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FUND

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Review of the financial terms and conditions of the Green Climate Fund financial instruments

Summary

This document provides a report on the review of the financial terms and conditions of the GCF financial instruments in accordance with decision B.09/04, in which the Board decided to review the financial terms and conditions of the GCF financial instruments on an annual basis, and decision B.15/05, wherein the Board adopted the terms of reference for the review. The review was led by the Investment Committee with the support of the Secretariat and an external consultancy firm.

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I. Introduction

1. The Board, in decision B.09/04 (see annexes II and III to this document), adopted the financial terms and conditions for the financial instruments of GCF. Through decision B.09/04, the Board also decided that the financial terms and conditions should be reviewed on an annual basis.

2. In decision B.12/15, the Board requested the Investment Committee to provide the draft terms of reference for the annual review of the financial terms and conditions for consideration by the Board at its fifteenth meeting. The terms of reference (TOR) for the review of the financial terms and conditions of the GCF financial instruments, contained in annex IV to this document, were adopted by the Board in decision B.15/05. The TOR does not address additional reviews for which the investment committee has proposed a revised TOR, which can be found in annex V.

3. In decision B.17/08, the Board decided that, pending the conclusion of the review of the financial terms and conditions, the financial terms and conditions set out in annex III to decision B.09/04 should be applied in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.

II. Scope and objective

4. The terms of reference for the review of the financial terms and conditions of the GCF financial instruments, as adopted by the Board in decision B.15/05 (see annex IV for the full terms of reference), specified the scope of the review, as follows:

(a) The scope of the review will include an internal component, which takes stock of the projects and programmes approved by the Board and the GCF policies related to financial terms and conditions, and an external component, which takes stock of the practices with respect to the terms and conditions of financial instruments used by other organizations with policy mandates related to those of GCF; and

(b) The review will take stock of the projects and programmes approved by the Board, including those that may be approved at its fifteenth meeting, and analyse to what extent the principles of decisions B.05/07 and B.07/06 have been followed in the assessment of the adequacy of the selected financial instruments. Such a review will take into account all the financial terms and conditions (interest rate, commitment fee, service fee, other fees if applicable, tenor and grace period of the financial instrument). The review will also take into account whether the project/programme is public or private, the theme (mitigation, adaptation or cross-cutting) and total project/programme size category (micro, small, medium or large).

III. Linkages with other documents

5. The following documents are also relevant to the financial terms and conditions of the GCF financial instruments:

(a) "Business Model Framework: Terms and Criteria for Grants and Concessional Loans" (document GCF/B.05/07);

(b) "Investment Framework" (document GCF/B.07/06);

(c) "Level of Concessional Terms for the Public Sector" (document GCF/B.10/06);

(d) "Concessionality: potential approaches for further guidance" (GCF/B.19/12/Rev.01); and

(e) “Risk Management Framework” (document GCF/B.19/19).

IV. General principles applied to the financial terms and conditions of the GCF financial instruments

6. By decision B.05/07, the Board adopted the following principles and factors for determining the terms and conditions of the GCF financial instruments for both public and private sector operations:

(a) Guiding principles applicable to public and private sector operations:

  (i) Grant elements should be tailored to incremental cost or the risk premium required to make the investment viable, or to cover specific activities such as technical assistance;

  (ii) Seeking the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment;

  (iii) Levels of indebtedness capacity of the recipient should be taken into account so as not to encourage excessive indebtedness;

  (iv) Structure terms on a case-by-case basis to address specific barriers;

  (v) Avoid crowding out commercial financing;

  (vi) Leveraging of other financing, including public and private financing, seeking to maximize leverage in the case of private financing;

  (vii) Promote long-term financial sustainability; and

  (viii) Apply due diligence to assess the risk to the investment;

(b) When determining terms of financial instruments applicable to both public and private operations, the following factors will need to be taken into account:

  (i) The average concessionality or grant element of the financial inputs to the Fund and the average concessionality or grant element of financial instruments of the Fund;

  (ii) The grant element of concessional finance will be tailored to provide the appropriate incentive to facilitate the implementation of mitigation and adaptation activities;

  (iii) Concessional forms of finance will be designed to minimize market distortions and potential disincentives to private investment;

  (iv) The expertise and capacity of financial intermediaries and implementing entities; and

  (v) The risk sharing between public and private investment, when relevant.

V. Review findings and recommendations

7. Based on the terms of reference adopted by the Board in decision B.15/05, a consulting firm (Nodalis Conseil) was engaged to support the work of review. The executive summary of the review from the consultant is attached as annex VI. The scope of the review covered funding proposals approved by the Board up to and including the seventeenth meeting of the Board. The key findings of the review are provided below:

8. For public sector projects:

(a) The portfolio-level review demonstrated that Board guidelines have broadly been met in terms of adaptation allocation for vulnerable countries, geographical balance and engagement with the private sector;

(b) While a larger share of nominal GCF resources went to private funding proposals, in grant-equivalent terms a larger share went to the public sector proposals;

(c) Board decisions do not provide guidance to accredited entities (AEs) preparing funding proposals, neither on how to choose between grants and concessional loans, nor on how to choose between the two types of concessional loans; and

(d) Due to a lack of quantitative analysis for the selection of a specific level of concessionality, the lack of a clear rationale for the GCF-level of concessionality requested, and the rare use of arguments related to the level of indebtedness of the recipients, the project-level analyses indicate potential issues with Board-approved guidelines ("principles") on the choice of instrument and on instrument terms and conditions.

9. For private sector projects:

(a) The review did not identify issues of non-compliance with Board-approved guidelines on the choice of instrument and on instrument terms and conditions; and

(b) Risks stemming from the lack of mechanisms to ensure that GCF concessionality is effectively transferred down to the intended beneficiaries.

10. Practices at other institutions:

(a) Most development financing institutions rely solely or at least partly on country-based criteria, such as the level of indebtedness or the gross domestic product of the recipient countries to determine the types of instruments that can be extended, and the terms and conditions of their instruments or a mixed approach combining country and other criteria;

(b) Financial institutions such as the Global Environment Facility (GEF) and the Clean Technology Fund (CTF) adopt a project-specific barrier-based approach;

(c) GCF, GEF and CTF loans are similar for the highest level of concessionality, but the low level of concessionality of GCF loans is slightly lower than the International Development Association standard conditions for blend countries, and lower than the low level of concessionality of other institutions;

(d) Several private sector-focused development finance institutions determine financial terms and conditions and concessionality in a similar fashion on a case-by-case basis, following an analysis of the barriers preventing private investment in the project with margin spreads, which are usually based on internal ratings that include a country risk and a project risk element; and

(e) The International Finance Corporation has instituted since 2012 an independent Blended Finance Committee to review projects that request the use of concessional instruments.

