

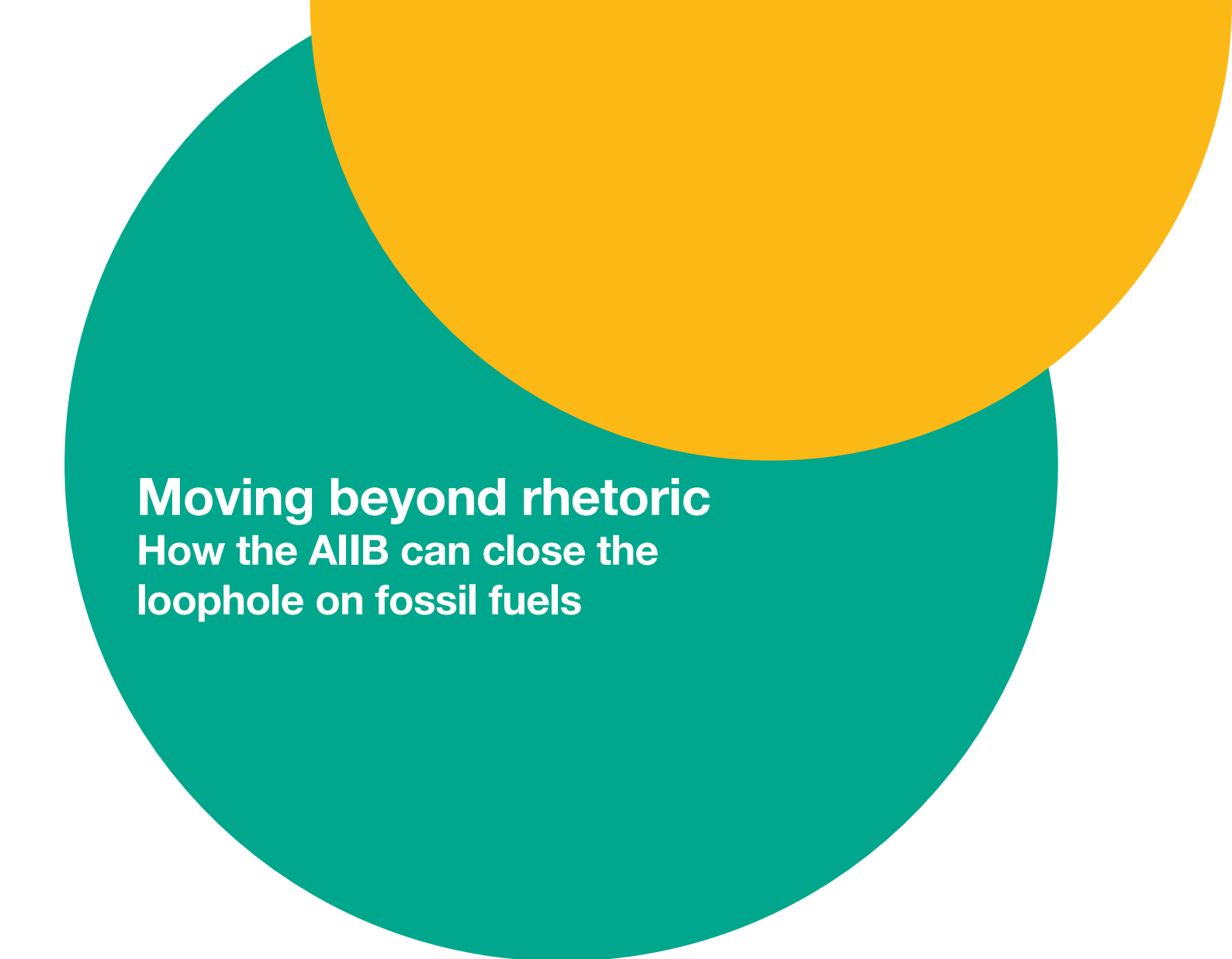
Moving beyond rhetoric

How the AIIB can close the loophole on fossil fuels



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Cover image: View over the Shwe Taung cement plant in Myanmar, which is fuelled by coal.

