The Development Finance Corporation and Climate Change: Recommendations to the Biden/Harris Administration for the first 100 days

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With the largest investment portfolio of any bilateral development finance institution (DFI), the US International Development Finance Corporation (DFC) can significantly contribute to the Administration's efforts to tackle the climate crisis and help reassert the US as a global climate leader. Investment decisions today affect emissions tomorrow so a forward-thinking lens is imperative to ensure long term progress towards limiting warming to 1.5C.

Extreme poverty will not be eradicated by 2030 without jobs, economic growth, and increased local tax revenue -- all development outcomes produced by DFI investments. Given their growing portfolios and clear development mandates, there is significant potential for DFIs to address the climate crisis. Already by 2014, European DFIs had provided one-third of all climate finance in Sub-Saharan Africa. This is a key area of opportunity since DFIs are able to crowd-in private investors who may remain hesitant to invest in large scale renewable energy projects in low income countries without the de-risking that DFIs can provide.

Building off best practices from European counterparts, **Mercy Corps has developed the following recommendations for the DFC's first 100 days to move the US beyond course correction to drive global climate action.** Alongside mapping out specific opportunities and recommendations for the DFC, this brief summarizes overall figures of other bilateral DFIs and then provides a deeper look at the climate finance priorities of the four largest actors.

Key Recommendations

While the DFC alone cannot be an all-encompassing answer to achieving the SDGs and the Paris Agreement, it has strong potential to enable significant progress. Our research shows encouraging initiatives taken by European DFI counterparts can act as a blueprint for the US to work off. There is considerable potential for transferring learnings and best practices so the DFC can quickly advance the objectives of the Biden Administration to address climate change. Outlined below are some of the key recommendations for the DFC to consider putting into action within the Biden/Harris Administration's first 100 days in office:

- **Commit the DFC to a Net Zero portfolio by 2050 (at the latest).** Investment decisions today affect emissions tomorrow so a forward-thinking lens is imperative to ensure long term progress. As the UK's CDC Group and entire country governments such as South Korea and China have committed to, the DFC can demonstrate their climate leadership by ensuring their nearly $30 billion investment portfolio is working towards a net zero world. There are very valid critiques of the concept of net zero not being an ambitious enough target. Such perspectives should be well understood and addressed by the DFC. Making this announcement at the Climate Summit would be a useful 'deliverable' and show the US's commitment to addressing the climate crisis with all facets of it's foreign aid toolkit.

- **Integrate climate change as a priority into DFC's Roadmap for Impact.** Introduced in 2020, the current strategy document of the DFC does not once mention climate change. Revising this guiding document to include the importance of treating the climate crisis as

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a priority will be essential in formally signaling the DFC's commitments in this critical space. The Roadmap or any future DFC strategy should include:

Enhance DFC's existing Impact Quotient system to streamline analysis and reporting on climate-related commitments and impacts using existing international frameworks. To allow for scaled investments from private sector actors and enable needed collaborations, aligned metrics are essential. There are two specific frameworks that should be taken into account by the DFC: the EU Sustainable Finance Taxonomy[1] and the Task Force on Climate-Related Financial Disclosures[2]. Such alignment will also allow for the DFC to align with European DFIs and actors such as the OECD and EBRD to ensure their impacts are counted towards global commitments.

Introduce a cross-cutting climate change initiative. One way to ensure that the inclusion of climate change in DFC's strategy is to introduce it as a formal initiative. DFC's existing cross-cutting initiatives (2X Women's Initiative, Connect Africa, Portfolio for Impact and Innovation, Blue Dot Network, Health & Prosperity) enable its investments to prioritize these important issues across its investment decisions. Leveraging the structures of these existing initiatives will help ensure that climate change is a consideration for all investment decisions.

- **Devote targeted efforts for adaptation and resilience**. As has been committed by France's AFD, at least 50% of annual commitments of the DFC should finance projects with climate adaptation and resilience co-benefits. This will ensure alignment with the 2015 Paris Agreement commitments on climate finance. These co-benefits should be clearly identified and monitored using frameworks such as the Adaptation Solutions Taxonomy and EU Sustainable Finance Taxonomy as is governing the European Green Deal.

- **Collaborate closely with USAID and MCC counterparts.** With the DFC moving beyond projects solely targeting economic growth, it is essential for all USG actors to work together. Furthermore, given high levels of competition for building investment pipelines, the DFC must work diligently to minimize the potential for creating dependency of local private sector actors on noncompetitive and concessional financial terms for transactions as this will jeopardize long-term development.

- **Join existing high-level international coordinating mechanisms for climate change and development.** Given the critical role of collaboration to achieve the SDGs and Paris Agreement targets, it will be important for the DFC to leverage partnerships to facilitate synergies rather than re-inventing the wheel. Along with the UN Framework Convention on Climate Change, mechanisms like the Public Development Banks network, Principles for Responsible Investment initiative, InsuResilience Global Partnership and the Global

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[1] The EU Sustainable Finance taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. Setting a common language between investors, issuers, project promoters and policy makers, it helps investors to assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change.

