



GREEN
CLIMATE
FUND

Decision of the Board on the revised terms of reference for the review of the financial terms and conditions of the GCF financial instruments

B.BM-2019/08

30 May 2019

Decision approved between meetings

Decision of the Board on the revised terms of reference for the review of the financial terms and conditions of the GCF financial instruments

The Board, having considered document GCF/BM-2019/08 titled “Revised terms of reference for the review of the financial terms and conditions of the GCF financial instruments”:

- (a) Approves the revised terms of reference for the review as set out in annex I;
- (b) Takes note of the first review of the financial terms and conditions of the GCF financial instruments led by the Investment Committee as set out in annex II;
- (c) Requests the Secretariat to conduct biennial reviews of the financial terms and conditions of the GCF financial instruments, as set out in annex II to decision B.09/04, based on the approved revised terms of reference and to report biennially the outcome of such review to the Board; 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 GCF financial instruments will only be necessary in the case that such changes are considered material by the Secretariat and the Investment Committee.

Annex I: 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, which reviews the current practices with respect to the terms and conditions of financial instruments used by other institutions with policy mandates related to those of GCF, covering different national circumstances in developing countries.
3. The review will also explore and recommend ways the GCF can: (i) more effectively use guarantee instruments; and (ii) include local currency financing in GCF projects and programmes.
4. The review will focus on projects and programmes approved by the Board since the last review, which was for projects approved up to and during the seventeenth meeting of the Board (B.17), and it will provide a view on whether there is any substantial difference in the use of financial instruments from the projects approved up to B.17. 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, and 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), the total project/programme size category (micro, small, medium or large), and the different national circumstances of the recipients.

III. Methodology

5. 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, and 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, and tenor and grace period of the financial instrument) and identify emerging patterns and

other issues that 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

- (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).

6. The review will also assess and report on the current use of the guarantee instrument and make recommendations on ways it can be more effectively used in GCF project/programme financing. In addition, the review will explore the opportunities for utilizing local currency to finance GCF projects/programmes by carefully examining and comparing against similar funds and providing recommendations with suggested action plans under the oversight of the Investment Committee.

7. 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.

8. The review will also assess how accredited entities and the Secretariat assess the 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.

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

10. 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.

11. 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

12. The outputs of the review will include a presentation to the Investment Committee and a report to the Board that incorporates input/feedback from the Investment Committee. The review may propose additions or adjustments to the adopted financial terms and conditions of the GCF for the Board's consideration, consistent with GCF policies. In addition, the report will include analysis of the guarantee instrument and explore opportunities for utilizing local currency to finance GCF projects/programmes. A consulting firm will be working under the oversight of the Investment Committee on the review.

13. This review is also expected to generate lessons learned, not only related to the financial terms and conditions of the GCF but also for conducting the review itself going forward. As the

review is to be conducted 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.

14. 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

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

Annex II: Review of the financial terms and conditions of the GCF financial instruments

I. Introduction

1. The Board, in decision B.09/04 (see annexes III and IV 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 for the review of the financial terms and conditions of the GCF financial instruments, contained in annex V to this document, were adopted by the Board in decision B.15/05.
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 II 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 VI 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, and 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” (document 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 GCF and the average concessionality or grant element of financial instruments of GCF;
 - (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 (Nodalys Conseil) was engaged to support the work of the review. The executive summary

of the review from the consultant is attached as annex VII. The scope of the review covered funding proposals approved by the Board up to and during 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 pilot, 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. The Investment Committee proposes to update the terms of reference of the review of the financial terms and conditions of the GCF financial instruments. In updating the terms of reference, the committee also took note of the review of the financial terms and conditions and recommends that the Secretariat 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 updated terms of reference as set out in annex I to this document.

Annex III: Decision B.09/04: Financial terms and conditions of the GCF instruments

The Board adopted the following decision:

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 IV: Financial terms and conditions of grants and concessional loans

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 V: 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.² 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.

² Please refer to document GCF/B.08/11 titled "Financial terms and conditions of grants and concessional loans".