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European Bank
for Reconstruction and Development

GUIDANCE NOTE

Methodology to determine the Paris Agreement alignment of directly financed EBRD investments

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1. Introduction and purpose of the EBRD's Paris alignment methodology

Context

- 1.1 The Paris Agreement is an international treaty with the goal of “holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 °C above pre-industrial levels”.
- 1.2 All of the economies in which the European Bank of Reconstruction and Development (EBRD) invests have endorsed the Paris Agreement.¹ It also has the widespread support of the Bank's shareholders.
- 1.3 In July 2020, the EBRD set out its Green Economy Transition (GET) Approach for 2021-25 and committed to “aligning its activities with the principles of international climate agreements, including principally the Paris Agreement”.² The EBRD's approach to aligning its activities with the Paris Agreement (“Paris alignment”) is an integral part of the Bank's activities to support the climate action of the economies in which it invests.
- 1.4 EBRD Management has proposed that, by the beginning of 2023, all of the EBRD's activities be aligned with the Paris Agreement. EBRD Management is working with the Board of Directors to prepare a resolution to this effect to be put before the Board of Governors at the Bank's 2021 Annual Meeting.
- 1.5 The Paris alignment of the EBRD's financial flows is anchored in Article 2.1(c) of the Paris Agreement, which commits signatories to make “finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”.³ Its alignment, therefore, relates to both the mitigation and adaptation goals of the Paris Agreement.

¹ Despite formally endorsing the goals of the Paris Agreement, Kosovo is unable to be a signatory of the Paris Agreement due to its status at the United Nations (UN). All other economies in which the EBRD invests have signed and ratified the agreement, with the exception of Turkey, which has signed but not ratified it. While Turkey endorses the goals of the agreement, it has not proceeded to ratification because of concerns about limits on its ability to access international climate finance.

² See EBRD (2020).

³ See United Nations (2015).

Purpose and scope

- 1.6 This note sets out the EBRD's methodology to determine whether projects the Bank may finance are "aligned" or "non-aligned" with the mitigation and adaptation goals of the Paris Agreement.⁴ Paris alignment determination supports the EBRD's operational decision-making and reflects the Bank's views based on the application of its methodology.
- 1.7 The scope of this note is EBRD's direct finance investments, covering projects that involve specific capital expenditure. The methodology for other types of finance will be added in early 2022.⁵
- 1.8 Any direct finance project receiving Concept Review Memorandum (CRM) approval from 1 June 2021 will require a determination of Paris alignment by the time of Final Review Memorandum (FRM) approval, using this methodology.
- 1.9 The methodology will apply to new EBRD investments only. The EBRD will not determine the alignment of past projects.
- 1.10 The methodology will be reviewed at least annually and updated as required. These updates will reflect, among other things, lessons learned from the application of the methodology to different types of project, the experience of other institutions (including other multilateral development banks, or MDBs) with regard to Paris alignment and the development of external tools and reference works (many of which have been incorporated into this methodology).
- 1.11 Supplementary guidance on sector-specific issues relevant to the determination of Paris alignment will be prepared to support the application of this methodology. This sector-specific guidance will be added to this guidance note in a future update.
- 1.12 The methodology intersects with a number of Bank processes that are related to, but distinct from, Paris alignment. These include the EBRD's assessment of green economy financing, Environmental and Social Policy requirements, economic assessment of projects with high greenhouse gas (GHG) emissions and climate-related financial risk appraisal. These interlinkages are discussed further in Annex 1.

⁴ Projects are defined per the EBRD's Environmental and Social Policy (EBRD, 2019a). Specifically, a project is "the set of works, goods, services and/or business activities defined in the financing agreements and for which EBRD financing is sought by a client, and approved by EBRD". Depending on context, the project could also include any associated facilities, defined as "facilities or activities that are not financed by EBRD as part of the project but which in the view of EBRD are significant in determining the success of the project or in producing agreed project outcomes. These are new facilities or activities: (i) without which the project would not be viable, and (ii) would not be constructed, expanded, carried out or planned to be constructed or carried out if the project did not exist."

⁵ This guidance note covers directly financed EBRD investments for specific capital expenditure. In the case of directly financed investments not for specific capital expenditure, such as refinancing or working capital, projects will be assessed on a case-by-case basis to determine their alignment (and the methodology will be modified as required). The Bank's approach to indirect financing (for example, lending through financial intermediaries) will be added to the methodology in 2022.

Methodology overview

- 1.13 The EBRD's approach to determining the alignment of its projects with the Paris Agreement is grounded in the joint MDB alignment framework. This high-level framework guides MDBs in elaborating its Paris alignment methodologies, giving them the flexibility to reflect their mandates and business models. It also recognises that, for MDBs, alignment means supporting the full scope of activities required to achieve the Paris Agreement at investment, policy and corporate level.⁶
- 1.14 The Bank's approach to Paris alignment for climate change mitigation entails demonstrating that each project meets the following two conditions:
- a. consistency with long-term low-carbon development, to give assurance that it is part of a transition to a future consistent with the Paris Agreement mitigation goals
 - b. a low likelihood of carbon lock-in, to give assurance that the project does not enable an emissions-intensive asset to continue operating when economically preferable, lower-carbon options could replace it.
- 1.15 The Bank's approach to Paris alignment for climate change adaptation entails demonstrating that each project meets the following two conditions:
- a. that physical climate risks have been identified and addressed
 - b. that its activities do not undermine climate resilience in the context in which the project operates.
- 1.16 A project must meet each of these four conditions to be determined Paris aligned. For some projects, this will be straightforward (for example, projects with a limited carbon footprint), while for others (particularly those that entail significant GHG emissions or are exposed to material physical climate risks), this will require detailed analysis, drawing on complementary analytical tools and evidence. This approach recognises that projects have different levels of non-alignment risk with the goals of the Paris Agreement.
- 1.17 For alignment with the mitigation goals of the Paris Agreement, the Bank will use a two-step filtering process that takes into account the degree of uncertainty surrounding the alignment of a specific project.
- a. The first filter is a general screening that identifies project types for which there is low uncertainty as to Paris alignment. The general screening will use the "aligned" and "non-aligned" lists of project types agreed by the MDBs (see Annex 2). Any investment that meets the criteria of the European Union (EU) taxonomy for sustainable activities for a "substantial contribution" to climate change mitigation will be deemed aligned. Projects on either list will be assigned the corresponding determination and no further action will be required.

⁶ The [joint MDB approach to alignment with the objectives of the Paris Agreement](#) was presented at the United Nations Climate Change Conference (COP24) in 2018 (EBRD, 2018b). The approach has six "building blocks" for Paris alignment: (BB1) alignment with mitigation goals; (BB2) adaptation and climate-resilient operations; (BB3) accelerated contribution to the transition through climate finance (in the EBRD's case, GET finance); (BB4) strategy, engagement and policy development; (BB5) reporting; and (BB6) alignment of internal activities (for example, administration, procurement and treasury). Therefore, Paris alignment has a project-screening element ("BB1" and "BB2"), a climate finance and policy element ("BB3" and "BB4") and a corporate element ("BB5" and "BB6").

