GREEN CLIMATE FUND

Meeting of the Board
6 – 8 July 2019
Songdo, Incheon, Republic of Korea
Provisional agenda item 16(a)

GCF/B.23/19

28 June 2019

Review of the initial investment framework

Matters related to incremental and full cost calculation methodology and policies on co-financing and concessionality

Summary

This document provides background information on three related methodologies and policies relevant for the GCF funding proposal approval process, namely the incremental and full cost calculation methodology, and the policy on co-financing and on concessionality. It considers their interlinkages in the context of the review of the initial investment framework of GCF and presents draft methodology and policies for the Board's consideration.

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I. Introduction

1. The Board, by decision B.07/06, adopted the initial GCF investment framework, as contained in annex XIV to the decision (annex XIV to document GCF/B.07/11). When adopting the initial investment framework, the Board decided to keep the framework under review and to take action as necessary, in particular with respect to the criterion on needs of the recipient countries in the investment guidelines (decision B.07/06, para. (e)). By decision B.09/05, the Board further developed the initial investment framework by adopting initial activity-specific subcriteria and indicative assessment factors.

2. In decision B.17/10, the Board requested the Secretariat to develop a proposal for the Board's consideration at its nineteenth meeting, to address, among others, the development and application of an incremental cost calculation methodology, a policy on co-financing and options for further guidance on concessionality.

3. In decision B.19/06, the Board requested the Secretariat to develop an integrated approach to address the policy gaps identified in decision B.11/11 for the Board's consideration at its twentieth meeting. In particular, the Board noted:

(a) The linkages between matters related to incremental costs and concessionality, as well as issues related to co-finance and other matters; and

(b) That addressing policy gaps requires an integrated approach that considers their interlinkages and requested the Secretariat to develop an integrated approach to resolve these interrelated issues for consideration at the twentieth meeting of the Board.

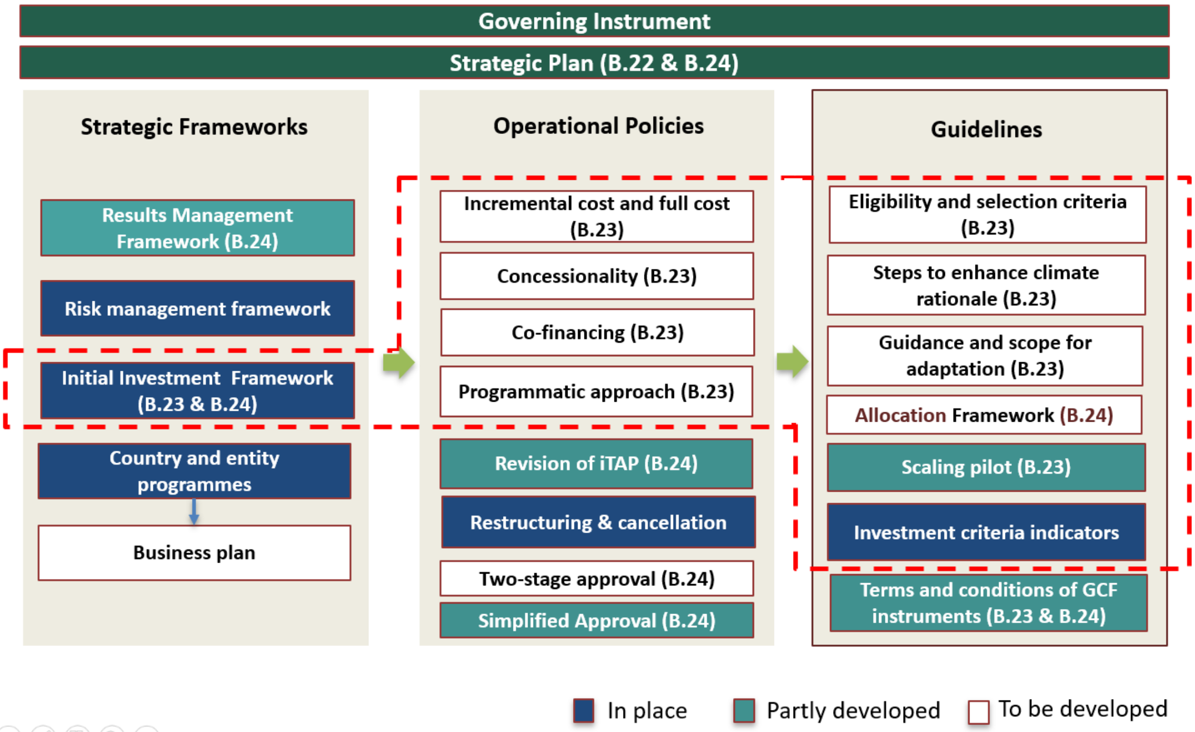
4. At the twentieth and twenty-first meetings of the Board, the Secretariat presented policy documents on incremental and full cost calculation methodology, co-financing and concessionality. The agenda items on these policies were not opened at either Board meeting.

5. For the twenty-second meeting of the Board (B.22), the Secretariat undertook and completed the consultation process with the Board members with the same policy documents, but these policy items were not included in the B.22 agenda.

6. Through decision B.22/02, paragraph (c), the Board adopted the revised workplan of the Board for 2019, which includes a review of the initial investment framework, to be informed by matters such as developing an incremental cost methodology, co-financing policy and co-financing arrangements with other financial institutions, and further guidance on concessionality, including the level of concessionality for the public sector.

7. The investment guidelines, methodology and policies referred to in this paper, the understanding of their interrelations and how they are applied to GCF funded projects and programmes are necessary to address the policy gaps related to the GCF funding proposal approval process. **Figure *1*** below presents an overview of key policies related to funding proposals in the context of the Board's 2019 workplan. The boxes encompassed by the dashed red line are items that relate to the initial investment framework. The interlinkages exist at a number of levels, including between and across the three different categories, strategic framework, operational policies and guidelines.

Figure 1: Key policies related to funding proposals and the 2019 Board workplan

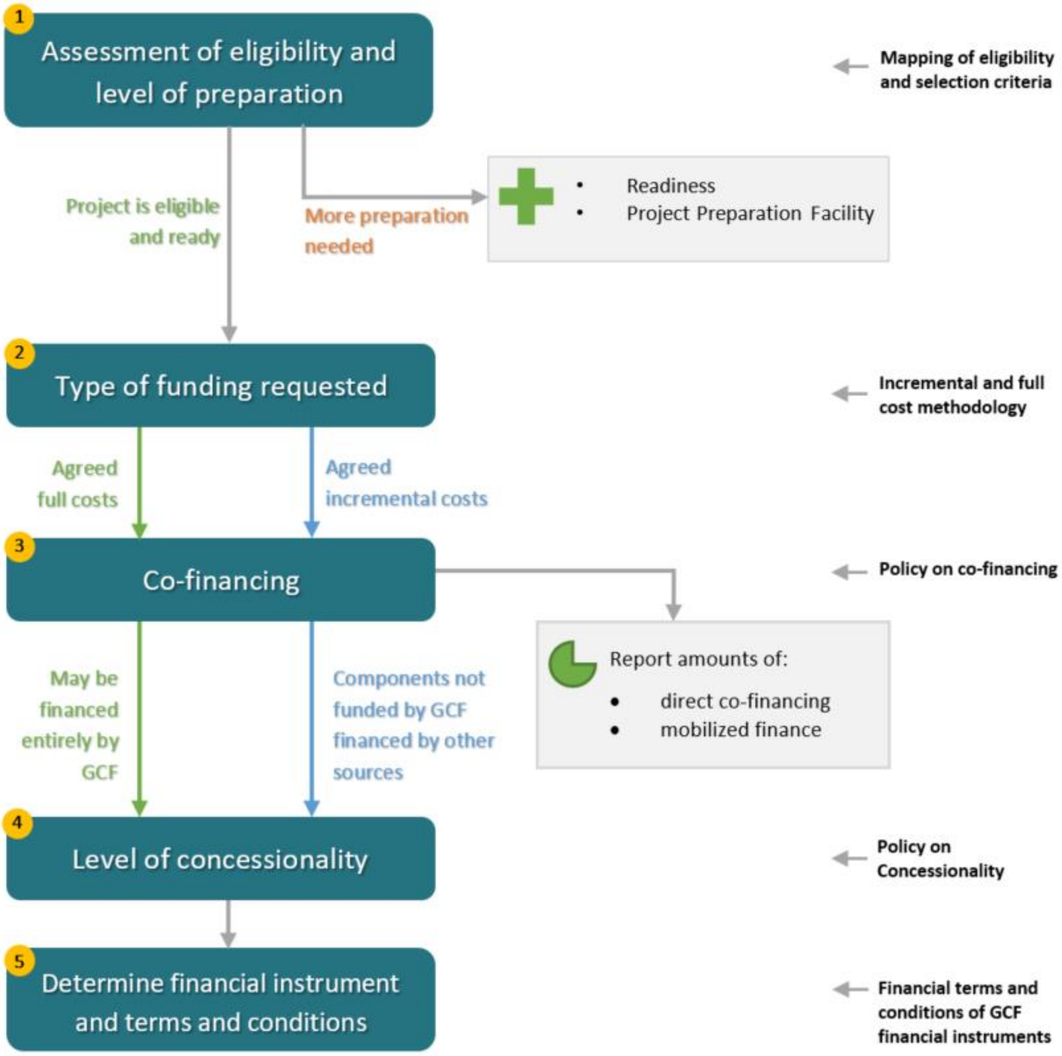


8. This paper provides background information on these three methodologies and policies, namely the incremental and full cost calculation methodology, policy on co-financing and options for further guidance on concessionality. It considers their interlinkages in the context of the review of the initial investment framework of GCF, presents draft policies for the Board's consideration, and articulates briefly how their adoption and implementation are likely to impact initial investment by GCF.