11. The Secretariat notes that the following main recommendations arising from the review have already been implemented/are under implementation:

(a) Development of a grant equivalent calculator with a clear methodology to measure the level of concessionality needed;

(b) Adoption of a uniform approach to measuring concessionality that would also allow for better comparability between private and public sector projects;

(c) Clearer differentiation of policies and guidelines to enhance the readability of policies and guidelines for AEs;

(d) Provision of more guidance by GCF to AEs to enhance process predictability for all types of projects;

(e) Adjustment of the proposal review process, including the timing of intervention by the independent Technical Advisory Panel, so that basic design issues can be raised and resolved earlier;

(f) Implementation of a phased approach for large one-off proposals of a programmatic nature; and

(g) Continuation of the determination of the financial terms and conditions of private sector projects on a case-by-case basis.

12. In addition, based on the review, the Secretariat considers that the following recommendations require further consideration:

(a) Definition and communication of a set of criteria to assist AEs in choosing the level of concessionality granted to a project or programme proposal; and

(b) Differentiation of the level of scrutiny required on concessionality between pilots, scale-up and one-off funding proposals.

VI. Conclusion

13. The Secretariat will continue to review the financial terms and conditions of the GCF financial instruments as set out in annex II to decision B.09/04 based on the terms of reference to be agreed with the Investment Committee.

14. In addition, the Investment Committee proposes that the Board adopt the revised TOR for the review of the financial terms and conditions of the Green Climate Fund financial instruments as set out in annex V.

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.21/05 titled "Review of the financial terms and conditions of the Green Climate Fund financial instruments":

(a) *Takes note* of the review of the financial terms and conditions of the Green Climate Fund financial instruments led by the Investment Committee;

(b) *Requests* the Secretariat to conduct biennial reviews of the financial terms and conditions of the Green Climate Fund financial instruments as set out in annex II to decision B.09/04 and based on the approved revised terms of reference, and to report biennially the outcome of such review to the Board;

(c) *Approves* the revised terms of reference for the review as set out in annex V; and

(d) *Decides* that Board approval for subsequent changes to the revised terms of reference for the review of the financial terms and conditions of the Green Climate Fund financial instruments will only be necessary in case such changes are considered material by the Secretariat and the Investment Committee.

Annex II: Financial terms and conditions of the GCF instruments (decision B.09/04)

1. As background information, decision B.09/04 is provided here for reference:

DECISION B.09/04

The Board, having reviewed document GCF/B.09/08 Financial Terms and Conditions of the Fund's Instruments:

(a) Notes that the Fund will provide grants both with and without repayment contingency;

(b) Adopts the financial terms and conditions of grants and concessional loans as contained in Annex II to this document;

(c) Decides that use of grants with repayment contingency shall be limited to the private sector and that their terms and conditions shall be determined on a case-by-case basis;

(d) Also decides that the Fund will use differentiated terms for outgoing concessional loans to the public sector following the principles and factors set out in Annex III to decision B.05/07;

(e) Further decides the financial terms and conditions for non-grant instruments to the public sector, other than concessional loans, will be established on a case-by-case basis;

(f) Decides that all non-grant instruments extended to the private sector shall be determined on a case-by-case basis, taking into consideration Annex III to decision B.05/07 and section III in Annex XIV to decision B.07/06;

(g) Notes the need for the Fund, when making funding decisions, to consider the terms and conditions of the proposed financial instruments by the Accredited Entity to the recipient, as well as the financial terms and conditions of the financial instruments being requested from the Fund;

(h) Decides to review the financial terms and conditions of the Fund's instruments on an annual basis;

(i) Requests the Secretariat to prepare and submit for the Board's consideration at its tenth meeting a brief guideline on the application of the case-by-case provisions in the financial terms and conditions of the Fund's instruments; and

(j) Decides to consider at the tenth meeting of the Board a proposal regarding the cases in which the high level concessional terms and the low level concessional terms in Annex II, table 2, for public sector proposal will apply.

Annex III: Financial terms and conditions of grants and concessional loans

1. The GCF financial terms and conditions of grants and concessional loans are outlined in tables 1 and 2 below.

Table 1: Terms and conditions of grants

	Currency	Interest rate	Maturity	Grace period
Grants	Major convertible currency	Grants without repayment contingency: no reimbursement required[1] Grants with repayment contingency: terms adapted to the required concessionality of the project or programme		

Table 2: Terms and conditions of outgoing concessional loans to the public sector

	Currency	Maturity (years)	Grace period (years)	Annual principal repayment years 11–20/6–20 (% of initial principal)	Annual principal repayment years 21–40 (% of initial principal)	Interest	Service fee (per annum)	Commitment fee (per annum)
High concessionality	Major convertible currency	40	10	2%	4%	0.00%	0.25%	Up to 0.50%
Low concessionality	Major convertible currency	20	5	6.7%	Not applicable	0.75%	0.50%	Up to 0.75%

[1] All grants will be subject to an obligation for repayment if the recipient is found to be in a material breach of its contractual obligations towards the GCF or involved in a material violation of the GCF integrity or fiduciary standards, including those on corruption or fraud.

Annex IV: Terms of reference for the review of the financial terms and conditions of the GCF financial instruments

I. Scope of the review

1. The scope of the review will include an internal component, which takes stock of the projects and programmes approved by the Board and the GCF policies related to financial terms and conditions, and an external component, which takes stock of the practices with respect to the terms and conditions of financial instruments used by other organizations with policy mandates related to those of GCF.

2. The review will take stock of the projects and programmes approved by the Board, including those that may be approved at its fifteenth meeting, and analyse to what extent the principles of decisions B.05/07 and B.07/06 have been followed in the assessment of the adequacy of the selected financial instruments. Such a review will take into account all the financial terms and conditions (interest rate, commitment fee, service fee, other fees if applicable, tenor and grace period of the financial instrument). The review will also take into account whether the project/programme is public or private, the theme (mitigation, adaptation or cross-cutting) and total project/programme size category (micro, small, medium or large).

II. Methodology

3. Specifically, the review will:

(a) For all financial instruments, assess whether existing Board guidance has been correctly applied, including that contained in decisions B.09/04, B.05/07 and B.07/06, and make recommendations, if any, to enhance the application of this guidance. In particular, the assessment should take into account the need to tailor the level of concessionality to the overall impact of investment, consistent with decision B.05/07;

(b) For financial instruments extended to the public sector, review the application of the criteria used to assess the appropriateness of the financial instrument (grant, high concessional loan, low concessional loan) provided;

(c) For financial instruments extended to the private sector, identify emerging patterns and other issues which could lead to additional guidance on the parameters to be used for assessing private sector projects/programmes, including sector, geography and other characteristics of the project;

(d) For all projects/programmes with non-grant co-financing, compare financial terms and conditions approved by the Board compared with the financial terms approved by other project/programme co-financiers (where this information is available);

(e) Assess the impact that the conditions and covenants included in the approval of a project/programme has on the overall costs to the accredited entity (AE) and the executing entity. This assessment should include an assessment of the viability and ease of implementation of these conditions and covenants and their potential impact on enhancing the effectiveness of the project/programme;

(f) Assess the appropriateness of the AE fees for approved private sector projects and provide additional guidance on how to provide further clarity to AEs when preparing subsequent projects;

(g) Assess the approach taken to measure the grant equivalence of each project/programme and proposed enhancements to the methodology;

(h) Assess that the terms and conditions are being applied in a way that provides appropriate incentives to carry out mitigation and adaptation activities while avoiding market distortions and the displacement of other sources of financing, including crowding out the private sector; and

(i) Assess how the concessionality provided to the AE by the GCF in approved funding proposals is passed on to the recipients of the project/programme, provided that sufficient data are available.

