

Green Climate Fund

Initial Proposal Approval Process, Including the Criteria for Programme and Project Funding (Progress Report)

GCF/B.06/08

11 February 2014

Meeting of the Board

19-21 February 2014

Bali, Indonesia

Agenda item 12 (a)

Recommended action by the Board

It is recommended that the Board:

- (a) Takes note of the information presented in document GCF/B.06/08 *Initial Proposal Approval Process, Including the Criteria for Programme and Project Funding (Progress Report)*; and
- (b) Provides guidance to the Secretariat on the way forward with regard to the finalization of the initial proposal approval process.

Initial Proposal Approval Process, Including the Criteria for Programme and Project Funding (Progress Report)

I. Introduction

1. At its October 2013 meeting, the Board requested the Secretariat to develop and present an initial process for the review and approval of proposals to the Board, including the criteria for programme and project funding, at its second meeting in 2014.
2. The Board's request relates to paragraph 53 of the Governing Instrument:
"The Fund will have a streamlined programming and approval process to enable timely disbursement. The Board will develop simplified processes for the approval of proposals for certain activities, in particular small-scale activities."
3. This document provides a progress report on the process of review and approval of funding proposals.

II. Linkages with other documents

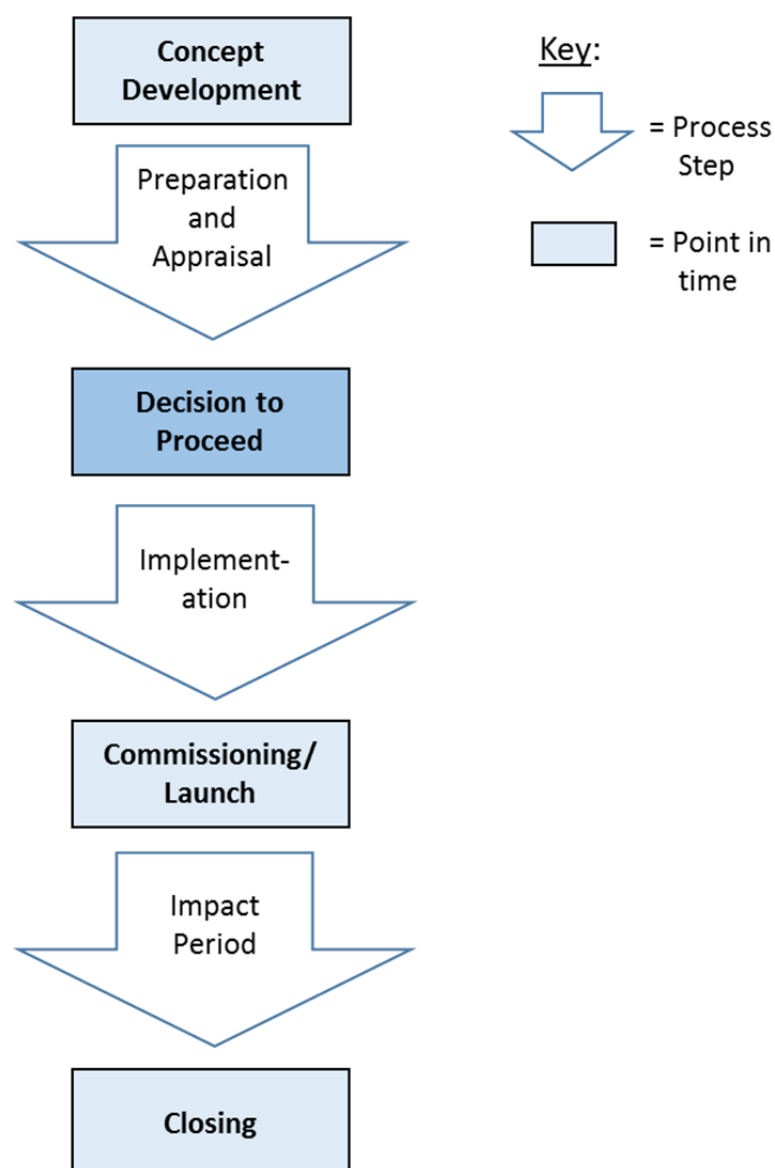
4. This document has linkages and cross-cutting matters with the following documents (each focusing as closely as possible on its own topic to avoid redundancy and repetition):
 - (a) *Initial Modalities for the Operation of the Fund's Mitigation and Adaptation Windows and the Private Sector Facility* (GCF/B.06/02);
 - (b) *Initial Results Management Framework of the Fund (Progress Report)* (GCF/B.06/04);
 - (c) *Policies and Procedures for the Initial Allocation of Fund Resources* (GCF/B.06/05);
 - (d) *Financial Risk Management Framework (Progress Report)* (GCF/B.06/10);
 - (e) *Investment Framework (Progress Report)* (GCF/B.06/11);
 - (f) *Detailed Programme of Work on Readiness and Preparatory Support* (GCF/B.06/14);
 - (g) *Additional Modalities that Further Enhance Direct Access, Including Through Funding Entities* (GCF/B.06/15); and
 - (h) *Financial Terms and Conditions of Grants and Concessional Loans* (GCF/B.06/16).

