



**GREEN  
CLIMATE  
FUND**

**Meeting of the Board**

1– 4 July 2018

Songdo, Incheon, Republic of Korea

Provisional agenda item 14

**GCF/B.20/18**

8 June 2018

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# An integrated approach to addressing policy gaps to ensure climate impact: an overview of policies related to the consideration of funding proposals

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## **Summary**

This document provides an overview of the policy papers to be presented to the Board at its twentieth and subsequent meetings, considers their interlinkages and explains how they are related to the integrated policy approach of GCF. It also proposes a schedule for the elaboration of policies and tools to address policy gaps identified in the approval of funding proposals in order to ensure climate impact.

## I. Introduction

1. At its nineteenth meeting (B.19), the Board, by decision B.19/06, requested the Secretariat to develop an integrated approach to address the policy gaps identified in decision B.11/11 and other matters considered at subsequent Board meetings for the Board's consideration at its twentieth meeting (B.20). In particular, the Board:

- (a) Noted the linkages between matters related to incremental costs and concessionality and the policy gaps identified in decision B.11/11, including project eligibility criteria, as well as issues related to co-finance and other matters considered at subsequent Board meetings;
- (b) Also noted the linkages between such policy gaps and the GCF results management framework, initial investment framework, country programmes and entity work programmes, and the risk management framework;
- (c) Further noted that addressing these policy gaps requires an integrated approach that considers their interlinkages; and
- (d) Requested the Secretariat to develop an integrated approach to resolve these interrelated issues for the Board's consideration at B.20, including:
  - (i) Steps to enhance the climate rationale of GCF-supported activities; and
  - (ii) Policies on the review of the financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs and co-financing;

2. In order to fulfil this mandate, the Secretariat is presenting a series of policy papers for consideration by the Board at B.20 as part of an integrated approach to addressing policy gaps to ensure climate impact. This is presented in the figure below. The Secretariat's approach is to divide the policy matters into the following three groups for the Board's consideration:

- (a) A single document with a **decision on policy principles**, proposed as a bundle;
- (b) Documents for **decision on processes**, containing updates on progress and proposals for next steps; and
- (c) Information documents **to take note of**, containing updates on progress and outlining next steps.

3. The first document contains three parts **on policy principles presented with one decision**; each part proposes principles, definitions and an approach for Board consideration that will guide the further development and implementation of the policy framework. The Secretariat proposes that the Board consider these as bundled together with a unified decision text in the document titled "Interrelated policy matters on incremental cost and full cost, concessionality and co-financing" (document GCF/B.20/19):

- (a) Part 1: Incremental cost and full cost methodologies;
- (b) Part 2: Options for further guidance on concessionality; and
- (c) Part 3: Policy on co-financing.

4. The second group contains the following three papers **for decision on processes**, each presenting updates on progress and proposals for next steps to be taken on the basis of the strategic frameworks and the principles set out in the document referred to in paragraph 3 above:

- (a) "Revision of the structure and operations of the independent Technical Advisory Panel" (document GCF/B.20/20);
- (b) "Two-stage approval process for GCF funding proposals" (document GCF/B.20/21); and
- (c) "Further options for decision-making relating to funding proposals" (document GCF/B.20/22).

5. The third group contains the following five information documents **to take note of**, each presenting updates on progress and outlining the next steps to be taken on the basis of the strategic frameworks and the principles set out in the document referred to in paragraph 3 above:

