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SCALING ADAPTATION FINANCE IN THE PRIVATE SECTOR

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About IDB Invest
IDB Invest, a member of the IDB Group, is a multilateral development bank committed to promoting the economic development of its member countries in Latin America and the Caribbean through the private sector. IDB Invest finances sustainable companies and projects to achieve financial results and maximize economic, social, and environmental development in the region. With a portfolio of $13.1 billion in asset management and 385 clients in 25 countries, IDB Invest provides innovative financial solutions and advisory services that meet the needs of its clients in a variety of industries.

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INTRODUCTION

The world, and Latin America and the Caribbean in particular, are experiencing changes in average temperature and rainfall, and an increasing frequency of extreme weather events. Global warming and its related events can lead to harmful consequences resulting in flooding, drought, fires, sea level rise, melting of glaciers, desertification, ocean acidification and subsequently loss of marine life, spread of vector-borne diseases and increased heat stress, loss of land, biodiversity loss, loss of lives, decreased water quality and quantity, and a myriad of economic impacts.

Implementing solutions proactively and before hazards materialize is more effective and less costly. They help companies reduce vulnerabilities, increase the resilience of human and natural systems at large, and carry with them a multitude of other socio-economic and environmental co-benefits. However, while the private sector is already dealing with the consequences of not including resilience measures into their operations, the needs and opportunities for climate change adaptation are still largely neglected.

This paper outlines the opportunities and challenges for private sector adaptation and resilience finance in Latin America and the Caribbean grounded on practical experiences of our work in the region. It covers (i) the current state of climate adaptation finance, (ii) the need to invest in climate adaptation and resilience, and the role of the private sector, (iii) the ongoing initiatives and synergies to increase climate adaptation, (iv) IDB Invest track record and lessons learned, and (v) practical recommendations to increase private sector climate adaptation finance. This paper is expected to contribute to the very important conversation on how to place adaptation at the forefront of global climate action with the support and involvement of the private sector.

CURRENT STATE OF CLIMATE ADAPTATION FINANCE

ADAPTATION TO CLIMATE CHANGE *is the process of anticipating and adjusting human and natural systems to the current and future effects driven by climate change[1]. Climate adaptation efforts include changes in behaviors, practices, skill sets, and knowledge to address anticipated short, medium, and long-term climate-induced impacts[2]. A term that is often used interchangeably with adaptation is climate resilience[3], which refers to the ability or capacity of a natural or human system "to anticipate, prepare for, and respond to hazardous events, trend, or disturbances" related to climate risks[4], and/or recover from these shocks while retaining the essential functions of the original system[5].*

Worldwide, adaptation finance increased by 53% in 2019/2020 (USD 46 billion) compared to 2017/2018 (USD 30 billion). Of all climate finance, adaptation accounted for only 7%, while projects with dual benefits (mitigation and adaptation) accounted for an additional 2%. Nearly all adaptation finance tracked was funded by public actors (98%) with development finance climate portfolios increasingly prioritizing adaptation. Of those resources, the majority was directed towards the water and wastewater sector and other cross-sectoral projects[6]. Tracking private sector financial flows to adaptation has proven challenging. Private sector actors often do not classify investments into their operational resilience as adaptation finance even when the projects would be designated as such by public actors, leading to an undercounting of private adaptation activity[7].

As a result of the climate finance targets and commitments of Multilateral Development Banks (MDBs), climate finance rose by more than 24% last year compared to 2020, according to the 2021 Joint Report on Multilateral Development Banks' Climate Finance. However, global mitigation finance by MDBs remains the largest beneficiary of climate funding reaching nearly $63 billion in 2021, while global adaptation finance continues to be a lower share of climate finance by reaching over $19 billion[8].

[1] European Commission, 2021; [2] World Bank & GFDRR, 2021; [3] European Commission, 2021; [4] Center for Climate and Energy Solutions, n.d.; [5] World Bank & GFDRR, 2021; [6] Climate Policy Initiative, 2021; [7] Climate Policy Initiative, 2020; [8] African Development Bank (AfDB) et al., 2022;

EXAMPLES FOR ADAPTATION

Anticipating and preparing for climate change will require the deployment of infrastructure to defend against flooding, including green infrastructure such as mangrove and coral restoration, and grey infrastructure such as dikes and sea walls. It will require heat-resistant pavements for roads and runways, and more resilient building materials. It will require better forecasting and warning systems, efficient water management, and drought-resistant crops, among others.

