than individual activities. But this could also be extended further; when the IFC makes an investment in an FI client, it should consider the climate and human rights risks associated with the client's entire portfolio.

Approaching risk in this way could help to drive up standards. A recent UN paper argues that “ringfencing by definition curtails the ability of a DFI to use its leverage and technical assistance to improve E&S performance across the portfolio” and potentially “leaves

responsibility for higher risk projects to the FI, without guidance, support or supervision from the DFI".[24] Instead of taking responsibility for only the lower-risk and more climate-friendly parts of a client's portfolio, this suggests that the IFC should instead be encouraging FI clients to align their whole portfolios with the Paris Agreement and with the IFC's environmental and social standards, including the GEA.

This issue is particularly pressing because the IFC has continued to work with commercial banks in South East Asia (see case study: Still working with coal financers in the Philippines) that are major funders of fossil fuels. While the IFC may be achieving something positive in supporting these banks to expand their climate and renewable energy portfolios, they are also evading their responsibility for their client's other high-risk investments (in this case, coal and gas). Rather than cherry-picking which bits of a client's portfolio it wants to be associated with, the IFC should use the leverage it has with its FI clients and make fossil fuel exclusions, particularly for coal power, a precondition of IFC investment.

> *Ringfencing by definition curtails the ability of a DFI to use its leverage and technical assistance to improve E&S performance across the portfolio...[leaving] responsibility for higher risk projects to the FI, without guidance, support or supervision from the DFI.*
>
> *UN OHCHR, Benchmarking Study of Development Finance Institutions' Safeguard Policies, 2023.*[25]

Traceability and management of funds

Even if we did accept that funds could be directed and tracked by commercial banks to only support the 'good' activities and not the 'bad', the evidence suggests that this does not always happen as it should. For example, a 2023 report by the Toxic Bonds campaign highlighted how Adani Green, the renewable energy arm of the Indian megacorporation Adani Group, had attracted investors by promising to ring-fence funds for renewable energy; however, evidence presented in the report shows that "once money flows into Adani-controlled entities, it then flows to other Adani Group private and listed entities", including to "Adani entities that are directly responsible for coal mining and coal-fired power expansion".[26] While this case could be exceptional, the IFC's Compliance Advisor Ombudsman (CAO) has also previously highlighted that the IFC had failed to set up effective management and tracking of ring-fenced investments with its FI clients. Without access to the IFC's loan agreements, it is impossible to verify whether the IFC has improved recently in this regard.

> *Twenty-eight investments in CAO's sample were flagged by IFC as MSME targeted investments. In 10 of these 28 investments, IFC's legal agreement with its FI client speified that IFC funds should be used only for MSME financing. However, only 3 of these 10 investments included a mechanism that would allow traceability of IFC funds.*
>
> Compliance Advisor Ombudsman, Third Monitoring Report, 2017.[27]

Broad sector definitions leaving door open to fossil fuels

The IFC's definition of a "climate project", or an eligible use of proceeds from green bonds, also merits some scrutiny. In 2017, the IFC published its *Definitions and Metrics for Climate-Related Activities,* which sets out a long list of activities that are potentially eligible to be counted towards the bank's climate finance target.[28] Of most relevance to this paper is that activities related to the manufacture of "climate-related products" that help to reduce greenhouse gas emissions are potentially eligible climate projects – leaving the door open to, for example, projects to produce critical minerals for EV batteries, even when powered by captive coal power.[29]

Furthermore, the joint MDB *Common Principles for Climate Mitigation Finance Tracking*, published by the WBG and other MDBs in 2021, would appear to supersede the IFC's definition. This document specifically states that "projects that support production of metals or alloys prevalently used in or critical for renewable energy", including the "smelting and refining of materials" are eligible mitigation activities subject to certain criteria.[30] These criteria mostly refer to the end-use of metals, and while they do state that the project should "adhere to a long-term strategy for integration of renewable energy and efficient use of energy and resources in the mining processes", this does not appear to exclude the use of fossil fuels, such as captive coal, to power smelters and refineries in the here and now. The criteria used in the *Common Principles* also guide eligibility for the IFC's Green Bond Framework, presumably meaning that the proceeds of IFC-backed green bonds can be used to support the smelting and refining of critical minerals.[31] The ICMA's *Green Bond Principles*, which were used to guide many of the IFC's climate and green bond investments between 2017 and 2022, also state that projects related to "infrastructure for clean energy vehicles and reduction of harmful emissions" from transportation are an eligible use of proceeds.[32]

The effectiveness of the IFC's ring-fencing approach also relies on its definition of small and medium enterprises (SMEs). This SME definition allows for on-lending to organisations with up to 300 employees, total assets of up to $15m and annual sales of up to $15m (only two of the three criteria need be satisfied).[33] This appears to be a rather broad definition of a small business which leaves open the possibility of on-lending to quite large corporations with high risk activities. For example, in many cases a Special Purpose Vehicle (SPV – a legal entity set up to manage funds for a specific activity) set up as the owner of a new fossil fuel project could qualify as an SME under these conditions. As Recourse found in 2021, after the IFC provided a loan to Federal Bank of India in 2017 for on-lending to SMEs, Federal Bank provided a loan to JSW Energy which was then loaned on to an SPV for the 1,080MW coal-fired Barmer Power Station in India.[34] As in most cases SPVs have no assets or revenue, this could have potentially met the IFC's definition of SME on-lending. Similarly, German NGO urgewald has argued that new enterprises created to develop projects in the Thar coalfields in Pakistan between 2013 and 2020, during which time the IFC was investing in local FIs, would have been eligible for SME on-lending under these criteria.[35]

The IFC should also be wary that SME lending can still contain risks. Furthermore, as research by the OHCHR argues, "FI portfolios inevitably entail risks, even in relation to SMEs in some sectors. For example, small tannery effluent can cause significant pollution, small scale factories might exploit forced labour or modern slavery, and microenterprise software developers may affect the human rights of thousands." The CAO also found evidence, in 2017, of SME on-lending to high risk activities – "IFC made an **SME targeted investment with a commercial bank that was acknowledged as lending to high risk sectors**...The investment

agreement did not require the client to implement the [Performance Standards – the IFC's environmental and social safeguards], although loans to larger businesses than those anticipated by IFC's official definition of an SME were allowed."

