Green Climate Fund

Report of the Private Sector Advisory Group (PSAG) to the Board of the Green Climate Fund[1]

GCF/B.07/10
19 May 2014

Meeting of the Board
18-21 May 2014
Songdo, Republic of Korea
Agenda item 5

[1] This version of the report is unedited.

Recommended action by the Board

The Private Sector Advisory Group recommends that the Board:

(a) Take note of the information contained in the report GCF/B.07/10 Report of the Private Sector Advisory Group;

(b) Adopt the decision contained in Annex II to the Report.

Report of the Private Sector Advisory Group (PSAG) to the GCF Board

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I. Introduction, scope and linkages with GCF documents

1. At its fifth meeting in October 2013, the GCF Board formally established the Private Sector Advisory Group (PSAG). A prior decision of the fifth meeting of the Board, GCF/B.05/23, Annex XIX, had defined the PSAG Terms of Reference as well as the membership composition.

2. The general scope and deliberations of the 2 PSAG meetings held to date were guided by these Terms of Reference (i.e. roles and functions; membership and observers; duration; and guidelines for operation), as well as the eight essential requirements for initial resource mobilization defined by the GCF Board.

II. Report on the Initial Activities of the Private Sector Advisory Group

Membership

3. The PSAG consists of 10 international experts, five from developing countries and five from developed countries. Members were selected according to the professional criteria noted in GCF/B.05/23, Annex XIX. PSAG member information can be found at the following link: http://www.gcfund.org/board/committees-and-panels.html

4. In addition to these 10 members, there are four representatives of the GCF Board: two from developing countries (Mr. Zaheer Fakhir and Mr. Farrukh Khan) and two from developed countries (Mr. Anton Hilber and Mr. C. Alexander Severens). Mr. Z. Fakhir and Mr. A. Hilber are serving as Co-Chairs of PSAG.

First PSAG Meeting (Virtual), 11 March 2014

5. A first virtual PSAG meeting was organized by the Secretariat on March 11, 2014. Essentially this was an introductory meeting among panel group members with an introduction by the co-chairs on their basic roles and responsibilities. There was a general discussion on the role of the private sector in the Green Climate Fund and the PSF. (see Annex III: Agenda for First PSAG Meeting)

6. Two principal outputs from the first PSAG meeting were (1) a draft work plan leading up to the May 2014 board meeting and (2) a series of GCF/PSF framing questions PSAG members were asked to provide input on for the May board meeting (see Annex IV).

7. Considering the range and complexity of issues needing PSAG targeted advice (i.e. financial risk management framework, the investment framework, initial modalities and structure), GCF alternate board member and PSAG Co-chair, Mr. Hilber, invited the PSAG for a meeting in Geneva, April 14-15, hosted by the Swiss government.

III. Report on the 2nd PSAG Meeting: Geneva, April 14-15.

8. The PSAG held its second meeting in Geneva, Switzerland on April 14-15 hosted by the Swiss government. In line with previous GCF Board decisions on PSAG, the Co-Chairs decided to also invite the Private Sector and CSO active Observers of the GCF Board.

9. In preparation for this meeting, the co-chairs integrated four key elements of GCF/B.06/02 as it lays out essential requirements for the Fund to receive, manage, programme and disburse financial resources. PSAG co-chairs focused attention on the critical areas of: initial operating modalities; structure of the Fund including PSF; financial risk management and investment frameworks; and financial instruments. Ahead of the Geneva meeting, PSAG members were asked to provide responses to a series of framing questions relevant to the key areas of discussion noted above. Participants' responses were then compiled and shared back with the group during the course of the two day meeting in Geneva. Highlights from these responses can be found in Annex V.

10. The two day meeting was structured to encourage a free, robust exchange of ideas but ultimately produce useful outputs for the Board as it grapples with organizational issues related to structure and modalities. Through plenary sessions and small group discussions, panel members synthesized broad framing concepts (i.e. how to increase private sector engagement in climate change) into recommendations for Board consideration. Co-chairs used a mixture of plenary sessions and small group discussions to elaborate concepts and fine-tine recommendations. Each plenary session was led by on of the Co-Chairs, while small group discussions were co-led by PSAG members from the private sector and CSOs (see the meeting Agenda in Annex VI).

11. Participants at the 2nd PSAG meeting included the following: 13 PSAG members (10 members, 4 board representatives) 3 designated observers (2 from private sector, 1 from civil society as 1 was unable to attend; 2 GCF Secretariat staff; 4 assistants for logistics and administrative matters; and 2 advisors to the PSAG Co-Chairs. A detailed participant list can be found in Annex VII.

12. Additionally, the Swiss government hosted a PSAG-dinner in the evening of April 14 where conversations about private sector engagement flowed into the evening from the afternoon's plenary sessions.

13. The meeting was well attended by PSAG members and critically important in making sufficient space for and directing conversations about complex issues around private sector involvement with GCF operating modalities, fund structure, risk management and financing instruments. Mr. Farrukh Iqbal Khan was unfortunately unable to participate. Two members, Mr. Jay Koh and Dr. Amal-Lee Amin, could not attend in person, but were able to participate, albeit sporadically, via telephone. Attendance by the other eight members was full and robust for both days.

IV. High-Level Recommendations from the Private Sector Advisory Group

14. After two days of intense discussion and sharing of ideas, participants organized their input into concise recommendations to the Board. These 14 recommendations are focused on the four subject key areas noted above. The full recommendations are found in Annex I.

V. Next Steps

15. Following the 7th GCF Board Meeting of 19-22 May in Songdo, the draft PSAG work plan contained in Annex IV will be updated and finalized.

16. A number of PSAG-relevant GCF Board papers for the 7th meeting have been distributed behind schedule. It was therefore not possible to generate agreed PSAG recommendations on the various GCF Board papers in time for the 7th Meeting of the GCF Board. Following the Board Meeting, the Co-Chairs of PSAG will analyze the resulting decisions and the outcome of Board deliberations on critical issues such as structure of the fund, operational modalities, risk management framework, investment framework, or financial instruments. Based on this analysis, a PSAG work schedule will be drafted, for the time leading up to the October GCF Board Meeting. This will ultimately be issued as part of the revised PSAG Work Plan.

17. The next PSAG meeting is tentatively scheduled for September 2014.

Annex I:

High-Level Recommendations from the Private Sector Advisory Group

The Private Sector Advisory Group of the Green Climate Fund (GCF) met from 14-15 April 2014 in Geneva, Switzerland. In line with its mandate to provide recommendations to the GCF Board, the PSAG is pleased to transmit the following high-level recommendations to the Board and related Board committees.

General Points on Private Sector Engagement with the GCF

1. **There is a specific need to understand how the private sector can best work with the GCF.** The private sector is very diverse and includes SMEs, project developers, manufacturing companies, technology providers, investors, and financial institutions. This can be taken up in the Private Sector Advisory Group's (PSAG) work plan regarding the development of specific engagement strategies for the private sector. The Green Climate Fund (GCF) should support the private sector to invest in and develop solutions for low-emission and climate-resilient development. There is an important need to work with the private sector to engage in private sector adaptation activities. More work is needed on the business case for adaptation activities. Some PSAG members recommended that the Board consider developing a comprehensive adaptation strategy, including identifying financial instruments specifically to enable investments in adaptation and climate resilience.

2. **On the structure of the GCF**, it was noted that the structure is not critical for private sector engagement and/or interest in the Fund. Rather, clear rules, reduced bureaucracy, and good investment vehicles are the elements that will determine whether the private sector is interested in working with the Fund. The structure of the Fund's investments, loans and other instruments, as well as the Fund's other modalities, are more important than Fund structure per se. PSAG members noted that the Board should aim to create a structure that can change and evolve relatively easily over time as once a structure is already in place, change is difficult.

3. **In terms of structure, modalities, financial instruments and the approvals process**, the Board needs allow for flexibility to address the fact that systems and approaches that work for public sector-based finance do not always work for the private sector. It would be crucial for the Board to understand the balances between the approaches for the public and private sectors, without creating a one-size fits all approach. The ultimate benchmark for decisions about modalities and instruments should be about the GCF's capacity to bring about transformative and sustainable change and to meet its strategic objectives on a long- term sustainable basis. Vehicles for mobilizing resource from institutional investors could also be used to support an aggregator model. The Board

will take up the issue of institutional investors in the GCF at its October 2014 session and this provides the PSAG an opportunity to lead this discussion.

