

BB1 and BB2 Technical Note

Joint MDB Assessment Framework for Paris Alignment for Direct Investment Operations

(Working Draft as of November 2021)

1. Background and Scope of this Document

1. At the 2019 UN Secretary-General's Climate Summit, the multilateral development banks (MDBs) reconfirmed in a joint statement our commitment to helping clients deliver on the goals of the Paris Agreement.¹ To this aim, the MDBs have 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).
2. This technical note, part of that broader framework, covers BB1 and BB2, providing guidance to experts evaluating whether direct investment operations are consistent with countries' low-emissions, climate-resilient development pathways and with the overall climate change mitigation, adaptation, and resilience objectives of the Paris Agreement². Institutions will adapt and interpret the framework according to their individual mandates and policies. It will be updated over time to reflect lessons learned by the MDBs and other financial institutions as we work to align our operations with the goals of the Paris Agreement.
3. The technical note was developed with input from the African Development Bank Group, the Asian Development Bank, the Asian Infrastructure Investment Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank Group, the Islamic Development Bank, the New Development Bank, and the World Bank Group (International Finance Corporation, Multilateral Investment Guarantee Agency, World Bank).

2. Overview and Main Principles

2.1 The MDB Paris Alignment Approach and Building Blocks

4. 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 integrating 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

¹ 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=EZSHARE-1729984378-16>.

² This is a technical note by the MDBs working on Paris Alignment, and should not be taken as institutional endorsement. Going forward, MDBs will develop their own methods in line with this technical note, as needed.

poverty,” by keeping global warming “well below” 2°C above pre-industrial levels and trying 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.³

5. This technical note discusses the framework that is part of the MDBs’ ongoing contribution to the operationalization of the Paris Agreement, and in particular its Article 2.1(c), on the alignment of finance flows.
6. The Paris Agreement and the SDG agenda both stress the importance of integrating climate action and development. In particular, they encourage countries to adopt long-term strategies (LTSs) to steer them onto low-emissions, climate-resilient development pathways.⁴ The frameworks presented in Sections 3 and 4 of this document lay out the high-level MDB approaches for evaluating whether operations are aligned with such pathways. The MDBs will regularly discuss alignment/non-alignment of operations to understand how MDBs are interpreting the framework in practice and to enhance consistency and improve the framework over time.
7. The evaluation of other aspects of operations, such as alignment with the SDGs or environmental and social safeguards, is not within the scope of this framework.

2.2. Assessment Outcomes: Operations Considered ‘Aligned’ or ‘Not Aligned’

8. An operation needs to be aligned with both mitigation (BB1) and adaptation and resilience (BB2) parts of the framework to be considered “Paris-aligned.”
9. BB1 is the MDB approach for characterizing operations as “aligned” or as “not aligned” with the overall mitigation goals of the Paris Agreement. It focuses on whether the operation in question is consistent with a low-GHG development pathway for that country and does not undermine a transition to a decarbonized economy, in that country and globally.
10. Many types of operations can be considered to be aligned with the Paris Agreement’s mitigation goals, including operations that directly reduce GHG emissions; operations that generate GHG emissions, but are in line with the country-specific decarbonization pathways; and operations that have a negligible (positive or negative) impact on climate change.
11. In assessing the Paris alignment of a financed activity, the focus under BB1 is on the consistency of the type of activity in question with a low-GHG development pathway in that country, rather than the activity’s specific physical impact in terms of projected CO_{2e} emissions. Factors to consider may include, as needed, the types and carbon intensity of technologies and infrastructure, the energy sources used, the carbon contents of materials, and behavioral choices that need to be made locally to meet decarbonization goals. Considerations may also be based on the inclusion of a financed activity within a valid long-term strategy, consistency with associated

³ 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.

⁴ Article 4.19 of the Paris Agreement states that all countries “should strive to formulate and communicate long-term low greenhouse gas emission development strategies (LTS) mindful of the long-term goals of the Paris Agreement.” In this technical note the LTSs are understood as overall national, subnational, or supranational strategies for achieving low-emission long-term (often focused on mid-century) development, considering broader sustainability, socioeconomic, and climate change adaptation goals [[MDB Principles for LTS support](#)].

public policies, or, on the contrary, whether a financed activity reflects development patterns or public policies that would prevent long-term decarbonization.

12. The MDBs are expected to carry out these assessments in light of the information and tools at their disposal. This will remain an expert judgment by the MDB, based on available information, as definitive references as to what constitutes low-GHG and climate resilient development pathways in a country are often not available yet, and they are likely to be revised in the future, reflecting the evolving body of scientific and economic information available to the MDBs and their clients. Despite these limitations, many countries are working to identify their low-GHG, resilient development pathways, and the MDBs plan to continue to support them in preparing their LTSs and updating their NDCs, including through the MDBs' work under BB4 on engagement and policy development support⁵.
13. 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 they manage physical climate change risks, are deemed to be consistent or inconsistent with the country's adaptation and climate resilience strategies and plans, and, where possible, leverage the transformational potential of the financed activities to contribute to climate-resilient development pathways. The MDBs are expected to carry out these assessments with the information and tools at their disposal.
14. BB1 and BB2 will also include other tools. In particular, when the activities to be financed by an operation cannot be assessed at the moment of approval (such as some operations with financial intermediaries, equity investments, municipal loans, corporate loans, or loans covering a large amount of small, diverse investments), a different approach will complement this framework—for instance, based on the client's decision-making process.
15. The definitions of key terms used in this note are provided in the Glossary (Section 4).

2.3. Overarching Principles: Alignment with Mitigation Goals

16. Assessments under BB1 rely on countries' NDCs, low-GHG development pathways and strategies, and other studies and analyses regarding pathways considered to be in line with low-GHG development.
17. Using this framework, the MDBs will apply expert judgement to characterize whether they consider a specific operation to be “aligned” or “not aligned”. In doing so, the MDBs do not provide any definitive endorsement of any type of operations as “aligned” or “not aligned,” nor do they make any judgment on a country' level of ambition, strategies, or priorities identified in its NDC or LTS.
18. MDBs will be transparent about the fact that the outcome of the assessment is based on the best available information at the time it is made.
19. Operations with multiple components will be assessed considering the overall objective of the operation and the alignment of each component. For the operation to be considered aligned with the mitigation goals of the Paris Agreement, all components must be aligned. As noted above,

⁵ The MDBs have worked together to develop a set of high-level principles that can guide each institution in its support to countries in developing, implementing, and monitoring robust, inclusive, and ambitious LTSs.

where it is not possible to assess the alignment of each component due to the lack of clarity on the nature of the supported activities, a different approach will be followed.