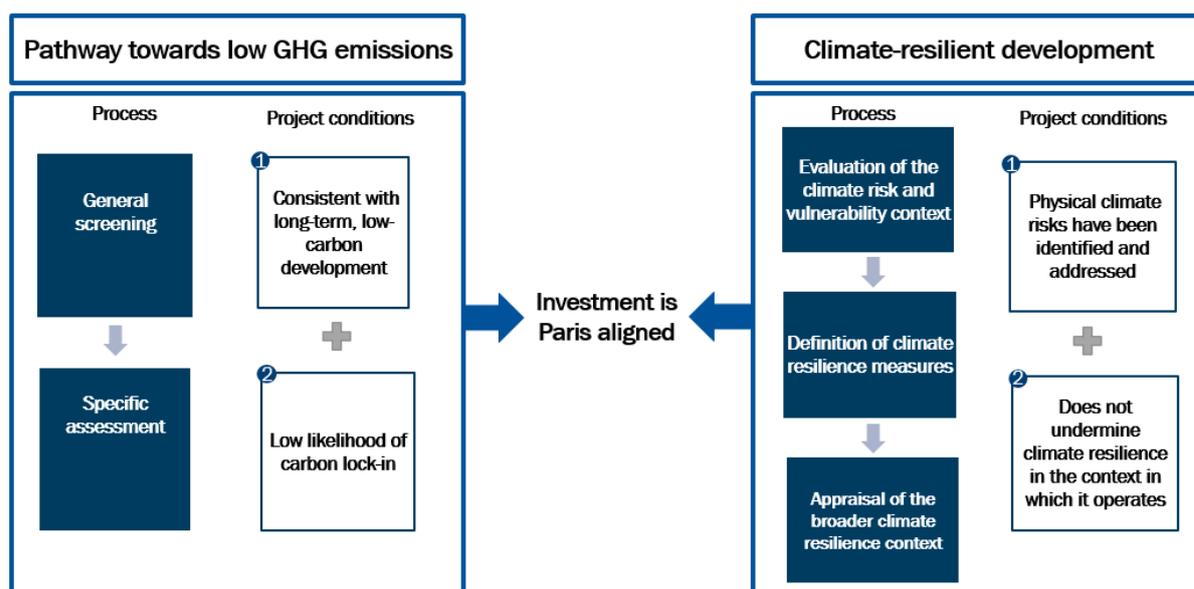
- b. The second filter is a “specific assessment” using the following analytical tools: a review against nationally determined contributions (NDCs), including the long-term strategies (LTSs) and other policy plans underpinning them; a review against low-carbon pathways (LCPs), including benchmarks and criteria derived from them; the application of carbon lock-in tests; and, for projects with significant GHG emissions, an economic viability test based on an economic assessment using a shadow carbon price. The evidence provided by these tools will be combined to determine Paris alignment.

1.18 For alignment with the adaptation goals of the Paris Agreement, the Bank will use a three-step process:

- a. establishment of the climate risk and vulnerability context of a project to identify materially relevant physical climate risks
- b. where physical climate risks are material, definition of climate resilience investments and other measures to build into project design
- c. appraisal of the broader climate resilience context of the project to ensure that it does not contravene national policies for adaptation or the climate resilience of the relevant wider system (for example, exacerbate climate risks for communities or businesses in its vicinity or for broader supply chains).

1.19 Figure 1 summarises the EBRD’s Paris alignment methodology.

Figure 1: Methodology to determine the Paris Agreement alignment of EBRD investments



Guidance note structure

1.20 The remainder of this note describes the methodology for mitigation (section 2) and adaptation (section 3). Section 4 explains how applying the Paris alignment methodology ties in with the EBRD’s project cycle (section 4). Context and further detail on the methodology can be found in the annexes.

2. Alignment of projects with the mitigation goals of the Paris Agreement

- 2.1 The mitigation goal of the Paris Agreement is expressed in terms of a global temperature target, specifically, “holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels”.⁷
- 2.2 Determining the alignment of a project requires evaluating how it fits into this global goal and drawing a link between them. The Paris Agreement offers guidance on drawing this link, including:
 - a. the features of a global emissions trajectory (Article 4.1): “reach global peaking of greenhouse gas emissions as soon as possible, recognizing that peaking will take longer for developing country Parties”; “rapid reductions thereafter”; and “achieve a balance between anthropogenic emissions by sources and removals by sinks of GHGs (i.e. ‘net-zero’ emissions) in the second half of this century”⁸
 - b. the need to reflect different national contexts, in particular, (Article 2.2): “equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances”
 - c. the mechanisms by which countries should set out their contribution to the aims of the Paris Agreement, for example, through the development and refinement of NDCs (Article 4.2) and LTSs (Article 4.19).
- 2.3 Even with this guidance, there are a number of complexities in determining the alignment of individual projects.
 - a. The specific trajectory of GHG emissions will vary from country to country and sector to sector and often be non-linear. The role of any single project in a given trajectory will be subject to uncertainty.
 - b. Policymakers have choices to make on how to share efforts to pursue the mitigation goal by sector and over time. These choices may change with new developments.
 - c. The aggregate commitments in current NDCs are insufficient to secure an emissions trajectory consistent with the global temperature goals.⁹ Moreover, NDCs and associated LTSs tend not to be sufficiently granular to determine the alignment of an individual project.
 - d. Even with robust NDCs and LTSs, the necessary policy framework and policy signals must be in place to ensure they are realised – something that is often not the case at present.

⁷ See United Nations (2015).

⁸ The Intergovernmental Panel on Climate Change has detailed extensively global emissions trajectories consistent with the Paris Agreement (IPCC, 2018).

⁹ See UNEP (2020).

- 2.4 A substantial amount of reference material is available to help overcome these complexities, building on the guidance of the Paris Agreement, and shape a more informed view on the alignment of individual projects. These are linked, either explicitly or implicitly, to LCPs and set out how specific countries and/or sectors can decarbonise in line with the goals of the Paris Agreement. They serve as guides, rather than prescriptive decision-making tools, and uncertainties will remain as to the role of specific projects in a Paris-aligned world, even if there is support for the project in external references.¹⁰
- 2.5 Such uncertainties can be investigated further by assessing whether activities could result in carbon lock-in. Carbon lock-in occurs when technical, economic or institutional factors mean an asset will continue to operate, even though there are economically preferable, lower-carbon options to replace it. Assessing activities for the risk of carbon lock-in – a risk that exists on a spectrum from low to high – is a means of clarifying the uncertainties surrounding the potential alignment of such activities with the goals of the Paris Agreement, especially when they appear to pose a material risk of non-alignment – for example, because they have a significant emissions footprint.

