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How can financial intermediation better contribute to the climate transition?

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METHODOLOGY

The findings are drawn from an analysis based on 1/ a literature review focusing on financial intermediation and impact, 2/ interviews (as detailed below), and 3/ the outcomes of a workshop held along the sidelines of the 2025 Finance in Common Summit, with representatives of research organisations and other civil society organisations as well as a few public development banks (PDBs).

Throughout this report, use of the acronym PDBs refers to multilateral development banks (MDBs), bilateral development banks, as well as development finance institutions (DFIs). In this research, a financial intermediary (FI) mostly refers to a regional or national development bank (NDB) or a local public financial institution (*e.g.* mortgage or housing finance provider), in a developing country, that channels international development finance to local beneficiaries.

To look into current practices for advancing Paris alignment through financial intermediation, the authors interviewed representatives of a sample of PDBs providing international development finance and of financial intermediaries. The PDB group (9 institutions) consists of multilateral and bilateral development banks as well as development finance institutions engaging with the private sector: *Agence française de développement* (AFD), the Asian Infrastructure Investment Bank (AIIB), British International Investment (BII), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank (IDB), the International Finance Corporation (IFC), KfW, and Proparco. The financial intermediary group (8 institutions) includes a regional development bank, which has been considered mainly for its role as a financial intermediary, several public financial institutions, including national development banks and national commercial banks, based in different geographies (mostly in Asia, but also in Latin America, and Africa): the National Bank for Economic and Social Development (BNDES), the Development Bank of Latin America and the Caribbean (CAF), Housing Bank for Trade and Finance (HBTF), Industrial Development Corporation (IDC), Kyrgyz Investment and Credit Bank (KICB), National Mortgage Company (NMC), *PT Sarana Multi Infrastruktur* (PT SMI), and *Türkiye Sınai Kalkınma Bankası* (TSKB). This limited sample is not meant to be comprehensive nor representative, but rather indicative of some of the practices currently deployed that could serve as levers for greater impact on climate and development outcomes.

Interviews were conducted between September 2024 and February 2025, with representatives mostly from teams in charge of climate-related issues and sometimes also with staff in charge of financial operations and/or risk management. Discussions in interviews covered the application of PDB practices relevant to financial intermediation, building on relevant practices towards Paris alignment for PDBs (Chin, *et al.* 2024), and the extent of their implementation by FIs. These include (i) requiring financed emissions from FIs; (ii) requiring FIs to define emission reduction targets; (iii) applying exclusion lists to FIs' investments (*e.g.* no financing of coal, upstream oil and gas in use of proceeds); (iv) applying inclusion lists to FIs' investments defining priority areas for financing; (v) requiring FIs to ensure consistency of their activities with national development pathways if not already mandated to do so; (vi) supporting FIs' transition and physical risk assessments; (vii) assessing FIs' portfolios' consistency with sectoral decarbonisation pathways; and (viii) advocacy for sustainable finance policy and reporting (*e.g.* engagement with regulators).

LIST OF ACRONYMS

ADB	Asian Development Bank
AFD	*Agence française de développement*
AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
ALIDE	Latin American Association of Development Financing Institutions
BII	British International Investment
BNDES	National Bank for Economic and Social Development (of Brazil)
CAF	Development Bank of Latin America and the Caribbean
CBAM	Carbon Border Adjustment Mechanism
DFI	Development finance institution
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EDFI	The Association of European Development Finance Institutions
E&S	Environmental & Social
GDP	Gross domestic product
GHG	Greenhouse gas
HBTF	Housing Bank for Trade and Finance (Jordan)
KfW	German promotional bank
FI	Financial intermediary
FICS	Finance in Common
IDB	Inter-American Development Bank
IDC	Industrial Development Corporation
IDFC	International Development Finance Club
IFC	International Finance Corporation
ISSB	International Sustainability Standards Board
KICB	Kyrgyz Investment and Credit Bank
MDB	Multilateral Development Bank
NDB	National Development Bank
NDC	Nationally Determined Contribution
NMC	National Mortgage Company
PDB	Public Development Bank
PT SMI	*PT Sarana Multi Infrastruktur*
TA	Technical assistance
TSKB	*Türkiye Sınai Kalkınma Bankası*

EXECUTIVE SUMMARY

Financial intermediation, understood as the indirect financing of beneficiaries through on-lending, equity investments, debt security, or guarantees to local financial institutions, has gained significant momentum over recent years. It is increasingly seen as a promising avenue to mobilise finance at scale, using concessional finance to leverage additional investments through financial intermediaries (FIs). Access to concessional finance can strongly motivate FIs to engage in climate-related investments, especially when they otherwise face financial constraints. With this additional finance, FIs can in turn fund local beneficiaries, including local financial institutions, through smaller size financial products. Financial intermediation is also considered to be an opportunity to build capacity among FIs to invest in line with the Paris Agreement's objectives. Yet, although it has the potential to drive climate-positive transformation of local markets, financial intermediation has several limitations related to transparency on use of funds and misallocation of funds, potentially perpetuating existing inequalities between financial actors, among others. As new methodologies are being developed to ensure Paris alignment of intermediated finance, and with the focus on impact in the real economy increasing, it is critical to ensure that evolving practices are consistent with one another, and deliver results that support local financial systems' and national economies' long-term transformation towards the achievement of the Paris Agreement's objectives.

This report aims to support better use of financial intermediation by public development banks (PDBs) providing international development finance, helping PDBs work better together as a system, with a common understanding of where they contribute the most to low-emissions and climate-resilient development. It mainly focuses on financial intermediation through on-lending to public (government-owned) financial institutions in developing countries (on-lending being more commonly used by MDBs and international PDBs with their financial intermediaries, compared to other financial instruments). It provides insights on the links between PDBs providing international development finance's practices and their financial intermediaries' alignment with the Paris Agreement, and highlights how PDBs can better engage with their financial intermediaries for impact. Compared to previous research in this area, it further brings in the perspective of financial intermediaries, and focuses on how better engagement can translate into climate and development outcomes.

Throughout this report, use of the acronym PDBs refers to MDBs, bilateral development banks, as well as development finance institutions (DFIs). In this research, a financial intermediary (FI) mostly refers to a regional or national development bank (NDB) or a local public financial institution (*e.g.* mortgage or housing finance provider), in a developing country, that channels international development finance to local beneficiaries.

The **Table** below provides an overview of current practices across PDBs providing international development finance in their requirements to FIs, and how they are mirrored in FIs' practices. The selected practices discussed in interviews with representatives of PDBs and FIs build on relevant practices towards Paris alignment for PDBs. Most common practices, *i.e.* applied by more than half of the PDBs considered, are highlighted in green.

TABLE. OVERVIEW OF PDB PRACTICES SUPPORTING PARIS ALIGNMENT OF FIs

Practices supporting Paris alignment	Practices across PDBs providing international development finance	Insights from FIs	Context for use of practices with FIs
Requiring financed emissions from FIs	6 out of 9 PDBs may sometimes ask for this or are considering adding it to their requirements	3 out of 8 FIs track financed emissions	Part of engagement on FI transition plans (not mandatory)
Requiring FIs to define emission reduction targets	5 out of 9 PDBs may sometimes ask for this or are considering adding it to their requirements	2 out of 8 FIs have emission reduction targets	Mainly considered for most advanced FIs on Paris alignment (not mandatory)
Applying exclusion lists to FIs' investments (*e.g.* no financing of coal, upstream oil and gas in use of proceeds)	9 of 9 PDBs apply exclusion lists (*e.g.* coal, upstream oil and gas)	2 out of 8 FIs apply exclusion lists to their investments based on PDBs' lists	Exclusion lists used by FIs are often part of broader environmental and social safeguards
Applying inclusion lists to FIs' investments defining priority areas for financing	4 out of 9 PDBs sometimes include positive lists of eligible investments for FI projects	4 out of 8 FIs define priority investments	Only considered as guidance by FIs (not binding)
Requiring FIs to ensure consistency of their activities with national development pathways if not already mandated to do so	4 out of 9 PDBs may sometimes ask about alignment with NDCs	4 out of 8 FIs mention this consistency as part of their mandate	For individual transactions only, part of the discussion with FIs (not binding)
Supporting FIs' transition and physical risk assessments	7 out of 9 PDBs may offer TA on climate risk assessments	3 out of 8 FIs already carry out these assessments and 3 are in the process of doing so	For FIs with material risk exposure following initial climate risk screening (*e.g.* exposure to fossil fuels, high climate vulnerability, ...)
Assessing FIs' portfolios' consistency with sectoral decarbonisation pathways	1 out of 9 PDBs systematically applies sectoral decarbonisation pathways to FI lending (*e.g.* by applying its sectoral policies to FI lending) and 3 may do high-level assessments	1 out of 8 FIs mentions consistency with sectoral decarbonisation pathways	Only used by most advanced PDBs and FIs on Paris alignment
Advocacy for sustainable finance policy and reporting (*e.g.* engagement with regulators)	5 out of 9 PDBs actively engage with local financial regulators on sustainable finance	–	Dependent on PDB resources and focus on sovereign entities