4. **There was general agreement that the GCF needs to be prepared to be a risk-taking Fund**. In this regard, the GCF should not aim to be an "AAA-rated" financial institution but rather a risk-bearing institution. PSAG members noted that "the Fund should be prepared to support projects that have a higher risk of failure, both financially and in terms of impact; there's no such thing as a risk-free project." It was also noted that the Fund's risk today is not risk of tomorrow. The GCF should focus on de-risking large-scale investments aimed at transformational change and a paradigm shift. The Fund should pilot models/approaches in support of small-scale programmes that could be scaled-up over time. One approach the Board could consider is aggregating a group of projects into a single vehicle, allowing the GCF to support small-scale projects more easily. Another option is to support a large-scale finance programme for SMEs that would bundle the biggest possible number of projects. The Board may also want to operate on the basis that some types of risks are acceptable while others are not. As such a robust risk management framework would assist the Board to invest strategically.

5. On the **GCF's risk approach**, PSAG members noted the following key considerations for the Board:

a) Risk management should follow from a clear strategy to address by example (market failure, providing new sources of funding for countries that could not access previously, innovation, mass transformation). There should be clear mandates and accountability, with responsibility to make decisions and accountability for not making them;
b) The Board needs to manage conflict, competition, stakeholders perceived conflict and issues around control;
c) A deal pipeline must be created and tested on a transaction by transaction basis against a mandate or the strategy with clear pilots and reference sites;
d) Incremental cost considerations. A narrow focus on providing only the incremental costs of sustainability of projects may crowd out opportunities, projects and priorities for the private sector;
e) The Fund should own the risk and executes this through intermediaries on behalf of the Fund. Intermediaries should be aware of the GCF's larger purpose of facilitating a paradigm shift and design their interventions accordingly.

6. **The PSAG urged the GCF Board to guard against slow and inefficient procedures as it prepares to engage with the private sector.** Given that the Board has agreed that the GCF and PSF will indirectly and directly fund the private sector, PSAG members noted that without delegated authority, clear accountability–and sufficient staffing and easy access- the

GCF will be perceived as slow and inefficient, preventing the private sector from engaging. Ultimately, the PSAG would see the GCF transitioning to working directly with the private sector rather than just operating via the IEs/Intermediaries. In moving towards a more complete architecture, the Board should not to lock the GCF into something that cannot evolve over time and respond to various circumstances. The work plan of the PSAG should respond to the stages to work towards a complete architecture.

7. **In relation to the GCF's investment framework, PSAG members noted the following key points for the Board's consideration**, namely:

a) The investment criteria need to adequately address financial viability and rates of return;
b) The investment criteria should support good government policies and regulations, including incentives for policies that can support the transformational and paradigm-shift objectives of the Fund;
c) Importance of including innovation as a guiding criterion;
d) The GCF should select activities that are transformative in nature and which catalyze greater private sector investment and greater blending with other sources of financial support;
e) Scalability and replicability of investments should be given strong consideration when deciding on projects or programmes;
f) The Board should not re-invent indicators that already exist, either for monitoring and evaluation purposes or for project / program approval and screening;
g) The Board should not re-invent skills, competencies and products/ functions that already exist, nor should it try to translate into financial terms non-financial indicators;
h) The use of well-structured public private partnerships should be given strong consideration when determining projects, particularly in terms of large infrastructure support project;
i) Readiness grants should be tied to specific investment opportunities and support project preparation, capacity for policy change, scaling-up, and design of effective implementation arrangements;
j) Building the institutional capacity of countries to support risk mitigation of potential private sector investments.

8. The pace and nature of the **accreditation process** for private sector related entities will be important to understand and as such should be designed appropriately to facilitate both indirect and direct private sector engagement. The speed at which the GCF will transition from working through intermediaries to achieving more direct access, via the agreed phased approach will be important for attracting further engagement from private sector actors. The importance of working with national and regional entities and intermediaries was also noted.

9. The PSAG noted the importance of **country ownership** when considering private sector projects. With respect to the procedure whereby national

designated authorities must confirm that all projects in their county are consistent with their national strategies, the PSAG urged the Board to not force a country to use an explicit no objection procedure, but rather to be given a choice if they wished to use explicit or tacit no objection procedure. Consistency with NAMAs, NAPs/NAPAs and with host country government policies could offer a streamlined approach for demonstrating alignment with national strategies. In order to respond to the speed at which the private sector works, the PSAG recommended that the no objection time-lapse period be limited. There needs to be limited time-lapse in dealing with the private sector.

10. **In relation to the role of intermediaries**, a number of issues were raised by PSAG members, namely:

a) The GCF needs to affect behavioral change at the intermediary level, particularly with multilateral development banks, international financial institutions and national development finance institutions;
b) There is a need to ensure that intermediaries' objectives are aligned with the objectives of the GCF;
c) The Board needs to provide leadership and a change in culture to the implementing entities to guide the GCF process and ensure the GCF's risk appetite is understood and accepted;
d) Consideration of possible sectoral allocations for intermediaries;
e) The need to make sure the concessionality provided to intermediaries is passed on to the private sector, consistent with the principle of minimum concessionality;
f) Private sector entities, including but not limited to commercial banks, should be eligible to serve as intermediaries and the accreditation process should be clear and transparent to encourage private sector participants as intermediaries;
g) Transparent and competitive bidding process are important approaches for the Board to consider; There is a large private sector appetite to deal with local actors including as financial intermediaries;
h) There is a need to understand the relationship between the MDBs and local financial intermediaries, particularly those intermediaries who can and have experience working with SMMEs.

11. **In terms of financial instruments, structure of grants and concessional loans**, the phased approach agreed to by the Board would start with relatively less complex financial instruments, but transition towards more sophisticated financial instruments, vehicles and products. PSAG members discussed whether grants and concessional loans are the most effective instruments for the private sector to bring about a paradigm shift. As the GCF evolves, the Board should consider a variety of instruments. It was pointed out that grants should be deployed by accredited intermediaries via the PSF to provide the de-risking and credit enhancing instruments that the private sector needs to scale up investments in low-carbon climate-resilient opportunities--whether these be large-scale clean energy infrastructure or aggregation of small-scale

opportunities. Some members noted that markets were more likely to drive behavioral and systemic change than grants and concessional lending. It should be noted that the Board is expected to take up the issue of additional financial instruments at its October 2014 session. PSAG members discussed the option of a re-finance aggregator role for the Fund, using a bond model, particularly for SMMEs and small-scale project developers and financiers. PSAG members also suggested consideration of equity authority as an additional instrument to catalyze private sector activity.

12. **The nature of how the GCF will provide grants to the private sector requires a detailed strategy so that the private sector is not subsidized unfairly**. Various views were expressed regarding the specific role that grants could play particularly for non-revenue generating private sector projects. It was suggested that private sector-based grants should be linked with multi-year policy commitment from governments in order for GCF funded programmes to be competitive with market alternatives. It was further noted a need for the smart design of grants- particularly as grants are important to change behavior, but also to make sure that projects/programmes are viable before utilizing grant-based financing. PSAG members also mentioned grants as basis for sustainable financing mechanisms to address energy access in Least Development Countries through the involvement of the private sector. Additional issues that were noted in relation to grants included:

a) Grants for adaptation could support long term cash flows for such projects/programmes;
b) The need to provide support to people/companies/programmes that need it or who cannot access traditional flows of private finance, particularly for SMMEs;
c) Grants need to be structured in order to leverage additional resources;
d) Grants could be used to provide equity or credit enhancement enabling private capital to provide the majority of financing for a given investment;
e) Grants need to be used to create sustainable financial mechanisms/investments. In this regard, projects must be basically viable before the enhancement and grants should not be used to create non-sustainable projects.
f) In accordance with agreed principles for financial instruments, Annex III of B.05/23, the Board should consider the role of grants as first loss capital (credit enhancement and/or covering the risk premium required to make investments viable).
g) The Board could consider having a maximum upper limit of the co-financing ratio for private sector projects of no more than 49%.
h) Consideration should be given to potential project development and preparation grants for SMMEs and small-scale actors.

13. On the **approvals process**, the PSAG underscored the need for clear, transparent, fast, and competitive process with a quick turn-around response. The PSF should be adequately staffed to enable a timely

response to proposals. The Board could also provide incentives to enhance country ownership via support and implementation of nationally appropriate mitigation actions (NAMAs), national adaptation plans (NAPs), national adaptation programmes of action (NAPAs) and technology needs assessments (TNAs). PSAG members also recommend the following elements for consideration by the Board:

a) The approval process should be based on an agreed guiding principles with a lean, fast, transparent and open process with clear accountability mechanisms;
b) The selection criteria aligned with the objective of the GCF, including specifying strategic goals for each results areas;
c) No- one size fits all, instead a balanced approach including a score card for proposal approvals;
d) Proposals should be selected on a competitive basis with proposals from countries of a similar level of economic development evaluated alongside one another;
e) Specific elements related to financial leverage[2], commercial viability should be included as key performance indicators (KPIs). Other KPIs could include carbon reduction, job creation, local capacity, sustainability, and scalability. The Board will also need to find a balance between its evaluation criteria;
f) The Board could consider having a threshold level for each of the agreed criteria;
g) The approval process needs to be an iterative learning process, which should be periodically reviewed and refined;
h) Once the Board has gained experience on approval of proposals it should move to delegate some levels of authority. For the private sector, delegation is critical to ensure timely approval procedures. Appropriate levels of delegation should be designed and implemented quickly
i) For countries with a national climate change plan in place, and a "positive list" for technology with defined processes and services (such as solar energy, energy efficiency, fuel-switching etc.), a fast-track project registry process should be considered.