II. Interlinkages between policies

9. Recognizing the interlinkages among the three policies and guidelines as elaborated in paragraph 3, figure 2 presents an illustration of the interlinkages and how they may be applied to the funding proposal approval process, bearing in mind that the application to individual funding proposals may differ.

Figure 2: Integrated policy approach for the funding proposal approval process [a]



[a] This chart is intended to illustrate the interlinkages between policy proposals and their application to the funding proposal approval process. The process for certain funding proposals may differ depending on circumstances.

1 *Is the funding proposal eligible for GCF financing, and is it eligible and prepared to begin the approval process? If not, it should be returned to the country and entity for further preparation and/or support from PPF and Readiness. The Mapping of Eligibility and Selection Criteria (GCF/B.23/Inf.14) enumerates elements related to project or programme eligibility and selection criteria that have been included in guidance from the Conference of the Parties, the Governing Instrument, and relevant Board decisions.*

2 *What type of funding is requested from GCF – agreed full costs or agreed incremental costs? Is this choice supported by the information provided? The Incremental and Full Cost Methodology (Annex II) outlines guiding principles and a methodological approach to estimating incremental costs and full costs.*

3 *What type of co-financing is needed? Agreed full costs would be funded entirely by GCF, while financing from other sources would be needed to finance components not covered by agreed full or agreed incremental costs. The Policy on Co-Financing (Annex III) presents the general principles and approaches to determine and monitor co-financing applicable to all GCF-funded activities.*

4 *What level of concessionality should be applied to support the funding proposal? The Policy on Concessionality (Annex IV) provides guidance to ensure consistency and a systematic approach in the application of principles underpinning concessionality as it pertains to the selection of the GCF financial instruments, the terms and conditions to be applied, reporting on concessionality as well as the supportive evidence needed for concessionality to be applied.*

5 *Following agreement on the appropriate level of concessionality, concessional terms applied through the Financial Terms and Conditions of GCF Financial Instruments (Decision B.09/04, Decision B.17/08).*

10. Addressing climate change is at the core of any project or programme to be funded by GCF. However, the Board, through its decisions, has identified other considerations in addition to climate rationale to define eligibility for GCF resources. These include, among others, alignment with the six investment criteria and completeness of the funding proposal and documentation. Projects and programmes that do not fulfil all these requirements can benefit from resources offered by the Readiness and Preparatory Support and Project Preparation Facility to be strengthened before resubmission to GCF.

11. Activities dedicated solely to addressing climate change, including capacity-building, barrier-removal to address climate change or projects where the costs of a baseline scenario are zero, are eligible for agreed full costs. Projects and programmes with both developmental and climate objectives are eligible for agreed incremental costs, while those with purely developmental objectives should be financed from sources other than GCF. Annex II to this paper proposes a methodology to determine eligibility for incremental or full costs.

12. The determination of incremental or full cost calculation is one of the main factors to be considered in determining co-financing for GCF funded projects and programmes as formulated in the GCF co-financing policy in Annex III. For projects and programmes for which GCF is funding agreed full costs, co-financing is possible, but without using co-financing metrics as stand-alone targets. For the projects and programmes that GCF is funding through agreed incremental costs, financing from other sources is needed to fund the other costs. This could be financing by the proposing accredited entity (AE), or additional financing provided by third parties. All co-financing must be in line with the overall vision and mandate of GCF.

13. Depending on whether the funding is covering certain types of incremental costs, further guidance on the selection of the most appropriate financial instrument and the relevant level of concessionality is also needed, in order to find the appropriate balance between ensuring the achievement of impacts and the feasibility of the project or programme.

III. Review of the initial investment framework

14. The GCF initial investment framework consists of the following three components: (a) investment policies; (b) investment strategy and portfolio targets; and (c) investment guidelines.

15. The set of three policies and guidelines proposed for Board review and approval aims at addressing the policy gaps by further developing policy tools and methodologies related to the GCF funding proposal approval process. Their adoption alongside other investment policies and guidelines, including the programmatic approach, implies an update of components (a) and (c), thereby completing the strategic frameworks and hence strengthening the initial investment framework.

16. The Board is invited to consider these documents and to initiate review of the initial investment framework. The proposals have been developed taking into account, where appropriate, the experience and lessons learned of similar policies from other climate finance

delivery channels, in particularly the Global Environment Facility (GEF)[1] and the Climate Investment Funds (CIF)[2] with regard to concessionality, co-financing and incremental cost.

17. Other decisions, including decision B.22/15 related to the investment criteria indicators, are also likely to inform this review.

18. Future work in the context of replenishment, including the updated Strategic Plan and the Strategic Programming paper, are likely to determine whether or not the Board will make a change to component (b) of the initial investment framework, namely the investment strategy and portfolio targets for the first GCF replenishment period.

19. The Secretariat recommends the Board to adopt an approach and schedule for review of the initial investment framework that will enable all major decisions to inform such a review in a comprehensive manner for application as part of the first GCF replenishment period.

IV. Recommended action by the Board

20. It is recommended that the Board adopt the draft decision set out in annex I to this document.

[1] The Global Environment Facility (GEF) Operational Guidelines for the Application of the Incremental Cost Principle proposes a five step process to quantitatively and qualitatively demonstrate incremental costs and simplify the negotiation process. Through these steps, the transparency of the determination of incremental costs of a project during the preparation and implementation periods can be enhanced by determining the environmental problem and the business as usual scenario without GEF support; identifying the global environmental benefits, links with GEF strategic programmes and priorities of the focal areas; developing the result framework of the intervention; providing the incremental reasoning and GEF role; and negotiating the role of co-financing. In the case of GEF, the policy on co-financing is applicable to the Secretariat and all GEF Partner Agencies and to all projects and programmes financed with resources of the GEF Trust Fund. GEF policy sets out mandatory requirements for Co-Financing throughout the GEF project and programme cycles, as well as for portfolio monitoring and reporting by the Secretariat. Co-Financing is required for all GEF-financed Full-Sized Projects (GEF Project Financing exceeding USD 2 million), medium-sized projects and programmes (GEF project financing of up to USD 2 million). Co-financing is encouraged for all enabling activities, making reference to projects for the preparation of a plan, strategy or report to fulfil commitments under a Convention. In the case of GEF policy, during the concept stage, project identification forms and programme framework documents are required to be submitted for work programme entry or CEO approval. Agencies provide indicative information regarding the expected amounts, sources and types of co-financing, and the sub-set of such co-financing that meets the definition of investment mobilized. At the CEO endorsement/approval stage, agencies provide confirmed information regarding the expected amounts, sources and types of co-financing and investment mobilized, with appropriate supporting evidence. Finally, during project implementation and at project completion, agencies provide information on the actual amounts, sources and types of co-financing and investment mobilized in their mid-term reviews and terminal evaluations.

[2] The experience in application of concessional finance of the Climate Investment Funds has been considered in the guiding principles and principles for implementation reflected in Annex IV: Policy on concessionality.

