Recommendations from the Private Sector Advisory Group to the Board of the Green Climate Fund

GCF/B.10/16

18 June 2015

Meeting of the Board
6-9 July 2015
Songdo, Republic of Korea
Provisional Agenda item 21*

* The agenda item number will be determined when the final sequence of items in the provisional agenda is confirmed by the Co-Chairs.

Recommended action by the Board

It is recommended that the Board:

Takes note of the information contained in document GCF/B.10/16 *Recommendations from the Private Sector Advisory Group*.

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Introduction

The Annex of this document contains recommendations from the Private Sector Advisory Group (PSAG). These recommendations are included as received from the PSAG without changes or editing, including the title of the document.

Annex I: Recommendations from the Private Sector Advisory Group to the Board of the Green Climate Fund

I. Introduction

1. This document contains the recommendations of the Private Sector Advisory Group to the Board in accordance with its mandate to make recommendations to the Board on Fund-wide engagement with the private sector and modalities to that end (Decision B.04/08 paragraph (i)). These recommendations were endorsed by the PSAG at its third meeting, held May 18-19 in Paris, France. The agenda for the meeting, and the resulting recommendations of the PSAG, was determined based on current requests from the Board.

2. Mobilizing resources at scale and engaging local private sector actors:

(a) The Private Sector Advisory Group (PSAG) presented initial recommendations on mobilizing resources at scale and working with local private sector entities, including SMEs, at the eight meeting of the Board.

(b) At its ninth meeting, the Board reviewed GCF/B.09/11/Rev.01 Private Sector Facility: Potential Approaches to Mobilizing Funding at Scale, and GCF/B.09/12 Private Sector Facility: Working with Local Private Entities, Including Small and Medium-Sized Enterprises. After discussing those documents, the Board requested the PSAG to present further recommendations on both topics at its 10th Board meeting. Those recommendations comprise the next two sections of this report.

3. Readiness: At its eighth meeting, the Board also took a decision on the design of the GCF's readiness and preparatory support program (Decision B.08/11). In that decision, the Board requested the PSAG to make recommendations on deploying readiness funding to encourage private sector engagement.

4. Accreditation: When deciding on the GCF's accreditation framework during its 7th meeting, the Board requested further work related to potential accreditation of private sector actors, and requested that PSAG participate in that work (Decision B.07/02).

II. PSAG Recommendation on Potential Approaches to Mobilizing Funding at Scale

5. **Two-pronged approach: proactive and reactive.** The need for funds for climate mitigation and adaptation is tremendous, and in order to be transformative, a key part of the GCF's role is to mobilize significant additional finance. The GCF is in position to use concessional financing tools to mitigate some of the barriers to investment in low-carbon and climate-resilient development and in so doing, facilitate greater financial flows to that end. The PSAG notes that the GCF Board has taken a number of decisions which enable the GCF Secretariat to begin work on fostering a pipeline of innovative and transformative projects to address climate mitigation and adaptation. In parallel, under authority of the Board, the Secretariat is working with the Accreditation Committee to find adequate entities which can mobilize funds at scale. The GCF can currently receive proposals for private sector activity for mobilizing funds at scale, relying on proposals brought to the GCF on an ad-hoc basis or those encouraged

through GCF outreach/business development activities. The PSAG, however, recognizes that there is value in supplementing the PSF's outreach efforts both to increase efficiency (outreach is labor intensive and time consuming) and broaden potential GCF counterparties. It would not be possible for the PSF staff to meet with and discuss project ideas with each and every prospective project or sponsor. In order to maximize the mobilization impact of the GCF and to maximize the opportunity of finding ways to mobilize more funds for climate mitigation and adaptation, the PSAG believes the PSF should complement this approach. To most effectively mobilize funding at scale the GCF should actively present the private sector with a clear and well-defined description of what it wants and to advertise widely in search of great ideas that would mobilize funds for climate change mitigation and adaptation. Hence, the PSAG recommends that the GCF develop an approach to garner proposals for activities that mobilize funds at scale. The PSAG recognizes that there are several mechanisms for proactive engagement with the private sector. One mechanism the PSAG recommends is a Request for Proposals (RFP) process, which is the focus of the recommendations that follow. To be clear, however, the PSAG recognizes the current activities underway by the Secretariat are useful and should continue and the PSAG also recommends that there be flexibility to develop other mechanisms for proactive engagement with private sector, as needed.

