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Investing in rural people

Progress Report on Applying the Multilateral Development Banks' Methodologies for Climate Finance Tracking

Note to Executive Board representatives

Focal points:

Technical questions:

Margarita Astralaga
Director
Environment, Climate, Gender and Social Inclusion Division
Tel.: +39 06 5459 2151
e-mail: m.astralaga@ifad.org

Thomas Eriksson
Director
Operational Policy and Results Division
Tel.: +39 06 5459 2425
e-mail: t.eriksson@ifad.org

Liza Leclerc
Lead Technical Specialist
Environment, Climate, Gender and Social Inclusion Division
Tel.: +39 06 5459 2940
e-mail: l.leclerc@ifad.org

Lauren Phillips
Lead Advisor, Policy and Results
Operational Policy and Results Division
Tel.: +39 06 5459 2877
e-mail: l.phillips@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

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Contents

Abbreviations and acronyms

APR	Asia and the Pacific Region
ESA	East and Southern Africa
GHG	greenhouse gases
LAC	Latin America and the Caribbean
MDBs	multilateral development banks
NDCs	nationally determined contributions
PoLG	programme of loans and grants
SECAP	Social, Environmental and Climate Assessment Procedures
tCO2e	metric tons of carbon dioxide equivalent
WCA	West and Central Africa
3S	Initiative for Sustainability, Stability and Security in Africa

I. Purpose

1. This document aims to brief the Executive Board on IFAD's progress in applying the Multilateral Development Banks' (MDB) Methodology for Tracking Climate Change Adaptation Finance and the MDB Methodology for Tracking Climate Change Mitigation Finance (MDB Methodologies)[1] in projects approved between the beginning of the Eleventh Replenishment of IFAD's Resources (IFAD11) and 30 September 2020. The report highlights key lessons and challenges to inform the way forward.

II. Results at a glance

2. The IFAD11 replenishment cycle (2019–2021) committed to ensuring that at least 25 per cent of IFAD11's programme of loans and grants (PoLG) was specifically climate-focused.[2] This was intended to support IFAD members in delivering on their climate priorities and commitments, as reflected in their nationally determined contributions (NDCs) under the Paris Agreement. In order to track progress towards this target, IFAD adopted the internationally established MDB Methodologies. Given the approach selected, IFAD's climate finance is calculated on an ex-ante basis, at project design, based on the budgets of relevant components, subcomponents and activities. Climate finance is not tracked through project implementation.[3]

3. Based on the MDB Methodologies, as of 30 September 2020, IFAD11 had committed US$736 million in climate finance across 47 approved projects. Given the IFAD11 target of programming 25 per cent of the Fund's US$3.5 billion PoLG as climate finance (i.e. US$875 million), this means that only US$139 million must still be programmed to fulfil the IFAD11 commitment. Expressed on a rolling basis, 36 per cent of the IFAD11 PoLG approved between 1 January 2019 and 30 September 2020 has been validated as climate finance. Of this total, US$665 million has been identified as adaptation finance and US$71 million as mitigation finance.

III. Background

4. The Paris climate conference (COP21) in December 2015, concluded with the adoption of the Paris Agreement on climate change. Parties to the Agreement committed to three interlinked, long-term goals:

   - Limiting the increase in global average temperatures to well below 2° C, and ideally 1.5° C, above pre-industrial levels;
   - Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas (GHG) emissions development, in a manner that does not threaten food production;
   - Making finance flows consistent with a pathway towards low GHG emissions and climate-resilient development.

5. Underpinning the achievement of these long-term goals are the NDCs. These embody the priorities and commitments of individual countries to reduce their national emissions and adapt to the impacts of climate change. The Paris Agreement requires each Party to communicate and implement progressively more ambitious NDCs. Countries shared their first NDCs on their signature of the Paris Agreement. Between 2020 and 2021, a second generation of more ambitious NDCs

[1] MDBs, 2020: *2019 Joint Report on Multilateral Development Banks' Climate Finance*: www.eib.org/attachments/press/1257-joint-report-on-mdbs-climate-finance-2019.pdf.
[2] GC 41/L.3/Rev.1
[3] IFAD, like other funds, monitors climate and environment results during implementation through dedicated environment and climate indicators and impacts assessments.

is to be communicated to the United Nations Framework Convention on Climate Change.