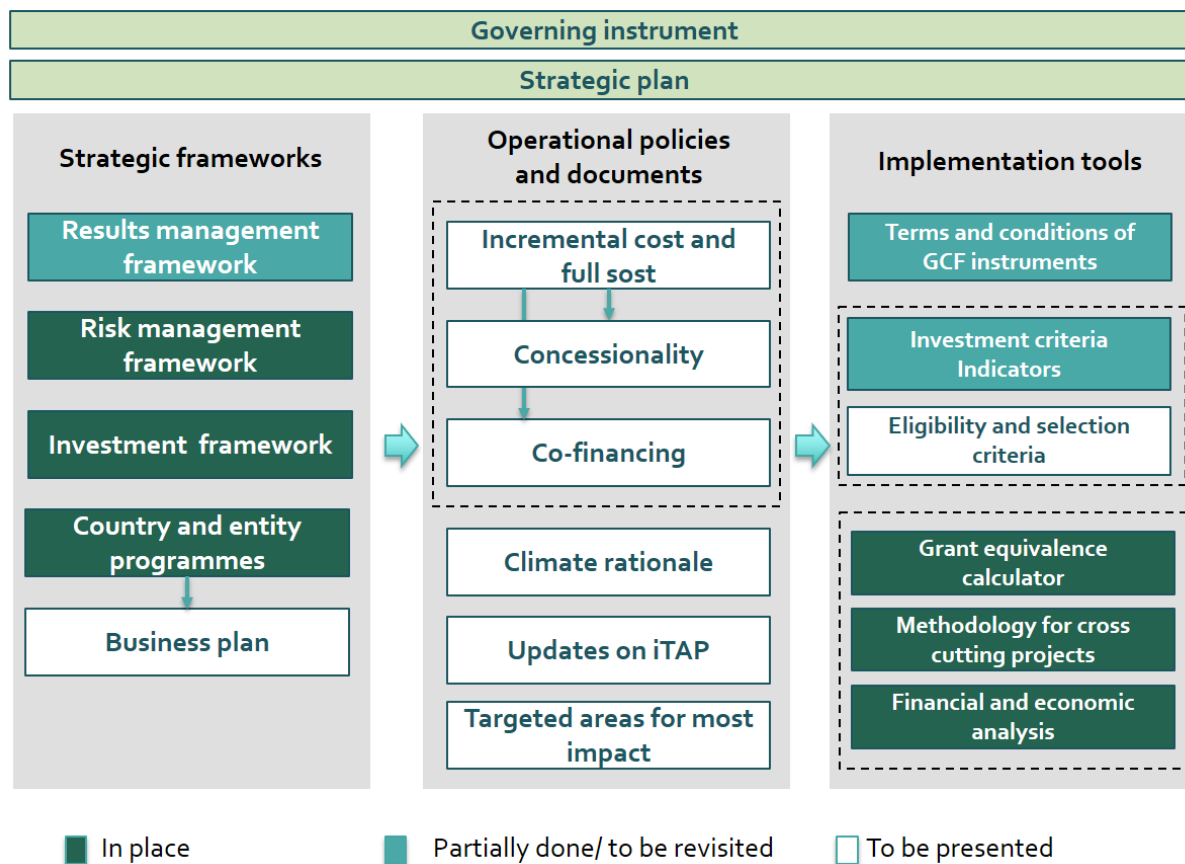
- (a) "Steps to enhance the climate rationale of GCF-supported activities" (document GCF/B.20/Inf.11);
- (b) "Review of the financial terms and conditions of the Green Climate Fund financial instruments" (document GCF/B.20/Inf.12);
- (c) "Mapping of elements related to project or programme eligibility and selection criteria" (document GCF/B.20/Inf.13);
- (d) "Investment criteria indicators" (document GCF/B.20/Inf.14); and
- (e) "Identification of results areas where targeted GCF investment would have the most impact" (document GCF/B.20/Inf.15).

6. This overview paper provides a summary of each of the papers listed in paragraphs 3, 4 and 5 above. The background to the development of these policies is outlined, followed by a brief analysis of the interlinkages. The principles and approaches elaborated within each paper are then summarized.

7. The Secretariat's approach to further addressing policy gaps is outlined in annex II, which proposes a schedule for the elaboration of policies and tools relating to the remaining policy areas. Annex II is intended to provide the Board with an indicative road map for the further completion of policy gaps.

8. The Board is invited to review the policies and approve the Secretariat's proposed approach and schedule for completing the strategic frameworks and for further developing policy tools and methodologies.