Annex I: Draft decision by the Board

The Board, having considered document GCF/B.23/19 titled "Review of the initial investment framework: Matters related to incremental and full cost calculation methodology and policies on co-financing and concessionality":

(a) *Adopts* the incremental and full cost calculation methodology as set out in annex II;

(b) *Adopts* the policy on co-financing as set out in annex III;

(c) *Adopts* the policy on concessionality as set out in annex IV;

(d) *Requests* the Secretariat option to develop a detailed concessionality methodology based on section IV of annex IV, and provide a restatement of principles and a detailed methodology by the twenty-sixth meeting of the Board;

(e) *Requests* the Secretariat to issue technical guidance notes as necessary to accredited entities that provide information on the application of the methodology and policies and to update such technical guidance notes as necessary based on feedback from consultations with accredited entities, national designated authorities (NDAs) or international experts;

(f) *Requests* the Secretariat to design and implement a capacity-building programme, as part of the Readiness and Preparatory Support Programme, to support the accredited entities, particularly the direct access accredited entities, to enable the implementation of the full cost and incremental cost calculation methodology and the co-financing concessionality policies, alongside their reporting and evaluation requirements;

(g) *Further requests* the Secretariat to update the templates for concept notes and funding proposals to reflect the methodology and policies by the twenty-fifth meeting of the Board, in keeping with the Secretariat's current practice of updating templates no more than once per year;

(h) *Decides* that the incremental and full cost calculation methodology and policy on co-financing will apply to funding proposals approved at the twenty-sixth meeting of the Board or later, and the policy on concessionality will apply to funding proposals approved at the twenty-eighth meeting of the Board or later, to allow accredited entities to review and use the technical guidelines noted in paragraph (e) above;

(i) *Decides* that funding proposals submitted under existing requests for proposal and pilot programmes will be exempt from the application of the methodology and policies: the micro, small and medium-sized enterprises, mobilizing funds at scale, enhancing direct access and REDD-plus requests for proposal and the pilot simplified approval process programme;

(j) *Requests* the Secretariat to review the incremental and full cost calculation methodology and policies on co-financing and concessionality three years after adoption to develop lessons learned and improvements to the methodology and report back to the Board; and

(k) *Recalls* decision B.17/09, paragraph (h), which requests the Secretariat to present to the Board implementation challenges identified in the application of the initial proposal approval process, including policy matters identified during the Secretariat's assessment of funding proposals, for the Board's consideration at the earliest opportunity, including information on budgetary considerations.

Annex II: Incremental and full cost calculation methodology

I. Objectives

1. The purpose of this document is to outline guiding principles and a methodological approach to estimating incremental costs and full costs that seeks to achieve the following objectives:

(a) Further facilitating the application of the GCF initial investment framework, particularly with respect to the effectiveness and efficiency criterion to ensure that GCF funding targets the full costs or incremental costs of climate-related activities as appropriate;

(b) Facilitating Secretariat and independent Technical Advisory Panel (TAP) review and Board decision-making by providing a detailed assessment of the components of a proposed project that are directly related to climate change adaptation and mitigation as opposed to other co-benefits such as economic development;

(c) Guiding national designated authorities (NDAs)/focal points and accredited entities (AEs) in articulating climate change considerations in funding proposals, while limiting any additional burden;

(d) Incorporating the methodology into funding eligibility criteria, financial instrument selection, and concessionality policies by having differentiated criteria in those policies depending on whether the activities and related funding requested in a proposal are incremental and the extent to which the proposed funding is used for an activity which has a quantifiable net financial benefit to the sponsor; and

(e) Integrating the methodology into the results management framework and impact evaluation by more directly linking each activity in a funding proposal to the results and impact related to the climate activities of GCF.

II. Definitions

2. For GCF, the agreed incremental costs of a project are the difference in expenses incurred with respect to a baseline project to produce a new output or an equivalent output in a way that results in mitigation and/or adaptation impacts.[3]

3. A baseline project is the investment producing the same or equivalent output in a way that does not result in mitigation and/or adaptation impact, but would have occurred if the GCF project were not to be implemented. The cost of the baseline project may be zero, under the assumption that no action would have been taken in the absence of climate change.

4. The agreed full costs of a project or a component are all costs associated with outputs that result in mitigation and/or adaptation impact. For adaptation, it means the costs of discrete activities to be implemented to address the adverse impacts of and/or risks posed by climate change. For mitigation, it would refer to the costs of discrete interventions to reduce GHG emissions.

III. Principles

5. Both agreed full costs and agreed incremental costs should be utilised by GCF in its capacity as an operating entity of the financial mechanism of the United Nations Framework

[3] In some cases, the lifecycle costs of the project may be lower than the costs of the baseline project.

Convention on Climate Change (UNFCCC) in support of the implementation of developing countries' activities and investments to address climate change.

6. The estimation of agreed incremental costs to compare the proposed intervention to a project baseline provides a clear and transparent framework to optimize the use of GCF investments in a manner that is consistent with its mandate to address climate change. Application of the incremental cost approach should be simple, pragmatic, logical and cost-effective.

7. Activities dedicated solely to climate change, including capacity-building, barrier-removal to address climate change, or projects or components where the costs of a baseline scenario are zero, are eligible for agreed full costs, if appropriate justification is provided.[4]

8. Additionally, funding for enabling activities such as under readiness and Project Preparation Facility (PPF) are considered agreed full costs.

9. Because agreed incremental costs or agreed full costs only cover project costs that are climate-related, any costs that cannot be tied to climate objectives are expected to be funded by sources other than GCF. In this context, the total costs of a project/programme would be the costs of a project/programme that are climate-related (agreed incremental costs or agreed full costs) plus the costs that are not climate-related (which may be zero).

10. Both full and incremental costs could be co-financed with other partners. When GCF finances are blended with other financing, one or more co-financiers may have different incremental cost methodologies or requirements. In these cases, the AE would include in the proposal information on co-financiers' methodologies for estimating incremental cost, with an explanation of the reasons that particular approach was selected.

IV. Process

11. When developing funding proposals, AEs should propose the cost of the project, the portion that should be financed by GCF, and the instruments and level of concessionality GCF should use to finance its portion of the costs. For each component in the funding proposal, AEs should state clearly whether they are requesting GCF support for agreed incremental costs or agreed full costs and justify that request based on the requirements described in sections VII and VIII.

12. Based on this assessment, GCF and AEs will agree on which part of the project is eligible to be funded by GCF and which may be better suited for co-financing, if any. Agreement will occur at various stages throughout the process. By submitting a letter of no-objection to the funding proposal, national designated authorities (NDAs) would be agreeing with the incremental or full costs proposed by the AE. By reviewing the funding proposal and submitting to the independent TAP and the Board, the Secretariat would be agreeing on the application of incremental and full costs proposed by the AE. By approving the funding proposal, the Board would be agreeing with the proposed incremental and full costs.

13. Given the wide variety of countries, result areas and AEs involved in GCF projects, it is prudent to maintain some flexibility in the criteria used to determine whether the GCF funds incremental costs or full costs for any given project.

14. The concessionality guidance will inform the selection of appropriate financial instruments and terms for the portion financed by GCF to ensure efficiency and effectiveness.

15. The Secretariat will issue technical guidance notes to address specific issues within the scope of this methodology or clarify any ambiguities in the methodology.

[4] Pilot projects designed to demonstrate new technologies may be justified under one or more these categories.

V. Requirements for all funding proposals

16. At a minimum, each funding proposal shall include an appropriate incremental cost reasoning connected to a strong theory of change, which will be reviewed and assessed by the Secretariat as part of its second-level due diligence. This incremental cost reasoning should include:

(a) A detailed description of the baseline project scenario, including its estimated cost;

(b) A detailed description of the project, clearly identifying:

(i) An explanation of how the proposed investment will achieve transformative mitigation and/or adaptation results and/or reduce barriers to climate change-related activities;

(ii) Project components and associated costs, including percentages thereof, that are directly related to climate-related outputs and those related to other outputs; and

(iii) Differences in costs over time between the proposed project and the baseline project described in paragraph 16(a).

VI. Requirements for full costs

17. According to paragraph 35 of the Governing Instrument, "The Fund will finance agreed full and agreed incremental costs for activities to enable and support enhanced action on adaptation, mitigation (including REDD-plus), technology development and transfer (including carbon capture and storage), capacity-building and the preparation of national reports by developing countries." As such, the Board retains the discretion to approve funding proposals for agreed full costs.[5] Any activities that GCF considers for full costs should have a strong paradigm shift potential towards low emission and/or climate resilient development supported with a clear theory of change, taking into account how the intervention would contribute to the long-term temperature goal of the Paris Agreement and shifting financial flows consistent with a pathway towards low greenhouse gas emission and climate resilient development.

18. A number of activities are eligible for full project or component costs, including:

(a) Adaptation activities in accordance with paragraph 35 of the Governing Instrument;

(b) Readiness and preparatory support;

(c) Capacity-building activities;

(d) Reporting activities where appropriate;

(e) Barrier-removing activities to climate change; and

(f) Projects where the costs of a baseline scenario are zero.

[5] In the context of the UNFCCC, "agreed full cost" refers to the agreed level of support for UNFCCC reporting requirements [eg:e.g. National Communications and Biennial Update Reports] that have historically been delivered through the Global Environment Facility (GEF). Importantly, the definition of "agreed full cost" in the UNFCCC context is independent of the consideration of requirements for full costs in the GCF.

