

March 2019

**AIIB equity strategy and financial intermediaries:**

**Meeting best practice**

This brief aims to summarise current good practice among international financial institutions with regard to financial intermediary (FI) lending, to help serve as concrete examples for the Board of the Asian Infrastructure Investment Bank to use in ensuring it promotes and upholds the highest standards. Issues covered include transparency and climate-related policies.

This brief aims to inform Board members and shareholders in light of the fact that:

* The Board will be discussing a proposed new equity strategy at its meeting on 8 April 2019;
* There have been rapid developments in this field of lending, with new reforms announced by the IFC in late 2018 and February 2019;
* The AIIB has told us that it is “working on the refining of the implementation of our environmental and social policy for this specific type of investments, and *in doing so we are taking into account the work done by our peers*”;
* FI lending now comprises over 11% of AIIB’s total lending, and this is set to rise in coming years;
* The AIIB’s current FI portfolio includes investments such as the IFC [Emerging Asia Fund](https://bic-europe.org/wp-content/uploads/2018/11/Financing-development-in-Myanmar-FINAL.pdf) which backs two heavily fossil fuel-intensive clients. See [AIIB and fossil fuels](https://bic-europe.org/wp-content/uploads/2018/11/AIIB-and-fossil-fuels-Nov-2018-FINAL.pdf) for further information.

We encourage Board members to ensure that the AIIB:

* Requires **timebound disclosure** of sub-project information in advance of approval;
* Discloses the **name, sector and location of higher risk sub-projects** financed via FIs on the AIIB’s website and on the client’s website;
* **Publicises the AIIB’s involvement** in sub-projects at the project sites, ensuring that it is clearly visible and understandable to affected communities;
* Adopts a requirement for all FI clients to **track and disclose coal and other fossil fuel investments;**
* Ensures that none of its investments results in an **increase in coal use**: whether for power generation or industrial uses, or for associated facilities such as transmission lines and rail- ways or ports primarily meant for the transportation of coal;
* **Excludes upstream oil and gas**;
* Does not invest in clients with more than **5% portfolio exposure to coal**;
* Invests only in FI clients who commit to develop a **portfolio decarbonisation plan** to achieve emissions reductions in line with targets set under the Paris Climate Agreement
1. **Transparency**

International financial institutions recognise the importance of transparency not only in improving accountability to shareholders and citizens, but in helping to avoid and manage risk. AIIB President Jin Liqun has stated: "Transparency and accountability are the two main pillars of AIIB’s governance."

Transparency has been a particular challenge in financial intermediary lending, given the longer chain from investor to project; conversely, transparency is all the more important in this type of lending given its higher risk profile. When risks are spotted early on, they are more easily avoided or mitigated, leading to better project outcomes and lower reputational risk.

*Examples of current good practice:*

**The Green Climate Fund**

The Green Climate Fund (GCF) is a highly relevant institution for the purposes of comparison with the AIIB’s financial intermediary lending, since 100 per cent of its lending is carried out through intermediaries (or as the GCF calls them ‘Accredited Entities’). The GCF has adopted a high degree of disclosure in line with international best practice, including timebound disclosure of crucial project information – such as environmental and social impact assessments – ahead of approval. The degree and timing of disclosure is calibrated according to the risk profile of the investment: with more and better disclosure for the highest risk (Category A). The following excerpts from its 2016 Information Disclosure Policy describe the degree of disclosure:

* + 1. **“Environmental and social reports.** With respect to project and programme funding proposals that have an environmental or social impact, the Accredited Entities (AE’s) shall disclose and announce to the public and, via the Secretariat, to the Board and Active Observers:
		2. (a) in case of Category A projects, the Environmental and Social Impacts Assessment (ESIA) and an Environmental and Social Management Plan (ESMP) at least 120 days in advance of the AE’s or GCF’s Board decision, whichever is earlier;
		3. “(b) in the case of Category I-1 programmes, the Environmental and Social Management System (ESMS)2 at least 120 days in advance of the AE’s or GCF’s Board decision, whichever is earlier;
		4. “(c) in the case of Category B projects, the ESIA3 and an Environmental and Social Management Plan (ESMP)4 at least 30 days in advance of the AE’s or GCF’s Board decision, whichever is earlier; and
		5. “(d) in the case of Category I-2 programmes, the ESMS at least 30 days in advance of the AE’s or GCF’s Board decision, whichever is earlier.”

