



African Financial Alliance on Climate Change

# GUIDING PRINCIPLES

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AFRICAN DEVELOPMENT BANK GROUP

# AFAC: The Principles

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## I. Rationale

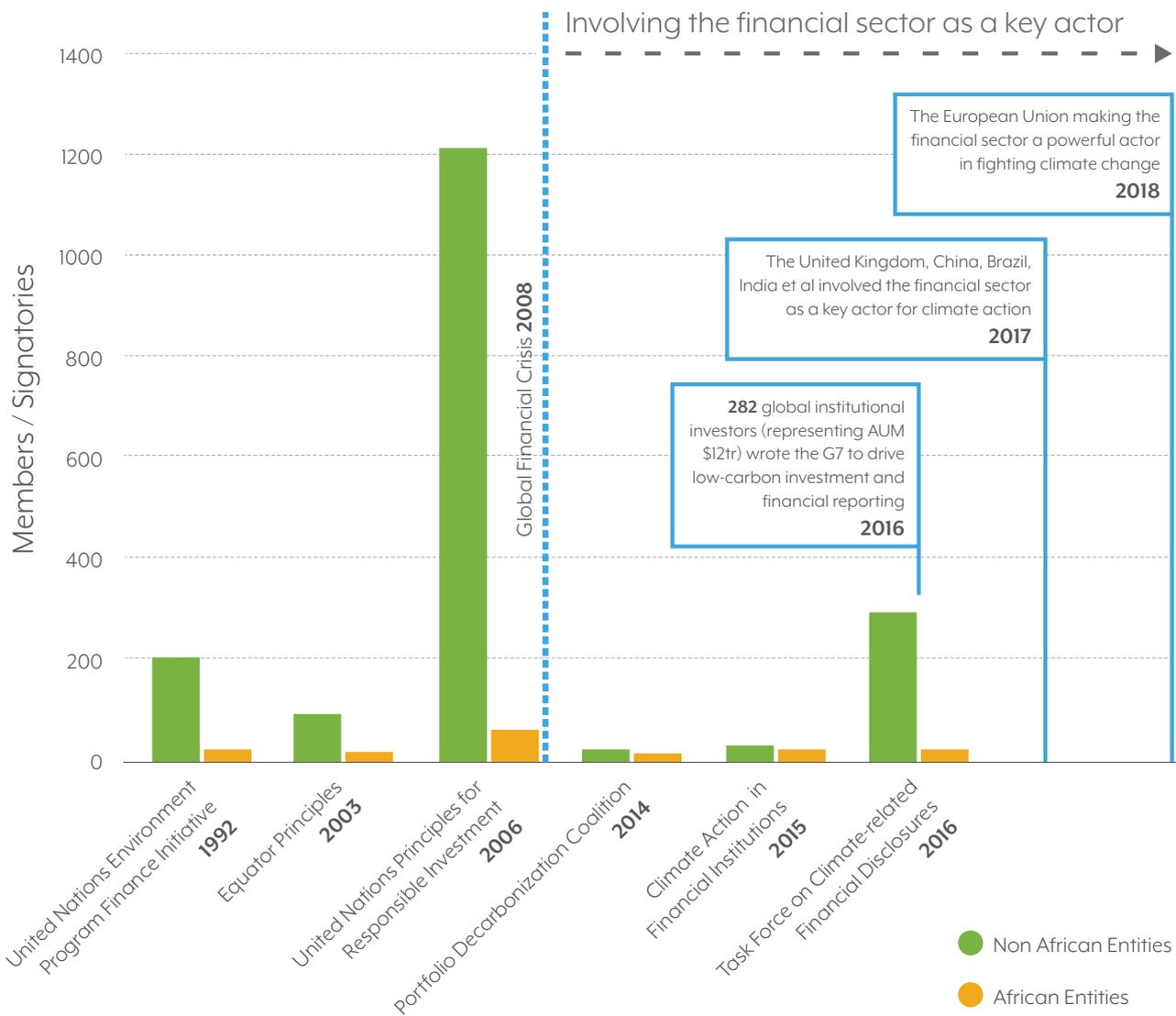
The cost of meeting Africa's commitment to the global Climate Change Agreement presents an investment opportunity estimated at over US\$3 trillion by 2030. It is expected that the bulk of these resources will come from the private sector. It is for this reason that the African Development Bank has rallied Africa's key financial sector owners and purveyors of capital to play a leadership role in mobilizing and deploying climate finance to deliver climate action in Africa.

