G7 Progress Report: Adaptation & Resilience Investors Collaborative

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Adaptation & Resilience Investors Collaborative

Prepared by:

CLIMATE POLICY INITIATIVE

The Adaptation & Resilience Investors Collaborative (the "Collaborative") is a partnership of development finance organizations formed in 2020 to accelerate and scale up private investment in climate adaptation and resilience in developing economies. In May 2021 the Collaborative put forward an ambitious plan of action to the G7, which it deepened and refined at COP26 in November 2021.

This report outlines the Collaborative's progress to date and previews its activities over the remainder of 2022.

CONTEXT OF THE COLLABORATIVE

The impact of climate change is no longer a far-off concern, but is increasingly affecting communities and natural ecosystems around the world, particularly in the most vulnerable places. The latest IPCC report emphasizes that urgent action to foster climate resilient development is needed to address these impacts, and that some efforts to date have already helped to reduce vulnerability.

At the same time, the U.N. estimates that adaptation in developing economies will cost between USD 155 and USD 330 billion annually by 2030. However, total adaptation finance globally reached just USD 46 billion in 2019/2020[1], an increase from prior years but still far short of what is needed. The public sector provided nearly all of this, due to a confluence of well-documented challenges for private sector investment. These fall into two broad categories: (1) barriers to mobilizing private sector investment in adaptation and resilience and (2) data limitations on tracking the private sector investment that does occur. On the first point, the main barriers include among others:

- Uncertain returns and high perceived risks;
- Lack of capacity of financing institutions and counterparties to assess and take action; and
- Inadequate regulatory frameworks

The Collaborative therefore responds to a substantial and growing global need for investment in adaptation and resilience, especially from the private sector. Investments must help boost the resilience of specific infrastructure projects and support the companies that offer the products and services that make taking action possible. Governments, DFIs, the private sector, and other stakeholders must act now to bridge the gap between current and future finance needs and to smooth the path for actors on the ground to implement solutions.

1 CPI. 2021. Global Landscape of Climate Finance 2021.

PROGRESS OF THE COLLABORATIVE TO DATE

Launched at the 2020 Finance in Common Summit, the Collaborative promotes collaboration and action to overcome barriers and market failures hindering private investment in climate adaptation and resilience. The Collaborative has rapidly grown and is currently composed of 18 members.

In May 2021, the Collaborative announced several commitments, welcomed by the G7 Foreign and Development Ministers. This included committing to:

- Pursue a substantial increase of investments in adaptation and resilience and engage in further joint work towards the adoption of a common methodological approach for identifying eligible investments and reporting on progress, building on the existing ones whilst ensuring their usability by private investors.
- Work towards ensuring all investments are resilient to physical climate risks, and towards improving the Collaborative's collective ability, and those of their counterparties, to identify, assess, and manage physical climate risks in their investments.
- Increase support and collaborate to shape markets and build the pipeline of bankable A&R investments.
- Support the public and private sector collaboration needed to (a) assist developing countries with identifying and articulating their adaptation needs and potential private sector opportunities to address these, and (b) create the conditions for accelerating private sector finance for the adaptation and resiliency solutions required to deliver their country and/or local level adaptation plans and strategies.

To meet these commitments, the Collaborative has launched an ambitious work program which seeks to support members' progress against their commitments (see Annex for details). This includes reviews of existing and potential approaches for tracking and measuring impact of adaptation finance; the development of draft metrics for assessing impact; an understanding of the types of strategies DFIs can and are using to develop a bankable pipeline; and the development of guidance for physical climate risk assessment.

At COP26 in November 2021, the Collaborative added further detail to its commitments, specifically pledging to:

- Adopt common principles for tracking finance for climate adaptation and resilience;
- Disclose the volume of adaptation finance committed on an annual basis, following different implementation timelines for each institution;
- Continue to promote adoption of standardized ways to measure the contribution of their investments towards adaptation and resilience impact goals; and

- Develop common good practice approaches for physical climate risk identification, assessment, and management, including common tools for engaging with counterparties.

In addition, a number of Collaborative members have announced initiatives that focus on building a bankable pipeline of adaptation and resilience investment and on advancing support for public-private collaboration (see Annex).

THE PATH FORWARD

The Collaborative has come a long way since its launch late in 2020, but there is still much to be done. In early 2022, Collaborative members undertook a planning process to formalize the Collaborative and map out a technical work and business plan for the coming years.