III. General considerations

3.1 Project and programme approval cycle

5. For the Fund, the difference between a project and programme is as follows. A project is a time-bound arrangement established to deliver specific (often tangible) outputs in line with predefined time, cost and quality constraints. A programme is a portfolio comprised of multiple projects that are managed and coordinated as one unit with the objective of achieving (often intangible) outcomes and benefits. A programme is typically less apt to be time-bound than a project.
6. The approval process for activities supported by the Fund is embedded in a transparent funding cycle that the Fund will follow. As a general rule, projects or programmes will typically follow these steps:

Figure 1: Key phases in the funding cycle



7. Each of these phases will consist of a number of specific steps, with differing actors, responsibilities and tasks. For the Fund, they would typically involve the steps laid out below and in Annex I.

8. **Concept step** would be a voluntary step where the accredited implementing entity (IE) or intermediary, or the executing entity (EE) (such as project/programme sponsor), prepares a brief concept note to validate whether the project/programme concept is aligned with Fund objectives. The concept note is submitted to the Secretariat (copying the national designated authority (NDA) or focal point) for endorsement, to ensure that the concept is aligned with the Fund's investment framework, results management framework and other Fund criteria and to provide a recommendation to the Board. The Board will then endorse the proposal. This endorsement can be direct, or under delegated or streamlined procedure, if the Board has adopted this option.

9. **Preparation and appraisal** involves the preparation of feasibility studies, financial and economic analyses, environmental and social impact assessments, etc. to determine the project's or programme's feasibility and viability within the framework of the Fund's approval criteria and the country's climate change strategy. The studies would be the responsibility of the

EE and would be reviewed by the IE or intermediary as part of their appraisal due diligence. The Secretariat would make appraisal toolkits and other resources available to assist national and regional intermediaries and IEs with their appraisal. Financial support may also be provided by the Secretariat (through the readiness work programme, if this option is retained by the Board) or by partner agencies, if needed.

10. The Secretariat would carry out its due diligence on the proposal appraisal documentation submitted by the IE or intermediary for adequacy and accuracy, and would compile for the Board an assessment of the proposal according to the Fund's activity-specific decision criteria (see below). These decision criteria represent the second tier of the Fund's two-tier allocation process. The assessment of the activity would be placed within the Fund's common analytical framework to allow cross-country and cross-project/programme comparison of proposals. If the Board deems it appropriate, the Secretariat could draw on technical advice by an advisory panel, in order to assess the proposal's transformational impact. The draft decision regarding such a technical advisory panel would be presented to the Board for consideration at its October 2014 meeting, in line with the approved work plan of the Board for 2014.

11. In parallel, the Secretariat would prepare draft financial terms and conditions¹ (term sheet), based on the Fund's overall framework of terms and conditions approved by the Board, and prepare draft legal documents (grant/loan agreement and project/programme agreement) based on the Fund's standard templates.² They would be shared with the submitting intermediary or IE.

12. **Decision to proceed** involves the review by the Board (or by the Secretariat under delegated or streamlined procedure, if this option is retained) of the IE's or intermediary's appraisal documentation of the project or programme, and the Secretariat's due diligence thereof. This step will only take place once the no-objection procedure has been implemented (see document GCF/B.06/07). Based on this review, the decision would be taken whether or not to proceed. In certain cases, approval could be provided conditional on modifications to project or programme design, or guidance can be provided on how to structure the project or programme to enhance its probability of approval. The IE or intermediary, and NDA or focal point, would be informed of the outcome of the approval process.