[2] The Task Force on Climate-Related Financial Disclosures: Without reliable climate-related financial information, financial markets cannot price climate-related risks and opportunities correctly and may potentially face a rocky transition to a low-carbon economy, with sudden value shifts and destabilizing costs if industries must rapidly adjust to the new landscape the Financial Stability Board established the TCFD to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks.

Commission on Adaptation (specifically the Finance track) have been working towards cohesive action in the climate and development space. Each of these have high-level members from across sectors and countries so joining these efforts would be helpful to demonstrate US leadership.

- **Prioritize low income and climate-vulnerable countries.** Despite stated intents of investing more in least developed countries (LDCs), a recent analysis found that only 29 of the 47 LDCs received investments from DFIs in 2017. The DFC can establish itself as a leader by prioritizing investments in these states and filling this critical gap. Developing investment criteria and metrics that incentivize conventionally riskier markets will allow for greater economic resilience to buffer potential shocks and stresses. The DFC can be a leader in this space which has the dual benefit of addressing climate security concerns. Doing so will further DFC's specified intent to support projects in fragile states in alignment with the Global Fragility Act as stated in DFC current Roadmap for Impact strategy.
- **Support innovative instruments addressing climate adaptation and resilience.** Given that adaptation and resilience returns are harder to monetize compared to mitigation, innovative instruments are key to unlocking structures that can scale and have impact. The DFC and US Government can establish itself as a leader in the climate adaptation space by having the DFC prioritize a robust pipeline and portfolio of such projects and sharing learnings across DFIs. One potential mechanism of doing so would be to open a new funding window for small deal sizes and that can move faster and with fewer administrative constraints. To get a sense of what such investment portfolios can include, the DFC can refer to initiatives highlighted by the Global Innovation Lab for Climate Finance and the International Climate Finance Accelerator.

Bilateral Development Finance Institutions By The Numbers

As of 2020, there are 17 bilateral DFIs in existence, 15 in Europe and 2 in North America.

Name	Country	Founded	2017 portfolio	2018 portfolio	2019 portfolio
BIO: Belgian Investment Company for Developing Countries	Belgium	2001	$856.3 million	€757 million	€ 865 million
CDC Group	UK	1948	$5.3 billion	€7,906 million	$5.8 billion
COFIDES: Compañía Española de Financiación del Desarrollo	Spain	1988	$1.1 billion	€1,053 milion	€1,757 million
DEG: Deutsche Investitions- und Entwicklungsgesellschaft	Germany	1962	$9.9 billion	€8,143 million	€ 8.8 billion
FinDev Canada	Canada	2017	-	-	$94 million
Finnfund: Finnish Fund for Industrial Cooperation	Finland	1980	$472 million	€838 million	€967 million
FMO: Netherlands Development Finance Company	Netherlands	1970	$11 billion	€9,551 million	€10.4 billion
IFU: Investment Fund for Developing Countries	Denmark	1967	$1.5 billion	€779 million	€836 million
Norfund: Norwegian investment Fund for Developing Countries	Norway	1997	$2.5 billion	€2,486 million	€2,757 million
OeEB: Oesterreichische Entwicklungsbank	Austria	2008	$1.3 billion	€1,193 million	€1,373 million
PROPARCO	France	1977	$5.5 billion	€5,002 million	€7.2 billion
SBI-BMI Belgian Corporation for International Investment	Belgium	1971	$44.4 million	€38 million	€37 million
SIFEM: Swiss Investment Fund for Emerging Markets	Switzerland	2005	$757.1 million	€683 million	€755 million
SIMEST	Italy	1991	$1.2 billion	€1,084 million	€1,171 million
SOFID	Portugal	2007	$12 million	€7 million	€12 million
Swedfund	Sweden	1979	$560.1 million	€455 million	€547 million
DFC (formerly OPIC)	USA	2018	$23.2 billion*	$23 billion*	$29.9 billion