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The following recommendations apply to PDBs providing international development finance, in order to tailor their approaches to Paris alignment of financial intermediation, drawing on their collective experience with financial intermediaries:

- **Outside of a specific FI transaction:**
  - PDBs should evaluate whether national development pathways are adequately defined in nationally determined contributions (NDCs) or national planning documents and assist in the development of these pathways where needed, in addition to requiring FIs to align with these pathways. This alignment can also be supported by engaging with national regulators to adjust local financial institutions' mandates to these pathways, and by ensuring NDCs target these institutions' role in the achievement of climate targets in the country.
  - PDBs should continue to support, both technically and financially, the development of regulatory environments and reporting requirements that enable and strengthen financial flows towards climate and development outcomes. National and international regulatory requirements as well as requirements from investors are a major driver of change for FIs.
- **When arranging on-lending with FIs (prior to approving transactions):**
  - Fossil fuel exclusion lists are difficult to implement in contexts where the economy is fossil fuel-dependent, and PDBs should continue to support deep decarbonisation in these contexts, parallel to their engagement with FIs. On the other hand, exclusion lists linked to environmental and social (E&S) safeguards still have room for improvement (*e.g.* in their scope of application) and can deliver further climate benefits when combined with Paris alignment considerations. Monitoring exclusion list application by FIs during execution is important, particularly for those with higher risk and lower capacity.
  - PDBs should consider using green inclusion lists as they prove to be a good starting point in order to promote climate-smart objectives, and can be integrated into existing strategic objectives and help prioritise FI investments towards Paris-aligned activities.
  - PDBs need to systematically consider how engagement with FIs can support improvement in their practices (*e.g.* through results-based financing, dialogue on Paris alignment and priority areas for investment and institution-level transition, application of E&S safeguards ...) and further influence FIs' practices, prior to disbursement as well as throughout the relationship with the FI;
  - PDBs need to adjust the abovementioned requirements to FIs' level of advancement on climate, and the financial instruments used to the local context (*e.g.* disclosure requirements already in place, level of transition risk *i.e.* exposure to fossil fuels, limited opportunities for climate finance in market, vulnerability to physical risks, ...), while relying on publicly disclosed assumptions that reflect local needs, and scenarios that reflect the country's pathway towards decarbonisation and resilience.
- **Throughout the on-lending period:**
  - Technical assistance is key to supporting the implementation of all the abovementioned practices in many cases. For example, physical and transition risk assessment is often taken up after initial support or technical assistance from PDBs providing international development finance. Technical assistance to navigate sustainability reporting requirements and support financed emissions tracking where relevant could also play an important role in building capacity on climate performance self-assessment. It can help address data availability issues, which are an important limitation to emissions tracking. Tracking financed emissions is not yet within reach for most FIs interviewed in this study.
  - Setting emission reduction targets (at project or portfolio level) requires FIs to track financed emissions, and also requires significant internal buy-in. As such, it is a practice for more advanced FIs on climate, and should be considered carefully to ensure it is in line with the FIs' development mandate, for instance. It can also be replaced with or complemented by the tracking of other metrics that reflect improvement in Paris alignment and that can reflect the increase in climate-related activities and investments and/or decrease in activities with adverse climate impacts.
  - In addition to targeted technical assistance to FIs, which most FIs considered in this research benefitted from, PDBs should help build capacity of FIs by supporting knowledge-sharing on institutional climate mainstreaming or regional challenges to the transition, through communities of practice and networks of financial institutions facing similar issues (*e.g.* regional networks and alliances of PDBs & DFIs (ALIDE, EDFI, *etc.*), FICS, IDFC, Mainstreaming Climate in Financial Institutions, *etc.*).

INTRODUCTION

Throughout this report, use of the acronym PDBs refers to multilateral development banks (MDBs), bilateral development banks, as well as development finance institutions (DFIs). In this research, a financial intermediary mostly refers to a regional or national development bank (NDB) or a local public financial institution (*e.g.* mortgage or housing finance provider), in a developing country, that channels international development finance to local beneficiaries. Some of the insights from this research are also applicable to private financial institutions acting as financial intermediaries, as PDBs can similarly engage with them along their journey to align with the Paris Agreement (*e.g.* to reduce fossil fuel exposure, to support climate risk assessments and transition planning, *etc.*).

Lending through financial intermediaries (FIs) represents a significant part of overall lending by public development banks (PDBs) providing international development finance. For example, it accounts for about a third of all commitments by the European Bank for Reconstruction and Development (EBRD), and the European Investment Bank (EIB) (Fuchs, *et al.* 2021), and more than forty percent of all commitments by the International Finance Corporation (IFC) (IFC 2024). The Asian Development Bank (ADB)'s lending to FIs increased tenfold in the past decade (Geary 2021). Financial intermediation has gained significant momentum over recent years, and is not limited to multilateral development banks (MDBs).

Financial intermediation is increasingly seen as a promising avenue to mobilise finance at scale, using concessional finance to leverage additional investments through FIs. It can also help channel funds to a larger number of local economic actors that would otherwise not benefit from climate finance and other development finance. It could also support the alignment of all financial flows to deliver more positive impact, when it contributes to channelling misaligned financial flows towards projects in line with low-emissions and climate-resilient development pathways. For instance, past discussions held within the framework of the Alliance of Subnational Development Banks in Latin America and the Caribbean have highlighted that subnational development banks can contribute to channelling international resources towards local projects with increased impact, as well as towards development and transition strategies. They moreover can demonstrate their leadership and stimulate innovation with intermediated finance (Alianza de Bancos Subnacionales de Desarrollo de América Latina y el Caribe 2023).

Acknowledging the potential of financial intermediation to mobilise more funds and to mobilise them better, MDBs and other PDBs providing international development finance have progressively developed methodologies to ensure the use of proceeds channelled through FIs contributes to the Paris Agreement's objectives. They have also developed approaches to assess the credibility of commitments from their counterparties to engage in institutional alignment with the Paris Agreement. For example, in 2023, MDBs jointly agreed on methodological principles for assessing alignment of new intermediated financing operations with the Paris Agreement, following a transaction-based approach when use of proceeds is defined, or a counterparty-based approach for undefined use of proceeds (*i.e.* non-earmarked lending) (MDBs 2023)[1].

As new methodologies are being developed to ensure Paris alignment of intermediated finance, and with the focus on impact in the real economy increasing, it is critical to ensure that evolving practices are consistent with one another, and designed to deliver results that support local financial systems' and national economies' long-term transformation towards the achievement of the Paris Agreement's objectives.

This report aims to support better use of financial intermediation by PDBs providing international development finance, helping PDBs work better together as a system, with a common understanding of where they contribute the most to low-emissions and climate-resilient development. It mainly focuses on financial intermediation through on-lending to public (government-owned) financial institutions in developing countries (on-lending being more commonly used by MDBs and international PDBs with their financial intermediaries, compared to other financial instruments). The report provides insights on the links between PDBs' practices and their financial intermediaries' alignment with the Paris Agreement, and highlights how PDBs can better engage with their financial intermediaries for impact. Compared to previous research in this area, it further explores the perspective of financial intermediaries, and focuses on how better engagement can translate into climate and development outcomes.

1 In this joint assessment framework, MDBs assess alignment of intermediated finance either through (i) the transaction-based approach, in which the MDB assesses use of proceeds for alignment with mitigation goals, and analyses risk and materiality to ensure climate resilience of operations, or (ii) the counterparty-based approach, in which the MDB assesses the credibility of the counterparty's Paris alignment pathway. The counterparty-based approach applies whenever there is no defined use of proceeds, or when there are insufficient counterparty capabilities. Ensuring counterparty Paris alignment would then rely on financial and technical support from the MDB.

1. POTENTIAL AND LIMITATIONS OF FINANCIAL INTERMEDIATION

1.1. Financial intermediation as a driver of local market transformation

Financial intermediation has a transformative potential on local markets that can materialise in different ways. It can help build domestic capital markets by increasing economic actors' ability to borrow domestically from financial institutions that act as financial intermediaries. It can also help transform these markets by creating a demonstration effect, increasing demand for sustainable finance products. This may be particularly true for earmarked credit lines as they involve financing specific, defined activities that align with the global sustainable finance agenda. This financing often comes with better financial conditions and associated technical assistance.

Financial intermediation helps transform banks' practices through associated due diligence processes focused on counterparty alignment. These due diligence requirements can lead to broader policy dialogue and capacity building on climate considerations and Paris alignment (Pauthier and Kachi 2023). Some of the PDBs providing international development finance interviewed consider that any improvement in financial intermediaries' climate practices (*e.g.* development of climate risk assessment methodologies, measurement and disclosure of direct and indirect greenhouse gas (GHG) emissions, commitment to no new coal, …) already has potential for significant impact on the decarbonisation of economic activities.