13. If the decision has been taken that the Fund should support the proposed activity, funding terms and conditions would be finalized with the IE, intermediary or EE (depending of the nature of the activity and funding flows), based on the term sheet, and legal documents would be finalized. They would be signed by the Executive Director and by the IE, intermediary or EE. The Trustee and the NDA or focal point would be informed.

¹ The appropriate level of concessionality contained in the terms and conditions (and analysing other matters, e.g. crowding out of alternative sources of funding), would depend on policy elements contained in document GCF/B.06/11. Examples of such policies are contained in the document. As the document lays out, all funding (grants, deeply concessional loans, moderately concessional loans, and, at a later date, any other financial products as decided by the Board) would be assessed on a common grant equivalent basis. The *level of concessionality* delivered to the project or programme in grant equivalent will be equal to the minimum needed to trigger the investment decision by the EE to proceed. The *nature of delivery* of concessional financing (i.e. grant, deeply concessional loan, moderately concessional loan, etc.) will depend on credit-worthiness criteria, such as country indebtedness, project or programme financial viability, etc.

² The grant/loan agreement would fit within a master agreement on terms, conditions and compliance (the "Financial Procedures Agreement" or "General Conditions of the Green Climate Fund") that would have been concluded with the IE or intermediary as part of the accreditation process. These legal agreements will be considered in the document on provisions for legal and formal arrangements with intermediaries and IEs, including policies on fees and payment, foreseen for the May 2014 Board meeting. The "master agreement" will need to be discussed and agreed by the Board.

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14. Annex II articulates possible agreements and funding flows. For grants executed by an EE, the grant agreement would be signed by the Fund and the IE or intermediary. The IE or intermediary would then have a grant agreement with the EE.
15. For the special case of grants executed by an IE or intermediary (if such operations are approved by the Board), the grant agreement would also be signed by the Fund and the IE or intermediary. The IE or intermediary would then have a service agreement with the EE for services rendered under grant financing from the Fund.
16. In the case of concessional loans, the loan agreements would be signed by the Fund and the intermediary. The intermediary would then have a funding agreement (loan, guarantee, equity participation etc.) with the EE.
17. **Implementation** involves project or programme development, during which funds would be disbursed by the Trustee against the criteria contained in the grant or loan agreement. An annual external audit of activity implementation (project or programme) would be prepared under the responsibility of the IE or intermediary, to verify that the Fund's requirements contained in the grant or loan agreement are met. This audit would be submitted to the Trustee and the Secretariat.
18. **Commissioning/launch** of the activity is the moment at which the project or programme becomes effective and commences its contribution to the Fund's climate change objectives of mitigation and adaptation. At this point, the monitoring and evaluation of outcomes would commence as well. The IE or intermediary would have reporting requirements as part of the grant or loan agreement; these reporting requirements would cover both the activity's impact (within the framework of the Fund's results management framework) and the activity's financial/economic performance (within the framework of the Fund's financial risk management framework).
19. **Impact period.** The period during which the activity will make an impact on climate change will vary according to the type of activity. Activity outcomes would be monitored and evaluated on a case-by-case basis as part of the Fund's results management framework and reported to the Board at the portfolio level. Monitoring of the financial and economic performance of the activity would be undertaken by the IE or intermediary and reported to the Secretariat on a regular basis, based on requirements contained in the grant/loan agreements and/or implementation agreements. Activity-level financial and economic performance is a key component of asset-side risk within the financial risk management framework, this reporting is, therefore, important to enable the Risk Management Committee, the Board and the Secretariat to have an accurate assessment of the Fund's risk profile.
20. **Debt service.** If the nature of the funding extended to the activity is in the form of a concessional loan, the intermediary would service the debt to the Fund via the Trustee. An annual external audit of the activity would be undertaken by the IE or intermediary and submitted to the Trustee and the Secretariat. The IE or intermediary would inform the Secretariat on a regular basis (e.g. quarterly) of the status of its outstanding loan portfolio and on the status of loan or grant covenants for each activity in their Fund portfolio.
21. **Closing.** The closing of the project or programme is the date from which the activity's impact would no longer be measured.

