Accounting for mobilized private climate finance: input to the OECD-CPI Report

On September 6th 2015 in Paris, ministers and senior officials from various developed country governments agreed to a common methodology to track and report mobilized climate finance. This methodology relies on the following principles: to ensure that only finance mobilized by developed country governments is counted towards the $100 billion goal and that, where multiple actors are involved, the resulting finance is only counted once in tracking finance; and to ensure that the reporting framework encourages and incentivizes the most effective use of climate finance.

Based on these principles and for the purpose of the OECD/CPI report commissioned by France and Peru, the following document outlines the methodologies that were used by the group to provide their bilateral data for the purposes of this report as well as some technical recommendations related to the accounting of flows mobilized by developed countries towards the $100 billion Copenhagen goal. It is worth noting that due to differences in data systems in use across countries, and in light of the compressed timeline for providing data for this report, not all providers were able to apply this precise methodology for the data submitted. This methodology builds on technical discussions over the past years within the OECD-hosted Research Collaborative on Tracking Private Climate Finance; it reflects the best available technical understanding and data availability, acknowledging that further improvements will take place in the future in the light of changing data availability and lessons learned from trialing these recommendations.

- **Sectoral coverage:** the data provided by the group to OECD/CPI did not include finance related to coal projects; however Japan and Australia consider that financing for high efficiency coal plants should also be considered as a form of climate finance and Japan provided a separate estimate of the amount of finance that Japan provided for high efficiency coal plants projects. In the report this estimate will be indicated separately from, and additionally to the main total climate finance estimate.

- **Classification of actors as public or private:** the group applied the OECD DAC standard definition to determine if an entity was public or private: official (i.e. public) transactions are those undertaken by central, state or local government agencies at their own risk and responsibility, regardless of whether these agencies have raised the funds through taxation or through borrowing from the private sector. The group reported data with the view that 100% of the finance by such entity should be counted as public or private depending on the definition of the entity.

- **Geographic source of private flows mobilized:** considering the importance of mobilizing flows from the widest variety of sources and of strengthening the private sector in developing countries, in particular small and medium enterprises, the data provided by the group included both domestic and international private flows mobilized by a developed country public intervention, with the understanding that multilateral data would follow the same convention. Where possible, the group agreed to aim to indicate where flows originated, using international standard based on Foreign Direct Investment statistics definitions, which relies on the residence principle as defined by the balance of payments.

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1. Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Poland, Sweden, Switzerland, United Kingdom, United States, and the European Commission.
3. The Research Collaborative is an open network, co-ordinated and hosted by the OECD Secretariat, of interested governments, relevant research institutions and international finance institutions.
4. except if equipped with CCS
5. For increased transparency, in addition to total public finance, the group intends to provide information on public budgetary sources and/or grant equivalent in future reporting.
• **Data sets:** the group provided activity-level data were available, or aggregates estimates based on activity-level data analysis. Only robust proxies were occasionally used\(^7\) when no such data was available.

• **Causality between public intervention and private finance:** the group understands private finance as being mobilized where there is a clear causal link between a public intervention and associated private finance and where the activity would not have moved forward, or moved forward at scale, in the absence of our governments’ intervention; and reported data accordingly. Data provided by the group relied on project-level boundaries for grants, loans and syndicated loans. For other types of financial instruments, such as guarantees and collective investment vehicles, the precise boundaries varied according to the level and quality of available data, as well as causality considerations based on conservative approaches.

• **Instruments:** as both are useful to effectively mobilize private sector towards low-carbon and resilient development, the group was of the view that private finance mobilized both by public finance and by policy support should be included, to the extent that data existed and that a causality link could be demonstrated, and fairly taking into account public finance and policy support provided by developing countries themselves. At this stage however, for practical reasons, data availability and coherence, the data provided by the group only reflected private finance mobilized via public instruments, until robust methodology and necessary data become available.

• **Currency:** the data provided by the group relied where possible on exchange rates from the OECD DAC.

• **Attribution – co-financing:**

  In order to prevent double counting and to recognize the role that developing countries’ public finance plays in mobilizing private finance, the group recommended that mobilized private finance be accounted based on a volume-based, pro-rata attribution approach, and reported its bilateral data accordingly. In other words: if several public actors are involved in one project, the mobilized private climate finance associated with this project would be attributed to the various actors in equal proportion to the share of public finance (estimated at face value) that each public financier provided. Only developed countries’ shares of private finance mobilized should be reported, excluding private finance mobilized by developing countries’ public finance.

• **Attribution – multilateral institutions:**

  The group recommended that climate finance mobilized by multilateral entities with complex ownership structures, such as multilateral development banks and other multilateral entities, be attributed to the various owners based on the following methodology.