6. With regard to the finance goal, developed countries have specifically committed to jointly mobilizing US$100 billion per annum in climate finance by 2020 and until 2025, at which point a new target of more than US$100 billion will be set. The Paris Agreement mandated developed countries to report biennially on the financial support they provide through public interventions in developing countries. At the same time, the Agreement encouraged developing countries to report regularly on climate finance and other support required and received.

7. To ensure consistent financial flows to the countries' long-term, low-carbon and climate-resilient development pathways, six major MDBs[4] have, since 2011, jointly reported annually on their programmed climate finance using the MDB Methodologies.[5] Tracking climate finance is important as it builds trust and accountability with regard to the respective commitments under the Paris Agreement and SDG 13. Using harmonized methodologies and collective data allows enhanced comparability across institutions and increases confidence that potential for double-counting has been minimized. Furthermore, tracking climate finance flows helps monitor climate-related investment outcomes.

8. Contributing to this effort, IFAD11 committed to invest at least 25 per cent of its PoLG in climate-focused activities, estimated according to the MDB Methodologies. Since early 2019, therefore, each new investment is individually screened for climate finance. Section V of this report presents the cumulative results for the 47 projects thus far approved in IFAD11.[6] Together with this commitment, all new IFAD country strategies (country strategy notes and country strategic opportunities programmes) from IFAD11 onwards must include an analysis of countries' NDCs to maximize strategic alignment between national climate priorities and IFAD's climate-focused investments.

9. Alongside IFAD's PoLG climate finance commitment, in its strategy and action plan on environment and climate change (E&CC) (2019-2025),[7] the Fund has also committed to mobilizing an extra US$500 million in supplementary climate and environment finance in IFAD11 and IFAD12, from sources outside IFAD (at least US$200 million in IFAD11).

IV. Two distinct methodologies

A. Tracking adaptation finance

10. There are important differences between tracking adaptation and mitigation finance. While mitigation activities are universal, and they (and finance associated with them) are identified based on a positive list of eligible activities, the same does not apply to adaptation activities. The highly context- and location-specific nature of climate vulnerability requires a case-by-case assessment process to define appropriate and project-specific adaptation responses. A positive list approach, based on defined eligible activities, would not be appropriate for adaptation, as it may have a restrictive or negative effect on project design. An activity that builds climate resilience in one location or project context may not necessarily deliver a positive adaptation impact in another. Instead, a three-step

[4] African Development Bank; Asian Development Bank; European Bank for Reconstruction and Development (EBRD); European Investment Bank; Inter-American Development Bank; World Bank Group. Importantly, 2019 was the first reporting year in which Islamic Development Bank data was included in the cumulative MDB climate finance figures (see *MDBs, 2020*). In addition, the joint report for 2019 also summarizes information on climate finance investments from the Asian Infrastructure Investment Bank (AIIB), although AIIB climate finance commitments were not yet included in the total MDB climate finance.

[5] Since 2019, IFAD has actively participated in the MDB Working Groups on Adaptation and Mitigation Finance tracking as an observer, engaging in technical and methodological discussions.

[6] As of 30 September 2020.

[7] E&CC strategy: http://www.ifad.org/en/document-detail/asset/39434396.
Results Management Framework: https://webapps.ifad.org/members/eb/126/docs/EB-2019-126-R-3.pdf.

approach is used to identify adaptation finance, which must be embedded in project designs. Adaptation finance is tracked only if:

STEP 1. The project's climate change vulnerability context is clearly set out.

STEP 2. An explicit statement of intent to address climate vulnerability is made.

STEP 3. A clear and direct link between the climate vulnerability context and the specific project activities is articulated.[8]

11. In addition, the adaptation methodology foresees the application of the principles of granularity and conservativeness. The former means that reported climate finance covers only those components or proportions of investments that directly contribute to, or promote, adaptation; while the latter means that when an estimate of the incremental cost for adaptation is not available, a conservative percentage of the total financing for a component or activity is assigned.