6. **Well-designed requests for proposals (RFPs) are a proven tool in mobilizing finance through a proactive approach.** RFP tender processes are a well-understood mechanism often used by the private sector as well as public entities wishing to catalyze private sector activity and to demonstrate a proactive agenda of soliciting specific sorts of ideas. This signaling effect informs the world investment community of the GCF's seriousness and intent, and helps define the types of investments that the PSF wishes to participate in. The PSAG noted examples of public-sector RFP models that have successfully mobilized private sources of financing, including the South African Renewable Energy Independent Power Producers Procurement Programme (REIPPPP) and the NAMA facility, to name a few. The PSAG recommends that, in its proactive approach, the GCF make use of a RFP process to quickly and efficiently identify possible projects which might not otherwise be discovered. Any such RFP process would deploy GCF funds in a manner that: (i) furthers GCF goals, (ii) insures that a minimum level of concessionality is applied, (iii) addresses financial barriers to low-carbon investment, and (iv) crowds-in/mobilizes greater sources of financing. While recognizing these benefits of RFPs the PSAG notes that responding to RFPs may not be desirable to all companies or entities, so acknowledges that many will wish to continue developing proposals directly with the Secretariat on specific proposals.

7. **RFPs can provide the necessary clarity to the private sector to catalyze engagement with the GCF and crowd-in greater and new sources of financing, from a diversity of private sector actors.** The PSAG recommends that the RFP process would be complementary to, and not a substitute for, proposals that may come to be submitted to the adaptation and mitigation windows. Many private sector actors may be unfamiliar with the GCF, so the PSAG recommends the RFP process as a way to efficiently convey information about the GCF and its financing capabilities as widely as possible. The PSAG also notes that RFPs would have the added benefit of encouraging a variety of private sector actors to go through the accreditation process. The PSAG recognizes that unfamiliarity with the accreditation process may hamper RFP responses. We address this concern later in this document. Through the RFP process, the GCF Secretariat will also have more opportunities to help NDAs understand the GCF's financing capacity and its ability to leverage significant resources for climate change mitigation and adaptation.

8. **Mitigation and Adaptation.** The GCF should pursue a proactive strategy in both adaptation and mitigation. The PSAG recommends using the RFP process for adaption as well as mitigation. The PSAG plans to engage in further discussion on engaging private sector in adaptation activities when it meets later in 2015 and provide further recommendations on this matter to the Board.

9. **Principles and processes for the proactive approach.** The PSAG recognizes that the actual mechanics of issuing an RFP, evaluating proposals and selecting winning proposals will require specific knowledge of GCF processes and policies, so refinements to the process may be required as the Board considers this. If eventually approved by the Board, the Secretariat would be asked to operationalize the RFP process in a manner that is complementary to the current efforts of the Secretariat. The PSAG recommends integrating the following criteria and design features into the GCF's RFP process:

(a) **Operating principles**

(i) **Innovation and ingenuity** – Stress innovation in order to incentivize development of new ideas that shift investment into low-emissions and climate-resilient activities, and be open to ideas tested in one place, that the GCF could scale-up or replicate in new places.

(ii) **Crowding-in / leverage** – When assessing proposals, the GCF should weigh materially the proposal's ability to mobilize maximum private sector capital. For instance, a RFP can require selected implementing entities to secure a minimum level of private financing before being allowed to receive any of the finance that GCF has committed to the activity (e.g., GCF may select the proposal and commit $X, but the project proponent must secure a certain amount of leveraged finance before they receive any disbursement from GCF).

(iii) **Transparent and open** – To meet best-practices and to maximize the number of high quality proposals received, the process will need to be carefully articulated, transparent and open. That includes the RFP clearly stating the process of assessing and selecting proposals for funding and the relevant action/decision timeline.

