

# Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment of New operations

## Direct Investment Lending Operations

Version 1.0 June 2023



# **Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment of New operations**

## **Direct Investment Lending Operations**

Version 1.0 June 2023

These principles were prepared by a group of multilateral development banks (MDBs), composed of the African Development Bank (AfDB), the Asian Development Bank (ADB), the Asian Infrastructure Investment Bank (AIIB), the Council of Europe Development Bank (CEB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank Group (IDBG), the Islamic Development Bank (IsDB), the New Development Bank (NDB) and the World Bank Group (WBG).

# Contents

<b>PREFACE.....</b>	<b>4</b>
<b>JOINT MDB METHODOLOGICAL PRINCIPLES FOR ASSESSMENT OF PARIS AGREEMENT ALIGNMENT OF DIRECT INVESTMENT LENDING OPERATIONS.....</b>	<b>5</b>
<b>1. Overview and Main Principles</b>	<b>5</b>
1.1 Assessment Outcomes: Operations Considered ‘Aligned’ or ‘Not Aligned’	5
1.2 Overarching Principles: Alignment with Mitigation Goals	6
1.3 Overarching Principles: Alignment with Adaptation and Resilience Goals	6
<b>2. Explanation of the BB1 Framework (Mitigation)</b>	<b>6</b>
2.1 A Two-Pronged Approach	6
2.1.1 Uniform Assessment Criteria	6
<b>3. Explanation of the BB2 Framework (Adaptation and Climate Resilience)</b>	<b>10</b>
3.1 Decision-Making Approach and Criteria	10
<b>ANNEX TO JOINT MDB METHODOLOGICAL PRINCIPLES FOR ASSESSMENT OF PARIS AGREEMENT ALIGNMENT FOR DIRECT INVESTMENT LENDING OPERATIONS .....</b>	<b>12</b>
<b>BB1: Illustration of How to Apply the Specific Assessment Criteria</b>	<b>12</b>
<b>BB2: Illustration of How to Apply the Three Criteria</b>	<b>14</b>
<b>Glossary   Selected Terms and Definitions</b>	<b>17</b>

# Preface

The Paris Agreement and the Sustainable Development Goals (SDGs), both adopted in 2015, reflect a shared vision for sustainable development in the context of climate change, which requires scaling-up efforts to shift to a low-carbon and climate-resilient pathway while pursuing core development goals.

The Paris Agreement's stated aim is to "strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty," by keeping global warming "well below" 2°C above pre-industrial levels and pursuing efforts to stay below 1.5°C; fostering adaptation, resilience and low-emissions development without threatening food production; and making finance flows consistent with a pathway toward low-emissions, climate-resilient development.<sup>1</sup>

In 2017 and 2018 at the One Planet Summits, Multilateral Development Banks (MDBs) committed to align their financial flows with the objectives of the Paris Agreement. To ensure a consistent approach to the implementation of the Paris Alignment commitment, at the 2019 UN Secretary-General's Climate Summit, the MDBs reconfirmed their commitment to helping clients deliver on the goals of the Paris Agreement in a joint statement.<sup>2</sup>

To this end, the MDBs developed an approach for aligning activities with the Paris goals, with six building blocks: alignment with mitigation goals (BB1), adaptation and climate-resilient operations (BB2), accelerated contribution to the transition through climate finance (BB3), engagement and policy development support (BB4), reporting (BB5), and alignment of internal activities (BB6): published at COP24.<sup>3</sup>

These notes set out joint MDB methodological principles for assessment of Paris Agreement alignment, providing a common technical approach for a range of financial instruments and financing types MDBs may use, addressing both BB1 and BB2 within each. Joint MDB methodological principles have been prepared for: (i) Direct investment lending operations, (ii) Policy-based lending operations, (iii) Intermediated financing, and (iv) General corporate purpose finance. Universally aligned and universally non-aligned lists of activities were also prepared and included in a separate section.<sup>4</sup>

These joint MDB methodological principles will be used by the MDBs to inform and facilitate the Paris Alignment assessments of their new financing operations. They have been developed through piloting work that has been going on over the past two years and which will continue. Building on these joint MDB principles, MDBs may develop their own methodological guidance and toolkits<sup>5</sup> to be applied according to their internal processes and procedures to determine whether an operation is "aligned" or "not aligned" with the mitigation and adaptation goals of the Paris Agreement. MDBs will continue to work together to enable consistency and harmonization in the way the principles are applied across MDBs and update them as needed.

---

<sup>1</sup> UNFCCC. 2015. "Paris Agreement." FCCC/CP/2015/10/Add.1. Paris: United Nations Framework Convention on Climate Change. [http://unfccc.int/paris\\_agreement/items/9485.php](http://unfccc.int/paris_agreement/items/9485.php). Art. 2.

<sup>2</sup> MDBs. 2019. "High Level MDB Statement." Issued at the UN Secretary-General's Climate Action Summit, September 22, 2019. New York: African Development Bank (AfDB), Asian Development Bank (ADB), Asian Infrastructure Investment Bank (AIIB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank Group (IDBG), Islamic Development Bank (IsDB), New Development Bank (NDB), and World Bank Group (WBG). <https://www.iadb.org/document.cfm?id=EZSHARE-1729984378-16>.

<sup>3</sup> [Joint Declaration MDBs Alignment Approach to Paris Agreement COP24 Final.docx \(worldbank.org\)](#).