Specific Recommendations for the GCF's Private Sector Facility ("PSF")

14. **It will be important for the Board to ensure the PSF is both sustainable and sizeable**. One approach is to identify, beyond the elements already identified in Decision B.04/08, the specific gaps for private sector finance that the Fund is trying to fill. A second approach is to identify what additional mechanisms the Fund will require to make an impact and meet its results.

[2] Leveraging at the project level is different from the global concept of leveraging private sector resources- should not necessary be seen as a financial element alone, could include leveraging actions and actors

Annex II:

Draft Decision of the Board

The Board having reviewed the document GCF/B.07/10

Takes note of the report of the Private Sector Advisory Group;

Requests the Board committees, groups, panels, and teams, to consider the high-level recommendations of the first meeting of Private Sector Advisory Group in all of their deliberations, with a view towards incorporating those recommendations in any proposed documents or decisions.

Annex III:

Agenda for the First Meeting of the Private Sector Advisory Group (PSAG)

(via teleconference, Tuesday March 11, 2014)

1. Roundtable introduction by the participants (including introduction of co-chairs)

2. The Green Climate Fund, the Private Sector Facility and the PSAG – context, current status and key issues[3]
3. Key deliverables of the PSAG and anticipated work plan[4] for the year, focusing on work needed in advance of the May Board meeting

4. Discussion – operations of the private sector facility (PSF)
    a. What should the PSF do?
    b. How should it operate through intermediaries initially?

5. Administrative matters, including working modalities of the PSAG[5]

6. Next steps, next meeting, frequency of meetings

[3] Will cover outcomes of last (6th) Board meeting, held February 2014
[4] Work program over first 3 months should focus on deliverables for next (7th) Board meeting in Songdo, which include recommendations for the modalities for the operation of the PSF, recommendations on any policies or procedures the Board may decide on in May (e.g. no-objection procedure), and any more forward looking recommendations that are appropriate.
[5] Information on other administrative matters will be provided prior to the meeting, including:

- Determination of quorum, PSAG decision making process, and anticipated working arrangements
- Relationship with the Executive Director, Board, Board Co-Chairs, and other committees/panels
- Travel policy/arrangements related to physical meetings of the PSAG
- Confirmation of confidentiality, non-disclosure and conflict of interest management procedures plus other legal matters

Annex IV:

PSAG Work Plan and Framing Questions

Private Sector Advisory Group (PSAG) of the Green Climate Fund (GCF)
Follow-up to introductory virtual meeting

Following the first teleconference of the PSAG, held on 11 March 2014, this document aims to advance the PSAG from introductions to beginning substantive work. The following sections:

1) Provide background information on the GCF and its private sector engagement;
2) Present a work program prior to the May 2014 Board meeting; and
3) Request initial input from the PSAG representatives on priority topics for the May Board meeting.

If possible, please provide feedback:

- By **Friday 21 March** on your ability to attend a physical meeting in Geneva on **14 or 15 April**.
- By **Friday 4 April** provide initial input on topics listed in section three of this document

1. Background Information

Decisions of the 5th Board meeting – See Annex XIX starting on page 50. It is the terms of reference (ToR) for the PSAG describing what this group is asked to do. It is also worth reading the ToRs of the Risk Management Committee (Annex XVI, page 47) and Investment Committee (Annex XVI, page 48). The PSAG is asked to provide advice to the Board, Secretariat, and these two committees. These two committees are also explicitly asked to consider recommendations and advice provided by the PSAG.

Decisions of the 4th Board meeting – See Decision B.04/08 starting on page 6. It describes the private sector facility (PSF) and establishment of the PSAG.

GCF Governing Instrument – The Governing Instrument (GI) provides the foundation of the GCF and is often referred to. It is worth reading the entire GI, but with a particular focus on the section on Private Sector (paragraphs 41-44 on page 11).

Documents for the Sixth Board meeting – These provide further background on specific agenda items on which the PSAG may provide advice. Documents, and portions of those documents, that are relevant for current PSAG priorities are noted in section three of this document.

2. Work program until May 2014

The PSAG is tasked by its terms of reference in the following way: "Make recommendations to the Board on the design and application of the Fund's policies, procedures and financial instruments as the relate to engagement with the private sector." (Terms of Reference, point I.2.(b)). This will guide the PSAG as it develops its work plan.

At its fifth meeting, held in October 2013, the GCF Board decided on eight essential requirements (ERs) for the Fund to receive, manage, program and disburse financial resources. These must be finalized before the initial resource mobilization process can commence. They are:

1. Initial **Fund structure** and Secretariat structure;
2. **Financial risk management and investment** frameworks;
3. Initial **results management** framework;
4. Procedures for **accrediting** national, regional and international implementing entities and intermediaries; including the Fund's **environmental and social safeguards**, and **fiduciary principles and standards**;
5. Policies and procedures for the initial **allocation of Fund resources**;
6. Initial **proposal approval** process;
7. Initial **modalities for the operation** of the Fund's mitigation and adaptation windows and the Private Sector Facility;
8. The **terms of reference** of the Fund's Independent Evaluation Unit, the Independent Integrity Unit and the independent redress mechanism.

The Board structured its work plan to prioritize consideration of the eight ERs at its first two meetings in 2014 (February and May). Decisions were taken on two of the eight ERs—(#5) on allocation and (#8) on the ToRs of accountability mechanisms—at the February Board meeting, while the other six were the subject of initial discussions and progress reports. The Board will aim to approve the remaining ERs at the May Board meeting. Several of the above items would benefit from input and advice from the PSAG. In addition, other topics that will be on the agenda of the May meeting that could be relevant to the PSAG include:

- Financial terms and conditions of grants and concessional loans;
- Country ownership (specifically a no-objection procedure).

Prior to the May Board meeting – The PSAG is to provide advice the topics above, as prioritized in section 3. In addition, the PSAG is required to submit a work plan to the Board that responds to relevant Board decisions and the ToR of the PSAG. The plan prior to the May Board meeting is to:

- Receive initial input from the PSAG over the next few weeks on priority topics
    - See section three for more detail on providing input
    - The PSAG Board members and/or Secretariat will compile all input
- Discuss these topics at the next PSAG meeting in mid-April
    - Two documents will be provided to the PSAG prior to this meeting:

        - Compilation of initial input
        - Draft annual work program of the PSAG (see draft schedule in box below)
    - Based on this discussion, a draft document summarizing PSAG views on the priority essential requirements will be circulated to the PSAG for final comment
- Finalize and submit recommendations on the priority essential requirements to the Board
- Finalize and submit an annual work plan to the Board

Draft PSAG meeting schedule in relation to May & October 2014 Board meetings (subject to confirmation and availability)

Date	**Location**	**Description**
[14/15] April	Geneva, Switzerland	**PSAG Meeting** – Discuss recommendations for May Board meeting
[30 April]	(Virtual)	**PSAG Meeting** – Finalize recommendations for May Board meeting
17-21 May	Songdo, Korea	*GCF Board meeting* – Opportunity for brief physical PSAG meeting on 17th. PSAG can apply for observer status of the full Board meeting.
[30 June]	(Virtual)	**PSAG Meeting** – Plan for October Board meeting
[8 September]	(Virtual)	**PSAG Meeting** – Finalize recommendations for October Board meeting
[XX] October	TBD	*GCF Board meeting* – Opportunity for brief physical PSAG meeting on X. PSAG members can re-apply for observer status of full Board meeting

3. Request for initial input from the PSAG members for the May 2014 Board meeting

Below is a list of priority topics on which PSAG input is requested. For each topic, the following includes a short background, links to additional information, and some specific questions. Answers to these questions will be helpful, but the questions are also intended to stimulate thinking. Input on any aspect of the following topics is very welcome. Based on input provided, a discussion document will be drafted to help facilitate the next PSAG meeting.

Initial operational modalities – The initial operating modalities of the Fund, including the PSF, must be established before the GCF commences operations, or even commences an initial resource mobilization process. Document

GCF/B.06/02 provides more background, and on page 4, includes a proposed list of what needs to be in place for the GCF (in general) to be operational. At its February 2014 meeting, the Board made the decision to develop the modalities of the PSF based on the recommendations of the PSAG. Questions for the PSAG:

- In order to accomplish the GCF's goals regarding private sector development and involvement in climate finance what do PSAG members believe should constitute the initial operating modalities of the PSF?
- Are there any operating modalities that are unique to the PSF?
- Is there a recommended sequence of establishing such modalities?