Figure 1: Integrated approach to addressing policy gaps



## II. Background and context

9. GCF is mandated to “promote the paradigm shift towards low-emission and climate-resilient development pathways” (Governing Instrument for the GCF, para. 2). Strategic frameworks have been put in place to guide the activities of GCF towards this objective, notably the results management framework, the performance measurement framework, the investment framework and the risk management framework (although the performance measurement framework has been only partially adopted). The development of country and entity programmes also contributes towards a more programmatic approach to the activities of GCF that will help it to achieve its mandate.

10. However, the Board has identified the need to fill various gaps in the GCF operational policy framework in order to complete and implement the strategic frameworks. The main policy areas identified include enhancing the climate rationale of GCF activities, as well as policies on concessionality, incremental and full cost methodologies, co-financing and the financial terms and conditions of GCF financial instruments.

11. Completing the policy framework will provide greater clarity to national designated authorities (NDAs), accredited entities (AEs) and other GCF stakeholders on what GCF is looking for in projects and programmes, and will help to improve the quality and transformational ambition of proposals. It will also provide guidance to the Secretariat in developing and applying implementation tools, including methodologies for assessment, measurement, reporting and verification of the implementation of the GCF project portfolio.

### III. Interlinkages between policies

12. The policies identified by the Board at B.19 to be addressed through an integrated approach are closely interconnected, both to each other and to the strategic frameworks.

13. The Board has held useful discussions on how to address policy gaps on several occasions from its eleventh to nineteenth meetings. However, agreement has proved difficult to reach on individual policy areas, mainly as a result of the overlaps and interlinkages between policies. The recognition of these interlinkages has led to the Board's request for an integrated approach to completing the policy framework.

14. The interlinkages exist at a number of levels and include the following:

- (a) Criteria need to be established to determine how full and incremental costs are agreed (the Governing Instrument states that GCF will finance "agreed full and agreed incremental costs"). However, this determination is also one of the main factors to be considered in formulating the GCF co-financing policy. Agreed incremental costs or agreed full costs could be covered by GCF, but the remaining project costs should rely on co-financing;
- (b) The calculation of incremental costs of climate change is also relevant for the concessionality policy, since concessionality is related to what would otherwise be considered a business as usual activity; and
- (c) The principles used to determine levels of concessionality is linked to the application of the financial terms and conditions of the financial instruments of GCF.

15. For these reasons, the policy framework governing the above-mentioned interlinked policy issues needs to be determined on an integrated basis, rather than as discrete and disconnected policies.

### IV. Summaries of the bundled interrelated policy matters

16. Summaries of the methodologies and policies proposed for incremental and full cost, concessionality and co-financing, developed in response to the Board's mandate given at B.19, are provided below. Descriptions of each matter's objectives, principles and the proposed approach to fill the respective policy gaps are provided. As discussed above, the Secretariat proposes that the Board consider these matters as bundled together with a unified decision text in the document titled "Interrelated policy matters on incremental cost and full cost, concessionality and co-financing" (document GCF/B.20/19):

17. **Incremental and full cost methodologies:**

- (a) As defined in the document referred to in paragraph 3 above, incremental cost refers to the additional expenses incurred with respect to a baseline (which may be zero) to produce a new output or an equivalent output in a different manner. In this context, the full cost would equal the baseline cost plus the incremental cost;
- (b) This paper describes how GCF will develop the principles to apply when deciding whether to finance full project costs or only the incremental costs resulting from climate change and the approach to applying these principles to projects. These principles are needed to ensure that GCF financing is required, additional and adequate. The paper also informs concessionality and co-financing approaches by identifying the share of costs that GCF will fund in various situations; and
- (c) Based on a review of practices of other funds, the key principles proposed are as follows:

- (i) Incrementality is a key tool to assess climate rationale;
  - (ii) Quantitative approaches should be applied to mitigation activities when sufficient data are available;
  - (iii) Qualitative approaches connected to a strong project logic may be used for adaptation activities or activities lacking sufficient data for a quantitative approach; and
  - (iv) Funding for full costs may be justified under certain circumstances.
- (d) The paper proposes a phased approach to implementing methodologies for calculating incremental and full costs. The first phase will be based on engagement and learning from AEs, with a second phase comprising the gradual application of incremental and full cost principles over time, which will involve a shift from qualitative to quantitative measurement.
18. **Options for further guidance on concessionality:**
- (a) As specified in the document referred to in paragraph 3 above, concessionality is a measure of the level of benefit provided to a borrower when compared with financing available at full market rates;
  - (b) This paper describes the principles that GCF will consider when selecting the level and types of concessional instruments to fund a project and the approach to applying these principles to projects. These principles are needed in order to ensure that GCF financing is adequate and predictable, and does not crowd out private sector finance. The principles established are as follows:
    - (i) Concessionality for **private sector projects** will be determined on a case-by-case basis according to the needs of the project and the three key variables: the proposal's strengths in delivering climate impact, paradigm shift potential and potential for reflows;
    - (ii) Concessionality for **public sector projects with reflows** will be determined according to the needs of the project and the three considerations referred to in paragraph 18(b)(i) above within the boundaries imposed by the financial terms and conditions of GCF. The terms and conditions are to be updated regularly, and future revisions could consider greater flexibility, similar to the private sector approach, in line with the principles outlined in this paper; and
    - (iii) Concessionality for **public sector projects with no reflows** will be determined by the current financial terms and conditions of GCF; and
  - (c) The paper proposes a phased approach for implementing a policy on concessionality consistent with the approach for incremental and full cost methodologies. The first phase involves learning from AEs and capacity-building, with a second phase comprising a gradual application of concessionality principles over time.
19. **Policy on co-financing:**
- (a) As stipulated in the document referred to in paragraph 3 above, the proposed definition for co-finance is all the financial resources from third parties that flow into the project/programme alongside the financing provided by GCF, also referred to as additional financing or primary co-finance;
  - (b) This paper describes the principles that GCF will consider when assessing co-finance and leveraged finance from private and public sources and the approach to applying these principles to projects. These principles are needed to ensure that resources

mobilized by AEs and other partners are new, additional, adequate and predictable. The proposed key principles are as follows:

- (i) **Project proposals should seek to incorporate appropriate levels of co-financing to maximize the impact of GCF resources.** The level of co-financing should be at the maximum level appropriate based on each project's individual characteristics;
  - (ii) **While maximizing co-financing is desirable, GCF should avoid using co-financing metrics as stand-alone targets.** Doing so may be counterproductive, as it may disincentivize financing projects/programmes with a strong climate rationale and high paradigm shift potential but inherently low prospects for co-financing. Rather, co-financing should be considered as one appraisal item among many in the investment framework;
  - (iii) **Where GCF funding covers the incremental costs of a project, the non-climate related costs should be provided by co-financing.** In the case where a project is only eligible for the agreed incremental costs, the co-financing should complement GCF resources and be proportionate and commensurate so as to cover, as a minimum, the non-climate related components of the project;
  - (iv) GCF should ascertain that **financial resources of third parties that are tracked by GCF as co-finance or leveraged finance are consistent with the objectives of GCF;** and
  - (v) **The methodology should be based on the basic financial instruments of GCF.** These instruments consist of grants, (concessional) loans, guarantees and equity investments. The methodology is not applicable to policy interventions (e.g. capacity-building support on regulatory issues).
- (c) The paper proposes that the implementation of a co-financing policy be aligned with the phased approach proposed for the incremental and full cost methodologies based on a gradual learning process to accommodate the needs of GCF stakeholders, including NDAs and AEs.

## V. Summaries of policy papers for decision on processes

20. The following section summarizes each of the policy papers presented to the Board for decision on processes, containing progress updates and proposals for next steps.

### 21. **"Revision of the structure and operations of the independent Technical Advisory Panel" (GCF/B.20/20):**

- (a) This paper presents various options to revise the structure of the independent Technical Advisory Panel (TAP) to respond to new modalities for funding proposal assessment adopted by the Board after the terms of reference for TAP were established, and to fluctuations in the pipeline of funding proposals, in terms of both volume and areas of thematic expertise.