The African Financial Alliance on Climate Change (AFAC) aims to bring together representatives of Africa's financial institutions and regulators including development and commercial banks, central banks, insurance companies, sovereign wealth and pension funds, private equity, stock exchanges and other investment companies towards the common goal of significantly raising the share of climate finance in their investments.

The realization that climate action can best be achieved through collective stakeholder efforts has spurred the establishment of global and regional initiatives that bring together key stakeholders to commit to aligning their actions towards supporting low-carbon and climate-resilient development. Currently, African financial and non-financial institutions are under-represented in the leading initiatives (Figure.1).

It is hoped that AFAC, through well-designed fit-for-purpose principles that are tailored to African ecosystem, would help bring the African financial sector at par with the rest of the world to help drive low-carbon investments and manage climate-related risks on the African continent. AFAC member institutions shall commit to these principles, which will be finalized post discussion and approval by members of the Steering Committee of AFAC.

Fig.1. Leading global financial initiatives on climate action



Source: AFAC Secretariat

## II. Overview of the Design of the AFAC Principles

AFAC's mandate gives it a multi-dimensional approach to addressing climate change by the financial sector in an African setting. The African continent presents a market that is considered the next global growth frontier with good returns on investments underpinned by its young population, high levels of digitization, and abundant natural resources. However, it also a market with high risks. AFAC therefore addresses climate change both as a risk and an opportunity. In that regard, it intends to address four support areas that unlock the potential to ramp up low-carbon and climate-resilient investments in Africa.

AFAC will also straddle the principles of other global initiatives while recognizing Africa's specificities (Annex 1).

1. Knowledge sharing amongst members,
2. Disclosures of climate actions by members,
3. Processes/mechanisms to help deliver climate-action effectively and efficiently, and
4. Development of tools/instruments to benchmark/rate progress.

The AFAC Principles will adapt existing good practice principles to ensure they are fit-for-purpose for the African financial ecosystem, and directly support the Paris Agreement on Climate Change. An assessment of principles of other global initiatives was done to develop AFAC principles. The objective was to develop a set of principles that would not only address Africa's specificities but also with which all intermediaries of the financial ecosystem would be able to identify with and adhere to. It is envisaged that AFAC, through well-designed fit-for-purpose principles, would help bring the African financial sector at par with the rest of the world to help drive low-carbon investments and manage climate-related risks. There are four main differences between leading global initiatives and AFAC (Table 1):

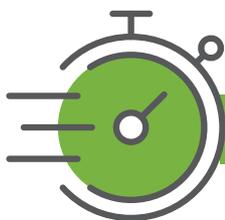
1. Areas covered: While other initiatives cover ESG or climate-risk alone, AFAC addresses both climate risk and opportunities.
2. Sector: AFAC addresses only the financial sector.
3. Added Value: AFAC would not only assess and rate participating institutions; it will offer support to strengthen participating institutions across all dimensions that will contribute to the success of the initiative.
4. Geographic scope: AFAC will specifically address the African financial ecosystem to ensure inclusiveness and wider appeal across financial institutions.