12. The systematic adoption of the MDB Methodologies is already positively influencing the design of IFAD11 investments. The existing mandatory climate risk screening, foreseen by IFAD's Social, Environmental and Climate Assessment Procedures (SECAP), satisfies Step 1 in IFAD projects. Now, designs seeking to programme climate finance must also include a clear climate rationale on the basis of this robust, location-specific climate vulnerability context and designate clear budget allocations for climate change adaptation action.

B. Tracking mitigation finance

13. Unlike adaptation, mitigation results are global and easier to measure. Where adaptation progress relies on proxy indicators that combine complex sociocultural and environmental factors, mitigation progress can be measured universally, in terms of metric tons of carbon dioxide equivalent (tCO2e) emissions avoided or reduced.

14. Mitigation finance can therefore be identified on the basis of a positive list of eligible mitigation activities by investment sector.[9] Nevertheless, to count as mitigation finance, projects must quantify GHG reduction potential of their eligible activities. They must do so by using GHG assessment tools such as the ex-ante carbon balance tool (EX-ACT) to ensure that emissions really can be reduced or sequestered in relation to the project's overall GHG footprint.

15. In line with the practice of most MDBs,[10] IFAD separates adaptation and mitigation finance strictly in its reporting while, in practice, many activities (especially in the agricultural sectors) can yield co-benefits in terms of both. While this ensures that the risk of double-counting climate finance is minimized, in IFAD's case it means that current mitigation finance is probably underestimated, given the comparatively limited coverage of GHG assessments in IFAD operations to date. However, as GHG analyses become more widespread in IFAD's portfolio, as is foreseen, mitigation finance shares are also likely to rise.

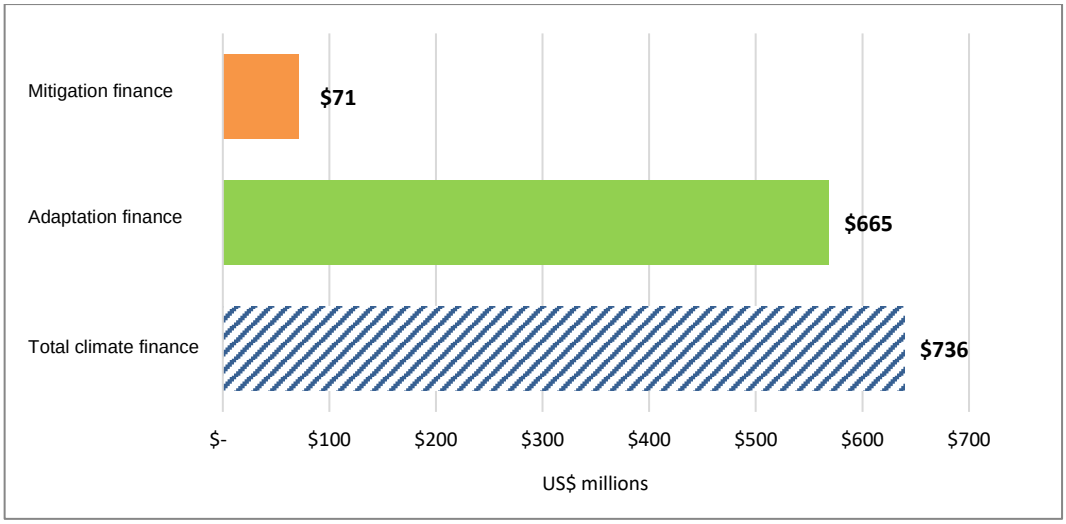
V. Climate finance in IFAD's portfolio

16. In dollar terms, IFAD11 has committed to investing at least US$875 million in climate-focused finance (at least 25 per cent of a US$3.5 billion investment portfolio). As of 30 September 2020, IFAD11 had committed US$736 million in climate finance across 47 approved projects. This means that 36 per cent of the IFAD PoLG approved between 1 January 2019 and 30 September 2020 has been validated as climate finance under the MDB Methodologies. Of this total,