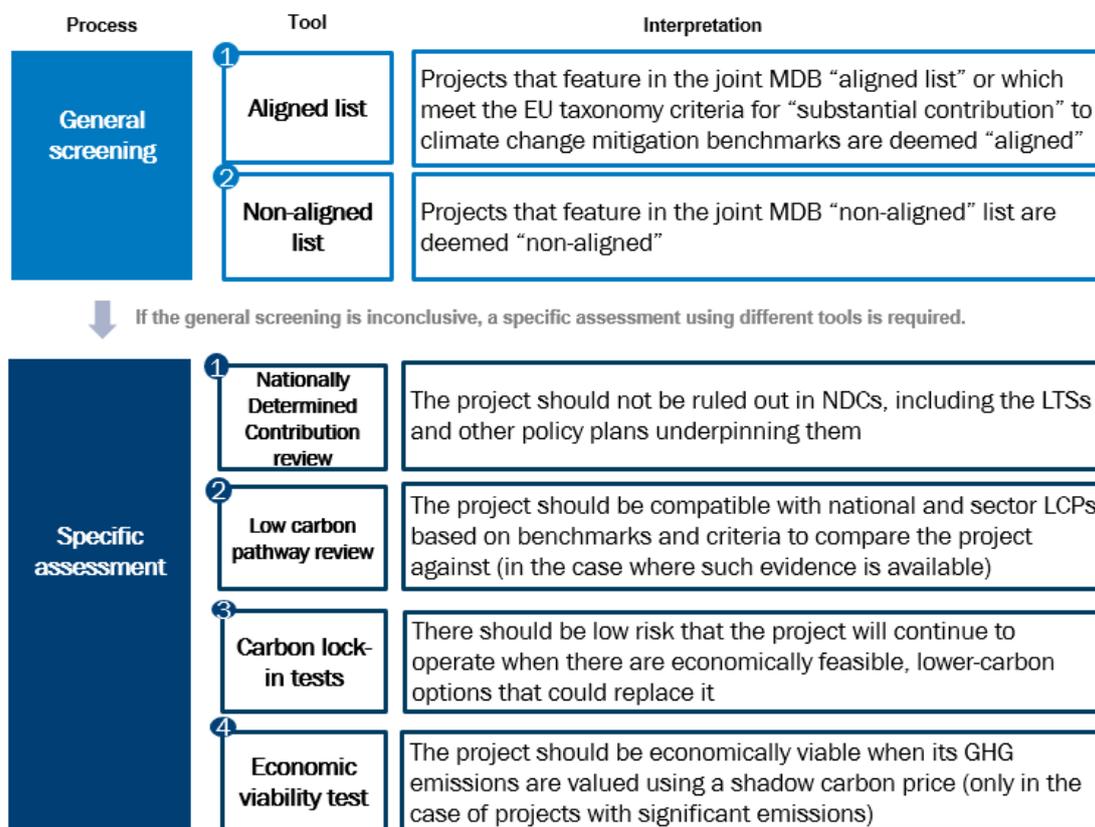
Assessment approach

- 2.6 In this context, the Bank’s approach to Paris alignment entails demonstrating, for each project, that it meets the following conditions:
- a. consistency with long-term low-carbon development, to give assurance that the project is part of a transition to a future consistent with the Paris Agreement mitigation
 - b. a low likelihood of carbon lock-in, to give assurance that the project does not enable an emissions-intensive asset to continue to operate when economically preferable, lower-carbon options could replace it.
- 2.7 To assess these alignment conditions, the Bank will use a two-step filtering process that takes into account the degree of uncertainty surrounding a specific project’s alignment: (1) a “general screening” and (2) a “specific assessment”. The general screening will use the “aligned” and “non-aligned” lists of project types agreed by the MDBs and criteria from the EU taxonomy for sustainable activities.¹¹ If the general screening produces a conclusive determination, no further assessment of that project is needed. Other projects will require a specific assessment.
- 2.8 The “specific assessment” will draw on a range of different and interrelated analytical tools: (1) a review against NDCs, including the LTSs and other policy plans underpinning them; (2) a review against LCPs, including benchmarks and criteria derived from them; (3) the application of carbon lock-in tests; and (4) for projects with significant GHG emissions, an economic viability test, based on an economic assessment using a shadow carbon price. All of the outputs of these reviews and tests will be considered in determining a project’s alignment.
- 2.9 The overall approach is illustrated in Figure 2 and explained in detail below.

¹⁰ An LCP is an analytical view of the evolution of a sector/country based on current best science to achieve rapid decarbonisation and a transition towards carbon neutrality in line with the goals of the Paris Agreement. Global pathways documented by the IPCC can be accessed using its [online database](#) and have been adapted for use by the [Network of Central Banks and Supervisors for Greening the Financial System](#) to guide central banks in [scenario analysis](#). Other resources include the [International Energy Agency \(IEA\)](#), the [Mission Possible Platform](#), the [United Nations Principles for Responsible Investment \(UNPRI\)](#), the [2050 Pathways Platform](#), [CDLINKS](#), [Pik-Potsdam](#) and [Shell](#).

¹¹ See European Commission (n.d.).

Figure 2: Approach to assess the alignment of projects with the mitigation goals of the Paris agreement



General screening

- 2.10 The general screening filter is based on the “aligned” and “non-aligned” lists of activities jointly developed by the MDBs to help determine the Paris alignment of projects. In some cases, activities are subject to accompanying conditions. Both lists of activities, as well as the accompanying conditions, are set out in Annex 2.¹²
- 2.11 If a project’s activities are included in the MDB “aligned” list and meet any accompanying conditions, it will automatically be deemed aligned. Examples of such projects are the generation of electricity from solar photovoltaic (PV) panels or onshore wind, the manufacture of electric vehicles or projects with insignificant GHG impacts, such as investments in healthcare and education.
- 2.12 If a project’s activities are included in the joint MDB “non-aligned” list, it will automatically be deemed non-aligned. The non-aligned list agreed by the MDBs comprises coal mining, extraction and electricity generation that involves either coal or peat. This list may be updated and extended in future.

¹² For some project types, this alignment determination is subject to a number of general and sector-specific conditions. For example, low-carbon agriculture is automatically aligned, unless it involves expansion into areas of high carbon stock or biodiversity value.

- 2.13 The screening criteria used to define “substantial contribution” under the EU taxonomy for sustainable activities will also be incorporated into the EBRD’s general screening filter.¹³ Projects that make a substantial contribution to climate mitigation objectives, as set out in the EU taxonomy regulation,¹⁴ will be deemed aligned for all economies in which the EBRD invests, including those outside the EU.
- 2.14 Projects that pass the general screening filter are deemed aligned or non-aligned without detailed analysis of the national context. No further action is required for such projects.

Specific assessment

- 2.15 Projects that do not pass the general screening stage will be subject to specific assessment using a variety of tools:
- a. review against NDCs, including the LTSs and other policy plans underpinning them
 - b. low-carbon pathways and related benchmarks and criteria
 - c. carbon lock-in tests
 - d. economic viability test, incorporating a shadow carbon price.
- 2.16 All four tools are used to determine the alignment of projects with a “significant” emissions footprint. Otherwise, the first three tools are used. Emissions are considered significant if a project leads to an increase of 25,000 tonnes of carbon dioxide equivalent (CO₂e) per year relative to a baseline or has a footprint of more than 100,000 tonnes of CO₂e per year in absolute terms.¹⁵ For projects with GHG emissions below these “significant” thresholds, an economic viability test is not required.
- 2.17 The following subsections detail the tools and how they will be used.