Structure of the Fund, including the PSF – At its meeting in July 2013, while the Board considered the PSF, it also considered the institutional structure of the facility. The Board considered how separate or integrated the PSF should be from the rest of the GCF, and decided the PSF will operate under the guidance and authority of the Board as an integral component of the Fund. At the February 2014 meeting, the Board considered document GCF/B.06/12 on the Structure of the Fund, including the PSF (see page 9, section VI on Structure and staffing of the PSF). The PSAG should provide advice on the structure of the PSF. It is important that the private sector will be interested in doing business with the GCF, and as noted in the recent Board document, a key challenge is ensuring that decision-making processes of the PSF can keep pace with private sector activities. Questions:

- The PSF will operate under the Board, and presumably in the early stages of GCF operation the Board will want strong oversight over approving proposals for financing. Will the private sector be interested in approaching an institution with this form of governance? Would that interest change based on whether the private sector receives finance via an intermediary, or directly from the PSF? Do you have any suggestions (general or specific) for refining the PSF governance to work better with the private sector?
- The Board decided that the PSF will initially work through accredited national, regional, and international implementing entities (IEs) and intermediaries. What would be the best role for IEs and intermediaries to play? And so how should that interaction be structured and what types of entities (public, private, or PPPs) should be eligible for accreditation?

Financial risk management and investment frameworks – Progress reports on both the financial risk management framework (document GCF/B06/10) and investment framework (document GCF/B.06/11) were considered by the Board at the February 2014 meeting. The PSAG is asked to provide advice to both the risk and investment committees, which are working to form their respective GCF frameworks. The PSAG is invited to comment on the full extent of both frameworks. Below highlights a few areas where PSAG input may be particularly helpful:

- Risk appetite – There is an ongoing discussion about what the appropriate "risk appetite" of the GCF should be. Can you comment on how much, or what forms of risk the GCF should be willing to take, particularly in light of what is needed to maximize private sector engagement?

- Type of risks considered – Focusing on the so-called "asset-side risks," do you think this list of types of risks appropriately covers/represents risks that private sector activities may present to the GCF? (see page 15, annex II of risk management framework document)

- Investment policy – In the investment framework document, an outline of an investment policy for the GCF is provided. That will change based on other Board decisions (particularly the allocation decision), but also introduces portfolio targets/limits based on a) whether financed activities generate revenue, b) whether finance recipient is private, public, or a PPP; c) the financial instrument used. Please provide your initial reactions to the investment policy as a whole, and particularly these elements that most clearly relate to private sector activities.

Financial instruments – Terms and conditions of grants and concessional loans were considered at the February 2014 meeting (document GCF/B.06/16). The Board did not make a decision, primarily due to concern that the proposed decision did not clearly take account of the agreed principles for determining such terms and conditions, which are described in the background document (page 1, section II). Grants and concessional loans will be considered again at the May Board meeting. Further, a clear convergence on the first PSAG call was a need for flexibility in providing finance for private sector activities. So although consideration of additional financial instruments is not on the agenda for the May Board meeting, consideration of other financial instruments in relation to the private sector may be helpful now. Some specific questions:

- Regarding grants and concessional loans, what approach to determining the terms on a case-by-case basis would you suggest? Reference to the guiding principles may be helpful here.

- Thinking of private sector engagement, do you have any recommendations on which other financial instruments to prioritize, and how best to determine the terms and conditions for those instruments? Please keep in mind that the GCF has its own international legal personality.

Annex V: Highlights from PSAG Member inputs to Framing Questions

INITIAL OPERATIONAL MODALITIES

Background	Questions for the PSAG	Documents	Recommendations
The initial operating modalities of the Fund, including the PSF, must be established before the GCF commences operations, or even commences an initial resource mobilization process. Document GCF/B.06/02 provides more background, and on page 4, includes a proposed list of what needs to be in place for the GCF (in general) to be operational. At its February 2014 meeting, the Board made the decision to develop the modalities of the PSF based on the recommendations of the PSAG.	• In order to accomplish the GCF's goals regarding private sector development and involvement in climate finance, what do PSAG members believe should constitute the initial operating modalities of the PSF?	• GCF/B.06/02: Once the Fund has been capitalized and declared operational by the Board, its initial modalities will consist of providing resources to fund projects and programmes for climate mitigation and adaptation in developing countries; and tracking the use of these funds, in terms of climate impact and risk management. • Governing Instrument (Section V, number 2, paragraphs 41 to 44): The Fund will have a private sector facility that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels. The operation of the PSF will be consistent with a country-driven approach. The PSF will promote the participation of private sector actors in developing countries, in particular, local actors, including small-and medium-sized enterprises and local financial intermediaries. The PSF will also support activities to enable private sector involvement in SIDS and LDCs. The Board will develop necessary arrangements, including access modalities, to operationalize the facility.	• On the relationship between the PSF and the mitigation and adaptation windows, it would be advisable to provide more clarity on this relationship. Specifically, it would be advisable to have the PSF integrated as part of the mitigation and adaptation windows instead of being a totally separated window. For the sake of clarity, for instance, the PSF integrated to the mitigation window could be denominated "PSF-NAMA Facility" and the PSF integrated to the adaptation window could be denominated "PSF-NAPA/NAP Facility". Having the PSF integrated with the mitigation window, for instance, would avoid having the Recipient Country needing to figure out which piece of their proposals should be submitted through which window. Under this simplified approach, it would be clearer that any private sector project or programme should request access to the PSF either through the mitigation window or the adaptation window, as the case might be. • At least during the initial operating phase of the PSF, it is recommended that the Recipient Country´s private sector access to the facility is made: (i) exclusively through accredited national, regional and/or international Implementing Entities(IEs)* and/or Intermediaries (i.e. banks), and not via direct access; and (ii) with the endorsement of the relevant responsible national ministry of the Recipient Country (i.e. Energy, Transport, Agriculture, Waste, Housing, Environment & Sustainable Development, Forestry, Industry, Mining, etc). This strategy would allow for relevant host country stakeholders involvement right from the beginning and, as a consequence, it is more likely that high-level of political support, country ownership and stakeholder buy-in be achieved, which would have a positive impact on the PSF chances of being successfully implemented in the corresponding Recipient Country. Additionally, several risk dimensions to which otherwise the GCF might be exposed, as will be described later, can effectively be mitigated or eliminated. • Under this architecture, the Fund would avoid taking direct full credit risk to specific projects/programmes but instead would be taking risk to, or sharing risk exposure with, the corresponding IE and/or Intermediaries. The Fund would benefit from the IEs and Intermediaries´ own risk assessment capacity, knowledge and experience in working with the Recipient Country´s private sector and in taking, at least partial, direct credit risk to projects in the Recipient Country. • After the initial operating phase has concluded, a second access modality could be added through which the PSF could directly interact with the Recipient Country´s private sector project developers, although this alternative should be further analyzed as the costs -in terms

Background	Questions for the PSAG	Documents	Recommendations
			of risk exposure for the Fund- would possibly outweigh the benefits of having a more direct and straightforward access to the Fund. However, in some cases, a direct access to the Fund could prove useful, as in the case of micro, small and medium size enterprises, where the PSF could develop specific instruments and modalities to effectively address specific barriers being faced by such entities in their countries. * i.e. UN agencies, multilateral development banks, international financial institutions and regional institutions.
	• Are there any operating modalities that are unique to the PSF?	Governing Instrument (Section V, number 2, paragraph 41): the Fund will have a private sector facility that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels.	• Under the proposed revised structure where the PSF is integrated to the mitigation and adaptation windows, the Recipient Country´s private sector would interact with the GCF exclusively by submitting proposals to the PSF through the mitigation or adaptation windows. This could be also extended to PPP proposals in terms that GCF funding could be drawn from the PSF also, rather than from the main mitigation and/or adaptation funds properly, in order to demonstrate Donor Countries how GCF funding is supporting private sector initiatives.
	• Is there a recommended sequence of establishing such modalities?		A proposed sequence for establishing the initial modalities of the fund might be the following: (i) formally integrate the PSF to the mitigation and adaptation windows; (ii) establish that private sector or PPP proposals seeking PSF funding for mitigation projects and/or programmes should request access to the “PSF-NAMA Facility” (through IEs and Intermediaries) and that private sector or PPP proposals seeking funding for adaptation projects and/or programmes should request funding from the “PSF-NAPA Facility” (also through IEs and Intermediaries); (iii) develop a simplified process for the approval of private sector proposals for both the “PSF-NAMA Facility” and the “PSF-NAPA Facility”, which would require the establishment of a PSF Executive Committee (see next question); (iv) appointment of the members of the PSF Executive Committee who would be responsible for the review, selection and funding approval of proposals submitted to the PSF and for reporting funding approval decisions to the Board (see next question); (v) appointment of a National Designated Authority (NDA), who might help to put forward the most attractive and ambitious private sector proposals within each Recipient Country to achieve the paradigm shift called for in the Governing Instrument. The operating modalities of the PSF should be determined in a way that is consistent with supporting broader sector- or –economy wide policies and programmes at national host country level as well as climate change objectives, strategies and plans of the GCF; (vi) accreditation of national, regional and international IEs and Intermediaries; (vii) design and institution by the GCF of competitive funding rounds so that proposals from different Recipient Countries can be compared against each other on a regular basis (i.e. quarterly or semi-annually) in order to select the strongest and most ambitious proposals. As it will be discussed later, it would be advisable to establish separate funding rounds in order to address the needs of less developed countries that might not compete on equal terms with countries with a higher economic development.