Table 1: Overview of global initiatives highlighting differences

INITIATIVE	GOAL/OBJECTIVE	PRINCIPLES
<p><b>Task Force on Climate-related Financial Disclosures (TCFD)</b></p>	<p>Mainstreaming climate-related financial reporting. Climate-related financial risk disclosures for use by companies in providing information to Financial Institutions</p> <p>Core elements of Climate-related Disclosures: Governance, Strategy, Risk Management and Metrics &amp; Targets</p>	<ol style="list-style-type: none"> <li>1. Disclosures should present relevant information</li> <li>2. Disclosures should be specific and complete</li> <li>3. Disclosures should be clear, balanced, and understandable</li> <li>4. Disclosures should be consistent over time</li> <li>5. Disclosures should be comparable among organizations within a sector, industry, or portfolio</li> <li>6. Disclosures should be reliable, verifiable, and objective</li> <li>7. Disclosures should be provided on a timely basis</li> </ol>
<p><b>UN Principles of Responsible Investment</b></p>	<p>Investment implications of ESG factors. Support its network of investor signatories to incorporate these factors into their investment and ownership decisions.</p>	<ol style="list-style-type: none"> <li>1. Incorporate ESG issues into investment decision making</li> <li>2. Be active owners who incorporate ESG issues in ownership policies and practices</li> <li>3. Seek appropriate disclosure on ESG issues by entities invested in</li> <li>4. Promote acceptance and implementation of principles in investment industry</li> <li>5. Work together to enhance effectiveness in implementing principles</li> <li>6. Report on own activities and progress towards implementing principles</li> </ol>
<p><b>Equator Principles</b></p>	<p>Risk management framework, for FIs, for determining, assessing and managing Environmental &amp; Social risk in Projects. Primarily intended to support responsible risk decision-making.</p>	<ol style="list-style-type: none"> <li>1. Review and Categorize Project</li> <li>2. Environmental and Social Assessment</li> <li>3. Applicable Environmental and Social Standards</li> <li>4. Environmental and Social Management System and Equator Principles Action Plan</li> <li>5. Stakeholder Engagement</li> <li>6. Grievance Mechanism</li> <li>7. Independent Review</li> <li>8. Covenants compliance</li> <li>9. Independent Monitoring and Reporting</li> <li>10. Reporting and Transparency</li> </ol>
<p><b>Climate Action in Financial Institutions</b></p>	<p>Focuses on sharing expertise, knowledge and practices among Supporting Institutions. Based on 5 voluntary Principles for Mainstreaming Climate Action within Financial institutions</p>	<ol style="list-style-type: none"> <li>1. Commit to Climate Strategies</li> <li>2. Manage Climate Risks</li> <li>3. Promote Climate Smart Objectives</li> <li>4. Improve Climate Performance</li> <li>5. Account for your Climate Action</li> </ol>
<p><b>Portfolio Decarbonization Coalition</b></p>	<p>Mobilizing financial markets to drive economic decarbonization</p>	<p>Commit to decarbonize portfolio</p>
<p><b>UNEP Finance Initiative</b></p>	<p>UNEP Statement of Commitment by Financial Institutions on Sustainable Development represents the backbone of the Initiative</p>	<ol style="list-style-type: none"> <li>1. Commit to Sustainable Development</li> <li>2. Sustainability Management</li> <li>3. Public Awareness and Communication</li> </ol>
<p><b>AFAC</b></p>	<p>Addressing climate risk and opportunities by the African financial sector supporting knowledge sharing; disclosures; Processes; and instruments for climate action</p>	<ol style="list-style-type: none"> <li>1. Commit to urgent Climate Action</li> <li>2. Manage Climate Action and Risks</li> <li>3. Integrate Climate Action into strategic decisions</li> <li>4. Develop and monitor Climate Action</li> <li>5. Disclose Climate Actions and Risks</li> </ol>

### III. Proposed AFAC Principles

The proposed AFAC principles below, collectively, serve as a guide for financial institutions in Africa to assess and develop new mechanisms and commitments to manage climate-related risks and opportunities in Africa. The Principles apply universally, across all aspects of the financial value-chain, products and asset classes, to help financial institutions (and subsequently their value chains) to progressively increase the share of investments that promote low-carbon and climate-resilience. They are not intended to be applied retroactively; however, the Principles can be applied to the expansion or upgrades (wherever changes in scale or scope may create significant climate impact) and to new greenfield investments (*Table 2 for indicative actions across the financial sector*).