ADAPTATION FINANCE *comprises local, national or transnational financing, from public, private or alternative sources, that seek to support actions aligned with the Paris Agreement's goal of "enhancing adaptive capacity, strengthening resilience, and reducing vulnerability to climate change"[9].*

Latin America and the Caribbean has one of the largest adaptation financing gaps, given the additional US$14.7-18.1 billion per year needed to respond and prevent the continued losses that the region is already experiencing[10].

Additionally, to achieve the goals of the Paris Agreement, filling the investment gap for adaptation to climate change is critical. Finance must be scaled by several orders of magnitude, from both public and private actors, as the investments are still far from what is needed to avoid the worst climate change impacts. While international public support is crucial, the private sector could close the current gaps in adaptation finance.

Adaptation finance gap in Latin America and the Caribbean amounts to

$14.7-18.1 billion per year

[9] UNFCCC, 2021; [10] Tall et al., 2021.

INVESTING IN CLIMATE CHANGE ADAPTATION AND RESILIENCE

ADAPTATION FINANCING NEEDS

Nationally Determined Contributions (NDCs), are the countries' main climate action plans to cut emissions and adapt to climate impacts. While NDCs have adaptation components, they are mostly concerned with mitigation, and therefore other instruments such as National Adaptation Plans (NAPs) are used as bridges to operationalize adaptation commitments and sectorial planning. The updated NDCs of several countries reveal higher financing needs estimates for adaptation, in line with an increased focus on the adaptation component[11]. Agriculture, infrastructure, water, and disaster risk management have the highest adaptation finance needs, according to a sectoral analysis carried out by UNEP[12].

ECONOMIC COSTS

Despite recent positive trends, the total available adaptation finance remains insufficient to respond to current and future climate change. For example, extreme weather events associated with climate change in coastal urban areas globally could lead to costs of more than a trillion dollars each year by 2050[13]. For developing countries, according to UNEP's Adaptation Gap Report, annual adaptation costs in developing countries are estimated at USD 70 billion, and they are expected to reach USD 140-300 billion in 2030 and USD 280-500 billion in 2050[14].

Annual adaptation costs are in the range of

$280-500 billion by 2050

[11] International Institute for Sustainable Development, 2021; [12] UNEP, 2021; [13] Global Commission on Adaptation, 2019; [14] UNEP, 2021.

RETURNS

The overall rate of return on investments in improved resilience is generally very high, with benefit-cost ratios ranging from 2:1 to 10:1 and reaching even higher ratios in some cases. This means that failure to harness the considerable economic benefits of climate adaptation with high-return investments would undermine trillions of dollars in potential growth and prosperity[15]. These figures highlight the importance of increasing investments towards adaptation efforts, given their positive dividends, particularly in developing and most vulnerable countries.

Rate of return on adaptation investments are in the range of

2:1 to 10:1

Furthermore, it is estimated that the global net benefits of investing in infrastructure resilience in low— and middle— income countries would be USD 4.2 trillion over the lifetime of new infrastructure, which translates into four dollars for every dollar invested in resilience[16]. The net benefit is not only a matter of avoiding losses, but in sectors like agriculture and tourism, the benefit of adaptation leads to increased productivity and social and environmental spillover effects. The Global Commission on Adaptation[17], formed to raise the political visibility of climate adaptation on the global agenda and inspire action, divides the benefits of adaptation into three groups:

- **Avoided losses:** improving infrastructure to be climate-resilient can increase costs, but the benefit-costs ratios reach about 4:1. For example, spending USD800 million on developing early warning systems can avoid losses of USD3 to USD16 billion per year – a benefit cost ratio in the range of 3.75 to 20. Today we are already seeing damages that amount to the billions. The Category 5 hurricane that impacted The Bahamas in 2019 caused 74 deaths, 282 people missing and had an impact of USD 3.4 billion in damages to infrastructure, in indirect losses and emergency response costs, losses that may have been reduced with more adequate preparedness[18].