PDBs providing international development finance, including MDBs, help build the capacity of national development banks (NDBs), especially for pipeline development, in new sectors that may be key for decarbonisation (Griffith-Jones, Attridge and Gouett 2020). This can also be the case with regional and subnational development banks. Historically, NDBs have played a crucial role in the global financial architecture by providing long-term financing for projects that contributed to national development. Initially, their focus was on agricultural, industrial, and infrastructure development, which was essential for economic growth and modernisation in many developing countries. Over time, their roles expanded to include supporting small and medium enterprises (SMEs), fostering innovation, and addressing social and environmental challenges. In addition, there has been increased attention in recent international financial architecture discussions on the role of NDBs as local convenors and access points for country platforms. One example is the Brazilian climate and ecological transformation investment platform, for which the National Bank for Economic and Social Development (BNDES) acts as the Secretariat.

MDB-NDB cooperation leverages local contextual knowledge and networks of NDBs, enabling MDBs to extend their reach and impact in developing countries (Ahlgren, *et al.* 2023). NDBs can customise financial products to meet the specific needs of local markets, enhancing the effectiveness of MDB-funded projects. In addition, financial cooperation between MDBs and NDBs through co-financing and on-lending, which has been increasing for projects focused on climate and environmental issues (Léon, forthcoming), can help pool more resources for climate-related investments. Furthermore, access to concessional finance through MDBs can strongly motivate NDBs to engage in such investments, especially when they otherwise face financial constraints. This is also true when other PDBs providing international development finance, such as bilateral development banks, engage with NDBs. In some cases (*e.g.* DBNM in North Macedonia, DBN in Nigeria, *etc.*) where NDBs act as second-tier banks, they can in turn lend smaller size financial products to local financial institutions, who then on-lend to SMEs. Cooperation between MDBs and NDBs can also materialise as institutional technical cooperation, including for country policy support, infrastructure financing, and to build capacity of local public institutions on climate-related considerations (Gebel, *et al.* 2025).

Working with MDBs and other PDBs providing international development finance has a positive impact in the long run for financial intermediaries: it allows them to engage with higher risk clients (as it builds their technical capacity), and attracts other funders (through the signalling effect created by previous transactions), leading to a potentially catalytic effect. When intermediated finance is successfully channelled towards climate-related activities, it can also be beneficial for MDBs, and other PDBs providing international development finance, to increase their overall climate finance volumes without having to source deals at local project level.

With support from MDBs and other PDBs to adopt international best practice, financial intermediaries can also contribute to promoting sustainable finance products within local financial systems. The Inter-American Development Bank (IDB)'s private sector arm, IDB Invest, for example, worked with Bancolombia on the issuance of the first sustainability-linked bond by a bank in Latin America and the Caribbean, by helping define the project's key performance indicators (IDB Invest 2022). Similarly, *Agence française de développement* (AFD) helped the Development Bank of Southern Africa (DBSA) issue its first green bond in 2021 (DBSA 2021), and supported the Development and Investment Bank of Türkiye (TYKB)'s first sustainable bond in 2022 (AFD 2022). In addition, experts reported that, due to cooperation with MDBs and other PDBs on climate, financial intermediaries are increasingly seeing climate change as a business opportunity and not only a risk. This leads to higher levels of competitiveness around sustainable financing, which in turn helps stimulate less developed markets.

1.2. Limitations to financial intermediation's contribution to the transition

Despite its significant potential for climate-positive transformation, financial intermediation also has several limitations and current practices still need to improve to increase transparency of intermediated financial flows. Recent research looking at financial intermediation's broader development impacts in Africa showed that intermediated lending can sometimes reduce transparency of financial flows, as it becomes challenging to track and report how the funds are used, and whether they achieve the intended development impacts (Léon 2024). In some cases, it is difficult to trace funding to specific final beneficiaries, especially in the case of multiple beneficiary intermediated loans where funds are not disbursed against actual expenditures (EIB 2017). Although financial intermediation often represents an opportunity to reach sectors that have been underserved in the past (*e.g.* Micro-, Small, and Medium-sized Enterprises (MSME) sector and unbanked people), there are also examples of misaligned transactions through financial intermediaries, supporting fossil fuels for instance, despite preexisting Paris alignment commitments of MDBs (Recourse 2023). Some are taking further commitments and action to address this issue (IFC 2023).

The lack of transparency can lead to misallocation of resources, undermining the development goals that PDBs aim to support (Léon 2024). Another critical issue highlighted is the potential for intermediated lending to perpetuate rather than solve existing inequalities within the financial system, with the same few financial intermediaries being considered for on-lending. For instance, in Africa, financial institutions that act as intermediaries channelling international development finance provided on commercial terms are in fact much larger in terms of assets, liabilities, equity, and employment than those that do not receive any of this finance (Gajigo, *et al.* 2022). Local financial intermediaries also tend to prioritise lending to established businesses with lower risk profiles, which can result in small and medium-sized enterprises (SMEs) and underserved sectors being overlooked. In addition, depending on local context, financial intermediaries may struggle to find projects that meet the climate-related requirements of lenders (this is further discussed in the next section). Risk-sharing mechanisms, designed to protect PDBs and intermediaries, can sometimes lead to risk aversion, where intermediaries become overly cautious in their lending practices (Léon 2024). Some of the MDBs considered in this research, such as EIB and EBRD, tend to focus on larger, more systemic financial institutions for their intermediated lending, for their higher potential impact given their position in local markets.

Accounting for different local contexts and for the diversity of financial intermediaries can be challenging. PDBs providing international development finance can sometimes bring forward one-size-fits-all solutions that do not consider the specificities of all financial intermediaries (*e.g.* size, resources, portfolio, …), compromising financial intermediation's potential to contribute to transformational change. Financial intermediaries' climate ambition in fact differs depending on their technical capacity, as well as their policy and investment contexts (CPI 2024).This is further discussed in the next section.

Although MDBs have made efforts to harmonise their Paris alignment methodologies along common principles, most reporting standards on financial intermediary investments are still not harmonised among PDBs, making it difficult to compare practices for improvement (Fuchs, *et al.* 2021). There is also room for further collaboration and harmonisation across PDBs on their support to financial intermediaries and their climate-related due diligence requirements, to limit the reporting burden for financial intermediaries engaged with different lenders. In addition, as reported in interviews with practitioners, there is no sufficient quantitative data available on the outcomes and impact of financial intermediation, in the context of Paris alignment and transformation of local economies towards more aligned activities. MDBs as well as other PDBs are further developing impact indicators, which will help address data limitations and reflect the outcomes of their indirect finance on climate and development (MDBs 2024). Initial reflections on how to better monitor impact, including the MDB Common Approach to Measuring Climate Results, are covered in section 4 of this report.

Financial intermediaries have also stressed that the requirements set by PDBs (*e.g.* project ticket size (too small), reporting, …) may hinder their ability to finance activities they have identified as critical to support their clients' decarbonisation, such as decarbonising the energy supply of large industrial clients' processes.

Experts interviewed have moreover highlighted that high transaction costs may sometimes deter financial intermediaries from pursuing funding.

Table 1 below summarises the key qualities of financial intermediation as a driver for local market transformation highlighted above, as well as its current limitations, with a focus on its contribution to climate and development outcomes.

TABLE 1. SUMMARY OF THE POTENTIAL AND CURRENT LIMITATIONS OF FINANCIAL INTERMEDIATION IN CONTRIBUTING TO THE CLIMATE TRANSITION

Financial intermediation's potential to shift local financial systems to sustainable finance	Current limitations of financial intermediation
• Builds and stimulates domestic capital markets' climate investment capacity • Creates a demonstration effect for sustainable finance products and sustainability standards within local financial systems • Helps transform financial intermediaries' practices through due diligence requirements (*e.g.* E&S, climate, …) • Helps build capacity of financial intermediaries for pipeline development • Helps pool more resources for climate-related investments (*e.g.* decarbonisation) and leverage local knowledge • Helps financial intermediaries attract other funders	**For PDBs:** • Lack of collaboration and harmonisation across PDBs providing international development finance, on their support to financial intermediaries and their due diligence requirements • Lack of consideration of specificities of financial intermediaries when defining investment eligibility criteria (*e.g.* ticket size) • Reduced transparency of financial flows **For FIs:** • Perpetuation of existing inequalities in the financial system as risk aversion increases and financial intermediaries finance larger beneficiaries • Higher transaction costs

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2. FINANCIAL INTERMEDIATION IN DIFFERENT LOCAL CONTEXTS

There is no 'one-size-fits-all' approach to financial intermediation. The reality of currency risk, of cost of financing, and of diverging technological maturity, especially to install renewables, must be accommodated within financing arrangements. PDBs providing international development finance must tailor the instruments they use to deliver funding, the conditionality of the funding, and the strategic relationship, to the FI's existing climate capabilities (Pauthier and Kachi 2023).