20. As the Paris Alignment characterization of the operation has to consider its consistency in the context of a low-GHG pathway, in some instances, the extent of assessment needs to take into account the broader **economic activity** in which the **operation** operates. The following aspects of the operation can be considered when defining the extent of the assessment, as appropriate:
 - **Technologies utilized by the operation:** Whether the technologies and the inputs on which they rely are consistent with a plausible low-GHG pathway;
 - **Outputs delivered by the operation:** Whether the outputs (goods or services), as well as the revenue they generate, are consistent with a plausible low-GHG pathway; and
 - **Policy and regulatory landscape:** Whether the operation's viability depends on or promotes policies or regulations that are consistent with the low-GHG pathway.
21. The assessment is expected to be transparent with regard to its extent, namely what components, technologies and outputs were included or disregarded. Other considerations, such as geographical or time boundaries, will also be made explicit.

2.4 Overarching Principles: Alignment with Adaptation and Resilience Goals

22. This assessment framework adopts a context-specific and process-based approach, in line with established good practices on climate change adaptation and resilience-building. This approach recognizes the heterogeneity of potential climate-related impacts and sets a requirement that assessments must be contextualized.
23. The BB2 assessment framework and the MDB methodology for tracking adaptation finance⁶ have some process similarities. However, their objectives are fundamentally different: BB2 aims to determine whether an operation is managing its vulnerability to physical climate risks and is considered aligned with a country-specific, climate-resilient development pathway, while the climate finance tracking methodology aims to determine the amount of finance dedicated to adaptation and resilience-building activities. Also, while the adaptation finance tracking methodology is applied at the subproject/project-element level, BB2 requires an assessment at the project level. Under BB2, a project exposed to a certain number of identified climate risks that can materially affect project performance is expected to reduce all identified risks to the extent possible, while ensuring that residual risks are at an acceptable level.

3. Explanation of the BB1 Framework

3.1 A Two-Pronged Approach

24. The activity characterization framework is a two-pronged assessment approach. As illustrated in Figure 1, it includes (1) an initial screening using uniform assessment criteria that identify operations or activity types that are universally considered to be aligned or not aligned, and (2) for operations or activities that cannot be characterized through the initial screening, the

⁶ (1) Setting out the climate change vulnerability context of the project, (2) making an explicit statement of intent of the project to reduce climate change vulnerability, and (3) articulating a clear and direct link between specific project activities and the project's objective to reduce vulnerability to climate change

application of specific assessment criteria that consider national circumstances and other operation-specific contexts.

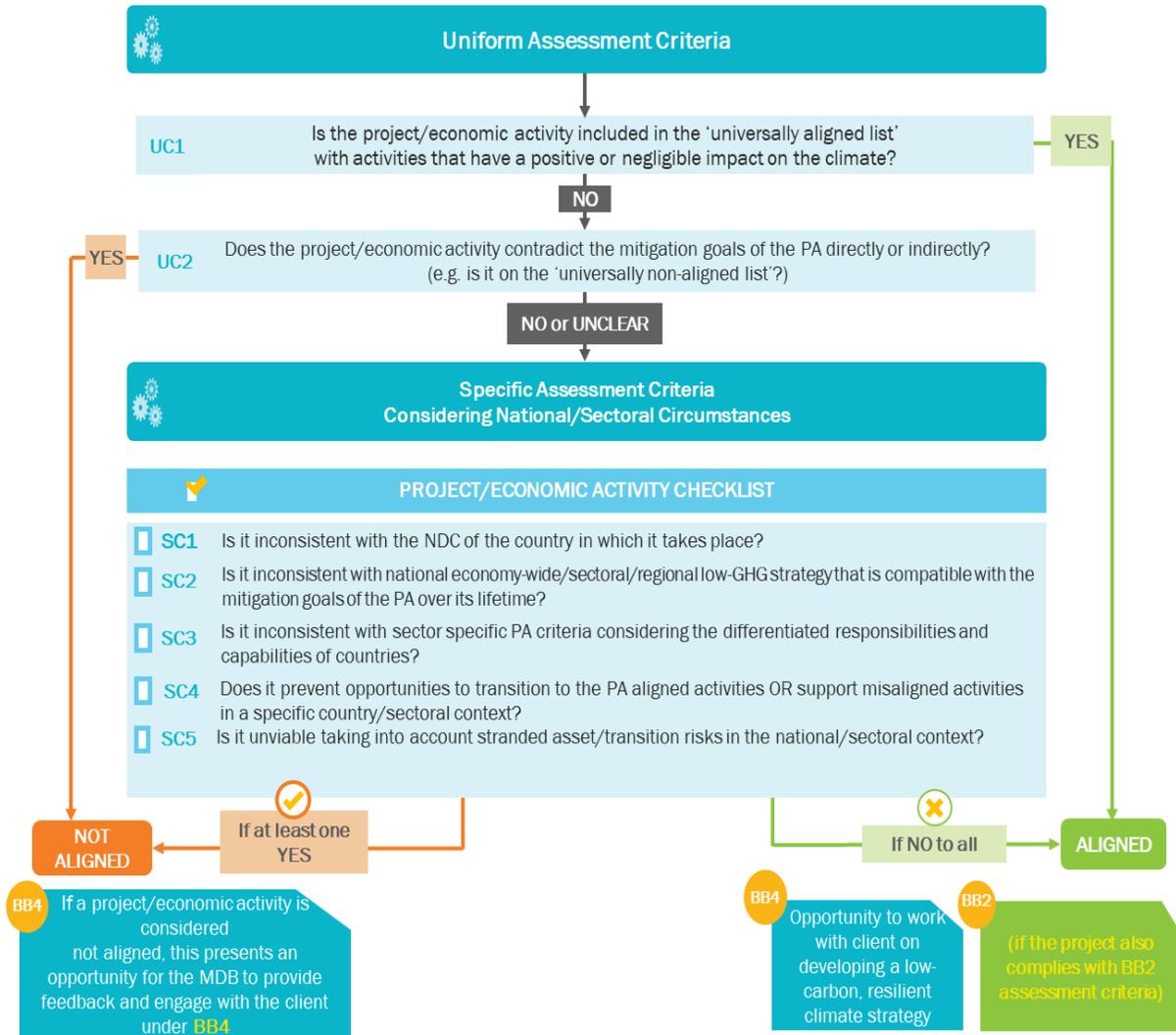


Figure 1: Schematic representation of the MDBs assessment framework for alignment with the Paris Agreement’s mitigation goals (BB1)

3.2 Uniform Assessment Criteria

25. The uniform assessment criteria are presented as lists of activities that the MDBs currently consider to be universally aligned or not aligned with the mitigation goals of the Paris Agreement, across countries and under all circumstances.
26. An operation that supports activities included on the “universally aligned” list would generally be considered to be aligned with the mitigation goals of the Paris Agreement, unless one or several of its components require the use of specific assessment criteria—in which case the operation will be considered aligned or not aligned depending on the outcome of the specific criteria assessment.