VII. Requirements for incremental costs

19. Where data and capacity permit, AEs shall also provide a detailed estimate of incremental costs as part of the economic analysis provided with the funding proposal. Each economic analysis submitted to GCF will construct a minimum of three scenarios:

(a) The counterfactual scenario that would exist without the project;

(b) The project scenario, in which the GCF project is implemented; and

(c) The baseline project scenario, in which a baseline project is implemented.[6]

20. In this analysis, incremental cost will be determined by the difference between the costs in the project scenario and the costs in the baseline project scenario over the economic life of the project. When the cost of the baseline project is zero, agreed incremental cost is equal to agreed full cost.

21. Any cost expected to be incurred over the economic life of the project shall be taken into consideration in both the project scenario and baseline project scenario, including capital costs, operating costs and any other costs necessary to realise the outcomes of the project. These estimations shall apply standard principles of economic benefit-cost analysis, including appropriate discounting.

22. AEs will submit these calculations in spreadsheet format to GCF as an annex to the funding proposal. A written description of the calculations and their underlying assumptions will be included in the funding proposal or a separate annex, along with the incremental cost reasoning described in paragraph 16.

23. In contexts where detailed quantitative estimations are unfeasible due to data scarcity or capacity limitations, AEs may omit the detailed estimates described in paragraphs 19-22 above and provide an explanation and appropriate justification for the omission. Each case will be considered individually, and funding proposals without a detailed estimate shall not be penalized in terms of priority or funding amount, provided the incremental reasoning is faithfully applied.

24. As necessary, the Secretariat will issue technical guidance notes that elaborate on the technical methods to be used for these calculations.

[6] In some cases, this might be identical to the counterfactual scenario presented in paragraph 19(a).

Annex III: Policy on co-financing

I. Purpose

1. The purpose of this policy is to present the general principles and approaches to determine and monitor public and private co-financing applicable to all GCF-funded activities, as well as approaches to monitor, track and report the mobilization of additional resources to maximize the impact of GCF interventions in developing countries.

2. This paper also provides clarity for all GCF stakeholders by defining key terms so that comparisons can be made within the context of GCF operations, and reporting can be consistent across all types of projects. The policy proposes key guiding principles that can assist entities and countries in understanding, defining and applying the concepts of direct co-financing and of leveraged/mobilized finance in the specific context of the mandate of GCF. The Secretariat will support focal points, national designated authorities (NDAs), accredited entities (AEs) and all relevant stakeholders in adopting this approach.

3. The Secretariat will implement the current policy and will ensure that the following actions are carried out:

(a) Review all new funding proposals to ensure consistency with the requirements of this policy and other interrelated policies;

(b) Provide relevant documentation to support stakeholders in the calculations and reporting of co-finance and mobilized finance;

(c) Maintain a funding proposal database or registry to record all co-financing data during all the stages of the GCF project cycle; and

(d) Monitor, evaluate and report to the Board, including on the progress achieved in improving the levels of co-financing over time both at the project and the portfolio level.

4. In the implementation of this policy, the Secretariat will avoid imposing a minimum threshold and/or specific co-financing sources as part of the individual project or funding proposal assessment process, cognizant that while always desirable, co-financing may not always be achievable.

5. GCF is collaborating with the Organisation for Economic Co-operation and Development (OECD) and other multilateral and bilateral institutions to achieve alignment with definitions and methodology, to make sure that official co-financing metrics and statistics on private climate finance mobilized through public interventions are robust and consistent, eliminating the risk of double-counting.

6. Aligning all GCF accredited entities, in particular direct access entities, will require additional consultations and the provision of capacity-building in some cases, to make sure that information on scope, metrics and reporting are fully understood and applied across the entire GCF portfolio.

7. Therefore, in this policy GCF seeks to align definitions and present a simplified methodology that can be applied immediately upon approval of this policy. GCF will work on the consultations and capacity-building to reach full alignment with OECD and other bilateral and multilateral institutions, with a view to introduce an instrument-based methodology within a two-year time frame. This recognises the needs for additional capacity-building to strengthen the skills and knowledge of direct access entities to apply the proposed policy. It also reflects the fact that negotiations are still ongoing with multilateral development banks and financial institutions to seek alignment with OECD methodology.

8. So far, data collection through the OECD Common Reporting Standard is operational for five financial instruments: guarantees, syndicated loans, shares in collective investment vehicles (investment funds), direct investment in companies and credit lines (see data below). Methodological work is ongoing to cover two additional financial instruments/arrangements: project finance structures (public-private partnerships) and standard loans and grants in "simple" co-financing arrangements with private investors (e.g. matching grants).

II. Applicability

9. Public and/or private co-financing is encouraged for all GCF funding proposals as a means to maximize the opportunity for strategic partnerships to achieve of the highest possible impact and ambition in accordance with the GCF mandate and the Paris Agreement. In this regard, co-financing can strengthen climate action through both public-sector and private-sector contributions to the projects and programmes supported by GCF, thus generating ownership to support climate impacts as well as providing additional resources for the long-term sustainability of the action.

10. The co-financing policy is applicable to all new funding proposals, beginning from its date of effectiveness. Its application will be consistent with other related policies.

III. Guiding principles

11. The general principles that GCF stakeholders should abide by in determining the appropriate level of co-financing to funding proposals are as follows:

(a) **Project proposals should seek to incorporate appropriate levels of co-financing to maximize the impact of GCF resources, as determined on a case-by-case basis;**

   (i) Co-financing may play a role in ensuring country ownership by supporting more effectively the translation of national priorities into action. It also supports greater climate impact, including through knowledge transfer and the consideration of best practices in climate finance. While public co-financing by host country institutions is considered positively, the GCF acknowledges the scarcity of financial resources in many countries; and

   (ii) An appropriate level of co-financing by the AE plays a critical role in aligning interests. Co-financing by the AE might comprise: direct co-financing by the AE; official development assistance funds administered by and channelled through the AE; and AE financing of earlier phases of interventions which shall be scaled up with the support of GCF as well as other comparable funding;

(b) In general, **co-finance maximizes the opportunities for partnerships by bringing more resources alongside GCF financing and promotes joint learning.** Potential public and private sources of co-financing to be encouraged by the GCF include additional resources from national governments, AEs, other partners' agencies and private sector actors. However, establishing the appropriate level and source (private vs public) of co-finance is dependent on project characteristics and determined on a case-by-case basis;

   (i) Mobilizing private sector co-financing will be key to trigger transformational change and to ensure financial sustainability beyond initial concessionality and support by the GCF. Crowding in the right private sector sources and ensuring the creation of a positive appetite for further funding activities in the sector will be crucial and will require a full analysis of the maturity of: i) the sector/project for private sector financing, as well as ii) the private sector for climate finance.

AEs will have to seek to maximize the impact of the project considering not only potential synergies and efficiencies when bringing in the private sector but also risks and inefficiencies;

(c) **While maximizing co-financing is desirable for all proposals, GCF should avoid using co-financing metrics as stand-alone targets.** Maximizing climate mitigation and adaptation results does not necessarily equate with minimizing or optimizing spending on climate mitigation and adaptation. Co-finance ratios or planned levels of mobilized private finance should therefore not become stand-alone targets. High levels of co-finance and mobilized finance may not always be achievable or relevant. Using them as stand-alone targets may be counterproductive, as doing so may disincentivize financing projects/programmes with strong impact potential and high paradigm shift potential. Rather, co-financing should be considered as one appraisal item among many in the investment framework;

(i) AEs and the Secretariat shall have a strong focus on the long-term financing structure targeted for projects in the sector of the intervention and should define their co-financing strategy against this context, with a view that, with time, decreased co-financing and concessionality may be needed to support the viability of a given operation, as illustrated by the project/programme theory of change;

(d) **Where GCF funding is covering the incremental costs of a project, the non-climate related costs (if present) should be financed by other sources**. GCF policies on incremental costs and full costs provide the guiding principles for defining funding eligibility as agreed incremental costs or agreed full costs. In the case where a project is only eligible in respect of the “agreed incremental costs”, the additional financing should complement GCF resources and be proportionate and adequate to at least cover the non-climate related components of the project;

(e) To the extent practicable, GCF should ascertain that **financial resources of third parties are used in a manner consistent with the mandate and the objectives of GCF** and that appropriate legal and compliance safeguards have been included to allocate appropriate responsibilities and obligations among the co-financing parties;

(f) In determining co-financing, the Secretariat and the AEs will endeavor to **establish and report on the causal links between financing streams**, as much as it is feasible;

(g) In **sequenced and parallel financing**, GCF will endeavour to explore the possibility of scaling up pilot projects and programmes that have been supported through other climate finance delivery channels mandated by the United Nations Framework Convention on Climate Change (UNFCCC). In those cases where a causal link between the two financing streams can be established, it could be possible to include the financing as direct co-financing, ascertaining on a case-by-case basis;

(h) **The methodology should be based on the basic financial instruments of GCF**. These instruments consist of grants, (concessional) loans, guarantees and equity investments. Reporting will be done in absolute numerical terms without converting loans to their grant equivalent. The methodology is not applicable to policy interventions (e.g. capacity-building support on regulatory issues); and

(i) **The methodology recognizes that mobilized finance may be harder to track than direct co-finance.** The Secretariat relies on the ability of accredited and executing entities to track it. All AEs should, as much as practicable, report on mobilized co-financing through annual performance reports (APRs) or semi-annual reporting. However, the policy provides flexibility on reporting – in terms of frequency, when, how and whether at project/sub-project level – based on the nature of the Funded activity and project and context specificity.