(iv) **Competitive** - To ensure the quality of proposals receives, the RFP should clearly establish specific benchmarks against which proposals will be assessed.

(v) **Time limited** – To align with private-sector decision-making, the entire RFP process should be time-bound to a short period. Three to six months is recommended (Figure 1).

(vi) **Specific amount** – A significant scale of resources for the first RFP is necessary in order to garner wide interest in the process and be concrete as to what resources are available, thereby attracting scalable proposals from the private sector. A target amount for an initial RFP shall be recommended by the PSF. The PSAG recommends that the RFP program be scaled up to at least $1 billion over time. To be clear, a $1 billion target would be a floor for PSF sponsored RFPs and is expected to complement other PSF funding activities, which are expected to be of significant scale.

(vii) **Aligned with GCF goals and policies** – The RFP must be aligned with the GCF's results areas, investment framework, and environmental and social safeguards, and ensure appropriate dialogue with NDAs. Given the sensitivity of making sure GCF funds do not inadvertently over-subsidize the private sector, the RFP must make clear that the concept of minimum concessionality will be built into any project the GCF Board approves just as it should be across all GCF funding.

(viii) **Specificity** – The RFP should make available a specific finance instrument and include examples of types of mobilization proposals being sought to maximize interest, impact and engagement.

(b) **Process**

(i) **Accreditation integration** – The accreditation process should either take place in parallel to the RFP process or the selection of a RFP proposal would be conditioned on accreditation. Using one of these approaches is important so as not to limit the RFP process to already-accredited entities. Entities that submit proposals that are not yet accredited should simultaneously submit accreditation proposals, to be considered for accreditation either in parallel with the RFP process or immediately after a proposal is (conditionally) selected.

(ii) **External advice** – While the Secretariat would be heavily engaged and would be responsible for determining what to send forward to the Board, in order to manage the workload and the process, the PSAG believes that external support may prove useful and should be retained to work with the Secretariat to: 1) provide additional human resources that may be needed to issue, manage and execute the RFP process, 2) market the process to a wide diversity of private sector entities, and 3) provide a market benchmark, i.e. based on their market expertise help gauge whether the proposal and its expected impacts are in-line with market standards. The GCF Secretariat would run the process and provide oversight and direction to any external consultant(s).

Evaluation of technical merit – The panel or team evaluating RFP proposals should include both Secretariat staff and impartial external experts, who may come from the independent technical advisory panel (TAP). The panel or team would screen proposals and present a package of recommended proposals to the Board for approval. Proposals should be screened taking the GCF's investment framework and into account the relevant operating principles described above.

10. Sequencing and predictability. Assuming the first RFP launch is successful, the GCF may determine that if funds allow, having a regular and routine schedule of RFPs can have a strong impact in terms of incentivizing proposals and engagement. As a general principle, the PSAG recommends offering RFPs on a periodic and predictable basis so that the private sector becomes accustomed to the process and can plan accordingly. This can be assessed and altered depending on responses, but is a good principle from which to start. The PSAG believes it is also important that the GCF commence the RFP process as soon as possible so as to engage the private sector while interest levels are high and to demonstrate the effectiveness of the GCF.

11. Capturing learning and generating knowledge. In order to learn from the RFPs in order to promote replication and/or scaling up innovative approaches, the RFP process should be backed by a monitoring and evaluation process that captures lessons. Costs for this M&E and translating this into knowledge products should be set aside.

12. RFP focus areas. There are specific RFP products/designs that the PSAG noted as being well-suited to addressing real barriers to increased investment in low-carbon and climate-resilient development and for efforts to further mobilize resources to that end.

