



**GREEN
CLIMATE
FUND**

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Terms of reference for the annual review of the financial terms and conditions of the Green Climate Fund financial instruments

Summary

At its ninth meeting, the Board adopted the financial terms and conditions for the financial instruments of the GCF and decided that they would be reviewed annually. This document proposes the terms of reference for such a review.

I. Introduction and background

1. The GCF provides financial instruments through accredited entities (AEs), including grants, both with and without repayment contingency, concessional loans, equity and guarantees. The Board, through decision B.09/04, adopted the financial terms and conditions of these instruments, including:

- (a) Terms and conditions of grants, which may be provided with or without repayment contingency;
- (b) Terms and conditions of concessional loans to the public sector, for which two categories were defined: high concessionality and low concessionality. For each case, maturity, grace periods, repayment profile, interest, and service and commitment fees were specified; and
- (c) Terms and conditions of other financial instruments provided to the public sector, as well as of all non-grant instruments extended to the private sector, are to be determined on a case-by-case basis, taking into consideration the guiding principles and factors for determining terms of financial instruments adopted in decision B.05/07 (annex III to document GCF/B.05/23) and the investment guidelines contained in the initial investment framework adopted in decision B.07/06 (section III of annex XIV to document GCF/B.07/11).

2. It was also established in decision B.09/04 that the financial terms and conditions of the instruments of the GCF would be reviewed annually. In decision B.12/15, the Board requested the Investment Committee to provide the draft terms of reference for the annual review.

3. This document presents the proposed approach to undertaking such a review, taking into account the experience gained by the Board during its first year of approval of projects/programmes as well as the practices of other organizations and market developments. The review may inform the future work on indicative minimum benchmarks.

II. Elements to be considered during the review

2.1 Lessons learned from projects/programmes approved by the Board

4. As of its fourteenth meeting, the Board had approved total of 27 projects/programmes serving the public and private sectors. The table below summarizes the financial instruments used to support these project/programmes.

Table 1: Projects/programmes approved by the Board: distribution of financial instruments

Financial instrument	Amount (million USD)
Grant	541.6
Concessional loans to the public sector	80
Loans to the private sector	393
Equity	135
Guarantee	20
Total	1,169.6

5. In a funding proposal, AEs request the financial instrument to be used in support of the proposed project/programme, in close cooperation with national designated authorities through the no-objection procedure. As part of its second-level due diligence, the Secretariat reviews that request, taking into account the guiding principles and factors for determining terms of financial instruments and the investment guidelines referred to in paragraph 1(c) above, including with regard to:

- (a) The adequacy of the level of concessionality requested to ensure that the activities are viable and financially sustainable, and that the terms and conditions provide appropriate incentives to carry out mitigation and adaptation activities and avoid generating market distortions and the displacement of other sources of financing;
- (b) The indebtedness capacity of the recipient;
- (c) Leveraging of other sources of financing;
- (d) Risk due diligence;
- (e) The average concessionality or grant element of the financial inputs to the GCF and the average concessionality or grant element of the financial instruments of the GCF;
- (f) The expertise and capacity of the AEs;
- (g) Risk sharing between public and private investment, when relevant; and
- (h) The use of loans only for revenue-generating activities.

6. It is recommended that the proposed review take stock of the projects/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 should take into account all the financial terms and conditions (interest rate, commitment fee, service and other fees, tenor and grace period of the financial instrument). The review should 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).

7. Specifically, the review would:

- (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 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 AE and the executing entity. This 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; and

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

8. Additionally, the review can 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.

2.2 Practices used by other organizations and other market developments

9. As a continuously learning institution, the GCF should periodically assess the evolution of the practices of other institutions with respect to the terms and conditions of their financial instruments. Additionally, it is important to assess the evolution of overall financial markets and the prevailing terms and conditions of financial instruments from other institutions in order to gain insights. GCF's financial terms and conditions should take into account current market conditions and must be consistent with previous Board decisions, including the need to avoid market distortions while providing the necessary incentives to make mitigation and adaptation activities viable.

10. The proposed review should therefore take stock of such practices with respect to the terms and conditions of the financial instruments used by other organizations with policy mandates related to those of the GCF. Emphasis should be placed on any changes that may have taken place since October 2014, when the Secretariat provided the Board with a review of the practices of other organizations providing concessional loans.¹ Institutions should 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.

11. Additionally, particularly with respect to financial instruments provided to the private sector, the practices of other institutions active in the area of climate financing should be assessed. This should include 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.

12. The Secretariat may seek the support of external consultants or a consultancy firm to deliver the review report.

III. Proposed deliverables of the review

13. The output of the review will be a report to the Board based on the assessment of the elements defined in chapter II above. The review report may propose additions or adjustments to the adopted financial terms and conditions for the Board's consideration, consistent with GCF policies. The review report is aimed for delivery at the B.16 meeting and no later than the B.17

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

meeting. An interim update on the status of the review will be provided to the Investment Committee before the final report.

14. The first review is expected to generate lessons learned, not only related to GCF's 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 this terms of reference for Board consideration.

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.15/9 titled “Terms of reference for the annual review of the financial terms and conditions of the Green Climate Fund’s financial instruments”:

- (a) Adopts the terms of reference for the review of the financial terms and conditions of the Green Climate Fund’s financial instruments contained in annex II to this document; and
- (b) Requests the Secretariat to carry out such a review, with support from external consultants and in consultation with the Investment Committee, with the aim to submit a review report to the Board at its sixteenth meeting, and no later than its seventeenth meeting.

Annex II: Terms of reference for the review of the financial terms and conditions of the Green Climate Fund's 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 the 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; and

- (g) Assess the approach taken to measure the grant equivalence of each project/programme and proposed enhancements to the methodology.
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 GCF's 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 this 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".