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OXFAM



Submission on the IFC Green Equity Approach to Financial Institutions

15 May 2019

We welcome the invitation to comment on the IFC’s Green Equity Approach, which represents an important opportunity for the World Bank Group to address the climate impacts of its indirect investments through financial intermediaries.

We welcome the initiative of IFC to “green” its equity investments in financial institutions, which will set an example for other international and national financial institutions. Given the urgency of action to avoid catastrophic climate change, we urge IFC to be bolder in its goals, and to be driven by science-based targets¹ to ensure warming does not exceed 1.5 degrees Celsius.

To achieve these goals, it is important to make firm, clearly defined commitments that are enshrined in IFC policy as well as practice so that these commitments remain a priority at all levels of the institution. These are important first steps toward what should be a progressively stronger approach to addressing the climate crisis and should be viewed as a strong foundation on which more ambitious commitments can be built.

- 1. Application to all fossil fuels:** While it is welcome that the draft strategy for consultation addresses coal, any green equity approach needs to address all fossil fuel exposure, including oil and gas.

¹ See: <https://sciencebasedtargets.org>

- It is welcome that the draft strategy for consultation states that “the work with clients on reducing coal exposures will also lay the foundation for managing other climate related risks. IFC intends to help banks manage and reduce climate-related risks as close as possible to zero by 2030, with specific interim targets to decrease exposures to coal.” However, the proposed approach is not aligned with this stated goal. In order to reduce climate-related risks to zero by 2030, oil and gas exposure should be integrated into IFC’s phased approach now. This should include immediate commitments on tracking and disclosure of upstream oil and gas exposure, as well as integrating actions on midstream and downstream assets into later phases.
- We reiterate our call for the IFC Green Equity Approach to uphold the World Bank Group commitment to phase out upstream oil and gas after 2019. A suitable first step for this could be for the IFC to begin tracking financial intermediary (FI) clients’ exposure to upstream oil and gas, and to incorporate a reporting requirement on upstream oil and gas exposure in legal documents with all new FI clients, as is now being done for coal exposure. Disclosure of these investments is an important prerequisite to the IFC’s stated goal of eliminating climate-related risks by 2030, and critical for financial risk management from both a non-climate and climate perspective.
- Further expansion of oil and gas production and the infrastructure that facilitates this expansion - whether in the upstream, downstream, or midstream segment - is no longer compatible with the Paris Agreement. The IPCC Special Report on Global Warming of 1.5°C (SR15) is clear: in order to have the best chance of limiting warming to 1.5°C, greenhouse gas emissions must decline rapidly, falling 45% from 2010 levels by 2030, and reaching net zero by 2050. The implications of this for oil and gas were shown in a 2016 report by Oil Change International and updated in a more recent report.^{2,3} These analyses demonstrate that even if coal mining were immediately phased out, the emissions from the oil and gas in already operating fields alone would result in more than 1.5°C of warming. When considering coal as well as oil and gas, the potential carbon emissions in the world’s already operating fields and mines threaten to take us beyond 2°C. Given this, it is not sufficient from a risk management or Paris Alignment standpoint to limit the IFC’s green equity approach to coal investments at this time.
- If the IFC is to align with Paris Agreement, then it must integrate the phase out of upstream oil and gas investments, as a first step towards drawing down the exposure of its FI clients to oil

² Greg Muttitt, “The Sky’s Limit: Why the Paris Climate Goals Require a Managed Decline of Fossil Fuel Production,” Oil Change International, September 2016. <http://priceofoil.org/2016/09/22/the-skys-limit-report/>