- **Economic benefits:** adaptation actions reduce risks, lower financial costs, and increase security. For example, reducing the risk of water scarcity by adopting drip irrigation technologies increases agricultural productivity which would increase incomes; and investing USD250 - USD500 per hectare in good farming practices could increase yields by 70-140 percent, bringing higher economic benefits. This way, economic growth will not be damaged by climate change as much as it would be without adaptation.

- **Social and environmental benefits:** protecting biodiversity and natural capital provides benefits not only from an economic perspective, but also from social and environmental points of view, protecting for example people from coastal flooding and benefiting sectors like fisheries, agriculture and forestry, and cleaning air and water.

[15] Global Center on Adaptation & Global Commission on Adaptation, 2019; [16] Hallegatte et al., 2019; [17] Global Commission on Adaptation, 2019;
[18] IDB and ECLAC, 2020 and German Watch, 2021.

Climate Change is projected to have strong impacts on the development of Latin America and the Caribbean, affecting both urban and rural areas, which have different degrees of vulnerability. According to estimates by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), climate change could cost countries between 1.5% to 5% of gross domestic product (GDP) per year[19]. However, climate change extreme weather events, which have increased in frequency and magnitude, can lead to drastic consequences for countries affected. The impact of Hurricane Dorian on the physical infrastructure of The Bahamas in 2019 meant a cost of 18% of the country's GDP[20].

Climate change could cost between

1.5% to 5% of GDP per year

There is substantial potential for investment in both climate mitigation and adaptation. The private sector in Latin America and the Caribbean could unlock new market opportunities in low-carbon, sustainable business models. The Business & Sustainable Development Commission (BSDC) estimates that by 2030, there will be approximately USD 1.2 trillion of investment opportunities for both climate mitigation and adaptation in Latin America and the Caribbean. In terms of employment, for example, developments in mobility, infrastructure, and urban construction could generate about 11 million jobs[21].

[19] Watson & Schalatek, 2021; [20] IDB/BH-L1056, 2022; [21] Business & Sustainable Development Commission (BSDC), 2017.

ADAPTATION IN THE PRIVATE SECTOR

The private sector is already facing the consequences of climate change on its assets, operations, supply chains, and other resources. Climate-induced risks vary between sectors and geographies. The magnitude of their impact is determined by companies´ exposure to chronic and acute climate change events, also known as physical risks. These physical risks become material financial risks and losses by damaging assets and interrupting business activities.

The private sector has unique expertise and capacity for innovation and production of new technologies for adaptation and resilience building. Private actors can play three different roles[22]:

1. Adapting its operations, assets, and supply chains to climate change, to ensure business continuity and protect the people who depend on private jobs or infrastructures

2. Providing adaptation finance to others

3. Supporting others through products and services for resilience

Another key role that the private sector plays refers to the mobilization of investments into adaptationactions (i.e., technologies, products and services, projects, and other measures) to close the existing adaptation finance gap required for an effective response to climate-induced risks. In addition, the private sector can provide innovative mechanisms with benefits that expand beyond the assets they are protecting and lead to job creation.

The unlocking of climate-related opportunities requires businesses to bridge the knowledge and investment gaps. Understanding the effects of climate change on a business´ bottom line is not evident in certain cases. In addition, since adaptation is context-specific, defining indicators and measuring the impact of resilience actions is challenging. Nevertheless, the costs incurred to rebuild infrastructure after disasters, the reduction of agricultural productivity, and the increasing insurance premiums are at the center of the business case for the adoption of climate-smart technologies and resilient construction methods and operations.

For financial institutions, managing climate-related risks, and taking advantage of the opportunities that may arise, is critical to ensure good performing loans; to maintain assets´ value, and deliver long-lasting development impacts, safeguarding the institutions´ financial sustainability and reputation. Therefore, investing in adaptation can also be considered financial resilience for businesses.

