

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

General Corporate Purpose Financing

Version 1.0 June 2023



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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).

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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.¹

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.²

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 COP24.³

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.⁴

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 toolkits⁵ 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.

¹ 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. Art. 2.

² 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=729984378-16>.

³ [Joint Declaration MDBs Alignment Approach to Paris Agreement_COP24_Final.docx \(worldbank.org\)](https://www.worldbank.org/declaration MDBs Alignment Approach to Paris Agreement_COP24_Final.docx).

⁴ 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.

⁵ 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 Alignment of General Corporate Purpose Finance

This note provides methodological principles for assessing the alignment of operations with mitigation goals (BB1) and adaptation and climate resilient operations (BB2) of the Paris Agreement, by taking into account the core principles of 'Direct Investment Lending Operations' and adopts the concept into private real sector investment operations without targeted use of proceeds.

1. Core considerations

1. The Joint MDB Methodological Principles for the Assessment of Paris Alignment of General Corporate Purpose (GCP) Finance applies to direct, private real sector investment operations without targeted use of proceeds using a counterparty approach. This methodological framework may be applied to the following, amongst others:
 - a. Working capital,
 - b. Revolving credit facilities,
 - c. Trade finance through a corporate,
 - d. Supply chain finance with a corporate anchor company,
 - e. General purpose corporate loans and bonds for corporates,
 - f. Equity investments for corporates,
 - g. General guarantees which do not specify coverage to specific activities or assets.

2. Overview and Main Principles of the Joint Technical Framework

2. Where the **use of proceeds or activities to be financed cannot be identified**, Paris Alignment assessment will use a **counterparty-based approach**. Counterparty will be understood as either the legal entity⁶ that is signing the finance agreement with the MDB, or, alternatively, another party having control over the project activity, as applicable for the MDB.
3. The MDB will conduct two analyses for PA on mitigation and adaptation and resilience, respectively; an MDB operation will be considered Paris aligned if it is **aligned according to both**.

Overarching Principles: Alignment with Mitigation Goals

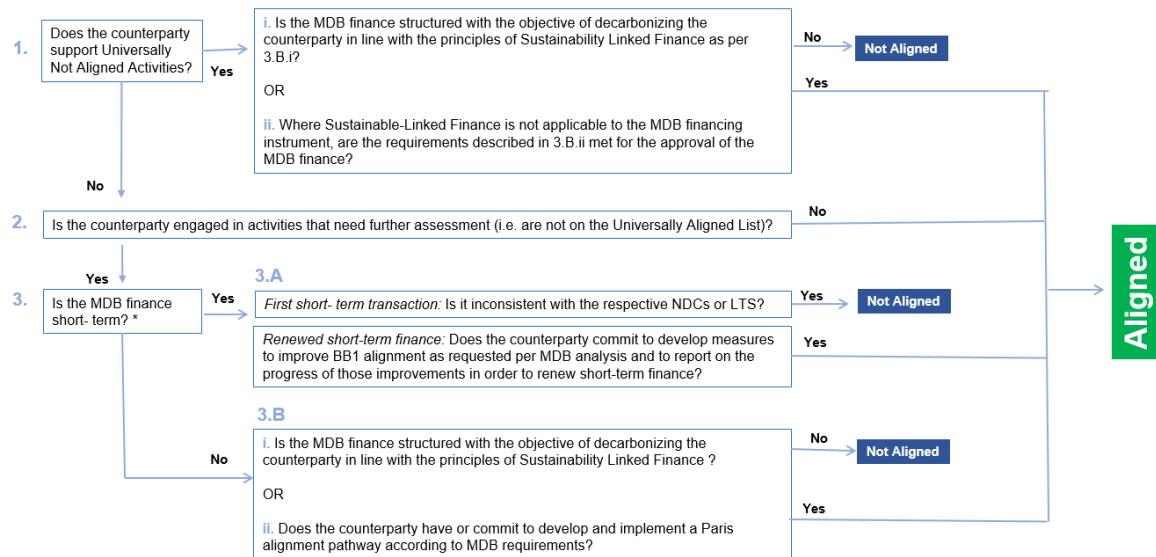
4. Given the nature of financial transactions of the real sector that are covered by this framework and understanding that money is fungible, the counterparty-based approach is informed by a two-fold focus on:
 - a. Channeling MDB financing to counterparties committed to a transition towards Paris Alignment and,
 - b. Preventing the enabling of non-aligned activities and focusing on activities that are considered material for the alignment with the mitigation goals of the Paris Agreement.