27. The draft lists of activities considered universally aligned or universally not aligned will be periodically updated by the MDBs, moving farther away from higher-emitting activities over time to meet the goals of the Paris Agreement. Updates will also reflect the latest evolution of technologies, policies, practices, and consumer behavior. Guidance on criteria that could be used for revising this list will be discussed among the MDBs. The lists can also be revisited by MDBs based on the insights and experience they gain in testing and applying the framework.

3.2.1 Activities Considered Universally Aligned (Criterion UC1):

28. The draft list of activities that are considered universally aligned is provided in Annex 1. In short, it covers:

- Activities that contribute to climate action consistent with the pathways toward the mitigation goals of the Paris Agreement under all circumstances, and
- Activities that have a negligible impact on climate change, as they do not harm countries' transition to long-term low-GHG development pathways and do not lead to lock-in of carbon-intensive patterns.

3.2.2 Activities Considered Universally not aligned (Criterion UC2):

29. The draft list of activities that are considered universally not aligned is provided in Annex 1. In short, it covers:

- Highly emissive activities (e.g., coal- or peat-fired power plants) that are considered to be universally (regardless of context) inconsistent with countries' low-GHG development pathways or incompatible with the mitigation goals of the Paris Agreement; and
- Activities directly supporting coal or peat extraction that are considered as universally inconsistent with these pathways.

3.2.3 How to Apply the Uniform Assessment Criteria

30. The determination simply requires checking the operation type against the lists of activities that are considered universally aligned and not aligned. Whether or not an operation falls within one of the listed categories, a brief narrative should be provided to explain why that conclusion was reached.

3.3 Overview of Specific Assessment Criteria

31. Operations that cannot be characterized as aligned or not aligned on the basis of the uniform assessment criteria will need to be further assessed against a set of specific assessment criteria. These criteria evaluate the operation in light of the specific country circumstances and national and sectoral strategies that are likely to define that country's transition pathway(s) to low-GHG development (and its contribution to the mitigation goals of the Paris Agreement).

32. This part of the assessment includes five specific criteria, SC1–SC5. As shown in Figure 2, meeting any one of the five criteria is expected to lead to an operation or activity being characterized as not aligned.

3.3.1 How to Apply the Specific Assessment Criteria

33. In many instances, especially at the early stages of implementation of this framework, information may not be available, or only be limited, on multiple levels: (i) limited number of existing country or sectoral decarbonization strategies; (ii) insufficient corporate tools available to implement the assessment according to this framework; and (iii) incomplete data included in the internal operation documentation. However, these limitations are not expected to prevent an assessment from being carried out—it will simply be based on the information that can reasonably be obtained at that time.
34. The specific criteria are presented in parallel to indicate that there is no hierarchy among them. The proposed approach is designed to complement any missing information through the application of other criteria. For instance, where a “national strategy compatible with the goals of the Paris Alignment” does not yet exist, Criterion SC2 is not expected to lead to a classification as not aligned. Instead, the activity would be deemed as aligned or not aligned on the basis of the other criteria, as long as there is not a high risk of inconsistency with the type of strategies highlighted in SC2. A “No” response to questions SC1 to SC5 can either mean that the answer to the question is “No,” or that no data were available to answer the question. It is expected that SC4 can always be answered.
35. MDBs are expected to characterize an operation as considered aligned or not aligned based on the five specific criteria. Depending on the available information, MDBs might not be able to apply some of the criteria and would focus more on the other criteria, as long as they can justify their choice to do so.
36. Going through the multi-criteria approach can help identify key gaps and areas of engagement with counterparts to develop or improve long-term low-GHG development and other relevant strategies. This is particularly useful when the operation takes place in a country or in several countries that have yet to develop low-GHG and climate-resilient strategies.

3.3.2 Specific Assessment Criteria

The boxes below provide explanations of each specific criterion and what the framework aims to capture/assess with each one of them. They also include references that can be used to support the assessment.

SC1: Is the operation/economic activity inconsistent with the NDC of the country in which it takes place?
Clarification/Guidance
This specific criterion involves checking whether the operation is “inconsistent with” the country’s NDC. It will only lead to a “yes” answer (and therefore to an assessment of “not aligned”) if the NDC rules out the operation.
Further guidance
To check for inconsistency, the MDB verifies whether the NDC covers the sector or activity in question. If so, the MDB checks whether the operation is in line with the pathways laid out for that particular sector or activity (see example 1 below). If the activity or sector is not included in the relevant strategy, then in most cases it can be concluded that the activity is not inconsistent with the strategy, and the MDB can continue applying the remaining specific criteria to determine alignment. However, there may be cases where the MDB can infer from the information available in the strategy that the activity is likely inconsistent with the strategy. Examples 2 and 3 below illustrate such cases. A number of operation types, especially those that do not have significant direct or indirect GHG emissions, are normally not mentioned in NDCs, LTSSs, or global low-GHG emissions pathways. In those cases, the assessment would focus mainly on SC4 and SC5.

As noted above, the expert judgment made by MDBs of operations should not be interpreted as a judgment or endorsement of the country's NDC or other relevant documents used in the assessment.

The more aligned an NDC is with the long-term goals of the Paris Agreement (for instance, when the NDC is informed by a pathway to decarbonization by mid-century), and the more sectors it covers, the more robust the assessment under SC1 is expected to be.