³ Kelly Trout, “Drilling Towards Disaster: Why US Oil and Gas Expansion is Incompatible with Climate Limits,” Oil Change International, January 2019. <http://priceofoil.org/2019/01/16/report-drilling-towards-disaster/>

and gas investments more broadly. This is important because the world already has more than enough fossil fuels to push us well beyond the globally-agreed limit of well below two degrees Celsius⁴. Estimates of fossil fuel resources are highly uncertain, but some estimates have found that if the world's fossil fuel resources were fully extracted and burned, this could raise global temperatures by over 6 degrees of warming⁵ – a catastrophic level. The insurance giant AXA recently said it will stop insuring controversial oil pipelines and tar sands⁶ – a milestone which has arguably taken fossil fuel divestment to the next level. Meanwhile, the insurance giant Swiss Re has also limited its underwriting of shale gas, tar sands and Arctic drilling projects⁷. The Asian Development Bank (ADB)'s policy from 2009 states: “as oil is an internationally traded commodity with established private sector involvement, ADB will not, in general, fund oil field development projects”⁸. There is little case for IFC to be indirectly supporting projects that pose such fundamental financial, economic, social and governance risks.

2. Debt investments, ring-fencing and convertible loans

➤ The lack of transparency and accountability around the so-called ring-fencing of debt investments in FIs continues to be a major concern. This is important given IFC's claim in the Green Equity approach paper that, with the exception of “a small percent of sub-debt investments,” all loans to FIs are ring-fenced. In its Third Monitoring Report of IFC's Response to the FI portfolio audit⁹, the CAO found that in the vast majority of the SME targeted FI investments that CAO examined, IFC's legal agreement with the FI fails to actually ring fence the use of funds, even when it purports to do so on its public project portal. Of a sample of 28 such investments that CAO looked at, only 10 had legal agreements that actually limited the use of funds and only 3 of those 10 included a mechanism that would also allow traceability of IFC funds to ensure that they were actually used only for SMEs. The CAO views both of these conditions (legally restricted and traceable) as necessary for a loan to be considered ring-fenced.

➤ While we appreciate IFC's assurances that ring-fencing has become more robust in investments made after those examined by the CAO, IFC's public disclosures about ring-fencing and use of proceeds on the project portal must be independently evaluated and subject to compliance testing by the CAO. The development effectiveness of these investments should also be evaluated by the Independent Evaluation Group to determine whether they are achieving their intended purpose and not freeing up funds for FIs to expand their financing of fossil fuels and other harmful activities.

⁴ <https://www.nature.com/articles/nature14016>

⁵ <https://www.nature.com/articles/nclimate3036>

⁶ <https://www.theguardian.com/environment/2017/dec/12/insurance-giant-axa-dumps-investments-tar-sands-pipelines>

⁷ <https://www.environmental-finance.com/content/news/swiss-and-french-re/insurers-doing-most-to-avoid-coal-underwriting.html>

⁸ <https://www.adb.org/sites/default/files/institutional-document/32032/energy-policy-2009.pdf>

⁹ See: http://www.cao-ombudsman.org/documents/CAOMonitoringReport_FIAudit_March2017.pdf

- We welcome IFC's application of the Green Equity approach to sub-debt investments that cannot be ringfenced. However, we call upon IFC to be explicit that any debt investment in which the use of proceeds is not i) legally restricted, ii) subject to annual reporting by the FI and iii) traceable by IFC or an external auditor, shall be treated like equity in line with the new approach.
- In the case of a convertible loan, the equity rules should apply at the time of IFC's investment and not at the time of conversion. Waiting until conversion to apply the equity rules does not make sense, as these investments are made with the intention of converting them to equity, and it is at the pre-investment stage when IFC has the most leverage to encourage the FI to make a commitment to phase out investments in coal.