STRUCTURE OF THE FUND, INCLUDING THE PSF

Background	Questions for the PSAG	Documents	Recommendations
At its meeting in July 2013, while the Board considered the PSF, it also considered the institutional structure of the facility. The Board considered how separate or integrated the PSF should be from the rest of the GCF, and decided the PSF will operate under the guidance and authority of the Board as an integral component of the Fund. At the February 2014 meeting, the Board considered document GCF/B.06/12 on the Structure of the Fund, including the PSF (see page 9, section VI on Structure and staffing of the PSF). The PSAG should provide advice on the structure of the PSF. It is important that the private sector will be interested in doing business with the GCF, and as noted in the recent Board document, a key challenge is ensuring that decision-making processes of the PSF can keep pace with private sector activities.	• The PSF will operate under the Board, and presumably in the early stages of GCF operation the Board will want strong oversight over approving proposals for financing. Will the private sector be interested in approaching an institution with this form of governance? Would that interest change based on whether the private sector receives finance via an intermediary, or directly from the PSF? Do you have any suggestions (general or specific) for refining the PSF governance to work better with the private sector?	Governing Instrument (Section II, Governance & Institutional Arrangements): • The Fund will be governed and supervised by a Board that will have full responsibility for funding decisions. • The Board will have 24 members, composed of an equal number of members from developing and developed country Parties. • Decisions of the Board will be taken by consensus of the Board members. The Board will develop procedures for adopting decisions in the event that all efforts at reaching consensus have been exhausted. • A two-thirds majority of Board members must be present at a meeting to constitute a quorum. Governing Instrument (Section V, Operational Modalities): • Programming and approval processes: 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.	• The decision-making body of the PSF is the Board of the GCF. However, due to the dynamics of the private sector´s decision-making process, it seems unlikely that project developers from Recipient Country´s private sector would feel attracted to get involved in climate finance if it needs to interact directly with an entity with a–presumably- rather complex and cumbersome approval process, where any financing proposal would need to be approved by consensus of 24 Board members (or 16 in the case of the two-thirds majority). • The Governing Instrument sets out that the Fund will have a streamlined programming and approval process to enable timely disbursement of funds and that the Board will develop simplified processes for the approval of proposals. Accordingly, it would be advisable that the GCF Board institute a formal 6-member PSF Executive Committee (with 3 members from developing countries and 3 members from developed countries) plus a Secretary (without a right to vote) who would report to the Board the results of each meeting of the Executive Committee. The Executive Committee would need to receive the assistance of a "Technical Support Unit" in order to review the proposals submitted by Recipient Countries through both the mitigation and adaptation windows and make recommendations to its members who would then decide on the approval, by consensus, of the different proposals. The selection process should avoid a "first in, first served" approach, but instead should base the decision on a transparent and competitive basis with the aim of selecting the strongest and most ambitious proposals. In order to address the needs of less developed countries that might not compete on equal terms with countries with a higher economic development, it would be advisable that the GCF considers a structure in which proposals compete within "pools" of countries with similar levels of economic development. Then the Secretary would report such funding approval decisions to the Board for ratification and, if obtained, it would communicate the outcome to the respective beneficiary (through the corresponding IE or Intermediary). To keep pace with private sector activities, the Executive Committee should be able to meet on a regular basis (e.g. weekly, fortnightly or monthly basis). • In the case of concessional loans, a simple and streamlined approval process would consider the following steps: (i) the private sector Project Developer requests access to the "PSF-NAMA Facility" or to the "PSF-NAPA/NAP Facility" through an IE or Intermediary (e.g. a local lending institution); (ii) the IE or Intermediary would then verify that the proposal meets general eligibility, ambition and feasibility criteria to receive funding and that it is consistent with the Fund´s goals and objectives and would then perform a comprehensive credit risk assessment of the project being proposed; (iii) the IE or Intermediary would then seek internal approval from its Credit Committee in case it takes direct partial credit risk to the specific project/programme; (iv) if approval is granted, the IE or Intermediary would formally submit a proposal to the PSF´s Executive Committee,

Background	Questions for the PSAG	Documents	Recommendations
			on behalf of the private sector Project Developer, requesting access to the PSF-NAMA Facility or to the PSF-NAPA/NAP Facility, as appropriate; (v) if approved by the PSF Executive Committee and such approval is ratified by the GCF Board, then the IE or Intermediary would inform the private sector Project Developer to start with the implementation phase.
	• The Board decided that the PSF will initially work through accredited national, regional, and international implementing entities (IEs) and intermediaries. What would be the best role for IEs and intermediaries to play? And so how should that interaction be structured and what types of entities (public, private, or PPPs) should be eligible for accreditation?	Governing Instrument (Section V, Operational Modalities, letter D): • Access modalities and accreditation: access to Fund resources will be through national, regional and international implementing entities accredited by the Board. Recipient countries will determine the mode of access and both modalities can be used simultaneously.	• The role of IEs and Intermediaries should be to act as a focal point between private sector Project Developers (or beneficiary of the grant or concessional loan) and the PSF, as well as between the NDA and the PSF. IEs and/or Intermediaries could also have an important role in sharing, at least, part of the risk associated with specific projects and programmes and to provide insight as to the most adequate financial instrument to use to overcome the main barriers to low-carbon investment in the respective host-country. As described above, the PSF would benefit from the IE and/or Intermediary risk assessment capacity, knowledge and experience in working with the Recipient Country´s private sector. In terms of types of entities that should be eligible for accreditation, the list of existing IEs and Intermediaries accredited by other relevant funds as set out in Annex VIII of GCF/B.05/23 should serve as a starting point, but it would be advisable to include other entities as well, such as: (i) national government development agencies, which would be useful to promote country ownership; and (ii) other implementing partners, such as public institutions or international organizations with a proven track record of expertise in the field of climate change mitigation and adaptation and with experience in working with governments and other public institutions.

FINANCIAL RISK MANAGEMENT AND INVESTMENT FRAMEWORKS

Background	Questions for the PSAG	Documents	Recommendations
	• Risk appetite – There is an ongoing discussion about what the appropriate "risk appetite" of the GCF should be. Can you comment on how much, or what forms of risk the GCF should be willing to take, particularly in light of what is needed to	GCF/B.06/10: In order to achieve a paradigm shift, the Fund needs to finance new and unconventional projects and programmes, or the scaling-up of conventional technologies new for the location. They would not be financed on the market, because of perceived or real risk, or lack of economic and financial viability due to their costs or insufficient revenue. By their nature, these activities and projects will at times assume a higher level of climate-related risk than	There are several risk dimensions that might be considered which are common to any private sector investment. The proposed structure, where the Recipient Country´s private sector Project Developer would interact directly with IEs and/or Intermediaries in order to have access to the PSF, would prevent the Fund from taking full direct exposure to such risks. In such case, the PSF would reduce significantly its level of exposure to most of the below listed risks, although the PSF would be exposed to implementation/delivery risk to the relevant IE and/or Intermediary. Of course, a careful project in-depth appraisal shall be carried out not only by the relevant IE and/or Intermediary but also by the Technical Support Unit that would support the work of the Executive Committee. Some of the aforementioned risks are the following: • Political Risk: i.e. expropriation or nationalization of project assets, failure of government department to grant a consent or permit necessary for starting, completing commissioning and/or operating a project; imposition of increased taxes and tariffs in connection with the project; imposition of