PDBs providing international development finance should fully consider the factors external to local financial institutions, which shape the climate readiness of the country and thus constrain their capacity to invest in low-emissions and climate-resilient development. The factors that may influence FIs' climate investments stem from the macroeconomic and investment context, the FIs' internal structure (mandate, governance, and adherence to multi-institutional frameworks), as well as the financial and regulatory environment.

2.1. Constraints and incentives stemming from the macroeconomic environment

Depending on the economy's reliance on fossil fuels or carbon-intensive industries and country context, national and sub-national development banks will have different starting and finishing lines in their journeys towards aligning with the Paris Agreement. A useful indicator to characterise domestic reliance on fossil fuels is a country's GHG emission intensity relative to GDP. Recent research shows that high-ambition public financial institutions tend to be based in economies with low emissions intensity; conversely, economies with high emissions intensity tend to host public financial institutions (particularly NDBs or sub-national development banks) with limited climate ambition (CPI 2024). As an example, public financial institutions in the high-ambition cluster have committed to Paris alignment, have approved a divestment or exclusion policy, deploy a counterparty engagement policy, have developed an institutional climate strategy, and in some cases have set a net-zero target. On the other hand, public financial institutions in the 'limited ambition' cluster have approved institutional climate strategies, but few or no other commitments. This clustering is relevant as many of the NDBs assessed in CPI's analysis are in turn financial intermediaries to PDBs providing international development finance.

This suggests that PDBs providing international development finance should adjust their requirements to the FIs' domestic context, as well as the FIs' existing capacity with regards to climate action. For instance, FIs operating in high-emitting countries will struggle to exclude coal or fossil fuels from their portfolios but may promote energy efficiency in housing or contribute to the expansion of renewable energy capacity. The adjustment means that rather than applying uniform requirements to all FIs in pursuit of Paris alignment, PDBs providing international development finance should match the requirements to the technical and economic feasibility of achieving a shift to lower-emission economies while accounting for development goals. In this context, the dual counterparty vs transaction approach laid out in the Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment proves useful.

Another external enabling factor is the investment context. A typical challenge faced by local banks in delivering Paris alignment goals is a weak pipeline of bankable projects. The lack of easily identifiable and bankable projects with sufficient volume, scale, and reasonable risk-return ratios is a well-documented roadblock for investment in support of long-term climate objectives, stemming from a lack of detailed investment plans at national level (OECD 2018). This points to the importance, for PDBs providing international development finance, of adapting the financial instruments used to the local potential for project development. PDBs can also support robust project pipelines through project preparation facilities, for instance (OECD 2018).

IDC's sustainable development pathways: Paris alignment in carbon-intensive sectors

The Industrial Development Corporation (IDC) of South Africa is a long-term impact investor with a mandate around industrial development, and operates in high-emitting industrial sectors. Although decarbonising an equity portfolio is more challenging than for a loan portfolio, there is also great potential for transformation since energy and infrastructure are enablers for industrial development. IDC has also set Paris alignment as a priority – with an emphasis on social development.

Rather than a standalone climate plan with GHG emission reduction targets, IDC relies on "sustainable development pathways" which seek to align energy transition with productive sector transition – in acknowledgement that 'an energy transition on its own may lead to a negative net impact on the economy'. These pathways are used to define IDC's strategic priorities. Two of them explicitly focus on climate targets: "Catalysing Low-Carbon and Green Growth", and "Resilience to Economic & Physical Climate Risks".

As part of this scope, IDC supports clients in transitioning away from fossil fuels and enabling decarbonisation, supporting newly emerging green industries, transitioning existing industrial productions, preventing de-industrialisation risks, and protecting existing strategic industrial capacity. IDC also works with its investees to help them reach compliance with climate change and environmental requirements (e.g. carbon budget, carbon taxes, water and waste licenses, Carbon Border Adjustment Mechanism (CBAM) requirements for exports, *etc.*). IDC also verifies the consistency of client investments in coal, liquid fuels, natural gas, uranium, and nuclear with achieving the NDCs and SDGs, using specific in-house tools.

PDBs providing international development finance have in some respect driven the stronger integration of Paris alignment and the redefinition of what Paris alignment entails for IDC. IDC has received support from several PDBs, including AFD, AfDB, EIB, and KfW, through earmarked funds and general-purpose funds. This concessional funding allows IDC to fund certain sectors, namely renewable energy and energy efficiency. However, the more immediate driver for adopting climate targets and procedures (and related data systems) is the need for clients funded by IDC to comply with national or international regulation.

2.2. Constraints and incentives stemming from the FI's mandate

Public development banks are characterised, among other criteria, by their mission to achieve public policy objectives. These government mandates can be tied to a specific sector: for example, 25% of public development banks globally have a mandate for supporting MSMEs, 10% for promoting exports and foreign trade, 8% for social housing, and 7% for agriculture; 36% have non-specific or multiple mandates. A smaller percentage have mandates for infrastructure, international investment, or local objectives (Léon, Xu, *et al.* 2024). Half of the FIs interviewed in this research are mandated to support national development pathways. Nearly half of the PDBs providing international development finance considered in this research require their FIs to ensure consistency of their activities with national development pathways.

Climate action supported by PDBs providing international development finance must be in step with the FIs' government-driven mandate for promoting development in order to be effective. These mandates may directly or indirectly reference Paris alignment. When the FIs' mandate does not include Paris alignment considerations, PDBs providing international development finance can help update their financial intermediaries' mandate towards Paris alignment, for instance through policy-based loans, and with technical assistance to design the mandate (Gebel, *et al.* 2025).

Literature suggests that narrower mandates, or those centred on high-emitting sectors are more difficult to align with climate objectives. However, even a mandate with a clear climate focus may be derailed by a lack of national policy support (CPI 2024). The existence of national or sectoral decarbonisation policies and nationally determined contributions (NDCs), provided these are sufficiently detailed and ambitious, can help financial institutions define their commitments. Thus, the influence of the mandate is closely linked to the policy and regulatory environment.

2.3. Constraints and incentives stemming from the policy and regulatory environment

The policy and regulatory environment can facilitate or impede financial intermediaries' contribution to the transition. In a survey of 135 FIs conducted by EBRD, half of the respondents mentioned that regulatory requirements were the key driver for climate risk management, and that the lack of regulatory guidance and tools were impediments to better integration of climate risk into their own processes and structure (EBRD 2021). Similarly, in an IFC survey of its client financial institutions, the insufficient support from regulatory bodies was one of the frequently cited barriers to increased disclosure of climate-related risk (IFC 2023). Examples of regulatory requirements or guidance that may contribute to building banks' climate capacity include guidance issued by central banks on stress-testing, adoption of carbon accounting standards, national climate disclosure requirements, or use of national emissions factors (UNEP FI 2024).

Integration of the multiple policy options which regulators and central banks use to shift financial systems towards greater sustainability varies across countries and regions. The bottom line is micro and macro-prudential regulation to ensure financial stability (stress testing, disclosure using double materiality approaches, and capital requirements). Alignment-specific policies (taxonomies, transition plans, decarbonisation targets) can build on this basis. Monetary and credit allocation policies (preferential rates or earmarked funds) can also be part of regulatory measures supporting the transformation of local financial systems, although used to a lesser extent (Kachenoura, *et al.* 2024). Globally, taxonomies, corporate disclosures, supervisory review and prudential disclosures are the best-integrated tools; yet there is some variability in the maturity of the regulatory environment which FIs are subject to. For instance, Europe is most advanced in integrating nature-related risk in each above-cited category, followed by the Asia-Pacific region. Corporate disclosure of nature-related risks is only required in Europe, while the integration of minimum capital requirements and macroprudential measures is lagging globally (UNEP FI and WWF 2024).

Interviews conducted for this research showed that the existence of in-country regulatory pressure and mandates to implement NDCs influenced the willingness of FIs to engage with PDBs on Paris alignment. Several FIs in fact adopted climate strategies and Paris alignment policies as a direct result of regulatory pressure, and not because of specific requirements from PDBs that fund them. This points to the high impact potential of designing activities to support the alignment of the entire local financial system, rather than focusing on use of proceeds for individual FIs. On the other hand, in economies where capital markets are still maturing and regulatory ecosystems under development, financial intermediaries operate in the absence of national taxonomies, climate action plans, or state-led transition programs. In these cases, tailored support through technical assistance and capacity building are foundational to introducing more ambitious climate practices. When placing requirements that go beyond country-level ambition on their FIs, PDBs should take care to adapt these requirements and avoid higher reporting burdens.