The GCF expects its conditions to be met when working with other multilaterals, raising the possibility of the AIIB being obliged to improve disclosure if it works with the GCF. For example, in the case of the GCF’s involvement with the European Bank for Reconstruction and Development’s Green Cities Project, the GCF’s Board stipulated additional conditions:

“In relation to each Category A public sector sub-project to be funded under the Facility, the Accredited Entity shall disclose the Project Summary Document, Environmental and Social Impacts Assessment (ESIA) and Environmental and Social Action Plan (ESAP), and, as appropriate, inclusive of the Resettlement Policy Framework (RPF) and/or Land Acquisition and/or Resettlement Action Plan (LARAP or RAP), and any other associated information required to be disclosed in accordance with the Accredited Entity’s Public Information Policy (“Project Disclosure Package”). The Accredited Entity, 120 calendar days in advance of its Board meeting, shall disclose, in English and the local language (if not English), the Project Disclosure Package on its website and shall require that the Borrower does so in locations convenient to affected peoples, and provide the Project Disclosure Package to the GCF Secretariat for further distribution to the Board and Active Observers and for posting on the GCF website.”[[1]](#footnote-1)

Further, in response to a complaint filed by the GCF’s CSO Active Observer for Developed Countries, the Information Appeals Panel found the GCF in breach of its disclosure policy in regard to investments with the World Bank and Asian Development Bank in Indonesia and Pakistan, and noted “that overall any delay in providing such documents is a risk to the reputation of the GCF and should be avoided in the future.”[[2]](#footnote-2)

**The World Bank**

The World Bank invests in financial intermediaries and requires and practices a great degree of disclosure – including of sub-projects supported through commercial banks. Under the disclosure clause of the World Bank’s 2013 Operational Procedure BP 4.03, the World Bank requires its financial intermediary clients to disclose and permit, in writing, the World Bank to disclose the summary of the Environmental and Social Impact Assessment (ESIA) of any sub-project considered high risk (Category FI-1 and FI-2). In practice, however, the World Bank seems to go beyond summaries by disclosing full reports of impact assessments, mitigation, and resettlement plans.”[[3]](#footnote-3)

Examples include the World Bank’s investments in Turkish banks, TKB and TSKB, for which the World Bank disclosed 208 documents relating to the investments and their sub projects.

**The International Finance Corporation**

The International Finance Corporation (IFC) discloses different information dependent on the type of FI client. It has made several significant reforms over the past five years, largely in response to civil society pressure and a number of highly-damaging cases.[[4]](#footnote-4)

For **private equity fund clients:** in its 2012 Performance Standards, IFC committed to “periodically disclose a listing of the names, locations and sectors of high-risk sub-projects that have been supported by IFC investments through private equity funds, subject to regulatory constraints and market sensitivities.” This was updated in 2015 when in response to pressure from civil society, IFC started to disclose all sub projects supported via its private equity fund clients, stating: “with input from CSOs and other stakeholders, we have improved transparency by now disclosing all private equity fund sub-projects.”[[5]](#footnote-5)

In 2017, the IFC applied this new rule retrospectively to all PE fund clients since 2012: “We publish the name, sector and location of every investment of our funds’ portfolio companies. In 2017, IFC fulfilled 100 percent of this requirement for the 63 fund investments initiated since 2012, and published information on more than 387 funds’ portfolio companies.”[[6]](#footnote-6)