IV. Definitions

12. GCF proposes the following main definitions that take into account the specifics of the work and mandate of GCF, and in particular as it refers to the robustness of data collection and reporting for both internal and external purposes. For example, a demonstrable causal link between the official and private investment underpin the methodologies of the OECD Research Collaborative on Tracking Finance for Climate Action, as well as by the multilateral development banks. The definitions below should be adhered to when reporting co-financing and mobilized private finance to GCF:

(a) **Direct co-finance** (also referred to as **co-finance, additional finance, primary co-finance**) includes all financial resources – which can be private or public – from third parties that originate from and/or flow through the AE into the project/programme alongside the financing provided by GCF. There must be a causal link between GCF resources and third-party resources. The provision of co-financing alongside GCF is determined on a project by project basis, distinguishing between public and private co-financing, and is not applicable to all funding proposals;

(b) **Mobilized finance** (sometimes also referred to as **leveraged finance** or **catalyzed finance**) is all financial resources from third parties, aside from those channelled through the AE, that flow into the intervention that can reasonably be assumed to have been the result of financing provided by GCF. Mobilized finance requires a causal role between GCF and third-party financiers. In other words, the additional financial resources would not have been applied in the absence of GCF participation. Ideally, this causal role needs to be proven, but may also be assumed because of the pivotal role of GCF, such as the role of anchor investor, financier of the riskiest tranche or provider of guarantees. These resources can be public or private and includes financing that is directly channeled to the GCF project (outside of the AE) under project finance, such as finance channeled directly to the sponsors by commercial banks for infrastructure. In the case of an equal partnership in catalysing additional financing (e.g. by another anchor investor alongside GCF or an investor with the same financing terms), the amount will be calculated on a volume basis and pro-rated;

(c) In the specific context of the GCF, and of the GCF work vis-à-vis other UNFCCC-mandate climate funds, **sequenced financing and parallel financing** define the resources that are flowing alongside GCF resources to a project, but that are earmarked for other outcomes, which may be consistent with general mitigation and adaptation solutions but are not part of the GCF funding proposals, and as such are not tracked as GCF impacts.[1] This can also be the case of projects/programmes where GCF takes the role of investor to further scale up the project/programme which may have been initially (e.g. in its pilot phase) supported through a grant by the Global Environment Facility or the Adaptation Fund. In those cases where a causal link between the two financing streams can be established, it could be possible to include such financing as direct co-financing;

[1] Some AEs use the term "parallel" financing in a different manner than that of GCF, which may overlap with GCF's definition of mobilized finance.

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(d) **Public finance** is all financial resources other than the GCF resources that flow into projects/programmes from the public sector or entities that are more than 50 per cent owned by the public sector;[2] and

(e) **Private finance** is all financial resources that flow into projects/programmes from entities that are more than 50 per cent owned by private shareholders.

V. Reporting requirements

5.1 Accredited entities

13. **Timing:** the ex ante estimation of all public and private direct co-finance and potentially mobilized finance takes place at the start of the project or programme. The tracking of actual co-finance takes place annually or periodically over the project/programme duration, as agreed in the funded activity agreement (FAA). All AEs should, as much as practicable, report on mobilized co-financing through annual performance reports and semi-annual reporting. However, based on the nature of the Funded activity and project and context specificity, GCF and the AE may agree on different frequency and timing, such as at mid-term and final evaluations. Amounts of co-finance also will be tracked cumulatively, separately for public and private sources, while those of mobilized finance will be tracked based on the relevant agreements with the accredited entity (AE). At project/programme completion, an assessment will be made of the extent to which the actual co-finance and mobilized finance amounts lived up to estimations (expressed as a percentage of actual co-finance and mobilized finance amounts vis-à-vis estimated amounts).

14. **Data source**: the main source for ex-ante estimation of public and private co-finance and mobilized finance is the funding proposal submitted to GCF by the AE. The estimation should be backed up by a solid explanation and methodology, notably in cases of expected mobilized private finance downstream. The main source for tracking of all co-finance and mobilized finance is the AE-reported data that will be included in the annual performance reports submitted to GCF by the AEs, with the scope determined in the relevant FAA.

15. **Methodology:** to determine public and private co-finance and mobilized public and private finance, the following steps need to be undertaken by the AE:

(a) Identify the GCF financing to the funding proposal;

(b) Identify the total financial resources from third parties, distinguishing between public and private sources, that flow into the project/programme through the AE alongside the financing provided by GCF. This is the **co-financing** amount. GCF accredited entities are required to report all co-financing, in accordance with the FAA;

(c) Identify the financial resources (additional investment) by third parties that flow directly into the project/programme outside the AE that are funded by the project/programme supported by GCF. Where available, this can be backed up by documentation, but will primarily rely on the judgment of the task manager, taking into account the nature of the role of GCF (e.g. anchor investor, financier of the riskiest tranche,[3] or provider of guarantees). In the case of an equal partnership in catalyzing additional financing (e.g. by another anchor investor alongside GCF or an investor with

[2] The Secretariat is following closely the discussion on the definition of private and public finance – and its evolution - alongside the OECD Research Collaborative on private climate finance reporting and with financial institutions. For example, proposed changes link to the nature of ownership of the final beneficiary and the outcome of that specific financing stream.

[3] The risk level of different instruments from least to highest risk is: loans, concessional loans, equity, guarantees, and reimbursable grants, grants.

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the same financing terms), the amount will be calculated on a volume-based pro rata calculation;

(d) Add (b) and (c). This is the total investment or **mobilized (leveraged) financing** amount;

(e) Divide (b) by (a). This is the **co-financing ratio**;[4] and

(f) Divide (d) by (a). This is the mobilized **financing ratio**.

16. The following guiding definitions and references are used to support the GCF methodology:

(a) **Main term:** GCF tracks both co-finance and mobilized private finance to ensure alignment with current practices and collected data to date, and to ensure alignment with the other climate funds such as the Global Environment Facility (GEF) and international financial institutions while also responding to the specific needs of GCF;

(b) **Capital source:** GCF tracks both public and private flows of co-financing to be in line with most approaches. This is also because GCF actively cooperates with both public and private financing partners;

(c) **Boundaries:** GCF distinguishes between co-financing and mobilized finance flows to adequately track and map where in the investment value chain the mobilization impact takes place. Based on the nature of the Funded activity and project and context specificity, GCF and the AE will agree on whether to report at the project or sub-project level. This enables GCF to transparently explain and show why some projects generate higher co-financing and mobilized finance amounts and ratios than others;

(d) **Causality:** GCF includes an assessment of the causal role by determining the financing that can reasonably be assumed to have been catalysed by the financing provided by GCF. Through this endeavour, GCF will gain better insights into its role as a catalyst of climate finance;

(e) **Point of measurement:** GCF tracks committed co-financing flows by default as those are included in the financing structure of funding proposals. GCF also tracks disbursed flows where applicable (e.g. usually not applicable in the case of guarantees) and available. This ensures that GCF tracks actual financing flows, but retains the flexibility to fall back to committed amounts where disbursed amounts are not applicable, or where data collection is not feasible (e.g. exact disbursed co-finance amounts to a project invested by a climate fund that is in turn invested by a fund-of-funds to which GCF provided financing); and

(f) **Reporting**: GCF tracks co-finance as agreed in the FAA and will report on direct co-finance and mobilized finance at project inception (through the funding proposal), during the monitoring phase (through reports) and at project completion/closure. This is in line with the approach of the main peer multilateral climate funds of GCF. It provides insights into progress, as well as the extent to which projects lived up to initial expectations (where applicable).

17. The staff from the Secretariat who is responsible for the project/programme, is expected to assess the plausibility of the co-finance and mobilized finance estimates and underlying assumptions, notably in cases of expected mobilized finance downstream.

18. During the project implementation and at project closure, defined as the end of implementation period, GCF AEs will report to the Secretariat on realized co-financing according to source and type, **as much as it is feasible and demonstrable on the basis of known financing structures**. This will include resources secured or mobilized during project

[4] It is expressed as a ratio where 1 represents the unit provided by GCF (e.g. 1:4 or 1:6.7).

implementation that are in addition to the co-financing confirmed at the time of Board approval. All such financing will count as realized co-financing and realized mobilized financing in monitoring and evaluation documents.

19. In relation to the GCF operational framework on complementarity and coherence, AEs are also requested to report funds received from other UNFCCC-mandated climate funds related to the proposed project, whether completed or done in parallel, **as much as it is feasible and demonstrable on the basis of known financing structures**.