Any number of these types of examples could be incorporated into an initial RFP, but the PSAG recommends focusing on one or two of these ideas for the initial RFP, and recognize that other ideas could be developed over time (e.g. for land use/forestry). There was substantial consensus within the PSAG on soliciting proposals for the equity investment vehicle for renewable energy as the first RFP. Soliciting proposals for the equity investment vehicle has shown promise in other settings and the PSAG believes there are more potential projects and funds that could easily be mobilized if the GCF were to enter this space. The PSAG recognizes that the particulars of each of these proposed ideas would need to be flushed out in detail and that various challenges could arise in implementing any number of them. The various finance mobilizing areas discussed by the PSAG are outlined in further detail in Table 1 and are as follows (this list is not intended to be exhaustive):

(a) Equity investment vehicles for renewable energy

(b) Revolving funds for energy efficiency

(c) Foreign exchange (FX) facility for long term currency risk management of climate-relevant investments

(d) Adaptation innovation fund

(e) Risk sharing for “green” debt issued by actors investing in emerging markets

PROPOSED NEXT STEPS

- If these recommendations are agreed by the Board, the Board should direct the Secretariat to begin the RFP process in line with the above recommendations (focus area, size, timing, criteria etc.). This would include retaining a third party advisor to help develop the RFP language and mechanics.