#### Principle 1: Commit to Urgent Climate Action

There is a sense of urgency in addressing climate change in Africa when considering that **7 out of 10 most vulnerable countries to climate change are in Africa**; climate change is expected to wipe out between 1-10% of Africa's GDP by the end of this century. For Africa's economy to survive and thrive, the financial industry has to urgently align its operations, strategies and policies. Clear intention to drive climate action have to be promoted by capital owners at the Board and Management levels.



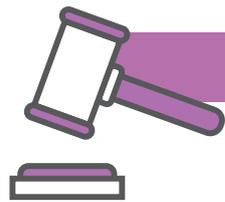
#### Principle 2: Manage Climate Action and Risks

Africa is considered the next growth frontier making it a smart choice for business to invest in climate action and in managing climate risks. The principle recognizes the opportunity in climate action with good returns on investment. The financial industry needs to progressively increase investments in climate smart projects, promote financial products that de-risk investments in climate smart technologies as well as enhance capacity internally to prioritize climate action in investments.



### Principle 3: Develop Tools to Monitor Climate Action

To entrench good practice and system change, the financial industry has to develop tools and methodologies that are transparent and credible to measure progress and encourage conformity within the industry.



### Principle 4: Integrate Climate Action in Strategic Decisions

Mainstreaming climate action in operations is facilitated by directives and policy statements that are translated into action plans and guidelines for investments. The entity has to formulate and promote decisions that signal the promotion of climate action within the entire business operation's chain.



### Principle 5: Disclose climate action and risk

Transparent disclosure of climate information promotes informed investment decision-making which makes markets more efficient and correctly reward innovation and good practice. Disclosure systems have to be comparable, robust and reliable such that climate risks are adequately priced and managed.

**Table 2: Summary Table on proposed AFAC Principles, rationale, and indicative actions**

Principle	Rationale	Indicative Actions
 <p><b>1. Commit to urgent climate action</b></p>	<p>There is a need for a top-down approach articulating intent for climate action that is visibly and clearly demonstrated in the institution's guiding strategy</p>	<ul style="list-style-type: none"> <li>• Capital owners/purveyors acknowledge urgent need for climate action</li> <li>• Commit to urgent climate action by formulating climate-related investment beliefs that accords ability to influence climate action through their mandates (E.g. Policy, Investment thesis, vision and/or mission statement, corporate strategy, targets, etc)</li> <li>• Promulgate a governance structure that ensures appropriate traction and action (e.g. legislation, regulations, incentives, investment portfolios, Board representation on climate change)</li> </ul>
 <p><b>2. Manage climate action and risks</b></p>	<p>Undertaking action that supports climate-related risks and opportunities and the action needs to be consistent with the institution's mandate / investment objectives</p>	<ul style="list-style-type: none"> <li>• Identify the activities/investments that contribute/can contribute to climate action</li> <li>• Determine risk-reward trade-offs for activities that foster lower carbon emissions across the investment value chain at portfolio and pipeline and in new investments</li> <li>• Implement activities, techniques/mechanisms to manage climate change</li> </ul>
 <p><b>3. Develop and monitor climate action</b></p>	<p>Leveraging standard / existing tools, methods, and metrics to help monitoring and evaluation for the purpose of standardization and mainstreaming</p>	<ul style="list-style-type: none"> <li>• Adopt (or adapt) tools and metrics that effectively incorporate the risks and opportunities into their financial assessments</li> <li>• Monitor and track climate action and progress (It is necessary to establish a baseline as reference benchmark)</li> </ul>
 <p><b>4. Integrate climate action into strategic decisions</b></p>	<p>Assessing actions/ portfolios &amp; future pipeline to build resilience towards climate impacts and improve sustainability of investments. This will help measure progress, as well as demonstrate commitment</p>	<ul style="list-style-type: none"> <li>• Develop rigor and diligence to help mainstream within mandates /investment portfolios to:                             <ul style="list-style-type: none"> <li>• Mitigate climate risks (new and existing) as per identified parameters within mandate /investment criteria</li> <li>• Invest in opportunities /develop pathways, which are consistent with low-carbon development /targets</li> </ul> </li> </ul>
 <p><b>5. Disclose climate action and risks</b></p>	<p>Sharing quantitative and qualitative information on climate-action will help influence change, and foster peer-to-peer learning</p>	<ul style="list-style-type: none"> <li>• Share information (e.g. investment targets, decarbonization plan, strategic asset allocation, stakeholder engagements, investment/decision criteria, incentives, etc)</li> <li>• Measure and report performance on climate-metrics (e.g. ecological foot print, GHG accounting, climate finance, climate risk (Value-at-risk), etc.</li> </ul>