Key Collaborative priorities for 2022-23 include increasing coordination and impact of its activities, improving dissemination and knowledge exchange, and enhancing visibility of the Collaborative. To support these priorities, the Collaborative has agreed on the following key areas of work, and identified a set of possible activities:

- **Investor-relevant metrics.** The Collaborative will produce draft guidance regarding a menu of metrics and a related analytical approach to ensure consistent measurement. This will leverage hypothetical use cases of member investments to test approaches. The Collaborative will develop a practical toolkit to support measuring and reporting on relevant metrics.
- **Physical climate risks.** The Collaborative will draft guidance to identify, assess, and manage physical climate risks for direct transactions such as corporate and project financing, and develop a toolkit for engaging with and assessing counterparties in the context of indirect transactions such as financing via intermediaries.
- **Investment vehicles and approaches.** The Collaborative will help build awareness of business models and financing structures, develop a common guidebook to guide investment, share pipeline when feasible, and set up pitch sessions for entrepreneurs.

In addition, in April 2022 members agreed on a governance model and business plan to support and execute the goals of the Collaborative. By Q3 2022 the Collaborative will aim to set up a formal steering committee; the launch of new secretariat arrangements and finalization of a long-term funding model will follow.

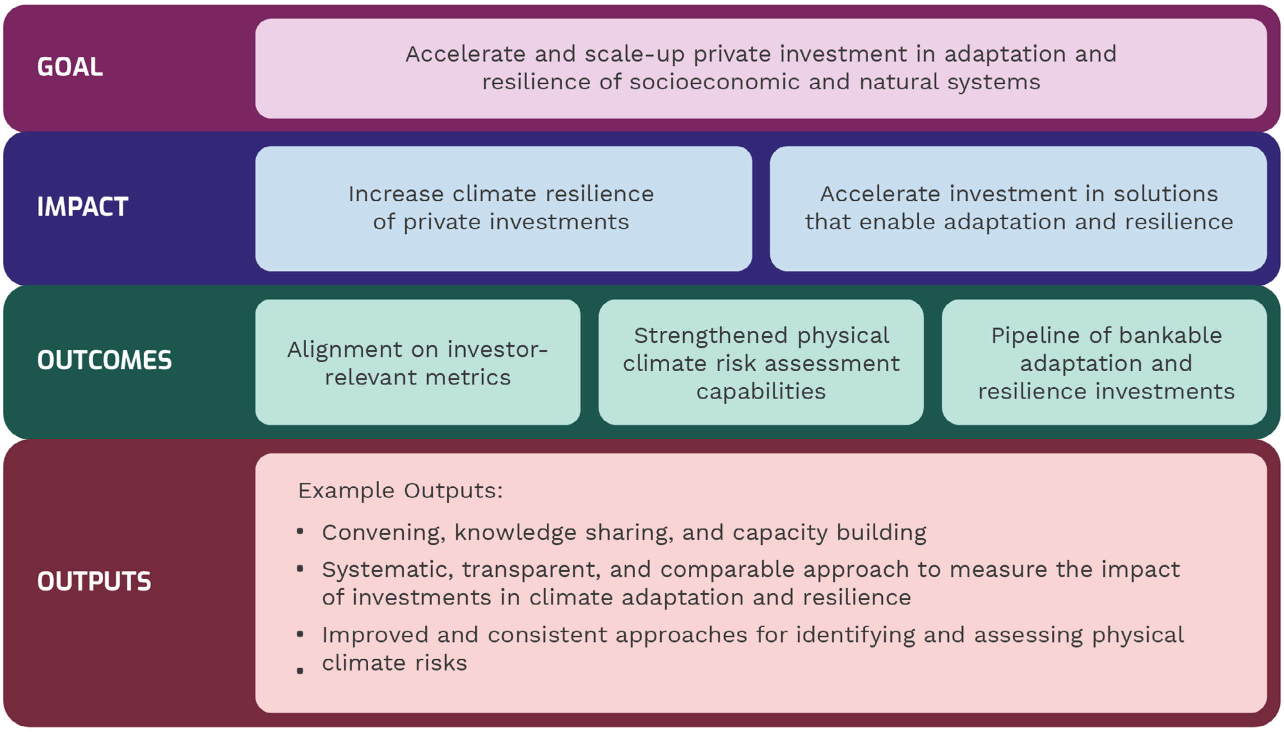
CONCLUSION

Collaborative members vary in their mandates, degree of maturity on climate adaptation, geographies they serve, and financing avenues available, among other factors. The market for adaptation and resilience investment will grow as areas of alignment among this diverse group emerge, leveraging their respective roles in the investment value chain and varying degrees of risk appetite and tolerance. Even as the Collaborative remains committed to achieving its ambitious goals, governments must create effective policy and wider enabling environments. The Collaborative calls on the global community to join in accelerating and scaling private investment in the adaptation and resilience of socioeconomic and natural systems.

ANNEX I: DETAILS OF PROGRESS 2021-2022

The G7 commitments form the basis of the Collaborative's work program, which the Collaborative's theory of change illustrates (Figure 1). Individually and jointly, Collaborative members have made progress on the commitments and have planned ambitious activities for 2022 and 2023 across each of the commitment areas.

Figure 1: The Collaborative's theory of change focuses on accelerating private investment in adaptation.



This section details the Collaborative's progress toward meeting its goals.

1. ADOPTING A COMMON METHODOLOGICAL APPROACH

In 2021, the Collaborative pledged to work towards adopting a common methodological approach to identify eligible adaptation and resilience investments and report on progress. To that end, the Collaborative's investor-relevant metrics working group has sought to:

a. Adopt common principles in line with best practice for a stepwise, process-based approach, granularity, and conservativeness (explained below), following assessment of the common factors uniting members' existing approaches as well as approaches implemented in other institutions and jurisdictions.