Explanation of the Counterparty-based approach for BB1

5. The MDB will follow the steps outlined below to determine if the MDB operation is aligned with the mitigation goals of Paris Agreement:

⁶ Each MDB will define the legal entity or entities that will be considered as a counterparty for this assessment depending on the complexity of the financial structure and targeting the legal entity or entities that have the control of implementing the PA pathway.

Figure 1. Decision making approach of GCPs for alignment with the Paris Agreement's mitigation goals (BB1)



1. Does the counterparty support Universally Not Aligned⁷ activities?

6. If so, the MDB finance may be considered aligned to BB1 only if (a) the MDB finance is structured with the objective of decarbonizing the counterparty in line with the principles of Sustainability-Linked Finance as described in 3.B.i. or (b) where Sustainable-Linked Finance is not applicable to the MDB financing instrument, the requirements described in 3.B.ii are met for the MDB operation to be aligned with the mitigation goals of the Paris Agreement.

2. Is the counterparty engaged in sectors or activities that need further assessment (i.e., are not on the Universally Aligned list)?

7. If not, the MDB finance is considered aligned to BB1. If a counterparty is engaged in one or more activities that are not on the universally aligned list, or in activities with potentially material transition risks, go to (3). To facilitate the assessment, the MDB assessment can focus on the illustrative list of sector/activities that would require further assessment in Annex 1.

3. Is the MDB finance short-term⁸?

8. In those cases where an operation has both long-term and short-term finance, the MDB will apply the requirements for long-term finance and skip directly to considerations in 3.B.

3.A. A first **short-term** transaction can be considered aligned, as long as it is not inconsistent with the respective countries' climate commitments, including Nationally-Determined Contribution (NDC), National Adaptation Plan (NAP), and Long-Term Strategy (LTS) (if available) and other relevant strategies⁹. The MDB will require an improvement of alignment on mitigation to renew short-term financing and consider the MDB finance Paris aligned on mitigation. The MDB will conduct an analysis of the counterparty's context, scope of activities, and will request improvements according to the sub-sector and differentiated responsibilities and capabilities. If the counterparty commits to develop measures to improve alignment on mitigation as requested per MDB analysis to renew short term finance, then the MDB finance can be considered aligned on mitigation.

⁷ This refers to the list of activities referenced in the Joint MDB Assessment Framework for Paris Alignment for Direct Investment Lending Operations. The list may be updated periodically as needed. A company that engages in an activity considered universally not aligned may still receive direct finance for the transition towards a Paris aligned business model.

⁸ As defined by each MDB's accounting rules. If multiple MDBs provide finance to the same counterparty they would need to apply a common definition of short term.

⁹ As outlined in the Joint MDB Assessment Framework for Paris Alignment for Direct Investment Lending Operations.

3.B. If financing is **long term**, in order to be considered Paris aligned to BB1 the transaction must either:

- i. Be structured with the objective of decarbonizing the counterparty in line with the principles of Sustainability-Linked Loans and Bonds on a timeline consistent with the goals of the Paris Agreement. Therefore, the counterparty must set ambitious targets attached to the transaction to substantially reduce the carbon intensity of their operations and phase down fossil fuels during the tenor of MDB finance AND contribute to reach net zero greenhouse gas (GHG) emissions by mid-century. It is recommended that the process be subject to independent external review and verification. The International Capital Market Association Sustainability-Linked Bonds and/or Loan Market Association Sustainability-Linked Loan Principles may be taken as a reference; **OR**
- ii. The counterparty must have or commit to develop and implement a Paris alignment pathway during the tenor of the MDB finance. Additionally, the counterparty must report to the MDB periodically on the progress of development and implementation of the pathway. The MDB will decide on a way to assess the counterparty and its context and establish requirements for the pathway's scope based on the materiality of the sectorial mitigation levers and implementation timeline considering the counterparty's sector decarbonization pathways, country Nationally-Determined Contributions (NDCs) and Long-Term Strategy (LTS), country context and capabilities, amongst others. The pathway at a minimum shall cover:
 - a. A decarbonization plan aligned with sectoral and country-wide decarbonization pathways that specifies measures to be undertaken within the tenor of the MDB finance, to be presented to the MDB according to the MDBs required timeline and including:
 - A mid-term, rolling, quantitative emission reduction target where accounting methodologies are available.
 - Descriptions and/or assessments of commercially available decarbonization solutions, to contribute to achieve maximum decarbonization up to net zero emissions towards mid-century.
 - Internal management procedures to implement the pathway.
 - Consider scope 3 GHG emissions within the decarbonization plan, where possible, and if scope 3 emissions are considered significant.
 - b. Address carbon lock-in and stranded asset risks if applicable.
 - c. Address the risk of expansion or promotion of expansion into areas of high carbon stocks or high biodiversity areas if applicable.

Overarching Principles: Alignment with Adaptation and Resilience Goals

9. 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 the counterparty manages material physical climate change risks.
10. MDBs will adopt a supportive, ‘enabling’ approach towards physical climate risk management, engaging with counterparties to help build readiness and capacity for physical climate risk management where appropriate.
11. A key issue to be assessed by the MDB is whether the counterparty has processes in place to identify and consider the materiality of physical climate change risks, and whether this is translated into risk management procedures that inform strategic and operational decision making.

12. With the information and tools at their disposal, the MDBs are expected to assess the materiality of the counterparty's exposure to climate risks and the adequacy of the counterparty's climate risk management processes.

Explanation of the Counterparty-based approach for BB2

13. The MDB will follow the steps outlined below to determine if the MDB finance is aligned with the adaptation goals of the Paris Agreement:

Table 1. Steps to determine if the MDB finance aligned with the adaptation goals of the Paris Agreement

MDB Finance Characteristics	Assessment by MDB	Climate Risk Management Processes	Reporting on climate risk
Short term	None is required prior to approval	None is required at approval	Counterparty to report any material exposure to climate risk after approval and throughout the tenor of the MDB financing. If material exposure is identified, for the renewal of short- term finance the counterparty shall establish or commit to establish climate risk management processes.
Long Term Low or immaterial risk	MDB assesses material climate risk.	None is required at approval	Counterparty to report any material exposure to climate risk throughout the tenor of the loan. If material exposure is identified, the MDB shall require the counterparty to establish processes to manage climate risk.
Long term NOT low or immaterial risk, or Unknown (If MDB cannot determine materiality prior to approval)	MDB will assess if the counterparty has adequate processes in place to manage material risks.	When applicable counterparty shall develop and implement processes	Counterparty to report on progress in developing and implementing processes. Counterparty to report any material exposure to climate risk throughout the tenor of the loan.

1. Is the finance provided by the MDB to the counterparty short-term¹⁰?

14. If so, in order for the operation to be aligned with BB2, the counterparty shall commit to report ex-post the occurrence of any climate impact or material climate risk¹¹ throughout the tenor of the MDB finance. This would allow the MDB to identify if there are any material climate risks that need to be addressed for the renewal of the short-term finance. If during the tenor of the MDB finance material climate risks are identified, then the MDB shall request the counterparty to develop and implement a risk management process commensurate with the risk in order for the short-term renewal to be aligned with BB2.