Examples

1. If the NDC of a country says, a fossil-fuel powered technology should be phased out by 2035, an operation in 2025 that would support such technology with an expected lifetime of 10 or more years could be deemed to be inconsistent with the NDC, and thus not aligned under SC1.
2. If the NDC makes no mention of the fossil-fuel powered technology, then an operation that supports such technology is *not* inconsistent with the country's NDC and can go on to be evaluated under the remaining criteria.
3. If the NDC makes no mention of the fossil-fuel powered technology but sets up an ambitious renewable energy target that would make such technology unnecessary unless renewable energy deployment is limited, the assessment under SC1 would be expected to be considered together with the assessment under SC4. This could possibly lead to it being deemed "inconsistent" with the NDC and not aligned with the Paris mitigation goals.

References

[UNFCCC NDC Registry: https://www4.unfccc.int/sites/ndcstaging/](https://www4.unfccc.int/sites/ndcstaging/)

[Climate Action Tracker: https://climateactiontracker.org](https://climateactiontracker.org)

SC2: Is the operation/economic activity, over its lifetime, inconsistent with the country's LTS or other similar long-term national economy-wide, sectoral, or regional low-GHG strategies compatible with the mitigation goals of the Paris Agreement?

Clarification/Guidance

SC2 assesses the operation's consistency with the country's long-term strategies and other official national, sectoral, or subnational strategies or policies (or drafts undergoing public consultations).

LTSs and other relevant national, local or sectoral low-GHG development strategies are expected to achieve long-term decarbonization, in line with the mitigation goals of the Paris Agreement. Other relevant national, local or sectoral low-GHG emission strategies should be used to inform the assessment.

Further guidance

Follow the same approach as with SC1, but applied to the LTS and other relevant low-GHG strategies.

The more ambitious and realistic an LTS is⁷, the more robust the assessment under SC2 will be. The consistency of the operation with that LTS considerably reinforces the likelihood of characterization of the operation as "Paris-aligned," as it is then not only consistent with a plausible pathway, but with a formal country-owned strategy. LTSs can lay out a path for countries to decarbonize in a timely manner to keep global warming well below 2°C (while pursuing efforts to limit it to 1.5°C), build climate resilience, and facilitate an orderly transition for all sectors of the economy and society. With more countries developing their LTSs and updating their NDCs accordingly, the information gap in applying the SC2 is expected to be reduced.

Examples

If the LTS says that the energy sector or the whole economy will be carbon-neutral by year X, and the expected lifetime of a fossil fuel power installation (without carbon capture and storage) extends significantly beyond that year, then this operation could be deemed to be incompatible with the LTS and be not aligned.

References

[UNFCCC LTS Database: https://unfccc.int/process/the-paris-agreement/long-term-strategies](https://unfccc.int/process/the-paris-agreement/long-term-strategies)

National/Sector Development Plans [list to be constructed]

National Climate Action Plans

⁷ The [high-level LTS principles](#) proposed by MDBs can help development, implementation, and monitoring of robust, inclusive, and ambitious LTSs.

SC3: Is the operation/economic activity inconsistent with global sector-specific decarbonization pathways in line with the Paris Agreement mitigation goals, considering countries' common but differentiated responsibilities and respective capabilities?

Clarification/Guidance

SC3 checks the operation's compatibility with widely accepted data and findings in the global literature on sector-specific decarbonization pathways in line with the Paris Agreement's mitigation goals.

SC3 applies these global studies to the country context. This can be particularly useful:

- When an assessment under SC2 is not feasible due to the lack of an LTS or similar national strategies;
- For operations in high-emitting sectors for which global Paris-compatible pathways are available; and
- For operations that cover multiple countries or that are closely linked to international trade.

Sector-specific decarbonization pathways may include sector roadmaps developed by international organizations (e.g., the International Energy Agency), academia, or industry associations. Sector scenarios (with a more limited scope than pathways) provide estimates in terms of emission thresholds (e.g., tonnes of CO₂ per tonne of cement) that could also inform the assessment, as applicable.

Further guidance

See further guidance for SC1.

Considering countries' "common but differentiated responsibilities and respective capabilities," a foundational principle within the UNFCCC, means taking into account that countries are at different stages of development and have different resources and capacities that may affect their ability to decarbonize their economies in line with global pathways. As a result, an operation that would be deemed inconsistent in one country context might be deemed consistent in another context.

Examples

An operation will finance the procurement of diesel-fueled buses. Prospective studies (such as those published by [IEA](#)) suggest that in some countries, it is feasible to electrify public transport in the near term, as a step toward decarbonization. However, the pace at which this transformation can occur depends on the country context. In countries that are more advanced in their capabilities or opportunities for electrification of transport, the transition can be faster than in countries with more limited capacity or opportunities to transition to electrified fleet for several more years.

References

[IPCC Special Report: Global Warming of 1.5C](#)

[CD Links: Linking Climate and Development Policies – Leveraging International Networks and Knowledge Sharing](#)

[IEA Sustainable Development Scenario \(SDS\) and Net Zero Emissions by 2050 case \(NZE2050\)](#)

SC4: Does the operation/economic activity prevent opportunities to transition to Paris-aligned activities, OR primarily support or directly depend on non-aligned activities in a specific country/sectoral context?

Clarification/Guidance

SC4 compares the operation to lower-carbon alternatives and considers the risks of (i) creating lock-in or (ii) preventing future deployment of Paris-aligned activities.

SC4 also considers the broader impact the operation could have on the likelihood of achieving the low-GHG transition, even beyond the immediate scope of the operation, as applicable ("is the operation preventing opportunities to transition?").

SC4 may be informed by relevant low-GHG development pathways (same or other than those considered under SC2) and by studies carried out under BB4 or other country strategy support provided by the MDBs. When such studies are available, the MDBs will assess the consistency of operations with such pathways, according to the MDBs' own expert judgment.

Further guidance

Low-GHG development pathways considered under SC4 can be either economy-wide or sector-specific. They need to be consistent with the objectives of the Paris Agreement, but also consider the circumstances of the country, best available technologies, and capabilities of the client (in other words, they must be plausible).

Even before countries reach the stage of having an official LTS, interim analyses produced as part of capacity-building efforts or other country-level diagnostics, including those supported by MDBs, may represent useful inputs for assessment under SC4. The more such interim analyses comply with the principles for a robust LTS, the more useful they will be for enabling a robust assessment.

SC5: Is the operation/economic activity economically unviable, when taking into account the risks of stranded assets and transition risks in the national/sectoral context?

Clarification/Guidance

SC5 incorporates climate change considerations into the quantitative economic or financial analysis of the operation. This, in turn, involves monetizing, to the extent possible, the costs and benefits related to risks associated with climate change impacts and relevant climate policies. Each MDB is expected to apply the SC5 based on its internal methods and approaches.