5.2 Secretariat

20. The Secretariat will monitor overall portfolio public and private co-financing and both public and private mobilized financing that materialized as reported by the AE and will report to the Board on levels of co-financing and mobilized financing through the annual portfolio review or other such reports as the Board may determine. Reporting will include:

(a) The total direct co-financing and mobilized financing at the GCF level, including corresponding ratios, distinguishing public and private sources, and

(b) The total direct co-financing and mobilized financing at the individual project/programme level, including corresponding ratios, distinguishing public and private sources.

21. Reporting will take place based on the estimated amounts provided in the funding proposals. Once a project/programme is financed by GCF, the actual annually reported co-financing figures will also be reported, subject to data availability.

22. In reporting, the Secretariat will break down co-financing and mobilized financing amounts by private or public, and by type of instrument. This will further inform GCF as well as the climate finance community on the effective design of the climate policy and associated financial instruments in such a way as to mobilize further public and, in particular, private finance.

23. In reporting, the Secretariat will present results in a visual manner as much as possible to facilitate understanding. GCF will also provide explanations on the methodology, assumptions and challenges encountered in a transparent manner. This may be included in the reporting itself or through clear referrals to other GCF documents.

24. The GCF reporting methodology seeks to strike a balance between alignment with international guidance and the main approaches by partners (AEs) and peers, as well as practical limitations and current practices to date. The GCF methodology makes reference to guidance of the OECD, multilateral development banks, GEF, and the Climate Investment Funds.

Annex IV: Policy on concessionality

I. Objectives, scope and definitions

1. The purpose of this paper is to outline guiding principles that underpin the determination of the adequate level of concessionality for funding proposals, consistent with the GCF investment criteria for public and private sector operations.

2. GCF offers concessionality in order to facilitate high-impact climate actions that would otherwise not take place. In many countries, a paradigm shift towards low-emission and climate-resilient development pathways cannot be achieved through existing market mechanisms. Although reducing greenhouse gas emissions and increasing climate resilience have economic benefits for the public, these benefits are often under-priced in public and private investment decisions, leading to suboptimal outcomes. To circumvent these market failures, GCF provides concessional financing to align the financial incentives with the economic benefits, thereby leading to low-emission and climate-resilient investments. In accordance with paragraph 35 of the Governing Instrument, all developing country Parties to the United Nations Framework Convention on Climate Change (UNFCCC) are eligible to receive resources from the Fund.

3. This policy is consistent with and builds upon the initial guidance adopted by the Board in B.05/07, as set out in paragraph 8 below.

4. The application of further guidance on concessionality is relevant at various stages in the in the project approval process:

(a) At origination and design stages, through the determination of the applicable instruments (e.g. grant, loan, equity, guarantee);

(b) At financial due diligence and financing structure stage, through the definition of the terms and conditions underpinning the instruments (e.g. low- or high-concessional loans); and

(c) At post-implementation stage with regards to reporting on concessionality.

5. The proposal in this paper does not constitute a detailed methodology. The Secretariat will provide a restatement of principles and a detailed methodology.

6. The paper underscores the key principles to support concessionality for GCF funding proposals in order to achieve the following objectives:

(a) To provide guidance to ensure consistency and a systematic approach in the application of principles underpinning concessionality and the selection of GCF financial instruments. This guidance can facilitate the work of national designated authorities (NDAs) and accredited entities (AEs) in developing funding proposals by having a clearer description of the criteria to be used in linking the GCF financial instruments and their terms and conditions to specific activities in funding proposals;

(b) To facilitate the assessment of funding proposals with respect to principles and performance parameters agreed by the Board in decision B.05/07, such as maximizing leverage of GCF funding and avoiding crowding out private sector investments; and

(c) To facilitate the work of the Secretariat and the independent Technical Advisory Panel in assessing funding proposals, particularly with respect to the investment criteria, which underpins the review of the level of concessionality requested in funding proposals.

2. This process will require coordination with related policies on incremental and full cost calculation methodology, co-financing, the financial terms and conditions of the GCF financial

instruments and the risk management framework, among others. It will also require the Secretariat to elaborate tools for assessing projects according to the principles adopted by the Board and a robust programme of capacity-building among AEs and NDAs where necessary. As such, the policy is to be developed through a phased approach, thus enabling GCF to implement the changes gradually, learn from past experiences and improve the policy as necessary.

3. Previous studies conducted on behalf of the Secretariat by Nodalis Conseil as part of the review of the financial terms and conditions of the GCF's financial instruments (document GCF/B.21/05/Add.01) made a number of recommendations that could inform a concessionality approach. The table below summarizes those recommendations and explains how the Secretariat has dealt with these proposals:

Table 1: Selected recommendations from Nodalis Conseil in document GCF/B.21/05/Add.01

Recommendation (selected)	Action taken
There needs to be a clear methodology to assess and measure the level of concessionality.	This is provided through this paper, which further defines tools and evidence (for example, through economic and financial analyses) to derive pricing and conditions for lending, through the primary due diligence of AEs and the secondary due diligence by the Secretariat. In addition, both at design phase and at the reporting phase, the grant equivalent calculator can support calculations of equivalency across instruments.
Provide more guidance to AEs to enhance process predictability for all types of project (e.g. impact indicators).	This is addressed through the approval of the investment criteria indicators in decision B.22/15.
GCF resources would provide more overall leverage to public-sector projects if loan instruments were more frequently used.	More flexibility in conditions and rate setting is introduced here, whereby public-sector projects with a cash-flow and ability to repay (reflow generation) can be assessed on a case-by-case basis. In certain cases, a small grant may be more efficient than a loan in enabling GCF to leverage private sector financing.
Use of macro-characteristics and vulnerability.	This is an issue for discussion by the Board.
Seek to transfer concessionality equitably and efficiently in country-wide renewable energy or energy efficiency programmes that lower the cost of such investments in a given country and usually come in support of a national programme.	This is provided for in the principles of ensuring the trade-off between minimum concessionality and the right level of incentive to make that project viable.

Recommendation (selected)	Action taken
Differentiation of the level of scrutiny required on concessionality between pilots, scale-up and one-off funding proposals.	This can be explored further. However, justifications need to account for sustainability and viability of a funding proposal first vis-à-vis climate impacts to be achieved.
The IFC has been at the forefront of setting up an independent "Concessionality Committee" that functions very much like a Credit Committee. 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.	Each AE working with non-grant instruments has a dedicated committee where terms and conditions of loans and of co-finance operations are determined. This is part of the AE primary due diligence. The Secretariat also has an Operations Committee, which reviews the financial terms and conditions of funding proposals, among other responsibilities.
Definition and communication of a set of criteria to assist AEs in choosing the level of concessionality granted to a project or programme proposal.	As above, GCF works alongside the AE when determining concessionality and its application, including terms and conditions and pricing. Each AE working with non-grant instrument has a dedicated committee where terms and conditions of loans and of co-finance operations are determined. This is part of the AE primary due diligence. The Secretariat also has an Operations Committee, which reviews the financial terms and conditions of funding proposals, among other responsibilities.

II. Guiding principles

4. GCF concessionality will be applied to projects and programmes, subject to the principles and procedures in this policy, in alignment with the relevant GCF frameworks. The level of concessionality provided by GCF will be the minimum amount necessary to make a proposal viable, as assessed on a case-by-case basis, and help achieve the climate impact and paradigm shift objectives of GCF, as stated in the investment criteria.

5. Concessionality can be extended to interventions of both the public and the private sector, in several ways:

(a) As a non-reimbursable grant (i.e. 100 per cent concessionality), where there is no direct repayment (or reflow) mechanism, or in operations where a non-repayable capital expenditure or operational expenditure grant is most efficient;

(b) As minimum concessionality, typically to reflow-generating private sector clients or established sub-sovereign clients with revenue-generating operations (e.g. utilities). Reflows are the resources that are paid back as principal (capital repayment), interest, fees and capital gains. Terms can vary and can include below-market rates, as well as longer tenors and grace periods;

    (i) In funding proposals using debt structures, a concessional loan can have different seniorities (senior, pari passu, subordinated) and may have a heavily discounted interest rate with generally longer tenors and grace periods before first repayment, as well as facilitation of more flexible terms; and

    (ii) In equity, concessionality can be extended as first loss shares in junior positions in tiered funds or can be the "anchor" portion of the fund that de-risks the investment for private investors and thus catalyses further equity participation, with preferred equity returns for the private sector to move the flow of financing to climate finance sectors; and

(c) As guarantees, which can also be structured as instruments to address specific risks and barriers to investments, and can be deployed alongside other investment instruments, such as debt or equity.

6. GCF, in cooperation with the AEs, should always seek the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment, and avoid crowding out commercial financing.