¹³ The EU taxonomy is a classification system, consisting of a list of economic activities and accompanying screening criteria. Sustainable economic activities “substantially contribute” to at least one of six defined environmental objectives and “do no significant harm” to any of the other objectives, while meeting minimum social safeguards. The six environmental objectives of the taxonomy are climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. Accompanying legislation came into force in July 2020 and ongoing refinements will be guided by the EU Platform on Sustainable Finance.

¹⁴ See European Union (2020).

¹⁵ To determine whether emissions are significant, the Bank, in line with its Environmental and Social Policy, will consider scope 1 (direct) and scope 2 (indirect or electricity) GHG emissions. Scope 3 GHG emissions (those related to the upstream and/or downstream impacts of the project) will generally not be included, as there is no agreed methodology for these types of impact and there is a risk of double-counting. However, as the EBRD is keen to consider the upstream or downstream impact of its projects, scope 3 GHG emissions may be taken into consideration for some projects where these are particularly relevant (for example, energy pipelines).

Review against NDCs, including the LTSs and other policy plans underpinning them

- 2.18 NDCs are determined unilaterally and normally include targets for GHG emission reductions, reflecting a country's "highest possible ambition". NDCs are submitted at a maximum of five-yearly intervals as part of the Paris Agreement mechanism. Each subsequent NDC is supposed to be more ambitious than the previous one (the ratchet mechanism). Although NDCs express emission reduction targets (and, therefore, tend not to contain detailed and comprehensive information on the evolution of economic activities in all sectors), they can include specific commitments relevant to a project (for example, ruling out activities in a certain sector). In addition, NDCs are typically underpinned by LTSs and other policy plans, which are important additional reference points rooted in the Paris Agreement.
- 2.19 To date, total aggregated country commitments to reduce GHG emissions, typically only extending to 2030, are insufficient to meet the aims of the Paris Agreement. Moreover, only a handful of countries have produced associated LTSs and/or specific policy plans to accompany their NDCs.
- 2.20 Therefore, the review of NDCs (including the LTSs and other policy plans underpinning them) is necessary, but not sufficient in and of itself to determine Paris alignment. In future, NDCs may become sufficiently ambitious and detailed, allowing them to be used as the principal piece of evidence in determining the alignment of individual projects. This would normally require the NDC to include, or be underpinned by, a sufficiently detailed LTS.
- 2.21 If a project entails investment in an activity that is explicitly ruled out by the NDC, it will be determined "non-aligned". In all other cases, even if a project involves investment in an activity for which there is support in the NDC, it requires further assessment to determine alignment.
- 2.22 NDCs (including LTSs and other policy plans underpinning them) will be reviewed based on formal NDC submissions to the United Nations, collated in the United Nations Framework Convention on Climate Change (UNFCCC) NDC Registry. Other NDC "trackers" may be also used for context in assessing national climate-change ambitions (for example, climate action trackers).

Low-carbon pathways

- 2.23 When LCPs are available, they can provide information to inform the assessment of individual projects for Paris alignment. Consequently, they must be credible and linked to the mitigation goals of the Paris Agreement. The requirements for credible LCPs are presented in Box 1.
- 2.24 Projects for which a suitable LCP (including benchmarks and criteria derived from them) is not available will rely on carbon lock-in tests (and, where applicable, an economic viability test) to determine alignment.
- 2.25 Where a suitable LCP is available, the following information (if present) can be used to compare the LCP outputs with project-specific characteristics:
- a. the types of technology and energy used by the project and their evolution over time
 - b. the project's key characteristics – in particular, its size, emissions intensity and operating regime
 - c. any assumptions on wider sector developments – for example, the phase-out of technology, types of energy and policy signals – should be consistent with the assumptions used in a project's business case.

2.26 It is also possible to use existing, publicly available benchmarks or criteria derived from LCPs (or that serve a proxy for an LCP). These benchmarks and criteria can be used to see if the project fulfils a set of relatively simple technical criteria that can be verified easily and practically (such as emissions intensity per unit of output). Meeting benchmarks and fulfilling criteria gives confidence that the project is consistent with low-carbon development. Examples of existing low-carbon benchmarks and criteria that the Bank may use include:

- a. sector benchmarks, as defined by leading expert bodies, such as those used by the Transition Pathway Initiative, Science Based Targets Initiative and Paris Agreement Capital Transition Assessment (PACTA) (global)
- b. energy-efficiency standards for equipment and industrial activities introduced to support LTSs (global and regional)
- c. rating schemes and benchmarking that may become available, particularly in relation to the (voluntary) disclosure of sustainability performance data
- d. the “do no significant harm” criteria for mitigation of the EU taxonomy (regional).

2.27 Benchmarks could also be derived from global and/or sectoral LCPs. The benchmark would be calculated based on the evolution of the relevant LCP over the lifetime of the project and represent a Paris-aligned emission-intensity level a project should achieve. Meeting or exceeding this level would give confidence the project was consistent with low-carbon development. The calculation of such a benchmark would be based on:

- a. the evolution of the pathway
- b. the lifetime of the project
- c. the specific emissions per output of the project
- d. the project scope and context, for instance, whether it directly replaces old capacity or is new capacity.

2.28 The choice of LCP and how it is used depends on the characteristics of the project and the availability of information. For any project, only one of three types of LCP will be used, in the following order of preference:

- a. An existing country-endorsed LCP. When available and suitable, a country-endorsed LCP should be used.
- b. A sector-specific global or regional LCP (for steel, for example), including benchmarks and criteria that have been derived from sector-specific LCPs. If a country-endorsed LCP is not available or not suitable for the sector in question, a sector-specific LCP (or related criteria and benchmarks) could be used, on the condition that the selected LCP was sufficiently representative of the project type and its operations.¹⁶
- c. A bespoke LCP developed for a specific country and/or sector (likely to have been developed in cooperation with the Bank or other development partners). A bespoke LCP for a specific country and/or sector should be used in cases not covered by the two other types of LCP.

¹⁶ It is important that the operational mode covered by the LCP is sufficiently representative for the expected projects' operational mode. This may not be the case if e.g. the project's operational mode is expected to change significantly over time or when the project's alignment depends critically on other activities in the sector, region or economy.

2.29 With the introduction of the Paris alignment methodology, the Bank will develop and maintain a list of different LCPs, benchmarks and criteria that the Bank has assessed, confirmed and made available for Paris alignment determination. This list will be reviewed at the end of the first year in which the methodology is applied and updated at periodic intervals thereafter.

Box 1: Criteria for the use of LCPs in the EBRD's Paris alignment methodology

The Bank would generally expect any LCP used to have the following features:

- It should be consistent with the climate goals of the Paris Agreement. In practice, this requirement will be expressed in terms of the year by which the sector reaches net-zero emissions, which for CO₂ emissions would typically (although not always) be no later than 2050, and broad consistency with achieving peak emissions as early as practically feasible, which will be no later than 2030 in most sectors.
- It should include any critical cross-sector interdependencies.
- It should be based on primary bottom-up modelling. This modelling should be reflective of underlying technical and economic considerations (typically some form of cost-optimisation).
- It should have transparent assumptions and be based on best available information in the relevant region, country and/or sector. Information from external sources should clearly referenced.
- It should incorporate any activities to which policy makers have already committed.
- It should be underpinned by broad-based stakeholder engagement.
- It should be time-relevant. In other words, it should have been prepared relatively recently, as many sectors are characterised by significant technological progress and pathways will need to be up to date.
- It should be possible to readily confirm the important characteristics of the project from the LCP.