# Annex 1



# Annex 1: Overview of Principles of leading global Climate Initiatives

Since the Earth Summit in Rio two decades ago, there has been some considerable shift amongst the owners of capital to promote responsible investments. The private sector has been proactive in building sustainability in its investment portfolios. There is common convergence on the objective to promote climate action and/or sustainable development, albeit with varying degree of emphasis.

Many institutions in Africa's Financial sector have already subscribed to one or several of these initiatives (especially ESG ones) and therefore in conceptualizing the AFAC Principles consideration was taken not duplicate effort but rather build on best practices of existing initiatives and establish Principles that enable AFAC to achieve its main objective – addressing climate risks while harnessing opportunities brought about by climate change.



# Climate Action in Financial Institutions

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## Principle 1: Commit to Climate Strategies

Organic approaches to addressing climate change may not alone be sufficient to integrate climate change within investor operations. Owner commitment to address climate change can have a positive influence throughout all layers of management and operations.

## Principle 2: Manage Climate Risks

Entities have to understand and address climate risks within their portfolios and operations and in future investments.

## Principle 3: Promote Climate Smart Objectives

Investors have to promote actions among clients and external stakeholders which create opportunities for increasing climate smart investments. These include approaches to promote instruments, tools and knowledge on how best to overcome risks and barriers to low-carbon and climate-resilient investments. This may include mobilizing and catalyzing additional financing and developing specialized financing vehicles/products, such as green bonds, risk sharing mechanisms or blended finance.

## Principle 4: Improve Climate Performance

Financial entities must possess appropriate operational tools, as well as systems to track, monitor and incorporate climate considerations into operations. Without such tools, an institution may be unable to understand, assess and quantify its climate performance.

## Principle 5: Account for your Climate Action

Investors have to be transparent in disclosing climate information related to their investments. This provides decision-makers, investors, shareholders and the market in general with critical information that can help drive greater climate action by a wider number of institutions, companies and consumers.



# Equator Principles

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Equator Principles provide minimum/baseline due diligence practices that are applied by Equator Principles Financial Institutions (EPFIs) to projects financed through four financial products: project finance advisory services, project finance, project-related corporate loans and bridge loans. These apply to all sectors:

**Principle 1: Review and Categorisation**

**Principle 2: Environmental and Social Assessment**

**Principle 3: Applicable Environmental and Social Standards**

**Principle 4: Environmental and Social Management System and Equator Principles Action Plan**

**Principle 5: Stakeholder Engagement**

**Principle 6: Grievance Mechanism**

**Principle 7: Independent Review**

**Principle 8: Covenants**

**Principle 9: Independent Monitoring and Reporting**

**Principle 10: Reporting and Transparency**

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# Portfolio Decarbonization Coalition

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The Coalition aims to withdraw capital from carbon-intensive investments and re-invest it in carbon-efficient activities. It capitalizes on institutional investors who are investing on the basis of a

company's greenhouse gas emissions profile thereby incentivizing investors to prioritize clean technology investments. All Coalition members must commit to a concrete decarbonization plan.