3.2 Generation of project or programme proposals

22. The initial project/programme applications, either in the form of concept notes or full appraisal reports, would be generated through:
- (a) Calls for proposals initiated by the Secretariat;

(b) Unsolicited submissions from sub-national, national, regional or international IEs or intermediaries.

23. Whereas, over time, it is expected that the bulk of funding proposals would come unsolicited directly from IEs and intermediaries, in its initial phase, the Fund would use calls for proposals through IEs and intermediaries to seek valid proposals from its potential beneficiaries. This will be particularly important to accomplish the Fund's objective of achieving a balance of funding between mitigation and adaptation, as prior experience appears to suggest that more proposals of the former type are likely to be spontaneously proposed by IEs and intermediaries than of the latter.

24. To enable a comparison of unsolicited proposals, the Fund would establish regular cycles, e.g. monthly or quarterly (depending on the volume of pipeline flow), during which all proposals (both generated through calls for proposals and unsolicited) would be considered, to ensure that the Fund selects the best proposals for funding.

3.3 Decision to proceed

25. With regard to project and programme approval cycle, the decision to proceed is the most important step in terms of outcomes for the activity and the Fund. The way this decision is taken will have a significant impact on the efficiency and effectiveness of the Fund's operations as well as on the Fund's governance.

26. In order to ensure the right balance between efficiency and speed of decisions and strong governance, it would be most effective to focus the Board's work on developing the overall strategic frameworks and parameters, including the investment framework, and on large or highly innovative funding requests. This is an approach adopted by some other climate finance funds as well as certain multilateral financing institutions (MFIs).

27. On this basis, specific funding operations could be grouped into two categories, according to certain criteria with regard to the decision to proceed:

- (a) Activities with large funding amounts, or that are highly innovative, where Board approval would be needed; and
- (b) Activities that are standard and require limited funding amounts, where the specific funding decision would be either delegated or made through a streamlined approval process.

28. In the case that the Board decides to delegate a subset of activities to the Secretariat for funding approval, the investment framework would lay out the criteria which would distinguish these two categories of activities with regard to the approval process.

3.4 Activity-specific decision criteria

29. The criteria on which the decision to fund a specific activity would be based represent the second tier of the Fund's two-tier resource allocation system, and will need to be set by the Board, based on the recommendation from the Investment Committee, and modified from time to time, as appropriate. There needs to be close concordance with monitoring criteria contained in the results management framework to ensure consistency of approvals with Fund objectives. Criteria could, for example, belong to six broad categories, and be differentiated between mitigation and adaptation, as appropriate.³

³ These six categories of criteria are aligned with the proposed results management framework to be discussed by the Board at its February 2014 meeting.

- (a) Impact potential;
- (b) Transformational potential;
- (c) Needs of beneficiary country/region;
- (d) Institutional capacity of beneficiary;
- (e) Economic efficiency of activity; and
- (f) Financial viability of activity (if revenue-generating).
30. These criteria are set out in Table 1:

Table 1: Examples of possible criteria for the decision to proceed

Criteria category		Definition	Example of criterion	Example of indicators from other funds
1.	Impact/result potential	Potential to contribute to the achievement of a fund's objectives and result areas	Expected reductions in greenhouse gas emissions	Net carbon intensity of the new gas-fired power plant, or new units within an existing plant for coal-fired power plants (Clean Technology Fund)
2.	Transformational potential	Degree to which a fund can achieve impact beyond a one-off project or programme investment through replicability and scalability	Transformational potential	Measured by the ratio of the trajectory of reduced emissions that would result if the financed project or programme were to be replicated throughout the targeted area, region, and/or sector over emissions reduction from project or programme alone (High ratio would have more transformational potential than smaller ratio) (Clean Technology Fund)
3.	Needs of beneficiary	Degree to which a beneficiary needs the finance more than others, or is relatively less capable than others to fulfill this need through other funding sources	Relative vulnerability of a population to climate change impacts (e.g. populations living in low-lying flood-prone areas)	Country's ranking in the Human Development Index (Pilot Programme for Climate Resilience)
4.	Institutional capacity	Beneficiary's capacity to implement a funded project or programme (policies, regulations and institutions)	Supportive country policy and institutional framework (both ambition and outcome)	Scoring of country policies and institutions; additional weight given to environment-related policies and institutions (Global Environment Facility)