IFC is in the process of developing a new strategy on disclosure, which will include: “a voluntary initiative with our financial intermediary clients exposed to high-risk projects for the next two years to promote disclosure of such high-risk sub-projects initiated from IFC lending, including the name, sector, and host country of the project.”[[7]](#footnote-7)

**RECOMMENDATION:**

The AIIB should adopt an equity strategy that commits to principles of disclosure and transparency and enshrines best practice, including:

* Requiring timebound disclosure of project information in advance of approval;
* Disclosure of the **name, sector and location of higher risk sub-projects** financed via FIs on the AIIB’s website and on the client’s website;
* Disclosure of the AIIB’s involvement in sub-projects at the project sites, ensuring that it is clearly visible and understandable to affected communities;
1. **Climate change mitigation**

The AIIB’s Energy Sector Strategy commits to align with the Paris Agreement on Climate Change. Addressing AIIB lending through financial intermediaries is crucial in ensuring both direct and indirect investments uphold this commitment.

A first step is to ensure FI investments exclude coal. Environmental analysts E3G note: “To meet the Paris Agreement, [the science shows that coal phase-out is needed by 2030](http://climateanalytics.org/files/climateanalytics-coalreport_nov2016_1.pdf) in the OECD and EU28, 2040 for China and **no later than 2050 for the rest of the world.**[[8]](#footnote-8) Considering the average life-span of a coal plant is 40 years, any new and existing investments would directly contradict meeting the goals of the Paris Agreement and will cause catastrophic climate change.”[[9]](#footnote-9)

Many financial institutions are beginning to address this challenge in their policies. Some emerging policy and practice are highlighted below.

**The International Finance Corporation**

The CEO of the IFC, Philippe Le Houérou, is instituting a number of significant reforms at the IFC aimed at reducing its fossil fuel exposure, including in its financial intermediary business.

In its new [Interpretation Note](https://www.ifc.org/wps/wcm/connect/38d1a68049ddf966af3cbfda80c2ddf3/FI%2BInterpretation%2BNote%2BNovember%2B2018.pdf?MOD=AJPERES) for financial intermediaries from November 2018, the IFC states: “The Exclusion List can be extended by adding more excluded activities, as part of the E&S risk management efforts. For instance, in case of any targeted products IFC will **exclude coal related sub-projects including coal mining, coal transportation or coal-fired power plants**, as well as infrastructure services exclusively dedicated to support any of these activities. In case of projects involving collective investment vehicles such as PE Funds, the coal related investments will be either excluded up front or when this is not feasible IFC will opt out from such investments.”

The IFC also committed in the Interpretation Note to improve disclosure around coal exposure, including by requiring FI clients to report annually to the IFC: “For an FI, E&S performance reportsto IFC should typically include: ... Where relevant, the FI clients’ exposures to high risk activities (e.g. coal related activities, palm oil, etc.)”

The IFC also commits to make this information on coal exposure public: “We will require new equity financial intermediary clients exposed to coal projects to publicly disclose their total exposure in this sector.”[[10]](#footnote-10)

In February 2019, the IFC went further and shared a draft **Green Equity Strategy** with civil society (it is expected to be finalised soon). Commitments include:

* an aim to reduce coal exposure to zero;
* not to invest in FI clients that do not have a plan to phase out investments in coal;
* a new strategy for equity clients that includes specific targets on phasing out coal in clients’ entire portfolios.

**Other examples**

Other DFIs have also responded to the climate challenge by instituting policy and practice reforms. These include:

**The UK government development finance institution (DFI) CDC’s policy[[11]](#footnote-11) states** “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.” Significant proportion “means that more than 10% of the FI’s current or predicted future loan portfolio is for coal-fired thermal power investments”[[12]](#footnote-12).

**The Dutch DFI, FMO,** states: “FMO can provide loans to banks and non-bank financial institutions that provide loans to coal-fired power projects, coal mines and dedicated thermal coal transport/infrastructure, to a maximum threshold of 20% of the Financial Intermediary’s total balance sheet or total investment portfolio”[[13]](#footnote-13).