When the Bank relies on bespoke LCPs, the LCP is generally expected to have the following features (in addition to the ones above):

- It must be specific to the country *and* explicitly cover the relevant sector.
- It should be prepared in partnership with the relevant stakeholders, including national authorities. In this context, partnership means extensive engagement by the relevant national authorities, including support for developing a pathway, consultations during the development phase and support for its findings.

The specific project under review must be readily identifiable from the LCP to allow inferences to be drawn about the project.

In addition, where possible, all LCPs the Bank uses should include gender-responsive considerations, in line with the UNFCCC's enhanced Lima work programme and action plan on gender.

Carbon lock-in tests

- 2.30 Carbon lock-in occurs when technical, economic or institutional factors mean an asset will continue to operate in an emissions-intensive way, even when there are feasible and economically preferable, lower-carbon options that could replace it.¹⁷ A lower-carbon option in this context refers to an asset for which there is a high degree of certainty that it will be economically viable in a world in which the goals of the Paris Agreement are met.¹⁸
- 2.31 Carbon lock-in is distinct from the concept of stranded assets.¹⁹ The risk of an asset becoming stranded is primarily an issue of financial risk. It is, therefore, part of the Bank's considerations with regard to sound banking and risk management and not explicitly part of the Paris Alignment methodology.²⁰
- 2.32 Carbon lock-in is intrinsic to the concept of Paris Alignment. If an asset does not displace future investments in lower-carbon options (and, therefore, does not result in carbon lock-in), the risk of the asset undermining efforts to achieve the goals of the Paris Agreement is low.
- 2.33 The risk of carbon lock-in will be assessed as follows:
- a. If the project entails investment in assets that will cease to operate in an emissions-intensive way in the near future, the risk of carbon lock-in is low and no further review is required. What constitutes the "near future" varies from sector to sector, but it will generally be shorter than 10 years.
 - b. If the project does not involve investments in any assets (such as refinancing or short-term commodity trading), the risk of carbon lock-in is low and no further review is required.
 - c. If the project credibly demonstrates low-carbon readiness, the risk of lock-in is low and no further review is required. This will be ascertained by assessing whether the project can be developed for low-carbon use in the near future, potentially with limited investment, and taking into account the wider technological, economic and/or policy changes that may be needed to enable this. To credibly demonstrate low-carbon readiness, a project must fulfil the following requirements: (1) it must be technically feasible for the project to be developed for low carbon use (with any investment to this end being limited); (2) technological, economic and/or policy changes that result in low-carbon use becoming economically viable must occur well before the end of the technical life of the asset; and (3) there must be a high likelihood of a switch to low-carbon use – for example, because it will be commercially attractive to do so or because of a client commitment. If these requirements cannot be demonstrated, but there is, nonetheless, support for the low-carbon readiness of the project, these elements will be considered alongside others in the detailed assessment of carbon lock-in risks.

¹⁷ Carbon lock-in is a widely used term in policy literature and by MDBs, financial institutions and some frameworks (such as the Stockholm Environment Institute (Erickson et al., 2015), Economic Consulting Associates (2015) and CDC Group (CDC, 2020).

¹⁸ In practice, in many sectors, the choice of a lower-carbon option will be clear – for example, solar PV or onshore wind in the power sector. It is important, however, that a lower-carbon option deemed an alternative to an emissions-intensive asset be able to meet similar needs.

¹⁹ In the context of climate change, an asset can become stranded when actions to meet climate targets result in the asset suffering from an unanticipated or premature write-down, devaluation or conversion to a liability.

²⁰ Stranded assets and carbon lock-in risks are related and interlinked, but can potentially come into conflict. A carbon-intensive asset may avoid becoming stranded if its contractual framework allows it to continue operating at the expense of less carbon-intensive assets (for example, because it benefits from a long-term contract that guarantees operation). In such cases, however, the asset is likely to result in carbon lock-in.

- 2.34 For all other projects, a detailed assessment will be conducted by considering the different routes through which investment in a project can result in lock-in. These routes will be reflected in the form of questions.
- 2.35 While the specific lock-in test questions will be tailored to individual sectors, they will focus on the following aspects (alongside the low-carbon readiness analysis described):
- a. The project's commercial arrangements. For example, do the project's commercial arrangements create a risk that it will continue to operate even when lower-carbon options that could replace it become economically feasible? Does the project benefit from a long-term contract that guarantees operations at high utilisation rates?
 - b. The market structure of the project sector (and, if relevant, related sectors).²¹ For example, does the market structure mean a project risks continued operation when lower-carbon replacements are economically feasible (for instance, because there is a lack of regulatory framework/market signals to attract low-carbon investments or because the project has a dominant market position that would deter market entry)?
 - c. The wider project context. For example, does the country in which the EBRD is investing have a credible commitment to moving towards decarbonisation, for example, through policies such as carbon pricing that support low-carbon sources? Does the client have a corporate climate-governance action plan? Does the project have characteristics that may make it politically difficult to displace in future (for example, because it is a significant source of employment)?
- 2.36 For projects with significant emissions, an additional aspect of carbon lock-in will be considered: the cost structure of the assets covered by the project and how these compare with the costs of future lower-carbon alternatives and (current) more emissions-intensive alternatives. Assets with a large amount of sunk costs and relatively lower operating costs may be difficult to displace once the sunk costs have been incurred. The risk of this happening can be assessed by considering how the cost of the asset, with and without the sunk cost, compares with the costs of alternatives.²² This risk will be assessed through the economic test analysis, so will only be assessed for projects with significant emissions.
- 2.37 The approach to evaluating carbon lock-in – specifically, the depth of the analysis – will depend in part on the outputs of the other tools. For example, if a project does not have a significant emissions footprint and is consistent with a conservative benchmark derived from an LCP, the lock-in risk is likely to be lower and the scope of the lock-in evaluation can be more limited. Alternatively, projects for which a suitable LCP (including benchmarks and derived criteria) is not available may require a more in-depth evaluation of lock-in risks.

²¹ The scope of the lock-in tests will extend to the relevant markets in which the project may create a risk of lock-in. The route by which a project leads to lock-in may depend on its interaction with other markets. For example, to assess whether a gas pipeline leads to carbon lock-in, it will be important to consider the impacts of the gas pipeline in the downstream markets, such as residential or commercial heating and industrial use, and determine whether the pipeline might lead to investments in other markets that caused carbon lock-in. Such dependencies will be covered by the carbon lock-in tests.

²² In particular, to assess the likelihood of an asset's short-run costs remaining below the expected future long-run costs of lower-carbon alternatives and to understand whether the asset is likely to compete against future low-carbon assets or current assets that are more emissions intensive.