In short, the definitions being used by the IFC for its ring-fencing are far from watertight, and contain several key gaps that could enable the leaking of public finance to more fossil fuel projects. As detailed in our case studies below, the most pressing danger presented by these loopholes is the potential for IFC climate funding and green bond investments to be supporting projects involved in the smelting and refining of critical metals, projects that in many cases are powered by captive coal power plants. With the levels of captive coal set to expand rapidly in the coming years, and with green bonds and climate finance representing increasingly prevalent means of MDBs investing their funds, there is an urgent need to close this loophole.[36]

Lack of transparency

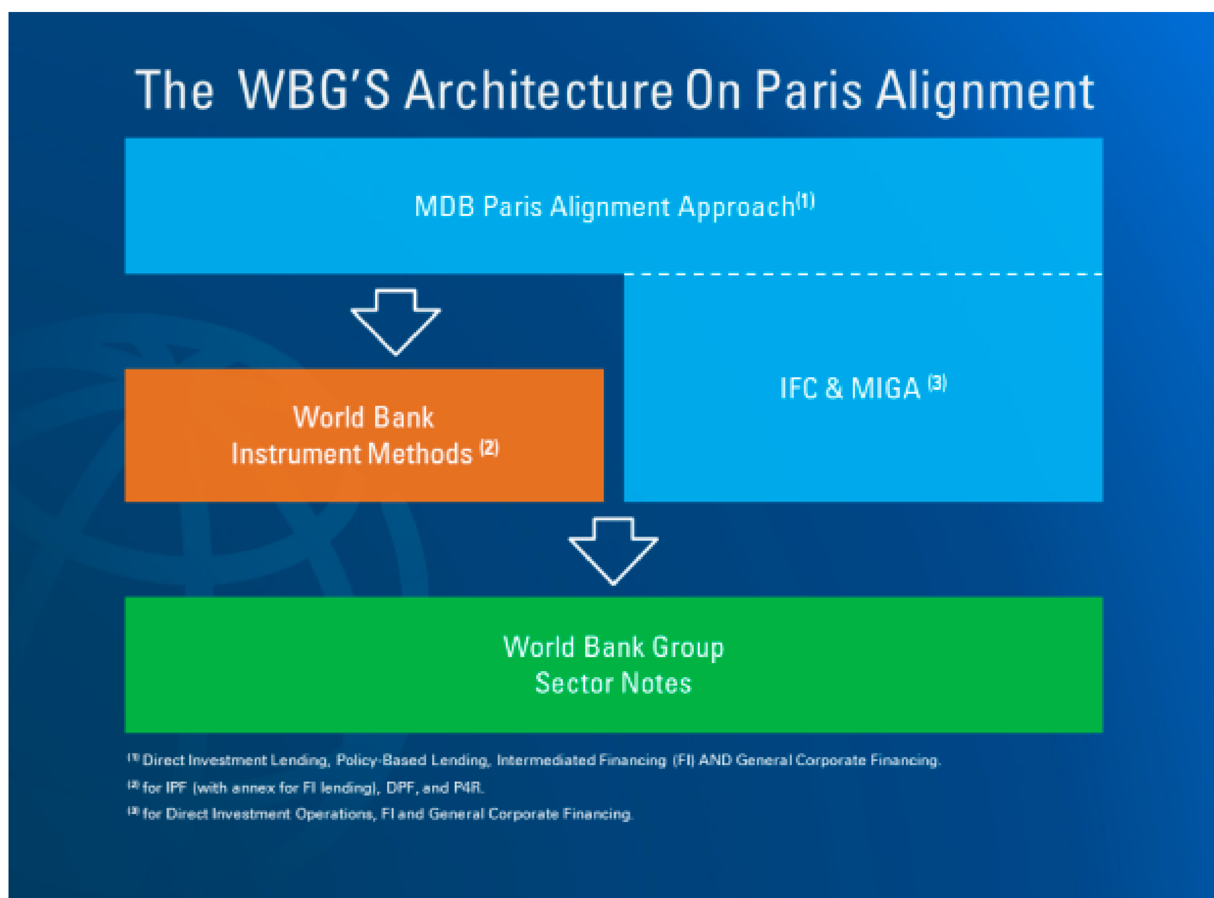
Perhaps most importantly, there is almost a complete lack of transparency over the terms of IFC loan agreements, which makes it near-impossible to independently verify how strong this ring-fencing approach is in practice. In almost all cases, the IFC's website will state an eligible use of proceeds for ring-fenced loans; but this is limited to simply saying “climate”, “green bonds” or “SMEs”. The strength of the ring-fence, as the CAO highlighted in 2017, is defined by the IFC's loan agreements with its clients that are not made publicly available. That means that, even if the IFC were able to avoid the issues listed above, it is entirely possible that strong ring-fencing terms may not be included in a client's loan agreement.

LOOKING FORWARD: THE IFC'S APPROACH TO PARIS ALIGNMENT

From July 2023 onwards, while much of the above approach will stay in place, the IFC will also have to consider another set of criteria in determining whether the level of risk associated with (the majority of) its investments is acceptable: the Paris alignment methodologies.

While 100% of World Bank (WB) operations from July 2023 onwards will have to be Paris-aligned, only 85% of new investments made by both the IFC and the Multilateral Investment Guarantee Agency (MIGA) will have to be Paris-aligned (until 1 July 2025, from which point on 100% of new operations for both IFC and MIGA will have to be Paris-aligned).[37] As illustrated by the diagram below, the IFC's methodology will be based on both the *Joint MDB Principles* and the *World Bank Group Sector Notes* (the World Bank's *Instrument Methods* do not apply to IFC and MIGA operations).

Figure 4: The World Bank Group's Architecture on Paris Alignment.[38]



Within the *Joint MDB Principles* are separate documents outlining the Paris-alignment process for intermediated finance (i.e. FI investments) and a list of activities considered 'universally aligned' or 'universally not-aligned' with the Paris Agreement. Positively, the extraction of, and electricity generation from, coal and peat, are considered to be universally non-aligned activities.[39] This appears to reaffirm the IFC's commitment, made in April 2023, to stop funding new coal power-related operations via financial intermediaries.