   To enhance understanding of adaptation and resilience finance and support the adoption of common principles, the Collaborative has developed five case studies from members' direct and indirect investments. The case studies include both those intended to increase the resilience of private sector investments as well as investments in solutions that enable adaptation. Specifically, they illustrate:

- The value of a process-based approach where evidence demonstrates that an investment contributes to climate adaptation and resilience
- Application of the principle of granularity, where adaptation activities must be disaggregated from non-adaptation activities
- Application of the principle of conservativeness, under which it is preferable to under-report than to over-report when data is unavailable

At the same time, this work also underscores the need to build the capabilities of intermediaries, fund managers and financial institutions on climate finance investing and reporting. This is relevant to expand the reach and scale of adaptation and resilience investing and financing. The development of bespoke toolkits is one of the options being considered.

b. Advance towards a systematic and transparent approach to produce clear, consistent, and comparable adaptation impact metrics. To date, the Collaborative has:

- Surveyed current approaches to measuring impact that focus on or are relevant to adaptation and resilience investment
- Advanced key features and analytical underpinnings that arise from surveyed approaches
- Outlined a proposed framework and preliminary high-level menu of metrics that members of the Collaborative could consider committing to
- Proposed next steps the Collaborative could consider in building on the proposed menu of metrics

Collaborative members have discussed a number of challenges and options associated with measuring adaptation impact. For example, the heterogeneity and diversity of physical climate risks and responses do not allow for one-size-fits-all metrics. Other challenges include:

- Long time horizons and changing climate conditions create uncertainties around adaptation outcomes and their causality
- There are tradeoffs between simplicity, ability to aggregate at the portfolio level, and the extent to which metrics are implementable across varying contexts
- There are challenges associated with assessing the link between the positive outcomes of adaptation measures and climate risk reduction
- The effectiveness of adaptation to reduce climate risk can vary under different climate scenarios (it likely decreases with increased warming)

Members have discussed options for measuring the benefits of climate adaptation and resilience investments. Proposed metrics include avoided losses of physical assets and/or incomes, and adaptation solutions made available to vulnerable populations.

The Collaborative has made progress against these challenges but needs to do more work and knowledge exchange, including with other initiatives and members of the private sector.

2. ENSURE ALL INVESTMENTS ARE RESILIENT TO PHYSICAL CLIMATE RISKS

The Collaborative has committed to improve members' collective ability to identify, assess, and manage physical climate risks in investments. To date, the Collaborative's physical climate risks working group has developed an initial overarching, sector-agnostic, step-by-step framework to provide guidance for systematic and consistent physical climate risk identification, assessment, and management. The guidance, which includes a bespoke approach for the agricultural sector, is meant to enable a standardized categorization of transactions based on the relative degree of physical climate risks, in order to inform decision making throughout the investment cycle.