[8] See annex B of MDBs, 2020 for the *Joint methodology for tracking climate change adaptation finance:* https://www.eib.org/attachments/press/1257-joint-report-on-mdbs-climate-finance-2019.pdf.
[9] See annex C of MDBs, 2020 for the *Joint methodology for tracking climate change mitigation finance:* https://www.eib.org/attachments/press/1257-joint-report-on-mdbs-climate-finance-2019.pdf.
[10] Only a few MDBs additionally consider dual benefit finance, e.g. EBRD and the Inter-American Development Bank Group.

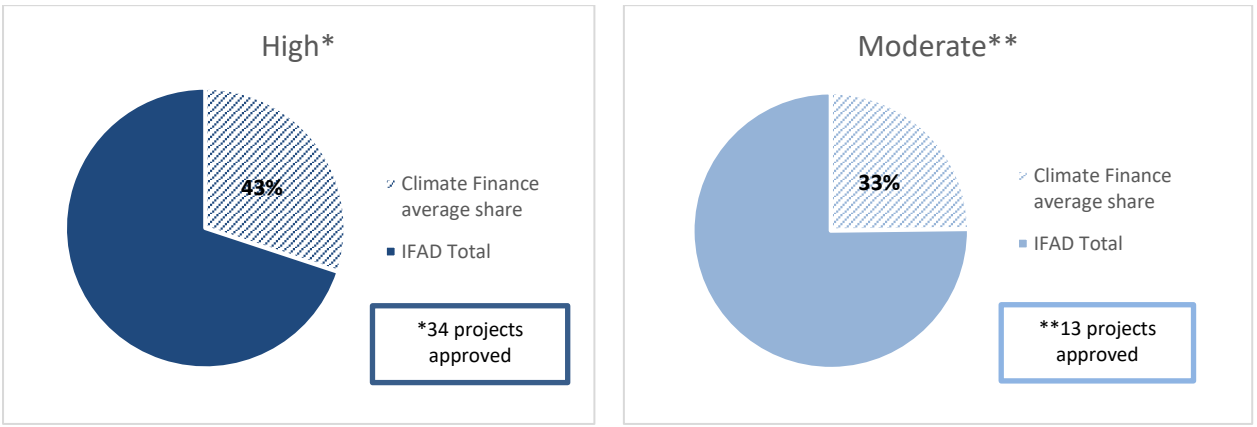
US$665 million has been identified as adaptation finance and about US$71 million as mitigation finance (figure 1).

Figure 1
IFAD11's climate finance programming (as at 30 September 2020)



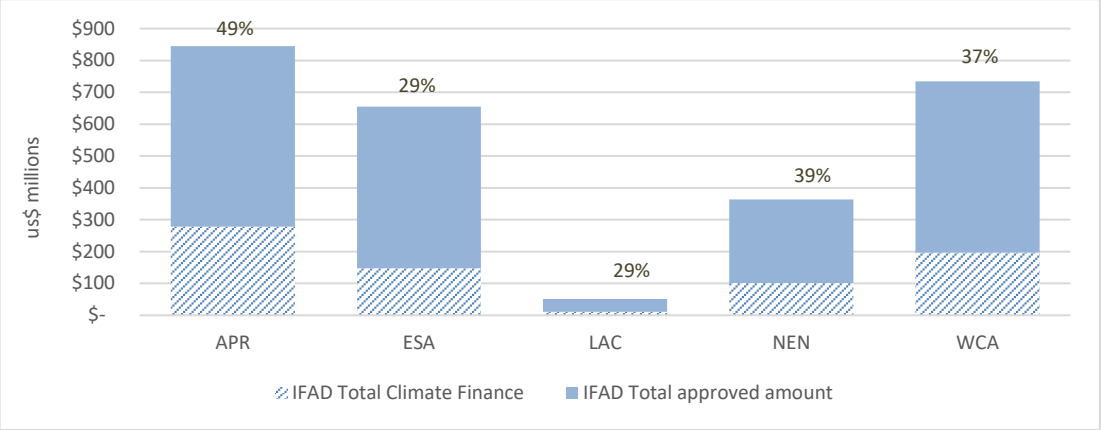
17. Figure 2 shows the SECAP climate risk classifications of the projects approved to date. The average climate finance share of projects in locations where climate risk has been classified as high amounts to 43 per cent of IFAD's total investment, while in locations of medium climate risk the average share is 33 per cent. While the comparatively higher average share of climate finance is to be expected in higher-risk areas, it should nevertheless be noted that these averages do mask wide ranges in projects' climate finance. This is because the focus of a project is not determined by climate risk exposure alone, but also responds to other priorities.

