

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

Policy-based Lending Operations

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 (IDB), 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/en/publications/joint-declaration-mdb-s-alignment-approach-paris-agreement-cop24).

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 Agreement Alignment of Policy-based Lending Operations

This note provides methodological principles for assessing the alignment of operations with the mitigation (BB1) and adaptation and climate resilient (BB2) goals of the Paris Agreement. The note takes into account the core principles of Direct Investment Lending Operations⁶ and extends the concept to operations where financial flows support national and sub-national programs of policy reforms and institutional actions that promote growth, poverty reduction and sustainable development through Policy-based lending operations (PBLs).

1. Overview and Main Principles

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

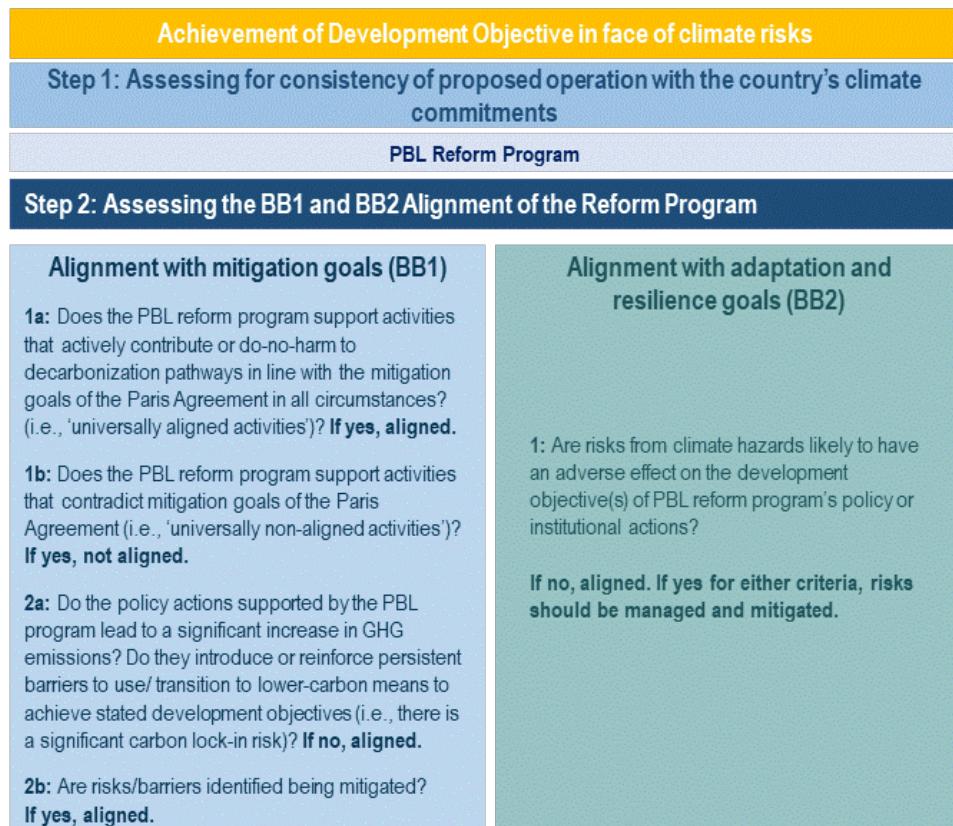
1. An operation needs to be aligned with both the mitigation and climate adaptation and resilience goals of the Paris Agreement to be considered “Paris-aligned.” There are separate sets of questions for assessing the alignment of PBL operations with mitigation and climate adaptation and resilience goals. The outcome of a PA assessment is “aligned” or “non-aligned”.
2. Section 2 describes the two-step PA methodological principles for assessing alignment of PBL operations with the goals of the Paris Agreement. Section 3 outlines the first step, which consists of assessing whether the reform program supported by the PBL operation is consistent with the country’s national commitments and priorities on climate, while Section 4 describes the approach for assessing the alignment of the policy or institutional actions supported by the PBL operation with the mitigation (BB1) goals and climate adaptation and resilience (BB2) goals of the Paris Agreement.
3. Section 4.1 describes the approach for assessing alignment with mitigation goals (BB1). An operation is considered aligned with the Paris Agreement’s mitigation goals when it either (i) actively contributes to decarbonization in all circumstances by reducing greenhouse gas (GHG) emissions or increasing sinks (e.g., renewable energy), (ii) has no impact on decarbonization as it has negligible GHG emissions (e.g., school curriculum development) or (iii) generates GHG emissions but is consistent with the country’s decarbonization pathways, which are compatible with the Paris Agreement goals, and it has a low risk of locking in emissions-intensive patterns. An operation is considered not aligned on climate mitigation when it supports activities that contradict the mitigation goals of the Paris Agreement, and/or leads to a significant risk of carbon lock-in when compared to lower-carbon alternatives considering national circumstances and capabilities.
4. Section 4.2 describes the approach for assessing alignment with the climate adaptation and resilience goals of the Paris Agreement (BB2). Operations are characterized as “aligned” with climate adaptation and resilience goals when the design reflects climate resilience/adaptation good practices responding to current or future physical climate change effects⁶.
5. MDBs are expected to carry out these assessments considering the information and tools at their disposal. The assessment outcomes will remain an expert and – to a certain extent – subjective and dynamic judgment, based on available information at a given point in time that may change, as strategies to implement a country’s low-carbon and climate resilient development pathways are often not available yet. Despite these limitations, many countries are working to identify their low-carbon, climate resilient development pathways, and MDBs plan to continue to support them in preparing their Long-Term Strategies (LTSs) and updating their Nationally-Determined Contributions (NDCs).