[22] Stockholm Environment Institute (SEI), 2019.

INITIATIVES AND SYNERGIES FOR ADAPTATION

Multilateral Development Banks and the International Development Finance Club (IDFC), in line with their commitment to promote and support climate-resilient development in their investments, apply the Common Principles for Tracking Climate Change Adaptation Finance, agreed in July 2015. MDBs and the IDFC are working on updating and improving the definitions and understanding of different approaches and principles for tracking climate change adaptation finance. However, there are still opportunities to improve the measurement, tracking, and reporting of adaptation investments, especially in the labeling of adaptation activities[23].

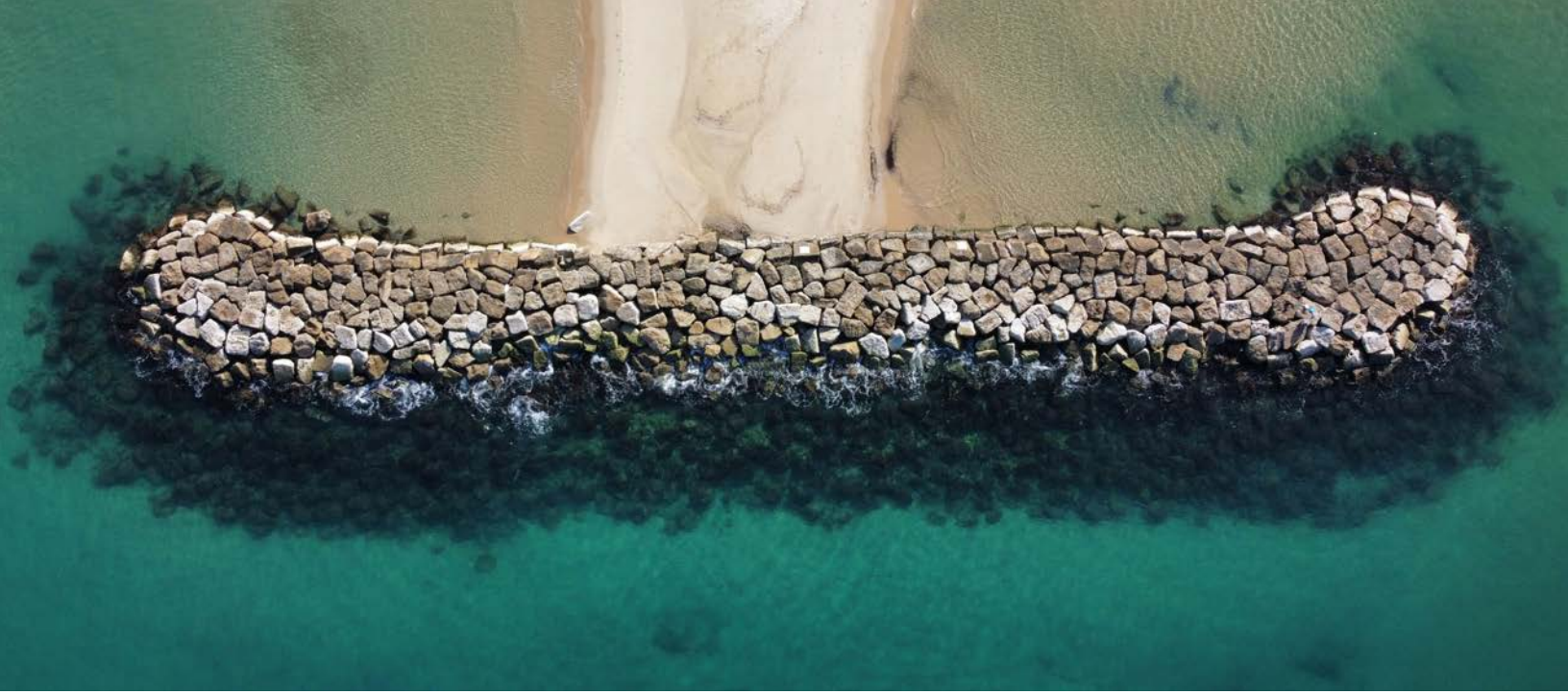
IDB Invest has been collaborating with MDBs on expanding the definition of adaptation. Beyond achieving adaptation of the project by (i) establishing the project´s context of vulnerability to climate change, (ii) making an explicit statement of intent to address this vulnerability as part of the project, and (iii) articulating a clear and direct link between the vulnerability and the specific project activities, it is equally relevant to consider activities that increase the adaptive capacity of the system through the project. The new climate adaptation financing methodology will be presented in COP27 and aims to broaden the adaptation definition to include both considerations.