However, that could be considered to be the absolute bare minimum that the Paris-alignment process could have achieved, and even then there remain several loopholes that the *Joint*

MDB Principles failed to reckon with. In sum, the *Joint MDB Principles* are disappointing and flawed.

Below we have summarised the key ways in which the IFC's approach to Paris alignment will continue to allow the financing of fossil fuels, including coal, with recommendations for how these gaps can be closed in future periodic reviews of Paris alignment methodologies.

Captive coal

Firstly, neither the *Joint MDB Principles* nor the IFC's updated GEA exclude the possibility of FI clients supporting 'captive coal' power stations. According to Global Energy Monitor, 197,617MW of captive coal power capacity was in operation globally as of July 2023, with the majority of this located in China.[40] Instead of generating electricity to feed into the national grid, captive coal power plants are instead used to power industrial facilities, such as the production of chemicals or smelting of metals. The latter is of particular concern as many facilities involved in the smelting of aluminium, nickel and cobalt (metals that will play a critical role in a green transition and in producing components for electric vehicles and renewable energy) are powered by captive coal. In Indonesia, the world's biggest nickel producer, over 13,000MW of captive coal are currently under construction, representing 69% of Indonesia's total planned coal developments (as of end 2022).[41]

Because the *Joint MDB Principles* only exclude "electricity generation from coal", and because the GEA makes clear that its definition of coal-related activities "excludes captive coal-fired power plants used for industrial applications such as mining, smelters, cement or chemical industries", it appears that captive coal power plants could still be eligible for financing under Paris alignment.[42] This is a huge and deadly oversight, especially at a time when the demand for smelters powered by captive coal is rapidly increasing. Although these facilities can have links to the renewable energy supply chain, and in *some* cases captive coal units can be fairly small, the emissions from captive coal units still contribute to global warming and harm local communities. For example, fourteen captive coal plants located in Obi Island, Morowali and Weda Bay in Indonesia produce the equivalent of one quarter of Germany's entire coal capacity, with further nickel-processing expansion planned on the islands of Sulawesi and Maluku.[43] As we have detailed in our case study below, the IFC's FI clients are contributing to this expansion by funding nickel-smelting projects on Obi Island.

> ***This is a huge and deadly oversight, especially at a time when the demand for smelters powered by captive coal is rapidly increasing.***

The IFC must not continue to fund coal power expansion, and by extension the pollution of local communities and increased greenhouse gas emissions, through this loophole. It is imperative that the WBG and Joint MDB Working Group urgently carry out a reassessment of Paris alignment methodologies and ensure that funding for captive coal is explicitly excluded. The IFC should also exclude captive coal in the GEA (some development finance institutions, such as British International Investment and FMO, have already stopped financing businesses with captive coal expansion plans).[44]

Failure to exclude oil and gas

As referenced above, the *Joint MDB Principles* on Paris alignment (which the IFC is using in lieu of developing its own tailored methodology) only treats extraction of, and electricity generation from, coal or peat as universally non-aligned activities, and fails to introduce broad exclusions for oil and gas projects. This leaves the door open for the continued IFC funding of oil and gas, which is completely incompatible with limiting global warming to 1.5°C.

The failure to exclude support for fossil gas power is particularly worrying as gas is increasingly being touted as a transition fuel in the journey from coal to clean energy. But despite rhetoric about it being a 'clean' fossil fuel, fossil gas is a high carbon-emitting fossil fuel that contributes to climate change, causing devastating floods, droughts, and health problems. New fossil gas development is also incompatible with 1.5°C as it emits methane, a powerful greenhouse gas that is 80 times more potent at warming than carbon dioxide over a 20-year period.[45] The further build-out of fossil gas projects will only lock in a reliance on fossil fuels for decades to come, and will divert resources away from the much needed transition to renewable energy.

In order to be truly Paris-aligned, the IFC and other MDBs must urgently exclude future support for oil and fossil gas projects, including via financial intermediaries.

The underwriting loophole

There also remain gaps in how the MDBs' approach to Paris alignment deals with the issue of financial intermediary clients underwriting bonds and equities for coal developers and projects. The *Joint MDB Principles* state that financial instruments that "do not have a long exposure window…(e.g. less than one year of exposure)" will be considered to be Paris-aligned under a transaction-based approach.[46] As many bonds end up being bought up and sold on very quickly by commercial banks and investors, this could act as a big loophole for fossil fuel financing.

Similarly, the IFC's GEA states that coal-related projects are defined as those in receipt of "long-term (more than 36 months) project finance and/or corporate finance" from IFC clients – a definition that excludes the funding of coal projects via underwriting.[47] As highlighted above, this is a major flaw as, in 2022, roughly 36% of global fossil fuel financing, approximately $669bn, was directed via underwriting.[48]

Furthermore, we already know that the IFC only treats certain types of underwriting as material exposure. In response to the filing of the historic RCBC climate complaint by the Philippine Movement for Climate Justice, IDI and Recourse in 2017, the CAO decided that, alongside 10 projects that had received project finance from RCBC, the only example of underwriting that exposed IFC to coal was where RCBC had underwritten and held bonds designed to raise funds for a specific coal project. In the case of eight further coal projects that RCBC had financed through general corporate bond underwriting, the IFC was deemed to be not materially exposed to the projects.[49] This was, at the time and is still today, a huge accountability gap for the communities impacted by this type of investment.

Given this, under the current Joint MDB approach to Paris alignment, it seems that IFC clients will still be able to finance fossil fuel projects via the underwriting of corporate bonds and equities. As we detail in our case study on Postal Savings Bank of China below, this is a wide open loophole in urgent need of closing if the IFC is going to ensure that it stops its clients financing coal once and for all.