Photo credits: Victoria Milko/Frontier

Introduction

At the official launch of the Asian Infrastructure Investment Bank (AIIB) in January 2016, President Jin Liqun stated that its core values were to be “lean, clean and green”.¹ The launch came hot on the heels of the 2015 Paris Agreement on climate change, which commits to keeping global average temperatures well below 2 degrees Celsius above pre-industrial levels. The bank has since committed to support the agreement and help countries switch to a low carbon path, promising in its Environmental and Social Framework (ESF) to “prioritise investments promoting greenhouse gas emission neutral and climate resilient infrastructure, including actions for reducing emissions, climate-proofing and promotion of renewable energy.”^{2 3}

As a new player on the field, and with a commitment to learn essential lessons from the existing multilateral development banks (MDBs) and the private sector,⁴ the AIIB has an opportunity to leapfrog towards more sustainable practices than those of its peers. There have been some promising signs, such as the AIIB’s first approved investments in renewable energy, including what could become the biggest solar park in the world in Egypt.⁵ Moreover, during the AIIB’s 2017 Annual Meeting in South Korea, President Jin stated that the AIIB “will not consider any proposals if we are concerned about their environmental and reputational impact.”⁶

But there have also been disappointments, such as the failure to explicitly exclude coal from its potential investments.⁷ Moreover, there is a troubling proportion of projects supporting gas and other fossil fuels in its portfolio. So far the AIIB has invested almost US\$1 billion in fossil fuel generation, representing over half of its direct investments in the energy sector, excluding funding for energy transmission and distribution. In terms of its current policies and practices, the AIIB is therefore currently at best on par with other MDBs, or indeed already falling behind on low-carbon development. For example, despite lagging in areas such as public consultation and environmental standards, the Brazil, Russia, India, China and South Africa (BRICS) New Development Bank’s first five projects were almost exclusively for renewable energy.⁸

Without the legacy encumbering other MDBs, the AIIB has a real opportunity to assume a leadership role in promoting low-carbon development from the very start. On its quest to be a transformational development bank, not only for Asia, but for countries

around the world, the AIIB must move beyond rhetoric, and take concrete actions to deliver on its promise to promote a green, low-carbon future.⁹

Coal in the greyzone

The first major opportunity for the AIIB to pitch itself as a leader in low-carbon development came with the bank’s Energy Sector Strategy (ESS), approved in June 2017. The ESS claims that it “embraces, and is informed by, the principles underpinning the Sustainable Energy for All (SE4ALL), the 2030 Agenda for Sustainable Development, and the Paris Agreement”, emphasising the importance of renewable energy and energy efficiency to achieve the goals.¹⁰

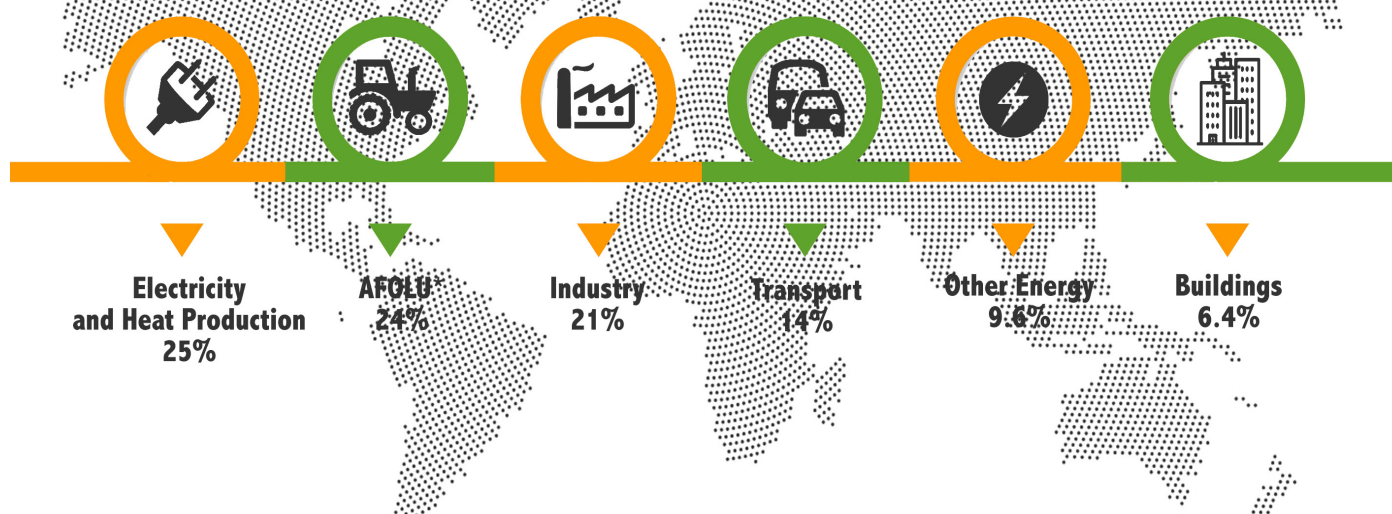
However, the ESS lacks a clear prohibition on funding for coal – the largest source of carbon emissions, and a major contributor to climate change.¹¹ It also leaves the door wide open for continued funding for fossil fuels, by emphasising the “significant role” they will play in the transition period.¹² This includes not only gas-fired power generation, but also “carbon efficient oil- and coal-fired power plants ... if they replace existing less efficient capacity or are essential to the reliability and integrity of the system, or if no viable or affordable alternative exists in specific cases.” Moreover, the strategy allows investments in oil and natural gas processing, transportation and distribution, where the AIIB will support investments “provided that they improve energy security or promote regional integration and trade.”