There are clear synergies between an enabling environment for climate action and counterparty alignment efforts. This emphasises that, next to counterparty and project-based approaches, PDBs' financial and technical support for developing an enabling national regulatory environment for climate action should be an integral part of helping countries make progress on Paris alignment.

AFD's climate governance framework for financial systems

In order to promote the integration of climate into public policies, AFD tailors its support to financial regulators and central banks based on national characteristics, captured through five criteria:

- Ratio of financial assets to GDP (weight of the financial system).
- Sophistication of the financial system, measured by the IMF's financial development index.
- Level of financial inclusion (share of adults with formal bank accounts).
- Country vulnerability to climate change.
- Exposure to transition risks as evaluated by AFD.

Four groups of countries were defined using these criteria. Group A includes Brazil and Türkiye; Group B South Africa, Indonesia, Nigeria, Vietnam, Mexico, and Indonesia; Group C Bangladesh, Niger, Pakistan, Rwanda, and Senegal; and Group D Egypt, Ghana, Morocco, Tunisia, and Peru. Specific types of assistance target each group (Kachenoura, *et al.* 2024).

Countries from Groups A and B boast a sophisticated and large financial system, with Group B more strongly exposed to physical and transition risk. Provoking a shift away from fossil fuel assets and supporting private finance mobilisation are at stake for regulators. AFD assists regulators in these countries through specific, one-off operations, such as developing tailored climate scenarios (Mexico) or green taxonomies (Indonesia).

Countries from Groups C and D have less sophisticated and inclusive financial systems, and financial risk arises from specific risk linked to sectoral exposure or sovereign risk rather than systemic shocks. Here, AFD supports progressive capacity building against financial climate risk by designing regulations and tools, and promotes financial inclusion.

3. PDBs NEED TO BETTER DEFINE AND MONITOR THEIR IMPACT THROUGH FINANCIAL INTERMEDIARIES

3.1. Although impact may be monitored by PDBs, climate-related outcomes of financial intermediation can be better measured

Efforts by PDBs to measure the impact of their investments through financial intermediaries are a meaningful contribution to accountability frameworks for intermediated finance transactions. These efforts must also consider financial intermediaries' technical capacity (or lack thereof) for such reporting. Some PDBs consider that monitoring financial intermediaries' financing of activities with environmental benefits, such as renewable energy, could reflect such impact. However, it will not be sufficient to reflect financial intermediation's overall contribution to the climate transition. Some of the positive externalities of investments, in adaptation for instance, are currently not sufficiently accounted for, as metrics often focus on decarbonisation (since emission reductions can be measured). Comparable reporting methodologies and enhanced disclosures, including climate-related disclosures from beneficiaries that PDBs can then support, are key to improving accountability (AFD & FiCS forthcoming). The Global Impact Investing Network (GIIN) highlights that impact investors still face several challenges when it comes to measuring their investments' real-world impact[2], such as difficulties in comparing impact results with peers, fragmentation across impact measurement frameworks, confusing guidance from regulatory bodies, or challenges in verifying impact data received by investees, among others (Global Impact Investing Network 2025). The GIIN has also developed tools and guidance to increase impact data clarity and comparability, that could make it easier to report impact results (Global Impact Investing Network n.d.).

The need for more robust impact metrics overall, aligned with sustainability objectives, is gaining traction in international discussions. The first draft of the Fourth International Conference on Financing for Development (FFD4) outcome document invites "DFIs to harmonize and strengthen impact metrics as a basis for mobilization targets, building on on-going work, and to align incentives with maximizing sustainable development impact." (FFD4 2025, p. 8). It highlights that this harmonisation should be tailored to national circumstances, as discussed in the previous section. It also calls on shareholders of MDBs to align MDBs' impact measurement frameworks with the Sustainable Development Goals, and to work to measure both positive and negative impacts.

PDBs are making progress on how they track activities that would qualify as high-impact levers towards climate objectives. AFD for instance has started identifying both direct and indirect leverage effects. The impact of direct leverage effects can be somewhat quantified (*e.g.* , overall climate finance flows of financial intermediaries compared to initial funding from AFD), whereas for indirect leverage effects, outcomes are considered as broader contributions. The levers identified by AFD include:

- for direct leverage effects: cofinancing of investments for climate mitigation or adaptation; subordinated debt financing for climate finance; green bonds;
- for indirect leverage effects: technical assistance and capacity building to mainstream climate in the financial institution's strategy and operations; equity financing conditioned to the implementation of the financial institution's transition plan / climate strategy; technical assistance and support to financial regulators for the adoption of sustainable finance regulation.

2 Impact can be defined as a "causal, demonstrable relationship between a financial institution's action and a real-world change – in the case of climate change, a change in greenhouse gas emissions" (ADEME 2024, p. 7).

IFC's impact management framework

IFC developed an impact management framework to assess the climate-related impact of its interventions, where it considers both direct effects through the project, and market-level effects.

For the project-level assessment, similarly to AFD, IFC assesses how the intervention supports FIs in pursuing climate opportunities by tracking the growth of their climate finance portfolio and share of climate finance in their overall portfolio.

For the market-level assessment, first the market stage is assessed by considering: (i) the level of adoption of climate mitigation/adaptation practices, products, standards used by FIs in the market; (ii) the depth of regulatory/legal frameworks and policy environment; (iii) the institutional capacity to support climate-oriented practices and innovations; and (iv) the availability of financial mechanisms to support uptake or scaling up of climate mitigation/adaptation practices across the market. Then, the potential of the intervention is considered in terms of contribution to the market's resilience, competitiveness, and sustainability, given (i) the degree of innovation; and (ii) the potential for the market to scale the changes, e.g. through the demonstration effect on other financial institutions.

IFC has also developed the Climate Assessment for Financial Institutions (CAFI) tool, to allow FIs to compute and report on their investments' impact. The tool includes modules on adaptation, energy efficiency, and renewable energy, for projects that have an identified climate component.

In addition to efforts to monitor impact, most PDBs providing international development finance have started to adopt practices to better target impact, and to ensure their operations and their activities' contribution on broader climate and development goals. MDBs and some bilateral development banks exclude certain types of activities that they consider misaligned with the objectives of the Paris Agreement. In addition, some MDBs, such as the European Bank for Reconstruction and Development (EBRD), require commitments on Paris alignment and transition plans from their financial intermediaries, which is critical for general purpose loans. IFC's Green Equity Approach (GEA) is another example of PDB approaches targeting further impact. The GEA is meant to increase FIs' climate lending and reduce their exposure to coal-related projects, by requiring a commitment from FIs to not originate and finance any new coal projects. Moreover, technical assistance and other non-financial support complementing these requirements is one of the most relevant types of support, according to financial intermediaries, to help raise their capacity and increase alignment of their operations with the Paris Agreement. It should be tailored to the institution's needs and rely on clear objectives to make progress on their journey to align with the Paris Agreement (Pauthier and Kachi 2023). This is further discussed in the next section.

PDBs providing international development finance should seek to further influence financial intermediaries' practices and systematically consider how engagement with financial intermediaries prior to disbursement can support improvement in their practices, for both earmarked and non-earmarked lending. Earmarked funds must align with mitigation and adaptation objectives for financial intermediaries to look for the appropriate investment opportunities that contribute to low-emissions and climate-resilient development and ideally be reused for similar purposes. For non-earmarked funds, this can translate into use of financial incentives such as results-based finance, and the establishment of an ongoing dialogue on Paris alignment, among others. Ensuring additionality of intermediated finance overall, *i.e.* that investments would have otherwise not occurred through typical market actors, will be key for PDB support to target areas where it would have most impact (Léon 2024).

3.2. Recent developments to integrate climate-related outcomes of financial intermediation into impact measurement

MDBs have been often called upon to report on climate results rather than mere volumes of climate finance. They have developed an initial common approach to measuring climate results and provided an update on indicators during COP29, to reflect both their activities in support of country climate transition, and those in support of private sector clients' climate-readiness and Paris alignment (MDBs 2024). This approach suggests the following set of indicators relevant to intermediated finance activities' outcomes that could be monitored to better measure climate results from MDB operations:

1. Number of beneficiaries with access to financial products and services, via financial intermediaries, that support eligible climate mitigation activities (cross-sectoral result area).
2. Number of beneficiaries (businesses, including MSMEs) accessing climate financing via financial intermediaries, to fund eligible climate mitigation and adaptation activities (financial mobilisation result area).
3. Number of financial intermediaries supported in climate transition plan and readiness condition development and implementation (client transition support result area).
4. Number of beneficiaries accessing financial products and services, including via financial intermediaries, to manage physical climate risk (poverty eradication and livelihoods result area).
5. Number of beneficiaries, such as MSMEs, cooperatives and individuals, that receive financial products and services for adaptation including via financial intermediaries (poverty eradication and livelihoods result area).