5.	Economic efficiency	Benefit-cost balance of activity: impact per US dollar ⁴ delivered by a fund	Avoided deforestation or forest degradation	Number of hectares affected per US dollar spent (Amazon Fund)
6.	Financial viability (for revenue-generating activities)	Activity is financially sound	Funded activity covers its costs net of grants over lifetime of project	Project financial return (International Development Agency)

31. An assessment of the degree to which each proposed activity performs with respect to these decision criteria would be made by the IE or intermediary in the appraisal report of the funding request, and the Secretariat would further evaluate it as part of its due diligence. This assessment of activity performance against the decision criteria will provide essential input when the decision whether or not to proceed with funding is taken by the Board (or by the Secretariat, under delegated or streamlined approval, if this option is retained).

32. Similar to other climate finance funds, it is expected that the number of proposals having met the funding criteria would not exceed the volume of financing available, so a project or programme which meets all the criteria would receive funding. In the event that the project and programme pipeline exceeds available funding, proposals would be compared as part of a regular funding cycle (quarterly or monthly depending on deal flow) with the most attractive (in the sense of the Fund's criteria) being retained for funding. In this second scenario, portfolio-level criteria, notably contained in the investment framework (e.g. balance between mitigation and adaptation) would be taken into account as well.

33. The Secretariat's assessment could draw on a technical advisory panel if the Board decides to establish such a panel when discussing the matter at its October 2014 meeting, in line with the approved work plan of the Board for 2014.

34. The activity cycle outlined above would include proposals of both public and private projects and programmes. Implementing entities and intermediaries would play a key role as sub-national, national, regional and international facilitators dealing directly with the eligible EEs or project/programme sponsors in both the public and private sectors, in terms of project initiation, development and implementation.

35. This approval process would therefore apply across public and private projects and programmes. This means that each activity is approved on the basis of its merits with regard to the decision criteria.

IV. Recommendations and next steps

36. As it takes note of the information presented in this document and other associated documents, the Board may wish to provide guidance to the Secretariat on the selection of criteria categories proposed for the second-tier allocation of resources:

- (a) Impact potential;
- (b) Transformational potential;
- (c) Needs of beneficiary;
- (d) Institutional capacity of beneficiary;
- (e) Economic efficiency; and
- (f) Financial viability (for revenue-generating activities).

⁴ As the Fund's currency is US dollar.

37. In addition, the Investment Committee could provide guidance to the Secretariat on the establishment of activity-specific decision criteria within each of these categories, and ensure that they form part of the Fund's investment framework.

38. In terms of next steps, the Secretariat could prepare, on the basis of prior Board decisions, a document entitled *Financing Products, Terms and Review Procedures* for the future use of IEs and intermediaries, which would summarize:

- (a) Financing products agreed by the Board for the Fund in its initial phase;
- (b) Expected terms and principles for such financing, as agreed by the Board;
- (c) Procedures for IEs and intermediaries to ensure standards are met with respect to the deployment of such funds;
- (d) Procedures for handling investments, including problem investments, with respect to the deployment of such funds; and
- (e) Supervision and reporting procedures for such investments.

