

Green Climate Fund

Policies and Procedures for the Initial Allocation of Fund Resources

GCF/B.06/05

7 February 2014

Meeting of the Board

19-21 February 2014

Bali, Indonesia

Agenda item 9

Recommended action by the Board

It is recommended that the Board:

- (a) Takes note of the information presented in document GCF/B.06/05 *Policies and Procedures for the Initial Allocation of Fund Resources*; and
- (b) Adopts the draft decision presented in Annex I to this document.

Policies and Procedures for the Initial Allocation of Fund Resources

I. Introduction and linkages with other documents

1. At its October 2013 meeting, as part of its consideration of the Fund's business model framework, the Board, in its decision B.05/05:

- (g) *"Request[ed] the Secretariat to develop and present to the Board at its second meeting in 2014 a resource allocation system, based on this decision and taking into consideration the views expressed by the Board, that facilitates:*
- (i) *Cross-cutting proposals;*
 - (ii) *A results-based approach;*
 - (iii) *A country-driven approach;*
 - (iv) *A geographically balanced approach; and*
 - (v) *Private sector mitigation and adaptation activities at the national, regional and international levels."*

2. As part of its decision on the work plan of the Board for 2014, the Board foresaw the document to address the policies and procedures for initial resource allocation (decision B.BM-2013/04, Annex III).

3. This document builds on document GCF/B.05/05 and Board deliberations, in particular its decision B.05/05. This decision provides clear guidance, as the Board:

- (a) *"Decide[d] that the Fund will adopt a theme/activity-based approach to the allocation of resources in order to meet the Fund's objectives;*
- (b) *Decide[d] that the Board will keep the allocation system under review with the intention of improving it over time;*
- (c) *Decide[d] that the Fund will initially make allocations under adaptation, mitigation and the Private Sector Facility, and that there will be balance between adaptation and mitigation and the appropriate allocation of resources for other activities;*
- (d) *Decide[d] that, in relation to adaptation, resources will be allocated based on:*
 - (i) *the ability of a proposed activity to demonstrate its potential to adapt to the impacts of climate change in the context of promoting sustainable development and a paradigm shift;*
 - (ii) *the urgent and immediate needs of vulnerable countries, in particular LDCs, SIDS and African States;*
- (e) *Decide[d] that, in relation to mitigation, resources will be allocated based on the ability of a proposed activity to demonstrate its potential to limit and reduce greenhouse gas emissions in the context of promoting a paradigm shift;*
- (f) *Decide[d] that, in relation to the Private Sector Facility, resources will be allocated based on the contribution a proposed activity makes towards promoting a paradigm shift and to:*

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- (i) *Directly and indirectly finance private sector mitigation to limit and reduce greenhouse gas emissions and adaptation to the impacts of climate change activities;*
 - (ii) *Promoting the participation of private sector actors in developing countries, in particular local actors, including small and medium-sized enterprises and local financial intermediaries, and activities to enable private sector involvement in SIDS and LDCs.”*
 4. This document should be read together with documents:
 - (a) *Initial Proposal Approval Process, Including the Criteria for Programme and Project Funding (Progress Report) (GCF/B.06/08);*
 - (b) *Initial Modalities for the Operation of the Fund’s Adaptation and Mitigation Windows, and the Private Sector Facility (GCF/B.06/02) (that provides a framework for documents presented to the Board at its February 2014 meeting); and*
 - (c) *Investment Framework (Progress Report) (GCF/B.06/11).*
 5. Together, these processes will ensure that the Fund remains flexible, responsive and country-driven.

II. General considerations

6. **Available resources:** An initial resource mobilization is planned once the essential requirements are met. The Board will focus on working towards meeting these requirements at its February and May 2014 meetings. Following that, the Secretariat expects additional resources to be pledged from time to time by governments and the private sector, including through replenishments. The total pool of resources available for commitment by the Fund in the form of grants and/or concessional loans will vary from one year to another.
7. **Definitions:** It is recommended that initial allocation targets be specified and monitored in terms of cumulative commitments, i.e. the resources committed by the Fund, including through the Private Sector Facility (PSF), to specific themes, as a percentage of the Fund’s total cumulative resources available for financing of proposed activities over comparable periods.
8. **Grant equivalence:** On the liability side of the Fund’s balance sheet, the Fund may receive resources either as capital contributions, grants or concessional loans. On the asset side, the Fund may commit resources either as grants or concessional loans. On both sides of the balance sheet, concessional loans will be converted into grant-equivalents (net present values) at the same discount rate. These discounted grant-equivalent values will be used to calculate allocation targets for all categories identified by the Board. The Secretariat will consult the Board about the choice of discount rate(s) for reporting purposes.
9. **Initial two-tier allocation system:** Following extensive deliberations, the Board decided to start Fund operations with a two-tier allocation system:
 - (a) The **first tier** will set allocation targets relative to available resources for two *themes* (mitigation and adaptation) and one *modality* (the PSF). Additionally, a minimum floor target will be set for *country* groups identified as being particularly vulnerable to the adverse effects of climate change: least developed countries (LDCs), small island developing States (SIDS) and African States; and
 - (b) The **second tier** will allocate available resources to proposed *activities*. The second tier is elaborated upon in document GCF/B.06/08. In this second tier, there will be an element of competition for the use of Fund’s resources both for the private and the public sectors. Proposals will be evaluated against their potential contribution to a paradigm shift and on their potential mitigation and/or adaptation benefits.