Economic viability test

- 2.38 A carbon price is a critical policy instrument in achieving the goals of the Paris Agreement. It seeks to put a monetary value on GHG emissions and corrects for associated market failure. For a given combination of policies, carbon prices can be set at levels that will lead to a pattern of economic activity that meets the mitigation goals of the Paris Agreement. In a world with a universal carbon price, only activities consistent with the goals of the Paris Agreement would be economically viable.²³
- 2.39 Although there has been substantial progress in recent years, carbon prices remain limited or non-existent in many of the economies where the EBRD invests. In the absence of an adequate market price for carbon, the EBRD uses a “shadow” carbon price in its economic assessment of projects with significant GHG emissions.
- 2.40 The economic assessment approach is guided by the EBRD’s publicly available “methodology for the economic assessment of EBRD projects with high greenhouse gas emissions”.²⁴ The economic viability test will apply this methodology, which also defines the Bank’s shadow carbon price and is used in all projects with significant GHG emissions.²⁵
- 2.41 Interpreting the results of an economic assessment requires comparing the proposed project with an alternative scenario or “counterfactual” (that is, what would happen in the absence of the project). The choice of counterfactual(s) will depend on the specific investment and be assessed on a project-by-project basis. In general, the Bank will consider how the net present value (NPV) and/or economic cost of the investment compares with other alternatives, including more emissions-intensive and lower-carbon alternatives. These comparisons will be informed by insights derived from the other specific assessment tools.
- 2.42 If a project is shown to be economically viable in an economic assessment using a suitable shadow carbon price (as defined by the Bank’s methodology), this would contribute to the case for its alignment with the mitigation goals of the Paris Agreement. Similarly, the risk of an investment that is the cheapest among realistically available alternatives being non-aligned is likely to be lower. Therefore, the economic viability test will check one or both of the following: compared with a baseline a project has either (a) a higher positive NPV if an economic assessment is based on a cost-benefit analysis, or (b) a lower economic cost if a cost-effectiveness analysis is used.²⁶

²³ The carbon prices needed to meet the goals of the Paris Agreement depend on other policies that can influence GHG emissions. Each policy mix will require a specific set of carbon prices. This interdependency is one of the sources of uncertainty in determining the “correct” set of carbon prices. For any accompanying policy mix, there can be several combinations of carbon price, which differ by sector and/or country, which collectively meet the goals of the Paris Agreement.

²⁴ See EBRD (2019b).

²⁵ The EBRD routinely conducts economic assessments for large infrastructure projects (regardless of their GHG emissions footprint). Where possible, the results will be presented as part of relevant project documentation and, where applicable, incorporate a shadow carbon price.

²⁶ The economic assessment for the economic viability test will also incorporate other environmental externalities where valuation is feasible. Recognising that the focus of mitigation is on GHGs, results will be shown in a disaggregated manner.

3. Alignment of projects with the adaptation goals of the Paris Agreement

- 3.1 Article 8 of the Paris Agreement sets the global goal for climate change adaptation, or increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience, by:
- a. enhancing adaptive capacity
 - b. strengthening resilience and reducing vulnerability to climate change with a view to contributing to sustainable development
 - c. ensuring an adequate adaptation response in the context of the Paris Agreement temperature goals.
- 3.2 Since 1880, an increase in the global temperature of approximately 1°C has been observed, accompanied by the greater frequency of extreme weather events and chronic climate impacts. There is, therefore, a need for projects to be resilient to the effects of climate change. Moreover, given the uncertainty over future climate impacts, it is important to prepare for the range of potential climate futures.
- 3.3 At project level, this means that when the EBRD is considering financing a project, it needs to understand the project's vulnerability to climate change and the actions that could build climate resilience. This requires an approach that is (a) context specific, taking into account the specific attributes of the project at both its geographical location and across any related supply chains; and (b) able to understand and assess present and future climate risks.
- 3.4 To address a project's consistency with the Paris Agreement's adaptation goals, the Bank will draw on the latest information and best-practice principles for climate-resilient financing. This includes the use of the latest climate models and assessing climate resilience over a range of temperature scenarios. It will also draw on policy documents at the national and/or regional level, as appropriate – including NDCs, National Adaptation Plans (NAPs) and their equivalent. Its findings will also draw on the latest insights and project-level criteria of the EU taxonomy.

Assessment approach

- 3.5 The Bank's approach to Paris alignment for climate-change adaptation entails demonstrating that each project meets the following conditions:
- a. physical climate risks have been identified and addressed
 - b. project activities do not undermine climate resilience in the context in which it operates.
- 3.6 The EBRD will use a three-step process (summarised in Figure 3) to assess whether these conditions are met:
- a. Evaluation of the climate risk and vulnerability context of a project to identify and assess physical climate risk. This will determine if the project has materially relevant climate risks.
 - b. Where climate risks are material, the definition of climate resilience measures to address physical climate risks and build climate resilience. This will identify concrete measures and investments to build into the project design.

- c. Appraisal of the broader climate resilience context of the project, ensuring it does not contravene national policies for adaptation or the climate resilience of the wider system in question (for example, exacerbate climate risks for communities or businesses in its vicinity or broader supply chain).
- 3.7 This three-step process is based on principles agreed by MDBs for assessing an individual project's alignment with climate-resilient development. The three steps consider the local nature of physical climate change impacts. This means there is no positive list of sectors or activities that are automatically aligned. Rather, each project needs to be assessed individually using a process-based approach that takes into account its specific circumstances based on location, sector, nature of business and assets.
 - 3.8 To ensure appropriate focus and insight, the materiality of identified climate risks will inform the level and depth of assessment to be undertaken. Therefore, the approach taken will be commensurate with the size and complexity of the project.
 - 3.9 This process will also be aligned with the physical climate-risk screening methodology developed as part of the Bank's implementation of the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations for physical climate-risk assessment (to be adopted over the course of 2021). Under this approach, every new direct finance project will be screened at the concept stage for exposure to physical climate risks at both counterparty level (to feed into the Bank's approach to climate-related financial risk) and project level (which will also be used to determine alignment).

Step 1: Evaluation of the climate risk and vulnerability context

- 3.10 The starting point is to describe the climate hazards to which the project is exposed and the magnitude of climate risks at sector level. The Bank has identified a number of climate hazards and, for each industry sector, has assessed the risk of significant disruption if the project or business activity were exposed to that hazard. This will identify the primary physical climate risks (such as rising flood risk or heat stress) relevant to the project. Sectoral risks are designated as "low", "medium", "high" or "very high" for each industrial classification code.²⁷
- 3.11 For each climate hazard that presents a "high" or "very high" risk to the project sector, a determination is made as to the likelihood of that hazard occurring at the project location over the project's lifetime. This determination makes use of a variety of publicly available geographical climate-risk tools.²⁸ Likelihood is rated as "not likely", "plausible" or "probable" and a numerical score is assigned to each hazard. The project is then given an overall physical climate risk score of 1 to 10, calculated by weighting the scores for each hazard. Projects with a physical climate-risk score of 6 or less will be deemed not significantly exposed to physical climate risks and will proceed directly to step 3. Projects with a score of 7 or more will require further analysis to identify options to reduce physical climate risks.²⁹

²⁷ The climate hazards include increasing mean temperatures, extreme heat event, wildfires, extreme wind event, increasing water stress, sea-level rise, drought, flood, erosion and extreme mass movement.

²⁸ World Bank - Climate Change Knowledge Portal (CCKP); Swiss Re - CatNet; WRI - AqueductClimate; and Central - Coastal Risk Screening Tool

²⁹ These thresholds are set based on the findings of a portfolio review focused on two EBRD countries (Serbia and Egypt) and will be revised over time.