### 22. **"Two-stage approval process for GCF funding proposals" (GCF/B.20/21):**

- (a) This paper outlines a policy proposal for a two-stage approval process for GCF funding proposals. The policy aims at strengthening the screening and appraisal process for concept notes with quality checks and a strategic overview undertaken by the senior management team of the Secretariat, based on the strategic fit of the proposal vis-à-vis the mandate of GCF. Assessments and summaries of the strategic screening are then sent to the Board for information and for comments. The policy also foresees the introduction of mandatory concept notes and simplification of templates and on-line

automation. The stronger quality control at the senior management team stage, the provisions of comments and questions by the Board, in addition to technical assessments and due diligence by the GCF divisions, will inform the development of the second stage, with final Board approval at the funding proposal level, which remains as it is.

23. **“Further options for decision-making relating to funding proposals” (GCF/B.20/22):**

- (a) This paper discusses the modalities for decision-making regarding funding proposals including current practice, decision-making in the absence of consensus and decisions taken between meetings. It seeks to clarify certain matters related to the process of adopting decisions between meetings in consideration of the challenges previously encountered by the Secretariat on such decisions.

## VI. Summaries of policy papers for note

24. The following section summarizes each of the policy papers for note presented to the Board as updates on progress and outlines of next steps. These are information documents with follow-up actions by the Secretariat but no decision text.

25. **“Steps to enhance the climate rationale of GCF-supported activities” (document GCF/B.20/Inf.11):**

- (a) This paper sets out the steps being taken to enhance the climate rationale of GCF-supported activities based on the best available science and evidence. The paper describes activities for the following areas:
- (i) Strengthening the guidance to NDAs, AEs, readiness delivery partners and other GCF stakeholders;
  - (ii) Improving Secretariat review processes;
  - (iii) Continuing collaboration and developing strategic partnerships; and
  - (iv) Developing a capacity-building strategy in support of the integrated policies to improve the climate rationale.

26. **“Review of the terms and conditions of the Green Climate Fund financial instruments” (document GCF/B.20/Inf.12)**

- (a) This paper reviews the application of the principles and factors currently used to establish the GCF terms and conditions for a project and the recommendations arising from the review. It concludes that many of the recommendations have either already been implemented or are under implementation, but highlights some recommendations that should be considered by the Board within its approach to concessionality.

27. **“Mapping of elements related to project or programme eligibility and selection criteria” (document GCF/B.20/Inf.13):**

- (a) This paper identifies all the elements related to project or programme eligibility and selection criteria that have been included in the following:
- (i) The Paris Agreement and related guidance of the Conference of the Parties to the United Nations Framework Convention on Climate Change;
  - (ii) The Governing Instrument for GCF;
  - (iii) Previous Board decisions; and



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- (iv) Conditions and recommendations for funding proposals; and
28. **“Investment criteria indicators” (document GCF/B.20/Inf.14):**
- (a) This paper outlines the proposal by the Secretariat on the investment criteria indicators. It builds on a two-phase process led by the Investment Committee to produce indicative minimum benchmarks, with support from the Secretariat and an external consultancy firm. The paper has been updated in the light of the discussions during B.19 on document GCF/B.19/04/Rev.01 titled “Indicative Minimum Benchmarks” and the written comments submitted to the Secretariat following the Board meeting. The document also discusses the application of the indicators to the GCF portfolio.
29. **“Identification of results areas where targeted GCF investment would have the most impact” (document GCF/B.20/Inf.15):**
- (a) This paper identifies areas where targeted GCF investment would have the greatest impact. It analyses the GCF portfolio through the eight GCF results areas and compares it with analyses of country programme briefs. The removal of barriers is identified as key to achieving the most impact, including by mobilizing investment in insurance and reinsurance. It includes a review of the quality of climate information, and data used in the approved funding proposals are presented. The paper also includes several follow-up actions to be pursued by the Secretariat in areas where targeted GCF investment would have the most impact.