<sup>4</sup> The Universally Aligned List of activities includes those activities that contribute to climate action consistent with the mitigation goals of the Paris Agreement under all circumstances, and those that have no material impact on climate change, as they do not harm countries' transition to long-term low-greenhouse gas (GHG) emissions development pathways and do not lead to lock-in of carbon-intensive patterns. The Universally Non-Aligned List of activities includes those that are considered universally (regardless of context) inconsistent with countries' low-GHG emissions development pathways or incompatible with the mitigation goals of the Paris Agreement.

<sup>5</sup> Due to differing mandates, policies and strategies in MDBs there could be observable differences in the operationalisation of these principles, in which case the PA assessments will be carried out using the MDB's respective methodological guidance and toolkits. Some MDBs have already developed Paris alignment approaches building on the joint work of the MDBs over recent years and will in those cases take account of the latest joint MDB approaches during future updates.

# Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment of Direct Investment Lending Operations

This note provides methodological principles for assessing the alignment of operations with the mitigation goals (BB1) and adaptation and climate resilience goals (BB2) of the Paris Agreement. MDBs published a working draft of the note for Direct Investment Lending Operations in November 2021. This note will inform MDBs and facilitate consistency among them as they develop their own methods.

## 1. Overview and Main Principles

### 1.1 Assessment Outcomes: Operations Considered ‘Aligned’ or ‘Not Aligned’

1. An operation needs to be aligned with both mitigation (BB1) and adaptation and resilience (BB2) parts of the framework to be considered “Paris-aligned.”
2. **BB1** is the MDB approach for characterizing operations as “aligned” or as “not aligned” with the overall mitigation goals of the Paris Agreement. It focuses on whether the operation in question is consistent with a low-greenhouse gas (GHG) development pathway for that country and does not undermine a transition to a decarbonized economy, in that country and globally.
3. Many types of operations can be considered aligned with the Paris Agreement’s mitigation goals, including (i) operations that directly reduce GHG emissions; (ii) operations that generate GHG emissions, but are in line with the country-specific decarbonization pathways; and (iii) operations that do not have a material (positive or negative) impact on climate change.
4. In assessing the Paris alignment of a financed activity, the focus under BB1 is on the consistency of the type of activity in question with a low-GHG development pathway in that country, rather than the activity’s specific physical impact in terms of projected CO<sub>2</sub>e emissions. Factors to consider may include, as needed, the types and carbon intensity of technologies and infrastructure, the energy sources used, the carbon contents of materials, and behavioral choices that need to be made locally to meet decarbonization goals. Considerations may also be based on the inclusion of a financed activity within a valid long-term strategy, consistency with associated public policies, or, on the contrary, whether a financed activity reflects development patterns or public policies that would prevent long-term decarbonization.
5. The MDBs are expected to carry out these assessments in light of the information and tools at their disposal in a given time frame. This will remain an expert judgment by the MDB, based on available information, as definitive references as to what constitutes low-GHG and climate resilient development pathways in a country are often not available yet, and they are likely to be revised in the future, reflecting the evolving body of scientific and economic information available to the MDBs and their clients. MDBs will be transparent about the fact that the outcome of the assessment is based on the best available information at the time it is made. Despite these limitations, many countries are working to identify their low-GHG, resilient development pathways, and the MDBs plan to continue to support them in preparing their Long-Term Strategies (LTSS) and updating their Nationally Determined Contributions (NDCs), including through the MDBs’ work under BB4 on engagement and policy development support.
6. **BB2** is the MDB approach for characterizing operations as “aligned” or as “not aligned” with the overall adaptation goals of the Paris Agreement. Under the MDBs’ BB2 approach, operations are expected to be characterized as “aligned” or “not aligned” depending on whether they manage likely material physical climate change risks, are deemed to be consistent or inconsistent with the country’s adaptation and climate resilience strategies and plans, and, where possible, contribute to climate-resilient development pathways. The MDBs are expected to carry out these assessments with the information and tools at their disposal.

## **1.2 Overarching Principles: Alignment with Mitigation Goals**

7. Assessments under BB1 rely on countries' NDCs, low-GHG development pathways and strategies. Other studies and analyses regarding pathways considered to be in line with low-GHG development could also inform the assessment.
8. Using this framework, the MDBs will apply expert judgement to characterize whether they consider a specific operation to be "aligned" or "not aligned". In doing so, the MDBs' assessments do not constitute an endorsement of similar types of operations as "aligned" or "not aligned," nor do they make any judgment on a country' level of ambition, strategies, or priorities identified in its NDC or LTS.
9. Operations with multiple components will be assessed considering the overall objective of the operation and the alignment of each component. For the operation to be considered aligned with the mitigation goals of the Paris Agreement, all components must be aligned. The assessment is expected to be transparent regarding its extent, namely what components, technologies, and outputs were included or disregarded. Other considerations, such as geographical or time boundaries, will also be made explicit.

## **1.3 Overarching Principles: Alignment with Adaptation and Resilience Goals**

10. This assessment framework adopts a context-specific and process-based approach, in line with established good practices on climate change adaptation and resilience-building. This approach recognizes the heterogeneity of potential climate-related impacts and sets a requirement that assessments must be contextualized.