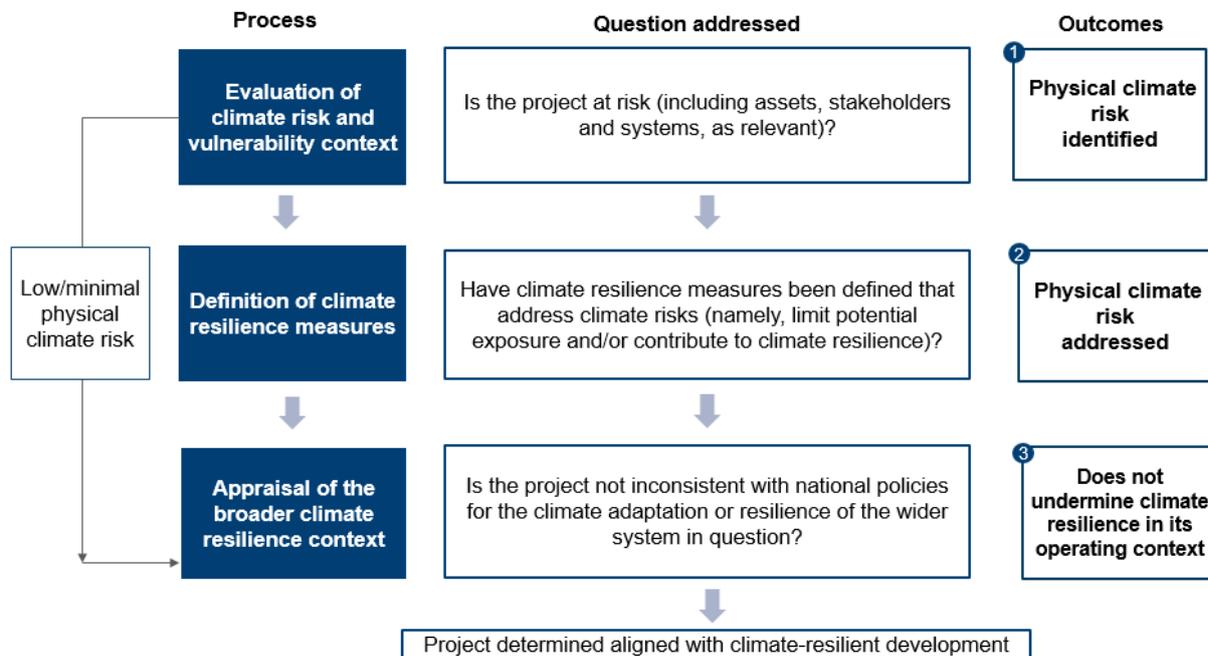
Step 2: Definition of climate resilience measures

- 3.12 This step will examine whether higher risk projects have appropriate climate resilience measures that correspond to the specific physical climate risk identified during step 1. For each of the relevant physical climate risks identified, corresponding climate resilience measures will need to be integrated into project design. These climate resilience measures may be technical or structural (e.g. adjusting infrastructure design or technology selection), or non-structural (e.g. improved climate modelling or weather forecasting capacities).
- 3.13 The proposed climate resilience measures are assessed to determine whether they are appropriate and meaningful responses that limit potential financial exposure and/or contribute to climate resilience. They should correspond to the relevant physical climate risks identified. This is done by identifying the expected climate resilience outcomes associated with each climate resilience measure. Climate resilience measures may include changes to physical infrastructure, for example, to address a greater risk of flooding, or changes to the choice of technology, for example to reduce reliance on water in water-stressed regions.
- 3.14 Projects that demonstrate appropriate and meaningful climate resilience measures that correspond to the relevant physical climate risks, verified by the identification of corresponding expected climate resilience outcomes, will move on to step 3. Projects that do not will be deemed non-aligned.

Step 3: Appraisal of the broader climate resilience context

- 3.15 All projects will be subject to checks to ensure that they do not present any inconsistency with national policies or strategies related to climate adaptation or resilience and to ensure they are not expected to impair the climate resilience of the wider system in which the project is located or of which it forms part.
- 3.16 This step recognises that, in some cases, projects that may not be exposed to physical climate risks may exacerbate climate risks for communities or businesses in their vicinity. For example, projects that use large volumes of water may not be exposed to water stress themselves, but could create climate risks for farmers dependent on the availability of water downstream from their business activities.
- 3.17 This step makes use of the Bank's existing processes to guide climate-resilient investment and manage risks (for instance, a project's environmental due diligence, especially in relation to potential impacts on ecosystems and communities). To undertake the appraisal, the project is assessed against the national climate resilience context (for example, international/transboundary agreements, national policies/strategies, sectoral policies/strategies and local/community considerations). This ensures that projects are not inconsistent with applicable national climate resilience strategies and policies. The double negative (not inconsistent) is intentional, recognising that national climate adaptation or resilience policies and strategies do not tend to be comprehensive or exhaustive, so cannot be expected to cover all potentially valid climate adaptation or resilience actions or priorities.
- 3.18 Projects that are not inconsistent with the national/broad climate resilience context (after having already graduated from previous steps) will be deemed aligned with the adaptation goals of the Paris Agreement. Projects that do not pass step 3 will be deemed non-aligned.

Figure 3: Alignment of projects with the adaptation goals of the Paris Agreement



Annex 1. Links between the EBRD's Paris alignment methodology and other processes

A1.1. The determination of a project's Paris alignment is linked to several other Bank processes, as explained below.

- a. *Climate data management.* The determination of a project's Paris alignment will be supported by the Bank's central IT system (Monarch) and work in this regard will be completed in 2021-22. The full integration of the Paris alignment determination methodology into Monarch will also enable the Bank to track the most relevant climate indicators over the project cycle. These data will be available for different purposes, including GET assessments, risk assessment and internal and external reporting.
- b. *Climate-related financial risk.* Determining a project's Paris alignment is distinct from the concept of climate-related financial risk. Climate-related financial risk encompass potential risks from climate change – be they from the low-carbon transition (“transition risks”) or climate impacts (“physical risks”) – that could affect the commercial viability of financial institutions and broader financial stability. While likely to draw on the same source information for individual projects, this perspective is captured through the Bank's approach to risk management and disclosure, in line with the TCFD principles.
- c. *Environmental and Social Policy.* The Bank's Environmental and Social Policy (ESP) guides project-level due-diligence.³⁰ The environmental and social assessment of a project provides important environmental information relevant for Paris alignment (such as the level of GHG emissions from the investment and in client operations). These are a prerequisite to understanding the impacts of EBRD projects with respect to the mitigation goals of the Paris Agreement. EBRD's own approach to project-level GHG accounting is guided by international best practice and set out in its GHG protocol and GET Handbook.³¹ Environmental due diligence also considers a project's exposure to physical climate risks.
- d. *GET finance attribution.* This is the EBRD's measure of “green” finance. Projects or project components that qualify for GET must have measurable environmental benefits. The three main categories of environmental benefit are: (1) climate change mitigation (reduction of GHG emissions); (2) climate change adaptation (enhancement of climate change resilience); and (3) other environmental benefits (including improved resource efficiency, reduced local pollution, greater resilience and the restoration of ecosystems). The aggregate volume of GET finance is reported annually as a share of annual banking investment (ABI). A project must be deemed Paris aligned to be eligible for GET finance attribution; both will use common datasets and evidence. A project that is Paris aligned may not necessarily involve GET finance, however.