MDBs are also working on the alignment of their operations with the Paris Agreement. This concept refers to the consistency of operations with the countries´ low-emission, climate-resilient pathways, as well as compatibility with the Paris Agreement´s climate change objectives. MDBs´ operations need to be aligned under both mitigation and adaptation perspectives to be considered "Paris Aligned." This commitment represents a great opportunity to promote adaptation at the operational level.

Private financial institutions are taking steps to increase adaptation finance through various internal tools and incorporating a sustainability lens into risk mitigation and business origination. Leading banks, such as Rabobank, are including climate risk analysis into the general risk assessment and adjusting the creditworthiness of transactions based on climate data[24]. International institutions are also working on the development of a set of tools that enable the private sector to identify climate risks and identify investment opportunities[25].

At the same time, the market is demanding increased transparency and accountability, and improved governance practices. This global drive towards climate disclosures and transparency will affect markets in Latin America and the Caribbean, and central banks and financial regulators are beginning to embrace this demand. For example, the Central Bank of Brazil positioned itself as a leader in the region with the initiation of climate-aligned financial regulation[26]. Since 2019, Chile´s central bank has enacted a "Green Agreement" which seeks to gain voluntary disclosures from the private sector[27]. While countries like

[23] World Bank & GFDRR, 2021; [24] Dutch Central Bank - DNB, 2020; [25] International Institute for Sustainable Development (IISD), 2020; [26] BCB, 2021; [27] Ministry of Finance - Chile, 2019.



Costa Rica, Panama and Ecuador also have some form of voluntary disclosure policy enacted, others like Colombia and Argentina are developing methodologies for alignment with the Task Force on Climate-Related Financial Disclosures (TCFD).

The financial sector in the region is responding to this agenda by establishing voluntary alliances such as sustainability roundtables, green protocols, and sustainable finance councils, where members and practitioners discuss Environmental, Social, and Governance (ESG) trends, establish guidelines, share best practices and crossed learning with the aim to increase climate investments. However, the primary focus of both public and private initiatives remains on mitigation.

Private companies, MDBs, and stakeholders from the financial sector have also progressively started to set targets and commitments for adaptation finance. In the specific case of MDBs, the trend is to develop climate adaptation plans that include actions that respond to the three different roles of private actors: (i) to adapt their own operations, (ii) to finance the adaptation of others, and (iii) to support others through products and services[28]. Some of the actions proposed in such plans include supporting capacity building at the organizational level, integrating adaptation into all direct lending operations, and the investments in climate information technology to better anticipate and adapt to future climate risk.

The public sector has a key role in enabling private investment by facilitating further engagement through governmental financial incentives, as well as targeted technical assistance measures that strengthen capacities to identify, scale and finance adaptation investment opportunities[29].

New instruments are now available to scale up climate finance, including for the private sector adaptation financing. Some of these emerging instruments include, for example, opportunities for raising adaptation finance through resilience bonds; using adaptation finance to leverage private investment (i.e., blended finance to de-risk investments)[30]. Green bonds have also been cited as one of the most promising tools to finance climate adaptation in Latin America and the Caribbean[31].

Multi-sectoral partnerships between governments, private, and non-governmental actors, are required to respond to climate change, for which the financial leverage of the private sector is an important aspect[32]. Moreover, financial resources mobilized from the private sector are a complement to scientific expertise and knowledge of local climate data, projections, and contexts[33]; when combined, these can transform potential climate impacts into business opportunities, to ensure sustainable economic growth and business continuity.