*OPIC Data not DFC

Climate Finance In the Four Largest DFIs After DFC

	British CDC Group (UK) *$5.8 billion (2019 portfolio)*	**The German Development Finance Institution (DEG-KFW)** *€ 8.8 billion (2019 portfolio)*
Investment Products	Intermediated Equity (41%) Direct Equity (38%) Debt (20%) Guarantees (1%)	Long term loans Equity capital Mezzanine finance
Priority Sectors	financial services (30%) infrastructure (28%) health manufacturing food and agriculture construction and real estate	Financial sector (30%) Infrastructure (25%) Industry/manufacturing (23%) Agribusiness (9%) Services and other (13%)
Top Geographies	India (28%) Nigeria (6.8%) Kenya (4.9%) South Africa (4.8%) Cote D'Ivoire (4.5%) Morocco (4.2%)	Latin America (30%) Sub-Saharan Africa (21%) East Asia & Pacific (18%) South Asia (13%) Europe & Central Asia (12%)
Dedicated Climate Commitments?	Yes, strategy launched in July 2020	Not through this arm of the German government but Germany has set up other climate-dedicated funds
Key Climate Commitments	Net zero by 2050: investing for a net zero world, because investment decisions today affect emissions tomorrow. Just transition: supporting a 'just transition' to a net zero economy by keeping the creation of decent jobs and skills development at the forefront of the change. Adaptation and resilience: strengthening adaptation and resilience of sectors, communities, businesses and people to the effects of climate change.	KfW has made statements about the importance of addressing climate change both in mitigation and adaptation, but it's unclear how or whether this trickles down to DEG. Significant funding (~€4 billion) is diverted towards the International Climate Initiative (IKI) which provides various types of grant funding including for adaptation
Mention of Adaptation	Yes, one of three pillars	Yes but through a different mechanism
Notes	Largest Limited Partner in Africa - invested in 70 funds across the continent.	DEG (German Investment Corporation) is a wholly-owned subsidiary of KfW (German state owned development bank). Though their portfolio is sizable, they don't brand their work as impact/socially/climate minded as other DFIs. That being said, Germany has established and funded climate-dedicated initiatives such as the International Climate Initiative and the InsuResilience Global Partnership.

	Dutch Entrepreneurial Development Bank (FMO) *€10.4 billion (2019 portfolio)*	**The French Development Finance Institution (PROPARCO)** *€7.2 billion (2019 portfolio)*
Investment Products	Loans & Syndications Private Equity (direct & indirect) Guarantees Trade Finance	Debt (72%) Equity and Quasi Equity (25%) Guarantees (2%)
Priority Sectors	Agribusiness, food, & water Energy (29%) Financial Institutions (36%) Dutch Business	Financial Sector (31%) Infrastructure (31%) Industry/Manufacturing (13%) Agribusiness (8%)
Top Geographies	Africa (35%) Asia (25%) Latin America (18%) Eastern Europe & Central Asia (14%)	SS Africa (36%) Latin America & Caribbean (26%) Europe and Central Asia (10%) East and South Asia (11%)
Dedicated Climate Commitments?	Yes - very ambitious	Yes, AFD's climate strategy launched in 2017 and is very ambitious. Important to understand how commitments from AFD trickle down to PROPARCO.
Key Climate Commitments	"Since 2015 we have a Green Label in place that steers our investments towards reducing greenhouse gas emissions, increasing resource efficiency, preserving and growing natural capital, and supporting climate adaptation. Over 80% of our energy portfolio is in renewables and our Agriculture Food and Water department is investing into forestry and climate smart agriculture. Furthermore, we are leveraging new opportunities for climate finance through blending structures like Climate Investor One, ElectriFI. and the Dutch Fund for Climate and Development (DFCD)."	"Special efforts will be devoted to adaptation and to the African continent. The objective that at least 50% of annual commitments in foreign states correspond to the financing of projects with climate co-benefits will be extended to the entire AFD Group. This will lead to the yearly deployment of more than EUR 5 billion of climate finance in foreign states in 2020. Differentiated targets based on geographical areas will be maintained (climate commitments should represent at least 70% of funding for Asia and Latin America, 50% for the Mediterranean and 30% for sub- Saharan Africa). Within this objective, the AFD Group will aim to substantially increase the financing volumes for adaptation in all geographies, with a focus on Africa, LDCs and small island states, in order to triple its funding. Funding for adaptation will reach more than EUR 1.2 billion per year by 2020."
Mention of Adaptation?	Yes	Yes, very central
Rough Analysis / Potential for Influence	Given their portfolio / investment volume, FMO is the largest European bilateral DFI. They have been at the forefront of sustainability metrics and climate change and have already put a lot of thought and effort into developing their approach in this space. Even still, the majority of climate investments cited in their annual reports are in mitigation. FMO houses multiple Dutch Government Funds (Access to Energy Fund, Building Prospects, Dutch Fund for Climate and Development, MASSIF, Nasira, Ventures Program)	AFD/PROPARCO appear to have the most ambitious strategy and commitments in terms of climate adaptation including explicit mentioning of the need for capacity building resources for the most vulnerable countries.

CONTACT

APARNA SHRIVASTAVA
Climate Finance Lead
Zurich Flood Resilience Alliance
ashrivastava@mercycorps.org

ANN VAUGHAN
Head, Influence and Advocacy Workstream
Zurich Flood Resilience Alliance
avaughan@mercycorps.org

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Mercy Corps is a leading global organization powered by the belief that a better world is possible. In disaster, in hardship, in more than 40 countries around the world, we partner to put bold solutions into action — helping people triumph over adversity and build stronger communities from within. Now, and for the future.

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1111 19th St NW #650
Washington, DC 20036
888.842.0842
mercycorps.org