4. Additionally, the review may be extended to assess the conditions and covenants applied to the project/programme with a view to gaining knowledge of their potential impact during implementation and ensuring that such conditions/covenants contribute to enhancing project/programme effectiveness without putting undue hindrance on recipients.

5. The review will also take stock of practices with respect to the terms and conditions of financial instruments used by other organizations with policy mandates related to those of the GCF. Emphasis will be placed on any changes that may have taken place since October 2014, when the Secretariat provided the Board with a review of practices of other organizations providing concessional loans.[1] Institutions will include: the International Development Association, the Clean Technology Fund, the International Finance Corporation, the Global Environment Facility and large foundations providing both grant and non-grant financial instruments, such as the Bill & Melinda Gates Foundation.

6. Additionally, particularly with respect to financial instruments provided to the private sector, the review will incorporate the practices of other institutions active in the area of climate financing, including at least one international financial institution, one national development bank, one fully private sector organization focused on climate-related investments in emerging markets and one foundation or non-governmental organization.

III. Deliverables

7. The output of the review will be a report to the Board based on the assessment of the elements defined in chapter I above. The review may propose additions or adjustments to the adopted financial terms and conditions for the Board's consideration, consistent with GCF policies.

8. The first review is expected to generate lessons learned, not only related to the GCF financial terms and conditions, but also for conducting the review itself going forward. As the review is to be done annually, the review report may also propose adjustments to the scope of future reviews for the Investment Committee's consideration. The Investment Committee may then wish to modify these terms of reference for Board consideration.

IV. Reporting arrangements

9. The external consultants supporting the review will report to the Secretariat, who will in turn report to the Investment Committee.

[1] Please refer to document GCF/B.08/11 titled "Financial terms and conditions of grants and concessional loans".

Annex V: Revised terms of reference for the review of the financial terms and conditions of the GCF financial instruments

I. Purpose of the review

1. The review will:

(a) Assess the degree to which there has been compliance with existing policies on financial terms and conditions in GCF operations;

(b) Assess whether existing GCF policies related to financial terms and conditions are fit for purpose; and

(c) Propose additions or adjustments on how policies related to financial terms and conditions could be improved.

II. Scope of the review

2. The scope of the review will include an internal component, which considers the current financial terms and conditions as they relate to the projects and programmes approved by the Board and an external component that reviews the current practices with respect to the terms and conditions of financial instruments used by other organizations with policy mandates related to those of GCF, covering different national circumstances in developing countries.

3. The review will focus on projects and programmes approved by the Board since the last review, which was for projects approved up to and including the seventeenth meeting of the Board. Such a review will take into account all the financial terms and conditions i.e. interest rate, commitment fee, service fee, other fees if applicable, tenor and grace period of the financial instrument and where relevant recommend appropriate changes for the consideration of the Board. The review will also take into account whether the project/programme is public or private, the theme (mitigation, adaptation or cross-cutting) and total project/programme size category (micro, small, medium or large) and recipient's different national circumstances.

III. Methodology

4. Specifically, the review will:

(a) For all financial instruments, assess whether the existing Board policies related to financial terms and conditions have been correctly applied;

(b) For financial instruments extended to the public sector, review the financial terms and conditions i.e. grant elements, interest rate, commitment fee, service fee, other fees if applicable, tenor and grace period of the financial instrument;

(c) For financial instruments extended to the private sector, review the financial terms and conditions i.e. interest rate, commitment fee, service fee, other fees if applicable, tenor and grace period of the financial instrument and identify emerging patterns and other issues which could lead to additional guidance on the parameters to be used for assessing private sector projects/programmes, including sector, geography, capacity of the recipient and other characteristics of the project and other characteristics of the project; and

(d) For all projects/programmes with non-grant co-financing aspects, compare the financial terms and conditions approved by the Board against the financial terms

approved by other co-financiers with policy mandates related to those of GCF (where this information is available).

5. The review will assess the degree to which Board policies provide clear guidance on the financial terms and conditions that should apply to each project as well as analyse how existing Board policies were applied to each funding proposal approved since the last review and make recommendations for improvement.

6. The review will also assess how accredited entities and the Secretariat assesses concessionality needed for each funding proposal in relation to the Governing Instrument for the GCF and relevant GCF policies. This will include assessment of the use of different financial instruments (i.e. grant, loan, guarantee and equity) and their terms and conditions to make sure that the GCF contribution is incentivizing mitigation and adaptation action while avoiding market distortion and crowding out/displacing other sources of finance.

7. The review will also take stock of practices with respect to the terms and conditions of financial instruments used by other organizations with policy mandates related to those of the GCF. Emphasis will be placed on any changes that may have taken place since the conclusion of the previous review, which was H2 2017.

8. [1] Institutions will include: the International Development Association, the Clean Technology Fund, the International Finance Corporation, the Global Environment Facility and large foundations providing both grant and non-grant financial instruments.

9. Additionally, particularly with respect to financial instruments provided to the private sector, the review will incorporate the practices of other institutions active in the area of climate financing, including at least one international financial institution, one national development bank, one fully private sector organization focused on climate-related investments in emerging markets and one foundation or non-governmental organization.

IV. Deliverables

10. The output of the review will include a presentation to the Investment Committee and a report to the Board which incorporates input/feedback from the Investment Committee. The review may propose additions or adjustments to the adopted financial terms and conditions for the Board's consideration, consistent with GCF policies.

11. This review is also expected to generate lessons learned, not only related to the GCF financial terms and conditions but also for conducting the review itself going forward. As the review is to be biennially, the review report may also propose adjustments to the scope of future reviews for the Investment Committee's consideration. The Investment Committee may then wish to modify these terms of reference for Board consideration.

12. The output of the review will also include an examination of the service fee and commitment fee, and its relationship with the Governing Instrument and relevant GCF policies.

V. Reporting arrangements

13. The external consultants supporting the review will report to the Secretariat, who will in turn report to the Investment Committee.

[1] Please refer to document GCF/B.21/05 titled "Review of the financial terms and conditions of the Green Climate Fund financial instruments".

Annex VI: The executive summary of report on the review of the financial terms and conditions of the GCF's financial instrument

Review of the financial terms and conditions of the GCF's financial instruments

Final Report – Executive summary

Nodalis
CONSEIL

Contributors	BG, FB, BC, AB
Validation	FB
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ACRONYMS AND ABBREVIATIONS

AE	Accredited Entity
AFD	French Development Agency (Agence française de développement)
AMA	Accreditation Master Agreement
CTF	Clean Technology Fund
DFI	Development Finance Institution
EE	Energy efficiency
EIB	European Investment Bank
FAA	Funded Activity Agreement
FFEM	French Global Environment Fund (Fonds français pour l'environnement mondial)
FP	Funding Proposal
GCF	Green Climate Fund
GEF	Global Environment Fund
ITAP	Independent Technical Advisory Panel
MDB	Multilateral Development Bank
NDA	National Designated Authority
PM	Project Manager
PMC	Project Management Costs
RE	Renewable energy
T&Cs	Terms and Conditions

A. METHODOLOGY

Objectives and overall methodology

The objective of this review, as set in its terms of reference, is:

- To evaluate the compliance with the GCF's policies of the terms and conditions of the financial instruments extended in the framework of projects and programmes approved by the Board;

- To propose for the Board's consideration additions or adjustments to the adopted financial terms and conditions which should be consistent with GCF's policies.