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10. The Board will keep the allocation system under review with the intention of improving it over time.
11. **Rationale for the first-tier initial allocation targets.** The Governing Instrument (paragraph 50) requires the Board to “balance the allocation of resources between adaptation and mitigation activities under the Fund and ensure appropriate allocation of resources for other activities.” There are, however, no Board decisions that provide more specific guidance or specify quantitative targets. In the absence of any scientific or economic basis for setting these quantitative targets, the Board can adopt a transparent and iterative process by which it will:
- (a) Set initial targets, as proposed in Annex I; and
 - (b) Adjust these targets as necessary, to respond to the lessons learned in the Fund’s start-up period. This process will also allow for the political consensus to evolve over time.
12. **Interaction with the results management framework:** The Governing Instrument (paragraph 51) states that:
- “A results-based approach will be an important criterion for allocating resources.”*
13. The reports foreseen in the implementation of the results management framework will inform the Board and the Secretariat about the mitigation and adaptation results attributable to the Fund’s financing in relation to the Fund’s result areas. These reports would normally include:
- (a) **Performance measurement** of on-going projects and programmes;
 - (b) **Ex-post impact assessment** of projects and programmes whose implementation has been completed; and
 - (c) **Evaluation**, usually bringing together lessons learned from a group of activities (projects or programmes) over a longer period of time.
14. The wealth of information available at these three levels of the results management framework will be an important input into future Board decisions on both tiers of allocation, including:
- (a) Whether to change the balance between the thematic allocation targets;
 - (b) Whether to change the allocation target for the PSF;
 - (c) Whether to change the allocation floor targets for country groups (LDCs, SIDS and African States) under the adaptation theme; and
 - (d) Whether or not to approve financing for individual projects or programmes submitted to the Board (i.e. second-tier allocation decisions).

III. Recommendations

15. **Balance between mitigation and adaptation.** At present, a significant majority of climate finance worldwide goes to mitigation rather than to adaptation. While it is difficult to scientifically ascertain “balance” and set such an allocation target ex ante, the Board could adopt 50/50 as the medium-term allocation target between mitigation and adaptation. Such a target would ensure a sustained focus on increasing the share of resources committed to adaptation.
16. **Private Sector Facility (PSF).** Separately from the mitigation and adaptation allocation targets, the Board decided to also make an initial allocation for activities funded under the PSF. Over the medium term, it is clear that private sector resources will become one of the main sources of climate change financing. From that perspective, a significant medium-term share of allocations could be both desirable and credible. For the shorter term, the Board may wish to

approve an initial start-up allocation target of 20 per cent for the PSF. Strong results from the private sector would provide a basis for the Board to revise the PSF target allocation upwards in future. In reporting back to the Board on the results emerging from the PSF allocations, the Secretariat will also report on the PSF's progress in promoting the participation of private sector actors in developing countries, in particular local actors, including small and medium-sized enterprises and local financial intermediaries, and activities to enable private sector involvement in LDCs, SIDS, and African States.

17. **Particularly vulnerable countries.** The Governing Instrument (paragraph 52) states that:

"In allocating resources for adaptation, the Board will take into account the urgent and immediate needs of developing countries that are particularly vulnerable to the adverse effects of climate change, including LDCs, SIDS, and African States, using minimum allocation floors for these countries as appropriate."

18. Decision B.05/05, paragraph (d) (ii), also states that:

"...in relation to adaptation, resources will be allocated based on: the urgent and immediate needs of vulnerable countries, in particular LDCs, SIDS and African States."