Existing clients

Finally, there are also gaps in terms of how Paris alignment applies to the IFC's existing FI clients. In cases where the IFC has active equity investments in financial intermediaries, it will use the "counterparty-based approach" set out in the *Joint MDB Principles* to assess whether the new operations of the client are Paris-aligned.[50]

The problem with this approach, as currently set out, is that it is incredibly vague and ill-defined. If the client is engaged in funding non-aligned activities that will create a material exposure for IFC, such as project financing for coal projects, then the client will only be required to "commit to a credible pathway towards Paris alignment…the scope and pace [of which] shall depend on the counterparty's capabilities and the applicable regulations".[51]

This approach appears to place an absolutely minimal onus on the FI client to shift its financing away from fossil fuel activities, with no targets or timelines set out in the *Joint MDB Principles* at all. FI clients will be "expected to implement a relevant climate strategy and incorporate it in internal management systems" – a process that would "gradually" replace non-aligned activities with aligned activities. This appears to be a very soft approach towards IFC's engagement with its own clients that does not match the urgency of impending climate catastrophe.

It should be noted that the IFC's updated GEA *does* state that it requires existing clients to stop funding new coal and reduce coal exposure to near zero by 2030 (with the caveats that this does not cover captive coal and underwriting as previously highlighted).[52] However, it is currently unclear if and how this is being enforced. For example, as Inclusive Development International, Recourse and Trend Asia highlighted in a recently published case study, Postal Savings Bank of China is an existing IFC equity client that has embarked on a huge level of coal financing in recent years, including support for the Jambi 2 coal power project.[53]

But the problem also goes beyond coal, as neither the GEA nor *Joint MDB Principles* would appear to prevent clients from massively increasing funding for oil and gas in the years to come – only a loose commitment to produce a gradual, long-term plan to shift away from such activities would apply.

The IFC may say that it has little additional leverage to use with its existing clients, as the investment has already taken place. This is not entirely the case; with equity clients, the IFC has leverage as a shareholder, and through its ability to divest its stake (although it rarely uses this ability). But if the IFC does feel unable to influence the investment patterns of its clients, then this demonstrates exactly why financial intermediary lending, an outsourced form of development financing, is incompatible with the need to limit global warming to 1.5^{o}C. A rapid shift in financing from coal to clean energy is needed to meet the goals of the Paris Agreement, with robust timelines, targets and penalties for non-compliance put in place for public and private financers.

If the IFC is unable to require this of its clients, it should not be investing billions of dollars in FI clients each year in the first place.

Gender and Paris alignment

One further, cross-cutting problem is that the *Joint MDB Principles* for Paris alignment are largely gender-blind, despite commitments made by the IFC and other MDBs to support women's empowerment as a priority. This is problematic because women are disproportionately impacted by the impacts of climate change. Therefore, a weak Paris alignment methodology, that fails to help limit global warming to 1.5ºC, will undermine MDBs' commitments to support women's rights and progress towards achieving the Sustainable Development Goals (particularly SDG5: Gender Equality and SDG7: Affordable and Clean Energy).

- Despite the World Bank Group saying that its approach to Paris alignment "takes into account equity concerns", gender equity is reflected nowhere in the *Joint MDB Principles*. There is no explicit mention of gender in any of the numerous supporting documents (on direct investments, intermediated financing, policy-based, general corporate finance, and universally aligned/non-aligned activities) that make up the Paris alignment methodology.
- Given that women are more likely to experience energy poverty than men, energy access is a key issue that needs addressing through Paris alignment. On a positive note, the List of Activities Considered Universally Aligned with the Paris Agreement's Mitigation Goals includes "Cleaner cooking technologies", but it ends there.
- While other aligned activities may help to reduce greenhouse gas emissions, there is no acknowledgment in the methodology about how such investments might impact gender rights. This can be very problematic, especially considering research published by Gender Action which shows the weak gender responsiveness of the IFC's Performance Standards (assessed to be "77% weak").[54]
- Even low carbon-emitting projects can enable land grabs, gender-based violence, and gender-based exclusion. To avoid or mitigate these risks, gender risks should be considered throughout the investment process – yet such risks and concerns are not acknowledged at all in the *Joint MDB Principles*.
- The Paris Agreement itself is also fairly light on references to gender, but does include key provisions for respecting human rights and promoting gender equality.[55] Being Paris-aligned is therefore not solely a question of supporting climate-compatible investments, but about equity at a deeper level. This is the true meaning of Paris alignment, and on this basis the *Joint MDB Principles* are currently failing.

CASE STUDY: CAPTIVE COAL POWER ON OBI ISLAND, INDONESIA

Neither the IFC's GEA nor the *Joint MDB Principles* appear to exclude captive coal units, constructed to power or support industrial processes, from the remit of IFC investment. This is a crucial oversight because captive coal power is expanding rapidly in China and Indonesia and is set to further increase as the demand for critical minerals to support a renewable energy transition increases.

The IFC is already exposed to captive coal through its FI client Hana Bank Indonesia, in which the IFC owns an equity stake. In April 2022, Hana Bank Indonesia was a mandated arranger in a $530m project loan to PT Halmahera Jaya Feronikel, a subsidiary of Trimegah Bangun Persada (TBP), which is building a nickel smelter on Obi Island, according to Bloomberg.[56] PT Halmahera Jaya Feronikel is the owner of a 4x380MW captive coal power plant in the Obi Island industrial park.[57]

Perhaps more worryingly, the IFC is also potentially exposed to a nickel refinery project on Obi Island, also powered by captive coal, via another investment intended to support climate projects. OCBC NISP is an Indonesian subsidiary of Oversea-Chinese Banking Corporation (OCBC), a commercial bank based in Singapore. In 2020, the IFC made a $200m investment in OCBC NISP's Sustainability Bond programme, comprising Green and Gender bonds, for the purpose of on-lending to climate projects and Women-Owned SMEs.[58] After that investment, in April 2021, OCBC NISP was one of nine commercial banks that invested a combined $625m in the PT Halmahera Persada Lygend (another subsidiary of TBP) nickel refinery project on Obi Island, North Maluku province.[59] The refinery produces nickel sulphate and cobalt sulphate, materials that are critical in the production of EV batteries. Financial authorities in Indonesia were recently reported to be considering classifying projects involved in the EV supply chain as green projects that are eligible for climate funding.[60]

However, the Obi Island refinery is powered by a coal-fired power station, of up to 4,200MW capacity when fully built, that is being constructed entirely for the purposes of powering nickel projects in the area (making it a ‘captive’ coal plant).[61]

The IFC's website states that its investment in OCBC NISP will be used for “on-lending to eligible green projects (including refinancing of existing portfolio projects)", which will potentially (but not exclusively) include “small hydro, biomass power plants, solar power, energy efficiency, wastewater treatment and green buildings". The IFC also states that “coal related projects…will be excluded"; however, in other guidance documents the IFC has said explicitly that its definition of coal-related projects does not apply to captive coal power.[62] These definitions do not therefore rule out support for the Obi Island nickel refinery from this investment.