Figure 2
Average share of project climate finance by SECAP climate risk rating



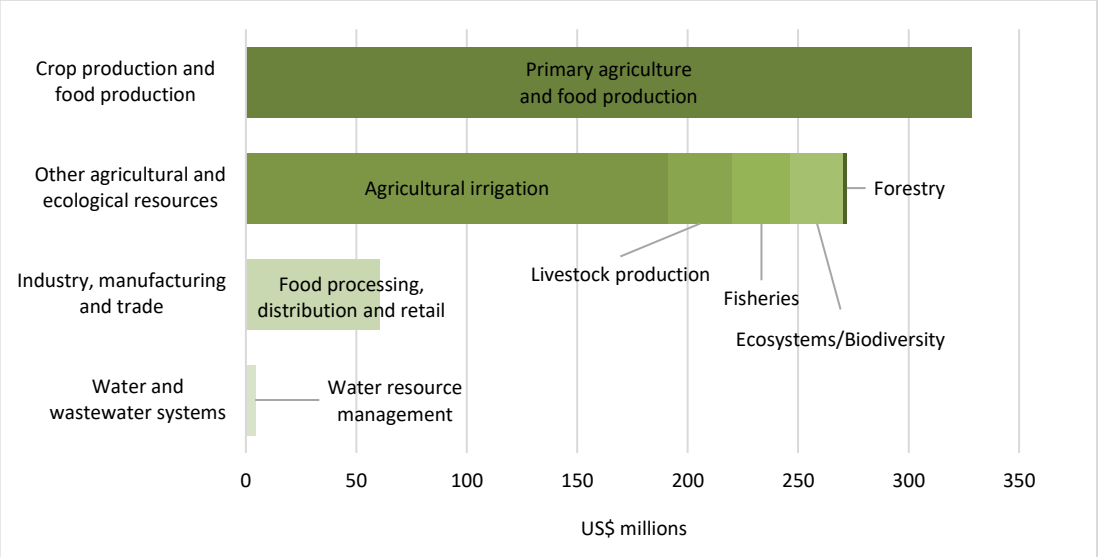
18. Figure 3 shows that most climate finance has been programmed in the Asia and Pacific Region (APR) (US$278 million) followed by West and Central Africa (WCA) (US$197 million), East and Southern Africa (ESA) (US$148 million), Near East, North Africa and Europe (NEN) (US$102 million) and Latin America and the Caribbean (LAC) (US$11 million). LAC's lower share is due to the comparatively lower volume of finance approved overall to date; however, climate finance investments represents a promising 29 per cent of the total approved, equalling ESA's investment in climate finance. Although WCA is the region where the most projects have been approved to date (15 projects), APR has the largest average share of climate finance per project (US$23.2 million across 12 projects approved).