An operation will be considered not aligned if it fails to meet the individual MDB's thresholds for economic or financial viability once such considerations are incorporated in the analysis or in an equivalent qualitative assessment, if available.

For example, the economic or financial analysis may account for the risks of an asset's lifetime being unexpectedly shortened, in particular due to climate policies (stranded assets risk).

Shadow carbon prices can be a possible simplified way to incorporate climate change considerations into the economic analysis.

Further guidance

SC5 may be linked to the adaptation and resilience assessment under BB2. For example, the economic or financial analysis may also consider physical climate change risks faced by an asset.

4. Explanation of the BB2 Framework

4.1. Decision Tree Steps and Criteria

37. The BB2 assessment framework is built around three decision steps:

- Identifying and assessing physical climate risk: Is the operation at risk?
- *Addressing physical climate risk and building climate resilience*: Have adaptation and resilience measures been identified to reduce material physical climate risks and/or contribute to building climate resilience?
- *Assessing the broader context for climate resilience*: Is the operation not inconsistent with relevant policies/strategies, private sector or community-driven priorities for climate adaptation and resilience?

38. The decision tree in Figure 2 illustrates the process for assessing the alignment of an operation with the adaptation and resilience goals of the Paris Agreement, following these three steps. Each MDB will be guided by its internal procedures to assess operations against the BB2 criteria, reflecting its own business models and processes.

39. The criteria and guiding questions for each decision step are described below.

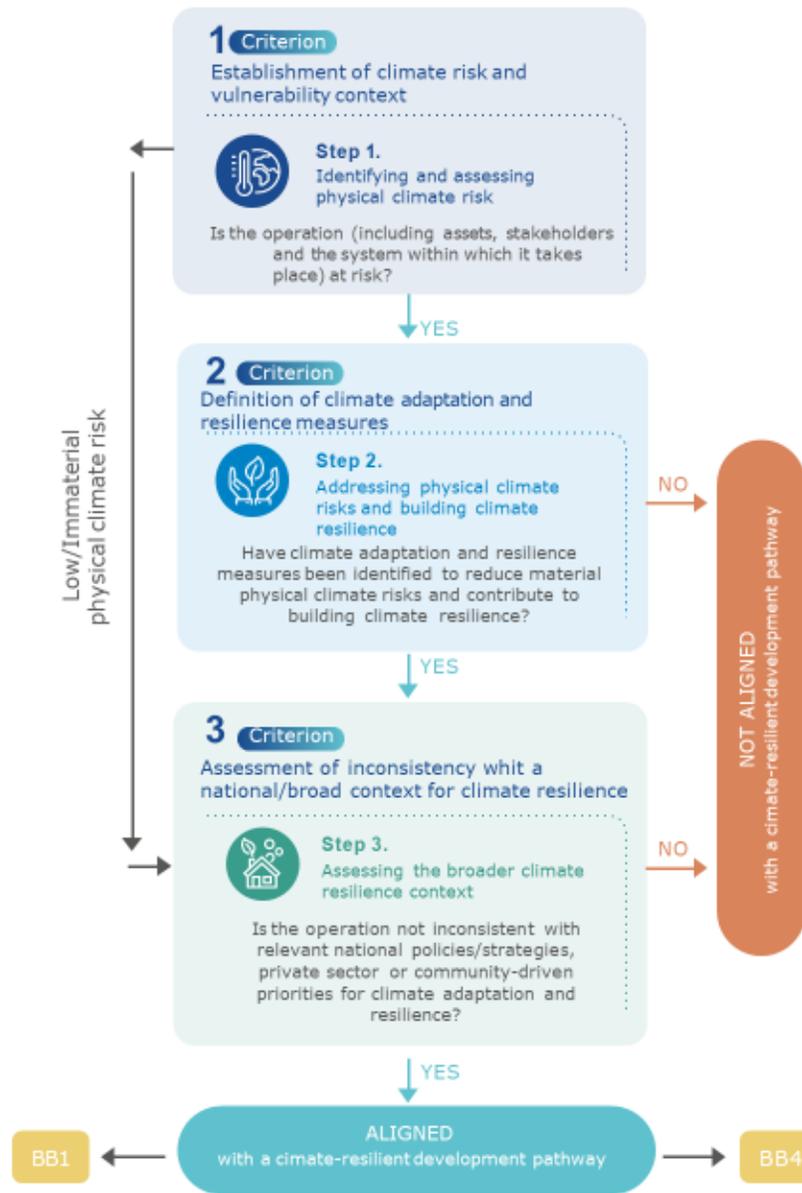


Figure 2: Decision tree for evaluating whether an operation/activity is aligned with the Paris Agreement's climate change adaptation and resilience goals.

4.1.1 Criterion 1: Establishment of climate risk and vulnerability context

Criterion 1: Establishment of Climate Risk and Vulnerability Context
Purpose: Identify and assess physical climate risk—is the operation (including assets, stakeholders, and systems as relevant) at risk?

Clarification/Guidance

The objective of Step 1 is to determine whether an MDB operation is vulnerable to climate change.

At a minimum, in order to successfully move to the next step, the climate risks to which the operation may be exposed to need to be identified and assessed, following each MDB's own internal policies.

Criterion 1 lays out a systematic approach for identifying and assessing the physical climate risks that could affect the operation over a relevant time horizon. Depending on the project boundaries, this could refer to impacts on its assets, the services it aims to provide, associated human and natural systems (e.g., ecosystem services), or its targeted beneficiaries, and it could be over short, medium or long-term timeframes.

In identifying and assessing physical climate risks, the MDBs will consider:

- The context within which the operation will take place;
- The operation's exposure, sensitivity and overall vulnerability to climate hazards; and
- The need for a climate risk assessment as appropriate.

If the operation is deemed not to be at risk (that is, the risk is considered low or immaterial), Step 2 can be skipped, and Step 3 will be completed next.

If the operation is deemed to be at risk, the assessment moves on to Step 2.