Furthermore, a *Sustainability Bond Framework*, published by OCBC NISP's parent company OCBC in 2020, states that projects related to the production of “wind turbines, solar panels, battery storage, and [other renewable energy appliances and products]" or projects related to infrastructure and “capacity improvement" for EVs are eligible uses of proceeds for Green bonds.[63] Nickel is a critical resource for the above technologies as it is used in the production of lithium-ion batteries, a vital component of EVs.[64] It therefore seems plausible that OCBC NISP could have used proceeds from the issuance of its Green bonds to contribute to the construction of the Obi Island nickel refinery as a project that supports a transition to renewable energy, despite the project necessitating the potential construction of 4,200MW of coal power capacity. This would appear to be a flaw in the IFC's approach to ring-fencing.

While funds may technically not support the construction of a captive coal power plant, if they enable the development of a project that depends on captive coal power (that the project developer will seek to fund via other means) then the investment is still contributing to the expansion of coal use.

Across Indonesia, and particularly in the case of Obi Island, the environmental and social impacts of nickel mining and processing are devastating. Indonesia has been the world's biggest nickel producer for several years and has, along with Australia, the world's largest known nickel reserves. Since the Indonesian government began to progressively ban the export of raw nickel ore in 2014, demand for nickel smelters and processing facilities in Indonesia has greatly increased.[65] It should be recognised that, as a general principle, the development of such industries in the Global South gives lower income countries the opportunity to retain greater value from the critical mineral supply chain, rather than being coerced into selling raw, unprocessed materials to international corporations (e.g. Tesla) at rock bottom price.

However, the benefits and impacts of this nickel boom are being keenly and unevenly felt, and the industry has had hugely detrimental impacts on fishing, Indigenous Peoples and marine ecosystems.[66] An investigation by the *Washington Post* earlier this year reported that the Obi Island processing facility, which uses the controversial, slurry-producing High-Pressure Acid Leaching (HPAL) method to extract higher grade nickel, produces "4 million metric tons of toxic waste…every year — enough, approximately, to fill 1,667 Olympic-size swimming pools".[67] The *Environmental Justice Atlas* reports a series of additional impacts from the facility that include (but are not limited to) a local increase in infectious diseases, elevated levels of lung infections in newborns and toddlers, biodiversity loss, air pollution, decrease in fisheries, dangerous levels of chromium in drinking water, deforestation, and the loss of traditional livelihoods, knowledge, practices and cultures.[68] Beyond this, Trend Asia has also highlighted impacts on biodiversity and the local bird population, land disputes and forced evictions as impacts of nickel development on Obi Island.[69] This is before even taking into account the increased greenhouse gas emissions, and the long-term impacts they will have on climate-vulnerable populations in Indonesia, of 4,200MW of coal power.

OCBC NISP appears heavily exposed to the risks of Indonesia's nickel boom beyond the Halmahera Persada Lygend project. Financial statements published by the project owner Harita Nickel (also known as PT Trimegah Bangun Persada) show outstanding loans of IDR 177bn and IDR 1.8tn (approx. \$11.6m and \$120m respectively) to OCBC NISP.[70] Harita Nickel is also the owner of numerous other nickel projects, including the Megah Surya Pertiwi ferronickel smelter, which is powered by another 114MW captive coal power plant on Obi Island; the Gane Permai Sentosa mine, which produces ore for the local processing facilities, and a proposed second HPAL nickel smelter to also be located on Obi Island.[71]

Greater attention to the risks of captive coal expansion in Indonesia, and beyond, is needed from the IFC. Despite commitments to move away from coal as part of the \$20bn Just Energy Transition Partnership (JETP) deal in 2022, the Indonesian government continues to support captive coal expansion, which could represent up to 13,000MW of additional coal power in "nickel hotspots," such as Obi Island, Morowali and Weda Bay.[72] Yet the IFC has said explicitly that its GEA, which encourages equity clients to reduce exposure to coal related-projects over time, does not include "captive coal-fired power plants used for industrial applications such as mining, smelters" in its definition.[73] This loophole must be urgently addressed for equity clients and, with captive coal and its high social and environmental impacts set to expand in the years to come, the IFC must also ensure that its ring-fenced loans are not indirectly financing coal by supporting projects that are reliant on captive coal power.

CASE STUDY: SUPPORTING GAS POWER IN SRI LANKA

As highlighted earlier, there is no clear exclusion in the IFC's Paris alignment methodology for supporting gas power. This case study is just one example of how one of the IFC's FI clients has supported gas power expansion in recent years, and how it could continue to do so despite the introduction of Paris alignment commitments.

The Commercial Bank of Ceylon (CBC) is one of Sri Lanka's largest private banks, with overseas subsidiaries operating in Bangladesh, Maldives, and Myanmar. In 2003, the IFC invested $25m ($11m equity, $14m loan) in CBC.[74] Between 2009 and 2020, the IFC invested another $356m in loans, equities, and guarantees, including another $15m equity purchase in 2020 alongside two $50m loans for on-lending to women-owned SMEs.[75] With the equity purchase, CBC became subject to the IFC's GEA.

As of 2022, the IFC held 7.11% of the 17,022 ordinary voting shares of the CBC. The IFC also holds other shares in the Bank through the IFC Emerging Asia Fund (3.67%), and the IFC Financial Institutions Growth Fund (3.67%). Combined, IFC-related shares amount to 14.45%, which makes the IFC the second largest shareholder after the 18.95% collectively owned shares of entities related to the Sri Lankan state. The Asian Infrastructure Investment Bank (AIIB) is also exposed to investments made by the CBC through the IFC Emerging Asia Fund, into which it invested $150m equity in 2017.