7. Adopted by the Board in decision B.05/07, the following principles are restated as best practice in private sector operations and public sector funding proposals with the potential to generate reflows, namely the ability to repay the capital and interest received:

(a) Extend the **minimum level of concessionality needed** for the project or programme to make it viable, thus avoiding any market disruptions by **crowding out** private sector investors in the climate sector or otherwise distorting broader markets;

(b) Ensure that GCF intervention is mostly a catalyst for further co-financing, **crowding in** *other* investors, co-financiers or financial institutions; this is the case of acting as "anchor" capital in equity structures or in providing risk mitigation;

(c) Ensure the **sustainability of the intervention beyond first concessionality**, whichever the financing instrument used. This includes dedicated capacity-building and knowledge transfer in full concessionality instruments; or ensure 'graduation' or movement towards partial or full commercial viability, in the case of concessional loans;

(d) Structure the concessional product in such a way that it dedicates GCF resources to mitigation and adaptation measures that **address the root cause of market failures** and work towards the removal of barriers to pro-climate investments, thereby bringing market transformation towards low-emission and climate resiliency. This entails that certain instruments may be better suited than others to target specific barriers, for example support to alignment in policy and regulation may be best targeted through grants for policy dialogue, while project-related financial barriers such as lack of available finance may be best targeted through concessional debt or equity; and

(e) Ensure that the GCF concessional tranche is central to **upholding higher standards** in the development of funding proposals throughout the entire cycle, for example by including key consideration as defined in the investment criteria of GCF.

7. The above principles will be implemented in the assessment of funding proposals in the context of the review of the investment criteria. For example, some of the above can be assessed in the various subcriteria indicators under the effectiveness and efficiency criteria of the investment framework. Others can be assessed under the paradigm shift potential of the investment framework, under the scaling for subcriteria indicators on knowledge learning, and the creation of an enabling environment.

III. Guidelines for implementation

8. When developing funding proposals, AEs, executing entities (EEs) and GCF need to elaborate the following to determine its financial structure:

(a) The cost of the project, including an assessment of whether the costs are reasonable;

(b) Current market rates and conditions, including average costs and returns for similar investments in the country;

(c) An analysis of barriers and risk to the investment;

(d) The cost to hedging local currencies, or the cost of currency swaps, if such foreign exchange risk management options are sought by clients;

(e) In case of financial intermediation between the underlying project and GCF, AEs and EEs should analyse the pricing mechanism at each level and target financial terms AEs and EEs aim to provide to final beneficiaries;

(f) The cost and funding needs that should be financed by GCF;

(g) The instruments GCF should use to finance its portion of the costs;

(h) Comparison between GCF concessionality and that of co-financing, particularly that of the AE, based on pricing, tenor, grace period, seniority, fees, estimated returns and grant equivalency; and

(i) The grant equivalency in case of non-grant transactions.

IV. Policy on concessionality

9. Since its tenth meeting, the Board has discussed options for a concessionality policy at multiple Board meetings. Most of these discussions have focused on one of two different systems for determining the level of concessionality in a project. The first seeks to provide rules-based criteria to decide the level of concessionality available for a funding proposal based on extrinsic factors of the project. The second seeks to determine the level of concessionality based on intrinsic factors of the project. Board consultations have highlighted the merits and challenges of each system, and these consultations are summarised in annex V. The proposal presented below has taken into consideration these views and the guidance received from the Board. The intent of this paper is to seek the Board's guidance, in order to develop a detailed methodology on concessionality.

10. The approach is project-based for all private sector and all sub-sovereign operations where the project proponent is majority publicly owned with a revenue generating stream and is based on current rates and conditions as determined in the financial terms and conditions of the Fund for the other cases.

11. This approach recognizes the needs of the private sector to be granted flexibility to determine concessionality on the basis of market conditions, while also recognising that sub-sovereign, revenue-generating projects which are majority publicly owned have characteristics similar to private sector projects. Therefore, their concessionality can be based on market conditions (including financial and economic analysis, as stated below):

(a) Concessionality for **private sector projects** will be determined on a case-by-case basis (as they are now) according to the needs of the project, consistent with the guiding principles outlined in section II and the guidelines for implementation outlined in section III;

(b) Concessionality for **public sector projects (e.g. sub-sovereign) with reflows** (i.e. resources that are paid back as capital and interest) will be determined according to the needs of the project, consistent with the guiding principles outlined in section II and the guidelines for implementation outlined in section III; and

(c) Concessionality for **public sector projects with no reflows** will be determined by the current financial terms and conditions of the Fund.

12. After the project has gone through the incremental and full cost calculation process, and the amount that the GCF will finance is known or being negotiated, then an assessment will be undertaken by the GCF Secretariat and supported by the proposing AE, with the aim to agree on:

(a) The most appropriate financial instrument for the proposal that is being presented for approval to the GCF (e.g., grant, concessional loan, equity, guarantee). The GCFs initial Investment Framework states that only revenue-generating activities that are intrinsically sound from a financial point of view will be supported through loans by the Fund.

(b) The financial and economic analysis of activities proposed in the project, as well as strategic considerations will help determine the most suitable instrument for GCF funding. These analyses are provided in the funding proposal package. These analyses could include consideration of country circumstances in relation to the project, as proposed in the Nodalis Conseil review of the financial terms and conditions (document GCF/B.21/05/Add.01);

(c) The grant equivalency (in non-grant structures) can be derived used the Grant Equivalency calculator (GEC). This can be done both for the GCF component as well as for the entire financing package; and

(d) The terms and conditions to be applied (e.g. interest rates, tenors, grace periods, seniority, fees, investment ratios).

Table 2: Concessionality - How it is applied

Terms and conditions		**How to determine**
Choice of financial instrument	- Grant - Non-grant: loan, guarantee, equity	- Financial analysis - Cash-flow analysis - Economic analysis - Strategic context - Grant equivalent calculator (GEC)
Establishment of conditions	- Interest rate - Tenor - Grace period - Local currency - others	- Qualitative and quantitative analysis - Market overview - Technical, risk or financial assessment - Grant equivalent calculator (GEC)
Reporting	- Intensity/equivalency of concessionality - Other qualitative / descriptive	- Grant equivalent calculator (GEC)

13. In addition to the above, and in support of existing GCF policies and consistent with the mandate of GCF and recognised principles in blended finance, the following will also be assessed by the Secretariat, in order to support the choice of financial instrument to be used and the pricing and conditions applied:

(a) The existence and availability of other climate finance products and the elements or areas they address;

(b) Whether the project would occur without concessional resources, thus ensuring GCF additionality; this could include consideration of country circumstances in relation to the project, as identified in the Nodalis Conseil review of the financial terms and conditions (document GCF/B.21/05/Add.01);

(c) Evidence (e.g. market studies; technical, risk or financial assessments) to inform decisions on the size and type of concessionality alongside the objective of that concessionality, that is, to remove barriers related to affordability;

(d) A financial analysis that calculates the internal rates of return with and without GCF concessionality and estimates whether a project generates sufficient reflows to be sustainable;

(e) Sensitivity analyses using different models, rates and conditions to test different scenarios;

(f) Assessments of the primary due diligence of the accredited or executing entity;

(g) The capacity of the borrower to repay;

(h) An economic analysis that estimates both the financial and non-financial benefits of the project (e.g. reduced greenhouse gas emissions) against the counterfactual scenario that would prevail without the project, especially for projects without reflows; and

(i) An assessment of risk to ensure that concessionality is not captured by intermediaries but that it is shared between GCF and co-financiers as appropriate and extended to the end-beneficiaries of a given transaction.

14. A project-based approach to determining concessionality has clear efficiency benefits, as it improves the ability to determine the minimum concessionality needed to make the project viable. Such efficiency improvements could enable GCF to finance more projects using the same budget envelope. The application of the guiding principles and guidelines for implementation described in sections II and III also improve over existing practice by providing greater transparency and consistency.

15. Extending a case-by-case approach to certain public sector projects could also be studied as part of the review of the financial terms and conditions of the Fund.