## **2. Explanation of the BB1 Framework (Mitigation)**

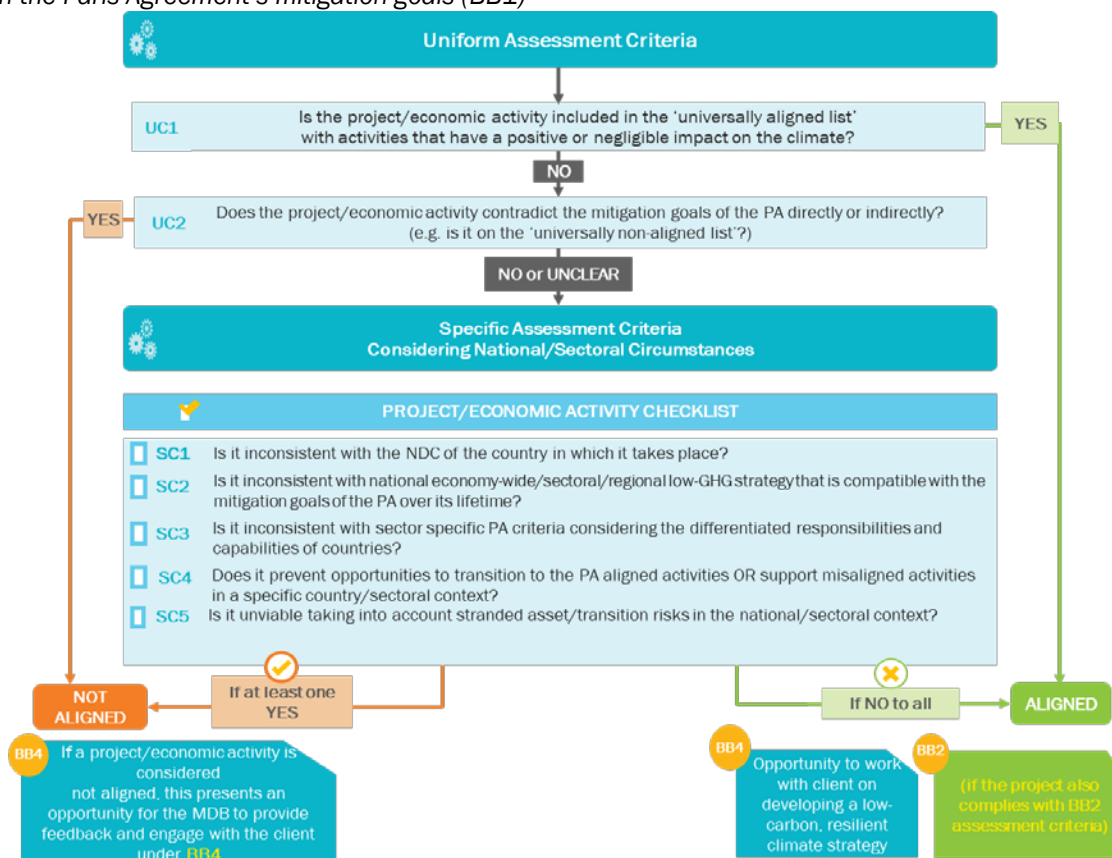
### **2.1 A Two-Pronged Approach**

11. The activity characterization framework is a two-pronged assessment approach. As illustrated in Figure 1, it includes (1) an initial screening using uniform assessment criteria that identify operations or activity types that are considered to be universally aligned or not aligned, and (2) for operations or activities that cannot be characterized through the initial screening, the application of specific assessment criteria that consider national circumstances and other operation-specific contexts.

#### **2.1.1 Uniform Assessment Criteria**

12. The uniform assessment criteria are presented as lists of activities that the MDBs currently consider to be universally aligned or not aligned with the mitigation goals of the Paris Agreement, across countries and under all circumstances.
13. An operation that supports activities included on the "universally aligned" list would generally be considered aligned with the mitigation goals of the Paris Agreement, unless one or several of its components require the use of specific assessment criteria.
14. The lists of activities considered universally aligned or universally not aligned will be periodically updated by the MDBs, moving farther away from higher-emitting activities over time to meet the goals of the Paris Agreement. Updates will also reflect the latest evolution of technologies, policies, practices, and consumer behaviour. Guidance on criteria that could be used for revising this list will be discussed among the MDBs. The lists can also be revised by MDBs based on the insights and experience they gain in testing and applying the framework.

Figure 1. Decision-making approach for determining the alignment of direct investment lending operations with the Paris Agreement's mitigation goals (BB1)



**i. Activities Considered Universally Aligned (Criterion UC1):**

15. The list of activities that are considered universally aligned is provided in a separate note. In short, it covers:

- Activities that contribute to climate action consistent with the pathways toward the mitigation goals of the Paris Agreement under all circumstances, and
- Activities that have no material impact on climate change, as they do not harm countries' transition to long-term low-GHG development pathways and do not lead to lock-in of carbon-intensive patterns.

16. Operations with activity project types included on this list will have to go through the specific criteria assessment if any of the operation's components fall under any of the following:

- Operations whose economic feasibility depends on external fossil fuel exploitation, processing, or transport activities.
- Operations whose economic feasibility depends on fossil fuel subsidies.
- Operations that rely significantly on the direct utilization of fossil fuels.

**ii. Activities Considered Universally not aligned (Criterion UC2):**

17. The list of activities that are considered universally not aligned is provided in a separate note. It covers:

- Highly emissive activities (e.g., coal- or peat-fired power plants) that are considered universally (regardless of context) inconsistent with countries' low-GHG development pathways or incompatible with the mitigation goals of the Paris Agreement; and
- Activities directly supporting coal or peat extraction that are considered as universally inconsistent with these pathways.