When it comes to client transition support, indicator 3. above would reflect MDB support to financial intermediaries in the development and/or implementation of climate-related strategies, plans, procedures, frameworks, disclosures and related capacity building from MDB advisory activities and technical assistance. Key areas of MDB support mentioned include (i) transition plans and related governance and implementation procedures supporting decarbonisation and building climate resilience; (ii) climate-related disclosures aligning with international reporting standards; and (iii) readiness conditions for less advanced clients, including the development of GHG accounting systems, physical climate risk management capabilities. The indicator could be disaggregated for instance by institution type, thematic coverage, sector and inclusion of wider social and gender considerations, and potentially by stage of development/implementation and number of beneficiaries of capacity building.

MDBs can also define if projects such as on-lending will be assessed ex-ante for their relative GHG emissions, and if so, will then define the screening criteria to determine materiality for assessment (*e.g.* financial threshold and/or physical threshold based on relative and/or absolute emissions) (MDBs 2024). This highlights the need for quality and availability of data, which is often mentioned as a significant limitation in current PDB impact monitoring practices. Both MDBs and NDBs will need to work together to develop impact-centred monitoring and evaluation (Gebel, *et al.* 2025). PDBs providing international development finance will also need to build FIs' capacity on impact measurement.

4. A DEEP DIVE INTO CURRENT CLIMATE-RELATED PRACTICES

4.1. Overview of current practices across PDBs providing international development finance and FIs

To look into current practices for advancing Paris alignment through financial intermediation, the authors interviewed representatives of a sample of PDBs providing international development finance and of financial intermediaries. The PDB group (9 institutions) consists of multilateral and bilateral development banks as well as development finance institutions engaging with the private sector: *Agence française de développement* (AFD), the Asian Infrastructure Investment Bank (AIIB), British International Investment (BII), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank (IDB), the International Finance Corporation (IFC), KfW, and Proparco. The financial intermediary group (8 institutions) includes a regional development bank, which has been considered mainly for its role as a financial intermediary, several public financial institutions, including national development banks and national commercial banks, based in different geographies (mostly in Asia, but also in Latin America, and Africa): the National Bank for Economic and Social Development (BNDES), the Development Bank of Latin America and the Caribbean (CAF), Housing Bank for Trade and Finance, Industrial Development Corporation (IDC), Kyrgyz Investment and Credit Bank (KICB), National Mortgage Company (NMC), *PT Sarana Multi Infrastruktur* (PT SMI), and *Türkiye Sınai Kalkınma Bankası* (TSKB).

This limited sample is not meant to be comprehensive nor representative, but rather indicative of some of the practices that could serve as levers for greater impact on climate and development outcomes. The below table provides an overview of current practices across PDBs providing international development finance in their requirements to FIs, and how they are mirrored in FIs' practices. The selected practices discussed in interviews with representatives of PDBs and FIs build on relevant operational benchmarks towards Paris alignment for PDBs (Chin, *et al.* 2024). Most common practices, *i.e.* applied by more than half of the PDBs considered, are highlighted in green.

TABLE 2. OVERVIEW OF PDB PRACTICES SUPPORTING PARIS ALIGNMENT OF FIs

Practices supporting Paris alignment	Practices across PDBs providing international development finance	Insights from FIs	Context for use of practices with FIs
Requiring financed emissions from FIs	6 out of 9 PDBs may sometimes ask for this or are considering adding it to their requirements	3 out of 8 FIs track financed emissions	Part of engagement on FI transition plans (not mandatory)
Requiring FIs to define emission reduction targets	5 out of 9 PDBs may sometimes ask for this or are considering adding it to their requirements	2 out of 8 FIs have emission reduction targets	Mainly considered for most advanced FIs on Paris alignment (not mandatory)
Applying exclusion lists to FIs' investments (*e.g.* no financing of coal, upstream oil and gas in use of proceeds)	9 of 9 PDBs apply exclusion lists (*e.g.* coal, upstream oil and gas)	2 out of 8 FIs apply exclusion lists to their investments based on PDBs' lists	Exclusion lists used by FIs are often part of broader environmental and social safeguards
Applying inclusion lists to FIs' investments defining priority areas for financing	4 out of 9 PDBs sometimes include positive lists of eligible investments for FI projects	4 out of 8 FIs define priority investments	Only considered as guidance by FIs (not binding)
Requiring FIs to ensure consistency of their activities with national development pathways if not already mandated to do so	4 out of 9 PDBs may sometimes ask about alignment with NDCs	4 out of 8 FIs mention this consistency as part of their mandate	For individual transactions only, part of the discussion with FIs (not binding)
Supporting FIs' transition and physical risk assessments	7 out of 9 PDBs may offer TA on climate risk assessments	3 out of 8 FIs already carry out these assessments and 3 are in the process of doing so	For FIs with material risk exposure following initial climate risk screening (*e.g.* exposure to fossil fuels, high climate vulnerability, ...)
Assessing FIs' portfolios' consistency with sectoral decarbonisation pathways	1 out of 9 PDBs systematically applies sectoral decarbonisation pathways to FI lending (*e.g.* by applying its sectoral policies to FI lending) and 3 may do high-level assessments	1 out of 8 FIs mentions consistency with sectoral decarbonisation pathways	Only used by most advanced PDBs and FIs on Paris alignment
Advocacy for sustainable finance policy and reporting (*e.g.* engagement with regulators)	5 out of 9 PDBs actively engage with local financial regulators on sustainable finance	–	Dependent on PDB resources and focus on sovereign entities

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4.2. Examples of practices across PDBs providing international development finance

Most adopted practices across PDBs providing international development finance include:

- applying exclusion lists to FIs' investments (*e.g.* no financing of coal, upstream oil and gas in use of proceeds).
- supporting FIs' transition and physical risk assessments.
- advocating for sustainable finance policy and reporting (*e.g.* engagement with regulators).
- requiring financed emissions from FIs.
- requiring FIs to define emission reduction targets.

Widely adopted practices towards FIs often reflect PDBs' own practices towards achieving Paris alignment. For instance, exclusion lists are applied across all interviewed PDBs providing international development finance, for both their direct and indirect investments. These exclusions can easily be passed on to financial intermediaries as part of contractual arrangements. Relevant to Paris alignment, exclusions usually target coal. Other fossil fuels may also be excluded but given local investment contexts of financial intermediaries, and their portfolio's existing exposure to fossil fuel sectors, this is rarely the case. This exposure can be significant for financial intermediaries in areas that still heavily rely on fossil fuels, in which case climate-related transition risk management proves to be crucial. Support to climate-related risk assessments is in fact another widely applied practice with financial intermediaries, as it is important for lenders to manage and disclose their physical and transition risk exposure through intermediated investments. It also reflects most common market practices across the financial sector, such as applying the International Stability Standards Board's IFRS standards S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and S2 (Climate-related Disclosures), which developing jurisdictions are starting to adopt. Financial institutions in developing countries and their regulatory authorities are starting to adopt these recommendations, and may also be incentivised by investors to report on climate-related risk exposure. For financial intermediaries, working with PDBs providing international development finance to map exposure to climate-related financial risks is the first step towards fully assessing and managing exposure to climate-related financial risks.

Several PDBs providing international development finance also support the development of sustainable finance policy by engaging with financial regulators and supervisors, therefore complementing other practices with their financial intermediaries. This aligns with their mandate to support systemic change and policy reforms in favour of the transition to low-emissions and climate-resilient development.

Tracking financed emissions and adopting emission reduction targets depend on FIs' capacity to assess and monitor climate performance more broadly, which may often be limited due to data availability or quality issues. It may therefore prove more difficult to ask for systematically, and is mainly considered for most advanced financial intermediaries on their journey towards Paris alignment, or can be part of PDBs' engagement with their intermediaries on their transition plans.

Another set of practices, also aiming to leverage impact in transactions with financial intermediaries, are less frequently implemented by PDBs:

- applying inclusion lists to FIs' investments. These lists may define priority areas for financing and designate activities that contribute to climate-positive outcomes
- requiring FIs to ensure consistency of their activities with national development pathways if not already mandated to do so (*e.g.* non-public FIs).
- assessing FIs' portfolios' consistency with sectoral decarbonisation pathways.

These practices are overall less commonly applied within PDBs providing international development finance for their own investments, which may contribute to explaining why they are not required from financial intermediaries as much.

In addition to the practices highlighted above, technical assistance, which can be provided by MDBs and other bilateral development banks depending on dedicated resources for capacity building, is considered by financial intermediaries as one of the most impactful levers for them to further align with the Paris Agreement. This is further discussed in the next section, which provides insights from financial intermediaries.

Areas where technical assistance proves to have most impact relate to the implementation of climate-related strategic objectives, the assessment and management of exposure to climate-related financial risk, and the increase in climate-related activities and investments. For instance, technical assistance provided by the Inter-American Development Bank's private sector arm (IDB Invest) to its private sector counterparties, including financial intermediaries, can aim to (i) improve the identification of climate project opportunities prior to investment including through capacity building on climate, (ii) support market development through demonstration effects, or (iii) attract private investors by supporting the structuring of blended finance operations or facilitating knowledge production to guide investor decision-making (Blackman, *et al.* 2025).