Figure 3
Total IFAD climate finance by region vs total volume of IFAD finance approved



19. Figure 4 breaks down IFAD's US$ 665.2 million in adaptation investments by MDB adaptation sectors and corresponding subsectors.[11] To date, almost half of IFAD's entire adaptation investments (US$328.5 million) supports the crop production and food production sector. Investments in other agricultural and ecological resources (US$272 million, about 40 per cent of IFAD's adaptation finance) are distributed across five subsectors. In order of magnitude, these are: agricultural irrigation (US$191.1 million, almost 30 per cent of IFAD's adaptation investments); livestock production (US$29.3 million); fisheries (US$25.9 million) and ecosystems/ biodiversity (US$24.4 million) – each accounting for around 4 per cent of IFAD's adaptation investments; and forestry (US$1.3 million, or 0.2 per cent). In line with IFAD's specialized mandate, its adaptation investments in the MDB sector of industry, manufacturing and trade exclusively flow to food processing, distribution and retail (US$60.5 million, roughly 10 per cent of IFAD's adaptation investments). Finally, a very small portion of investments is dedicated to the MDB sector water and wastewater systems (US$4.2 million, or 1 per cent).

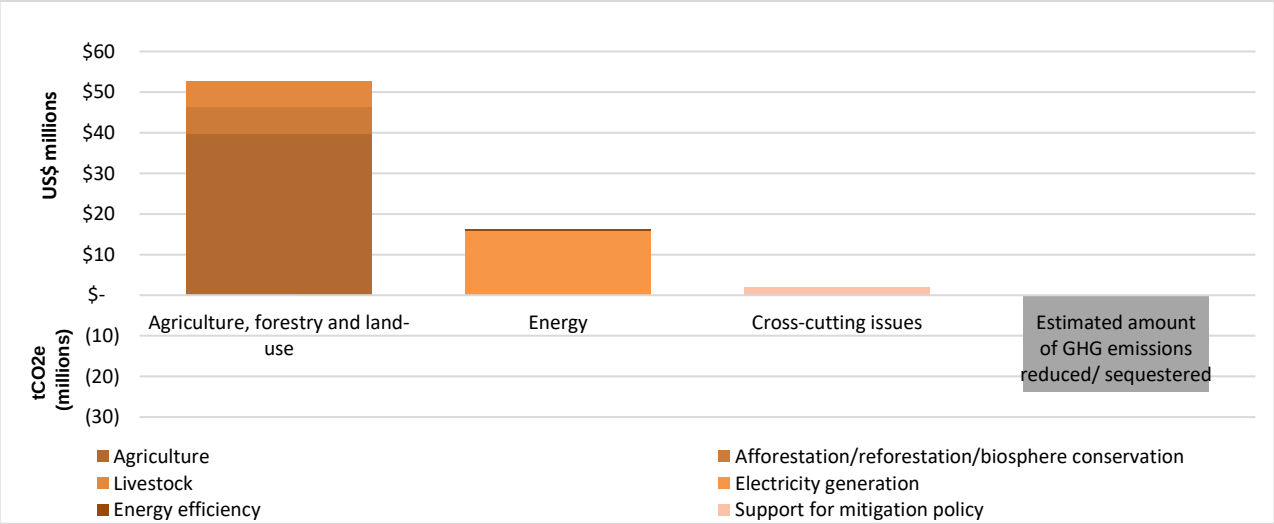
Figure 4
IFAD climate change adaptation finance by MDB sectors and subsectors



[11] For the purpose of preparing these figures, MDB adaptation sectors and subsectors are mapped at project level (not at activity level, as done for mitigation finance).

20. Regarding the US$71 million IFAD has programmed in mitigation finance to date, this sum concerns only seven projects.[12] Figure 5 presents IFAD's mitigation finance according to the categories and subcategories of the MDB Methodology on Tracking Climate Change Mitigation Finance.[13] The bulk of IFAD's mitigation investments flowed to the agriculture, forestry and other land use sector (US$52.7 million, or 74 per cent of IFAD's mitigation investments). Agriculture (crop production, for MDB purposes) contributed US$39.7 million to this total, specifically through the eligible mitigation activities of: reduced energy use in agricultural processes; reduction of non-CO2 emissions from agricultural practices/technologies; agricultural projects that improve existing carbon pools such as rangeland management, collection and use of bagasse, rice husks, or other agricultural waste; reduced tillage techniques that increase carbon contents of soil; rehabilitation of degraded lands; peatland restoration, etc. The subcategories of afforestation/reforestation/biosphere conservation (US$6.6 million) and livestock (US$6.4 million) contributed smaller amounts. IFAD's second-largest mitigation investment area was energy (US$16.3 million) with electricity generation from biogas and solar power contributing almost all of this sum – US$15.9 million. Support for national/subnational/local policies that promote mitigation action amounted to US$2 million. The total estimated GHG reduction potential of IFAD projects including mitigation finance amounts to -23.7 million tCO2e over 20 years, based on their aggregated EX-ACT analyses.