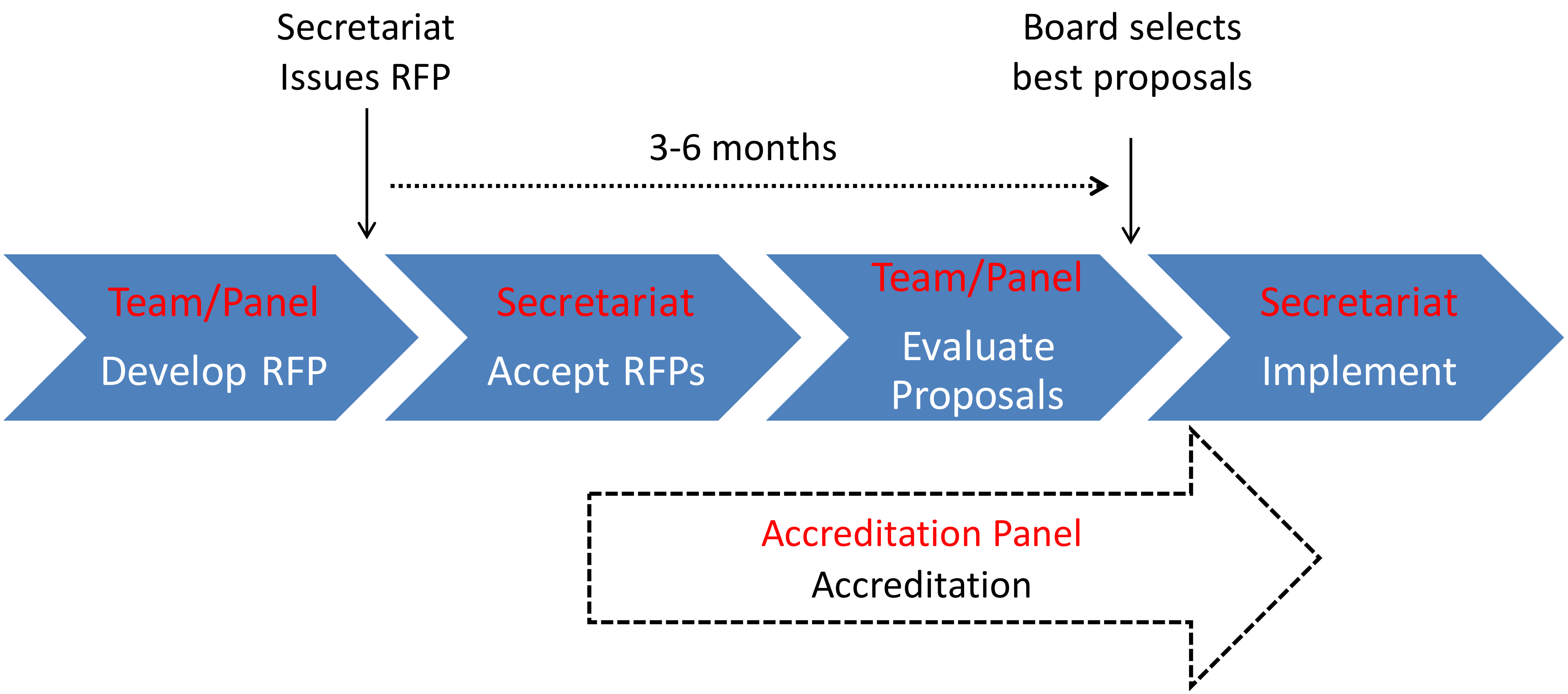

Figure 1: Flow chart of proposed RFP process. The above schematic is a simplified version of the process, which would have to complement GCF's normal policies and processes and would have to be operationalized by the Secretariat.

Table 1: Possible Areas for RFP issuance

Instrument	Benefits	Risks mitigated	GCF's potential role	Examples of best practice
Equity investment vehicles for renewable energy projects	Equity investment vehicles that own portfolios of low-risk, long-term projects can substantially reduce the cost of capital for renewable energy development. Moreover, by bundling mature projects together (with differing technologies and geographies), such a structure would attract long-term institutional investors who currently are absent from many developing markets.	Lack of liquidity is a major market barrier and one of the sources of high costs of capital in developing countries. By providing a means of refinancing equity and construction debt, an equity investment vehicle would provide a viable path to exits/realizations for early stage investors. This market liquidity permits the recycling of funds into more renewable projects and drives down the overall cost of capital to which renewables are especially susceptible.	GCF would provide subordinated funding (debt and equity). For example, while ensuring the principle of minimum concessionality, the GCF can tender tranches of junior equity (capped upside/return/first loss) as a seed investment to leverage other equity into a vehicle targeting renewables in specific geographies. Such a structure would, among other benefits, increase the amount of funding flowing into low carbon projects in developing markets, reduce the cost of upfront financing by providing exits, and increase local lending capacity for renewables.	TerraForm Emerging Markets; TerraForm Power; and NextEra Energy Partner
Revolving fund to reduce upfront costs of energy efficiency, including through Energy Service Companies (ESCOs)	Reduce payback period of energy efficiency measures to make them more commercially attractive. Do so through a revolving fund to maximize reach of fund.	Notwithstanding the short term payback (in the form of energy savings) of many energy efficiency investments, businesses often fail to make such investments. In part this is due to a premium placed on short term cash needs and liquidity. By reducing payback periods and upfront costs this can tip the balance in favor of greater EE investments.	GCF program can provide ESCO financing to cover a portion of initial investment. GCF could also provide partial guarantees for the cash flows generated by the scheme.	ESCOs throughout USA; Energy Savings Insurance pilot proposed by IADB + the Global Innovation Lab

FX facility for long term currency risk management in climate-relevant investments	Additional private capital can be attracted by a much broader set of developing countries since investors will not be deterred by uncertainties related to FX fluctuations in those countries with currencies that are not extensively traded in global currency markets.	FX risk is one of the key deterrents cited by investors in emerging markets since the cost of managing FX often renders potential investments not-commercially viable.	GCF can remove uncertainty for project developers and private investors by providing them with an FX solution that would be cheaper than any comparable product on the international markets.	TCX is one of the only examples available but this is currently targeted to a limited set of eligible users. A new version of TCX is being developed and funded that will increase its effectiveness, capacity and flexibility.
Adaptation innovation funds	Mobilize private sector finance for adaptation services and products. Prime the pump for greater adaptation activities and facilitate the mainstreaming of adaptation concerns in private and public endeavors.	Private sector climate finance is heavily weighted to mitigation opportunities. Commensurately most professional fund managers also focus on mitigation driving new products and innovation. By seeding adaptation funds, the GCF would leverage private sector experience to refocus on the underserved adaptation sector.	GCF to tender funding in the form of junior equity (fixed coupon/capped upside) to seed private equity funds focused on providing capital for companies that developing adaptation/resilience products and services in emerging markets. Funding tied to crowding in additional LP equity and GP “skin in the game").	OPIC Investment Fund support model; IFC Private Equity and Investment Funds program
Risk sharing for “green” debt issued by actors investing in emerging markets	Closes the viability gap for potential debt investments thus making sure the transaction can proceed with sufficient investment from private sector.	Lowers the likelihood that private investors will be exposed to losses thereby making them more likely to want to invest. Reduces the overall cost of capital for investors.	While ensuring the concept of minimum concessionality, the GCF could provide a cash reserve up to a capped amount, say 20% of total investment required, that would shield investors from risk of losing their investment. This could be a very effective way at providing an incentive for more issuance of green bonds by private sector in developing countries looking to raise funds for specific low-carbon projects from the debt capital markets.	EIB has a credit-enhancement tool for green project bonds focusing on power sector in EU. They provide up to 20% of funding (as subordinated debt rather than a first loss tranche) that reduces overall cost of capital and provides investors with more comfort about that creditworthiness of the green project bond.