³⁰ See EBRD (2019a).

³¹ The EBRD has helped shape the International Financial Institution Framework for a Harmonised Approach to Greenhouse Gas Accounting (UNFCCC, 2015) and its [associated methodologies](#). The Bank's GHG Protocol (EBRD, 2017) and GET Handbook (EBRD, 2018a) guide the estimation of GHGs in EBRD projects. The EBRD first published the GHG impact of its investments on GHGs in 2002 and reports annually in the [EBRD Sustainability Report](#) (EBRD, 2019c).

- e. *Green transition impact.* “Green” is one of the EBRD’s six transition qualities. To have a green transition Impact, the project must have GET finance attribution. Projects are awarded a higher transition impact rating if they enhance systemic impact, such as large, positive environmental outcomes, complementary policy dialogue or innovation (for example, major demonstration impact). A project’s green transition impact can also be supported by the Bank’s other transition qualities, such as corporate climate governance under (well-governed); green capital market development (resilience); policy engagement to decommission state-owned fossil fuel infrastructure (competitive); development of plans for electric-vehicle charging infrastructure networks (integrated); and consideration of just transition (inclusive).
- f. *Economic assessment for projects with high GHG emissions.* The use of a shadow carbon price in the economic analysis of a project is closely related to the concept of Paris alignment. The Bank has committed to conducting economic assessments of projects associated with significant emissions. Its approach to conducting this analysis is set out in its “*methodology for the economic assessment of EBRD projects with high greenhouse gas emissions*” (EBRD, 2019b).

Annex 2. Joint MDB aligned and non-aligned project lists

A.2.1. To assess alignment of projects with the Paris Agreement mitigation goals, project lists for aligned and non-aligned activities have been developed with other MDBs as part of technical discussions in the MDB Paris Alignment Working Group. These activity types, presented below based on the MDB project list, will be used by EBRD to determine alignment of projects. The lists represent a shared view as of May 2021 and will be revised and updated in consultation with other MDBs on a regular basis.

Aligned list³²

Sector	Eligible project type	Conditions and guidance
Energy	Generation of renewable energy from solar, wind, wave power, run-of-the-river hydro or geothermal with negligible lifecycle GHG emissions	Includes generation of heat or cooling
	Rehabilitation and desilting of existing hydropower plants, including maintenance of the catchment area (for example, a forest management plan)	Rehabilitation includes works on the water-holding capacity of dams and works to pipes/turbines to increase productivity, to bring additional grid stabilisation benefits and for pumped storage
	District heating or cooling systems with negligible lifecycle GHG emissions	Using significant renewable energy or waste heat or cogenerated heat <u>or</u> including: a) modifications to lower temperature delta b) advanced pilot systems (control and energy management, etc.)
	Electricity transmission and distribution, including energy access, energy storage and demand-side management	
	Cleaner cooking technologies	Cleaner cooking technologies replace the use of solid biomass fuels in open fires; cleaner technologies include improved biomass or electric cook-stoves

³² Projects in this list will have to go through specific assessment if: (a) their economic feasibility depends on external fossil-fuel exploitation, processing and transport or (b) their economic feasibility depends on existing fossil-fuel subsidies.

Sector	Eligible project type	Conditions and guidance
Manufacturing	Non-energy-intensive industry ³³	Consider the nature of the product produced (carbon content, lifetime, ability to be reused and recycled)
	Manufacture of electric vehicles, non-motorised vehicles, electric locomotives and non-motorised rolling stock	
	Manufacture of components for renewable energy and energy efficiency	
Agriculture, forestry, land use and fisheries	Afforestation, reforestation, sustainable forest management, forest conservation, soil health improvement	With the exception of operations that expand and promote expansion into areas of high carbon stocks or high biodiversity
	Low-GHG agriculture, climate-smart agriculture	With the exception of projects that expand and promote expansion into areas of high carbon stocks or high biodiversity and taking into account (international) transport
	Conservation of natural habitats and ecosystems	With the exception of projects that expand and promote expansion into areas of high carbon stocks or high biodiversity
	Fishing and aquaculture	
	Non-ruminant livestock with negligible lifecycle GHG emissions	
	Flood management and protection, coastal protection, urban drainage	
Waste	Separate waste collection (in preparation for reuse and recycling), composting and anaerobic digestion of bio-waste, material recovery and gas recovery from closed landfill	
Water supply and wastewater	Water supply systems (for example, expansion or rehabilitation); water quality improvement; water efficiency (such as non-revenue water reduction or efficient industrial processes); drought management; water management at watershed level	Desalination plants need to go through specific assessment
	Gravity-based or renewable energy-based irrigation systems	

³³ EBRD interpretation of the energy intensive industries are base chemicals manufacturing, cement manufacturing, pulp making, primary aluminium smelting, iron and steel smelting.

Sector	Eligible project type	Conditions and guidance
	Wastewater treatment (includes domestic or industrial) including the treatment and collection of sewage; sludge treatment (such as digestion, dewatering, drying, storage); wastewater reuse technology; resource recovery technologies (for example, biogas into biofuel, phosphorous recovery, sludge as agriculture input, sludge as a co-combustion material)	
Transport	Electric and non-motorised urban mobility	
	Rural roads with low traffic volumes providing access to communities that currently do not have all-weather access (for example, connecting farmers to markets or providing access to a rural school, hospital or better social benefits)	Unless there is any risk of contributing to deforestation
	Electric passenger or freight transport	
	Short sea shipping of passengers and freight ships	
	Inland waterway passenger and freight transport vessels	
	Port infrastructure (maritime and inland waterways)	
	Rail infrastructure	
	Road upgrades, rehabilitation, reconstruction and maintenance without capacity expansion	
Buildings and public installations	Buildings (education, healthcare, housing, offices, retail, etc.)	Must meet green building certification criteria as established by each individual MDB ³⁴
	LED street lighting	
	Parks and open public spaces	Excluding energy-consuming installations beyond lighting and routine maintenance (such as watering)
Information and communications technology (ICT) and digital technologies	Information and communication, excluding data centres	

³⁴ MDBs are working to harmonise their approach to assessing the Paris alignment of buildings and the role of certification schemes. This approach will also take into account the impact of materials on the alignment of buildings, with a pathway to low GHG emissions.

Sector	Eligible project type	Conditions and guidance
Research, development and innovation	Professional, scientific, research and development, and technical activities	
Services	Public administration and compulsory social security	
	Education (non-infrastructure/buildings)	
	Human health and social work activities (non-infrastructure/buildings)	
	Social protection, cash transfer schemes	
	Arts, entertainment and recreation (non-infrastructure/buildings)	
Cross-sectoral activities	Conversion to electricity of applications currently covered by fossil fuels	

Non-aligned list

Mining of thermal coal
Electric power generation from coal
Extraction of peat
Electricity from peat

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