Federal Ministry
for the Environment, Nature Conservation
and Nuclear Safety

IKI INTERNATIONAL CLIMATE INITIATIVE

IKI Focus

Transforming the financial sector

IKI mobilises finance, and shifts its flows and frameworks towards low-carbon, climate-resilient development

As one of Germany's climate finance vehicles, the International Climate Initiative (IKI) is inextricably associated with accelerating the achievement of the goals of the Paris Agreement (PA). The Parties to the PA have agreed to make financial flows consistent with a pathway towards low-carbon and climate-resilient development (PA, art. 2.1c). To achieve this, it is essential that ambitious climate mitigation and adaptation requirements are considered for all financial decisions (mainstreaming). At the same time, policy and regulatory frameworks such as incentives and disclosure regulations need to be developed to create enabling environments that allow the divestment of assets not aligned with the Paris Agreement. This process also contributes to the achievement of sustainable development goals (SDGs).

Public funding to mobilise private finance

However, the funding needed to reshape economies into low-carbon or net-zero systems cannot be provided solely from public finance. Public funds like the IKI must be supplemented by a variety of sources that include private climate finance as well as other bilateral and multilateral contributions such as the Green Climate Fund (GCF), the Global Environmental Facility (GEF), the Adaptation Fund (AF) or the Climate Investment Fund (CIF). Yet questions remain about approaches to raising funds from private sources, as well as the necessary frameworks or securitisation instruments. Accordingly, public funds must also be deployed effectively to mobilise private finance for climate change mitigation and adaptation. This is where the IKI can make a difference.

Reshaping investments and financial frameworks

Alongside changes in the regulatory and policy environment, the private sector also has a crucial part to play here. While private sector investment in climate projects has increased significantly in recent years, challenges still remain. In particular, there is a lack of bankable projects, combined with high investor risk and non-enabling environments for private sector investment in climate action. Accordingly, the IKI works with its partners in international development activities to promote projects that are aimed at implementing article 2.1c and fostering private sector engagement. These projects seek to mobilise finance by supporting sustainable business models as well as innovative financing instruments for private investment in transformational climate mitigation and adaptation.

Examples of such instruments include the provisioning of lines of credit for the refinancing of specific climate-related credit programmes offered by local financial institutions as well as advising key actors (e.g. finance ministries or central banks) on the adjustment of regulatory measures to foster Paris-aligned financial flows. Support is also provided for blended finance instruments that aim to reduce private-sector investment risk with equity participation in first-loss tranches, for example. The successful integration of climate-relevant aspects into public and private investment decisions supports an overall shift in financial flows while also increasing the levels of available finance. Since 2015, approaches to PA-compatible financial market development have become increasingly important. Accordingly, the IKI supports a growing number of projects that implement sustainable financial policies and the regulatory frameworks necessary to increase green investments.

Measuring Paris Agreement alignment and financial risk in financial markets
BMU grant: €3,806,294.00, duration: 11/2015 to 12/2022
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Lowering financial barriers to investment

When financing sustainable projects in emerging market and developing economies, major obstacles typically include a lack of technical capacities and financial resources during the project development phase. Project development credit facilities can help to accelerate project planning and ensure that these projects receive a corresponding level of finance. In addition, this approach gives potential investors access to a pipeline of technically robust and financially mature projects.

In terms of breadth, IKI funding ranges from financial support in the pre-investment phase to the provision of technical support to projects in later stages of project development, as well as start-up capital investment to reduce high initial costs and risks for clients and investors alike. The latter helps to remove the financial barriers that are typically problematic in the project development phase.

Seed Capital Assistance Facility
BMU grant: € 20,000,000.00, duration: 05/2020 to 04/2027
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Capacity building in the banking sector

A lack of suitable financing options remains a major obstacle to investment in climate action projects and adaptation measures. Important reasons for this include a lack of awareness for opportunities with renewables (for example) on the part of banks and investors, which in turn fosters excessive risk aversion. Accordingly, the IKI promotes measures that are aimed primarily at capacity building in private financial institutions. Supported measures include improving general organisational conditions in financial institutions as well as training in relation to the development of climate finance products and the review of loan applications made in the green finance segment.

Capacity Building for Green Energy and Climate Finance
BMU grant: €20,000,000.00, duration: 11/2015 to 03/2022
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Measuring risks and highlighting potential

To achieve climate finance goals, climate criteria must be mainstreamed as part of all investment decision-making. At the same time, political and regulatory frameworks must also be established that create incentives for divesting large volumes of assets. Accordingly, the IKI supports projects that help partner countries to develop the overall greening of their financial systems by increasing the level of cooperation with policymakers, national and regional development banks, and central banks.

In the field of international climate and development finance, the concept of blended finance is adopted as a strategic measure for mobilising flows of private capital in emerging market and developing economies. Blended finance strategies seek to reduce risks for private sector involvement, and are also being developed with the aim of mobilising private and public climate-friendly investment. One example of the innovative use of climate finance instruments to mobilise green investment is the Compact with Africa (CwA) project (see below).

Catalysing private finance for climate impact in Africa
BMU grant: €20,000,000.00, duration: 01/2021 to 12/2026
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The IKI also supports the creation of domestic markets in its partner countries. Given the huge levels of funding required to implement nationally determined contributions (NDCs) in developing countries, the financial sector has a critical role to play. However, aspects such as a limited understanding of climate finance opportunities and a lack of consistent policies have so far hindered an appropriate mobilisation of funds. With its '30 by 30 zero' project, the IKI supports the alignment of financial sector strategies to support NDC implementation. By 2030, the project aims to increase climate lending as a proportion of the total credit portfolio held by participating banks to 30 percent, while also reducing climate- and carbon-related risks.

'30 by 30 Zero'
BMU grant: €20,000,000.00, duration: 07/2020 to 12/2027
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www.bmu.de/en | IKI6@bmu.bund.de
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