2. Is the climate risk low or immaterial?

¹⁰ As defined by each MDB's accounting rules. If multiple MDBs provide finance to the same counterparty they would need to apply a common definition of short term.

¹¹ For example, the counterparty shall report if their supply chain or if their own production was affected by a severe drought.

15. To assess material exposure, where it is practical, the MDB may determine the climate risk exposure by applying its own tools. If there are no material risks identified and therefore climate risk management procedures are not deemed necessary at the moment of approval of the operation, the MDB will request the counterparty to periodically review its exposure and report to the MDB any material changes in exposure to physical climate risk during the tenor of the MDB finance, unless applicable regulations do not allow for it. If during the tenor of the MDB finance material climate risks are identified, then the MDB shall request the counterparty to develop and implement a risk management process commensurate with the risk.

- 3. Does the counterparty have adequate processes in place to manage any material climate risks?**
 - a. If prior to approval the climate risk exposure of the counterparty is not considered low or immaterial or if the climate risk cannot be determined by the MDB due to the complexity of analysis¹², then the MDB will assess if the counterparty has adequate processes in place to manage material climate risks.
 - b. If the counterparty has processes in place the MDB will assess if these are adequate based on the MDB's own frameworks and policies, considering whether these processes allow to both identify material exposure and vulnerability based on their activities and operations as well as mitigate the risk where possible and necessary.
 - c. If the climate risk management processes are adequate, the MDB will consider the counterparty to be BB2 aligned. The counterparty shall report to the MDB regular progress on the CRM and, to the best effort possible, notify the MDB of any material exposure changes during the tenor of the MDB finance, unless applicable regulations do not allow for it.
 - d. If there are no adequate processes in place, and where it is practical, the MDB will determine the climate risk exposure and request the counterparty to: i) put climate risk management processes in place; and ii) regularly report to the MDB on progress made in developing and implementing processes, unless applicable regulations do not allow for it. The degree and scope of these requirements will be commensurate with the level of materiality and risk. The MDB will establish the criteria for the establishment and/or gradual improvement of processes that lead the counterparty towards BB2 alignment. Each MDB will determine a timeline for the developing and establishment of the climate risk processes.

¹² This may be the case for example of counterparties that have multiple assets in multiple locations or where there is lack of information regarding supply chain aspects.

Annex 1: Illustrative list of high-emitting sectors that require further assessment under Step 2 of the Counterparty-based approach for BB1

A counterparty that is engaged in any of the below activities or sectors will require a further assessment:

1. Fossil fuel-dependent industries and activities: Operations whose economic feasibility depends on external fossil fuel exploitation, processing, and transport activities; Operations whose economic feasibility depends on existing fossil fuel subsidies; Operations that rely significantly¹³ on the direct utilization of fossil fuels.
2. Fossil fuel-based industries: gas production, oil and gas distribution, power generation, heat supply.
3. Energy-intensive industries or high emission industrial processing: chemicals, hydrofluorocarbons (HFCs), iron and steel, pulp and paper, non-ferrous metals (e.g., aluminum, copper), non-metal minerals (e.g., cement, lime, glass)
4. Aviation: understood as aircraft manufacturing and operations, aircraft leasing, airline operations, airport operations, air-freight transport of goods and products.
5. Shipping¹⁴ and other forms of transport¹⁵ as core business.
6. Animal products: ruminant livestock supply chain and non-ruminant livestock with non-negligible GHG emissions, both including feed supply (related to 7).
7. Sectors or activities that may directly lead to expansion or promote expansion into areas of high carbon stocks or high biodiversity areas (e.g., soybean, palm oil, sugar, cacao, wood products, buildings, among others)¹⁶.

¹³ To be defined by the MDB in terms of the specific production conditions of the counterparty.

¹⁴ For example, shipping companies or companies that depend on shipping for their business model.

¹⁵ For example, car rental companies.

¹⁶ Excluding counterparties that have third party certification or evidence that they are not expanding or promoting expansion into areas of high carbon stocks or high biodiversity areas.