### **2.1.2 Overview of Specific Assessment Criteria**

18. Operations that cannot be characterized as aligned or not aligned on the basis of the uniform assessment criteria will need to be further assessed against a set of specific assessment criteria. These criteria evaluate the operation in light of the specific country circumstances and national and sectoral strategies that are likely to define that country's transition pathway(s) to low-GHG development. In many instances, especially at the early stages of implementation of this framework, information may not be available, or only be limited. However, these limitations are not expected to prevent an assessment from being carried out—it will simply be based on the information that can reasonably be obtained at that time.
19. This part of the assessment includes five specific criteria, SC1–SC5. As shown in Figure 1, if the answer is yes to any one of the five criteria, it is expected to lead to an operation or activity being characterized as not aligned.

#### ***i. How to Apply the Specific Assessment Criteria***

20. The specific criteria are presented in parallel to indicate that there is no hierarchy among them. The proposed approach is designed to complement any missing information through the application of other criteria. For instance, where a “national strategy compatible with the goals of the Paris Alignment” does not yet exist, Criterion SC2 is not expected to lead to a classification as not aligned. Instead, the activity would be deemed as aligned or not aligned on the basis of the other criteria, as long as there is not a high risk of inconsistency with the type of strategies highlighted in SC2. A “No” response to questions SC1 to SC5 can either mean that the answer to the question is “No,” or that no data were available to answer the question. It is expected that SC4 can always be answered.
21. MDBs are expected to characterize an operation as considered aligned or not aligned based on the five specific criteria. Depending on the available information, MDBs might not be able to apply some of the criteria and would focus more on the other criteria, as long as they can justify their choice to do so.

#### ***ii. Specific Assessment Criteria***

22. The sections below provide explanations of each specific criterion.

#### **SC1: Is the operation / economic activity inconsistent with NDC of country in which it takes place?**

23. This specific criterion involves checking whether the operation is “inconsistent with” the country's NDC. It will only lead to a “yes” answer (and therefore to an assessment of “not aligned”) if the NDC rules out the operation.
24. To check for inconsistency, the MDB verifies whether the NDC covers the sector or activity in question. If so, the MDB checks whether the operation is in line with the pathways laid out for that particular sector or activity. If the activity or sector is not included in the relevant strategy, then in most cases it can be concluded that the activity is not inconsistent with the strategy, and the MDB can continue applying the remaining specific criteria to determine alignment. However, there may be cases where the MDB can infer from the information available in the strategy that the activity is likely inconsistent with the strategy. As noted above, the expert judgment made by MDBs of operations should not be interpreted as a judgment or endorsement of the country's NDC or other relevant documents used in the assessment.



**SC2: Is the operation/economic activity, over its lifetime, inconsistent with country's LTS or other similar long-term national economy-wide, sectoral, or regional low-GHG strategies compatible with the mitigation goals of the Paris Agreement?**

25. SC2 assesses the operation's consistency with the country's long-term strategies and other official national, sectoral, or subnational strategies or policies (or drafts undergoing public consultations, as applicable).
26. LTSs and other relevant national, local, or sectoral low-GHG development strategies are expected to achieve long-term decarbonization, in line with the mitigation goals of the Paris Agreement. Other relevant national, local, or sectoral low-GHG emission strategies, as well as the MDB's own or other publicly available analysis, should be used to inform the assessment. The assessment follows the same approach as SC1 but applied to the LTS and other relevant low-GHG strategies.

**SC3: Is the operation/economic activity inconsistent with global sector-specific decarbonization pathways in line with the Paris Agreement mitigation goals, considering countries' common but differentiated responsibilities and respective capabilities?**

27. SC3 checks the operation's consistency with widely accepted data and findings in the global literature on sector-specific decarbonization pathways in line with the Paris Agreement's mitigation goals. SC3 applies these global studies to the country context. This can be particularly useful:
- When the lack of an LTS or similar national strategies makes an assessment under SC2 not feasible;
  - For operations in high-emitting sectors for which global Paris-compatible pathways are available; and
  - For operations that cover multiple countries or that are closely linked to international trade.
28. Sector-specific decarbonization pathways may include sector roadmaps developed by international organizations, academia, or industry associations.

**SC4: Does the operation/economic activity prevent opportunities to transition to Paris-aligned activities, OR primarily support or directly depend on non-aligned activities in a specific country/sectoral context?**

29. SC4 compares the operation to lower-carbon alternatives and considers the risks of (i) creating lock-in or (ii) preventing future deployment of Paris-aligned activities. SC4 also considers the broader impact the operation could have on the likelihood of achieving the low-GHG transition ("is the operation preventing opportunities to transition?").
30. SC4 may be informed by relevant low-GHG development pathways (same or other than those considered under SC2) and by studies carried out under BB4 or other country strategy support provided by the MDBs, as applicable.

**SC5: Is the operation/economic activity economically unviable, when taking into account the risks of stranded assets and transition risks in the national/sectoral context?**