Investing in fossil fuels, and coal in particular, is not only environmentally unsound, it is also bad economics, in particular when the costs of pollution control as well as CO₂ emissions are taken into account.¹³ Despite this, new coal-fired power plants are planned around the world, with an overwhelming majority located in Asia.¹⁴ According to the bank’s ESS, Asia’s emissions grew by 3.6 per cent per year from 2006-2014, 3 per cent more than the global average.¹⁵

Despite the weak language in the ESS, the AIIB has countered claims that it could end up funding coal. Most significantly, President Jin in his opening statement at the bank’s 2017 Annual Meeting stated: “there are no coal projects in our pipeline”.¹⁶ This was backed up by AIIB’s Vice President and Chief Financial Officer, Thierry de Longuemar, who told news agency AFP: “There are things [the AIIB] won’t finance, like coal-fired power plants.”¹⁷

Globally, most attention is understandably directed towards reducing the estimated 60% of greenhouse gas emissions (GHG) attributed to the energy sector, in

DIRECT GREENHOUSE GAS EMISSIONS BY ECONOMIC SECTOR



* AFOLU stands for Agriculture, Forestry and Other Land Use

particular power generation from coal and other fossil fuels. But little attention has been paid to the GHG emissions derived from industrial processes, which

according to the Intergovernmental Panel on Climate Change accounted for over a fifth of direct global GHG emissions in 2010.¹⁸ For example, the World Bank's Energy Directions Paper explicitly excludes coal used for industrial processes from its ban on funding for coal from all but "exceptional circumstances" – a deeply troubling loophole.

Yet emissions from industrial processes keep growing, particularly in Asia. A large part of future growth is expected to come from increased demand for materials, such as steel and cement. Cement production alone represented 13% of direct GHG emissions from industrial processes in 2010. Almost half of this comes from fuel combustion, often coal.¹⁹ It is clear that the lack of attention to industrial emissions represents a giant loophole that no MDB – including the AIIB – is currently adequately addressing in its policies or its practices.

Risky financial intermediaries

To assess AIIB's progress towards a low-carbon future, it is necessary to track both its direct investments and its indirect investments through financial intermediaries (FIs). Unlike direct investments in a company or project on the ground, an FI investment essentially 'outsources' funding decisions to a commercial bank or private equity fund, which in turn invests the capital in 'subprojects' or 'subclients.' This model is used extensively by MDBs as a way to help mobilise funds

and attract private capital, but it comes with significant risks due to its 'hands-off' approach.

The AIIB made its first FI investments in 2017, approving three projects: Indonesia's Regional Infrastructure Development Fund, the India Infrastructure Fund, and the IFC Emerging Asia Fund (EAF). These investments occurred in the absence of robust policies to manage the high risks intrinsic to FI investments. Indeed, in its Environmental and Social Framework (ESF), the AIIB delegates all decision-making regarding FI subprojects, such as selection, approval and monitoring, to the FI itself, apart from those considered high-risk, in which case the bank "undertakes selective supervision and monitoring".²⁰ As a result, these investments threaten to undermine the AIIB's commitment to be a 'green' institution.

The AIIB does not publicly disclose any information about the sub projects its FI clients invest in, as a result of weak transparency policies. For example, the ESF is not sufficiently robust in its disclosure requirements. It does not, for example, commit to disclose project documents a specific number of days before project approval, nor does it mention information disclosure relating to FI investments. The AIIB's draft Public Information Policy, released for public consultation at the beginning of 2018, failed to fill this gap, and instead places restrictions on information disclosure, "if doing so would prejudice the financial worth or competitiveness of a natural individual person or the Bank or any other corporate entity, or their assets." Additionally, the draft policy fails to commit to time bound disclosure of project information – an es-

sential step in ensuring information is available early enough in the project cycle for risks to be spotted and managed or averted. FI investments therefore create a significant loophole where, for example, financing of coal and other fossil fuel projects can occur through the back door.