⁶This definition recognizes that some physical climate risks cannot be fully mitigated and are beyond the scope of Paris Alignment.

2. Explanation of the MDB Principles for Assessment of PBLs

6. PBL operations support national and subnational programs of policy reforms and institutional actions that promote growth, poverty reduction and sustainable development. Financing is made available as non-earmarked general budget financing, upon satisfactory implementation of a policy and institutional reform program that consists of a set of policy or institutional actions to achieve certain results. PBL operations have broad potential impact in the country, given their scope is at the sector or country level and that budget support is unearmarked.

Figure 1. Assessing alignment of PBLs with Paris Agreement goals



7. The PBL PA assessment consists of (i) ensuring that the broader PBL engagement is not inconsistent with the country's commitments on climate change as articulated in its NDC, Long-Term Strategy (LTS), National Adaptation Plan (NAP) or equivalent documents, and (ii) assessing the alignment of the reform program supported by the PBL operation with mitigation (BB1), and climate adaptation and resilience (BB2) goals (Figure 1).

3. Step 1: Assessing Consistency of the PBL-supported Government reform program with the Country's Priorities on Climate Change

8. This first step consists of ensuring the PBL engagement supporting the government program is not inconsistent with the country's priorities on climate change and does not hinder the achievement of national climate goals and commitments for achieving the goals of the Paris Agreement.

9. While commencing a PBL engagement in a country, the Government and the MDB team should discuss the reform program to be supported by the PBL so as to ensure that it is not inconsistent with the country's NDC (the most recent NDC submitted to the UNFCCC) and its National Adaptation Plan (NAP) (if available) and with the country's long-term decarbonization strategy (LTS)

(if available), as well as MDB's own or other publicly available analysis. This dialogue should inform the structuring of the reform program/selection of policy or institutional actions.

10. If the above analysis concludes that there may be inconsistencies between the reform program supported by the PBL engagement and any of the country's NDC, LTS or NAP, the PBL will be considered 'Not Aligned' and as such, should not be supported by the MDB 'as is'. The government and the MDB would be expected to continue working on the design of the proposed PBL engagement.
11. If the policy and institutional reforms under the PBL program are not captured directly or indirectly in the relevant strategy, and therefore its consistency is inconclusive, the task team can proceed to the next step.

4. Step 2: Assessing the BB1 and BB2 Alignment of the Reform Program

12. This second step entails assessing the alignment of the reform program supported by the PBL operation with mitigation (BB1) and climate adaptation and resilience goals (BB2) of the Paris Agreement. For a PBL operation to be considered "Paris-aligned", the reform program should be aligned with both mitigation and climate adaptation and resilience goals.⁷

4.1 Principles for Assessing Alignment of the reform program with Mitigation Goals (BB1)

14. Principles for assessing the alignment of the reform program with mitigation goals are twofold:

I. STEP 1

Criterion 1a: Does the PBL reform program consist of policy actions that support activities that actively contribute or do-no-harm to decarbonization pathways in line with the mitigation goals of the Paris Agreement in all circumstances? (i.e., 'universally aligned activities')?

13. If the PBL reform program consists of policy actions that only support activities that are considered *universally aligned*, the reform program is considered *aligned with mitigation goals*. Universally aligned activities are defined by the universally aligned list and its eligibility conditions and comprises:

- Activities that actively contribute to decarbonization pathways in line with mitigation goals of the Paris Agreement under all circumstances and in all countries (for example, renewable energy, electric and non-motorized urban mobility); and
- Activities that do-no-harm to decarbonization pathways in line with the Paris Agreement mitigation goals under all circumstances and in all countries (for example: cash transfer schemes).