Annex I: Project and programme approval cycle

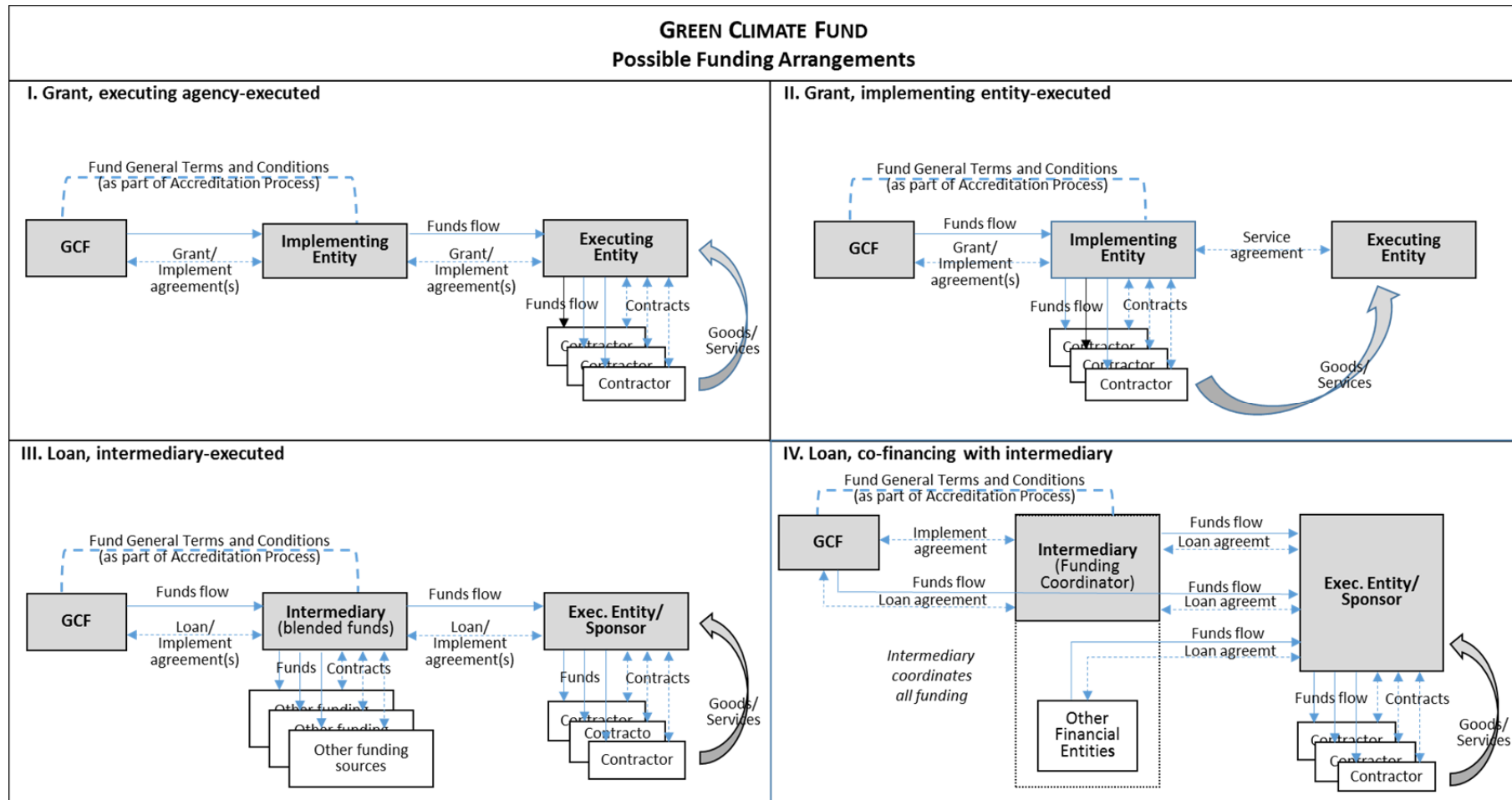
KEY STEP	ACTOR	RESPONSIBILITY AND TASK
I. Concept (voluntary) If detailed proposal exists, go to Step II		
1.	Concept development	IE, intermediary or EE (e.g. project/programme sponsor)
		IE, intermediary or EE prepares brief concept note to validate whether the project or programme concept aligns with Fund objectives
2.	Submission of the concept note to the Secretariat	IE, intermediary
		IE or intermediary submits to Secretariat. NDA or focal point copied on submission
3.	Endorsement of the concept by the Fund	Board, based on assessment and recommendation by the Secretariat
		The Secretariat reviews the alignment of the concept with the investment framework, results management framework and other Fund criteria Responds to submitter (with copy to NDA or focal point) and provides feedback on alignment with Fund objectives
II. Preparation and appraisal		
4.	Proposal preparation	IE, intermediary or EE (e.g. project/programme sponsor)
		Preparation of feasibility studies, financial and economic analyses, environmental and social impact assessments, etc. to determine project or programme feasibility, viability and alignment with Fund criteria
5.	Proposal appraisal	IE, intermediary
		The proposal appraisal reviews and assesses the entire project or programme from a climate change, economic and financial points of view to ensure acceptability to the Fund The Fund will make appraisal toolkits and other resources available to assist IEs and intermediaries with their appraisal Support may be provided by the Secretariat or contributor to IEs and intermediaries as necessary, to assist in ensuring quality appraisal
6.	Submission to the Secretariat	IE, intermediary No objection provided by NDA or focal point
		The Secretariat notes submission of proposal appraisal, reviews for completeness, and acknowledges