Background	Questions for the PSAG	Documents	Recommendations
	maximize private sector engagement?	conventional investments undertaken on the market. The actual level of risk that the Fund will adopt will involve a trade-off between: (a) Excessive climate-related risk, which, by funding an excessive amount of non-viable projects, would endanger the long-term viability and sustainability of the Fund (and therefore its mission; and (b) Insufficient climate-related risk, which would mean that the Fund will not achieve its stated objective of promoting a paradigm shift in developing countries and will not be truly catalytic in relation to its partners and stakeholders. One of the most important responsibilities of the Board in overseeing the overall operations of the Fund will be to determine what the “right” level of risk is and set the overall risk management framework within which the Secretariat will operate. By periodically reviewing the risk monitoring data prepared by the Secretariat, showing the actual level of risk assumed by the Fund, the Board will provide guidance to the Secretariat to make the necessary course corrections.	exchange controls restricting transfer of funds outside the host country or availability of foreign exchange; politically motivated strikes; terrorism; war and civil disturbance, etc. One of the most effective ways of managing and reducing political risks is to fund through, or in conjunction with, multilateral agencies, regional or national development banks. There is a view that, when one or more of these agencies is involved in a Project, then the risk of interference from the host government or its agencies is reduced on the basis that the host government is unlikely to want to offend any of these agencies for fear of cutting off a valuable source of credits in the future. • Legal & Regulatory Risk: i.e. changes in law having the effect of increasing the Project Developer´s or any other relevant party´s obligations with respect to the project; in general terms, legal risk is the risk that the laws in the host jurisdiction will be interpreted and applied in a way consistent with the legal advice obtained from lawyers in the relevant jurisdiction at the outset of the project. For instance, in the lesser developed countries, many basic concepts of security are not well developed and consequently, the lenders may well have to discount the value of such security completely or in part at least. • Counterparty Risk: this is the risk that any counterparty with whom the project company contracts in connection with a project might default under the contract; i.e. a contractor, a bank providing performance and/or defects liability bonding for a contractor, a supplier of goods and/or services to the project company, a purchaser of products from the project company, an insurer providing insurances in connection with the project, a third party providing undertakings or support in connection with the project, etc. It is also referred to the risk that a lending institution assumes in relation to the Sponsor or Project Developer of an specific project as to its ability to contribute the required equity and completion guarantees that might be requested by the lending institution. Other relevant risks that would need to be adequately appraised and mitigated are: • Construction/Completion risks, Project Management risks, Technical/Technological risks, Market/Revenue risks, Performance risks, etc.
	• Type of risks considered – Focusing		The sample financial risk register in Annex II is very comprehensive. Some additional “asset-side risks” which might be considered are the following.

Background	Questions for the PSAG	Documents	Recommendations
	on the so-called "asset-side risks," do you think this list of types of risks appropriately covers/represents risks that private sector activities may present to the GCF? (see page 15, annex II of risk management framework document)		Asset-side risk (portfolio level) • Event: breach of covenants or event of default under legal documentation subscribed between the GCF/Donors or GCF/IE or Intermediary. • Event: lack of monitoring and evaluation to assess the performance of the PSF as a whole. Asset-side risk (project and programme level) • Event: lack of monitoring and evaluation to assess the performance of PSF in relation to specific projects and programmes. • Event: reputation of project sponsor in host-country deteriorates due to non-compliance of environmental and/or social commitments. Asset-liability mismatch risk • Event: floating vs fixed interest rate mismatch between interest paid on loans received and interest received in loans granted.
	• Investment policy – In the investment framework document, an outline of an investment policy for the GCF is provided. That will change based on other Board decisions (particularly the allocation decision), but also introduces portfolio targets/limits based on a) whether financed activities generate revenue, b) whether finance recipient is private, public, or a PPP; c) the financial instrument used. Please provide your initial reactions to the investment policy as a whole, and particularly these elements that most clearly relate to private sector activities.	GCF/B.06/11: The Investment Policy will set out the overall investment goals and guiding principles of the Fund. The Investment Strategy, including portfolio targets and limits, will set out funding objectives for each different class that the Board may wish to distinguish, e.g. between mitigation and adaptation, or between public and private sector activities. Investment Guidelines relate to the specific criteria that will be applied by the Board for the selection of activities to be financed under the proposal approval process.	Investment Policy: as a general comment, the Investment Policy of the PSF should seek to promote domestic policy changes in host-countries and attract additional funding from the host-country, IEs/Intermediaries and the private sector itself, with a view to support sector- or economy-wide actions, rather than just individual projects, with an emphasis to shifting to a lower carbon development path. Please see Annex I for other comments on Investment Policy. Investment Strategy and Portfolio Targets: a first comment would be that indicative allocation targets for the windows are useful as long as they can be reviewed and adjusted from time to time in order to build upon previous experiences. Please see Annex II for additional comments on portfolio targets/limits. Investment Guidelines: in relation to the specific criteria for the selection of activities to be financed, a set of six core criteria [as proposed by the Center for Clean Air Policy (CCAP)] might be useful to consider and/or adopt as Investment Guidelines for the GCF: • Supported and endorsed by host-country government, including commitment to provide financial support; • Has potential to achieve significant greenhouse gas (GHG) reductions; • Contributes to sustainable development goals, including health and poverty reduction goals; • Catalyzes emissions reductions across sectors or nationally; • Includes policy actions and financial mechanisms to address barriers to low-carbon development; and • Utilizes GCF funding to catalyze private investment and mobilize additional finance.

FINANCIAL INSTRUMENTS

<table>
<tr><th>Background</th><th>Questions for the PSAG</th><th>Documents</th><th>Recommendations</th></tr>
<tr>
<td>Terms and conditions of grants and concessional loans were considered at the February 2014 meeting (document GCF/B.06/16). The Board did not make a decision, primarily due to concern that the proposed decision did not clearly take account of the agreed principles for determining such terms and conditions, which are described in the background document (page 1, section II). Grants and concessional loans will be considered again at the May Board meeting. Further, a clear convergence on the first PSAG call was a need for flexibility in providing finance for private sector activities. So although consideration of additional financial instruments is not on the agenda for the May Board meeting, consideration of other financial instruments in relation to the private sector may be helpful now.</td>
<td>Regarding grants and concessional loans, what approach to determining the terms on a case-by-case basis would you suggest? Reference to the guiding principles may be helpful here.</td>
<td>GCF/B.06/16, Annex II</td>
<td>The Board approved the final terms and conditions of grants and concessional loans presented below:
<table>
<tr><th></th><th>Currency</th><th>Interest Rate</th><th>Service Fee</th><th>Maturity</th><th>Grace Periood</th></tr>
<tr><td>Grants</td><td>International
Local</td><td></td><td colspan="3">No repayment required</td></tr>
<tr><td>Concessional Loans 1</td><td>International
Local</td><td>0%</td><td>0.75%</td><td>15 to 40 years</td><td>5 to 10 years</td></tr>
<tr><td>Concessional Loans 2</td><td>International
Local</td><td>Benchmark rate of lending, e.g.:
Euros: European Central Bank rate
US Dollars: United States Treasury Bond rate</td><td>0.75%</td><td>8 to 15 years</td><td>2 to 4 years</td></tr>
</table>
Given that, at least during the initial operating phase of the PSF, the Recipient Country´s private sector access to the facility would be made exclusively through accredited national, regional and/or international Implementing Entities and/or Intermediaries, the investment decision process should take into account the terms of concessional loans provided by such entities which are prevailing from time to time.
Other elements that should be defined for determining the terms and conditions of grants and loans to specific projects:

Due diligence process (legal, financial, technical, market, insurance, social and environmental)
Maximum indebtedness or D/E ratio of the Borrower (or minimum amount of Equity that must be contributed by the Sponsors of the Project)
Debt Service Coverage Ratio for debt sizing (minimum, global)
Co-financing with local banks (blending) or providing concessional loans to development agencies for on-lending to local banks and from them to Borrower
Compliance with IFCs Performance Standards, Principles of Equator
Currency
Type of interest rate (floating or variable). Ideally, fixed rates. Otherwise, local banks would require the Borrower to enter into complex Interest Rate Swaps
Conditions for voluntary and mandatory prepayments
Security
Breakage costs