3. Disclosure and Transparency:

- We welcome the addition into IFC's Green Equity Approach of a requirement for its financial intermediaries "to publicly disclose, on annual basis, their aggregated exposures to coal related projects on the financial institution's website/annual report and/or on IFC's project disclosure portal." The disclosure of its FI client's exposure to coal is critical to ensure that its commitments in the Green Equity Approach can be monitored, tracked and verified externally, including by civil society.
- When Philippe Le Houérou announced this Green Equity Approach last October, he also mentioned that IFC will work to "define the parameters of this new approach, including a framework for transparency and disclosure as well as time-bound commitments." He also mentioned that "It is [IFC's] intent that this twin strategy [the Green Equity Approach and the Framework for Transparency] aimed at creating incentives for financial intermediary equity clients to reduce or exit coal projects, as well as improving transparency". However, we have not seen yet anything on the Framework for Transparency, the second component of IFC's twin strategy.
- For this reason, firstly, we strongly recommend IFC to develop and put forward for consultation the expected Framework for Transparency of its commitment to a voluntary initiative to promote and enhance disclosure of high-risk subprojects of its FI clients, including the name, sector, and host country of the project, and how exactly IFC plans to do this.
- Secondly, in terms of transparency within the Green Equity Approach, we recommend IFC to go beyond disclosure of aggregated information of its FI client's exposure to coal. To effectively understand its FI client's exposure to coal, their progress and performance in reducing that exposure, IFC should include specific commitments, requirements and criteria on transparency and disclosure, including:

- Support its FI equity clients in developing a disclosure policy that reflects IFC's own Access to Information policy for direct investments. Such a policy should also incorporate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) by highlighting the financial risks of exposure to carbon-related assets. Critically important, such disclosure and transparency policy should be publicly available in the FI website.
- IFC will no longer invest in new clients or existing clients with new business that do not have a transparency and disclosure policy.
- For existing equity clients with no new business, IFC should use a similar approach to the Green Equity Approach and request its clients to develop a disclosure policy. IFC should divest from clients that do not do so within the agreed timeframe.
- IFC should require its FI clients and support them to develop and set up appropriate internal mechanisms and systems to disclose their coal exposure on their websites as well as on IFC's Project Information Portal.
- IFC should require its FI clients to disclose publicly on their websites as well as on IFC's website their decarbonization plans.
- IFC should publicly disclose its FI clients' total exposure to coal investments not only in terms of percentage of total portfolio but also dollar value.
- The disclosure of coal exposure should be also disaggregated by financial instrument used by its FI clients (project finance, project related corporate loans, general corporate finance, and other instruments such as bonds).
- The disclosure of coal exposure should also be disaggregated by individual client/project name and location.
- As noted above, IFC should also track and disclose FI clients' exposure to upstream oil and gas. The Green Equity Approach should incorporate a reporting requirement on upstream oil and gas exposure in legal documents with all new FI clients.
- Disclosure should also include any blended grant finance from IDA or guarantees from MIGA and other similar public participation to understand better the subsidy elements.

4. Targets and Timeline

➤ It is very gratifying that the “Global Coal Exit List” (GCEL), a comprehensive database of companies participating in the coal value chain is also included in the IFC Green Equity Strategy. The German NGO Urgewald has put together the first ever database listing all the major companies in this industry and provides key statistics on 775 companies. During the 2019 Spring Meetings, a representative of the IFC announced that IFC will ask client financial institutions to screen their exposures against the Coal Plant Developers List, which is provided by this database. This is also reflected in the draft approach paper. Urgewald will soon provide a revision and is consulting on this with major international insurance companies, banks and the IFC.

➤ The current draft approach paper does not have a clear definition of coal exposure. While it states that IFC will ask its clients to screen their portfolios against the GCEL, this does not appear to be how coal exposure is defined for the purposes of the strategy. Instead, the draft appears to define coal exposure as project finance or project-related corporate finance for "coal-related projects." With the sole exception of power generation companies that generate more than 30% of energy from coal-fired power plants, general purpose corporate finance to coal companies is not covered in the draft. This excludes general corporate finance for coal power companies that do not meet the percentage criteria but are nonetheless involved in expanding or developing new coal power plants. Also, companies from other business sectors besides power, but which are also driving the coal plant pipeline, are not included. Furthermore, the draft entirely excludes general corporate finance for mining companies, which is the most common means through which new coal mining projects are financed.