III. PSAG Recommendations on a Program for Micro-, Small-, and Medium-Sized Enterprises (MSMEs)

13. **General Approach to the MSME Program**. Given the diversity of MSME conditions in the various regions, countries and sectors, the PSAG emphasizes the need for a diverse rather than a homogeneous program. The PSAG recommends that the initial phase of the program would need to test appropriate business and institutional models, and various financial instruments in order to ensure the Fund's resources reach MSME and have a measurable impact on the ground. It also deems it would be useful to learn from existing mechanisms and to consider piggybacking existing MSME initiatives with traction on the ground.

14. **Making the initial phase a learning phase.** The PSAG recommends that to learn from the initial phase and to support the scaling up of MSME activities, the initial phase of the MSME program should be backed by a solid monitoring and verification process and an on the ground presence to measure the impact and scale, as well as the levels of innovation. Costs for this monitoring and evaluation should be included in the project budgets and a specific set-aside at program level should be foreseen. Additionally, the PSAG recommends that the initial phase should aim to support proposals from a diversity of regions, sectors, and implementing entities, to maximize the learning that can come from this phase.

15. **The need for scale.** The PSAG recommends to the Board:

(a) To consider a number of initiatives with the potential for high impact, scalability and replicability. Such initiatives should also target innovative financial solutions for social entrepreneur MSMEs that have developed innovative low-emission and climate-resilient solutions (e.g., for clean lighting and cooking) that could be deployed by low-income communities with limited energy access.

(b) To structure the RFP in a way that the proposals need to demonstrate that they respond to market needs and opportunities, as well as their ability to leverage additional resources, in order to ensure a sustainable market driven approach.

(c) To establish pilot activities for various regions, that would take into consideration various sectors and geographies, and address in-country diversity. One approach could be to support flagships or lighthouse projects, such as the elimination of kerosene or charcoal cooking, support (off-grid) LED lighting, distributed renewables, or off-grid solar.

(d) To focus on a small number of sectors for the initial phase and then scale up the sectoral approach over time, based on market, regional needs, and demands.

16. Size of the MSME Program. The PSAG considered a number of approaches to the size of the MSME program, namely establishing:

(a) A program, and then agree on first allocation or tranche;

(b) A program with a cap on both the program size and proposal size; and

(c) A program with a cap on proposal size.

Following deliberations, the PSAG recommends an allocation of USD200 million for the initial phase of the program with a per proposal cap of USD20 million. The PSAG understands that the proposal size any proposing entity could bring forward would need to respect the size of project that entity could be accredited by the GCF to implement.