The problems associated with FI lending at other institutions, especially the World Bank's private sector arm, the International Finance Corporation (IFC), have been well documented.²¹ In recent years the IFC has come under fierce scrutiny as a result of dozens of investments that have been implicated in environmental and human rights abuses. President Kim committed in 2013 that the World Bank would only fund coal "in exceptional circumstances" and for the Bank's direct lending portfolio, that commitment has held. However, in its indirect lending - through policy loans²² and through FIs - the Bank remains, however advertently, steeped in coal. In just a handful of countries, recent research uncovered over 40 coal mines and plants backed by the IFC through FIs since that 2013 pledge.²³ This was not part of some deliberate strategy to back coal secretly - rather it happened because stringent protections and exclusions to ensure such damaging projects did not slip through the net were either absent or not enforced. Escalating criticism resulted in the IFC's CEO committing to reduce the proportion of high-risk lending through FIs.²⁴

In January 2018, 30 CSOs wrote to AIIB's President Jin calling for urgent steps to be taken to address risks in AIIB's FI lending.²⁵ The AIIB's Vice President for Policy and Strategy, Joachim von Amsberg, responded with a commitment that both FI clients and the AIIB would release information about FI subprojects, including disclosure by FIs of "relevant social and environmental documentation" in a manner "proportionate to the associated environmental and social risks and impacts". To date, however, this promise has not been fulfilled.

Emerging Asia Fund – fossil fuels through the back door?

In late September 2017, the AIIB Board approved a US\$150 million investment in an FI run by the IFC, called the Emerging Asia Fund (EAF). The EAF was established in 2014 under the IFC's Asset Management Company (AMC), which mobilises and manages third party funds for investment and encourages larger institutional investors to invest alongside the IFC. EAF makes investments across all sectors in the emerging markets of Asia with a focus on IFC's proprietary pipeline of investments.

At the time the AIIB approved its investment, the EAF had two companies in its portfolio, Summit Power International in Bangladesh and Apollo Health Care in India. It was also considering its first investment in a frontier market, the expansion of a cement plant operated by Shwe Taung Cement Company Limited (STC) in Myanmar.

The latter project had already caused controversy when the IFC was considering a direct investment in the project, which was approved in mid-2017. The news of the proposed investment prompted over 170 civil society groups to write an open letter to the IFC calling on the Board to refuse funding. One of the central concerns for many of these civil society groups was the use of coal in the industrial process and the expansion of a coal mine that supplies the cement plant.²⁶

When the AIIB subsequently listed EAF in its proposed project pipeline, Inclusive Development International (IDI), Bank Information Center (BIC) Europe and Urgewald wrote to President Jin expressing serious concerns about the project and the need for heightened due-diligence. Despite these concerns, the AIIB's Board approved the investment in EAF. Soon afterwards, in early 2018, EAF confirmed its investment in STC. Two years after its launch, the AIIB thus took its first step into coal.

Coal: Shwe Taung Cement, Myanmar

Currently the most controversial sub-project under EAF is its US\$20 million investment to finance the expansion of STC's cement plant in the Mandalay Region, Myanmar. A key feature of the cement plant expansion is the investment in a new kiln which will increase capacity from 1,500 to 4,000 tons per day, which also means that the volume of coal burned to fuel the kiln will increase substantially, as well as associated GHG emissions. Moreover, the expansion of the plant will require increased extraction from the coal mine that supplies the plant exclusively from 60,000 to 150,000 tons per year, more than doubling its output, with supplementary coal purchases from other suppliers also likely.

The open letter to the IFC in June 2017 from over 170 civil society groups, the vast majority local, called on the IFC's board of directors to reject the funding for this project on a number of different grounds, most significantly due to the increased extraction and burning of coal that it would require: "As the World Bank has pledged not to finance coal power plants in Myanmar due to their devastating environmental, health and climate impacts, it is not clear why the IFC

is considering funding this project.” The letter also listed a number of other negative social and environmental impacts, such as pollution of lands and waters, deforestation, destruction of sensitive habitats and impacts on livelihoods near the coal mine and factory areas. Moreover, it noted that farmers complaining about impacts on their land and resources had been subject to “judicial harassment”.²⁷

In its response, the IFC did not deny that the project involved expanding the use and extraction of coal, but argued that the new kiln and waste heat recovery unit would be more carbon efficient than the current one, and that it also allows for alternative fuels to be

used. However, there is no indication in IFC’s publicly available documentation that alternative sources of fuel have been considered, nor that this has been implemented at the plant.