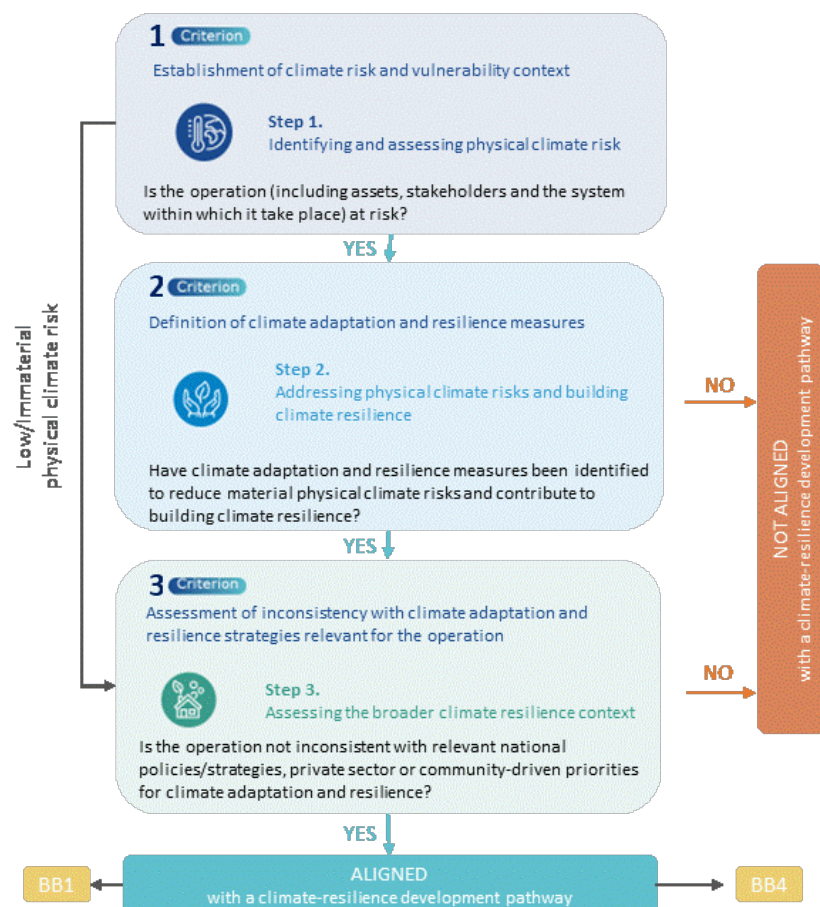
31. SC5 incorporates climate change considerations into the quantitative economic or financial analysis of the operation. This, in turn, involves monetizing, to the extent possible, the costs and benefits related to risks associated with climate change impacts and relevant climate policies. Each MDB is expected to apply the SC5 based on its internal methods and approaches.
32. An operation will be considered not aligned if it fails to meet the individual MDB's criteria for economic or financial viability once such considerations are incorporated in the analysis or in an equivalent qualitative assessment, if available. For example, the economic or financial analysis may account for the risks of an asset's lifetime being unexpectedly shortened, in particular due to climate policies (stranded assets risk). Shadow carbon prices can be a possible simplified way to incorporate climate change considerations into the economic analysis.

### 3. Explanation of the BB2 Framework (Adaptation and Climate Resilience)

#### 3.1 Decision-Making Approach and Criteria

33. The BB2 assessment framework is built around three decision steps: (i) Identifying and assessing physical climate risk: Is the operation at risk? (ii) Addressing physical climate risk and building climate resilience: Have adaptation and resilience measures been identified to reduce material physical climate risks and enhance climate resilience? and (iii) Assessing the broader context for climate resilience: Is the operation not inconsistent with relevant policies/strategies, private sector or community-driven priorities for climate adaptation and resilience?
34. The decision-making approach in Figure 2 illustrates the process for assessing the alignment of an operation with the adaptation and resilience goals of the Paris Agreement, following these three steps. The criteria and guiding questions for each decision-making approach are described below.

Figure 2. MDB Decision-making approach for determining the alignment of direct investment lending operations with the Paris Agreement's climate change adaptation and resilience goals.



#### Criterion 1: Establishment of climate risk and vulnerability context

*Purpose: Identify and assess physical climate risk—is the operation (including assets, stakeholders, and systems as relevant) at risk?*

35. The objective of Step 1 is to determine whether an MDB operation is vulnerable to climate change. At a minimum, in order to successfully move to the next step, the climate risks to which the operation may be exposed to need to be identified and assessed, following each MDB's own internal policies.

36. Criterion 1 lays out a systematic approach for identifying and assessing the physical climate risks that could affect the operation over a relevant time horizon. Depending on the project boundaries, this could refer to impacts on its assets, the services it aims to provide, associated human and natural systems (e.g., ecosystem services), or its targeted beneficiaries, and it could be over short, medium, or long-term timeframes. In identifying and assessing physical climate risks, the MDBs will consider the context within which the operation will take place; the operation's exposure, sensitivity, and overall vulnerability to climate hazards; and the need for a climate risk assessment as appropriate.
37. If the operation is deemed not to be at risk (that is, the risk is considered low or immaterial), Step 2 can be skipped, and Step 3 will be completed next. If the operation is deemed to be at risk, the assessment moves on to Step 2.

#### **Criterion 2: Definition of Climate Resilience Measures**

*Purpose: Address physical climate risks and enhance climate resilience—have climate adaptation and resilience measures been identified to manage the assessed physical climate risks?*

38. The objective of Step 2 is to ensure that climate resilience measures have been included in the operation to address or manage any material physical climate risks identified in Step 1. In order to successfully move into the next step, an operation is expected to have identified and included measures to reduce the identified physical climate risks.
39. Notably, though Step 2 aims to ensure that adaptation measures minimize risks, considering synergies, trade-offs, and opportunities to enhance overall climate resilience, it does not set a bar for adequacy, minimum response, or thresholds for residual risks. It is expected that each institution will undertake reasonable measures to address identified risks, recognizing that climate adaptation and resilience measures and their impacts will be highly contextualized in practice.
40. This step considers:
- Measures to address identified climate risk and build climate resilience.
  - The potential for maladaptation (if relevant); and
  - The documentation of the selected climate resilience response.