14. If the reform program consists of one or more policy actions for which the response is 'no', the assessment continues to criterion 1b.

Criterion 1b: Does the PBL reform program consist of policy actions that support activities that contradict the mitigation goals of the Paris Agreement (i.e., 'universally non-aligned activities')?

15. Criterion 1b determines if the PBL reform program comprises policy actions that provide support to activities that contradict the Paris Agreement's mitigation goals under all circumstances, as defined by the universally not-aligned list. If the PBL reform program has policy actions that support activities that are considered universally not-aligned⁸, the PBL program is considered *not aligned with mitigation goals*.

16. If the response is 'no', the assessment continues to Step 2.

⁷ The criteria outlined below may not be relevant for reform programs in certain policy areas (e.g., civil service reform). In such cases, the response to the relevant criteria could be 'not applicable' supported by a transparent justification, and the assessment can proceed to the subsequent criteria. Reform programs for which all criteria are 'not applicable' can be considered Paris Aligned.

⁸ This currently includes mining of thermal coal and peat, electricity production from coal and peat.

ii. STEP 2

Criterion 2a: Do the policy actions supported by the PBL program lead to a significant increase in GHG emissions? Do they introduce or reinforce persistent barriers to use/ transition to lower-carbon means to achieve stated development objectives (i.e., there is a significant carbon lock-in risk)?

17. Criterion 2a assesses if the PBL reform program comprises policy actions that are likely to result in significant GHG emissions. It also determines if the reform program supports policy actions that introduce or reinforce persistent barriers to use /transition to lower carbon means in support of the development objective(s). If the program favors a significant increase in GHG emissions and also introduces or reinforces barriers to the low-carbon transition, then there is a risk of carbon lock-in.
18. If the response to this criterion is ‘no’ for all relevant policy actions, the PBL reform program is not expected to lead to carbon lock-in. It is considered *aligned with mitigation goals* and no further assessment is needed. If the response is ‘yes’ for one or more policy actions, the assessment continues to criterion 2b.

Criterion 2b: Are risks identified being adequately mitigated?

19. If there are substantial risks that PBL-supported policy actions would lead to carbon lock-in, these risks would need to be identified, managed and mitigated, given the sector and country context and the operation’s development objective, taking account of low-GHG development pathways consistent with the objectives of the Paris Agreement. Addressing these risks can be done through existing country systems. If the country’s system has any major shortcoming, risks identified can be mitigated through adjusting the relevant policy or institutional actions; or other means to mitigate the risks.
20. If the risks for relevant policy actions under the PBL-supported program are adequately managed and mitigated, the PBL operation is assessed as aligned with climate mitigation goals. If the risks are not managed or mitigated, the policy action is not aligned with mitigation goals and should not be supported by the PBL.

4.2 Assessing Alignment of the PBL Reform Program with Adaptation and Resilience Goals (BB2)

21. A PBL operation is aligned with climate adaptation and resilience goals when its design incorporates fit-for purpose resilience features responding to risks from current or future climate change impacts. To assess this, the following question is asked:

Criterion 1a: Are risks from climate hazards likely to have an adverse effect on the development objective(s) of the PBL reform program’s policy actions?

22. The design of a policy action may not fully consider the country’s vulnerabilities to climate hazards to achieve the PBL development objective. This risk should be assessed in the context of the country, and in particular taking into account any relevant country systems and institutional capacity which may inform the level of risk. Unintended adverse effects from a PBL reform program on a country or sector’s vulnerability to climate hazards should be identified, managed and mitigated, which may be addressed through existing policies applying to PBLs in each institution.
23. If the effectiveness of all the policy actions is unlikely to be significantly impacted by risk from climate hazards, the PBL reform program is considered *aligned with adaptation and resilience goals*. If it is likely for one or more policy actions, the assessment continues to Criteria 1(a).

Criterion 1b: If yes, does the design of the policy action(s) reduce the risk to an acceptable level, considering climate resilience/adaptation good practices?

24. If policy actions' contribution to the PBL reform program development objective(s) is at risk, the MDB should confirm that the design reflects climate resilience/adaptation good practices mitigating the risks from current or future climate change impacts to ensure the satisfactory achievement of the overall PBL development objective.

25. Addressing climate risks associated with a PBL reform program can be done through existing country systems. If the country lacks such a system or the country's system has any gaps, risks identified can be mitigated through adjusting the relevant policy action; including additional policy actions, or other measures outside the PBL operation, that may be supported for example by technical assistance or investment projects (by the MDB or other development partners for example).