GCF key principles on concessionality and additionality are to tailor grant elements to incremental costs or to the risk premium required to make the investment viable, and to seek the right level of concessionality, so as not to displace investments that would otherwise have occurred.

However, there is no way to determine with certainty whether the two principles above are met on any given project, because the exact counterfactual (what would have occurred without the GCF participation) does not exist[4].

Absent the possibility of simple, clear-cut determination, our approach combined:

- **Basic compliance**: assess the compliance of approved projects and programmes to the principles and criteria outlined in the GCF policies from an analysis of basic data on all projects;

- **Pattern analysis**: identify meaningful patterns in the data on all projects and programmes approved by the Board, which may evidence issues not visible at the individual project or programme level;

- **Case studies**: more detailed reviews for a sample of projects[5] through interviews that provide for an understanding of the underlying context of each selected project;

- **Process review**: through case studies and interviews with AE and GCF staff, identify whether the processes implemented to decide on terms and conditions (T&Cs) were adequate to lead to compliance with Board policy.

We also carried out a benchmark of policies and practices in other organizations with similar policy mandates.

Through these tools, the review provides for project- and portfolio-level analyses with the purpose of formulating recommendations to the Board and the Secretariat both in terms of how to better enforce Board guidance, and how to adjust Board guidance,

[4] See for instance Paddy Carter, Overseas Development Institute / OECD, 2017, "Wanted: mechanism for additionality", https://oecd-development-matters.org/2017/05/10/wanted-mechanism-for-additionality/
[5] FPs 017, 021, 029, 033, 038, 039, 043, 044, representing a mix of adaptation/mitigation, private/public-sector, instruments and type of AEs.

towards better achieving GCF's core objectives.

Measuring concessionality

To perform an analysis of the GCF portfolio in terms of financial T&Cs, and more specifically in terms of the level of concessionality of the instruments extended to projects and programmes approved by the Board, we must provide for quantitative definitions of a few concepts:

- The **grant element** of a loan is defined by the World Bank as "the difference between the loan's nominal value (face value) and the sum of the discounted future debt-service payments to be made by the borrower (present value)" [6]. The International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) use the same definition.

- The **level of concessionality** for a given instrument is defined in this report as the ratio of its grant element to its face value.

We think that the key points to consider for establishing **a grant-element calculator** are the following:

- **It must be adapted to its purpose**: a grant-element calculator can be used for a general portfolio analysis, as is the case in this review, or to inform the decision-making process on a specific project. Although both purposes can be useful for the GCF, we see these two purposes as contradictory since comparing and analysing the levels of concessionality of different types of instruments if those levels are calculated with different methodologies could lead to misinterpretations of the results obtained.

- **It must be adapted to its users**: we find crucial to design a transparent and user-friendly calculation method, so that all accredited entities share the same understanding of how the GCF approaches concessionality.

- **It must be consistent with data quality**: drawing on this last point, the other shortcoming of a sophisticated methodology is that it can give the illusion that the results obtained are precise, regardless of data quality. The data available in many emerging markets is most often, if existent at all, very inconsistent and unreliable. The sophistication of the calculator must be coherent with the quality and relevance of the available data.

[6] IDA website: http://ida.worldbank.org/financing/grant-element-calculations.

– **It must not reverse the GCF's mandates**: the GCF is not a financial investor seeking to maximise its return. Its primary objective is to tackle the causes and effects of climate change in beneficiary countries. Using concessional funds as efficiently as possible to complement markets is only a secondary requirement to this primary objective. Using sophisticated market comparators could lead to restricting the use of instruments necessary to correct market failures, such as equity and guarantees, as concessionality, and thus discriminate against these riskier products. This could be highly counterproductive: acknowledging that many barriers come from market failures implies that the GCF, to address such barriers, is in fact taking less risk than the non-loan instrument suggests, and therefore that the market comparator is biased against GCF primary objectives.

Since this review aims at comparing all financial instruments approved by the GCF Board, we have decided to adopt the World Bank's approach and have used a flat discount rate of 5%. This approach is consistent with previous calculations undertaken by the GCF.

B. KEY FINDINGS

At portfolio level

The GCF Board has approved 55 financial instruments corresponding to 43 projects and programmes until its 17th meeting. While a larger share of nominal GCF resources went to private funding proposals (53%), the grant-equivalent amount of GCF public funding accounted for 79% of the total grant-equivalent amount of GCF funding.

Table 1: Overview of GCF portfolio

Private sector	Number of instruments	Face value of GCF instruments	
Grants	7	$ 82,359,334	7%
Loans	5	$ 692,840,666	58%
Equity	5	$ 397,222,000	33%
Guarantee	1	$ 20,000,000	2%
TOTAL	**18**	**$ 1,192,422,000**	

This is mainly because the level of concessionality of financial instruments extended to the private sector is much lower (22% on average) than the level of concessionality for the public sector (93%), as illustrated in Table 2. This very high concessionality stems from the nature of financial instruments, since 83% of instruments provided for public-sector projects were grants.

Table 2: Overview of GCF concessionality[7]

Private sector	Vulnerable	Other	All countries
Adaptation	N/A	N/A	N/A
Cross-cutting	35%	0%	28%
Mitigation	5%	23%	21%
All projects	15%	23%	22%

Public sector	Vulnerable	Other	All countries
Adaptation	98%	100%	99%
Cross-cutting	100%	100%	100%
Mitigation	71%	90%	78%
All projects	89%	97%	93%

The portfolio-level review further shows that Board guidelines have broadly been met in terms of adaptation allocation for vulnerable countries, geographical balance and engagement with the private sector (see Table 3).

The portfolio target relating to the balance between mitigation and adaptation activities has been roughly met if it is assessed in terms of grant elements (respectively 39% and 58%), but not in terms of nominal resources (respectively 64% and 32%).

[7] The list of vulnerable countries used is the consolidated list of Least Developed Countries, Small Island Developing States and Low-Income Economies presented in Annex II to document GCF/B.10/06

Table 3: Evaluation of achievement of portfolio targets

Initial allocation parameter	Initial portfolio targets	Evaluation
Balance between mitigation and adaptation	50/50 (over time)	This target can be evaluated in three different manners. See below for more details.
Adaptation allocation for vulnerable countries	Floor of fifty per cent of adaptation allocation	56% of the adaptation allocation went to vulnerable countries.
Geographic balance	Reasonable and fair allocation across a broad range of countries	The issue is not in the scope of our review but we did not see any systematic bias against countries or regions.
Engagement with the private sector	Maximize fund-wide engagement with the private sector, through significant allocation to the PSF	Private sector projects and programmes have received 53% of the GCF resources and 21% of their concessionality
Readiness and preparatory support	Sufficient support for readiness and preparatory activities	This target is not in the scope of our review and has not been evaluated

Since mitigation normally benefits from lower concessionality, it would be useful for the Board to clarify whether a nominal or a grant-equivalent balance should be targeted.