  The development of this methodology was guided by the principles below:
  
  - The methodology should be transparent and as simple as possible;
  - Only amounts that can reasonably be attributed to developed countries should be counted;
  - The contributions of developed countries to the capacity of MDBs and multilateral entities to mobilize resources should be recognized, including contributions to concessional windows and paid-in and callable capital contributions to non-concessional windows;
  - The method should be dynamic; it should be relatively easy to adapt to changing circumstances as appropriate.

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\(^7\) By some DFIs in particular
The MDB concessional windows, as well as dedicated climate funds, operate on a “money-in, money-out” model—they are not leveraged (they do not raise funds in bond markets for their financing), and they have to be replenished regularly. Their resources come from contributions made during the replenishment process by countries and from retained earnings (reflows from loans and other instruments and interest on investments).

The overall approach recommended to calculating the attributable share of finance from concessional windows involves separating flows that originate from the most recent replenishment from flows originating from reflows and past replenishments. The former should be imputed using the developed countries’ share of contributions in the most recent replenishment; the latter should be imputed using the developed countries’ share of historical contributions. This translates in the following formula:

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\left( x \left( \frac{\text{Developed country contributions}}{\text{All contributions}} \right)_{\text{Current}} + y \left( \frac{\text{Developed country contributions}}{\text{All contributions}} \right)_{\text{Historical}} \right) \times \text{Annual climate finance flow}
\]

where \( x \) is the portion of climate finance from the concessional window or fund that derives from recent contributions, and \( y \) is the portion that comes from retained earnings.

Non-concessional windows

The financial mechanics of the MDB non-concessional windows, which rely on leverage, require a different approach. The non-concessional windows fund themselves through (1) resources raised in the bond market and (2) retained earnings. The banks’ ability to fund themselves is determined by their capital, which is usually of two types: paid-in and callable. The banks’ AAA credit ratings allow them to raise larger volumes of finance in the markets and at terms that are more attractive than the banks’ borrowers could secure on their own.

The banks’ credit ratings derive from the quality of their balance sheets and the extraordinary support that shareholders are committed to providing in the form of callable capital, whose value is taken into account by rating agencies in their judgment only if it is highly-rated (HR). The importance of this capital to a particular institution’s credit rating depends on several factors, including the strength of the bank’s portfolio. For some MDBs, highly-rated callable capital results in uplift of one or more notches in the rating of the bank beyond what the Stand Alone Credit Profile would provide. In other cases, highly-rated callable capital is deemed as increasing the MDB’s lending and borrowing headroom. In all cases, highly-rated callable is deemed as providing stability to the MDBs’ credit ratings.

The proposed approach to calculating the attributable share of finance from non-concessional windows involves two elements. The first is developed countries’ share of paid-in capital, and the second is

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8 To calculate the amount of climate finance that can be attributed to developed countries in a given year, the climate finance outflows of the MDB concessional windows and dedicated climate funds for that year will be separated into those that are sourced from recent contributions and those that are based on retained earnings. The portion sourced from recent contributions will be multiplied by the share of the total replenishment contributed by developed countries in the most recent cycle. The portion sourced from retained earnings will be multiplied by the share of developed countries in historical contributions, which is the sum of all replenishments except for the most recent one. The two terms are then added together and the resulting ratio is multiplied by the total climate finance flow from that window or entity for the relevant year.

9 Highly-rated callable capital is understood for the purpose of this exercise as capital contributed by countries whose median credit rating among the three major credit rating agencies is “A” or above (higher of the two, if one of the three is missing).
developed countries’ share of highly-rated callable capital\textsuperscript{10}. To recognize that callable capital is not equal to paid-in capital, the eligible callable capital should be affected with an important discount\textsuperscript{11}. This approach translates into the following formula:

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\left[ \frac{\text{Paid in capital}_{\text{Developed countries}} + (\text{HR Callable capital}_{\text{Developed countries}} \times 0.1)}{\text{Paid in capital}_{\text{All countries}} + (\text{HR Callable capital}_{\text{All countries}} \times 0.1)} \right] \times \text{Annual climate finance flow}
\]

\textsuperscript{10} The ratio of climate finance from non-concessional windows attributable to developed countries will be calculated as (1) the sum of developed countries’ paid-in capital and developed countries’ highly-rated callable capital (with discount), divided by (2) the sum of the total paid-in capital and the total highly-rated capital (with discount).

\textsuperscript{11} To recognize that paid-in capital has substantially more value than callable capital, a discount rate should be applied to the callable-capital portion of the calculation. Setting a discount rate is not an exact science but the group proposes to discount highly-rated callable capital by 90%, thereby only counting 10% of its volume.