Figure 2 provides a simplified overview of the key ways to identify, assess, and manage physical climate risk throughout the investment cycle.

Figure 2. Approach to physical climate risk identification, assessment, and management

	Key objective	Key output
Screening due diligence	Identify which physical climate risk(s) may affect the performance of the activity during its expected lifetime	Inherent physical climate risk categorization
In-depth due diligence	Gain enhanced understanding about exposure and vulnerability to physical climate risks, related implications and counterparty's capabilities Identify and evaluate climate A&R solutions	Residual physical climate risk categorization informed by A&R solutions Investment decision
Investment decision	Take investment decisions informed by physical climate risks and A&R opportunities	
Investment legal agreement	Secure and formalize the commitment and resources required to increase an activity's / the counterparty's resilience to climate change shocks and stressors	A&R solutions formalised in an A&R action plan and supported with capital where needed
Monitoring & reporting	Oversee and support the counterparty to implement A&R solutions and build physical climate risk management capabilities Receive information on physical climate risks and the implementation of A&R solutions over the life of the investment	Ongoing physical climate risk management through A&R
Exit with value add	Enhanced activity's & counterparty's capabilities to withstand climate shocks and stressors Longer-term delivery of climate-resilient development impact objectives	Successful exit and value creation materialised

3. BUILD INVESTMENT PIPELINE AND STRENGTHEN PUBLIC-PRIVATE COLLABORATION

Individual members have made progress in developing avenues for a bankable pipeline of adaptation and resilience investments. Examples include:

- **AFD Group** is launching the second phase of the AdaptAction Programme with an additional budget of EUR15 million to support 12 African countries. This phase consists in 3 pillars (understanding, planning, investing) and 2 cross-cutting components (Gender and social inclusion; knowledge management and outreach). Phase 1 (2017-2022) reached a leverage effect of 595M€ on adaptation projects funded by AFD or co-funded with GCF or the UE.
- **British International Investment** secured a GBP200 million Climate Innovation Facility from its shareholder FCDO which will seed pioneering climate solutions, including for adaptation and resilience. The first investee of the facility, Kenya-based agri-focused insuretech business Pula, offers "pay-at-harvest" parametric insurance to smallholders in several African countries to accelerate uptake.
- **FMO** manages the Dutch Fund for Climate and Development (EUR160 million available), which made an anchor investment of EUR 75 million in its water facility, Climate Investor Two.
- **The US International Development Finance Corporation (DFC)** has launched a Climate Action Facility, which will deploy at least USD50 million in technical assistance funds to build a robust pipeline of climate finance investment transactions, including for adaptation and resilience.
- **The Global Center on Adaptation (GCA)** has announced increased funding for its Africa Adaptation Acceleration Program (AAAP) in partnership with the African Development Bank. Since its inception in 2021, the AAAP's Upstream Financing Facility has been able to influence over USD3bn worth investments for adaptation in Africa.

Collaborative members have also made progress through the investment vehicles and approaches working group. Within the working group, members have collaborated on potential investment strategies and are exploring avenues to develop a pipeline and/or co-invest in projects. The core output of this working group to date is a draft report outlining potential strategies to foster investment. Building partnerships — for example with accelerators, donor agencies, or philanthropies — emerges as a key strategy. Other strategies involve engaging local financial institutions, funds, and platforms for identifying opportunities for adaptation and resilience within their existing portfolios or pipelines.

The draft report highlights the relevance of each strategy towards generating three types of investments: direct investments in adaptation and resilience solutions providers, direct investments in increasing the resilience of projects or companies, and indirect investments through financial intermediaries such as financial institutions or funds.

ANNEX II: MEMBERS OF THE COLLABORATIVE

As of May 2022 the 18 members of the Collaborative are: Agence Française de Développement, British International Investment, Cassa Depositi e Prestiti in its role as Financial Institution for International Development Cooperation, the European Investment Bank, FinDev Canada, Finnfund, FMO of the Netherlands, the Global Center on Adaptation, the Global Innovation Fund, the Islamic Development Bank, KfW Development Bank, the Nordic Development Fund, Proparco, Swedfund, the UK Foreign, Commonwealth, and Development Office, USAID, and the U.S. International Development Finance Corporation.