Guiding Questions and Further Guidance

The assessment under Criterion 1 has two main parts, each with several guiding questions that may be used:

1. Assessing the level of exposure and sensitivity of the operation within its boundaries

Establishing operation's boundaries: A key first step is to ensure that appropriate operation boundaries have been determined (based on each institution's operating policies). Operation boundaries can be seen as the direct and indirect physical, economic, social, and temporal realms of reasonable impacts. Physical boundaries may consider conservation areas in the proximity of the operation, urban expansion areas, and destination areas in the case of transportation projects. Economic boundaries could include the sources of raw materials and the sites of important links in the value chain. Social boundaries could include demographic growth resulting from increased economic activity triggered by the operation. Temporal boundaries could be the timeframe within which extreme weather events are expected.

Defining the operation's level of exposure (within its boundaries and specified timeframe) to specific climate-related hazards: Do existing national or regional records of historical climate hazards, and/or scenario-based projections of future climate, provide evidence that the operation, within its boundaries and specified timeframe, may be exposed to climate-related hazards? In the case of an operation aimed at institutional strengthening: Is the institution (its functioning, service provision) vulnerable to climate-related hazards? (For instance, climate hazards could disrupt home visits by educators in an operation aimed at improving the quality and management of child development services. Or in an operation aimed at capacity building, training facilities may not be accessible for participants during the timeframe foreseen for the trainings.)

Scoping the operation's sensitivity to climate change: Does the evidence in the existing literature, historical records, etc., of the impacts of climate change and climate variability on similar or actual operations suggest that this type of operation (for instance, a specific type of infrastructure or service) may be sensitive to climate-related risks?

2. Overall vulnerability to climate hazards and the need for a system-level risk assessment

Determining overall vulnerability to climate hazards within the operation's boundaries: Are the activities financed by the operation vulnerable to or at risk from climate change? Was the operation deemed to require a climate risk/vulnerability assessment? If so, what type of assessment was conducted to define climate resilience measures (e.g., third-party ad-hoc assessment, qualitative assessment, quantitative assessment, a detailed disaster risk assessment, etc.)? Qualitative and/or quantitative types of assessments could be used depending on the level of effort required for the type of climate risk identified (e.g., level of criticality). Can the conducted assessment be considered robust and sufficient?

Determining the need for a system-level risk assessment: Has the operation considered any indirect climate impacts and risks? Might the operation itself increase climate vulnerability or shift it beyond the project's

spatial/temporal boundaries? (For example, a road improvement or expansion could enable growth in the dairy sector in an area susceptible to drought.) If indirect or unintended climate impacts and risks have not been considered, is this recommended, given the nature of the operation? This includes risks to the wider system in which the project operates, for which opportunities for partial and/or collaborative (with partners beyond the project's scope) management will be assessed when adequate.

4.1.2 Criterion 2: Definition of Climate Resilience Measures

Criterion 2: Definition of Climate Resilience Measures
<p>Purpose: Address physical climate risks and build climate resilience—have climate adaptation and resilience measures been identified to manage the assessed physical climate risks and/or contribute to building climate resilience?</p>
<p style="text-align: center;">Clarification/Guidance</p>
<p>The objective of Step 2 is to ensure that climate resilience measures have been included in the operation to address or manage any material physical climate risks identified in Step 1.</p> <p>In order to successfully move into the next step, an operation is expected to have identified and included measures to reduce the identified physical climate risks.</p> <p>Importantly, Criterion 2 also encourages an assessment of the opportunities for resilience-building presented by a changing climate and urges the adoption of climate adaptation and resilience measures that provide benefits beyond the boundaries of an operation.</p> <p>Notably, though Step 2 aims to ensure that adaptation measures minimize risks, maximize gains, and strengthen overall climate resilience, it does not set a bar for adequacy, minimum response, or thresholds for residual risks. It is expected that each institution will be as ambitious as possible, recognizing that climate adaptation and resilience measures and their impacts will be highly contextualized in practice.</p> <p>This step considers:</p> <ul style="list-style-type: none"> • Measures to address identified climate risk and opportunities to enhance climate resilience; • The potential for maladaptation (if relevant); and • The documentation of the selected climate resilience response.
<p style="text-align: center;">Guiding Questions and Further Guidance</p>
<p>The following guiding questions may be considered for each aspect of the analysis under Criterion 2:</p> <p>1. Measures to address climate risks and opportunities and enhance climate resilience</p> <p><i>Incorporating measures to address climate risks:</i> Which measures were incorporated into the operation to address the identified climate risks? These measures can focus on risk avoidance or on risk mitigation.</p> <p><i>Identifying additional opportunities to enhance climate resilience:</i> Is the operation, or are particular investments/activities, aimed at increasing climate resilience? Is climate resilience built into the entire project, other than responding to the specific climate-related risks that were identified? If not, does the operation have the potential to incorporate additional measures that enhance climate resilience? These will be measures that raise ambition and assist the country in moving further along a climate-resilient development pathway. In the case of an operation aimed at institutional strengthening in a climate-relevant or -sensitive realm: Are the institutional strengthening activities contributing to building adaptive capacity?</p> <p>2. Potential for maladaptation</p> <p><i>Considering the potential for maladaptation:</i> From a preliminary assessment, could the proposed climate adaptation and resilience measures contribute to maladaptation? Have trade-offs between different adaptation options been considered?</p> <p>3. Documentation of selected climate responses</p>

Documenting the processes or measures established for climate adaptation and resilience: Are all measures related to the climate response- and related information documented?