#### **Criterion 3: Assessment of Inconsistency with Climate Adaptation and Resilience Strategies Relevant for the Operation**

*Purpose: Assess the broader climate resilience context—is the operation not inconsistent with relevant policies/strategies and with private sector or community-driven priorities for climate resilience?*

41. The objective of Step 3 is to ensure that operations are not inconsistent with country's climate commitments/policies/strategies/plans for climate adaptation and resilience and any other climate strategies relevant for the operation. In order to successfully complete the assessment under Step 3, an operation will be expected not to be inconsistent with priorities set forth in national or sectorial policies/strategies/plans for climate resilience. This step does not make a judgment on the adequacy or appropriateness of the policies/strategies/plans for climate resilience, or of private sector or community-driven priorities within the country.
42. This step entails:
- Identifying policies/strategies/plans for climate adaptation and resilience; and
  - Assessing that the operation is not inconsistent with these policies/strategies/plans or priorities.
43. If the activity or sector supported by the operation is not captured directly or indirectly in the relevant policies/strategies/plans, the operation is not considered inconsistent.

# Annex to Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment for Direct Investment Lending Operations

## BB1: Illustration of How to Apply the Specific Assessment Criteria

As the Paris Alignment characterization of the operation has to consider its consistency in the context of a low-greenhouse gas (GHG) pathway, where relevant, the operation should be assessed in the context of the broader activity or system-level framework in which the operation is designed and will operate. The assessment should focus on the overall impact of a project, as well as the policy and regulatory landscape.

Going through the multi-criteria approach can help identify key gaps and areas of engagement with counterparts to develop or improve long-term low-GHG development and other relevant strategies. This is particularly useful when the operation takes place in a country or in several countries that have yet to develop low-GHG and climate-resilient strategies.

The sections below provide additional details for the application of each specific criterion. For an overview of each criterion, see the Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment for Direct Investment Lending Operations.

### SC1: Is operation / economic activity inconsistent with NDC of country in which it takes place?

The more aligned a Nationally-Determined Contribution (NDC) is with the long-term goals of the Paris Agreement (for instance, when the NDC is informed by a pathway to decarbonization by mid-century), and the more sectors it covers, the more robust the assessment under SC1 is expected to be.

#### Examples

If the NDC of a country says, a specific fossil fuel-powered technology should be phased out by 2035, an operation in 2025 that would support such technology with an expected lifetime of 10 or more years could be deemed to be inconsistent with the NDC, and thus not aligned under SC1.

If the NDC makes no mention of the fossil fuel-powered technology, then an operation that supports such technology is not inconsistent with the country's NDC and can go on to be evaluated under the remaining criteria.

If the NDC makes no mention of the fossil fuel-powered technology but sets up an ambitious renewable energy target that would make such technology unnecessary unless renewable energy deployment is curtailed, the assessment under SC1 would be expected to be considered together with the assessment under SC4. This could possibly lead to it being deemed "inconsistent" with the NDC and not aligned with the Paris mitigation goals.

#### References

UNFCCC NDC Registry: <https://www4.unfccc.int/sites/ndcstaging/>

Climate Action Tracker: <https://climateactiontracker.org>

### SC2: Is the operation/economic activity, over its lifetime, inconsistent with country's LTS or other similar long-term national economy-wide, sectoral, or regional low-GHG strategies compatible with the mitigation goals of the Paris Agreement?

SC2 follows the same approach as with SC1 but applied to the Long-Term Strategy (LTS) and other relevant low-GHG strategies.

The more ambitious and realistic an LTS is<sup>6</sup>, the more robust the assessment under SC2 will be. The consistency of the operation with that LTS considerably reinforces the likelihood of characterization of the operation as “Paris-aligned,” as it is then not only consistent with a plausible pathway, but with a formal country-owned strategy. LTSs can lay out a path for countries to decarbonize in a timely manner to keep global warming well below 2°C (while pursuing efforts to limit it to 1.5°C), build climate resilience, and facilitate an orderly transition for all sectors of the economy and society. With more countries developing their LTSs and updating their NDCs accordingly, the information gap in applying the SC2 is expected to be reduced.

### Examples

If the LTS says that the power sector will be carbon-neutral by year X, and the proposed fossil fuel power installation (without carbon capture and storage) is not part of the country’s least-cost decarbonization pathway with emissions constraints aligned with the LTS’ carbon-neutral target, then this operation could be deemed to be inconsistent with the LTS and be not aligned.

### References

[UNFCCC LTS Database: https://unfccc.int/process/the-paris-agreement/long-term-strategies](https://unfccc.int/process/the-paris-agreement/long-term-strategies)

National/Sector Development Plans

National Climate Action Plans

**SC3: Is the operation/economic activity inconsistent with global sector-specific decarbonization pathways in line with the Paris Agreement mitigation goals, considering countries’ common but differentiated responsibilities and respective capabilities?**

Considering countries’ “common but differentiated responsibilities and respective capabilities,” a foundational principle within the UNFCCC, means taking into account that countries are at different stages of development and have different resources and capacities that may affect their ability to decarbonize their economies in line with global pathways. As a result, an operation that would be deemed inconsistent in one country context might be deemed consistent in another context.

### Examples

An operation will finance the procurement of diesel-fueled buses. Prospective studies (such as those published by [IEA](#)) suggest that in some countries, it is feasible to electrify public transport in the near term, as a step toward decarbonization. However, the pace at which this transformation can occur depends on the country context. In countries that are more advanced in their capabilities or opportunities for electrification of transport, the transition can be faster than in countries with more limited capacity or opportunities to transition to electrified fleet for several more years.