</td>
</tr>
</table>

Background	Questions for the PSAG	Documents	Recommendations
			• Conditions precedent to disbursements • Covenants (affirmative covenants, negative covenants, financial covenants, reporting covenants) • Events of default • Applicable Law (Jurisdiction)
	• Thinking of private sector engagement, do you have any recommendations on which other financial instruments to prioritize, and how best to determine the terms and conditions for those instruments? Please keep in mind that the GCF has its own international legal personality.	GCF/B.06/16: The Fund will initially deliver its support through grants and concessional loans. It will develop and employ additional financial instruments as necessary to effectively achieve the objectives of the Fund, as may be approved by the Board. Implementing entities (IEs) and Intermediaries will play an important role in the initial stage in appraising projects and programmes and, where appropriate, tailoring the right blend of financial products to make programmes viable without displacing other potential sources of finance. The following financial instruments will be deployed by the Fund in its initial stage of operations: 1) Grants; and 2) Concessional loans*: • Concessional loans 1 (deeply concessional); • Concessional loans 2 (moderately concessional) * In its broadest meaning, concessional finance comprises financial products, including loans, guarantees, and equity investments, provided on terms that are below market rates. According to the OECD/IMF definition, concessional loans are loans extended on terms more generous than market loans. Concessionality is achieved either through interest rates below those available on the market, the impact of which can be further enhanced through a favorable tenor or	Apart from grants and concessional loans, there is a variety of other financial instruments which could be used by the Fund to deliver its support, which could be designed to mobilize and leverage additional capital investment in mitigation and adaptation projects. These financial instruments, however, should be tailored to address the unique financial market conditions prevailing on each Recipient Country, so as to effectively address impediments or financial barriers to achieve such goals on each host country. Therefore, a first step in designing the financing instruments should be to perform a comprehensive review of existing financial conditions on each host country. Bearing in mind that all of these financial instruments serve as credit enhancements for private sector financing, it is important to emphasize that in the design of a financial instrument, credit enhancements should not be designed and used to make "bad projects" financially viable, but to mitigate or remove certain risks to investors/lenders who serve to catalyze investment in projects and programmes for climate mitigation and adaptation. For example, the following is a list of financial instruments that could be deployed by the Fund at a later stage: • <u>Partial Credit Risk Guarantees</u>: this financial instrument deals with local banks concerns about perceived credit quality of borrowers and inadequate collateral for projects. It is designed to protect lenders from loan defaults for up to a specified portion of the loan. Donor funds (grants) are placed in a Guaranteed Reserve Account (to be held by a Trustee) to cover a portion of up to 50% of a project´s credit risk to banks. This mitigates the risk to the lender and should reduce the cost of borrowing (not helpful in high interest rate environments). Projects will nevertheless need to meet bank credit quality requirements as banks will sustain losses if a Project fails. • <u>Debt Service Reserve Accounts</u>: is similar in many respects to partial credit guarantees. Donor funds are placed in an account to cover a specified number of months of debt service payments, typically between 6-12 months. The reserve account is accessed in the event a Project fails to generate sufficient revenues to meet debt service payments. This prevents default on a loan if a project runs into short-term operational difficulties. Funds are taken from the reserve account to make timely debt service payments while the project operator seeks to remedy operational problems. Once the project is again financially viable, the operator is required to replenish the reserve account. • <u>Creation of special funds to finance clean energy projects</u>: where commercial bank financing is not available. PSF resources would capitalize special funds with specific project eligibility criteria; competitive bidding for private sector management of the fund; repayments to the fund from

Background	Questions for the PSAG	Documents	Recommendations
		repayment profile. A methodology to calculate the appropriate concessionality of funding from the Fund will be determined at a later stage.	loans revolve and are used to finance future projects. Should have exit strategy after specific performance milestones. Multiple exit strategies available. Performance Risk Guarantees: this instrument is proposed for energy efficient projects in order to provide lenders a guarantee of projected savings in an energy service company (ESCO) contract. While banks are fully capable of assessing the credit quality of a borrower they often do not have the skills to properly assess performance risk. This is a big challenge for energy efficiency projects where energy and cost savings from investments are expected to be sufficient to cover debt payments. For large energy projects, banks can retain outside experts to conduct a performance risk assessment of a project but for most energy efficiency and smaller-scale renewable projects this is not cost effective. To address this impediment, Donor funds could be used to capitalize a performance risk guarantee programme that provide bankers with assurances of performance (generation of sufficient revenue to meet debt service). This is often done by setting up an energy services company or ESCO, which is responsible for providing performance due diligence for the banks and backing up the assessment with a guarantee. If a project fails to meet performance levels, the donor funds are used to make up the difference between guaranteed and actual energy savings from a project. The third-party ESCO administrator is selected base don extensive knowledge of the types of projects covered. If properly structured, this guarantee mechanism can achieve much higher leverage than a partial credit guarantee. • Creation of Special Purpose Entities or SPEs: many renewable and energy efficiency projects are often too small to be effectively financed on an individual basis. The transaction costs relative to loan amounts are such that banks don´t find the projects attractive. SPEs, which can be public, private or PPP entities, can be used to bundle multiple small-scale projects for financing through one single debt instrument. The SPE uses standard eligibility requirements financial analysis and legal agreements to lower the transaction costs of projects and reach critical mass of financing to attract private sector lenders/investors. Other possible financial instruments that might be considered are: • First Loss Guarantee • Subordinated Debt. • Mezzanine Debt.

INVESTMENT POLICY

Investment Policy – GCF/B.06/11 – 5.1	Comment
The Fund should seek to finance climate-related activities (projects and programmes) that demonstrate an ex –ante positive benefit-to-cost balance[1], once climate-related externalities have been taken into account. 1. Benefits and costs, including externalities, discounted at social discount rates. If the Board decides to include a benefit-to-cost balance assessment for proposals seeking funding from the Fund, it will need to discuss the methodology utilized.	The GCF should aim to fund the most promising and ambitious projects and programmes that are submitted. In order to submit the most attractive and ambitious proposals, the NDA of each prospective Recipient Country would need to ensure that full endorsement of the national ministry responsible for the project and/or programme is obtained. Such endorsement by the local government might be expressed through letters of support which would demonstrate that the suggested proposals fit in the country´s policy framework and are aligned with national policies and development priorities. Also, the support letter should address the ambition criteria, which seek to ensure that the proposals correspond to the most ambitious and feasible projects, in terms of: (i) potential for transformational change; (ii) sustainable development co-benefits; (iii) financial ambition as to potential to mobilise a substantial funding contribution from other sources, most importantly, private; (iv) mitigation and/or adaptation potential, etc. This sort of analysis would be helpful to answer the question on the benefit-to-cost balance –a calculation that would be difficult for the private sector Project Developer to make by itself- and could also be helpful for the proposed Executive Committee to decide on whether to approve funding to climate-related activities where it is not easy to estimate the benefit-to-cost balance.
For certain climate-related activities, for which it will not be possible to accurately estimate the benefit-to-cost balance (e.g. financing climate mitigation and adaptation strategies, or certain adaptation activities), the Board will decide on a qualitative basis whether the activity merits support from the Fund.	
Funding received and extended by the Fund will be accounted for in economic terms as grant-equivalent financing to provide an accurate and equitable comparison of funding amounts between grants and loans.	[Further explanation is needed. If the rationale for this methodology is to serve as a means to define and/or verify portfolio targets and limits based on the cumulative gross commitment of funds by different Donors, it seems correct].
The Fund may differentiate the pricing (if any) of its funding between recipient groups (in the sense of differentiating the risk-adjusted cost of its loans and credits between middle-income and low-income countries), and between different activities depending on the risk-return profile, in order to be able to deliver more concessional financing to low-income countries and extend the Fund´s reach.	It is reasonable to have different pricing depending on whether the Recipient Country is a less developed country or a middle-class income economy , or on the risk- return profile of the climate-change activity for which funding is needed or when country risk is included in the evaluation. However, a clearer definition on this matter would require an in-depth analysis of how well developed the local financial markets are in each host-country and their availability to provide long-term funding on a competitive basis. A possible segmentation might consider, for instance, that middle-income economies with well developed financial markets may have limited access to moderately concessional lending, whilst low-income economies where capital markets are under-developed, could get preferred access to deeply concessional loans.
The Fund should not “crowd out” potential public or private sector, or other funding sources by underpricing when alternative financing is available.	
The Fund may decide not to cross-subsidize between contributors and partners, such that providers of grants are subsidizing debt service payments to providers of loans. (The matter of cross-subsidization between contributor groups, depending on the nature of the contribution, is considered in greater detail in document GCF/B.06/10).	The most likely alternative to cover non-performing loans risk (NPLs) as set out in the Progress Report on the Financial Risk Management Framework will be to establish or set aside a discrete capital cushion for the Fund, which based on the indications from the banking industry and Standard & Poor’s (study on Project Finance Default Rates for the Period 2000-2010), could be set initially at no less than 10% of the outstanding loan portfolio. Although this cushion looks reasonable, the Fund might consider introducing a framework to promote the conservation of this initial capital cushion and the build-up of adequate buffers to protect the Fund against future, presently undefined losses arising from non-performing loans (NPLs).
In order to maximize its climate impact, the Fund will seek to minimize the subsidy it delivers for each activity funded to the minimum required to achieve the impact.	As noted before, the selection process should be transparent and competitive, which is in line with the idea of minimizing the subsidies delivered for each activity funded. Even though it might be possible to address the requirements of the less-developed countries by increasing the amount of subsidies granted to such countries, it would probably be more advisable and equitable if the GCF could consider a structure in which proposals