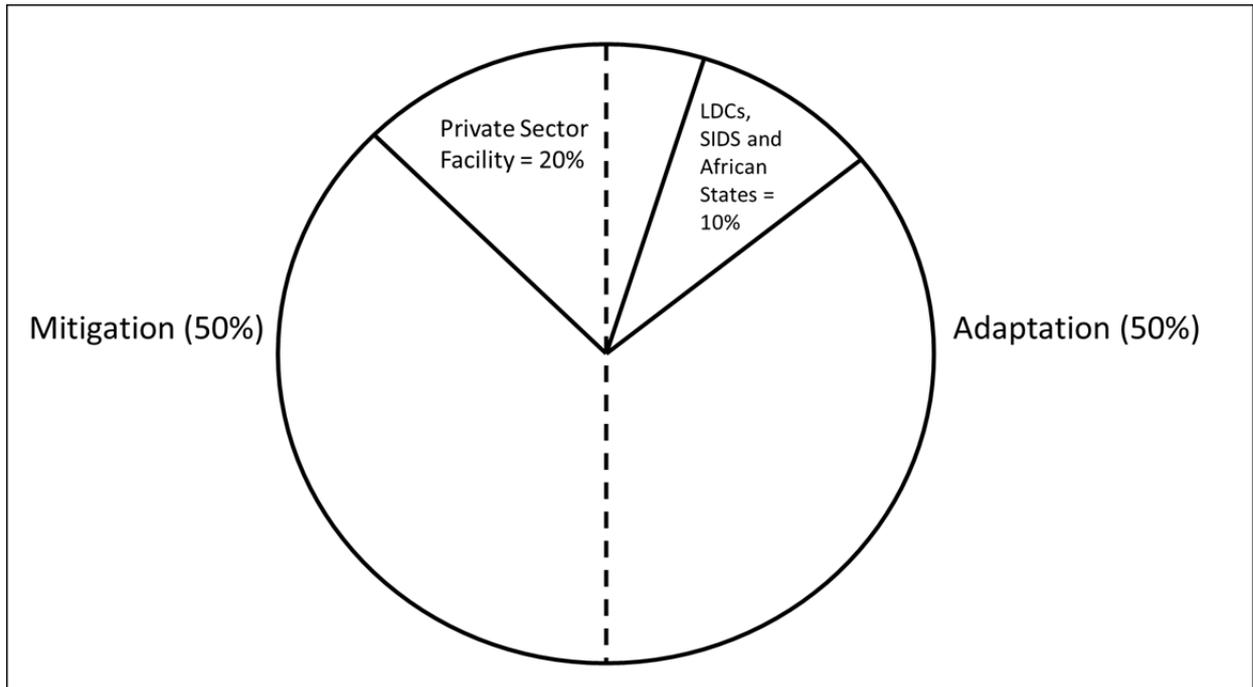
19. In response to these mandates, this document does not attempt to identify "particularly vulnerable countries" but seeks to establish an allocation target within the adaptation theme for the following group of countries: LDCs, SIDS and African States. The Board may approve an initial *floor allocation* target of 10 per cent for this group of countries. At any time, the Board may review and revise the working definition of this group of countries, as appropriate.

20. **Geographic balance.** The Governing Instrument (paragraph 52) stipulates that the "Board will aim for appropriate geographic balance." While there is no further Governing Instrument or Board guidance on geographical balance, the Board may introduce a universal *single-country limit* to ensure that Fund resources are deployed equitably across eligible developing countries. This ceiling would cap the Fund's total cumulative commitments to one country, in grant-equivalent terms, at five per cent of the Fund's total cumulative commitments. Using grant-equivalence for this target will allow countries that are better positioned to incur new debt obligations to take a larger share of Fund's loan resources at undiscounted face value. The single-country limit is an important part of the overall allocation system and should be reviewed by the Board from time to time. In the event that the Fund introduces a third-tier, country-based, allocation system in the future, the third tier would replace the single-country limit.

21. **Periodic adjustments of allocation targets.** The Secretariat would report to the Board once a year. The report would:

- (a) Outline commitment outcomes versus commitment targets for all targets;
- (b) Outline planned corrective actions to ensure more rapid progress towards reaching the commitment targets in the following year; and
- (c) Recommend to the Board possible changes to the commitment targets to reflect the lessons learned in the previous year.

Figure 1: Illustration of initial first-tier allocations



Annex I: Draft decision of the Board

The Board, having reviewed document GCF/B.06/05 *Policies and Procedures for the Initial Allocation of Fund Resources*:

- (a) Adopts an overall target range of 30-50 per cent between cumulative commitments for mitigation and cumulative commitments for adaptation (including, in both cases, resources committed through the PSF);
 - (b) Adopts an initial target of 20 per cent of total cumulative commitments for the funding committed through the Private Sector Facility for both mitigation and adaptation;
 - (c) Adopts an initial target floor allocation of at least 10 per cent of total cumulative commitments for the funding committed to adaptation in particularly vulnerable countries;
 - (d) Adopts a ceiling of five per cent for any one country's share of total cumulative commitments (in grant-equivalent terms); and
 - (e) Requests the Secretariat to report to the Board at least once a year on the progress towards reaching these targets for cumulative commitments, together with recommended corrective actions and possible changes to these targets, as necessary.
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