4.1.3 Criterion 3: Assessment of Inconsistency with a National/Broad Context for Climate Resilience

Criterion 3: Assessment of Inconsistency with a National/Broad Context for Climate Resilience
Purpose: Assess the broader climate resilience context—is the operation consistent with relevant policies/strategies and with private sector or community-driven priorities for climate resilience?
Clarification/Guidance
<p>The objective of Step 3 is to ensure that operations are not inconsistent with policies/strategies/plans for climate adaptation and resilience at the national, local, city, regional, or territorial level, as considered relevant, and/or with private sector or community-driven priorities.</p> <p>In order to successfully complete the assessment under Step 3, an operation will be expected not to be inconsistent with priorities set forth in national or sectorial policies/strategies/plans for climate resilience. If applicable and possible, it will also be expected to enhance private sector participation in the implementation of said policies/strategies/plans.</p> <p>This step does not make a judgment on the adequacy or appropriateness of the policies/strategies/plans for climate resilience, or of private sector or community-driven priorities within the country.</p> <p>Operations in the same context (e.g., multiple/similar operations in the same region, sector and in overlapping time spans) should consider the same broader context for climate and, where applicable, adequate stakeholder engagement to better contribute to long-term strategies for climate resilience.</p> <p>This step entails:</p> <ul style="list-style-type: none"> • Identifying policies/strategies/plans for climate adaptation and resilience, or private sector or community driven priorities in the country; and • Establishing that the operation is not inconsistent with these policies/strategies/plans or priorities.
Guiding Question/Further Guidance
<p>The following guiding questions may be considered in completing those tasks under Criterion 3:</p> <p>Identifying policies/strategies as well as private sector or community-driven policies for climate resilience</p> <p><i>Identifying policies/strategies and private sector or community-driven priorities relevant to the operation:</i> Which policies for climate adaptation and resilience exist at the national, regional, or local level (laws, strategies, action plans such as National Action Plans, NDCs, regional/city/local plans)? If applicable, which private sector or community-driven priorities exist at the national, regional, or local level?</p> <p><i>If climate resilience-related policies and priorities do not exist:</i> Is this an operation that should be encouraged in the context of a climate-resilient development pathway for the country?</p> <p>Establishing that the operation is not inconsistent with these policies/strategies/plans or priorities</p> <p>Which of the identified policies/strategies/plans at the national, local, city, regional, and territorial level, and/or private sector or community-driven priorities are considered relevant and applicable? Is the operation not inconsistent with these policies/strategies/plans or priorities “as considered relevant and applicable”?</p>

4. Glossary

Operation: Financial and related operational support to specific productive activities (projects) with defined development objectives, activities, and results, entirely or partially provided by an MDB to an investee and disbursed against specific eligible expenditures (i.e., capital investment or operational and maintenance expenses). Capital investment can be provided to initiate new economic activity (e.g., operation finance of a new power plant), support existing economic activity (e.g., working capital for a farm), or finance the components of existing economic activity (e.g., energy efficiency improvements at a manufacturing facility).

Carbon lock-in occurs when, due to technical, economic, or institutional factors associated with a given investment, an emissions-intensive asset is expected to continue to operate even after there are feasible—and economically preferable—lower-carbon options that could replace it.

Stranded assets are assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities.

Climate change adaptation and climate resilience: These terms are sometimes used interchangeably, but although they overlap, they are distinct from each other and should be treated accordingly in the context of the BB2 decision tree:

- **Climate change adaptation** is the process of human and natural systems adjusting to the actual or expected impacts or effects of climate change. It includes adapting to short-term weather fluctuations, inter-annual variability, and longer-term changes over decades, and it relates to adjustments in behaviors, practices, skill sets, natural processes, and knowledge that anticipate short-, medium-, and long-term changes.
- **Climate change resilience** is the ability of a system to withstand climate-related shocks or stressors. It is the capacity of a system to cope with, or recover from, those effects, while retaining its essential original components. Climate resilience is an important and growing subset of building system-level resilience to multiple shocks.

Climate hazards are physical occurrences with the potential to affect human, environmental, or economic systems. Climate hazards may be **chronic** or slow-onset (that is, progressive shifts in climate conditions, such as gradual reductions in annual rainfall), or **acute** or rapid-onset (that is, extreme weather events, such as floods, cyclones or storms).⁸ They may result in the loss of life, physical injuries, loss of livelihoods, asset underperformance, environmental degradation, etc. The extent of those impacts depends on:

- *Exposure*—is the operation⁹ in a location and setting where (directly or indirectly) a slow- or rapid-onset climate hazard is expected to occur?
- *Sensitivity*—to what degree can the operation be affected (directly or indirectly) by changes in climate and variability?
- *Timeframe*—over what timescale could the operation, its target community, or the ecosystem potentially be exposed to a given climate hazard?
- *Climate vulnerability*—to what degree is an operation, its target community or ecosystem susceptible to, and unable to cope with the adverse effects of changes in climate and variability?

⁸ Different organizations use different definitions and taxonomies of climate hazards, which may present some barriers to wider action on physical climate risk management. One attempt to arrive at a more consistent breakdown for physical climate hazards has been provided by the European Union's Sustainable Finance Action Plan—specifically, its Sustainable Finance Taxonomy: https://ec.europa.eu/info/publications/sustainable-finance-teg-taxonomy_en.

⁹ This includes also a target community or an eco-system

[Vulnerability is a function of the hazards to which an operation is exposed to, its sensitivity and adaptive capacity]

- *Adaptive capacity*—what capacities does the operation, or its sponsor/beneficiary have to cope with exposure to a given climate hazard?

Climate-resilient development pathway: In the context of the BB2 decision tree, a country’s climate-resilient development pathway is defined as a trajectory in which climate change does not prevent progress toward sustainable development goals (economic growth, human development, environmental protection, etc.) and the gains from a “new climate normal” are maximized where possible. These trajectories are continually evolving and are built on two components: actions to mainstream the development of strategies and climate risk management procedures, and incremental or transformative climate adaptation and mitigation actions to reduce human-induced climate change and its impacts.

Climate risk management and resilience opportunities: Climate risk management and resilience opportunities are defined as the preservation or creation of value through the effective anticipation and/or management of physical climate risks and systemic adjustment to expected changes in the climate.

Indirect climate risks: Indirect climate risks are risks arising from systemic, transboundary, and/or long-distance impacts or effects of climate change.¹⁰ These include the effects on human, economic, social or environmental dimensions beyond the MDB operation’s physical boundaries, within a specific period of time. Moreover, the interconnectedness of these systems highlights the potential for complex relationships between sources and drivers of risk and appropriate climate resilience responses. A good way to understand indirect risk is through an example provided by the Stockholm Environment Institute (SEI¹¹): direct impacts of climate change (e.g., a drought or a flood) will affect a specific “receptor system” such as a shared river basin or an international supply chain, and then climate risk is transmitted via one of four main pathways: people, biophysical, trade, and finance.

Maladaptation refers to climate adaptation actions that increase current or future climate vulnerabilities within the boundaries of an operation, shift vulnerabilities from within the boundaries of an operation to an external/surrounding system (causing adverse effects on social, environmental, economic, or physical aspects of the system), or undermine sustainable development. Maladaptation occurs when an adaptation action undermines the coping capacities of existing systems, diminishes the capabilities of future generations to respond to climate vulnerabilities, or places a disproportionate burden for climate action on present-day or future external actors.