Annex V: Timeline and background of policy on concessionality since B.10

BM	Proposal	Objections and comments
B.10	• The Board, through decision B.09/04, adopted two types of concessional loans: high concessionality and low concessionality. The Board furthermore decided to consider a proposal at its tenth meeting regarding the **cases in which the high-level concessional terms and the low-level concessional terms would apply.** • The Secretariat prepared document GCF/B.10/06, "Levels of Concessional Terms for the Public Sector", which provided an analysis of best practices for the determination of the level of concessionality for public-sector projects in other institutions. It outlined three options for the cases in which various levels of concessionality will apply for the public sector: 1. **Project based**, which based levels of concessionality on project characteristics, such as the revenue generation and economic viability; 2. **Project and income level based**, which based levels of concessionality both project characteristics and country income levels, with higher concessionality going to lower income countries; and 3. **Project, income level and vulnerability based**, which based levels of concessionality on project characteristics, country income levels and the degree to which the project targets vulnerable communities, with higher concessionality going to those that do target vulnerable communities. • Following further discussions by Board members and owing to a **lack of consensus** it was agreed that the RMC, with the support of the Secretariat, would present a revised decision to the Board at its twelfth meeting.	Main objections from discussions at the meeting include: • Some Board members sought clarity on the **definition of vulnerability**. A number of Board members felt that, instead of referring to income levels, the definition should correspond to existing definitions in the context of the UNFCCC. • Some Board members saw **criteria relating to income and sovereign indebtedness as useful** and felt that it should be taken into account, whilst others did not support this approach. One Board member saw it as pre-judging the ability of countries to promote the paradigm shift through access to the Fund. • Another Board member stressed that there should be **no further categorization of developing countries in the Fund as this would contradict the UNFCCC.** • One Board member saw it as equally important to **consider countries' access to finance**. Another Board member stated that the Fund should take into account country capacities and existing debt structures. • Many Board members backed an approach to determine the level of concessionality on a **case-by-case basis**. • Many Board members backed the **project-based approach** in determining the level of concessionality.
B.17	• After the issue was deferred a few times, in decision B.17/10, paragraph (c), the Board requested the Secretariat, under the guidance of the Co-Chairs, to develop a	

<table>
<tr><th>BM</th><th>Proposal</th><th>Objections and comments</th></tr>
<tr><td></td><td>proposal… to address, among other issues, “options for further guidance on concessionality, building on related work.”

• Also in decision B.17/06, the Board instructed the Secretariat to ensure that the financial terms and conditions proposed in concept notes and funding proposals for concessional loan products meet the principle of minimum amount of concessionality, among others, and apply the financial terms and conditions set out in decision B.09/04 in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.</td><td></td></tr>
<tr><td>B.19</td><td>• Secretariat published a draft document GCF/B.19/12/Rev.01 titled “Options for further guidance on concessionality, building on related work”, which proposed 3 options:
1. Revisit options discussed as B.10 to increase the range of projects falling under a rules-based approach;
2. Redefine the “efficiency and effectiveness” investment criterion to more explicitly consider concessionality in a broader context; or
3. Implement concurrently both options 1 and 2.

• However, the Board could not agree on concessionality document and urged on the need for a technical and practical approach regarding financial terms and conditions, investment criteria indicators, and a grant equivalent calculator.

• Board also requested the Secretariat through decision B.19/06, paragraph (d) to develop an integrated approach to resolve interrelated policy matters for consideration at its twentieth meeting including “policies on the review of the financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs, and co-financing.</td><td>Main objections from discussions at the meeting and from a call for inputs on B.19 agenda items include:

• Level of concessional finance offered by GCF should be calculated based on the specific characteristics and requirements of each project, not the overall characteristics or income level of the country concerned. Any country classification that is done should be in line with the Governing Instrument and not simply based on income levels.

• Rules-based approach:
○ A rules-based approach may not be consistent with the UNFCCC and in order to maximize the transformational impact of a project, it would be necessary in certain cases to increase, rather than reduce, the level of concessionality offered;
○ If a purely rules-based approach were used, entities co-financing GCF projects could use GCF concessional finance as a way to minimize their own concessional rates and financial risk; and
○ A rules-based approach helps in cost efficiency and predictability, so it is encouraged to go towards rules-based approach as far as possible. GCF</td></tr>
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BM	Proposal	Objections and comments
		should build on existing work such as the "Hamburg principles" and the DFI Working Group on blended concessional finance. GCF should abide by those widely recognized principles, with regard to its private sector operations. • **Financial risks should not be shifted from GCF onto developing countries** and said that the purpose of GCF, in line with previous climate negotiations, was to provide developing countries with funding for mitigation and adaptation projects that did not necessarily need to be repaid. • Purpose of concessionality: (a) to **make investments possible** that would otherwise not be and therefore, concessionality should be set at the minimum amount versus (b) to **maximize the use of GCF funds.**
B.20	• Prior to publication, through Board consultations, the Secretariat received comments on topics such as key variables, examination of the grant equivalence of overall proposal, grant equivalents of different transactions structures, and the need to consider Nodalis report. • The proposal stated that GCF will base the degree of concessionality on the nature of each funding proposal, as a function of **three key variables:** the proposal's strengths in delivering **climate impact, paradigm shift potential, and potential for reflows.** It would be applied in the following ways: ○ **Private sector =** case-by-case based on the **needs of the project** and the **three variables;** ○ **Public sector with reflows =** case-by-case based on the **needs of the project** and the **three variables** within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions.**	Main objections and comments from these consultations include: • The **'three key variables' listed in the paper (the proposal's strengths in delivering climate impact, paradigm shift potential, and potential for reflows) should not determine concessionality**, as impact and paradigm shift potential more closely relate to existing GCF investment criteria, i.e. whether a proposal warrants GCF support, whereas other factors should determine the terms of that support. The variables are problematic, particularly in the case of private sector projects where they risk introducing market distortions; • **Link the degree of concessionality to that necessary to overcome market failures and other barriers**, lack of data and knowledge, perceptions of risk, capacity and political economy barriers; as well as affordability questions, e.g. related to a country's access to capital markets, that otherwise make the project unviable;

BM	Proposal	Objections and comments
	• Taking these comments into consideration, the Secretariat **removed 3 options and proposed only on guiding principles and implementation phases.** • A draft document GCF/B.20/19 titled "Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing" was published containing a combined decision text. The document noted on the linkages between incremental cost and full cost, concessionality and co-financing and set out principles and definitions of concessionality in Annex III. • The item was included in the B.20 meeting agenda, but it was **not opened during the Board meeting.**	• The concessionality level does not consider the mobilisation effect of the instruments nor the grant equivalent and its size compared to alternative transaction structures. If the **GCF can leverage private sector financing with a small grant**, this might be more efficient than a large concessional loan. As a consequence, some Board members felt that the GCF restricts the use of potentially highly efficient and catalytic grants to a very small number of projects; and • The term **reflows needs to be defined.** If economic viability of a project is given, any initial investments will be somehow repaid (either by revenues (e.g. in RE), reduced spending (e.g. in EE) or in a reduced risk exposure (e.g. in adaptation). If such a wide definition of reflows would be applied, some Board members struggled identifying any projects with no reflows in the ex-ante perspective.
B.21	• In preparation for B.21, guidance from Co-Chairs was to separate the 3 papers and present separate decision text. • Through Board consultations, the Secretariat received comments on the concessionality level and best practices and other approaches. • Taking these comments into consideration, the Secretariat proposed a draft document GCF/B.21/24 titled "Options for further guidance on concessionality", which proposed options similar to B.20 but without the three key variables: ○ **Private sector =** case-by-case based on the **needs of the project;** ○ **Public sector with reflows =** case-by-case based on the **needs of the project** within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions.**	Main objections and comments from these consultations include: • Re finding in Annex III relating to approved private sector projects that **those with high impact potential and transformational change potential** (and high potential for reflows) **generally see greater grant equivalence** in their funding: The **implication of this finding is not clear** (including whether it is simply an observation of past practice or a suggestion of expected future practice); • Annex III also links high potential for reflows with a high score for efficiency and effectiveness; however, this is not our interpretation of efficiency and effectiveness – indeed all the **private sector proposals have high potential for reflows from loans or equity** as these are the main instruments, **but this does not mean they should therefore be financed on highly concessional terms;**

BM	Proposal	Objections and comments
	• The item was included in the B.21 meeting agenda, but it was **not opened during the Board meeting.**	• Grant equivalence should not only be provided for reporting purposes and only once a project is approved. The **grant equivalent needs to be provided in advance of any investment decision** in order to ensure an efficient use of GCF funds; • The **terms of GCF support should not be determined only after the amount that the GCF will finance is known –** ideally the two (amount and terms) need to be considered together since overall grant equivalence rates can also be affected by the relative size of the GCF contribution; and • Other comments were **reiterated from B.20.**
B.22	• While an updated document was being drafted by the Secretariat, the item was dropped from the final agenda because of other impending items. There was no Board consultation, and the item was ultimately **not included in the meeting agenda.**	
B.23	• Guidance was given from Co-Chairs **to integrate the papers under review of investment framework with one combined decision text** from incremental and full cost, co-financing and concessionality. The draft Concessionality Policy proposed the following: ○ **Private sector = case-by-case** based on the needs of the project; ○ **Public sector with reflows = case-by-case** based on the needs of the project within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions** • Taking these comments into consideration, the Secretariat revised to share with the CC teams for clearance.	Main comments from Board consultation include: • Through B.23 Board consultations, the Secretariat received comments on the need to include findings of the Nodalis report and the use of grant equivalence; and • Reiteration of the use of the grant equivalence during the initial assessment of concessionality in relation to co-finance and to the terms and conditions, and then also reported.

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