In November 2021, CBC joined a syndicated loan facility led by Hatton National Bank (HNB) to finance a 350MW liquefied natural gas (LNG) power plant developed by Sobadhanavi Ltd, a subsidiary of Lakdhanavi Ltd. The value of the loan agreement signed by the banks was not disclosed. The LNG power plant is currently under construction in Kerawalapitiya. It is significant, as the first of its kind in Sri Lanka.

Aside from this 350MW LNG plant, the government of Sri Lanka plans to add at least six other LNG power projects based on its 2023–2042 Long Term Generation Expansion Plan.[76] This includes a planned LNG terminal with a floating storage regasification unit on the coast of Kerawalapitiya that will supply the LNG power plants with the imported fossil fuel. In 2019, the Asian Development Bank provided $225,000 worth of technical assistance to support the Ceylon Electricity Board in exploring LNG as a fuel for power generation.[77] In February 2021, the Public Utilities Commission of Sri Lanka approved the construction of the LNG power plant in Kerawalapitiya.

Civil society groups in Sri Lanka have voiced concerns about the building of LNG projects in Kerawalapitiya. The Center for Environmental Justice (CEJ) says that the LNG projects in Kerawalapitiya will damage the biodiversity-rich Muthurajawela marshland and negatively impact the marshland's flood-retaining capacity.[78] Building the planned LNG terminal will also negatively impact the marine environment as well as the livelihoods of the fisherfolk in the area. According to CEJ, the Sri Lankan government cannot meet its commitments of having 70% renewable energy-based electricity production by 2030, and to be carbon neutral by 2050, if the planned LNG projects are built.[79]

CASE STUDY: STILL WORKING WITH COAL FINANCERS IN THE PHILIPPINES

In May 2022, IFC made a $100 million investment in a 'blue bond' issued by BDO Unibank in the Philippines.[80] This investment was ring-fenced to support "ocean-friendly projects and critical clean water resources protection" as defined by the IFC's *Guidelines for Blue Finance* and the ICMA's *Green Bond Principles* (discussed earlier) – as a debt investment it is not subject to the GEA.[81] However, BDO Unibank is also one of the biggest funders of coal expansion in the Philippines, and has continued to fund coal since IFC's investment.[82] The question therefore is whether the IFC can ensure that its investment is definitely *not* helping BDO Unibank to continue its coal financing, even indirectly, and whether the IFC could be doing more to encourage BDO Unibank to stop funding coal altogether.

The IFC and BDO Unibank have had a close relationship over the past two decades, with the IFC having previously made a $150m equity investment in the bank as well as providing numerous loans (for SME financing and climate projects) since 2002. As a 2018 report by Inclusive Development International, Recourse and the Philippine Movement for Climate Justice highlighted, the IFC had to date provided a total of $563m to BDO Unibank and RCBC. These banks, together, were major financiers of the Philippine coal boom between 2013 and 2018, providing $13.4bn of project finance, corporate loans and bond underwriting for the coal sector in this period (despite the World Bank having committed to stop funding coal).[83] Civil society's exposure of this coal support led to the filing of the "first mass climate-related complaint ever filed against the IFC" by the Philippine Movement for Climate Justice, Recourse and Inclusive Development International – but the IFC divested its equity stake in BDO Unibank before the complaint was filed.[84]

Nonetheless, BDO Unibank has continued to fund coal projects in the Philippines, even after the IFC's latest investment. The Philippines-based Withdraw from Coal campaign lists BDO Unibank as the second biggest funder of coal in the Philippines (2009–-23) and as having increased its coal exposure in the last twelve months, despite having announced a commitment to not fund coal in 2021 (the commitment only covered some lending and not bond issuances).[85] As recently as December 2022, BDO Unibank's subsidiary BDO Capital & Investment Corporation (BDOCIC), acted as joint issue Manager, joint Lead underwriters and bookrunners on bonds issued by San Miguel Corporation Global Power (SMCGP), to the tune of PHP 9bn ($159m), the proceeds of which will partly support the Mariveles Power Generation Corporation's coal-fired 4x150MW power plant in Mariveles, Bataan province.[86]

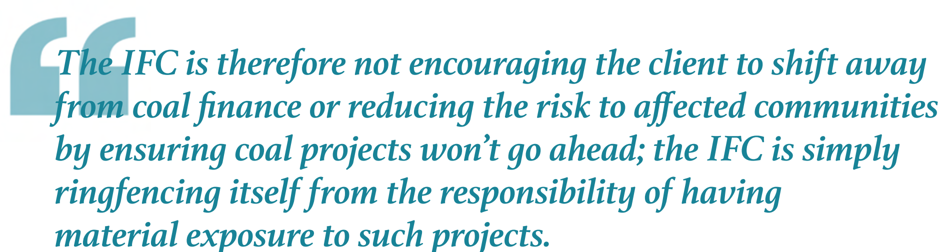
This followed the July 2022 issuance of another SMCGP bond, which was also used to fund the Mariveles power plant, worth up to PHP 40bn (approx. $700m). For this issuance, BDOCIC had also acted as joint issue Manager, joint Lead underwriters and bookrunners, with an underwriting commitment of PHP 8.4bn ($147m).[87] According to analysis by the Institute for Energy Economics and Financial Analysis, despite SMCGP's claims that this bond issuance would fund a "clean" energy future, "76% of the proceeds went toward funding fossil fuel projects, while just 0.1% went to renewable generation projects".[88]

Notably, two further IFC clients, China Banking Corporation and Union Bank Philippines, who have also received ring-fenced IFC loans since 2018 (for green bonds and SME loans respectively), are also listed in Withdraw from Coal's report.[89] The 2023 scorecard lists

China Banking Corporation as the 6th biggest financier and Union Bank at number 15, while demonstrating that China Banking Corporation has also participated in the recent SMCGP coal bonds.[90]

On paper, there are several protections against the IFC's 2022 investment in BDO Unibank being used to finance coal. The IFC's Disclosures page states that the project "will not support coal-related activities", coal power would not meet the eligible use of proceeds as defined by the IFC's guidelines for blue finance, nor would it be eligible under the criteria of the ICMA's *Green Bond Principles* (although it should be noted that these are described as voluntary principles only).[91] Furthermore, both the IFC and ICMA guidelines state that bond issuers should clearly define how proceeds will be managed, with funds "credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner", and sub-projects reported annually to investors, to ensure that only eligible projects are supported by the investment.[92] However, without seeing the investment agreement between the IFC and BDO Unibank, BDO Unibank's Blue Bond prospectus, or the annual reports made to the IFC on how funds have been used, none of which appear to be publicly available, it seems impossible to verify whether the above has happened in this case.