17. **Institutional model**. Given the nature of the MSME sector, the PSAG notes that working with institutions with a proven record of accomplishment will be important, but that this should not block innovation or close the process to new initiatives. The PSAG recommends that the GCF avoid a uniform, one-size-fits-all model, but rather look towards institutional arrangements that

are diverse and innovative. The Board may wish to consider approaches that vary by region. An important consideration as part of any RFP assessment is to ensure that proposals rely on partners with high credibility and a sound knowledge of the local context. The PSAG stresses that it is important to avoid too many/multiple layers of authority and control of the decision-making and disbursement processes because MSMEs often address bottom of pyramid issues with multiple, dynamic players.,

18. **Financial instruments.** The PSAG recommends that the Fund deploy financial instruments that address the MSME financing gap currently not provided for by conventional financing. Financial instruments that deliver competitive working capital for MSME entrepreneurs with proven low-emission and climate-resilient solutions ready to scale-up would address a critical gap. For example, the Board may wish to consider options for providing up front guarantees to cover the initial risk of investing in MSMEs. The Board could consider the GCF as an anchor lender and that a share of the overall program size be dedicated to this. A second consideration is to match larger companies with the MSME supply chains.

19. **Technical support, capacity building, and readiness needs for MSMEs.** The PSAG recommends the GCF provide capacity building support in the MSME program, as proposed in Document B.09/12. The PSAG underscores the importance of technical assistance in the proposal development stage and in supporting a sustainable market for MSME goods and services. The PSAG also identified the need for capacity building for local financial institutions and other, potentially new, market facilitators and aggregators to engage MSMEs, and create potential for those that receive GCF support to continue to grow and scale up activities after the GCF project/program is implemented. The PSAG sees the need for any capacity building in the SME program to complement, but not duplicate, GCF's readiness program. The program should also include specific consideration of how to strengthen access to finance for women-owned MSMEs.

IV. PSAG Recommendations on Operational Considerations

4.1 Accreditation

20. **Accreditation and a RFP process.** In relation to a proactive approach for attracting proposals, and a possible RFP process, the PSAG recommends to the Board and the Accreditation Panel:

(a) The RFP process should be designed to incorporate accreditation within it. The aim is to avoid any lag time in the RFP process, and to maximize the chance of successfully engaging private sector actors and implementing proposals that advance PSF mandates (e.g., mobilizing funds at scale, engaging local private sector MSMEs). As entities that are seeking accreditation which have responded to an RFP should hear from the Accreditation Panel whether they meet the accreditation standards as soon as possible.

21. **General accreditation process and the private sector.** In relation to accreditation generally, the PSAG noted that the accreditation process as currently designed is something very unfamiliar to the private sector, and that it may be a deterrent for potentially strong private sector accredited entities to come forward. As such, certain principles could be operationalized through the accreditation process to facilitate private sector engagement. In so doing, there should be no watering down of the existing high standards the GCF is using. In particular, the PSAG recommends to the Board consideration of the following:

(a) Where possible, use compliance with regulatory requirements or other international standards as evidence of meeting the GCF's fiduciary standards (FS) and environmental and social safeguards (ESS). In particular, private sector entities are subject to considerable domestic and international regulation on fiduciary matters. A good record of compliance with regulation should be taken as evidence that they meet fiduciary standards, as the GCF does not have the resources to replicate stringent financial regulation.

(b) Ensure that the GCF has adequate human resources to manage an accreditation process which will be thorough and efficient and not deter the private sector from seeking accreditation.

(c) Be clear with private sector entities that they can be accredited as international entities, but could be accredited through their regional/national subsidiaries if it better suits their operations and the needs of countries.

4.2 Readiness

22. **Engaging private sector in current readiness program.** The PSAG recommends that the GCF should strongly encourage engagement of private sector actors in a country's own readiness process, particularly ensure that:

(a) *Readiness Activity 1*: NDA's have adequate capacity to engage with private sector actors.

(b) *Readiness Activity 2*: Private sector actors are included in stakeholder consultation of broad national climate plans and specific strategic frameworks that will guide a country's engagement with GCF.

(c) *Readiness Activity 4*: Private sector is engaged in generating concepts included in the initial pipeline of proposals to the GCF

23. **Broader private sector engagement**. Additional for, such as regional workshops, could be developed to build relationships and exchange information between NDAs, and other relevant public entities, and the private sector active in a particular country or region.

24. **Readiness and private sector RFPs.** In the case that a RFP process is developed to attract proposals, some additional readiness funding could be allocated to support wide understanding and dissemination of the RFP.

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