# Task Force on Climate-related Financial Disclosures (TCFD)



## **Principle 1: Disclosures should present relevant information**

The organization should provide information specific to the potential impact of climate-related risks and opportunities on its markets, businesses, corporate or investment strategy, financial statements, and future cash flows.

## **Principle 2: Disclosures should be specific and complete**

An organization's reporting should provide a thorough overview of its exposure to potential climate-related impacts; the potential nature and size of such impacts; the organization's governance, strategy, processes for managing climate-related risks, and performance with respect to managing climate-related risks and opportunities

## **Principle 3: Disclosures should be clear, balanced, and understandable**

Disclosures should be written with the objective of communicating financial information that serves the needs of a range of financial sector users (e.g., investors, lenders, insurers, and others). This requires reporting at a level beyond compliance with minimum requirements. The disclosures should be sufficiently granular to inform sophisticated users, but should also provide concise information for those who are less specialized. Clear communication will allow users to identify key information efficiently

## **Principle 4: Disclosures should be consistent over time**

Disclosures should be consistent over time to enable users to understand the development and/or evolution of the impact of climate-related issues on the organization's business. Disclosures should be presented using consistent formats, language, and metrics from period to period to allow for inter-period comparisons. Presenting comparative information is preferred; however, in some situations it may be preferable to include a new disclosure even if comparative information cannot be prepared or restated.

## **Principle 5: Disclosures should be comparable among organizations within a sector, industry, or portfolio**

Disclosures should allow for meaningful comparisons of strategy, business activities, risks, and performance across organizations and within sectors and jurisdictions.

## **Principle 6: Disclosures should be reliable, verifiable, and objective**

Disclosures should provide high-quality reliable information. They should be accurate and neutral—i.e., free from bias.

## **Principle 7: Disclosures should be provided on a timely basis**

Information should be delivered to users or updated in a timely manner using appropriate media on, at least, an annual basis within the mainstream financial report.

# UNEP – Finance Initiative

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As one of the oldest Business Alliances around sustainability issues, the principles combine the promotion of environmental and social safeguards standards with the aim of anticipating and preventing potential negative impacts on the environment and society.

## **1) Commitment to Sustainable Development**

Entities have to commit to the broader objectives of sustainable development as a fundamental aspect of sound business management.

## **2) Sustainability Management**

Entities have to adhere to national and international regulations and pursue to promote environmental and social risk assessment in investment planning and implementation.

## **3) Public Awareness and Communication**

Entities have to promote public awareness through the publication of sustainability policies that report progress on the integration of environmental and social considerations in operations. It strives to grow the membership of sustainability-conscious investors.

# UN Principles of Responsible Investing (PRI)

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## **Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes**

Entities aim to mainstream ESG practices within its operations through its investment statements, development of tools, and building internal capacity of portfolios teams.

## **Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices**

Entities develop and disclose active ownership policy consistent with ESG; develop engagement capacity and indicate shareholder resolutions with long-term ESG considerations and report ESG related engagement.

## **Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest**

Promote standardized reporting on ESG issues in financial reports, clear information on corporate adoption of relevant standards and codes of conduct that promote ESG principles.

## **Principle 4: We will promote the acceptance and implementation of the Principles within the investment industry**

At a funding level, the entity has to include ESG principles-related requirements in the funding proposals. Promote alignment of investment mandates, and monitoring procedures and performance indicators within the programming cycle. Communicate ESG expectations to service providers and revisit relationships with defaulting entities; support developing of tools.

## **Principle 5: We will work together to enhance our effectiveness in implementing the Principles**

Entities have to promote information sharing and networking, collective solution-finding and collaborative initiatives.

## **Principle 6: We will each report on our activities and progress towards implementing the Principles**

Entities have to disclose progress in integrating ESG principles, ownership activities, and communicate with beneficiaries about the principles; and raise awareness.



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