Bilateral development banks such as AFD have also identified technical assistance activities that have a ripple effect on local financial systems. AFD has for instance provided technical assistance to the African Export-Import Bank (Afreximbank) and the West African Development Bank (BOAD) for the adoption of long-term climate strategies or to develop tools to help assess risks and opportunities at financial portfolio level. By doing so, AFD aims to have an impact on strategies, governance, and internal processes of its financial intermediaries, to help create a demonstration effect and redirect financial flows more widely towards financing low-emissions and climate-resilient development pathways.

Some MDBs, such as IDB, have identified additional levers of impact that they consider supportive of Paris alignment practices in financial intermediaries. For example, when engaging with NDBs, it can provide performance-based financial incentives, as part of the 'Latin America and the Caribbean Facility for Greening Public Development Banks and the Financial Sector' initiative it has launched in the region in 2024 (IADB 2024). In addition, as part of these efforts, IDB supports peer-to-peer exchange of good practices on climate ambition as it coordinates several platforms where PDBs can share best practice for incorporating climate-related policies. IFC's Sustainable Banking and Finance Network (SBFN) is another example of MDB-facilitated network allowing knowledge-sharing and capacity building on sustainable finance. A recent survey by EIB and the Latin American Association of Development Financing Institutions (ALIDE) found that a lack of know-how of green investment and climate change adaptation among clients and PDBs represented a barrier to scaling up green projects in Latin America and the Caribbean (EIB 2024).

PDBs providing international development finance should further build on their collective experience and success stories with financial intermediaries, to identify levers of impact that should be prioritised for greater climate and development outcomes. This identification should rely on the results highlighted in Table 2 above, complemented with ex-post assessments of achieved impact where possible. It should also highlight the conditions under which these levers are useful, building on the initial insights shared in Table 2 above.

Moreover, as highlighted in the example with IDB's and IFC's support to peer-to-peer networks, in addition to targeted technical assistance to financial intermediaries when their resources allow such technical support, PDBs providing international development finance should help build capacity by supporting knowledge-sharing through communities of practice and networks of financial institutions facing similar challenges.

4.3. Examples of practices across FIs

4.3.1. Implementation of Paris alignment practices as required by lenders

Whether in response to PDB reporting requirements, policy or regulatory obligations, or internal drivers, FIs adopt a broad range of strategies to enact their climate commitments. Of the practices supporting Paris alignment of FIs (presented above) used by PDBs, none are universally implemented by the sample of FIs interviewed. In **Figure 1**, the financial intermediaries interviewed are ranked by the number of alignment practices that they implement. Within the sample, only a single financial intermediary fully (as opposed to partially) implements more than half of the practices. Alignment practices are also ranked, from top to bottom, from the most to least commonly implemented. The outcome highlights which practices are most widespread and which are most difficult to implement.

FIGURE 1. ILLUSTRATION OF ALIGNMENT PRACTICES' IMPLEMENTATION AMONG SAMPLE OF FIs

Alignment practices	1	2	3	4	5	6	7	8
Consistency with national development pathways	Full	Full	None	Partial	Full	Full	None	Partial
Inclusion list	Full	Full	Unknown	Full	Full	Unknown	None	None
Track financed emissions	Full	Full	Full	Partial	Partial	Partial	Partial	Partial
Exclusion list	Partial	Partial	Full	Full	Partial	None	Partial	Partial
Risk assessments (transition and physical)	Full	Partial	None	Full	None	Partial	Partial	Partial
Emission reduction targets	Full	Full	None	Partial	Partial	None	Partial	None
Disclosure of risky projects	Unknown	None	Full	Unknown	Unknown	Unknown	Unknown	Unknown
Consistency with sectoral decarbonisation pathways	Full	Unknown	None	Unknown	Unknown	Unknown	Unknown	None

Level of implementation: Full | Partial | None | Unknown

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The most widely used practices are inclusion lists and ensuring consistency with national development pathways, fully implemented by half of the FIs interviewed. The consistency with national development pathways is frequently mentioned as part of NDBs' mandate and is less likely to be influenced by PDBs providing international development finance. Inclusion lists are generally under the guise of sustainable finance taxonomies or priority investment sectors and are sometimes quantified as portfolio-wide targets. Emissions tracking is the only practice to be implemented across the board, though partially in the majority of cases (often meaning that only emissions from scopes 1 and 2 are measured instead of financed emissions). Most FIs applied some form of exclusion list, building on environmental and social (E&S) safeguards that are already in place, established thanks to past support from PDBs providing international development finance. However, none specifically excluded all fossil fuels from their investments (at least one excluded oil through pre-existing E&S safeguards), except when exposure was already very low or inexistant due to the sectors they invest in.

4.3.2. From Paris alignment requirements to internal processes

The assessment of practices above helps demonstrate which levers PDB lenders can use to encourage counterparties to align but does not capture all aspects of a financial intermediary's journey to align with the Paris Agreement. In their 2023 paper, Pauthier and Kachi set out steps for aligning internal processes with climate objectives, against which the advancement of FIs can be measured. Examples of approaches taken by different FIs are described in **Table 3**.

TABLE 3. STEPS FOR ALIGNMENT OF INTERNAL PROCESSES WITH PARIS AGREEMENT OBJECTIVES (BASED ON PAUTHIER AND KACHI, 2023)

Climate Mainstreaming Principle	Area of work	Example of the practice as implemented by a financial intermediary
Commit to climate strategies	Develop climate governance (*i.e.* board oversight of climate target achievements)	*HBTF's push to go green developed from the CEO's vision, seeing an opportunity to become a market leader. The green finance programme will continue regardless of international funding, because viewed as a market opportunity.*
	Integrate climate considerations in the financial institution's strategy	*BNDES has a climate strategy defined by public policies. The current strategy does not focus on portfolio level carbon neutrality but is directed towards supporting climate neutrality at country level, generating greater overall impact. The strategy still explicitly aims to increase client engagement, thus contributing to reducing emissions.*
	Develop climate-related targets	*CAF has a corporate target of reaching 40% of green finance in all new approvals in 2026. To prop up this target, business units should work with clients to ensure compatibility of their activities.*
	Implement climate-related strategic objectives	*Several banks report that working with PDBs providing international development finance has helped them build capacity and acquire tools to implement climate-relevant project assessments.*
Manage climate risk	Assess and manage exposure to climate-related financial risk	*TSKB has developed an in-house Climate Risk Evaluation Tool (CRET) to assess both physical and transition risks. Through this, climate risks are integrated into loan assessment, allocation, and monitoring procedures.*
Promote climate smart objectives	Increase climate-related activities and investments	*PT SMI has increased its renewable energy portfolio for 5 years. This was driven by its GCF accreditation, its mandate as the Energy Transition Mechanism Country Platform Manager, its mandate as a catalyst for infrastructure development, and multiple engagements and cooperations with MDBs.*
	Access and mobilise new sources of climate finance	*Several banks are accredited to the GCF, allowing them to raise complementary funding from other sources.*
	Reduce activities with adverse climate impacts	*CAF relies on its E&S safeguards, which include climate and biodiversity issues, as the core of its exclusion list. Specific exclusion lists can be drawn on a case-by-case basis when dealing with sector-focused credit lines.*
Improve climate perfor-mance	Assess and monitor climate performance	*TSKB has established emission reduction targets approved by the Science-Based Targets initiative (SBTi), including three sectoral decarbonisation targets – two for the electricity generation sector and one for the real estate sector.* • *Reducing greenhouse gas emissions from the electricity generation project finance portfolio by 85.6% per kWh by 2035, compared to the 2021 baseline.* • *Reducing greenhouse gas emissions from the electricity generation sector within the corporate loan portfolio by 85.7% per kWh by 2035, compared to the 2021 baseline* • *Reducing greenhouse gas emissions from the commercial real estate sector within the corporate loan portfolio by 71% per square meter by 2035, compared to the 2021 baseline.* *TSKB also monitors client emissions where possible.*
Account for action	Report on (disclose) climate-related risks and performance	*Several banks disclose the sector breakdown of investments and the volume of climate-related activities.*

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Many FIs in smaller markets may lack the resources and infrastructure to adopt a full range of climate strategies and instruments. To help FIs progressively advance on meeting compliance requirements and raising climate ambition, a tiered approach is recommended. The phases (early stage, intermediate, advanced practice) and corresponding requirements are described in detail in the paper by Kachi and Pauthier (2023).