Coal exposure should be defined as long-term project finance or general purpose corporate finance, including equity, for companies that meet any one of the following criteria:

1. Percentage Criteria: 30% or more of the company’s power production or revenues are coal-based.
2. Absolute Criteria: Companies whose annual coal production equals 20 million tons or more, and companies whose installed coal-fired capacity equals 10,000 MW or more.
3. Expansion Criteria: Companies involved in coal mining expansion or coal power expansion plans.

➤ We encourage the IFC to use this opportunity to align with Article 2.1c of the Paris Agreement “making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development” and its goal of limiting warming to 1.5°C; therefore, the timeframe to achieve divestment from existing coal-intensive clients should tighten, and we reiterate that this should be a policy that combines both divestment and

engagement with financial intermediaries. According to the science, to be in line with the Paris Agreement, the OECD and EU countries need to phase out coal by 2030, China by 2040, and the rest of the world by 2050¹⁰. Given that coal plants have an economic lifetime of 40 years, this means immediately ending any coal investment¹¹.

- IFC should set a stringent timeframe to divest from all existing coal-intensive clients by 2022 instead of 2025; unless clients develop a decarbonization plan committing themselves to not providing any new coal-related finance, including bond underwriting and purchasing, by 2025. We feel that setting the year 2022 as the target year sets a stronger incentive to ensure no new coal plants are built, especially given that local commercial banks tend to limit loan tenor to around eight years, while corporate bonds are typically issued with a tenor of around five years¹². Hence, IFC should only invest in new equity clients, i) with a maximum of 15% exposure to coal¹³, and ii) if the client agrees to put in place a decarbonization plan that will result in coal exposure being reduced to zero by 2025.
- Furthermore, the IFC should monitor and ensure compliance of its clients with the new policy; for example, it is advisable to include this clause within the legal agreement particularly for new businesses. Engagement with the financial intermediary could be also an opportunity to support it in the uptake of the recommendations of TCFD.
- The timeframe needs to also consider the wider context, given the trend of insurers divesting from coal, which is exposing the climate risk inherent in coal-intensive projects¹⁴ - and this could result in some assets being repriced.

5. Green Banking Certificate

- We welcome the Green Banking Certificate as this is going to be important for FI staff to be empowered to adopt a decarbonization plan. However, we feel the name may not be appropriate because the process is limited only to divestment from coal. If this is going to be aligned to the Paris Agreement this is an incredible opportunity to ensure that the staff are aware of the risks of all fossil fuels, including oil and gas projects. Therefore, we feel that the IFC name this certificate differently – perhaps a ‘Bronze Award’ or ‘Step 1 Award’ as focusing only on coal does not reflect the Paris climate goals in their entirety.

¹⁰ <https://climateanalytics.org/briefings/coal-phase-out/>

¹¹ https://wedocs.unep.org/bitstream/handle/20.500.11822/22106/EGR_2017_ch_5.pdf?isAllowed=y&sequence=1

¹² <https://climatepolicyinitiative.org/wp-content/uploads/2018/11/Energizing-Renewables-in-Indonesia-Optimizing-Public-Finance-Levers.pdf>

¹³The CDC Group – the UK’s Development Financial Institution – policy on coal fired power generation, from 2014, states that “Where CDC invests in banks or other Financial Intermediaries (FIs) and where CDC reasonably expects a significant proportion of that FI’s funds to be used to fund coal-fired power..., the general presumption will be that CDC would seek a “carve out” to exclude CDC funds being used for any new coal-fired thermal power plants.” In this clause, “significant proportion” which “means that more than 10% of the FI’s current or predicted future loan portfolio is for coal-fired thermal power investments”.

¹⁴ See <http://www.climateaction.org/news/an-increasing-number-of-insurance-companies-divest-from-fossil-fuels>