Furthermore, while it may be possible for the IFC to demonstrate that none of the funds from this specific investment have been used to finance coal power, the IFC can say neither that their engagement with BDO Unibank has resulted in the bank ending its coal support, nor that the IFC's investment hasn't enabled BDO Unibank to redeploy funds earmarked for blue/green projects to other parts of its business (namely coal finance). The fungibility of funds, whether tracked or not, make it more or less impossible to guarantee that investing in a coal-funding institution will not ultimately enable more coal power development. The IFC is therefore not encouraging the client to shift away from coal finance or reducing the risk to affected communities by ensuring coal projects won't go ahead; the IFC is simply ring-fencing itself from the responsibility of having material exposure to such projects. Ultimately, what the IFC should be doing in the cases of BDO Unibank, China Banking Corporation and Union Bank, and indeed with all prospective FI clients, is making the introduction of a "no new coal" policy a prerequisite for investments.



CASE STUDY: EXISTING CLIENTS EXPANDING COAL IN CHINA

Ahead of its initial public offering in 2015, Postal Savings Bank of China (PSBC) secured a $300 million investment from the IFC, a transaction that has exposed the IFC to a vast portfolio of fossil fuel financing, in particular for coal.[93] As has been highlighted in a recent case study on PSBC, published in September 2023 by Inclusive Development International, Recourse and Trend Asia, this investment has exposed IFC to at least 36 coal projects across China, Indonesia and Cambodia, representing 62GW of coal expansion (for more on these projects, see *Blowing Smoke: How Coal Finance is Flowing through the IFC's Paris Alignment Loopholes*).[94]

According to the 2023 update of the GEA, the IFC's pre-existing clients will be required to adhere to the IFC's 'no new coal' commitment. However, it is not currently clear if and how this is being enforced.

Even if the IFC did start to apply its 'no new coal' commitment to existing clients, PSBC's support for these major coal developers would *still* be allowed through another major loophole in Paris alignment: the underwriting of corporate bonds. In 2018, when the historic first climate complaint was filed against the IFC for its funding of major coal financier RCBC in the Philippines, the Compliance Advisor Ombudsman (CAO) ruled that the IFC could only be held to account when its FI clients had underwritten bonds for specific coal projects, but not for the underwriting of general corporate bonds of coal developers. According to the Global Coal Exit List, PSBC has underwritten a total of $10.31 billion for coal companies and developers between January 2019 and November 2021. While *some* of this funding may be for specific projects, much of it will not and therefore will not be covered by Paris alignment.

As such, there is little sign at present that the *Joint MDB Principles* would prevent PSBC from continuing to fund coal power projects, and no specific targets or deadlines in the 'counterparty approach' for PSBC to phase coal out of its portfolio. Furthermore, it is unclear whether the GEA is being enforced by the IFC to stop PSBC financing new coal. In order to have a credible and robust Paris alignment methodology, the IFC must urgently spell out how it is going to convince existing clients such as PSBC away from coal, and how it is going to prevent its clients underwriting bonds for some of the world's biggest coal developers.

CASE STUDY: INSURING COAL EXPANSION IN VIETNAM

In August 2021, the IFC invested $7.48m in PVI Holdings (PVI), an insurance company established by the state-owned energy firm PetroVietnam (and in which PetroVietnam still holds a 35% stake).[95] The investment is subject to the GEA.

As of March 2021, PVI was the "the largest non-life insurance company in Vietnam in terms of gross written premium". According to the IFC, the intended development impact of the project was to increase access to non-life insurance in Vietnam, particularly in health and engineering. However, the IFC categorised the investment as FI–1, high risk, owing to PVI's "sizeable exposure to large corporate clients operating in high-risk sectors", including coal, gas and oil.
The IFC states that, at the time of investment, PVI was exposed to several coal-fired power plants, representing "3.7 percent of its total Gross Written Premium as of December 31, 2020".[96] Financial analysis by Inclusive Development International shows that this includes insurance for the 1,900MW Nghi Son 2 coal-fired power plant, the Duyen Hai 2 coal-fired power plant, the Hai Duong coal-fired power plant, the Vinh Tan 4 coal-fired power plant extension, the Thai Binh 1 coal-fired power plant, and the Thang Long coal-fired power plant.[97] As a GEA client, PVI will be required to disclose aggregate coal exposure annually to the IFC and to decrease its coal exposure by 50% by 2025. However, the investment was made before the IFC's 'no new coal' commitment, and no specific exclusion for supporting new coal was agreed as part of the investment (as happened with Federal Bank in India).

This is significant because in October 2021, after the IFC's investment, PVI insured a *new* coal power plant – the 1,200MW Vung Ang 2 project in Vietnam.[98] According to *Coal Insurers of Last Resort*, by Solutions For Our Climate and Insure Our Future, PVI provided $203m in insurance for Vung Ang 2.[99] Documents published by the project developers KEPCO confirm this, showing that the insurance contracts (for cargo insurance, 3rd party liability insurance, terrorism insurance and marine insurance) run from October 2021 to October 2025.[100] These documents also show that PVI Holdings acted as syndicate leaders on these contracts, effectively facilitating the provision of a further $3 billion of insurance for the Vung Ang 2 project.[101]

Construction on Vung Ang 2 began in December 2021 and is expected to be commercially operational by 2025. According to BankTrack, Vung Ang 2 is highly likely to "exacerbate environmental pollution and health hazards in the Ha Tinh province, Vietnam", with negative impacts expected on local farmland, fishing, public health, and aquatic ecosystems.[102] Local residents have complained that the Vung Ang 1 power station has already contributed to toxic air and water quality, dried out paddy fields, dying fish and banana trees failing to produce fruit.[103] The *LA Times* reported that proper relocation and compensation processes have not been followed for the construction of Vung Ang 1 and 2, with residents asked to sign papers without compensation amounts being agreed.[104] In 2020, the Environmental Law Alliance Worldwide (ELAW) concluded that the environmental impact assessment for Vung Ang 2 did not comply with international standards as it failed to consider alternatives to coal power, permitting wet handling of ash and discharge of thermal effluent in violation of IFC Performance Standards, and by applying weak emissions standards.[105]