4.3.3. Assessment of PDB influence in driving Paris alignment

The degree of influence that FIs attributed to lenders in driving their alignment practices and climate strategies varies. On the one hand, funding of specific green credit lines by PDBs providing international development finance is essential to expanding renewable energy and energy efficiency in many countries. On the other, some FIs describe a mismatch between credit line conditionality and technological capacity, investment context, or technical capacity for reporting.

PDB influence on Paris alignment in FI practices is diminished by the complex reporting landscape. Many FIs may borrow from multiple PDBs, each of which may have their own requirements, adding to FIs' reporting burden. Greater coordination among PDBs and mutual recognition of alignment criteria and reporting processes deployed by peers would help alleviate this issue. In addition, inclusion lists used by PDBs are sometimes contradictory to local requirements defined in taxonomies, making it difficult for FIs to comply with inclusion lists.

Other factors also have a significant influence over Paris alignment processes. For instance, board buy-in is crucial to establishing climate governance within the institution and can be a stronger driver for internal change than transactions with PDBs. Several FIs and PDBs also suggested that pre-existing (i.e., pre-dating a focus on climate action) E&S safeguards and internal E&S human resources still had a major role to play for increased impact on the ground, including in terms of climate commitments.

Technical assistance provided by PDBs for developing tools and building staff capacity is unanimously seen as valuable to driving Paris alignment by FIs. Support for impact assessment, monitoring and evaluation, as well as project preparation ranked as the highest priorities for technical assistance among surveyed members of Finance in Common (IPC 2024). In the context of financial intermediation, technical assistance is especially important in helping FIs acquire expertise in climate-relevant market segments that are new to them (agriculture, for instance). Funders can thus help reduce start-up costs and improve programme efficiency. This could help avoid the unintended slowdown in lending activity experienced by some financial intermediaries in Africa (Léon 2025). Apart from bilateral technical assistance, there is a clearly perceived influence of networks, such as the International Development Finance Club (IDFC), for building capacity among technical staff.

Technical assistance is also impactful when it helps FIs develop tools that sustain project assessment frameworks. For instance, BNDES received support from KfW to calculate avoided emissions from projects, providing analysts with avoided emissions indicators for their operations. In another example, EIB supported FONPLATA in developing a system to assess project alignment with sustainable development goals (SDGs), providing clear information throughout the project lifecycle (Alianza de Bancos Subnacionales de Desarrollo de América Latina y el Caribe 2023). PDBs can also efficiently support FIs with technical assistance through co-development of climate risk assessment tools. An example of this is IDB's support for mapping the climate risk vulnerabilities in key value chains in Mexico and Brazil. The tool helped identify the main climate risks and the most exposed regions and agricultural chains within FIRA's (Trust Funds for Rural Development of Mexico) portfolio. This in turn helped deliver more targeted investments to build climate resilience (Frisari, *et al.* 2023).

4.3.4. Lessons drawn from FI case studies

In order to tailor their approaches to Paris alignment to the context of their financial intermediaries, PDBs providing international development finance should take the following into account:

- PDBs should evaluate whether national development pathways are adequately defined in nationally determined contributions (NDCs) or national planning documents, and assist in the development of these pathways where needed, in addition to requiring FIs to align with these pathways. This alignment can also be supported by engaging with national regulators to adjust local financial institutions' mandates to these pathways, and by ensuring NDCs target these institutions' role in the achievement of climate targets in the country.
- Fossil fuel exclusion lists (usually referring to coal and upstream oil and gas) are difficult to implement in contexts where the economy is fossil fuel-dependent, and PDBs should continue to support deep decarbonisation in these contexts, in parallel with their engagement with FIs. On the other hand, many FIs suggest that exclusion lists linked to E&S safeguards still have room for improved implementation and can deliver further climate benefits when combined with Paris alignment considerations. Monitoring exclusion list application by FIs during execution is important, particularly for those with higher risk and lower capacity.
- Green inclusion lists are a good starting point in order to promote climate-smart objectives, as these can be integrated into existing strategic objectives and can help prioritise FI investments towards Paris-aligned activities.
- Financed emissions tracking is out of reach for most FIs interviewed in this study due to limited technical capacity. Technical assistance to support financed emission tracking where relevant, for instance in case of exposure to high-emitting sectors, could play an important

role in building capacity on climate performance self-assessment. Data availability issues will however remain an important limitation. In acknowledgement of these limitations, PDBs should support FIs in finding other ways to track climate performance.

- Setting emission reduction targets requires FIs to track financed emissions, which as mentioned above is only feasible for FIs with the most advanced climate practices, and also requires significant internal buy-in. As such, emission reduction targets should be considered carefully to ensure they are not contradictory to the FIs' development mandate, for instance.
- Regulatory requirements are a major driver of change, and MDBs can help bring about enabling regulatory environments through their work with regulators and central bankers. However, technical assistance to comply with these requirements is a recurring request from FIs, and is particularly important in less sophisticated financial systems.
- Disclosure at project level is infrequent, though it is considered by several PDBs as critical to Paris alignment since portfolio aggregation can prevent from identifying opportunities for increased ambition and can downplay weak spots. However, disclosure requirements can place an additional administrative or reputational burden on FIs, and so appear to be used sparingly. It can be a lever for increasing ambition with later-stage FIs.
- Physical and transition risk assessment is often taken up after initial support or technical assistance from PDBs providing international development finance.

5. PDBs SHOULD BETTER TARGET IMPACT: RECOMMENDATIONS FOR PDBs

The following recommendations apply to PDBs providing international development finance, in order to tailor their approaches to Paris alignment of financial intermediation, drawing on their collective experience with financial intermediaries:

Outside of a specific FI transaction:

- PDBs should evaluate whether national development pathways are adequately defined in nationally determined contributions (NDCs) or national planning documents and assist in the development of these pathways where needed, in addition to requiring FIs to align with these pathways. This alignment can also be supported by engaging with national regulators to adjust local financial institutions' mandates to these pathways, and by ensuring NDCs target these institutions' role in the achievement of climate targets in the country.
- PDBs should continue to support, both technically and financially, the development of regulatory environments and reporting requirements that enable and strengthen financial flows towards climate and development outcomes. National and international regulatory requirements as well as requirements from investors are a major driver of change for FIs.

When arranging on-lending with FIs (prior to approving transactions):

- Fossil fuel exclusion lists are difficult to implement in contexts where the economy is fossil fuel-dependent, and PDBs should continue to support deep decarbonisation in these contexts, parallel to their engagement with FIs. On the other hand, exclusion lists linked to environmental and social (E&S) safeguards still have room for improvement (*e.g.* in their scope of application) and can deliver further climate benefits when combined with Paris alignment considerations. Monitoring exclusion list application by FIs during execution is important, particularly for those with higher risk and lower capacity.
- PDBs should consider using green inclusion lists as they prove to be a good starting point in order to promote climate-smart objectives, and can be integrated into existing strategic objectives and help prioritise FI investments towards Paris-aligned activities.
- PDBs need to systematically consider how engagement with FIs can support improvement in their practices (*e.g.* through results-based financing, dialogue on Paris alignment and priority areas for investment and institution-level transition, application of E&S safeguards …) and further influence FIs' practices, prior to disbursement as well as throughout the relationship with the FI;
- PDBs need to adjust the abovementioned requirements to FIs' level of advancement on climate, and the financial instruments used to the local context (*e.g.* disclosure requirements already in place, level of transition risk *i.e.* exposure to fossil fuels, limited opportunities for climate finance in market, vulnerability to physical risks, …), while relying on publicly disclosed assumptions that reflect local needs, and scenarios that reflect the country's pathway towards decarbonisation and resilience.

Throughout the on-lending period:

- Technical assistance is key to supporting the implementation of all the abovementioned practices in many cases. For example, physical and transition risk assessment is often taken up after initial support or technical assistance from PDBs providing international development finance. Technical assistance to navigate sustainability reporting requirements and support financed emissions tracking where relevant could also play an important role in building capacity on climate performance self-assessment. It can help address data availability issues, which are an important limitation to emissions tracking. Tracking financed emissions is not yet within reach for most FIs interviewed in this study.
- Setting emission reduction targets (at project or portfolio level) requires FIs to track financed emissions, and also requires significant internal buy-in. As such, it is a practice for more advanced FIs on climate, and should be considered carefully to ensure it is in line with the FIs' development mandate, for instance. It can also be replaced with or complemented by the tracking of other metrics that reflect improvement in Paris alignment and that can reflect the increase in climate-related activities and investments and/or decrease in activities with adverse climate impacts.
- In addition to targeted technical assistance to FIs, which most FIs considered in this research benefitted from, PDBs should help build capacity of FIs by supporting knowledge-sharing on institutional climate mainstreaming or regional challenges to the transition, through communities of practice and networks of financial institutions facing similar issues (*e.g.* regional networks and alliances of PDBs & DFIs (ALIDE, EDFI, *etc.*), FICS, IDFC, Mainstreaming Climate in Financial Institutions, *etc.*).

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