At project level – Public sector

Our analysis shows that among public-sector projects, the projects who had at least one loan in their financing structure (extended either by the GCF or by another co-financier) had a higher concessionality leverage ratio. As illustrated in Figure 1, the mean value of the concessionality leverage ratio is equal to 1.54 for all public-sector projects while it reaches an average 3.81 for projects with at least one loan.

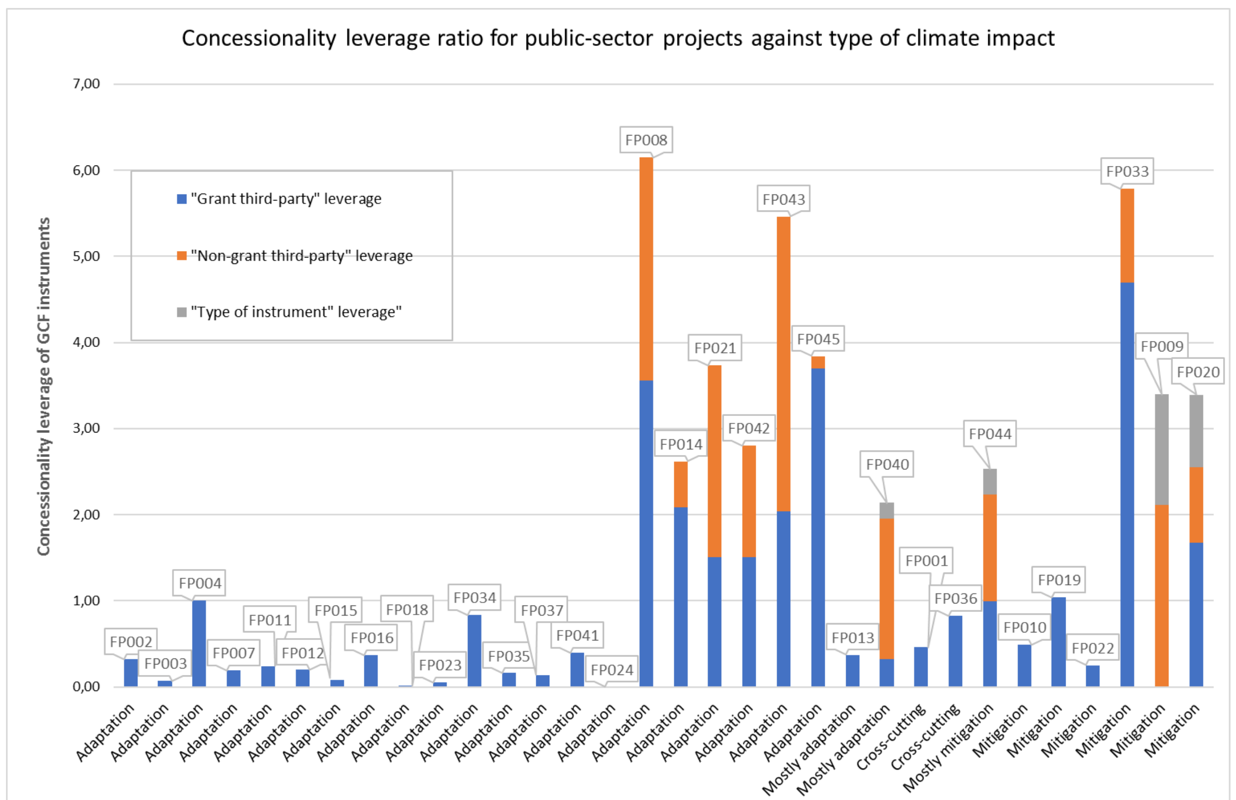

Figure 1: Concessionality leverage ratio for public-sector projects

This analysis also evidences a lack of connection between, on one side, concessionality, leverage and the choice of instrument, and on the other side, the six investment criteria defined by the Board in decision B.05/07. We notably identified that there is no significant correlation between the rating obtained with the ITAP assessment and the level of concessionality, or the share of the budget which was financed by the GCF.

There is a similar lack of connection between on one side concessionality and the choice of instrument, and on the other side, country income or debt-distress status, which is illustrated in Figure 2. The aggregate indicator used in the analysis shown in this figure is the sum of two components:

- A **country indicator** with rating from 0 to 5, for which the country category (vulnerable or not) accounts for 2 points and the country status (UMI, LMI, LI, LI/YL, LI/RL) accounts for 3 points.
- A **project indicator** with rating from 0 to 5, for which the project theme (adaptation, cross cutting or mitigation) accounts for 2 points, the type of financial participation (fund, project finance, revenue generating public-project or non-revenue generating public project) accounts for 2 points and the scale of the project (pilot, one-off or scale-up) for 1 point.