### References

[IPCC Special Report: Global Warming of 1.5C](#)

[CD Links: Linking Climate and Development Policies – Leveraging International Networks and Knowledge Sharing](#)

[IEA Sustainable Development Scenario \(SDS\) and Net Zero Emissions by 2050 case \(NZE2050\)](#)

**SC4: Does the operation/economic activity prevent opportunities to transition to Paris-aligned activities, OR primarily support or directly depend on non-aligned activities in a specific country/sectoral context?**

SC4 may be informed by relevant low-GHG development pathways (same or other than those considered under SC2) and by studies carried out under BB4 or other country strategy support provided by the MDBs.

---

<sup>6</sup> The [high-level LTS principles](#) proposed by MDBs can support the development, implementation, and monitoring of robust, inclusive, and ambitious LTSs.



Low-GHG development pathways considered under SC4 should be consistent with the objectives of the Paris Agreement, but also consider the circumstances of the country, best available technologies, and capabilities of the client (in other words, they must be plausible).

Even before countries reach the stage of having an official LTS, interim analyses produced as part of capacity-building efforts or other country-level diagnostics, including those supported by MDBs, may represent useful inputs for assessment under SC4. The more such interim analyses comply with the principles for a robust LTS, the more useful they will be for enabling a robust assessment.

## **BB2: Illustration of How to Apply the Three Criteria**

### **Criterion 1: Establishment of climate risk and vulnerability context**

*Purpose: Identify and assess physical climate risk—is the operation (including assets, stakeholders, and systems as relevant) at risk?*

The assessment under Criterion 1 has two main parts, each with several steps that may be considered when assessing Criterion 1:

#### **1. Assessing the level of exposure and sensitivity of the operation within its boundaries**

*Establishing operation's boundaries:* A key first step is to ensure that a clear and appropriate assessment boundary has been determined based on each institution's operating policies. The boundary should primarily comprise of the physical and non-physical activities (assets, systems, services, etc.) being financed through the operation, their geographic coverage and lifetime. In case the success of the operation significantly depends on external factors, the boundaries may be expanded to consider relevant physical, economic, or social realms of reasonable impacts. Physical realms may include aspects such as conservation areas in the proximity of the operation, extent of urban expansion, or destination areas (in case of transportation projects). Economic realms could comprise the sources of raw materials or important links in the value chain. Social realms could include behavior change resulting from services being provided by the operation.

*Defining the operation's level of exposure (within its boundaries and specified timeframe) to specific climate-related hazards:* Current and future climate-related hazards relevant to the operation could be identified using existing national or regional records of historical climate hazards, and scenario-based projections of future climate. The operation's exposure to such hazards (defined by the assessment boundary) should be assessed under appropriate climate change scenarios over suitable time frames based on the nature and lifetime of activities being financed. For example, the exposure of a road upgrading project being undertaken in a flood-prone area needs to consider precipitation and flood scenarios over the lifetime of the road infrastructure (i.e., 25 years).

*Scoping the operation's sensitivity to climate change:* Once an operation's exposure is identified, its sensitivity to climate change can be determined using evidence in the existing literature, historical records, etc., of the impacts of climate change and climate variability on similar or actual operations (for instance, a specific type of infrastructure or service). For example, in the case of an operation aimed at improving the quality and management of child development services, existing records may suggest that climate hazards could disrupt home visits by educators; or in an operation aimed at capacity building, historic climate trends may show that training facilities in certain locations may not be accessible for participants during the timeframe foreseen for the trainings.

#### **2. Overall vulnerability to climate hazards and the need for a system-level risk assessment**

*Determining overall vulnerability to climate hazards within the operation's boundaries:* The impacts of relevant climate hazards on the operation depend on its level of exposure and sensitivity to such hazards. The operation's vulnerability to these hazards can be determined by considering its ability to cope with the identified impacts (i.e., adaptive capacity). An operation may require a more in-depth climate risk/vulnerability assessment to define climate resilience measures (e.g., third-party ad-hoc assessment, qualitative assessment, quantitative assessment, a detailed disaster risk assessment,

etc.). Qualitative and/or quantitative types of assessments could be used depending on the level of effort required for the type of climate risk identified (e.g., level of criticality).

*Determining the need for a system-level risk assessment:* Depending on the nature of the operation, indirect or unintended climate risks and impacts to the wider system in which it operates may be considered (based on each institution's operating policies). For example, an agricultural intensification project could worsen water scarcity for urban households in an area susceptible to drought.

## **Criterion 2: Definition of Climate Resilience Measures**

*Purpose: Address physical climate risks and enhance climate resilience—have climate adaptation and resilience measures been identified to manage the assessed physical climate risks?*

The following steps may be considered for each aspect of the analysis under Criterion 2:

### **1. Measures to address climate risks and opportunities and enhance climate resilience**

*Incorporating measures to address climate risks:* Measures incorporated into the operation to address the identified climate risks should be proportionate to the operation's vulnerability to such risks. These measures can focus on risk avoidance or on risk mitigation.

*Identifying additional opportunities to enhance climate resilience:* In some instances, an operation may support particular investments/activities aimed at increasing climate resilience. Climate resilience could be built into the entire project, rather than responding to the specific climate-related risks. An assessment of the opportunities for resilience-building presented by a changing climate and adoption of climate adaptation and resilience measures that provide wider benefits is encouraged. As such, in addition to addressing climate risks, operations could explore measures that build climate resilience, which could assist the country in moving further along a climate-resilient development pathway. For example, institutional strengthening activities being supported by an operation in a climate-sensitive realm could contribute to building adaptive capacity.

### **2. Potential for maladaptation**

*Considering the potential for maladaptation:* Trade-offs between different adaptation options could be considered, along with the likelihood of the proposed climate adaptation and resilience measures contributing to maladaptation (based on each institution's operating policies).