Figure 5
IFAD climate change mitigation finance by MDB category and subcategory



VI. The way forward

21. IFAD is now over a year and a half into introducing the MDB Methodologies. Climate finance tracking is now well-integrated in IFAD's design cycle, and IFAD staff has been trained and quipped to implement the MDB Methodologies with appropriate guidance and tools. Nevertheless, several new developments that will affect the implementation of the MDB Methodologies and, more broadly, climate finance programming at IFAD, are on the horizon.

[12] IFAD only counts mitigation finance in projects that include an ex-ante GHG assessment establishing the emissions reduction potential of the investment. Any adaptation investment with the potential for mitigation co-benefits that remain unquantified is counted as adaptation finance, but is flagged for its mitigation potential. During implementation, a project may wish to pursue and quantify these mitigation co-benefits.
[13] Unlike adaptation investments, which are mapped at project level, mitigation investments are mapped at activity level against a positive list of eligible mitigation activities.

22. First, the MDBs are currently finalizing an update to the MDB Methodology for Mitigation Finance Tracking. IFAD is actively involved in the subgroup on agriculture, providing technical inputs. Once the updated methodology is formally launched by the MDBs (anticipated in 2021), IFAD will adopt it too. The MDB Methodology for Mitigation Finance Tracking will continue to be revised at regular intervals, to steadily guide multilateral finance towards low-carbon development pathways that are fully aligned with the Paris Agreement's temperature goal.

23. IFAD itself is currently finalizing a revision of its SECAP (SECAP 2020), which increases the Fund's emphasis on mitigation and enhances the nexus between climate change and IFAD's other mainstreaming themes. As regards IFAD's climate ambition beyond IFAD11, IFAD's Environment and Climate Change Strategy and Action Plan (2019–2025) has already established a higher target for IFAD12: at least 35 per cent of the IFAD12 PoLG will be climate-focused.

24. Furthermore, IFAD is poised to channel larger amounts of climate finance outside the PoLG, through the ambitious Rural Resilience Programme (2RP) currently under development. The 2RP is a global initiative that will initially be based on three pillars:

    (i) The Enhanced Adaptation for Smallholder Agriculture Programme (ASAP+) which is designed to increase the climate resilience of 10 million vulnerable people, particularly women and youth, and thus pave the way for an increase in food and nutrition security. To this end, a resource mobilization target of US$500 million from climate change finance sources is envisaged;

    (ii) The Initiative for Sustainability, Stability and Security in Africa (3S Initiative), which aims to restore 10 million hectares of degraded land and to create 2 million rural jobs in five years. The target is to mobilize donor funds equivalent to US$200 million per annum over a five-year period; and

    (iii) Green Climate Fund (GCF) support for the Great Green Wall Initiative (GCF-GGWI) which aims to restore 100 million hectares of degraded land, sequester 250 million tons of carbon and create 10 million jobs.

25. Finally, IFAD's support on climate change and related climate investments will be tailored to the second generation of NDCs, which are expected to be communicated by Parties to the Paris Agreement between 2020 and 2021. The COP26 climate conference (postponed from 2020 to 2021 due to the COVID-19 pandemic) also represents a crucial milestone in the United Nations climate negotiations as a whole, as it encompasses the first "global stocktake" on climate action undertaken towards realizing the Paris Agreement's three interlinked goals since its adoption in 2015. IFAD's donor and client Members alike will be looking to fulfil their individual reporting obligations, and will be seeking to partner with financial institutions like IFAD to "build back better" through climate-focused investments towards a more equitable, sustainable and resilient world.