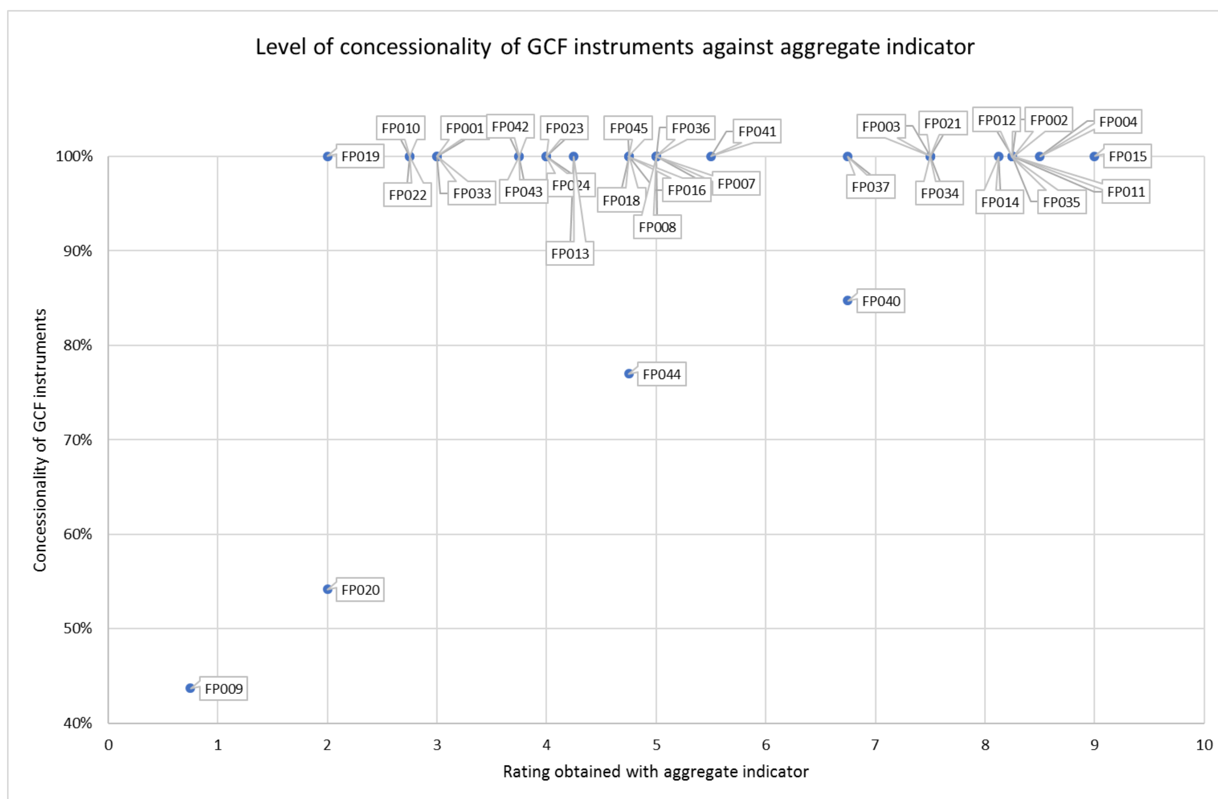

Figure 2: Relation between concessionality and aggregate indicator

Moreover, we cannot conclude about the relationship between approved terms and conditions for GCF funding, and efficiency in terms of expected results, because the magnitude of variations in any measure of funds efficiency first points to the need for methodological guidance in how key indicators are calculated (such as the carbon impact).

Project-level analyses thus point to potential issues regarding the compliance with Board-approved guidelines on the choice of instrument and on instrument terms and conditions: these are summarised in Table 4.

Table 4: Compliance with decision B.05/07

<table>
<tr><th>Principle</th><th>Compliance evaluation</th></tr>
<tr><td>Grant elements should be tailored to incremental cost or the risk premium required to make the investment viable, or to cover specific activities such as technical assistance</td><td rowspan="2">In many cases, there was no quantitative analysis for the selection of a specific level of concessionality.

For revenue-generating activities, funding proposals included a financial model [8] and used economic arguments (such as tariffs) to justify the overall level of concessionality.

But in many cases, there was no clear rationale</td></tr>
<tr><td>Seeking the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment</td></tr>
</table>

[8] Those models were not reviewed by the Consultant.

	behind the GCF level of concessionality requested.
Levels of indebtedness capacity of the recipient should be taken into account so as not to encourage excessive indebtedness	Arguments related to the level of indebtedness of the recipients were seldom considered in funding proposals.
Avoid crowding out commercial financing	All public revenue-generating projects appear to have negative financial returns, and therefore would not sustain commercial financing.
Leveraging of other financing, including public and private financing, seeking to maximise leverage in the case of private financing	Concessional loans achieved a concessionality leverage ratio between 2.14 and 3.40, but few concessional loans were extended.
Promote long-term financial sustainability	The AEs presented clear exit strategies in their funding proposals.

At project level – Private sector

Since the GCF policy relies on a case-by-case approach for private-sector projects, and since the principles of concessionality and additionality are more critical for private projects, our assessment of the level of concessionality and the additionality of the GCF participation has been grounded on a more detailed and qualitative analysis of those projects.

In a nutshell, project-level analyses did not identify issues of non-compliance with Board-approved guidelines on the choice of instrument and on instrument terms and conditions.

However, we believe that a small number of programmatic private sector mitigation projects could be at risk of running askance of Board guidelines in the course of their implementation, depending on how term sheet commitments are interpreted, effectively applied, and monitored. This issue does not appear in projects that use GCF funds for de-risking, but only concerns line-of-credit projects where concessionality is used to lower RE or EE projects' financing costs and where we see risks stemming from the lack of mechanisms to ensure that GCF concessionality is effectively transferred down. This is addressed in the recommendations below.

We also performed the same kind of quantitative analysis as for public-sector projects to determine whether general trends could be found in the current GCF portfolio of private-sector projects. Figure 3 shows that there is no clear relation between concessionality and the quality of the FPs as reviewed by the ITAP, although the average rating of private-sector FPs is superior to the average rating of public-sector FPs.

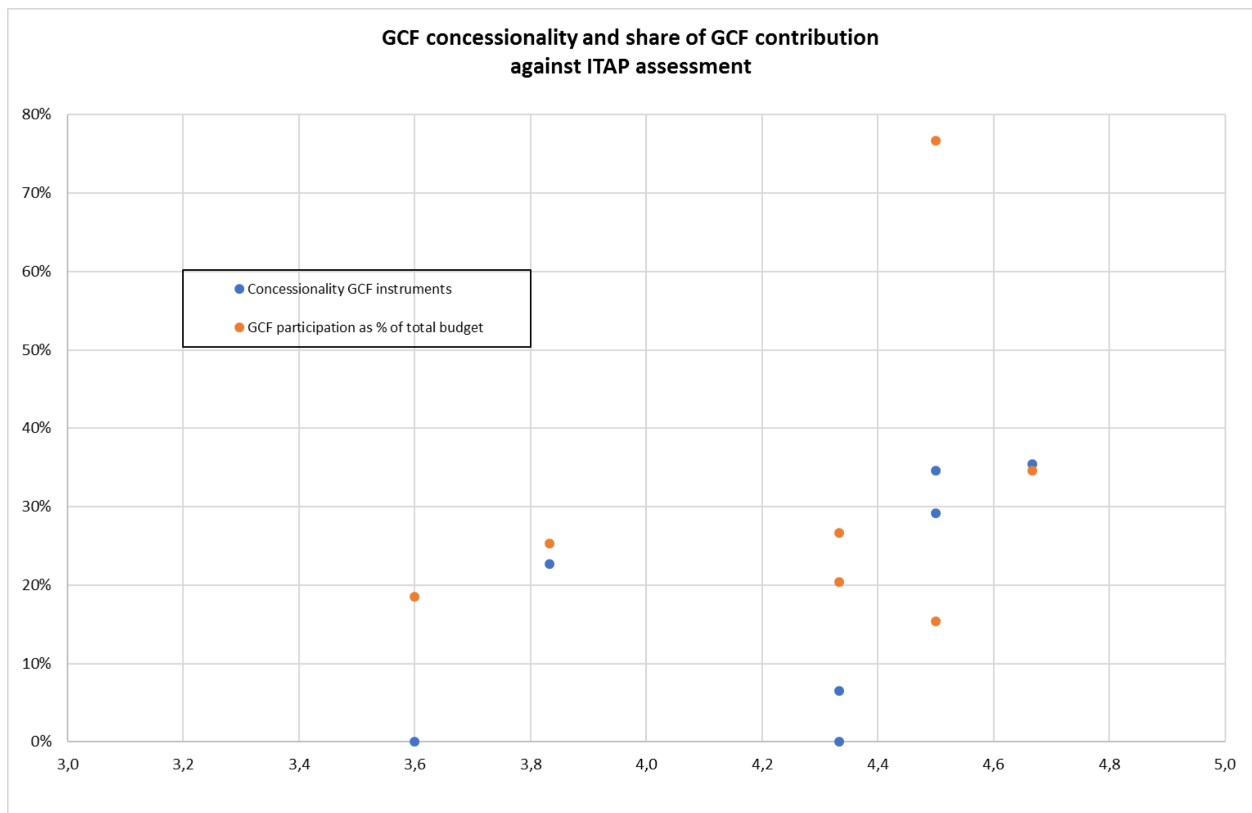

Figure 3: Relation between concessionality and ITAP assessment

Case studies

In terms of process, the main findings from our case studies are the following:

- AE's organization to work with the GCF: all but one of the interviewed AEs have a dedicated unit or at least dedicated staff that manages the use of climate funds, including the GCF, in AE operations.
- Relative timing of the GCF's and AE's approval processes: the time required from the idea to ask for GCF resources to GCF Board approval varied greatly between reviewed projects – from as short as six weeks to as long as two years. AEs that did not experience timing issues were those who took the opportunity of a GCF Request for Proposals. This appears mostly due to GCF staff ramp-up issues, which several Project Managers (PMs) found resolved in more recent interactions with the Secretariat, and due to the time needed to negotiate AMAs before FAAs could be finalized.
- Secretariat and ITAP FP development and review processes: AEs who benefited from early extensive involvement of the Secretariat viewed that experience as rather positive, whereas the ITAP review process raised more criticism (lack of local knowledge for example). Even when the ITAP review was found to have gone well, no interviewed PM found that it added much value to the FP's design, and many noted that this review was coming too late in the GCF project cycle.

Conditions and covenants set by the Board

The latter observation should be linked to the impact of conditions precedent and covenants introduced by the Board in its decisions, which we were asked to review as a part of financial terms and conditions.

In most cases, Board-required conditions precedent or covenants did not create difficulties nor imposed additional costs on the AE, but a high number of projects that we selected for case studies had one specific condition or covenant that was found to be particularly onerous:

- The requirement on tariff-setting in FP043;
- The condition precedent on financing house connections in FP021;
- The change in instrument pricing (half of the loan amount switched to low-concessionality instead of high-concessionality) in FP044.

Further, only the latter of these three concerns the use of GCF funds for climate objectives; the first two are design issues for which due diligence falls within the normal preparation work of the AE.

Project managers did not expect such fundamental issues to be raised so late in the preparation process. Even where they understood the GCF's Board rationale, they felt that a better solution could have been found to address the GCF's concerns, had the issues been raised earlier.

We also conducted a qualitative review of Board-imposed conditions precedent (CPs) or covenants for projects which were not selected as case studies. A detailed assessment would require more numerous in-depth analysis and interviews with AEs, however we could broadly observe several types of CPs and covenants:

- *Standard fiduciary, environmental and social safeguards, or legal conditions*: they constitute most of Board conditions and do not diverge from normal conditions imposed by other DFIs.
- *"Readiness" provisions*: a number of conditions consisted in requiring the AE to complete or provide evidence of elements that would normally be present in a final Board package. From a pure qualitative review, it seems that these "readiness" conditions are more frequent in the first half of FPs submitted to the GCF Board, which might indicate that they stemmed more from AE's learning curve.
- *"Design" provisions*: a small number of conditions deal with pure project design issues, like the two conditions described above for FP021 and FP043. Without judging the relevance of these requirements, we believe such critical design conditions should be raised earlier in the GCF review process
- *"Concessionality" provisions*: FP028 and FP030 (both private-sector) require commitment and demonstration that GCF-provided concessionality is "passed down"; FP014 (public-sector) requires that the "AE provides details on the rationale behind the project's use of grant funding by the GCF as opposed to other instruments (e.g. loans)". We note

that “concessionality pass-down” provisions were not imposed on other private-sector FPs that may present the same risks, however term sheets in these FPs require the AE to apply a “minimum concessionality principle” which would give the GCF sufficient legal ground to ask for the kind of monitoring and reporting required in FP028 and FP030 Board conditions.

The first two types are by far the most frequent and are unproblematic, but the two last types, which concern a small number of FPs, strengthen the case for process improvements.

C. OTHER INSTITUTIONS’ PRACTICES

Public sector

Several methods exist to determine the type of instruments extended and the level of pricing/concessionality of these instruments. On one hand, the detailed analysis conducted in our report shows that most development financing institutions rely solely or at least partly on country-based criteria, such as the level of indebtedness or the GDP of the recipient countries, to determine the type of instruments they extend, and the terms and conditions of their instruments; several use a mixed approach, combining country and other criteria. On the other hand, financial institutions such as the GEF and the CTF adopt a barrier-based approach, which is project-specific.

As discussed further in the next section, we believe that these two approaches can be combined to design an approach taking into account both country-specific criteria, which are fundamental to select the level of concessionality of financial instruments, and project-specific criteria, which are necessary to fully comply with the GCF’s specific mandate.

We also conducted a specific analysis of the level of concessionality of concessional loans extended by other institutions. Table 5 shows that the GCF, the GEF and the CTF loans are similar for the highest level of concessionality, but that the low level of concessionality of GCF loans is slightly lower than the IDA standard conditions for blend countries, and lower than the low level of concessionality of other Funds.

Table 5: Comparison of CTF, IDA and GCF concessional loans

Comparison with other institutions' instruments		
Institution	**Instrument**	**Level of concessionality**
GCF	High concessionality	67%
	Low concessionality	31%
GEF[9]	To LDCs and SIDs	68%
	To other countries	45%

[9] As explained in more detail in the report, it has been assumed for this calculation that the GEF does not charge service and commitment fees. For the other institutions, the level of concessionality has been calculated with these fees.

CTF	Softer concessional	67%
	Harder concessional	43%
IDA	Small Economy[10]	59%
	Regular	51%
	Blend	39%

Private sector

We interviewed several private sector-focused Development Finance Institutions (DFIs) active in climate finance. They all determine financial terms and conditions and concessionality in a similar fashion: they price their financing on a commercial basis, with margin spreads usually based on internal ratings that include a country risk and a project risk; they provide concessional products by blending their own commercial financing with concessional resources from other institutions or trust funds; and they determine concessionality on a case-by-case basis, following an analysis of the barriers preventing private investment in the project.

The only notable differences come from the internal process followed to determine concessionality levels. In most if not all DFIs, a separate unit manages the relationship with concessional funds providers and participates in the discussion with the project team to contribute their understanding of each concessional funds provider's specificities. One DFI however – IFC – has instituted since 2012 an independent "Blended Finance Committee" to review projects that request the use concessional instruments. This committee ensures that concessional resources are used consistently and, through adequate determination of the minimum amount of concessionality required, that concessional resources are used efficiently.

D. RECOMMENDATIONS

General recommendations

One of the findings of our review is that the GCF procedures on the terms and conditions of its financial instruments should more clearly differentiate between a policy approved by the Board and more precise guidelines prepared by the Secretariat, in order to enhance the readability of these policies and guidelines for accredited entities.