## Annex I: Draft decision of the Board

The Board, having considered document GCF/B.20/18 titled “An integrated approach to addressing policy gaps to ensure climate impact: an overview of policies related to the consideration of funding proposals”:

- (a) Takes note of the integrated approach to policy development as presented in document GCF/B.20/18 to address the policy gaps and consider their interlinkages;
- (b) Notes the guidelines and tools required to support policy development and implementation as set out in annex II; and
- (c) Adopts the proposed timeline for Board consideration of policies, as set out in annex II.

## Annex II: Implementation timeline to address policy gaps

### I. Schedule for the presentation of Board documents

1. In order to ensure an integrated approach to policy development, various policies relating to the consideration of funding proposals need to be developed. These policies are required to complete the GCF strategic frameworks, and to complete and implement the operational policies.
2. The table below sets out a schedule for the development of these policy elements. It is intended to provide the Board with an overview of the plans for policy development. The planning within this table is consistent with the work plan of the Board as proposed by the Co-Chairs for 2018, approved by the Board in decision B.18/01.
3. Various elements of the integrated policy papers, although presented as separate papers, should be considered integrally by the Board to allow for consistent adoption and implementation.

#### Schedule for the development of the various elements of the interlinked policies related to the consideration of funding proposals

Schedule	Policy item
<i>To be presented as <b>between Board meeting decision (pre B.20)</b></i>	Restructuring and cancellation policy
<i>Bundled together and to be presented at <b>B.20</b> for decision on policy principles, some with subsequent components to be presented at B.21 or later</i>	Incremental cost and full cost methodologies
	Options for further guidance on concessionality
	Policy on co-financing
<i>To be presented at <b>B.20</b> for decision on processes, some with subsequent components to be presented at B.21 or later</i>	Revision of the structure and operations of the independent Technical Advisory Panel
	Two-stage approval process for GCF funding proposals
	Further options for decision-making relating to funding proposals
<i>To be presented at <b>B.20</b> for note as information documents</i>	Steps to enhance the climate rationale of GCF-supported activities
	Review of financial terms and conditions of GCF financial instruments
	Mapping of elements related to project or programme eligibility and selection criteria
	Investment criteria indicators
	Identification of results areas where targeted investment would have the most impact

<i>To be presented at subsequent Board meetings</i>	Update to results management framework and performance measurement framework
	Definition and scope of second level due diligence
	Programmatic approach to funding proposals
	Guidance on approach and scope for providing support to adaptation activities

*Abbreviations:* B.20 = twentieth meeting of the Board, B.21 = twenty-first meeting of the Board, B.22 = twenty-second meeting of the Board, B.23 = twenty-third meeting of the Board.

## **II. Guidelines for the development of policies**

4. In developing the papers within this integrated policy approach, the Secretariat intends to observe the following guidelines:
- (a) All policies requiring modification of the funding proposal template should ensure that the changes to the template occur only once per year at most in order to minimize confusion among the national designated authorities (NDAs) and accredited entities (AEs);
  - (b) Consolidated guidance materials will be developed to minimize confusion among GCF stakeholders and ensure ease of use and application by NDAs and AEs; and
  - (c) Consolidated capacity-building activities will be undertaken to support the implementation of policies in an integrated fashion for greater efficiency.

## **III. Tools for implementation**

5. Implementation tools are required in support of the strategic frameworks and operational policies to be adopted by the Board. These tools will feed into strengthening the climate rationale by providing consistency in assessing projects and programmes. They will also inform guidance that should be provided to AEs, NDAs and other GCF stakeholders.
6. Tools are firstly developed and used by the Secretariat, in discussion with AEs, NDAs and other experts. Based on this, improvements are then proposed. The tools will be applied by the Secretariat to the extent possible to a sample of the GCF portfolio of approved projects, and observations will be used by the Secretariat to frame the relevant policy documents.