[28] Stockholm Environment Institute (SEI), 2019; [29] GIZ, n.d.; [30] UNEP, 2021; [31] AS/COA, 2022; [32] UNFCCC, n.d.; [33] GIZ, n.d.

IDB INVEST: ACTION ON ADAPTATION

IDB Invest adaptation and dual climate finance increased from $400,000 in 2016 to $105 million in 2021. This financing covers sectors of the real economy, such as agribusiness and infrastructure, but also banks that deliver adaptation and resilience solutions. **These figures are far from the actual adaptation financing required for Latin America and the Caribbean. For that reason, during 2022, IDB Invest engaged in an in-depth process of reviewing lessons learned and identifying ideas that have the potential to unlock private capital and deliver the much-needed adaptation resources for the region.**

IDB Invest track record[34]

IDB Invest has used its current processes and instruments to innovate in the space of adaptation with three goals in mind: promote adaptation across markets and increase private sector awareness, build capacity and crowd in private capital, and mainstream adaptation across transactions.

A) PROMOTE ADAPTATION ACROSS MARKETS AND INCREASE PRIVATE SECTOR AWARENESS

IDB Invest has been developing analytical tools to promote adaptation as part of the implementation of the Environmental and Social Sustainability Policy. Indeed, assessing climate risks is the basis for any enhancement or investment in adaptation. Therefore, anchored in climate and natural-disaster-related commitments in IDB Invest´s Environmental and Social Sustainability Policy, the institution has been supporting clients in identifying hazards and associated risks and/or opportunities. By applying its Climate Risk Assessment methodology to its direct investments, IDB Invest assists in building resilience to both current and future physical and natural disaster risks. One of the main lessons from this process is the fact that assessing vulnerability to climate change in infrastructure projects is crucial to identifying and incorporating adaptation measures during project design, construction, and maintenance. It also ensures the financial viability and long-term integrity of the infrastructure[35].

IDB Invest has developed a tool for the financial sector to evaluate a financial intermediary´s (FI) capacity to manage potential vulnerability and exposure to climate risks. A scorecard used for the diagnostic and benchmarking analysis of the maturity of an individual bank is used during the due diligence and supervision process, collecting information across three dimensions: strategy and governance,

[34] IDB Invest, DEO, 2022; [35] More information on the climate risk assessment methodology can be found in IDB Invest TCFD Disclosure as part of the Annual report. See https://www.idbinvest.org/en/publications/2021-annual-report;

environmental and social risk management, and green products. A final score is used to evaluate FI maturity vis-à-vis environmental, social, and climate risk measured at both the transaction and portfolio levels. As a result of this benchmarking, the FI receives recommendations within the Environmental and Social Action Plan, including requests to update matrixes for environmental and social risks that incorporate climate-related risks.

B) BUILD CAPACITY AND ENABLE CROWDING-IN OF PRIVATE CAPITAL

IDB Invest has created applied-knowledge products on adaptation using technical assistance resources. Technical assistance resources bridge the knowledge gap, support project preparedness, and develop local technical capacity across the project cycle. In markets that require first-loss structures to enable the crowding-in of commercial capital, technical assistance can serve as an enabler to generate data and information needed for the prospective investors´ decision-making process. It is crucial to compensate uncertainty, increased risk, or higher upfront costs associated with the resilience of investments. Some examples in the infrastructure sector include the preparation of market studies to help demonstrate the demand for resilient construction, identify location-specific adaptation and resilience measures, showcase the benefits for companies and individuals, build capacity among project developers, among others. The literature on development finance has recognized that to increase climate investments and mobilize private-sector resources, there needs to be a link between national policy and planning in the public sector but complemented with market-level knowledge and support along the project life cycle.

Technical assistance also supports the strengthening of supply chains. Adapting to climate change calls for understanding the climate risk of supply chains and building the resilience of suppliers. By helping small producers adjust their practices in the face of increasingly frequent floods, droughts, or other extreme weather events, large companies and producers stand to gain from increased productivity and fewer climate-induced supply-chain disruptions. For example, IDB Invest has supported apiculture investments to improve their productivity and maintain a steady supply of honey during droughts.