**RECOMMENDATIONS:**

In this rapidly-developing space, the AIIB has the opportunity to join the leaders in ensuring the transformation necessary to avert catastrophic climate change. To do so, the Board should encourage the AIIB to:

* Adopt a requirement for all FI clients to **track and disclose coal and other fossil fuel investments**;
* Ensure that none of its investments results in an **increase in coal use**: whether for power generation or industrial uses, or for associated facilities such as transmission lines and rail- ways or ports primarily meant for the transportation of coal;
* **Exclude upstream oil and gas**;
* Does not invest in clients with more than **5% portfolio exposure to coal**;
* Invest only in FI clients who commit to develop a **portfolio decarbonisation plan** to achieve emissions reductions in line with targets set under the Paris Climate Agreement.
1. Green Climate Fund GCF/B.21/34 p 71 Annex XV List of conditions and recommendations. [↑](#footnote-ref-1)
2. Green Climate Fund (2018) Summary of Appeal no. IDP/2018/C001, 28 November 2018. [↑](#footnote-ref-2)
3. Oxfam (2018) Open Books See <https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620559/bp-financial-institutions-disclosure-161018-en.pdf> [↑](#footnote-ref-3)
4. See for example: AgriVie case in Uganda (<http://www.cao-ombudsman.org/cases/case_detail.aspx?id=180>); GMR Kamalanga case in India (<http://www.cao-ombudsman.org/cases/case_detail.aspx?id=165>); RCBC bank in the Philippines (<http://www.cao-ombudsman.org/cases/case_detail.aspx?id=1266>); Ficohsa Honduras (<http://www.cao-ombudsman.org/cases/case_detail.aspx?id=209>) and Dragon Capital Cambodia (<http://www.cao-ombudsman.org/cases/case_detail.aspx?id=212>). [↑](#footnote-ref-4)
5. IFC (2015) IFC’s Work with Financial Intermediaries; see: <https://www.ifc.org/wps/wcm/connect/1c3013804a260251bf70bfe54d141794/IFC_FI_FactSheet_April2015.pdf?MOD=AJPERES> [↑](#footnote-ref-5)
6. IFC (2017) Sustainable Practices for Private Equity Funds Business see: [https://medium.com/@IFC\_org/sustainable-practices-for-private-equity-funds-business-5d841850f7c5](https://medium.com/%40IFC_org/sustainable-practices-for-private-equity-funds-business-5d841850f7c5) [↑](#footnote-ref-6)
7. Le Houérou, Philippe (2018) in Devex see: <https://www.devex.com/news/opinion-a-new-ifc-vision-for-greening-banks-in-emerging-markets-93599> [↑](#footnote-ref-7)
8. <https://climateanalytics.org/briefings/coal-phase-out/> [↑](#footnote-ref-8)
9. E3G and Institute for Energy Economics and Financial Analysis (2018) Options for a green equity investment approach to ensure financial stability, November 2018. [↑](#footnote-ref-9)
10. Le Houérou, P (2018) A new IFC vision for greening banks in emerging markets, in *Devex* 8 October 2018. [↑](#footnote-ref-10)
11. CDC Group (2014) [Policy on coal-fired power generation](https://assets.cdcgroup.com/wp-content/uploads/2018/09/08155012/Policy_on_Coal-Fired_Power_Generation__January_2014_.pdf) [↑](#footnote-ref-11)
12. CDC Group (2014) [Policy on coal-fired power generation](https://assets.cdcgroup.com/wp-content/uploads/2018/09/08155012/Policy_on_Coal-Fired_Power_Generation__January_2014_.pdf) [↑](#footnote-ref-12)
13. FMO (2016) [Position Statement on Coal Power Generation and Coal Mining](https://www.fmo.nl/l/library/download/urn%3Auuid%3Abc67f804-1588-4542-8ac8-5f168b5f417f/position%2Bstatement%2Bon%2Bcoal.pdf?format=save_to_disk&ext=.pdf) [↑](#footnote-ref-13)