When the IFC Board of Directors voted on the project in late July 2017, the US voted against it, referring to “significant concerns about the environmental due diligence”. Amongst its findings, it noted “gaps in baseline data for rare and endangered species as well as insufficient analysis and mitigation plans to address environmental impacts”, and expressed concerns about the lack of “emissions data for the coal mine and additional air quality data, without which it

A villager showing a photo of what used to be his land that was bulldozed by Shwe Taung without warning or compensation. (Photo: Victoria Milko/Frontier)



will be impossible to effectively assess the project's impact."²⁸

This project stands in stark contrast to President Jin's assurance that there are "no coal projects" in the AIIB's pipeline. The AIIB's investment will support the significant expansion of an existing coal mine and industrial consumption of that coal, leading to significant GHG emissions – however, no figures are publicly available on the current or future emissions related to the STC plant. This raises a number of questions on how AIIB will fulfill its commitment to promote GHG neutral investments, let alone support actions to reduce GHG emissions.

Fossil fuels: Summit Power, Bangladesh

Fossil fuels also feature strongly in the EAF's portfolio through its very first investment, made in August 2016, in Summit Power International – a holding company incorporated in Singapore which operates in Bangladesh through its subsidiary Summit Power Ltd. Summit is the largest independent power producer in Bangladesh, and owns and operates 13 power plants at different locations in the country. To date, all power plants operated by Summit are run on heavy fuel oil and liquefied natural gas, with no renewable energy projects in operation. In a joint press release, the IFC, EAF and a third investor, EMA Power, state that they have collectively provided US\$175.5 million in financing to Summit "to install green-field electricity-generation plants ... to help address the country's critical energy gap".²⁹

AIIB has not made publicly available any information on this subproject, and IFC's official project documentation is unclear and somewhat contradictory about what exactly the Summit investment will go towards. While the IFC's Environmental and Social Review Summary states that the supposed equity investment is not targeted at any of Summit's specific assets", according to its Summary of Investment Information it goes towards 715 MW of electricity-generating capacity through the financing of four unspecified power projects. Cross-checking the locations indicated, it may be assumed that the investment aims at financing power plants under construction at Barisal, Narayanganj and possibly Meghnaghat, where the IFC is also currently considering a separate direct investment. Classified as a high-risk project, some of the potential issues identified with the project are land acquisition, impacts on air and water, and the geo-

graphical spread of projects, including associated facilities such as gas pipelines and transmission lines.

What is clear is that none of these projects are geared towards renewable energy. In fact, fossil fuels form the very basis of Summit's business model. This should have rung alarm bells at both the IFC and the AIIB.

Recommendations

To live up to its promises to be "green" and to its stated commitment to the Paris Agreement and the Sustainable Development Goals, the AIIB should:

- Match the World Bank's recent commitment to end financing for oil and gas extraction, and establish a plan to phase out remaining investment in fossil fuels by 2020.
- Set an institutional target for GHG emissions reductions across the AIIB portfolio, and start measuring and publicly disclosing GHG emissions for all its projects and sub projects.
- Prohibit financing of coal for any purpose, including for power generation, for industrial processes and for coal-mining – both via direct and indirect lending.
- Prioritise off-grid, renewable energy projects, and ring-fence dedicated funds to provide energy access for poor and underserved communities.
- Establish a results measurement framework that assesses how the AIIB is performing against SDG7, to ensure access to affordable, reliable, sustainable and modern energy for all, and aligning its finance to the Paris goals.
- Contractually require FI clients to publicly disclose all AIIB sub-investments at the earliest stages, including names, locations, amount of investment and all environmental and social impact documentation, and permit the AIIB to disclose the information on its website. A provision requiring this disclosure of FI sub-projects should be included in the AIIB's forthcoming Public Information Policy.
- Require FI sub-projects to comply with all AIIB policies, relevant sectoral strategies and guidelines, including the full set of environmental and social standards that apply to direct investments. Ensure FI sub-projects remain accountable to AIIB oversight and due diligence at all stages of the project cycle.

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