Lastly, technical studies set the business case for nature-based solutions. Nature-based solutions are cost-effective adaptation and resilience mechanisms that offer multiple benefits, such as reducing climate risks, increasing climate resilience, restoring biodiversity, as well as improving human health, ensuring water security, and supporting the well-being of communities. Analytical work provided to clients to showcase the business case of adaptation measures, including nature-based solutions, for the project and the surrounding community can support the return of investments while ensuring the clients´ license to operate. An example of this type of work is the study Climate Risk and Ports: A Practical Guide on Strengthening Resilience[36] that provides port developers and operators with the steps to develop a site- and asset-specific risk assessment to identify adaptation needs and prioritize investments.

[36] IDB Invest, 2021.

C) INTEGRATE CLIMATE ADAPTATION ACROSS TRANSACTIONS

IDB Invest has been working with clients in the design of sustainability and climate strategies that consider climate proofing of their businesses. Private sector transactions in the real economy are seldom 100% adaptation. Transactions may include use of proceeds that can increase resilience and adaptive capacity of private clients, but the larger investments may respond to short-term needs. In the absence of a clear strategy to support the specific resilience use of proceeds, there is a risk that those investments will be postponed if short-term conditions change. Accompanying private clients with the design of climate strategies can help them integrate climate considerations into their projects and operations and ensure climate proof of their business models to future climate impacts.

IDB Invest has developed applied-knowledge products for the financial sector to scale up adaptation finance. In addition to working with specific private clients, supporting the financial sector to finance adaptation can have a multiplier effect on the economies of countries and the region. Building the capacity of banks to deploy climate-adaptation finance calls for a segmented approach. A good place to start is looking at whether a bank has a sustainability strategy in place, and if so, how mature it is, as well as its systems for managing environmental and social risks, which may or may not integrate climate risk, since this is a new area for banks. Some banks are just embarking on the green-finance path, while others are market leaders with increasingly sophisticated products, requiring several types of support. IDB Invest´s experience working with banks highlights the importance of ensuring their high-level commitment to actively supporting the development of green credit lines, including those of resilience lines. In addition, it is also critical to build bank capacity to design green strategies, select transactions to finance, and systematically track and report on the performance of that portfolio. Without these fundamentals in place, it is difficult to successfully deploy green finance lines, and especially green resilient lines.

Understanding how bank operations may be directly impacted by climate change is a first step towards understanding the climate risks facing their loan portfolios and the need to offer climate adaptation products. This means looking at the climate-risk systems, policies, and practices in place. For example, banks may face increasing defaults from borrowers in certain segments linked to the impacts of climate change; understanding the challenges and risks these borrowers face can, in turn, help banks devise appropriate products to finance adaptation strategies. To promote resilience lines, IDB Invest has been working with the clients of financial institutions on implementing the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). IDB Invest itself has been a TCFD supporter since November 2019 and has been convening a cross-functional working group on its journey of aligning with the recommendations.

IDB Invest introduced the "climate-events clause" and included climate scenarios in risk analysis. IDB Invest introduced financial-resilience clauses into the legal agreements and considered climate change in financial scenarios to ensure resilience in agricultural practices. The "climate-events clause" was introduced in four transactions to date in Argentina and Peru, which allows clients to reschedule one-year capital payments if a climate event has had adverse effects on their ability to pay, provided that the client meets certain requirements. This is a prime example of a loan structure with added flexibility, reflecting the unique characteristics of agricultural production.

ADAPTATION PRIORITIES MOVING FOWARD

Multilateral Development Banks have been progressively increasing efforts on adaptation. However, there remains an overall need to further increase commitments and take steps to unlock and scale up adaptation finance in the private sector. The recommended actions below are based on specific lessons learned to move the adaptation agenda forward:

A) PROMOTE ADAPTATION ACROSS MARKETS

Improve the promotion and identification of climate adaptation components

Private sector clients are already making investments that are linked to adaptation; however, they may not call it adaptation. For such reason, it is essential to accurately identify the adaptation components of the projects and give visibility to actions. IDB Invest recommends: (i) working with private sector clients, raising awareness about locally relevant climate hazards and expected impacts on its businesses and projects (ii) developing analytical tools, knowledge products, and taxonomies that can help standardize the assessment of vulnerability and climate risk of the transactions, and (iii) ensuring that due-diligence analysis for infrastructure projects mainstream climate in independent engineer reports, and leverage such reports for communicating climate-related risks and opportunities to project sponsors.