Moreover, minimum concessionality is an overarching principle we found in all DFIs and Trust Funds' policies reviewed during this study but there needs to be a **clear methodology to assess and measure the level of concessionality**. Since policies should be formulated in a manner that seeks to encompass all types of instrument, we recommend that a simplified approach like the one developed in this report be applied in order to calculate the level of concessionality, which in turn would be used to assess

[10] For most distressed countries (IMF "red light"), IDA provides only grants. The nominal amount of IDA funding is then reduced by 20% as compared to what it would have been if the country could access loans.

compliance of a given GCF contribution to GCF policies (in particular for terms and conditions for public-sector projects).

Adopting a uniform approach to measuring concessionality would also allow for **better comparability between private and public projects**. For mitigation in particular, there should be no reason for the GCF to provide different concessionality to the same project whether it is implemented through a public arrangement or through a private one.

The GCF should also **provide more guidance to AEs to enhance process predictability** for all types of project. For instance, the impact indicators are calculated in very different manners depending on the accredited entity submitting the funding proposal. GCF's key indicators (carbon impact, number of beneficiaries) could play a role in the determination of the level of concessionality if a clear calculation methodology were given to AEs at the concept stage (see Appendix B for more detail). We reviewed possible methodologies and indicated more detailed recommendations on this issue in Appendix B.

The **proposal review process**, including the timing of ITAP's intervention, would also gain from being adjusted so that basic design issues can be raised and resolved early, instead of translating into prohibitive approval-stage conditions precedent or covenants. Other recommendations on the ITAP assessment can be found in Appendix D.

Recommendations specific to public-sector projects

GCF resources would provide more overall leverage to public-sector projects if loan instruments were more frequently used for these projects, which would also be more in line with the GCF Board guiding principle on leveraging other financing (Annex III to decision B.05/07).

Furthermore, we believe that **the level of concessionality of financial instruments should be the key parameter of a revised policy on financial terms and conditions for public-sector projects**. Because for most public-sector projects, there is no way to calculate a "minimum required concessionality", and in line other DFIs' practice, we recommend defining **a limited number of levels of concessionality for the GCF participation in a project or programme**. For instance, the policy could provide for three levels of concessionality (33%, 66% and 100%), and within a given level of concessionality, allow the AE to tailor the type of financial instrument and its detailed terms and conditions to the specific needs of the project and to the co-financing instruments.

To enable a more frequent use of loan instruments (and thus make ales frequent use of the 100% concessionality-level for GCF funds), **a set of criteria should be defined and communicated to AEs to choose the level of concessionality granted to a project or programme proposal**. The objective would not be to adopt a "one size fits all" approach, but to share an analysis framework with accredited entities, so that they know how the specific issue of concessionality will be evaluated by the GCF. More specifically, we think that the criteria that should be considered are the following:

- Country-related criteria:

- For most MDBs, **country macro characteristics** (GDP, poverty and indebtedness) are the key determinant of concessionality and instrument choice. MDBs, like the GCF, target a wider and more diverse set of project types and sizes than other existing climate funds. The latest Development Aid Committee (DAC) guidelines of the OECD also require Official Development Assistance (ODA) providers to provide higher concessionality to lower-income, more debt-stressed countries.

- The **vulnerability** of the recipient, provided an exact list of vulnerable countries is agreed upon.

– Project-related criteria:

  - The **project theme** since adaptation activities should in general attract more concessionality than mitigation activity.

  - **Key indicators** could also be used in the determination of concessionality (GHG emission reduction for instance).

  - The **level of concessionality of cofinanciers resources** could also be one of the main parameters in the determination of the GCF concessionality. We noticed during our review that the level of concessionality of cofinanciers resources were not easily available, and was not discussed or justified in the funding proposals. The level of concessionality necessary for the project to be viable, and the exact repartition of this concessionality between the GCF and the cofinanciers should be discussed from the concept stage.

We recommend that the policy indicate the criteria to be considered and their general definitions, and that the guidelines give more specific guidance on how these criteria are used to determine the level of concessionality.

The policy could further indicate precise floors, caps or ranges of values which would help accredited entities to prepare projects in line with GCF requirements. **In particular, we recommend setting a cap on the share of the total project expenditure financed by the GCF**[11] to encourage co-financing.

This cap could be higher for adaptation activities than for mitigation activities, and could be defined as follows:

– For all types of projects, the share of the project budget financed by the GCF should never exceed 80%;

– For revenue-generating activities, the share of the project budget financed by the GCF should never exceed 50%.

Recommendations specific to private-sector projects

[11] The combination of both sets of rules is important since the same grant-element can be extended to a project by lowering concessionality and increasing the face value of the instrument.

The analysis of private-sector projects has been conducted with a differentiation between pilot, scale-up and one-off projects:

- A pilot project aims to test a new approach (deployment of a new technology, or of an existing technology in a risky market).
- A scale-up project builds on a pilot project or programme and aims at scaling up its impact in the same environment.
- A one-off project may be of large scale but does not rely on a previous pilot nor is planned to be replicated or expanded.

In line with all DFIs engaging with the private sector, we recommend keeping a case-by-case approach for determining financial terms and conditions of private-sector projects. Nevertheless, GCF guidance could **differentiate the level of scrutiny required on concessionality between pilots, scale-up and one-off funding proposals**. Pilots, especially for very innovative approaches or in very risky markets, may not need a very stringent review of concessionality. Scale-up FPs offer the opportunity to size the required concessionality precisely based on the results of the pilot and should demonstrate they have done so.

For large one-off proposals, especially of a programmatic nature, we recommend **phasing to enable the same virtuous cycle of testing the approach, and adjusting what is really needed based on the pilot's results**. However, to enable such an approach without increasing transaction costs for both the AE and the GCF (low transaction costs being a virtue of programmatic approaches), **the GCF should define a simplified approval mechanism for scaling up a funding proposal previously approved by the GCF**.

The policy on terms and conditions should also seek to **transfer concessionality equitably and efficiently in country-wide RE/EE programmes** that lower the cost of EE or RE investments in a given country and usually come in support of a national programme**.** The first risk to efficiently using GCF concessionality in such a programme is that there can be a trade-off between, on one hand, providing "minimum concessionality", and on the other hand, not distorting the market: adapting the level of concessionality to each project also means that developers may not be incentivised to focus on the most cost-efficient projects.

Because of the efficiency and sustainability risks of "flattening out" market signals, **we recommend, while having a "minimum concessionality" approach to the global country RE/EE programme, keeping a "flat concessionality" approach to sub-projects within the programme.**

Another risk in these programmes is that part of GCF concessionality could get absorbed in AE commercial pricing. An effective solution to this risk would be to **provide GCF concessionality to several AEs in each country** to ensure the concessionality is fully transferred down (either to attract investors or to lower tariffs).

Finally, the IFC has been at the forefront of setting up an independent "Concessionality Committee" that functions very much like a Credit Committee. This approach seems interesting and a donor working group exists on the topic. The GCF could **incentivize adopting such internal concessionality review mechanisms** either through the GCF approval process, in the AMA or through its Terms and Conditions.