7.	Due diligence of proposal	Secretariat Inputs from a possible technical advisory panel	Secretariat checks for completeness and accuracy and adequacy with investment policy, investment strategy and portfolio targets If a technical advisory panel is established by the Board at its October 2014 meeting, it would provide input to the Secretariat regarding the performance of proposed activity against the decision criteria, based on appraisal documentation Review of six sets of criteria: (i) Impact potential (ii) Transformational potential (iii) Needs of beneficiary (iv) Institutional capacity of beneficiary (v) Economic efficiency (vi) Financial viability (if revenue-generating activity) Criteria from proposal appraisal compared to the Fund's activity-specific criteria to ensure proposal meets Fund requirements and to allow cross-country and cross-project/programme comparison of proposals
8.	Preparation of draft terms and conditions (term sheet)	Secretariat	Based on framework terms and conditions decided by the Board Grant element should be set at a minimum necessary to ensure project or programme viability
9.	Preparation of draft legal documents (grant/loan agreement, project/programme agreement)	Secretariat in case of co-financing loans	Based on standard templates
III. Decision to proceed			
10.	Review of proposal appraisal documentation and due diligence	Board, or Secretariat under delegated or streamlined procedure	Board may determine to delegate approval for standardized projects/programmes and lower funding amounts to the Secretariat, either under a delegated or a streamlined approval process
11.	Decision to proceed	Board, or Secretariat under delegated or streamlined procedure and for small-scale activities	Decision noted by the Secretariat IE or intermediary, and NDA or focal point, informed of decision and next steps

12.	Negotiation and finalization of terms and conditions	Secretariat with IE, intermediary or EE (depending on nature of activity)	In the case of intermediaries, blending Fund resources with their own, the final terms and conditions extended by intermediary to EE would differ
13.	Negotiation and finalization of legal documents	Secretariat with IE, intermediary or EE	(a) Grants executed by an IE or intermediary: grant agreement between the Fund and the IE or intermediary (b) Grants executed by an EE: grant agreement between the Fund and the IE or intermediary (with a subsidiary agreement signed between the IE and the EE). (c) Loans implemented by an intermediary: loan agreement between the Fund and the intermediary (d) Co-financing loans coordinated/executed by an EE: loan agreement between the Fund and the EE
14.	Signature of legal documents	Secretariat under delegated or streamlined procedure	Trustee informed IE or intermediary, and NDA or focal point, informed
IV. Implementation			
15.	Disbursement of funds against agreed criteria	Trustee	Based on the terms of grant or loan agreement
16.	Preparation of annual external audit report	IE or intermediary	Submitted to the Secretariat and the Trustee within six months of the end of reporting period
V. Commissioning/launch			
17.	Project or programme becomes effective	IE, intermediary, EE (e.g. sponsor)	Project or programme commences its contribution to the Fund's climate change objectives
18.	Monitoring and evaluation of outcomes commences	IE or intermediary, Secretariat	IE or intermediary will have regular reporting requirements (impact and financial) as part of the grant or loan agreement
VI. Impact period			
19.	Monitoring and evaluation of outcomes	IE or intermediary, Secretariat	Outcomes tracked at the portfolio level by the Secretariat and reported to the Board
20.	Monitoring of financial and economic performance	IE or intermediary, Secretariat	A key component of the financial risk management framework (asset-side risk)

21.	Debt serviced according to loan agreement	Intermediary, Trustee	Based on the terms of grant or loan agreement
22.	Monitoring of loan covenants	IE or intermediary, reported to the Secretariat and the Trustee	Based on the terms of grant or loan agreement
VII. Closing			
23.	Activity exits the Fund's portfolio	n/a	n/a

Annex II: Possible funding arrangements¹



¹ This diagram may be moved to the financial risk management framework document when finalizing the document for May 2014 Board meeting.