### **3. Documentation of selected climate responses**

*Documenting the processes or measures established for climate adaptation and resilience:* Measures related to the climate response- and related information should be systematically documented.

## **Criterion 3: Assessment of Inconsistency with Climate Adaptation and Resilience Strategies Relevant for the Operation**

*Purpose: Assess the broader climate resilience context—is the operation not inconsistent with relevant policies/strategies and with private sector or community-driven priorities for climate resilience?*

The following steps may be considered in completing those tasks under Criterion 3:

### **1. Identifying policies/strategies as well as private sector or community-driven policies for climate resilience**

*Identifying policies/strategies and private sector or community-driven priorities relevant to the operation:* The assessment can consider policies for climate adaptation and resilience that exist at the national, regional, or local level (laws, strategies, action plans such as National Action Plans, NDCs, regional/city/local plans). If applicable, private sector or community-driven priorities at the national, regional, or local level could also be considered.

*If climate resilience-related policies and priorities do not exist:* The operation could be considered not inconsistent if it would not hinder a climate-resilient development pathway for the country.

**2. Establishing that the operation is not inconsistent with these policies/strategies/plans or priorities**

The relevance and applicability of identified policies/strategies/plans at the national, local, city, regional, and territorial level, and/or private sector or community-driven priorities to the operation must be determined. The operation must assess that it is not inconsistent with those policies/strategies/plans or priorities considered relevant and applicable.



## Glossary | Selected Terms and Definitions

Operation	Financial and related operational support to specific productive activities (projects) with defined development objectives, activities, and results, entirely or partially provided by an MDB to an investee and disbursed against specific eligible expenditures (i.e., capital investment or operational and maintenance expenses). Capital investment can be provided to initiate new economic activity (e.g., operation finance of a new power plant), support existing economic activity (e.g., working capital for a farm), or finance the components of existing economic activity (e.g., energy efficiency improvements at a manufacturing facility).
Carbon lock-in	Carbon lock-in occurs when, due to technical, economic, or institutional factors associated with a given investment, an emissions-intensive asset is expected to continue to operate even after there are feasible—and economically preferable—lower-carbon options that could replace it.
Climate change adaptation and climate resilience	<p>These terms are sometimes used interchangeably, but although they overlap, they are distinct from each other and should be treated accordingly in the context of the BB2 decision tree:</p> <ul style="list-style-type: none"> <li>Climate change adaptation is the process of human and natural systems adjusting to the actual or expected impacts or effects of climate change. It includes adapting to short-term weather fluctuations, inter-annual variability, and longer-term changes over decades, and it relates to adjustments in behaviours, practices, skill sets, natural processes, and knowledge that anticipate short-, medium-, and long-term changes.</li> <li>Climate change resilience is the ability of a system to withstand climate-related shocks or stressors. It is the capacity of a system to cope with, or recover from, those effects, while retaining its essential original components. Climate resilience is an important and growing subset of building system-level resilience to multiple shocks.</li> </ul>
Climate hazards	<p>Climate hazards are physical occurrences with the potential to affect human, environmental, or economic systems. Climate hazards may be chronic or slow-onset (that is, progressive shifts in climate conditions, such as gradual reductions in annual rainfall), or acute or rapid-onset (that is, extreme weather events, such as floods, cyclones, or storms). They may result in the loss of life, physical injuries, loss of livelihoods, asset underperformance, environmental degradation, etc. The extent of those impacts depends on:</p> <ul style="list-style-type: none"> <li><i>Exposure</i>—is the operation<sup>7</sup> in a location and setting where (directly or indirectly) a slow- or rapid-onset climate hazard is expected to occur?</li> <li><i>Sensitivity</i>—to what degree can the operation be affected (directly or indirectly) by changes in climate and variability?</li> <li><i>Timeframe</i>—over what timescale could the operation, its target community, or the ecosystem potentially be exposed to a given climate hazard?</li> <li><i>Climate vulnerability</i>—to what degree is an operation, its target community or ecosystem susceptible to, and unable to cope with the adverse effects of changes in climate and variability? [Vulnerability is a function of the hazards to which an operation is exposed to, its sensitivity and adaptive capacity]</li> </ul>

<sup>7</sup> This includes a target community or an eco-system.

	<ul style="list-style-type: none"> <li>▪ <i>Adaptive capacity</i>—what capacities does the operation, or its sponsor/beneficiary have to cope with exposure to a given climate hazard?</li> </ul>
Climate-resilient development pathway	In the context of the BB2 decision tree, a country's climate-resilient development pathway is defined as a trajectory in which climate change does not prevent progress toward sustainable development goals (economic growth, human development, environmental protection, etc.) and the gains from a “new climate normal” are maximized where possible. These trajectories are continually evolving and are built on two components: actions to mainstream the development of strategies and climate risk management procedures, and incremental or transformative climate adaptation and mitigation actions to reduce human-induced climate change and its impacts.
Physical climate risk	Physical climate risk is the potential for consequences where something of value is at stake and the outcome is uncertain. It is often measured as the probability that a hazardous event or trend may occur, multiplied by the impacts that would result. Building on this, the BB2 decision tree breaks down the definition of risk into three determinants, like the Network for Green Financial Services: <i>sensitivity</i> (to physical climate hazards), <i>exposure</i> (to physical climate hazards—in a geographical sense) and <i>timeframe</i> (time span of potential exposure to physical climate hazards). In this context, “risk” refers to the potential loss of value, and “value” may be defined in the broadest possible terms: financial capital, economic capital, human capital, social capital, environmental capital, etc.