Physical climate risk is the potential for consequences where something of value is at stake and the outcome is uncertain. It is often measured as the probability that a hazardous event or trend may occur, multiplied by the impacts that would result. Building on this, the BB2 decision tree breaks down the definition of risk into three determinants, similar to the Network for Green Financial Services: *sensitivity* (to physical climate hazards), *exposure* (to physical climate hazards—in a geographical sense) and *timeframe* (time span of potential exposure to physical climate hazards). In this context, “risk” refers to the potential loss of value, and “value” may be defined in the broadest possible terms: financial capital, economic capital, human capital, social capital, environmental capital, etc.

¹⁰ IPCC AR5

¹¹ SEI, Policy Brief: National Adaptation Plans and the indirect impacts of climate change

Annex 1: Activities Considered Universally Aligned or Not Aligned with the Paris Agreement’s Mitigation Goals

Building on the discussion in Section 3.2, this Annex presents draft lists of activity types that are currently considered to always be consistent or inconsistent with low-GHG development pathways. It is important to stress that these lists are expected to be revised over time, as additional evidence becomes available to help determine which operations are or are not Paris-aligned, under which conditions.

Activities Considered Universally Aligned

Operation types included on this draft list will have to go through the specific criteria assessment if they fall under any of the following:

- Operations whose economic feasibility depends on external fossil fuel exploitation, processing, and transport activities (e.g., a railway line that will have a significant income from the transport of coal from a coal mine).
- Operations whose economic feasibility depends on existing fossil fuel subsidies (e.g., a fishing fleet that would be unfeasible in the absence of subsidies to diesel fuel).
- Operations that rely significantly on the direct utilization of fossil fuels (e.g., a pharmaceutical production plant that makes use of diesel pumps).

Sector	Eligible operation type	Conditions and guidance
Energy	Generation of renewable energy (e.g., from wind, solar, wave power, etc.) with negligible lifecycle GHG emissions.	Includes generation of heat or cooling
	Rehabilitation and desilting of existing hydropower plants, including maintenance of the catchment area (for example, a forest management plan)	Rehabilitation includes work on the water holding capacity of the dam and work on pipes/turbines to increase productivity and bring additional grid stabilization benefits, and for pumped storage
	District heating or cooling systems with negligible lifecycle GHG emissions	Using significant renewable energy or waste heat or cogenerated heat OR Including: a) Modification to lower temperature delta b) Advanced pilot systems (control and energy management, etc.)
	Electricity transmission and distribution, including energy access, energy storage, and demand-side management	
	Cleaner cooking technologies	Cleaner cooking technologies substitute the use of traditional solid biomass fuels in open fires; they include sustainable biomass or electric cookstoves

Sector	Eligible operation type	Conditions and guidance
Manufacturing	Non-energy-intensive industry (excludes chemicals, iron and steel, cement, pulp and paper, and aluminum)	Consider the nature of the product produced (carbon content, lifetime, ability to be reused/recycled).
	Manufacture of electric vehicles; non-motorized vehicles, electric locomotives; non-motorized rolling stock	
	Manufacture of components for renewable energy or energy efficiency	
Agriculture, forestry, land use and fisheries	Afforestation, reforestation, sustainable forest management, forest conservation, soil health improvement	With the exception of operations that expand or promote expansion into areas of high carbon stocks or high biodiversity areas
	Low-GHG agriculture, climate-smart agriculture	With the exception of operations that expand and promote expansion into areas of high carbon stocks or high biodiversity areas and taking into account (international) transport
	Conservation of natural habitats and ecosystems	With the exception of operations that expand or promote expansion into areas of high carbon stocks or high biodiversity areas
	Fishing and aquaculture	
	Non-ruminant livestock with negligible lifecycle GHG emissions	
Flood management and protection, coastal protection, urban drainage		
Waste	Separate waste collection (in preparation for reuse and recycling), composting and anaerobic digestion of biowaste, material recovery, and landfill gas recovery from closed landfills	
Water supply and wastewater	Water supply systems (e.g., expansion, rehabilitation); water quality improvement; water efficiency (e.g., non-revenue water reduction, efficient process in industries); drought management; water management at watershed level	Desalination plants need to go through specific assessment
	Gravity-based or renewable energy-powered irrigation systems	
	Wastewater treatment (domestic or industrial), including treatment and collection of sewage, sludge treatment (e.g., digestion, dewatering, drying, storage), wastewater reuse technology, resource recovery technologies (e.g., biogas into biofuel, phosphorus recovery, sludge as agriculture input, sludge as co-combustion material)	
Transport	Electric and non-motorized urban mobility	
	Roads with low traffic volumes providing access to communities which currently do not have all-weather access (for example, connecting farmers to markets or providing access to a rural school, hospital, or better social benefits)	Except if there is any risk of contributing to deforestation
	Electric passenger or freight transport	
	Short sea shipping of passengers and freight ships	

Sector	Eligible operation type	Conditions and guidance
	Inland waterways passenger and freight transport vessels	
	Port infrastructure (maritime and inland waterways)	
	Rail infrastructure	
	Road upgrading, rehabilitation, reconstruction, and maintenance without capacity expansion	
Buildings and public Installations	Buildings (education, healthcare, housing, offices, retail, etc.)	Needs to meet green building certification criteria as established by each individual MDB ¹²
	LED street lighting	
	Parks and open public spaces	Excluding energy-consuming installations ¹³
Information and communications technology (ICT) and digital technologies	Information and communication, excluding data centers	
Research, development and innovation	Professional, scientific, research and development (R&D), and technical activities	
Services	Public administration and compulsory social security	
	Education (excluding infrastructure/buildings)	
	Human health and social work activities (excluding infrastructure/buildings)	
	Social protection, cash transfer schemes	
	Arts, entertainment and recreation (excluding infrastructure/buildings)	
Cross-sectoral activities	Conversion to electricity of applications that currently use fossil fuels	

Activities Considered Universally Not Aligned

At this time, the MDBs consider four activity types to be universally not aligned with the Paris goals:

- Mining of thermal coal;
- Electricity generation from coal;
- Extraction of peat; and
- Electricity generation from peat.

Note that the fact that being omitted from this list does not mean that an operation type is endorsed by or will be financed by the MDBs.

¹² MDBs are working on the approach to assess the Paris alignment of buildings and the role of certification schemes. This approach can also take into account the impact of materials on the alignment of buildings with the low-carbon pathways envisioned by the Paris Agreement.

¹³ Energy-consuming installations are those beyond lighting and routine maintenance such as watering. Examples are major built-up area (i.e., buildings) or energy-intensive installations (e.g., fountains or playground and recreational equipment that need a non-renewable power source).