Since the IFC's no new coal commitment was made in April 2023, new and existing clients will not be allowed to support new coal projects. Thankfully, this means, in theory at least, that PVI's insuring of Vung Ang 2 could not be repeated for another new coal power plant in future. However, with PVI's insurance contracts for Vung Ang 2 set to end in 2025, the question remains whether PVI could renew these contracts, as it would not classify as a new coal project. At present, the only restriction on PVI is to reduce its coal exposure, by 2025, to half of the 3.7% of its total Gross Written Premium that coal represented on IFC investment (and to near-zero by 2030). Therefore, whether PVI can renew its exposure to Vung Ang 2 will depend on when its exposures to other coal power projects come to an end (at least until 2030).. However, there appears to be little to prevent PVI from renewing its insurance contracts with Vung Ang 2 if it manages to reduce coal exposures elsewhere. The IFC accepts that the coal exposure of its FI clients will fluctuate over time and can go up as well as down. As long as PVI doesn't support other new coal projects, but is instead renewing contracts or refinancing existing exposures, then its continued support for Vung Ang 2 would be allowed.

RECOMMENDATIONS

Despite some changes and improvements in managing climate risk in recent years, the IFC is still investing in coal power and other fossil fuels. As we have demonstrated above, the introduction of the *Joint MDB Principles* on Paris alignment will do little to stop this.

The MDBs have committed to periodically review these principles and to learn from their implementation – so there is still time to course correct. However, this review should not be kicked down the road. Instead, an urgent root and branch reassessment of Paris alignment is needed, by the next World Bank Spring Meetings in April 2024 at the latest. This reassessment should involve full, open consultation with civil society – something that was starkly absent from the production of the first set of Paris alignment documents.

In some cases, some simple tweaks could be made to the *Joint MDB Principles*, and to the IFC's GEA, to close loopholes and cut off some of the last remaining funding channels for coal power. In other cases, however, a bigger change in approach is needed.

In order to stop funding coal once and for all, *and* to truly align MDB portfolios with the need to limit global warming to 1.5°C, we recommend that:

1. The MDBs commit to stop funding all fossil fuels. There is no doubt that the urgency of the climate crisis requires a rapid transition from fossil fuels to renewable energy. Public finance must stop funding the problem and scale up its support for the solution. In practice, this means that the *Joint MDB Principles* must be urgently updated to include clear exclusions for oil and gas financing in both direct and indirect investments. The IFC should also join the Clean Energy Transition Partnership to end international public finance for fossil fuels.[106]

2. The *Joint MDB Principles* and IFC's GEA are updated to stop funding for captive coal power and coal for industrial uses. Despite the use of captive coal in the renewable energy and electric supply chain, there can be no just energy transition for coal-affected and climate-vulnerable communities if coal expansion continues. With captive coal set to expand rapidly in the years to come, public finance must urgently be finding and funding real, sustainable alternatives.

3. The IFC should use its leverage with clients to encourage more portfolio-wide coal exclusions and drive up standards. While supporting the climate portfolios of its clients may help to expand renewable energy, IFC clients are still funding coal power expansion in other parts of their portfolio. Although the IFC may be able to demonstrate it is not materially exposed to such projects, its clients are still creating tangible risks for communities and the environment. Instead of protecting itself from responsibility for such projects, the IFC should more actively engage its clients on the need to stop funding new coal, including via bond issuances, and help to drive up standards globally. If the IFC is not able to effectively manage the risks associated with a client's *whole* portfolio, then it should stop investing and reconsider whether those clients are the best vehicle through which to fund a just energy transition.

4. The IFC, and MDBs as a whole, must cut out coal financing via underwriting. Underwriting plays a huge role in expanding fossil fuel finance globally, yet at present the MDBs appear solely focused on cutting out longer-term exposures and project finance for coal. The IFC's definition of "coal-related projects" in its GEA should be updated to prevent its clients from underwriting bonds and equities for coal projects and developers.[107] The transaction-based approach outlined in the *Joint MDB Principles* should also be updated to consider how financial instruments, such as bonds, with shorter-term exposure windows are still undermining progress towards the Paris temperature goal.

5. The IFC must clarify how it will enforce its no new coal policy with existing equity clients and the 'counterparty approach' in the *Joint MDB Principles* must be better defined. It remains unclear how the IFC is enforcing its no new coal policy with existing equity clients, and the counterparty approach mentioned in the *Joint MDB Principles* says little about how the MDBs will use their leverage with existing clients to shift portfolios from coal to clean. Urgent clarity, including clear targets and timelines, on this approach are needed, and all MDBs must use any leverage they can to encourage existing clients to stop funding coal.

6. MDBs must ensure that their taxonomies of climate projects, and projects eligible for funding via green bonds, are supporting genuinely sustainable renewables energy, a just transition, and projects that do no harm to communities or the environment. Although a complete analysis of the document was beyond the scope of this paper, the MDBs' *Common Principles for Climate Mitigation Finance Tracking* leaves the door open to the financing of captive coal, and other controversial technologies that cause harm to communities while also increasing greenhouse gas emissions. This taxonomy should be revised in line with Recourse's methodology for ensuring MDBs are supporting sustainable renewable economies.[108]

7. The IFC should amend its definitions of SMEs to ensure that targeted loans are not supporting fossil fuels. As highlighted above, the current definitions are too broad and leave open the possibility of funding being channelled to Special Purpose Vehicles for fossil fuel projects.

8. The IFC must improve the transparency around how its ring-fenced investments are working in practice. At present, it is near impossible to tell, from IFC Disclosures, how the IFC's ring-fenced loans are genuinely supporting climate projects, SME financing or women's empowerment. The IFC should, at the very least, commit to publishing summarised details of loan agreements and the details of subprojects publicly on its own website so that it is possible to better scrutinise the impact of these investments.

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