Investment Policy – GCF/B.06/11 – 5.1	Comment
	compete within “pools” of countries with similar levels of economic development. In this event, the subsidy component of each activity funded might be smaller in the case of more developed countries and larger in the case of less-developed economies.
The investment framework will establish hurdle financial rates of return for revenue generating activities (e.g. investments in renewable energy, public transport, etc.) that have an impact sufficient to justify support from the Fund from a climate change mitigation or adaptation point of view, to ensure the financial viability of the activity funded.	The principle is correct, in terms that only projects that demonstrate financial viability should be financed. The only problem with this methodology is that it normally works well ex ante during the financial modelling phase of the Project. As we have been able to witness recently in countries like Chile where the marginal cost of energy has soared, projects that sell their energy on a merchant basis at marginal cost have been receiving IRRs much higher than the hypothetical hurdle rates that were considered originally.
The investment policy will need to be adjusted from time to time to take account of the Fund´s evolving portfolio and experience. Notably, as portfolio reviews undertaken as part of the financial risk management framework bring to light systemic portfolio risks, new investment policies might need to be adopted by the Board.	It would be useful to seek formal cooperation between the Investment Committee of the GCF and similar bodies from other Funds that provide financial support to developing countries for climate-related activities (i.e. BMUB and DECC´s NAMA Facility) in order to bringing about cross-fertilization of experiences and lessons learned.

<u>INVESTMENT STRATEGY AND PORTFOLIO TARGETS (GCF/B.06/11)</u>

Investment Class	Example of Target (at the level of the Fund portfolio)	Comment
<u>Objective</u>: mitigation; adaptation; readiness and preparatory support	• Gross cumulative commitment of [50]% for mitigation and a further [50]% for adaptation • Upper and lower bound of [20]% of gross cumulative commitment around central target	As a first comment, setting targets and limits is useful as long as they are considered guidelines but not rigid boundaries within which the GCF must operate. As the Governing Instrument sets out, the Fund will be scalable and flexible and will be a continuously learning institution guided by processes for monitoring and evaluation. Hence the need for a periodical review of these targets and limits. To that extent, the Investment Committee should probably set up periodical meetings to review the consistency between such limits and the actual flow of promising and ambitious proposals which have been submitted to the GCF but are left out due to limit restrictions. This information should be then submitted by the Investment Committee for consideration of the Board, so it can take the decision to maintain or amend pre-set limit definitions in order to adapt to the observed demand for funding. The resource allocation process of the GCF might differentiate between main objectives and secondary objectives. The main objectives would be those which, at least initially, are structural to the Fund’s architecture: • Thematic allocation (e.g. mitigation and adaptation windows, and within each window, allocation to PSF-NAMA Facility and to the PSF NAPA/NAP Facility). • Geographical allocation of resources (which would take into account the needs of LDCs and SIDs)
<u>Financial Class</u>: revenue-generating; non revenue-generating	• Sufficient revenue-generating activities at the portfolio level to ensure maximum impact for the Fund, e.g. revenue-generating activities to exceed [50] % of gross cumulative commitment volume. • Grants and the grant element of loans should be set at the minimum needed for financial viability of the project or programme • For revenue-generating activities, a hurdle financial rate of return will be established, including grant received [e.g. 8%] to ensure activity-level viability.	
<u>Borrower/recipient class</u>: public sector; private sector; public-private partnership	• Gross cumulative commitment for private sector projects and programmes funded	

Investment Class	Example of Target (at the level of the Fund portfolio)	Comment
	through the PSF, pro rata private share in the activity, to meet [20]% of total funding • Levels to be tracked	And the secondary objectives being those which might be more dynamic in terms of setting up their limits as the fund evolves: • Instrument Class allocation, between grants, concessional loans and other instruments • Financial Class allocation between revenue-generating or non-revenue generating activities • Other, such as, sectorial or activity allocation. The Borrower/recipient class allocation between public sector, private sector and PPP should be properly dealt with by the thematic allocation between the windows and sub-windows (PSF).
<u>Instrument</u>: grant; concessional loan (if approved by the Board: equity; subordinated debt; guarantee)	• Initially, grants and concessional loans only • Grants provided by the Fund should not exceed a set rate to be determined of total funding provided (e.g. [50]%), in order to constitute a prudential cushion against financial risks • Loan and grant agreements for loans and grants received from partners should contain risk-sharing clauses (base don grant-equivalent accounting) to avoid the possibility of grant providers subsidizing loan providers • Aggregate cost of funding provided should be superior to aggregate cost of funding obtained plus expected non-performing loan rate	
<u>Country grouping</u>: SIDS, LDCs, African States; single-country limit	• A minimum of [10]% of gross cumulative commitments to SIDS, LDCs and African States for adaptation • No target set for low-income and middle-income countries • Single country limit set at 5% of total outstanding portfolio volume, in grant equivalent	

Annex VI:

Agenda, 2nd Meeting of the Private Sector Advisory Group of the Green Climate Fund (Geneva)

Date: Monday 14 April 2014 (afternoon) and Tuesday 15 April 2014

Venue: Geneva International Environment House, 11-13 Chemin des Anemones, 1219 Chatelaine, Geneva, Switzerland

Monday 14 April 2014

Time	*Item*
13:30 – 14:00	Arrival, registration, coffee
14:00 – 14:30	Welcoming & Opening Remarks
14:30 – 15:30	Overview of key Board decisions related to the Fund's private sector engagement and the PSF, priority topics for the PSAG and key deliverables in advance of the May 2014 Board meeting
15:30 – 16:00	Discussion by PSAG members how Board decisions shape their deliverables back to the Board
16:00 – 16:20	Coffee break
16:20 – 18:00	Structure of the Fund, including the structure of the PSF; Initial modalities for the operation of the Fund's mitigation and adaptation windows and the PSF, including No-Objection procedures; Terms and conditions of financial instruments; initial proposal approval process including criteria for programme and project funding

Tuesday 15 April 2014

Time	*Item*
09:00 – 09:30	Recap of yesterday's discussion and overview of today's agenda
09:30 – 11:00	Detailed discussion on (1) initial modalities for the operation of the fund's mitigation and adaptation windows and the PSF, and (2) the structure of the Fund, including the structure of the PSF
11:00 – 12:30	Detailed discussion on the Fund's financial risk management and investment frameworks
12:30 – 14:00	Lunch
14:00 – 15:30	Detailed discussion on Fund's financial instruments, including blending and co-financing
15:30 – 16:45	Roundtable discussion on other issues of near-term relevance to the PSAG, and key recommendation arising from this meeting.
16:45 – 17:00	Closing Remarks and next steps

Annex VII:

List of Participants, 2nd PSAG Meeting, Geneva International Environment House, April 14-15

List of Participants

GCF Board Members/Alternates

Mr. Anton Hilber (Switzerland) (PSAG Co-chair)
Head, Global Programme Climate Change, Swiss Agency for Development Cooperation, Federal Department of Foreign Affairs

Mr. Zaheer Fakir (South Africa) (PSAG Co-chair)
Head, International Relations and Governance, Department of Environmental Affair

Mr. C. Alexander Severens (United States of America)
Director, Environment and Energy Office, Department of the Treasury

PSAG Members

Dr. Amal-Lee Amin*
Associate Director, E3G

Mr. Dipal C. Barua
Founder & Chairman, Bright Green Energy Foundation (BGEF)

Dr. David N. Bresch
Director, Global Head Sustainability, Swiss Reinsurance Company Ltd

Mr. Jay L. Koh*

Mr. Torben Möger Pedersen
CEO, PensionDanmark

Mr. Aurelio Souza

Mr. Hiroyuki Tezuka
General Manager, Climate Change Policy Group, JFE Steel Corporation

Mr. Rodrigo C. Violic
Head of Project Finance, Banco BICE

Mr. Inderpreet Wadhwa
Founder & CEO, Azure Power

Mr. Kevin Whitfield
Head, African Treasuries, Carbon & Financial Products Unit, Nedbank Capital

*Ms. Amin and Mr. Koh are attending via teleconferencing on day 2.

Designated Observers

Ms. Meenakshi Raman, Third World Network (Civil Society Organization)

Mr. Abyd Karmali, Managing Director, Bank of America / Merill Lynch

Ms. Gwen Andrews, Vice President, Asia and Oceania, Alstom International
Green Climate Fund Secretariat

Mr. James Bond
Senior Advisor, Green Climate Fund

Mr. Paul Dolan
Adviser, Green Climate Fund

Advisers of the Co-Chairs

Richard Sherman (South Africa)
Stefan Schwager (Switzerland)

Meeting Assistants

Mariana Hug Silva
Johanna Bernstein
David Winters
Stefan Kellenberger