Introduce a pricing differential for adaptation

There is a misalignment in incentives to implement adaptation measures, even when there is ample evidence of the benefits of acting and investing early. For example, the financial teams of infrastructure project developers tend to consider that the costs of investing additional resources in adaptation measures are too high, as these changes may affect their ability to win tenders by submitting more expensive bids. However, examples from Latin America and the Caribbean have shown that developers are implementing adaptation measures ex-post, with clear implications for operational efficiency and infrastructure finances. Therefore, pricing the additional costs through a positive lens can be a game changer. IDB Invest recommends pricing the creditworthiness of resilient assets differently to monetize adaptation measures and improve the risk-return of these assets for private equity investors.

Define adaptation finance beyond the dollar amount

The vast majority of IDB Invest´s climate finance to date is focused on mitigation, which is consistent with the lending activity of other MDBs. That is partly due to the use of proceeds definition. Most often, investments in adaptation are a small portion of a much larger capital investment project, and only the share of the financing directly supporting adaptation counts as climate adaptation finance when, in fact, that share ensures resilience of the whole asset. In this regard, it is crucial to recognize the impact of the private sector in supporting assets to be adapted or resilient. IDB Invest recommends working on a new adaptation and resilience financing indicator that captures impact and incentivizes action on adaptation beyond merely considering the dollar amount invested.

B) DEVELOP A FIT-FOR-PURPOSE SET OF INSTRUMENTS

Repurpose financial instruments for adaptation

The climate change angle must be adjusted or included in our internal toolboxes. Financial instruments, such as combining committed lines with uncommitted lines until adaptation measures, are identified and can increase adaptation finance. This instrument allows for a time lag to generate information to invest in adaptation measures in the future or to implement the results of technical assistance with an adaptation component. Another instrument may be the Outcome Based Lending as a first step supporting transition and/or adaptation investment. IDB Invest recommends reviewing and adjusting the available financial instruments to benefit and promote adaptation.

Be mindful of the use of blended finance for adaptation

In the context of blended finance, the arguments to prove the additionality of the resources, externality, and social benefits are more complicated for adaptation than for mitigation. Adaptation is geography and sector specific, and therefore, the rationale for additionality and externality differs. Using the complementarity in production networks argument is a way forward. That means that increasing the resiliency of one firm within the value chain contributes to raising the resilience of other firms. It will be crucial to properly document the linkage between basic services, economic activities, and adaptation to illustrate the likely strong positive externalities on the economy of investing in climate resilience. IDB Invest recommends ensuring that concessional finance and blended finance principles are applied in the context of adaptation to incentivize private sector investment.

C) ENHANCE MAINSTREAMING OF ADAPTATION ACROSS TRANSACTIONS

Extend the application of the climate-events clause for financial resilience

Flexible financing tools set up before disaster strikes are critical to address climate-related emergencies and shocks. Defining financial-resilience clauses and introducing climate change in financial scenarios to ensure climate-resilient practices proved to be effective across Latin America and the Caribbean. In this regard, IDB Invest recommends the application of a climate-events clause to give clients more flexibility if climate hazards affect their repayment ability.

CONCLUSION

The efforts of Multilateral Development Banks have led to a progressive increase in climate finance. The 2021 total financing by Multilateral Development Banks already surpassed the estimations that MDBs had for 2025 climate finance. Nevertheless, adaptation funding remains low while the need to build resilient systems is increasingly imminent. IDB Invest is aware that there is still a considerable effort to do in this area and is committed to advancing the adaptation agenda in a practical and actionable manner. There are instruments to make this possible, but they need to be redefined, maximized, and applied specifically to adaptation. IDB Invest will develop an action plan to implement some of the measures that are crucial to promote adaptation and resilience.

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